Unsustainable California:
The Top 10 Issues Facing the Golden State

California Common Sense

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I. Introduction ................................................................................................................. 4
II. Water Supply ............................................................................................................... 6
   a. Water Supply and California’s Economy .............................................................. 7
   b. California Surface Water Storage ..................................................................... 7
   c. Unregulated Groundwater ................................................................................ 8
   d. Environmental Measures Affecting Water Supply ............................................. 8
   e. Water-Use Efficiency and Conservation .......................................................... 9
   f. Funding Challenges ............................................................................................. 10
III. Revenue Uncertainty ............................................................................................... 12
    a. Staking Everything on Personal Income ........................................................... 12
    b. Relying on Wall Street ...................................................................................... 14
    c. Measuring Volatility ......................................................................................... 14
    d. Adjusting to Unpredictability ........................................................................... 15
    e. Restructuring: Reducing Reliance on Income Taxes ....................................... 16
IV. Wall of Debt ............................................................................................................. 17
    a. Reassessing the Wall of Debt ........................................................................... 17
    b. The Impact of a Growing Wall ......................................................................... 18
    c. Accrual-Basis vs. Cash-Basis Budgeting ........................................................... 19
V. Public Retirement Benefits ...................................................................................... 21
    a. High-Risk, Benefit Hikes, and Underfunding ................................................... 22
    b. How to Manage Costs Going Forward .............................................................. 25
VI. Health Care .............................................................................................................. 27
    a. Rising Health Costs .......................................................................................... 27
    b. Diminishing Access to Care ............................................................................. 31
    c. Health Reform ................................................................................................... 32
VII. K-12 Education ...................................................................................................... 34
    a. California’s Low and Unstable K-12 Funding Levels ........................................ 34
b. Limited Personnel ........................................................................................................37

c. Poor Student Performance .........................................................................................37

d. Re-allocating Resources: The Local Control Funding Formula ..............................39

VIII. High-Speed Rail ......................................................................................................40

a. Unsecured Funding ....................................................................................................41

b. An Uncertain Plan for an Already Uncertain Future ................................................42

IX. Crime and Prisons .....................................................................................................44

a. Overcrowding, Cost Increases, and Prison Quality Degradation ..........................46

b. Shift to Rehabilitation and Realignment ..................................................................47

c. Criticism and Potential Threat to California's Future ..............................................47

X. Economy ....................................................................................................................49

a. Employment Growth and Industry Patterns .............................................................49

b. Unemployment and Underemployment ..................................................................51

c. Uneven Growth ........................................................................................................52

XI. Civic Engagement ....................................................................................................55

a. Low Transparency Limits Information ..................................................................55

b. Interest Groups Dominate .......................................................................................57

c. Corruption and Political Distrust ............................................................................57

d. Declining Voter Turnout ..........................................................................................58

XII. Conclusion ................................................................................................................60

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Introduction

Today's California is undergoing changes and facing uncertainty. Like many states nationwide, California is emerging from the recent economic recession short on revenue and high on debt. The state economy shows signs of recovery. California's recently released budget suggests that the state now has a modest operating surplus, and the state's political leaders have already begun painting a rosy picture of California's economic outlook. However, the full story is in the details.

A closer look reveals that California has many lingering challenges that the state's political leaders have yet to address and resolve. Studying these issues reveals a common underlying theme: unsustainability. California as we know it is simply unsustainable. To correct California's unsustainable course, the state requires informed citizens and leaders willing to tackle the state's budget and infrastructure realities. We must end the cycle of neglect, ignorance, and postponement. Unless we end the cycle we leave these costly problems for future Californian's to inherit.

Over the next several years, volatile revenues, disproportionate spending growth, mounting debts, and inadequate infrastructures present significant hurdles for the state and its citizens. All the while, California's population will grow and age considerably, placing even greater strains on state resources. Even worse, California's citizens are not armed with sufficient information due to California's notoriously low levels of transparency, public disclosure, and civic engagement.

In the following sections, California Common Sense presents and assesses California's 10 greatest challenges. The 10 critical issues are as follows:

- **Water Supply**: Outdated Infrastructures and Unreliable Water Supply
- **Revenue Uncertainty**: Unpredictable Tax Structures and Budgets
- **Wall of Debt**: Accounting Gimmicks and Understated Debt
- **Public Retirement Benefits**: Missed Payments, Mounting Debts, and Poor Management
- **Healthcare**: Rising Costs and Diminishing Access to Care
- **K-12 Education**: Low, Unstable Funding and Poor Student Performance
- **High Speed Rail**: Unrealistic Estimates and Poor Implementation
- **Crime and Corrections**: Massive Overcrowding, Rising Costs, and Measuring Realignment’s Impact
- **Economy**: Lagging Recovery and Uneven Economic Growth
- **Civic Engagement**: Lack of Transparency, Eroding Public Trust, and Low Voter Turnout
We selected these challenges due to their unsustainability and the risk they pose to future Golden State generations. While no report can cover all of California’s challenges, this report provides a core understanding of ten critical issues and the importance they bear on the state’s long-term future.
Water Supply

Outdated Infrastructures and Unreliable Water Supply

Last year (2013) marked the driest year on record for many regions in the state, and the same conditions are likely to persist in 2014. The state’s major reservoirs – Lake Shasta, Lake Oroville, and San Luis reservoir – were at 36%, 36%, and 47% capacity, respectively, at the end of January 2014 (Figure 1a). While many attribute the state’s unpredictable water supply to the drought and rising temperatures, California’s current drought conditions actually reveal weakness in the state’s water supply management policies.

Even under normal conditions, without the necessary policy reforms and different funding sources, California’s water supply would still be unreliable. The state’s old and insufficient water infrastructure, largely unmanaged groundwater supplies, inefficient water use, and environmental issues are just some of the threats to the state’s future water supply in the short- and long-term. As the population continues to grow and temperatures continue to rise, these challenges will intensify.

Figure 1a: Water Conditions for Major Reservoirs
Figure 1b: California Daily Water Use (in gal, per capita)
California's water availability varies within the state, particularly between the northern and southern regions. More than 75% of the state's precipitation occurs in Northern California, but Southern California demands 75% of the state's water. Furthermore, while water usage per capita has declined over time, California's growing population is likely to drive greater water demand overall in the future (Figure 1b).

**Water Supply & California's Economy**

In much of California, access to water has been unreliable in the face of numerous demands for various uses. Based on water consumed only by municipal, industrial, and agricultural users, agriculture uses approximately 80% of the total "developed water supply." Although agriculture remains an important source of income for the state, California's economy has become less reliant on water-intensive industries. For example, agriculture and other water-related industries now account for only 2% of the state's Gross Domestic Product. California receives the greatest portion of agricultural revenue in the U.S. (11.3%). In some cases, crops that generate large portions of the state's agricultural revenue require less acreage and less water compared to cheaper crops. During drought conditions, the state could increase its water use efficiency as well as its agricultural revenue by focusing production on valuable crops that require less water and acreage.

**California Surface Water Storage**

California has done little to expand its surface water storage facilities in recent decades. The backbone of the state's water system, the federal Central Valley Project (CVP) and State Water Project (SWP), have made no significant infrastructure investments since the 1970s. These projects designed their reservoirs to satisfy the water demands of the state's population when it was only about 19 million, half the size of the current population. California's fast-growing population is likely to increase water demand. Thus the aging water infrastructure is insufficient to satisfy the demands of California's 38 million current residents.

There have been significant developments in local surface storage construction such as the Diamond Valley Reservoir, which serves the Metropolitan Water District of Southern California in Riverside County. However, the federal government owns most of California's major reservoirs that require maintenance. Additionally, considering warmer temperatures, there is likely to be more winter precipitation falling as rain instead of snow. Therefore, California's water supply system should have a sufficient number of efficiently operating reservoirs to satisfy the needs of the growing population and maintain sufficient reservoir space for winter flood control.

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**Developed Water Supply:**
Developed water supply is the amount of precipitation, surface water, or groundwater available for use.
Building (about $2.3 to 3.2 billion) and maintaining (about $10 to $21 million annually) reservoirs and dams is costly, but it provides the state with operational flexibility. For example, they provide drought protection by compensating for the snowpack loss due to higher temperatures, environmental protection by releasing water when needed, and manage floodwaters. Thus while maintaining and building new surface water infrastructure is costly in the short-term compared, it secures the state's essential water supply system and offers the opportunity to respond to emergencies.

Unregulated Groundwater

California's surface and underground water is all part of the same system, yet, surface water is generally considered a public good, while ground water is considered a private good. As such, two different legal systems regulate surface and groundwater in California. This decentralized management could lead to an irreparable “groundwater overdraft,” which occurs when water is released faster than it is replaced through absorption. Groundwater overdraft can especially happen during drought conditions because there is insufficient surface water available. They can cause land to sink, or in case of coastal aquifers, lead to seawater intrusion. Some areas of the San Joaquin Valley have already started sinking at an alarming rate.

Groundwater storage is widespread, but these underground storages refill and empty much slower than the surface reservoirs, which makes them a more suitable water source during droughts. Between 1998 and 2005, groundwater resources supplied about 35% of California’s average annual water demand in urban, agricultural, and managed wetland areas. During drier years, this portion increased to 40% or higher statewide and as more than 60% in some regions.

The state has previously implemented various strategies to address groundwater management challenges and make it a more reliable water supply source. However, California still lacks a formal state-administered system that regulates and permits groundwater use.

Environmental Measures Affecting Water Supply

The Sacramento-San Joaquin River Delta ("The Delta") is the hub of California's two main water delivery systems – the SWP and the federal CVP. It is an important ecosystem and also a critical link in California's water supply system. Therefore, it has been the center of a power struggle among urban water use, agricultural water use, and environmental objectives.
As a result of recent drought conditions, a state court has ordered restrictions on Delta water pumping to protect certain fish species from extinction because water pulled directly through Delta channels increases the risk of fish getting trapped in the pumps. Additionally, the existing operations of the SWP and CVP pumps can reverse river flows, which can potentially alter salmon migratory patterns and contribute to the decline of sensitive fish species such as the Delta smelt. The court-ordered restrictions further reduces the surface water supply. Consequently, water users may turn to local underground resources, which can lead to a groundwater overdraft.

To resolve the dispute and increase water supplies, water agencies proposed the Bay Delta Conservation Plan. This plan includes the construction of two tunnels that would carry water beneath the Delta to the SWP and CVP pumping plants, and from there, the water would travel into the existing water channels that currently supply much of the state’s water. However, this solution requires strict governance and financial policies, as well as a systematic science program and ecosystem restoration under new conditions. This proposal, if successful, could solve the Delta’s environmental problem while stabilizing the water supply.

**Water-Use Efficiency and Conservation**

As Professor Barton Thompson, Co-Director of Stanford University’s Woods Institute for the Environment, said, we “cannot run out of water…all we can do is run out of cheap water.” Water is a scarce resource in California, and policymakers have primarily focused on increasing the supply of water to meet increased demand. Policymakers should also consider incentivizing reduced demand for water, particularly when it is extremely scarce.

Public institutions regulate most of California’s water so that it is priced far below true market value in urban and agricultural areas. Further, water prices do not adjust automatically to periods of shortage and excess.

However, research studies have shown that even higher water prices affect the public’s demand for water very little in California. Thus increasing the cost of water may be ineffective in reducing municipal water use. Yet, studies have found that increasing water prices may reduce agricultural water demand. Given the state’s dependence on the agricultural sector for food and resources, raising water prices could have additional negative effects, such as a significant increase in food prices.

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**Barton Thompson**

*Co-Director of Stanford University’s Woods Institute for the Environment*

“In theory, cities cannot run out of water. All we can do is run out of cheap water, or not have as much water as we need when we really want it.”
Funding Challenges

California’s local agencies are more responsible for delivering water services and maintaining infrastructure than the state and federal governments. They mainly fund their operations through monthly water and wastewater bills. State and federal spending is low relative to the local agencies’ water expenditures. In the late 2000s, local agencies spent about $30.3 billion annually, while state and federal agencies spent about $3.1 billion and $510 million, respectively (Figure 1c).\textsuperscript{17}

General obligation bonds, funded by tax revenues, have become a more reliable source of funding for the local agencies’ water projects. But water expenses have exhausted the existing water bond funds, and due to concerns regarding weak voter support, the state Legislature has postponed a ballot measure for the new bond until November 2014.\textsuperscript{18}

Due to recent drought conditions, Governor Brown announced a $687.4 million emergency drought-relief plan, which includes funds for housing and food for workers directly impacted by the drought, as well as secures emergency drinking water supplies. Critics such as the Minority Assembly leader Connie Conway and Vice Chair of the Assembly Water, Parks and Wildlife Committee Frank Bigelow have called the Governor’s plan an ineffective “drop in the bucket.” The Governor further proposed an additional $142 million in the May Revised budget to continue the immediate drought-related efforts.\textsuperscript{19} The state must develop a range of funding options to successfully face the challenges of sustainable water supply management.

Conclusion

In recent years, water agencies have made significant progress towards creating a reliable water supply system. However, California’s water system still faces a number of challenges such as old and insufficient water...
infrastructure, largely unmanaged groundwater supplies, inefficient water use, and environmental issues. These challenges have become even more difficult to tackle with population growth and higher temperatures. Thus improving water supply management policies and finding sustainable funding sources are essential means for the state to develop an effective and reliable water supply system.
In California, it has become common for the state's revenue to vary widely from year to year. This volatility reflects a dangerous aspect of California's budget process – unpredictability. In years when the state receives an unexpectedly large amount of tax revenue, state legislators tend to increase spending on programs and employee compensation significantly, believing the high revenues reflect a new normal. When those revenues later decline, legislators' inevitable, but sudden, cuts to programs and services hit heavily. This cycle of significant expansions and significant cuts is called “boom-and-bust budgeting.”

Staking Everything on Personal Income

California's revenue system is incredibly volatile because it has come to rely more on personal income tax returns as its sales and tax bases have narrowed. Of the state's “Big Three” tax sources – personal income, sales, and corporation – only personal income accounts for a growing share of state revenue. Consumer spending patterns explain some of the trend: In the last several decades, Californians began purchasing fewer taxed goods and more non-taxed services. California taxable sales, as a portion of personal income, have declined from a peak of 53% in 1979 to a mere 32% in 2012. As a result, sales taxes are a shrinking share of revenue and the state relies more heavily on personal income taxes to substitute for that lost sales tax revenue.

Figure 2a: Annual Percentage Change in CA's Tax Revenue, 1970-71 to 2014-15 (Inflation Adjusted)
In 1970-71, the state's tax base was markedly different because five revenue sources made up the bulk (87.4%) of the budget, not three. The “Big Five” taxes were sales, personal income, motor vehicle fuel, corporation, and vehicle fees. At the time, sales tax receipts represented the largest share of the state’s total revenue (33%) and personal income accounted for only 23%.

**Figure 2b: California Revenue Shift, the “Big 5” vs. the “Big 3”**

Today, personal income, sales, and corporation taxes must support as much of the budget as five taxes in 1970-71. On top of that, even among the Big Three, sales and corporate taxes have become less prominent budget sources today – 28% and 6.6%, respectively. As a result, the state has shifted a massive portion of the state’s spending burdens toward personal income taxes. In 2013-14, personal income taxes are expected to account 54% of all tax receipts. Realistically, this means that every year, we stake our very ability to provide essential services one single revenue source, and the most unpredictable source, at that.

California voters approved Proposition 30 (2012), which raised personal income and sales tax rates. For seven years, the proposition will raise tax rates for individuals’ whose personal income exceeds $250,000 annually. The rates
range from 9.3% to 13.3%, with higher earners paying more. According to the California Department of Finance, the top 1% of earners now pay 41.1% of all state personal income taxes.

Prop 30 is largely indicative of the state's increasing reliance on personal income tax revenue, particularly from high earners. As the California Legislative Analyst's Office notes, the state's heavily progressive tax structure (taxing higher incomes more heavily) is one of the two main contributors to the system's high volatility. The other cited contributing factor is that the state taxes capital gains as income.

**Relying on Wall Street**

Because California now relies heavily on personal income to fund its budget, total revenue tends to decline during economic slowdowns as layoffs and pay cuts become more common. In 2014-15, capital gains (profits gained by selling investment assets) are expected to consume a significant 10% of the General Fund budget. However, California is unique because it also considers and taxes capital gains as personal income. This means that fluctuations in stock market performance introduce additional revenue volatility for the state.

When both the job and stock markets are strong, California's revenues tend to be significantly higher than average, creating a sense of impending windfall cash. However, when both markets decline, the negative effects compound one another and result in revenues far below average. Essentially, relying heavily on capital gains drives extremes within the state budget – extremely high revenue years (e.g. 2005 to 2007) and extremely low revenue years (e.g. 2008 to 2011).

**Measuring Volatility**

Revenue volatility is a measure of how much and how frequently revenue levels vary during a time period. Changes in business cycles, investment performance, and employment levels can drive changes in personal income, consumption of goods, and corporate growth, thereby introducing revenue volatility.

The following analysis utilizes the same approach the California Legislative Analyst’s Office uses to measure basic revenue volatility. After adjusting the state’s revenues for inflation, we measure each type’s average annual growth (annual percent change) and compare how widely the growth rates vary from the average (standard deviation). A higher standard deviation corresponds to higher volatility.
Since 1970-71, among the Big Five, personal income and corporation tax receipts have been the most volatile, with corporation taxes exhibiting slightly higher volatility. Corporate tax receipts varied by an average 3% annually with a 12.9% standard deviation, meaning two-thirds of the time, corporate revenues will change between -9.9% and 15.9% compared to the previous year. Likewise, two-thirds of the time, personal income revenues will change between -6.7% and 18.3% compared to the previous years. These wide margins indicate significant volatility among both corporate and personal income taxes, but because personal income figures so prominently in the state’s revenue structure, its volatility has significantly more impact on the state’s year-to-year budget outlook.

Adjusting to the Unpredictability

California’s current revenue structure lends itself to substantial revenue volatility, and thus uncertainty. While a volatile revenue structure is not necessarily unsustainable, budgeting approaches that do not plan to adjust for extreme volatility are unsustainable. Numerous policy groups, analysts, and policymakers have noted the benefit of sufficiently setting unanticipated revenue into a reserve called a Budget Stabilization Account (BSA), or Rainy Day Fund, to accommodate for the system’s volatility. Under such a scheme, the legislature would establish firmer standards to determine what proportion of revenue to set aside in high-revenue years and allowances for their use in low-revenue years.

Currently, Proposition 58 (2004) mandates the transfer of 3% of estimated General Fund revenues to the Rainy Day Fund until it reaches $8 billion or 5% of the General Fund. However, the Governor may unilaterally suspend all or part of that transfer, as has been the case in recent years.

The state Legislative Analyst’s Office has argued that “setting aside above-average revenue growth” is the “most effective tool” for budgeting in light of California’s high revenue volatility. In his 2014-15 proposed budget, Governor Jerry Brown proposed a $1.6 billion transfer to the state’s depleted Rainy Day Fund, the first such transfer since 2007. Another $1.6 billion would fund bond debt payments. By comparison, under Proposition 58, the full $3.2 billion would go to the Rainy Day Fund.

In November 2014, citizens will vote on a ballot measure that would constitutionally mandate new Rainy Day Fund provisions that would strengthen the current BSA structure. The November proposition would mandate the following:
• Setting aside 1.5% of the General Fund in the Rainy Day Fund each year until it equals 10% of the General Fund.
• Depositing capital gains taxes greater than 8% of the General Fund into the Rainy Day Fund.
• For the first 15 years, using half of each deposit to help repay the state's debts.

Restructuring: Reducing the Reliance on Income Taxes

In the long-term, the state could also reduce the tax system's actual volatility by restructuring the revenue system so that it shifts the budget's dependence away from the volatile capital gains and/or traditional personal income taxes. Potential avenues for restructuring the revenue system include the following:

• Reducing capital gains tax rates to below traditional personal income tax rates to decrease dependence on the stock market's performance.
• Adjusting the sales tax to tax services and better capture actual consumer spending habits while restoring some of the balance between personal income and sales tax revenue.
• Adjust the distribution of the personal income tax burden to disperse the bulk of payments away from a relatively small number of high earners, whose income is incredibly volatile.

Conclusion

When revenue varies widely from year to year, budgeting effectively for the future can be difficult due to significant uncertainty. For Californians, the state's reactionary boom-and-bust budgeting in light of that uncertainty is both familiar and detrimental. Tax hikes, service cuts, short-lived programs, and overall instability are key symptoms of such a system, but that does not have to be the case. By reducing the state's reliance on the most volatile tax sources (such as capital gains) or setting aside funds in high-revenue years, California could better adjust to and eventually reform the nature of its system, which would offer much-needed budgetary stability in the Golden State.
Over the last decade, California amassed extensive debt that it will have to repay over the coming decades. More recently, the state government and media began referring to the state's billions of dollars of mounting debts as a “Wall of Debt.” Generally, state officials and the media depict that “wall” as $26.2 billion, far smaller than it actually is. California’s actual wall of debt is $443 billion.

The state's complete and growing Wall of Debt reflects unsustainable budgeting practices. As its repayment costs rise and shift to later generations, the Wall will redirect spending away from critical public services. Significantly reducing its size is crucial to securing the state's fiscal health and eliminating year-to-year budgeting gimmicks that mask deeper underlying challenges.  

Furthermore, aggressively excluding long-term liabilities (such as those for public employee pensions) from debt discussions is dangerous to citizens and policymakers, alike. While the state does acknowledge its long-term liabilities, it generally fails to treat them as “debt.” Governor Jerry Brown argues that “it is critical that the state develop a plan to address these liabilities which will crowd out the state's ability to take on new ongoing commitments.” However, refusing to include these critical liabilities in the official Wall of Debt can greatly diminish its significance in the mind of many voters and policymakers.

Reassessing the Wall of Debt

According to Governor Brown’s 2014-15 proposed budget, California's Wall of Debt amounts to $26.2 billion and largely includes short-term debts incurred since 2007-08. These debts include postponed payments to schools, community colleges, and California's Medicaid program (Medi-Cal).

Among these debts are the “deferral of state payroll costs from June to July,” an accounting gimmick that appears to reduce the year's overall payroll costs by delaying and pushing those payments into the next fiscal year. Another opaque budget approach included temporarily shifting money from dedicated funding pools called Special Funds to pay for other areas of the budget.

Ultimately, such accounting gimmicks obscure a government's true financial condition and undermine fiscal transparency by limiting the public's ability to fairly and accurately evaluate the state's budgetary and fiscal health. For example, the state has repeatedly resorted to borrowing from internal pools of money to “balance the budget.” On paper and in reality, this type of gimmick misrepresents actual costs to citizens, the media, departments, and policymakers.
The official Wall of Debt vastly understates the actual magnitude of the state’s debt. The actual wall is $443 billion. The complete wall builds upon the smaller official one and includes the following:

The state has largely foregone infrastructure maintenance over the last half-decade, and as a result, California now requires an estimated $64.6 billion in maintenance costs to restore the quality of its infrastructure. Officially, the state’s unfunded public pension and retiree healthcare liabilities total $218.6 billion. Additionally, the state’s outstanding general obligation bonds ($81.1 billion), unissued bonds ($30 billion) and lease revenue bonds ($11.3 billion) total $122.4 billion.

Finally, California borrowed $10 billion from the federal government to fund the state’s unemployment insurance fund. Of that $10 billion, the state currently owes the federal government an outstanding $8.8 billion.

At eighteen times the size of the Governor’s official figure, $443 billion is a far more accurate and comprehensive estimate of the state’s debt. If the Governor’s outlined $26.2 billion debt is a wall, then the full $443 billion the state owes is a skyscraper.

The Impact of a Growing Wall

The Wall of Debt’s impact will become increasingly apparent as it continues to crowd out often essential services throughout the state. Between 2007-08 and 2013-14, the state’s budget breakdown changed significantly. During the period, the state’s bond interest payments increased 24% and annual retirement payments increased 25%. Conversely, transportation, social services, the University of California, and the California State University’s portions of the state budget all shrunk, illustrating the crowd-out effect on some of the state’s key services. The costs associated with maintaining debt grow as it grows and remains unpaid. They may further harm the state’s fiscal sustainability by limiting its credit
worthiness and ability to borrow.\textsuperscript{44} Furthermore, delaying massive debt repayment inherently weakens the state’s long-term financial sustainability because it poses the risk that those debt costs will become prohibitively expensive for future generations to repay.\textsuperscript{45}

Without significant reform, citizens will continue financing rising debt interest, annual retirement benefit, and higher retiree health cost payments. In the long-term, chronically underfunded systems will hit critically low levels (as is currently occurring with the California State Teachers’ Retirement System, or CalSTRS), meaning they will require ever larger bailouts going forward.\textsuperscript{46} Inaction will result in even greater tax burdens on citizens and/or additional cuts to key public services.

In his January proposed budget, Governor Brown outlined a plan to pay down $26.2 billion of the state’s actual debt, but he has failed to address the state’s \textit{full} $443 billion in outstanding debts. Publicly emphasizing only 6\% of the state’s debts – and arguably the least pressing among them – deepens the impact of long-term fiscal obligations on both current and future citizens, jeopardizing the health of their communities.

\textbf{Accrual-Basis vs. Cash-Basis Budgeting}

The accounting gimmicks the state has used to balance its budget are only possible under “\textit{cash-basis budgeting}.” The practices, such as deferred payments and internal borrowing, have prompted some calls for state and local governments to use “\textit{accrual-basis budgeting}” in place of cash-basis budgeting.

Under cash-basis budgeting, borrowed funds are considered as revenue and expenditures are only recognized when cash actually changes hands. For this reason, governments using cash-basis budgeting may actually be misrepresenting their true fiscal conditions to the public. As stated by the State Budget Task Force, “The practice of cash-based budgeting facilitates gimmicks and short-term measures that obscure actual financial conditions.”\textsuperscript{47}

For example, in the current budget year, California is able to report a budget surplus because it is \textit{ignoring} billions of dollars in retirement costs earned, but not paid, during the fiscal year. These payments will instead be deferred to future budgets at higher costs. If the state adopted accrual-basis budgeting, it would acknowledge all of the costs accrued in the fiscal year. Doing so now would prevent the state from reporting a surplus, but it would help it better represent the costs facing citizens.
Conclusion

A growing Wall of Debt threatens the state’s ability to provide sufficient and often essential public services, which frequently serve as a cornerstone for California citizens. Left unchecked, the wall’s growth is unsustainable. The cost of maintaining too high of a wall manifests itself as higher taxes and/or service cuts for citizens – a prospect that has already become a reality throughout the state.\textsuperscript{48}

Reframing the public’s and policymakers’ understanding of our state’s full liabilities is critical for its future. However, the most substantive actions will be establishing and adhering to funding plans that will allow California to manage those growing long-term debts, debt interest payments, and retirement contribution levels.

Effectively managing the state’s debt means more than just paying down internal borrowing and reducing the state’s use of budget gimmicks to report a balanced budget. It requires slowing the growth of unfunded liabilities and working toward truly sustainable systems overall. For today’s citizens and future generations, the difference between the wall’s misrepresentation and reality may the defining aspect of their lives as Californians.
Nationwide, public retirement benefit plans are in a financial crisis. Unfunded liabilities total trillions of dollars and many retirement benefit plans face massive funding shortfalls. These shortfalls have ushered in higher costs that have led to cuts in public services and in extreme cases, municipal bankruptcies.

Rising retirement costs are particularly acute in California. Nearly half of the state's outstanding debts are attributable to unfunded public retirement benefit liabilities. Since 2007, the state's unfunded retirement benefit liabilities have more than tripled and now stand at $219 billion (Table 4a). The state's retirement benefit plans require significantly higher contributions to secure benefits and patch massive funding shortfalls. The largest of these liabilities belongs to teachers' pensions and the state retiree healthcare plan, with funding shortfalls of $74.4 billion and $64.6 billion, respectively.

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<td>Teacher Pensions</td>
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These liabilities represent costs that the state, through tax payers, will pay back in future years (with interest). Over the past decade, state-level retirement benefit costs have already increased 80% from $4.5 billion in 2005-06 to $8.2 billion in 2014-15. To pay down the state's retirement debt and pay for newly earned benefits, these costs will continue to grow rapidly in coming years. Furthermore, as we will discuss later, the state has not been fully funding its benefits, meaning that true costs are actually higher than official estimates indicate. Rising retirement costs already crowd out spending for other budget areas, at the detriment to current and future generations of taxpayers and public service recipients.
The public retirement benefit crisis is even more visible at the local level, where cities and counties also have billions in unfunded retirement benefit liabilities. The magnitude of this financial issue has progressed so far that some cities have openly considered bankruptcy as a viable option for tackling their retirement benefit debts.

For example, retirement benefit costs played significant roles in the bankruptcies of Stockton, Vallejo, and San Bernardino.\(^52\) In San Jose, retirement benefit costs have grown to nearly 25% of city expenditures, resulting in significant cuts to essential public services, including a 28% reduction in the city’s workforce.\(^53\)

**High Risk, Benefit Hikes, and Underfunding**

Contrary to popular claims, the recent economic downturn did **not cause** the current public retirement benefit crisis, but rather exposed it. A heavy reliance on risky investments, irresponsible benefit increases, and skipped contributions to retirement funds caused the current retirement benefit crisis. This reckless behavior compounded the economic crisis's financial impacts.

Had lawmakers and fund managers displayed greater prudence during the late 1990's and early 2000's, retirement benefit plans would be much healthier than they are today.

**Pension Plan’s Reliance on High and Risky Investments**

Pension plans are incredibly reliant on both high and risky investment returns (at least 7.5% annually on average) to pay for future benefits.\(^54\) Approximately 61% of all pension benefits are paid from these risky investment returns, while employer and employee contributions fund only the remaining 39%.\(^55\) Due to this heavily reliance in investment performance, pension plans’ financial conditions are extremely sensitive to investment volatility.

Pursuing 7.5% annually (which assumes that invested assets double every 10 years) is attractive to employers because, if achieved, it keeps employer and employee costs low. However, many economists argue that this rate of return is overly optimistic.\(^56\) The most recent economic recession illustrated this point when California's pension plans lost over one-quarter of their assets.\(^57\) The California Public Employee Retirement System (CalPERS), the California State Teacher’s Retirement System (CalSTRS), and the University of California Retirement Plan (UCRP) now assume a 7.5% annual rate of return, but have each averaged less than 6% over the last 15 years (Table 4b). When

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Chuck Reed:
San Jose Mayor (on Rising Retirement Costs)

“I got sick and tired of cutting services to my people — 10 years of services cuts — in order to balance the budget. We got to the point where we were facing service delivery insolvency.”

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investment returns fail to meet expectations, employer and employee contributions must increase to fund the difference.58

Table 4b: Investment Rate of Return by Retirement System59

<table>
<thead>
<tr>
<th>System</th>
<th>Currently Assumed Return</th>
<th>2013 Return</th>
<th>Moving Average</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>3 Years</td>
</tr>
<tr>
<td>CalPERS</td>
<td>7.5%</td>
<td>13.2%</td>
<td>11.3%</td>
</tr>
<tr>
<td>CalSTRS</td>
<td>7.5%</td>
<td>13.8%</td>
<td>12.6%</td>
</tr>
<tr>
<td>UCRP</td>
<td>7.5%</td>
<td>11.7%</td>
<td>11.1%</td>
</tr>
</tbody>
</table>

In pursuit of high returns, pension plans have undertaken riskier investments. Plans now invest more heavily in equities and alternative investments, which are particularly volatile asset classes. This is the trend nationally: data shows that risky asset allocation among nationwide public pension plans has increased over the past 20 years from about 57% of assets to 73% in 2010.60 This practice is also criticized, because this risk taking is in stark contrast to what providing legally guaranteed retirement benefits require: no risk.

Through the California state constitution and case law, pension benefits are heavily protected and are essentially guaranteed. However, risky pension funding strategies introduce the possibility that assets will be unavailable to provide those benefits.

Benefit Increases

Many lawmakers and pension plan managers assumed that the financial prosperity generated by the 1990s bull markets would last indefinitely. Under those assumptions, policy makers increased benefits significantly throughout the state. But investment returns failed to match those optimistic assumptions.

The most notable of these increases came through Senate Bill 400 (1999), which granted billions of dollars in retroactive pension increases to members of the California State Employees Retirement System (CalPERS). This lowered the retirement age to as young as age 50 with and allowed lifetime benefits of up to 90% of final year salaries.61 At the time, CalPERS promised that these pension increases would not cost taxpayers "a dime" because investment returns would fund the additional expense.62 However, CalPERS failed to disclose that this would be true only if it achieved its assumed rate of return (which was 8% at the time), which had only about a 50% chance of happening.63 Instead, these benefit increases added billions of dollars in additional costs to taxpayers' burden.
Similarly, multiple bills passed around 2000 retroactively increased benefits for members of the California State Teachers' Retirement System (as well as lowered plan contributions). The enactment of these bills added $55 billion to CalSTRS's existing pension debt. Had the legislature never increased benefits, CalSTRS would be 89% funded today, which would make it one of the nation's best funded pension plans.

**Missed Payments**

Beyond investment returns and benefit hikes, the state and its municipalities have frequently neglected payments to retirement plans altogether. Over the past 10 years, California's state-level retirement plans have at least $50 billion in missed payments. The bulk of these missed payments are for the CalSTRS defined benefit plan and the state retiree healthcare plan. Consequently, these plans have the largest unfunded liabilities statewide.

Unlike many other pension systems, CalSTRS lacks the ability to adjust its own contribution levels. Instead, its contribution rates are set in statute and the state legislature must approve any change. For more than a decade, the legislature has held contributions below the required amount, resulting in over $21 billion in missed payments since 2002 (Figure 4c). These missed payments have made addressing CalSTRS's funding shortfall much more expensive.

California's 2014-15 May Revised Budget sets forth a plan to pay down CalSTRS's $74.4 billion unfunded liability over the next 32 years. Overall, contribution increases over the next 32 years will total $238 billion. While this contribution increase is necessary, long term costs would have been much lower if the
state had implemented such a solution sooner.

California's retiree healthcare plan is particularly impacted by the state's failure to make payments. The state has never paid the required contribution, leaving the state retiree healthcare plan completely unfunded. Essentially, the state is leaving a $64.6 billion promise (which grows with interest) to future generations to figure out.

**How to Manage Costs Going Forward**

Hindsight reveals some best practices that the state can implement going forward to prevent further decline among the state's retirement benefit plans. Regardless of the benefit's cost (small or large), it is in all stakeholders' interests to set aside sufficient assets during the working careers of each employee to pay for his or her future retirement benefits. For this reason, retirement benefit plans should always pay their required contributions. Not only is this approach less expensive in the long term, but it also helps maintain intergenerational equity and reduces future budget uncertainties.

Further, the state should properly disclose the risk associated with pension fund investments to the public on all financial statements. More specifically, pension fund managers should disclose liabilities and projected annual costs at various return rates (including “risk-free” rates). Such a risk sensitivity analysis would have likely prevented benefit increases that have resulted in larger unfunded liabilities and higher retirement benefit costs.

The state and many of its localities have sought to reduce retirement benefits to help rein in rising costs. For example, in 2012, Governor Jerry Brown enacted Assembly Bill 340, legislation that increased retirement ages and reduced pension benefit levels for new state employees. Because current retirement benefit costs are attributable to current employees and retirees, this legislation actually failed to substantially impact the current condition of the state's pension plans.

Besides paying down liabilities, the only effective way to slow the growth of existing unfunded liabilities is to adjust the benefits current employees have not yet earned. In California, pension benefits for current employees are guaranteed to be at least as generous going forward as they are on an employee's first day of work. This benefit protection, coined the “California Rule,” is unique in that it applies to benefits that employees will earn in the future, rather than solely to benefits that they have already earned. The protections for retiree healthcare remain uncertain, as case law surrounding the issue is still evolving.
Rhode Island was able to tackle its pension issue by changing the benefits employees had not yet earned. Due to the California Rule, currently, such a reform is virtually impossible in California. Similar efforts were made in San Jose (Measure B), but they were overturned by the California Supreme Court. San Jose mayor Chuck Reed intends to place a pension reform measure on the November 2016 state ballot that would effectively mend the California Rule to allow stakeholders to renegotiate benefits that employees have not yet earned.

**Conclusion**

California’s retirement benefit systems are chronically underfunded and require significantly higher contributions to patch funding shortfalls. Given pensions’ strong legal protections, it is inevitable that rising retirement costs will continue to consume larger shares of California’s state and local budgets.

A heavy reliance on risky investments, unsecured benefit increases, and skipped contributions to retirement funds caused the current retirement benefit crisis. Knowing this, policymakers should learn lessons from these past mistakes and adopt best practices in response. In particular, retirement benefit plans and sponsoring governments should always be transparent about the true costs of retirement benefits (including disclosing costs and liabilities at various discount rates), the risks involved, and refrain from spending away surpluses without taking future risk into account.

The longer these retirement debts are left unpaid, the more expensive providing benefits becomes, and the greater the risk that the plans will have insufficient assets to provide legally guaranteed benefits. Without substantial reform, future generations will be responsible for paying down retirement benefits earned by previous generations, and at extremely high costs.
Nationwide, rapidly rising healthcare costs strain budgets of every form: household, business, and governmental. Even so, sufficient access to healthcare services is vital to ensure the health and well-being of all Americans. As Paul Spitalnic, Chief Actuary of the Centers for Medicare and Medicaid Services has stated, “Determining how to optimally balance our collective demand for the best possible healthcare with our not-unlimited ability to fund such care through private and public efforts represents one of the most challenging policy dilemmas facing the Nation.”

The national healthcare system has undergone significant changes in recent years, many of which are attributable to the federal Affordable Care Act (ACA). The ACA brings sweeping changes into health policy, with the stated goals to significantly reduce the number of uninsured Americans, lower healthcare costs, and improve the quality of the nation’s healthcare.

The ACA contains several provisions in pursuit of these effects. It has expanded the nation’s Medicaid program and established health insurance exchanges. In addition, the ACA requires that certain health services are included in all health plans, and mandates that all individuals either obtain health insurance or pay a fine.

While the impacts of the ACA are still settling in, California’s healthcare system faces a number of key financial and operational challenges. A rapid rise in health costs coupled with diminishing access to care has created enormous barriers to entry into the state’s healthcare system. As California’s population ages and its health declines (e.g. obesity, diabetes, heart health), the consequences of such barriers will become increasingly severe.

**Rising Health Costs**

Healthcare costs continue to outpace economic growth at an unsustainable rate. In 2013, Californians spent approximately $267 billion on personal healthcare services, amounting to $7,000 per person. Since 1991 (when health costs were $81 billion, or $2,700 per person), healthcare expenditures have grown nearly 6% a year, outpacing inflation and growth in the state’s gross domestic product (Figure 5a). In 1991, health expenditures represented 10% of the state’s gross domestic product, but now represents 13%.
While health spending growth has slowed in recent years, many health economists believe that it will accelerate in upcoming years largely due to the continued development of expensive medical technology.\(^8\)

**Figure 5a: Growth in California Personal Health Spending (1991-2013)**\(^8\)

According to the Bureau of Labor Statistics, health spending is the third fastest growing portion of the average American’s personal budget.\(^8\) These rising health costs force families to spend less on other areas or forgo required medical care altogether. In 2012, approximately 17.1% of Californians did not see a doctor due to the cost.\(^8\)

Health premiums for many individuals and employers have risen as a result of the Affordable Care Act. For example, young adults’ (Californians under age 27) individual health premiums have increased an average of 42%.\(^6\) Some health premium costs for low-income individuals (under 400% of Federal Poverty Limit) are offset by ACA subsides for those who purchase health insurance through the health exchange.

Most Californians (54% in 2012) receive healthcare through employer-sponsored insurance.\(^8\) Overall, California employer-based family health premiums grew 90% from 2002 to 2012, rising from an average $8,380 to $15,898.

**Figure 5b: Growth in Employer Health Premiums (2002-2012)**\(^8\)

- **2002**: $6,384 Employer: $1,996 Employee: $4,388
- **2003**: $6,809 Employer: $2,282 Employee: $4,527
- **2004**: $7,127 Employer: $2,430 Employee: $4,697
- **2005**: $8,161 Employer: $2,390 Employee: $5,771
- **2006**: $8,420 Employer: $3,073 Employee: $5,347
- **2007**: $8,638 Employer: $3,236 Employee: $5,302
- **2008**: $8,856 Employer: $3,398 Employee: $5,458
- **2009**: $9,148 Employer: $3,483 Employee: $5,665
- **2010**: $9,974 Employer: $3,845 Employee: $6,129
- **2011**: $11,867 Employer: $3,970 Employee: $7,897
- **2012**: $11,705 Employer: $4,193 Employee: $7,512

**Employer Contribution**

<table>
<thead>
<tr>
<th>Year</th>
<th>Employer Contribution</th>
<th>Employee Contribution</th>
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<tbody>
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<td>2002</td>
<td>$6,384</td>
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<td>$4,193</td>
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annually (Figure 5b). Some employers manage rising health costs by restricting benefits, increasing employee out-of-pocket costs, lowering wages, or reducing employment (not reflected). Also, employers manage rising costs by requiring employees to pay larger shares of health premiums. Indeed, employee contributions towards health premiums rose 110% while employer contributions rose 83%.

**Medi-Cal and Retiree Healthcare**

Over the past several years, health expenditures have consumed increasing shares of government budgets. In California, costs associated with both Medi-Cal (California’s Medicaid Program) and retiree healthcare have placed increasing strain on state and local governments and will likely do so in future years.

From 2005-06 to 2014-15, Medi-Cal costs have increased 93%, while state retiree healthcare costs grown 106% (Figure 5c). This growth far outpaces the growth in overall state spending, Corrections, K-12 Education, and Higher Education over the same time frame.

Medi-Cal now consumes a much larger share of the state's budget, have risen from 10% to over 15% of state expenditures during the period. Increased enrollment has been one of the primary causes of this rapid cost growth. In 1999, the program's enrollment was 5 million (1 in 6 Californians). In 2014-15, Medi-Cal enrollment is expected to be 11.5 million (nearly 1 in 3 Californians).

Some enrollment growth can be attributed to individuals who enrolled in Medi-Cal after losing their jobs and health coverage during the 2000 and 2008 recessions. Additionally, Medi-Cal enrollment is increasing from the state's expanded Medicaid eligibility and the individual mandate under the ACA. In 2014-15 alone, approximately 2.4 million individuals will have enrolled in Medi-Cal as a result of the ACA. Approximately 1.6 million of these enrollees will be newly eligible (mainly childless adults under 138% of the Federal Poverty Limit) and 815,000 will be those who were previously eligible, but chose to enroll only after the ACA (“woodwork enrollees”).

As a result of this enrollment increase, Medi-Cal costs are likely to increase rapidly in the upcoming years. The federal government has promised to pay 100% of the costs associated with the newly eligible Medi-Cal enrollees for the first three years. By 2020, its share will drop to 90% and the state will fund the remaining 10% thereafter. However, the federal government will only fund 50% (the standard federal government contribution) of the costs associated with the woodwork enrollees. These enrollees are expected to cost California $2.4 billion over 2 years.
Medi-Cal costs will also continue to rise due to the impacts of an aging population. In 2011, elderly enrollees accounted for about 30% of Medi-Cal's expenditures, but only 10% of program enrollment. These enrollees tend to be more expensive due to their heavy reliance on long-term care, such as nursing homes and in-home healthcare. In 2011, long-term care costs attributable to the elderly accounted for 17% of program expenditures. A separate study from UC Berkeley projects that Medi-Cal's long-term care costs will nearly double over the next decade due to an aging population.

While retiree healthcare comprises less than 2% of state expenditures, costs are expected to consume much larger shares of the state budget in future years. Retiree healthcare costs have grown mainly due to rising health prices, lengthening life spans, and increases in the number of retirees. Simply put, more retirees are receiving healthcare at higher costs for longer periods of time. The current value of benefits earned is $64.6 billion, to be paid in future years. Collectively, the state's impending Medi-Cal and retiree healthcare costs constitute a major budget concern.
Diminishing Access to Care

The Affordable Care Act has greatly increased the numbers of Californians with insurance. 1.4 million Californians obtained insurance through Covered California (the state's health exchange), and an additional 2.4 million will enroll in Medi-Cal this year. While increasing the numbers of insured Californians can be hailed as a success, it may also beg the question – will these newly insured Californians actually be able to access health care?

There are still several barriers to entry to healthcare services in California. Even prior to the ACA, the number of physicians was inadequate to match the needs of the population. With declining health statuses, retiring physicians, and chronically low reimbursement rates, a growing pool of insured patients is only set to exacerbate access to care.

In a 2009 study (prior to the ACA), the California HealthCare Foundation found that the supply of MD physicians in California was insufficient to match the needs of the population. They found that approximately 66,480 physicians with MD degrees were actively practicing in California, or 59 primary care physicians per 100,000 people. A number of studies indicate that 100,000 people require between 60 and 80 active physicians, meaning that California, with 59, falls below this generally accepted range. Low provider accessibility causes delays in delivering health services, sometimes to the detriment of health outcomes and often causing increased costs (such as unnecessary hospitalizations).

<table>
<thead>
<tr>
<th>Table 5e: CA Measures on Health Indicators</th>
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<tbody>
<tr>
<td>Indicator</td>
</tr>
<tr>
<td>Adult Smoking</td>
</tr>
<tr>
<td>Adult Obesity</td>
</tr>
<tr>
<td>Diabetes Rate</td>
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<tr>
<td>Hypertension Rate</td>
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</table>

California's population is aging considerably, affecting both the users and providers of healthcare. Approximately 25% of California's population will be over 65 in 2060 (compared to 11% today). This aging population will have greater demand for medical services. But at the same time, California's medical professionals are aging as well. Approximately 32% of all California doctors are over the age of 60, which is the second highest rate in nation. Many state physicians will likely be retiring over the next decade, meaning that there will be fewer providers to meet growing demand.

In addition to aging, California’s population is becoming less healthy by some measures: From 2001 to 2012, the percentage of California adults who smoke has declined, but the percentages of obese, diabetic, or hypertensive (high-blood pressure) Californians have increased significantly (Table 5e).
The provider access issue is perhaps most acute among the state’s Medi-Cal enrollees. In response to rapidly growing Medi-Cal costs, the state has often resorted to limiting its per-enrollee costs. Indeed, California spends the least per Medicaid enrollee in the nation. California primarily achieves this by reducing or limiting the rates at which it reimburses Medi-Cal health providers for providing services (called reimbursement rates). Many physicians refuse to see Medi-Cal patients due to these low reimbursement rates, which generally do not reflect the actual costs of health services. Consequently, only 57% of surveyed physicians accept new Medi-Cal enrollees (Figure 5f). This acceptance rate is much lower than for prospective patients with private insurance (90%) and Medicare (73%), and is only slightly higher than for prospective uninsured patients (46%). Given that nearly 1 in 3 Californians will soon be enrolled in Medi-Cal, this physician shortage is incredibly alarming.

Health Reform

A number of demonstration programs have been implemented throughout the state that test various provider payment methods, provider organization structures, wellness incentive programs, and insurance designs, meant to improve health and reduce costs. Ultimately, reducing healthcare costs should come from the results of improved quality of care (i.e. reductions in chronic diseases, lower rates of unnecessary hospitalizations, more efficient service provision, etc.) and not at the expense of it.

The lack of healthcare transparency cripples healthcare reform efforts. Health prices are largely obscured from those actually receiving health services. The Catalyst for Payment Reform gave California an “F” for its healthcare pricing transparency. California should implement a statewide “all payer claims database” which would contain data from both private and public health plans. Such data would inject broader information into the healthcare market and could help facilitate pricing improvements and efficiency. It would also provide researchers with the
data necessary to evaluate various payment models and insurance designs aimed at lowering health costs and improving health outcomes.

Conclusion

The rapid rise in health costs coupled with diminishing access to care has created enormous barriers to entry into the state's healthcare system. As California's population ages and as the state's performance on several key health indicators (obesity, diabetes, and hypertension) continues to decline, the consequences become increasingly severe. California's healthcare system requires more providers, increased transparency, and better financial management. Simultaneously lowering healthcare costs and improving the quality and access to care is not an easy endeavor, but it is essential investment for the health of all Californians.
Approximately 83% of Californians consider the quality of education to be at least somewhat of a problem for California schools.\textsuperscript{109} California’s K-12 schools educate over 6.2 million children, representing nearly one-eighth of the nation’s students.\textsuperscript{110} Therefore, many of the nation’s wide scale educational goals are heavily influenced by the performance of the state’s K-12 education system.

California’s schools face a series of unique challenges. Compared to other states, California’s student population has larger shares of English learners (23.2%, highest in the nation) and students that come from low-income families (54.1%, higher than the national average), indicating relatively high levels of need.\textsuperscript{111} While the state dedicates the largest share of its budget to fund education, its per-pupil spending levels still ranks among the nation’s lowest. Likewise, California lags behind the rest of the nation in terms of the number of educational staff and student performance.

It is essential for California to provide adequate resources to K-12 education to help foster successful future generations. However, California’s schools rely on low unstable funding, furthered threatened by rising retirement costs and the expiration of temporary tax increases. Relatedly, schools are understaffed, especially considering the number of high-needs students. Given these circumstances, it may come as no surprise that California performs below the national standards. The recently acted Local Control Funding Formula attempts to tackles these entrenched challenges.

**California’s Low and Unstable K-12 Funding Levels**

The economic recession hit California’s K-12 districts particularly hard. From 2007-08 to 2011-12, state funding to K-12 fell 19%.\textsuperscript{112} Prior to the recession, California per-pupil spending was $10,687 (inflation-adjusted), which ranked 25\textsuperscript{th} in the nation (Figure 6a). After cuts incurred during the recession, California’s per-pupil spending dropped to $9,892, 39\textsuperscript{th} in the nation. This amount is amount is $2,000 lower than the U.S. average. Other studies have shown that after adjusting for varied costs of living among states, California's per-pupil spending levels are even lower.\textsuperscript{113}

While California’s per-pupil spending lags behind the national average, the state contributes a large share of its budget to K-12. Approximately 28% of state-only funds are spent towards K-12 education, which is the 12\textsuperscript{th} highest budget share in the nation.\textsuperscript{114} However, these funds must be spread across a relatively high number of students. Approximately 16.5% of the state's population are K-12 students, the 8\textsuperscript{th} highest portion in the nation.\textsuperscript{115}
California’s school districts rely heavily on state, rather than local, funds, a system unlike most other states. In fiscal year 2012-13, the state provided approximately 80% of school district revenue. Ever since the passage of Proposition 13 (1978), which capped property taxes, the state has provided the majority share of school district funding. Proposition 98 (1988) guarantees that schools and community colleges receive a minimum of about 40 cents of every state General Fund dollar, which means that that minimum funding levels rises in high-revenue years, but fall in low-revenue years.

In addition, California voters approved Proposition 30, a personal income and sales tax increase that has substantially boosted state K-12 funding in recent years. In 2012-13, Prop 30 revenues accounted for 11% of school district revenue. It is important to note that Prop 30 is only a temporary tax increase that is set to expire in 2019 and that school districts will begin facing significantly higher costs associated with teachers’ pensions during the interim.
The funding shortfall of the California State Teacher’s Retirement Benefit System (CalSTRS) presents a looming threat to future school district budgets. CalSTRS now has a $74.4 billion funding shortfall and requires significantly higher contributions. California's 2014-15 May Revised Budget set forth a $238 billion funding plan to pay down CalSTRS's debt over next 32 years (Figure 6c). Of the $238 billion, school districts will pay the vast majority – $170 billion, or an average of $5.3 billion extra a year.

Squeezing these contributions into already tight school district budgets may prove to be difficult. $5.3 billion is nearly triple the amount that school districts spent on books and supplies in 2013 and is nearly equal to the amount of revenues that schools received from Prop 30. School districts already spend 20% of their budgets on employee benefits. To meet full contribution increases, that portion would likely rise significantly. The expiration of Prop 30 coupled with substantial pension contribution increases is likely to cause significant strain on future school district budgets.
Limited Personnel

California’s low per-pupil spending is reflected in its low number of teachers. In 2012-13, California had a student-to-teacher ratio of 25-to-1, the highest in the nation and much higher than the 15-to-1 national average.125 This means that California students experience much larger class sizes (10 students higher), must share resources with more students, and teachers have less time with each student.126

In 1996, the state implemented the Class Size Reduction program for grades K-3, which imposed financial penalties on schools that did not reduce class sizes.128 However, the state reduced these penalties in 2009, which in conjunction with budget cuts, likely lead to significant increases in class size. Between 2008 and 2013, the student-per-teacher ratio increased from 21-to-1 to 25-to-1.129

California also has relatively low numbers of educational support staff, including guidance counselors, librarians, and administrators. In 2011-12, the student-to-librarian ratio was 7,890-to-1 (highest in nation), the student-to-guidance counselor ratio was 818-to-1 (2nd highest in nation), and the student-to-administrator ratio was 389-to-1 (6th highest in the nation).130

These relatively low levels of school personnel likely exacerbate the relatively high needs of California’s students. Approximately 23.2% of California students are English learners which is the highest rate in the nation (Figure 6d). Furthermore, 54.1% of all California students qualify for free or reduced lunch (general proxy for measuring students that come from low income families) which is higher than the national average. The students typically have higher educational needs and require additional resources, which California appears to be lacking.

Poor Student Performance

Compared to other states, California students rank poorly on performance measures. Over the last decade, California students have lagged significantly behind national standards. For example, California’s 4th and 8th grade students are in the bottom ten nationwide in both math and reading (Table 6e).
In addition to low test scores, only 78% of California's high-school students graduate from high school, (30th highest nationwide) and California's high school dropout rate is 4.0% (13th highest nationwide). Among those who graduate, only 38% actually meet the requirements to go to one of California's public universities.

Among the state's diverse student population, there is a clear educational achievement gap among students with different ethnic and socioeconomic backgrounds. For example, Asian and White students have much higher high school graduation rates than Black and Hispanic students (Figure 6f). Furthermore, low-income students, as measured by qualification for free and reduced lunch, rank well below the student average. Free and reduced lunch measure is far from comprehensive, and recent studies that use more granular measures of income show a widening achievement gap related to poverty. California's schools have much larger shares of low-income and English learner students than schools in other states, meaning the achievement gap affects a great number of California students. Widening achievement gaps for disadvantaged students have in part motivated shifting resources to the state's neediest students.

Table 6e-California Ranking on Education Performance Measures

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<thead>
<tr>
<th>Measurement Type</th>
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<th>US Score/Value</th>
<th>CA Rank</th>
</tr>
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<td>Math (4th grade, 8th grade) National Association of Educational Progress</td>
<td>234, 276</td>
<td>241,284</td>
<td>47th, 45th</td>
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<td>Reading (4th grade, 8th grade) National Association of Educational Progress</td>
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<td>221,266</td>
<td>47th, 42nd</td>
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<tr>
<td>High School Graduation Rate</td>
<td>78%</td>
<td>80%</td>
<td>30th</td>
</tr>
<tr>
<td>High School Dropout Rate</td>
<td>4.0%</td>
<td>3.3%</td>
<td>13th</td>
</tr>
<tr>
<td>UC/CSU Readiness</td>
<td>38%</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Figure 6f: CA High School Graduation Rates by Demographic

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Asian/ Pacific Islander | Black | Hispanic | Low Income | White
Re-allocating Resources: the Local Control Funding Formula

In 2013-14, Government Brown signed one of the most notable education finance reforms in the state’s history, the Local Control Funding Formula (LCFF). Under the formula, school districts receive funds based on the proportion of students who are English learners, foster children, or children from low-income families. In this way, school funds will be distributed in a more transparent way that aims to better align funding with student needs.

LCFF target funding levels are much higher than what school districts currently receive. If the state fully implemented the LCFF in 2013-14, the state would have needed to spend $18 million more on K-12 education than it did in 2012-13 (it did not). The state plans to ramp up school funding over the next several years. By 2017-18, the state intends to increase per-pupil funds by $3,410 (still falling short of the LCFF target funding levels).

Conclusion

California’s schools have a long way to go. The problems California students face are complex. School funding and personnel are low, compared to nationwide measures and arguably insufficient for the state’s high-need student population. These problems are reflected in students’ poor performance on test scores, low graduation rates, and inadequate college preparation. The Local Control Funding Formula promises to reallocate resources towards schools that need it the most. However, reform efforts will be put at risk with upcoming drains on school budgets, including the expiration of Prop 30 and rising retirement costs.
In response to declining infrastructure and a fragmented rail transit system, California has undertaken the construction of a High Speed Rail (HSR) system. For two decades, the estimated $67.6 billion project has been in its planning and development phase, but the state has made little progress.\textsuperscript{136}

The current plan intends to use multiple construction phases to build the rail system and connect the San Francisco Bay Area with the Los Angeles Metropolitan Area. The rail’s stated purpose is to link the two regions, boost the state economy, and promote population growth. Officially, the estimated travel time between the locations will be 2 hours and 40 minutes.

As part of the national High Speed Rail Development Act of 1994, the Intercity High Speed Rail Commission (later the California High Speed Rail Authority, also known as CHRSA) established initial plans for a high speed rail corridor in California. The newly-established CHRSA was tasked with planning, developing, and constructing the rail.

Despite the CHRSA’s positive assessments of its own project management, many experts’ analysis and third-party groups find that the project’s financial, operational, and technical estimates are unrealistic. For instance, independent studies have shown that the rail, which cannot legally operate on a government subsidy, may never generate enough revenue to recoup its costs.\textsuperscript{139} Even the earliest iteration of the CHRSA’s Business Plan faced criticism. Its optimistic estimates of travel cost were still found to be nearly 50% less cost efficient than driving or flying. Further, the original $25 billion from the 2000 Business Plan has now ballooned to $67.6 billion.\textsuperscript{140}
Unsecured Funding

Funding for the plan still isn’t secured. The federal government has set aside approximately $3 billion through the 2009 federal stimulus. At the state level, voters approved $9 billion in state-issued bonds to fund the project through Proposition 1A (2008). Additionally, Governor Jerry Brown has proposed using $250 million from “cap-and-trade” auctions' proceeds for the project. The sum of these funds is wholly inadequate for any real progress toward the rail’s official $67.6 billion estimated cost, even excluding potential cost overruns (Figure 7c).

Two-thirds of the first phase, planned between Merced and the San Fernando Valley, remains unfunded. California's volatile fiscal history, waning public support, legal challenges, and budget uncertainties threaten the project’s future.

In addition to its financial hurdles, the CHSRA has faced legal challenges since the 1990s. Recently, a Sacramento County Superior Court Judge ruled that the state failed to comply with voter-approved restrictions that the state needs to identify sources of funding ahead of construction. Currently, the state has identified only $12 billion of the $31 billion required for the first phase. The legality of the Governor’s proposal to use $250 million in cap-and-trade funds toward the train’s cost has also been called into question.

The initial portion of the first segment is expected to connect Madera to Fresno, and its construction will produce an estimated 1,000+ jobs and will take place over four years. This initial segment’s estimated cost is $1-1.5 billion and Tutor Perini, Inc. won the contract with a $985 million bid. The firm made the lowest bid, and many criticized the contractor selection process because they believed it weighted bid price more and engineering quality less than it should have. Furthermore, a bid is not always a clear reflection of a project’s...
final cost: Tutor Perini has a history of cost overruns, such as its BART extension construction, Oakland Coliseum retrofit, and a Los Angeles subway construction project.\(^\text{145}\)

**An Uncertain Plan for an Already Uncertain Future**

In other instances of high speed rail construction, dependence on other forms of transport dropped significantly due to induced competition (Figure 7d).\(^\text{146}\) Should California High Speed Rail be as successful as the Business Plan’s claims, riders would be forgoing other forms of transport and the state may lose business activity throughout the rest of the transit sector. The Business Plan estimates the value of “disbenefits and mitigations” at between $145 and $239 million during the construction period. *The San Jose Mercury News* reviewed the High Speed Rail’s Business Plan and determined that it exaggerated its 1 million job creation estimate and that 20,000 – 60,000 jobs would be more realistic.\(^\text{147}\)

![Figure 7d: Popularity by Transport Method\(^\text{148}\)](image)

When they voted to pass Prop 1A in 2008, California citizens voted to fund an approximately $40 billion project. As we noted in our 2012 analysis of the project, that cost estimate doubled within just a few years of the vote before reaching its current $67.6 billion.\(^\text{149}\) They voted to introduce a self-sustaining system that could operate efficiently and at high speeds. However, the most recent plans propose blended rail systems that combine both high- and low-speed rail, which would not deliver the anticipated “High Speed Rail” classification throughout the entire system. The 2 hour 40 minute ride may increase to more than 3 to 4 hours according to a recent Reason Foundation study.\(^\text{150}\) Likely as a result of many of the changes to their original expectations, nearly two-thirds of voters want the State Legislature to re-vote on High Speed Rail.\(^\text{151}\)
Conclusion

The California High Speed Rail has reduced public support, legal setbacks regarding compliance with Proposition 1A, concerns about eligibility for federal and state funds, and insufficient private sector investment. These factors all throw the project's future existence into jeopardy. Unfortunately, the California High Speed Rail project runs the risk of becoming a boondoggle. Its inability to secure funding, high potential for cost overruns, and limited capacity to operate as a self-sustaining system all illustrate that the project's implementation over two decades has been both haphazard and ineffective.
Since 1971, the number of California prisoners has risen over 500% and the number of California Department of Corrections and Rehabilitation (CDCR) personnel has ballooned over 800%.\textsuperscript{152} The massive population and personnel cost have been contributing factors to the department’s ten-fold budgetary increase over the same period (Table 8a). The construction of prison facilities to accommodate new inmates failed to keep pace with prison population growth, resulting in severe overcrowding, and unconstitutional living conditions among inmates. Furthermore, prison guards’ compensation increases following high-pressure collective bargaining stressed the budget.

In an attempt to decrease overcrowding, curtail costs, and decrease \textit{recidivism}, the California State Legislature passed Assembly Bill 109, the Public Safety Realignment Act (also known as Realignment). Realignment assigns newly convicted criminals (who committed “non-sexual, non-violent, and non-serious” crimes) to county jails rather than state prisons. Through the program, the state has transferred $2 billion to counties to help them accommodate the additional prisoners as they see fit.\textsuperscript{153}

Realignment’s consequences and their impact on the CDCR’s future are hotly contested. It appears that California’s success with regard to corrections lies in reducing overcrowding, lowering costs, and the successfully implementing Realignment.

California’s prison population growth has been attributed to the following factors:

\begin{itemize}
\item \textit{Policy Changes} – “Three Strikes Law” imposed a life sentence on individuals who were convicted of felonies on their third offense. Often, offenders were convicted of less serious charges and were required to serve life sentences. Additionally, in the last 40 years, the state has passed nearly 1,000 bills that enabled the individuals to be charged with a greater variety of crimes. These types of changes increased the duration of inmates’ stays, and as a result, the total population.
\item \textit{Treatment Changes} – During his first term, Governor Jerry Brown’s administration (in 1977) established Determinant Sentencing, which set strict standardized prison sentences. Previously inconsistent and potentially lenient sentences were served on a conviction-by-conviction basis. As a result, inmates’ time in prison lengthened across the board. There had also been a shift away from rehabilitation (indeed, “Rehabilitation” was just introduced to CDCR’s name in 2008) until the Schwarzenegger administration.\textsuperscript{154}
\end{itemize}

Effectively crafting incarceration policy requires striking a balance between deterring crime while humanely carrying out justice.
High Recidivism – The three-year recidivism rate was 67.5% near California’s peak population. Lack of focus on rehabilitation has been attributed to high numbers of inmates returning to prison after a repeated offense, which in turn keep prison populations high.\footnote{155}

The impact of these changes and increased incarceration has correlated with lower crime rates (Figure B), but experts warn that this does not imply that greater incarceration has directly caused lower crime rates. Some have even argued that despite lower levels of reported crime, crime may have actually increased in some communities.\footnote{156}

In reaction to such high incarceration rates, voters passed Proposition 36 in 2000. It allowed for non-violent drug offenders (including Three Strikes qualifiers with a non-violent histories) to receive more lenient sentences. Proposed primarily to reduce costs, Prop 36 is estimated to have saved taxpayers several hundred million dollars since its enactment.\footnote{157}

<table>
<thead>
<tr>
<th>Table 8a: CDCR Quick Facts – 1971 vs. Today\footnote{158}</th>
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<tbody>
<tr>
<td><strong>Variable</strong></td>
</tr>
<tr>
<td>Prison Population</td>
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<tr>
<td>Prison Spending (per capita)</td>
</tr>
<tr>
<td>($23,761 - 2014 dollars)</td>
</tr>
<tr>
<td>Recidivism Rate (any duration)</td>
</tr>
<tr>
<td>Employee Count (Full-Time Equivalent)</td>
</tr>
<tr>
<td>Total Budget</td>
</tr>
<tr>
<td>Total Compensation\footnote{161}</td>
</tr>
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<td>Prisoner to Full-Time Employee Ratio</td>
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Overcrowding, Cost Increases and Prison Quality Degradation

High levels of incarceration have resulted in significant cost increases for housing and supervising inmates. The 31,000-member CDCR prison guard union, the California Correctional Peace Officers Association (CCPOA), has been influential in pushing for consistent compensation increases.

Rising prison guard compensation and inmate costs began to take their toll on the system’s operating budget, and consequently, maintaining infrastructure. Prisons housed inmates in aging buildings, forced them to triple-bunk, placed them in solitary confinement due to lack of space, and converted gymnasiums into cramped housing.

As facility quality declined, some prisons resorted to placing inmates in solitary confinement for over a decade. Suicide rates among California’s prison inmates were 80% higher than the national prisoner average. California’s inmate prison population peaked in 2006 with over 165,000 inmates held in facilities whose design could only hold half that amount. Several lawsuits, resulted in the 2011 United States Supreme Court ruling that state prison conditions were unconstitutionally poor with inadequate medical treatment for both physical and mental ailments.

Figure 8b: Property and Violent Crime Rate vs. Institutional Inmate Population (1971 - 2013)
Shift to Rehabilitation and Realignment

In 2011’s *Brown v. Plata*, the U.S. Supreme Court ruled that the overcrowding of prisoners violated the Constitution’s 8th Amendment, the provision barring cruel and unusual punishment.165 The Court-issued mandate stated that occupancy levels decline to below 137.5% of capacity, which California failed to achieve by mid-2013. After the state failed again to meet required occupancy levels in early 2014, the Court granted an extension until February 2016 to meet the mandated level.166 Currently, state prisons are at 144% of capacity.

In response to the U.S. Supreme Court order, Governor Brown’s administration advocated for Realignment.167 Realignment would shift the burden of incarcerating those convicted of “non-serious, non-violent, and non-sexual” crimes from state prisons to county jails. The intent would be to reduce overcrowding in state facilities and to adhere to the court-ordered mandate. To account for the added responsibility of housing and supervising additional offenders, counties receive state funds – $6 billion thus far.168

Not all counties receive the same funding per additional inmate they take from the state. For example, Alpine County will receive over $42,000 per inmate while San Bernardino County will receive less than $6,000 under the AB 109 Funding Plan for 2011-2012.169 Housing prisoners in county jails (which are cheaper to maintain and operate) is estimated to cost about half the amount that state prison sentences would cost.170

Realignment also includes a focus on reducing recidivism during the population transfer from prisons to jails. The state has assigned approximately $2,275 per prisoner for treatment and rehabilitation.171 Furthermore, housing inmates closer to their homes is intended to aid rehabilitation because it will keep them closer to nearby friends and family in preparation for release.

Criticism and Potential Threat to California’s Future

In December of 2013, the Public Policy Institute of California (PPIC) released a report stating that Realignment was responsible for an increase in *certain types of crime* between 2011 and 2012. During that time, auto theft grew the
largest amount, 14.8% year-over-year. The report suggests that spending funds on policing rather than incarceration would be a more effective use of tax-payer funds to lower crime.

The notion that the shift in incarceration policy is jeopardizing public safety and justice in exchange for funding is widespread among the public and experts. Organizations such as the Criminal Justice League Foundation (CJLF) noted increases in violent crime rates (California vs. nationally) that warrant closer study with regard to Realignment. CJLF further contends that practices that stem from Realignment make Californians less safe.

If California decides to take a more pro-rehabilitation approach, there are other ways to reduce recidivism that the state simply has not pursued as aggressively. For example, an initiative known as Prison University, which educates inmates, boasted a 5.4% recidivism rate compared to a 21.2% rate for prisoners of similar offense, demographics, and educational attainment. Overall recidivism rates (for all felons) was found to be 63.7% in 2012. Instead of releasing prisoners early or transferring them to county jails, it may be possible to devote funds to prisoner education to reduce spending down the road.

Conclusion

Realignment is a costly program that aims to lower state prison population, which could lower long-term costs. Should it fail, it would be seen as a poor policy decision that adversely affected the safety of tens of millions of people. Despite criticism and a one-year crime increase, Realignment's long-term impact on crime is unknown. Due to the Department of Corrections and Rehabilitation's size, changes made will not be immediately apparent. Looking forward, Californians must be proactive watching out for signs of Realignment's success or failure: Our safety depends on it.

Joan Petersilia
Faculty Co-Director, Stanford Criminal Justice Center

"Taxpayers should demand a full accounting – and a statistical model that keeps track of the costs. In theory, realignment has the potential to be very positive for California."
Many economic indicators suggest that California's economy is emerging from the most recent recession. For instance, the state has over one million new jobs since June 2009. In addition, California's Gross Domestic Product (GDP) – the monetary value of goods and services produced in the state – grew 3.5% in 2012, the nation's fifth highest growth rate.\(^{175}\)

On the other hand, while unemployment and underemployment rates are generally declining, they remain persistently high relative to the nation overall. Further, economic growth has been uneven across the state, with particularly large gaps between the coastal and inland areas. For example, Marin County's (coastal) unemployment rate is 3.9% while Imperial County's (inland) unemployment rate is 21.6% (the state's highest).\(^{176}\) While recent trends suggest positive economic growth, California's struggling labor market and uneven economic growth indicate that the economy has a long way to go before it is healthy and stable.

Policies that attract businesses to the state, stimulate job growth, and enable full-time employment are key in facilitating California's recovery. For example, the new California Competes credit program could incentivize businesses to locate and grow in California. In fact, the demand for the tax credits under the first round of this program has outpaced supply showing that the program has been rather successful at incentivizing companies to seek expansion opportunities in California. Job seekers on the other hand, can receive assistance and resources from the job centers throughout the state.\(^{178}\)

Experts believe that a core reason behind California's high unemployment levels is the existing "skills gap." Thus policies that help build a strong, skilled workforce are crucial to help California's economic well-being. The state, in return, could potentially benefit from higher tax revenues and less dependency on government assistance.\(^{179}\)

**Employment Growth & Industry Patterns**

Both California and the nation had positive employment growth in 2013. Figure 9a shows California's progress towards regaining the jobs it lost during the recession. The general employment level seems to have reached its pre-recession level. However, the state has also gained about two million more
residents adding more than half a million to the labor force, meaning its persistently high unemployment rates may partly be due to its fast-growing population. Other factors such as mismatches in the skills of workers and the state’s high rates of long-term joblessness may have added to its high levels of unemployment. Yet, as a lagging indicator, its downward slope suggests that the state’s economy has been growing. California topped other states with the greatest year-over-year jobs increase in March 2014. Still, California’s fast-growing population and overall economy require policies that incentivize businesses to locate or expand in California.

Among all sectors, California has lost the most jobs in the construction industry since December 2007 (Figure 9b). Despite the losses, construction employment grew about 8%, making the industry one of the state’s fastest growing in the last year (Figure 9c). On the other hand, manufacturing employment has been declining for decades and accounted for only 8% of the state’s employment in January 2014. Services and other sectors are expected to grow over the next decade but manufacturing is likely to remain stagnant. Moreover, if the state’s current drought conditions persist, it could reduce employment by a small margin in the coming years and further diminish the manufacturing and fishing industries.181

[Figure 9b: Total CA Job Growth by Sector]

[Figure 9c: CA Job Growth 2012-13]
Unemployment & Underemployment

As of April 2014, the state’s unemployment rate is 7.8%, compared to 6.3% nationally. California’s unemployment rate has been higher than the national rate for more than 20 years (Figure 9d). High unemployment could lead to greater poverty, lower living standards, as well as other social costs such as more crime. Additionally, it could require greater spending on government assistance.

Although California’s unemployment rate has declined, long-term unemployment remains high. In December 2012, 41% of unemployed Californians were “long-term unemployed” (Figure 9e). According to a recent Brookings Institute report, only about 11% of the long-term unemployed will ultimately find steady work. The long-term unemployed face issues such as skill erosion, reduced industry knowledge, and in some cases, potential stigmas associated with lengthy unemployment.182

Long-Term Unemployed:

According to the Bureau of Labor Statistics, the long-term unemployed are those who have been jobless for 27 weeks or more.
Further, it is important to note that the official unemployment measure counts only those jobless individuals who report actively looking for work in the four weeks prior to being surveyed as “unemployed.” The “underemployment” measure, on the other hand, includes part-time workers and jobless individuals who have stopped searching for work. As shown in Figure 9f, the underemployment rate has declined by 2.8 percentage points in 2012 since its 22.1% peak in 2010. As a lagging indicator its downward trend may suggest an improving economy. However, California’s underemployment remains more extensive than the nation’s overall.

Although California’s economy has been growing following the recent recession, its labor market remains weak. Nearly 1.5 million Californians remain unemployed and more than 3 million are considered underemployed.

Uneven Growth

In addition to unemployment and GDP growth, we should also assess California’s economic outcomes for citizens statewide and across a wide range of household incomes. Economic recovery has not been uniform. Due to regional differences in industry makeup and population growth, post-recession California is a tale of two economies. According to the UCLA Anderson Forecast report, an “east-west” divide in California’s economy occurs between both coastal and inland areas. For instance, employment growth in the Bay Area has outpaced that of more inland areas; even within the Bay Area, job growth in the East Bay has lagged behind the rest of the region.

Job growth tends to be higher and working age population growth tends to be slower in the coastal regions stretching from Marin County to San Diego. This helps the coastal regions to replace a greater proportion of lost jobs, have a higher median household income and grow much faster than the inland regions. Essentially, inland regions tend to have a potential labor force that are growing faster than the number of available jobs. As a result, they struggle with higher unemployment and poverty rates (Figure 9g). Thus wealth and prosperity mainly benefit those living in coastal areas and leave the fast-growing inland populations to struggle harder. Consequently, the inland
counties also have a higher number of people who receive public assistance compared to coastal counties (Figure 9g).

The state’s coastal regions mainly focus on high-wage technology and tourism sectors, industries that have comprised much of California’s job growth. The inland regions of the state on the other hand have depended largely on sectors that took the greatest hit during the last recession, such as construction. Recent data indicates that the construction industry is regaining its strength, but it is unclear how long it will take for inland California to fully recover.189

Conclusion

California’s economy is finally in the process of recovering since the recent recession. Job growth has been rising gradually and some industry sectors have been expanding. However, the state’s labor market remains in crisis due to high long-term unemployment and underemployment rates. Also, California’s recovery has not been uniform across the state: Coastal regions have greater job growth than the inland regions. However, the inland region’s working-age population growth tends to be higher, meaning that inland regions tend to have a potential labor force that are growing faster than the number of available jobs. Therefore, policies that attract businesses to the state, stimulate job growth, and enable full-time employment are essential. In return, California may potentially benefit from a broader tax base and citizens from greater financial stability.190

Jerry Nickelsburg
Senior Economist with the UCLA Anderson Forecast

"The California economy is growing unevenly. But it continues to grow."
Figure 9g: Economic Indicators by County

Map showing the percentage of population receiving CalWORKs 2013 and the percentage of population living below the poverty level 2010-2012 (3-Year Estimate) by county in California.
The most vibrant societies exist, in part, because their citizens *ensure* that they can thrive. Invested citizens express opinions, ask questions, consider the future, decry misdeeds, and call for corrections. Healthy governments should enable their citizens to participate by providing clear pathways to information, and being responsive to citizens' opinions and questions. Last but not least, governments should be composed of honest and accountable officials. These are incredibly basic tenants of good governance, but yet, it is clear that California and many of its localities fail to adhere to them at even the most basic levels.

California's larger political system is wrought with inefficiencies that prevent citizens from accessing information they need to engage. Dejected and subordinated, citizens buy into the idea that they have no sense of duty to participate in political activities, which only reinforces their limited capacity to do so. The cycle of civic disengagement is a vicious one.

The state's political system is absolutely dominated by special interest lobbyists and institutional political big spenders. Average citizens take a backseat to special interest groups such as public employee unions, corporations, and Native American tribes use outsized political spending to exert undue influence on the outcomes of elections and legislative priorities. That imbalance leaves the governance system vulnerable to illegal corruption, technically legal abuses, and misdirected policy priorities. Simply put, California's political status quo does almost nothing substantial for the vast majority of its key stakeholders – average citizens.

After the system discounts their importance time and time again, it is no wonder that Californians have chosen to disengage from the system. Today, they vote rarely and are typically armed with little information. They report little interest in state policy issues and, moreover, little sense of duty to take an interest. Even in their own local communities, Californians volunteer less than they once did, indicating a sense of disengagement with the systems and people closest to them.

**Low Transparency Limits Information**

Governmental transparency is fundamental to democracy. Transparency in government facilitates civic engagement and allows the general public to make better informed decisions. In a perfect world, governments would make all public documents and information easily accessible. However, in California, this is clearly not the case. Several studies and a plethora of anecdotal evidence rank California and many of its cities near the nation's bottom in terms of transparency (Table 10a). For example, in a United States Public Interest Research Group study, California received an 'F' grade for its online accessibility to state spending data. California's ‘34/100’ score is the nation's worst.
Additionally, the Sunlight Foundation has given California a ‘D’ grade for their availability of state legislature data. This creates enormous barriers for everyday citizens to simply check where their tax dollars are being spent and how their votes are panning out.

Table 10a: California Ranking on Transparency Measures:

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<tr>
<th>Source</th>
<th>Measure</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States Public Interest Research Group (U.S. PIRG)</td>
<td>Online Access to State Government Spending Data</td>
<td>34/100, F</td>
</tr>
<tr>
<td>United States Public Interest Research Group (U.S. PIRG)</td>
<td>Online Access to City Government Spending Data (Large Cities)</td>
<td>San Francisco: 90/100, A-</td>
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<tr>
<td></td>
<td></td>
<td>San Diego: 69/100, C-</td>
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<td></td>
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<td>Riverside: 54/100, D-</td>
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<tr>
<td></td>
<td></td>
<td>Sacramento: 44/100, F</td>
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<tr>
<td>The Center for Public Integrity</td>
<td>Public Access to Information</td>
<td>D-</td>
</tr>
<tr>
<td>The Sunlight Foundation</td>
<td>Availability of State Legislature Data</td>
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</table>

The California Public Records Act (PRA) grants the public the right to request specific information from public entities. However, the public records request process still needs improvement. Rather than encourage governments to actively volunteer critical information, it places the burden on citizens to seek it. Further, making and fulfilling requests can be timely and expensive, especially when governments duplicate efforts to provide the same information to multiple requesters. Many documents, some only a few years old, are not made available electronically, and those who request them must pay hefty fees. But even then, only those with inside knowledge know which documents to request and how to request them.

Greater transparency and an improved public records request process would allow the public to better hold officials accountable and assess government effectiveness. While not perfect, the PRA has still been critical in revealing official misconduct and mismanagement. For example, a citizen’s public records request for his city administrators’ and councilmembers’ salaries revealed a major financial corruption scheme in Bell, California (2010). Without access to the public records through the PRA, it is likely that those city officials would have continued with their illegal abuses as they had for multiple years.
Interest Groups Dominate

Small numbers of influential groups of lobbyists and interest groups often guide the passage of legislation without significant voter input. The Public Policy Institute of California found that 70% of Californians believed that the state government ran to serve “a few big interests.” Within the legislative system, lobbyists have earned the nickname “The Third House” due to their substantial political clout.

Lobbying and donations are avenues for individuals and groups to provide support to public officials, inform public officials on issues, and express their opinions. However, the process can certainly be abused. At its worst, this system allows only select prominent political lobbyists and donors to gain access to the legislative process. This can occur through the creation of personal relationships with lawmakers, lavish gift-giving, and sometimes by allowing special interests to author legislation itself.

Despite significant legislation to regulate interest spending, groups and individuals spent $300 million dollars on lobbying in 2013, the most in California’s history. Between 2000 and 2009, the Top 15 spending special interest groups spent more than a billion dollars lobbying the California State Legislature. Such spending can inhibit much needed reforms at the state and local level. As stated in the “Big Money Talks” report from the California Fair Political Practices Commission, “California's Top 15 special interest groups often win by spending money to defeat ballot measures – which has the effect of maintaining the status quo.”

Corruption and Public Distrust

Public corruption involves abuses of the public’s trust by governmental officials. Examples of public corruption include bribery, extortion, or fraud. In California, there have been 2,345 federal public corruption convictions between 1976 and 2010 (average of 65 a year). This is the second highest total in the U.S (9th highest on a per capita basis). More than half of these corruption convictions are from the Los Angeles region, which alone had 1,275 convictions over the time span.
In the last couple years, public corruption has emerged as a key topic in California news and discussions. This is in large part due to the recent indictments of State Senator Ronald Calderon and State Senator Leland Yee and the conviction of State Senator Rodrick Wright. Sen. Calderon was indicted for accepting bribes from an undercover FBI agent and Sen. Yee was also indicted for bribery, as well as gun trafficking. Sen. Wright was convicted of voter fraud.

Instances of public corruption can severely diminish public trust. Immediately following the news of Sen. Yee’s arrest, The Field Poll found that the state Legislature’s voter approval rating dropped 3% and the disapproval rating increased 6%. A 2014 Edelman Communications study found that only 28% of Californians trust the state government.

What’s worse is that instances of public corruption may actually be cultivating generations that hold low levels of trust for government officials. In a 2014 USC Dornsife and Los Angeles Times poll, it was found that millennials (age 18-34) were more likely to be ‘not surprised’ about public corruption than seniors were.

Such widespread distrust reflects dissatisfaction with the state’s political and governance systems, but it also increases the likelihood of reduced interest and willingness to participate in those systems. For example, it has been found that rising political corruption is related to lower to voter turnout.

Declining Voter Turnout

Voter participation is a key indicator of the democratic health of a political institution. Voting is perhaps the biggest tenant of political participation. However, in recent years, California’s voter turnout has been declining. Among eligible California voters, participation in statewide general elections has declined from a peak of 78% in 1940 to a mere 55% in 2012 (Table 10b). Voter turnout appears to be worse among the state’s youth. In the 2012 general election, only about 33% of eligible young adults (18-24 years old) voted.

Similar trends also exist at the local level. For example, Los Angeles only had a 23.3% turnout for its mayoral election in 2013. This is significantly lower than the 76% turnout for the 1969 Los Angeles mayoral election.
research shows that low voter turnout rates may not have substantial impacts on election results at the national level, they appear to have their greatest impact at local level. But regardless, low levels of voter turnout are indicative of low levels of civic engagement.

There are multiple reasons that may explain why Californians do not vote. As stated earlier, Californian’s hold low levels of trust for state lawmakers. Californians may have become disenchanted with the voting process itself and no longer view it as a priority.

There are also significant barriers, both language differences and access to information deficiencies, which make it difficult for Californians to actually make well-informed decisions. When surveyed, most Californians express support for establishing an independent citizens’ commission that would hold public hearings and make recommendations on the official voter guide. The access to information barrier is highlighted by the following: In the 2014 primary election, approximately 300,000 Californian’s still voted for State Senator Leyland Yee after he was indicted for bribery and gun trafficking.

**Conclusion**

Today, Californians are less likely to engage in their state and local government. They distrust their political leaders, vote much less than they once did, and simply do not have sufficient resources to become well-informed. As the state’s opaque system obscures actions by departments and public officials, it worsens its already poor record with public transparency and breeds an atmosphere that is susceptible to corruption. Unfortunately, those walls that keep out the public and prevent accountability are the same walls that reinforce citizens’ beliefs that they are helpless in efforts to rectify the system.
Conclusion

California faces a number of key challenges that are all rooted in levels of unsustainability, inadequacy, uncertainty, and continued inaction. If left alone, these issues will continue to worsen and have detrimental impacts on future generations. The issues presented in this report, while unique in their own right, are all interrelated.

On the financial side, California will see its budget increasingly dominated by rising healthcare costs, retirement benefit costs, and debt service payments. These rising costs, coupled with volatile and unstable revenues, will result in less funding for California's schools and many essential public services.

State resources and infrastructures will become increasingly strained by a growing and aging population. However, even today, California's water infrastructure is inadequate, its prisons are overcrowded, and the implementation of its largest transportation project is unstable.

California citizens and state lawmakers will meet difficult decisions ahead. These decisions will shape future budgets, future infrastructure, and the quality of lives for generations to come. But today, citizens and state lawmakers are ill-equipped to meet the challenges facing them. Californians do not trust their state leaders, vote much less than they once did, and lack access to necessary information. Lawmakers operate amidst corruption and have delayed taking action on key issues for far too long.

To correct California's unsustainable course, the state requires informed citizens and leaders willing to tackle the state's budget and infrastructure realities. We must end the cycle of neglect, ignorance, and postponement. Unless we end the cycle, we leave these costly problems for future Californians to inherit. We must act today to save the future of California, whose shine is not as 'golden' as it once was.
1 California Department of Water Resources. “Driest Year on Record?” http://www.water.ca.gov/waterconditions/.
3 Data comes from the United States Geological Survey Water Use Data for California.


http://www.ppic.org/content/pubs/report/R_211EHR.pdf.


35 “Governor’s Budget Summary, 2014-15.” Page 1, 16.
41 Ibid, Page 9.
43 Ibid, Page 3.
50 These values from the 2007 and 2013 Actuarial valuations for each retirement benefit plan. These documents are available on each system’s website. The 2013 unfunded liability for the State Employee Pension Plan (CalPERS) comes from the Legislative Analyst’s Office, who have more recent values than the most recent CalPERS actuarial report. The data for Trial Courts comes from California’s 2013 Comprehensive Annual Financial Report. The California Legislative Analyst’s Office. “Addressing California’s Key Liabilities.” May 7, 2014. Page 19. http://www.lao.ca.gov/reports/2014/finance/liabilities/addressing-california-key-liabilities-050714.pdf.
52 For example, see the following report about the City of Stockton.


53 These are the current assumed rates of return for UC Pensions, CalSTRS and CalPERS. Note that CalPERS and CalSTRS have lowered their return assumption in recent years.


55 For example, the California Employees Retirement System (CalPERS) and the California State Teachers’ Retirement System (CalSTRS) lost over one-quarter of their assets in 2009.


57 The resulting unfunded liability must be amortized with interest equal to the assumed rate of return.


61 This value comes from subtracting the unfunded liabilities today minus the unfunded liabilities under the 1990 benefit structure, as calculated by Milliman, CalSTRS’s consulting actuary.


67 Missed Payments are classified as the ARC minus Actual Contributions. Values were obtained from the Comprehensive Annual Financial Reports and Actuarial Valuations for each pension system. Does not include missed payments for Judge’s Pensions or trial court retiree healthcare.
69 Ibid
72 AB 340 will lower the normal costs for new employees, which technically will lower current costs. But these savings will be minimal for several years. The full impact of AB 340 will not be realized for decades.
79 This estimate comes from extrapolating state spending data from 2009 to 2013 using the National Health Expenditure Projections (2012-2022) from the Centers for Medicare and Medicaid Services (CMS). Extrapolations were done for each type of spending (ie hospital, dental, home health) in order to make the estimate more California specific. Official CMS estimates for state-by-state health spending data were only available up until 2009 at the time of this report.
80 California GDP only available up until 2012.
Department of Finance. California State Gross Domestic Product (GDP), 1963 to 2012.


83 Ibid, Centers for Medicare and Medicaid Services.

84 Author’s calculations. According to the Bureau of Labor Statistics Consumer Expenditure Survey 1984-2012, healthcare costs are the third fastest growing portion of household spending.


93 Ibid, the California Department of Finance. Schedule 9-Comparative Statement of Expenditures. 2005-06 to 2014-15. Note that 2015 values come from the proposed budget. Medi-Cal are even higher in the May Revision.


100 Note that not all of these individuals were previously uninsured.
U.S. Department of Health and Human Services. Profile of Affordable Care Act Covered Expansion Enrollment for Medicaid / CHIP and the Health Insurance Marketplace from 10-1-2013 to 3-31-2014; California.

http://www.chcf.org/~media/MEDIA%20LIBRARY%20Files/PDF/PDF%20FewerAndMoreSpecializedMDSupplyInICA.pdf.

102 However, the study did find there to be a significantly higher number of specialists throughout the state. Overall, the state met the recommended range of 85 to 105 specialists per 100k people, with the state having 115.


http://kff.org/medicaid/state-indicator/medicaid-payments-per-enrollee/.


http://www.ppic.org/content/pubs/survey/S_413MBS.pdf.

110 National Center for Education Statistics. Selected Statistics from the Common Core of Data: School Year 2011-12. Table 2.

111 National Center for Education Statistics. Table 204.20. Number and percentage of public school students participating in programs for English language learners, by state: Selected years, 2002-03 through 2011-12.


http://www.census.gov/ poate/data/state/totals/2012/.
National Center for Education Statistics. Selected Statistics from the Common Core of Data: School Year 2011-12. Table 2.


121 Other includes uncategorized revenue. Note that this data is not directly comparable to the revenue data from the National Education Center.


Note that state measures of per-pupil funds do not directly agree with those obtained from the National Center of Education statistics and the National Education Association, due to methodology differences. For comparison of these methodologies, please consult the following:


152 Offender Information Reports.


160 Table 7, 2012 Outcome Evaluation Report.

162 Taken and consolidated from 'Average Daily Prison Population' reports, produced by the Department of Corrections. These can be found in PDF form on the following site, by year: http://www.cdcr.ca.gov/reports_research/offender_information_services_branch/Annual/.


164 Ibid


166 ibid

167 The Cornerstone of California's Solution to Reduce Overcrowding, Costs, and Recidivism. California Dept. of Corrections and Rehabilitation. (http://www.cdcr.ca.gov/realignment/).

168 2012 Outcome Evaluation Report. CDCR.

169 Funding Public Safety Realignment. Public Policy Institute of California. Mia Bird and Joseph Hayes.

170 Rethinking the State-Local Relationship: Corrections. Public Policy Institute of California. Dean Misczynski.

171 Ibid Rethinking the State-Local Relationship: Corrections. Public Policy Institute of California. Dean Misczynski.


174 2012 Outcome Evaluation Report. CDCR.


177 Data from the California Employment Development Department.

178 California Competes Tax Credit FAQ. http://www.business.ca.gov/Portals/0/CA%20Competes/Docs/California%20Competes%20Tax%20Credit%20FAQ.pdf.


183 Author's calculations using the California Employment Development Department data.


186 Author's calculations using the United States Census Bureau, American Factfinder.


Grey counties indicate missing data. Kern county excluded because of extreme value.
The United State Census Bureau American FactFinder; Kidsdata.org

http://www.uspirg.org/sites/pirg/files/reports/Follow%20the%20Money%202014%20US%20v2.0.pdf


http://www.stateintegrity.org/california

http://openstates.org/reportcard/

Martinez, Michael. “Former California City Manager Sentenced to 12 Years for Corruption.” CNN. April 16, 2014.

http://www.ppic.org/content/pubs/survey/S_513MBS.pdf

Sá, Karen De. “State senator aims to double lobby fee in California -- to 14 cents a day.” San Jose Mercury. December 25, 2011.


http://www.uic.edu/depts/pols/ChicagoPolitics/leadingthepack.pdf


http://www.huffingtonpost.com/2014/03/02/ron-calderon-leave_n_4887265.html


