Planning for a Better Future

CALIFORNIA 2025

2013 UPDATE

Budget

Climate Change

Corrections

Economy

Education

Health Care

Housing

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Workforce

The Public Policy Institute of California is dedicated to informing and improving public policy in California through independent, objective, nonpartisan research.

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CALIFORNIA BUDGET

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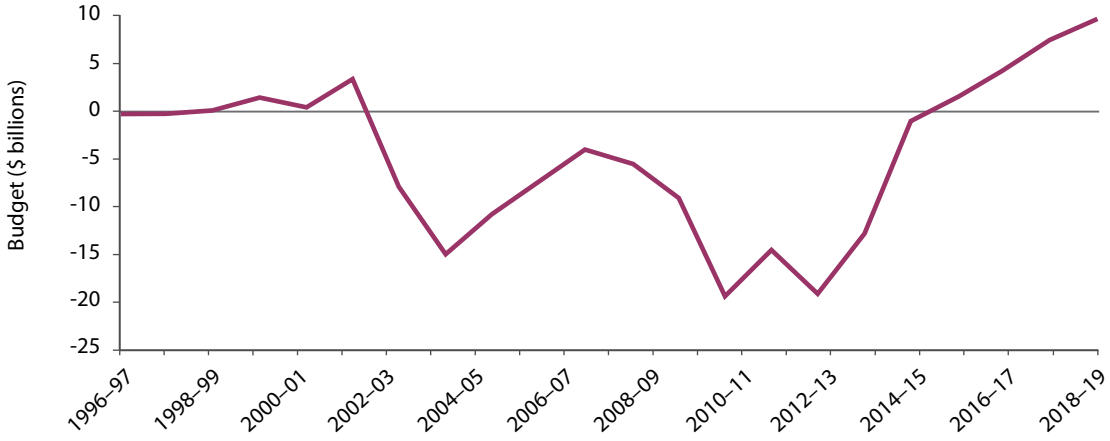
CALIFORNIA'S BUDGET PICTURE BRIGHTENS, ALTHOUGH CHALLENGES REMAIN

After a decade of budget deficits, California's fiscal situation improved significantly in 2012. The passage of Proposition 30 in the November 2012 election temporarily increased sales and income taxes, providing $6 billion a year to the state budget for several years. Voter approval of Proposition 39 raised corporation taxes primarily for out-of-state businesses, adding another $1 billion annually in revenues. These new revenues and the state's budget actions improve the immediate budget outlook, and the improving economy allows for a rosier long-term budget forecast.

But California still faces fiscal challenges. The state's budget problems were exacerbated by the Great Recession, which hit the state hard. In 2009, state tax revenues plummeted 14 percent from the previous year, compared to 9 percent nationally. This dramatic drop widened the gaps between revenues and expenditures—gaps the state had been wrestling since 2000. The legislature responded with an array of actions including temporary tax increases, fee increases, funding shifts, and budget cuts—all at a time of increased demand for Medi-Cal and other public assistance programs. This has left the state with significant liabilities that will need to be addressed in the future, including budgetary debt, debt service obligations, and unfunded retirement costs. Recent PPIC Statewide Surveys show voters closely divided about whether to raise taxes and increase government services or cut spending and reduce service levels.

BUDGET SURPLUS PROJECTED TO BEGIN IN 2014–15



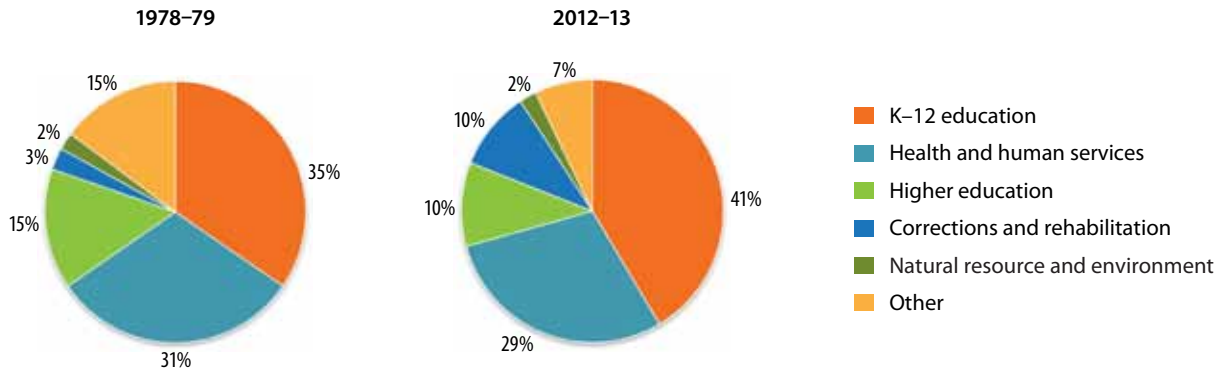
SOURCE: Legislative Analyst Office's Fiscal Outlook projections at the start of each budget cycle and estimates through FY 2017–18.
NOTES: Figure does not show budget solutions to close the gap in past years. For example, in November 2011 the LAO estimated a $12.8 billion budget gap for fiscal year 2012–13. The 2012–13 Budget Act and Proposition 30 mostly closed this. The LAO now estimates that unless corrective action is taken, the state will close 2012–13 with a $943 million deficit because spending is higher and tax receipts are lower than projected in the enacted budget.

HOW DOES THE STATE MANAGE ITS MONEY?

California spends more than the average state, and it collects more in revenues. It is also distinct in the way it raises revenues, relying more on income and sales taxes and less on property taxes.

- **California's state government is a more than $200 billion enterprise.**
  In the fiscal year ending June 30, 2012, the state spent $213 billion, of which $87 billion came from the state's main discretionary fund, the General Fund. Another $78 billion came from federal funds. Special funds supplied $35 billion, and $13 billion came from bond funds. The vast majority of General Fund spending is in three areas: K–12 and higher education (more than 50 percent), health and social services (about 30 percent), and corrections (10 percent).

EDUCATION HAS LONG DOMINATED GENERAL FUND SPENDING

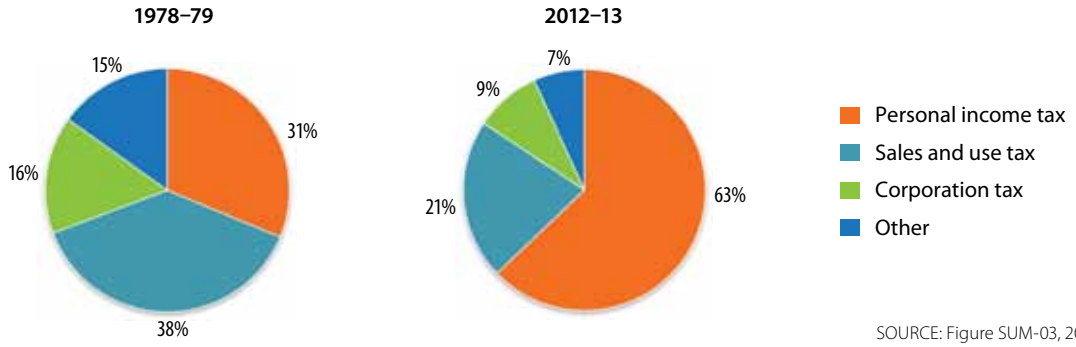


SOURCE: California Department of Finance, Chart C and 2012–13 enacted budget summary chart 4.
NOTES: Figure includes only General Fund expenditures. "Other" includes business, transportation, and housing; tax relief; state consumer services; and other expenditures.

- **California's tax burden is above average.**
  Even before voters passed Proposition 30, California had the highest state sales tax of any state and the third-highest marginal personal income tax rate, according to the Tax Policy Center (only Oregon and Hawaii tax income at a higher rate). Thanks to Proposition 13, California's statewide property tax rate is low, though home prices are higher in California than in other states. In fiscal year 2009–10, the latest year for which comprehensive data are available, California's state and local governments collected $252 billion, or $6,752 per capita, from taxes, fees, charges, and other miscellaneous sources. By this measure, California had the 11th-highest tax burden in the nation. However, as a high-income state, California has a large tax base. When state and local general revenues are expressed as share of economic activity or personal income, California's ranking edges down to 15th nationally.

- **Revenue volatility is an issue in California.**
  Tax experts have repeatedly urged California to flatten and simplify its revenue system by broadening tax bases, lowering tax rates, and eliminating certain tax preferences. California's revenue system is highly dependent on personal income taxes (including taxes on capital gains), corporate taxes, and sales and use taxes. The income tax is volatile because it relies heavily on a narrow slice of taxpayers whose earnings tend to fluctuate with the economy (in 2009, 15 percent of tax filers—those with incomes above $100,000—paid 80 percent of this tax). Sales and use taxes are also tied to economic fluctuations—these revenues plunged during the recession. Moreover, the passage of Proposition 13 left California less reliant on a relatively stable revenue source, the property tax.

CALIFORNIA'S REVENUE SOURCES HAVE CHANGED OVER TIME



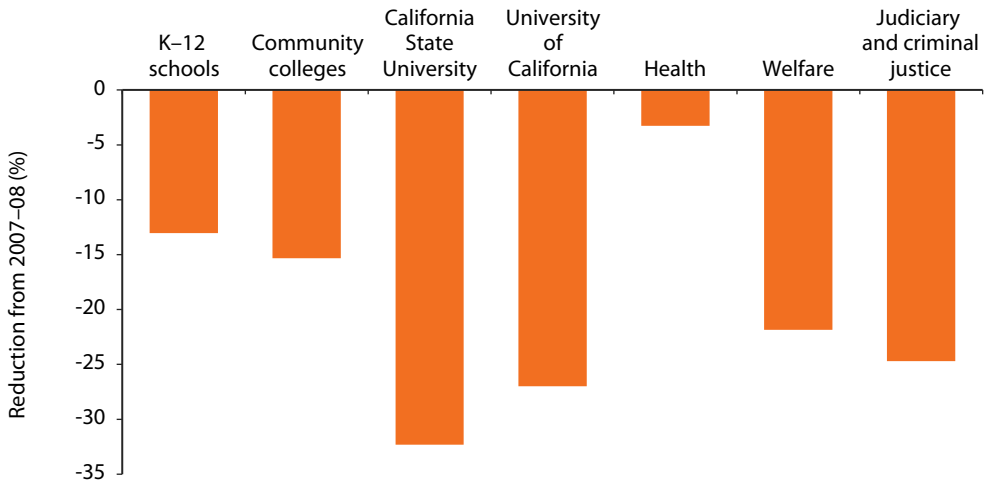
SOURCE: Figure SUM-03, 2012–13 Enacted Budget.
NOTE: Figure includes only General Fund revenues.

LOOKING AHEAD

Although the budget picture is brightening, balancing the budget remains a significant short-run challenge. According to the Legislative Analyst's Office, the state will have a $1.9 billion gap between expenditures and revenues for the budget year that begins in July 2013. This gap is much smaller than in the past, but the immediate focus is likely to remain on spending reductions, not budget increases. Over the longer run, if projected surpluses materialize, the state can restore some of the cuts made during the recession and address the long-term liabilities that have accumulated over the past decade.

Restoring past budget cuts. As the economy improves, the pressure to restore funding to programs that have seen years of budget reductions will likely be intense. Overall, General Fund spending fell 7 percent from 2007–08 to 2012–13. Some funding cuts have been replaced by revenue from other sources—for instance, a portion of the cuts to the state's colleges and universities was offset by higher tuition charges. But most programs are smaller now than they were before the recession, and the pent up desire to address unmet needs is significant.

MOST PROGRAMS HAVE EXPERIENCED MAJOR GENERAL FUND CUTS SINCE 2007–08



SOURCE: The 2012–13 Budget: California Spending Plan, Legislative Analyst's Office, September 2012. California Spending Plan 2009–10, November 2009.
NOTE: Change is calculated as the difference between the 2012–13 Budget Act and actual 2007–08 spending levels.

Pension funds and OPEBs. The state and many local governments pay monthly pensions to their retirees. In addition, retired public employees often receive health, dental, and other benefits collectively known as "other post-employment benefits" or OPEBs. Longer life expectancies and rising health care costs have made OPEBs and pensions a ballooning cost for state and local governments throughout the nation. California has an estimated $62 billion unfunded OPEB liability. In addition, the state's unfunded pension liabilities have been estimated at $181 billion; they may be higher, depending on the modeling assumptions (including the choice of a discount rate). Governor Brown signed a pension reform package in 2012 that reduces the state's liabilities by about $10 billion.

Outstanding debt. Over the past decade the state closed most of its budget gaps through temporary measures such as payment deferrals, bonds, and loans from special funds. This has created an outstanding budgetary debt of $35 billion. In addition, the state borrowed $10 billion from the federal government to cover unemployment benefits and must restore $10 billion to K–12 education after making cuts during the recession. Finally, the state is responsible for about $5 billion in annual capital and interest costs on $81 billion in general obligation and lease revenue bonds for infrastructure and long-term investments.

Tax reform. Tax reform has been on the policy agenda in Sacramento for several years. Voter approval of Proposition 39, which fixed a loophole in the corporate income tax law, suggests voters are willing to consider some revisions to the system. One proposal is to extend the sales tax to areas such as services. PPIC Statewide Surveys indicate that a majority of Californians oppose taxing services. Our surveys also show that while most Californians support Proposition 13's restraints on the residential property tax, they would support a "split roll" tax, which would raise commercial property taxes.

Budgeting for volatility. Californians may also want to consider ways to budget for peaks and troughs in revenues, which appear to be a fact of life in the state. The PPIC Statewide Survey finds that most Californians favor using some of the future budget surplus to build a "rainy day" fund that would protect the state from revenue volatility. Improvements to budget forecasting could also help to orient voters and lawmakers to future needs. In particular, the state could expand the forecasting period from four or five years to ten years and make projections more transparent, highlighting the tough choices needed to maintain voter priorities.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

California's State Budget
PPIC Statewide Survey: Californians and Their Government
California's Debt: What Does It Pay For?
Consumption Tax Options for California

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CALIFORNIA CLIMATE CHANGE

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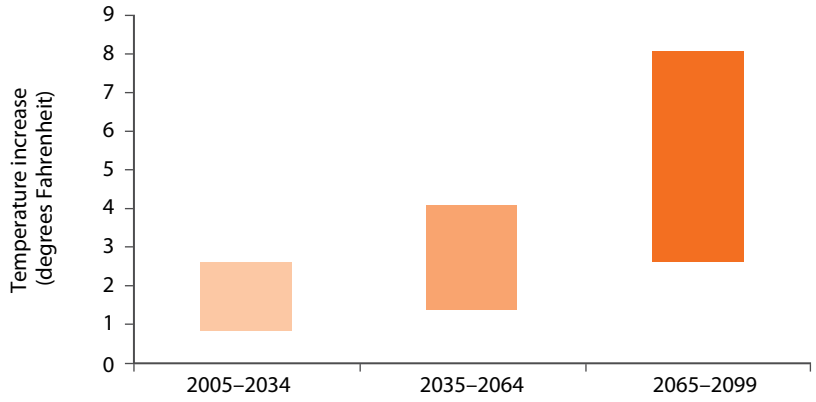
CLIMATE CHANGE THREATENS CALIFORNIA'S FUTURE

Increases in global emissions of greenhouse gases (GHGs) are leading to higher air and water temperatures as well as rising sea levels, with serious consequences for California. Air temperatures are projected to increase throughout the state over the coming century. Sea level is expected to rise 17 to 66 inches by 2100, and the frequency of extreme events such as heat waves, wildfires, floods, and droughts is expected to increase. Higher temperatures will result in more rain and less snow, diminishing the reserves of water in the Sierra Nevada snowpack. Even if all GHG emissions ceased today, some of these developments would be unavoidable because the climate system changes slowly.

AIR TEMPERATURES ARE PROJECTED TO RISE IN CALIFORNIA, ESPECIALLY UNDER HIGH EMISSIONS SCENARIOS



SOURCE: D. R. Cayan, A. L. Luers, et al., "Overview of the California Climate Change Scenarios Project," *Climatic Change* 87 (2008): S1–S6.
NOTE: Projected temperature increase relative to 1961–1990.

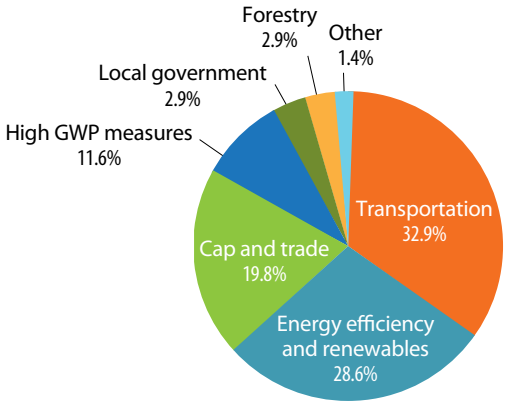
In the face of these threats, California has taken the lead in global efforts to reduce emissions. Assembly Bill (AB) 32, the Global Warming Solutions Act of 2006, requires the state to reduce greenhouse gas emissions to 1990 levels by 2020; this would result in emissions roughly one-third less than what would be expected under "business as usual." An executive order calls for emissions to be reduced to 80 percent below 1990 levels by 2050. Reductions of this magnitude are needed on a global scale to stabilize the earth's climate. California now faces a twofold policy challenge: finding the least expensive ways to reduce emissions and preparing for the climate changes that are expected even if emissions are successfully reduced.

California is not alone in tackling this global issue. But its actions are crucial because they set an example for other states, regions, and parts of the world. The state must continue to forge new strategies, even though the nature and timing of climate change are uncertain and global efforts to reduce emissions may or may not be successful.

CALIFORNIA IS USING A MULTI-FACETED APPROACH TO REDUCE EMISSIONS

The California Air Resources Board (CARB) is responsible for implementing the Global Warming Solutions Act. In late 2008, CARB adopted a Scoping Plan that outlines the programs designed to reach the 2020 target. Because this is the first comprehensive plan of its kind within the United States (and one of the first such plans internationally), many are looking to California as a model.

ENERGY AND TRANSPORTATION ARE THE LARGEST COMPONENTS OF THE SCOPING PLAN



SOURCE: CARB, "Climate Change Scoping Plan: A Framework for Change" (2008).
NOTE: GWP = global warming potential; gases with high GWP include refrigerants and solvents.

- **New standards for passenger vehicles are key.**
  California adopted the first-ever greenhouse gas emission standards for passenger vehicles in 2004. These standards, which began to apply in the 2009 model year, will reduce emissions from new passenger vehicles by approximately 30 percent by 2016. The federal government has set national standards that match California's.

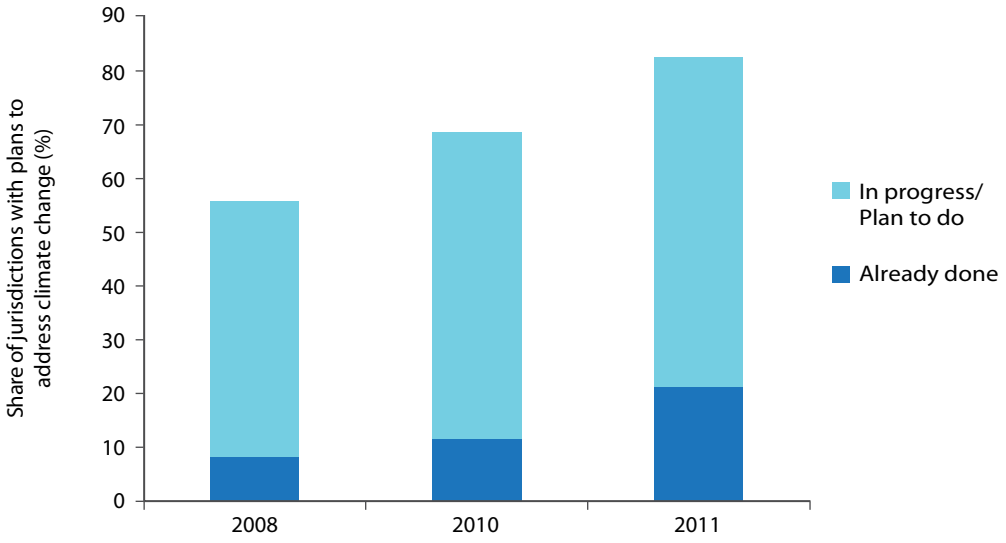
- **So are ambitious renewable energy goals.**
  California's Renewable Portfolio Standard, established in 2002 and expanded in 2006 and 2011, sets one of the nation's most ambitious targets for expanding renewable energy. The program now requires utilities to provide 33 percent of total procurement from renewable energy resources by 2020. Although certain storage, distribution, and financing challenges remain, the state is projected to meet this target three years ahead of schedule.

- **A statewide cap-and-trade program has been adopted.**
  California adopted the first GHG cap-and-trade program in the nation in 2011. Under this program, firms that would need to spend a lot to reduce emissions will be allowed to trade emission reduction credits with firms that can reduce emissions at lower cost. The auctions—successfully launched in late 2012—initially cover electric utilities and large industrial emitters, and will eventually cover 85 percent of the state's GHG emissions. Talks are underway to link the program with Quebec's cap-and-trade program, and other western states and Canadian provinces in the Western Climate Initiative expect to join in the future.

- **California has also adopted other pathbreaking strategies.**
  Adopted in 2008, Senate Bill (SB) 375 aims to reduce emissions by integrating investments in land use and transportation to reduce driving. This bill provides incentives to achieve these reductions by easing environmental review requirements for qualifying projects. In September 2010, CARB adopted regional per capita GHG emission reduction targets from passenger vehicles for 2020 and 2035. Reduction targets for the four largest regions range from 13 to 16 percent, relative to 2005 levels, by 2035. By late 2012, Southern California, Sacramento, and San Diego had plans in place to meet these reduction targets, and the Bay Area's plan will be adopted in 2013. The 15 smaller regions covered by the bill face lower targets, and their plans are expected to be in place by 2014.

- **California's local governments are also addressing climate change.**
  Roughly 80 percent of California's cities and counties are developing plans and programs to address climate change. In many instances, these measures are also being promoted as ways to reduce energy costs and work toward broader sustainability goals. Opinion polls also suggest continued public support for meeting the state's climate goals, even in difficult economic times.

GROWING NUMBERS OF LOCAL GOVERNMENTS ARE ADDRESSING CLIMATE CHANGE



SOURCES: 2008 data from Hanak et al., "Climate Policy at the Local Level: A Survey of California's Cities and Counties" (PPIC, 2008) (sample size 309); 2010 data from Bedsworth, Hanak, and Stryjewski, "Views from the Street: Linking Transportation and Land Use" (PPIC, 2011) (sample size 347); 2011 data from Office of Planning and Research, "Annual Planning Survey Results 2012" (OPR, 2012) (sample size 451). The 2008 survey refers to climate action plans; the 2010 survey refers to climate action plans or similar plans that address climate change; and the 2011 survey refers to policies and/or programs to address climate change and/or reduce greenhouse gas emissions.

CALIFORNIANS' SUPPORT FOR THE STATE'S CLIMATE POLICIES IS STRONG

	% Favor (all adults)
Global Warming Solutions Act of 2006	71
Emission standards for new passenger vehicles	78
Increasing the use of renewable energy	77
Requiring local governments to change land-use patterns so people drive less	77
Requiring an increase in energy efficiency for residential and commercial buildings and appliances	77
Requiring industrial plants, oil refineries, and commercial facilities to reduce emissions	82
Cap and trade	53*

SOURCE: Baldassare et al., *PPIC Statewide Survey: Californians and the Environment* (July 2012).
* For cap and trade, an unusually large share of respondents (11%) replied "don't know."

CALIFORNIA NEEDS TO PREPARE FOR THE EFFECTS OF CLIMATE CHANGE

California is well ahead of other states in developing information on the effects of climate change, but much work must be done to prepare for these effects.

- **The effects of climate change are already being seen around the state.**
  Spring runoff from snowpack is occurring earlier now than it did in the first part of the 20th century. Some plant and animal species normally found in the southern part of the state have been observed in more northern locations.

- **Sea level rise threatens coastal infrastructure, homes, and habitat.**
  A 2012 National Research Council study projected that sea levels in California south of Cape Mendocino will rise by 17 to 66 inches by 2100. The Pacific Institute found that near the higher end of this range (55 inches), 1,750 and 1,800 miles of highways and roads along the ocean coastline and San Francisco Bay, respectively, are at risk of inundation. Coastal armoring (e.g., sea walls or breakwaters) can help protect infrastructure and homes along the coast, but these are expensive remedies and would eliminate some recreational and ecological uses of the coastline.

- **Water management faces challenges.**
  The diminishing mountain snowpack reduces water storage and increases the risk of Central Valley flooding. Rainfall variability is also expected to increase, leading to more frequent droughts and floods. In addition, sea level rise threatens fragile Delta levees, which are important for the state's water supply.

SEA LEVEL RISE

THREATENS THE BAY AREA

- Inundation with 16-inch sea level rise
- Inundation with 55-inch sea level rise

SOURCES: Map from San Francisco Bay Conservation and Development Commission; inundation data from Noah Knowles, "Potential Inundation Due to Rising Sea Levels in the San Francisco Bay Region" (California Climate Change Center, 2009).

NOTE: The map illustrates the potential inundation with 16 inches and 55 inches of sea level rise, toward the upper end of the range expected by 2050 and 2100, respectively.

- **Public health will be at risk.**
  An increase in extreme events—heat waves, wildfires, and floods—will pose challenges to public health and the state's emergency preparedness agencies and health care infrastructure. Case in point: A prolonged heat wave in 2006 resulted in more than 140 confirmed deaths and a significant increase in emergency room visits and hospitalizations.

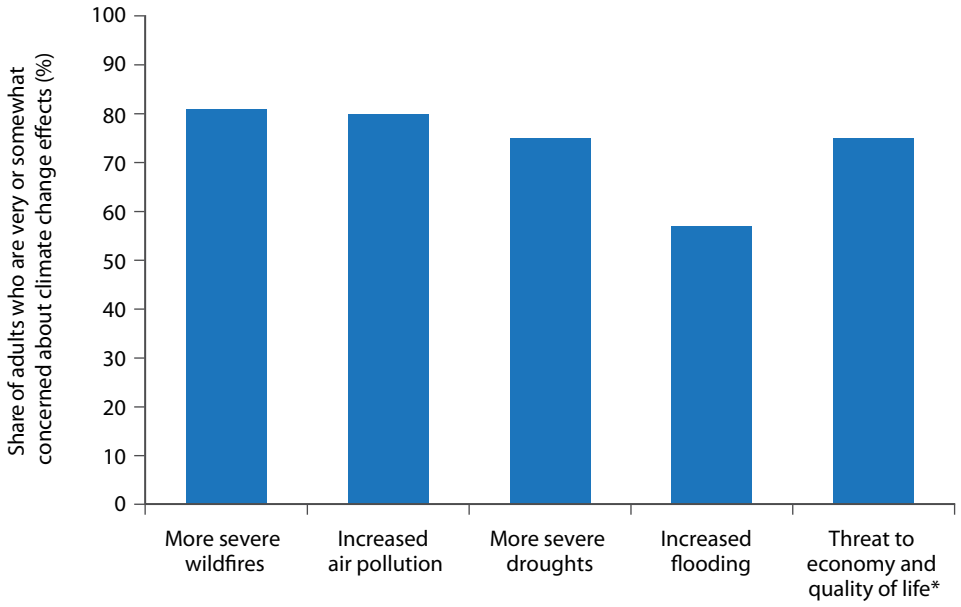
- **Air quality will worsen.**
  The San Joaquin Valley and the Los Angeles area already have some of the worst air quality in the nation. Increasing temperatures and other effects of climate change will worsen air quality, likely requiring additional pollution controls to attain state and federal air quality standards.

- **Biodiversity is under threat.**
  Climate change places an additional burden on many of the state's plants and animals. As temperatures rise, many species will need to migrate to more hospitable areas. Current development patterns could hinder this movement and threaten extinction for some species.

- **Readiness to cope is variable.**
  Water and electric utilities have begun to consider climate change in their long-range planning and have tools available to develop adaptation strategies. The Natural Resources Agency has developed a statewide adaptation strategy (to be updated in early 2013), and some regions are taking the lead in thinking about adaptation (e.g., San Diego and the Bay Area). But in areas such as ecosystem management and flood control, the institutional and legal frameworks are ill-equipped to handle the changes.

- **New tools may help local governments prepare for climate change effects.**
  In 2010, only a quarter of local governments had begun efforts to reduce their vulnerability to climate change (according to the Governor's Office of Planning and Research). Two new state-supported tools may help them prepare. The online tool Cal-Adapt allows users to identify potential climate impacts in specific geographic regions. Knowledge of these risks can help localities begin to determine and plan for their own vulnerabilities. Another online source, the California Climate Adaptation Policy Guide, provides an overview of climate impacts and vulnerabilities by geographic region, along with adaptive measures that are within the jurisdiction of local governments.

CALIFORNIANS ARE CONCERNED ABOUT THE EFFECTS OF CLIMATE CHANGE



SOURCE: Baldassare et al., *PPIC Statewide Survey: Californians and the Environment* (July 2011 and July 2012). *For threats to the economy and quality of life, the results are from July 2012 and the figure shows the share of adults who think the problem is somewhat or very serious.

LOOKING AHEAD

To lessen the impact of climate change on California, emission reductions will be needed on a global scale; large reductions will be needed soon to avoid the most severe effects. Even with these reductions, the state needs to prepare for some inevitable effects of climate change.

- **Develop an integrated climate change policy.**
  An integrated climate change policy that includes efforts to reduce emissions and plans to prepare for climate change will ensure that mitigation and adaptation policies are complementary.

- **Achieve near-term greenhouse gas emission reductions.**
  Actions taken today will affect the concentration of greenhouse gases in the atmosphere several decades from now. Therefore, near-term emission reductions are needed to work toward future climate stabilization.

- **Undertake some "no regrets" measures now.**
  In some areas, accounting for future climate changes in current planning will head off unacceptably high costs. For example, considering climate change in today's land-use planning decisions could facilitate species' migration as the climate changes. And limiting development in areas at increasing risk of flooding will avoid future costs.

- **Tap into local enthusiasm for undertaking climate action.**
  Local governments' experience and learning will be especially important in meeting the greenhouse gas emission reduction targets set under SB 375, the state's transportation and land-use law.
- **Continue to develop information to reduce policy uncertainties.**
  Better information is needed to assess progress toward meeting emission reduction goals and the cost-effectiveness of policy options. More detailed assessments of local climate effects will help pinpoint vulnerabilities and develop priorities for adaptation.
- **Continue to play a leadership role.**
  California has long been a leader on environmental policy, and climate change is no exception. This leadership is important in encouraging other governments to address climate change. Without global cooperation to reduce emissions, California's economy and society may face severe consequences.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

Driving Change: Reducing Vehicle Miles Traveled in California
Climate Change Challenges: Vehicle Emissions and Public Health in California
Preparing California for a Changing Climate
PPIC Statewide Survey: Californians and the Environment
Climate Policy at the Local Level: A Survey of California's Cities and Counties

Contact a PPIC expert:
Ellen Hanak

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CALIFORNIA CORRECTIONS

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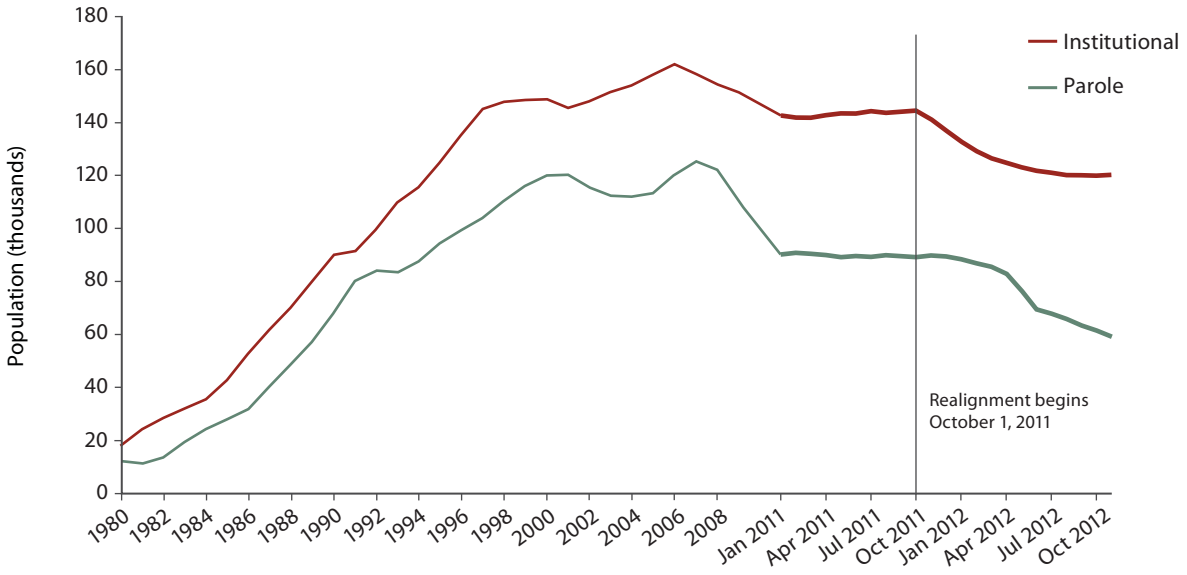
CALIFORNIA IS PURSUING HISTORIC CHANGES TO ITS ADULT CORRECTIONS SYSTEM

The past 30 years have seen dramatic changes in California's prison system. Between 1980 and 2006, the adult prison population increased more than sevenfold. The number of prisons also increased, from 12 to 33 during that time, but crowding worsened, and cost became an issue. Spending on corrections rose from 2.9 percent of the state's general fund in the 1980 fiscal year to 10.5 percent in fiscal year 2010. Felony crime rates dropped by 52 percent between 1980 and 2010, fueling debate about whether mass incarceration has been an effective remedy or a costly response to a now-diminished problem.

A lawsuit filed in 2001 citing the state's "grossly inadequate" provision of prisoner health care prompted a May 2011 U.S. Supreme Court decision that gave the California Department of Corrections and Rehabilitation (CDCR) two years to reduce its institutional population to 137.5 percent of design capacity—equivalent to a reduction by some 33,000 prisoners. Assembly Bill (AB) 109, signed that spring by Governor Brown, shifted responsibility for many non-serious, non-violent, and non-sexual offenders to county jail and probation systems. As of October 1, 2011, many felons who would have gone to state prison are now incarcerated in counties or given alternative sanctions. And many parolees from the state system will now be supervised by the counties. This unprecedented policy shift—known as "realignment"—will have a substantial impact at the state, county, and community level.

CALIFORNIA'S INSTITUTIONAL AND PAROLE POPULATIONS PEAKED IN THE LAST DECADE



SOURCE: CDCR annual data from 1980–2010 and monthly data from 2011–2012.
NOTES: "Institutional" refers to the population housed in the 33 adult institutions within California; it does not include inmates in fire camps, private facilities, or facilities out of the state. Institutional populations for 1985 and 1986 are imputed.

THE STATE PRISON AND PAROLE POPULATIONS ARE DECREASING—AND CHANGING

- **Realignment has reduced the state prison population.**
  By the end of October 2012, the institutional population had declined from 144,500 to 120,200—a 17 percent decrease in the first full year of realignment. This left the institutional population at 147 percent of design capacity—more than 10,000 inmates over the 137.5 percent target. Another 8,503 inmates were housed in private prison facilities in Arizona, Mississippi, and Oklahoma; this total has not changed significantly in the past three years.

- **Violent offenders are a growing majority of the prison population.**
  The number of violent offenders in state prisons has been climbing steadily for the past 20 years. Their proportion of the whole has increased as the numbers of other types of offenders have stagnated or dropped off. As realignment has begun to send nonviolent felony offenders to county jurisdiction instead of to state prison, the mid-year share of violent criminals has risen (from 59 percent in 2011 to 68 percent in 2012).

- **As the parole population declines, the proportion of serious, violent, and sexual offenders on parole is increasing.**
  By the end of October 2012, the parole population had declined from 89,200 to 59,300—a 34 percent decrease in the first year of realignment. As counties take responsibility for less serious offenders, the composition of state parole now has a greater proportion of serious, violent, and sexual offenders. On June 30, 2011, parolees with a serious or violent current or prior offense made up 46 percent of the parole population; a year later they constituted 60 percent.

COUNTIES FACE NEW RESPONSIBILITIES

How well prepared are the counties—each with a unique set of corrections resources, attitudes toward incarceration, and public safety realities—to take on their new tasks?

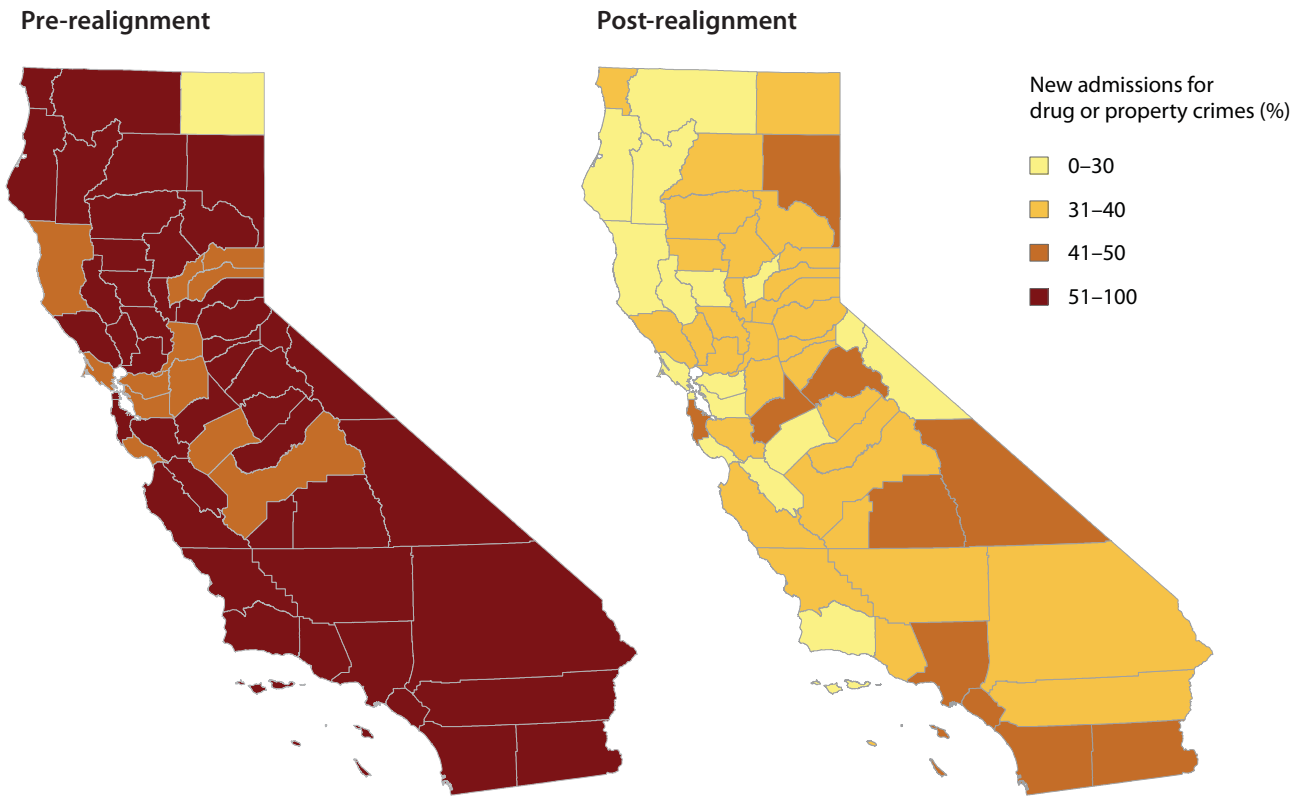
- **Some counties are focusing on alternatives to incarceration …**
  Since many counties will not be inclined, or able, to incarcerate all of the additional offenders, some jurisdictions are putting resources into alternative sanctions. For parole and probation violators, return to state prison is no longer an option, so counties will rely on jail terms or alternatives such as "flash incarceration" (sending violators to jail for a few days at a time), drug abuse treatment, work release, education, and community-based residential programs.

- **… while others are augmenting their jail capacity.**
  AB 900, passed in 2007, provided funding for jail construction, and 20 counties have received a total of $1.2 billion. Calaveras, Madera, and San Bernardino Counties began adding capacity in 2011; San Diego and Solano Counties began construction in 2012. Other counties—including some, like San Francisco and Contra Costa, that have been focused on alternatives to incarceration for some time—are addressing anticipated capacity needs by reopening closed facilities.

- **The funding formula has changed to accommodate counties' disparate experiences.**
  The projected realignment population of prisoners and probationers figured heavily in the first-year formula the state used to allocate funds to each county. Officials in counties that have been pursuing alternatives to incarceration for some time objected that they were being penalized for pioneering the kind of "evidence-based" alternatives to prison that the state is now encouraging. Officials of smaller counties and counties at jail capacity also argued they were being shortchanged, so the second- and third-year rules provide counties some flexibility to choose their allocation formula among several options.

- **Counties have differing jail capacities …**
  All counties in California except Alpine County have their own jail facilities. The smallest capacity is in Sierra County, which has one jail built to hold 14 inmates, and the largest is in Los Angeles, with multiple facilities for a total of 13,688 inmates. In all, the state's 58 counties have a jail capacity of around 76,000.

FEWER DRUG AND PROPERTY OFFENDERS ARE GOING TO STATE PRISON



SOURCE: New Felony Admissions and Parole Violators with a New Term, CDCR, 2010–2012.

- **… and differing jail populations.**
  In September of 2011, the state's county jails had an average daily population of about 72,000. In the 12 months before realignment was implemented, 14 counties maintained average daily populations in their jails that exceeded their capacities, and 32 counties released inmates because of a lack of capacity. As of November 2012, 18 counties were operating under court-imposed or self-imposed caps limiting the number of inmates in their jails. Counties that consistently run their jails under capacity often rent out space to state or federal corrections agencies, so the number of available jail beds at the county level is difficult to estimate. In the nine months following realignment, the average daily population in the state's county jails increased to about 78,000.

REALIGNMENT'S IMPACT IS UNCERTAIN

- **Will crime go up?**
  There has been much speculation and some anecdotal evidence that crime has gone or will go up as a result of realignment. The intent of realignment is to decrease reliance on custodial sanctions, so a larger share of the supervised population will be in the community rather than incarcerated in jail or prison. However, it may be that an emphasis on rehabilitation will ultimately reduce crime. Gathering sufficient evidence to isolate the effects of this new policy on crime rates will take some time.

- **Recidivism of state parolees will probably decline, but will this be an improvement?**
  Before realignment, close to two-thirds of offenders in California were returned to prison within three years of being released on parole. A minority were convicted of a new crime; typically, 65 to 75 percent were sent back to prison by the state parole board for criminal and noncriminal administrative violations of parole. Under realignment, parole and probation violators will serve their revocations in county jail or be subject to alternative sanctions. This will lower the rate at which offenders are returned to California prisons, but unless parole is more successful at the county level, there may be no change in arrest rates. Offenders remaining under state parole supervision are also likely to show decreases in recidivism, as serious, violent, and sexual offenders historically have lower rates of arrests than other kinds of offenders.

- **Will overcrowding worsen at the county level?**
  If overcrowding at the state level is simply being passed along to county jails, which are typically less suited for long-term stays, the average prisoner's conditions of confinement and prospects for rehabilitation will not improve.

- **Will health care delivery improve?**
  CDCR officials are optimistic about the prospects for improving health care as the prison population decreases. However, in September 2012, a federal judge again rejected the state's request to end the federal receivership that has controlled the prison health care system since 2006. At the county level, officials are relying on existing local systems of health care delivery, which frequently experience serious resource constraints. However, federal support for county-based Low Income Health Programs currently provides health care access for this population, and the expansion of the Medi-Cal program through the Affordable Care Act should offer many low-income probationers access to comprehensive health care starting in 2014.

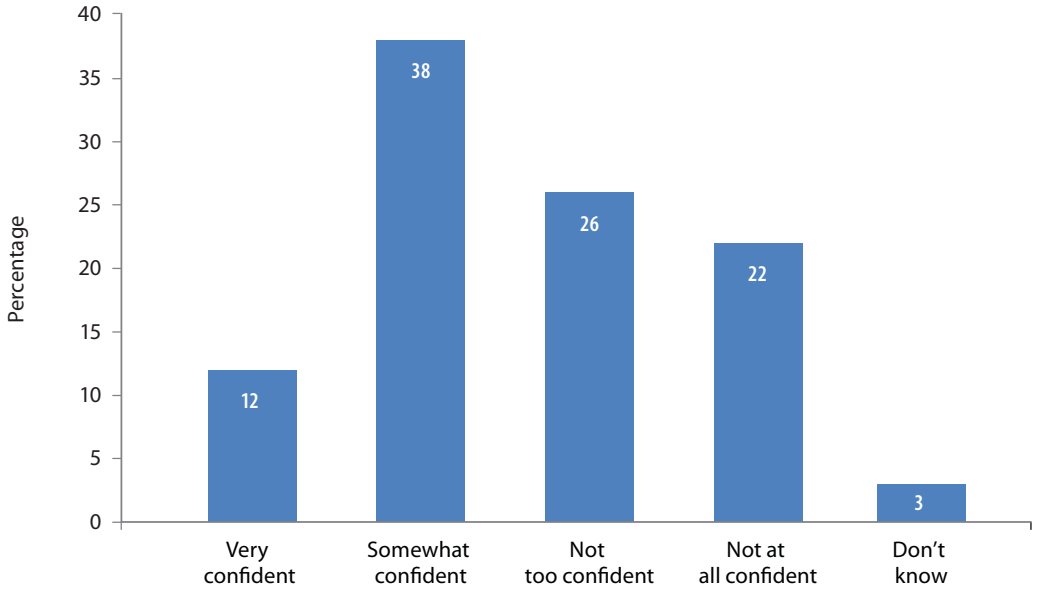
- **Will prosecution and sentencing change?**
  County officials may be responding to the incentives introduced by realignment by altering their approach to prosecution and sentencing. In marginal cases, district attorneys may opt for more serious charges (known as "up-charging") in hopes of sending offenders to prison instead of county jail. Similarly, prosecutors may decide to charge rearrested parolees with new crimes rather than allow them to be handled as administrative violations of parole. These approaches might increase prison commitment rates over time. Alternatively, judges may opt for lighter sentences or split sentences that keep offenders in local custody for less time.

CALIFORNIANS ARE AMBIVALENT ABOUT CORRECTIONS

- **Californians have not traditionally prioritized corrections spending.**
  PPIC Statewide Survey respondents have consistently ranked corrections spending low on the list of programs they would most want to protect from spending cuts. During the last ten years, the proportion of respondents ranking it first has never risen above 8 percent and it has always polled behind the other three major budget areas: K–12 education, higher education, and health and human services.

- **Views of the counties' readiness for realignment are consistent across the state.**
  In January 2012, the PPIC Statewide Survey asked respondents how confident they were of their local government's ability to take on the responsibilities of public safety realignment. Nearly twice as many (22 percent) said they were "not at all confident" as said they were "very confident" (12 percent), but the majority expressed no strong opinion. These results did not change substantially from the two previous surveys, in September and November 2011, nor do they vary appreciably when broken out by region, race/ethnicity, or political ideology.

CONFIDENCE IN LOCAL GOVERNMENTS ABILITY TO HANDLE CORRECTIONS REALIGNMENT IS MIXED



SOURCE: PPIC Statewide Survey results, January 2012.

LOOKING AHEAD

Now that corrections realignment is under way, there are a number of areas to watch.

Funding. Governor Brown's 2012–13 budget proposal established corrections realignment as a top priority, fully funding it via the sales tax and vehicle license fee. With the recent passage of Proposition 30, funding for realignment has been secured as a constitutional guarantee, so county officials may now be more willing to commit to long-term changes in their public safety programs.

Board of State and Community Corrections. The 2011 Budget Act created the Board of State and Community Corrections (BSCC), which assumed its responsibilities on July 1, 2012. As regards realignment, its mandate is to provide coordination and technical assistance to local governments. The BSCC reports to the governor's office—instead of to the CDCR—and is required to seek advice from a balanced range of stakeholders and experts in adult and juvenile corrections.

Evaluation. The state has not made funding available for evaluating county practices; nor does it require counties to report back to the legislature or even to collect data on their caseloads. Because AB 109 establishes no incentives, resources, or standards for counties to measure outcomes, it may be difficult to assess what California's most significant justice reform in decades has achieved. A coordinated evaluative effort, with widespread county participation and clearly defined goals, will improve the prospects for a successful public safety realignment.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

Capacity Challenges in California Jails
Corrections Realignment: One Year Later
Evaluating the Effects of California's Corrections Realignment on Public Safety
California's Changing Prison Population

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CALIFORNIA ECONOMY

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CALIFORNIA'S ECONOMY IS ON THE MEND, SLOWLY

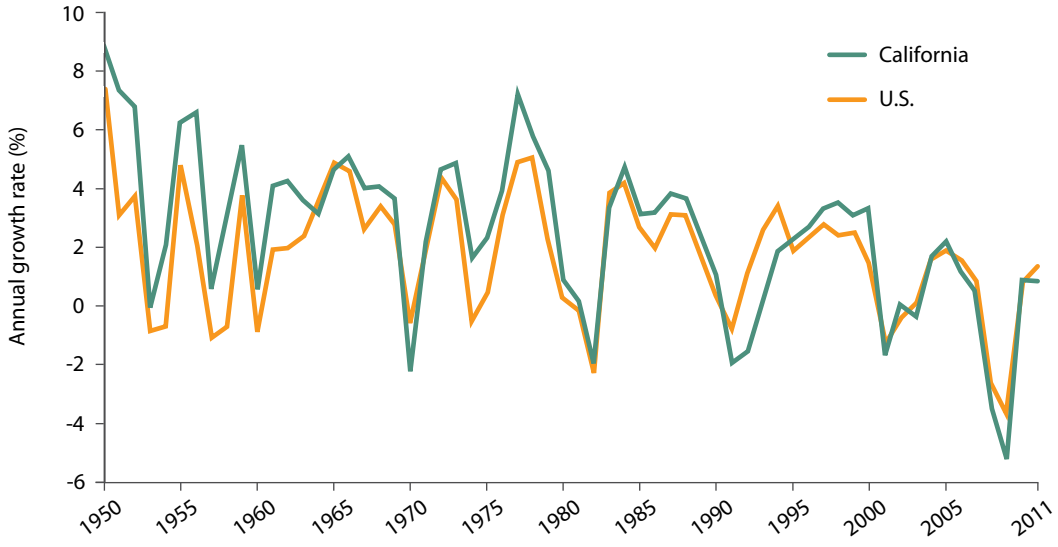
By many measures, California is seeing a consistent pattern of economic recovery following the Great Recession. California's unemployment rate has fallen more than 2 full percentage points from its recession-era peak. By the end of 2012 the state was adding jobs at a higher rate than the nation as a whole. However, a large share of Californians are still unemployed or underemployed. Because of this, family incomes in California continued to decline well into 2011, and perhaps beyond. These facts are reflected in Californians' views of the economy: according to PPIC's December 2012 statewide survey, 50 percent believe that the economy will face bad times over the next year.

Despite the lingering pessimism, long-term historical patterns are still the best guide to California's economic future. Economies tend to return to growth rates and unemployment levels established over the long term, and major industry shifts—such as the transition from manufacturing to services—can take place over decades.

CALIFORNIA'S LONG-TERM ECONOMIC PROSPECTS ARE FUNDAMENTALLY STRONG

The California economy generally keeps pace with the U.S. economy. California consistently experiences higher unemployment and higher costs of doing business than other states, but these trends are explained or offset by the state's strengths and are likely to remain permanent features of the California economy.

CALIFORNIA JOB GROWTH TRACKS GROWTH IN THE NATION OVERALL

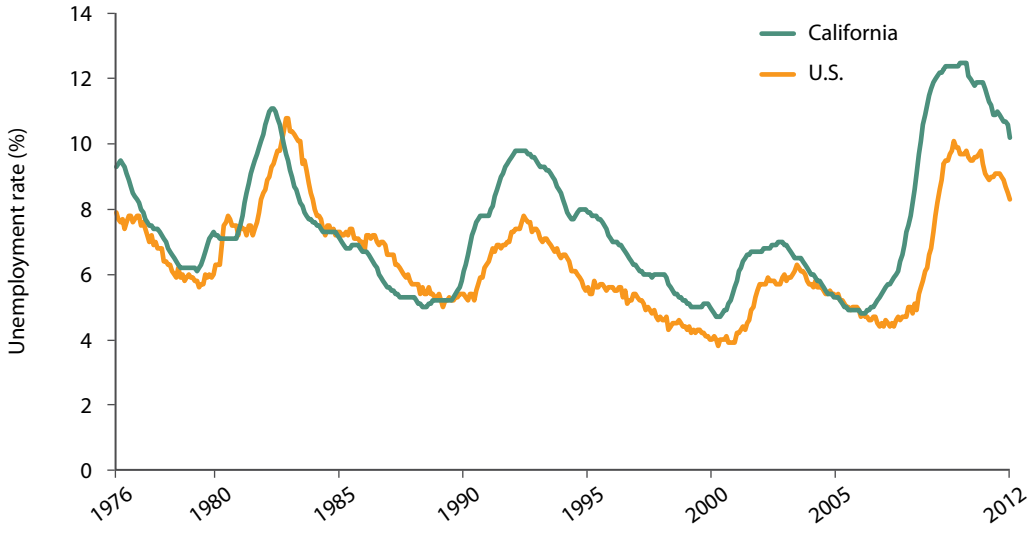


SOURCES: U.S. Bureau of Labor Statistics and California Employment Development Department.
NOTE: Annual change in nonfarm employment, December to December.

- **California's economic performance closely tracks that of the nation as a whole.**
  The broadest measure of California's economic performance—employment growth—follows the nation's growth rate very closely. Over the past 30 years job growth has averaged 1.2 percent annually for both California and the nation—and both saw positive job growth in 2012. Toward the end of 2012, job growth in California outpaced that of the nation, growing at an annual rate of 2.1 percent.

- **Unemployment is persistently higher in California.**
  In October 2012, California's unemployment rate was 10.1 percent; the national rate was 7.9 percent. While high, these rates reflect two years of declines from the peak during the Great Recession. California's unemployment rate remains higher than that of the nation and has done so for 20 years—even when the state's employment growth has surpassed national growth, as it did during the technology boom in the late 1990s. This seeming paradox occurs because California's labor force grows faster than the U.S. labor force: the state's economy generates jobs at a rate similar to the national rate, but this is not enough to keep up with California's faster-growing population. So California unemployment is likely to remain above the U.S. level even after it fully recovers from the recession.

UNEMPLOYMENT IS ON THE DECLINE



SOURCES: U.S. Bureau of Labor Statistics and California Employment Development Department.
NOTES Monthly unemployment rate, seasonally adjusted.

- **Labor market conditions have contributed to sizeable declines in family income.**
  California unemployment remains historically high. Moreover, in 2011 the average period of unemployment reached 37 weeks—the longest average since 1948, when this data was first collected. Workers are employed for fewer hours, on average, and are less likely to work full-time than before the recession. Unemployment and underemployment caused median household income to fall 14 percent between 2006 and 2011. Declines were greater for the median household in California than for the median household nationwide, which experienced a 7 percent decline over the same period. However, median income levels are higher in California than in the nation as a whole, particularly for households headed by those with a college degree: income is 78 percent higher for the median household headed by someone with a bachelor's degree than for the median household headed by someone with a high school education only.

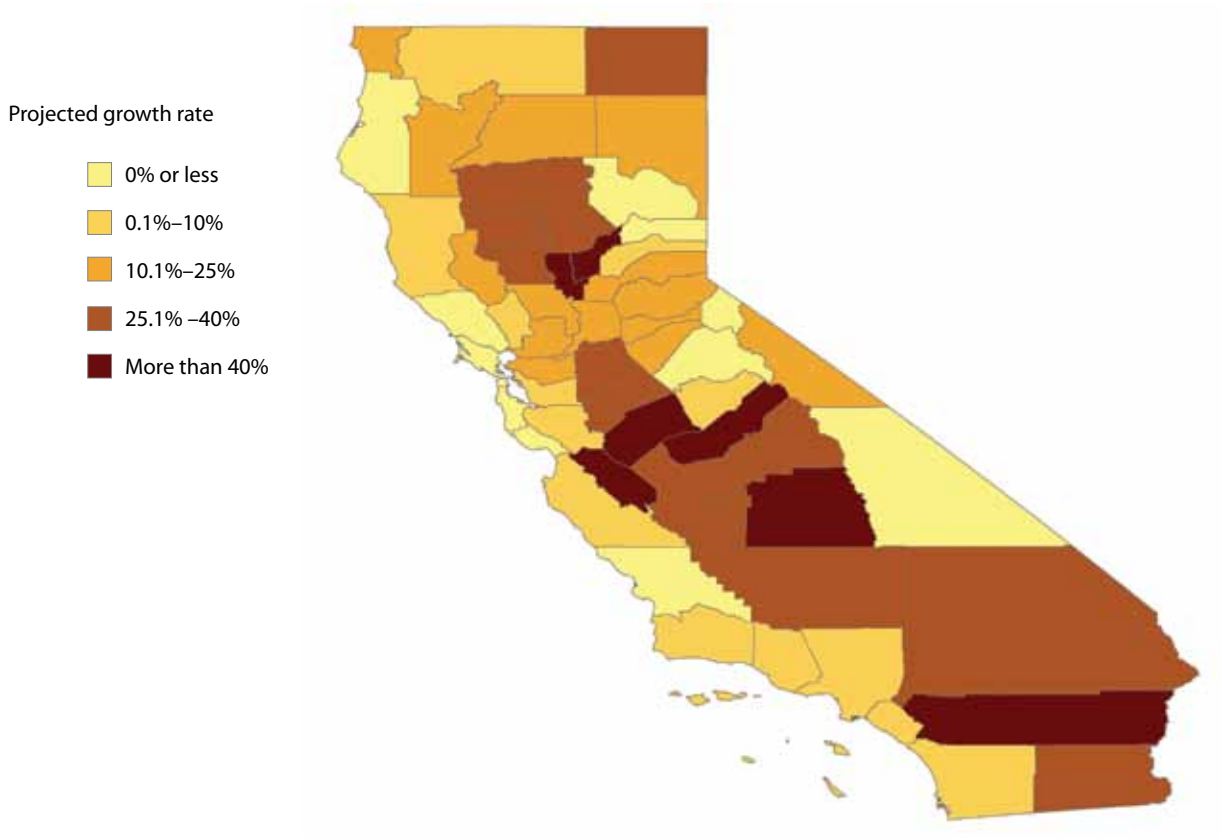
- **California is a high-cost, high-benefit state.**
  California workers, on average, earn 12 percent more than the national average—even after adjusting for differences in workers, occupations, and industries. But output per worker in California is 13 percent above the national average, so California's higher productivity fully offsets the higher average wages. All of California's immediate neighbors—Nevada, Oregon, and Arizona—pay their workers less and have lower output per worker.

- **The "business climate" debate understates California's strengths.**
  California consistently scores poorly on many business climate rankings that focus primarily on taxes and other costs of doing business. California's economic performance is stronger than these business climate rankings alone would indicate. Businesses locating in California face higher costs but they also enjoy many benefits, such as the skill level of the workforce, the availability of capital and support for new business, and the amenities that make California an attractive place to live.

GROWTH WILL BE UNEVEN

- **Regional economic differences are dramatic—and persistent.**
  Economic differences within California are likely to continue. Unemployment tends to be higher in the Central Valley—sometimes considerably higher—than in the urban, coastal parts of the state. This variation is attributable to a different industry mix and to the faster-growing workforce in the inland parts of the state. Even among urban coastal areas, California's regional economies don't move in concert: in most years some regions of the state grow quickly while others grow slowly or contract. Although inland California currently has higher unemployment rates, that region's low housing costs will contribute to high growth of its workforce. The working-age population is projected to grow more than 25 percent between 2010 and 2025 in much of inland California; in California overall, the growth rate will be 13 percent.

INLAND CALIFORNIA'S LABOR FORCE WILL GROW FASTEST

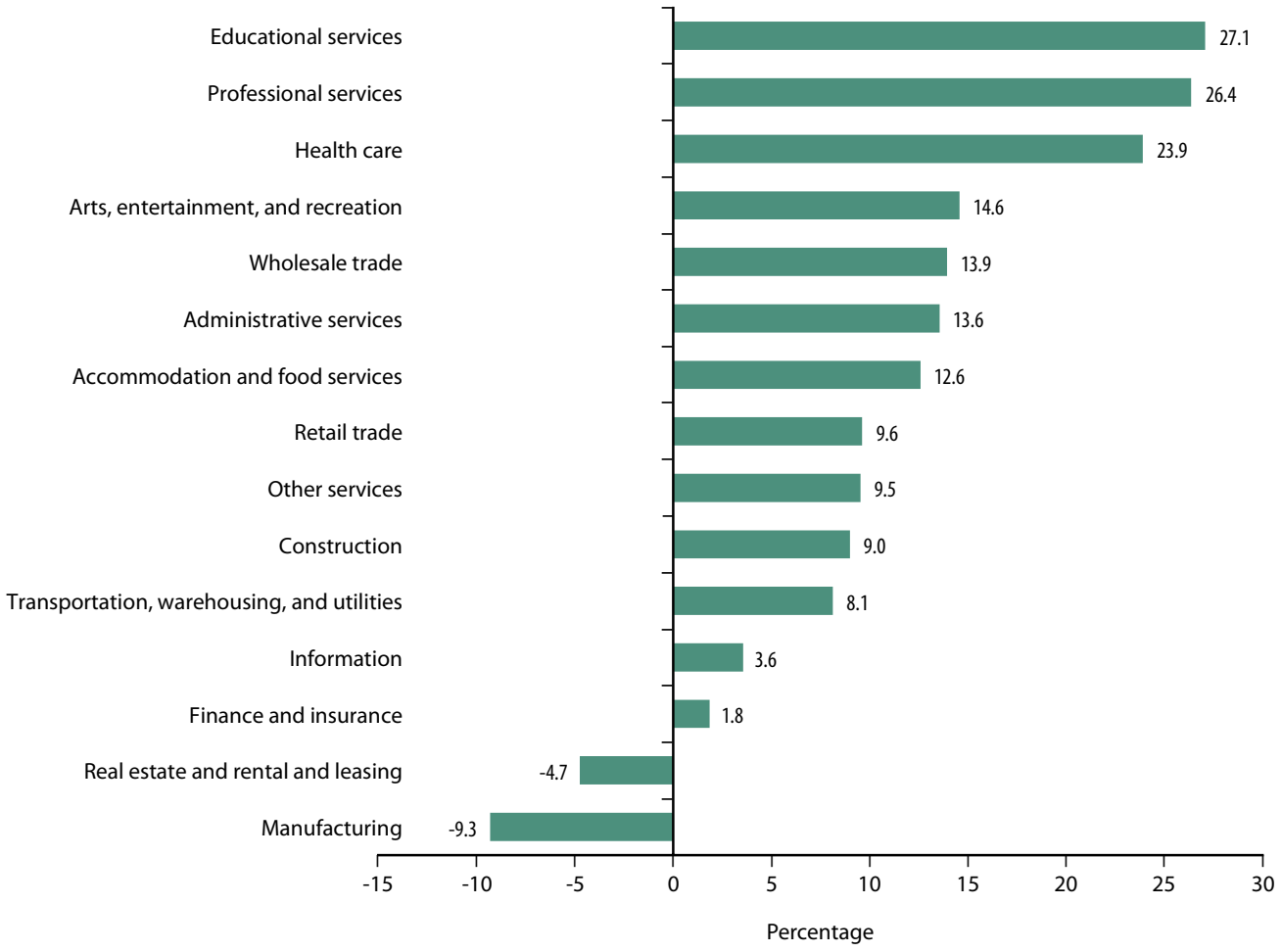


SOURCE: California Department of Finance.
NOTE: California's projected growth rate, by county, of working-age population, 2010–2025.

- **Housing is still expensive and probably always will be.**
  Even during the Great Recession, housing in California was much more expensive than in the nation as a whole. In October 2012, the average U.S. home was worth $155,400; in California, the average home was worth $314,500, according to Zillow. Expensive real estate makes it harder for some businesses to locate in California and attract workers, potentially pushing growth out of state. In the last year, median housing prices have increased across most of California—in both inland and coastal regions—with the largest gain in San Jose metro area (an 11 percent increase over October 2011–2012) and the largest decline (15 percent) in the Susanville metro area.

- **Services will continue to grow; manufacturing will continue to stagnate.**
  Manufacturing accounted for only 9 percent of California's employment in October 2012; year over year, manufacturing employment fell about 1 percent in October 2012. Its share has been declining for decades, and it will continue to be California's fastest-declining sector. During the recession, the construction industry contracted most sharply. As the housing market rebounds and the existing housing stock is being absorbed by California's growing population, construction employment has rebounded as well. Over the past year, construction employment grew about 5 percent and is predicted to continue to grow, but not to boom-time levels. The fastest-growing industries over the longer term are projected to be professional services, education, and health care—these are also the sectors least hurt by the recession.

PROJECTED PRIVATE-SECTOR INDUSTRY GROWTH, 2008–2018



SOURCE: California Employment Development Department.
NOTE: EDD Employment Growth Projections, 2008–2018 (private sector only).

LOOKING AHEAD

California's long-term economic trends reflect strengths but also create pressures that policy must respond to. The most effective economic policies require accurate assessments of California's economic performance, a balanced view of the state's competitiveness, and a realistic sense of the state's strengths and weaknesses.

- **Pursue policies to help create jobs and foster full-time employment.**
  California's economic recovery is proceeding, but slowly. Nearly 2 million Californians remain unemployed, and more workers are underemployed or have left the labor force. Creating jobs and increasing full-time employment is key to enhancing California's recovery. A thriving California economy is the best route to future employment growth in the short and long run. Economic policy that stimulates business and fosters a strong, skilled workforce are crucial to job creation in California.

- **Don't pin all hopes on one industry.**
  Although many industries—such as film, high-technology, and wine-making—are highly concentrated in California, the state's economy is in fact very diversified, and its industry mix is quite similar to the nation's. Economic policy should reflect the breadth and diversity of the state's economy. Tempting as it is to identify the next boom industry—such as clean technology—and focus economic development efforts there, booms usually don't deliver stable, steady growth, as the Internet and housing industries demonstrate. And some hyped industries fail to take off at all. Economic development policy needs to nurture both new, innovative industries that might constitute California's next boom and established, steadily growing industries such as health care services.

- **Promote economic opportunity through education.**
  Education is essential to Californians' economic well-being. Highly educated workers were somewhat protected from the impact of the Great Recession and are likely to do better during future boom and bust cycles. Promoting education is thus an important strategy for ensuring economic opportunity across the income spectrum and addressing income inequality. And because the new economy demands a highly skilled workforce, education has a crucial role in helping California remain economically competitive.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

The California Economy: Employment in 2012
The California Economy: Unemployment in 2012
The Great Recession and Distribution of Income in California
Consumption Tax Options for California
Business Climate Rankings and the California Economy
Are the Rich Leaving California?

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Sarah Bohn

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CALIFORNIA EDUCATION

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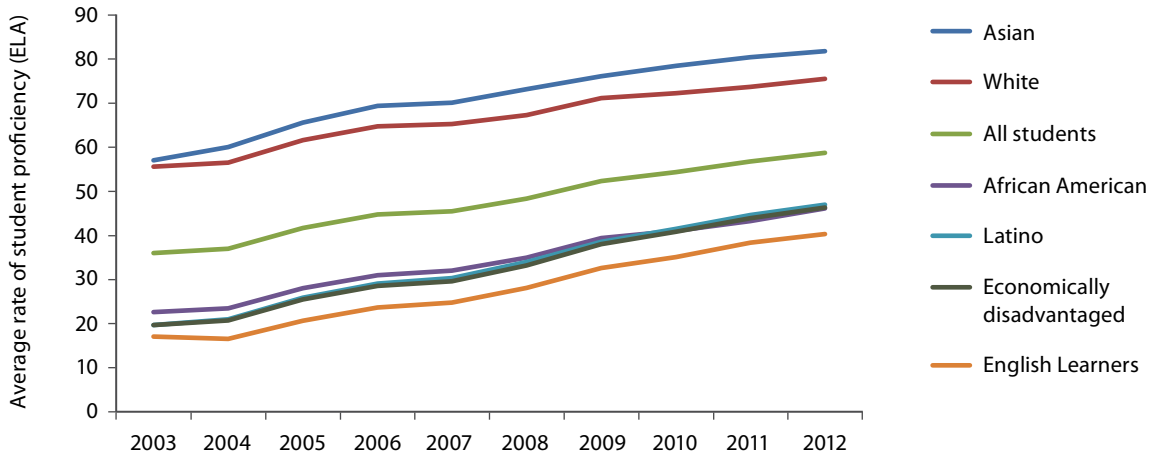
California educates more than 6 million children in its K–12 public schools. Many of these children are economically disadvantaged, and many (a higher percentage than in any other state) are not native English speakers. Despite these challenges, and despite four years of constrained budgets, test scores have been rising. But further improvement is likely to be challenging, given the inequitable distribution of school dollars and the complexity of federal, state, and local funding mechanisms. According to a recent PPIC Statewide Survey, two-thirds of California likely voters say the quality of education in the state's schools is a big problem.

In November 2012 voters approved Proposition 30, which temporarily increases the state sales tax and tax rates on higher incomes, protecting K–12 from "trigger" cuts. And the Department of Finance projects that an improving state economy will mean significant increases in per pupil funding over the next four years. But California's public schools still face many fiscal challenges, in addition to long-standing issues related to the achievement gap and the accountability system.

SOME IMPORTANT EDUCATIONAL OUTCOMES ARE IMPROVING, BUT GAPS REMAIN

- **Proficiency in both math and English language arts (ELA) has risen 21 percentage points in the past nine years.** By these measures, California schools appear to be heading in the right direction, especially considering the fact that California's academic standards are the highest in the nation. But the state is not on track to make No Child Left Behind targets of 100 percent proficiency by 2014. Most states have escaped this mandate by participating in the Obama administration's waiver program, but the U.S. Department of Education has not approved California's waiver proposal.

PROFICIENCY IN ENGLISH LANGUAGE ARTS VARIES BY GROUP



SOURCE: California Department of Education (2003–2012).
NOTE: A multiracial category was added in 2010, which ranges between 2 to 3 percent of all students.

- **The achievement gap is still significant.**
  White and Asian students' ELA proficiency levels are higher than those for Latino and African American students. Gaps in math proficiency are similar to those in ELA, with a few notable exceptions. Asian students' proficiency rates are dramatically higher than those for whites (85 percent versus 71 percent in 2011). African American students have the lowest math proficiency rates, on average 7 percentage points lower than those for English Learners (ELs).

- **Graduation rates have increased somewhat, but there are large disparities among groups.**
  In 2011, 76 percent of California high school students graduated within four years, a slight increase over the previous year. At 32nd place, California ranks in the bottom half of the 48 states (plus Washington DC) that have comparable graduation rate data. States set their own graduation requirements, so it is possible that California's low ranking is due partly to its high standards and its relatively high proportion of disadvantaged students. Notably, there are large gaps in graduation rates among California's students: 85 percent of white and 89 percent of Asian American students graduate from high school, compared to 70 percent of Latino, 63 percent of African American, and 60 percent of EL students.

CALIFORNIA STUDENTS FACE MANY CHALLENGES

- **California students are more disadvantaged than their peers in other states.**
  Fewer than one in ten students in the United States are ELs; in California, nearly one out of every four students are ELs. More than half (56 percent) of all students in California are eligible for free or reduced-price meals; this share is higher than in the rest of the nation (47 percent).

- **Gaps in school readiness and academic skills are evident in kindergarten.**
  Some students struggle more than others. On average, low-income, African American, Latino, and EL students begin school less prepared. So do those whose parents have low levels of education. These groups score lower on the standardized tests that begin in second grade, and the achievement gaps persist into later grades.

- **Early, high-quality interventions are critical.**
  A growing body of research indicates that investments in pre-kindergarten programs can produce both short- and long-term benefits that exceed costs. Similarly, targeted interventions in elementary school can positively affect later graduation rates.

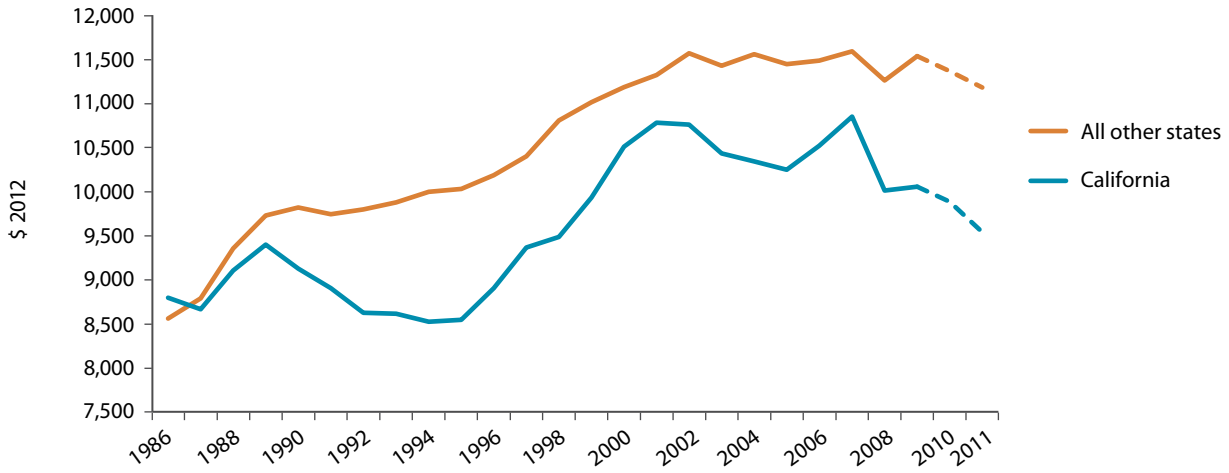
CALIFORNIA SCHOOLS FACE ONGOING FISCAL CHALLENGES

- **Proposition 30 is not a cure-all.**
  Proposition 30 and an improving economy will increase per pupil funding by more than $2,500 over the next four years, according to Department of Finance projections. This would be a 37 percent gain from 2011–12 funding levels. But schools have experienced large reductions since 2007–08 and have long been funded below the national level. In addition, some of the new funding will be used to pay down more than $20 billion in outstanding obligations to public schools and community colleges, including unpaid claims for state-mandated activities from previous years, deferrals (payments made after the close of the fiscal year for programs and services already provided), and Proposition 98 maintenance (funding that restores cuts made during the recession).

- **Revenue volatility is still a problem.**
  The Proposition 98 formulas that determine state funding for schools rely on the overall health of the state's economy and General Fund revenues. The personal income tax provides the largest share of General Fund revenues and has been a very volatile source of revenue historically. This volatility makes it difficult for schools to plan and budget appropriately for their students' needs.

- **Per pupil funding varies widely and districts with greater challenges do not always receive greater funding.**
  Many studies have found California's school finance system inequitable, with wide variation in per pupil funding across—and even within—school districts. Despite efforts to equalize funding, large differences persist across districts: among the 10 largest districts in California, funding per pupil ranged from $7,500 to $11,200 per pupil in 2010–11.

CALIFORNIA'S PER PUPIL SPENDING LAGS THE NATIONAL AVERAGE



SOURCES: National Center for Education Statistics, National Education Association.
NOTES: Inflation-adjusted spending (2012 dollars). Funding is not adjusted for regional costs across states. The dashed lines represent estimated spending from the NEA since government data are not yet available.

Additionally, districts with higher per pupil costs—for example, those with more disadvantaged, special education, or EL students—do not necessarily receive enough additional resources to address their students' needs. An equitable funding formula would provide additional revenue to districts facing extra costs.

ACCOUNTABILITY PROGRAMS ARE IN NEED OF IMPROVEMENT

- **California's accountability programs have known shortcomings.**
  The state's school ranking system, based on state test scores, has not been updated since it was created in 1999. But research has shown that school accountability scores may reveal more about the type of students who attend a school than about the effectiveness of teachers and administrators at that school. Schools that meet accountability requirements have lower percentages of economically disadvantaged and EL students and lower total enrollments, on average. In addition, school accountability scores are based on test score gains at the grade level, rather than at the individual student level. This makes accountability scores less accurate because they cannot be adjusted to account for the changing demographics of a school.

- **Initial steps have been taken to improve the system.**
  The State Board of Education has joined a consortium of states to develop new state tests based on the Common Core State Standards (CCSS). The new tests, expected to be implemented in spring 2015, are being designed to increase the accuracy of school accountability scores and to permit states to measure individual student gains. In addition, new legislation (SB 1458) expands the performance indicators used to rank high schools, beginning in 2016. Together, these actions represent the first steps toward creating a new framework for the state's accountability system, one that is more accurate and better reflects student preparation for success in career and college.

LOOKING AHEAD

To improve the state's economic well-being and ensure that California's children are equipped to succeed in the 21st century, policymakers need to take steps to help the state's school systems maintain and build on recent improvements.

- **Reform school finance.**
  Governor Brown has proposed an overhaul of California's school finance system that would make funding more equitable and transparent. Although the legislature did not accept his 2012 proposals, he is expected to introduce a new proposal in 2013, giving the legislature an opportunity to create a school finance system more responsive to student need.

- **Get ready for the new Common Core State Standards.**
  California recently adopted the new standards—as did all but a few states. California's own academic standards had not been updated since 1997. These new standards are widely thought to set a high bar for students, requiring more high order skills, advanced content knowledge, and advanced English language skills. As these standards and assessments (scheduled for implementation in 2015) are put into practice, the state should ensure that districts are training teachers to successfully impart these higher-level skills.

- **Improve outcomes for English Learners and former English Learners.**
  California's 1.4 million EL students underperform relative to their English-speaking peers. But former EL students have better academic outcomes than even native English speakers. California is poised to reconsider the policies that determine when EL students are considered to be proficient in English. New policies should be informed by understanding the long-term academic outcomes of ELs and former ELs under various reclassification scenarios, and will need to be flexible so as to incorporate the new state standards.

- **Increase efforts to create a single data system that tracks students from preschool through higher education.**
  The California Longitudinal Pupil Achievement Data System (CALPADS) aims to merge student-level data that districts already collect into a single, centralized database and to make it possible to identify effective policies for improving student learning. Some districts already use student, teacher, and school data to fine tune instruction and programs—but others lack this capacity. California is decades behind states like Texas, Florida, and North Carolina, which are already using comprehensive data systems to improve educational quality.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

California's Changing K–12 Accountability Program
School Finance
California's English Learner Students
Passing the California High School Exit Exam: Have Recent Policies Improved Student Performance?
PPIC Statewide Survey: Californians and Education

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CALIFORNIA HEALTH CARE

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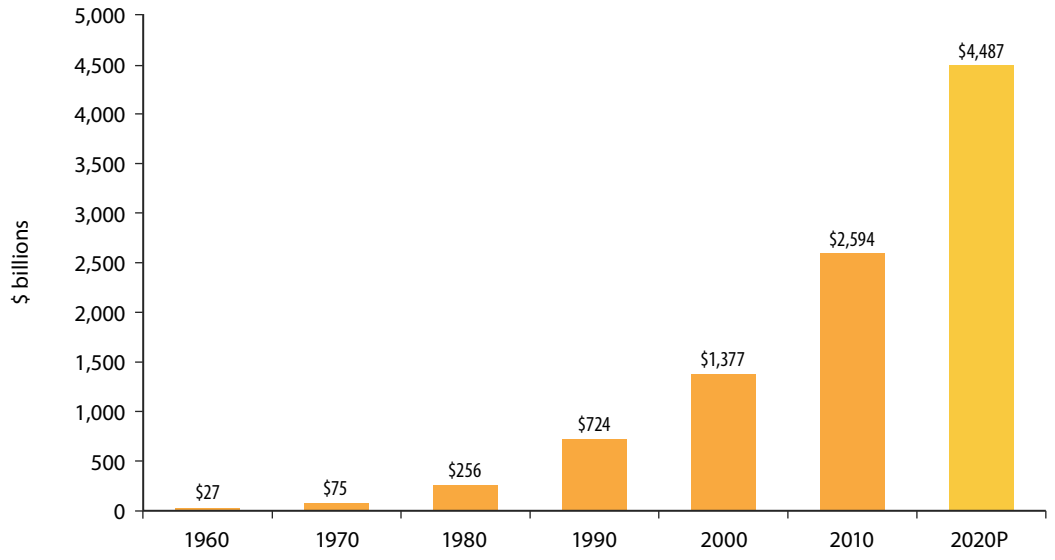
CALIFORNIA IS PREPARING FOR HEALTH CARE REFORM AMID BUDGET CONSTRAINTS AND GROWING NEED

California faces myriad health care challenges. The state currently has more than 7 million uninsured residents. Health care costs continue to increase and for many years have outpaced economic growth, threatening economic competitiveness and state fiscal solvency. And health care quality remains uneven.

Government plays an important role in the financing and delivery of health care services. Federal, state, and county governments finance public programs and services for millions of Californians who are older, disabled, low-income, or uninsured. The growth in health care costs across government programs represents an increasing demand on scarce public dollars and squeezes the availability of funds for other state priorities.

The federal Affordable Care Act (ACA) represents sweeping policy change intended to achieve near-universal health care coverage, contain health care costs, advance quality, and improve health outcomes. The ACA provides a clear federal framework but allows states significant flexibility in implementation. But policymakers don't have much time: Even though the ACA's major provisions don't take effect until January 2014, required implementation tasks are numerous, varied, and complex.

NATIONAL HEALTH CARE SPENDING HAS INCREASED DRAMATICALLY SINCE 1960



SOURCE: *Health Care Costs 101*, California HealthCare Foundation, August 2012. Used with permission.
NOTES: Health care spending refers to National Health Expenditures reported by the U.S. Centers for Medicare and Medicaid Services. Projections in 2020 include the impact of the Affordable Care Act.

THE PROBLEM OF THE UNINSURED IS SIGNIFICANT AND GROWING

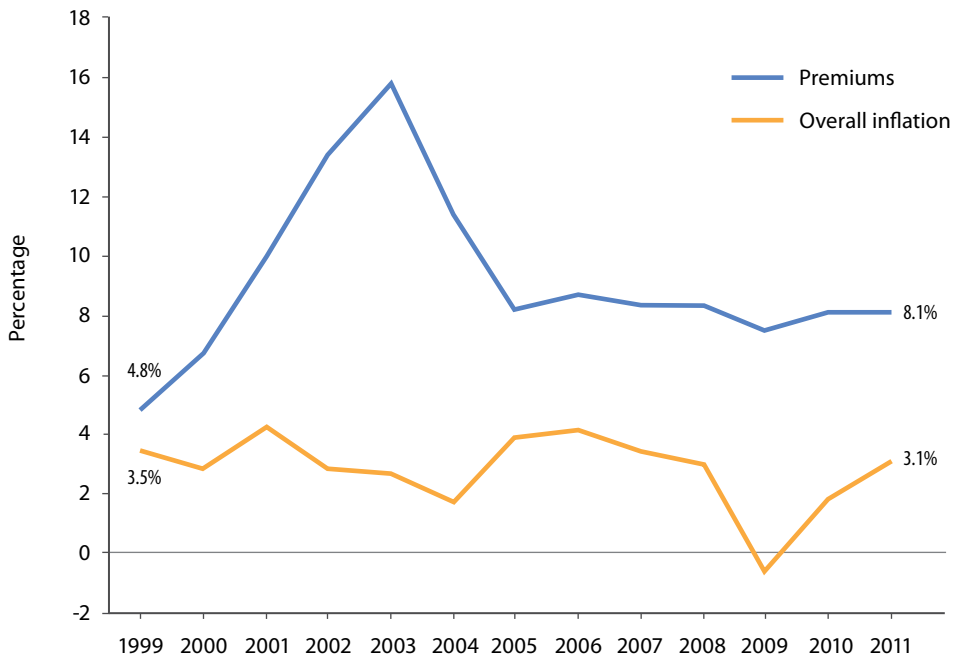
- **A large and growing number of Californians are uninsured.**
  In 2011, 7.3 million Californians lacked health insurance coverage, up from 6.3 million in 2007. Lack of insurance is associated with poor access to and quality of care. Uninsured individuals forgo medical care, pay significant out-of-pocket costs, and rely on hospital emergency rooms for basic medical needs.

- **Employer-based coverage has fallen steadily over the last decade.**
  Coverage through employers declined from 62 percent in 2000 to 53 percent in 2010; this decline has not been offset by expansions in Medi-Cal or individual coverage. Among the non-elderly uninsured, six in ten live in families with at least one full-time worker.

DESPITE A RECENT SLOWDOWN, HEALTH CARE SPENDING CONTINUES TO GROW

Health care spending can be measured a number of ways—as a percentage of gross domestic product, total state government spending, employee compensation, or household expenditures. Regardless of measure, spending on health care is a significant and growing investment.

PREMIUMS FOR FAMILY COVERAGE IN CALIFORNIA CONTINUE TO RISE FASTER THAN INFLATION



SOURCE: *California Employer Health Benefits Survey*, California HealthCare Foundation, December 2011. Used with permission.

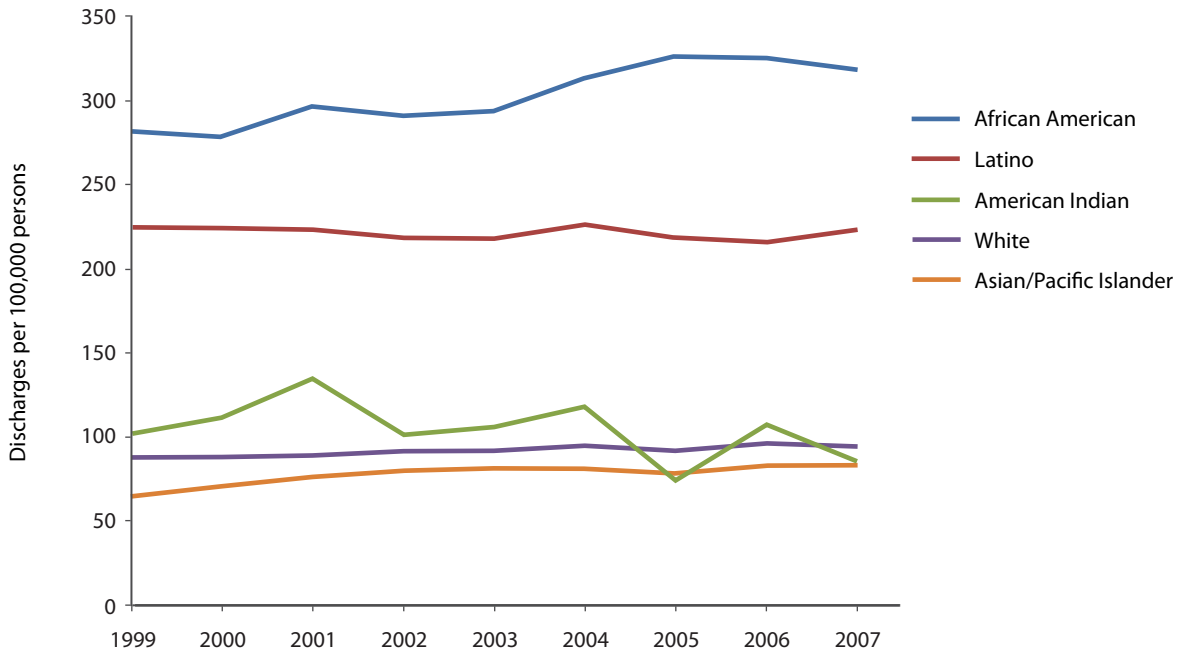
- **Medi-Cal is the state's second-largest General Fund expenditure.**
  In the 2012–2013 budget year, Medi-Cal (the state's Medicaid program) will spend an estimated $14.4 billion from the General Fund and provide services for 8 million Californians. Medi-Cal serves low-income families, seniors, and people with disabilities, including 1.2 million individuals eligible for both Medi-Cal and the federal Medicare program. This "dual eligible" group comprises about 15 percent of the total Medi-Cal caseload and is a very expensive population to serve.

- **Workers are paying more for employer-sponsored family coverage.**
  The growth in health insurance premiums has slowed in recent years, but continues to outpace the inflation rate.
- **A number of factors are driving the growth in health care spending.**
  New or increased use of medical technology represents upward of two-thirds of cost growth. Other key factors include increases in chronic conditions and obesity rates and low productivity gains in the health care sector.

DESPITE SIGNIFICANT AND GROWING SPENDING, QUALITY IS UNEVEN AND HEALTH DISPARITIES PERSIST

- **California's health care quality is slightly lower than average.**
  Health care quality can be measured across a number of domains, including coverage, access to services, the patient experience, utilization, and outcomes. Compared to other states California consistently ranks on the low end of the average range, according to measures developed by the U.S. Agency for Healthcare Research and Quality.
- **Across California there is significant variation in health care access, quality, and outcomes.**
  Certain populations—such as those without insurance and those with limited incomes—are at higher risk of poor health and poor outcomes. Communities of color also face more barriers to care and receive poorer quality of care compared to non-Hispanic whites. African Americans, in particular, face high levels of disease, disability, and mortality. Improvement in key health indicators—including infant mortality, obesity, and diabetes management—is especially urgent.

AFRICAN AMERICANS AND LATINOS ARE ESPECIALLY VULNERABLE TO COMPLICATIONS FROM DIABETES

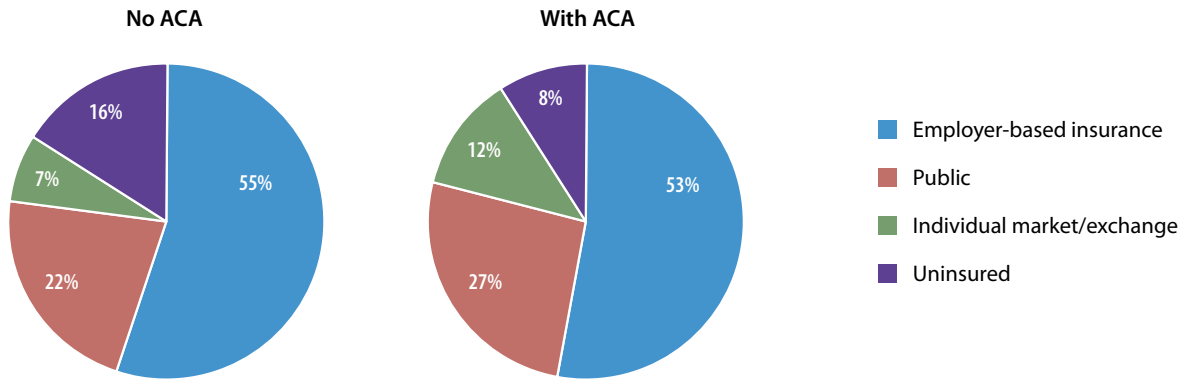


SOURCE: *Racial and Ethnic Disparities in Healthcare in California*, Office of Statewide Health Planning and Development, Winter 2010.
NOTES: This graph measures hospitalization rates for long-term diabetes complications. "Latino" consists of people who identify as Hispanic. "American Indian" includes Eskimo and Aleut and may be under-reported. "Asian/Pacific Islander" combines various populations that may have different overall health characteristics.

THE FEDERAL AFFORDABLE CARE ACT CALLS FOR SWEEPING CHANGES

Implementation of the ACA will result in major shifts in the way health care is financed and delivered. Beginning January 1, 2014, health insurers will be required to provide coverage to all individuals, regardless of health status, pre-existing conditions, or age.

THE ACA IS PROJECTED TO CUT THE NUMBER OF UNINSURED CALIFORNIANS IN HALF BY 2019



SOURCE: *Nine out of Ten Non-elderly Californians Will Be Insured When the Affordable Care Act Is Fully Implemented*, UCLA Center for Health Policy Research and UC Berkeley Labor Center, June 2012.
NOTES: The "With ACA" figure displays results from the "Enhanced" model scenario, which assumes stronger outreach and enrollment efforts that result in increased take-up rates of available coverage.

- **Medi-Cal will be expanded.**
  Beginning in January 2014, eligibility for the Medi-Cal program will expand to include single adults with no dependent children. In addition, income eligibility levels will increase to 138 percent of the federal poverty level (about $32,000/yr for a family of four).

- **An online health care marketplace will be created.**
  California's new health benefit exchange, now known as "Covered California," will provide an online marketplace for individuals and employees of small businesses to shop for, compare, and purchase plans. Individuals with incomes up to 400 percent of the federal poverty level ($92,200, for a family of four) will be able to use tax credits to purchase subsidized coverage. Certain small businesses will be eligible for tax credits to offset insurance costs.

- **Larger businesses will be required to contribute to employee coverage.**
  Slightly more than half of Californians are insured through their employers. Under the ACA, employers with more than 50 employees will be required to contribute to the cost of coverage for their employees or pay a fee.

- **Coverage will expand considerably, but a significant number of Californians will remain uninsured.**
  Estimates indicate that roughly one million uninsured Californians will secure coverage under the Medi-Cal expansion. An additional 1.2 million uninsured individuals will gain coverage through Covered California and receive subsidies. Still, an estimated three million Californians are expected to remain uninsured, more than a million of whom are undocumented immigrants.

- **The ACA provides new ways to improve health care services and public health.**
  Beyond coverage, the ACA establishes new incentives and requirements for insurers and health plans to promote coordinated care, achieve better quality, and lower costs. The ACA also includes new resources to pursue health promotion and wellness activities, improve public health infrastructure, and increase community prevention—the Community Transformation Grant program is one good example.

LOOKING AHEAD

With the Supreme Court decision to uphold the ACA, attention now shifts to the states. The California context for ACA implementation is challenging, given the state's large uninsured population and lingering economic uncertainty. California took early action on the health policy front, enacting legislation to implement many key elements of the ACA. Still, state policymakers have much work to do and relatively little time—decisions made in the next 12 months will directly impact the success of reform. Policymakers will need to:

Redesign Medi-Cal to strengthen the foundation of reform. Medi-Cal is the foundation upon which federal ACA reforms will be built. Yet, as the second largest general fund expenditure, Medi-Cal will continue to be subject to near-term budget constraints that could compromise its strength. Policymakers will need to leverage ACA payment and care delivery tools to improve Medi-Cal affordability and quality goals, particularly for high-cost, high-need populations.

Simplify eligibility determination and enrollment to facilitate coverage. Eligibility determination and enrollment processes will need to accommodate the millions of Californians expected to enroll for the first time in Medi-Cal and in subsidized coverage through Covered California. The state will need to evaluate long-standing labor- and paper-intensive processes to simplify eligibility rules and offer multiple pathways to coverage, including self-service, online systems.

Expand the health care workforce to assure access. The ACA's coverage expansion will place significant demands on the state's health care workforce—which is already struggling to meet the needs of California's growing, aging, and increasingly diverse population. A comprehensive strategy should include expanded training of primary care providers, greater use of allied health professionals, broader use of telehealth and telemedicine, and increased use of team-based care models that capitalize on existing medical personnel.

Create a new insurance marketplace to improve affordability and quality. Covered California will be a gateway to subsidized coverage for millions of Californians and can also serve as a more competitive insurance marketplace to assist those who buy insurance without subsidies. As a major purchaser of health insurance, Covered California can structure competition based on price and quality—and stimulate changes in the way care is paid for and delivered.

Reform care delivery to improve value. State policymakers will need to take steps to improve value—such as creating greater transparency on provider costs, quality, and outcomes. In addition, they can help promote insurance designs that encourage the use of high-value providers and services. Through Medi-Cal, Covered California, and CalPERS (insurance coverage for state employees), the state is well-positioned to catalyze a variety of new approaches.

Promote a culture of health and wellness to improve health, reduce disparities. Leaders from health care, public health, philanthropic, and community organizations will need to work collaboratively to bridge the gap between health coverage and community prevention, identify opportunities for Medi-Cal and Covered California to incorporate health goals in their purchasing strategies, and take advantage of ACA resources to invest in population health. This broad environmental approach is critical to improving health outcomes and health equity, reducing demands on the health system, and lowering costs associated with preventable disease and disability.

Reconsider state and local responsibilities to promote accountability. Many medically indigent adults who are served by counties today will become eligible for Medi-Cal or Covered California in 2014. Additionally, many individuals now eligible for service- or disease-specific state programs will also gain access to comprehensive coverage. As a result, policymakers will reassess the roles and responsibilities of state and local government in the provision of health care for low-income residents.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

Access to the Health Care Safety Net in California
Expanding Medi-Cal: Profiles of Potential New Users
PPIC Statewide Survey: Californians and Healthy Communities
Emergency Department Care in California: Who Uses It and Why?
Pay-or-Play Health Insurance Mandates: Lessons from California

Contact a PPIC expert:
Shannon McConville

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CALIFORNIA HOUSING

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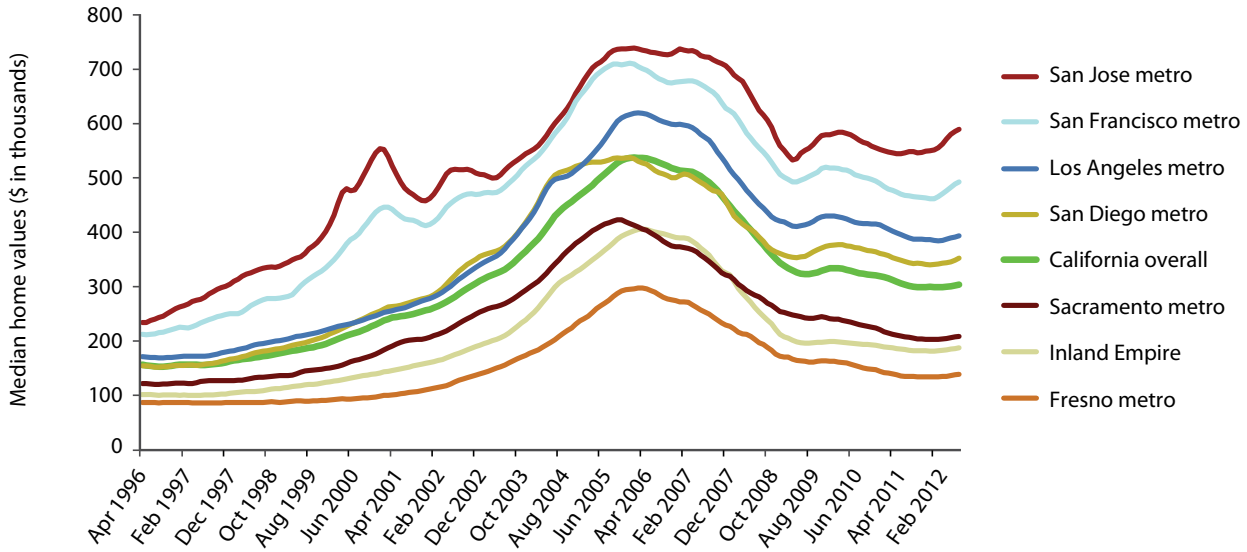
CALIFORNIA FACES IMMEDIATE AND LONG-TERM HOUSING CHALLENGES

California is still experiencing the aftereffects of the most recent housing bust, and the long-term challenges of housing California's population haven't gone away. The housing bubble, which popped in 2008, left the state with a foreclosure problem and large losses of construction jobs, which accounted for 6 percent of California's employment when housing prices were at their peak (according to the California Employment Development Department). Millions of California's homeowners remain "underwater," owing more on their houses than they are worth.

There are a few signs of improvement. Housing price declines, along with low interest rates, have led to historically high rates of affordability. In many Inland areas of California, a large majority of households can afford the median-price home, and half of the state's households can afford to pay the median price for a home even in California's most expensive metropolitan area, San Jose. Housing values seem to have reached bottom statewide, with a slight increase over the past year. Vacancy rates are low in California compared to the rest of the country, and there will be strong population growth among adults old enough to establish their own households, which should increase housing demand. Of course, high unemployment and difficulty in borrowing undercut these hopeful signs.

In both the short and the long term, California's economic performance and livability depend on its housing market. The perennially high cost of housing in coastal California reflects the fact that people and businesses are willing to pay more to be there. It is also a consequence of barriers to building new housing. Economic recovery in the state's inland areas could depend in part on policies designed to address their acute negative equity and foreclosure crises.

MEDIAN HOME VALUES IN CALIFORNIA: BOOM AND BUST



SOURCE: Zillow.
NOTE: Values are in nominal dollars for single family houses and condominiums.

THE HOUSING BUST IS FAR FROM OVER, BUT THERE ARE SIGNS OF RECOVERY

California appears to be in the nascent stages of a recovery from the housing bust. Home values are increasing in some of the state's largest metropolitan areas and statewide new home construction is up 24 percent over the past year. Even so, prices remain at or near their post-bubble lows, construction is slow by historical standards, and 29 percent of mortgaged residential properties remain underwater (according to CoreLogic).

- **Home values in California have started to rise in some metro areas.**
  Home values in California are down more than 40 percent from their bubble-era peak, but over the past year values have gone up slightly. By October 2012, the average home value in California was $314,500 (Zillow). Since the post-boom low, values have increased by more than 6 percent in the San Francisco and San Jose metropolitan areas and by more than 3 percent in the San Diego, Inland Empire, and Fresno metropolitan areas.

- **Large numbers of Californians owe more on their homes than they are worth.**
  According to CoreLogic, 29 percent of California homeowners with mortgages were underwater in the second quarter of 2012, the sixth-highest share in the nation (after Nevada, Florida, Arizona, Georgia, and Michigan). In all, 2 million of the state's 6.8 million mortgaged households were underwater. In 2011, more than half of mortgaged homeowners in the Stockton and Modesto metropolitan areas and almost half in the Inland Empire were underwater. By contrast, only 10 percent of mortgaged homeowners in San Francisco, San Mateo, and Marin counties were underwater, and the average net equity for mortgage holders in those areas was $371,000, by far the highest in the nation.

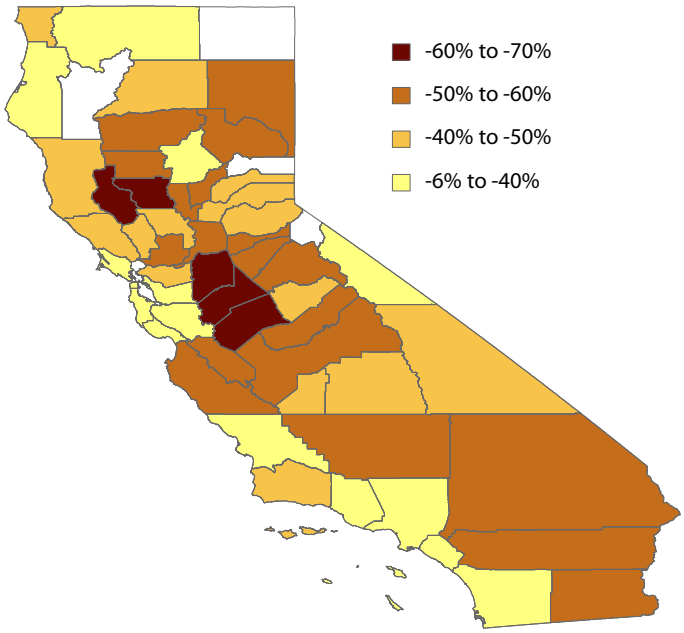
- **Foreclosure rates are high but falling.**
  California appears to be over the worst of the foreclosure crisis. The number of foreclosures has declined by 27 percent over the past year (September 2011 to September 2012, according to RealtyTrac). Even so, foreclosure rates have remained more than twice as high as in the rest of the nation. In September 2012, only Florida had a higher foreclosure filing rate.

- **New home construction is low but increasing.**
  Turmoil in the housing market along with relatively weak population growth has discouraged new construction. New residential construction permits are on a pace to reach almost 60,000 this year, up from only 33,000 in 2009 but still far lower than the 200,000 new units built annually from 2003 to 2005 (according to U.S. Census Bureau data).

- **Homeownership rates have fallen.**
  Homeownership rates, already much lower in California than the rest of the nation, fell more in California than elsewhere in the country, reaching 55 percent of all housing units in 2011 (compared to 65 percent for the nation). Between 2005 and 2011, the number of owner-occupied housing units fell by more than 200,000 in California, while the number rented increased by almost 600,000.

- **Coastal metropolitan centers have fared better than inland California.**
  During the post-bubble years, home values declined less steeply in the metropolitan areas of San Jose (25 percent) and San Francisco (34 percent), as well as in San Diego (37 percent) and Los Angeles (38 percent). The largest declines have occurred in some of the same inland metros that had experienced the fastest run up in values, including Merced (69 percent decline, from $351,100 to $107,600), Modesto (64 percent decline, from $368,200 to $128,100) and Stockton (65 percent decline, from $410,900 to $144,800). Prices fell by more than 50 percent in Sacramento, Fresno, Bakersfield, and the Inland Empire. Not surprisingly, foreclosure rates have been higher in these inland areas. In the first quarter of 2012, Stockton, Modesto, and the Inland Empire had the highest foreclosure rates of any metropolitan areas in the United States (RealtyTrac).

HOME VALUES HAVE DECLINED MORE STEEPLY INLAND THAN ON THE COAST



SOURCE: Zillow market value report for California counties.
NOTES: Percentage change, local price peak to October 2012. No data available for areas in white.

HOUSING REMAINS EXPENSIVE IN MUCH OF THE STATE

Falling prices make buying a house more affordable, but rents have actually risen (in nominal terms). Even with the decline in prices, median values are almost $600,000 in the San Jose metro area and just under $500,000 in the San Francisco metro area. California's statewide median remains twice as high as the national median, and among the state's seven largest metropolitan areas, only Fresno has lower average home values than the rest of the nation.

- **Housing is dense relative to other states.**
  California is often thought of as the epitome of sprawl, but its housing density is 35 percent above the national average and rising. Census data show that the Los Angeles and San Francisco metropolitan areas have the second- and third-highest residential density in the nation, after New York, while San Jose and San Diego are also in the top ten. High density goes hand in hand with high prices: where real estate is expensive, developers build upward and closer together, and people are willing to live in smaller spaces. California's population density is heightened by its household structure: the average household size in California is 3 people, compared to 2.6 people nationally.

- **Rents are high and rising.**
  Rental units account for 45 percent of California's occupied housing stock, according to the American Community Survey. According to HUD, five of the ten most expensive large metropolitan rental markets in the U.S. are in California: San Francisco, Orange County, San Jose, Oakland, and Los Angeles. And, unlike housing prices, typical rents were higher in 2012 than in 2006 in nearly all metropolitan areas, in nominal terms. Even more striking, since 2006 rents have risen more in some of the metropolitan areas with higher foreclosure rates, even though home prices have fallen more sharply in those areas.

- **Vacancies are low, relative to most states.**
  Despite sharply falling prices in recent years and increases in vacancy rates, the residential vacancy rate in California remains among the lowest in the country. The vacancy rates in other states with the highest foreclosure rates (Arizona, Florida, Georgia, and Nevada) are among the highest in the U.S. But even in the San Joaquin Valley and Inland Empire, residential vacancy rates are near the national average. In most other states, foreclosure often leads to abandonment, whereas in California it often means turnover. (Vacancy rate data are from HUD, USPS, and American Community Survey.)

LOOKING AHEAD

California needs to address both immediate and long-term housing challenges with policies that help resolve the foreclosure crisis, fund affordable housing construction, and remove unnecessary barriers to expanding the supply of housing in high cost areas.

- **With the job and housing markets slowly recovering, foreclosures will continue to abate.**
  Foreclosures displace families and can ruin access to credit, but keeping people in homes they cannot afford risks slowing down recovery in the housing and financial markets. California does not require judicial review of foreclosure actions, so foreclosures can be processed more quickly, and it is likely that the bulk of the state's foreclosures have already occurred. Most housing policy is set at the federal level, and most housing financial institutions—including Fannie Mae, Freddie Mac, and the large banks—are national. Recent revisions of federal programs intended to keep homeowners in their houses—for example, allowing them to refinance at lower interest rates even if they owe more than the house is worth—could help thousands of California homeowners.

- **Funding for affordable housing is threatened.**
  Affordable housing construction in California is funded partly through state housing bonds. Continued state budget troubles raise the cost of borrowing and limit the scope for authorizing and issuing new general obligation bonds. If it wants to support affordable housing construction, California needs to establish new funding mechanisms.

- **Regulations help keep housing prices high in coastal areas.**
  Why is housing so expensive in California? Many people and industries are willing to pay a premium to be here, which keeps demand high. At the same time, the supply of new housing is constrained both by geography and regulation. Most of populated California is nestled against natural barriers to construction—the ocean, the Bay, and the mountains. Moreover, the state and many local governments have strong land-use and building regulations, especially in the major coastal cities, which curtail construction and keep prices high.

We invite you to dig deeper at ppic.org.
Related PPIC resources include:
California's Housing Market
Housing in California
California's Newest Homeowners: Affording the Unaffordable
Urban Development Futures in the San Joaquin Valley

This publication is part of PPIC's Planning for a Better Future project.

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CALIFORNIA POPULATION

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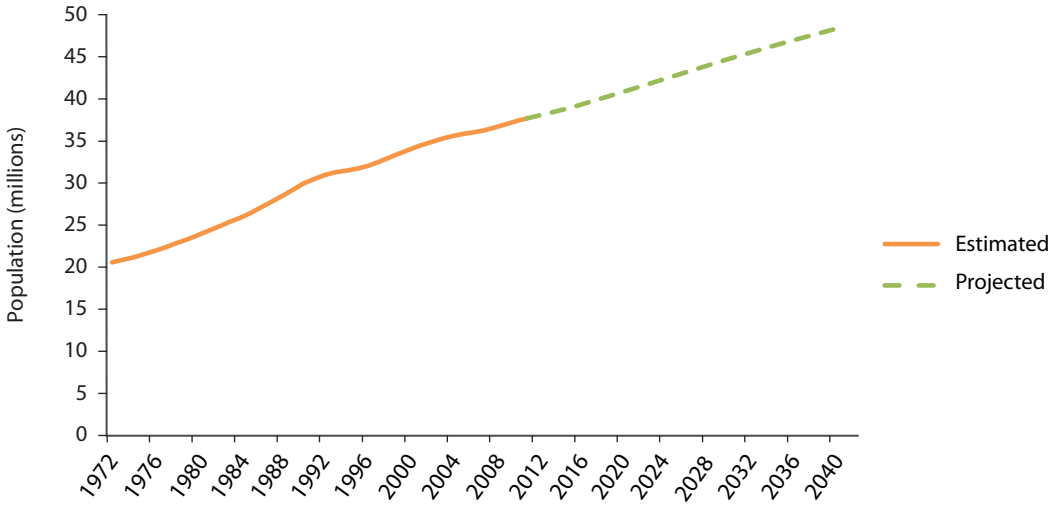
GROWTH WILL PUT PRESSURE ON INFRASTRUCTURE

California has long been known for and even defined by its tremendous population growth. No other developed region of similar size anywhere in the world has sustained so much growth over such a long period. Equally remarkable has been the population's increasing diversity. California is home to large groups of immigrants from more than 60 nations, and no race or ethnic group constitutes a majority of the state's population. Although growth rates have slowed, the state added 3.4 million people from 2000 to 2010 (according to Census counts), reaching a total population of 37.3 million. The most recent estimate by the California Department of Finance (July 2011) places the state's population at 37.6 million.

During the next 20 years California's population will continue to increase, with millions of new residents each decade. This growth will lead to increased demand in all areas of infrastructure and public services—including education, transportation, corrections, housing, water, health, and welfare.

CALIFORNIA'S POPULATION WILL CONTINUE TO GROW



SOURCES: U.S. Census Bureau, Intercensal Estimates of Resident Population and Current Population Estimates Vintage 2011; J. Pitkin and D. Myers, *Generational Projections of the California Population by Narivity and Year of Immigrant Arrival* (USC PopDynamics Research Group, 2012).
NOTE: Population as of July of each year.

GROWTH WILL CONTINUE AS REGIONAL, RACIAL/ETHNIC, AND AGE GROUPS SHIFT

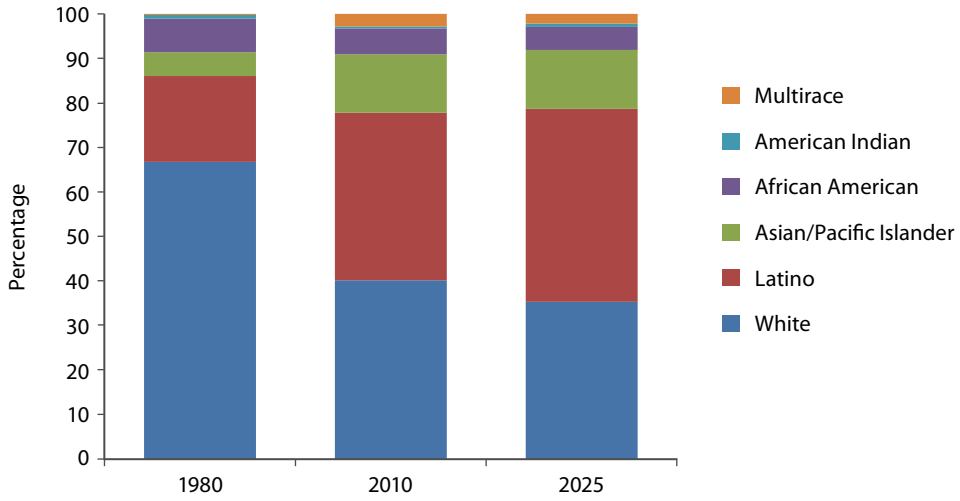
- **Population gains are projected to continue.**
  By 2025, California's population is projected to reach about 43 million. Annual growth rates are expected to be just 1 percent, similar to growth experienced in the 1990s and the 2000s but substantially slower than in earlier decades. Even so, average annual increases between now and 2025 will exceed 350,000—equivalent to adding the population of a city the size of Bakersfield each year.

- **Inland areas will see higher growth.**
  The inland areas of California have experienced faster growth rates than the coastal areas for many decades, but coastal counties are still home to most of the state's population. Projections indicate that the Inland Empire, the Sacramento region, and the San Joaquin Valley will grow faster than other areas of the state.

- **Migration will account for a small share of growth.**
  Until 1990, most of California's population growth was due to migration, primarily from the rest of the United States. Most of the state's growth since 1990 has been due to natural increase—that is, the gap between the number of births and the number of deaths. Over the past ten years, gains through international migration have been fully offset by domestic migration out of California. Population projections suggest that this pattern will continue: almost all of the state's population growth is expected to come from natural increase.

- **California's population will continue to diversify.**
  No ethnic group composes a majority of the state's population, with whites (non-Hispanic) making up 40 percent of the state's population and Latinos making up 38 percent. The California Department of Finance projects that in 2016 Latinos will replace whites as the largest ethnic group. Among children age 12 and under, Latinos already make up 52 percent of the population. Latino increases are due to both immigration and relatively high birth rates. Immigrants are projected to make up 29 percent of the state's population in 2025, a modest increase from 27 percent in 2009.

LATINOS WILL BECOME CALIFORNIA'S LARGEST ETHNIC GROUP



SOURCES: 1980 and 2010 Censuses; California Department of Finance projections.

- **Large numbers of Californians will soon reach retirement age.**
  In 2010, 11 percent of Californians were age 65 and over, compared to only 9 percent in 1970. By 2025, that share will grow to 16 percent. The total number of adults age 65 and over is projected to grow from 4.2 million in 2010 to more than 7 million in 2025.

- **The number of children will increase very slowly.**
  From 2010 to 2020 the number of children in public schools is projected to increase only 2 percent according to the California Department of Finance. This is a consequence of slight declines in birth rates along with a small increase in the number of women aged 15 to 44. In contrast, during the 1990s the number of school children grew more than 20 percent.

LOOKING AHEAD

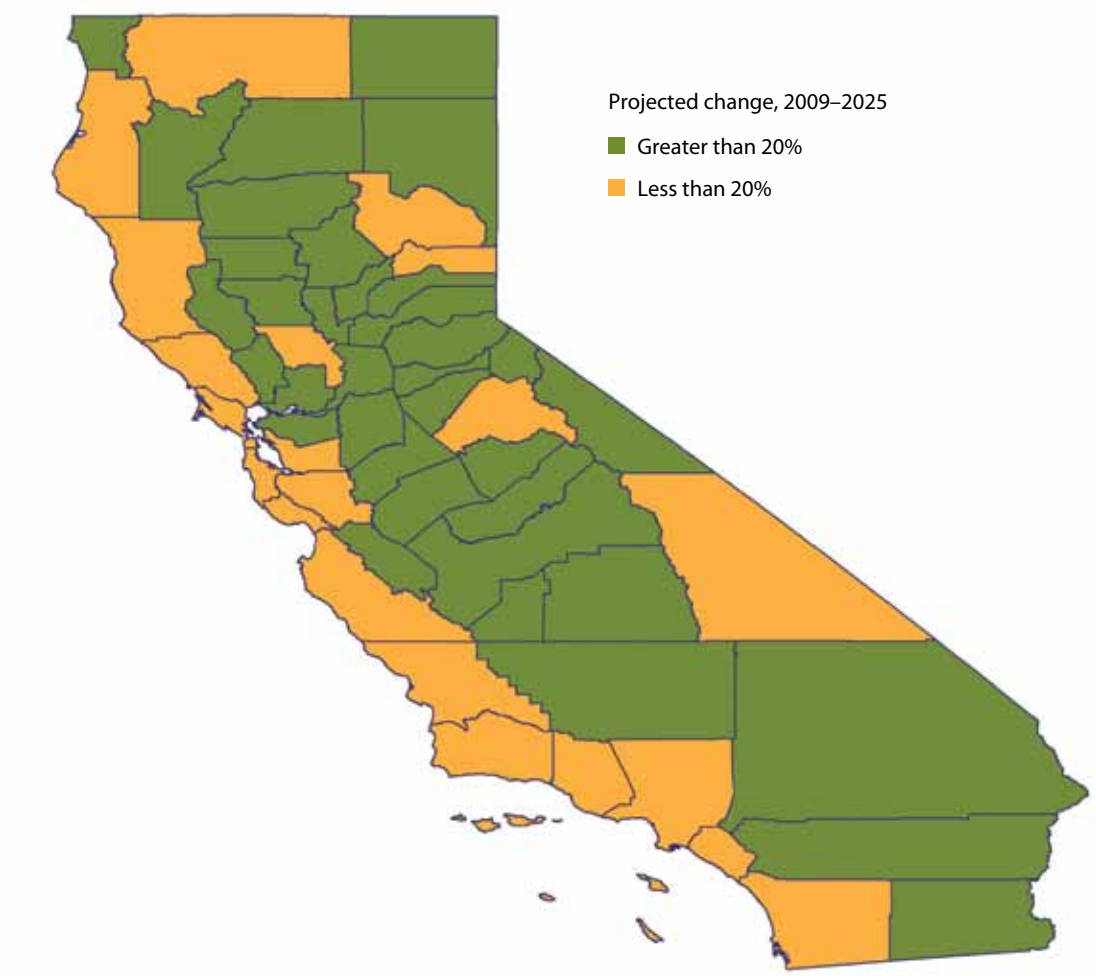
The state's growing and changing population will put pressure on a variety of infrastructure needs and public services. Key areas to watch:

Health and human services. Meeting the needs of a large and growing elderly population will pose more challenges. For example, even though Medi-Cal enrolls a far larger share of children, elderly adults account for a much higher share of expenditures. Annual costs per enrollee are at least five times higher for adults over age 50 than for children. Nursing home care is especially expensive.

Housing. After the elderly, adults in their late 20s and early 30s will be the fastest-growing age group. Between 2010 and 2025, the number of adults ages 25 to 39 will increase by almost 30 percent. These are the ages at which young adults typically get married, start families, and establish their own households—driving up housing demand.

Schools. The relatively slow growth in the number of school-aged children could give the state time to catch up on school infrastructure needs and a chance to adjust school budgets, perhaps increasing per student expenditures. Demand for higher education should remain strong as the number of students graduating from high school levels off but at a historically high level.

INLAND COUNTIES WILL EXPERIENCE FASTER POPULATION GROWTH



SOURCE: California Department of Finance projections.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

California's Population
Immigrants in California
The Age Gap in California Politics
The Inland Empire in 2015
PPIC Statewide Survey: Californians and Population Issues

Contact a PPIC expert:
Hans Johnson

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CALIFORNIA WATER

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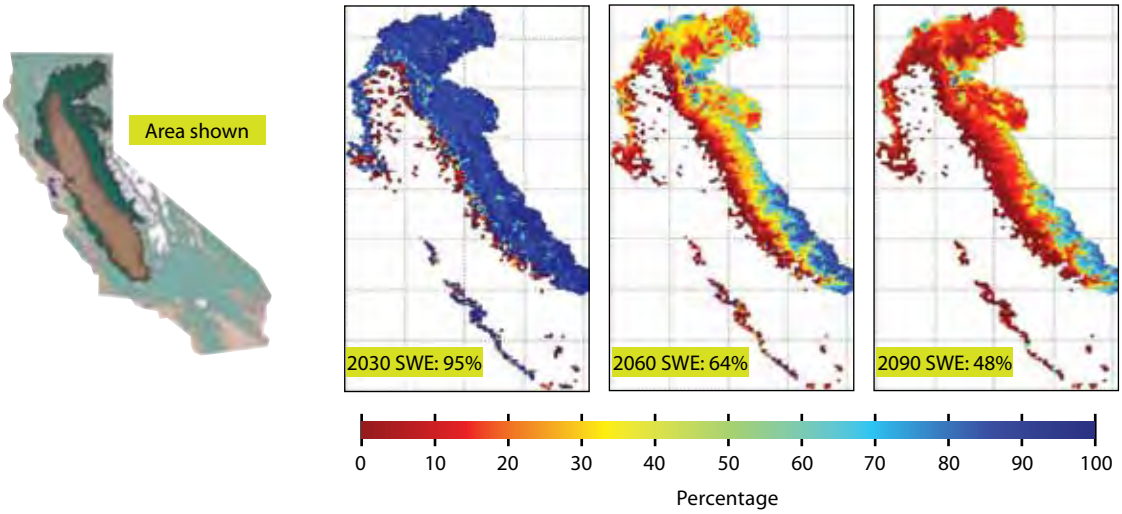
CALIFORNIA FACES GROWING WATER MANAGEMENT CHALLENGES

Water management in California has always been difficult: the state's variable climate is marked by long droughts and severe floods, with stark regional differences in water availability and demand. A vast network of storage and conveyance facilities delivers water from the wetter parts of the state to population and farming centers in the Bay Area, the San Joaquin Valley, and Southern California. This network is now threatened by the physical and biological fragility of the system's hub in the Sacramento–San Joaquin Delta.

Other challenges are on the horizon. Although per capita water use is decreasing, population growth is likely to increase urban water demand in some regions. At the same time, conflicts are growing between human water uses and water needed to support fish and other wildlife. In addition, California faces serious and growing threats to life and property from flooding.

Climate change will play an important, if uncertain, role. California's natural variability is likely to increase, accentuating droughts and floods. Rising air temperatures are expected to significantly reduce the Sierra Nevada snowpack, affecting water storage as well as winter and spring flood flows. Higher water temperatures may make it harder to maintain aquatic habitats for native fish species. Over time, all of these challenges are likely to intensify. Potential solutions will involve difficult and sometimes costly tradeoffs, as well as inconvenient legal and political changes.

RISING TEMPERATURES WILL DIMINISH THE SIERRA NEVADA SNOWPACK



SOURCE: N. Knowles and D. R. Cayan, "Potential Effects of Global Warming on the Sacramento/San Joaquin Watershed and the San Francisco Estuary," *Geophysical Research Letters* 29, no. 18 (2002).

NOTES: SWE is snow water equivalent. These scenarios are based on projected temperature increases: 0.6˚C (2020–2039), 1.6˚C (2050–2069), and 2.1˚C (2080–2099), expressed as a percentage of estimated present conditions (1995–2005). These are modest increases relative to some model projections. With higher temperature increases, the snowpack would be commensurately smaller.

CALIFORNIA'S BIGGEST WATER CHALLENGE: INSTABILITY IN THE DELTA

As the fragile hub of California's water supply, the Delta now poses serious risks to the economies of the Bay Area, Southern California, and the San Joaquin Valley. Sea level rise and earthquakes threaten the weak Delta levees. The collapse of native fish species has led to cutbacks of pumping from the southern Delta. The Delta's physical deterioration will not be delayed by political indecision: the state faces inevitable, fundamental change in this region.

- **Moving water beneath the Delta could reduce both ecosystem and economic risks.**
  The current system relies on pulling water directly through Delta channels to the pumps. A new management plan, known as the Bay Delta Conservation Plan, is now being formulated by state, federal, and local water agencies. They are considering the construction of two tunnels to tap some water upstream on the Sacramento River and move it underneath the Delta to the pumps. This change could be good for the environment: fewer native fish would be trapped in the pumps and it would be easier to restore more natural flows within the Delta. The state's economy could also benefit from improved water quality and water supply reliability.

- **Governance and finance solutions are needed; so is attention to the Delta economy.**
  To ensure that the tunnels are managed for environmental benefits, the project should include performance-based limits on water diversions from the Delta. Water users have said they will pay for the new conveyance infrastructure, but funds must be found for large ecosystem investments. Funds will also be needed to support economic transitions in the Delta, because the region will likely lose some agricultural islands from levee failures, whether or not tunnels are built.

CALIFORNIA HAS MANY TOOLS TO COPE WITH WATER SCARCITY

There has been little expansion in the state's major water infrastructure since the early 1970s, but California's economy has still prospered. From 1967 to 2005, per capita water use declined by half, real per capita state GDP doubled, and the economic value of each unit of water increased four-fold. These trends reflect increased efficiency of water use in all sectors and a decline in the relative importance of agriculture, which accounts for more than three-quarters of water use but only 1 to 2 percent of state GDP.

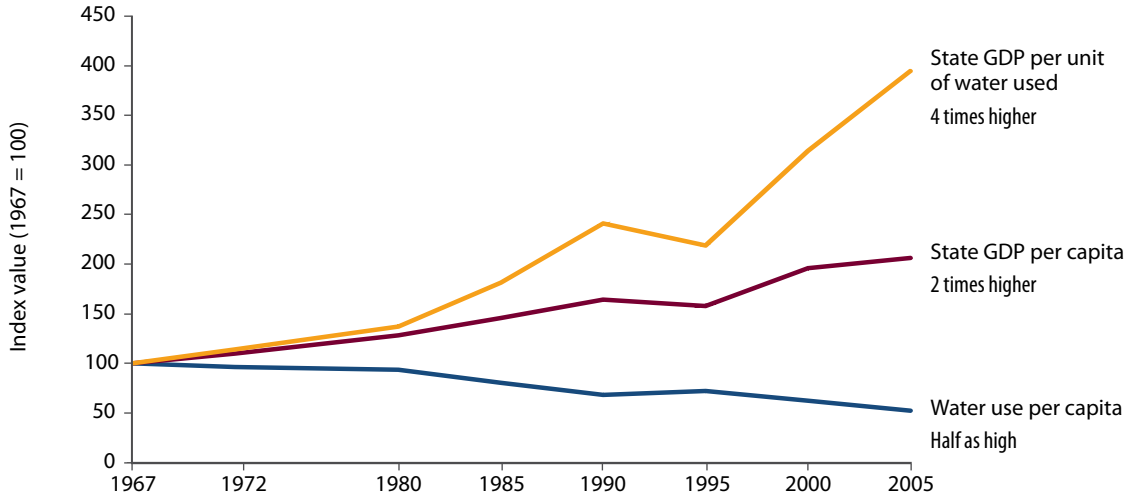
- **California is fortunate to have many options for meeting new demands.**
  Expanding traditional supply sources—particularly surface reservoirs and native groundwater supplies—is more difficult today than in the past. But there is considerable scope for cost-effective expansion of nontraditional supplies such as recycled wastewater and for improving water use efficiency. Water marketing—the sale or leasing of water—plays an important role in increasing efficiency; it allows water to be transferred to growing urban areas and from lower- to higher-value farming. It also creates broad incentives to conserve.

- **Much progress has been made since the drought of the early 1990s.**
  Water markets have been valuable in supplying water to cities and high-value agriculture during droughts and for long-term growth. Urban water use efficiency has risen in most areas thanks to new plumbing codes, better technology, and better pricing incentives. Regional cooperation is helping local utilities cope with supply emergencies.

- **Underground storage still has great untapped potential.**
  Where space is available in aquifers, storing water underground can be a cost-effective way to save it for dry years. This "groundwater banking" will become increasingly important as the snowpack declines. The current lack of state regulation makes success dependent on agreements among local parties. Groundwater banking provided significant relief during the late 2000s drought, but much more could be done, particularly in the Central Valley.

- **Surface storage expansion has been very contentious.**
  Increased surface storage could make up for some loss of storage in the snowpack and could also provide more flexibility in managing floodwaters and environmental flows. However, new storage has not been proven to provide large new supplies of water, and it will be less valuable if climate change reduces overall precipitation. Large financial and environmental costs also raise concerns. Public opinion appears split: 50 percent of all adults feel that California should focus on improving water use efficiency while 47 percent prefer building new storage (PPIC Statewide Survey, December 2012).

THE ECONOMIC EFFICIENCY OF WATER CONTINUES TO RISE



SOURCE: Hanak et al., *Water and the California Economy* (PPIC, 2012), using data from the Department of Water Resources, the Department of Finance, and the U.S. Bureau of Economic Analysis.
NOTE: State GDP (Gross Domestic Product) is adjusted for inflation. Water use estimates are for applied use in the agricultural and urban sectors.

CALIFORNIA HAS ONLY JUST BEGUN TO ADDRESS EXTREME FLOOD RISKS

Sacramento has the highest flood risk of any major U.S. city, and many other areas in the Central Valley and the Bay Area are at extreme risk of flooding. These risks are expected to grow with climate change. Although the state has recently increased investments in flood control infrastructure, more work is needed to keep new development out of harm's way.

- **Flood management faces major funding challenges.**
  This sector has traditionally relied on large (65 percent) federal cost shares for new investments, but federal contributions have been lagging and are likely to decline in the future. State investments in flood prevention increased considerably after Hurricane Katrina, thanks to voter approval of $5 billion in state general obligation bonds. However, the remaining funds fall far short of estimated needs (more than $17 billion in the Central Valley alone).

- **Local governments have few incentives to limit flood risk exposure.**
  A 2003 court decision made the state liable for damage from failure of many Central Valley levees, even those maintained by local agencies. A legislative package passed in 2007 requires that locals make land-use decisions that will reduce flood risk to new homes in the Central Valley, but it is unclear whether climate change will be taken into account in setting new rules.

- **Residents also have few incentives to limit flood risk exposure.**
  As long as buildings are located behind levees deemed to provide protection against a "100-year flood," there is no requirement to disclose flood risks to residents at the time of sale, even though many areas would face serious flooding if levees were breached. Within the Central Valley, the state recently began to send annual flood risk notices to landowners in these zones—a positive step. Few Californians hold flood insurance, which is required only in areas with extreme flood risk.

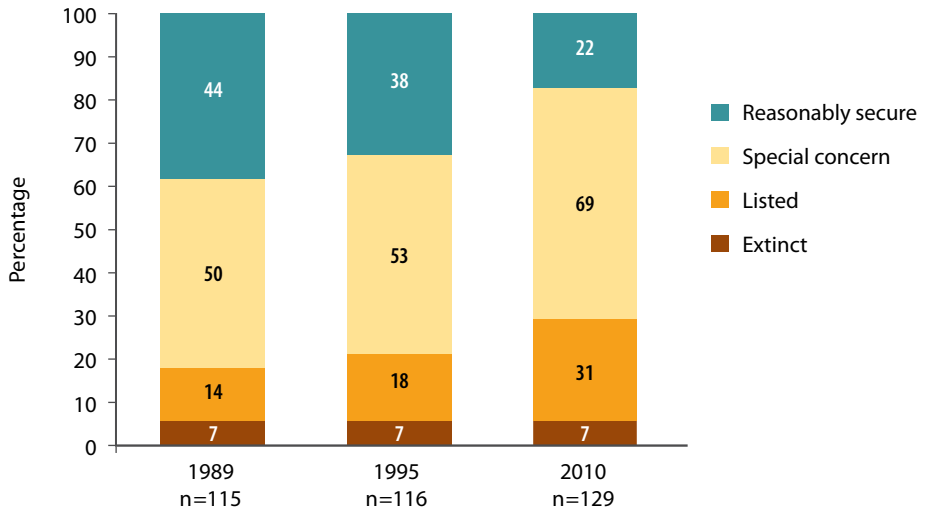
CALIFORNIA MUST IMPROVE MANAGEMENT OF AQUATIC ECOSYSTEMS

The demand for environmental water, healthy watersheds, and clean beaches has been increasing and is likely to grow. However, the state faces major challenges in meeting some environmental goals.

- **Native fish species are in decline.**
  Populations of native fish species—an important indicator of overall ecosystem health—are declining across the state, despite several decades of well-intentioned efforts and expense. These declines heighten conflicts with other water management goals, because they lead to increasingly tight and costly restrictions on water supply, wastewater, and flood protection projects.

- **Ecosystem-based approaches can help.**
  At present, environmental management is often "siloed," with each agency and each project addressing particular issues in particular locations—water quality, wetlands, flows, habitat—without an integrated vision of how to contribute to overall improvement of ecological conditions. Coordinated approaches that seek to improve environmental performance for entire watersheds would be much more effective in protecting native species and would enable California to spend its dollars (and environmental water) more wisely.

CALIFORNIA'S NATIVE FISHES ARE IN TROUBLE



SOURCE: Moyle, Katz, and Quinones, "Rapid Decline of California's Native Inland Fishes: A Status Assessment," *Biological Conservation* 144: 2414–23 (2011).
NOTES: "Extinct" = extirpated from California; "listed" = threatened or endangered under state or federal Endangered Species Acts; "special concern" = in decline and could qualify for listing in the future; "reasonably secure" = widespread and abundant according to current knowledge. N = number of species.

CALIFORNIANS MUST DECIDE HOW TO FILL FUNDING GAPS

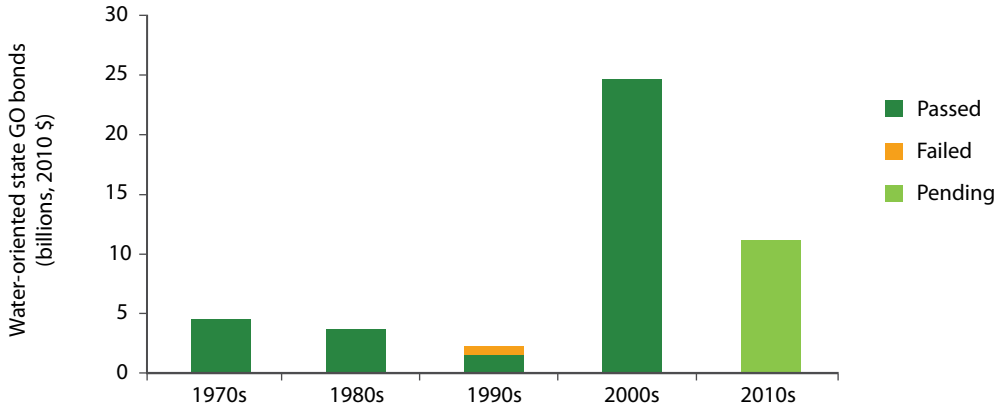
Although Californians pay for most water system expenditures through their monthly water and wastewater bills, the state began to rely more heavily on state general obligation bonds (funded by tax dollars) over the past decade.

- **State bonds have provided valuable support.**
  These bonds have helped local water agencies fund some innovative projects, like water recycling and groundwater banking, and they have been essential for flood protection and ecosystem management, which do not have adequate alternative funding sources.

- **But public appetite for more bonds may be waning.**
  Existing bonds are nearly depleted, and concerns about weak voter support have led the legislature to twice delay putting a new $11 billion bond on the ballot (originally scheduled for November 2010, now delayed until November 2014). When investments lead to true public benefits, such as ecosystem restoration, relying on tax dollars makes sense. But these investments also take general revenue funds away from education and other state budget priorities.

- **Will the public get behind more locally based funding?**
  Given these tradeoffs, California may need to rely more heavily on the "user pays" principle to fund ecosystem programs (through higher monthly water bills and property assessments). Gaining public backing for more ecosystem funding may prove challenging: 61 percent of Californians say they support increasing state spending to improve conditions for native fish, but support falls to 39 percent if it means an increase in residents' water bills (PPIC Statewide Survey, December 2012). Increasing local contributions are likely also necessary for flood protection, but this requires making a case to local voters.

THE 2000s SAW UNPRECEDENTED GROWTH IN STATE WATER BONDS



SOURCE: Hanak et al., *Water and the California Economy* (PPIC, 2012).
NOTES: Values are converted to 2010 dollars using the construction cost index from *Engineering News-Record*. Past bonds have supported water supply, water quality, flood infrastructure, and ecosystem and open space improvements. In 1960, voters approved a $1.75 billion bond ($18.7 billion in 2010 $) for the construction of the State Water Project, but this bond has been paid for by water users, not general fund tax dollars.

LOOKING AHEAD

California has the tools to help secure a safe and reliable water supply, improve conditions for aquatic species, and reduce flood risks. In recent years, water managers have made significant progress toward these goals. But the challenges are increasing with population growth and climate change. Increased momentum in policy reform—coupled with new investments—is essential to the state's future. Some changes will be politically difficult. The following issues require sustained attention.

The Delta. The proposed new tunnels have the potential to safeguard the Delta's environment while maintaining water supply reliability. But this solution requires solid policies on governance, finance, and mitigation for Delta landowners and residents, and a well-organized and well-funded science program to adapt and refine ecosystem management under changing conditions.

Ecosystem protection. Beyond the Delta, a more comprehensive, coordinated, and proactive approach is needed to support California's aquatic ecosystems and the species that depend on them.

Water efficiency. Better pricing policies—such as tiered water rates with higher prices for greater use—can heighten incentives to conserve while allowing local water suppliers to balance their budgets.

Groundwater management. Better basin management is a prerequisite to realizing the significant potential of groundwater banking. Many groundwater basins have effective local management protocols, especially in Southern California and Santa Clara County. But progress is needed elsewhere.

Flood risk exposure. To reduce risks to new development, state floodplain mapping should account for climate change and increasing flood risks. To boost homeowner awareness, the risks of living behind levees should be disclosed statewide, building on the new policy in the Central Valley, and flood insurance requirements should perhaps be strengthened.

Funding. The state will need to find ways to pay for rising water infrastructure costs and for critical improvements in aquatic habitat. Even if voters ultimately approve new state bond funding, local funding by ratepayers (and property owners in flood zones) will need to increase.

Climate change. Higher water temperatures and sea level rise will alter aquatic habitat in significant but largely unexplored ways. Environmental laws will require that water users respond to these changes with potentially costly management actions (e.g., changing reservoir operations). Anticipating the likely changes would allow the design of more cost-effective responses.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

California's Water Market, By the Numbers: Update 2012
Where the Wild Things Aren't: Making the Delta a Better Place for Native Species
Water and the California Economy
Transitions for the Delta Economy
Managing California Water: From Conflict to Reconciliation
California Water Myths

Contact a PPIC expert:
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CALIFORNIA WORKFORCE

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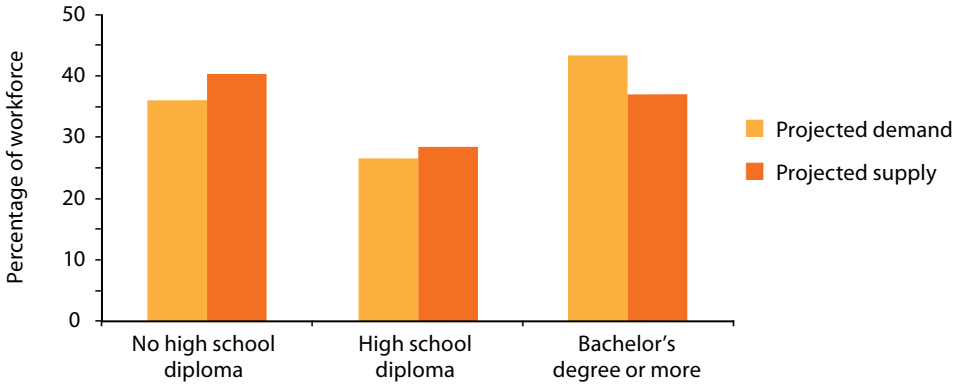
CALIFORNIA FACES A SKILLS GAP

California's education system is not keeping up with the changing demands of the state's economy—soon, California will face a shortage of skilled workers. Projections to 2025 suggest that the economy will continue to need more—and more highly educated—workers, but that the state will not be able to meet that demand. If current trends persist, in 2025 only 35 percent of working-age adults in California will have at least a bachelor's degree but 41 percent of jobs will require at least a bachelor's degree. This equates to a shortfall of one million college graduates. Substantial improvements in educational outcomes are needed to meet the demands of tomorrow's economy and ensure the economic prosperity of Californians. Failure to make improvements will result in a less-productive economy, lower incomes for residents, less tax revenue for the state, and more dependence on social services.

BY 2025, DEMAND FOR COLLEGE-EDUCATED WORKERS WILL OUTSTRIP THE SUPPLY



SOURCE: PPIC projections.

POPULATION TRENDS AND ECONOMIC DEMAND ARE DIVERGING

- **California's economy increasingly demands highly educated workers.**
  For decades, California employers have needed more workers with college degrees. This shift toward more highly educated workers has occurred as a result of changes both within and across industries.

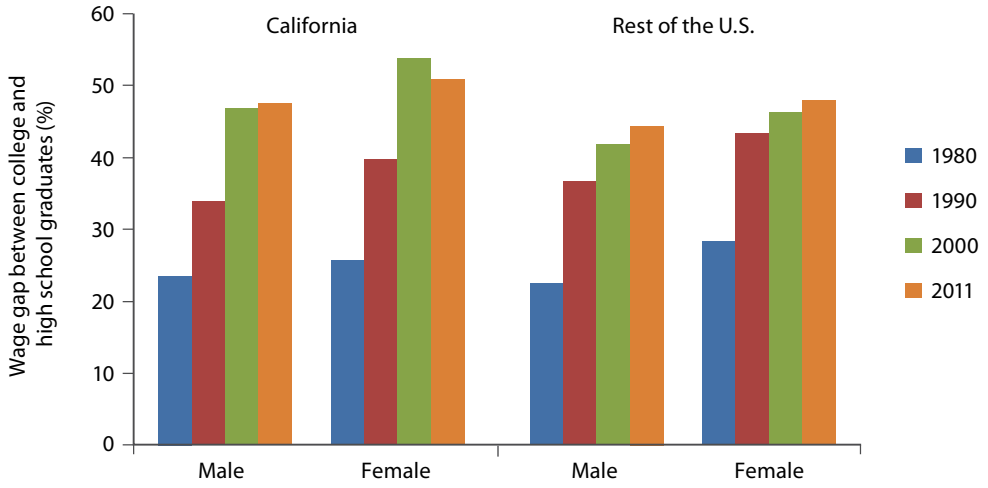
- **The supply of college graduates will not keep up with demand.**
  Two demographic trends will work against future increases in the number of college graduates. First, the baby boomers—a well-educated group—will reach retirement age, and for the first time large numbers of college graduates will leave the workforce. Second, the population is shifting toward groups with historically lower levels of educational attainment. In particular, Latinos—who now make up the largest group of young adults—have historically had low rates of college completion. And there will not be enough newcomers to California—from abroad or from other states—to close the skills gap.

- **Higher education is largely a public endeavor in California.**
  More than four of every five college students in California are enrolled in one of the state's three public education systems: the community colleges, the California State University, or the University of California. Three of every four bachelor's degrees awarded annually come from either CSU or UC.

- **Large numbers of California's high school graduates attend college . . .**
  More than 60 percent of California's high school graduates enroll in college within a year of completing high school. Most (35 percent) go to community colleges—open access, widespread geographic distribution, and relatively low fees make California's community colleges especially popular. Compared to other states, California's college-bound high school graduates are more likely to enroll in community colleges than in four-year colleges or universities.

- **. . . but many never earn a degree.**
  Lack of preparation for college-level work and lack of financial resources impede many students' ability to move through the higher education system. Only about one in ten community college students transfers to a four-year university. Even among those taking transfer-eligible courses, only about one in four eventually succeeds in transferring. About half of CSU students graduate within six years of entering as freshmen. Completion rates for transfer students are similar to those of other CSU juniors, with about three in four transfer students obtaining bachelor's degrees. Graduation rates are much higher in the UC system, with four of every five students earning a degree within six years of entering university.

CALIFORNIA COLLEGE GRADUATES EARN MORE, AND THE GAP IS WIDENING



SOURCE: PPIC estimates based on wage regressions using Current Population Survey outgoing rotation files, restricted to full-time workers.

CALIFORNIANS CARE DEEPLY ABOUT HIGHER EDUCATION

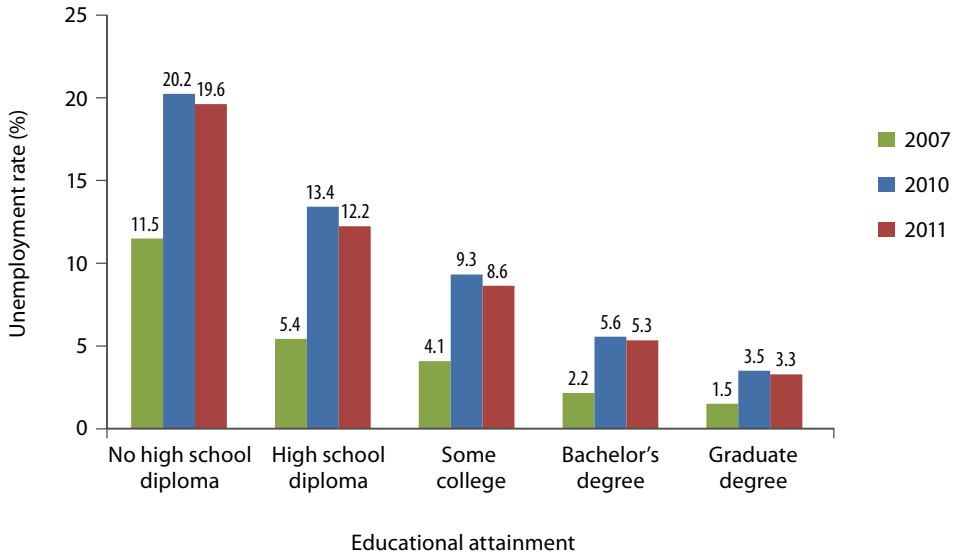
- **Californians have high hopes for their children's education.**
  Strong majorities of parents hope that their youngest child will attain at least a four-year college degree, and 51 percent would like to see their child attain a graduate degree—including 46 percent of Latinos and 51 percent of whites. College aspirations are shared across the income spectrum, with those making less than $40,000 a year (81 percent) and those making more than $80,000 a year (98 percent) both hoping that their children attain four-year degrees or more. Far fewer parents overall (6 percent) wish to see their children receive two-year college degrees or career technical training.

- **But many worry about college affordability and access.**
  Concerns about the affordability of a college education run high, with 65 percent of Californians calling it "a big problem." Majorities across age, income, and racial/ethnic groups share this view. Accessibility is also a concern, with 43 percent of Californians calling it "a big problem"—up 19 points since 2007.

- **The value of a college degree remains high.**
  Census Bureau data show that the wages of college graduates are about 50 percent higher than the wages of workers with only a high school diploma. The value of a college degree grew rapidly from 1980 to 2000 and remains at near-record levels. Even in the fragile post-recession economy, unemployment rates are far lower for college graduates than for adults with less education.

- **Concerns persist about the future of California's higher education system.**
  Despite the passage of Proposition 30, which averted "trigger" cuts to state spending on higher education, majorities of Californians across age, income, and racial/ethnic groups—as well as political parties—view the state's budget situation as "a big problem" for higher education. What about the state government's ability to plan for the future of higher education? Residents' opinions are mixed: 13 percent say they have "a great deal" of confidence, 37 percent have "only some," 34 percent say "very little," and 15 percent say "none."

UNEMPLOYMENT RATES ARE MUCH LOWER FOR COLLEGE GRADUATES



SOURCE: March CPS, all civilians in the labor force, restricted to California residents.

LOOKING AHEAD

California is facing a serious shortfall in its supply of college-educated workers. In a future with fewer college-educated adults, unemployment rates will be higher and wages will be lower. A recent PPIC Statewide Survey (December 2012) found that 85 percent of Californians view the higher education system as very important to the state's quality of life and economic vitality over the next twenty years. Improving the educational attainment of the state's young adults will foster greater individual success and increase economic growth.

- **Modest improvements can result in substantial gains.**
  Gradual increases in college enrollment rates, a 20 percent improvement in transfer rates, and an improvement in completion rates at CSU would, together, reduce the skills gap by one-half by 2025.

- **Reductions in higher education funding are making things worse.**
  Without concerted efforts to improve college attendance and graduation in California, the state's economic future will be much less bright. California's higher education institutions have born a disproportionate share of the state's budget cuts. One consequence has been a decline in college enrollment rates. Shortchanging education for quick budget fixes could seriously shortchange California's economic future.

- **Alternative forms of postsecondary training are needed.**
  Because it is unlikely that the state will be able to completely close the skills gap by increasing the number of graduates with bachelor's degrees, other forms of postsecondary training and workforce skills development are essential to the state's future.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

Defunding Higher Education: What Are the Effects on College Enrollment?
Higher Education in California: New Goals for the Master Plan
Educating California: Choices for the Future
Closing the Gap: Meeting California's Need for College Graduates
California's Future Workforce: Will There Be Enough College Graduates?
PPIC Statewide Survey: Californians and Higher Education

Contact a PPIC expert:
Hans Johnson

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