

**Suck It In:  
Round Two on the California Budget in Jerry Brown's Second Round as Governor**

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*"Suck it in; vote for the tax."*

Governor Jerry Brown's 2012 advice for voters<sup>1</sup>

The California budget saga has no beginning and no end. Each budget is in large part the product of prior budget decisions and earlier events. Once a budget is signed, its story does not end. A budget is a plan and a forecast of revenues and expenditures. However, plans may not work out; forecasts may prove inaccurate. But whatever happens, the current budget will influence budgets to come.

In prior editions of *California Policy Options*, our annual chapters on the state budget have traced current events and past historical developments that either led to those events or which illuminated what was happening with similarities and contrasts with the past. Below, I provide some background to the passage of the 2012-13 budget, the second budget passed during Jerry Brown's current iteration as governor. A critical part of that budget involves passage (or rejection) by voters of a tax initiative sponsored by the governor for the November 2012 ballot. Readers will know the results of that election but this chapter ends with the completion of the legislative session in the late-summer of 2012 and thus was written before voters had their say.

**Deep Background: The Golden State Moves Beyond its Golden Era**

*"Those who have not undergone minor disasters are usually being held in reserve for something major."*

Author Gore Vidal<sup>2</sup>

Although it may seem difficult to imagine from today's perspective, in the 1950s and 1960s, California was often seen as a model of state governance and achievement. Cars flowed freely on its newly-built freeways. New college campuses were under construction providing, along with the older ones, higher education at very low cost to California's students. Water traveled long distances on aqueducts considered to be engineering and political marvels. Of course, there were also troubles in paradise.

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<sup>1</sup> Quoted in David Siders, "Jerry Brown Says Tax Signatures in Hand," *Capitol Alert* blog of the *Sacramento Bee*, May 3, 2012. Available at <http://blogs.sacbee.com/capitolalert/latest/2012/05/jerry-brown-says-tax-signatures-in-hand.html>. The history in this chapter draws heavily from major news sources such as the *Sacramento Bee*, the *Los Angeles Times*, and the *San Francisco Chronicle*. Most footnotes from such sources included in this chapter refer to direct quotes.

<sup>2</sup> Quoted in California's Capitol's website at <http://www.californiascapitol.com/calcap/2012/08/too-often-too-true/>.

Most prominently in the mid-1960s, there were racial tensions which exploded in the Watts Riots and the student anti-war demonstrations at Berkeley. But racial tensions were hardly unique to California during that era of southern desegregation and civil rights legislation. And student unrest during the Vietnam War era quickly spread beyond California.

By the 1990s, however, the negatives of California seemed to outweigh the positives in comparison to other states. California was mired in a fiscal crisis in the early part of that decade. Civil disturbances were back – this time in the form of the Los Angeles Riots. The freeways were still operating but the era of their wholesale expansion was over and traffic congestion was becoming the norm. Promises of nearly-free tuition at the state’s public universities were distant memories.

Attempts at quick fixes by voters for these disappointments did not pan out as anticipated. Incumbent Governor Gray Davis was replaced during a budget crisis via recall in 2003 by movie star Arnold Schwarzenegger. But Schwarzenegger left office in January 2011 during a renewed budget crisis. By then, he was equally as unpopular as Davis had been at the time of the recall.<sup>3</sup> The idea that voters could provide quick remedies through direct democracy was tarnished but not gone. Indeed, new voter-approved changes in legislative redistricting and the implementation of a “top-two” primary system were the reforms *de jour* playing out in the background of California’s budget process. More budget-related reforms were placed on the November 2012 ballot, the same ballot that would decide voters’ preferences regarding new taxes including those favored by Governor Brown.

How did these turns of events occur? Why did the state develop what is often called a “structural” budget deficit which even periods of prosperity don’t seem to erase? The easy answer is to look at the political institutions of the state, particularly California’s above-mentioned “direct democracy” of ballot propositions which limit fiscal discretion by the legislature. But such political institutions cannot be the whole story since the state had direct democracy during its golden years when it was viewed as a model of good governance.

There is a deeper cause. As Chart 1 shows, California’s population (and economy) generally grew more rapidly than the U.S. as a whole from statehood in the mid 19<sup>th</sup> century until the first decade of the 21<sup>st</sup> century. But within that long period, as can be seen on the chart, there are two prominent inflection points. There was particularly rapid growth starting around 1940 and ending in 1990. That five-decade

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<sup>3</sup> Governor Schwarzenegger’s unpopularity was increased around the time he left office by a last-minute reduction in a prison sentence he gave to the son of a former speaker of the assembly who had been convicted of murder. In addition, it was revealed that he had fathered a child by a housekeeper who remained in the Schwarzenegger household, a revelation that led to divorce proceedings. Schwarzenegger generally remained out of the policy limelight initially, resuming his movie career and later opening a museum in Austria dedicated to his accomplishments. In the summer of 2012, a public policy institute at USC was opened in his name but Schwarzenegger generally stayed out of discussions of the California budget unlike his predecessor, Gray Davis. Davis regularly appeared on TV news programs and in other forums during the terms of his successors commenting particularly on general budget issues. To the extent that Schwarzenegger commented on California concerns, his remarks emphasized his record on environmental matters which he saw as a legacy and he complimented Governor Brown for pursuing his environmental agenda.

period encompassed the massive military spending that accompanied World War II and then the Cold War, punctuated by the Korean War and the Vietnam War. During that era, federal expenditures developed and promoted what became the California aerospace industry and other military-related sectors and activities.

In 1990, with the dissolution of the Soviet Union, the Cold War ended and the aerospace and related industries shrank to a fraction of their former importance in California. While the rest of the U.S. had a very mild recession in 1990-91, California experienced an extended decline and a multi-year state budget crisis. There were warnings of a structural deficit in the mid-1990s but the problem was soon masked by the dot-com boom. A new crisis merged with subsequent the dot-com bust. But a second mask appeared with the housing and mortgage bubble that began to burst in 2006 and 2007 and that developed into the financial crisis of 2008 and the Great Recession. Nonetheless, there was evidence of denial among state officials; the state's Department of Finance's estimate of the 2010 California population was overstated by well over a million persons until the federal Census of Population came along with the definitive figures.

Chart 1 also contains a long-term projection of future trends in California. The rapid growth relative to the rest of the U.S. is gone in that projection. California at best becomes an average state growing at the average U.S. rate. And while being average might not seem to be a terrible fate, it appears that voter expectations for the state are still stuck in the era of super-normal growth when there was always money for infrastructure and social programs and a dollar for X did not require a dollar less of Y. The gap between expectations and reality is an underlying cause of the California malaise. If California had always been average, it might have adjusted better to the three post-1990 economic downturns than it actually did.

The shift to a "new normal" after 1990s can also be seen on Chart 2 in terms of jobs. As California departed from its old trend line, the job gap between reality and projection grew. Not surprisingly, the widening job gap, particularly in periods of high unemployment, has become a political issue beyond its obvious budgetary implications. But as far as the state budget goes, fewer workers and taxpayers cuts into revenue in obvious ways.

Is California a particularly high-tax state as a result of the new normal? Chart 3 compares state and local taxes in California against those in other large states and for the U.S. as a whole. State and local taxes have to be combined in such a comparison because each state divides the responsibility for state and local services between the two levels of government differently. California is not a low tax state but it is not at the top, either. It tends to be below average at the local level since Proposition 13 of 1978 restricts local property taxes and makes public services at that level, particularly schools, dependent on state finance. The state government, therefore, shows up as higher-than-average in taxation.

Ultimately, you cannot say that "the" problem in California at the aggregate level is spending or taxes. The problem is a combination of the latter relative to the former. California's political processes – which

ultimately reflect, even if imperfectly – voter “tastes,” produce more spending chronically than its tax base supports.

## **Budgetary History**

*“This is an era of limits and we had all better get used to it.”*

Jerry Brown in 1976 during his first iteration as governor<sup>4</sup>

As noted at the outset, there is no one place to start in California’s budgetary history since each budget reflects prior decisions and results. It is useful, however, since Jerry Brown has had two episodes as governor, to begin descriptively in his first. Brown was the son of former Governor Pat Brown (1959-67) who is now mostly remembered for his freeways, water works, and university expansions. However, when he sought a third term in office in 1966, Pat Brown was defeated by Ronald Reagan in part because of public anger over a budget crisis that developed toward the end of his second term. Voters also blamed him to some degree for the Watts Riots and the student demonstrations at Berkeley.<sup>5</sup> Jerry Brown, as his early political career developed – and although he was a Democrat like his father - seemed to want to be the anti-Pat, i.e., a fiscal conservative with no taste for grand infrastructure projects and with a strong stance against disorder.

Although not a former movie star like Ronald Reagan (or the later Arnold Schwarzenegger), the younger Brown became a national celebrity through politics in his first iteration as governor (1975-83). He was noted for New Age attitudes and being “different” from typical political figures of that era. And he managed both to have an austere personal lifestyle, driving a Plymouth rather than some gubernatorial limo, while also traveling with movie star Linda Ronstadt.

In his first term, however, Brown seemed not to detect growing public anger about rising property taxes, a reflection of both general inflation and a state housing bubble. Neglect and then late recognition of the anger culminated with Prop 13, an initiative placed on the state ballot of June 1978 which passed overwhelmingly. Prop 13 drastically cut local property taxes, especially cutting into school budgets, and imposed a two-thirds vote requirement for tax increases.<sup>6</sup> One of the aggravating factors behind the

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<sup>4</sup> Quoted on the Alternative History forum at <http://www.alternatehistory.com/discussion/showthread.php?p=2501045> and other websites. Although the quote is well known, none of the sources provide a date and location.

<sup>5</sup> At the time Pat Brown ran for a third term, there were no term limits. However, only one prior governor – Earl Warren – had been elected three times (and Warren left before his third term ended to become Chief Justice of the U.S. Supreme Court).

<sup>6</sup> Proposition 13 has been challenged in court on various grounds over the years but has been upheld. At this writing, a lawsuit challenging the two-thirds requirement filed by former UCLA Chancellor Charles Young and others is likely heading to the state Supreme Court. It has been turned down at lower court levels. The suit is premised on the distinction between an amendment to the state constitution – allowed by initiative – and a more fundamental change (not allowed).

ultimate success of 13 was an accumulation of a large reserve at the state budget level under fiscally-conservative Brown.

Despite his late opposition to Prop 13 before it passed, Brown flipped and promised to make 13 work, essentially by bailing out localities with the large state reserve (until it was exhausted) and by spending cuts at the state budget level. His second term was largely consumed with dealing with the aftermath of Prop 13 and a growing budget crisis that resulted from taking on local bailouts during two back-to-back recessions in the early 1980s. Brown lost a U.S. Senate race to San Diego Mayor Pete Wilson in 1982 and largely disappeared from state politics until the end of the decade. His successor as governor, Republican George Deukmejian (1983-91), was left to deal with the budget crisis which he did – and which won him a second term in 1986.

Meanwhile, Prop 13 had set in motion an ongoing political process. In 1979, Prop 4 was passed as a follow-up to the Prop 13 taxpayer revolt. Prop 4 put a ceiling on state spending based on a formula linked to population growth and inflation. Under Prop 4, if revenue exceeded the ceiling, taxpayers were due a refund. Such a refund occurred during Deukmejian's second term, angering the public school establishment which had become highly dependent on the state in the wake of Prop 13's cut in property taxes. The result was Prop 98 of 1988 (and a related later Proposition 111) which gutted Prop 4's spending cap and required that K-14 funding be based on a complicated system of three alternative contingent formulas.

Although George Deukmejian had been reelected in large part due to his success with resolving Jerry Brown's budget crisis, he left a later budget crisis legacy to his successor, Republican Pete Wilson (1991-99). The new crisis was linked to a national recession but also importantly – as noted earlier – to the end of the Cold War and the resulting structural shift in state growth. Wilson spent much of his first term struggling with the budget. By the time he was up for reelection in 1994, some level of fiscal stability had been achieved, aided in part of the incipient dot-com boom. And by the time his second term ended, Wilson left a buoyant economy and a temporarily-repaired fiscal situation to his successor, Democrat Gray Davis (1999-2003).

Table 1 traces California's fiscal history from the end of the Wilson era through June 30, 2012, the end of Jerry Brown's first complete fiscal year. Data on the table come from the cash statements issued by the state controller for the general fund – the operating budget of the state. They differ from official budget figures for reasons, sad to say, that are never fully explained in the public accounts. Indeed, accounting discrepancies – as will be described below in this chapter – became part of a fiscal scandal by the summer of 2012.<sup>7</sup> Nonetheless, the controller's cash statements provide a general picture of fiscal developments.<sup>8</sup>

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<sup>7</sup> The state has underway a plan dubbed FISCAL for integrating the accounting for the various funds that finance its operations. Such an integrated system might (emphasis on "might") produce more consistent results. The inability to reconcile the accounts is not entirely a technological issue. On the plan, see Legislative Analyst's Office,

For a time, thanks to the dot-com boom, state cash reserves rose substantially and short-term debt of the state was paid off. But at the peak of the boom, the state was already running a deficit, a fact that suggested a budget crisis was inevitable in the coming bust. The state is normally constitutionally barred from borrowing long term for general fund operating costs, but it can borrow short term within a fiscal year externally using a device known as Revenue Anticipation Notes (RANs). And it can borrow internally by putting IOUs into other state accounts outside the general fund. But excessive borrowing internally can interfere with the activities that the non-general fund accounts are supposed to support.<sup>9</sup> If such external and internal borrowing proves insufficient, the next step is short-term borrowing bridging two fiscal years through Revenue Anticipation Warrants (RAWs).

Governor Davis found himself using all three devices during the dot-com bust. Although he won reelection in 1982 against a weak opponent, by the summer of 2003, as noted earlier, he was facing a recall election. Ultimately, Davis was replaced by Republican Arnold Schwarzenegger. Schwarzenegger then faced the budgetary challenge that he had inherited from Davis. The state could in theory have rolled over its Davis-era RAWs into new short-term debt but financial markets were become impatient and punishing interest rates would have been required. Davis had proposed instead rolling over the accumulated short-term debt into a long-term state general obligation bond, a remedy that seemingly was unconstitutional.

Davis had proposed a route that ostensibly would surmount the constitutional bar but as a practical matter was dubious. Such a bond would inevitably face legal challenges and lenders were not likely to buy a bond that could be declared void by some eventual court decision. So Schwarzenegger took the Davis plan, enlarged it, and – using his popularity – persuaded voters to approve a constitutional amendment allowing long-term borrowing on a one-time basis under Props 57 and 58 of 2004. Voters were assured that the state would “throw away the credit card” after the one-time borrowing.

Schwarzenegger was reelected in 2006 as the housing bubble and its related prosperity was peaking, in part by identifying himself with expanded infrastructure – also on the 2006 ballot - to be paid for with additional borrowing. Once the bubble began to burst in 2007, the state’s budget problems returned. The Schwarzenegger agenda became increasingly budget centered and his popularity waned.

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“The 2012-13 Budget: Evaluating FISCAL,” April 30, 2012. Available at <http://www.lao.ca.gov/analysis/2012/ss/evaluating-fiscal-043012.pdf>.

<sup>8</sup> The official budget accounts are reviewed later in this chapter.

<sup>9</sup> For example, the state has a fund that finances beverage container recycling. Deposits on containers go into the fund which subsidizes recycling. At one point, there was so much borrowing from the fund that recycling activity was threatened. In 2010, the legislature took steps to stop additional borrowing and repay old loans. See Legislative Analysts’ Office, “Overview of the Beverage Container Recycling Fund,” April 11, 2012. Available at [http://www.lao.ca.gov/handouts/resources/2012/Overview\\_of\\_BCRF\\_04\\_11\\_12.pdf](http://www.lao.ca.gov/handouts/resources/2012/Overview_of_BCRF_04_11_12.pdf). The fund has other problems including an ostensibly high recycling rate that tends to drain it. There is some suspicion that there may be illegal imports of used bottles and cans from out-of-state to claim refunds.

By winter 2009, after resisting tax increases, the Governor Schwarzenegger went along with a package of temporary tax increases. Because of the two-thirds vote requirement under Prop 13, a few Republican votes were needed and were obtained (barely). But those Republicans who went along with the package were punished by their party. GOP legislative leaders lost their posts and one assemblyman was threatened with a recall, although it never came to pass. But the episode left a legacy which Jerry Brown would inherit under which obtaining Republican votes for taxes was almost impossible. Moreover, voters were unhappy with the new taxes and rejected extending those taxes beyond 2011 in a special election called in May 2009.

Meanwhile Jerry Brown had reemerged in California politics, first as chair of the Democratic Party, then as mayor of Oakland, and then as state Attorney General. Because he had served his prior two terms before voters imposed term limits in 1990, he was eligible for another two terms and ran as the Democratic gubernatorial candidate in 2010. His GOP opponent, former eBay CEO Meg Whitman, despite spending heavily on her own campaign, lost badly to Brown, partly because of “housekeeper-gate,” a personal scandal involving hiring an illegal immigrant housekeeper and then firing her abruptly. Brown also ran a successful campaign to tag Whitman as another version of the now-unpopular Schwarzenegger. That is, she was tagged as an outsider candidate from the business world who, unlike Brown (but like Schwarzenegger), would come into office not understanding how government worked.

#### **Brown’s First Budget: General Background**

*“For 10 years, we’ve had budget gimmicks and tricks that pushed us deep into debt. We must now return California to fiscal responsibility...”*

Governor Brown in January 2011 submitting his budget for 2011-12<sup>10</sup>

Although Brown’s political comeback began in the late 1980s, his earlier gubernatorial experience had come in an earlier era in which party polarization in the legislature was much less than it was when Brown took office as governor in 2011. In that earlier era, there were centrists in both parties and crossing party lines was not a political death sentence. Indeed, it was not a rarity. Even legislative leaders could be elected by a mix of votes from both parties.

Brown had been elected in 2010 on a pledge of no new taxes without voter approval. As described in last year’s chapter, his initial budget strategy was in fact to obtain voter approval for extension of the 2009 temporary taxes. As noted above, however, when given a chance to vote on such extensions in May 2009, voters had rejected the option. In effect, Brown’s plan was to have them reconsider and acquiesce, hopefully by June 2011 before the 2011-12 fiscal year would begin.

There are two routes to putting propositions on the ballot. The legislature can do it with a two-thirds vote. Or it can be done by petition. The latter has two disadvantages. First, the petition route costs

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<sup>10</sup> Quoted in a media release by the governor’s office dated January 10, 2011. Available at <http://gov.ca.gov/news.php?id=16872>.

money, about \$1-\$2 million to hire commercial signature-gathering firms. Despite brave assertions by proponents of various initiatives that they will conduct a grass-roots signature campaign and not hire professionals, as a practical matter you need the professionals to put an initiative on the ballot.

The second disadvantage is that an initiative by petition could not be said to be bipartisan, since it entirely avoids using the legislature. That disadvantage was seen as the advantage by Brown of going the alternative legislative route. Obtaining a two-thirds vote in the legislature would necessarily involve a few Republicans, thus making possible the claim of a bipartisan approach.<sup>11</sup> From Brown's perspective, moreover, all he would be asking from Republicans was to put the issue on the ballot. They would not have to support a "yes" vote.

As it turned out, however, even just giving the voters a tax option on the ballot had become virtually impossible for Republican legislators interested in a continuing political career. When Brown decided to forego the petition route and rely on offering incentives to Republicans to go along with a tax extension proposition, he unknowingly set in motion a process that resulted in no ballot proposition through either route (so the temporary taxes of winter 2009 expired). That expiration posed a problem for Brown since his initial budget proposal of January 2011 was built on an assumption that there would be a proposition and that it would be enacted by voters.

June 2011 proved to be an exciting month for the upcoming 2011-12 budget. In the background was a proposition voters had passed in November 2010 allowing budgets to pass by a simple majority, dropping a two-thirds rule that had a history back to the Great Depression. That is, the legislature could pass a budget with just Democratic votes. But it could not include either a tax increase or a ballot proposition that might lead to a tax increase because either would require two thirds. Brown kept negotiating with Republicans until Democrats panicked and quickly passed a budget that was "balanced" by some definition but only on paper. Brown then vetoed that budget.

Their panic was a reflection of another element of the proposition that allowed budgets to be passed with a simple majority. The same proposition indicated that if legislators did not pass a budget by June 15 – the constitutional deadline – they would not be paid for days with no budget. Democratic leaders in the legislature argued that they had met their obligation despite Brown's veto. However, the state controller, John Chiang, ruled that the budget passed by the legislature did not meet certain technical requirements and refused to pay the legislature.

Ultimately, since it became clear that there would be no GOP votes and no paychecks, the legislature and the governor agreed on a budget that simply assumed about \$4 billion in extra revenue – beyond what was projected for the sum of the taxes actually forecast – and that budget was deemed "balanced"

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<sup>11</sup> There was discussion of a possible route by which a proposition could be put on the ballot by a simple majority if it were dressed up as a modification of an earlier proposition. But there were enough legal doubts to make such an attempt unattractive.



(on paper).<sup>12</sup> Not surprisingly, as Table 2 shows, the assumed extra revenue did not appear. On a cash basis, revenue fell short of the original forecast by over \$4 billion.<sup>13</sup> The impact of the gap between actual and assumed revenue was partly offset by inclusion of automatic mid-year “trigger cuts” that would be imposed should revenue fall short of target by varying magnitudes. However, the cuts were not made on a dollar-for-dollar basis and there was no guarantee that the cuts would be made sufficiently large to guarantee the projected end-of-year reserve in the general fund would be positive. Although there were trigger cuts, the target was not met and the general fund ended with a negative reserve at the end of 2011-12.

### Looking at the Budget Numbers

*“Revenue accounting and reporting practices, however, are becoming increasingly confusing...”*

Report of the Legislative Analyst’s Office<sup>14</sup>

As noted, reconciliation of the cash and official budget data is not possible. And, indeed, while the cash statements, once they are issued, form an unchanging historical record, in budget data the past, particularly the near past, is quite variable. In part, the problem stems from the use of accrual methodology by the governor and legislature for budget data. Accrual in principle means assigning revenue to when it becomes owed to the state as opposed to when it is actually received. For example, income tax for 2012 is due on April 15, 2013 but accrues to the state during 2012.

Unfortunately, in practice, the accrual approach, as actually applied by governors and legislatures, opens the door to moving around revenue and expenditure in ways which obscure – rather than enhance – an understanding of the budget. The Legislative Analyst has recommended that a consistent methodology for accrual be required by law.<sup>15</sup> It may be, however, that given the pressures to adjust figures in ways

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<sup>12</sup> A court challenge was filed against Chiang, essentially arguing that it was only the legislature that could determine if a budget meeting constitutional requirements had been passed. The controller had no such power, the plaintiffs argued, even though he is the state’s paymaster. A court decision endorsing that view eventually was issued but the legislators never asked for, nor were they given, back pay for the episode. Meanwhile, the case is on appeal by Chiang as of this writing. Chiang waited until a budget deal was struck for 2012-13 before filing his appeal.

<sup>13</sup> One study found that government agencies around the world have a tendency to be overoptimistic about their projections so California is not necessarily unique. However, the current rules (since 2010) allowing a simple majority to pass budgets but a two-thirds vote for tax increases or certain other actions may encourage such behavior. See Jeffrey A. Frankel, *Over-Optimism in Forecasts by Official Budget Agencies and its Implications*, working paper 17239, July 2011, National Bureau of Economic Research. Available at <http://www.nber.org/papers/w17239>.

<sup>14</sup> Quoted in Legislative Analyst’s Office, “Issues Concerning the Accounting of California’s Special Funds,” August 9, 2012. Available at [http://www.lao.ca.gov/handouts/state\\_admin/2012/Accounting\\_Special\\_Funds\\_8\\_9\\_12.pdf](http://www.lao.ca.gov/handouts/state_admin/2012/Accounting_Special_Funds_8_9_12.pdf).

<sup>15</sup> Legislative Analyst’s Office, “The 2012-13 Budget: Overview of the Governor’s Budget,” January 11, 2012, pp. 16-17. Available at [http://www.lao.ca.gov/reports/2012/bud/budget\\_overview/budget-overview-011112.pdf](http://www.lao.ca.gov/reports/2012/bud/budget_overview/budget-overview-011112.pdf).

that are convenient, a return to cash accounting – despite its drawbacks – should be considered.<sup>16</sup> What is inferior accounting in theory may be superior in practice.

Table 3 shows four depictions of the 2011-12 budget from four sequential budget documents. On the left is shown the budget as officially enacted, including the last-minute \$4 billion phantom revenue that was assumed. In the official document, the state was going to run a budget surplus of about \$2.5 billion during the year, turning the reserve in the general fund from a negative \$1.2 billion to a positive \$1.3 billion by the end of that year.

When the governor presented his budget for the upcoming 2012-13 in January 2012, his estimate of the then-current 2011-12 year was that the budget – rather than running a surplus – was in fact running a slight deficit. The estimate reserve at the beginning of the 2011-12 year (six months before) had mysteriously become more negative, -\$3.1 billion instead of -\$1.2 billion. Yes, there were explanations; no, these were not helpful.

When the governor issued his “May Revise” for the upcoming 2012-13 year, his estimate of the negativity of the reserve ten months earlier had dropped by a little over \$200 million and the budget for the year as a whole was to be in a slight surplus. And by the time of budget enactment, the negativity in the reserve at the beginning of 2011-12, now 12 months earlier, had dropped slightly again. In flow terms, the 2011-12 budget was shown as being in a slight surplus but nonetheless ending with a negative reserve of about -\$2.9 billion. As noted, the cash statement shows the budget running a deficit and – in absolute terms – a much larger negative reserve at the year’s end.

Table 3 also shows the governor’s proposals and the eventual enactment of the subsequent budget for 2012-13. We will return to the proposals and enactment in the narrative below. As pointed out in the introductory section, the budget – although it is enacted in discrete units for particular fiscal years – is in fact a continual process. One year’s budget blends into the next.

### **New Fiscal Year and New Approaches**

*“...We’re not finished.”*

Governor Brown on signing the 2011-12 budget<sup>17</sup>

If anything was learned by Governor Brown from the legislative process that produced the budget for 2011-12, it was that political polarization meant that there would be no prospect for cooperation from

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<sup>16</sup> The Government Accounting Standards Board (GASB – generally pronounced gaz-bee) suggests using cash inflows and outflows to depict short term matters and accrual to depict long term obligations. See GASB, “Economic Conditions Reporting: Financial Projections,” November 29, 2011. Available at [http://www.gasb.org/cs/ContentServer?site=GASB&c=Document\\_C&pagename=GASB%2FDocument\\_C%2FGASBDocumentPage&cid=1176159500453](http://www.gasb.org/cs/ContentServer?site=GASB&c=Document_C&pagename=GASB%2FDocument_C%2FGASBDocumentPage&cid=1176159500453).

<sup>17</sup> Quoted in “California’s \$85.9 Billion Budget: Here are the Major Provisions,” *Sacramento Bee*, July 1, 2011. Available at [http://www.sacbee.com/2011/07/01/v-mobile/3740427\\_californias-859-billion-budget.html](http://www.sacbee.com/2011/07/01/v-mobile/3740427_californias-859-billion-budget.html).

Republican legislators regarding the next budget. The world had changed since the late 1970s when he first entered the governor's office, a period in which cross-party deals and compromises were more common. Budgeting via compromise was no longer on the table.

Governor Brown – who wanted to be the governor who ended California's ongoing fiscal instability – surely had to be uncomfortable with signing a budget that was premised on a phantom \$4 billion windfall that would come from no-one-could-say-where. His initial idea on taking office had been to obtain voter approval for a tax extension. Now that the taxes he wanted to have extended had in fact expired, he couldn't pursue the extension approach. He could still ask voters for more tax revenue, but any such permission would have to come through the initiative process and not via a proposition enacted by the legislature (which would require GOP votes). And he would face the disadvantage of having to ask voters for new taxes, not extensions of old - albeit temporary - ones.

### Thinking Big

*"I've never seen a CEQA exemption that I don't like."*

Governor Brown commenting on the state's major environmental law often used to block big projects by opponents<sup>18</sup>

There were other signs of a gubernatorial shift in approach. The not-like-dad stance that characterized his first iteration of governor had disappeared with regard to big infrastructure projects. Pat Brown had been identified with freeway construction, a major water project, and expansion of public colleges and universities. Jerry Brown now endorsed a large-scale project involving construction of a high-speed rail system connecting the Bay Area and southern California, despite substantial opposition. He compared high-speed rail to the building of the Transcontinental Railroad in the 19<sup>th</sup> century. Brown also promoted a successor plan to the Peripheral Canal, a water project that had been defeated by voters in 1982 during his earlier term as governor, and which again sparked considerable opposition.

One overarching element of big infrastructure spending that remained undecided, apart from particular projects, was how to pay for whatever infrastructure the state wanted to support. Basically, there are two methods for funding infrastructure. You can borrow for it so that the eventual payment comes from either future general revenue or revenue that the projects themselves may ultimately generate. Or you can fund it out of current revenue on a pay-as-you-go basis. In recent years, the split between the two methods has been 65% vs. 35%, respectively. Given the structural shift in California's growth since 1990 discussed earlier and the prospect that such restrained post-1990 growth would continue indefinitely, a possible shift in infrastructure finance and planning seemed also to need attention. But

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<sup>18</sup> Quoted in David Siders, "California Gov. Jerry Brown Upsets Environmentalist Friends with his CEQA Critique," *Sacramento Bee*, July 31, 2012. Available at <http://www.sacbee.com/2012/07/31/4676598/california-gov-jerry-brown-upsets.html>.

apart from reports by the Legislative Analyst and the State Treasurer, however, the focus remained on particular projects and not the more general funding issue.<sup>19</sup>

### **Summertime 2011**

*“People are saying, ‘Where can we sign up?’ and ‘Let’s set up a Facebook page.’”*

Riverside County Supervisor Jeff Stone  
concerning his proposal to have southern California  
secede from the rest of the state due to the state budget<sup>20</sup>

Since there was not going to be a tax-extension ballot in the fall of 2011, what might have been a busy summer preparing and fundraising for a campaign was relatively quiet from a political viewpoint. However, cuts in the budget enacted in June began to be felt. CalWORKs benefits (“welfare”) were cut as of July 1. At later dates in the year, other social welfare spending was reduced in such areas as adult daycare, child care, and Medi-Cal. Higher ed spending was cut, triggering proposals for increased tuition.

A Riverside County supervisor called for southern California to secede, angered by the revenue squeeze imposed on cities (such as San Bernardino, later to declare bankruptcy) and lack of state funding to open a UC-Riverside medical school. The City of Santa Clarita turned its library system over to a private contractor to save money. Brown angered organized labor by vetoing a bill allowing a “card check” system of union recognition in agriculture.<sup>21</sup> But since there would be no campaign for a tax extension initiative which would have been largely funded by public sector unions, there was little risk for Brown in

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<sup>19</sup> California Legislative Analyst, “A Ten-Year Perspective: California Infrastructure Spending,” August 2011. Available at [http://www.lao.ca.gov/reports/2011/stadm/infrastructure/infrastructure\\_082511.pdf](http://www.lao.ca.gov/reports/2011/stadm/infrastructure/infrastructure_082511.pdf). The Treasurer noted that he projected debt service would rise to 7.8% of the general fund in 2011-12, more than double the percentage in 2003-04. California State Treasurer, “The Challenge Ahead: Balancing California’s Infrastructure Investment and Service Needs,” October 2011. Available at <http://treasurer.ca.gov/publications/2011dar.pdf>.

<sup>20</sup> Quoted in Dave Downey, “Riverside County Supervisors Cool to Idea of Calling for Secession,” *North County Times*, July 2, 2011. Available at [http://www.nctimes.com/news/local/sdcounty/article\\_a9170e74-b533-5eaf-a7ee-e11810ba0ea5.html](http://www.nctimes.com/news/local/sdcounty/article_a9170e74-b533-5eaf-a7ee-e11810ba0ea5.html).

<sup>21</sup> The federal government does not regulate labor relations in agriculture and the state therefore has jurisdiction through its Agricultural Labor Relations Act (ALRA), a statute enacted during Brown’s first iteration as governor. In that period, Brown was identified with Cesar Chavez’s campaign to unionize farm workers which had some success but which fell apart in the 1980s. Under the ALRA, workers can choose to be unionized through an election process similar to what workers in the nonagricultural private sector have through federal law. “Card check” is a less formal procedure under which union recognition could be obtained by having a sufficient number of cards signed by farm workers saying they wanted a union to represent them. It makes union success in gaining employer recognition easier. Brown later signed a lesser bill favored by the Farmworkers that permitted the Agricultural Labor Relations Board to certify a union representative if it could be shown that workers were being intimidated by their employers to remain nonunion during organizing campaigns.

the veto.<sup>22</sup> In addition, the legislature added anti-layoff protections for school teachers thus pleasing the powerful California Teachers Association, a union far more influential in Sacramento than the United Farm Workers.<sup>23</sup> And a bill in the legislature, which the governor ultimately signed, created some obstacles for local governments seeking blanket bans on project labor agreements, an issue important to construction unions.<sup>24</sup>

If there was drama in the aftermath of the 2011-12 budget's enactment, it was over the imposition of the "Amazon tax," a requirement that Internet retailers with no presence in California nevertheless collect sales tax on purchases from within the state.<sup>25</sup> Amazon initially refused to collect the tax and cut off its relationship with California suppliers, hinted at a lawsuit, and put money into a referendum to repeal the requirement.<sup>26</sup> The legislature responded with a bill that, if passed, would have effectively made the requirement to collect the tax referendum-proof.<sup>27</sup> At one point, Amazon proposed it would open some distribution centers in California if the state would drop the tax collection requirement. In

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<sup>22</sup> One union that did take a hit in the budget in the form of layoffs was the California State Law Enforcement Association representing certain workers in the Attorney General's office. The union had endorsed Meg Whitman for governor in 2010 and was responsible for promoting the "whore-gate" affair. The affair involved a recording in which someone on the governor's staff (the person could not be identified) referred to Whitman as a whore for exempting police from her pension proposals. Whore-gate never caught fire as a scandal, however. There was, not surprisingly, speculation that the layoffs were retribution for the union's 2010 election actions. Another law enforcement union, the once powerful California Correctional Peace Officers Association (prison guards) suffered a loss, but not from gubernatorial action. It had attempted to reverse Schwarzenegger-era furloughs that had been imposed on its member on the grounds that the days off could not actually be taken because of scheduling problems in the prisons. The union had won a lower court decision upholding its position but that verdict was overturned on appeal. (Generally, legal challenges to state furloughs from the Schwarzenegger period did not succeed but in a few cases there were some reversals – and litigation {appeals by the state} pending at this writing concerning such reversals.)

<sup>23</sup> School districts were instructed to budget on the assumption that there would be no trigger cuts which might require layoffs.

<sup>24</sup> Project labor agreements can occur in both the public and private sectors. In either case, builders sign an agreement with various construction crafts that bar strikes and set up an alternative mechanism for resolving disputes. In effect, the agreements mean that the builders will use unionized construction contractors and workers. The bill signed by Governor Brown did not require local governments to use such agreements but did forbid them from enacting a *blanket* ban. Thus, each possible agreement had to be considered on a case-by-case basis.

<sup>25</sup> Apart from the loss of state revenue when online sales occur and sales tax is not collected, state retailers lose sales since their prices include the tax. See Liran Einav, Dan Knoepfle, Jonathan D. Levin, and Neel Sundaresan, *Sales Taxes and Internet Commerce*, working paper 18018, National Bureau of Economic Research, April 2012. Available at <http://www.nber.org/papers/w18018>.

<sup>26</sup> Technically, California buyers from firms such as Amazon were required to remit the sales tax on their own, even though it was not added to the purchase price. In reality, few customers did so and the law was not enforceable, thus costing the state lost revenue and angering California retailers that were subject to the tax and that had to compete with companies such as Amazon.

<sup>27</sup> The bill would have an urgency clause preventing a referendum. Such a clause would have required a two-thirds vote, i.e., some Republican support. Because California retailers supported the bill (to prevent Amazon from having a tax-free advantage), it was thought that some Republican votes might be forthcoming. When it came up to a vote, however, no Republican votes could be found.

the end, Amazon agreed to a delayed version of the tax collection requirement and dropped its plans for a ballot measure.<sup>28</sup>

Another drama that also began in the summer of 2011 involved local redevelopment agencies. These agencies relied largely on “tax increment” financing for their activities. The agencies would redevelop areas – ostensibly to remove blight but often to promote general local economic development – through receipt of the added property tax that would come as a result of the increased property valuations due to the redevelopment. They could float bonds against the stream of future property tax revenue. The problem for the state evolved out of Prop 98’s guarantees to K-14 for formula-based funding. To the extent that local property tax was “diverted” to redevelopment agencies, the state had to make up the property tax lost thereby to schools.

During the ongoing budget crisis, the state had found various ways of trying to capture local revenue – including revenue that would otherwise go to redevelopment. In 2010, local authorities – including redevelopment agencies - put a proposition on the state ballot that appeared to ban what they regarded as state revenue grabs of their monies. Voters approved the proposition but the victory from the viewpoint of the redevelopment agencies was short lived.

When Governor Brown proposed his 2011-12 budget, he proposed completely abolishing redevelopment agencies. If they did not exist, he reasoned, taking their money was not prohibited. The upshot was a compromise deal under which, rather than be abolished, the agencies would “voluntarily” pay the state under protest and then take their legal case to the courts. As it turned out, litigating the issue was a big mistake for the redevelopment agencies. In the end, the California Supreme Court ruled against the voluntary payments but supported the right of the legislature to abolish the agencies entirely. The agencies thus litigated themselves out of existence. But during the summer of 2011 this outcome was not expected; the agencies made their voluntary payments under protest and pursued their inadvertent judicial path to oblivion.

There were others who did not foresee exactly where their budgetary actions would lead. Democratic Assembly member Anthony Portantino had refused to go along with his party’s vote for the 2011-12 budget which contained more cuts than he wanted to support.<sup>29</sup> As a result, his office budget was slashed, officially because of past overspending. Portantino retaliated by demanding and litigating over public access to other legislative budgets and other information, information the legislative leaders were not anxious to share. He released his own information and challenged Assembly Speaker John Pérez to do likewise for all Assembly members. Portantino eventually succeeded in forcing a partial information

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<sup>28</sup> The deal was that Amazon and other online retailers would lobby Congress for a uniform national law. If no law emerged (and none has at this writing), Amazon would start collecting California tax by mid-September 2012.

<sup>29</sup> Portantino was termed out but was said to be considering a run for Congress in a liberal district in which his opposition to the cuts might have voter appeal. He made preliminary moves for such a run but later pulled out of the contest, citing family obligations.

release and the cuts to his office budget were reversed. Still more information was released when newspapers took the issue to court - and won - in January 2012.

And there were other repercussions. The Cal State System recruited a new president of San Diego State at a substantially higher salary than his predecessor, sparking public outrage and a letter protesting the arrangement from the governor. Pay of State University presidents remained an issue, even after the Board of Trustees of the System established a plan whereby future salaries would be capped and salary bump ups would be paid using non-state foundation funding.

If large dollar amounts were involved for university presidents, much smaller amounts caused confusion for motorists whose car registrations expired over the summer of 2011. One of the 2009 tax increases that might have been extended – but wasn't – was the Vehicle License Fee ("car tax"). The drop was partly offset by another fee but because of budgetary uncertainty, the California Department of Motor Vehicles was delayed in getting out notices for registration renewals. When the notices finally went out, car owners had little time to comply or were told their fees were overdue. In practice, however, additional time to pay fees was eventually granted.

No fee dispensation was given to rural residents who rely on state firefighting services. A proposal for a firefighting fee had been proposed during the Schwarzenegger era but was finally enacted as an element of the 2011-12 budget. Not surprisingly, such residents preferred to have such services provided for free and protested the new charge.

Another user charge is public university tuition, increases in which had sparked student demonstrations and protests. Under the new 2011-12 budget, even without the trigger cuts that were contingent on phantom revenue, the ratio of tuition revenue to tax revenue for students was rising. At the University of California (UC), for example it was noted that the ratio had reached the point where more revenue was coming from tuition than from the state budget.<sup>30</sup> The issue was contentious enough that the Regents refused to consider a long-term schedule of tuition increases at their September 2011 meeting that had been proposed by the UC administration. They did endorse a proposed tobacco tax ballot proposition that would fund cancer research to be on the June 2012 primary ballot, since some of the funding would spill over into UC medical center research. (The proposition was narrowly defeated.)

The public pension issue – about which a later section in this chapter will be devoted – continued to simmer during the summer. When Governor Brown was negotiating, without ultimate success, with Republicans for support in putting a tax-extension proposition on the ballot, he offered various limits on public pensions in California. Had a deal along those lines been struck, 2011 might have seen major changes in pensions on the ballot and much activity on that issue during the summer. But no deal occurred. Pensions remained largely a matter of local concern; San Francisco placed a pension measure

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<sup>30</sup> Much of the UC budget comes neither from the state nor from tuition. Federal and other research grants, hospital patient revenues, and other sources account for more than three fourths of the budget.

on the ballot for the fall and almost a year later pension propositions were passed by voters in San Jose and San Diego.

To some extent, the pension issue stood as a proxy for battles in other states with Republican governors and legislatures, most notably in Wisconsin and Ohio.<sup>31</sup> Various constraints in those states were placed on public unions – that tend to fund Democratic candidates – including eliminating public sector bargaining or constraining union political funding abilities. Given the political tilt in California, such drastic steps were not feasible at the state level. And threats of political groups to put a statewide pension initiative on the ballot foundered without sufficient funding for such an effort.<sup>32</sup>

But some local jurisdictions with conservative political leaders and voters moved, to the extent they could, in related directions. Notable was the southern California City of Costa Mesa where the activity took the form of outsourcing as much of the local public sector as possible. The city council also undertook moves to become a charter city which would reduce the influence of the legislature on the municipality with regard to its actions. Those actions received national attention when one city worker committed suicide by jumping off the roof of city hall. And much litigation over outsourcing and other issues, some still underway at this writing, followed.

Although other cities were to follow a year later, the only California city in actual bankruptcy during the summer of 2011 was Vallejo. Vallejo emerged from bankruptcy with reduced pensions for new hires and higher pension contributions for incumbent workers. Pensions of retirees were not affected. Some other cities – indeed, the League of California Cities – had hoped for a test of the legal position that pensions already promised to current workers cannot be touched. However, Vallejo – in part because of pressure from CalPERS – the very large pension covering state employees (other than UC and certain other state groups) and many local jurisdictions – not to push in that direction.

Republicans in the legislature had been able to keep the governor negotiating on the idea of a tax extension proposition until June when he gave up and the minority party essentially lost any voice in the enactment of the 2011-12 budget. But the GOP still had some potential future power due to the two thirds vote requirement for taxes and certain other legislative actions. The problem was that even that limited leverage could end given the new redistricted legislative boundaries drawn up by the citizen commission mentioned earlier that voters had set up. Although taking redistricting out of the hands of the Democratic legislature had long been a GOP goal, it appeared that even the new districts could conceivably give Democrats two-thirds control.

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<sup>31</sup> Opponents of a pension measure on the ballot in San Francisco noted that large donors to the Wisconsin and Ohio efforts were also providing funding for the San Francisco campaign. See Heather Knight, "SF Pension Reform Donors Tied to Antiunion Efforts," *San Francisco Chronicle*, October 4, 2011. Available at <http://www.sfgate.com/news/article/SF-pension-reform-donors-tied-to-antiunion-efforts-2328609.php>.

<sup>32</sup> A group called California Pension Reform filed two initiatives but could not raise the funding for signature gathering, let alone a ballot campaign, and dropped its efforts in early February 2012. The group blamed the summary written by the Attorney General for the measures for scaring off potential donors with language about teachers, nurses, and police.



Republicans filed an initiative in August 2011 that challenged the new districts that had been drawn up but just those districts for the state senate. They did not challenge assembly or congressional districts. Ultimately, they raised the funds needed to gather the needed signatures. Ironically, when the needed signatures had been gathered and the measure went on the ballot for November 2012, Republicans abandoned the campaign. It was too late to take the initiative off the ballot but the “pro” argument in the ballot pamphlet for what became Prop 40 told voters that the initiative was no longer needed.<sup>33</sup>

Even as the summer of 2011 was drawing to a close, Governor Brown appeared to be looking ahead to proposing a new budget for 2012-13. Given the lesson learned from the 2011-12 process – that there would be no Republican support for any tax measures – the governor knew that if he wanted new taxes, he would have to go the initiative route. The legislature, however, had passed a bill that would require paid signature gatherers to wear buttons indicating they were hired hands – a provision that would make signature gathering more difficult. Brown vetoed the bill. He also vetoed proposed changes in the trigger cuts contained in the 2011-12 budget agreement. If the trigger were pulled – as seemed likely – whatever saving it generated would be needed.

#### **Fall 2011**

*“Unfortunately, there are few easy options left for balancing California’s budget. Difficult program reductions have already been passed and significant one-time actions may be more elusive than in prior years. Accordingly, the remaining work of eliminating the state’s persistent, annual deficit will require more difficult cuts in expenditures and/or increases in revenues.”*

November 2011 report of the Legislative Analyst<sup>34</sup>

Even before the date where the trigger might be pulled, the budget squeeze in California reached out of the state. In early October, the U.S. Supreme Court agreed to hear a challenge to Medi-Cal (Medicaid) cuts filed by health care providers whose reimbursements were cut. In accepting federal funding, the states must meet federal rules for access to health care by the poor. If payments to providers are cut to the point where many of them drop out of the program, that access could be compromised.

But much of the fiscal action was within-state. There were glimmers of coming trigger cuts when the state controller reported that revenues for the first quarter of the 2011-12 budget year were over \$700 million below budget forecasts. Brown signed a bill allowing the California Department of Parks and Recreation to avoid budget-related state park closures by making deals for private funding through nonprofit groups. This seemingly non-controversial bill was to come back to haunt the governor in his campaign to persuade voters to enact a tax increase a year later. As will be described below, a major

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<sup>33</sup> The rationale given for this unusual ballot argument was that the state Supreme Court had allowed the 2012 election to go forward with the new districts in place. It was unclear why the issue was pursued as long as it was. Early polling suggested that voters were not keen on overturning a system they themselves had created.

<sup>34</sup> Legislative Analyst’s Office, “The 2012-13 Budget: California’s Fiscal Outlook,” November 2011, p. 2. Available at [http://www.lao.ca.gov/reports/2011/bud/fiscal\\_outlook/fiscal\\_outlook\\_2011.pdf](http://www.lao.ca.gov/reports/2011/bud/fiscal_outlook/fiscal_outlook_2011.pdf).

scandal erupted when it turned out the Department had funds in accounts that it did not know about and which might have averted park closures without external fundraising.

Although the parks bill's future implications were not understood, there was a strategic move in the legislature to change the initiative process in ways likely to benefit Democrats. Up to that point, initiatives that were certified as having sufficient signatures would be placed on the next election ballot, which could be a primary or special election as opposed to a regular general election in November. The next ballot in 2012 would be the presidential primary seen as more likely to turn out Republicans than Democrats. (President Obama was the sure Democratic nominee. But in the fall of 2011, the Republican race was open and conceivably there might be no all-but-anointed candidate by the time of the California primary. Republicans would then be more likely to vote than Democrats.)

The Democrats' bill moved initiatives to the November general election only. This move left only two statewide propositions on the June 2012 primary ballot. There was a relaxation of term limits which passed. And there was a tobacco tax which – as will be discussed below – narrowly failed.

One item that might have ended up on the June primary ballot was a “paycheck protection” initiative. Under paycheck protection, unions would be forbidden to use dues money for political purposes and corporations would be forbidden from making employee payroll deductions for political purposes. This seemingly-balanced formula in fact was aimed at unions since corporate political campaigns are not typically funded by payroll deduction. Basically, since union money goes mainly to Democrats, it would defund Democrats and initiatives favored by Democrats such as any tax initiative that might be part of the 2012-13 budget. The bill that was passed by the legislature and signed by the governor did not prevent paycheck protection from appearing eventually on the ballot; it did wind up on the November 2012 ballot but not in the June primary. Republicans filed a referendum to overturn the bill but never obtained the required signatures.<sup>35</sup>

By the fall of 2011, as noted earlier, only one city in California had declared formal bankruptcy, Vallejo, a Bay Area city with a population of about 116,000. That bankruptcy, filed in May 2008 before the full weight of the financial crisis was felt, was an early product of the housing bust.<sup>36</sup> As it turned out, however, by summer of 2012, there were other municipal casualties that ended in bankruptcy proceedings: Stockton, Mammoth Lakes, and San Bernardino. The state's tendency to pull local revenue up to Sacramento was in the background but, of course, each fallen city had its own special story.<sup>37</sup>

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<sup>35</sup> As noted earlier, another Republican-backed referendum for which signatures were obtained sought to undo the district lines drawn by a citizens' tribunal for the state senate. This initiative eventually appeared on the November 2012 ballot but was abandoned by its backers.

<sup>36</sup> On Vallejo, see Charles D. Sakai and Genevieve Ng, “We’re Bankrupt... Now What?,” *CPER Journal*, May 2010, pp. 5-12. Available at <http://www.publiclawgroup.com/wp-content/uploads/2011/12/2010-05-Were-Bankrupt-Now-What.pdf>.

<sup>37</sup> The bankruptcy of Mammoth Lakes seemed linked to a dispute with a developer rather than deeper causes.

Since it was evident from the Vallejo example that other such bankruptcies might follow, the governor signed a bill that would set in motion an investigative process in some cases before bankruptcy could be declared. The bill was heavily favored by public-sector unions that feared their labor contracts might be abrogated by a bankruptcy judge. On the other hand, Governor Brown continued his pattern of sometimes giving something to organized labor and sometimes not. He vetoed a bill requiring local government to undertake economic impact studies when “big box” stores – read Wal-Mart – applied for building permits. Nonunion Wal-Mart has been anathema to unions, particularly those representing workers in unionized grocery chains, because of its anti-union stance and its competition with union supermarkets.

While some municipalities were slowly edging toward bankruptcy, counties were in a different position. Thanks to the “realignment” component of the 2011-12 budget, certain state prisoners were to be moved to county jails and supervision. Past bond money was made available to counties to enlarge their jails, creating a local building boom of sorts. But at least in the short run, in some counties there was a shortage of facilities – both physical and in the form of parole agents – to handle the added responsibility. Some local police officials worried about increased crime as a result of realignment although their public statements tended to give reassurance that the new responsibilities would somehow be handled. Whether votes would connect increased crime – if it occurred – with the state budget and possibly some future tax initiative was unclear.

### **Pension Tension**

*“We view the Governor’s (pension) proposal as a bold starting point for legislative deliberations.”*

Legislative Analyst’s review of  
Governor Brown’s pension proposals<sup>38</sup>

*“You got resources, brother, we got resources too. If you want a war we did not start, let’s get it on.”*

Union spokesperson reacting to a City of Los Angeles proposal  
to adopt a lesser two-tier pension plan for new hires<sup>39</sup>

Perhaps the biggest budget-related event was the proposal by the governor for a revamp of all state and local public sector pension plans. “Budget-related” may not be a good term, however, because in the short term, pension costs, while rising, were not a major part of the state budget crisis; the basic cause was the overall structural problem described earlier plus the Great Recession. Still, the pension

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<sup>38</sup> Legislative Analyst’s Office, “Public Pension and Retiree Health Benefits: An Initial Response to the Governor’s Proposal,” November 8, 2011. Available at

[http://www.lao.ca.gov/reports/2011/stadm/pension\\_proposal/pension\\_proposal\\_110811.pdf](http://www.lao.ca.gov/reports/2011/stadm/pension_proposal/pension_proposal_110811.pdf).

<sup>39</sup> Quoted in Kate Linthicum, “L.A. Council Considers Two Tax Increases and a Pension Change, *Los Angeles Times*, August 22, 2012. Available at <http://www.latimes.com/news/local/la-me-0822-city-tax-hikes-20120822,0,7359532.story>.

problems of the state to some degree were a reflection of the gap between public expectations and fiscal reality that developed post-1990.

Public employees generally have “defined benefit” pensions, i.e., a retirement annuity whose monthly value is determined by a formula related to the retiree’s length of work service, his/her earnings history, and the age at which retirement is taken. Such plans were once common among larger private employers, too, but have gradually been abandoned in favor of “defined contribution” plans in which the employer makes a contribution to a tax-preferred savings account whose investments are then managed by the employee from a menu of options. Whether there is enough in the account to provide an adequate retirement benefit will reflect the amount of the contributions and the employee’s skill (luck?) in investments plus how long he/she lives.<sup>40</sup>

There are essentially three issues that arise with defined benefit pensions. First, sloppily-constructed defined benefit formulas can be gamed by employees. The goal of defined benefit pensions is to provide a continuance of income in some relation to *normal* work income after retirement. Thus, the formula for the monthly annuity should reflect only normal earnings, not an artificial spike in earnings typically just before retirement. It is relatively easy to ensure against such pension “spiking,” however. Basically, the earnings history used for calculating the pension should involve a multi-year period and should exclude erratic jumps in income from bonuses, overtime, unused vacation time, etc. Not all public plans, unfortunately, use formulas that block such abuses.

Second, defined benefit pensions are promises in lieu of other forms of worker pay. When workers are paid partly in promises, the promises should be adequately funded *at the time those promises are made*. Otherwise, workers providing services today will be effectively be paid by future generations that did not receive those services. Funding current service consumption adequately requires a willingness to pay into the plan an amount which, assuming a realistic assessment of future earnings, will cover current promises. Pension wonks refer to this sum as the “normal cost” of the pension.

In fact, as was the case with many American households before the Great Recession, there was a tendency to charge current consumption to the future. Pension administrators made unrealistic estimates of future earnings of the funds they held in their portfolios and did not put away the normal cost, year by year. Households similarly assumed that their homes would forever appreciate at high rates. In effect, they borrowed for current consumption against that unrealistic expectation and did not adequately save. Now both pension administrators (and taxpayers) and households face the bills for their past excesses.

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<sup>40</sup> Employees on retiring can take the funds in their defined contribution accounts and buy a lifetime annuity from a private insurance company. Such annuities insure against the risk of outliving the amount saved. But private annuities typically are costly and are not government-insured. Private defined benefit plans are government-insured, in contrast. State and local defined benefit plans are not federally insured but, as will be explained below, are relatively ironclad obligations of the government employer.

That sad result has produced the third (political) problem for public pensions. Households, particularly baby boomers who assumed that their houses and inadequate savings would pay for their retirements, are facing retirement years with incomes less than expected. When they look at public workers with defined benefit pensions that protect them from such unhappy results, they resent not having such plans.<sup>41</sup>

Public pensions became an issue in the 2010 California gubernatorial election campaign. Brown during that campaign said he would provide some form of pension reform – without saying what that would be. He offered various pension proposals to the Republican legislators he was trying to induce to put tax extensions on the 2011 ballot. But – as noted – he could not reach a deal with them. So he waited until October 2011 to offer a pension proposal to the legislature and the general public. His twelve-point plan for all state and local pensions, which would have applied to new hires only, involved a “hybrid” mix of defined benefit and defined contribution, caps on pensions, higher employee contributions, and protections against spiking and other perceived abuses.<sup>42</sup> Some of these ideas were those offered by the governor to GOP legislators during his unsuccessful budget negotiations regarding the 2011-12 budget and leaked to the news media at the time.

Although governor’s proposal took the form of a lengthy document, it was not initially presented as a detailed piece of legislation and would have required voter approval for some elements.<sup>43</sup> More importantly, the proposal was not entirely clear. For example, the governor proposed a cap on retirement benefits of 75 percent of final earnings. But exactly how do you cap a mix of defined benefit and defined contribution where the latter is essentially variable and would depend on how much an employee had earned on the funds in his or her account?<sup>44</sup>

The governor’s twelve-point program did not meet with favor from public sector unions or Democrats in the legislature who were nonetheless polite and just thanked the governor for his thoughts. Since that reaction was predictable, it is possible that Brown offered the plan as an opening bid in a *de facto* negotiation and was prepared at the time to accept less. Republicans, however, scored political points by fully accepting the plan just as offered by the governor. Although as the minority in the legislature they could not enact it, they could point to the spectacle of Republicans endorsing the governor’s plan while his fellow Democrats did not.<sup>45</sup> Meanwhile, some Democrats pushed a plan (SB 1234) that would

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<sup>41</sup> In reality, almost all private sector workers do have a defined benefit pension plan: federal Social Security. Social Security covers many – but not all – state and local workers. Thus, some public defined benefit pension plans cover workers who do not have Social Security.

<sup>42</sup> The plan dated October 27, 2011 is available at [http://gov.ca.gov/docs/Twelve\\_Point\\_Pension\\_Reform\\_10.27.11.pdf](http://gov.ca.gov/docs/Twelve_Point_Pension_Reform_10.27.11.pdf).

<sup>43</sup> Detailed language was presented in early February 2012.

<sup>44</sup> CalPERS – the largest state pension plan – raised this question and others in its draft analysis of the governor’s plan. The draft analysis is available at <http://www.calpers.ca.gov/eip-docs/preliminary-analysis.pdf>.

<sup>45</sup> There was ongoing discussion about groups allied with Republicans filing some kind of pension initiative. But there was never the money available to finance such a move. While filing is cheap, obtaining signatures is costly.

have expanded the CalPERS state pension in some form to the private sector for those private workers without employer-based pensions.<sup>46</sup>

After the fall 2011 announcement and the flurry surround it, pensions receded into the background during winter and spring, although there were legislative hearings. As in the prior year, the attention went back to the budget during that period and pensions did not resurface as a major issue until August 2012 when the legislature began to develop its own version of pension reform. That episode will be discussed below. However, by the time Brown put out his pension proposal, he surely had sufficient knowledge about the upcoming budget to know that he would be seeking a ballot initiative for a temporary tax increase. In fact, a little more than a month after presenting his pension program, he filed such a tax initiative.<sup>47</sup>

Governor Brown likely believed that showing the public that he had accomplished some version of pension reform would help in the future campaign to pass his tax initiative. However, even if his twelve-point plan were implemented in full, the impact on the immediate budget was quite limited and the long-term savings of such proposals tend to be less than proponents suggest.<sup>48</sup> But the issue was delicate since he would need union support to run a campaign for his tax initiative. Because of the paycheck protection initiative that would also appear on the November 2012 ballot, unions' funding for other politics would be more limited than otherwise. Their first priority would be fighting paycheck protection.

In the end, a pension bill was negotiated between legislative leaders and the governor and enacted at the tail end of the legislative session in August 2012. The deal gave the governor the ability to cite a pension reform as part of his campaign for his tax initiative. However, the bill retained the defined benefit structure of public pensions and did not include a defined contribution component as the governor originally proposed. It included a pension cap, although generally not the tight cap the

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And an actual campaign for a ballot initiative would be still more costly. At the local level, however, some pension ballot propositions were proposed and adopted by voters.

<sup>46</sup> Oddly, this idea had surfaced earlier in the form of a confusing initiative filed by the same right/populist group that had started the recall against Governor Gray Davis. There is some evidence that public pension plans throughout the U.S. generally follow the lead of CalPERS in their portfolio allocations. See Nancy Mohan and Ting Zhang, "An Analysis of Risk-Taking Behavior for Public Defined Benefit Pension Plans," W.E. Upjohn Institute working paper 12-179 (2012). Available at [http://research.upjohn.org/up\\_workingpapers/179/](http://research.upjohn.org/up_workingpapers/179/). So it is possible that any changes in the general structure of CalPERS would have national implications. However, at this writing, discussion of extending some version of CalPERS to the private sector – while it has attracted some media attention – seems unlikely to be enacted in the foreseeable future.

<sup>47</sup> The first version of the initiative was filed on December 1, 2011. As will be discussed below, that version had to be replaced later with another.

<sup>48</sup> Plans that affect new hires only have an impact as new hires occur but there tend to be fewer new hires than normal during periods of fiscal distress. In addition, most public employers in general terms try to pay their employees in total compensation something approximating private sector pay for equivalent jobs. Generally, studies of public/private pay differentials show rough comparability – particularly if employer size is considered – although public compensation tends to have a larger share of benefit-type pay in the wage-benefit mix. So if pensions or other benefits are reduced, over the long run some other form of pay will need to be increased.

governor had originally proposed, and later retirement ages for new hires. Existing workers would pay higher contributions toward their pensions.

The bill did not cover all state and local plans – exempting certain city retirement plans and the University of California, for example – unlike the original governor’s plan which seemed to apply to all public pensions in the state. However, when the August 2012 deal was announced, the governor chose to characterize it as “a significant step forward.”<sup>49</sup> As news stories began to point to the fact that the deal was less extensive than the original 2011 proposal, Governor Brown enhanced his description. The deal became “the biggest rollback of public pensions in California history.”<sup>50</sup> At the state level, however, it was unclear that there ever had been any prior rollback.

### Winter Arrives

*“I don’t know of another approach than the triggers we already voted on.”*

Assembly Speaker John Pérez quashing talk that the legislature would modify existing budgetary triggers<sup>51</sup>

*“Nemo dat non habet.”*

Governor Brown (former classics major at UC-Berkeley) announcing trigger cuts (*“No man gives what he does not have.”*)<sup>52</sup>

Shortly after the original pension plan announcement in 2011, the Legislative Analyst had released his review of the budget problem facing the state. As the Analyst saw it, although California had run a surplus in 2010-11, thanks to the temporary tax increases enacted in 2009, with the expiration of those taxes, California would run a deficit in 2011-12, even with a probable trigger cut. Thus, the already-negative reserve in the general fund would be still more negative by the end of June 2012. And the problem would intensify in 2012-13, absent further revenue enhancements and/or spending cuts.<sup>53</sup>

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<sup>49</sup> Quoted in gubernatorial media release of August 28, 2012. Available at <http://www.gov.ca.gov/news.php?id=17694>.

<sup>50</sup> Quoted in gubernatorial media release of August 31, 2012. Available at <http://www.gov.ca.gov/news.php?id=17701>.

<sup>51</sup> Quoted in John Myers, “Rethinking Budget Trigger Unlikely, Says Speaker,” *KQED Capital Notes*, November 28, 2011. Available at <http://blogs.kqed.org/capitalnotes/2011/11/28/rethinking-budget-trigger-unlikely-says-speaker/>. An earlier attempt by the legislature to modify the trigger was vetoed by Governor Brown in September 2011.

<sup>52</sup> Quoted in John Myers, “Brown Announces Some, Not All, Budget Trigger Cuts,” *KQED Capital Notes*, December 13, 2011. Available at <http://blogs.kqed.org/capitalnotes/2011/12/13/brown-announces-some-not-all-budget-trigger-cuts/>.

<sup>53</sup> Legislative Analyst’s Office, *The 2012-13 Budget: California’s Fiscal Outlook*, November 2011, p. 3. Available at [http://www.lao.ca.gov/reports/2011/bud/fiscal\\_outlook/fiscal\\_outlook\\_2011.pdf](http://www.lao.ca.gov/reports/2011/bud/fiscal_outlook/fiscal_outlook_2011.pdf).

Others in government also worried about what was to come. For example, local officials who were taking state prisoners into county jails and probation systems became nervous about whether the state would continue to fund such “realignment.” They pondered filing a ballot initiative to compel future realignment support (but ultimately didn’t).<sup>54</sup> More immediately, there were concerns about the likely firing of the trigger that would produce midyear budget cuts.

Some government entities had simply assumed the trigger would be pulled and built the cuts into their fiscal year plans. Both UC and CSU announced that even with the trigger, there would be no midyear hikes in tuition since they had planned for the cuts in advance.<sup>55</sup> However, school districts had been ordered to assume no trigger cuts would occur in their budgets and making midyear adjustments was more difficult for them.

As it turned out, when the trigger was pulled, close to \$1 billion was cut midyear. The bulk of the cuts came from education, particularly higher education, and social welfare spending. Yet the amount cut was less than half of the drop in revenue that was officially certified by the Department of Finance.<sup>56</sup> There may have been a public impression that having a trigger would create cuts sufficient to offset the revenue drop, dollar-for-dollar, But that was not how the process contained in the 2011-12 budget operated.

While the trigger might have been expected to be the last dramatic aftershock of the 2011-12 budget, the state Supreme Court delivered the final one. As noted earlier, local redevelopment agencies had bet their futures on a lawsuit challenging their treatment in that budget. That turned out to be a very bad bet. The Court indicated that the governor and legislature could indeed enact a provision terminating the agencies (and thus take their money). But the Court did not allow the life-saving alternative that had been enacted as a compromise, i.e., that the agencies could stay alive by making “voluntary” contributions to the state.

The agencies and their local supporters pleaded with the legislature to lift the Court’s death sentence and proposals were made along those lines. But the Court had given the agencies only one month to terminate and no reprieve could be negotiated in that limited time, particularly after the governor said

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<sup>54</sup> In the end, they dropped the idea.

<sup>55</sup> Whatever chance there might have been for a UC tuition increase ended with an incident at UC-Davis in which “Occupy” demonstrators were pepper-sprayed by campus police. YouTube videos and internet photos circulated widely and there were explosive demonstrations at Regents meetings.

<sup>56</sup> The cuts were put at \$980 million but the revenue gap was estimated by the Department of Finance to be \$2.2 billion. Under the budget formula, the midyear forecasts of the Department of Finance and the Legislative Analyst would be compared. The gap estimate would be the *lesser* of the two and the latter’s estimate was about \$1.5 billion higher. Source: Letter from Department of Finance to the Legislature, December 13, 2011, available at [http://www.dof.ca.gov/documents/2012\\_Rev\\_Forecast\\_Determination.pdf](http://www.dof.ca.gov/documents/2012_Rev_Forecast_Determination.pdf).



the “funeral” of redevelopment could not be delayed.<sup>57</sup> In the end, the abrupt death of redevelopment left the state and cities fighting over the carcasses of the defunct agencies – a process still underway at this writing.<sup>58</sup>

### **Proposing the 2012-13 Budget**

*“I will mix boldness with some pragmatism, so I get it done.”*

Governor Brown reflecting on his first year in office<sup>59</sup>

The California constitution requires the governor to present a budget proposal for the upcoming fiscal year to the legislature in early January. Often, hints about the budget are leaked out before the formal presentation. It was well known by January that the governor would be seeking a tax initiative in 2012 as part of his budget plan since he had submitted one.<sup>60</sup> But other administrative shifts and consolidations designed to save money were also leaked out.

However, the official unveiling of the budget suddenly was moved up after someone mistakenly posted a copy on the Department of Finance website only five days into the new year. The Democratic governor had some consolation over the early release; the GOP official response to his 2012 State of the State speech was somehow released online as a video *before* the governor had given it. Premature online release was at least shown to be a bipartisan failing and bipartisan displays were rare in Sacramento.

As Table 3 shows, the new Brown proposal conceded that even with the trigger cuts announced in December 2011 and with new midyear cuts that were part of his January plan, the ongoing 2011-12 fiscal year would end with a negative reserve in the -\$3 billion range. Even with a successful tax initiative in November 2012 (which would produce some revenue attributable under accrual accounting to 2011-12), the reserve at the end of 2011-12 would be negative. And for fiscal 2012-13, the trigger concept would be renewed. This time, however, the trigger would be pulled if voters did not approve the tax initiative. That feature would fulfill the governor’s 2010 campaign promise that there would be no new taxes without a vote of the people.

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<sup>57</sup> Quoted in Micaela Massimino, “AM Alert: Deadline Looms for Action on Redevelopment Agencies,” *Capitol Alert* blog of *Sacramento Bee*, January 23, 2012. Available at <http://blogs.sacbee.com/capitolalert/latest/2012/01/am-alert-deadline-looms-for-action-on-redevelopment-agencies.html>.

<sup>58</sup> At issue is paying off ongoing commitments and bonds of the former agencies. There was a rush to make commitments when the idea of terminating agencies first surfaced. The state and local governments were left to feud over what commitments were real once the agencies were killed by the state Supreme Court.

<sup>59</sup> Quoted in John Myers, “Brown Interview: Pensive, Upbeat, More Latin,” *KQED Capital Notes*, December 27, 2011. Available at <http://blogs.kqed.org/capitalnotes/2011/12/27/brown-interview-pensive-upbeat-more-latin/>.

<sup>60</sup> Because of a typo, a second version was submitted to the Attorney General’s office on January 13, 2012. As will be seen below, a more major modification had to be submitted later.

The new proposal also represented another deviation from the prior year. When Brown formulated his first budget a year before, he also had a tax proposition in mind (which was thwarted when the GOP would not go along). At that time, he could have presented two budgets, one with and one without voter approval of his then-proposed tax plan. But he presented only a budget proposal containing the tax plan (that ultimately morphed into the actual 2011-12 budget with phantom revenue and partial trigger cuts). He never presented a “budget from Hell” assuming both reasonably forecast revenue and voter rejection. This time, however, there was an element of the budget from Hell in that specific cuts were spelled out in the event of voter rejection. And the cuts spelled out were heavily in education including K-12 – an area which California voters have always seen as a priority.

Given the new strategy and voter priorities, there were some risks in linking the tax initiative to potential cuts in school spending, albeit cuts that could be avoided with a “yes” vote. The tax initiative would have to be sold as protecting schools but would be seen as somehow connected to school cuts. Not surprisingly, early polling suggested opposition to school trigger cuts.<sup>61</sup> There would be at least one other tax measure on the ballot, the so-called Molly Munger initiative, which raised money earmarked for schools, debt repayment, and early childhood programs and had adequate financing – from Munger’s personal wealth - for a full-fledged campaign.<sup>62</sup> There would also be the union-opposed “paycheck protection” initiative on the ballot that would be diverting union campaign money that might otherwise support the Brown tax plan.

Apart from the overall dollar inflows and outflows projected in the budget, Brown incorporated potentially important policy changes. Included were proposals to change the basic formula for funding K-12 away from average daily attendance and away from various categorical programs to weighted amounts per student. The weights would depend on such things as low-income background and English-language proficiency of students. Such reforms have long been advocated by educational experts. But the governor also proposed delaying the start of a new transitional kindergarten program that was otherwise due to start in the fall of 2012.<sup>63</sup> And in the juvenile criminal justice area, the state’s youth prison facilities would be eliminated in favor of facilities run by local authorities. In welfare spending, the time limit for a recipient to find work would be reduced.

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<sup>61</sup> The cuts would not be in the initiative itself since a rejected initiative is just that – rejected. It cannot dictate what happens if it is voted down. The cuts would be in the budget and enacted by the legislature, not the voters. Poll results suggesting resistance to school trigger cuts along but support for the governor’s tax plan (even though the two were connected in the actual plan) can be found in Public Policy Institute of California, “January 2012: Californians & Their Government,” January 24, 2012. Available at [http://www.ppic.org/content/pubs/survey/S\\_112MBS.pdf](http://www.ppic.org/content/pubs/survey/S_112MBS.pdf).

<sup>62</sup> The Munger initiative increased personal income tax revenues in the upper brackets from 2013 through 2024. The increase was estimated by the legislative analyst to bring in \$5 billion in 2012-13 and \$10 billion the following year.

<sup>63</sup> The program was ultimately put into effect.

For the three segments of higher education (UC, CSU, community colleges), Brown proposed a long-term (multiyear) funding plan in exchange for certain outcome improvements.<sup>64</sup> Exactly what these improvements were to be was unclear. Given past cuts, enrollments at UC and CSU (acceptances and actual attendance as opposed to admissions) as a proportion of new high school grads have been declining with some students diverting to community colleges where they then met course shortages.<sup>65</sup>

But there are two problems with a long-term plan. First, even if the legislature went along for 2012-13, it could not bind future legislatures and future budgets, particularly given the short memories that term limits entail. Second, the legislative analyst tends not to be keen on proposals that seem to limit legislative discretion which a multiyear commitment – even if not legally binding – seems to do. And the legislature puts significant weight on the opinions of the legislative analyst.<sup>66</sup> In short, long-term plans for higher education seemed not to be on the legislative agenda.<sup>67</sup> Gubernatorial proposals for cuts in Cal Grants – the state higher education scholarships - were met with little legislative enthusiasm and were largely rejected (although elements of these cuts remained in the eventual budget).

The budget proposal also became intertwined with environmental concerns. Under a Schwarzenegger-era law, California was due to operate a “cap and trade” program under which pollution emitters would buy permits up to a ceiling for emissions through an auction process. The governor estimated that \$1 billion in revenue would accrue to the state and could be used for environmental programs. Some of the inflow of revenue could in effect fund existing environmental programs, thus freeing money for other purposes in the general fund. But the revenue, to qualify as a fee rather than a tax, would have to be spent on programs that were sufficiently close to the activity being regulated, raising some legal issues about the budget proposal.

Finally, what the budget proposed to cut – even items that would not result in reduced services – had complicated indirect effects. By law, the state must pay local governments for any services that it mandates. However, some of these services would be provided by the locals in any case, mandate or not. So removing the mandate saved the state money but did not directly cut services where the mandate was superfluous.

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<sup>64</sup> Community colleges were especially hard hit by the ongoing budget crisis and had limited ability to raise alternative sources of funding. A proposal by Santa Monica College to ease course rationing by creating additional sections of high-demand courses at higher prices for those willing to pay was met with opposition, including from the state, and was eventually killed. But the result was that fewer courses net were offered.

<sup>65</sup> Hans Johnson, *Defunding Higher Education: What are the Effects on College Enrollment*, Public Policy Institute of California, May 2012. Available at [http://www.ppic.org/content/pubs/report/R\\_512HJR.pdf](http://www.ppic.org/content/pubs/report/R_512HJR.pdf).

<sup>66</sup> Legislative Analyst’s Office, “The 2012-13 Budget: Analysis of the Governor’s Higher Education Proposal,” February 8, 2012. Available at <http://www.lao.ca.gov/analysis/2012/highered/higher-ed-020812.pdf>.

<sup>67</sup> Within the University of California, the ongoing budgetary squeeze provoked calls for greater autonomy at some campuses, notably Berkeley and San Francisco. At UCLA, a battle was fought within the Academic Senate over making the MBA program “self-supporting” (the word “privatization” is avoided), and ultimately the self-supporting plan was approved at the campus level and later blocked at the systemwide level.

Still, there are two less obvious impacts of dropping redundant mandates. First, the local governments were receiving funds for the mandates that they no longer would receive if the mandates ended. So while they might not cut back on a specific mandated activity once the mandate for it is lifted, the locals would have less revenue in total and might cut back elsewhere. In addition, reducing the state's general fund by cutting mandates reduces the state's immediate and/or longer-term funding obligation for schools and community colleges under Prop 98's requirements for K-14 funding.

There was always the chance that some mandates might turn out not to be redundant, i.e., that the local governments would cease performing the function. For example, one proposed mandate elimination ended a requirement that animal shelters not euthanize strays for an extended period. Animal lovers, led by former state senator Tom Hayden, pleaded with Brown to think about his own dog Sutter (often trotted out by the governor to public events), before removing that mandate. In short, some mandates had significant political support.

The fact that the governor proposes a budget does not obligate the legislature to enact it. And to the extent the budget has complicated policy elements – such as changes in educational, incarceration, welfare, and environmental programs - the legislature is likely to want to take its time. In addition, there are always uncertainties about forecast revenues, particularly because of the state's heavy dependence on income tax receipts from high-income earners. Such earners' taxable incomes are often linked to the stock market and capital gains and the Facebook initial public offering (IPO) was beginning to loom in Sacramento's consciousness. Depending on how that IPO went, there could be a perceptible rise in tax receipts.

Senate president Darrell Steinberg said the midyear cuts being proposed for the ongoing 2011-12 fiscal year were "premature."<sup>68</sup> And the legislative analyst thought the revenue projections associated with the proposed tax initiative were too high.<sup>69</sup> More generally, the legislature typically awaits the opinions of the legislative analyst and after the budget proposal was unveiled in January 2012, the analyst provided detailed reviews of many different aspects of the budget in a stream of online publications. In short, the legislature had many reasons – a whole menu in fact - to postpone quick action.

### **Considering the Budget**

*"It is said that the road to hell is paved with good intentions and digging ourselves into a deep financial hole – to do good – is a bad idea. In this time of uncertainty, prudence and paying down debt is the best policy."*

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<sup>68</sup> Quoted in Dan Walters, "Let the California Budget Games Begin," *Sacramento Bee*, January 6, 2012. Available at <http://www.sacbee.com/2012/01/06/4166643/dan-walters-let-the-california.html>.

<sup>69</sup> Legislative Analyst's Office, "The 2012-13 Budget: Economic and Revenue Update," February 27, 2012. Available at <http://www.lao.ca.gov/analysis/2012/update/economic-revenue-update-022712.pdf>.

Governor Jerry Brown's 2012 State of the State speech<sup>70</sup>

As soon as the budget was presented, there were complaints and roadblocks. The governor's tax initiative, although billed as a millionaires' tax, in fact had a mix of an income tax increase at the upper end of the income scale plus a sales tax increase. Liberal Democrats didn't like the sales tax element because of its regressive characteristics.<sup>71</sup> Republicans wanted no tax increase at all. A court decision blocked the portion of the trigger cut in the 2011-12 budget that applied to home care aides.<sup>72</sup> Another court decision blocked cuts to Medi-Cal providers. And the Obama administration refused to go along with a plan to charge co-pays to recipients of Medi-Cal.

In addition, looming on the November ballot was a much-postponed flotation of a multi-billion dollar water project bond which seemed to contradict Brown's idea of not running up state debt. The water bond could be postponed again by the legislature – and eventually was. Court and federal decisions, however, are outside the reach of the governor and legislature. And if the tax initiative was to be rejiggered, it could only be done by filing a new version and obtaining the needed signatures in time for placing the initiative on the November 2012 ballot.

The governor had to depend on union support for his tax initiative. The largest and most influential unions – the California Teachers Association and the Service Employees International Union – did back the initiative but another union, the California Federation of Teachers, had its own version of a millionaires' tax which could potentially wind up on the ballot in competition with the Brown plan. The alternative plan also had support from significant elements in the Democratic Party. Brown apparently was in discussions with backers of the alternative as early as February and hinted at some kind of deal with them, telling party officials that their "marching orders" would be coming "soon enough."<sup>73</sup>

As part of the negotiating process, Brown released a poll that indicated that if two similar millionaires' taxes were on the ballot, both would lose. His poll – as did others – suggested in addition that the Munger tax initiative for schools was failing to capture majority support. However, there was no indication from Molly Munger that she was ready to fold her campaign and support the governor's

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<sup>70</sup> Available at <http://gov.ca.gov/news.php?id=17386>.

<sup>71</sup> The state income tax is progressive and highly dependent on upper-income recipients. Thus, it is quite volatile since upper-income recipients have investment related income such as capital gains. The sales tax is regressive so that when all state *and local taxes* are combined, those at the bottom of the income scale pay more as a percentage of their income than others. The combination of all taxes crudely flattens out for the top 60% of earners at around 8%. The state, however, gets more than half its general fund tax receipts from the income tax. Source: California Budget Project, "Who Pays Taxes in California?," April 2012. Available at [http://www.cbp.org/pdfs/2012/120413\\_Who\\_Pays\\_Taxes.pdf](http://www.cbp.org/pdfs/2012/120413_Who_Pays_Taxes.pdf).

<sup>72</sup> The legislature and the governor reversed another trigger cut in February 2012 that affected rural school district student bus service. In that case, however, the cut was financed by spreading a like amount over all school districts.

<sup>73</sup> Quoted in David Siders, "Jerry Brown Sidesteps Taxes, Says 'Marching Orders' Coming," *Capital Alert* blog of *Sacramento Bee*, February 11, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/02/jerry-brown-sidesteps-taxes-says-marching-orders-coming.html>

initiative. In fact, she indicated that there would be no folding of her self-funded campaign and that she “had the resources” and was “going to spend them.”<sup>74</sup> Discussions continued for a time with “nice e-mail” exchanges between Munger and Anne Gust, Jerry Brown’s wife, without any changes in Munger’s position.<sup>75</sup> Indeed, the Munger campaign announced plans to give away a car each week to the top signature gatherer.

Apart from core union supporters, the governor wanted to claim – and did claim - some business support from particular firms.<sup>76</sup> But traditional business organizations such as the California Chamber of Commerce had not given any blessing. Obtaining such support without providing other business-sought items such as regulatory changes as part of larger deal would be difficult. The California Business Roundtable signaled that it might be open for discussions by rejecting the Munger and the rival millionaires’ tax but not the governor’s initiative and the California Chamber followed its lead.

Meanwhile, fellow Democrat Lieutenant Governor Gavin Newsom publicly criticized the governor’s proposed budget cuts for focusing only on “solvency” while lacking “a vision for greatness.”<sup>77</sup> The Lieutenant Governor of California has relatively little responsibility – “It’s so dull,” Newsom said of his time in Sacramento at one point and so may have had more time for developing great visions than the governor.<sup>78</sup> In any event, and not surprisingly for a budget based in part on phantom revenue, the state’s solvency was in question. The state controller warned of a cash crisis and issuance of IOUs if the legislature didn’t give him permission for additional internal borrowing from funds outside the general fund – which it did.

Another fellow Democrat, California State Superintendent of Public Instruction Tom Torlakson, seemed to endorse the governor’s tax initiative and maybe the rival millionaires’ tax and the Munger tax, too. But he said having a trigger that would cut school budgets if the governor’s tax didn’t pass was

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<sup>74</sup> Quoted in John Myers, “‘Whatever it Takes,’ Says Munger on Campaign,” *KQED Capital Notes*, March 2, 2012. Available at <http://blogs.kqed.org/capitalnotes/2012/03/03/whatever-it-takes-says-munger-on-campaign/>.

<sup>75</sup> Quoted in David Siders, “Jerry Brown: Munger Sent ‘Nice E-mail,’ But No Deal in Works,” *Capitol Alert* blog of *Sacramento Bee*, March 20, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/03/jerry-brown-oil-company-still-supportive-of-tax-measure.html>.

<sup>76</sup> Firms operating in industries that might be targeted for specific taxes (oil, liquor, soft drinks) if the governor’s general tax initiative failed contributed to the governor’s tax initiative campaign defensively. Other firms which rely on goodwill in Sacramento also contributed. And, of course, there were contributions from labor unions. See Anthony York, Gov. Jerry Brown Lines Up Unusual Allies on his Tax Hike Initiative,” *Los Angeles Times*, August 27, 2012. Available at <http://www.latimes.com/news/local/la-me-proposition30-20120827,0,684082.story>.

<sup>77</sup> Quoted in David Siders, “Gavin Newsom Suggests Jerry Brown Lacks ‘Vision for Greatness,’” *Capitol Alert* blog of *Sacramento Bee*, February 1, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/02/gavin-newsom-suggests-jerry-brown-lacks-vision-for-greatness.html>.

<sup>78</sup> Quoted in Tim Murphy, “Quote of the Day: ‘I Just, Ugh, God,’” *Mother Jones*, May 29, 2012. Available at <http://www.motherjones.com/kevin-drum/2012/05/quote-day-i-just-ugh-god>.

“blatantly unfair.”<sup>79</sup> Only the governor’s tax plan was tied to such triggers so Torlakson’s enthusiasm for Brown’s proposal among the others seemed soft.

In mid-March, a compromise deal was reached with the California Federation of Teachers – sponsor of the rival millionaires’ tax – and the governor, apparently with legislative leaders acting as mediators. The result was a new initiative that blended the two, with less of an increase in the sales tax (a quarter of a cent increase instead of half a cent) and a larger upper bracket income tax increase than the governor had wanted.<sup>80</sup> However, starting with a new initiative at that point meant abandoning the signature drive for the previous version and starting anew with another drive. Apart from the cost – and a significant premium to signature gatherers would have to be paid - there was by then only very limited time to acquire the necessary signatures and to meet the deadline for appearing on the November budget. With what appeared to be especially rapid treatment by the Attorney General and the Secretary of State, however, the new compromise tax initiative did ultimately meet the deadline and was certified.

While the compromise on the initiative was good news for the governor, the CalPERS pension system provided some bad news at about the same time. It cut its expected long-term earnings forecast from 7.75% to 7.50% which had the effect of raising pension costs to the state (and to localities that were part of CalPERS).<sup>81</sup> And the legislative analyst continued to have a lower estimate that the governor of how much the tax initiative would raise: \$6.8 billion in the coming fiscal year instead of \$9 billion.<sup>82</sup>

Although the high-speed rail project the governor favored had little direct impact on the general fund, it became intertwined with budget discussions. The project actually goes back in planning to 1996 but voters authorized \$9 billion in bonds for the plan in 2008, despite the ongoing financial crisis of that period. Various plans were put forward but the overall budget for the project went as high as \$100 billion before Governor Brown installed new leadership into the entity in charge of planning and lowered the estimated cost to \$68 billion. Even so, there is a big gap between what voters authorized, what the federal government seemed willing to chip in initially (about \$3.5 billion), and the estimated cost which would ultimately have to be filled by passenger receipts and other sources. (The governor

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<sup>79</sup> Quoted in Dan Walters, “Torlakson Calls Jerry Brown’s Spending Cut Triggers ‘Blatantly Unfair,’” *Capitol Alert* blog of *Sacramento Bee*, March 8, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/03/torlakson-calls-browns-spending-cut-triggers-blatantly-unfair.html>.

<sup>80</sup> The sales tax increase would apply from calendar 2013 through 2016. The income tax increases would begin in 2012 and run through 2018. Higher brackets ranging from 10.3% to 12.3% would apply to individuals earning over \$250,000 per year and joint filers earning over \$340,000. About 1% of California income tax filers would be affected by the higher rates.

<sup>81</sup> CalPERS provided a two-year period of adjustment to the lower rate, somewhat easing the immediate budget squeeze.

<sup>82</sup> Legislative Analyst’s Office, “2011 Initiative Analysis: The Schools and Local Public Safety Protection Act of 2012” Version 3, March 16, 2012. Available at <http://www.lao.ca.gov/ballot/2012/120208.aspx>. (The title contains the 2011 date because the first version of the governor’s initiative was submitted in 2011. As noted earlier, a second version with a typo correction was submitted subsequently.)



proposed that cap-and-trade revenues might be used.) The legislative analyst showed considerable skepticism about the project and opponents of the governor's tax initiative often cited it as an example of wasteful state spending.<sup>83</sup>

Apart from the high-speed rail issue, there were other aggravating factors that tended to undermine the case for the legislative majority to rally around the governor's budget. Salaries paid to new CSU campus presidents became an issue, in part because of rising tuition, course rationing, the threat of withholding certain graduate tuition grants (ultimately reversed), and limits on new enrollments. Legislative Republicans proposed cutting pay of state workers and a host of other cuts Democrats would not accept in place of the tax initiative. In addition, the budget-linked realignment plan moving state prisoners to county jails and parole supervision ran into criticism in LA County where some parolees disappeared.

### **Prelude to the May Revise**

*"It's just March; it's just March."*

Senate President Darrell Steinberg  
explaining limited progress on the budget<sup>84</sup>

*"...(T)he legislature has to man up, make the cuts, and get some taxes and we'll make it."*

Governor Brown during a radio interview<sup>85</sup>

By the end of March and early April, the governor was clearly becoming impatient with slow progress in the legislature in making cuts, particularly since there were indications – again, not surprisingly in a budget built partly on phantom revenue – that forecast revenues were not arriving as projected. However, he conceded that, given the normal process under which the governor presents a May Revise of the budget, "it's a little early yet."<sup>86</sup> By that time, however, polling suggested that there could be problems in obtaining voter support for the governor's tax initiative.

A PPIC poll indicated that 54% of "likely voters" would support the initiative.<sup>87</sup> But the usual folk wisdom is that prior to the actual campaign for a ballot measure, potentially controversial propositions

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<sup>83</sup> Legislative Analyst's Office, "The 2012-13 Budget: Funding Requests for High-Speed Rail," April 17, 2012. Available at <http://www.lao.ca.gov/analysis/2012/transportation/high-speed-rail-041712.pdf>.

<sup>84</sup> Quoted in Kevin Yamamura, "California Legislative Democrats Balk at Jerry Brown's Budget Cuts," *Sacramento Bee*, March 27, 2012. Available at <http://www.sacbee.com/2012/03/27/4368814/california-legislative-democrats.html>.

<sup>85</sup> Quoted in David Siders, "Jerry Brown Tells Legislature to 'Man Up,' Make Cuts," *Capitol Alert* blog of *Sacramento Bee*, April 13, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/04/jerry-brown-tells-legislature-to-man-up-make-cuts.html>.

<sup>86</sup> Quoted in David Siders, "Jerry Brown Says Budget Gap Could Grow by \$1 Billion or More," *Capitol Alert* blog of *Sacramento Bee*, April 17, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/04/jerry-brown-says-budget-gap-could-grow-by-1-billion-or-more.html>.

<sup>87</sup> Public Policy Institute of California, "April 2012: Californians and Education," April 2012. Available at <http://www.pplic.org/main/publication.asp?i=1014>.



should poll 60% support or more since some support slips once negative campaigning begins. And there would be two sources of negative campaigning. First, there would be the usual anti-tax groups. Second, supporters of the Munger tax might well denounce the Brown initiative as inferior.

By early May, the Munger petitions were being handed in to the Secretary of State. At about the same time, Brown declared he had sufficient signatures for his tax plan, too. Signatures were also being turned in for a third “Steyer” tax initiative that would close what proponents viewed as a corporate tax loophole with a little over half the money raised going for energy efficiency projects.<sup>88</sup> (Thomas Steyer, the initiative’s sponsor, is a wealthy California hedge fund manager.) So there would be three tax measures on the November ballot along with initiatives on other subjects.

Looming on the June 2012 ballot was a potential earlier test of voter willingness to enact new taxes. Prop 29 would impose a new tobacco tax with the money raised earmarked for cancer research. Since most voters are not smokers and since curing cancer is inherently appealing, voter rejection of Prop 29 would signal voter resistance to any kind of tax. Health advocates supported the measure (including New York Mayor Michael Bloomberg). But there was bound to be significant funding for a “no” vote campaign financed by tobacco companies.

Could a well-financed campaign defeat a “sin tax” that had inherent appeal to many voters? If so, a less-well-funded opposition campaign for a more controversial tax – such as the governor was advocating – might succeed. As the negative campaigning began, support for the tobacco tax dropped from 67% in March to 53% in May, according to the PPIC poll.<sup>89</sup>

Whatever the fate of the tobacco tax, what did seem unlikely in June was a repeat of a gubernatorial veto of whatever budget the legislature did finally pass, as had occurred in the prior year. That episode was the result of gubernatorial insistence on trying to negotiate a deal with GOP legislators to the point that the Democratic majority panicked that the June 15 deadline would pass and they wouldn’t be paid. This time, however, there was no need for panic since the GOP was essentially a bystander on the budget and the governor had no incentive to seek Republican cooperation. The initiative route would take care of putting a tax hike on the ballot. And only a majority – which the Democrats had - was

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<sup>88</sup> Under the Steyer initiative, out-of-state firms would not have the option of using either of two alternative tax treatments and would have to base their tax only on one of the options, the proportion of their sales in California. The two-option system arose from a budget deal during the Schwarzenegger era. The legislative analyst estimated the change in tax treatment would raise about \$1 billion annually. The Steyer initiative earmarked revenue for energy efficiency. An alternative bill in the legislature would have made the same tax change but earmarked revenue for tuition reduction at public universities. That version would have required a two-thirds vote in the legislature. It passed in the assembly but failed in the state senate.

<sup>89</sup> Public Policy Institute of California, “May 2012: Californians and Their Government,” May 2012. Available at <http://www.ppic.org/main/publication.asp?i=1019>.

needed to pass a budget. On national television, Governor Brown referred to the GOP as stuck in “a reactionary cul-de-sac” that “takes on the quality of a cult.”<sup>90</sup>

Moreover, it was less likely that the controller would rule that whatever budget passed did not meet technical requirements and refuse to issue paychecks. A court had ruled that the legislature, not the controller, would decide whether whatever budget it enacted passed muster.<sup>91</sup> However, there still was a need for the governor and the legislature to reach an agreement for a budget to be in place by July 1, 2012.

### **The 2012 May Revise**

*“The state employees particularly have come forward with some very imaginative ideas. They’ve been willing to step up to the plate.”*

Governor Jerry Brown commenting on the quasi-furloughs for state employees proposed in his May Revise budget<sup>92</sup>

*“We’re not some tired country of Europe.”*

Governor Brown pointing to the state taking corrective action on its budget through his May Revise budget cuts, his ballot initiative, and proposed his infrastructure plans<sup>93</sup>

As noted in the earlier discussion of accounting procedures in the state, it is difficult (apparently impossible) to reconcile the cash flow data with the official accrual-based budget data. We know that in the end, the 2011-12 year on a cash basis finished with over \$4 billion less in receipts than had been budgeted, an amount roughly corresponding to the phantom revenue assumed in June 2011 to pass the budget by majority vote. (Table 2) All we can say is that when the May Revise was presented (Table 3), there was little difference between the January depiction of what the governor said would happen in 2011-12 and what he said would happen in that year as of May. If his tax initiative passed in November 2012, there would be some accrued tax liability during 2011-12 which would boost revenues. Even with

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<sup>90</sup> Quoted in Leigh Ann Caldwell, “Jerry Brown: GOP Must Move Out of Their ‘Reactionary Cul-de-Sac,’” *CBS News*, April 29, 2012. Available at [http://www.cbsnews.com/8301-3460\\_162-57423835/jerry-brown-gop-must-move-out-of-their-reactionary-cul-de-sac/](http://www.cbsnews.com/8301-3460_162-57423835/jerry-brown-gop-must-move-out-of-their-reactionary-cul-de-sac/).

<sup>91</sup> The controller eventually appealed the court decision and might have refused to issue paychecks, setting up a legal tussle. But since the legislature was unlikely to pass a panicked budget, the technical deficiencies that the controller cited the year before would probably not arise.

<sup>92</sup> Quoted in Jon Ortiz, “California State Workers May Face Shorter Workweeks, Less Pay,” *Sacramento Bee*, May 15, 2012. Available at <http://www.sacbee.com/2012/05/15/4490008/california-state-workers-may-face.html>.

<sup>93</sup> Quoted in “Gov. Jerry Brown says California is Not a ‘Tired’ European Country,” *CBS News*, May 18, 2012. Available at [http://www.cbsnews.com/8301-505267\\_162-57436905/gov-jerry-brown-says-california-is-not-a-tired-european-country/](http://www.cbsnews.com/8301-505267_162-57436905/gov-jerry-brown-says-california-is-not-a-tired-european-country/).

that added amount, he was short in that year by close to \$4 billion (because the reserve at the end of the year would be -\$2.5 billion instead of +\$1.3 billion that the original budget projected.

Most of the problem to be dealt with in the May Revise, however, was in the coming year which the governor addressed partly with his proposed tax initiative which he assumed in the budget would pass. Since the Facebook IPO had not been factored into the January estimates for 2012-13, but was factored in by the May Revise, there was a “new” assumed increment of \$1.5 billion in income taxes for the coming fiscal year. If the tax initiative did not pass, there would be trigger cuts of a little over \$6 billion. The bulk of those cuts would come from K-14 (\$5.5 billion) and the rest from higher education (\$0.5 billion) plus a scattering of other programs. Various other cuts were made, trigger or not, primarily in social welfare spending.

There would be a \$400 million saving in the general fund (plus a similar amount in funds outside the general fund) by reductions in state employee pay which would have to be negotiated with unions. The governor came up with an elaborate plan for rescheduling work hours to a four-day, 38-hour week (with less pay due to the hours reduction). It appeared that this elaborate plan was mainly to differentiate what the governor was proposing from simpler Schwarzenegger-era furloughs.

However, going to a four-day work would have raised a host of service delivery problems. In the end, most unions accepted simpler furloughs – although the f-word was avoided - to achieve the saving. They had a strong incentive to go along with the governor and not become involved in disputes with him that might undermine passage of the tax initiative.

The legislative analyst expressed some concerns about possibly overestimated revenue forecasts. In particular, the analyst noted that the savings to the state that resulted from the abrupt termination of redevelopment by the state Supreme Court might be less than anticipated. At the very least, there would be litigation over what was owed to the state that could delay redevelopment receipts thanks to the sloppiness of a sudden termination of a longstanding major program in midstream.<sup>94</sup>

Apart from the overall numbers, the May Revise included some refinements in the governor’s January plan for changing K-12 funding, reducing mandates on local governments that the state had to fund, and restricting Cal Grants. The last item, as noted in the discussion of the January 2012 proposal, was particularly unpopular with legislative Democrats, although in the end they approve some cuts which the governor sharpened via his line-item veto.

In contrast to realignment for the prisons – which emphasized the benefits of local administration – the governor moved in the opposite direction with the state court system, centralizing control and removing local discretion.<sup>95</sup> There was also consolidation within state government through consolidating certain

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<sup>94</sup> Legislative Analyst’s Office, “The 2012-13 Budget: Overview of the May Revision,” May 18, 2012. Available at [http://www.lao.ca.gov/reports/2012/bud/may\\_revise/overview-may-revise-051812.pdf](http://www.lao.ca.gov/reports/2012/bud/may_revise/overview-may-revise-051812.pdf).

<sup>95</sup> There had been an ongoing, and very public, dispute between some in local court administration and the chief justice of the state Supreme Court (who is also the chief court administrator) concerning centralization vs.

agencies and eliminating some boards and commissions. The state's Little Hoover Commission endorsed the plan, and the legislature did not disapprove it, so that the changes would become effective in 2013-14.

Despite the risks entailed in talking up expensive infrastructure projects while proposing budget cuts, Governor Brown continued to tout high-speed rail and other long-term investments such as a new state water plan. The theme of his administration of the 2010s, in contrast to that of the Jerry Brown of the late 1970s and early 1980s, seemed to have switched from small is beautiful to big is beautiful – at least in the context of long-term growth. While a focus on the Big Picture by the governor posed political risks, it at least obscured the tendency of the legislature to become involved in minutiae. On May 25, for example, the state senate proclaimed that May was to be California Beer Distributor Month. Shortly thereafter, the state panel that sets the pay of legislators and other elected state officials, cut their pay by 5% citing the ongoing budget problems.

### **Budget Enactment**

*"I'd run for governor whether it was a paid job or not. I derive a lot of psychic income."*

Governor Jerry Brown commenting on his 5% pay cut<sup>96</sup>

As the legislature was debating the May Revise proposal of the governor, which included the assumption that his tax initiative would pass, the June 5 primary contained some inauspicious information. The tobacco tax proposition – despite its early favorable polling – was narrowly defeated with 50.2% voting "no."<sup>97</sup> Meanwhile, as the June 15<sup>th</sup> deadline for legislative enactment of a budget loomed (with the threat of no pay for every day it was late), there was a flurry of back and forth communications – some public, some undoubtedly private – over what the governor would accept.

The differences between the legislative majority and the governor were over his proposed social welfare cuts. While in theory the legislators could have passed a budget unacceptable to the governor and yet met their constitutional obligation, such a development and impasse might have undermined public support for the tax initiative. What occurred was a budget enacted in pieces.

On June 15<sup>th</sup>, an incomplete plan was sent to the governor while discussions continued. There appeared to be differences between the leadership in the senate and assembly as to their respective positions. The state controller in principle might have tested the court decision indicating he lacked the power to

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autonomy. The governor came down on the side of centralization, mainly for budget reasons rather than some grand philosophy of management. Local courts had maintained local cash reserves which the governor proposed to use to offset other cuts in the court budget.

<sup>96</sup> Quoted in Torey Van Oot, "Jerry Brown on Pay Cut," *Capitol Alert* blog of *Sacramento Bee*, May 31, 2012.

Available at <http://blogs.sacbee.com/capitolalert/latest/2012/05/jerry-brown-on-pay-cut-i-derive-a-lot-of-psychic-income.html>.

<sup>97</sup> A partial recount requested and paid for by a proponent of the proposition in Los Angeles County did not reverse the loss.

withhold legislators' pay – but he didn't – allowing the three-way talks to continue.<sup>98</sup> Six days later, a "conceptual" deal was reached involving greater cuts in CalWorks ("welfare") than the legislators had wanted. In the interim, and with a speed one observer satirically termed a "miracle," the governor's tax initiative was officially certified for the November 2012 ballot by the Secretary of State.<sup>99</sup> It was later disclosed that the governor had phoned at least one county election official to make what a spokesperson called a "friendly inquiry" about how the counting was going.<sup>100</sup>

Once the outlines of the 2012-13 budget deal were announced (and even before a final deal was approved), complaints began over the specifics. There was vocal opposition to a proviso ending the "Healthy Families" program of health insurance for children of the working poor and merging it into the larger Medi-Cal program. Opponents of the shift worried that because of the low payments to health providers under Medi-Cal, there could be access problems for the affected children.<sup>101</sup> UC and CSU officials complained that the deal reportedly contained a last-minute feature that would cut their budgets if there were tuition increases (assuming the governor's initiative passed).<sup>102</sup> A last-minute bill provided an additional tool to aid the state in its battle with local governments over revenue from the corpse of the defunct redevelopment agencies. The state was given the power to withhold sales and property tax receipts that would otherwise flow to the locals if they resisted the state's interpretation of what it was owed.

The actual budget bill signing took place on June 27, three days before the new fiscal year. However, along with the signing came line-item vetoes which, for the general fund, reduced spending by \$129 million. The vetoes decreased Cal Grants for certain private school higher ed students, reduced spending on selected programs for young children, and cut funding for a K-12 college readiness program.

### **Who's on First?**

*"This attempt to change the rules in the middle of the game is a manipulation of the political process..."*

Spokesperson for Molly Munger concerning various procedures

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<sup>98</sup> The controller waited until the new fiscal year began and then filed an appeal of the earlier court decision saying he had no power to withhold legislative pay, as he had done in 2011.

<sup>99</sup> The signatures for the revised version of the governor's tax initiative were turned in sufficiently late so that there was a danger they would not meet the deadline for the November ballot. However, the verification process seemed "miraculously" expeditious. See Joe Mathews, "Jerry's June 20 Miracle," *Fox and Hounds*, June 25, 2012. Available at <http://www.foxandhoundsdaily.com/2012/06/jerrys-june-20-miracle/>. Mathews noted that the governor's initiative was certified before the other two tax initiatives that also ended up on the November ballot even though the petitions for those two were handed in earlier.

<sup>100</sup> Quoted in Anthony York, "Did Jerry Brown Pull Rank to Get Petition Signatures Processed?," *Los Angeles Times*, July 1, 2012. Available at <http://www.latimes.com/news/local/la-me-jerry-brown-20120701,0,177012.story>.

<sup>101</sup> Some advocacy groups, however, argued that Medi-Cal in principle provided more services than Healthy Families (assuming, of course, that access was available).

<sup>102</sup> UC later committed itself not to raise tuition. CSU officials were less committal.

that put the governor's initiative first on the November ballot and ahead of the Munger initiative<sup>103</sup>

A combination of three actions put the governor's tax initiative in first place – as Proposition 30 – on the November ballot. As noted earlier, there was the “miracle” by which the initiative was certified before others whose petitions had been handed in earlier. In addition, the legislature passed a bill declaring that bond issues should go first on the ballot (knowing it would soon yank the one November bond issue from the ballot) and that constitutional amendments – such as Brown's – would go next. Normally, such a bill could not take effect in time to affect the November ballot but budgetary “trailer” bills have an exception and go into effect immediately. So the legislature included a \$1,000 appropriation in the bill, thus invoking the budget trailer exception.

Folk wisdom has it that ballot propositions that appear first have a better chance of approval than those lower down. And there is some evidence for that view based on the order in which candidates appear. Candidates appearing first have a better chance than others, according to some research.<sup>104</sup> While some observers might be offended by the tactics used to put the governor's initiative first, Governor Brown has not been a milquetoast when it comes to the political process. As attorney general, he refused to take action when then-Governor Schwarzenegger pushed to obtain his way on some legislation. Brown observed back then that the process of politics was not one of “doilies and tea.”<sup>105</sup>

Molly Munger was offended by the process, however, and filed a lawsuit against the ballot ordering on behalf of her initiative, alleging misconduct by county officials involved in signature verification. A lower court temporarily blocked the numbering at one point. Eventually, however, Munger dropped her suit. The Howard Jarvis Taxpayers Association continued with its own lawsuit on the issue of ballot ordering but with no success at this writing. And as the clock ran, it became difficult to change ballot materials. So the governor's tax initiative remained on top as Prop 30.

Munger's school-oriented tax became Prop 38. The third Steyer tax initiative aimed at closing a corporate tax loophole became Prop 39. Another budget-related proposition – Prop 31, supported by a business-oriented political reform group - would change the overall state fiscal process, notably by switching to a two-year budget cycle and by giving the governor to make certain spending cuts during

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<sup>103</sup> Quoted in Kevin Yamamura, “Brown Rival Sues to Block His Tax Measure from Ballot Top,” *Capitol Alert* blog of *Sacramento Bee*, June 28, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/06/molly-munger-anti-tax-groups-considering-lawsuits-on-california-ballot-bill.html>.

<sup>104</sup> See Marc Meredith and Yuval Salant, “On the Causes and Consequences of Ballot Order Effects,” undated working paper (2012?), Department of Political Science, University of Pennsylvania. Available at <http://www.sas.upenn.edu/~marcmere/workingpapers/BallotOrder.pdf>.

<sup>105</sup> Quoted in Torey Van Oot, “Brown Not Troubled by Schwarzenegger's Veto Threats,” *Capitol Alert* blog of *Sacramento Bee*, October 9, 2009. Available at <http://blogs.sacbee.com/capitolalertlatest/2009/10/brown-says-schw.html>.

fiscal emergencies. The other propositions on the ballot did not directly deal with taxes or budgeting. However, Prop 32 – a so-called “paycheck protection” GOP-supported initiative – would ban use of union dues for political purposes. Since defeating Prop 32 was seen as a life-or-death matter by labor unions, it had the potential to divert union funding that would otherwise go to supporting the governor’s tax initiative.

### **Pensions, Trains, and Parks**

*“The governor has a hybrid (pension) concept but does not have a fleshed-out proposal.”*

Senate president Darrell Steinberg<sup>106</sup>

*“Here you have an unpopular, multibillion-dollar long-term project kind of rearing its head in the middle of this budget cutting. ... (T)hat’s really what’s jeopardizing the Brown (tax) measure.”*

Pollster Mark DiCamillo<sup>107</sup>

*“The department has been going around telling people we had to close parks and it comes to light we had been sitting on this kind of money... This is the worst violation of the public trust that one could imagine.”*

Retired parks official commenting on the discovery of “hidden” funds at the California Department of Parks and Recreation<sup>108</sup>

As the summer began, there were promises that the legislature would enact some kind of public pension bill before the end of August. From the governor’s viewpoint, obtaining a pension deal would enhance the chances of voter approval for his tax initiative. Exactly what the legislature might enact on pensions and what the governor would accept was unclear.

Polls suggested the governor’s high-speed rail plan was unpopular and might decrease those chances. It was uncertain, however, whether voters linked the two issues, other than when pollsters did it for them. Nonetheless, the legislature needed to authorize initial construction for the project if it were to proceed. Approval to begin building the rail line squeaked through the legislature early in July, as far away in time from the November ballot as possible.

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<sup>106</sup> Quoted in Kevin Yamamura, “Steinberg: Jerry Brown Has Pension Concept But No Proposal,” *Capitol Alert* blog of *Sacramento Bee*, July 3, 2012. Available at <http://blogs.sacbee.com/capitolalert/latest/2012/07/darrell-steinberg-jerry-brown-has-california-pension-concept-but-no-proposal.html>.

<sup>107</sup> Quoted in David Siders, “Rail Vote Potential Pitfall for Gov. Jerry Brown’s Tax Initiative, Field Poll Finds,” *Sacramento Bee*, July 5, 2012. Available at <http://www.sacbee.com/2012/07/05/4610612/rail-vote-potential-pitfall-for.html>.

<sup>108</sup> Quoted in Matt Weiser, “Hidden California State Parks Funds Spark Outrage,” *Sacramento Bee*, July 21, 2012. Available at <http://www.sacbee.com/2012/07/21/4646682/hidden-parks-funds-spark-outrage.html>.



Although the high-speed rail issue was recognized early as something to deal with and move on, an unexpected scandal regarding state parks was not anticipated. During the ongoing budget crisis, there had been repeated threats of state park closures. An attempt was made in 2010 to enact an initiative that would have added to park funds through a motor vehicle fee hike, but voters rejected it. As the threat of closures unfolded, various local government and private groups engaged in fundraising to keep their parks open. It was then discovered that the Department of Parks and Recreation had \$54 million in “hidden” funds on hand, a discovery that led to the resignation of the Department’s head and the firing of the second in command.

While amounts in the millions of dollars won’t solve state budget problems in the billions, the distinction in magnitude can easily be lost in public perceptions. There was fear that the parks scandal could undermine the governor’s message that more tax money was needed by the state. Opponents of tax increases added the new scandal to pensions and high-speed rail as reasons to reject the governor’s initiative. Legislative and other investigations were begun of the parks situation. The governor tried an optimistic approach saying it was better to discover you haven’t spent all your money than to discover you had spent what you didn’t have.<sup>109</sup>

The parks scandal continued during the summer of 2012 and it appeared that some illegal spending in the Department may also have been involved. However, there may be been a salutary effect, albeit not one for obtaining voter approval for the governor’s tax initiative. The scandal pointed to the proliferation of accounts outside the general fund, to poor state information systems that did not allow managers to know in real time how much money they had or were spending, and to the apparently non-reconcilable gap – discussed earlier – between cash flows and what the legislature thinks it is allocating and receiving in the budget. If the parks situation were to lead to addressing these weaknesses that adversely affect administration and policy making, state fiscal policy could be much improved.

### **An Inconclusive Conclusion**

*“At this stage of my life, as I see many of my friends dying – I went to the funeral of my best friend a couple of weeks ago – I want to get sh\*t done.”*

Governor Jerry Brown advocating a new water infrastructure plan<sup>110</sup>

As noted at the outset of this chapter, the California budget story has no real beginning or end. In the chapter, the story ends inconclusively in mid-summer 2012. Readers will know by the time this chapter

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<sup>109</sup> See David Siders, “Jerry Brown Calls Parks Scandal a ‘First,’ Downplays Significance,” *Capitol Alert* blog of the *Sacramento Bee*, July 25, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/07/jerry-brown-calls-california-parks-scandal-a-first-downplays-significance.html>.

<sup>110</sup> Quoted in David Siders, “Jerry Brown: ‘I Want to Get S--- Done’ at this Stage of Life,” *Capitol Alert* blog of *Sacramento Bee*, July 25, 2012. Available at <http://blogs.sacbee.com/capitolalertlatest/2012/07/jerry-brown-i-want-to-get-s---done-at-this-stage-of-life.html>.



appears in *California Policy Options* what happened to the governor's tax initiative and all the other initiatives on the November 2012 ballot. Readers will know in addition the consequences of the national elections of 2012 that could also have long-term impacts on California and its budget dilemma.

But despite the inconclusiveness, there are some take-aways from what has been covered. The California budget crisis is in immediate terms the product of the Great Recession. And the process of dealing with the aftermath of the Recession reflects the state's political institutions and their dysfunctions. Yet underlying the difficulty California has had with adjusting its budget to a soft economy is a factor that appears to go back further than 2008 or even the decade of the 2000s.

From the beginning of World War II to the end of the Cold War, California experienced super-normal growth relative to the U.S. average. There were bumps in the road during that era reflecting the national business cycle. But given the long-term super-normal trend, a trend fueled by military expenditures in the state, there was generally money around for infrastructure expansion and for social programs without a need for sharp trade-offs. When the state's growth became average, public expectations for services remained stuck on the old trend line. Until the gap between expectations and reality closes, institutional reforms will help but won't fix the underlying California fiscal problem.

**Table 1: General Fund Debt, Cash, and Disbursements (\$ billions or percent)**

Year Ending June 30	Short Term Debt*	Cash Balance	Total Cash**	Disbursements	Debt as Percent of Disbursements
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End of Pete Wilson Regime					
1998	\$0	\$0.9	\$1.0	\$53.1	0.0%
1999	0	0.8	2.1	58.6	0.0
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Gray Davis Regime					
2000	0	8.5	9.3	64.5	0.0
2001	0	3.4	3.6	83.5	0.0
2002	10.4	0.0	0.0	80.4	12.9
2003	11.0	0.4	3.0	78.7	14.0
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First issuance of Economic Recovery Bonds*** (Schwarzenegger)					
2004	0	0.5	2.8	79.6	0.0
2005	0	6.4	7.2	82.0	0.0
2006	0	9.2	10.5	91.5	0.0
2007	0	2.5	4.1	104.1	0.0
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Second issuance of Economic Recovery Bonds**** (Schwarzenegger)					
2008	1.5	0.0	0.9	107.3	1.4
2009	11.9	0.0	0.0	98.2	12.1
2010	9.9	0.0	0.0	86.7	11.4
2011	8.2	0.0	0.0	93.8	8.7
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Jerry Brown Regime					
2012	9.6	0.0	0.0	89.2	10.6
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\*Outstanding loans (external and internal).

\*\*Differs from cash balance by Special Fund for Economic Uncertainties (a "rainy day" fund maintained for the General Fund).

\*\*\*Refinanced short-term debt on a longer-term basis.

\*\*\*\*Issuance of remaining authorized Economic Recovery Bonds allowing longer-term funding of short term debt.

Source: June cash reports of the California State Controller. Available at <http://www.controller.ca.gov>.

**Table 2: Actual vs. Forecast Results for 2011-2012 Budget on Cash Basis (\$ Billions)**

	<b>June 2011 Forecast*</b>	<b>Actual</b>	<b>Actual -Forecast Difference</b>
Receipts	\$92.2	\$87.8	-\$4.5
Disbursements	89.3	89.2	+ .1
Surplus or Deficit	+3.0	-1.4	-4.4
End of Year Reserve	-5.2	-9.6	-4.4

\*Details may not add to totals due to rounding.

Source: California State Controller, June 2012 cash statement. Available at [http://www.sco.ca.gov/Files-ARD/CASH/fy1112\\_june.pdf](http://www.sco.ca.gov/Files-ARD/CASH/fy1112_june.pdf).

**Table 3: Budget History: 2011-12 and 2012-13 Budgets Proposed and Enacted (\$ Millions)**

<b>Fiscal Year 2011-12</b>				
	<b>Enacted June 2011</b>	<b>Reported Jan. 2012</b>	<b>Reported May 2012</b>	<b>Reported June 2012</b>
Beginning Reserve	-\$1,206	-\$3,029	-\$2,844	-\$2,685
Revenue & Transfers	88,456	86,309	86,809	86,830
Expenditures	85,937	86,646	86,500	87,027
Surplus or Deficit	+2,519	-337	+309	-197
End Reserve	+1,313	-3,416	-2,535	-2,882
<b>Fiscal Year 2012-13</b>				
		<b>Proposed Jan. 2012</b>	<b>Proposed May 2012</b>	<b>Enacted June 2012</b>
Beginning Reserve		-\$985*	-\$2,535	-\$2,882
Revenue & Transfers		95,389	95,689	95,887
Expenditures		92,553	91,387	91,338
Surplus or Deficit		+2,836	+4,302	+4,549
End Reserve		+1,851	+1,767	+1,667

\*Differs from -\$3,416 million shown above because assumed voter-approved tax increase is partly attributed to 2011-12 fiscal year.

Source: California Department of Finance, budget documents. Available at

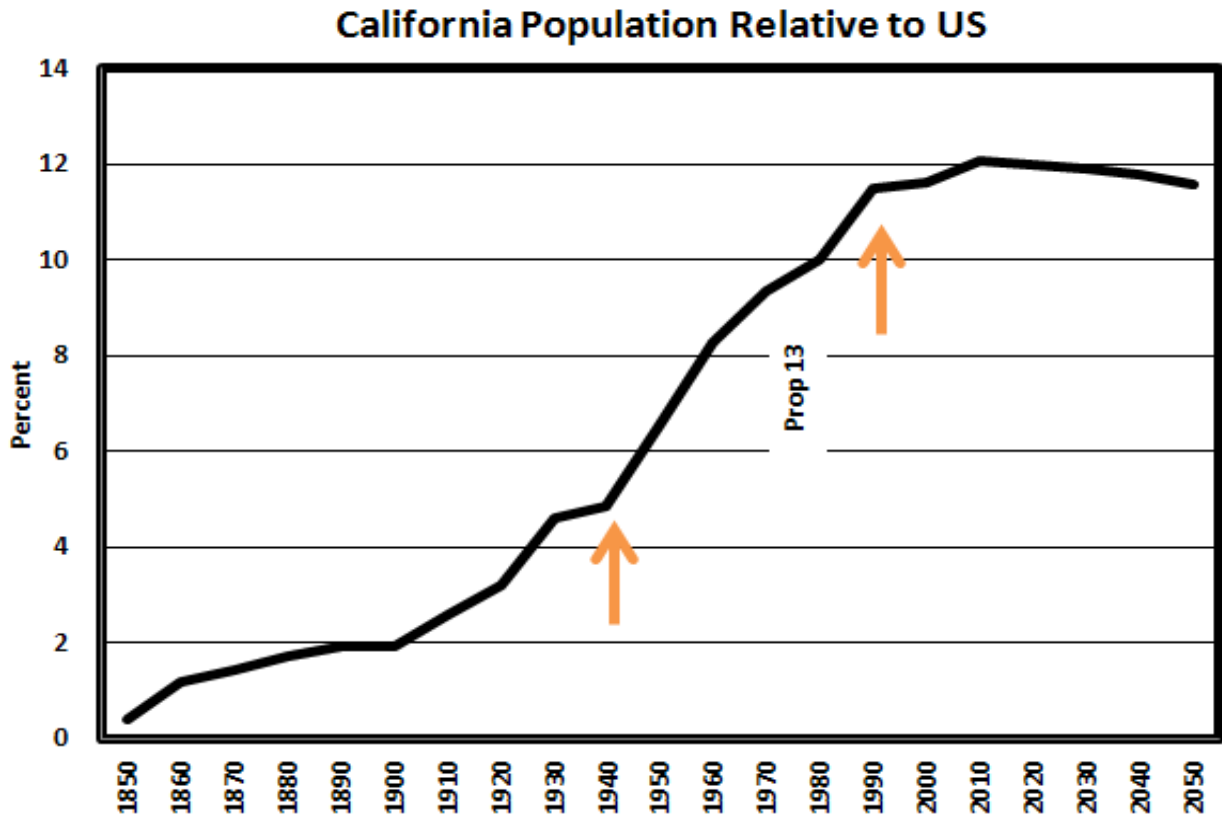
<http://www.ebudget.ca.gov/BudgetSummary/BSS/BSS.html>,

<http://www.ebudget.ca.gov/Revised/BudgetSummary/BSS/BSS.html>,

<http://www.ebudget.ca.gov/Enacted/BudgetSummary/BSS/BSS.html>,

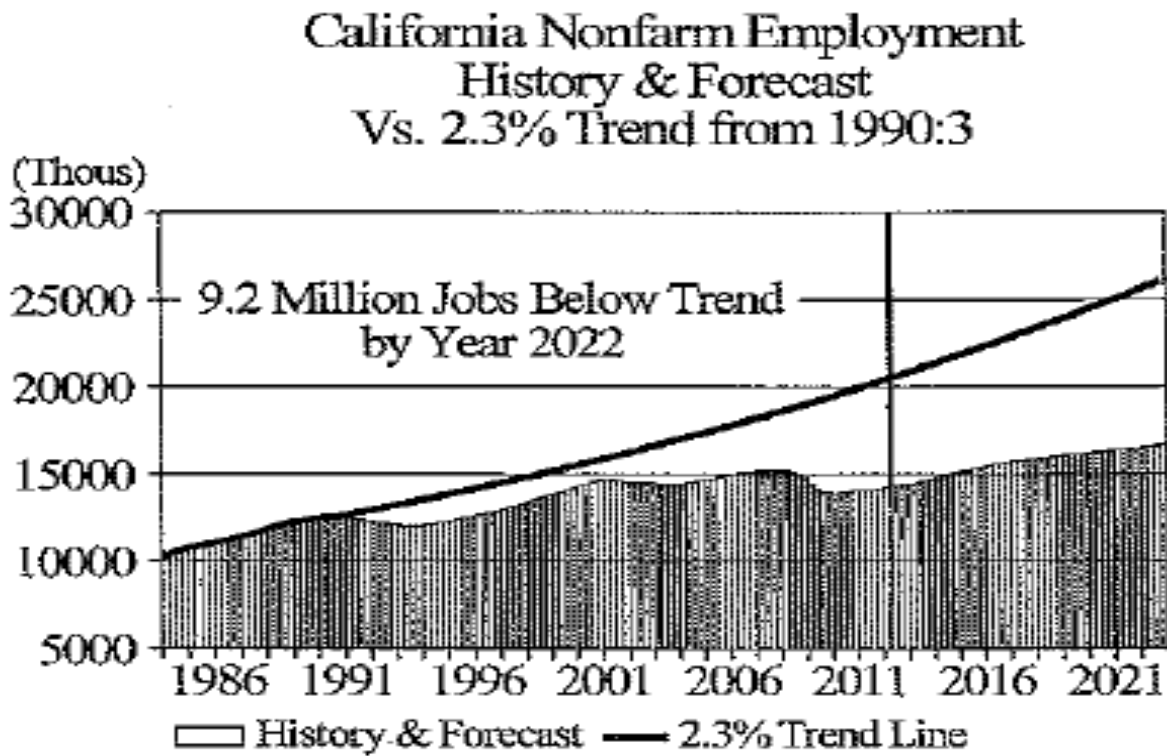
<http://2011-12.archives.ebudget.ca.gov/Enacted/BudgetSummary/BSS/BSS.html>.

Chart 1



Source: U.S. Bureau of the Census and California Department of Finance. Projections from <http://www.census.gov/population/www/projections/files/nation/summary/np2008-t2.xls> and [http://www.dof.ca.gov/research/demographic/reports/projections/interim/documents/Final\\_2012\\_Interim\\_Proj\\_Web.xls](http://www.dof.ca.gov/research/demographic/reports/projections/interim/documents/Final_2012_Interim_Proj_Web.xls).

Chart 2



Source: UCLA Anderson Forecast, *The UCLA Anderson Forecast for the Nation and California: June 2012* (Los Angeles: UCLA Anderson Forecast, 2012), p. California-115.

**Chart 3**

Taxes as percent of personal income in study states, 2009							
	California	Illinois	New Jersey	New York	Texas	Virginia	United States
<i>Tax revenue as % of personal income</i>							
<b>State &amp; local government tax revenue</b>	<b>11.1</b>	<b>10.8</b>	<b>11.7</b>	<b>15.0</b>	<b>9.5</b>	<b>9.2</b>	<b>10.7</b>
State government tax revenue	6.6	5.6	6.3	7.2	4.6	4.9	6.0
Local government tax revenue	4.5	5.2	5.5	7.8	4.9	4.3	4.7
<i>Tax revenue as % of personal income, compared to average for all states (US=100)</i>							
<b>State &amp; local government tax revenue</b>	<b>104.1</b>	<b>101.3</b>	<b>110.0</b>	<b>140.5</b>	<b>89.3</b>	<b>86.1</b>	<b>100.0</b>
State government tax revenue	110.2	93.1	104.4	119.3	76.9	80.8	100.0
Local government tax revenue	96.3	111.9	117.3	167.8	105.3	93.0	100.0

Source: State Budget Crisis Task Force, *Report of the State Budget Crisis Task Force*, July 2012, p. 93.

Available at <http://www.statebudgetcrisis.org/wpcms/wp-content/images/Report-of-the-State-Budget-Crisis-Task-Force-Full.pdf>