

INTRODUCTION

California's Economy—Lots of Zeroes, Lots of Contradictions Having to Do with Wealth, Opportunity, and Livability

By Bill Whalen

Good luck trying to get your arms—and your head—around the enormity of California's economy.

Last month, the state's 2015 gross domestic product (GDP: a measure of goods and services) was calculated at \$2.46 trillion.

That's trillions, folks, with nine zeros—as in nine shutout innings from Clayton Kershaw, nine Oscar losses suffered by Peter O'Toole and Harrison Ford, or nine months without rain in an area that not so long ago was mired in a historic drought.

Other ways to appreciate the strength of California's economy: in 2015, the US GDP increased 3.7 percent; California's hummed along at 5.6 percent—the [fourth consecutive year](#) that California outpaced the nation. The only countries, in addition to the United States, with higher GDP output were China, Japan, Germany, and the United Kingdom.

Yet beneath the showy numbers are some serious structural problems—fitting for a state that rests along fault lines.

Take, for example, personal prosperity.

At last count, California was home to [124 of America's 540 billionaires](#) (neighboring Arizona, Nevada, and Oregon have but 19) with a combined wealth surpassing half-a-trillion dollars.

On the flip side, the Golden State's [20.6 percent poverty rate](#) is the nation's worst, challenged the closest by Florida at 19 percent.

You can blame that in part on California's exorbitant cost of living, which leads to cruel contradiction.

On the one hand, modern-day California lives up to its legacy as a land of opportunity.

San Jose, the state's fast-growing metropolitan area, experienced stronger economic growth than all but two of the nation's 382 metropolitan areas in 2015. California unemployment stood at 4.9 percent, a far cry from the 12.5 percent in the aftershock of the Great Depression. If you're looking for work in the Golden State, begin in the San Francisco Bay Area; it's home to about two-thirds of the new jobs created in California in March.

But I wish you good luck in finding a place to live and getting to work. Since 2010 California's population has grown by roughly 6 percent. Meanwhile the nation-state's supply of housing

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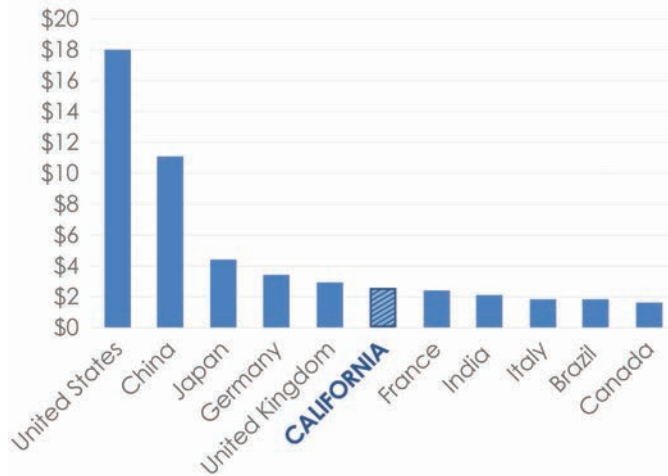
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THE WORLD'S LEADING ECONOMIES, BASED UPON GDP (IN TRILLIONS)



Source: World Bank and Visual Capitalist/CA Department of Finance
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has grown by only 2.9 percent ([this May 2015 edition of Eureka](#) explores “California’s Housing Conundrum”).

To say that affordable housing is in demand would be an understatement. According to a recent “[migration report](#)” by the real estate brokerage Redfin, about one in five potential home buyers in San Francisco looked outside the region for a home.

Could you cut it in the California economy? First, try weighing two numbers: if you’re a homeowner, the value of your property versus something similar in an economic hotbed like Santa Clara County (home to Google and many a Facebook plutocrat), where the typical single family home clocks in at \$1.05 million, up 1.5 percent from last year.

Second, check your paycheck. In adjacent San Mateo County, home to Facebook, the federal government has deemed \$103,500 as the low-income cutoff point for a family of four.

Why mention the price of housing? Because lawmakers, in their search for additional revenue, may encourage voters to repeal a portion of [Proposition 13](#), which four decades ago placed a rate cap on commercial and residential property taxes (some historians argue that the Prop. 13 campaign was the opening salvo of the Reagan revolution that came along two years later).

Where all of this is going is anyone’s guess. California’s population continues to grow: at last count, the nation-state is but a modest-sized city from surpassing forty million residents.

But appropriate for a state with a company holding a patent on blue jeans, the California of 2017 is not unlike an overweight

man trying to stuff himself into a pair of dungarees several sizes too small.

Nowhere is that more apparent than California’s state budget. Despite relatively low unemployment, bull markets, and houses selling like hotcakes—all of which add up to lots of revenue pouring into Sacramento’s coffers—state spending remains a high-wire juggling act.

The “May Revise” to the governor’s proposed 2017–18 state budget (the constitutional deadline for passing California’s budget is June 15; the new fiscal year begins July 1, with spending and revenue constitutionally required to be in balance) reflects this contradiction (if you want to don your green eye-shades and pour through the state’s budget math, [here’s](#) a pdf of the revised spending plan).

That’s because the state collected “**only**” **\$15.98 billion in April**: the peak month for tax revenue finding its way to Sacramento. That figure may sound formidable, but in fact it is \$1.05 billion short of what had been projected for the month.

Breaking down that revenue disappointment:

- In April, California typically collects about 17 percent of its personal income tax receipts; this year, collections lagged by more than 5 percent
- Retail sales and use tax receipts fell short of projections by 13 percent (almost \$107 million)
- Corporation tax receipts for April were nearly 14 percent less than earlier budget estimates

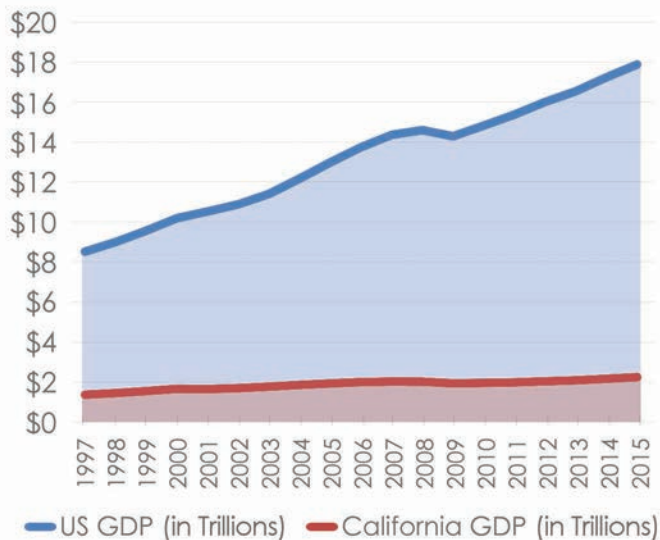
In the bigger picture, for the first ten months of the California fiscal year that began last summer, total revenues of \$96.88 billion were \$1.83 billion below last summer’s budget estimates and \$211.3 million shy of January’s revised fiscal year-to-date predictions. Total FYTD revenues were \$1.74 billion higher than for the same period of the prior fiscal year.

The simplest way to read these numbers is that California has more money to spend but not nearly enough to feed the beast that is the state budget, which has tripled, from \$57.5 billion in 1994 to \$183.4 billion now currently on the table, in the nearly quarter of a century that I’ve lived in the Golden State.

California’s economy is growing, but not enough to keep pace with lawmakers’ more grandiose ideas. Given that the state, in an economic sense, is living on borrowed time, as you’ll see in the accompanying chart, a recovery that’s currently three years longer than expected: something has to give.



US VS CALIFORNIA REAL TOTAL GDP—YEAR-TO-YEAR (IN BILLIONS)



Source: U.S. Department of Commerce, Bureau of Economic Analysis
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The translation is that lawmakers will have to do more in the immediate future to prime the economic pump so as to add more to the state's coffers, or they should prepare for cut in spending, given an economic contraction that's a question of when, not if.

If this isn't a government call to arms, what is?

In this edition of *Eureka*, we'll examine a few thorny issues germane to California's economy.

That includes

- Tammy Frisby, a Hoover Institution research fellow, details the latest Hoover Golden State Poll that asks Californians for their preferences on infrastructure improvements and their willingness to fiddle with Prop 13.
- Daniel Heil, a Hoover Institution research fellow, examines the state's lack of interest in tax reform and creating lasting economic incentives (the last significant tax reform in California was two decades ago).
- Kevin Klowden, executive director of the Milken Institute's California Center, lays out a vision of state infrastructure for the next fifty years (it's now a half-century since the legendary Governor Pat Brown and his vision of freeways and waterways).
- Loren Kaye, president of the California Foundation for Commerce and Education and senior adviser to two governors, walks us through the pros and cons—mostly cons—of putting Californians on a nondriving "road diet."

We hope you enjoy this latest installment of *Eureka* and that it gets you thinking about where California stands and if we're moving in the right direction.

Happy reading!

Bill Whalen is a Hoover Institution research fellow, primarily studying California's political trends. From 1995 to 1999, Bill served as Chief Speechwriter and Director of Public Affairs for former California Governor Pete Wilson.



POLL ANALYSIS

Californians on Their State's Economy: Signs of Optimism, Concern, and a Mutual Embrace of Hayek and Higher Taxes

By Tammy M. Frisby

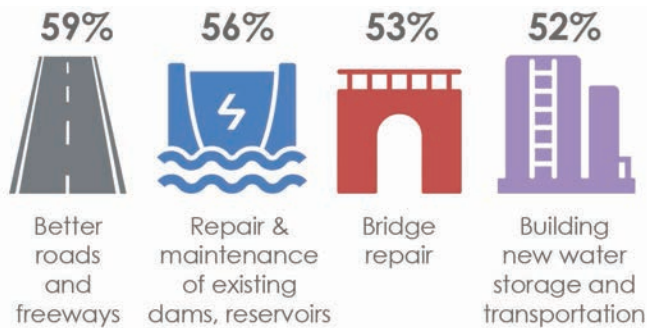
This spring saw the routine preparations for the annual [May revision](#) of California's proposed state budget disrupted by the political bargaining required to raise the gas tax for the first time in twenty-three years. In the midst of that unusual political scene, the Hoover Institution's Golden State Poll surveyed Californians about their economic well-being and their opinions on economic policies that affect the nation-state's global-sized GDP, including infrastructure spending and a possible revisit of the property-tax limiting Proposition 13.

The survey, administered by the survey research firm YouGov, was conducted from April 28 to May 4, 2017. The survey's sample was 1,700 adult Californians, including about 1,500 self-identified registered voters. The margin of error is plus or minus 3.75 percent for the full weighted sample. The full results, with data reported by demographic and political groups, are available [here](#).

Among our most notable findings

Your Tax Dollars at Work: Support for Infrastructure Spending

As we were writing our survey and getting ready to poll Californians, Governor Jerry Brown and the state legislature were in the middle of a heated debate about increasing the state gas tax to pay for road repair as well as other government spending. Rather than asking a specific question about



Source: Hoover Institution Golden State Poll

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a particular version of that bill that might not be the final legislative package, we opted for a more general question to gauge Californians' appetites for paying higher taxes to support road repair. With this approach, we also asked about a range of other possible infrastructure projects. The idea was to measure where road repair and improvement, just one of California's infrastructural needs, sits in the minds of Californians.

Of the twelve types of projects we offered, Californians said they'd be willing to have their taxes go up to pay for four of them: better roads and freeways (59%), repair and maintenance of existing dams and reservoirs (56%), bridge repair (53%), and building new water storage and transportation (52%).

Democrats, Republicans, and Independent voters had similar patterns of support for the different infrastructure projects. All these groups had the four road- and water-related projects as their top choices. A majority of Democrats and Independents said they would be willing to pay higher taxes for each of these types of projects.

Republicans, however, did not reach majority support for any of the projects. Their aggregate levels of willingness to pay higher taxes for these four projects ranged from 43 percent (better roads and freeways) to 31 percent (bridge repair).

Another notable point is that respondents who report the highest levels of interest in following political news were the mostly likely to say that they would pay higher taxes for repair and maintenance of existing dams and reservoirs (61% compared to 49% among the rest of survey respondents). This suggests that these respondents might be thinking about the problems with [the Oroville Dam](#) and other sites being covered in the news as they form their opinions about public policy choices.

The upshot is that Californians' priorities for infrastructure spending by Sacramento are solidly focused on roads and water. Beyond that, state policy makers are going to have a much tougher sell on tax increases for infrastructure investment funded by state tax dollars.

At the bottom of Californians' lists are electric vehicle charging stations (26%) and port facility modernization (23%).

This question was a rare good-news time for California high-speed rail. With a track record of coming in dead last on our other surveys when we ask about issue priorities, high-speed rail managed to place ahead of electric vehicle charging stations and port modernization. Thirty-two percent of Californians said they were willing to see their taxes go up to pay for high-speed rail, just 2 percent shy of the 34 percent who said they would pay more tax dollars to have government investment in public high-speed Internet.

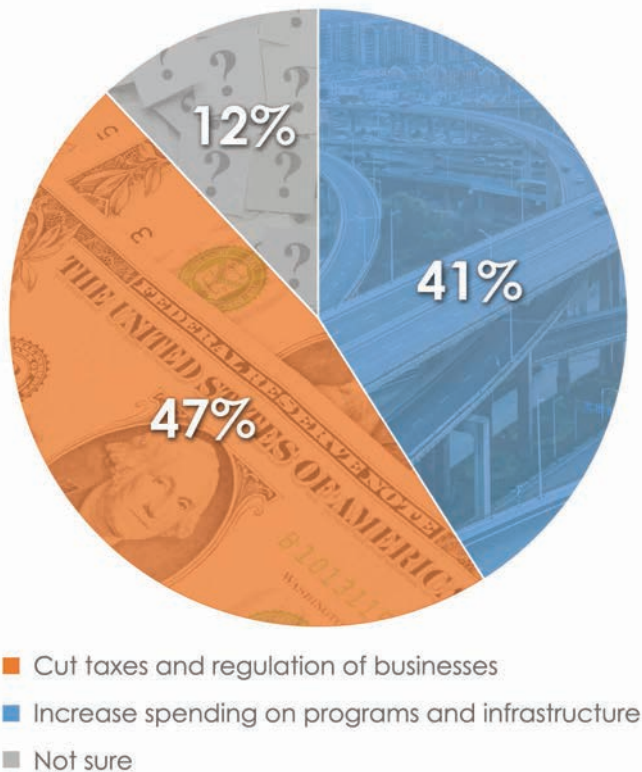
Age differences came across loud and clear on willingness to pay more taxes for both public high-speed Internet and high-speed rail. More than half (51%) of 18- to 29-year-olds we surveyed said they would pay higher taxes for public high-speed Internet. This is in contrast to 36 percent of those ages 30–44, 33 percent of respondents ages 45–64, and just 15 percent of Californians 65 or older. Almost half, 45 percent, of 18- to 29-year-olds were willing to pay more for high-speed rail. Like high-speed Internet, support declined in the older age groups.

Prop 13: Split Roll

We also surveyed a potential brewing storm in California politics: the prospect of repealing the commercial property tax provisions of Prop 13. Approved by California voters two years before Ronald Reagan's landslide presidential win, some historians cite [the Prop 13 tax rebellion](#) as the opening salvo of the 1980s Reagan revolution.

With our Internet-based survey administration, respondents read our questions rather than listening to them read over the phone. This means we can ask longer questions that include more detail about policies, which means we run the risk of our respondents not following the question. In the May survey, we took advantage of this to measure public opinion on reform of Prop 13. We provided a fairly detailed explanation of Prop 13 and what would be involved in making a change to treat commercial and residential property differently for property taxation: in Sacramento parlance, a "split roll." We were even able to include brief arguments for and against the change.

Among our full survey sample, Californians broke slightly in favor of repealing the Prop 13 limits on commercial property while maintaining the residential protections. Thirty-nine



Source: Hoover Institution Golden State Poll

Note: Response items were rotated to prevent selection bias

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percent said they were either somewhat or strongly in favor of removing the commercial limits while retaining the residential protections. Fewer Californians, 33 percent, responded that they opposed a change to a split roll.

Notable was the consistency in support for Prop 13 reform across Californians who said they owned residential property and those who said they were not currently homeowners. Thirty-nine percent of both groups supported a split roll reform to Prop 13.

The differences between owners and nonowners are found in levels of opposition to changing Prop 13 along these lines. Although 39 percent of residential property owners said they opposed a split roll (the same share as said they supported it), only about a quarter, 26 percent, of nonowners took a position against a split roll.

That leaves 34 percent of nonowners who said they neither supported nor opposed the reform at this time. One of the key challenges for Prop 13 reformers, then, is to persuade renters who are undecided that they should support split roll and show up to vote for it.

How Keynesian Are Californians?

We also asked Californians some big-picture questions about economic policy, focusing on what voters consider the best incubators of economic growth and whether the credit should go to the government or the private sector. In other words, are Californians closer to Keynes or Hayek in their economic outlook?

We asked Californians who they thought did the most to create jobs and grow the economy: government, businesses, or consumers? Even in progressively blue California, the plurality answer, at 43 percent, was businesses. Consumers came in second at 33 percent, 12 percent identified government, and 11 percent said they were not sure.

Democrats provided the most interesting responses. They were most likely to say consumers, at 41 percent, and twice as likely to answer businesses (31%) as government (15%).

Republican responses were mostly as expected, with far and away the most popular answer being businesses (66%). Government and consumers had similar low-double-digit response rates (12% and 16%, respectively). If there was a surprise in these findings, it would be that government received double-digit support among Republicans; only 7 percent of Independent voters said the buck stopped with government.

We followed up that question by asking about the best way for government to encourage economic growth and job creation. Again, despite the partisan makeup of California's state- and national-level elected officials, Californians' positions on economic policy are not so decidedly Democratic. When given two broad sets of policy options—increase spending on programs and infrastructure or cut taxes and regulation of businesses—Californians went slightly in favor of the limited government approach, with 47 percent choosing a reduction in taxes and regulation and 41 percent pointing to government actions to increase spending.

The California Economy and the Trump Presidency

Let's be upfront about the realities of public opinion survey work; sometimes a big news event related to your survey question injects itself between the time you conduct your survey and when you release your results. In the case of the last month and events surrounding the nascent Trump administration, sometimes dozens of important news cycles are happening at the same time.

So it's with a cattle car of caveats that we share our findings related to public opinion among Californians about the Trump administration and its possible impact on this state's economy.

We wanted to see if Californians had adjusted their expectations for a Trump presidency now that it's been under way for a few months, so we re-asked our question on this topic from our [January 2017 poll](#).

What we discovered was that the share of Californians expecting a successful Trump presidency was stable—and low: 35 percent in this spring survey and 36 percent in the January 2017 survey.

The percentage of Californians who are pessimistic increased slightly, with 54 percent responding that they expect Trump's term to be unsuccessful, compared to 46 percent in January. The motion toward the negative evaluation comes entirely from Democrats and Independents. Republicans were not just holding the line on unsuccessful expectations (9% across both surveys). The percentage of Republicans responding that they had positive expectations ticked up a bit, from 76 percent in January to 82 percent in our latest survey.

In this survey, we also asked Californians to think specifically about the Trump administration's possible effect on the California economy. Consistent with the overall assessment of a Trump presidency, only 29 percent of Californians said they were confident in Trump's ability to improve the California economy; 60 percent felt uneasy.

Given the political events of the past month, these figures almost certainly represent a high watermark among Californians for the Trump presidency. Unless, that is, many Californians who were previously negative about or doubtful of Trump found reasons for optimism in the House vote on the AHCA or the leaked details of the president's budget.

Last but Not Least: The Microeconomics

In addition to our usual set of questions about Californians' financial well-being, we asked about finances compared to their parents, prospects for California's next generation, and the feasibility of affording retirement. To highlight our findings on just two of these questions:

For all the dire reports about millennials and [their harrowing finances](#), the youngest cohort of Californians in our survey—18- to 29-year-olds—aren't, as a group, bemoaning their plights. These young Californians are more likely to say they're better off than their parents were at their age than say they are worse off (41% better off to 26% worse off). They're also just as likely, statistically speaking, to say better off than 30–44 and 45–64-year-olds (39% and 38%, respectively).

The only age group that doesn't run in the positive direction is the 45–64-year-olds, the parents of young adults in college

or at the earliest stages of their working lives. Thirty-eight percent said they were better off than their parents; 40 percent responded that they were worse off. That 40 percent worse off response is also the highest negative assessment across the four age groups.

When we asked about the future economic prospects of the next generation compared to their parents, predictions were less sunny, although also less dour than might be expected. Among 18–29-year-olds, the responses were 31–36 percent (next generation better off versus worse off than parents). The next age cohort, 30–44, held similar views (31–37%), while the two oldest age groups, 45–64 and 65+, were most pessimistic as a group (24–43% and 25–44%, respectively).

When asked to take the long view about the prospects for the next generation, there was a stark difference between white and Hispanic respondents. Only 20 percent of white Californians said they expected the next generation to do better than their parents; 46 percent said they expected them to do worse. But among Hispanics, the view was more positive than negative, 35 percent to 32 percent.

That brighter outlook among Hispanic respondents is a good reminder that we can't always understand the California economy and public opinion about it without paying attention to who Californians are today—and will be increasingly so in the future.

Tammy M. Frisby is a Hoover Institution research fellow, who studies American national politics and public policy making. She leads survey design and data analysis for the Hoover Institution/Lane Center Golden State Poll.



FEATURED COMMENTARY

The California Economy Needs Tax Reform—Not More Special Tax Breaks

By Daniel Heil

Soon before his presidency reached its 100-day mark, Donald Trump addressed a major campaign promise by offering his vision for tax reform. The Trump plan promises to cut rates, slash loopholes, and simplify the tax code. As more details



of the plan emerge, however, the president will learn a lesson familiar to countless would-be reformers: tax reform is easy on paper and nearly impossible in reality.

On paper, loopholes are easily eliminated to finance pro-growth rate cuts. In reality, each loophole is a deduction or credit that, its recipients assure us, serves a noble social purpose. In the abstract, simplifying means less work for taxpayers but actually involves taking away the deductions and credits beloved by taxpayers.

This lesson is not unique to federal policy makers. For decades, Californians across the political spectrum have labored to fix the state's burdensome tax code, with little success.

In 2009, then California governor Arnold Schwarzenegger assembled the Commission on the Twenty-First Century Economy. The Parsky Commission (named after its chairman, Southern California financier Gerald Parsky) proposed an overhaul to the tax system (Parsky discussed his experiences leading the commission [in his previous Eureka article](#)).

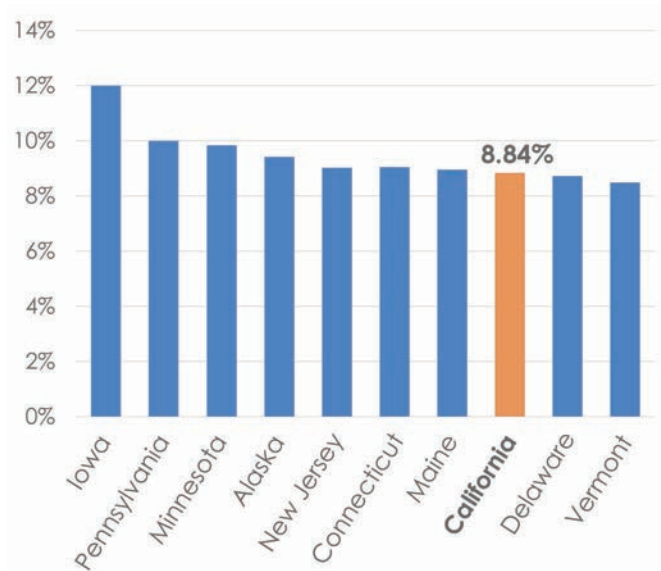
More recently, State Controller Betty Yee tasked her office's Council of Economic Advisers on Tax Reform with identifying the principles that should guide comprehensive reforms to a tax code she labeled as "outdated, unfair, and unreliable."

Despite these efforts, there seemingly is little appetite for reform in Sacramento. State lawmakers prefer special business tax breaks. At best, however, these provisions offer minor incentives for particular businesses to hire and invest. More likely, these tax breaks will only compound tax complexity and result in higher taxes for other businesses. The early returns from California's new business incentives are mixed.

In 2013, the State Legislature established the California Competes tax credit to provide subsidies to businesses that promise to hire and invest in the state. In April 2017, General Motors received \$8 million in promised tax savings from the credit. The automaker is not alone. Thus far, \$492.5 million in California Competes tax credits have been awarded to nearly seven hundred businesses. The Governor's Office for Business and Economic Development [expects](#) businesses that have received the credit to generate 70,000 new jobs and invest \$14.4 billion.

Also in 2013 lawmakers added a tax credit to subsidize employers who hire workers in economically depressed areas. The New Employment Credit, however, has largely gone unnoticed by employers. Early estimates predicted

2017 Top Corporate Income Tax Rates by State



Source: Tax Foundation

Note: Texas, Nevada, Ohio and Washington have Gross Receipts Taxes which are not easily comparable to the corporate income tax rates (different bases).

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employers would claim \$91 million of the credit during the first two years. A [preliminary report](#), however, finds businesses have been discouraged by the credit's complexity and have only claimed \$5.6 million.

The following year, lawmakers expanded the state's Film and Television Tax Credit to provide \$330 million in annual tax credits. The Legislative Analyst Office (LAO) [found](#) projects that received an earlier iteration of the state's film credit spent \$6 billion in the state. Although that amount far exceeds the \$800 million in film credits awarded, the LAO estimated that one-quarter of the \$6 billion would have been spent in California without the subsidies.

Evidence from other states suggests Californians should not expect these tax breaks to return large dividends. Businesses nationwide receive somewhere between \$45 and \$80 billion annually in state business incentives. Despite their widespread use, incentives typically fail to generate significant returns. A [2017 analysis](#) by the Michigan-based Upjohn Institute for Employment Research, for example, found little relationship between state business incentives and unemployment levels or growth rates.

Perhaps California's business incentives will outperform other states' programs and deliver the promised jobs and

investment. Nevertheless, even under the best-case scenario, the relatively small credits will do little to improve the state's multitrillion-dollar economy. Rather than enacting more of these tax breaks, California lawmakers should finally admit that the tax system fails to meet the needs of today's economy.

California's tax system stifles economic growth with heavy tax burdens on business and investment income. The state's top income tax rate is the highest in the nation, at 13.3 percent. Its 8.8 percent corporate tax rate is the eighth highest. California even assesses a minimum \$800 annual tax on most businesses whether or not they earn a profit. Making matters worse, the code is rife with loopholes and tax breaks that add significant complexity to the code.

Meanwhile, the budget's reliance on volatile revenue sources such as income and investment taxes inevitably leads to large deficits during economic downturns. Lawmakers have attempted to close these periodic deficits with higher tax rates, exacerbating the very tax policies that create budget instability and weaken California's economy.

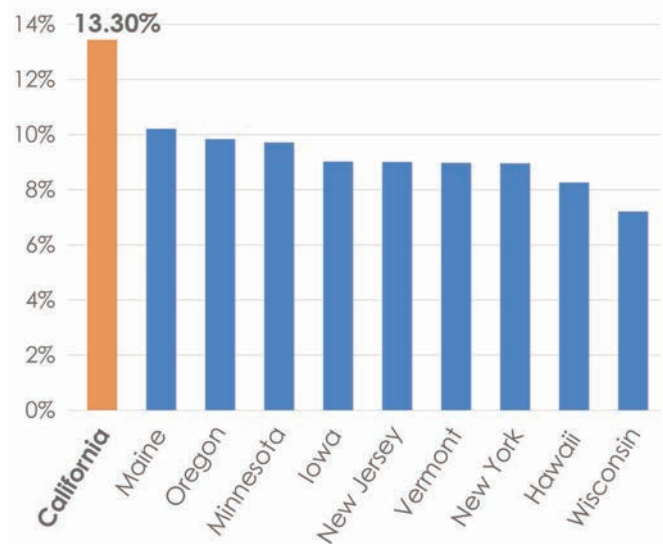
It is thus no surprise that a [recent analysis](#) by Ball State University's Indiana Communities Institute found California's business climate receives low marks from a variety of separate studies. Despite using different methods, the studies reach a similar conclusion: California's policies, particularly its tax code, make it hard to hire and invest in California.

Defenders of the current tax code argue recent positive economic trends prove high taxes are not an impediment to growth. As evidence, they point to the state's relatively strong employment gains over the last decade. State employment has risen by 8 percent since 2007, while national employment only increased by 5 percent. California's above average employment gains, however, are largely confined to Silicon Valley. Despite accounting for less than one-quarter of California workers, the Bay Area was responsible for over 45 percent of job gains during the last decade.

Pro-growth reform must be more than merely tax cuts. Historically, rate reductions have offered only temporary improvements. During Pete Wilson's governorship in the 1990s, Californians benefited from a wave of growth-friendly tax cuts, but these provisions expired or were erased by subsequent legislation. Californians need lasting reforms, which requires changing the way the state taxes.

Although it failed to garner much political support, the Parsky Commission offered a blueprint for sustainable reforms. It proposed replacing the state's corporate tax and its general purposes sales tax with a value-added tax (VAT). The

2017 Top Individual Income Tax Rates by State



Source: Tax Foundation

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new tax would be levied across a broad tax base, ensuring the state could raise sufficient revenues with low business tax rates (4 percent). The low rate and overall design of the VAT would improve incentives for businesses to invest in the state. Further, complicated tax provisions—such as business incentive tax credits—would no longer pollute the tax code.

From its tech-hub in Silicon Valley to its entertainment industry in Los Angeles, the Golden State has inherited many economic blessings. Its tax system, however, isn't one of them. The state's tax code impedes economic growth, leaving fewer opportunities for all Californians. Papering over the code's failings with narrow tax breaks does not address these issues, rather it exacerbates them. Instead, lawmakers must overcome the political challenges inherent to any tax reform effort and finally pursue substantive changes to the tax system.

Daniel Heil is a research fellow at the Hoover Institution whose focus is on the federal budget, tax policy, and the federal antipoverty programs. Heil served as Governor Jeb Bush's economic policy adviser during the 2016 presidential campaign, counseling him on the federal budget, tax policy, and the federal antipoverty programs.





CALNOTES:



THE COLOSSUS OF THE COAST

We've talked about California's economy in global terms. Now, let's describe the giant in state terms. Texas (a \$1.47 trillion GDP in 2015) and New York (a \$1.26 trillion GDP) eat the Golden State's highly regulated exhaust. California's production is greater than that of the [fifteen states](#) west of the Mississippi River and north of the Texas-Arizona corridor. There's also the colossus within the colossus: the stretch of enterprising land from Los Angeles to Long Beach. It's [\\$930.8 billion GDP](#)—37.8 percent of California's output—bests that of Washington and Philadelphia combined (\$902 billion).

NOTE TO CALIFORNIA: DON'T MESS WITH TEXAS ON TAXES

Last December California governor Jerry Brown fired this salvo at Trump Energy Secretary and former Texas governor Rick Perry: "California is growing a hell of a lot faster than Texas, and we have more sun than you have oil." Brown was right, based on 2015 job growth (3 percent for California, double the Texas rate). Where he's on shakier ground is the friendlier climate. Although tax reform is a nonstarter in Sacramento, Austin lawmakers soon may ease property taxes and phase out the state franchise tax, which applies to business gross receipts. Let the nonpartisan [Tax Foundation](#) do the judging: its 2017 State Business Tax Climate Index ranks Texas fourteenth and California forty-eighth, ahead of only New York (forty-ninth) and New Jersey (fiftieth).

Crisis Management for California Infrastructure: Fifty Years after the Last Big Buildup, Time to Envision the Next Fifty Years

By Kevin Klowden

If Governor Edmund "Pat" Brown's greatest legacy is the physical and intellectual infrastructure of highways, water systems, and universities that transformed California to a nation-state and a global economic force, his son, Governor Jerry Brown, may be remembered best as the guy who tried to fix it all after decades of neglect.

The younger Brown's challenge is that there is little glamour in infrastructure and little political capital to be gained from

spending billions of tax dollars on maintaining it—breaking ground, yes, repairs, no.

Historically, politicians have shown that they are usually willing to spend on infrastructure in one of three cases: it is flashy and new, it is a component of a grander vision, or there is a crisis. Unless the project is so big and spectacular that it captures the public's imagination—think the Panama Canal or Dwight Eisenhower's Interstate Highway System—most politicians are unlikely to pay attention, which is why it took six years of severe drought, followed by record rainfall and the February near-collapse of [the Oroville Dam](#), to spur Brown and the legislature to action.

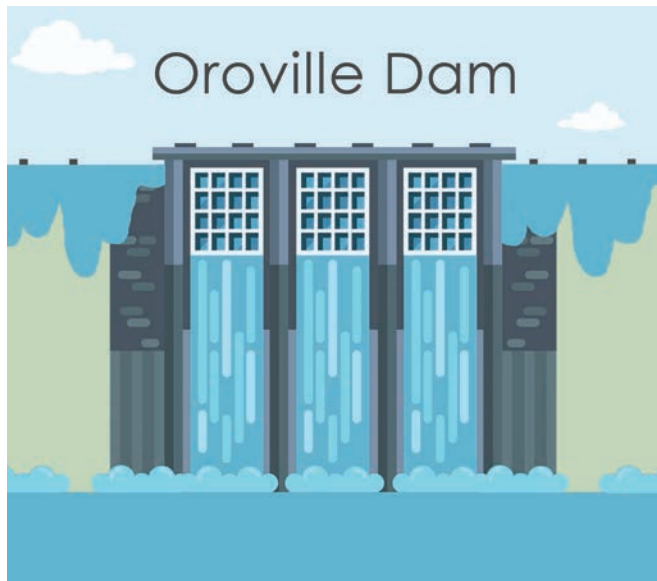
But water transport and storage aren't California's only infrastructure problems. Brown has outlined [\\$100 billion](#) in infrastructure projects that will be needed over the next decade to repair the state's roads, bridges, and water systems. The problem is that California's population has grown so large since its crumbling infrastructure was built—it was a little shy of 20 million residents in 1967, the year Pat Brown left office; at present, it's just shy of 40 million residents—that California would still face an infrastructure crisis even if every project on Brown's wish list were to be completed.

What California needs, but has lacked for half a century, is leadership with the vision to see what the state needs to ensure prosperity for the next fifty or a hundred years and the will to build it. Voters have shown at both the local and the statewide level that they are willing to pay for tax and fee increases if they feel the money will be spent on infrastructure projects they need. That includes Governor Arnold Schwarzenegger's 2006 [infrastructure bonds](#) and, more recently, [Measure R](#) and [Measure M](#) in Los Angeles County.

Governor Brown and the State Legislature finally stepped into the void, [passing a bill](#) that includes a twelve-cent increase in the state's per-gallon gas tax, an increase in vehicle fees, and, as of 2020, a special "vehicle improvement fee" to be charged to zero emission vehicles to recapture road use costs.

This step, although not glamorous, provides a major step toward addressing the significant structural issues facing the state's streets and highways. The key test for the governor in facing popular opinion is whether the money is spent where intended and whether it proves sufficient to address the severe damage the winter of 2016–17 and years of neglect have inflicted on the state's roads.

That said, the only truly visionary project that has Sacramento's support today is one originally authorized by



Source: Hoover Institution

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voters back in 2008: [Proposition 1A](#), which placed a \$9.95 billion down payment on a statewide high-speed rail. Although approved by the voters and championed by Governor Brown, however, this project has proven so expensive and technologically challenging that completing a key portion between Bakersfield and Los Angeles may not be possible as currently planned.

Yet if completed, the rail may meet California's greatest infrastructure need: fast, reliable transportation that could open regions of rural and semirural California to commuters now squeezed by soaring housing costs and mind-numbing commutes to job centers in metropolitan Los Angeles and the San Francisco Bay/Silicon Valley region.

The next most critical priority is to address the significant problems in transporting and providing enough water to a vastly expanded population and agriculture business.

California's [population grew](#) from 2.8 million to 37.3 million from 1910 to 2010, since the time when William Mulholland developed the first great systems for transporting water from the Owens Valley to Los Angeles. It is clear that, although many parts of the state did not go dry in the recently ended drought, the aging water infrastructure is both energy- and cost-inefficient for meeting many future water needs. One key way to address this need is to localize water storage by using large cisterns to capture and store rainwater—a technique successfully used for centuries in

other arid parts of the world—and improve recycling capacities. Both would reduce dependence in Southern California and the Central Valley on mountain reservoirs and canals in the north.

But before delving deeper into solutions, it is worth considering just how California got into this mess.

The elder Governor Brown envisioned a future in which economic growth would be driven by a network of state-of-the-art freeways to move people, reservoirs, and canals to capture and transport water and intellectual capital from low-cost institutions of higher education. He sold that vision to the public and, in doing so, as the late historian Kevin Starr wrote, putting California on "[the cutting edge of the American experiment.](#)"

Rising costs slowed growth before the elder Brown was finished. His son, who began his first two-term governorship nearly a decade later, in 1975, brought the antigrowth slogan "small is beautiful" to Sacramento. With it, any impetus to build his father's infrastructure came to a halt. The fact that further politicians failed to fund properly the necessary maintenance and less ambitious expansion of the capacity led to an ever-declining system that has resulted in the American Society of Civil Engineers [rating California's infrastructure a D+](#).

By the time Jerry Brown began his second two-term stint as governor earlier this decade, the state was recovering from the Great Recession and [facing a \\$15.7 billion budget deficit](#), a fiscal crisis that allowed Sacramento little room to consider the deterioration in the state's roads and bridges or the overcrowding in its universities. Earlier this year Brown projected [a \\$1.6 billion deficit for fiscal 2017](#), but that was before emergency repairs to prevent the collapse of the Oroville Dam forced lawmakers to think seriously about how to at least shore up the state's overstressed physical infrastructure.

Now that the attention of the governor and legislature are focused on infrastructure, what should they do?

Already facing a budget deficit, their options are limited. Brown has proposed funding the improvements through increases in fuel taxes and vehicle fees. One option is President Trump's stated desire to spend \$1 trillion on infrastructure needs. But so far the Republican president has shown little interest in helping one of the most solidly Democratic and vocally hostile states.

In March, Transportation Secretary Elaine Chao stopped the transfer of \$647 million in federal funds to help pay



Source: Hoover Institution

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for the San Francisco-South Bay Caltrain to switch from diesel to electric power, a move the system must make before a high-speed line can become reality (though **\$100 million** may eventually make its way to California). Chao's decision at the least threatens to delay the projected rail project.

The high-speed rail would do far more than transport cushy business travelers from the Bay Area to Los Angeles. It also would open up inland regions, with their lower costs of living, to commuters working in San Francisco, Silicon Valley, and Los Angeles.

In that regard, the single most important features of the line are the sections linking Los Angeles to Bakersfield in the southern San Joaquin Valley and Fresno to San Jose in the north. With its open spaces and lower living costs, the region could provide a welcome option for commuters trapped by Los Angeles and the Bay Area's clogged freeways and exorbitant housing costs. As envisioned, the rail would cut the trip from Bakersfield to Los Angeles in two to three hours in rush-hour traffic to about one. Orange County residents could travel from Anaheim to downtown Los Angeles, a trip that takes more than an hour, to about twenty minutes.

Another aspect of California infrastructure that doesn't get the attention it deserves is the use of large cisterns to augment traditional water supplies. Other countries encourage

their use: Bermuda and the US Virgin Islands both require rain-catching systems to be a part of new home construction. Australia, Germany, and Spain **offer incentives** to help pay for cistern installation, as do several US states including Arizona, New Mexico, and Texas.

More than a decade ago, the San Fernando Valley community of Sun Valley, frequently flooded by runoff from winter storms, **developed plans** for a drainage system that would divert the water to the Pacific Ocean by way of the Los Angeles River. Before construction began, city planners realized that they were about to waste a precious resource. Instead of diverting water to the river, they built massive underground cisterns beneath a city park.

Referring back to ancient Roman technology, they were capable of capturing 8,000 acre-feet of water, twice as much as the city's annual consumption. From the cisterns, the water is cleaned and then drains back into natural aquifers for future use. With the project, Sun Valley **solved the two nemeses that plague** the Los Angeles basin almost every year: a dearth of water in the summer and the brief, sometimes disastrous, deluge of storm runoff during the winter.

Once upon a time California invested generously and wisely in its infrastructure needs. A governor offered a vision the public embraced and used his political capital to make it happen. This legacy was built on the dreams of leaders such as William Mulholland: individuals who applied their engineering genius to mountainous challenges.

Now is the time when California's infrastructure needs are no longer a matter of building something amazing and new, but rather fixing the major issues we have now.

Voters have shown they are willing to tolerate additional tolls, fees, and taxes to fix infrastructure if the money is spent responsibly. It's up to the governor and legislature to do so.

Kevin Klowden is the executive director of the Milken Institute's California Center and a managing economist at the Institute. He has written on the role of transportation infrastructure in economic growth and job creation in reports such as "California's Highway Infrastructure: Traffic's Looming Cost" and "Jobs for America: Investments and Policies for Economic Growth and Competitiveness."



CALNOTES:



WILLIAM MULHOLLAND

Looking to credit—or blame—someone for today's Los Angeles? Start with William Mulholland, an Irish immigrant and self-taught engineer who led the construction of a 233-mile waterway from the High Sierra to the City of Angels over a century ago. Seen by some as a design challenge of a magnitude similar to the Panama Canal, which opened nine months later, in August 1914, the Los Angeles Aqueduct ushered in today's Southland of traffic jams, swimming pools, movie stars, and epic water wars (think Jack Nicholson in Chinatown). Mulholland's words to his fellow Californians on the completion of his great project? "There it is. Take it."

HIGH-SPEED RAIL'S FUTURE

For four years now Hoover's Golden State Poll has asked Californians to rank California's top government priorities. Each and every time, high-speed rail has finished at or near the bottom of some twenty policy options. A May survey conducted by J. Wallin Opinion Research backs that up. Only one in eight Californians wanted to keep money dedicated to high-speed rail; three-fourths would instead move it to schools or infrastructure. What is the future of high-speed rail in California? Not just finding billions in funding and staying on construction schedules but also doing a better job of selling the concept to its future ridership.

Driving Californians out of Their Cars: Painful, Inconvenient—and Perhaps Downright Undemocratic

By Loren Kaye

In a state whose locals are obsessed not only with curbing waste but trimming their waistlines, it should come as no surprise some lawmakers in Sacramento want to put California on a “road diet.”

Not to be confused with Atkins, South Beach, or Jenny Craig, a road diet basically implements [Yogi Berra's maxim](#) that “No one goes there nowadays, it's too crowded.” Another way to look at it is tough love. Halting road and highway expansion will create more congestion, which will convince drivers to seek out more efficient transportation options, such

as transit, carpools, or relocation near their jobs or schools (or out of state).

As is the trend in California public policy, the road diet was inspired by the state's consuming interest in reducing carbon emissions. Just last year, the legislature [adopted a goal](#) to reduce greenhouse gas (GHG) emissions by 40 percent below 2020 levels, which is in addition to an [earlier law](#) that capped 2020 emissions at 1990 levels.

The mildest expletive for that new goal is “ambitious.” Between 2020 and 2030, California must reduce GHG emissions by about 4 percent a year—double the pace of the last decade. This comes after having squeezed out the least costly energy efficiencies and increasing renewable electric power purchases to one-third the total portfolio, stopping import of coal-fired generation from out of state, and gaining the benefit of more-stringent national auto fuel economy standards.

California also initiated a first in the nation [cap-and-trade program](#) covering the state's four hundred largest carbon-emitting facilities, which include fossil fuel power plants as well as motor vehicle fuels.

Those were the easy steps. The decade beginning 2020 will bring much more stringent and expensive compliance requirements and lifestyle changes to California businesses and residents.

Planners and regulators devote their attention to the transportation sector because it makes up the [largest chunk](#) of GHG emissions. Key strategies include increasing fuel prices through the cap-and-trade market, mandating [less carbon-intensive fuels](#), and [subsidizing the purchase of electric vehicles](#). But [according to the California Air Resources Board](#), even more is required:

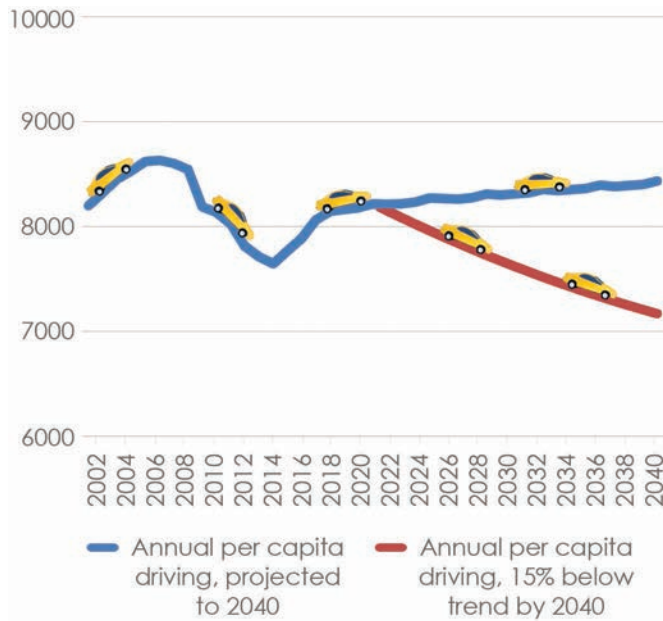
A reduction in the growth of VMT (vehicle miles traveled) is needed. VMT reductions are necessary to achieve the 2030 target and must be part of any strategy evaluated in this plan.

The bottom line, per the Air Board's draft regulatory goal, is a 15 percent reduction in total light-duty VMT by 2050. (Note that even though last year's legislation creates a 2030 goal, regulators use a 2050 benchmark for many of their regulations, using executive orders signed by Governor Jerry Brown and his predecessor, Arnold Schwarzenegger.)

To put the Air Board's dictum in perspective, this chart illustrates how a 15 percent reduction in passenger car and light truck vehicle travel would change driving behavior. (The illustration assumes the reduction starts in 2021 and continues through 2040.)



VMT PER CAPITA ON STATE HIGHWAYS



Source: California Road Charge Technical Advisory Committee
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The policy would require an absolute cut in per-capita mileage, meaning that on average California residents will need to figure out how to commute, get to school, and manage their daily lives while driving fewer miles. California businesses would need to figure out how to deliver more goods to a larger population during the next two decades, while projecting to add **another 6.5 million residents** and while driving fewer miles.

The Governor's **Office of Planning and Research (OPR)** has taken the road diet to another level: incorporating the principle into the state's most powerful land use tool, the California Environmental Quality Act (CEQA).

According to a **draft OPR regulation** that provides guidance in the interpretation of CEQA,

Reducing roadway capacity (i.e., a "road diet") will generally reduce VMT and therefore is presumed to cause a less than significant impact on transportation. Building new roadways, adding roadway capacity in congested areas, or adding roadway capacity to areas where congestion is expected in the future, typically induces additional vehicle travel.

Since additional VMT would be a "significant effect" under CEQA, agencies will need to mitigate those effects for these

CALNOTES:

CALIFORNIA'S LOVE AFFAIR WITH THE CAR



*If Detroit's the Motor City, then California would be the Motor State. In the first quarter of 2017, registrations for new cars sold in the Golden State exceeded 500,000—the twenty-second consecutive year-to-year increase in quarterly registrations. Each year the state's nearly 25 million registered automobiles account for nearly \$5 billion worth of registration and vehicle license fees dumped into Sacramento's coffers. Evidence that, even in no-fault divorce California, breaking up is hard to do? The average vehicle on California's roads is eleven years of age. Chalk it up to good weather, poor transportation alternatives, and a car-culture mentality but certainly not **cheap gasoline prices**.*

new projects, whether they are road capacity improvements, new housing developments, or job-creating commercial investments.

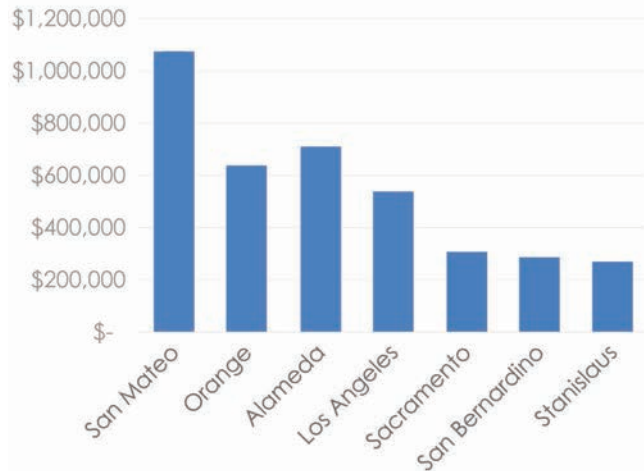
The short-term and intended effect of these policies will be to dissuade investment in projects that create more traffic or rely on expanded transportation infrastructure. But the long plan is to alter fundamentally California's land-use policy and priorities from a tradition of meeting housing demand with a diverse menu of housing choices and price points to a laser focus on creating dense, urban housing near transit hubs, without regard to affordability.

The **Air Board's plan** sets the terms of this new land-use regime. It proposes additional actions to be undertaken by state and local officials that would further discourage automobile trips:

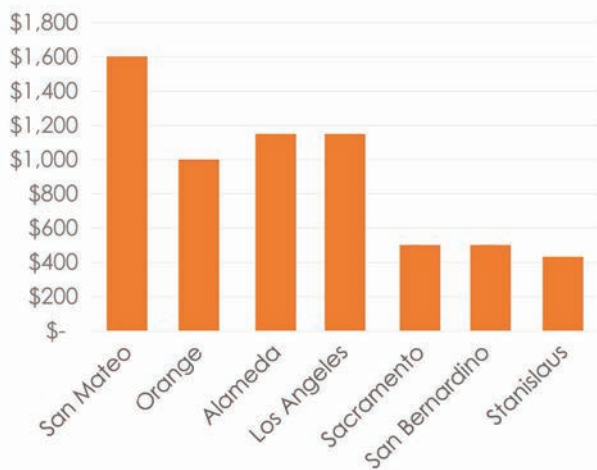
- Accelerating equitable and affordable transit-oriented and infill development through new and enhanced financing and policy incentives and mechanisms.
- Promoting stronger boundaries to suburban growth through enhanced support for sprawl containment mechanisms, including urban growth boundaries and transfer of development rights programs.
- Identifying performance criteria for transportation and other infrastructure investments, to ensure alignment with GHG reduction goals and other State policy priorities, and improve proximity, expanded access to transit, shared mobility, and active transportation choices.
- Promoting efficient development patterns that maximize protection of natural and working lands.

HOUSING COSTS: COASTAL AND INLAND COUNTIES

Housing Costs: Median Sales Price by County



Housing Costs: Median Rental Price by County



Source: Trulia

FACTS ON THE ISSUE

In principle, a greater emphasis on urban infill housing seems like a good idea. After all, reducing transportation burdens and conserving farmland or open space are important attributes.

But the natural consequence of directing development into urban areas and away from suburban or greenfield areas is to ratchet up even further the price of housing in the job centers. When the price of close-in housing inevitably rises, more workers will inevitably seek affordable housing further afield, thereby increasing commute times and cars on the road.

CALNOTES:

NOT THAT WE SAW IT COMING DOWN THE ROAD, BUT . . .



A year ago, our Hoover Golden State Poll asked Californians if they'd be willing to switch from a tax at the pump to a tax on miles driven. The results were that 53 percent said no to the idea. When told the gas tax is growing less effective as better fuel mileage means less revenue, voters remain dug in, even more so when privacy concerns over how the state would collect mileage data was added to the conversation. Where this leaves state lawmakers, now that they've raised California's gas tax for the first time in twenty-three years, from eighteen to thirty cents a gallon is, in auto sales nomenclature, trying to sell a new model while keeping last year's model in the showroom.

This chart shows the coastal/inland dichotomy on housing prices. Living and working in metropolitan areas (which also make up the bulk of the state's employment) is becoming less affordable as housing production falls further behind job creation and population growth.

Regulatory infill policy contains the seeds of its own destruction. When government creates scarcity, prices will rise. A housing policy that favors dense urban development and discourages regional housing solutions (urban limit lines, differential CEQA burdens on outlying projects, infrastructure improvements that favor infill development) will price out low- and middle-income Californians, who will seek more-affordable housing options further from the favored urban (and jobs) center. After all, an urban growth boundary creates an economic distinction, not a literal wall preventing commutes from outlying areas.

But don't take my word for it.

The nonpartisan California [legislative analyst found](#) a direct relationship between housing costs and commute times.

Our analysis found that many important factors have statistically significant effects on commute times. These include whether the commuter drives, walks, or takes public transit to work; the metro area's land size, population, and density; the metro's median income; and weather. After controlling for these factors—in essence isolating the effect of housing costs on commute times—a 10 percent increase in a metro's median rent is associated with a 4.5 percent increase in individual commute times.



Using US census data, [a transportation researcher](#) looking at the San Diego region found that

Housing costs have repelled many prospective migrants, and at the same time encouraged residents to relocate to Riverside County. Disproportionately, those leaving San Diego for Riverside are low-income people, not well-off homeowners chasing a bigger house . . . For the foreseeable future, people leaving the county for the Inland Empire will be facing long, unreliable, expensive commutes.

Perhaps most insidious is the antidemocratic nature of the road diet. Creating a new course of action under CEQA for increased miles driven will undermine new, voter-approved local transportation projects. Throughout the state [voters have agreed to increase their sales taxes](#) in return for specific improvements in local streets and highways.

Just last month [the legislature narrowly approved](#) the first fuel tax increase in decades, with promises to improve the

state transportation network. Whether these improvements can survive the Scylla of climate policy and the Charybdis of CEQA will be a momentous test of political will by California leaders.

After many years of mostly theoretical debate over the direction of California under ambitious climate change policies, real effects on ordinary Californians are now within sight. The road diet will be but the first of many new policies to constrain Californians' lifestyle. Will it reshape our society for the better or starve middle-class Californians of new housing?

Loren Kaye is president of the California Foundation for Commerce and Education, a think tank affiliated with the California Chamber of Commerce. He served in senior policy positions for both former California Governors Pete Wilson and George Deukmejian.



EUREKA

ABOUT THE PUBLICATION

Eureka was created to serve as an occasional discussion of the policy, political and economic issues confronting California. Like the Golden State motto from which this forum's title was borrowed, the goal here is one of discovery—identifying underlying problems and offering reasonable and common-sense reforms for America's great nation-state.

Ever since Archimedes supposedly first uttered the word, *eureka* has meant joy, satisfaction and a sense of accomplishment. Drawing on the combined wisdom of Hoover's policy experts and leading California thinkers, we hope that you'll find enlightenment in these pages. Hoover research fellow Bill Whalen, who has nearly two decades of experience in California politics and public policy, serves as this forum's editor.

For additional information and previous issues, visit www.hoover.org/eureka.

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EUREKA

CALIFORNIA'S POLICY, ECONOMICS, AND POLITICS

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