

## **WARREN'S WAY BACK FROM THE BUDGET CLIFF: "ACTION, ACTION, ACTION" WON'T BE NOT ENOUGH\***

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

*"We support Prop 57 and we support Prop 58, and I think you will see very shortly even the Democratic Party will come on board and support both of those initiatives. They are essential to our economic survivability. We need those in order for the state's fiscal crisis not to be pushed over a cliff."*

Assembly Speaker Fabian Nuñez  
supporting state borrowing to cover past and current  
deficits under  
Propositions 57 and 58 on the March 2004 ballot<sup>1</sup>

*"...Never again will the politicians drive our state to the verge of bankruptcy. It will be a whole new ballgame. Trust me."*

Governor Arnold Schwarzenegger  
supporting Propositions 57 and 58<sup>2</sup>

*"You really know how to hurt a guy."*

Governor Arnold Schwarzenegger  
when asked whether his budget proposals, involving  
borrowing to cover  
deficit spending, were not similar to former  
Governor Davis' proposals<sup>3</sup>

In the previous edition of *California Policy Options*, we traced the evolution of California's state budget crisis up through the October 2003 gubernatorial recall election.<sup>4</sup> Various remedies that have been discussed by fiscal analysts were outlined in that chapter. None of these proposals have been adopted. The budgetary fix of 2004-05 is widely viewed as temporary and postpones problems that will emerge in later years.

Although through July 2004 attention focused on the day-to-day negotiations and procedures that ultimately produce the annual state budget, the fact is that the forces that led to the budget crisis developed over many years. Governor Schwarzenegger was elected to provide "*Action, Action, Action*" in the immediate future to resolve the state's

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\* This chapter covers through the passage of the 2004-05 state budget and up until late September 2004. It does not discuss the voluminous state performance review released in early August 2004, although that review could have significant fiscal effects in future years. At this writing, that review is undergoing public hearings.

ongoing budget crisis.<sup>5</sup> But we argue below that there are lessons from California history that will illuminate the path back to budgetary stability. Keeping to that path will require patience and reform over an extended period. Perhaps not surprisingly, given California's reputation as an automobile state, those lessons come from one of California's major infrastructure projects: its freeway system under Governor Earl Warren in the late 1940s.

As a result of that observation, which we document below, this year's chapter is divided into two basic sections. In Part I, we provide an account of budget developments since the recall election of 2003. Readers are urged to consult our previous budget chapter in the 2004 edition of *California Policy Options* for an analysis of the developments that brought about the budget crisis of the early 2000s and the recall.

In Part II, we go back to the 1940s history of the modern California freeway system and its implications for the state's current and future fiscal policy. What is noteworthy about the launching of that emblematic transportation system in the late 1940s is that Californians demanded that their gas taxes be *raised* to pay for it. In contrast, tax increases have been strongly resisted as a response to the current crisis and one tax – the “car tax” – was rolled back in response to public opinion by Governor Schwarzenegger immediately upon taking office. Clearly, the car tax in 2003 was viewed very differently than the gas tax in 1947. Why was that? What has changed?

**Several findings emerge from this year's chapter:**

- The state budget signed by Governor Gray Davis in August 2003 for the 2003-04 fiscal year remained largely in place after the 2003 recall. But because the new Governor undid Davis' car tax hike and found that mid-year budget cuts were difficult, more borrowing was required.
- For budgeting in the subsequent fiscal year (2004-05), however, the 2003 recall led to a change in the roles of the Governor and the Legislature. Specifically, the Governor became a much more central player in the budget process than his predecessor. Although the Governor – by constitutional mandate – proposes an initial budget, the negotiations process that take that proposal to final adoption also seemed to migrate to the Governor's office. The Legislature's role in budget making was correspondingly squeezed as a result. Adding weight to that shift, voters soundly trounced an initiative that would have restored bargaining clout to the Legislature in March 2004. Pushback against this legislative erosion of power led to a failure – once again – to produce an on-time budget for 2004-05.
- Many observers trace the current budgetary problems of the state to Proposition 13, the 1978 initiative that drastically cut and limited property taxes. However, Proposition 13 reflected a more fundamental political development; a loss of trust of the electorate in state and local government. Voters are unlikely to support tax increases at the state level until that trust is restored. Nevertheless, their behavior

in recent local elections indicates that they are willing to pay more for government services IF they believe that those services will be delivered.

- The issue of trust is well illustrated by the history of California freeways. That history – which is documented at length in this chapter – suggests that voters will even support increased state taxes once they have a sense that tangible and valuable services are going to result.
- Restoration of trust – if it occurs – will be a multiyear process. For many years, as an indirect consequence of Proposition 13, responsibility for governmental service moved to Sacramento. Part of the restoration process must be a rebalancing toward local government. It must also entail heavy use of the types of fiscal instruments that economists and good government advocates detest: earmarked taxes and specialized trust funds.
- Transparency in budgeting – a theme repeatedly invoked in earlier budget chapters – is an important element in restoring trust in state government. However, the incentives to produce a transparent budget are weak at best in the short term, when fiscal tricks designed to produce a seemingly-balanced budget are regularly employed. In principle, the Legislative Analyst could provide the needed transparency, but the Analyst so far has not been willing to challenge the basic formatting of the budget. That leaves one elected official – the state controller – with a potential incentive to push for transparency.

### **Part I: Background to the 2004-05 Budget Process**

By now, the outlines of the state budget crisis are well known.<sup>6</sup> There were warnings as early as the mid-1990s that California faced an eventual long-term structural deficit due to its evolving commitments and demographics. However, a rocketing stock market produced a rush of capital gains tax revenue from stock options and other stock transactions. This revenue masked emerging long-term problems whose broad outline was already apparent to researchers. There was an increase in state reserves as a result of capital gains so it is not true that no “rainy day” saving occurred. But by the time revenue peaked, outflows from the General Fund already exceeded inflows. The subsequent recession and stock market decline, especially the decline in California-centered high-tech and dot.com stocks, drastically cut state revenues. Despite the revenue loss, there was no concomitant cut in expenditures. Accumulated reserves were quickly drained and the state had to borrow increasing amounts to cover the net outflow of cash.

The fiscal crisis was highlighted by paralysis in the decision-making process. Budgets were not adopted on time as new fiscal years began on July 1. These delays caused administrative problems in paying state bills and suggested to lenders and bond-rating agencies that California’s budgetary problems were not being responsibly addressed by elected officials. The state’s bond ratings were downgraded, leading to higher interest costs on the expanding state debt.

Nonetheless, voters re-elected Governor Davis in 2002, despite an earlier electricity crisis that had brought rolling blackouts, especially in northern California. But his re-election was due to the lack of a credible Republican opponent rather than to public confidence in Davis. The recall procedure allowed Republican Arnold Schwarzenegger to avoid the primary process, a process that had produced a losing candidate in 2002. And the fiscal crisis then combined with the electricity crisis to lead to Davis' recall and Schwarzenegger's victory.

## **Early Days**

*"I love working for the people of California. It is better than being a movie star."*

Governor Arnold Schwarzenegger  
State of the State address, January 6, 2004

*"You cannot not like this governor. He won't let you."*

State Senator Sheila Kuehl  
describing Governor Schwarzenegger<sup>7</sup>

By the time Governor Schwarzenegger took office, the state had floated a tobacco bond – thereby using up the remains of its future stream of tobacco settlement revenue – and was in the initial process of floating legally-questionable deficit financing bonds and pension bonds that were part of the August 2003 "Davis" budget. Substantial borrowing was occurring through short-term revenue anticipation warrants and revenue anticipation notes. Bond rating agencies were downgrading the state's credit rating and a potential cash crisis loomed by June 2004.

Various state services were reportedly degrading, ranging from prison visiting hours to the provision of technical information to taxpayers by the Franchise Tax Board and to maintenance of flood control projects. In different ways, the state had effectively transferred revenue from local governments to its own uses, thus causing erosion of services at the local level. This problem was compounded by special economic factors affecting particular localities. Bay Area local governments were particularly hit by revenue losses associated with the dot.com bust and the resulting regional recession. And some southern California local governments had had to expend resources fighting a rash of wildfires that erupted in mountainous areas. The General Fund had tapped other state accounts originally created for special purposes, notably for transportation. As a result, transportation projects were delayed, cancelled, or simply not planned at all.

Apart from these short-term developments, a host of longer-term problems had evolved by the time of the recall. For example, the K-14 school system had become dependent on Sacramento for support after the passage of Prop 13 in 1978. To protect its share of the General Fund, the local educational establishment – especially the California

Teachers Association (CTA) – successfully pushed for Prop 98 in 1988. That proposition earmarked funds for K-14 through complex formulas, thus removing legislative discretion.

The shift in responsibility to Sacramento, however, led to a complicated set of allocation formulas within the overall Prop 98 guarantee, so-called “categoricals” which earmarked funds for particular educational programs. And within K-14, it was really K-12 that had political muscle through the CTA and other organizations. Thus, community colleges were likely to be squeezed whenever there were fiscal crises. Incoming Secretary of Education Richard Riordan called for a “systematic reform of the entire system.”<sup>8</sup> But such longstanding issues were not the top priority of the Governor’s office in the early days of the Schwarzenegger administration.

Shortly after taking office, the new Schwarzenegger administration proposed cuts in the existing (2003-04) budget that it tabulated as totaling \$1.9 billion. But over a period of months following the inauguration, a pattern developed of floating unappetizing budget-related proposals and then pulling back and negotiating a compromise. To some extent, there was a good cop/bad cop routine in which Director of Finance Donna Arduin, or someone else, would announce a distasteful proposed budget cut – such as reduced aid to the disabled. Then the cut would be withdrawn and replaced by a less onerous proposal after consultation with interest groups and opponents.

In other cases, the Governor tried to avoid actions that would appear harsh, for example, promising there would be no state layoffs before Christmas. At one point, the Governor made concessions to hunger strikers who had camped in a park near the Capitol.<sup>9</sup> Various counties and nonprofit agencies operated on the basis of letters from the state indicating that contracts for funding would be forthcoming. When a “freeze” on new contracts was imposed, they were informed that the promised funds would not arrive. Protests led to a reversal and the promised funds were delivered. An outcry by animal rights activists over a proposal to relax a mandate requiring a minimum period before euthanasia of stray pets led to the Governor terming the idea a “mistake” and quickly dropping it.<sup>10</sup> However, two issues stood out in the early days of the Schwarzenegger administration: 1) the car tax and its relation to local government finance and 2) legislative approval for a new bond issue and a related spending cap.

### **The Car Tax and Local Governments**

*“Hardworking Californians who want safe, reliable transportation for their families were especially hard hit by this regressive tax. Now they will have more money in their pockets to pay for needed goods and services.”*

Governor Arnold Schwarzenegger  
Press release dated November 11, 2003  
announcing car tax repeal

*“...As an elected official, I don’t operate in an ideal world. Instead, I operate in one where money comes in envelopes from Sacramento. And as long as that’s the case, I’ll squawk just as loud as all the other pressure groups and demand that the envelopes for my city be as fat as possible.”*

William Fulton  
Ventura City Councilman<sup>11</sup>

The car tax – more properly known as the Vehicle License Fee (VLF) – became a major issue in the recall election. During the late 1990s, when revenue was flush, the Legislature cut this tax. However, the VLF was not really a state tax. Rather it was a local property tax on cars. The VLF was collected by the state Department of Motor Vehicles (DMV) for historical reasons and then distributed to local governments where the cars were registered. As such, the tax really had nothing to do with financing services associated with cars, e.g., street repairs or traffic control, even though most voters and taxpayers probably assumed that it did. It was essentially general revenue for local governments that they could spend on any local functions, car-related or not. We will return to this point later. However, since the VLF was not a state source of revenue – but the state was nonetheless cutting it - Sacramento “backfilled” the lost revenue from the General Fund (reimbursed localities for the lost revenue).

When the VLF was cut, the Legislature enacted a “trigger” that would raise the tax back to its original level – thus relieving the state of the need to backfill – if there was inadequate state revenue in the future. The trigger was vague, however, about what exactly was needed to pull it and who would do the pulling. After the state controller refused to be the triggerman, Governor Davis had his Director of Finance do the pulling and incorporated the saving into his 2003-04 May Revise budget.

Candidate Schwarzenegger promised both repeal of Davis’ VLF increase and a continued state backfill during the recall election campaign. Upon taking office, he did roll back the VLF increase, potentially costing local governments about \$4 billion per year. But soon after the rollback, word began to come out suggesting that local governments might in fact lose some or all of the revenue, i.e., the state would not make them whole.

Local officials, not surprisingly, loudly denounced the potential revenue loss. Los Angeles Mayor James Hahn called the prospect of lost backfill funding “illegal” and said that it would be “immoral for people to break their word, to go back on pledges.”<sup>12</sup> The Governor soon found a way to reimburse the localities for the lost VLF revenue. But having done so, within a short time he proposed taking away \$1.3 billion in local property taxes for the 2004-05 budget year and appropriating that money for the state. New outcries arose. Soon the localities were able to develop a negotiating chip by circulating a ballot initiative that would effectively block the state from taking local revenues without voter approval. The consequences of those later negotiations are discussed below.

California was not alone among the states in facing budgetary woes. All affected states engaged in some mix of spending cuts and tax increases – although the major tax sources such as income taxes and sales taxes were typically off the table.<sup>13</sup> There was even a gubernatorial recall effort in Nevada – ultimately abortive – that mimicked California’s. However, California had earlier gone further than many states in stripping local governments of independent tax resources, chiefly the property tax, and making them dependent on state funding decisions. Thus, it is not surprising that frictions between local governments and state government would become especially heated in the wake of the on-again/off-again car tax and the expropriation of local property tax revenue by the state.

### **The Passage of Propositions 57 and 58**

*“Unless you find a very big bank to rob, there’s no other way to get this kind of money.”*

John Burton  
Senate President Pro-Tem<sup>14</sup>

*“He allowed the Democratic leadership a place at the table. I don’t think he expected them to eat the whole meal.”*

Republican Assemblyman Ken Maddox<sup>15</sup>

*“I am a happy governor because today is a new day for California. There is now order in our fiscal house.”*

Governor Arnold Schwarzenegger  
on reaching a deal with legislative Democrats  
putting Props 57 and 58 on the ballot<sup>16</sup>

Under the original Davis budget that was inherited by the new Governor, there was to be a deficit-financing bond of \$10.7 billion plus a pension bond to cover retirement fund obligations. Both of these were legally questionable. The state constitution requires a popular vote on long-term general obligation bonds and requires that bonds be for some particular purpose rather than for general revenue. But there had been no vote of the people on the Davis bonds and the deficit-financing bond was not for a specific purpose. A legal challenge had already been filed to the pension bond by the time Arnold Schwarzenegger took office.

Davis’ deficit-financing bond ostensibly avoided the long-term issue by requiring an annual vote of the Legislature concerning whether to pay each year’s debt service. It contained a complicated “triple flip” feature to avoid being considered a General Fund obligation. Under this arrangement, a portion of the sales tax was earmarked to back repayment of the bond. The earmarked revenue stream would make the bond more attractive to investors. Since the earmarking arrangement took sales tax revenue from

local governments, they were reimbursed by taking property tax from local school districts. In turn, the school districts were to be reimbursed by the state's General Fund.

The alternative Schwarzenegger proposal involved borrowing up to \$15 billion, but with a vote of the people approving both the borrowing and the fact that the bond was not for a specific purpose. Along with the bond approval there was to be an accompanying "cap" on state spending and a requirement for a "rainy day" fund. To place these items on the March 2004 ballot, the Governor needed either approval of the Legislature or circulation of initiative petitions. The latter route would have required very rapid signature gathering. Hence, from a timing perspective the legislative route was much more desirable. In on-and-off negotiations with legislative Democrats – accompanied by a further downgrading of the state's credit rating by Moody's in early December 2003 – the Governor eventually agreed to a watered down "cap," criticized by some Republicans as not a real cap at all.<sup>17</sup>

Under the agreed-upon cap provision, the Governor was given the authority to proclaim a fiscal emergency and summon the Legislature into special session if there were a substantial decline in revenues or rise in expenditures. During a 45-day period, the Legislature was not to recess or work on any non-budget legislation. There was also a requirement for a "balanced" budget. But, as in the past, the definition of what that term means is not precise and could involve some form of borrowing. There was a requirement beginning in 2006-07 for a schedule of transfers into a "rainy-day" reserve reaching \$8 billion or 5% of General Fund revenue – whichever is greater. But funds could be transferred out of the reserve to cover expenditures.<sup>18</sup>

In contrast, the Governor's initial cap proposal utilized a formula limiting expenditures to a combination of population growth and per capita income. And the Governor would have had the power to cut expenditures if a deficit began to appear. Agreeing to the watered down cap was the first major compromise of the Schwarzenegger administration.

Propositions 57 (the bond) and 58 (the cap) were the products of the negotiations between the Legislature's Democrats and the Governor.<sup>19</sup> The triple flip feature of the old Davis bond was retained so that the new bond would have an earmarked revenue source. That feature would give it a better rating than an ordinary general obligation bond. In the aftermath of the deal on putting the bonds on the ballot, the Governor created a "California Performance Review Commission" to improve state efficiency. That effort may have been a more orderly outgrowth of the "audit" promised by candidate Schwarzenegger and hastily conducted on taking office.<sup>20</sup>

A Public Policy Institute of California poll taken about three weeks before the March 2004 election showed Prop 58 narrowly passing and Prop 57 leaving the electorate split with a large undecided vote.<sup>21</sup> A major campaign in support of the two propositions had the Governor threatening "Armageddon" if the bond did not pass and arguing that with the cap the state would be tearing up its credit cards in the future. Ultimately, the

two bond measures were overwhelming passed. Prop 57 received 63.4% support of the voters and Prop 58 received 71.2%.<sup>22</sup>

State Controller Steve Westly, a Democrat, supported the two measures as did the legislative Democrats who had originally negotiated the deal. The only major officeholder who withheld support was Phil Angelides, the Democratic state treasurer, who ironically would be administratively responsible for the bond flotation. Angelides argued that “no one should be threatening the voters... with Armageddon,” and favored a tax increase.<sup>23</sup> In the Legislature, Republican Tom McClintock – who ran in the recall election as a fiscal conservative – also opposed the two propositions. But other Republicans, grudgingly perhaps, went along with the Governor’s plan.

The ability to borrow under Props 57 and 58 – and to borrow more than Davis had proposed – created a degree of breathing room for fiscal years 2003-04 and 2004-05. State borrowing ability was further enhanced by persuading a taxpayers group that had backed the Governor in the recall to abandon its legal challenge to pension bonds.<sup>24</sup> (The Legislative Analyst and the Legislative Counsel nonetheless expressed concerns about the legality of pension bonds.) *De facto* borrowing supplemented official borrowing, even for relatively minor items. For example, the state “saved” \$1.7 million by not paying membership dues to organizations such as the National Governors Association, effectively leaving such groups with an IOU to be paid some time in the future.<sup>25</sup>

Large-scale layoffs of state employees had been threatened under the Davis budget, but these did not occur. Most contractions of state employment occurred through attrition and leaving vacancies unfilled. Initially, the Governor indicated he didn’t want to lay off anyone before Christmas. And after Christmas he wanted to study the issue further. Similarly, proposals to renegotiate existing collective bargaining agreements covering state employees did not lead to actual contract revisions during 2003-04.<sup>26</sup> Many state workers in fact ultimately remained scheduled to receive 5% pay increases on October 1, 2004.

An important element with regard to layoffs or contract negotiations is that most state-funded services are not carried out by state civil servants. The state provides funding to localities and school districts that perform many services. Whether or not those employees were laid off was in the hands of the local authorities. Within the universe of direct state employees, well over a third work for the University of California and the Cal State systems. Decisions on employment in higher education are in the hands of administrators at those institutions who have a significant degree of autonomy.

The Department of Corrections employs about 14% of the state workforce. As a state agency, the opportunity to lay off state workers there is greater than in higher education or the localities. But although there was much concern about inefficient prison administration and the political influence of the prison guards’ union, staffing needs in prisons are largely determined by crime rates and sentencing practices.<sup>27</sup> And the Governor let it be known that he opposed Prop 66 on the November 2004 ballot that would soften the “three-strikes” sentencing law.

Finally, there are agencies the Governor did not want to cut, even if there were no constraints on doing so. Four hundred new hires were actually authorized for the Department of Motor Vehicles, an agency where most middle class voters are likely to come in contact with the state annually as they renew car registrations and drivers' permits. Apparently, the specter of long lines at the DMV angering such voters was behind the hiring. In any event, in June 2004, an end was announced to the loose hiring "freeze" that had been in effect since October 2001.<sup>28</sup>

### **The Failure of Proposition 56**

*“Opponents say Proposition 56 would make it easier to raise taxes. To some degree, they’re right. If it had been in effect for the last two years, the governor and the Legislature would have been more likely to solve the fiscal crisis with a responsible combination of budget cuts and temporary tax increases...”*

Editorial in the *Los Angeles Times*  
supporting Prop 56<sup>29</sup>

*“The real purpose of Proposition 56 is to give the Legislature a free hand to raise taxes. That’s a tough sell, so they added window dressing to make it sound better, to help sell it. They’re even calling it budget accountability.”*

TV ad opposing Prop 56<sup>30</sup>

California requires a two thirds vote in the Legislature for budget approvals or tax increases. Since Republicans have had somewhat over one third of the votes in both houses, even a party-line vote by Democrats cannot pass a budget or raise taxes without some minority party support. The March 2004 ballot included an initiative – Prop 56 – which would have cut the required supermajority to 55%. To entice voters, the initiative included a penalty provision mandating that the Legislature and Governor would not be paid their salaries for each day of the new fiscal year in which no budget was enacted. A loose “rainy day” fund mandate was also included to attract votes.

As part of the deal with legislative Democrats on Props 57 and 58, Governor Schwarzenegger did not actively campaign against Prop 56, even though he officially opposed it. Despite the resulting gubernatorial silence, Prop 56 received only 34.3% support in the election. That outcome was itself significant since it strongly suggested that there would be no tax increase in 2004-05 or beyond unless the Governor supported one. The Governor at times toyed in public with the possibility of a tax increase at some vague point in the future. But it was certainly not on offer for 2004-05.

Prop 56, therefore, symbolized both lack of voter trust in the Legislature and – when compared with the margin of passage of Props 57 and 58 – the increased power of the Governor. A little more than a month after the March 2004 election, the Governor speculated in public that California might be better off with a part-time Legislature.

“Spending so much time in Sacramento, without anything to do, then out of that comes strange bills,” he said.<sup>31</sup> Members of the Legislature, however, protested that the Governor was trying to “marginalize” their branch of government and complained of a lack of “public input” into gubernatorial decision making.<sup>32</sup>

As the Governor cut deals with various interest groups such as teachers, local governments, and others, Democrats in the Legislature began to focus on issues of waste and abuse. A particular focus was placed on various scandals related to the prisons, and on prior negotiations of what were now seen as overly-generous pay increases to prison guards. Issues of that type are high profile and receive media attention. But such concerns often involve relatively small sums when compared with the aggregate budgetary problem.

Ultimately, however, the Governor cannot have a budget unless the Legislature enacts one. Budget enactment after July 1 puts the state in a fiscal-legal limbo in which it cannot pay (some) suppliers and most state employees are supposed to be paid only the minimum wage or nothing at all.<sup>33</sup> Governor Davis’ late budgets were a prominent element in the recall. Thus, the Legislature retained some leverage over the Governor as the budget deadline approaches or passes.

In principle, the Legislature is supposed to enact a budget by June 15. That date came and went in 2004 without a budget for 2004-05. However, the delay was initially attributed by the Governor’s office to events related to the Reagan funeral. As July 1 approached, the Governor met with the Democratic and Republican leaders of the Assembly and Senate (the so-called “Big 5”) and played down the consequences of missing the deadline. The final budget was not signed until July 31.

### **A Deal for K-12/K-14 Education**

*“I don’t believe the governor wants to cut education. He has said that publicly. He said it personally to me... We are talking. I am hopeful we can work it out.”*

Barbara Kerr  
President, California Teachers Association<sup>34</sup>

*“I need \$2 billion. Can you help me get it? What would that look like?”*

Alleged phone call from Governor Schwarzenegger to the California Teachers Association political director<sup>35</sup>

Under Proposition 98 (1988), a complicated set of formulas determines spending for K-14. Although the community colleges are included, the real clout lies in K-12 and in the California Teachers Association (CTA) that sponsored Prop 98. Because of the formulaic nature of Prop 98, CTA has a built-in floor from which to begin negotiations on budget matters. A supermajority of the Legislature can override the requirements of

Prop 98. However, when budget squeezes arise there is limited flexibility in practice. Much depends on the willingness of the K-12 establishment to accept a temporary erosion below the Prop 98 floor in exchange for future promises to pay back the lost funds.

Education continues to be important to the voting public as the passage of Prop 98 demonstrated. There is little political payoff in being anti-school and potentially much to be lost from that stance among middle class voters. Thus, it is not surprising that the first real deal between the Governor and an interest group would involve Prop 98 funding. The outlines of the deal involved a “deferral” of \$2 billion out of the \$4 billion increase in K-14 spending Prop 98 was expected to require. This arrangement allowed the Governor to say that he did not cut K-14 (since spending would rise) while at the same time reducing the size of the rise below what Prop 98 would otherwise have mandated.<sup>36</sup>

### **Local Governments (Seem to) Make a Deal**

*“I was at a Los Angeles City Council meeting when practically every council member stood up to make a fawning speech thanking Schwarzenegger for restoring cuts from the rollback of the vehicle license fee. ‘What fools,’ I whispered to a companion. Any dope could have predicted that whatever money Schwarzenegger stuffed into one pocket, he’d grab from another.”*

Steve Lopez  
*Los Angeles Times* columnist<sup>37</sup>

*“It is time to change the system and keep local dollars where they belong.”*

Paul Stein  
President, California Association of Counties<sup>38</sup>

*“It was the same old story: Sacramento spends, local government pays, and local government suffers.”*

Governor Arnold Schwarzenegger  
campaigning for Proposition 1A<sup>39</sup>

The January 2004 budget proposal for 2004-05 released by the Governor contained a diversion of \$1.3 billion in property tax revenue from local governments to school districts.<sup>40</sup> And the empire struck back in the form of a proposition designed to prevent such takeaways that eventually qualified for the November 2004 ballot. But even as petition signatures were gathered and then verified, the localities – through organizations such as the League of California Cities - reached a deal with the Governor. They would abandon their proposition – which the Governor would have opposed in any event – and would accept cuts in 2004-05 and the following fiscal year. But in exchange, a new proposition would be put on the ballot by the Legislature that would limit the

ability of the state to impose such takeaways starting in 2006-07. And the Governor would support that one.

Local governments had reason to believe that in the face of gubernatorial opposition, their preferred original ballot proposition would fail. An independent poll in Los Angeles County – the state’s largest county – found that public opinion was roughly split over the idea of using local tax money to reduce the state’s deficit.<sup>41</sup> Since Los Angeles tends to be more liberal than the state as a whole, voter support for any protections of local revenue – absent a deal with the Governor – might not be forthcoming. The League of California Cities’ own polling suggested that pushing the original initiative in the face of the Governor’s opposition would be risky. And the Governor’s opposition might have been joined with that of the California Teachers Association due to the dependence of school districts on state financial support. Moreover, legislative Democrats were unenthusiastic about restricting the ability of the state to take local funds, whether under the original proposition or the Governor’s alternative (which would require legislative action to be put on the November ballot).<sup>42</sup>

Ultimately, it was the local government deal that caused passage of the 2004-05 budget to be delayed beyond June 30, 2004, pushing California into the legal limbo of no budget to pay bills, for a period of one month. Although the Governor had made a deal with local governments, he could not force the Legislature to go along. As a result, the Governor apparently conceded more flexibility to the Legislature to draft a referendum for a constitutional amendment than the local governments were originally promised. But there was dispute about exactly what the Governor had worked out with legislative Democrats. As July 1 came and went without a new budget, and the Governor began a public campaign to pressure the Legislature. Eventually, a compromise was reached with restrictions on future state appropriation of local revenues but not as strict as the localities would have liked. The compromise became Proposition 1A on the November 2004 ballot.

### **A Compact on Indian Gaming But Not With Everyone**

*“Today we are here to declare victory for California once again. We are going to sign new gaming compacts with Tribal Governments.”*

Governor Arnold Schwarzenegger  
Press release dated June 21, 2004

*“...The new pacts will... produce considerably less money than the \$500 million per year ‘fair share’ money the governor had set as his goal – and would have little effect on the state’s current budget crisis.”*

Dan Walters  
Sacramento Bee columnist<sup>43</sup>

*“We’re very bullish on California. The (gambling) market is there. The demand is there.”*

Executive of a casino management firm<sup>44</sup>

There was a time when Californians with an itch to gamble (legally) had a choice of Nevada casinos, a few local card clubs, race tracks, and church bingo. In the 1990s, that choice was widened to include a growing number of casinos on Indian reservations. Because the various recognized tribes have a degree of sovereignty, the precise dollar amounts involved in Indian gambling are unclear. However, the tribes have developed a sufficient cash flow to have become important players in the legislative and ballot proposition arenas.

The relatively small state “take” from Indian gambling became a major issue in the 2003 recall campaign. Governor Davis was charged by opponents with negotiating a bad deal for the state.<sup>45</sup> However, voter sentiment in the 1990s seemed to favor terms that were generous to the Indian side rather than to the state. Proposition 5 in 1998 was approved by voters and opened the opportunity for tribes to set up Nevada-type gambling operations. Although Prop 5 was struck down by the California Supreme Court in 1999, the tribes threatened to put an amended version on the ballot the following year. Eventually, a deal was reached with Davis and effectively ratified by voters in a referendum.

Basically, the state can’t directly tax Indian gambling. But it can withhold permission for expansion of slot machines and other concessions. The power to withhold potentially profitable licenses to expand gives the state limited negotiating power to obtain compacts with the tribes that provide the state with added revenue. During the recall, the tribes opposed Schwarzenegger. Non-Indian gambling interests succeeded in putting on the November 2004 ballot a proposition that would break the Indian monopoly if the tribes did not agree to generous terms.<sup>46</sup> There was a possibility that the new Governor might back that initiative. And there was a strong likelihood that he would oppose a rival Indian ballot proposition (also to be on the November 2004 ballot) that would allow Indian casino expansion with only a limited take for the state. These fears led some of the tribes to negotiate a new compact.

Other tribes, however, did not like the Governor’s deal, particularly a component making it easier for unions to organize casino workers in exchange for a no-strike pledge. That feature had been put there at the insistence of legislative Democrats. Tribes that opposed the labor element announced in mid-July that they would instead work for their own ballot initiative (and against the initiative by non-Indian gambling interests). And one tribe that struck a deal with the Governor for an urban casino in the Bay Area found that legislative approval would not be forthcoming.

Originally, Governor Schwarzenegger was said to be seeking \$500 million per year in state revenue from his Indian negotiations. The eventual deal reached in June 2004 in effect delegated borrowing from the state to the tribes. A \$1 billion payment to

the state would be made through a bond issue that was to be floated by the tribes. And there would be annual payments to the state of another \$150 million or more. In exchange, an expansion of slot machines would be permitted. The \$1 billion would be diverted to transportation infrastructure projects that had been neglected as the state dipped into special funds that were originally intended for such projects.

### **The Higher Education Compact**

“The University of California and California State University systems went in like sheep carrying their own scissors.”

State Senator Sheila Kuehl<sup>47</sup>

*“We believe we had to stop the bleeding. We did it because we felt it was the best of the options we were looking at.”*

UC Vice President Larry Hershman<sup>48</sup>

*“He looked (UC President) Bob Dynes and me in the eye and he said, ‘I will keep my commitment.’ And that’s all I need.”*

CSU Chancellor Charles Reed  
describing the higher education  
negotiations with the Governor<sup>49</sup>

Under the Master Plan for Higher Education adopted in 1960, all Californians were guaranteed access to higher education at nominal cost. The top one eighth of high school graduates were to be admitted to UC and the top third to CSU. Anyone with a high school degree could enroll in a community college for the first two years of college and then transfer – if qualified – to a four-year institution. Doctoral education and research were to be primarily reserved for UC.

During subsequent budget crises, student fees (the word “tuition” has been avoided officially) rose to make up for lost support from the state budget. In the late 1990s, fees were actually cut by Governor Davis as state tax revenue soared. However, once the budget crisis of the early 2000s began to unfold, the pattern of fee hikes resumed despite litigation aimed at halting the rise. Much of the UC budget comes from external sources for research and for other purposes such as hospital services and running the federal government’s nuclear labs. But because that money is earmarked for particular purposes, it cannot be diverted to pay for educational support. Thus, resources for degree-granting programs come mainly from either the General Fund or from student fees.

As early as September 2003, UC announced that it would not consider applications from 1,500 transfer students. This move foreshadowed later announcements that UC and CSU would turn away 3,200 and 3,800 undergraduate applicants, respectively.<sup>50</sup> Those applicants were to be “redirected” to community colleges –

although no specific resources were earmarked to pay for that redirection. Both moves ostensibly were designed to save money on grounds that the average cost of an undergraduate exceeds fee revenue. While this assertion about costs and fees is technically true, it is not the relevant calculation.

It is likely in fact that the rejection of students who otherwise would have been admitted was perceived by higher education officials as a bargaining chip in budget negotiations. From a budgetary perspective, the relevant cost/benefit calculation is what it costs to ADD an incremental student relative to the revenue that incremental student brings. Although no studies address this issue – itself a telling fact – it is probable that incremental students do cover their cost. However, the bargaining chip approach was made explicit by CSU Chancellor Charles Reed who testified that an unnamed legislator had told him that *“until you turn students away, you will never get the support for higher education.”*<sup>51</sup>

Within UC, there seemed to be two views about how the University should respond to repeated budget cuts. One group cited examples of the Universities of Michigan and Virginia. The “Michigan Model” was used as shorthand for a deal under which, over time, UC would move to a much lower level of state support and raise tuition to “market” (private school) levels. There would be an understanding with the state that baseline funding cuts would be offset with tuition increases. In effect, the result would be “privatization” with a social face, since the deal would include a guarantee of access to eligible Californians and a substantial reduction of state micro-management. Enhanced loan programs would be one element in any access guarantee.<sup>52</sup>

The other camp at UC pointed to prior deals with earlier governors during budget squeezes. Under those deals, UC would take temporary cuts to help the state in exchange for a commitment to restoration and growth at a later date when the economy improved. But continued heavy dependence on state funding would entail more limited autonomy than under the Michigan Model.

As the Governor negotiated deals with other groups, the idea of doing what had been done in the past rather than pursuing the more radical Michigan Model apparently became dominant. Fears of being left out as others cut deals with the Governor prevailed. UC’s president and the CSU chancellor then negotiated a compact with the Governor. (For CSU, a Michigan approach would not be appealing.) The compact, which officially extended out to June 2011 – several months after a hypothetical second term for the Governor, committed UC and CSU to accept the budget cuts and fee increases already proposed in the Governor’s May Revise budget in exchange for future assurances.<sup>53</sup>

These assurances, however, were contingent on the fulfillment of various targets related to student/teacher ratios. And such targets created incentives to limit enrollment, whether nor not justified by the Master Plan.<sup>54</sup> UC announced higher admission standards in June 2004 that had the effect of reducing future enrollments, but the Regents

postponed action while the budget remained in play, given the access concerns of legislative Democrats.

The eventual higher education deal contained in the enacted budget allowed the diverted students to enroll in UC and CSU after all, although controversy persisted about the precise terms of the belated enrollment. It also gave the higher education institutions more funding than called for in the compact.<sup>55</sup> But legislative Democrats rather than UC and CSU administrators did the negotiating. The result was after-the-fact recriminations. One Assembly representative declared that the compact was “*ill-conceived and broke a promise with every scholastic achieving student in California.*” UC president Robert Dynes defended the compact as “*a floor, not a ceiling.*” But a Regent complained that “*the UC people didn’t push for the students.*”<sup>56</sup>

Even with the limited funding added by the Legislature in 2004-05, the issue of access to higher education for California remains, despite the compact. A Rand report in the mid-1990s pointed to an access gap that would emerge by the mid-2000s, based on the perceived funding and demographic trends at that time.<sup>57</sup> The report noted that under then-existing policy, the state would have to increase the share of its budget going to higher education to meet student demand. But such a scenario appeared unlikely due to spending mandates and entitlements to which the budget was committed. The access issue was masked by the windfall of capital gains revenue that the state received in the late 1990s, but is once again visible with the disappearance of that windfall.

### **The Pension-Pay Deal**

*“This is a very creative solution to a difficult problem.”*

Assemblyman Darrell Steinberg  
commenting on the pension-pay deal<sup>58</sup>

*“Congratulations!!! You won the pension fight! YOU DID IT!!! You made some 20,000 calls to your legislators. You made countless visits to their offices at the Capitol and their districts. All your work has paid off!”*

Jim Hard, President  
Service Employees International Union Local 1000  
reporting to members on pension-pay deal<sup>59</sup>

In the 1930s, California politics were roiled by various pensionite movements. These included the Townsendites, who pushed for a very expensive plan for all U.S. citizens over 60 that became a rival to the Roosevelt administration’s proposal for Social Security. Still more flamboyant was the Ham and Eggs Movement, a state-level proposition to provide all Californians over age 50 “\$30 Every Thursday” to be financed by a new state currency.<sup>60</sup> While these colorful movements ultimately faded away, California did introduce a pension plan for state workers in the early 1930s. The

California State Employees Association (CSEA), now a branch of the Service Employees International Union (SEIU), was formed originally to agitate for that plan.

Since that time, California's public pension systems have been considerably extended. Three major pension plans are operated by the state: a system for UC, a system known as CalSTRS covering teachers, and a system covering state civil servants known as CalPERS. In addition, there are a number of special retirement funds for protective service workers and others. These "defined-benefit" pensions determine the monthly retirement annuity by a formula involving age, years of service, and pay history. Contributions to the programs are invested in stocks, bonds, and other assets to meet future liabilities.

The UC system has a pension system that is generally well funded and for many years has earned enough on its investment portfolio to obviate the need for contributions. But that happy state of affairs has not applied to the other systems which require annual state infusions. To reduce state pension costs to CalPERS, the Governor proposed a two-tier pension arrangement whereby new hires would qualify only for a more limited defined-contribution plan, essentially a tax-favored savings account. Under a defined-contribution plan, money accumulates for employees while they work. When they quit or retire, whatever is in the account belongs to them. What that sum will buy in terms of a monthly pension cannot be known in advance, since it depends on such factors as actuarial tables and interest rates prevailing at the time.<sup>61</sup> Apart from that proposal, there were others regarding repealing prior legislation that added certain new workers to a specialized advantageous pension arrangement for protective service workers.

At the end of the process, however, no such repeal occurred. State employees had a 5% pay raise due on October 1, 2004 under earlier collective bargaining contracts and legislation and that raise was also not repealed. Only prison guards made any concessions and those were less than had been sought. Indeed, in late July, a federal judge threatened a take-over of the prisons on the grounds that the contract precluded necessary reforms. Although the Governor declared that "*we will have great, great prison reforms,*" the larger issue of prison administration and related labor-relations deals remains unresolved at this writing.<sup>62</sup>

Certain elements of a two-tier pension remained in the eventual agreement with the Governor. New hires would make contributions for the first two years of employment. They could then decide to join the existing CalPERS system or go into a defined-contribution plan. If they chose to join CalPERS, they would receive credit for the first two years (and the plan would have to meet the resulting liability). Essentially, there would be a saving in the first two years of the deal that would be partly undone if a large fraction of the new hires opted into the existing plan. Current employees, therefore, did not experience any takeaways as a result of the deal and in fact received a pay increase.

The only immediate penalty seemed to fall on the head of the SEIU/CSEA local involved in the negotiations. He was arrested for distributing a flyer explaining the deal

to state workers in a government building without a permit. However, the issue of pensions and retirement benefits seems likely to remain on the table. Some local pension systems – notably San Diego’s – have turned out to be overextended. And there have been concerns about disability retirement benefits among the state’s Highway Patrol officers.

### **The Deals with the Governor That Weren’t**

*“What we have here is the poorest people in our society – the elderly, the blind and the disabled – being asked to pay for basically the car tax cut.”*

Senate President Pro Tem John Burton<sup>63</sup>

*“...A bankrupt California will not be able to provide services for anyone.”*

Governor Arnold Schwarzenegger<sup>64</sup>

*“I don’t think we’re losing sight of our progressive ideals. What happened is, the proponents of progressive ideals lost sight of fiscal reality.”*

State Senator Jim Brulte  
Senate Republican leader<sup>65</sup>

Although demonstrations on behalf of welfare recipients and others who receive government support sometimes occur, there is no equivalent of the California Teachers Association or the League of California Cities to negotiate deals on their behalf. At most, such groups can rely only on public sympathy for certain recipients such as children of the working poor without health insurance. In some cases, labor organizations such as the Service Employees International Union (SEIU) provide indirect advocacy. SEIU represents – among others – tens of thousands of low-paid home care aides who are provided to the disabled. The wages of those aides are paid with state financial support and the union resisted cuts in those resources. *“Our interests are getting people out of poverty,”* said the head of the SEIU local representing the aides and referring to his members.<sup>66</sup> Presumably, however, the disabled benefit if their aides receive better pay.

Generally, advocates for such recipients favored tax increases to avoid benefit cuts. However, there was stiff opposition from business groups and taxpayer groups to such proposals. For example, a plan to put a proposition on the ballot lifting some of Proposition 13’s restrictions on commercial – but not residential – property tax assessments eventually died as business opposition crystallized. The anti-tax position centered on maintaining a business-friendly climate to foster growth and job creation.<sup>67</sup> Efforts to have the cut in the car tax overturned by court action also failed.

Given the resistance to general tax increases, members of the Legislature focused on improving efficiency, cutting waste, selling state assets, reducing the number of state

holidays, and trying to cajole more money from the federal government.<sup>68</sup> The *New York Times* reported seriously that Governor Schwarzenegger pointed to a switch in the state Capitol from two-ply to one-ply toilet paper as a money saver – a comment that turned out to be a joke.<sup>69</sup> Combating waste and exposing fraud are, of course, legitimate efforts for government to undertake. The problem is that such efforts generally produce savings – if they do at all – in the millions of dollars, when the state’s budget crisis is in a different order of magnitude: billions. There seemed to be some sentiment that if the public were convinced that waste and inefficiency had been addressed, it would then be in the mood for a tax increase. But whether the exposure of abuse would have that effect in the near term is uncertain at best. It might simply reinforce the conviction of some voters that their dollars were being wasted.

What is clear from both California and national trends is that fiscal policies that are heavy on income redistribution have lost ground politically. There is evidence that the California state and local tax system – net – is regressive despite a highly progressive state income tax, but such tabulations have not reversed the anti-redistribution trend.<sup>70</sup> Yet income and demographic trends in California suggest that even existing programs of redistribution and income support are likely to become more costly and could crowd out other programs that appeal to middle class voters. That process in turn would tend to undermine support for redistribution.

As we will stress below, if proponents of redistribution want to have influence on state priorities, they will need to ensure that middle-class voters have a sense that both state and local services on which they depend are adequately provided. Quickly-filled potholes and short lines at the DMV are routes to increased public confidence that voters are receiving value for tax monies paid. Perhaps, if voter confidence were regained, there would be more willingness to be generous. Certainly, a sense that basic services are not being provided will lead to further voter resistance to a restoration of fiscal balance at the state level.

### **Fiscal Proposals on the November 2004 Ballot**

*“We understand the opponents are going to spend vast sums of money, but we think Californians will understand to receive lifesaving treatment is important to them.”*

Peter Warren  
Spokesperson for California Medical Association  
and the Prop 67 telephone tax initiative<sup>71</sup>

*“California is already a high tax state. If you add a tax on talking, that’s not something that’s good for taxpayers or ratepayers.”*

Todd Harris  
Spokesperson for Californians to Stop the Phone  
Tax<sup>72</sup>

*“Ballot box budgeting is bad. But the state not keeping a promise to the mentally ill for 36 years is worse.”*

George Skelton  
*Los Angeles Times* columnist writing in support of  
the Prop 63  
proposal to tax millionaires to pay for mental health  
services<sup>73</sup>

As is often the case, a host of ballot propositions placed before voters for the November 2004 election.<sup>74</sup> Some had little or no fiscal implications. But those propositions with budget implications were put there by interests that felt they could not achieve their goals through the legislative process.

Two dueling tribal gambling initiatives referenced earlier – both opposed by the Governor – qualified for the November ballot (Props 68 and 70). And there was one proposition to prevent state takeaways of local revenue that was abandoned by the localities after they negotiated a compact with the Governor (Prop 65). It was this compact that caused passage of the 2004-05 budget to be delayed beyond July 1, 2004. A more future-oriented ban that the Governor, legislature, and localities could agree on was subsequently offered as a ballot alternative as Prop 1A.

Also featured was a proposition taxing incomes above \$1 million and earmarking the revenue obtained for mental health services (Prop 63). And there was also a proposed tax on telephone service to provide emergency room health care – the so-called “911 Initiative” – supported by the California Medical Association and other groups (Prop 67).<sup>75</sup> At this writing, the fate of these ballot proposals is unknown.

### **Budget Proposals for 2004-05**

*“Even if every solution proposed by the governor were adopted and the savings scored by the administration were realized, we estimate there would be at least a \$6-billion structural budget problem remaining.”*

Legislative Analyst Elizabeth G. Hill  
commenting on the January 2004 budget proposal<sup>76</sup>

*“Guys, don’t worry. You see me worry? It’ll be take care of. It’s a piece of cake.”*

Governor Arnold Schwarzenegger  
commenting on concerns about growth  
of state debt under the budget proposal<sup>77</sup>

*“We have a great budget. The May revise is really spectacular.”*

Governor Arnold Schwarzenegger  
describing his May revise budget proposal<sup>78</sup>

As we have stressed in our chapters in previous editions of *California Policy Options*, and which we discuss further below, budget transparency – or the lack thereof – remains a major obstacle in evaluation of state fiscal policy. While it should not be a chore to determine what ongoing revenues are expected and what ongoing expenditures are proposed, unfortunately, that basic information is obscured in official documents by a miasma of fund transfers and oddities such as negative expenditures. Under the state constitution, the Governor must propose a budget for the forthcoming fiscal year each January. In mid-May, it is customary for the Governor to modify the proposal in the so-called “May revise.” The May revise includes updated information on taxes and expenditures and a revised forecast for the new fiscal year that by then only about 6 weeks away. Apart from these economic inputs, the May revise contains a political input, namely the reaction of the Legislature to the January proposal. Since a two-thirds vote of both houses is required for budget enactment, the Governor is likely to adjust the January proposal to mollify legislative resistance.

A crude way to avoid the miasma is to remove the “other” category from “revenues and transfers” in the official budget statement on the receipt side and to eliminate negative expenditures on the spending side. If we make these adjustments to the January 2004 proposal for the 2004-05 budget we find anticipated receipts of about \$73.3 billion and expenditures of about \$80.3 billion. Thus, there is a deficit of about \$7 billion.<sup>79</sup> There are some sources of state revenue other than taxes such as interest earnings on state funds and various fees. Perhaps \$2 billion of revenue might be expected from such sources in 2004-05, so the planned deficit might have been as low as \$5 billion in the January proposal. On the other hand, the Governor assumed transfers from the federal government that might not materialize, receipts from Indian gaming may not appear, and questionable revenues from a program of seizing a share of certain civil lawsuit awards. Thus, it is not surprising that the Legislative Analyst identified a structural deficit of over \$6 billion in the January plan.

Although the January proposal did not close the structural deficit, the financial community was generally forgiving. *“It’s a proposal; it is somewhere to start,”* said one.<sup>80</sup> However, if the assumption was that the gap would be closed by the time the proposal was refined for the May revise, that did not happen.

By the May revise, the Governor had negotiated various deals and responded to outcries from recipients of programs targeted for cuts, basically raising proposed spending. However, forecast revenue had risen somewhat roughly covering the added expenditures reflected in the May proposal. Basic tax revenue was now projected to be \$73.9 billion and expenditures at \$80.7 billion. By this accounting, the deficit was slightly reduced to \$6.8 billion, a change from January that is essentially noise given the difficulties and vagaries of forecasting. The May revise also took account of the success

of Props 57 and 58 allowing long-term borrowing to cover past and future deficits. And it proposed a pension bond to cover growing liabilities for pensions to state civil servants – a proposal that has raises some legal questions.

### **The Missed Deadline**

*"Of course we will miss the deadline, but you have to shoot for something; that's my goal. It's the same as shooting for a 500-pound lift and you make it with 495 or something like that. 'Is it disappointing? No, it's great. It's a terrific lift. No one else can do it.'"*

Governor Arnold Schwarzenegger  
commenting on missing the June 30 deadline for  
enacting a 2004-05 state budget<sup>81</sup>

*"In business, when you get close to a deal, everyone goes the extra mile to get it done. In the Capitol, when you get close to a deal, everyone goes the extra mile to get one last thing in that they want."*

Dan Schnur  
Republican political consultant<sup>82</sup>

*"That is part of the Governor's gestalt. He likes the crowd and he likes to go out. And that is fine with me. Gestalt. You can look it up. It's a German word meaning gestalt."*

Senate leader John Burton  
commenting on the Governor's public efforts  
to pressure the Legislature to enact his budget.<sup>83</sup>

A background issue to the 2003 recall was the habit of the Legislature and Governor of going beyond the June 30 deadline for enacting a state budget. This failure had become particularly pronounced during the 1990s, as can be seen on Appendix A, Figure A1. At one point, Governor Schwarzenegger seemed to indicate that the traditional May revise budget proposal would be completed in April to provide more time for enactment. But that notion proved unrealistic. Despite efforts to speed the process, Governor Schwarzenegger found himself in the same dilemma on July 1, 2004 that had faced his recalled predecessor a year before: no state budget in effect.

After two weeks without a budget, the political rhetoric became nasty when the Governor referred to legislators holding up the budget as "children" and "girlie men." Legislative Democrats complained that the Governor should be negotiating rather than name-calling. *"You can't kick somebody in the groin and then say... let us join hands and sing 'Kumbaya.' It doesn't work that way..."* said Senate leader John Burton in explaining why the Democrats were not responding to the Governor's call for passage of his budget.<sup>84</sup> Meanwhile, Republican legislators - who were needed to pass any budget due to the two-thirds vote requirement - pushed for repeal of two Davis-era laws, one

restricting contracting out by school districts and another enabling workers to sue employers for violations of labor laws.

In the eventual compromise, the contracting out legislation was dropped when it became dubbed the “Laidlaw Law” after the private bus company that provides contracted service to schools and which was anxious to preserve its market. The “sue your boss” law was modified to make suits more difficult. A deal was also reached on a tax loophole allowing buyers of yachts to avoid state sales tax. Finally, compromise language was developed on future protection of local government from loss of revenue to the state. “*We now have a terrific budget,*” the Governor declared at the end of the process.<sup>85</sup> However, the 31-day delay in budget enactment in 2004 was almost the same as the 33-day delay a year earlier.

### **The Eventual Budget for 2004-05**

*“I’m worried about this year. People are talking out the out years. This year! This year is where the action is. This year. Then, after we have solved the problem this year, then we go to the next year and we solve the problems next year.”*

Governor Arnold Schwarzenegger<sup>86</sup>

*“How did it happen? I think speaking for myself and my Senate colleagues, when we accepted the fact that we were really ‘girlie men,’ we were just able to get over that.”*

Senate President John Burton<sup>87</sup>

*“It’s not the Schwarzenegger budget. This is the Burton budget.”*

Republican Senator Jim Brulte<sup>88</sup>

Although there was much heat surrounding the negotiations for the 2004-05 budget, in overall fiscal terms the end product was not much different from the May revise. Using the same methodology we employed earlier to analyze the May revise and January proposals, ongoing tax revenue for 2004-05 in the version enacted at the end of July 2004 was \$74.5 billion. So as in May, there was upward creep in revenue assumptions. Expenditures increased to \$81.8 billion by the same methodology. So the deficit was \$7.4 billion, up by roughly half a billion dollars from the May revise. If it is assumed that fees and miscellaneous revenue sources other than taxes will add another \$2 billion to receipts, the deficit would be in the \$5 billion range. The difficulty is that the various deals that had been cut to obtain that budget will require repayment or loss of ongoing revenue in the future. And, of course, there was growing debt service on the officially-contracted debt under the deficit bonds that had been approved by the voters in March 2004.<sup>89</sup>

It is also interesting to note that the outcome for 2004-05 was not much different than what had occurred in 2003-04, essentially under the Davis budget. The state controller's cash statement for 2003-04 puts receipts at \$71.9 billion (removing the effect of a one-time tax amnesty and tobacco bond revenue).<sup>90</sup> On the expenditure side, removing fund transfers and negative spending puts disbursements at \$77.2 billion. So the deficit in the Davis budget for 2003-04 showed the about the same \$5 billion gap as appears in the subsequent Schwarzenegger budget for 2004-05. Appendix A, Figure A2 illustrates this repetition.

Eventually, the structural deficit will have to be addressed. Legislative Democrats may be assuming that at some point the Governor will cave and consent to a tax increase. But even if he were to do so, the Republicans in the Legislature have an effective veto due to the two-thirds rule. Alternatively, some of the deals that were cut to obtain the 2004-05 budget may not be honored. Assuming passage by the voters for protections of local government in November 2004 and taking account of Prop 98's protections for K-14, the higher education compact seems particularly vulnerable to future reinterpretation.

### **Transparency Remains an Important Issue**

*"In the last two budgets, the easy choices were made. Those budgets were shell games, using tricks and gimmicks to put off the hard decisions until after the next election cycle."*

Governor Arnold Schwarzenegger<sup>91</sup>

*"There are always gimmicks in budgets, and they will slowly come out as people read the detail."*

John Ellwood  
Professor of Public Policy  
UC-Berkeley<sup>92</sup>

As noted above, and in prior budget chapters in *California Policy Options*, budget transparency has been a major concern. Sadly, it remains so. California does an excellent job in putting its key budget documents on the web, thus ensuring timely public access. However, accessibility is only one element of transparency – a necessary but not sufficient condition. No single number can sum up the condition of the state budget. But simply providing adequate information on annual deficits or surpluses – with those terms defined in a meaningful fashion – would go a long way.

Despite the need for clear information, the current system of presentation of budget data is opaque. California is not unique among state and local governments in using an opaque methodology; its budget confusions are widely found elsewhere.<sup>93</sup> But the fact that others provide opaque budgets does not mean that California must do so.

California tends to confuse borrowing and revenue. The perils of that confusion are apparent when one considers that if state methodology were applied at the federal level, the massive federal deficits of recent years would vanish since they were financed by borrowing. Indeed, by California definitions, the federal government has never been in deficit since the cash needed for federal operations is always obtained through some combination of tax revenue and borrowing.

Lack of transparent budget methodology contributes to the ongoing loss of public trust. During budget crises, the public is first exposed to warnings of “deficits” – somehow defined and alternatively described as “gaps” or “holes” or “shortfalls” – that run into the billions of dollars. These deficits are often impossibly large when compared with actual annual revenues or expenditures. Then the public is told that the problem has been fixed for this year, i.e., the budget has been “balanced,” but that hard choices in the future remain. And the future always lies ahead.

To the extent that a service disruption occurs or is threatened, the disruption is tied to a delay beyond June 30 in passing a budget rather than to a deficit. The difficulty with this practice is that if this year’s budget is always ultimately depicted as “balanced,” and if the hard choices are always in the future, it is tough to convince the public that a true problem exists. From the public perspective, the only problem seems to be slow decision making and legislative gridlock in producing a "balanced" budget.

Since the transparency problem is chronic, it is reasonable to suppose that it persists because neither the Legislature nor the Governor has any incentive to address it. During hard times, an honest accounting that made it apparent that a particular year’s budget was neither fixed nor balanced, would not enhance the public image of the Legislature or the Governor. And during good times, there is not much public attention paid to California’s fiscal affairs. Is there anyone else in the state establishment that could have an incentive to push for transparent budgets?

### **The Legislative Analyst**

*“If adopted, (the May revise) would result in a balanced budget in 2004-05...”*

Report of the Legislative Analyst<sup>94</sup>

The Legislative Analyst might seem to be the obvious candidate, since it is her job to research and interpret budgetary options for the Legislature in a nonpartisan way. However, although the Analyst contributes importantly to public knowledge, she has felt it necessary to use whatever format the Governor proposes in his January and his May revise budget proposals. The result is statements such as the one above which use the word “balanced” to mean something like “identifies sources of cash, including borrowing, to pay the bills.” Such terminology is at best misleading since any budget will be “balanced” – at least prospectively – by that definition.

The graphics in Appendix B, taken from various reports of the Legislative Analyst's Office, illustrate this point. LAO has repeatedly warned of "structural" deficits in recent years, that is, a long-term tendency for revenue to fall short of expenditures, even with economic recovery. Each November before the Governor issues his initial January budget proposal for the following fiscal year, LAO produces a report on the fiscal outlook. When the May revise proposal is received from the Governor, a similar report is issued. The charts on these reports tend to show the revenue and expenditure lines close together, or in "balance", in the near term and then springing apart in the out-years.

This pattern of near-term convergence and longer-term divergence results from the fact that the LAO follows the gubernatorial format of treating borrowing in various forms as "revenue" but assumes that such borrowing can't go on indefinitely. Hence, in the out-years, "revenue" takes on the common-sense meaning of taxes, fees, and interest earnings on state funds. Expenditures in the out-years have the common-sense meaning of state purchases and transfers with no budgetary oddities such as negative spending. Put another way, the LAO's long-term outlooks are consistent with ordinary notions of surpluses and deficits but the short-term depictions mimic the gubernatorial and legislative obfuscation.

It may simply be that because the Legislature has no particular interest in transparency – and perhaps has an interest in retaining the confusing *status quo* - the Legislative Analyst feels no need to take on the battle for clarity. The LAO is, after all, the Legislature's consultant. Whatever the reason, it seems unlikely – based on past history – that the Legislative Analyst will take on the task of fostering clear budget presentations.

### **The State Controller**

*"Since I was six years old, I have always wanted to be California State Controller."*

Never said by anyone and never will be

There is one elected state official, however, who might work for transparency. The State Controller is charged with producing monthly and annual cash statements for the state (along with other functions). It is doubtful that anyone runs for State Controller without an eye to some other, more visible elected position in the future. No one has ever made the "quote" at the head of this section! One way for the Controller to achieve greater public visibility and to play an active part in the budget process would be to redo the format of the cash statements. Specifically, those statements could be formatted to produce clear and common-sense tabulations of deficits and surpluses. And whenever the Governor or Legislature produces a budget proposal or an actual budget, the controller could translate that proposal or actual budget into a transparent cash statement.

Such a move would be a departure from the current role of the Controller who more typically produces cash statements after the fact. The Controller would be producing anticipated cash statements based on budget proposals and budget documents. These anticipatory statements in fact need to be produced whenever state bonds are floated. But such projections are found only in bond prospectuses that are not connected to the budget documents seen by the Legislature and presented in the newspapers.

An aggressive Controller could highlight the degree to which a budget or budget proposal would increase or decrease net state debt, i.e., the degree to which it was in deficit or surplus in a meaningful sense. Such a role would make the controller an active player in the state budget-making process. The current Controller, Democrat Steve Westly, has sometimes cooperated with the Governor – as in the campaign on behalf of the economic recovery bonds under Props 57 and 58 – and sometimes issued warnings about the structural deficit. He has not taken on the transparency issue.

### **The State Treasurer**

*“It is now official. With his signature on (the 2004-05) budget, Governor Schwarzenegger has broken his word to the people of California to end the state’s crazy deficit spending and balance the budget.”*

Treasurer Phil Angelides<sup>95</sup>

Conceivably, the state Treasurer could pick up the transparency issue if the Controller does not choose to do so. Treasurer Phil Angelides, also a Democrat, has opposed borrowing (and Props 57 and 58) and generally issued harsher warnings about continued deficits. However, the Treasurer’s official role does not involve keeping the books. When a bond issue is floated, the Treasurer does present budgetary information in the prospectus. However, the data presented are largely derived from public information obtained from the Controller and the Department of Finance. Of course, the Treasurer could go beyond official duties and issue a transparent set of budgetary accounts. But unlike the Controller, the Treasurer cannot point to a mandate to do so.

### **A Transparent Budget Statement**

*“Accounting and financial reporting standards are essential to the efficient and effective functioning of our democratic system of government. Financial reporting plays a major role in fulfilling government’s duty to be publicly accountable. Financial reporting by state and local governments is used to assess that accountability and to make economic, social and political decisions.”*

Governmental Accounting Standards Board  
Mission Statement<sup>96</sup>

What would appear on a transparent budget statement? Such a statement would distinguish borrowing from ongoing revenue. An example of such a format is shown as Appendix C to this chapter. Note that the suggested format identifies borrowing from other state funds outside the General Fund and from other levels of government. Borrowing, in short, includes more than issuance of bonds and other state securities. Basically, any funding that has to be paid back to the source is borrowing, not revenue. There are undoubtedly improvements or reasonable modifications that could be made to the suggested format, perhaps to accommodate the kind of borrowing that takes place against Prop 98 commitments. At present, it is unfortunately not possible to take readily-available official budget documents and reformat them along the lines of Appendix C.

It may not be in the short-term interest of key players in the budget-making process – the Governor and the Legislature – to produce meaningful, user-friendly statements. But as the historical section below demonstrates, trust is a key element in any long-run solution to California’s ongoing fiscal dilemma. And trust would be promoted by clearly-presented budgetary information.

## **Part II: Lessons from California’s Freeway History for Today’s Budget Dilemma<sup>97</sup>**

*“The people of this state do not trust their government. They feel it is corrupted by dirty money, closed doors and backroom deals.”*

Candidate Arnold Schwarzenegger  
during the 2003 recall election campaign<sup>98</sup>

*“Someone like you could do fine in California. You could go into politics; you could do anything you want.”*

Earl Warren advising Howard Jarvis  
while at a Republican event in Chicago in 1934<sup>99</sup>

The reported 1934 chance meeting of Earl Warren – then District Attorney of Alameda County – and Howard Jarvis – the father of Proposition 13 – cited above represented an early encounter of two personalities who ultimately moved California in opposing directions. Warren – an ambitious Republican politician with presidential ambitions - was first elected governor of California in 1942 and was the only California governor elected three times. He was a fiscal conservative who insisted on putting away some of California’s war-enriched revenue as a “rainy day” fund even while cutting taxes.<sup>100</sup> But Warren viewed state government as a potential instrument of progress. Indeed, at least in that era, he preferred state solutions over federal.<sup>101</sup>

Under Warren, the University of California was expanded, health facilities were constructed (including the UCLA medical school), the prison system was modernized, the freeway system was created, and the state enjoyed a period of dramatic economic expansion. Jarvis, in contrast, distrusted government at all levels and was totally devoted to his anti-tax movement. In the end, the current fiscal problems of California represent a

lack of trust of the electorate in public institutions, a shift towards the Jarvis position and away from the Warren view.

Many blame Jarvis' Prop 13 for these problems, if not Jarvis himself. Jarvis was a colorful character who – like some earlier advocates of ballot box legislation – reportedly had some problems keeping track of what was his money and what belonged to the causes for which he raised funds.<sup>102</sup> But Prop 13 – passed in 1978 – was itself a symptom, not the product of a single individual.<sup>103</sup> It would not have become law absent voter support.

Voters enacted Prop 13 because of a growing sense that they were paying more for government and not getting valued services in return. Property tax bills shot up in the 1970s, due to skyrocketing home prices. But local services did not improve proportionately or at all.

Although homeowner wealth was rising with property values, incomes were not rising anywhere near as fast as tax bills. Elderly homeowners were fearful of being taxed out of their residences. And the state refused to use what was termed its “obscene surplus” to provide local property tax relief. Some observers have interpreted the passage of Prop 13 as voters wanting to get “something for nothing.”<sup>104</sup> But an alternative interpretation is that voters felt they were paying substantially more and receiving nothing for the added money.

Prop 13 in turn created a host of inadvertent consequences that compounded the problems. These include a shift in authority for local services – especially schools – to Sacramento, making such services less responsive to local needs. The phenomenon of continuing ballot-box fiscal policy and the “fiscalization of land use,” a policy tilting local planning toward retail purposes that generate sales tax revenue, also were the byproducts of Prop 13. It is likely that voters who voted for Prop 13 did not foresee these effects and would probably not have favored them. But the opponents of Prop 13 did not anticipate the inadvertent impacts either. It took years to create California's budget problems. Whatever else might be said about Governor Schwarzenegger's focus on fixing this year's problems and hoping for the best in the future, it is clear that it will take years to repair California's long-term fiscal morass.

Even in the current political climate, voters – especially at the local level – can be persuaded to approve tax or fee increases IF they believe services will be delivered as a result. The March 2004 election included voter options in 93 jurisdictions for raising taxes or fees or continuing taxes that would otherwise have expired.<sup>105</sup> In 30 cases, voters gave these options two-thirds support (necessary under Prop 13 for most – but not all – of the increases to be enacted). In some cases, the margin needed was only a majority. Had only a majority been needed in all cases, 80 jurisdictions would have yielded the needed 50%+1.

Of course, such options are typically not put on the ballot unless proponents believe they have a reasonable chance of passage. So the success rate has an upward

bias. In 55 of the 93 cases, data were available on party registration in the jurisdictions involved.<sup>106</sup> The proportion of Democrats – a group that tends to expect government to deliver services more than Republicans or independents – in the jurisdictions where the ballot options were offered averaged 48% of registered voters, somewhat higher than the statewide average of 43%.<sup>107</sup> Nonetheless, the results suggest that a significant proportion of the contemporary electorate is still willing to support *local* tax and fee increases. Yet under Earl Warren there was a time when trust in government was higher, so high in fact that the public demanded a *statewide* tax increase. We turn to that episode below.

### Warren's Way

*“California’s tremendous progress in the century that has elapsed since its admission to the Union has been due in large part to the steady development of its highway system... We have been hard-pressed to keep up with the demands for new and improved highways. To meet these demands we are now spending nearly \$100,000,000 per year on our highway program. We must continue to spend this much or more for many years to come, to keep in step with our growing population and our expanding transportation needs.”*

Governor Earl Warren in 1950<sup>108</sup>

*“Governors and legislators have grabbed more than \$3 billion in dedicated transportation funds to balance deficit-ridden state budgets, mostly in the form of ‘loans’ whose repayment is uncertain. Gov. Arnold Schwarzenegger is touting his new deal with casino-owning Indian tribes that would provide \$1 billion for transportation... but that’s a tiny fraction of the need and would merely replace no more than a third of the missing money, rather than provide any truly new funds.”*

Dan Walters  
Sacramento Bee columnist<sup>109</sup>

When Governor Schwarzenegger decided he needed an impressive-looking desk to sign key legislation for photo ops, his staff discovered the “Earl Warren” desk. The oversized desk was in fact first used by Warren's predecessor as governor, Culbert Olson. But Warren inherited it and among the bills he signed on the desk was the Collier-Burns Act of 1947, the bill that created California's freeway system.<sup>110</sup> To enact that bill over strong opposition, Warren had to rally public support for a state tax *hike*. He had to convince the electorate that highway improvement was what the state needed, and do so in the days before there were the substantial federal subsidies for road building that came along in the mid-1950s. The ability of Warren to make his case to the public, and the structure of the Collier-Burns Act itself, provides clues about what will be needed in California in the years to come. To understand the significance of Collier-Burns, it is first necessary to review the role of highways in California and the nation.

## Background on American Highway Development

*“It winds from Chicago to L.A., more than two thousand miles all the way.  
Get your kicks on Route 66.”*

Song popularized by Nat King Cole in 1946<sup>111</sup>

Since at least the ancient Romans, roads and advanced civilizations have been linked. However, for much of the 19<sup>th</sup> century, American roads were basically dirt paths or were city streets suited for horses and wagons. In the early part of that century, there were some notable road projects such as the Lancaster Pike in Pennsylvania and the federally-sponsored (and controversial) National Road to the “west” (Ohio and Indiana). For long-distance hauling, other means of transportation came to be used: rivers and canals and later railroads. In rural areas, roads were means to move farm produce to nearby rail stations or ports. They were spottily maintained by local authorities that in some cases conscripted local residents to carry out the repair work.

Attempts to operate private or public turnpikes (toll roads) were not particularly successful since it was hard to keep trespassers off rural pathways. In urban areas, municipal governments maintained streets that were often filled with mud or – given the use of horses – worse. States and the federal government played little role in most road construction, although the constitution did give Congress authority to build “post roads.” Roads were basically local matters.

Toward the late 19<sup>th</sup> century, the advent of the bicycling as a middle-class pursuit gave rise to the so-called “Good Roads” Movement, which advocated improving and paving the limited road system that then existed.<sup>112</sup> At the federal level, agitation from cyclists led to creation of the Office of Road Inquiry in 1895. California created a State Bureau of Highways in response to such pressures, also in 1895. But, of course, it was the arrival of the automobile and, in particular, affordable cars such as the Model T Ford (first sold in 1908), that led to intensified demands for federal, state, and local governments to pursue road building in a serious way.

In the pre-World War I era, automobile and tire interests were able to cajole local governments to link and improve existing roads to create what eventually became the “Lincoln Highway” from New York to San Francisco (finally completed in 1930). Route 66 from Chicago to Los Angeles was officially completed in 1926, although much of it was not paved at the time. The felt need for an improved national road network was increased by advanced engine technology that would allow long-distance trucking and bus transportation, assuming the roads were there to carry such vehicles. Paving technology also advanced.

In 1914, officials from these various state highway departments formed the American Association of State Highway Officials (AASHO) to promote “a plan of Federal cooperation in road construction.”<sup>113</sup> The federal Bureau of Public Roads and Rural Engineering was created in 1915. However, it had relatively little funding or

authority on its own, and mainly provided a degree of information and coordination to state highway departments. In the World War I era, road construction was still largely a local operation.

Not surprisingly, given that fact, local automobile clubs evolved from social organizations for wealthy motorists early in the 20<sup>th</sup> century to lobbying groups that could influence state and local governments. In California, a group of “automobilists” held a planning meeting in 1900 for what became the Auto Club of San Francisco which in turn evolved into the Automobile Club of California in 1901. By 1907, this group combined with similar organizations in northern and central California to form the California State Automobile Association. Similar developments were occurring in the south, where the Automobile Club of Southern California was created in 1900.<sup>114</sup>

Over time, however, the federal role expanded, particularly during the Great Depression, when road construction was seen mainly as a mechanism for creating employment. A federal gasoline tax was imposed in the 1930s, although for general budgetary purposes, not specifically for roads. Nonetheless, the federal government’s share of highway funding rose from below 5% in 1929 to over 41% in 1936. Job creation was a major motivation behind these expenditures.

It was possible by the 1930s to drive across the country, albeit passing through the centers of numerous farm towns and major cities along the way. Federal planners began seriously discussing creation of a network of interstate highways before World War II. But these plans that went on hold during the War. As a result, when the War ended the federal portion of highway funding was back down to its 1929 share.<sup>115</sup> Thereafter the federal role in highway construction increased again, although the grand plan for an interstate highway system sponsored at the federal level did not come to fruition until 1956.

Meanwhile, California was experiencing a population explosion in the 1940s, first due to the wartime build up of its aircraft, shipbuilding, and other military-related production, and later to the settling of returning GIs within its borders. If the state wanted to deal with the resulting transportation problems, it would have to find its own solutions. California could not wait for a federal consensus to develop on how to fund an extensive state road network. The question was how to pay for California’s needed roads.

Several funding options were available for California, other states, and the federal government. Roads could be built and maintained from general revenue on a pay-as-you-go basis. But construction was expensive. Bond financing from general revenue could spread out the construction cost, but ultimately that cost had to be repaid. And newly-constructed roads required ongoing maintenance expenses. Tolls could be charged, a route followed by a number of eastern states. However, the available technology for collecting tolls – essentially a toll collector in a booth – was itself expensive and could cause congestion and accidents.

Perhaps more importantly, state highway officials – while willing to accept tolls for stand-alone projects such as bridges – disliked the administrative arrangements that went with that revenue source. Where toll roads were constructed in other states, there was generally created an authority – independent of state highway officials - to collect the monies and operate the new roads. Toll roads, in short, meant loss of control by established highway departments, not an enticing prospect for California highway officialdom.

Finally, “free” roads could be financed by state user charges other than tolls. Such charges were basically auto registration fees and – especially – gasoline taxes. Oregon was the first state to impose a gas tax in 1919; New York imposed a car registration fee in 1901. California’s gas tax was initially adopted in 1923. In that regard, California was not a pioneer; nineteen states had already enacted gas taxes before 1923.<sup>116</sup> Despite growing opposition of oil companies to gas taxes – a point taken up below – such taxes had become a major source of highway finance in the period just before World War II.<sup>117</sup>

In the era before and during World War II, federal reports on the prospects for what later became the interstate highway system tended to downplay the possibility of tolls as a means of finance. The planning documents produced – especially a report entitled *Toll Roads and Free Roads* – were impressive in length and seeming thoroughness, although the methodology used was problematic.<sup>118</sup> Subsequent reviews have noted that *Toll Roads and Free Roads* made questionable use of information from surveys and existing toll road information.<sup>119</sup> But even accepting its basic estimates, *Toll Roads and Free Roads* now seems based on flawed economics.<sup>120</sup> Nonetheless, the report tilted subsequent public policy away from tolls – especially in the west – thus requiring some other means of financing highways.<sup>121</sup>

### **Background to Collier-Burns**

*“Opposition to the (Collier-Burns) bill was strong and backed by a powerful lobby sponsored by certain vested interests. However, the Governor stood firm in his demands for passage of an adequate bill and took a most active part in support of the legislation. It was one of the most stubborn and dramatic fights in California legislative history.”*

Richard H. Wilson on Governor Earl Warren’s fight for passage of the 1947 Collier-Burns Act creating California’s freeway system<sup>122</sup>

The Collier-Burns Act of 1947 has been described as “*one of the most far-reaching postwar policy decisions of the legislature.*”<sup>123</sup> In essence, the Act raised California’s gasoline tax and certain other car-related fees, earmarked the money for road construction, and placed it in a trust fund (the Highway Users Tax Fund) designated for that purpose. The law created the freeway system, a network of limited access highways that became the centerpiece of the state’s transportation system.

California certainly did not invent the idea of limited-access highways. That concept developed gradually as a result of urban congestion and the fact that anyone alongside a conventional rural road had automatic access to that road from the adjacent property. As a result, cars from houses or businesses that fronted on a road could enter and exit, causing oncoming traffic to slow and potentially leading to accidents. Conventional intersections involved placement of stop signs or stop lights, also slowing traffic and inviting collisions. The limited-access road avoided those problems.

Early examples of limited-access roads included Robert Moses' parkways surrounding New York City in the 1920s and within-city limited-access roads constructed with an eye to job creation in the 1930s.<sup>124</sup> The autobahn was built in Germany during the 1930s as a Nazi showcase and, indeed, attracted international notice, including attention from American highway planners. In the U.S., the Pennsylvania Turnpike, built partly on an abandoned railroad right-of-way, opened in 1940.

California had also dabbled in such construction before World War II. What is now the Pasadena Freeway was completed in 1940 as a landscaped parkway in the Robert Moses style. And there was much planning in California before and during World War II about constructing a more elaborate network of such roads, plans that were receiving national attention.<sup>125</sup> Moreover, a politics of roads had emerged in the Legislature involving rural vs. urban and north vs. south road financing.

Viewed from the perspective of the early 21<sup>st</sup> century, freeways are often seen as creators of urban "sprawl," sources of a host of environmental problems, and as destroyers of mass transit. But that was not the perspective of the 1940s. In that era, freeways were perceived as a form of modern mass transit, albeit for people with automobiles.

Even if residents didn't have cars, buses could provide rapid transit by using the freeways. In contrast, electric streetcars, which ran on city streets, were often caught in traffic and were even less flexible than buses. They could not be easily rerouted without laying new rails and wires and could not avoid ordinary obstructions on the existing tracks. So what is now termed "light rail" did not have a good image as a viable transit system, particularly since private streetcar systems were having financial difficulties. In California, the peak ridership on California's streetcar systems had occurred in the 1920s, and – with a brief exception during the gas rationing of World War II – trended downward thereafter.<sup>126</sup>

Of course, an alternative for rail above ground could be subways underneath. But freeways were less expensive than subways since they did not require tunneling. As noted, freeways stand accused nowadays of creating sprawl. But what is criticized as sprawl today was seen as affordable housing in the suburbs for the new families that were about to spawn the baby boom. One observer of southern California in the late 1940s noted that "*with more automobiles per capita than any other city in America, and with the worst rapid-transit system, Los Angeles was almost ideally prepared for a decentralization which it did not plan but from which it will profit in the future.*"<sup>127</sup>

Moreover, freeway routes tended to converge in central cities and were therefore perceived as preserving the city core, not eroding it.<sup>128</sup> All roads once led to Rome in ancient times and Rome prospered. If that was true back then, why should it not be true for California cities in the 1940s?

But whatever the perceived cost advantages of freeways relative to other means of transportation, in absolute terms they were still expensive. Although California's state government was flush with cash at the end of World War II, Governor Warren – as a fiscal conservative – did not want an orgy of spending. During the War, Warren and the Legislature had cut taxes at the recommendation of a citizens' committee appointed by the Governor, although notably not the gas tax.<sup>129</sup> However, the committee's report also called for maintaining a prudent reserve from the wartime revenue.<sup>130</sup>

Despite the call for fiscal prudence, in the immediate postwar period it was hard for the Legislature to restrain itself, given its new-found resources. What emerged was the so-called "Christmas Tree Bill," – the name says it all – a spending bill enacted by the Legislature in 1946, vetoed by Warren, and then passed over his veto.<sup>131</sup> Given that recent history, Warren was not likely to support building the freeways out of existing general revenue or, for that matter, even from bond funding. Loans through bond issues would eventually have to be paid back from general revenue.

### **Enacting Collier-Burns**

*"So Governor Warren went directly to the people with the issue, and that's the reason that you have to give Warren great credit for starting this improved highway system and knocking these people's heads together a little bit. He went on the radio and made a series of broadcasts. He called a spade a spade. It was pretty powerful stuff. And the legislation finally went through."*

Herbert L. Phillips  
Sacramento Bee columnist<sup>132</sup>

*"...In the years to come, 1947 will be remembered as a memorable year in California's motoring history because we are now moving forward toward the development of facilities over which the motoring public may move with greater rapidity and safety."*

Harry J. Bauer  
President, Auto Club of Southern California,  
commenting on the passage of Collier-Burns Act<sup>133</sup>

The Collier-Burns act bears the name of two legislators, State Senator Randolph Collier and Assemblyman Michael J. Burns. Of these two, the initial actor in the legislature was Collier, who represented the Yreka area from 1938 to 1976. At the time, Collier was a Republican, although he switched to the Democrats in 1959. Collier was especially interested in road legislation as a means of protecting the share of funding going to rural areas such as his district.

Indeed, prior to his involvement in the Collier-Burns Act, Senator Collier had even proposed having his area of the state secede from the rest of California. The threat of seceding and creating a new “State of Jefferson” was seen as a means of generating publicity and enticing the Legislature to provide road enhancements for his constituents.<sup>134</sup> However, by the time Collier-Burns was under serious consideration, Collier knew that he needed both urban and rural support for new roads and he sought both; he also understood that hair-brained schemes such as secession would not produce the highways he was seeking.

Burns, who represented the Eureka area, had his name on the bill primarily because he chaired the Committee on Transportation and Commerce. His role in the ultimate passage of Collier-Burns came later in rescuing the bill from near death in the Assembly. Burns did not go on to make a name for himself in the highway area and is at least as well known for helping to create the veterinary school at UC-Davis and for water projects as for Collier-Burns. When the bill finally passed, however, Burns' resurrection of the bill was recognized by Governor Warren who referred to the legislation as “Burns-Collier.”<sup>135</sup>

Ultimately, however, Collier-Burns would have died, or would have been so gutted as to be effectively dead, had it not been for Warren's intervention. As a Sacramento journalist noted, “...Warren's blistering radio attacks on entrenched lobby influence were sufficient to stir up wide public reaction and carry the vital freeway plan to enactment.”<sup>136</sup> Warren's own view was that Collier did not in fact have much to do with passage of the bill and that other senators were more significant.<sup>137</sup> And given the opposition, it is clear that absent Warren's efforts, there would have been no Collier-Burns.

On taking office as Governor, Warren appointed Charles H. Purcell, who had been in charge of construction of the Bay Bridge, as his Director of Public Works. Warren also took control of the State Highway Commission by initially appointing three confidants to its membership: Verne Scoggins, his press secretary, William Sweigert, a personal advisor (and a registered Democrat), and Helen MacGregor, his executive secretary. Purcell and others in the highway establishment kept the issue of roads and postwar transportation alive in the Legislature and before the general public.<sup>138</sup> Collier-Burns then emerged as a result of efforts in the Legislature at such planning. The Legislature created a Joint Fact-Finding Committee on Highways, Streets and Bridges in 1945 under Collier's chairmanship. Collier then went around the state, raising the road issue in various public forums.<sup>139</sup>

In November 1946, the Committee published a series of reports it had commissioned including one on highway finance, noting that the state had become the major source of highway funding in the 1930s. The finance report suggested the means of funding a major enhancement of the state's road system including substantial “expressway” construction. It proposed raising the gas tax to 4 or 4.5 cents per gallon (up from 3 cents), depending on what was done with other fuel and vehicle-related taxes.

Gasoline prices (including the federal gas tax) were probably about 20 cents a gallon at the time, so each 1 cent of state tax was roughly a 5% increase. The report stressed the importance of reducing congestion and motor vehicle accidents. Toll roads were dismissed as “not practical” and not what the public wanted.<sup>140</sup>

Governor Warren – who had been re-elected in 1946 on both the Republican and Democratic tickets – called a special session of the Legislature in January 1947 to consider the highway issue and long-term plans for expansion. The initial version of Collier – Burns (SB 5) was more ambitious than the earlier plans suggested. The gas tax was to be raised to 5 cents per gallon, a 2-cent increase, along with hikes in various other motor vehicle-related fees and taxes. A system of expressways totaling about 3,200 miles was envisioned including over 650 miles in metropolitan areas.

It is not clear that Warren had foreseen the major battle that would erupt over this proposal. In late 1946, his legislative secretary gave him memo providing a preview of the issues that were entailed. But the memo focused on the likely controversy over dividing the pie between northern and southern California, rather than whether there would be a pie to divide.<sup>141</sup> Not projected was the intensity of opposition from some Los Angeles-area legislators who apparently feared their motoring constituents would be taxed to produce rural roads.<sup>142</sup>

What emerged at the other end of the legislative pipeline was a cutback financing scheme with the gas tax rising only 1.5 cents instead of the 2 cent increase originally proposed. But there was almost no bill at all along the way and in the end Warren had to give the Legislature a restructured California Highway Commission that would report to it rather than the Governor. As was expected, a substantial amount of jockeying between northern and southern and urban and rural representatives developed. As it moved through the legislative process, each iteration of the bill was accompanied by reports from consultant Richard Zettel showing the split in funding across the various jurisdictions.

Generally, despite the issues of divvying up the revenues, the Senate was supportive of Collier-Burns. Opposition was centered in the Assembly that at one point gutted the bill by removing the funding component. Various external players were involved. Trucking companies were concerned about the proposed hike in diesel fuel taxes and other truck-related taxes; they preferred shifting as much of the cost as possible on to gasoline (although diesel trucks create more road wear than gasoline-fueled cars). Utility companies wanted to be reimbursed for the costs of moving wires and poles that were in the path of the proposed new roads. However, the key opposition – and the most vociferous – came from the oil industry, represented by the Western Oil and Gas Association, which opposed raising the tax on gasoline. Despite the opposition, influential newspapers such as the *Los Angeles Times* supported Collier-Burns and its attendant tax increases.<sup>143</sup>

The ups and downs of Collier-Burns have been described elsewhere.<sup>144</sup> Ultimately, Warren's strategy took on various elements. He attacked the idea of special

interests (oil especially) thwarting public needs. The notion of automobile safety was invoked. Bad roads led to accidents and Warren therefore suggested that those blocking the bill would have blood on their hands. When the bill appeared to die in the Assembly, Warren stated that *"the bill may be dead and with it a great many Californians..."*<sup>145</sup> He referred to an interim version of the Assembly bill – which had cut out the proposed taxes – as a *"thoroughly dishonest bill."*<sup>146</sup>

There were hints that if the Legislature could not enact a satisfactory bill, the issue would be put on the ballot as an initiative.<sup>147</sup> Efforts to kill Collier-Burns were termed *"the lowest form of lobby activity."*<sup>148</sup> Warren used radio to urge the legislature to cease yielding to the *"hidden power"* of lobbyists representing *"powerful, selfish interests."* Referring to accidents, he pushed the Legislature *"to end the slaughter."*<sup>149</sup> It was this rhetoric, aimed at generating public pressure on the recalcitrant Assembly, that finally resulted in the enactment of Collier-Burns.

As the battle went on, the impact of Warren's harsh characterization of Assembly opponents caused these legislators to complain. When Collier-Burns revived in the Assembly, opponents tried to keep the gas tax increase to 1 cent, but Warren insisted that 1.5 cents was the *"minimum"* that could be accepted and *"the least that could do the job."*<sup>150</sup> One assemblyman complained that there was *"pressure to thrust this bill down our throats."*<sup>151</sup> Another proclaimed defensively that despite Warren's accusations about the influence of special interests, his conscience was *"as clear as a baby's."*<sup>152</sup> Warren was not above "horse trading" to obtain passage of Collier-Burns, literally. He reported in his autobiography making a deal with one Assembly member to sign a bill requiring labeling of horse meat in pet food in exchange for a favorable vote on Collier-Burns.<sup>153</sup>

It is important to note that Collier-Burns utilized earmarked tax revenue and a trust fund to provide its promised road network. Generally, such devices are seen by fiscal experts as poor policy instruments, since they constrain expenditures in the future without regard to whatever changes in circumstances may occur. Earmarks and trust funds may well be poor policy in that regard. But they constitute a mechanism for building public confidence that taxes payments will in fact produce promised services. The use of these devices in 1947 carries an important lesson for contemporary California.

### **Oil's Puzzling Opposition**

*"The fallacy of (your) position is indicated by a distinction which is apparent to almost every business executive except those in control of oil companies, and that is that this tax is going to be devoted to the improvement and extension of roads which will directly result in their greater use and consequent sale of vastly increased amounts of gasoline and other products required in transportation."*

Letter of Collier associate Kemper Campbell  
to G.C. O'Brien, VP of Standard Oil<sup>154</sup>

In retrospect, the opposition of the oil companies to gasoline taxes as the means of finance under Collier-Burns is puzzling. Much of the incidence of gasoline taxes falls on the consumer, not the supplier.<sup>155</sup> And even that view is a static one, since gas taxes under Collier-Burns were to be earmarked for more roads that would mean more cars and more gasoline sales.

Efforts to explain this simple tax-roads-cars-gas linkage to oil executives in 1947 were futile. A Collier associate wrote letters to heads of major oil companies on this point, stating “*it seems too obvious for argument that more automobile drivers will travel more miles on wider, safer and more numerous highways, resulting in the consumption of more gasoline.*”<sup>156</sup> In the understated view of one subsequent commentator, the reactions of the oil companies to Collier-Burns “*do not seem to have been very foresighted.*” Despite the fact that that “*sales of gasoline, and the revenue therefrom, soared,*”<sup>157</sup> in the years after Collier-Burns was enacted, oil interests persisted in their political opposition to Warren.

Ironically, Warren’s first job after receiving his law degree was with an oil firm; he had no particular desire to punish the industry.<sup>158</sup> But he was able to cast the industry during the Collier-Burns battle as a villain. During one episode, when gas prices rose, Warren termed the increase a “*political rise*” aimed at killing the bill. The implication was that collusion of oil companies was behind the increase. To back that claim up, Warren asked the U.S. Department of Justice to investigate the alleged price fixing.<sup>159</sup> Attacking the oil companies was sufficiently popular that the charge of price fixing was touted in Warren’s semi-official campaign biography when he ran for Vice President in 1948.<sup>160</sup>

William Keck, President of Superior Oil, had supported Warren in his first campaign for governor in 1942.<sup>161</sup> Indeed, critics of Warren had labeled him “Oil Warren” for taking a campaign contribution from the petroleum industry.<sup>162</sup> But Keck became a particular opponent of Warren’s after Collier-Burns. Warren felt Keck, who he termed a “*vitriolic millionaire,*” was behind efforts to thwart his bid for the Republican nomination for the presidency in 1952.<sup>163</sup> A Keck associate charged that Warren had “*abandoned Republicanism and embraced the objectives of the New Deal*” during the 1952 presidential primary campaign. Later, when he became Chief Justice of the Supreme Court, Warren believed that Keck and others in the California oil industry were continuing their vendetta by backing the “Impeach Earl Warren” movement.<sup>164</sup>

Today economists tend to justify use of gas taxes on efficiency grounds, i.e., covering the hidden costs of pollution and congestion, as well as promoting conservation and providing highway funding.<sup>165</sup> Efficiency and conservation are not considerations that would be expected to be attractive to oil companies. But it is unclear why the oil companies failed to back Collier-Burns from pure self-interest in 1947. Of course, from their perspective, it would have been preferable if the freeways could have been built from manna falling from heaven. But that source was not on offer. Almost a decade later, as noted below, road-building manna did fall on California – although from

Washington rather than heaven. However, that manna was also financed by a (federal) gasoline tax.

The best that could be said for the oil company opposition was that there was a history in the pre-World War II era of diversion of gas tax and other motor vehicle-related taxes to non-car uses in many states. A study before the War estimated the percentage of this diversion at around 15%.<sup>166</sup> But this tendency was not a California-centered phenomenon. Indeed, California officials looked at the problem in reverse. The existing gas tax was supposed to pay for roads and yet from their perspective the state's problem had been that General Fund money had been diverted to roads indirectly to pay off highway-related bonds.<sup>167</sup>

In fact, California voters had already passed a constitutional amendment – Prop 3 in 1938 – designed to avert diversion of gas tax funds to non-road purposes. Although no enacted rule is ironclad – even one placed in a state constitution – almost two-thirds of the voters favored Prop 3. That margin suggested strong political support in California for using the state's gas tax revenue for roads.

Moreover, the intent of the Governor and legislative proponents of Collier-Burns was clearly to expand California's road system. As a follow-on to Collier-Burns, the Legislature passed another bill creating the Institute of Transportation and Traffic Engineering at the University of California.<sup>168</sup> Thereafter, the Division of Highways regularly recruited its technical personnel from UC-Berkeley.<sup>169</sup> In line with California's progressive traditions, the aim of the bill was to foster technical expertise for future highway planning. The new Institute provided a home for Richard Zettel, who had done much of the research on Collier-Burns as it progressed through the Legislature, and many others. Thus, road-building was intended to be ensconced in state public policy. And road-building was given a formal academic base on which the state could call in the future as the freeway system was expanded.

Of course, the current state budget crisis has seen diversion of funding from transportation – just as the oil companies feared back in 1947. But we are now decades beyond Collier-Burns. All in all, the gas tax turned out to be a pretty good investment for the industry purely from a perspective of gasoline sales. The gas tax was subsequently raised to capture the portion that had been lost in the compromise over Collier-Burns. By the time Congress passed the legislation creating the interstate highway system in 1956, California had already built 330 miles of freeways. In short, oil's opposition to Collier-Burns is an illustration of the simple fact that sometimes special interest groups do not know what their special interests are.

### **The Federal Aftermath**

*“Legislation to provide a modern, interstate highway system is even more urgent this year than last.”*

President Dwight D. Eisenhower  
Annual message to Congress in 1956<sup>170</sup>

Although Collier-Burns is often treated as a footnote in histories of the American interstate highway system, it seems more likely that it was in fact a model – or at least a contributing influence – for the later Federal-Aid Highway Act of 1956.<sup>171</sup> That Act created the 41,000-mile Interstate and Defense Highway system and substantially increased available funding for California’s expanding freeways. In official histories, the Interstate system is often attributed personally to President Eisenhower and the impression made on him in occupied Germany by the Nazi’s autobahn. Whatever the inspiration, debate in Congress mirrored what had occurred in California nine years earlier. There was debate about a toll system versus a free system. Toll financing was still considered a live option in the early 1950s for the federal government, and in several northeastern states.<sup>172</sup> Indeed, it was the initial preferred option of the Eisenhower administration.<sup>173</sup>

Despite this early support, tolls were eventually pushed off the table as the default financing mechanism. There was instead to be a California-style gas tax earmarked for a trust fund to build the system, a proposal fiercely resisted by oil companies and with trucking firms battling to avoid a substantial tax on diesel fuel. But as in the California case, the use of a trust fund was a way of assuring that the gas tax paid by motorists would be funneled back into roads for the use of those motorists.<sup>174</sup> Warren-style arguments for enhancing motorists’ safety were invoked by proponents. And – again – subsequent observers were left to marvel at the opposition of oil companies to a financing plan that would lead to more driving.<sup>175</sup>

Could Congress have been unaware of the California model as the debate transpired and history repeated itself? Vice President Nixon was a Californian and a former senator and congressman from the state. What is now the (pre-Collier-Burns) Pasadena Freeway passed through his congressional district. That freeway’s high cost was among the influences that led to a search for an alternative to general fund financing of such roads.<sup>176</sup> Nixon spoke on behalf of Eisenhower to both the AASHO and the Governors Conference in 1954, stressing the deficiencies in the existing national highway system.<sup>177</sup> There were 30 California representatives in the House and two California senators. One of those senators, William Knowland, was Republican minority leader. As a member of the California state senate, Knowland had backed Prop 3 in 1938 which barred diversion of gas tax and registration fee revenue to non-road purposes.<sup>178</sup> So he clearly had an early interest in highway finance and the California approach to it. Richard Zettel, the California highway expert who provided much of the background information to the Legislature when Collier-Burns was enacted, also acted as a consultant to the Eisenhower administration on highways.<sup>179</sup>

By the mid-1950s, California had long been seen as an automobile state and it had already been building its freeways, thanks to Collier-Burns. It is implausible that the federal model ended up as a larger version of what California had already done merely as a coincidence. Some California observers have not been shy about noting that Collier-Burns became a model for others to imitate.<sup>180</sup> When the City of Yreka built a monument to Randolph Collier, it inscribed it with the phrase “Father of the *American* Freeways.”

(Italics added) Perhaps that phrase should more properly have been carved on Earl Warren's memorial.<sup>181</sup>

California in the 1970s, with Prop 13, provided the model for the taxpayer revolt that spilled over into national politics in the Reagan era. But California in the 1940s was a model for something else. Its freeways provided a national model for a major expansion of federally-financed public works in the Eisenhower era and beyond. The Collier-Burns experience suggested that the national electorate would support achievements in public works, even if those works required higher taxes. After all, the California electorate had already done so.

### **Lessons from Collier-Burns for Today**

*"The Collier-Burns Act can be considered an important milestone in the life of our State. ...It will keep our State among the most progressive and forward looking states in the Union."*

Governor Earl Warren  
announcing implementation of the newly-passed  
law<sup>182</sup>

*"...No state had ever invested in public services and development as California did in the 1950s and 1960s."*

Peter Schrag, *Paradise Lost*<sup>183</sup>

Commentators on California's fiscal dilemma point to the era of Governor Edmund (Pat) Brown (1959-67) as the high point for the state. During that era the system of higher education was greatly expanded under the Master Plan, freeway construction advanced (with the infusion of federal money under the Eisenhower program), and new and extensive water projects were built. Such commentators despair of ever returning to that Golden Age and point to underperforming schools and deteriorating public services as a consequence of Prop 13 and subsequent ballot propositions.

But there is an important point to note. The Pat Brown era did not occur in a vacuum. Had it not been for Warren's earlier success with the freeways and other state endeavors, subsequent governors would not have had the public trust that would enable them to expand state infrastructure. It took years to establish that trust and will take years to re-establish it.

Why was Warren able to rally public support for the Collier-Burns Act? Obviously, as Governor, he was able to use his personal popularity in his appeals to the public. But there are two other reasons for his success: 1) a jaundiced reputation of the Legislature and 2) an earlier history of California in successfully constructing public works.

Notions of special interests thwarting the Public Good had long been a motivating force in California, a state with a history of being a center of the Progressive Movement. And the image of the California Legislature of the 1940s was no better than it is today, when lobbyists are viewed as the “third house” along with the Assembly and Senate.<sup>184</sup> A legislative bribery scandal in the late 1930s had already led to the "Philbrick report" which dealt the corrupting influence of bribes, campaign contributions, and lobbying activities.<sup>185</sup>

Part-time legislators in the 1940s often relied on lobbyists to meet their daily living expenses while residing in Sacramento. In that decade infamous liquor lobbyist Artie Samish - prominently mentioned in the early Philbrick report - bragged openly that the Legislature was like a ventriloquist's dummy in his hands. He even posed for a magazine photo with a dummy just to make the point.<sup>186</sup> A newspaper editorial, summing up the legislative session of 1947 commented:

*“Experienced lookers-on at Sacramento have no hesitation in pronouncing the actions of the Legislature this session the most flagrant in years... The amount of corridor-huddling with lobbyists that goes on is shameless, and what results from this wide-spread spirit of mal-government is a general attitude of do-nothing until the question of ‘What’s in it for me?’ has been asked and answered.”*<sup>187</sup>

Rallying public opinion against oil interests intent on blocking Collier-Burns was made easier for Warren, given the negative public perceptions of the Legislature and its proclivities. But such perceptions did not guarantee success for Warren. In the same 1947 session, he was unable to rally public opinion sufficiently to enact universal health insurance for Californians, also a major Warren goal.<sup>188</sup> An important difference was that California had a positive track record in producing public works but no past record of expertise in health insurance.

In the water area, for example, the City of Los Angeles had completed its remarkable Owens Valley Project in 1913. San Francisco had built its Hetch-Hetchy dam (1923) as part of its water supply. And in the 1941, the Colorado River Aqueduct began bringing water to much of southern California through the Metropolitan Water District. As in the case of the freeways, environmentalists now look askance at these endeavors. But at the time they were seen as engineering miracles that fostered regional economic development.<sup>189</sup> As for roads, California had completed the acclaimed Golden Gate Bridge and the Bay Bridge in the San Francisco area.

Thus, when Collier-Burns was being debated in the Legislature, the public had every reason to believe that if the money were appropriated, the roads would be built. Yes, the public knew that there could be corruption, waste, and special influence in state and local government. But the overall record was good enough so that when Warren called on the public for support to pass the bill, he obtained the response he needed. Moreover, the poor image of the Legislature at that time made credible Warren's charge that special interests were out to deny Californians their needed highways.

It is noteworthy that up to 1947, the major public works in California were local or regional affairs, even if state (and federal) money was involved. Warren's success was due in part to a credibility established at other levels of government. Although the Legislature was not highly esteemed, Warren could overcome that obstacle as Governor by virtue of California's local history and by capitalizing on his own popularity. The lesson is clear for contemporary California and its policy makers from the Governor on down. If the state is to return to a sound fiscal system, improvements in government delivery of service are needed to re-establish the earlier credibility and trust upon which Warren and successor administrations drew.

Then as now, most of the services Californians receive from state and local government are in fact delivered by local governments: counties, cities, and special districts for schools, sanitation, and pest control. The long way back to fiscal rationalization at the California state level will have to start locally. And at the state level, Warren's focus on highways may also have important lessons. Road construction and similar transportation projects are highly visible. Such projects could again be visible symbols to a public now skeptical about government's capability to deliver.

At the moment, however, liberals in the Legislature have goals such as expanding health coverage to the uninsured, providing access to affordable higher education, and generally addressing a host of social ills. In pursuit of those objectives, they butt heads with fiscal and social conservatives, producing legislative paralysis and political turmoil. Those in the Legislature with grand social goals will need to understand an important lesson from history: Unless the potholes are filled, the holes in California's social safety net are unlikely to be.

The fact that the car tax became a major issue in the 2003 recall suggests that the electorate doesn't have confidence that it is getting value for its tax dollars. Roads are congested and maintenance has been deferred. Of course, fiscal aficionados will note that the car tax historically was just a property tax on cars and that it is really a local tax for general revenue rather than an earmarked tax for roads. However, the voting public does not consist of tax aficionados. Since both the car tax and the property tax are deductible from federal income taxes, these are taxes the state should least want to reduce. But that logic did not apply to the property tax under Prop 13, enacted because of the disconnect that developed between tax bills and local services in 1978. And it did not apply to the car tax in 2003.

## **Conclusions**

Although the electorate was evidently persuaded at the time of the 2003 recall that a new Governor would overcome legislative gridlock and produce on-time budgets without deficits, those hopes were not realized. California did not receive an on-time budget for 2004-05 and a significant structural deficit remains to be addressed. The Governor in 2004 had to borrow to deal with prior and ongoing deficits - as former Governor Davis had ended up proposing in 2003. But since he cut the car tax and was

unable to make all the mid-year cuts Davis had envisioned for 2003-04, Governor Schwarzenegger had to borrow more than Davis requested.

On the other hand, the new Governor did his borrowing with consent of the electorate under Props 57 and 58 – unlike the original Davis plan. And he did set in motion a plan to evaluate state government efficiency. Sadly, progress was not made in enhancing transparency in the presentation of the budget for 2004-05. Perhaps the issue of budgetary transparency can yet be linked to the efficiency review.

California history provides guidance on the long-term steps that will need to be taken to avert a future of continual budget crises. It will be necessary to demonstrate in tangible ways that when taxpayers pay, they also get. Californians were willing to support the construction of the freeway system in 1947, even though a state tax hike was part of the plan. They had confidence that what was promised would be delivered. Much of what Californians had received in the way of public works up to that time had been delivered at the local or regional level. That local history was sufficient to allow the passage of Collier-Burns at the state level. And the state did deliver the promised roads. With state credibility came public support for the later Master Plan for higher education and the water projects of the 1960s.

Today, it remains the case that most voter contacts with government are local. Cities, counties, and special districts provide police, fire, sanitation, street maintenance, and schools. A longer-term resolution of the fiscal crisis will require a shift of both resources and responsibility away from Sacramento and to the local level. And the process of restoring that trust may well entail constraining fiscal devices such as earmarked taxes and dedicated funds, as under Collier-Burns. Good government types may dislike such devices and portray them as fiscal straight jackets. Legislators with social welfare objectives may want increased state revenues to pursue their goals. But without re-established trust linked to provision of tangible services to voters, legislative gridlock and imprudent state fiscal policy will persist.

## Appendix A: Budget Trends

Figure A1: Days of Budget Delay Beyond June 30 by Budget Year

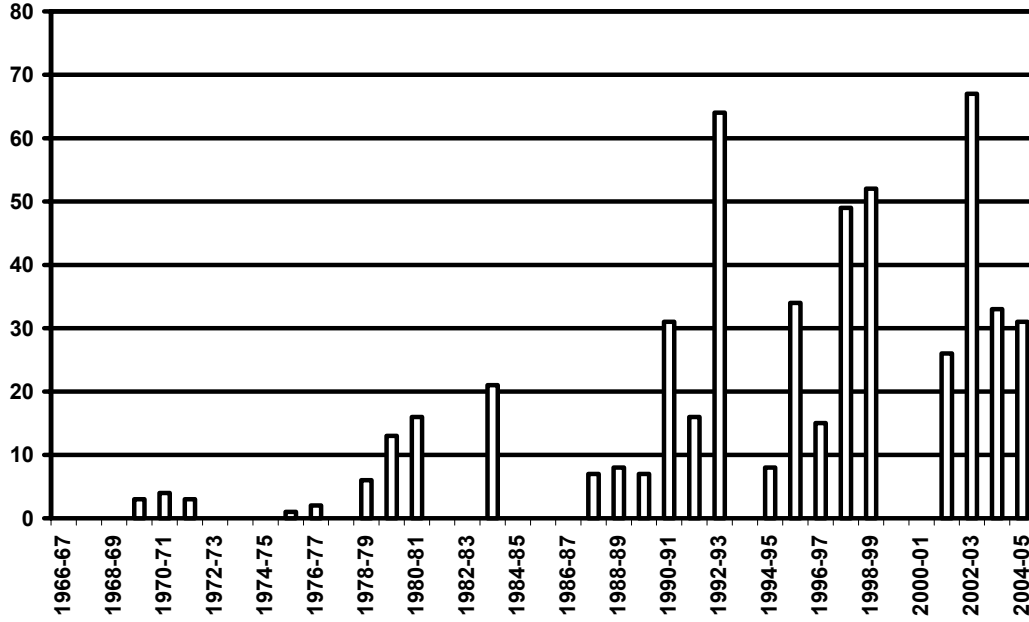
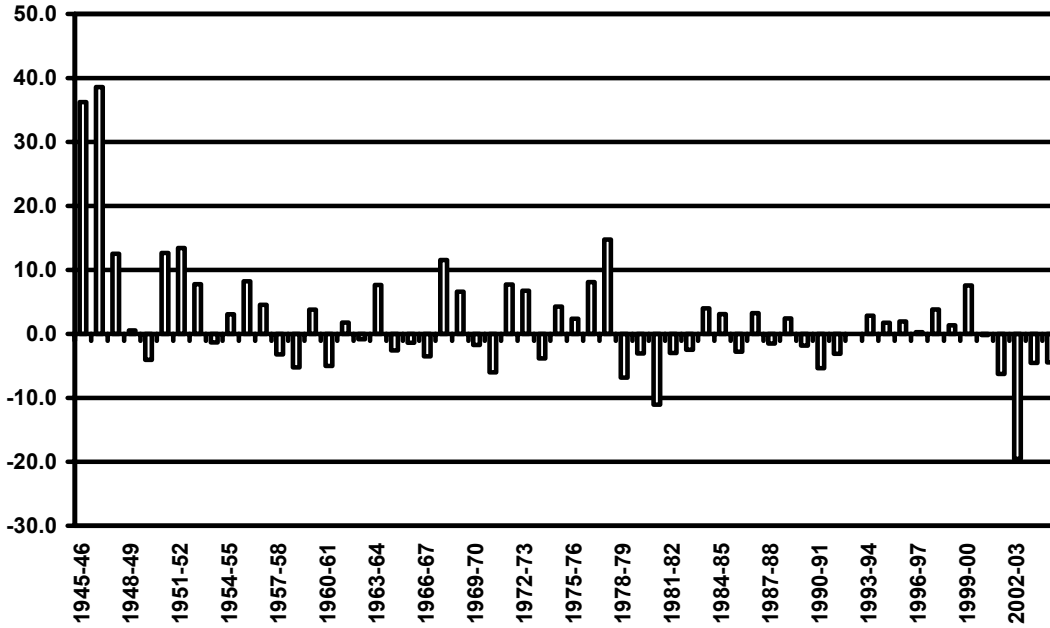
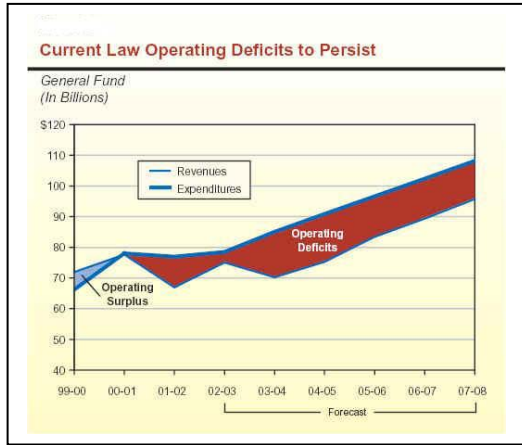


Figure A2: Surpluses or Deficits as Percent of Adjusted Revenues and Transfers

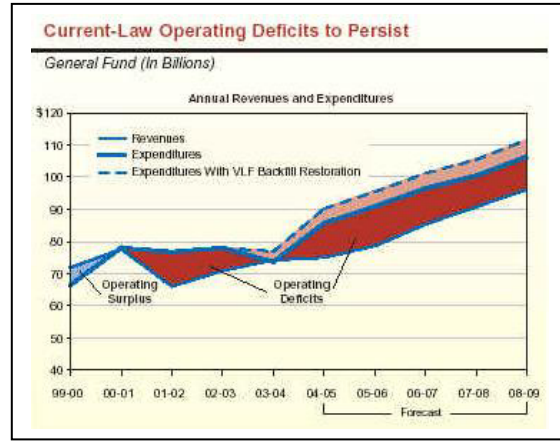


**Appendix B: Graphics from Selected Reports of the Legislative Analyst**

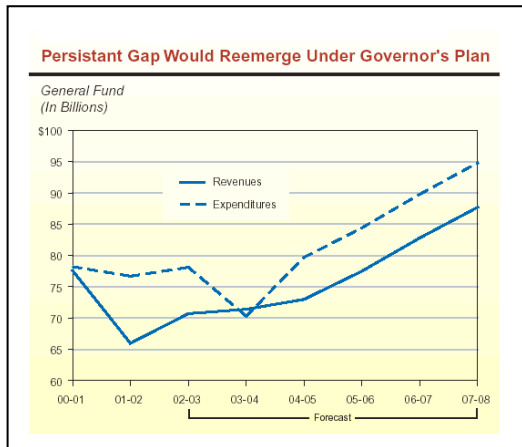
**Figure B1: LAO Analysis of Nov. 2002 Nov. 2003**



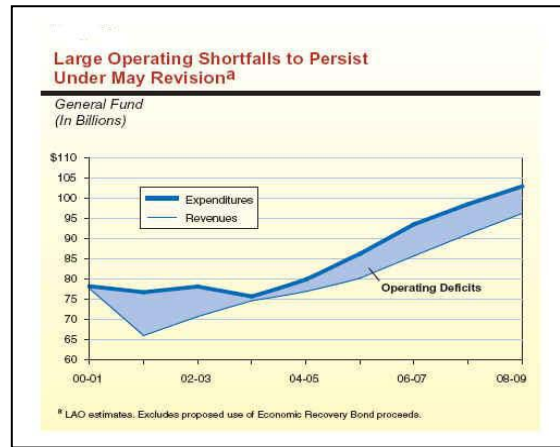
**Figure B3: LAO Analysis of**



**Figure B2: LAO Analysis of May Revise 2003 May Revise 2004**



**Figure B4: LAO Analysis of**



Appendix C: A Proposed Transparent Budget Format for the General Fund

**Receipts**

Revenue

\*Receipts expected from taxes, user fees, payments in lieu of taxes (e.g., Indian gambling), and interest received on state funds

\*Transfers from other state and local funds that do not have to be repaid to those funds excluding funds set up to borrow

\*Transfers from the federal government that do not have to be repaid

Borrowing

\*Transfers from federal, state, and local funds that have to be repaid

\*Loans from external financial markets and institutions including transfers from funds set up to borrow

Asset Accumulation and Liability Reduction

\*Addition to reserves including loans to local funds

\*Reductions in debt to federal, state, and local funds

\*Reduction in debt to external financial markets and institutions including transfers to funds set up to borrow

*Note: Borrowing + Asset Accumulation and Liability Reduction = surplus if positive or deficit if negative. Deficit or surplus will also be equal to Revenue - Disbursements.*

**Disbursements**

Direct purchases of goods and services including labor

Transfers and grants to federal or local governments or other state funds including debt forgiveness and excluding debt repayment

Direct grants to individuals or private entities

Interest on state debt (not including principal reduction)

## Endnotes

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- <sup>1</sup> Quoted in Joe Mathews, “Democrats to Endorse Props. 57 and 58,” *Los Angeles Times*, February 10, 2004.
- <sup>2</sup> Quoted in Margaret Talev, “Governor Pitches to Convention,” *Sacramento Bee* web posting, February 21, 2004.
- <sup>3</sup> Quoted in Peter Nicholas, “Gov. Goes Along to Get Along,” *Los Angeles Times*, June 30, 2004.
- <sup>4</sup> See Werner Z. Hirsch and Daniel J.B. Mitchell, “Family Time, Cliffs, and Train Wrecks: Recalling the California State Budget” in Daniel J.B. Mitchell, ed., *California Policy Options 2004* (Los Angeles: UCLA School of Public Policy and Social Research, 2004), pp. 23-82. In this chapter, much material has been drawn from news accounts, especially from the *Los Angeles Times* and *Sacramento Bee*. We footnote specific news articles only when direct quotes or highly-specific facts are taken from them.
- <sup>5</sup> The widely-cited “action” quote used the word four times, but later versions cut it to three. See Robert Salladay, “Incoming Governor’s Mantra: ‘Action,’” *San Francisco Chronicle*, October 23, 2003; “A Gray Davis Budget,” editorial, *Sacramento Bee*, June 30, 2004. We do not claim that voters followed the details of the state budget and budget deficit. As we have stressed in earlier budget chapters and repeat below, the state budget is not transparent. However, the fact that budget enactment was delayed well beyond the start of the fiscal year in 2002 and 2003 was widely noted. The one volume devoted to the 2002 gubernatorial election and the 2003 recall makes only passing reference to the fiscal crisis. That fact is itself evidence that in its current format, the budget is viewed as too esoteric to analyze by most journalists, political analysts, and political consultants. See Gerald C. Lubenow, ed., *California Votes: The 2002 Governor’s Race and the Recall that Made History* (Berkeley: Berkeley Public Policy Press, 2003). The recall documents, however, do make reference to fiscal mismanagement by Governor Davis.
- <sup>6</sup> Because these developments were analyzed in the prior budget chapters in *California Policy Options*, especially in the previous edition, readers are directed to the earlier volumes for details on the developments and events prior to the October 2003 recall.
- <sup>7</sup> Quoted in George Skelton, “Budget’s Late Again, But at Least They’re Getting Along,” *Los Angeles Times*, July 1, 2004.
- <sup>8</sup> Quoted in Deb Kollars, “Total Overhaul Sought in Funding for Schools,” *Sacramento Bee*, December 11, 2003.
- <sup>9</sup> The West Contra Costa County Unified School District was paying a relatively high interest rate to the state on a loan. After they fasted for 25 days, the Governor conceded a lower rate to the protesters in June 2004, although he did not meet other demands.
- <sup>10</sup> The idea was to save money at local animal pounds. As a state mandate, the state was supposed to reimburse localities for the cost of the requirement.
- <sup>11</sup> William Fulton, “Umbilical Cord that Bleeds Instead of Nourishing,” *Los Angeles Times*, op ed, January 18, 2004.
- <sup>12</sup> Quoted in Jessica Garrison, “Governor’s About-Face on Budget Immoral, Hahn Says,” *Los Angeles Times*, December 11, 2003.
- <sup>13</sup> John Holahan, Teresa A. Coughlin, Randall R. Bovbjerg, Ian Hill, Barbara A. Ormand, and Stephen Zuckerman, “State Responses to 2004 Budget Crises: A Look at Ten States,” working paper, Urban Institute, February 2004.
- <sup>14</sup> Quoted in Nancy Vogel and Evan Halper, “Assembly Democrats Back Cuts,” *Los Angeles Times*, February 11, 2004.
- <sup>15</sup> Quoted in Evan Halper and Joe Mathews, “Governor’s Muscle Squeezed GOP First,” *Los Angeles Times*, December 15, 2003.
- <sup>16</sup> Quoted in Dan Morain and Carl Ingram, “Revived Fiscal Plan Goes on the Ballot,” *Los Angeles Times*, December 13, 2003.
- <sup>17</sup> It was reported that the Governor’s wife, Maria Shriver, and moderate Republican Assemblyman Keith Richman played an important role in negotiating the final deal.
- <sup>18</sup> California actually already had a cap provision – the so-called Gann limit – enacted by voters in 1979. Because of the recession that followed, the Gann limit did not constraint fiscal policy until 1986-87, when it triggered a tax rebate. Prop 98 in 1988 effectively exempted K-14 from the limit. And Prop 111 – pushed by the transportation lobby – removed gas taxes from the limit in 1990. Since then, the Gann limit has had no impact.

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- <sup>19</sup> Prop 57 was formally known as the “Economic Recovery Bond Act.” Prop 58 was the “California Balanced Budget Act.”
- <sup>20</sup> The original plan was for recommendations to be sent to the state’s Little Hoover Commission by the end of April 2004 for comment. That deadline was not met, however.
- <sup>21</sup> *PPIC Statewide Survey*, February 2004.
- <sup>22</sup> Also on the ballot was a \$12.3 billion educational bond issue which narrowly passed with 50.9% support.
- <sup>23</sup> Quoted in Joe Mathews, “Gov. Warns of ‘Armageddon Cuts,’” *Los Angeles Times*, January 21, 2004.
- <sup>24</sup> This deal was contingent on the Governor obtaining pension “reforms” that would cut future pension liabilities. The reforms included requiring larger employee contributions to worker pensions (effectively, a pay cut) and a two-tier pension system under which new hires would receive less generous pensions than incumbents.
- <sup>25</sup> This practice had begun under Governor Davis in 2002-03.
- <sup>26</sup> The Governor indicated in April 2004 that in the new budget, he would include special lines for employee pay that would be subject to line-item vetoes. In effect, he could then cut the dollars available to meet collective bargaining obligations if unions did not agree to cuts voluntarily. Such cuts did not occur.
- <sup>27</sup> A variety of recommendations to reorganize the corrections system were made by a special panel appointed by the Governor in early July 2004. These recommendations are to be considered as part of the larger governmental restructuring initiated by the Governor.
- <sup>28</sup> Although the number of state employees had declined since October 2001, employment grew under Schwarzenegger even before the DMV hirings. See Alexa H. Bluth, “Hiring Freeze Officially to End: But With Money Still Tight, Large Increases in the Work Force are Called Unlikely,” *Sacramento Bee*, June 28, 2004.
- <sup>29</sup> “Yes on Proposition 56,” *Los Angeles Times*, February 8, 2004.
- <sup>30</sup> Quoted in “Prop 56 Opponents: It’s a ‘Blank Check,’” *Sacramento Bee* web posting, February 14, 2004.
- <sup>31</sup> Quoted in Peter Nicholas, “Gov. Wants a Part-Time Legislature,” *Los Angeles Times*, April 7, 2004. Three other states have full-time legislatures: Michigan, New York, and Pennsylvania. California switched to full time in 1966.
- <sup>32</sup> Connie Bruck, “Supermoderate: the New Governor Dazzles the Celebrity-Struck Legislators of Sacramento,” *New Yorker*, June 28, 2004, pp. 68-87. The quotes are from Assemblywoman Sheila Kuehl (p. 87).
- <sup>33</sup> In both the budget delays for 2003-04 and 2004-05, the controller cited technical difficulties in reprogramming payroll computers to distinguish between employees eligible for full pay and those eligible only for the minimum wage as a rationale for not docking anyone’s paycheck.
- <sup>34</sup> Quoted in Peter Nicholas and Evan Halper, “Governor is Willing to Bend on Budget,” *Los Angeles Times*, December 2, 2003.
- <sup>35</sup> Reported quote from Duke Helfand and Evan Halper, “Personal Tie Led Unlikely Allies to Education Deal,” *Los Angeles Times*, January 9, 2004.
- <sup>36</sup> Apart from the deal with CTA, in late June 2004, the Governor negotiated the outlines of a settlement of a lawsuit claiming that schools in poor areas are underfunded. Estimates of the cost to the state budget for fiscal 2004-05 under the settlement were \$138 million for instructional material and \$50 million for building maintenance. A detailed settlement was announced in August 2004. It was not clear exactly what would be the source of funds for the ongoing costs.
- <sup>37</sup> Steve Lopez, “\$olution: Sell the Golden State,” *Los Angeles Times*, January 11, 2004.
- <sup>38</sup> Quoted in press release dated April 15, 2004 put out by “Californians Protect Local Taxpayers and Public Safety,” an organization created to put the original proposition supported by the localities on the November 2004 ballot.
- <sup>39</sup> Quoted in Rick Orlov, “Arnold Stumps for Prop. 1A,” *Sacramento Bee*, September 16, 2004.
- <sup>40</sup> As part of an earlier budget crisis, local property taxes were diverted to schools through the Education Revenue Augmentation Fund (ERAF) to meet Prop 98 requirements. The \$1.3 billion was an addition ERAF transfer. By relieving the General Fund of some Prop 98 obligations, such transfers indirectly contribute to that Fund.
- <sup>41</sup> Public Policy Institute of California, *PPIC Statewide Survey, March 2004* (San Francisco: PPIC, 2004), p. 8. Among likely voters, there was greater bias against taking local tax money for the state than among all adults. However, these sentiments were tabulated absent a gubernatorial effort to enlist public support.

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<sup>42</sup> Democrats also complained that the “fiscalization of land use” – caused by the local reliance on sales tax – would not be fixed by the proposed deal and would, in fact, be locked into the constitution. The reliance on sales tax causes local planning agencies to favor retail stores as opposed to housing or other commercial uses. In addition, the car tax would be permanently left at the level to which it was cut by the Governor unless it was raised by a two-thirds vote of the Legislature.

<sup>43</sup> Dan Walters, “Governor’s Tribal Casino Compacts Fall Short of Verbiage,” *Sacramento Bee*, June 22, 2004.

<sup>44</sup> Quoted in Dan Morain, “California on Path to Become Nation’s Gambling Capital,” *Los Angeles Times*, August 25, 2004.

<sup>45</sup> Davis negotiated a new compact with one tribe during the early stages of the recall campaign.

<sup>46</sup> Indian gambling interests failed in a legal challenge aimed at blocking the initiative from the ballot.

<sup>47</sup> Quoted in Evan Halper, “Senators Rip Cal State, UC for Deal,” *Los Angeles Times*, June 8, 2004.

<sup>48</sup> Dan Walters, “Governor’s Side Deals Frustrate Democrats’ Tax Demands,” *Sacramento Bee*, June 8, 2004.

<sup>49</sup> Quoted in Peter Nicholas, “Deal-Cutting Schwarzenegger Opts to Put Off the Pain,” *Los Angeles Times*, May 14, 2004.

<sup>50</sup> The Legislative Analyst has argued that UC was taking some students who should not have been admitted under the Master Plan criterion of the top one eighth. However, it was the position of both UC and CSU that the students denied admission were in fact eligible.

<sup>51</sup> Lesli A. Maxwell, “UC, CSU Leaders Grilled by Senators,” *Sacramento Bee*, June 8, 2004.

<sup>52</sup> There are various state and federal loan programs already in operation. In addition, the state provides a vehicle for tax-preferred college savings known as Golden State ScholarShare accounts.

<sup>53</sup> Professional schools, such as law and business, were not explicitly part of the compact but it appeared that they would be moved closer to privatization than other graduate schools or undergraduates.

<sup>54</sup> The Legislative Analyst has argued that UC admits a larger pool of applicants than the Master Plan suggests. See Legislative Analyst’s Office, *Maintaining the Master Plan’s Commitment to College Access* (Sacramento: LAO, 2004). In June 2004, a committee of the Academic Senate endorsed raising minimum grade point average (GPA) standards for admissions. Such steps may exacerbate conflict with legislative Democrats concerned about access.

<sup>55</sup> The January budget proposal ostensibly terminated the UC Institute for Labor and Employment, a research and training program especially supported by the state’s labor movement. Although the termination was pushed by various employer and conservative groups, the move was blocked by legislative Democrats. The January budget proposal also included termination of “outreach” programs which draw minority and disadvantaged students into higher education. However, that element was also blocked. Funding was added for continued development of UC-Merced.

<sup>56</sup> The quotes are found in Tanya Schevitz, “Why UC, CSU Chiefs Kept Quiet on Cuts,” *San Francisco Chronicle*, August 10, 2004.

<sup>57</sup> Michael A. Shires, *The Future of Public Undergraduate Education in California* (Santa Monica: Rand, 1996).

<sup>58</sup> Quoted in Alexa H. Bluth, “Major Budget Barrier is Cleared,” *Sacramento Bee*, June 28, 2004.

<sup>59</sup> Quoted in June 28, 2004 “California Insider” weblog by Daniel Weintraub, *Sacramento Bee*.

<sup>60</sup> See Daniel J.B. Mitchell, *Pensions, Politics, and the Elderly* (Armonk, NY: M.E. Sharpe, 2000).

<sup>61</sup> Defined-contribution plans are more portable than defined-benefit plans since the money in the former can simply be transferred upon termination of employment to an Individual Retirement Account (IRA). In general terms, defined-benefit plans favor long-service career employees; defined-contribution plans favor more transitory workers.

<sup>62</sup> Quoted in Andy Furillo, “Sparring Continues on Prison Contract,” *Sacramento Bee*, July 22, 2004.

<sup>63</sup> Quoted in “Burton Promises Budget Plan Battle,” *Sacramento Bee*, January 12, 2004.

<sup>64</sup> Quoted in Evan Halper, Peter Nicholas, and Jeffrey L. Rabin, “Schwarzenegger Unveils Budget,” *Los Angeles Times*, January 10, 2004.

<sup>65</sup> Quoted in Peter Nicholas and Virginia Ellis, “Budget Signals Narrowed Ambitions,” *Los Angeles Times*, February 18, 2004.

<sup>66</sup> Quoted in Tom Chorreau, “Nation’s Largest Labor Union Steps into California Budget Fight,” *Los Angeles Times*, June 27, 2004.

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<sup>67</sup> The resistance to business taxes was tied in a complicated way to demands for reform of the state's workers' compensation insurance system because of escalating insurance premiums. Some reforms were enacted, although the resulting premium cuts were not as great as promised. There were also concerns about the financial condition of the state's unemployment insurance program and the potential for increased payroll taxes to pay for it.

<sup>68</sup> Efforts to reduce state holidays failed in the Legislature.

<sup>69</sup> The episode was reported in Dan Weintraub, "Gov's Staff Comes Clean on TP," California Insider weblog, *Sacramento Bee*, June 29, 2004.

<sup>70</sup> See California Budget Project, "Who Pays Taxes in California?" press release dated April 15, 2004.

<sup>71</sup> Quoted in Laurence Darmiento, "Medical Group Gearing Up for War Over 911 Phone Tax," *Los Angeles Business Journal*, May 3, 2004.

<sup>72</sup> Quoted in Lisa Rapaport, "Hospital Ballot Drive Loses Key Group," *Sacramento Bee*, April 8, 2004.

<sup>73</sup> George Skelton, "For Mentally Ill, Ballot Box Budgeting Might Be the Answer," *Los Angeles Times*, May 6, 2004.

<sup>74</sup> A \$10 billion bond issue to finance a high-speed rail system was originally to be on the November 2004 ballot but was deferred by the Legislature to 2006. There was, however, a \$3 billion bond issue to finance stem cell research (Prop 71). This bond was partly a vehicle for voters to protest restrictions on stem cell research imposed by the Bush administration at the federal level. There was also be a \$750 million bond issue for construction and repair of children's hospitals (Prop 61). Prior to the recall, the Legislature passed and the Governor signed SB 2, a quasi-mandate for employer-provided health insurance. A proposition to repeal SB 2 was placed on the ballot (Prop 72). Some local governments might have the expense of adding certain workers to their employee health plans if SB 2 is not repealed. Finally, there was a proposition to maintain partisan primaries that included an unrelated provision earmarking revenue from sales of state property to paying off the Prop 57 bond approved in March 2004. This element had no real fiscal effect, but was added to make the proposition more attractive to voters. A court decision caused this proposition to be divided into two separate propositions (60 and 60A), due to the general rule prohibiting a single proposition from dealing with more than one topic.

<sup>75</sup> The initiative lost the support of the trade group representing California hospitals soon after qualifying. Apparently, the hospitals viewed the initiative as unlikely to pass.

<sup>76</sup> Quoted in Evan Halper, "Analyst Says Budget Plan Doesn't Go Far Enough," *Los Angeles Times*, January 14, 2004.

<sup>77</sup> Quoted in Charlie LeDuff and John M. Broder, "Arnold Seeking Key Role in NYC," *Los Angeles Daily News*, June 23, 2004.

<sup>78</sup> Quoted in David M. Drucker, "State of Fiscal Fantasy," *Los Angeles Daily News*, May 23, 2004.

<sup>79</sup> Basic budget documents from which the analysis that follows was drawn can be found at [www.dof.ca.gov](http://www.dof.ca.gov).

<sup>80</sup> Steven G. Zimmerman of Standard and Poors quoted in Evan Halper and Gregg Jones, "Burton Calls Budget Plan 'Unworthy,'" *Los Angeles Times*, January 13, 2004.

<sup>81</sup> Quoted in David M. Drucker, "All-Nighter on State Budget," *Los Angeles Daily News*, June 30, 2004.

<sup>82</sup> Quoted in Mark Martin, "Schwarzenegger Shows He's a Mortal in Politics," *San Francisco Chronicle*, July 11, 2004.

<sup>83</sup> Quoted in Evan Halper, "From Governor, Mixed Signals on Deadlock," *Los Angeles Times*, July 14, 2004.

<sup>84</sup> Quoted in Robert Salladay and Peter Nicholas, "Progress on State Budget Stalls as Talks Give Way to Rancor," *Los Angeles Times*, July 20, 2004.

<sup>85</sup> Quoted in Lynda Gledhill, "Budget Deal Rests on Hefty Deficit, Heavy Borrowing," *San Francisco Chronicle*, July 28, 2004. The bill passed comfortably in the Assembly by 69-11. The vote was closer in the Senate, 28-11. Most of the negative votes came from Republicans but some Democrats also voted "no."

<sup>86</sup> Quoted in Evan Halper, "Governor's Budget Misses Opportunity, Analyst Says," *Los Angeles Times*, May 18, 2004.

<sup>87</sup> Quoted in Evan Halper, "Budget Deal Ends Weeks of Stalemate," *Los Angeles Times*, July 27, 2004.

<sup>88</sup> Jordan Rau, "Senate Barely Passes Budget," *Los Angeles Times*, July 30, 2004.

<sup>89</sup> Governor Schwarzenegger vetoed over \$100 million in expenditures in signing the budget. That amount was substantially more than the Davis veto of \$1 million the year before. However, the 2004-05 vetoes

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were small when compared with the magnitude of the budget problem, although they produced outcries among the constituents and supporters of the programs that were trimmed.

<sup>90</sup> The controller's "General Fund Cash Basis Report" for 2003-04 can be found at [www.sco.ca.gov](http://www.sco.ca.gov).

<sup>91</sup> Quoted in Evan Halper, Peter Nicholas, and Jeffrey L. Rabin, "Schwarzenegger Unveils Budget," *Los Angeles Times*, January 10, 2004.

<sup>92</sup> Quoted in John Hill, "Budget Prompts Sense of Déjà vu," *Sacramento Bee*, January 11, 2004

<sup>93</sup> See David Osborne and Peter Hutchinson, *The Price of Government: Getting the Results We Need in An Age of Permanent Fiscal Crisis* (New York: Basic Books, 2004), pp. 25-38.

<sup>94</sup> Legislative Analyst's Office, *Overview of the 2004-04 May Revision*, May 17, 2004, p. 3. Available at [www.lao.ca.gov](http://www.lao.ca.gov).

<sup>95</sup> Press release dated July 31, 2004. Available at [www.treasurer.ca.gov](http://www.treasurer.ca.gov).

<sup>96</sup> Quoted from "Facts about GASB, 2002-2003." Available at [www.gasb.org](http://www.gasb.org).

<sup>97</sup> Various staff members at the California State Archives in Sacramento were very helpful in providing access to the Earl Warren, Randolph Collier, and Harrison R. Baker collections.

<sup>98</sup> Quoted in John Hill, "State Layoff Impact Still Under Wraps," *Sacramento Bee*, January 27, 2004.

<sup>99</sup> Quoted in Howard Jarvis, *I'm Mad as Hell* (New York: Times Books, 1979), p. 230.

<sup>100</sup> Warren stressed the need for accumulating a reserve from the wartime state surpluses as early as his 1943 inaugural address and cautioned against the "constant temptation to everyone to spend it just because it is there." (Inaugural addresses of all California governors can be found at [www.governor.ca.gov](http://www.governor.ca.gov).)

<sup>101</sup> Earl Warren, "Address to the Legislative Joint Interim Committee on Constitutional Revision and its Advisory Committees, October 29, 1947" in Henry M. Christman, ed., *The Public Papers of Chief Justice Earl Warren* (New York: Simon & Schuster, 1959), pp. 9-10.

<sup>102</sup> Peter Schrag, *Paradise Lost: California's Experience, America's Future* (New York: The New Press, 1998), pp. 130-131.

<sup>103</sup> Indeed, Prop 13 was the product of a partnership between Jarvis and Paul Gann who went on to put other initiatives on the ballot. Soon after Prop 13 was passed, Gann and Jarvis had a falling out. Gann felt that the more flamboyant Jarvis had denied him his share of the credit for Prop 13. For background on Prop 13 and earlier attempts at property tax and spending limitations, see David R. Doerr, *California's Tax Machine: A History of Taxing and Spending in the Golden State* (Sacramento: California Taxpayers' Association, 2000), pp. 69-165.

<sup>104</sup> David O. Sears and Jack Citrin, *Tax Revolt: Something for Nothing in California* (Cambridge, MA: Harvard University Press, 1982).

<sup>105</sup> In one instance, 7 Bay Area counties were joined with regard to a regional proposition to raise bridge tolls to support transportation improvements. The figures in the text treat each county as a separate observation. Only a majority was required for this proposition to pass and it received at least a majority in all seven counties.

<sup>106</sup> Data were available only if the jurisdiction was a county or city. Party registration was not available for other jurisdictions such as school districts.

<sup>107</sup> There was little difference between successful and failed propositions in terms of the proportion of registered Democrats. Where the propositions received two-thirds of the vote, the Democratic proportion was 50%. Where the propositions received less than a majority, the average proportion of Democrats was 47%.

<sup>108</sup> Quoted in Kenneth C. Adams, ed., *California Highways and Public Works: Centennial Edition* (Sacramento: California State Printing Office, 1950), inside cover.

<sup>109</sup> Dan Walters, "Stressed-out Highway 99 Symbolizes State Transportation Crisis," *Sacramento Bee*, July 2, 2004.

<sup>110</sup> Margaret Talev, "Old Desk Gets a Front-Row Seat to More History," *Sacramento Bee*, June 28, 2004. An accompanying photo shows Warren signing the Collier-Burns Act on the desk.

<sup>111</sup> Lyrics and music by Bobby Troup.

<sup>112</sup> References on the history of American road building include Tom Lewis, *Divided Highways* (New York: Penguin Books, 1997); Mark H. Rose, *Interstate: Express Highway Politics, 1939-1989*, revised edition (Knoxville: University of Tennessee Press, 1990); James A. Dunn Jr., *Driving Forces: The Automobile, Its Enemies, and the Politics of Mobility* (Washington: Brookings Institution, 1998); James A. Dunn Jr., *Miles to Go: European and American Transportation Policies* (Cambridge, MA.: MIT Press, 1981); Bruce E. Seely, *Building the American Highway System: Engineers as Policy Makers* (Philadelphia:

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Temple University Press, 1987); James J. Flink, *The Car Culture* (Cambridge, MA.: MIT Press, 1975); Janet F. Davidson and Michael S. Sweeney, *On the Move: Transportation and the American Story* (Washington: National Geographic, 2003); Russell Bourne, *Americans on the Move: A History of Waterways, Railways, and Highways* (Golden, CO.: Fulcrum, 1995).; Dan McNichol, *The Incredible Story of the U.S. Interstate System* (New York: Barnes & Noble, 2003); U.S. Department of Transportation, *America's Highways: 1776-1976* (Washington: GPO, 1976); John L. Butler, *First Highways of America* (Iola, WI.: Krause, 1994).

<sup>113</sup> AASHO later became AASHTO (adding “and Transportation”) to its name in 1973 to include mass transit, airports, and harbors. The quote is from American Association of State Highway and Transportation Officials, *AASHTO 1914-1989: Moving America Into the Future* (Washington: AASHTO, 1990), p. 13.

<sup>114</sup> Tom Turner and John Sparks, *The Sprit of the Road: One Hundred Years of the California State Automobile Association* (San Francisco: VIA Books, 2000); Kathy Talley-Jones and Letitia Burns O'Connor, *The Road Ahead: The Automobile Club of Southern California, 1900-2000* (Los Angeles: ACSA, 2000).

<sup>115</sup> Charles L. Dearing and Wilfred Owen, *National Transportation Policy* (Washington: Brookings Institution, 1949), pp. 109, 420.

<sup>116</sup> Finla Goff Crawford, *Motor Fuel Taxation in the United States* (Syracuse, NY: Self-published, 1939), p. 3.

<sup>117</sup> See Philip H. Burch, Jr., *Highway Revenue and Expenditure Policy in the United States* (New Brunswick, NJ: Rutgers University Press, 1962), p. 37.

<sup>118</sup> U.S. House of Representatives, *Toll Roads and Free Roads: Message from the President of the United States* (Washington: GPO, 1939); U.S. House of Representatives, *Interregional Highways: Message from the President of the United States* (Washington: GPO, 1944).

<sup>119</sup> Jonathan Lewis Gifford, *An Analysis of the Federal Role in the Planning, Design and Deployment of Rural Roads, Toll Roads, and Urban Freeways*, PhD dissertation, University of California-Berkeley, 1983, pp. 113-141.

<sup>120</sup> The report purports to present estimates of traffic on toll roads with tolls set to maximize revenue and compare those estimates with others assuming the roads were free. On a linear demand curve, revenue is maximized at the half-way point. So traffic with the revenue-maximizing toll should be half of what would occur with a zero toll. Yet the report has the tolled traffic at roughly one fourth the free traffic.

<sup>121</sup> Charles H. Purcell, Earl Warren's Director of Public Works (see below), was a member of the federal Interregional Highway Committee, that continued planning for an interstate system during World War II. See W. Lee Mertz, “Origins of the Interstate,” on the website of the U.S. Dept. of Transportation, [www.fhwa.dot.gov/infrastructure/origin.pdf](http://www.fhwa.dot.gov/infrastructure/origin.pdf). (This document has no page numbers.) The Committee expanded on the *Toll Roads and Free Roads* report - with its bias towards free roads in the subsequent *Interregional Highways* document cited above.

<sup>122</sup> Quoted in Richard H. Wilson, “Highway Progress Since 1943,” in Adams, *op. cit.*, p. 135

<sup>123</sup> William Buchanan, *Legislative Partisanship: The Deviant Case of California* (Berkeley: University of California Press, 1963), p. 30.

<sup>124</sup> Robert A. Caro, *The Power Broker: Robert Moses and the Fall of New York* (New York: Alfred A. Knopf, 1974).

<sup>125</sup> Fred J. Grumm, “California’s Plan for Freeways in Metropolitan Areas,” *Civil Engineering*, vol. 11 (October 1941), pp. 569-572.

<sup>126</sup> David W. Jones, “California’s Freeway Era in Historical Perspective,” UCB-ITS-RR-89-16, Institute of Transportation Studies, UC-Berkeley, 1989, pp. 112-136.

<sup>127</sup> Carey McWilliams, “Look What’s Happened to California” reproduced in David Farrelly and Ivan Hinderaker, eds., *The Politics of California: A Book of Readings* (New York: Ronald Press, 1951), p. 22.

<sup>128</sup> See, for example, Scott L. Bottles, *Los Angeles and the Automobile: The Making of a Modern City* (Berkeley: University of California Press, 1987).

<sup>129</sup> Gas tax revenues, however, fell significantly during World War II because gas rationing reduced driving.

<sup>130</sup> Citizens’ Tax Committee, *Report of the Citizens’ Tax Committee* (Sacramento: Calif. State Printing Office, 1943).

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<sup>131</sup> Passage of this bill, which provided revenues to local governments and districts, is described in Oliver J. Carter, “A Leader in the California Senate and the Democratic Party, 1940-1950,” Earl Warren Oral History Project, 1979.

<sup>132</sup> Earl Warren Oral History Project, *Bee Perspectives of the Warren Era*, 1976, interview with Herbert L. Phillips, p. 72.

<sup>133</sup> Quoted in Richard R. Mathison, *Three Cars in Every Garage: A Motorist’s History of the Automobile and the Automobile Club in Southern California* (Garden City, NY: Doubleday & Co., 1968), p. 215.

<sup>134</sup> Wolfgang S. Humburger, “Harmer E. Davis, Founder of the Institute of Transportation and Traffic Engineering,” UCB-ITS-MISC-97-1, Institute of Transportation Studies, UC-Berkeley, 1997, p. 91.

<sup>135</sup> Herbert L. Phillips, “Governor Gets \$91,000,000 Highway Measure,” *Sacramento Bee*, June 21, 1947. (The Phillips columns are preserved in the Earl Warren Collection at the California State Archives.)

<sup>136</sup> Herbert L. Phillips, *Big Wayward Girl: An Informal Political History of California* (Garden City, NY: Doubleday & Co., 1968), p. 115.

<sup>137</sup> Earl Warren Oral History Project, *Conversations with Earl Warren on California Government*, 1982, interviews conducted in 1971 and 1972. On p. 174 Warren said “*Well, Collier has been mixed up with the highway program for many, many years. Even before that. He claims to be the father of the highway bills, but I know that in that particular instance, they blocked him clear out of the play, because they didn’t have any confidence in the way he was acting. So they blocked him out, and he had nothing to do with the final passage of that bill. George Hatfield and Butch (Harold J.) Powers and the rest of them in the senate put that bill through, and they just kept him out of their councils even.*”

<sup>138</sup> See, for example, C.H. Purcell, “The State Looks at the Current Highway Situation,” address to the California Chamber of Commerce, December 4, 1946. Harrison R. Baker Collection, California State Archives, F3778:140.

<sup>139</sup> California State Senate, “*The Legislature Takes a Look at California Highway Needs*” and *Other Addresses by Senator Randolph Collier* (Sacramento: California State Printing Office, 1947).

<sup>140</sup> Bertram H. Lindman, *A Proposed System of Highway Financing for the State of California* (Sacramento: California State Printing Office, 1946). On tolls, see p. 100.

<sup>141</sup> Beach Vasey to Warren, memo of December 9, 1946, Earl Warren Collection, California State Archives, F3640: 8396. The issue was the so-called “Breed Amendment formula” that allocated earlier funding on a north/south division.

<sup>142</sup> Key opponents of Collier-Burns were Glenn Anderson (Hawthorne), Ernest Geddes (Pomona), Augustus Hawkins (Los Angeles), John Evans (Los Angeles), Ralph Dills (Compton), Vincent Thomas (San Pedro), Jonathan Hollibaugh (Los Angeles), and Laughlin Waters (Los Angeles). Files of Harrison R. Baker, member California Highway Commission, California State Archives, “History of the Collier-Burns Highway Act of the 1947 (Extraordinary) Session,” LP229:12.

<sup>143</sup> “Let’s Try a 5-Cent Gasoline Tax,” editorial, *Los Angeles Times*, February 26, 1947. Oddly, the state’s construction unions seemed not to be much involved in Collier-Burns, despite its potential for job creation. Taft’s major study of California union activity in this era makes no mention of Collier-Burns. Philip Taft, *Labor Politics American Style: The California Federation of Labor* (Cambridge, MA: Harvard University Press, 1968). Unions, especially the more conservative AFL unions (which included construction trades), often supported Warren on legislative issues.

<sup>144</sup> A chronology of the legislative history of Collier-Burns can be found in Jeffrey Richard Brown, *Trapped in the Past: The Gas Tax and Highway Finance*, MA thesis, Dept. of Urban Planning, UCLA, 1998, pp. 171-233; Wesley Duncan Vail, *The Legislative History of the Collier-Burns Highway Act of 1947*, MA thesis, Dept. of History, Stanford University, 1955; Nelson C. Price, *Digest of Testimony and Reports Considered in Enacting the Collier-Burns Highway Act of 1947* (Sacramento: California State Legislature, 1949).

<sup>145</sup> Quoted in Brown, *op. cit.*, p. 228.

<sup>146</sup> Quoted in Herbert L. Phillips, “Joint Action Is Urged On Highway Bill,” *Sacramento Bee*, May 5, 1947.

<sup>147</sup> Herbert L. Phillips, “Highway Tax Issue May Go Over to 1948,” *Sacramento Bee*, April 12, 1947.

<sup>148</sup> Herbert L. Phillips, “Future Action on Road Bill is Uncertain,” *Sacramento Bee*, April 9, 1947.

<sup>149</sup> Quoted in Brown, *op. cit.*, pp. 229-230, and Herbert L. Phillips, “House Passes Badly Battered Highway Bill,” *Sacramento Bee*, April 8, 1947.

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- <sup>150</sup> Quoted in Herbert L. Phillips, "Assembly Tax, Road Bills Go to Senate," *Sacramento Bee*, June 13, 1947; Herbert L. Phillips, "Senate May Insist on 1½ Cent Gas Tax," *Sacramento Bee*, June 11, 1947.
- <sup>151</sup> Ralph Dills quoted in Herbert L. Phillips, "Governor Gets \$91,000,000 Highway Measure," *Sacramento Bee*, June 21, 1947.
- <sup>152</sup> Chester Gannon quoted in Herbert L. Phillips, "House Passes Badly Battered Highway Bill," *Sacramento Bee*, April 8, 1947.
- <sup>153</sup> Earl Warren, *The Memoirs of Chief Justice Earl Warren* (Garden City, NY: Doubleday, 1977), pp. 208-209. In true Warren style, he defends the deal by noting that labeling horse meat was "honest advertising."
- <sup>154</sup> Letter dated April 15, 1947. Randolph Collier files in California State Archives, LP229:12.
- <sup>155</sup> Hayley Chouinard and Jeffrey M. Perloff, "Incidence of Federal and State Gasoline Taxes," Dept. of Agricultural and Resource Economics, University of California-Berkeley, Working Paper 952, 2003.
- <sup>156</sup> Letters of March 21, 1947 by Kemper Campbell to the presidents of Standard Oil, the Texas Company (Texaco), and the Union Oil Company (Unocal). Randolph Collier files in California State Archives, LP229:12.
- <sup>157</sup> Buchanan, *op. cit.*, p. 33.
- <sup>158</sup> G. Edward White, *Earl Warren: A Public Life* (New York: Oxford University Press, 1982), pp. 21-22. Warren did not particularly like his first job and quit after a year. However, the source of his dislike was his boss, not the oil industry.
- <sup>159</sup> Quoted in Herbert L. Phillips, "Week Brings Little Progress on Road Bill," *Sacramento Bee*, April 5, 1947. See also Warren, *op. cit.*, p. 208.
- <sup>160</sup> Irving Stone, *Earl Warren: A Great American Story* (New York: Prentice-Hall, 1948), pp. 145-146.
- <sup>161</sup> Ed Cray, *Chief Justice: A Biography of Earl Warren* (New York: Simon & Schuster, 1997), pp. 140-141.
- <sup>162</sup> Jack Harrison Pollack, *Earl Warren: The Judge Who Changed America* (Englewood Cliffs, NJ: Prentice-Hall, 1979), p. 77.
- <sup>163</sup> Warren, *op. cit.*, pp. 249-250.
- <sup>164</sup> Cray, *op. cit.*, pp. 227, 390.
- <sup>165</sup> Martin Wachs, "A Dozen Reasons for Raising Gasoline Taxes," Institute of Transportation Studies, University of California-Berkeley, Working Paper UCB-ITS-RR-2003-1, 2003; Pietro S. Nivola and Robert W. Crandall, *The Extra Mile: Rethinking Energy Policy for Automotive Transport* (Washington: Brookings Institution, 1995), pp. 48-50.
- <sup>166</sup> Charles L. Dearing, *American Highway Policy* (Washington: Brookings Institution, 1941), pp. 176-182.
- <sup>167</sup> Brown, *op. cit.*, p. 96.
- <sup>168</sup> Humburger, *op. cit.*, p. 115.
- <sup>169</sup> California Dept. of Transportation, "Highway Recollections of James E. Roberts," oral history interview, Caltrans, 1999, p. 7.
- <sup>170</sup> Quoted in Lewis, *op. cit.*, p. 119.
- <sup>171</sup> An exception of the downplaying of the California model can be found in Brian Deane Taylor, *When Financing Leads Planning: The Influence of Public Finance on Transportation Planning and Policy in California*, PhD dissertation, Dept. of Urban Planning, UCLA, 1992. Taylor refers to California as the "prototype" for the country in 1956 because it had "led the nation in post-war freeway development." (p. 59)
- <sup>172</sup> Wilfred Owen and Charles L. Dearing, *Toll Roads and the Problem of Highway Modernization* (Washington: Brookings Institution, 1951).
- <sup>173</sup> A history and analysis of the passage of the 1956 legislation creating the interstate highway system can be found in Gary T. Schwartz, "Urban Freeways and the Interstate System," *Southern California Law Review*, vol. 49 (1976), pp. 406-513.
- <sup>174</sup> Eric M. Patashnik, *Putting Trust in the US Budget: Federal Trust Funds and the Politics of Commitment* (Cambridge: Cambridge University Press, 2000), chapter 6.
- <sup>175</sup> John Chynoweth Burnham, "The Gasoline Tax and the Automobile Revolution," *Mississippi Valley Historical Review*, vol. XLVIII (June 1961), pp. 457-458.
- <sup>176</sup> See the symposium on "Metropolitan Freeways and Mass Transportation" in *Transactions of the Commonwealth Club of California*, vol. XXII (August 1946), especially p. 113.
- <sup>177</sup> W. Lee Mertz, "Origins of the Interstate," on the website of the U.S. Dept. of Transportation, [www.fhwa.dot.gov/intrastructure/origin.pdf](http://www.fhwa.dot.gov/intrastructure/origin.pdf).

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<sup>178</sup> Knowland was one of the signatories of official the “pro” arguments for Prop 3. His biography describes him as a leading figure in that campaign. See Gayle B. Montgomery and James W. Johnson, *One Step from the White House: The Rise and Fall of Senator William F. Knowland* (Berkeley: University of California Press, 1998), pp. 24-25.

<sup>179</sup> Zettel was later interviewed about his role but the transcription is poor and garbled. It appears that the California highway establishment did not particularly favor a federal role. The preferred approach was repeal of the existing federal gas tax, so that the state could presumably raise its tax to replace it and then continue building its own system. Zettel believed that the federal role led to highway construction around the country where interstate expressways were not needed. Nonetheless, he would have been a conduit of information about the California model. See “Oral History Interview with Mr. Richard M. Zettel,” February 28, 1988, available from the Institute of Transportation Studies, UC-Berkeley.

<sup>180</sup> Buchanan, *op. cit.*, p. 31.

<sup>181</sup> Warren has a freeway named after him in the Oakland area, a portion of State Highway 13. Collier has a tunnel with his name in Del Norte county. However, such recognition was not confined only to those who supported Collier-Burns. Vincent Thomas, an assemblyman from San Pedro who opposed Collier-Burns, has a major suspension bridge named after him at the Los Angeles harbor.

<sup>182</sup> Quoted in “Legislation Provides \$76,000,000 Annually for New Construction on California State Highway System,” *California Highways and Public Works*, vol. 25 (July-August 1947), pp. 1-2, 7, 26. (The volume number appears to be mislabeled no. 26 in the original.)

<sup>183</sup> Schrag, *op. cit.*, p. 35.

<sup>184</sup> Jay Michael, Dan Walters, and Dan Weintraub, *The Third House: Lobbyists, Money, and Power in Sacramento* (Berkeley: Berkeley Public Policy Press, 2002).

<sup>185</sup> H.R. Philbrick, *Legislative Investigative Report* (No City: Edwin N. Atherton & Associates, 1938).

<sup>186</sup> Phillips, *op. cit.*, chapter 18; Arthur H. Samish and Bob Thomas, *The Secret Boss of California: The Life and High Times of Art Samish* (New York: Crown Publishers, 1971). Doerr, *op. cit.*, claims that Samish helped push Collier-Burns through the Legislature and makes a vague reference to Samish’s autobiography. However, although Samish does refer to a bill in the late 1930s involving taxation of diesel fuel which he helped kill, there is no reference to Collier-Burns in his autobiography. It is nonetheless likely that Samish did have some involvement in Collier-Burns because of his relationship with the trucking industry and others have so suggested. See Earl Warren Oral History Project, “The Governor and the Public, the Press, and the Legislature. 1973, interview of Verne Scoggins, press secretary, pp. 60-61. Samish’s ventriloquist analogy is somewhat ironic since the actions of certain legislators in “questioning” oil company representatives at hearings on Collier-Burns was compared at the time to a Edgar Bergen/Charlie McCarthy act. (Bergen was a celebrity ventriloquist on radio and in films.) The implication was that the witness had supplied the questions. See Vail, *op. cit.*, p. 44.

<sup>187</sup> Editorial of the *San Francisco Chronicle* of June 13, 1947, quoted in William Buchanan, *op. cit.*, p. 33.

<sup>188</sup> Warren had also tried to enact universal health insurance in 1945. See Daniel J.B. Mitchell, “Warren’s Waterloo: The California Health Insurance Plan That Wasn’t (And the New York Plan That Was and Is)” in Daniel J.B. Mitchell, ed., *California Policy Options 2001* (Los Angeles: UCLA School of Public Policy and Social Research, 2001), pp. 84-115.

<sup>189</sup> Norris Hundley, Jr., *The Great Thirst: Californians and Water, A History*, revised edition (Berkeley: University of California Press, 2001).