Economic Considerations for Calaveras County

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Executive Summary

This report reviews the current financial challenges facing Calaveras County and discusses solutions to those challenges in light of the likely future economic environment.

- According to the 2008-09 budget, Calaveras' government has been running structural deficits and is in jeopardy of running out of cash next year if changes are not made. Efforts should be made to cut costs, and to grow the tax base through pro-business policies.

- Counties all around the state are in similar predicaments, but tend only to focus on cost cutting rather than address policies that inhibit economic growth.

- The Calaveras unemployment rate is 9.5% and well ahead of the state average 8.2%.

- Hindrance rather than help is coming from the State of California while it grapples with its own insolvencies for years to come. Consequently, Calaveras must take unilateral action to strengthen its local economy.

- Inflation, interest rates and unemployment should rise substantially in the decade ahead due to the size and magnitude of the nation's debts. The federal government has only two choices regarding its debts and entitlement liabilities: 1) change the rules (i.e. default), and/or 2) inflate the money supply to pay its debts with depreciating currency.

- Short-term solutions for Calaveras government include cost cutting, but long-term investment must be made the priority.

- Development projects currently before the Planning Department should be acted upon without delay to put local residents to work and increase tax revenues.

- The Ridge at Trinitas stands out as uniquely positioned to contribute to county revenue shortfalls almost immediately. It also offers dozens of new jobs to local residents at a time when unemployment is the number one economic concern.

Calaveras County Government

Calaveras County's government currently faces a structural budget deficit that reduced its cash carry each of the past two years and threatens to leave the government without any cash come the 2009/10 budget year. It is painfully evident that spending cuts are needed immediately as a short-term fix, and the government's willingness to make these hard decisions is absolutely essential. However, the importance of acting now to also implement long-term revenue solutions cannot be forgotten. The economy in Calaveras County, the State of California and elsewhere in the nation has changed dramatically in the past year. Macroeconomic discussions later in this report will demonstrate that Calaveras County needs to brace for tough economic conditions for many years to come.

The California State Association of Counties compiled a list of numerous counties facing similar problems. They report, "The current economic crisis has significantly impacted California counties across the state, forcing them to revisit their own budgets and deal with deficits. A decrease in key revenue sources, such as property taxes, sales taxes, fees and interest, are plaguing counties, in addition to cuts in the state budget that affected counties. At the same time, the demand for public services has dramatically increased." Here's a taste of what's happening:

- El Dorado County: "Although the board adopted a balanced budget in September, the county now faces a $20 million deficit for fiscal year 2009-10 if it doesn't act quickly to cut costs. Latest projections show a dramatic decline in revenues from sales tax, property tax and interest rates."[1]
- Stanislaus County: "The county depends on the state for much of its funding, and dramatic cuts are being proposed this week in Sacramento... County tax revenues also are suffering, with declining property tax and sales tax income."[2]
- Sacramento County: "In response to state cuts in funding, Sacramento County's Board of Supervisors today will look to adopt a final budget for 2008-09 with $15 million in cuts to programs that serve the area's neediest and most vulnerable. The cuts – which are on top of nearly $68 million in cuts the county made when it passed its proposed budget in June – follow the spending plan the state adopted in late September, which included less funding for counties."[3]
- Riverside County: "The strategies follow a grim meeting last week in which one supervisor compared the current economic situation in the county to the Great Depression and officials discussed the possibility of future layoffs of county employees."[4]
- Butte County: "With an unexpected $10 million deficit looming over Butte County, Supervisor Jane Dolan of Chico said…: County staff cuts are all but unavoidable...The slump in the housing market, a profound contraction in sales tax, the crisis in the loan industry, the state's failure to pay its bills to Butte County, and this past summer's fires, have joined to create a $10 million deficit...."[5]
- Merced County: "the Board of Supervisors unanimously approved cutting 39 filled positions within the Human Services Agency and the Department of Workforce Investment. It also axed 58 empty positions that had been frozen... The county projects a $1.65 million shortfall in funding

[1] The Sacramento Bee, November 7, 2008, El Dorado County Supervisors Weigh More Cuts
[2] The Modesto Bee, November 7, 2008, Stanislaus County Girds for Tough Budget Future
[3] The Sacramento Bee, November 12, 2008, Sacramento County Readies Deeper Budget Cuts
[4] The Press-Enterprise, November 5, 2008, Riverside County Bracing for Falling Revenue, Planning Savings Measures

[5] Chico Enterprise Record, November 5, 2008, Butte County Supervisors Hear about Budget Woes

> this fiscal year and another $4.85 million for fiscal year 2009-2010. HSA gets most of its roughly $141 million budget from the state and federal governments. The county is only responsible for about $7 million."[6]

Calaveras county government is also entertaining layoffs as one of many necessary short-term solutions to the recent dramatic fall in county revenues. Not surprisingly eight of the proposed layoffs are in the Building Department as a result of the slow down in real estate. It seems prudent to implement the suggestion of Community Development Agency (CDA) director John Taylor and combine the CDA with the Environmental Management Agency. These actions alone will not erase the government's structural deficit as the Stockton Record reported on November 21st that even a "bare-bones staff will require roughly $375,000 from the county's contingencies fund." Further budget cuts are required and this may lead to a reduction in quantity and quality of services provided by the county.

While budget cuts are the quickest solution to balance the budget, the county government needs long-term revenue increases if it's to be effective in serving a population estimated to grow 22% by the year 2020.[7] The very worst way to raise revenue during an economic downturn is to increase taxes and fees. Such policies are debilitating because they drive businesses and residents to competing counties and/or motivate non-compliance and evasion which then increases enforcement costs. Furthermore, each dollar lost by residents in taxes and fees is a dollar lost toward private enterprise, thereby shrinking rather than expanding the tax base. The far better revenue solution is to increase the tax base, and the county has the opportunity to do so with a number of economically positive projects currently languishing in the Planning Department for various reasons, some beyond the control of the county, but others upon which action could be taken immediately.

Calaveras County Economy

The Calaveras economy has been hit hard by the recent real estate and credit bubble bursts as evidenced by its 9.5% unemployment rate as of October, 2008. This rate will most certainly climb in coming months should the county fail to take proactive measures favoring the expansion of business in the county. Already the county is plagued with vacancies in commercial centers threatening the fiscal health of those real estate owners. A situation sure to get worse if consumer spending falls due to increased unemployment.

This report demonstrates that the financial circumstances in California and the nation as a whole do not bode well for the future. Consequently Calaveras government must act swiftly and aggressively to implement productive projects that can increase employment and tax revenues.

State of California (a.k.a. State of Disrepair)

The county is already acutely aware that Sacramento will be part of its budgetary problem rather than solution. Many States in the Union are or will be running massive budget deficits, but California is near the top of the list of poorly run governments. Its tax and spend policies have it

[6] Merced Sun-Star, November 5, 2008, Dozens Will Lose Merced County Jobs
[7] California Department of Finance, Demographic Statistics, 2007

running an estimated $11.2 billion budget deficit expected to balloon to $28 billion in 18 months according to Governor Schwarzenegger's office despite the fact California possesses the 4th highest tax burden among all States.[8]

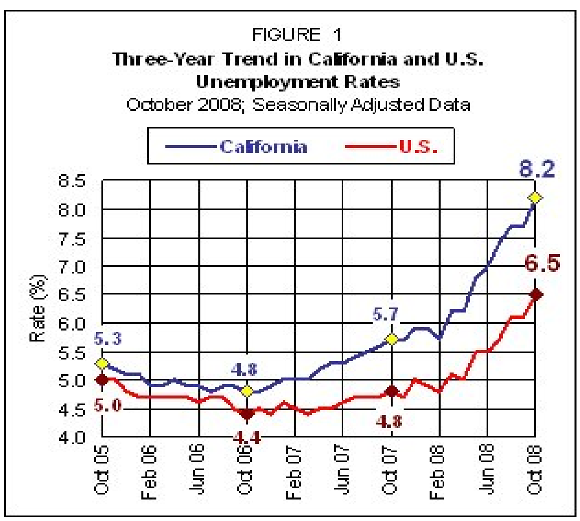
The situation will get dramatically worse for the State of California. A significant portion of its revenues come from capital gains taxes, which obviously will be greatly reduced at today's asset prices and impending capital loss write-offs. Moreover, approximately 45% of the State's revenues come from reduced personal income taxes due to rising unemployment.[9]

Figure-SUM-02
2008-09 Revenue Sources
(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2007-08
Personal Income Tax	$55,720	$1,449	$57,169	$1,306
Sales Tax	27,111	6,464	33,575	1,386
Corporation Tax	13,073	-	13,073	1,147
Highway Users Taxes	-	3,383	3,383	-18
Motor Vehicle Fees	29	5,937	5,966	638
Insurance Tax	2,029	-	2,029	-142
Liquor Tax	341	-	341	7
Tobacco Taxes	114	934	1,048	2
Other	3,574	7,980	11,554	-3,801
Total	**$101,991**	**$26,147**	**$128,138**	**$525**

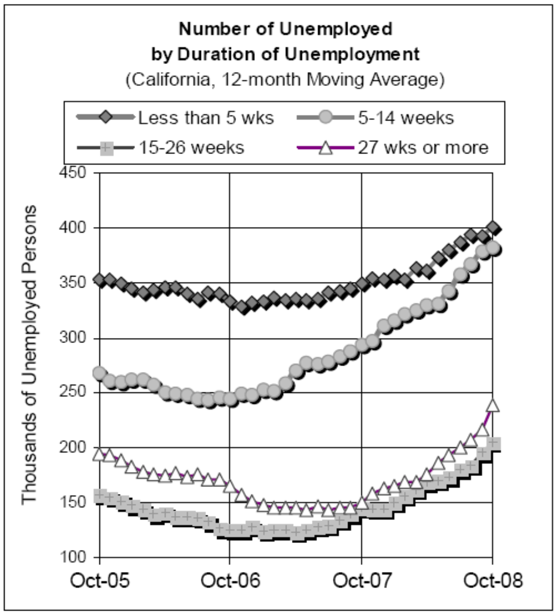
Note: Numbers may not add due to rounding.

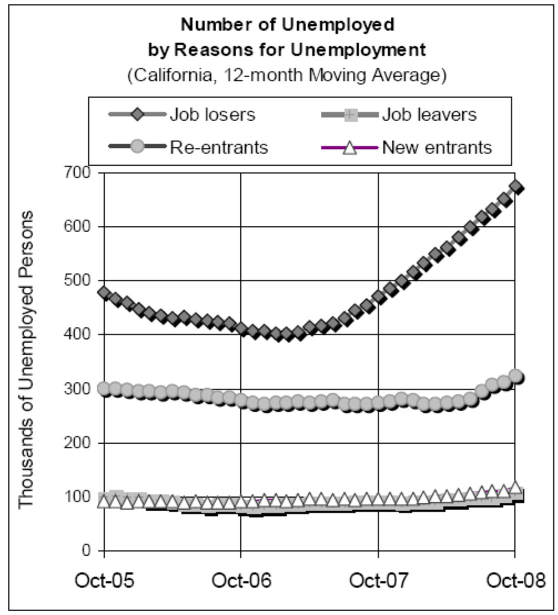
California's seasonally adjusted unemployment rate as of October stands at 8.2% and climbing as indicated in the following chart.[10] This is a 12-year high.



[8] The Tax Foundation, "State and Local Tax Burdens: All States, One Year, 1977-2008." http://www.taxfoundation.org/taxdata/show/336.html
[9] California State Budget 2008-09
[10] California Employment Development Department. http://www.labormarketinfo.edd.ca.gov/article.asp?ARTICLEID=1232

Of particular concern is the rate of increase in California's unemployment, which was a 2.5% year over year jump; the largest since December of 1982. Note the steeply increasing number of people who remain unemployed longer in the chart at left below. Californians are losing their jobs and it's taking longer and longer to find new ones.





The burgeoning unemployment rolls will cut income and sales tax revenues while at the same time more rapidly depleting the State's unemployment insurance fund. A report earlier this year estimated the unemployment fund will have a $1.6 billion deficit by the end of 2009 and $3.5 billion a year later, but the report assumed a 6.4-6.6% unemployment rate. The unemployment rate has quickly blown through that assumption, and one estimate is now that the fund will pay out $2.7 billion more than it takes in during 2009.[11] The State has to borrow from the federal government if the fund runs dry and Sandre Swanson, Assembly Labor and Employment Committee Chairman, said interest on the loan could amount to $85 million by 2010.[12]

The State of California is in dire straits fiscally, and therefore it cannot be depended upon to help the situation locally. In fact, it can probably be counted on to burden the county and its residents in the years to come. Calaveras must take unilateral action to strengthen its local economy.

Macroeconomic Environment and Forecasts

The national economy and the fiscal behavior of the federal government directly affect interest rates and employment at the local level. Events are unfolding that strongly point toward higher interest rates in the decade ahead, and potentially double digit inflation. It is quite possible that

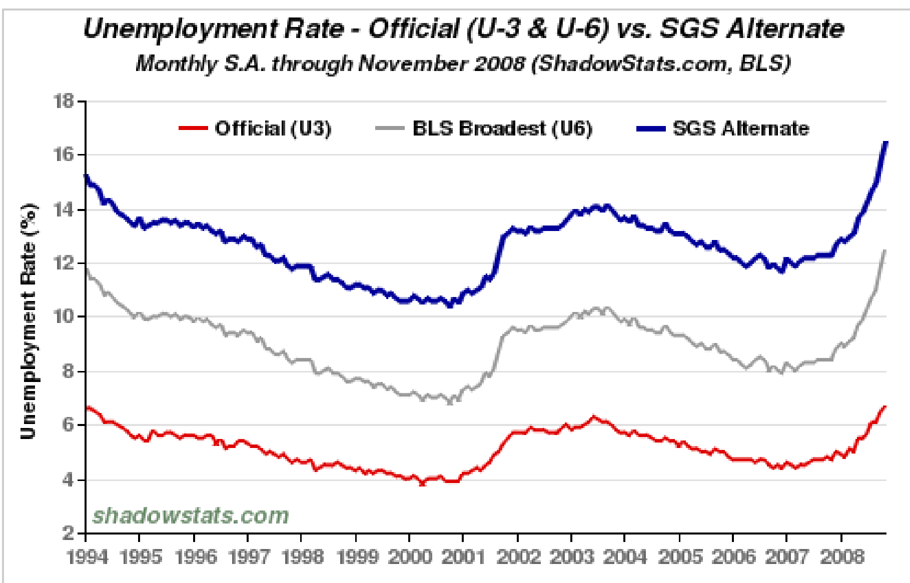
[11] Andrew Edwards, Inland Valley Daily Bulletin, October 8, 2008, "California may run out of money for unemployment aid"
[12] Josh Richman, Oakland Tribune, October 7, 2008, "Unemployment insurance fund headed for insolvency"

interest and inflation rates over the next 10-20 years will far exceed the levels of the late 1970s and early 1980s. As a reminder, the prime rate hit an all-time high of 21.5% in December, 1980. High interest rates constrain economic growth and increase unemployment.

Unemployment nationwide increases each passing week it seems as corporations eliminate thousands of people from their payrolls. Such news reports have become routine in the 4th Quarter of 2008. The national unemployment rate increased to 6.7% as nonfarm payrolls lost 533,000 jobs in November, well ahead of the 320,000 analysts expected. The number of long-term unemployed (27 weeks or more) was up nearly 60% from a year ago.[13]

Unemployment causes a vicious downward spiral for both the private and public sectors as the unemployed spend less, tax receipts fall, business profits decline, layoffs increase and round and round again until new entrepreneurial capital (generated by savings from producers) puts the unemployed resources back to work.

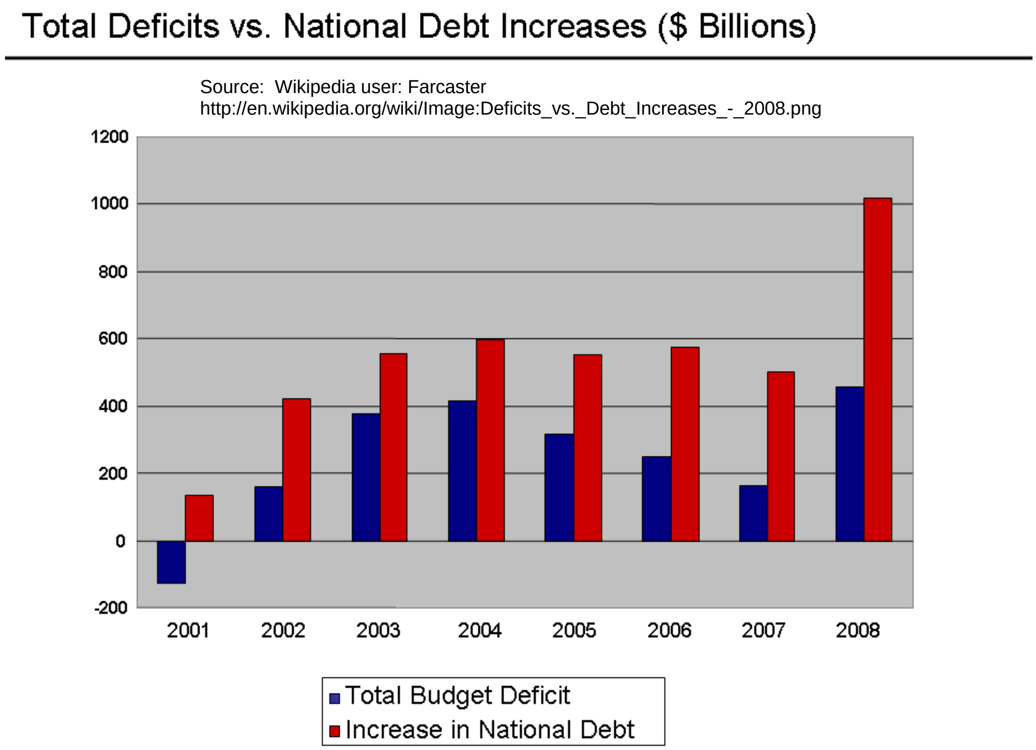
It's worthwhile to note that during the Clinton Administration the federal government changed the way it calculates Unemployment. It no longer counts in the labor force those it considers "Discouraged Workers". Consequently we have to add these people back into the calculation if we're to make any meaningful comparison with unemployment rates of the past, and the Bureau of Labor Statistics does this with their broadest measure of unemployment. The BLS Broadest seasonally adjusted measure is actually 12.5% as of November, 2008.



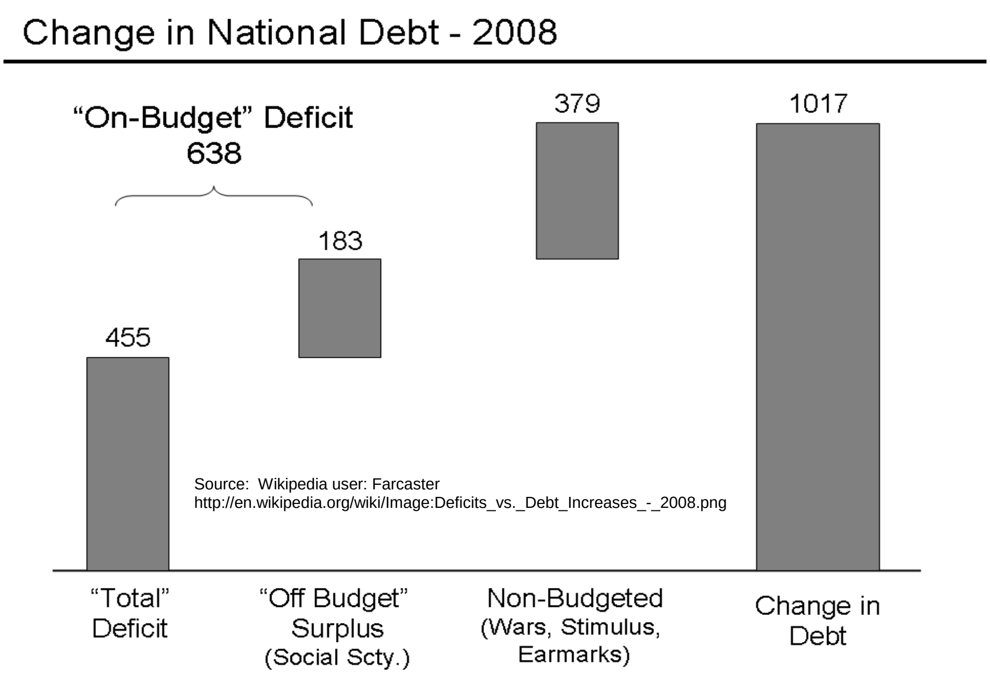
Federal deficits and debt are absolutely exploding. October's deficit alone was an all-time record for one month at $237.2 billion. Federal revenues were only $164.8 billion, which means Washington spent 244% of its receipts. The reported 2008 annual budget deficit was $454.8 billion, but that doesn't include the wars in Iraq and Afghanistan. And when the surplus of Social Security receipts for the year is backed out, we can see that the federal government

[13] Bureau of Labor Statistics, December 5, 2008, "The Employment Situation: November 2008"

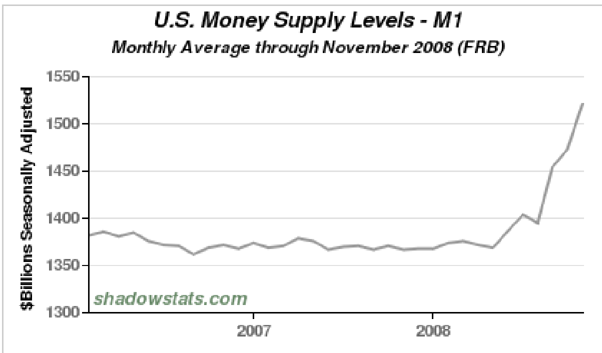
actually spent $1 trillion more than it received for the year. The following graph exhibits the growth in the federal debt each of the past eight years.

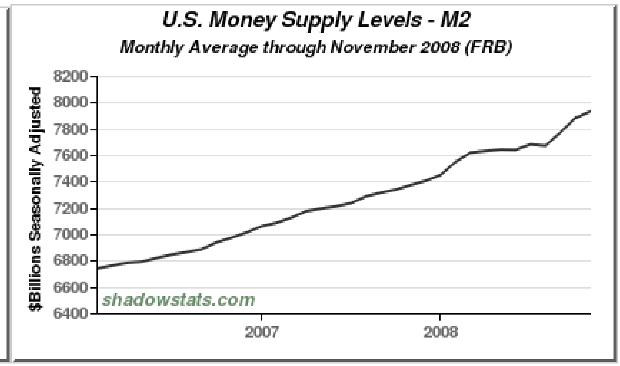


Federal debt is growing faster than the reported budget deficits because of off-budget Social Security revenues counted in deficit calculations and supplemental appropriations like the wars and the Economic Stimulus Act of 2008 not counted. The following chart helps explain:



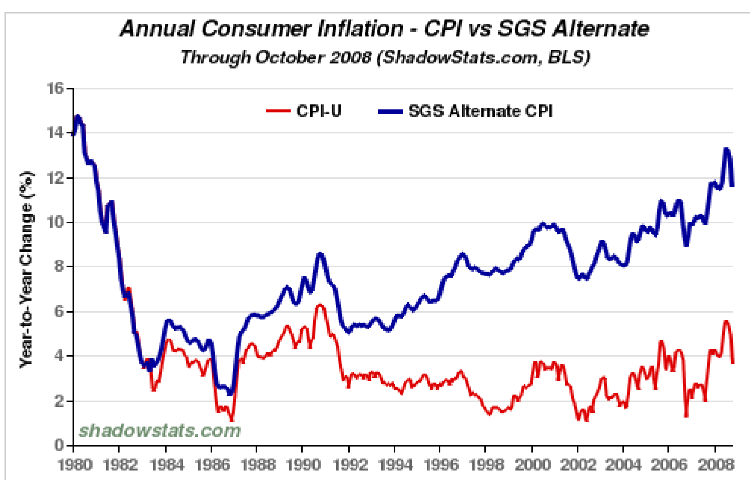
The federal debt now totals $10 trillion; however it's well over $53 trillion when Social Security and Medicare liabilities are included. Considering that annual federal revenue is only about $3 trillion and the fact that Washington has experienced on-budget surpluses only twice in the past 41 years[14], there quite simply isn't the remotest possibility that the federal government has the fiscal discipline to pay these debts without inflating the currency (i.e. printing the money out of thin air). This process has already begun as indicated by the rapid increase in the money supply this year resulting from federal bailouts of corporations.





This irresponsible behavior at the federal level will in all probability lead to hyperinflation in the next decade as the Baby Boomers begin turning age 65 in 2011 and become eligible for Medicare and full Social Security. 78 million Baby Boomers are spread out over 18 years, and the federal government does not have even one dime set aside to pay its promises to them. Therefore, we can only expect the government will run the printing presses to pay these bills.

Inflation will be the inevitable result, and most likely hyperinflation. Though the federal government's current inflation numbers suggest we need not be concerned, it should be noted that the Consumer Price Index (CPI) calculation has been changed a number of times to bias the figures downward to keep Social Security cost of living indexing low. Economist John Williams compares the current government CPI calculation to the CPI calculated according to the methodology used by the government in 1980, and here's the result:



[14] Congressional Budget Office. http://www.cbo.gov/budget/data/historical.pdf

The blue line reflects the CPI as if it were calculated using the methodologies in place in 1980. If Mr. Williams is correct, then our economy is well on its way toward terribly high real inflation rates in coming years, which will force interest rates up by eroding the value of bonds.

Furthermore, inflation has declined in the second half of 2008 because of the forced sale of assets resultant from the unwinding of leverage. In other words, borrowed money was used the past several years to buy assets and those now collapsing loans require the sale of the assets they purchased. The federal government's bailout packages are aimed at transferring these bad debts to the federal balance sheet, thereby "reflating" the private sector and enabling it to leverage up again. When it does, inflation will take off to new heights.

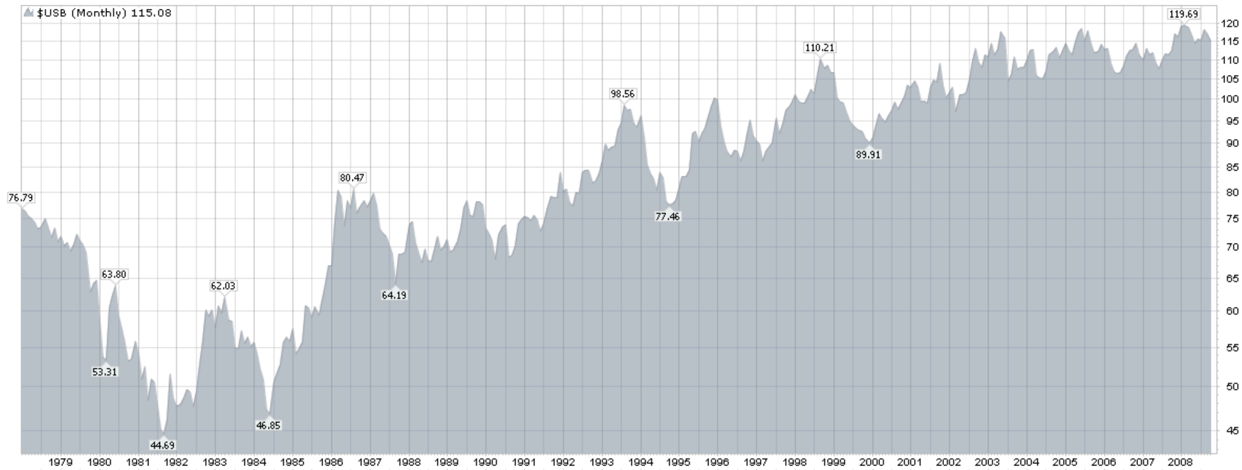
Interest Rates Headed Higher

The recent bursting of the "credit bubble" spread fear throughout the investment markets and caused investors to run to the "safety" of federal Treasury bonds sending their prices to record highs. As a result, Treasury yields are at all-time lows, but this is a short-term phenomenon driven by fear surrounding current uncertainty. What is certainly known is that the federal government is absorbing massive amounts of risk with what CNN reports now to be more than $7 trillion in bailouts.[15] The feds are certain to increase the federal debt by more than $1 trillion again in fiscal year 2009. This massive transfer of risk from the private sector to the public sector will eventually cause the bond market to sell off Treasury bonds en masse. The following facts will cause dramatic selling of Treasury bonds in coming years:

1. The federal government cannot afford to pay its debts and must either default or inflate the currency and pay bondholders back in newly printed currency with less value.
2. International holders of treasuries, such as China, will sell some of their Treasury bond reserves to pay for their much needed infrastructure improvements. China announced just such a $600 billion spending spree two weeks ago.
3. The federal government's deficits are leading to record issuance of new treasuries that will flood the market with supply; an estimated $2 trillion in 2009 alone.[16]

The following chart demonstrates that the rally in 30-year Treasury Bond prices since the 1980s has slowed, and in light of the considerations above is likely to reverse. Channel News Asia reports, "Mike Larson, an analyst at Weiss Research, says the long-term bond market could be 'the biggest bubble of all,' worse than the dot-com and real estate bubbles."[17]

[15] David Goldman, CNNMoney.com, November 28,2008, "Bailouts: $7 trillion and rising"
[16] Tom Petruno, L.A. Times, November 15, 2008, "Obama needs eager bond buyers"
[17] Channel News Asia, December 7, 2008.
http://www.channelnewsasia.com/stories/afp_world_business/view/394695/1/.html



It's worth noting that these prices have risen largely as the result of trade surpluses by Asian, Middle Eastern and other developing countries. If these countries now take their surpluses and begin spending them on their own internal development, they not only stop buying U.S. Treasury bonds, but actually become net sellers of the bonds. The level of buying support for treasuries in previous decades cannot be sustained and inconveniently diminishes at the exact same time that Washington D.C. begins years of record new issuance.

This impending collapse of Treasury bond prices will send their yields, and consequently all interest rates, much higher. High interest rates cause economies to stagnate and even contract. Americans need look no further than the "stagflation" of the late 1970s to gather an idea of what awaits in the coming decade. Unfortunately, the inflationary and interest rate environment of the coming decade is likely to be much worse than that of the '70s because of the sheer magnitude of the entitlement and Treasury bond liabilities owed today and coming due in the very near future.

<u>Solutions for Calaveras County in the Current and Coming Economic Environment</u>

The citizens and government of Calaveras County must prepare for a decade of volatile economics at best, stagnant economics most likely, and depression era economics possibly. The solution under any of these scenarios is to expand and diversify the business and tax base of the county. This can only occur if the county gets proactive in attracting new projects and moves quickly to approve those projects already in the development and planning process. Time is of the essence given the current unemployment tsunami awaiting the county and state.

It's imperative that the Calaveras economy not be allowed to contract, because growth is made exponentially harder following contraction. For example, a 5% contraction in the tax base must be followed by a 5.26% expansion just to return to the original starting point. A 10% contraction requires an 11.1% advancement to regain the lost ground. So as Calaveras enters this economic slowdown every stoploss effort should be made as soon as possible.

Several housing subdivisions are listed among current projects in the Planning Department. It's beyond the scope of this report to investigate all the issues leading to delays of these projects, but from an economic vantage point the county clearly needs the increased property tax revenues and various user fees that would result from Sanguinetti Estates, Sawmill Lake and Wallace Lake Estates.

Two commercial ventures, the Valley Springs Shopping Center and The Ridge at Trinitas, are listed as currently before the Planning Department. These projects possess tremendous revenue potential for the county and employment opportunities for Calaveras residents. A thorough economic report about The Ridge at Trinitas was generated by Cirian Villavicencio, MPA, and should be reviewed in its entirety. Highlights from this report include:

- A $1.5 million payroll desperately needed at a time when the county’s unemployment rate is 9.5%
- Sales tax revenue estimates of $264,000 - $1.1 million
- Transient Occupancy Tax estimate of about $50,000 annually
- Local construction expenditures of $20 million
- Approximately 48-60 new jobs
- $250,000 in building fees
- Road improvements paid by the developer
- Economic impacts from out-of-county guests ranging from $3.5 - $14.9 million
- Total county tax revenues of $500,000 - $1.4 million

The economic multiplier effects referenced in the Villavicencio report are of interest and tremendous importance. Of particular significance is the influx of millions of dollars the project can generate from sources outside the county. This amounts to a large “trade surplus” with the world outside Calaveras County as locally grown goods and services (Olive oil, agricultural co-op, restaurant, golf course laborers and construction workers, etc.) are sold to out-of-county guests. Trade surpluses are the communal “income” by which one community becomes wealthier than another. Conversely, communities that run trade deficits become poorer since they’re either spending savings or borrowing to consume beyond their aggregate income. The Trinitas project would contribute positively to Calaveras County’s trade account, or in other words to its aggregate net income, thereby enriching the entire community either directly or indirectly.

As of October, the county’s unemployment rate was 9.5% and climbing. The previous discussion involving macroeconomic considerations suggests employment prospects will not improve by themselves, but more likely will worsen. Instead, Calaveras must embrace and encourage rather than discourage what may be very few significant employment ventures in the years to come. It won’t be often during times of economic recession that businesses capable of employing dozens of residents present themselves to Calaveras County. The opportunity should be seized whenever available during times like these.

The county’s $1.6 million cash carry is in jeopardy of disappearing with the next annual budget, and yet tax revenues from the Trinitas project would go a long way toward fixing this problem. Trinitas is uniquely positioned to be part of the solution, because the project is ready to move forward immediately. From solely a fiscal consideration, one has to wonder why the county has failed to move such a lucrative project through to approval. Delaying this project and the ensuing revenues may cost the county further layoffs, or reductions in public safety services. If on the other hand the county takes a proactive approach to increasing employment and tax revenues, citizens in Calaveras County will be able to weather the oncoming economic storm.

Calaveras county has tools it can employ to defend its economy and its government from the current economic malaise and potentially devastating contractions of the future. Yet it remains to be seen whether the will exists to make the required political decisions. The conclusion of this report is that beneficial solutions exist and should be acted upon.