

**UC Berkeley**  
**California Journal of Politics and Policy**

**Title**

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**Permalink**

<https://escholarship.org/uc/item/6w34z3zd>

**Journal**

California Journal of Politics and Policy, 1(2)

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**Publication Date**

2009-06-15

**DOI**

10.5070/P2401N

Peer reviewed

## First Steps: Solving California's Long- and Short-Term Budget Problems

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California, facing severe economic hard times, plummeting tax revenues, an outdated tax system, and a dysfunctional political process that requires a two-thirds vote for both budget and tax increases, is in dire straights. Governor Schwarzenegger has recently proposed a list of budget cuts to stem the state's staggering \$21 billion shortfall. But these "solutions" are unthinkable in their scope and implication. The governor proposes to slash state funding for schools and community colleges by

an astounding \$5.3 billion. He proposes to add 940,000 California children to the rolls of the uninsured through elimination of the Healthy Families Program. He's proposing to do away with the CalGrant Program, which would put college out of reach for tens of thousands of young people—the workforce California needs to ensure its economic competitiveness.

While the state's immediate problems are staggering, California faces an even more troubling long-term problem—an imbalance of revenues and expenditures that persists even in good budget times and constitutional limits on fiscal policymaking that make it difficult to craft a solution to the state's problems.

Over the years, Governor Schwarzenegger has presented voters with three sets of choices at the ballot box to solve the state's budget crises. The first, Propositions 57 and 58 of 2004, allowed the state to borrow its way

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out of the worst of the budget crises of the early years of the decade in exchange for creation of a “rainy day fund.” The former prevented the wholesale destruction of public services, such as the governor’s current proposals; the latter was a reasonable approach. However, in budgetary terms, it hasn’t stopped raining long enough to fill up the fund. In 2005 and again this year, the governor’s efforts to impose stiff caps on spending that would have limited the state’s ability to meet current and future challenges were soundly rejected at the polls.

If the governor’s proposals aren’t the answer, what would an appropriate response entail? In the short run, the state has little choice but to approximate a balanced budget. No combination of spending cuts or tax increases is sufficient on its own to remedy the current shortfall without inflicting significant harm to the poor and the state’s economy. But California also needs more federal assistance, and in the best interest of the nation, the federal government should give California more. California—the world’s 8th largest economy—is too big and too important to the nation to fail. Legislators and the state treasurer are already looking to the federal government for loan guarantees to help fend off a looming cash crisis. Loan guarantees alone would lower the state’s short-term borrowing costs, an important, but inadequate, stopgap measure. California needs direct federal assistance to buy

time until economic recovery boosts state revenues, as well as to allow the state to enact a much-needed restructuring plan.

While federal dollars could mitigate the worst of the current crisis, restoring California to fiscal health will require much more. Many states are reeling from fiscal problems, but California has itself to blame for its dysfunction, much of which has been brought about through voter-approved initiatives dating back to the passage of Proposition 13 in 1978. There’s no doubt that the initiative process, with its ability to lock in tax dollars and lock out the flexibility to respond to changing conditions and tough budget times, is also in need of repair.

California must also put its own house in order. First and foremost, recent corporate tax cuts that endanger the state’s long-term fiscal stability should be repealed. A prudent mix of spending reductions and tax increases—chosen to minimize their impact on a fragile economy—should be part of the plan to close current and projected budget shortfalls. State officials should stop interpreting the failure of the May measures as a desire for cuts alone. There’s plenty of evidence to demonstrate that voters rejected Proposition 1A not because of the tax increases associated with it, but because they understood that the measure was a gimmick that failed to fundamentally address the state’s fiscal problems.

Finally, California needs to use this crisis as an opportunity to once and for all address its dysfunctions—its outdated tax system, which does not bring in enough revenue to support state services, and the gridlock-producing two-thirds vote requirement needed to pass a budget and the tax increases to finance it.