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Proposition 76: State Spending and School Funding Limits

On Nov. 8, 2005, California voters will decide whether to pass Proposition 76, known as the "Live Within Our Means Act." Sponsored by Gov. Arnold Schwarzenegger, the measure seeks to address state budget problems that have been particularly severe in California since 2002 due to cuts in state taxes and increases in state expenditures.

Proposition 76 would create a new limit on how much the state government can spend each year, and it would grant the governor power to adjust state expenditures during the course of the budget year. It would also make significant changes in how the state's minimum funding guarantee for education works.

Based on a voter-approved 1988 initiative called Proposition 98, the California Constitution mandates a specific formula for the annual funding of K–14 education (schools serving kindergarten through 12th grade and community colleges). The exact amount is determined based on a set of calculations that take into account the growth in personal income, state revenues, and the number of students in public schools. The goal of Proposition 98 was to create a minimum funding guarantee for schools that would *at least* keep pace with increases in student population and the personal incomes of Californians and *at best* further improve the level of resources schools receive. It was amended in 1990 through Proposition 111 to allow for a "fair share" reduction when the state faced difficult budget years.

This brief explains the basic provisions of Proposition 76 and how it would change existing law in California, including its impact on education's minimum funding guarantee.

The measure would limit the growth of state expenditures

Currently, the California State Legislature is responsible for passing a state budget by June 15 each year. Passage requires a two-thirds vote. The governor proposes a budget in January for the upcoming fiscal year. The Legislature uses that as a starting point but is free to amend it significantly. After the Legislature passes a budget, the governor then has final authority to approve it and can reduce spending on specific programs.

Policymakers' flexibility to allocate budget dollars is limited in a number of ways. Proposition 98's minimum funding guarantee for K–14 education is just one of them. In addition, the Legislature cannot reduce funds for local governments or transportation. Some revenues, such as excise taxes on gasoline and cigarettes, are placed in special funds that must be spent for specific purposes.

The California Constitution also sets several limits on the state government's ability to increase General Fund expenditures. One of those limits, popularly called the Gann Limit, was passed by voters in 1979 and later amended. But the Gann Limit is $11 billion higher than the 2005–06 state budget and thus has no real impact on current state spending. The Legislature must also pass a balanced budget each year due to the passage of Proposition 58 in 2004. That measure also created the Budget Stabilization Account (BSA), a state reserve fund meant to help buffer state revenues in years when the economy is less robust.

Proposition 76 would further limit the annual growth in state expenditures, preventing the state from making ongoing spending commitments in a single year when revenues are particularly high. Beginning in 2006–07, the state's spending limit would be based on the prior year's expenditures, adjusted by the average growth in revenues over the three previous years. In years of strong economic growth, this average would likely be lower than the current-year growth, thereby constraining spending below what might otherwise occur. Proposition 76 would also create a revenue surplus that state officials would have to use to pay back current state debts and to contribute to two funds: the state reserve fund (BSA) and the Schools, Roads and Highways Construction Fund. In bad revenue years, the BSA would theoretically provide the funds necessary to maintain state programs.

The governor would assume greater power over the budget

Under the proposed measure, the governor would also have new budgetary powers beyond those recently granted by Proposition 58. Passed last year, Proposition 58 enables the governor to declare a fiscal emergency and call the Legislature into special session if expenditures exceed revenues at any point after the budget is signed. If the Legislature does not then act to address the imbalance within 45 days, it is prohibited from adjourning or acting on other bills until it does so.

Proposition 76 expands the conditions under which the governor could declare a fiscal emergency. Such a declaration would be allowed if, at the end of any fiscal quarter, the Department of Finance estimates that General Fund revenues will fall by at least 1.5% or that the balance in the BSA reserve will decline by more than one-half. The governor could then declare an emergency irrespective of the actual balance between expenditures and revenues.

Once the governor declared an emergency, he or she would call the Legislature into special session. Legislators would then have 45 days to address the shortfall between the current condition and the adopted budget, an action that would require a

two-thirds vote of both houses. The governor could veto all or part of any action the Legislature took.

If the Legislature failed to act within 45 days, the governor would have the power to reduce items in the budget—including K–14 education funding—to eliminate the shortfall. The Legislature would retain its right to pass legislation or override the governor's veto through a two-thirds vote. If any of these actions included a cut to education, it would permanently lower the Proposition 98 minimum guarantee.

The governor could make cuts regardless of any other state laws *except* he could not reduce spending required by federal law, impose reductions that would violate state contracts, or cut payments for debt service.

This measure substantially increases the governor's power to call a fiscal emergency and to act unilaterally to cut state programs in response to that emergency. But this general type of gubernatorial power is not without precedent. Governors in many other states have some level of mid-year budget-cutting authority, and so did California's governor until 1983 when state law was changed as part of budget negotiations.

In addition, under Proposition 76, if a state budget were not enacted prior to the beginning of a new fiscal year, the spending levels in place in the previous year would simply continue. Under current law, only some specified expenditures can continue absent a new budget. In California, the delay of budget passage beyond the beginning of the new fiscal year has been a common and often disruptive occurrence.

Under this proposition, the funding guarantee for education would be fundamentally changed

Proposition 76 also fundamentally changes the minimum funding guarantee for education that now exists under Proposition 98, as amended by Proposition 111.

Essentially, Proposition 98 works to ensure that K–12 schools and community colleges receive funding which—at a minimum—grows along with increases in students and growth in Californians' personal income. This is commonly referred to as "Test 2" or the minimum guarantee. State leaders can provide funding for schools above the guarantee. When they choose to do so, they are also increasing the base from which the next year's funding will be calculated.

The California Constitution allows state officials to temporarily reduce education funding below the minimum guarantee under two conditions. One occurs when the state's General Fund revenues grow less than personal income. This is referred to as "Test 3." The other occurs when two-thirds of the Legislature votes to suspend the guarantee for a given year. In both cases, the funds saved must be restored to schools in the next year that state general fund revenues grow faster than personal income.

Over the past three years, the state has used these mechanisms to accrue a debt to K–14 education of $3.8 billion. Of this amount, $1.8 billion was borrowed using Test 3 and $2 billion was the result of suspending Proposition 98.

Proposition 76 terminates the Test 3 option for reducing education funds and also eliminates the requirement that any reduction in the minimum guarantee must be restored. It addresses the existing $3.8 billion debt by obligating the state to pay it off completely within 15 years. However, the payments would not be applied to the Proposition 98 base. That would effectively reduce the ongoing guarantee by $3.8 billion, the equivalent of $15,000 per classroom in California.

Going forward, if the Legislature wanted to fund education below the Test 2 amount, it would have to vote to suspend Proposition 98. Under his new budgetary powers, the governor would also be able to reduce education and other program funding if he declared a fiscal emergency. In either situation, those reductions would never have to be restored or repaid, and the minimum guarantee would be permanently reduced.

Conversely, if the Legislature chose to provide funds to education above the minimum, it would not increase the base funding as it does today. Instead, under Proposition 76, any extra money would be counted as one-time funds. Thus state leaders could never increase the ongoing minimum guarantee above what Test 2 provided in a given year, but they could take actions to decrease it as noted above.

How can I find out more?

This proposal is being contested by the major education organizations in the state as well as by several public employee unions. The main opposition campaign is under the umbrella of the Alliance for a Better California at **www.betterCA.com/Prop76**. The California Budget Project has also published a detailed analysis that is critical of the measure at: **www.cbp.org**

As sponsor of Proposition 76, Schwarzenegger and his supporters present arguments in favor at **www.joinarnold.com**. Other supporters of Proposition 76 include the California Business Round Table, the California Chamber of Commerce, and California Business for Education Excellence.

The official, impartial analysis of the measure is available from the Legislative Analyst's Office at **www.lao.ca.gov**. In addition, the Institute of Governmental Studies at UC-Berkeley has published an analysis at:
www.igs.berkeley.edu/library/htSpendingLimits.html

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