CALIFORNIA SENATE REPUBLICANS

May 22, 2023

Dear California,

Our Senate colleagues in the majority have released information regarding their “Protect Our Progress” budget plan. Their documents lay out the key values they intend to reflect as the budget process moves forward.

There is no doubt that the past decade has been an extraordinary one for California’s budget, which has seen state spending double in roughly six years up to 2022-23. However, while budget discussions often focus on how much is spent, the reality is that spending itself is not a metric of success. The more essential issue to examine is what that spending accomplished. Californians should be asking what actual results they can see in their lives as a result of state spending.

In this document, Senate Republicans present an overview of how California has performed recently in ways that represent the results seen by Californians, not just the spending headlines or lists of programs. When evaluating actual results on core issues like education, housing, jobs, and crime, the unfortunate reality is that California is not performing well, despite the dramatic growth in state spending over the past decade. This document addresses the following issues:

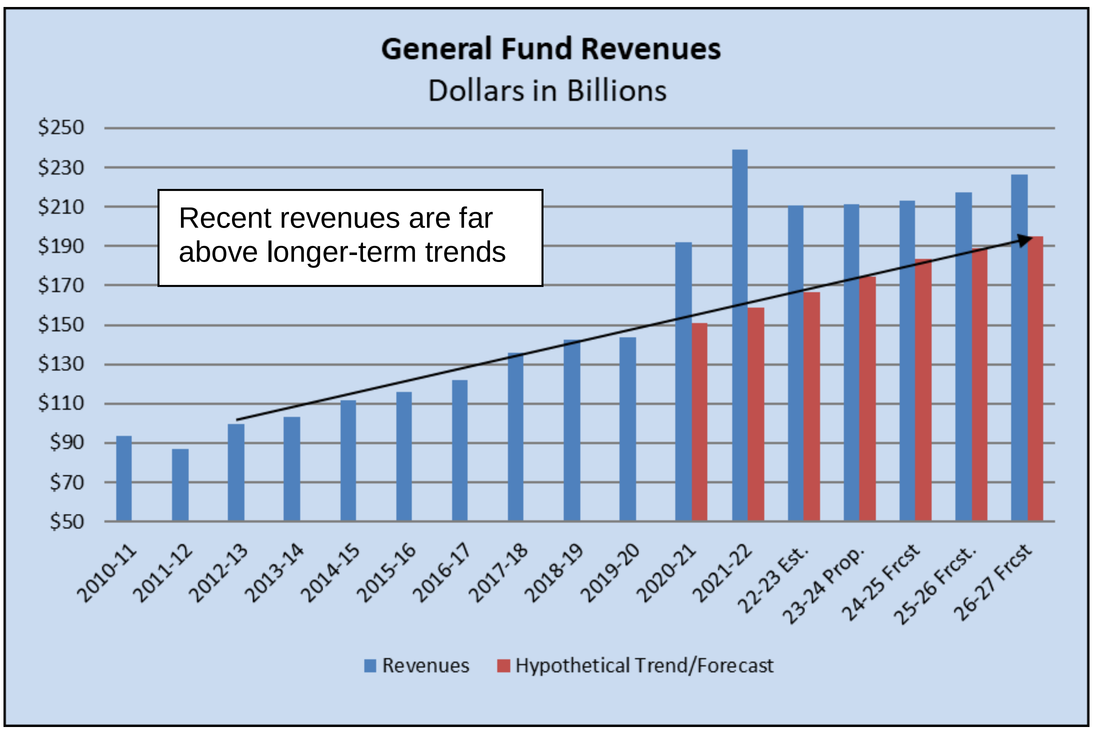
- **Overall Tax and Spending Growth.** State tax revenues and expenditures have both increased dramatically over the past decade and over the last several years in particular.
- **Budget Reserves.** California’s reserves have improved significantly since 2014, but as a share of the budget, reserves have actually declined in the past few years, despite the surpluses.
- **What About Results?** Measurements of actual outcomes are concerning in numerous areas that significantly affect Californians’ lives, including:
    - Education
    - Housing and homelessness
    - Jobs
    - Crime
- **What Has Been Left Out?** The state spending spree has neglected to address numerous challenges affecting Californians, such as the high cost of living, water infrastructure, and adequate forest management.

Overall Budget Grew Dramatically Over Past Decade

"Decade of Responsible Budgeting" Showed Little Spending Restraint. Senate Democrats are promoting a "Decade of Responsible Budgeting." In reality, California's budget reaped taxes from one of the most successful and profitable industries in history, the Silicon Valley tech industry, during a decade where it experienced supercharged growth.

At the same time, the majority party passed multiple tax increases through the legislature, such as the 2017 gas tax, or at the ballot box. In addition, unprecedented federal stimulus spending gave states a burst of fiscal adrenaline for three years. These factors combined to drive state tax revenues sky-high. With per capita spending more than doubling over the past decade, even after setting aside money for mandatory reserves, an objective observer may question if there was spending restraint.

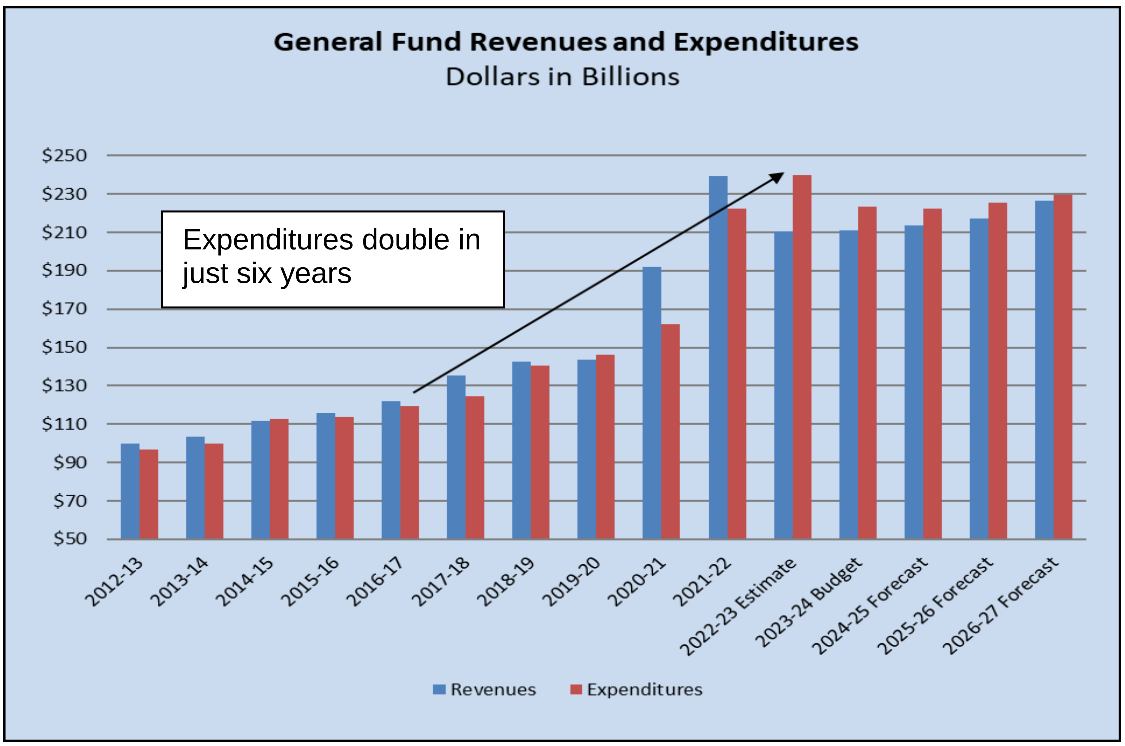
Revenues Spiked During Pandemic; Now at Risk of Falling Substantially. State revenues rose in rapid fashion from late 2020 to mid-2022, driven largely by federal pandemic spending and a dramatic rise in tech-driven state capital gains taxes. These factors helped turn initial expectations of a deficit in June 2020 to a dramatic increase in revenues and a surplus in 2020-21, as shown in the chart below. Now, the forecast from the Governor's January 2023 budget proposal shows a roughly 10 percent drop in revenue from 2021-22 but then a continued increase.



However, the trend in state tax revenues over the past decade paints an alarming picture of California's near-term future. Even following the Governor's downward revision to projections, General Fund revenues are still well above recent trends. Starting from 2012-13, the year that Democrats and their allies campaigned to pass a tax increase initiative on the ballot, General Fund revenue growth averaged 5.3 percent annually through 2019-20. If revenues merely return to that growth trend, before considering a broader recession, they would drop by a total of $77 billion over a two-year period compared to the Governor's budget. This shortfall would be far worse if an actual recession occurs.

The difference between the Governor's forecast and the trend over the past decade begs the question: Did anything fundamentally change in California's economy during the pandemic that would keep tax revenues at the higher level, or was the revenue surge more likely a result of the combination of federal stimulus spending, low interest rates, and California's capital gains structure? The latter explanation appears more plausible.

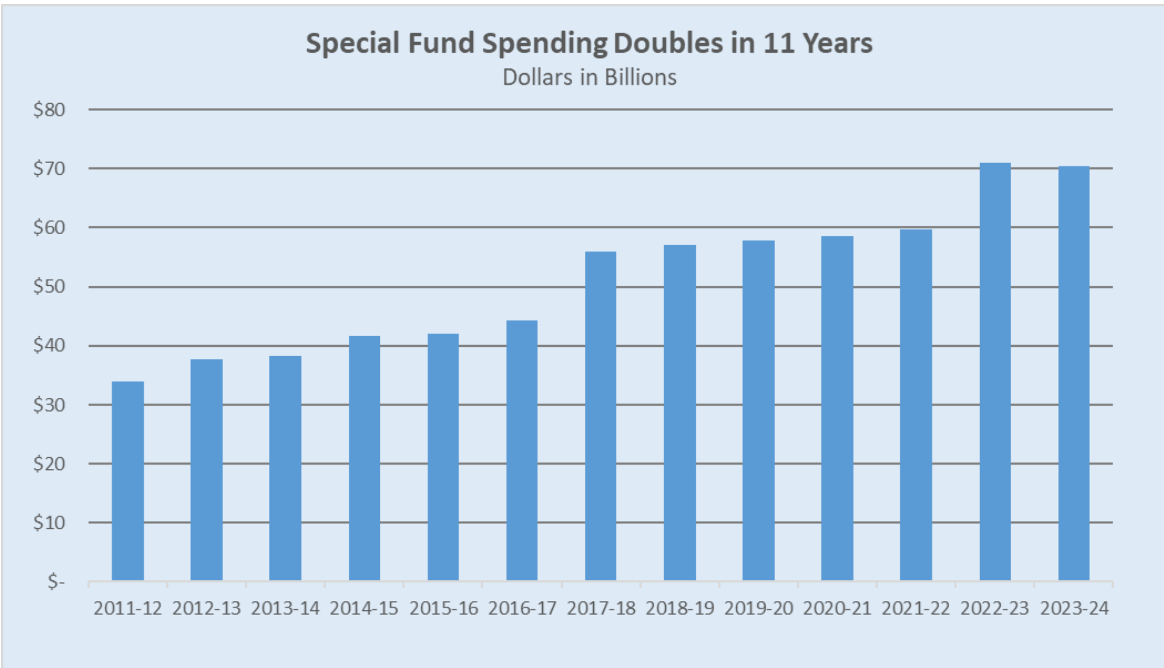
General Fund Spending Doubles in Six Years. Following the rapid rise in revenues, California's spending increase of 50 percent in 2021-22 far outpaced any other state: the average state spending increase was 18 percent, and the next fastest increase after California was Vermont at a "mere" 34 percent. Partly as a result of this one-year binge, state spending doubled in six years from 2016-17 to 2022-23, as illustrated in the chart below. This is an unprecedented increase—prior to 2016, it took 18 years to double spending. Looking back further at what Senate Democrats are calling their Decade of Responsible Budgeting, we see that state spending increased by 149 percent from 2012-13 to 2022-23.



The majority party enacted a budget for 2022-23 that was already projected to return the state to operating deficits, even if revenues continued to grow. Now, despite the Governor's proposed solutions for the deficit, expenditures would exceed revenues each year in the forecast, as seen in the chart above.

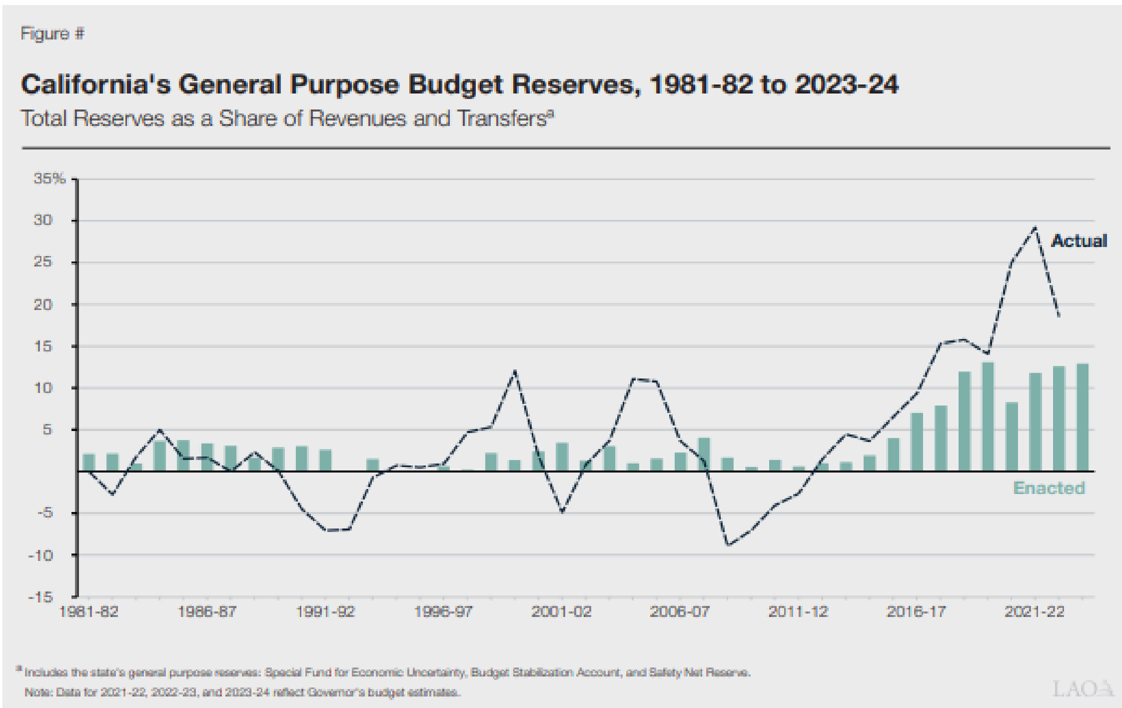
California Faces Deficit as Other States Enjoy Surpluses. With economic malaise stretching nationwide, one might think most states are now facing budget deficits. However, California's revenue decline and deficit stand in contrast with most other states: 33 other states reported that their revenues are exceeding original budget forecasts (out of 41 states that provided information), according to a recent Wall Street Journal article. Several of those states, including those with Democratic governors, have proposed tax cuts in their budgets. This illustrates that California's deficit results from imprudent budget choices, rather than national trends.

Special Funds Double in 11 Years. In addition to dramatic General Fund spending increases, the state also significantly expanded other taxes and spending in the past decade. As shown in the chart below, it took 11 years for Democrats to double spending from various special funds, which grew from $33 billion in 2011-12 to $70 billion in 2022-23. A key increase was the imposition of new gas taxes beginning in 2017, which caused special fund spending to jump by 26 percent in one year from 2016-17 to 2017-18.



Reserves Improved Through Bipartisan Initiative

Reserves Improve Through 2019 but Decline Since. Reserves began to improve annually following voters' 2014 enactment of Proposition 2, a bipartisan ballot measure. However, despite three straight years of surplus beginning in 2020-21, the reserves have declined as a percentage of revenues, as shown in the chart below, provided by the nonpartisan Legislative Analyst's Office (LAO). (Note that "Actual" reserves could be higher or lower than the "Enacted" levels if revenues prove to be higher or lower than predicted at the time of budget enactment.)

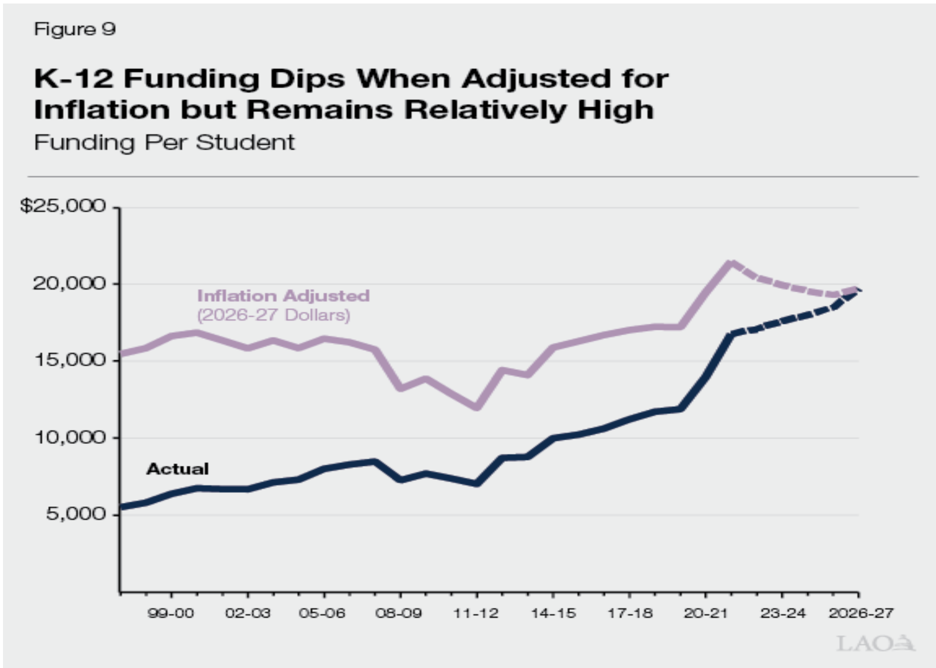


Imprudent Past Use of Reserves in 2020-21. There should be no need to withdraw money from reserves when the budget is in surplus, but that is what the Governor and legislative Democrats did in 2020-21, as shown by the dramatic drop that year in the chart above. After initially believing a massive deficit was imminent at the onset of the pandemic, the state soon realized a substantial surplus would appear instead. Nonetheless, the Governor and Democrats failed to reverse the initial withdrawal from reserves that reduced the Rainy Day Fund balance by $8.9 billion in 2020-21. The LAO advised against that approach of using reserves to fuel additional spending during a surplus. Now that the surpluses have predictably disappeared, it is clear that the state should have done more to increase reserves during the surplus years, or at the very least avoided drawing down reserves when spending was already increasing.

Note that the reserve graph included in the Senate Democrats' "Protect Our Progress" document (see page 10) offers an odd presentation of state reserves. Their graph simply provides raw reserve levels over four decades but does not account for the growth in the budget since 1985. The entire General Fund budget that year was $26 billion, compared to $240 billion in 2022-23, so obviously any reserves at that point would look small compared to today. Omitting this basic information from that chart exaggerates the degree to which reserves have grown recently compared to previous decades.

What About Results for Education?

K-12 Per-Student Spending Rose Significantly... As the overall budget has grown over the past decade, Proposition 98 has largely directed the increase in K-12 spending, as shown in this chart by the Legislative Analyst's Office.



Source: Legislative Analyst's Office

This increase in spending moved California up the state rankings for spending per student. California ranked 35 on that metric in 2011-12 but rose to 20th in 2019-20 (the latest available data from the National Center for Education Statistics).

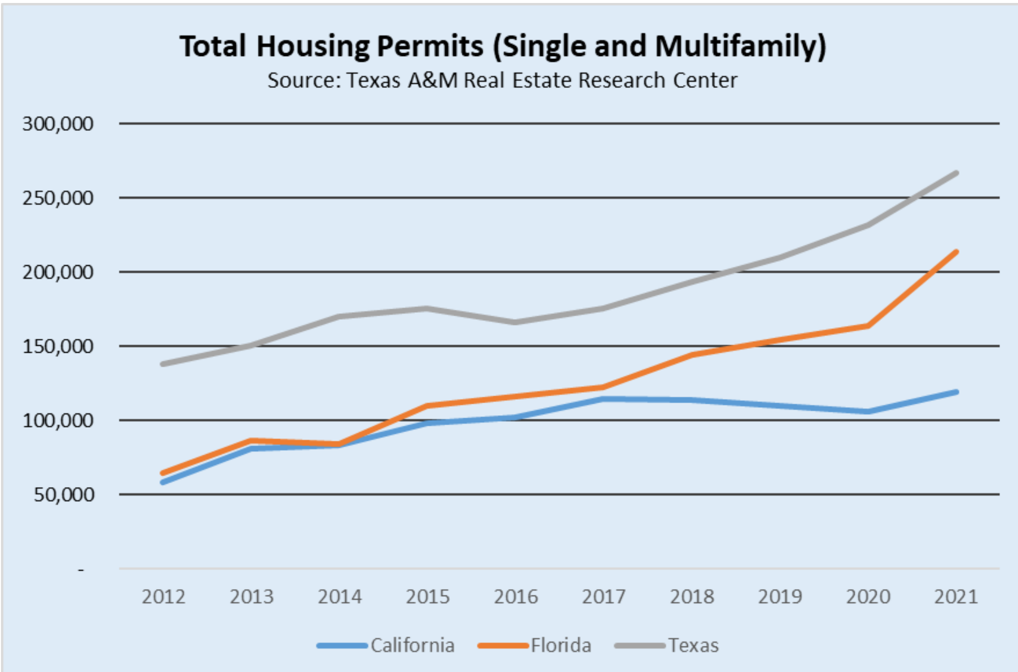
…But Student Performance Showed Mixed Results. Despite the increase in per-student spending, the results in student performance were mixed. As summarized in the table below, which compares 2011 with 2022, the percent of 4th and 8th graders who performed at or above the "Basic" or "Proficient" levels in Math decreased, despite the increased spending. Students performed slightly better against those standards in Reading, though the improvement was minimal for the Basic level.

California Student Performance and National Rank	Mathematics				Reading			
	Grade 4		Grade 8		Grade 4		Grade 8	
	2011	2022	2011	2022	2011	2022	2011	2022
Student Performance								
Percent of Students at or Above "Basic" Level	74	67	61	56	56	58	65	67
Percent of Students at or Above "Proficient" Level	34	30	25	23	25	31	24	30

Source: National Center for Education Statistics

What About Results for Housing and Homelessness?

State Continues to Lag on Homebuilding, Despite Spending Surge. The budget dramatically increased spending on housing subsidies over the past five years, reaching $11.2 billion (all fund sources) on various housing programs as of the 2022 Budget Act. Nonetheless, California continues its trend of failing to meet the goal of building 180,000 units of housing per year, which is an oft-cited benchmark for improving housing access. As illustrated in the chart below, California's housing permit numbers were virtually unchanged from 2017 to 2021. In contrast, the competitor states of Florida and Texas build dramatically more housing in raw numbers, despite having populations that are significantly smaller.



Throwing Money at a Broken System. Governor Newsom promised during his campaign to "lead the effort to build 3.5 million new homes by 2025." However, since 2018, California has built or permitted under 570,000 units in total, despite all its subsidies. Governor Newsom has since dramatically reduced his stated goal, which is now to build 2.5 million units by 2030. This raises the question of what is going wrong. While housing is affected by both local government and state policies, California's majority party has refused to reverse a variety of recent mandates and restrictions on homebuilding in California, such as prevailing wage requirements on affordable housing projects and solar mandates for all new home construction.

Homelessness Grows Despite Unprecedented Spending. California's population represents 12 percent of the nation's total, but California's homeless population of 171,521 represents nearly 30 percent of the nation's homeless (582.500) for 2022. Throwing money at the problem has not helped. Over five fiscal years (FY 2018-19 to FY 2022-23), California will spend more than $20 billion to try to solve homelessness. Over that same timeframe, California's homeless population increased by more than 24 percent – from 129,972 homeless in 2018 to 171,521 in 2022. Part of the issue is California's refusal to fund any anti-homeless program that doesn't use the "Housing First" approach, which suffers from a lack of accountability.

What About Results for Jobs?

Unemployment Remains Among Nation's Highest. While California's job total has increased since before the pandemic, its level of actual employment has not. Total employment in February, meaning the number of people actually working, was still 243,000 jobs (1.3 percent) below the pre-pandemic peak.[1] (The difference between jobs and employment is in the number of unfilled jobs.) Despite these higher job vacancies, California had the 8th highest unemployment rate among the states as of February 2023.[2]

Poor Results Despite Major Spending. The poor jobs and employment results described above occurred in spite of the state attempting to spend its way into a jobs recovery. The budget approved a long list of grants and workforce training programs in the past two budget years, totaling in the hundreds of millions of General Fund dollars each of those years, often without significant discussion of how the new spending fit into existing programs or how it might be duplicative.

The nonpartisan Legislative Analyst's Office, writing about the $5.2 billion proposed for a laundry list of workforce proposals for the 2021-22 budget, raised the following concerns:[3]

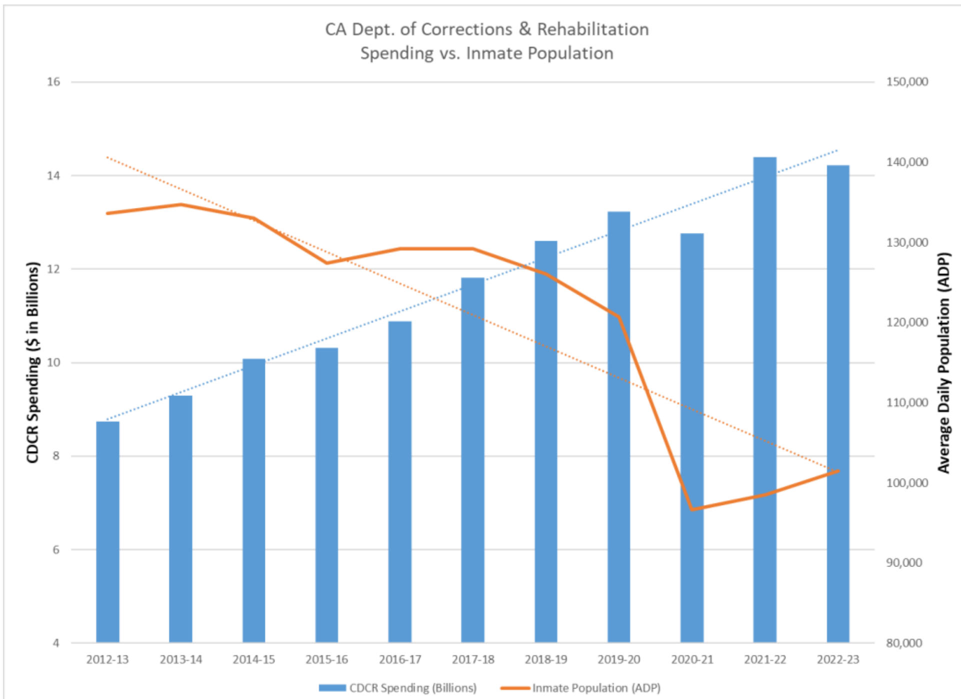
- Most proposals have notable weaknesses, such as a definition of the workforce problem the administration is trying to address, the number of persons intended to be served, and how the program would be structured.
- Many proposals are new and so large that agencies likely lack the capacity to administer them in a timely way.
- Many proposals lack a clearly defined role for industry to provide input on its workforce needs or leave out other key workforce stakeholders (such as local workforce boards).
- Many proposals lack performance measures and reporting or evaluation requirements to help monitor whether objectives are being met.
- No Overarching Plan or Clear Set of Goals. The administration has not set forth how its myriad individual proposals are intended to interact with each other to meet overarching state objectives both in the near and long term.
- Several new initiatives duplicate or significantly overlap with other existing programs and funding streams.

Unfortunately, the majority party enacted most of these proposals without addressing the LAO's concerns, and the money ostensibly intended to promote jobs and employment apparently had little effect.

[1] Ibid.
[2] California Center for Jobs, February 2023 Jobs Report
[3] The 2021-22 May Revision—Overview and Analysis of Workforce Development Proposals (ca.gov)

What About Results for Crime?

Prison Spending Grew While Inmate Population Declined. Spending increased on the Department of Corrections and Rehabilitation by $6.2 billion, or 72 percent, in the decade leading up to 2022-23, even though the number of inmates declined by about 38,000 (28 percent) in that time, as shown in the chart below. The increased spending occurred despite the state shifting some responsibilities and funds to counties in the 2011 Realignment.



Results Showed Little to No Improvement. Such an increase might be justified if the additional spending reduced reconviction commensurately. However, California scarcely moved the needle on that front. The three-year reconviction rate for the cohort of inmates released in 2008-09 was 49 percent, compared to 48 percent for the 2016-17 release cohort and 45 percent for 2017-18 (the most recent data).

Crime Moving in the Wrong Direction. More alarming than spending per inmate is the question of how the safety of California communities has changed recently. Unfortunately, crime trends in this state are in an alarming place compared to the rest of the country. According to the latest data from the Federal Bureau of Investigation (FBI), compared to the rest of the country in 2020, California had:

1) 66 percent more robberies per person.
2) 21 percent more burglaries per person.
3) Nearly twice as many motor vehicles stolen per person (93 percent higher).
4) Nearly 13 percent higher violent crime.
5) Nearly 11 percent higher property crime.

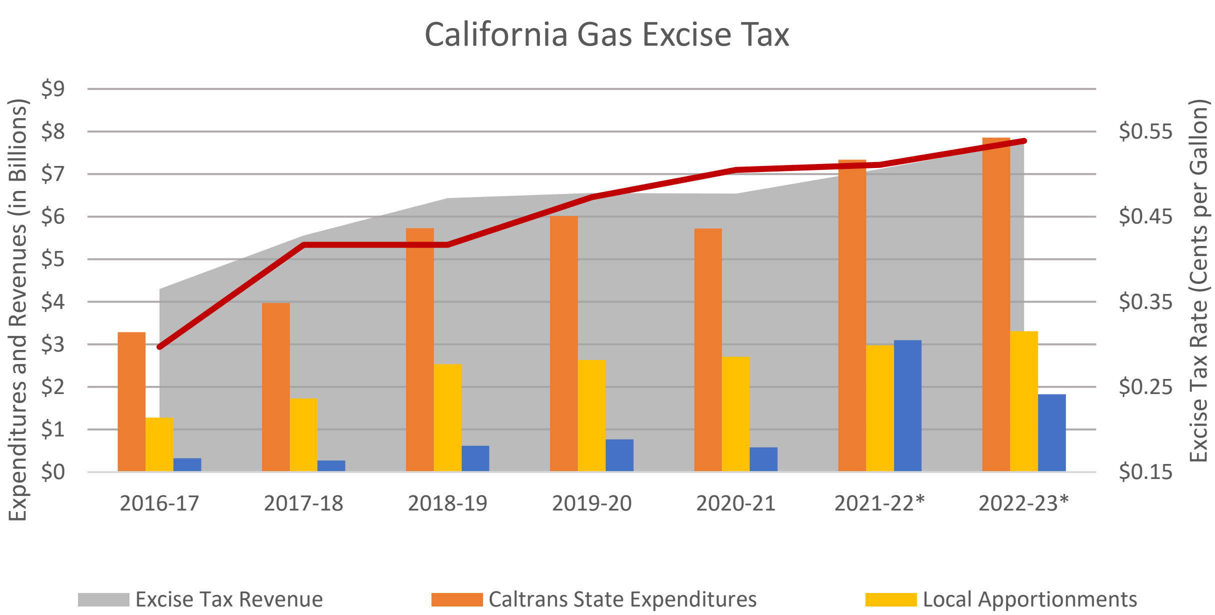
Although California's murder rate in 2020 was about 16 percent lower than the rest of the country, it still surged by almost 31 percent compared to 2019.

What About Results for Other Issues?

Increased Dependence on Government Healthcare. Medi-Cal, once a health safety net program for specific vulnerable populations is now on pace to be the means of healthcare coverage for a projected 15.5 million California residents by 2024, an amazing 40 percent of the state's population. This enrollment is up from 22 percent of the population in 2012. And what was once a $56 billion total program in 2010 ($18.5 billion of General Fund) is now a whopping $132 billion program ($35 billion in General Fund).

Democrats added to the caseload by slowly expanding Medi-Cal eligibility to the low-income undocumented population, one age cohort at a time, beginning in 2016. The 2022 health trailer bill added the last phase of the expansion in 2024 for roughly 700,000 undocumented adults ages 26 through 49. This expansion would make Medi-Cal an entitlement for any low-income undocumented individual who can claim a California residence. When fully implemented, the state will spend more than $5 billion in General Fund annually on Medi-Cal for an estimated 1.2 million undocumented enrollees.

Gas Taxes Driving Up the Cost of Living. In the spring of 2017, Democrats claimed a gas tax increase was needed to provide an extra $5 billion per year to fix the roads. Since that time, though General Fund revenues have increased by $89 billion. This makes it clear no tax was needed, but rather a reprioritization of tax money already flowing to Sacramento. Nonetheless, SB 1increased gas taxes by 24.2 cents per gallon over the past five years, bringing the total gas tax to 53.9 cents per gallon today. The graph below displays increased gas excise taxes, corresponding revenues, and state and local spending. Additionally, SB 1 also added a Transportation Improvement Fee on all vehicles registered in California. This fee ranges from $56 to $196 per vehicle, based on vehicle value. In summary, as compared to amounts prior to SB 1 implementation, the 2022-23 budget estimates gas excise tax revenue is 80 percent higher, spending by the California Department of Transportation (Caltrans) is 168 percent higher, and the local share of transportation tax revenues is 160 percent higher.



*Revenue and expenditure amounts for these years are estimates.

High-Speed Rail. In 2008, California voters approved the Safe, Reliable, High-Speed Passenger Train Bond Act (Proposition 1A), authorizing the issuance of $9.95 billion in bonds for the project, to be supplemented with other private and public investment. The 2022-23 budget appropriated the remaining voter-approved bond funds for the high-speed rail project.

Since voters approved Proposition 1A, the estimated project cost has ballooned from $34 billion to $113 billion. Voters were also told the full system, including extensions to Sacramento and San Diego, would be operational in 2030. Instead, current timelines assume operations from San Francisco to Los Angeles (Phase I) will begin in 2033. This timeline is extremely speculative and likely unrealistic.

The Phase I costs and 2033 completion date can only be realized if more money is sent to the project faster. With the current flow of money to the project, cost escalation outpaces progress, and there will never be enough money to actually build it.

In addition to the bond funds, the project receives 25 percent of revenues generated from the state's cap and trade auctions, estimated to be between $500 million to $750 million annually. This Cap and Trade money would be better spent on forest health and fire prevention projects, which actually reduce greenhouse gas (GHG) emissions. Assuming the zero-emission vehicle goals established by the Governor become reality, by the time the high-speed rail train is fully operational, people will be parking their electric cars to ride an electric train. There is no GHG reduction when electricity is swapped for electricity.

State Employee Count Grows Far Faster Than the Population. Over the decade from 2012-13 to 2022-23, the number of state employees increased by about 81,000, a 23 percent jump, even though the state population increased by only 2.6 percent over the same period. The employee increase occurred even after the state shifted some human services and incarceration duties to counties in the 2011 Realignment, which should have slowed the growth in employees somewhat. State government now has the highest number of employees per capita for the past fifty years. (Data before 1970 is not available.) After many Californians waited on the phone for hours for the Employment Development Department to pick up, it is doubtful that many Californians feel like the services they receive have improved.

What Has Been Left Out?

Despite the state doubling its General Fund spending in six years, Democrats neglected to address major well-known challenges facing the state. Looking at what has been missed is as important as what has been enacted.

Mental Health Infrastructure. An increase in mental health and substance use treatment capacity was the key component of a budget request letter that legislative Republicans sent to Governor Newsom in early 2022. While the 2022-23 budget did include some expenditures in this area, it fell far short of the Republican proposal to use $10 billion of the projected surplus to permanently end the psychiatric treatment bed deficit in California. According to a 2022 study conducted by the RAND Corporation, California has a deficit of 4,767 acute and subacute inpatient psychiatric treatment beds. If we add lower acuity treatment beds in community residential facilities to the total, the estimated deficit is 7,730.

The 2022-23 budget included just $1.7 billion for county behavioral health departments and non-profit community partners to construct, acquire, or rehabilitate properties in order to increase mental health treatment bed capacity and another $1 billion for counties to provide tiny homes and other short-term shelters for those individuals with serious mental illnesses. Given the budget surplus in 2022, this was a missed opportunity to fully address the needs of tens of thousands of mentally ill homeless individuals living on California's streets. With the surplus in the rearview mirror, Governor Newsom just proposed bond funds to build what could have been addressed with the surplus.

A Sustainable Medi-Cal Program. While Democrats have dramatically expanded Medi-Cal enrollment, they have largely ignored the need to pay health care providers enough to ensure Medi-Cal enrollees actually can find doctors and to keep hospitals in business. Madera Community Hospital closed in January, and others around the state that serve a significant number of Medi-Cal patients are at serious risk of closing. The California Hospital Association has called for $1.5 billion in Medi-Cal rate increases to keep doors open, arguing that "Dozens of California hospitals — many of which serve high numbers of Medi-Cal patients — are at great risk due to the fact that California pays just 74 cents for every dollar it costs to provide care to Medi-Cal patients."

Unemployment Insurance Debt Reduction. During the height of the pandemic, California borrowed roughly $20 billion in federal unemployment insurance loans, and the outstanding debt still totals $18.6 billion as of March 2023. Despite three successive surpluses, California's leadership did virtually nothing to pay down this debt. The enacted 2022-23 budget included a meager $250 million towards paying down the balance, and now California is one of only four states that still has not paid off its debt. In the absence of state action, employers must pay the principal on the debt through an increase in unemployment taxes, beginning with a $21 per employee increase in 2023 and continued annual increases until the debt principal is paid. The state is liable for the interest payments and General Fund costs for the interest are projected to be up to $630 million in 2023.

Timely Forest Management. In the past few years, Democrats belatedly began directing funds toward better forest management, though forestry experts have called for better management for decades. California has reached a goal with the federal government — which owns most of the state's forested land — to treat a million acres annually by 2025. That entails setting and monitoring low-intensity small fires, building and extending fuel breaks, and clearing rights-of-way. However, in the 2021-22 fiscal year, the state conducted only about 600 fuel-reduction projects across 101,000 acres. An additional 21,000 acres was scheduled to be cleared in 2022. These results are far short of what is needed to make up for decades of neglect and to help prevent more devastating wildfires.

The state could use Cap & Trade funds for forest management and remain consistent with the environmental goals of the Cap & Trade program. Wildfires produce enough greenhouse gas emissions to offset many years' worth of reductions elsewhere. However, Democrats still allow the doomed High-Speed Rail project to siphon off hundreds of millions of Cap & Trade dollars each year.

Adequate Water Infrastructure. Nine years after Californians approved bond funds to build water storage, not a shovel has been turned toward building Sites Reservoir. Senate Republicans called for funding Sites and other water conveyance projects with surplus funds in prior years, but Democrats ignored these requests. Now, as historic precipitation offers the potential to prepare for the inevitable return of droughts in the future, California has taken insufficient steps to increase storage.

Historic Employment Development Department Debacle. With the surge of unemployment insurance claims that began at the onset of the pandemic, flaws in the Employment Development Department were thrust into the spotlight. The media has reported widely on the potentially $30 billion in fraudulent claims that EDD paid out, while legitimate applicants were forced to navigate a nightmare of non-responsiveness from the department. The system's deficiencies had been pointed out following the Great Recession in 2009, but somehow the Democrats took no steps to fix the problems during their Decade of Responsible Budgeting.

Judicial Workload Problem Persists. The need for additional judgeships to meet caseload demands in trial courts throughout the state has been well documented and ongoing since 2001. The last legislation to establish new judgeships was AB 159 (Jones, 2007), which established a total of 50. Those positions remained unfilled and unallocated to specific courts due to a lack of funding until the Budget Act of 2018 funded the first two. The 2019 Budget Act subsequently funded 25 more. The 2022 Budget Act funded the remaining 23 judgeships that were established fifteen years prior. Even after these positions are filled, however, there will still be a need for 98 additional judgeships to address existing trial court workload. The need is particularly acute in the Central Valley and Inland Empire, where the Counties of Kern, Riverside, and San Bernardino account for 63 of the 98 new judgeships needed. There is currently no plan to address this workload need, even though providing access to the justice system is a basic function of government.

State Debts Remain Despite Surplus. Despite the recent surpluses, the state did little beyond the constitutional minimum to pay down debts and liabilities. In addition to the Unemployment Insurance debt described above, recent budgets:

- Failed to retire $1.4 billion in special fund borrowing from previous years, instead paying only $608 million in 2022-23. As pointed out by the LAO, the state's failure to pay these deficit loans back means that the budget continues to borrow in order to pay for current spending.
- Failed to address unpaid local mandate claims dating back over a decade, which the California League of Cities recently noted totals over $1 billion.
- Failed to take discretionary steps to reduce $157 billion in state pension and retiree health liabilities. Instead, the Governor claimed he fulfilled the constitutional requirement to pay some debts under the Proposition 2 rules.

Now the Governor has proposed new borrowing of $850 million to help address the deficit and $1.7 billion in bonds to pay for infrastructure projects previously planned for cash funding.

As pointed out, Senate Republicans believe we can do better. We pledge to work with the Governor and our Legislative colleagues to address high priorities and achieve positive and measurable results.