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CALIFORNIA POLITICAL FORECAST 2008

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Ladies and gentlemen, we face important issues that should unite us. I believe we have the opportunity to move past partisanship, to move past bi-partisanship, to move to post partisanship. Post-partisanship is not simply Republicans and Democrats each bringing their proposals to the table and then working out differences. No. Post-partisanship is Republicans and Democrats actively giving birth to new ideas together. I believe it would promote a new centrism and a new trust in our political system. And I believe we have a window to do it right now.

Gov. Arnold Schwarzenegger,
Second inaugural speech, Jan. 5, 2007

The window of post-partisanship in California didn't stay open long. After a political rebound in 2006 that saw Governor Arnold Schwarzenegger sign the first on-time budget since 2000, his re-election in a landslide, and voter approval of a bi-partisan \$40 billion infrastructure bond package, it looked for a moment as if fate were again smiling on the golden state and its golden governor. Schwarzenegger's second inaugural in January brimmed with talk of post partisanship and ambitious goals on health care, water, education, prisons, and the environment.

But what a difference six months can make. Partisanship returned like a cyborg from the future. The 2007 budget was 56 days late, the third latest in 40 years. It was held up until Labor Day in the state Senate by the Republican bloc, until the governor agreed to use the line item veto to cut \$700 million in spending. The Republican leadership also turned its back on the governor's health care plan. And as partisanship is always exacerbated by budget woes, in October, the Legislative Analyst delivered the bad news that an \$8-\$10 billion deficit looms because of decreasing state revenues and increased spending, including interest on the \$40 billion in infrastructure bonds. Anticipated initiatives for health care reform and water projects may be headed from the legislature to the February and June ballots, but their support will be weakened by partisan differences, and vulnerable to relentless ad campaigns by deep-pocketed opponents.

"On the governmental mess that he inherited from his predecessors," wrote Peter Schrag in the *Sacramento Bee*, "Schwarzenegger's first four-year 'term' ends pretty much where it began, stuck with an ongoing gap between revenues and spending.

"It's a gap that Schwarzenegger helped perpetuate with the \$4 billion cut in the vehicle license fee that was virtually his first act in office and with the borrowing and deferrals that were always the chief accomplishments of California's latter-day bipartisanship."¹

And with the housing slump, higher gas prices, fires to the south, and oil spills to the north, Californians are gloomy again, which isn't going to help in the voting booth. A statewide

survey in September 2007 by the Public Policy Institute of California, taken before the natural disasters and the bleak budget outlooks were published, revealed that 60 percent of the state's residents predict "bad economic times in the coming year," up ten percent from January. And 50 percent believe the state is headed in the wrong direction, a 13 percent jump since January."²

A pessimist might be tempted to adapt the Noel Coward tune from *Cowardly Custard*: "There are bad times just around the corner / We can all look forward to despair / It's as clear as crystal / From Burlingame to Barstow* / That we can't save democracy / And we don't much care."³

But an optimist, like Governor Schwarzenegger, would more likely call on the memory of another optimist, Ronald Reagan, who led through some dramatic state and national downturns with a favorite story. It was about the parents who, worried that their son was too optimistic, took him to a psychiatrist. To dampen the boy's spirits, the psychiatrist showed him a room piled high with nothing but horse manure. The boy looked at the pile, clambered to the top, dropped to all fours, and began digging. "What do you think you're doing?" the psychiatrist asked. "With all this manure," the little boy replied, "there must be a pony in here somewhere."⁴

This 2008 California Political Forecast will look ahead through at issues, personalities, challenges, and constraints facing state government and try to walk the fine line between despair and the pony and look at the likely directions the political leaders, policy-makers, and voters are headed.

The Budget

On November 14, the independent California Legislative Analyst (LAO) hit Sacramento with a three-part bomb. First boom: because of "softness in the state's economy" and the housing slump, the state faces a \$1.9 billion deficit at the end of the fiscal year in June. Second boom, the deficit will be much worse next year and the next, upwards of \$8-\$10 billion a year. The third boom was more like a prediction of aftershocks: a structural deficit in the range of \$3 billion a year, a small relief as \$11 billion in bond loans, which Schwarzenegger championed in a state referendum when he first came to office, will be paid off in the spring of 2010.⁵

Shortly after the release of the LAO budget analysis, the governor has told policy leaders that, by his staff's calculations, the deficit is likely to be in the range of \$14 billion. The Governor asked state agencies to begin preparing for across-the-board 10 percent cuts. A month later he announced he would declare a "fiscal emergency," under Proposition 58, a budget balancing mechanism the governor championed in the 2004 special election, which also included \$15 billion in bond measures to get the state out of its previous debt. The fiscal emergency brings the legislature into special session, which puts Sacramento under pressure to make cuts and/or propose tax increases under a 45 day deadline.

The Governor's official response will come in the form of his proposed budget, which he will submit to the legislature in January. That budget is likely to include across the board budget cuts, accounting tricks, and possibly tax and fee increases, which Republicans firmly oppose. The last general tax increase in California was in 1993.

No one can say what will happen when budget talks actually start, but three trends are likely. First, the Democrats, led by Fabian Núñez (D-Los Angeles) in the Assembly and Don Perata (D-Oakland) in the Senate, will work to defend programs that benefit the sick and disabled, K-14 and higher education. Second, the Republicans, led by Mike Villines (R-Clovis) and Dick Ackerman (R-Tustin), will argue that the growth in spending has outpaced any inflation or cost-of living, and refuse to raise taxes, which Republicans hold a large enough minority to do. The third tendency will be to defer, borrow, and re-allocate wherever possible.

Sacramento Bee columnist Dan Walters, the current dean of the Sacramento press corps, predicts that the governor may well be able to submit a 2008-2009 budget that contains neither drastic cuts nor increases on fees and taxes. “For one thing,” Walters wrote, “the state still has \$3.7 billion in borrowing capacity left from the \$15 billion deficit-refinancing bond issue passed in 2004. He (Schwarzenegger) could probably talk leaders of the powerful ‘Education Coalition’ into accepting some short-term reductions in school aid, although the funds would have to be repaid later, and he could postpone about \$1.6 billion in bond payments.” Walters also cites unprotected local government funds, the selling of the state’s student loan operation and leasing the state lottery to a private operator as potential sources of revenue.

“Put it all together and throw in some of the usual tricks, such as overestimating revenue and underestimating expenses, and Schwarzenegger and the Legislature probably could cobble together another get-out-of-town, balanced-on-paper budget that delays the day of fiscal reckoning for one more year.”⁶

But whether the day of fiscal reckoning occurs this year or next, it is clear that the era of post-post partisanship has begun. Senate President pro Tem Don Perata issued a statement: “The ‘LAO report is another sobering reminder that quick fixes will not provide a long-term solution to the state’s budget woes. . . . There is an ongoing gap between state expenditures and revenues that this Governor helped create by slashing vehicle license fees and refusing to balance that loss with revenue from another source. That alone accounts for \$6 billion of this problem,” He also added a reference to the possibility of tax increases, by saying, “An honest dialogue about closing the budget gap must include exploring all options.”⁷

But Legislative Republicans, who despite their minority status have the power to block tax increases through the two-thirds majority required under Proposition 13, vowed to pursue cuts: “We need to look at cost containment, reexamine our budget priorities and maybe even mid-year cuts,” said Senate minority leader Dick Ackerman (R-Tustin). “It is up to the Legislature and the Governor to act responsibly and ensure that we control our spending so that it is in alignment with our growth.”⁸

Health Care

In January, Governor Schwarzenegger said, “I believe that in Sacramento this year we are going to make history. Using a comprehensive approach built on shared responsibility where everyone does their part we will fix California’s broken health care system and create a model that the rest of the nation can follow.”⁹

The governor opened with a proposal based in part on the Massachusetts model, which had strong bipartisan support in that state when it passed two years ago. The Schwarzenegger plan called for all residents to have insurance, shared costs between employers and workers and add a new tax on hospitals and doctors. Shortly after, the Democrats began to develop their own version, after the Republican leadership opted out, on inauguration day, on immigration issues, as Schwarzenegger said his plan would cover the families of undocumented California residents.¹⁰ The Republicans later proposed a plan without mandatory insurance, which relied largely on HSA-eligible High Deductible Health Plans.

The Governor's plan requires state residents to have health insurance and that insurers would be required to accept all applicants. Existing state insurance programs would be expanded to help the poor, and tax subsidies would be put in place to help middle-class families. For businesses that do not provide health insurance, employers and workers would share the costs. There would also be a new four percent tax on hospitals, but the tax on doctors was dropped after physician opposition. As of this writing in early December, 2007, the plan has stalled. The governor and the Assembly Speaker seemed to reach an accord but it is unclear whether the Senate president will go along. There also seem to be splits in organized labor as to whether to support the revised Governor-Speaker plan.

Before the deficit became an issue, the sticking point on health care was how to fund the estimated \$1.4 billion needed to expand state health coverage after the doctor tax was dropped as politically infeasible. The Democratic leadership called for the expansion of state insurance programs by increasing the tax on cigarettes by \$2 a pack. The Governor initially called for funding the plan by leasing out the California Lottery, which he believes would increase lottery ticket sales and revenue. Eventually, however, he appears to have gone along with the tobacco tax. Since the deficit became an issue, however, the sticking point may be how much existing health programs stand to lose in the process of the budget cutting.¹¹

The hope for the Governor and the Democrats was for a bill before the end of 2007 so that they could put the package before voters as a referendum in the November 2008 election. But even if the governor and the legislature get the health care plan on the November ballot, passage by California voters is far from assured. Most voters have health coverage. Many of them fear that a state program would increase health costs for them and have a negative effect on services.

In addition, the tobacco industry will spend heavily to defeat a cigarette tax. Pharmaceutical companies will campaign against the existing package because of a provision that the state would be allowed to purchase drugs in bulk. The November election is also a presidential election and other factors such as the difficulty of raising funds for candidates and referenda from the same donors, the way that health care plays out in the national debate, and voter attitudes toward the Governor and the legislature in the wake of the next summer's deliberations over the budget deficit, will all play unpredictable roles.

Term Limits

California has one of the most strict term limits laws in the country. Passed in 1990, California legislators are allowed to serve a maximum of 14 years – six in the Assembly, eight in

the Senate. Proposition 93, which will appear on the February 2008 presidential primary ballot, would cut the maximum to 12 years, but those years could be served all in one house or any combination of the two. It also would allow members to serve 12 years in their current house regardless of years served in the other house.

Proponents contend Proposition 93 is a needed reform. With too-short terms and too-early seniority, they say, policy-making is hampered by lack of experience. First term legislators find themselves chairing committees and beholden to lobbyists for historical perspective and information. Opponents, however, have characterized Prop 93 as a power grab by incumbents – particularly the current legislative leaders – who seek to stay in office.

When the idea of easing term limits was first proposed, it had considerable support. An August Field Poll showed 59 percent in support of the measure and 30 percent opposed. In the months that followed, however, easing term limits has taken on a partisan tone. A series of stories in the *Los Angeles Times* questioned Assembly Speaker Núñez, who would be termed out if the measure fails, on the use of campaign funds for lavish gifts and accommodations reminiscent of the extravagances of former Speaker Willie Brown, which first inspired the term limits in 1990. By October 2007, support for Proposition 93 had dropped to 49 percent of likely voters who said they would vote “yes,” compared with 31 percent who would vote “no” and 20 percent undecided.¹²

However, by the end of September, the “yes” side had raised more than \$3.25 million – from some of the state’s largest corporations and labor unions – compared with \$158,000 for the “no” side. But the no side has gained steam after Insurance Commissioner Steve Poizner, a wealthy high-tech entrepreneur and potential Republican candidate for governor, pledged \$1.5 million of his own money to defeat the proposition. Another \$1.5 million has come in from New York developer Howard Rich, who supports conservative initiatives like term limits. The state’s prison guards union, the California Correctional Peace Officers Association, after the legislature passed a prison reform legislation the union opposed, has also split from other unions backing the measure, and donated \$500,000 to No on 93.

If the measure fails, it will have major political consequences. Núñez and Perata will be termed out. The dynamic of confronting the budget crisis will be altered by new legislative leadership. Ironically, Republicans, who have been the champions of term limits, would potentially lose the most. In the Assembly, Republicans would risk two seats designated as democratic in the 2001 gerrymander, bringing Democrats just three members shy of the 2/3 vote margin. In the senate, Democrats need just two seats to make the 2/3 mark. Three seats would be at risk, including that of one of the most powerful conservative voices in the Senate, Tom McLintock (R-Sherman Oaks).¹³

Redistricting

In early December 2007, Governor Schwarzenegger announced his support for a November 2008 ballot measure to create an independent commission to redraw state legislative districts after each decennial census. (It would not affect Congressional districts.) Called “California Voters First,” it would establish a 14-member commission managed by the state auditor, who is appointed by the governor and the Legislature. This commission would include

five Democrats, five Republicans and four independent voters. The measure would end the state Legislature's authority to set the boundaries that determine Senate and Assembly seats.

Schwarzenegger failed in a 2005 special election to get a similar proposal approved. This time, he has aligned himself with a coalition of good government groups promoting the measure, including the League of California Women Voters and California Common Cause. Proponents argue that elected officials protect themselves by drawing up districts to make sure incumbents or their political parties win. Safe districts allow the most committed and politically-extreme voters to dominate primaries. The result has been excessive partisanship in by legislators who have no reason to compromise or move to the middle.

Water

California water supplies are down because of drought and use. The systems that transport water to southern California and the northern cities are antiquated and in precarious states along seismic faults, and a recent federal court ruling to reduce pumping water south to protect an the endangered delta smelt will have the same permanent effect on supply as a seasonal drought.

Despite a year of wrangling and a special session of the legislature, Sacramento is at an impasse. And while everyone agrees on what needs to be done – construct reservoirs, restore the Sacramento delta, and start on new water-delivery system to southern California – stalemates over canals and dams, who pays, and who oversees the construction, have overwhelmed the search for solutions.

The controversial centerpiece of Schwarzenegger's proposal is \$5.1 billion to build two dams – one near Sacramento and the other near Fresno – and to enlarge a reservoir in Contra Costa County. The Governor is supported by agricultural interests and business leaders in the Silicon Valley. But the Democratic leadership, backed by urban water suppliers, wants more spending on aquifers, a better conveyance system through the Sacramento delta, and regional projects. Environmentalists want more attention to conservation and groundwater storage.

And into the breach, the California Chamber of Commerce has filed four differently worded initiatives similar the Governor's plan, opening the door for competing plans – the Democrats would have to file theirs as a referendum as well – to put before voters in November.

Other Issues to Watch

Year 2008, which promises to be the year of the deficit, was to be the Year of Education. Proposition 98, passed by the voters in 1988 requires a minimum percentage of the state budget to be spent on K-14 education and an annual increase in education in the California budget. The Governor has the power to suspend Proposition 98 or to bargain with an "education coalition" that consists of union heads and school officials and administrators, as he did in the last shortfall. The governor, however, later reneged on a promise to restore funding. The result was a concerted campaign against the governor's referendum reform package, which went down in defeat.

For higher education, first the big picture, UC's share of the state General Fund has fallen from 7 percent in 1970 to just over 3 percent today. Since 1990, the state's contribution to the

cost of education for each UC student has fallen 34 percent, from \$15,830 to \$10,370 in constant inflation-adjusted dollars.¹⁴ In 2004 the governor, the California State University chancellor, and the University of California president reached agreement on a six-year “Compact” that provided for the CSU and the UC systems would absorb cuts in that year’s budget, but which promised a 3 percent state General Fund increase in 2005/06 and 2006/07, and an increase of 4 percent to the prior year’s base budget for basic needs including salary increases, health benefits, maintenance and inflation.

The cost to fully fund the compact is about \$200 million a year, which is not included in the structural general fund budget, and must be added each year. (As an interesting comparison, estimates of the additional costs to the state for the wildfires and the oil spill that occurred in the fall of 2007 have also been hovering at about \$200 million). Most observers agree that the compact will be very difficult to maintain, and higher education administrators have quietly begun to plan for cuts. The governor and the legislature could also raise fees, but there has been a lot of pressure against that strategy in the legislature, where access to education is a paramount issue, to not balance the budget on students.

There is also Proposition 92, an initiative on the February 2008 ballot in California, which would establish a separate Proposition 98 funding guarantee for the California Community Colleges, as well as a separate enrollment growth formula. It also contains provisions to reduce student fees and alter the governance of the community colleges. The UC Regents, however, have refused to back it on the grounds that it would leave less state General Fund money available for UC and the California State Universities that are not protected by state guarantees or mandates.

State human services and health agencies have no comparable compact with the governor. In fact, in the 2007 budget the governor used 51 line-item vetoes to cut \$702 million from services and programs. More than \$526 million of that came from social services earmarked for low-income Californians, including the homeless, elderly on fixed incomes as well as the blind and disabled. The state is also limited in how much it can cut in health care at the risk of losing federal matching funds for Medicare and Medicaid.

California’s prisons, with an annual budget of \$10 billion, about equal to what the state spends on The University of California and the California State Universities, are big expenditures and powerful players in Sacramento. Under a new state law, California will spend \$7.4 billion to build 40,000 new prison beds, over and above the current annual operating budget. Interest payments alone on the billions of dollars of bonds that will be sold to finance the new construction will amount to \$330 million a year by 2011. The powerful California Correctional Peace Officers Association is also flexing its muscle. The guards’ union was an early supporter of Proposition 93, the term limits initiative, but switched sides in part because of the state Legislature passed a \$7.9 billion prison construction package that the union opposed. Also in the background is increasing federal court supervision of California’s prison system which can lead to judicially mandated spending increases.

Conclusion

The State of California, the governor and the legislature face a major budget dilemma. The state’s structural deficit was never resolved. As of this writing some observers are saying

that it will take \$14 billion or more of cuts and/or revenue increases to deal with the combined 2007-08 and 2008-09 fiscal years. Because of voter-mandated spending requirements, there is very little flexibility within the general fund. The Proposition 13 requirement that any tax increase has to be approved by two-thirds of the legislature has made it almost impossible to raise needed revenue without putting the question before voters.

State agencies are still recovering from the cuts they took in the last downturn only four years ago. Ambitious plans for health care, education, water transfer, and transportation are hostage to the structural deficit. Political partisanship has come roaring back. Voters are becoming pessimistic and angry and don't have a lot of trust in the legislature and state government generally.

The only major political difference between this crisis and the previous crisis that fed the recall of Governor Gray Davis is that Governor Schwarzenegger has maintained a high approval rating, close to 60 percent. The challenge of leadership is going to rest on his shoulders. He has three years left as governor before he is termed out. Since re-election in 2006, he has maintained his commitment to issues such as health care and has fostered a reputation for seriousness and flexibility. But he has yet to be the transformational leader he envisioned himself to be when he first ran for governor in 2003.

Endnotes

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