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Are California's Fiscal Constraints Institutional or Political?

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Summary

California's record-setting late budget of 2008 has again called into question the wisdom of requiring a two-thirds vote of the legislature—a supermajority—to pass a state budget, especially in an era of intense partisanship. But other than hindering the process of passing a budget each year, what are the policy consequences of requiring a supermajority? This paper examines this question, as well as the possible consequences of other constraints on California governance. We compare state and local revenues and spending in California with other states that are not so similarly constrained.

We find that in fact, there is not much distinctive about California's revenue and spending patterns compared to other, less constrained states. Overall state and local spending in California has increased as agencies and local jurisdictions have found various other means —such as charges, fees, bonds, and sales taxes—to make up for property taxes lost after the passage of Proposition 13 in 1978 and other subsequent voter-imposed limitations.

Notwithstanding the view of some conservatives that the supermajority requirement will constrain taxes and spending, the reality is that limiting government spending through a supermajority budget requirement is like squeezing a balloon in the hope of reducing the overall volume of air. The volume of air in the balloon will not diminish, but squeezing it will distort its shape, creating bulges in places of less pressure. Institutional constraints such as the supermajority threshold have reshaped the form and mix of California's revenues and expenditures to some degree, but have not served the conservative goal of limiting total state and local spending. Moreover, many of the fiscal patterns found in California are similar to those in other states that have far fewer institutional constraints, some of them with none. This similarity results from larger political forces at work, including a decline in trust in elected officials to make sound fiscal decisions, changing tastes in public services, and an aversion to higher general taxes.

As in the 1990s, the 2008 budget stalemate has led to calls for constitutional reform. In addition to the question of the supermajority vote, any systematic review of the budget process such as ours must consider related problems: the ease with which groups can change the budget through the initiative process, revenue stability, and the political disconnect between the public's demand for services and its willingness to pay for them.

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Introduction

In 1933, California voters adopted a proposition requiring a two-thirds vote of the legislature—a supermajority—if spending grew by more than 5 percent. In 1962, the spending limit was dropped but the supermajority requirement remained. The result in 2008 is that California makes it harder for its legislature to pass a budget than all but a few other states. Over the years, numerous commissions and reform groups have suggested institutional fixes for California's fiscal problems, in the hope that better budget processes will lead to better fiscal decisions. Five organizations over the last 15 years—the California Constitutional Revision Commission, the California Governance Consensus Project, the California Budget Project, the California Business Roundtable and the League of Women Voters of California—have all recommended that California abandon the two-thirds threshold for a simple majority (Simmons, 2002).

At a purely procedural level, the most important advantage of doing so is to increase the chances of passing budgets on time. Until 2008, tardy budgets caused some inconvenience and damaged the legislature's reputation, but the fiscal consequences were not serious enough to galvanize any reform effort. But the prolonged 2008 budget battle has created a more serious crisis and has made the simple majority idea much more appealing. Moreover, with California's political parties and elected officials becoming more polarized, a budget rule that assumes mutual compromise and bargaining looks impractical. It also raises a fundamental question: Is there any good policy reason to have a supermajority budget rule?

Proponents of supermajority vote thresholds believe that there is—that more is at stake than just legislative efficiency. They argue that higher thresholds lead to less government spending, simply because they make it harder for lawmakers and voting majorities to increase taxes or expenditures.

A supermajority requires that unless the size of the legislative majority party equals or exceeds the threshold, that party will need the support of some minority party members, even if the majority controls both the legislative and executive branches. Because the California Legislature has been controlled by Democrats since 1974, the need for Republican support should result in lower overall spending because of concessions that would advance that conservative goal. (Of course, if the reverse were true, the supermajority requirement could be used to forestall a cut in spending that Republicans want. This is a useful reminder that when political circumstances change, the same rules can lead to a different policy outcome.)

The notion that high procedural hurdles will lower spending levels is based on some fairly strong assumptions regarding the state's economy, its ability to exploit non-tax revenue bases, the depth of party unity, and the ease of making fiscal decisions at the ballot box. It also fails

to anticipate potentially important unintended or unpredicted fiscal effects, especially if officials and interest groups adapt creatively to the freshly imposed limits on traditional taxes and find new resources.

We compare California's institutional constraints with other states, and then examine the general academic evidence about the importance of such formal restrictions. Next, to see if these constraints have resulted in some distinctive patterns, we compare California's history of local and state taxing and spending with small samples of similarly restricted and unrestricted states. Lastly, we will examine what our findings mean for California in terms of the value of future institutional reforms.

Constraints on California's Fiscal Policymaking

Beginning with Proposition 13 in 1978, Californians have passed numerous measures to restrict the state's fiscal activities. Despite many debates, conferences, and blue ribbon commissions warning of the problems of serial adoption of such restrictions, most have not been changed or removed. As a result, California's elected officials are institutionally constrained in their ability to make budgetary and fiscal decisions, more so in fact than any other state. There is little sign of imminent change. Few elected officials are willing even to broach the topic of amending—much less abolishing—Proposition 13. The Constitutional Revision Commission's attempt in the early 1990s to amend the two-thirds provision required for a budgetary vote in the state legislature proved futile. Only Proposition 39 in 2000, a measure that reduced the level of voter approval needed to pass local school district bonds, from two-thirds to 55 percent, moved in a less constraining direction.

Constraint can take many forms, and Table 1 displays several. First, there are direct fiscal constraints, such as supermajority voting requirements that raise the threshold for raising taxes or enacting a budget, and other statutes and constitutional provisions that specifically limit state spending or revenues. Another meaning of fiscal constraint is to deny elected representatives their customary monopoly of control over the budget. Hence, direct-democracy states, which allow voters to override and limit the budgetary decisions of elected officials, are more constraining in this sense. Lastly, constraints can mean limitations on the legislative capacity to review and scrutinize budgets. Although no evidence indicates that term limits lead directly to lower levels of taxing and spending, they have altered the budget process by weakening the legislature's incentives and abilities to participate in budgetary review and oversight (Cain and Kousser, 2004). California has all three types of constraints: higher thresholds and direct limits, shared budgetary responsibility, and limited legislative capacity.

As Table 1 shows, California is one of only three states with a supermajority budget vote requirement; six other states require a supermajority vote under specific conditions only, such as failure to enact a budget on time. California is one of 27 states that have adopted a spending or revenue limitation. It is one of only 16 states that have adopted a legislative supermajority requirement for all tax increases. Seven of these states, including California, require a two-thirds vote, five have a three-fifths threshold, and four need a vote of three-fourths of the legislature. California has very strict term limits: six- and eight-year limits for the assembly and state senate respectively, and a lifetime ban on returning to office when terms expire. It also possesses comparatively friendly direct democracy processes at both the state and local levels; these enable voters with only a simple majority to weigh in on fiscal matters, using a constitutional or statutory initiative, and gives them the ability to overturn legislative actions by referendum.

Table 1. Constraints on Taxing and Spending in California and Other States

State	Supermajority Budget Vote Requirement	Supermajority Tax Increase Vote Requirement	Revenue or Expenditure Limits	Constitutional Amendment Initiatives	Statute Initiative	Referendum	Term Limits
California	yes, 2/3	yes, 2/3	E	yes	yes	yes	yes
Arkansas	yes, 3/4	yes, 3/4		yes	yes	yes	yes
Colorado		yes, 2/3	E,R	yes	yes	yes	yes
Nevada		yes, 2/3	E	yes	yes	yes	yes
Arizona		yes, 2/3	E	yes	yes	yes	yes
Michigan		yes, 3/4		yes	yes	yes	yes
Missouri		yes, 3/4	R	yes	yes	yes	yes
South Dakota		yes, 2/3		yes	yes	yes	yes
Oklahoma		yes, 3/4	E	yes	yes		yes
Oregon		yes, 3/5	E, R	yes	yes	yes	
Montana		no	E	yes	yes	yes	yes
Washington		yes, 2/3	E		yes	yes	
Nebraska		no		yes	yes	yes	yes
Ohio		no		yes	yes	yes	yes
Maine		no	E		yes	yes	yes
Florida		yes, 3/5	R	yes			yes
Louisiana		yes, 2/3	E				yes
Massachusetts		no	R	yes	yes	yes	
North Dakota		no		yes	yes	yes	
Utah		no			yes	yes	
Idaho		no	E		yes	yes	
Mississippi		yes, 3/5	E	yes			
Wyoming		no			yes	yes	
Kentucky		yes, 3/5				yes	
Alaska		no	E				
Delaware		yes, 3/5			yes		
Illinois		no		yes			
Maryland		no				yes	
New Mexico		no				yes	
Rhode Island	yes, 2/3	no					
Connecticut		no	E				
West Virginia		no	E				
Hawaii		no	E				
Indiana		no	E				
New Jersey		no	E				
North Carolina		no	E				
South Carolina		no	E				
Tennessee		no	E				
Texas		no	E				
Wisconsin		no	E				
States with no constraints							
Alabama, Georgia, Iowa, Kansas, Minnesota, New Hampshire, New York, Pennsylvania, Vermont, Virginia							

Sources: National Conference on State Legislatures, corrected data; Kurtz, Cain, Niemi, p. 12; Rafool; Initiative and Referendum Institute at the University of Southern California.

Although California is not always the most restrictive state by particular feature, Table 1 shows that the state is without peer in terms of the breadth of its self-imposed restrictions. Only California imposes all of the listed constraints at some level or degree of rigor. At the other end of the spectrum are large eastern states such as New York and Pennsylvania that have none of these features; they provide an important basis for comparison below.

A number of scholars have addressed the contentious question of whether fiscal constraints even matter. Several statistical studies seem to show that across states, the adoption of supermajority requirements for increasing taxes does reduce the amount of state taxation (Bails and Tieslau, 2000; Knight, 2000; Besley and Case, 2003). Brian Knight estimates that constraints reduce taxes as a proportion of state revenue by 1.7 percent to 3.6 percent, or about 0.2 percent of the average state GDP. Timothy Besley and Anne Case estimate that supermajority rules reduced state taxes by as much as 8 percent between 1960 and 1997. So, across states and on average, there is statistical evidence that supermajority rules reduce taxation levels.

The evidence is mixed on the effectiveness of other constraints. Limits on state spending expenditures or revenue are common. Colorado and Oregon have both, 21 states have expenditure limits only, and three have revenue limits only. The academic evidence on whether they make a difference finds that these limits either have no effects (Rueben, 1996) or even "perverse" effects suggesting the limits are actually associated with higher spending (Besley and Case, 2003)[1].

Although the number and breadth of fiscal constraints in California are impressive, their effectiveness rests on both political and socio-economic assumptions that may not hold. Supermajority rules for the budget and for tax increases will restrict spending and taxes only if all of the following conditions are met:

1. The majority party is smaller than the supermajority threshold, or if not, has serious splits within its ranks;
2. The minority or dissenting majority party faction has a more conservative fiscal position;
3. The majority is not able to pick off members of the minority with district-based benefits;
4. One party controls the executive and legislative branches.

The last condition is especially important in light of the fact that divided government has been the norm in California for much of the period since 1978. Except for the last two years of the Jerry Brown administration and the five recall-interrupted years of the Gray Davis administration, California has had Republican governors who have been more fiscally conservative than the Democratic majorities in the legislature. This has made supermajority rules less important than they otherwise would have been.

[1] Besley and Case attribute this to endogeneity of the decision to adopt limits: States with high spending may be more likely to adopt them.

In the last 25 years, the first and second conditions have prevailed in California, as has the third, with the exception of some early Davis administration budgets. The fourth condition has not. The Democratic majorities in the legislature have not been supermajorities and the Republican caucus has been distinctly more conservative than the Democrats, especially on fiscal matters. Party discipline among Republicans has been strong, limiting the Democrats' ability to pick off support from their ranks. But the governor has been Republican for all but the five years between 1998 and 2003.

Considering all of these, the conditions for supermajority rules to have the greatest effect were during the latter part of the Davis administration. At that time, Republican party discipline was strictly enforced, the Democratic majority was not large enough to carry a supermajority, and an economic slowdown brought an end to surplus budgets and thus, the ability to pick off dissidents in the other party with district benefits. But in most other years, divided government was as much responsible for the shape of the budget as any other factor.

There is no specific cross-state evidence that the imposition of term limits has directly affected state and local spending. Republicans and conservatives supported the term limits initiative, Proposition 140, to a greater degree than did liberals and Democrats, but the initiative did not result in the wholesale transformation of the legislature that some expected. Nonetheless, in the budget process it has clearly weakened the legislature relative to the governor, and has diminished the incentive of assemblymembers in particular to invest time in budget subcommittee work and oversight (Cain and Kousser, 2004): Although term-limited legislators could be less worried about the electoral consequences of their subcommittee votes, they would not have the time necessary to devote to mastering budgetary matters.

The availability of direct democracy options is an important part of the tax and spending mix. As noted above, initiative states are more likely to have supermajority tax requirements and spending and revenue limitations. They are also more likely to have term limits. In addition, since the passage of Proposition 218 in 1996, local authorities in California need majority voter approval for any increase in taxes and for most new property-based revenues. The effect of Proposition 13 and Proposition 218 was to increase dramatically voters' involvement in fiscal decision-making. Kim Rueben and Pedro Cerdan report that between 1986 and 2000, there were more than 2,500 local tax and bond measures. Two-thirds of these were for the approval of taxes and fees, and one-third were for bond measures (Rueben and Cerdan, 2003). There is some evidence, perhaps because of all the above factors, that direct democracy states have lower levels of spending (Matsusaka, 1995).

In summary, California has a broader array of fiscal constraints than most other states. Some academic studies have shown that supermajority rules and direct democracy lead to lower tax and spending levels. On the other hand, given that California has had divided government 21 out of the last 30 years, there is reason to question whether the supermajority budget rules have had that much of a constraining effect. Other evidence shows that direct

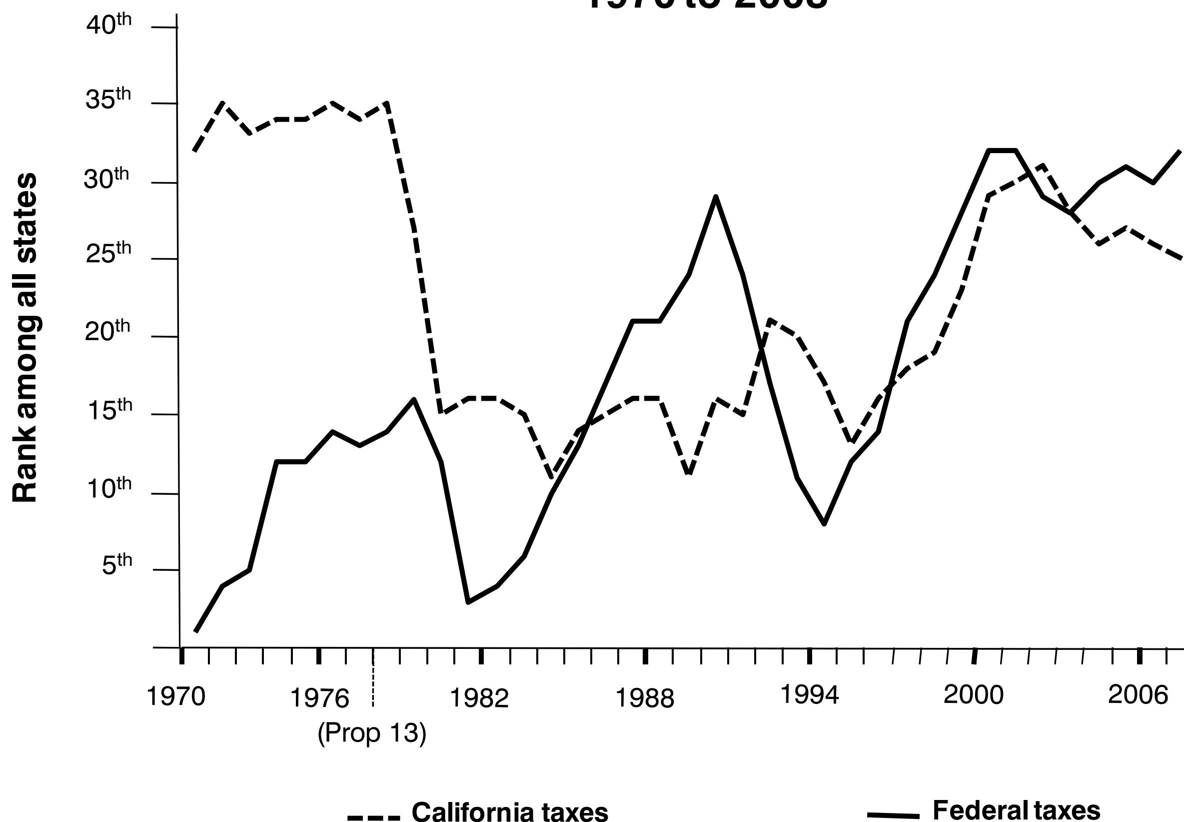
democracy limits taxes and spending, and that term limits weaken the legislature's fiscal expertise and power. This effectively gives the governor (who is more often than not a Republican) more budgetary control. In a state with Republican governors and Democratic legislatures, this could be important.

Looking for Effects

If rules and processes matter, then fiscal constraints should have observable tax and expenditure consequences. The academic literature suggests that in particular, the super-majority rules should have lowered taxes and spending in California. But the record suggests that the supermajority effects are more evident in a changed revenue *mix* rather than in the *level* of either expenditures or taxes.

Despite all its constraints, California is not a low-tax state. A PPIC study showed that based on a measure of state and local general revenues per capita, California had 14 percent higher tax levels than the average of all other states (Gordon et al, 2007). Further, the data revealed that California has always been an above-average tax state, even in the period immediately following Proposition 13. To be sure, Proposition 13 and a deep recession in the early 1990s caused per capita revenues to drop, from nearly one-third above the national average before 1978 to a low of 6 percent above the national average in 1997. But with economic recovery, California's relative standing rose by 8 percent from 1997 to 2002, placing it 10th among all states at that time.

California's level of taxation is closer to the national average if state and local revenues are measured against personal income. Tracy Gordon and her co-authors calculate that California's general own-source revenues per $1,000 of personal income rose from 15 percent above the national average in 1978 to 5 percent below average in 1979; it then rose again to 5 percent above, in 2002. By these calculations, California ranked 19th measured against all states at that time. Using similar calculations, the Tax Foundation compared the ranking of tax shares paid to the federal and state and local governments by California taxpayers over time. Figure 1 shows that before 1978, California's state and local ranking was in the top 10 while its federal ranking was in the bottom 25. Proposition 13 dramatically lowered California's state and local tax ranking down to the middle in 1979. However, since the end of California's recession in the early 1990s, both the federal and state and local tax rankings have risen. California is not yet back to where it was in 1978, but clearly, 30 years of restrictions have not prevented this upward trend.

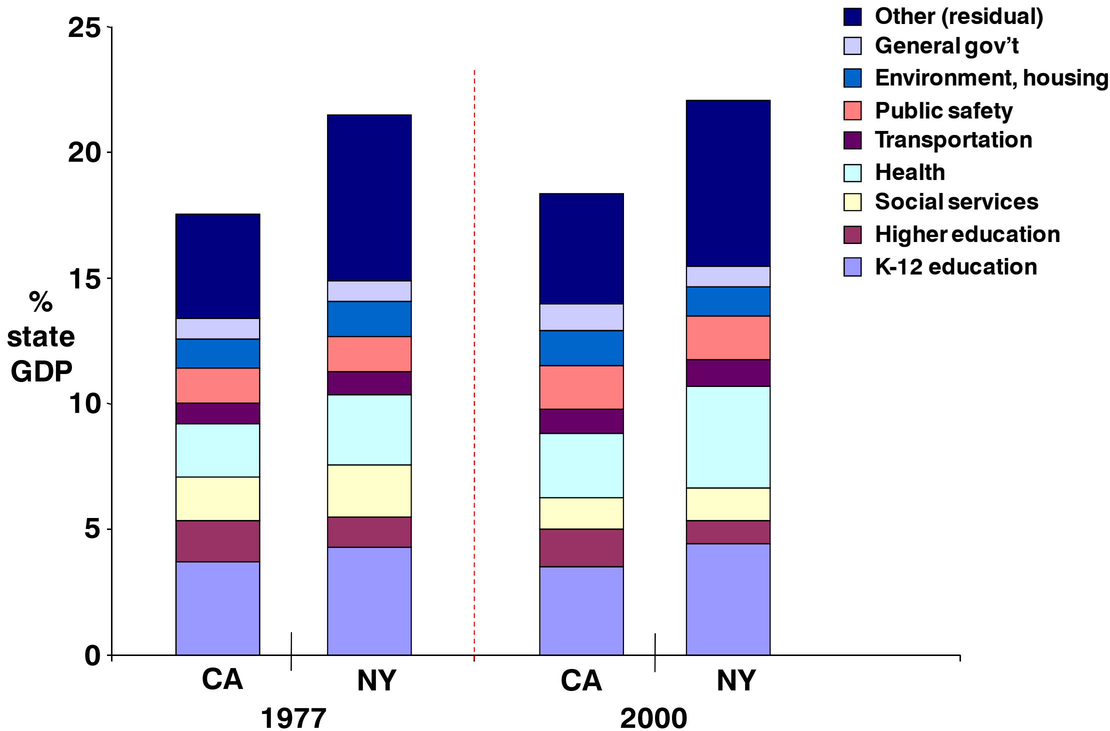


Source: Annual State and Local Government Finance Data. Pivot tables produced by the Public Policy Institute of California. Available at http://www.ppic.org/main/datadepot.asp. Data from U.S. Bureau of the Census, Annual Survey of State and Local Government Finances, multiple years.

Despite these comparisons, the statistical studies discussed above do suggest that California's fiscal constraints may have had some effect. The counterfactual scenario is that California might have climbed back higher and faster in the state rankings had the constraints not applied. The fact that California's state and local revenues as a share of personal income began to rise in the mid-1990s under conditions of divided government indicates that some of this rebound occurred under politically constrained circumstances. Part of the rebound can also be attributed to the increased income tax Californians paid on the extraordinary capital gains they accrued from stock market gains at the end of the decade. If both the divided government and supermajority conditions had been different, the revenue rebound would have been steeper; removing only the supermajority rule would be unlikely to make much or any difference because the Democratic legislature has been checked by a Republican governor for most of the period since 1978.

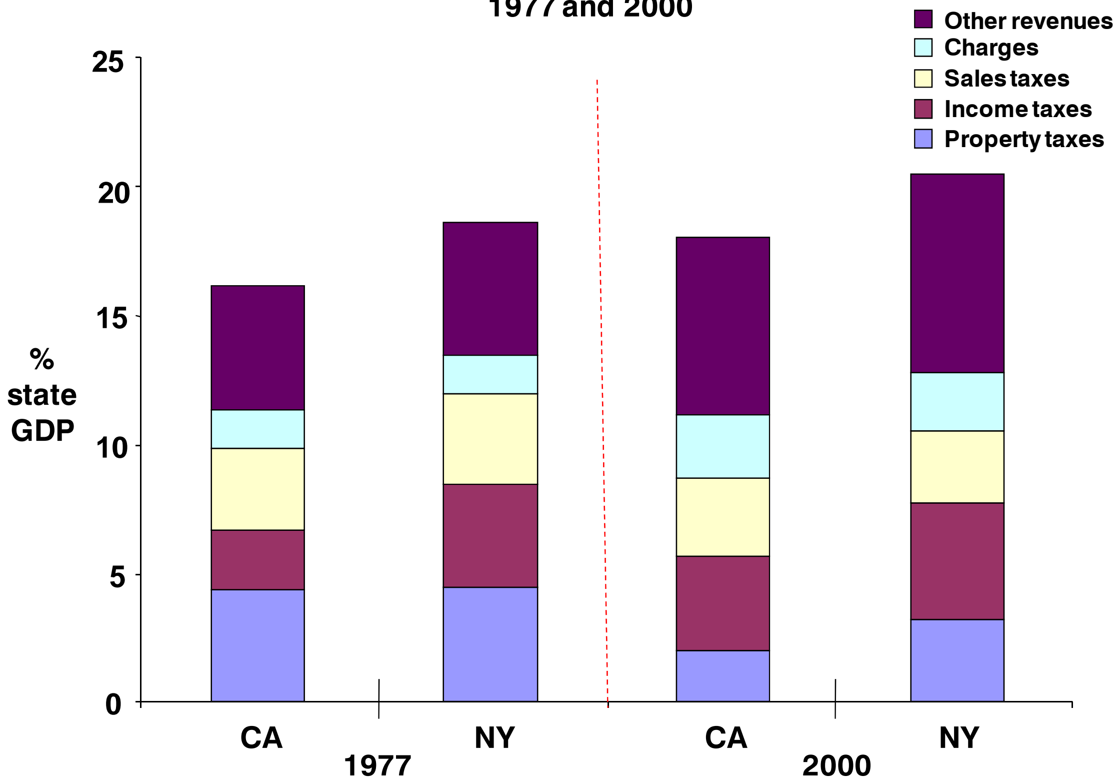
Curiously, California's state and local expenditure and revenue patterns in the same period did not differ significantly from New York's, the comparison state that Gordon et al use, and a state that has none of the institutional constraints that California does. The choice of New York for comparison may seem odd, given that state's high levels of taxation and expenditure. However, the change in expenditure and revenue levels over time resulting from a common influence, which is our main interest, should not be affected significantly by initial levels. Figure 2 compares California and New York's expenditures as a percent of state GDP in 1977 and 2000 and shows that the differential between the two states changed little over 23 years.[2] Expenditures in New York did not grow dramatically relative to California. Similarly, revenues in California and New York both increased as a percent of state GDP by comparable amounts in the same period (see Figure 3). As with expenditures, New York collected more than California in revenue before 1977. The post-1978 restrictions cannot explain this difference.

Figure 2. California and New York – Local and State Expenditures 1977 and 2000



Source: See Figure 1.

[2] State GDP is used as the scaling variable because it is the aggregate that best measures the size of the potential tax base. The years 1977 and 2000 were chosen because a business cycle was in an expansionary phase in each year. The most recent year for which generally comparable data are available is 2004. The initial year, 1977, precedes the enactment of Prop 13.



Source: See Figure 1.

Of course, the most pronounced difference between the two states is found not at the endpoints, but on the paths they followed between 1977 and 2000. California's revenues dipped dramatically as the result of Proposition 13 and the recession of the early 1990s, while New York followed a much steadier path. In the Tax Foundation rankings, California was fifth in 1977, dropped to 29th by 1983, recovered to 10th and then fell to 15th in 2006. New York was ranked either first or second in its state and local tax burden during this entire period.

There is a certain contradiction to New York's having a more stable fiscal environment than California: One of the common arguments in favor of supermajority rules is that they should produce more predictability and stability in state revenue. Why should stability be enhanced? Because the two-thirds vote should mean that a tax increase enjoys some degree of bipartisan support; it should also lower the odds that the tax policy changes when the party in power changes. In a system that passes taxes by a simple majority vote, a narrow legislative majority might pass a tax that could be reversed at the next election. A recent example of this was the restoration and then abolition of the vehicle license fee at the end of the Davis and the

beginning of the Schwarzenegger administrations. The fact that California's revenue path has been more variable than New York's should remind us that even if supermajority rules have a mild stabilizing effect, they can be overridden by other factors such as economic volatility—California's tax base is more cyclically sensitive than New York's base—or compensating fiscal strategies.

Despite an impressive array of fiscal constraints, revenue and expenditures in California have rebounded from their low post-Proposition 13 levels. To put it another way, even if the supermajority requirements and other constraints have lowered revenues and expenditures marginally (as econometric studies suggest), they have not prevented a recovery in public spending as some had hoped. Instead, public officials at the state and local levels found ways to compensate for the lost revenue. One compensating strategy, for instance, was to finance more infrastructure through bonds.[3] Between 1965-66 and 2005-06, the amount of state infrastructure financing derived from bonds rose from 42 to 73 percent (Rueben and de Alth, 2005). Between 1972 and 2005, California voters approved $117 billion in general obligation bonds, 39 percent of which went to K–12 education. Assuming that half the financing obtained this way was a reaction to the restrictions, and that it was spent by the state, expenditures would have been higher by about 0.2 percent of state GDP on average.[4] In 2007, voters approved nearly $43 billion in infrastructure bonds. Bonds have also been used to balance shortfalls in the budget. The passage of Proposition 39, which lowered the approval threshold for issues of local bonds to finance schools from two-thirds to 55 percent, increased both the number of such initiatives and their success rate (Reuben and Cerdan, 2003).

The constraints that Proposition 13 imposed on traditional revenue-raising channels also created entrepreneurial reactions from local officials and increased competition for retail tax income among cities. These actions included enhancing property tax revenues through redevelopment, imposing new fees and charges, and generating new sales tax revenue by encouraging the establishment of more retail businesses—the so-called fiscalization of land use (Lewis and Barbour, 1999; Dreach and Sheffrin, 1997; Shires and Haber, 1999). The increased reliance on bonds, fees, and charges has had some policy consequences, discussed below.

The behavior of the overall level of state and local revenue and expenditure raises two important issues. First, as happens so often when laws and regulations of any kind are meant to control political outcomes, the static nature of the rule is overcome by the dynamic response of the regulated. By placing what amounted to ceilings on certain sources of revenue, these constraints created the incentive for officials to find other permissible ways of raising revenues.

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[3] Ultimately, taxes will have to be raised (or other spending reduced) to service the increase in debt, but that increase may be postponed by borrowing.

[4] The figure of 0.2 percent of state GDP is a rough estimate, and is derived by taking one half of the $117 billion raised through general obligation bond issues and expressing it as a percentage of the sum of annual state GDP during the 1972–2005 period.

California's fiscal story is similar in this respect to its campaign finance reform story. In both cases, the attempt to control is frustrated by the ability of the regulated to evade and innovate.[5]

Second and more importantly, California voters supported these compensatory fiscal strategies: The bond measures had to be approved by sufficient numbers of voters. Although Californians remained deeply suspicious of general revenue increases, they were willing to approve specific revenue enhancements that were targeted to particular services even after Proposition 216 in 1996. They were also more willing to buy on credit than to pay up front. The tax limitation movement sensed accurately that voters were mistrustful of giving elected officials much discretion with their money, but it may also have underestimated the public's desire for specific government projects, especially those dealing with schools, infrastructure, and prisons.

The question that the econometric studies do not answer (although several have tried) is whether fiscal rules can really restrict public spending to levels below the median voter preference. The studies arguably show that own-source revenues are lower in states with supermajority rules and direct democracy, but they cannot rule out the possibility that states with such restrictions had a reduced taste for public goods in the first place. That is, the studies do not prove that in a democracy a minority really can dictate public spending levels to a majority over an extended period. Even if all decisions could somehow be changed to require a simple majority, the electoral majority could change the state's supermajority rules through the initiative process if it did not like its current level of government and services.

Critics of the supermajority rule sometimes intimate that California is spending less than it really wants to. But in fact, through the ballot box, the majority has restored spending to something between what it was in 1977 and what it approved in 1978. Could it be that California would really like to tax and spend at levels close to New York's? Possibly, but the state did not tax and spend at those levels before 1978, and many of the measures that have restricted taxing and spending since were passed by (and could be overturned by) a majority initiative vote. A more plausible explanation is that California's voting majority has used supermajority rules to make certain kinds of general taxes and discretionary spending less likely. Along the way, there was a drop in state and local resources that reversed after officials figured out ways to soften the immediate costs or to specify the targets of the tax more definitely.

[5] Campaign finance reform has been compared to hydrology in that every time a barrier intended to limit contributing or spending money is imposed, money flows around it. Hence, PACs and independent spending have negated the purpose of limits on the amount that individuals or groups can contribute to candidates. Nonprofits have replaced soft money spending by political parties after the McCain-Feingold campaign finance law went into effect.

The Revenue Mix

The debate over supermajority votes and other restrictions in California has focused almost exclusively on aggregate tax and expenditure levels. But if the actual effect of these restrictions is not to give the voting majority less than it really wants, but to restrict certain general and discretionary avenues of taxing and spending—that is, to channel the fiscal flow, not restrict it severely—then perhaps there are other observable fiscal effects.

One possibility is that California and similarly constrained states have a distinctive revenue mix or expenditure pattern because the combination of supermajority rules and direct democracy make general discretionary tax increases more difficult to achieve. Posed this way, the question is not how much the state collects or spends, but rather how it distributes its revenues across different types of taxes and its expenditures across different categories. Given that California's taxing and spending activities require a high degree of agreement and much direct voter consent, perhaps this skews the revenue mix towards certain kinds of taxes and expenditures towards certain kinds of services.

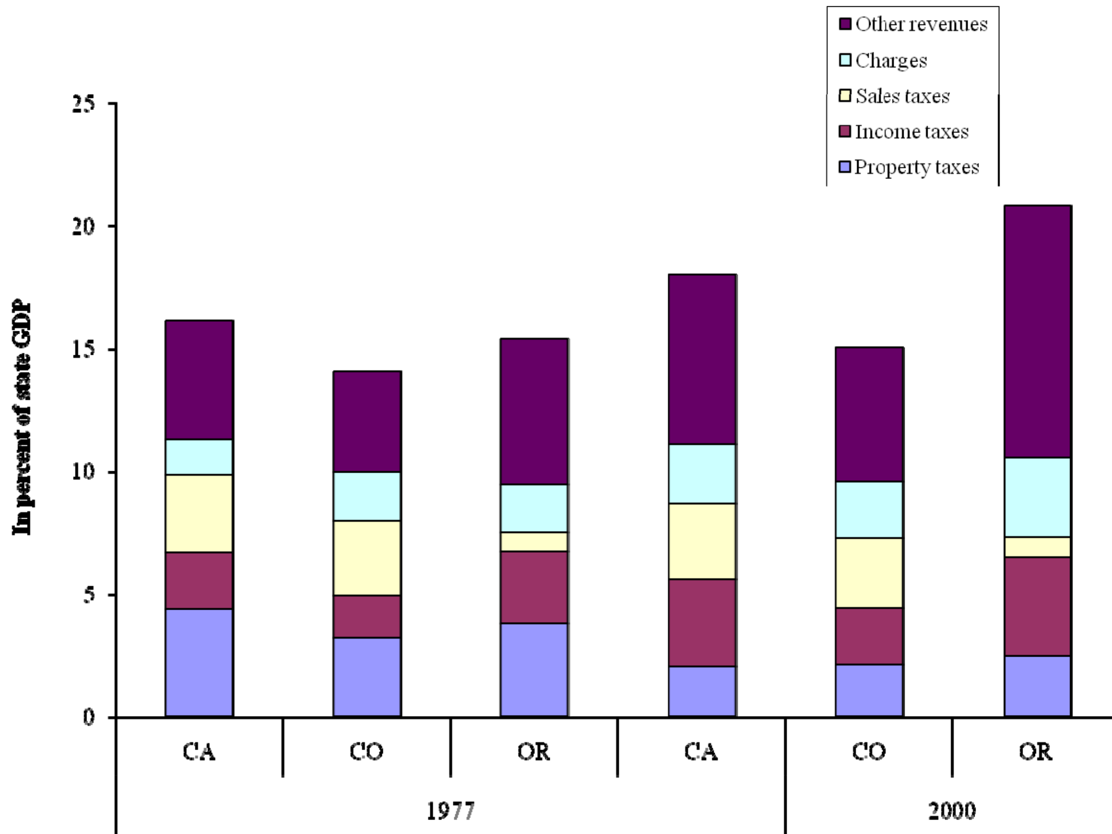
How might voting conditions affect the choice of tax? Taxes are rarely welcomed by voters, but some are more unpopular than others. Broadly based taxes affect more people, so self-interested political-electoral logic would dictate that support for a particular tax increase is likely to be inversely related to how many voters are affected by it. Similarly, large mandatory payments that come due in lump sums (such as the motor vehicle license fee or property taxes) will likely be more unpopular than smaller, voluntary fees paid by those who choose to use a service.

Because most state and local revenue enhancements in California require direct voter approval, California taxes might adhere more closely to this logic than most states. Taxes that broadly affect large numbers of voters will be less popular than taxes that target smaller groups—such as a tobacco tax that targets an unpopular minority constituency, user fees that charge people who make use of government services directly, and high marginal income tax rates that place the burden on the small number of wealthy taxpayers.

California has dramatically increased its reliance on charges, such as park admission fees, hunting licenses, property transfer fees, and court filing fees, as a source of revenue. California also targets the wealthy; its top income tax rate of 9.3 percent is substantially higher the all-state average. But California's alcohol ($3.30 per gallon of spirit) and tobacco (87 cents a pack) taxes are not among the highest in the country.

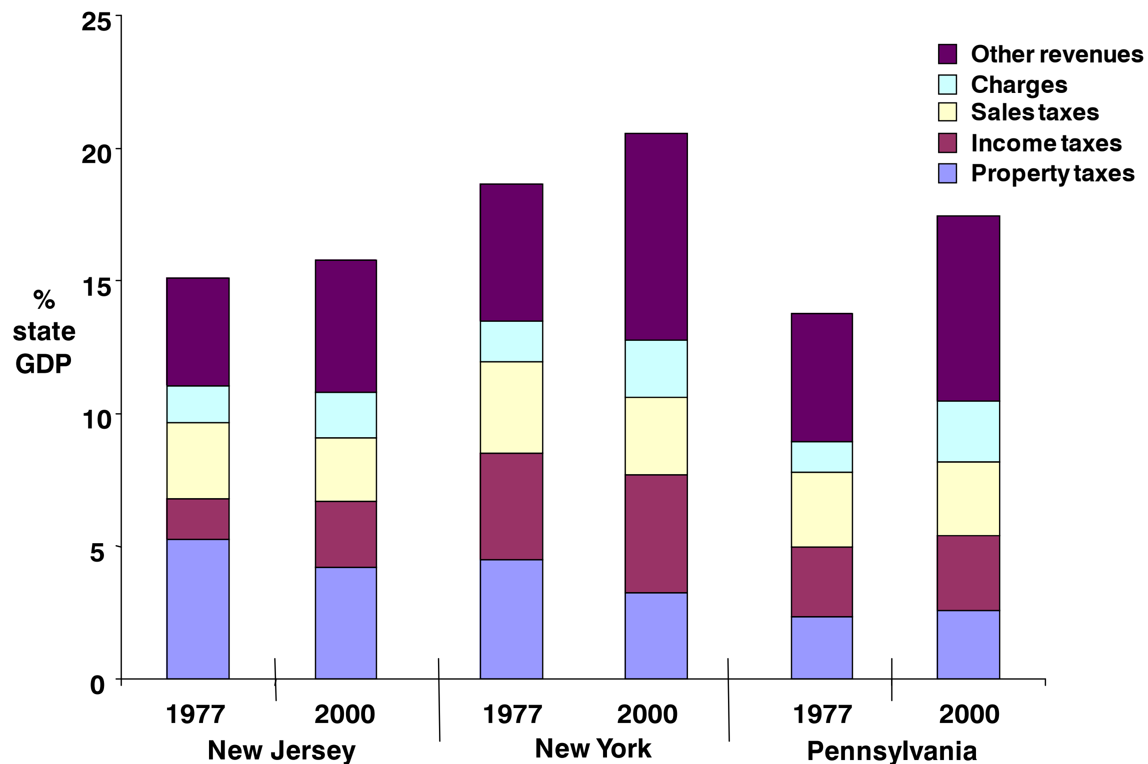
To compare trends in California's revenue sources, Figures 4 and 5 display the tax mixtures of six states, including California. Three are highly constrained by direct democracy and supermajority rules (California, Oregon, and Colorado) and three are not (New York, Pennsylvania, and New Jersey). We compare the years 1977 and 2000. Tax shares are expressed as percentages of the state's GDP.

Figure 4. California, Colorado, Oregon—State and Local Revenues



Source: See Figure 1.

Figure 5. New Jersey, New York, Pennsylvania – State and Local Revenues



Source: See Figure 1.

The data seem to indicate that California shares general taxing trends with other states. As one might expect, and as other PPIC studies have reported, the most dramatic change since 1977 is in the property tax share of the total revenue mix, which declined from 4.4 percent of state GDP in 1977 to 2 percent in 2000 because of Proposition 13. Property tax shares of revenue also dropped both in the other highly constrained states and in New York and New Jersey. However, the decline in California is the largest, whether the measure is in proportional (percent of state GDP) or in percentage point terms. The decline in the property tax shares in all three constrained states lowered them to below the share in Pennsylvania, the lowest of the three unconstrained states.

In the other direction, income taxes increased their share of state GDP in all six states, but the increase in California from 2.3 percent to 3.6 percent of state GDP was larger than that of the others. Among the constrained states, California and Oregon have high top marginal rates while Colorado, which uses a flat rate of 4.6 percent of federal taxable income, does not. This could account for the variation among the three states. Similarly, New York and New Jersey have more progressive income tax rate structures than Pennsylvania.

California was also second only to Oregon in its increasing usage of charges. Charges in California went from 1.5 percent to 2.4 percent of state GDP, in Oregon from 1.9 percent to 3.3 percent and in Colorado from 2 percent to 2.3 percent. But the percentage also went up in the unconstrained states: 1.6 percent to 2.2 percent in New York, from 1.2 percent to 2.3 percent in Pennsylvania, and from 1.4 percent to 1.7 percent in New Jersey. Both the overall levels and amount of change in the constrained states are higher than in the unconstrained ones, as one might expect from the electoral logic model.

Sales tax proportions stayed pretty much the same or decreased in all states, regardless of constraints. In California, Oregon, and Pennsylvania, they changed little. The biggest changes were decreases in New Jersey (from 2.9 to 2.4 percent of state GDP), New York (3.4 to 2.9 percent), and Colorado (3.1 to 2.8 percent).

It is interesting to note that in all states, the largest and fastest growing category is other revenues, or miscellaneous revenues. These include fines and forfeitures, lottery revenues, interest earnings, rents, royalties, special assessments, utility charges and insurance trust revenues.[6] These have increased from 4.8 percent to 6.9 percent in California. The increase at the local level in California from 1.8 percent to 3.2 percent is particularly notable. Only New York is comparable.

Putting it all together, we can say that California mostly mirrored tax trends in comparison states. However, in California the declining role of property taxes was pronounced, and the enhancement of the role of charges and income tax was greater than it was in most of the other states.

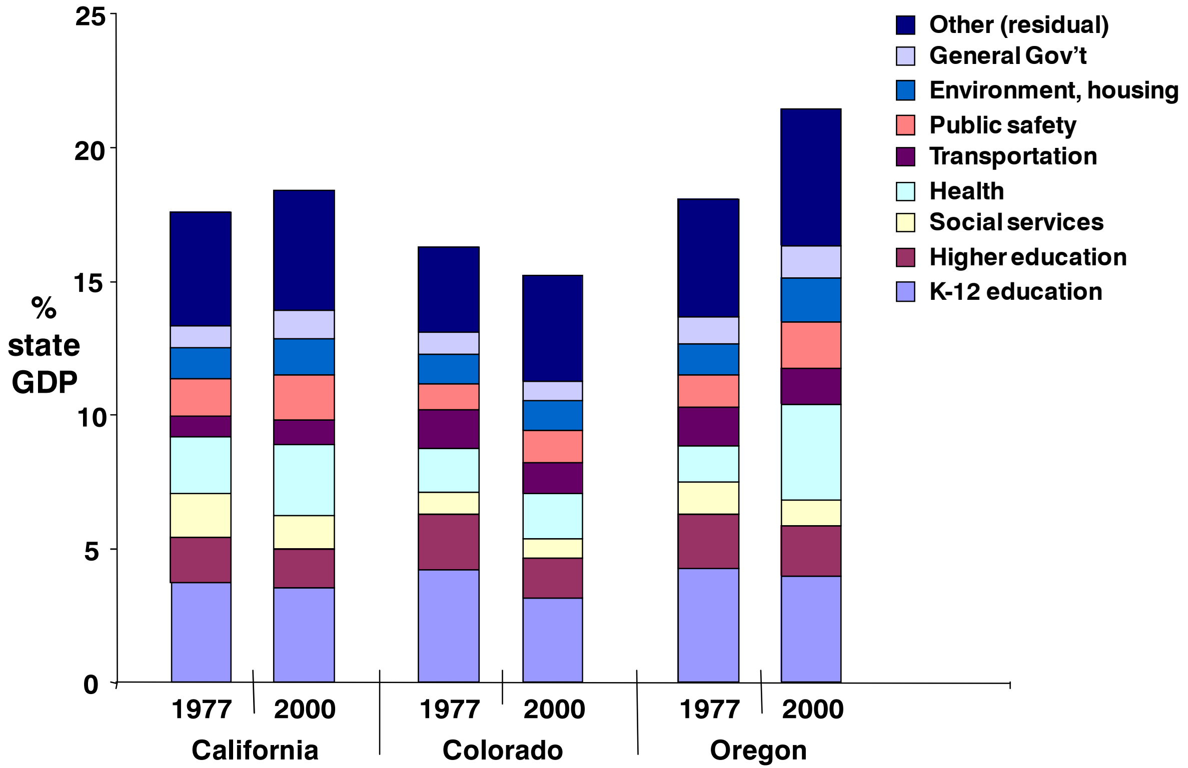
The Expenditure Mix

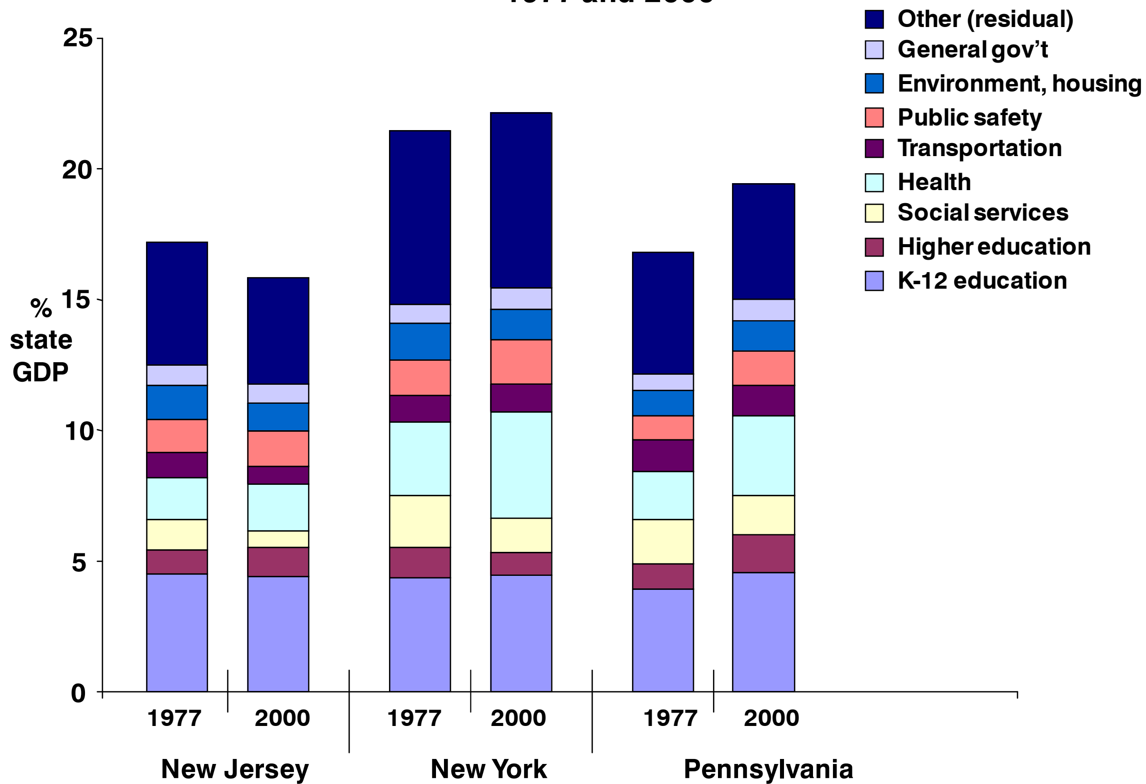
Another possibility is that California's fiscal constraints have created a distinctive expenditure mix, that is, a state that ties taxes to particular services and presents them to voters at the ballot box might favor certain expenditures over others. Where the logic of tax popularity favors concentrated over dispersed costs, the vote-maximizing logic for expenditures conversely favors widespread benefits that are visible to the population. California's ballot measures have theoretically shaped expenditures in several ways. Bond measures, for instance, are intended to finance specific functions or programs that voters will approve. Similarly, earmarked specific taxes and funds for designated purposes (such as Proposition 99, a tobacco tax for health programs) and mandated expenditure levels for certain services (such as Proposition 98, requiring a minimum level of K–12 spending) ask voters to mistrust the fiscal judgment of elected officials.

[6] The Census Bureau defines insurance trust revenues as "amounts derived from contributions, assessments, premiums, or payroll taxes required of employers, employees and others to finance compulsory or voluntary social insurance programs operated by the public sector, and any earnings on assets held or invested by such funds."

As before, we compare California's data with the data of the five states used above. Figures 6 and 7 display the expenditure shares as a percent of GDP. What is striking is that for all the complaints over three decades about the initiative process and how it has limited the legislature's discretion and distorted spending in California, the trends in California from 1977 to 2000 are very similar to those in both the other constrained states and the unconstrained ones.

Figure 6. California, Colorado, Oregon – State and Local Expenditures 1977 and 2001





Source (Figures 6, 7): See Figure 1.

The largest spending category in all six states is K–12 education. California's share declined slightly from 3.7 percent to 3.5 percent, and decreased more in the other constrained states, Colorado (4.2 to 3.2 percent of state GDP) and Oregon (4.3 to 4.0 percent). In New York and New Jersey, the share stayed essentially the same, and increased in Pennsylvania from 3.9 percent to 4.5 percent of state GDP. As a result, the share of GDP devoted to K–12 spending remained higher in the unconstrained states.

The share of higher education spending decreased in California, Oregon, and Colorado, but increased in New Jersey and Pennsylvania. The three constrained states have spent more on higher education proportionately than the three unconstrained states. Nonetheless, this finding is consistent with the fact that higher education does not give campaign contributions and has a smaller base of users than K–12 education. In addition, term limits have weakened the influence of public sector interests and strengthened groups with electoral resources. This diminishes higher education's ability to compete in both the legislature and initiative arenas.

All three of the constrained states maintained or increased their spending on the environment and housing, although the increase was marginal in California. Two of the three unconstrained states reduced their proportionate spending in this category.

In other spending categories, the trends are very similar across all the states. In all six, spending for social services increased, and for health and public safety decreased. In the areas of general government and transportation, no particular pattern emerges except that California devotes less to transportation than all states except New Jersey.

Given the number of California bond issues and initiatives that deal with public safety and K–12 education, it is somewhat surprising that California spent similar or smaller amounts than other states. It is also worth noting, in light of several decades of reformers' concerns about budgetary distortions caused by supermajority rules and direct democracy, that California exactly mirrored national trends in health, social services, and public safety. As before, we conclude that political constraints may have shaped some areas distinctively (education, higher education, and the environment), but the overall picture is not dramatically different. A final verdict would require a more systematic statistical study than we have undertaken.

Implications

Some reformers look for institutional solutions to California's fiscal problems. The Constitutional Revision Commission focused on the supermajority budget threshold, and others have advocated lowering ceilings for local bonds and taxes. These changes would have some tangible effects, such as increasing the odds that state budgets are passed on time, or that local measures with majority but not supermajority support would succeed. But the savings would be much less than fiscal conservatives had hoped.

To sum up, California ranks first in the number and types of formal fiscal constraints. Although some of these were intended to keep taxes and spending down, total local and state expenditures have risen significantly in recent decades.

Proposition 13 dramatically reduced California's local tax burden, but in the three decades since, that burden has been restored to a level between the relative high reached in 1977 and the post-1978 low. Some of this increased burden was achieved by the resourceful responses of state and local officials who found alternative ways to make up for lost revenues. But since 1996, increased spending has required frequent public assent, and California voters have approved many bonds, taxes and other revenue enhancements in response. The new revenues tend to be linked to particular capital projects and to specific government services. The public seems more reluctant than in the past to allow elected officials the discretion to spend general tax money, but it has restored much of the revenue lost in 1978 despite the new constraints.

California's fiscal picture is distinctive in some ways but in most respects revenue and expenditure trends seem to mirror national trends. Proposition 13 produced a larger shift away from relying on property taxes, but most other states shifted as well. Similarly, with respect to increasing reliance on charges, income tax, and other revenues, California was different more in degree than in kind. With respect to expenditures, California and other similarly constrained states have reduced spending on higher education and increased spending on the environment to a greater degree than the unconstrained states, but this could reflect differences in political cultures. Otherwise, trends in spending on social services, health, and public safety also reflect national trends.

The counterfactual—that California might have raised or spent more money under pure majority rules and less direct democracy, or even allocated its expenditures much differently—ignores various political realities and possibilities. Given California's recent history of electing Republican and moderate Democratic governors, there was much institutional counter-pressure to spending at New York levels in any event. And if a Democratic governor and Democratic legislature had raised taxes to a higher level, it might have cost the Democrats control of one or both houses.

It is conceivable that the public may in the future accept more modifications to the supermajority rules, as it did with Proposition 39. But despite what many experts have recommended, it is highly unlikely that it will revoke its right to approve tax increases, or to reform or restrict the use of the initiative process. An alternative approach for state leaders would be to work within the framework of public consent, targeted taxes, mistrust of government, and sequential ballot box budgeting to make the system work better. However, there would be challenges to this approach:

1. Getting the public to connect more closely the level of services it wants with its willingness to pay for them—to relinquish the idea that California can have a New York level of public goods and services with an Alabama level of taxation. The latter view rests on the belief that savings from rooting out waste and fraud or from eliminating profligate spending on interest group agendas can pay for voters' wishes.

2. Improving oversight. The legislature has allowed its oversight functions to decline; its scrutiny of the budget in the era of term limits is less careful. To assure taxpayers that they are getting what they pay for, the legislature should improve its oversight function to address more directly public concern about waste and fraud

3. Achieving coherence within a fiscal framework of sequential ballot box choices by the public. The current system leaves many fiscal decisions in the hands of individuals and groups that push their priorities through the initiative process. The sum of these decisions may reflect political and organizational strength rather than

true public need. The legislature's role has increasingly become a reactive one, attempting to balance and fill in where the public has left gaps. The current approach to budgeting reduces the flexibility of the process, because additional revenue increasingly must be devoted to specific programs. The difficulty of raising general revenues makes it less likely that the state's goal of a timely balanced budget will be achieved. This topic was raised by the last Constitutional Revision Commission but needs to be taken up again.

4. Maintaining equity. In the fiscal shift that followed Proposition 13, the state increasingly acts as the equalizing agent. The Serrano decisions on greater equality in financing public education, Proposition 98, and the property tax shift have added K–12, healthcare, and social services to the state's responsibilities. Cities and special districts have fewer redistributive responsibilities, and the level of services they provide is a function of the willingness and ability of the communities to pay. There is already some evidence that wealthier communities are more inclined to pass revenue enhancement measures (Rueben and Cerdan, 2003). This raises the possibility that there will be rising inequality in amenities such as parks and libraries among communities. Inequalities in the provision of law enforcement could also increase, with more serious effects.

5. Reviewing revenue sources. Because the most obvious effect of the various restrictions on spending and taxing in California has been on the revenue side, it is reasonable to ask whether that revenue mix is in fact optimal. Revenues are more unstable now, and localities are relying more on fees and charges. A new Constitutional Revision Commission should take up this topic. Perhaps California needs new, more stable sources of revenue, such as taxes on services, more flexibility to run debt from one year to the next, or a larger rainy day fund. The question of revenue volatility cannot be ignored.

Still, a word of caution about institutional change: There is a danger of overestimating the effects of procedural reform and of underestimating the degree to which the underlying problems are political—such as the failure to reconcile the demand for public services and the willingness to pay—reflecting the public's contradictory view that it dislikes taxes but wants high levels of public service at the same time. Procedural change is no solution for political problems. In the end, rules do not determine budgets; voter preferences do.

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