

# **UCLA**

## **California Policy Options**

### **Title**

Two: Standing in Front of the California Ballot-Box Train: The Present and Past of Ballot-Box Budgeting

### **Permalink**

<https://escholarship.org/uc/item/2tt6917g>

### **Authors**

Mitchell, Daniel J.B.  
Hirsch, Werner Z.

### **Publication Date**

2006

# **STANDING IN FRONT OF THE CALIFORNIA BALLOT TRAIN: THE PRESENT AND PAST OF BALLOT-BOX BUDGETING**

**Daniel J.B. Mitchell, Ho-Su Wu Professor at the UCLA Anderson School of  
Management and Department of Public Policy, UCLA School of Public Affairs  
Werner Z. Hirsch, UCLA Professor of Economics, Emeritus**

*“They [members of the Legislature] can join and jump on the train. No. 2, they can go and stay behind and just wave... Or, No. 3, they get in front of the train. And you know what happens then.”*

*“It is my preference to go and work with the legislators. This is my No. 1 preference.”<sup>1</sup>*

Governor Arnold Schwarzenegger

*“Arnold negotiated his own contracts in Hollywood... He was shocked in Sacramento. Unlike the private sector, sometimes people sit at a table just to look like they’re trying to negotiate.”<sup>2</sup>*

Former Republican Senate Leader Jim Brulte

*“However Schwarzenegger may have first imagined it, deal making in politics isn’t like muscling and manipulating people in Hollywood. It’s far more complicated and involves many more competing interests. It may even be more honorable.”<sup>3</sup>*

*Sacramento Bee* columnist Peter Schrag

Governor Arnold Schwarzenegger arrived in office by recall, the first California governor to do so. Despite that unusual route to the governorship, he had roughly the same time as any new arrival to put together an initial budget proposal. The challenge he faced was a significantly unbalanced budget inherited from his displaced predecessor. If we look for historical parallels, the first year of Ronald Reagan’s governorship is a natural.

Republican Reagan – a former film star like Schwarzenegger – inherited a significantly unbalanced deficit budget from the Democratic incumbent he defeated in 1966, Governor Edmund “Pat” Brown. Both Schwarzenegger and Reagan discovered that compromises with the Legislature would be necessary. And frustrated by the need for compromise, both ultimately turned to ballot box initiatives to solve budget problems. In both cases, proponents of these initiatives saw California’s direct democracy system as a chance to foster a national movement aimed at restriction of governmental growth.

Reagan’s diagnosis seemed to be that whatever might be the political forces that were driving increased spending, a state constitutional amendment would reverse that

pressure. In the Schwarzenegger case, however, the diagnosis went further; a single budget amendment would not be sufficient and it would also be necessary to change – through other amendments – the underlying political system. Thus, a variety of issues including legislative redistricting and union funding of political candidates and causes became intertwined with the budget issue in the Schwarzenegger case. And all became linked closely with the Governor as a personality.

In this chapter, we first review recent budget developments in California under the Schwarzenegger administration. We then look back at the Reagan episode for insights into current events.

### **A Recap of Recent Events and Chapters**

*“It’s been – which human nature is – postpone, postpone, and hope that we get lucky. We haven’t really gotten that lucky.”<sup>4</sup>*

Former State Senate President John Burton

As we have noted in the budget chapters of earlier editions of *California Policy Options*, California budgeting has been obscured by vague definitions and overly flexible accounting methodology. In these regards California is not necessarily worse than other state and local governments. Indeed, even national governments have been known to engage in elastic budgeting.<sup>5</sup> So a single state would surely have the same temptations.

In the California case, however, the consequence of fuzzy budgeting seems to be delay in recognizing fiscal problems by key policy makers, let alone in finding solutions. Some would attribute this sluggishness to imposition of legislative term limits, which produce representatives ill-equipped to penetrate arcane budget practices. But as outlined in last year’s budget chapter, term limits are themselves a product of loss of trust by the electorate in their elected representatives, a loss that dates back to the 1970s.

In any event, as we will see in the historical material, back in the 1960s – long before term limits – the legislature and Governor seemed confused over the difference between the concepts of tax withholding and the accrual accounting of taxes. The former actually brings in revenue sooner; the latter simply puts revenue on the books sooner, but produces no acceleration in receipt of actual cash. Elastic budgeting – in short – has long contributed to California’s fiscal problems. But despite the slew of ballot proposals in 2005 – the many submitted and the few that actually made it on to the ballot – none focused on transparent accounting methodology.

Probably, the worst confusion in California budgeting is a lack of a clear line between revenue and “receipts” from borrowing. Ultimately, the outgoing Davis administration came to rely on borrowing in various forms to finance current state expenditures. But whereas the Davis administration had proposed legally-questionable borrowing – without a constitutionally-required vote of the people – for fiscal year 2003-04, the incoming Schwarzenegger administration went the constitutional route and did obtain voter approval under Propositions 57 and 58 on the June 2004 ballot.

In piecing together the deal that led to those propositions and the budget for 2004-05, the Governor also included various promises and electoral constraints concerning future budgets. Pension bonds – challenged in court and never issued – were proposed. History repeated itself in the initial proposal for the 2005-06 budget when Indian gambling bonds – to be used for transportation – were also challenged and never floated.<sup>6</sup>

Money effectively taken from local governments in 2004-05 was used to meet state commitments to K-14 education prescribed by Proposition 98. But under an agreement reached with local governments under Prop 1A (November 2004), the state would be more constrained about dipping into local revenue sources in the future. Although there was always a state-local fiscal linkage, after dramatic cuts in property taxes in 1978 under Prop 13, state and local budgets became much more heavily intertwined. Thanks to the ongoing fiscal crisis, there is now even a link to private, nonprofit service organizations. When there is state fiscal distress, these organizations receive less funding from public sources and yet have more claims placed on them to make up for public cutbacks.<sup>7</sup>

Unlike the incoming Reagan administration in 1967, the Schwarzenegger administration did not raise taxes and blame its predecessor for the hike. Indeed, Governor Schwarzenegger cut the “car tax” (Vehicle License Fee) upon taking office. Voters, however, felt free in November 2004 to add a higher bracket for high earners to the state income tax that is estimated to bring in about \$750 million a year.<sup>8</sup> But in raising taxes through the ballot box, voters also earmarked these new receipts for “mental health,” not necessarily the highest priority use for these new funds.

Voters also decided in November 2004 to add to state general obligation debt in that election by enacting a \$3 billion stem cell research bond under Prop 71. Those bonds, at this writing, are held up by litigation and have not been issued. But even without them, state general obligation debt (including the Governor’s economic recovery bonds) was about \$45 billion at the end of fiscal 2004-05. Debt service currently takes about 4% of the General Fund.<sup>9</sup> While 4% may not seem to be a large number, it represents an outlay greater than the state’s General Fund expenditure on the University of California. Moreover, that fraction will inevitably rise in the future, reducing resources available for other purposes.

The squeeze on the budget and an absence of (unearmarked) new tax revenue has tended to produce upward pressure on user fees of various types. Notable in this regard has been rising tuition at public higher educational institutions. A recent poll suggests that almost half of California parents hope their children will obtain a college degree and that over 40% hope for a graduate degree.<sup>10</sup> Undergraduate tuition at California public universities – despite recent increases – still tends to be lower than in other states. However, professional school tuition for graduate degrees such as medicine, law, and management are moving toward “market” (i.e., private) levels, given budget constraints. And in the long term there will be pressure to accelerate the upward drift of undergraduate tuition as the state remains unable to provide its past level of support. Other user fees will be under similar (upward) pressure.

California's fiscal processes seem increasingly to be marked by gaps of various sorts. There is, of course, a gap between revenue and expenditure. Revenue is held down by Prop 13. The 2/3 rule for passing a budget and/or tax increases also has prevented revenue enhancement. Expenditures are often not discretionary but are reflections of population growth and the changing demographics of the state. The result is a more fundamental gap between public hopes that budgets and other policies will be worked out on a bipartisan basis and the reality of a chronic tendency toward stalemate and late budgets.

From the public viewpoint, mixed budgetary signals abound. On the one hand, Governor Schwarzenegger – in a well publicized photo – gave Assembly Speaker Fabian Núñez a kiss on the cheek in March 2005. On the other hand, rhetoric preceding the enactment of the state budget for 2005-06 and surrounding the special election called by the Governor for November 2005 was not reflective of a cooperative spirit.

### **Personalizing the Budget**

*“If it’s just a party of one, we’re going to be no better off after he leaves than we were when he came.”<sup>11</sup>*

Republican political consultant Dave Gilliard

*“He’s still rallying his own supporters. But he’s also rallying Democrats against him. He’s a rallying figure – but not the way he intended.”<sup>12</sup>*

Pollster Mark Baldassare

*“Relying on one-liners, insults and platitudes, he has time and again fallen back on his Hollywood persona. Had he gone against type and spoken to Californians as adults, people would have listened and might have even understood what he was trying to do.”<sup>13</sup>*

*Sacramento Bee* columnist Dan Weintraub

There was bipartisan support for the placing of Props 57 and 58 on the June 2004 ballot, authorizing issuance of bonds (borrowing) to refinance and cover the state's deficit. But once the Governor decided on use of a special election in November 2005 to deal with budget and other matters, the atmosphere in Sacramento became chilly. And a variety of photo ops – designed to attract support for the Governor's ballot agenda – did not have the intended effect of attracting favorable public attention.

Thus, a scene in which the Governor cruised in his Hummer with a reform sign became a controversy over whether the car was properly licensed, the environmental effect of Hummers, etc. Other photos – the governor with a faucet spilling red ink and an armored truck with money bags falling out – generated debate over what costs there were to the state for staging the scenes. A photo op of the Governor filling a pothole generated controversy over whether the pothole had been dug for the occasion. Another photo op related to redistricting – and supposed to take place at a seemingly-arbitrary district boundary – ended up on the wrong location. Apart from the photo op problems, there

were other elements of gubernatorial PR producing unintended negative side effects and controversies. For example, allegations that TV ads supporting the Governor contained product placements surfaced (and were denied).

While such tempests might be expected, they occurred against a dramatic decline of the Governor's standing in various polls. The Field Poll reported a drop in his approval rating among registered voters from 65% before the January 2005 budget proposal to 55% after the proposal and down to 37% after the May revise proposal.<sup>14</sup> A "Thank you, Governor" rally at the Capitol reportedly fizzled. Groping litigation in Britain refused to go away. And a controversy erupted over disclosure of a lucrative deal between the Governor and the publishing arm of the "diet supplement" industry. That issue, in turn, led to scrutiny of other private income sources of the Governor. Despite the Governor's subsequent support for healthy foods, complaints over his connection with the diet supplement industry were filed with the Fair Political Practices Commission.

Apart from slippage in the Governor's personal popularity, the polls also suggested public resistance to having a special election – the cost issue was raised – and various proposed initiatives. The election cost issue (which also surfaced at the time of the recall) might be attributed to public inability to distinguish millions vs. billions of dollars. If one believes that a special election costing millions will fix a state budget problem in the billions, then the cost of the election is a bargain. However, the polls also indicated initial voter aversion to specific proposals supported by the Governor and/or his allies that were to be on the ballot.

As spring approached, only the libertarian Cato Institute seemed to be applauding the Governor's achievements – on the grounds that he did not raise taxes and was orchestrating an elaborate performance review of the state government.<sup>15</sup> But even the basis for that accolade seemed uncertain since, as noted above, the electorate went ahead and raised income taxes on higher earners without the Governor's support. Moreover, the performance review – after producing a lengthy report and hearings around the state – seemed largely to end up in a drawer.

### **Making Enemies**

*"Name-calling... helped polarize the electorate. [The Governor picked] fights with teachers, nurses, firefighters, and cops, who are more respected than Hollywood superstars."*<sup>16</sup>

*Los Angeles Times* columnist George Skelton

*"He's getting bad advice and following it. You know, taking on the nurses — talking about kicking their butt. I mean, who's ever mad at a nurse unless, you know, they've given you an enema or something?"*<sup>17</sup>

Former State Senate President John Burton

Once a decision was made to use the ballot box for budget purposes, resistance from public sector unions was inevitable. However, there seemed to be a scattershot making of enemies. The Schwarzenegger administration attempted to override state standards regarding nurse-to-patient ratios that had been enacted during the Davis administration with strong support from nurse unions. While public hospitals were affected, the main opposition to the mandated ratios came from the private health care industry.

The upshot of gubernatorial attempts to undo the ratio requirements was to make an enemy of the powerful California Nurses Association and other nursing unions. Moreover, initial court decisions went against the Governor; he had acquired an enemy without changing the ratios. At one point, a judge threatened contempt proceedings against the Governor for failing to enforce the required nurse standards, although she later withdrew the threat. Attempts by the Governor to highlight a nurse training initiative did not quell the hostility. Similarly, an effort by the administration to revise state labor standards for worker meal breaks also inflamed private sector unions. Whatever the merits of these policies, neither seemed high priority compared with other problems – especially the budget – that were facing California.

When these gubernatorial activities were combined with initiatives that focused on teachers, on public pensions, and on unions more generally, the effect was to galvanize the opposition into financing a series of anti-Schwarzenegger TV commercials. Pro-governor commercials that were run in response did not seem to offset the negatives. By spring, the issues of 1) who was setting priorities for the Governor and 2) whether the Governor was sufficiently focused were at the forefront of journalistic political commentary.

### **Priorities**

*“[The Governor’s] got 20 things which are different, and play to different values, and are not easy to explain, no matter how much money you throw at it...”<sup>18</sup>*

Cal State Sacramento Professor Barbara O’Connor

*“Team Arnold seems to be playing by Blanche Dubois rules, depending on the kindness of strangers to do their work for them... The governor should fire his political team. Thanks to their incompetence, he is being mercilessly dragged through the political muck...”<sup>19</sup>*

Tony Quinn, political consultant

The 2003 recall election revolved around two major issues: the state budget crisis and the state electricity crisis. When budgets were long delayed, state bond ratings were falling due to deficits, and the lights were going out, voters decided to pick someone new to deal with those immediate problems. But after the new Governor persuaded the electorate that borrowing was the short-term solution to the deficits, the budget problem remained in the form of periodic reminders from the Legislative Analyst. As the Analyst

repeatedly pointed out, the state still has a “structural” deficit, i.e., one that economic growth by itself would be unlikely to cure. Moreover, the state has become more prone to any future economic downturn; borrowing to cover future crises would be more difficult under the various compromises reached and initiatives enacted as part of Governor Schwarzenegger’s first round of budgeting. Yet public perception of a fiscal crisis receded since borrowing kept state services flowing and the Governor had characterized the passage of Props 57 and 58 as tossing away the credit card.

There were also warnings that electricity shortages could again develop if there were hot spells – requiring more air conditioning – and technical failures in the grid. In August 2005, such a failure occurred. Other things equal, rising economic activity helps the state budget but also puts more demand on electrical capacity. The August 2005 failure showed that the state was close enough to capacity so that a technical problem somewhere in the system could cause blackouts. Presumably, the level of power usage in summer 2006 – just prior to the November 2006 gubernatorial election – will likely be higher than in summer 2005, absent an economic downturn. One could therefore argue that given the difficulty in focusing public attention and political capital on a multitude of issues, the gubernatorial priorities should have remained centered on just two areas: budget and electricity.

Some administrative actions were taken on electricity, but there was little public focus on that issue. In calling a special election, the Governor ended up with an electricity re-regulation initiative on the ballot which he didn’t support. (He was nearly spared this problem by a court decision – quickly reversed – striking the initiative off the ballot.) Thus, once the election was finally set, he had to look forward to explaining to the public what he was against, rather than what he was for, on electricity. And ultimately he had to concede that role to utilities opposed to the initiative.

With regard to the budget itself, there appeared to be a chain of gubernatorial thought that attributed the fundamental fiscal problem to election results, i.e., to the fact that the legislature was in the hands of generally liberal Democrats. Democrats want to tax and spend, so this reasoning went, and they receive funding and support from labor unions. Minority Republicans can block taxes but not spending (which they often like), producing fiscal imbalance. Despite this tendency, however, both Democrats and Republicans in the Legislature benefit from the current system of gerrymandered safe districts. So what must be done – according to this logic – is to change the election district rules in some way to elect more Republicans or at least more centrists.

With more competitive legislative district boundaries, a weakening of union funding would help Republicans, since unions are heavily allied with Democrats. And in case all else fails, some kind of constitutional limit on state spending and deficits is needed. This chain of reason is complicated and, even if accepted, does not produce the details of what might be done about election districts, about funding controls, or about budget rules. Moreover, the median California voter may not buy the union-to-Democrat-to-budget model. He or she might instead see the fiscal problem as a mutual failing of legislators and the Governor to “get along.”



Finally, opinion polls have continually indicated high public concern about education. The Governor clearly wants to be seen as a proponent of education reform and improvement. But teacher unions are viewed by the administration as opponents because a) they defend Prop 98 (which earmarks a major portion of the General Fund to K-14) and b) they resist “pay for performance.” Teacher union defense of Prop 98 makes budgeting more difficult because it reduces flexibility and fiscal discretion. And ultimately it is better to have teachers and schools who “perform” than teachers and schools that don’t. But Prop 98 is popular. For better or worse, it was enacted by the voters because they didn’t want the Legislature and Governor to squeeze the K-14 budget. And while almost everyone will agree at some level that good performance should be rewarded, the specifics of how that concept is defined – and whose fault it is when targets are not met – do not easily follow from the broad idea of “reform.”

Because of the need to prioritize in the face of such complications, it is important that once priorities are set, the specifics are carefully delineated by the Governor and his staff. But there seemed to be a problem at that point, too. The Governor has the advantage of access to a technical bureaucracy at agencies such as the Department of Finance. And he has competent political appointees in charge of these agencies who can formulate legislative proposals and ballot initiatives. But there are dangers if initiative development is instead left up to outsiders in nominally independent fundraising committees such as the “Citizens to Save California.” The key leaders of such committees tend to have their own agendas, which do not necessarily dovetail with the Governor’s. They may also not have the technical and political expertise needed to craft ballot initiatives.

While there are constraints on political fundraising if such committees are not kept “independent” in a legal sense, ultimately there is little such committees can do absent the support of, or at least acquiescence of, the Governor. By late 2004 and early 2005, it seemed that the committees, or individuals associated with them, were doing the initiative drafting. Outsourcing this key function meant that the Governor was faced with other peoples’ agendas, which he had to endorse (or not endorse). Moreover, the committees were not necessarily politically attuned. In one instance, for example, signature counting and verification was contracted out to India, not necessarily the best thing to do in a state in which concerns about loss of high-tech jobs to India and elsewhere were simmering. (The final result of that brouhaha was that in July 2005, the Governor signed a bill banning the sending of voter data abroad.)

In the end, a paradox had emerged. The budget and other ballot issues had become highly personalized by the Governor. Yet he was not personally orchestrating what did or did not go on the ballot.

### **Blowing Up the Boxes**

*“The governor said, ‘I’m going to blow up the boxes,’ and people said, ‘Hey, wait a minute. This is my box and you don’t even know what’s in it.’”<sup>20</sup>*

Democratic State Senator Liz Figueroa

*“Organizational change is not the best way to reduce costs. Other tools are often easier and more effective at capturing savings.”<sup>21</sup>*

California Little Hoover Commission

At the time of the recall, improving state government efficiency was depicted as an important component of the Schwarzenegger campaign. An elaborate written report with a large number of suggestions – some controversial – was prepared and issued after the 2004-05 budget was enacted in early August 2005. At that point, a schedule of hearings around the state was established to provide public input. Substantial resistance developed to proposals to abolish various regulatory boards and was reflected at those public hearings.

While it appeared that the final recommendations from this process would be a centerpiece of the Governor’s 2005 agenda, the report ultimately seemed to go into hibernation after referral to the state’s Little Hoover Commission. The Commission subsequently issued a report suggesting that “blowing up the boxes” (reorganizing state agencies) was less important than managing the existing structure effectively. It also suggested that improving managerial efficiency, albeit a desirable goal, would itself not contribute much to resolving the state’s fiscal dilemma.<sup>22</sup>

There was some restructuring of the state penal system with a combining of the youth and adult authorities into a single agency. However, even there problems arose. Attempts to improve and economize on the parole system through electronic monitoring were shelved, as was a decision to reopen a private prison. (Two other private prisons were reopened to deal with a population overflow.) There was also a brief controversy over whether parole officials had been encouraged to avoid sweeps of parole violators to avoid the budgetary costs of re-imprisonment.

Although he opposed relaxing the “3 strikes” law under Prop 66 (on the November 2004 ballot), the Governor did express an interest in a greater focus on rehabilitation to avoid recidivism.<sup>23</sup> However, prison conditions and relations with the prison guards’ union remained a problem for the administration. In addition, a federal judge took control of the prison health care system because of various failings. The prison system, it might be noted, accounts for about 8% of General Fund expenditures.

Other reorganization efforts produced mixed results. A proposed cabinet-level energy agency was found to be unconstitutional by the Legislature’s legal counsel and the Attorney General on grounds that it would infringe on the authority of the Public Utilities Commission. Efforts were made to improve state purchasing and management of information technology, and to cut travel costs.<sup>24</sup> But a plan to restructure Cal/EPA was shelved. Ultimately, the idea of “blowing up the boxes” to achieve substantial state fiscal savings seemed to have dissipated by the end of fiscal 2004-05.

## Federal Money

*“The governor realized that our ‘donor state’ status was a problem during the recall campaign and he said he was going... to get our fair share... We’re still waiting.”<sup>25</sup>*

Congresswoman Zoë Lofgren

*“There is a fair-share amount that California is entitled to, but I don’t think we ought to kid anybody. Federal money is not going to balance the state budget.”<sup>26</sup>*

Former Clinton budget director Leon Panetta

California receives funding from the federal government for programs ranging from “welfare” to homeland security. During the recall, candidate Schwarzenegger promised to be a “collectinator,” i.e., to augment the flow of funds emanating from Washington to California. However, a governor has limited ability to squeeze money from the feds; the California congressional delegation has a (much) greater role in that area. And in the California case, that delegation is not always united and coordinated with the Governor.<sup>27</sup>

Federal homeland security expenditures remain an issue, since it is generally agreed that California has prime terrorist targets (such as the Los Angeles International Airport and the ports of L.A. and Long Beach). While it can be argued that the entire homeland security effort nationally is drastically underfunded, California clearly should be receiving a substantially disproportionate share of whatever resources there are. But the opposite has been occurring. On the other hand, there have been complaints that the state has not spent all of the homeland security funding that is coming to it under present allocations.<sup>28</sup>

There are ongoing complaints that California receives less in federal funding than it pays in federal taxes. That ratio by itself has little meaning for the state budget since much federal spending goes for such programs as Social Security payments, on the one hand, and purchases of supplies and services from private companies, on the other. Yet California pays for services which are arguably federal responsibilities. Examples are imprisonment of illegal aliens caught in criminal activities (only partially reimbursed by the feds), education of school children in the country illegally, and unfunded mandates. All states, including California, face the issue of rising health care costs which push up spending on Medicaid (Medi-Cal in California).

The Governor did negotiate a federal waiver on certain rules regarding Medi-Cal in order to move more towards a managed care/HMO approach. There has been controversy over this arrangement as to whether it will lock in funding and protect the state against future federal cuts or whether it will ultimately produce less revenue for the state. And there are uncertainties concerning what impact the new federal drug program will have on California state finance, a concern shared by other states. Unfortunately, because the entire national health insurance system seems in flux, it is difficult to predict

the impact of these federal policies on the state. Such health-related policies are likely to change in the future.

It might be noted that most federal funding that does come to the state government, relatively little enters the General Fund. Almost all such federal revenue received by Sacramento enters through special state accounts outside the General Fund; about three-fourths of that money is disbursed by local governments. At the state level, much of the federal funding outside the General Fund goes to higher education (chiefly the University of California), social programs, and transportation. The special federal funds come to a magnitude of about 70% of the expenditures of the General Fund, and so constitute an important component of public policy in California. Absent the federal spending, demands on the General Fund would surely be greater. Yet because the state's fiscal problem has been centered in the General Fund, federal funds elsewhere in the budget have not taken center stage in the fiscal crisis of the first half of the 2000s decade.

### **Ballot Propositions**

*"We're going right there where all the evil is, and we're going to fix this problem once and for all."*<sup>29</sup>

Governor Arnold Schwarzenegger

*"It's going to be like having the 2006 election a year early, because if we're able to push through all of this stuff – either through negotiations with the legislature or through the election outright – [the governor's] going to be golden."*<sup>30</sup>

Unnamed "Team Arnold" advisor

*"This special election is not about the Legislature. It's about the Governor wanting to star in another war movie."*<sup>31</sup>

State Senate President Don Perata

To relieve the state's fiscal malaise, the Governor – with great fanfare – personally began collecting signatures for various ballot initiatives on March 1, 2005. At that point, the official agenda was the budget, teacher tenure, and public pensions. We will discuss these initiatives below. But as the process began, the question of why these matters could not wait for a regularly scheduled election in 2006 surfaced – well before the Governor officially called the special election. There were complaints – noted earlier – that a special election in November 2005 would cost \$50-\$70 million dollars.

The new Republican Secretary of State Bruce McPherson at one point put the cost as high as \$80 million.<sup>32</sup> At the time of the special election proclamation, however, the Governor attributed an estimate to the Secretary of State of \$44.7 million. These costs would be borne by county election agencies. Relative to the state budget, such costs are small. But they matter to local officials. Indeed, one Yolo County election officer was said in mid-April to be considering civil disobedience in not running such an election (not a serious threat).

Fundraising appears to have been an element in the decision to call a special election rather than wait. Litigation established that contribution limits wouldn't apply to "independent" committees not officially controlled by the Governor.<sup>33</sup> (Otherwise a cap of \$22,300 for donations – the ceiling applied to a gubernatorial candidate – would have applied.) There was some indication that it might be more difficult to separate the Governor – and his donation cap – from the campaign for initiatives in 2006, a gubernatorial election year, than in 2005. The official calling of the special election did not occur until June. But while the decree had been expected to spark considerable positive publicity by gubernatorial aides, its announcement tended to be eclipsed by media coverage of the acquittal of singer Michael Jackson on child molestation charges.

### **Pensions: The Vanishing Initiative**

*"We cannot continue with that madness."*<sup>34</sup>

Governor Arnold Schwarzenegger

*"For firefighters and their families, death and disability benefits are not frills."*<sup>35</sup>

Firefighter widow

*"...The University [of California] cannot support the [pension initiative] in its present form... Public entities, including the University of California... need flexibility to design a pension program to meet our needs and to meet our obligations to the State."*<sup>36</sup>

UC Regents chair Gerald Parsky

Pensions – both public and private – come in two basic models: defined benefit and defined contribution. In the former, a worker's monthly retirement benefit is determined by a formula typically based on age, earnings history (usually earnings in the period leading up to retirement), and length of service with the employer. The formulas tend to favor long-service employees who retire at, or close to, the official retirement age in the plan. (The flip side is that they tend not to be attractive to younger individuals who do not expect to have long careers with the employer.) To meet the pension promises, the employer establishes a trust fund and is responsible for seeing to it that there are adequate resources in the fund to pay future benefits.

Defined benefit plans typically involve regular employer contributions to the fund and – particularly in the public sector – may also require employee contributions. No taxes are applied to the fund on earnings of its assets (usually bonds and stocks). Employer contributions are tax deductible as business expenses. Employee contributions – if required – can be arranged to be paid in pre-tax dollars.<sup>37</sup> Actual pension benefits received by retirees are subject to income taxes.

In contrast, defined contribution plans are really just tax-favored savings accounts. The employer and employee each put a designated amount into the plan each pay period.<sup>38</sup> As in the defined benefit case, the employer contributions are deductible

and employee contributions can be made in pre-tax dollars. Earnings in the plan are not taxed. The employee receives an individual account and may have various options for investing. But when he/she retires, there is no guarantee of any fixed monthly income. A retiree might buy an annuity from a private insurance company – or possibly through the employer – that would turn the lump sum in the account into a guaranteed monthly income for life. But what that income would be would depend on how much was in the account, prevailing interest rates, and actuarial tables.

Defined benefit plans put the risk of investing to provide adequate retirement income largely on the employer. Generally, private defined benefit plans – associated with large firms and particularly unionized firms – are subject to more elaborate regulation and funding requirements than public plans. Private plans are also partially backed by a federal government agency that can take over plans in danger of bankruptcy. Public defined benefit plans – since they are run by state and local governments – are not subject to as much federal regulation (other than the tax code) as private plans and have no federal insurance. Defined contribution plans (public or private), are also subject to relatively little regulation since they are largely the responsibility of the employee. Since defined contribution plans do not promise any specific benefit, they have no funding requirements and cannot go bankrupt.

At the state level, California has three large defined benefit plans for its employees: CalPERS for state civil servants and CSU, CalSTRS for teachers in various school districts, and the Regents-run UCRP for the University of California. Local governments such as cities and counties also have such plans. The state is not responsible for meeting unfunded obligations of local government plans but is responsible for the state-level plans. Local governments (and the state for its plans) ultimately have to meet their accrued pension obligations to employees and retirees.

In his first (January 2004) budget address, Governor Schwarzenegger indicated that “*State employees will continue to be secure in the knowledge that a volatile investment market will not affect retirement benefits because they will continue to be covered by a defined benefit retirement plan.*”<sup>39</sup> A year later, however, priorities seemed to have changed. At the local level, some jurisdictions, most notably the City of San Diego, had developed substantial unfunded pension liabilities. In the San Diego case, the pension crisis – which damaged the credit rating of the City – led to an upheaval in mayoral politics and ultimately resignation of the incumbent mayor. The City attorney threatened lawsuits against those running the pension, and there was general municipal turmoil. Some other California jurisdictions, including Orange County – which had an unrelated bankruptcy in the 1990s – also disclosed significant pension underfunding.

Defined benefit pensions are subject to abuses of various types if not properly managed. First, their funds can be poorly invested or their future earnings can be assumed to be unrealistically high. Such practices will lead to eventual underfunding in which assets fall well short of liabilities. Second, the plans can be gamed on the employee side if the rules for pension calculation are lax. For example, if overtime pay is included in the final earnings used to set benefits, and if the final earnings period is short

(say, only one year), the plan can be subject to “spiking.” An employee might arrange to work large amounts of overtime in his/her final year before retirement. Well-managed plans, in contrast, seek to avoid such problems through conservative investment strategies, realistic earnings projections, and benefit formulas that make spiking difficult. The UC plan, for example, has required no state contributions for many years and uses a formula designed to avoid opportunities for spiking.

At around the time of the Governor's 2005 state of the state and budget messages, Assemblyman Keith Richman (Republican - Northridge) – a candidate for state treasurer in 2006 – filed a pension initiative that would have required state and local employers to switch to defined contribution plans for new hires. It would have encouraged existing employees to shift to defined contribution. It also would have limited employer contributions to the new defined contribution accounts. Richman's objective was to limit state and local budgetary obligations to retirees over the long term. The Howard Jarvis Taxpayers Association endorsed the Richman approach. As a result, the Governor endorsed the defined contribution proposal and made it part of the agenda for his special election initiatives.

Not surprisingly, the pension initiative ran into rough weather. It sparked protests from public sector unions. But there was other dissent. Four members of the CalSTRS board who had been newly appointed protested the initiative and were removed by the Governor (who had just put them on the board). A fifth member he had appointed – who didn't dissent – did not receive legislative approval and left the board. The chair of the UC Board of Regents – who had chaired the Bush campaign in California in 2004 – pointed out that the UC defined benefit plan was overfunded and thus did not impose costs on the state. Yet, he noted, the plan being pushed by the Governor would damage faculty recruitment. Finally, a TV campaign suggested that a flaw in the initiative's language could undermine pensions received by widows and orphans of protective service workers.

After petitions for the pension initiative began to circulate with gubernatorial support, the entire effort was suddenly aborted by the Governor. There were suggestions that the issue was merely being deferred to 2006, although exactly what the Governor would endorse then was unclear. A proposal by CalPERS was adopted that involved 15-year averaging of investment returns. This change cosmetically reduced underfunding, but, in fact, did not change the actual financial position of that plan. While averaging returns over a multiyear period in such plans is common, 15 years is outside the norm. Nonetheless, there were hints from the Governor's office that this cosmetic change was acceptable.

Exactly what might be done eventually about public pensions remained unclear by the time the 2005-06 budget was adopted. From an economic perspective, what matters most is the total cost of employee compensation rather than a particular component of the pay package. From that viewpoint, the problem with underfunded pensions is that decision makers treat labor costs as lower than they really are because deferred and unfunded promises are not being explicitly recognized. The budgetary

perspective is similar. What ultimately matters from a budget perspective is the cost of government-hired labor. Whether that cost is paid out in cash wages, pension accruals, or other benefits is of lesser significance. Finally, from a personnel management perspective, what matters is that the package of wages, benefits, and conditions offered to public workers is sufficient to attract, retain, and motivate them appropriately. All of these approaches suggest that taken by itself, a dollar of pension reduction does not necessarily result in a dollar of reduced budget expenditures.

There are associated concerns about the costs of public retiree health care benefits – which unlike pensions are not prefunded – and which also remained on the table for future resolution. Meanwhile, in May 2005, the state was ordered by a court to pay CalSTRS for a contribution it had deferred two years earlier. Previous attempts by the state to avoid its current pension obligations through the flotation of pension bonds have been stymied by litigation over the constitutionality of such bonds. In short, budget-related issues swirling around deferred employee compensation are unlikely to fade away. They were not resolved in the 2005-06 budgetary round in the Legislature and were not slated to be resolved by the November 2005 special election.

### **Education: Prop 74 and Another Vanishing Initiative**

*“Breaking his word to the CTA and other school groups probably is the single most damaging error Schwarzenegger has committed as governor. It soiled his image as a straight shooter.”*<sup>40</sup>

*Los Angeles Times* columnist George Skelton

The Governor's relationship with the teachers union – especially the California Teachers Association (CTA) – became particularly contentious as a result of budgetary, pension, and educational actions. In 2002, when Arnold Schwarzenegger first made an appearance in the public policy arena, he actively supported a ballot initiative that earmarked funding for after-school activities. Since it added funds for education, the CTA endorsed the Schwarzenegger after-school initiative, which ultimately passed.<sup>41</sup>

When the Governor took office after the 2003 recall, he quickly negotiated a deal with the CTA that saved him \$2 billion in Prop 98 costs for fiscal year 2004-05. However, he also promised full funding of Prop 98 obligations in the next year. The funding he proposed in his January 2005 budget message for fiscal year 2005-06, although an increase over the prior year, did not come up to this level, however. And the proposal also called for school districts to assume pension contributions the state had been making. Moreover, the budget was unveiled at around the time the Rand Corporation published a report in which California school funding was compared unfavorably to that of other states.<sup>42</sup>

It may well have been that the incoming Governor did not understand the magnitude of his 2003 promise at the time he made it. Because of the formulas in Prop 98, that magnitude was contingent on future developments, which could not be known precisely until they occurred. However, although the Governor later denied making a



guarantee about Prop 98 funding, there appears to be little doubt that he did so; denying it seemed to exacerbate the relationship with the teachers. The result of the breached promise was a TV campaign funded by the CTA that emphasized the gap between what was promised and what was contained in the budget. (The response of the Governor and his spokespersons was that K-14 spending was up in the budget, albeit up by less than what the promise implied.)

Ironically, one of the teachers who appeared in the CTA ads had appeared in advertising endorsing the Schwarzenegger after-school initiative in 2002. And, of course, local school board members and administrators were also offended by the breached promise. The superintendent of the Campbell Unified School District (K-8) sent the Governor a “bill” for \$19 million in April 2005, saying she had lost that amount in recent years due to state budget cuts.

Politics is what economists call a “repeat game,” since the participants negotiate compromises with each other year after year. In such settings, maintaining trust and keeping one’s word is very important. Once your word is no longer trusted, you will have difficulty reaching deals that involve future actions. In this regard, politics shares a characteristic with collective bargaining – also a repeat game – the world from which CTA comes.

Did the Governor understand the significance of breaching a promise? When the Governor praised outgoing Senate leader John Burton, he did so by noting that “*he [Burton] has a reputation for keeping his word like no one else.*”<sup>43</sup> So the Governor appeared to have an understanding of the virtues of trust in political relationships. Researchers at the Claremont Graduate School recently found evidence that a nasal spray of the chemical oxytocin makes people more likely to trust one another, even when there was no reason to do so. Considerable oxytocin spraying in Sacramento seemed to be needed in the aftermath of the Prop 98 controversy.<sup>44</sup> But even had oxytocin been liberally applied, relations with the teachers were likely to be rocky in 2005 because of other gubernatorial proposals.

The eventually discarded pension initiative was one of these. But there was another – a constitutional initiative to require that teachers be paid on the basis of merit rather than seniority. Like the pension initiative, this one also eventually died, thus sparking conflict unnecessarily. The main problem was that while the idea of “pay for performance” is appealing, specifying the details of what amounts to a personnel policy in the state constitution is unwieldy at best.

Eventually, a substitute proposition was developed – Prop 74 – which lengthened the minimum time a teacher must serve before receiving “tenure” protections.<sup>45</sup> While this version seemed potentially popular in the sense that opinion polls indicated it would likely pass, it did not address the pay for performance concerns the Governor had previously put forward. Prop 74 seemed unlikely to reduce the gaps in California student test scores or to have much impact on other measures of scholastic achievement. And its connection to the state budget was tenuous at best. Prop 74, in short, seemed to be on the

ballot because the original pay-for-performance proposition wasn't. In its endorsement of Prop 74, the best the Los Angeles Times could say was that "... *it wouldn't help very much, but it would help a little.*"<sup>46</sup>

### **Redistricting and Prop 77: The Almost-Terminated Initiative**

*"It is time to make our representatives more responsive to the people who elect them."*<sup>47</sup>

Governor Arnold Schwarzenegger

California's Legislature has never been popular. However, in the era after World War II and into the 1960s, when freeways, water projects, schools, and universities were being expanded (particularly under Governors Earl Warren and Pat Brown), the public was willing to support upgrading the Legislature. Despite periodic scandals, the bottom line was that the state was delivering services the public valued. As long as that was the case, Sacramento foibles were tolerated.

As discussed in last year's budget chapter, however, that era of goodwill faded in the 1970s, leading to a taxpayer revolt centered on property taxes and Prop 13. By the 1990s, the electorate under Prop 140 approved imposing relatively restrictive term limits on the Legislature, at the same time reducing its budget and abolishing its pension plan. A proposal to relax term limits very modestly – Prop 45 – failed to pass 42% to 58% in 2002. Meanwhile, at a time when more urgent budgetary business was looming, the Legislature – by entertaining bills on, for example, regulating cloning of pet cats – did not improve its public image.

From the Governor's perspective, his inability to influence outcomes in what were seen as possibly vulnerable legislative districts in 2004 suggests that gerrymandering district lines has produced too many safe seats. His analysis – noted earlier – was that the resulting polarization between safely ensconced legislators on the left and right prevents reasonable budgetary compromises. The solution he encouraged, therefore, was to put redistricting into the hands of a panel of retired judges who presumably would designate more competitive districts that would elect middle-of-the-road representatives. Judges, he argued, would not have the conflict of interest that legislators have in drawing boundaries.

Early opinion polling suggested that the voting public might not buy this analysis – at least not without persuading. It appeared, according to newly-appointed Republican Secretary of State Bruce McPherson, that there could not be immediate redistricting due to logistical barriers.<sup>48</sup> Indeed, he indicated that the actual process might be delayed several years, making the 2000 Census data out of date and bringing the process close to the next Census in 2010. (Later, when he began to toy with the idea of running for a second term as Secretary of State, McPherson indicated that perhaps such redistricting could occur in time for the June 2006 elections.)

The safe-seat phenomenon means that voters are by in large in tune with the representative from their districts; that's what makes the seats safe! Moreover, if the Legislature sometimes seems to focus on trivia such as cloned cats, the Governor also has at times also failed to focus on pressing budgetary business. Thus, as negotiations were stalemated on the 2005-06 budget and the state was facing yet another missed July 1 deadline, the Governor issued a press release protesting a failure to award Oscars to movie stunt persons.

Outsourcing of the redistricting initiative – Prop 77 – ultimately led to a legal problem. Petition language signed by voters was not identical to the language approved by the Attorney General for circulation. As a result, the Attorney General filed suit to prevent Prop 77 from appearing on the November ballot. On July 22, a court decision ordered the Secretary of State to remove Prop 77 from the ballot. Proponents vowed to appeal and succeeded in keeping the process of placing the proposition on the ballot running while awaiting a final court review. There then developed a dispute over whether the version posted on the Secretary of State's website – which was filled with hard-to-read handwritten corrections – was or was not the circulated version. In the end, the California Supreme Court ruled in August that the initiative could go on the ballot, although the possibility of a post-election challenge – perhaps by members of the Legislature and Congress of both parties – remained.

### **Paycheck Protection: Prop 75**

*“Sources close to the governor said [paycheck protection is] an idea he supports.”<sup>49</sup>*

*Sacramento Bee* reporter Gary Delsohn

*“The resources will be there to win this fight. The California business community recognizes the importance of this and how completely doable it is.”<sup>50</sup>*

Grover Norquist, President, Americans for Tax Reform

*“If... public employee unions have to fight for their right to participate in politics in California, that's going to be nuclear war.”<sup>51</sup>*

Union president Jim Hard

*“Unions aren't the bugaboo among the public that the governor thinks they are. That should be a warning to him.”<sup>52</sup>*

Pollster Phil Trounson

Although it is possible to track individual union contributions to political campaigns in California through such online services as [www.electiontrack.com](http://www.electiontrack.com), obtaining an aggregate figure is difficult. Money is donated by individual unions, union locals, and union-related political action committees (PACs). In addition, unions provide in-kind support such as running phone banks. It is clear from national data that unions give most of their contributions to Democrats.<sup>53</sup> On the other hand, business-related and

trade association PACs give substantially more in dollar contributions to political campaigns than do union PACs.

In June 1998, a ballot measure generally termed “paycheck protection” was defeated, 53% to 47% – despite early polling suggesting it had strong majority support. The idea was to require an OK by each union member before his/her dues could be used for political purposes. A cut-down version of this proposal – Prop 75 applying only to public sector unions – qualified for the special election ballot of November 2005. The individual behind the initiative – Lewis K. Uhler, president of the National Tax Limitation Committee – was not a member of the Governor’s staff. (His name will come up later in the discussion of the Reagan budget initiative of 1973.) Although the Governor did not officially support this new paycheck protection initiative at first, he appeared to approve of it. As noted, especially from the Republican perspective, public sector unions are seen as supporting Democrats who, in turn, push for government spending and cause fiscal distress when sufficient revenue is not available. In that indirect sense, Prop 75 was linked – at least by those associated with the Governor – to the budget problem. Eventually, the Governor officially endorsed Prop 75 and the trust of the campaign morphed from fixing the budget to protecting public workers from “union bosses.”

As Figure 1 shows, the image of a union-represented worker in California as someone working in a manufacturing plant is no longer appropriate.<sup>54</sup> Over half of union-represented workers in the state now work in the public sector. Most work for state and local governments, although a small percentage are federal employees (e.g., postal workers). Due to the erosion of private sector unionization, the tilt of unions toward the public sector has been underway for a long time, as illustrated by Figure 2. However, even in the early 1980s, well over a third of union-covered workers were in the public sector.

Union coverage in California as a proportion of the workforce is much more extensive in the public sector than in the private. As Figure 3 indicates, in the private sector, union coverage dropped from one out of five workers to one out of ten during 1983-2004. During that same period, well over half of public sector workers were union-represented. It is important to remember that much of the state’s budget goes toward financing local government activities, such as K-14 education. Thus, union-represented public sector workers are not confined to the Sacramento area. Indeed, as Figure 4 shows, they are scattered around the state with large numbers in the urbanized Southern California region and the Bay Area. In short, there are significant numbers of public union workers in every election district.

The U.S. Bureau of Labor Statistics maintains a computer file of “major” collective bargaining contracts – those covering 1,000 or more workers.<sup>55</sup> This file allows a view of the distribution of public sector workers within California by employer type (Figure 5) and union organization (Figure 6). Over a fourth of union-covered public sector workers in California are in K-12 districts. The entire educational sector (including UC, CSU, and community colleges) raises the fraction in education to over

40%. Just under a fourth of unionized public sector workers are state civil servants. These employees include those in the prison system. By far, the largest union – at least with regard to workers under “major” contracts – is the Service Employees, with 45% of the workers covered. The California Teachers Association – an affiliate of the National Education Association – and the American Federation of Teachers represent collectively about 15% of these workers.

While many public sector unions function exclusively within government, the Service Employees union covers many private sector workers in such areas as health care and janitorial services. Similarly, the Communications Workers union is centered in the private telephone industry although it has public members. A number of construction unions – including the Operating Engineers shown on Figure 6 – have some public sector representation in California. This fact is important since unions interpreted Prop 75 as affecting labor organizations with any public sector workers, even if they are predominantly private. That interpretation, of course, brought more unions into direct opposition to Prop 75.<sup>56</sup>

Apparently, the framers of Prop 75 believed that public opinion would view unions negatively. A leaked conference call among donors to the campaign for Prop 75 included the idea of developing a “phenomenon of anger” against public unions.<sup>57</sup> However, polling data did not suggest that voters in California naturally felt that way.<sup>58</sup> Indeed, union-sponsored TV ads picked up the “phenomenon of anger” quote as demonstrating a nefarious secret plan.

There has not been a history of voter anti-unionism in California. In 1958, for example, a push for a “right to work” initiative opposed by organized labor helped sink the gubernatorial campaign of Republican Senate leader William F. Knowland and put the governorship into the hands of Democrat Edmund “Pat” Brown. Nonetheless, as with its 1998 predecessor, early polling suggested that Prop 75 had majority support.

### **Budget Initiative: Prop 76**

*“If the legislators don’t do their job the people will and I will stand with them to stop the red ink.”<sup>59</sup>*

Governor Arnold Schwarzenegger

*“Would you rather give the budget to the legislators that have run down this state and created a budget deficit (sic) of \$22 billion, or would you rather give it to me. Somebody who has hundred of millions of dollars and has [made] the best investments in Hollywood... Because I can guarantee you I can turn \$1 into \$2.”<sup>60</sup>*

Governor Arnold Schwarzenegger

*“Its provisions are so sloppily contrived that they would exacerbate the problems it claims to alleviate. While the administration rails about how much of the state budget is*

*subject to automatic formulas, the act would place even more spending on autopilot... ”*<sup>61</sup>

*Los Angeles Times* columnist Michael Hiltzik

*“California needs real budget reform that reins-in out of control government spending. Governor Schwarzenegger ran for office on the premise that California needed to get its house in order, but the ‘Live Within Our Means Act’ does absolutely nothing to fix the state’s structural fiscal problems.”*<sup>62</sup>

Mike Spence, President of the California Republican Assembly

*“Soon you will see it on the ballot in every initiative state.”*<sup>63</sup>

Grover Norquist, President, Americans for Tax Reform

When Californians think of budget issues at the ballot box, they usually start with Prop 13 of 1978, which cut local property taxes roughly in half. Prop 13 changed the traditional system of property assessments from one in which a local assessor would determine real estate values to one in which the tax base would be the 1975-76 valuation or the sales price when the property was sold, whichever was later. The tax rate was limited to 1% of the base in the first year and could rise no more than 2% annually, even if the property itself appreciated faster. Prop 13 imposed a two thirds requirement on the Legislature to approve state tax increases and a requirement that local governments could not raise “special” taxes without a popular two-thirds vote. In effect, these constraints were designed to prevent state and local legislators from substituting other taxes for the reduction in property taxes.

Prop 13 – as will be noted later – was the third property tax cutting initiative offered to the voters in the years before 1978 and the only one that passed. It had its genesis in the rapid rise in real estate prices of that era which produced large jumps in property tax bills (and without a proportionate improvement in local services). Prop 13 did not set a limit on spending except indirectly by limiting potential revenue. But it did shift authority toward Sacramento with regard to local services such as schools, because the state initially “bailed out” local governments that had lost significant funding from the property tax. The combined state and local tax system was made more volatile by the reduced use of the property tax and by greater reliance on sales, profits, and income taxes (which are sensitive to the business cycle). The key point, however, is that Prop 13 was and is a *taxing* limit, not a spending limit.

An actual state *spending* limit was established in 1979 under Proposition 4, which imposed a cap on expenditures of the prior year’s budget plus an adjustment for inflation and population growth. However, a series of subsequent propositions provided various exceptions so that even the surge of state spending in the late 1990s did not hit the modified Prop 4 limit as it was then calculated. (After-the-fact recalculation suggests the limit was actually exceeded.) Nonetheless, the passage of Prop 4 originally indicates that it is possible to pass such a limit, providing that the electorate is in an anti-tax mood (as it

was in the aftermath of Prop 13) and that the initiative is relatively simple and easy to understand.

Note that anti-tax is not quite the same as anti-tax *increase*. The former suggests that the voters are demanding tax cuts – as under Prop 13. The latter – which seems to characterize the current era – suggests that there is strong resistance to tax increases, but not a demand for cuts. Simplicity is also important. The original Prop 4 formula was relatively straightforward. Hold spending to current levels adjusted for inflation and population, i.e., to real spending per capita. If there were more dollars in revenue than the spending limit allowed, it was to be rebated to taxpayers.

The initial Schwarzenegger plan, articulated in the budget message of January 2005, was that if there were insufficient resources to cover expenditures, spending for all programs would be cut equally across the board, with a few exceptions such as debt service. But a system of equal percentage cuts to everything is immediately subject to the criticism that it sets no priorities. Conservative state senator Tom McClintock complained that, “*This [the Governor’s plan] treats the highest priority the same as the lowest. That’s not rational budgeting.*”<sup>64</sup> However, the Governor defended the January across-the-board plan saying, “*People come in and someone will say, ‘Education is important to me. Someone else will say ‘Health care is important to me. I don’t care about education.’ This way it creates more equality across things.*”<sup>65</sup>

One immediate effect of the Governor’s initial proposal was on the projections of the Legislative Analyst. The Analyst had noted for years that the state faced a structural deficit. This fact showed up in charts, which showed the forecast structural gap between revenues and expenditures in future years, i.e., in years following the budget year. The revenues and expenditures would always converge in the proposed budget, however, due to the various budget gimmicks routinely applied in preparing such proposals. Since the Legislative Analyst generally followed the Governor’s assumptions, the gimmicks – mainly treating borrowing as revenue – always closed the gap in the budget year (but not thereafter).

Figure 7 shows the Analyst’s report on the budget outlook shortly before the January 2005 budget proposal. The then prior-year 2003-04 budget showed near balance followed by larger deficits thereafter.<sup>66</sup> Once the Governor included in his January budget a constitutional amendment that would ban deficits through across-the-board cuts, the Analyst in principle could no longer produce a chart showing a structural deficit in future years. By assumption, such deficits would be outlawed! And, indeed, in the initial analysis of the Governor’s budget, the structural chart did not appear. By February, the simple deficit banning idea had morphed into the more complicated proposal ultimately slated for the special election in November 2005. The Analyst returned to the structural deficit chart, shown as Figure 8.

Several weeks before the special election, the Analyst released a report on the possible impact of Prop 76, suggesting that while the impact was highly contingent on the path of the economy and future revenues, it would likely reduce spending. Another

report by the Analyst, released at roughly the same time, made projections for 2006-07 which implicitly ignored the possible impact of Prop 76.<sup>67</sup>

As in the case of other initiatives for the special election that the Governor seemed to favor, the drafting of a budget initiative was outsourced. That aspect was particularly puzzling since the Governor's finance director – Tom Campbell – was a former Stanford law professor with a Ph.D. in economics and past experience as a congressman. A combination of law, economics, and politics would seem ideal for drafting a budget initiative.<sup>68</sup>

The version that actually emerged and was circulated by petition did not use the across-the-board cutting approach. Instead, it used a moving average process, made changes in Prop 98, and included other features. Conservative and anti-tax groups complained the new version would not sufficiently control state spending. In calling the special election, Governor Schwarzenegger devoted the bulk of his remarks to the budget, although also making reference to the redistricting and education initiatives (but not yet paycheck protection). Thus, the across-the-board cut budget plan was dead and the new version was the one the Governor officially favored.

Prop 76, the new budget initiative, was written by R. William Hauck, President of the California Business Roundtable, and Allan Zarembeg, President of the California Chamber of Commerce. Ironically, Hauck was the author of a legislative report sharply criticizing the budget initiative supported by Ronald Reagan when he was governor in the 1970s, as will be detailed below. Hauck had also in the past advocated doing away with the two-thirds vote requirement on passing a budget – something not included in Prop 76 – and on putting constitutional initiatives on the ballot in special elections.<sup>69</sup>

Although the official title of Prop 76 was the “California Live Within Our Means Act,” the ballot title given by the Attorney General was “State Funding and School Funding Limits.” The highlighting of “School Funding” – because of the modification of Prop 98 contained in the initiative – was a source of discomfort to proponents, since California voters tend to support education and Prop 98's funding protections for education.<sup>70</sup> However, the initiative did propose important changes in Prop 98.

Prop 76 added a spending limitation to the existing (and now largely ineffective) Prop 4.<sup>71</sup> It also supplemented a feature added by voters when they approved the Governor's deficit financing bonds under Props 57 and 58 in March 2004 known as the Budget Stabilization Account. This account, meant to establish a reserve in the future, sets aside a portion of the General Fund partly to repay the bonds over time. Under Prop 76, expenditures in the General Fund and special funds (such as transportation) could only rise from the prior year by the annualized growth rate over the past three years. If revenues exceeded that amount, i.e., if there were a potential budget surplus, the special funds retained the excess (but didn't spend it), thus adding to their reserves for some future “rainy day.”



A surplus in the General Fund – if one developed – was allocated one-fourth to the Budget Stabilization Account, one fourth for highway and school construction, and one-half to repay past “debt” to K-14 resulting from prior underfunding of Prop 98, and to repay loans from the Transportation Investment Fund. The debt and loan repayments were limited to one-fifteenth of what was owed annually, i.e., a 15-year repayment period. These various surplus payments would not count as expenditures in future calculations of the three-year moving average growth rate. Any excess beyond these amounts goes to the account for retirement of the deficit financing bonds approved by voters in 2004.

The moving average constraint’s impact by itself would not have had an effect on the ongoing budget problem, had it been put into effect at the peak of the boom of the late 1990s. Expenditures were rising rapidly and the problem was that revenue suddenly fell off with the decline of the stock market and the general recession. In the current period, however, expenditures have been limited by the budget crisis. So if the economy boomed again and the stock market rose, Prop 76 would tend to produce surpluses, which would be allocated as described rather than put into new programs or into program expansions.

However, Prop 76 would make it more difficult to repeat the borrowing that was used to cushion the decline in revenue in the first half of the 2000s. It forbade borrowing from special funds, other than the routine interfund cash management transfers that occur on a short-term basis to manage state cash flows. Prop 42 (2002) directed that sales tax on motor fuel go to the Transportation fund but allowed for emergency suspensions of the transfer of that revenue to Transportation by the Legislature. Prop 76 forbade such suspensions and required repayment of the monies that were diverted from Transportation over a 15-year period. Although the state is supposed to reimburse local governments for expenditures it mandates, during the budget crisis it deferred such payments. Prop 76 required repayment of those deferrals over a 15-year period to education and a 5-year period to other local governments. In short, in a future budget crisis, the Legislature would be foreclosed from the kind of borrowing and deferrals that went on during the current crisis. And it would also be faced with repayment obligations left over from the current crisis.

Under Prop 98, various tests were brought into play to determine what proportion of the General Fund goes to K-14. In normal times, the allocation was whatever was paid in the prior year plus an adjustment for changes in average daily school attendance and per capita personal income. However, during hard times, the Legislature can suspend this formula by a two-thirds vote (the same proportion required to pass a budget). Or another formula can come into play that produces lower-than-normal amounts. When either happens, the state, in effect, owes to K-14 the gap between what is actually paid and what should have been paid under the normal formula. When new revenues arrive as the economy recovers, the state begins to pay off this debt, thus pushing up the allocation to K-14 faster than the normal formula during the repayment period. The state may also owe K-14 additional funding if estimates of the factors used to calculate the obligation are revised upward. Finally, if the Legislature chose to allocate more to K-14 than Prop 98 required, the additional amount was added to the base for next year. Thus, Prop 98

contained a ratchet element whereby the amount allocated is forever higher if the Legislature decides to put more than the minimum into K-14.

Prop 76 eliminated the ratchet effect by keeping above-required expenditures out of the base. It required repayment over 15 years to K-14 of the amount owed due to legislative decisions during the current budget crisis. On the other hand, it eliminated the hard times formula. In some future budget crisis, in other words, the Legislature could reduce its Prop 98 obligation by a two-thirds vote and not incur future obligation to repay K-14 for what was lost. In that respect, Prop 76 made it somewhat easier for the Legislature to deal with revenue problems by cutting the budget including K-14. The bottom line from the K-14 perspective, therefore, is that Prop 98's guarantees were weakened. And since other avenues of adjustment such as borrowing from Transportation were cut off, it is more likely that the Legislature would put more of the burden of adjustment on K-14.

K-14 was a "loser" under Prop 76. Transportation and activities that depend on the special funds outside the General Fund were "winners." Non-education local governments were likely to be winners, too. For other sectors – such as UC and CSU – it is unclear whether they would come out better or worse in some future budget crisis. On the one hand, the fact that more could be taken from K-14 would benefit such sectors. (Certain local government functions that depend on funding from special funds might be constrained by the three-year moving limitation – which would affect such funds.) On the other hand, the fact that the state would be more constrained to avoid borrowing from transportation and other areas could be a negative for state functions such as UC and CSU.

Prop 76 contained a feature related to budget enactment which made its eventual effect still more uncertain. Under the constitution, a new budget is supposed to be in place by the beginning of the fiscal year (July 1) when the old budget expires. Thus, if the Legislature stalemates and does not produce a budget on time – which it is prone to do because of the two-thirds vote requirement – there is no budget in effect. In principle, the state then cannot pay its bills although, due to various court decisions, certain bills are paid. However, the longer the stalemate goes on, the greater the potential for administrative disruption. Under Prop 76, if there were no budget on July 1, the old budget stayed in effect. Prop 76 solved the no-budget problem since bills could be paid on or after July 1, regardless of a legislative stalemate.

What would happen as time goes on with no new budget would depend on prevailing economic conditions. As long as adequate revenue was coming in to meet budget obligations (under the terms of the previous year's budget), the stalemate could continue indefinitely. In effect, one-third of the Legislature could keep a new budget from being enacted, and could freeze the old budget into place indefinitely.

Under Prop 76, the Governor could declare a budgetary emergency if a) General Fund revenues dropped 1.5% below Department of Finance projections, or b) if the balance in the Budget Stabilization Account appeared likely to fall by half or more during

the fiscal year. At that point, the Legislature would have 45 days to address the drop in revenue. If no legislative solution were passed, the Governor could then cut expenditures unilaterally except for debt service and contractual obligations (but not collective bargaining contracts). Note that a drop of 1.5% in revenues could occur without posing an immediate budget crisis, particularly if the budget in effect was frozen due to a legislative stalemate. In any event, the Governor was the “winner” under Prop 76 in terms of budgetary authority and the Legislature was the “loser.”

Prop 76 was clearly complicated and its precise effects could not be known in advance, simply because the path of the economy and the behavioral impact on the Legislature and Governor under such a system were hard to predict. Moreover, as the history of Prop 4 demonstrates, voters could amend Prop 76 or any other proposed budget proposition in the future. In many respects, Prop 76 was less ambitious than the failed budget cap initiative proposed by Governor Ronald Reagan and discussed below. That initiative had the explicit goal of shrinking the size of state government relative to the overall economy. Prop 76 was more aimed at smoothing the budget cycle to avoid the tendency to spend revenue windfalls on a permanent basis.

The fact that Prop 76 added a new formula to the budget process did not appeal to those who simply want the Legislature and Governor to deal with the budget in the old fashioned way, i.e., compromise. It definitely did not appeal to K-14 supporters and participants. Although Prop 76 clearly moved power to the Governor and away from the Legislature, it did not in that respect necessarily conflict with the desire of voters to restrict legislative authority, e.g., term limits. When voters installed a new Governor in the 2003 recall, they clearly took the view that the Governor should take the lead role in solving state fiscal problems. They also seemed to like his proposal to roll back the “car tax.” As the special election approached, the Governor hinted that if voters did not give him Prop 76, some kind of tax increase might be the result.

Much depended, therefore, on the popularity and persuasiveness of the Governor. In calling a special election, Arnold Schwarzenegger was counting on his personal appeal to overcome inevitable arguments that Prop 76 was a gubernatorial “power grab,” bad for education, too complicated, and still more budgeting by ballot box formulas. Yet his ratings in public opinion polls were falling. Recent studies suggest that in the private sector, CEOs often suffer from overconfidence in their own views, resulting in bad decisions in such areas as mergers and acquisitions.<sup>72</sup> Possibly, this finding applies to political executives as well. On the other hand, the Governor’s famous line as the Terminator – “*I’ll be back*” – made the American Film Institute’s list of the top 100 movie quotes in June 2005. Declining popularity and adverse opinion poll results can be reversed. The ballot initiative campaign was a gamble that such a public opinion reversal was possible.

## **Other Initiatives**

*“Outside a Home Improvement store in Elk Grove Friday, Heather Gibson collected petition signatures... After seven years as a paid petition signature gatherer, Gibson*

*says – on an average day – she gets about 100 people to sign. Right now, she gets about \$1 per signature, but she hopes that price will go up as the deadline draws near.*<sup>73</sup>

KCRA TV report

*“I thought it would be a temporary thing until I saw how much money I was making.”*<sup>74</sup>

Professional signature gatherer

It only costs \$200 to start the initiative process rolling. Basically, once an initiative is filed with the Attorney General, a title and various summary and analytical statements are assembled. At that point, petition circulation can begin. About 375,000 signatures are needed for a statutory initiative and about 600,000 are needed for a constitutional amendment. In practice, substantially more signatures must be obtained because many will prove to be invalid when checked by the Secretary of State. To obtain sufficient signatures, it is estimated that proponents must spend about \$2 million. Often, professional signature gatherers are used. Still more money must be devoted in a campaign to obtain voter approval. Tens of millions of dollars are potentially involved, particularly when issues are especially controversial.

In early 2005, many proposed initiatives were filed. As a spokesperson for the Attorney General put it, *“There is definitely a feeling here that we have been spammed by just about everyone with 200 bucks and an idea.”*<sup>75</sup> Filers may submit various versions of their initiatives as flaws are discovered in wording. But the notion of counter-initiatives was also at work. If the Governor and his associates were going to put items on the ballot for a special election, opponents sought to file initiatives that the Governor would not like. It was thought that the prospect of such initiatives might lead him to abandon the idea of a special election or to negotiate compromise deals.

In the end, apart from the initiatives discussed above, opponents placed an initiative re-regulating electricity (Prop 80) and another requiring the state to negotiate discount drug prices with pharmaceutical firms (Prop 79). (As noted above, the electricity initiative was briefly knocked off the ballot by court decision in July 2005. It was then restored to the ballot by the California Supreme Court.) Neither the electricity re-regulation plan nor the negotiated drug discount plan were proposals that the Governor favored. Oddly, organized labor – which was the most prominent opponent of the Governor’s agenda, especially due to paycheck protection – did not ultimately put anything on the November 2004 ballot directly related to employment.<sup>76</sup> For example, no proposal for raising the minimum wage (something California voters in the past had approved) was included.<sup>77</sup> However, the drug proposal produced a counter-counter-initiative sponsored by major drug companies that involved a voluntary discount drug plan (Prop 78).

Unrelated to the fight with the Governor – but qualifying for the special election – was an initiative requiring minors to obtain parental approval for abortions (Prop 73). It was unclear whether an abortion initiative, which would draw both pro-life and pro-choice voters to the poll, would tilt in favor of, or against, passage of the Governor’s budget proposal. However, the Governor came out in favor of Prop 73 saying he would

want to “kill” someone who gave an abortion to his daughter without his parental permission.<sup>78</sup> Supporters of the Governor apparently targeted religious “right-to-life” groups to turn out the vote for Prop 73, hoping that their followers would also vote for other gubernatorial propositions. Not submitted in time for the special election – but of potential budgetary significance – was the “Preschool for All Act” – an initiative associated with potential gubernatorial candidate and actor Rob Reiner – which would add an income tax for high earners to fund a universal preschool program. That initiative, if it qualifies, might, however, appear on the June 2006 ballot.<sup>79</sup>

### **Initiatives as a Budgetary Bargaining Chip**

*“I have hope... that the legislators will come to the table and will start negotiating... How much we will be able to... settle legislative vs. the ballot, I don’t know yet.”<sup>80</sup>*

Governor Arnold Schwarzenegger

*“I think to the extent that they hold out the budget for not good reasons... [the governor] will use that as ammunition in the special election... and say ‘See, it’s not working, I need this stuff.’”<sup>81</sup>*

Republican Senate leader Richard Ackerman

California has had a problem of chronically late budget enactment. The 2004-05 and 2003-04 budgets were over one month late. And the 2002-03 budget was over two months late. In some states, such situations force a shutdown of government activity and thus put extreme pressure on legislators to come to an agreement. For example, a budget delay in Minnesota in July 2005 produced just such a shutdown. But because the consequences of budget delay in California are not so severe, there is less pressure forcing a settlement.

It does appear that the threat of a special election – while not producing an on-time budget – did bring about a deal relatively quickly by California standards. The final 2005-06 budget was signed by the Governor on July 11. By that time, two initiative campaign committees associated with the Governor – the “California Recovery Team” and “Citizens to Save California” – had raised \$33 million and \$9 million, respectively. Although Governor Schwarzenegger’s fundraising activity seemed to contribute to his drop in popularity, the amount of money raised had to suggest to opponents that the Governor was serious about his agenda.<sup>82</sup> Meanwhile, the “Alliance for a Better California” – linked to organized labor – had raised over \$9 million and other union-related PACs and resources could be expected to contribute substantially more to the campaign against the Governor’s initiatives.<sup>83</sup> Ultimately, in the weeks before the campaign the Governor’s advertising focused on unions and the funding they were putting into the election, especially against paycheck protection. Both sides made a campaign issue out of the fundraising of the other.

Although the looming special election seemed to accelerate the budget accord – apparently legislative Democrats did not want to give voters a sense that there were

severe budgetary problems with which the Legislature could not deal – it did not induce an accord on alternate, compromise budgetary initiatives. Such initiatives could have been put on the special election ballot by the Legislature with a two-thirds vote, but that would have required Republican support, impossible to obtain unless a deal were reached with the Governor. Calls to cancel the election outright – which would have moved all of the initiatives to June 2006 – were also unsuccessful.

The result of forcing a (relatively) early accord on the budget was that the Democrats had to accept a budget with no tax increases. On the other hand, the budget still was in structural deficit. Below we look at the outcome of the 2004-05 budget and analyze the budget proposals and actual budget agreement for 2005-06.

### **Budget Results for 2004-05**

*“I don’t think anything should be off the table this year. This [would] be at least the third year we’ve punted.”<sup>84</sup>*

Democratic Assemblyman Joe Canciamilla

In earlier budget chapters in this series, we have noted the many problems in budgetary methodology. Rather than repeat that analysis, we concentrate here on the cash results with certain adjustments; they are a better reflection of recent history than the official budget data. When Arnold Schwarzenegger inherited the governorship in 2003 through the recall election, the 2003-04 budget had already been enacted under Governor Davis. His initial solution was largely a refinancing of short-term debt into longer-term debt, accomplished through the passage of Props 57 and 58 along with ongoing deficit financing. However, his first budget year, which was not inherited was fiscal 2004-05, beginning July 1, 2004.

During that budget year, there were two factors that added to the state’s General Fund inflow of revenue. The first was the natural process of economic growth. Of course, the pace of economic growth has to be forecast and connected with tax receipts in formulating a budget. Thus, there can be revenue “surprises,” positive or negative, due to forecasting errors. However, the economic forecast made at the time of the January 2004 budget proposal for 2004-05 seems to have been reasonably accurate with regard to personal income and employment trends, two key indicators. Nonetheless, connecting those indicators to actual receipts of state tax revenue cannot be done precisely.

The second factor that added to cash revenue in 2004-05 was a tax amnesty program that turned out to bring in more receipts than anticipated. This higher amount was apparently due to stringent penalties for those who did not pay their past liabilities, both individuals and businesses. Apparently, those appealing past adverse tax judgments were advised by their legal counsels to pay the state’s claims under protest, just in case the state’s claims were upheld. Such prepayments would avoid the penalties. Much of this under-protest money may have to be returned after full adjudication. And since some of the money would have been paid in subsequent years after adjudication, the amnesty in effect lowered future receipts. However, a total of \$4.6 billion arrived as amnesty

money, although it largely is a forced loan from the private sector to the extent it will have to be returned or is merely an advance on future payments.

### **The January 2005 Budget Proposal**

*“There will be a serious review of what we can afford going forward. Health and human services is a large part of the focus.”<sup>85</sup>*

Finance Director Tom Campbell

*“This budget is not everything that I want, but the fact is it’s a budget forced on us by a broken system...”<sup>86</sup>*

Governor Arnold Schwarzenegger

Table 2 summarizes the Governor’s budget proposals for 2005-06 and the eventually enacted budget. All figures are official Department of Finance estimates. The Legislative Analyst regarded the Department of Finance forecasts as somewhat pessimistic, i.e., as projecting revenues too low and expenditures too high. However, given the vagaries of such forecasting, the Department of Finance estimates were certainly reasonable. The use of conservative assumptions nevertheless helped the administration put a spotlight on painful choices and enhanced its argument that institutional changes were needed in budgeting, legislative districting, etc.

As in previous budget chapters, we focus here primarily on the overall fiscal aspect of the budget rather than the various expenditure and tax components. But the highlights of the January proposal involved a proposal for an Indian gambling bond of roughly \$1 billion that would fund transportation improvements. There was also the above-mentioned partial renegeing on the previous year’s deal with the California Teachers Association to fund Prop 98 expenditures on education fully, and various cuts in “welfare” type programs. Teacher pension costs were shifted to local school districts. Cost savings were to be negotiated with state labor unions. The state would limit its reimbursement for home care aides to the state minimum wage (leaving the cost of any higher wage payments to local authorities). The proposed budget relied on explicit borrowing through unissued Prop 57/58 bonds and continued to borrow sales tax receipts from the Transportation fund. It continued in addition to propose the flotation of a legally questionable pension bond as well as another bond to cover the costs of a lawsuit related to flood control – the *Paterno* case.<sup>87</sup>

Standing in the background were controversies over such areas as funding of a replacement for a segment of the earthquake-damaged Bay Bridge, trial balloons from within the administration about replacing the gas tax for transportation with a mileage tax, the abortive pension proposal to shift to defined contribution (discussed above), and a deal with the federal government to move Medi-Cal recipients to managed care and HMO style coverage. The tone of the budget presentation was different than that of the previous year. If the budget and related reforms were not enacted by the Legislature, initiatives would be placed on the ballot to accomplish the Governor’s objectives.

Even with the painful adjustments posed by the Governor, as Table 2 indicates, fiscal 2005-06 was to be another deficit year. Moreover, because even the limited deficit assumed deferral of obligations – such as those under Prop 98 – structural problems would persist into the future. Of course, if some form of constitutional amendment were enacted that either overrode such future commitments or constrained other elements of the budget to pay for them, then the structural problem would cease to exist.

### **The Budget in May**

*“It is a prudent budget that uses one-time revenue for one-time expenditures and it does not make long-term commitments the state can’t keep.”<sup>88</sup>*

Governor Arnold Schwarzenegger

*“Some people are trying to say there isn’t any difference between my budget and the budget the majority in the Legislature is proposing. Nothing could be further from the truth.”<sup>89</sup>*

Governor Arnold Schwarzenegger

The Legislature did not enact the Governor’s January program and showed little sign of doing so by the time the May revise was due. However, by that time, the \$4.6 billion in tax amnesty money had arrived. As noted earlier, much of that money appears to be a kind of forced loan to the state. But amnesty did put cash into the Treasury, at least on a temporary basis. Table 2 indicates that the May revise was a less stringent budget, showing a larger deficit.

If we assume, as we did on Table 1, that about a fourth of the amnesty money would ultimately be retained by the state, the Governor would have an additional \$1 billion-plus as revenue over the future. He cancelled the Indian transportation bond and put funds of roughly that magnitude back into the transportation fund (instead of borrowing sales tax receipts from that fund again). There were legal questions about the Indian bond and spending on transportation infrastructure for maintenance and enhancement had been constrained by lack of funds for several years.<sup>90</sup> Thus, a decision to put money into transportation was understandable, particularly since traffic congestion was emerging as a major political issue.<sup>91</sup> Nonetheless, the deficit grew by more than the reallocation of transportation funding.

It is hard to look at the figures without concluding that the amnesty money was treated as a windfall loan, i.e., money that was temporarily available to fill gaps in the 2005-06 budget and ongoing infrastructure needs. From the Governor’s perspective, this windfall would enable the state to make it through another fiscal year, after which – due to ballot initiatives that he hoped would be passed in November 2005 – there would be a new budget and political process in place that would deal with the future structural imbalance. One element in the May revise was an earlier-than-required repayment to local governments for lost “car tax” (Vehicle License Fee) revenues. That feature



suggested to local governments that it would be advantageous not to join the campaign against the Governor's initiatives in the special election, especially the campaign emerging against the budget initiative. The early repayment indicated that the Governor's priorities include resources for local government activities.

### **The Final 2005-06 Budget**

*"This is a terrific budget."*<sup>92</sup>

Governor Arnold Schwarzenegger

*"We got a very good budget short of reforming the process. What this shows is that we've got to reform the process."*<sup>93</sup>

Finance Director Tom Campbell

*"You are using borrowed money from last year to repay borrowed money. That gets you precisely nowhere."*<sup>94</sup>

Republican Senator Tom McClintock

Although the budget negotiations went into overtime, a final compromise budget was signed on July 11, 2005. Given the prospect of a special election in November, no party to the negotiations wanted to be seen as responsible for a fiscal stalemate. Table 2 indicates an increase in the official operating deficit relative to the May revise. The Legislative Analyst estimated that even if all savings in the 2005-06 plan were realized, the structural deficit in the following year would be about \$6 billion. Table 2 suggests that the 2005-06 deficit was also of that magnitude, suggesting that there was little progress in closing the ongoing gap.

It appears that the special election threat accelerated enactment and implementation of a budget but not fundamental repair of the ongoing budget problem. As Figure 9 shows, the first budget year of the Schwarzenegger administration did produce a reduction (although not elimination) of the deficit. However, because that year – 2004-05 – involved deferrals and future obligations, the deficit crept back up.

Ultimately, the relentless pressure of the deficit could be resolved either by more revenue or by reduced discretionary and/or formula-based spending. Republicans strongly resist any tax increases to provide additional revenue. The electorate was willing to enact a tax increase earmarked for mental health in 2004, but mainly because the tax was targeted at a narrow group of upper-income individuals. It may do so again if a universal pre-school initiative qualifies for a future ballot. Meanwhile, expenditure cuts have proven difficult.

It is not surprising – given this dilemma – that ballot initiatives which would override the existing system and revamp underlying political institutions would be appealing to the Schwarzenegger administration. In effect, Governor Schwarzenegger would be the new Hiram Johnson, the progressive Republican governor elected in 1910 to clean up Sacramento through such electoral reforms as the initiative, referendum, and

recall. Johnson and his followers focused on the Southern Pacific Railroad as the great corrupting influence of the Legislature. The Southern Pacific no longer even exists as a corporate entity and recent scholarship suggests that it was not the monotone villain depicted by progressives.<sup>95</sup> In any event, the new corrupting influence – from the viewpoint of the Governor – is played by organized labor, an interest group which also may not be perceived by the public as an unmitigated agent of corruption.

California history suggests that the initiative route to reform is tricky. There were parallels between the 2005 push for a special election and similar events in 1973 when then-Governor Ronald Reagan sought to override the budgetary process with a constitutional amendment. Reagan failed to obtain voter approval. So the issue for the November 2005 election was whether voters would view the initiatives as they did under Hiram Johnson or under Ronald Reagan.

### **The November 2005 Special Election**

*“I guess I didn’t do a good enough job to convince them otherwise.”<sup>96</sup>*

Governor Arnold Schwarzenegger

*“It took courage to do it.”<sup>97</sup>*

Former Governor Pete Wilson

*“Today we kicked Arnold’s butt.”<sup>98</sup>*

Art Pulaski  
Executive Secretary-Treasurer, California Labor Federation

When Election Day arrived in November 2005, polls were already indicating that the Governor’s propositions were in trouble. In the end, voters rejected every proposition on the ballot including those endorsed by the Governor. The budget proposition (Prop 76) – the key issue for the Governor given the state’s structural deficit – did worst with only 37.9% voting “yes.” Redistricting (Prop 77) received 40.5% yes votes. Teacher “tenure” (Prop 74) received 44.9% and “paycheck protection” (Prop 75) received 46.5%. Clearly, the Governor had obtained the Reagan result, not the Hiram Johnson outcome he desired.

His strategy of focusing on public sector unions had led to a united opposition from that sector. And the public had little sense of how teacher tenure, paycheck protection, redistricting, and the budget fit together. Voters were under the impression – incorrect though it may have been – that when they had earlier approved the Governor’s borrowing plan in 2004, the state budget crisis was over. Thus, the rationale for having a special election – presumably called because a problem was urgent – was not understood.

Although there was a deluge of TV ads on both sides – estimates of campaign expenditures related to the November 2005 election were being put in the \$200 million range – the short spots could not provide an explanation. Ads for the Governor often

simply cited a vague mess in Sacramento and could only provide a sound-bite – if that – about each proposition. Opposition ads featured sympathetic public workers – nurses, teachers, firefighters, police, home care aides – arguing that the Governor was blaming “people like me” for the state’s problems. In the end, a majority decided that voting “no” was preferable to voting for seemingly unrelated initiatives that did not have an obvious rationale.

Could the Governor have avoided the sad end to his “year of reform?” Perhaps if he had looked at the failure of ballot-box budgeting under Ronald Reagan, some important lessons might have been drawn.

### **Governor Ronald Reagan and Proposition 1**

*“Two California Governors I greatly admire are Hiram Johnson, the Republican reformer, and Pat Brown, the Democrat builder. These leaders demonstrated the importance of moving in a new direction, and they made tough choices for the good of California.”<sup>99</sup>*

Governor Arnold Schwarzenegger

*“Reagan’s proposed tax and spending limit in 1973 was rejected by the voters in an embarrassing defeat and sapped his clout in the Capitol. The Great Communicator, in a rare lapse, couldn’t communicate a coherent sales pitch.”<sup>100</sup>*

*Los Angeles Times* columnist George Skelton

Governor Schwarzenegger cited Hiram Johnson and Edmund G. (“Pat”) Brown as the earlier governors he most admires. Internet ads for his “Join Arnold” website have featured alternating pictures of these two governors with the current governor.<sup>101</sup> Hiram Johnson, as noted above, was elected as part of the progressive Republican movement in 1910, bringing about the initiative, referendum, and recall, along with women’s suffrage and workers’ compensation insurance. Pat Brown was elected in 1958 in a major Democratic sweep in California. He is identified with freeway expansion, the state water project, and the Master Plan for Higher Education. Under the Master Plan, new campuses were built in the UC and state college (now CSU) systems and formalization of the relation between the state’s three tiers of higher education (including the community colleges) was established.

Since Hiram Johnson’s regime brought about the recall option that placed Governor Schwarzenegger in office, it is natural that Johnson should be singled out as an ideal predecessor. Pat Brown, however, although identified with infrastructure expansion, brought about a budget crisis somewhat analogous to the crisis that emerged under the Gray Davis administration. For that and other reasons, Brown failed to be re-elected to a third term in 1966, losing to Ronald Reagan who promised to restore fiscal responsibility. Thus, Brown was a somewhat problematic idol for Schwarzenegger.

Reagan, a celebrity like Schwarzenegger, might seem to be a better choice. But there are two problems which would make Reagan as problematic as Brown. Reagan as candidate, and in the early days of his governorship, planned to deal with the budget problem by across-the-board spending cuts (somewhat similar to the original – but abandoned – proposal contained in Governor Schwarzenegger’s budget speech of January 2005). However, he found himself unable to make such cuts and wound up engineering a large tax increase – something Governor Schwarzenegger has eschewed. Reagan agreed to another tax increase in 1972. But the following year, he called a special election and placed a budget control initiative on the ballot, Proposition 1. Reagan was convinced that voters would approve his formula-based spending cap. After a major campaign effort, the initiative failed at the polls despite growing homeowner concern about rising property taxes that would later lead to Prop 13 in 1978.

In what follows, we explore this earlier episode of attempted budgeting by initiative referendum and Prop 1’s failure to pass. It is certainly not the case that history taught that budget-related initiatives inevitably fail. Prop 13 illustrated just the opposite. The still later – and now largely ineffective – Prop 4 of 1979 did impose a spending cap, showing that under some circumstances voters are willing to enact formula-based budget controls. Nonetheless, history suggests some lessons about what elements in ballot box budgeting are more or less appealing to the electorate.

We focus on the budget aspects in this section. Biographies of the principal characters are widely available to interested readers.<sup>102</sup> In terms of the budget aspects, both Prop 76 and Reagan’s Prop 1 depended in part on the electorate being convinced that there was an urgent fiscal malaise justifying a special election (and the costs thereof). And in the post-Prop 13 environment – where Sacramento has more responsibility for local services – one might argue that dealing with the state’s budget problem is more urgent now than it was in 1973. The Reagan initiative was more ideologically driven than Schwarzenegger’s. But the design and campaign for both were delegated and outsourced in similar fashion.

### **Background to the Reagan Initiative**

*“The function of government is not to confer happiness, but to give men the opportunity to work out happiness for themselves.”<sup>103</sup>*

*“If our plan works at the state level, it could be a laboratory example, and then at the national level someone might want to try it.”<sup>104</sup>*

Governor Ronald Reagan

Ronald Reagan was originally a liberal Democrat whose political orientation, as in the case of many who grew up during the Great Depression in difficult circumstances, was much influenced by the New Deal. His Hollywood movie career led to election as president of the Screen Actors Guild. He was exposed to the internecine political warfare on the left of that era, as well as the ever-turbulent internal politics of the Guild itself, a preparation for the external political environment. The liberal/New Deal side of Reagan

remained on an individual basis; his long-time secretary reported that he often sent personal checks to those who wrote him for help as Governor (and later as President).<sup>105</sup> But as his movie career ended in the 1950s, Reagan became a spokesperson for General Electric and generally shifted to the political right. By 1960, he was a “Democrat for Nixon” and within a couple of years formally changed to a registered Republican. Reportedly, he had his eye on the Republican nomination for president as early as 1964, even before running for Governor.<sup>106</sup>

Various associates – the so-called “kitchen cabinet” – pushed Reagan toward a political career and to a run for the governorship in 1966 against incumbent Pat Brown, up for a third term. Election as Governor would certainly be a stepping stone to the presidency for Reagan. Reagan developed the phrase “creative society” to characterize his emerging conservative approach, presumably in contrast to President Johnson’s “great society” concept.<sup>107</sup>

### **Pat Brown’s Last Budget**

In recent years, Pat Brown has been depicted as presiding over a golden age in California, largely because of the infrastructure and educational projects mentioned earlier. As did Reagan, Brown switched political parties. But in Brown’s case, the switch was from Republican to Democrat. During his two terms as Governor, Brown had ups and downs and certainly was never viewed at the time – even among allies – as a likely candidate for future political sainthood. And although Brown was elected by a wide margin in 1958, much of that victory was due to Republican self-destruction in the hands of U.S. Senator and Senate Minority Leader William Knowland. Eisenhower had once written of Knowland, “*In his case, there seems to be no final answer to the question, ‘How stupid can you get?’*” and in 1958, Knowland’s actions seemed in keeping with that description.<sup>108</sup>

Knowland wanted to be the Republican candidate for president in 1960 and for personal and political reasons decided that the governorship would be a better stepping stone to the presidency than the Senate. He forced the popular incumbent Republican Governor Goodwin Knight – who would otherwise have sought re-election – to run instead for the senate seat Knowland decided to vacate so that he (Knowland) could run for Governor. This forced switch angered voters, destroying the political careers of both Knight and Knowland, and tilting the election to Brown and other Democrats.<sup>109</sup>

Despite his achievements in infrastructure and education, Brown had problems with the social issues of the day. He opposed the death penalty philosophically, but tended to be wishy-washy in practice, angering those on both sides of the debate. An image of vacillation led to his appellation as a “tower of jelly.”<sup>110</sup> He was a big supporter of the civil rights movement, but that inclination was costly to him in the era of the “white backlash,” the Watts Riot, and other racial disturbances. Brown pushed for passage of a fair housing bill known as the Rumford Act of 1963. After it passed, voters repealed it by initiative (Prop 14 in 1964), a repeal which later was voided by decisions by the California and U.S. Supreme Courts.<sup>111</sup> Student riots at UC Berkeley led to

charges that Governor Brown was not taking a firm hand in keeping order on campus and not properly overseeing UC's administration. Brown had doubts about the wisdom of the Vietnam War, but publicly supported President Johnson, angering the anti-war left wing of the Democratic Party.

Governor Brown had on-and-off feuds with Jessie Unruh, the majority leader in the State Assembly known as "Big Daddy," because of his size and resemblance to a hefty character in the movie *Cat on a Hot Tin Roof*. Unruh, who came from a poverty background, started in the left wing of Democratic politics in California and became more pragmatic as he expanded his influence. Nowadays, and since the time of Governor Deukmejian in the 1980s, budget impasses in the Legislature have often been settled by negotiations among the "Big 5," the Governor and the minority and majority leaders of the Assembly and Senate.<sup>112</sup> Before that era, however, it was not uncommon for just one of the majority leaders in the Legislature to be especially important in such negotiations. And in the 1960s, Unruh was the key player.

Unruh thought he had a deal with Brown that the Governor would not be a candidate for a third term in 1966, so that he (Unruh) could then run. When Brown decided to seek a third term, Unruh felt double-crossed and was not going to do the Governor any favors in passing a budget. Moreover, it appeared that the 1966-67 budget would be in significant deficit, absent a tax increase, which the Legislature was not going to pass. The constitution requires the Governor to submit a budget that appears "balanced" in the sense that the Governor is supposed to explain the sources of funding (which can include running down reserves). However, even running down reserves plus expected tax revenue would not cover the proposed spending for 1966-67. A combination of the Unruh-Brown feud and a reluctance to raise taxes in an election year ultimately led to a budgetary trick.

The maneuver that resulted is often described loosely as a switch from cash accounting to accrual accounting in order to make the books appear to balance. Presumably, Hale Champion – Brown's finance director – expected that if re-elected, Brown could somehow come up with a remedy. And if not, the unbalanced budget would be someone else's problem. Thus, the switch to accrual accounting was the approach taken to deal with the cosmetic side of the budget in the pre-election period. But although histories of that era stop with the cash-to-accrual explanation, in fact a *properly-done* shift to accrual accounting would not have done the job of covering up the budget imbalance. What seemed to be involved was a confounding of the concepts of tax withholding and accrual accounting, leading to an *improperly-done* shift from cash to accrual.

Although the state had a personal income tax in the Brown era, it did not have a system of payroll deductions and withholding of income taxes, unlike the federal income tax system. That meant that most taxpayers paid their entire tax bill on April 15 for the previous calendar year.<sup>113</sup> Thus, the state General Fund received a large dollop of cash each April, the taxpayer liability for which had accrued in the prior calendar year. The highly seasonal flow of cash into the state treasury, combined with the more even outflow

of spending for government programs, created a cash flow problem. This problem typically was handled by short-term borrowing in the months before April and a payback of the loans in the months thereafter.

If the state had implemented a withholding system – something that had been discussed but never implemented – the cash flow into the state would have been more even and income tax receipts would come in close to the time that tax liabilities actually accrued. In addition, if in any fiscal year the state were to shift to withholding from its existing system, within that one transition year there would be an extra roughly six months of income tax cash received. On April 15 of the transition fiscal year, the General Fund would receive 12 months of income tax from the prior calendar year *plus* 6 months of receipts that were being withheld in the current calendar year. This extra receipt would be a one-time event; once withholding was in effect, each year after the transition year would go back to receiving 12 month's of receipts (but on a more even and timely basis). In short, if the state had switched to withholding in 1966-67, there would indeed have been a substantial revenue gain, *albeit one-time only*. (There might also have been some ongoing gain to the extent that tax evasion was reduced.)

However, the state did not switch to tax withholding in 1966-67. What it did instead was to switch to accrual accounting. The switch in accounting methods by itself produced not one penny more of cash than under the old system. Nor would accrual – *properly-done* in even a bookkeeping sense – produce a large dollop of accrued receipts. A year, after all, still consists of 12 months regardless of the accounting system. At most, a switch to accrual would produce a relatively small booked “gain” as long as taxable incomes were expanding. The small gain comes from the fact that without withholding, a cash system of accounting records receipt from past taxpayer liabilities whereas accrual records current liabilities. Since with expanding incomes, current liabilities for any period will tend to be bigger than past liabilities for a period of the same length, accrual will produce a modest recorded gain in receipts (although no gain in cash).

The original Brown budget proposal – despite the electoral risks – did call for an income tax increase along with a switch to accrual. Oddly, the Legislative Analyst – A. Alan Post – seemed to endorse a shift to accrual conditioned on there being some cash left in the general fund. Even with the proposed tax increase, however, there would not have been enough cash on full accrual so the Analyst called essentially for partial accrual to the extent that some cash would be left.<sup>114</sup> Whatever might be said analytically for cash vs. accrual, there is no case at all for that form of partial accrual – other than the argument that half a trick is preferable to a whole trick. Perhaps the Analyst was simply trying to fashion a compromise. It is impossible to know at this distance from the events.

In any event, what was done in the 1966-67 budget was to switch to accrual done *improperly* and without a tax increase. The switch was done *as if* there had been a change to withholding, thus recording a phantom one-time bulge in booked receipts. That is, the essence of the budgetary trick was not the shift to accrual but rather the pretense that accrual and withholding were the same thing. The one-time revenue gain

that withholding would have produced was added to budgeted receipts under the guise of accrual.

Figure 10 provides a guide to the shift in methodology. Case 1 shows the situation as it was before 1966-67. Income tax liabilities from calendar year A show up as receipts cash in fiscal year A-B on April 15 of calendar year B. Case 2 shows what would happen under a withholding system with retention of cash accounting on an ongoing basis. Receipts in fiscal year A-B would reflect taxpayer liabilities in fiscal year A-B. If incomes were expanding, cash receipts in fiscal year A-B would be somewhat larger than without withholding, since incomes during the period July A through June B would be somewhat larger than receipts in calendar year A. But the effect would not be huge.

Case 3 shows the effect of imposing withholding with cash accounting effective in calendar year B. During the transition fiscal year A-B, there would be cash receipts accruing in calendar year A plus withholding and accruing receipts of cash for the period January B through June B. The acceleration of receipts from January B through June B would provide a one-time jump of cash inflow.

Case 4 shows a *properly-done* shift to accrual, but without withholding. Income tax receipts booked for fiscal A-B are those that accrued in fiscal A-B. There are 12 months of receipts. With an expanding economy, there would be some gain in booked receipts – not a substantial amount – but no more actual cash.<sup>115</sup> To pay the state's bills – since there is not more actual cash in Case 4 – the state controller would have to borrow, either from other state funds or externally, or run down reserves (if any). Finally, Case 5 shows what actually occurred in fiscal 1966-67. There was a shift to accrual, but a pretense that there had also been a shift to withholding. In effect, Case 5 pretends that Case 3 had occurred. Unfortunately, pretending creates no cash revenue.

### **Reagan's Fiscal Dilemma**

Brown initially had believed that Reagan would be a weak candidate for Governor. Gray Davis intervened in the 2002 Republican gubernatorial primary to undermine the candidacy of former Mayor Riordan of Los Angeles (deemed to be the stronger candidate compared with his rival William Simon). In the same manner, Brown intervened in the 1966 Republican primary to undermine candidacy of the Mayor of San Francisco. But what worked for Davis (at least temporarily) did not work for Brown. His action made Reagan the frontrunner and, because Brown's intervention was seen as a "dirty trick," tended to undermine his own campaign. Ultimately, Reagan won by almost one million votes, roughly the margin by which Brown had beaten Knowland eight years earlier. He then had to deal with Brown's 1966-67 budget imbalance.

Some observers view Reagan's victory as simply a matter of his being more polished as an actor in the use of TV. But being telegenic has never been a guarantee of electoral success. Brown was convinced that voters just needed to see the greatness of California and his contribution to it in the forms of infrastructure and education. He



attributed his loss to the voters having become “bored” with him.<sup>116</sup> But the fact is that on a variety of dimensions, things seemed to be going wrong in California and one of those things was the unbalanced budget. More than boredom or acting ability was involved.

Once Ronald Reagan was elected Governor in November 1966, he needed to come up with a budget proposal for 1967-68 by January. The incoming Reagan administration had difficulty in finding a willing candidate for finance director and Reagan’s initial budget problems are sometimes laid to the fact that his first director – Gordon Smith – was not the best person for the job. An irony that will become apparent below is that Reagan offered the job to the above-mentioned Legislative Analyst of that period, A. Alan Post, who declined the offer and remained in his position as Analyst. Post reported that he was surprised that Reagan had claimed in his campaign that he would hire him (Post) to carry out his plans, a claim made without first consulting Post.<sup>117</sup> However, the interpretation that Reagan’s subsequent budget problems were due to the inexperienced Gordon Smith seems implausible. The problem was the imbalance, not the finance director.

It is true that Smith was not the best candidate in the state to be budget director.<sup>118</sup> His personal correspondence in the Reagan gubernatorial archives reveals that he overdrew his own checking account by \$8.50 while serving.<sup>119</sup> But Smith did at least have a professional background in accounting. In contrast, Hale Champion, Brown’s last budget director, was a journalist and public relations person, not a public finance expert. If all that Reagan needed was someone who could pull off a budget trick – such as the improper accrual approach – great financial talent was not needed. Champion had surely demonstrated that.

The problem was that once the trick had been played by Champion, Governor Brown, and the Legislature, there was no way to avoid its real consequences regardless of who was finance director. And the consequences were not hard to understand. The professional staff of the Department of Finance could quickly explain the problem to whoever held the top budget job. Ultimately, the problem in dealing with the budget was political and not a matter of accounting knowledge. The fact is that Champion himself, in an after-the-fact oral interview, seemed not to understand the difference between switching to withholding and switching to accrual.<sup>120</sup> And, for that matter, cabinet minutes suggest that despite the best efforts of Smith and state controller Houston Flournoy, Governor Reagan never quite understood cash vs. accrual.<sup>121</sup>

Reagan took office at a time of federal government expansion, a process that spilled over into state budgets through such programs as Medicaid (Medi-Cal in California). Just as today, Medicaid – and now the new federal drug program – poses challenges at the state budget level, so did it in Reagan’s day.<sup>122</sup> As a conservative, Reagan could rail against the federal expansion in health insurance. But he could not persuade the Legislature – and Brown’s nemesis Jessie Unruh – to eliminate such programs, even if he (Reagan) had been prepared to go that far.

In any event, Reagan – while moving to the right – never lost all of his New Deal instincts; he preferred to see the problem as preventing social programs from becoming too expensive – and of preventing government support of undeserving people – rather than moving to some libertarian ideal of no social programs at all. Medi-Cal encouraged recipients “*to seek help for the most trivial of ailments,*” according to Reagan, but, on the other hand, government did have a “*responsibility to those less fortunate.*”<sup>123</sup> That viewpoint meant drastic budget cutting was not on the table.

On the other hand, the idea of borrowing to pay current bills simply did not occur to anyone in Reagan’s conservative entourage, although it appears they were forced to do so to deal with the deficit in the final Brown budget. (That position is in sharp contrast to contemporary California budgeting, symbolized by approval of Props 57 and 58 of 2004.) If the Reagan administration couldn’t cut spending in line with actual cash receipts and it could not even think of borrowing to cover the revenue deficiency, tax increases become inevitable. That is the short version of what happened to Governor Reagan in 1967. Reagan’s tax increase decision was made more palatable by the claim that under the previous administration, the treasury had been “*looted and drained of its resources in a manner unique in our history.*”<sup>124</sup>

### **The Initial Reagan Budget**

*“The truth is that, with the 30 days available, it has been impossible for us to make all of the hard and realistic decisions required to provide you with... completeness in the proposed 1967-68 financial plan...”*<sup>125</sup>

Governor Ronald Reagan

In his memoir, Reagan remembers proposing and imposing a ten percent cut on all government programs as part of his initial budget.<sup>126</sup> And, indeed, an attempt was made to impose such an across-the-board cut, along with a hiring freeze, controls on official travel, and purchases of new equipment and cars. But as one sympathetic biographer put it, “*Ronald Reagan’s stories... are often instructive in what they omit.*”<sup>127</sup>

What was omitted in this case is that what was intended to happen – a ten percent cut across the board – didn’t in fact happen; budgets were not cut across the board by ten percent, although there was definite squeezing of budget items. In reality, exceptions were granted to the freeze. Some programs, if cut, such as employment of auditors, would have led to losses in revenue and were spared. Overall spending increased. Reagan remained opposed to income tax withholding on the grounds that taxes should be painful. His resistance to withholding persisted for several years thereafter. Indeed, Reagan famously said his feet were set in concrete on that issue.<sup>128</sup> Eventually, he gave in to his advisors and reversed his stance, but that cracking of the concrete did not happen until 1970.<sup>129</sup>

Early on in 1967, the new Governor – who had promised a special audit of the state fiscal situation – issued a report by public accountancy firms.<sup>130</sup> In fact, the firms did not conduct an audit in the sense of actually delving into state records. They simply

cited data from the Department of Finance and other agencies. Their report said what was already known, the state was facing a significant cash deficiency. Indeed, that the switch to accrual would hide a substantial gap between receipts and expenditures was known well before the final Brown budget was enacted.<sup>131</sup> However, the audit report helped justify the need for a tax increase, once Reagan had moved to that viewpoint.

The press was focused on the drama of Reagan vs. UC (due in part to student disturbances at UC Berkeley) and whether the budget problem would lead to tuition at public higher educational institutions. The details of the state books were not the focus. If reporters had done their sums, they would have known that even if Reagan had succeeded in cutting expenditures by 10% across the board, he would have finished 1966-67 with a substantial deficit. After the fiscal year ended, the state controller reported that the deficit was \$351 million and that the General Fund was left with a carry-over debt of \$194 million.<sup>132</sup> With General Fund expenditures of close to \$3 billion, a 10% cut would have been something under \$300 million, not enough to plug the deficit or come close to eliminating the carry-over debt.<sup>133</sup>

### **Reagan's Initial Tax Increase**

Property tax increases were becoming a political issue by the time Reagan became Governor and one way to provide property tax relief was to raise other taxes. Reagan did propose some increases in the state sales tax and minor taxes during the back-and-forth with the Legislature and Jessie Unruh, in particular, in negotiations on the 1967-68 budget. In his memoir, Reagan reported gaining a “grudging respect” for Unruh as a “legislative tactician,” although he characterized him as a “tax-and-spend liberal.”<sup>134</sup> Tax increases of approximately \$1 billion were imposed, with \$190 million earmarked for property tax relief.<sup>135</sup> All the major taxes were raised: personal income taxes, sales taxes, and corporation taxes. Former Governor Brown later conceded that a tax increase had been necessary, although he argued that Reagan overdid it, i.e., that \$1 billion was substantially more than necessary at that point.<sup>136</sup> Reagan's memoir briefly mentions the tax increase – although not the magnitude or composition – and blamed it on “the fiscal mess left by the Brown administration.”<sup>137</sup>

With the new taxes in place, the General Fund ran a surplus of \$296 million in 1967-68, enough to pay off the debt of \$194 million from the prior year and still leave a significant positive reserve balance.<sup>138</sup> Reagan vetoed about \$44 million in spending, roughly 1% of budgeted expenditures. Included in the veto was a symbolic rejection of public funding for a new governor's mansion.

### **The Legacy Problem**

*“Governor Reagan reversed his position on ‘no new taxes’... He chose to go with the Democrats and at once, the phrase ‘Reagan-Unruh Axis’ was heard all over the legislature.”<sup>139</sup>*

Conservative critic Kent Steffgen

From the viewpoint of conservatives on the extreme right, Reagan's initial year of governorship was a grave disappointment. It was bad enough that his appointments included moderate Republicans and even some Democrats. But a special betrayal of conservative principles was the 1967 tax increase. The fact that Reagan could, and did, blame the tax increase on his predecessor was not enough to mollify his conservative critics who would have preferred dramatic spending cuts, particularly in social programs.

Prior to running for Governor, Reagan had written a book entitled *Where's the Rest of Me?*, a line from one of his best films. The book was generally a folksy autobiography dealing with his upbringing and his radio, film, and TV career. It contained a version of "the speech" that he had given in multiple forums, which attacked overreaching government.<sup>140</sup> In 1968, disappointed conservatives published an attack book – *Here's the Rest of Him* – that pointed to Reagan's deficiencies.<sup>141</sup> Included was a chapter entitled "*The Largest Tax Increase In The History of All The States Of the Union.*" The conservative disappointment was in turn celebrated by Reagan critics on the liberal side who gloated that "*it was clear that Reagan had misled his most dedicated supporters.*"<sup>142</sup>

Figures 11 and 12 summarize fiscal affairs in the Pat Brown and Reagan administration. Pat Brown imposed tax increases during his two terms. But he ended up bequeathing a substantial negative reserve to Reagan who had to deal with the deficiency. Reagan – like Brown – raised taxes. But, unlike his predecessor, Reagan bequeathed a significant positive reserve to his successor, Jerry Brown (who continued accumulating until Prop 13 came along in 1978). However, Reagan's surplus was not the product of notable frugality relative to Pat Brown.

Real per capita spending in California rose at an annualized rate of 6.3% during the Reagan years compared with 6.0% under Pat Brown. Given the vagaries of adjusting for inflation (the GDP deflator was used for these calculations), it would be unwise to make much of the 0.3 percent annual gap between the two figures. Moreover, some of the "spending" took the form of local property tax relief and should properly have been recorded as lower revenue rather than increased expenditure. And the business cycle was more turbulent during Reagan's second term than during Brown's. But it can at least be said that Reagan's ending surplus was not due to a substantial squeeze on spending relative to Pat Brown. Thus, the shift from negative to positive in end-of-administration reserves had to be due to increased real per capita revenues.<sup>143</sup> Reagan proved to be a better tax collector than Pat Brown.

Reagan was considering running for the Republican presidential nomination in 1976 – or at some point – and needed soon to leave a gubernatorial legacy, his second term would end in January 1975. That legacy would have to counteract his actual tax and spending increases which contrasted with his anti-government rhetoric.<sup>144</sup> Reagan could point to incremental shifts – *de facto* tuition in public higher education, property tax relief, and an end to an inefficient business inventory tax. But such steps were not the fundamental changes that would excite his conservative constituency.<sup>145</sup>

Moreover, there had been tax cutting initiatives on the ballot during Reagan's governorship which he had *opposed*. These propositions were the so-called (Philip E.) Watson initiatives (Prop 9 of 1968 and Prop 14 of 1972) – predecessors to Prop 13 of 1978 – which aimed at cutting property taxes and which had been defeated. As part of his conservative creed, Reagan believed that, as much as possible, government services should be provided at the lowest feasible level of government. But if property taxes were sharply curtailed by Watson's propositions, local governments – which were heavily dependent on those receipts – would turn to the state (as indeed happened after passage of Prop 13).<sup>146</sup> So he opposed Watson. As a result, one post-Prop 14 review noted that Reagan's opposition to Watson's Prop 14 had “stunned” its supporters.<sup>147</sup>

Reagan did want to provide property tax relief and provided it at various points during his governorship. But his approach was effectively to use state tax rebates to offset local property taxes. That way, local governments would continue to collect their property taxes and make decisions locally. But the sting of the property tax would be offset by the state. In 1972, the Legislature, in a deal with the Governor, passed SB 90. Among other features, SB 90 raised the state sales tax by 1 cent (to 6%) effective July 1, 1973. The idea was that the funds would be used in part for property tax relief. However, raising one tax to offset another was not appealing to conservatives who wanted to reduce government activity generally. (SB 90 did put limits on property tax rates but unlike the later Prop 13, did not cap assessments.)

Use of some form of constitutional constraint to restrain federal spending was in the air in conservative circles during the 1970s. There was talk about balanced-budget amendments or other fiscal devices. The details were unclear but the general idea – at least among conservatives – was that democratic systems tended to respond to special interest group and populist pressures for increased public spending. But voters would be less keen on taxes than on spending so that there would be a tendency toward budget deficits, according to this line of thinking.

Conservative economists such as James M. Buchanan, Jr. – a member of the UCLA faculty in the late 1960s – developed models built on the assumption that politicians and bureaucrats maximize their own welfare in pushing for public programs and tax policies.<sup>148</sup> Buchanan and others emphasized the importance of the constitutional rules of the political game as drivers of public policy outcomes. Given the national interest in these concepts, enacting a specific constitutional fiscal constraint in California would attract attention around the country. It could be the legacy Reagan was seeking. And, indeed, the campaign surrounding Prop 1 in California did garner significant national interest.

Reagan himself declared at the height of the campaign for Prop 1, “*This can work at the national level...*”<sup>149</sup> And Congressman Jack Kemp – later to be Bob Dole's running mate in 1996 – announced just prior to the November 1973 special election that he was “working on” a federal constitutional amendment modeled after Proposition 1.<sup>150</sup>

## Proposition 1

*“Well, it sure was not well written.”<sup>151</sup>*

Ronald Reagan quoted by Ken Hall, chief deputy director, Department of Finance

Prop 1 – officially titled “Tax and Expenditure Limitations” on the November 1973 ballot – had a series of features. Its centerpiece, in the view of its drafters, was a revenue limit defined essentially as state tax revenues as a percentage of state personal income.<sup>152</sup> The drafters thought that the ratio was then about 8.5% and proposed to reduce the fraction by 0.1 percentage point a year until it reached 7% (after 15 years). In early deliberations, they had proposed a more rapid rate of decline and put the eventual target at 5%. But the more gradual schedule was finally adopted. Once the 7% target was reached, the annual 0.1 percentage point reductions would continue unless the Legislature voted by 2/3 to halt them.

A floor on how low the limit could go in any year (which would override the personal income calculation) was also provided. That floor was designed to keep real revenues per capita from falling below the level when Prop 1 became effective. It was derived from state population estimates and the national Consumer Price Index. The floor allowed proponents to argue that revenues would not be held below current levels. (But revenues could fall below “workload” levels. For example, if the number of inmates in state prisons rose faster than the general population, and/or the costs per prisoner rose faster than general inflation, the workload budget related to prisons would rise faster than the Prop 1 floor. Growth in unfunded federal mandates could also push up the workload budget.)

As will be noted below, use of personal income in a constitutional amendment poses difficulties, since the personal income series is subject to revision and has, in fact, undergone major revision over time. (It is used, nonetheless, in Prop 4 and Prop 98.) However, the drafters were looking for a readily-available measure of state economic activity and the personal income series is released on a regular basis without a long delay. Nonetheless, estimates of personal income would need to be made under Prop 1 and a special commission was to be created to carry out that function. The starting base year was intended to be fiscal year 1973-74. Tax revenues for that fiscal year were to be determined as a proportion of personal income for calendar year 1973.

Prop 1 contained various tax reductions and rebates. However, the Legislature granted a portion of these reductions and rebates separately from the initiative, thus reducing Prop 1’s net effect on immediate tax relief (and thereby making it less attractive to taxpayers than it otherwise would have been.) Although certain taxes required a 2/3 vote of the Legislature to increase, Prop 1 extended this requirement to all state taxes (thus foreshadowing the later Prop 13). Prop 1 prevented local governments from raising their property tax rates except in certain specified circumstances. But it did not thereby halt the rise of property tax bills which were increasing due to increasing property values and resulting assessments. New mandates by the state for local governments that

increased local costs had to be paid for by the state. But if the state cut back on revenue sharing with the localities due to Prop 1, pressure to continue existing local services might conceivably lead to local tax increases. Certainly, opponents of Prop 1 made that argument.

To deal with the argument that special unforeseen circumstances might require the revenue limit to be raised, Prop 1 allowed the Legislature to put such increases to the people but only by a 2/3 vote. Voters could then approve such increases by majority vote. In addition, a special fund equal to 0.2 percent of personal income was to be created to deal with emergencies declared by the Governor.

The drafters of Prop 1 essentially were trying to envision future contingencies and objections. Thus, they included such definitions in the proposition's language as the "State Tax Revenue Limit Population-Inflation Quotient." Such components, however, could be highlighted by opponents as symptoms of excess complexity and hard-to-understand provisions. The drafters failed to understand that in trying to be complete, they were making the proposition less attractive.

## **Planning**

Once a decision was made in early 1972 to push for a constitutional approach to budget control, a Tax Reduction Task Force was formed. In principle, the Task Force reported to Frank Walton, Secretary for Business and Transportation. Notably, an early report signed by Walton refers to federal spending as well as state and local spending as needing control.<sup>153</sup> Thus, the national scene was on the agenda from the beginning.

Despite Walton's titular role, the running of the Task Force was left to Lewis K. Uhler (who had earlier held various positions in the Reagan administration and was the official proponent of the paycheck protection initiative on the November 2005 ballot). Uhler assembled a group of conservative economists, including Milton Friedman, James Buchanan, William Niskanen, C. Lowell Harriss, W. Craig Stubblebine – Stubblebine is often viewed as the major force among the economists involved – and several UCLA economists including J. Clayburn LaForce and Armen Alchian.

Reagan's sympathetic biographer, Lou Cannon, viewed the development of Prop 1 by the Task Force as "*a cautionary tale about indulging ideology at the expense of common sense.*" He interprets this episode as "*a story of misjudgment of aides who ignored historical lessons and political realities and thereby failed Reagan...*" He singles out Uhler as an aide who "claimed to be a Reagan loyalist" as the "driving force" behind Prop 1 and notes that Reagan "airbrushed" Uhler out of his memoir because of Uhler's "extreme views and Bircher associations."<sup>154</sup> Another Reagan biographer, Bill Boyarsky, cites an unnamed administration source who termed Uhler an "unmanned missile."<sup>155</sup> Suffice it to say that Uhler and Stubblebine in later oral interviews saw the Prop 1 story somewhat differently.<sup>156</sup>

Uhler put the blame for deficiencies in the campaign for Prop 1 on Michael Deaver, another Reagan aide. Stubblebine also noted problems with Deaver. And others have also suggested Deaver was a poor administrator.<sup>157</sup> Deaver's judgment was certainly open to question. During the campaign, he stated publicly that proponents were hoping for a low turnout in the election, since that would favor enthusiastic proponents who would turn out. Reagan was forced to say that of course he hoped that everyone would vote and that Deaver's views were based on a "misunderstanding." As for Deaver himself, there is no mention of Prop 1 in his rather disjointed memoir on his service to Reagan – a fact suggesting that Prop 1 was an unpleasant memory for him.<sup>158</sup>

But Deaver's deficiencies notwithstanding, ultimately it was the Governor's decision to delegate the process and to have an outside committee – largely composed of academics with no political experience – put together an initiative that would essentially have the Reagan's name on it. As the Task Force was completing its work in late 1972, Reagan had lunch with its members; he was certainly aware of the program and the planning going on.

The fact that Reagan emphasized delegation of authority as Governor is well known. A standard explanation is that he was inexperienced in running an organization before taking office. This explanation ignores his experience in heading the Screen Actors Guild and, in any event, seems strained when placed in the context of a second term as Governor. Another explanation for Reagan's propensity to delegate is that as a conservative he was not interested in Big Ideas for government and emphasized efficient operation instead.<sup>159</sup> However, Prop 1 was a Big Idea – albeit in shrinking government. And the effort to formulate – and then campaign for – Prop 1 was not well managed. In essence, Prop 1's failure reflected excess delegation to the point that the chief executive was not asking critical questions.

Given the complexity of what was being proposed as a constitutional amendment, some external testing was needed. The Task Force did commission a public opinion survey. Stubblebine suggests that Uhler wanted the survey to give the "right" answer, i.e., that the proposal should be put to the voters. But Stubblebine indicated that he understood that just asking people whether they liked paying taxes would not provide useful information. A good survey would have to get at trade-offs: How much were people willing to pay for what?

In the end, however, it is not clear that the survey actually taken really did what Stubblebine wanted. Because the Task Force was composed of like-minded people, the danger of Group-Think abounded. There was no process for testing the developing plan against the ideas of those likely to be opposed. No one likely to be in the opposition was consulted. Even a suggestion by an official within the Department of Finance that the administration run its initial projections on Prop 1 by the Legislative Analyst (so that a "numbers war" could be avoided) was apparently not heeded.<sup>160</sup>



## **Warning Signs**

There were warning signs on display early on, however, if someone had cared to look. Finance Director Verne Orr was apparently not keen on the idea of a constitutional amendment. His deputy, Ken Hall, indicated that he (Hall) had played the role of devil's advocate as the proposal emerged. However, his activity appears to have been more than just role-playing; he also was not keen on the concept. Although Orr and Hall later had to defend the proposal in public, their internal reticence was surely a signal that something was amiss.

Houston Flournoy, the Republican state controller – who later ran for governor and lost to Jerry Brown in 1974 – had significant doubts about Prop 1. Flournoy, although independently elected, was certainly consulted by and a participant in the Reagan administration on various matters. Ultimately, as a good soldier as the campaign progressed, he formally endorsed Prop 1, but his reluctance and qualifications were apparent and were cited by Prop 1 opponents. Apart from the specifics of Prop 1, Flournoy and other moderate Republicans were not enthusiastic about constitutional constraints on the budget process.

Finally, Henry Salvatori, a member of Reagan's "kitchen cabinet," reported in an oral interview that he had had doubts about the specifics of Prop 1, although he supported the general idea.<sup>161</sup> Whether he was asked for his views at the time of the campaign is unclear. But if not, he was certainly available to be asked, if someone had wanted an alternative view.

Uhler was gung-ho on the Prop 1 initiative. He boasted of taking the plan directly to Nancy Reagan's parent's house during the Christmas break in December 1972, so that the Governor would definitely see it. But although Uhler and others may have been enthusiastic, the delegating and outsourcing took place because the Governor wanted a legacy and pushed the project forward. If the project was not going to be done by a reluctant Verne Orr, it could be carried on elsewhere. But given the reluctance of his finance director to formulate Prop 1, perhaps the Governor's pursuit of legacy would better have been carried out through some other means.

## **Outsourcing, Delegating, and Campaign Administration**

In any event, the outsourcing and delegation of authority proved to be a problem. The Task Force could attract prominent names. Norman Topping, past president of the University of Southern California, chaired the pro-Prop 1 campaign conducted by "Californians for Lower Taxes." But respected names and efficiency of administration were not the same things. Thus, the Task Force seemed on the verge of not having enough signatures at one point to put its proposition on the ballot. Professional signature gatherers were hired to fill in the breach. Stubblebine reported warning the administration that the campaign shouldn't go on vacation during the summer of 1973, although apparently that is what happened. Yet a poll taken for the administration

revealed that as of June 1973, less than a fourth of Californians had even heard of the proposition.<sup>162</sup>

Reagan's own involvement in the effort to sell Prop 1 was problematic. His principal opponent in the campaign for Prop 1 was Democratic Assembly Speaker Bob Moretti. Reagan originally submitted the Prop 1 proposal to the Legislature to put on the ballot, although he could be reasonably sure that the Legislature would not do so. The idea was to let the Legislature debate the plan, demonstrate that the Legislature would not willingly give the people the opportunity to vote on Prop 1, and then use the petition/signature route to put the plan on the ballot anyway. However, the strategy of nominally going through the Legislature anointed Moretti as the key opponent. And Moretti and others in the Legislature could hold hearings on the plan Reagan had submitted and control their agenda.

Moretti obtained substantial mileage out of calls for Reagan to debate him directly on the Prop 1 issue. The calls started in the spring of 1973 and were constantly repeated. But Reagan shied away from such matches – probably because of the complexity of the plan. Reagan was a good communicator but a communicator of simple concepts. Eventually, a debate was held on *The Advocates*, a public television program, less than a month before the election. But by that time the image had developed of the Governor avoiding a debate until forced into it. After the defeat of Prop 1, Reagan complained that opponents “*desperately avoided debating the central issue: whether taxes are too high now and whether the tax burden should be reduced.*”<sup>163</sup> But Prop 1, with its long-term potential shift of taxes from the state to the localities, did not pose the question so simply. And it had been Reagan who was reluctant to debate, not Moretti.

### **Attacking Post**

The other personality pulled into prominence by the strategy of first going to the Legislature was Legislative Analyst A. Alan Post, the man Reagan had wanted to be his first finance director. Prop 1 did not appeal to Post, who had been Legislative Analyst since 1950 and had been with the Analyst's office since 1946. Unlike Pat Brown, whose candidacy for political sainthood came well after his terms of office, Post was already a living saint. Post's tenuous analysis of the accrual vs. cash issue back in 1966 has already been noted. Nonetheless, he had the image of Mr. Clean, Mr. Neutral, and Mr. Competent Technocrat, someone who understood the nuances of state budgets. Presumably, that image was why Reagan wanted him back then as finance director.

When Post expressed severe doubts about Prop 1, Reagan and his administration went into attack mode. And Post was targeted on two of his perceived strengths: neutrality and competence. Post had begun his adult life as a Republican. Exactly what his party inclination was at the time is unclear since his role was officially non-partisan.<sup>164</sup> But the attack on him simply did not resonate with the public.

Reagan cited “horrendous errors” of forecasting made by Post in the past and said the supposedly non-partisan Analyst in fact was supporting “his bosses” (presumably

legislative Democrats).<sup>165</sup> Economic forecasting in this period was especially difficult, due to the impact of federal wage and price controls, the end of fixed currency exchange rates, and other factors. Thus, it is likely that Post did have difficulty in forecasting budget outcomes. But he was not perceived as someone who deliberately tilted his forecasts, the crucial point in the attack.

Initiatives must include a statement prepared by the Legislative Analyst on fiscal impact. Post's language projected substantial cuts in state expenditures relative to workload projections. Ken Hall, the chief deputy director of finance who was not enthused by Prop 1, was sent to an Assembly hearing to complain about Post's wording as "*misleading, distorted, biased, and not befitting the Office of the Legislative Analyst.*"<sup>166</sup> But such attacks by Reagan or members of his administration detracted from the campaign for Prop 1. As one commentator noted, rather than attacking Post, Reagan would have been better off suggesting "*that a woman's place is in the kitchen or that Yosemite Park would be a fine place for a housing development.*"<sup>167</sup> Post held himself aloof from the criticism saying, "*I don't debate governors. That's not my function.*"<sup>168</sup> Meanwhile, Secretary of State Jerry Brown declined a request from the Reagan administration to order Post to rewrite his analysis, but he did require a rewrite of the proponents' statement.

### **SB 90 and the Sales Tax**

One of the oddities of the attack on Post is that the Prop 1 proponents – who were supporters of reduced government – found themselves arguing that the impact of the initiative would be much milder than Post's projection. That is, it appeared that public support for Prop 1 depended on a perception that it would not do anything drastic. But here SB 90, the tax legislation of 1972, began to play a critical role. Prop 1 used 1973-74 as a base year. SB 90 raised the sales tax 1 cent to 6% on July 1, 1973. But the state turned out to have a surplus without the 1-cent increase and after a delay and negotiation, Moretti and Reagan agreed on a temporary rollback. (The tax initially went up during a stalemate in the negotiation and then dropped down.) The rollback and tax cuts contained in Prop 1 itself potentially lowered the 1973-74 base, causing a greater squeeze on future spending than proponents at least said they had intended.

Proponents managed to obtain a fuzzy opinion from Republican Attorney General Evelle Younger that a court, in interpreting Prop 1 – if it passed – might not insist in cutting the base despite the rollbacks and tax cuts. But his opinion was just that – an opinion – and an uncertain one at that. It was based on the premise that a court would not read the literal language and rely instead on what proponents surely intended, but didn't say. The base issue – accentuated by the attack on Post – suggested sloppy drafting of Prop 1's language, yet another demerit of Prop 1 in the public view.

### **Task Force Costs**

Opponents of Prop 1 complained that the Governor should not be using public resources to promote Prop 1. That complaint by itself was silly. Governors routinely

advocate or oppose public policies and are elected to do so. However, more traction was obtained on the specific sources of funds used for the Task Force. Uhler had apparently cobbled together a budget from various agencies, using funds which arguably were appropriated for other purposes. Some litigation on this issue from 1973 was still going on in the early 1980s. However, the total amount of funding was itself small and some of the Task Force's activities had been financed from outside sources. Yet the funding issue opened the door to legislative inquiries about improper use of public resources.<sup>169</sup>

Prop 1 proponents countercharged that Bob Moretti was using legislative resources to oppose the proposition. But Moretti took the position that he was entitled to do so rather than denying the use. Thus, the issue regarding Moretti never had the traction that the controversy surrounding the Task Force attained, despite litigation filed against Moretti and against others by pro-Prop 1 forces.

An indirect cost issue was the expense of calling of a special election rather than waiting for the next scheduled election in June 1974. Calling a special election opened the door to charges that the election was a waste of government funds. Some local elections were to be held in November 1973 so in some districts there would have been polling costs in any event. However, it could be argued that there was no particular need for a long-term budget constraint initiative to be on the ballot in November rather than the following June. There may have been thinking within the Task Force that a special election with just one issue – Prop 1 – would draw in more voters sympathetic to the Governor's goals than a general election. The Deaver comments noted earlier suggest that view. But it is not clear that the Task Force or those delegated with the Prop 1 project really weighed the timing options.

### **The Pro-Prop 1 Campaign**

The campaign for Prop 1 did have some notable successes. For example, it obtained the endorsement of Philip Watson, the L.A. County Tax Assessor whose previous cut-the-property-tax initiatives had been opposed by Reagan. Howard Jarvis – later to lead the crusade for Prop 13 – also supported Prop 1. Democratic Assemblyman Randolph Collier, whose name was identified with the creation of the California freeway system, also endorsed the proposition.<sup>170</sup> So did two Democratic finance directors (one from the Pat Brown administration).<sup>171</sup>

Although, as noted earlier, State Controller Flournoy had his doubts, other prominent Republicans did get on board. Included were Ivy Baker Priest, the State Treasurer and, Caspar Weinberger, Reagan's former finance director who had become Nixon's Secretary for Health, Education and Welfare. Former San Francisco State President Sam Hayakawa – a Reagan favorite for his tough stance against student demonstrators at the college – was a Prop 1 supporter. (Hayakawa later became a U.S. Senator from California.)

If there was a coup in obtaining endorsements, it probably was a vote by the L.A. City Council to support Prop 1. The campaign for that endorsement involved personal

phone calls from Reagan to selected council members. (However, L.A. Mayor Tom Bradley opposed Prop 1.) Perhaps a runner up for a coup in endorsements was an editorial in the *Los Angeles Times* supporting a “yes” vote on Prop 1 just before the election, after an earlier editorial in the *Times* had opposed it.<sup>172</sup> A third runner up was probably the endorsement by James Roosevelt, a former congressman and son of FDR, who had been the Democrats’ candidate for governor in 1950.

Although there were radio and television ads, the Prop 1 campaign came up with what was then a unique telephone ad by Reagan himself. A message from the Governor was automatically dialed to Republicans and others. (There were apparently at least two versions – a partisan and a non-partisan message). Recipients heard both a direct message from the Governor and then were invited by him to stay on the line and speak with an operator to volunteer their support. Such telephone communications had been used before in some local elections, but never on a statewide basis.

### **The Anti-Prop 1 Campaign**

The organizations in opposition to Prop 1 were the usual suspects: labor unions – with the California Teachers Association prominent in that role – minority organizations, and other liberal groups. The League of Women Voters was also prominent in the opposition camp. Arguments against Prop 1 centered around the complexity of the initiative, sloppy drafting (the base year problem noted earlier), and the cost of a special election (“a staggering waste of your money”). Opponents hired Whitaker and Baxter, normally a Republican campaign consultant firm, to run the anti-Prop 1 campaign. Clem Whitaker of the firm quickly labeled Prop 1 “a hoax.” Secretary of State Jerry Brown pushed the additional argument that a cap on the state budget would push responsibilities down to local governments, thereby causing local taxes to rise.

Californians for Lower Taxes – the pro-Prop 1 campaign organization – feared that if the initiative was seen as a partisan issue, it would lose. “*This must not (underlining in the original) be allowed to become a Morretti (sic) – Reagan fight or we could lose it,*” an internal campaign document declared. In fact, the opposition likely agreed with this diagnosis; it did its best to portray the proposition as a partisan matter relating to Reagan’s presidential ambitions. And the contest did become a Moretti vs. Reagan fight to a considerable extent.

Moretti released a lengthy report by R. William Hauck, director of the Assembly Office of Research, criticizing Prop 1 in detail. (Ironically, Hauck – now president of the California Business Roundtable – was a co-author of Governor Schwarzenegger’s budget restraint initiative for the November 2005 ballot.) The “Hauck-Moretti Report” triggered a detailed rebuttal by economists associated with Californians for Lower Taxes. However, that sort of debate – economists wrangling with economists – reinforced the impression that Prop 1 was a complex technical matter.

From Reagan’s perspective, the problem was that although the language of Prop 1 was complicated, the idea behind it was simple, if only voters would understand. “*We*

have not been able to get through to the people that we are not trying to reduce the dollar amount of the budget,” he complained.<sup>173</sup> At one press conference, he complained that the media were “unwilling” to put out the true message – and then quickly apologized.<sup>174</sup>

But it was finally Reagan’s own misstep that cemented the idea of complexity. When asked if the average voter could understand the initiative’s detailed language, he replied, “No, he shouldn’t try. I don’t either.” Whitaker and Baxter created newspaper ads proclaiming, “When a Proposition’s Chief Sponsor Doesn’t Understand It, It’s Time for The Rest of Us To Vote No On Proposition No. 1.” Reagan tried to correct the impression by saying he was being “facetious.” But the damage was done.<sup>175</sup> Complexity by itself, however, wasn’t the issue; it was complexity mixed with a voter perception that there was no emergency. Why vote for something hard to understand if there is no pressing need? In the end, Prop 1 went down to defeat, 46% (yes) to 54% (no).

### **Contemporary Lessons from Prop 1**

*“In the fall of 1973, I campaigned for Proposition 1... Opponents... claimed that the state could not live under the restrictions... (The) budget which I present to you today... calls for expenditures no larger than those which would have been permitted if the constitutional amendment had been enacted...”<sup>176</sup>*

Governor Ronald Reagan presenting his 1974-75 budget proposal

*“Whatever the reasons for the defeat, it wasn’t due to a lack of campaign funds.”<sup>177</sup>*

Commentator Bruce Keppel

When Governor Reagan submitted his 1974-75 budget in January 1974, he argued that it met the Prop 1 formula and thus proved that there would have been no drastic cuts if Prop 1 had passed. However, because of the uncertainty about the base year interpretation, that issue is not clear. Reagan’s budget was submitted on the assumption that the higher base interpretation was correct. But only a court could have made that decision. (And as is always the case, what was submitted in January was not what eventually was passed.)

Apart from the immediate next budget year, we can ask what the world would have been like over the longer term if Prop 1 had passed. Because of Prop 1’s complexity – what counted, what did not – that question is also difficult to answer. However Figure 13 shows total state revenue against the 7% target of Prop 1. In most years shown, spending after 1973-74 is above the target. But that observation raises an interesting point.

In the period around the point where Prop 1 would have gone into effect, current data suggest that the revenue percentage was close to 7%. Yet the designers of Prop 1 thought that the base number was around 8.5% and that Prop 1 would cause a gradual

descent to 7%. The discrepancy seems to lie in the fact that personal income data are subject to revision and were in fact revised upward, pulling down the ratio significantly. How such revisions would have been reflected in California fiscal policy is uncertain. Unlike the Consumer Price Index, personal income estimates are not designed for indexing. So retroactive revisions can result from changes in methodology and definition. Would a court have reset the target when the personal income estimates changed? It's hard to know.

Another issue is whether voters would have approved Prop 13 in 1978, if they had previously approved Prop 1 in 1973. W. Craig Stubblebine – who, as noted early, is often credited with the design of Prop 1 – in fact, did not support Prop 13 when it came along. However, he believed that Prop 13 would not have been enacted if Prop 1 had been in place. If that is correct, the jump in state expenditures shown on Figure 13 after Prop 13 was passed – as local governments became more dependent on the state – would not have occurred. But the assumption that Prop 13 would not have been passed if Prop 1 had is itself open to question. Presumably, the escalation of property values that hiked property tax bills would have occurred after 1973, Prop 1 or not. And it was rapidly-rising property tax bills that triggered Prop 13. If both Prop 1 and Prop 13 had been in effect, the state bailout of the localities after Prop 13 passed would have been constrained. What would then have followed is unclear.

Prop 4 of 1979 was closer in spirit to Prop 1 than was Prop 13. Prop 4 imposed a spending limitation based on inflation and population growth. However, when Prop 4 triggered a rebate to taxpayers in the mid-1980s, voters passed Prop 98 which weakened Prop 4 and steered state money toward K-14 education rather than into rebates. Using retrospective data, it appears that the spending boom of the late 1990s should have hit the modified Prop 4 ceiling. But the vagaries of data revision apparently kept state spending below the ceiling as it was measured at the time even though the cap in hindsight was exceeded. And even if the cap had officially been binding, there were routes around it that the Legislature might have used.<sup>178</sup>

The Prop 4 experience suggests that even constitutional amendments can be modified by voters if they don't like the results. California's constitution is much easier to modify than the federal constitution. Constitutional amendments need more signatures than initiative legislation if the petition route is used to put them on the ballot. But only a majority of voters is needed to pass such amendments, once on the ballot. Thus, while Prop 4 passed with 74% of the vote, Prop 98 – which amended it – squeaked through with barely more than 50% support.

Complexity became an issue for Prop 1. But the voters since that time have passed complicated measures. Prop 98, with its various formulas is anything but simple. And Prop 98's modification of Prop 4 stuck personal income – with its problem of data revision – into the formula mix. What seems to be the case is that complex measures can pass if they seem to address a felt need. Prop 13 addressed capping rising property taxes, a felt need. Prop 98 addressed funding for schools, a popular concern. Prop 4 was sold as protecting the very popular Prop 13. In short, the Reagan experiment with ballot-box

budgeting has more lessons for political leadership and campaign tactics than it does for economic formulas or consequences.

In the end, the Prop 1 campaign became the only election Reagan ever lost in his political career. Much later he termed Prop 13 – California’s far-reaching property tax limitation – as “a similar measure” to Prop 1.<sup>179</sup> But Prop 13 – as noted earlier – was more similar to the earlier Watson initiatives (that Reagan had opposed as Governor) than it was to Prop 1. And Reagan’s memoir is notable for what it leaves out; although Bob Moretti is mentioned in the book in another context, his connection with the defeat of Prop 1 is not discussed.<sup>180</sup>

The defeat of Prop 1 left Reagan without the hoped-for legacy to carry into the national arena, a result cheered by liberals.<sup>181</sup> Of course, ultimately Reagan won the presidency in 1980 despite Prop 1’s failure. And it may be that taking sides on initiatives means less than is often believed for a candidate’s electoral success. Moretti hoped his successful battle against Prop 1 would take him into the governorship in 1974. But it failed even to earn him the Democratic nomination for governor, which went instead to Jerry Brown.<sup>182</sup>

In his own mind, Reagan was convinced to the end that the defeat of Prop 1 was due to false propaganda by opponents and that his side “*just didn’t have the resources to counter their advertising blitz with the truth.*”<sup>183</sup> He was sure that the voters had a need for Prop 1 and simply didn’t know it. But apart from the merits or demerits of Prop 1, Reagan’s side clearly had more resources than Prop 1’s opponents for advertising and campaigning generally. It was estimated that proponents of Prop 1 outspent opponents 3-to-1. The same report indicated that workers within the pro-Prop 1 campaign felt that the effort had been mismanaged.<sup>184</sup>

## **Lessons from History**

In the aftermath of the November 2005 special election on budget constraints and other issues, the contrast and parallels with Prop 1 of 1973 are interesting. The 2005 election was different from that of 1973 in that there were several items on the ballot. Redistricting and paycheck protection were linked to the budget in the mind of Governor Schwarzenegger (but not the electorate) through the political channel. He assumed that a weakening of unions and Democrats would tend to improve budgeting, even apart from the explicit budget proposition that was also on the ballot. Reagan was focused on one issue; Schwarzenegger had several, not all of which were on the ballot.

But one lesson stands out: Outsourcing and delegating the campaign carried out in the Governor’s name was a major problem for Reagan; raising campaign dollars was not. The same was true of Governor Schwarzenegger; he could raise money, but had outsourced his agenda. Although the electricity and budget crises had elected him in 2003, only one of his initiatives aimed at the budget – and that one was written by outsiders. Electricity was on the ballot only in a form the Governor didn’t like. In effect, the Governor’s agenda had been captured by others who had their own interests.



When Reagan was president, he argued in the context of an arms treaty that it was necessary to “trust, but verify.” Given the myriad functions of a governor, it is essential to delegate authority to trusted underlings. But it is also necessary for a governor to set priorities and to verify that those entrusted are carrying out the key agenda items competently, not setting them. Just raising money after the fact won’t do that. Money isn’t everything.

Figure 1: Workers Covered by Union Contracts: 2004

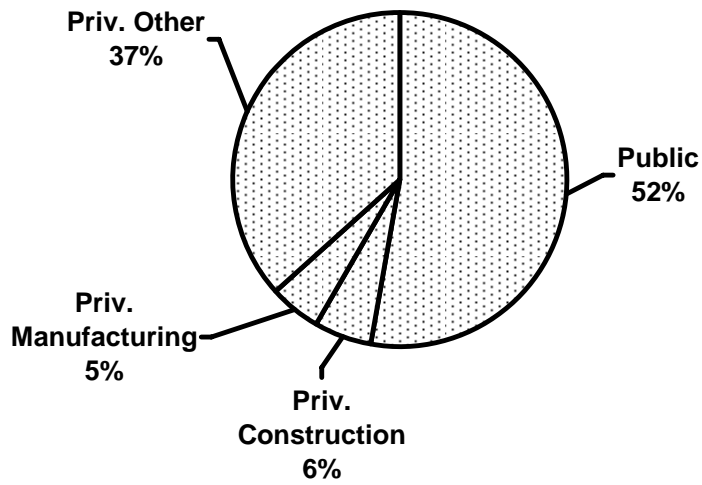
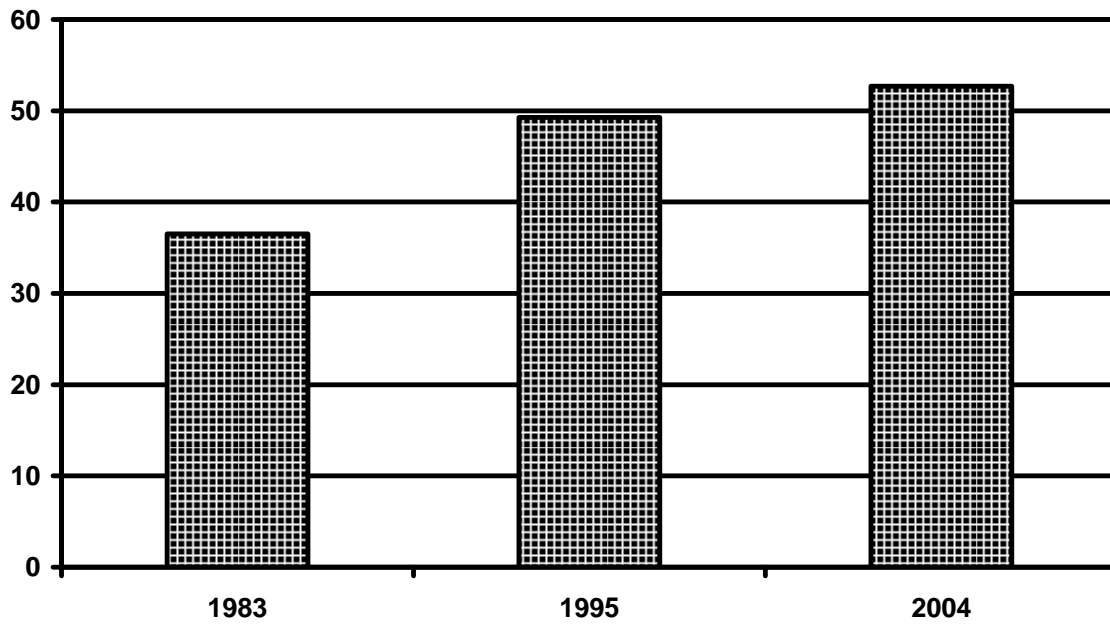
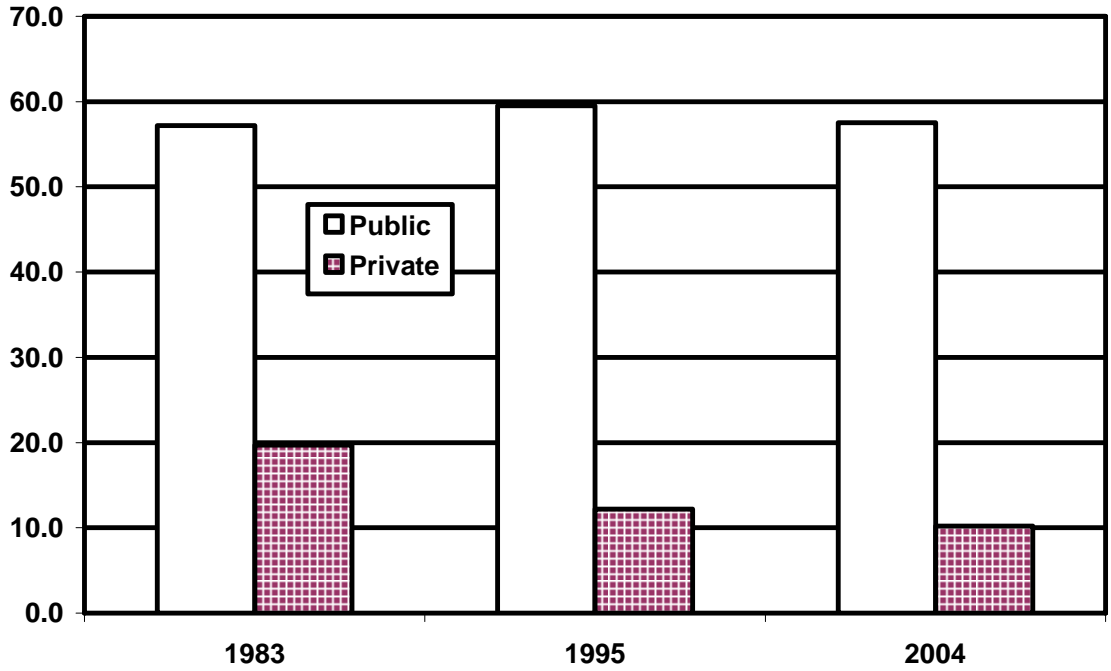


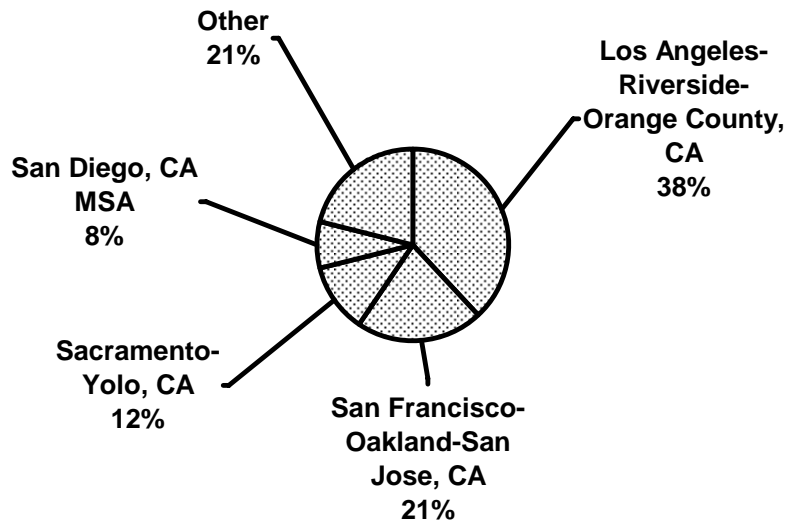
Figure 2: California Public Sector Union Coverage as Percent of Total Union Coverage



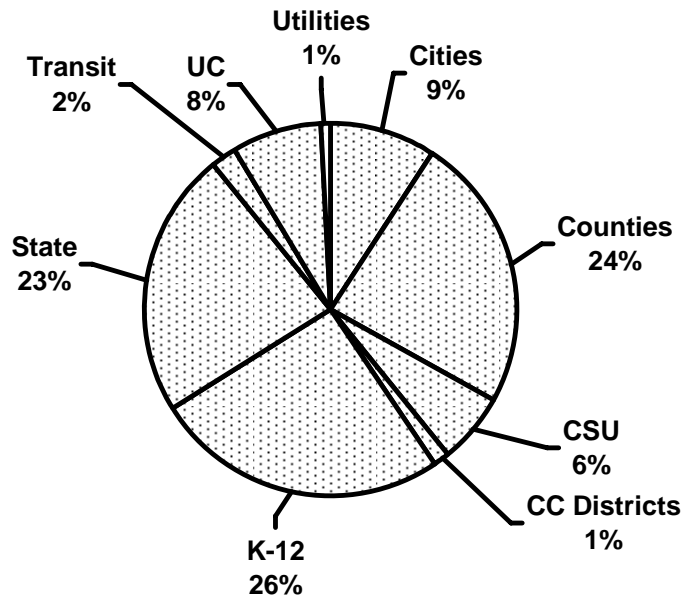
**Figure 3: Union Coverage as Percent of Wage & Salary Employment**



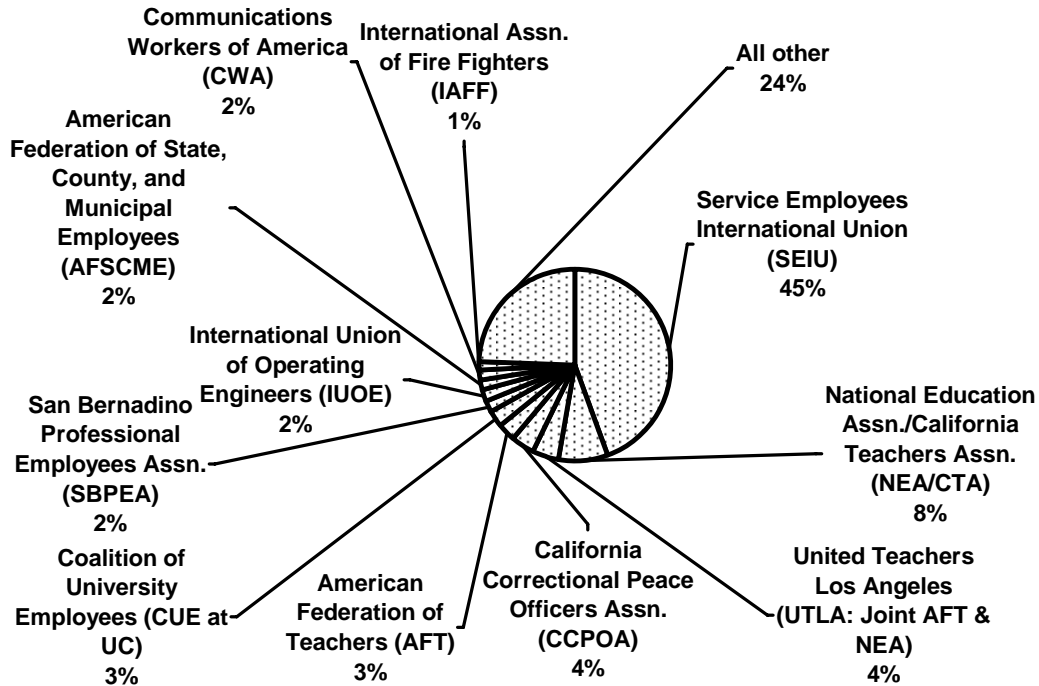
**Figure 4: Regional Distribution of Public Sector Workers Covered by Union Contracts: 2004**



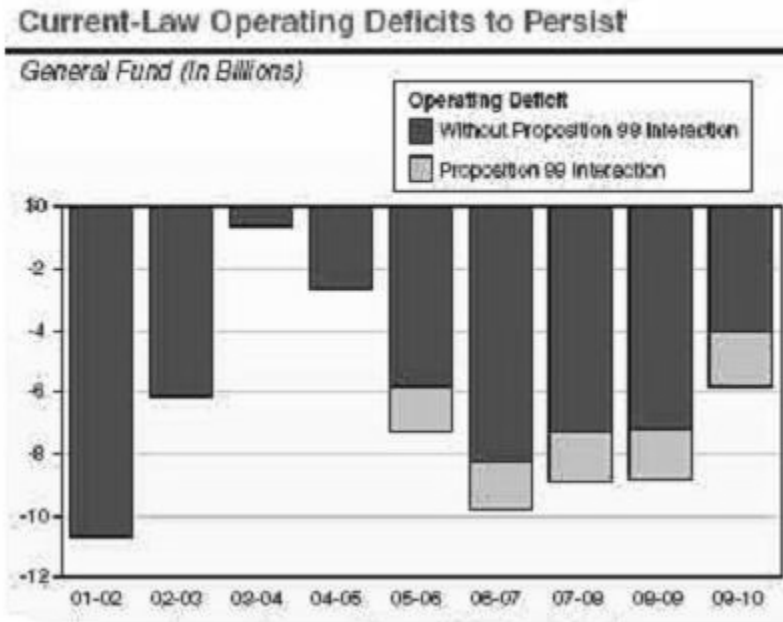
**Figure 5: Distribution of Public Sector Workers Under Major Union Contracts**



**Figure 6: Distribution of Public Sector Workers by Major Union Contract Coverage**

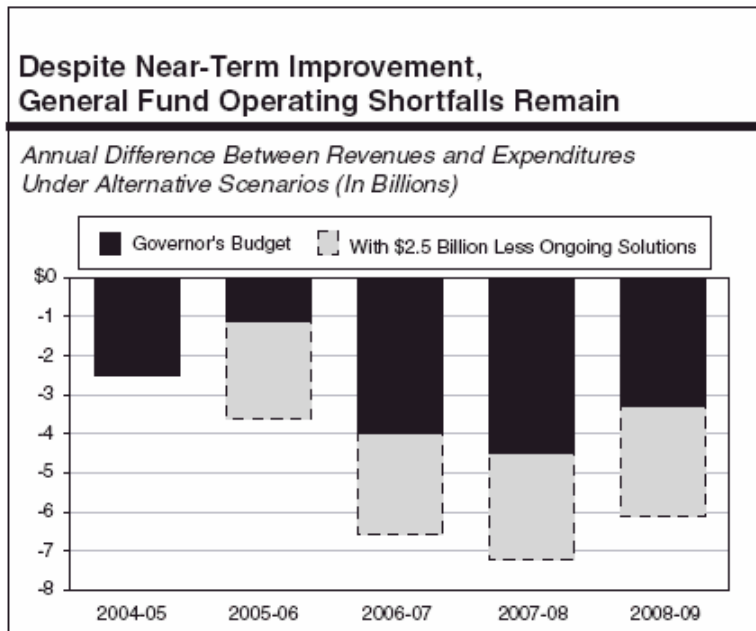


**Figure 7**



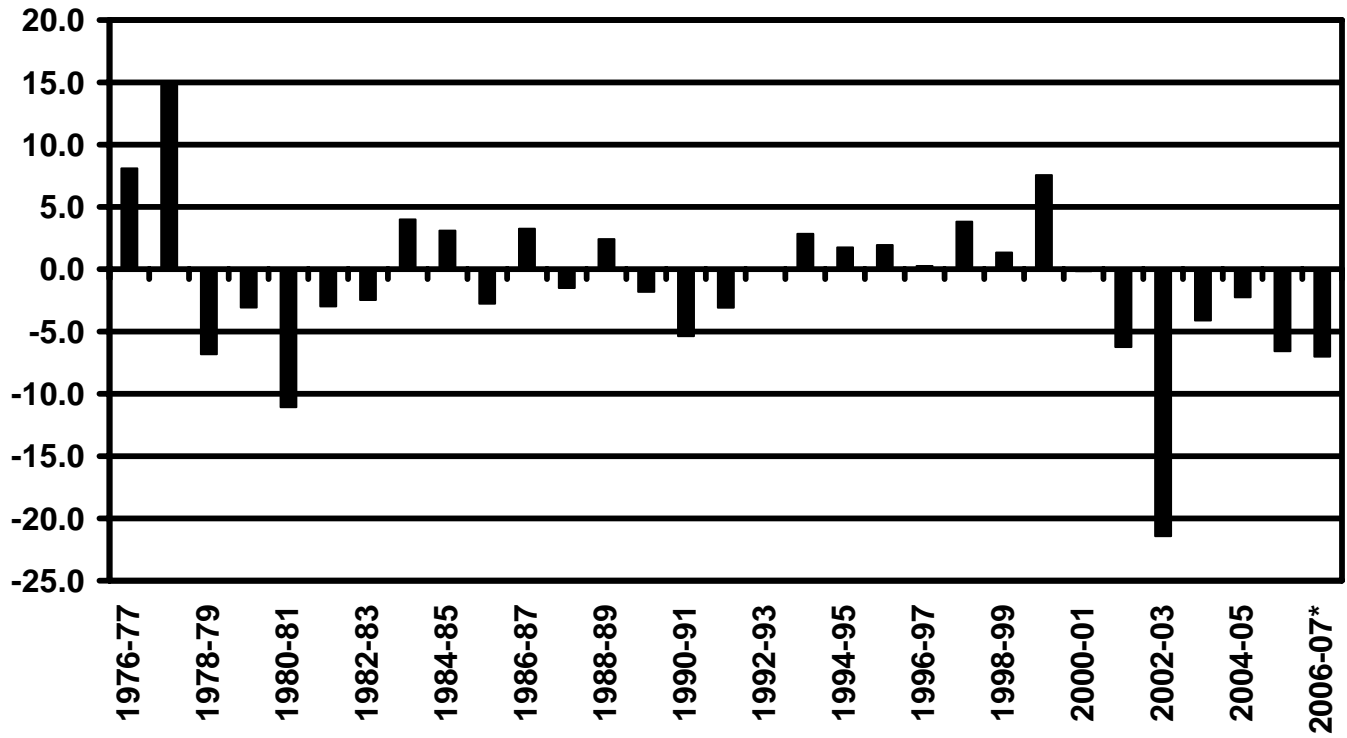
Source: Legislative Analyst's Office, *California's Fiscal Outlook*, November 2004, [http://www.lao.ca.gov/2004/fiscal\\_outlook/fiscal\\_outlook\\_04.pdf](http://www.lao.ca.gov/2004/fiscal_outlook/fiscal_outlook_04.pdf)

**Figure 8**



Source: Legislative Analyst's Office, *The 2005-06 Budget: Perspectives and Issues*, February 2005, [http://www.lao.ca.gov/analysis\\_2005/2005\\_pandi/pi\\_part\\_1\\_anl05.htm](http://www.lao.ca.gov/analysis_2005/2005_pandi/pi_part_1_anl05.htm)

Figure 9: Surplus or Deficit in General Fund as Percent of Revenues and Transfers



Note: Adjusted for electricity crisis spending in early 2000s.  
 \*Workload budget estimated by Legislative Analyst.

Note: Data from Department of Finance.

**Figure 10: Alternative Tax and Budget Treatments**

**Case 1: Ongoing**

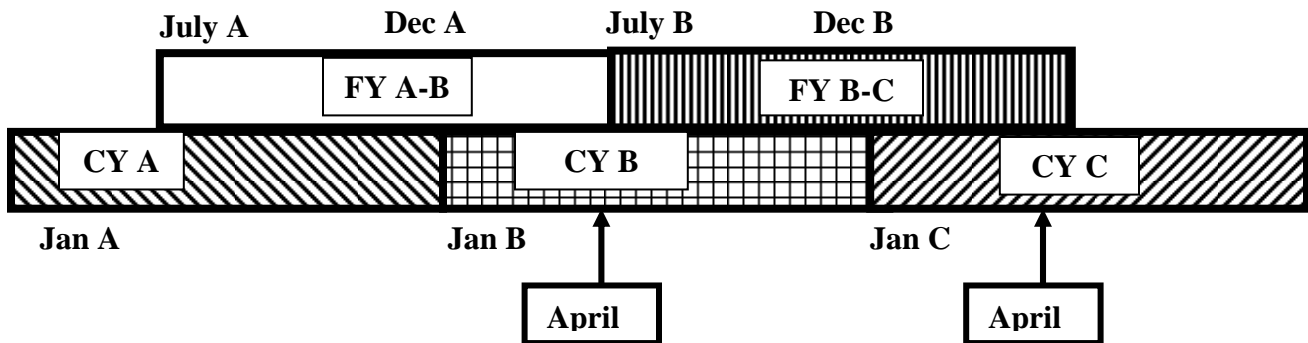
Cash Basis - No Withholding

Revenue accrued in calendar year (CY) A  
received in fiscal year (FY) A-B on  
April B.

**Case 2: Ongoing**

Cash Basis - Withholding

Revenue accrued in FY A-B  
received in FY A-B as it  
accrues.



**Case 3: Transition in FY A-B**

Cash Basis - Withholding Imposed Jan B

Revenue accrued in CY A plus  
revenue accrued first half of  
FY A-B (Jan B-June B) received in  
FY A-B.

**Case 4: Ongoing or Properly-Done Transition**

Accrual Basis - No Withholding

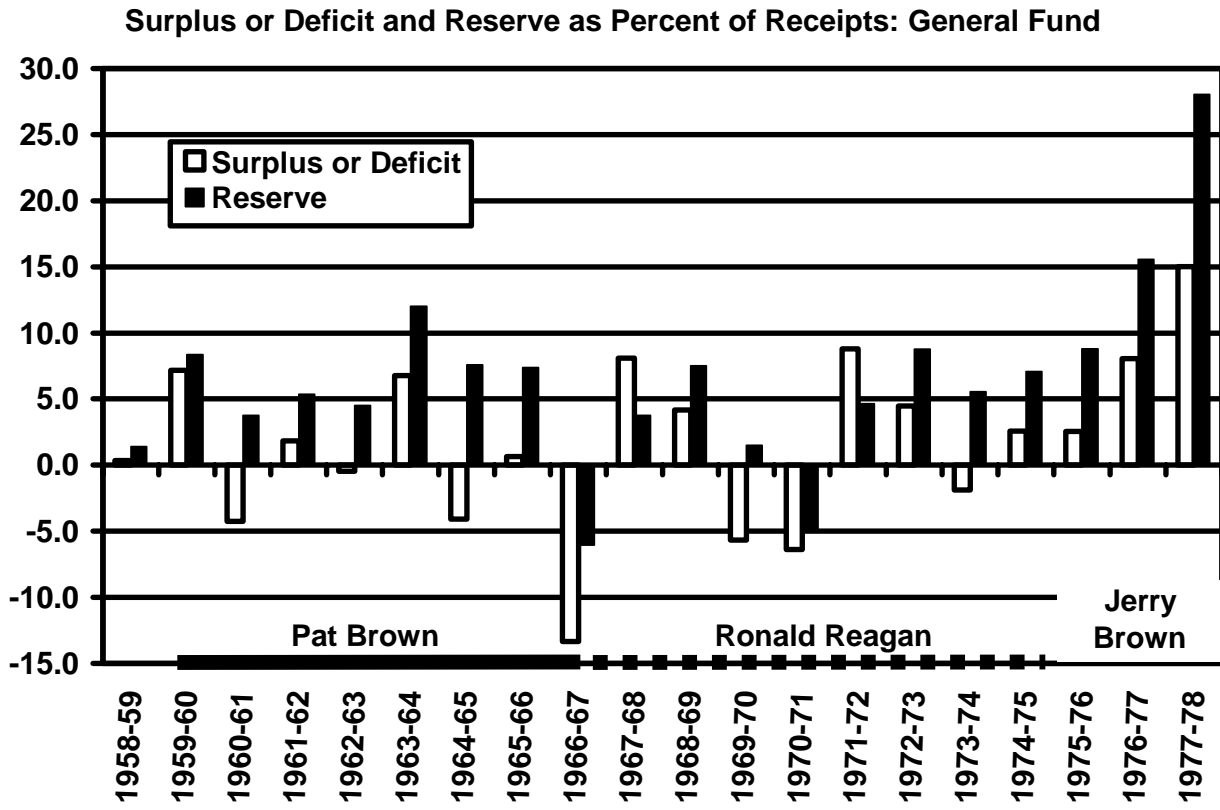
Cash actually received same as Case 1.  
Revenue shown as received same as Case 2.

**Case 5: Improperly-Done Transition of FY 1966-67**

Accrual Basis - No Withholding

Cash actually received same as Case 1.  
Revenue shown as received same as Case 3.

Figure 11

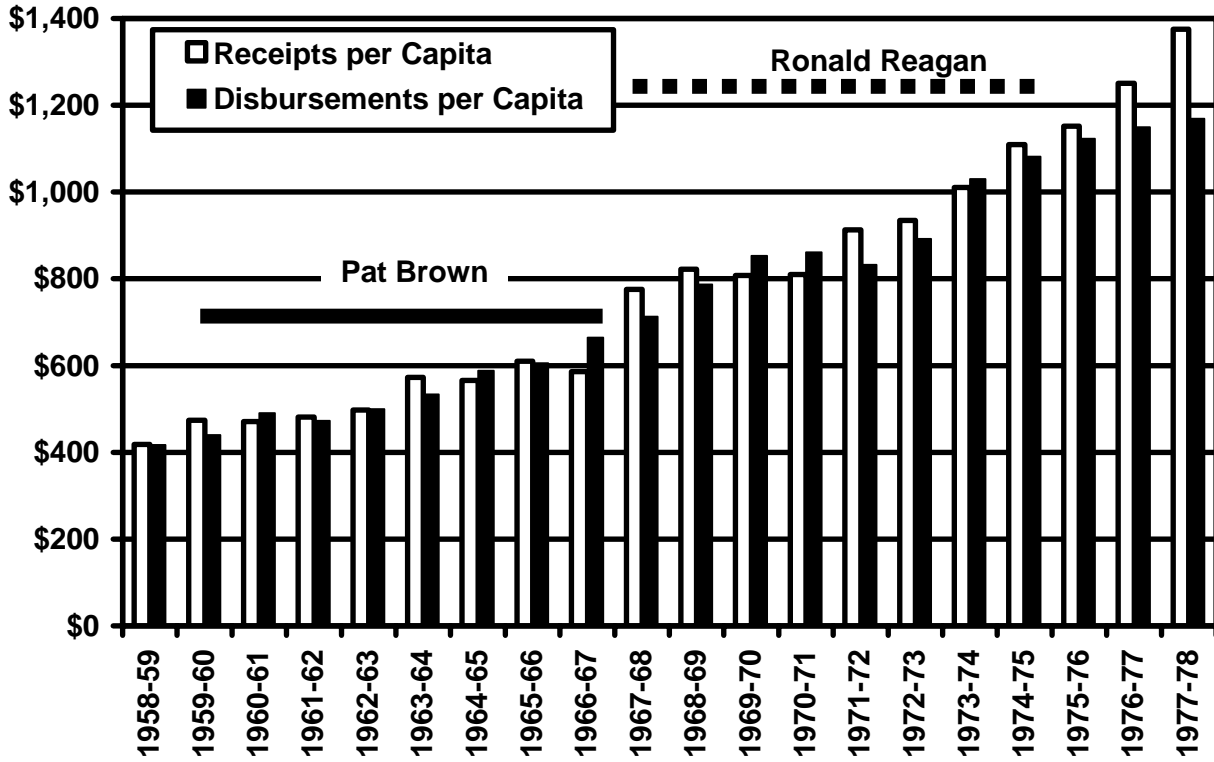


Note: Data drawn from cash statements of the State Controller.



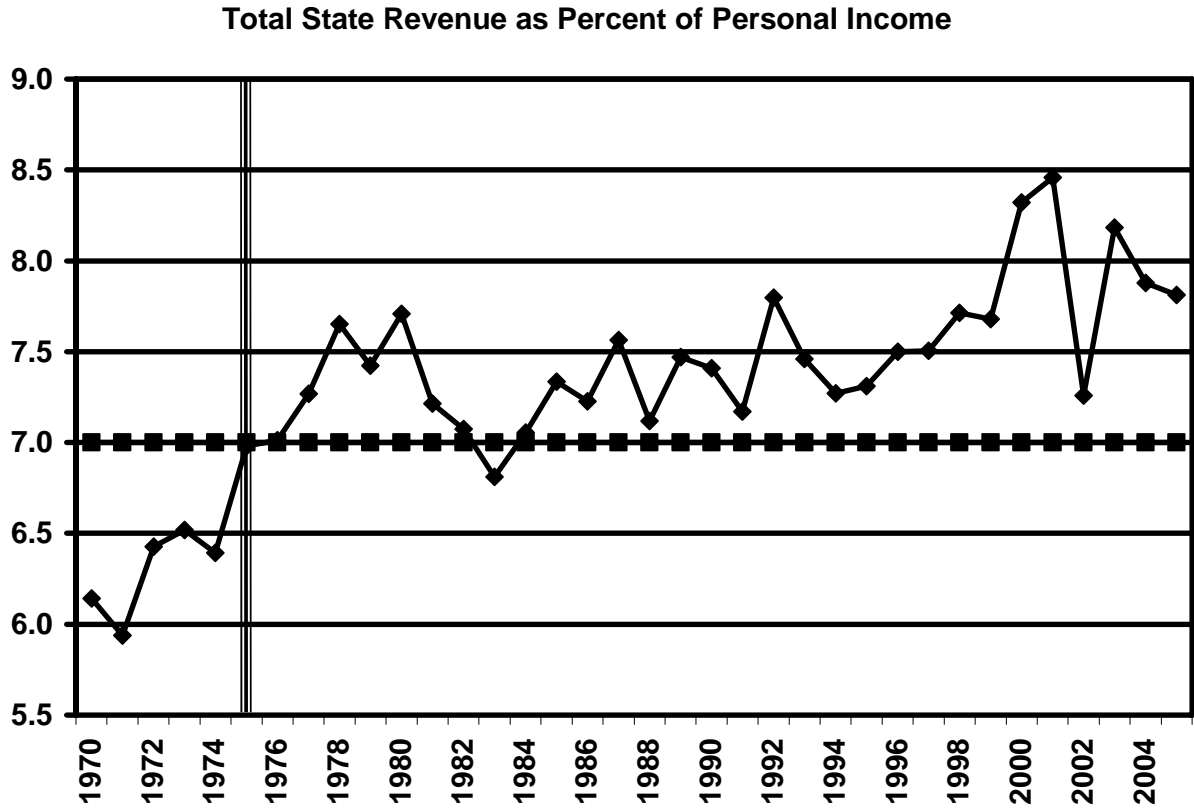
Figure 12

Real Per Capita Receipts and Disbursements: 2000\$



Note: Nominal figures deflated by GDP chained deflator. Budget data from cash statements of the State Controller.

Figure 13



Note 1: Personal income in fiscal year assumed to be average of surrounding calendar years. Personal income from Bureau of Economic Analysis, U.S. Department of Commerce. Revenue data from Department of Finance.

Note 2: Personal income estimated at the time Prop 1 was under consideration was about one fifth lower than current estimates.

**Table 1: Data for Fiscal Year 2004-05 (\$ billions)**

	Actual 2003-04	Jan. 2004 Estimate for 2004- 05	Jan. 2005 Estimate for 2004- 05	May 2005 Estimate for 2004- 05	Actual 2004-05
Cash Basis					
Receipts excluding 75% of 2005 amnesty					
Alcoholic beverage tax	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3
Corporation tax	\$8.0	\$7.7	\$8.9	\$9.7	\$9.7
Cigarette tax	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
Inheritance, gift, estate tax	\$0.6	\$0.3	\$0.4	\$0.4	\$0.5
Insurance tax	\$2.1	\$2.1	\$2.2	\$2.2	\$2.2
Personal income tax	\$36.8	\$37.9	\$40.3	\$41.7	\$41.9
Retail sales tax	\$23.7	\$24.9	\$25.2	\$25.0	\$25.4
Income from pooled money fund	\$0.1	\$0.2	\$0.2	\$0.2	\$0.2
Other	\$3.8	\$3.4	\$2.6	\$1.7	\$1.7
Total	\$75.5	\$76.9	\$80.2	\$81.4	\$82.0
Estimated Economic Growth Effect	-	\$1.5	\$4.7	\$5.9	-
Actual Economic Growth Effect	-	-	-	-	\$6.5
Post-Jan. 2005 Revenue "Surprise"	-	-	-	\$1.2	\$1.8
Disbursements	\$79.6	\$77.3	\$85.5	\$84.0	\$82.0
Deficit	-\$4.1	-\$0.4	-\$5.3	-\$2.6	\$0.0
Budget Basis					
Revenues and Transfers	\$74.6	\$76.4	\$78.2	\$79.5	\$79.9
Expenditures	\$77.6	\$80.3	\$82.3	\$82.0	\$81.7
Deficit	-\$3.1	-\$3.9	-\$4.1	-\$2.5	-\$1.8

Note: On budget basis, amnesty payments that represent accelerations or future refunds are subtracted from future year revenues. Budget basis figures are as officially reported. Cash basis figures in the two left-most columns remove 75% of the amnesty money received in 2004-05. "Negative expenditure" excluded from actual 2003-04 budget basis estimate.

Source: State Controller cash statements, Department of Finance budget documents, Legislative Analyst's Office.

**Table 2: Governor’s Budget Proposals and Enacted Budget: 2005-06 (\$ billions)**

	January 2005	May Revise	Enacted
Revenue & Transfers	\$83.2 0.5	\$83.9 0.2	\$84.3 0.2
Expenditures	\$85.7	\$88.5	\$90.0
Official Deficit	-\$2.0	-\$4.7	-\$5.6
Deficit Excluding Transfers	-\$2.5	-\$4.9	-\$5.8
Deficit Excluding <i>Paterno</i> Judgment Bond/loan, Pension Bond, and Transfers	-\$3.7	-\$6.0	-\$6.8
Note: <i>Paterno</i> Judgment Bond/loan	\$0.5	\$0.5	\$0.5
Pension Bond	\$0.8	\$0.5	\$0.5

Note: The *Paterno* bond was changed to a direct loan from a Wall Street firm in the May revise.

Source: Department of Finance, Legislative Analyst’s Office.

## **Appendix: Official Ballot Summary of Proposition 1, November 1973**

*This measure, if adopted, would add a new article to the Constitution containing the following major provisions:*

### *Limit on State Expenditures*

*An expenditure limit would be established for each fiscal year commencing with the 1974-1975 fiscal year. The limit would be based on a percentage of total California personal income.*

*State expenditures in excess of the limit would be prohibited, except that the Legislature could authorize expenditures in excess of the limit:*

*(a) To pay state indebtedness.*

*(b) To meet an emergency situation where the Governor declared the emergency and requested the Legislature to increase expenditures.*

*(c) To pay a tax refund from money received in excess of the revenue limit.*

*The limit could be increased or decreased if approved at a statewide election.*

*The measure includes various provisions for the adjustment of the expenditure limit where costs are shifted from one level of government to another.*

### *State Taxation*

*1. The Constitution now requires a two-thirds vote of the Legislature to change state insurance and corporation taxes. Under this measure, a two-thirds vote of the Legislature would be required to impose any new state tax or change the rate or base of any existing state tax: however, tax refunds or reductions by appropriation from tax surpluses could be enacted by a majority vote.*

*2. This measure includes, as a constitutional requirement, a provision similar to existing law which provides that for the year 1973 and thereafter, a single person with an adjusted gross income of less than \$4,000, and a married couple or head of a household with an adjusted gross income of less than \$8,000, would pay no state income tax. The Legislature, by a two-thirds vote, could change this provision after 1973.*

*3. For 1974 and years thereafter, state personal income tax rates could not exceed those in effect on January 1, 1973, less 7 1/2 percent. The Legislature, by a two-thirds vote, could change this provision.*

### *Local Taxation*

*1. Provisions, somewhat similar to those now contained in the law, would be added to the Constitution to provide that cities, counties, and special districts, other than school districts, could not levy property taxes at a rate in excess of the rate levied in the 1971-72 or 1972-73 fiscal year, whichever is higher.*

*Property taxes could, however, be increased:*

*(a) To secure funds to meet the costs of an emergency situation when authorized by a four-fifths vote of the governing board of the local agency.*

*(b) When population or cost of living increases faster than the assessed valuation of property for tax purposes.*

*(c) To allow for special circumstances creating hardship for individual local agencies.*

*(d) When the federal government or a court imposes new costs on the local agency.*

*(e) When authorized by the voters of the local agency.*

*The limitation on property taxation would not apply to taxes necessary to pay indebtedness or retirement benefits approved by the voters.*

- 2. No local agency, including a school district, could impose an income tax, unless authorized to do so by the Legislature by a two-thirds vote.*
- 3. Various provisions are included for the adjustment of local property taxing limits where costs are shifted from one level of government to another or from one local agency to another.*

#### *State-Mandated Local Costs*

*This measure contains provisions somewhat similar to those now in the law which would require a state appropriation to reimburse a local agency, including a school district, for its costs under any new program or service required by state law. However, no reimbursement would be required in the following cases:*

- (a) Where the state requirement is applicable to private entities and individuals as well as to local agencies.*
- (b) Where the workload under an existing program is increased by the state requirement.*
- (c) Where the state requirement consists of a change in the definition of a crime or the definition of a new crime.*
- (d) Where the state requirement implements a statute in existence on the effective date of this measure.*

#### *Legislative Enactments*

*The Legislature would be required, both specifically and generally, to enact statutes necessary to carry out the provisions of the new article. Thus, the effect of the measure, to some extent, would depend upon the provisions of the statutes so enacted.*

#### *Statute Affecting Above Measure*

*This measure includes a provision that taxpayers will receive a refund of 20 percent of their 1973 state income tax unless such refund has been previously made by the Legislature. Such a refund was made by the Legislature (Chapter 296, Statutes of 1973). Therefore, adoption of this measure would not provide an additional refund.*

*Note: The full text of Prop 1 is available at the Secretary of State website through the link to the Hastings website:*

*[http://www.ss.ca.gov/elections/elections\\_j.htm](http://www.ss.ca.gov/elections/elections_j.htm)*

## Endnotes

---

<sup>1</sup> Both quotes from same press conference reported in George Skelton, “Words Are Unclear; Intent to Win Isn’t,” *Los Angeles Times*, February 17, 2005. The chronology of events in this chapter draws heavily on reports in newspapers and their associated websites. Generally, for space reasons, footnote references are confined to verbatim quotes.

<sup>2</sup> Former state senate Republican leader Jim Brulte quoted in George Skelton, “Schwarzenegger Is Getting a Dose of Partisan Politics Reality,” *Los Angeles Times*, February 21, 2005.

<sup>3</sup> Peter Schrag, “State’s Newest Political Game: Initiative Chicken,” *Sacramento Bee*, March 9, 2005.

<sup>4</sup> Former state senate President Pro Tem John Burton quoted in Jim Sanders, “Burton’s Last Words: Blunt, Profane, Funny,” *Sacramento Bee*, December 1, 2004.

<sup>5</sup> Vincent Koen and Paul van den Noord, “Fiscal Gimmickry in Europe: One-Off Measures and Creative Accounting,” Economics Department Working Paper 417, Organisation for Economic Co-operation and Development, February 10, 2005.

<sup>6</sup> Race track interests – which compete with Indian gambling – challenged the bonds and later dropped the case. They could, however, challenge any new proposals.

<sup>7</sup> Helmut K. Anheier et al, *Driving Change: The State of the Nonprofit Sector in Los Angeles* (Los Angeles: UCLA School of Public Affairs, Center for Civil Society, 2005), pp. 16-19.

<sup>8</sup> An initiative further to raise the top bracket may be on the ballot in June 2006 if enough signatures are gathered. This initiative would earmark the revenue for pre-school and is sponsored by potential gubernatorial candidate Rob Reiner.

<sup>9</sup> Prop 57 authorized \$15 billion in Economic Recovery Bonds. However, “only” \$10.9 billion was actually issued. The remaining unissued bonds could be used to finance future budget deficits.

<sup>10</sup> Mark Baldassare, Public Policy Institute of California, “PPIC Statewide Survey, April 2005: Special Survey on Education,” p. 18, [http://www.ppic.org/content/pubs/S\\_405MBS.pdf](http://www.ppic.org/content/pubs/S_405MBS.pdf)

<sup>11</sup> Republican political consultant Dave Gilliard quoted in Dan Smith, “GOP has High Hopes of ’06 Ticket,” *Sacramento Bee*, February 14, 2005.

<sup>12</sup> Mark Baldassare, pollster for Public Policy Institute of California,” quoted in George Skelton, “Californians Aren’t Wild About Schwarzenegger or His ‘Reforms,’” *Los Angeles Times*, May 26, 2005.

<sup>13</sup> Dan Weintraub, “Arnold’s Top 10 Mistakes,” *Sacramento Bee*, July 3, 2005.

<sup>14</sup> Field poll summaries can be found at [www.field.com](http://www.field.com). The Governor trailed State Treasurer Phil Angelides and State Controller Steve Westly in hypothetical gubernatorial races in the Field Poll.

<sup>15</sup> Stephen Moore and Stephen Slivinski, “Fiscal Policy Report Card on America’s Governors,” Policy Analysis no. 537, Cato Institute, March 1, 2005, p. 30.

<sup>16</sup> George Skelton, “Governor Resisting Leap from Celebrity to Political Figure,” *Los Angeles Times*, May 5, 2005.

<sup>17</sup> Former state senator leader John Burton quoted in Phillip Matier and Andrew Ross, “City fails to rock MTV’s world,” *San Francisco Chronicle*, April 6, 2005.

<sup>18</sup> Prof. Barbara O’Connor, California State Sacramento, quoted in Carla Marinucci, “Governor Taking Hits In His PR War with Dems,” *San Francisco Chronicle*, April 4, 2005.

<sup>19</sup> Tony Quinn, “Other View: Arnold’s Own Keystone Kops,” *Sacramento Bee*, July 26, 2005. Quinn was an official in the Deukmejian administration and was an advisor to the California Republican Caucus before that.

<sup>20</sup> State senator Liz Figueroa (Democrat – Fremont) quoted in Jordan Rau, “Gov. Pulls Plan to Abolish Panels,” *Los Angeles Times*, February 18, 2005.

<sup>21</sup> California Little Hoover Commission, “Historic Opportunities: Transforming California State Government, December 10, 2004, <http://www.lhc.ca.gov/lhcdir/176/report176.pdf>.

<sup>22</sup> California Little Hoover Commission, “Serving the Public: Managing the State Workforce to Improve Outcomes,” June 14, 2005, <http://www.lhc.ca.gov/lhcdir/report181.html>. Paul Miner, who headed the performance review effort for the Schwarzenegger administration, resigned in April 2005.

<sup>23</sup> The Governor’s brother reportedly served time for assault.

<sup>24</sup> There was some controversy about the awarding of the contract to revise purchasing policy.

<sup>25</sup> Congresswoman Zoë Lofgren, Democrat from San Jose, quoted in Zachary Coile and Mark Martin, “Governor to Test Muscle in D.C. – Again,” *San Francisco Chronicle*, February 14, 2005.

- 
- <sup>26</sup> Leon Panetta, former Clinton White House budget director, quoted in Evan Halper and Richard Simon, "Washington Blamed for Fiscal Woes," *Los Angeles Times*, February 15, 2005.
- <sup>27</sup> There was controversy over gubernatorial support for federal funding aimed at enhancing the 405 freeway in Southern California. Initially, the administration held back full support because it felt funding for improvements in the Alameda Corridor (a rail system that handles freight from the ports of L.A. and Long Beach) might be jeopardized. It is unclear in fact whether the two projects are politically in competition. After the Governor came around on the 405 project, the Legislature failed to act after a controversy developed over whether state employees or outside contractors would be involved in the design. At this writing, the status of the project remains uncertain.
- <sup>28</sup> Apart from not spending all of the federal money available for homeland security, the state faces penalties for not meeting certain targets for its child support collection efforts.
- <sup>29</sup> Governor Schwarzenegger quoted in Gary Delsohn, "Governor Calls GOP to 'Great Battle,'" *Sacramento Bee*, February 12, 2005.
- <sup>30</sup> Unnamed "Team Arnold" advisor quoted in Phillip Matier and Andrew Ross, "Governor's Election May Hinge on Special Vote," *San Francisco Chronicle*, March 6, 2005.
- <sup>31</sup> California Senate leader Don Perata in website comment of June 13, 2005 on governor's call for special election.
- <sup>32</sup> McPherson's Democratic predecessor was forced to resign after a series of scandals, thus allowing the Governor to appoint a new Secretary of State. Christian Berthelsen, "GOP Official Disagrees with Schwarzenegger," *San Francisco Chronicle*, May 18, 2005.
- <sup>33</sup> The Fair Political Practices Commission appealed a court decision that it could not impose the \$22,300 cap in March 2005. However, it appeared unlikely that the decision would be overturned in time to affect an election in 2005.
- <sup>34</sup> Governor Schwarzenegger quoted in John Hill, "State Pension Battle Begins," *Sacramento Bee*, February 11, 2005.
- <sup>35</sup> Widow of firefighter quoted in Harrison Sheppard, "Pension Reforms Attacked," *Los Angeles Daily News*, March 3, 2005.
- <sup>36</sup> Testimony of Regents chair Gerald Parsky, March 2, 2005, available at <http://www.universityofcalifornia.edu/news/2005/parsky030205.pdf>.
- <sup>37</sup> Tax law requires the employee to designate that he/she wants to pay in pre-tax dollars.
- <sup>38</sup> Many private employers offer "401k" plans (and public employers offer similar "403b" plans). But these plans, while similar to defined contribution plans, are voluntary for the employee. All depend on the employee agreeing to save a designated amount (subject to tax code limitations) and make contributions in pre-tax dollars. A true defined contribution plan is mandatory, not voluntary, in the sense that the employer requires all employees to participate.
- <sup>39</sup> Quoted in Mark Martin, "Governor Facing a Tough Sell This Year," *San Francisco Chronicle*, March 7, 2005.
- <sup>40</sup> Columnist George Skelton, "The Governor Owes Schools an Apology – And \$2 Billion," *Los Angeles Times*, April 14, 2004.
- <sup>41</sup> The initiative, however, has not provided funding for after-school activities because it is triggered only when surplus funds become available.
- <sup>42</sup> Stephen J. Carroll, Cathy Krop, Jeremy Arkes, Peter A. Morrison and Ann Flanagan, *California's K-12 Public Schools: How Are They Doing?* (Santa Monica, CA: Rand, 2005).
- <sup>43</sup> Governor Schwarzenegger quoted in Kimberly Kindy, "John Burton's Legacy: Unlikely Legend," *Orange County Register*, December 5, 2004.
- <sup>44</sup> Paul J. Zak, Robert Kurzban, and William T. Matzner, "The Neurobiology of Trust," Center for Neuroeconomics Studies, Claremont Graduate University, *Ann. N.Y. Acad. Sci.* 1032: 224–227 (2004). <http://www.pauljak.com/pdf/TrustNYASPUBLISHED.pdf#search='oxytocin%20claremont'>
- <sup>45</sup> The word "tenure" has generally been applied to this issue. Teachers do not receive tenure in the university sense. Rather, they achieve regular status which makes them hard to discharge.
- <sup>46</sup> "Stormy Tenure," *Los Angeles Times* (editorial), October 12, 2005, p. B12.
- <sup>47</sup> Governor Schwarzenegger quoted in press release of February 17, 2005.
- <sup>48</sup> McPherson was appointed in February 2005 by the Governor after a scandal forced his Democratic predecessor to resign.
- <sup>49</sup> Gary Delsohn, "Ambitious Initiative Effort Is On," *Sacramento Bee*, March 17, 2005.



- 
- <sup>50</sup> Grover Norquist, head of Americans for Tax Reform, quoted in Dion Nissenbaum, “Ballot Measure Threat to Democrats,” *San Jose Mercury News*, June 15, 2005.
- <sup>51</sup> Jim Hard, president of Service Employees International Union Local 1000 quoted in Jordan Rau and Nancy Vogel, “Governor, Public Workers’ Unions Square Off for a Battle Over Clout,” *Los Angeles Times*, May 6, 2005.
- <sup>52</sup> Phil Trounson, pollster for Survey and Policy Institute, quoted in George Skelton, “Poll Shows Gov. Needs to Make a Conciliatory Leap on Reform and Fast,” *Los Angeles Times*, July 7, 2005.
- <sup>53</sup> About 90% of contributions from union-related PACs went to Democrats in the 2001-02 congressional and senate campaigns. See U.S. Bureau of the Census, *Statistical Abstract of the United States: 2004-2005* (Washington: GPO, 2005), p. 260.
- <sup>54</sup> Figures 1-4 come from U.S. Bureau of Labor Statistics “Current Population Survey” data as compiled by Barry T. Hirsch and David Macpherson at [www.unionstats.com](http://www.unionstats.com).
- <sup>55</sup> Available at [www.bls.gov](http://www.bls.gov). The Bureau continues to track some contracts where coverage falls below 1,000 for a time. Hence, a few contracts in the sample cover fewer than 1,000 workers. Data shown in Figures 5 and 6 were drawn from the file as of June 2005. The sample is periodically updated.
- <sup>56</sup> The claim of a public-to-private spillover was made early on in the campaign by unions but then dropped. Probably it was thought that if the proposition passed, it would be best to defend a narrow interpretation.
- <sup>57</sup> Quoted in Robert Salladay, “Candid Talk on the Party Line,” *Los Angeles Times*, June 5, 2005. In the same article, the call coordinator – noting that Democrats would favor taxes on the wealth – said that “I think it (the hypothetical tax increase) will affect anybody who is on this call.”
- <sup>58</sup> See the poll results from the Survey and Policy Research Institute, San Jose University, issued July 7, 2005, available at <http://www2.sjsu.edu/spri/05survey/SPRI070705p>.
- <sup>59</sup> Governor Schwarzenegger quoted in press release of February 23, 2005.
- <sup>60</sup> Governor Schwarzenegger quoted in Jill Lawrence, “Schwarzenegger Won’t Shy from Confrontation,” *USA Today*, June 9, 2005. The \$22 billion figure was often cited by the Governor. It was developed by Finance Director Tom Campbell, apparently as the sum of debt estimated to have accumulated up through the end of fiscal year 2003-2004 and is referenced in the prospectus for the Proposition 57/58 bonds. Although the prospectus refers to an appendix as the source of the calculation, it is not possible from that appendix to derive exactly how the number was calculated.
- <sup>61</sup> Michael Hiltzik, “He’s a Lot Weaker Than He Looks,” *Los Angeles Times*, April 25, 2005.
- <sup>62</sup> Michael Spence quoted in press release of [www.nodeficits.com](http://www.nodeficits.com), March 30, 2005.
- <sup>63</sup> Grover Norquist quoted in Evan Halper, “Spending Cap Called Key to National Plan,” *Los Angeles Times*, July 25, 2005.
- <sup>64</sup> State Senator Tom McClintock (Republican – Thousand Oaks) quoted in Lynda Gledhill, “‘Simple’ Budget Plan Actually Quite Risky,” *Sacramento Bee*, February 2, 2005.
- <sup>65</sup> Governor Schwarzenegger quoted in Lynda Gledhill, “‘Simple’ Budget Plan Actually Quite Risky,” *Sacramento Bee*, February 2, 2005.
- <sup>66</sup> The Analyst made alternate assumptions about Prop 98 requirements which are reflected on Figure 7.
- <sup>67</sup> Legislative Analyst’s Office, *California Spending Plan 2005-06* (September 2006); and *Proposition 76: Key Issues and Fiscal Effects* (September 30, 2005), both available at [www.lao.ca.gov](http://www.lao.ca.gov).
- <sup>68</sup> Campbell did endorse the budget initiative and left office in the weeks prior to the election to campaign for it. He announced plans to return to office briefly after the special election and then return to his deanship at the UC-Berkeley business school.
- <sup>69</sup> Michael Hiltzik, “Sad Fate of Thoughtful Attempt at Reform,” *Los Angeles Times*, June 23, 2005. Hauck chaired the California Constitutional Revision Commission. The Commission’s “Final Report” in 1996 argued that voter turnout should be increased and that confining constitutional amendment initiatives to regular elections would enhance such turnout. (p. 31) The report called for balanced budgets. But it noted that with a two thirds vote requirement, a minority can (and had) forced additional spending on pet projects and thus favored a majority only to pass the budget. (p. 38) The Final Report is available at <http://www.library.ca.gov/CCRC/pdfs/finalrpt.pdf>.
- <sup>70</sup> That title was a compromise by proponents worked out with the Attorney General who at first designated a title with School Funding at the beginning.
- <sup>71</sup> The material below draws heavily on the analysis provided by the Legislative Analyst to the Attorney General on March 17, 2005, available at [www.lao.ca.gov/ballot/2005/050176.htm](http://www.lao.ca.gov/ballot/2005/050176.htm).

---

<sup>72</sup> Ulrike Malmendier and Geoffrey Tate, “CEO Overconfidence and Corporate Investment,” National Bureau of Economic Research, Working Paper no. 10807, October 2004; Ulrike Malmendier and Geoffrey Tate, “Who Makes Acquisitions? CEO Overconfidence and the Market’s Reaction,” National Bureau of Economic Research, Working Paper no. 10813, October 2004.

<sup>73</sup> TV report, KCRA Sacramento, March 11, 2005, <http://www.officer.com/news/IBS/kcra/news-2624400.html>.

<sup>74</sup> Professional petition signature gatherer Jeff Johnson quoted in John Marelius, “Petition Hawkens a Breed Apart,” *San Diego Union-Tribune*, April 16, 2005.

<sup>75</sup> Nathan Barankin, spokesperson for Attorney General Bill Lockyer quoted in Robert Salladay, “Voters Might Face Flood of Fall Ballot Initiatives,” *Los Angeles Times*, February 11, 2005.

<sup>76</sup> Unions did file an initiative which might be put on the June 2006 ballot that would provide a parallel to paycheck protection for corporate shareholders. Under that initiative, shareholders would have to give permission before corporate money could be spent for political purposes. Such a provision would be strongly opposed by the business community and the threat of such a ballot proposition if paycheck protection passed – union leaders may have reasoned – might give business second thoughts about contributing to, or otherwise supporting, the paycheck protection initiative.

<sup>77</sup> A minimum wage initiative was filed but not circulated in time for the November 2004 ballot.

<sup>78</sup> Governor Schwarzenegger quoted in Peter Hecht, “Proposition 73 – Abortion Notification: Burden Would Fall on Doctors,” *Sacramento Bee*, October 9, 2005.

<sup>79</sup> The initiative was viewed as setting the stage for a possible “Meathead vs. Terminator” battle, named after roles played by Reiner and Schwarzenegger.

<sup>80</sup> Governor Schwarzenegger quoted in Kate Folmar, “Foes of Governor Emerge to Fight His Initiatives,” *San Jose Mercury News*, March 17, 2005.

<sup>81</sup> Republican state senate leader Richard Ackerman quoted in Alexa H. Bluth, “GOP Maps Budget Tactics,” *Sacramento Bee*, May 19, 2005.

<sup>82</sup> The Governor’s out-of-state fundraising activities were spotlighted by Lieutenant Governor Bustamante, who technically becomes governor in such cases and who therefore receives notice of all periods when the Governor is not in California. Bustamante noted in May 2005 that the Governor had been out of state more than Governor Davis during his 5-year term in office. This observation led a spokesperson for the Governor to note that the Lieutenant Governor’s duties seem limited to counting the days the Governor is gone.

<sup>83</sup> Another consequence of the special election threat - and particularly the paycheck protection initiative - was to induce the CTA to cancel plans to put an initiative on the June 2006 ballot for an increase in business property taxes earmarked for school funding. CTA had spent a reported \$2 million in gathering the needed signatures but decided not to submit them in August 2005. One interpretation was the CTA wanted to use its political resources to fight the paycheck protection proposition.

<sup>84</sup> Assemblyman Joe Canciamilla (Democrat – Pittsburg), quoted in Alexa H. Bluth, “Battle Lines Form Over Raising Taxes,” *Sacramento Bee*, November 22, 2004.

<sup>85</sup> Finance Director Tom Campbell quoted in Evan Halper, “Health Care Targeted for Cuts,” *Los Angeles Times*, December 18, 2004.

<sup>86</sup> Governor Schwarzenegger in remarks of January 10, 2005 available under speeches at [www.governor.ca.gov](http://www.governor.ca.gov).

<sup>87</sup> The *Paterno* case, decided in November 2003, held the state responsible for defects in a flood control project even though the project itself had not been built by the state. Because the state operated the system, it was held liable for such defects and their consequences.

<sup>88</sup> Governor Schwarzenegger in remarks of May 13, 2005 available under speeches at [www.governor.ca.gov](http://www.governor.ca.gov).

<sup>89</sup> Governor Schwarzenegger quoted in Alexa H. Bluth, “Budget in Apparent Stalemate,” *Sacramento Bee*, June 22, 2005.

<sup>90</sup> Race track interests had challenged the issuance of the Indian gaming bond. The challenge was withdrawn after the May revise but could be filed again if such bonds were again proposed. Race track interests were probably not opposed to the bonds per se, but may have seen litigation against the bonds as leverage in their continuing political and economic competition with Indian gaming.

- 
- <sup>91</sup> The Governor was later attacked for not adequately supporting a fund-matching plan to obtain Congressional authorization for a freeway improvement in the San Fernando Valley. After a few days of controversy, and an angry editorial in the *Los Angeles Daily News*, the Governor provided the match.
- <sup>92</sup> Governor Schwarzenegger quoted in Evan Halper, "Accord Ends State Budget Stalemate," *Los Angeles Times*, July 6, 2005.
- <sup>93</sup> Finance Director Tom Campbell quoted in Daniel Weintraub, "Professor Campbell's Class: Budget Balancing 101," *Sacramento Bee*, July 14, 2005.
- <sup>94</sup> State Senator Tom McClintock quoted in "The Roundup" website, July 8, 2005. [www.capitolbasement.com](http://www.capitolbasement.com).
- <sup>95</sup> Richard J. Orsi, *Sunset Limited: The Southern Pacific Railroad and the Development of the American West, 1850-1930* (Berkeley: University of California Press, 2005).
- <sup>96</sup> Governor Arnold Schwarzenegger quoted in Michael R. Blood, "No Props for Arnold: Voters Defeat All Four Reforms," *Los Angeles Daily News*, November 9, 2005.
- <sup>97</sup> Pete Wilson quoted in Michael Finnegan and Robert Salladay, "Voters Rejecting Schwarzenegger's Bid to Remake State Government," *Los Angeles Times*, November 9, 2005.
- <sup>98</sup> Press release of November 8, 2005.
- <sup>99</sup> "A Special Message for Governor Arnold Schwarzenegger," press room, March 25, 2005.
- <sup>100</sup> George Skelton, "Special Elections Hold Pitfalls for Governors Who Call Them," *Los Angeles Times*, June 20, 2005.
- <sup>101</sup> Material for this section was drawn in part from collections at the Reagan Presidential Library and the California State Archives. The former maintains substantial documentation and news clippings related to the Reagan governorship. The latter contains a complete set of oral histories from that era. Staffs of both libraries are thanked for their cooperation.
- <sup>102</sup> Major sources for the narrative in this section are Lou Cannon, *Ronnie & Jessie: A Political Odyssey* (Garden City, NY: Doubleday, 1969); Lou Cannon, *Governor Ronald Reagan: His Rise to Power* (New York: PublicAffairs, 2003); and Ethan Rarick, *California Rising: The Life and Times of Pat Brown* (Berkeley: University of California Press, 2005). See also Martin Schiesl, ed., *Responsible Liberalism: Edmund G. "Pat" Brown and Reform Government in California, 1958-1967* (Los Angeles: Edmund G. "Pat" Brown Institute of Public Affairs, 2003).
- <sup>103</sup> Ronald Reagan, *The Creative Society* (New York: Devon-Adair, 1968), p. 20.
- <sup>104</sup> Ronald Reagan quoted in Norman C. Miller, "California Governor Has Much to Gain, Little to Lose, With Tax Plan," *Wall Street Journal*, October 16, 1973.
- <sup>105</sup> Helene Von Damm, *At Reagan's Side: Twenty Years in the Political Mainstream* (New York: Doubleday, 1989), p. 67.
- <sup>106</sup> Ann Edwards, *Early Reagan: The Rise to Power* (New York: William Morrow & Co., 1987), p. 488.
- <sup>107</sup> Ronald Reagan, *The Creative Society* op. cit.
- <sup>108</sup> Quoted in Rarick, *op cit.*, p. 89.
- <sup>109</sup> See Gayle B. Montgomery and James W. Johnson, *One Step from the White House: The Rise and Fall of Senator William F. Knowland* (Berkeley: University of California Press, 1998).
- <sup>110</sup> This phrase is sometimes rendered as "tower of Jello."
- <sup>111</sup> *Reitman v. Mulkey*, 387 U.S. 369 (1967).
- <sup>112</sup> Jeffrey J. Barker, "The Big 5," *Sacramento News and Review*, August 4, 2005.
- <sup>113</sup> Some higher-income taxpayers did make a pre-payment each fall. In the example that follows, we simplify by assuming that all income tax revenue arrived in the April following the calendar and tax year. Without withholding, about 60% of income tax receipts arrived in April.
- <sup>114</sup> Legislative Analyst's Office, *Analysis of the Budget Bill of the State of California for the Fiscal Year July 1, 1966 to June 30 1967*, February 18, 1966, pp. x-xi.
- <sup>115</sup> Official records followed the switch to accrual in years after 1966-67 making it difficult to compare the results under cash vs. accrual. However, the Department of Finance in July 1967 did make an estimate for 1968-69 on both bases. That estimates assumed that only the income tax would be affected and that accrual approach would produce a number that was less than 2% above the cash approach. Given the nominal expansion of the economy, that estimate is probably too low. (The estimated gap between accrual and cash was estimated to be larger for 1967-68 because of the tax increases imposed as part of the budget agreement for that year described below.) See Gordon P. Smith to Ronald Reagan, July 7, 1967. Reagan Library, Box F20.

---

<sup>116</sup> Roger Rapoport, *California Dreaming: The Political Odyssey of Pat & Jerry Brown* (Berkeley: Nolo Press, 1982), p. 95. Rapoport takes the non-telegenic view of Brown's defeat. It is notable that Brown's campaign book was more a celebration of California – complete with Ansel Adams photographs – than a biographical statement. See Ansel Adams et al, *California: The Dynamic State* (Santa Barbara: McNally and Leftin, 1966).

<sup>117</sup> Post reports that the offer was made through (then-state senator) George Deukmejian. See California State Archives, *Oral History Interview with A. Alan Post, State Legislative Analyst, 1950-1977*, p. 264.

<sup>118</sup> Smith was replaced after a year by Caspar Weinberger. State Controller Houston Flournoy indicated that Smith had been essentially fired. On the other hand, Reagan preferred to interpret Smith's departure as a matter of Smith needing to make more money in private employment. See Claremont Graduate School, "Ronald Reagan Era: Houston I. Flournoy, California Assemblyman and Controller," 1982, p. 155; Bancroft Library, UC-Berkeley, "Governor Reagan and His Cabinet: An Introduction," 1986, pp. 36-37 in section on "Ronald Reagan: On Becoming Governor."

<sup>119</sup> Smith to Security First National Bank, letter dated April 21, 1967, Reagan Library, Box F20.

<sup>120</sup> Champion argued in an oral interview that Reagan needed only withholding, not a tax increase, to deal with his budget problem. But withholding would have provided only a one-time increment of revenue, whereas Reagan needed either ongoing budget cuts or an ongoing increase in tax receipts. See Bancroft Library, UC-Berkeley, "Hale Champion, Communication and Problem-Solving; A Journalist in State Government," 1981, pp. 107-108.

<sup>121</sup> In a meeting of January 15, 1968 – well after the close of the prior fiscal year – Reagan stated: "I think I am as clear as a non-accountant can get. That reminds me: When I was a sports announcer, I was dating a young girl, and she, out of duty to me, asked me once what a single-wing position is. I explained it in detail, drew and diagram and all – and when I was finished she asked, 'Yes – but what is a single wing?'" Reagan Library, Box GO 24.

<sup>122</sup> Thomas MacCurdy, Raymond Chan, Rodney Chun, Hans Johnson, and Margaret O'Brien-Strain, *Medical Expenditures: Historical Growth and Long Term Forecasts* (San Francisco: Public Policy Institute of California, 2005).

<sup>123</sup> Ronald Reagan, *The Creative Society* (New York: Devon-Adair, 1968), p. 68.

<sup>124</sup> Quoted in Lee Edwards. *Reagan: A Political Biography* (San Diego: Viewpoint Books, 1968), p. 194.

<sup>125</sup> Ronald Reagan's budget message of January 31, 1967 contained in *California State Budget for the Fiscal Year July 1, 1967 to June 30, 1968*.

<sup>126</sup> Ronald Reagan, *An American Life* (New York: Simon and Schuster, 1990), p. 159.

<sup>127</sup> Lou Cannon, *Governor Ronald Reagan*, op. cit., p. 41.

<sup>128</sup> When he later reversed himself, Reagan joked about the concrete cracking. See Lou Cannon, *Governor Reagan*, op. cit., pp. 198, 333-335.

<sup>129</sup> Caspar Weinberger, Reagan's second budget director who took office in 1968, was more sympathetic to withholding than the Governor. Various communications in his file at the Reagan library suggest that apart from the cash flow issue, there were other concerns that influenced Weinberger such as the tendency of withholding to discourage tax evasion. See Box F28, Weinberger to Thomas, letter of March 1, 1968. In 1968, the executive director of the Franchise Tax Board (the agency that collects state taxes), presented estimates of the impact of withholding to the Legislature and to Weinberger. Agitation for withholding continued until Reagan's reversal. The tax evasion component was certainly an issue, apart from cash flow. Apparently, the U.S. Internal Revenue Service had ceased providing California with data on federal income tax filers in 1966. A report for the Governor-elect by the California Taxpayers Association dated December 1966 made this point.

<sup>130</sup> Press release of January 30, 1967 in Reagan Library, Research Unit Box 18.

<sup>131</sup> See, for example, "State Budget Trickery," (editorial) *Los Angeles Times*, April 1, 1966.

<sup>132</sup> The state retained \$36 million as a kind of petty cash reserve.

<sup>133</sup> See State Controller, *State of California Annual Report: 1966-67 Fiscal Year*, July 1967, p. 4.

<sup>134</sup> Ronald Reagan, *An American Life*, op. cit., pp. 160, 185.

<sup>135</sup> Smith to Legislature, report dated December 11, 1967, p. 3, Reagan Library, Box GO 9.

<sup>136</sup> Edmund G. (Pat) Brown, *Reagan and Reality: The Two Californias* (New York: Praeger, 1970), pp. 72, 205.

<sup>137</sup> Ronald Reagan, *An American Life*, op. cit., p. 165.

- 
- <sup>138</sup> State Controller, *State of California Annual Report: 1968-69 Fiscal Year*, July 1968, p. 4.
- <sup>139</sup> Kent Steffgen, *Here's the Rest of Him* (Reno: Forsight Books, 1968), pp. 22-23.
- <sup>140</sup> Ronald Reagan with Richard G. Hubler, *Where's the Rest of Me?* (New York: Duell, Sloan and Pearce, 1965).
- <sup>141</sup> Kent Steffgen, *Here's the Rest of Him*, op. cit, pp 22-29.
- <sup>142</sup> Joseph Lewis, *What Makes Reagan Run: A Political Profile* (New York: McGraw-Hill, 1968), pp. 182-183.
- <sup>143</sup> Real per capita receipts rose at an annualized rate of 4.3% during the Pat Brown years and 8.3% during the Reagan years.
- <sup>144</sup> There was no bar at the time to a third Reagan term but he insisted that he was not going to run for the governorship in 1974.
- <sup>145</sup> The inventory tax was assessed on a single day in some jurisdictions. Businesses would load inventory on trains that would take their goods out of state on that date. Pat Brown also wanted to address this tax but his solution was to end the single day of assessment so that the tax could not be avoided by inventory trains.
- <sup>146</sup> See Reagan's remarks on Prop 14 to the California Real Estate Association (whose members generally favored Prop 14) in which he explains his opposition. Reagan Library, Box GO 177. Watson was the Los Angeles County Tax Assessor.
- <sup>147</sup> Donna E. Shalala, Mary F. Williams, and Andrew Fishel, "Final Report: The Property Tax and the Voters," unpublished report of the Policy Institute, Syracuse University, November 1973, p. 38, contained in Reagan Library, GO 121.
- <sup>148</sup> Buchanan won the Nobel prize in economics for his theories in 1986.
- <sup>149</sup> Ronald Reagan quoted in Carl Irving, "Reagan Makes Emotional Pitch for Tax Proposal," *San Francisco Examiner*, October 2, 1973.
- <sup>150</sup> Press release of Jack Kemp dated November 1, 1973. Reagan Library, Box GO 120. At the federal level, there were contradictory currents. David Packard of HP organized a bipartisan citizens' committee of business people and academics to look for ways to restrain government spending but not through a constitutional amendment. And due to the inflation of that era, there was talk of a possible federal tax increase.
- <sup>151</sup> "Kenneth F. Hall, 'Playing the Devil's Advocate: The Governor's office and the Department of Finance in California, 1966-1974,'" p. 22, in Bancroft Library, UC-Berkeley, "Legislative Issue Management and Advocacy, 1961-1974," 1983.
- <sup>152</sup> State personal income is defined as "income that is received by, or on behalf of, persons who live in the state. It is calculated as the sum of wage and salary disbursements, supplements to wages and salaries, proprietors' income with inventory valuation adjustment (IVA) and private capital consumption adjustment (CCAdj), rental income of persons with CCAdj, personal dividend income, personal interest income, and personal current transfer receipts, less contributions for government social insurance." Source: U.S. Bureau of Economic Analysis, [http://www.bea.gov/bea/glossary/glossary\\_s.htm#State\\_PI](http://www.bea.gov/bea/glossary/glossary_s.htm#State_PI).
- <sup>153</sup> Document entitled "Tax Reduction Task Force" of June 12, 1972, signed by Walton. Reagan Library, Box GO 118.
- <sup>154</sup> Lou Cannon, *Governor Ronald Reagan*, op. cit., pp. 368-369.
- <sup>155</sup> Bill Boyarsky, *Ronald Reagan: His Life and Rise to the Presidency* (New York: Random House, 1981), p. 162.
- <sup>156</sup> Claremont Graduate School, "The History of Proposition #1, Precursor of California Tax Limitation Measures. Oral History Program, Interviews with Wm. Craig Stubblebine, Lewis K. Uhler, 1982. The John Birch Society, to which Uhler had briefly belonged, was an extreme right wing group with a major base in Orange County. It was to Republicans on the right what the Communist Party had been earlier to Democrats on the left. Mainstream politicians in both parties tended to eschew the views of these groups, but not necessarily the votes of their members or sympathizers.
- <sup>157</sup> Reagan's long time secretary noted in her memoir that "Michael Deaver's strengths did not include management and organization." Helene Von Damm, *At Reagan's Side: Twenty Years in the Political Mainstream* (New York: Doubleday, 1989), p. 197. After leaving the Reagan presidential administration, Deaver was involved in an embarrassing scandal.

- 
- <sup>158</sup> Jerry Gillam, "Reagan Hopes for Big Turnout in Tax Election," *Los Angeles Times*, September 19, 1973; Michael K. Deaver, *A Different Drummer: My Thirty Years with Ronald Reagan* (New York: HarperCollins, 2001).
- <sup>159</sup> These two explanations are featured in Gary C. Hamilton and Nicole Woolsey Biggart, *Governor Reagan, Governor Brown: A Sociology of Executive Power* (New York: Columbia University Press, 1984), pp. 181-200.
- <sup>160</sup> Azevedo to Verne Orr and Ken Hall, November 8, 1972. Reagan Library, Box F178.
- <sup>161</sup> California State University, Fullerton, Oral History Program, "The 'Kitchen Cabinet,' Four California Citizen Advisors of Ronald Reagan," 1983, pp. 34-35 of Salvatori interview.
- <sup>162</sup> The results of the poll undertaken by "Decision Making Information" are contained in Reagan Library, Box GO 121.
- <sup>163</sup> Ronald Reagan, "Reflections on the Failure of Proposition #1," *National Review*, December 7, 1973. Available through [www.nationalreview.com](http://www.nationalreview.com).
- <sup>164</sup> He stated in an oral history that "*my family was arch-Republican. They still are. I'm the only one who ever left.*" *Oral History Interview with A. Alan Post*, op. cit., pp. 26, 78.
- <sup>165</sup> Gubernatorial press release of April 30, 1973. Reagan Library, Box GO 177.
- <sup>166</sup> Statement of Kenneth Hall before Assembly Ways and Means Committee, August 9, 1973. Reagan Library, Box GO 177.
- <sup>167</sup> Bob Schmidt, "Did Reagan Mean What He Said?," *Long Beach Press-Telegram*, September 2, 1973.
- <sup>168</sup> Alan Post quoted in William Endicott, "Reagan Accuses Post of 'Distortions' in Tax Initiative Report," *Los Angeles Times*, August 29, 1973.
- <sup>169</sup> The funding controversy was similar to an attack on Pat Brown's finance director, Hale Champion, for diverting money to a study of state infrastructure needs without an appropriation. Champion, however, was cleared by the Sacramento District Attorney, and managed to turn the accusation against his accuser. Uhler was unable to turn the tables and the accusation festered. On the Champion episode, see James R. Mills, *A Disorderly House: The Brown-Unruh Years in Sacramento* (Berkeley: Heyday Books, 1987).
- <sup>170</sup> There was a rumor that a deal had been struck to name a potential rival to Collier to a judgeship, thus eliminating a competition that had been created by redistricting. The rival, Fred Marler, did receive a judgeship in 1974.
- <sup>171</sup> "Marketing and Communication Plan for Yes on Proposition 1," September 4, 1973, Reagan Library, Box GO 120.
- <sup>172</sup> The earlier editorial appeared on March 25, 1973.
- <sup>173</sup> Ronald Reagan quoted in "Reagan Invokes Constitution to Defend Tax Plan," *San Diego Union*, October 5, 1973.
- <sup>174</sup> Dennis J. Opartny, "Reagan Raps Press, then Apologizes (sic)," *San Francisco Examiner*, October 5, 1973.
- <sup>175</sup> This episode is described in detail in Bill Boyarsky, *Ronald Reagan: His Life and Rise to the Presidency*, op. cit., pp. 164-165.
- <sup>176</sup> Governor's budget message, January 10, 1974.
- <sup>177</sup> Bruce Keppel, "An Offer Californians Did Refuse," *California Journal*, December 1973, p. 402.
- <sup>178</sup> The Department of Finance indicates that spending exceeded the cap in 1999-00. See [http://www.dof.ca.gov/HTML/BUD\\_DOCS/charts/chart-1.pdf](http://www.dof.ca.gov/HTML/BUD_DOCS/charts/chart-1.pdf). In 2000, the Legislative Analyst noted that the Legislature could shift appropriations toward various exempt purposes to avoid the cap. See Legislative Analyst's Office, "The State Appropriations Limit," April 13, 2000, [http://www.lao.ca.gov/2000/041300\\_gann/041300\\_gann.pdf](http://www.lao.ca.gov/2000/041300_gann/041300_gann.pdf).
- <sup>179</sup> Ronald Reagan, *An American Life* op. cit., p. 207.
- <sup>180</sup> Moretti is mentioned only in the context of welfare reform which Reagan remembers as an episode in which he bested the Assembly leader. Ronald Reagan, *An American Life*, op. cit., p. 190.
- <sup>181</sup> Pat Brown in particular was cheered by the outcome of the Prop 1 campaign. See Edmund G. (Pat) Brown and Bill Brown, *Reagan: The Political Chameleon* (New York: Praeger, 1976), pp. 62-67, 173.
- <sup>182</sup> Moretti died at a young age in 1984; his career never went beyond the State Assembly.
- <sup>183</sup> Letter from Reagan to Mr. and Mrs. Bowman, reproduced in Kiron K. Skinner, Annelise Anderson, and Martin Anderson, eds., *Reagan: A Life in Letters* (New York: Free Press, 2003), pp. 180-181.
- <sup>184</sup> "Tax Ceiling Supporters Outspent Foes 3 to 1," *Los Angeles Times*, December 7, 1973.