Center for American Progress Action Fund

Can Californians Trust What Whitman is Selling?

An Analysis of Gubernatorial Candidate Meg Whitman's Economic Policy Proposals

Michael Reich August 2010

Introduction and summary

This paper analyzes Republican candidate for Governor Meg Whitman's economic policy proposals for California, as stated in her 48-page policy document, *Meg 2010, Building a New California, Meg Whitman's Policy Agenda.*[1] Since Democratic gubernatorial candidate Jerry Brown has issued policy documents related to green jobs and pension policy, but not an economic policy program, we could not conduct a side-by-side analysis of the two candidates' economic policy programs at this time. Nonetheless, Whitman's *Meg 2010* is well worth individual analysis.

Meg 2010 presents a diagnosis of California's current woes and a set of policies to address them. Whitman asserts that California has lost its competitive edge because it has a poor business climate caused by too much public spending, a bloated public-employee structure, too high taxes, and excessive regulation. Whitman promises to restore economic growth and create two million private-sector jobs by cutting $15 billion in state spending, eliminating 40,000 state employees, redefining public-employee pension plans, cutting state taxes on the wealthiest Californians, reducing some worker protections, and reducing regulations, such as delaying and effectively ending California Assembly Bill 32, the Global Warming and Solutions Act of 2006.

What would be the consequences of such deeply conservative economic policies on the future economic fortunes of our state and our citizens? This paper assesses the damage that Whitman's economic program would deliver to most Californians. We find that Whitman's proposed:

- Tax cuts for wealthy people and businesses would reduce the state's economic growth while exacerbating the state's budget deficit problems.

- Elimination of climate change regulation would harm to the environment, would sharply reduce clean-tech venture capital spending in the state, and would reduce employment.

- Spending cuts would have negative consequences on employment.

In short, Whitman's diagnosis of the California economy is deeply flawed and her "solutions" would be deeply damaging. Her approach to economic policy, which she calls "my kind of supply-side economics," is wrong for California. As we document, the economic "studies" she draws upon are unscientific and an unsound basis for policy. If implemented, her policy proposals are likely to have *negative* effects on jobs and economic growth and to *deepen* the state's budget crisis.

Can California recover from the Great Recession and grow again?

Republican gubernatorial candidate Meg Whitman's economic policy program*, Meg 2010,* claims that the California economy grew more slowly than it could have over the past decade, based on a report from the conservative Milken Institute.[2] She wants California to become more competitive with neighboring states by reducing taxes and regulations.

In fact, until the Great Recession of 2007-2009, California's performance in the 2000s exceeded the national average, with GDP growth of 2.3 percent per year, compared to 2.1 percent for the nation as a whole.[3] The Milken study selected seven comparison states that had high-tech manufacturing centers, each of which had grown faster than California. Were these representative comparisons? No. In another analysis of all the other states that also had high-tech manufacturing centers, California's growth was higher than those in all of the other states.[4] The Milken study is inaccurate and unscientific because it selected unrepresentative states for its comparisons.

California remains the economic powerhouse of the United States. Our nation's high-technology industry is heavily concentrated here. The state receives over half of all venture capital investment in the country, a higher share than a decade ago, and nearly two-thirds of all clean-tech venture capital—a sector that barely existed a decade ago and that grew rapidly after the passage of California Assembly Bill 32, the Global Warming and Solutions Act of 2006, or AB32. California ranks third among the states in the proportion of new businesses[5] and it is a leader in research and education, with over one-quarter of the top 25 engineering schools. California's comparative advantages are still rooted in its innovative industries, technically-skilled workforce, and world-class universities, not in competing with other states or countries for low-wage industries.

Contrary to Whitman's diagnosis, the state's current economic woes result primarily from the deep national economic downturn, combined with a particularly severe hit from the U.S. mortgage finance crisis. California's unemployment rate is higher than the national rate primarily because the state's residential construction and associated real estate and finance sectors overexpanded during the housing bubble more than in the rest of the United States. The mortgage sector was notably more deregulated than in other states. The collapse of these sectors has been more intense as well. *Meg 2010* neither mentions the housing and credit bubbles and their aftermath nor how the state should respond to them.

Fortunately, a tentative national economic recovery is underway, generated by action in Washington—including the 2009 American Recovery and Reinvestment Act—as well as a moderate upswing in business and consumer spending and international trade. California's economy is beginning to recover as well. According to forecasts from the State Department of Finance and from independent forecasters, California should gain 1.25 million jobs by 2015 without any of Whitman's policies.[6]

For the state to help speed recovery, some policies are more effective than others. *Meg 2010*'s proposed policies will send the state backwards. Whitman proposes to cut spending and taxes, even though government spending has a much greater "multiplier effect" than tax cuts. A multiplier is economic parlance for the amount of "bang for the buck"—the amount of economic activity related to every dollar spent or invested—that a particular policy proposal will deliver to an economy. According to Moody Analytics's Mark Zandi, Whitman's favored tax cuts for those in the highest income tax brackets would have the *lowest* multiplier effect on the California economy.[7] This implies that tax *increases* on top incomes to help close the budget gap would have the smallest adverse effect on the state economy of any of the proposed budget solutions.

To balance the state budget with the least adverse impact on the state economy, smaller cuts in state spending should be balanced with increases in the highest marginal tax brackets. Whitman wants to do the opposite. So let us first look at her proposals to tackle California's budget deficit and then examine her underlying assumptions about what ails the state.

Whitman's proposals to fix the state budget

California's estimated budget deficit for the coming fiscal year stands at $20 billion. Whitman proposes to cut $15 billion in spending in her first year in office, while also reducing taxes by billions of dollars a year. Alas, these numbers do not add up to $20 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 may be achievable there is no evidence to support this claim.

California's revenues and expenditures rise in boom years while revenue falls sharply and demand on human services increase in bust years, creating a "cyclical" deficit. As the noted Berkeley economist Alan Auerbach argues, 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.[8]

Spending cuts

In fiscal year 2009-10 California's general fund budget amounts to $86 billion, of which $34.6 billion is for K-12 education, $10.6 billion for higher education, $25 billion for health and human services, $9.8 billion for corrections, and $6.1 billion for everything else.[9] Most of these funds are spent directly on programs and services.

Whitman's plan to cut $15 billion from the budget therefore necessarily implies significant reductions in spending on education, health, and social service programs on top of the deep cuts already made in the past two years. But additional cuts in these areas would further reduce the level of current economic activity in the state. Education, health, and social service expenditures are investments that will make Californians more productive. Cuts in these programs will therefore reduce the state's potential to grow in the future.

Cuts to health and social service programs would also have a particularly large depressing effect on the state's economy because federal matching rates for state spending are high and because these funds are spent predominantly within the state.[10]

Education

California currently ranks 36th among states in high school graduation rates, 48th or 49th in fourth grade and eighth grade reading and math scores, 45th in per pupil education spending, and last in teachers per student.[11] According to Next 10, a San

Francisco-based, nonprofit research institute, current policies will leave per pupil spending in California $3,200 (23 percent) below the national average by 2015.[12] Cutting K-12 spending further thus will only make these disparities greater.

Whitman wants to fix education by reducing spending on overhead and putting more money into the classroom. She claims that only 60 percent of education funding reaches the classroom and that 40 percent is spent on wasteful bureaucracy, even though the number of principals and administrators per student in California is one-third to one-half the national average. The proportions for the counselors, librarians, secretaries, custodians, cafeteria workers, and school bus drivers that make up the rest of the staff are also lower.[13] California's K-12 system would benefit from constructive financial and regulatory reforms, but education experts across the political spectrum agree that such reforms will require *more* resources, not less.[14]

Whitman proposes to increase funding for higher education by $1 billion. Such an increase is much needed. Other than a general statement about cutting the $86 billion budget elsewhere, *Meg 2010* does not specify how she will pay for this increase.

Health and Human Services

California's Medicaid program, Medi-Cal, currently accounts for $11.2 billion of the state's budget. The recently passed national health care reform will greatly expand eligibility for Medi-Cal. Funding for the newly eligible Medi-Cal populations will be paid 100 percent by the federal government in 2014, when the expansion begins, and phase down to 90 percent by 2019.

The federal health care reforms include so called "maintenance-of-efforts" requirements on the states that receive federal funding. For Medi-Cal to maintain the services it provides to currently covered Californians, it will need to maintain these efforts to ensure a high federal matching rate. Cuts to state health care spending as proposed by Whitman would therefore have particularly large multiplier effects on reducing employment in California.

Whitman also proposes to reduce eligibility for CalWorks, California's Temporary Assistance for Needy Families program. California currently spends $2.4 billion on TANF from its own funds and an additional $3.7 billion from federal funds. Cutting CalWorks beyond Governor Arnold Schwarzenegger's previous cuts would result in significant loss of federal funding for this program, too.

Cutting education, health, and human services not only causes poor school performance for students and personal pain for the sick and needy but also eliminates thousands of jobs. University of California, Berkeley researchers Ken Jacobs, T. William Lester, and Laurel Tan estimate that a tax *increase* of $1 billion for the top income stratum would reduce spending and lead to a loss of 6,000 jobs in California. By comparison, under Whitman's proposed plans, equivalent cuts in Medi-Cal and CalWorks spending would lead to a loss of 63,200 jobs.[15]

Prison correctional services

Whitman proposes to reform spending on health care for prisoners, arguing that the state spends more on health care per prisoner than any other state in the nation. California is currently under federal court order and in receivership to improve health care for prisoners.[16] While some savings may be achieved in this area, they are not likely to be significant.[17]

New technology

Whitman proposes to harness the power of technology by upgrading the state government's antiquated computer systems. Although upgrading the state's computers is a good idea, it will require a major upfront investment with a payoff in future years. This represents another cost Whitman does not take into account in her economic policy program.

Can California afford to experiment with economic policies based on Whitman's economic assumptions?

Meg Whitman's economic policy proposals are predicated on her understanding of what she thinks ails the state economy. But is she correct in assuming that the state government is too large, or that Californians are over-taxed, or that California businesses are over-regulated? Let's look at each of these assumptions to see how they square with the facts.

Is California government too large?

Is the state's deficit due to bloated government employment, as Whitman claims? In a word: No. The deficit is chiefly caused by severely reduced revenues due to the Great Recession and the absence of a mandated "rainy day" fund. In 2008, the most recent year available, California's government employment per capita was 28 percent below the U.S. average, ranking 48th among the states, and California state employment per capita has not increased since the early 1980s.[18]

Nonetheless, Whitman proposes to reduce the state workforce by 40,000 workers, excluding the University of California system, corrections, and public safety. This number would equal nearly 25 percent of the remaining state workforce of 162,000. That many employees cannot be cut without substantially reducing state services, from DMV to foster care. As already mentioned, most of the cuts would fall on education, health, and human services.

Whitman wants to cut retirement benefits by moving all new public employees to so-called defined-contribution plans, in which employees select investments to save for their retirement. This change would enable the state government to make smaller contributions to public pension plans compared to what it must contribute to its current employees' defined-benefit plans—which define the level of benefits upon retirement. The likely savings from this proposed move in the first five years would do little to balance the state budget because the number of new hires will be small while commitments to the public sector's incumbent workers will remain.

What's more, California's state employees are paid 8 percent less in salaries and benefits than *comparable* workers in California's private sector.[19] And cutting benefits further by shifting to defined-contribution plans for new employees would make it more difficult to attract talented employees into the state workforce.

Whitman's ambitious proposals to move entirely to defined-contribution plans for new employees are problematic for another reason, too. Without the contributions to the defined-benefit plans from new employees, the state's required employer contributions to those plans would very soon become larger.

Defined-benefit plans share risk across employees so that retirement is not put at risk if the economy is in recession when individual employees reach retirement age. Moving entirely to defined-contribution plans over time both weakens the funding basis for current retirees and shifts additional risk to new employees.

Whitman claims that pension-fund costs for the state have spun out of control because benefits are too high. Yet in 2009 employer contributions remained lower than they were in the early 1980s. The state's contributions fell especially during the late 1980s and early 1990s, when tax revenue was declining and Republicans held the governor's office.[20] California does not face higher costs today just because of the stock market crash in 2008. If the state had maintained its earlier contribution levels to public pension funds in the 1990s and 2000s, and not gambled that higher stock market returns would continue, then California state pension funds would not be so substantially underfunded today.[21]

Some public pension reforms—such as increasing the retirement age to 60 or 65 to align more with the private sector and eliminating pension "spiking," or sudden increases in defined benefits for employees nearing retirement—are desirable. But they would help only somewhat in reducing underfunding problems in our state's public pension system. And anyway, average benefit levels are not overly generous.

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 rates of the top nominal income tax brackets in different states and ignores California's lower taxes on property. In 2007 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 recession years, the ratio falls to below average.[22]

In any case, research shows that taxes play a secondary role in the location of business and attraction of skilled workers compared to investments in education, infrastructure, and public services. A literature review by economist Terry Buss concludes, "tax literature, now in hundreds of publications, provides little guidance to policy makers trying to fine tune economic development."[23]

The upshot: Whitman's proposed cuts in taxes and fees paid by businesses are likely to have little positive effect relative to the number of jobs that would be lost by the resulting drop in public investment. These cuts could result in a loss of revenue of $6 billion to $10 billion a year or more, depending on how they were implemented. These tax cuts would add substantially to the state's budget crisis.

Capital gains cuts

Whitman proposes to eliminate *entirely* the state personal income tax on capital gains, or profits realized from investments instead of earnings. Moderate cuts in *federal* capital gains taxes in the past produced small one-time increases in revenues as some investors take advantage of the newly lowered rates, but research shows that soon thereafter the net effect of lower rates on revenues is negative and the effects on economic growth are extremely small at best.[24]

The problem is that Whitman's proposal to *eliminate entirely* state capital gains taxes would not produce even a one-time revenue gain, although it would benefit the richest people in the state. How do we know that? In 2007, taxes on capital gains generated approximately $11 billion in revenue for the state. After taking into account stock market declines since 2007, eliminating the capital gains tax would reduce revenue by about $4 billion to $4.5 billion a year over each of the next five years, and the revenue losses would increase in subsequent years.[25]

Eliminating the state capital gains tax would do very little to spur investment in the state. Most California investors' portfolios are diversified nationally and internationally. Consequently, the vast majority of private income retained by investors would be spent on stock purchases of companies outside the state.

Moreover, Californians who benefit from cuts in the state capital gains 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. So the more Whitman reduces the state capital gains tax the more Californians will have to pay in federal taxes.

Would the elimination of income taxes on capital gains induce some multimillionaires to move to California, bringing their spending with them? The available evidence indicates that the highest-income households have not been leaving the state because of the state's income tax.[26] This finding suggests that the relocation back to California of any of its multimillionaires who did leave would not be substantial either.

Other proposed Whitman tax cuts

Whitman's *Meg 2010* proposes other ways to find savings in the state budget. These savings are either too small to be meaningful from a fiscal perspective (even if some of them are desirable in terms of government efficiency) or could in fact increase the state budget deficit. Some of her proposals include:

- Eliminate the filing fee for new businesses. The cost of eliminating the fee would reduce state revenue by approximately $68 million a year.

- Eliminate so-called sales taxes and use taxes on manufacturing equipment in the state. Analyses of similar proposals (AB 1812; AB 829) place the costs at between $1.1 billion and $1.3 billion a year.

- Increase the research and development tax credit to 20 percent from 15 percent. The Legislative Analyst Office estimates this change would result in a loss of $40 million in FY 2009-10, $65 million in FY 2010-11, $57 million in FY 2011-12, and $60 million in FY 2012-13, for a total of $222 million in lost revenue over a four-year period.

- A $10,000 tax credit for home purchases. The cost of the proposal would depend on the exact specifications, but similar proposals (in Assembly Bill 183) are projected to cost about $200 million a year.

- A series of other business tax reductions that are specified too generally to analyze their cost, among them a water conservation tax credit, the creation of academic enterprise zones, an acceleration of business tax depreciation, and a green-tech tax credit.

These proposals have some merit. But their combined effect would still increase California's budget deficit. During a time of economic hardship and high unemployment, reducing taxes while cutting services for low- and middle-income Californians is likely to depress rather than spur economic growth.

Is California over-regulated?

The Whitman plan *assumes* that all business regulations can only increase business costs and that they do not create any economic benefits. But that is often not the case. Some regulations generate benefits that are greater than their costs. The 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 finance fiasco and the need for better financial regulation at the state level.

Similarly, regulatory incentives imposed 20 years ago to conserve energy have *created* jobs in California while reducing energy use. Yet Whitman would effectively eliminate AB32, California's Global Warming Solutions Act. *Meg 2010* says the full implementation of AB32 will cost $100 billion and destroy one million jobs, based on a report by Sacramento State University business school professors Sanjay Varshney and Dennis Tootelian.[27] These estimates diverge radically from all the other studies of AB32, such as that of energy economist Matthew Kahn of UCLA.[28]

Meg 2010 depends upon another Varshney and Tootelian study that purports to find that business regulation in California costs about $17,000 per resident. This estimate—one- third of the state's gross product!—is simply not credible. Indeed, their study was called "useless" by the nonpartisan California Legislative Analysts Office, was labeled "one of the worst examples of shlock science" by economists

John Haveman and Christopher Thornberg, the founders of the Beacon Economics forecasting firm, and was said to have "no basis in reality," according to economics professor David Neumark of UC Irvine.[29]

Undoubtedly, some state regulations need to be improved. But Varshney and Tootelian ignore any benefits of regulation and treat all regulations as equally harmful. Their indices of regulatory burdens are seriously flawed because they are based upon arbitrary indices to rank California's business climate. One of these indices is based only upon the top nominal corporate and personal income tax rates, which is not a measure of regulation. Their underlying index of business regulation is based upon subjective discussions by editors at *Forbes* and surveys of business leaders' attitudes that basically reflect a political agenda without any statistical relationship to economic growth.[30]

Finally, their statistical methods are remarkably outmoded. The problems include not controlling for a state's size, improper tests for statistical significance, and no attempts to distinguish correlation from causality. For noneconomists, this means Varshney and Tootelian fail to provide credible evidence that business regulations in California have reduced economic growth. While there are undoubtedly many individual regulations that need modification, their study does not contribute to our understanding of how regulations function.

Whitman wants, further, to create "enterprise zones" near UC campuses where regulations and taxes on business would be lower. There is no evidence that such zones work to encourage spin-offs from university research, which are not based on cheap labor and low taxes. Spin-offs develop with a critical mass of high-tech workforce expertise, entrepreneurial and business management talent, access to venture capital, and proximity to leading universities. Most "science parks" around the world attempt to recreate this kind of critical mass, though some in developing countries also sometimes offer lower taxes and cheap labor to attract start-up companies from other countries, including the United States. California's competitive advantage, however, lies in its overwhelming mass of intellectual prowess, business talent, and venture capital. Several UC campuses, such as UC San Diego and UC San Francisco, already attract biotech and other high-tech companies. Whitman's proposal for tax breaks is not helpful.

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. Whitman wants to eliminate the daily overtime provision, which would give employers but not employees the choice over schedules.

Daily overtime was eliminated for most workers in California in 1998 and then reinstated in 2000. It was also suspended temporarily for employers rebuilding Los Angeles freeways after a 1994 earthquake. These policy changes allowed researchers to study its effects.[31] The studies found that the daily overtime policy generates significant negative effects on the use of overtime, and that repeal of daily overtime would reduce employment by between 1.6 percent and 2 percent.

Employers' savings from not having to pay overtime would transfer over $1 billion from workers to employers. This transfer of wealth from low- and middle-income salaried employees who spend almost all of their overtime pay to employers who will spend and invest significantly less in the state economy means slower economic growth and less tax revenue.

Conclusion

Meg 2010 is based on faulty economic theories and on studies that are fundamentally unsound. The nonpartisan 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."

Because *Meg 2010* is not based on facts or experienced analysis its economic policy prescriptions are equally dubious. If implemented, Whitman's program would worsen California's budget malaise and its economic performance. Californians need to examine carefully her faulty economic assumptions as well as understand the consequences of her misguided conservative economic proposals.

References

Auerbach, Alan. 2010. "California's Future Tax System." Working Paper. UC Berkeley, available at http://www.econ.berkeley.edu/~auerbach/cafuture.pdf.

Bender, Keith A. and John S. Heywood. 2010. "Out of Balance? Comparing Public and Private Compensation Data over 20 Years." Washington: Center for State and Local Government Excellence, available at http://www.slge.org/vertical/Sites/%7BA260E1DF-5AEE-459D-84C4-876EFE1E4032%7D/uploads/%7B03E820E8-F0F9-472F-98E2-F0AE1166D116%7D.PDF.

Buchmueller, Thomas and Sarah Senesky. 2002. "The Effect of California's Daily Overtime Law on Hours of Work: A Re-examination." Working Paper. Department of Economics, UC Irvine.

Business Alliance for a Green Economy. 2010. "Experts Discredit Small Business Studies." California, available at http://www.ca-greenbusinessalliance.com/wp-content/uploads/2010/03/CA-BAGE_Experts-Discredit-Small-Business-Studies.pdf.

Buss, Terry. 2001. "The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature." *Economic Development Quarterly* 15 (1): 90–105.

Center for Continuing Study of the California Economy. 2009. "Numbers in the News: Are Businesses and High-Income Residents Fleeing California?" Palo Alto, available at http://www.ccsce.com/PDF/Numbers-July09-Fleeing-Calif.pdf.

________2009. "Numbers in the News: State and Local Employees: Where Does California Rank? 2008 Update." Palto Alto, available at http://www.ccsce.com/PDF/Numbers-Dec09-Govt-Employees-Rank.pdf.

Center on Budget and Policy Priorities. 2007. "Policy Points: Experts Agree That Capital Gains Tax Cuts Lose Revenue." Washington, available at http://www.cbpp.org/cms/?fa=view&id=1286

California Department of Finance. 2010. "California Economic Forecast: Annual and Quarterly." Sacramento, available at, http://www.dof.ca.gov/HTML/FS_DATA/LatestEconData/FS_Forecasts.htm

DeVol, Ross et al. 2009. "Manufacturing 2.0: A More Prosperous California." Santa Monica: Milken Institute, available at http://www.milkeninstitute.org/pdf/CAManufacturing.pdf.

Friedman, Joel, Iris Lav, and Peter Orszag. 2001. "Would a Capital Gains Tax Cut Stimulate the Economy?" Washington: Center on Budget and Policy Priorities, available at http://www.cbpp.org/cms/index.cfm?fa=view&id=2164.

Hamermesh, Daniel S. and Stephen J. Trejo. 2000. "The Demand for Hours of Labor: Direct Evidence from California." *Review of Economics and Statistics* 82 (1): 38-47.

Jacobs, Ken, T. William Lester, and Laurel Tan. 2010. "Budget Solutions and Jobs." Berkeley: Center for Labor Research and Education, UC Berkeley, available at http://laborcenter.berkeley.edu/californiabudget/budget_solutions_jobs10.pdf.

Kaplan, Jonathan. 2008. "How California's School Districts Spend Their Funds." Sacramento: *School Finance Facts,* California Budget Project, available at http://www.cbp.org/pdfs/2008/080506_HowDistrictsSpendtheirFunds.pdf.

_______ 2010. "Race to the Bottom? California's Support for Schools Lags the Nation." Sacramento: *School Finance Facts,* California Budget Project, available at http://www.cbp.org/pdfs/2010/1006_SFF_how_does_ca_compare.pdf.

Kauffman Foundation. 2009. "The 2008 State New Economy Index: Benchmarking Economic Transformation in the States." Kansas City, available at http://www.kauffman.org/uploaded-files/2008_state_new_economy_index_120908.pdf.

Loeb, Susanna, Anthony Bryk, and Eric Hanushek. 2007. "Summary Report: Getting Down to Facts: School Finance and Governance in California." Stanford: Institute for Research on Education Policy and Practice, Stanford University.

Low, David. 2010. "Testimony of David Low." Sacramento: Little Hoover Commission.

Next Ten. 2010. "Budget Challenge," available at http://www.nextten.org/budgettool/site/thesim/flashcheck.html.

Public Policy Institute of California. 2009. "Just the Facts." San Francisco.

Skelton, George. 2010. "Whitman's tax plan would benefit some but put California at risk." *Los Angeles Times*. April 9, available at http://www.latimes.com/news/local/la-me-cap8-2010apr08,0,5253022.column.

Sweeney, James and Matthew Kahn. 2010. "A flawed cost/benefit study of a greener California." *Los Angeles Times*. March 24.

Urban Institute and Brookings Institution.2010. "Tax Facts: State and Local Tax Revenue as a Percentage of Personal Income, Indexed to U.S. Average." Washington, available at http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=512.

Wassmer, Robert W. and Katherine Chalmers. 2007. "What Really Determines Whether a Manufacturing Firm Locates and Remains in California?" Social Science Research Network, available at http://ssrn.com/abstract=1088485.

Zandi, Mark. 2010. "Using Unemployment Insurance to Help Americans Get Back to Work: Creating Opportunities and Overcoming Challenges," 2010. Testimony before the U.S. Senate Finance Committee, available at http://www.economy.com/mark-zandi/documents/Senate-Finance-Committee-Unemployment%20Insurance-041410.pdf.

About the Author

Michael Reich is Professor of Economics at the University of California at Berkeley. He received his Ph.D. in economics from Harvard University, and has published ten books and monographs and nearly a hundred professional articles and policy briefs.

Endnotes

1 Meg Whitman for America, "Building a New California," (2010), available at http://www.megwhitman.com/userfiles/pdfs/policy_agenda.pdf. *Meg 2010*, which was released in the Spring of 2010 also contains proposals on welfare reform, immigration, and crime that are not considered here. On July 15, 2010, the Whitman campaign released a 34-page booklet "Creating Jobs for a New California." [Meg Whitman for America, "Creating Jobs for a New California," (2010), available at http://www.megwhitman.com/userfiles/pdfs/Whitman_Meg_Policy_Agenda_Jobs.pdf.] The economic analyses and proposals in this document are unchanged from *Meg 2010*. As of August 2, 2010, Democratic candidate Jerry Brown had issued statements on the environment and green job creation, and on public sector pension reform, but not on the economy. This paper therefore examines only the Whitman program.

2 Ross DeVol et al., "Manufacturing 2.0: A More Prosperous California," (Santa Monica: Milken Institute, 2007), available at http://www.milkeninstitute.org/pdf/CAManufacturing.pdf.

3 Based upon U.S. government data. See, for example, http://www.bea.gov/newsreleases/regional/gdp_state/gsp_newsrelease.htm.

4 See Center for Continuing Study of the California Economy, "Numbers in the News: Are Businesses and High-Income Residents Fleeing California?" (2009), available at http://www.ccsce.com/PDF/Numbers-July09-Fleeing-Calif.pdf for evidence that inferences from state comparisons are sensitive to the states selected for comparisons.

5 Kauffman Foundation, "The 2008 State New Economy Index: Benchmarking Economic Transformation in the States" (2009), available at http://www.kauffman.org/uploadedfiles/2008_state_new_economy_index_120908.pdf.

6 Others with similar predictions include the Anderson School forecast (UCLA), Beacon Economics, and the University of the Pacific Business School forecast.

7 Mark Zandi, "Using Unemployment Insurance to Help Americans Get Back to Work: Creating Opportunities and Overcoming Challenges," Testimony before the U.S. Senate Finance Committee, April 14, 2010m, available at http://www.economy.com/mark-zandi/documents/Senate-Finance-Committee-Unemployment%20Insurance-041410.pdf.

8 As noted in Alan Auerbach's "California's Future Tax System," the cyclical volatility of state revenues provides a desirable automatic stabilizer for the state economy. Hence the emphasis on reducing volatility in spending. [Alan Auerbach, "California's Future Tax System." Working Paper. (UC Berkeley, 2010), available at http://www.econ.berkeley.edu/~auerbach/cafuture.pdf.]

9 "Budget Challenge," *Next 10,* available at www.nextten.org/budgettool/site/thesim/flashcheck.html.

10 For matching rates, see Jacobs, Ken, T. William Lester, and Laurel Tan, "Budget Solutions and Jobs," (Berkeley: Center for Labor Research and Education, UC Berkeley, 2010), available at http://laborcenter.berkeley.edu/californiabudget/budget_solutions_jobs10.pdf.

11 National Center for Educational Statistics, "Indicator List," available at http://nces.ed.gov/programs/coe/list/i2.asp. California's school spending now lags other states by the greatest amount in 40 years. See Jonathan Kaplan, "Race to the Bottom? California's Support for Schools Lags the Nation." (Sacramento: California Budget Project, 2010), available at http://www.cbp.org/pdfs/2010/1006_SFF_how_does_ca_compare.pdf.

12 Since most education spending is on salaries and benefits, interstate comparisons should adjust for differences in living costs. The National Center for Policy Analysis has computed such adjustments. In 2005, among the top 50 major metropolitan areas, teacher salaries in San Francisco and Los Angeles ranked second and fourth respectively, in dollar terms, and 49th and 48th after adjusting for cost of living differences. National Center for Policy Analysis, "Teachers' Cost of Living Matters More," (2005), available at http://www.ncpa.org/pub/ba535.

13 National Center for Educational Statistics, "Indicator List."

14 Susanna Loeb, Anthony Bryk, and Eric Hanushek, "Summary Report: Getting Down to Facts: School Finance and Governance in California." (Stanford: Institute for Research on Education Policy and Practice, Stanford University, 2007).

15 Jacobs, Lester, and Tan, "Budget Solutions and Jobs."

16 For information on the California Prison Receivership see "California Prison Health Care Services: Frequently Asked Questions," available at http://www.cprinc.org/faq.aspx.

17 Governor Schwarzenegger has proposed outsourcing as a means of generating savings, but has not made the case successfully. For a discussion of the Receivership's difficulty in cutting spending, see its recent report California Prisons Health Care Services, "Achieving a Constitutional Level of Medical Care in California's Prisons," available at http://www.cprinc.org/docs/court/T14_20100515_Tri-AnnualReport.pdf.

18 Center for Continuing Study of the California's Economy, "Numbers in the News: State and Local Employees: Where Does California Rank? 2008 Update." (2009), available at http://www.ccsce.com/PDF/Numbers-Dec09-Govt-Employees-Rank.pdf.

19 State employees are more likely than private sector workers to have college degrees and to work in professional and managerial occupations. To compare apples with apples, a recent study (Bender and Heywood 2010) controls for education and occupation and finds that state employees are paid less than private sector workers, in all the states as a whole, and specifically in California.

20 See for example: "BFA UC Pension Fund Report," available at http://ucbfa.org/projects/the-pension-fund/.

21 David Low, "Testimony of David Low," Little Hoover Commission.

22 Data are from the U.S. Department of Commerce, Bureau of Economic Analysis. See also Alan Auerbach "California's Future Tax System," and Urban Institute and Brookings Institution**,** "Tax Facts: State and Local Tax Revenue as a Percentage of Personal Income, Indexed to U.S. Average" **(2010),** available at http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=512**.** Compared to most other states, California relies more on state-level taxes than on local taxes, a legacy of Proposition 13. States that do not have a state income tax have much higher property taxes.

23 Terry Buss, "The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature." *Economic Development Quarterly* 15 (1): 101. See also Robert W. Wassmer and Katherine Chalmers, "What Really Determines Whether a Manufacturing Firm Locates and Remains in California?" (Social Science Research Network, 2007), available at http://ssrn.com/abstract=1088485.

24 Joel Friedman, Iris Lav, and Peter Orszag, "Would a Capital Gains Tax Cut Stimulate the Economy?" (Washington: Center on Budget and Policy Priorities, 2001). available at http://www.cbpp.org/cms/index.cfm?fa=view&id=2164; Center on Budget and Policy Priorities, "Policy Points: Experts Agree That Capital Gains Tax Cuts Lose Revenue" (2007), available at http://www.cbpp.org/cms/?fa=view&id=1286.

25 Calculated from data in Franchise Tax Board Annual Reports.

26 Public Policy Institute of California, "Just the Facts" (2009)., Center for Continuing Study of the California Economy, "Numbers in the News: Are Businesses and High-Income Residents Fleeing California?" (2009), available at http://www.ccsce.com/PDF/Numbers-July09-Fleeing-Calif.pdf.

27 Varshney & Associates, "Cost of AB 32 On California Small Businesses," (2009), available at http://www.sbaction.org/get_resource.php?table=resource_kmqap4_18z4ys&id=kmqaq1_1ed1wo.

28 James Sweeney and Matthew Kahn, "A flawed cost/benefit study of a greener California." *Los Angeles Times*. March 24, 2010. Varshney and Tootelian ignore completely the increased spending on other goods and services that would occur with reduced spending on energy.

29 Business Alliance for a Green Economy, "Experts Discredit Small Business Studies" (2010), available at http://www.ca-greenbusinessalliance.com/wp-content/uploads/2010/03/CA-BAGE_Experts-Discredit-Small-Business-Studies.pdf.

30 Varshney andTootelian also cite several indices developed by conservative organizations, but they refer repeatedly to each others' studies for confirmation and they all draw essentially from the same attitudinal data.

31 Daniel S. Hamermesh and Stephen J. Trejo, "The Demand for Hours of Labor: Direct Evidence from California." *Review of Economics and Statistics* 82 (1) (2000): 38-47; Thomas Buchmueller and Sarah Senesky, "The Effect of California's Daily Overtime Law on Hours of Work: A Re-examination." Working Paper. (Department of Economics, UC Irvine, 2002).