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Edited by Daniel J.B. Mitchell

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Preface

Once again the UCLA Luskin School of Public Affairs offers *California Policy Options*, our annual collection of research and insight on the multi-faceted issues and challenges facing the State, produced together with the Ralph and Goldy Lewis Center, which advances research solutions for California's urban and regional challenges, with an emphasis on transportation, economic development and housing, and the environment.

For 2014, Professor Daniel J.B. Mitchell has collected and edited new and timely California-focused articles by Luskin and Lewis Center center-affiliated UCLA faculty and graduate students. Professor Mitchell has again contributed an original analysis of the state's budget processes and details.

As real-world exemplars of policy analysis – across academic boundaries – on issues and problems important to all of us, these research articles are made available on Luskin School and academic websites as a resource for researchers, journalists, and citizens. The publication also serves as a teaching tool, informing our students in the popular Luskin class on California policy issues co-taught each winter quarter by professors Mitchell and Michael Dukakis.

Franklin D. Gilliam, Jr.

Dean
UCLA Luskin School of Public Affairs

Introduction

Our 2014 *California Policy Options* volume can be divided into three broad sections. The first, with three chapters, reviews general economic and fiscal developments in California in the context of a general continued economic recovery from the Great Recession. The second, containing two chapters, deals with some special issues in the education sector that have tended to receive less attention than the tradition focus on budgets and student achievement. Finally, we look at some issues related to local urban and regional affairs in the third group of four chapters.

Jordan G. Levine and Christopher Thornberg provide a broad overview of the state's economic trends. California's economy reflects the wider national economy whose advance has been hindered by gridlock and dysfunction in Washington. Housing and related financial practices were the root causes of the Great Recession and are largely national matters when it comes to regulation. But unfortunately, the dysfunction in Washington means that needed reforms are slow to develop. Nonetheless, California has bucked the national headwinds and, by some measures, is recovering faster than the rest of the U.S. The high cost of housing in the state, however, is flagged by the authors as a longer-term issue of concern. At the moment, thanks to the housing bust in prices, affordability is much less of a retardant to employment growth than it was at the peak before the 2008 downturn. But the real estate market is again advancing which is bringing up prices.

In their chapter, Paul M. Ong, Chhandara Pech, and Deirdre Pfeiffer focus specifically on the housing market and on the causes of the wave of foreclosures in the Los Angeles area in the aftermath of the Great Recession. The foreclosure wave did not hit all groups equally. Minority homeowners felt more pain than others. Foreclosures especially involved relatively recent home purchases, often financed through risky and shaky lending practices. LA was disproportionately hard hit by the foreclosure crisis compared with the U.S. as a whole, but much of the reform policies needed would have to come from Washington. Ong, Pech, and Pfeiffer are thus in accord with Levine and Thornberg that policies that would prevent a repeat of the 2008 bust have yet to be put in place.

The improved economic outlook in California reflects itself in tax receipts. Daniel J.B. Mitchell notes that the improved budget situation in the state which was aided in addition by voter enactment of Proposition 30 in 2012. Prop 30 raised income and sales tax rates on a temporary basis. Mitchell traces California's budget history since the 1930s, including the period when Jerry Brown had his first iteration as governor. In his second iteration, after being elected in 2010, Brown inherited both a short term and a structural budget deficit and crisis from predecessor Arnold Schwarzenegger. Ultimately, Brown went the initiative route, putting the above-mentioned Prop 30 on the ballot. Although it was not clear that they would do so, voters ultimately approved the proposition.

Since Prop 30 was adopted, Brown has tended to position himself as a budgetary gatekeeper, the adult in the room holding back spending. But in contrast with his earlier iteration as governor, Brown now favors potentially expensive infrastructure, notably high speed rail and a major water project. The outlook for these projects is uncertain. Meanwhile the budget's brightened outlook depends critically on continued economic recovery.

"Transparency" nowadays is often seen as an unmitigated Good Thing, particularly in the public sector. In recent years, emails and other communications among faculty and researchers at public universities have been targeted by public records requests, particularly in instances where the requester didn't like conclusions that were reached or the opinions held. The senders and receivers of such messages might have assumed their communications were private, but that is often not the case (although in similar private universities they would be). Stan Paul examines a request for such communications in a politicized controversy regarding a ballot proposition and researchers at the University of California, Davis. In that particular case, proponents of the proposition disliked the conclusions of a study on the potential economic effects of the initiative and sought all internal documents related to the study. The court involved eventually concluded that the researchers' ability to communicate freely (and confidentially) outweighed the possible public interest in access to such communications. However, the position of the court – that each case is different and that the competing interests must be balanced – has left the issue in a state of uncertainty in public higher education.

There has been much concern in recent years about childhood obesity and its potential long-term effects on health. As a result, the possibility of using the K-12 school system to combat obesity has been considered. Sometimes such efforts take the form of changing food offerings at school. Another possibility, however, is burning up extra calories through physical education. Jessica Padilla, Asma Men, Erin Steva, and Kenechukwu Ojukwu consider such a possibility in a study conducted for the Los Angeles County Department of Public Health in selected schools in the Los Angeles Unified School District. The authors found that just burning calories through exercise was unlikely to produce significant weight loss. Schools generally follow rules regarding time spent in physical education so there was not much scope for adding more exercise time. There are long-term benefits from exercise, however, so encouraging exercise as a habit might have benefits apart from the original goal of reduced weight.

As noted earlier, Governor Jerry Brown has been promoting a north-south high speed rail system for California. However, the proposal faces considerable political resistance and funding uncertainty. Its business plan and assumed passenger revenue have been challenged. However, Jerry Nickelsburg sees a possible solution involving a relatively minor re-routing of the proposed rail line. For many years, the airport in Palmdale has either been little used or entirely closed due to lack of commercial interest by airlines. A major problem is that the local population cannot support a major airport and there is no easy way for potential air passengers from more populated areas to get to and from Palmdale. Nickelsburg suggests that if the proposed high speed rail diverted into the airport, the airport would be viable with fast connections to major population centers in both southern California and the Bay Area. The passenger traffic revenue generated by the airport connection would also make the rail line viable.

Transportation by car inevitably involves parking. Donald Shoup outlines the problems posed by illegal "apron" parking in the neighborhoods around UCLA (cars which project over the sidewalk) and the excess demand for free (unpriced) parking in the area. He notes that there are market solutions involving fees for permit parking and the use of shared cars. A market approach could generate revenue that could be used for neighborhood enhancement. While resistance to change is inevitable, parking on sidewalks violates federal disability law and ultimately must be discontinued.

Cities and states often see great value in attracting movie and TV production to their locales. But as Patrick Adler points out, there are other forms of entertainment that are often neglected, notably music. The music industry is under strain, as the Internet has changed access to, and distribution of, recorded music. However, there remains a market for live music and music festivals. And there is the potential for local economic gain from hosting such activities. Local festivals tend to encourage and boost local talent and thus the economic development of the local music industry. But as Adler also points out, there are cost externalities of such festivals in terms of policing and public services. In some cases – such as Coachella near Los Angeles – the immediate localities that carry the cost do not reap the benefits which go to a more distant location.

Local governments can find themselves under pressure to improve their "business climates." The threat is that businesses will leave or not enter their jurisdictions if the climate is poor. As William Parent points out, individuals and groups often begin ideologically to define business climate and what attracts and retains business. Parent examines a case in which two groups in California on the opposite end of the ideological divide agreed to examine the climate issue analytically. What was found didn't fit the usual notion that low taxes and little regulation were the keys to a good business-attracting and business-retaining climate. Most of the action in the local labor market does not involve entrance and exit of businesses.

The areas within LA that seemed to be growing both jobs and high wages were those with higher taxes and reputations for difficult regulatory hurdles. Areas doing poorly often used tax incentives to try and pull in jobs. It appears that business-attractive areas experience an enhanced tax base as economic activity increases. The result is more demand for services and picky upper- end residents with environmental concerns. At the end of the day, however, the report produced for legislative consumption tended to ignore such controversial empirical observations. The interface between policy analysis and the politics of policy making is often imperfect, as this case study demonstrates.

Daniel J.B. Mitchell

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CHAPTER 1

California's Economic Outlook

Jordan G. Levine

Christopher Thornberg

Jordan G. Levine is Director of Economic Research of Beacon Economics.
Christopher Thornberg is Founding Partner of Beacon Economics.

This chapter was written in late October 2013
and reflects information available to that point.

We have met the enemy and he is us.

Oft-cited "Pogo" comic strip quotation

The California economy ultimately is tightly linked to U.S. economic trends. At one level, we might be able to take some comfort in the remarkable ability of a comic strip character to describe the current path of the U.S. economy. On another level, it is very frustrating to realize that the massive advances in our understanding of the inner workings of the U.S. economy remain very far removed from the political debates in Washington, D.C. It becomes positively maddening when this ignorance is allowed to have negative consequences for an economy that is still struggling to throw off the last recession.

Yet policy dysfunction is exactly what has been happening over the course of the last few years, with actions in Washington serving to further slow an already tepid recovery. As this chapter was being completed, the federal government shut down, caused by an inability to pass a budget, finally ended as the debt-ceiling limit rapidly approached. As the political pressure grew, those who had been blocking any reasonable compromise were forced to back off their positions. Thankfully, cooler heads prevailed and a deal was reached before the standoff led to broad negative economic consequences. But the fact that it happened at all will continue to keep investors fearful and consumers doubtful, in addition to leading many in the rest of the world to wonder just what is going on in our nation. And in the meantime, the United States continues its sluggish recovery.

The fundamentals of the U.S. economy have certainly improved since the bottom of the Great Recession. There is plenty of opportunity for growth, and we have the ability to address the long-term structural challenges and throw off the remaining effects of the downturn. But these challenges can only be met if our elected congressional leaders start doing the things they should be doing and stop doing the things they shouldn't.

Moving Slowly Ahead

There is little doubt that the recovery from the Great Recession has been slow, owing in part to the numerous severe shocks that hit the economy: the housing crisis, the financial meltdown on Wall Street, the dire fiscal issues for numerous state and local governments including California's, and the decline in household wealth. Since the recession came to an end in mid-2009, the economy has also had to grapple with the negative economic impact of the military drawdown from two foreign wars, a European recession, and the longer-term impact of the structural changes of the information technology revolution.

Despite the negatives, our national economy has pushed forward, showing the underlying resilience of the U.S. system. Private-sector demand has grown at a reasonable annual pace since the recession ended in 2009 — the reason for slower overall growth rates has been the ongoing pull back in public spending. Some of the countervailing steadiness of the economy comes from consumers. Spending growth started to bounce back from the sharp tax impact of the end of temporary reductions in payroll taxes that slowed things down in early 2013. Part of the steadiness in the economy is due to a vastly improved financial situation relative to the bottom of the Great Recession. Rates of saving are still too low from a long-term standpoint, but this issue should become an important policy priority only when the Great Recession is well behind us.

Labor Market Improvements

U.S. labor markets are improving. Unemployment has been falling and there has been job opportunity, particularly for high-skilled workers. The gains are now starting to shift down the skill ladder. While the number of long-term unemployed job seekers (those persons without a job for more than a year) remains high, it also has started to fall. Over the course of 2012-2013, the number of people who gave up looking for a job, but who still wanted one, has also fallen.

Improvements in the Housing Sector

There have been some signs that other mid-term problems in the economy might be starting to turn the corner as well. The housing market has clearly been in recovery mode. Home prices have risen significantly. Foreclosures are down sharply and, by our calculations, the number of owner-occupied units began to rise for the first time since the wave of foreclosures started back in early 2007.

Federal Reserve Policy

Despite criticisms**,** the Federal Reserve seems to be managing the money supply just fine. It will need to address the challenge of unwinding quantitative easing – its substantial accumulation of assets – at some point in the future. But growth in consumer prices has remained around or below the Fed's inflation targets, and the chance of excessive inflation is currently zero since most of the cash injected into the system still sits in the banks in the form of excess reserves. Once you remove this liquidity from the equation, it looks as though the growth in the money supply is well within normal levels. And with bank lending activity still very weak, inflationary pressures are contained.

While some observers have forecast that long-term interest rates will bounce back up sharply after the end of the Fed's stimulatory programs, we don't think so. After all, most of the declines in rates occurred prior to the recession as a result of what outgoing Fed chair Ben Bernanke has termed the "global savings glut." There is still plenty of liquidity in the world markets relative to the demand for capital. We expect reasonably low interest rates to be with us for some time.

Good News and Bad News

There is additional positive news from abroad. Problems outside of the United States seem to be waning. Europe appears to be pulling out of its downturn. There are signs of modest growth acceleration in China and Japan as well, which would bode well for U.S. exports. In short, there are plenty of reasons to look for better times both at home and abroad.

However, despite all the good news, consumers are still wary of borrowing and confidence is soft. Business investment is still low despite strong profits, and housing construction is still close to rock bottom. As noted, bank lending remains flat. Why? The economy faces many challenges, to be sure, but much of the blame can be laid at the feet of the 535 people we collectively refer to as Congress. Over the past few years, much has been debated in our elected bodies. Members of Congress seem phenomenally obsessed with issues that don't mean much in the short term such as the Affordable Care Act and our short-term budget deficits. And a small group of them have managed to highjack the entire process, shutting down the government for a time in pursuit of their goals.

The chaos that has erupted probably shouldn't be much of a surprise. Gerrymandered congressional districts and changes in campaign contribution laws have created a system where extremists on both ends of the spectrum (although the problems today are coming mostly from the right) funded by a small number of deep-pocket individuals are becoming more and more prevalent in the House. The net result has been gridlock and bitter wars over unimportant issues, even while sensible policies have been completely neglected. These political battles have caused a series of negative hits to the economy that have kept it from further improving and, if continued, could even go so far as to push the economy into another recession. We are not forecasting anything so dire, but let's consider a few ways in which misplaced priorities have had a negative impact on the economy.

Inability to Address Housing and Banking Policy

We all understand that a foreclosure is tough on those being forced to move. Yet despite all of the posturing and finger-pointing, the reality remains that most foreclosures take place because the borrower can't pay back the loan. The collateralized lending system that is the backbone of the modern financial system requires that under such a circumstance the asset (the home) is to be taken over by the lender. While abuses of the system should not be tolerated, the fundamental process needs to be respected.

Of course, many of the bad loans occurred because credit standards had collapsed, allowing potential homeowners to receive loans for amounts above and beyond their ability to repay. During this time, homes sold for excessively high prices in a speculative frenzy. Ultimately, lenders and borrowers were both to blame. As for the so-called spillover effect – where foreclosures cause home prices to fall leading to more foreclosures and so on, it doesn't persist indefinitely – particularly in a world where new investors have been aggressive in buying distressed properties. Indeed the markets with quick and efficient foreclosure systems (such as California and Arizona) are past the crisis, while those with slower systems (such as Florida, New Jersey, and Nevada) are still dealing with a huge number of distressed properties.

The right wing in Congress has pushed back ferociously against any new regulations for the banking system, despite clear and growing evidence of the transgressions that played a fundamental role in the broader financial meltdown (and, in some cases, continue to go on). As such, the Dodd-Frank Act that was supposed to fix the financial system is still largely incomplete. This void is leaving many banks in a state of regulatory uncertainty, which is often worse than having either a good rule or a bad rule in place. Instead, the entire process is stuck in limbo due to the congressional stalemate.

What should have been done? A clear set of new regulations that don't demonize either side - but acknowledge lapses by both lenders and borrowers - is needed to prevent such problems in the lending markets in the future. Instead of trying to stop foreclosures, it would have been better to hasten them, while giving assistance to those residents who were pushed out to help them find new housing and clean up their credit scores. Either the barons of Wall Street need to be financially culpable for their misdeeds, or strict rules need to be put into place that prevent the problems from reoccurring, albeit with a loss of financial flexibility.

Instead, we have billions in wasted funds, have provided little or no relief in the short run for the housing market, and have retained a banking system that – surprise, surprise – isn't terribly willing to go out and lend to potential home owners. This reluctance has kept ownership rates from bouncing back. It is investors – not the middle class – who are the primary cause and beneficiaries of the bounce in housing. And lack of lending to individuals has reduced the demand for new single-family homes, contributing to the ongoing depressed state of the housing market and to the ongoing drag on the construction industry.

Misplaced Concerns

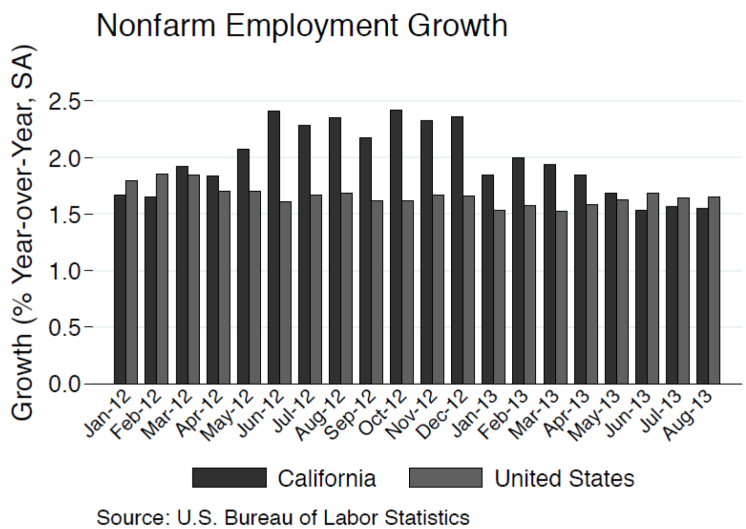
The Washington stalemate has focused on federal deficit reduction at a time when budget deficits are not the major problem facing the U.S. economy. As a result of the stalemate in late 2012, payroll taxes went up in 2013 and "sequestration" cut government spending. Both were negatives for the economy, reducing growth from what otherwise would have been possible. There are issues over the longer term to be addressed, including trimming federal social insurance programs. But these issues are not key factors now in the sluggish economy; they need to be addressed when the economy returns to a more normal condition.

Similarly, the focus on "Obamacare" – the Affordable Care Act – is misplaced. By itself, the new program has little to do with economic recovery despite the obsession of opponents. There are flaws in the program's design that will need to be addressed. In short, there is room for a deal of some type on a variety of longer-term economic issues, but the current approach of stumbling from crisis to crisis is not the way to get there.

California: Still on the Mend Despite the Federal Headwinds

California's economy continues to improve, though the pace of growth was slowed by federal policy changes during the first half of 2013. Rising taxes due to the fiscal cliff crisis and the federal spending reductions known as the sequester have meant that aggregate demand, although increasing, has not done so at the pace that would have otherwise been achieved without these drags on the economy. What is true for the U.S. economy is inevitably true for California. With the continued impact of the defense industry in the state, as well as California's reliance on consumer spending and tourism, these changes at the national level have meant that economic growth in California has yet to reach its full stride.

Figure 1



In spite of the headwinds emanating from Washington, D.C., California continues down the road to recovery. Indeed, as can be seen on Figure 1, California's employment grew faster than the nation's from spring 2012 to spring 2013. Add it all up and California has made significant progress in rebuilding its economy after the damage done by the Great Recession.

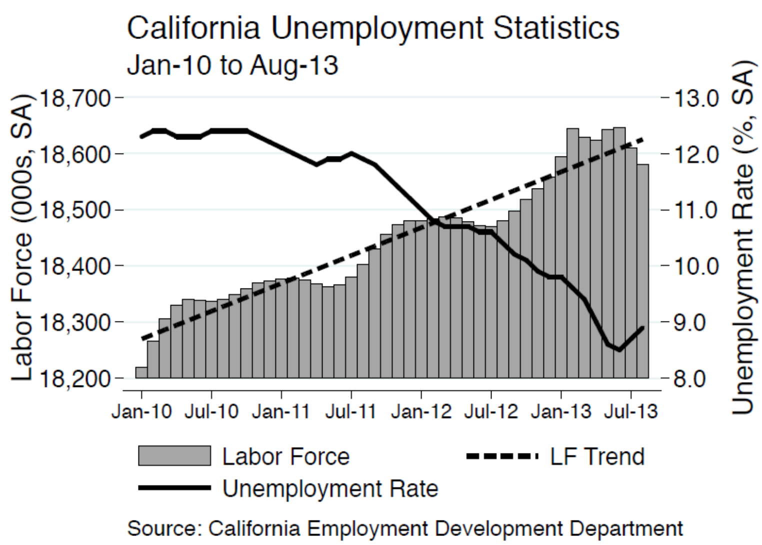
Fortunately, the employment recovery in the state remains broad-based across both sectors and regions, though certain industries and regions have fared better than others. The recovery in the housing market, in terms of prices and low inventories, has driven a consequent uptick in new permitting activity and construction. Furthermore, California remains a top tourist destination.

While tourism tends to feature lower-paying jobs, there has also been growth in sectors and occupations that are relatively high paying. Nonetheless, there are issues facing certain areas, notably manufacturing, where state regulatory policy may have led to a decline in that important sector.

However, employment growth has been found in most parts of the state although areas such as San Jose and San Francisco, with their high-tech emphasis, have been especially favored.

During 2013, the Central Coast—particularly San Luis Obispo County—has seen an acceleration in job growth driven by the booming tourism industry and by gains in agriculture. Orange County and Los Angeles likewise outpaced the state in job growth, though by a smaller margin than in the Bay Area. Bakersfield, bolstered by some new energy and infrastructure projects, has also shown solid growth. But other areas, such as the inland areas of southern California, have experienced a more subdued job market. However, even the regions that have been slower to bounce back have seen modest increases in payroll positions.

Figure 2



SA = seasonally adjusted.

Clearly, there is still room for improvement in California's economic recovery, but we believe that the state is headed in the right direction. The state has added nearly two-thirds of the jobs lost during the Great Recession, and the unemployment rate has dipped below 9% for the first time since 2009 in 2013. And, importantly, this improvement in the unemployment rate has come despite the fact that the labor force has trended upward since the end of the downturn, as can be seen on Figure 2. Virtually every major sector has begun to expand, and although some parts of the state are faring better than others, every major region is adding jobs. It's still too early to throw the car into cruise control, but we continue to progress down the road to full recovery.

Domestic Migration: A Window into California's True Enemy

California has experienced negative *domestic* migration in recent years. The increase in the number of out-migrants who used to call the Golden State home is often linked by commentators to the level of personal income taxes in California. In fact, this view was one of the main arguments against Proposition 30 of 2012, which raised the statewide income tax rate in order to help solve the state's fiscal woes.

However, data from the U.S. Census Bureau show that these fears are likely overblown. In fact, statistics on the characteristics of California's inbound and outbound migrants suggest that the patterns in domestic migration experienced over the past decade are more closely related to housing costs in the state than to our local income tax structure. As tantalizing as some of the anecdotal evidence is about how tax rates negatively impact the quality of life of high-income earners in particular, the data on individual migration reveal that the picture is much more complex than blanket statements about taxes would have you believe. While many states have seen an inflow of former California residents, California has, in turn, attracted residents from the rest of the United States. And in many cases, the residents who continue to migrate to California are the highly educated, high-income individuals that work in sectors such as information and professional services, the very sectors that have helped to drive the above-average growth that California enjoyed prior to the Great Recession.

Figure 3

California Net Migration by Destination 2007 to 2011

State	Inbound Migrants	Outbound Migrants	Net Migration
Florida	56,078	41,898	14,180
Illinois	45,055	31,347	13,708
Michigan	24,798	12,094	12,704
New York	60,518	51,963	8,555
Hawaii	27,317	23,664	3,653
New Jersey	18,824	15,271	3,553
Virginia	33,186	41,878	-8,692
North Carolina	23,541	32,499	-8,958
Utah	19,774	31,705	-11,931
Oklahoma	5,848	20,993	-15,145
Colorado	38,166	53,966	-15,800
Arizona	67,890	90,142	-22,252
Washington	57,975	81,579	-23,604
Nevada	57,931	82,456	-24,525
Oregon	35,004	63,483	-28,479
Texas	81,844	144,013	-62,169
Total	978,612	1,181,550	-202,938

Source: American Community Survey

According to the American Community Survey, California did experience negative net migration of nearly 203,000 between 2007 and 2011. That is, 203,000 more people moved out of California to other states than moved in during that period. Virtually all of that out-migration was accounted for by just nine states. Five of these (Utah, Colorado, Washington, Nevada, and Texas) have either no individual income tax or have a flat personal tax rate. Oregon has no general sales and use tax. Two of the other states, Virginia and North Carolina, are in the midst of a new energy boom thanks to the shale-gas industry. This description might seem to lend credence to the claim that we really do have a "business-killing tax regime" *if* we ended the story there.

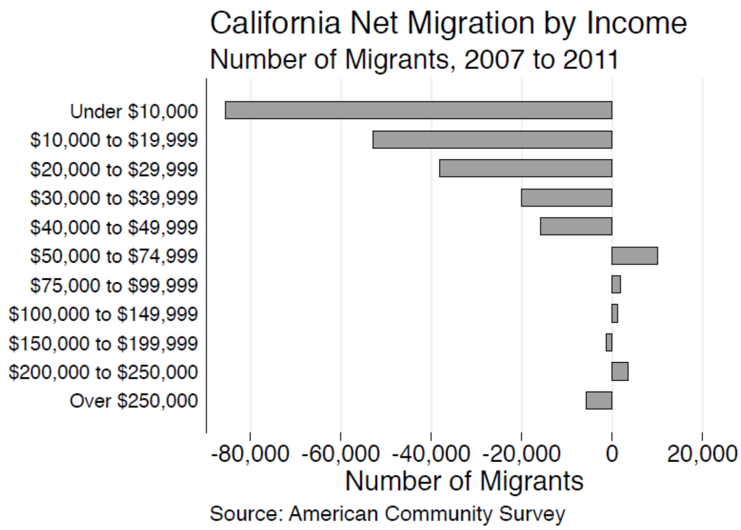
The reality is that despite out-migration to these states, California was actually a net importer of residents from more than 17 states over the same five-year period: Florida, Illinois, Michigan, New York, Hawaii, New Jersey, Connecticut, Alaska, Minnesota, Ohio, Mississippi, Pennsylvania, Missouri, Wisconsin, Maryland, West Virginia, and Alabama. Five of these states have either no personal income tax (Alaska and Florida) or have a flat personal tax rate (Michigan, Illinois, and Indiana)—so clearly taxes can't be the whole story. If so, we would see a clear delineation of out-migration to flat or no income tax states. Instead, we find that we lose people to some of these states and we also *attract* residents from other flat and no-income-tax states.

So what's going on? We know that California does have a relatively high and relatively more progressive tax rate. *But the even more fundamental variable is the cost of housing*. For years, Beacon Economics has argued that California is chronically undersupplied with respect to affordable housing. Our development and permitting processes, as well as our regulatory climate, have been keeping the new supply of housing muted. This limitation in turn has driven up the cost of housing disproportionately in California. Despite the fact that California represents more than 12% of the nation's population, the state has consistently accounted for a lower share of residential permitting for almost 20 years straight.

This fact has made it increasingly difficult for lower-income Californians to maintain their quality of life in the state. In contrast, those embarking on their careers, individuals with higher levels of educational attainment, and workers in high-wage occupations continue to find the state an attractive place to live. So who are the folks who are choosing to leave and who are moving in? If it isn't because of taxes, then why are they moving? Again, it comes down to the cost of housing.

The individuals who come to California are primarily concentrated in high-wage occupations which enable them to better absorb the high cost of living in the state. For example, over 160,000 healthcare practitioners, architects, engineers, and computer/mathematical workers moved into California between 2007 and 2011. These are all occupations in which a larger number of workers came to California than moved out of it. Conversely, workers in occupations typically associated with lower wages were some of the most prone to move out of the state, including workers in production and food preparation/serving.

Figure 4



Given that the occupations of many of the out-migrants tend to have relatively low wages (Figure 4) and that California has a relatively progressive tax system, the tax burden was less likely to affect these workers in comparison with workers in the occupations paying higher wages. Yet the lower-paid workers left in greater numbers, while California saw an influx of higher-wage workers. Indeed, breaking down the migration statistics by income bracket puts a finer point on these findings.

For example, between 0.5% and 2.0% of the population earning less than $50,000 per year migrated out of the state between 2007 and 2011, on net. In contrast, net migration was positive for all income brackets earning over $50,000 per year, with the exception of the top income bracket (0.07% of that group left the state) and folks earning between $150,000 and $200,000 (0.42% of that group left California). Indeed, the largest group of in-bound migrants, on a proportional basis, was individuals making between $200,000 and $250,000 per year.

Ultimately, the choice of where to live is a consumption choice and reflects a confluence of preference factors. Based upon the data, it appears that folks who can afford to live in California will move to the state because of all it has to offer. That tendency does not mean that we should set aside the task of making the state's business climate better through new policies and more streamlined and efficient regulations. Still, the data suggest that it might be more effective to focus on housing costs rather than on personal income tax rates.

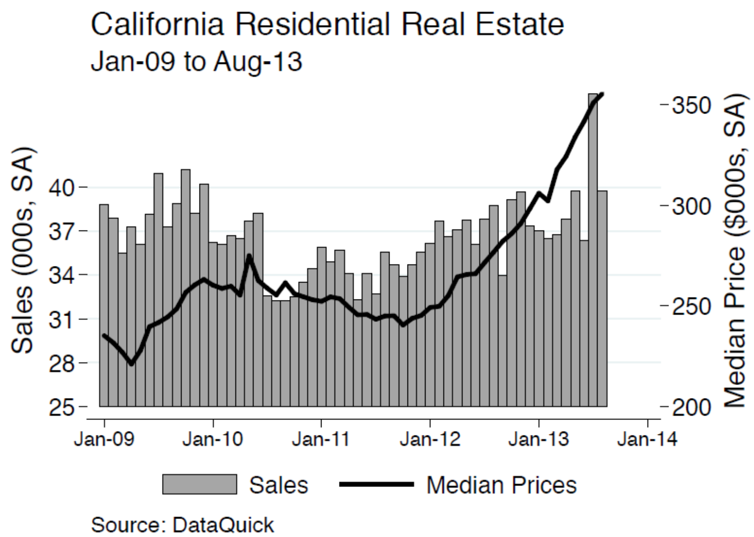
Does this migration pattern mean that California is the most "business friendly" state in the nation? Absolutely not; there are clearly some industries and occupations (such as manufacturing and construction) that are more affected by California's tax and regulatory environment than others. Rather, we are simply arguing that, as does every other state in the nation, California has its strengths and weaknesses and plenty of room for improvement. Could our permitting rules and our regulatory environment be friendlier to take on California's real enemy—the cost of housing? Without a doubt. But "business friendliness" also hinges on access to a highly skilled workforce, the ability to get your products to market both domestically and abroad, a culture of innovation and entrepreneurship, and simply having an idyllic climate and being a place where people still want to live from a quality of life standpoint. These attributes are all areas where California still ranks high on the list.

California Real Estate Revved-Up

Despite the chronic undersupply of housing, and perhaps, at least in part, because of it, the residential real estate market has come back strongly in California. The median price of a home sold in California started off the year posting over 20% growth on a year-over-year basis. By August 2013, as shown on Figure 5, the median sales price of a California home had risen to over $355,000 on a seasonally-adjusted basis. That number was still more than 27% below the pre-recession peak of almost $490,000, but it represented a 60% increase over the April 2009 trough of just $221,000.[*]

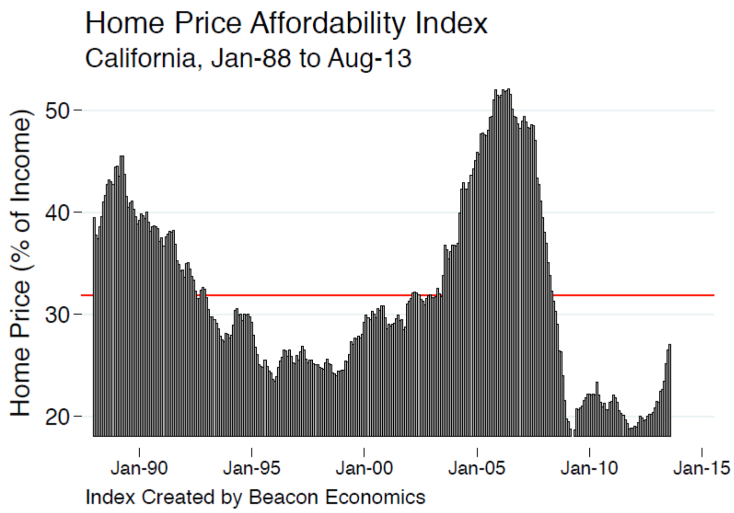
[*] It is important to keep in mind that the figures represent a median price for all homes sold within California, which is distorted by the mix of homes being sold. For example, back in 2009 and 2010, there were a significant number of distressed sales in the mix. Because these homes typically sell with a discount over non-distressed sales, a larger share of foreclosure sales tends to bias median prices downward, all else equal. Similarly, as foreclosures have dwindled over the past three years, the share of non-distressed sales has increased, putting additional upward pressure on the median sales price. In other words, it is not necessarily the case that a home sold today would command a price that was 60% higher than the price back in April 2009; rather, the increase in the median price reflects some price appreciation as well as additional increases due to a smaller number of foreclosure sales.

Figure 5



What is driving this remarkable growth? There are two primary factors driving these figures: affordability and supply. From a fundamental standpoint, home affordability is as good in California as it has been in many years. Aided in large part by mortgage interest rates that remain near historical lows, the cost of the median-priced home as a percentage of household income remains near 27% at this writing, as shown on Figure 6. That level is well below the unsustainable 52% reached during the height of the bubble and it is even below the long-run average of 32%. As the economy has begun to heal and as the state has created more jobs, residents and investors are taking advantage of this affordability, which in turn has boosted demand for housing throughout the state.

Figure 6



Rising demand, coupled with limited supply, has generated the strong price appreciation that we are seeing across the state. From a long-run standpoint, California still does not have enough housing, which, as we have noted, helps to maintain a relatively more expensive housing market compared with other states. In fact, California maintains one of the lowest housing vacancy rates in the nation despite all of the building that took place during the bubble. However, this longer-term problem has been exacerbated over the short run by a lack of building during the recession.

Fortunately, these supply issues, together with rising home values, have started to incentivize new construction in the state. This new building in turn has helped to drive new construction jobs across the state, contributing to the overall economic recovery. New construction has come to life despite the fact that mortgage lending remains relatively lackluster and credit standards remain high. In other words, residential real estate would be even hotter if mortgage debt were flowing more freely. That said, the caution on the part of mortgage lenders should help to prevent the next bubble from forming.

Of course, the ownership side of the equation, strong though it may be, pales in comparison to the current state of California's rental housing market. Apartment vacancy rates across California's major markets remain well below 10% at this writing, the level typically associated with tight markets. Unsurprisingly in the face of such strong demand, apartment rents are up across the board.

There's no doubt that the strength in the rental market is associated with the sharp increase in mortgage defaults and foreclosures that took place during the housing collapse. With homeownership taken off the table, rental housing was the only possibility for many California households. In fact, the homeownership rate, which had reached as high as 60% during the housing bubble, has since fallen back toward historical norms of roughly 55%. As a result, the number of renter households has increased dramatically, from just over 5 million households in 2012 to nearly 6 million households in 2013. The strength in the rental market has generated a substantial amount of new multifamily construction.

This strength is a positive development for the state's economy, but there are also potential risks on the horizon—particularly with respect to multifamily housing. It is important to keep in mind that apartments are only one side of the rental housing market. Many single-family homes have been purchased by investors and then rented to former owner households. Thus, the future of the multifamily rental market depends in large part on what investors decide to do with these single-family rentals, as well as on the state's trends in homeownership over the next few years.

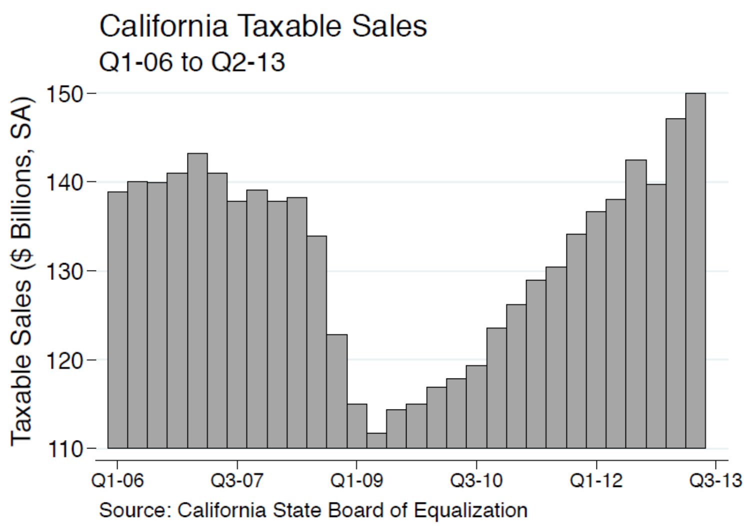
If homeownership rises moderately again or remains flat, population growth and economic improvements will allow us to absorb these new multifamily units with relative ease. However, if homeownership rises more significantly, it will reduce the number of rental households in the state, thereby eroding demand for the multifamily units that we are currently building. And, if investors decide to maintain their single-family rentals in the face of rising homeownership, these units could provide steep competition for apartments, with both trying to capture the dwindling renter population.

Of course, a surge in homeownership would need to be precipitated by an increase in mortgage lending—something that has yet to materialize. Thus, it is difficult to predict how these three dynamics will play out over the next few years. But keeping a careful eye on mortgage lending and homeownership will be critical for analysis of the multifamily market in California.

California Back to Business

As important as the labor markets and real estate markets are to California's economy, there are plenty of other reasons to be optimistic about the future of the Golden State. Other key indicators of economic and business activity also show ongoing signs of strength. Take consumer spending as a prime example; by the midpoint of 2013, California had hit its 14th consecutive quarter of year-over-year growth in consumer spending. Since hitting bottom in the second quarter of 2009, taxable sales in the state - a proxy for consumption in the state - have expanded by more than 34% according to the latest figures available at this writing. That level exceeds the pre-recession peak by 4.7%. Indeed, the *retail* real estate market is among the healthiest segments of commercial space in California.

Figure 7

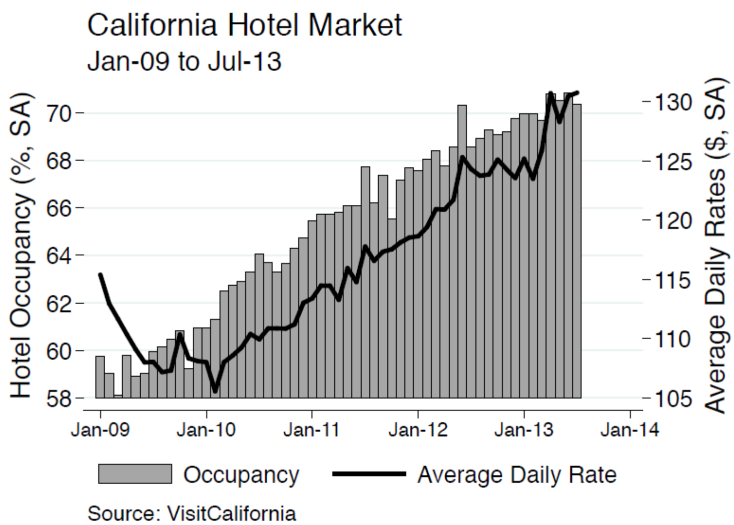


SA = seasonally adjusted

Tourism is a strong force in the state's economy as well. Hotel occupancy across the state remained above 70% as of summer 2013, continuing a three-year uptrend that began in early 2010. Indeed, at over 70% occupancy, hotels in California are seeing much more business than hotels across the remainder of the United States, where occupancy was less than 62%. Fortunately, the tourism boom is relatively broad-based, with every major state region seeing year-over-year increases in occupancy, with the exception of Bakersfield. Not only were hotels more full in 2013, but each room was commanding higher rates.

This development is good for the hotels themselves and also for the local municipalities who rely on transient occupancy taxes to finance the provisioning of public and social services. It is also good for the community at large as tourism-related jobs have been among the strongest-performing industries in the state over the past year. In light of a weak dollar and the rebounding global economy, California is expected to remain a top tourist destination for domestic and international visitors alike.

Figure 8



SA = seasonally adjusted

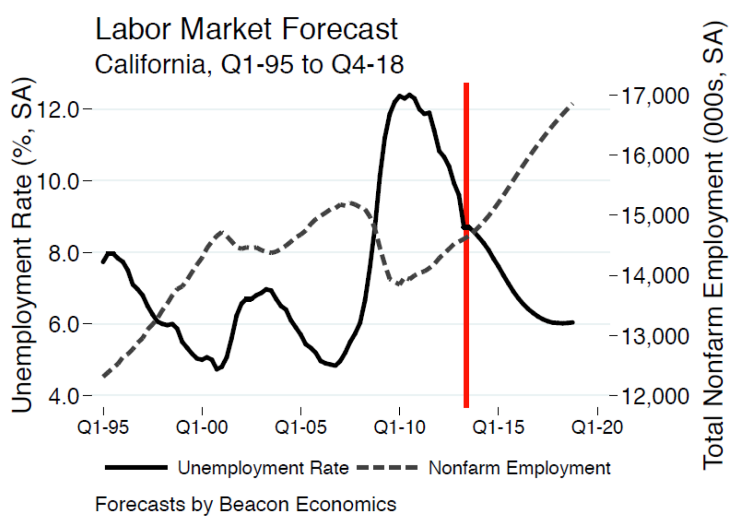
Not all sectors of the California economy are doing as well as tourism. Port traffic remained relatively weak at this writing. Yet, even in that area, there are glimmers of hope. Exports of several key commodities and goods, including aircraft, chemical products, and pharmaceuticals, continued to grow strongly. As problems in Europe begin to wane, and as the dollar remains affordable by historical standards, the outlook for exports remains positive.

Fortunately, all of these improvements in the broader economy and business environment have begun to translate into improvements in state and local government budgets. Clearly there is still a lot of work to be done on that front, but strong performances from both personal income taxes and sales taxes—aided by increased tax rates associated with Proposition 30—have helped to improve government budgets. Of course, the recent municipal bankruptcies in Vallejo, Stockton, and San Bernardino still loom large in the public psyche, but the core drivers of revenue are moving in the right direction.

The Forecast

All in all, California continues to move down the road to recovery. Although that recovery has not progressed at a rapid pace, the state continues to get stronger each month. Beacon Economics is projecting job growth to accelerate and range from 2% to 2.5% during 2014. (Figure 9) As the state regains its pre-recession peak employment levels, Beacon Economics expects job growth to level off in the 3% range in 2015 and beyond. The unemployment rate, which has already dropped into the single digits, will continue to fall, dipping below 7% by late 2015.

Figure 9



SA = seasonally adjusted

The real estate market, which is already strong, is expected to continue to perform well over the near term. Specifically, Beacon Economics forecasts that home price appreciation will remain in the double digits into mid-2014. It will moderate back down toward historical norms, between 5% and 7%, in 2015 and 2016. In part, this appreciation will be driven by tight housing inventories as well as by the gradual healing of the labor market and rising worker incomes. Even though interest rates will begin to rise for mortgages, from a historical standpoint affordability will remain high, which should help to support housing demand in the state.

New home construction, both on the single-family and multifamily sides, is expected to remain robust over the next several years as well. Not only are home prices rising, but California's housing inventory remains chronically undersupplied. This low inventory, rather than a "business unfriendly" climate, is the true enemy facing California. The tight supply keeps home prices high relative to other states and makes it very difficult for individuals to afford the cost of living while maintaining their quality of life. Indeed, this tendency is borne out by the migration data cited earlier that show a much larger number and proportion of low- and middle-income workers migrating out of the state, and only a minimal number and share of high-income out-migrants.

California's population will continue to expand, though the rate will remain below 1% per year as shifting demographics lead to lower levels of natural increase (births minus deaths). Still, as the cyclical effects of the Great Recession fade, net migration should provide an upward influence on the state's population base. This increase should also help to grow the state's spending base, which is important both for the businesses that are supplying and selling consumer goods, and for the local governments who rely on sales tax revenues to finance significant portions of their operations.

It is not quite time to pop champagne corks and raise a toast to California's full recovery which has yet to occur. But the Golden State has made significant progress over the past three years in repairing the damage done by the Great Recession despite the dysfunction in Washington. Employment is growing, housing is improving, business activity and tourism are expanding, and incomes are rising again. Some sectors, such as manufacturing and exports, face continued difficulty owing to the tumultuous global economy and other factors, but even there we see glimmers of hope. There is still a long way to go before California's recovery is complete, but it is clearly time to start feeling optimistic particularly if Washington will cooperate.

CHAPTER 2

The Foreclosure Crisis in Los Angeles

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After five devastating years, the housing market in Los Angeles turned around in early 2013. Prices increased and properties received multiple bids, often at or above asking level (Khouri and Lazo 2013; DataQuick 2013). While this development is good news for the construction industry and homeowners, approximately 143,000 households lost their homes during the preceding housing crisis. Many more remain "under water," owing more than the market value of their homes. Others are left with a heavy financial burden.

For the region, the foreclosure crisis reversed the trend of rising homeownership, leading to concentrated vacancies or rental conversions in distressed communities. It also deferred the American dream of moving up in social status through owning property for many families, especially those of color. This chapter contributes to our understanding of the causes and consequences of the foreclosure crisis in Los Angeles County by detailing its drivers and dynamics.

Part 1 summarizes the existing literature, both nationally and locally. The foreclosure crisis is a result of multiple factors: mistakes by governmental agencies and predatory practices by lending institutions, unrealistic expectations by buyers that led to risky borrowing, and a collapse of a housing bubble that was further exacerbated by the worst economic downturn in decades. The adverse impacts were unevenly distributed, with minorities and previously strong housing markets such as Los Angeles suffering more.

Part 2 tracks the housing bubble and foreclosures in the Los Angeles region using temporal data from multiple sources. Housing prices skyrocketed to unsustainable levels during the mid-2000s. A wave of foreclosures soon followed, driven by increasing financial burdens from subprime loans, growing numbers of owners with negative equity, and climbing unemployment and declining income due to the Great Recession (2007-2009).

Part 3 examines racial/ethnic differences of the foreclosure crisis. Latinos and African Americans were disproportionately affected by the Great Recession. They were targets of unfair lending, and they fared worse during the economic downturn. The chapter concludes with some lessons learned.

Part 1: Causes and Consequences of the Foreclosure Crisis

The foreclosure crisis was the outcome of a set of complex dynamics and multiple factors. According to one analysis, a precipitating cause was Alan Greenspan's lowering of the interest rate following the 9/11 terrorist attacks, a preventative measure to stimulate risk taking and investment and to avoid recession. Lowered interest rates made home buying attractive so long as prices remained stable. But resulting housing demand drove up prices, which increased faster than incomes. The national median single-family home price increased 25% between 2003 and 2006 (Joint Center for Housing Studies 2007), while real median household incomes only increased 1.5% (U.S. Census 2011).

Questionable Loans

To offset the price rise, the financial industry responded to (and furthered) the imbalance between home prices and incomes by offering creative lending products that enabled prospective homeowners to temporarily afford the increased costs. These products included no documentation and no down payment loans, adjustable and subprime interest rates, and interest-only or partial interest payments. Subprime lending (loans with interest rates three or more points above the treasury rate) became most widespread, increasing from 8% of mortgage loans in 2003 to 20% in 2006 (Faber 2013). People not only used these risky products to buy homes but also to refinance their homes, driven in part by a faulty expectation that home prices would continue to increase.

The Bubble Bursts

The mid-2000s housing bubble was short-lived. In 2006, home prices fell in many metropolitan areas nationwide, and a year later price declines were widespread. Median single-family home sale prices dropped about 10% between 2007 and 2008 and an additional 6% between 2008 and 2009 (Joint Center for Housing Studies 2011).

The bust of the housing bubble perpetuated a foreclosure crisis, which was driven by a consequence of three factors. One, the resetting of risky loans drove up interest rates. This rate hike meant a greater burden on the affected owner.

Two, falling home prices increased the number of “underwater” mortgages, meaning that homeowners owed more on their homes than the homes were worth. Financially, there were no incentives for these homeowners to hold onto their homes, and many chose to walk away from their mortgages. Nationally, about 15% of homeowners were underwater in 2011 (Joint Center for Housing Studies 2011).

Three, the Great Recession deepened and prolonged the economic downturn. Unemployment in the nation rose five percentage points from 4.6% to 9.6% from 2006 to 2010. As workers lost their jobs, they had trouble making their mortgage payments.

Results of the Collapse

The consequences of these three factors can be seen in the numbers. Notices of default and foreclosure skyrocketed between 2007 and 2008, in concert with declining home prices. Between the middle and end of 2008, the percent of homeowners 60 or more days delinquent on their loans rose close to two percentage points, from about three to five percent (Joint Center for Housing Studies 2009). About 3.3% of loans were first-lien loans that were in foreclosure by the end of 2008, a 62% increase from the following year (Joint Center for Housing Studies 2009).

About 3.5 million homeowners foreclosed between 2008 and 2010, the height of the crisis (Joint Center for Housing Studies 2011). Homes bought with subprime mortgages were disproportionately likely to foreclose. While subprime loans accounted for 22% of originations between 2005 through 2008, they accounted for 64% of foreclosures between 2007 and 2009 (Bocian et al. 2010b).

Minority Impacts

Minorities disproportionately experienced subprime lending and foreclosure. Controlling for income and loan amount differences, African Americans and Latinos were more likely to receive subprime loans than whites, and Asians were less likely (Faber 2013; Bocian et al. 2011; Bajaj and Fessenden 2007). A wealth of research shows that minorities had higher foreclosure rates than whites across U.S. urban areas (Coulton et al. 2008; Gerardi and Willen 2008; Laderman and Reid 2008; Bocian et al. 2010a, b, 2011).

Nationwide, African Americans and Latinos accounted for 8% and 11% of mortgage originations from 2005 to 2008 but 12% and 16% of foreclosures from 2007 to 2009, respectively (Bocian et al. 2010b). Although Asians' share of foreclosures was similar to their share of originations, Pacific Islanders were disproportionately likely to foreclose. These disparities are heightened after controlling for income.

California exhibits similar racial disparities in foreclosures. African American and Latino homeowners had foreclosure rates 1.9 and 2.3 times higher than whites, respectively, from September 2006 through October 2009, relative to their share of loan originations (Bocian et al. 2010a). These differences become more pronounced among borrowers with higher loan amounts (Bocian et al. 2010a). Asians, however, had similar foreclosure rates relative to whites (Bocian et al. 2010a).

The reasons for minorities' disproportionate experience of foreclosures and wealth declines are debatable. Certainly their higher receipt of subprime and other risky lending products played a role (Gerardi and Willen 2008; Coulton et al. 2008; Bocian et al. 2010b; Rugh and Massey 2010). Neighborhood segregation, particularly for African Americans, may have driven up their higher subprime lending rates (Rugh and Massey 2010).

African Americans and Latinos, in turn, experienced higher unemployment rates during the recession, hindering their ability to make payments (Bureau of Labor Statistics 2011). Minorities also have fewer savings and other forms of wealth (independent from their homes) that would enable them to continue to make payments when facing underemployment or unemployment. Finally, minorities' residency in more unstable housing markets, also driven by voluntary and involuntary segregation, may have contributed to these outcomes (Rugh and Massey 2010).

Minorities' disproportionate experience of foreclosure has led them to experience steeper homeownership and wealth declines. Between mid-2006 and 2010, the black and Latino homeownership rates dropped by about 4% and 2% respectively, compared to 1.5% among whites, erasing much of the gains made in closing the racial homeownership rate gap during the 1990s and 2000s (Joint Center for Housing Studies 2011). Minorities also lost much greater home equity during the recession. Latinos lost about one half of their equity, while Asians lost one-third and African Americans lost one-quarter. These compare to declines of about one-fifth among whites (Taylor et al. 2011).

Spatial Patterns

Foreclosure rates also exhibit strong spatial patterns. The Sunbelt and Rustbelt have higher foreclosure rates nationwide (Immergluck 2008). California had the fourth highest foreclosure rate in the country in 2010 (Bocian, et al., 2010, page 3). While Sunbelt foreclosures are driven by subprime loans and bursting housing bubbles (fueled by overheated demand), Rustbelt foreclosures are driven more by unemployment and depressed housing demand. Also heavily affecting the Sunbelt are underwater mortgages. In states such as California, Nevada, and Florida, between 40% and 60% of homeowners were underwater with their mortgages during the recession (Schwartz 2010).

Similar to variations in foreclosures by state, there were also variations across metropolitan areas. Los Angeles County was one of the epicenters of the housing downturn. The Los Angeles Metropolitan Statistical Area (MSA) had the 37th highest foreclosure rate in August 2008 among 358 MSAs nationwide, with about 122 foreclosures per 10,000 homes with a mortgage (the nearby Inland Empire had the 4th highest rate, 357) (Immergluck 2008). Within California, the Los Angeles MSA had the highest number of foreclosures among California MSAs – just over 200,000 between September 2006 through October 2009.

Part 2: The Housing Bubble and Foreclosure Crisis in Los Angeles County

This section provides an overview of the housing cycle in LA County from 1999 to 2012. Figure 1 shows the trends of the housing bubble, which closely mirrors the figures for the nation. Two indicators of the housing cycle were examined: 1) average sale prices for single-family homes (adjusted for inflation to 2012 dollars), and 2) the number of homes sold.

Trend in Home Prices

Average house prices began increasing slowly in 1999, accelerating after 2003, and peaking to its highest level in 2006. From 2003 to 2006, the average price of a home increased well over 50 percent from $370,000 to $619,000. Prices were greatest in 2005 through 2007, a period we ascribe in this chapter as the "Boom" period.

After peaking in 2006, house prices began falling. By 2008, the bottom fell out, and home prices plunged by 19 percent from the peak year. Prior to the housing boom, the number of homes purchased increased gradually before peaking in 2004. However, as prices escalated, sales declined. By 2006, the number of sales declined dramatically. From 2004 to 2008, housings sales collapsed 52 percent.

Figure 1. Average Sales Price (2012 dollars) and Total Number of Sales, LA County, 1999-2012

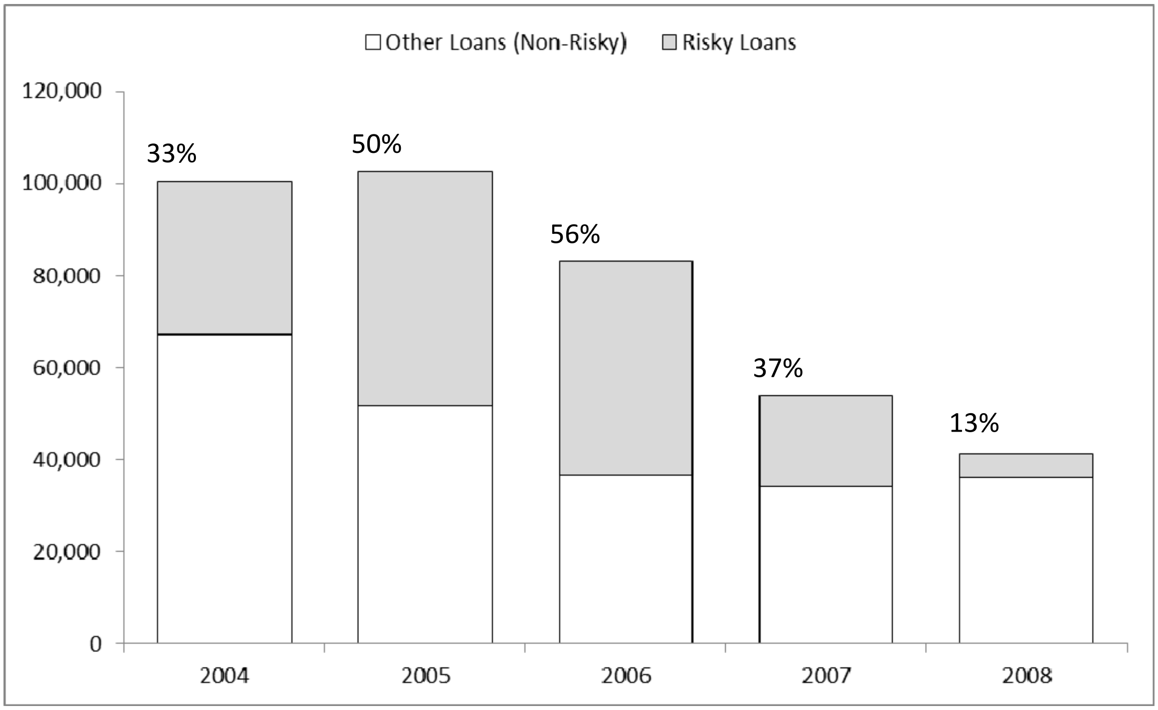
Data Source: RAND Corporation, 1999-2012

Risky Loans

During the period of price escalation, many buyers took out risky and other non-traditional loans to cover the increase in housing prices. Figure 2 displays the number of home loans originated from 2004 to 2008 using data obtained from the Home Mortgage Disclosure Act (HMDA), broken down by the riskiness of their terms. For this analysis, we define risky loans as primary loans with interest rate of 3 percentage points or more above prime and/or a second lien loan.

The dramatic increase in risky loans from 2004 to 2006 is evident in Figure 2. Of the total home purchase loans that originated in 2004, one-third was considered risky. This figure increased to 50 percent in 2005 and 56 percent in 2006. The number of risky loans declined following the collapse of the housing market. In 2007, the number of risky loans (19,710) was less than half the number that originated the year before (46,388), a decrease of 58 percent.

Figure 2. Risky & Non-Risky Loans, LA County, 2004-2008



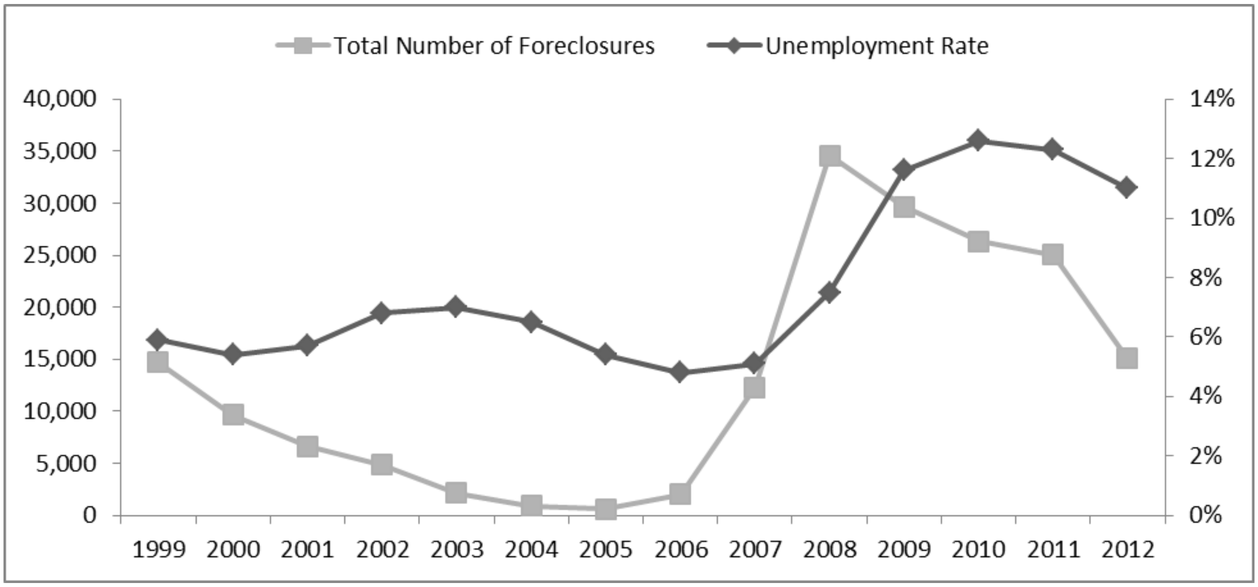
Data Source: HMDA 2004-2008

Timing of the Crisis

Figure 3 shows when the foreclosure crisis started. The chart tracks the number of foreclosures in the county from 1999 to 2012. Foreclosures remained relatively low from 1999 to 2005, but by 2006, foreclosures started picking up, and by 2008, the number of foreclosures had skyrocketed (Figure 3). Figure 3 also tracks unemployment trends in the county. Employment in the county fell considerably during the recession, and high unemployment levels have persisted (Figure 3).

Coinciding with the increase in unemployment is the decrease in income. From 2007 to 2011, median household income declined nearly 10 percent, from an estimated $58,000 (adjusted to 2011 dollars) to $52,000 in 2011. As homeowners lost their jobs and incomes, many became delinquent on their mortgages, and some eventually foreclosed.

Figure 3. Total Number of Foreclosures and Unemployment Rate, LA County, 1999-2012



Data Source: RAND Corporation, 1999-2012

Vulnerability of Boom Buyers

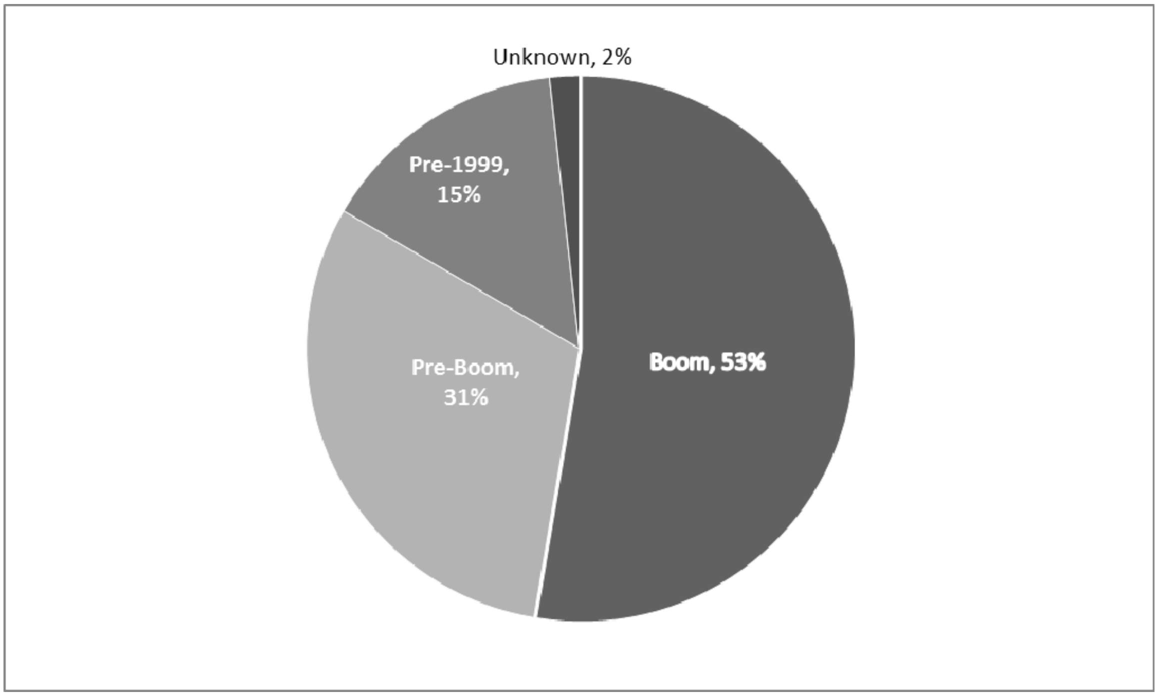
The foreclosures that occurred from 2007 to 2012 were concentrated primarily among homeowners who purchased during the Boom period. Using a combination of 2007 parcel data and 2007-2012 foreclosure data from DataQuick, we estimate foreclosure rates by the year of home purchase.[1] Three categories were created based on the year of purchase: 1) Pre-1999 (1990-1999), Pre-Boom (1999-2004), and Boom (2005 or later)[2]. Over half of the foreclosures occurring from 2007 to 2012 were for homes purchased during the Boom period (Figure 4). Boom buyers were nearly three times as likely to go into foreclosure compared to owners who had purchased prior to the Boom, 23 percent and 8 percent, respectively (Figure 5).

The disproportionate concentration of foreclosures among those who purchased during the Boom is due to two factors. First is a disproportionate higher percent of loans that were subprime, highly leverage and/or risky. Second is the higher amount of their mortgages, which led to higher payments and increased odds of being underwater when the market collapsed.

[1] From the 2007 parcel data, we kept only those parcels with homeowners in 2007. The parcel data was then linked with the 2007-2012 foreclosure data by a common index – the Assessor's Parcel Number (APN). By merging the 2007 parcel and foreclosure data, we were able to track whether or not homeowners in 2007 went into foreclosure during the foreclosure crisis.

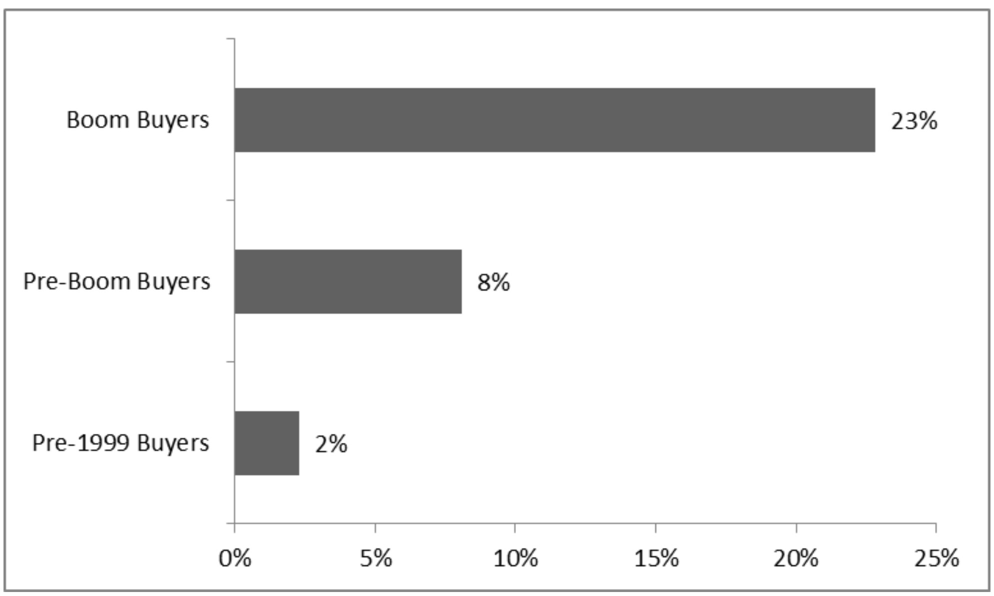
[2] According to one estimate, about 30% of mortgage defaults during the foreclosure crisis can be attributed to home owners who took out equity loans during the housing boom (Laufer 2013).

Figure 4. Percent of Foreclosures from 2007 to 2012 by Year of Home Purchase, LA County



Data Source: LA County Parcel Data, 2007 & DataQuick, 2007-2012

Figure 5. Foreclosure Rates by Period of Purchase, LA County

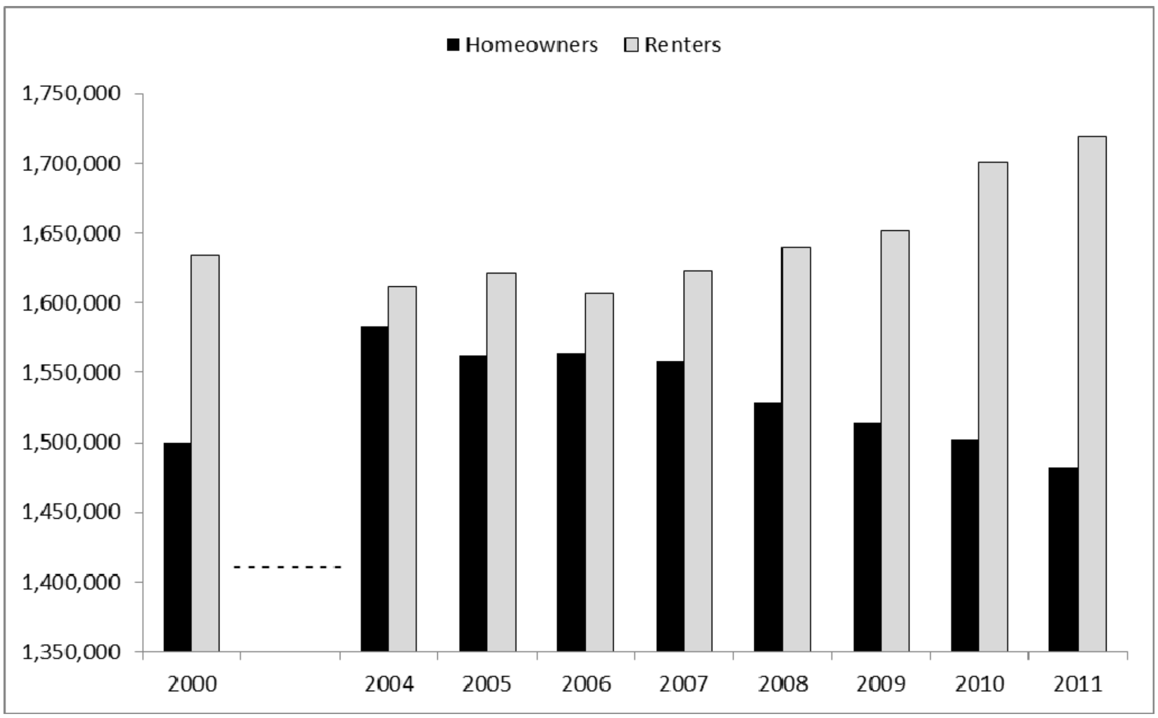


Data Source: LA County Parcel Data, 2007 & DataQuick, 2007-2012

Consequences of the Crisis

There are deep and far-reaching consequences to the foreclosure crisis. Immediately, it has resulted in a decrease in homeownership and increase in housing burden. Figure 6 displays changes in the number of homeowners and renters from 2000 to 2011. (Data were not available for years 2001-2003). In the early 2000s, homeownership grew moderately, peaking in 2004. By the end of 2004, homeownership began to decline. The greatest loss in homeownership occurred following 2007. In 2011, the overall number of homeowners in the county had fallen below that of 2000 levels. Renting increased in concert with this decline. By 2011, the number of renters had reached its highest level within the decade.

Figure 6. Number of Homeowners and Renters, LA County, 2000 & 2004-2011

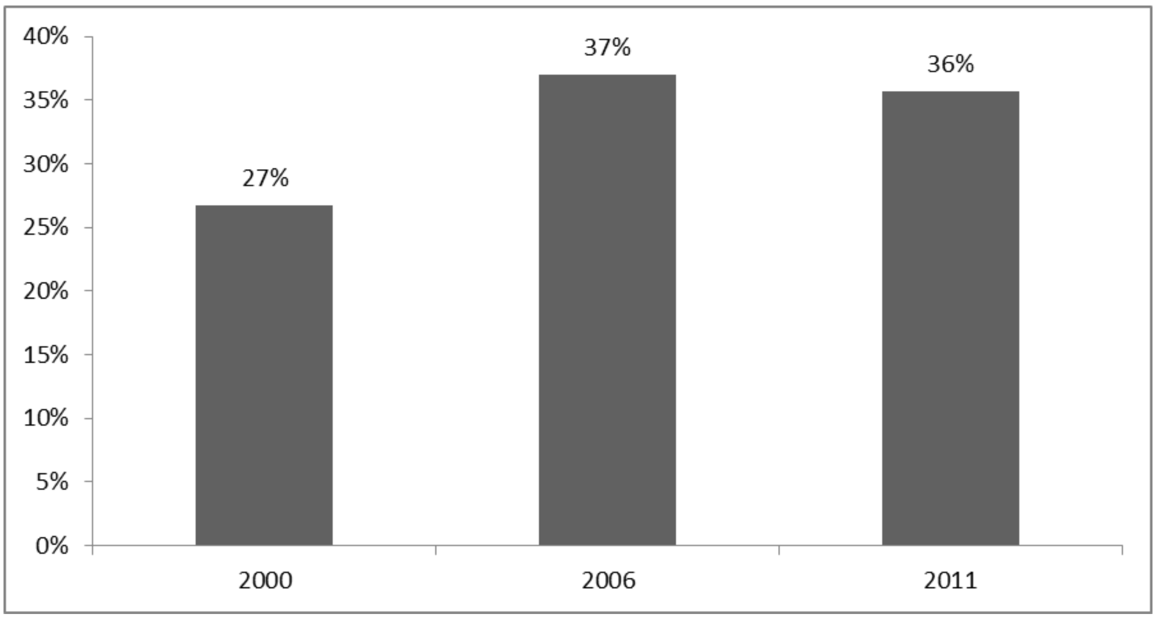


Data Source: 2000 Decennial Census, 2004-2011 Single-Year ACS

The number of households with a housing burden also increased in the wake of the housing crisis. Any household paying more than 30 percent of its monthly income on housing costs is considered "cost-burdened." The Census also computes a more moderate threshold of housing burden, which is defined as households paying 35 percent or more of their income on monthly housing costs. For this study, we provide estimates of cost-burdened homeowners who pay 35 percent or more.

Figure 7 compares the percentages of cost-burdened homeowners for years 2000, 2006, and 2011. In 2000, over a quarter of homeowners were cost burdened. By the Boom period, the percentage of cost-burdened homeowners had increased by ten percentage points. Even as housing prices declined following the housing collapse, the percentage of cost-burdened homeowners remained relatively unchanged. This outcome is partially the result of homeowners losing their income and jobs (see Fig. 3).

Figure 7. Percent of Homeowners with High Burden, LA County, 2000, 2006 & 2011



Data Source: 2000 Decennial Census, 2006 & 2011 Single-Year ACS

Part 3: Disproportionate Impacts on Minorities

The housing crisis disproportionately affected minorities, particularly those who purchased during the Boom period. Figure 8 compares the racial and ethnic distribution of homeowners for the years 2000, 2004, and 2005-2007 (Boom Period). Minorities, particularly Latinos, were more likely to buy during the Boom period relative to the base year (2004). In 2004, 29 percent of homeowners were Hispanic or Latino. By the Boom period, 36 percent of homeowners were Latino. While Latinos' representation increased, non-Hispanic whites' and African Americans' representation decreased. Asians also accounted for higher percentage of homeowners during the Boom period (15% compared to 13% in 2004).

Figure 8. Estimated Racial and Ethnic Distribution of Homeowners, 2000, 2004, & 2005-2007 (Boom-Period)

	2000	2004	Boom Period
Non-Hispanic White	52%	48%	41%
Hispanic or Latino	25%	29%	36%
Black or African American	8%	8%	6%
Asian	12%	13%	15%

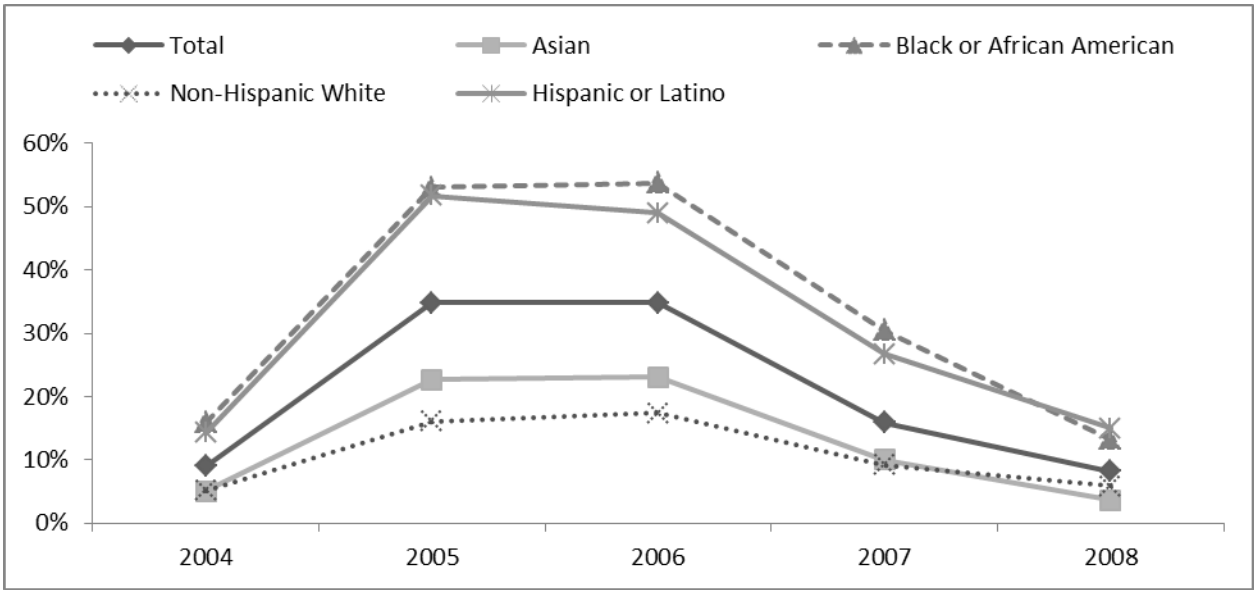
Data Source: 2000 Decennial Census, 2005-2007 5-Year ACS PUMS

Subprime Targeting

As mentioned earlier, minorities were often targeted by subprime lenders. Figure 9 compares the subprime rates for the major racial and ethnic groups from 2004 to 2008. Subprime lending increased for all groups, but blacks and Hispanics were far more likely than whites to receive higher-cost mortgages. In 2005, over half of loans originated to African Americans and Latinos were subprime, compared to only 16 percent for Non-Hispanic whites. African American and Latino homebuyers were three and a half times more likely to receive a subprime loan than non-Hispanic white homebuyers. The share of higher-priced loans fell sharply following 2006 for all groups.

The greatest decline in subprime mortgages from 2006 to 2007 was among Hispanics (74 percent); the drop was 73 percent for blacks and 55 percent for whites. However, minority households remained far more likely to receive a higher-priced loan than Non-Hispanic white households. In 2008, Latinos were still over two times more likely to receive subprime loans than Non-Hispanic whites.

Figure 9. Subprime Rates for First-Lien Loans by Race & Ethnicity, LA County, 2004-2008



Data Source: HMDA 2004-2008

Loan-to-Income Ratios

Another indicator of loan risk is the loan-to-income ratio. A common threshold is that the value of a mortgage should not exceed three times a households' gross income. For this analysis, an index was created for a loan-to-income ratio of 4 to 1 or greater for loans originated (either first or second lien loans) during the Boom period. A household with a loan-to-income ratio of 4 to 1 or greater is considered to be at high risk of default and foreclosure. Our data show significant variation in the loan-to-income ratio among the major racial and ethnic groups. African American and Latino homebuyers were between about 40% to 75% more likely than non-Hispanic white households to receive high-risk loans during the Boom period, respectively.

Figure 10. Rates of Risky Borrowing, LA County, 2005-2007

	Subprime Rate	Percent with 2nd Loan	Loan-to-Income Ratio of 4 to 1 or Higher
Non-Hispanic White	20%	24%	23%
Hispanic or Latino	54%	56%	40%
Black or African American	56%	48%	32%
Asian	27%	29%	26%
Total Households	33%	37%	30%

Data Source: HMDA, 2005-2007

Ethnic and Racial Disparities

During the housing crisis, many homeowners took out higher value loans than they could sustain. The Boom period saw an increase in the percent of cost-burdened homeowners compared to prior years, as previously discussed. Figure 11 presents data on the proportion of cost-burdened homeowners by race and ethnicity based on the year that homeowners moved into their homes. Two categories were created: 1) Pre-Boom Buyers and 2) Boom Period Buyers. Homeowners who reported moving in to their homes before 2005 were categorized as “Pre-Boom Buyers,” and homeowners who reported moving into their unit between 2005 and 2007 were categorized as “Boom Period Buyers.”

Figure 11 shows that buyers during the Boom period were more likely to be cost-burdened than buyers during the Pre-Boom period. The likelihood of being cost-burdened varied substantially among racial and ethnic groups. Minorities who bought during the Boom faced greater hardship than non-Hispanic whites that bought during the Boom. From about 60% to 70% of minority Boom buyers experienced housing burdens compared to about half of whites.

Figure 11. Percent of Homeowners with a High Cost Burden by Period Moved-in and Race and Ethnicity LA County.

	Pre-Boom Buyers	Boom Buyers
Non-Hispanic White	29%	48%
Hispanic or Latino	41%	69%
Black or African American	39%	70%
Asian	34%	58%
Total Homeowners	34%	59%

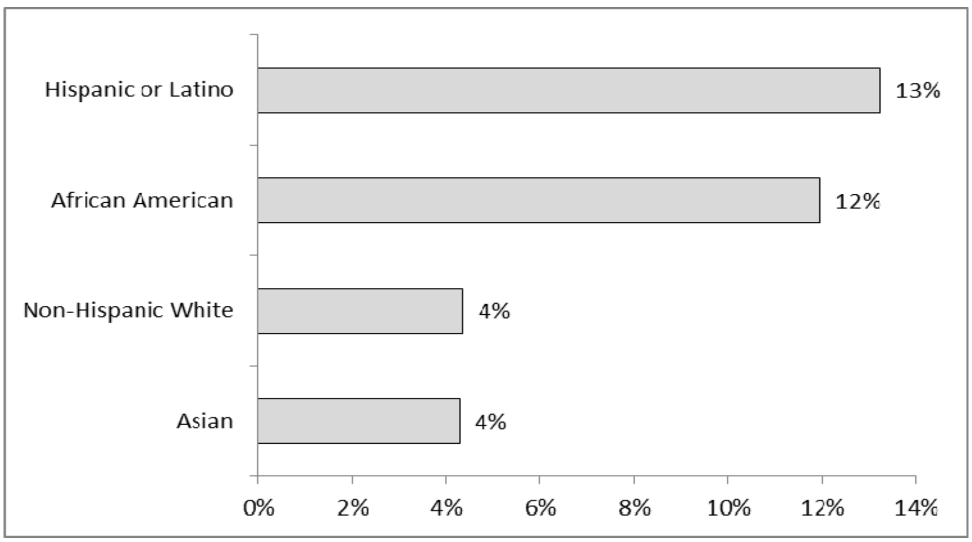
Data Source: 2005-2007 ACS PUMS

Minorities’ disproportionate purchasing during the Boom period and greater cost burdens contributed to their higher foreclosure rates. Figure 12 provides estimates of foreclosure rates by race and ethnicity. Although DataQuick does not identify the race or ethnicity of the buyer, it does include their surname.

U.S. Census Bureau data on the likely racial or ethnic identity of surnames was used to impute buyer race or ethnicity. Buyers with a surname that had a 70 percent or greater probability of being part of a racial/ethnic group were assigned to that group. In other words, a buyer with a surname that had a 70 percent or greater probability of being Latino was identified as Latino. Home buyers who surname does not meet the 70 percent threshold for any racial/ethnic category were assigned as "other race." (They are included in the totals but are not shown separately.)

This racial variation in foreclosure rates in the county is consistent with those previously reported for nation and California. Latinos had the highest rate, followed by African Americans. Both racial/ethnic groups had foreclosure rates three times higher than whites. Although Asians were less affected by foreclosures than Latinos and African Americans in the aggregate, they experienced ethnic variation in foreclosure rates.[3]

Figure 12. Foreclosure Rates by Race & Ethnicity, LA County, 2007-2012



Data Source: LA County Parcel Data, 2007 & DataQuick, 2007-2012

Homeownership Effects

The decline in homeownership following the housing crisis differed slightly for the major racial and ethnic groups. To compare homeownership rates across groups, we used data files from the 2000 Decennial Census and the 2006 and 2011 single year American Community Survey (ACS). The 2006 ACS was chosen primarily because it represents the year in which homeownership rates peaked in LA

[3] We produced some preliminary estimates of foreclosure rates by further assigning surnames Asian ethnic membership. These estimates indicate that Filipinos (11%), Koreans (10%), and Cambodians (9%) were hit hardest by the housing crisis, with foreclosure rates over two times higher than all Asians (4%). Both Chinese and Japanese seem to have fared better during the housing crisis than all Asians and non-Hispanic whites, with each group experiencing only a two percent foreclosure rate.

County. The 2011 ACS provides the most recent data available following the housing crisis. We used 2000 Decennial data as the base year to measure changes within the last decade.

While all racial and ethnic groups have experienced a decline in homeownership rates since 2006, the fall has been steepest for Hispanics and non-Hispanic whites, with each group experiencing a three percentage point drop in the homeownership rate. For both Hispanics and Asians, rates have fallen back to 2000 levels. Rates for non-Hispanic whites and African Americans have dipped just below their 2000 levels.

Figure 13. Homeownership Rates by Race and Ethnicity, LA County, 2000, 2006 & 2011

	2000	2006	2011
Non-Hispanic White	58%	59%	56%
Hispanic or Latino	38%	41%	38%
Black or African American	37%	37%	35%
Asian	51%	52%	51%
Total Homeowners	48%	49%	46%

Data Source: 2000 Decennial Census, and 2006 & 2011 1-year ACS

Increased Housing Cost Burdens

The housing crisis not only decreased homeownership in Los Angeles, but also increased housing cost burdens. In 2000, over a quarter of homeowners experienced housing burdens. By the end of the peak Boom year (2006), this number had increased to 37 percent. The number of burdened homeowners increased for all racial and ethnic groups following 2000 (Figure 14). Minorities, particularly Latinos, experienced the greatest increase, with the proportion of homeowners considered cost-burdened increasing by twelve percentage points from 2000 to 2006. Despite home prices falling after the housing crisis, the percentage of cost-burdened homeowners has remained relatively the same since the Boom period, and higher than 2000 levels.

Figure 14. Cost-Burden Homeowners by Race & Ethnicity, LA County, 2000, 2006 & 2011

	2000	2006	2011
Non-Hispanic White	22%	32%	31%
Hispanic or Latino	33%	45%	41%
Black or African American	32%	41%	43%
Asian	28%	36%	36%
Total Homeowners	27%	37%	36%

Data Source: 2000 Decennial Census, and 2006 & 2011 1-year ACS

Concluding Remarks

After suffering one of the worst housing crises in generations and economic recessions in decades, Los Angeles is recovering. However, fundamental policies have not been implemented to prevent repeating the mistakes of the mid- to late-2000s. The same confluence of forces that created the national foreclosure crisis was at work in Los Angeles, and the impacts were far worse than for the rest of the country. The housing bubble was proportionately larger, as was the collapse.

One of the key lessons is that government failed to provide adequate oversight of financial markets. The absence of oversight promoted risky and unsound lending practices. Another lesson is that the consequences were unevenly distributed, and the groups hit hardest are the same groups that have been disadvantaged in the past, leading to a reproduction of socioeconomic inequality. Without new safeguards, Los Angeles and the nation remain potential victims of future housing crises. What is needed is a serious analytical evaluation of the institutional and policy failures, the development of evidence-based policies and practices to correct what went wrong, and the political will to implement meaningful systemic changes.

Data Sources

This study relies upon various data sources and data sets to better understand the nature and magnitude of the foreclosure crisis in Los Angeles County. The five primary data source for this report includes: 1) US Bureau of Census (BOC), 2) RAND California Statistics, 3) Home Mortgage Disclosure Act (HMDA), 4) DataQuick, and 5) 2007 Los Angeles County Assessor's parcel data. Information on homeownership and housing burden were obtained from the BOC's 2000 Decennial Census, 2004-2011 single-years American Community Survey (ACS), and 2005-2007 3-year ACS Public Use Microdata (ACS PUMS). Data on sales, prices, and number of foreclosures from 1999-2012 comes from RAND California Statistics. Information on the number of loans, including risky loans, was obtained from HMDA's Loan Application Registers (LAR) datasets for 2004 to 2008. Foreclosure rate estimates broken down by race/ethnicity were derived using a combination of 2007-2012 foreclosure data purchased through DataQuick, and the 2007 County Assessor's parcel data.[4]

[4] Additional information, including limitations, about each datasets are available through the following websites:
1) Decennial Census and American Community Survey:
http://www.census.gov/history/www/programs/demographic/
2) California RAND Statistics: http://ca.rand.org/stats/
3) DataQuick: http://www.dqnews.com/
4) HMDA: http://www.ffiec.gov/hmda/history2.htm

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CHAPTER 3

California's Sleep Well Budget

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This chapter covers the period through the end of August 2013. Subsequent developments are not reflected.

"You can sleep well tonight now that we have a signed budget."

Governor Jerry Brown upon signing the 2013-14 budget[1]

In past editions of *California Policy Options*, we have tracked the ups and downs of the California state budget, especially its fluctuations during the current century.[2] But we have also gone back in time and looked at the fiscal history of governors back to the era of the father of our present governor. No, dear reader, we don't expect *you* to read all of those previous chapters. So instead we will start with a brief recap of that history in qualitative terms and save the numerical history for the Davis-Schwarzenegger-Jerry Brown period. It is clear that the budgetary nightmare that characterized that period is over *for now*. But how easy should we sleep, despite Jerry Brown's assurances as quoted above? That is the key question to be explored in this chapter. At this point in time, the answer has to be that it wouldn't take much of a negative economic shock to move us back into the trouble zone.

Once we have presented our historical fiscal recap, we will pick up where we left off in last year's *California Policy Options*. That chapter stopped short of the November 2012 general election in which voters were offered Proposition 30, an initiative sponsored by Governor Brown that provided for temporary increases in the state personal income and sales taxes. With hindsight, we know that Prop 30 passed along with another initiative that also provided added state revenue. But at the time our prior chapter concluded, opinion polls suggested that the passage of Prop 30 was iffy. Thus, apart from the fiscal element, the November 2012 election revealed something about political polling as it applies to the state budget and other issues.

Finally, we also will do a review of budgetary accounting as we proceed. It is one thing to assert that the budget is "balanced." It is another to define what that term – and others commonly used to describe the budget – actually mean or how they might be measured.

Depression Legacy

"During the Great Depression, Americans in California saw their way through the most trying ordeal possible short of invasion or civil insurrection, and they prevailed. They created a version of American culture...which... continues to intrigue the rest of the nation..."

California historian Kevin Starr[3]

Like all states, California's social system came under great strain during the Great Depression of the 1930s. Left and right ends of the political spectrum battled, sometimes in the streets. The state undertook some major public works projects involving water, roads, and bridges despite a dearth of resources. But scars were left on the state's fiscal system. As economic activity dried up, so did tax revenue. One of the long-lasting consequences was a change in the state's constitution requiring a two-thirds "supermajority" vote in the legislature to approve a new budget. That requirement – often confused with a much later requirement (see below) for a two-thirds vote on *tax increases* – remained on the books until voters removed it in 2010 under Proposition 25.

In the years since the 1930s, the budget-enactment supermajority requirement sometimes pinched more and sometimes less. But especially in the period beginning in the 1990s, it resulted in delays in adopting a budget, sometimes delays that extended well into the fiscal year (which begins each July 1). Removal of the two-thirds budget requirement was a major shift, a change that benefitted Jerry Brown in his second iteration as governor.

World War II and the Cold War

"It was a time of growth and abundance, and this, in turn engendered a persistent note of optimistic boosterism in public discourse."

California historian Kevin Starr[4]

Just as the Great Depression put state finances under strain, World War II – with its surge in military-related economic activity – had the opposite effect. The wartime impact was especially felt in California which was a center of the budding aircraft (later aerospace) industry that experienced a surge of military orders. The state also had major ports and developed a shipbuilding industry that serviced the War's Pacific Theater. Starting with World War II and continuing into the Cold War, California was the home of a population boom and grew notably faster than the rest of the U.S. as Chart 1 shows. However, the end of the Cold War terminated that era of super-normal growth as military expenditures in the state declined.

California governors and legislatures for five decades from the start of World War II to the end of the Cold War – and perhaps the general public to this day – did not fully appreciate the fiscal impact of the military stimulus. There came to be an assumption that supernormal growth was just a natural tendency of the state. If the economy is expanding rapidly for whatever reason, tax revenue also increases. An expanding budgetary "pie" allows avoidance of nasty trade-offs. A dollar more of X doesn't necessarily imply a dollar less of Y (or a tax increase). The shift in regime from an ever-expanding pie to a system of unpleasant trade-offs was at the heart of California's fiscal difficulties in the two decades following the end of the Cold War.

Of course, even with an expanding pie, the rate of expansion after 1940 varied. In particular, there were two major hot wars after World War II – Korea and Vietnam – contained within the umbrella Cold War. Moreover, budgetary problems can arise from the expenditure side as well as the revenue side. Over-commitment to programs – particularly if they are open ended – can push spending to levels that outrun revenue. And even in the Golden Era of rapid pie expansion, the national business cycle was inevitably reflected in state revenue. California's major trading partner is the rest of the U.S. The state cannot be insulated from the ups and down of the U.S. economy, even in a period in which its long-term growth outpaces the nation.

From the Earl to the Knight

"...I advocated what I chose to call a 'rainy day' fund. I argued that in the life of every person, family, business, or government there comes a day when adversity of some kind calls for funds in reserve..."

Former California Governor Earl Warren[5]

Republican Earl Warren, first elected in 1942, was the state's only governor to be elected to three *consecutive* terms and because of term limits, he is and will be the last. (Jerry Brown is in his third term, but it is not consecutive with his first two.) Warren entered office during World War II just as military-related tax revenue began to pour into Sacramento. During the War, the diversion of national and state resources to military purposes limited state expenditures so that when the conflict ended, the state had built up a large budgetary reserve. Warren pushed to prevent what he regarded as excessive expenditure at war's end, partly because it was widely feared that with the halt of wartime expenditures, both the U.S. and California economies might fall back into the Great Depression.

Even as anxiety about a renewed Depression dissolved, Warren still pushed to retain what he termed a "rainy day" fund. Thus, when he proposed new programs, including a plan for universal state health care (which failed) and another for a state freeway system (which succeeded), he tied the proposals to pay-as-you-go earmarked revenue streams. For the failed health plans (there was more than one Warren proposal), the funding mechanism would have been through payroll taxes. The gas tax became the funding mechanism for the freeways.

Warren left office in 1953 during his third term after being named by President Eisenhower to become Chief Justice of the U.S. Supreme Court. The terms of his successor, Republican Lieutenant Governor Goodwin ("Goodie") Knight, generally weren't marked by major budgetary program proposals.[6] But Knight was popular enough to be re-elected as governor in 1954. In 1958, however, an internal struggle within the GOP opened the door to election of a Democrat as governor, then-Attorney General Pat Brown, Jerry's father.[7]

Jerry's Dad

"My mother had the good sense to name me after my father."

Jerry Brown commenting on his name recognition[8]

Pat Brown's two terms in office are remembered for major state infrastructure development. Freeways expanded, thanks to new highway funding from Washington, and the state built new universities and state colleges under the Master Plan for Higher Education. In addition, a major water project was shepherded by Pat Brown into fruition.

Brown had put through a tax increase at the start of his first term to help pay for his enlarged vision of the role of the state's public sector in both infrastructure and social spending. But by 1966, when he ran for a third term against movie and TV actor Ronald Reagan, California had developed a major fiscal problem. It is unclear whether Brown and his finance director fully understood the dimensions of the budget crisis that was unfolding. Nonetheless, the budget crisis – combined with the Watts Riot and student unrest at the University of California, Berkeley – ended Pat Brown's political career.

What was critical in the 1966 election was that Reagan promised to deal with the state's fiscal problem (which he did), and take a tough line on student and racial unrest. Today, Jerry Brown's dad is mainly remembered positively for his infrastructure. But his father's unpopularity at the time of his 1966 electoral defeat left an impression on young Jerry. Jerry Brown took the lesson to be that fiscal conservatism and opposition to social disruption were the keys to future political advancement in California.

The Not-Pat

"The time has come for us to decide whether collectively we can afford everything and anything we think of simply because we think of it. The time has come to run a check to see if all the services government provides were in answer to demands or were just goodies dreamed up for our supposed betterment. The time has come to match outgo to income, instead of always doing it the other way around."

Former Governor Ronald Reagan giving his first inaugural address[9]

While campaigning in 1966, candidate Reagan may well have believed that he could resolve the budget crisis he would be inheriting by cutting waste and social programs and by making Sacramento more efficient. Within a few months of taking office, however, he found it necessary to put through a major tax increase. To this day, the phrase "Reagan raised taxes" is often recited by liberals in reference to that episode when conservatives resist proposed tax increases. Liberals are saying, in effect, if Reagan did it, why can't you?

Indeed, the 1967 tax hike was not the only time Reagan raised taxes during his two terms as governor. And in real terms, state spending under Reagan rose at about the same pace as under his predecessor, Pat Brown. But the Reagan rhetoric was different from Pat's. And the emphasis on spending changed. For example, the promise of free tuition in state higher education institutions contained in the Pat Brown-era Master Plan was a casualty of the Reagan period.

Governor Reagan had his eye on the presidency and hoped to be the GOP's candidate in 1976. Conservatives at the national level were pushing the idea that government could be checked by a constitutional amendment that would limit federal spending by some formula. Reagan put a state version of that idea on the ballot in 1973, hoping its enactment by voters would provide a platform on which to campaign. However, his Proposition 1 entailed a complex formula which looked funny to voters and which Reagan, when pressed by reporters, could not himself explain. After Prop 1's defeat, the Reagan administration in Sacramento seemed to run out of steam. Reagan ultimately did make it to the presidency but in 1980, not 1976.

The Anti-Pat

"For four years (Jerry) Brown had been berating the state's schools and universities... Rarely, he said... had public institutions roiled the society in so many ways... And the same, in his view, appeared to be the case for a great many other programs – freeway construction in particular... – that were among his father's proudest achievements... (Jerry) Brown was the father of Proposition 13 in many more ways than he knew."

Journalist Peter Schrag in 1998 explaining the 1978 passage of Prop 13[10]

During the Reagan governorship, Democrat Jerry Brown had moved from election as a community college trustee – one strongly opposed to student unrest – to election as California's state secretary of state. Brown's two terms in his first iteration as governor seemed to emphasize being the anti-Pat, i.e., being the opposite of his father. Instead of expansive infrastructure and social programs, the state – and, he argued, the nation – was in an "era of limits." In some respects, however, he was a traditional Democratic liberal, pushing state laws establishing labor union rights in agriculture and in the public sector.[11] But in other respects he articulated "new age" thinking and prided himself in being unconventional – again, very much the anti-Pat. Although Reagan was a celebrity before being governor as a movie and TV actor, Jerry Brown became a political celebrity – gaining national media attention and soon dabbling in presidential politics.

During Brown's first term, the economy was generally in an inflationary upswing after a deep recession in 1975. Both the inflation (which pushed people into higher tax brackets under the state's progressive personal income tax) and the expansion of the real economy fueled state revenue. With expenditures in check given a fiscally conservative governor, the state's reserve (Earl Warren's rainy day fund) rose to unprecedented levels. Indeed, the ratio of reserves to spending or to revenue has never been approached since. At the same time, however, general inflation – combined with a housing bubble – pushed up local property taxes.

As property tax bills soared, both the governor and the legislature seemed unaware of the political upheaval that was impending. Conventional property tax systems involve both the relatively frequent valuation of property (the assessed value) and the setting of a rate at which that value is taxed. So a housing bubble would be reflected in rapidly rising property tax bills unless local governments cut the tax rate to offset the valuation increase. But local governments in California did not cut rates, or did not do so sufficiently to offset the jump in tax bills.

The political result of that failure was Proposition 13 of June 1978. By the time the legislature realized the magnitude of what was later termed the taxpayer revolt and put a more moderate alternative on the ballot, it was too late. Prop 13 passed by a wide margin and its repercussions have shaped California state and local finance and governance since that time.

Prop 13 fundamentally changed the property tax system. The assessed value henceforth would be the purchase price of property determined when property changed hands.[12] Thereafter, the assessed value could rise a maximum of 2% per annum even if market values rose faster. Thus, in a period of rapid real estate inflation, assessed values for most properties would depart farther and farther from market values. After such a period, the average assessed value would substantially understate the true market value since only recently acquired property would reflect the market; other property would be under-assessed due to the 2% cap.

The tax rate under Prop 13 was set as 1% of the assessed value, a rate that substantially slashed local revenues from the tax. As a result, a major source of local revenue, particularly for school districts, no longer was available. School districts and to a lesser extent other local governments became dependent on the state for bailout and support.

The state could initially provide such support because of the huge rainy day fund that Jerry Brown had developed. Indeed, the rainy day fund that accumulated arguably had fueled support for Prop 13 in the first place; voters saw the state reserve piling up at the same time their property tax bills were escalating. The fact that a distinction might be made between local taxes and state taxes did not seem salient. And, as just noted, with the locals more dependent on the state after Prop 13, the proposition made the state-versus-local distinction less salient thereafter. State and local finance became heavily intertwined.

Although Prop 13 is widely seen as a property tax measure, it contained another element that had major repercussions for state finance. *The initiative also required a two-thirds supermajority in the legislature for any future tax increases.* Supporters of Prop 13 didn't want the state simply to substitute new taxes for the reduced property tax. Unlike the Depression-era supermajority requirement for passing a budget which voters scrapped in 2010, the tax increase supermajority requirement of Prop 13 remains in place despite litigation challenges.[13] Indeed, voters subsequently tightened it by narrowly defining user fees (which don't require a supermajority to be raised) so that fee increases cannot be easily substituted for tax increases by the legislature. Note, however, that as with any ballot proposition, voters – as opposed to the legislature – can raise taxes with a simple majority. That is, the two-thirds rule does not apply to voter-approved propositions that raise taxes.

Jerry Brown had opposed Prop 13 before it passed June 1978. But as soon as it passed, he flipped and pledged to make Prop 13 "work." Although pundits often tagged Reagan as "Teflon" for his ability to escape political damage, Brown's flip on Prop 13 in 1978 was the ultimate Teflon performance. Doing that flip enabled him to win re-election in November of that year. That re-election in effect rebutted the perception that the real fellow in charge of California was Howard Jarvis, the co-sponsor of Prop 13 (with the less visible Paul Gann). Shortly after Prop 13 had passed, veteran comedian Bob Hope had quipped that when he knocked on the door of the governor's mansion, Jarvis answered.[14] (Brown, as part of projecting his frugal image, didn't live in the mansion but the joke was telling, nonetheless.)

In any event, making Prop 13 work was possible for Brown for a time, due to the large rainy day fund. However, the bailout of the locals involved running down those reserve funds – which could not go on indefinitely. Additionally, there were two back-to-back recessions in the early 1980s, the second being quite severe, that cut into state revenue. A state budget crisis by the end of Brown's second term was the inevitable result. Rather than seek another term as governor, Brown tried to run for the U.S. Senate in 1982 and lost. He then seemed to disappear completely from the political scene for several years, but began his second coming in the late 1980s.

George Does It

"Deukmejian is... the quintessential middle class man, cautiously conservative but not anti-government..."

Columnist Dan Walters[15]

With the general fund reserve depleted and revenue down, Jerry Brown's successor, Republican George Deukmejian, was left with a major fiscal challenge.[16] Given the taxpayer revolt and his Republican background, Deukmejian relied mainly on squeezing spending. But he did undertake what he described as closing tax loopholes which some critics complained was really tax raising. In any event, 1982 was the trough of the recession of that period, and subsequent economic recovery brought in more state revenue. By 1986, Deukmejian could run for re-election, and win, as the fiscal savior of California.[17]

However, there were more repercussions of the taxpayer revolt that had spawned Prop 13. In 1979, the momentum of Prop 13 carried over into the passage of Prop 4 which limited state spending using a formula based on inflation and population growth. In a way, Prop 4 was a much less complicated version of Reagan's ill-fated Prop 1. Prop 4, termed the son of 13, was passed by voters. But it became a dead letter for many years because of the economic downturn of the early 1980s and subsequent budget cutting. The so-called Gann limit under Prop 4 (named after Paul Gann, the promoter of Prop 4 and co-sponsor with Jarvis of Prop 13), was well above actual expenditures due to the cuts.

By Deukmejian's second term, however, there was sufficient economic recovery and expansion so that the Gann limit was hit. As a result, excess tax revenue was returned in refund checks to state taxpayers. But that action had political ramifications. Under Prop 13, school districts had become dependent on the state due to the loss of local property tax support. The districts and teacher unions had hoped that economic recovery would add more state support. But the Gann limit capped those hopes. So the school establishment put Prop 98 on the ballot in 1988 which voters narrowly passed. Prop 98 (and a later companion proposition) effectively gutted the Gann limit and set state spending on K-14 through formulas.

Roughly 40% of state general fund spending became earmarked for K-14 under the new formulas. The legislature can suspend the Prop 98 guarantee. But the withheld funding then piles up as a debt on what is termed by Sacramento budget wonks as the "credit card" which the state must repay in the future.

There are two key effects of Prop 98. First, when the economy recovers from a downturn and more revenue comes into the general fund, much of it is swallowed up by Prop 98 and K-14. Creative ways to limit this effect are periodically developed in state budget practices that have produced a complex and convoluted fiscal system. Second, local property taxes – although reduced by Prop 13 – still go to schools and other local governments. Property taxes that go to schools are part of the Prop 98 formula system. Thus, state and local finances are linked by formula. In particular, anything that diverts local property taxes from schools effectively ends up tapping state revenue.

Pete and Re-Pete

"Once, people retired to California. Now they were retiring from California, selling their homes at inflated prices, and going to kinder, gentler places."

Historian Kevin Starr describing
California after 1990[18]

By the 1990 gubernatorial election, the U.S. economy was feeling the effect of a mild and short-duration recession. But for California, the downturn was turning into a big and long-lasting recession due to the ending of the Cold War. Deukmejian was succeeded as governor by Republican Senator Pete Wilson, the man who had defeated Jerry Brown for the U.S. Senate in 1982. Until he took office, Wilson didn't realize the gravity of the budget crisis which eventually became the preoccupation of his first term in office.

As noted, Californians generally did not understand the degree to which state economic growth over the preceding half century was based on a military infusion from Washington. So Wilson was hardly alone in assuming initially that the budget problem could be quickly remedied. But as Chart 2 illustrates, if the Cold War job trend is projected into the post-Cold War era, a widening gap appears between actual job creation and the earlier Golden Age trend. What Wilson was facing was a structural change, not a temporary setback.

At first, a tax increase was enacted in the hopes that it would resolve the state's budget problem. But the crisis persisted year after year with budget cuts becoming the main instrument of adjustment. Although standard practice has been to propose a budget that ends with a positive (or non-negative) reserve in the general fund, it began to be apparent that multi-year solutions were needed. A quick fix was not going to be possible.

Under the California constitution, borrowing from financial markets is supposed to occur only for long-term projects (infrastructure) and then only after a vote of the people to approve the borrowing. However, court decisions have allowed short-term borrowing through flotation by the state treasurer of Revenue Anticipation Notes (RANs) *within* a fiscal year to deal with irregularities in cash flows. In unusual situations, such as occurred under Wilson, the state can also borrow short-term *across* fiscal years using Revenue Anticipation Warrants (RAWs) floated by the state controller. Both methods of borrowing were used by Wilson as the budget crisis continued. At one point, however, the state handed out IOUs instead of paying all its bills.

While aerospace and military spending declined in Southern California, there was a reverse trend in the Bay Area. What was later to become the dot-com boom of the late 1990s was underway. The Silicon Valley had been developing since the 1950s, but the arrival of the Internet as a commercial endeavor created an economic rush. By the time Wilson ran for re-election in 1994, the effects were already beginning to be felt on the state budget. But politics moves with a lag.

Wilson and his administration married budget concerns with illegal immigration which was argued to be a drain on the state budget. A major element in the 1994 Wilson campaign was his support of Prop 187 which would have barred illegal immigrants from most state services. In the end, Prop 187 was enacted and Wilson won against Pat Brown's daughter (and Jerry Brown's sister) Kathleen Brown on the illegal immigration issue. That election had long-term political effects as it created a division between the GOP and the state's growing Latino population and electorate. But the short-term effects for the GOP were positive in the gubernatorial and legislative campaigns of 1994. And Wilson's final budgets produced rising levels of reserve funds and the elimination of the short-term debt that had occurred during the heart of his fiscal crisis.

Gray Numbers

"...(T)he man that is failing the people more than anyone is Gray Davis. He's failing them terribly and that is why he needs to be recalled and this is why I am going to run for governor..."

Arnold Schwarzenegger announcing his candidacy
on the Jay Leno Show[19]

We have so far spared you the strain of looking at budgetary numbers. But by 1998, when Democrat Gray Davis – Jerry Brown's one-time chief of staff – won election, the dot-com boom was in full swing and the decline of aerospace and military spending had largely run its course. Table 1 – based on the cash statements of the state controller – shows the development of a considerable reserve of over $9 billion in the general fund at the peak of the dot-com boom. Unfortunately, hidden under that reserve was the fact that at the very peak of the boom, the state was starting to run a small deficit (inflow below outflow).

A deficit at the peak should have been a warning to Davis. If there is a deficit at the peak of record boom, it can only worsen as the economy slows and reverses. However, Davis was something of a detail freak and had problems in delegation. As long as money was flowing into the state treasury, you don't have to be a great manager as governor. But if you try to control and manage everything, when problems arise, you are likely to end up with an out-of-control situation. Thus, appropriate action was not taken to ward off the oncoming budget crisis. As in the early 1990s, the U.S. went into a mild recession at the turn of the new century. But also as in the 1990s, special circumstances in California magnified the effect.

The dot-com industry and bubble was disproportionately concentrated in California in the 1990s, just as aerospace had been disproportionately concentrated in the 1980s. Moreover, the state's progressive income tax depends heavily on high-income earners. Such earners receive significant returns from financial markets. During the dot-com boom, there were capital gains to be taxed as internet stocks rose in value. During the bust, however, those gains and the taxes they generated suddenly evaporated. The state was thrust into a budget crisis as the 2002 gubernatorial election approached.

Apart from the budget crisis, the state had developed an electricity crisis – complete with rolling blackouts – thanks to an earlier ill-planned deregulation of the electricity market during the Wilson era. There had been advance warnings for the electricity crisis, as there had been for the budget crisis. But there, too, trying to manage everything produced control of nothing. Thus, the outlook for Davis' re-election did not look bright *if the GOP put up a reasonably strong candidate*. Probably, the strongest candidate Republicans could have put up in 2002 would have been Los Angeles mayor Richard Riordan. But Davis intervened via TV ads in the Republican primary that painted Riordan as a flip-flopper on issues such as abortion. In the end, Riordan was bumped out of the running and the Republican nominee became William Simon, a financier who conducted a weak campaign in the general election.

Davis won a tepid victory for a second term. But almost as soon as he was inaugurated in 2003, a recall drive against the governor was begun, ultimately financed by GOP Congressman Darrell Issa who hoped to ride it into Sacramento. In the end, however, Issa dropped out, movie actor Arnold Schwarzenegger dropped in, and – after a circus-like recall election with well over 100 candidates – Schwarzenegger emerged as the victor. In October 2003, Davis was replaced after serving less than a year of his second term.

The (Temporary) Budget Crisis Terminator

"I had big ambitions heading into my second term. I was determined to keep my reelection promises and take on big tough issues... The recession was past, the economy was growing again, and thanks to that and a lot of discipline, we'd narrowed the budget deficit... So the stage was set for dramatic action."

Former Governor Arnold Schwarzenegger[20]

Governor Davis had formulated a plan to deal with the budget crisis. As Table 1 shows, he had essentially gone into the Pete Wilson mode of short-term borrowing to cover the budget deficit. What Davis – like Wilson – was seeking was a multi-year solution. Ultimately, he came up with a proposal to substitute long-term borrowing for the escalating cost of short-term borrowing. But there was a catch. As noted earlier, the state constitution doesn't allow long-term borrowing to cover operating expenses. And any long-term borrowing, in addition, requires a vote of the people for approval.

Davis had developed a scheme to avoid these constitutional requirements but his legally-questionable scheme would probably not have worked, even had he remained in office. Investors would be unlikely to buy a legally-dubious bond offering since a court might well have voided the bonds as unconstitutional and left the investors with nothing. When Schwarzenegger came into office, however, he had substantial voter support and projected an optimistic and sunny outlook. He ended up adopting the Davis plan and actually enlarging the amount of borrowing to about $15 billion. But there was one major difference; *Schwarzenegger put the plan on the ballot* amending the constitution on a one-time basis to permit the borrowing. He promised the voters that the state would never do such borrowing again. It would "throw away the credit card" and build up an enhanced rainy day fund.[21]

Voters approved Props 57 and 58 allowing the borrowing in 2004. And by that time, the underlying economy was improving as a housing boom began to replace the defunct dot-com boom. One might have assumed – based on the Deukmejian history – that being perceived as rescuing the state from a budget crisis would have guaranteed Schwarzenegger's re-election as governor in 2006. But there was a bump along the way.

Schwarzenegger, flush with success from his campaign for Props 57 and 58, decided he would "reform" the state's fiscal and governance systems by calling a special election in 2005 for various ballot initiatives that he saw – but voters didn't – as fixing the state's underlying problems. The details are too complicated to go into here but the election turned out to be a fiasco for the governor and his popularity ratings sank. Thus, the 2006 election was not going to be a sure thing for Schwarzenegger.

However, it was here that Governor Schwarzenegger's prior movie career provided guidance. If you produce a movie that flops at the box office, you fire the screenwriters and others responsible and get yourself a new script and a new team. Schwarzenegger did just that. He revamped his top administration and selected as the new script the rebuilding of state infrastructure. New roads and such are always appealing to voters, particularly if no taxes are raised to pay for the improvements, and long-term bonds defer the costs to some ill-defined future. Infrastructure construction also creates jobs and appeals to labor unions and contractors. Major infrastructure borrowing was placed before voters in November 2006 which they approved.

Re-elected in 2006, Schwarzenegger announced that the year 2007 would be devoted to creating a universal health insurance plan for the state modeled after a Massachusetts plan (which eventually also became the model for the later Obama plan). But other factors began to intervene. As in the Davis case, poor management played an important role – but through a different channel.

While Davis was buried in details, Schwarzenegger liked the big picture and big issues. The details of those issues or even prioritizing them were not the governor's forte. The budget was already causing problems as the fall in reserves on Table 1 illustrates. A universal health plan for the nation's largest state presents complex issues – but there appeared to be no detailed plan for much of 2007, just a broad idea. Schwarzenegger also wanted to be seen as a "green" governor and supported environmental programs to cut greenhouse gas emissions – even speaking to the UN on the subject to enthusiastic applause. In the end, the budget situation worsened, the health plan failed in the legislature, and only the greenhouse gas element remained.

Part of the state's economic problems stemmed from a housing boom – which turned into a bubble – and which – like the dot-com bubble – eventually burst. The housing problem was fueled by a financial wave of flaky mortgages and related securities. Thus, a large workforce of jobs in construction, finance, real estate, and allied industries was at risk.

The impact of the financial crisis became severe throughout the U.S. and, indeed throughout the world in 2008. And just as California had a disproportionate share of aerospace in the 1980s and dot-coms in the 1990s, so, too, did it have a disproportionate share of inflated house prices, speculative housing developments, and flaky mortgages in the 2000s. Not all of the governor's long-term borrowing authority of 2004 had been exhausted and so more bonds were floated. An emergency session of the legislature produced a set of temporary tax increases in February 2009. A special election was called to see if voters would extend the temporary taxes beyond their expiration dates. They declined to do so.

The governor then came up with a draconian budget which the legislature wouldn't pass. By the summer of 2009, the state was handing out IOUs instead of paying all its bills. There seemed to be some chance that California might receive special aid from the new Obama administration. It had become a reliable "blue" state delivering 55 electoral votes in presidential elections to Democrats. But in the end, the state received its share of federal stimulus money but not more. Despite Governor Schwarzenegger's 2004 promise of throwing away the credit card, short-term debt again piled up.

By the time Arnold Schwarzenegger left office, his ratings in public opinion polls were about where Gray Davis' ratings were at the time of the 2003 recall. In addition, there was a negative reaction to a pardon issued at the end of his term to the son of a legislative leader and the revelation of a family scandal which ended Schwarzenegger's marriage. Since leaving office, Schwarzenegger – apart from an uncertain resumption of his movie career – has sought public rehabilitation by speaking out on environmental issues and establishing a public policy institute at the University of Southern California (USC).[22]

Jerry's Back

"The job (of attorney general) puts its occupant in a prime position to run for governor. Attorney General (Jerry) Brown issued a constant stream of news releases describing his actions in cracking down on fraud, gangs, and despoilers of the environment... Brown, blazing an unprecedented comeback trail, was poised to reclaim the office he had held more than three decades earlier."

Brown biographer Chuck McFadden[23]

The comeback of Jerry Brown occurred in stages and included being elected chair of the state Democratic Party and then – for a time as a radio commentator – dropping his party registration and even praising Rush Limbaugh. Being aloof from partisan politics is actually an old California tradition going back to the "progressives" of the early 20th century with their installation of direct democracy. So it is less surprising than it might seem for Brown to have adopted that position. Being nonpartisan has shown up repeatedly in state politics; Arnold Schwarzenegger was often termed "post-partisan" despite being a Republican. And it may yet have some impact on future California budgets due to voter enactment of nonpartisan redistricting and nonpartisan ("top two") primaries.

At the municipal level, nonpartisan elections are common in California. Brown's comeback involved being elected mayor of Oakland. But at the state level, short of the extraordinary 2003 recall, candidates ultimately need to have party support. Brown's move back into state political office involved a successful campaign for attorney general and before that campaign he resumed being an official Democrat. When he put himself up for the governorship in 2010, other than a short-lived effort by San Francisco mayor Gavin Newsom, Brown had little opposition in the Democratic primary.[24]

The Republican contest was more heated. In the primary race for the nomination, there was a three-way contest between two wealthy former Silicon Valley executives, Steve Poizner and Meg Whitman, and Tom Campbell, a one-time state budget director under Schwarzenegger, a former congressman, and an academic. Campbell had little money, however, and dropped out of the gubernatorial race to try for the U.S. senate – and failed. So the primary on the GOP side ended up with Whitman and Poizner in an expensive campaign in which they competed to be tough on immigration while asserting that their former business backgrounds would qualify them to fix the state's budget problems.

Whitman emerged successful from the primary but now weighed down with her immigration stance. She tried to backpedal on immigration but it is hard to undo months of TV ads and the backpedaling opened her up to charges of flip-flopping. There were personal history issues such as an apparent physical confrontation with an employee at eBay and bad behavior of an adult son. Still, polls indicated that Brown and Whitman were essentially tied as of September 2010. But then came "housekeeper-gate," an affair in which it was disclosed that Whitman had abruptly fired her illegal immigrant housekeeper when the possibility of running for governor arose. The polls seemed to go against Whitman after that disclosure with its image of a billionaire being nasty to a poor household worker. [25]

In the end, despite a vast expenditure of personal money on TV and other advertising, Whitman lost to Brown, receiving fewer votes than a proposition that would have legalized marijuana in California (and which also lost). What was surprising in the campaign was the lack of focus on the state budget, the issue that was bothering the electorate. Brown indicated that his familiarity with state political institutions would guide him to deal with the budget and promised no new taxes *without a vote of the people*.

Given the fact that at that point Democrats had less than a two-thirds majority in the legislature and that the two-thirds requirement for tax increases was (and is) part of the state constitution, as a practical matter, there could be no new taxes unless they were enacted by a ballot proposition.[26] Whitman's budget solution was "running the state more like a business," a position that reminded voters of the now-detested Governor Schwarzenegger and the promises he made during the 2003 recall campaign. Indeed, one of the most effective pro-Brown TV ads of 2010 was a side-by-side comparison of Schwarzenegger and Whitman saying the same thing.

The Option Man

"Thirty years ago he preached the era of limits and now he's got it."

Journalist Peter Schrag[27]

When Brown took office in January 2011, he had to present a budget for 2011-12 almost immediately. The budget plan he unveiled involved having the legislature put on the ballot a proposition to extend the temporary tax increases that had been enacted in February 2009 and were soon to expire. He made an ill-fated decision not to go the initiative petition route but instead to have the legislature do the proposition. Brown thought that if the legislature did it, even with minimal Republican support, the proposition could be billed as bipartisan. For the legislature to do the deed, a two-thirds vote was needed, and the Democrats lacked two thirds so a few Republicans would have to cooperate.

Brown thought he could persuade a few Republicans to go along with putting the *option* on the ballot even though they personally opposed the tax extensions. He saw a difference between offering voters an option and supporting the taking of that option. And he thought that he could offer Republicans some things they might like in order to obtain their votes on the basis of that distinction.

As it turned out, however, Republicans did not buy the idea that there was a difference between offering an option and supporting an option. Or, if they did see the difference, their core constituents made it clear that any such deal with Brown was a form of no-tax-increase heresy. To the distress of legislative Democrats, Brown kept negotiating long after they (the Democrats) viewed his effort as useless. Brown's experience with the legislature during the late 1970s and early 1980s, when cross-party deals were common, seemed to blind him to the fact that ideological polarization had totally changed the legislature as of 2011.

The Democrats were distressed because voters had adopted in 2010 a proposition ending the two-thirds requirement for enacting budgets; only a simple majority was needed henceforth. But the same proposition required that if the legislature had not adopted a budget by the constitutional deadline of June 15, its members would forfeit pay for each day without a budget enactment. It was unclear, however, what would constitute enacting a budget.

At the last minute, Democrats adopted what they termed a budget which Brown promptly vetoed. The veto itself would not have caused a pay forfeiture – the proposition did not require that the governor go along with what the legislature produced, only that they produced it. But the state controller – who is the writer of most state payroll checks (other than for UC) – decided that what the legislature hastily adopted had technical errors and was incomplete and thus withheld their pay.[28] In the controller's view, what the legislature had passed wasn't a true budget.

Later, a court ruled that the controller had no power to decide what was and what wasn't a budget; it was up to the legislature to make that determination. But at the time, both the governor and the controller became media heroes for blocking a budget that wasn't "balanced," a misreading of what had actually occurred. In any event, since it was by then apparent that Republicans would not go along with any feasible deal, a new budget was developed by the governor and legislature that simply assumed that a phantom $4 billion windfall would appear somewhere in state revenue during 2011-12. That assumption "balanced" the budget on paper. And this time the controller had no objections.

Not surprisingly, however, the phantom funds did not appear. Moreover, absent the ballot proposition that Brown had sought to negotiate with Republicans, the temporary taxes of February 2009 expired. As Table 1 indicates, the result was an increase in short-term debt in the general fund by the end of fiscal 2011-12.

If at First You Don't Succeed...

"What is shocking to me coming back here after 27 years is the hyper-partisan quality of debate."

Governor Jerry Brown[29]

Budget proposals are put together in late fall and early winter for presentation to the legislature in early January. Brown had learned from his experience in trying to negotiate a deal with Republicans during the first six months of 2011 that such deal-making would likely fail if he tried it again in 2012. So he didn't. Essentially, Republicans were left out of the process.

Democrats could pass a budget with a simple majority. And temporary tax *increases* (they were no longer tax *extensions* since the February 2009 temporary taxes had lapsed) could be put before voters by the initiative process. That approach couldn't be termed bipartisan but the situation was what it was. And so the budget proposal for 2012-13 was built around an initiative that temporarily raised the state income and sales tax.

In last year's chapter in *California Policy Options*, we described the process of negotiating both the budget for 2012-13 and the structure of the initiative. Of course, this time the negotiations were between the governor and legislative Democrats (and with certain Democratic constituency groups concerning the tax initiative). By the constitutional deadline in June 2012, the legislature had acted on a budget which assumed passage of the initiative – which became Prop 30 of November 2012. Automatic trigger cuts in spending if Prop 30 failed were also included.

Obtaining the needed signatures in sufficient time was something of a cliffhanger. But perhaps aided by the fact that the secretary of state (who is in charge of electoral matters) and the attorney general (who writes a summary of initiatives) were both Democrats, enough signatures were validated and Prop 30 was readied for the November 2012 general election. It appeared at the top of the ballot propositions, i.e., the proposition with the lowest number, thanks to a bill passed by the legislature using a maneuver eventually found illegal in a court challenge. Being at the top was considered advantageous for its enactment.[30]

In addition, another initiative had been put on the ballot – Prop 39 – which “closed a corporate tax loophole” that was billed as favoring out-of-state interests. Revenue from that initiative, if it passed, was earmarked for environmental purposes but had the potential to aid the general fund. Our prior chapter ended with an enacted 2012-13 budget and an uncertain outlook for Prop 30 as reported in public opinion polls as of late summer 2012.

Success

"I wouldn’t be a bit surprised if the outcome is even more positive than most of you are probably expecting."

Governor Jerry Brown, speaking of Prop 30, while casting his ballot[31]

Prop 30 raised the state sales tax by 0.25 percentage point temporarily (from calendar 2013 through 2016) so it affected virtually all state residents. But most of the additional money would come from temporary increases in the upper brackets of the state income tax (in 2012-2018). With the advantage of hindsight, we know that Prop 30 was passed by voters. But poll data taken over the summer suggested that the proposition was not a sure thing. In addition, an initiative for a tobacco tax earmarked for cancer research (Prop 29) had narrowly failed in June 2012, despite being a “sin” tax affecting only a minority (smokers) and being dedicated to a popular cause. That result could have indicated voter aversion to any tax increase.

As far as Governor Brown was concerned, if Prop 30 failed, he would not support another tax proposition – or so he said publicly.[32] He also said he would not support any legislation to undo the trigger cuts if Prop 30 failed. “There’s only, yes, we get the money... or, no, we have the trigger cuts.”[33]

If Prop 30 did not pass, the trigger cuts built into the budget would subtract almost $6 billion from 2012-13 expenditures, in part to assuage concerns in financial markets about the state’s credit. Of the cuts, $5.4 billion would come from the Prop 98 world (K-14) and another half billion (split evenly) would come from the University of California (UC) and California State University (CSU) systems. In effect, the trigger was on a gun aimed at what voters seem to like best: education. And the trigger was amplified by a decision by the CSU board to approve a tuition increase contingent on Prop 30 failing and another decision by CSU administrators to so-inform applicants. UC was more diplomatic and just hinted that failure of Prop 30 would mean tuition hikes.[34] The trigger was basically a political gamble.

Would voters resent the trigger-and-threat approach as a kind of blackmail and turn against Prop 30? Or would they see it as an incentive to vote for Prop 30? In truth, no one knew the answer when the key decisions on framing Prop 30 were made.

Folk wisdom in Sacramento is that a controversial proposition should start with a 60% favorable poll response by voters before the campaign, since opposition advertising will inevitably drive down its support. And even 60% may not be sufficient, as another proposition on the November ballot – Prop 37 requiring labeling of genetically-modified foods – showed. About three fourths of likely voters said they would vote for Prop 37 in September but it lost after a major opposition effort by food-related companies.[35] Prop 30 never even had as much as 60% support in opinion polls, however.

Along with Prop 30 was a rival Prop 38 – an initiative sponsored by Molly Munger, a liberal wealthy woman who heavily funded the pro-38 campaign. Prop 38 promised more aid to education than Prop 30. Prop 38 never did well in opinion polling. But even as a losing proposition, it might have drained support from 30.[36] It was unclear why its backer kept dumping money into the campaign for 38, but she did. As one journalist noted, the continued Prop 38 effort "shows what happens when someone enters the political arena with too much money and too little sense."[37]

The ballot also presented voters with Prop 32, an anti-union "paycheck protection" measure sponsored by Molly's conservative brother, Charles Jr., which presented a challenge to Prop 30.[38] (Paycheck protection measures seek to prevent union dues from being used for "politics" without individual member permission.) Two earlier versions of paycheck protection had been rejected by voters in prior elections.[39] But in 2012, there seemed to be an arrangement for a joint pro-32/anti-30 campaign. Out-of-state money flowed into that campaign from an organization which would not reveal its ultimate donors but that was reported to be backed by the conservative Koch brothers. Part of the strategy seemed to be to divert union money that would otherwise go toward Prop 30 into the anti-32 effort.

As of September 2012, Prop 30 was polling with a narrow majority of 52% in the PPIC poll (with 40% opposed) and 51% in the Field Poll (with 36% opposed) among "likely voters."[40] However, things began to break in favor of Prop 30. The early advertising for rival Prop 38 explicitly attacked Prop 30, but Molly Munger eventually agreed that later advertising would simply support 38 without attacking 30 (so both would not fail). A controversy and litigation erupted over the hidden, out-of-state funding for the pro-32/anti-30 campaign which likely added to support for 30.[41]

Out-of-state interests are not popular with voters as shown by their early and continued support for Prop 39, billed as closing a tax loophole for out-of-state corporations. (Prop 39 was polling so well in September that its chief backer, financier Thomas Steyer, pulled its supporting TV and radio ads.) Unions did divert money to fight 32 but they used a mirror image anti-32/pro-31 joint strategy for their campaign.

As the Appendix to this chapter shows, the major unions in California's public sector are the Service Employees International Union (SEIU) and the California Teachers Association (CTA) along with other teacher organizations. (See Appendix Chart A.) The campaign contributors for and against Prop 30 are also shown (Appendix Table A) and, not surprisingly, SEIU and CTA were key supporters of the pro-30 campaign. If the strategy of the opposition was to divert union money to fighting Prop 32, it appears the strategy failed. It was offset by combining the pro-30/anti-32 campaigns. And the funneling of money through a secretive entity made the entire anti-30/pro-32 campaign suspect and controversial.

Despite its poor credit rating, the state was able to float a general obligation bond at a record low interest rate in September, seeming to suggest that financial markets saw California's fiscal situation as manageable. The so-called "Amazon tax" – the sales tax due on online purchases from internet suppliers with some presence in California – began to be paid into the state treasury.[42] The state (and national) economy advanced at a sluggish pace – but advancing, even slowly, promised to help both state revenues and public impressions of an improving situation.[43]

Brown was able to sign legislation supported by both business and labor to reform the state's workers' compensation system.[44] With support of business groups, the state reopened some of its trade-promotion offices abroad. The California Chamber of Commerce remained neutral on Prop 30 but some businesses and business groups were supportive.[45] He signed a compromise bill reducing future costs of state and local public pensions.[46] That bill was seen as taking the pension issue off the table prior to the vote on Prop 30, thus defusing the argument that any additional monies from the proposition's tax hikes would just flow into pensions. And he signed a bill extending the state's film and TV credit tax which had labor and management support within the entertainment industry.

On the other hand, Brown vetoed bills he characterized as wasteful, thereby indicating to voters that they had a champion of fiscal restraint in their governor. He also vetoed some bills favored by unions, thus showing that even though unions were major supporters of Prop 30, he was not in their pocket. The result of these actions was a sense created that Sacramento affairs were on the mend or at least under adult supervision. To the extent that critics opposed aspects of his budget plan, Prop 30, or other policies, Brown simply answered that "I play the cards I'm dealt."[47]

As it turned out, one of the dealt cards was the presence of inaccurate polling. In late October, Brown walked into a coffee shop in San Diego and asked the employees if they had heard of Prop 30. Most had not, despite the barrage of TV advertising then on the air.[48] Yet when pollsters called respondents about Prop 30, there were relatively few "don't knows." That discrepancy is not surprising once it is understood that the pollsters tell the people they ask what the issue is about so that "don't know" means "I don't know what to think about what you just told me" and not "I've never heard of the issue and so don't know anything about it."

As Table 2 illustrates, the poll results on the eve of the November 2012 election put Prop 30 in a marginal position at best. No poll showed a clear majority favoring Prop 30, given the don't knows. Just as there is folk wisdom that controversial initiatives should start with 60% approval, there is also folk wisdom that the don't knows end up voting "no" rather than figure out what their opinion should be. So there began to be speculation in the news media about the impact of the impending trigger cuts and early critiques of Brown's campaign for Prop 30. Lieutenant Governor Newsom – who has ambitions to drop the word "lieutenant" from his title – criticized the Brown campaign in a radio interview in mid-October.[49] In the end, the polling and punditry were wrong and Prop 30 passed with 55% support.

There was much hand wringing after the election about where the polling errors had occurred. Maybe it was more youth vote than expected. Maybe newly registered voters made the difference. But the truth seems to be that while these explanations may partly explain part of the discrepancy, much is unknown.[50] A 55% victory for a controversial proposition – raising taxes – that had well-funded opposition is a strong result. Yet even before Prop 30 fell below 50% in the opinion polls, the outcome – if the proposition won at all – was expected to be a squeaker.

As expected, Prop 39 also passed (by 61%) – which put some added money into the general fund. Prop 32 – the paycheck protection initiative that had been paired with the campaign against Prop 30 – lost, receiving only 43% of the vote. Innovative use of social media to supplement the barrage of TV advertising was an important feature of the pro-30/anti-32 campaign. The Democrats upped their representation and won a bare supermajority in the legislature, potentially depriving Republicans of a *de facto* veto of future legislative tax increases. Brown, however, promised that he would not support future taxes without a vote of the people, his original 2010 campaign platform.

In theory, with a supermajority, Democrats could both pass tax increases and override a gubernatorial veto. In practice, however, neither was likely to happen given Brown's stance. One-time Republican leader in the state senate Jim Brulte commented that although legislative Democrats should be grateful to Brown for his campaign, "the half-life of gratitude in Sacramento is about a week." [51] But the political limits were more important than gratitude.

What had given Democrats in the legislature their supermajority were prior electoral changes involving redistricting and the non-partisan "top-2" primary. As it turned out, Democrats figured out how the new election institutions changed the game better than Republicans. The marginal Democrats who pushed the total to two-thirds of the legislative seats came from "swing" districts and would have to answer to Republican voters as well as Democrats in their districts. They were unlikely to want to be seen as tax-raising profligates who would go against their own governor's fiscal restrictions.

The politics were clear to the Democratic legislative leaders in the assembly and senate who reinforced Brown's cautionary note. When one state senator proposed raising the so-called "car tax" using the supermajority, he quickly was made to backtrack.[52] In any event, for the rest of the fiscal year, the Democrats sometimes had a supermajority and sometimes didn't, owing to mid-year turnover of some legislators.

Biblical Prudence and Budget Cosmetics

"We need the prudence of Joseph going forward over the next seven years and I intend to make sure that that's the story that we look to for our guidance."

Governor Brown after the November 2012 election
referring to the Biblical story of Joseph advising the Pharaoh
and to history's first rainy day fund[53]

With the passage of Prop 30, Brown was suddenly a political genius. And Lieutenant Governor Newsom was reminded of his pre-election radio and other criticism of Brown's Prop 30 campaign by a post-election tweet from Brown's press secretary containing a link to the song "Are You Lonesome

Tonight."[54] There was a general sense of a California comeback, not only in the state but nationally, particularly in contrast to the congressional gridlock in Washington, D.C. over "fiscal cliffs" and debt ceilings. Talk of possible general tuition hikes at UC and CSU ended. Charles Munger, Jr., who had backed the unsuccessful anti-30/pro-32 campaign, looking over the election results, reflected that "Our role as Republicans for awhile will be to choose the best Democrat."[55] But once the post-election excitement ended, the governor faced the task of putting together a budget for 2013-14 that would have to be unveiled in January.

And not all the fiscal news was good. The state budget for 2012-13 assumed revenue from cap-and trade auctions of pollution credits. But the first auction in November produced less money than forecast. And litigation was challenging the entire program. There were uncertainties about potential Medi-Cal (Medicaid) costs to the state under the Obama health plan as newly-insured individuals were brought into the system. On the other hand, an appeals court upheld earlier reductions in state payments to Medi-Cal providers.

One budgetary challenge was cosmetic. As it traditionally does, the Legislative Analyst's Office (LAO) issued a budget outlook report in November. Basically, LAO uses updated information on expenditures and revenues – combined with a revised economic outlook – and applies that information to the enacted state budget. The result is production of a revised estimate of how the immediate fiscal year would conclude and what might happen thereafter. Although the governor's budget for the upcoming fiscal year does not have to be presented until January, both the governor's Department of Finance (DOF) and the LAO have the same information. But they have different motivations.

Governor Brown wanted to be able to say – after the passage of Prop 30 – that given his much-advertised fiscal prudence – all was now well in state finance. In principle, the general fund should end each fiscal year with a positive reserve. But the prior year, 2011-12, had ended with a negative reserve. As Table 3 shows, on a cash basis in fact, the reserve was a negative $9.6 billion. And on an accrual basis, it was a negative $2.9 billion when estimated originally by the governor. Now accrual and cash accounting are bound to be different but the gap between the two figures should make you uncomfortable, particularly because the state publishes no reconciliation.

When LAO did its November update, its estimate on an accrual basis was that the prior year's ending reserve had actually been a negative $1.9 billion. And when the governor put out his January budget proposal, he had it at a negative $1.7 billion. The issue going forward was that the LAO saw the 2012-13 fiscal year ending with a slightly negative reserve – which didn't fit with the governor's "all-is-now-well-after-Prop-30-and-me" narrative. When the governor presented his January budget, he had the ending reserve for 2012-13 (as of June 30, 2013) be slightly positive. Note that we are talking about the already enacted 2012-13 budget to this point, not the proposed budget for 2013-14 (to be discussed in the next section). The slightly positive figure, although it varied somewhat, remained in the governor's May revise proposal and in his June estimate of the final result. But as Table 3 shows, the cash statement of the state controller shows a negative ending reserve for 2012-13.

Now you could argue that a little cosmetology on budget figures doesn't matter. The LAO, even though it projected a negative reserve in the general fund for the end of 2012-13 at the time of its November 2012 review, nonetheless saw a brighter outlook ahead due to a combination of Prop 30 and a recovering state economy. But actually, there is a problem with elastic budget accounting. Fiscal cosmetology has costs, not to the budget but to the making of sound budget policy.

In theory, accrual accounting assigns revenues and expenditures to the period in which they actually occur. It should be a better guide to policy than cash accounting which can be affected by accidents of timing. If a check arrives on June 30 or July 1, there should be no real implication for policy but there will be in cash accounting but not accrual. The problem with accrual, as found in California budgeting, comes not in theory but rather in practice. In actual state practice, revenues and spending can be moved around under accrual accounting for reasons of appearance. Such discretionary accrual can distort perceptions rather than make them more accurate.

It is important to note that elastic accounting did not start in November 2012, nor was it an invention of Jerry Brown. Unfortunately, it is a long tradition. We flag the issue here because the best time for fixing the problem is when the budget is not under strain. During periods of crisis, considerations of consistent accounting are inevitably submerged by circumstances. The LAO could flag the use of elastic accounting and produce consistent figures. But even though it is non-partisan, LAO does answer to the legislature and the legislature, just as the governor, likes flexibility in accounting. At one time, the state did have an independent budgetary review agency and one could be recreated. Absent such an entity, fuzzy methodology is likely to prevail.

Hints of a Better Era

"We are beginning a new era in California. I think it will be a better era."

Senate president Darrell Steinberg[56]

"By the way, living within our means means we don't get everything."

Governor Jerry Brown[57]

It is common practice for governors to leak out hints of what their January budget proposal will contain before making the formal announcement. The main leak of substance was that the governor would be proposing a change in the structure of funding for K-12 education. In essence, since Prop 13, the state had been a key funder of public schools. A hodge-podge of an allocation system had developed based on average daily attendance and then topped by various categorical programs for particular school activities.

Educational reformers had argued that funding should vary by child so that students with more difficult educational problems (such as lack of basic English) should receive more money than others. Of course, that is an abstract concept. Any change in funding structure might advantage some districts and disadvantage others in terms of per-student state allocations. Governor Brown had tried to implement K-12 funding reform in his 2012-13 budget, but the outcry from school districts that saw themselves as fiscal losers killed the plan. Governor Brown let it be known that he would again be producing a proposal based more on student needs than on body counts. But details were not provided ahead of the official budget unveiling.

Other bits leaked by the governor involved some kind of plan for improved efficiency in higher ed. Republicans tried to enter the pre-budget proposal discussion with a demand that UC and CSU tuitions be frozen for seven years since, they argued, voters had enacted Prop 30 with that understanding. But the problem for GOP legislators was that once they had not compromised with Brown during his first budget cycle, they had been largely cut out of the process. With fewer seats during the third cycle than in the second, Republicans had even less influence than before. One Democratic assemblyman quipped that his Republican colleagues could busy themselves with "some great new smartphone apps" while the Democrats worked out the budget without their participation.[58]

Budget compromises for 2013-14 *would* have to be negotiated, but the negotiations were between the governor and the Democratic legislative leaders. During previous governorships, final budgets were often produced by negotiations among the so-called "Big 5," the governor, the two Democratic legislative leaders and the two Republican leaders. But the two-thirds requirement to enact a budget no longer existed which undermined the leverage of the minority Republicans. And whatever incentive there might have been for even a courtesy inclusion had been lost in the first budget cycle.

All of the pre-budget unveiling discussion, as well as the actual formulation of the January budget proposal, came against a backdrop of uncertainty stemming from federal fiscal gridlock. It appeared that Congress might run over the federal "fiscal cliff" which would have meant sudden tax hikes as of January and a possible slowing of the economy as a result. A slowing national economy – if it occurred – could cut into expected state tax revenue.

As it happened, a deal was cut in Washington around the January 1 deadline. And the fiscal cliff threat might have actually added to state tax revenue as high-end taxpayers may have taken capital gains before the end of calendar 2012, hoping to avoid potential higher tax rates in the future.[59] It turned out that the state received significantly more income tax revenue than forecast, possibly due to that circumstance. But the windfall of receipts was not known when the 2013-14 January budget proposal was unveiled, although it was to influence budget negotiations six months later.

Something to Remember Me By

"Clearly, he wants a legacy."

Professor Kimberly Nalder, Cal State-Sacramento, commenting
on Governor Brown's 2013-14 State of the State message
and his post-Prop 30 budget priorities[60]

When the budget was unveiled, as expected, there was a formal proposal for restructuring K-12 finance known as the Local Control Funding Formula (LCFF) and a proposal for a higher education tuition freeze and performance standards related to such measures as time-to-graduation. Prison realignment – transfer of less dangerous prisoners from the state prisons to county jails and supervision – would continue (albeit not to the level courts were demanding). State tax breaks for "enterprise zones" – zones set up by local governments to entice businesses and jobs – would be ended on the grounds that the zones were not effective. Funds from the zones would be rechanneled to a more effective job creation plan.

There is no doubt that Prop 30 plus the economic recovery had changed the budget outlook. But not everyone was pleased with the governor's 2013-14 budget plan, notably advocates for the court system who argued that courts were underfunded and were functioning with delays and service reductions. Part of the difficulty in political terms was that state judges themselves were involved in an internal dispute over administration of their branch of government which made presenting a united front to Sacramento difficult.

Advocates for the school system were generally pleased with an end to a budget squeeze, but the details of the governor's restructuring plan were controversial. With more money in the pot than in the prior year, it could be said that even districts that were not winners under the revised formula (districts without large numbers of students from disadvantaged backgrounds) would gain something. But obviously, they would gain more from retaining the old system of fund distribution. The governor also was able to divert some of the Prop 39 environmental money into K-14 for energy saving building upgrades. Such a diversion helped satisfy the Prop 98 guarantee but did not necessarily put the earmarked money to its best environmental use.

The UC regents praised Brown effusively at their meetings (at which he showed up as an *ex officio* regent). But UC administrators worked behind the scenes to reduce the degree of budget-related mandates in the budget plan, largely by promising to do what was wanted "voluntarily." Under the state constitution, UC has a degree of autonomy. Moreover, only about one in 10 dollars of its total budget comes from the state. That dollar is roughly matched by student tuition and the combination (state+tuition) covers "core" educational functions. (The rest – roughly eight dollars in 10 – comes from hospital revenues, research grants, fees for co-managing the Department of Energy labs, and other miscellaneous sources). CSU and the community colleges, which do not have a special place in the state constitution, were more exposed to budgetary conditions and mandates.

In broad terms, when you look at Table 4, the final budget looks much like the January proposal. But what is surprising is that the forecast inflow of funds in the budget in January is actually a bit higher than later forecasts. Yet the seeming windfall – about $5 billion - of income tax revenue described earlier that may have related more to the Washington fiscal cliff than anything specific to California began to influence the legislature's view of the budget. Maybe things were even better than they appeared in late 2012 when the January 2013 proposal was put together. Maybe there was more to spend than the governor recognized. Maybe all or much that had been cut during Hard Times could be restored, particularly in the area of social welfare programs. Maybe – even if the windfall didn't last – revenue could be obtained from a tax on petroleum if what some saw as a potential oil boom materialized.[61]

In the background of the better times in Sacramento were the aftershocks of the Great Recession on certain cities and ongoing state vs. local tensions. During the years of the state budget crisis, various diversions of local revenue were used to support the state budget. By 2013, some cities with high-tech revenue bases such as San Francisco, San Jose, and Santa Monica were doing well. But there were the notable bankruptcies of Stockton and San Bernardino and struggling cities such as Riverside in the heart of the foreclosure belt. The earlier state budget crisis had killed off local redevelopment agencies. Now local enterprise zones were due for termination under the budget proposal.

Things That Could Have Gone Wrong

"California has once again confounded our critics."

Governor Jerry Brown in his 2013 State of the State address[62]

*"Don't know if it's a setback. I mean, look, sh*t happens."*

Governor Jerry Brown commenting on defects
in the Bay Bridge replacement[63]

When one looks back at history, what occurred often seems to be the inevitable workings of events – one leading to another. With hindsight, we know that the Brown budget for 2013-14 was enacted on time and ultimately with more or less what he wanted, as will be detailed below. But it was not inevitable that everything would have ended that way. Prop 30 might not have passed. The economy might have stalled. Either circumstance would have choked off revenue and produced a much different budget outcome.

In less advantaged times, and with more of an effective opposition in the legislature, there were many events in various stages of unfolding that could have undermined the governor's credibility or fueled opposition. The governor supported high-speed rail between Southern California and the Bay Area. But the initial plan, thanks to a complicated entanglement with Washington, had the first segment to be built between Fresno and Merced. That segment was not exactly a dense corridor in which heavy passenger usage could be anticipated.

Although opponents of Prop 30 made reference to high-speed rail as an example of a Sacramento boondoggle, the fact that the plan was not more advanced than it was did not allow it to become a magnet for controversy. Essentially, all that existed was a plan. No track had been laid. And in mid-April 2013, the winning bidder for the first segment of the proposed rail line ostensibly asked a lower price than had been anticipated while at the same time a lawsuit challenging the line on environmental grounds was settled.[64] (Well after the budget was enacted, a judge ruled that the funding plan did not meet legal requirements. The full consequences of that decision are not known at this writing but its later timing meant that the 2013-14 budget process was unaffected.)

Governor Brown favored a massive state water project which had echoes of the "peripheral canal" plan that had been rejected by voters during the second term of his first iteration as governor. The new plan, among other elements, involved construction of two large water tunnels in the Sacramento-San Joaquin Delta area, and ultimately would attract a similar north vs. south water debate to the one that killed the earlier canal. But the water project was even more of an abstraction than the rail system.

For the project to be constructed, the legislature would have to rework an earlier water bond proposal that had been repeatedly postponed and then put it on the ballot. None of that had occurred when Prop 30 was under consideration or when the 2013-14 budget was being debated although the tunnel plan was certainly mentioned in the governor's 2013 State of the State address (as was the rail plan). A PPIC poll suggested that voters were split on both the rail and water projects (when they were described). But no one was asking the electorate to do anything about either one.[65]

Less abstract was the state's construction of a replacement of a major segment of the Bay Bridge by the state. There was a steady rain of disclosure of scandal and incompetence surrounding that project. Inspections for some components had been falsified. In other cases, inspected or not, defective parts had been used. The Bridge segment was targeted to be opened by Labor Day 2013 but information available at this writing indicates that the target will be met only by temporary fixes. Unlike the proposed rail system, the Bridge was under construction and visible during the budget process. But its problems never caught on as an issue during the Prop 30 campaign or the passage of the 2013-14 budget. Perhaps the public saw it as a local matter rather than a state affair even though it was a state project. Governor Brown let it be known he would not attend the opening ceremony and would be out of the state when it occurred.[66]

Harder to avoid was a scandal in the state parks system. During the years of budget crisis, there were threats to close parks due to fund shortages. Park advocates had put an initiative on the ballot to raise motor vehicle fees for the parks, which failed. Private fundraising and attempted rescues by localities were undertaken. Then it turned out there were "hidden" park reserve funds that could have been used to keep the parks open. Audits suggested the result was a combination of deliberate malfeasance – although not for obvious reasons – and incompetence. The official in charge was replaced. Another official resigned and paid a fine. The total monies involved were on the order of a rounding error in the larger state budget but the scandal produced headlines.

Once a hidden funds scandal had been discovered in the parks, journalists looked for other hidden funds and found some at Cal Fire, which had diverted some funds from legal settlements to an external nonprofit entity. The Cal Fire revelation led to legislative hearings and had the potential to create a wider controversy because of ongoing litigation by rural residents over a fire-fighting fee imposed by the state. But the legislative hearings and announcements of audits of state agencies to detect any other hidden funds seemed to end the controversy.

There was a finding that fees paid by motorists for special license plates to benefit particular causes were somehow not always being directed to those causes, but the information came and went without definitive action. The Department of Toxic Substances Control turned out not to have collected $100 million in fees owed by polluters for a quarter of a century for cleanups of contaminated sites. Yet there were real issues apart from just the particular hidden or misdirected or non-collected monies uncovered.

The inability to reconcile the state's budget on a cash basis and on an accrual basis, for example, reflects a defect in basic bookkeeping and has fiscal policy ramifications. There is a tendency to view accounting, bookkeeping, and transparency simply as devices to conduct forensic audits, i.e., to search for illegal activities and misdeeds. For example, one do-good organization that awarded California's level of budgetary transparency an F did so largely on that ground.[67] But there need not be anything illegal occurring, and yet poor fiscal policy may be in place. It's not just transparency, i.e., ease of finding raw information that is needed. There need to be consistent definitions. Furthermore, those definitions need to accord with common-sense English terminology that the public can understand.

Opponents of Prop 30 certainly made reference to the parks scandal. But timing seemed to matter. The worst of the revelations occurred before the major push for Prop 30 occurred. And then it appeared that the problem had been fixed in that the hidden funds were being used to prevent park closures. The Cal Fire scandal occurred after the Prop 30 campaign but could conceivably have affected the later 2013-14 budget process.

Apart from these issues, there was the matter of public pensions in California including the large CalPERS plan (covering most state employees except UC and many localities) and the CalSTRS system (for school teachers). Since pension funding was discussed in last year's *California Policy Options* volume, that analysis won't be repeated here. Suffice it to say that the issue has created tensions between public sector unions and California's state and local governments.

Had Meg Whitman won the governorship in 2010, there would have been a battle royal over the pension issue since she had campaigned on drastic changes.[68] Brown in contrast had said there should be reforms of some kind that would be fair to taxpayers and public employees – but during the 2010 campaign he did not say what those reforms were. Brown ultimately had gotten a pension reform bill through the legislature in September 2012 at a time when the Prop 30 campaign was underway. The issue had the potential to create a divide between the governor and public sector unions which would otherwise be a base of support, both monetary and in-kind, for Prop 30.

Nonetheless, with furloughs ending and pay raises in sight as labor contracts with the state expired, Brown's relation with the unions was more cordial than had been the case under Schwarzenegger. Indeed, Brown had explicitly promised to avoid "Boulwarism" in dealing with state unions, an obscure reference to a mid-20th century GE executive known for hard-line negotiating tactics.[69] In part because public pensions were depicted as more generous than what was usually available in private employment, the legislature enacted a plan – really a study to see if a true plan was possible – to provide a pension vehicle through the state for private workers.[70] In any event, in Brown's view he needed a pension bill enacted – even if it was at the displeasure of public sector unions – to assure voters that Prop 30 money would not be eaten up by retirement funding.

That logic was ultimately persuasive and, as described earlier, unions did strongly support Prop 30. The pension debate was defused at the state level although unions at the local level have filed court challenges to certain provisions of the legislation. The pension issue was also being contested in court by bondholders of bankrupt cities such as Stockton and San Bernardino who argued that pension liabilities should not be privileged relative to other city debts. There was a brief tangential flurry when it was revealed in January 2013 that certain CalPERS management personnel had held dual jobs at the agency, apparently to evade restrictions on paying them overtime. The Brown administration effectively halted the practice although there were claims that it saved money regarding a computer project.[71] Similar activities in other agencies including the prisons were also revealed.

Even a claim of saving money was hard to sustain when it came to the computer system for handling state payrolls. At most, all that could be said for that affair was that it involved reducing losses. The state has had difficulty mounting new computer systems for a variety of purposes. Sadly, the payroll system was no exception. In February 2013, the project to replace a 1970s-era system was terminated after unsatisfactory performance of a new system (and reported expenditures of $373 million).[72] A state senate investigation of what went wrong was delayed until summer 2013, i.e., after the budget was enacted. Brown may also have benefited from the fact that the payroll system is under the jurisdiction of the separately-elected state controller, John Chiang. Chiang ultimately had to defend the decisions involved, not Brown, even though the costs were ultimately borne by the state's general fund.

A final issue that might have upset the budget plan was the state prison system and a problem Brown inherited from the Schwarzenegger era. Federal courts were demanding that California reduce its prison population – which substantially exceeded the official capacity of its prisons – on the grounds that overcrowding and lack of adequate medical facilities were violations of the federal constitution. Brown's solution was realignment – moving state prisoners to local county jails and parole systems – ostensibly with funding for the counties to handle the influx. However, even with realignment, the prison population was not reduced to the levels demanded by the courts.

Realignment was unpopular with the counties and generally local law enforcement saw it as potentially creating more crime since there would ultimately be releases of individuals who would otherwise be incarcerated. There were anecdotes of crimes committed by such individuals but at the time of the Prop

30 campaign, there was little in the way of hard data that would document a bump up of crime rates. Moreover, Brown was able to play both sides of the issue. On the one hand, he did support realignment. But on the other hand he kept filing appeals of court decisions demanding more prison population reductions. So he could argue that realignment was the product of irresponsible federal judges and law firms appointed by courts to represent inmates and that he was doing his best to keep it in check by proposing the least distasteful plan possible.[73]

The most recent annual crime data which were not available during the Prop 30 campaign or during the subsequent budget process actually do show a slight increase in the violent crime rate after a long period of decline, as Chart 3 indicates.[74] One announced GOP candidate for governor when and if Brown runs for re-election in 2014, former Lieutenant Governor Abel Maldonado, has indicated he will make crime and realignment an issue. Meanwhile, whether the increase in crime is a one-time blip or is causally related to realignment is not known.[75]

One might have expected that the property crime rate rather than the violent crime rate would show an effect of realignment since individuals bumped out of county jails would more likely be in that category. But the blip in the official crime figures – as noted above – came too late to influence the Prop 30 campaign or the budget process. And, as also noted, Brown had the ability to be both for and against realignment.

In the end, however, a key reason why issues from prisons to pensions to water did not upend the governor's 2013-14 budget was the weakened state of the Republican opposition. Although the governor had a friendly dinner with Republican legislators in March 2013, he really didn't have anything that he needed from them. And they had nothing to offer him. As Brown later put it, "*While we don't have one-party rule in California, at least we have a diminished opposition. And hopefully that will bode well.*"[76]

Revelations that might in earlier years have given GOP legislators traction simply didn't have that impact in 2013. Issues would arise such as a finding by the Legislative Analyst that the prison system was not collecting all it could for its medical system from the federal Medicaid program, but such revelations would dissipate with little effect on budget outcomes. As noted, the state seemed to be unable to update its various large-scale computer systems without cost overruns and failures. But the headlines came and went. When the Cal Fire hidden funds story broke, Governor Brown said it was "a relatively boring story" and despite criticism for that statement, the issue faded.[77]

The Budget Process

"That's life – life is obstacles. I didn't get to be governor 37 years later by not overcoming obstacles."

Governor Jerry Brown commenting on
complaints by business leaders[78]

Of course, not all news was bad for the budget by any means. As described, there was the January 2013 $5 billion windfall. Later that month, one of the three bond rating agencies – Standard and Poor's – raised its grade for state general obligation bonds from A- to A.[79] (Fitch waited until August 2013 – after the budget was enacted – to make the same upgrade.) In principle, an improved bond rating would allow the state to borrow at lower interest rates than had previously been the case. (Ironically, California shortly thereafter sued Standard and Poor's for its faulty ratings of mortgage securities which played a major role in the 2008 financial crisis and the losses by the state's two largest pension funds: CalPERS and CalSTRS.)

Essentially, however, absent a fiscal crisis, once the governor submits the January proposal, the legislature holds hearings but doesn't do much more than that on the budget until mid-May when the governor submits the "May revise," a modified proposal that reflects later data on revenues and expenditures and on the general economic outlook. In the case of California, the economy looked to be continuing on a slow but steady recovery. While at one time, the federal sequester might have especially hurt California due to its large military-related sector, the shrinkage of that sector after the Cold War ended made the state less affected by Washington problems than it would have been in the past.

But the economy and broad revenue projections are not the only influence on the May revise. The interim months between January and May give interest groups a chance to suggest, protest, or endorse. And the Legislative Analyst weighs in with detailed comments on particular elements of the budget.

For example, the Analyst questioned the legality of certain proposed uses for fees and cap-and-trade revenues. Under Prop 13, tax increases are subject to a two-thirds vote whereas user fees are not. Thus, before Prop 13, the tax vs. fee distinction was not important but after 13, defining just what a fee was took on new significance. Indeed, as late as 2010, the electorate – while freeing the enactment of the budget from the supermajority requirement – tightened the fee definition.

The Analyst believed that some uses the governor had proposed went beyond the allowable purposes.[80] Brown had expressed dislike for the Legislative Analyst's Office well before these evaluations; it is doubtful that they improved his disposition. In the previous September, he vetoed a bill which would have had the LAO convene a study group to set goals for higher education, saying the topic was "way too important to be delegated to the Legislative Analyst."[81]

The Legislative Analyst was more positive about the governor's proposal to restructure the funding formula for K-12, although some tweaks were recommended, particularly regarding English-language learners. However, the diversion of Prop 39's revenues that were seemingly dedicated for general energy efficiency toward K-14 energy efficiency projects and the governor's counting of that spending as part of the Prop 98 guarantee were questioned by the Analyst. (The Legislative Counsel, in effect the legislature's lawyer, appeared to agree with the Analyst.) The Analyst also noted that the impact of the federal health insurance plan ("Obamacare") on the state's Medi-Cal program was not reflected in the budget proposal. And it was noted – as mentioned earlier – that California's problem with providing prisoner mental health programs could be reduced if the state were more effective in seeking federal reimbursement through Medi-Cal (Medicaid).

Hearings and reports suggested a residue of problems stemming in whole or in part from the Great Recession and its aftermath. Community colleges are "protected" by Prop 98 but the K-12 component of K-14 is the political powerhouse. The community colleges – which are supposed to function as inexpensive paths to the first two years of college and as colleges of last resort for those not qualifying for UC or CSU – had experienced particularly large budget cuts.[82] Nonetheless, the governor wanted the community colleges to assume responsibility for adult education programs that had previously been handled by K-12 school districts.

Furloughs of state employees helped deal with the immediate budget crunch but with involuntary time off, employees reduced their use of paid personal leaves and vacations, thus building up a future liability for the state. All pension plans' portfolios were adversely affected by the financial crisis but CalSTRS became particularly underfunded. Unlike the CalPERS' board, the CalSTRS trustees cannot raise contribution rates on their own motion; the legislature must do the mandating. UC's regents can in principle set contributions at whatever level they like. But they cannot order the state to pay for them so, absent state cooperation, raising tuition is their alternative.[83]

Similarly, K-12 schools and community colleges were owed money on the Prop 98 "credit card" as a result of past suspensions of the guarantees under that proposition's formulas. Governor Brown liked to refer to external debt service on bonds plus all of these other liabilities as the state's "wall of debt." But there was no pretending that all of these liabilities were going to be resolved quickly just because of the improved budget outlook.

Even though a final budget is due to be enacted by the legislature by mid-June, the period between the initial proposal by the governor in January and the May revise is ultimately a quiet time. But – as noted – there were reminders of the convoluted fiscal institutions that developed as the state has struggled through budget crises and attempted to find ways around the various voter-mandated and other strictures in budgeting. For example, in March 2014, the Board of Equalization imposed an (annual) increase in the excise tax on gasoline to be offset by an equivalent (revenue neutral) drop in the sales tax on gasoline. Why? The sales tax was earmarked for local transit agencies, while the excise tax goes for state transportation programs. The excise tax could thus be used to pay the debt service on state transportation bonds that was previously met by general fund revenue. As a consequence, therefore, general fund revenue could be freed up for other purposes.

Although Prop 13 tended to create an interconnection between state and local budgets, and although the state had arguably raided local revenue sources in the aftermath of the Great Recession, the problems of the localities did not loom large in Sacramento during the period leading up to the May revise. Indeed, there continued to be a search for eliminating state mandates of local activities, not to give the locals the freedom to eliminate the activities, but to find activities which – if they weren't mandated – the locals would perform anyway.[84] Mandates from the state to the locals must be funded by the state; activities which are "voluntary" at the local level are paid for locally.

The bankruptcies of Stockton and San Bernardino were in the news. And there were reports about litigation by local governments against the state as the latter tried to collect what it said it was owed due to the earlier termination of local redevelopment agencies. But the governor seemed more focused on the external world, specifically a trade promotion trip to China. The adage about all politics being local did not appear to apply to California.

In some respects, the period before the May revise is similar to that shortly before the January budget proposal. There are hints and leaks about what the revision will contain. The governor's proposed K-12 redirection of funds toward low-income and disadvantaged districts was provoking opposition from districts that feared they would lose out. Brown promised that his opponents were "going to get the battle of their lives" if they tried to kill the plan.[85] More generally, he warned Democrats that they should not assume windfall revenue in making their spending proposals – although a windfall had seemed to occur. "The revenues, guys, wait 'til the May revise," said the governor in what may have been inadvertent rhyme.[86]

Revise and Dissent

"They don't call me Moonbeam any more... We're getting things done. We're building the foundation for a renewed California."

Governor Jerry Brown
April 2013 interview with the *Financial Times*[87]

Although the policy issues – particularly the K-12 funding reforms – were well known before the May revise was released, the most contentious question involved revenue projections. With more tax receipts coming in than had been anticipated when the January proposal was made public, would more optimistic projections be made for the coming fiscal year? If so, there could in principle be more spending on various programs. As Table 3 indicates, the governor was willing to up the revenue estimates for the then-current fiscal year 2012-13. But Table 4 also shows that he did not push up revenue estimates for 2013-14. In fact, somewhat less revenue was assumed than in January with the lower amount attributed to a less robust state economic recovery due to the congressional sequester.

Note that the revenue estimates are not the same thing as the actual revenue that will be received. If "conservative" figures are used and more money comes in than estimated, the result will be a somewhat bigger reserve than initially projected. In effect, a rainy-day fund accumulates. Recall as well that when cash estimates of the reserve in the general fund by the state controller are considered, the fiscal year 2012-13 did not in fact end with a positive reserve, contrary to the accrual estimates of the governor. The more dollars that might accumulate in the general fund over the course of 2013-14, the more likely it would be that it would no longer be necessary to "adjust" the accounting to achieve a positive reserve by the end of June 2014.

The problem for the governor was that the Legislative Analyst believed that the underestimate of revenue that had occurred in 2012-13 was not a one-time fluke but in fact signaled a more optimistic outlook for the state and its tax receipts. According to the Analyst, revenues would be $2-3 billion per annum more than the governor was forecasting out through 2016-17.[88] Moreover, the Analyst argued, the legislature could frame the budget to include contingent spending so if the extra revenue did not appear, spending would be reduced. Legislative leaders said positive things about the May revise, but did not commit to observe the governor's cautious revenue figures.

For example, Assembly Speaker Pérez said that he "appreciate(d) the governor's commitment to maintaining... fiscal stability." But he went on to say that the legislature would "review the governor's proposals and revenue projections, along with the LAO's revenue projections..." Senate President Steinberg was more blunt and spoke about the "disappointing aspect" of the budget's failure to make up for earlier cuts in social spending. Indeed, Brown received more favorable comments from minority Republicans. Republican senate leader Bob Huff said he had "common ground" with the governor and that Brown's biggest challenge would be in "restraining" Democratic legislators' spending urges.[89]

The spending Brown did propose made some adjustments to his K-12 funding formula reforms (and won the support of the influential California Teachers Association), softened some of the mandates that had been directed at public higher education, and created a process for ending tax breaks for enterprise zones while substituting a more general subsidy to manufacturing. (Ultimately, elimination of the zones was enacted, but it occurred in July 2013, after the adoption of the budget.) The May revise proposal included borrowing half a billion dollars from anticipated cap-and-trade revenue for the general fund. That item was one of those unfortunate – but common – instances in state accounting in which borrowing is treated analogously to revenue for cosmetic reasons. Putting more borrowing money in the general fund would, other things held constant, make the reserve at the end of fiscal 2013-14 appear that much more positive.

Whatever the merits of the various proposals, the balance of forces favored the governor in negotiations with the legislature. First, the legislature had to produce a budget by June 15 or lose pay. Only a simple majority would be required. In principle, thanks to the earlier fight and litigation with the state controller, legislators could enact something the governor would surely veto and say that they had met the deadline. What would happen in that event, however, was not entirely clear. Would the majority Democrats really want to get into another battle over their pay if the enacted budget was a sham? What if the controller found some grounds not to pay them again for not enacting a real budget on time, despite previous litigation saying he couldn't?

Secondly, the governor could veto the entire budget, even one that was not a sham, if he thought the budget was not fiscally responsible. Or he could use his line-item veto to cut out parts he didn't like. In theory, the supermajority possessed by the Democrats would enable them to override a veto. But the centrist Democrats that had been elected in swing districts under the top-two primary system would be unlikely to go along with an override. So the two-thirds supermajority would evaporate in such a contest.[90]

Enacting the Budget

"I like political theory. It is more coherent than political practice."

Governor Jerry Brown speaking to
UC-Berkeley political science students[91]

From the governor's perspective, even with a strong hand in negotiations with the legislature, there was a downside to out-and-out conflict. So he still had some incentive to compromise. The simple way out for both sides would be for the legislature initially to play with budget proposals that embedded the LAO's more optimistic revenue projections for a few weeks leading up to the June 15 deadline.[92] Plans to spend more money than the governor wanted would be included in the proposals, pleasing various constituencies. But the extra money would then be squeezed out of the final version through the conservative revenue estimates which the governor would force on reluctant legislators.

There could even be a sweetener for legislators whose pay had been cut during the lean years. In late May, the governor's Department of Finance certified to the commission that sets legislators' pay that the state had the funds for a pay raise because the June 30 reserve under the accrual method would be positive. And subsequently, a five percent pay increase resulted.

In reality, most people don't follow the details of the state budget or know much about it. They don't like to admit it, however. In a poll taken after the May revise was issued, only 11% admitted to having no opinion about the budget or not having heard about it, a ridiculously low percentage.[93] The result, as noted earlier, is that pollsters characterize budget options when questioning respondents and then ask for their opinions based on the characterizations. And in general terms, voters seem to prefer thrifty ideas such as reducing debt or building a reserve to vaguer proposals for increasing spending on "social service programs" (whatever that term might convey). That fact also added to the governor's negotiating position.

Similarly, the governor, in negotiating with state unions, was able to maintain a stance of fiscal limits. In a deal with Service Employees International Union Local 1000, a union representing about half of unionized state workers, a general pay raise as of July *2014* (not 2013) was made contingent on the budget condition at that time. In the event of an unsatisfactory budget situation, the raise would be delayed another year. No general increases had been negotiated since 2007-08. Although some minor pay adjustments in the union's contract with the state were made, the 2013-14 cost of the deal was estimated by the LAO to be trivial.[94]

Although there were some changes in the K-12 reallocation formula, in the end the governor largely got his way.[95] There was some adjustment in the handling of Prop 39 funds. Killing off enterprise zones was not accomplished at the time due to local pushback as reflected in the legislature.[96] (But as noted above, the termination was enacted separately in July 2013.) Some constituents were disappointed since with more conservative revenue estimates than the LAO favored, there was less money to spread around.

Asking too much in at least one case backfired. UC for several years had been asking for $15 million to found a new medical school at its Riverside campus. The sum requested was supposed to be (somehow) on top of the funding UC would otherwise receive. What it got instead was a directive to devote $15 million to the plan, but in effect to take the money out of its regular allocation, something it could have done all along. Be careful what you wish for, seemed to be the lesson; you may get it in a way you don't like. Assembly Speaker Pérez was more successful in having his wish granted. A scholarship program aimed at cutting costs for middle-class students at UC and CSU that he had promoted was included in the final budget, even though the Legislative Analyst was reported to favor alternative ways of dealing with access and affordability.[97]

Once the budget was passed by the legislature, there were some aftershocks. Included had been a provision ending a mandate for local governments to grant public access to internal record requests. (Local governments must be reimbursed by the state for the costs of mandates so – as noted earlier - repealing mandates saves the state money.) The argument for repealing this particular mandate was that local governments would maintain public access, even if not required by the state to do so. However, the elimination of the mandate triggered a storm of complaints by journalists and others, fearing diminished ability to obtain public documents. What if the local governments didn't continue their access policies without a state mandate? In the end, the mandate was restored by a subsequent action.

Because the budget deal was ultimately negotiated between the governor and the Democratic legislature, the line-item vetoes by the governor were minor and mainly affected certain school and pre-school programs. One oddity was the governor's veto of his own proposal to mandate additional online education in public higher education. However, the veto was made with a tacit understanding that online education would nonetheless be extended within UC and CSU.

Final Thoughts

"I gotta do one thing at a time. You can't get it all done. And if I got it done all in one year, you wouldn't need me."

Governor Jerry Brown[98]

"I have a husband who thinks that his job is like a vacation. He's like 'What do you mean get away from work? This is like a vacation.'"

First Lady Anne Gust Brown[99]

"Brown ... is enjoying a degree of success and authority he and his opponents could scarcely have imagined when he returned to Sacramento to begin a second tour as governor in 2010."

New York Times report[100]

The budget signing ceremony of June 27, 2013 was in marked contrast to the governor's first budget signing in 2011. At that time, it will be recalled, he had failed to muster Republican support to put a temporary tax extension on the ballot. The budget thus ended up assuming that a phantom $4 billion would arrive (which didn't). There was little celebrating on that occasion. The 2012 budget signing assumed that the temporary tax increases of Prop 30 – an initiative done by petition and not needing Republican legislative support – would be passed by the voters. Trigger cuts would follow if they rejected the proposition. So the signing ceremony participants were cautiously optimistic and not glum as in the year before. Not surprisingly, at the June 2013 ceremony, with Prop 30 passed and the economy continuing to recover, there was laughter and cheer all around.

As noted, while on an accrual basis, the budget had a small positive reserve in the general fund at the start of the 2013-14 fiscal year, the cash accounts suggest a negative reserve. By late August 2013, there were already unexpected potential draws on the general fund in the form of spending on suppression of a major fire in Yosemite, additional potential prison expenditures, and even unanticipated high costs of liability for state-owned automobile accidents. The governor's plan (with its conservative revenue projections rather than those of the LAO) might nonetheless produce a positive reserve by the end of June 2014. However, small negative or positive reserves really are not critical since the state has internal borrowing capacity from funds outside the general fund.[101] The main issue that remains is that California is still vulnerable to adverse economic events, particularly in the light of its heavy reliance on the volatile personal income tax.

The focus in 2013 on the state's fiscal recovery was understandable, but California – particularly after Prop 13 – has a complicated intertwining of state and local finance. Local governments vary in their fiscal health. Despite the raids by the state on local revenues during hard times, some jurisdictions are nonetheless doing well because of an industrial mix with a heavy high-tech presence. Other localities, particularly in the mortgage foreclosure belt, are struggling. In some cases they are struggling with overt bankruptcy.

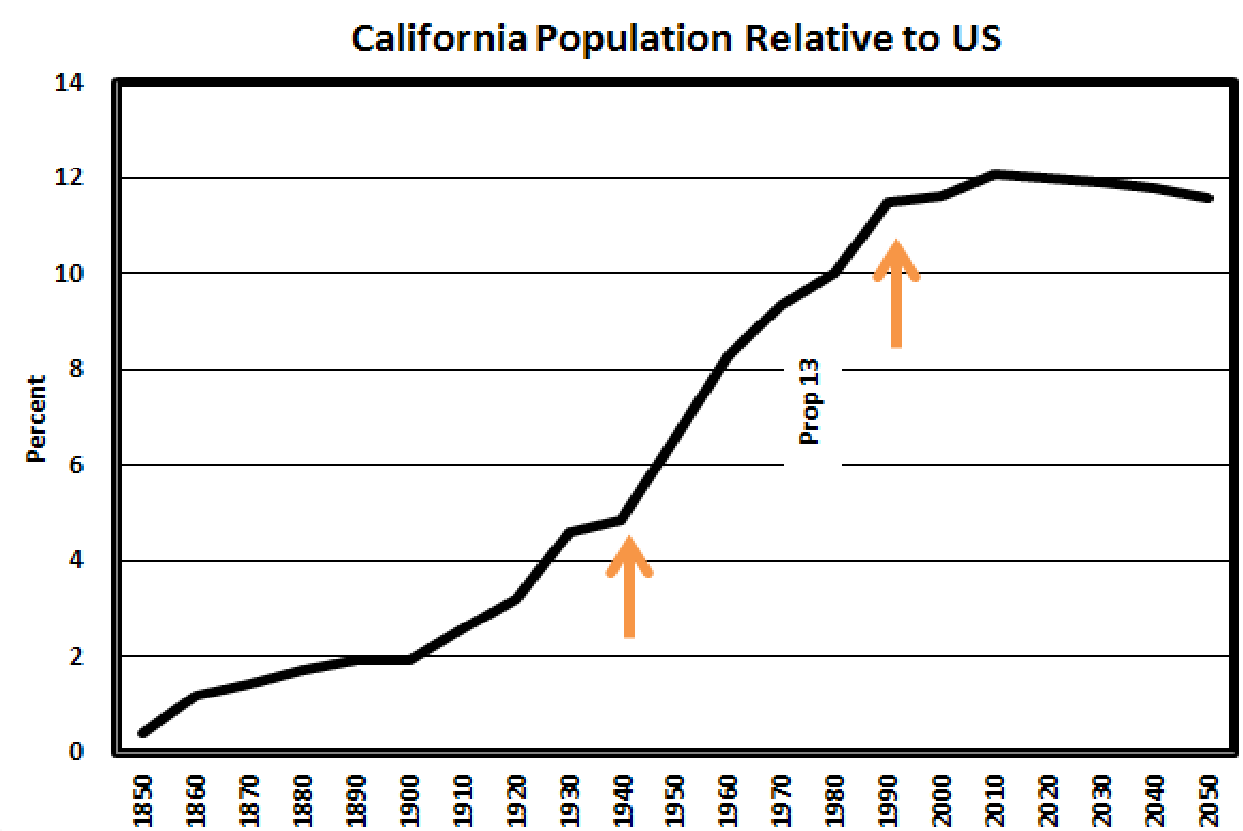
As yet, the problems of the locals – other than school districts thanks to Prop 98 – have not really been the deliberate focus of the governor or the legislature in budgetary matters. The realignment scheme for moving state prisoners to local jails is really a product of court decisions, not a grand philosophy that local government is best suited for the task. The killing of redevelopment was more a matter of rechanneling money to the state than a careful consideration of the effectiveness of local programs.

Since California residents receive much of their public services at the local level regardless of funding source, greater attention by the state to local fiscal issues would be appropriate now that there is at least a breather after a prolonged state budget crisis.

On a longer-term basis, California is still adjusting to the end of the Cold War and the resulting halt to decades of military-related federal stimulus. In retrospect, Governor Brown's first iteration of governor – with his pronouncements about an era of limits – came prematurely; the Cold War's end was nowhere in sight at the time. There are limits now, however, which will continue to challenge Brown for as long as five years – assuming he runs again and wins in 2014 – and will challenge governors thereafter.

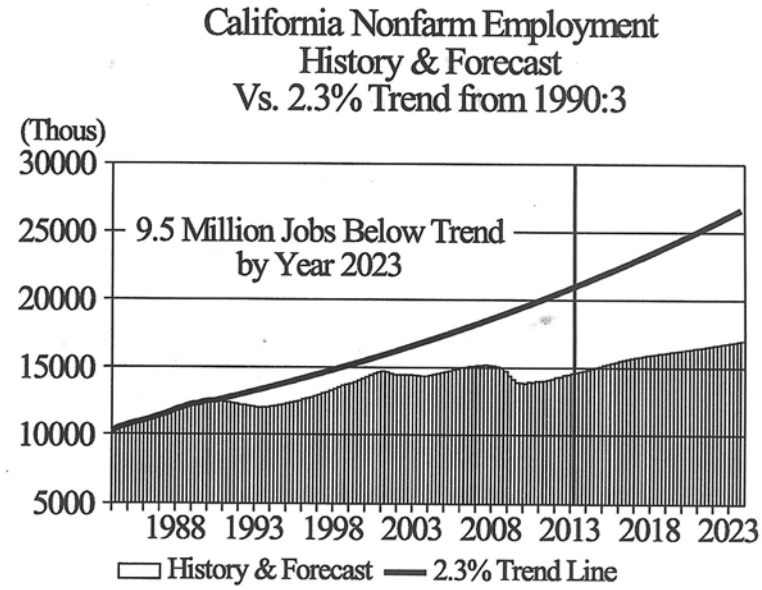
In the end, a California that grows at more or less the same rate as the rest of the U.S. – which is what demographers suggest will continue to occur – faces a future in which more of X in the state budget will mean less of Y (or more taxes). Other states, which never had decades of super-normal growth, have developed institutions to deal with making the necessary trade-offs. The question is whether California's institutions – which now include term-limited legislators and a self-marginalized opposition party – can adapt to being normal.

Chart 1



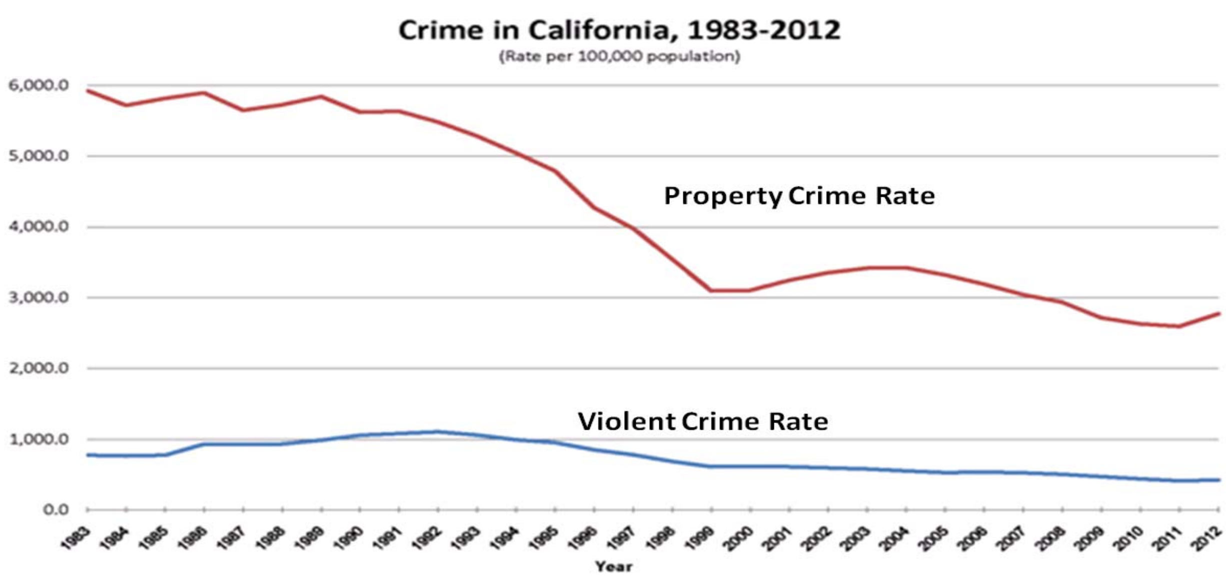
Source: U.S. Bureau of the Census and California Department of Finance. Projections from http://www.census.gov/population/www/projections/files/nation/summary/np2008-t2.xls and http://www.dof.ca.gov/research/demographic/reports/projections/interim/documents/Final_2012_Interim_Proj_Web.xls.

Chart 2



Source: UCLA Anderson Forecast, *The UCLA Anderson Forecast for the Nation and California: June 2013* (Los Angeles: UCLA Anderson School, 2013), p. California-97.

Chart 3



Source: California Attorney General, http://oag.ca.gov/crime (August 17, 2013).

Table 1: General Fund Debt, Cash, and Disbursements ($ billions or percent)

Year Ending June 30	Short-Term Debt*	Cash Balance	Total Cash**	Disbursements	Short-Term Debt as Percent of Disbursements
End of Pete Wilson Regime					
1998	$0	$0.9	$1.0	$53.1	0.0%
1999	0	0.8	2.1	58.6	0.0
Gray Davis Regime					
2000	0	8.5	9.3	64.5	0.0
2001	0	3.4	3.6	83.5	0.0
2002	10.4	0.0	0.0	80.4	12.9
2003	11.0	0.4	3.0	78.7	14.0
First issuance of Economic Recovery Bonds***					
Schwarzenegger Regime					
2004	0	0.5	2.8	79.6	0.0
2005	0	6.4	7.2	82.0	0.0
2006	0	9.2	10.5	91.5	0.0
2007	0	2.5	4.1	104.1	0.0
Second issuance of Economic Recovery Bonds****					
Schwarzenegger Regime					
2008	1.5	0.0	0.9	107.3	1.4
2009	11.9	0.0	0.0	98.2	12.1
2010	9.9	0.0	0.0	86.7	11.4
2011	8.2	0.0	0.0	93.8	8.7
Jerry Brown Regime					
2012	9.6	0.0	0.0	89.2	10.6
2013	2.4	0.0	0.0	96.2	2.5

*Outstanding loans (external and internal).
**Differs from cash balance by Special Fund for Economic Uncertainties (a "rainy day" fund maintained for the General Fund).
***Refinanced short-term debt on a longer-term basis.
****Issuance of remaining authorized Economic Recovery Bonds allowing longer-term funding of short term debt.
Source: June cash reports of the California State Controller. Available at http://www.controller.ca.gov.

Table 2: October Poll Results for "Likely Voters" and Actual Outcome of Vote for Proposition 30

	Favor	Oppose	Don't Know /Refused
PPIC	48%	44%	8%
Field	48%	38%	12%
USC-Dornsife/ LA Times	44%	46%	14%
Actual	55%	45%	na

na = not applicable
Sources: http://www.ppic.org/content/pubs/survey/S_1012MBS.pdf; http://www.field.com/fieldpollonline/subscribers/Rls2431.pdf; http://gqrr.com/images/Blog_posts/documents/USC-LAT/latusc.fq.102812.pdf.

Table 3: General Fund (GF) Budget for 2012-13

$ millions	Controller Cash 7-10-13	Governor Accrual 6-28-12	LAO Accrual 11-14-12	Governor Accrual 1-10-13	Governor Accrual 5-14-13	Governor Accrual 6-17-13
Beginning GF balance	-$9,593*	-$2,882	-$1,885	-$1,615	-$1,658	-$1,658
Inflow**	103,425	95,887	96,610	95,394	98,195	98,195
Outflow***	96,266	91,338	93,950	92,994	95,687	95,665
Surplus/ Deficit	+7,159	+4,549	+2,660	+2,400	+2,508	+2,530
Ending GF balance	-2,435	+1,667	-244	+785	+850	+872

*Figure first became available 7-10-12.
**Termed "receipts" in controller's statements and "revenues and transfers" in governor and LAO reports.
***Termed "disbursements" in controller's statements and "expenditures" in governor and LAO reports.
Sources: http://sco.ca.gov/ard_state_cash_fy1213.html ; http://www.lao.ca.gov/reports/2012/bud/fiscal-outlook/fiscal-outlook-2012.pdf; http://www.ebudget.ca.gov/home.php?selectedYear=2013-14; http://www.ebudget.ca.gov/2012-13-EN/Enacted/BudgetSummary/BSS/BSS.html.

Table 4: The 2013-14 General Fund Budget as Proposed and Enacted

$ millions	January Proposal	May Revise	June Enacted*
Beginning reserve as of 6-30-13	+$785	+$850	+$872
Revenue & transfers	98,501	97,235	97,098
Expenditures	97,650	96,353	96,281
Surplus/ Deficit	+851	+882	+817
Ending reserve as of 6-30-14	+1,636	+1,732	+1,689

*Includes vetoes.

Sources: http://www.ebudget.ca.gov/2013-14/pdf/BudgetSummary/FullBudgetSummary.pdf; http://www.ebudget.ca.gov/2013-14/pdf/Revised/BudgetSummary/FullBudgetSummary.pdf; http://www.ebudget.ca.gov/2013-14/pdf/Enacted/BudgetSummary/FullBudgetSummary.pdf.

Appendix

Table A: Campaign Donations, Proposition 30

Top 10 Donors Supporting Prop 30 Reported Through Nov. 3, 2012

California Teachers Association	$11,439,297
SEIU/California State Council of Service Employees	$10,746,928
Democratic State Central Committee of California	$5,089,646
American Federation of Teachers	$4,179,229
The Coca-Cola Company	$2,072,793
California Association of Hospitals and Health Systems	$2,000,000
PepsiCo Incorporated	$1,633,863
California School Employees Association	$1,500,495
California Beer & Beverage Distributor's	$1,094,311
California Nurses Association	$1,106,417
Note: All Donations	$67,100,000

Top 10 Donors Opposing Prop 30 Reported Through Nov. 3, 2012

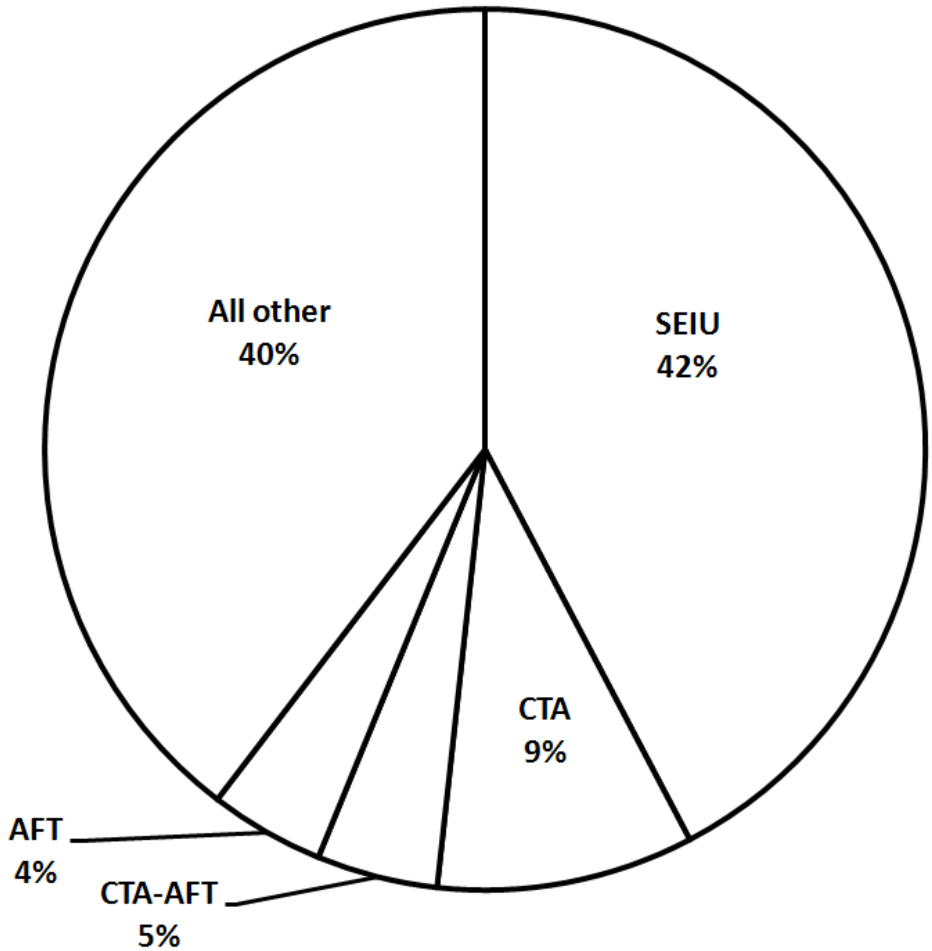
Charles Munger, Jr.*	$35,075,000
Americans for Responsible Leadership*	$11,000,000
William Oberndorf*	$1,100,000
Jerrold Perenchio*	$750,000
John Scully*	$500,000
Margaret Bloomfield	$500,000
Howard Jarvis Taxpayers Association*	$440,249
New Majority California PAC*	$350,000
Charles B. Johnson	$200,000
T. Boone Pickens*	$100,000
Note: All Donations**	$53,400,000

*No on 30; Yes on 32.

**Includes some No on 30; Yes on 32.

Source: Balletopedia, http://ballotpedia.org/wiki/index.php/California_Proposition_30,_Sales_and_Income_Tax_Increase_%282012%29.

Appendix Chart A: Composition of Employment in Major California Public Sector Unions by Union Representative



SEIU = Service Employees International Union
CTA = California Teachers Association (affiliate of National Education Association)
AFT = American Federation of Teachers
CTA-AFT = United Teachers, Los Angeles (affiliate of both AFT and CTA)

Source: Data from U.S. Department of Labor, online file of major public sector contracts (contracts covering 1,000 or more workers) as of mid-August 2013. Available at http://www.dol.gov/olms/regs/compliance/cba/.

Footnotes

[1]Quoted in Dan Walters, “Budget Won’t End Fiscal Angst,” *Sacramento Bee*, January 28, 2013. Available at http://www.sacbee.com/2013/06/28/5530359/budget-wont-end-fiscal-angst.html

[2] Past editions of *California Policy Options* are available on the author’s faculty website. Much of the contemporary material in this chapter comes from popular news media websites such as those of the *Los Angeles Times*, the *San Francisco Chronicle*, and other similar sources. In general, citations from such sources are made only for quotes.

[3] Kevin Starr, *Endangered Dreams: The Great Depression in California* (New York: Oxford University Press, 1996), p. viii.

[4] Kevin Starr, *Golden Dreams: California in an Age of Abundance, 1950-1963* (New York: Oxford University Press, 2009), p. x.

[5] Earl Warren, *The Memoirs of Chief Justice Earl Warren* (New York: Doubleday, 1977), p. 182.

[6] Knight, like Warren, was a Republican. However, governors and lieutenant governors in California run independent campaigns; they are not a “slate.” So it is possible for the two officials to be from opposing parties.

[7] Knight had planned to run for re-election as governor in 1958, but he was opposed by U.S. Senator (and Republican minority leader in the Senate) William Knowland. Knowland really wanted to run for President in 1960 but believed – erroneously – that a senator couldn’t be elected president while a governor could. (As it happened, Massachusetts Senator John F. Kennedy *did* win the White House in 1960, and Kennedy had never been a governor nor had he ever held a prior governmental executive position.) Knowland used his political clout to force Knight to run for Senate and leave the Republican nomination for governor to him. This attempted switch in offices, viewed by voters as a dirty deal, led to a major Republican defeat in California.

[8] Quoted in Chuck McFadden, *Trailblazer: A Biography of Jerry Brown* (Berkeley: University of California Press, 2013), p. 136.

[9] Ronald Reagan, First Inaugural Address, January 2, 1967. Available at http://governors.library.ca.gov/addresses/33-Reagan01.html.

[10] Peter Schrag, *Paradise Lost: California’s Experience, America’s Future* (New York: The New Press, 1998), pp. 153-154.

[11] Federal labor law largely preempts state regulation of labor unions and collective bargaining except in the agricultural and state and local public sectors. These omitted areas are left to state regulation.

[12] For all property at the time Prop 13 was enacted, the initial assessment was set at the 1975-76 assessed value.

[13] The most recent legal challenge by former UCLA chancellor Charles Young reached a dead end when the state Supreme Court refused to hear an appeal in November 2012.

[14] Quoted in “Brown Bids to Reverse Engineer His Own Legacy,” *Calbuzz*, September 17, 2012.

[15] Dan Walters, “Unspectacular Governance,” *Sacramento Bee*, February 19, 1986.

[16] Deukmejian narrowly won against Los Angeles Mayor Tom Bradley. The election left a residue of apparently false political wisdom. Some polls had indicated that Bradley would narrowly win. There was a popular story that is unearthed from time to time known as the Bradley effect. It was said that white voters would not admit to pollsters that they were voting against Bradley who was black. (Note that this is a different statement from the assertion that some voters would tend to vote against black candidates which is clearly true. The supposed Bradley effect is that white voters would not tell pollsters truthfully who they were really voting for when one candidate was black.) There is little evidence to support that story but it was resurrected during Barack Obama’s first election campaign for the presidency in 2008.

[17] The opposing candidate was again Los Angeles Mayor Tom Bradley.

[18] Kevin Starr, *Coast of Dreams: California on the Edge, 1990*-2003 (New York: Knopf, 2004), p. 630.

[19] Quoted in Joe Mathews, *The People’s Machine: Arnold Schwarzenegger and the Rise of Blockbuster Democracy* (New York: Public Affairs, 2006), p. 140.

[20] Arnold Schwarzenegger, *Total Recall: My Unbelievable True Life Story* (New York: Simon & Schuster, 2012), p. 555.

[21] The reforms Schwarzenegger included in his propositions involved a weak balanced budget constraint along with a rainy day fund. Forty-nine of the 50 states have some form of balanced budget constraint. There is evidence

that tight balanced budget requirements lead states to adopt more extensive spending cuts and sales of assets during downturns than weak requirements. See Anna M. Costello, Reining Petacchi, and Joseph Weber, "The Hidden Consequences of Balanced Budget Requirements," working paper dated September 2012. Available from http://ssrn.com/abstract=2151598.

[22] His first solo film since leaving the governorship, "*The Last Stand*," did poorly at the box office. Apart from a difficult general budget situation that Schwarzenegger bequeathed to Brown, he left a minor annoyance in the form of a plan to sell state office buildings and lease them back from the private owners. In essence, the plan was a very expensive way of borrowing money which the Legislative Analyst and others condemned. Brown killed the plan but in summer 2013, the disappointed developers who wanted to buy the buildings sued the state for canceling the plan. At this writing, the outcome of that litigation is unknown.

[23] McFadden, pp. 134-135.

[24] Newsom switched to running for lieutenant governor and won the nomination and election.

[25] Whitman became CEO of Hewlett-Packard after losing to Brown. Generally, Silicon Valley has supported immigration reform and favors libertarian positions on social issues. Thus, while during the 2010 campaign, Whitman supported California's Prop 8 banning gay marriage, she reversed that position in early 2013 and urged the Supreme Court to overturn Prop 8.

[26] A few Republicans in the legislature had gone along with the February 2009 tax increase and were duly punished with recall attempts and removal from legislative leadership. By 2010, it was unlikely that sufficient renegade Republican support could be gained for any tax increase.

[27] Quoted in McFadden, p. 170.

[28] *Sacramento Bee* columnist Dan Walters – in a video op ed http://web.registrar.ucla.edu/selfservice – argued that a critical state senate report on the controller's handling of a failed computer project (see below in the text) was "payback" for the lost pay. See http://blogs.sacbee.com/capitolalertlatest/2013/08/dan-walters-daily-salary-severed-senate-strikes-back.html.

[29] Quoted in McFadden, p. 164.

[30] To become effective by the November 2012 election, the bill (AB 1499) would normally have needed a two-thirds vote, but the Democrats did not have two thirds. However, a $1,000 appropriation was added to the bill, supposedly converting it into a budget bill that could be passed by a simple majority. A court later ruled that adding a token amount to such a bill did not exempt it from the two-thirds requirement.

[31] Quoted in Robin Wilkey, "Jerry Brown Votes: California Governor At The Polls On Prop. 30, 34," *Huffington Post*, November 6, 2012, http://www.huffingtonpost.com/2012/11/06/jerry-brown-votes_n_2083999.html.

[32] Phillip Matier and Andrew Ross, " 'Gov. Brown' Tax bid will be final try," *San Francisco Chronicle*, September 17, 2012. Available at http://www.sfgate.com/bayarea/matier-ross/article/Gov-Brown-Tax-bid-will-be-final-try-3870277.php.

[33] John Myers, "Brown on revisiting trigger cuts: 'I'm not going down that road,'" *News10/KXTV*, October 18, 2012. Available at http://www.news10.net/capitol/article/213841/525/Gov-Brown-interview-No-second-look-at-trigger-cuts.

[34] CSU has been more aggressive in political issues than UC. For example, CSU issued a "legislative scorecard" giving members of the legislature grades ranging from F to B+ for support of higher education. In one instance, a CSU administrator sent out a pro-Prop 30 email, resulting in a lawsuit by the Howard Jarvis Taxpayers Association and an admission by CSU that the email was improper.

[35] Jayson L. Lusk and Brandon McFadden, "Voter's [sic] Intentions on Proposition 37 Requiring Mandatory Labeling of Genetically Engineered Foods in California," working paper dated October 1, 2012, Oklahoma State University. Available at http://agecon.okstate.edu/faculty/publications/4369.pdf.

[36] If both propositions passed, it appeared that the one with the highest number of votes would prevail, but there were legal ambiguities that never had to be resolved, since Prop 38 failed as expected. The two major teacher unions, the California Teachers Association and the California Federation of Teachers endorsed Prop 30. The California State PTA endorsed both 30 and 38.

[37] Scott Herhold, "What's behind Molly Munger's attack on Jerry Brown's school funding measure," *San Jose Mercury-News*, October 10, 2012. Available at http://www.mercurynews.com/scott-herhold/ci_21741811/herhold-whats-behind-molly-mungers-attack-jerry-browns.

[38] Charles Munger Jr. had been active in earlier California political campaigns and was known for hardball tactics against less-monied opponents. See, for example, Michael Hiltzik, "Charles Munger Jr.'s fee claim may chill public interest suits," *Los Angeles Times*, October 31, 2012. Available at http://articles.latimes.com/2012/oct/31/business/la-fi-hiltzik-20121031.

[39] The initiative was framed as preventing both corporations and unions from using payroll deductions for politics without individual worker approval. But corporations do not generally use payroll deductions for such purposes and unions do. So in reality the initiative was aimed at unions. Typically, union political money goes to Democrats so the initiative had partisan overtones.

[40] The USC-Dornsife/Los Angeles Times poll put the favorable total for likely voters in September at 50% with 42% opposed. See http://gqrr.com/images/Blog_posts/documents/USC-LAT/latusc_fq_093012_final.pdf. For Field and PPIC, see http://www.field.com/fieldpollonline/subscribers/Rls2425.pdf and http://www.ppic.org/content/pubs/survey/S_912MBS.pdf.

[41] The state's Fair Political Practices Commission became involved in investigating the identities of the campaign backers. In December 2012, it tightened up disclosure rules regarding disclosure of those providing funding for initiatives.

[42] Sales tax had always been due on online purchases, but it was the duty of customers to pay it, not the seller. After a political battle involving a threat by Amazon to put an initiative on the ballot, Amazon had gone along with a delayed duty to collect which began in September.

[43] The text reads "promised" because the controller's cash statement through September 2012 showed somewhat less revenue than forecast when the 2012-13 budget was enacted. As will be discussed below, when the fiscal year as a whole was tallied, revenue exceeded the forecast.

[44] The workers' compensation bill had a near death experience, but Brown pushed key parties to make a deal on the last day of the legislative session (August 31, 2012).

[45] In contrast to the California Chamber of Commerce, the U.S. Chamber sponsored a TV ad which did not mention any particular proposition but complained about the business climate and hinted that schools could be funded by doing away with "waste." It was unclear why the U.S. Chamber involved itself in California politics. However, in 2006, it sponsored a TV ad that generally favored the re-election of Arnold Schwarzenegger and supported his infrastructure plan.

[46] The UC pension was omitted since UC had previously adopted a similar change.

[47] Quoted in Josh Richman, "California Gov. Jerry Brown pleads with voters to pass tax-hike measures," *San Jose Mercury-News*, September 12, 2012. Available at http://www.mercurynews.com/elections/ci_21518765/california-gov-jerry-brown-pleads-voters-pass-tax-video.

[48] "Jerry Brown discouraged by 'the non-TV voter,'" PolitiCal blog of the *Los Angeles Times*, October 23, 2012. Available at http://latimesblogs.latimes.com/california-politics/2012/10/california-jerry-brown-proposition-30-non-tv-voter.html.

[49] The interview can be heard at http://www.youtube.com/watch?v=oxY2ChoXbw4. Newsom had a cable TV show on the Current TV channel. But Current TV was acquired by the English service of Al Jazeera and remaining on the air, under that label, would have been politically difficult. In any event, the cable show was dropped.

[50] See "Sexy story, that youth carried Prop. 30, is a myth," *Calbuzz*, November 14, 2012. Available at http://www.calbuzz.com/2012/11/sexy-story-that-youth-carried-prop-30-is-a-myth/.

[51] Quoted in David Siders, "Jerry Brown plans to restrain Democratic desires at the Capitol," *Sacramento Bee*, November 9, 2012. Available at http://www.sacbee.com/2012/11/09/4972576/jerry-brown-plans-to-restrain.html.

[52] The "car tax" – more correctly the Vehicle License Fee – is essentially a local property tax on vehicles collected by the state Department of Motor Vehicles and distributed to the localities. During the flush days of the dot-com boom, the legislature cut the car tax and was thus mandated to provide equivalent state revenue to the local governments. The deal at the time was that if the budget ran into trouble, the car tax would be raised to its old level. Before the 2003 recall, Governor Davis raised the tax, thus creating a backlash used against him in the recall

vote. When Arnold Schwarzenegger took office, he immediately cut the car tax back to its dot-com boom level (thus worsening the state's already difficult fiscal condition). In 2004-05, the car tax backfill was made more complicated with the result that localities as a whole began to receive more backfill than they are losing due to the reduced car tax. See California Legislative Analyst's Office, *Understanding California's Property Tax*, November 29, 2012, p. 39. Available at http://www.lao.ca.gov/reports/2012/tax/property-tax-primer-112912.pdf. It appears that a few areas may receive less than a complete backfill for the lost car tax, however. See California Legislative Analyst's Office, Insufficient ERAF: Examining a Recent Issue in Local Government Finance, December 18, 2012. Available at http://www.lao.ca.gov/reports/2012/localgov/ERAF/eraf-121812.pdf.

[53] Quoted in "Jerry Brown urges 'prudence of Joseph' on future spending," CapitolAlert blog of the *Sacramento Bee*, November 8, 2012. Available at http://blogs.sacbee.com/capitolalertlatest/2012/11/jerry-brown-urges-prudence-of-joseph-on-future-california-spending.html. In the Biblical story, Joseph, interpreting a dream, advises the Pharaoh during seven good years to store sufficient food inventory to meet needs for a period of seven lean years that would then follow.

[54] Evan Halper and Anthony York, "Prop. 30 win gives Jerry Brown major boost," *Los Angeles Times*, November 8, 2012. Available at http://articles.latimes.com/2012/nov/08/local/la-me-jerry-brown-20121109.

[55] Quoted in Anthony York, "GOP may scale back its goals," November 23, 2012. Available at http://articles.latimes.com/2012/nov/23/local/la-me-GOP-20121123.

[56] Quoted in "Besides budget, Steinberg has full plate for lawmakers," PolitiCal blog of *Los Angeles Times*, January 7, 2013. Available at http://latimesblogs.latimes.com/california-politics/2013/01/california-steinberg-budget.html.

[57] Quoted in "CA Gov. Jerry Brown calls 2013 'Year of Fiscal Discipline,'" CapitolAlert blog of *Sacramento Bee*, January 8, 2013. Available at http://blogs.sacbee.com/capitolalertlatest/2013/01/gov-jerry-brown-calls-2013-year-of-fiscal-discipline.html.

[58] Assemblyman Tom Ammiano quoted in "California Senate resolution gets shelved in unusually public fashion," The Buzz blog of the *Sacramento Bee*, January 22, 2013. Available at http://www.sacbee.com/2013/01/22/5130861/the-buzz-california-senate-resolution.html.

[59] The eventual fiscal cliff deal did cost the state certain estate tax monies that would have flowed to the state in the 2012-13 fiscal year. The total loss was estimated at $45 million. See " 'Fiscal Cliff' deal eliminates estate tax revenue for California," CapitolAlert blog of *Sacramento Bee*, January 3, 2013. Available at http://blogs.sacbee.com/capitolalertlatest/2013/01/fiscal-cliff-deal-kills-death-tax-revenue-for-california.html.

[60] Quoted in David Siders, "Jerry Brown, at a turning point, delivers State of the State address," *Sacramento Bee*, January 24, 2013. Available at http://www.sacbee.com/2013/01/24/5136885/jerry-brown-at-a-turning-point.html.

[61] California has a significant oil industry and at one time was the center of an oil boom, as the film "There Will Be Blood" illustrates. This time, however, the boom would depend on the use of "fracking" which raised environmental issues in terms of both water pollution and possible earthquake effects.

[62] State of the State address of January 24, 2013. Available at http://gov.ca.gov/news.php?id=17906.

[63] Steven Harmon, "California Gov. Jerry Brown breaks silence on cracked Bay Bridge bolts," *San Jose Mercury-News*, May 7, 2013. Available at http://www.mercurynews.com/politics-government/ci_23191037/california-gov-jerry-brown-breaks-silence-cracked-bay.

[64] At this writing, it is unclear if a ground-breaking for the rail line will occur within summer 2013 or not. No such date has been announced, however, making such a start doubtful.

[65] Mark Baldassare et al, *PPIC Statewide Survey, March 2013, Californians and Their Government*, Public Policy Institute of California. Available at http://www.ppic.org/content/pubs/survey/S_313MBS.pdf.

[66] Lieutenant Governor Newsom – who becomes acting governor whenever the governor is out of state – reportedly will attend.

[67] CalPIRG, *Following the Money 2013: How the 50 States Rate in Providing Online Access to Government Spending Data*, March 2013. Available at http://www.calpirg.org/reports/caf/following-money-2013.

[68] Whitman wanted most public employees to be switched over to defined contribution plans instead of the defined benefit plans most common in the public sector. A few smaller cities in California have defined

contribution plans as their main pension. But most state and local government employees have defined benefit plans, either through the state (CalPERS and CalSTRS) or through locally-operated plans.

[69] You can hear Brown's remarks at http://www.youtube.com/watch?v=sOZ28d-z7Hw.

[70] At least one observer suggests that the plan as proposed would not qualify for the tax-favored treatment normally granted to employment-based retirement plans. See Edward A. Zelinsky, "California Dreaming: The California Secure Choice Retirement Savings Trust Act," Cardozo School of Law, Faculty Research Paper No. 389, April 2013. Zelinsky sees that flaw as resulting from the plan's "cash balance" format. The paper is available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2258630.

[71] The managers were "exempt"employees, which is personnel-speak for being ineligible for overtime. The secondary jobs were non-exempt. In the case of the computer project, it was claimed that using incumbent employees through this mechanism was cheaper than hiring additional workers.

[72] California Senate Office of Oversight and Outcomes, *Crash Course: Failure to Heed Early Warnings, Troubles of the Past Contributed to Payroll System Collapse*, August 12, 2013. Available at http://sooo.senate.ca.gov/sites/sooo.senate.ca.gov/files/crash%20course%2008%2012%2013%20FINAL.pdf. Some of the money lost by the state may be reclaimed after litigation against the private computer system supplier. The controller's report on the project's failure tended to put the blame on the supplier. California State Controller, *Preliminary Internal Review of the 21st Century Project*, August 2013. Available at http://www.scribd.com/doc/159896752/State-Controller-s-Preliminary-Report-on-Payroll-System-Problems.

[73] Some events that might have highlighted the prison problem occurred after the enactment of the 2013-14 budget. During summer 2013, there was a hunger strike by prisoners protesting solitary confinement which attracted some celebrity support for the prisoners. It was disclosed that women who had given birth in prison had been pushed, perhaps coerced, to be sterilized. An outbreak of "valley fever" occurred in some prisons causing prisoners to have to be moved to other locations. In August 2013, the U.S. Supreme Court rejected an immediate stay of a lower court decision to release prisoners while an appeal was pending, thus triggering releases the governor was resisting. However, the state indicated it would continue the appeal.

[74] There were semi-annual data for the first half of 2012 available that showed an upward blip, but such figures are even more prone to noise than the annual numbers.

[75] There was also an issue of compensation for victims of crime. In some cases, inmates of state prisons have part of their in-prison earnings redirected to their victims. Local jails, however, do not have systems for making such collections and don't have work programs that could generate earnings.

[76] Quoted in "In China, Jerry Brown laments California's red tape," CapitolAlert blog of *Sacramento Bee*, April 10, 2013. Available at http://blogs.sacbee.com/capitolalertlatest/2013/04/in-china-jerry-brown-laments-californias-red-tape.html.

[77] Quoted in "Jerry Brown downplays Cal Fire reports, dubs it boring story," CapitolAlert blog of *Sacramento Bee*, February 5, 2013. Available at http://blogs.sacbee.com/capitolalertlatest/2013/02/jerry-brown-downplays-cal-fire-reports-dubs-it-boring-story.html.

[78] Quoted in "Gov. Jerry Brown: Texas, come on over," PolitiCal blog of *Los Angeles Times*, February 4, 2013. Available at http://latimesblogs.latimes.com/california-politics/2013/02/gov-jerry-brown-texas-come-on-over.html.

[79] "A" is not a top rating. The highest is AAA, a grade which California has not had since 1986. The state's bond rating history with the three rating agencies can be found at http://www.treasurer.ca.gov/ratings/history.asp.

[80] California Legislative Analyst's Office, The 2013-14 Budget: Resources and Environmental Protection, February 2013. Available at http://www.lao.ca.gov/analysis/2013/resources/resources-budget-analysis/resources-budget-analysis-021913.pdf.

[81] Quoted in "Jerry Brown finds decisions 'way too important' for LAO," CapitolAlert blog of *Sacramento Bee*, September 14, 2012. Available at http://blogs.sacbee.com/capitolalertlatest/2012/09/jerry-brown-finds-decisions-way-too-important-for-lao.html.

[82] See Sarah Bohn, Belinda Reyes, and Hans Johnson, *The Impact of Budget Cuts on California's Community Colleges*, Public Policy Institute of California, March 2013. Available at http://www.ppic.org/content/pubs/report/R_313SBR.pdf. It might be noted that the infusion of Prop 30 seemed

to take pressure off the community colleges to come up with creative ways of generating funds, even if they were the weak sister to K-12 in political terms. Santa Monica College had tried to implement a two-tier fee system for certain courses that were in short supply. Essentially, the idea was to charge more for extra sections of certain core courses that the college could not afford to put on in adequate numbers. Some students would pay extra for the supplementary sections if they had the money and the wish to do so, and that would create more space in the standard fee courses. The idea was suspended after a disturbance at a meeting to discuss the proposal. But in April 2013, the chancellor of the community colleges shut the plan down completely.

[83] The UC pension plan receives roughly two out of three dollars from non-state sources, chiefly federal research grants and contracts, patient revenues, and fees for administering the U.S. Department of Energy labs. However, it cannot charge these non-state sources at higher rates for pension contributions than it charges state funds. So every dollar not put into the plan on behalf of state-funded employees that should be collected (but isn't) creates a three dollar increase in liability for the plan as a whole. The regents can borrow to put funds into the plan, either from internal reserves and accounts or from the outside market. Some internal borrowing has occurred.

[84] For example, various tuberculosis control activities are mandated by the state for local governments to carry out. The governor's budget proposed eliminating the mandate.

[85] Quoted in "Jerry Brown promises opponents 'battle of their lives' on education overhaul," CapitolAlert blog of *Sacramento Bee*, April 24, 2013. Available at http://blogs.sacbee.com/capitolalertlatest/2013/04/jerry-brown-promises-opponents-battle-of-their-lives-on-education-overhaul.html.

[86] Quoted in "Jerry Brown urges budget restraint despite strong revenues," CapitolAlert blog of *Sacramento Bee*, April 23, 2013. Available at http://blogs.sacbee.com/capitolalertlatest/2013/04/jerry-brown-urges-budget-restraint-despite-strong-revenue.html.

[87] Matthew Garrahan, "Second Coming," *Financial Times*, April 5, 2013. Available at http://www.ft.com/cms/s/2/331e85b0-9cb1-11e2-9a4b-00144feabdc0.html.

[88] California Legislative Analyst's Office, *The 2013-14 Budget: Overview of the May Revision*, May 17, 2013, p. 12. Available at http://www.lao.ca.gov/reports/2013/bud/may-revise/overview-may-revise-051713.pdf.

[89] Quoted in "Rapid Response Roundup: Jerry Brown's May budget proposal," CapitolAlert blog of *Sacramento Bee*, May 14, 2013. Available at http://blogs.sacbee.com/capitolalertlatest/2013/05/post-36.html.

[90] A test of the centrists came in a bill to target and penalize large employers whose workers ended up on Medi-Cal rolls due to low pay. The bill was essentially aimed at nonunion Wal-Mart, long a target of union complaints. The bill needed a supermajority to pass and failed in late June 2013, due to defection of centrist Democrats from swing districts.

[91] Quoted in Anthony York, "Jerry Brown gathers his thoughts while lying low," *Los Angeles Times*, August 13, 2013. Available at http://www.latimes.com/local/political/la-me-pc-jerry-brown-ivan-illich-political-theory-20130813,0,3369585.story.

[92] The assembly and senate versions of the budget as of late May 2013 can be found (with comparison to the governor's May revise) in California Legislative Analyst's Office, The 2013-14 Budget: Conference Committee Overview, May 31, 2013. Available at http://lao.ca.gov/handouts/Conf_Comm/2013/Conference-Overview-53113.pdf.

[93] Mark Baldassare et al, *May 2013: Californians and Their Government*, Public Policy Institute of California, May 2013. Available at http://www.ppic.org/content/pubs/survey/S_513MBS.pdf.

[94] California Legislative Analyst's Office, *MOU Fiscal Analysis: Bargaining Units 1, 3, 4, 11, 14, 15, 17, 20, and 21 (SEIU Local 1000)*, June 21, 2013. Available at http://www.lao.ca.gov/reports/2013/MOU_Fiscal/MOU-Fiscal-Local-1000-062113.pdf.

[95] The State Board of Education and the Superintendant of Education were given key roles in administering the program and determining the precise dollar allocations.

[96] Generally, organized labor favored the termination of the enterprise zone program – characterizing it as an ineffective subsidy to employers without a positive job effect – and local governments opposed the termination.

[97] Jim Sanders, "Pérez tuition aid plan not best way to increase college access, analyst says," *Sacramento Bee*, June 14, 2013. Available at http://www.sacbee.com/2013/06/14/5496173/perez-tuition-aid-plan-not-best.html. A

representative from the Legislative Analyst's Office had been invited to testify at a legislative hearing but was not called up when it was apparent that she would not rank Pérez's option favorably against others.

[98] Quoted in Steve Harmon, "In his own words: Gov. Jerry Brown has business people rolling in laughter," *San Jose Mercury-News*, May 23, 2013. Available at http://www.mercurynews.com/ci_23305153/his-own-words-california-gov-jerry-brown-has.

[99] Quoted in "Anne Gust Brown discusses life with Jerry, role in running state," CapitolAlert blog of *Sacramento Bee*, June 5, 2013. Available at http://blogs.sacbee.com/capitolalertlatest/2013/06/anne-gust-brown-discusses-life-with-jerry-brown-role-running-california.html.

[100] Adam Nagourny, "Brown Cheered in Second Act, at Least So Far," *New York Times,* August 16, 2013. Available at http://www.nytimes.com/2013/08/17/us/brown-cheered-in-second-act-at-least-so-far.html.

[101] However, the legislature at the end of August was considering the need to repay the IOUs that had been placed in special funds outside the general funds, potentially hindering the ability of those special funds to fulfill their tasks.

CHAPTER 4

Researcher Communications in California: The Public Interest in Non-disclosure

Stanley M. Paul

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formerly served as the Director of Communications
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"This case presents issues concerning the balancing of public interest in research related to an academic study published by a state entity and the disclosure of documents pertaining to prepublication communications and deliberations to that study."

The Humane Society of the United States v. The Superior Court of Yolo County[1]

Introduction: Proposition 2 (2008)

In November 2008, California's Proposition 2, listed in the state voter guide as "Standards for Confining Farm Animals. Initiative Statute," and also known as the Prevention of Animal Cruelty Act and set to go into effect in 2015, was passed by voters by more than 63%.[2] It requires, "that calves raised for veal, egg-laying hens and pregnant pigs be confined only in ways that allow these animals to lie down, stand up, fully extend their limbs and turn around freely."[3] But while the proposition passed, and although its full economic, health and other effects of implementation are yet to be seen, a controversy little noticed in the press led to court proceedings.[4]

The proceedings revolved around a demand for information under the California Public Records Act (codified in the California Government Code, section 6250, et seq.) by parties advocating support for the proposition before the 2008 vote. Litigation continued into 2013 at the

[1] Described in a nutshell, the first sentence of The Humane Society of the United States v. The Superior Court of Yolo County., 214 Cal. App. 4th 1233; 155 Cal. Rptr. 3d 93. Opinion filed March 27, 2013. Page numbers referred to in this summary article are from the PDF version of the opinion which is available through the California Courts website at:
http://appellatecases.courtinfo.ca.gov/search/case/mainCaseScreen.cfm?dist=3&doc_id=1967293&doc_no=C067081

[2] Yes 8,203,769 (63.50%) No, 4,731,738 (36.50%) Statement of Vote, November 4, 2008, General Election (Certified by the California Secretary of State, 12-13-08)
http://www.sos.ca.gov/elections/sov/2008-general/sov_complete.pdf
The 2008 California Propositions results also may be found at:
http://www.latimes.com/la-oe-greene21-2008sep21,0,4134112.story#axzz2j2G7LGj8

[3] The web page for the 2008 California General Election with information on Proposition 2 (including Title and Summary, Analysis, Arguments and Rebuttals, and the Text of Proposed Law) may be accessed at:
http://voterguide.sos.ca.gov/past/2008/general/title-sum/prop2-title-sum.htm

[4] See the *Metropolitan News-Enterprise*, March 28, 2013, "C.A. Upholds Secrecy of Documents Connected to UC Egg Study" at: http://www.metnews.com/articles/2013/humane032813.htm

California Court of Appeals. This chapter reviews the issues in the court case related to researcher confidentiality at a public university.

The Voter Guide Pros and Cons of Proposition 2

The voter guide for the November 2008 ballot prepared by the California Attorney General provided information stating the positions of proponents and opponents of the propositions.

For the **Pro** side (Yes on Prop. 2), the listed benefits included the protection of "animals, consumers, family farmers, and our environment," a view supported by, among others, the Humane Society of the United States (HSUS), California Veterinary Medical Association, Consumer Federation of America, and the Center for Food Safety.

On the **Con** side (No on Prop. 2), the comments provided in the voter guide argued that the passage of the proposition was, "too RISKY" and that "Californians enjoy safe, local, affordable eggs." In addition, the comments stated that, "A UC Davis study says Proposition 2 eliminates California egg production. Instead, our eggs will come from out-of-state and Mexico. Public health experts oppose Proposition 2 because it THREATENS increased human exposure to Salmonella and Bird Flu."

Along with the views of both sides, the voter guide included an "Analysis of the Legislative Analyst," with the following text about the fiscal effects of Prop. 2: [5]

> "Compared to current practice most commonly used by California farmers in the affected industries, this measure would require more space and/or alternate methods for housing pregnant pigs, calves raised for veal, and egg-laying hens. As a result, this measure would increase production costs for some of these farmers. To the extent that these higher production costs cause some farmers to exit the business, or otherwise reduce overall production and profitability, there could be reduced state and local tax revenues. The magnitude of this fiscal effect is unknown, but potentially in the range of several million dollars annually."

While the passage of Prop. 2 dates back to the early days of the Great Recession, it is the research and communications related to the UC Davis study and recommendation that

[5] http://voterguide.sos.ca.gov/past/2008/general/analysis/prop2-analysis.htm

remained the point of contention in this litigation. Even before the election took place, the study titled, "Economic Effects of Proposed Restrictions on Egg-laying Hen Housing in California"[6] (hereinafter "Economic Effects") raised controversy. In March, 2013, a California appellate court (Third Appellate District, Yolo County) ruled on issues related to Proposition 2.

The following is a summary of the appellate court's 50-plus page published decision and the related issues of law and policy brought up by the litigation and considered by the three-judge appellate panel. While this chapter cites extensively from the court's opinion,[7] not all of the points of law and procedure in the case are discussed. However, the full opinion is well worth reading for the case's finer points.[8]

Summary of the Case and Proceedings

"In enacting this chapter, the Legislature, mindful of the right of individuals to privacy, finds and declares that access to information concerning the conduct of the people's business is a fundamental and necessary right of every person in this state."

Section 6250 of the California Public Records Act (CPRA) (Gov. Code section 6250 et seq.)

"The CPRA does not have an express exemption for general academic research. It is the application of the catch-all exemption set forth in section 6255 that is at issue here."

The Humane Society of the United States v. The Superior Court of Yolo County

This case began in July 2008 when the Humane Society of the United States requested all records related to the UC Davis study referenced in the voter guide and published in that same month through the University of California Agricultural Issues Center (AIC). The AIC is described as, "a forum for the identification and analysis of important issues affecting the agricultural

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[6] The full report may be accessed at: http://aic.ucdavis.edu/publications/eggs/egginitiative.pdf
[7] Unless otherwise indicated, all quotes are taken directly from the appellate court opinion written by Justice William J. Murray, Jr.
[8] For example, the case may be consulted for a lengthy discussion on the following procedural issues: timeliness of the petition by HSUS and the adequacy of the record for review (procedural arguments that were both rejected by the appellate court. See pages 14-23 of the online opinion.)

sector."[9] What was requested amounted to more than 3,000 pages that would include "any records and communications concerning the funding, preparation, release and publication of 'Economic Effects.'" The request included "any records and communications concerning Proposition 2 on the November 2008 California ballot as well as communications with the American Egg Board, among others, that might show that the UC Davis study had been improperly influenced."

What HSUS received was a response from the Regents of the University of California (the real party in interest in this case) on an estimated production date of October 1 (for any nonexempt items). The long delay proposed was apparently unsatisfactory to HSUS. HSUS then filed a writ of mandate under California Government Code section 6258 in which "Any person may institute proceedings for injunctive or declarative relief or writ of mandate in any court of competent jurisdiction to enforce his or her right to inspect or to receive a copy of any public record or class of records under this chapter…."

Subsequently, the Regents provided more than 350 pages of documents to HSUS, about a tenth of the documents at issue. The Regents claimed withheld pages were exempt under three provisions of the state's government code:

> **Section 6255:**[10] the so-called "catch-all" exemption balancing the public interest in disclosure vs. nondisclosure;
>
> **Section 6254,** subdivision (a), providing a balancing test for preliminary drafts or memoranda not retained in the ordinary course of business; and,
>
> **Section 6254,** subdivision (k), relating to documents privileged as "official information" under Evidence Code section 1040.

One of the contentions of HSUS was that trial court – when it issued its opinion – "improperly created a *de facto* 'researcher' exemption with a presumption of nondisclosure, unless the

[9] For more information, see the UC Davis web page "Mission of the UC Agricultural Issues Center" at: http://aic.ucdavis.edu/aboutus/aboutus2.htm

[10] Section 6255 (a) states: "The agency shall justify withholding any record by demonstrating that the record in question is exempt under express provisions of this chapter or that on the facts of the particular case the public interest served by not disclosing the record clearly outweighs the public interest served by disclosure of the record."

party seeking disclosure could prove 'improper influence.'" HSUS contended that this approach resulted in an inappropriate shifting of the burden of proof to the party requesting records.

Spoiler Alert: In March 2013, the appellate court hearing the appeal concluded the following: "…**the public interest served by not disclosing the records clearly outweighs the public interests served by disclosure of the records**." However, there is much more to this story. Let's look at how this conclusion was reached and what interests were weighed in coming to that ruling, and what it means for future cases having to do with researcher communications in California.

Research and the UC Davis Study

"Our analysis indicates that the expected impact would be the almost complete elimination of egg production in California…"

Executive Summary of the UC Davis study, "Economic Effects"[11]

"*I am certain that the ability to communicate information would evaporate if outside individuals and groups expected that any communication with our researchers would be likely to be in the public domain."*

Declaration of Daniel A. Sumner[12]

Included in the evidence submitted by the Regents were declarations of the director of the AIC, Daniel A. Sumner, co-author of the study and a professor in the Department of Agriculture and Resource Economics at the University of California, Davis (UCD) with a 30-plus-year career as researcher. Prior to coming to UCD in 1993, Sumner served as Assistant Secretary of Economics at the U.S. Department of Agriculture.[13] Sumner stated in the declarations that the study, "Economic Effects," was based on "raw financial data" provided by farmers and that the study was conducted "like any other research." He described the research process as follows:

[11] The full Executive Summary may be accessed at: http://aic.ucdavis.edu/publications/eggs/executivesummaryeggs.pdf
[12] Quoted on page 8 of appellate opinion.
[13] For biographical information about Daniel A. Sumner, see: http://aic.ucdavis.edu/aboutus/aboutusdirector.html

> "At the University of California, and at AIC in particular, the process of research involves trying new ideas and approaches, investigating lines of thinking that do not work out, suggesting ideas that turn out to be wrong, brainstorming and trying out drafts of explanations that turn out to be far from the final exposition of our approach and results. All of this back and forth happens among a team of project participants and with others who may have information and expertise upon which we can draw. Some of this process is undertaken by junior scholars who are relatively new in their research careers and serves as part of the training process for graduate students, postdoctoral scholars and others."

In fact, the co-researchers/authors listed on the study included a research analyst, a post-doctoral fellow at AIC, a professor in another UC Davis department, a Ph.D. student, and a research assistant. Sumner further explained that researchers "communicate informally, often in jargon or shorthand," providing an illustrative example: "…, ***an idea may be proposed in an email, discussed in a hallway conversation and rejected, with no record of why it is no longer pursued. That said, for much of what we say and do, it would be easy to misinterpret the communications.***" [Italics of Professor Sumner]

For external communications (with those outside the research team), Sumner stated, "If collaborators outside our teams expected that any communication with University researchers in general, and AIC specifically, may become part of public record, they would be (rightly, in my opinion) [Sumner's opinion], much less forthcoming with frank opinions and potentially confidential data." Furthermore, Sumner went on, "based on my extensive experience, I am certain that the ability of AIC to fulfill its mission would be significantly hampered if we had to make public our research-team communications whether it be our internal communications or our communications with those outside the team."

AIC researchers also communicate with a Board of Advisors to which "We communicate regularly and frankly with members." Sumner adds, "If private informal communications with Board members were, instead, public communications, it would stifle the advising process and convert what is now a simple, direct and informal process into a time-consuming formal activity that would be much less productive and may well defeat the purpose of the process…."

The Documents and the Special Master in the Lower Court

"(T)he people's right to know is not absolute."

The Humane Society of the United States v. The Superior Court of Yolo County

In January 2009 the trial court issued a tentative ruling stating that it would review "all" of the withheld documents *in camera* (i.e., not in public) and require disclosure of records related to HSUS's concern about improper influence. To do so (on April 13, 2009) the lower court appointed what is called a special master to review all documents in question. As HSUS claimed improper influence regarding the "conduct or result of the study," the documents were to be grouped into three categories:

- Documents showing no influence by the egg and/or poultry industry
- Documents showing improper influence by the egg and/or poultry industry
- Documents showing influence (but not improper influence) by the egg and/or poultry industry.

In April 2010, the special master reported that none of the documents reviewed showed "improper influence," that some documents showed "influence but not improper influence," and that all others showed "no influence" by the egg and/or poultry industry. While, in an amended report, the special master recommended making public documents that indicated "any influence" along with any that showed "improper influence," and nondisclosure of the remaining documents. However, the court did not follow this recommendation.[14]

The ruling of the lower court (the trial court) in this case included the following:

- Raw financial data was exempted from disclosure.
- Rejection of the "deliberative process" exemption proposed by the Regents.
- A failure of the Regents "to demonstrate the existence of a 'researcher's privilege'" in California Law.

[14] The appellate court comments on this on page 50 of the opinion: "We conclude that the reason the trial court rejected the special master's recommendation on disclosing documents that showed only simple, noncoercive influence is obvious. The court did not agree with the special master's balancing analysis and neither do we."

However, the court did conclude that section 6255, subdivision (a) “catch-all exemption” did apply in balancing the interests of protecting academic research with the public interest in disclosure (in this case, the disclosure of any improper influence). In all, the court ordered that a total of 28 pages be disclosed as having no applicable exemption. In addition, the court found that a number of documents were not within the scope of HSUS’s request for documents, and that all other documents were exempt from disclosure under section 6255 (catch-all).[15] An interesting footnote on “deliberative process” on p. 35-36 of the appellate opinion is worth reproducing here:

> “California courts recognize a “deliberative process privilege” under section 6255’s catch-all exemption, but it has been applied to policy makers (Times Mirror Co. v. Superior Court (1991) 53 Cal.3d 1325, 1324; see *id.* At page 1343), not to academic research. Here, we do not hold there is an academic privilege. We hold only that, based on the facts of this case, supported by evidence we have discussed, the public interest identified by the Regents should be weighed in the balance.”

Evidence: Speculation vs. Expert Testimony

The court also considered a contention by HSUS that Sumner’s declarations were merely speculation as to how disclosure of information from outside parties would affect the future ability of researchers to get such information. The court disagreed with HSUS and viewed Sumner’s declarations as “admissible expert opinion” based on his many years of experience, citing California’s Evidence Code (section 801, sub. (a)) and thus his opinion was related to a subject that is “sufficiently beyond common experience” and that his opinion would “assist the trier of fact.”

> “It was not speculation for a person of Sumner’s credentials, with 30 years of experience, to declare that academic researchers communicate informally, often in jargon or shorthand, trying new ideas, investigating lines of thinking that do not work out, suggesting ideas that turn out to wrong, and brainstorming in informal ways open to misinterpretation. Furthermore, based on Sumner’s experience and his description of the process, it is not speculation for him to opine that disclosure of communications would fundamentally impair the academic research process for AIC.”

[15] In addition, the court cited an “official information privilege” under Gov. Code section 6254 (k) and the Evidence Code, section 1040.

The Chilling Effect: Admissible Expert Opinion and General Human Behavior

The appellate court ruled that the trial court, as "evidentiary gatekeeper" had discretion to overrule the objection by HSUS to Sumner's declarations. In addition, the appellate court, recognized Sumner's "admissible expert opinion" on the "chilling effect" of disclosure of prepublication communication in academic research. The appellate court, as described above, did not consider this process within common knowledge, but indicated that the effect also is "consistent with commonly understood human behavior." Citing a prior discussion of this concept by the same court in another case in which the court stated, "[T]he facts which drive our legal conclusions are not adjudicative but legislative in character. 'Legislative facts' refer to the basic generalized knowledge that a fact finder possesses regarding human affairs, and the way the world works." The declarations of all the researchers included in "Economic Effects," were not required as the court considered these other declarations as affecting the weight, not the admissibility, of the opinions offered by Sumner.

The "Catch-All" Exemption and Balancing the Interests

"That is not what the trial court did."

The Humane Society of the United States. v. The Superior Court of Yolo County

HSUS claimed that the court, in effect, deemed all documents exempt first, then determined whether the documents contained any evidence of improper influence. By not applying the so-called balancing test under section 6255 first to the documents, HSUS argued that the court had upheld a categorical exemption put forth by the Regents. The ultimate effect of this approach was to shift the burden of proof to HSUS.

Indicating that HSUS's argument was "flawed," the appellate court, while recognizing that the court did put the documents into categories, said that the trial court did, in fact, apply the balancing test to each of the documents, citing the court's August 2009 amended order of reference. A number of other indications that the trial court applied the balancing test to each of the documents were referenced. Summing this argument up, the appellate court found that, "The evidence here supports a conclusion that disclosure of prepublication research communications would fundamentally impair the academic research process to the detriment of the public that benefits from the studies produced by that research. The trial court accommodated that interest by examining the documents for potential improper influence, which would weigh on the disclosure side of the balance.

Conclusion: A Case by Case Decision

Did the appellate court create a blanket researcher's exemption for future cases? No. Here is what the court said in rejecting this assertion (on page 35 of the opinion): "…(O)ur decision in this case will not create an academic researcher's exemption immunizing disclosure of university documents in future cases. And, citing past cases, "A decision regarding the catch-all exemption is necessarily limited to the facts of the particular case,"[16] and, "a case-by-case balancing process is required."[17] Finally, quoting language in an earlier California case, "our decision against requiring disclosure is necessarily limited to the facts of this particular case; in another case, with different facts, the balance might tip in favor of disclosure of nonexempt information."[18]

The issue of where the line should be drawn in demands for research communications at public universities in California is thus still uncertain. It is important to note that had the study in question been undertaken at a private California university, there would be no public access. Only if a government entity is involved does public access become an issue, a situation that might be argued to put public universities at a disadvantage relative to their private counterparts. In recent years, there have been cases of demands for emails and other communications of faculty at public universities around the country where political opinions

[16] American Civil Liberties Union Foundation v. Deukmejian, (1982) Cal. 3d at p. 454, fn. 14.
[17] County of Santa Clara v. Superior Court (2009), 170 Cal. App. 4th 1301, 1323; CBS, Inc. v. Block (1986), 42 Cal. 3d, 656-657.
[18] American Civil Liberties Union Foundation v. Deukmejian, (1982) Cal. 3d at p. 454, fn. 14.

may be the motivation behind the requests.[19] It appears that California courts will continue to struggle with what communications may be made public.

[19] In fact, the appellate court notes that HSUS did request documents of this nature (i.e., "any records of and correspondence concerning university policy on participation in political campaigns by university employees or agents, including correspondence concerning the limitations on such activities." page 3 of appellate opinion) under the theory that there is a public interest in these documents as they could show whether any university policies or state law had been violated related to "political campaign activity." However, the appellate court indicates that the original CPRA request by HSUS did not "expressly request documents that might reflect violations of university policy of California law; it merely requested records pertaining to university practices, policies and regulations concerning participation in political campaigns" (page 48 of appellate opinion). In rejecting this "new public interest theory related to disclosure of political campaign prohibition violations," Justice Murray writes, "Here, although this new theory involves a public interest, it does not involve a pure question of law, because HSUS is challenging the trial court's review of individual documents."

CHAPTER 5

Physical Education on the Ground: Results and Recommendations from Eleven Los Angeles County Case Studies

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This chapter is based on an Applied Policy Project undertaken by the authors as part of the MPP Program at the Luskin School.

Childhood obesity is a growing epidemic plaguing the United States; since the 1980s, obesity rates for youth have tripled to 17%. From a public health perspective, the prevalence of childhood obesity often creates further health disparities, particularly for disadvantaged populations. Some ethnic groups experience childhood obesity at much higher rates than others. Notable disparities between minority groups exist in Los Angeles County with 35% of Pacific Islanders, 27% of Hispanics, and 22% of black youth categorized as overweight, compared to 12% of Asians and 13% of non-Hispanic Caucasians.[1]

Physical education (PE) is often considered a tool for reducing childhood obesity. In a study initially based on this premise, we asked three questions to understand how the Los Angeles County Department of Public Health (LACDPH) could reduce obesity through PE. LACDPH additionally commissioned the study to improve its targeting of grants towards overcoming barriers that prevent schools from successfully implementing PE as the state requires.

In undertaking this study, we first assessed whether and how PE influenced weight. Varying accounts indicated that a majority of schools failed to meet California's PE standards. LACDPH requested an analysis to measure schools' compliance with legislatively set state standards of 200 minutes of PE over 10 days, and moderate to vigorous activity (MVPA) in PE. Finally, we measured the types of PE barriers schools encountered when trying to implement quality PE. The study focused on under-resourced schools to inform LACDPH about ways to improve PE quality for these particularly disadvantaged students struggling with obesity. [2]

Rather than assume that PE would reduce childhood obesity, we sought to evaluate whether there was a significant effect.[3] To tackle this issue, we examined, first, whether PE was occurring and, second, whether instruction in the case-study schools could encourage obese children to lower their body mass indices over the short and long-term. The research discussed

[1] "Childhood Obesity: Tipping the Balance Toward Healthy, Active Children." Los Angeles County Department of Public Health, July 2008. Available at http://publichealth.lacounty.gov/ha/docs/LA_HEALTH_BREIFS_2008/Childhood_Obesity_final.pdf

[2] We use the term "disadvantaged" to mean coming from a school that showed the following four characteristics relative to LA County averages: Having 1) above average proportion of students on free and reduced lunch, 2) above average proportion of students classified as English Language Learners (or ELL), 3) above average proportion of ethnic minority students enrolled, and 4) below average Academic Performance Index (API) Base Scores.

[3] We recognized that nutritional habits and caloric intake play an important role in physical health; however, for simplicity, the study's scope was limited to a physical activity-centered approach for affecting change in children's body compositions.

in this chapter yielded new ideas about how to shape physical education policy in ways that would allow creative activities to dominate and positively influence children's health outcomes.

In sum, the following tools available for LACDPH to implement a policy change are what drive our recommendations provided in this chapter:

- Modifying grant-funding incentives, conditions, and targeting
- Conducting further research and potentially scaling baseline data collection
- Providing lawmakers with relevant and timely information

A key recommendation is that LACDPH view PE's benefits as encouraging long-term healthier lifestyles of exercise rather than as a method to induce significant short-term weight loss.

Research Approach

The project task was to collect baseline compliance data from LACDPH-funded elementary schools. By design, the case studies produced baseline quantitative information (i.e., surveys) and qualitative information (i.e., interviews and field observations) about PE practices at eleven Los Angeles County elementary schools. We assessed whether PE could encourage a reduction in obese students' body mass index in the short or long-term.

With enough time spent in vigorous activity, students could theoretically burn enough calories to lose weight or avoid gaining weight. We estimated roughly how many calories students could and do burn in PE during a school year.[4] The results indicated that intense time-consuming scenarios—what we refer to as the sweat-it-out approach—obese students burned approximately 300 calories per week. This calorie burn is not only easily offset with unhealthy nutrition, but theoretically, it would only cause up to 1.7 pounds of weight loss. Thus, we found that PE is unlikely to reduce obesity rates in the short-term through caloric burn.[5]

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[4] Calorie range was estimated by multiplying time spent exercising by calories burned per minute. Estimates ranged based on likely time spent exercising, weight of students, and intensity of the exercises.

[5] Numerous studies also concluded PE is unlikely to cause a reduction in students' body mass index in the short-term. One such study is Cawley, J., Meyerhoefer, C., and Newhouse, D. (2007), The impact of state physical education requirements on youth physical activity and overweight. *Health Econ.,* 16: 1287–1301. doi: 10.1002/hec.1218.

We believed at the outset that PE could also support a reduction in a student's body mass index by encouraging more physical activity over a lifetime. But our literature review indicated that PE could encourage or discourage exercise over an individual's lifetime. Studies showed that lifelong activity increases in youth who learn skills that increase their confidence in an activity and in youth who find exercises they enjoy.[6] This effect requires focusing PE on lesson instruction and varying the activities.

However, physical activity decreases when students dislike the activities or do not know how to do, or cannot do, the exercise.[7] PE can discourage future exercise when there is unclear instruction, activities children cannot do, or are unvaried, uninteresting activities. We concluded PE should teach skills and cover a variety of activities. This way, children are more likely to increase physical activity over their lifetime.

The Current View of PE

The sweat it out approach is considered a direct, short-term impact. We used students' weight to estimate calories burned in activities of various degrees of vigor such as walking versus soccer. Additionally, we used this model to estimate PE's immediate impact on obesity and to suggest whether LACDPH should focus on PE's induced calorie burn (i.e., having a direct, short-term impact) or instruction of lifelong skills (i.e., having an indirect, long-term impact).

We tracked physical activity that produced at least light sweating or a slight to moderate increase in breathing or heart rate. This kind of activity is known as moderate to vigorous physical activity (MVPA).[8] Medical experts recommend youth participate in 60 minutes of MVPA daily whether in or out of PE.[9]

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[6] Centers for Disease Control and Prevention. Guidelines for school and community programs to promote lifelong physical activity among young people. March 7, 1997/46(RR-6). Available at http://www.cdc.gov/mmwr/preview/mmwrhtml/00046823.htm.

[7] Deforche, Benedicte, Johan Lefevre, Ilse De Bourdeaudhuij, Andrew P. Hills, William Duquet, and Jacques Bouckaert. "Physical Fitness and Physical Activity in Obese and Nonobese Flemish Youth." *Obesity* 11.3 (2003): 434-41. Print.

[8] Expert interview. Personal communication. January 11, 2013.

[9] U.S. Department of Health and Human Services, Centers for Disease Control and Prevention. "The Association Between School-Based Physical Activity, Including Physical Education, and Academic Performance." (2010). Available at http://www.cdc.gov/healthyyouth/health_and_academics/pdf/pa-pe_paper.pdf.

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Figure 1: Direct Impact of Reducing Obesity via Physical Activity

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Shifting the focus of PE towards a lifelong physical activity approach

We established that the sweat it out approach is not ideal and that it might actually adversely affect our population of interest. If we think about PE in terms of the direct and indirect impact that it can have on physical activity, we see that the direct impact, with its focus on burning calories, can lead to reduced body mass index but we know that burning calories alone will not reduce obesity.

In our review of the literature, we found that PE can influence activity over the long-term. Looking at the indirect impact of PE, physical activity that includes elements that kids find enjoyable and teaches skills can have a similar impact as the sweat it out approach in terms of calories burned in PE. However, indirect impact of PE has the added benefit of instilling lifelong appreciation for exercise. LACDPH can use this indirect, lifelong approach and shift its focus towards PE to re-imagine how PE can impact childhood obesity.

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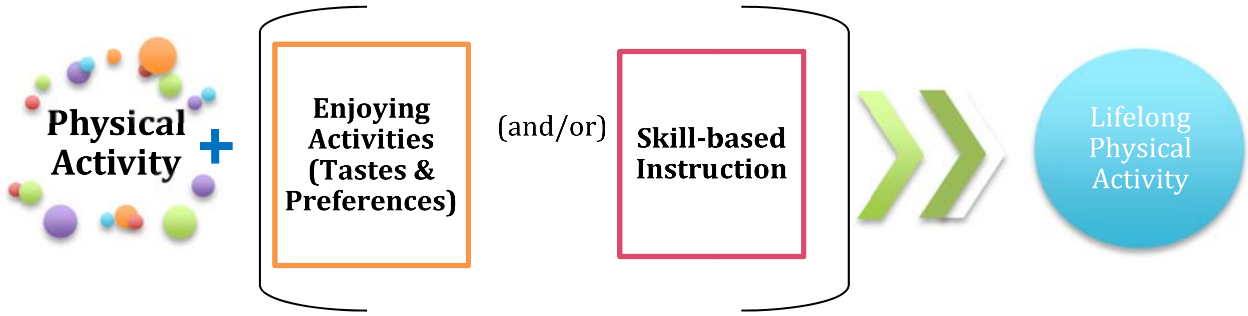
Figure 2: Indirect Impact of Reducing Obesity via Physical Activity



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Key Findings

Below, we list several strategies for improving physical activity in the context of a physical education setting. However, we recognize that these strategies must be implemented in tandem with policies that support better nutrition and encourage healthy behaviors. Given the case study approach used to gather this information, more work needs to be done in order to determine if and how physical education policies can be used to reduce obesity trends significantly. We recommend that such research be undertaken.

Nonetheless, the information we were able to gather led us to the conclusion that PE, in the schools that we observed, is generally part of the curriculum and schools are mainly adhering to state PE requirements. The fact that teachers generally maintain the required time allotment for physical education, however, paints an incomplete picture of a larger problem. We found that PE *quality* varies widely across teachers and schools.

For the most part, teachers tend to teach to the test. Teachers focus the bulk of their instructional time on activities that are tested in the state Physical Fitness Test, also known as the FITNESSGRAM®, regardless of the grade level being taught. Monotonous instruction further exacerbates the problem. Many students displayed signs of boredom and apathy. In the schools we observed, more than half of PE time was spent practicing how to run the mile. Little instruction accompanied the instructors' requests to run around blacktops with no visible lane markings.

Addressing PE Barriers

Top barriers—as identified by teachers and administrators—that adversely affect the quality of PE were: 1) lack of time, 2) inadequate PE equipment, 3) little or no funding for PE, and 4) unstructured PE curriculum. Interviews supported the survey findings. The largest reported barriers to achieving quality PE and maximizing instructional time could be curtailed by addressing the areas we discuss below.

Not Having Inadequate Funding and Equipment

Principals reported that PE was a low funding priority; therefore, simply increasing a school's PE budget would not likely improve PE. This finding is not surprising given that our sample included schools with fewer resources. Although 72% of teachers reported lack of funding as a barrier, most interviewed teachers struggled to identify how they would use additional funds for PE.

When prompted, teachers and principals mentioned they could use more money for equipment or for hiring PE teachers. Teachers reported equipment shortages limited the games they could lead, and said that too little equipment decreased physical activity time as students waited longer to participate in games. Even schools that complied with minute requirements struggled with having adequate equipment, although they still managed to meet the time mandate. Overall, the perceived funding shortage may lower PE quality due to the inadequate equipment and the chances that resources are not spent on PE professional development or coaches and instructors. Principals additionally reported that PE was a low funding priority. Therefore, it seems simply increasing a school's PE budget would not likely improve PE.

Being Pressed for Time

The time shortage for conducting PE often results from teacher prioritizing other subjects and not planning PE time or cutting PE entirely, which inadvertently hurts PE quality. Teachers reported that they struggled with scheduling PE given other competing priorities such as improving school test scores. The time shortage meant teachers did not plan PE curriculum, which hurt PE quality. Teachers sacrificed previously allotted PE time when they fell behind on other subjects.

Lack of Accountability

Lack of accountability makes it easy for teachers to avoid teaching PE and contributes to teachers viewing PE as the subject they can sacrifice. Although administration was not a reported barrier, minimal school administration oversight meant teachers were not held accountable for PE activities. Some principals did not request that teachers schedule PE into their daily lessons. Even if principals told teachers to schedule PE minutes, many principals did not follow-up to check PE had occurred.[10] One teacher reported, "I schedule it because I'm told I'm supposed to, but no one checks whether it occurs... And they check in on other subjects."[11] A principal we interviewed presented a parallel view. In commenting about PE schedules, the principal explained that "they have to show me in their schedule and that's all they are doing... is showing."

Having No Curriculum and Level of Discomfort with PE instruction

Some teachers indicated that they needed more professional development and opportunities to collaborate with peers. Several teachers and principals reported that fellow teachers

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[10] Teacher Interview, Personal Communication. February 7, 2013 and January 24, 2013. Principal Interview, Personal Communication. January 18, 2013.
[11] Teacher Interview. Personal Communication. January 24, 2013.

struggle with coming up with activities to teach during PE. Those teachers who were uncomfortable with the subject were less likely to teach it.

The fact is that PE has limited capacity to encourage weight loss. But it has other benefits that might promote more physical activity. In our analyses, we modeled different scenarios, including extreme scenarios to come up with tangible boundaries and potential effects for PE and the ability to produce weight loss through PE instruction, all else equal. The results showed that although PE may not cause weight loss immediately, it can encourage weight loss over the long-term. Using PE to teach skills and making the activities more enjoyable for students may potentially increase the likelihood that they will participate in such activities rather than sit out because they are not engaged.[12]

The problem is not non-compliance with state PE requirements. In fact, most schools do comply with California's PE mandate. Schools averaged 90 minutes per week and only 30% of schools missed the state compliance mark by more than 20 minutes every two weeks. The chart below shows a snapshot of the varying levels of compliance across the schools in our study.

Literature on childhood obesity and compliance to physical education policy

We turned to literature to understand whether current PE actually stimulates weight-loss or reduces Body Mass Index (BMI) and found that there was no causal connection between the two. For example, prior research indicated that students with more PE instruction exercised more outside of PE classes but did not have significantly different BMI scores than students with less PE time.[13] The authors concluded there was no "scientific base to declare raising PE requirements [as] an anti-obesity initiative for either boys or girls."[14] *Physical Education, as currently executed, has a small to neutral influence on obesity rates.*

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[12] Data sources: Class time available for MVPA, average time spent in MVPA, qualitative notes from evaluation tool about when students were having the most fun, if available.

[13] Cawley, J., Meyerhoefer, C. and Newhouse, D. (2007), The impact of state physical education requirements on youth physical activity and overweight. *Health Econ*., 16: 1287–1301. doi: 10.1002/hec.1218.

[14] Cawley, J., Meyerhoefer, C. and Newhouse, D. (2007), The impact of state physical education requirements on youth physical activity and overweight. *Health Econ.,* 16: 1287–1301. doi: 10.1002/hec.1218. Another meta-analysis of PE interventions found one study with a small, yet statistically significant, reduction in BMI for boys and no impact on girls when PE was extended by two hours per week. Gonzalez-Suarez, Consuelo, Anthea Worley, Karen Grimmer-Somers, and Valentine Dones. "School-Based

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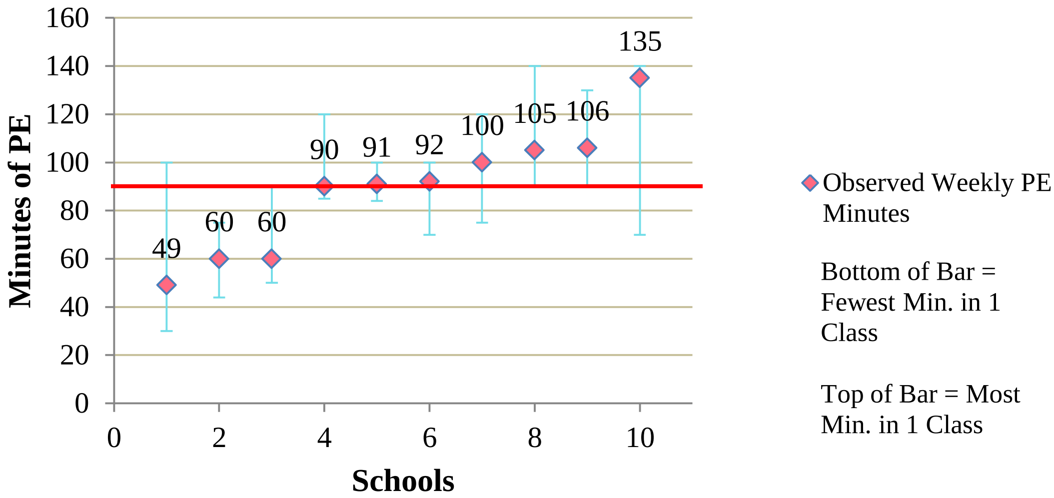
Figure 3: Observed Weekly PE Minutes of Selected LA County Schools[15]



Source: Observational data and ethnographic notes.

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Furthermore, student's nutrition likely explains these counterintuitive results on PE and weight. Diet can easily offset PE's weekly caloric burn of approximately 170 to 315 calories. For example, two slices of pizza or three sodas would counteract calorie burn in rigorous PE.[16]

A nutrition expert we interviewed, Dr. William McCarthy, noted that he could not accurately predict the net weight impact of our calorie expenditure model because physical activity also increases appetite.[17] Since weight-loss is so dependent on physical activity <u>and</u> nutrition, calorie loss can potentially be offset or even overcompensated by poor nutritional choices. Three other pediatric doctors we interviewed affirmed that nutrition is typically the chief

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Interventions on Childhood Obesity A Meta-Analysis." *American Journal of Preventative Medicine,"* 2009 Nov;37(5):418-27. Available at http://www.ncbi.nlm.nih.gov/pubmed/19840696.

[15] The California compliance standard is 200 minutes every 10 days or an average of 100 minutes every week. Each vertical line represents the distribution of minutes for a given school. The dot indicates the observed weekly minutes for that school based on our site visit data. The upper bound represents the scheduled minutes or upper bound of what may happen in a given week, while the lower bound reflects the shortest amount of PE minutes that we think a teacher does in a given class during the week.

[16] A pizza slice is approximately 200 calories and soda is approximately 140 calories per twelve ounces according to http://caloriecount.about.com/. Accessed March 11, 2013.

[17] March 8, 2013 Interview with Dr. McCarthy, Professor at UCLA Fielding School of Public Health.

determinant of weight and acknowledged that an intervention excluding nutrition would not likely influence weight loss. *However, although solely increasing physical activity does not reduce obesity rates, some doctors and researchers argue that if encouraged at an early age, physical activity can increase lifelong physical activity and prevent future obesity development.*[18]

Recommendations for improving existing barriers to achieving better PE

Based on our review, some key recommendations from the report regarding strategies that the Los Angeles County Department of Public Health should consider include:

1. *Rethinking PE's Instructional Approach:* For LACDPH to accomplish their goal of reducing obesity, we recommend it deemphasize PE calorie burn and MVPA. Instead, we encourage focusing on encouraging lifelong activity by teaching skills and teaching varied, enjoyable PE. This suggestion could mean funding physical activities that do not reduce obesity but provide skill instruction or are enjoyable.

2. *Investigating a Different PE Approach:* We recommend LACDPH continue funding current PE but also investigate whether other innovative physical activities can increase student's exposure to skills and enjoyable activities. If findings support this, LACDPH could promote a broader definition of PE that includes innovative physical activities.

Because LACDPH cannot implement recommendation number two immediately, we make the following four suggestions for overcoming the biggest barriers to quality PE in the near-term:

a. *Overcome Inadequate Oversight and Accountability:* We recommend that LACPDH grant-receiving schools identify and fund "PE Champions" who promote PE at their schools.

[18] Spear, Bonnie, Sarah Barlow, Chris Ervin, et. al. "Recommendations for Treatment of Child and Adolescent Overweight and Obesity." *Pediatrics* 4th ser. 1.20 (2007): S254-288. http://pediatrics.aappublications.org/content/120/Supplement_4/S254.full.pdf+html.

b. *Overcome Deficient Knowledge and Training Follow-Through:* LACDPH should provide accessible curriculum and additional professional development on that curriculum for teachers.

c. *Overcome Lack of Time:* LACDPH should hire district-wide PE Coordinators who help schools carryout effective PE plans and make PE implementation easier for teachers.

d. *Overcome Lack of Adequate Equipment:* LACPDH should provide adequate equipment because PE quality can depend on access to appropriate equipment. Teachers are limited in the activities they can provide by availability of equipment.

Final Thoughts

Childhood obesity is a severe problem the public health community cannot ignore. Although calorie burn in PE is unlikely to immediately reduce obesity, PE is a crucial opportunity to teach students valuable skills and enjoyable activities. Our PE approach discussion and recommendations on how to implement that new approach can guide LACDPH's future approach to PE. Our recommendations are also of value to other agencies interested in using school-based physical activity interventions to improve the youth obesity epidemic.

Our observations were surprising. Most schools do comply or nearly comply with state standards. We mostly observed valuable PE where students enjoyed themselves and learned important movement-based skills. Nonetheless, schools can improve instruction, especially for obese children's needs. That improvement requires increasing PE activity variety and using differential instruction. Our recommendations would increase instruction quality by improving teachers' knowledge and encouraging greater accountability. Our recommendations work towards our project motivation of reducing obesity by increasing students' physical activity in the near-term and improving the likelihood of participation in lifelong physical activity.

CHAPTER 6

Switching to the Future Track: An Essay on California High-Speed Rail

Jerry Nickelsburg

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California's High Speed Rail (CHSR) is on the way, maybe. Governor Jerry Brown calls it "a bold idea… (I)t's taking technology and imagination and reshaping our future."[1] But the voters who approved Proposition 1A, the initial bond funding for CHSR seems to have soured on it due to construction costs ballooning and uncertainty about it ever getting out of the Central Valley.[2]

A number of critical reviews of the initial assumptions behind CHSR, including one by this author, raise further doubts as to the economic and social viability of the system. These considerations include an original estimate of a $40 billion price tag, revised to $118 billion, and then lowered to $68 billion,[3] an alternative to fossil fuel burning cars as Californians rush towards electric and hybrid vehicles,[4] a 220 mph transportation system, now possibly slowed by urban interfaces,[5] economic growth inducing infrastructure resulting in 450,000 new jobs,[6] and revenue and ridership estimates based on existing foreign high speed rail lines which replaced older dense-demand low speed rail lines.[7]

Despite these issues, other serious critiques, and calls for a new vote on CHSR, it appears likely that the first segment in the San Joaquin Valley will be built. But will it be, as some have suggested, a fast train that only provides an alternative to auto travel on California Highway 99? Jerry Brown's courtship of Chinese investors not withstanding, the private funding for the completion of the system is not on the horizon as investors shy away from a project seen as

[1] Interview with Governor Brown prior to his April 2013 trip to China. Quoted in http://sanfrancisco.cbslocal.com/2013/04/04/high-speed-rail-a-highlight-of-gov-browns-upcoming-china-trip/.
[2] "Californians & Their Government," *PPIC Survey*, March, 2013. Available at http://www.ppic.org/content/pubs/survey/S_313MBS.pdf.
[3] Official information on the California High Speed Rail is available at www.hsr.ca.gov .
[4] Jerry Hirsch and Brian Thevenot, "Electric Vehicles in Short Supply," *Los Angeles Times*, June 5, 2013. Available at http://articles.latimes.com/2013/jun/05/autos/la-fi-hy-autos-electric-cars-sold-out-20130605.
[5] Kathy Hamilton, "High Speed (Rail) Politics: Fact and Opinion," *Examiner.com*, July 10, 2013. Available at http://www.examiner.com/article/high-speed-rail-politics-fact-and-opinion.
[6] Jerry Nickelsburg and Saurabh Alhuwalia, "California High Speed Rail and Economic Development: Lessons From Japan," *UCLA Anderson Forecast*, June, 2012.
[7] Mac Taylor, "High-Speed Rail Is at a Critical Juncture," California Legislative Analyst's Office, May 10, 2011, [http://www.lao.ca.gov/reports/2011/trns/high_speed_rail/high_speed_rail_051011.pdf] and Peer Review Comments in "Revised 2012 Business Plan," California High Speed Rail Authority, April 2012. Available at http://californiastaterailplan.dot.ca.gov/docs/1a6251d7-36ab-4fec-ba8c-00e266dadec7.pdf.

financially risky.   Without it, only government funding —not likely in these days of lean budgets —can ensure the completion of the system as currently contemplated.

This chapter asks a different question about CHSR. Is there a way to reconstitute the plan without significantly altering the original vision such that it will be attractive to private investors and become what its proponents have always argued, a game-changer for California? I argue the answer to the question is "yes," absolutely, and that the problem is not that CHSR is too big and too ambitious. Rather the problems with CHSR as currently constituted are large and the solutions proposed thus far are too small and not ambitious enough. Specifically, we ought to be looking at transportation infrastructure synergies as they apply to the 21st century and if we do, CHSR can snatch victory from the jaws of defeat.

High-Speed Rail and Other Major Transportation Infrastructure Projects

The proponents' rationale for high-speed rail is mainly twofold. The first is congestion. California's population is forecast by the state's Department of Finance to be 46 million by 2035.[8] Movement of people and goods is critical to a vibrant economy. Transportation corridors currently in place are insufficient to accommodate a larger and growing population and increased economic activity. The solutions outlined in Governor Brown's 2012 State of the State address are high-speed rail, expanded airports, and new freeways. His assertion, and that of many supporters of CHSR, is that rail is the most cost effective way to increase transportation bandwidth.[9]

The second chief argument by proponents is the economic development inducing aspect of "bold investments" in transportation infrastructure. In U.S. economic history, the canals of the early 19th century, the transcontinental and trunk railroads of the mid- to late-19th century and the Interstate Highway System in the mid-20th Century are pointed to as examples of the power of large transportation projects. There is no doubt that those infrastructure projects facilitated

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[8] http://www.dof.ca.gov/research/demographic/reports/projections/P-1/

[9] Jerry Brown, "State of the State 2012: California on The Mend," http://gov.ca.gov/news.php?id=17386

economic growth. But are they the appropriate analogs for CHSR? The answer, it turns out, is no. Each of the previously cited projects moved both people and goods and dramatically lowered transportation costs. CHSR will only move people and is priced to be competitive with other modes of transportation, but not priced to blow them out of the water.

Despite seemingly good reasons for CHSR, private investors, the key to the completion of the system, are taking a wait and see approach.[10] The first segment of CHSR is to be between Fresno and Bakersfield. There are reasonable doubts that the demand for travel between the two stations will be significant. That will leave CHSR in an operating deficit. The doubts stem from the relatively low level of business and personal travel between the cities, particularly to destinations within walking distance or a short cab ride from the high-speed rail stations.

Automobile travel between the cities is relatively easy and has the added benefit of flexibility in both time and destination. Moreover, the travel time between any pair of cities along the line by auto is not burdensome. From the beginning, private investors have viewed CHSR as too risky.[11] The initial segment is not likely to ease those concerns. Lacking obvious financing, the California High Speed Rail Authority has revised its plans by extending the time-to-build, and by creating a blended rather than dedicated high-speed rail system.

California's Other 21st Century Transportation Problem

Apart from ground transportation issues, a major transportation problem in California is in the air. California styles itself as the Gateway to the Pacific due to its advantageous location on the Pacific Rim, its dynamic tech industry, and its ethnic connections to all of the other Pacific Rim

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[10] Daniel C. Vock, "California's High-Speed Rail Gains Momentum But Doubts Remain," Pew Center on the States, August 1, 2013. Available at http://www.pewstates.org/projects/stateline/headlines/californias-high-speed-rail-gains-momentum-but-doubts-remain-85899431366.

[11] "California High-Speed Rail Authority Board Financing Workshop," September 3, 2009. Available at http://www.hsr.ca.gov/docs/brdmeetings/2009/September/brdmtg0909_meet_wrkshp.pdf

countries.[12] This claim has certainly been prominent over the past 20 years as trade and travel between the growing Pacific Rim countries and California has exploded.

But such an advantage could be lost. California has two *bona fide* international airports, Los Angeles (LAX) and San Francisco (SFO). LAX is potentially the most likely chief portal, but despite a multi-billion dollar building program, it is far from a 21st Century airport.[13] It is not going to be superior to Dallas (DFW), or Denver (DIA) after the renovations are complete.

DIA has ample room to expand to six additional runways, is building a multi-functional terminal with direct commuter rail to downtown and DFW is building its eighth runway and putting DART commuter light rail directly into the airport.[14] In contrast, LAX cannot move one runway 300 feet to increase safety and landing capacity for large aircraft without major community and political resistance. Moreover, to use public transportation to get into town, weary travelers—to and from LAX—will likely have to transfer onto a people mover to connect with an off-airport MTA rail station.

California should be as concerned with Denver and Dallas attempting to capture international business travel and the concomitant economic development as it is about the diversion of sea transport through the Panama Canal. But when it comes to airport capacity and quality enhancements, California does not seem to have a "Panama Canal" fright. The modernization of LAX, important as it is, is insufficient for the next 50 years. Getting to and from the airport, making connections, moving through security, customs, and immigration are all issues for the traveling public today and will remain so. To modernize LAX into a 21st Century Airport is possible, but every proposal thus far, from moving the north runway, to a central check-in terminal has run into strong resistance. Simply put, the necessary upgrades to LAX are not going to happen.

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[12] "California: America's Gateway for Pacific Rim Economies," California Chamber of Commerce, 2011. Available at http://www.calchamber.com/international/trade/documents/calchamber-apec-brochure-08112011.pdf

[13] http://www.lawa.org/laxdev/laxdev.aspx

[14] https://www.dfwairport.com/development/masterplan/index.php
http://business.flydenver.com/community/masterplan/airportmasterplan.asp

There is no energy elsewhere for an international airport to serve California in the 21st Century. The state seems willing to let international travelers go to other parts of the U.S. and then, if they need to be in California as part of their trip, make connections from one of the inland hubs. SFO is basically capacity constrained, has frequent weather related delays, and has no plans for expansion. Regional airports around the state with decent transportation to the principal destinations of travelers and the ability and will to expand do not exist. The best option would have been for the former El Toro military airport to replace John Wayne Airport in Orange County. But the voters preferred converting the El Toro site into a grand park instead.[15]

Making CHSR a Game Changer

Here is where thinking bolder and more ambitious thinking is needed. There is one airport in the state strategically located with the physical capability of being a world-class 21st Century international airport. Unlike LAX or SFO, it has community support for expansion and would be a game changer for CHSR. I will argue in the rest of this chapter that venue is Palmdale Airport north of Los Angeles (owned by the same entity that runs LAX). When combined with CHSR's current plan with a few modifications, Palmdale would do what the major infrastructure projects of past centuries did. It could significantly lower the cost of moving goods and people such that substantial economic development is induced. It could propel the California economy forward for the balance of this century.

First, let's look at logistics. The current map of CHSR's proposed location runs close to the Palmdale Airport. Since not a spade of desert sand has been turned, there is no reason why it could not run right *into* the terminal of the new California Palmdale International Gateway (CPIG). Were it to do so, then passengers from Asia and Europe arriving in California could go

[15] Indeed one of the arguments made in favor of CHSR is "Air flights between the Los Angeles and San Francisco Metropolitan Areas—the busiest short-haul market in the U.S.—are the most delayed in the Country…" *California High-Speed Rail Program Revised 2012 Business Plan*, April 2012. Available at http://www.hsr.ca.gov/docs/about/business_plans/BPlan_2012ExecSum.pdf

directly onto the train (as in Hong Kong [HKIA], Kuala Lumpur [KLIA], Seoul [IIA] and Beijing [BCIA]).[16]

According to the CHSR website, southbound passengers are expected to arrive at Union Station in approximately one hour. Passengers arriving at the competing LAX would need to secure a taxi and should expect at least one hour transit to downtown. But the difference would be the convenience, the improved airport experience and the additional amenities of the train. Moreover, as with HKIA, KLIA, and BCIA, passengers coming into CPIG could have tickets that combine air and rail or remote check-in facilities at CHSR terminals.

For northbound passengers transit to the Trans-Bay Terminal in San Francisco would be no more than 1 hour and 40 minutes. To San Jose, the transit time would be less.[17] Compared to the potential weather delays at SFO, and the experience, or lack thereof, of tired international travelers going through SFO and onto their final destination on BART, CPIG/CHSR is highly competitive.

Furthermore, and this is important, travelers into California can use Palmdale as a base of operations with a train ride to LA, then on to San Jose and back to CPIG for their outbound flight. Although the managers of other airports will not like it, CPIG will take traffic away from LAX and SFO and from DFW, ORD, and DIA.[18] So this additional capacity is not just moving traffic *around* the state; it is lowering costs and moving business *into* the state.

Crucial to the proposal is for CHSR Authority to set up a business park and aircraft maintenance facility in the land surrounding the airport. Between the free cash flow of a successful airport and the profit from leasing additional land to businesses wishing to locate near a hub airport, CPIG can generate substantial revenue. Such revenue by itself could cover any shortfalls in the

[16] KLIA links to kliaekspres a high speed rail system while BCIA uses a light rail system which is now operating at capacity.

[17] www.hsr.ca.gov

[18] As noted earlier, Palmdale is owned by the same entity that operates LAX, so the tensions surrounding competition with LAX may be mitigated.

CHSR system (were they to occur). The airport/rail synergies lower the risk to investors and will make CHSR much more attractive to the private sector.

But the airport/rail combination likely won't need to use the free cash thrown off by the airport and business park because the arrivals at CPIG will generate additional traffic on the CHSR system. Arriving in Palmdale and renting a car to go to Los Angeles or the Bay Area defeats the purpose of using CPIG. Simply the convenience of CHSR at Palmdale moves airline passengers into high-speed rail passengers. KLIA, a much smaller airport than CPIG would be, generates four million passengers on its Kliaekspress trains each year.[19]

In 2012 the volume of international travel at LAX and SFO was 26.5 million travelers.[20] If CPIG were to garner only 20% of these passengers, that number would amount to five million additional riders per year. This estimate does not include the growth in demand due to population and economic growth between now and 2025 nor does it include domestic air travel.

The CHSR Authority Business Plan (as revised in 2012) estimates ridership to be 5.8 million on the low side and 10.5 million on the high side. The addition of traffic from Palmdale means that the Business Plan estimates can be very wrong, much more so than the critics assert, and the Plan still pencils out. Once again, a reduction in the risk associated with the business plan forecasts is an important element in attracting the requisite private investment to complete the project.

Building a world-class 21st-century airport is expensive and this would add to the estimated $68 billion CHSR capital expenditure. As it turns out, it would not add significant cost and the cost-benefit ratio would easily be less than one. Recent new airports in Kuala Lumpur, Beijing, Seoul and Denver have had costs in the range of $5 billion to $10 billion.[21] Since land is inexpensive in

[19] www.kliaekspress.com .

[20] http://www.lawa.org/laxstatistics.aspx and http://www.flysfo.com/web/page/about/news/pressres/stats.html .

[21] DIA cost $4.8 billion in 1995, KLIA $3.5 billion in 1998, BCIA $5 billion in 2004, and HKIA and IIC, which involved creating artificial islands, at $20 billion in 1998 and $5 billion in 2001, respectively.

Palmdale, these estimates are probably in the ballpark. Suppose the entire project came in at $12 billion. This amount would represent only 15% of the capital cost of the combined system and would generate 38% of the revenue traffic using the estimates above.

Aside from the synergistic benefits of combining a new world-class airport with a new world-class high-speed rail system, there are additional economic growth-inducing benefits. International business executives coming to California to visit their design or R&D centers would have easy access to the cities of the San Joaquin Valley. This access reduces both the time and cost of incorporating business travel to and from a factory in Visalia or Fresno or other Central Valley cities into other business travel.

And here is another game changer; locating multiple sites for a company in California and taking advantage of the differential cost and workforce skills between coastal and inland cities now may make economic sense. This advantage is precisely the kind of significant reduction in cost attributed to the Interstate Highway System, the Trunk Freight Rail System and other bold transportation investments.

Looking to the future

Finally, the new high-speed rail system and the airport proposed here have to be forward-looking. The current century will see changes more rapid and incredible than ever before. One of those will be space travel. The current race for commercial space travel playing out in California and elsewhere will result in a new age of transportation. California's Mojave Spaceport is one of the competitors.[22] As space travel becomes increasingly in demand, the most convenient, most strategically located, and most connected to the world will be the winner.

[22] Spaceport America in Las Cruces, New Mexico, Kiruna in Lapland, Sweden, Wallops Island in Virginia and Kodiak Island in Alaska are some of the competitors for commercial space travel. Leonard David, "Spaceports: Building Up the Space Travel Industry," May 17, 2006. Available at: http://www.space.com/2413-spaceports-building-space-travel-industry.html.

California is competing with New Mexico, Florida and elsewhere to be the launch pad. The final competitive advantage for California could well be the ease with which customers from all over the world can get to the Mojave Spaceport. The proposed CHSR line from Bakersfield to Palmdale runs close to the Mojave Spaceport. With a little engineering it could run right into the terminal. This direct connection could trump what is planned elsewhere in the world and, if so, would once again push California into the leadership spot as we move into the future.

As things stand now, however, California High Speed Rail is in trouble. Another ballot on it and the body politic might well vote for its demise. Solving the problem of finding private sector investors is critical and yet the business plan has not generated any significant enthusiasm absent unlikely government guarantees.

Wait-and-see is not a good strategy for a system that is only funded for an initial segment from Fresno to Bakersfield. What will be seen by investors will be a losing proposition and not a place to bet on the future. California's position as the gateway to the Pacific Rim is also in jeopardy. Inland airports with space to expand and a desire to attract international business are moving forward to challenge California's international airports. But with a limited ability to expand at California's existing airports, the responses to this competition are likely less than required to stave off the challenge.

In this chapter, I have proposed not going smaller to meet the critics of CHSR, but going bigger. Solve both problems at once and the state can attract private sector investors, build CHSR more rapidly than in the current plan, and change the game for the rest of the century. A modern high-speed rail system linking the state's population centers, a world class 21st century airport—and even the world's gateway to space—are the bold visions that are the stuff of the California dream.

CHAPTER 7

Informal Parking on Sidewalks: The Broken Windows Effect

Donald Shoup

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Cities regulate every aspect of parking, using everything from time limits for on-street parking to zoning requirements for off-street parking. Cities also employ legions of parking enforcement officers to ensure that drivers obey these regulations, and tickets for parking violations are a major revenue source. Los Angeles, for example, earned $134 million from parking tickets in 2011 (City of Los Angeles 2012: 307). If so much parking is formal, regulated, and policed, what then is informal parking? What do we learn about the practice of informal parking and about better formal parking policy from the neighborhood around UCLA?

Informal Parking

Informal parking markets operate outside the regulated system, and they fill market niches hard to serve in any formal way. They often appear near the Los Angeles Coliseum, for example, where residents charge nonresidents to park in their driveways on game days. Drivers may have to walk a few blocks to the stadium. But after the game they can leave from a residential driveway much faster than they can leave from a large stadium lot that takes a long time to clear when everyone tries to exit at the same time. The residents park their own cars on the street and rent space on their driveways to ticket-holders, some of whom are regular customers. Drivers may think that paying for parking is un-American, but residents who receive the revenue know that paying for what you use is a traditional American value.

Nonetheless, informal parking can create problems. Where on-street parking is underpriced and overcrowded, many drivers feel they have no alternative to illegal parking. For example, the *Los Angeles Times* describes the chaotic informal parking in Mexico City: “Cars dominate nearly every square inch of Mexico City’s public space. Vehicle owners double- and triple-park on the streets, to say nothing of curbs, sidewalks, gardens, alleys, boulevards and bike paths” (Dickerson 2004: 26).

This anything-goes informal parking is more common in developing countries, but drivers also park on sidewalks in some California cities, although it is clearly illegal:

> No person shall stop, park, or leave standing any vehicle whether attended or unattended . . . on any portion of a sidewalk, or with the body of the vehicle extending over any portion of a sidewalk (California Vehicle Code §22500).

Despite this legal prohibition, Los Angeles has adopted a policy of "relaxed enforcement" of the law against parking on sidewalks.[1] The informal custom of parking on the sidewalk has evolved in some neighborhoods in response to a shortage of free parking spaces on the streets and the city's failure to enforce the law.

Informal parking on the sidewalks in North Westwood Village

I began to study informal parking on sidewalks in 2005 when teaching a course on Urban Transportation Economics at UCLA. Many of the students lived in North Westwood Village, a neighborhood next to campus. They mentioned that drivers often park on the aprons of driveways (the paved area between the sidewalk and the street), with part of the car extending over the sidewalk (Figure 1). Parking enforcement officers ignored this violation because the North Village is a student area and its city councilmember had requested relaxed enforcement.

Figure 1. Cars parked on the sidewalk in North Westwood Village

Most cars are too long to park entirely on the apron, and many drivers park with the front of the car extending over the sidewalk. Some also park on the driveway with the back of the car extending over the sidewalk (and no part of the car on the apron). No matter how far the cars extend over the sidewalk from either the apron or the driveway, drivers call it apron parking.

The Broken Windows Effect

Unfettered parking over the sidewalk is a good example of what George Kelling and James Wilson referred to as the "broken windows" theory of urban disorder:

> Social psychologists and police officers tend to agree that if a window in a building is broken and is left unrepaired, all the rest of the windows will soon be broken. . . . one unrepaired broken window is a signal that no one cares, and so breaking more windows costs nothing (Kelling and Wilson, 1982).

If we substitute cars parked on sidewalks for broken windows, North Westwood Village illustrates this theory: Where enforcement officers do not ticket the first cars parked on the sidewalk, more drivers will park on the sidewalk. Eventually, drivers will park on sidewalks throughout the neighborhood. Because the city has relaxed parking enforcement, an informal parking market has taken over the sidewalks.

Informal Protocols

North Village residents have developed several informal protocols for dealing with apron parking. For example, if cars are parked on the apron, how do residents who park in the garage of an apartment building get out? To solve this problem, some apron parkers exchange car keys and can move apron-parked cars blocking the driveway. They also text each other about any plans to use their cars, so that owners can move apron-parked cars that are blocking someone who wants to leave.

On days when parking is prohibited on one side of the street for the weekly street cleaning, every car illegally parked on the side of the street being cleaned usually gets a ticket. Cars illegally parked over the sidewalk on the other side of the street, however, rarely receive a ticket. The parking enforcement officers selectively ticket street-cleaning violations and ignore parking on the sidewalks. If an apron-parked car extends into the street on the side being cleaned, however, it *always* receives a street-cleaning ticket. In North Westwood Village, parked cars are more important than pedestrians.

The Magnitude of the Problem

My students began to study the informal parking problems in the North Village. They counted parking spaces and parked cars, analyzed census data, interviewed residents and property owners, and documented the situation with many photographs. Table 1 summarizes their findings about apron parking in the North Village.[2]

Table 1

Curb Parking Occupancy Rates in North Westwood Village

Street	Curb Parking Spaces	Legally Parked Cars	Cars Parked in Aprons	Other Ilegally Parked Cars	Total Illegally Parked Cars	Total Occupancy (percent)
	(1)	(2)	(3)	(4)	(5)=(3)+(4)	(6)=[(5)+(2)]/(1)
Landfair	118	112	54	24	78	161%
Roebling	25	21	16	0	16	148%
Glenrock	46	46	15	1	16	135%
Midvale	89	84	26	1	27	125%
Levering	97	90	26	3	29	123%
Gayley	79	77	15	3	18	120%
Kelton	129	125	23	5	28	119%
Ophir	61	59	9	1	10	113%
Strathmore	136	129	17	2	19	109%
Veteran	70	68	4	3	7	107%
Le Conte	7	6	0	0	0	86%
Total	**857**	**817**	**205**	**43**	**248**	**124%**

The students counted 205 cars parked on the driveway aprons. The 2000 Census showed that 11,021 residents live in the North Village and they own 5,879 cars. This suggests that only 3.5 percent of the residents' cars are parked on the aprons (205 ÷ 5,879), and only 1.9 percent of residents park their cars on an apron (205 ÷ 11,021). Although only a tiny minority of residents park on the aprons, their cars extend over the sidewalks on every block.

Population Turnover

A population shift toward residents who do not own a car can happen quickly. The 2000 Census found that almost half the residents in the North Village had not lived there one year before. A population turnover of 50 percent per year is understandable because student apartments naturally have a high turnover rate. And living in the North Village without a car is manageable because it is a short walk to campus. Anyone who owns a car needs a parking space, but not everyone needs a parking space because not everyone owns a car. If only 205 residents without cars replace residents who park on the aprons, the reduction in parking demand will be enough to clear the sidewalks of parked cars.

Since there are not enough apron parking spots for all tenants who want one, landlords either charge tenants for parking on the aprons (usually about $50 a month) or give them permission to apron-park when they lease an apartment (and presumably charge higher rent for the privilege). If landlords could no longer rent apron parking spaces to tenants, car owners would find apartments without off-street parking less desirable.

Someone who owns a car and cannot find an apartment in the North Village with off-street parking should not expect to park on the sidewalk. Anyone who cannot get along without a car might find that another part of town with more off-street parking would be a better place to live, and a student who does not own a car can then rent the North Village apartment without off-street parking. As a result, more apartments would become available at lower rents to students without cars. Clearing cars off the sidewalks would also make the North Village more walkable.

Political support for apron parking

Michael Dukakis, former Governor of Massachusetts and Democratic candidate for President in 1988, lives in the North Village when he teaches in the Luskin School of Public Affairs at UCLA during the winter. He walks to campus, and was appalled to see the chaos on every block as he threaded his way between cars on the sidewalks. He contacted city officials to seek remedies but, much to his dismay, was ignored. Nevertheless, due to his celebrity, Dukakis became notorious for protesting apron parking in the North Village.

Political uproar followed, at least in the blogosphere. Residents who apron parked in the North Village vilified Dukakis (and occasionally me) in blog posts, many scatological but a few amusing. Apron-parked cars are like squatters, and ending informal but illegal squatting is difficult once it has become established. As Oliver Wendell Holmes said, “A thing which you enjoyed and used as your own for a long time, whether property or an opinion, takes root in your being and cannot be torn away without your resenting the act and trying to defend yourself, however you came by it” (Holmes 1897). When it comes to parking, informal does not mean easily changed.

Many people have a stake in apron parking and do not want it to end. Landlords who now rent apron parking privileges to their tenants would lose revenue to which they have no legitimate claim. Residents have also come to depend on apron parking, even if they realize they are blocking the sidewalks.

The Americans with Disabilities Act

Informal parking on the sidewalks may seem solely a local issue, but in 2003, the U.S. Supreme Court ruled that the Americans with Disabilities Act (ADA) applied to sidewalks. The decision in *Barden v. Sacramento* requires cities to make public sidewalks accessible to the disabled. Because of this ruling, cities must remove barriers that block access for people with disabilities.[3] This decision has created a serious liability for Los Angeles because the city has informally allowed drivers to park their cars on the sidewalks in North Westwood Village, although it violates both California and Los Angeles law.

Two ADA lawsuits against the city have spurred reform. Both lawsuits deal with broken sidewalks and cars parked on the sidewalks. The lead plaintiff in one was a UCLA student who uses a wheelchair and had to make a long detour on the way to campus because cars parked on the sidewalks prevented taking the shortest route through the North Village (Pesce 2007). The lawsuit alleges:

> Due to his mobility disability, Named Plaintiff Victor Pineda uses a motorized wheelchair. Plaintiff Pineda is a graduate student at UCLA and lives in residential North Westwood Village . . . Plaintiff Pineda has consistently experienced apron parking on a number of sidewalks . . . The narrow spaces between the vehicles on the sidewalk prevent Plaintiff Pineda from traveling along the sidewalk. As a result, Plaintiff Pineda often must travel on the street to reach his destination, literally risking his life.[4]

After years of neglect, lawsuits have forced the city to reconsider the informal policy of relaxed enforcement for apron parking violations, and to decide exactly what should be legal and what should not.[5]

Regularizing apron parking

Because of the ADA lawsuits, city staff proposed allowing apron parking that does not extend over the sidewalk or too far into the street. Figure 2 illustrates the proposal.[6] Cars parked on the aprons could extend onto the street as far as the width of the parking lane, and cars could also parallel park on the street in front of the apron if they have a permit. Parking with part of the car extending over the sidewalk or into the street beyond the parking lane would remain illegal.

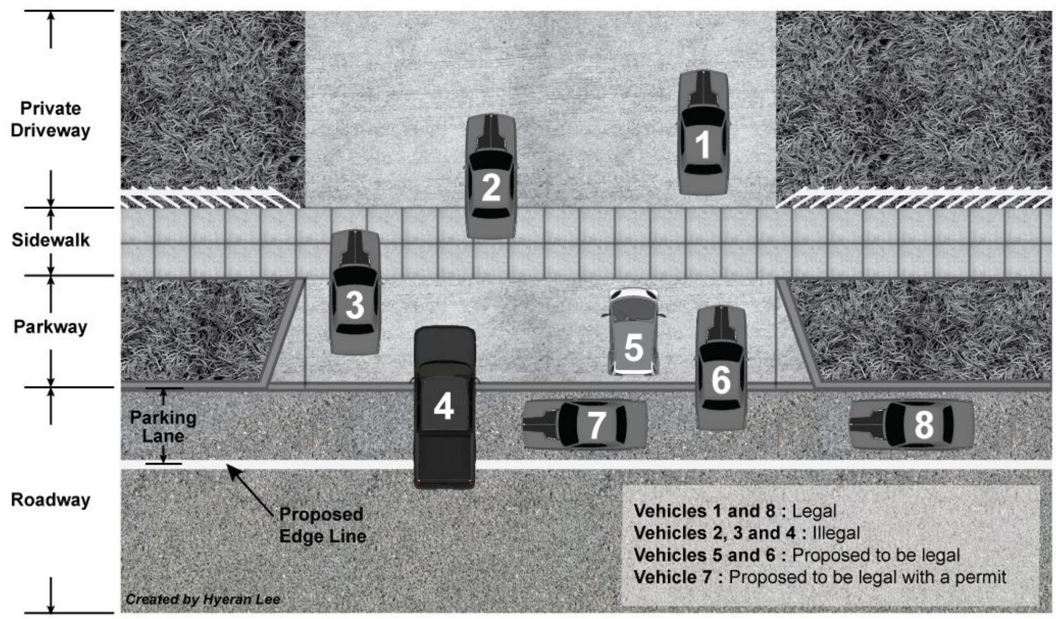

Figure 2. Proposal for legal apron parking in Los Angeles.

The easiest reform is illustrated by Vehicle 7 in the figure—parallel parking in front of one's own driveway. Some cities already sell permits that allow residents to parallel park on the street in front of their own driveway. Parallel parking on the street in front of a driveway does not accommodate as many cars as perpendicular apron parking does, but the parked cars do not extend over the sidewalk or into the street beyond the parking lane. Residents can use these block-your own-driveway permits to provide guaranteed parking for guests, home help, and service vehicles.[7]

Parallel parking in front of a driveway is illegal in Los Angeles, but enforcement officers do not issue citations in front of single-family houses unless someone complains – another example of relaxed enforcement. Parallel parking in front of an apartment building's driveway poses difficulties, however, because it can block all the residents' cars parked off-street. Nevertheless, it may work if residents cooperate by sharing keys to the parallel-parked cars that block the driveway.

Formal rules for apron parking can cure the problem of informal parking on the sidewalks only if the city enforces these rules consistently, but Los Angeles' proposed apron-parking rules would be hard to enforce. The city must first establish criteria for citing cars that extend too far over the sidewalk (from the apron or the driveway) or too far into the street. How far is too far? If apron parking is made legal for vehicles 5 and 6 in Figure 2, parking enforcement officers cannot see from their patrol cars whether any of vehicles 2, 3, 4, 5, and 6 illegally extend over the sidewalk. In this scenario, they have to get out of their cars to examine each vehicle.

Easing the path to formality

Given the threat of ADA lawsuits over inaccessible sidewalks, all cities that informally allow illegal parking on sidewalks will need to find ways to mitigate the withdrawal pains caused by enforcing the law. Fortunately, Los Angeles has already established one program that promises to ease the path to formality: dedicating curb parking spaces for shared cars.[8]

Car sharing's greatest benefit is to divide the fixed costs of automobile ownership (including parking) among a group of potential users. Because all residents have access to the shared cars, the neighborhood becomes more attractive to everyone who does not own a car. Shared cars in the North Village could serve the approximately 5,000 residents who do not own a car, attract even more residents who do not own a car, and thereby reduce the demand for curb parking. In public meetings, however, some residents who park on the street vehemently opposed car sharing because of the loss of curb parking.

Reducing Parking Demand

Despite this opposition, the city contracted with Zipcar, a car sharing company, to place its cars on the streets. The city has dedicated seven on-street spaces in the North Village to Zipcar, and the company has obtained four more off-street spaces. The survey of on-street parking found 857 legal curb spaces in the North Village (see Table 1). While the shared cars remove seven curb spaces from the parking supply (0.8% of the total curb spaces), they probably reduce parking demand by many more spaces by reducing the demand for private cars. Several studies have estimated that each shared car replaces between 9 and 13 private cars (Osgood, 2010; Martin and Shaheen, 2011), so the 11 shared cars in the North Village may have reduced the demand for parking by between 99 and 143 spaces. The shared cars can thus reduce, rather than increase, the competition for curb parking.

Similar opposition to car sharing arose in 2010 when Hoboken, New Jersey, reserved curb spaces at corners throughout the city for 42 shared cars, so that 90 percent of the population lives within a five-minute walk of a shared car. The city estimated that each "Corner Car" would replace 17 private cars, but some residents strongly opposed the loss of curb parking:

> At the beginning of the program, 42 of the city's roughly 9,000 on-street spaces were sacrificed to a city car-sharing program, known as Corner Cars, leading many residents to decry the arrival of new vehicles on their blocks, where claims to curbside space have long been regarded as sacrosanct. . . . As of July 2012, nearly a quarter of the program's roughly 3,000 members said they had given up their cars or decided against buying one because of the car share. Since 2009, the number of people with residential parking permits has decreased by about 1,000, to 16,000 total parking permits (Flegenhimer 2012).

We can use the Hoboken data to estimate how dedicating 42 curb spaces to shared cars reduced the demand for parking. If a quarter of the 3,000 car-share members shed one car, each shared car replaces 18 private cars (750 ÷ 42). And if car sharing explains the 1,000 fewer residential parking permits, each shared car reduces the demand for curb parking by 24 spaces. Allocating a few curb spaces exclusively to shared cars can thus improve parking even for residents who park their cars on the street.

Like peer-to-peer parking reservations, car sharing is another example of collaborative consumption based on sharing rather than owning resources. Because sharing a car also means sharing a parking space, it can greatly reduce the demand for parking. The internet is key to the ease of finding and reserving the shared cars, so the growing ubiquity of smartphones helps to explain the growing popularity of car sharing. The web-based formal market for car sharing may thus eventually help to resolve the problems caused by informal parking on sidewalks.

A formal parking market for curb parking

The loss of apron parking in the North Village will increase the already high demand for curb parking. Many students say the parking shortage already makes life in the North Village miserable. Residents who rely on curb parking say they have to plan their lives around finding a parking spot, and they often cruise for 20 minutes to find a curb space. Visitors also find it frustrating to hunt for a curb space when visiting the North Village.

To address these problems, Los Angeles can allow the residents of any block in North Westwood Village to adopt an Overnight Parking Permit District that prohibits overnight parking on the street except by permit-holders. Enforcement officers need to make only one visit during a night to cite all cars parked without permits. Los Angeles charges residents $15 per year (less than half a cent per day) for each permit in an Overnight Parking Permit District. Residents can also buy guest permits for $1 per night.

Rationing or Market Pricing

Given the high residential demand for on-street parking in North Westwood Village, the demand for overnight permits priced at $15 a year will greatly exceed the supply of on-street parking spaces. The city can keep the permit price low and limit the number of permits in some way, such as by a lottery. Alternatively, the city can charge a fair market price for the permits, so the number of permits demanded will equal the supply of on-street parking spaces.

Suppose Los Angeles charges the same price for a North Village parking permit that UCLA charges students for a parking permit in the nearby campus residence halls–$89 a month. If the city charges $89 a month (about $3 a day) for 857 overnight permits (equal to the number of on-street parking spaces in the North Village), the new revenue will amount to about $76,000 a month (857 x $89), or $915,000 a year. If the demand for permits priced at $89 a month is more or less than the 857 curb parking spaces, the city can nudge the price up or down. The right price for the overnight permits is the lowest price that will prevent a shortage of curb parking.

Directing Parking Revenue to Local Needs

Charging for curb parking will never be politically popular, but residents will be able to find a curb space more easily. To increase the acceptability of this market-based solution, the city could spend all the new parking revenue to improve public services in the North Village. The city could use the revenue to repair broken sidewalks, plant street trees, and fill potholes—all of which the North Village needs. These public improvements would greatly increase the livability of the North Village, and could satisfy the city's impending obligation to make the sidewalks accessible for the disabled.

The revenue from parking permits could quickly pay to repair all the sidewalks in the North Village. Because it usually costs less than $20 per square foot to replace sidewalks in Los Angeles, the parking revenue of $915,000 per year would pay to replace at least 46,000 square feet of sidewalk per year. Because the sidewalks in the North Village are five feet wide, the revenue would pay to repair at least

9,000 linear feet, or 1.7 miles, of sidewalk per year. The North Village has about five miles of sidewalks, so about three years of parking revenue would probably be enough to completely renew all the sidewalks. Replacing only the damaged parts of the sidewalks would of course cost much less and would be completed much faster.

Some may object that charging for curb parking and giving tickets to cars parked on the sidewalks would place an unfair burden on many low-income students who live in the North Village. But if drivers can no longer park on the sidewalks and have to pay for parking on the street, fewer people with cars will want to rent apartments without parking. Rents may decline, but people without cars will then rent the apartments. That does not seem unfair to students who are too poor to own a car.

Crime Reduction

In addition to fixing sidewalks, the city could also use the new parking revenue to increase police patrols in the North Village. In 2012, this 17-block neighborhood experienced three rapes, 15 robberies, 20 aggravated assaults, 58 burglaries, and 89 larceny thefts (see Figures 3 and 4).[9] I am *not* saying that the city's failure to enforce the law against apron parking *causes* any of this crime. I *am* saying that using the revenue from charging market prices for curb parking can *reduce* some of this crime. Which policy will make North Westwood Village a better place to live: free parking, broken sidewalks, and high crime, or paid parking, good sidewalks, and a safer neighborhood?

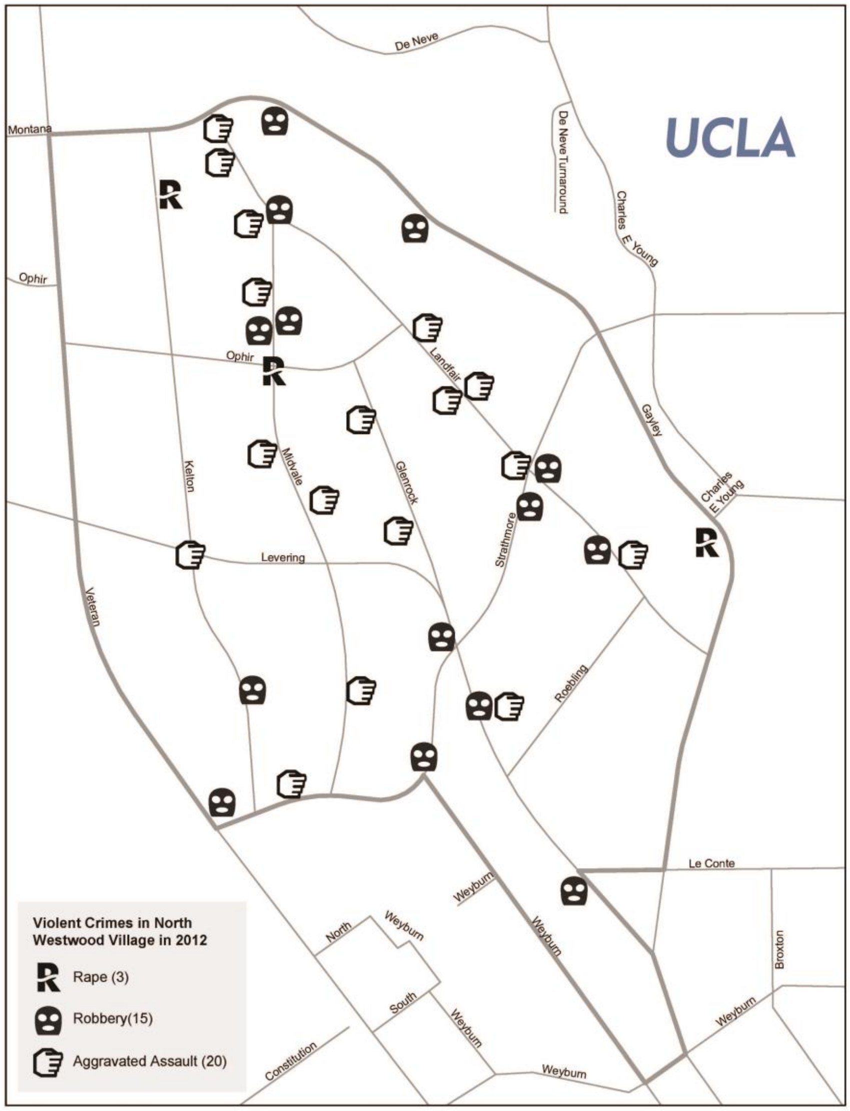

Figure 3. Violent Crimes in North Westwood Village in 2012

Even drivers who park on the street can be better off with paid parking, for at least three reasons. First, overnight parking permits will guarantee them on-street parking spaces in convenient locations. Second, their cars will be safer. In addition to the crimes listed above, four cars were stolen and six were broken into in the North Village in 2012. Third, the drivers will be safer while walking from their street parking

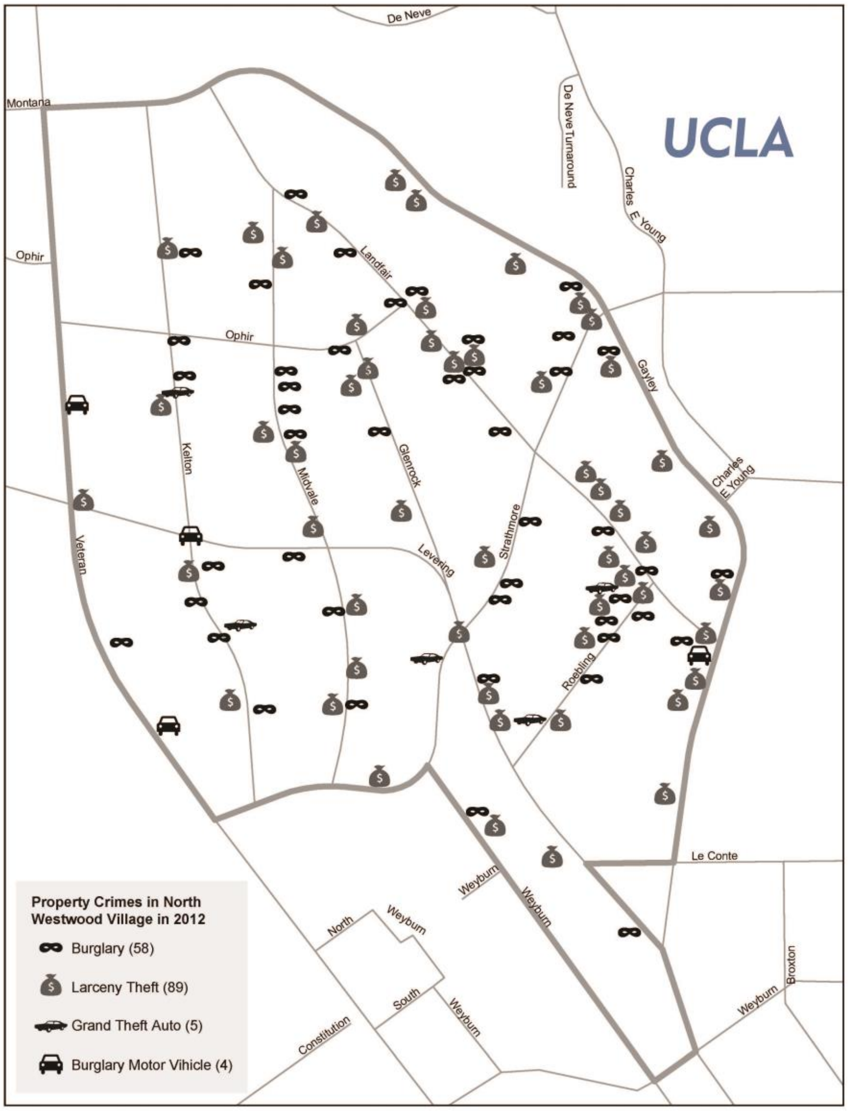

Figure 4. Property Crimes in North Westwood Village in 2012

spaces to their residences. If the choice is between free parking and high crime, or paid parking and more police protection, even the small minority of North Village residents who park on the street may prefer paid parking.

Daytime Parking

Overnight parking permits will not solve all the curb parking problems in the North Village. Commuters to UCLA, for example, may try to park free in the North Village during the day. In this case, the city can add a daytime permit district on blocks that request it. If the residents agree, the city can also allow nonresidents to pay for parking on blocks that have daytime vacancies, and the revenue will pay for even better public services.

Dedicating parking revenue to the neighborhood that generates it has built political support for paid parking in other cities (Kolozsvari and Shoup 2003; Shoup 2011). The 857 motorists who park on the streets overnight will pay a fair market price for their permits, but they will also find it much easier to find a curb space. All the rest of the 11,000 people who live in the North Village will pay nothing, but will live in a better neighborhood.

The sound of change

A solution to the problems created by apron parking in North Village will have long-term economic and environmental benefits but also short-term political costs. As Niccolò Machiavelli wrote in *The Prince* in 1532, "There is nothing more difficult to plan or more uncertain of success or more dangerous to carry out than an attempt to introduce new institutions, because the introducer has as his enemies all those who profit from the old institutions, and has as lukewarm defenders all those who will profit from the new institutions." Or as Woodrow Wilson said almost 400 years later, "If you want to make enemies, try to change something."

Most people want sustainable cities, great public transportation, less traffic, and more walkable neighborhoods. But they also want free parking, which conflicts with all these other goals. Fortunately, few people will have to give up a car if the city enforces the law against parking on the sidewalks in the North Village. Instead, a few car owners will decide that the North Village is not the best place to hunt for an apartment, and people who cannot afford a car will take their place. During the transition, the whining will be the sound of change.

Conclusion: Turning the problem into an opportunity

Informal parking markets often respond to the failure of cities to create formal markets for on-street parking. Even on some of the most valuable land, cities offer free curb parking on a first-come-first-served basis. In dense neighborhoods, such as those surrounding UCLA, how could informal markets for this free parking not emerge?

If curb parking is free, entrepreneurs will find ways to create informal markets that serve drivers who are willing to pay for convenience. These informal markets respond to the problems caused almost entirely by free curb parking. The shortage of free curb parking is not merely a problem, however. It is also an opportunity to create a formal market with fair prices that allocate land for parking efficiently: *parking reform is land reform*. A fair, formal market for on-street parking will reduce traffic congestion, air pollution, and greenhouse gas emissions, and will generate ample public revenue.

Fair market prices could end the Hundred Years' War over free curb parking in Westwood and similar urban areas. The new parking revenue could provide a peace dividend to rebuild neglected public infrastructure. Livable, walkable cities are worth far more than free parking on the streets and sidewalks.

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Endnotes

1. San Francisco also has an informal policy of not citing cars parked on the sidewalk if the cars leave some room for pedestrian access: http://shoup.bol.ucla.edu/ParkingOnSidewalksInSanFrancisco.pdf.

2. The students' research is available online at: www.its.ucla.edu/shoup/NorthWestwoodVillageDatav3.pdf.

3. Shoup (2010) explains ADA requirements for sidewalk accessibility.

4. Pages 8–11 in the lawsuit, Pineda vs. City of Los Angeles: www.its.ucla.edu/shoup/PinedaVsCityOfLosAngeles.pdf. The second lawsuit that involves apron parking on sidewalks is Willits vs. City of Los Angeles: http://shoup.bol.ucla.edu/WillitsVsLosAngeles.pdf.

5. When I first learned that the ADA requires accessible sidewalks, I wrote to the Los Angeles City Attorney to explain the informal parking problems in North Westwood Village, and asked him if the city would begin to enforce the law against parking on sidewalks. Perhaps naively, I expected an answer. When I received no answer, I wrote to Los Angeles City councilmembers, the Mayor, and the Deputy Mayor for Transportation (who was a former student), but never received a single reply to any of my 30 letters and email messages. This correspondence is available online at: www.its.ucla.edu/shoup/ParkingOnSidewalksInNorthWestwoodVillage.pdf..

6. Memo from the Los Angeles Department of Transportation to the City Council, "Apron Parking/Parking in Front of Driveways," November 7, 2011: http://shoup.bol.ucla.edu/ApronParkingReform.pdf.

7. Hermosa Beach, for example, issues permits for drivers to block their own driveways: http://shoup.bol.ucla.edu/HermosaBeachDrivewayParkingPermit.pdf.

8. See Osgood (2010) for an explanation of how cities allocate on-street parking to shared cars.

9. I am grateful to Jonathan Kwan in the University of California Police Department for providing these crime statistics.

CHAPTER 8

From Capitol to Coachella: Exploring the Role of Festivals in LA's Music Cluster

Patrick Adler

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The American music industry is currently undergoing two transformations. The first is quantitative in nature and involves the hemorrhaging of revenue and jobs out of music production, as recorded music becomes ubiquitous. The second transformation is qualitative. Even as economic value is leaking out of the industry, it is being refocused away from the production of goods, and towards the production of experiences. Music Festivals in particular have seen rapid growth even as the overall industry is shrinking. This chapter explores the spatial consequences of a move towards experience in music, a move in Los Angeles from the "Capitol Records" model to the Coachella model. It proposes that artists from festival home markets will be over-represented at these festivals, and then tests this theory through analysis of an original dataset. It argues that festivals act as an important externality for local artists, in a world where music choice is unlimited and music "curation" is more important than ever.

I. The Music Industry in Time and Place

The English-language music industry is either *in* a serious crisis or *at* an inflection point. As is typical when industries evolve, the origin of this change has been technological (Schumpeter, 1939). The rise of personal computing in the late 1990's transformed the industry by ending the monopoly that firms had enjoyed on the production and distribution of recorded music. Whereas an artist once needed the backing of capital in order to record music, s/he could now do so from the comfort of home with off-the-shelf software. Where music was once delivered to market by an elaborate transportation system, Napster made this function possible on an instantaneous, consumer to consumer basis.

These changes have shifted power from the firms who assemble music for profit, to individual artists and consumers. According to Forrester Research, US music sales dropped from $14.6 billion in 1999 to $6.3 billion a decade later (Goldman, 2010), and the decline is continuing. As the traditional industry craters, the onus is now on firms to figure out how to re-establish their once dominant position in the marketplace.

Because the music industry is highly concentrated geographically, the effects of the Napster crisis have been highly uneven. While Detroit and the rest of the so-called rustbelt have been adjusting to revolutionary change in heavy manufacturing, America's music and recording cities have dealt with an industry contraction of their own. Together, Los Angeles, New York, and Nashville contain a full 12% of musicians and 40% of recording establishments (Florida et al., 2009). Local economic policymakers who often try to *expand* the number of well-paying, “clean” jobs have had to contend with job losses in these industries. And just as firms must try to figure out a path forward, it is incumbent on local officials to support the preservation of music industries as much as possible. Los Angeles, in particular, faces this challenge.

The analysis in this chapter suggests how music industries, music, and policy makers in music–oriented regions might proceed in this highly tumultuous time. It provides two original contributions. First, it departs from a new literature on the importance of music festivals, to propose that LA can promote the development of its home grown industries by supporting large, local festivals. Second, it tests whether or not there is a “home-market effect” in music festivals that might be exploited by Southern California policymakers, as well as any officials with festivals in their backyard. In an age where the music industry is increasingly devoted to the export of live performance, local music festivals such as Coachella have started to assume larger economic roles. How and why is that happening? Also examined below are various issues related to local economic impacts of the evolving music industry.

Section II will contextualize the paper within previous work on music and regional development. Section III present some stylized facts on LA’s music industry and how it has been changing. Section IV will suggest how Coachella, LA’s premiere music festival, might play an important role in promoting music post-Napster. A portion of this model will be tested in Section V, using analysis of an original dataset on the origin of festival acts. The final section will conclude and review some policy implications of this research.

II. Previous Literature: “Music Scenes” In Economic Development

There are generally two ways to view the role that a strong music industry can play in the operation of a local or regional economy. The classical view treats music as developmentally significant if it contributes to a region’s wider industry base. More recent authors have proposed that strong “scenes” - the non-basic music industry - can generate development through indirect channels.

Music as an Industrial Base

Music can be seen as a central activity in a city’s export economy. Just as regions can export cars and financial services in exchange for revenue, they can also export music products and services. Hallencreutz and colleagues (2003) identify five specific types of music exports: “phonographs [by which they mean any form of recorded music], published music, live performances, copyrights, and music productions.” While live performance is intrinsically very different to produce than music products (i.e., harder to produce at scale, more salary-intensive), all five can be sent abroad in exchange for revenue. From the standpoint of local economic development (LED), this feature is crucial because, generally, regions need some kind of *export-base* in order to support their non-exported activities. Schools, dry cleaners, construction firms and a myriad of other urban enterprises could not be sustained without a base of revenues from outside.

Very few regions are capable of exporting a significant amount of music to the outside world, but the literature does identify a handful of places for which music is an important export industry. These places (henceforth called music clusters) can be distinguished from most places which produce music for local production only and mostly of the live music variety. Richard Florida and colleagues (2010) have identified three prominent U.S. clusters – New York, Los Angeles, and Nashville – which have high location relative concentrations of music as well as high absolute music employment.

Why do clusters tend to become stronger over time? The incidence of export-oriented clusters coincides with a number of favorable supports which act to raise the productivity of firms in the cluster area. Clustering firms have access to more efficient labor markets (among other inputs), better information, and technological know-how. However, clusters are formed in the first place, these external advantages tend to re-enforce themselves over time.

Examples of non-American music clusters abound. Stockholm exports music more efficiently than any city in Europe, while Kingston, Jamaica has successfully marketed entire genre (reggae) to the world (Power and Hallencreutz, 2002). In Los Angeles, the film and music clusters coincide with only a fair amount of trade and interaction between these sectors; in Mumbai, India, the massive “Bollywood” movie industry is complemented by a music industry which is largely dedicated to distributing film soundtracks (Lorenzen et al., 2008). As is the case domestically, however, examples of large music clusters are rare.

The music industry’s role in LED is straightforward according to the economic base perspective. Music clusters, by exporting a significant amount of music products to other places, bring in revenue that helps to support other economic activity and raise regional wealth. But it is important to consider a less straightforward and more speculative channel along which development and music can be linked.

Music Scenes as Amenities for Human Capital

A city's music industry can form a local amenity that helps to lure "good jobs" into a region. A battery of studies has indicated that a region's average level of human capital is highly related to economic development outcomes such as income per capita and housing prices (Abel and Gabe, 2010; Florida et al., 2008; Glaeser et al.; 1995; Rauch, 1993). This finding suggests that regional actors can help to improve development by attracting the educated into the city.[1]

Glaeser and colleagues (2001) suggest that highly educated workers are motivated to live in areas with certain sets of amenities. They cite the rise of reverse commuting since the 1960 as evidence of this process; city-suburb commuting grew more in percentage terms between 1960 and 2000, than did suburb-city commuting. More significantly, they find that the highest earning residents (i.e., those in the best bidding position) are increasingly found within one mile of the central business district. The authors trace this re-urbanization to the consumption advantages that are found there.

A correlation between neighborhood-level amenities and development outcomes has been corroborated by a range of other authors. (Florida, 2002; Markusen and Schrock, 2006; Clark, 2011). While these authors conduct analysis with different amenity sets at different geographic scales, they all use some measure of music and find significant results. The amenity argument for music is almost the inverse of the economic base argument. In the classical view, it is the exported portion of the music industry that is crucial, because exported music brings in revenue. Amenity approaches focus exclusively on music that is consumed within the home area. High skilled workers seek to live in places where they can consume music. Places with strong music scenes are predicted to have high concentrations of human capital and wealth.

These views do not conflict; rather they specify two completely different channels by which a strong local music industry might improve regional economic performance. This chapter contributes to each of these streams of thought. It proposes that, in addition to fulfilling an important amenity function, festivals like Coachella also make it easier to export music abroad. The implications for the LA area are developed below.

[1] A lively debate exists in the LED field between these authors and others (Scott, 2010; Storper, 2011) who suggest that smart workers cannot be courted directly. The discussion in this section proceeds as though there is merit to the People-Centered interpretation of the Human Capital/Development Finding.

III. Anatomy of a Music Cluster: LA in the Current Music Industry

The available literature identifies LA as a significant music exporter and current data show that this is still the case. Music industry data are scattered under several disparate industry headings. The sub-industries of Musical Groups and Artists (NAICS 71113)[2] and Sound Recording Industries (NAICS 5122)[3] are chief among these and will be used to stand-in for the industry as a whole in the remainder of the discussion. Los Angeles employs more employees in the Music Groups and Artists category than any other city in the country, including New York. It employs the second-most sound recording industry employees in the country. Concentration in these industries is much larger than population itself would predict. The 2010 location quotient was 2.55 for musical groups and a whopping 5.82 for sound recording industries (BLS, 2010). [4]

LA Music in Local Context

Of course, compared with LA's large and diverse economy, the LA music industry does not look especially significant. Figure 1 shows the size of the music sub-industries in comparison with the music industry generally, the motion picture industry and the entire economy. Together the music industries of interest account for less than 0.2% of all LA workers. However, the employment numbers conceal two important features of the local music industry.

First, LA Music is very much export-oriented, and each of these jobs supports numerous other non-basic jobs through high multipliers. Second, these jobs command a disproportionate share of wages. While the LA music industry is a smaller component of the local economy than the motion picture industry, its wage levels are higher, on average.

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[2] According to the U.S. Bureau of the Census, "this industry comprises (1) groups primarily engaged in producing live musical entertainment (except theatrical musical or opera productions), and (2) independent (i.e., freelance) artists primarily engaged in providing live musical entertainment. Musical groups and artists may perform in front of a live audience or in a studio, and may or may not operate their own facilities for staging their shows."

[3] According to the US Bureau of the Census, "this industry comprises establishments primarily engaged in producing and distributing musical recordings, in publishing music, or in providing sound recording and related services."

[4] Location quotients are ratios that compare the concentration of a resource or activity, such as employment, in a defined area to that of a larger area or base. If a region has 5% of the nation's employment but 10% of national employment in a particular industry, that industry in that region has a location quotient of 2.

Figure 1

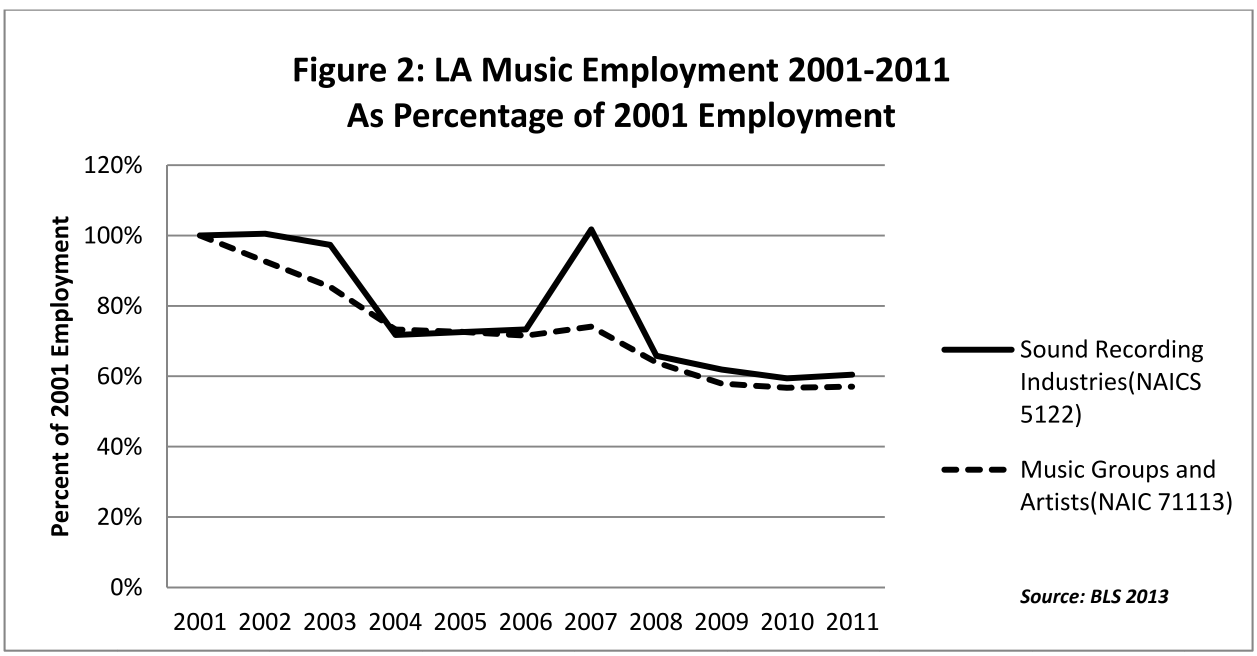
LA's Music Performance and Sound Recording in Context (2010)

Industry code description	Paid employees	% of Workforce	Average Wage	Annual payroll ($1,000)
Music Industries	8,354	0.18%	$106,665	$871,511
Musical groups and artists	2,689	0.06%	$78,291	$210,524
Sound recording industries	5,665	0.12%	$116,679	$660,987
Motion Picture and Video	*117,841*	*2.43%*	*$96,300*	*$11,348,088*
All Industries	*4,852,354*	*100.00%*	*$49,462*	*$240,006,735*

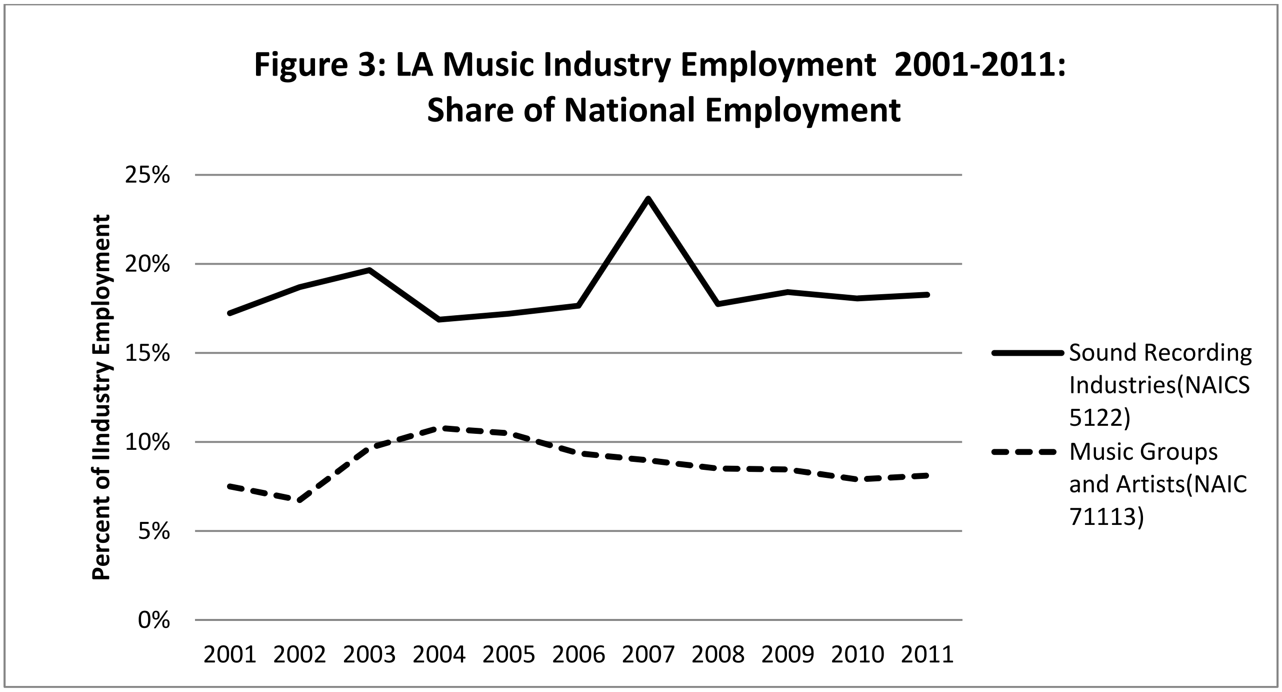
Source: County Business Patterns, US Census Bureau, 2012.

LA Music Since 2001

Longitudinal data make it clear that the LA industry has been affected by contraction in the national music industry. Figure 2 shows that employment in both sub-sectors has fallen by roughly 40 percent over the past decade. It is striking that this change has affected music groups as much as sound recording, given that the "Napster Crisis" has chiefly served as a threat to the distribution of recorded music. It is possible that the liberalization of music production helped to flood the music market with unprofessional musicians, who in turn drive down revenues and wages in the professional industry. The Sound Recording sector spikes in 2007 (for reasons unknown) but the general trend is resumed by 2008.



Recent data also suggest that the local share of national music employment has held steady, if not improved over the past decade. Figure 3 shows that sectoral changes in the music industry have not been felt disproportionately in LA, and that local share of the national industry is actually higher at the end of the study period. It is possible that this development foretells the further concentration of the music in music clusters.



If the non-historical data paint a picture of LA music as a locally-small, but nationally significant sector, then the longitudinal figures show an industry under siege. As the region's population continues to grow steadily, local policymakers are looking for ways to add more "good jobs" to the city's economy. The hemorrhaging of well-paid music jobs represents a move in the wrong direction. There is an economic rationale for public intervention on behalf of the LA music cluster. But if local policy is to make any difference than it must informed by a post-Napster, post-2001 understanding of the global music industry.

IV. Festivals and Live Performance in the Modern Music Economy

In the current age, music festivals such as Coachella might support the development of local music industries. This section begins with a review of stylized facts which chart the growing importance of live performance to the music industry. From there it proposes three channels through which festivals can improve economic development.

Live Performance Post-Napster

The overall contraction of the music industry since the late 1990s obfuscates growth in some subsectors. Proceeds from live performances of music have been increasing, even as employment and revenues drop. Between 1999 and 2009, sales of concert tickets in the US skyrocketed from $1.5 billion to $4.6 billion (Lee, 2012). The same trend has been observed in the United Kingdom where, in 2008, revenues from live performances began to eclipse revenues from recorded music, and have been growing since (Bintliff, 2010).

A significant study from a team of Harvard economists (Mortimer et al., 2012) suggests that the decline of recorded music sales over the same period is more than coincidental with the rise in live performance. They find evidence that the digitization of music increased exposure for small artists, and this exposure has translated into more concert-sales for lesser-known groups. They find that concert growth is driven by smaller and less-established artists. One could say that the same force (digitization) which led to a contraction of recorded music profits increased the opportunity to consume live music. Live performance growth has been propelled, in part, by the growth of music festivals, which can be defined as one-off music events. One estimate has U.S. festival proceeds growing by more than $2 billion, between 2001 and 2011 (Grose, 2011).

The Coachella Music Festival, held in Indio, California, is a perfect illustration of how music festivals have grown. Coachella did not even exist in the pre-Napster era. When it began in 1999, Napster was just being unleashed on the world. After a financially poor debut, the festival took a year off before returning in 2001. Since then, it has grown continuously from a single day concert, to a two-weekend mega-event. Even as growth in concert tickets shows signs of leveling off since 2010, Coachella continues to sell-out faster and faster (Ring, 2011).

There are, in fact, two transformations affecting the music industry. One transformation is quantitative in nature and involves the hemorrhaging of revenue and jobs out of music production. The second, however, is qualitative. At the same time that economic value is leaking out of the industry, it is being refocused away from the production of goods, and towards the production of experiences. For policymakers in LA (as well as in Nashville and other music clusters), both changes are worthy of attention.

Music Festivals and the Economic Base

As the American music industry becomes more oriented around live performance, it is worth asking whether thinking about music scenes should be revised. For the most part, the approaches cited in Section II were developed before the MP3 crisis. How does the decline of music employment and revenue, alongside the rise of performance change these approaches, if at all? In order to appreciate the implications of recent changes, it is worth asking how music festivals in particular can be connected to regional economic outcomes. There are three channels, two familiar by now and one less so, through which festivals might drive local development.

Music festivals can improve development outcomes by contributing to the economic base of a region. The regional base benefits the most from festivals that are located in or near the region itself. Local festivals are staffed primarily by workers from the immediate area, and these workers are likely to consume most of their proceeds in the home region. If the festival is managed and housed locally (e.g., Coachella is managed by Golden Voice, an LA company), then profits are more likely to flow to the local area and be circulated there. It seems possible that a dollar earned by a local festival will have a higher multiplier than the same dollar earned by a local recording firm – which usually has physical music products manufactured far afield from where they are developed. One might imagine that suppliers to the local festival are more local, and revenues are more likely to stay within the region.

If the only consumers of a local festival are consumers from the home market, then there will be fewer benefits to the economic base – the only one perhaps being an import-substitution benefit, as consumers keep more money within a region. But large festivals are touristic. Coachella attracts thousands of visitors from out of state and a great deal more from out of their home region within California (Descant, 2013).

Local clusters can also benefit from festivals held far afield. Regions benefit when they export home acts to other festivals. Home acts that earn money abroad will eventually return home and consume local goods and services. The same might also be said of support personnel (not necessarily performers themselves), who go abroad to support the production of music festivals.

Music Festivals as Regional Amenities

A less sure hypothesis is that music helps attract skilled workers. It seems unlikely that workers would make their location decisions based on the location of a single event, but perhaps the “marginal worker” (at whom many economic development policies are directed) can be swayed by the presence of this or that festival. Perhaps that worker gains an introduction to a region by traveling there for a festival. Perhaps the festival helps to place a city on the map of cities to which a worker might relocate.

While the festival-as-amenity hypothesis is not self-evident, it is in line with some literature. If music amenities do attract talent, as some argue, then festivals, especially a critical mass of them, might promote talent attraction. Even as the festival economy has expanded, there are still a relatively small number of places that can offer the music lineups of Coachella or South by Southwest (SXSW). If music festivals were more ubiquitous or more homogenous, then this channel could be ruled out completely, but they are not.

Music Festivals as Curators

There is a potential new channel running from mega-festivals to economic development. This path is not specified in the music cluster or music scene literature, but can affect both the exported and amenity portions of a city's music economy. It is possible that large, nationally and internationally significant festivals can raise the visibility of local bands, and that this function is ever more important in the current phase of the music industry.

Major music festivals attract a great deal of national and international publicity, with thousands of music journalists snapping up press passes to cover the most important festivals. Getting a handle on how much coverage festivals receive is difficult in the age of bedroom bloggers and iPhone photojournalists, but a look at Google results demonstrates the visibility of major festivals. Figure 4 shows the number of raw results for fairly unique terms, related to several live events.

Figure 4: Google Search Results for Selected 2013 Acts

Search Term	Raw Results
"Super Bowl 2013"	**178,000,000**
"SXSW 2013"	**93,000,000**
"Comic-Con 2013"	**76,200,000**
"Coachella 2013"	**25,800,000**
"Academy Awards 2013"	**20,800,000**
"Sasquatch 2013"	***5,770,000***
"Westminster Dog Show 2013"	**2,440,000**
"Bonnaroo 2013"	***680,000***
"Final Four 2013"	**306,000**

It shows that music festivals, while nothing on the level of the Super Bowl, hold their own among very large events. Both the Coachella and the South by Southwest festival have more results than the much more established Academy Awards. All festivals seem to get more coverage than the Final Four, no small event in its own right.

Music festivals are also occasionally simulcast by Google's video service YouTube. In the past few years, live streams to festivals such as Coachella, Lollapalooza, and Brazil's Carnival have been linked from YouTube's homepage to music lovers worldwide. An estimate of viewership for the 2007 Bonnaroo was put at well over a million people (Resnikoff, 2010). The most important point is that major music festivals generate a significant level of exposure, more than solo performances by touring bands.

This level of visibility and attention is especially important in an age where the supply of music has grown dramatically. By lowering barriers to recording music, digital technology has ushered in an era of infinite music choice in hearing that music. A recent study finds that the number of officially catalogued music tracks grew from 11 million in 2001 to more than 100 million in 2011 (Masnick and Ho, 2012). Obviously this number is well short of the number of tracks that are not officially registered.

Electronic distribution has increased the accessible supply of recorded music. When consumers buy physical music recordings from physical (bricks and mortar) retailers, they are theoretically limited by the amount of shelf space available in their market. However, the digital distribution of physical music through websites like Amazon, as well as the digital distribution of digital music through download and streaming sites, removes physical constraints on supply for most consumers.

In a world of unlimited supply, consumers face significant search problems in accessing the music that is best for them. It would be impossible to comb through 100 million songs in search for a couple of thousand that can fit on an MP3 player. In this world, knowing about artists is a fairly reliable predictor that you will consume their music. Curators, intermediaries with the ability to connect consumers to the sort of music that they will like, provide a more important service. Curators can come in myriad forms, from the automated (e.g., Amazon's algorithm based recommendations) to the traditional (e.g., disc jockeys) to the personal (friends and family).

Music festivals can act in a curatorial capacity. Most festival attendees are drawn to festivals to see acts that they already know about, but festivals also will inevitably expose them to new acts if not wholly new types of music. Indeed it is the combination of novelty and reliability that renders these festivals attractive in the first place.

The recommendation of a curator (be that a festival organizer or an algorithm or a personal contact) has obvious regional economic effects. It can lead to the purchase of music-related products (not just recorded music, but also merchandise and memorabilia), which flows back to communities active in the supply chain. It can also lead to the purchase of later live-performance tickets, either at other festivals or stand-alone engagements.

To summarize, there are three channels through which music festivals might support local development in areas such as Los Angeles. The first is via direct support to the local economic base. Local festivals help to substitute local entertainment consumption and to support the tourist industries of the local economy. Festivals held abroad function as service exports. Festivals might also act as amenities that attract human capital, itself a driver of development. Finally, the largest and most visible festivals might act indirectly to support music clusters, by raising the profile of local artists and helping them to stand out from the crowd. But how much of a curatorial role do festivals play?

V. Home Field Advantage?

Music festivals are biased in their content to local acts, and that preferable access to performance at a local festival acts as a competitive advantage for less-established acts. Festivals are likely to have a local bias for two types of reasons. On the supply side, the costs of performing at a local festival are lower for home artists; they will not need to travel as far to the festival venue, nor will they have to pay for accommodations. These factors allow for local artists to sell their services at a lower price than competitors from farther afield.

There is also an important demand explanation. Music festival organizers face the same general “tyranny of choice” that music consumers do. They must filter through an unlimited supply of artists to come up with a list of artists that can fit on their stage(s). But organizers do not make their decisions in a vacuum, but are instead embedded within local music scenes and local networks. They are more likely to have connections with and knowledge of local artists, and the roster of acts they would even consider is probably locally biased.

Framing Research Questions

If there were no local bias, no "home field advantage" in the content of festivals, then local artists would not benefit disproportionately from having festivals in their backyards. However, if there is a local bias, then mega-festivals can be seen as important externalities in the regions they operate. The costs of festivals are largely external to musicians, but the potential benefits of visibility and differentiation are immense.

There is some empirical evidence on the tendency of music festivals to feature local content. The focus will be on Coachella, which is the largest festival in California and one of the most significant festivals in the country. But three other festivals will be considered. Two related research questions can be asked:

Question 1: Do Los Angeles acts receive more exposure at Coachella than they do at other music festivals?

Question 2: Is there a general tendency for large music festivals to feature local content more than content from other areas?

Study Design: Comparative Research Framework

The research questions demand a comparative study framework. Because Los Angeles is one of only three significant music clusters in the country, we might expect for LA artists to be well represented at every festival. To determine whether Coachella's location confers additional exposure, it is necessary to appreciate it within context. For a more general understanding of the music-local development, the home field advantage must also be considered. Thus, the evidence below analyzes not only the local content of Coachella 2013, but also of similar festivals. Ideally, it would be useful to compare local content across the thousands of music festivals that are held every year in the United States. But this preliminary research is limited to four large music festivals. Figure 5 summarizes the cases.

Figure 5: Sample of Music Festivals

Festival	Largest Metro Within 200 Miles	Number of Acts	'12 Attendance
Coachella	Los Angeles	176	85,000*
SXSW	Austin	~1717	12,000
Bonnaroo	Nashville	101	85,000
Sasquatch	Seattle	66	22,000

* Attendance number is for a single weekend.

Each case in the sample is a significant music festival that attracts more than 10,000 visitors and generates more than 500,000 unique Google results. Moreover, the festivals all have genre-neutral mandates, unlike, say, the New Orleans Jazz Festival or Stagecoach, since they are not confined to a certain regional flavor. Finally the festivals all feature some of the same acts. Eighty acts are featured at two of these festivals, fourteen are featured at three and three are featured at all four. Some level of continuity across festivals provides modest assurance of comparability.

The sample features a considerable amount of heterogeneity, some of which is desirable. Each festival is drawn from a different region of the country, and the home markets of each vary significantly by size. All home markets have at least one million inhabitants. As a result, the findings can only be generalized to large metropolitan areas. But one home market – Los Angeles – is significantly larger than the rest.[5]

Study Design: Determining Home

Data collection involved assigning a primary metropolitan area to every act performing at the chosen festivals. Festivals, generally, do not disclose where their performers hail from, so this analysis required direct collection. The population of artists for Coachella, Bonnaroo and Sasquatch was determined to be all artists on a festival promotional poster. SXSW's thousands of acts would not fit on any single promotional poster, so its population was assumed to be all official acts listed on the SXSW website. Acts were assigned a home using a hierarchy of sources listed in Figure 6. The preference was to use sources where a representative of an act self-disclosed where it was based. The preferred source was Sound Cloud, an artist-maintained music website, where artists are asked to list where they are located. If Sound Cloud did not have information on home metropolitan area, Twitter and Facebook were used.

A full 69% of sample artists could be catalogued using these primary sources. The remaining were catalogued using secondary sources. For example, the *All Music Guide* is an online encyclopedia of music acts which regularly includes information about where they are based. In addition, music journalism tends to reference an act's home.

[5] There is no festival around New York City that was large enough to be compared to Coachella.

Figure 6: Hierarchy of Sources

Priority	*Source*	*Description*
1	*Sound Cloud*	*Self-Populated Music Directory*
2	*Twitter*	*Widely Used Social Media Website*
3	*Artist Website*	*Maintained by artist or label*
4	*Facebook/My Space*	*Less Used Social Media Websites*
5	*All Music*	*Music Encyclopedia*
6	*Secondary Journalism*	*Various, Secondary*

If the home listed was not a metropolitan or "micropolitan" area, the parent metro was recorded (e.g., Venice, California became Los Angeles). If two homes were listed in the primary source, secondary sources were utilized to establish a dominant locale. If multiple cities were listed, and the band was distributed across multiple metros, then the metro of the act's formation was used. This method of coding is obviously subject to a degree of measurement error, but it was able to turn up a base for all 2060 acts that makeup the sample dataset. Each designation has a defensible source.

Study Design: Determining Advantage

Three types of dependent variables were used to measure whether home artists are disproportionately represented. The first is the absolute share of festival artists. If there is a home field advantage then we would expect for the home metro's share of artists at the home festival to be larger than its share at the other three festivals. Similarly, we would expect for the home share of artists to be large in comparison with other metropolitan areas. In case the absolute measure is biased toward large metropolitan areas, I also collected a measure of total acts per capita. We would expect for home cities to out-compete other places on an acts per capita basis, and for acts/ capita to be higher at home festivals than the other three festivals.

Finally, the shares of less established acts at a festival were collected. The hypothesis is that home field advantage works to promote more obscure artists. The previous measures may overestimate this effect for places with a large stable of established artists who have already distinguished themselves from the large supply of lesser-known musicians. There are numerous ways to define such musicians. In this study a lesser-known artist is an artist that only played at one of the four music festivals.

Results: Absolute Shares

Results of this study are consistent with the hypothesis that home artists receive a bonus from festivals located in their backyard. Figure 7 shows the share of acts from six cities at each of the festivals. In addition to the four festival cities, it also lists two benchmark cities for LA: New York and Chicago. Figure 8 shows the home metro's rank for each of the four festivals. Taken together, these figures show that more of Coachella's acts are from Los Angeles than anywhere else. Los Angeles ranks first overall in festival share, well ahead of New York from which 10 percent of acts are drawn.

Figure 7: Share of Festival Acts from a Sample of Metros

Metro	Coachella (LA)	SXSW (Austin)	Bonnaroo (Nashville)	Sasquatch (Seattle)
Festival Metros				
Los Angeles	**18.18%**	8.32%	18.63%	15.15%
Austin	0.00%	**12.80%**	0.00%	0.00%
Nashville	0.57%	3.78%	**2.94%**	0.00%
Seattle	1.14%	1.11%	0.98%	**7.58%**
LA Benchmark Metros				
New York	10.23%	10.36%	21.57%	16.66%
Chicago	1.7%	2.1%	1.96%	3.03%

Figure 8: Ranks of Local Metros at Their Home Festival

Festival	Home Metro Rank (Overall)	
Coachella	1st	
SXSW	1st	
Bonnaroo	4th	
Sasquatch	4th	

LA's Coachella dominance does not suggest that LA artists have a home festival advantage. LA acts could just be well represented at every festival, because LA artists are so successful. When we read across Figure 7, we see evidence for both interpretations. LA artists are well represented at each festival, which is no surprise considering that it is a large music cluster. Its 18% share at Coachella is higher than its shares at SXSW and Sasquatch, and roughly equal to its Bonnaroo Share.

There are two ways to interpret the finding that LA artists do similarly at Coachella and Bonnaroo. One reading is that LA artists do realize an advantage at Coachella *and* another kind of premium at Bonnaroo. Another is that there is no home bonus whatsoever and Coachella's representation of LA artists is coincidental.

The second explanation is cast into doubt when we examine the other three festivals. There does seem to be a home festival advantage for Seattle artists, who see seven times the representation at Sasquatch than the three other festivals, and Austin Artists who are only represented at SXSW. Austin's overall share of artists ranks first among all cities at SXSW, higher than New York and LA, while Seattle artists take a respectable 4^{th} place at Sasquatch.

The home field advantage is decidedly more muted for Nashville artists, who are better represented farther away at SXSW than they are at home. Nashville artists still rank fourth at Bonnaroo, however – which might be impressive when we consider that Bonnaroo is not a country-music festival. Nashville artists are predominantly employed in the Country and Western music industry, so that cluster might be too specialized to have a strong representation at Bonnaroo. Perhaps, LA's superlative performance at Bonnaroo can be reduced to a smaller home effect operating there. Comparisons with more festivals will help clarify these issues.

Results: Acts Per Capita

The per capita numbers are more consistent in pointing to a home festival bonus. Figure 9 shows per capita figures for each festival city and LA's benchmarks, while Figure 10 shows ranks on a per capita basis. Ranks are limited to places with 1 or more act, in order to compensate for a small-city bias in per capita numbers.

LA outperforms each of the reference cities (New York and Chicago) on a per capita basis, and ranks fourth overall. The cities that rank ahead of LA on a per capita basis (Reykjavik, Kingston, and Bristol) have only two acts each, and account for a combined 6% of all festival acts. LA's per capita number is much higher at Coachella than at Bonnaroo and Sasquatch. In this case SXSW is not a very good comparator because it features many more acts than Coachella.

Figure 9: Acts Per Capita (100,000) By Festival – Home Festivals in Bold

Metro	Coachella	SXSW	Bonnaroo	Sasquatch
Festival Metros				
Los Angeles	**0.25**	1.12	0.15	0.08
Austin	0.00	**13.84**	0.00	0.00
Nashville	0.07	4.27	**0.20**	0.00
Seattle	0.03	0.57	0.03	**0.15**
LA Benchmark Metros				
New York	.1	.94	.12	.06
Chicago	.03	.38	.01	.01

Figure 10: Home Metro Ranks (Per Capita)

Festival	Home Metro Rank (Per Capita*)
Coachella	4th
SXSW	1st
Bonnaroo	1st
Sasquatch	1st

*Rank out of all cities with 2 or more acts at the festival

At the three other festivals, home metros rank first on a per-capita basis. This is even true in Nashville, which had a rather lackluster showing in the absolute share analysis. The per-capita analysis consistently points to a home metro advantage. This advantage seems particularly strong in the case of cities outside of large music clusters. For instance, Austin artists only have representation at their local festival.

Results: Less Established Acts

What happens when the share analysis is restricted to less established artists only? LA's share of the one-time only artists at Coachella (that is, its share of artists who perform at Coachella and not the other three festivals) is 15.2%. While this is slightly lower than LA's share of all artists, it is enough for first place overall. Most LA artists at Coachella are performing there and nowhere else. These results are consistent with the prediction that home music festivals give less-established artists an opportunity to perform. These numbers would probably be even more striking if a more restrictive filter for obscure acts had been used.

Figure 11: Share of One-Time Festival Acts

Metro	One-Time Acts	Home Share of One-Time Acts (Rank)	% Home Acts That Are One-Time Acts
Coachella	23	15.20% (1st)	71.88%
SXSW	220	13.21% (1st)	100.00%
Sasquatch	2	7.69% (Tied for 2nd)	40.00%
Bonnaroo	3	2.97% (4th)	100.00%

Austin also ranks first in the share of one-time artists. All of the home acts at Bonnaroo are one-time artist. Only 40% (2) Sasquatch artists are one-time performers, a finding that I have a hard time explaining. Still, Seattle trails only New York – a music cluster- in share of one-time acts and is tied at second with London and LA – two other clusters.

Clearly, these results are suggestive rather than definitive. But overall, they do suggest that having a local music festival is good for local musical talent. To the extent that such local talent is a boost for local economic development, a local festival could be said to foster such development.

VI. Conclusion and Policy Implications

The results presented in this chapter support the idea that Los Angeles-area musicians have better access to the Coachella stage than they would if they were based outside LA. The results also point to a general home field advantage in three other festival cities. LA artists are better represented at Coachella than at the other three festivals on both an absolute and per capita basis. Less established artists also seem to be better represented at the local festival. It appears that Coachella, in addition to providing an infusion to the Coachella Valley tourist industry, elevates the profile of LA musical acts.

The small sample size means that the results can be said to be consistent with the hypothesis rather than proof of it. An extensive analysis could corroborate the findings that were presented. It should be noted that the research has not begun to probe the *magnitude* of a home festival advantage from an economic development standpoint. Surely, obscure home acts will benefit from being chosen to perform at a big festival. But how much does the marginal home act tend either to improve the economic base of a region on one hand, or improve its amenity suite on the other? Further research is needed to quantify the benefits of added visibility to the extent that those can be quantified.

If we assume that festivals like Coachella act as a kind of positive externality for the local music industry, then there are at least two implications for the local policymakers:

1) **The modern music industry is worthy of economic development attention.** In Los Angeles, music has never been seen as the same economic driver as movies and TV, and the contraction of the music industry might discourage any additional involvement. However, this chapter suggests that the live music economy can support economic development outcomes both inside the music industry *and* in the wider economy. Policymakers would do well to recognize live music as a source of good-paying jobs with reasonable economic multipliers. Currently, there is no large-scale strategy to promote live music in the greater LA region. Perhaps there should be. In LA, where a small but significant portion of the economic base has been evaporating, it is incumbent on policymakers to consider how they could support the experiential music economy.

   One policy mission would be to encourage even more local participation representation at large music festivals like Coachella. Perhaps policymakers can encourage local sourcing of festival performances in the same way they sometimes do in other industries. In addition, music policy can seek to support local live performance venues. Music venues are often seen as sources of negative externalities (i.e., noise, crowding, drugs). But it is important to remember that the venues play a role in the development of musicians into festival-ready and tour-ready acts. Indeed, before the Beatles sold out arenas worldwide, they were mainstays of the local Liverpool music scene.

2) **There can be a mismatch between the benefits and costs of music festivals.** Music festivals might improve the functioning of the music industry in a home region. But in most cases, the physical location of festivals is outside of the home region. Coachella may be a boon to LA artists, but it is held 127 miles from downtown LA in Indio. The significant demands that the festival places on police, fire, and road infrastructure are thus absorbed fully by communities such as Indio and Palm Springs, even though the music industry in these areas is probably too small to benefit from the advantages of proximity. To be sure, the area immediately around Coachella benefits from the influx of more than 100,000 visitors every April. But LA derives its benefits from Coachella without paying

any costs at all. There might be an opportunity for High Desert lawmakers to lobby for support from LA officials.[6] A first step, however, would be for LA policymakers to recognize the potential gains from encouraging local musical artists.

[6] The same issue faces Sasquatch and Bonnaroo which are also held in rural areas, but are not germane to SXSW (which is based in the City of Austin).

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CHAPTER 9

Case Study: Can Business and Urban Community Non Profits Find Common Ground on California's Future?

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Early in 2013, the dean of the UCLA Luskin School of Public Affairs was approached by a member of the school's board of advisors with an interesting challenge. The board member had been having conversations with two different organizations over the issues of what public policies are best to spur inner-city economic development in Los Angeles. One organization, the California Business Roundtable (CBR), advocates that the best way to spur economic development is to reduce taxes and ease costly environmental and safety regulations that inhibit new business investment. The other organization, The Los Angeles Urban League (LAUL), makes its investments in public education and job training to enhance a local workforce attractive to businesses and industries.

While neither organization believed their differences were mutually exclusive, they recognized a divide in values and priorities that prevented them from pursuing a common agenda for their common goal: more jobs and businesses in South Los Angeles. The Business Roundtable, in fact, is a state lobbying organization pushing for an improved business climate. It hoped to enlist members of the state legislature's Latino and black caucuses to support its business growth agenda in the upcoming legislative season. The questions to the dean of the Luskin School were these:

- Could the UCLA Luskin School serve as a neutral research partner for both organizations?
- What does the academic research tell us about inner city economic development?
- Are there data on local business growth that shed light on the issues?
- What do Luskin faculty think, and why?

The list was an excellent set of policy questions to which the Luskin School, with its three departments of public policy, social welfare, and urban planning, was well-positioned to respond. The challenge also offered a window on how public policy is developed, deliberated and influenced outside of the legislative institutions of government. Such deliberation occurs in civil society, where partisan non-profit organizations, trade associations, and even churches work to set the policy agenda, to mobilize support, build alliances, and even draft legislation. In addition, the dean of the Luskin School had been exploring a concept of "fast-track research," where agencies and organizations can contract with the Luskin School to provide non-partisan, evidence-based literature reviews on policy. The board of advisor's request fit the bill.

Methodology

As a start, the Luskin School assembled a research team that consisted of a senior urban economist, a PhD student in urban planning, and the author of this paper who served as project director and managing editor. The senior economist, Matthew Drennan, is a professor *emeritus* at Cornell University and a visiting professor in the UCLA Luskin's Department of Urban Planning. Over his long career, Professor Drennan has conducted research on the transformations of urban economies, New York City's most prominently, particularly in the shift from manufacturing to information and technology-based industries. He is the co-author with Michael Manville of "Falling Behind: California's Interior Metropolitan Regions," which examined the disparities between the California coast and inland areas in technology-based growth.[1]

The Urban Planning Ph.D. student, Taner Osman, is conducting his doctoral research centered on the question why cities in the same metropolitan region experience different economic fortunes. His dissertation (in progress) is titled, "The Shadow of the Silicon Valley: The Dispersion of the IT Industry within the San Francisco Bay Area, 1990-2011." My interest, as director of the UCLA Center for Civil Society and recent author of a series of chapters on the state's left-right political divide, centered on the unusual partnership between two divergent non-profit organizations. In this unique case, the two were seeking a research-based foundation from which to promote a common advocacy agenda for economic development for inner city neighborhoods in Los Angeles.

From the outset, we avoided re-analyzing back-and-forth debates over specific legislation, such as increasing the minimum wage or AB 32, the California measure that imposes stronger

[1] *Berkeley Planning Journal*, vol. 21, 2008. Available at http://escholarship.org/uc/item/6xk8s5wb#page-2

greenhouse gas restrictions than any other state. Our goal was to step back and look at the economics of inner-city development – what works and what doesn't – and use that information to start a common-ground conversation. The title of the project, negotiated with the Los Angeles Urban League and the California Business Roundtable (CBR), through CBR's communications firm, KP Public Relations, was "Common Ground, Common Goal: Improving California's Regulatory Business Climate, The Impact on Urban Communities."

Our research approach was two-pronged. First, Professor Drennan, with the assistance of Luskin Urban Planning master's degree student Ann Brown, would conduct a review of the literature, looking at the major academic journals in urban planning and economics over the past 10 years. Drennan and Brown summarized the most up-to-date research findings and contrasted those with available data on employment, income, and poverty in the Los Angeles and surrounding regions.

Second, Taner Osman, through the National Establishment Time Series (NETS) database, examined 22 years of business firm behavior in Los Angeles, with regional, statewide and national comparisons. The NETS database allowed us to look at employment, business types, relocations, start-ups, and closings down to the zip code level. Our aim was to put together a long-term picture of business development as well as to test assumptions that came up conversationally with the CBR and the LAUL.

For instance, the CBR, along with such business organizations as the California Chamber of Commerce, have long believed – from strong anecdotal evidence from their membership – that there has been a serious, long-term business exodus from California on the part of firms seeking a less onerous state and local tax and regulatory regime. At the same time, they have argued, firms are less likely to relocate to California for the same reasons. The NETS database would allow us to test these assumptions. Such testing could be done statewide, regionally, and by zip code to see if and how relocation not only affects the state's economy, but also regional and even neighborhood economies.

We agreed that we would present the data in three sessions during the summer of 2013 to audiences assembles by CBR and LAUL. The first presentation would be an overview of the region, looking at the evolution of economic, employment, and business conditions in the Los Angeles metropolitan region. It would include some comparisons to the economies of the San Jose region, San Francisco, San Diego, and Bakersfield. We would look at which industries were growing, and which were in decline; what industries were leaving the region as well as those moving in, as well as the average wages in those firms.

The second presentation would take the same data, and drill down to the neighborhood level in the Los Angeles region. It would devote particular attention to higher-poverty neighborhoods inhabited by African American and Latino populations. And, the third presentation would examine how public policy factors – including taxes and fees, zoning laws, building codes, and environmental regulations – affect the performance of firms in the region.

Los Angeles In Decline

While state and local business climates, regulations, and taxes matter, the most important drivers of local business development are global and national economic trends. From a national perspective, Los Angeles has been in a state of stagnation and/or decline for the past 45 years. In 1969, Los Angeles ranked tenth in the nation in per capita personal income. In 2011, it ranked 46th. By comparison, San Francisco ranked third in the US in 1969. In 2013, it still ranked third.

For Los Angeles, the major reason for its decline has been the erosion of the post-Cold War aerospace industry and manufacturing, which has both gone overseas and become more automated, resulting in the loss of local jobs. In 1990, the aerospace industry in Southern California (primarily in Los Angeles County) employed 272,000 workers, mostly with wages significantly higher than the regional average. By 2011, only 130,000 workers were employed by the local aerospace industry.

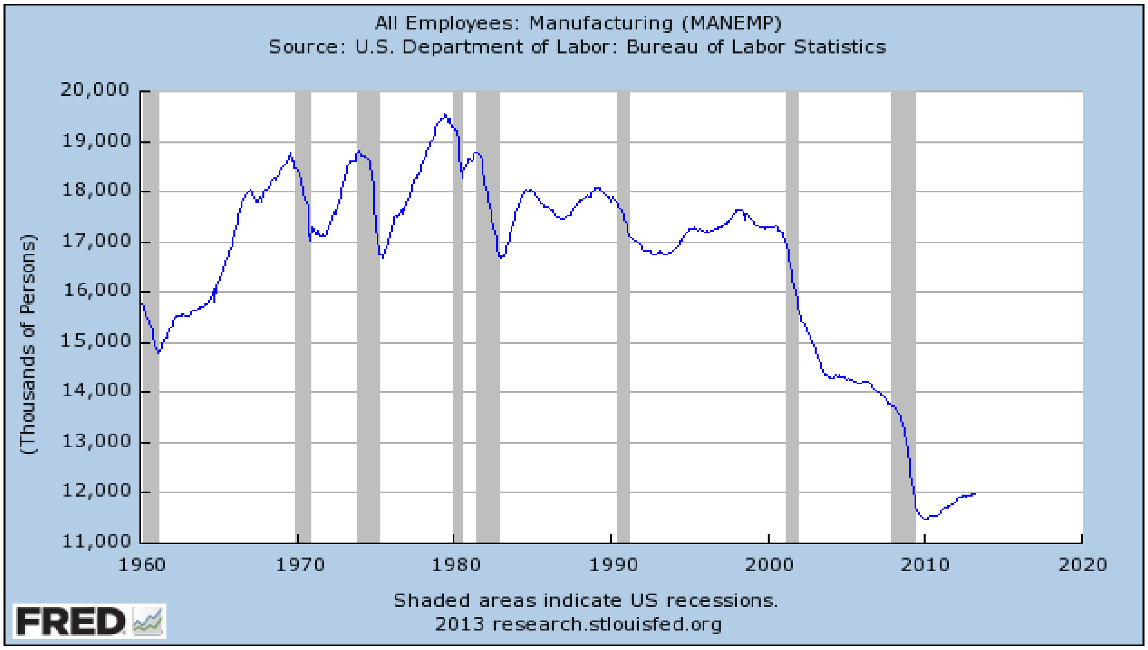
Beyond aerospace, including metal fabrication, electronics, machinery, apparel, furniture, and computer manufacturing, over 321,000 manufacturing jobs disappeared across the Los Angeles region between 1990 and 2010, according to the NETS data. What's more, across all occupations between 1990 and 2011, new jobs added to the Los Angeles region were in industries that paid an average wage of $52,840. Jobs lost from the regional economy were in industries that paid an average wage of $76,000.

In the business world, a popular explanation for Los Angeles's decline and stagnation is that manufacturing jobs moved to other states with better business climates, defined by lower tax rates and milder environmental regulations. The NETS data, however, shows the exodus has been minor in terms of the number of firms leaving, and the average wage difference between jobs that left California and relocated into California was more or less the same. In terms of businesses: between 1990 and 2011, there were 310,000 business relocations within, into and out of LA County, but only 7,121 of those relocations were to other states. In the same period, 6,051 companies relocated into Los Angeles County from other states. In terms of jobs, out of just 3 million jobs relocated in and out of LA County, only 100,749 relocated to other states, and 72,112 jobs relocated from other states to Los Angeles.

Relocations from LA County to other states were in industries that paid $69,646 on average. Those that came in from other states were in industries that paid $71,200 on average. In short, moves of firms out of and into the LA area are not the main labor market story. Most of the action is occurring *within* firms that remain in the area.

The disappearance of manufacturing jobs is also not unique to southern California. Nationally, there were 17 million manufacturing jobs in 1990, and there are fewer than 12 million today. A number of states, including Michigan, North Carolina, Ohio, New York, South Carolina, and Massachusetts all lost a higher percentage of manufacturing jobs than California. As Chart 1 shows, manufacturing employment essentially stagnated in the 1980s and 1990s nationally and went into a steep decline in the 2000s. There has been some uptick since the end of the Great Recession but the general direction of decline is evident.

Chart 1



While the drop in manufacturing jobs has been dramatic, in Los Angeles new job growth is better described as anemic. Over the last 21, Los Angeles County, has added roughly 370,000 jobs, a growth of eight percent. But during the same time period, California added 3.4 million jobs, a 23 percent increase. What's more, in 1990, the average wage paid by industries in the county was $60,600; by 2010, it had fallen to $58,400, in constant dollars. And the fastest growing industries are concentrated in jobs requiring advanced education: administrative and support services, professional scientific and technical services, and health services.

Los Angeles and the Three Californias

Where does Los Angeles stand in comparison to other California cities and regions? The decline in manufacturing, along with a few other trends, such as a sharp drop in film and television production in local streets and studios, has left Los Angeles in the middle of the road compared to the rest of the state when it comes to jobs, wages, poverty, and other economic trends. There are three Californias: the top performing region in the state is the San Jose region that includes Silicon Valley, followed closely by San Francisco; the bottom performing regions are inland areas such as Bakersfield and Fresno; and, Los Angeles and San Diego trend steadily in between the two extremes.

What is interesting about the three Californias is the consistency of their rankings over the past 20 years, even through the Great Recession of 2008, despite their different regional reputations for business climate friendliness. The conservative inland regions were hit hardest by the recession, with the percentage of low income families rising from 38 percent of the population in 2006 to 46 percent in 2010. The recession caused a five-point increase in low-income families in liberal Los Angeles, a six-point rise in conservative Orange County, and a three-point rise in liberal San Francisco. Only San Diego County, which has more Democrats than Republicans but which is also home to some of the most conservative elected officials in the state, held even in this category through the recession. San Diego is alone in having a slight drop in the number of families classified as low-income, quite possibly due to the wartime role of the military in the local economy.

We looked at tax burdens across the state and found one interesting disparity. Across the state – Los Angeles, Bakersfield, San Diego, and San Jose – the per capita tax burden looks more or less the same, hovering in the $500 range. In San Francisco, however, which has become a booming bedroom community for the Silicon Valley, the tax burden is four times as high, and has risen over 25 percent in the last 10 years. High taxes don't appear to be inhibiting growth in the Bay Area.

We also found, however, that Los Angeles leads the rest of California by a mile in business license taxes per capita. Such taxes come to less than $10 in San Francisco but over $115 in Los Angeles. The culprit in LA is an arcane gross receipts tax, which the Los Angeles City Council is currently struggling to reform to improve the city's anti-business reputation.

The Four Cities of Los Angeles

Just as there are three different Californias economically, we found Los Angeles County to hold tales of four cities. The first Los Angeles consists of areas where there has been a steady *increase in both jobs and income* over the past 20 years. This group includes affluent communities like Calabasas, and Beverly Hills, as well as Pasadena, Arcadia, and fast-growing industrial centers like Walnut and Diamond Bar.

The second Los Angeles is comprised of areas where there has been *job gain, but income loss*, signaling a growth in service sector and administrative work. This includes an interesting mix of cities including Burbank, Glendale, Torrance, Carson, and Santa Monica, which was just beginning its "Silicon Beach" resurgence in the closing years of the NETS data period.[2] The third Los Angeles – which is the most expansive, including most of the Westside, the San Fernando Valley, and a swatch of cities along the coast of the coastal cities – is characterized by *job loss and income gain*, signaling an economy driven by real estate, services and private investment.

Finally, the fourth Los Angeles, which is characterized by *job loss and income loss,* includes South Los Angeles, Compton, El Monte, Hawthorne, and Long Beach. Reinforcing the bleakness of this category, the NETS data also revealed that after the City of Los Angeles itself, the cities that lost the most jobs over the past 20 years include El Segundo, San Fernando, El Monte, Compton, Hawthorne, Pomona, Thousand Oaks, and La Puente.

What was most interesting about the "Tale of Four Cities" data for our purposes was that when we compared them to the August 2012 Los Angeles County Business Incentives report, there seemed to be no significant differences in the incentives in place to attract business across the four categories. The report lists by city available tax incentives, enterprise zones, utility and parking taxes, expedited permit processes etc.[3] In fact, many of the lowest-performing areas had especially extensive offerings, such as enterprise zones, business improvement districts and generous tax and land-use policies.

Many of the highest performers, places such as Santa Monica and the coastal cities, offered much more modest incentives, and in fact, have reputations for imposing more onerous regulations, taxes, fees, and permitting processes. In other words, across Los Angeles business

[2] Santa Monica has since become a major attractor of high-tech and Internet-oriented businesses with accompanying high-end retail, restaurants, and development. It also has two major health centers and would likely fall into the first category.
[3] Enterprise zone credits were heavily restricted by state law in 2013.

is booming in many places noted for poor business climates. Business is stagnant in many areas that have put in place a wide range of incentives to demonstrate more business friendliness.

From the NETS data analysis, Taner Osman drew the following conclusions:

- LA County is experiencing lower growth than the rest of the state.
- The City of Los Angeles has been struggling for the past 20 years and beyond, mainly due to the loss of manufacturing jobs.
- Neighborhoods across the city have fared differently. High-cost places are performing better than low-cost places.
- The center of the county, from South Los Angeles to Long Beach continues to struggle. There are factors in these communities preventing job growth from occurring there.
- Higher sales tax rates across cities are associated with higher rates of employment growth.
- Utility tax rates do not have a statistically significant impact on economic growth across cities.
- Business and property tax revenues have no significant impact on employment growth across cities.
- Neither zoning nor economic development had a statistically significant impact on employment growth across cities in metropolitan Los Angeles.
- Median income across communities had a statistically significant impact on employment growth. More affluent communities saw high rates of growth. This suggests that business were more likely to flourish in communities with better schools, lower levels of crime, and better public services (which demand higher local tax rates).

In sum, examination of twenty years of business firm, employment, and income data challenged long-held assumptions by both the business community and government and nonprofit agencies trying to figure out how best to spur economic growth in the inner city. The decline in manufacturing, which formerly supported hundreds of thousands of semi-skilled and unskilled workers in well-paying jobs, is more likely due to jobs that disappeared due to the end of the Cold War, became automated, or moved overseas, rather than relocated to other states and cities with better business climates.

Local business incentives established by local governments thus seem to have little effect on regional economic growth. Local taxes and regulations are less significant in the establishment of new firms and businesses than many observers have hoped and believed. Indeed, business appears to be booming where it is most expensive to do business. Booming business adds to the tax base, produces demands for better public services, and raises costs such as residential and commercial rents and land values.

Where Do We Go From Here: Academic Perspective

The second track of the research looked at the problem from a different, more academic perspective. According to Matthew Drennan, understanding what works for cities starts with understanding the difference between community economic development and urban economic development. Community economic development, often grassroots based, aims to improve the quality of life by encouraging residents to exert greater control over community enterprises and planning. Urban economic development, on the other hand, aims to raise per capita income and employment of residents. The most effective strategies for urban economic development entail activities that increase the demand for labor, increase the supply of labor with the right skills, and focus on traded goods and services in and out of the region, not just the neighborhood.

In Drennan's critique, the wide range of public policies and practices widely thought to increase the demand for labor – including financial incentives to attract new establishments, enterprise zones, tax increment financing, and business improvement districts – have all shown themselves to be limited in their effectiveness. Financial incentives have been shown to have high costs per job created so that the level of job expansion is unlikely to offset tax revenue loss. Finally, upfront incentives, such as tax waivers, are ineffective without performance measures and penalties for nonperformance or for moving away after receipt of a tax benefit.

Similarly, enterprise zones and the like, which are aimed at encouraging jobs to move into high poverty areas, have shown themselves to be costly – estimated at $40,000 - $60,000 per job – and ineffective. A study of 75 enterprise zones over 15 states found few relocation decisions made in response to place-based incentives and a lack of positive effect of enterprise zones on job creation. An evaluation of the Los Angeles Revitalization Zone (1992 – 1998) concluded that geographically-targeted tax credit investments do not promote neighborhood investment.[4]

According to Drennan, a more effective short term strategy to increase the supply of labor would be to 1) require investment in job training incentives, which have been shown to be 10-16 times more effective in jobs created per dollar spent than tax incentive programs; 2) enhance community college training that stays close to what local employers require; 3) provide work study programs for high school and college students; and, 4) offer affordable day care and transportation, which have been shown to be key barriers for people in poverty seeking employment.

For the long term, Drennan advocates increased investment in K-12 education. In fact, one of the most distressing statistics we found in our research, from the 2013 National Center for Education Statistics was that the city of Los Angeles ranks 12 among large U.S. cities in 4th-grade reading, well behind such growing cities as Austin, Charlotte, North Carolina, Miami, Boston, New York and San Diego. And just below Los Angeles are the troubled cities of Washington, D.C., Baltimore, Philadelphia and Milwaukee. In terms of educational achievement, Los Angeles seems to be on a precipice between cities that are growing and becoming more prosperous and cities that are in rapid decline economically. Data on student achievement from the National Center for Educational Statistics shown on Chart 2 indicate that student achievement in the Los

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[4] As previously noted, enterprise zone tax credits in California were heavily restricted in 2013.

Angeles Unified School District ranks below that of other large urban districts.[5] Drennan, in consultation with Professor Donald Shoup of the UCLA Luskin Urban Planning Department, also identified a series of public policy responses to the most egregious barriers to economic development in Los Angeles. Interestingly, these barriers were not taxes or environmental regulations, *per se*. Drennan and Shoup focused on public investment and long-needed zoning changes that are designed to spur local economic growth:

- Invest more in K-12 education and community college programs aligned with business needs.
- Encourage wage subsidy strategies, better public transportation from poor neighborhoods to areas with more employment opportunities, and quality early childhood education and day care.
- Redevelop residential and mixed-use property at higher density by encouraging voluntary land assembly through graduated density zoning, which allows higher density on larger sites. This strategy can increase the incentive for owners to cooperate in a land assembly that creates higher land values.
- Ease or eliminate residential off-street parking requirements for multi-family residences and office buildings. Developers should be given option of paying a fee (lower than current parking space costs) to be applied to finance neighborhood public parking spaces.
- Incentivize transit-oriented development, i.e. graduated density, mixed-use four story buildings along subway and light rail lines.
- Discourage transit-oblivious development.
- Eliminate gross receipts tax on business; replacing it with a business tax based upon a small percent of taxable income.

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[5] See also http://nces.ed.gov/nationsreportcard/pdf/dst2011/2012456XL4.pdf. The scale on Chart 2 ranges from 0 to 500. Students scoring 150 (or higher) are able to follow brief written directions and carry out simple, discrete reading tasks. Students scoring 200 are able to understand, combine ideas, and make inferences based on short uncomplicated passages about specific or sequentially related information. Students scoring 250 are able to search for specific information, interrelate ideas, and make generalizations about literature, science, and social studies materials. Students scoring 300 are able to find, understand, summarize, and explain relatively complicated literary and informational material. Source: Footnote 3, http://nces.ed.gov/programs/digest/d13/tables/dt13_221.85.asp.

Chart 2

4th Grade Reading Scores for Large US Cities, 2011

City	Score	Rank
Austin	224	1
Charlotte	224	2
Miami-Dade	221	3
Boston	217	4
New York	216	5
San Diegio	215	6
Houston	213	7
Atlanta	212	8
Albuquerque	209	9
Dallas	204	10
Chicago	203	11
Los Angeles	201	12
District of Columbia	201	13
Baltimore	200	14
Philadelphia	199	15
Milwaukee	195	16
Fresno	194	17
Cleveland	193	18
Detroit	191	19

Source: National Center for Education Statistics, 2013

Note: Data are for central cities.

Conclusion

The ultimate goal of this project was to inform a dialogue that might define a common ground between the business lobby and inner city nonprofit leaders, policy makers, and legislators. We fell short of perfection, as might be expected in a political environment. In the second presentation, we showed that business is expanding in many wealthier areas with perceived poor business climates and contracting in other areas providing various tax breaks. After that presentation, the California Business Roundtable and the Los Angeles Urban League independently published a report, *A Tale of Three Cities: Wealth, Poverty and Economic Disparity in Los Angeles County,* written by KP Public Relations.[6]

The two organizations presented the KP Associates report in an August 2013 session with the Legislative Black Caucus and Latino Caucus in Sacramento. The Luskin School team was not involved in the report and not invited to the session. We did not have the opportunity to present our final analysis and recommendations.

The *Three Cities* report focused on the decline of Los Angeles, a flight of jobs, the need for middle-income jobs, economic and employment disparities, and the lags in educational achievement. But it did not mention the paradox of current business growth in wealthy, higher taxed and regulated areas. It did not mention the small percentages of businesses that have left California for other states or moved into California from other states. Its recommendations to the Latino and Black Caucuses were to:

- Remove the barriers: Re-examine state and local policies that are pushing middle-income jobs to other states and location, and take immediate action to mitigate those impacts;
- Train the workforce: Develop a blueprint for educational parity, including early childhood education and workforce training opportunities that align with growth industries;
- Bring the jobs: Establish certainty for companies that are currently operating and or are seeking to operate in metropolitan areas by ensuring stability of regulations, leveling the competitive playing field with other states, and incentivizing companies to create stable jobs.

[6] Available at: http://luskin.ucla.edu/sites/default/files/A_tale_of_three_cities%20FINAL%5B1%5D.pdf.

The differences in the analysis and recommendations are telling and worth more dialogue and exploration. Instead of being a step toward common ground, they underscored a significant divide in perspective and values. Urban economic development is a complicated and undependable phenomenon.

In his recent book, *Keys to the City: How Economics, Institutions, Social Interaction, and Politics Shape Development*,[7] UCLA Luskin Urban Planning Professor Michael Storper differentiates globally among “wealthy but congested high-cost and high income cities,” that have to maintain their “local genius”; Middle-income regions that need to “re-specialize” and “raise education and skill levels” and lower-income regions need to focus on “getting into the game” by concentrating on comparative advantages and infrastructure development. The Los Angeles region encompasses all of the above.

Finally, Storper also wrote, in the context of dealing with the complexities, competing interests, and lives of cities: “Leadership that convenes is subtle, yet it is possibly the most valuable type of institution building to be done.” The *Common Ground* project of the Los Angeles Urban League, the California Business Roundtable, and the UCLA Luskin School was a moderately successful attempt at such a convening, data gathering, and conversation. It was less successful at reaching the political figures that might put better public policies in place. The single best hope for the Los Angeles region is that we all continue trying, keeping open minds, and bringing the best empirical evidence we can gather to the conversation.

[7] Princeton University Press, 2013.