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Institutional Causes of California's Budget Problem

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Abstract

Since the early 1990s, California has experienced a recurring budget crisis. This article examines the combined budgets of state and local government and the institutions for creating these budgets to ascertain the source of the problem. The facts are that the state collects more taxes and fees as a percent of income than most other states, but local government has lower revenues in California. Total revenues to all governments as a percentage of income are very near the national average. On the expenditure side, the state spends less than the average for other states, but local governments spend much more. High local expenditures are financed by revenue transfers from the state that account for about 40 percent of the state's budget. The cause of California's unusual fiscal relationship is decades of initiatives that more severely constrain local revenues than state revenues. The state has responded by creating a system of state-local transfers that allow local governments to face a form of soft budget constraint, leading to excess local spending and lack of clear accountability for the state's recurring fiscal crisis. Because the cause is the cumulative effect of numerous state-wide initiatives, the only plausible cure is initiative reform and revision of numerous initiatives, which most likely can be accomplished only through a state constitutional convention. All other pending reforms are at best palliatives, and many would make the fiscal situation worse.

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I. Introduction

California has a serious and persistent budget problem that first emerged in the early 1990s and became more severe in the new millennium. The most visible aspect of the problem is an annual fiscal crisis. The crisis begins with a projected budget deficit, which then precipitates a legislative battle over the combination of tax increases and expenditure cuts that must be adopted to satisfy the state constitutional requirement to balance the budget. The June deadline for passing a budget usually is missed, causing shut-downs of many state programs, substitution of IOUs for payments to vendors that supply goods and services to state agencies, and collateral budget crises for local governments which cannot adopt budgets in a timely fashion due to uncertainties about the magnitude and composition of state transfers. When finally passed, the budget typically includes accounting gimmicks to achieve balance, thereby passing on the crisis to the next budget cycle. The political consequence of frequent budget crises is a continuing decline in citizens' approval of state officials, as exemplified by the low performance ratings of the state legislature and all recent governors as they leave office, regardless of party or ideology.

The less apparent and more contested aspect of California's budget problem is how California's political institutions contribute to the recurring crisis. Whereas citizens, responding to the visible aspect of the budget problem, tend to blame elected officials for failing to adopt a

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timely budget, policy analysts tend to emphasize the budgetary effects of California's political institutions.[2] Some argue that the primary source of the budget problem is the two-thirds vote requirement in each house of the legislature to pass a budget or a bill that raises taxes. Others argue that California's budget problem is caused by the design of the election system, including the semi-closed primary (eliminated by a June 2010 initiative), weak regulation of campaign finance, term limits, and the system for drawing boundaries for state legislative districts (replaced by a Citizens Redistricting Commission in a 2008 initiative). Some also argue that the budget problem is exacerbated by the fragmented state executive branch, which diffuses accountability and erects barriers to comprehensive budget planning. Finally, some analysts conclude that the root cause of California's budget problem is the initiative process. Initiatives affect the budget directly by limiting taxes while increasing expenditures, and indirectly in that most of the other governance problems were created by ballot measures.

While these institutions factor into California's fiscal problems, we believe that an additional distinctively dysfunctional element of California governance is the fiscal relationship between state and local governments. Most local government expenditures in California are paid from revenue transfers from the state through an opaque process that blurs the connection between the provision of public services by local governments and the costs of these services. The misalignment of revenue responsibility and decisions about the level and composition of local government services encourages irresponsible budgeting. Moreover, because the institutions that create these perverse incentives are hard-wired into the state constitution, they are difficult if not impossible for elected officials to change, even if they recognize and seek to

2. For a comprehensive analysis of the budgetary and policy consequences of California's governance institutions, see Bruce E. Cain and Roger G. Noll (editors), *Constitutional Reform in California*, Institute for Government Studies Press, University of California, 1995.

correct the problem. Our primary conclusion is that until the political institutions that create perverse incentives are fixed, California's fiscal problems will persist, especially during economic downturns.

To elucidate the basis for our conclusion, this article analyzes the uniqueness of California's budget problem by identifying how both budgets and the process for creating them differ between California and other states. The next section reviews recent data to ascertain precisely where revenues and expenditures of state and local governments diverge between California and other states. The value of this exercise is that it identifies whether the annual budget crisis and the attendant widespread dissatisfaction with the performance of government on budget issues are due to a combined state and local government budget that is outside the range of normal outcomes in the U.S. To some, this exercise is uninteresting. Citizens, public commentators and political leaders whose policy preferences lie outside the range of normal political outcomes in the U.S. are likely perpetually to be dissatisfied with the budget, regardless of how one state's public sector compares with another. But if the distribution of Californians across the ideological spectrum does not differ dramatically from the ideological distribution of citizens in other states, this exercise is interesting because it sheds light on whether public dissatisfaction with budgeting in California has a basis in the size and composition of state and local government budgets.

The principal findings from this analysis are that, taking into account all taxes and fees, California is not a high-tax state, expenditures on state government functions in California are below the national norm, and local government expenditures are substantially higher while local government tax revenues are substantially lower than in most other states. The unusual aspect of California's system of public finance is that the state collects an atypically large proportion of total revenues but gives an atypically high proportion of these revenues to local governments. If widespread dissatisfaction with the California budget process has a basis in budget outcomes, the cause is the allocation of responsibility between state and local government, with the state responsible for the politically unpopular task of raising taxes and local governments responsible for the politically popular task of providing services. This anomaly gives rise to a political puzzle: why do state elected officials persistently accommodate atypically high local government expenditures while starving state programs?

Section III addresses this puzzle. This section identifies unique features of California's political environment that plausibly could lead to greater decentralization of the expenditure side of the budget than occurs in other states. Among these are heterogeneous demand for public services among local communities, the cumulative effect of decades of initiatives that constrain taxes and increase spending, the size of legislative districts, and the effect of term limits. But an additional cause of California's budget problem is that state-local fiscal relations in California have created a form of "soft budget constraint" for local governments. Atypically high state revenues, local expenditures, and transfers from the state to local government cause the "price" to local voters of incremental local services, as measured by the incremental taxes and fees they pay, to be substantially below the incremental cost of those services, thereby encouraging local governments to overspend. Political institutions lead state legislators to accommodate high local spending by increasing state revenues and cutting expenditures on state programs.

Section IV analyzes various pending institutional reform initiative measures in California to determine the extent to which these proposals address the root causes of budget deficits and so would be likely to have a significant impact on the state's budget problem. The November 2010 state ballot contains several propositions that have important budgetary implications. Other reform proposals either have qualified for the ballot in February 2012 (the presidential primary) or are in the process of gathering signatures for qualification. Some propositions would affect the budget directly by changing the tax system or altering expenditures. Others would affect the budget indirectly by changing the process for making decisions about revenues and expenditures.

We conclude that these proposals are unlikely to solve the state's budget problem because they do not directly address the underlying causes of the state's persistent fiscal crisis: the cumulative effect of numerous popular initiatives, which has been to constrain taxes while increasing expenditures, thereby causing the budget to be increasingly inflexible and difficult to balance; local heterogeneity of the citizenry that creates an incentive to decentralize expenditure decisions; concentration of revenue generation in the state government; and the mismatch between the source of revenues and decisions about expenditures, which undermines accountability for the balance between revenues and expenditures. To fix the underlying problem will require either a large number of coordinated initiatives or a constitutional convention that completely retools the state's political institutions.

II. California State and Local Public Finance

To assess the nature of the budget problem in California, this section reviews the details of the budgets of state and local governments in the U.S. to identify how California differs from other states. The articles in this issue by Professor Alan Auerbach on taxation and D. Roberick Kiewiet on government employee pensions deal with pieces of the problem.

Professor Auerbach shows that California is roughly in the middle in terms of total taxation by state and local governments, but that California differs from other states with respect to the relative importance of different taxes. In particular, California has relatively low property taxes but relatively high individual and corporate income taxes. The effects of this difference are that in California the state receives a much larger fraction of total tax collections and total tax revenues are more cyclically sensitive. Professor Kiewiet shows that California's pension funds for state and local employees are both generous and underfunded, creating a potential time bomb for future budgets. But Professor Kiewiet also shows that California's pension problem is not unique and that pension funds in California are less underfunded than in many other states.

This article complements the other two by examining all state and local revenues and expenditures by California's state and local governments, using data from the annual survey of state and local public finance by the U.S. Census Bureau. This source of data is not perfect. The data come from a survey of local governments. The survey responses are not necessarily accurate, and are subject to a sampling error of about 3 percent in total revenues and expenditures and about 5 percent in specific revenue and expenditure categories.[3] Coverage is most problematic for special districts, which often are small and may not report as accurately. Nevertheless, the sample includes all states and all of the most populous cities and counties. These entities account for most state and local revenues and expenditures, and implement the most important state and local programs. Hence, these data provide useful insights about state and local budgets and the causes of California's budget problem.

A shortcoming of currently available census data is that it does not reflect the full impact of the current recession. The most recent data are from fiscal 2008, which for most states began in July or October of 2007. Thus, the data reflect the start of the recession that began in late 2007, but not the financial crisis beginning in September 2008. Because California's state and local budgets are highly sensitive to the business cycle, the 2009 and 2010 data, when available,

3. See "2008 Annual Surveys of State and Local Government Finances Methodology," U.S. Census Bureau, 2009.

are certain to show a relative deterioration in California's financial condition after 2008.

A. Revenues

Table 1 summarizes the key budget items in 2008 for California and for all state and local governments in the U.S. Table 2 contains a summary for fiscal 2005 to facilitate comparison between recession and full employment. Both tables show California's share in national state and local revenues and expenditures. The baseline for the comparison is California's share of gross domestic product (gdp).[4]

In 2008 California's estimated share of U.S. gdp (13.0 percent) was slightly lower than California's shares of state and local revenues (13.3 percent) and state and local taxes (13.2 percent), but substantially lower than the state's share of total state and local expenditures (14.6 percent). The revenue and tax shares are not statistically significantly different from gdp share. The data show that in 2008 California was an average revenue state but a high expenditure state.

In 2005 (Table 2) the state's shares of gdp (13.2 percent), state taxes (13.4 percent), and total revenues (15.1 percent) were higher, but the state's share of spending was lower (14.3 percent). California's combined state and local budget was in surplus in 2005 by 6.5 percent of total revenues, while in 2008 the combined budget was in deficit by 6.7 percent of total revenues.

The data in Tables 1 and 2 illustrate the high sensitivity of California's total government

4. A measure of economic activity is an appropriate benchmark for comparisons because the demand for most government services and the ability to pay for these services increase with income. The alternative to gdp share is some measure of income. Total state income differs from gdp in that the former takes into account the income in a jurisdiction that is earned from activity elsewhere and ignores income earned in California by non-residents. Personal income is the fraction of total income that accrues to households. Normally the differences in state shares of these measures are small. In 2008, Californians received 13.1 percent of U.S. personal income, compared to 13.0 percent of gdp. By comparison, California accounted for 12.2 percent of the U.S. population in 2008. Per capita gdp in California was 6.6 percent above the national average while per capita personal income was 7.4 percent above the U.S. average.

revenue to the business cycle. The data also show that California state and local governments smooth expenditures over the business cycle. California accounted for 34 percent of the total deficit of all U.S. state and local governments in 2008 but 25 percent of the total surplus of all state and local governments in 2005, both of which are far above California's share of gdp.

The estimated difference between California's revenue share and gdp share in 2008 is a small fraction of revenue. If California's share of state and local government revenue in 2008 had equaled its gdp share, revenue would have been $9 billion less (a reduction of about 2.6 percent). A tax reduction of $4 billion in 2008 would have reduced California's share of state and local tax revenues to its gdp share.[5] Thus, in 2008 the burden on the California economy from taxes and fees did not differ substantially from the average for all states.

California political leaders have complained that the state does not receive its fair share of federal revenues. In 2008 California received 12 percent of total federal transfers to state and local governments. This figure, while statistically significantly below California's gdp share, is only slightly below the state's share of total population, and in any case the impact of the shortfall below gdp share is small. If California had received 13 percent of all federal transfers, rather than 12 percent, the incremental revenue would have been less than $5 billion. Because federal transfers typically are tied by federal law to state spending on specific programs, additional revenue most likely would require an increase in expenditures. Consequently, more federal revenue is not a plausible solution to the state's budget problem.

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5. Because California accounts for a substantial fraction of national economic activity, the appropriate method for measuring the magnitude of a change in a revenue or expenditure item that would bring California's share to the national average is as follows. Let C be the California item in the Table, C* be the value that would arise if California's share equaled its gdp share (in 2008 13 percent), N be the national number after subtracting the amount for California, and s = C/N, so that $C = s(N+C) = (.13)(N+C) + (s - .13)(N+C)$. C* then arises when $(s-.13) = 0$, implying that $C^* = (.13)(N+C^*) = (.13/.87)N = (.149)N$. For 2005, $C^* = (.152)N$.

Two revenue items depart substantially from the national average: fees and charges, and payments to social insurance programs. The latter includes unemployment insurance, disability insurance, and pensions for state and local employees. Because revenues from fees and social insurance programs are tied to benefits for those who pay, the accounting convention is to separate them from taxes.

California's revenues from fees and charges are much higher than its gdp share, but the primary reason is that publicly owned utilities are more common in California than elsewhere. For example, the Los Angeles Department of Water and Power is the largest publicly owned electric utility in the nation and among the largest regardless of ownership, and the Sacramento Metropolitan Utility District ranks sixth nationally among publicly owned utilities.[6] California accounts for more than 20 percent of total U.S. state and local revenues from publicly owned electric and water utilities. If California's revenues from utilities owned by state and local government as a proportion of gdp were equal to the national average, California's share of national state and local revenues in 2008 would have been 13 percent. Thus, California was a "high revenue" state in 2008 only because of its unusually high degree of public ownership of electric and water utilities. Because Californians would pay similar charges for utility service regardless of whether the supplier was public or private, utility revenue does not represent the same type of burden on citizens that is represented by taxes or other mandatory fees that pay for standard government programs.

Reported revenues from social insurance were negative in 2008 (a loss of $550 million, rounded to $1 billion in Table 1). This performance was far worse than the experiences of other states. The negative revenue entry is the result of an accounting convention that counts gains

6. "Electric Utility Industry Financial Statistics," U.S. Department of Energy, 2000.

and losses in the value of investments by social insurance trust funds as part of revenue. Because the prices of stocks and real estate tanked in fiscal 2008, states that invested large accumulated surpluses in pension programs showed enormous losses. The cause of California's negative revenue for social insurance programs in 2008 was a loss of $12.8 billion by pension funds (the difference between the decline in asset values and new contributions).

In the boom year of 2005, when asset values were high and rising, California accounted for 23 percent of nationwide revenues from state and local social insurance programs, due primarily to a surplus in pension funds. In 2005, California pension funds received $69 billion in gross revenues (compared to an expenditure of $22 billion), which was 21.9 percent of total national revenues for state and local pension funds. Had California received revenue from this source in 2005 equal to its share of gdp, California's revenue from all sources would have been $31 billion lower, causing total revenue to fall from 15.1 percent of the national total to 14.0 percent. The turn-around in gross revenue for pension funds between 2005 and 2008 was nearly $90 billion, or about 25 percent of California's total revenue.

The main lesson from these data is that California is not atypical on the total revenue side of its budget. Although the share of state gdp that is accounted for by taxes and fees is above the national average, nearly all of the revenue difference is accounted for by atypically large public ownership of utilities and, in boom years, capital gains in public employee pension funds. The revenue that is used to pay for standard functions of state and local government is not very different from the average among all states. The other important feature of California's government revenue is its sensitivity to the business cycle, arising from greater reliance on income taxes, lesser reliance on property taxes, and variation in the asset value of pension funds for public employees.

B. Expenditures

In 2008 California's share of total spending by state and local governments, net of transfers between governments within the same state, was 14.6 percent, which was substantially above the state's share of gdp. Had California's spending share equaled its gdp share, expenditures would have lower by $54 billion (13 percent). Of this amount, $13 billion is accounted for by higher expenditures for publicly-owned utilities, leaving $41 billion of additional spending due to conventional government programs.

Table 1 shows the main categories of expenditures. The first four expenditure items are general categories that are not tied to specific programs: salaries and wages of government employees, interest on debt, capital expenditures, and general administration. Of these, interest and capital outlays are slightly above the state's gdp share. Spending on these items was about $3 billion above the state's gdp share.

Salaries and wages are significantly higher in California than in other states. Had California's share of salaries and wages equaled its share of gdp, expenditures would have been lower by roughly $13 billion (11 percent). Two factors determine the payroll budget: the number of employees and the wage structure. California does not have an atypically large number of state and local employees. California accounts for 11.1 percent of full-time equivalent (FTE) state and local employment, which is below its population share (12.2 percent).[7] The cause of California's high payroll expenditure is high pay. Expenditures per employee in California are roughly 30 percent above the national average and roughly 22 percent above parity with other

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7. Calculated from "Government Employment and Payrolls, 2008," U.S. Census Bureau, 2009.

employee compensation in California.[8]

Expenditures on administration in California also exceed the national norm. This category is a hodge-podge that includes financial administration, the judiciary and other legal functions, public buildings, elected bodies, and executive officials that cannot be allocated to specific programs.[9] The excess spending in this category over California's gdp share is about $6 billion and is due to relatively high spending on judicial, legal and general administration.

The remaining expenditure entries in Table 1 cover the most important functional categories of state and local programs. These categories are divided according to whether California's share in the national total is above or below its gdp share. California spends significantly less than its gdp share on elementary and secondary education, highways, and waste disposal. Estimated welfare costs also are below the state's gdp share, but the difference is not statistically significant. Estimated expenditures on higher education are about $1 billion more than gdp share, but this difference also is not statistically significant. The program areas in which California spending significantly exceeds gdp share are health care, public safety, parks and recreation, housing and community development (including redevelopment authorities), and social insurance. Together the categories in which estimated expenditures exceed gdp share (whether significant or not) had excess expenditures over gdp share of the following amounts.

Higher Education – $1 billion;
Health Care (including public hospitals) – $6 billion;
Public Safety (police, fire, corrections) – $10 billion;
Parks and Recreation – $1 billion;
Housing and Community Development – $4 billion;
Social Insurance and Pensions – $12 billion (half attributable to pensions).

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8. This calculation is the ratio of actual compensation to hypothetical compensation if state and local employees in California were paid the same wage premium, 7.4 percent, that Californians earn over the national average.
9. Because a substantial fraction of administrative costs are salaries, administrative cost has considerable overlap with payroll cost.

California's excess of expenditures over gdp share in 2005 was $31 billion. Because $11 billion of this total was accounted for by publicly owned utilities, $20 billion is attributable to programs and administration, which was less than half of the excess in 2008 for these items. For higher education, California expenditures in 2005 were slightly below the state's gdp share. The excess of expenditures in the other major program areas that had excess spending in 2008 were:

Health Care – $4 billion;
Public Safety – $6 billion;
Parks and Recreation – $1 billion;
Housing and Community Development – $3 billion;
Social Insurance – $8 billion ($3 billion due to pensions).

For all of these items, California's excess of spending over gdp share rose between 2005 and 2008. Whereas national expenditures by state and local governments were higher in 2008 than in 2005, the increases in California were much greater in relation to gdp share. Of course, state and local budgets for 2008 were passed in mid 2007 before the recession hit, so the principal explanation for the greater deterioration in California's financial position in 2008 was that California's highly pro-cyclical revenues were affected by the recession but its expenditures were not. This phenomenon explains about half of the excess in California's spending on these items relative to other states in 2008. The remaining $20 billion is an excess of expenditure over gdp share in the items discussed above. This spending gap would be eliminated by reducing total non-utility expenditures by about 5 percent.

The lesson from these data is that while California spends a greater share of gdp on state and local government programs, the amount of additional spending is not large. If the state decided to spend at the average rate for all state and local governments in the U.S., this goal could be achieved relatively easily over the next few years by some combination of modest tax increases and modest expenditure cuts measured against normal growth in income. If taxes and charges grew by one percent more than income and if expenditures rose by one percent less than income, the state's additional spending over the national norm would disappear in three years. Given that California is so near the national norm and could match that norm relatively easily, the persistent inability of the state to pass a timely budget does not reflect financial reality.

C. Comparisons with Large States

The preceding analysis compares California's state and local government budgets with the budgets of all other states. Another useful comparison is between California and the other most populous states. The largest states are more heterogeneous than smaller states in economic structure, the political ideology of their citizens, and the diversity of their populations. The largest states also contain large cities that are likely to cause the composition of demand for government services to differ from smaller states, regardless of other sources of heterogeneity.

Table 3 compares revenues and expenditures in 2008 among the six states with the largest population and the highest gdp. Each revenue and expenditure item is shown as a fraction of state gdp. California has much higher revenues as a fraction of gdp than Illinois and Texas, but lower total revenues than the other states. Taxes in California are substantially lower than New York, slightly higher than Florida, Illinois and Pennsylvania, and much higher than Texas.

On the expenditure side, California is below New York but above all the other states. Again, Texas and Illinois spend substantially less than other large states, but California also spends 1.3 percent of gdp more than Florida and 2.5 percent of gdp more than Pennsylvania. If California spent the average of these two states, its expenditures would be $28 billion less.

Table 3 also compares the composition of expenditures by function. The only categories in which California has the highest spending are higher education, social insurance, and administration, although in all cases other states are close. California also is near the top in salaries and wages, public safety, and utilities. In general, the distribution of expenditures among programmatic categories in these states varies substantially, but California is not outside the range of variation.

The greatest difference between California and other states is the allocation of revenues and expenditures between state and local government. Local government expenditures in California are the highest among the large states, while local tax collections are lower than any state except Texas. The difference between state and local tax collections is 2.6 percent of gdp in California, 1.8 percent in Pennsylvania, 0.9 percent in Illinois, 0.3 percent in Texas, and negative (meaning that local governments collect more taxes than the state) in Florida and New York. The differences between taxes and expenditures of local governments as a percent of gdp are as follows: California – 10.2, Florida – 8.6, Illinois – 6.5, New York – 7.4, Pennsylvania – 6.5 and Texas – 6.0.

The shortfall of revenues compared to expenditures by local governments is financed primarily by transfers from the state. California transfers five percent of GDP from the state to local governments, more than any other state. The percent of state revenue that is transferred to local governments is as follows: California – 45.8, Florida – 32.6, Illinois – 28.3, New York – 37.5, Pennsylvania – 27.9, and Texas – 25.8. In short, local governments in California spend the most money and are the most dependent on state transfers for balancing their budgets.

The dependence of California local governments on the state is not primarily due to the effects of the limitation on property tax collections that were enacted in Proposition 13. Property tax revenue as a fraction of gdp is lower in California than in three of the five other states, but the differences between California and the states with the highest property tax collections are not large enough to account for the gap between revenue and expenditure among local governments in California. The state with the highest property tax revenue is Florida, collecting 1.2 percent of gdp more than California, but the difference in state transfers between California and Florida is 2.0 percent of gdp. Thus, a difference between California and other states is the generosity of the state in supporting local expenditures.

California's separation of decisions about spending priorities from decisions about revenue generation creates perverse incentives for local officials. From the perspective of citizens, the state's financial system attenuates the relationship between the scope of local government services that they demand and the amount that they must pay to acquire those services. Because so much of local services are paid for by the state, local officials are in a position to reap the benefits of expanding local services, but state officials bear the political costs of either raising revenues or sacrificing other programs in order to finance expanded local services. The puzzle is not that local officials would seek to obtain more state money to expand local services, but that state officials would allow them to do so.

D. Allocation between State and Local Governments

Given that local governments spend so much more in California than elsewhere, the remaining issue is to identify the categories that account for this spending. Table 4 contains a detailed breakdown of revenues and expenditures by state and local governments for California and the rest of the nation.

On the revenue side, California's share of the national revenue of state governments is actually less than California's gdp share. The state accounts for nearly one-third of national utility revenue, which arises from electricity sales by the state water project. After eliminating utility charges, California receives only 12.2 percent of all state government revenue. By comparison, local government revenue in California is far above California's gdp share. Not counting utility charges, local governments in California receive 16.1 percent of all U.S. local government revenue. This proportion would have been even higher had local government pension funds not experienced losses in 2008.

While local revenue is high in California, local taxes are low. Whereas California accounts for 15 percent of state government tax revenue in the U.S., local governments in California account for only 12.5 percent of nationwide local taxes. Thus, California's status as a state with a middling tax burden arises from combining a high-tax state government and low-tax local governments. This mismatch explains the high rate at which the state transfers funds to local governments.

The California state government does not spend substantially more than California's share of gdp in nearly all budget categories. Whereas California accounts for 14.2 percent of national spending by state governments, 38 percent of that spending is transfers to local governments. For categories other than transfers, California's expenditures are only 12.2 percent of total spending by states. In addition to transfers, the only expenditure categories in which both the percentage and absolute amount of state spending over gdp share is substantial are corrections and social insurance.

While state spending in California is below average, local government spending is higher than average in most categories. The only program areas in which local governments in California spend less than their gdp share are elementary and secondary education, highways, and waste disposal. In some cases, a high share of local spending is matched to a low share of state spending, reflecting greater delegation of program implementation. Examples are higher education, welfare, health care, and housing and community development. Finally, in a few categories both the state and local governments spend more than their gdp share, notably public safety, utilities, social insurance (especially pensions), and administration.

Whereas California's low spending on elementary and secondary education receives considerable publicity, three other unusual budget items are not as widely recognized. The first is the relatively low spending by the state and high spending by local government on higher education. This spending pattern is accounted for by California's atypical reliance on community colleges, which are operated by local special districts. The other two are California's low expenditures on highways and waste disposal. California's low spending on these infrastructure categories is surprising, given the state's reliance on motor vehicle transportation and stringent environmental laws.

While some local programs are controlled by the state through delegation of operating responsibility combined with tied transfers of state funds, other items are largely controlled by local governments. Examples of the latter are public hospitals, public safety, parks and recreation, and community redevelopment. Because total state and local expenditures on state-controlled items (notably public education and highways) generally are not dramatically higher than California's gdp share, high spending in categories controlled by local governments is the primary cause of the excess of total spending over the national norm.

An important source of high local expenditures is high compensation of local employees. While state employees are highly paid, in 2008 the state employed only 9 percent of all state employees in the U.S. and its payroll for state employees was only 12.1 percent of total U.S. state payrolls. These employees are relatively productive in that California's share of state spending exceeds its share of state payrolls. In the U.S. 13.3 percent of state expenditures are accounted for by salaries and wages, whereas the proportion in California is only 11.3 percent. California local governments account for 11.8 percent of all local government employment (bellow the population share), but 15.2 percent of the national payroll for local employees. As discussed in the article by Professor Kiewiet, California public employees also have substantially higher pensions. Because local governments have roughly 3.5 times as many employees as the state government, the most important single source of higher state and local expenditures in California is the high total compensation of local government employees.

Whereas the combined state and local government budgets in California showed a deficit in 2008, the state accounted for most of the shortfall. For the state, spending exceeded revenue by $46 billion, while local government spending exceeded revenue by $13 billion. Most of the state's revenue shortfall was accounted for by the deficit in the pension funds, which spent $21 billion and had negative revenues (due to the fall in the value of trust funds) of $11 billion (a net loss of nearly $32 billion). Local governments spent $8 billion on pensions and lost another $2 billion in the net value of trust funds. Thus, on operations other than pensions, the state had a deficit of $14 billion while local governments had a deficit of $3 billion.

In the better economic environment of 2005, the state's fiscal condition was healthier. State revenues exceeded expenditures by $40 billion, although nearly all of this amount – $38 billion – was accounted for by a surplus in state pension funds, leaving the remainder of the state budget roughly in balance. Local governments in California technically showed a surplus of $3 billion in 2005, but the excess of revenues over expenditures for pension funds was $9 billion, implying a deficit in the remainder of local budgets of $6 billion.

The deficit in the state budget is much smaller than state transfers to local governments. For example, the state had a deficit in 2008 (excluding pension funds) of $14 billion, but net transfers to local governments were $93 billion. One should not be surprised that in a budget crisis the state seeks to cut transfers to local governments. With transfers equal to 38 percent of expenditures, the state could not plausibly balance its budget without cutting local transfers.

III. Explaining the Unique Pattern of California's Structural Deficit

The preceding section identifies how state and local budgets differ between California and other states: high centralization of revenue compared to expenditures. Conventional wisdom places the blame for this imbalance on Prop 13, which limited local government's capacity to raise revenue. The puzzle is why the state accepts the political liability of higher taxes to provide funds that allow local officials to reap the political rewards of greater spending.

Because this pattern of revenue and expenditure is unique to California, the explanation must come from something unusual about Californians or their government. One possibility is that the circumstances and diversity of California' population creates distinctive preferences regarding government programs, the allocation of policy responsibility among types of governments, or methods for raising revenue. The other possibility is that California has unique institutions that cause its public finances to differ from other states in a manner that distorts the combined budget of state and local governments. This section shows that political institutions are the primary cause of California's unusual allocation of revenues and expenditures.

A. Theoretical Background: Soft Budget Constraints

In analyzing the details of how California's political environment affects state and local government budgets, a useful starting place is the political economic theory of intergovernmental fiscal relationships. California political institutions establish the regional (state) and local components of the larger federal system in which Californians live. Federalism is a system of government in which subordinate levels of government have some autonomy to determine the level and composition of public services for their residents. Fiscal federalism refers to a system in which higher levels of government transfers revenue to lower levels to assist the latter in providing decentralized government services.

In the 1950s and 1960s, economists developed "first generation fiscal federalism," which identified how national economic welfare could be improved if a higher level of government financed certain local government functions.[10] Decentralization of the provision of public services is potentially beneficial if citizens in different localities differ in their tastes for government services and if local governments possess better information about the preferences of their citizens than do higher levels of government. But even if these conditions are present, decentralization of both taxation and expenditure decisions may not maximize economic welfare for four reasons. First, some locally provided government goods plausibly affect the welfare of citizens in other jurisdictions, in which case autonomous local governments will provide inefficient amounts of the service – too little if the service benefits other communities (e.g., arterial roads) or too much if a local service harms other communities (e.g., a waste disposal facility at a community boundary). Second, the amount of local services that will be provided by an autonomous local government depends on the wealth of its residents, so that a higher level government may seek to impose floors on the level of services to achieve equity objectives. Third, the costs (including economic distortions) of taxation may differ among types of taxes and the level of government at which the tax is imposed, so that the optimal taxation system for

10. For a summary of first-generation and second-generation theories of fiscal federalism, see Wallace Oates, "Towards a Second Generation Fiscal Federalism," *International Tax and Public Finance* 12(4) (January 2005), pp. 349-73.

balancing the combined budgets of all governments may lead to differences between taxes and expenditures at each level of government. Fourth, only the national government can implement effective macroeconomic policy, and the center may seek to stimulate demand by paying for increased local spending. An example is the current U.S. stimulus program that provides revenue to local governments to enable them to avoid layoffs of teachers, police and fire fighters.

Several important assumptions underpin first-generation fiscal federalism, two of which are important for understanding the California budget problem. The first is that elected officials at all levels of government seek to maximize national economic welfare, and the second is that government officials possess sufficient information about the value of government services to different communities to design the optimal decentralization of services, taxation, and method for transferring revenues between levels of government. "Second-generation fiscal federalism" is based on more realistic assumptions about the effect of democratic elections on the goals of elected officials and the extent to which these officials and the citizens who elect them have good information about the effects of taxes and expenditures on economic welfare.

The origin of second-generation fiscal federalism is the theory of the "soft budget constraint" that arose from the experiences of Hungary in attempting to democratize and decentralize government and the economy in the 1980s.[11] While this theory originally was developed to explain why breaking up state-owned enterprises into competing, autonomous units did not substantially improve their efficiency, the theory soon was expanded to fiscal relationships between governments in a federal system.[12]

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11. Janos Kornai, "The Soft Budget Constraint," *Kyklos* 39(1) (February 1986), pp. 3-30.
12. For a survey of the expanded application of the idea of a soft budget constraint, see Janos Kornai, Eric Maskin and Gerard Roland, "Understanding the Soft Budget Constraint," *Journal of Economic Literature* 41(4) (December 2003), pp. 1095-1136.

The idea behind the soft budget constraint is that if local officials believe that officials at higher levels of government will respond to a local budget crisis by providing additional funds, then the amount of local spending will be excessive. The reason is that greater transfers enable local officials to increase the amount of services that they deliver to their constituents without proportionately increasing the taxes that their constituents must pay. This problem is exacerbated if the information that is available to citizens and government officials about the effects of programs, taxation methods, and the connection between revenues and programs is imperfect. When information is incomplete, accountability for the performance of the public sector is undermined, creating a trade-off between the welfare benefits of decentralization and the tendency of decentralization to cause local governments to spend too much.[13]

Whether fiscal federalism causes local governments to be too large depends on the details of how revenue and expenditure decisions, including transfers to local governments, are made.[14] Transfers from higher to lower level governments do not necessarily lead to soft budget constraints, and an important lesson from second-generation theory is that a federal system in which local governments have considerable autonomy and face hard budget constraints facilitates the development of a robust market economy.[15] The key to whether fiscal federalism enhances or reduces economic welfare is the design of federal system, including the fiscal relationships among governments, which typically (as in California) are determined by constitutional provisions that are difficult to change.

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13. David E. Wildasin, "Externalities and Bailouts: Hard and Soft Budget Constraints in Intergovernmental Fiscal Relations," World Bank Policy Research Paper 1843, August 1997.
14. Barry R. Weingast, "Second-Generation Fiscal Federalism: The Implications of Fiscal Incentives," *Journal of Urban Economics* 65(3) (May 2009), pp. 279-93.
15. Barry R. Weingast, "The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development," *Journal of Law, Economics and Organization* 11(1) (1995), pp. 1-31.

The implications of fiscal federalism for California's budget problems reside in the details of California's political environment. Sufficient conditions for fiscal federalism to have potential efficiency benefits are local differences in the demand for public services and in the ability to pay for services that, for equity reasons, society wishes to provide more equally than would be the case if these services were financed solely from local revenues. But the potential for increased welfare from decentralization will not be realized if the fiscal relationships between the state and local governments create incentives for elected officials that distort the level and composition of government services. The remainder of this section examines state and local fiscal relationships in light of these insights.

B. Population Heterogeneity

One factor that affects the desirability of decentralization of public services and that is likely to influence California's intergovernmental fiscal relationships is the heterogeneity of the population. Providing local services through a large network of cities, counties and special governments (California has the most special governments of any state in the U.S.) may serve a diverse state better even if it creates coordination problems and drives up total spending.[16] Because California's population is diverse, local government jurisdictions vary in economic structure, the wealth of residents, ethnic composition and fraction of foreign born residents, and the political ideology of the median voter. These sources of heterogeneity cause differences in the level and composition of demand for public services. By delegating more policy authority to local government, the state allows the composition of public services to respond to heterogeneity

16. A recent study finds that local spending goes up with the number of separate overlapping local jurisdictions. See Christopher Berry, "Piling On: Multilevel Government and the Fiscal Common-Pool," *American Journal of Political Science,* Volume 52, number 4, pp. 802-820.

in demand. Citizen heterogeneity implies that voter satisfaction can be greater if local governments choose the amount and composition of public services that their residents receive.

While citizen heterogeneity helps to explain some aspects of California's public finance system – especially the highly fractionalized way local services are delivered – it is not a complete explanation of the state's distinctive fiscal arrangements. California's racial and ethnic diversity is significantly higher than the rest of the country (47% non-Hispanic white versus 65% on average in the US), but not higher than other large states. Moreover, aside from the need for language assistance, race and ethnicity does not translate as closely into a differentiated demand for local government services as does socio-economic diversity. Californians have slightly higher incomes than the average for the U.S., but California is not the wealthiest state, and the percent living below the poverty line is pretty much the national norm (13%). In other words, Californians are socio-economically diverse, but not more so than citizens of the other most populous states. There is no basis for concluding that upstate versus downstate New York, Cook County versus the rest of Illinois, southern Florida versus the rest of the state, and eastern versus western Pennsylvania exhibit less diversity in their expectations for government services than California does. Moreover, population diversity provides us with no explanation for why the state continues to transfer revenues to local governments to provide these services. For this, we must turn to the history and structure of California's governance institutions.

C. Institutions: The Legislature

Several unusual institutional features of California apply to the legislature, making it especially prone to special interest influence, heavy discounting of future fiscal problems, and excessive partisanship and gridlock. In politics, size matters. California is the most populous state, but the California legislature, with 120 members, ranks 35th in size. Among other populous states, Florida has 160 state legislators, Illinois has 177, Texas has 181, New York has 212, and Pennsylvania has 253.[17] California state Senate districts contain over 900,000 people and state Assembly districts contain over 450,000. Legislative districts in other populous states are much smaller. The ratio of the population to the number of state legislators in the six largest states is approximately as follows:

California	300,000
Florida	115,000
Illinois	75,000
New York	90,000
Pennsylvania	50,000
Texas	135,000

A smaller legislature with larger districts implies more heterogeneous constituencies, a smaller proportion of voters who know their legislator, and hence less citizen satisfaction with their representatives. Moreover, larger districts make personal campaigning more difficult even for candidates who are widely known. As a result, campaign finance is a more important determinant of electoral success in larger districts, enhancing the influence of campaign contributors and, hence, organized interests such as large corporations, unions, and single-issue citizen groups. Many California public sector groups have thrived in this situation, including teachers, nurses, police officers, prison guards, and fire fighters. The money and endorsements of these groups are especially important to state legislators and local elected officials. In addition, the effect of shifting more of the burden of local government funding to the state has been to push more local interest group efforts out of the nonpartisan confines of local government into the partisan state-wide arena where the politics are both more bitter and more expensive.

17. All information about state legislatures is from the web site of the *National Conference of State Legislators*.

Another feature of the legislature that has affected the budget process is legislative term limits. In 1992, California was among the first three states to adopt term limits for legislators and its limits are among the most stringent in the nation. Although 15 states have legislative term limits, California's limits – 6 years in the Assembly and 8 years in the Senate – are tied with Arkansas and Michigan for the shortest. California also is one of only six states to impose a lifetime ban on term-limited legislators. None of the other five largest states has term limits; the largest states with term limits are Michigan and Ohio, and only Michigan imposes a lifetime ban.

California's term limits imply that at least 10 senators and 27 assembly members (about 30 percent of the state legislature) will not run for re-election in each election cycle. Because term limits cause legislators to be on the lookout for the next job as soon as they are elected, some run for another office or accept another position (including local government positions) before their terms expire, causing the turnover after each election sometimes to be even higher. Rapid turnover also creates an incentive to please local governments, which may provide the next job opportunity for a legislator. Term limits constrain the ability of a legislator to develop either expertise in a policy area or a record of accomplishment on which to base future campaigns, and also increases the importance of campaign financing and the dependence of legislators on interest groups.

California's relatively drastic term limits contribute to the budget problem by reducing accountability for the long-term effects of legislative actions. The state's cyclically sensitive revenues expand rapidly in booms, creating an opportunity for higher spending or lower taxation that is not sustainable when the boom comes to an end. Term limited legislators who vote for expansion of programs or tax cuts in a boom are mostly no longer in the legislature when the boom ends and a deficit looms. The ensuing political costs of spending cuts or tax increases are suffered by a different set of legislators than those who created the problem.

Two other features of California's system of legislative elections may have contributed to California's budget problems by making it harder to achieve bipartisan agreement: the semi-closed primary system and bipartisan redistricting by the legislature. Together these institutions all but eliminated marginal districts and weakened the moderating effect that competitive elections might have on hard line budget positions. Reform groups hope that the recent adoption of the top-two nomination system and a non-partisan redistricting process will increase the likelihood of bi-partisan compromises and reduce the frequency of partisan gridlock.

In a semi-closed primary system, each political party nominates a single candidate to run in the general election, and only members of that political party and unaffiliated voters are allowed to vote to select the party's candidate. Because registered partisans tend to be more ideologically extreme and unaffiliated voters tend to be less inclined to vote in a partisan primary, the primaries exerted a centrifugal force on candidate positions. In a top-two nomination system, all candidates appear on a single ballot, but only the two candidates with the most votes then run in the general election. The hope of advocates of top-two primaries is that voters in safe seats will get to choose between a moderate and a more ideologically pure candidate from the dominant party in the final round, and that unaffiliated voters plus voters from the other party will join forces with moderate voters of the dominant party to elect more centrist candidates. Whether this will happen in enough instances to significantly change the composition of the legislature and whether moderate Democrats and Republicans would nonetheless toe the party line on taxes and the budget are as yet unanswered questions.

Similarly, the reform community hopes that a politically balanced but impartially chosen citizen commission will be less likely to draw safe seats for incumbents. The so-called Prop 11 commission almost certainly will draw district lines to put more seats in the competitive range than the legislature did last time, and as one study has shown, that should result in at least 1/5th of the seats being potentially competitive.[18] But whether this effect translates into a large enough group of centrist legislators to force a compromise on fiscal matters is open to question, given that the Republicans first initiated and enforced party line discipline on their members in the late nineties when the elections were held under district lines that were drawn by the court.

The strongest case for the moderating effect of these reforms is that together they will create a centrist caucus that is sufficiently large to exert an influence on budget negotiations similar to the impact that blue dogs and centrist U.S. Senators had on the health care reforms at the national level. But the health care example also reminds us that the compromises that arise from empowering moderates can produce an outcome that causes dissatisfaction from the entire political spectrum.

Moderating the legislature through better electoral engineering, if that is the primary goal, would work best if California retained its two-thirds legislative vote requirement for passing a budget or changing a tax. By itself, empowering the minority does not necessarily lead to partisan gridlock on the budget if the parties both contain centrists willing to break from party orthodoxy. Gridlock arises from the conjunction of polarized, unyielding caucuses with the two-thirds budget and tax vote requirement. If the nomination and redistricting reforms work as they are intended and create a large enough bloc of centrist legislators, the leverage of the moderates would be likely to be greater with supermajority than simple majority budget and tax rules.

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18. Except for extremely non-compact and likely unconstitutional redistricting schemes, it appears that based on a line-drawing simulation exercise, 20% is the normal expectation for seats that are within a historically determined competitive range. See Bruce E. Cain, Iris Hui and Karin MacDonald, "Sorting or Self-Sorting: Competition and Redistricting in California," in *The New Political Geography of California*, edited by Frederick Douzet, Ken Miller and Thad Kousser, Berkeley Public Policy Press, 2008.

Consider, for example, how centrists in the U.S. Senate use the filibuster rule. If California voters impose a simple majority budget rule, the majority party will not have to win any votes from the minority party or even from its own moderates to obtain passage of the budget, possibly neutralizing the impact of the reforms of the nomination and redistricting systems. Super-majority rules are meant to induce moderation by requiring compromise with some number of the other party's caucus, and after the annual ritual of summer gridlock, this is typically what happens in California. The fact some reform groups have simultaneously pushed for reforms intended to enhance the electoral chances of moderates but also support the simple majority budget votes is a curious logical inconsistency, most likely for the sake of keeping together a bipartisan coalition. Californians have to make a decision: do they want cross-party compromises even when one party controls both the legislative and executive branches, or do they want simple majority rule with clearer electoral accountability?

Another moderating effect on budget negotiations is split control of government. The fact that the Governor's office and one or both houses of the legislature can be held by different parties can create a powerful incentive for budgetary compromise. Curiously, a consequence of the two-thirds majority budget vote requirement is that it undercuts the authority of the governor by reducing the power of the veto. Once the legislature has adopted a budget with a two-thirds vote, a veto by the governor is likely to be over-ridden. In a similar fashion, if the governor's party does not control the legislature, a veto override requires a two-thirds vote and so has a similar effect to imposing a two-thirds requirement for the original bill.

The important difference between an original two-thirds vote requirement and the prospect of a veto is that the governor may have different budget priorities than the members of the governor's party in the legislature. Because governors are elected from a state-wide constituency, they are more likely than legislators to be near the ideological center, and hence more likely than the legislative leadership of the governor's party to be able to reach a compromise with legislators of the opposite party. Thus, indirectly institutions that weaken the governor can increase the frequency of partisan gridlock

These various legislative problems contribute to California's fiscal problems, but do they account for the state's unique dysfunction (i.e. the misalignment state and local fiscal incentives)? The rise in partisanship, after all, is a national phenomenon. The severity of the state's term limits and the extent of its supermajority rules are less common but not unique. Together, however, they contribute to legislative failure (e.g. inability to sign budgets on time, tendency to ignore structural deficits until they lead to crisis, etc.), which in turn leads to initiative attempts to fix the problem, many of which only make the situation worse. Divided government and supermajority rules for legislative constitutional amendments mean that unless the two major parties agree on a fundamental change, it will die somewhere along the line to passage. As pointed out in our earlier book, *Constitutional Reform in California*, the fact that constitutional change requires only a majority of those voting on an initiative but 2/3 of the legislature locks in key features of the fiscal status quo unless and until a well-funded interest group sponsors an initiative that gives the statewide electorate the chance to change the system.

So why does the legislature consent to fund local government through state taxes? Local services are popular with voters of both parties, in part because decentralization of the budget allows local governments to adjust spending to local conditions. Moreover, endorsements by certain public sector employees (e.g. police and fire) are available to both parties and are electorally significant. Term limits, by causing legislators always to be looking for their next job, increases the responsiveness of legislators to requests from potential political rivals who hold positions in local government. But these features cannot be the cause of high transfers to local government and the loss of fiscal discipline that these transfers create because they are not unique to California. An additional source of the problem is the constraints imposed on both state and local governments by ballot measures that have reduced the flexibility of state-local fiscal arrangements and the accountability of legislative officials for the distortion in expenditures and revenue sources. In particular, the legislature cannot adopt a system of transferring revenue to local government that is based in part on local tax effort because doing so is unrealistic if local governments face institutional constraints that prevent them from adopting an appropriate system of local taxation. Thus, the existing system in which local governments are heavily subsidized by the state exists primarily because the neither the state nor local governments have sufficient authority to fix the problem.

D. Institutions: Fragmented Executive

A highly fragmented executive branch is another unique feature of California's governance institutions. An illustration of executive fragmentation is the governance of education, by far the largest state and local program area. Management of state education is divided among an independently elected Superintendent of Public Instruction, who heads the Department of Education; the Secretary of Education, who holds the education portfolio in the governor's cabinet; and the State Board of Education, the voting members of which are appointed by the governor. The Superintendent serves as the non-voting secretary of the Board. The Secretary of Education, while periodically invited to make a presentation to the Board, has no formal relationship with either the Department or the Board.

Similar fragmentation is present in financial management, which is diffused among an independently elected Treasurer, an independently elected Controller, an independently elected Board of Equalization, and the Director of Finance (appointed by the governor), who heads the Department of Finance. The Controller, the Chair of the Board of Equalization, and the Director of Finance also constitute the Franchise Tax Board.

. Fragmentation of the executive branch has the effect of reducing accountability for the performance of state government. Fragmentation can affect the budget because it interferes with the ability of the governor to manage all aspects of the budget and to make trade-offs among programs that are controlled by other executive officials. By weakening the authority of the governor, fragmentation enhances the authority of the legislature, which in turn increases the likelihood of partisan gridlock due to the tendency of governors to be more centrist than the legislative leaders of their party.

E. The Initiative Process

California has a relatively user-friendly and highly professionalized process for qualifying initiatives for the ballot that allows voters to adopt fiscal constitutional amendments through an initiative that requires only simply majority approval. Consequently, California has enshrined many fiscal policy decisions into its state constitution. In addition, even statutory initiatives cannot be amended by the legislature without voter approval. At the same time, various initiative measures constrain local sources of revenues and limit the legislature's ability to divert funds from local services for other purposes. Partisanship and supermajority rules for legislative constitutional amendments prevent the majority party from imposing its solution, leaving structural problems to fester. As documented in the companion article by Isabel Rodriguez-Tejedo and John Joseph Wallis, highly visible dysfunction of the legislature stokes more initiatives that impose further constraints, leading to a continuing downward cycle of legislative failure and initiative reaction.

Ballot measures created the rules and constraints that have contributed to the state's budget gridlock. Proposition 13 and other tax limitation measures not only cut or limited taxes and enacted higher vote thresholds for increasing taxation, but also created a highly pro-cyclical revenue system that is centralized in the state. The cumulative effect of initiatives over the last half-century has been to reduce local sources of revenue, to increase spending (a major recent example is the 2008 measure that authorized a $43 billion high-speed rail system), and to reduce the flexibility of elected officials in balancing the budget, thereby exacerbating the consequences of the 2/3 vote requirement. Consequently, many analysts identify the initiative as the root cause of the budget problem. Yet the initiative process that created the budget problem is popular with voters, and rarely have voters approved repeal of a previously adopted measure.

Three key features of the initiative are especially problematic.

First, the initiative creates ossification of the budget. The state constitution permits a simple majority of voters to impose a super-majority requirement on legislators to raise taxes or to cut expenditures. Consequently, a temporary electoral majority – perhaps responding to an unusual circumstance – can, in effect, impose a long-term solution to a short-term problem, binding the hands of future majorities to undo prior actions that prove to be counter-productive. A legislative amendment to undo a constitutional fiscal measure requires a supermajority vote and some measure of bipartisanship to qualify for the ballot. An initiative can also be overturned by a subsequent popular initiative, but the opacity of both the budget and the budget process combined with a generic mistrust of the legislature works against such a measure. Moreover, qualifying a new measure requires sufficient financial support from interest groups to make successful reversal of a prior initiative feasible.

Second, the initiative process encourages “feel good” measures that are fiscally irresponsible. The initiative process permits ballot measures that cut taxes without specifying which expenditures will be cut to accommodate the fall in revenues, or that increase expenditures without specifying how these expenditures will be financed. Whereas most voters like tax cuts, a minority of voters support spending cuts in each major program area. The willingness of voters to approve cuts and caps on taxes along with measures that increase expenditures has made balancing the state budget increasingly difficult.

Third, the initiative centralizes policy at the state level. The initiative process allows a statewide majority to impose rules on local communities about their fiscal process, undermining local choice and sovereignty. Allowing a statewide majority to impose rules on state fiscal processes makes sense, although whether that should be done by a simple majority vote is questionable. But allowing the state’s electorate to dictate rules for local communities limits the freedom of communities to meet the varying demands for local public services that are sure to be present in a diverse state. Needless to say, concentration of policy making at the state level also causes a misalignment of state revenue and local expenditures because statewide restrictions limit the ability and incentive to find local revenue even when the demand for local services is robust. Lobbying the legislature for state funds or exploiting state pension systems to reward local employees is politically easier than trying to get supermajority support for tax increases from voters. But there is more to the story than political convenience.

The initiative is available at all levels of government, but groups that sponsor initiatives have a powerful incentive to introduce measures at the state level. First, because local governments are subordinate to the state, a state law can constrain all local governments, even those whose citizens would not support that law at the local level. Fighting an initiative battle at the state level, therefore, is likely to be both less expensive and more likely to succeed than fighting the same battle separately in numerous local jurisdictions. Thus, even measures that are aimed at constraining local government, such as the property tax limit in Proposition 13, are likely to be proposed as state measures.

The effect of an easy initiative that encourages the use of state measures to constrain local policy decisions has been to impose greater limits on local taxation than on the state. At the same time, the principal effect of the initiative on expenditures has focused on state programs, leaving local governments more flexibility than the state in allocating budgets among program areas. In a polarized state political environment, decentralization of a great deal of expenditure authority is a means of creating partisan compromise. Whereas state legislators may vehemently dislike the policy preferences of members of the other party in the state legislature, each is likely to favor the policies that are adopted by local governments in their constituencies. That is, state legislators are unlikely to favor seriously undermining the financial condition of the local governments in their constituencies because doing so will make them less popular at home and more vulnerable to same-party challengers for their seats, the primary source of which is city councils and county commissions. Consequently, under a two-thirds vote rule for the budget in the state legislature, the majority party is likely to be forced to make more concessions on programs that are controlled by the state than on overall budget support for local governments.

The implication of this analysis is that the proximate cause of California's budget problem is legislative dysfunction (i.e. polarization, short term-limited time horizons, powerful interest groups that donate large sums of money, etc.) that arises from the incentives that have been created by governance institutions, as discussed above. The ultimate cause, however, is the initiative, which is the source of both perverse governance institutions and unworkable constraints on the state budget. The only way this problem can be solved is be rewriting the state constitution, either from scratch (a constitutional convention or a revision commission) or through a long series of initiatives that amend the constitution provision by provision.

The more likely reform is a sequence of further initiatives, as the prospects for a successful constitutional convention or revision commission are remote at best. The gridlock that the initiative process has helped to create also prevents the legislature from undertaking fundamental reform, as illustrated by the death in the state legislature of all of the proposals from the Constitution Revision Commission. Many initiatives have been proposed to deal with the budget problem or to reform California's governance in ways that would have important budgetary impacts, but they are often logically inconsistent and fail to address fundamental problems. The challenge is to forge a coherent fiscal system that addresses core problems like the misalignment of revenue and expenditures though a series of separate initiative measures. The next section reviews some of the current efforts at reform by initiative measures, and the last section offers some final thoughts about what needs to be addressed but has not been so far.

IV. Pending Reform Proposals

In recent years, some political leaders, citizens' organizations and interest groups have taken to the ballot attempting to reform California's political institutions in ways that could affect state and local budgets. Prominent examples are the unsuccessful measures that were sponsored by Governor Arnold Schwarzenegger in 2005 and 2008, the successful 2008 Prop 11 initiative creating a citizens' redistricting commission for redrawing the boundaries of state legislative districts in response to the 2010 Census, and the successful 2010 Prop 22 initiative instituting the top-two primary system.

Several initiatives that have qualified for the November 2010 ballot have potentially important budget implications.[19] They fall into three categories: proposals to fix the budget problem by focusing on revenue and expenditures (Props 19, 21 and 24), proposals that seek to reform the budget process (Props 22, 25 and 26), and proposals that might affect the budget negotiations by altering the political process (Prop 27). Emanating from different groups with varying agendas, they illustrate the problem of reform by separate initiatives and the allure of a more coherent, synthetic approach such as a constitutional convention or revision commission. While the intentions in most instances are sincere, the passage of some carries the risk of exacerbating rather than improving California's fiscal problem.

A. Measures that Focus on Revenues and Expenditures

Proposition 19: Legalize and tax marijuana, thereby potentially increasing state and local tax revenues while decreasing expenditures on incarcerating people for marijuana possession, use and sale. The sponsor of the initiative estimates that Californians spend $15 billion annually on illegal marijuana and estimates that state and local governments could increase tax revenues by "billions of dollars" if the measure were adopted, although the actual budget impact if the measure passes is highly uncertain.[20] The measure does not set a tax on marijuana, but it authorizes local governments to do so. The measure does not change existing

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19. Initiatives and referenda that have qualified for the ballot or that are in the process of qualification are listed on http://www.sos.ca.gov/elections/elections_1.htm.
20. If marijuana were subject to the state sales tax and the legalization of marijuana had no effect on the dollar magnitude of marijuana purchases, total state and local revenues would increase by a bit more than $1 billion. Most likely, legalization would lower the price and increase the quantity sold, with an unclear net effect on sales tax revenue. For legalization to create "billions of dollars" or new revenues, most likely state and local governments would have to tax marijuana at a higher rate than the states sales tax rate.

vote requirements for adopting a new tax, so that a state marijuana tax in excess of the state sales tax would require a two-thirds vote by the legislature, and a higher local tax would require local voter approval. The revenue effect of this measure also hinges on whether the federal government will tolerate an open market for a product that is illegal by federal law. Even if the federal government does not allow an open marijuana market, this measure may succeed in shifting the cost of enforcing the prohibition against marijuana production and use to the federal government. In this case, the costs of police, the legal system, and prisons will be lower, although the effect is likely to be small.

Proposition 21: Increase the vehicle license fee by $18, generating approximately $500 million in revenue to be used exclusively for state parks and programs to protect wildlife and natural resources. Unlike most ballot propositions that mandate increased spending, this measure would generate revenue to pay for the proposed expenditure and so would not make the budget problem more severe. Nevertheless, this measure would slightly reduce the flexibility of the state legislature by earmarking the increase in the vehicle license fee. State spending on parks and recreation is below the national average as a share of gdp, and this measure would eliminate the gap; however, because local governments spend much more than the national average in this category, the measure would cause California's overall share of spending on parks and recreations to rise to 16.5 percent.

Proposition 24: Change the methods of calculating corporate tax liability in a manner that would increase corporate tax liability by approximately $1.7 billion. In 2008, California collected $11.8 billion from the corporate income tax, so this measure represents an increase of about 15 percent. The projected revenue increase is too small to have much of an effect on the perennial state budget crisis. Because corporations can avoid this tax increase by relocating corporate headquarters out of the state, the revenue from the measure could be substantially less than the estimate. The measure could even cause a decline in total revenue if some large companies relocated. In general, this measure continues the trend in California of shifting the tax burden to the state.

B. Measures to Change the Budget Process

Proposition 22: Prohibit the state from transferring revenues from local governments that support certain local services, community redevelopment projects, and transportation programs. This measure would cause local revenues to be higher (and net state revenues after local transfers to be lower) by several billion dollars in periods of unusually low tax revenue, such as the present. This measure exacerbates the principal source of the state's budget problem, which is unusually high spending by local government combined with unusually high transfers of revenues from the state. Proposition 1A, passed in 2004, allowed the state to borrow revenues from funds that were earmarked for specific uses, but only temporarily. In addition, in some cases the state legislature, by a two-thirds vote, can cut expenditures that are mandated by ballot measures. This initiative eliminates these possibilities, thereby causing state programs to bear a greater portion of the burden of a reduction in state government revenue during a recession. By reducing the flexibility of the state's response to lower revenues, this measure would lead to more severe budget crises during economic downturns, and would increase the likelihood that the legislature would be forced to increase state taxes and fees to produce a budget. The measure also would further attenuate the relationship between local government expenditures and taxation, thereby reducing the accountability of government officials for the budget problem. In short, this measure will make the state's recurring budget problem worse.

Proposition 25: Eliminate the two-thirds vote requirement in the state legislature for passing the annual budget, but retain the two-third requirement for changes in taxes. This measure would enable the majority party in the legislature to pass a budget, but would not necessarily solve the problem of delayed budgets if the governor was a member of another party and vetoed the budget. Moreover, because the two-thirds vote is retained for taxes, the likely response of the state will be to increase the share of revenue that is accounted for by fees and charges. Examples are higher tuition at state universities and greater reliance on tolls to finance highways. Because the measure allows the budget but not tax increases to be passed by a majority vote, it could exacerbate the tendency to expand programs beyond the capacity of the state to finance them, especially during the boom phase of the business cycle.

Proposition 26: Impose a two-thirds vote requirement for the legislature to change fees imposed by the state other than taxes, and require voter approval of changes in fees by local governments. This measure would increase the difficulty of using increases in state fees and charges to balance the budget. If Proposition 25 passes, ending the two-thirds vote requirement to pass a budget bill, this measure would prevent the shift in revenue enhancements from taxes to fees and increase the likelihood that a projected deficit will be closed by cutting expenditures. In addition, by imposing a referendum requirement on local governments to increase fees, this measure would increase the dependence of local governments on state transfers, thereby further attenuating the relationship between revenues and expenditures by local governments.

C. Measures that Affect the Budget by Changing the Political Process

Proposition 27: Repeals the 2008 initiative that created the citizens' commission to draw the boundaries of state legislative districts. Because the new Citizens Redistricting Commission will redraw districts only after data from the 2010 census are available, no elections have occurred under the new system, so no evidence exists about whether the method of drawing districts matters. A non-partisan method for drawing district boundaries may reduce partisan gridlock by creating more districts that are not securely held by one party, which would have a beneficial effect on the ability of the legislature to pass a timely budget. Experience with redistricting commissions in others states, including Arizona (the closest analog to the California Commission), indicates that the method of defining legislative districts does not have much of an effect. The balanced partisan composition of commissions and their tendency to try to draw districts on the basis of communities of interest both favor homogenous, hence safe, districts.

D. Measures beyond 2010

Looking past the November 2010 election, we see more of the same. Two initiatives have qualified for the February 2012 ballot. One measure, which falls in the "fix the politics" category, would change California's term limits for state legislatures from eight years in the senate and six years in the assembly to a total of 12 years in one or both. This measure would increase the average length of a legislative career because fewer than half of assembly members become state senators after serving six years in the assembly. Thus, the measure would reduce the proportion of inexperienced legislators and increase the long-term accountability of legislators for current actions. Most likely, this measure would lead to a small improvement in the functioning of the legislature, but the effect on the budget problem would be small in the absence of other measures that would reduce polarization of the parties and the inflexibility in the current system of state and local public finance.

The second qualified measure, an example of the revenue/expenditure category, would impose a higher tax on cigarettes and designate that the revenue be used for cancer research. This measure has the admirable feature of identifying a source of revenue to finance the proposed increase in expenditures. The increase in the cigarette tax will cause a small reduction in cigarette consumption, which will reduce existing state revenue from the cigarette tax, thereby slightly worsening the state's budget problem. In the long run, this measure could reduce state expenditures on medical care for cancer patients, although this effect is likely to be small and will not be apparent for many years. Like other expenditure measures, this proposition sets in concrete a decision to increase substantially state support for cancer research. Given that the research that will emanate from this program will be a tiny fraction of total expenditures on cancer research by the federal government and various private foundations, the notion that in the current budget situation the best use of a new tax is to increase cancer research is certainly far from obvious. Thus, this proposition is an excellent illustration of the dubious rationality of deciding the budget one issue at a time through ballot measures.

Beyond measures that have qualified, numerous other initiatives that would directly or indirectly affect the state budget are in the process of gathering signatures. These measures fall into same general categories of past measures, either adding still more unmanageable constraints to the state budget or to tinkering with governance in ways that by themselves are unlikely to have much effect on California's perpetual budget crises. What nearly all of these measures fail to do is address the deeper structural problems in comprehensive way.

The exception to this generalization is a proposal to call a state constitutional convention that would be limited to reforming the budget process and the election system. A constitutional convention could adopt a coherent system of constitutional reforms, which would be placed on the ballot for approval by the voters. The supporters of this measure, a coalition of "good government" citizens' groups, originally sought to place this proposal on the November 2010 ballot, but failed to qualify the measure. Whether they will continue to try, and if so, whether they will succeed in qualifying the measure, remain open questions. Nevertheless, a state constitutional convention is a fascinating proposal. The advantage is that it could address all of the political institutions and past budget-related initiatives that have caused inflexibility and lack of accountability in California governance. The disadvantage is that asking a small group of citizens not only to figure out a solution to California's budget problem but to advocate it successfully to the voters, given the well-financed special interest opposition that comprehensive reform would generate, is indeed a tall order.

V. Conclusion: Addressing Deeper Problems

Discussing the fiscal situation in California without partisan considerations taking over is a difficult task. Those who favor smaller government want more restrictions on taxes and expenditures, while those who favor more expansive government favor new programmatic initiatives. Whatever one's ideology and partisan affiliation, there should be agreement that the incentives of both citizens and their elected leaders should be aligned to foster responsible and accountable fiscal decision making. This is not the case in California for three reasons.

First, the effect of various initiative measures has been to restrict the capacity of local governments to raise revenue from local sources and to make the state responsible for paying for many local services. The 1996 Constitution Revision Commission (CRC) recognized the need for rationalizing the responsibilities of state and local governments, given that local governments were sometimes using local revenues to provide state-mandated services and that the state was paying for local services. The CRC proposed Home Rule Community Charters to sort out issues of state versus local responsibilities and powers, but this proposal died with the Commission's demise. Subsequent initiative measures, such as Proposition 1A in 2004 and Proposition 22 in 2010, have sought to protect local government spending in periods of lower revenue and to preserve and even expand the current system of high state transfers.

In assessing the causes and cures of California's budget problem, the mismatch between revenues and expenditures cannot be ignored. While this mismatch does not account for all of California's fiscal problems, it does account for the uniquely dysfunctional element of the state's current situation. Even if Community Charters are not the best answer, the realignment of state and local responsibilities and taxation power needs to go forward. Communities should have the right to decide what level of local services they want to provide, but should bear primary responsibility for paying for the excess of spending over a state-determined and state-financed minimum. In a diverse state, a closer connection between revenues and expenditures in each unit of government gives citizens choices about trade-offs between taxes and services.

Second, the initiative process should be reformed. Ballot box budgeting and institutional engineering is the source of much of the state's current dysfunction. Unless California's popular initiative process is reformed, the state will continue to see more fiscal constraints and misaligned expenditure and tax decisions. Unfortunately, despite three decades of discussion about initiative reform, and widespread agreement among many experts and close observers of California politics that the direct democracy system needs repair, there has been absolutely no progress on this front. California voters like the idea that they govern themselves and make fiscal decisions even though the evidence is overwhelming that the cumulative effect of these decisions has been to cause the performance of state and local government to deteriorate. Meanwhile the initiative industry has become ever more professionalized and is heavily utilized by political candidates and interest groups who want to take their legislative battle to a different arena. Only one circulating measure deals with the initiative process, and it would seek to make initiatives more difficult to qualify for the ballot. More importantly, California should reconsider whether fiscal policy should be decided by initiatives at all, and if so, whether by constitutional amendments and statutory measures that cannot be amended by the legislature. Additional reforms that should be considered seriously are to sunset all initiatives after ten years, requiring reauthorization by the voters if they are to remain in force, and "pay as you go" requirements whereby proposals to cut taxes or to increase expenditures would be required to specify how they would be accommodated on the other side of the budget.

Third, proponents of political reforms need to ask themselves what they are trying to achieve and then to use objective analysis to match their reform proposals to their goals. If the purpose of reform is simply to make sure that budgets are timely, reducing the vote requirement for the budget but not for taxes may increase the frequency with which the budget is passed on time, but that is not the same as solving the budget problem. If the goal is to eliminate the structural deficit by encouraging pay-go thinking and partisan compromise, this proposal is counter-productive because a system in which it is easier to pass the budget than to increase taxes will facilitate responding to the short term incentive to increase the structural deficit.

If the larger political goal is to empower the ideological center in order to encourage partisan compromise, electoral and governmental reforms should be on the same page. Adopting a simple majority rule will reduce the frequency of prolonged budget battles; however, an effort to encourage more moderate elected officials through a new system for electing legislators can be neutralized by reducing the vote required for budget approval. If voters do not like what they get, they can vote the majority party out of office. On the other hand, if the goal is to avoid reversals of policy and to induce moderation, then supermajority votes plus the right electoral institutions are a more plausible solution. In short, the goals of electoral and legislative reform cannot be divorced, and can be achieved only through one coherent package of proposals.

To date, the debate about how to change the system of electing state legislators has been unimaginative, largely accepting some of the main causes of dysfunction in the legislature. For example, two proposals that are worthy of serious consideration are vastly to increase the number of legislators and to move to a unicameral legislature (reducing the size of constituencies for any given total number of legislators). Another proposal worth serious evaluation is to create a legislature in which some members are elected through proportional representation (party votes within either the entire state or regions within the state). Proportional representation increases party unity, but allows small parties to obtain representation and is more likely to lead to centrist control of the legislature. Still another reform that deserves consideration is to strengthen the authority and accountability of the governor by eliminating most state-wide elective executive offices and converting them to cabinet appointments.

The unfortunate conclusion from this litany of reforms that are either actively under consideration or not being considered at all is that relief from the annual budget crisis is not likely to arrive any time soon. If the cause, as argued here, is the death of a thousand cuts from a series of initiatives that have created a budgetary process that lacks accountability, the only solution is wholesale reform of California's governance structure. Such wholesale reform requires either many separate initiatives or a constitutional revision. In either case, there are no obvious candidates to provide the energy and money to fix the problem.

TABLE 1: TOTAL STATE AND LOCAL REVENUES AND EXPENDITURES 2008 – CALIFORNIA VS. U.S.
(Figures in $ Billions)

Category	U.S. Total	California Total	California % U.S.[a]
Gross Domestic Product	14,166	1,847	13.0
Total S&L Net Revenue[b]	2,660	354	13.3
S&L Tax Revenue	1,331	176	13.2
Federal Transfers	481	58	12.0
Fees and Charges[c]	198	42	21.2
Social Insurance and Pensions	88	-1	na
Total S&L Expenditures[d]	2,839	415	14.6
Salaries and Wages	801	115	14.4
Administration	127	22	18.2
Capital Outlays	349	47	13.4
Interest	100	14	13.6
Education	826	104	12.6
Elementary & Secondary	566	71	12.5
College & University	223	30	13.2
Highways	154	16	10.2
Sewage and Solid Waste	90	10	11.0
Welfare	405	51	12.6
Health Care	209	32	15.3
Police and Fire	129	22	17.1
Corrections	73	14	18.8
Parks & Recreation	41	6	15.3
Housing & Development	51	10	20.2
Social Insurance and Pensions	235	41	17.4
S&L Owned Utilities	193	36	18.6

Notes:
[a.] Because the first two columns are rounded and the third column is derived from unrounded numbers, the percentages in the last column differ from the ratio of the first two columns.
[b.] All revenues including net intergovernmental transfers.
[c.] The most important are college tuition, public hospital charges, highway tolls, charges for use of airports and ports, charges for sewage and solid waste disposal, public housing rent, and charges to customers of government-owned utilities.
[d.] Includes both capital and operating expenditures.

Sources: Bureau of the Census, "State and Local Government Finance by Level of Government and by State," and Bureau of Economic Analysis, "Regional Economic Accounts," both of which are released annually on the web site of the U.S. Department of Commerce.

TABLE 2: TOTAL STATE AND LOCAL REVENUES AND EXPENDITURES 2005 – CALIFORNIA VS. U.S. (Figures in $ Billions)[a]

Category	U.S. Total	California	
		Total	% U.S.
Gross Domestic Product	12,339	1,629	13.2
Total S&L Net Revenue	2,529	381	15.1
S&L Tax Revenue	1,099	147	13.4
Federal Transfers	439	55	12.5
Fees and Charges	513	111	21.6
Social Insurance and Pensions	383	88	23.0
Total S&L Expenditures	2,364	339	14.3
Salaries and Wages	695	97	13.9
Capital Outlays	278	38	13.6
Interest	92	12	13.4
S&L Owned Utilities	156	31	19.7
Social Insurance and Pensions	196	33	17.0
Administration	106	18	16.7

Note:
[a.] Notes and Sources for Table 1 also apply to Table 2.

TABLE 3: REVENUES AND EXPEDNMITURES FOR LARGEST STATES, 2008

	Calif.	Florida	Illinois	New York	Penn.	Texas
State GDP ($billion)	1,847	744	634	1,144	553	1,224
Budget Items % GDP						
Total Revenues	19.2	19.9	16.4	21.3	19.9	16.1
State	10.9	9.2	9.2	12.8	12.9	9.7
Local	13.3	13.6	9.9	13.2	10.6	8.8
In-state Transfers[a]	5.0	3.0	2.6	4.8	3.6	2.5
Federal Transfers	3.1	3.1	2.7	3.9	3.5	2.7
Tax Revenues	10.1	9.9	9.1	12.1	9.8	7.1
State	6.3	4.8	5.0	5.7	5.8	3.7
Local	3.7	5.0	4.1	6.4	4.0	3.4
Property Tax	2.9	4.1	3.4	3.4	2.8	2.7
Sales Taxes	2.9	4.6	3.0	3.0	2.9	3.3
Pers. Income Tax	3.1	0.0	1.6	4.1	2.6	0.0
Corp. Income Tax	0.6	0.3	0.5	1.0	0.4	0.0
Fees & Utilities	4.7	1.8	1.3	1.5	4.6	1.1
Soc. Ins. & Pensions	0.0	0.4	0.8	0.2	1.7	1.8
Total S&L Expenditures	22.5	21.2	18.3	23.0	20.2	15.4
State[b]	8.5	7.7	7.7	9.2	9.7	6.0
Local[b]	13.9	13.6	10.6	13.8	10.5	9.4
Salaries and Wages	6.2	5.6	5.5	6.5	5.0	4.8
Capital Outlays	2.5	3.4	2.1	2.8	2.2	2.7
Interest on Debt	0.7	0.7	0.9	0.9	0.9	0.7
E&S Education	3.8	4.1	3.6	4.5	4.3	3.7
Higher Education	1.6	1.1	1.3	1.0	1.4	1.5
Police, Fire, Corrections	1.9	2.0	1.3	1.5	1.2	1.1
Welfare & Health	4.5	4.3	3.4	5.4	4.8	3.0
Highways	0.9	1.4	1.1	0.8	1.4	1.2
Sewage & Sol. Waste	0.5	0.7	0.3	0.6	0.5	0.3
Utilities	1.9	1.5	1.1	2.2	0.8	1.2
Administration	1.2	1.1	0.7	1.0	1.0	0.5
Soc. Ins. & Pensions	2.2	1.2	2.0	2.2	2.0	0.9

Notes:
[a.] Gross transfers between state and local governments within state.
[b.] Not including transfers between state and local governments.

Source: Same as Table 1.

TABLE 4: DISTRIBUTION OF REVENUES AND EXPENDITURES BETWEEN STATE AND LOCAL GOVERNMENTS, 2008[a]
(Figures in $ Billions)

	U.S.		California			
	State	Local	State		Local	
			Total	% U.S.	Total	% U.S.
Total Revenues	1,619	1,531	201	12.4	246	16.1
Federal Transfers	423	58	49	11.6	8	14.3
Taxes	782	549	117	15.0	69	12.5
Fees	15	43	1	9.6	13	30.4
Utility Charges	17	123	5	32.7	21	17.3
Soc. Ins. & Pensions	83	6	1	1.7	-2	na
Total Expenditures	1,734	1,593	247	14.2	259	16.3
Salaries and Wages	230	571	28	12.1	87	15.2
Administration	52	75	9	16.9	14	18.3
Interest on Debt	45	55	6	12.6	8	14.3
Intrastate Transfers[b]	477	16	94	19.6	1	3.8
Direct Expenditures	1,257	1,577	153	12.2	259	16.4
Education	232	594	23	10.1	81	13.6
Elem. & Sec.	8	557	X	5.1	70	12.6
Higher	187	37	19	10.3	10	27.9
Welfare	354	51	35	9.9	16	31.4
Health Care	92	117	10	11.2	22	18.5
Highways	91	63	8	9.1	7	11.8
Police & Fire	12	117	2	13.5	20	17.4
Corrections	47	26	8	17.9	5	20.5
Parks & Rec.	6	35	X	7.6	6	16.5
Hous. & Dev.	11	40	X	2.5	10	24.9
Sew. & Sol. Waste	4	67	1	38.3	8	12.7
Utilities	26	167	5	20.0	31	18.4
Soc. Ins. & Pensions	201	34	33	16.3	8	23.9

Notes:
[a] Notes and sources in Table 1 apply to Table 3.
[b] From state to local and from local to state.
X indicates less than $500 million.