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WILSON’S WOES SHOULD KEEP US ON OUR TOES: WHERE IS PLAN B FOR THE CALIFORNIA STATE BUDGET?

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“Peoples and governments never have learned anything from history, or acted on principles deduced from it.”

Friedrich Hegel¹

In past editions of *California Policy Options*, we have traced the path of the California state budget through the crisis that led to the 2003 recall of Governor Gray Davis and the abortive attempt by Governor Arnold Schwarzenegger at institutional reform by initiative in 2005. We have also called on history to illuminate earlier budgetary crises and fiscal policies. In particular, two episodes seemed especially significant in light of recent events.

First, we noted Governor Earl Warren’s insistence after World War II in maintaining a “rainy day fund” to deal with inevitable future downturns in state revenues. Warren – who we noted started the modern California freeway system – insisted that even the freeways (a long-lived capital project) should be financed on a pay-as-you-go basis through an earmarked gasoline tax. Warren had lived through the Great Depression when fiscal turmoil affected both the tax and expenditure systems and produced ongoing deficits and borrowing.²

Second, we noted Governor Reagan’s failed attempt to persuade voters to endorse a complex budget control initiative with some similarities to the Schwarzenegger effort of 2005. In this chapter, we follow the same approach, focusing on current issues and then lessons from the past. We begin with an analysis of current fiscal events and then point back to the administration of Governor Pete Wilson in the early- and mid-1990s as a source of lessons for the present.

Initiative Defeat

“I have absorbed my defeat and I have learned my lesson. And the people, who always have the last word, sent a clear message – cut the warfare, cool the rhetoric, find common ground and fix the problems together. So to my fellow Californians, I say – message received.”

Governor Arnold Schwarzenegger³

The current chapter picks up the story after the voter rejection of Governor Schwarzenegger's initiative proposals in 2005. A total of eight initiatives appeared on the November 2005 special election ballot, four of which were sponsored by the governor: teacher "tenure" (Prop. 74), "paycheck protection" for public sector union dues (Prop. 75), budget controls (Prop. 76), and legislative redistricting (Prop. 77).⁴ All eight were defeated. It was estimated that over \$300 million was spent on the eight initiatives, pro and con, and over \$200 million on the four initiatives sponsored by the governor – with much of the money going into TV advertising.⁵ The budget control initiative – arguably the most important for the governor given the fiscal crisis that brought him to power – fared worst of his favored four. Apart from the ballot results, the push for the initiatives – and the attack ads it provoked – led to a dramatic drop in public support for the governor as reflected in opinion polls. Put another way, with a re-election contest only one year away, the governor clearly needed a different public stance and persona, one seen as working with the legislature despite the Democratic majority there, rather than conflict.

Infrastructure

"Our systems are at the breaking point now. We need more roads, more hospitals, more schools, more nurses, more teachers, more police, more fire, more water, more energy, more ports... more, more, more... I say build it."

Governor Arnold Schwarzenegger⁶

Soon after the election, Governor Schwarzenegger made a vague reference to \$50 billion for state infrastructure as a future issue. Fifty billion dollars is a great deal of money, even in a state as large as California. It is an amount likely to attract the support of construction unions and contractors. Moreover, the prospect of un-jamming congested freeways has much attraction for voters. The political shift toward infrastructure began a turnaround in the governor's popularity ratings. Eventually, a plan laying out infrastructure projects with a price tag of well over \$200 billion was released, but much of that was already projected to be funded by existing resources. Of the total, \$68 billion in added spending was to be funded through new General Obligation bonds (borrowing) that would have to be approved by the voters.⁷

The proposed use of borrowing for roads in particular was striking, given the Warren precedent of pay-as-you-go highway financing through a hike in the gas tax. No gas tax hike or other tax hike was proposed for infrastructure purposes, either on a pay-as-you-go basis or simply to pay off the new bonds. Republicans pushed for pay-as-you-go with no tax hike, i.e., earmarking a portion of the general fund for infrastructure projects.

Various proposals were floated for user fees (such as tolls on roads) and public-private partnerships. Senate leader Don Perata aired TV ads for his own proposal, one of which dramatized flood dangers and reminded viewers of Hurricane Katrina in New Orleans. There was talk of moving quickly to put the infrastructure package on the June

2006 ballot. But Republican opposition and insistence on inclusion of various water proposals – and Democratic pressure for inclusion of parks – meant that there were fewer than the needed two-thirds vote for legislative passage.

Since the infrastructure proposal would add to the state burden of debt service, the legislature ultimately trimmed the package of new borrowing down to \$37 billion. Four infrastructure bond measures were put on the ballot for November 2006: transportation (Prop 1B - \$20 billion), housing (Prop 1C - \$3 billion), education (Prop 1D - \$10 billion), and water levees (Prop 1E - \$4 billion).⁸ A related proposition more tightly earmarked the state sales tax on gasoline (not to be confused with the gas tax) for transportation (Prop 1A) to prevent future “raids” on this revenue for the general state budget. Also on the ballot was a separate water supply bond (Prop 84 - \$5 billion). Other issues unrelated to infrastructure also were placed on the ballot, giving voters a total of 13 propositions to consider.⁹

The infrastructure proposals – combined with a focus on environmental concerns such as greenhouse gases – seemed to reverse the governor’s political fortunes. According to the Public Policy Institute of California (PPIC) poll, the governor’s approval ratings climbed from 40% to 49% between January and July 2006. While he was at the bottom of his popularity around the time of the November 2005 special election, the California Field Poll put the governor behind likely Democratic gubernatorial opponents including Phil Angelides. By July 2006, the final Democratic candidate – Phil Angelides – showed up as trailing the governor in the PPIC poll. And he lost badly on Election Day.

Some of this reversal was due to a bruising Democratic primary in which controller Steve Westly ran TV ads labeling Angelides as a tax-raiser and environmental degrader. One mimicked an ad run by Democrat Kathleen Brown in 1994 against incumbent Governor Pete Wilson listing an array of taxes Wilson was said to have raised. Summer TV ads for Governor Schwarzenegger posed the question of “What if Steve Westly was right?”

Although the public seemed to like the idea of more infrastructure and rewarded the governor with a more favorable impression, the June 2006 primary election suggested that liking infrastructure and voting for bonds to support it were not the same thing. Prop 81 on the June ballot, a library construction bond measure, was rejected. Rejected, too, was a tax on the rich for universal preschool (Prop 82), identified with movie director Rob Reiner.¹⁰ This rejection was a change from 2004 when voters approved a tax on the rich for mental health (Prop 63).

Opinion polls close to the November 2006 election indicated that passage of the infrastructure propositions was not a certainty. There was a push to sway voters close to Election Day, notably a bipartisan TV ad featuring Republican Governor Schwarzenegger and Democratic U.S. Senator Dianne Feinstein. In the end, all of the infrastructure propositions passed by a reasonable margin.

Governor Schwarzenegger had said he could “guarantee” that the infrastructure package would be “done” in 2006, presumably meaning that he would campaign successfully to obtain voter approval.¹¹ But there was some question about whether he was equally keen on all components of the package. Observers noted that in public appearances, he tended to neglect mentioning the housing bond – a Democratic priority. When asked about the omission, the governor replied “I forgot.”¹² However, ultimately, the voter support that was generated for the propositions officially endorsed by the governor and legislature (1A through 1E) seemed to carry over to the unendorsed Prop 84.¹³

The Budget for 2006-07

“We still have work to do to eliminate the structural budget deficit. But thanks to our renewed fiscal strength we can address today's needs as well as plan for the kind of California we want to leave for our children.”

Governor Arnold Schwarzenegger¹⁴

“There's no doubt that the Governor's election year budget reflects Democratic priorities, and we're pleased he has finally given schools the resources the law entitles them to. But with prosperity comes an obligation to middle-class and low-income Californians who have suffered from the Governor's harsh budget cuts of the past two years.”

Assembly Speaker Fabian Núñez¹⁵

While infrastructure was a center of attention, the annual state budget for 2005-06 was also under consideration.¹⁶ In previous editions of *California Policy Options*, we have traced the difficult history of the state budget in the early 2000s. The story in its essence is simple enough. In the late 1990s, the dot.com boom – and the rising stock market more generally – produced substantial state revenue, especially through capital gains taxation on stocks and stock options. Although the state managed to save some of the revenue for a time, at the peak of the cycle, the General Fund was in a slight deficit. That left the state in a precarious fiscal condition. When you are at the peak of the mountain, you can't fall up, only down.

Ongoing state spending at the peak assumed continual capital gains funding. But when the bubble burst, the revenue surge disappeared. The result was budgetary stalemate between Governor Davis and the legislature with the governor proposing painful adjustments and the legislature rejecting them. Budgets were signed that led to *de facto* short-term borrowing. Davis won re-election in 2002 against a weak Republican candidate. Meanwhile, a cash crunch for the 2003-04 fiscal year led to an elaborate proposal to refinance and to borrow without a vote of the people.

Davis' approach was an attempt to circumvent the state constitution's requirement that bonds be for some specific project – not just general spending – and that they be approved by the voters. The recall of 2003 effectively overrode the Davis plan. But the

Schwarzenegger substitute plan also included heavy borrowing, albeit with voter approval obtained in spring 2004 under Props 57 and 58.

The 2004-05 budget included the proceeds of Props 57-58 borrowing and various deals and compacts reached with groups such as teachers and Indian gambling interests. In particular, the deal with the influential California Teachers Association (CTA) involved suspension of the Prop 98 guarantee (covering K-14) in exchange for “fully funding” the guarantee the following year. Not keeping his end of the bargain contributed importantly to the opposition to the governor’s initiatives in the November 2005 special election. During the later months of the 2004-05 fiscal year, a tax “amnesty” brought in a windfall of revenue, although some of the windfall appeared to be precautionary payments that would later go back to the protesting taxpayers.¹⁷

The budget outlook improved during the 2005-06 fiscal year. Not surprisingly given his earlier special election/initiative debacle, the governor moved to fund Prop 98 “fully” in the 2006-07 budget, thus defusing CTA opposition in a gubernatorial election year. CTA remained officially behind Phil Angelides, the Democratic gubernatorial candidate. But as Angelides’ poll numbers dropped, CTA and other unions put their resources into other races. Beyond the education issue, the governor promised that there would be no future tax increases – “I totally rule it out” – positioning himself for the November 2006 gubernatorial election.¹⁸

Budgetary accounts are kept on two bases: accrual, which in principle assigns revenues and expenditures to the fiscal year to which they are properly attributed – and cash – which simply records fiscal flows when they occur. Table 1 presents the 2005-06 budget on both bases and Figures 1, 2, and 3 provide graphic representations of the cash flows. The following points emerge.

- Revenues flowed in exceeding the original projections.
- Actual disbursements fell slightly below original projections on a cash basis although they increased somewhat on an accrual basis. The cash basis drop occurred primarily in what are labeled “local” expenditures, primarily social welfare type spending, perhaps reflecting the general economic uptick. (Figure 3)
- The net result on both a cash and accrual was a swing from a projected deficit in 2005-06 to a surplus. On a cash basis, the swing from deficit to surplus was on the order of \$10 billion. (Figure 1)
- Not surprisingly, the receipt growth was concentrated in the major tax sources for the state: personal income taxes, sales taxes, and corporation tax. However, the bulk was in the personal income tax. (Figure 2)

The fact that much of the revenue boost came in the personal income tax suggests that the gain was from higher income taxpayers (who are much overrepresented in the personal income tax due to its progressivity). It is likely that capital gains are again an

important contributor, perhaps from stock market returns as in the late 1990s, but also from real estate. Many observers – including the economists of the UCLA Anderson Forecast – have argued that California real estate was exhibiting signs of a “bubble” – as the stock market did in the earlier budgetary cycle. Nonetheless, the added revenue triggered an upgrade in the ratings of California state bonds in May 2006, despite the risk of another punctured bubble.

Technically, budgets are supposed to be passed by the legislature by June 15. That deadline is rarely met, and wasn’t in June 2006. One hang-up was the issue of illegal immigration, an issue with which the governor has tried to placate conservative Republicans – who want tough anti-illegal immigrant laws – and liberal Democrats – who have pushed for such proposals as drivers’ licenses for illegals. In the case of the last-minute budget negotiations, an extension of child health care coverage that might have included illegal immigrants was a matter of contention. The governor said he did not support denying health services to children of any status, but also did not want to spend excessively on such programs. Ultimately, the issue was shelved in a budget compromise reached before the end of the fiscal year. Thus, California was able to begin the 2006-07 fiscal year with a budget in place on July 1, an unusual occurrence.

The Longer-Term Fiscal Outlook

“So I have gone through this now – this is now the third budget. And when I ran, I thought it was easier to balance the budget, to be honest with you. But it’s very, very difficult because you’re not sitting over there alone in the Capitol, you’re making decisions together.”

Governor Arnold Schwarzenegger¹⁹

“These revenues will not last forever.”

Legislative Analyst Elizabeth Hill²⁰

Of course, the improved fiscal situation in 2005-06 was welcome news. What was done as a consequence was less welcome from the viewpoint of fiscal prudence, however. The new budget for 2006-07 was revised to reflect the revenue growth. As Figure 4 shows, it included a considerable projected deficit, in effect dissipating the surprise growth in reserves during 2005-06. The infrastructure proposals – as noted – rely on borrowing and therefore more debt service than otherwise in the future.

There are uncertain future expenditures on the way for state prisons, due to litigation on conditions in these facilities.²¹ And the governor “bought out” tuition increases at UC and CSU which will require either ongoing drains on state revenues or a sudden and large hike in tuition in the event of future fiscal distress. As Figure 4 indicates, the projected deficits persist beyond fiscal 2006-07, what the legislative analyst terms a “structural” problem, i.e., deficits that economic growth will not quickly eradicate. Little was said about this concern in the election campaign for governor or any other state office. One of the governor’s TV ads released close to Election Day citing various newspapers included the phrase “passed a balanced budget.” Undoubtedly, the

quote literally was correct in the sense that the words were as stated in the article. But the writer of the article was incorrect; the 2006-07 budget was in deficit with projected expenditures exceeding revenues.²²

In short, there are echoes of the history of the late 1990s and beyond in the fiscal 2006-07 budget. During the 1990s cycle, only budget aficionados worried about the potential for an eventual budget crisis; the public did not perceive a problem until the crisis materialized. And in the current period, the state has less flexibility thanks to accords and constitutional amendments adopted to deal with the fiscal crisis of the early 2000s, as well as Prop 1A in November 2006. One can hope for good luck on the economic and budgetary fronts. But it should not be thought that the events of the early 2000s were so unique that they can't repeat.

Wilson's Woes

"I am proud of the fact that while I inherited a budget deficit from my predecessor, I will leave my successor... a balanced budget and a Triple A credit rating."

Outgoing Governor George Deukmejian²³

"Kiplinger, speaking... at a Sacramento luncheon, predicted a ninth straight year of expansion for California's economy in 1991 and took to task those who say the state is headed for hard times as a result of defense cuts and high housing costs."

News account of predictions of Austin Kiplinger,
Editor of Kiplinger newsletters, made shortly after
November 1990 election²⁴

Memories are short. When Californians think of state fiscal distress, they are likely to focus on the period after 2000 when – thanks to recession and the dot.com bust – a string of budget deficits ultimately led to the recall of Governor Gray Davis in 2003. Because of the uniqueness of the dot.com episode – a stock boom producing substantial tax revenue and a subsequent bust taking it away – it is easy to conclude that the post-2000 budget crisis is very unlikely to repeat. However, history says otherwise; only a decade before the dot.com bust, California suffered through a similar period under Governor Pete Wilson. Wilson's struggle with the state's fiscal crisis of that era should provide a cautionary tale to those who believe that from now on California will remain on an upward trajectory with only minor blips from time to time.

Pete Wilson began his electoral career as a state assemblyman (1976-71). He became mayor of San Diego (1971-83), then a U.S. senator from California (1983-91), and finally emerged in 1990 as the Republican candidate for governor. By his Election Day victory in November 1990, it was clear that the state budget was going to be a problem. The incumbent governor, Republican George Deukmejian, had already had difficulty dealing with the 1990-91 budget and had to resort to such accommodations as not funding the growing liability of the CalPERS pension program for state employees.

Even to reach such a deal, Deukmejian had to agree to base pensions on the final year of salary, a personnel practice that can invite pension abuse.²⁵

Ironically, Wilson's Democratic opponent for governor – former San Francisco mayor Dianne Feinstein – made an issue of Senator Wilson's campaigning in California when, she argued, he should have been dealing with the *federal* budget deficit. At the time, President Bush (Sr.) had proposed an unpopular tax increase to deal with that deficit, a reversal of his stance in the 1988 presidential campaign. (“Read my lips; no new taxes.”) Wilson voted against Bush's tax increase, establishing himself as an anti-tax candidate in the state. Yet state budget exigencies were soon to force Wilson to follow the Bush example. The difference was that Wilson, unlike Bush, had not explicitly uttered a literal read-my-lips promise that state taxes would not be raised (although voters might have perceived that to be his stance).

Of course, there were other major concerns during Wilson's first term including the Los Angeles Riot (1992) and the Northridge earthquake (1994). Today, Wilson's name is most commonly associated with Prop 187, a largely invalidated 1994 ballot proposition that would have denied public services to illegal immigrants. Prop 187 became entwined in Wilson's successful re-election campaign that year. But dealing with the budget, a reflection of California's severe economic slump, became the ongoing challenge of his first term as governor.

There were other ironies during Wilson's struggle with the state's fiscal distress. In 1990, voters passed Proposition 140 – supported by candidate Wilson – which imposed term limits on the legislature and cut legislative administrative support budgets. Litigation followed, but eventually Prop 140 passed its legal hurdles. The then-leader of the Assembly Democrats, Willie Brown, was in many respects the implicit target of Prop 140. It was assumed that term limits would weaken Brown and make it easier for Wilson as governor to deal with the legislature. As it turned out, Brown was needed by Wilson to enact some of the painful budgets that followed the 1990 campaign. And as term limits came fully into effect, subsequent governors have found dealing with relatively weak assembly speakers a difficulty, not an asset, in fiscal affairs.

The Looming Fiscal Problem

“The lack of an offset to these direct (aerospace) job losses in the goods sector is now apparent in the economy-wide slowdown afflicting California, which is perhaps best summarized by the growing state budget deficit.”

David G. Hensley
Director, UCLA Business Forecast²⁶

“I'm going to present a budget that is going to be one where I'm compelled to spread some pain.”

Governor-Elect Pete Wilson²⁷

By the time of the 1990 election, the Cold War was largely over. The Soviet Union still existed but was disintegrating and would disappear at the end of 1991. California's aerospace industry would clearly be adversely affected by the end of the Cold War. Nonetheless, it was widely expected that the state's diverse economy would somehow pick up the slack left by declining aerospace. Unfortunately, that happy outcome did not occur; the state was entering a slump that was to last half a decade and be centered in southern California.

Figures 5 and 6 depict the condition of the California labor market during the 1990s as a proxy for the general shape of the state economy. It was not until the middle of the decade that the dot.com/high-tech boom in the Bay Area became a sufficient force to resolve the state's fiscal crunch. The recovery from the 1990s downturn was becoming apparent by 1994, but it wasn't until 1995-96 that employment was at least back to the 1990 peak.

Since the adult population and potential labor force continued to grow, albeit slowly during the slump, the unemployment rate did not drop to the level seen in the late 1980s until the end of the 1990s. Indeed, as the recession worsened in the early 1990s, there was domestic out-migration from California to other states in the U.S. by "natives." This out-migration was sufficiently counterbalanced by immigration from Mexico and elsewhere along with natural population growth so that adult population growth was slowed, but not negative.

Nonetheless, as Figure 7 indicates, the downturn of the 1990s had a permanent effect on California's job trend. Even with the boom in the late 1990s, jobs were around 9% below trend at the cyclical peak in 2000. By mid-2006, despite economic recovery, the percentage gap had roughly doubled and – if the projections shown on Figure 7 prove to be correct – the gap will have tripled between 2000 and 2020. Moreover, the job and population trend after the 1980s entailed a loss of middle-income jobs and a greater polarization of California's income distribution. Growth at the bottom suggests more strain on state and local public services. Growth at the top suggests a more volatile pattern of state revenue due to heavy reliance in the state on a highly progressive income tax that reflects the fluctuations in income of those in the top brackets.

Budgets are based on economic forecasts, especially on the revenue side. Table 2 compares forecasts made by the Department of Finance (DOF) and the UCLA Business Forecast. Actual outcomes are shown on the bottom of the table. The DOF forecast was made early in the first year shown; the UCLA forecast was made just prior to the beginning of that year. Each forecast covers a two-year period, thus giving a sense of the expected direction of the economy. For the tenor of the economy, the table uses the change in nonfarm payroll employment, generally an anchor for state forecasting because of that series' timely availability.

Initially, neither DOF nor UCLA foresaw the downturn. Slow growth was expected for 1990 and even slower for 1991 by UCLA. But DOF saw relatively rapid

growth in 1990 and an acceleration in 1991. In fact, UCLA was close to the mark for 1990. But the growth slowdown predicted by UCLA for 1991 in fact turned out to be an actual decline in jobs. The following year, UCLA predicted a downturn and then a reversion to past growth in 1992. DOF saw only a slowdown, not the actual 1991 downturn, and then acceleration. In fact, the downturn was worse than UCLA predicted and there was no uptick in 1992. Indeed, the pace of the downturn accelerated.

The DOF prediction in early 1992 was for slow growth and then an acceleration in 1993. UCLA predicted a continued downturn – albeit less sharp than actually ensued. UCLA predicted a modest return to growth in 1993. In fact, the downturn continued into that year. By 1993, both UCLA and DOF were predicting further downturn and both were reasonably accurate as compared with the actual result. Both foresaw an uptick in 1994, although faster than the actual outcome.

After three years of downturn, both DOF and UCLA forecast a modest further decline in 1994, to be followed by a modest uptick in 1995. In fact, for a change 1994 turned out better than anticipated – modest job growth – and the acceleration in 1995 was stronger than either expected. For 1995-96, UCLA forecast rapid growth in the first year and then a more modest pace in the second. DOF was more accurate, predicting modest growth in the first year and an acceleration in 1996.

Although the forecasting record sometimes favored UCLA and sometimes DOF, when it comes to budgets, the consequences of over-optimism are more serious than excess pessimism. And the time pattern is important. DOF was overoptimistic early on in the fiscal crisis, leading to budget proposals that were based on an expanding economy when in fact the state's economy was in decline. The result was unpleasant fiscal surprises requiring painful adjustments and a resort ultimately to short-term deficit borrowing.

Budget proposals are fluid. The governor proposes a budget in January for the following fiscal year, but as new data arrive – both economic and political – the budget begins to change. In May, the governor submits the “May Revise” proposal based on the newer information. Further modifications are made by the legislature, often with back and forth negotiations between the governor and the four majority and minority legislative leaders, the so-called “Big Five.” The enacted budget contains forecasts of revenues and expenditures that may prove to be inaccurate, particularly if the underlying economic forecast is inaccurate.

Unfortunately, California budget accounting methodology does not tightly distinguish actual revenues from borrowing. Borrowing may occur when the general fund is supported by what amounts to forced loans from other state funds or through explicit borrowing from outside lenders. Although long-term borrowing is supposed to require voter approval and is not supposed to be used for general operations, court decisions allow short-term state borrowing without a vote of the legislature or people.

Revenue Anticipation Notes (RANs) are issued *within* fiscal years, ostensibly to deal with seasonality in revenues and expenditures. When short-term borrowing *crosses* from one fiscal year to the next, Revenue Anticipation Warrants (RAWs) are issued. Movements of funds obtained through RAWs can occur through transfers from state funds outside the General Fund into the General Fund. All of these devices cloud the common-sense meaning of terms such as surplus and deficit. In particular, when state officials talk of surpluses (deficits), they do not necessarily mean situations in which annual receipts are in excess of (less than) expenditures. State budget-speak is inconsistent with federal, and common parlance.

Tables 3A-3E provide information on “revenues and transfers” as compared with expenditures. These tables are based on budget data from documents of the period, rather than on subsequent revisions now available from the Department of Finance. They thus present data as it would have been viewed by the governor and legislators of the period. As can be seen, Governor Wilson inherited a deficit budget in 1990-91, although reserves from prior years were initially available to finance the gap. The enacted budget for 1991-92 purported to provide a surplus – but turned out to be in deficit. A similar result occurred in 1992-93. The 1993-94 budget projected a surplus but produced one that was much more modest. Moreover, by that time the definition of surplus and deficit had become clouded by short-term borrowing reflected in inter-fund transfers. It is only in 1994-95 and 1995-96 that the outlook truly brightens. And it required continued surpluses to deal with the past debt that had accumulated.

Figure 8 provides information on the actual budgetary results of the Wilson era. It relies on revised data available from the Department of Finance. However, to try and filter the problem of borrowing treated as revenue, the data of Figure 8 have been adjusted. The figure makes it clear that significant deficits occurred through 1992-93, with a turnaround becoming evident thereafter. Of course, at the time, policy makers could not be sure that an ongoing turnaround was underway and would, in any case, have needed some revenue to pay off the debt previously accumulated. As perceived by participants, the turnaround did not arrive clearly until 1995-96, i.e., into Governor Wilson’s second term. Wilson, in other words, spent his first term in office enmeshed in budgetary woes.

The First Budget Proposal for 1991-92

“We don’t agree with some of the things the governor proposed, but we recognize the bleakness of the situation we’re in.”

Senate President Pro-Tem David Roberti²⁸

“I don’t begrudge (welfare recipients) a six-pack of beer, but it’s not a necessity.”

Governor Pete Wilson²⁹

By the time of Wilson's inauguration, headlines were warning of a worsening state budget crisis. In fact, as noted above, the crisis was already being felt well before the 1990 gubernatorial election and began to pinch various state social welfare programs during the 1990-91 fiscal year, the last budget year for outgoing Governor George Deukmejian. As an example, elderly recipients of the state's Supplemental Security Income program had their state benefit cut to offset the cost-of-living adjustment they would receive under Social Security. Thus, their nominal income remained unchanged despite inflation. Despite this early budgetary strain, Wall Street assumed that the state would somehow soon right its fiscal affairs and continued (initially) to apply its highest triple-A bond rating to state debt.

Governors normally have two early-in-the-year messages to deliver to the legislature. The first is a state-of-the-state address followed about a week later by a budget message (along with a proposed budget for the fiscal year beginning July 1.) Incoming governors have a third speech, an inaugural address. Wilson's first inaugural contained little about the budget, possibly because an incoming governor faces the problem of putting together a fiscal proposal hurriedly. It was mainly an inspirational address pointing to ancient redwoods and the like. Just as Governor Schwarzenegger sometimes does, Wilson called on the ghosts of past governors Republican Hiram Johnson, the progressive reformer, and Democrat Pat Brown, the infrastructure builder. Ironically, given later events, he condemned "ballot-box budgeting," something he was (unsuccessfully) to propose later in his term.

The state-of-the-state speech was more specific about the budget in that it repeated the governor's perceived campaign pledge not to raise general taxes but also hinted at developing some new revenues.³⁰ When the particulars of the budget plan were announced, the proposal involved raising tuition in public higher education (user fees, not "taxes"), imposing the sales tax on certain items that had been exempt (such as newspapers), and increasing motor vehicle fees. Social welfare spending would be cut including monthly welfare grants. The economic projections of underlying revenues in Governor Wilson's budget were generally viewed at the time as on the optimistic side, as has already been seen on Table 2.

As the year wore on, UC fees were hiked by 40% and various staff reductions were proposed. By early February, Standard and Poors had put California's bond rating on a "credit watch." The legislative analyst released a more gloomy economic forecast than that underlying the governor's budget proposal. Interest groups, including adversely affected government agencies and local governments, began to push for exemption from cuts or more generous treatment. The California Teachers Association, in particular, threatened retaliation against proponents of suspending Prop 98, the 1988 initiative that provides formula-based funding for K-14.³¹

Proposals (re)surfaced to modify Prop 13 – the 1978 property tax limitation initiative – by allowing a "split roll" system for commercial property.³² By mid-March, Governor Wilson's staff was meeting with a bipartisan group of legislators focused on assorted tax increases including sales, income, and corporation.³³ Reports indicated that

over \$10 billion in tax increases were under discussion. Apart from proposals for tax increases and spending cuts, the report the group ultimately produced surfaced the idea of shifting responsibility for various programs to local governments and letting them raise revenues to handle the programs. This idea, which ultimately came to fruition along with a tax increase, had two appealing features from the viewpoint of the state. First, the onus for tax-raising would fall on local government. Second, shifting some of the general fund to localities would reduce the impact of Prop. 98 on the state.

In any event, the legislature – facing major cutbacks in its own administrative support budget under Prop 140 – was forced by the exigency of events to turn its attention away from a lawsuit aimed at overturning the proposition to the budget. In hindsight it was just as well; eventually the California Supreme Court refused to void Prop 140. By April, the state controller, Gray Davis, was beginning to warn about a cash crunch in which the state might not be able to meet its payroll and other expenses.³⁴

The Revised Wilson Proposal for 1991-92

“The situation is almost unimaginable. The solution will demand unprecedented bipartisan cooperation and creativity. I don’t know that the Legislature and the governor have ever faced such a test.”

Assemblyman John Vasconcellos³⁵

“There were a lot of people hoping and arguing that the state would be spared the brunt of the national recession, and I think clearly that’s not true.”

David G. Hensley, Director, UCLA Business Forecast Project³⁶

Governors have traditionally produced a “May Revise” budget proposal that reflects updated economic forecasts as well as political adjustments to what the legislature is likely to accept. In mid-April, Governor Wilson decided to concentrate on his May Revise – but to do it in late April – and to forego a possible budget “summit” with key legislators until he could put his own proposal on the table.³⁷

The proposal, when announced, featured tax hikes, cuts in various programs, borrowing from various state funds, and another underfunding of CalPERS.³⁸ Assembly speaker Willie Brown expressed encouragement at the proposal and called for early debate in the legislature. But those on the political right were not encouraged. A group called the “No-Tax-Increase Task Force” produced its own proposal which would have dealt with the budget crisis entirely through spending cuts.³⁹

Enacting a Budget for 1991-92

“I have this word for Governor Wilson. Read my lips. If you increase taxes and if you turn the cities of California over to militant homosexuals, this will be the last term you will serve as Governor.”

TV Evangelist Pat Robertson⁴⁰

“Stalemate is a better alternative to passing a bad budget.”

Republican Assemblyman Tom McClintock⁴¹

“It’s the easiest thing in the world to hunker down and chant, ‘No new taxes.’”

Governor Pete Wilson⁴²

One element in efforts of the Wilson administration in seeking to win support for the governor’s revised budget proposal was to shift blame to his immediate predecessor.⁴³ Reaching still further back in history, Wilson noted that Ronald Reagan had had to raise taxes during his first year as governor to deal with a budget crisis left by his predecessor, Pat Brown.⁴⁴ These efforts may have helped on Wilson’s right flank, especially when combined with enunciation of a general principle that any tax hikes must be accompanied by “reforms.” These included changing the Workers’ Compensation system to make it less expensive. Wilson also wanted to transform the Board of Trustees of CalPERS, shifting it to political appointees.

But on the left, legislative Democrats wanted a higher ratio of tax hikes to spending cuts and less in particular of cuts in welfare. They wanted more of the tax hike to come from the (progressive) income tax and less from the (regressive) sales tax. The public, according to the Field poll, preferred raising the income tax at the highest bracket and was not keen on a general increase in the sales tax.⁴⁵

While there were periodic bouts of optimism that a deal could be reached, a stream of on-again-off-again “summits” between legislative leaders and the governor produced little forward motion – especially in the Assembly. Bad news on state revenue was reported regularly. By mid-June, the technical constitutional deadline for passing a budget, the Senate had reached a deal with Wilson, but the Assembly remained deadlocked – with much of the opposition to an accord coming from Republicans.

The Assembly did approve the spending portion of the governor’s proposal on June 21, but that left the tax side – including a sales tax increase – in limbo. Although Republicans were in the minority, the state constitution’s two-thirds vote requirement for budgets and tax hikes gave them veto power. Wilson cut his own pay by 5% in late June; something that might have appealed to the public but that bought him no Assembly votes. Indeed, some members were annoyed that they might also be pressured to give up 5% of their paychecks.⁴⁶

Despite the need for a new budget by July 1, that date came and went with the Assembly still at loggerheads over tax increases. Although the spending part of the budget had passed both houses, the governor refused to sign it until a revenue deal was reached.⁴⁷ The governor began to shift toward a hike in the upper bracket of the state income tax – which Democrats were pushing – but only if the hike were tied to workers’ compensation reform.

As the new fiscal year began without a budget in place, some payments to local governments by the state were not made. However, a deal on the sales tax – separate from the overall budget – produced an accord on a 1.25-cent increase on July 15. Ultimately, the full budget package was completed on July 16, along with changes in workers’ compensation. Wilson was able to push a budget through only because of Democratic cooperation – with Speaker Willie Brown a major factor – and Wilson’s ability to peel off nine Republican votes from the no-tax-increase group within the Republican minority in the Assembly.

Wilson pushed for increased use of managed care and capitation payments for recipients of the Medi-Cal program. Another objective of the governor was an R&D tax credit to encourage high-tech industry. He proposed pushing responsibility for certain health and welfare programs down to the local level (with revenue in theory to go with them), and workers’ comp reform. All of these goals were included in the final package. He proposed ending COLA adjustments in various welfare programs but settled for a five-year COLA suspension. In other areas, however, such as unilateral ability to cut wages of state civil servants (despite union contracts) and control of CalPERS, Wilson was not successful.

And there were items that were not quite wrapped up. Since ultimately he couldn’t cut civil servants’ pay, Wilson pushed state labor unions for negotiated pay concessions that were assumed in the budget. But obtaining such concessions was not a done deal. The extension of the sales tax to “snack” foods involved complex definitions of what exactly was a snack. (Prop 163 of November 1992 eventually repealed the “snack tax.”) An attempt by Wilson to pass along health insurance cost increases to state employees was resisted by Controller Gray Davis and then overturned by a court decision. Still, enough budget tightening was done to allow California to keep its triple-A bond rating – although not for long.

Prelude to the 1992-93 Budget

“Hi, I’m Pete Wilson and I tax snacks.”

Anti-Wilson sticker placed around Sacramento⁴⁸

“Although there is no constitutional requirement that the state balance its budget... California has generally acted as if there were one. We may be edging away from that tradition...”

Sacramento Bee Columnist Dan Walters⁴⁹

It became apparent soon after the 1991-92 budget was enacted that California’s fiscal difficulties were far from over. Politically, Governor Wilson had angered the anti-tax wing of his party by raising taxes; those in that wing began talking about “one-term Pete.”⁵⁰ Legislative Democrats were not ideologically opposed to tax increases – quite the contrary – but they preferred taxes on higher income individuals to regressive sales taxes.

There were also elements of the enacted budget open to challenge. Continuing efforts to impose a 5% pay cut on state workers ran afoul of controller Gray Davis – who termed the cut illegal absent agreement by state labor unions or legislation – and subsequent court decisions supported Davis.⁵¹ Accounts appeared in the media of welfare recipients suffering due to benefit reductions. Fees at UC were raised 40% in the fall of 1991; CSU fees went up 24%. Wilson’s public opinion poll ratings – not surprisingly – fell as the impacts of tax increases, tuition (fee) hikes, spending cuts, and political controversy continued.

Although initially resistant, the governor called a special legislative session to deal with the budget in mid-December 1991, a month ahead of the usual budget presentation. In issuing his call, Wilson was influenced by revenues that were already falling short of projections for 1991-92. And bond rating agencies were by then in the process of downgrading the state’s credit rating as the bad news continued to arrive.

Governor Wilson also proposed a ballot proposition – to be titled the “Taxpayer Protection Act” – for the November 1992 election.⁵² The proposal – which eventually became Proposition 165 – would allow the governor, in times of fiscal emergency or legislative impasse, to reduce state spending. The proposition would also have cut welfare grants. Wilson’s proposal bore some resemblance to Proposition 1, a failed initiative backed by Governor Reagan in 1973 which applied various formulas to reduce state spending. However, Prop 1 was not geared to fiscal emergencies; instead it was an effort to shrink state government over an extended period.

Wilson’s proposal was focused on emergencies and was not as formula-driven as the Reagan version. In making the proposal, Wilson surely knew of the fate of Reagan’s Prop 1. But he may also have been thinking of Prop 4 of 1979 – passed by the voters in the wake of Prop 13 of 1978 as part of the “taxpayer revolt” of that era. Prop 4 did place a ceiling on state spending, although the voters largely gutted it in 1988 and 1990 under Props 98 and 111 (which provided formula-driven guaranteed funding for K-14 education). Whatever his thinking, the proposal was sure to complicate the governor’s relationship with the state legislature – still reeling from a state supreme court decision upholding term limits and cuts in the legislature’s administrative support budget.⁵³

The January Proposal for the 1992-93 Budget

“We’re saying the administration has been too optimistic on the revenue side. The recession is deeper and we think the recovery is longer.”

Legislative Analyst Elizabeth Hill⁵⁴

“I have no idea how to fix this budget.”

Assemblyman and Chair of the Ways and Means
Committee John Vasconcellos⁵⁵

The essential feature of the January message was a proposal to engage in deficit financing for the current year (still underway) and fix the problem, as the governor defined it, over the course of 1992-93. Wilson assumed that an economic recovery would be in full swing by then. Deficits in the general fund would be met by pulling money from other state funds and delaying some payments into 1992-93. However, the proposed budget for 1992-93 relied on unpopular elements such as taking local property tax revenue from special districts – leaving them to raise fees to make up for lost funding.

More importantly, continued bad economic news suggested that a recovery within the time-frame envisioned by Wilson was not a sure thing. Nonetheless, the governor tended to emphasize funding for K-14 education (in part because of Prop 98) and focused his proposed cuts on health and welfare spending. UC and CSU would need to rely on still more fee increases to deal with their funding needs for the 1992-93 fiscal year.

Efforts by officials to persuade bond rating agencies to give California back its Triple-A rating were unsuccessful. The agencies saw a deepening crisis, not a turn-around situation. Meanwhile, there were complaints that students were taking too long to graduate from UC and CSU, raising state costs for higher education. And the governor announced he would cut various benefits for state employees – most of whom were under expired collective bargaining agreements by then – although core compensation (pay, health care, and dental benefits) could not be cut due to a court decision. One union – that of the state’s prison guards – cut a deal with the governor. But that union found its tentative agreement rejected when put to a membership vote.⁵⁶ The only “good news” – if that is what it was – was that the use of CalPERS funds for dealing with the 1991-92 budget crisis was upheld by a court decision.⁵⁷

The May Revise Proposal for the 1992-93 Budget

“If we closed all the universities, all the prisons, the governor’s office, and the Legislature, we couldn’t balance this budget.”

Assemblyman and Chair of the Ways and Means
Committee John Vasconcellos⁵⁸

Initially, the Democrats had suggested adopting a budget early enough to avoid the traditional May Revise proposal. But the choices were too painful for an early budget. As the date for the May Revise budget approached, Governor Wilson turned in petitions for his ballot initiative. By that time, some state employees were pulling money out of financial institutions that had publicly supported the initiative. (The initiative would give the governor the power to cut state wages 5% during fiscal emergencies.) However, some state unions had already agreed to a 5% wage cut in negotiations.

The governor threatened to hold up approval of any budget that did not meet his demands for spending cuts until the November election when he hoped to pass his initiative and elect more Republicans.⁵⁹ Wilson refused to consider any legislative

proposal that again raised taxes. He wanted the above-noted authority to cut wages 5%, various cuts in welfare spending and Medi-Cal, elimination of the renters' tax credit, and major increases in UC and CSU tuition.

Warnings were in the air of the state running out of cash and needing to issue IOUs to its employees and suppliers. April income tax revenues were disappointing, leading the governor to call for cuts above and beyond those in the January budget proposal. Meanwhile, disclosure of a generous retirement package and other perks for outgoing UC president David Gardner tended to undermine calls to protect the UC budget from further cutbacks.

California – especially southern California – was enduring woes beyond budgetary matters. Los Angeles experienced a riot after a group of police officers were found not guilty in the Rodney King beating case. The governor received blame for slow deployment of national guard troops to restore order. In the aftermath, Peter Ueberroth, who had just chaired a gubernatorial commission that decried the state's business climate as unfriendly, was named to head an agency charged to "Rebuild LA."⁶⁰

Stalemate

"Our revenues have deteriorated... Our cash position can honestly be described as a crisis."

Governor Pete Wilson⁶¹

"There is nothing we can point to in the recent evidence to suggest a local recovery is imminent."

David G. Hensley, Director UCLA Forecast⁶²

As the official June 15 deadline for a budget to be passed approached, the governor and legislative leaders engaged in intense negotiations. State employees were given early retirement incentives to pull them off the payroll. Fee increases at UC and CSU were agreed. Pressure for tax increases seemed to fade away in an election year. There was talk of a "rollover" of deficit spending from 1992-93 into the following year.⁶³ However, with the two-thirds vote requirement in place, ultimately passage of a budget would require assent not only from the majority Democrats but some Republicans. Meanwhile, a judicial challenge to Prop 13 – which if successful might have revamped the entire state and local tax system in the midst of the negotiations – failed at the U.S. Supreme Court.⁶⁴

As in prior years, a legislative stalemate took the state into the 1992-93 fiscal year without a budget. Registered warrants (IOUs), rather than cash, began to be paid out to service providers and state workers. But because most recipients were able to cash them at accommodating banks, the move created less of a crisis than might have been expected.⁶⁵ Notions of fully funding K-14 under Prop 98 dropped off the table, leading the California Teachers Association to air anti-Wilson ads on TV and radio. Ratings of

California bonds were cut. Assembly Speaker Willie Brown and Governor Wilson were at odds publicly. But by late July, the differences seemed to quiet.

The Final Budget for 1992-93

“I spent more time explaining Wilson to my caucus and keeping them from going off the deep end... My members wanted me full time to destroy him... And I wouldn’t do it.”

Democratic Assembly Speaker Willie Brown⁶⁶

“He sounds like General Lee trying to spin (the surrender at) Appomattox.”

Wilson Communication Director Dan Schnur⁶⁷

The paradox was that in the ongoing Pete Wilson/Willie Brown feud, although Brown and Wilson were in different political camps, both needed each other if there was to be a budget. However, in early August, there was still no budget in place. There were simply not enough Republican or Democratic votes to be had, given the painful choices to be made. And there were limits to how far Brown or Wilson were willing to go to produce an acceptable package.

One Republican senator, Frank Hill of Whittier, seemed willing to work out a compromise – or at least act as go-between – between the Republicans and Democrats. Wilson, however, would not agree to Hill’s proposals involving welfare and funding of local government programs and threatened a veto. The governor offered instead a revised budget in mid-August which was rejected. His plan included a *de facto* “rollover” under which schools would receive certain funding in 1992-93 but would pay it back in future years by reducing state allocations then. It was not, however, until the end of August that a deal was finally put together (including the school rollover). Wilson was able to push the revised proposal through the Senate under the auspices of minority leader Kenneth Maddy (R-Fresno) and majority leader David Roberti (D-Van Nuys).⁶⁸ The Senate compromise, in effect circumvented Brown’s Assembly and – given the length of the crisis – put the Assembly and Brown under heavy pressure to acquiesce.

The budget was officially signed at 1:45 a.m. on September 2, (temporarily) ending the fiscal crisis. One observer attributed the prolonged stalemate to “a clash of immense egos” – Willie Brown and Pete Wilson.⁶⁹ But this view oversimplifies what occurred. At the end, Brown and Wilson were the odd couple who measured each other and put each other under heavy pressure. Willie Brown served as a convenient foil for making the legislature the villain in the budget delay. Brown had been the poster child for passage of Prop. 130, the 1990 term limits initiative. And at the tail end of the budget battle, Brown played a role in rounding up Assembly votes by assuring Assembly members that the California Teachers Association was resigned to the outcome for schools and would not campaign against them in November.⁷⁰

In the battle over the 1992-93 budget, Wilson ultimately had the upper hand, in part because of the threat of his initiative – Prop 165 on welfare reform and budget – on the November 1992 ballot. He felt sufficiently vindicated by passage of the budget to call a special session of the legislature in September to deal with his proposals for workers’ compensation reform. And he now termed his tax increase of the previous year a mistake. Meanwhile, under Prop 140, term limits would eventually put an end to long-term influential Assembly speakers. (Brown would be termed out by 1996; he actually dropped out and ran successfully for Mayor of San Francisco in 1995.) In the budget crisis a decade later, Governor Gray Davis would not have a Willie Brown with whom to cut a deal, a major factor in Davis’ recall in 2003.

Proposition 165

“If we lose this year, we may never get another chance.”

Governor Pete Wilson in a fundraising letter⁷¹

“It was not exactly a good evening for Wilson.”

Assembly Speaker Willie Brown
commenting on election night⁷²

With the November 1992 election approaching, Governor Wilson believed that the budget deal would produce the popular momentum needed to pass his Proposition 165 and even obtain a Republican majority in the Assembly. Such a majority, if attained, would dethrone Speaker Brown from his leadership position. But as Governor Schwarzenegger would find out over a decade later, and Governor Reagan had learned in the 1970s – complicated budget-limitation initiatives (particularly if they can be depicted as gubernatorial power grabs) are vulnerable.

In the Wilson case, a provision of Prop 165 that gave the governor the right to cut the budget when state revenues fell more than 3% below Department of Finance projections became controversial. The Department of Finance is part of the administration; a governor – opponents argued – could arrange projections guaranteed to overestimate revenues by 3%.⁷³ Moreover, a flaw in this provision – conceded by proponents to be a minor technical error that courts could later correct – appeared to prevent the legislature from overriding a gubernatorial veto of a budget it might pass.⁷⁴

Beyond the specific language, Wilson’s Prop. 165 – although the governor saw it as a unified package – was not tightly focused. Was it welfare reform? Or was it a budgetary device? By combining these two issues, Prop. 165 opened the door for broader opposition. Some conservatives, for example, who might have favored the fiscal component opposed the initiative fearing the welfare side – which discouraged having children while receiving support – would encourage recipients to have abortions.⁷⁵

While Prop 165 was not as unfocused as Schwarzenegger's failed campaign in November 2005 for his four initiatives (only one on the budget), Wilson's proposition also would fall victim to the same electoral tendencies. Budget control suggests cutting spending. Yet as recently as 1988, the electorate had passed Prop 98 to give guaranteed funding to K-14. Concerns about schools and school performance remained and Prop 165 might lead to reduced school expenditures. The enacted budget for 1992-93 was already pinching school and other expenditures.

Moreover, the governor could not prevent other items from ending up on the ballot. Among them were Prop 163 repealing the snack tax (which passed), Prop 167 which ended the snack tax but also raised the income tax for higher-income taxpayers and raised other taxes (failed), Prop 155 floating bonds for school construction (passed), and Prop 156 floating bonds for rail and clean air projects (failed). Mixed with these propositions was a mandate for employer-provided health insurance (failed), term limits for congressional representatives and senators (passed but voided as unconstitutional), and permission for physician-assisted suicide (failed).⁷⁶ In fact, a total of 16 propositions ended up on the November 1992 ballot. As in the Schwarzenegger case, the governor's agenda was mixed with a variety of other voter diversions.

Apart from the propositions, Republicans did not gain control of the Assembly; in fact, they lost seats. California also elected two Democratic U.S. senators, Barbara Boxer and Dianne Feinstein, and went with the country as a whole for Bill Clinton as president. The loss of incumbent Republican Senator John Seymour to Feinstein was especially embarrassing for Wilson; the governor had appointed Seymour to fill the senate seat he had vacated upon taking office in Sacramento.

In the end, Prop 165 was not a triumph built on the seeming budget victory only two months before. Wilson seemed to realize belatedly that his budget victory was not being perceived as a plus by many voters. He even allowed his picture to be used in an unflattering way in a brochure with Willie Brown's picture to support the proposition; some observers saw this move as an odd attempt to use his personal unpopularity to pass his initiative.⁷⁷ After the election, in fact, there was much talk (again) about Wilson as a one-term governor, possibly even losing in the 1994 Republican primary to some other GOP nominee. And before even contemplating the 1994 gubernatorial election, Wilson had another budget battle looming for 1993-94 starting in January 1993.

Repeal of the snack tax – by constitutional amendment that the legislature could not undo – was both a direct slap at Wilson and a loss of revenue in the current and 1993-94 budget that would have to be made up somehow.⁷⁸ To shore up his business base and move away from his 1991 decision to raise taxes, Wilson indicated he would just as soon let the 1991 sales tax increase expire in 1993.⁷⁹ But his future budget battle would be more constrained. A court decision in early December 1992 ruled that in the future, state employees would have to be paid in real money – at least at the level of the minimum wage – rather than in registered warrants should another budget impasse go beyond June 30.⁸⁰

The January 1993 Proposal for the 1993-94 Budget

“If we are to create jobs, we’ll have to cut taxes.”

Governor Pete Wilson⁸¹

“I did not hear Pete Wilson say ‘Read my lips, no extension of the sales tax.’ I think what he said was ‘I don’t want personally to do it.’”

Assembly Speaker Willie Brown⁸²

As 1993 began with the state still in recession, the governor shifted from an emphasis on budget balancing to job creation. Tax credits and loan guarantees for business, workers’ compensation reform, and letting the sales tax revert to its pre-1991 rate were featured parts of Wilson’s new economic policy. College fees would again rise, various state agencies would be eliminated, and more responsibilities – and the pain of asking for tax increases to deal with them – would be shifted from the state to local governments. Welfare cuts of the type envisioned in the failed Prop. 165 were to be enacted by legislation (or again put to voters if not enacted).

The budget proposed foreshadowed Wilson’s endorsement of Prop. 187 – the November 1994 initiative that proposed cutting government services to illegal immigrants. It assumed \$1.4 billion that the federal government would be asked to pay for the cost to the state of such immigrants. This amount in fact far exceeded what was actually received during the budget year.

The exigency of the budget situation was sufficient to bring about a legislative willingness at least to discuss some issues that were previously off the table. Wilson proposed ending the renters’ tax credit, a credit given to renters in the 1960s when property tax relief was financed by raising the sales tax. He had in fact proposed ending the credit in his previous budget proposal but the legislature was not in a mood to do so then. Now, however, terminating the credit was definitely being given consideration.⁸³

Claimants on the state budget were increasingly looking for protections from further cuts. UC and CSU toyed with the idea of an initiative with a Prop. 98-type guarantee to apply to them.⁸⁴ Police and fire officials, with the governor’s blessing, sought a constitutional amendment that would give them first claim on local budgets.⁸⁵ But neither the higher education nor the police/fire proposals actually made it to the ballot. However, to make 1993-94 budgeting easier, there was talk of going to two-year budgets. The assumption was that the economy next year would be better and a two-year averaging would make balancing the budget easier – a forecast disputed by Wilson’s staff.⁸⁶ (Two-year budgets had been last implemented during the Great Depression on a similar rationale.) The only positive budget news was an agreement to maintain funding for the neutral Legislative Analyst’s Office, an agency that might have been killed by the cuts in the legislature’s administrative budget mandated by Prop. 140.⁸⁷

Wilson moved to neuter school funding as a budget issue by offering to keep the per-pupil level of nominal spending unchanged. Because the budget situation was dire,

the school establishment was willing to go along with such an offer. However, the proposed spending was to be financed by shifting local property taxes to school districts from other local governments – and then leaving it to local governments to raise taxes to maintain non-school services. So what was grudgingly acceptable to schools was opposed by other local governments.

The May Revise for 1993-94

“It will put the tax and spending authority where they belong – at the local level.”

Governor Pete Wilson calling for a special election allowing local sales tax hikes⁸⁸

As the May Revise (and the gubernatorial election approached), the governor’s staff let it be known that Wilson would consider a “rollover,” i.e., a deficit in 1993-94 which would be made up the following year.⁸⁹ The May Revise in fact did include a rollover. And with the rollover came the notion of using revenue anticipation warrants – short term borrowing that crosses the fiscal year and avoid the registered warrants (IOUs) of past budget stalemates, should one occur.

In addition, the governor called a surprise special election for November 1993 in which voters would be asked if they wanted to raise local sales taxes. He eventually agreed to a 6-month extension of the sales tax increase of 1991 that would have otherwise expired on June 30, 1993. His proposals also involved a welfare reform – time limits for receiving welfare – that mirrored proposals being debated in Washington and by the Clinton administration.

The Final 1993-94 Budget

“It’s easy to criticize this budget until you’re forced to offer a better alternative. Plenty of better options exist, but they all exist in a better economic climate than this.”

Governor Wilson’s Communication Director Dan Schnur⁹⁰

“They all told me it was a walk in the park – Jurassic Park.”

Governor Pete Wilson on signing the budget⁹¹

The sales tax extension became a sticking point in attempts to produce an on-time budget (technically to be passed by the legislature on June 15). Democrats wanted a simple extension for a year or more. Wilson was willing to go only for the 6-month extension and a vote within counties about local extension beyond December 31, 1993. Because the governor had also put workers’ comp reform on the menu, that issue also held up enacting a budget while negotiations on these diverse issues continued.

Democrats voted for a budget in the Assembly and Senate that “passed” on a party-line vote on June 15 in the sense of obtaining a simple majority of votes. But since budgets require a two-thirds vote, the vote was simply for show. However, the basics of a budget were passed by two-thirds on June 22, omitting some controversial “trailer bills” that would be needed to complete the package.

Ultimately, substantial arm-twisting was needed on the part of legislative leaders and the governor. The governor had already compromised with teachers (keeping per-pupil spending level). However, this leveling was done by having the schools “borrow” against future years’ revenues. Wilson now worked out a deal with local law enforcement dedicating a half-cent of the sales tax to police – subject to voter approval in November as Prop. 172 – to soften the blow of the elaborate raids on local funds that had been concocted to aid the state budget.

Although the June 15 deadline had passed by the time the full budget was enacted, the legislature and the governor produced a budget that was ready to be put in place on July 1 – with the last piece enacted June 30. There would be no period without a budget and no registered warrants in the summer of 1993. And by mid-July, the governor got his workers’ comp reforms from the legislature. There were the usual sad accounts in the press about individuals adversely affected by the new budget. But the general impression was that some kind of fiscal corner had been turned. UC officials began to talk again about opening a tenth campus at Merced. Wall Street seemed happy to buy state revenue anticipation notes. Meanwhile, litigation challenges to the property tax shift contained in the budget were failing. It seemed too good to be true; and it was. The state would have another budget battle the next year.

The Initial Proposal for the 1994-95 Budget

“The entire budget is dependent on (federal funding for illegal immigrants). We make no bones about that fact.”

Governor Pete Wilson⁹²

“I’d say it’s a long shot at best.”

Paul Leonard, Center on Budget and Policy Priorities
commenting on the prospects of federal funding for illegals⁹³

The decisions regarding the 1994-95 budget by the governor and legislature occurred with the 1994 gubernatorial election (and other elections) in the background. California’s economy remained in a slump, making the issue of job creation especially salient. Particularly for the governor, running for re-election against the background of a depressed economy was going to be difficult. Despite fiscal pressures, the legislature – pushed by Willie Brown in the Assembly and more reluctantly David Roberti in the Senate – adopted various tax breaks for business labeled as job creators.⁹⁴

Although the economy and the fiscal condition of the state were important, there were other issues about which voters were also concerned. Toward the end of summer 1993, the legislature enacted – and the governor signed – a bill preventing illegal immigrants from obtaining drivers’ licenses, a signal that illegal immigration was becoming a source of voter anxiety. Of course, almost all issues are somehow interrelated. In this case, the governor saw illegal immigration as placing fiscal strains on state and local governments.

Public jitters about crime were linked to the November 1993 ballot item – Prop 172 – extending the half-cent sales tax but earmarking it for public safety purposes. Concerns about educational quality in K-12 were represented on the ballot in a voucher proposal – Prop 174. But despite the support of conservatives for vouchers, the governor opposed the proposition, primarily because of their potential adverse fiscal effect on the state. In the end, the voucher initiative received only 30% support from voters. The sales tax extension was approved by 58%.⁹⁵

In his state of the state address in early January 1994, Wilson focused on crime, illegal immigration, and proposed an income tax cut, although not slated to go into effect in the 1994-95 fiscal year. The budget proposal itself called for \$2.3 billion in federal funding for illegal immigration. However, the prospects for such an amount were slim. The \$1.4 billion he had proposed initially for the current (1993-94) fiscal year was more than a billion more than actually received by the state. A large portion of the \$2.3 billion was aimed at the cost of educating children of illegals, although some of these children – those born in the U.S. – were American citizens. Also included in the budget was a \$25 income tax credit (tax reduction) for lower-income taxpayers.

As might be expected, the budget was immediately criticized for its cuts or inadequate funding of particular programs, for its tax credit, and for its assumption of federal funding beyond what was likely to arrive. Adding to the budgetary woes was the magnitude 6.7 Northridge earthquake on January 17, which raised the specter of major reconstruction costs. Much of the earthquake tab was ultimately picked up by the federal government, but that fact made substantially more funding for California for illegals still less likely. And California would still have significant costs related to the earthquake – estimated initially as \$1.9 billion – as part of cost-sharing with the federal government.⁹⁶

A \$2 billion earthquake bond was put on the ballot – as opposed to a current tax hike – to deal with repairs and retrofitting. But Prop 1A failed to pass (along with other bond measures) in June 1994, receiving only 46% support. Another budget-related proposition (Prop. 175) requiring the state to reinstate renters’ tax credit also appeared on the ballot in June and failed with 43% support.

The May Revise and Final Budget for 1994-95

“Congress must be forced to bear the fiscal consequences for its immigration policy.”

Governor Pete Wilson⁹⁷

“(The budget) continues to rest on risky assumptions.”

Legislative Analyst Elizabeth Hill⁹⁸

“This is the first time in history the state has surrendered some of its sovereignty. But this action was absolutely necessary...”

Controller Gray Davis⁹⁹

By late May, the budget had become a major element in the forthcoming gubernatorial race. Treasurer Kathleen Brown – the Democratic frontrunner in the June primary – raised the possibility that the state would not have enough cash on hand in the next fiscal year and would have difficulty selling short-term notes to raise the needed funds.¹⁰⁰ After winning the primary, she proposed a deficit financing bond along the lines enacted a decade later under Governor Schwarzenegger.¹⁰¹

In basic terms, the May Revise submitted by the governor was not much different from the January proposal; it still depended importantly on federal money for illegal immigrants that was unlikely to arrive. Wilson’s long-shot opponent in the Republican primary, Ron Unz, proposed drastic cuts in health and welfare spending.¹⁰² Once the primary was past, serious negotiations began among the “Big Five” – the governor and the four legislative leaders from both parties. It became clear that discussions revolved around yet another “rollover,” i.e., a deficit to be financed in the future. Democrats sought a tax “trigger” that would be pulled by formula if revenues fell below forecast – ostensibly to reassure bond investors.

The eventual outcome – a few days into the new fiscal year – did contain a trigger, but one that promised automatic spending cuts, not taxes, under specified circumstances. It contained a feature ending additional payments for welfare recipients who have additional children and other welfare cuts, reflecting the growing national (and state) push for “welfare reform.” However, litigation over the summer forced a *de facto* repeal of the cuts.¹⁰³ As in the prior year, Assembly Speaker Willie Brown was widely credited with bringing reluctant Democrats around – and received a thank-you phone call from the governor for doing so.¹⁰⁴ Indeed, the speaker termed Kathleen Brown’s budget proposal “a hindrance” in enacting the final budget.¹⁰⁵

Budget enactment was high drama but likely a drama obscured by the early phases of the televised O.J. Simpson trial. Nonetheless, the budget resolution (not so late that warrants had to be issued) – and the budget-related immigration focus – created the momentum for Wilson to win re-election despite the state’s fiscal and economic distress. Wall Street was less impressed, cutting the state’s bond ratings shortly after the budget passed.

Prelude to the 1995-96 Budget

“...Educators, local government officials and others (are) frustrated and dismayed that neither Republican Wilson nor Democrat Brown has focused on what they see as the state’s most important problem – a lack of money.”

Dan Bernstein, Sacramento Bee reporter¹⁰⁶

Despite the ongoing budgetary distress, the November 1994 gubernatorial election centered around immigration, Prop 187, crime, and other matters that moved attention away from fiscal affairs. And, of course, there were other issues and candidates on the ballot including a proposal to establish a single-payer health plan for California (overwhelmingly defeated at the polls). In the end, Wilson defeated Kathleen Brown with 55% of the votes. Significantly, Republicans ended up with 41 of the 80 seats in the Assembly, seemingly enough to oust Willie Brown as speaker. (Democrats had held 47 seats prior to the election.)

In fact, the matter of assembly control proved more elusive to the Republicans than they expected. One Republican assemblyman, Paul Horcher, was induced to switch to being an independent and voted for Brown, creating a 40-40 deadlock. Horcher’s move would cost him his seat in a recall.¹⁰⁷ There was a prospect that this split could become 40-39 in favor of Brown; one Republican member of the Assembly had also been elected to the Senate in a special election and would have to give up his assembly seat.

Brown managed to hold on to the speakership – or *de facto* control of the speakership, though 1995. In a series of semi-comic moves, a renegade Republican assemblywoman Doris Allen defected and voted with the Democrats to elect her as ostensible speaker in June 1995. But without cooperation from her former Republican colleagues, she relied entirely on Willie Brown for Democratic votes. She was ousted in September and recalled by voters in her district, blaming “power-mongering men with short penises” for her misfortune.¹⁰⁸ Another renegade Republican – Brian Setencich – took her place with Brown’s support and served until January 1996, when Brown departed to be mayor of San Francisco and the Republicans took genuine control of the speakership.¹⁰⁹ The upshot of these legislative maneuvers was that that governor unexpectedly still had to deal with Willie Brown regarding passage of the 1995-96 budget.

In the period after the November 1994 election, various tax cut plans were floated by advisors to Wilson, plans that would be phased in as the state economy recovered and more revenue flowed in, assuming that occurred.¹¹⁰ Wilson in 1995 became an unofficial candidate for the Republican nomination for president, a fact that colored his agenda. Also in the post-election period, Orange County declared bankruptcy (in December), a situation attributed to speculation by its treasurer in derivatives but – at least partially – a reflection of the general fiscal malaise afflicting both state and local governments. And the Wilson administration kept losing in litigation over past budgets, including some of

his delayed payments to CalPERS – the largest state pension fund – and issuance of registered warrants instead of cash to state employees.

Turning Point: The Budget for 1995-96

“You know, you spend a little bit of time trying to take my job, I’ve got to look at you (Wilson) kind of strange. I am absolutely unforgiving.”

Assembly Speaker Willie Brown¹¹¹

As it turned out, 1995 was the first full year of the California recovery, a fact that – other things equal – might have been expected to ease budget passage. Although Southern California continued to struggle, the dot.com boom was firmly underway in the Bay Area. It eventually would shower revenue into the state treasury until the boom became the bust of 2000-01. While not expecting a revenue shower, Wilson called for more spending on education and prisons, cuts in health and welfare, a shift in responsibility for such programs to counties, and a tax cut. His budget was undoubtedly put together before it became clear that the Democrats and Willie Brown would retain control of the Assembly. The budget had a conservative tilt and – after Paul Horcher defected from the Republicans (giving Willie Brown the speakership) – Wilson became involved in the campaign to recall Horcher.

Despite the improving economic outlook, the Willie Brown speakership combined with other non-fiscal influences to divert attention from the budget. Ward Connerly, a UC regent appointed by Governor Wilson in 1993, advocated ending affirmative action in university admissions; by July the regents had adopted the Connerly proposal. The affirmative action controversy became another “wedge” issue in California politics – joining illegal immigration – and culminating in the passage of Prop. 209 in 1996. (Prop. 209 outlawed affirmative action in all state agencies and institutions, not just UC, except where required by federal regulations or to obtain federal funding.) There were also questions as to whether the state should provide some type of assistance to Orange County as it moved toward formal bankruptcy. And there was uncertainty over federal policy, especially the welfare reform then being debated in Congress, which had significant potential fiscal effects on states.

Meanwhile, the Wilson campaign for the Republican nomination for president moved from speculation to semi-reality.¹¹² In the end, the campaign was ill-fated. Wilson’s tax increase when he first took office was a turn-off for anti-tax Republicans. There was a disclosure that in 1978, his ex-wife hired an illegal alien as a house cleaner, damaging his anti-illegal credentials. Wilson required throat surgery in April that ultimately prevented him from speaking or speaking effectively as the campaign progressed. He eventually had to abandon the presidential effort by September.

The May Revise was not much changed from the initial January budget proposal. By June, the Republicans had succeeded in recalling Horcher, only to find renegade

Doris Allen as speaker under the *de facto* control of Willie Brown who she named as “speaker-emeritus.” Normally, budget compromises are negotiated by the “Big-Five,” the governor and the four legislative leaders. Wilson, however, implicitly rejecting Allen’s legitimacy, insisted that Assemblyman Jim Brulte – who would have become speaker had the Republicans controlled events – also be invited.¹¹³ The Big Five then became the Big Six. But whether Five or Six, no budget was in place on July 1.

Indeed, it took until early August to produce a budget with increasing pressure on Wilson regarding his soon to abort presidential campaign. As long as the budget remained in limbo, campaigning out of state was hindered. But the eventual budget included most of Wilson’s proposed welfare cuts. On the other hand, his phased income tax and corporation tax reductions were dropped. Enough compromises were reached on educational funding to obtain endorsement by the California Teachers Association. Tuition hikes at UC and CSU were avoided. The budget was nominally left with a slight reserve.

In a sense, this time the budgetary battles and the political circus surrounding the assembly speakership obscured a fact that became more evident as time passed. California’s budget crisis was over, at least for the next half decade. Underlying structural problems remained but the dot.com revenue would obscure them until the next crisis. With the immediate pressure to deal with these underlying difficulties removed, there proved to be little incentive to address them during the good times that followed.

No Plan B?

“What, Me Worry?”

Alfred E. Neuman¹¹⁴

Economic forecasting differs from predicting eclipses. Astronomers can tell you exactly where and when an eclipse will occur. Forecasters can not tell you exactly when a recession will occur or how long it will last. They can make educated estimates, but these are made with inevitably imperfect models. And the estimates can be overridden by unforeseen events such as crises in the Middle East, terrorist attacks, or even sudden moves in the stock market.

And since the stock market is noted for periodic gyrations, consider the following question. If you want to make money in stocks, which would you prefer? The advice of the best Wall Street economists? Or tomorrow’s *Wall Street Journal* today? Clearly, the latter should be your choice. It is always better to know the future for sure than to have an educated guess about it. But, sadly, we cannot do better than an educated guess.

In principle, the governor could propose an actual budget (Plan A) and a Plan B budget, assuming less optimistic economic outcomes than are expected. Both could be passed with a proviso that if revenues fall below expectations by some margin, Plan B

would go into effect. Such a strategy would be prudent. But it is also one that has not been observed in practice and may never be observed in the future.

The striking characteristic of the Wilson years of budgetary woes is that the handling of each budget cycle amounted to a muddling through. Often, there was over-optimism that the next year would surely bring relief. In a limited sense, this “strategy” was ultimately a political success since the governor was re-elected in 1994, despite hard times.

Pete Wilson’s successor, Governor Gray Davis, also tended to treat each budget year as a short-term issue – both on the upside and on the down – and to hope that whatever problems remained would somehow be resolved the following year. He was less successful than Wilson in political terms; re-elected in the Hard Times of 1992 but recalled in 2003. Most recently, it appears that Governor Schwarzenegger, the beneficiary of that recall, decided – at least after his initiatives failed in November 2005 – that short-term muddling through is the only viable approach. That would explain his election year budget with its projected operating deficit of almost \$7 billion.

There may be a simple political logic to the complete lack of interest in preparing a Plan B budget in case unforeseen negative economic performance reduces revenues (and/or increases expenditures). Such a Plan B budget would entail contemplation of politically-costly painful cuts in spending or painful tax increases. As Figure 9 shows, the payoff for NOT having a Plan B budget may be higher for governors and legislators than having one.

If fate decrees that there is no need to invoke Plan B, i.e., economic projections turn out to be consistent with Plan A after all, elected officials would have experienced pain and offended constituents for no apparent reason. By enacting a Plan B, they would have revealed to constituents whose pet programs would be cut should revenues prove inadequate. Those who would be adversely affected by the hypothetical cuts would surely be offended that their programs were evidently the lowest priority.

Had the governor and legislature just produced Plan A, and Plan A turned out to be realistic, complaints about the budget would be minimized compared to a Plan A+B strategy. A prediction was made which proved accurate and the budget consistent with that prediction operated as planned. Clearly, if Plan B proves unnecessary, the payoff might well be higher to not having a Plan B than being fiscally prudent by having one.

But what if Plan B turned out to be needed? Wouldn’t the gains from having a Plan B exceed the losses in that case? Not necessarily. If it can be plausibly argued that the Plan A budget was realistic, given the economic projections *at the time* of experts, how can elected officials be faulted for not having bothered with a Plan B? “Who could have known?” becomes a plausible defense. We just followed expert advice.

Indeed, in a situation where Plan B was validated (and Plan A was not), elected officials might be faulted for having concocted the optimistic Plan A, if they had

prepared both A and B. They could be charged with dazzling the public with over-optimistic Plan A projections and promises when they must have known that A could not be implemented. In short, the upper quadrants of Figure 9's payoff matrix may be more positive than the lower quadrants. Not having a Plan B may be politically better than having one even when you need it (or when you don't)!

Absent a Plan B budget, the only possible fiscal backup is a reserve – a “rainy day fund” – built up in Good Times. But the lesson of the Davis years is that reserves can disappear very quickly unless expenditures are quickly cut or revenue is increased. Reserves provide only a modest cushion in practice. The enacted 2006-07 general fund budget had the reserve dropping to \$2.6 billion by June 2007 – all of it really borrowed money under Props 57 and 58 of 2004 – in the context of a \$100 billion budget. That is not much of a cushion; it is much less than Davis had when his revenues headed south. Moreover, the various deals cut by Governor Schwarzenegger to muddle through his initial budget crisis now provide less latitude for future governors and legislatures. It will be difficult in coming years to grab at such palliatives as squeezing money from local governments.

Lessons for Contemporary Budget Policy

“Those who cannot remember the past are condemned to repeat it.”

George Santayana¹¹⁵

“Let's not make the same mistake as we did just a few years ago where we took that (windfall) money and used it for ongoing programs.”

Governor Arnold Schwarzenegger¹¹⁶

The most important lesson of the extended budget crisis under Pete Wilson in the early 1990s is that the budget crisis of the early 2000s was not a unique event. Yes, there was the unusual dot.com bust and the 2003 recall of Governor Gray Davis in the later episode, certainly dramatic events. But California has had budget crises extending over several years in the early 1980s, 1990s, and 2000s. Undoubtedly, to many of the participants, each of these crises may have seemed to be once-in-a-lifetime events. Certainly, the end of the Cold War – with its repercussions on California aerospace in the early 1990s – was unusual.

Unfortunately, the lesson should be that there is no evidence that recessions have been eliminated from the California or U.S. economies, that revenues will not fall in recessions, or that state fiscal distress can no longer persist for multi-year periods. Unusual events, history tells us, are not so usual. It is sad, however, that even when Californians do remember the past, they nonetheless seem condemned – and perhaps content – to repeat it.

Table 1: Revisions in the General Fund 2005-06 Budget (\$ billions)

| | Estimates as of: | | | | Change: |
|---------------------------|------------------|--------------|-------------|--------------|-------------------|
| | July 2005 | Jan. 2006 | May 2006 | June 2006 | Jan.-June 2006 |
| <hr/> | | | | | |
| Official Budget: | | | | | |
| Revenues & Transfers | \$84.5 | \$87.7 | \$92.5 | \$92.7 | +\$5.1 |
| Expenditures | 90.0 | 90.3 | 92.6 | 92.7 | +2.4 |
| Surplus/ Deficit | -5.6 | -2.6 | -0.1 | 0.0 | +2.6 |
| Reserve at End of Year | 1.9 | 7.0* | 9.4 | 9.5 | +2.5 |
| <hr/> | | | | | |
| Cash Basis: | | | | | |
| Receipts | \$84.4 | - | - | \$93.3 | - |
| Disbursements | 92.2 | - | - | 91.5 | - |
| Surplus/ Deficit | -7.9 | - | - | +1.8 | - |
| Reserve at End of Year | 7.1 | - | - | 10.5 | - |
| <hr/> | | | | | |

Source: Department of Finance; Legislative Analyst; State Controller

*The increase in estimated reserves from July 2005 to January 2006 apparently reflects revisions related to prior budget years. A full reconciliation is not readily available from official documents.

Note: Details may not sum to total due to rounding. Flows in cash statement exclude non-revenues.

Table 2: Forecasts for Annual Percent Change in California Nonfarm Payroll Employment by Department of Finance (DOF) and UCLA Business Forecast

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|--------|------|------|------|------|------|------|------|
| DOF | +3.1 | +3.4 | | | | | |
| UCLA | +1.9 | +1.3 | | | | | |
| DOF | | +1.7 | +3.7 | | | | |
| UCLA | | -.6 | +3.4 | | | | |
| DOF | | | +.6 | +2.7 | | | |
| UCLA | | | -1.3 | +1.7 | | | |
| DOF | | | | -1.0 | +1.2 | | |
| UCLA | | | | -1.1 | +1.5 | | |
| DOF | | | | | -.6 | +.7 | |
| UCLA | | | | | -.2 | +1.3 | |
| DOF | | | | | | +1.8 | +2.5 |
| UCLA | | | | | | +3.6 | +1.7 |
| Actual | +2.1 | -1.1 | -1.7 | -.9 | + .9 | +2.2 | +2.6 |

Note: DOF forecasts appear in January/February issue of California Economic Indicators of first year shown. UCLA forecasts appear in the December forecast publication of prior year.

Table 3A: General Fund Budget Plans and Later Results
\$ millions

| | Result as Seen After Close of Fiscal Year | Plan Adopted | Result as Seen After Close of Fiscal Year |
|------------------------|--|-----------------|--|
| | 1990-91 | 1991-92 | 1991-92 |
| Revenue & Transfers | \$39,160 | \$46,290 | \$42,064 |
| Expenditures | \$40,519 | \$43,368 | \$43,019 |
| Surplus/ Deficit | -\$1,359 | +\$2,922 | -\$955 |

Table 3B: General Fund Budget Plans and Later Results
\$ millions

| | Result as Seen After Close of Fiscal Year | Plan Adopted | Result as Seen After Close of Fiscal Year |
|------------------------|--|-----------------|--|
| | 1991-92 | 1992-93 | 1992-93 |
| Revenue & Transfers | \$42,064 | \$43,421 | \$41,041 |
| Expenditures | \$43,019 | \$40,792 | \$41,107 |
| Surplus/ Deficit | -\$955 | +\$2,629 | -\$66 |

Table 3C: General Fund Budget Plans and Later Results
\$ millions

| | Result as Seen After Close of Fiscal Year | Plan Adopted | Result as Seen After Close of Fiscal Year |
|------------------------|--|-----------------|--|
| | 1992-93 | 1993-94 | 1993-94 |
| Revenue & Transfers | \$41,041 | \$40,623 | \$39,743 |
| Expenditures | \$41,107 | \$38,520 | \$39,347 |
| Surplus/ Deficit | -\$66 | +\$2,103 | +\$396 |

Table 3D: General Fund Budget Plans and Later Results
\$ millions

| | Result as Seen After Close of Fiscal Year | Plan Adopted | Result as Seen After Close of Fiscal Year |
|------------------------|--|-----------------|--|
| | 1993-94 | 1993-94 | 1993-94 |
| Revenue & Transfers | \$39,743 | \$42,418 | \$42,553 |
| Expenditures | \$39,347 | \$41,778 | \$41,732 |
| Surplus/ Deficit | +\$396 | +\$640 | +\$821 |

Table 3E: General Fund Budget Plans and Later Results
\$ millions

| | Result as Seen After Close of Fiscal Year | Plan Adopted | Result as Seen After Close of Fiscal Year |
|------------------------|--|-----------------|--|
| | 1994-95 | 1995-96 | 1995-96 |
| ----- | | | |
| Revenue & Transfers | \$42,553 | \$44,057 | \$46,137 |
| Expenditures | \$41,732 | \$43,421 | \$45,441 |
| Surplus/ Deficit | +\$821 | +\$636 | +\$696 |
| ----- | | | |

Source of Tables 3A-E: California Legislative Analyst's Office. Data drawn primarily from "State Spending Plan" publication where available or similar publications available on the web at www.lao.ca.gov.

Figure 1

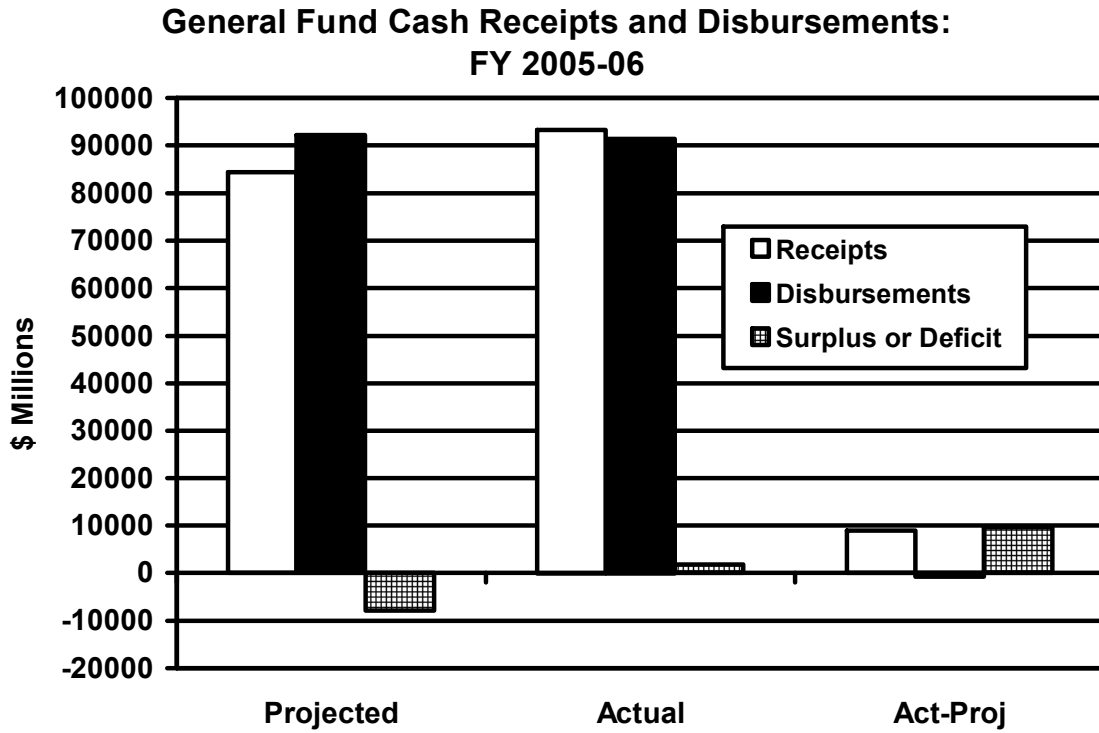


Figure 2

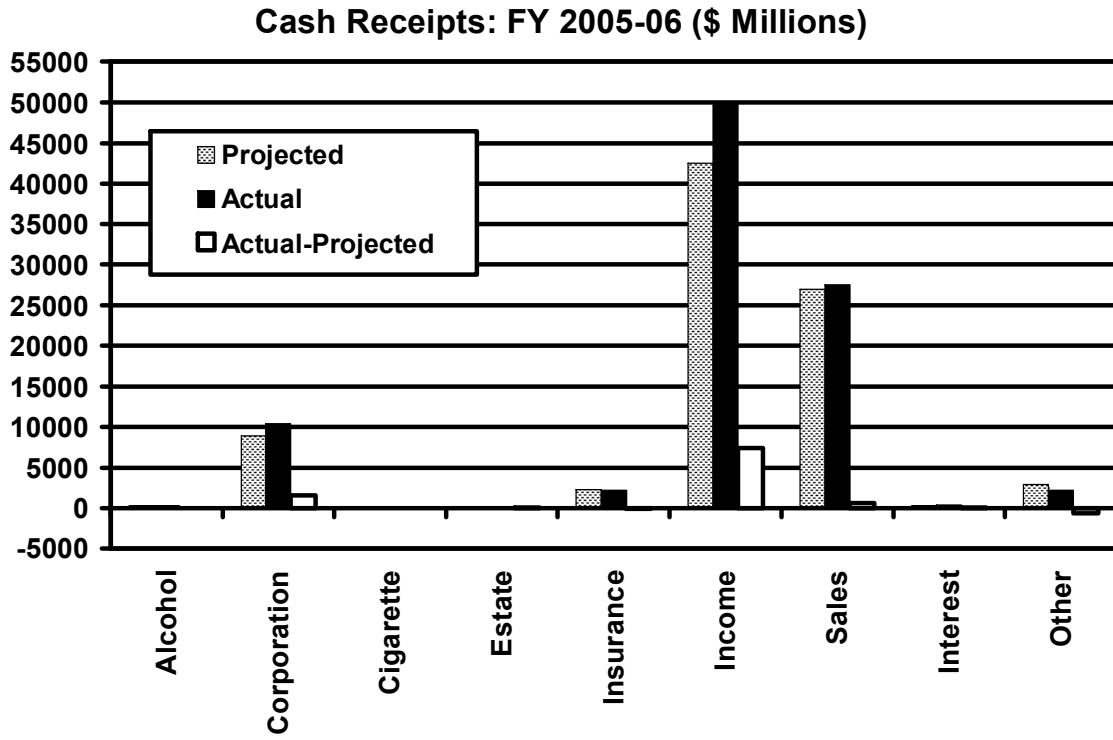
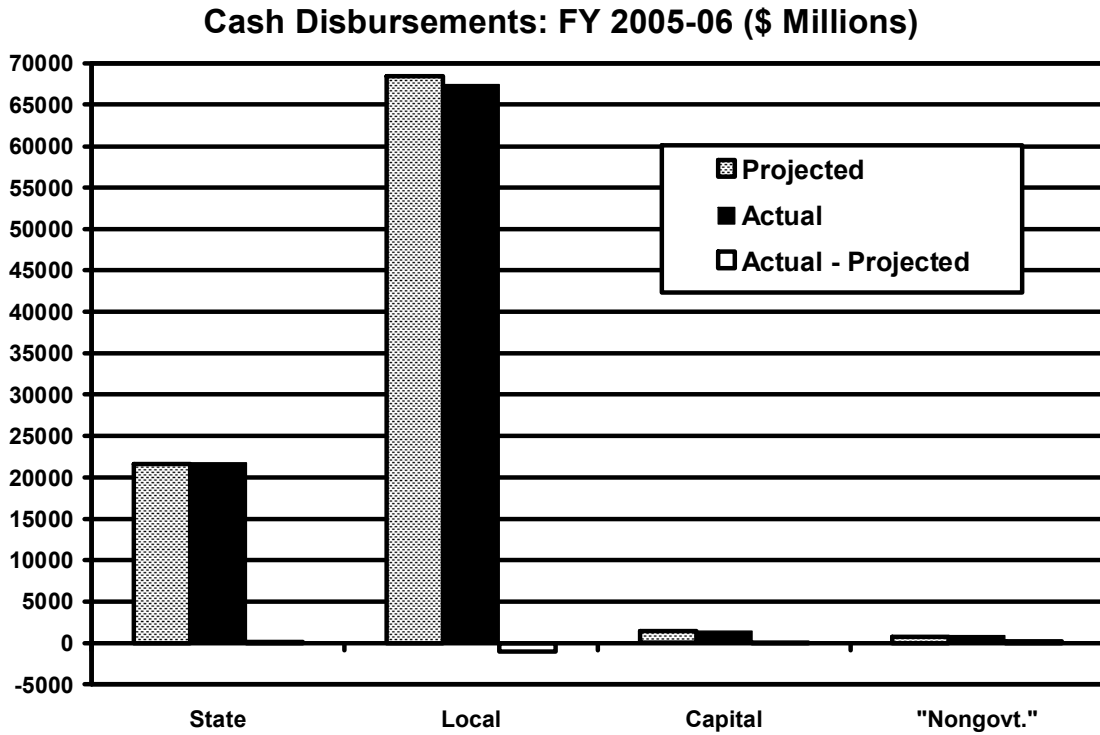
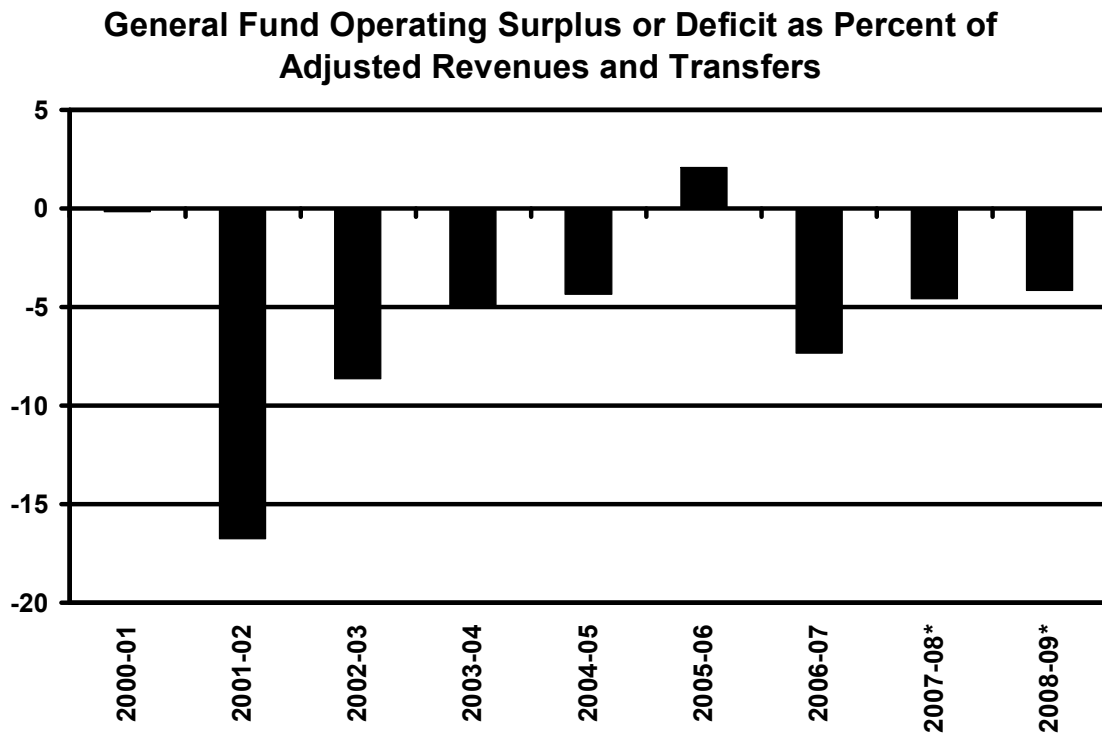


Figure 3



Note: "Nongovernment" refers to transfers to various funds outside the General Fund and advances to counties for welfare spending.

Figure 4



*Legislative Analyst projection as of July 2006. Midpoint of projection with assumed 10% per annum revenue growth.

Figure 5

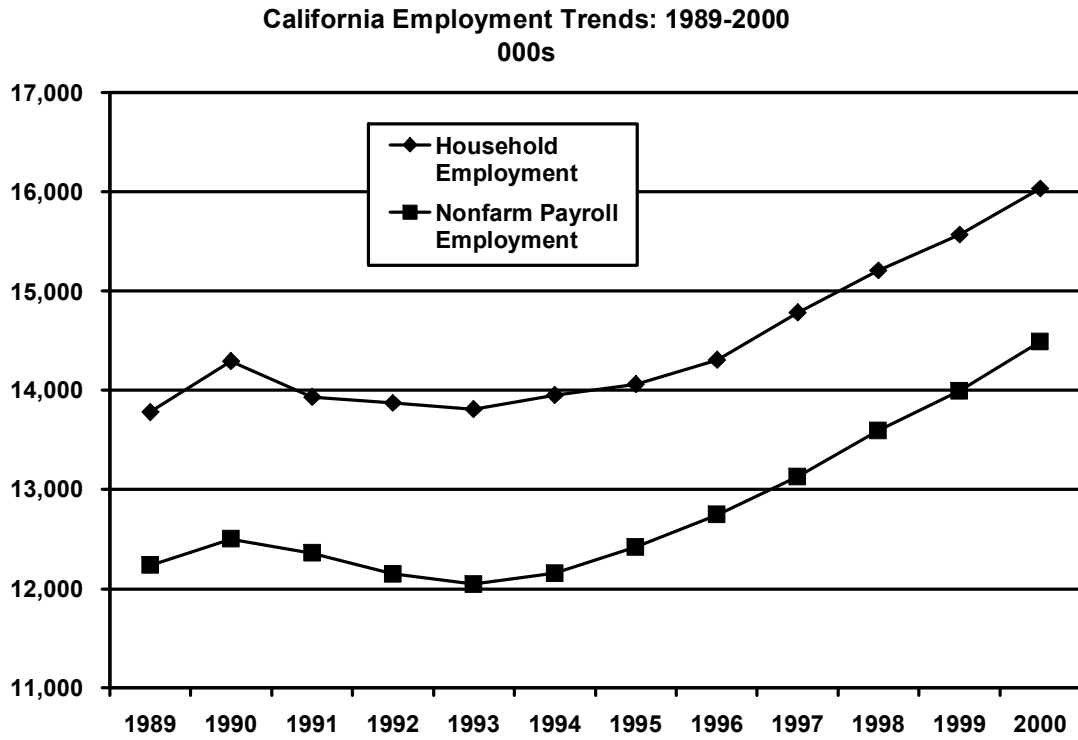
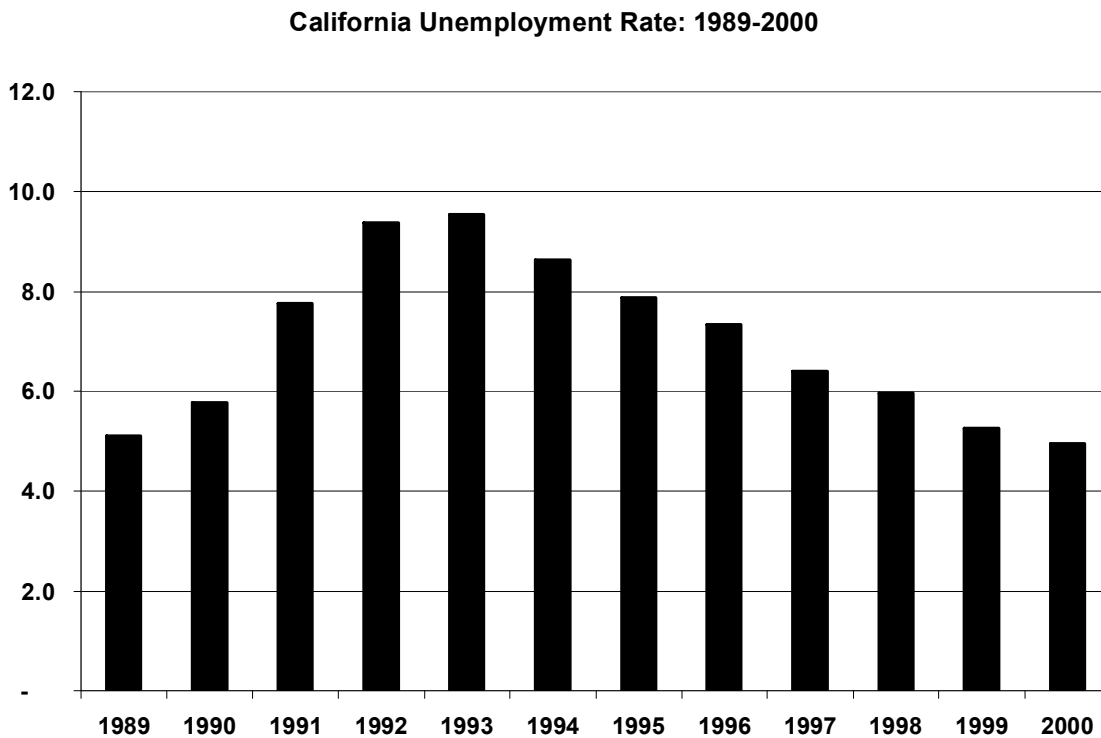
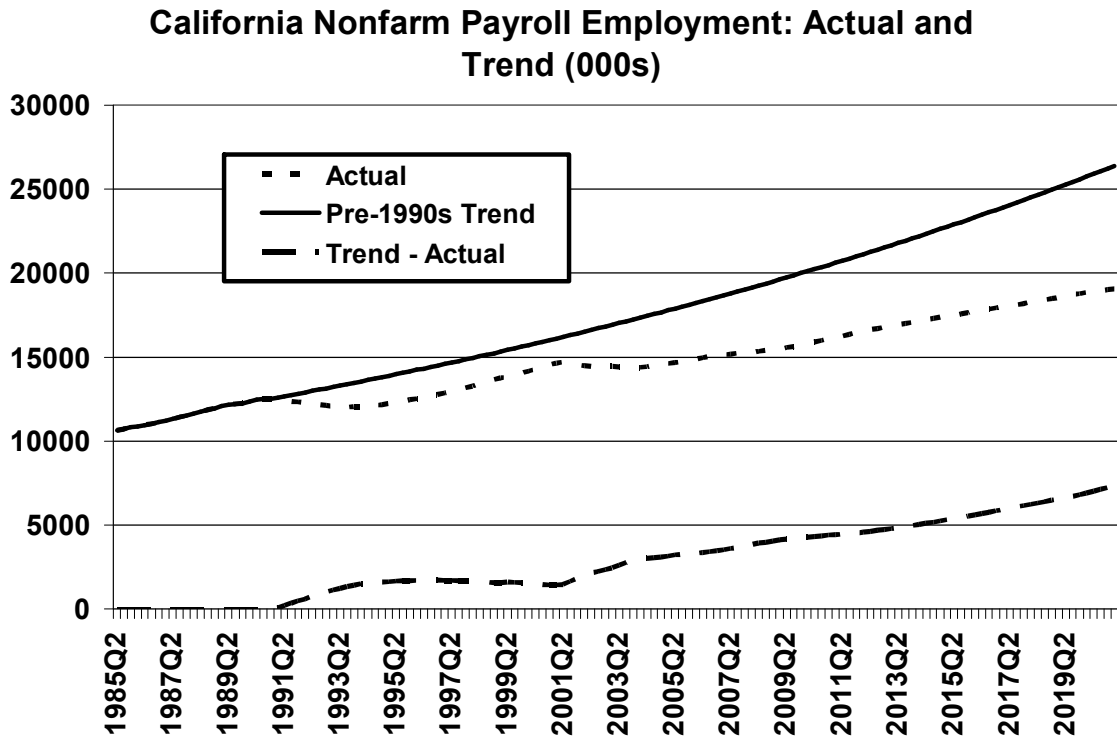


Figure 6



Source: U.S. Bureau of Labor Statistics. Data in percentage point.

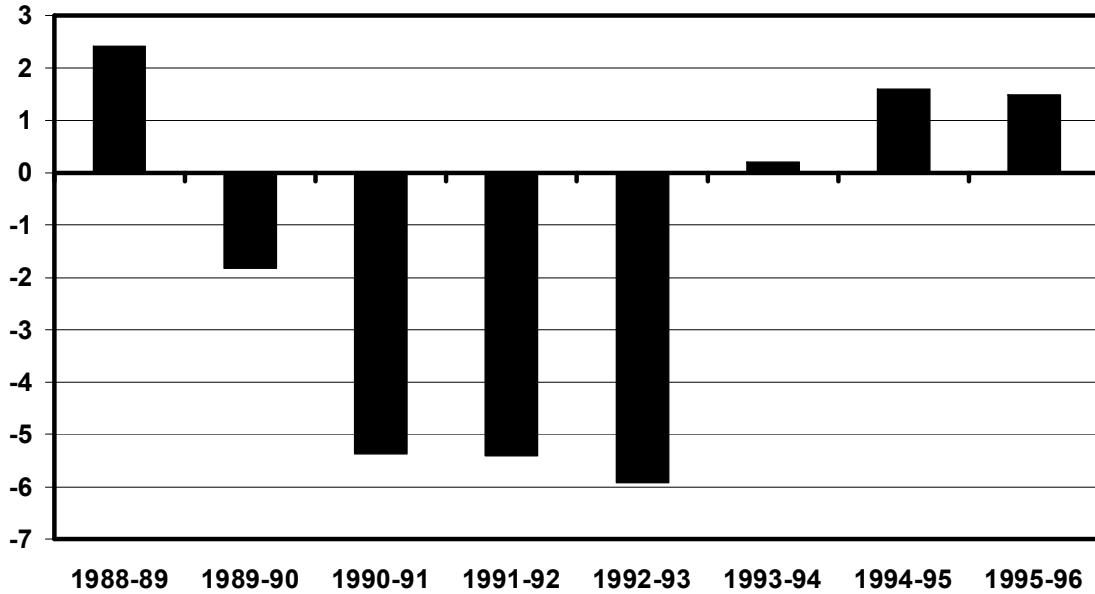
Figure 7



Source: Estimate of UCLA Anderson Forecast as of June 2006.

Figure 8

Adjusted General Fund Surplus or Deficit as Percent of Adjusted Revenues



Note: Revenues refer to “revenues and transfers” through 1990-91 and to “resources available” thereafter.

Source: California Department of Finance,
<http://www.dof.ca.gov/Budget/BudgetCharts/chart-a.pdf>

Figure 9: Payoff Matrix for Alternative Budget Planning Strategies

| | | | |
|-----------|-------------------|---|---|
| | | Outcome: | |
| | | Plan B Not Needed | Plan B Needed |
| Strategy: | Plan A only | <i>Success!</i> | <i>Who could have known?</i> |
| | Plan A and Plan B | <i>Why did you put us through the pain of designing an unneeded Plan B? Now we know who you would cut in a crunch.</i> | <i>You knew all the time that Plan A was unrealistic and were fooling us by proposing it.</i> |

Endnotes:

¹ John Bartlett, ed., *Familiar Quotations*, eleventh edition (Boston: Little, Brown and Company, 1937), p. 1062. The quote is often translated as “The only thing we learn from history is that we don’t learn anything from history,” or variants thereof.

² James E. Hartley, Steven M. Sheffrin, and J. David Vasche, “Reform During Crisis: The Transformation of California’s Tax System during the Great Depression,” *Journal of Economic History*, vol. 56 (September 1996), pp. 657-678.

³ January 5, 2006, “State of the State” address. At this writing, the official gubernatorial website was being modified. The speech should be available through www.gov.ca.gov, although the exact URL may be changed.

⁴ Also on the ballot were parental notification for teen abortions (Prop 73), two dueling drug cost initiatives (Props 78 and 79), and Electricity regulation (Prop. 80). The governor belatedly endorsed Prop 73, apparently in the hopes that conservative Christian voters would be drawn to the polls and would then vote for his other initiatives.

⁵ Andy Furillo, “For the Ballot, Money Matters,” *Sacramento Bee*, February 4, 2006.

⁶ January 5, 2006, “State of the State” address, www.gov.ca.gov. See note above on the precise URL.

⁷ “California Five-Year Infrastructure Plan 2006,” on the Web at http://www.dof.ca.gov/HTML/CAPOUTLY/Infrastructure_Rept_06_w3.pdf. See also “Strategic Growth Plan Briefing Packet” at http://www.governor.ca.gov/govsite/pdf/press_release_2006/SGP_Overview.pdf.

⁸ A proposal for a high-speed rail system has been regularly bumped by the legislature from year to year. It was moved to the November 2008 ballot in May 2006. Originally, the proposal was to appear in November 2004.

⁹ The other items included restrictions on sexual offenders/“Jessica’s Law” (Prop 83), parental notification for teen abortions/modified version of failed Prop 73 of November 2005 (Prop 85), a \$2.60 cigarette tax hike for health care (Prop 86), an oil tax for alternative fuels and research (Prop 87), a \$50/property parcel tax (which circumvents Prop 13’s cap on property taxes) for K-12 education (Prop 88), public financing of election campaigns via a hike in the corporation tax (Prop 89), and restrictions on eminent domain (Prop 90).

¹⁰ Reiner became a center of controversy because of ads sponsored by the California First 5 Commission (California Children and Families Commission) that appeared aimed at supporting Prop 82. The Commission was formed as a result of Prop 10 of 1998 – an initiative sponsored by Reiner – to support various programs for preschool children with a tobacco tax. Ultimately, Reiner stepped down from the Commission.

¹¹ Andy Furillo, “Governor Guarantees Bond Victory,” *Sacramento Bee*, March 16, 2006.

¹² Andy Furillo, “What About the Housing Bond?,” *Sacramento Bee*, June 19, 2006.

¹³ Initial tabulations by the Secretary of State reported the “yes” votes for Props 1A through 1E as, respectively, 76.6%, 61.3%, 57.5%, 56.6%, and 64.0%. Prop 84, in contrast, passed but with 53.8%, a smaller margin of victory than any of 1A through 1E.

¹⁴ Governor’s budget message, January 10, 2006, <http://www.ebudget.ca.gov/BudgetSummary/GOV/1249556.html>.

¹⁵ “Speaker’s Statement on the Governor’s May Revise Budget,” press release PR06 098, May 12, 2006.

¹⁶ California’s fiscal years begin on July 1.

¹⁷ Taxpayers who were in litigation with the state over liabilities were advised to pay the disputed amounts by their legal counsels even if the probability was they would eventually be determined not to be liable (and would receive a rebate).

¹⁸ Quoted in Kevin Yamamura, “Governor: No Tax Increase in Second Term,” *Sacramento Bee*, July 6, 2006.

¹⁹ Quoted in Daniel Weintraub, “Governor’s Budget Would Make a Tax Hike Likely,” *Sacramento Bee*, January 12, 2006.

²⁰ Quoted in Dan Walters, “Even in Flush Times, Politicians Just Can’t Resist Overspending,” *Sacramento Bee*, February 24, 2006.

²¹ A special session of the legislature was called to deal with prison issues over summer 2006.

²² The newspaper cited was the *Marin Independent Journal*. The precise reference to the quote was not given.

²³ “Wilson’s Biggest Challenge Looms in State Budget,” *Sacramento Bee*, November 11, 1990.

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- ²⁴ “California Will Dodge Slump, Kiplinger Says,” *Sacramento Bee*, November 15, 1990.
- ²⁵ CalPERS is a “defined-benefit” pension plan so that pensions are based on length of service, age, and earnings history. When the “history” is condensed to the final year, the system invites pension “spiking,” i.e., arrangements under which the final year salary is artificially boosted. Using a longer history makes it more difficult for such spiking to occur.
- ²⁶ UCLA Business Forecasting Project, *The UCLA Business Forecast for California*, December 1990, p. 3.
- ²⁷ “Pete’s Chance to Be a Hero,” *Sacramento Bee*, January 5, 1991.
- ²⁸ “Wilson’s Tight Budget – \$55.7 Billion ‘Austerity’ Plan Has Taxes, Cuts,” *Sacramento Bee*, January 11, 1991.
- ²⁹ “Wilson Defends Cut in Welfare,” *Sacramento Bee*, January 12, 1991.
- ³⁰ As noted earlier, Wilson did not make an ironclad pledge not to raise taxes when campaigning but he was perceived as anti-tax as a result of his voting in the U.S. Senate against the federal tax increase implemented by President George H.W. Bush.
- ³¹ “Coalition, Teachers Clash Over School Funding Guarantee,” *Sacramento Bee*, March 14, 1991.
- ³² Split roll proposals involve retaining Prop 13’s protections for residential property but allowing reassessment of commercial property to market levels.
- ³³ “\$10 Billion in New Taxes Considered,” *Sacramento Bee*, March 16, 1991.
- ³⁴ “State May Have Trouble Meeting June Payroll,” *Sacramento Bee*, April 5, 1991.
- ³⁵ “Needed by Governor: A New Miracle,” *Sacramento Bee*, March 30, 1991.
- ³⁶ “Big Deficit Linked to Recession,” *Sacramento Bee*, April 2, 1991.
- ³⁷ “Governor Puts Off Lawmakers, Postpones State Budget Summit,” *Sacramento Bee*, April 19, 1991.
- ³⁸ The CalPERS underfunding was to be accomplished by an accounting trick of raising the expected rate of return on investments, thus seemingly obviating the need for funding.
- ³⁹ Lewis Uhler, a former appointing of the Reagan gubernatorial administration, apparently was a leader of this group. Uhler was involved in crafting Reagan’s ill-fated effort at ballot-box budgeting and in 2005 was involved in one of Governor Schwarzenegger’s ill-fated initiatives. “Voodoo Redux,” *Sacramento Bee*, May 1, 1991.
- ⁴⁰ “Conservative Rip Wilson for Urging Tax Hikes,” *Sacramento Bee*, May 5, 1991.
- ⁴¹ “Wilson Puts Budget Heat on Assembly,” *Sacramento Bee*, June 13, 1991.
- ⁴² “Wilson Emerges with a Few Scars,” *Sacramento Bee*, July 18, 1991.
- ⁴³ Wilson jokingly reported a fictional conversation with Deukmejian:
Wilson: “Duke, is there perhaps something you forgot to tell me?”
Deukmejian: “I didn’t forget. Actually, I never liked you, Wilson.”
- “Wilson Speaking Louder About Mess Left By Duke,” *Sacramento Bee*, May 4, 1991.
- ⁴⁴ “Wilson Invokes Reagan Tax Hike Precedent,” *Sacramento Bee*, May 8, 1991.
- ⁴⁵ “Californians Favor Raising Income Tax,” *Sacramento Bee*, June 11, 1991.
- ⁴⁶ Technically, Wilson promised to give back 5% of his pay to the state. He also insisted that top administrators should do the same. “Wilson Asks Managers to Take 5% Cuts,” *Sacramento Bee*, June 29, 1991.
- ⁴⁷ Wilson would have been forced to veto the spending plan – thus complicating the entire budget negotiation – to keep his word. Assembly Speaker Willie Brown, however, worked out an arrangement whereby he took the bill back from the governor to delay the deadline for a veto. “Wilson Battling a Wimp Factor,” *Sacramento Bee*, July 5, 1991.
- ⁴⁸ “GOP Fires Back as Demos Launch Guerrilla Campaign,” *Sacramento Bee*, September 14, 1991.
- ⁴⁹ Dan Walters, “Balanced State Budget a Myth,” *Sacramento Bee*, December 24, 1991.
- ⁵⁰ “Wilson Facing Discord in GOP Ranks,” *Sacramento Bee*, September 13, 1991.
- ⁵¹ The prison guards’ union – which had supported Wilson – did agree to the cut.
- ⁵² The actual title as it appeared on the ballot was the “Government Accountability and Taxpayer Protection Act of 1992.”
- ⁵³ The U.S. Supreme Court upheld Prop 140 in 1992 and, after another challenge, in 1998.
- ⁵⁴ Thorne Gray, “Budget Plan Unrealistic, Analyst Says,” *Sacramento Bee*, February 27, 1992.
- ⁵⁵ Thorne Gray, “Assembly Budget Ace Throws Up His Hands,” *Sacramento Bee*, March 3, 1992.
- ⁵⁶ Stephen Green, “Additional Cuts Due in Workers’ Benefits,” *Sacramento Bee*, February 29, 1992.
- ⁵⁷ Mary Lynne Vellinga, “Balancing Budget With Pension Funds OK’D,” *Sacramento Bee*, March 14, 1992.

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- ⁵⁸ \$750 Million Loan Sought to Keep State Afloat,” *Sacramento Bee*, May 13, 1992.
- ⁵⁹ Thorne Gray and Jon Matthews, “Wilson Threatens to Block Proposed Budget,” *Sacramento Bee*, April 9, 1992.
- ⁶⁰ Ueberroth was well known in California for producing the 1984 Olympics in Los Angeles on a self-supporting basis.
- ⁶¹ Thorne Gray, “State Fiscal Crisis: Bad to Worse,” *Sacramento Bee*, May 21, 1992.
- ⁶² Dan Walters, “Economy Still in Free Fall,” *Sacramento Bee*, July 8, 1992.
- ⁶³ Dan Walters, “Fiscal Rollover in the Offing?,” *Sacramento Bee*, May 29, 1992.
- ⁶⁴ The challenge in *Nordlinger vs. Hahn* was based on the difference in taxes paid on identical properties bought in different years. Under Prop 13, the property tax base is the purchase price of the house, not its current value. The Supreme Court rejected the challenge 8-1 on June 18, 1992.
- ⁶⁵ Registered warrants pay interest. Thus, banks were not entirely acting altruistically by cashing them at face value. Indeed, the City of Sacramento – where many state employees and suppliers reside – accepted them as investments and deposited equivalent amounts in the bank accounts of local residents who wanted to cash them. The ability to cash the warrants, of course, took some of the pressure off the governor and legislature to end the budget impasse. Mary Lynne Vellinga, “City to Start Cashing State IOUs on Monday,” *Sacramento Bee*, August 7, 1992. Private holders of the warrants also benefited from rulings that the interest on them was tax free. Mark Glover, “Interest from IOUs Gets Tax-Free Status,” *Sacramento Bee*, July 25, 1992. However, Bank of America and some other institutions stopped accepting warrants in early August. Thorne Gray, “B of A to Stop Honoring IOUs Today,” *Sacramento Bee*, August 4, 1992.
- ⁶⁶ James Richardson, “Brown to Wilson: Hey, I’m Not an Enemy,” *Sacramento Bee*, September 11, 1992.
- ⁶⁷ James Richardson, “Brown to Wilson: Hey, I’m Not an Enemy,” *Sacramento Bee*, September 11, 1992.
- ⁶⁸ Maddy was generally viewed as a “moderate” allied with Wilson. He lost his leadership post in 1995 due to conservative opposition within his party. (Wilson and Maddy had been rivals in a 1978 bid for the GOP gubernatorial nomination – which both lost to Attorney General Evelle Younger.) Roberti was a liberal later targeted with an unsuccessful recall in early 1994 by gun owners. He failed to be elected state treasurer later that year.
- ⁶⁹ William Endicott, “Taking Stock of Wilson, Brown,” *Sacramento Bee*, August 29, 1992.
- ⁷⁰ Thorne Gray and James Richardson, “Finally, A Budget,” *Sacramento Bee*, September 2, 1992.
- ⁷¹ Amy Chance, “Wilson Bets Political Future on Prop. 165,” *Sacramento Bee*, October 4, 1992.
- ⁷² Dan Walters, “Wilson, GOP Take Huge Hit,” *Sacramento Bee*, November 5, 1992.
- ⁷³ Amy Chance, “Prop. 165 Foes Blast Wilson ‘Power Grab,’” *Sacramento Bee*, September 16, 1992.
- ⁷⁴ Amy Chance, “Error Makes Prop. 165 ‘Constitutionally Flawed,’ Foe Says,” *Sacramento Bee*, September 29, 1992.
- ⁷⁵ Amy Chance, “Hard Times Hurting Chances for Wilson Welfare Initiative,” *Sacramento Bee*, October 31, 1992.
- ⁷⁶ Proposition 164 was never enforced since a U.S. Supreme Court decision involving another state made it clear that the terms of federal office holders were specified in the federal constitution.
- ⁷⁷ Amy Chance, “Hard Times Hurting Chances for Wilson Welfare Initiative,” *Sacramento Bee*, October 31, 1992; Jon Matthews, “Wilson Unveils Ad Bashing Politicians,” *Sacramento Bee*, October 23, 1992. The ad focused on the pay cutoff to the governor and the legislature when budgets were not enacted on time. “Send them a message and hit ‘em where it hurts.”
- ⁷⁸ The annual revenue loss was estimated at \$330 million. Rick Kushman, “95 in Auditor’s Office Face Layoff in Wake of Vote,” *Sacramento Bee*, November 5, 1992.
- ⁷⁹ Herbert A. Sample, “Let Sales-Tax Hike Die, Wilson Says,” *Sacramento Bee*, November 13, 1992.
- ⁸⁰ Denny Walsh, “State IOU Paychecks Broke Law, Judge Says,” *Sacramento Bee*, December 3, 1992.
- ⁸¹ Amy Chance, “Wilson Urges Business Tax Breaks to Spur Economy,” *Sacramento Bee*, January 7, 1993.
- ⁸² Dan Bernstein and William Endicott, “Brown, Wilson Clash on Extending Sales Tax Hike,” *Sacramento Bee*, January 13, 1993.
- ⁸³ Dan Bernstein, “Renters’ Credit Could Die This Year, Some Lawmakers Say,” *Sacramento Bee*, February 1, 1993.
- ⁸⁴ Lisa Lapin, “Proposed Amendment Would Add UC, CSU to Prop 98 Spending Guarantees,” *Sacramento Bee*, March 5, 1993.
- ⁸⁵ Herbert A. Sample, “Wilson Touts Police-Fire Spending Priority Plan,” *Sacramento Bee*, April 16, 1993.

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- ⁸⁶ Dan Bernstein, “2-year Budget Plan Gains GOP Supporter,” *Sacramento Bee*, March 13, 1993.
- ⁸⁷ An attempt to restore funding for the LAO through a ballot proposition failed in the November 1992 elections.
- ⁸⁸ Dan Bernstein, “Governor Sets Vote on Local Sales Tax,” *Sacramento Bee*, May 21, 1993.
- ⁸⁹ Dan Walters, “Approaching a Slippery Slope,” *Sacramento Bee*, May 6, 1993.
- ⁹⁰ Dan Bernstein, “Time Bombs Tick Away in State Budget Package,” *Sacramento Bee*, June 27, 1993.
- ⁹¹ Dan Walters, “Timely Budget a Notable Feat,” *Sacramento Bee*, July 2, 1993.
- ⁹² Dan Bernstein, “State Budget Plan Hinges on U.S. Help,” *Sacramento Bee*, January 8, 1994.
- ⁹³ Herbert A. Sample, “U.S. Aid for State – Dickey – Wilson Plan Needs Immigration Funds,” *Sacramento Bee*, January 12, 1994.
- ⁹⁴ Dan Bernstein, “Tax Breaks for Business Approved,” *Sacramento Bee*, September 11, 1993.
- ⁹⁵ Also on the November 1993 ballot was Prop 169 which would have simplified the passage of “trailer bills” (bills that follow the budget and incorporate various agreed-upon elements of the budget deal). Prop 169, which failed with only 39% support, would have allowed one unified trailer bill to be enacted.
- ⁹⁶ Dan Bernstein, “State Estimates Its Share of Quake at \$1.9 Billion,” *Sacramento Bee*, February 9, 1994.
- ⁹⁷ Dan Walters, “Wilson Pushing on Immigration,” *Sacramento Bee*, April 28, 1994.
- ⁹⁸ Dan Walters, “State Budget a Huge Mess,” *Sacramento Bee*, June 2, 1994.
- ⁹⁹ Dan Bernstein, “Wilson, Legislators Forge Budget Plan,” *Sacramento Bee*, July 2, 1994.
- ¹⁰⁰ Dan Bernstein, “Brown Claims Backing for Budget Criticism,” *Sacramento Bee*, May 24, 1994. Brown’s opponents were state senator Tom Hayden and insurance commissioner John Garamendi.
- ¹⁰¹ Ken Chavez, “Brown Counters Governor With Own Budget Plan,” *Sacramento Bee*, June 21, 1994.
- ¹⁰² Unz – a Silicon Valley entrepreneur – opposed Prop 187 in 1994, although later he was castigated by some immigrants-rights proponents for sponsoring Prop 227 in 1997 which limited bilingual education. He received 34% of the vote in the primary.
- ¹⁰³ Ken Chavez, “1-2 Punch KOs Cuts in Welfare Benefits,” *Sacramento Bee*, August 31, 1994.
- ¹⁰⁴ Dan Walters, “Speaker Saves Wilson Budget,” *Sacramento Bee*, July 3, 1994.
- ¹⁰⁵ Dan Walters, “Brown, Brown in Dissonance,” *Sacramento Bee*, July 7, 1994.
- ¹⁰⁶ Dan Bernstein, “What Wilson, Brown Avoid: State’s Shortage of Money,” *Sacramento Bee*, September 1, 1994.
- ¹⁰⁷ After Brown became mayor of San Francisco, Horcher was rewarded with a job as Director of San Francisco’s Solid Waste Management Program.
- ¹⁰⁸ John Jacobs, “Doris, We Hardly Knew Ye,” *Sacramento Bee*, December 3, 1995.
- ¹⁰⁹ In January 1996, Curt Pringle became speaker and served until November. He later was elected mayor of Anaheim.
- ¹¹⁰ Ken Chavez, “Wilson Panel’s Tax Cuts Would Phase in Slowly,” *Sacramento Bee*, December 22, 1994. A panel of special advisors had been assembled by George P. Schultz, former U.S. Secretary of State, Treasury, and Labor, in the 1970s and 1980s.
- ¹¹¹ John Jacobs, “Willie Brown’s Tough Budget Talk,” *Sacramento Bee*, January 29, 1995.
- ¹¹² Wilson did not officially launch his campaign until late August, in part because of the need to deal with the budget stalemate that ensued over the summer.
- ¹¹³ Dan Walters, “California Gets a Digital Salute,” *Sacramento Bee*, June 21, 1995.
- ¹¹⁴ Fictional character featured in *Mad* magazine.
- ¹¹⁵ Quoted in George Seldes, ed., *The Great Thoughts* (New York: Ballantine Books, 1985), p. 367.
- ¹¹⁶ Quote in Clea Benson, “Limit New Spending, Says Governor,” *Sacramento Bee*, June 1, 2006.