



May 13, 2004
San Diego Regional Economic Development Corporation
San Diego, California
7:30 am - 10:00 am

Welcome, Introductions, and Project Overview

- Julie Meier Wright, President, San Diego Regional Economic Development Corporation: “I decry the loss of civic dialogue in our state. There is a need to have a civic and civil dialogue again.” “People don’t understand a \$100 billion dollar operation, which is what the state budget is.”
- Noel Perry Noel Perry, Founder and Managing Director, Baccharis Capital Inc: “A strategic plan is needed for California. We can let the future happen to us or we can plan our future.”

Basic Budget Education

- Stephen Levy, Director and Senior Economist, Center for the Continuing Study of the California Economy (CCSCE). CCSCE is a private research organization founded in 1969 to provide an independent assessment of economic and demographic trends in California. Dr. Levy presented an overview of the state budget (attached).

Q&A

- Q. What is the role of state pensions in the budget crisis? Where does state pension expense hit the budget?
A. Everywhere. State pension expense hits the budget on the payroll expense in every program category of spending. It is not highlighted as a separate line item in this presentation.
- Q. Need to know more about the difference between caseload growth driving expenditures versus general population growth. People highlight that spending is growing faster than overall population growth.
A. Caseloads for K-12 and colleges are growing faster than the total population is growing. Also, healthcare inflation is growing faster than overall inflation. This is another driver of expenditure growth. It is important to distinguish between pure population growth versus demand for state services.
- Q. How do we unmandate mandates?
- Q. What are the demographic drivers of enrollment growth? E.g. are “illegals” taking advantage of programs?
A. It has been established that all kids are able to attend public schools. It is my understanding that expenditures for undocumented immigrants tends to affect counties the most; for example, in expenses associated with serving all patients at county hospitals.

- Q. Wages and retirement expenses are high, so we've been relatively nice to state employees. Because of people living longer, now people work 30 years and collect retirement for 40 years. We need more information on this topic.
- Q. 25% of the City of San Diego's general fund went toward pension contributions this year. Would like to know how we stand compared to other cities. Is this normal?
- Increasing fees at community colleges is justified when you compare the state subsidy to the actual tuition charged. People are not paying anything close to what it really costs to educate a person in our higher education system. State subsidy for UC's is \$18,000 per student, for CSU is \$8,500, and for community college is \$4,500.
- Policy decisions are as important as efficiency issues. You can not separate one from the other.

Answers to three questions after Steve's presentation:

Question 1: What were your major take-aways? What surprised you?

- Surprises - California has lowest number of employees per population compared to other states.
- Surprises - relation of deficit to 2000-2001 boom.
- Surprise - K-12 spending reflects national average.
- Take-aways: a) federal funding formulas used nationwide the same; b) No variance in allowance for the higher cost of living in California.
- Not getting our share of revenue from federal funds.
- The amount of ear-marked money in the state budget, and that paralyzes state government.
- Surprise: caseload dependency of budget
- The state budget is structured for perpetual annual increases in spending and can not adjust to declines in revenue
- Surprised that long-term budget projection for deficits is bleak.
- Major take-aways: budget problem is significantly more complex than is typically publicly discussed; budget behavior at its most basic is not terribly dissimilar to the average citizen's.
- Detailed description of the problem with no plausible solutions due to lack of political will at the state level.
- It was interesting that the current structural deficit is approximately equal to the tax that was collected on stock options and capital gains during the boom. In general it's evident that there are no obvious areas to make the huge cuts that would be necessary to balance the budget.
- That there is a gap of revenues and expenditures and that the internet boom (stock options) created a long-term problem when politicians followed voter wishes and spent on on-going programs and not one-time expenditures.
- Didn't realize that the \$15 billion bond had cleared up accumulated debt
- Limited options - how we got here with the 2 years of increased revenue and spending - very interesting and well-presented
- The level of overall general fund spending on education
- Major surprises - position of California versus the national average and other states on Education spending, HHS spending, number of state employees, etc.

- Take-aways: the extent to which number of state employees are relatively low. Deficit is thus largely a function of monetary disbursements.

Question 2: Was the Steve Levy's presentation consistent with your prior understanding?

- Yes, consistent, but refreshing to hear it in a non-political sense.
- Yes, but clarified sources. Presentation was consistent with my understanding.
- Yes - no major surprises although it is very interesting to note that "structural deficit" size in comparison to "stock option revenue" balloon.
- Was consistent with prior understanding, although it shed in-depth and insightful light on many of my misunderstandings or lack of information
- Yes - however, little was discussed on effect of local government and businesses.
- The presentation was generally consistent with my pre-conceived notions, but it did bring the issues together in a concise way, very helpful.
- A very complex issue presented in a very understandable, educated manner that I get. Printed material can be given to someone else and they would get it.
- Presentation: very useful, good flow of information
- Number of employees does not matter. Number of those employed doing government business does. Outsourcing can not be ignored.
- Would have thought property taxes were bigger impact since I pay a lot!
- Percent of funds for education - subsidized tuition that is perceived as an entitlement
- Fairly consistent but as I don't do too much work on budget, opened my eyes to many issues I was unfamiliar with.

Question 3: What additional information do you need?

- More info needed: Steve Levy talked about expenditure determinants within the context of "caseload growth". Others talk about "population growth" being less than expenditure/revenue increases since 1998-99. Understanding that caseload growth is different from population growth. It would be helpful to understand if there is huge dichotomy between the two.
- More info needed: What obligations do we as a state have for the next 5 years with respect to union contracts, etc?
- Options and trade-offs exercise in the fall with Sim California - to work with resources and make trade-offs sounds interesting. Should include that investment in infrastructure adds jobs and economic growth and needed for future quality of life issues.
- More info needed: Projections for the future as opposed to comments from past trends.
- For consideration: hierarchy of service needs - define, debate, communicate; how to measure success of any initiatives; spending efficiencies and associated questions are never answered; ratio of service providers to recipients; thresholds for service eligibility - vary as function of money available; suspend mandates; risk reserve - any consideration.
- Unfunded mandates - I thought they were higher? How to undo it. More information on how cities and counties are at the mercy of Sacramento.

- On a specific issue, I'd be interested in knowing the impact of services provided to the individuals in the state who are here in violation of federal immigration laws.
- More in-depth discussion on tracking Proposition 13.
- Take an example and put into the presentation. I pay \$4000 a year in property tax - how does that break down through the system?
- Break out California state & local pension costs above national average, California trend lines, comparison states.
- Would like to have clarified what can be done to roll back excessive pension and other benefits of state employees.
- What is it about the state budget process that makes it so difficult to solve this problem?
- Information needed: how much state money is used to match or leverage other money
- Benchmarks - more detailed education tuition comparison great but state subsidy comparison needed.
- Spending efficiencies in comparison to other states, not really answered. Term limits relationship to budget; were services really good in 2000-2001 when revenue was so high? I'd like to see comparison of services from 2000-2001 to now with restructured budget.
- Real understanding of equity among taxpayers. Impressions versus reality?
- Compare higher education cost of California versus other states
- How does the California Lottery fit into the picture and into the education budget?
- I would like to have increased knowledge of the budgetary process
- If we get more tax money, don't spend all of it. Establish reserve accounts.
- I have plenty of information just not sure which programs to cut other than the prison system (3 strikes law)
- Projected role for increasing creative class
- Information was appropriate
- How to increase the political will, or lack of it, that causes state budget problems, while local government survives and is regularly raided by state. Pension benefit costs compared to private sector.
- Some scenarios/models show what happens because of hardwiring in budget (e-mail Erik Bruvold for longer explanation)
- More specifics - how to unmandate supposed mandated spending/rules.

Trade-Offs Discussion: Ideas for closing the \$7 billion dollar gap

As we know, the state of California currently has a structural (on-going) deficit of \$7 billion per year.

Q: What specific set of options (revenue increases, spending cuts) would you recommend the state pursue to balance the budget?

Group 1:

- Increase fees for higher education (our fees are very low compared to other states). We could pay more.
- Look at the property tax as an option for revenue

- Increase the real estate transfer tax
- Reduce spending on corrections by reforming the “three strikes and you’re out” law. The three strikes law puts people away for long periods of time for trivial crimes, which is very expensive for the state.
- Proposition 13 has helped residential owners by limiting the increases in valuation to 2% a year. We should keep this protection.
- There has been a net outflow from our state due to lower natural growth and loss of jobs.
- Increasing revenues by changing commercial property tax assessments is a “job killer”.
- Fiscalization of land use is a problem in local government that has led to too many big box retail and too few housing units being approved. This needs to be reformed by keeping more of the property tax with local government.
- We need to keep what’s generated locally here (property tax).
- How much of growth in spending is due to increasing caseload? How different is caseload growth from overall population growth?
- Increase efficiency at every level of state government.
 - The term “efficiency” is distinct from “waste, fraud and abuse”. Efficiency is referring to poor delivery of services, not any belief that there has been fraud by government employees.
 - Bureaucracy and administration in state government is unbelievable.
 - For example, getting a real estate license is too hard. Getting a straight answer from government agencies to help navigate the system is hard to find.
 - Enforcement agencies at local, state and federal levels all duplicate each other’s work. E.g. environmental laws are reviewed by federal and state workers - why can’t they consolidate enforcement reviews?
- Pursue a quasi Zero-Based budgeting approach. For example, go back to 1998 level of spending and then have any increases since then be reviewed and re-justified.
- Are there any increases that can come from the lottery? How much lottery money goes to education? Answer: \$800 million per year. How much lottery money is spent on administration and can this amount be reduced?
- Start getting revenue from Indian gaming operations. Other states get 25% of gaming revenues from casino operations. Also, why don’t we impose other taxes on Indian gaming such as sales, corporate and hotel taxes?
- Renegotiate labor union contracts to reduce pension expenses and payroll.
- Consider going to a part-time legislature.

Group 2:

- No new taxes
- Services increased after 1998. Can we go back to earlier service load?
- Need to do a results-based evaluation of providers to reduce duplication.
- California Performance Review by state is supposed to lead to reduced waste.
- Roll back pensions to pre-1998 levels (pre Governor Davis)
- Remove monopoly of Indian tribes - increase tax rate paid by Indian tribes. Put state slot machines at race tracks.
- Renegotiate labor contracts
- Means-test college tuition

- Change from defined benefit plans to defined contribution plans to reduce pension obligations.
- Increase the value added sales tax
- As long as there is an entrenched bureaucracy there will be no change in the taxation system. Need to change the bureaucracy.
- We need a new paradigm for the education of our kids. For example, we have lost arts programs in our schools - this is problem. Need more math and science and more innovation being taught. Need to invest in innovation to create a rise of the creative class.
- We could increase state income tax instead of raiding local government.
- Save revenue increases for a rainy day. (However, we see that if we had given back the internet boom money back to taxpayers, we would have halted the rise in spending post-1998.)
- All state workers and politicians need to ask themselves: How can I do what I am doing more cost effectively?
- Go to a total sales tax system and eliminate the income tax.
- Tax on profits of Native Americans.
- Export more taxes (like Florida)
- Increase the fees for higher education across the board
- Do more competitive bidding i.e. increase outsourcing. LA bus drivers can not be outsourced.
- Would you pay more taxes if you could trade taxes? E.g. lower income taxes in exchange for higher property taxes.

Group 3:

- Increase level of federal funding
- Need for reform of Proposition 13 - it has not worked so well.
- Higher education fees need to go up
- Increase higher education workload
- Improve tax collection and reduce waste and fraud
- Proposition 13 - property tax rules are disjointed from expectation of local control. Need a review of revenue received and distributed.
- More local money should stay local.
- Proposition 55 example - Need for the state to do more long-term analysis. Need to take a closer look at what the 10 year outcomes would be if changes are made.
- State could look at its budget more like a balance sheet. State assets are currently not capitalized and they could be.
- Political will is required to say "no" and to explain that either expectations need to be lowered or revenues need to be raised. Also came up in the context of willingness to accept disparities between local levels of expenditures if money stays local.
- Economic growth could help solve the deficit if the regulatory environment were better.
- If Nevada and Texas can create regulatory environments that are conducive to business attraction, why not California? How do other states pay for services without income taxes?
- Housing - Concern about costs and supply
- Also concern about unfunded mandates e.g. health care

- Don't kill the economy - the economy is the goose that laid the Golden egg.
- Address the corrections issue - look at Three Strikes law
- Term limits
- More research on cuts, revenues, mandates