



CALIFORNIA'S JOBS AND FUTURE



**COUNCIL ON CALIFORNIA
COMPETITIVENESS**

April 23, 1992

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INTRODUCTION

The membership of the Council on California Competitiveness was formally introduced by Governor Pete Wilson on December 18, 1991. The 17 members of the council — men and women, Democrats and Republicans, business and labor — were charged with finding ways to remove the barriers to creating jobs and increasing state revenues in California.

The Council was formed in response to the realization that the state was in trouble — its population was growing along with unemployment, and there was an expanding gap between state revenues and the needs of the state government. Because the problems were increasingly critical, the Council was asked to act promptly so that legislative action could take place during 1992.

To carry out this assignment, the Council organized itself into task forces. Each task force was assigned to a specific area in which problems seemed to impede the state's economic development and progress. In studying these areas over several months, the Council examined a wide range of published evidence, including scientific studies, academic papers, and articles. Council members also heard testimony in private interviews and in public forum, reaching out beyond their own extensive experience to collect information from a wide variety of sources — representatives of small business; corporate leaders; government officials; various individual experts; spokespersons for labor, minorities and other groups, along with any interested citizens who wished to add their voices. Almost without exception, these witnesses were keenly aware of California's problems and were often impassioned in expressing their views. The individuals to whom we spoke were extraordinarily dedicated to their responsibilities and to the betterment of the state.

The Council represents the agenda of no special group. Rather, the members are united primarily by their deep concern for and love of the state of California. The report and recommendations that follow are based in large part on what the council members heard and learned during this period. They are formulated to answer as directly and objectively as possible the goal of making the state competitive for the future by providing more and better jobs for its people and thereby increasing the economic well-being of all Californians.

California, April 23, 1992

Peter V. Ueberroth
Chairman

THE CHALLENGE

To Keep California's Promise

A biting economic wind is blowing in California. It brings with it a feeling of personal threat, broken promises, and a sense of crisis. The economy is stagnating, while the government appears immobilized. California is losing its competitive edge, and the Council on California Competitiveness believes it is critical for all Californians to unite in taking immediate action to begin moving the state forward again.

The perception is becoming widely shared that California is a bad place to do business. The national media have trumpeted the state's high taxes and high cost of housing. Most recently, *60 Minutes* treated millions of viewers to a scathing examination of widespread fraud and abuse in the state's workers' compensation system. We may as well be putting two-sided billboards on our state borders — on the eastern side warning: "Go Away! Too Expensive!" and on the western side proclaiming: "Welcome to Nevada/Arizona, a Better Place to Do Business — We Want Your Jobs."

There are real problems and they are only going to worsen. As unemployment continues to climb, so does the population of California — at the rate of 600,000 a year. By the end of the decade, California will have gained six million new citizens. This new population adds increased responsibility and heavy financial burdens on the state government.

Just to stay even with the population increase, we will need an annual increase of 250,000 more jobs. Yet California is losing jobs at an even greater rate. In 1991 alone, we lost over 333,000 jobs, either from business failures, cutbacks, or companies moving out of state. Our unemployment rates are high, probably understated, and growing. Jobholders, through taxes they pay, support state government, including schools, police, highways, and other services we have come to take for granted. The result has been a devastating loss of revenues to all levels of government and a loss of opportunities for our people.

So, population is going up, and jobs, especially good-paying jobs, are going down; public costs are going up, and tax revenues are going down. Our state cannot long operate in this way. We are on the road to fiscal disaster.

The Problems

California's job hemorrhage is partly the result of the recession and of cutbacks in defense and aerospace spending. But the major problems besetting California are self-inflicted. Through our indifference to the need for job creation in this state, we are crippling ourselves. As a result, California is losing jobs in a variety of ways:

- ◆ Small and medium-sized businesses, which are the real creators of new jobs (and upon which we have focused) are being discouraged, harassed, shut down, and driven off.
- ◆ Manufacturing is being squeezed out by rigid and excessive regulation.
- ◆ Many existing businesses in California are taking their expansions to another state.
- ◆ There is a shift from higher-paying jobs to low-skill, low-paying jobs.
- ◆ Our most prized industries are being plucked away by other countries and states.
- ◆ Key national technology projects, such as the Earthquake Research Center going to Buffalo, New York, are lost to other states by our political failures.

Jobs leave because staying is too hard and too expensive. California has created a nightmarish obstacle course for business, job and revenue growth. Among the hurdles addressed in this report are:

- ◆ A permitting and regulatory quagmire that overwhelms small and medium-sized business managers and, in some cases, causes projects to take longer to get started than it took the United States to win World War II.
- ◆ A system of fees, permits, and exactions that costs as much as \$40,000 per housing unit and virtually assures that, unless the system changes, affordable housing cannot be built in California.
- ◆ A system in which agencies support themselves by means of self-determined fees and fines for which they are both judge and jury.

- ◆ A workers' compensation system that is a national disgrace because of its tolerance of fraud and abuse. Employer costs are among the five highest in the country, while worker benefits rank 44th.
- ◆ A tax structure that fails to encourage entrepreneurs to take risks and start vital new businesses, thus stalling the engine of new employment and reducing tax revenues.
- ◆ An educational system whose students are unprepared for the modern workplace.
- ◆ Government agencies that have developed adversarial, even arrogant, relationships with the taxpayers they are supposed to serve.
- ◆ A civil legal system that produces capricious results and costs too much, making products and services more expensive without adding value.
- ◆ Laws that were originally passed to protect our quality of life, now being used to thwart environmentally sound economic growth without balancing job impact with environmental needs.
- ◆ A tangle of special-interest groups and single-purpose agencies that pursue their own agendas with little or no regard for the common good or for common sense.

Government's proper economic role lies in creating the climate in which businesses can compete and thrive on their merits. In this, California is doing a terrible job. The most persistent single theme to emerge during the Council's investigation was a widespread lack of faith in public institutions. **There is a strong conviction that government is no longer working.**

The picture is of a government frozen, without the vision or will to formulate policies or carry out long-range plans for the benefit of all people. We see a government divided by internal bickering and power struggles while it is expending its energy and talents on meeting the demands of special-interest groups and single-issue partisans. Major problems go unresolved for years.

Action Plan

We must start now to solve these problems. We can only succeed through a cooperative effort that includes all Californians, in both the private and public sector. Our highest priority recommendation is to initiate a thorough redesign of governance in California at all levels. But to begin, we must take an **immediate series of actions to be carried out over the next 12 months**. The Council urges that:

- ◆ The state legislature adopt the legislation called for in this report.
- ◆ The governor immediately implement the executive branch actions called for in this report.
- ◆ The Democratic and Republican leadership join together to ask every business to do its part and commit to retain its jobs in California for the one year that it will take to get the initial solutions in place.
- ◆ The congressional delegation of California's U.S. senators and members of the House of Representatives meet monthly, starting in May, in order to ensure Californians fair treatment in federal policy and spending, and jobs.
- ◆ The California Judicial Council adopt the rule changes described below and sponsor legislative action to streamline the judicial system and reduce unnecessary legal action.
- ◆ Every citizen become familiar with the issues affecting our state and insist that our elected officials vigorously pursue the actions described herein.
- ◆ Finally, as Californians, we all unite in promoting a positive image of our state and its great strengths.

We can achieve anything we want, but we must agree on what needs to be done and how to do it. California has enormous advantages that set it apart from other places — its location, climate, resources, and especially its creative and innovative people. Because of its position on the Pacific Rim, California is already a leading participant in Asian trade, and the state is poised for even greater growth as the Far Eastern industrial expansion continues. The state's mild weather, rich culture, and spectacular scenery draw visitors from all over the world.

California has a tradition of adapting to change and growth, setting trends, and solving problems that other regions are just starting to identify. In the past, California government has provided the state with an infrastructure to match its economic progress, including an efficient freeway network, a vast water supply system, and one of the finest higher education systems anywhere. We must continue to work toward a cleaner and safer environment, but we must also find better and more innovative ways to maintain our habitat while balancing the economic need for jobs.

The Council believes in the promise of California. The recommendations for action that follow are proposals for permanent changes. They do not solve all of society's problems, but they will get the economy rolling again. They are designed to impart a speed-to-market mentality and a recognition that we are competing internationally. They are intended to develop performance measurements and accountability in all our major public programs. Finally, they should develop a **sense of direction** so that everyone working for the good of the state can direct their energies toward clear goals.

By implementing the Council's 12-month urgent action program, the following major, long-term improvements will be achieved for every Californian:

- ◆ A reformed workers' compensation system that serves its original intent and eliminates blatant fraud and abuse, while increasing worker benefits and reducing employer costs.
- ◆ A redesign of permitting actions that achieves a predictable, fair, and short decision process.
- ◆ A socioeconomic assessment of existing and future regulations so that a balanced use of our financial resources yields the greatest societal rewards.
- ◆ Economic incentives that encourage investment in new and expanding businesses.
- ◆ Education and training programs that dramatically and measurably increase the skills and productivity of our workers.
- ◆ Fairness, speed, and efficiency in our civil legal system.
- ◆ A statewide electronic reporting and paperwork simplification program with special relief for small businesses.

- ◆ An economic development network that makes enterprises feel welcome in California.
- ◆ A customer-service attitude in every government employee and a Total Quality Management program in every state and local agency to constantly improve efficiency.
- ◆ A consensus vision of California's future with clear goals.
- ◆ A process for planning California's long-term future.
- ◆ And a new design for the governance of California.

There is no magic that will automatically cure our ills. It will not be easy. But by working together, we can turn things around and ensure that California will continue to be a world leader and fulfill its bright potential by supplying more and better jobs for its people.

1. ROLES OF GOVERNMENT

California always has been a magnet for people, and historically, the state's political leadership has encouraged the growth of a vibrant community. To maintain its quality of life, California must create a framework that provides a sound economy, adequate affordable housing, improved infrastructure, and improved educational facilities.

Today, however, government in California is not working at any level. It is in a state of paralysis. Executive orders are not being implemented, excessive legislation has created a logjam, and agency budgets are being held hostage by partisan games and political infighting.

It is time for all of us — citizens, business, and government — to recognize the need to cooperate in order to attain all of California's common goals. There is a need for partnership, customer service training, quality management process, and global thinking to produce a sound economy. California must guarantee an environment in which jobs will be readily created and available in order for the state to ensure the quality of life of all its citizens.

The people of California must demand reform and change now in: (a) the current structure, operation, and planning of government; (b) the current relationship between government and business, including their adversarial view of each other; and (c) the lack of coordination in economic development activities at all levels of government. The specific recommendations that follow provide proposed solutions to these as well as other problems.

A. Need to Redesign Government Structure and Improve the Relationship Between Government and Business

Problem:

Inadequate state planning and a lack of coordination and efficiency at all levels of government cloud the state's future. Consequently, the California community suffers because there is no expressed state vision, growth policy, or long-term economic plan for developing domestic and international markets. California must have a strategic consensus vision which would include the state's goals and objectives for planned growth and economic development while integrating, reconciling, and balancing the competing interests and needs of government agencies and self-regulating, independent agencies at the state, regional, and local levels.

Actions:

- ◆ The governor should lead the **development of a strategic plan** that presents a consensus vision of the state, is supported by Democrats and Republicans, business and labor, and is coordinated by an outside organization, such as Stanford Research Institute, that has done such plans for other states.
- The governor should state the **top five priorities** for the citizens of California and, with the legislature, ensure that such priorities are implemented by government agencies and self-regulating, independent agencies throughout the state.
- The governor should develop and annually update a master plan that coordinates and streamlines the current 50 state plans (see Appendix III, which provides a list of the major state plans that bear on growth).

Problem:

California has no executive agency responsible for overseeing and managing the state's budgetary, policymaking, and regulatory entities to ensure that they are operating efficiently and in concert. In addition, much of the administration of the state is carried out by agencies with a single mission. As a result, each agency makes independent decisions without guidance and coordination as to the state's long-term plans. Neither the governor's office nor any existing agency can handle the

overwhelming burden of reviewing each agency's mission, plans, and progress. We, the taxpayers, are not getting our money's worth, and we are losing out on the opportunity to cut the cost of government. (See Appendix IV for an organization chart of state government.)

Actions:

- ◆ **Create an oversight body** that is analogous to the federal system's Office of Management and Budget (OMB), to coordinate the policy and budgetary decisions being made by the state government. This Management and Budget Office should encompass such departments as the Department of Finance and the Office of Administrative Law, and should consider whether the Office of Planning and Research should be included. It would report directly to the governor. In addition, the Management and Budget Office's responsibilities would include the following:
 - Review agency budgets and prepare the annual budget for the governor.
 - Streamline reporting and permitting regulations.
 - Review the laws of permitting power.
 - Review the performance of each agency and its organizational and managerial structures.
 - Require and review a cost/benefit analysis for all regulations and legislation prior to submission to the governor.
 - Develop and coordinate a statewide electronic database to enable all state agencies to communicate and coordinate state policy and activities.
 - Set in motion checks and balances that in the short term could redesign and in the long term would exercise control over the proliferation of agencies and regulations.

Problem:

There is redundant paperwork mandated by government agencies with no existing central filing system for retention and storage in place; therefore, citizens are

required to fill out numerous redundant forms in order to fulfill the state licensing and regulation requirements.

Action:

- ◆ In order to enforce a **paperwork reduction act** for all state agencies as well as simplify all business reporting and compliance requirements, the governor should mandate within one year the implementation of an electronic filing system whereby citizens could **file once** to meet licensing or regulation action.

Problem:

State government has become a behemoth that seemingly lacks direction and is unable to effectively address California's complex problems. The state's budgetary, policymaking, and regulatory agencies go about their work with little coordination or sense of common purpose. In addition, overlapping jurisdiction occurs not only at all levels of government — state, regional, and local — but with single-purpose agencies as well. The result is a labyrinth of policies and regulations which, instead of fostering a thriving business community, confound and stymie small and large business alike. For example, California currently has over 50 state plans and 72 agencies in Los Angeles alone that have jurisdiction over and solely deal with environmental concerns.

In addition, since the implementation of Proposition 13, city and local governments have not had adequate revenues for services such as infrastructure. Many entities have been forced to supplement their budgets through the imposition of regulatory fees, fines, and exactions on businesses and citizens within their jurisdiction, and such revenues are placed directly in that agency's budget. Also, with the current structure, there are independent agencies that are not accountable to a general oversight body for the budgets, fees, and policies they create and implement. These revenues are *de facto* taxes but are not approved by the normal democratic process. In fact, we wind up with a dramatic imbalance between the funds provided to general-purpose agencies for infrastructure versus the resources available to the special-purpose agencies. As a result of the agencies' overlapping and competing interests, businesses are paying for redundant, yet mandated, services. Hence, the current revenue-generation system for state and regulatory agencies and local governments through their impact fee and fining powers necessarily results in excessive costs, frequently stunting growth and impeding the attraction and retention of business in the state.

Action:

- ◆ The governor should appoint a **Governance Commission** to recommend the restructuring of government at all levels in order to (a) eliminate excessive, overlapping governance, (b) redeploy the state's resources and redesign the mechanism for state revenue collection, budgeting, and spending systems and policies at all levels of government, and (c) if suggested by such a commission, recommend regional governance to integrate the various self-regulating, independent agencies and to set priorities among the various regulatory programs.

Problem:

For California to prosper, government and business must work together. Unfortunately, rather than accepting each other as partners in a common cause, the two do not appear to understand each other and often seem to work at cross purposes. In fact, government agencies funded by self-generated revenues become advocates for perpetuating their own programs, regardless of the impact of rules and regulations. As a result, they often lose sight of who their customers are. Instead of promptly issuing a permit with ensuring safeguards, such a bureaucracy is more likely to interpret its job as a mandate to do nothing. At the same time, if business had been more proactive, and proposed appropriate modifications, it might have helped solve this problem a lot sooner. As we have learned from the example of other nations, government and business, when working in concert, are a formidable economic force. The responsibility for improving this situation must be shared by business people and government agencies.

Actions:

- ◆ Require immediately that all state and local government agencies develop and implement a **customer service training program**. The city of Sunnyvale has been successful in implementing such a program. (See Appendix V.)
- ◆ Require immediately that all state and local government agencies institute a **Total Quality Management program** in order to continuously improve quality and efficiency.
- ◆ Business and government should establish and expand intern programs such as the White House Fellows and the CORO Foundation to encourage business leaders to learn about and participate in government.

- ◆ All business people should be proactive in their local and state governments. Business trade associations need to continue their efforts in providing education and issue materials to businessmen and businesswomen, and in aiding them to become more directly involved with the appropriate entities of government.

B. Coordinate National, State and Local Economic Development Activities

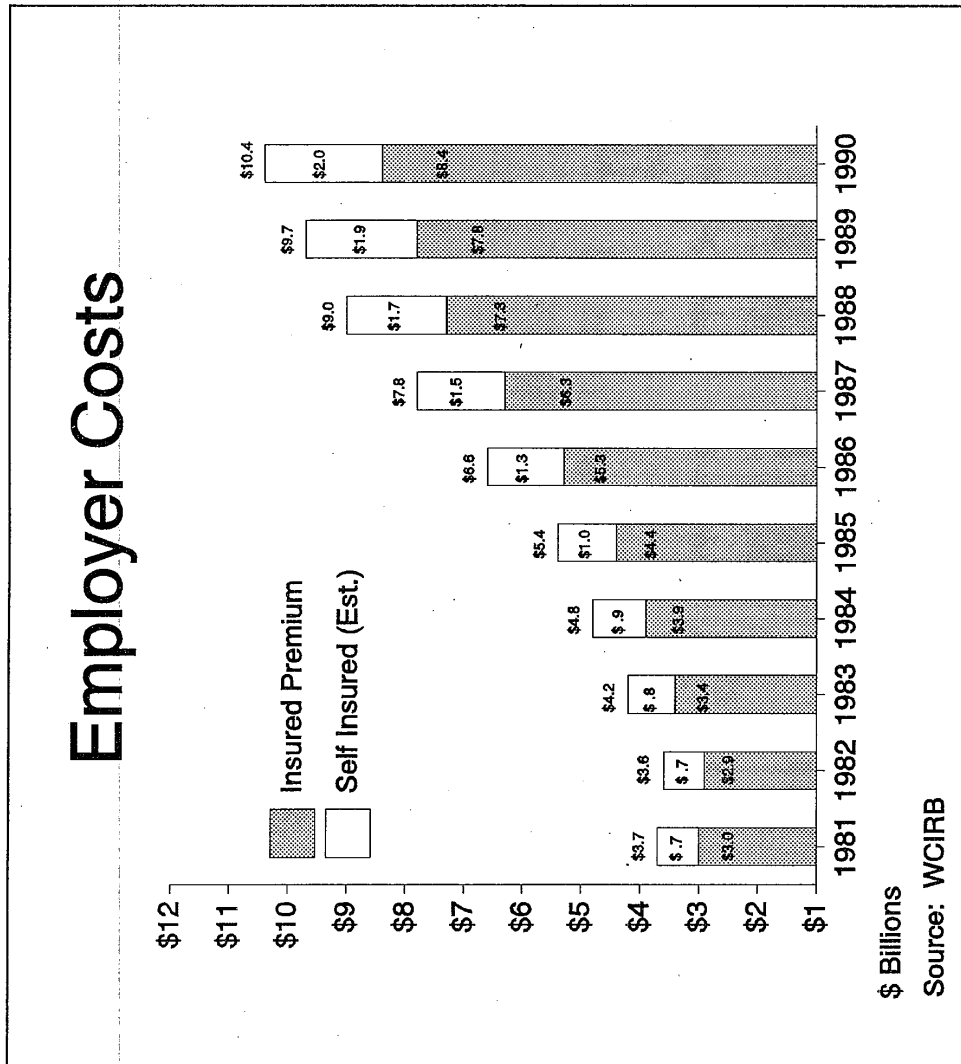
Problem:

Economic development policy in the state of California is formulated and implemented by a myriad of unrelated state and local organizations. Without diminishing the contribution that each of these groups makes, it is clear that the state suffers from this lack of coordination and lack of a uniform policy. In addition, many organizations and businesses do not participate effectively in local economic development activities. By strengthening their infrastructure and by coordinating strategy, the various economic development agencies throughout the state can increase their overall effectiveness and contribution to state government and statewide economic growth. Equally important is the fact that we simply are not selling our state: Other states are having a field day attracting our business. Our federal officials are not aggressively pursuing federal grants and programs. Finally, there is little coordination between our federally elected officials and state elected officials for local economic development activities.

Actions:

- ◆ All of California's U.S. senators and congressmen should convene in Washington, D.C. monthly, starting in May, to discuss California's strategy for obtaining its fair share of federal spending and influencing federal policy. The California delegation is the largest but has been called the least effective. Their failure to meet regularly for this purpose is irresponsible. This effort should be led by senior Democrats and Republicans and should be carried out immediately. In addition, they should meet with the governor two times a year in order to coordinate state and federal policy.
- ◆ The delegation should seek federal funds to support the extraordinary health and education costs attributable to the disproportionate flood of immigration.
- ◆ State Assembly and Senate members need to coordinate with their corresponding congressional members to share in cooperative efforts toward building jobs in their respective district. They should consider themselves to be marketing teams for their districts and band together to pursue job opportunities and prevent job losses.

- ◆ The Director of Commerce should be elevated to the proposed position of Secretary of Commerce in order to provide the commerce function with the power needed to solve business issues.
- ◆ Each city or county should develop a strong program to attract and retain business and implement the program on the local level by strengthening and coordinating local economic development organizations. (See Appendix VI, which outlines the Alameda County Economic Development Program's approach to promoting business development).
- ◆ The California Department of Commerce should establish an advisory council made up of economic development officers from the local economic development organizations to advise the proposed Secretary of Commerce on an economic development plan for California.
- ◆ The governor should create a Competitiveness Committee composed of a cross-section of high-level, bipartisan and diverse (geographically, ethnically, and occupationally) business and labor individuals. This committee should meet with the governor at least two times a year to assess and report on competitive issues facing the state, and advise the governor on economic development and strategy. The proposed Secretary of Commerce should be a member of such a committee.
- ◆ The existing Department of Commerce field offices in the state should be given increased responsibility for the economic development within their communities. Such field offices should be transformed into full-service agencies in order to implement the local economic development and the retention and attraction program.
- ◆ The Commerce Department, in conjunction with the governor, should develop an aggressive trade policy, expand their budget and mission, and implement such policy through outreach programs, such as trade shows, seminars, trade missions, and research, in order to promote the state for investment, tourism, and exports.
- ◆ Transfer all trade agencies and appropriate commerce-type functions throughout government, such as the governor's trade offices, the World Trade Commission, etc., to the Commerce Department in order to coordinate and strengthen economic development and international trade and investment.



Additionally, defects in the system have created an open invitation to abusive and fraudulent claims. Billions of dollars are wasted, and the system is training a generation of cheaters. The losers are (1) California employers forced to pay among the highest compensation rates in the nation and (2) genuinely injured workers whose benefits are among the lowest. This outrage must end. Fraud must be

The Council has identified six "problem areas" that have led to what has been accurately called a "runaway, multi-billion dollar system" in a downward spiral:

- ◆ Fraud and Abuse
- ◆ Insurance Rating System
- ◆ Stress Claims
- ◆ Medical Treatment Costs
- ◆ Litigation Costs
- ◆ Vocational Rehabilitation

The Council has made specific recommendations in each of these areas. The objective of these recommendations is to control costs and ensure predictability while preserving the fairness of the workers' compensation system. The Council is convinced that these reforms will result in significant savings. **When such savings are verified and documented, the legislature should allocate 50 percent of the savings to increased benefits for injured workers.**

The insurance companies have recently requested another 23 percent increase in the minimum workers' compensation insurance rate. This increase, if allowed, would seriously jeopardize, and perhaps bankrupt, hundreds of small and medium-sized businesses. It is another sign of a system that is out of control. **Major reform must be undertaken immediately.**

A. Fraud and Abuse

Problem:

Some authorities estimate that 20 to 30 percent of claims filed are fraudulent. Lawyer advertising and unscrupulous "referral networks" are serious problems, particularly in Southern California where minority communities are specifically victimized.

Actions:

- ◆ Require aggressive, yet cost-effective, criminal prosecution of doctors, lawyers, applicants, employers, and referral services who participate in fraud or false advertising.
- ◆ Urge initiatives by the State Bar and the Supreme Court to impose professional standards on lawyer advertising to the extent permitted by the First Amendment.
- ◆ Encourage employers to be proactive in educating workers, cooperating with prosecutors, and pressuring insurance companies to prevent fraud.

B. Insurance Costs

Problem:

Under the current system, insurers perform a vital function but have little incentive to contain costs. A survey of California businesses showed that 80 percent of employers do not believe that switching insurance companies would lower their costs. It is a common complaint that insurers are not responsive to small businesses. The Workers' Compensation Reform Act of 1989 created an independent Commission to study and report on the rating and pricing of workers' compensation insurance. The Commission has voiced major criticisms of the system.

Action:

- ◆ The Council recommends that the current "minimum rate/guaranteed costs" system be scrapped in favor of a system that encourages price competition among insurers.

C. Stress Claims

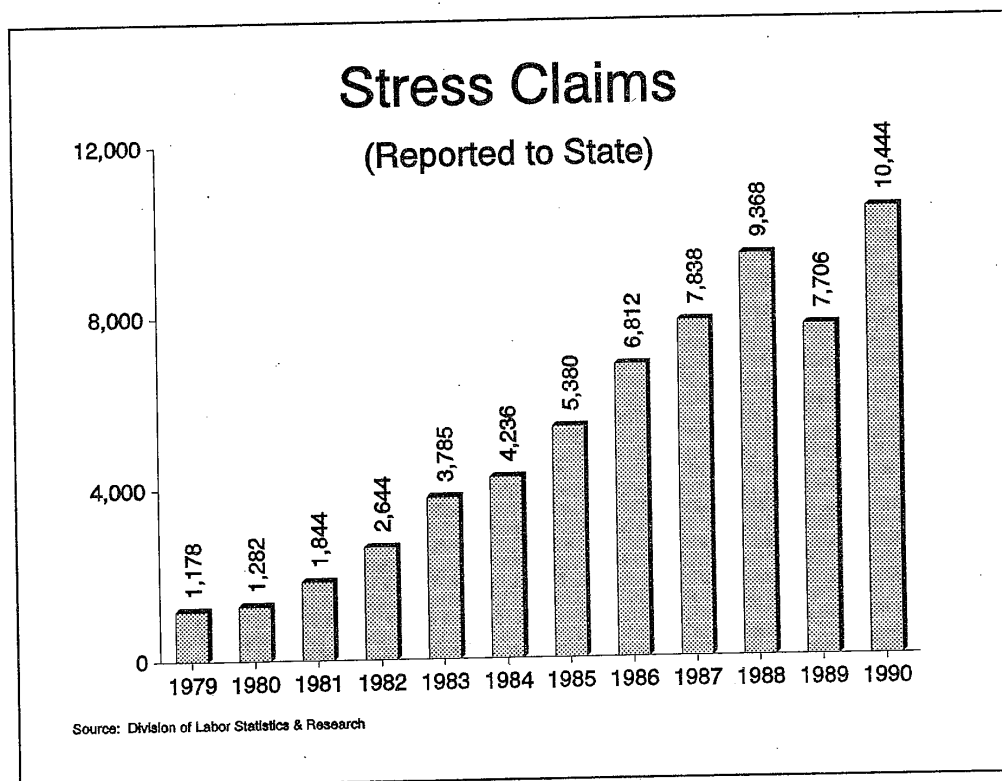
Problem:

"Stress" claims have increased over 700 percent in the last ten years. These claims now account for 7 percent of claim costs — over \$450 million. The average cost of a mental stress claim is significantly higher than other disability claims. California is one of only six states that allow claims for "cumulative stress" (i.e., day-to-day workplace pressure); including Hawaii, Kentucky, Michigan, New Jersey and West Virginia. The ease with which these claims can be successfully pursued under the current system leads to abuse. The availability and abuse of stress claims contribute to the decline of our work ethic, and they tear at the fabric of the relationship between employer and employee.

Actions:

- ◆ Raise workplace causation to "predominant cause" (i.e., 51 percent), and require "clear and convincing evidence" of mental disorder under widely accepted psychiatric standards.
- ◆ Eliminate the "cumulative trauma" concept — i.e., the stress-inducing event must be sudden, extraordinary, unexpected.
- ◆ Exclude good-faith, nondiscriminatory personnel actions (e.g., demotion, discipline, layoff, termination) from the category of events that cause compensable stress.
- ◆ Ensure exclusivity of the workers' compensation remedy for all compensable workplace stress (excluding employment discrimination and discharges that violate "public policy." See Part C of Section 6, Legal Systems).

Note: The Council emphasizes that **all** of the above recommendations must be implemented in order to solve effectively the abuse of stress claims. If these recommendations are not accepted in total or are watered down by compromise, the Council would abolish stress claims entirely as a basis for workers' compensation claims.



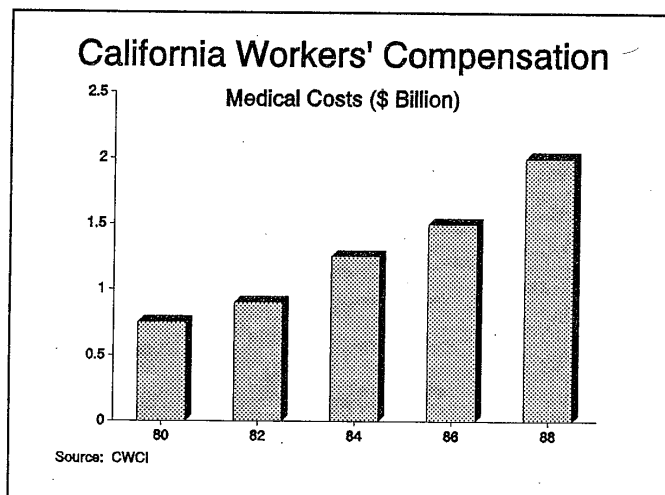
D. Medical Treatment Costs

Problem:

Medical treatment costs increased 187 percent between 1980 and 1988. According to California's own Department of Commerce, "The abnormal growth of medical costs are the result of excessive utilization of a relatively broad list of medical benefits in a system with little cost management." Workers' compensation is one of the few remaining health care systems that includes virtually no mechanism for cost containment. The Council believes that while the injured worker is certainly entitled to quality medical care at the employer's expense, reasonable oversight of treatment costs must be established in order to contain runaway expenses. We must impose efficiencies on the system.

Actions:

- ◆ Institute "Practice Guidelines" (e.g., medical fee schedules, auditing procedures, case management, utilization review, and prohibitions on self-dealing referrals) such as in Medicare.
- ◆ Allow employers and insurance carriers to manage medical costs for the duration of treatment by utilizing state-certified health maintenance organizations and preferred provider organizations in conjunction with existing employee health care programs whenever the employee has not designated (in advance) a "personal physician" for treatment and referrals in work-related injury.



E. Litigation Costs

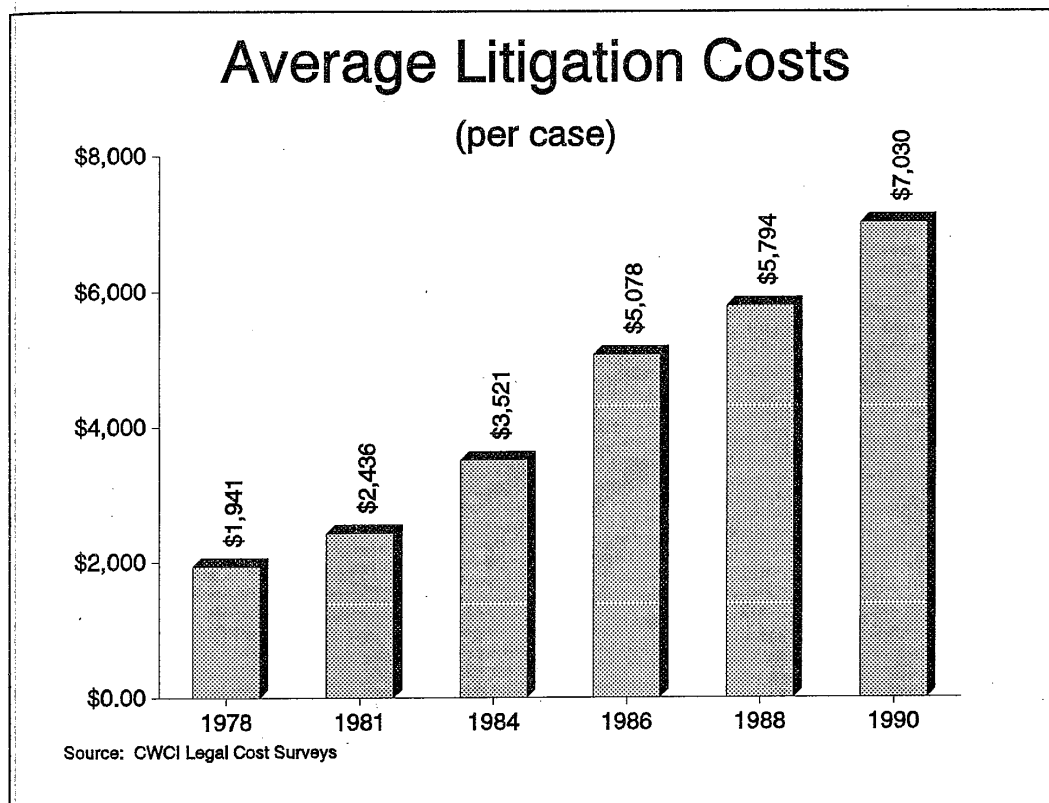
Problem:

Litigation costs increased from \$400 million in 1984 to \$1.5 billion in 1990. A large component of this staggering amount is the cost of "medical/legal" forensic opinions. This element of the system is largely uncontrolled, and represents an enormous drain on the system. The "dueling doctors," who often render extreme positions at the behest of "dueling lawyers" on either side of a litigated case, can add thousands of dollars to the cost of handling a workers' compensation claim. These doctors are not the treating physicians (whose cost is discussed in Part D), but the "experts" who give "opinions" on the extent of alleged injury and permanent disability. The lawyers and doctors who engage in the litigation process are "middlemen" who profit from friction in the system and, indeed, have an incentive to create and prolong such friction. Workers' compensation is designed to be a "no fault system," and even though some disputes are inevitable, the system should rely on impartial, reliable, competent medical information and eliminate adversarial medical testimony. The following proposals will help to hold down costs in those 62 percent of litigated cases where the principal issue is the existence and extent of permanent disability.

Actions:

- ◆ Establish more objective medical standards for the determination of impairment and disability (e.g., American Medical Association's "Guide to the Evaluation of Permanent Impairment").
- ◆ Reform the process by which permanent disability determinations are made:
 - The treating physician or referred specialist makes the initial determination of medical condition and degree of impairment.
 - A disability rating is then determined based on the treating physician's information and objective standards applied by the state's Disability Evaluation Unit.
 - Establish and utilize a pool of impartial Qualified Medical Examiners to evaluate contested cases. One examiner, assigned at random from the pool, reviews the treating physician's conclusions and the determination of disability benefits.

- ◆ The worker may appeal the disability determination to a Workers' Compensation Judge, who may appoint an independent medical examiner. A final appeal to the Workers' Compensation Appeals Board is available.



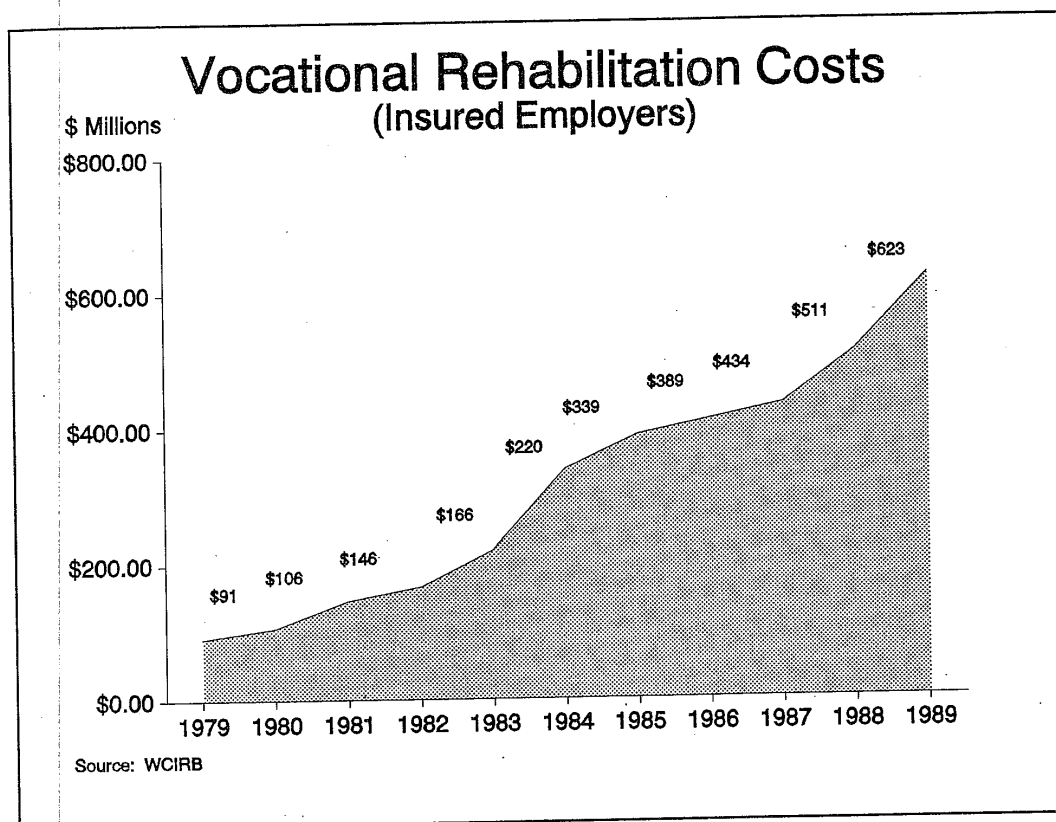
F. Vocational Rehabilitation

Problem:

In addition to medical treatment and physical rehabilitation (the costs of which are discussed in Part D), California provides for worker retraining or "vocational rehabilitation." California's own Department of Commerce has noted: "California is one of only a few states that make vocational rehabilitation mandatory, and the only state without treatment protocols which promote timely return to work." This benefit, intended to provide injured workers with training for new occupations, often involves costly schooling programs of dubious value. Vocational rehabilitation, which is often not successful, now consumes 13 percent of benefits. Employers' payments for "rehabilitation," in addition to "permanent disability" and "reasonable accommodation" for workers under handicap discrimination laws, create overlapping and duplicative costs. Thus, an employer is required to compensate an employee for permanent inability to perform the old job, and required to pay for training to perform a new job. Other states such as Washington, Oregon, Alaska, Florida, and Colorado have reduced or eliminated vocational rehabilitation as a benefit entitlement. Vocational rehabilitation has been identified as "the fastest growing cost factor" in the California workers' compensation system, and it must be brought under control.

Actions:

- ◆ Institute limits on scope, duration, and cost of rehabilitation programs.
- ◆ Allow employers to "reasonably accommodate" (i.e., re-employ) a disabled worker (per the federal Americans with Disabilities Act and state Fair Employment and Housing Act) in lieu of vocational rehabilitation.
- ◆ Allow employer and employee to compromise rehabilitation claims.
- ◆ Require that vocational rehabilitation, if pursued, be completed before final settlement of permanent disability benefits; amount of disability to be determined on the basis of the "new" occupation acquired through rehabilitation.



Alternative Opinion

The representatives of organized labor on the Council take exception to the majority's recommendations concerning stress claims (Part C) and vocational rehabilitation (Part F). These members of the Council believe that the availability of stress disability awards and vocational rehabilitation should not be curtailed.

3. REGULATORY STREAMLINING

California cannot restore its competitiveness by allowing the degradation of its environment. As a state with a widely varied and sometimes delicate ecology, California must make continuing efforts to maintain a clean and healthy environment. California must also have a healthy economy to produce and retain jobs and to supply resources for investment in environment, education, infrastructure, and other social needs.

Testimony presented to the Council removed any doubt that California's regulatory system and permit processes have gotten out of control. Decades of good intentions have produced an accumulation of regulations that in the aggregate are placing a massive burden on California's businesses, municipalities, consumers, and taxpayers. As a consequence, process takes precedence over rational policy-making. For example, the following table illustrates the extraordinary number of agencies that oversee the environment in Los Angeles County alone.

INVENTORY SUMMARY OF AGENCIES WITH ENVIRONMENTAL AUTHORITY IN SOUTHERN CALIFORNIA

♦ 72 total agencies

27 (38%) local (Los Angeles City, Los Angeles County, regional)
32 (44%) state
13 (18%) federal

♦ 39 agencies with water quality authority

14 (36%) local
18 (46%) state
7 (18%) federal

♦ 38 agencies with hazardous waste authority

17 (45%) local
13 (34%) state
8 (21%) federal

◆ 17 agencies with air quality authority

6 (35%) local
6 (35%) state
5 (29%) federal

◆ 14 agencies with solid waste authority

7 (50%) local
6 (43%) state
1 (7%) federal

The proliferation of agencies has become unmanageable, and the single-minded focus of many agencies has caused negative socioeconomic impacts that are yet to be evaluated or measured. California needs a process to assess the overall socioeconomic and environmental impacts of all regulations and to set priorities for the use of our fiscal resources.

When single-purpose agencies fund themselves through fees and fines, a substantial problem results. The existing budget process of many agencies circumvents the traditional democratic process designated to balance our social goals, needs and resources. Freedom from budgetary review and, consequently, program review, has diminished agencies' accountability to the public and has fostered an attitude of arrogance.

For businesses, the cost of compliance can mean the difference between remaining in business or leaving the state. Whether businesses leave the state in search of better opportunities elsewhere, or terminate operations altogether through bankruptcy or some other form of closure, the net effect on the California economy is a loss of jobs.

The burden of excessive regulation does not just affect business. It also affects our local and regional governments and delays vitally needed infrastructure improvements. Testimony was received from over a dozen counties and more than 30 cities on their inability to navigate the regulatory maze and their view that too many agencies are involved, the statutes and regulations are ambiguous, and the results being achieved do not justify the taxpayer costs. County after county and city after city cited the fact that funds which could otherwise be allocated to public works construction are being used to pay for regulatory processing.

The following samples of testimony from cities and counties illustrate the mounting statewide concern about California's regulatory system. Local officials are the best barometer of what is happening in California. They interact daily with businesses and with other regulatory agencies. Their comments are highly useful and instructive.

- ◆ A Marin County official stated that "we are more often than not overwhelmed with regulatory stipulations required for public projects The review process itself involving some or all of these agencies is extremely time consuming, often adding years to simple projects Trying to administer all of the processes involved taxes our limited resources. We have actually considered creating a staff position for regulatory processing Specific recent examples of our frustrations include such minor projects as the replacement of an existing tidegate and the installation of safety guardrail."

The official continues: "It seems like the most difficult obstacle to overcome is an attitude amongst the regulatory agencies that the process is the goal. Somehow the actual construction of a project has been overlooked for the sake of process."

- ◆ A Ventura County official reaffirms testimony that was presented by countless witnesses about a specific state agency: "Our experience with . . . has been that they have tunnel vision and do not accept the premise that there are other public policy purposes to be served other than their own. This gives rise to unreasonable proposals for modifications to construction activities, or maintenance regimens and, accordingly, sets the state for protracted negotiations and delays in accomplishing construction work or maintenance activities." He continues that "These activities by . . . serve to drive up the cost of government, as well as the cost of doing business."

The Ventura representative further adds: "I would be remiss if I didn't mention my belief that revisions to CEQA are long overdue. What began as a well-intended statute aimed at improving the public decision-making process has deteriorated into a statute used as a tool to thwart or delay projects, not on the basis of their merits or demerits, but rather on the basis of the process."

- ◆ A City of Anderson official noted that "there is no organized procedure for obtaining state review and coordination of permits even with State Clearinghouse review under CEQA." The city also noted problems with the Department of Fish and Game and its review of wetlands issues.

- ◆ A City of Buena Park official noted that "the primary challenge cities and the business community are forced to contend with is the multiplicity of environmental and business regulators and the overwhelming amount of rules and regulations which govern our activities. If California is to reverse the flight from our state of prime employers we must reconsider the manner in which our regulatory agencies do business and assist in streamlining the process."
- ◆ An official of Cathedral City called for consolidation or elimination of special districts and other independent agencies that promulgate duplicative or conflicting regulations. The city also noted the dictatorial attitude of certain regulatory agencies.
- ◆ The City of Ceres observed that "CEQA was originally about protecting the environment. Unfortunately, it has become a ritualized exercise in process." The city also comments that "the California Clean Air act is another piece of legislation that threatens to do considerable damage to the economy while doing very little to clean up the air."
- ◆ A City of Davis official commented that it was uncertain that "the state fully understands the consequences of the seemingly endless requirements that it cavalierly imposes on local government."
- ◆ A City of Modesto official recommends that the Department of Fish and Game not be funded by means of CEQA fees; that General Plans and Specific Plans face vigorous CEQA review, and that projects in conformance with those plans receive streamlined review; that better science be used in developing regulations; and that less emphasis be placed on process/litigation.
- ◆ A City of Palm Springs official documented in detail the problems stemming from multiple agencies involved in permitting, conflicting and complex regulations, and the onerous burdens imposed by the excesses of CEQA. The city also noted that the Injury and Illness Prevention Program has "caused local government and the business community to develop exhaustive and in many cases excessive safety programs including paper trails of unparalleled dimension."
- ◆ A City of Placerville official documents a pattern of arrogance and poor communication on the part of one state agency, which resulted in months of delay for a specific project.

The goal of the Council is not to eliminate regulation but to refine regulation, to maintain and enhance its positive effects while eliminating the burdens. The Council is particularly concerned about the adverse impact of California's regulatory system on the goal of providing a supply of affordable housing. The reforms proposed here are partially directed at resolving that problem.

At the heart of the matter is the need for a new attitude about the relationship between our environment and our economy. Business, government, and community groups must work together to examine the validity of regulations and procedures and seek to provide the most efficient and least costly regulatory system possible. This partnership's goal must be to eliminate the regulatory controls and practices that do not achieve their desired results or whose benefits are found to have little value, and to find a way to balance the use of our fiscal resources to the highest good.

This section addresses the 12 problems raised most frequently during testimony before the Council and recommendations for alleviating those problems. Available upon request is an extended report that gives greater detail on the testimony and more in-depth analysis. The first problem applies to all state and local agencies with regulatory/permitting power. The next five problems in this report have been categorized as "land-use problems" and focus primarily on issues related to the development of real property and affordable housing. The next five problems have been categorized as "environmental problems" and focus primarily on issues related to air quality, water quality, and the handling of solid and hazardous waste. Although the Council recognizes that there is significant overlap between categories, the distinction provides a useful frame of reference for the reader. Finally, the last problem deals with just one program in which a worthy goal — worker safety — is being implemented in a way that lacks common sense and is particularly onerous for small business.

A. Agency Funding and Oversight

Problem:

California's present agency system does not effectively cope with the state's complicated web of social needs and priorities. Traditional mechanisms for the oversight and control of our public agencies are not working. Neither our elected officials nor the public have the time and resources required to monitor the profusion of regulatory bodies operating with full-time staffs. As a result, agency actions are frequently implemented without consideration of how they might affect jobs or other socioeconomic factors.

This is particularly true for California's many self-funded agencies, which rely entirely on assessed fees and fines for their revenues — *de facto* taxes. These agencies escape the normal democratic budgeting process of the general fund, and can easily expand without regard to costs. Further, they escape the review and budget constraints imposed on general-purpose agencies, which have equally worthy goals. Many are also single-purpose in focus, narrowing their scope of consideration before they take action or set new regulations.

Actions:

- ◆ Require that all appropriate fees and fines collected from the regulated community be deposited into the general fund.
- ◆ Finance all agencies through the general fund, and allocate funds based on an approved budgetary process.
- ◆ Require regulatory agencies to submit budgets to the newly proposed Management and Budget Office, detailing each program or regulation and stating how it will advance the primary goal of the agency. Require agencies to prioritize programs and regulations according to their total socioeconomic and environmental impact.
- ◆ Review all levels of current jurisdictions through the Governance Commission, as outlined above in Section 1, to integrate, to reduce, streamline, and oversee the regulatory process.
- ◆ To improve decision-making, the legislature should require that development of all laws and regulations include a comprehensive socioeconomic assessment before they can be adopted. The science component of this analysis is the measurement of risk as determined

through valid risk-assessment practices. The socioeconomic component of this analysis must include, at a minimum, the following: (1) agency resources to develop, implement, and enforce the law or regulation; (2) the lost research, development, and production that is incurred as a result of compliance with the law or regulation; (3) the lost tax revenues and lost jobs that result when the increasing burden of regulations drives businesses out of the state or out of business, or deters them from entering or expanding; (4) other social programs that must be forsaken; and (5) the problems of compliance with regulations which depend on the development of new technology. This analysis will result in balanced management of social resources rather than mechanical application of standards without regard to impacts.

- ◆ Require that all proposed environmental legislation and regulations include an analysis of alternatives that would achieve the same or nearly the same benefits but with a more efficient use of resources, and a justification for choosing a higher-use over a lower-use alternative.
- ◆ Require a sunset provision in all environmental legislation and regulations forcing reevaluation, at an appropriate time after adoption, of the socioeconomic analysis and reauthorization or amendment as appropriate.
- ◆ To improve scientific assessment and ensure that regulations are based on good science, use an independent scientific body at the state level (perhaps the California Council on Science and Technology) to review scientific issues and develop appropriate standards for legislation and regulations.

B. Land-Use Problems

California's population is expanding by 600,000 annually, whether we plan for it or not. Poor facilities, infrastructure, and housing will not deter the immigration, but they will lower the quality of life for those currently living here.

(1) State Planning and Growth Management

Problem:

All segments of the community suffer because of the poor planning and inadequate management of California's growth. Development decisions occur all too often on a project-by-project basis. Consequently, the balancing of the public goals of development and environmental protection, as well as the public debate over limits on growth, now occur only in the context of a specific construction project.

California needs a growth-management system that reconciles and balances the state's competing needs. State government must clearly identify statewide objectives and require regional and local agencies to conduct their activities in concert with those objectives. Better planning at all levels of government provides predictability in land use for resource protection and for development.

A sound growth-management system should provide environmental protection standards, require local governments to zone buildable land for housing, establish clear and objective standards for permit approval, require the preparation of local capital improvement plans, set statutory standards to limit antigrowth moratoria, and establish state limits on and guidelines for local development impact fees. All of these steps can help reduce housing costs.

Other states have found that comprehensive state planning can reduce red tape, provide greater predictability for resource protection and for development, and increase efficiency in permit processing.

Actions:

- ◆ Adopt a growth management strategy for California that establishes clear state policies, goals, and objectives, focuses all land-use decision-making in the hands of local governments, and holds local governments accountable for conducting their activities in accordance with state objectives. The growth management strategy should consider

environmental quality, economic development, housing, public facilities, infrastructure and a process that provides predictability in land use.

- ◆ Provide funding and support to the governor's Office of Planning and Research as the primary state planning body.
- ◆ Make the State Clearinghouse perform its intended role as a lead agency and coordinating body for state review of documents that require comment or approval by various state agencies.

(2) Local Planning

Problem:

The land development approval process in California is a time-consuming maze. To obtain approval, public works directors, cities, counties, businesses, builders, etc., must interact with literally dozens of agencies and prevail in many public hearings before citizen advisory councils, planning and other commissions, and local elected city councils and boards of supervisors and other similar bodies.

Extensive public input is imperative, but not in the current form, in which the same issues are rehashed in agency after agency, jurisdiction after jurisdiction — a quagmire of a process that wastes resources and puts us further behind in coping with growth.

Occasionally, attempts have been made to make the land-use permitting process less cumbersome and costly. "Permit streamlining" laws, for example, have been enacted. Time limits have been placed on federal, state, and local agencies for the processing of public facilities, infrastructure, tract maps, and permits. In most cases, jurisdictions literally ignore these reforms and procedures.

Many of the laws and procedures enacted during the past two decades were based on a very real need to protect the environment. But instead of incorporating the environmental concerns into a single planning process, the implementation of these laws has become a whole new layer of agency and jurisdictional bureaucracy, limiting predictable land-use decision-making and the development of affordable housing.

There has been little attempt, at any level of government, to reconcile the process by which public policy objectives of environmental quality, economic development, and other social needs are handled in a timely and efficient fashion. California lacks a concise process for local planning.

Actions:

- ◆ Reinforce and strengthen the "General Plan" as the central tool for planning, and rename it the "Comprehensive Plan."
- ◆ Require cities and counties to prepare Comprehensive and Specific Plans.
- ◆ Require that the Comprehensive Plan clearly address state and regional goals.
- ◆ Grant local jurisdictions maximum flexibility in meeting state goals through the Comprehensive Plan.
- ◆ Require a Master EIR on the Comprehensive Plan and make the Comprehensive Plan the primary vehicle for environmental assessment and mitigation.
- ◆ Require that all facilities and agencies within the jurisdiction of the state of California, including state facilities, school districts, and other special districts, be subject to each jurisdiction's Comprehensive Plan.
- ◆ Require that each Comprehensive Plan include a long-term capital facilities (infrastructure) plan, including the construction of schools.
- ◆ Require that each Comprehensive Plan be prepared and adopted in coordination with adjoining jurisdictions to the maximum extent possible.
- ◆ Require that the Comprehensive Plan and the Specific Plans provide far more detail for development and resource protection than is now required. If the necessary level of detail is not available in the Comprehensive Plan, then the issues which will be considered in future Specific Plans must be listed. To develop an inventory of what additional detail will be needed, input should be sought from public works officials, businesses, community groups, and all interest groups.
- ◆ Require that each Comprehensive Plan provide sufficient development capacity to accommodate the anticipated growth in the jurisdiction.
- ◆ Provide adequate opportunity for public participation in the preparation of the Comprehensive Plan and Specific Plans.

- ◆ Upon a finding that a project is consistent with the Comprehensive Plan and Specific Plans, require that the project be deemed approved.
- ◆ Allow projects consistent with the Comprehensive Plan and Specific Plans to proceed.

(3) California Environmental Quality Act

Problem:

The California Environmental Quality Act (CEQA) was enacted more than twenty years ago to require public agencies to evaluate the environmental impacts of projects they undertake directly. CEQA was later expanded by a 1972 state Supreme Court decision to include all development projects that required discretionary approval by a governmental agency.

CEQA is cumbersome, costly, and often abused. Groups use lawsuits to stall projects — not to protect the environment. Multiple overlapping agencies administer CEQA and its related laws, which are directed at traffic, air, water, waste, endangered species, toxics, preservation of archaeological sites, transportation, wetlands, and a host of other concerns. Under current law, there are no limitations on the number or type of reviews that a local jurisdiction can require, even if the project is completely within the parameters of the General Plan.

The failure of the system to provide a single clearly defined procedure for planning has created excessive cost and a high level of unpredictability in resource management. It is not uncommon for public works directors in siting facilities, businesses seeking to build new manufacturing plants, or developers planning new housing projects to be forced to perform multiple environmental impact reports (EIRs) in an attempt to obtain approvals. Costs for these redundant reports range from tens to hundreds of thousands of dollars.

For example, on February 7, 1992, ten years after the original permit application was submitted, ground was broken in San Marcos for a \$140 million recycling and waste-reduction center. In those ten years, the project was the target of over 20 lawsuits by citizen groups and neighboring cities, all but one of which were unsuccessful. In addition, it was necessary to abandon the incinerator component of the project, which deprived the project of its waste and energy reduction benefits. Procedural problems with CEQA were the basis of the suits.

In another example, a company is building three identical plants to produce oxygenate in Pennsylvania, Mississippi, and California. The oxygenate is needed to

meet the federal Clean Air Act's November 1, 1992 deadline for oxygenated gasoline in carbon monoxide nonattainment areas. All three projects were started at the same time. The projects in Pennsylvania and Mississippi have received all the necessary permits. The California project is being held up by three citizens' groups that have appealed the city's determination that an environmental impact report is not required. This action will delay the project, and as a result, the company will have to import oxygenate from other states at significant extra cost in order to comply with the federal requirements.

Actions:

- ◆ Require a Master EIR on the Comprehensive Plan and make the Comprehensive Plan the primary vehicle for environmental assessment and mitigation.
- ◆ Revise the CEQA Guidelines to eliminate redundant environmental review and to reflect environmental policies and performance standards that are more consistent with the intended objectives of CEQA. For example, limit the number of project alternatives and eliminate the "no project" alternative. In addition, reduce the number of factors that trigger preparation of an EIR.
- ◆ Amend the CEQA guidelines to shorten the environmental review process to six months, with one 30-day extension, and prohibit waivers of the time periods. Include in the Guidelines a strong policy statement opposing the practice of denying approval because review has not been completed on a timely basis.
- ◆ Allow projects that comply with an already reviewed EIR to receive focused environmental review, which would include only those issues not addressed by the Master EIR (new information not known at Plan adoption, issues not addressed in the Master EIR, subsequent changes in projects, etc.).
- ◆ Provide maximum opportunity for public participation in the preparation and adoption of the Comprehensive Plan and the Master EIR, limit interest group review of specific projects which are consistent with the Comprehensive Plan and the Master EIR and adopt procedures to govern legal challenges, the award of attorneys fees, and similar considerations.
- ◆ Require EIRs to contain a socioeconomic impact analysis that compares the total social impact mitigation measures with the social benefits to

be derived. Require the local legislative body to weigh other societal benefits, such as affordable housing and job production, when deciding the extent of the mitigation measures to be required.

- ◆ Insert the word "economically" in front of the words "feasible alternatives" wherever they occur in the Guidelines.
- ◆ Revise Appendix G of the Guidelines, which lists examples of consequences that will normally have a significant effect on the environment, to diminish the negative bias against accommodating California's population growth. Revise the Guidelines to require consideration of California's growing population and the need to provide housing and jobs to serve it. The existing section that purports to accomplish this objective is ineffectual.

(4) State Land-Use Court

Problem:

Many of the problems in the operation of the existing land-use permitting system result from the refusal of agencies to follow existing law and administrative procedures. Laws that have been enacted for the sole purpose of streamlining the permitting process, increasing predictability, and limiting the overall cost of the permit process are often ignored.

There is a land-use litigation explosion in California, which makes it far more difficult for the state to carry out sensible land-use planning and growth management. The legal system fails to resolve land-use disputes expeditiously, encourages frivolous claims, and greatly adds to the cost of housing. Under the current system, land-use cases are regularly delayed because higher priority is given to criminal cases. Land-use cases are often heard by judges who have no special expertise in land use, construction, or environmental law. As more of the important disputes wind up in litigation, it becomes increasingly clear that the current judicial structure is unable to render consistent and timely decisions.

Actions:

- ◆ Establish a state-level land-use court to decide all project-level disputes between project proponents, local governments, and third parties.

- ◆ In jurisdictions with a plan adopted in conformance with state laws and plan guidelines, allow appeal of any local decision regarding a development project and its consistency with a local plan.
- ◆ Grant the court jurisdiction over the following types of cases:
 - Disputes arising from project-level actions of government agencies.
 - Challenges to the sufficiency of the environmental review process including both substance and procedure.
 - The failure of local agencies to act within adopted schedules.
 - The appropriateness of fees imposed by a jurisdiction.
 - Interjurisdictional disputes between public agencies involving land-use plans and decisions.
 - The adequacy of a local plan and its consistency with state growth policy.
- ◆ Grant the court authority to implement the following remedies:
 - Compel the issuance of a permit.
 - Sustain the local agency action denying the issuance of a permit.
 - Award damages and attorney fees where appropriate.
 - On matters of plan dispute, certify a plan as being consistent with state growth policies.
 - Require that an inconsistent plan be revised.
 - Order the reduction or elimination of a fee that is determined to be inconsistent with the law.
- ◆ Establish specific local performance measures, such as the time-frame for hearings, reviews, and making consistency determinations. Failure to comply with these criteria would result in automatic project approval, unless findings of extenuating circumstances (which should be a part of

the performance criteria) are adopted. The validity of the findings may be grounds for damages against the jurisdiction.

(5) Impact Fees/Exactions

Problem:

Fees and exactions are imposed on commercial and residential projects in most states throughout the country. However, nowhere are impact fees as onerous as they are in California. Since the passage of Proposition 13, local government has financed much of its infrastructure and services for its citizens through the use of fees and exactions imposed on new projects.

The practice of transferring the financial responsibility for general community services and facilities to the applicants for building permits is commonplace throughout California. Public officials recognize that residents continue to demand the same level of services and facilities but are unwilling to pay for them. General funding bond issues that require a two-thirds vote are often vetoed by a minority of the public. Accordingly, those proposing to build or expand a structure are expected to pay for such facilities as parks, schools, fire stations, public infrastructure, libraries, childcare facilities, public art objects, community centers, and low-cost housing.

In the end, the costs of these facilities needed by the whole community are borne by only the users of the new project. This is unfair, and it cripples new building and job growth. It is an ill-conceived way to deal with permit applicants and public planning. An applicant should not have his permit held hostage to an agency's demands for unrelated public amenities. Permitting agencies should not be the bodies that determine funding for general public amenities unrelated to the project being permitted. That should be the job of the planning agencies dealing with the general issues of traffic, housing, day-care, etc.

Although current law requires local agencies to justify the fees and exactions they impose on projects and to establish a "reasonable nexus," this requirement is frequently ignored. There may be little connection between the fee or exaction being imposed and the projects that are, in theory, generating the need for the fee or exaction.

At present, the typical jurisdiction imposes a variety of fees on new projects that can

reach \$40,000 per dwelling unit. In the city of Santa Clarita Valley, fees on a 1650-square-foot house total more than \$34,000. Following is a listing of per-unit fees for a representative sample of other jurisdictions:

* Brentwood	\$21,865
* Danville	\$21,754
* Oakley	\$22,086
* San Ramon	\$23,634

The Corona-Norco Unified School District is currently requiring \$15,000 per unit — or approximately \$9.40 per square foot in school fees alone. In Milpitas, although the unified school district has a number of empty schools, it extracted from one housing project more than \$1 million in school fees. From these examples, the depressing effect that fees and exactions have on the construction of affordable housing is obvious.

Having depressed the supply of affordable housing by exactions, and with a shrinking supply of federal dollars to finance affordable housing, cities and counties have reacted by adopting still more exactions on other projects, *i.e.*, mandatory inclusionary housing programs and housing trust funds. These programs require that residential and commercial projects provide solutions to the community's lower-income housing problems as a *quid pro quo* for project approval. Masked as a density bonus incentive, these techniques are little more than a private subsidy for what should be public obligations borne by society as a whole.

San Francisco offers an excellent example of the types and sizes of fees that businesses face. In 1991, as much as 15 percent of the cost of a four-story, 100,000-square-foot office building could be attributed to fees. Following is a partial list of fees on such a hypothetical building:

* Housing impact fees	\$ 700,000
* Transit impact fees	\$ 500,000
* Open space fees	\$ 200,000
* Childcare fees	\$ 100,000
* Building permit	\$ 48,626
* Plan check and processing fee	\$ 31,570
* Conditional use permit (maximum)	\$ 52,754
* School fees	\$ 25,000
* Fire fees	\$ 1,516
* Water meter fees	\$ 2,700
Total Fees	<u>\$1,832,166</u>

This list of fees **excludes** the cost of the environmental impact report and review, as well as annual fees for ongoing transit management, which collectively add another \$90,000 to this hypothetical project.

All these fees must be paid upon issuance of the permit to build. However, the impacts that the fees are meant to mitigate will not arise, if ever, until the building is completed and occupied. The party paying the fees cannot hope to obtain the revenue to reimburse these fees until the building is completed and occupied. This delay places the cost of funds totally on the project, and, in the end, taxes the consumer.

Actions:

- ◆ Strengthen existing statutes to provide that payment of development fees not be required until the date of actual fiscal impact on the locality, typically the date of the final inspection, or the date on which the certificate of occupancy is issued, whichever occurs first. Circumstances under which fees could be collected earlier should be specified and very narrowly constrained.
- ◆ Amend the state constitution (Article XVI, Section 18) to reduce the voting requirement from two-thirds to a simple majority for passage of general obligation bonds. If the general fund can be better funded, the need to squeeze public services from permit applicants will lessen.
- ◆ Restrict local ability to impose affordable housing "linkage" fees on commercial projects and to impose mandatory inclusionary housing programs for lower-income housing on projects as a condition of approval. Current fee practices used by local government to fund social programs that are unrelated or marginally related to the proposed developments should be curtailed.
- ◆ Enact the action called for in Section 1 to form a Governance Commission to restructure the sources and use of funds at all levels of government.

C. Environmental Problems

(1) Permitting and Reporting Requirements

Problem:

The procedural hurdles associated with obtaining the necessary permits and approvals to operate in California are a deterrent to business. There are multiple environmental agencies at the federal, state, and local levels with overlapping jurisdictions and different permitting and reporting requirements. It is often difficult for a business or project proponent to identify the numerous agencies from which permits must be obtained, and the requirements imposed by different agencies are often duplicative and sometimes contradictory. In addition, the permitting and reporting requirements of many individual agencies are burdensome and time-consuming. Agency staff has little or no incentive to process permit applications on a timely basis. Even where statutory requirements exist, agencies request a waiver or simply reject an application if pressed, and the applicant must begin the process all over again.

For example, because of the difficulty in getting a permit for a new manufacturing plant, Rohr Industries moved to Arkansas, where permits for its new plant cost only \$750. Permitting this plant in California would have cost \$750,000.

Similarly, an aerospace aluminum manufacturing company, which employs 750 people, decided to move to Nevada after spending ten months and \$360,000 on permit fees. With no progress toward building its new plant, and facing excessive regulation from the local air quality management district, the company could no longer face the uncertainty of California's permitting process.

In another example, as a cost-cutting measure, a Buena Park furniture manufacturer, Panel Concepts, wanted to move its operations to a smaller plant in Southern California. However, the local air quality management district would not allow the company to transfer its permits to the new site. Finally, the company spent \$1 million and moved its operations to North Carolina. According to the company's CEO, the request to transfer the permits was never actually denied, the company simply could not get an answer from the agency.

Examples of this problem are not limited to the business community. Governmental agencies have similar difficulties with the state's regulatory maze. The deputy public works director of Humboldt County notes that "the most troublesome area that our public works department has in dealing with other agencies is in the environmental process and with permits from regulatory agencies When it comes to our construction projects the environmental process has become so cumbersome that it is ridiculous Something must be done." He cites endless delays, excessive fees, and negative attitudes of state regulators.

Actions:

- ◆ Restructure environmental permitting into a one-stop process that covers all environmental issues. Include in this restructuring a centralized database for information that must be reported by businesses.
- ◆ Allow businesses to submit to Cal/EPA industrywide health, worker-safety, and pollution-prevention plans in lieu of obtaining individual permits from various agencies. Allow businesses to certify adherence to the plans through self-audits verified by state-certified audits.
- ◆ Require Cal/EPA to develop industrywide general permits which encompass all environmental requirements. Allow businesses to notify Cal/EPA of their intent to be covered by the general permit and to certify adherence to the permit by a self-audit conducted annually.
- ◆ Assign to a specific state agency the task of addressing permitting matters on a continuing basis. Require this agency to establish guidelines to help businesses determine which permits are necessary and what information is required to obtain permits and satisfy reporting requirements.
- ◆ Require Cal/EPA to establish a uniform permit review timetable for all regulatory agencies. Monitor adherence to the timetable and establish a system of incentives for agencies to adhere to the review requirements. Provide for immediate appeal of permitting decisions and delays in acting on permits to an administrative law court.
- ◆ Provide staff at state, regional, and local agencies with incentives for processing permit applications on a timely basis.

(2) Flexible Regulations

Problem:

Traditional "command and control" environmental regulations do not provide any flexibility to businesses to reduce pollution in the most cost-effective manner possible. Every business is different, and every business knows how it can most efficiently reduce pollution. In addition, traditional regulations provide little or no incentive to businesses to be creative about reducing pollution; this stifles innovation.

Actions:

- ◆ Require the agencies to include the regulated community in the process of drafting regulations.
- ◆ Require all environmental agencies to replace traditional command and control regulations with standards of performance, and provide flexibility for businesses to determine how to meet the standards.
- ◆ Require agencies to focus on financial incentives and market forces when drafting regulations.
- ◆ Require all environmental agencies to issue facilitywide permits, rather than permits tied to specific pieces of equipment. Allow businesses to determine the best way to comply with the permits at the facility level.

(3) Socioeconomic Impact Assessment

Problem:

Regulations must be based on good scientific and socioeconomic analysis to ensure that the public's money is being spent efficiently. The benefit of environmental regulation is achieved at a cost. For regulators to make informed decisions about proposed regulations, they must understand and balance these impacts and benefits. Otherwise, limited resources will be allocated inefficiently, resulting in a net loss to society. Currently, the legislature and regulatory agencies often fail to perform the type of comprehensive scientific impact and socioeconomic analyses that will allow efficient allocation of resources.

At times the goal of regulations is to eliminate all risk associated with a perceived health or environmental hazard. Risks should indeed be reduced to a reasonable

and safe level, but the attempt to eliminate **all** risk has profound and damaging socioeconomic effects. The legislature and agencies often fail to consider this use of social resources. Included in costs is bureaucratic cost incurred in developing, implementing, and enforcing regulations; foregone investments such as research, development, and increased production; lost tax revenues, social services, and jobs that result when businesses close, are driven out, or are deterred from expanding or entering the state; and the loss of other environmental programs that could have been developed with a greater net benefit.

In assessing risk, scientific analysis should consider all available evidence. Yet such issues as differences in metabolism between humans and laboratory animals are frequently ignored or discounted. Current scientific assessment at times focuses on concentrated exposures to toxic substances in the laboratory setting while ignoring the real-world context in which small exposure might occur.

The Association of California Water Agencies has stated that regulatory requirements are the factor with the greatest bottom-line impact on water bills. Dealing with radon, a naturally occurring radionuclide, will cost California water suppliers about \$3.7 billion in capital costs and hundreds of millions of dollars a year in operating costs. The current best estimate of the benefit of this program is eight lives saved in California per year. Society must decide whether programs such as these are a wise use of limited resources rather than spending on trauma care centers or other health activities.

Actions:

Refer to recommendations in Section A on agency funding and oversight.

(4) Uniform Standards

Problem:

Federal, state, and local layers of standards imposed on the society create confusion in administration and are a frequent waste of resources. Local standards may be set to reflect special local needs. On the other hand, it must be recognized that federal standards set the baseline. Local agencies can only impose regulations in an ever-narrower upper limit. Layers of tighter and more resource-consuming regulations have been created by various local politicians and agencies so that they appear to be reducing more and more risk regardless of the imbalance the process causes in the total society.

In many cases, more stringent standards are not justified in terms of improved human health or environmental quality. State agencies duplicate work, including scientific research, that has already been performed at the federal level. The cost of this duplicated work is passed on to the regulated community through fees. The regulated community must sometimes contend with the administrative costs of complying with two different sets of regulations. Finally, the overall resources used to comply with more stringent standards is generally much higher. These costs make California businesses less competitive relative to businesses in other states.

Consider also that California's ambient air quality standard for ozone is more stringent than the federal standard. The Bay Area Air Quality Management District projects attainment of the federal ozone standard by 1996. The additional costs of control measures for stationary sources, aimed at attaining the incremental state ozone standard after 1996, are estimated by the District to be between \$25.4 million and \$34.2 million. Assuming that the U.S. Environmental Protection Agency has set standards and developed regulations intended to protect human health and the environment, why must the California community be saddled with the costs of more stringent requirements? The federal standard already reduces risks to levels acceptable for individuals with pulmonary problems.

Action:

- ◆ Obtain authorization to administer all environmental programs at the state level in lieu of federal programs. To eliminate an extra layer of agencies, require that the state programs meet and do not exceed required federal standards as soon as possible. Prevent local and regional agencies from adopting programs or standards that are different than those developed at the state level. Allow more stringent standards at the state level only through a process of hearings in which socioeconomic and environmental benefits are reviewed by an independent body.

(5) Amendment of Federal Legislation

Problem:

Certain federal environmental regulatory programs do not adequately balance the community need to protect the environment with other interests of individuals, businesses, and other private and public entities. The effectiveness of the reforms proposed by the Council may be limited by the need for state programs to comply with requirements set at the federal level. Therefore, it is necessary to seek reform

of the processes for developing legislation, regulations and standards at the federal level along the lines proposed for reform at the state level:

Actions:

- ◆ Urge the California congressional delegation to actively support efforts to reform the process for developing federal legislation and regulations as well as efforts to amend existing federal programs to consider the socioeconomic impact of the regulations on the total community and the quality of scientific assessment.
- ◆ All programs developed at the federal level should include an analysis of the states' ability to fund the program. Where state programs are authorized in lieu of federal programs, federal funding should be provided for the state program.

D. Amend Injury and Illness Prevention Program

Problem:

The Injury and Illness Prevention Program (SB 198), enacted by the legislature in 1990, is imposing unnecessary and unproductive costs on many businesses for which application of the program makes little sense. Literally millions of dollars in needless hard costs and lost productivity will result from the current application of this program to businesses whose work environments pose virtually no risk to the safety of their employees. The Council supports taking appropriate steps to prevent worker injuries. The requirements and associated penalties of SB 198, however, are extreme in the context of many low-risk businesses.

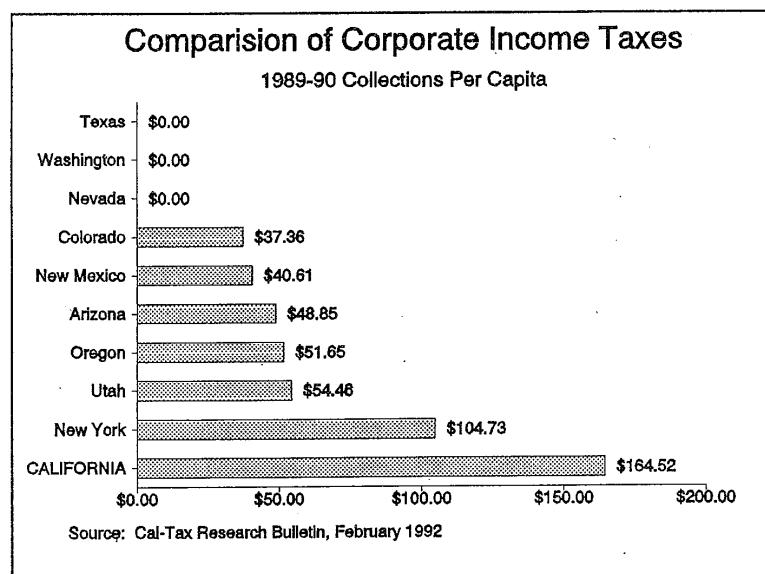
The Council sees no need to include those employers who are not on the list of "high-hazard industries" published by the Division of Labor Statistics and Research of the Department of Industrial Relations.

Action:

- ◆ Amend Title 8, Section 3203 of the California Code of Regulations and the California Labor Code to exclude employees who are not included in the list of "high-hazard industries" by the Division of Labor Statistics and Research of the Department of Industrial Relations.

4. CAPITAL AND ECONOMIC INCENTIVES

California taxes are driving business and investment out of our state. Most of the companies relocating or expanding out of state in 1991 cited relief from state taxation as their primary motive. While we continue to lose jobs from such defections, small businesses in California, historically responsible for most of our new job growth and the expansion of state tax revenues, are literally starving for new capital.



Although California provides a high level of services to its citizens, its high marginal tax rates and aggressive tax policies put Californians at a competitive disadvantage in attracting equity capital and encouraging investment in equipment, machinery, and research and development. Unlike many competing states, California requires growing businesses to provide costly public infrastructure and environmental mitigation measures as a condition to building and expanding production facilities. Redundant state banking regulations have exacerbated these concerns by contributing to the current tight commercial-lending environment.

The Council has developed cost-effective recommendations that will counter such impediments to capital investment and economic expansion. Unproductive tax policies should be addressed immediately, and tax credits should be used sparingly to offset current disincentives to investment. At the same time, successful programs

that enhance California's position internationally should be expanded. Californians should encourage partnerships between the private and public sectors in economic development activities and should facilitate the construction of quality affordable housing.

In the near term, the Council urges the following specific actions to facilitate capital formation and long-term investment in California:

- ◆ Reduce capital gains taxation to attract small-business investment
- ◆ Restore competitive loss carryover treatment
- ◆ Provide tax incentives to encourage expansion and jobs creation
- ◆ Oppose detrimental initiatives and tax proposals
- ◆ Expand trade finance and assistance
- ◆ Streamline banking regulations
- ◆ Enhance the role of utilities in economic development
- ◆ Expand state financing sources for affordable housing

Over the long term, California needs to address three overriding concerns. We must strive to reduce overall tax rates and adopt the mission of returning the highest possible value to our individual and corporate taxpayers. We must work further to eliminate or counter disincentives and impediments to investment and capital formation, and enhance the ability of Californians to compete. Finally, our tax policies need to be predictable and long term, to allow sound business decision-making and long-range planning.

A. Attract Small Business Investment

Problem:

California lacks a long-term investment incentive for start-ups and small businesses. These companies, which have played a critical role in jobs creation and economic growth, have been most affected by the widely publicized "credit crunch" of commercial lenders. Today's surging public equity markets are typically beyond their reach. The primary institutional source of funds for these enterprises — venture capital — has declined sharply in recent years. Annual investments in California venture capital funds fell by nearly half between 1989 and 1990 to \$461 million — the lowest level since 1981.

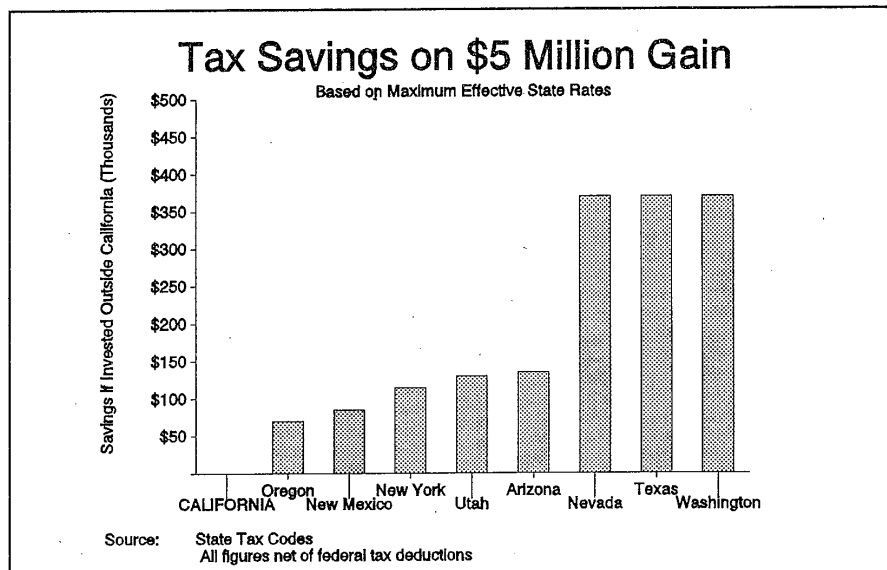
Historically, private individual investors have been the greatest source of capital for fledgling businesses. A 1988 Small Business Administration study found that nationwide, over 700,000 private investors provided approximately \$55 billion annually to small business, as compared to \$3 billion of venture capital. The Western Association of Venture Capitalists estimates that private investors account for over 90 percent of capital investment in start-up and emerging companies in California today. This source of investment in future jobs and tax revenues must be stimulated.

Actions:

- ◆ Encourage new long-term investment in privately held small businesses. Reinststate California's "Small Business Stock" Provision to eliminate capital gains taxation on new investments in small companies, defined as those with fewer than 500 employees, which are held for three or more years. California's high marginal individual tax rates put state businesses at a competitive disadvantage in attracting long-term equity investors, including key employees who defer some immediate salary for potential long-term gains through stock ownership.
 - Include in this exemption realized gains on qualifying small-business stock where the investment is continued through an exchange of securities by an acquiring company.
 - Include in this exemption gains on qualifying small-business stock investments held and distributed by partnerships.

Exclude from this exemption capital gains on assets or businesses that do not create jobs or that already receive significant preferential tax treatment, such as real estate.

Californians are subject to one of the highest effective capital gains tax rates in the United States. As shown below, an investor, whether a private individual, venture capital fund, or key employee, would be \$370,000 wealthier on a \$5 million gain simply by living and investing in a competing state. Reversing this inequity for investments in small companies would provide a powerful incentive for new investment in our state. The potential cost to California in foregone capital gains revenues pales in comparison to the permanent loss of taxes if such investments are driven to other states.



The following analysis of a \$10.4 million investment in a hypothetical start-up electronics company indicates that such a venture would generate a net tax benefit to the state of \$1.9 million in its first six years, even considering the loss of revenues from the "Small Business Stock" exemption. While the state might forgo up to \$1.7 million in capital gains tax, **only when and if the company were sold**, the analysis shows that California would forfeit over \$3.6 million if the company were to be formed outside of our state.

Analysis of "Small-Business Stock" Exemption

Estimated State Tax Benefits
From a Start-up Electronics Company

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6
Tax Revenues from New Company						
- Personal Income Taxes	\$178,464	\$227,136	\$288,476	\$365,040	\$462,384	\$588,620
- Sales Taxes	107,078	136,282	173,086	219,024	277,430	353,172
- Bank & Corporation Taxes	800	800	10,515	25,000	57,085	132,900
Total Taxes on New Company	\$286,342	\$364,218	\$472,077	\$609,064	\$796,899	\$1,074,692
Cumulative Taxes on New Company	\$286,342	\$650,560	\$1,122,637	\$1,731,701	\$2,528,600	\$3,603,292
Capital Gains Tax Exempted (If Company Sold At End of Each Year)	0	(80,080)	(176,176)	(832,810)	(1,228,204)	(1,702,638)
Net Tax Benefit to State (After Exemption)	\$286,342	\$570,480	\$946,461	\$898,891	\$1,300,396	\$1,900,654
Assumptions:	<ul style="list-style-type: none"> ◦ \$10.4 million invested in a new electronics company with 20% annual return on investment ◦ 20% annual return on investment (based on national average) ◦ Jobs created at 27% compound annual rate (based on national average) ◦ Job-creation multiplier of 2.5 times used (based on national average) ◦ Payroll calculations based on California Department of Commerce averages 					

Source: Western Association of Venture Capitalists

B. Restore Competitive Tax Treatment of Losses

Problem:

California is only one of two states with corporate income taxes that currently offer no Net Operating Loss (NOL) tax treatment. NOL carryovers are a form of income averaging for business. They allow taxpayers who experience losses in one tax year to carry over those losses to offset taxable income in future or past years. NOL provisions have significant economic value for biotechnology and other emerging growth companies, which typically lose money for several years after start-up, and for industries facing heavy restructuring costs, such as aerospace and defense.

California's NOL provisions, until recently limited to 50 percent of NOLs in all but enterprise zones, were suspended in 1991. While our state still allows 100% NOL treatment in enterprise zones, 43 other states currently offer such treatment statewide. We have learned that NOL treatment is not perceived as a key incentive by the types of companies considering relocation to enterprise zones; however, it is an important feature to the kinds of companies considering relocation and expansion outside of California. This puts Californians at a significant economic disadvantage, and if unchecked will result in job losses and diminished tax revenues.

Actions:

- ◆ Immediately restore California's 50 percent NOL carryover provision to minimize disincentives to risk capital investment and corporate restructuring in our state.
- ◆ Phase in 100% NOL treatment statewide by 1994.

C. Encourage Business Expansion and Jobs Creation

Problem:

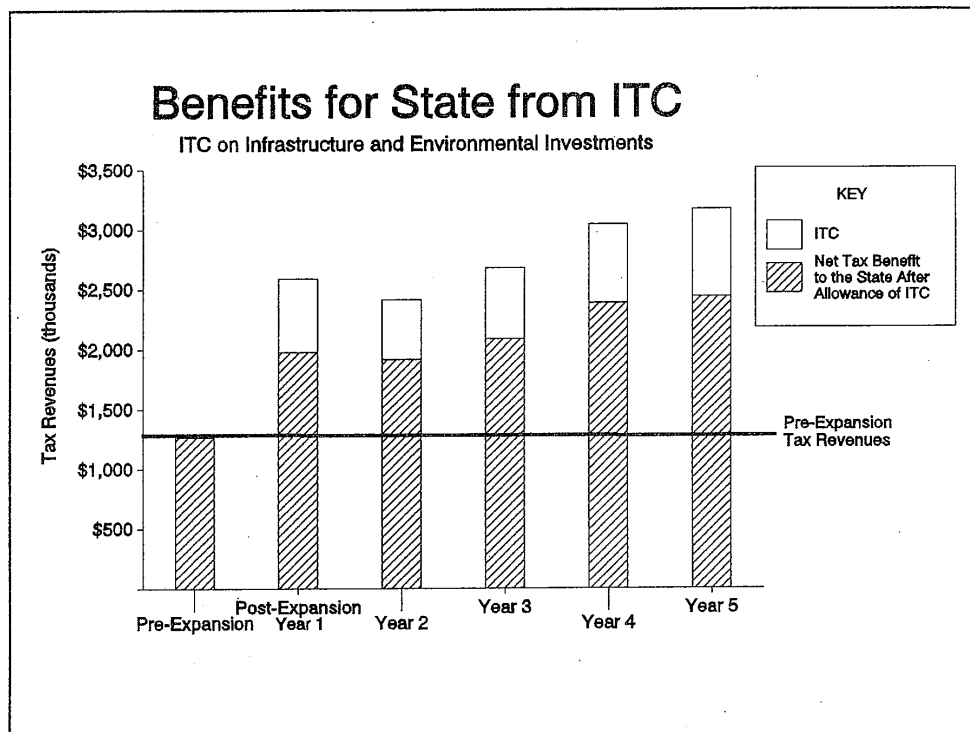
New jobs and retooling of the defense sector will require California employers to make significant new investments. At a time when reinvestment and expansion should be encouraged, California businesses are being required to provide costly public infrastructure and environmental mitigation measures in return for permission to build or expand production facilities. These investment costs, which currently produce no tax offsets for the employer, are borne by state and local governments in many other states, and they make the total capital outlay required to do business in California higher and uncompetitive with these states. In addition, California currently imposes sales and use taxes on investments in machinery and equipment — the means of production — providing a further deterrent to expansion and the creation of new jobs.

Actions:

To encourage the construction of new facilities and the expansion of existing facilities in California, our state's tax policies should permit businesses to recoup a portion of the public infrastructure and environmental mitigation costs, and other capital outlays borne by growing businesses. To further encourage state businesses to create jobs through reinvestment and expansion, California should also provide credits for taxes paid on investments in machinery, pollution-control devices, and other capital equipment.

- ◆ Create an investment tax credit (ITC) for public infrastructure and environmental mitigation associated with plant expansion. The Council recommends an ITC on capital expenditures and on required public infrastructure and pollution-control investments for California ventures that create 20 or more new jobs. To protect existing state revenues, application of this credit should be limited to 50 percent of the incremental state tax revenue generated by the new or expanded facility.
- ◆ Expand sales tax credit for machinery and equipment purchases. Currently, California provides a corporate income tax credit for sales and use taxes paid on purchases of manufacturing and pollution-control equipment in state enterprise zones. **Thirty other states provide such exemptions statewide.** To be competitive, California should extend this credit to all businesses in the state.

The following example illustrates that an ITC for plant expansion, public infrastructure and environmental mitigation can be implemented now without jeopardizing existing state tax revenues. In this case, California would immediately benefit from public infrastructure and environmental mitigation investments of \$6 million on a \$20 million capital-expansion project. Over the first five years of the project, the state would receive approximately \$7.4 million in increased tax revenues, and the plant would add over 100 new jobs. Alternatively, the hypothetical company could invest in one of many other states that do not require public infrastructure investments on expansion or that currently offer investment tax incentives.



- Assumptions:
- \$26 million total investment; consisting of \$20 million in new capital assets, \$5 million in public infrastructure and \$1 million in environmental mitigation.
 - ITC based on 15% of capital improvements; 75% of infrastructure costs; and 75% of environmental mitigation costs.
 - Example based on multi-state company with \$5 million in taxable income growing at 15% annually.
 - The new facility results in a tax loss of \$500,000 in each of years 1 and 2, and in year 3 taxable income is \$500,000 with a 25% annual growth thereafter.

Source: Price Waterhouse

D. Oppose Detrimental Initiatives and Tax Proposals

Problem:

For California to foster jobs creation and economic prosperity, it must limit investment barriers and decrease the high costs of doing business in the state. Initiatives and tax proposals that will drive jobs and tax revenues out of our state should be strongly opposed. Along with the perceived benefits, Californians must consider the consequences of such legislation on California's competitive position.

Actions:

The following initiatives would be highly detrimental to California's competitiveness and would damage the state's ability to retain and create jobs. Accordingly, the Council recommends:

- ◆ Oppose split-roll taxation. Taxes on commercial and agricultural properties currently account for two-thirds of state property taxes, while taxes on residential properties account for one-third. Imposing a larger tax burden on business-related properties directly raises production costs and reduces the availability of private capital-investment resources. A "split-roll" tax policy should be opposed. It would increase the cost of operating in California and decrease economic growth.
- ◆ Oppose the Californians For Taxpayer Reform initiatives. Two similar tax proposals are being sponsored by public employee unions. They are anti-business, and have been estimated to increase the tax burden on California businesses by \$1.7 to \$4 billion. The sponsors claim that offsetting tax reductions included in the initiatives will amount to \$1 billion, but they result from an accelerated rollback of the temporary boost in sales taxes, which is set to expire in 1994 anyway. Some of the more detrimental provisions of these initiatives include:
 - Requirement for a change of ownership reassessment for all property of a corporation when, cumulatively, more than 50 percent of its stock changes hands.
 - Increase in the bank and corporation tax rate from 9.3 to 10.3 percent beginning in 1992.

- Increase in the alternative minimum tax rate for corporations from 7 to 7.7 percent.
- Repeal, effective January 1, 1993, of the bank in-lieu tax, thus subjecting banks and federal institutions to all local taxes.
- Revocation of S Corporation status for corporations with total sales over \$10 million.

E. Streamline Banking Regulations

Problem:

Redundant and costly bank regulations have contributed in a big way to the current drought in working capital loans to small- and medium-sized businesses. Failure to coordinate state and federal banking regulations leads to higher financing costs and constrains the free flow of capital. Frequent changes in regulations make compliance difficult, and exhaustive documentation requirements are very costly. The American Bankers Association estimates that banks spend between \$500 million and \$1 billion a year on regulatory compliance. These funds could have generated \$4 to \$12 billion in commercial loans.

Independent community banks, the primary lenders to small business and often the only source of credit in rural and isolated communities, are the hardest hit by these overlapping state regulations and costs of compliance. Community banks are in jeopardy, and if current regulatory trends continue, the result could be devastating for small businesses — California's most potent job producers.

Actions:

Federal regulations obviously affect all states, but California financial institutions are in an optimum position to react swiftly to federal reforms that will benefit California borrowers. Federal reforms should be addressed through the newly created "California Institute for Federal Policy Research." California can reduce regulatory costs and improve the availability and formation of capital by adopting the following measures:

- ◆ Eliminate duplication: State-chartered banks should no longer be subjected to examinations by both state and federal regulators. Banking institutions should be reviewed by the state and the report shared with the federal agencies, or vice versa.
- ◆ Reverse preemption: Whenever possible, California banking regulations should contain "reverse preemption" clauses. If a federal law preempts an established state regulation, then compliance with federal requirements would suffice.
- ◆ Review financial institution charters and licenses: Given the dramatic changes in the financial markets during the last ten years, it is recommended that the state review its financial institution franchising

and licensing practices. The review should focus on regulatory burden and its effect on capital flows.

- ◆ Regulatory cost-benefit analysis: Benefits of regulations affecting financial institutions should be measured against their impact on capital availability and their contribution to the "credit crunch."

The governor and California's congressional delegation need to focus immediate attention on these state and federal regulatory reforms, which are particularly harmful to independent community banks and their small-business borrowers.

F. Expand Trade Finance and Assistance

Problem:

California leads the nation in export trade, and the state needs to maintain and capitalize on this key competitive advantage. International trade already accounts for over one million California jobs. Trade also boosts economic growth. Over 80 percent of the growth in the U.S. economy in 1990 was generated through international trade, and California exports grew by 7.6 percent during the recession in 1991. In addition to the other recommendations of the Council, expanded support for state trade programs will be rewarded in new jobs growth and added tax revenues, and should assure our competitive edge over other states for many years to come.

The World Trade Commission (WTC) is the most aggressive and efficient state-funded trade program in the United States. In 1991, the WTC, targeting small to medium-sized exporters, provided export financing of \$23.7 million through its loan guarantee program, and export assistance at 24 international trade shows. This resulted in export sales by California companies of approximately \$212 million. It is estimated that four dollars of tax revenue are returned to the state for every one dollar of general fund revenue appropriated to the WTC. The state Department of Commerce also provides trade development services through its overseas offices.

In addition, California currently has six federally chartered Foreign Trade Zones (FTZ), which offer trade-related businesses the opportunity to defer, reduce, or eliminate U.S. customs duties. Excessive documentation requirements, processing time, and lack of awareness about the program benefits now hinder the use of FTZs by California exporters.

Actions:

California should develop a comprehensive, and coordinated "International Trade Policy" and expand its commitment to successful programs that encourage international trade.

- ◆ Expand export development and trade-finance assistance. To enhance California's worldwide competitiveness, it is recommended that support for the WTC export finance and development programs be expanded. The \$1.9 million appropriated for the WTC in 1991 resulted in increased tax revenues of over \$7.6 million — a 300 percent return on investment.

The Council specifically recommends that the WTC's Export Finance Fund be expanded from \$5 million to \$10 million, with increased operational funding as required, to increase exports and create new California jobs. This will be self-supporting, as it is projected to add more than \$120 million in new export sales and over 6,000 new jobs.

CALIFORNIA WORLD TRADE COMMISSION 1991 COST/BENEFIT ANALYSIS

(Dollars in Millions)

WTC Supported Export Sales ⁽¹⁾	<u>\$212.000</u>
State Corporate Tax ⁽²⁾	\$ 1.908
State Income Tax ⁽³⁾	3.834
State Sales Tax ⁽⁴⁾	<u>1.881</u>
Total State Tax Revenues	\$ 7.623
Total Appropriation to WTC	<u>(1.906)</u>
Net Tax Benefit	<u>\$ 5.717</u>
Return on Funds Appropriated	300%

- 1) Combined annual export sales generated by WTC Export Finance Office loan guarantee program and WTC Office of Export Development trade shows program.
 2) California average corporate income tax rate of 9% applied to 10% of sales.
 3) California average personal income tax rate of 3.7%, based on personal income of \$103.6 million.
 4) California sales tax rate of 5.5%, based on 1/3 of total personal income spent on sales taxable items.

Source: California World Trade Commission, 1992 Report to Legislature.

- ◆ Expand use of California's Foreign Trade Zones. The Council recommends marketing the benefits of FTZs more aggressively to California exporters and streamlining the paperwork and approval processes for use by the FTZs to facilitate use of the program.

G. Enhance the Role of Utilities in Economic Development

Problem:

Utility companies **outside of California** are **regular partners** in state economic development endeavors. To enhance California's competitive position, California utilities will need to participate in such efforts. Maintaining or expanding their economic base through business retention and expansion should result in lower rates for both residential and commercial ratepayers.

State legislation (AB 2054), which was passed in 1991, directs the California Public Utilities Commission (PUC) to authorize utilities to engage in economic development programs, and to include such expenditures in their rates to the extent of ratepayer benefit. This legislation specifically allows utilities to engage in the retention and recruitment of business.

However, the PUC has not yet taken steps to activate AB 2054, and it is not currently encouraging California utilities to retain and expand their economic base.

Actions:

AB 2054 should be aggressively implemented to make California more competitive. Specifically, it is recommended that the PUC act by January 1993 to:

- ◆ Permit utilities to be full partners with state and local agencies in economic development efforts.
- ◆ Allow utilities to support local economic development agencies with market research, technical assistance, and site inventory analysis, providing California's economic development agencies with improved advance notice of companies considering leaving or coming to California.
- ◆ Allow a liberal interpretation of "reasonable expenditure" and "cost-effectiveness" for utilities' involvement in economic development.

H. Expand State Financing Sources for Affordable Housing

Problem:

California voters and business leaders agree that the high cost of housing is harmful to the state's economy. As noted earlier, permitting processes and growing development fees are key elements in the pricing of all new California homes. The cost and availability of capital to developers and builders have also become major constraints on the development of new affordable housing. The Council specifically urges the state to act to expand financing sources for low- and moderate-income housing.

Tax increment revenues in redevelopment areas and private-activity bonds present excellent opportunities for the development and purchase of quality affordable housing. Current restrictions placed on the use of set-aside funds, generated from the increment of new taxes from redevelopment projects, keep municipalities from using them aggressively to meet their housing needs. The use of private-activity municipal bonds for single-family and multi-family housing projects is hampered by federal issuance limits that are too low to materially impact California's housing markets.

Actions:

California can provide expanded financing for housing through the following:

- ◆ Allow more flexible use of redevelopment tax increment set-aside funds, which accrue from redevelopment projects. Municipalities should be permitted to use set-aside funds for the construction of moderate-income housing and for the rehabilitation of low- and moderate-income housing. Municipalities should also be permitted to "pool" set-aside monies, creating a source of capital for use in building housing, providing security for mortgage bonds, or for purchaser down payments.
- ◆ Raise limits on private-activity bonds. Federal volume caps, which limit the amount of private-activity bonds that can be issued by the state in any year, should be raised or eliminated to permit expanded use of these tax-exempt funds. Expanding volume cap requirements would assist in the provision of tax-exempt financing for not only affordable housing, but also facilities such as sewage and solid-waste disposal facilities and certain other infrastructure required to service new housing areas.

5. EDUCATION AND TRAINING

Getting a job is a necessity, but it is not a right. A worker must be prepared for the workplace. Each person has the responsibility to acquire the knowledge and skills he or she will need in life. In turn, California must provide a public education system that will offer to all students equally the opportunity to fulfill their highest potential, to get good, high-skill jobs, and to become taxpayers. Today we spend over \$28.5 billion on public education, but with dismal results. In a 1990 survey, 77 percent of California business leaders stated that the education level of job applicants is a major problem. Among the largest firms in California, 63 percent report that new applicants for entry-level positions lack a satisfactory education. Overall, only an estimated 46 percent of new job applicants demonstrate adequate basic math and verbal skills on written examinations. Pacific Bell reports that six out of ten entry-level job applicants flunk examinations geared to seventh-grade knowledge levels. The company estimates that it spends over \$14 million per year on employee training to provide remedial education. While some companies may have no choice but to try to cure this problem themselves, many other companies can just go elsewhere in search of a better workforce — and they do.

The challenge for California is not an easy one. California regularly absorbs nearly 45 percent of all documented immigrants to the United States, and, presumably, an even higher percentage of the nation's undocumented immigrants. As a result, California's primary and secondary school enrollment is now approaching six million, and is expected to continue increasing at a rate of 200,000 pupils per year — a number equal to the total enrollment in the state of Idaho. By the year 2000, one in every eight children in the United States will attend California's public schools.

Today approximately one hundred languages are spoken in California schools. One in every seven pupils comes to school with no knowledge of English. Of new students entering our schools during the last five years, 92 percent are ethnic and racial minorities and 65 percent are "limited-English-proficient."

Our schools have become one of history's great social experiments — and the experiment is not a success. California is 42nd in the nation in its percentage of high school students who graduate. In 1989, over 33 percent of all California students dropped out or were held back in high school. The dropout figure is even higher for some minority youngsters. Projecting this rate over the next ten years will add 1.4 million dropouts to our population. Many of these young people will become public charges.

Our failure to date is not for lack of trying. We have increased school budgets markedly. We have introduced a host of demonstration projects and innovations such as magnet schools. Thoughtful and qualified people have studied the problems. We have even had some successes, such as the primary schools in Inglewood where principals and teachers have energetically advanced the literacy and overall performance of their inner-city students. But it is not enough, and it will not be enough for the growing school population and shrinking job market — unless more is done.

We do not necessarily need more money per child, but we do need more: more strategic planning, more accountability for results, more choice, more intelligent use of resources, more total schooling, and more career training directed toward high-skill jobs.

A. More Strategic Planning

Problem:

California's public education system at the primary and secondary levels is administered and directed by the state Department of Education, the state Board of Education, the Superintendent of Public Instruction, 58 county offices of education, and 1,013 local school districts. Moreover, there are duplications among primary and secondary education authorities, community college administrators and other state-supported education agencies. This welter of overlapping and often warring administrators could not be expected to generate a comprehensive strategic plan for our schools, and it has not done so. **The first requirement for holding the system accountable for its work is to have a plan against which its achievements can be measured.**

Actions:

- ◆ Adopt as law the basic principles which the state wishes to apply in restructuring its education system. These principles must include, among others, the concepts of accountability, freedom of choice, and job-skill education that are detailed below. Before July 1, 1992, the governor and the legislature should jointly appoint an Advisory Council on Education and Training, made up of qualified people from the worlds of education, business, labor, and the professions, to advise on the nature of such principles. Once the principles are adopted, the Advisory Council should create and issue annually five- and ten-year rolling plans setting forth the educational and job training objectives of California, consistent with the basic principles. The Advisory Council should recommend restructuring the current system to meet the principles and objectives, and offer legislative proposals as necessary. The Advisory Council should regularly measure the success of California schools in meeting these objectives, and report to the public.
- ◆ The Advisory Council, in conjunction with each major state education agency, shall meet with the governor monthly and report publicly on the state of their progress with respect to achieving the goals of this report and of the five- and ten-year plans.
- ◆ As to the actions called for in this report which can be accomplished by executive action, the administration should take all such actions immediately. There is no need to delay such reforms until the Advisory

Council begins its work. The solutions to these education problems are needed urgently.

B. More Accountability

Problem:

The system is not accountable for its results — financially or educationally. The state provides almost two-thirds of the budget of each school district, but has little or no control over spending. The biggest expenditure, the collective bargaining agreement with the teachers, is negotiated by each district separately, within only the broadest state guidelines. This disconnection between the entity paying the bill and the entity committing to the amount of the bill is a classic case of how costs get out of control.

Actions:

- ◆ Implement the recommendations of the Little Hoover Commission of June 1991, concerning the tightening of accounting controls on school districts.
- ◆ Either implement statewide collective bargaining on behalf of school districts, as recommended by the Little Hoover Commission, or give school districts the right to raise discretionary funds by local ballot initiatives. Such local funds would be the source of money to which districts would have to turn for the funds they commit to pay in setting labor costs. One way or the other, **make the party negotiating the labor cost be the party responsible for raising the funds.**

Problem:

Educationally, the system exacts absolutely no penalty for poor performance. There is periodic student testing of basic skills under the California Assessment Program at grades 4, 5, 8, and 10, but there are no consequences for the results, bad or good. The measurements for funding and resources relate only to inputs — average daily attendance figures, numbers of buildings, numbers of teachers — not to outputs. Teachers are not paid on the basis of accomplishments, and schools are not funded on that basis. The result is the same result as in every other place where accomplishment is ignored — not enough is accomplished.

Action:

◆ Enhance the use of the California Assessment Program examinations and apply them to measure individual student performance as well as to publicize and, in extreme cases, apply sanctions to schools where statewide norms in basic skills are not achieved. Create a bonus pool from existing funding to reward schools that show improvements in test results as well as improvements in other important issues such as school violence and drug use. By focusing on **improvements**, the bonus pool will not benefit just the schools with the fewest problems. Simultaneously, ease the restrictive burden of the excessively detailed constraints on curricula and content of education in conjunction with the freedom of school choice discussed below. Encouraging variety in school programs and measuring the results by testing will allow parents to shop for the best public schools and force the schools to work for their state funding by improving the education they provide.

C. More Choice

Problem:

Today our society has two tiers of consumers of educational services: the affluent, who can choose among schools, public or private, for their children's education; and the rest of us, who must take what the state schools monopoly offers. This is unfair, and its natural result is an unresponsive public system. Teachers and principals adhere to a model state curriculum, and do not show the full initiative and creativity their experience and training would allow them in establishing unique educational approaches and products. Our professionals sink into distracted boredom; our students attend (or drop out of) assigned schools as though serving sentences. The market mechanism that drives our whole society is left at the schoolhouse door.

Actions:

- ◆ **Implement freedom of school choice for parents and children throughout each public school district.** Across the nation there is a rising flood of support for allowing parents and children to choose the school they will attend. It has been broadly tried, with great success, in such diverse places as Minneapolis, Minnesota, and East Harlem, New York. In California, the proliferating magnet schools are a strong step in this direction. We must go much further.
 - Empower principals, teachers, and parents to come together to set their own curricula and form their own "schools within schools" in existing school facilities. These schools must be free of most government regulations that restrict their ability to use the best ways and schedules for teaching, the best curricula, and the best reward structures.
 - Control the quality of the work of these schools by the use of the California Assessment Program tests. Publish and use these test results and surveys of school violence and drug use to help parents and children choose schools. Parents should not have to send their children to failing schools.
 - Fund these schools as is now done on the basis of their attendance levels, and out of the bonus pool, discussed above, on the basis of measured performance improvements.

- Provide transportation assistance and parent information programs to assure that real choices are available for all children and parents.
- Implement safeguards, such as some admissions by lottery, to be sure diversity standards are met among the student body.
- While implementing district public school choice, as discussed above, continue assessment and demonstration projects of broader market strategies to expand choices for children and parents, such as interdistrict public school choice, and voucher programs, which would include private schools.

D. More Intelligent Use of Resources

Problem:

School population growth is spiraling. Just to stay where we are today, California would need to build 20 classrooms a day, seven days a week, every week of the year for the next decade. This cost alone would be \$30 billion. If California is to improve its facilities situation, it will have to accelerate that pace and make better use of existing facilities. Because of the state constitutional requirement of a two-thirds vote for school bonds, a minority of the public has been able to veto school construction. Over \$5 billion of badly needed school construction projects are now stalled in the state Allocation Board for lack of funding. Nevertheless, only \$1.9 billion in bond authority will be on the June 1992 ballot. And funding is not the only hurdle. Any school construction proposal must cross a regulatory swamp. At the state level alone, approvals are needed from the Office of Local Assistance, the Office of the State Architect, the Department of Education, and the state Fire Marshal. The approval of the Office of the State Architect typically takes one year after funding is approved and allocated. The whole saga, from identifying the need to opening the school doors, normally consumes six years. We must find better and faster ways to build more schools, and to get more use out of those we already have.

Actions:

- ◆ Amend the state constitution to require only a majority vote to authorize school bonds applicable to primary and secondary schools as well as community colleges.
- ◆ Implement the recommendations of this Council on Regulatory Streamlining, particularly with regard to school funding and construction agencies.
- ◆ Employ year-round schooling in all overcrowded districts, as Los Angeles has done, to maximize use of existing staff and facilities. Eliminating the long summer recess is good for the education of our children and lessens the social problems arising from enforced idleness.
- ◆ Mobilize California's telecommunications and computer industries to apply the latest technologies to teaching in California schools. We should lead the world in interactive computer applications. This can stretch our faculty budget toward giving pupils the benefits of a small-

class environment without all the expense of reducing class size to optimum levels.

- Much of our high technology equipment needs must be met by innovations from industry. Industry must act with an understanding of the direct connection between an educated workforce and a healthy economy. Establish voluntary partnerships between schools and businesses to develop pilot projects and demonstration programs. We must be the nation's technological leader.

E. More Total Schooling

Problem:

When we have the classrooms and teachers, we make too little use of them. Our 180-day school year is among the shortest in the western world. Our school day is short. When we have the pupils in our grasp, we should take the time to teach them.

We do not focus our instruction where it counts. The youngest children are the most educable in basic skills. Yet too many children do not enter the system until age six or seven. **English comprehension and literacy are the minimum admission tickets for a good job in this state.** Also, literacy and comprehension, in general, are fundamental components of self-esteem. But in California, in every average class of thirty high school sophomores, four pupils will not be able to speak English fluently. Our system is denying these young people an equal chance for the high-skill jobs.

Actions:

- ◆ Extend the minimum school year to 200 days. This will still trail Japan (243 days) and Germany (226 to 240 days), but it will be a strong step forward.
- ◆ Extend the minimum school day by one hour. This will further enhance education while dealing in part with the problems arising from "latchkey kids."
- ◆ Provide the opportunity for all children to have at least two years of pre-kindergarten schooling, with associated health and social services. State funds should supplement Head Start and other federal funds. Repeatedly, this has been shown to be the most valuable application of funds toward improving children's performance. Further, for a parent receiving welfare assistance, having a young child in school may give him or her the best chance to obtain gainful employment.
- ◆ Require that **all pupils will be capable of reading and writing English by the end of the third grade.** Test to verify this result. (For students who enter school late or who do not have continuous attendance, all schools must provide instruction to enable these students to be able to be functional in English in the shortest possible time.) If necessary, eliminate or restructure all other programs in the first three grades to

obtain this result, but obtain this result. For many children, the opportunity for two years of preschool, called for above, will make this third-grade goal achievable. We recognize the equal dignity and important contributions of all cultures and languages, but we want all our children to participate with equal opportunity in the job market and in the larger society. Once grounded in English, the students will be best able to benefit from the variety of other programs and subjects available in school commencing in the fourth grade.

F. More Career Training Directed Toward High-Skill Jobs

Problem:

Our high school students are offered a generally standardized education. There is not enough focus on work skills for those not continuing to college, and what programs we have are not matched to job availability. In the current business climate, this problem is compounded by the rapid disappearance of high-paying industrial jobs for those with only a high school diploma. Without some focused training or post-secondary education, a young person's future may only offer lower-paying service jobs.

Actions:

- ◆ Test all tenth-grade students to allow them to consider a focused career program in the eleventh and twelfth grades. Unlike some European countries, California should make participation in such programs purely voluntary.
- ◆ High schools, in partnership with business and community colleges, must develop high-quality eleventh- and twelfth-grade career programs and provide apprenticeships and other clear paths from school to work for those who choose the career program. Industry must take an active role in establishing the curricula and testing standards, and it must help finance and provide specialized facilities and faculty assistance. Industry must continually identify the areas of the economy for which trained workers are really needed. The Graphic Arts Academy at Pasadena High School, developed in conjunction with the Printing Industry Association, is a fine example of such a program.
- ◆ The high school diploma should be accompanied by appropriate certificates of qualification for those who have taken the career option and passed the industry-standard testing. Only as an industry-generated standard will these certificates become tickets to jobs.

Problem:

The state invests enormous funds in post-secondary education and adult education and training. Career education and job training programs alone cost over \$3 billion annually. However, the system is uncoordinated, duplicative, and wasteful. Job-training programs particularly suffer from fragmentation, with a bewildering array of 23 separate programs (see the following table) that are undirected, over-bureaucratized, and aimed at achieving only minimum skill levels.

Actions:

- ◆ The Advisory Council on Education and Training should report to the governor by October 31, 1992, with rules for career-training programs, departments, and agencies to make education and training more cost-effective in achieving economic development. These rules should coordinate the existing training and job placement programs in the state and provide direction to support the state's economic development. We must eliminate duplication.
 - The existing State Council on Vocational Education and California Occupational Information Coordinating Committee and their budgets, totaling about \$600,000, should be merged into the Advisory Council to avoid a proliferation of advisory councils.
- ◆ Establish public information centers at numerous locations around the state to provide assessment and referral services so that each worker can be guided into the appropriate career program.
- ◆ The existing Employment Training Panel (with its budget of over \$60 million) must work closely with the Advisory Council on Education and Training, and provide funding to assist in developing the career programs with industry standards directed toward high-skill jobs.

PROGRAMS BY TARGET GROUP

Program	Client Groups Targeted							
	Job Ready	Dislocated Workers	Youth	Public Aid	Vets	Disabled Workers	Older Workers	Low Income
Postsecondary Voc. Education	♦	♦		♦		♦		
Secondary Voc. Education, ROC/Ps			♦			♦		
Adult Education		♦		♦		♦	♦	
Job Training Partnership Act		♦	♦	♦	♦		♦	♦
GAIN				♦				
Vocational Rehabilitation			♦	♦		♦		
Job Service	♦	♦	♦	♦	♦	♦	♦	
Employment Training Panel Program	♦	♦						
CA Conservation Corps			♦					
Refugee Assistance Services				♦				
Inmate Employment								♦
Vocational Education for Inmates								♦
Supported Employment			♦	♦		♦		
Special Veterans Services					♦	♦		
Food Stamp Employment & Training								♦
Wagner-Payser 10% Projects			♦	♦		♦		♦
Service Center Program				♦				♦
Senior Community Employment Service							♦	♦
Ward Employment			♦					♦
Apprenticeship Training	♦							♦
Job Agent Program				♦				♦
California IMPACT			♦					♦
Career Opportunity Development				♦		♦		
TOTALS	4	5	9	12	3	9	4	7

SOURCE: Employment Development Department

Problem:

The lack of accepted training standards that apply across an industry is a fundamental problem in our system to prepare people for the workplace. Unlike our European and Asian competitors, which have widely accepted national training standards for most industries, California has such standards for only a few industries, and even these can vary from one location to the next. There is little consistency from one company or training agency to the next in what workers are expected to be able to perform. In many cases there are no performance standards at all. This lack of explicit expectations makes it impossible for students to plan their education, not knowing what courses are essential or what skills future jobs will require, and it makes it impossible for employers to rely on the competence of graduates from such programs. Further, there is a shift in the nature of work in California. Low-skill manufacturing jobs are leaving, and many of them will never return. Career training currently is too often directed toward yesterday's jobs, not the high-skill positions of tomorrow. Without knowing a program's record in placing its graduates, a prospective student cannot see if it is a path to success.

Actions:

- ◆ The Advisory Council on Education and Training must propose concrete action plans by October 31, 1992, for setting clear industry-wide standards for the skills needed in high-skill, high-wage organizations. Industry skill standards, pegged to world-class levels, will determine the certification of new workers, the retraining and conversion of displaced workers, and the upgrading of the skill levels of the existing workforce. Such standards will transform education and training.
- Establish regional joint committees containing industry and labor representatives as well as people from the local schools and community colleges to formulate curricula, assessments, and credentials based on the new high-skill standards. State educators should support business and labor to implement the action plans for setting industry-specific high-skill standards.
- As a first priority, the Advisory Council on Education and Training must set action plans to develop career-training standards in eleven critical industries: aerospace, biotechnology, computer-based applications, energy, environmental sciences, financial services, health, international trade, printing, telecommunications, and transportation.

♦ All career training programs must be evaluated annually, with particular emphasis on the percentages of graduates successfully placed in industry and their wage levels. Such results should be published, so prospective students can choose among programs. We should not be training our workers for jobs that are not there.

6. THE LEGAL SYSTEM

Discourage litigation. Persuade your neighbors to compromise whenever you can. — Abraham Lincoln

*We [should] again make litigation an exception, a last resort, a necessary evil at the margins of our common life.
— Walter K. Olson, "The Litigation Explosion — What Happened When America Unleashed the Lawsuit"*

Last year, Californians ignored this sound advice by filing a record 850,000 lawsuits. The resulting burden of excessive, often unmeritorious, and always costly litigation is an acute and widely held concern about the California business and jobs climate.

While all Californians are understandably proud of their state's reputation for innovation and generosity, these qualities, when too freely applied to the state's legal system, have led to excesses. The sorry result is that surging liability insurance costs, huge legal bills, large settlements, and unpredictable jury verdicts impose a heavy "tort tax" on every business, large and small, in the state — a tax borne ultimately by all Californians in the form of costlier goods and services, fewer jobs, and less investment in California. Litigation is big business in the United States; a recent report by RAND's Institute for Civil Justice (RAND ICJ) estimates that simply operating our nation's civil courts costs \$2 billion a year, without reference to the billions spent by litigants. As usual, California is a leader; while California's population grew 25 percent in the last ten years, its active lawyer population grew 44 percent. California's legal system consumes enormous amounts of public and private resources, and unless corrected, abuses of that system will continue to diminish the competitiveness of California businesses and cost badly needed jobs.

Notwithstanding this grim recital, California, in recent years, has made progress in rationalizing many portions of its legal system, for example: (1) The Medical Injury Compensation Reform Act (MICRA) has brought needed stability to the medical profession by limiting contingency fees, capping noneconomic damages, and promoting arbitration; (2) California has an excellent, although insufficiently used, arbitration statute; (3) Proposition 51 eliminated many of the abuses directed toward "deep pocket" defendants; (4) the California Supreme Court has made progress in scaling back some of the extreme frontiers of tort liability; and (5) California's judiciary is widely admired, hardworking, and honorable.

Still, the perception, and often the reality, remains that the litigation climate is worse in California than in other states. Litigation continues to be a growth industry, but that growth is a dubious benefit to the people of California: even if one accepts the existing rules of law, the cost of producing its outcomes is grossly disproportionate to the values produced. **A national study applicable to California states that out of every \$1 spent on the legal system (court expenses, lawyers' fees, trial preparation, etc.), less than 50 cents goes to successful plaintiffs** (a RAND ICJ study states that in 1985, the U.S. legal system incurred \$16-19 billion in transaction costs to deliver \$14-16 billion, net, to plaintiffs). **We are not getting our money's worth from a legal system when it costs \$1 to provide less than 50 cents to the prevailing party.** The justice delivered is often sadly delayed, and what the system delivers to those who use it — whether plaintiff or defendant — is often woefully unpredictable. Rather than risk its chancy outcomes, the parties to lawsuits in California settle without going to trial judgment in more than 92 percent of all cases filed. While the compromise of disputes is desirable, and the Council endorses arbitration and mediation, this action should result from free choice of the parties before lawsuits are filed and not from a lack of faith in the fairness of the trial outcome.

California's laws relating to employer-employee relations also need repair — a recent RAND ICJ study suggests that California's expansive view of wrongful termination claims may cause reduced levels of employment in California, perhaps by as much as 4 to 5 percent, in a labor force of millions. A further burden is added by multi-media, aggressive, and dubious lawyer and lawyer-referral advertising which suggests that every misfortune is an opportunity for instant riches. Often the result is the filing of unworthy claims in hopes of collecting at least a nuisance settlement — usually modest individually, but collectively a substantial cost of doing business in California.

The Council has determined that significant legal system reforms are needed now to deal with these problems so as to improve the competitiveness of California business enterprises and to save and create jobs. The Council calls upon the legislature, the California State Bar, the Judicial Council, and the Supreme Court to institute rules of procedure and of professional ethics to:

- ◆ Eliminate frivolous and marginal litigation.
- ◆ Mandate wherever possible the use of arbitration and mediation to settle disputes.
- ◆ Stimulate settlements by honoring the confidentiality of settlement agreements.
- ◆ Curtail abusive discovery.

- ◆ Rationalize California's laws relating to product liability.
- ◆ Curtail lawyer advertising and eliminate improper referrals.

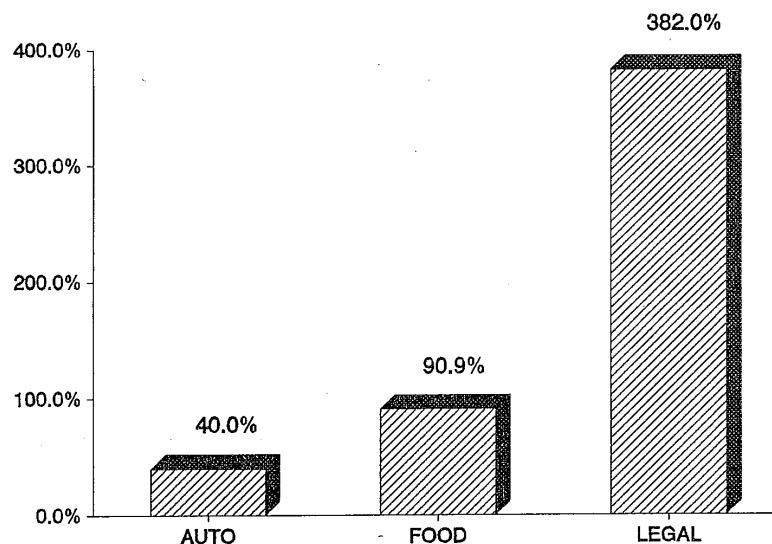
In addition, the Council urges these same bodies to:

- ◆ Change the procedure and standards for awarding punitive damages.
- ◆ Repeal the Corporate Criminal Liability Act.
- ◆ Limit noneconomic damages in employment termination cases.

Note: One of several subjects not covered in this report is no-fault auto insurance: a study and recommendations on that important subject were simply beyond the scope of the Council's present efforts.

The recommendations set forth in the following pages are not an exhaustive list of needed reforms, but they are major steps to take **now** to accomplish critically needed reforms. They will not deny free access to our courts to those who need it. Adopting them will begin the process of restoring credibility and community purpose to our legal system. These proposals will encourage employers to come to California, to expand in California, and to create jobs.

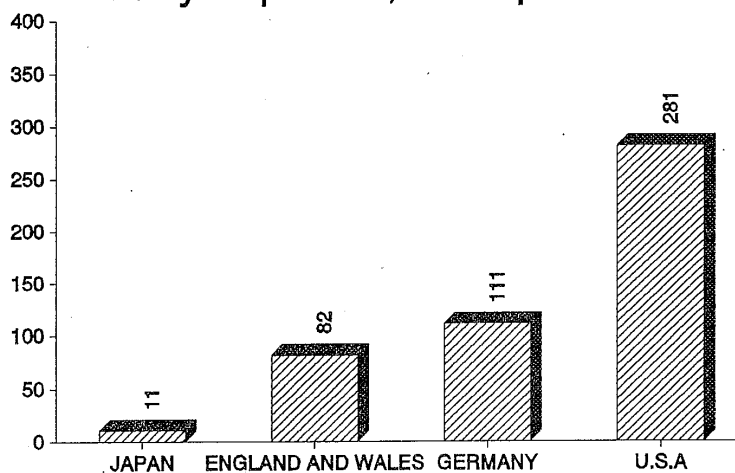
Growth of the Legal Industry 1977-1989



SOURCE: Survey of Current Business, April 1991; U.S. Dept. of Commerce

California is a leader; it is the home of one of every seven lawyers in the U.S.

Lawyers per 100,000 Population



SOURCE: Cam. Law Jnl, July 1990, Vol. 49(2); Intro to Research in Japan, 1991

A. Frivolous Litigation

Problems:

Recent surveys inform us that the high level of litigation is a key concern within the California business community. **The concern is justified — in fiscal 1991 almost 850,000 new civil lawsuits were filed in California Superior and Municipal Courts alone.** The California legal system does not sufficiently discourage filing or pursuing frivolous or marginal cases. In the federal system, such cases are actively discouraged and, once filed, are subject to more effective summary disposition before the defendant is required to incur unnecessary expense.

A lawyer cannot file a lawsuit until he or she has a client. Some lawyers have responded to this need for clients by largely uncontrolled advertising. In many cases this advertising is both exaggerated and deceptive, whether through the use of testimonials (16 states prohibit testimonials) or otherwise. Many for-profit lawyer referral services, particularly those advertising in minority communities, are thinly disguised "capping" operations that take advantage of the ill-informed and unsophisticated for the benefit of the referral service which, for a fee, steers the "client" to a cooperating lawyer.

Actions:

- ◆ Impose sanctions on parties and lawyers who file frivolous, unmeritorious suits (Federal Rule of Civil Procedure 11 is a good model).
- ◆ Require trial court summary judgments (and summary adjudications) against unmeritorious suits (Federal Rule of Civil Procedure 56 and U.S. Supreme Court opinions are good models).
- ◆ Prohibit deceptive lawyer advertising and deceptive lawyer referrals to the extent permitted by the First Amendment, while recognizing the need to preserve universal access to the courts.

B. Limit Punitive Damages

Problem:

Punitive damages were originally intended to punish truly egregious conduct on the part of the defendant in those few cases having a significant public interest. They were also intended to deter others from similar conduct by the imposition of what is tantamount to criminal sanctions. In California, however, punitive damages are now regularly alleged against businesses in an extraordinary range of cases, often, apparently, in the hope that sufficient evidence will materialize before trial to justify the claim as well as to provide pretrial settlement "leverage" against the defendant. They are all too often awarded for amounts far in excess of any reasonable relationship to the plaintiff's injury or to the defendant's financial condition. As a consequence, punitive or "exemplary" damages are frequently the main game in settlement negotiations and at trial. Even though trial and appellate courts usually reduce the most outrageous awards, the threat of the award of these damages and publicity about outsized jury verdicts (before reduction) often cause serious and uncalled-for injury to the defendant, irrespective of the ultimate outcome. The unpredictable vagaries of punitive damages are an outrage to our notions of due process. Other states function quite well without punitive damages (or with tougher standards and reasonable caps on awards). In this regard, they enjoy a competitive edge over California as potential sites for business location or expansion and thus defeat needed job creation.

Action:

- ◆ Amend California Civil Code § 3294 and the state Constitution to require that the determination of the amount of punitive damages be made by the trial judge after the jury has found liability for such damages and has determined, unanimously, that punitive damages are warranted "beyond a reasonable doubt."

C. Emotional Distress Damages In Employment Law

Problems:

During the 1980s, California employers experienced excessive judicial activism in the development of laws applied to employee relations. As a result, the workplace has become a new source of employer tort liability and employee relations have suffered. Over time, these new concepts regarding the law of "wrongful discharge" and of "employment discrimination" have become the basis for full-fledged tort litigation, with accompanying jury trials and risk of "noneconomic" damages. These legal concepts cost jobs. Not only do they deter businesses from locating and expanding in California, they also affect hiring decisions for all employees. A recently completed study by the RAND ICJ reports that for employers the risk of liability for wrongful termination casts a long and dark shadow over actual hiring decisions — the step by which jobs come into being. This shadow is longer and deeper in California, where court decisions allow a broad range of theories for recovery by discharged employees. **This RAND ICJ study suggests that employers respond to this threat by reducing hiring levels 4 to 5 percent below those which would otherwise prevail. These are the very jobs Californians so sorely need.**

Noneconomic damage (e.g., "emotional distress") is an unpredictable element of many employment-related suits. Thus, in addition to being deluged by dubious "stress" claims in the workers' compensation system (see Section 2, Workers' Compensation), California employers are regularly subjected to open-ended claims from terminated employees for "emotional distress" damages. This "damage" is necessarily wholly subjective, is impossible to measure accurately, often leads to manifest quackery in expert testimony, and encourages perjury and fraud. **Federal civil rights law imposes a cap on these damages, leaving California at a competitive disadvantage with states that follow, in substance, the federal pattern.**

Actions:

◆ Conform the limitations on recoveries in California Fair Employment and Housing Act and "public policy" discharge cases to those of the Federal Civil Rights Act:

<u>No. of Employees Employed by Defendant</u>	<u>Maximum Emotional Distress Recovery by Plaintiff Employee</u>
15-100	\$ 50,000
101-200	\$100,000
201-500	\$200,000
501 or more	\$300,000

- ◆ Restore to the Fair Employment and Housing Commission the authority to award emotional distress damages in the course of proceedings of that agency to encourage earlier and less costly non-judicial resolution of employment discrimination disputes.

D. Corporate Criminal Liability Act

Problem:

A recent and troubling trend in California is the criminalization of civil wrongs, i.e., turning actions that, at most, warrant a claim for civil damages into the basis for a charge, and possible conviction, of a crime. A good example is the Corporate Criminal Liability Act of 1989, which may put business managers in jail for failure to warn of serious concealed dangers in the workplace, in products, or in the environment. At present, a simple negligence test is applied, so that even if a manager didn't know of a potential danger, the fact that he or she "should have known" may be enough to earn a jail sentence. California is the first state to enact such a statute, which has been called the "be-a-manager, go-to-jail law" by business people who regard it as unfair and as symbolizing an antibusiness attitude on the part of the state's lawmakers. This recent law provides an all-too-tempting vehicle for publicity-seeking prosecutors, and it serves as an unnecessary threat to those who would otherwise seek to create jobs in California. The Council is, of course, concerned about employee and public safety, but it concluded that preexisting criminal and civil liability laws provide sufficient remedies for dealing with serious workplace safety offenses; this law is simply redundant to the purpose sought and adversely affects business decisions to locate or expand in California.

Action:

- ◆ Repeal the California Corporate Criminal Liability Act.

E. Court Delays and Abusive Discovery; Confidential Settlement Agreements

Problem:

Litigation becomes lengthy and expensive in direct proportion to the use (and abuse) of various forms of pretrial discovery. The extended discovery now permitted in California courts imposes costs on litigants in the form of additional fees and expenses that often far exceed the value of the evidence produced for purposes of resolving the dispute. Extended and massive discovery is also often an element of litigation strategy rather than a means of producing information useful in the case, for example, it may be used to exhaust the financial resources of a smaller enterprise or to require or threaten the disclosure of proprietary information.

Assurance of the confidentiality of settlement arrangements is essential to the compromise of disputes, and confidentiality should be honored in the absence of a compelling public interest in disclosure.

In tests instituted in California by the Judicial Council, the practice of "direct calendaring" (in which one judge is assigned to a case for all matters arising in the case from beginning to end) has proved effective in encouraging settlements and reducing litigation delays, discovery abuses, and other litigation problems.

Actions:

- ◆ Impose strict, closely supervised limits on costly and time-consuming "discovery," i.e., depositions, interrogatories, so as to prevent abuse.
- ◆ Oppose attempts to weaken judges' power to protect the confidentiality of information disclosed in the course of discovery, and preserve the confidentiality of settlement agreements freely entered into by the parties to disputes.
- ◆ Institute the use of direct calendaring in all California civil trial courts.

F. Encourage Alternative Dispute Resolution

Problem:

Many disputes are better suited for nonjudicial resolution, whether for economic reasons, required expertise, time constraints, or otherwise. In fact, more than nine out of every ten lawsuits filed are settled by negotiations between the parties before judgment (itself a form of "nonjudicial" resolution) but only after the expense and trauma of litigation. Notwithstanding the numerous economic, delay-avoidance, and other benefits of resolving disputes by means other than litigation, businesses often fail to make use of the many available forms of alternative dispute resolution, most notably arbitration and mediation. A 1989 RAND ICJ study of California court-referred arbitrations found that arbitration cases were decided in about half the time required for court cases, while another RAND ICJ study of U.S. District Court referrals found that costs to the parties were 20 percent lower. The State Bar has assigned a high priority to the adoption of comprehensive legislation dealing with alternative dispute resolution. Bar president John Seitman notes, among other things, that the use of alternative dispute resolution would help relieve the congestion of our court system. The failure to take advantage of these increasingly flexible alternatives to expensive and time-consuming lawsuits often seems to occur because lawyers and their business clients simply are not aware of the availability and flexibility of this means of settling business-related disputes, whether by referral, by agreement after the problem has arisen, or by contract at the time the business or employment relationship is entered into.

Action:

- ◆ Implement the use of arbitration and mediation by contract, by agreement after a dispute has arisen, and through court referrals. Educate the public, courts, and lawyers on the advantages of the numerous available alternatives to resolving disputes through litigation.

G. Product Liability

Problem:

Although product liability litigation is encountered more and more by businesses throughout the United States, California's product liability law often puts its manufacturers at a disadvantage relative to companies based in other states and in other nations. Further, manufacturers' product liability is often open-ended in time, with claims in many cases made more than 15 years after the product was manufactured. Generally, product liability law is the states' domain, and since neither Congress nor the U.S. Supreme Court has suggested that this situation is going to change, it is up to each state to improve the nation's product liability laws by improving its own laws. As a major commercial and industrial state, California can be a leader in this important reform. Further, improvements in California product liability laws, particularly as they relate to certain areas of product innovation and design (e.g., pharmaceuticals and medical instrumentation) will send a strong and positive message about this state's desire to maintain a hospitable business climate. These improvements will enable and encourage California's businesses to grow and create more jobs.

Actions:

- ◆ Limit manufacturer liability for design defects to cases in which the plaintiff proves that the particular design danger alleged was known to the defendant at the time of manufacture, that the danger outweighs the safety benefits of the design selected, and that a feasible and practicable alternative design was, in fact, available at the time of manufacture.
- ◆ Limit liability for a defective warning about a product's use to cases where the plaintiff proves by a preponderance of the evidence that (1) the danger was known or reasonably knowable when the product was made, and (2) there existed an alternative warning that would have averted the injury and would not have reduced the effectiveness of warnings made against other dangers, if any, related to the product.
- ◆ Restore the legal rule that evidence of negligence, of design or manufacturing defect, or of inadequate warning may not include those remedial or precautionary measures (for example, the repair of a broken safety device) taken by the defendant or others after the event which is the basis for the plaintiff's claim.

◆ Enact a "statute of repose" that bars product liability claims against manufacturers based on products manufactured more than fifteen years before the claim is made.

H. Allocation of Fees

Problem:

Abuses arise under California's prevailing contingency-fee system, in which the filing of a marginal lawsuit or failure to accept a good-faith and adequate offer carries no real risk of substantial penalties either to the plaintiff or, in the latter case, to the lawyer who counsels his or her client not to settle. As a consequence, far too many of the hundreds of thousands of lawsuits filed in California each year are "nuisance" claims seeking a quick and undeserved settlement payment to the plaintiff and his or her lawyer. Under the so-called English Rule, the losing party (plaintiff or defendant) pays all the prevailing party's costs of litigation, including any attorneys' fees. The Council believes that a variation of this practice will reduce the number of marginal cases filed and encourage the early settlement of meritorious cases.

Action:

- ◆ Amend the California Code of Civil Procedure § 998 to provide for the court-ordered payment of an opponent's attorneys' fees in lawsuits in which a party who rejects an offer of settlement receives less (or loses more) through trial than the settlement offer.

7. SUPPORT CRITICAL INDUSTRIES

What determines prosperity today is the potential of a region's industries to upgrade constantly. This means relentless productivity improvement in existing industries through improving products or increasingly sophisticated processes. Such a process of upgrading drives sustained productivity growth. For a region or a nation, competitiveness does not just mean creating jobs, but rather creating the type of jobs which command high and rising wages. Industry must continually improve, innovate, and move to more sophisticated types of competitive advantage involving higher and higher levels of skill and technology. The region's products must keep improving in features and quality. — Professor Michael E. Porter, "The Competitive Advantage of Massachusetts"

Professor Porter also accurately states that "government cannot create competitive industries, only companies [can]. Government's proper role is creating the *environment* in which firms compete." Government continues to debate its proper role with industry. It swings from a laissez-faire, hands-off approach to an industrial policy of aggressive direct intervention; consequently, there is no long-term policy or effort to create the environment that would allow firms to compete.

California is the home to many great industries that are the envy of the world. Extraordinary efforts are required of the state's leadership to create the environment that will preserve and enhance the competitiveness of our key industries, some of which are:

- ◆ Entertainment
- ◆ Agriculture
- ◆ Aerospace
- ◆ Manufacturing
- ◆ Tourism
- ◆ Electronics
- ◆ Personal Computers
- ◆ Biotechnology
- ◆ Financial Services
- ◆ Construction
- ◆ Sports and Casual Apparel
- ◆ Retail Sales

California needs to support its key industries by investing in higher education, research, infrastructure, and advanced communications networks. The Council has not investigated the status of and the actions required in these long-term issues. However, immediate actions are recommended in the following, due to the current challenges they face:

- ◆ Retention of aircraft and aerospace industries.
- ◆ Retention and growth of the manufacturing sector.
- ◆ Attraction of future high-technology projects.
- ◆ Encouragement of small business.

A. Aerospace Retention

Problem:

In 1990, the aerospace industry employed 485,000 Californians directly, and provided indirect employment for an estimated 730,000 others. This industry provided 155,000 direct jobs for minorities, paid \$2.5 billion in California taxes, and fostered many important spinoff industries and technologies. Given the apparent end of the Cold War, the military portion of the aerospace industry is undergoing a profound contraction.

The Council has highlighted this industrial sector because of its long-term potential and promise. **Aerospace is not dead.** Even after cutbacks, the aerospace/defense industry will be a \$100 billion market. California has the world's largest pool of skilled technicians and manufacturing workers, a broad and diverse array of committed and competitive industrial suppliers, important linkages between education and industry, and the potential to exert strong leadership over the federal agenda for defense, space, and commercial aviation. Yet this state does not appear to be committed to retaining our major prime contractors and multiple tiers of suppliers.

Actions:

- ◆ Provide visible assurances, in concert with the Department of Commerce, to military, civil space, and commercial customers that California values and will support their key programs, as well as their research and procurement agencies. **Specifically, California must quickly take actions to prevent the relocation of the Los Angeles Air Force Station.**
- ◆ California must use the combined voice of its congressional delegation to support research programs that are crucial to the long-term strength of our core aerospace markets (e.g., National Aeronautical Space Plane, SDI, Advanced Aircraft Technology) and to assure that the existing California-based federal research facilities (e.g., Jet Propulsion Laboratory, Ames Research Center) receive required funding to ensure California's competitiveness in aerospace and commercial aviation.
- ◆ Form an *ad hoc* Advisory Council, headed by a senior aerospace executive, that will champion coordination between government agencies and companies, at the prime and subcontractor level.

B. Manufacturing

Problem:

California is one of the strongest and most important manufacturing centers in the world. The state accounts for over 10 percent of U.S. manufactured output and about 11 percent of the total U.S. manufacturing employment — over 2 million jobs. Access to an abundant and diverse labor force, technology and innovation, and capital investment should keep California manufacturers on top. Annual productivity gains in the 1980s for California manufacturers averaged 4.7 percent per year, while U.S. manufacturing productivity increased by only 3.7 percent annually. Manufacturing is a significant wealth creator for our economy, and it has provided an important entry point and upward mobility opportunity for low-skill workers.

The structural challenges facing both the California and national economies represent significant risks for our manufacturers. Unfortunately, it is also manufacturing industries that bear the brunt of environmental and other government regulations. And the waning of the Cold War and cutbacks in defense spending will certainly have an impact in California, where one-third of our manufacturing jobs are tied to aerospace and defense. **The Council believes that every effort must be made to retain a healthy manufacturing sector in our economy.** In addition to the many recommendations in other sections of this report, we make the following proposals.

Actions:

- ◆ All government and regulatory agencies must recognize the vital importance of manufacturing business and jobs to our economy. They must cooperatively seek solutions to pollution requirements and other regulatory burdens **so that the manufacturers can stay in business and not be lured to other states.**
- ◆ Establish Industrial Resource Centers similar to the Pennsylvania model, to provide technical assistance to manufacturers to aid them in becoming more competitive through the use of advanced processes and technologies. This help is especially important to the many small manufacturers in California.
- ◆ Continue the Department of Commerce's Competitive Technology program and support the various ongoing technology transfer programs, such as that at the Jet Propulsion Laboratory.

◆ Fund university research in those technologies, where applications for industry and manufacturing would be significant. An excellent example is the development of technologies for alternate-fuel vehicles.

C. High-Technology Projects

Problem:

To maintain California's competitiveness in advanced technology, our state needs a plan for attracting key high-technology projects that are being lost to other states. (See Appendix VII.)

Actions:

- ◆ Implement specific programs and funds designed for attracting high-technology projects.
 - Create a state research and development matching fund to provide direct matching support to nationally sponsored research and development projects.
 - Support Project California's effort to advance a comprehensive action plan that will position California as the international leader in research, and applications of high-performance, environmentally safe transportation systems.
- ◆ Direct the California Council on Science and Technology to develop a high-technology strategy for California, with annual updates.

D. Small Business

Regulatory, financial, and legal demands on business do not distinguish between large and small companies. A big company has the manpower and deep pockets to cope, while a small one does not. Typically, small ventures fail because of what is broadly called "mismanagement." But we are now in a climate in which California faces the loss of well-managed businesses whose owners have simply "had enough." Cumulative regulatory burdens are killing California's small business.

We use the term "small business" as if most ventures were "big." That's perception, not reality.

- ◆ Approximately 97 percent of the 796,070 ventures in California in 1990 had fewer than 100 employees, and were the source of about 42 percent of all jobs.
- ◆ About 76 percent of all California business employed fewer than ten workers, accounting for one in 11 jobs statewide.
- ◆ On the other end of the spectrum, 1,240 companies with 1,000 or more employees — less than .2 percent of all ventures — accounted for 23 percent of total jobs.
- ◆ Small ventures are the yeast of job creation in California. According to a 1990 Wells Fargo Bank report, ventures with under 80 workers accounted for one out of three jobs created in California during the last decade. The Small Business Administration has shown that ventures of 500 or fewer workers accounted for more than half of the 1.6 million California jobs created between 1984 and 1988.

California entrepreneurs are in retreat. Where they are not closing doors or moving away, they are delaying expansion and cutting jobs. They are distracted from competition by lawsuit-minded employees, regulators, and municipal inspectors and permittees. (See Appendix VIII.) We propose the following problems and actions:

Problem: The burden of workers' compensation is particularly severe on small businesses. Workers' compensation premium increases and reserve account decisions occur without small businesses having any influence on the ultimate cost to them. Small businesses cannot self-insure, have little flexibility and no effective representation.

Action: Implement the workers' compensation actions discussed in Section 2.

Problem: Accumulation of fixed fees rather than scaled fees can be very damaging to a small business that is trying to make payroll. These accumulations of fees are disproportionately burdensome on small businesses.

Action: Review for reduction all local and state assessments, permits, and fee schedules that affect small business.

Problem: Regulations requiring excessive reporting to local, state and federal agencies (e.g., Cal-OSHA safety plan) make extreme time demands on small-business owners, preventing them from putting their real efforts toward growing the business.

Action: Implement paperwork simplification as discussed in Section 1.

Problem: Small-business owners feel that legislators are insensitive to the impact of their actions on small businesses. Frequently, legislation that imposes new regulations and reporting requirements fails to consider the cumulative burden of these requirements on a small business. The volume of legislation and regulation is so great that entrepreneurs cannot keep up with changes, nor can they afford professional help to explain or protect them from liability.

Action: Prepare a simplified summary of laws and regulations that impact small businesses of up to 500 employees. Require all subsequent legislation to include an impact study on small businesses, and provide a legislation and regulation summary that is easily understood.

Problem: Entrepreneurs have a lack of information about available resources and perceive that state government is unresponsive to their needs.

Action: Support and expand the Department of Commerce/Small Business Administration field offices, and provide an "800" number for assistance and information.

CONCLUSION

The recommendations outlined in this report represent the shared conviction of this Council that the present economic situation calls for major prompt and decisive action. Unless we take steps to encourage business to produce new jobs, California is in for a difficult and uncertain economic future at best.

The Council is a bipartisan group with wide-ranging views. This report is the product of this diverse group. We have come together to spotlight the gravity of California's economic problems.

The problems we face are equally the responsibility of Democrats and Republicans. We now ask all Californians to join together in a partnership to set our jobs and economy on an upward path.

This report is not the end of the Council's work. We will convene again in six months to report on the progress made toward implementing these recommendations. However, the Council does not pretend that the carrying out of these recommendations will cure all of the current ills of the state. Undoubtedly, there are many more things that urgently need to be done, and certainly there are inventive approaches to alleviating our economic ills that have not yet been voiced. Californians are a creative and progressive-minded breed, and the history of the state is replete with examples of large problems willingly tackled head-on and solved.

Yet, no real solution is possible unless we temper our attitudes toward government and business. Nothing can succeed in an atmosphere of mutual suspicion. The Council believes, for example, that it is vital to substitute cooperation for the "command-and-control" approach: environmental regulators and business must work together to achieve the goal that all Californians desire — a clean and healthy place to live and fulfilling jobs for our citizens. We also believe that special groups must look beyond their own narrow interests toward an honest system that will more effectively benefit all. Every Californian must share the sense of urgency and become an agent of change.

We believe these things are possible, and it is with hope and optimism for the future of California that the Council submits these recommendations.

APPENDIX I

MEMBERS OF THE COUNCIL

Laura Balverde-Sanchez, Los Angeles, President and co-owner of New El Rey Sausage Company.

Ron Cedillos, Huntington Beach, President, Cedillos Testing Company, a testing company of aerospace parts.

Ward Connerly, Sacramento, President, Connerly and Associates, a housing and community development consulting firm.

Walter Gerken, Corona Del Mar, former Chairman and Chief Executive Officer of the Pacific Mutual Life Insurance Company.

Sam Ginn, San Francisco, Chairman and Chief Executive Officer of Pacific Telesis.

Wilford "Woody" Godbold, Jr., Los Angeles, President and Chief Executive Officer of Zero Corporation, manufacturer of cabinets, cases, cooling equipment, luggage and air cargo containers.

David Hale, Rancho Bernardo, Chairman, President, and Chief Executive Officer of Gensia Pharmaceuticals, Inc., a biopharmaceutical company.

John "Jack" Henning, San Francisco, Executive Secretary-Treasurer of the California Labor Federation, AFL-CIO.

Bruce Lee, Fullerton, Director of the United Automotive Workers (UAW) Region Six and Vice President of the Los Angeles County Federation of Labor.

David Lee, Los Altos Hills, President and Chief Executive Officer of Qume Corporation, a computer parts manufacturing company.

Mervyn Morris, Atherton, founder of Mervyn's Department Stores.

David Moore, Irvine, Chairman of the Board, President and Chief Executive Officer of the Western Growers Association (WGA).

Jane Netherton, Long Beach, President and Chief Executive Officer, International City Bank.

Beth Rogers, Los Angeles, Managing General Partner of Pacific Earth Resources, a real estate and environmental horticulture company.

Nathan Shapell, Beverly Hills, Chairman and Chief Executive Officer of Shapell Industries, Inc., a real estate development company.

Donna Tuttle, Los Angeles, President, Korn Tuttle Capital Group, Inc., a consulting and investment company.

Peter Ueberroth, Council Chairman, Newport Beach, Principal, The Contrarian Group, Inc., a management operating company.

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SUPPORT STAFF

Marcella Andreoli
Mary Ann Rea
Diane Poindexter

APPENDIX II

APPRECIATION

The Council's work was completed in a very short period. It was a volunteer effort, and involved committee meetings, public hearings and the expenditure of many thousands of hours and many weekends.

The law firm of Latham & Watkins, out of its dedication to the long-term health and prosperity of California, generously provided extensive professional advice, editorial support, administrative staffing and office space to the Council. In addition, Latham & Watkins provided publication services without which this report could not have been produced. Latham & Watkins deserves our special gratitude.

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Those individuals who provided critical assistance are listed below. We apologize to those whose names may have been inadvertently omitted. This list does not include those people who took their time to provide testimony to the Council.

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Paul Berman	Dave Kilby	Mark Pisano
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Leslie Bridgeman	Larry D. Kurmel	Robert Rivinius
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Edward C. Cazier, Jr.	Russell Leatherby	Phillip Romero
Rudy Cervantes	Jim Little	Joel Rubenstein
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Tom Conneely	Marshall Lumsden	Nikki Shacklett
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Kenneth Gibson	Charles Miller	David Welsh
Arthur Goodman	Maria Morris	Helaine Whilden
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APPENDIX V*

CITY OF SUNNYVALE
CUSTOMER SERVICE TRAINING PROGRAM

"Thank you for the opportunity to . . . offer some examples of actions taken by the City of Sunnyvale and where there may be merit or application at the state level. The result of the City's actions was to connect customer service with economic development to create a powerful economic development tool, a coordinated and motivated team that will eventually include every single employee in the City at no increased cost.

We began with a continuous process improvement technique, borrowed and assisted by our local industry. We asked how we were doing and learned that there are a myriad of opportunities to do better. We learned that:

1. Technical capability and proficiency is not enough. We have to be willing to act to produce results.
2. There must be a clear message of commitment to economic development from the top of the organization down.
3. There is tremendous opportunity to achieve the economic development goals in the day to day decisions and attitudes of management and staff.
4. Every person who works in a public capacity colors the customer's perceptions.
5. There must be a high awareness of economic development and the role each person can play in it.
6. We must begin to send a clear, consistent message to business and development community.

As a result we have begun a fundamental positive change in the attitudes of city employees around economic development."

* From the City of Sunnyvale Memorandum to the Roles of Government Subcommittee dated February 19, 1992, which memorandum outlines, among other things, the City's successful implementation of a customer-service training program.

APPENDIX VI

CRITICAL CONDITIONS IN ORGANIZING AND IMPLEMENTING A LOCAL ECONOMIC DEVELOPMENT PROGRAM*

1. A clear understanding of the problems faced by community in retaining and attracting business. Should include an assessment of community's assets and liabilities, driving and restraining forces for business retention and expansion. The process for defining the problem should involve all key sectors and interest groups. Once problem defined, solution should be tailored to address problem.
2. In communities where multi-government bodies exists, there should be full participation by all cities and districts in the development of the economic development program. The organizational/implementation plan should clearly define roles and responsibilities of each party. An economic development program cannot be implemented with money alone, but requires participation and commitment through inter-agency agreements, and extensive, ongoing communication at all levels (staff and elected officials.).
3. The economic development organization must be designed as a combination of volunteer business, labor, environmental, education, regulatory and elected officials working in concert with economic development, planning and regulatory professional staffs. Since no one governmental body has complete statutory authority to intervene to address problems/issues, need to gain organizational legitimacy through broad-based participation by key public, private and non-profit groups.
4. Economic development program objectives and work plans must remain flexible, and project should be carefully evaluated to determine if the planned intervention can make a difference (does it add value?). Build on short-term successes to gain confidence in addressing long-term problems/issues.
5. Education of the public, as well as all elected officials and community leaders on the issues and proposed resolution, is critical to any real

* Prepared by Bruce L. Kern, Director of Economic Development for Alameda County (March 1992).

change in the business environment. We can fight battles all the time and sometimes win, but won't be successful until the battles don't need to be fought because the rules/regulations are changed through enlightenment.

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APPENDIX VII

LOST DEVELOPMENT OPPORTUNITIES

Examples of Very Large Scale California Research and Development Project Lost Opportunities:

1. The State of Florida in 1991 succeeded in winning a national competition for the siting and operation of the National High Magnetic Field Laboratory. This is being established at Florida State University in partnership with the University of Florida and Los Alamos National Laboratory. It has received a 5-year commitment of \$58 million from the State of Florida, an amount nearly equal to the \$60 million NSF grant. NSF has budgeted \$14 million for this project for the next fiscal year and this will be a major national R&D facility into the 21st century. Significantly, a highly competitive, distinguished group of California-based scientists and engineers were encouraged to develop a proposal to locate this important facility in California. They declined to do so because of the competitive disadvantage presented by the absence of state matching funds. Extraordinarily, Dr. Robert Schrieffer, Physics Nobel Laureate, formerly at The University of California, Santa Barbara was recruited to Florida to direct this project. It is anticipated that the Florida facility will have very significant impact on the state's economy.
2. In 1988, a consortium of American semiconductor manufacturers (SEMATECH) was formed to conduct research aimed at assuring leadership in manufacturing capability for the U.S. semiconductor industry. Texas was successful in a national competition for the location of SEMATECH, which has an annual budget of \$200 million. Half of the funding is provided by the federal government and half by member organizations that include California companies such as Advanced Micro Devices, Inc., Hewlett-Packard Company, Intel Corporation, National Semiconductor, and Rockwell International. Not only did California lose the federal funding, but California companies are contributing to the Texas economy through SEMATECH. The state of Texas committed \$60 million to the start-up costs for this program and also provided a tightly integrated proposal in winning the final competition over California and Massachusetts.
3. In 1986, the Research Foundation of the State University of New York at Buffalo won a national competition for the siting and operation of the National Center for Earthquake Engineering Research. This is part of a research consortium that includes Princeton, Columbia, and Cornell Universities and the Rensselaer Polytechnic Institute. The \$30 million the

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center has received from NSF has been matched by \$16 million from the state of New York, \$8 million from the private sector and \$8 million from the State University of New York. Earthquake engineering had been pioneered in California, and the research centers in California were clearly leaders in earthquake engineering research. However, California's proposal to NSF was not well coordinated and did not commit matching state funds to the extent of the New York initiative.

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APPENDIX VIII

THE ENTREPRENEURS

The complexity of the frustration and problems faced by entrepreneurs is best expressed in their own words. These are the voices, so often unheard, which must now be needed:

Lee Arnone, owner of a Los Angeles-based demolition service called IDS Building Services, has 15 core employees and sometimes as many as 50 or 60. His gross revenue is approximately \$600,000. In business since 1978, Arnone has decided to close his operation by May 1 if he cannot resolve multiple claims on his workers compensation policy.

For five years, Rene Luna has been the sole proprietor of a two meat departments operated within Latino food markets in Southgate and Lynwood. He has eight employees, and gross revenues of about \$900,000. Luna objects to the vast amount of Spanish-language advertising which encourages workers to sue for workers' compensation. "It is not fair," he says. "The advertisements are very good. This advertising is money for three groups — the clinics, the lawyers and the media." Bogus claims on Luna's workers' compensation policy make it harder for him to care for employees who are genuinely hurt on the job. "I like my insurance to give good money and service, and if the employee is good, he comes back to work. I see these advertisements and I get mad — these guys are ruining my business."

David Goodreau and his brother run Burbank-based Newman Machine works, a 50-year-old family business which manufactures components for aircraft. The business currently employs 11 workers — it had 25 a couple of years ago. Gross sales are almost \$900,000. Because of his inability to find quality skilled help, Goodreau almost went out of business a couple of years ago. The biggest problem for a company Goodreau's size is local government, he says: "They're beginning to throw us all these fees that are mounting up. Environmental regulations don't affect me terribly, but they affect my vendors and customers, who pass on their costs to me. And then my customers think about leaving the state." If he could afford to move his business, Goodreau says would leave California "in a heartbeat."

If Sam Rubinfeld's father didn't need something to keep him occupied, chances are Rubinfeld would by now have shut down the family showcase manufacturing business, employer of 20, which has operated in downtown Los Angeles for 40 years. As a user of environmentally-unfriendly materials, Rubinfeld has learned to cope with a multitude of regulations. The crowning blow, however, was a \$3,000-a-year

benefit assessment placed on the business because its warehouse is within five blocks of the Metro Rail system under construction. Rubinfeld helped lead the successful court challenge against the assessment, now delayed until 1993. But the fight burned him out; "When the city does something, they feel they have a mandate for it, and they don't care what you do. They go through the legal obligations of notices that appear in the backs of newspapers nobody reads, or they send out fliers that nobody understands."

Linda Prod is a third-generation Californian, and her husband Harry is also a native. Restaurant experts, they bought a piece of Southern California history in 1989 — the chain of Tiny Naylor coffee shops, which they are now being forced to sell off because of workers' compensation insurance policy price hikes. In 1989, the Prods had more than 500 employees — now they are down to 150. Of the workers who had jobs at restaurants already sold, Prod estimates that only 90 kept their positions, because the only way a new owner can get a more favorable premium is by changing 50 percent of the work force. Many of those who lost their jobs were older workers who had been with the chain for many years. "We have one restaurant in Monterey Park which maybe we will keep, but otherwise we will not be in California again. We are aware the recession is not just here, but to add insult to injury, California is so against business."

Roger and Stephanie Valek worked 20 years to build an auto body shop in Escondido. Between 1976 and 1980, they paid an approved waste removal company to transport thinner, about 15 barrels worth, to a Los Angeles barrel yard. When the state declared the site an environmental hazard, the waste removal company went bankrupt, and the state turned its attention to people like the Valeks, who have been ordered to pay \$7.9 million — by check or money order — for cost recovery by the state Hazardous Substance Cleanup Fund.