The laughing-stock of America gets serious about its budget

The Economist, 1-17-13

CALIFORNIA'S governor, Jerry Brown, has never bothered to disguise his irritation with those who mock the Golden State as America's answer to Greece. So it was with some relish that he strutted before journalists, on January 11th, to announce that California had eliminated its budget deficit. The general fund (which accounts for about two-thirds of state spending, bar federal transfers) would, he predicted, end the 2013-14 fiscal year $851m in the black. Surpluses of varying size were projected for the next three years.

Even better, the provisional budget he unveiled did not, for the first time in years, take an axe to public services. Instead Mr Brown was able to increase spending on schools and universities by around 5%, and to avoid cuts in most other areas. Money was found to help the state meet its new obligations under Barack Obama's health-care law. Listening to the governor giving the news was like "waking up from a nightmare", said a San Diego college official.

On January 14th the independent Legislative Analyst's Office (LAO), which in November had forecast a $1.9 billion deficit in 2013-14, said that the books were "roughly in balance" without quite agreeing that the deficit had gone. Mr Brown's numbers are no more than best guesses: he must revise his budget in May after 2012's tax returns come in. But this is a solid achievement for a governor who just last May took to YouTube to announce that "much greater" cuts were needed to deal with a deficit that had ballooned to $16 billion.

The balance has been reached thanks not only to the cuts of previous years but also to $5.8 billion of fresh revenues from a pair of initiatives approved by voters in November. Proposition 30, championed by Mr Brown, raised income-tax rates on the wealthy and nudged sales taxes upwards, although the extra revenues will expire in 2018 and 2016 respectively. Proposition 39, backed by a wealthy hedge-funder, closed a corporate-tax loophole. (In a quibble that could arise only in California, the LAO frowned at the budget's appropriation of Prop 39 revenues to meet the education-spending requirements of another initiative, passed in 1988: Proposition 98.)

Campaigning for his measure last year, Mr Brown deployed a curious blend of soak-the-rich rhetoric with austere pledges of responsible stewardship. Now that the rich have been duly soaked, only the fiscal hawk remains. California's legislature, which must pass a budget in June, has a two-thirds supermajority of Democrats, many of whom are itching to reverse some of the deep cuts of recent years. But for now they seem quieted, and Mr Brown is eager that they remain so. "I accept and embrace my role of saying 'no'," he said.

Could the fiscal recovery be derailed? Mr Brown admits that the uncertainty in Washington is a threat. In its response to his budget, the LAO warned that its previous projections did not account for the expiry of the payroll-tax cut agreed as part of the fiscal-cliff deal. Because that will crimp consumer spending, it may mean sales-tax revenues fall short of expectations. Similarly, if deep cuts to federal spending emerge from Washington's budget talks, California will not be left unscathed.

Such matters are beyond Mr Brown's control. But in other respects, too, California is overexposed to the shenanigans in Washington. The state taxes capital gains as income. If the stockmarket wobbles as the deadlines for raising the debt ceiling or tackling the budget "sequester" near, revenues could take a hit. Previous share slumps have hit California hard.

This is because California relies heavily on income taxes on the rich. Income taxes account for 63% of the

income-tax revenue will come from those earning over $200,000 a year. (The budget does create a $1 billion reserve fund, which should help protect against volatility in future years.)

Another threat is posed by California's longer-term obligations. The state has accrued $28 billion in debt in recent years by raiding special funds to cover outlays. Mr Brown's budget sees this "wall of debt" falling to $4.3 billion by the end of the 2016-17 fiscal year. But add health-care pledges to the elderly and unfunded pension liabilities, which the budget estimates at $181 billion, and the wall starts to look a lot higher. David Crane, a former adviser to Arnold Schwarzenegger, Mr Brown's predecessor, calculates that general-fund expenditures on pensions and other retirement costs have risen by over 50% since 2006-07, when overall revenues were roughly equivalent to the 2013-14 forecast.

California is hardly alone in having made rash promises to public employees. But its liabilities are more extensive than most. Moreover, some may start to bite soon. Mr Crane points out that the money needed this year to keep CalSTRS, the state's pension fund for teachers, afloat could more than swallow up the budget's increase in schools funding.

Meanwhile, the cuts of previous years have hardly been victimless. To replace lost subsidies, tuition fees have almost doubled in the California State University system since 2007-08. Social services such as child care have been stripped to the bone. Cuts to the judicial system have left some courts struggling to provide due process. Even with the extra funds, per-pupil spending in California will remain well below the national average.

To add to the pressure, California is facing a demographic squeeze as the ranks of the elderly swell, the birth rate falls and population growth declines. Acknowledging this, Mr Brown said schools with higher numbers of pupils from poor or non-English backgrounds would receive more money. This has annoyed some wealthier school districts, who suspect they will lose out under the plan. A similar proposal fell flat last year, but the passage of Prop 30 puts the governor in a stronger position.