Propositions 1A-1F: Legislature Calls Emergency Election to Vote on Budget

April 12, 2009 and May 3, 2009 Meetings of the Forum, Unitarian Universalist Church of Palo Alto
Led by Everett DePangher

Background on February 19 Budget Compromise[1]

As the economy slowed, Californians entered 2009 with our spending and revenue on trajectory for an approximately $40,000,000,000 deficit in FY 2009-10 (July 1, 2009-June 30, 2010). This is a substantial number considering that it is almost half of our total FY 2007-08 sending ($103,000,000,000). In response, the Legislature went into marathon negotiations to craft a plan that could both balance the state's budget (as required by state law) and garner the significant two-thirds support in both the State Senate and State Assembly required for passage.

On February 19 and with the Governor's support, legislators pulled this off by the skin of their teeth: after delicately crafting compromises on all sides, they approved a balanced budget by just one vote in both the Senate and Assembly (although some specific provisions garnered much more support). They agreed to a framework projected to drop FY 2009-10 spending to $92,000,000,000 while bringing in equivalent revenue plus $6,000,000,000 more to pay off our outstanding FY 2008-09 expenses. On paper, this budget closes the gap with a mixture of spending cuts ($15,400,000,000), tax increases ($12,500,000,000), federal money paid from its recently-passed stimulus plan ($8,500,000,000), and borrowing ($5,300,000,000).

The following is a table pulled out of a report from the Legislative Analyst's Office (LAO), the state entity responsible for providing both state officials and the general public with neutral analysis of state finances and laws. The table lists in more detail the mixture of steps taken to close the deficit:

[1] The following information is based in part on official analysis from the Legislative Analyst's Office (LAO). See LAO, "Overview of State Budget" (25 February, 2009) (online, available: <http://www.sos.ca.gov/elections/public-display-051909/overview-lao.pdf>, 9 March, 2009). See also: Jim Sanders, *The Sacramento Bee*, "At long last, a budget deal dawns in the capital" (20 February, 2009) (online, available: <http://www.sacbee.com/politics/story/1639231.html>, 9 March, 2009).

Excerpt from LAO Summary of the February 19 Budget Compromise[2]

How the February 2009 Budget Package Closes the $40 Billion Shortfall

(In Millions)

	2008-09	2009-10	Two-Year Total
Tax Increases			
Increase sales tax by 1 cent	$1,203	$4,553	$5,756
Increase vehicle license fee by 0.5 percent	346	1,692	2,038
Increase personal income tax rates by 0.25 percentage point	—	3,658	3,658
Reduce dependent credit	—	1,440	1,440
Create new tax credits	-15	-363	-378
Subtotals	($1,534)	($10,980)	($12,514)
Spending-Related Savings			
Reduce Proposition 98 spending	$5,775	$2,647	$8,422
Reduce health and social services spending	131	1,518	1,650
Furlough state workers and reduce other employee costs	333	834	1,167
Reduce higher education spending	132	756	888
Seek voter approval to redirect Propositions 10 and 63 monies	—	835	835
Redirect transportation funds	254	407	661
Reduce Corrections and Rehabilitation (Governor's veto)	—	400	400
Reduce other spending	140	1,198	1,337
Subtotals	($6,765)	($8,594)	($15,360)
Borrowing			
Issue lottery bonds	—	$5,001	$5,001
Borrow from special funds	$234	94	328
Subtotals	($234)	($5,095)	($5,329)
Federal Stimulus Funds	$2,825	$5,701	$8,527
Total Solutions	**$11,358**	**$30,371**	**$41,730**

However, because the State Constitution requires direct voter approval for portions of this plan (largely because they either amend the State Constitution or override previous voter-approved laws), the Legislature's compromise also triggered what is essentially an emergency special election on May 19. These rare circumstances bring voters back to the polls just six and a half months after we had last voted and over a year before our next election, still scheduled for June 8, 2010.

In this election, the Legislature will ask us to sign off on six specific sections of the budget: Propositions 1A, 1B, 1C, 1D, 1E, and 1F. These are the only propositions on the statewide ballot.

As this vote nears, there are two overarching issues that California must resolve: one is balancing the upcoming FY 2009-10 budget. If we approve Propositions 1B, 1C, 1D, and 1E, balance would be reached under the Legislature's original financial

[2] This table was produced in Mac Taylor, "2009-10 Budget Analysis Series: The Fiscal Outlook Under the February Budget Package" (13 March, 2009) (online, available: <http://www.lao.ca.gov/2009/bud/feb_overview/feb_overview_031309.pdf>, 18 March, 2009), 6.

projections. If we do not, then the Legislature will have to make adjustments for those sections of the budget. Second, we must stabilize future budgets. Proposition 1A is designed to adjust spending and taxes to help with this. However, according to the LAO, even this will not resolve future budget problems, and additional action in the Legislature would be required. Proposition 1F, meanwhile, minimally pertains to the budget itself but is a part of the plan that changes our policy regarding compensation of state legislators.

Updated LAO Numbers
Unfortunately for the compromise, a major development occurred after the compromise was reached: on March 13, the LAO released new financial projections claiming that revenue will be $8,000,000,000 lower than the plan had assumed, effectively reopening the deficit. A greater-than-expected drop in national GDP during 2008's fourth quarter was a partial cause of the reassessment. The May 19 election does not address this new problem, and the Legislature will have to revisit it later on.[3]

Proposition 1A[4]

Proposition 1A is one of only two proposals in this package that is not geared toward the upcoming fiscal year's budget (Proposition 1F being the other). Instead, Proposition 1A reorganizes future budgets over the medium and long term. It is an amendment to the State Constitution and contains three main provisions: tax increases, changes in state spending, and an expansion of the governor's discretion over expenses. The Senate voted 30-8 to put this on the ballot, and the Assembly concurred 74-6.

Tax Increases
Under the budget plan, the Legislature exercised emergency authority to increase taxes temporarily, including a 1% sales tax increase, an income tax boost of 0.25% across all brackets coupled with a sizable tax credit cut, and almost a doubling of the vehicle license tax. These increases will basically expire in 2011 and would then return to current levels. However, the Legislature wishes to extend these increases for one to two years further, and this additional time requires our approval of Proposition 1A. Below is a chart comparing the duration of these increases if this vote succeeds to if it fails.

[3] Taylor, "2009-10 Budget," 20-1.

[4] The following information is heavily based on official analysis from the LAO. See LAO, "Proposition 1A" (25 February, 2009) (online, available: <http://lao.ca.gov/ballot/2009/1A_05_2009.pdf>, 7 April, 2009).

Tax Increase Extensions Under Proposition 1A[5]				
Type of tax raised under budget agreement	**Old rate**	**New temporary rate**	**Duration of temporary increase under Legislature's action irrespective of Proposition 1A**	**Extension of temporary increase if Proposition 1A passes**
Sales tax	7.25% (plus any municipal additions: Santa Clara County's total was 8.25%)	8.25% (plus any municipal additions: Santa Clara County's total is 9.25%)	April 1, 2009 – July 1, 2011	July 1, 2011 – July 1, 2012
Income tax	Brackets vary between 1% and 10.3%; dependent credit was $309	Increase of 0.25%* in each bracket; dependent credit is $99	2009 and 2010 tax years	2011 and 2012 tax years
Vehicle license fee	0.65% of vehicle value/year	1.15% of vehicle value/year	May 19, 2009 – June 30, 2011	June 30, 2011 – June 30, 2013

** The February 19 compromise left open the possibility of the increase being only 0.125% if the state treasurer and state finance director determined by April 1 that federal stimulus money would be above a certain amount. They determined that it would not be. For more information, see: Kevin Yamamura,* The Sacramento Bee*, "State faces higher income tax, more cuts" (28 March, 2009) (online, available: <http://www.sacbee.com/politics/story/1735514.html>, 7 April, 2009).*

Changes to the So-Called "Rainy-Day Fund"

We keep some of our savings in a reserve called the Budget Stabilization Account (BSA), and Proposition 1A would rename it the Budget Stabilization Fund (BSF). More importantly, this proposal would significantly change the formulae governing deposits into and withdrawals from the BSF (which has been being referred to popularly as a "rainy-day fund"). The following is a summary comparing the current BSA rules to Proposition 1A's proposed rules for the BSF:

[5] For more information on the sales tax increase, see: California State Board of Equalization, "California City and County Sales and Use Tax Rates" (6 April, 2009) (online, available: <http://www.boe.ca.gov/sutax/pam71.htm>, 9 April, 2009). For the vehicle license fee increase, see: California Department of Motor Vehicles, "Vehicle License Fee (VLF) Increase Effective May 19, 2009" (online, available: <http://www.dmv.ca.gov/faq/faq_vlf.htm>, 9 April, 2009).

Proposed Changes to the So-Called "Raining-Day Fund"		
Rule	**Currently**	**Under Proposition 1A**
New definition of extra revenue	N/A	Revenue in excess of either (a) the previous ten-year trend, factoring in recent tax policy changes, or (b) the last year's spending levels, factoring in inflationary and population changes
Obligations for extra revenue before any deposit into the rainy-day fund	None	If necessary, fill education funding gaps left unfulfilled under our spending formulae for K-12 and junior college
Fund's spending obligations	50% devoted to an expedited payment of 2004 bond debt obligations*	If Proposition 1B also passes, then starting in FY 2011-12, the fund would incur a $9,300,000,000 obligation to fund education. 1.5% of total revenue must be withdrawn each year until this obligation is met. During that time, 50% of the remainder would go toward expedited payment of 2004 bond debt obligations.* When the education obligation is met (or immediately if Proposition 1B fails), then 1.5% of total revenue must be spent from the fund each year toward either bond debt or infrastructure. Meanwhile, 50% of deposits would continue to go toward expedited payment of 2004 bond debt obligations.
Amount of annual revenue automatically deposited	3%	3% plus, starting in FY 2010-2011, extra revenue left over after higher-priority obligations are met
Circumstances under which governor can suspend automatic deposits	Any time	Funds devoted to education could never be suspended; for the rest, starting in FY 2011-12, only when (a) there is a natural disaster or (b) revenue dips below the previous year's spending, factoring in inflationary and population changes
Cap at which the fund is considered full and automatic deposits cease	The greater of (a) $8,000,000,000 or (b) 5% of annual revenue (today, approximately $5,000,000,000)	12.5% of annual revenue (today, approximately $12,000,000,000)
Obligations for remaining excess money if the rainy-day fund is full	N/A	Must go toward paying off debt
** In 2004, we approved Proposition 57 to take out $15,000,000,000 in loans through bonds to close another budget deficit that had arisen at the time. We have been using this fund to increase the rate at which we pay down that debt.*		

More Discretion for Governor on Spending

Finally, the plan increases the governor's ability to reduce spending once a budget is already in place. The governor could cut certain operational expenses by up to 7%. Also, when the Legislature passes a budget, it can specify certain items for which the governor can suspend the cost-of-living adjustment (COLA) during the upcoming fiscal year. However, suspension of the COLA would largely not pertain to state employee salaries.

LAO Financial Assessment

The LAO's predictions are very cautious, arguing that the impact of these various changes in budgetary formulae is hard to determine in advance. However, the LAO believes that Proposition 1A will have the general effect of helping to stabilize budgets from year to year. Currently, revenue can vary substantially between years, so by forcing some income into the rainy-day fund during high-revenue years, we could more easily level peaks and troughs in spending. The tax increase extension would also bring in additional revenue during its couple of years. Overall, while all of these formulae could have various effects on revenue depending on the future economy, the LAO expects that reserves in the rainy-day fund would more likely be higher under Proposition 1A.

Proposition 1B[6]

This is a constitutional amendment that pertains to education funding formulae. The Senate approved it 28-10, and the Assembly did so 68-11.

Context
In 1988, we approved Proposition 98 which amended the State Constitution to require that K-12 schools and community colleges receive a minimum amount of funding. This plan was itself amended in 1990. Under the current Constitution, the formula that determines minimum educational funding in a particular year differs depending on the state's revenue levels at the time. When the state goes through a year in which we use one of the lower formulae (because revenue is down), then under at least certain circumstances, savings from using that lower formula would be computed and the difference made up later as back payments.

Coming out of FY 2007-08, we had accumulated $1,400,000,000 in back payment obligations. In addition, we are using a lower formula in FY 2008-09, but according to the LAO, there are different schools of thought on both whether we are obligated to pay back savings from this particular formula and also, if we do, how quickly. If we must pay, the amount would be $7,900,000,000, bringing the total to $9,300,000,000.

Plan
This proposal amends the State Constitution to release us from our back payment obligations without specifying whether those obligations are the $1,400,000,000 or the $9,300,000,000. Instead, we would pay $9,300,000,000 (irrespective of whether we actually owe that amount) over time from the rainy-day fund starting in FY 2011-12.

By doing this, we would effectively defer the back payments out a few years to give ourselves breathing room in the current budget situation. The procedures and funding sources for this are set up under Proposition 1A: starting in FY 2011-12, we would pay 1.5% of general fund revenue over a few years until the $9,300,000,000 total is reached (for more information, see the Proposition 1A section above). Thus, because Proposition 1B is unfunded without Proposition 1A, we would have to pass them both for Proposition 1B to go into effect.

Finally, this proposal also makes some adjustments to the specific educational purposes for which the money would be spent.

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[6] The following information is heavily based on official analysis from the LAO. See LAO, "Proposition 1B" (25 February, 2009) (online, available: <http://lao.ca.gov/ballot/2009/1B_05_2009.pdf>, 7 April, 2009).

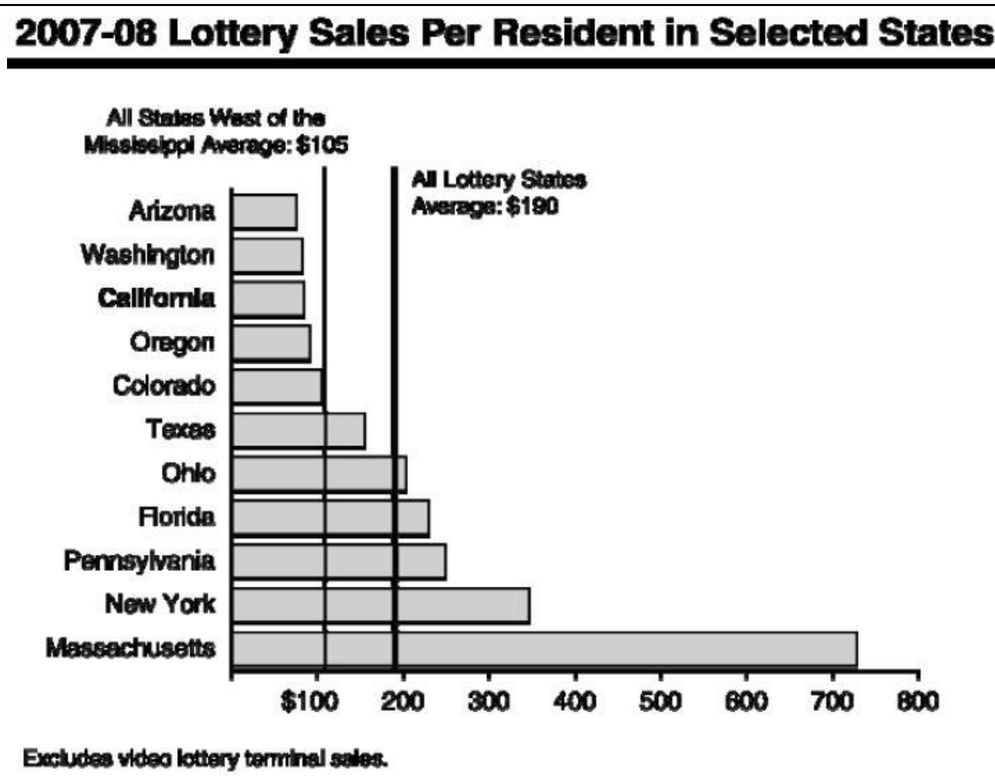
LAO Financial Assessment
Because of the dispute over the amount of back payments we owe our education system, the LAO cannot definitively say what the financial impact is. If our obligations do stand at $9,300,000,000, then we would be temporarily saving billions by deferring payments. However, whether our net long-term education expenses go up or down is also unclear, but the LAO believes that there is a possibility that they would go up.

Proposition 1C[7]

The third piece of the budget compromise that requires our approval is a combination constitutional amendment and statutory change dealing with revenue coming from the state lottery. It passed the Senate 30-8 and the Assembly 70-8.

Context
When we passed Proposition 37 in 1984, we created a state lottery, and ever since, California has raised revenue by selling tickets. Today, however, our lottery experiences a below-average level of activity when compared to other states. According to the LAO, among states with lotteries, the average resident purchases $190/year in tickets. Californians, meanwhile, spend a far lower average of $83/year. Below is a chart from the LAO comparing some lottery states' average spending per resident:

Excerpt from LAO Briefing Paper Comparing Average Lottery Ticket Spending per Resident Among Certain States[8]



[7] The following information is heavily based on official analysis from the LAO. See LAO, "Proposition 1C" (25 February, 2009) (online, available: <http://lao.ca.gov/ballot/2009/1C_05_2009.pdf>, 7 April, 2009).

[8] This table was produced in LAO, "Proposition 1C," 9.

While there are certainly many different reasons for this state-to-state variance, one cause may be that California's lottery prizes are relatively small and thus less appealing. Under current law, 50% of ticket-sale revenue goes to prizes, but some other states use a higher figure. By increasing this percentage, our lottery may become more attractive to consumers. The LAO reports that there is some evidence for thinking this: for instance, Florida expanded its prizes in 2002 and since has seen a large growth in sales.

Expansion of State Lottery
This proposal seeks to raise more state revenue by increasing lottery ticket sales. The California State Lottery Commission, the body that oversees the lottery, could raise prizes above 50% of ticket sales if it believed that doing so would increase sales to such a degree that net profits would also increase. The LAO predicts that this would probably occur: an expanded prize package could grow ticket sales 30%-80% and thereby create nine-digit (hundred million) dollar increases in net profits annually.

In addition, Proposition 1C makes other systemic changes to the lottery and lottery funds. It would:

1. *Reduce the total amount allocated for overhead.* Currently, the Lottery Commission can spend 16% of sales revenue on overhead. This plan reduces it to 13%. However, this change is currently immaterial because overhead expenses are lower than 13% anyway.

2. *Expand discretion on overhead expenses.* It would give the Lottery Commission greater flexibility over how it pays for its overhead expenses. This includes a greater ability to use no-bid contracts and to carry unused overhead funds into the next fiscal year.

3. *Grow investment in gambling addiction hotline.* Currently, around $250,000 of sales revenue goes toward the Office of Problem Gambling's toll-free hotline for people seeking assistance for gambling-related problems. This would expand the amount to $1,000,000.

4. *Give the Legislature more freedom to change the lottery.* This proposal does not directly alter or expand the type of lottery games available or machinery used. However, it does allow the Legislature to do so with a supermajority (two-thirds) vote in both the Senate and Assembly.

This collection of changes would likely, according to the LAO, make the lottery more appealing and profitable.

Borrowing from Increased Lottery Revenue
Part of the compromise to close the FY 2009-10 deficit involved this anticipated new lottery income. Under Proposition 1C, we could (and almost certainly would) immediately try to borrow $5,000,000,000 by selling bonds backed by the anticipated new revenue. The LAO estimates that between principal and interest payments, this would cost between $350,000,000/year and $450,000,000/year for twenty to thirty years.

This process ensures that several years' worth of new revenue becomes available immediately to solve our current situation. Also, although not instantly applicable, this proposal allows borrowing off of the lottery in future years too.

Changes to Expenditure of Lottery Revenue
This plan also involves a fairly technical rearranging of public education funding. Currently, all lottery profits are allocated to education. Under this plan, that would cease and all profits would go toward paying off state debts: first and foremost debt from borrowing off of the state lottery (such as this $5,000,000,000) and then other types of state debt.

However, in exchange, our General Fund would start incurring new education obligations. In FY 2009-10, the General Fund would allocate an amount equal to the FY 2008-09 lottery profit (roughly $1,000,000,000) adjusted for changes in the cost of living and student population. In future years, the previous year's amount would be allocated again after a similar adjustment.

LAO Financial Assessment
As mentioned above, the LAO is inclined to think that both lottery ticket sales and profits will increase under this plan. However, it does question our ability to bond $5,000,000,000 given the current credit market's weaknesses.

As for the education funding, the LAO predicts that it would increase (eventually maybe even in the hundreds of millions of dollars per year). However, the total amount of funding in question under Proposition 1C represents only a very small percentage of the overall education budget. Nevertheless, since potentially most of the new revenue goes toward paying off new debt (and even more would if future borrowing occurs), the LAO doubts that the increased ticket sales would be enough to offset these new expenses. Consequently, we would need to find additional funding sources in the future.

Finally, the LAO reports that there may be a decrease in other types of gambling revenue and local sales tax revenue if consumers switch their purchases away from other goods and services and toward lottery tickets.

Proposition 1D[9]

This piece of the plan received approval 37-0 in the Senate and 75-3 in the Assembly. It rearranges and reallocates funds currently going to early childhood health and welfare.

Context
In 1998, we passed Proposition 10 to raise the cigarette tax by $0.50/pack (packs are also currently taxed an additional $0.37 for other purposes). This $0.50 tax revenue goes to fund the First 5 program, a combination of efforts to promote early child health and development. These include funding of health care and insurance, preschool, new parent training, child disability assistance, sustenance for poor families with young

[9] The following information is heavily based on official analysis from the LAO. See LAO, "Proposition 1D" (24 February, 2009) (online, available: <http://lao.ca.gov/ballot/2009/1D_05_2009.pdf>, 7 April, 2009).

children, prenatal care, and other programs. The LAO estimates that in FY 2009-2010, the $0.50 tax would bring in $500,000,000 and that that amount will likely decrease in future years.

Proposition 10 also allowed unused cigarette tax funds to rollover into the next year. As of June 30, 2008, the First 5 program had accumulated $2,500,000,000 in unused reserves.

Plan
Proposition 1D takes most of these First 5 reserve funds and spends them to help close the deficit. In FY 2009-10, up to $608,000,000 would be moved from the reserve to pay for non-First 5 programs related to young children's welfare. By doing so, an equivalent sum of General Fund revenue would no longer be necessary and the deficit would close by that amount. After that, an additional $268,000,000 would be removed each fiscal year up though FY 2013-14.

In addition, this proposal contains a few other changes. It would:

1. *Adjust the allocation of some First 5 funds.* 6% of First 5 money is currently allocated to media marketing of children's health issues. This would move that money into a more unspecified category of expenses related to children's health.

2. *Change audit requirements for First 5 funds given to counties.* Currently, counties receive most First 5 money, and a designated commission in each county allocates the funds. This plan requires that (a) the county auditor serve on the commission and (b) the commission submit their yearly audit report to the county board of supervisors.

3. *Set minimum allocation for counties.* All counties would be guaranteed at least $400,000/year.

4. *Allow counties to borrow their funds for other purposes.* A county's controller could borrow First 5 funds as long as doing so would not disrupt the First 5-funded programs and would be paid back with interest.

LAO Financial Assessment
Beyond its numbers listed above, the LAO only gives a fairly general statement that because this plan may shift funding between different young child health and welfare programs, some better-funded programs could see increased costs as Californians switch their reliance to those programs.

Proposition 1E[10]

Proposition 1E cuts mental health funding to help reduce the deficit. It garnered approval 36-2 in the Senate and 76-4 in the Assembly.

[10] The following information is heavily based on official analysis from the LAO. See LAO, "Proposition 1E" (25 February, 2009) (online, available: <http://lao.ca.gov/ballot/2009/1E_05_2009.pdf>, 8 April, 2009).

Context
In 2004, we approved Proposition 63 to create a 1% income tax increase on the bracket above $1,000,000. We also designated that this new revenue stream would fund various types of mental health care (such as treatments, training of health care providers, early detection, technological improvements, and other programs). Since its enactment, the 1% tax has brought in between $900,000,000 and $1,500,000,000 each year for these programs.

Meanwhile, totally apart from this funding, federal law requires California to have an Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) Program. The EPSDT Program is mostly financed by federal matching funds and state funds and provides health care (including some mental health care) to young people under age twenty one.

Plan
This plan cuts state mental health care investment for the next two fiscal years. For FY 2009-10 and FY 2010-11, it would take approximately $230,000,000 each year away from Proposition 63's programs and use it to pay for part of the EPSDT Program. By doing so, it frees us from having to spend that amount out of the General Fund and thus lowers the deficit.

LAO Financial Assessment
Cutting public financing of mental health care could have various social and financial consequences for California according to the LAO. Consequently, municipal governments may feel the need to increase some of their spending. Also, as the state cuts funding, it may lose some federal matching funds in the process.

Proposition 1F[11]

The final piece of this election package won approval in the Legislature unanimously: in the Senate, 39-0, and in the Assembly, 80-0. It is a state constitutional amendment pertaining to legislative and executive officer compensation.

Context
Through previous propositions, we created independent bodies to determine the compensation levels of elected executive branch officials, state legislators, and members of the State Board of Equalization. Various criteria go into determining compensation. These include a comparison to people in similar positions and (for legislators) the amount of time that they spend in session. Currently, base salaries for these positions vary quite a bit. The governor makes the most at $212,000, and legislators earn the lowest with $116,000.

Plan
Proposition 1F would prevent the independent bodies from increasing pay for these officials when the state is in fiscal hardship. Specifically, the state finance director would annually make a finding about whether a particular reserve fund (not the one altered by Proposition 1A but another less-restricted one) is on track to be in the red

[11] The following information is heavily based on official analysis from the LAO. See LAO, "Proposition 1F" (25 February, 2009) (online, available: <http://lao.ca.gov/ballot/2009/1F_05_2009.pdf>, 8 April, 2009).

by an amount more than 1% of the General Fund. If it is, then compensation for these elected officials would not increase during the next pay-adjustment cycle.

LAO Financial Assessment

State savings, according to the LAO, are hard to determine under this proposal. Elected official base salaries have increased on four occasions since 2000, but these increases were never greater than inflation. It also reports that given current compensation levels, a hypothetical denial today of a 1% increase would save the state about $160,000. Beyond that, the rest is open for guessing since both the future economic climate and the independent bodies' intentions are not fully knowable. The LAO additionally notes that changes in officials' behavior as a result of Proposition 1F may have an effect on the budget-crafting process. The impact of this too, however, is speculative.

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Conclusion

A special election like this is highly unusual in California, and its occurrence reinforces the severity of this economic climate. The Legislature's February 19 passage of this budget may or may not meet with voters' liking when these six pieces of it come before us for approval on May 19. We shall either accept them, reject them (and thereby send them back to the Legislature for changes), or do some combination of both.