

How Golden State sank into budget morass

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So how did it come to this - that powerhouse California, a nation-state of 33 million with a budget larger than most small countries, has again been brought to its knees in a life-or-death struggle for financial survival?

And just how familiar is this scenario?

Consider then-gubernatorial candidate Arnold Schwarzenegger lambasting California leadership over out-of-control finances - in 2003: "Our elected officials in Sacramento are facing a budget crisis unseen in this state since the Great Depression, and it was entirely avoidable," he railed. "Teachers are getting pink slips, cops are getting laid off and the taxpayers are facing an increase in taxes and California's future is in danger."

Six years later, under his leadership, it's *deja vu*: With the June 30 fiscal year deadline looming, the Legislature is frantically at work trying to close a \$24.3 billion budget gap in the state's main bank account.

And as the state's finances again head off the cliff, the latest California scenario "isn't 'Thelma and Louise,' " observes Hoover Institution research fellow Bill Whalen. "It's 'Groundhog Day.' "

Now Californians, like the Bill Murray character who lives the same day over and over, may be finally forced to confront the roots of the insanity.

There are several factors that contribute to the state's recurring inability to deliver an on-time, balanced budget. Among them:

-- **Partisanship:** California's gerrymandered legislative districts tend to protect incumbents and encourage more political extremes - Republicans on the right and Democrats on the left with less incentive to reach out to the political middle, much less compromise at the Capitol.

-- **Term limits:** Proposition 130, passed in 1990, limits legislators terms to six years in the Assembly and eight in the state Senate.

-- **Ballot-box budgeting:** Initiative-loving Californians mandated set-aside funding for all kinds of single-interest issues, from education to stem cell research.

-- **Prop. 13:** The 1978 landmark law slashed commercial and residential property tax rates, shifting state reliance to other more volatile sources.

-- **The two-thirds majority rule:** The Golden State is one of just three states that require a two-thirds majority vote from each legislative house to pass budgets.

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"The problem with the budget is that it's spin-the-wheel. And wherever the wheel lands, there's a problem," Whalen said. "It's not just the governor, or the Legislature" who have roles in this problem, but also the voters. "And the economy isn't helping."

California's budget has seen a structural deficit in nearly all of the years since the dot-com bubble burst, said Michael Cohen, deputy legislative analyst.

But during the '90s, when California was flush with cash, the Legislature expanded spending in many areas of the budget - including schools, Medi-Cal, Healthy Families - while also reducing taxes such as the vehicle license fee, he said.

Today, the legislative analyst is forecasting multibillion-dollar structural deficits for the next few years. Cohen said the only way to eliminate such shortfalls is for lawmakers to take the reins and either cut spending or raise ongoing revenue, not rely on one-time solutions such as borrowing or accounting gimmicks like collecting taxes earlier in the year.

"We've played these games for so long - borrowing fees and deferring the problem - that the average single-interest voter assumes (this budget) will be business as usual," said Barbara O'Connor, professor of political communication at Cal State Sacramento. "But this time, it's no longer a shell game. We will run out of cash. We need to solve this problem immediately - and move on to make sure it never happens again."

Partisanship, redistricting

Republican state Sen. Abel Maldonado of Santa Maria (Santa Barbara County), a moderate who helped Schwarzenegger and Democrats pass a two-year budget in February, said the virulent partisanship in Sacramento hasn't helped.

"We're fighting and we're losing sight of the real issues," he said in a week in which Republicans held firm against new taxes and Democrats insisted they would not accept the governor's cuts to health care and social programs. "Neither Republicans nor Democrats will put everything on the table ... but we're all in this together."

Maldonado's solution: an open primary, which he hopes will be on the 2010 ballot and would mitigate political extremes on either end of the political spectrum.

Term limits, Maldonado said, may also need to be re-examined. The current system limits legislative terms, but also creates a revolving door - newbie politicians confronting a myriad of complex issues, even as they look ahead to the next steppingstone to elected office.

Meanwhile, Maldonado said, "the third house" - lobbyists - "are well-educated. They have all the institutional knowledge."

Ballot-box budgeting

But Stanford economics Professor Roger Noll said California voters must also share the blame. They've approved dozens of ballot measures creating programs without identifying how to pay for them.

The current budget crisis is "partly political, partly institutional and partly because of decisions California has made," he said, "which is to have its greater portions of revenues come from places that are sensitive to the

economic cycles. Fundamentally, we're experiencing a cumulative effect of a whole bunch of initiatives over the past 30 years."

Such "ballot-box budgeting" has set aside funding for everything from stem cell research to mental health programs. The largest of such set-asides: Prop. 98, passed in 1988, which reserves about 40 percent of the state's general fund for K-12 schools and community colleges.

One solution, Noll suggests: The state could require any bills or ballot measures to identify a funding source - including bond measures.

Proposition 13

And increasingly, some critics mention Prop. 13, the landmark measure passed by voters in 1978 that put a cap on property taxes - and reduced them by an average 57 percent - as meriting another look.

Reason: Due to the measure, "the state now relies heavily on income tax and, secondarily, on sales tax" for its revenue stream, and those are "highly cyclically sensitive," Noll said.

State Senate President Pro Tem Darrell Steinberg, a Democrat from Sacramento, agrees. "Until we tackle that intended or unintended consequence of Prop. 13," he said, "we won't fix the system."

But Jon Coupal, who heads the Howard Jarvis Taxpayers Association - the nation's largest taxpayer association, named after the author of Prop. 13 - said Steinberg and his fellow Democrats are "still in a state of denial."

"Not only did Prop. 13 not slow down the tax burden" on California landowners, he argued. "We're not a low-tax property tax state. We're in the middle."

He said efforts to rework the measure - a so-called "split roll" that could recalculate and possibly increase commercial rates - would be exactly the wrong message to business and job-creators in the current fiscal crisis.

Two-thirds majority rule

A better idea, according to Coupal: work on efforts to "right-size" government, and install a budgetary spending cap.

Coupal also strongly argued against a move that Democratic and progressive leaders say they support - to eliminate the two-thirds requirement to enact a new budget and new taxes.

The mandate makes California one of only a handful of states that have such a high bar for budget passage. Critics say it ensures gridlock, but Coupal said jettisoning the rule would make California's budget process even more "captive of the special interests."

"The problem is that neither side has been held to account," said John Ellwood, a professor at UC Berkeley's Goldman School of Public Policy. "Republicans are not blamed because there's only a third of them and Democrats are not blamed because they don't have a supermajority to pass taxes."

If Democrats, who hold the majority in both houses of the Legislature, "keep hiking taxes, at some point the voters will just throw them out. That's what representative government is all about," he said.

Political observers say leadership - and a long-term view - will put the state right.

"California is not ungovernable," said Sunne Wright McPeak, who heads the California Emerging Technology Fund. "The current situation should not dissuade us from what we know is the answer: that what makes California more competitive will drive more jobs.

"We do know how to get out of this mess, or at least make it a lot better: You go back to what improves our competitive position," McPeak said. "We should invest more in infrastructure, education and research. ... You look at ways to get more money, not slash and burn."

'We will come out of this'

Despite California's challenges, Steinberg said, it isn't the time to give up on the Golden State.

"I understand the microscope is on California and everybody is already writing the obituaries for California. I, frankly, am tired of it," he said. "Yes, there are problems here. Sometimes the partisanship is great.

"But by the time we get this done by June 30, this Legislature and the governor will have solved a \$60 billion problem without catastrophe," he said. "It's not right to throw in the towel on California ... we will come out of this."

And Schwarzenegger, who first warned Californians as a candidate in the 2003 recall election of impending crisis, insists he's convinced that this time, "crisis brings opportunities."

"There are things we can do at this crisis that maybe we could not do in the last five years," he told The Chronicle. "When revenues go up, it's very difficult to make change."

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