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**Setting Aside Politicians:
The Effects of Set-Aside Initiatives on
California Local Governments**

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Abstract

Through direct democracy, California voters pass local and state initiative measures, assuming the role of the legislature and many times mandating how government should act or spend funds. But are voters really getting what they want through the initiative process? Initiatives known as “set-asides” provide a unique aspect of local direct democracy to study because they interact with fiscal policy differently than other ballot measures. A set-aside initiative directs a local government to spend money on a specific program without identifying a new source of revenue. This study analyzes the effects that set-asides have on local fiscal policy. It asks whether local governments respond to set-asides either by spending more overall or by taking funds from one service to increase spending on another. It finds that the passage of set-asides causes cities to spend and tax more than cities without these ballot measures. There is no preponderance of evidence to suggest that governments take from one service to meet the mandated funding of a set-aside. Instead of “robbing Peter to pay Paul,” they impose slightly higher taxes on all.

Keywords: initiative, local government, direct democracy, fiscal policy, set-aside

Setting Aside Politicians: The Effects of Set-Aside Initiatives on California Local Governments

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In many cities across the state of California, voters have passed unique initiatives known as “set-asides.” These measures interact with local fiscal policy differently than other initiatives because they mandate specific spending practices without identifying the source of revenue for such expenditures. For instance, in 1994, voters in the city and county of San Francisco passed Measure E, creating the Library Preservation Fund. Measure E required that \$0.025 for every \$100 of assessed property value be set-aside for library services and created a “baseline fund” or minimum expenditure that the city must budget each year for libraries (Griffin 2008). In 2007, the voters, through Measure D, renewed the Library Preservation Fund and prohibited the city from spending less than it did on libraries during the previous year, thus requiring San Francisco to spend a baseline amount of \$36 million in fiscal 2008-09 (Griffin 2008). In the city of Oakland, voters passed a set-aside in 1996 establishing a “Kid’s First! Oakland Children’s Fund” that requires the city to spend 2.5% of general fund revenue each year on children’s health and services with no new revenue source identified. In other instances, existing revenues are diverted to certain services such as when Healdsburg voters in 2002 passed Measure Q requiring “the revenue from the existing hotel tax be committed solely to providing the public with parks, recreation, and community services” (CEDA 2006). Set-asides such as these are found throughout the state at the city level of government.

Where does money come from to fund set-asides? Since these measures—perhaps to make their passage smoother—do not specify a source, elected officials are left to decide where the money should come from. There are three possible effects that set-asides can have on local fiscal policy. First, local government could increase in size by spending and taxing more in order to meet the demands of the ballot measures. Second, elected officials could take funds from one service in order to increase spending on the identified service in the set-aside measure. Third, there might be no substantive change in spending practices because elected officials were already delivering what voters wanted.

This research shows that elected officials take the first path. Set-asides, such as the examples described above, have caused cities to spend and tax more than those cities without these particular initiatives. I find that cities with set-asides spend \$128.19 more per capita than cities of the same population that don't have set-asides. Additionally, I find that cities that pass set-asides tax their citizens \$34.39 more per capita than those cities without set-asides.

In the first systematic analysis of local set-asides, this research combines an original dataset on their passage with local fiscal records to see which of these scenarios follows their implementation. I first compare overall revenue and expenditures over an eleven-year period between my two test groups. I then examine how individual set-asides affect spending on a variety of city functions. Finally, the use of regression testing is used to determine the statistical significance of my findings. The results of my research on set-asides have lessons for elected officials and voters in the future, as they continually face the issue of passing new set-asides.

What Set-Asides Tell Us about Direct Democracy

Through direct democracy, California voters pass local and state initiative measures assuming the role of the legislature and many times mandating government to act or to spend funds. But are voters really getting what they want through the initiative process? This has been the focus of a wealth of study on direct democracy in relation to the use of the initiative and referendum. Much empirical study in political science has examined the initiative at the state level, with local initiatives only recently being given proper attention. An examination of set-asides will further explain local initiative effects.

Concerning the question of voter competency and the use of the initiative to pass legislation, there are two schools of thought. There are scholars who have demonstrated that voters are competent to make decisions on ballot measures using techniques such as short-cuts and external factors (Lupia and Matsusaka 2004; Bowler and Donovan 1998; Gerber and Lupia 1993; Gerber, Lupia, McCubbins, and Kiewiet 2001), or trusting the knowledge they learn from others to draw complex inferences (Lupia and McCubbins 1998). Such scholarship asserts that voters understand the choices they are making at the ballot box. This means that when voters pass set-aside measures with complex spending formulas, they have tools to make competent choices.

The second group states the opposite: voters are uninformed and cannot understand the consequences of their decisions. As long as there have been initiatives on ballots there have been journalists and politicians pointing to the deficiencies of letting voters make laws directly. Writers show that the initiative is a radical departure

from constitutional checks and balances, and that special interest groups subvert the initiative process for their own purpose instead of for the benefit of the many (Schrag 2004; Broder 2000). While it is difficult to measure local preferences, I will demonstrate the set-asides' effect on local government and compare that to general trends in voters' preferences, such as for low taxes and high service output.

Additionally, one recent pair of scholars has put forth specific work on voter competence at the local level. In 2008 Elizabeth Garrett and Mathew D. McCubbins released a paper, "When Voters Make Laws: How Direct Democracy is Shaping American Cities." Garrett and McCubbins study the effect of "take-it-or-leave-it" offers, where agenda setters leave voters to either accept the proposal or keep the status quo; there is no mechanism to allow the voter an option more aligned to their preferences. Regarding voter competence, Garrett and McCubbins point out that voters must have "*correct* beliefs about the consequences of their vote" (2008, 4) for the above arguments to hold. Garrett and McCubbins provide anecdotal evidence that voters are sometimes informed; but the authors are not confident that voters are equipped to make decisions consistent with their desires, especially on local bond issues. While their study is in no way definitive, it does imply that the general direct democracy literature does not consistently apply across all levels of government. In particular, voters may generally understand and get desired results at the state level, but the environment that set-asides are passed in may not produce voters that are fully informed on the consequences of their decisions.

Examining the California local initiative provides a rich body of literature to draw upon. Tracy M. Gordon's *The Local Initiative in California* as reported in 2004 by the Public Policy Institute of California (PPIC) gives a comprehensive analysis of the effects local initiatives have had on California cities. Gordon's work shows that local initiatives are "rare events" (2004, 42) and are concentrated in a few areas of the state, predominantly the Bay Area and the South Coast Region. The particularly relevant portion of Gordon's study to my research shows that the local initiative has a positive relationship to per capita own-source revenue¹ and no relationship with either per capita expenditures or fees and charges. Part of my research design will be analyzing similar relationships concerning fiscal components of local government with set-asides.

The other major empirical studies of local initiatives have been conducted by one of the leading authorities on direct democracy, John G. Matsusaka (1995, 2000, 2003, and 2004). In his 2004 book *For the Many of the Few*, Matsusaka evaluates the impact that the initiative has had on state and local governments. This book provides excellent statistical analysis of the fiscal impact at the state and local level. It is important to note that his study looks at cities throughout the United States, not just California. While not in line with the purely local scope of my analysis, Matsusaka's study of state initiatives and their impact on local governments is neverthe-

less insightful: local spending is 3% higher in states with the initiative than those without. Like Gordon, Matsusaka also finds that local initiatives boost city spending—6% by local initiative and 13% by state initiative. However, Gordon's and Matsusaka's results differ on the impact local initiatives have on charges (fees) and taxes. Gordon finds no relationship, while Matsusaka finds a statistically significant effect on charges, but not on taxes. One possible effect of set-asides is that local governments have to increase their overall revenue amount to support the set-aside mandates. If this is true, my results will show an increase in charges or taxes.

The Question

Set-asides provide a unique aspect of local initiatives to study because they interact with fiscal policy differently than other ballot measures. For example, when property taxes are increased to provide the city more police, there is a clear increase in revenue to increase a service or expenditure. Set-asides do not offer as straightforward an explanation. Local government might increase its revenue through fees and charges, or perhaps local officials will take funds from another service to fulfill the set-aside mandate. No scholarly research has been conducted on this particular type of local initiative; yet, the potential for public policy impact from set-asides is great. I attempt to explain such effects, if any, that set-asides have on fiscal practices of local governments.

Even if set-asides and their effects are proven empirically, of what significance is this to political observers or typical voters? With larger questions about direct democracy remaining in the literature, it is important to understand the consequences of decisions, including at the local level. Voters need to be aware of the effects of set-aside ballot measures and decide for themselves if the fiscal realities of these initiatives coincide with their preferences. The difficulty with set-asides is that the fiscal consequences of the measure are not apparent to the voter. While most parcel taxes clearly show the increased revenue source and the recipient of the funds, a set-aside *only* informs the voter that a service will now be funded at the designated level. Missing information such as where the funding will come from requires voters to make decisions based on incomplete information. For this reason, the state of California and its voters need to recognize that set-asides have a distinct end result different from other initiatives.

I hypothesize that voter-mandated set-asides force local governments to alter their revenue and expenditure practices. I test this hypothesis in the following way:

(1) If set-asides force government to increase overall spending, then there should be higher taxes, fees and charges, and total spending in cities with set-asides than those without the ballot measure.

(2) If set-asides force government to take funds from existing services, then there should be a decline in spending on certain corresponding services at the same time that spending increases on the set-aside mandated service.

(3) If neither of the above tests proves true, then set-asides have no fiscal effect on local government.

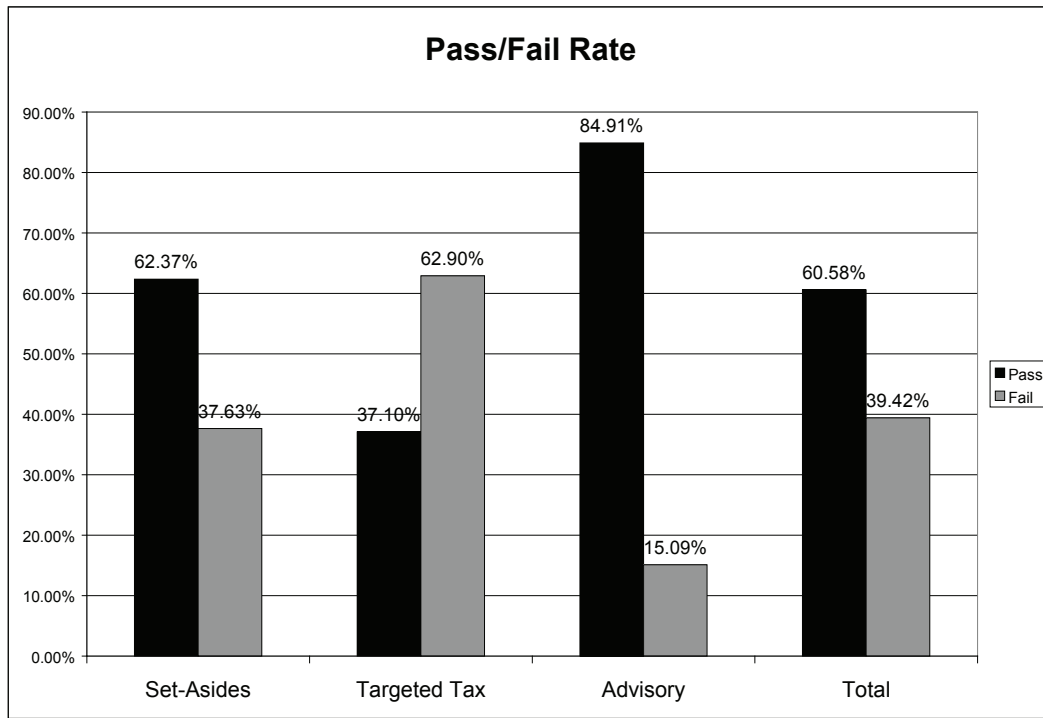
Set-Asides: Categories, Geographic, and Passage Trends

The Institute for Social Research (ISR) at Sacramento State University has created the California Elections Data Archive (CEDA), which documents all local election results from 1995 to 2006. Using the CEDA database, I read through 12 years of local ballot measures that were proposed to the voters and determined that there were three categories of set-aside initiatives. The first ballot measure is the set-aside. This ballot measure mandates funding on a local service or program without identifying a new source of revenue. This can either come in the form of setting a baseline funding requirement—the minimum amount that must be spent each year on that service—or set aside a percentage of either new or existing revenue for a specific program. Many times these set-asides mandate the creation of a special fund with revenues being used solely for the purpose of funding a specific service.

The second category is what I call the targeted tax. This measure involves increasing revenue, but still mandates that those funds go to a specific service. It is important to note that these targeted tax measures are different than the many other ballot measures that increase taxes to raise funds in that the measure specifies the distribution of the revenue. When coding measures as targeted taxes, the summary had to include specific words and identify a particular service in order to qualify. Simply listing a range of services that local governments fund excluded the measure from this category. The remaining category is advisory measures. The most significant difference between the previous measures and advisory measures is that advisory measures have no force of law. When voters pass an advisory measure they are expressing an official opinion, but such a declaration does not necessarily require targeted spending or any specific action.

The local initiative in California is predominately found in the Bay Area and along the southern coast (Gordon 2004, 28), as is the case for set-asides. At the city level, 31% of set-asides appear along the southern coast, with 57% of all city set-aside measures appearing in the Bay Area and the southern coast. While set-asides can be found throughout the state, the far north, sierra, and southern inland held little

Figure 1. Percentage of Pass/Fail Rate, by Category



Source: California Elections Data Archive (1995-2006)

to no set-aside votes for the eleven years studied. City set-aside measures across the state pass at a rate of 63%. Approved city measures are found in the greatest number along the entire California coast as well as throughout the Bay Area. Still, there is no compelling evidence in this study of set-asides that disagrees with Gordon's work concerning the geographic prevalence of local ballot measures.

The acceptance of set-aside ballot measures is generally positive among California voters, but differs when broken down by category. Overall, these measures have a 61% pass rate. Set-asides have a much more successful pass rate than targeted taxes, but are not as popular as advisory measures (Figure 1). Interestingly, set-asides and targeted taxes have a practically inverse pass/fail rate. This clearly demonstrates that voters are willing to specify where existing revenue should go or what programs should receive priority, but when it comes to increasing taxes for these service demands, voters are less inclined to foot the bill. Additionally, advisory measures have the highest pass rate because they simply ask voters to express an opinion, without any direct financial consequence to the outcome. These

pass/fail rates are very telling as to voter's preferences and unwillingness to pay for what they demand.

Research Method

My research design is modeled after the work of Kousser, McCubbins, and Rozga (2008), which employs an interrupted time-series analysis to estimate the effects of tax and expenditure limits (TEs). Such a design allows me to compare different set-asides while recognizing that they are not randomly assigned to cities. Cities that have passed a set-aside are placed in the treatment group, while those that have not remain as the control group. By having data on the fiscal year prior to any set-aside being implemented, I have a pretest that I can compare to the end of my time period, or post-test. Such a test allows me to measure the difference between the treatment and control groups prior to any set-asides being passed, and then compare that difference to the change at the end of the time-series. This is known as the "pretest, post-test with control group" approach. This research design controls for other variables, making sure that only the treatment (set-aside approval) is causing a change in revenue or expenditure practices.

The first test of fiscal effects of set-asides is to look at total revenue and total expenditures, followed by an analysis of taxes, charges and fees.² The mean is then taken for the two groups based on their per capita revenue, expenditures, taxes, charges and fees for the 11 fiscal years that data was available. FY1995-96 provides a baseline to begin comparing, since it preceded any set-asides being introduced into the test. By plotting the mean on graphs, one can see the change in time, as well as measure the difference between the control and treatment groups. This difference reveals if there is a larger change in spending that can be attributed to set-asides, rather than just a typical increase over time.

Using the same basic test design as described above, I then perform a time-series, cross-section analysis to measure individual service expenditures. By examining all cities that pass a set-aside on a specific service (roads for example) I can test for changes in spending. By marking when the treatment is applied (the set-aside passes), I then look to see if other services decline in spending at that point within the series. By testing all set-asides on a particular topic for individual cities, I ensure that the entire population is tested, meaning that it is the result of the set-aside, and not some other unidentified variable which affects service spending.

The graphic analysis provides a clear visual understanding of the relationship between set-asides and overall revenues and expenditures. However, the graphs fall short of telling *how much* of an impact exists. In order to measure the significance of the results from the graphs, I have run regression tests. By using a regression

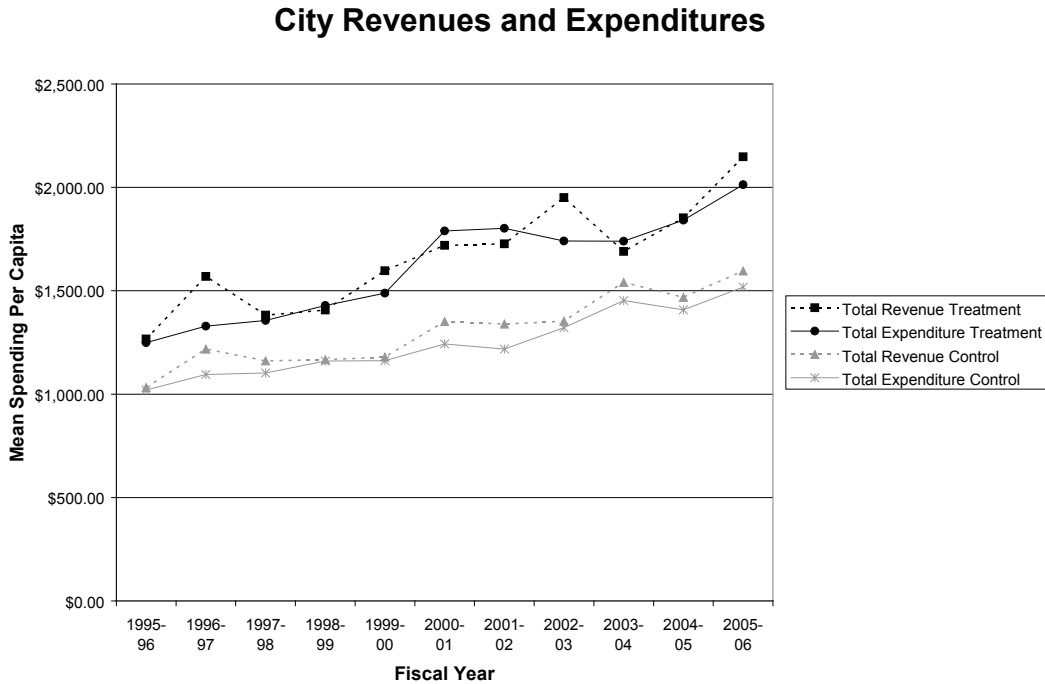
and the determined coefficient, I can test if my independent variable is the cause of my dependent variables changing, and whether or not it causes that change by a statistically significant amount. The city tests are composed of a panel group of 20, due to the data being from the 20 most populous California cities. There are 219 observations—20 cities over 11 fiscal years, with the city of San Diego not submitting a financial report for the last fiscal year. From this data I tested the significance of set-asides on total city expenditures.

Data and Findings

Looking only at total revenues and expenditures demonstrates that over the entire time period studied, cities with set-asides spent more than those without them. While the cities that tend to pass set-asides have always been relatively high spenders, the key to determining the effects of these initiatives is to show how these cities changed, compared with other large cities. The city treatment group's revenue and expenditure increased more than that of the control group (Figure 2). In the first fiscal year of my time period, the control group spent \$1,019.51 per capita and the treatment group spent \$1,248.68 per capita. While the treatment and control per capita revenues and expenditures begin relatively similar in FY1995-96, over time the treatment group continues to spend more than the control group. By the last FY2005-06 the treatment cities spent \$2,012.97 per capita and the control cities \$1,517.85 per capita. The difference in spending between the city groups starts at \$229.17 per capita in FY 1995-96, then grows to \$495.12 per capita by the end of the time period; more than doubling the gap. These results show that the implementation of set-asides causes the total size of government to grow. The graph showing city revenues and expenditures supports the first part of my hypothesis.

Knowing that cities with set-asides have higher total revenue and expenditures than those cities without them, it is then important to determine more accurately where the additional revenue is coming from. The mean city taxes were higher for the treatment group than for the control group by \$82.15 per capita in FY1995-96, with the difference increasing between the groupings by the end of the time period to \$171.47 per capita (Figure 3). The same was true for city charges and fees, though to a slightly lesser degree—the difference begins at \$78.51 per capita and increases to a \$105.35 per capita difference. Overall, more city revenue comes from charges and fees than taxes. Just looking at the treatment cities in FY2005-06, charges and fees per capita were \$896 compared to \$686.87 per capita from taxes. Such results show that local government gathers revenue in varying degrees from different sources.

Figure 2. City Total Revenues and Expenditures, Mean Spending Per Capita, FY1995-06

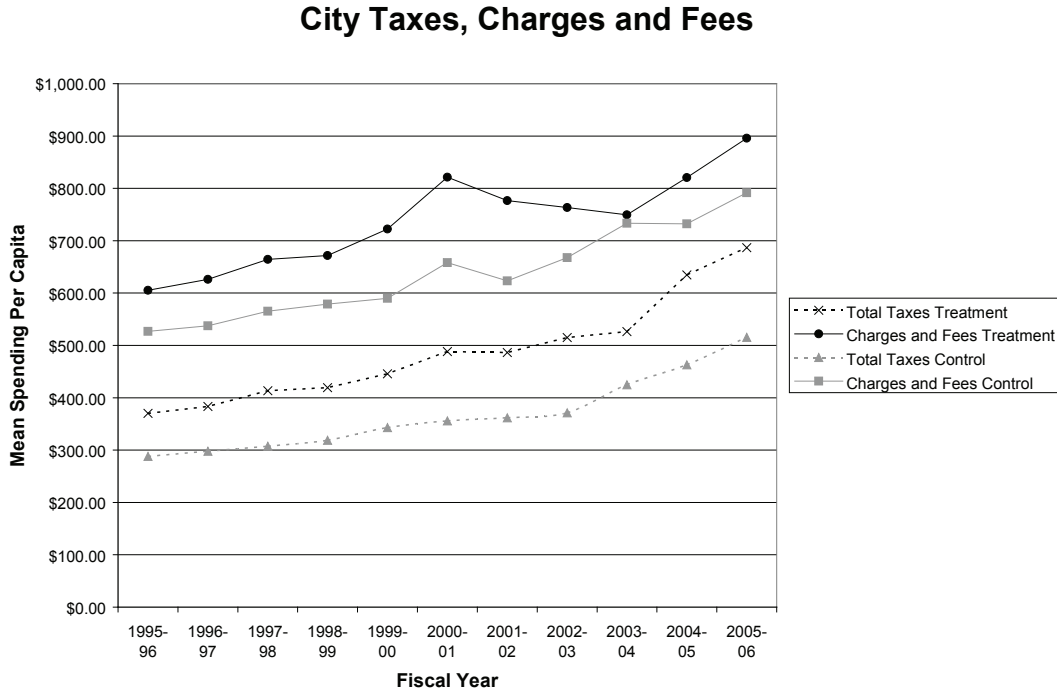


Sources: California State Controller’s Office, *Cities Annual Report* (1996-2006)

In the regression below (Table 1), the estimated coefficient on passage of set-aside initiative—when a city receives the treatment—tells us that when a city passes a set-aside, we’d expect city officials to spend \$128.19 more per capita than a city of the same population that didn’t pass a set-aside. This model contains both city and year fixed effects, to control for all the anomalous characteristics of each California city and for whatever effect fiscal conditions in a given year had on all cities studied. Using Beck and Katz’s (1995) method of estimating panel-correlated standard errors, this effect is significant at the 94% confidence level. We would only find an effect this large due to pure chance in six out of one hundred instances. This also means that the effect is statistically significant at the 95% confidence level in a one-tailed test, which is appropriate here because of the clear direction of my hypothesis: that set-asides should lead to higher, rather than lower, spending.

Additionally, running the same test, I find that cities that pass set-asides tax their citizens \$34.39 more per capita than cities of the same population that don’t pass a set-aside (Table 1). Like expenditures, city taxes have an r-squared value of .93, meaning that these variables explain 93% of the variation in city taxes per

Figure 3. City Total Taxes, Charges and Fees, Mean Spending Per Capita, FY1995-06



Sources: California State Controller’s Office, *Cities Annual Report* (1996-2006)

capita. This result shows that cities with set-asides tax significantly more than those without them, though slightly weaker in significance to overall spending. The significance is too small when looking at revenues and charges and fees.

Breaking expenditures on individual services down by individual cities shows the specific results of set-aside measures on services. The analysis that follows covers the same time periods as the first tests, but instead of looking at the mean for all cities, I isolate the spending on specific services for one city. By marking when the set-aside measure goes into effect, one can see if spending increases or decreases, by which individual service it does so by, and at what moment in time. I have analyzed each ballot measure individually, but provide a sample of my results as examples in this paper. The results vary, but provide interesting insight into how elected officials change fiscal practices as a result of these measures.

The city of Huntington Beach passed several set-asides during the time period examined, consisting of set-asides, targeted taxes, and advisory measures (Figure 4). The parks and recreation targeted tax of 2000 created a sharp increase in park spending, with a decrease in road and transportation service expenditures. The road

Table 1. City Regression Results, Total Expenditures and Taxes, FY1995-06

Dependent Variable: City Total Expenditures Per Capita, and City Total Taxes Per Capita

	Expenditures	Taxes
Passage of set-aside initiative	128.19* (67.31)	34.39** (11.90)
Population size of city	-.00037 (.00023)	-.00037 (.000026)
City fixed effects	included	included
Year fixed effects	included	included
Constant	2253.97** (104.63)	399.18** (9.97)
Observations	219	219
Number of cities	20	20
R-squared	0.94	0.93

**p<0.01; *p<0.05

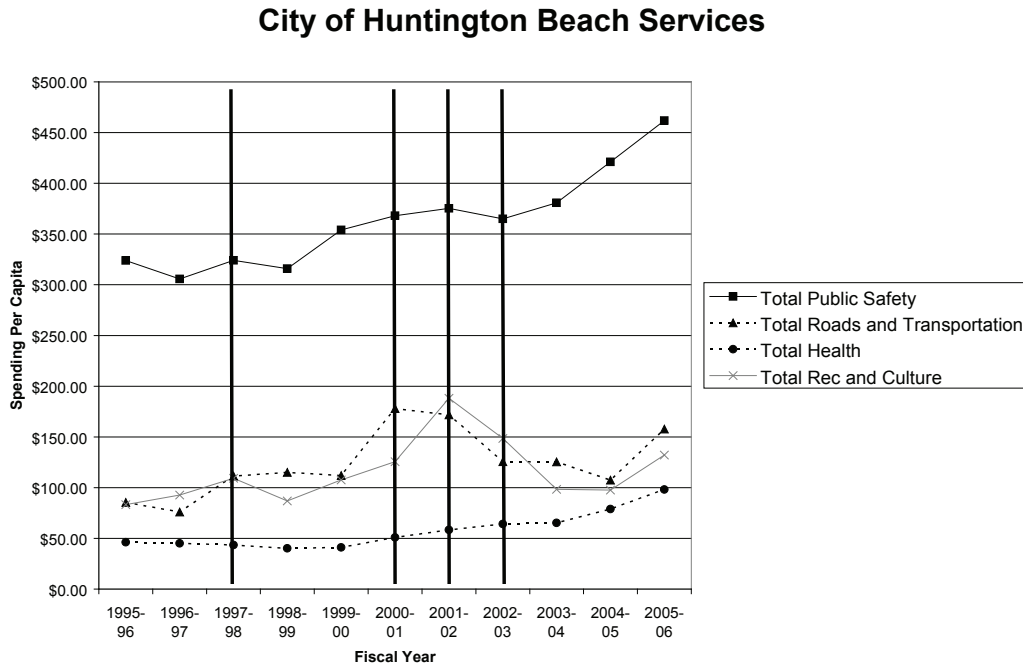
Note: Panel corrected standard errors in parentheses.

Sources: California State Controller's Office, *Cities Annual Report* (1996-2006)

set-aside in 2002 caused a slight increase in transportation spending with spending on recreation declining. It should be noted, however, that the 2000 measures for both parks and roads appeared to have no effect, as all services decreased in funding—though this might be a result of some unknown variable. Still, Huntington Beach shows some correlation to set-asides and individual service spending.

The cities that I studied showed varying results. There were some cities where the increase in spending on the identified service was very slight, such as Riverside and Los Angeles. In other cases, like San Jose, there was an actual decrease of spending on the mandated service. For still other cities, the ballot measure was passed near the end of my time series, so I am unable to accurately document the effects. Again, there is data to suggest that city officials take the approach of reducing funding on one service to raise spending on another. However, the answer to

Figure 4. City of Huntington Beach Services, Before and After Passage of Six Transportation and Recreation Set-Asides, Spending per capita, FY1995-06



Sources: California State Controller’s Office, *Cities Annual Report* (1996-2006)

Note: Solid lines denote when set-aside went into effect. Some years contain more than one set-aside.

this hypothesis is much more complicated than simple subtraction and addition of expenditures.

Conclusion

In California, set-aside initiatives are most often proposed in the Bay Area and along the southern coast, with higher passage rates concentrated in the same geographic locations. Overall passage rates for this initiative remain at 61%, implying that voters generally have no qualms about demanding more spending on certain services by their government. Voters ask for more spending on a given service and that is what they get. Looking at individual service spending for a specific city, the data show at least an increase in spending for the identified service.

Yet this funding does not come at the expense of a decrease in other service funding. Where the “vacuum” analogy persists is in the fact that overall spending increases more in cities that pass set-asides than in those that do not. The reality that the size of government increases in the treatment group of cities is a consequence that voter’s do not confront when asked to pass a set-aside.

So where does this leave us concerning the future of set-asides? I have shown that cities with set-asides will spend and tax more than cities without these ballot measures. This proves the first part of my hypothesis correct: that set-asides lead to larger government through overall increased expenditures. Concerning the effects on individual services at the city level, there is no preponderance of evidence to suggest that governments will always take from one service to meet the mandated funding of a set-aside.

There are several lessons that can be taken from my research in connection with direct democracy. The first is that voters must realize that nothing is free. The wording of set-asides can be appealing, but voters must understand that they will still end up paying for the demanded services in the form of increased taxes, charges and fees, and larger government. For those with a vested interest in set-asides and the services that they cover, my data shows that voters are inclined to support these measures and that they lead to general increases in spending on the identified services. Finally, for those government officials who must incorporate these initiatives into fiscal policy, the task is not impossible and there are ways to find the needed revenue to cover funding of all services, including the set-aside mandates.

The principle behind direct democracy is to provide the average voting citizen an opportunity to participate directly in the governance of their society. In California and at the local level, voters have been passing initiatives and referendums for over a century, many of which have caused great transformations of government. The set-aside is no exception. As I have demonstrated in my research, the decisions voters have been making through set-asides have substantial fiscal consequences; and yet there still remains much to be explored about this unique ballot measure. The knowledge learned from research on set-asides is not only relevant to political scientists, but to the voters who are so often asked to support these measures.

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Notes

¹ Gordon defines own-source revenue as total revenue minus intergovernmental grants.

² Financial information, by fiscal year, is from the California State Controller's Office, *Cities Annual Report* (1996-2006).