USC UNIVERSITY OF SOUTHERN CALIFORNIA

Prop 76: summary points

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Background

Proposition 76, the *State Spending and School Funding Limits. Initiative Constitutional Amendment*, is a response to the state's most recent fiscal crisis that emerged in the 2001-2002 fiscal year. By 2003, the state's projected budget deficit reached $38 billion according to the state's Department of Finance, about one-third of annual state spending, and its debt rating plunged to near-junk bond status.

The root cause of the fiscal crisis, in the view of most observers, was the explosive growth of spending in the late 1990s, coupled with the failure of the governor and legislature to respond aggressively to the deteriorating fiscal situation beginning in 2001-2002. The broad intention of Proposition 76 is to prevent the state from spending more money than it collects in revenue, hence the label by its proponents, the "Live Within Our Means Act."

The provisions of Proposition 76 impact the budgetary process and the budgets implemented by the State of California in profound ways, including the alteration of initiatives passed by California voters in previous elections.

Proposition 76 Key Provisions

The issues that Proposition 76 is designed to address are complex, and the provisions of the initiative are correspondingly complex. Proposition 76 makes a number of changes to the California Constitution, among others, the following:

Balanced Budget

- The California Constitution currently requires the budget adopted by the legislature and governor to balance but does not require imbalances that occur during the fiscal year to be corrected; Proposition 76 requires imbalances in excess of 1.5 percent of the budget during the fiscal year to be corrected.
- If the legislature and governor cannot agree how to address an emerging deficit, the governor is required and empowered to make cuts to any program to solve the problem. The legislature presumably retains the option to adopt a new budget if it dislikes the governor's cuts.
- If the annual budget is not adopted on time, the previous year's appropriations are automatically adopted until a new budget is approved.

Spending Growth

- Proposition 76 limits the growth of state spending in any year to the average growth of state revenue over the previous three years.
- Reduces over time the growth in the minimum spending requirements for education that are part of the state constitution as a result of Proposition 98, approved by voters in 1988.

Education Spending

- Proposition 98, passed by the voters in 1988 and amended by Proposition 111 several years later, establishes a minimum-funding guarantee for K-12 schools and Community Colleges. Roughly speaking, spending for education must be at least as much as the previous year adjusted upwards for income growth and enrollment. If the state declares an emergency and under funds education, it must "repay" the money when the emergency ends.
- Proposition 76 requires that the current repayment obligation be met over fifteen years and removes that repayment from the future Proposition 98 guarantee. The long term consequences of this are to reduce the growth of the minimum guarantee over time – the magnitude of this effect will depend on the magnitude of future Cost of Living Adjustments to the guarantee.
- Proposition 76 also changes the Proposition 98 guarantee such that if the state does appropriate extra money for education in any year, those additional funds do not increase future Proposition 98 guarantees.

POTENTIAL CALIFORNIA IMPACTS

Research and previous budget experiences help to guide insights into the possible economic, social, and legal impacts of Proposition 76.

Balanced Budgets

- Research on deficit policies for 47 states over a 20-year period shows that a requirement to balance the approved budget does not generally eliminate deficits, but a ban on deficit carry-overs as in Proposition 76 does prevent deficits.
- Research also suggests that states with strong anti-deficit rules respond more aggressively to revenue shortfalls than states without them.
- Empirical research on antideficit provisions strongly suggests that Proposition 76 will prevent the emergence of large deficits like those of the last few years.

Spending Growth

- Simulations using fiscal data for the last 25 years suggest that spending would have been about $12 billion (about 10 percent) lower in the current fiscal year (2005-06) if the cap had been in place since 1980 and taxes were not increased.
- Assuming no tax increases, the spending cap would have been binding in 23 of the last 25 years.
- The spending cap will probably slow the growth of spending; spending growth would have been slower throughout the 1990s. The cap would have grown significantly over time, although more slowly than actual spending grew.
- The anti-deficit provision of Proposition 76 would have had less of an impact for controlling spending over the previous 25 years while the spending cap would have done most of the work.
- The spending cap would apply to funds provided to counties to support a variety of health, human service, and mental health programs and could force the counties to make up cuts in state funds to continue the level of spending on these services.

Education Spending

- Proposition 76 provides additional flexibility over education spending than currently exists under current law; the state would have the ability to either spend above or below the Proposition 98 guarantees as they currently exist.
- Any increased level of spending beyond the minimum-funding guarantee would not become a part of the new minimum guarantee.
- Nothing in Proposition 76 compels a reduction in education spending, but under the most likely political scenarios, it will result in a lower growth of education spending over time.

Other Issues

- The measure is ambiguous as to whether the legislature has the authority to over-ride gubernatorial vetoes of spending following a declared fiscal emergency and inability of the legislature and governor to reach a new budget agreement.
- Allows the governor to reduce appropriations during a fiscal year, but does not end legal entitlements meaning that funding for entitlements could run out before the end of a fiscal year.
- The measure would make it possible for one-third of the legislature to keep state appropriations from growing from one year to the next.

CONCLUSION

Based on the research and the experiences of other states with anti-deficit provisions, Proposition 76 would likely prevent the emergence of substantial deficits in the future. This would likely come about more as a result of its spending-cap provisions and not because of its anti-deficit provisions. Simulations suggest that spending would have been about $12 billion (about 10 percent) lower in the current fiscal year (2005-06) if the cap had been in place since 1980, *ceteris paribus*, and taxes were not increased.

Proposition 76 would provide the governor additional control of the budgetary process if the legislative and executive branches of government cannot work out a viable solution in times of a fiscal emergency.

The initiative's likely impact on any particular spending program is unclear. For education, the measure provides additional flexibility over spending by removing existing constraints to either increase or decrease spending. Nothing in the measure compels a cut in education spending, however, under the most likely political scenarios education spending is likely to be lower in fiscally lean times and grow more slowly during fiscally robust times if the measure passes.

For a more complete discussion of the specific issues and research presented in this brief, please refer to the full report titled, "Proposition 76 Analysis" found at www.usc-cpi.org.

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