# *Options for Reforming the California State Budget Process*

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## INTRODUCTION: PERCEIVED PROBLEMS

Since 1990 California has experienced its worst sustained economic performance since the Great Depression. The poor performance of the economy has caused a series of persistent budget deficits in the state's General Fund. Poor economic performance coupled with an inability to gain the necessary votes to raise taxes and/or make permanent spending reductions led to a series of very large projected General Fund deficits—$14.3 billion in 1991-1992 (or some 34 percent of General Fund expenditures), $11.2 billion in 1992-1993 (or some 27 percent of General Fund expenditures), $8.0 billion in 1993-1994 (or some 21 percent of General Fund expenditures), and $4.9 billion (or 11.8 percent of General Fund expenditures) in 1994-1995. Most of the state's budget analysts believe that even though the economy is in recovery the state continues to roll over year-end deficit balances of up to $3 billion.

In the first year of the budget crisis the Republican governor and the Democratic-controlled legislature responded with a combination of tax increases, the rolling forward of some expenditures, and a few actual program reductions. The fact that most of the spending decreases turned out to be temporary while the tax increases led to a rapid decline in the governor's popularity prevented a further repeat of this compromise. The inability or unwillingness to devise another tax increase and spending cut package created a three-month deadlock the following year. As a result, over the next three years the governor and the legislature turned to a strategy of shifting the responsibility of providing services back to counties and cities and a series of accounting gimmicks in order to close yearly budget deficits. One effect of these actions was to undo the fiscal assistance that the state had provided starting in 1979 following the passage of Proposition 13.

A central question for this chapter is whether the provisions of the California Constitution have created or exacerbated these budgetary failures. And, if so, are there alternative constitutional provisions that would lead to an increase in the state's capacity to budget.

In his 1990 book Allen Schick bemoaned the decline in the national government's capacity to budget (Schick 1990). As evidence he cited:

C "Record deficits (that) have tripled the national debt. . . . "

C "An increasing portion of the budget (being) . . . allocated to mandatory payments. . . . "

C "A breakdown of budgetary procedure. . . . Congress rarely completes its budget on schedule. . . . "

C "Malaise has spread from legislative chambers to executive offices."

C "A general loss of budgetary potency has enfeebled all major participants."

C The basic rules of accounting for budget transactions have broken down. Without actually paring a single dollar from outlays, Congress and the president use bookkeeping tricks to show that spending or the deficit has been cut.

To a remarkable extent these complaints are mirrored by those directed against California's budget process. Specifically:

C Some believe the budgetary process has failed because the state has consistently (and continues to) run General Fund budget deficits.

C The state has allowed an increasing proportion of its General Fund expenditures (up to 88 percent by some counts) to be set by constitutional and/or statutorally mandated formulas rather than through the annual appropriations process. And, to the extent that this is true, some argue that the political process is less and less able to adjust yearly spending to meet unanticipated shocks.

C Over the past decade (including years when the state was not in recession) the legislature has frequently been unable to enact the budget on time. In 1992 it was unable to enact the budget until two months (63 days) after the beginning of the fiscal year. Some would point to this failure to meet deadlines as a failure of the budget process.

C Because of the constitutional requirements of a super majority vote to pass the budget or enact a tax increase, some believe that a minority of legislators will block what they oppose unless they are granted their personal wish list of policies. To the extent this occurs supermajorities can actually lead to increases in expenditures and the growth of inefficient expenditures and programs.

- Alternatively, even with revenue limitation, expenditure limitations, and supermajority voting requirements in place, some believe that the inherent bias of representative democracy toward ever higher levels of spending and deficits requires further constraints on elected officials.

The fact that the same complaints are directed at a national budget process that is governed by few restrictions (no expenditure, revenue, or deficit limits and simple majority voting) and at a California budget process that is highly constrained by constitutional limits and supermajority voting requirements should restrain those who quickly want to modify the state's budgetary system.

## MAJOR CONSTITUTIONAL PROVISIONS AND THEIR EFFECTS ON THE STATE'S BUDGET PROCESSES AND POLICY OUTCOMES

As with many states, California's Constitution reads more like a series of statutes than a document that establishes fundamental jurisdictions and procedures. Many of its provisions limit the discretion of elected officials in small as well as large ways. Thus, retirement benefits for elected and constitutional officers are set out; a minimum public school teacher salary ($2,400/year) is mandated; property tax exemptions are stipulated for such uses as cemeteries, the growing of crops and timber; etc. New restrictions are constantly being added through amendment. Since 1884 California's Constitution has been amended 480 times—placing the state second only to Alabama, which has amended its constitution 538 times (Rosenberg, 1993).

### Summary of the California Budget Process

As summarized by Kevin Rosenberg:

> California is one of seven states whose budgetary process is constitutionally mandated (along with Georgia, Maryland, Massachusetts, Missouri, New York and West Virginia). The entire process, which ideally should last eighteen months, begins when the various agencies within the executive branch develop budgetary figures. (Constitutionally) by January 10th of each year the governor must submit an itemized budget proposal to the legislature for the following fiscal year. . . .

Once the bill has been introduced, (by statute) the Legislative Analyst's Office (LAO) prepares comprehensive evaluations of and recommendations on the governor's budget proposal. During mid-May, again by statute, the governor usually submits an updated version of the budget proposal to the legislature which reflects revisions in budgetary figures. The budget bill should arrive on the floor of the legislature for a vote by the end of May.[1]

The California Constitution requires that the budget bill be passed no later than June 15 by a two thirds vote of each chamber. . . . When both houses pass the bill, it is then presented to the governor for signature. Once the governor signs the bill, it becomes law. Rather than sign the bill, the governor may veto the entire bill or exercise (his Constitutionally provided) line item veto power to reduce or strike individual items of the bill.[2] The legislature may, in turn, override the governor's veto by a two-thirds vote.

## Specific Constitutional Provisions

### *Periodicity*

California is one of 31 states that operates on an annual budget cycle. The remaining 19 states operate on a biennial cycle. Although it has been traditionally held that annual budget cycles cause higher levels of expenditures, recent work by Paula Kearns indicates that "biennial states spend more, *ceteris paribus*, than annual budget states spend" (Kearns 1994).

### *Deficit Prohibition*

Every state but Vermont and Wyoming has a constitutional or statutory provision prohibiting or limiting budget deficits (in most cases deficits in the General Fund). Such prohibitions are of two kinds: some states prohibit deficits between projected revenues and expenditures—that is, they require

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[1]After receiving the governor's budget each chamber in effect prepares its own budget. If a conference committee cannot reconcile the differences an informal process occurs during which the governor and the majority and minority leaders of the assembly and senate meet to put together a compromise. During this period there are, in effect, four budgets before the legislature.

[2]The governor has the ability to veto an "item of appropriation."

that the budget that is submitted by the governor, and in some cases passed by the legislature, not be in deficit—while other states require that expenditures not exceed revenues at the end of the fiscal year. California falls in the first category—the constitution requires that the governor submit a budget by January 10th in which estimated appropriated expenditures do not exceed estimated revenues.[3] Of the 47 states that have such provisions, 32 are contained in the state constitution. It should be noted, however, that California is one of only nine states where the legislature does not have to pass and the governor does not have to sign a budget where estimated expenditures are at least equal to estimated revenues. Moreover, California is one of only 14 states that allow actual deficits to be carried over to the next fiscal year. (In the other 36 states actual expenditures—in the General Fund—cannot exceed actual revenues at the end of the fiscal year.) Thus, among the states, next to Vermont and Wyoming which have no constitutional or statutory provisions prohibiting budget deficits, California has the least restrictive of deficit prohibitions.[4]

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[3]The California Constitution prohibits borrowing for the General Fund in excess of $300,000. The California courts, however, have allowed the state to incur short-term debt to meet General Fund immediate cash flow needs by borrowing against anticipated tax revenues. During periods of multi-year recessions (especially the 1930s and the 1990s)—the state has in effect rolled over its short-term debt (Reforming California's Budget Process 1995).

[4]The exact classifications of budget provisions are open to interpretation. Thus, while we have adopted the Advisory Commission on Intergovernmental Relations (ACIR) classification of California's provisions, in their recent paper on the effects of institutions on the interest rate price set by markets on state debt, Robert C. Lowry and James E. Alt place California among those states that require the budget to be balanced at the end of the fiscal year (see Lowry and Alt 1995).

*Line-Item Veto and Ability to Reduce Expenditures Without Legislative Approval*

California is one of 41 states where the governor is granted the line-item veto. This veto allows the governor to reduce as well as veto appropriations—but both actions can be overturned by a two-thirds vote in both chambers. But California is one of a minority of 11 states where the governor is not granted power to make expenditure reductions without the approval of the legislature.

*Two-Thirds Vote Requirements*

The California Constitution requires a two-thirds vote of each chamber for the following types of votes (Rosenberg 1993):

- Approval of General Fund appropriations bills, including the state budget, except for those funding schools.
- Changes in state taxes enacted to increase revenue.
- Overriding the governor's veto of a bill or a budget item (the line-item veto).
- Enactment of an urgency statute—defined as a stature whose fiscal effects will take effect immediately.
- Legislation that submits a constitutional amendment or state obligation bond act to the voters.
- Suspension for one year the constitutionally required minimum funding for school and community college districts (Proposition 98).

California is one of only five states—Arkansas, California, Illinois, Nevada, and South Dakota—that require a supermajority to pass budget bills.[5] (*The Book of the States 1994-95*, followed up by telephone survey.) In addition, California is one of only seven states—Arkansas, California, Delaware, Louisiana, Missouri, Oklahoma, and South Dakota—that require a supermajority to raise revenues. (*The Book of the States 1994-95*, followed up by telephone survey.)

*Revenue and Expenditure Limits*

[5]In Illinois a supermajority is needed to pass the budget if it has not been enacted by May 30.

*Revenue Limits*: Proposition 13, enacted in 1978, amended the California Constitution to place a limit on the property tax of one percent of the full cash value of the property. Once the property is owned, moreover, its full cash value cannot increase by more than two percent in any year.

*Expenditure Limitation*: Proposition 4 amended the California Constitution to limit the growth of state and local appropriations to the growth of personal income and the change in the population. California is one of 24 states that have such limitations. In 11 of these states—Alaska, Arizona, California, Hawaii, Louisiana, Michigan, Missouri, Oklahoma, South Carolina, Tennessee, and Texas—the limitation is contained in the state's constitution.

### *Mandated Spending*

In a budgetary world without mandated (or uncontrollable) spending, decision makers are able to respond to unanticipated shocks or changes in public opinion by reducing any program's expenditures for the current or upcoming fiscal year. In practice, however, institutions, processes, and provisions have been established that limit the discretion of policymakers to reduce various programs' expenditures. In short, some mandates are more restrictive than others and to some extent one can rank the order of mandated spending by the degree of difficulty of changing the level of expenditures in the short-run.

*Constitutional Mandates*: As with many states California mandates spending for various programs through its constitution. California is unique among the states, however, because its constitution mandates a minimum level of funding for the General Fund's biggest program—state aid for elementary and secondary (and community college) education. In 1988 California voters passed Proposition 98, which amended the constitution to guarantee minimum funding for K-14 education (elementary and secondary education and community colleges).[6]

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[6]As amended by Proposition 111, K-14 education is guaranteed the greater of three tests: (1) the percentage of 1986-1987 General Fund revenues that went to K-14 education—about 40 percent); (2) the prior-year level of total funding for K-14 education from state and local sources, adjusted for growth in enrollments and per capita income; or (3) the prior-year total level of funding for K-14 education from state and local sources, adjusted for enrollment growth and for growth in

Other provisions of the constitution as interpreted by the courts have had the effect of limiting the budgetary discretion of elected officials. For example, in *Committee to Defend Reproductive Rights v. Myers* (99 Cal 3rd 252, 20 ALR4th 1118) the State Supreme Court in 1981 held that the California Constitution's privacy and equal protection guarantees prohibited the legislature from barring Medi-Cal funding of abortions. In so doing it declared budgetary actions of the California Budget Acts of 1978, 1979, and 1980 unconstitutional.

In 1994 the voters used the initiative process (Proposition 184) to make sure that the legislature could not modify or revoke the "three-strikes-and-you're-out" sentencing requirements. One effect of this action is to eliminate judicial discretion in a large number of criminal cases. The degree to which this requirement will limit control over the budget will to a great extent depend on the degree to which the appellate courts will limit the ability of trial judges to add discretion to sentencing and the legislature's ability to determine prison conditions.

As will be pointed out below, the California initiative process allows initiatives enacted under a simple majority rule to contain provisions requiring supermajorities for their repeal. Such is the case with the provisions of Proposition 13. The initiative process, in effect, allows voters to significantly limit the discretion of future legislatures.

*State Legislative Mandates*: The legislature has passed statutes that require spending on many programs, such as Renters' Tax Relief and Youth and Adult Corrections. To set these statutes aside (in order to control spending levels in the short-run) the legislature must enact new (nonbudgetary) legislation. However, for some of these programs incremental funding changes might be possible in the short-run. For example, although existing legislation requires that Youth and Adult Correction Facilities be available for offenders, it does not specify how much must be spent for prison guards, beds, food, and other cost components of these facilities. As indicated above, however, the courts (especially the federal

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General Fund revenues per capita, plus one-half percent of the prior-year level. These tests can be suspended for one year through an urgency bill (which requires a supermajority for passage in each house) other than the budget bill. The procedure also contains an elaborate formula for a mandatory restoration of K-14 funding to the level it would have attained if the suspension had not occurred (LA0 1992 and Shires, Krop, Rydell, and Carroll 1995).

courts) have acted in the past to require certain levels of spending for the construction and operations of prisons.

*Federal Legislative Mandates:* Many policymakers and researchers categorize the state match of a federal program as mandated spending. The two largest programs in this category are the state share of the Medicaid program (called Medi-Cal in California) and the state share of the Aid to Families With Dependent Children (AFDC) program. In the case of the Medicaid program a state can decide whether to participate in the program (for many years Arizona chose not to participate) and can select from a menu of over 30 services that it will fund. The dropping of a service, however, again requires action outside the annual budget process. In the case of AFDC each state is required to establish a minimal standard of living criterion. Once established, a state cannot pay less than 80 percent of the standard unless it receives a waiver from the federal government. This procedure has the effect of locking in the actions of a more "liberal" legislature.

*Contracts*: The state has little choice (other than default) but to fulfill its many contracts. The most obvious category is the short-term borrowing that is routinely undertaken to balance the General Fund. But the state also is limited in its ability to reduce expenditures for multi-year contracts. A category that few classify as mandated spending are expenditures to fulfill multi-year contracts in nonmandated programs. Often programs that most would classify as nonmandated, such as the Forestry and Parks programs, involve significant yearly expenditures from this type of contracts.

As the above discussion indicates, there is a wide range of opinion as to whether expenditures for various programs are controllable in the short-run. Some analysts have indicated that up to 88 percent of the General Fund's expenditures were mandated to some degree (California Citizens Budget Commission, 1995). To get to this figure one must include corrections expenditures under the mandated rubric (a classification that is more defensible today than at the time). It should be noted, however, that the concept of mandated or uncontrollable spending is attenuated as one adopts a multi-year budgetary perspective. What remains, however, is the fact that some types of spending reductions require larger coalitions and perhaps the agreement of the courts or the federal government than do others. Therefore, the concept of mandated spending becomes another case in which program advocates have been able to insulate their programs from unanticipated shocks—be they economic or political. What makes

California unique is not the existence of such barriers but—because of Proposition 98—the extent of their budgetary impact.

*The Initiative*

Although beyond the scope of this chapter, it is clear that the existence of the initiative has had a dramatic effect on all aspects of the policymaking process in California. Many of the limitations discussed above were put in place by the initiative process. As such, these initiatives clearly reflect the voters' distrust of the legislature and are an attempt to limit the freedom of the legislature on budgetary matters. It should be noted that the initiative process allows voters to appropriate expenditures for programs by a simple majority while the California Constitution requires a supermajority for enacting the budget bill. In addition, the constitution requires that legislatively enacted appropriations must be passed by a two-thirds supermajority while appropriations enacted through an initiative require a simple majority. Also, all appropriations enacted by the legislature are subject to the governor's line-item veto, where the governor can add to or subtract from the legislature's actions. This is not the case for appropriations enacted through the initiative process (Dubois and Feeney 1992). Consequently, some have felt that the initiative process is biased toward higher levels of state spending. It is also the case that while the enacted budget bill for the General Fund must be in balance, the initiative process allows voters to mandate additional spending without specifying the additional revenues (or compensating spending reductions in other programs) needed to maintain the General Fund balance. Moreover, the inability (under the constitution's initiative provisions) of the legislature to amend the provisions of initiatives has the effect of creating a mandated spending program.

*A Capital Budget and Special Funds*

California is one of eight states that do not have a formal capital budget. Capital expenditures are either approved through individual bond issues or through appropriations (Hush and Peroff 1988).

The various deficit prohibitions of the constitution only apply to the state's General Fund. In the 1995-96 state budget of a total of state expenditures of $56.3 billion, the General Fund accounted for 74 percent, various special funds accounted for 25 percent, and various bond funds accounted for the remaining one percent. Recently an increasing proportion of state expenditures are coming from various special funds. In 1983-84 special funds accounted for about 13 percent of total state expenditures; by 1994-95 this figure rose to 28 percent. In recent years the shift of programs that previously were funded by the General Fund to the counties has been carried out by shifting state tax revenues to a special fund (LAO 1994). Some have argued that faced with limitations on the General Fund the legislature has turned to special fund financing.

*Information Asymmetries*

Proposition 140, which applied term limits to the state legislature, also contained a constitutional requirement that the legislature reduce its budget by 30 percent. The legislature chose to make the required cuts by reducing its staff. Moreover, it chose to make bigger staff reductions in its analytic than its political staff. To the extent that one believes that information asymmetries matter, the proposition can be argued to have increased the power of the executive branch *vis-à-vis* the legislative branch—particularly in technical policy areas such as budgeting.

**Research on the Effects of Constitutional Provisions**

The general findings of a wide variety of academic studies of statutory and constitutional restrictions to limit the growth of state expenditures, revenues, and debt are that these institutional and procedural restraints are not very effective in achieving their goals.

*Taxation and Expenditure Limitations*

- Dale Bails, employing a variety of statistical methods, found that the presence of a tax and/or expenditure limitation had virtually no impact on the growth of statewide expenditures or revenues. In addition, while aggregate state expenditures and revenues exhibited some decline during the tax revolt years, this decline was short-lived and has since been reversed (Bails 1990).
- In an earlier article Bails presented evidence that tax expenditure limitations (as designed in the late 1970s) were relatively ineffective in restraining public-sector growth. He pointed to three factors: First, his historical simulations indicated that neither inflation adjusting limitations nor personal income based tax limitations would have signifi-

cantly lowered tax burdens in overwhelming number of states. Second, the evidence documented the tendency for these legal maximums to become legal minimums. Finally, the inclusion of emergency escape clauses gave political decision makers a device whereby the limitation could be exceeded with relative ease (Bails 1982).

*Deficit Prohibitions and Expenditure Levels*

Relying on regression models, Burton Adams and William Dougan found that various constitutional limitations (balanced-budget requirements or constitutional limits on government spending or taxes) did not exert a significant independent effect on aggregate budget decisions. States with these provisions appeared to spend at the same levels as those without the provisions (Adams and Dougan 1986).

*Constitutional Prohibitions and Debt Financing*

James Clingermayer and B. Dan Wood, employing a pooled time-series analysis of state-level data, have found that constitutional or statutory tax, expenditure, and debt limitations "do not significantly alter growth in debt for state governments. Tax and expenditure limitations may actually increase growth in state debt, as self-interested politicians evade formal constraints through alternative means of financing. Likewise, debt limitation institutions have no effect in reducing the growth in state debt" (Clingermeyer and Wood 1995).

Three recent analyses do find that institutional arrangements matter, however.

C James Alt and Robert Lowry find that, when it comes to state fiscal outcomes, divided government matters, institutions matter, and party control matters. They show that faced with an unanticipated deficit or the inheritance of a deficit, "unified party governments not subject to deficit carryover laws might allow it to grow (if they remained in office) while those subject to such laws eliminate deficits more quickly" (Alt and Lowry 1994).

C In a more recent paper Lowry and Alt find that states that require a balance in the general or operating funds at the end of the fiscal year (that is, states that do not permit the carryover of unanticipated deficits) are charged a lower debt service cost by financial markets, even when economic circumstances compel them to run a deficit, than states that allow unanticipated deficits to be carried over. They posit that strict deficit prohibitions at the end of the fiscal year are effective, "because the operation of bond markets gives politicians an incentive to maintain orderly fiscal policies, namely, lower operating costs of government (and thus more funds to spend on other things) in those cases where unforeseen economic circumstances compel running a deficit in the short term." In short, they posit that such end-of-year deficit prohibitions send a signal to markets that all politicians (whether they are committed to eliminating deficits or not) will more likely act to eliminate unanticipated deficits than would be the case if such prohibitions were not in place (Lowry and Alt 1995).

C James Poterba, using a different data set than Alt and Lowry, also determines that where stronger deficit prohibitions exist governments adjust more quickly to unanticipated deficit shocks. As with Alt and Lowry, Poterba also finds that unified governments adjust more quickly to unanticipated deficit shocks than do divided governments. In addition he finds that unified governments make most of their adjustments with tax changes (rather than spending cuts) (Poterba 1994).

From the above discussion it is clear that the requirement that expenditures not exceed actual revenues at the end of the fiscal year is more likely to limit debt financing than the California requirement that estimated expenditures not exceed estimated revenues.

### *Annual Versus Biennial Budgeting and Expenditure Growth*

As previously indicated, although it has been traditionally held that annual budget cycles will cause higher levels of expenditures, recent work by Paula Kearns indicates that "biennial states spend more, *ceteris paribus*, than annual budget states spend" (Kearns 1994).

### *Supermajority Vote Requirements*

Not much is known empirically about the effects of supermajorities. It stands to reason that such requirements are harder to achieve than simple majorities. It follows that the existence of a supermajority will make passage of budgetary legislation more difficult. At the same time, it is possible that while supermajorities lower the level of activity, they can also increase the inefficiency of how public goods or services are provided (or how revenues are collected). This result could occur if the marginal voter's power under a supermajority rule has increased (over what it would be under a simple majority rule) to such an extent that she can and will demand more inefficient side-payments for her support.

## NORMS OF A "GOOD" BUDGET PROCESS

Whether and/or how one would change California's budget process should be driven by one's notion of the norms of an ideal budget process. Or at least, one's recommendations for change should be driven by one's explicit beliefs as to what is wrong with the current budget process.

### The Norms of Classical Public Administration

The classical public administration treatment of the budget was first set out by Leon Say in 1885. Say identified four essential qualities of an ideal budget:

1. The budget must have unity.
2. The budget must be annual.
3. The budget must be made in advance.
4. The budget must represent an accounting personality (quoted in Sundelson 1935).

From the work of J. Wilner Sundelson it is evident that by the 1930s students of public administration had expanded the list as follows:

I. As to the relation between the budgetary system and the fiscal activities of the political unit:
   - (1) *Comprehensiveness*, or all government expenditures and revenues must be subject to the budgetary mechanism and must enter into the recognized budgetary procedure.
   - (2) *Exclusiveness*, or all nonfiscal material should be excluded from the budget. This is a prohibition of adding general legislation—or riders—to the budget.

II. As to treatment by the budgetary mechanism of the factors included in the system:
   - (1) *Unity*, or a prohibition of various devices to divide and separate some of the material in the system from the regular or ordinary budget.

(2) *Specification*. It has two subcategories: qualitative specification and quantitative specification. In the case of qualitative specification appropriations are to be expended solely for the purposes specified in the budget. In the case of quantitative specification expenditures are allowed only when, and to the extent that, funds are provided in the budget.

(3) *Annuality*, or the notion that every system should have a specified accounting period (not necessarily a year) and the system should adhere to that accounting period.

(4) *Accuracy*, or the idea that the estimates in the budget should be as accurate (and without bias—particularly intentional bias as in the case of accounting tricks) as possible.

III. As to forms and techniques for presentation of the budget contents:

(1) *Clarity*, or the notion that no budget system can fulfill any of its functions unless it provides for an understandable presentation and leaves room for no doubt or choice in the minds of those who read or are guided by the budget.

(2) *Publicity*, or the ability of the public to understand and use the budget to hold their representative accountable for fiscal decisions (adapted from Sundelson 1935).

**Modern Norms of Budgeting**

Many of these budgetary principles or axioms still resonate. The norms of comprehensiveness and unity are mirrored in the desire of economists and policy analysts to be able to compare the marginal dollar for activity X to the marginal dollar for activity Y. The norms of comprehensiveness, unity, and accuracy are still alive with those who worry about end-runs, accounting tricks, and other devices that are used to circumvent institutional rules and limitations. The norm of annuality resonates with those who worry about a budget system not meeting its deadlines. The norms of clarity and publicity are alive and well with those who worry about the failure of the political system to use the budget process as a tool of political accountability.

What is missing from this classical presentation is a notion that a "good" budget process should produce a certain policy outcome. That it should result in no or less deficit financing. That it should result in the limitation of government growth. That it should benefit (or create an incentive for) some types of expenditures and/or revenues as against other types. Listening to the complaints about the failures of the California budget process, one can see both the classical and the policy determinant strains.

## WHAT IS WRONG WITH THE CONSTITUTIONAL ASPECTS OF CALIFORNIA'S BUDGET PROCESS AND OPTIONS FOR FIXING THEM

### Alternative 1: Nothing is Fundamentally Wrong With the Procedures of the California System

Many commentators believe that the various constitutional restrictions on the California budget process that have been described in this chapter explain why the budget process has failed. Before we turn to the specific failures and possible changes to eliminate them, however, we should consider the possibility that the supposed failures of the process have more to do with the poor performance of the California economy and with the particular partisan divisions of the state than with the specific provisions and political institutions set out in the California Constitution.

As evidence for this hypothesis one could point to the fact that the national budget process—which is not limited by the initiative process, supermajority voting requirements, debt limitations, etc.—seems to be suffering from exactly the same failures as the California process (Schick 1990). The notion that partisan divisions (and the attitude structure of the electorate) have more to do with budgetary outcomes than do various procedural institutions is supported by an examination of the pattern of California state and local expenditures over the past three decades. Before the enactment of Proposition 13 in 1978 California state and local revenues (and expenditures), either on a per capita or per $1,000 of personal income basis, clearly exceeded the national average by up to 30 percent. After the implementation of Proposition 13 California became an average state on these measures—where it has remained to this day. But the pattern of California's capital expenditures gives one pause. Before the Reagan governorship—which occurred before the enactment of Proposition 13—California state and local capital expenditures were also clearly greater than the national average. These expenditures dropped to the national average in 1970—almost a decade before the enactment of Proposition 13—and have remained below the national average since that time. So, it could be that a change in the electorate's preferences led to a policy change and the imposition of Proposition 13's limitations.

One could also take the position that bright politicians and their bright staffs are smart enough to figure a way around the limitations that other bright politicians and their bright staffs have put in place. The academic studies that have found little evidence that revenue, expenditure, and debt limitations have made a difference support this notion.

**Alternative 2: The Classical (Norms) Solution—An Unbiased and Transparent Process**

This alternative would be chosen by those who believe in the classical norms of budgeting and (perhaps) by their economist allies. It calls for an unbiased and transparent process. It is based on the notion that elected officials are best held accountable through information. As such, if one followed this strategy one would eliminate all provisions that give a comparative advantage to one type of expenditure or revenue over another or limit the activity of elected officials. Specifically, following this strategy one would:

- Ideally, eliminate all supermajorities. Or, alternatively, apply such provisions to all legislation (including the so-called trailer bills that are enacted after the passage of the budget bill to make the necessary modifications in authorizations that are required to achieve the dollar levels of the budget bill.)
- Eliminate revenue, expenditure, and debt limitation provisions.
- Eliminate limitations that have the effect of giving a comparative advantage of one type of expenditure over another. Specifically eliminate the special protection of K-14 funding offered by Proposition 98, as amended.
- Modify the initiative, so that it cannot be used (a) to create mandated spending and/or (b) to appropriate expenditures through a simple majority while other expenditures face supermajority and deficit prohibition rules and procedures.
- Eliminate the Proposition 140 restrictions on the appropriations of the legislature that have had the effect of reducing the number and perhaps quality of analytic staff.

Although the evidence is mixed at best, in all likelihood the implementation of these changes could lead to a larger public sector in California. In practice, therefore, if one is a conservative, one would have to trade-off the comprehensiveness, unity, accuracy, clarity, and publicity of this system for the possibility of more government.

**Alternative 3: The Present Limitations Are Not Effective Enough to Bring About the Policy Outcomes Desired by the Voters**

If one believes that representative government contains an inherent bias toward a larger public sector and more and larger deficits, one might want to mandate a policy outcome from the budget process. The academic literature offers some evidence for suggestions as to how the present restrictions and limitations that seek to affect the policy outcome can be made stronger.

Specifically:

- It appears that a requirement that actual outlays not exceed actual revenues at the end of the fiscal year is more effective in limiting debt financing than is California's relatively weak requirement that the governor submit a budget in which estimated expenditures cannot exceed estimated revenues. If one thinks that California has been running unnecessary General Fund deficits, creating an end of fiscal year deficit prohibition might make a marginal difference.
- There is a good deal of anecdotal evidence that the California state budget system has responded to the need to reduce expenditures by simply shifting these moneys to various special funds. One answer to this end-run is to place expenditure and revenue limitations on special funds as well as on the General Fund. Alternatively, one could try to create global limitations for total state spending (although this still can be avoided by shifts to the counties and cities).

We should add that we believe that the global cap strategy is futile. Moreover, it comes at the cost of a decrease in the transparency of budgetary decision making and budget documents.

Since most state and local governments do engage in long-term borrowing for large capital projects, it follows that a requirement that actual expenditures not exceed actual outlays should be accompanied with a formal capital budget process. This would allow a global cap on all activities except long-term capital, which could be funded through a sinking fund mechanism. The trick, however, would be to prevent the gradual inclusion of nonlong-term capital projects in the capital budget.

**Alternative 4: Decrease the Probability of Budgetary Conflict**

Many of the supposed failures of the California budget process result from the state's version of the Madisonian system. Compared to the average state California has a professional legislature. Its long ballot increases the probability of various executive branch officeholders coming from different political parties. One could suggest a range of strategies that would result in what appears to be a 'neater" budget process—one that is more likely, for example, to meet budgetary deadlines.

**Alternative 4A: Parliamentary Government**

A parliamentary system in which the executive rose out of a majority party in the legislature would sharply reduce conflict within the legislature and between the legislature and the executive. What would not be guaranteed is a particular outcome. Should liberals control the parliament, increased government is more likely than the present system. However, should conservatives control the parliament, a smaller government than the present system is possible.

**Alternative 4B: A One-Chamber Legislature**

One might hypothesize that moving from a two-house legislature to a one-chamber assembly could reduce the level of conflict, particularly if fewer actors are involved. Party or individual member accountability might also increase.

**Alternative 4C: A Weaker Legislature and a Stronger Executive**

Turning the California legislature into a nonprofessional citizen legislature might reduce conflict with the executive. Such a strategy would call for a dramatic reduction in legislative staff so as to dramatically increase the information asymmetry between the executive branch and the legislature. Simultaneously the governor's power could be increased by moving from the long to the short ballot.

**Alternative 4D: Eliminate Supermajority Voting**

One of the side effects of an elimination of supermajority voting is an increase in the ability of legislative leaders to form minimum winning coalitions. Again, the trade-off might be a larger public sector.

### Alternative 4E: Eliminate California State Constitutionally Mandated Spending

California is unique in the percentage of its General Fund expenditures that can reasonably be characterized as mandated or uncontrollable in the shortrun. But this unique status results almost totally from two provisions—Proposition 98's K-14 funding mandates and the recently enacted initiative that placed the three-strikes-and-you're-out sentencing requirements in the constitution.

If these two provisions were repealed, up to 60 percent of General Fund expenditures that are currently protected from short-term budgetary changes would again fall within the annual budget process. This would dramatically increase the options open to the legislature (and the governor). As such, it could have the effect of reducing the probability of legislative deadlock (under the assumption that the possibility of compromise increases as the actors have more options to trade).

### Alternative 5: Move to a Multi-Year Budget Process

If one is unwilling or unable to roll back the various provisions that mandate General Fund expenditures in the short-run one, can attenuate the negative side effects of such mandates by moving to a multi-year budget process. Budgetary changes that are impossible to carry out in the short-run can become part of a multi-year agenda. It should be noted, for example, that although up to 80 percent of federal budget outlays are relatively uncontrollable by the annual budget process, once a multi-year process is in place the only truly uncontrollable outlays are those for interest on the public debt and other contracts that have been legally entered into by the government (and even here some savings might occur through the cancellation of contracts and the payment of cancellation penalties).

It should be recognized, however, that multi-year budgeting is not a panacea. It requires the adoption of a multi-year baseline, which in turn, is highly dependent on economic and technical assumptions (Muris 1989). Some would argue that it increases the ability of elected officials to "game" the system either by adopting wildly optimistic economic assumptions or by promising to be "good" in the future while maintaining their "bad" behavior in the present.[7]

**Alternative 6: Authors' Choice—A Simple Clean Budget Process (That Will Probably Lead to a Larger Public Sector)**

No budgetary process is perfect—all are bound to have flaws since we as citizens demand contradictory outcomes. Given our bias in favor of the need for greater public investment and a belief that limitations in the end are bound to be largely avoided or, if successful, create greater distortions than they are worth, we would opt for a classical "clean" system that would include:

1. To the extent possible, everything being on the table so that the marginal dollar of X can be compared to the marginal dollar of Y.
2. The elimination of supermajorities and limitations of all sorts.
3. The simplification of California's governmental structure by modifying the initiative so that its results can be altered by the normal political process and so that it cannot be used to create mandated spending.
4. Increasing the analytic capability that supports the decision-making process.

We have to admit that such a system would probably lead to a larger public sector and would not significantly decrease budgetary conflict. One can even posit a scenario under which conflict would increase.

[7]Some might hold that constitutional spending and taxing mandates, such as Proposition 98 and Renters' Tax Relief, would still be uncontrollable. But from a policy perspective this would not be the case. In a multi-year world one would simply call for a change in the constitutional provisions; realizing, of course, that such a change would be more difficult to bring about than a statutory change.

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