Center for American Progress Action Fund

Open Letter to Californians regarding Republican Gubernatorial Candidate Meg Whitman's Economic Policy Proposals

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Dear fellow Californians,

Gubernatorial candidate Meg Whitman's 48-page economic policy document *Meg 2010—Building a New California, Meg Whitman's Policy Agenda* presents an inaccurate diagnosis of California's economic woes and an inappropriate set of policies to address them. She asserts in *Meg 2010* that California has lost its competitive edge because it has a poor business climate caused by a bloated public sector, too much spending, too high taxes, and excessive regulation. Whitman promises to restore economic growth and create 2 million private sector jobs by cutting $15 billion in state spending, eliminating 40,000 state employees, redefining public pensions, cutting taxes for the rich, and reducing environmental and worker protections. These promises are not credible.

The evidence and theory that Whitman uses to diagnose California's problems are unscientific and an unsound basis for policy. As a result, her diagnosis and her proposed economic policies are both deeply flawed. If implemented, her policy proposals will *deepen* California's budget crisis and are likely to *reduce* employment and economic growth. In this letter we take issue with a variety of her misdiagnoses and flawed economic policy proposals. The details of our critique are available in a report titled Can Californians Trust What Whitman is Selling?, published recently by the Center for American Progress Action Fund.

Can California recover from recession?

Meg 2010 claims that California has been growing more slowly than it could based on a report from the conservative Milken Institute. In fact, California's performance in the 2000s matched the national average. The Milken study is inaccurate because it selects unrepresentative time periods and states for its comparisons.

California remains the economic powerhouse of the United States. The high-technology industry is heavily concentrated here. The state receives over half of all venture capital investment in the United States, a higher share than a decade ago, and two-thirds of all green-tech venture capital. It ranks third among the states in the proportion of new businesses. And it is a leader in research and education, with over one-quarter of the nation's top 25 engineering schools. California competes on the basis of innovation and a having a highly productive work force, not through lowering living standards, reducing public services, and weakening environmental protections.

Contrary to Whitman's diagnosis, the state's economic woes result primarily from the national economic downturn, combined with a particularly severe hit to the state from the mortgage finance crisis. Our residential construction and associated real estate and finance sectors overexpanded during the housing bubble. The overhang from this crisis continues to burden the state's economy. Yet *Meg 2010* does not mention the bubble and its aftermath or what the state can do about it.

Whitman claims that her policies will create 2 million jobs by 2015. But according to forecasts from the State Department of Finance and independent forecasters, California should gain 1.25 million jobs by 2015 without any of her policies.

State policy can speed recovery, but some policies are more effective than others. *Meg 2010* has things backwards. Whitman proposes to cut spending and taxes, even though government spending has a greater "multiplier" for creating jobs than do tax cuts in a severe recession. Her favored tax cuts for the top income brackets have the *lowest* multiplier.

Whitman's proposals to fix the state budget

California currently has a $20 billion budget gap. Whitman proposes to cut $15 billion in spending while also reducing taxes by well over $4 billion a year. But these numbers, if she added correctly, leave a budget gap of $9 billion. And her plan does not specify where most of the cuts will fall.

Whitman asserts that the state government can provide the same level of services while reducing costs by 20 percent. While some efficiency gains are achievable there is no evidence that supports this claim. It is quite unlikely that she could identify and pass into law policies that create 20 percent savings with no service cuts, something the current Republican governor could not do.

California's tax revenues and expenditures rise in boom years while revenue falls sharply in bust years when demand for human service expenditures increases. This pattern is largely responsible for the state's budget gap. As many economists note, mandating that California put more of its revenue in good years into a "rainy day" reserve fund would go far toward limiting spending growth to sustainable levels and eliminating the cyclical deficit.

Is California government too large?

Is the deficit due to bloated government employment, as *Meg 2010* claims? In fact, California's government employment per capita is 27 percent below the U.S. average, ranking 48th among the states. Whitman proposes to cut the state payroll by 40,000 workers (excluding the University of California, California State University, corrections, and public safety). This amounts to nearly 25 percent of the remaining state workforce of 162,000. That number of employees cannot be cut without substantially reduced state services, from DMV to foster care.

Most of the cuts would have to fall on education, health, and human services. Yet California currently ranks 45th among states in per pupil education spending and dead last in teachers per student. Cutting K-12 spending further will only make the educational system weaker. Cutting education, health, and human services not only causes poor school performance and personal pain and suffering, but also eliminates jobs. A $1 billion cut in Medi-Cal and CalWorks, for example, would lead to a loss of 62,000 jobs in California.

Whitman wants to cut retirement benefits by moving new public-sector employees to so-called defined-contribution plans that require employees to make their own investment decisions, with smaller employer contributions. The likely savings in the first five years would do little to balance the state budget, while shifting risk to new employees and weakening the funding basis for current retirees who rely on so-called defined-benefit plans that pay a regular pension upon retirement. These changes will further harm California's state employees, who are paid 8 percent less in salaries and benefits than comparable private-sector workers.

Is California overtaxed?

Meg 2010 repeats the claim of the pro-business Tax Foundation that California ranks 48th in its "tax climate." This claim is based almost entirely on the top marginal income tax rates and ignores how low property taxes are in the state. In fact, California's state and local tax revenue, as a proportion of personal income, was only 2.4 percent higher than the average for all states in 2007. In recession years, the ratio falls to below average.

Moreover, taxes play a secondary role in the location of business and attraction of skilled workers, compared to investments in education, infrastructure, and public services. Whitman's proposed cuts in taxes and fees paid by businesses are likely to have little effect relative to the number jobs that would be lost by the resulting drop in public investment.

Whitman proposes to eliminate the state personal income tax on capital gains. This would reduce California tax revenues by around $4.5 billion a year, while benefiting the state's richest people. Research shows that eliminating the capital gains tax would do little to spur investment; the vast majority of private income retained would be spent on stock purchases of companies outside the state. Moreover, Californians who benefit from cuts in the state tax would pay about one-third of it back to the U.S. Internal Revenue Service, because state income taxes are deductible from federal income taxes.

Is California over-regulated?

Whitman's plan *assumes* that deregulating business always creates economic benefits, but that is not necessarily so. Many regulations' benefits are greater than their costs. Lax regulation of the California mortgage market, for example, led to the foreclosure of a quarter million homes, while stricter regulation on mortgages in Texas kept foreclosures much lower there. *Meg 2010* is silent on the mortgage fiasco and the need for financial reform.

Similarly, regulatory incentives imposed 20 years ago to conserve energy have *created* jobs in California while reducing energy use. Yet Whitman wants essentially to eliminate AB32, California's Global Warming Solutions Act. *Meg 2010* says AB32 will cost $100 billion and destroy 1 million jobs. These estimates diverge radically from all the other studies of AB32, such as that of economist Matthew Kahn of UCLA.

Meg 2010 depends upon another study that purports to find that regulation in California costs $17,000 per resident. This estimate—one-third of gross state product!—is not credible. It is "one of the worst examples of shlock science," according to economists John Haveman and Christopher Thornberg, the founders of Beacon Economics, and has "no basis in reality," in the words of economist David Neumark of UC Irvine.

Whitman also proposes to reduce worker protections, such as overtime pay after eight hours and meal breaks. Current law permits employees to agree to alternative work schedules, such as four ten-hour days instead of five eight-hour days, through a secret ballot election or collective bargaining agreement. She wants to give employers, but not employees, the choice over schedules. Repeal of daily overtime would reduce employment by nearly two percent and employers' savings from not having to pay overtime would transfer over $1 billion from workers to employers.

Conclusion

Meg 2010 is based on faulty economic theories and on studies that are fundamentally unsound. The California Legislative Analysts Office states that one of these studies is "unreliable" and that the other "contains a number of serious shortcomings that render its estimates of the annual economic costs of state regulations essentially useless."

Whitman's proposed tax cuts for wealthy people and businesses would generate little economic benefit while exacerbating the state's budget problems. Her proposed elimination of climate change regulation could bring harm. The negative impacts on employment from her proposed spending cuts are likely to far outweigh any positive stimulus from the tax cuts.

Meg 2010 is not based on facts or experienced analysis. If implemented, Whitman's program would worsen California's budget malaise and its economic performance.