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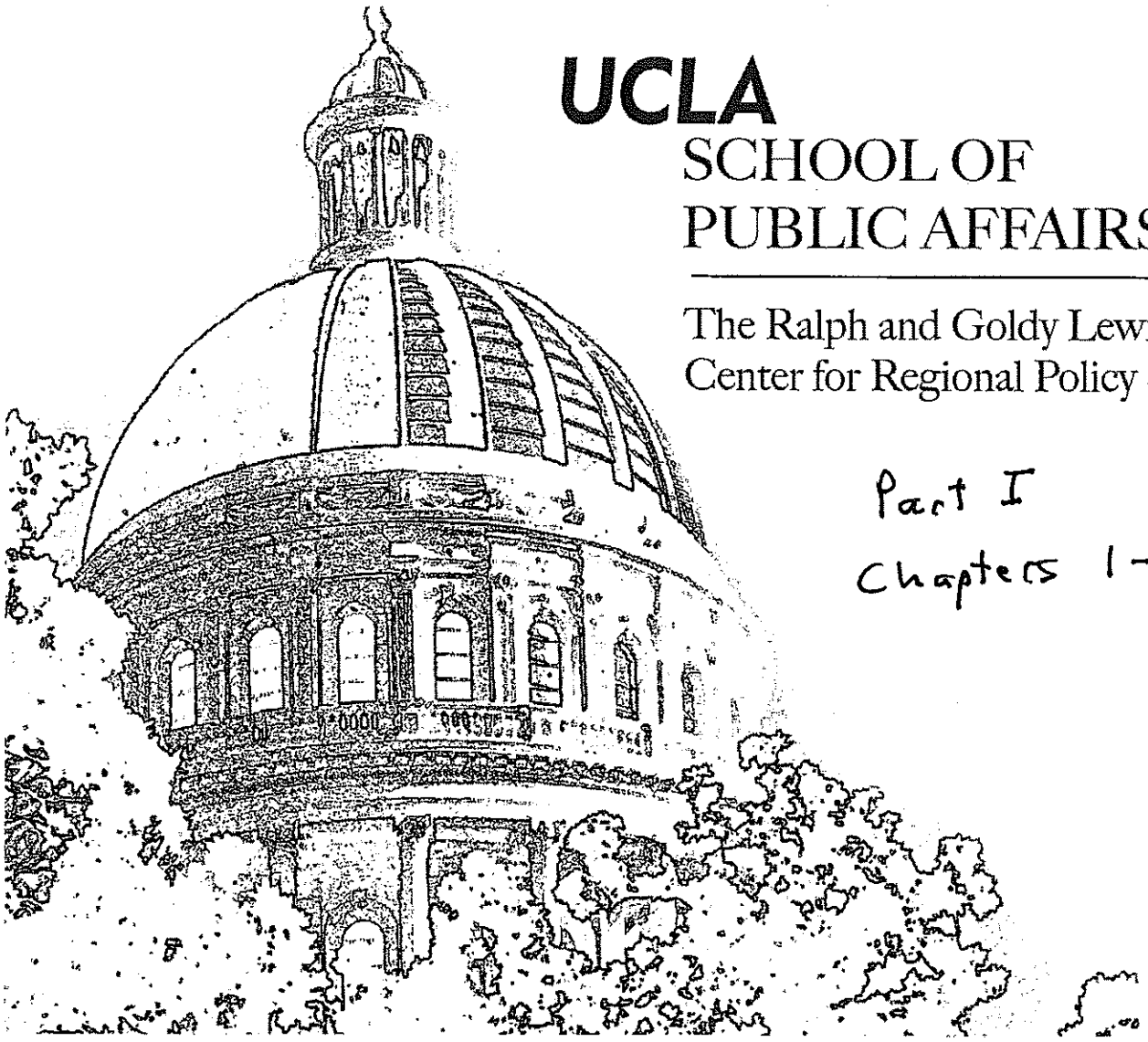
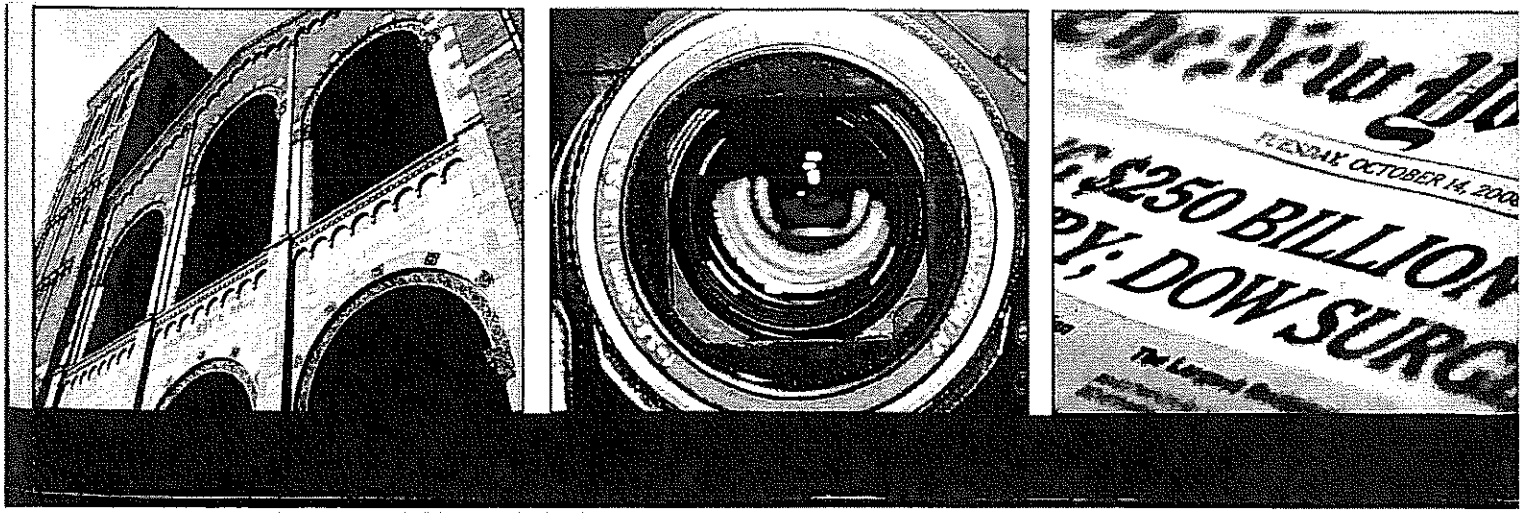


UCLA
SCHOOL OF PUBLIC AFFAIRS

The Ralph and Goldy Lewis
Center for Regional Policy Studies

Part I
Chapters 1-5

California Policy Options 2009



CALIFORNIA POLICY OPTIONS 2009

Edited by
Daniel J.B. Mitchell

The School of Public Affairs
University of California, Los Angeles
and
The Ralph and Goldy Lewis Center
for Regional Policy Studies

California Policy Options 2009

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Preface

The purpose *California Policy Options* is to collect and publish annually fresh UCLA research on public policy issues facing California. This 2009 edition *of California Policy Options*, which includes articles on policy topics as diverse as the housing bubble and subsequent burst, K-12 and higher education, transit issues, crime deterrence through video surveillance, and unionization in California, captures the breadth, range, and depth of our research.

The *California Policy Options* report of the UCLA School of Public Affairs has built on its legacy as an outgrowth of the annual UCLA *Anderson Forecast*. Now produced in conjunction with the Ralph and Goldy Lewis Center for Regional Policy Studies, it has become a trusted source of thoughtful research and analysis on policy issues affecting the state of California.

This broad scope reflects not only California's complexity, but also the interdisciplinary mission and expertise of the UCLA School of Public Affairs, with regular contributions from our departments of Urban Planning, Social Welfare, and Public Policy as well as from UCLA faculty collaborators across campus. The UCLA School of Public Affairs is a leader in convening academic and policy leaders to solve policy problems across boundaries. In this light, we are pleased to present the 2009 edition of *California Policy Options*.

Franklin D. Gilliam, Jr.
Dean
UCLA School of Public Affairs

Introduction to *California Policy Options 2009*

With its economy in decline, California faces a tough year in 2009. In the first chapter of this edition of *California Policy Options*, **Christopher Thornberg** points to the bursting of the real estate bubble and its many negative repercussions on the state and national economies. Thornberg was one of the first forecasters to point to the real estate bust as likely to induce a recession.

The economic downturn has highlighted the difficulties in state governance as the legislature wrestles with the fiscal consequences of falling tax revenue. In November 2008, an initiative supported by Governor Arnold Schwarzenegger narrowly passed that will remove legislative redistricting after the 2010 Census from the hands of the legislature. In our second chapter, **William B. Parent** discusses redistricting reform and voter behavior in California more generally. **Daniel J.B. Mitchell** in the third chapter then describes the record delay in passing the 2008-09 state budget, a budget which quickly fell apart after its enactment in mid-September 2008. He points to a diffuse gubernatorial agenda as part of the problem that state has had in dealing with the budget crisis. Mitchell notes the parallel to the 1978 passage of Prop 13, the initiative that drastically cut local property taxes and required a two-thirds vote for tax increases. In 1978, political leaders – particularly the governor – also seemed unable to focus on what was then the critical issue of state and local finance: property tax relief.

Education is the largest public program in California. Many observers view education as a path to economic advancement and labor-market success. Chapter four by **Sophie Fanelli, John Rogers, and Melanie Bertrand** takes up the issue of how well the state's K-12 system is performing. The authors note that when broken down by race and ethnicity, California schools do not perform well for any group. Within the groups, however, minority-population schools are especially likely to be disadvantaged by such factors as lower-quality teachers.

California's higher education systems have long been taken as a model for the public sector. But as **Werner Z. Hirsch** points out in the fifth chapter, the state's fiscal system can not support higher education as envisioned in the old Master Plan. Other needs and constraints tend to crowd out higher education as a state priority. Hirsch notes that as other states have faced similar dilemmas, they have moved to a more privatized version of public higher education – particular in the form of the so-called Michigan model which involves both higher fees but also high financial aid and access for state residents.

At the local level, the public looks to government to provide basic services such as transportation, street repair, and crime suppression. In the sixth chapter, **Brian D. Taylor, Hiroyuki Iseki, Mark A. Miller,** and **Michael Smart** report the results of a survey of state public transit users. They find that the most important determinant of user satisfaction with a transit stop or station is frequent, reliable service in an environment of personal safety. The physical characteristics of that stop or station are a lesser concern of users. For those traveling on foot, however, sidewalk conditions are important. As **Donald Shoup** points out in the seventh chapter, local governments – pressed by restricted budgets – may have difficulty in financing timely sidewalk maintenance. Shoup, using the example of the City of Los Angeles, notes that homeowner responsibility for sidewalk conditions, linked to sales of homes, could provide a financing model.

Crime control often suggests direct police presence. However, technology can substitute for such an in-person presence though the use of video camera surveillance. In the eighth chapter, **Jennifer King, Deirdre K. Mulligan,** and **Steven Raphael** provide an analysis of the San Francisco experience with such surveillance. The authors distinguish between property crime and violent crime. Evidence suggests that video surveillance does reduce the former in the vicinity of the camera, but not the latter.

In the ninth and final chapter, **Daniel J.B. Mitchell** looks at survey data on unionization in California. California has experienced de-unionization along with the rest of the U.S., but the state's absolute unionization rate is notably higher than the national average, largely due to high unionization in the public sector. Over time, the mix of workers within California unions has tilted towards a higher percentage in government employment. Mitchell reviews recent union developments in a variety of California industries. Included are data from a survey undertaken by the Bureau of National Affairs, Inc., with the support of the UCLA Institute for Research on Labor and Employment. While federal law largely pre-empts private sector union regulation by the state, agriculture and the public sector are subject to state control.

Finally, I would like to extend my thanks to UCLA student Patricia Lynn Porter and Stan Paul, Director of Communications for the UCLA School of Public Affairs, for their assistance in the production of this edition.

Daniel J.B. Mitchell
Professor Emeritus of Management and Public Policy
UCLA

December, 2008

THE CALIFORNIA FORECAST: WILL THE REAL ECONOMY PLEASE STAND UP?

Christopher Thornberg, Beacon Economics

Close watchers of the economy are likely suffering from an acute case of whiplash.* Unemployment in the U.S. started rising at a solid pace at the start of 2008 (and in California in the beginning of 2007). Industrial production was in negative territory and the home market in a total tailspin. But there seemed to be complete denial of these underlying issues not only by policy makers but by many economists. For example, in April 2008, Treasury Secretary Hank Paulson boldly predicted on Bloomberg television that "We are closer to the end of this problem than we are to the beginning." Even the respected UCLA Anderson Forecast continued to predict there would be no recession in its outlook for the nation.

Perhaps these positive prognostications might be forgiven. After all, real GDP growth in the second quarter of 2008 was 2.8 percent, close to average (despite weak results for the previous two quarters) and certainly the stock market had held up to that point. As if those contradictions weren't enough, home prices were plummeting, but overall consumer spending growth remained positive, albeit weak. Exports were booming due to the fall of the dollar.

Change in Perspective

But the second quarter results proved short-lived. Financial markets went into a spasm in September 2008, causing the demise of some of the market's largest and most venerable players. In an historic period that has lasted less than two weeks, Fannie Mae, Freddie Mac, Lehman Brothers, Merrill Lynch, and AIG all followed their smaller cousin, Bear Stearns, and passed into history. Goldman Sachs and Morgan Stanley, the last two large independent investment banks, changed their status in order to try and survive. Washington Mutual and Southern California's Indymac Bank both folded along with 15 other smaller banks. Stock markets in the U.S. and across the globe went into a complete tailspin.

By the end of the third quarter of 2008, gone was the discussion of doldrums or a soft landing. The tide shifted and we instead moved into what seems to be an overreaction to the fundamental forces affecting the U.S. economy. Perhaps there was no better example than the views of John Thain, former CEO of the now-defunct Merrill Lynch, who had said in April 2008 that the worst was behind us. After his firm's debacle, he stated that the crisis was on par with the Great Depression of the 1930s. This switch was a remarkable turnabout for a man who was more or less at the middle of the financial storm that put us into crisis in the first place. Thain, of all people, should have known what was coming – but he didn't.

Comparative Optimism

Beacon Economics is starting suddenly to seem bullish, at least in contrast to others like Thain who have shifted to dire outlooks. Our opinion has been that both the U.S. and California

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* This chapter was written in mid-November 2008 and does not reflect later developments.

economies were already in a recession by the first quarter of 2008 or perhaps even in the 4th quarter of 2007. Consider the following trends in the economy prior to October 2008 (the date of writing of this chapter):

- National unemployment rose by 1.5 percentage points over the previous year and a half, with most of the increase occurring more recently. The average recession sees unemployment increase from 2 to 2.5 percentage points. We were well on our way there by fall 2008.
- Payroll employment was down by roughly 80,000 jobs per month nationally at the time of this writing, or close to 1 million annualized. Some economists have claimed that since recessions are typically associated with job losses of 200,000 or more per month (or 2.4 million per year), this decline did not qualify as a true recession. But it is the change "off trend" that needs to be considered. The nation normally adds 2 million jobs per year. By fall 2008, we were losing 1 million jobs per year – that is, the nation was off trend by 3 million jobs per annum. Typically we are 4.5 million off trend in a recession. So, again, were well on our way.
- During a recession, industrial production typically falls at a 10 percent annualized pace, as opposed to growing at 6 percent or 7 percent. In fall 2008, industrial production was falling at about a 4 percent pace. Thus, we were 10 percent off trend as opposed to the 16 percent off trend typical in a recession.
- Unit auto sales fell by about 16 percent over the year ending in fall 2008. This drop was the largest decline since the early 1980s. Nominal dollar retail sales outside of autos were still growing at a 5 percent pace year-over-year, but much of this increase was due to surging food and gas prices. Consumers were spending more but buying less in real terms.
- Manufacturing orders were effectively flat in the second and third quarters of 2008, with a broad slowing in demand offset by rising orders for goods related to airplanes and energy.

These declines were very significant and they don't even touch on the accompanying turmoil in the financial markets. So the debate over recession ended. The meaningful questions became 1) how bad will the downturn become? And 2) how long will it last?

The good news is that the dire predictions are overstated. In fact the numbers by fall 2008 looked very much like a run of the mill (but bad) downturn. It's bad, but not that bad, not Great Depression bad. The U.S. and California will recover in a reasonable period of time. So business executives need to take a deep breath, prepare to cut costs, and to work hard to generate new sales. The year 2009 will be a rough one. But it won't be the end of the world.

The Housing Canary

What set off the turmoil? Recessions begin when a significant adverse shock hits the economy. The shock may be exogenously induced, such as the oil shock in the mid-1970s or the interest-rate shock in the early 1980s (when the Federal Reserve tightened interest rates to fight inflation). Or the shock can come from the rapid correction of a major imbalance inside the economy. An example was the 2001 downturn, which originated with the dot-com bubble. What

was the imbalance then? Business spending on high-tech rose, but business profits did not. The collapse in business spending, beginning in mid-2000, was the source of turmoil that pushed the United States into the 2001 recession.

Recession Imbalances

The recession of 2008 also started with a fundamental imbalance in the economy – this time in the real estate market and the house price correction in that market. The first signs of trouble emerged in late 2005 when, after years of unprecedented and clearly unsustainable price increases, the real estate market began to falter. Transactions slowed, followed by flattening prices and falling issuance of permits for new home construction. The extraordinary rise in mortgage foreclosures began in early 2007. The first credit shock in August of that year finally put home prices into a complete tailspin.

But falling prices – especially in California - should not have come as a surprise as we pointed out in last year's *California Policy Options*. In California, home prices nearly tripled between 1999 and 2006. Over the same period, the average homeowner's household income increased a mere 20 percent. The imbalance was blatant. Astonishingly, many observers and commentators managed to justify the prices being paid for real estate, even though the numbers made no sense and the pace of the price increases was unparalleled in history.

The reality is that people simply could not afford the homes they were buying. For example, in early 2006, the median house in Los Angeles had peaked at $550,000 while the median home-owning household was earning $78,000. With a 6 percent fixed-rate mortgage and a 10 percent down payment (20 percent down used to be typical, but who has a free $110,000 kicking around?) the median household would be using over 65 percent of its annual income to pay mortgage, insurance, and property taxes. Thirty percent to 35 percent is the level generally considered to be at the edge of affordability.

The House Price Turnaround

Of course, when home prices are rising, owners running into affordability trouble can typically refinance their way out of trouble. In a worst-case scenario they can easily sell their home to avoid more extreme consequence of foreclosure. However, refinancing doesn't work in a housing market of falling prices. Consequently, when the housing market finally turned down, foreclosures began mounting rapidly. In the second quarter of 2008 close to one percent of all mortgages in the United States were put into foreclosure according to figures from the Mortgage Bankers Association. In California, 2 percent of all mortgages went into foreclosure. More trouble lies ahead for the state. Over 3 percent of all mortgages in California by fall 2008 were 60 to 90 days behind on payment.

It wasn't only buyers who indulged in excess. Builders became involved as well and started constructing new homes at an unprecedented rate relative to the number of new households. Data from the Census Bureau show that the ratio of housing units to households rose from 1.12 in 1993 to 1.17 in 2008. This 5 percentage point increase may not seem like

much, but it points to an oversupply of housing of over 4 million units, two-to-three times the normal rate of home completions.

It was not just the raw number of units built that mattered. In California, a quick look at the numbers indicates a housing *shortage* - something contradicted by the amazing collapse of new housing permits issued in the past 2 years. The issue is less one of overall quantity than a total mismatch between what was built in the years before the collapse (3000 square foot homes in outlying suburban areas) with what is actually needed (low rent apartments in city centers). California has by far the worst crowded housing situation among low-income families in the nation, a crisis that perversely will get worse as the bubble continues to deflate.

How Low Can You Go?

How far will home prices tumble? Just to get back to historic levels of affordability, even when controlling for lower-than-average interest rates, home prices will need to fall 40 to 45 percent from their peak in California. For the US overall, the numbers are less dramatic since many portions of the nation did not see the same degree of appreciation as California. National declines of 20 percent would cure the imbalance. The good news: Both California and the nation are roughly halfway there. The bad news: Given the turmoil in the economy and excess supply of homes, it is likely that home price drops will overshoot these historic norms. Look for prices to drop 50 to 60 percent peak to trough in California from their lofty peak.

The Consumption Problem

So where will the economy go from here? As of fall 2008, were we near the bottom? Unfortunately, the answer is no, not likely. The housing meltdown and the resultant upheaval in the financial markets were the opening act. There is another major imbalance in the U.S. economy that also needs to work its way out of the system—the imbalance in consumer spending.

Americans were once decent savers, if not great ones. For years, the rate of saving (disposable income minus current expenditures) ran from 8 percent to 12 percent, depending on a variety of influences. But in the mid-1990s, the savings rate started to fall. Despite a brief increase in 2003, it fell back basically to 0 percent. This decline in savings was reflected at the national level by the enormous trade deficit the nation has been running (to the benefit of California ports). We became a nation in the midst of a consumption binge, reflected by our borrowing from the rest of the world.

Why did this happen? These two declines in savings – before and after 2003 – correspond with two of the largest bubbles in U.S. history – the equity bubble of the late 1990s and the credit/real estate bubble of the 2000s. The Federal Reserve publishes a quarterly estimate of the market value of all assets in the U.S. economy. For both these periods of time, market valuations in the United States soared, in real terms, by 50 percent from 1995 to 2000, and then by 35 percent from 2003 to 2007.

Paper Wealth

These developments are not coincidences. One important driver of savings is wealth. People don't bother contributing to their 401K saving programs after they win the lottery. Similarly, there is little incentive to save when your home doubles in value (or you think it is going to). Instead, Americans borrowed, using home equity and other forms of credit to cash in on their newfound paper wealth. In the process, household debt levels rose by 50 percent relative to income.

But the bubble has burst. Financial markets went into turmoil, home prices began collapsing, and all the paper wealth began to disappear – leaving behind very real debt. When the markets finally settle, Americans will likely find themselves in a financial position not seen since the 1970s. American consumers are likely to save more and consume less.

The Consequence of Increased Saving

The father of modern macroeconomics, John Maynard Keynes, viewed the problem created by such an adjustment as the "paradox of thrift." We know we need to save, but when saving rates go up, the economy typically slows because of the decrease in aggregate demand. Not all this pain will be felt in the U.S. – the pullback in consumer spending will affect the rest of the world through reduced U.S. imports. There will be substantial dislocation as the economy reconfigures around a new equilibrium where consumption plays less of a role in growth and business spending (investment), and exports play a larger one.

This adjustment to higher saving is the next step in the U.S. downturn – the pullback in consumer spending. It has already begun. Consider the dramatic drop in auto sales by fall 2008. Some blamed oil prices, but oil price hikes should simply have shifted demand from larger to smaller vehicles, not reduce overall demand dramatic amounts. And, in any event, oil prices began to plunge bring gas prices down and yet autos sales continued to fall.

Tax Rebates

The signs of the coming crisis were evident by early 2008. In the second quarter of 2008, what was most interesting was not what happened but what didn't happen. In May and June of 2008, close to $90 billion in federal income tax rebate checks were doled out to the American consumer, creating one of the largest quarterly increases in disposable income in decades. Consumer spending typically grows at roughly 3 percent per quarter (annualized rates). These rebate checks should have caused another 1.4 percentage point growth in spending. What actually happened was that consumer spending grew by a weak 1.2 percent. In other words, take those rebate checks away and the consumer downturn had already begun. The rebates partially masked the underlying weakness in consumption.

Retail Distress

As consumers started to pull back – estimates of retail sales began to paint a grim picture. At this writing, it appears that the consumer slowdown will begin to take its toll on the economy in earnest during the 2008 Christmas sales period. The ultimate depth of the downturn will depend on the rot in the financial system. The deeper the rot, the greater the decline in asset values – and the larger the pullback in consumer spending. Third quarter 2008 numbers were already indicating the problem. Consumer spending was clearly in decline by then. Major retailers such as Circuit City declared bankruptcy or closed underperforming stores.

The National Outlook

California has its special problem with housing but its economy is largely driven by its largest trading partner, the rest of the U.S. Our forecast calls for the U.S. unemployment rate to continue to rise through 2009 to around 8 percent overall. Export growth and import declines will offset some of the negative shock to the U.S. economy – although this domestic offset implies that some of our pain will be exported overseas. We don't foresee a very deep quarter of negative growth, but rather a long, shallow downturn.

However, despite all the current pessimism, none of the major economic indicators evident in fall 2008 were unusual for a recession. Initial claims for unemployment insurance were running at regular recession levels. While consumer spending fell sharply, as just noted, much of this pain was being shifted to the rest of the world in the form of smaller demand for imports.

What will happen when this national downturn ends? Typically, downturns in consumer spending are matched by increases after a recession concludes. But this development occurs when the economic downturn pushes consumer spending below its long-term stability level. This time it will be different. Consumer spending is falling because it has been too high, and hence there will be no bounce at the back end. We expect a weak recovery, with at best tepid growth through the first half of 2010.

The good news? The U.S. economy *will* recover. Another Great Depression is not at hand. The fundamentals are in place – a productive workforce, solid infrastructure, reasonably competent public institutions, and unsurpassed technology. And when it does emerge, the result will be a healthier economy better able to grow into the future. California – which is home to major high-tech firms – will benefit from those fundamentals.

But the short run is going to be rough. The nation has partied for over a decade, and we are about to wake up with a serious hangover.

California: Center of the Storm

Hope for the best but prepare for the worst is a valuable old adage. While we all hope that tomorrow will be better than today, we are well-advised to be prepared in the event that things take a turn for the worse. As the budget chapter in this year's *California Policy Options* suggests, California's state budget strategy seems to adhere to a slightly different logic, one that might be summed up as: Hope for the best and ignore the obvious. Given the state of the California economy today, the underlying assumptions on which the state budget hangs are categorically off-mark.

The State's Mortgage Excesses

The state truly was at ground zero in this downturn. One third of all subprime mortgages and alt-A mortgages were written on California properties. Home prices rose at one of the highest paces in the nation and at this writing are falling with an equal ferocity. The economic news, perhaps unsurprisingly, is grim. All indications are that the worst is yet to come for California. The economy, already battered and bruised by collapsing housing markets, will now face an even tougher test — the pull back in consumer spending as the last vestiges of the phantom wealth created by the credit led real estate bubble disappear. This will be an economic downturn in California on par with that of the early 1990s when the state suffered from a national recession and the decline of its aerospace industry as the Cold War ended.

The California Budget

Consequently, the fiscal landscape for California is bleak. The state created a structural budget gap in the late 1990s as permanent spending was ramped up based on a temporary surge in revenue generated from the dot-com boom. When the dot-com bubble collapsed, the budget gap that opened up was never truly fixed. Rather, temporary measures such as pilfering reserves and borrowing cash were used to fill the gap until the next great bubble — this one driven by the housing market and credit boom — fueled a second wave of temporary tax revenues. With the unwinding of the housing bubble the structural gap will reemerge and this time ER triage won't work. California needs to head straight into budget surgery.

Reverse Causality

The credit crisis that began in August 2008 captured headlines and caused a dramatic shift in the attitudes of the policymakers and economists who previously had previously denied the possibility of a recession. At that point, the conversation shifted to finding a solution to the financial crisis before Wall Street dragged Main Street down with it. While stabilizing the banking sector was an important step towards ultimate recovery, the causality was completely reversed. The State of California was not being threatened with recession because of what was happening on Wall Street. California was already in a recession for a number of quarters, and its housing bubble/mortgage problems were putting the pressure on Wall Street.

The Recession Profile

To paraphrase Tolstoy, all economic expansions look alike, but each recession is painful in its own way. The downturn had a very slow start due to the fact that the various components of spending – housing, consumer spending, business spending, and the external accounts – have not been cycling together as they normally do. The initial weakness in the state was due primarily to problems in the housing market and slowing of residential construction. The rest of the economy continued forward.

Subsequently, the situation shifted. Problems that began in housing spread to the rest of the economy. Mortgage problems led to a broader financial crisis. The drop in net wealth due to declining home prices and the battering financial markets took a toll on consumer spending. Corporate profits suffered and business spending started to move into freefall.

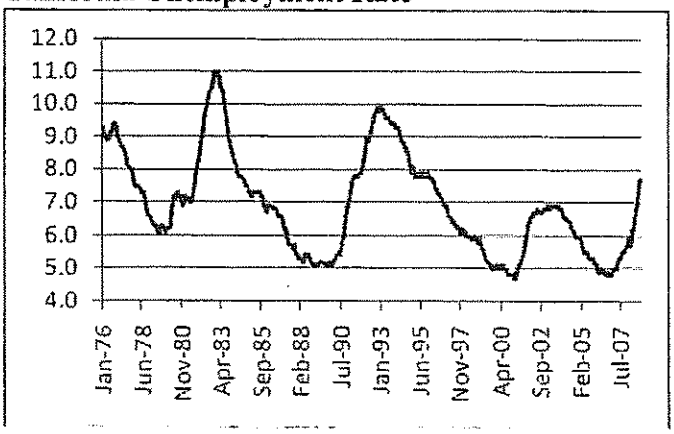
The last bastion of strength in the economy – the external accounts (exports and imports) – is likely to take a turn for the worse as the U.S. dollar has surged in during the financial turmoil to levels not seen since 2006. In short, the U.S. and California were moving during 2008 from a housing recession into a full-blown general recession.

Labor Market Developments

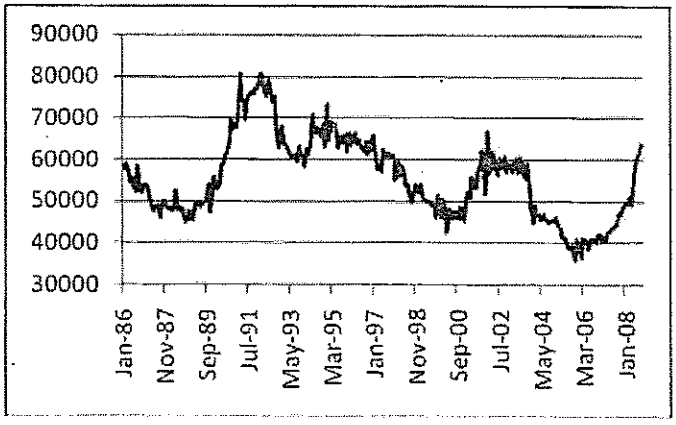
However, it is a unique recession. Consider the most basic indicator of an economic downturn – the unemployment rate. Typically this index is considered to be a concurrent indicator – that is to say it starts to rise around when the economy is starting to suffer, and only declines after the downturn has ended and the economy is already moving forward. For example unemployment in California started rising in May of 1981 and the recession officially started in July, two months later. During this recession however, the unemployment rate started rising way back in 2006 and by fall 2008 was about 3 percentage points above the trough. That rise was worse than the increase during the 1980 and 2001 recessions, and rapidly approaching that seen in the 1981 recession when unemployment increased by a total of four percentage points.

There was little discussion about what was happening in the labor market initially because 1) GDP was still growing and 2) the state was still adding payroll jobs albeit at a slowing pace. Many forecasters in the state continued to preach in 2008 that there would be no recession despite the fact that it looked as if we were already in one. We forecast that unemployment in California will rise to close to 10 percent, for a total increase of 5 percentage points, greater than during the 1990 downturn.

California Unemployment Rate

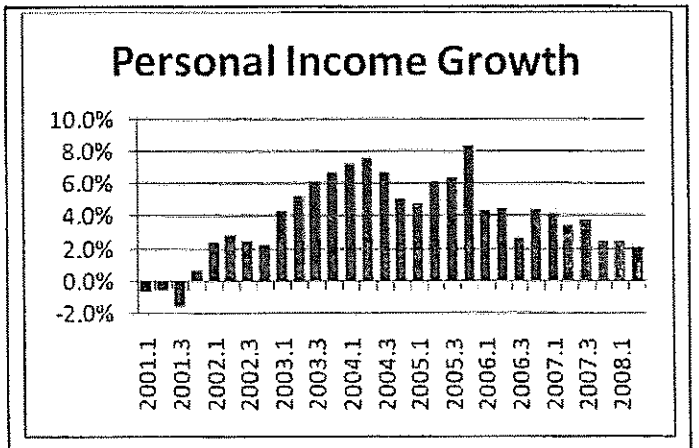


California Initial Claims for Unemployment Insurance



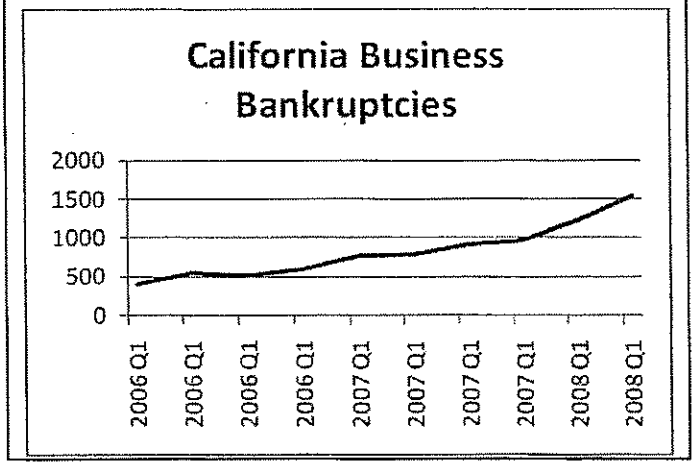
Personal Income

By current estimates income growth was slowing in the state at this writing. There are three key issues to bear in mind when evaluating personal income trends. First, current income figures are based on estimates derived from tax withholdings and quarterly payments from private business. These estimates will change over time, and potentially for the worse. Second, the turmoil and the decline in the equity markets that developed in the third quarter of 2008 will have substantial implications for future state income tax receipts. Capital losses will be written off on gross income — a process that had substantial implications for the budget in 2001 and 2002. Finally, layoffs lead to reduced income. We predict that personal incomes in California will continue to shrink for some time.



Business Weakness

We are also starting to see signs of weakness on the business side of the economy. State business incorporations have fallen. Moreover, California business bankruptcies surged to over 1500 in the second quarter of 2008, up from 500 per quarter in 2006. In short, business taxes are unlikely to make up for losses in personal income taxes.



Consumer Spending

State and local governments in California rely heavily on sales taxes. Indeed, one of the current discussions is a temporary increase in the state rate in order to help deal with the state's budget crisis. Unfortunately, such an effort is not likely to accomplish much in terms of increasing revenues. As noted above, the last shoe to drop in this recession is the pullback of consumer spending. With home equity rapidly disappearing and consumers holding record levels of debt, households are pulling back on their discretionary spending.

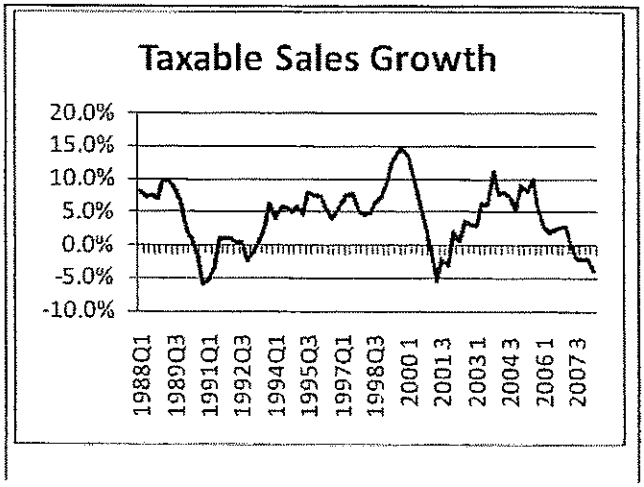
Taxable sales had been growing at a substantial ten-percent pace between 2003 and 2005, along with the strong increase in overall home values in that period. That pace was unusually

high, since sales typically increase at roughly the same rate as income growth. The rapid growth in taxable sales was indicative of the home equity effect on spending. But as sales and home prices started to decline through 2006, taxable sales growth also cooled, falling from its previously lofty level down to the two percent range before finally tipping into negative territory in 2007. Auto sales in particular were dropping by 2008.

The Housing Market

Finally, there is housing. While the problems in the state's economy started in that sector, we now know that housing is no longer the sole problem. As noted previously, it was the canary in the credit coalmine. The general asset bubble that is in the process of unwinding began with housing but has spread across the financial system's many parts. Corporate debt and other personal debt are all showing the same type of stress – rising delinquencies and heightened write-offs by banks.

Even as home prices were falling at a record pace, so, too, did the equity markets. Since housing was a leading indicator of larger financial developments, it is worth looking at the housing market to see if there are signs of a housing turnaround. Such a turnaround could be a predictor that other measures were bottoming out.



There was an increase in house sales by fall 2008, but unfortunately that increase is a false indicator.

Sales in the state were driven more by foreclosures than true strength in the market. The jump was due to foreclosure sales. And this isn't much of a surprise – according to data from Realtytrac, approximately 3.5 percent of all housing units in the state, around 400,000 units in fall 2008, were in the foreclosure process or already owned by the foreclosing bank. With such a heavy stock of foreclosed homes, banks needed to rid themselves of inventory. Banks sold foreclosed properties at whatever price they could obtain. As a result, prices were actually falling with the sales of these units rather than firming up as is typically seen when sales activity ticks up.

More importantly, while sales will eventually help the housing market by drawing down the existing inventory of foreclosed units, such distress sales will have to increase much more in 2009 in order to make real headway against the rising tide of foreclosures. Of all current outstanding mortgages in the state as of fall 2008, 3.2 percent were 60 to 90 days behind on payments according to figures from the Mortgage Banker Association. Short of some radical change in federal policy, most of these will properties end up in foreclosure at some point

late 2008 or 2009. California has put a limited moratorium on the foreclosure process – but this largely delays the ultimate result.

The Delayed Effect of Exotic Mortgages

There are also longer-run problems that have yet to be addressed in housing. Quite a few recent homebuyers used "exotic" mortgages that had low initial payments. Many of these products do not reset (jump to a higher payment base) until 2010 and 2011. Most of these properties will likely go into foreclosure when this reset occurs, since the payments will still reflect the outrageous bubble prices that were being paid for homes at the peak. Even if foreclosure rates peak in the near term, they will remain substantially higher than their long-run average and will continue to put downward pressure on home prices.

In short, home prices will continue to fall for some time. The central problem with the housing market has always been prices. While the policy debate has centered on the terms of these mortgages, the basic problem was the amount being paid rather than the structure of the debt. Prices nearly tripled between 1999 and 2007 before they started to fall. A reasonable estimate is that home prices in the state will have to decline 40 to 45 percent from the peak to fall back in line with income levels. We also have to account for the fact that prices will likely overshoot on the way down due to the overall weakness of the economy. Therefore, prices will likely drop 50 to 60 percent from the peak by the time they bottom out. The good news – such as it is - is that prices have already fallen over 30 percent from their peak.

Commercial Real Estate

There is yet another land-related crisis unfolding. The real estate bubble was not just in residential property, but also in commercial real estate. There the problem was in falling "cap" rates – the ratio of the revenue streams of commercial buildings to their prices. The same issue that befell residential markets – too much credit driving wild speculation – is now unwinding in commercial markets. Cap rates are rising as a result, even as rents are starting to succumb to the economic pressures and are starting to fall. Commercial property prices – which also add significantly to California's property tax base – will likely fall 30 to 35 percent from peak before the cycle is completed. The net result will be a big impact on property taxes. This year's property tax roll may have escaped the worst of the downturn. With both residential and commercial property prices in decline, next year's will not.

Summary

It is now clear that both the U.S. and California economies had fallen into recession in 2008. The initial problems in the housing market spilled over into financial markets. Consumer spending, which was based on paper wealth from housing, was the driver of the past expansion. Once that wealth evaporated, consumption was depressed. A rising U.S. dollar in international currency markets – which seems to have been triggered by international financial turmoil – is tending to depress net exports and port activity in California. Depressed economic activity and lost tax revenue has created a renewed California budget crisis.

Despite these negatives, pessimistic comparisons with the Great Depression of the 1930s are unwarranted. A more likely scenario is a prolonged slump as excesses in real estate and consumer behavior are unwound. Since California was a center of the real estate bubble, the state will have an extended wait for an economic turnaround.

IS CALIFORNIA TOO DIVIDED AND BROKEN TO BE FIXED POLITICALLY?

(Not that there's an alternative we could agree on)

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There is a domain name, www.californiaisbroken.com. It is dormant now, but it was in the recent past the campaign site of Norman Breslow, a Democrat, who had planned to run for the state assembly to represent a large swatch of the San Fernando Valley. Mr. Breslow, however, withdrew, and his website now greets visitors with this message:

> **California is Broken**
>
> Nevermind! The thought of having to rub elbows with personality disordered politicians for two years was just too much for me. And while knocking on doors to get signatures for my nomination petition, I met a bunch of folks I don't want to represent. I'd rather live the life of a decadent successful artist, probably in another State. If you want to know what I stand for even though *I'm not running*, read on.
>
> Short Version:
>
> Vote for Norman Breslow for California State Assembly, and put the fear of YOU into the thieving and traitorous politicians. Maybe you feel the same way I do: *I'm mad as Hell and I'm not going to take it anymore!* . . .

There is a long version in the site, but the above sums it up well. Public confidence in politicians and government in California is at a serious low. In a September 2008 Public Policy Institute of California (PPIC) survey, *Californians and Their Government,* only 20 percent of Californians approved of the job the legislature is doing, and only 34 percent approved of the job their own legislators are doing.[1] Yet, scarcely two months after the survey, in an national election in which *change* was a prevailing theme, California's voters returned every incumbent running to the state legislature. Democrats picked up only two uncontested seats in the Assembly and one in the Senate, pretty much guaranteeing a continued stalemate as they are still three seats short in each house of the supermajority needed to increase taxes.

Governor Arnold Schwarzenegger called a special session after the election in hope of persuading termed-out legislators, who had nothing to lose, to cooperate on a cuts-and-taxes fix to the state's spiraling budget deficits. The Democrats proposed a 50/50, $16 billion combination of tax and fee increases and state budget cuts, but Republicans held their ground against tax and fee increases. However, they signaled that a deal could be made in the future if Democrats agreed to a state spending cap, an economic stimulus package that would lift some workplace and environmental regulations, and deeper (but unspecified) cuts than the Democrats were willing to make. The lame-duck assembly voted, predictably, along party lines and a budget bill never got to the senate. And the governor was left to comment: "Obviously I'm very disappointed with the way the legislature has failed the people of California today. It was a total failure on the legislators' part. You saw, it's like a kindergarten up there, where they point fingers at each other." [2]

It is hard not to sympathize with the legislature. A two-thirds majority is required to pass a spending increase, which neither party holds. Much spending is set by constitutional formulas – directly through measures such as Proposition 98, passed in 1988, which established mandatory minimum funding for schools, and indirectly through measures like the three-strikes initiative, which escalates prison costs. (Spending on prisons, it might be noted, now exceeds state spending for UC and CSU.) Term limits and closed primaries have also severely impaired institutional memory and discouraged party independence. And an income-based state tax revenue system is subject to booms and busts, which run counter to state needs. It is as if the voters put the state legislature in a strait jacket and are now booing it for its inability to juggle.

A State Divided

California is, quite simply, a rigidly divided state – geographically, ideologically, and politically. From afar, California seems to be a blue state, consistently supporting Democratic presidential candidates with 6.6 million registered Democrats and 5.2 million Republicans. But those numbers mask deep fissures between geographical regions and, as Peter Schrag puts it, between "older, whiter, more affluent people who vote and the younger, browner, poorer people who are most dependent on the schools and other public services." [3]

There are only two pockets of the state that vote consistently Democratic on economic and social issues: to the north, the San Francisco Bay area, with a population of about 8 million, and to the south, Los Angeles County, with a population of about 10 million. Together, they constitute about half of California's total population. In these two areas, Democrats outnumber Republicans by a margin of almost 2-1. They elect most of the Democrats in the California Assembly, Senate and U.S. Congress.[4]

Depending on the issue and the candidate, the more Democratic pocket can also spread north and south along the coast and include two inland counties. These two counties are Mono County with a population of just over 12,000 to the far east, which borders Yosemite and includes Mammoth Lakes, and Imperial County in the southeastern corner of the state, which has a population just under 150,000. Imperial County's population is over 70 percent Latino. Most of inland California, on the other hand, is very much a red state, consistently electing Republican candidates to congress and the state legislature.

In terms of ideology and politics, the blue-red divide in the state is profound, as if California were half Massachusetts and half Utah. According to a PPIC survey, seventy percent of California Democrats say they are willing to pay higher taxes for a state government that provides more services. But the same 70 percent of Republicans prefer lower taxes and fewer services.[5]

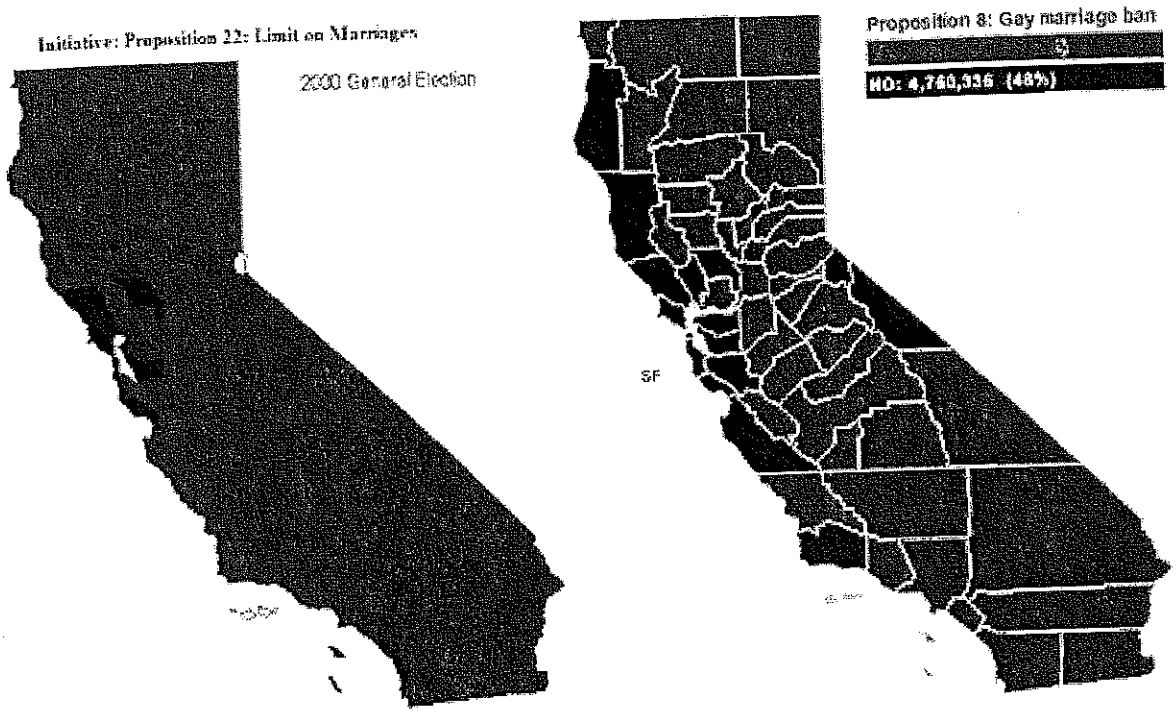
Democrats tend to favor a more active government and increased spending on education and health care. They support ballot measures that increase protections for minorities and assist the poor. Republicans, on the other hand, consistently come down on the opposite side on all of those issues. On immigration, for instance, just over 60 percent of Democrats see immigrants as "a benefit" to the state, while over half of Republicans see immigrants as "a burden." [6] The

Democratic pockets of the state voted against the recall of former Governor Gray Davis, in favor of affirmative action, and in favor of a loosening of the constitutional requirement requiring a two-thirds majority to pass a budget or a budget-related tax increase. But inland Republicans went the other way in those elections.

Republicans are also more rigid in their beliefs. Two out every three California Republicans describe themselves as conservative, while just over half of the Democrats describe themselves as liberal and a third see themselves as moderates. In a *Los Angeles Times* state exit poll the day of the 2008 presidential election, only 22 percent of the voters identified themselves as liberal, while 34 percent identified themselves as conservative, and 44 percent identified themselves as moderate.[7]

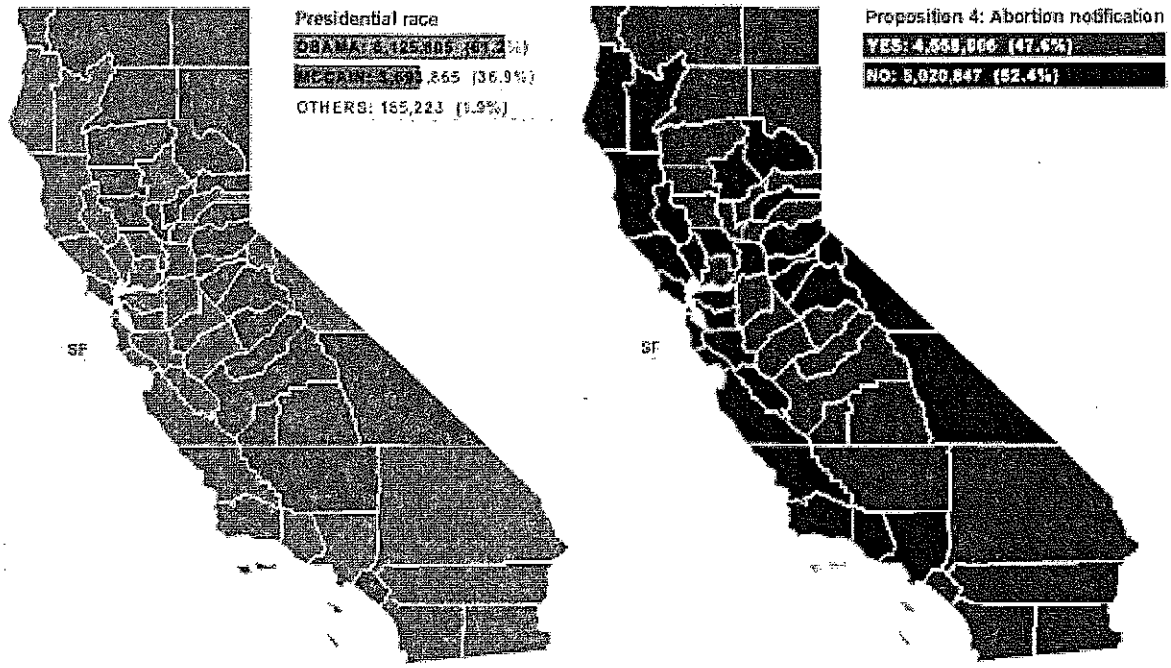
The state's divides were most dramatically illustrated in the results of referendum questions involving gay marriage, where the two Californias have voted as mirror images of the other. Eight years ago, voters passed Proposition 22, which created a statute defining marriage as between a man and a woman (and which was later overturned by the State Supreme Court). Only a handful of the most liberal California Bay Area counties voted against Proposition 22, while the rest of the state, including Los Angeles, voted overwhelmingly to support it.

In 2008, Proposition 8 called for a state constitutional amendment eliminating the right of same-sex couples to marry. Over 70 percent of the voters in 13 of California's more rural counties, north and south, voted in favor of Proposition 8 (Modoc, Shasta, Lassen, Tehama, Glenn, Sutter, Colusa, Calaveras, Merced, Tulare, Kings, Kern, and Imperial). By contrast, only two counties along the liberal coast, Marin and Santa Cruz reported more than 70 percent voting against the measure. Yes votes barely edged out no votes in Los Angeles. (Prop 8's passage has set off a bitter and acrimonious aftermath, recalling the fight over Proposition 6 in 1978. The battle over Prop 6, which would have forbid gays and lesbians from teaching in schools, is vividly depicted in the recent film *Milk*, about the late San Francisco supervisor Harvey Milk.)



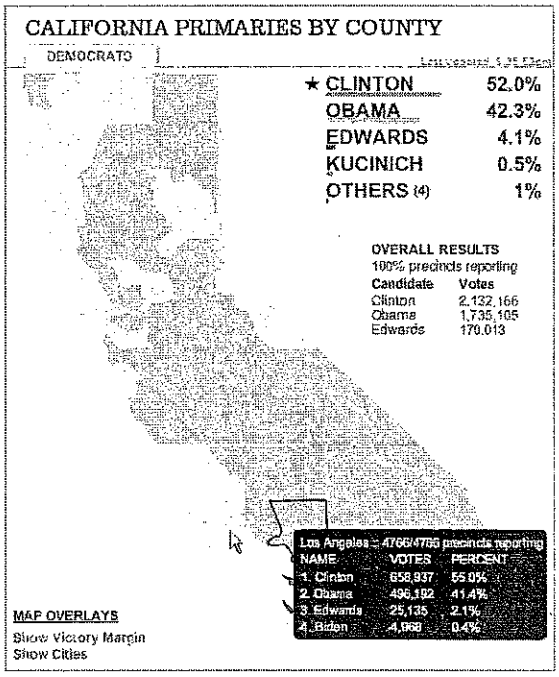
Source: California Secretary of State (http://vote.sos.ca.gov/)

There has been considerable speculation that a high turn-out of African American and Latino voters, who traditionally vote conservatively on social issues, came out to support Barack Obama, and helped pass Proposition 8. But, as the map shows, a higher than normal turn out for Obama in liberal borderline counties to the north and south of San Francisco may have also assisted the vote no side. The county results of the 2008 presidential election, in fact, were closer to the pattern of the other major social issue on the 2008 ballot that would have established a waiting period and parental consent for abortion, which was defeated.



Source: California Secretary of State (http://vote.sos.ca.gov/)

It is also interesting to note the 2008 primary results, which showed something of a geographic liberal-conservative divide even among Democrats, with Barack Obama taking most of counties he would win in the election, while Hillary Clinton ran stronger in the inland counties that John McCain would win in the general election, excluding Los Angeles.



Source: *The New York Times*, http://politics.nytimes.com/election-guide/2008/results/states/CA.html

The Divide and the Referendum Questions

Beyond gay marriage and the presidential election, on a number of the 2008 propositions, the California divides were also evident:

Proposition 1A, High Speed Rail, passed 52 to 49 percent, as support for a $10 billion bond measure to begin building a high speed (up to 200 mph) rail system – from San Diego, through Los Angeles, up through Bakersfield, Fresno, to Sacramento – was consistently high in counties along and adjacent to the proposed rail route. It was opposed by conservative groups, including the Howard Jarvis Taxpayers Association, on the grounds that the $10 million in bonds will eventually cost over $19 billion in principal and interest. It lost by wide margins in northern and eastern counties. Some observers surmised that many voters along the route saw the bond as a job creating public works project, making it attractive in a recessionary economy. California voters have also long supported bonds over new taxes and current use spending.

Proposition 2, Standards for Confining Farm Animals, passed 63 to 36 percent, literally to allow chickens to spread their wings, with an effective ad campaign focused on the humane support of farm animals. Opponents argued that it would drive up the cost of farm businesses, possibly making California eggs to expensive against Mexican farms. The measure passed everywhere except for a string of seven counties in the central valley, which is, not coincidentally, poultry farm country.

Proposition 3, Children's Hospital Bond Act, passed 55 to 45 percent, with support for the $980 million bond measure consistent along the same trail as the high speed rail. The opposition was consistent in the state's northern and eastern counties, again indicating a local job-creation factor and a willingness to support bond measures (along, perhaps, with the challenge of voting against something that's for "children's hospitals").

Proposition 4, Abortion notification, defeated 52 to 48 percent, with opposition that followed a geographical pattern in the state close to Barack Obama's victory. The strongest opposition was from single, college educated, women under the age of 30. It, too, was a "mirror division" issue with 68 percent of Republicans voting for the proposition compared 34 percent of the Democrats. Independent voters, who comprised 29 percent of the turn-out, sided more with Democrats.

Proposition 5, Improving Drug Treatment, defeated 60 percent to 40 percent, only won in six counties along the northern coast including San Francisco, Marin, and Humboldt and only narrowly there. It would have combined $460,000 in new state spending with liberal crime solutions. The current and four former governors opposed it. They argued that criminals could be released simply by making the case that their crimes were drug-related. Pundit Arianna Huffington supported it. It was opposed by between 60-70 percent of the voters in many conservative areas.

Proposition 6, Criminal Justice and Law Enforcement Funding, defeated 70 percent to 30 percent, combined $1 billion in spending on police and jails with tougher laws and penalties. Proposition 6 lost by one of the largest margins on the ballot, with not one county voting in support. As in the case of Prop 5, the result indicated that voters are willing to vote for bond borrowing but unwilling to vote for increased state spending.

Proposition 7, Renewable Energy, defeated 65 to 35 percent, called for a requirement for government-owned utilities to generate 20 percent of their electricity from renewable energy by 2010. Proposition 7 developed a reputation as a well intentioned, but poorly drafted, proposition that ended up being opposed by the Democratic and Republican parties, the Green party, and the Howard Jarvis Taxpayers Association.

Proposition 8, Gay Marriage ban, passed 52 to 49 percent. It was discussed earlier,

Proposition 9: Victim's Rights, passed 53 percent to 46 percent, funded with $4.8 million from Broadcom billionaire Henry T. Nicholas, after his sister was murdered, amended the state Constitution to require that crime victims be notified and consulted on developments in their cases. It would give them first claim on any restitution to be collected from offenders, and it would force prosecutors to take their opinions into account. With an effective ad campaign, it gained strong support across the state, except for the Bay Area and surrounding counties. Opponents argued it would keep prisoners in jail longer, costing more. They also pointed to Nicholas' indictment in June 2008 on fraud charges related to backdating of stock options.

Proposition 10, Alternative Fuels, defeated 60 to 40 percent, did not carry one county in California. Strongly supported by billionaire T. Boone Pickens, who has invested heavily in natural gas, it would have required a $5 billion bond to provide rebates for alternative fuel cars, including those that would run on natural gas. Prop 10 was opposed by the League of Conservation Voters, the Sierra Club, the Union of Concerned Scientists, the Natural Resources Defense Council, and Environment California.

Proposition 11, Redistricting, passed 51 to 49 percent. Handing state legislative redistricting from the state legislature to an independent commission after the 2010 census, Proposition 11 ran close across the state, with no particular liberal-conservative patterns. This was a vote that seemed to separate optimists, who argued that anything is better than the current legislator-run system, from pessimists, who viewed it as seriously flawed, not representative, and prone to the same kind of back-room wheeling and dealing that currently characterizes the legislature. At a UCLA discussion on the ballot propositions, former Democratic Governor Gray Davis and former Republican Assemblyman Keith Richman agreed that Proposition 11 was for them the most important item on the ballot. Both saw it as the only hope for doing something to break the partisan gridlock in Sacramento. Prop 11 was opposed by the California Democratic Party. It was supported by Governor Schwarzenegger, Common Cause, the League of Women Voters, and a host of "good government" organizations

Proposition 12, Loans for Veterans, passed 63 to 36 percent. California has floated bonds for veterans' home loan programs since 1922 and California voters have voted

"yes" 26 consecutive times. The bonds are paid pack through veterans repaying their mortgages. There have never been any costs to the taxpayers under the previous authorizations. The measure to put the question on the ballot was passed unanimously by the legislature. Prop 12's only opposition was from the Libertarian Party, and that was *pro forma*. The interesting point in this result is that a consistent support rate in the 60 to 30 percent range signals that, in a referendum election, thirty percent of the voters can be counted on to vote against anything with a dollar sign.

Might Proposition 11 Help the Divide?

The very narrow passage of Proposition 11, into which Governor Arnold Schwarzenegger poured $3 million and campaigned heavily, creates an independent commission to redraw legislative district boundaries every 10 years. As Daniel Weintraub wrote in the *Sacramento Bee*: "Legislative leaders will no longer be able to dangle favorable districts, or threaten unfavorable lines, to pressure lawmakers into voting one way or another on legislation. They won't be able to draw lines to favor a particular politician over another, or to reward or punish one party at the expense of another."[8]

The logic of redistricting reform is that extremes are inevitable once a district is gerrymandered to maximize either Democrats or Republicans and voters in primary elections only get to vote their party ballots. In such partisan "closed" primaries, party stalwarts tend to have the highest turn-out. The result is for the more extreme, left and right, candidates to prevail. And once they get to Sacramento, there is no incentive for them to deliberate and compromise. They are held by their base to the party line on every issue.

This problem is exacerbated by term-limits, according to redistricting reform proponents. Legislators are discouraged from casting any votes that can be seen as risking the support of the party base, particularly if they have ambitions to run for higher office. Prior to term limits, the argument goes, voters knew the whole records of longer-term politicians and tended to be more tolerant of compromises.

Redistricting reform, however, may have its limits, as the partisan divide may too complex a problem to solve with a single measure. First, there is evidence that partisan behavior was not influenced by what is thought to be one of the culprits, the 2001 redistricting process. That process sought to maintain a balance of Democratic and Republican "safe" districts, and, critics said, erased incentives for compromise. A study by Eric McGhee for PPIC showed that: 1) "Partisan behavior did not increase after 2001. It was about as common beforehand as it has been since; 2) legislators are remarkably consistent in the voting habits over time, even when their districts change; and 3) changing legislative districts to resemble those in existence before the 2001 redistricting process would probably not change the outcomes of many specific votes on such issues as the budget or hotly-contested business regulation matters."[9]

Second, as the 2008 electoral geographical distributions show, drawing more representative districts with the fairest of intentions will be difficult in California because of where people live and the way they think. There are 58 counties in California. If one looks at the number of registered Democrats and Republicans in each county, only 13 counties can be

considered competitive, i.e., the party difference is in the vicinity of 10 percent. Of these 13 possibly competitive counties, only three have populations over 100,000: Ventura, Fresno, and San Bernardino. The latter two counties follow a pattern common across the state; a concentrated urban area with a Latino and minority Democratic population and a suburban population that tends to vote Republican. Concentrated minority districts, however, are protected against being divided to assure minority representation under the national Voting Rights Act.

The *Los Angeles Times* has also pointed out that competitive districts don't necessarily mean more moderate campaigns or office-holders. The *Times* cited the close campaign, in the Ventura County area, between a conservative Republican, Tony Strickland, and a liberal Democrat, Hannah-Beth Jackson, in which Strickland was declared winner almost a month after the election. During the ballot counting, the *Times* editorialized: " . . . Strickland and Johnson ran old-school campaigns, slinging mud and running to their respective bases for funds, phone calls and precinct-walking. No matter who wins – if Strickland holds on and brings his no-tax pledge to Sacramento, or if Jackson pulls ahead in the count and helps her party jettison the two-thirds budget vote rule that for now gives Republicans disproportionate power – the 19th Senate District will be represented by a candidate who shunned the middle and played to the base."[10]

Nevertheless, optimists see the passage of Proposition 11 as a reason to hope for an at least slightly better system, possibly opening the doors to greater reforms, which voters have so far resisted. As Daniel Weintraub wrote, ". . .the passage of Proposition 11 proves that voters get it, that they are paying attention to the dysfunction of the Capitol and are open to proposals that would help correct it. . . . The victory should pave the way for a campaign to create open primaries, which would allow voters to choose candidates for public office without regard to party registration. Unlike Proposition 11, open primaries would dramatically change politics in California, which is why the idea will be opposed even more strenuously by the powers that be."[11]

Beyond a Legislative or Public Referendum Fix

The responsibility for gridlock and divided government may not simply rest with gubernatorial leadership or legislative intransigence, as suggested elsewhere in this volume. The real divides are between and among the people who live here, came here, come here, and continue to come here for very different reasons; who happen to live together in a leg-shaped state whose boundaries were formed via The Treaty of Guadeloupe Hildago and the Monterrey Constitutional Convention of 1849. Various migrations since – starting with the Gold Rush the same year and multiplying to 37 million – have left California with sundry groups of people who think as differently as dolphins and condors. And when it comes to government and society, there is just enough parity among fundamental differences, and just enough political cunning on various sides, to have brought us to a stalemate. What's more, we even may be too hard-wired neurologically in our political beliefs and attitudes to either swim or fly to toward a common way out.

UCLA neurologist Dr. Marco Iacoboni, along with colleagues working at New York University, recently reported in the journal *Nature Neuroscience* that, building on a number of studies with similar findings, there are "two cognitive styles – a liberal style and a conservative style." The liberal style is characterized as more open to conflicting views, and new experiences.

In contrast, the conservative style tends to be more resolute, structured, and persistent.

Dr. Iocabani studied two groups of UCLA students who completed an assessment identifying them as liberal or conservative. He connected each group to an electroencephalograph that measured activity in the anterior cingulate cortexes of their brains, which is where habitual thinking resides. The groups were instructed to tap on a keyboard when an M appeared on the computer monitor and to not tap when they saw a W. M appeared four times more frequently than W. The liberal students and the conservative students were equally able to recognize and respond to the Ms, but liberals had more brain activity and made fewer mistakes when they saw the Ws.

"The study demonstrates differences between liberals and conservatives not only in terms of brain responses, but in terms of behavior, Dr. Iacoboni told *UCLA Magazine*. "The conservatives made more errors when they had to suppress a habitual response."

In earlier studies, Dr. Iacoboni has shown that the amygdala part of the brain was more active among liberals watching scenes of violence than among conservatives looking at the same images. He has also shown that people tend to have greater response in emotion-activated areas of the brain emotion when they see their preferred candidate, while there is more activity among logically-oriented neurons when people see an opposing candidate.[12]

Similarly, George Lakoff, a liberal professor of linguistics at Berkeley, sees the two cognitive styles in more psychological terms, with "the conservative moral system having as its highest value preserving and defending the 'strict father' system." while "liberals' conceptual system of the 'nurturant parent' has as its highest value helping individuals who need help."[13] Lakoff's work sheds light on the use of language in political persuasion, which, Lakoff claims, was raised to an art form by the likes of Republican pollster Frank Luntz, who has issued edicts on words conservatives should and shouldn't say (e.g. privatization of Social Security vs. personal savings accounts).

Indeed, through Lakoff's lenses, it is easy to see California's political history is one of the nurturing mother and the strict father on a 160-year cycle of one winning, e.g. building Universities, schools, and water projects; and the other undermining the victor, e.g., by passing the likes of Proposition 13. And the result is a never-ending tug-of-war, not a healthy, constructive, civil society with a representative government that can find enough common ground and compromise to move the state forward and have the confidence of its people. For that goal to be achieved, the only hope is that circumstances – cultural and generational shifts, major economic upheavals, emigration or immigration – create more agreement among the population and its representatives about the fundamental roles of the individual in society.

Cultural and generational trends are, in fact, changing. One moderating trend in voter registration has been a sharp increase in independent voters, those who register, "decline-to-state." Since 1988, the number of Californians registered as decline-to-state has more than doubled and now comprises about 20 percent of the electorate, while the number of registered Democrats and Republicans has declined. A 2008 PPIC poll showed that almost 40 percent of independents see themselves as themselves politically moderate, 30 percent consider themselves

liberals, and an equal percentage see themselves as conservatives. But independents tend to vote more on the liberal side on such issues as abortion rights, the environment, gay marriage, health care, and immigration,[14] (even though, according to the *Los Angeles Times* exit poll, independents voted against Proposition 8 by 54 to 46 percent, which was also roughly the same percentage of voters who identified themselves as moderate). Registered independents also tend to be younger and better educated. Sixty-four percent of independent California voters voted for Obama. As pollster Mark Baldassare concludes, "California seems headed toward replacing its aging partisan electorate with a youthful independent electorate."[15]

A 2006 PPIC poll also estimated that 12 million of the state's 28 million adults were not registered to vote, and eligible nonvoters "want more active government, are less satisfied with initiatives that limit government, are less positive about elected officials that limit government, and favor ballot initiatives that would spend more on programs to help the poor." Eligible voters, on the other hand, are disproportionately white, older homeowners, college-educated, and more affluent.[16]

Immigration and demographic shifts are also bringing about electoral changes. Since 1996, the percentage of white voters in California has dropped from 77 percent to 67 percent. The percentage of Latino voters has risen from 11 percent to 19 percent. Asian voters have risen from six to eight percent, and African American voters have held constant at nine percent.

California Exit Poll Results

Voters	Obama	McCain	Yes Prop 8	No Prop 8
White	52%	46%	49%	51%
Black	94%	5%	70%	30%
Latino	74%	23%	53%	47%
Asian	64%	35%	49%	51%

Source: Los Angeles Times, November 8, 2008

In terms of the Latino vote, as Tim Rutten of *The Los Angeles Times* noted at the outset of the election, few people predicted that 70 percent of the California Latino vote would go to an African American. "A little more than a decade ago," Rutten wrote, "many analysts were predicting that Latinos, mainly Catholic and socially conservative, would be irresistibly drawn into the Republican orbit, much as Italian Americans of similar background had been after World War II in Eastern states. So what happened? Two things: immigration and organized labor. Beginning in 1994, when then-California Gov. Pete Wilson, a Republican, made support for Proposition 187 – which denied health, education and other benefits to undocumented immigrants – a centerpiece of his reelection campaign, Latinos across the country have been moving as far from Republican candidates as their legs will carry them."[17]

Asian voter participation is slowly increasing but their political profile is still emerging. UCLA Professor Paul Ong, who has termed the Asian vote a "sleeping giant," wrote just before the election, "Immigrant specific concerns do not define the Asian American vote. They share the same concerns and priorities as other Americans . . . (a) 2008 survey found that the top three

issues for Asian Americans are the economy, Iraq and health care. Previous surveys, including my own of Asian American voters in San Francisco, show similar commonalties with the larger public. They also appear to share the majority's support for Obama, although there are substantial differences along Asian ethnic lines."[18]

And finally, the downward spiraling economy is likely to have a significant effect on voter behaviors in the next elections. More people will need unemployment and welfare benefits and there will be less available funding for education, police and other services. The price of gas – which fluctuated wildly in 2008 – will affect public transportation demand. Taxpayers will have less income to tax, and property taxes will become more onerous for homeowners. And a Democratic government is likely to fund large scale infrastructure and public works projects to stimulate the economy. The effect on voting behavior will depend on perceptions of the fixes and their effectiveness.

Conclusion: Reason for Hope

Some political scientists have questioned whether the political divides of the country, and by extension, California, are all they have been reported to be. Proposition 8 aside, the 2008 California election both in the overwhelming victory for Barack Obama and in bipartisan support for a number of referendum questions, showed significant bipartisan agreement on a number of issues. Morris Fiorina has long contended that our culture wars are largely a myth. "Republican and Democratic elites unquestionably have polarized, Fiorina writes. "But it is a mistake to assume that such elite polarization is equally present in the broader public. It is not. However much they may claim that they are responding to the public, political elites do not take extreme positions because *voters* make them. Rather, by presenting them with polarizing alternatives, elites make voters appear polarized, but the reality shows through clearly when voters have a choice of more moderate alternatives."[19]

Indeed, both nationally and in California, Barack Obama may well have provided the breakthrough candidacy in terms of bringing disparate groups together. A long-time student of the divides, Stanley B. Greenberg has cited blue-collar Macomb County, outside of Detroit, as a national political barometer since Ronald Reagan won the county by a 2-to-1 margin in 1984. After the 2008 election, Greenberg noted: "So what do we think when Barack Obama, an African-American Democrat, wins Macomb County by eight points? I conducted a survey of 750 Macomb County residents who voted Tuesday, and their responses put their votes in context. Before the Democratic convention, barely 40 percent of Macomb County voters were "comfortable" with the idea of Mr. Obama as president, far below the number who were comfortable with a nameless Democrat. But on Election Day, nearly 60 percent said they were "comfortable" with Mr. Obama. About the same number said Mr. Obama "shares your values" and "has what it takes to be president."[20]

Barack Obama also succeeded in uniting the country and California in the presence of perhaps the most divisive issue in American history: race. He did it largely by transcending the hard-wiring of people's political brains; the tendency, as Drew Weston, author of *The Political Mind*, describes . . . "to believe what we want to believe . . . to draw conclusions consistent with what we want to be true." [21] As Franklin D. Gilliam, dean of the UCLA School of Public Affairs,

recently wrote: "Perhaps Obama does have the capacity to bring Americans together. Not just on race, but on a range of important social and political issues, he has framed his campaign through the lens of three important and widely shared values – shared fate, American ingenuity, and opportunity. Through these values he encourages people to understand the complex problems facing society – including race, and encourages them to see them as fundamentally American problems that affect all of us."[22] Former Los Angeles City Controller and UCLA lecturer Rick Tuttle notes that in Tom Bradley's successful campaigns for mayor and almost successful campaign for governor, the same transcending rhetoric was effective. Therein may lie a lesson for California politicians.

In the end, however, it is up to the voters. As former *Sacramento Bee* editorial page editor Peter Schrag wrote:

> "Almost every week brings another question asking whether California is governable. But the more pertinent issue may be whether California really wants to be governable. At a time when there's growing overseas competition in industries and technologies that California once regarded as its own, it is entirely possible that even under the best of circumstances, as planner William Fulton said, 'the best possible result might not be as good as it used to be.' The state's history and traditions of adventure and optimism are always there for those who care to recall and honor them. The question is which way California – or the national for that matter – really wants to go." [23]

We may begin to see an answer as all of California, rich and poor, liberal and conservative, stands together at the edge of a fiscal abyss in 2009.

Footnotes

[1] Mark Baldassare *et. al* PPIC Statewide Survey: Californians and Their Government, September 2008, p.18
[2] Jim Sanders and Kevin Yamamura, "Last ditch effort fails to pass state budget," *Sacramento Bee*, November26, 2008, p. 1A
[3] Peter Schrag, "California at a Crossroads," California Progress Report, www.californiaprogressreport.com/2007/01/california_at_.html
[4] Demographic and voter information in this article is drawn from the website of the California Secretary of State unless otherwise noted.
[5] Mark Baldassare, "California's Post Partisan Future" PPIC, January, 2008 p.5
[6] *Ibid* Baldassare.
[7] *Los Angeles Times* "National and California Exit Poll Results, November 5, 2008
[8] Daniel Weintraub, "Prop 11 Paves the Way for More Reform," *Sacramento Bee*, November 12, 2008
[9] Eric McGhee, "Redistricting and Legislative Partisanship," PPIC, September 2008 p. iv
[10] *Los Angeles Times* Editorial, "Prop. 11's Point," November 25, 2008
[11] *Ibid* Weintraub
[12] Paul Fineberg, "Campaign Tales: Left or Right: All in Your Head" *UCLA Magazine*, October 2008. Dr. Iacoboni and his colleagues do warn, however, that people have to be careful in extrapolating from the results, particularly attributing biological or hereditary roots to political orientation. One of Iacoboni's colleagues, Matthew D. Lieberman, an assistant professor of psychiatry at UCLA, said: "You've got to be careful here. Saying there's a biological component to political thinking is not the same as saying as saying there's a genetic one. Our individual politics are the result of an enormously complicated equation that involves how we grew up, the people we meet and know, our experiences and more. The mind and body are connected, Psychology is connected to biology. When someone engages in a violent act, there's a biological component, but one doesn't necessarily cause the other. It's the same with political thinking."
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[19] Morris P. Fiorina, "What Culture Wars; Debunking the Myth of a Polarized America," *The Hoover Digest*, No. 4, 2004 http://www.hoover.org/publications/digest/3010006.html
[20] Stanley B. Greenberg, "Good-Bye Reagan Democrats" *New York Times*, November 10, 2008
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WHEN LUCK RUNS OUT: LEADERSHIP – PRESENT AND PAST – AND THE CALIFORNIA STATE BUDGET*

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"If you put yourself in a vulnerable situation, you have to expect your luck is going to run out. Now the luck seems to have run out." [1]

Evan Halper
Los Angeles Times, November 7, 2007

In earlier issues of *California Policy Options*, we have traced the precarious fiscal situation of California from the days in which the Davis administration was proclaiming a nonexistent budget "surplus" through summer 2007 when Governor Schwarzenegger signed a budget said (incorrectly) to have a zero deficit. As has been repeatedly pointed out by the Legislative Analyst and others, California has an underlying "structural" deficit – a deficit that is sometimes hidden by revenue surges but tends chronically to reappear.

The causes of the structural deficit in California are varied. Common villains cited are the two-thirds requirement to pass a budget, the two-thirds requirement to raise taxes (imposed by Prop 13 of 1978), term limits, and gerrymandered legislative districts. Also cited are ballot propositions that establish formulas for various forms of state spending, most notably Prop 98 of 1988 which earmarks roughly 40% of the general fund for K-14 education.

All of these factors have played a role, producing a short-term fiscal focus and an inability of the governor and legislature to confront problems absent a severe crisis. However, as we will show later in this chapter, even in the supposed heyday of governmental flexibility and compromise – and when the two-thirds tax requirements and ballot-box budgeting constraints such as Prop 98 were not present – the legislature and governor had difficulty confronting a looming crisis. In the late 1970s, when the state budget was in surplus and the looming crisis was political – specifically, the growing taxpayer revolt that focused on property taxes – the powers-that-were came up with too little too late.

This chapter starts with the recent crisis and then looks at the earlier one that led to the passage of Prop 13. The lesson for governors from both crises is clear. Given the difficult political institutions of California, gubernatorial objects must be limited and focused on top priorities. Lack of focus produces lack of results, or unintended results.

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* This chapter covers budget and other developments through early October 2008. Subsequent events are not reflected.

Aftershocks

"It was a fiscal shock that set in motion a complex system of reactions and counter-reactions..."[2]

George F. Break
UC-Berkeley Economist

Prop 13 had far more profound effects than just the cutting and limiting of property taxes. As noted, it created the two-third rule for imposing new taxes. But perhaps more significant were the political aftershocks. Shortly, after Prop 13, voters endorsed Prop 4 – sold as the son of 13 - which placed a limit on state spending linked to a formula. When Prop 4 led to a refund to taxpayers of an overage in state revenues in the late 1980s, the educational establishment successfully pushed for the above-mentioned Prop 98 which – with a subsequent Prop 111 – largely gutted Prop 4.[3]

Other interests have since sought to earmark some of the state budget for their favored programs. In 2002, for example, then-citizen Arnold Schwarzenegger successfully pushed for an earmark for after-school activities (Prop 49) as part of a pre-campaign strategy for a possible run for governor.[4] Also in 2002, transportation advocates earmarked sales tax revenue collected on gasoline sales (as opposed to the traditional source: gas tax revenue) for roads and other transportation projects under Prop 42. Of course, not all efforts at earmarking have been successful. In February 2008, the state's community colleges – dissatisfied with their share of the Prop 98 earmark – unsuccessfully supported Prop 92 which would have given greater budgetary advantage to the community colleges.[5]

Although California has had direct democracy – initiative, referendum, recall – since the Progressive movement took control of the state government in the form of Governor Hiram Johnson in 1911 – the level of direct ballot activism has varied. In the 30 years before Prop 13 was passed, the state averaged substantially fewer than 2 initiatives on the ballot per year. Post-13, the rate has been closer to 5.[6]

Moreover, direct democracy tends to tilt more to causes favored by the political right than the left. As noted in last year's *California Policy Options*, although the right and left are roughly balanced in terms of what makes it on to the ballot, issues favored on the right (bans on affirmative action, tougher criminal sentencing, etc.) have a greater electoral success rate than those of the left, e.g., universal health insurance plans.[7] An industry has grown up consisting of organizations that develop ballot propositions (and raise dues and contributions in doing so), petition signature gathering firms, and, of course, campaign consultants and managers.

In this chapter, we first look at the California budget crisis of 2008. We then turn to the era of Prop 13's passage for some surprising parallels. As it turns out, shortsightedness and groupthink are not the recent developments in Sacramento that many pundits believe them to be. More importantly, there are strong parallels between current-Governor Schwarzenegger and his budget problem of 2008 and then-Governor Jerry Brown and his Prop 13 problem 30 years before. Both men are (were) media magnets. Both like (liked) to identify with Big Issues. But

these characteristics competed with a need for a tight focus on priority legislative and policy outcomes.

Roots of the 2008 Crisis

"I will go as far as saying that anyone, any candidate (for President) that writes a $14.5 billion check to the State of California, I would endorse. It's as simple as that. Anyone, Democrat or Republican alike."[8]

Governor Arnold Schwarzenegger
Sacramento Bee, January 31, 2008

The roots of the current state budget crisis are by now well known. Even in the mid-1990s, there were warnings that California faced a "structural" budget problem owing to the nature of its revenue base and the dynamics of state demographics.[9] This potential problem was, however, masked in the late 1990s by the dot-com boom, which generated substantial revenue for the state in the form of tax receipts from capital gains as the stock market rose. The legislature largely spent the new revenue so that when the stock market bubble burst – and the windfall disappeared – state spending had ratcheted up to a level that could not be sustained without the bubble-related tax receipts.

As a result, spending suddenly and substantially exceeded revenues and the reserves that had been accumulated were quickly dissipated. Although then-Governor Gray Davis had a reputation as a micro-manager, he had little luck in controlling the overall size of the budget when revenues rose.[10] And trimming spending back to the level of incoming revenue on the downside was even more of a challenge for Davis.

The budget crisis under Davis worsened and the incumbent governor was recalled by voters in October 2003, replaced by Arnold Schwarzenegger. The new governor took over a plan from Davis to borrow sufficient funds to refinance state debt and actually enlarged the amount that could be borrowed beyond what Davis had proposed. But he also fulfilled a campaign promise to cut the so-called "car tax" which exacerbated both the immediate and the structural problem.[11]

Governor Schwarzenegger used two ballot propositions, Props 57 and 58, to deal with legal issues raised by the stillborn Davis borrowing plan.[12] The two propositions were sold to voters as a way of "cutting up the credit card" – something that in fact did not happen. However, a new financial bubble – this one in home prices as shown on Chart 1 – stimulated the state economy. Although the prime revenue effect of the new bubble was felt in property taxes, a local rather than state revenue source, the general prosperity was reflected in sales and income taxes. At the same time, the stock market recovered sufficiently to produce capital gains-related revenue for the state along with capital-gains receipts linked to real estate.

Combined with a tax amnesty program in 2004-05 which brought in a transitory windfall, the state budget went into temporary surplus.[13] But by 2007, the structural deficit again began to show itself, as can be seen on Chart 2. After a protracted delay, the 2007-08 budget was signed in late August 2007 (almost two months late) with great ceremony. Although the participants

were willing to pretend the budget was in some sense balanced, it was – or should have been – apparent to all that a) it wasn't – the economic deterioration due to the mortgage crisis was already well underway - and b) the fiscal problem in the following year would be worse. Why, then, did California return to essentially the same budget crisis in 2008 that had sparked the recall of 2003? Why wasn't the problem fixed in the interim?

Unfocus

Tom Brokaw to Governor Schwarzenegger on TV's *Meet the Press*:

"When you ran for governor in 2003, you ran as a fiscal conservative who would change the system... If you were the CEO of a public company, the board would probably say, 'It's time to go.'"

Schwarzenegger to Brokaw:

"Are you always this positive?"[14]

Evan Halper
Los Angeles Times, June 30, 2008

With the benefit of hindsight, a theme emerges as a partial answer to the question of why the fiscal crisis returned. The initial "fix" of the budget in the period immediately after Governor Schwarzenegger took office was carried out cooperatively with the legislature and governor and resulted in the above-mentioned Props 57 and 58 which the voters endorsed. But in order to obtain breathing room to deal with the immediate budget crisis, the new governor made various "compacts" with different interests. While one of these – the compact with UC and CSU – had no real effect (and was quickly scrapped when budget problems re-emerged), others were more significant.

In particular, in a deal with the California Teachers Association (CTA), the influential teachers union, the Governor obtained an immediate cut of $2 billion education spending under Prop 98, the 1988 initiative described above that applies formulas to determine state funding of K-14. It appears that the Governor did not understand the full nature of his deal and its interaction with the Prop 98 formulas.[15] Exactly how that misunderstanding occurred has never been clear.

One possibility is that in the heat of the emergency, the governor's inexperienced new staff advisors did not comprehend the agreement's implications. However, the governor had the benefit of some experienced staffers who had worked for former Governor Pete Wilson, Davis' predecessor, along with veteran civil servants in the Department of Finance. More likely, it appears that the governor, accustomed to a Hollywood deal-making style of "let my people meet with your people" to hammer out important details, simply agreed to something unilaterally that could not be undone subsequently by more-informed advisors.

In any event, when Governor Schwarzenegger later reneged on the K-14/Prop 98 deal, CTA reacted with outrage. In the world of collective bargaining in which CTA operates – and in politics much more so than in Hollywood – trust in deal making is sacrosanct. Once it is violated, trust cannot be easily restored. The result of the controversy was that 2005 became the governor's politically disastrous "Year of Reform."

The governor's focus drifted quickly from longer-range budget solutions to a hodge-podge of four initiatives, two of which were aimed at neutering CTA. Only one of the four was aimed at trying to fix the structural budget problem. (Another initiative dealt with redistricting.) The public was unable to see the connection between an unfocused campaign for the four initiatives and a budget problem which in any case supposedly had been fixed by throwing away the credit card.

Ultimately, the four initiatives were handily defeated after a particularly clumsy campaign on their behalf as we have described elsewhere.[16] And with his popularity with voters at a low level and the November 2006 gubernatorial election on the horizon, the budget was dropped as an issue. Instead, the Governor made 2006 into the year of infrastructure, albeit infrastructure to be financed by borrowing. While borrowing for capital projects is not uncommon, financing such projects by general fund obligations rather than the earmarked gas tax or by user fees of some type was not the norm in California.[17] Nonetheless, the notion of improved infrastructure at no immediate cost was popular and the voters endorsed over $40 billion in infrastructure bonds – and re-elected the governor for a second term. But by now 2 years of no budget fix had elapsed.

Health care became the focus of 2007 after the November 2006 election. The governor endorsed a near-universal health insurance plan in January. But having dropped the idea into the legislature, the governor did not produce an actual bill containing the proposal. A long hiatus ensued before a plan that was essentially a press release became a serious bill. During that period, there was much national and international attention paid to the governor's various "green" initiatives on global warming which even led to a speech at the UN. Meanwhile, the health plan became increasingly enmeshed in state budget problems, which by then were becoming apparent. As we have described elsewhere, the plan emerged successfully – although in modified form – from the state assembly in late 2007, but was abruptly killed in the state senate in January 2008.[18]

In short, 2004 was a year in which the preoccupation was a short-term budget fix to resolve the fiscal legacy left by the Davis administration. The year 2005 was an unfocused year of (failed) reform in which the possibility of a long-term budgetary reform was lost. To address his drop in popularity, 2006 became the governor's year of (largely debt-financed) infrastructure with budget reform off the table. By 2007, the structural budgetary problems were returning but were held at bay by the effort on health insurance, a major plan that was left to compete with greenhouse gas proposals, hydrogen highways, and the like – and ultimately produced no health program. Officially, 2008 was supposed to focus on education reform, but by the time the year began, the budget loomed over everything else.

The Legislative Role

"...(I)f spending can go up... and most of us can't discern any difference, can we blame voters for being hesitant to put even more tax money in the hands of the state?"[19]

John G. Matsusaka
USC Professor

While the discussion so far has centered on the governor, the legislature is inevitably a partner or adversary in any major policy proposal. As many commentators have noted, the legislature has become particularly polarized. There was a time when, for example, Assembly speakers – notably including Willie Brown – could be elected by a mix of both Democratic and Republic legislators.[20] But such times are no more. Moreover, in many ways, Republican Governor Schwarzenegger has had more difficulty obtaining budgetary and other cooperation from his GOP colleagues in the legislature than from the Democrats. Shouldn't the legislature receive its share of the blame for the difficulty California has had in addressing its fiscal dilemma?

Although in the abstract the legislature can be blamed, in reality the legislature consists of 80 assembly members and 40 senate members, not a single individual with state-wide perspectives or responsibilities. Anyone elected governor has to deal with that reality -which means that at best a tight focus on one or two priority issues is needed. That tight focus was lacking in the budget crisis of 2003-04 and beyond. As we will show later, even in the less-polarized 1970s, there was a similar lack of focus by then-Governor Jerry Brown on the looming political crisis of Prop 13. Polarization is certainly part of the later story – but apparently not all of it. Focus – or lack thereof – is a bigger part.

As the lead-in quote to this section suggests, most voters do not see a close link between state spending and their personal welfare. It is important to note that a substantial portion of the state's general fund goes into transfers that provide services to those less likely to vote – or even not eligible to vote (if they are non-citizens) – than to higher-income persons – particularly in Republican districts. Depending on what function is counted, about one fifth to one fourth of state spending in 2007-08 went to "welfare" type income-support programs and related in-kind health and other services.[21] Moreover, although the funds come from the state, these transfers programs are largely administered by local jurisdictions, particularly counties. So to the average person, and certainly to the median voter who is not a recipient of transfers, a substantial part of the state budget seems to disappear into a black hole.

The legislature in its current gerrymandered arrangement reflects this tension. Representatives from jurisdictions where such transfers are important to their constituents push for their enlargement. Those from other jurisdictions push against demands for tax increases which they see as providing no special benefits for their constituents and supporters. As will be noted below, these divisions are not recent developments but reflect tensions that were certainly in evidence in the 1970s when Prop 13 passed. Indeed, the taxpayer revolt of the 1970s in California (and nationally) followed a period of enhanced welfare and anti-poverty programs, combined with racial tensions surrounding desegregation, busing, and affirmative action.

The Drama of 2008 Begins

"We never fixed the problem. It's been Scotch Tape and glue and staples and just praying we will never have to face the reality that the state government is on a path that is not sustainable." [22]

Christopher Thornberg
Beacon Economics

By late fall 2007, it was no longer possible even to pretend that the 2007-08 budget was in any sense balanced. The sub-prime mortgage crisis was well underway – and had been underway when that budget was signed in late August 2007. Rising gasoline prices were also cutting into consumer spending. A weakening economy meant weakening state tax revenues. The governor ordered state departments to come up with plans for 10% budget cuts. Plans for cuts are not the same, however, as actual implementation. Republicans pressed the governor to order a "fiscal emergency" pursuant to Prop 58. In principle, such a declaration would have prevented legislative consideration of anything other than the budget. But beyond that, a declaration would not in itself have produced a solution – and no emergency was imposed until January.

Former Governor Davis was charitable about his successor when asked about the renewed fiscal crisis. *"Nobody has repealed the business cycle,"* Davis said in late 2007.[23] While true, the same business cycle that was now cutting into revenue had provided revenue growth in the prior period during which the fiscal situation had improved but no basic reforms were enacted. Senate President Don Perata, however, was less charitable about one senate member – Republican Jeff Denham of Merced – who was expected to be a swing vote in passing the 2007-08 budget but refused to provide it. Perata initiated a recall against Denham for the June 2008 election – a campaign he aborted shortly before the actual election.[24] And just as the governor's health insurance plan ultimately fell victim to budgetary concerns, so, too, did his effort to put a water bond on the February 2008 ballot.

The governor began to move back to his 2005 Year of Reform concerns. In early December 2007, he announced support for a new ballot initiative on redistricting, somewhat similar to one of his four initiatives in 2005.[25] Word began to be leaked about across-the-board cuts. Such proposals immediately invited two criticisms.

At the level of general public policy, across-the-board solutions suggested no selection of priorities. And at the practical level, not all expenditures, e.g., debt service, can be cut - so others must be cut still more than the average. The governor also suggested early prisoner releases to reduce prison spending – something legislative Republicans immediately rejected. There was also advance warning of a proposed fire fighting "fee" to be added to property insurance, in part a recognition of the costs of dealing with various forest fires in fall 2007.[26] And in an echo of 2005, and the controversy over the deal with CTA suspending Prop 98, hints arrived just before the budget proposal was formally introduced that another such suspension would be part of the plan.[27]

On the Democratic side, State Treasurer Bill Lockyer – a possible future gubernatorial candidate – called for long-term solutions and suggested immediate remedies such as broadening the sales tax to cover "certain" services, ending general fund support for transportation (which had traditionally been financed by earmarked separate funds, and other remedies.[28] A California Field Poll released in late December 2007 showed that 43% of registered voters thought that the state's budget problems could be resolved without new taxes while 48% thought that taxes would have to be raised. Thus, there was a high degree of voter ambiguity on the subject of taxes. Unlike the era of the taxpayer revolt of the late 1970s and early 1980s when about 4 in 10 voters thought California's state and local taxes were too high, about 3 in 10 thought that way in late 2007.[29]

The January 2008 Proposal

"I will not raise taxes on the people of California because they pay enough taxes."[30]

Governor Arnold Schwarzenegger

"It's not real... (The governor) knows and we know that there is no way the Democrats... are going to suspend Prop. 98 and then cut $4 billion from schools... Nor are they going to cut a similar amount from Health and Human Services... So if it's not real, what is the real plan? He may not know at this point."[31]

Dan Weintraub
Sacramento Bee columnist

The idea that the budget was not "real" could actually be applied to most January budget proposals by California governors. California's constitution mandates that the governor submit a budget in early January. But the submission, nowadays accompanied by beautiful graphics and online videos, simply starts a slow-motion conversation. Since the new budget year does not begin until July 1, what normally occurs is some initial reaction, detailed analysis by the Legislative Analyst, less detailed summaries in the press, and then some hearings. Serious business really does not begin until the governor submits the "May revise," a budget proposal in mid-May that reflects updated information on the state of the economy and incoming revenue, as well as a reflection of what appears to be acceptable or not from the earlier legislative reaction.

Much of what had been leaked earlier was included in the January 2008 budget proposal. There were various short-term cuts for the current 2007-08 year and some delays in payouts until the next year designed to avoid a cash shortage at the end of June 2008.[32] Some of the cuts proposed for 2008-09 would have led to revenue losses from matching federal funds which would have been reduced.

A total of over $10 billion in cuts was proposed – the "across-the-board" total – although in fact some programs were exempted and others, therefore, cut more. Much of the cutting would have occurred in education, Medi-CAL (the state's Medicaid program for welfare recipients and certain others), and cuts to various "welfare" programs including those for low-income seniors and disabled persons. There were proposals to close some state parks and release state prisoners early. Shortly after the budget proposal was made public, the Fitch rating service

put California bonds – already tied with post-Hurricane Katrina Louisiana for the lowest state ranking – on a "negative watch." Since part of the January budget proposal involved the sale of $3.3 billion in economic recovery bonds left over from the 2004 voter authorization, Fitch's announcement was not helpful.[33]

Legislative Democrats seemed to assume that the governor's budget was meant to signal that without new taxes the consequences of what Assembly Speaker Fabian Núñez termed a "cuts only budget" would be so drastic that (somehow) new tax revenue would be found. Subsequently, Núñez began to argue for a 50-50 split between cuts and added tax revenue.[34] And Republicans also took the proposal as simply an attention getter. Assembly Republican leader Mike Villines termed it *"only the first of many steps."*[35]

The governor may also have had another motive in introducing a drastic cuts-only budget, however. He also – as hinted earlier – began to push for a ballot proposition, a variant of his failed initiative of 2005 – that would reserve a rainy day fund in good times to finance deficits in bad times. This idea, complete with impressive PowerPoint charts, seemed to become the centerpiece of the governor's budget strategy for a time.

The charts were meant to show that had the proposed proposition been in effect for an extended period, the 2008 budget crisis would not exist. But there were two problems. First, since there had been no such proposition in effect, passing it in 2008 would do nothing to meet the looming budget crisis. Second, even if a rainy day fund were created in 2008, there would need to be economic sunshine to accumulate the fund, something forecasters were definitely not predicting for the near term.

In any event, there was no time to complete the petition process in time for the February 2008 presidential primary ballot. There was only a little time left to place it on the June 2008 state primary ballot. And even for the November 2008 presidential election (well into the 2008-09 fiscal year), the clock was running. Ultimately, despite the rainy day charts and the various presentations by the governor around the state, there was no petition for such an amendment, not even one aimed at November. Yet the governor continued to talk about the idea into the summer of 2008.[36] If the purpose of the January proposal was to create a political climate for popular enactment of a sustainable budget solution in 2008, it didn't happen.

As will be noted below, a rainy day fund initiative will be on the ballot in 2009 as a result of the 2008-09 budget deal. The governor did kick off a drive for a redistricting initiative and necessary petition, an initiative which eventually landed on the November 2008 ballot as Proposition 11. Surprisingly, he did not propose a constitutional reform allowing midyear budget cuts in emergencies – a power that would have an immediate impact, unlike redistricting or a rainy day fund. Ultimately, he did get constrained midyear power to cut in the eventual budget deal for 2008-09, but not as a constitutional matter.

The budget crisis may have had some political effects on the February 2008 primary. On the ballot were four referendums to repeal certain state Indian gambling compacts. The repealing referendums were financed by a union trying to organize casino workers and certain non-Indian gambling interests. However, the governor – who had signed the compacts – argued

that the revenues the compacts would bring would help the budget situation and voters rejected repeal.[37] On the other hand, an initiative – pushed by Assembly Speaker Núñez that would have modified term limits and kept him and others in the legislature in office – failed despite gubernatorial support. The electorate may have felt that the initiative would reward those who were responsible for the renewed fiscal crisis.

Voters joined the governor in rejecting a proposition that would have earmarked an increased share of the general fund for community colleges on the grounds that a fiscal crisis was no time to allocate more spending by formula. And in the end, the legislature enacted what was billed as $1 billion in mid-year spending cuts for the current 2007-08 fiscal year, although some of these were cosmetic. One item *not* enacted for 2007-08 was eliminating a minor tax benefit for out-of-state yacht buyers, dubbed by Democrats the "sloophole." Because a two thirds vote was not available from legislative Republicans at the time, the sloophole remained in the law until finally removed in the 2008-09 budget deal.

The Budget Nun Intervenes

"Now may I remind you, you see though I'm a Republican, I'm a big believer when we have a financial crisis like this, we should all chip in. And this is why I totally agree with the Legislative Analyst's Office when she says that we should look at tax loopholes. We should look at those seriously."[38]

Governor Arnold Schwarzenegger

"I'm not for the recommendations she made, necessarily."[39]

Governor Arnold Schwarzenegger

In an unusual move in February 2008, the state's Legislative Analyst, Elizabeth Hill, sometimes dubbed the "budget nun," went beyond the usual comment and critique that normally followed a gubernatorial budget proposal. Generally, the Legislative Analyst's Office puts out a commentary and interpretation of the proposed budget, with some general references to alternatives. Given the crisis – and perhaps also because she was soon to retire – Hill departed from that format and instead presented an alternative budget. At the most general level, the LAO alternative was a mixture of less severe cuts than the governor proposed and revenue enhancement by reducing tax loopholes of various types. However, as did the governor, Hill relied in addition on the sale of the remaining Economic Recovery Bonds.

By the time the LAO report was made public, economic conditions had worsened. Table 1, based on the LAO analysis, compares the governor's January budget proposal with Hill's proposal released in February – both relying on LAO's economic projections. The figures on the table related to flows – revenues and expenditures – have been adjusted to exclude borrowing under the Economic Recovery Bonds. Although widely praised for providing an alternative, there are problems with both budgets. The governor's budget was projected to produce a surplus in 2008-09, even under LAO assumptions. But, as noted, there were strong reasons at the time to doubt that the cuts proposed, with almost no revenue "enhancements," would be acceptable by the Democratic majority in the legislature.

The LAO's mix of revenue enhancements was expected to provide essentially a balanced budget in 2008-09 as opposed to the governor's ostensible surplus. However, the LAO argued that in later years, the surplus would revert to deficit and remain a deficit (albeit a declining one) through 2012-13. LAO provided a chart, not a table, showing the out-year deficits. In analyzing its own alternative, LAO asserted that – taking account of the reserve – the budget would essentially average a balance through 2012-13, although precariously so. But it provided no numbers or charts to back these assertions. Moreover, the issue of political feasibility remained, whether the proposal was the LAO's or the governor's.

If it were true that the Democrats would not accept cuts of the magnitude the governor proposed, it was also true that closing loopholes might not obtain the two-thirds vote needed from legislative Republicans. As can be seen from the quotes at the start of this section, the governor first seemed to support the LAO alternative, but then backed away from the specifics. The only specific loophole closing both he and the LAO supported was the above-mentioned "sloophole" for yachts.[40]

The May Revise

"All we have to do is lock ourselves in a room for three days and not go outside – and not be allowed to go to the bathroom. And then we'll be getting upset because it starts smelling in the room a little bit. And all of a sudden we will come to an agreement."[41]

Governor Arnold Schwarzenegger

"Raise taxes. That clear enough? Raise taxes."[42]

Senate President Don Perata when asked
how the Democrats would balance the budget

"The governor does not believe that raising taxes is the solution for our chronic budget problems."[43]

Aaron McLear
Spokesperson for the governor

Much of the period up to the May revise was spent reiterating positions on the budget or taking symbolic or minor actions. State hiring was frozen – but not quite. Certain higher management salaries were frozen. Bills in the state senate that involved more than $50,000 in spending were suspended – with exceptions.

Externally, however, various interest groups were trying to head off budget cuts. Particularly notable in this regard was K-12 education, which aired various radio ads warning of the impact of a budget squeeze. Health providers aired a TV ad to the same effect. College students demonstrated against higher tuition. While the theme of these efforts was essentially "just say no," the California Chamber of Commerce indicated that temporary tax increases might be acceptable if they were part of a grand package of reforms.[44]

Republicans in the legislature hinted that they would be seeking a variety of non-budget reforms of labor and environmental regulation in exchange for any two-thirds vote on the budget.[45] Incoming Assembly Speaker Karen Bass proposed establishing a commission to study the state's tax base. And the idea of privatizing or "securitizing" (borrowing against) the state lottery – an idea that was originally rejected as a funding mechanism for the governor's ill-fated 2007 universal health plan – was revived.[46] Efforts were also underway to sell the state's EdFund, which guarantees student loans, although that idea was later shelved.

As in the case of the January budget, the May revise was proceeded with hints about what it would – and would not – contain. For example, word was put out that early release of state prisoners would not be in the new proposal, nor would closing state parks (but park entrance fees would be raised). Larger deficits were hinted. Some sort of ballot proposition would be suggested that would authorize borrowing against the lottery but trigger a sales tax increase if not approved. (It was never clear how a ballot proposition could trigger a tax increase by failing.) On the other hand, selling the EdFund – the prospects for which turned out not to be bright – was to be "postponed." Prop 98's guarantee for K-14 would be met. Some kind of user fee would be tacked on to property insurance for fire fighting. But unlike the earlier proposal, the fee would be risk-adjusted.

When actually released, the May revise and related proposals contained these elements and also assumed a more pessimistic revenue scenario as a result of a further softening of economic conditions. At about the time the May revise was released, a study by the California Research Bureau projected a disproportionate share of mortgage foreclosures would occur in the state because California had originated relatively more sub-prime loans than the U.S. average.[47] Given the deteriorating fiscal situation, it might have been expected that the governor and legislative leaders would have been undertaking early discussions to resolve the budget issue. But in a revealing interview, the governor said that he had to "negotiate with myself" to produce the May revise, since he had not been negotiating with legislative leaders since January.[48]

Even with the mid-year cuts, the May revise put the 2007-08 deficit (excluding the Economic Recovery Bonds borrowing) at over $6 billion. A new feature in the May revise was a plan to securitize the lottery which was supposed to bring in over $5 billion in 2008-09. Excluding that borrowing – although the governor's office was at pains somehow to differentiate the plan from borrowing – there would be a deficit in 2008-09 of about $4 billion, as shown on Table 2.

There was considerable skepticism in the LAO report on analyzing the May revise that the lottery plan would bring in as much as proposed. Indeed, shortly after the May revise was released, lottery officials lowered the projection of likely revenue for the year.[49] The LAO proposed a more modest lottery plan in place of the governor's suggestion and referred back to its alternate budget presented in February.

However, absent the lottery borrowing in either plan, LAO documents suggested that revenues would be about the same under the two – even though the LAO plan included loophole closings. The LAO plan included more Prop 98 K-14 funding than the governor's proposal. But exactly what total expenditures would be, or what the end-of-year reserve would be under the

LAO plan was not indicated. LAO continued to assert that its plan would produce an average balance over the period ending in 2012-13. But, as in February, no detailed charts or data were provided.

The sad fact was that while LAO had alternative approaches, and probably a more realistic projection of what revenue stream might be obtained from the lottery, there was no plan - absent significant spending cuts or revenue additions - which could balance the budget in a meaningful sense. And there had been no serious negotiation involving the legislative leaders and the governor on finding a solution. Not surprisingly, California Field Poll approval ratings among voters of both the governor and legislature began to drop.[50] A state commission that sets salaries of legislators and state elected officials toyed with the idea of cutting their pay, but ended up freezing it, partly because of legal barriers to an across-the-board cut.[51]

The Summer Stalemate Begins

"We have open doors and everything is on the table. I don't want to go and say to anything, No"[52]

Governor Arnold Schwarzenegger

"There's not enough money to fund next year. We're proposing raising taxes... This is not a morality play. This is life."[53]

Senate President Don Perata

"We're having a difficult time getting our (Democratic) counterparts to really change their original premise on the budget which is, 'We need taxes.'"[54]

Mike Villines
Republican Assembly leader

There are two constitutional dates that matter for the state budget. Technically, the legislature is supposed to pass a budget by June 15. However, a more important date is July 1, the start of the fiscal year. If there is no budget, the state controller will not pay certain bills. Over the years, however, the bills that will not be paid have been narrowed by court decisions.

Absent a budget, the state does not pay what it owes to local governments including school districts. But such local entities are able to go for a time without the payments, knowing that their funds will eventually arrive. However, without a budget, the local entities cannot be sure what their total revenue from the state will be.

Vendors of services to the state are also not paid, but many can borrow against the state's IOUs. Unlike local government entities, which cannot be sure of what the eventual budget will provide, the vendors will eventually be paid whatever the state's contractual obligation to them may be. Most welfare payments and state employee payments are made, although higher managerial and professional workers may not be paid. The bottom line, however, is that the average citizen does not feel any immediate emergency. If he or she goes to the DMV to renew a driver's license, the service there continues.

So life after June 30, 2008 continued despite the absence of a budget. And there was little action in the legislature to resolve the Democratic-Republican divide. *"It's almost like there is no emergency there,"* complained the governor in mid-July.[55] And, in a sense, since life was continuing, there wasn't. The senate and assembly considered budget bills but these did not have support of the Republican minorities. A court-appointed monitor continued to threaten to impose an added revenue drain on the state to support prison health care. The governor and U.S. Senator Diane Feinstein together endorsed new borrowing for state water projects. Various wildfires continued to add to state costs for fire fighting.

A meeting of the legislative leaders finally occurred on July 17, but no agreement was reached and there was even a difference in views of the participants about what transpired. The governor reported the Democrats were planning to borrow from local governments, transportation, and other funds outside the general fund – which he termed *"not a good idea."*[56] Democrats then denied any such intent.[57]

Technically, it was true that the Democrats' plan was to raise taxes, not to borrow. But if Republicans did not go along with a tax increase, and if Democrats resisted spending cuts, the only safety valve would be borrowing from somewhere. And it seemed unlikely a lottery plan – whatever it might turn out to be – could completely fill the gap between revenues and spending.

Creating Urgency

"Today I am exercising my executive authority to avoid a full-blown crisis... I have a responsibility to make sure our state has enough money to pay its bills."[58]

Governor Arnold Schwarzenegger
on signing an executive order to layoff certain workers
and cut others' pay to the federal minimum wage

"Please walk a week in a state worker's shoes before you sign this executive order and imagine yourself and your family surviving on $262 per week."[59]

Lieutenant Governor John Garamendi
in a letter to the governor

"...(B)ecause it is based on faulty legal and factual premises, I will not comply with the Order."[60]

State Controller John Chiang
July 31, 2008

With the state projected to enter a cash crunch at some point, it appeared that both sides in the legislature were engaged in a chicken race to see who would concede before the emergency reached public consciousness. In response, the governor – citing a court decision from an earlier budget crisis – leaked word that he planned to order that many state workers be paid only the federal minimum wage until a budget was in place. (They would then be paid back the difference between their regular salaries and the minimum wage.) However, California

controller John Chiang – whose office issues the targeted state paychecks – said he would not comply with such an order and that there would sufficient cash on hand to meet payrolls through September.[61]

Nonetheless, the governor issued the minimum wage order – which also provided for layoffs of selected temps, recalled retirees, and part-timers and elimination of most overtime - on July 31, 2008. The original estimate put the number of layoffs at around 20,000 but that figure was cut roughly in half after the governor spared various workers deemed to be in critical functions. A formal order was sent to Chiang demanding that the wage cut be implemented but Chiang indicated that the outmoded state computer system would require months of work to do the job – which in any case he had no intention of doing.

It was humorously noted that since the layoffs included recalled retirees – the only people who might remember how to work with the old computer programs couldn't be employed to undertake the task.[62] In any event, despite the litigation, no court challenge could be heard before September which guaranteed that regular pay rates would prevail through August. And there never was a minimum wage pay cut since a final budget deal was reached in mid-September.

Because of the ability to borrow from state funds outside the general fund, even negative reserves in the general fund to do not mean that the state is literally out of cash. It is difficult to determine from available figures exactly when a cash crisis could have been expected at the point of the Schwarzenegger challenge. The controller issues monthly statements on the state's cash position. Included is an estimate of "available borrowable resources." From these are subtracted any internal borrowing and short-term borrowing to produce an estimate of "unused borrowable resources."

In the budget crisis of the early 2000s, after accounting for borrowing via Revenue Anticipation Warrants (RAWs), unused borrowable resources were down to around $10 billion at the end of June 2003. At the end of June 2008, the controller's estimate was a comparable $12.8 billion. Estimates of the drop in resources from the summer of the year before (when there was also no budget), suggested that if $10 billion was in fact something of a danger range, the state was likely to fall below that level during the summer. However, there have been summers when the figure fell well below $10 billion. And at least the controller's end-of-July estimates held the unused borrowable resources total at around $10 billion and $9.6 billion at the end of August. It was thus unclear from publicly-available data when a cash crunch might arise.[63]

However, the state often runs out of cash within a fiscal year because tax inflows and spending outflows don't match and so borrows using short-term Revenue Anticipation Notes (RANs). It did so, for example, during 2007-08, borrowing $7 billion in the fall. The governor's January 2008 budget proposal assumed that $9 billion in RANs would be borrowed in September with a budget in place. So the state was expected to run out of cash (and borrow) in the fall, with or without a budget. The difference is that without a budget, the state must issue RAWs (Revenue Anticipation Warrants) rather than RANs and likely pay a higher interest rate reflecting Wall Street's appraisal of a disorderly fiscal house. Put another way, the minimum

wage/layoff action – although couched in terms of cash flow – was in fact a way of pressuring the legislature.

What Did He Say?

"The fact that the governor now has said we cannot balance this budget, we cannot get through the next three or four years, without at least a temporary tax I think is a step in the right direction... I'm glad he stepped up to this, but let's be clear, he doesn't have any support in his own party yet for this... (Legislative Republicans) have got to come up with proposals, and they have not done it."[64]

Senate President Don Perata

"Senator Perata's statement regarding the lack of Republican solutions is patently incorrect. We have been bringing ideas to the table since first learning of the fiscal crisis."[65]

Senate minority leader Dave Cogdill

"We are not discussing what is being negotiated in the Big 5."[66]

Unidentified spokesperson for the governor

"This year we have heard Republicans and Democrats in the Legislature talk about our budget system, but the time for talk is over – it is time for everyone to compromise and get this done."[67]

Governor Arnold Schwarzenegger
after proposing his "August revise" budget

In early August, word was leaked that Governor Schwarzenegger was willing to consider a 1-cent increase in the state sales tax (from 6.25 cents to 7.25 cents) to last three or four years. The quid pro quo would be a legislative agreement for reforms involving earmarking funds for (another) rainy day fund and a spending cap. Presumably, such an exchange would involve putting these provisions on the ballot as constitutional amendments. Democrats welcomed the idea of a tax increase, but not of the sales tax. They preferred raising the upper bracket of the personal income tax and were leery of constitutional spending caps. Republicans criticized the tax idea. *"I cannot envision any Republican legislature supporting such a proposal,"* said Senate minority leader Dave Cogdill.[68]

However, in the third week of August, the governor took the unusual step of unveiling an August revise proposal. A key element was indeed the temporary 1-cent sales tax increase (estimated to pull in an additional $4 billion in 2008-09) and continuing through the summer of 2011. To attract Republican votes, the proposed increase would be followed by a 1.25 cent decrease in September 2011, thus producing an eventual net decrease in the sales tax of a quarter cent. Various loans would be made from funds outside the general fund and other changes in tax treatment would be adopted.

The supporting documentation of the August revise was less complete than the May revise or the January budget proposals. But as Table 2 shows, it probably would have raised tax revenues on the order of $6 billion, leaving an operating deficit of something like $2 billion. That gap was to be made up through the above-mentioned borrowing of other state funds and by running down the reserve (which essentially existed only because of the earlier flotation of the unused Economic Recovery Bonds). Of course, the revenue figures depended in prior projections of state economic performance, which was anything but healthy.

Deal or No Deal

"It's time to get this budget done. It's been way too long."[69]

Senate Republican lead Dave Cogdill

"It's really no more than another get-out-of-town budget that will, more than likely, begin falling apart as soon as it's signed."[70]

Sacramento Bee columnist Dan Walters

"I'm not proud of this budget – it just kicks the can down the road."[71]

Senate President Don Perata

"I don't see much of a signing ceremony because there's nothing to celebrate."[72]

Governor Arnold Schwarzenegger

While it might have seemed that the governor's "August revise" proposal would have created a new dynamic and created a basis for a compromise budget, the stalemate continued. The California Taxpayers Association (CalTax) – a business-oriented group – supported the plan, albeit reluctantly. But Republicans would not accept a tax increase, even temporary and even followed by an eventual tax cut. And CalTax was denounced by the Howard Jarvis Taxpayers Association as "the mouthpiece for corporate California" whose original sin was opposition to Prop 13 in 1978.[73] In any event, the resulting plan that ultimately came up for a vote – and did not receive the needed two thirds – was a version of the governor's plan without the deferred sales tax cut. Governor Schwarzenegger confessed to a German magazine that he had little influence with Republican legislators. *"I have almost no contact with them – none. Because they're just so out there,"* he said.[74]

Since the governor could not deliver any Republican votes, the stalemate continued until the Democrats essentially gave up and produced a bill Republicans indicated they could endorse. As initially framed, a key element was raising income tax withholding, but not tax rates – basically an interest free short-term loan to the state by taxpayers. The governor then called a dramatic press conference saying he would veto the compromise deal because its rainy day fund features were not sufficiently stringent. He indicated that he expected that since the budget was

passed with a two-thirds vote – the same proportion needed to override a veto – his veto would also be overridden. But it turned out to be more complicated.

An increase in income tax withholding seemed likely to be very unpopular as it became evident that it was an interest-free loan. The smokescreen involved might well have proved more unpopular than an overt tax increase. And it was not clear that Republicans who supported the deal initially would want to override a gubernatorial veto. Moreover, the withholding part of the budget appeared in a separate bill which required only a majority vote – since it was technically not a tax increase. It appeared that contrary to the governor's expressed expectation, an override of his threatened veto was not going to be easy. As a result, the legislature modified the deal to include tighter rainy day fund provisions and passed it on September 19, 2008.

The budget was signed on September 23, 2008 after the governor vetoed about half a billion dollars in expenditures. Once a budget was officially in place, various state bills that had gone unprocessed by the state controller could be paid. And state employees – who never actually had their paychecks cut to the minimum wage – could nonetheless participate in a charity event with the opportunity to drop Finance Director Mike Genest into a dunk tank.[75]

As Table 2 shows, the final figures for revenue and expenditure looked more or less unchanged from the August revise estimates (and contained a deficit). But since there was no hike in the sales tax in the final deal, as there had been in August, additional revenue sources had to be developed. Some of the added revenue came from technical changes in corporate taxes including "accelerated" payments (which subtract revenue from the future) and accrual changes (which accelerate bookkeeping – but not cash).

However, the economic outlook for the state on which the revenue numbers were based was becoming more uncertain as the country (and global economy) faced a major financial crisis just as the budget was being signed. There were concerns, as credit markets froze, over whether the state might run out of cash and be unable to float Revenue Anticipation Notes – which had been planned for the fall – to cover its expenses. Based on the old economic estimates, the General Fund was to end with a reserve of $1.7 billion at the end of June 2009 – which would exist only because of the floating of the remaining Economic Recovery Bonds during 2007-08. Given the economic uncertainty surrounding the financial crisis, there were considerable downside risks built into the new budget.

Aftermath and Afterthoughts

"Governor Arnold Schwarzenegger today signed the 2008-09 state budget, concluding a very difficult budget year and delivering a real win for California with a proposal to achieve meaningful budget reform"[76]

Office of the Governor Press Release

"...(B)y common consent, everyone pretends that outdated numbers are still valid – in effect punting the problem into the next year. Or as they say in Silicon Valley, garbage in, garbage out."[77]

Columnist Dan Walters
Sacramento Bee

In the aftermath of the final budget deal, there were frustrated calls for revising key institutional features of California's political decision making. These ranged from calling a constitutional convention, a complex process, to specific changes such as relaxing the two thirds vote requirement (something voters rejected in 2004) or term limits (something the voters rejected in 2008). And there were proposals to penalize legislators if budgets were not passed on time in the future.[78]

The California Correctional Peace Officers Association – a union representing state prison guards – began the process of recalling the governor, apparently to pressure the governor in collective negotiations and as part of the union's own internecine politics. However, elements of the California Republican Party toyed with the idea of supporting the recall due to the governor's proposal of a tax increase in his August revise. While "barely" opposing a recall, the conservative *Orange County Register* denounced Schwarzenegger as "Gov. Weather Vane" for – in its view – "abandoning principles."[79]

As for the governor's victory in winning modifications of the budget, there are surely doubts that can be raised. He had already put redistricting on the November 2008 (Proposition 11) as a long-term reform. Yet in terms of priorities on the budget, it was an odd choice – given the money needed to obtain signatures and run a campaign for an initiative. Redistricting cannot take place before the 2010 Census results become available and any impact it might have would affect budgets after the governor left office. So redistricting surely had no foreseeable effect on the immediate 2008 budget crisis when the decision was made to push it.

Even as a long-term reform – the interaction of redistricting and the two-thirds vote requirement could conceivably make budget passage more difficult. The theory of redistricting is that less gerrymandered districts would produce more centrist candidates who would be more willing to compromise on budgets once elected. But it could also increase representation of a larger minority, essentially more Republicans, who would make a two-thirds vote less attainable.[80] California's Democratic Party, and allied groups such as organized labor, viewed the governor's redistricting plan as a Republican power grab.

The governor did win a ballot measure for a tightened "rainy day fund" (reserve in the General Fund) as a consequence of his veto threat. His target was to have an eventual reserve of 12.5% that could not be readily raided before it was accumulated or needed. But there are a number of problems with the focus on the rainy day idea. First, rainy day funds have to be accumulated when the budgetary sun is shining, which it assuredly was not in 2008 and was not likely to be in the near term. So the rainy day fund did not address the immediate budget crisis of 2008. Second, it is very difficult – whatever clever language is used – to prevent a *de facto* raid on a rainy day fund (or on other funds outside the General Fund) if the legislature is determined to do it. Third, a constitutionally required rainy day fund augmentation requires a

vote of the people. The legislature agreed to put such a measure on the ballot some time in 2009, perhaps March or June, but someone would have to mount (and finance) a campaign to win voter approval.

Fourth, recent history regarding the rainy day fund concept is not particularly promising. Although there was not constitutional requirement to do so, the dot-com and stock market bubble of the late 1990s gave Governor Gray Davis a General Fund reserve of about 12% just as his budget outlook began to sour. Essentially, the legislature blew through the reserve quickly and plunged into crisis. The lesson seems to be that an ample rainy day fund of the magnitude Governor Schwarzenegger wanted (and which Gray Davis had), gives the state about a year to come up with more fundamental solutions than just spending the reserve. If it doesn't find such solutions, the crisis is simply delayed a year.

The governor *did* obtain one concession relevant to the immediate 2008 crisis. One of the trailer bills that accompanied the budget deal provided him with authority to make midyear budget cuts in the 2008-09 budget – although hemmed in by various constraints on what could be cut and by how much. In principle, the authority extended beyond the 2008-09 budget year. But since this component of the deal was an ordinary bill – not a constitutional provision – the authority could be stripped away in future budgets. Thus, while the most pressing priority for dealing with the current budget crisis – as well as future ones – might have involved authority to make midyear cuts, the governor instead focused on redistricting in 2008, a reform with no immediate impact and uncertain long-run consequences.

We will have to await the verdict of history on Governor Schwarzenegger's approach to the state budget. However, history does provide some lessons on what happens when a governor has a diffused agenda and remains aloof from a developing problem. These lessons come in the form of Governor Jerry Brown and the passage of Prop 13 in 1978. We turn now to that episode for those lessons, noting also that Prop 13 led to fundamental changes in state and local fiscal affairs in California.

Prop 13's Genesis

"Nothing in life is so rigid that there aren't developments. That's true in politics. That's true in theology. That's true in personal relations. And for those small minds that slavishly adhere to foolish consistency, their irrelevance is their best reward."[81]

Governor Jerry Brown
explaining why he had turned from
opponent to supporter of Prop 13

In essence, Proposition 13 – on the ballot in June 1978 - was a simple initiative aimed at a simple problem. Rising home prices were causing local property tax bills to escalate. Prop 13 rolled back the assessment value to 1975-76 for existing properties or to 1% of the subsequent sales price, whichever was higher. It limited the tax rate on the assessment to 1%. (It had been the equivalent of anywhere from 1.5% to over 3% of assessed value, depending on jurisdiction,

averaging 2.7%). Prop 13 allowed only a 2% increase for inflation in the assessment each year until the property was sold.[82] At that point, the assessment would be at the new market price - whatever it was. Prop 13 also required a two-thirds vote for new state taxes or tax increases and a two-thirds vote of the electorate for local taxes.

Local property tax revenue was cut by an estimated $7 billion under Prop 13 (from a total of $12.4 billion). The state initially provided a backfill to the localities of $4.2 billion out of the $7 billion (with over half the bailout going to school districts).[83] It was able to provide the large bailout because as shown on Table 3, the state had been running surpluses and had accumulated a significant reserve. The state would have continued with a larger surplus in 1978-79 after Prop 13 was enacted. However, given the ballot initiative and the resulting bailout, the result – as the table indicates - was a state deficit of about $1 billion.[84] An initial legal challenge to Prop 13 on various technical issues failed when the state Supreme Court rejected the claims.

Current polling suggests the continuing popularity of Prop 13.[85] Not surprisingly, the further back in time homeowners purchased their house, the more familiar they are with Prop 13's details. But even recent homeowners indicate they would vote for Prop 13 if it were on the ballot now. Proposals to modify Prop 13 thus meet with suspicion and disapproval. The only change that might be acceptable – taxing commercial property at a different rate than residential – could conceivably win approval if it were pitched as taxing residential property at a lower rate than commercial as opposed to taxing commercial rate at a higher rate than residential.

Even that "split roll" approach – a proposal which pre-dates Prop 13 – would be problematic as a ballot measure since opponents would surely frame it as tinkering with Prop 13 more generally. Certainly, Governor Schwarzenegger would not propose or endorse any such tinkering. In a notable incident during the 2003 recall of Gray Davis, candidate Schwarzenegger's advisor, Omaha-based financier Warren Buffett, made an off-hand criticism of Prop 13 to the *Wall Street Journal* and created a political brouhaha. Schwarzenegger managed to skirt the damage by quipping *"I told Warren if he mentions Prop. 13 one more time, he has to do 500 sit-ups."*[86]

The Impact

"I'm sure Arnold was mortified when he read (Buffett's comments)."

Frank Schubert
Republican consultant

"Warren's right. It's an unequal system. But all the polling indicators I've seen show the appetite for changing the system is very low."[87]

Bruce Cain
Director, Institute of Governmental Studies at UC Berkeley

"... (I)f the current budget problem is a lack of revenue – which it isn't, of course, but let's pretend – then we still can't blame Prop 13 for today's budget imbalance. Why? Because about 5 years ago, the inflation adjusted, per capita property tax collections in California began to surpass Pre-Prop 13 levels."[88]

John Coupal
President, Howard Jarvis Taxpayers Association
in January 2008

As the quotes above suggest, the effects of Prop 13 are still debated. And, as will be noted below, the statistical component of the third quote does not square with the report on which it appears to be based. At the time it was passed, there was much debate about the impact it would have. But Prop 13 had one predicted effect. Since local governments, especially schools, were heavily dependent on property taxes, cutting the tax shifted the burden to the state, which – for a time – was able to prevent sharp cutbacks. However, when the state's economy (and tax revenue) turned down in the early 1980s, the state retreated temporarily from its role of subsidizing the local authorities.

Since Prop 13 allowed user fees to go up – but restricted general tax increases – localities (mainly cities) which could charge such fees became more dependent on them. Through zoning decisions leverage, they also could push land developers to undertake infrastructure responsibilities previously assigned to government.[89] But school districts which provide a free service and are not involved in zoning policy had little opportunity to charge such fees or shift such costs. So schools became especially tied to state finance and eventually pushed for a ballot-box guarantee of funding.

A less predictable effect was to make local authorities more dependent on their portion of the sales tax and the so-called "fiscalization of land use." That is, local zoning decisions tended to tilt toward developments such as retail and auto malls that generate sales tax and away from other uses such as manufacturing or residential. Finally, there was the political effect mentioned earlier of stimulating increased interest in using direct democracy to enact laws and constitutional amendments on budgetary matters and other issues. As noted, the pace of placing initiatives on the ballot increased after the success of Prop 13.

As the third lead-in quote to this section illustrates, it has sometimes been asserted incorrectly that property tax revenues, adjusted for inflation and population growth, eventually rose back to where they were prior to Prop 13. Note that since property tax assessments under Prop 13 have become a rolling weighted average of current sales (and therefore market prices) and earlier market prices (plus the 2%/annum adjustment), sufficient real estate inflation could bring about such a situation eventually. But the rate of property inflation – although rapid in some periods – was not fast enough overall to produce a catch-up over the entire period studied.

The combination of inflation and population growth since the passage of Prop 13 has been roughly 6% per annum. Even with the run-up in home prices in the early 2000s - before the bubble burst - the inflation only affected the assessed values of those properties that were sold. And, of course, the home price inflation then turned into dramatic deflation. A study by the California Taxpayers Association suggests that property tax revenues rose in nominal terms a bit over 8% per annum since Prop 13 came into effect. The roughly 2% per annum rise over population growth plus inflation is gradually raising the property tax take adjusted for those two factors. But even over the three decades since Prop 13 was passed, that relative growth would be unlikely to have made up for the inflation+population drop in revenue caused by Prop 13.[90]

In any event, the study that appears to be the basis of the quote - which the Howard Jarvis Taxpayers Association (HJTA) had commissioned - did not in fact say that adjusted property tax revenues had caught up.[91] It said instead that *total* state revenue adjusted for inflation and population growth was above pre-13 levels. In fact, that event had occurred long before 2002-03 (the final date of the study). On the other hand, county adjusted total revenue – although higher at the end of the period than the beginning – had followed a U-shaped path. City adjusted total revenue also had a U-shaped path, but recovered earlier than county revenue. School district adjusted revenue was essentially flat in the 1980s but then rose above pre-13 levels after the enactment of Prop 98.

The property tax is a local tax, not a state tax, so – as noted – the impact on the state was not as a tax recipient but as a subsidizer of the local authorities. Not surprisingly, the HJTA study showed that local property taxes, adjusted for inflation and population growth, had declined: a 60% drop for counties and 50% for cities. The report did not give a comparable property tax figure for school districts but the number had to be in the ball park of the county and city figures. (School districts are located within counties and their boundaries often encompass whole cities.)

Also not surprisingly, transfers to dependent localities from the state – adjusted for inflation and population growth – were up substantially: a 78% increase for counties. City data showed a big shift to fee income. School district data were again limited but – as noted – the ability of the districts to charge user fees is small. Federal subsidies were up but only a fraction of the increase in total school revenue. So it appears that the state became the schools' main patron.

What cannot be known is the degree to which Prop 13 altered the *total* of state and local revenue and spending in California. Since, as the HJTA study suggests, state and local budgets, adjusted for inflation and population growth, rose, it is clear that Prop 13 – even with its two-thirds vote requirement on taxes – was not an absolute cap. Part of the reason is that there was a two-thirds requirement to pass a state budget in effect long before Prop 13 came along – so the Prop 13 requirement was an incremental constraint, not something totally new. Moreover, Prop 13 does not stop the state from spending revenue windfalls that arise within its existing tax rates.

The Story of Prop 13

"I think Proposition 13 will be defeated and I will and I will do anything I can to see that happens."[92]

Governor Jerry Brown
before Prop 13 passed

"Limiting the public sector is the message of Proposition 13."[93]

Governor Jerry Brown
after Prop 13 passed

Various authors have traced the history of Prop 13 from both a journalistic and academic perspective.[94] And not all agree with Governor Brown's quote above that the public was anxious

to limit the size of the public sector.[95] Another interpretation is that people wanted services to continue but also want to have both predictability in the tax burden and less of a tax burden. However, the meaning of "services" can vary across individuals. Police and fire enjoy popularity as desired services. "Welfare" spending (transfers to lower-income persons) is less favored.

The basic story of Prop 13 is well known. There were anti-property tax movements which ebbed and flowed as far back as the 1950s. But these were often led by disparate gadflies, sometimes advocating tactics such as "tax strikes" (which could have endangered the properties of any homeowners who took part or at least subjected them to late tax penalties). When the calls for property tax relief would become particularly vociferous, the state would enact various types of tax rebates and the fever would decline.

Moreover, property tax relief was not a simple left-right issue. Politicians on both sides of the spectrum would take up the cause. For example, when she first ran for a seat on the San Francisco Board of Supervisors in 1969, Diane Feinstein made property taxes an issue in the campaign. Voters, she said, should take their tax bills to the polls (whatever exactly that meant).[96] Only after Prop 13 passed, was the taxpayer revolt cast as an issue of the right.

County tax assessors had a good deal of discretion in making assessments. Since they were elected, not appointed, assessors were likely to be sensitive to homeowner complaints (where the votes were). In some ways, they could act as a circuit breaker, cushioning the impact of jumps in real estate values (by undervaluing property). The result was a tilt of assessments away from private residences and toward commercial property. However, with discretion came opportunities for corruption. Thus, public policy shifted toward ensuring honest assessments. One of the inadvertent consequences of this reform was a shift in the property tax burden away from business and toward homeowners as assessments came closer to actual market values.

When home prices escalated and assessments rose in the 1960s and 1970s, anger tended to be focused on the county assessors who delivered the bad news to property owners. In Los Angeles County, Philip Watson was elected assessor on a platform of doing away with on-site investigators ("snoops") who would visit properties to evaluate them. Instead, he relied on developing computerized methods based on comparable sales and known house characteristics such as square feet. Even so, Watson had a political problem as the target for homeowner anger as assessments rose. At one point, he was charged with corruption in assessing a particular commercial property (and then acquitted in a high-profile trial).

Watson sponsored ballot initiatives – essentially prototypes of Prop 13 – in the 1960s and 1970s, which would have cut property taxes. He thus deflected voter anger from himself and refocused it on the system instead. But he was scapegoated by some members of the LA County Board of Supervisors for his anti-tax activism. Ultimately, Watson was forced to resign in 1977, just as the pressures that led to Prop 13 began to rise.[97]

In essence, a perfect storm developed, in part because in California tax assessors had a reputation for what one study termed a "high level of professionalism and expertise" in calculating market values.[98] Just before Prop 13 was enacted, the ratio of property taxes to

personal income was about 40% above the national average; only Massachusetts (which passed its own Prop 13-type initiative two years after Prop 13) had a higher ratio.[99] As Chart 1 indicates, home prices were rapidly escalating.

Typically, homes were re-assessed on a three-year cycle so assessments would jump with three-years' worth of house price inflation in one dollop. Disparate anti-property tax groups began to unite. Notably, two rivals in the movement – Howard Jarvis and Paul Gann – made sufficient peace with one another to co-sponsor Prop 13. And other influences that pushed property tax relief to the fore are often cited.

An earlier court decision in the *Serrano* case required the state to approximately equalize per pupil spending across school districts.[100] In effect, Serrano disconnected local property taxes from revenue going to local schools. Homeowners who might once have seen property taxes as a kind of user fee for schools, no longer had reason to do so.

While the influence of *Serrano* on the anti-tax movement is still debated, the rapid escalation of property tax assessments was also not linked to a visible upgrading of non-school local services. A homeowner's property tax might double. But streets were not twice as clean, potholes were not filled twice as fast, and police and fire departments did not respond in half the time to emergency calls.

Certainly, the school issue clearly had some influence. Particularly in LA's San Fernando Valley, the combination of *Serrano* and of court-ordered busing to end *de facto* segregation did not create a sense that schools were improving. In various ways, the anti-busing forces and the anti-property tax forces tended to fuse.[101] Both saw their route to salvation as the use of the ballot initiative. (An anti-busing initiative - Prop 1 of 1979 - and related litigation, ultimately brought the LA busing program to a halt.) Similarly, anti-growth movements were also developing as issues of congestion and density pitted the older development-political alliance against middle-class homeowners.[102] (Anti-growth forces eventually enacted Proposition U, placed on the LA City ballot in 1986.)

When Ronald Reagan was governor, he opposed the Watson approach because he feared – as a conservative – that shifting the financing of schools to the state and away from the local property tax would weaken local control. And the governor and legislature – as noted earlier – would periodically provide tax relief to homeowners in response to the initiatives and similar pressures. But as Prop 13 loomed as a possible ballot initiative and then became an actual ballot proposition, Governor Jerry Brown and the legislature seemed to dawdle. And Reagan – no longer governor but by then an active candidate for president – reportedly signed the Prop 13 petition. Prop 13 had become the centerpiece of an umbrella movement and an alliance of various forces in the taxpayer revolt.

Prop 13 was opposed by most – not all - local officials, public sector unions, and many in the legislature – not surprisingly. But it was also opposed by big businesses even though, as worded, the proposition would give more dollars back to business property than to homeowners if enacted. Chamber of Commerce types feared that ultimately cutting a local source of revenue would shift the tax burden more toward private business. On the other hand, many small

businesses – Jarvis represented apartment-house owners, often mom and pop operators – found the proposition appealing.[103]

While some observers have found the opposition to Prop 13 of big business paradoxical, the fact is that as with any major policy change, there are often consequences which interest groups don't understand or fail to forecast accurately. For example, real estate agents were enthusiastic supporters of Prop 13, distributing petitions and the like. But Prop 13 contained incentives for people to stay in their existing houses, not trade houses. And other things equal, less churning of houses is a Bad Thing if you are a realtor dependent on sales commissions.

Similarly, it is doubtful that Jarvis and his apartment house owner/backers could have predicted that Prop 13 would spawn rent controls. Renters had been promised that landlords would somehow share the windfall of lower taxes in the form of lower rents. Indeed, Prop 13 co-author Howard Jarvis had hinted at an agreement by apartment landlords to lower rents if the initiative passed.[104] But Prop 13 had no immediate effect on either apartment demand or apartment supply – so such rent reductions did not occur and angry tenants clamored for controls in response. Special interests do not always know for sure what their interests are.

In the end, despite the late arrival of an alternate ballot proposition placed there by the legislature and a rather ineffective campaign for the alternative and against Prop 13, Prop 13 won by a 2-to-1 margin. The alternative, Proposition 8, lost with 47% of the vote. As a result, Howard Jarvis – who was far more colorful and visible than the soft-spoken Paul Gann – became a folk hero (and even landed a comic part in the movie *Airplane*). His book – a kind of memoir and manifesto – was widely read.[105]

Jerry Brown – who opposed Prop 13 before it was passed - announced afterwards that he would make Prop 13 work as the will of the people. And he had the means, at least temporarily, to do so by bailing out the localities, given what state treasurer Jess Unruh called the "obscene" state reserve that had been accumulated.[106] Jarvis seemed to endorse both Brown and his Republican opponent, Attorney General Evelle Younger, in the fall gubernatorial election. (Younger had in fact given mild support to Prop 13 when it was on the June ballot.) Brown went on in November 1978 to win re-election to a second term as governor as a convert to the virtues of Prop 13. And, of course, Ronald Reagan won his first term as President in 1980, in part due to the spread of the taxpayer revolt from California to other parts of the country.

The Prop 13 episode has significant parallels to the budget crisis of 2008. In both cases, there were plenty of advance warnings of a coming crisis – Prop 13 in 1978 as a political crisis; the 2008 budget impasse as a fiscal crisis. Arguably, the legislature and governor had more potential ability to deal with the 1978 political crisis than the 2008 fiscal imbroglio. In the former case, the state was running a large budget surplus and had accumulated a reserve that could have been used for aggressive and pre-emptive property tax relief.[107]

Indeed, it was that surplus and reserve that allowed the state (partly) to bail out local governments when Prop 13 came into effect – at least until the recessionary climate of the early 1980s interacted with the bailout to cause a fiscal crisis for the state at the end of Governor Brown's second term. If such a transfer of resources was possible *after* Prop 13 was adopted, it

surely was possible *before*. What prevented action being taken preemptively at the state level? The actions (or lack thereof) of the governors in both the Prop 13 political crisis and the 2008 budget crisis had much to do with these two events.

Two Governors

"Maybe by avoiding doing things you accomplish quite a lot." [108]

Governor Jerry Brown

"Flip-flopping is getting a bad rap, because I think it is great." [109]

Governor Arnold Schwarzenegger

Initially, other than the fact that both have been governor of California, Jerry Brown and Arnold Schwarzenegger could not appear to be more different. Brown was raised immersed in state politics in the household of Pat Brown who was state attorney general and then governor (1959-67). Son Jerry first intended to be a Jesuit priest, but then changed his mind and went into politics, initially as an elected member of the Los Angeles Community College Board, then as California secretary of state, and eventually as governor. Schwarzenegger, in contrast, was an immigrant weight lifter who became a celebrity movie star/action hero. When Schwarzenegger ran in the 2003 recall, he promised voters "action, action, action." In contrast, Jerry Brown focused on lowered expectations and more meditation.

But there are some parallels, both in style and interest. Both governors enjoyed being recipients of publicity and media attention. Both characterized themselves as not being ordinary politicians. Both liked to cross traditional ideological lines. Both liked to identify with Big Issues, notably environmental. Both seemed aloof from nitty-gritty details of policy. Both liked to talk with a wide variety of people. Both were capable of taking actions that surprised their own staffs and both enjoyed having an eclectic mix of staff members. Both fitted the stereotypes about California as a place where unusual and amusing things happen, stereotypes which are popular outside the state and attracted national attention as a result. Both have proved capable of quickly reversing policy when the political need arose.

These characteristics work well in personal campaigns for elective office. They work less well in dealing with legislators who often *are* ordinary politicians with ordinary constituencies to please. They work less well in rounding up support for policies that are controversial and are opposed by major interest groups or in obtaining support for unpleasant actions in the face of fiscal distress or other difficult situations. On the other hand, the ability to reverse course, permits a political rebound when needed.

Thus, after Governor Schwarzenegger's "Year of Reform" ballot initiatives were all defeated in November 2005 and his popularity sank dramatically, he proclaimed "message received" in his January State of the State address and went on to win re-election in November 2006. Similarly, when Jerry Brown found himself on the wrong side of Prop 13 after it passed in

June 1978, he quickly became a dedicated Prop 13 supporter, wooing Howard Jarvis personally, and winning re-election in November of that year by a wider margin than his victory four years earlier.

Over time, what the issues are – and what will prove popular – changes. Jerry Brown made a point in his early career of not being just a copy of his dad and in fact in many ways was the anti-Pat. He took pride in running a budget surplus and holding spending below revenue. He took a hard line on student demonstrators. And, although opposed to the death penalty, Jerry Brown identified more with a tough-on-crime approach than with an emphasis on rehabilitation.

Pat Brown – although he now has attained retrospective gubernatorial sainthood for his freeways, waterworks, and university campuses – left office after defeat by Ronald Reagan blamed for student demonstrators, the Watts Riot, and a major budget crisis that he left to his successor to fix. Jerry clearly did not want to be identified with those images. Operating with such New Age themes as "small is beautiful" and "era of limits," Jerry generally opposed more freeways and similar infrastructure – with the exception of a fancied California state space program that never materialized.[110]

Schwarzenegger, ironically, invoked the now-sanctified senior Brown as the model great builder in pushing for Pat Brown-type infrastructure in 2006. The contrast between Jerry Brown's modest choice of a Plymouth as his state car and Schwarzenegger's predilection for Hummers simply reflects changing times. (And as public anxiety over rising gasoline prices came to the fore, the Hummers seemed to disappear from view.) Jerry Brown was interested in beaming solar energy from space. Arnold Schwarzenegger focuses on the "hydrogen highway."

Now that New Age symbols and rebellion against tradition are no longer the novelties and the political assets they once were, Brown as mayor of Oakland returned to the conventional. As he prepared to return to statewide politics in the early 2000s (a successful run for Attorney General in 2006), he disconnected from a longtime Zen guru/advisor – who had made himself an embarrassment. And he married his longtime girlfriend.[111] Similarly, after the 2005 Year of Reform fiasco, Schwarzenegger dropped the Hollywood-style photo ops that had become counterproductive. He instead turned to professional press conferences and talks to civic groups to push his agenda, often in a suit and tie.

1977-78: What Happened?

"Whenever I tell an audience local government will come to a halt, all I see is smiling faces."[112]

Assemblyman Paul Priolo
Republican minority leader

"This may be the time they waited too God-damned long to act."[113]

San Diego Mayor Pete Wilson

The fiscal year that ended in June 1978 – with the passage of Prop 13 – turned out to be a crucial period in California's budgetary history. Members of the legislature were certainly aware of pressures for property tax relief. A bill was in the hopper at the beginning of the fiscal year providing property tax postponements for seniors (until the property was sold) and other features. And there were policies considered that would allow taxpayers to defer property tax increases above a given percentage. Some Democrats were willing to consider caps on spending – state and/or local – an idea that had been unsuccessfully pursued via initiative by then-Governor Reagan in 1973.[114] Debate also centered about a demand from the business community to abolish a tax on commercial inventories, as part of some more general tax relief.

Complicating the task, however, was court-ordered legislative compliance with *Serrano*, which one way or the other seemed to imply losses to wealthy school districts to finance gains for poorer ones. Wealthier districts naturally resisted such reallocation. One spokesperson for such a district said that when residents of his district understand the implications of the redistribution, *"it's going to drive them right out of their skulls."*[115] The combination of school finance and dealing with state-supported local tax relief proved difficult from the start. Finally, Governor Brown was adamant that whatever the legislature did on those two fronts, no general tax increase could be included or should result from legislative action.

But although some state officials were concerned about property taxes, Sacramento began the fiscal year without a sense that something dramatic would come about in less than twelve months. Governor Brown, in August 1977, visited a NASA center in the Bay Area as part of "Space Day" and pushed for research into satellites. In attendance at Space Day were notables of the day such as astronomer Carl Sagan, oceanographer Jacques Cousteau, and LSD enthusiast Timothy Leary.[116] *"The public is really fascinated by space,"* the governor observed, citing the success of the recently-released *Star Wars* movie.[117] Nonetheless, back on Planet Earth, new residents of California coming from out of state were being shocked by the price of new homes, what one termed the *"great California real estate freak-out phenomenon."*[118]

Meanwhile, Howard Jarvis and Paul Gann, despite their differences, had begun circulating petitions on July 6 to put what would become Prop 13 on the state ballot. By late September, with no definitive response from the legislature, the two were projecting enough signatures to qualify for the June 1978 ballot. One activist attributed the success of the petition to *"the Legislature refusing to do anything about the tax mess."*[119] Indeed, the governor and the legislature could not agree on a plan for property tax relief when the first half of the 1977-78 session ended in September.

With the legislature out of session, there was little action on the property tax issue as the calendar year came to an end. As is standard practice, word began to be leaked by the administration about the content of the governor's forthcoming January budget proposal. In late December 1977, various legislators and the press were invited to a special briefing - former astronaut Rusty Schweickart was in attendance - on a communications satellite in which California would have a share and for which the budget would provide.[120] On property taxes, Governor Brown's executive secretary Gray Davis said the governor would favor a bill that included a limit on local governments' ability to raise property tax rates.

Once the legislative session resumed, Governor Brown argued that there would have to be a choice between property tax relief and income tax relief. California's income tax was highly progressive and inflation was pushing taxpayers into higher tax brackets. One remedy would be to index the brackets to inflation. But since there were calls for both income tax indexation and some version of property tax relief, the legislature would have to pick which one it wanted. *"The two ideas are incompatible,"* said Brown in mid-January.[121]

In the background of the debate was the 1978 gubernatorial race, already in progress. Attorney-General Evelle Younger, who would eventually emerge from the June primary as the Republican nominee for governor, favored tax relief. Nonetheless, when he formally announced his candidacy, Younger's initial program was along the lines of past legislative efforts at tax relief when initiatives threatened, rather than Prop 13 which by that time was definitely on the June ballot.[122] At a later point, he criticized the initiative as *"poorly drafted"* but said he might vote for Prop 13 as *"the lesser of two evils,"* the other evil being a bill then pending in the legislature.[123] In short, Younger's support of Prop 13 was limited at best.

However, other Republican candidates for the nomination were not so reticent about backing Prop 13. Former LA Police Chief Ed Davis proclaimed that he had *"perceived the angry mood of Californians who are not going to be denied their taxation revolution. I gladly join that revolution."* Another candidate, Assemblyman John Briggs of Fullerton, also was an enthusiastic Prop 13 supporter.[124] And there were supporters of the initiative developing even in the local governments that would lose property tax revenue if it passed. LA City Controller Ira Reiner, for example, endorsed Prop 13 as *"an understandable reaction to government excess."*[125]

By late February, the legislature was still dickering over the terms of a property tax relief program. Real estate agents were opposing a plan that would partly finance relief by a new tax on house sales. Their opposition was delaying a final plan. Assembly Speaker Leo McCarthy fretted that *"if we don't get a bill passed in the next few weeks, there really won't be time to mount an intelligent alternative to the Jarvis initiative."* But the governor remained silent on Prop 13, saying he was waiting to see what would emerge from the legislature.[126]

It is important to note that Prop 13 was not a sure thing as of early spring 1978. Polling results suggested that among those aware of the initiative, roughly a third favored it, a third opposed it, and a third were undecided.[127] By early March, the legislature finally did put an alternative Prop 8 on the ballot which provided more modest property tax relief than 13 and was more in the spirit of past legislative endeavors in that area. Governor Brown signed it saying *"This is real property tax relief – not a gimmick."*[128]

Although Prop 13 was still not a sure thing, by late April it was at least a possibility. Yet, former Legislative Analyst A. Alan Post observed that as far as he could tell, there was no contingency planning going on concerning how to deal with it if it passed. *"Nothing is happening,"* lamented Post, who – after Prop 13 did pass – was named to head a commission on how to deal with it.[129] However, by mid-May, word leaked out that the Brown administration had begun contingency planning. The governor reportedly told local officials who were warning

of dire consequences if Prop 13 passed that *"The thing is, I don't think people believe you when you're saying all that."* [130]

Information also began to come from other sources. Word began to leak in Los Angeles of large increases to be announced in property assessments.[131] And there were reports that the state surplus would be larger than originally projected.[132] But despite these leaks, polling suggested Prop 13 was still a toss up, even a few weeks prior to Election Day.[133] However, the initiative received a final fillip when the LA County tax assessor released the actual new assessments shortly before the election and Prop 13 passed with 65% of the vote. Prop 8, the legislative alternative, in contrast, lost with 47% of the vote.

Immediate Aftermath

"Governor Brown just discovered 13 after he knew the people were going to vote very heavily for it. By the day after election, he had clutched it to his bosom to the extent that you thought maybe he wrote it."

Former Governor Ronald Reagan

"A Brown-Jarvis alliance would have seemed bizarre less than a month ago, but that is no longer the case. Politics takes strange turns." [134]

Columnist David S. Broder
New York Times, June 30, 1978

Almost immediately after Prop 13 passed, Governor Brown addressed the legislature and said a new state budget plan – with no new taxes – would have be enacted in two or three weeks to bail out local governments. Prop 13's co-sponsor Paul Gann commented afterwards that *"for a speech he didn't have much time to prepare, what he said, I liked."*[135] Hiring was frozen in the state and pay rates were frozen. President Carter declined a request from Governor Brown to return to the state the federal tax windfall that would result from the decline in (income tax-deductible) property taxes.[136]

Although the legislature did not send the governor a final budget bill by the start of the fiscal year, it had one on his desk by July 6. But that was breakneck speed – particularly in view of the magnitude of the post-Prop 13 task – compared with contemporary budget delays. Governor Brown signed the bill but vetoed pay increases and cost-of-living adjustments in various welfare programs. The new budget, said the governor, *"keeps faith with the voters' mandate."*[137]

Governor Brown took up the mantle of tax cutting and spending limitations – supporting a federal balanced budget amendment – and decisively won re-election in November 1978. Paul Gann went on to put Prop 4 on the 1979 ballot which placed an effective cap on government spending and which passed with 78.5% of the vote. By 1980, however, when Howard Jarvis put Prop 9 on the state ballot to cut the state income tax, voters in California had apparently tired of the anti-tax fervor and "Jarvis II" failed with only 39% support. Later in the 1980s, voters gutted the Prop 4 Gann limit by passing Prop 98 and then 111 which earmarked state spending for K-

14. Gann and Jarvis never collaborated after Prop 13 but each went on proposing initiatives. Jarvis died in 1986. Gann died in 1989 of complications related to AIDS.[138]

A. Alan Post's commission on dealing with the longer term fiscal implications of Prop 13 produced a more orderly blueprint for dealing with future bailouts than was possible with the hasty plan enacted for 1978-79. In a 1998 interview, however, Post complained that Governor Brown never focused on its recommendations. *"I wasn't getting much help from Jerry Brown or his director of finance, Dick Silberman,"* he said. *"We even had a tough time getting the report printed and distributed."*[139]

In any event, recession in the early 1980s depleted the state treasury and Brown's new-found popularity faded. He lost a bid for the U.S. Senate to Pete Wilson in 1982. Thereafter, he retired from politics until 1989 when he beat Steve Westly in a race to become chair of the California Democratic Party. From his current post as California's attorney general, Brown is rumored to be planning a run to return to the governorship in 2010. Post, now in his 90s, continues to be active in state affairs and in a second career as a painter.

Leadership and the Budget

"I can't help you with what you must soon face, except to say that the future is not set. You must be stronger than you imagine you can be."

Kyle Reese
Visitor from the future in
Schwarzenegger's film *The Terminator*

California has had governors of varying personalities and leadership styles. All have had to deal with issues of state budgeting. But, depending on the economy and the political winds, fiscal affairs can be more or less challenging. It does appear, however, that when challenges arise, an ability to focus is a necessary – but not sufficient – condition to avoid having what started as a challenge become a crisis.

Of course, governors cannot enact budgets on their own. Legislative leadership is also important. But with term limits – a policy not in effect during the Prop 13 episode – strong leadership is now less likely to come from the legislature on fiscal affairs than it was in earlier times. Jerry Brown as governor let events overtake him when the property tax movement began to coalesce around Prop 13. In terms of winning re-election, he was successful. In terms of guiding the state's fiscal affairs in a troubled period, less so.

Arnold Schwarzenegger came to office in a recall, largely because of a state budget crisis. He clearly wanted to fix the problem. But after an initial short-term fix in 2004 – essentially borrowing to refinance the general fund – he mixed budget reform in 2005 with a variety of other issues and failed to enact any of them. Gubernatorial election year 2006 produced infrastructure plans – always popular – but again based heavily on seemingly-painless borrowing. Nonetheless, as with Brown's abrupt shift in direction in 1978, Schwarzenegger's shift in 2006 led to renewed popularity and re-election.

In 2007, the issue for Governor Schwarzenegger was to be universal health care. However, after an initial health proposal, gubernatorial attention wandered to other issues and by the time attention was refocused on health, the health plan proved to be a near miss: passed in the assembly, killed in a senate committee. And by the summer of 2008, the unresolved structural problem of the state budget had forced itself back as The Issue for California.

There is no guarantee that strong focused leadership could have repaired the state's underlying budgetary problem. Governor Schwarzenegger's favored reform for 2008, redistricting, seems only distantly connected to the budget and can't have an effect until after the 2010 Census. Moreover, the effect it might have could conceivably complicate attaining a two thirds vote on fiscal policy.

A bigger rainy day fund – the favored reform for 2009 – can't hurt. But history tells us that the legislature effectively blew out such a reserve in the early 2000s when the dot-com and stock market bubble burst. And accumulating a sizeable rainy day fund requires economic sunshine, something forecasters are not predicting for the near term.

An ability to make midyear cuts is helpful, absent other remedies, but to the extent such ability is not written into the constitution, it exists only with the will of the legislature. The governor did obtain (constrained) authority to cut as part of the 2008-09 budget deal. Whether he will continue to have such authority is a matter of legislative discretion.

Despite the unfavorable fiscal outlook, the future is not set. Strong and focused leadership from now on would help.

Table 1: Governor's January Budget Proposal and LAO Budget Proposal Under LAO Economic Assumptions ($ Billions)

	2006-07	2007-08	2008-09	2009-10
Governor				
Revenues	$95.9	$96.5	$102.4	na
Expenditures	$101.2	$103.6	$101.1	na
Surplus or Deficit	-$5.3	-$7.1	+$1.2	-$3.8
LAO				
Revenues	$95.9	$96.5	$103.4	na
Expenditures	$101.2	$102.5	$103.6	na
Surplus or Deficit	-$5.3	-$5.9	-$0.2	na
LAO End-of-Year Reserve	$5.0	$2.4	$2.2	na

Note: Reserve includes proceeds of $3.3 billion Economic Recovery Bond sale in 2007-08.

Note: na = not available

Source: California Legislative Analyst's Office, "The 2008-09 Budget: Perspectives and Issues," especially pp. 9, 11, 88, available at:

http://www.lao.ca.gov/analysis_2008/2008_pandi/pandi_08.pdf

Table 2: The Governor's May and August Revise Proposals and LAO May Alternative ($ Billions)

	Governor - May		LAO – May	August	Final
	2007-08	2008-09	2008-09	2008-09	2008-09
Revenues	$97.4	$97.9	$97.9	Approx. $101	Approx. $101
Expenditures	$103.5	$101.8	na	$103.4	$103.4
Surplus or Deficit	-$6.1	-$4.0	na	Approx. -$2	Approx. -$2

Note: Figures exclude borrowing under Economic Recovery Bonds in 2007-08 and lottery securitization in 2008-09. Also excluded are proposed loans from other funds in the August Revise and transfers in the final budget.

na = not available

Note: Revenue estimate from the August revise is the sum of revenues reported on p. 7 of the supporting document plus approximately $6 billion of non-borrowed revenue ($4 billion from the temporary sales tax increase plus other tax revenues including an amnesty which would technically be assigned to the prior fiscal year.

Source: California Legislative Analyst's Office, "Overview of the 2008-09 May Revision," May 19, 2008, especially p. 8, available at:

http://www.lao.ca.gov/2008/bud/may_revise/may_revise_051908.pdf, and "LAO

Alternative Budget: Revenue-Related and Revenue-Increasing Proposals," June 2, 2008, available at http://www.lao.ca.gov/handouts/FO/2008/060208_SBFR_Hearing.pdf; California Department of Finance, "August 2008-09 Update: Proposed Compromise" available at:

http://www.dof.ca.gov/budget/historical/2008-09/documents/August_Revision_R2-w.pdf.

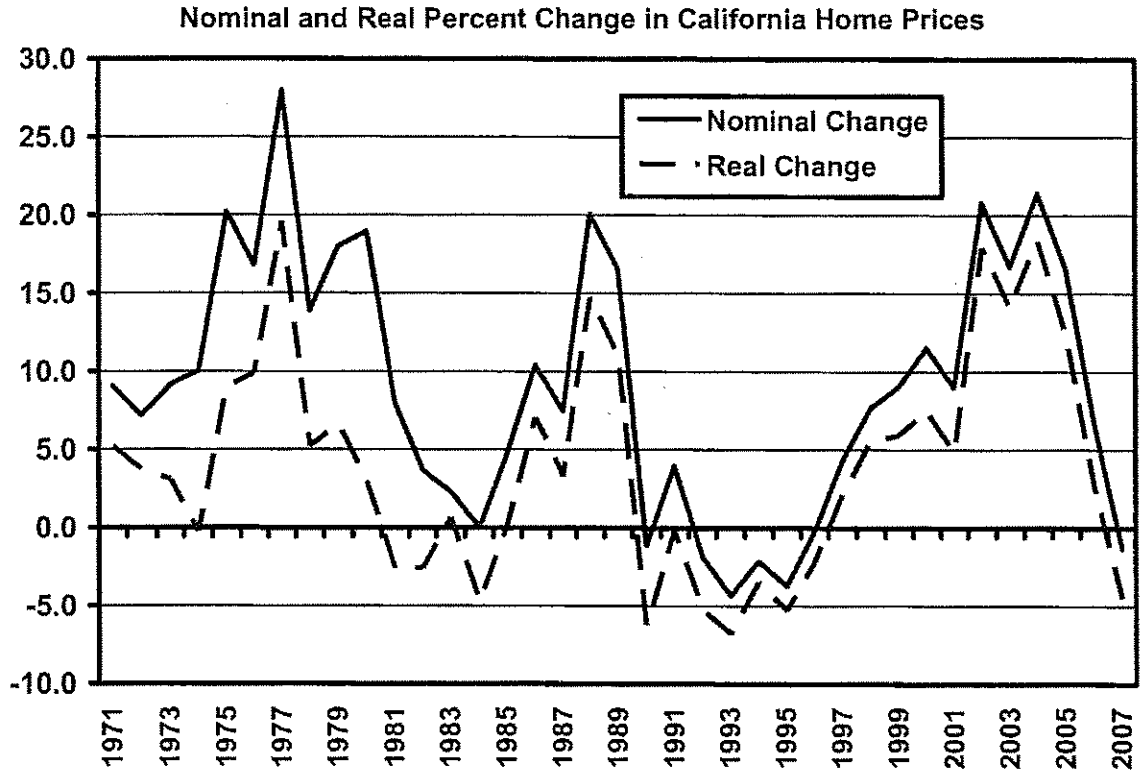
Table 3: California General Fund, 1974-75 – 1978-79 ($ billions)

Year	Revenues & Transfers	Expenditure & Transfers	Surplus or Deficit	Reserve
1974-75	$8.6	$8.3	+$0.3	$0.7
1975-76	9.6	9.5	0.1	0.8
1976-77	11.4	10.5	0.9	1.8
1977-78	13.7	11.7	2.0	3.9
1978-79	15.2	16.3	-1.1	2.9

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

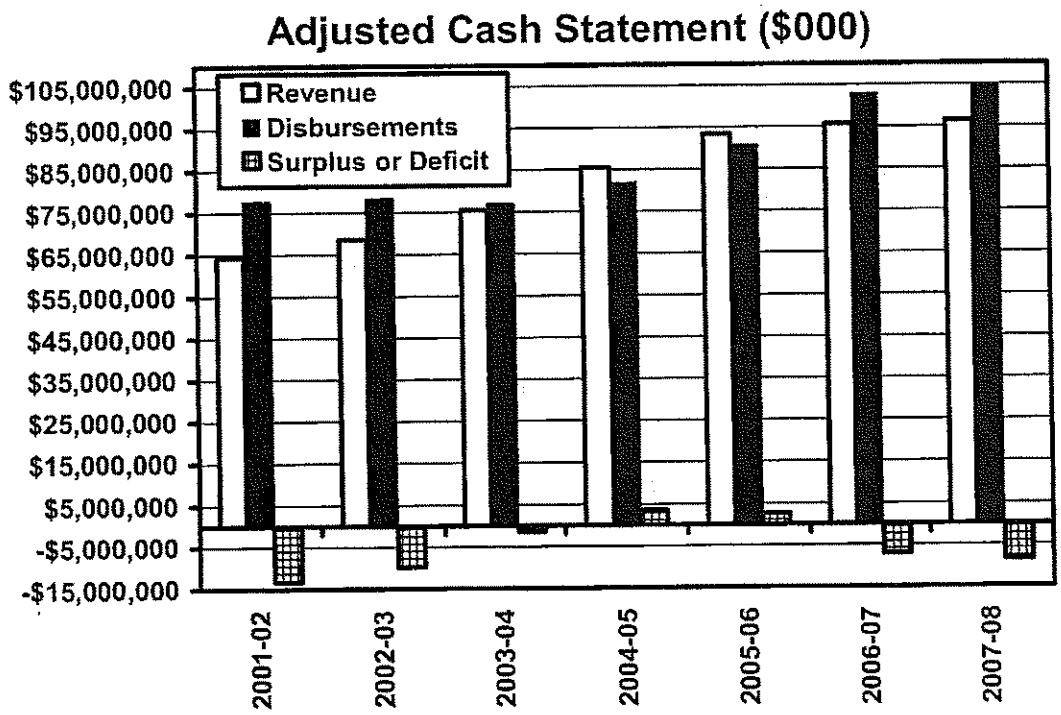
Source: California State Controller, *Annual Report of the State Controller*, various years.

Chart 1



Source: Annual median home price data 1971-78 from Marion S. Beaumont, "Proposition 13 Winners and Losers: Were First-Time Home Buyers Affected Adversely?" in Frederick D. Stocker, ed., *Proposition 13: A Ten-Year Retrospective* (Cambridge, MA: Lincoln Institute of Land Policy, 1991), p. 163; monthly home price data from UCLA Anderson Forecast converted to annual averages, 1979-2007, California Consumer Price Index (CPI-U) from California Department of Finance. All home price data originally credited to California Association of Realtors.

Chart 2



Source: California State Controller, June reports on General Fund Cash Receipts and Disbursements, available at http://www.controller.ca.gov/ard/cash/index.shtml.

Endnotes

[1] The author of this chapter quoted in Evan Halper, "Governor Teeters on the Edge of Deficit Abyss," *Los Angeles Times*, November 7, 2007.

[2] George F. Break, "Proposition 13's Tenth Birthday: Occasion for Celebration or Lament?" in Frederick D. Stocker, ed., *Proposition 13: A Ten-Year Retrospective* (Cambridge, MA: Lincoln Institute of Land Policy, 1991), p. 175.

[3] Daniel J.B. Mitchell, "From Jerry-Rigged to Petered Out: Lessons from the Deukmejian Era for Contemporary California State Budgeting," in Daniel J.B. Mitchell, ed., *California Policy Options 2008* (Los Angeles: School of Public Affairs, 2008), pp. 39-76, especially pp. 53-58.

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

[5] The California Teachers Association, a prime mover behind Prop 98, opposed Prop 92 as did the Regents of the University of California. Both groups expressed the concern that tying up more of the state budget was a Bad Thing. In the case of CTA, it had many more members in K-12 than in community colleges. But some unions – notably the California Federation of Teachers, a smaller group representing instructors at community colleges – supported Prop 92. Prop 92 received only 43% of the vote on Election Day.

[6] Data on initiatives per year comes from a database maintained by Hastings College at http://library.uchastings.edu/library/Research%20Databases/CA%20Ballot%20Measures/ca_ballot_measures_main.htm#ballotinits and recent election reports from the California Secretary of State at www.sos.ca.gov.

[7] Daniel J.B. Mitchell, "Unions and Direct Democracy in California: A New Pattern Emerging?" in Daniel J.B. Mitchell, ed., *California Policy Options 2008* (Los Angeles: School of Public Affairs, 2008), pp. 197-221.

[8] Quoted in *Capital Alert* (on-line service of the *Sacramento Bee*), January 31, 2008.

[9] See Stephen Carroll, Eugene Bryton, C. Peter Rydell, and Michael A. Shires, *Projecting California's Fiscal Future* (Santa Monica, CA: Rand, 1995). A Legislative Analyst's report in 1996 also warned of future budget deficits. See California Legislative Analyst's Office, *California's Fiscal Outlook: The LAO's Economic and Budget Projections, 1996-97 through 1998-99* (Sacramento: LAO, 1996).

[10] Davis' reputation as a micro-manager was emphasized in a lawsuit by one of his top officials – the former head of the Department of Motor Vehicles – claiming he was eligible for unemployment insurance after having been fired after the recall by incoming Governor Schwarzenegger. The lawsuit alleged that despite his high title, the official had no real authority and was thus an ordinary employee entitled to unemployment benefits. See John Hill, "A Juicy Benefits Battle," *Sacramento Bee*, November 18, 2007.

[11] The car tax is actually a property tax on motor vehicles that is collected by the state on behalf of local governments. Since it is really a local tax, when the tax was cut, the state reimbursed the local governments for the lost revenue. So reducing the car tax increases state spending on support for local governments. The car tax had been cut during the revenue boom of the late 1990s with a trigger that could raise it back to the old level if the state found itself in fiscal distress. Davis pulled the trigger during the period leading up to the recall and candidate Schwarzenegger promised to cut it back to the reduced level – which he did upon taking office.

[12] The state constitution requires that general obligation borrowing be approved by the voters and that such borrowing should be for specific projects, not general operating purposes. By amending the constitution to allow the borrowing, Governor Schwarzenegger short-circuited these requirements on a one-time basis. The original Davis plan did not involve going to the voters and relied on a questionable legal strategy that surely would have been challenged in court. A pending court challenge would likely have made Davis' proposed bonds impossible to sell, since an adverse ruling could void any investor claim on the state.

[13] Some of the amnesty money may have to be paid back in the future as tax litigation is completed. It appears that some taxpayers who were disputing tax liabilities paid the state under protest during the amnesty to avoid penalties if their cases ultimately resulted in a liability – even if they expected to win.

[14] Both quoted in Evan Halper, "Brokaw Needles Schwarzenegger on Spending, Economy," *Los Angeles Times*, June 30, 2008.

[15] Daniel Weintraub, *Party of One: Arnold Schwarzenegger and the Rise of the Independent Voter* (Sausalito, CA: PoliPoint Press, 2007), pp. 75-76.

[16] See Daniel J.B. Mitchell. "'They Want to Destroy Me'": How California's Fiscal Crisis Became A War on "Big Government Unions." *WorkingUSA: The Journal of Labor and Society*, (March 2006), vol. 9, pp. 99-121.

[17] See Daniel J.B. Mitchell. "Something Different in the Air? The Collapse of the Schwarzenegger Health Plan in California." *WorkingUSA: The Journal of Labor and Society*, (June 2008), vol. 11, pp. 199-218.

[18] See Daniel J.B. Mitchell. "Something Different in the Air? The Collapse of the Schwarzenegger Health Plan in California." *WorkingUSA: The Journal of Labor and Society*, (June 2008), vol. 11, pp. 199-218.
[19] John G. Matsusaka, "Where Does It All Go?," *Los Angeles Times*, July 17, 2008. In this op ed, Matsusaka cited a 40% increase in the state budget – although he focused on the overall state budget, not just the general fund.
[20] James Richardson, *Willie Brown: A Biography* (Berkeley: University of California Press, 1996), pp. 255-271; Willie Brown, *Basic Brown: My Life and Our Times* (New York: Simon & Schuster, 2008), pp. 146-156.
[21] If all state supported spending on health services, mental health services, development services, and social services is counted, the total of $28.4 billion is about a fourth of general fund expenditures. Counting only state-supported but locally-delivered SSI/SSP/IHSS, CalWorks, and Medical Assistance brings the total down to $21.5 billion or about a fifth of expenditures. Source: California State Controller, *Statement of General Fund Cash Receipts and Disbursements: June 2008*, p. A3. Available on line at http://www.sco.ca.gov/ard/cash/0708/jun.pdf.
[22] Quoted in Evan Halper, "Schwarzenegger Orders Plan for 10% Budget Cuts," *Los Angeles Times*, November 6, 2007.
[23] Quoted in George Skelton, "The State's Money Woes Will Trump Its Big Plans," *Los Angeles Times*, November 15, 2007.
[24] Denham was in one of the few legislative districts that were regarded as marginal for the GOP. The recall option remained on the ballot although it was abandoned by Perata in early May after both sides mounted significant TV advertising campaigns and at one point Denham charged Perata with illegal use of state staffers for the recall. Various interpretations could be made of Perata's action ranging from teaching a lesson to other recalcitrants (thereby conceivably easing enactment of the 2008-09 budget) to opening the possibility of adding a new Democratic senator to a mechanism to move campaign funds around to a favored campaign consultant. Dan Walters, "Denham Recall Drive Motivation Still Hazy," *Sacramento Bee*, June 23, 2008. One interpretation of Denham's refusal to provide the needed vote for the 2007-08 budget was that he was planning a run for Lieutenant Governor in 2010 and would need conservative support in the primary. Denham began proposing such steps as a constitutional amendment that would freeze legislative pay if a budget was not passed by the June 15 constitutional deadline. Such proposals had no chance of legislative enactment but could serve a purpose in a future Republican primary campaign.
[25] The defeated 2005 initiative would have put districting line drawing in the hands of retired judges and would have affected congressional as well as legislative districts (drawing opposition from congressional representatives in both parties). The new initiative would apply only to the legislature and would set up a panel of Republicans, Democrats, and independents or minor party representatives to do the redistricting and became Prop 11 on the November 2008 ballot.
[26] User "fees" are not subject to the two-thirds vote requirement as opposed to taxes. In this case, the insurance industry favored the fee as a way of limiting its fire liability. However, taxpayer groups charged that the fee was in reality a tax. And there was criticism of an across-the-board fee on all property insurance as opposed to a risk-based charge for those with property in high fire regions. See Marc Lifsher and Evan Halper, "Gov. Urges Insurance Assessment to Fund Firefighting," *Los Angeles Times*, January 9, 2008.
[27] Judy Lin, "Governor: Slash School Aid," *Sacramento Bee*, January 10, 2008.
[28] "Lockyer's Holiday Message: No Tooth Fairy for the Budget," *Capitol Alert*, December 14, 2007.
[29] California Field Poll, release #2257, December 28, 2007. (All California Field Polls are available at www.field.com by clicking on "archives.")
[30] Quoted in Dan Walters, "Crisis May Lead to a Grand Deal," *Sacramento Bee*, January 11, 2008.
[31] Dan Weintraub, "On Budgets and Leverage," *Capitol Alert*, January 10, 2008.
[32] If the state borrows within a fiscal year using Revenue Anticipation Notes (RANs), the borrowing is handled by the Treasurer with little fanfare. If the borrowing crosses the fiscal year line, however, the state must issue Revenue Anticipation Warrants (RAWs) through the Controller. While there is little difference between the two in financial terms, use of such RAWs might be taken as a signal on Wall Street of particular fiscal distress, since they are rarely used or needed. Courts have long viewed such short-term instruments as essentially a cash management tool rather than the kind of long-term borrowing that requires voter approval.
[33] The sale took place in February 2008. Because the Economic Recovery Bonds were attached to a dedicated revenue stream, investors viewed them as more desirable than other California state general obligation bonds.
[34] See Dan Walters, "Two Buddies Part Ways Over Taxes," *Sacramento Bee*, February 13, 2008.
[35] These quotes and those of other state officials can be found in the "The Budget Reaction," *Capitol Alert*, January 10, 2008.
[36] Evan Halper, "Legislature Considers Raiding Voter-Approved Funds," *Los Angeles Times*, July 18, 2008.

[37] As it turned out, one of the tribes whose compact was at issue had not actually signed the agreement and seemed as of mid-June to be holding out for better terms. See James P. Sweeney, "Sycuan Withholds Gambling Pact OK," *San Diego Union-Tribune*, June 19, 2008.
[38] Quoted in Kevin Yamamura, "Governor Backs Off Tax Breaks," *Sacramento Bee*, February 29, 2008.
[39] Quoted in Kevin Yamamura, "Governor Backs Off Tax Breaks," *Sacramento Bee*, February 29, 2008.
[40] As noted earlier, the sloophole was eventually removed as part of the budget deal for 2008-09.
[41] Quoted in "Governor Suggests No Potty Breaks," *Capitol Alert*, March 10, 2008.
[42] Quoted in Evan Halper, "State Democrats Determined to Raise Taxes," *Los Angeles Times*, March 5, 2008.
[43] Quoted in Jim Sanders, California Assembly Kills Núñez Oil Tax Plan," *Sacramento Bee*, March 13, 2008.
[44] Loren Kaye, "State Tax Hike Talk Must Be Linked to Budget Reform," *Sacramento Bee*, April 22, 2008.
[45] Judy Lin, "GOP Senators Demand Changes in Business, Environmental Policies," *Sacramento Bee*, April 30, 2008.
[46] Judy Lin, "Lawmakers Take a New Look at Privatizing California Lottery," *Sacramento Bee*, April 22, 2008.
[47] Rani Isaac, "Foreclosures in California," California Research Bureau, CRB 08-006, May 2008. Available at http://www.library.ca.gov/crb/08/08-006.pdf.
[48] Kevin Yamamura, "Governor Says Ball is in Lawmakers' Court," *Sacramento Bee*, May 16, 2008.
[49] Judy Lin, "California Officials Expect Revenue to Drop 8 Percent," *Sacramento Bee*, May 21, 2008.
[50] California Field Poll, Release #2272, June 3, 2008.
[51] John Myers, "With Hands Tied, A Salary Freeze," *KQED Capitol Notes*, June 10, 2008. Postings available at http://blogs.kqed.org/capitalnotes/. Go to archives for past postings. The California Citizens Compensation Commission could have only cut pay of new members of the legislature (all of the assembly and half of the senate) because it cannot cut pay during terms of office. No other elected officials could be cut in 2008 since all were in the midst of terms of office.
[52] Quoted in Evan Halper, "State Republicans See Opportunity Amid Crisis," *Los Angeles Times*, June 16, 2008.
[53] Dan Walters, "Senate Dems Throw Down the Gauntlet," *Capitol Alert*, June 11, 2008.
[54] "Villines Says Lawmakers 'Not Making a Ton of Progress," *Capitol Alert*, June 30, 2008.
[55] Quoted in Kevin Yamamura and Judy Lin, "Schwarzenegger Blasts Budget Inaction," *Sacramento Bee*, July 16, 2008.
[56] Quoted in Evan Halper, "Legislature Considers Raiding Voter-Approved Funds," *Los Angeles Times*, July 18, 2008.
[57] "Perata Insists Democrats Don't Want to Borrow," *Capitol Alert*, July 18, 2008.
[58] Quoted in "Text of Governor's Executive Order," *Los Angeles Times*, posted on-line on July 31, 2008.
[59] "Garamendi: Could You Live on $262 a week?," *Capitol Alert*, July 29, 2008. The federal minimum wage was $6.55 per hour. Garamendi's figure of $262 is the minimum wage times 40 hours.
[60] California State Controller, press release and attached letter dated July 31, 2008.
[61] Kevin Yamamura and Jon Ortiz, "Governor Set to Slash State Workers' Pay," *Sacramento Bee*, July 24, 2008.
[62] Certain critical workers were to be exempted from the minimum wage cut. About 180,000 workers were estimated to be subject to the cut and another 50,000 were excluded. Kevin Yamamura, "Schwarzenegger Formally Asks California Controller to Cut Pay," *Sacramento Bee*, August 6, 2008; Kevin Yamamura, "California State Computers Can't Handle Pay Cut, Controller Says," *Sacramento Bee*, August 5, 2008. Original estimates put the layoffs at 22,000, a figure that appeared in various news reports, e.g., Dan Walters, "Legal Picture Muddled in Game of Budget Chicken," *Sacramento Bee*, July 29, 2008. An early tabulation appearing in an on-line database maintained by the Sacramento Bee found about 32,000 potential layoffs.
[63] Perhaps not surprisingly, an effort by the author to obtain more detail on the calculation of unused borrowable resources from the controller's office was unsuccessful.
[64] Quoted in "'At Loggerheads', Perata Sees 'No End in Sight,'" *Capitol Alert*, August 5, 2008.
[65] Quoted in "Cogdill: Perata is 'Patently Incorrect,'" *Capitol Alert*, August 5, 2008.
[66] Quoted in John Howard, "Job Loss, Business Impacts Seen in Proposed Sales Tax Hike," *Capitol Alert*, August 5, 2008.
[67] Arnold Schwarzenegger, "A Compromise Budget for All Californians," op ed on the on-line *Fox & Hounds Daily*, August 21, 2008, available at http://foxandhoundsdaily.com/print/1267.
[68] Quoted in Jim Sanders, Schwarzenegger Proposes Sales Tax Increase," *Sacramento Bee*, August 5, 2008.
[69] Quoted in Matthew Yi, "Governor and Lawmakers Agree on Spending Plan," *Sacramento Bee*, September 19, 2008.
[70] Dan Walters, "Revised State Budget is Still a Sham," *Sacramento Bee*, September 19, 2008.

[71] Quoted in Evan Halper and Jordan Rau, "Schwarzenegger, Top Legislators Reach a Budget Deal," *Los Angeles Times*, September 19, 2008.
[72] Quoted in "AM Alert: What's Next," *Capitol Alert*, September 22, 2008.
[73] Jon Coupal, "CalTax Gets Rolled by the Governor," *Taxpayer Update* (emailed newsletter), September 7, 2008.
[74] Quoted in "The Buzz: Schwarzenegger Has No Regrets About Missing Convention," *Sacramento Bee*, September 9, 2008.
[75] "Put Mike Genest in the Dunk Tank," *Capitol Alert*, September 24, 2008.
[76] Office of the Governor, press release of September 23, 2008.
[77] Dan Walters, "Rosy Fiscal Forecasts? Forget It," *Sacramento Bee*, September 28, 2008.
[78] When there is no budget, legislators and their staffs are not paid. But they receive the back pay owed once the budget is signed. There were proposals simply to dock pay for each day of budget delay and not repay it once the budget was enacted.
[79] "No, But Just Barely, to Recalling Arnold," *Orange County Register*, September 12, 2008.
[80] Doubts about redistricting were raised in Eric McGhee, *Redistricting and Legislative Partisanship* (San Francisco: Public Policy Institute of California, 2008).
[81] Quoted in Dan Walters, "Schwarzenegger Flip-Flops Like Jerry Brown," *Sacramento Bee*, July 23, 2008.
[82] It is difficult to find exact statewide figures on pre-Prop 13 tax rates. The range estimates come from Valerie Raymond, *Surviving Proposition Thirteen: Fiscal Crisis in California Counties* (Berkeley, CA: UC-Berkeley Institute of Governmental Studies, 1988), p. 9. Note that the figures given in this source are provided on the basis of a 25% valuation of property – the ratio used prior to Prop 13. The figures have been divided by four to convert them to tax rates on full value. The average estimate comes from Roger L. Kemp, *Coping with Proposition 13: Strategies for Hard Times* (Malabar: FL: Robert E. Kreiger Publishing Co., 1988 [1980]), p. 151.
[83] Roger L. Kemp, *Coping with Proposition 13: Strategies for Hard Times* (Malabar: FL: Robert E. Kreiger Publishing Co., 1988 [1980]), pp. 93, 145, 171.
[84] It is unclear that – in the rush to deal with the fiscal crisis the localities faced in the short interval between the June election and the July 1 beginning of the new fiscal year – the legislature had good projections of what state revenues and expenditures apart from the bailout would be. Commentary from that period suggests more optimistic results than actually occurred. See Selma J. Mushkin, ed, *Proposition 13 and its Consequences for Public Management* (Cambridge, MA: Abt Books, 1979. See in particular the comments on p. 7 by Edward Hamilton. Hamilton projects a reserve at the end of the 1978-79 fiscal year of $9 billion, absent the bailout of $4.2 billion. That would suggest that with the bailout, the reserve should have been $4.8 billion rather than the actual $2.9 billion, as shown on Table 3.
[85] California Field Poll, "Proposition 13 Thirty Years After Its Passage," June 2008. Available at: http://field.com/fieldpollonline/subscribers/COI-08-June-Prop-13-Tax-Matters.pdf.
[86] Quoted in Mark Lachter, "What's the Harm in Talking About Prop 13?," *San Diego Business Journal*, September 1, 2003.
[87] Both quoted in Mark Simon, "Buffett's Prop. 13 Comments Cause Stir," *San Francisco Chronicle*, August 16, 2003.
[88] The Association sends out periodic email editorials. The statement appears in Jon Coupal, "One More Time: California's Budget Woes are Not Prop 13's Fault," January 7, 2008. Available at http://www.hjta.org/commentaryV6-01. As will be noted below, the statement is incorrect.
[89] Jeffrey I. Chapman, *Proposition 13 and Land Use* (Lexington, MA: Lexington Books, 1981).
[90] California Taxpayers' Association, "Cal-Tax 2008: Proposition 13 Revisited," June 2008, available online at http://www.caltax.org/Proposition13.pdf.
[91] Center for Government Analysis, "An Analysis of Government Revenues in California Since the Enactment of Proposition 13," October 2005. Available from the Howard Jarvis Taxpayers Association at http://www.hjta.org/content/pdf/CGA-HJTA-P13-Report.pdf. No reply was received by the author to a request for information to the Center on the inflation deflator used was received.
[92] Quoted in Roger Rapoport, *California Dreaming: The Political Odyssey of Pat & Jerry Brown* (Berkeley, CA: Nolo Press, 1982), p. 233.
[93] Quoted in Steven F. Hayward, *The Age of Reagan: The Fall of the Old Liberal Order, 1964-1980* (Roseville, CA: Forum/Prima Publishing, 2001), p. 528.
[94] This section relies heavily on Robert Kuttner, *Revolt of the Haves: Tax Rebellions and Hard Times* (New York: Simon and Schuster, 1980); and Clarence Y.H. Lo, *Small Property Versus Big Government: Social Origins of the Property Tax Revolt* (Berkeley: University of California Press, 1990). For a contemporary account, see also Robert

B. Hawkins, Jr., "Traveling Through the Tax Barrier: What It Looks Like on the Other Side of Proposition 13," *Publius*, vol. 9 (Winter 1979), pp. 11-25. A jaundiced view from the late 1990s can be found in Peter Schrag, *Paradise Lost: California's Experience, America's Future* (New York: The New Press, 1998), pp. 129-187.

[95] David O. Sears and Jack Citrin, *Tax Revolt: Something for Nothing in California* (Cambridge, MA: Harvard University Press, 1982).

[96] Jerry Roberts, *Diane Feinstein: Never Let Them See You Cry* (New York: HarperCollinsWest, 1994), p. 74.

[97] Watson claimed his battle with the supervisors led to heart problems and ultimately received a disability pension. However, when he suggested several years later that he might return to politics, the degree to which he was disabled was questioned by the supervisors and he retreated back to private life. See Jack Jones, "Ex-Assessor Philip E. Watson Dies at 62," *Los Angeles Times*, December 9, 1986.

[98] Robert J. Dworak, *Taxpayers, Taxes and Government Spending: Perspectives on the Taxpayer Revolt* (New York: Praeger, 1980), p. 72.

[99] Jack Citron, "Introduction: The Legacy of Proposition 13" in Terry Schwadron, ed., *California and the American Property Tax Revolt: Proposition 13 Five Years Later* (Berkeley, CA: University of California Press, 1984), p. 17.

[100] The *Serrano* case was actually a sequence of three California Supremen Court cases: *Serrano v. Priest*, 5 Cal.3d 584 (1971) (Serrano I); *Serrano v. Priest*, 18 Cal.3d 728 (1976) (Serrano II); *Serrano v. Priest*, 20 Cal.3d 25 (1977) (Serrano III). The first case, however, established the principle that variations in property values between wealthy school districts and poor school districts should not result in substantially disparate school revenues. On the debate over the impact of the Serrano case, see William A. Fischel, "Did *Serrano* Cause Proposition 13?," *National Tax Journal*, vol. 42 (December 1989), pp. 465-473; Kirk Stark and Jonathan Zasloff, "Tiebout and Tax Revolts: Did Serrano Really Cause Proposition 13?," *UCLA Law Review*, vol. 50 (February 2003), pp. 811-814 ; William A. Fischel, Did John Serrano Vote for Proposition 13? A Reply to Stark and Zasloff's 'Tiebout and Tax Results: Did Serrano *Really* Cause Proposition 13?,'" working paper 03-13 (August 2003), Dartmouth College Economics Department.

[101] A major figure in the anti-busing movement in the San Fernando Valley was Bobbi Fiedler. Like Jarvis, she was not a politician although she won first a seat on the LA school board and then in Congress as a result of her prominence in the movement.

[102] Mike Davis, *City of Quartz: Excavating the Future in Los Angeles* (New York, Vintage Books, 1992 [1990]), pp. 153-219. Unlike the anti-busing and anti-property tax movements, leadership of the anti-growth movement was primarily political, particularly LA City Councilman Marvin Braude.

[103] The fact that Jarvis represented apartment house owners was an issue in the campaign. Some observers have challenged the idea that the movement behind Prop 13 was really spontaneous and a grass-roots affair as a result. See Daniel A. Smith, "Howard Jarvis, Populist Entrepreneur: Reevaluating the Causes of Proposition 13," *Social Science History*, vol. 23 (summer 1999), pp. 173-210. However, most political movements involve alliances.

[104] Bruce Keppel, "Edelman, Jarvis in Sharp Clash Over Prop. 13," *Los Angeles Times*, March 15, 1978.

[105] Howard Jarvis (with Howard Pack), *I'm Mad as Hell: The Exclusive Story of the Tax Revolt and Its Leader* (New York: Times Books, 1979).

[106] Unruh's term is quoted in Jackson K. Putnam, *Jess: The Political Career of Jesse Marvin Unruh* (Lanham, MD: University Press of America, 2005), p. 397.

[107] Note that rising property taxes – because they are deductible from income taxes – actually cut into state and federal income tax revenue. When property taxes were cut by Prop 13, the state and federal governments received a windfall gain (that partly offset the gain to property tax payers).

[108] Quoted in Roger Rapoport, *California Dreaming: The Political Odyssey of Pat & Jerry Brown* (Berkeley, CA: Nolo Press, 1982), p. 156.

[109] Quoted in Dan Walters, "Schwarzenegger Flip-Flops Like Jerry Brown," *Sacramento Bee*, July 23, 2008.

[110] A state senate subcommittee killed the plan about a month before Prop 13 passed. Prop 13 then ended any prospect for reviving the plan. Larry Stammer, "Panel Shelves State Satellite," *Los Angeles Times*, May 9, 1978.

[111] Jacques Barzaghi, a French Zen devotee with minor movie credits, became an advisor to Jerry Brown in the 1970s. When Brown was mayor of Oakland, however, Barzaghi was charged with sexual harassment of a female employee and the city ultimately paid $50,000 to settle the case. A subsequent domestic dispute involving Barzaghi to which police were called led to his departure from the mayoral staff. Steven Rubenstein and Janine DeFao, "Barzaghi Leaves Jerry Brown's Staff," *San Francisco Chronicle*, July 20, 2004. In contrast to his unmarried relationship with pop star Linda Ronstadt while governor, Brown married Anne Gust in both a public ceremony conducted by Senator Diane Feinstein and a traditional Catholic ceremony later. Leah Garchik, "Oakland's Royal Wedding: Nearly 600 Attend Jerry Brown's Nuptials," *San Francisco Chronicle*, June 19, 2005.

[112] Quoted in Robert Fairbanks, "Property-Tax Issue Awaits Legislators," *Los Angeles Times*, January 2, 1978.
[113] Quoted in Kenneth Reich, "Wilson Taking Warmer View of Tax Initiative," *Los Angeles Times*, January 6, 1978. Wilson was at the time a candidate for the Republican nomination for governor.
[114] Robert Fairbanks, "Lawmakers Agree on Tax Break for the Elderly," *Los Angeles Times*, July 19. 1977; Daniel J.B. Mitchell, "Governor Reagan's Ballot Box Budgeting: One That Got Away," *Southern California Quarterly*, 89, 195-227; Ray Ripton, "Wrath Turns to Action on Tax Burden," *Los Angeles Times*, August 21, 1977..
[115] Quoted in Scott Moore, "Schools Await Impact of New Financing Plan," *Los Angeles Times*, July 24, 1977.
[116] Roger Rapoport, *California Dreaming: The Political Odyssey of Pat & Jerry Brown* (Berkeley, CA: Nolo Press, 1982), pp. 185-189.
[117] Quoted in David Johnson, "Brown Urges Energy, Space Spending," *Los Angeles Times*, August 2, 1977.
[118] Quoted in Dick Turpin, "Plight of the Newcomer," *Los Angeles Times*, August 7, 1977.
[119] Quoted in William McPhillips, "Tax Reform Failure Aids Initiative Drive," *Los Angeles Times*, September 22, 1977.
[120] George Alexander, "Proposed State Use of Satellite Detailed," *Los Angeles Times*, December 23, 1977.
[121] Quoted in Kenneth Reich, "Brown Sees 2 Ways to Ease Tax Load," *Los Angeles Times*, January 15, 1978.
[122] Kenneth Reich, "Younger Enters Governor's Race," *Los Angeles Times*, February 2, 1978.
[123] Richard Bergholz, "Younger Raps Drafting of Jarvis, Behr Measures," *Los Angeles Times*, March 30, 1978.
[124] Richard Bergholz, "Davis Says He Will Back Jarvis Initiative," *Los Angeles Times*, March 9, 1978.
[125] Quoted in Erwin Baker, "City Council Urged to Oppose Jarvis Plan," *Los Angeles Times*, April 18, 1978.
[126] Jerry Gillam, "Lobbying by Realtors Stalls Tax Relief Bill," *Los Angeles Times*, February 23, 1978.
[127] Mervin V. Field, "Prop. 13 Margin of Support Dips in Survey," *Los Angeles Times*, April 12, 1978.
[128] George Skelton and Jerry Gillam, "Legislature Passes Property Tax Relief," *Los Angeles Times*, March 3, 1978.
[129] Ronald L. Soble, "Tax Plans Needed, Post Says," *Los Angeles Times*, April 21, 1978.
[130] Quoted in Larry Stammer, "State Readying Spending Cuts in Case Prop. 13 Wins," *Los Angeles Times*, May 12, 1978.
[131] Erwin Baker, "Total Assessed Property Value of L.A. Up 17.5%," *Los Angeles Times*, May 16, 1978.
[132] Jerry Gillam, "Economic Boom Created Surplus, Fiscal Chief Says," *Los Angeles Times*, June 3, 1978.
[133] "Results of Poll Please Official," *Los Angeles Times*, May 18, 1978.
[134] Both the Reagan and Broder quotes appear in Robert Welkos, "Reagan's Advice to Jarvis: Stay Neutral," *Los Angeles Times*, June 30, 1978.
[135] Quoted in George Skelton, "Brown Asks Aid for Local Governments," *Los Angeles Times*, June 9, 1978.
[136] Jack Nelson, "Carter Won't Give the State Any Extra Revenue," *Los Angeles Times*, June 20, 1978.
[137] George Skelton and George Frank, "Brown Vetoes Raises," *Los Angeles Times*, July 6, 2008.
[138] Gann reportedly acquired the disease through a blood transfusion. State legislation dealing with transfusion safety now bears his name.
[139] Quoted in Bob Schmidt, "A. Alan Post: The 'Real Tragedy' of the Property Tax Revolt," *Cal-Tax Digest*, March 1998. Available at http://www.caltax.org/MEMBER/digest/Mar98/mar98-3.htm.

CALIFORNIA'S EDUCATIONAL OPPORTUNITY GAPS

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Over the last year, California's Superintendent of Public Instruction Jack O'Connell has called for greater public attention to the racial achievement gap in education. Highlighting evidence that white and Asian American students in California consistently outperform their African American and Latino peers, O'Connell has urged a statewide focus on eliminating this gap.[1] Some commentators have responded to O'Connell's appeals by arguing that the persistent racial gap in achievement scores is a product of cultural differences that must be addressed if the gap is to be closed.[2] This cultural argument suggests that the problem of low test scores resides within the African American and Latino communities. This analysis fails to account for the fact that California students *generally* have lower test scores than students across the nation. Notably, white students in California perform well below white students in almost all other states. Why do California's students underperform relative to their peers in other states? Why do some groups of California students perform, on average, better than others?

Sources of California's Educational Underachievement

This chapter draws upon UCLA/IDEA's *2007 Educational Opportunity Reports*[3] to examine California's poor and unequal educational achievement in light of the conditions in California's public schools. We identify two significant *opportunity* gaps that mirror California students' academic performance: the gap between learning opportunities in California and other states and the gap in learning opportunities between different public schools within the state.

Using publically available data from the California Basic Educational Data System, we document the relationship among California's educational infrastructure, rates of high school completion, and enrollment in the state's public four-year colleges and universities; investigate the opportunities provided in schools serving different racial groups; and analyze the math pipeline through middle school and high school.

The four sections of this chapter report on the key findings of the state data analysis:

- Racial Demographics of California Schools highlights the racial segregation in the state and presents data on the schools attended by African American and Latino students.
- Achievement, Graduation, and College Preparation in California shows that the state lags behind most other states in providing fundamental learning conditions as well as in student outcomes. Also, this section examines the effects of the California High School Exit Exam's "diploma penalty" on the class of 2006, the first cohort of students required to pass the Exit Exam as a condition for graduation.
- Inadequate and Unequal Learning Conditions and Opportunities points to the state's insufficient educational resources and their inequitable distribution.[4]

- Restricted Flow Through California's K-12 Mathematics Pipeline demonstrates that the flow of students through California's middle school and high school math curriculum is slowed by students' lack of access to reasonably-sized classrooms, rigorous coursework, and well-trained teachers.

Racial Demographics of California Schools

State Overview

California's public secondary schools (including middle schools and high schools) serve an extraordinarily racially diverse student body. Forty-five percent of California's secondary students are white or Asian, Pacific Islander, or Filipino.[5] Fifty-three percent are Latino, African American, or American Indian—the three groups that are underrepresented in California's higher education system.[6]

Despite this considerable diversity, California's different racial groups often attend schools isolated from one another. For instance, less than one-third of the state's African American students and approximately one-quarter of Latino students attend secondary schools with majority white and Asian enrollments. Approximately three-quarters of African American and Latino students are enrolled in secondary schools where the majority of students are from underrepresented groups, and a sizeable portion of these students attend highly segregated schools.

These patterns have resulted in California being one of the nation's most racially segregated states for African American and Latino students.[7] By contrast, less than 2% of California's white and Asian students attend secondary schools where 90-100% of the students are from underrepresented groups.

In the following tables and throughout the remainder of the chapter, data are presented on three categories of schools: 1) schools composed of less than 50% underrepresented students; 2) schools composed of 50 to 80% underrepresented students; and 3) intensely segregated schools where 90-100% of the students are from underrepresented groups.

Racial Composition of California Middle Schools 2005 - 2006

	Percent Underrepresented Students		
	0-49%	**50-89%**	**90-100%**
All	41.7%	41.1%	17.2%
White	74.1%	24.7%	1.2%
Asian	62.9%	34.4%	2.7%
African American	25.4%	53.4%	21.2%
Latino	18.5%	51.1%	30.5%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Racial Composition of California High Schools 2005 - 2006

	Percent Underrepresented Students		
	0-49%	**50-89%**	**90-100%**
All	50.4%	38.8%	10.8%
White	77.8%	21.6%	0.6%
Asian	66.0%	32.3%	1.8%
African American	30.2%	54.6%	15.2%
Latino	24.8%	53.3%	22.0%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Intensely segregated minority schools are far more likely than other secondary schools to serve high concentrations of low-income students and students learning English. Almost all (95%) of the intensely segregated middle schools enroll a majority of low-income students. In 70% of these middle schools, at least one-third of all students are English learners.

In contrast, few middle schools with small proportions of underrepresented students have high concentrations of low-income students and English learners. Only 13% of predominantly white and Asian schools enroll a majority of low-income students, and only 2% enroll one-third or more English learners. As the table below indicates, similar patterns are found at the high school level. Intensely segregated high schools are more than 10 times as likely as high schools where underrepresented students are in the minority to have high concentrations of low-income students, and 60 times as likely to enroll more than one-third English learners than schools where most students are white and Asian.

Concentrations of Low-Income Students and English Learners 2005-2006

	Percent Underrepresented Students		
	0-49%	**50-89%**	**90-100%**
Middle Schools > 50% FRPM[8]	13.2%	76.7%	95.4%
Middle Schools > 1/3 EL	1.9%	26.2%	69.5%
High Schools >50% FRPM	*8.7%*	50.8%	*89.2%*
High Schools > 1/3 EL	0.8%	11.7%	49.5%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

The following subsections explore the racial and socio-economic composition of the secondary schools attended by California's African American and Latino students.

California's African American Students

As noted above and as the table below shows, California high schools are extraordinarily racially diverse and they reflect the diversity of the state as a whole. In contrast to most other states, only a slight majority of high schools in 2005-2006 had majority white and/or Asian student bodies. California's 139,334 African American high school students comprise 8% of the state's high school students; even so, almost all California high schools (1027 of 1089) enroll at least some African American students.

Racial Composition of California High Schools Enrolling African American Students, 2005-2006

	Number of California high schools	Percent of California high schools
Schools with few white and Asian students (0-10%)	93	9%
Schools with some white and Asian students (11-49%)	384	35%
Schools that are predominantly white and Asian (50% - 100%)	612	56%
Total	1089	100%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

This overall diversity masks the fact that many African Americans are concentrated in a small number of schools. Less than one-third of African American students attend high schools where white and/or Asian students are the majority. This contrasts with the nearly four-fifths of white students and two-thirds of Asian American students attending schools that are predominantly white and/or Asian.

Distribution of African American Students Across Schools Differing in their Racial Composition (2005-2006)

	African American	White
Schools with few white and Asian students	15%	.6%
Schools with some white and Asian students	55%	22%
Schools that are predominantly white and Asian	30%	78%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

In 2005-2006, half of all African American high school students (69,845) were concentrated in only 107 schools, or about 10 % of the high schools in the state.[9] Eighty-six percent of these 107 schools have Latino, African American, and American Indian majorities, compared with 39% of the state's other 982 schools (hereinafter, ***the 982 other schools***.)

Racial Composition of the *107 Schools* Compared to *the 982 other schools (2005-2006)*

	The 107 Schools	*The 982 Other Schools*
Schools with few white and Asian students	20%	7%
Schools with some white and Asian students	66%	32%
Schools that are predominantly white and Asian	14%	61%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

In addition, 53% of the 107 schools are high-poverty schools in which over half of the students receive free and reduced price meals (FRPM); 34% of the 982 other schools are high-poverty schools.

Economic Composition of the 107 Schools Compared to the 982 Other Schools (2005-2006)

	The 107 Schools	**The 982 Other Schools**
Schools where over half of the students receive FRPM	53%	34%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

California's Latino Students

Similar to many African American students, Latino students often attend schools with small populations of white and Asian students and high levels of poverty. Additionally, many Latino students attend schools with high concentrations of English learners.

Large Numbers of Latino Students Attend High-Poverty Schools with High Concentrations of Underrepresented Students

Most Latino students attend schools with high concentrations of underrepresented students. Three-quarters of Latino high school students are concentrated in schools where most students are Latino, African American, or American Indian. One-quarter of Latino students attend high schools that are predominantly white and/or Asian.

Distribution of Latino Students across California's High Schools

	Latino	White	Asian
Schools with few white and Asian students	22%	0.6%	2%
Schools with some white and Asian students	53%	22%	32%
Schools that are predominantly white and Asian	25%	78%	66%

Latinos are more likely than any other racial group to attend schools with large concentrations of low-income students (schools where more than one half of students receive free and reduced price meals). 51% percent of California Latino high school students attend high poverty schools—compared with 11% of white high school students and 25% of Asian students. This concentration is important, because schools with many low-income students require extra educational resources that are often lacking, and thus students of all racial groups tend to exhibit relatively low academic achievement.

Distribution of Latino Students among California's Economically Diverse High Schools

	Latino	White	Asian
Percent of students attending high schools in which more than half of students receive free/reduced lunches	51%	11%	25%

Geographic Distribution of Latino Students

It is also useful to look at the distribution of Latino high school students across the state of California. While there are *some* Latinos in all 58 of California's counties, 89% of all Latino students are enrolled in 16 counties. (These counties are shaded on the map below. In many of these counties, Latinos are the largest group of high school students (counties that are both shaded and crosshatched on Figure 1). Latino students also comprise the largest group of high school students in some counties with relatively small numbers of students (counties that are only crosshatched). Notably, most of the 16 counties that include the highest percentages of Latino students are located in California's rural areas.

Achievement, Graduation, and College Preparation in California

Many California public school students achieve at high levels, enroll in challenging courses, and graduate from high school ready for college, the workplace, and civic life. In the last few years, California schools have made some notable gains. We have seen modest increases in the proportion of California's students scoring proficient on California's Standards Tests since those tests were implemented in 2002-2003. We have seen a growing number of students enrolling in rigorous math classes in California's middle schools and high schools.[10] And between 1997 and 2005, California steadily increased the proportion of 9th graders who graduated high school.

Yet despite this recent progress, California lags behind almost all other states in key markers of student achievement and rates of high school graduation and college enrollment. The 2007 results of the National Assessment of Educational Progress, or NAEP, are particularly sobering. NAEP is commonly referred to as the "nation's report card" because it allows state-by-state comparisons of student achievement at grades 4 and 8 in reading and mathematics. California's 4th graders rank 48th of all states in reading and 46th in mathematics. California's 8th graders rank 47th in reading and 45th in mathematics.[11]

Although surveys suggest that almost all California students enter high school with aspirations to graduate and enroll in college, few California students achieve these goals.[12] As shown on Figure 2, more than 520,000 students enrolled as 9th graders in Fall 2002. Four years later, fewer than 350,000 Californians graduated from high school. That means the class of 2006 shrunk to two-thirds of its original size. Not since 1997 has California failed to graduate such a high percentage of its 9th grade enrollment. The historically low graduation level in 2006 can be explained in part by California's decision to fully implement its Exit Exam policy in June 2006. This policy meant that the state denied diplomas to students who had not passed the Exit Exam but had fulfilled all other graduation requirements.[13] As a consequence, California's graduation rate now has fallen far below the national average.[14]

The number of 2006 California high school graduates who completed the sequence of courses necessary for enrollment in California's four-year public universities was only one-quarter the size of the 520,000 students in the original class. And, only slightly more than one student for every eight in the original cohort enrolled at a California State University or University of California campus in the fall of 2006. According to data from the College Board, California ranks 48th among the states in the percentage of its senior class that matriculates into a four-year college the following year. Only Mississippi and Arizona have lower rates of sending high school seniors to four-year universities.[15] In part, California's poor ranking on this measure reflects the strength of California's community college system. A number of California high school seniors enroll in community colleges, and some later transfer to four-year colleges. Nonetheless, California still ranks well below most other states in the percentage of high school graduates who receive a bachelor's degree within six years.[16]

Some argue that California's low rates of educational achievement are a product of the state's large number of students from low-income families, students of color, and students learning English. However, California's white middle class students perform well below comparable white students across the nation. For example, California's white 8th graders'

NAEP math scores are well below white 8th graders in most states, and their reading scores rank behind white students in all but two states.[17] Similarly, California's non-poor 8th graders rank below non-poor students in all but six states in both reading and math.[18] In sum, California has an education crisis that applies across the state and affects all students from all groups.

The following section investigates this statewide educational inadequacy and demonstrates that it disproportionately affects African American and Latino students, who, as explained above, often attend racially segregated schools. Our analyses reveal racially unequal patterns of distribution of educational opportunities, which affect the likelihood that African American, Latino, and American Indian students will thrive academically and persist in their schooling.

Inadequate and Unequal Learning Conditions and Opportunities

We now turn to analyses of the resources and opportunities provided in California's secondary schools. We find that almost all California students experience fewer educational opportunities than students across the nation. Their schools are more often overcrowded, and they have less access to teachers and counselors than their peers in most other states. Within California, secondary schools enrolling the highest proportion of Latino, African American, and American Indian students are those most likely to face these critical opportunity problems. These shortages are particularly burdensome for students from low-income families that do not have a history of college-going. Without qualified adults available at their schools, such students often lack information and support to navigate toward graduation and college preparation.[19]

Overcrowded Schools

California's secondary schools are larger, on average, than schools in every other state except Florida.[20] Many of California's middle schools and high schools are among the largest secondary schools in the nation. For instance, 36 middle schools enroll more than 2000 students, and 120 high schools enroll more than 3000 students. Nationally, the average middle school enrolls 605 students and the average high school enrolls 751 students.[21]

Many California schools are overcrowded, but underrepresented students are most affected. More than one-fourth of California middle and high school students attend schools that the state has defined as overcrowded, and almost two-thirds of the affected students attend intensely segregated minority schools where 90% or more of the students are Latino, African American, or American Indian.

Overcrowding creates unsafe environments and makes teaching and learning more difficult. Schools may need to teach students in auditoriums, gymnasiums, storage rooms, and other areas never intended to be used for instructional purposes.[22] Schools with too little space may not be able to maintain specially equipped rooms such as science labs or libraries because these spaces need to be "flexible" for teaching multiple subjects. Overcrowding has led some California school districts to employ policies such as year-round, multi-track school calendars in order to keep some portion of the teachers and

students off campus and "on break." Some of these calendars provide students with fewer days of instruction than are provided to other California students.

The graphic below displays the relationship between race and overcrowding in the three categories of California schools.

Secondary School Racial Composition and Overcrowding 2005 - 2006

	Percent Underrepresented Students			
	0-49%	**50-89%**	**90-100%**	**All Schools**
Students in Overcrowded Middle Schools	20.8%	28.0%	59.3%	30.4%
Students in Overcrowded High Schools	16.8%	30.9%	63.7%	27.4%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Limited Access to Counselors

Counselors provide students and their families with information, guidance, and support as students navigate through secondary schools and toward their postsecondary opportunities. Such counseling is particularly important for students whose families lack both knowledge of available opportunities and how students might take advantage of them. Immigrants and students learning English may be especially dependent on the support of knowledgeable counselors.[23]

On average, however, California's high schools provide one counselor for every 556 students compared with a national average of one counselor for every 229 students. The American School Counselor Association ranked California last of all states in providing high school students with access to counselors.[24]

Eight in nine California high school students attend schools that provide less access to counselors than the national average. Students attending intensely segregated schools are most likely to attend schools with fewer counselors than the national average. Moreover, middle school students in California have less access to counselors than high school students. On average, California's middle schools provide one counselor for every 753 students.

Limited Access to Qualified Secondary Teachers

California secondary teachers are responsible for more students than secondary teachers in any other state. Middle school teachers teach 49% more students than the

national median. High school teachers teach 42% more students than the national median.[25]

Student to Teacher Ratio in Secondary Schools 2003-2004

	U.S. Median	CA Median
Middle Schools	15.8	23.5
High Schools	15.4	21.8

Source: National Center for Education Statistics (NCES), available at http://nces.ed.gov/

Qualified secondary teachers are an essential resource, and California has an insufficient supply. Poorly qualified teachers have less content area knowledge, rely heavily on lecturing, and are often unprepared to have students engage in higher-order thinking and work. Schools with a severe shortage of qualified teachers, where more than 20% of the teachers lack full credentials, have high levels of teacher turnover; additionally, these schools do not have enough experienced and qualified teachers to mentor new and less prepared ones.[26]

As the table below shows, a severe shortage of qualified teachers is rarely found in secondary schools that enroll a majority of white and Asian students. 29% of intensely segregated middle schools have severe teacher shortages; they are 22 times more likely to experience such shortages than are middle schools where fewer than half of students are from underrepresented groups.

School Racial Composition and Teacher Shortages 2005-2006

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All Schools
Middle Schools w/ Severe Teacher Shortage	1.3%	7.3%	29.1%	7.4%
High Schools w/ Severe Teacher Shortage	5.4%	13.5%	33.3%	10.7%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Limited Access to High-Quality College Preparatory Curriculum

The California State University and the University of California have the same basic course requirements for admission, commonly referred to as the A-G Requirements. To be eligible to attend any public four-year university in the state, a student must take a minimum of 15 A-G courses—approximately two-thirds of their high school courses. Accordingly, to provide every student with the opportunity to satisfy these college eligibility requirements, California high schools must ensure that *at least* two-thirds of their

courses meet the A-G requirements. In schools with high rates of college-going, it is common for more than three-quarters of the school's courses to satisfy the A-G requirements.[27]

Nearly a million (995,436) California high school students attend schools that do not offer enough A-G courses for all students to take the college preparatory curriculum. Half of the high schools serving majority white and Asian students lack sufficient courses, while more than two-thirds of the high schools with a majority of underrepresented students face this problem.

School Racial Composition and Access to the College Preparatory Curriculum 2005-2006

	Percent Underrepresented Students			
	0-49%	**50-89%**	**90-100%**	**All High Schools**
Schools w/ too few A-G Courses*	50%	71%	67%	55%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

*A-G Courses refer to the sequence of 15 courses students must complete with a grade of C or higher to meet the UC and CSU course requirements for eligibility.

Sometimes schools offer college preparatory courses without providing high-quality instruction in those courses. For example, in one-quarter of California's high schools, more than 20% of college preparatory courses are taught by teachers teaching outside their subject area expertise. More than 300,000 California students attend schools facing this problem. Again this problem is not shared equally. Intensely segregated minority high schools are three times as likely to have large numbers of teachers teaching college preparatory courses without the appropriate credential as are high schools where less than half of the students are underrepresented.

High School Racial Composition and Unqualified College Preparatory Teachers 2005-2006

	Percent Underrepresented Students			
	0-49%	**50-89%**	**90-100%**	**All High Schools**
Severe Shortage of Qualified College Preparatory Teachers	16%	32%	48%	24%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Unequal Outcomes Mirror Unequal Opportunities

The unequal academic outcomes produced by California's schools strongly mirror the unequal educational opportunities present in those schools. High schools enrolling different proportions of underrepresented students yield dramatically different rates of progress to high school graduation and college. Students in predominantly white and Asian high schools were twice as likely as students in intensely segregated minority schools to complete the course sequence required for admission into California State Universities and University of California campuses.

These differences translate into comparable differences in college enrollment. Students in predominantly white and Asian high schools were more than twice as likely (17% to 7%) as those in intensely segregated minority schools to matriculate into four-year California public universities in fall 2006.

High School Racial Composition, Graduation, College Eligibility, and College-Going

	Percent Underrepresented Students			
	0-49%	**50-89%**	**90-100%**	**All California High Schools**
Out of Every 100 9th Graders in Fall 2002				
Graduated in 2006	78%	59%	43%	66%
Graduated w/ A-G	34%	18%	16%	25%
Enroll CCC Fall 2006	23%	19%	15%	20%
Enroll CSU Fall 2006	10%	7%	5%	8%
Enroll UC Fall 2006	8%	3%	2%	5%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/
California Postsecondary Education Commission, available at www.cpec.ca.gov

These patterns of disparate graduation and college-going rates across these three categories of schools are longstanding. However, the proportions of graduates fell across the board in the class of 2006, the first affected by the California High School Exit Exam's "diploma penalty" policy. The decline was steepest for the intensely segregated minority high schools where the graduation rate fell by 14% from 2005 to 2006. In comparison, the graduation rate decreased by 3.7% in the group of high schools with the smallest proportion of underrepresented students.

High School Racial Composition and the 2006 Decline in Graduation*

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All California High Schools
Percent Decline in Graduation Rate from 2005 to 2006	3.7%	6.3%	14.0%	5.7%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

*The above figures refer to the percentage point change in graduation rate from the Class of 2005 to the Class of 2006.

Intensely Segregated Minority Schools are Far More Likely to Face State Sanctions

Over the last decade, California's legislature has adopted a set of standards and tests of student proficiency that many have praised as among the most rigorous in the nation.[28] Following the requirements in No Child Left Behind (NCLB), the California legislature has enacted accountability measures that tie punitive consequences to these standards and tests. Schools are designated as "Program Improvement" (PI) schools if they fail to meet the state's test-score-increase goals for two or more consecutive years.[29]

Unfortunately, as the analyses in the previous sections make clear, California has not invested in the conditions necessary for schools to achieve these high standards and meet the requirements of the state's tough accountability mechanisms. According to the state's own data, in 2006, 43% of California's middle schools and 15% of California high schools were identified by the state and federal government as low-performing and in need of serious improvement. California's intensely segregated minority middle schools were more than six times as likely (89% to 14%) as majority white and Asian middle schools to be designated as PI schools. Although a smaller proportion of high schools than middle schools have been designated as PI schools, the disparities between majority white and Asian high schools and intensely segregated high schools is pronounced. Intensely segregated high schools are more than 19 times as likely (58% to 3%) as majority white and Asian high schools to be designated as PI schools.

Some California middle and high schools face serious sanctions because they have been in Program Improvement status for at least five years. NCLB requires districts to close or "reconstitute" such schools.[30] As the graph below shows, almost a third of intensely segregated minority middle and high schools are "PI 5" schools that face these sanctions. Notably, no majority white and Asian high schools are in this stage of Program Improvement.[31]

School Racial Composition and "Program Improvement 5" Status 2005 - 2006

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All Schools
Middle Schools in PI Year 5+	0%	20%	32%	13%
High Schools in PI Year 5+	0%	5%	30%	5%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Restricted Flow Through California's K-12 Mathematics Pipeline

One clear consequence of the state's combination of high standards and low opportunity is the restricted flow of students through California's math pipeline—the sequence of mathematics instruction that affect students' college opportunities and life chances. Students' success in these math courses, according to many analysts, also holds the key to the state's future well-being.[32]

Attention to math pipeline is especially important in light of new state curriculum policies. California's math standards, adopted in 1997 and then pushed forward with legislation supporting new textbooks in 2001-2002, called for students to take more and more rigorous math classes. This framework, combined with the state requiring algebra for graduation and the implementation of the California High School Exit Exam, have prompted an increase in secondary math enrollment overall, and in 8th graders taking algebra.[33] Also, a new California policy will require all 8th graders to enroll in algebra by 2011.[34]

Middle-school Obstructions in the Math Pipeline

The results of the 8th grade math NAEP suggest that California's standards and accountability reforms alone are not sufficient to promote math proficiency. In 2007, the average NAEP math score for California 8th grade students was 270, placing California behind 44 other states, and below the national average of 280. Fewer than one in four California 8th graders scored at the proficient or advanced level. More than 40% of California 8th graders scored "below basic"—the lowest level.[35] As noted earlier in this report, California's sub-par performance on the math NAEP holds for all students and all sub-groups—including white and non-poor students.

Among the complex mix of factors underlying this outcome are three middle school conditions known to undermine learning—large math classes, lack of access to rigorous mathematics coursework, and shortages of teachers trained in mathematics.[36]

Math class size

The state's Quality Education Investment Act (QEIA) of 2006[37] calls for secondary schools to limit class size to 25. Although this standard is a move in the right direction, California is far from reaching it, and it would still leave California students

with less access to teachers than most students across the nation. Currently, California ranks last among all the states in the average number of students in its secondary math classrooms, and 93% of intensely segregated middle schools enroll more than 25 students per math class.

Middle School Racial Composition and Math Class Size 2005 - 2006

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All Middle Schools
Middle Schools w/ Average Math Class >25	84.2%	87.3%	93.4%	86.7%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Rigor of coursework

California's curriculum framework in math encourages schools to enroll all students in algebra by 8th grade.[38] However, 57% of California's middle schools enroll fewer than half of their eighth graders in algebra or its equivalent. More than 600,000 students attend such schools. This problem cuts fairly evenly across all groups of California middle schools.

Middle School Racial Composition and 8th Grade Enrollment in Algebra 2005 - 2006

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All Middle Schools
< 50% of 8th Graders in Algebra	55.0%	60.4%	53.0%	56.9%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Math teacher preparation

California state law allows middle school math teachers to hold either a credential in mathematics or a "multiple subjects" credential. And, in more than one-third of California middle schools, the majority of math teachers lack specialized mathematics credentials.

However, California's high math standards require teachers with a strong grasp of the subject matter and a deep understanding of how to convey key mathematical concepts to adolescents. Without sufficient math specialists, middle schools have difficulty mounting high-quality mathematics programs. This shortage of middle school math teachers affects more than 400,000 students statewide, but it is twice as likely to occur in intensely segregated middle schools as in majority white and Asian middle schools.

Middle School Racial Composition and Shortage of Math Teachers 2005 - 2006

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All Middle Schools
Severe Shortage of Middle School Math Teachers	29.8%	42.9%	58.3%	38.8%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Ninety-seven percent of all California middle schools experience at least one of the above problems (overcrowded classrooms, insufficient access to rigorous coursework, shortages of prepared teachers) that limit students' access to high-quality mathematics instruction.

Some middle schools in the state face all three of these problems, making it extremely difficult for them to implement a quality mathematics program and for the students enrolled in these schools to meet the state's standards. More than 200,000 California students are enrolled in such middle schools and, as such, experience the combined impact of overcrowded math classes, insufficient access to algebra, and too few qualified math teachers. Intensely segregated minority middle schools are more than twice as likely as majority white and Asian middle schools to face all of these math problems.

Middle School Racial Composition and Multiple Math Pipeline Problems 2005 - 2006

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All Middle Schools
Three Problem Middle Schools	14.3%	19.3%	31.1%	18.6%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Given the prevalence of these problems, it is no surprise that so many California students leave middle school insufficiently prepared for the rigor of high school math.

High-school Obstructions in the Math Pipeline

With access to intensive support at the high school level, many students with inadequate middle school preparation might still be able to meet the state's rigorous math standards. But the lack of opportunities for high-quality math instruction in California's middle schools continues in California's high schools. The poor preparation of the state's middle school students combines with poor math preparation at the high school level and

both leave many students at the end of their schooling without core academic skills in mathematics.[39]

Math class size

As noted above, California's secondary math classes are the largest in the nation. More than 75% of California high schools average more than 25 students per math class—this is more than the state recommends in its QEIA, and far more than the national average. One and one-half million California high school students attend schools with such overcrowded math classes. This problem is more common in schools where the majority of students are from underrepresented groups.

High School Racial Composition and Math Class Size 2005 - 2006

	Percent Underrepresented Students			
	0-49%	**50-89%**	**90-100%**	**All High Schools**
High Schools w/ Average Math Class >25	72.9%	78.4%	78.5%	75.3%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Rigor of coursework

In the last four years, the proportion of California high school students taking higher-level math classes has increased. According to a widely acclaimed U.S. Department of Education study, enrolling in a rigorous high school curriculum is vital to students increasing their chances of earning a bachelor's degree.[40] The study also found that of all the high school courses, the highest level of mathematics taken is the most important for college success. The study also reported that taking rigorous high school courses had a greater impact on African American and Latino students than on white students.

Despite the recent increases, the proportion of students enrolling in such rigorous math classes remains quite small in most California high schools. In 75% of California high schools, less than one-quarter of 10th, 11th, and 12th grade students enroll in courses that the state designates as "higher level" math classes. Students in schools serving majority African American and Latino students are more likely than those in majority white and Asian schools to experience this problem.

High School Racial Composition and Enrollment in Advanced Math Classes 2005 - 2006

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All High Schools
Schools < 25% Students Enrolled in Advanced Math	69.1%	83.3%	81.7%	75.2%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Math teacher preparation

High-quality math instruction at the high school level requires a deep understanding of the subject matter. Yet, almost one-third of California high schools face severe shortages of fully certified math teachers, and, as such, fail to meet NCLB requirements. In these schools, more than 20% of the college preparatory math classes are taught by teachers without state credentials to teach mathematics. This problem affects more than one-half million California students. Schools serving predominantly African American and Latino students are almost three times as likely as majority white and Asian schools to face this problem.

High School Racial Composition and Math Teacher Shortages 2005 - 2006

	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All High Schools
Severe Shortage of High School Math Teachers	20.3%	43.8%	57.0%	31.7%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

As is the case with middle schools, 97% of California's high schools face at least one of the three math problems that create serious challenges for student learning—large class sizes, few students enrolled in advanced math, and shortages of qualified math teachers. However, these three math problems converge in one out of every six California high schools, affecting 398,426 students. Here, too, students attending intensely segregated minority schools are affected disproportionately. Students in these schools are more than four times as likely as students in predominantly white and Asian schools to experience all three of these problems.

High School Racial Composition and Multiple Math Pipeline Problems 2005 – 2006

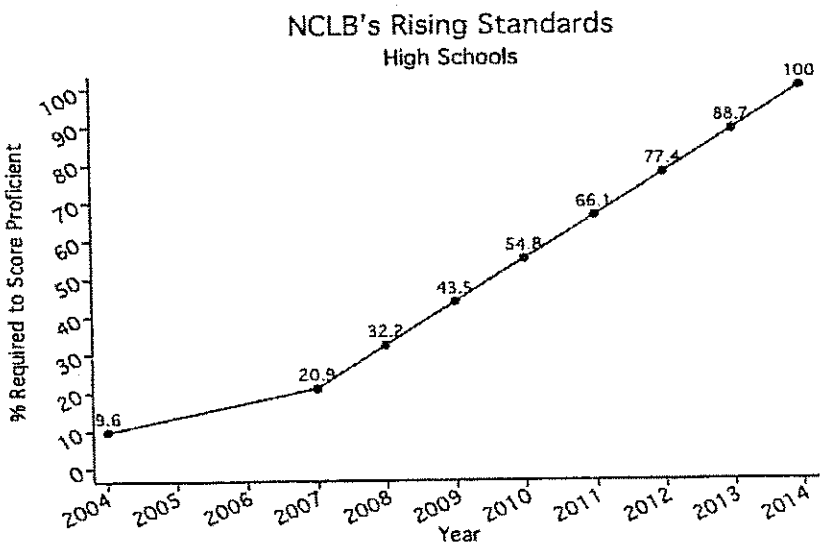
	Percent Underrepresented Students			
	0-49%	50-89%	90-100%	All High Schools
Three Problem High Schools	8.8%	25.5%	35.5%	17.0%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Almost all students in California's class of 2006 attended a school with at least one of these math problems sometime during their middle and high school years. And because middle schools with poor resources often feed into high schools with poor resources, a sizeable number of students in the class of 2006 experienced a convergence of math problems both in middle school and in high school. California lacks a longitudinal data system that would allow us to say with certainty how many students faced how many problems for how many years. What is clear, however, is that many California students, and particularly those attending predominantly African American and Latino schools, did not have sufficient opportunities to prepare for, and reach the state's goals in mathematics instruction.

One important consequence of these inadequacies and inequalities in the math pipeline is that few if any California secondary schools are on track to meet the goal o promoting universal proficiency. NCLB calls for all students to reach proficiency in mathematics and English/Language Arts by 2014. In the years leading up to 2014, high schools must demonstrate that they are moving toward this goal by enabling more and more of their students to achieve proficiency on standardized tests.

2005 – 2006



Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

For example, in 2007, high schools are required to show that at least 21% of their students have attained proficiency in mathematics. By 2010, 55% of students must attain proficiency.This accountability framework assumes that California schools have the capacity to improve student performance continually. However, the prevalence and distribution of math problems in the state's middle and high schools that we described above calls that assumption into question.

In fact, only about one in three California high school students attend schools that currently meet the math achievement goal for 2010. And, as the table below shows, less than 1% of those California students enrolled in intensively segregated schools are in schools that already meet this goal.

High School Racial Composition and Failure to Meet 2010 Math Proficiency Goal

	Percent Underrepresented Students			
	0-49%	**50-89%**	**90-100%**	**All High Schools**
Students in schools failing to meet 2010 Math Proficiency Goal	32.8%	92.0%	99.2%	63.0%

Source: California Basic Education Data System, available at www.cde.ca.gov/ds/sd/cb/

Many California high schools have increased the proportion of students scoring proficient in math over the last two years, and these schools hope to sustain their improvement. But it won't be enough for California high schools to continue to increase at their current rates (a very challenging prospect indeed). California's accountability scheme within NCLB requires that the yearly increases that schools make in the proportion of students that attain proficiency grow larger and larger over time. So, at their current rates of progress, nearly every high school in the state will be a failing school by 2014. By that year, less than 5% of California high school students will attend schools that achieved the math proficiency target. In fact, more than half of California students attend high schools that would need *more than 50 years* beyond 2014 to attain NCLB's math goal—*even if* these schools continue to improve every year at the rates they have demonstrated over the last two years.

Conclusion

California needs to address the gaps that this chapter highlights. The fact that California public schools offer fewer of the fundamental conditions all students need to learn is compounded by the fact that California's fundamental conditions for learning are not equally distributed. These two gaps combine in many harmful ways. For example, California's worst-in-the-nation student-to-teacher ratio and its unequal distribution of qualified teachers means that students in intensely segregated schools are more likely to experience very large classes taught by unqualified teachers.

Closing these gaps requires that California look beyond the rhetoric of "accountability" and "standards" in isolation, and focus on the opportunities for learning that students experience in their classrooms. California has enacted educational standards designed to produce a highly educated workforce for a technology-based economy and a well-informed citizenry. But achieving these standards is not a simple matter of motivating teachers and students to "try harder." California has not invested in its schools at a level commensurate with its standards, and our educational infrastructure is incapable of providing the opportunities these goals demand.

Further, the quality of education students receive is strongly related to their race or ethnicity and that of their classmates—replicating the inequalities historically associated with racial segregation. Truly closing the gaps that divide California's students will require directing new resources to those students who are most deprived of fundamental learning conditions. It is a necessary step if the state is serious about making California's learning standards accessible to all, regardless of race.

Figure 1

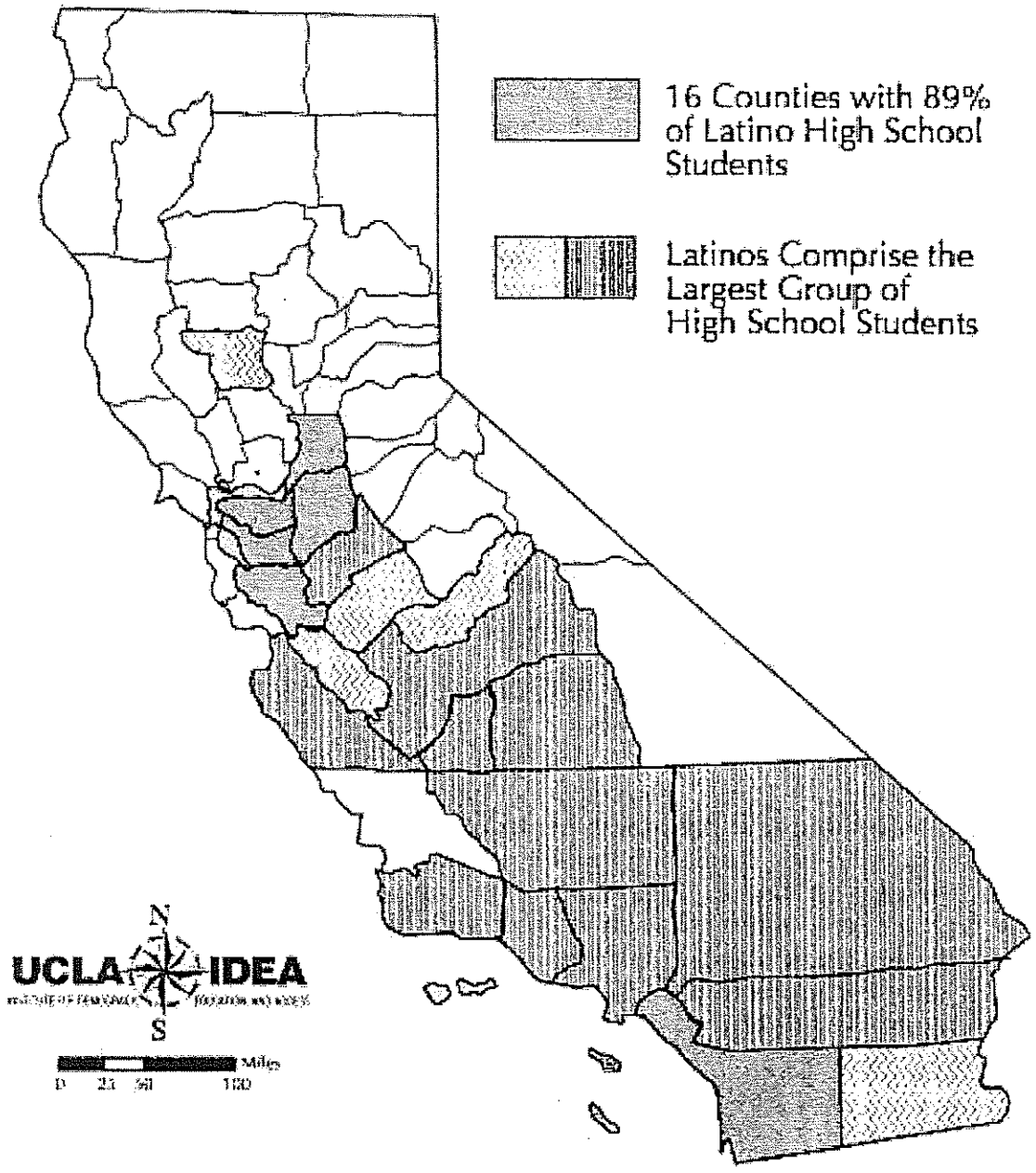
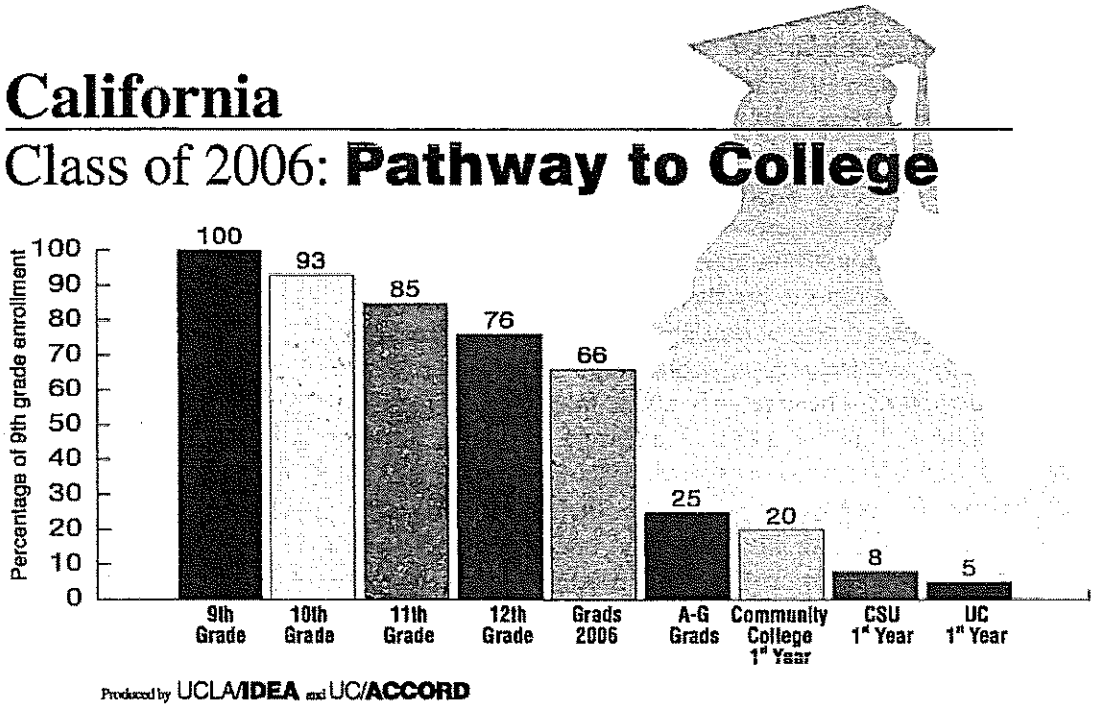

16 Counties with 89% of Latino High School Students
Latinos Comprise the Largest Group of High School Students
UCLA IDEA
N
S
Miles

Figure 2


California
Class of 2006: Pathway to College
Percentage of 9th grade enrollment
100
90
80
70
60
50
40
30
20
10
0
100
93
85
76
66
25
20
8
5
9th Grade
10th Grade
11th Grade
12th Grade
Grads 2006
A-G Grads
Community College 1st Year
CSU 1st Year
UC 1st Year
Produced by UCLA/IDEA and UC/ACCORD

Endnotes

[1] See, for example, Jack O'Connell, (November 9, 2007). "Starting Early to Fix the Achievement Gap," *Sacramento Bee.* B7.

[2] See, for example, *A way to close the achievement gap between white and minority students in California,* editorial in the San Francisco Chronicle, Tuesday, August 21, 2007.

[3] UCLA's Institute for Democracy, Education, and Access (IDEA) annually produces reports on the conditions and outcomes across Califronia's public schools. In 2007, IDEA released a statewide report and separate reports for each California legislative district. IDEA also produced a report on Latino students and a report on African American students in California's public schools. The entire set of reports can be accessed online at www.edopp.org.

[4] For additional analyses of education opportunity for California's African American and Latino students, see *African American Educational Opportunity Report, 2007* and *Latino Educational Opportunity Report, 2007.* These reports reveal that California's racial gaps occur in concert with considerable racial isolation. Although California high schools are extraordinarily diverse, half of all of African American high school students are concentrated in a relatively small number (107) of predominantly minority schools. Another 90 California high schools enroll especially high concentrations of English Learners who speak Spanish as a first language. These two groups of schools experience more severe opportunity problems than the rest of the state's high schools.

[5] Hereinafter, we use the shorthand "Asian" to refer to students designated as Asian, Pacific Islander, or Filipino.

[6] Hereinafter, we use the shorthand "Underrepresented" to refer to students designated as African American, Latino, and American Indian. These groups are underrepresented in the University of California system.

[7] Orfield, G. and Lee, C. (2007, August). *Historic Reversals, Accelerating Resegregation, and the Need for New Integration Strategies.* Los Angeles, California: Civil Rights Project/ Proyecto Derechos Civiles, University of California, Los Angeles.

[8] Free and Reduced Price Meals (FRPM) is the only indicator available to measure concentrations of poverty at the school level. See *California Educational Opportunity Reports Data Sources and Definitions*. Available online at www.EdOpp.org.

[9] Each of the 107 schools enrolled at least 370 African Americans. Not included in this group are some small high schools with high proportions of African American students.

[10] Ed Source. (2007). *Higher Standards + Support = More Students Taking Tougher Math.*

[11] United States Department of Education: National Center for Education Statistics. (2007). *National Assessment of Educational Progress.* Available online at http://nces.ed.gov/nationsreportcard/naepdata/

[12] Parents and Students for Great Schools. (2007). *Now That We Have the Facts: California Parents and Students Voice Their Demands for Public Education.* Available online at www.caljustice.org/cfj_live/images/ stories/07_reports/Education%20Survey.pdf and Baldasare, M. et al. (2007). *Californians and Higher Education.* San Francisco, CA: The Public Policy Institute of California.

[13] Rogers, J. (2007). Constructing Success: Accountability, Public Reporting, and the California High School Exit Exam. *Santa Clara Law Review* 47:755-80.

[14] The National Center for Educational Statistics (NCES) reported that California's graduation rate was only marginally lower than the national average in 2005. NCES calculates graduation what it calls an Average Freshman Graduation Rate by dividing the number of graduates by the

average of the number of students enrolled as 8th, 9th and 10th graders 5, 4, or 3 years before. In 2005, NCES reported a national average graduation rate of 74.7 and a California average of 74.6. While NCES has not yet reported graduation rates for the Class of 2006, we expect that California's graduation rate will now fall roughly 4% points below the national average.

[15] College Board. (2007). *Higher Education Landscape.* Available online at http://www.collegeboard.com/highered/res/hel/hel.html.

[16] National Center For Higher Education Management Systems. (2007). *Completion: Bachelor's degrees awarded per 100 high school graduates 6 years earlier.* Available online at http://www.higheredinfo.org/dbrowser/index.php?submeasure=85&year=2005&level=nation&mode=data&state=0.

[17] United States Department of Education: National Center for Education Statistics. (2007). *National Assessment of Educational Progress.* Available online at http://nces.ed.gov/nationsreportcard/naepdata/

[18] United States Department of Education: National Center for Education Statistics. (2007). *National Assessment of Educational Progress. The Nation's Report Card.* Available online at http://nces.ed.gov/nationsreportcard/naepdata/http://nationsreportcard.gov/math_2007/m0005.asp

[19] McDonough, P. (2004). Counseling Matters: Knowledge, assistance, and organizational commitment in college preparation. In William G. Tierney, Zoë B. Corwin & Julia E. Colyar (Eds.) P*reparing for College: Nine Elements of Effective Outreach.* Albany, NY: SUNY Press.

[20] United States Department of Education: National Center for Education Statistics. Available online at http://nces.ed.gov

[21] Table 5. – Average public school size (mean number of students per school), by instructional level and by state: School year 2000-2001; Available online at nces.ed.gov/pubs2002/overview/table5.asp

[22] Oakes, J. (2002). Education Inadequacy, Inequality and Failed State Policy: A synthesis of expert reports prepared for *Williams v. State of California.* Los Angeles, CA: UCLA/IDEA. Available online at www.idea.gseis.ucla.edu.

[23] McDonough, P. (2004). Counseling Matters: Knowledge, assistance, and organizational commitment in college preparation. In William G. Tierney, Zoë B. Corwin & Julia E. Colyar (Eds.) P*reparing for College: Nine Elements of Effective Outreach.* Albany, NY: SUNY Press.

[24] The American School Counselor Association analyzed the most recent available data (covering the school year, 2004-05) from the National Center for Educational Statistics'Common Core of Data. Available online at http://www.schoolcounselor.org/content.asp?contentid=460.

[25] We report here on NCES' most recent published data (from 2003-2004) on student-teacher ratio. See: Table C-8. Median public school student/teacher ratio, by instructional level: United States and other jurisdictions, school year 2003-2004. Available online at http://nces.ed.gov/

[26] Darling-Hammond, L. (2004). Inequality and the Right to Learn: Access to Qualified Teachers in California's Public Schools. *Teachers College Record,* 106, No. 10.

[27] We provide data about the percentages of A-G courses and rates of college-going separately for each high school in the on-line version of this report. Available online at www.EdOpp.org

[28] Finn, C., Petrilli M. and Julian, L. (2006). *The State of State Standards.* New York, NY: The Fordham Foundation. See also: Cronin, J. et al. (2007). *The Proficiency Illusion:* New York, NY: The Fordham Foundation.

[29] NCLB requires that state and school districts annually review the academic progress of all schools receiving federal Title I funds and to identify those schools that do not make annual progress toward 100% proficiency by 2014. Schools are identified as Program Improvement (PI) schools after two consecutive years of not making adequate yearly progress (AYP). California determines AYP for high schools by considering the following four measures: 1) The percentage of students scoring at the "proficient" or "advanced" level on the California Standards Tests for English-language arts and mathematics; 2) The percentage of students participating in those tests; 3) The graduation rate for high schools; 4) California's own accountability measurement of progress, the Academic Performance Index (API).

[30] United States Department of Education. No Child Left Behind Act: Part A Sec. 1116.b.8.B. Available online at www.ed.gov/policy/elsec/leg/esea02/pg2.html#sec1116.

[31] We report here on the number of California middle schools and high schools in at least their fifth year of Program Improvement in the 2006-2007 school year.

[32] For discussion of the need for California to improve its math instruction to sustain its competitive advantage in STEM related industries, see: California Council on Science and Technology and Center for the Future of Teaching and Learning (2007). *Critical Path Analysis of California's Science and Mathematics Teacher Preparation System.* Sacramento, California.

[33] Ed Source. (2007). *Higher Standards + Support = More Students Taking Tougher Math.* Mountain View, California: Ed Source. Available online at www.edsource.org.

[34] H. Blume. (September 22, 2008). *California's new 8th-grade algebra rule gets some poor marks.* Los Angeles Times.

[35] National Center For Educational Statistics. (2007). *Mathematics 2007 State Snapshot Report: California Grade 8 Public Schools.* Available online at http://nces.ed.gov/nationsreportcard/pdf/stt2007/2007495CA8.pdf

[36] National Center For Educational Statistics. (2007). *Mathematics 2007 State Snapshot Report: California Grade 8 Public Schools.* Available online at http://nces.ed.gov/nationsreportcard/pdf/stt2007/2007495CA8.pdf

[37] The Quality Education Investment Act (QEIA) was created through Senate Bill (SB) 1133 (Chapter 751, Statutes of 2006). The legislation provided approximately $3 billion for use by schools ranked as either decile 1 or 2 in the state's Academic Performance Index to reduce class sizes, improve teacher and principal training, and hire more school counselors.

[38] The introduction to California's math framework states: "A goal of this framework is to prepare all students to study Algebra by 8th grade." California Department of Education (2006). *Mathematics Framework for Califronia Public Schools: Kindergarten through grade 12.* Sacramento, CA. Available online at http://www.cde.ca.gov/ci/ma/cf/documents/math-front-intro.pdf.

[39] For example, more than 1 in 3 (37%) of the Fall 2006 first-year students in the Califronia State University system required remediation in Mathematics. See California State University, CSU Analytic Studies Development (2007). *Fall 2006 Regularly Admitted First-Time Freshmen Remediation Campus and Systemwide.* Available online at http://www.asd.calstate.edu/remediation/06/Rem_Sys_fall2006.htm.

[40] C. Adelman. (2006). *The Toolbox Revisited: Paths to Degree Completion from High School Through College.* Washington, DC: United States Department of Education.

THE UNIVERSITY OF CALIFORNIA AT THE MILLENNIUM

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At the start of the new Millennium, 20 members of the Glion Colloquium, Western leaders of Higher Education, met for four days in Glion, Switzerland, and issued a Declaration after having reflected on the challenges facing public higher education. The members of the Glion Colloquium include Regents, presidents, chancellors and rectors of leading universities, and other academic leaders. The group issued the Glion Declaration stating that Universities are learning communities created and supported for students to learn, clearly a function of critical importance to society in the pursuit of new knowledge." Those functions... "form the basis of an unwritten social contract by which, in exchange for the effective and responsible provision of those services, the public... contributes to its finance. ... Universities are experiencing severe financial constraints... (due to) other public needs which demand public investment."[1]

The Glion Declaration reminds us that "scholarship is a public trust in which, though it is rooted in individual insight and personal inquiry is a cooperative venture, supported though by public funds and private patrons as a social enterprise, because it enriches human understanding and contributes to human well-being." In the spirit of the Glion Declaration, this chapter examines major challenges facing higher education and, in particular, challenges facing the University of California. Three initiatives are offered to meet those challenges.

The University of California is one of the top universities in the world and one of the leaders of America's public research universities. As with many public universities, it faces serious challenges which deserve to be promptly addressed. Among these challenges, the focus will be on two which stand out: First, declining public financial resources for university support, and second, the need for new approaches which can keep the university at the cutting edge and in a position to carry out its mission with the help of new organizational structures.

Challenges

A. Financing

At a time that the demand for the admission of students and for world class faculty are at an all-time high, financial resources are a major problem. Funds provided by the state are shrinking, uncertain, and unstable and therefore threaten the ability of the university to meet its responsibility. Although states other than California have similar problems, the challenges have become especially serious in respect to the University of California, since the State is incurring particularly serious financial difficulties. At the same time, legislators and other elected officials press the university to admit more and more undergraduates. The state has about $15 billion budget deficit. Moreover, there is vigorous competition for faculty, particularly from well endowed private institutions.

Why does California have such severe financial difficulties? The reason is an imbalance between the demand for public services and capital investments on the one side, and the supply of tax dollars on the other. The latter fact can be traced to the passage in the late 1970s of Proposition 13.[2] Prop 13 greatly reduced local governments' ability to raise revenue from

property taxes, which had been a major source of local government funding, leaving the state to backfill support for local services, especially K-12 education. At the same time it requires the legislation to have a two thirds majority in voting for tax increases.

Unable to get a two thirds majority in votes to increase taxes, the state has turned to borrowing large amounts of money by selling bonds. As a result, the state must pay ever larger annual debt service charge. As an example, there are four general obligation bond measures on the November 2008 ballot totaling $16.8 billion in new authorizations. According to estimates by the Legislative Analyst, if the four measures were to pass, they would increase the General Fund's debt service by $2.7 billion a year and bring the debt Service ratio to 6.1 percent by 2011-12.[3] One result has been that the annual cost of servicing the debts is taking a major and increasing amount of money from the General Fund i.e., the money designed to fund government's operations.

Thus, the state's financial difficulties affect its ability to fund public education in general and public higher education in particular. The funding of higher education is at a disadvantage because it has a much delayed impact compared with that of most other services. For example, funds for health and personal security services will have an immediate life or death effect on the population, whereas UC's teaching and research effects will only be felt many years in the future. Moreover, the disadvantages of higher education in receiving state funding will further increase in the future. As California's population ages and loses interest in the future benefits of higher education, its willingness to pay taxes in support of UC is likely to decline.

The resulting financial challenges not only have an immediate negative effect on today's teaching and research. They will also affect the university's future. It will have great difficulty in hiring and retaining quality faculty as it competes with better-funded competitors, such as the many well-funded private institutions.

B. Organizational Structure

For quite sometime, few organizational changes have been made by universities including UC, while significant changes have taken place in the outside world. One example is the cyberspace information-communication revolution which tends to eliminate physical distance. A consequence for universities that faculty will be spending less time in campus offices and thereby spend less time commuting. For students, who are increasingly competent computer users, it means that they, too, will spend less time on campus. For university libraries, hard copies of books and scholarly journals can be replaced with electronic versions so that less money and fewer new library buildings are necessary. Another consequence is the almost universal need for the young generation to gain an education, a change with implies a far-reaching societal adjustment. Constituents expect the University of California to adjust its teaching and research to the new possibilities and they want to benefit personally from them.

In view of these developments, the old organizational structure of UC must be adapted. Two organizational features deserve special review. Undergraduate university programs can benefit from enhanced vertical integration as will be explained below. However, the fact that several countries have shortened the time needed to obtain a bachelors degree is important to note.

Campus specialization is another reform that needs to be implemented. Disciplinary comprehensiveness on each UC campus is costly and given the new forms of communication is increasingly unnecessary. UC became a multi-campus system by expanding from UC-Berkeley but insisting that each new campus emulate the original Berkeley model. But that approach, based in the climate of the 1960s, is no longer appropriate.

Three Proposed Initiatives

A. Financing and the Michigan Model

The University of California as a public university at one time relied heavily upon the state for financing. Circumstances have changed and the state's financial support has become increasingly unstable and inadequate interfering with the ability of UC to fulfill its mission. State support has declined from more than 60 percent of the UC's budget in the era of the 1960s Master Plan to about one sixth in recent years.[4] Since it can no longer depend upon adequate state support and since student fees are low compared to private universities, other sources, e.g., private giving, government and private sector research grants, and sale of services, have made up part of the shortfall. Increases in-state standard student fees to a large extent have been controlled by political considerations.

Under these circumstances a new funding system is needed to assure excellence, even if it moves the University of California from being a full-fledged public university to what former University of Michigan President James J, Duderstadt calls a "privately supported but publicly committed institution" which strives to assure access to every qualified student.[5] The initiative proposed in this chapter is built on the "Michigan Model" which was in large part developed by Duderstadt.[6] It freed the University of Michigan to determine student and tuition for in-state and out-of-state undergraduate students.

In-state undergraduates benefit from a high-fee/high-financial-aid policy. They are guaranteed that the university will meet their full financial need through a combination of grants and loans and work-study assistance. The high sticker price allows redistribution of revenues using needs-based pricing. Out-of-state undergraduate's tuition and fee levels are set at market rates, i.e., approximately comparable with private institutions. For graduate programs, in-state and out-of-state tuition and fees are set about equal to rates of competitive, mainly private, institutions.

One way to appraise the academic effect of the Michigan Model of financial is to consider the health of the University of Michigan. There can be no doubt that the economy of Michigan has suffered more in recent years than that of California due to the problems of the auto industry. Yet there are many indications that the University of Michigan's academic program has been more insulated from state economic conditions than has occurred at UC. But there are aspects of the Michigan Model that could be improved.

Under the present Michigan Model, all in-state students – rich or poor – are subsidized to some extent – a situation costly and unfair. In order to introduce increased fairness into the Michigan Model, the subsidy of tuition should become more progressive, i.e., more closely related to the student's family income and ability to pay. In short, the move would be to an almost purely income-determined model. Specifically, neither tuition nor fees would be paid by

in-state undergraduates with a relatively low family income, perhaps set as a fraction of the state's average family income. If their family income were higher, the payments would increase appropriately. For example, in-state students with a family income above a specified high level would pay tuition equal to the private market minus the per-student state appropriation. Out-of-state undergraduates would pay full cost or rates of comparable private universities. Thus, attracting out-of-state (possibly foreign) students would be financially rewarding and would help to finance the university grant/redistribution program.

UC should incur no legal obstacles in adopting the proposed initiative, since it, similar to the University of Michigan, has constitutional autonomy. A special UC Committee on University Constitutional Autonomy concluded that, based on various court rulings and an opinion by California's Legal Counsel, that unreasonable impairment by the State of the Regents' powers with respect to 'University affairs' is invalid, depending on" (a) the centrality of the subject matter to the functioning of the University as a university i.e., whether the subject matter falls within the scope of 'University affairs'; (b) the degree of impairment of the Regents' 'full' powers of governance; and (c) the public interest advanced by the legislative or executive action."

While the courts have never ruled on whether fee setting by Regents along Michigan Model lines is allowed, they very likely have that power since UC must have the necessary funds to carry out its academic mission. In fact, the Regents have set fees for a long time, albeit it under political constraints, since "full" powers of governance have been assumed to include authority to raise fees. While the necessary condition appears to be met, effective political accommodation is a sufficient condition. There would need in practice to b e an understanding between the Regents, the governor, and the legislature before a Michigan Model approach could be implemented. In particular, UC would have to demonstrate how the Model would deal with political concerns about access and about support for qualified but needy students.

Finally, since unforeseen financial circumstances can never be ruled out, it would be wise for UC to have a sufficient "rainy-day fund" or reserve and make sure to replenish it in good years. If UC is to be autonomous in rating setting, it needs sufficient reserves to guarantee that already-enrolled students can avoid sudden hikes in tuition in the midst of their academic careers.

B. Effectiveness and Efficiency

Two initiatives to improve the university's organizational structures for the purpose of raising its effectiveness and efficiency will be discussed below. One involves expanding vertical integration of key parts of the education system. It draws on a central aspect of the path-breaking 1960 California Master Plan which has greatly facilitated the transfer of community college students who have completed two years successfully into a UC campus' upper division baccalaureate program.[7] If such integration can occur with community colleges, it could also be extended to the K-12 system.

Vertical Integration: The Three Year Undergraduate Program

Under the proposed initiative, the 12th grade of high school would be integrated with first year of university undergraduate education. The latter would be reduced to three years to follow 12th grade of high school which would be significantly improved with the help of university faculty. This arrangement of moving well-prepared 12th grade students directly into the university's three-year baccalaureate program could result in a number of benefits.

1) Nine of the ten campuses of the university could devote more faculty time to teaching of pretty prepared undergraduates. (UC-San Francisco is a graduate medical school and thus would not be included.)

2) The shortened undergraduate program requiring undergraduate teaching could free funds to support graduate programs, the key mission of a research university.

3) Learning could improve, as 12th grade boredom – commonly acknowledged – is replaced by a more challenging curriculum. High school students could also avail themselves of Advanced Placement and Honor Classes and take advantage of summer school and university extension opportunities.

4) Students could reap gains due to a reduction time in the undergraduate program from four to three years. They would be able to save a year's living expenses, to gain a year's income due to entering the labor market one year earlier, and to save a year's worth of university fees.

5) In terms of the mission of a research university reducing a four year undergraduate program by a year would enable UC to focus more on graduate education and research, the intent of the original Master Plan.

Of course, there could be a downside to a vertical integration which reduces undergraduate education from four to three years. A more compressed and intensive learning environment can impose intangible costs for students from families with a limited academic background and learning tradition. Moreover, a three-year undergraduate program would sacrifice some of today's college experience. However, it is important to realize that the United Kingdom, Australia, Canada and other commonwealth countries, among others, have had three-year baccalaureate programs for some time.[8]

The above initiative would require significant cooperation and leadership from various government and university officials and those of the K-12 system. They include elected officials, U.C. Regents, president, chancellors, and faculty leaders as well as school board members and superintendents. All would have to play a major role in both the program origination and the allocation of funds. As an experiment, a pilot program could be established with a few schools and then expanded.

C. Reduction in Comprehensiveness and Duplication – Increased Specialization

The University of California, as it has moved from being one campus to ten campuses has supported disciplinary comprehensiveness and duplication on its campuses. Former UC

President Clark Kerr, a key author of the Master Plan, believed that new campuses deserved support for an immediate rapid development. However, this generosity and the relative affluence of the university during the era of rapid growth in the 1960s led to substantial horizontal disciplinary comprehensiveness and duplication. That policy is too costly for the current era, particularly in the face of modern communications advances.

Given interdisciplinary cooperation, selective specialization has merit. Specialization can benefit from opportunities created by the cyberspace information-communication revolution in reducing the importance of the location where teaching and research take place. Nine of the ten campuses (UC-San Francisco is the exception), stimulated by UC-Berkeley's disciplinary comprehensiveness and universally-recognized excellence, have sought to emulate its comprehensive approach. However, the present expansive duplication academic offerings by so many of the campuses can lead to reduced quality at all of them.

While most UC campuses now exhibit extensive horizontal disciplinary comprehensiveness, each could benefit from specializing in a select number of academic clusters in which they can build and maintain excellence and pursue emerging areas of inquiry. Each cluster might be composed of a number of disciplines and programs which have much in common, which complement one another, and which have rational internal synergy. The following are examples of potential clusters:

- Physical Sciences Cluster: Chemistry, mathematics, physics and engineering;
- Biological or life Sciences Cluster: evolutionary biology, genetics, microbiology, molecular biology, organic biology, and medicine;
- Social Science Cluster: anthropology, economics, political science, psychology, sociology and management and law;
- Humanities and arts: history, languages, literature, philosophy and arts.[9]

Further, if the campuses were to be divided into two groups – north and south – collaboration within each group could raise the total strength of UC significantly in the future. This arrangement could produce economies of specialization and scale, in part resulting from increases in the size of presently small classes (higher student/faculty ratios). Moreover, clustering could benefit research by faculty and graduate students as a campus gains great distinction in select disciplinary areas. Much can be learned from the experience of such outstanding, highly-specialized institutions as Caltech, MIT, and Rockefeller University.

A policy of carefully selected disciplinary specialization and of clusters will be easier to implement in new institutions than in established ones. It would require strong leadership coming from the Board of Regents, administrators, and academic leaders. The initiative can be undertaken by the university by itself, given its constitutional autonomy. But as with other major reforms, acceptance by key political figures would be essential in practice.

Summary and Conclusion

Public research universities, and especially the University of California, face a difficult future with many challenges. State funds are now, and will be, scarce and unreliable.

California's budget for 2008-09 was passed more than 3½ month late and remained in deficit. Increased reliance on borrowing is leading to higher levels of debt service. At the same times, political pressure for the admission of ever more undergraduate students is increasing. In order for the University of California to maintain its excellence, new initiatives, even if painful and controversial, must be taken.

Undoubtedly, there are many initiatives that could be undertaken to improve UC. In this chapter, however, the focus has been on the key issues of finance and adaptation to new technology. Proposed for UC is the Michigan Model, vertical integration with K-12, and campus specialization. None will be easy to implement, given the political realities of California and the internal politics of UC itself. It is to be hoped, however, that sufficient leadership can be found to make the essential changes.

Endnotes

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[1] Werner Z. Hirsch and Luc E. Weber, "The Glion Declaration: The University at the Millennium", *The Presidency*, Fall, 1998.

[2] Proposition 13, enacted in 1978, rolled back initial property tax assessments to their 1975 levels or the sales price, whichever came later, and restricted increases in assessments to 2% per year for as long as the property is retained by the same owner. Property taxes exceeding 1% of the property's full value were prohibited; increases in state taxes were permitted only if approved by a two thirds majority of both houses of the state legislature; and local taxes had to be approved by a two thirds majority of a jurisdiction's voters.

[3] Legislative Analyst, An Overview of state Bond Debt, Sacramento, July 2008.

[4] September 8, 2008 Communication to author of UCLA Vice Chancellor Steven A. Olsen.

[5] May 27, 2008 Communication to author of President James J. Duderstadt.

[6] Master Plan for Higher Education in California, California State Department of Education, Sacramento, 1980.

[7] University Education – Making it Pay, *Economist*, September 20, 2008.

[8] May 5, 2006 Communication to author of UCLA Executive Vice Chancellor Daniel Neuman.

[9] This issue is discussed in a 2006 unpublished report by Werner Z. Hirsch, Daniel J. B. Mitchell and Harold M. Williams in a report to Executive Vice President of the University of California "Assuring the University of California's Lasting Preeminence in Higher Education".