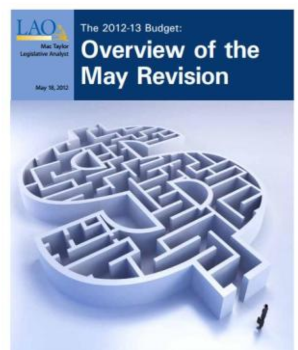
Mitchell's Musings 5-21-12: The Golden Mean

Daniel J.B. Mitchell

California, the Golden State, has had well-publicized budget problems for years. Its formal budget process consists of the governor proposing a budget in January for the upcoming fiscal year which begins July 1. The legislature is supposed to enact a budget by June 15 and the governor is supposed to sign it, possibly with line-item vetoes, by June 30. In fact, although budget hearings begin in the legislature shortly after the January proposal, there is a tradition that the governor comes back with a revised proposal in mid-May known as the "May Revise." Before the May Revise, not much is done.

The May Revise is based on updated information on state revenues and spending, economic trends, and the political reactions to the earlier proposal. At the beginning of last week, as shown in the photo above, California Governor Jerry Brown presented his May Revise. California's fiscal institutions include the state's Legislative Analyst Office (LAO) which prepares critiques of budgetary proposal from the governor for the legislature. The LAO points to policy issues, to disagreements over forecasts, and to legal constraints. At the end of last week, the LAO issued its report on the governor's May Revise. And now, the real work on the budget will begin.



This musing is not the place to go into the detailed numbers of the latest budget proposal or the immediate politics of it. The background, however, is that California had a major budget crisis in the early 1990s, when what was a mild recession in the rest of the U.S. – but a severe downturn in California - adversely affected state tax revenues. Efforts over several years, which included spending cuts and tax increases, brought the budget back into seeming balance by the mid-1990s. At around that time, however, there were warnings that over the long run the state had a "structural deficit," i.e., a tendency for spending to rise relative to revenue.

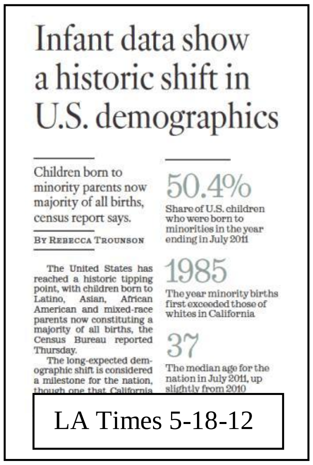
For several years thereafter, the dot-com boom of the late 1990s brought in substantial tax revenue from capital gains and masked the structural problem. Spending rose rapidly so that just as the economy peaked in 2000-2001, and as the dot-com boom turned to bust, the state found itself running a small deficit. The deficit quickly widened as another recession - again mild in the U.S. but severe in California – chopped state tax revenue. In political terms, the resultant budget crisis led to the recall in 2003 of Governor Gray Davis and his replacement by Arnold Schwarzenegger. As governor, Schwarzenegger implemented an enlarged and modified version of a plan to borrow his way out of the state's accumulated fiscal problems that had been in the works under Davis.

The housing/mortgage boom, as had the dot-com boom before it, masked California's underlying fiscal challenges during the mid-2000s. But even before the financial crisis of 2008, it was evident to budget aficionados that problems were accruing. The recession that was linked to the financial crisis, unlike the recessions of the early 1990s and early 2000s, was severe at the national level. But it was more severe in

California than elsewhere and the state staggered along with spending cuts, tax increases, and even the issuance of IOUs in lieu of state tax refunds and vendor payments at one point in 2009. Thanks to the renewed budget crisis, when Governor Schwarzenegger left office in January 2011, his poll ratings were as unfavorable as Davis' had been at the time of the 2003 recall. Since that time, the task of dealing with the California budget crisis has fallen to Jerry Brown.

California's fiscal problems tend to receive national attention. For example, Brown was interviewed last week at length by Charlie Rose on CBS news about his May Revise.[1] As part of his budget plan, Governor Brown has placed an initiative on the November 2012 ballot that would provide temporary tax increases. If it doesn't pass – and passage is not a sure thing – automatic trigger cuts would take effect. You can count on more headlines from California, either way.

Since I write an annual chapter on the California budget, these current events are of special interest to me. But there were other items in the news last week that caught my eye. In particular, there were longer-term demographic developments reported in the news media, both for the U.S. and California. There was national news about a Census report that minority births have exceeded those of non-Latino whites.


Infant data show a historic shift in U.S. demographics

Children born to minority parents now majority of all births, census report says.

BY REBECCA TROUNSON

The United States has reached a historic tipping point, with children born to Latino, Asian, African American and mixed-race parents now constituting a majority of all births, the Census Bureau reported Thursday.

The long-expected demographic shift is considered a milestone for the nation, though one that California

50.4%
Share of U.S. children who were born to minorities in the year ending in July 2011

1985
The year minority births first exceeded those of whites in California

37
The median age for the nation in July 2011, up slightly from 2010

LA Times 5-18-12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May 17, 2012

Latinos will soon be California's largest ethnic group, Census says

Latinos will become California's largest ethnic group very soon, a new Census Bureau report indicates.

The bureau issued its first post-2010 census estimates of population growth, birth rates, age cohorts, and racial and ethnic characteristics.

It pegs California's Latino population (it uses the term "Hispanic") at 14.4 million, 38.2 percent of the state's 37.7 million residents, while the non-Hispanic white population is just under 15 million or 39.7 percent, dropping below the 40 percent mark for the first time.

California is ahead of that trend. A related Census projection indicated that in a few years, the Latino population of California would be larger than the white "Anglo" (non-Latino) population. In effect, no ethnic group in the state will be a majority. Not surprisingly, much of the discussion around these issues has focused on political consequences. But there are other ways of looking at demographic trends besides changes in ethnic composition and the voting propensities of various groups. These alternatives may provide some insight into the underlying fiscal problems of California and into issues it may face in the future. They may also explain why California seems to have a harder time than other states in making fiscal adjustments.


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California's budget problems linger while many other states shape up

By David Siders
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The pile-on was in full effect within hours of Gov. Jerry Brown's announcement this week that California's budget deficit had grown to $15.7 billion, with The Week giving its national audience a summary of the Golden State's financial affairs.

Nick Ut / AP Photo

Gov. Jerry Brown

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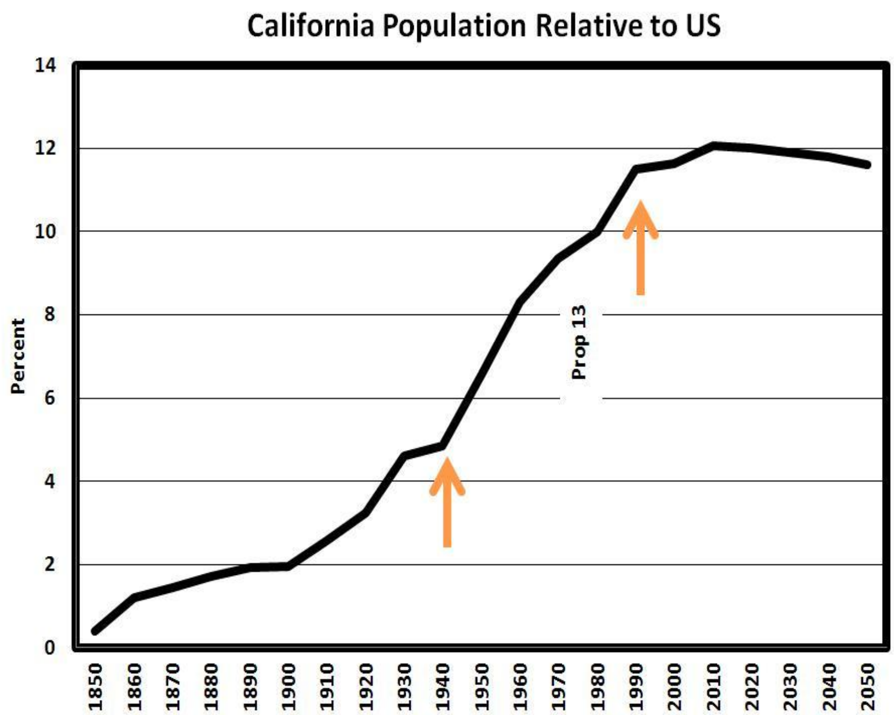
Since California became a state in the mid-19th century, its population has tended to grow faster than the U.S. population as a whole through a combination of natural increase (births over deaths), net in-

[1] http://www.cbsnews.com/8301-505267_162-57436905/gov-jerry-brown-says-california-is-not-a-tired-european-country

migration from the rest of the U.S., and immigration. However, some periods have exhibited more rapid growth than others. The chart on the next page shows California's population as a percentage of the U.S. total. Census of Population data are used through 2010. Thereafter, the figures are based on projections through 2050 by the California Department of Finance and the U.S. Bureau of the Census.[2] The chart may provide a clue as to why California seemed to have a rougher time adjusting its budget during and after the Great Recession when compared to other states.



Two notable inflection points appear on the chart: 1940 and 1990. Growth after 1940 represents the inflow of federal military funding for World War II, the Korean War, the Vietnam War, and the Cold War. After 1990, the Cold War ends. Within that 1940-1990 super-normal growth period, there is a slowdown in relative growth in the 1970s reflecting the end of the Vietnam War. However, taxes continue to rise thanks to a housing bubble (which raises property taxes) and inflation (which raised income taxes due to that tax's nominal rate progressivity). In the late 1970s, California thus became the home of the "taxpayer revolt" with the passage of Proposition 13, which drastically cut and capped local property taxes. Prop 13 was an omen of what might happen in California when voter expectations were frustrated by a growth slowdown.

Projections after 2010, particularly in the out-years, are at best forecasts with the chance for error increasing as we move into the more distant future. But loosely, the numbers suggest that California will

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[2] A cautionary note: The projections used by each agency are not necessarily based on the same assumptions. The Census has not yet released projections based on the 2010 decennial survey and recommends use of its 2008 estimates. U.S. figures used on the chart are from http://www.census.gov/prod/2010pubs/p25-1138.pdf. California figures are from http://www.dof.ca.gov/research/demographic/reports/projections/interim/documents/Final_2012_Interim_Proj_Web.xls

grow henceforth at roughly the same rate as the U.S. population. The state completes its transition from the super-normal growth before 1990 to being an average growth state after 2010.

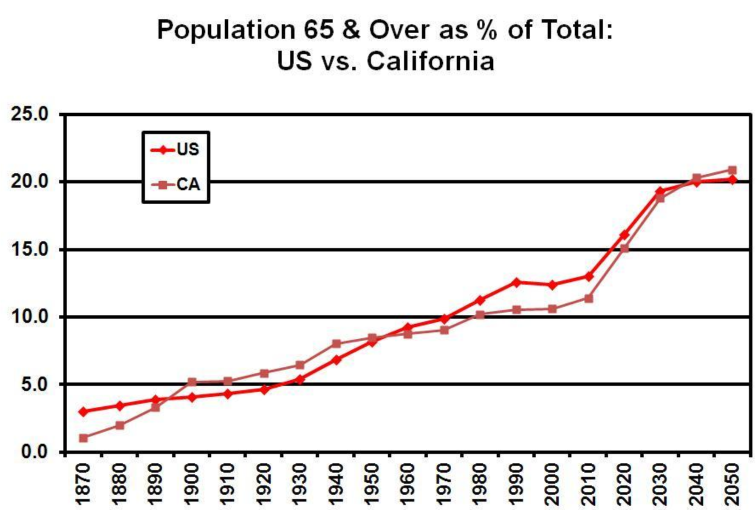
Being average in growth may not seem to be a major burden. But if you've had decades of super-normal growth, you have expectations based on an every-enlarging "pie" of economic resources including taxes to pay for roads, schools, universities, water projects, and other infrastructure along with social programs. Providing public services in such an environment avoids nasty trade-offs. An extra dollar for program X does not mean one dollar less for program Y, since the widening pie keeps adding to the available dollars. During super-normal growth, even if taxes have to be raised, the tax base is also growing.

At the root of California's seemingly endless fiscal problems is the gap between voter expectations, formed in the old pre-1990 super-normal regime, and the current (and future) period of being in the average range. Other states - which have been average for a long time - are better equipped to make unpleasant adjustments. Their voters don't have California-size expectations. They are used to trade-offs.

The future holds another burden for California. Ethnic mix projections of the type that caused the recent stir in the news media are interesting. But the dominant demographic shift at the national level is the aging of the population as the baby boom reaches traditional retirement age, not ethnic mix.

Prior to 1940 and the era of super-normal growth, California was an elderly state, much as Florida is today – a place to retire in the sunshine. And during that period when California was relatively old, its internal politics were roiled by various "pensionite" movements that appealed to older voters. But in the super-normal growth era after 1940, there was an influx of younger people that turned California into a relative youth state.

First came the wartime (young) workers into the budding aerospace and other related industries. Then came the returning (young) GIs after World War II. After them came young people to work in Cold War aerospace and other sectors. And those folks were joined by immigrants from outside the U.S. as immigration restrictions eased in the 1960s and as internal pressures in Mexico and elsewhere in the world brought in young populations, legally and illegally.



As the chart on the previous page shows, as California becomes an average growth state in the future, it also becomes an average age state. Its elderly population as a proportion of the total population converges with the U.S. national average.[3] California, the chart suggests, will not escape the fiscal pressures of an aging population experienced by the average state because it will be an average state. The difference is that – as in the case of growth rates – long-time average states are accustomed to being average. Perhaps after an extended period of being average, California will adapt to that reality. But right now the Golden State is not used to the Golden Mean.

[3] The same cautions noted in the prior footnote apply to this chart.