Mitchell's Musings 6-4-12: The Golden Mean – Part 2

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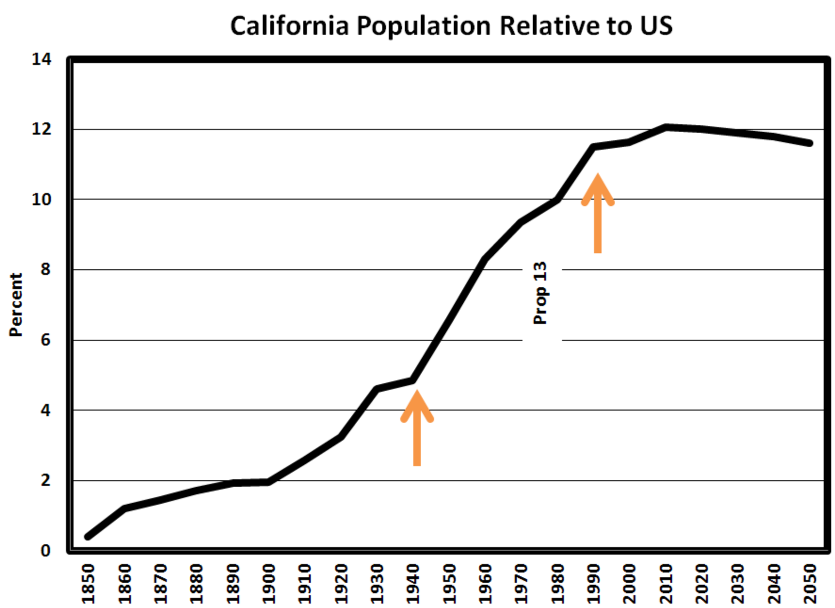
In my musing of May 21, 2012 entitled "The Golden Mean," I suggested that demographic trends could be an explanation of why California seemed to have chronic problems with its state budget, particularly since the 1990s. I showed that California, from World War II to the end of the Cold War, had enjoyed super-normal population growth. With the end of the Cold War (circa 1990), the federal military spending that had fueled the super-normal growth in the state's economy – which in turn created a pull of in-migration and immigration – dropped off. California then became a normal state in terms of population growth relative to the overall U.S. Indeed, long-term forecasts of population suggest that population growth in California will fall below the U.S. average in the decades to come as the chart below reproduced from that earlier musing indicates.[1]

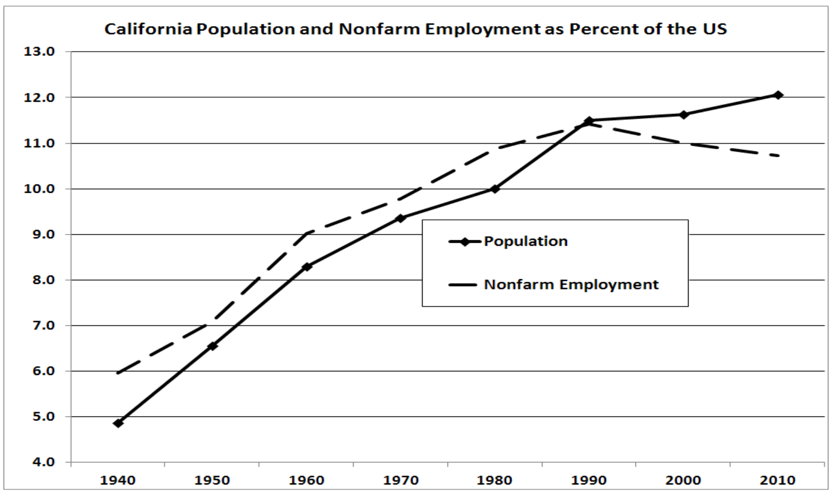


The missing piece in that musing was an explicit labor market component. Although it is not possible to go back to 1850 with regard to the labor market, it is possible to go back to 1940 – the initial inflection point on the chart above - and compare the population trend in California relative to the U.S. with the employment trend. Unfortunately, we cannot go back that far using total employment including self employment, family employment, and farm employment

[1] All charts shown in this musing use only decennial Census years as their data points, e.g., 1990, 2000, 2010, except where otherwise specified.

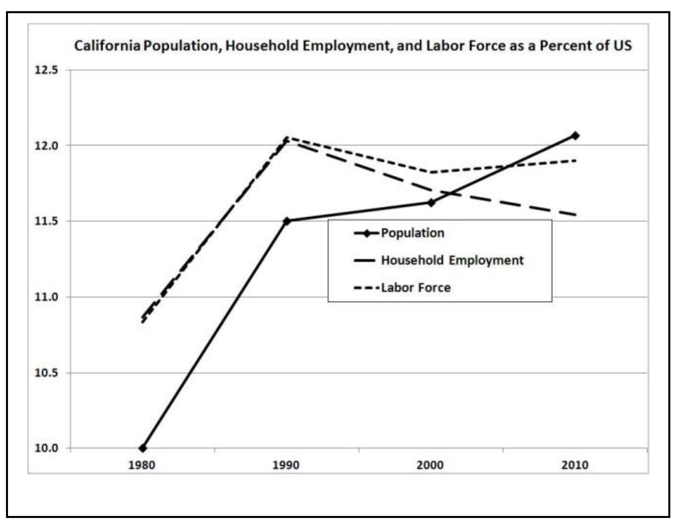
of the type now reported in the monthly household survey. That survey goes back to 1940 but state-level data from it are not available until the mid-1970s.

We do, however, have the establishment survey of nonfarm payroll employment. That survey counts only jobs in which there is an explicit employer (a boss and a payroll) and omits agriculture, somewhat distorting the results. But the payroll employment story, shown on the next page, tells the same general tale as the population story with regard to an inflection in 1990 – with an important difference.



There is a break in both series in the chart above at 1990. But while population rises more slowly than before in California relative to the U.S. post-1990, nonfarm employment falls in relative terms over the entire period. So California today seems to have fewer active workers available to provide support to the rest of the state's population than it once did.

As noted earlier, data from the household survey at the state level do not go back to 1940. To the extent that California has a disproportionate share of farm workers and self employed and family workers, its household survey of employment or labor force (which includes the unemployed as well as the employed) might show a higher ratio relative to the U.S. As the chart on the right – which covers only the post-1980 period – shows, there is indeed a higher ratio but household employment and labor force both begin a drop after 1990.



Again, the data indicate fewer active workers today in California to support the non-workers than was once the case. A more detailed view of the employment-versus-population trends in California relative to the U.S. can be seen below. It shows that the beginnings of the separation of the employment and population trends comes a few years before Census year 1990, a period in which major layoffs in California's big aerospace industry began to proliferate.

Source: UCLA Anderson Forecast, "The UCLA Anderson Forecast for the Nation and California: March 2012," p. California-67.

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Since the charts shown so far include the entire population, not just the working-age population that is typically used to calculate the standard employment-to-population ratio, the non-workers include children. Active workers thus provide support to non-workers in a variety of ways including intra-family transfers (parents to children) and tax-supported programs such as Medi-Cal (California-speak for Medicaid). (Apart from "welfare" type programs, most children also receive K-12 schooling at taxpayer expense.) Since California is nested in the larger U.S. economy, however, some of the transfers to non-workers in California come from external federal programs. On the other hand, Californians pay federal taxes, thus supporting non-workers in other states. The net of inflows and outflows to the federal government are probably a rough wash.

During California's golden age of super-normal growth (before 1990), its rate of expansion allowed for a certain level of generosity with regard to transfer programs. Significant shares of the California state and local budgets go to direct transfers to individuals or to services provided to individuals by non-government employees, e.g., medical providers who accept

Medi-Cal payments. Although California had a little over 12% of the U.S. population in 2010, full-time equivalent state and local employment in California accounted for a little over 10% of such employment nationwide.[2] Much of what many public workers do in California is pass money along to individuals and to providers of services to individuals.

Thirty-two percent of all U.S. recipients of the federal-state TANF program (Temporary Assistance for Needy Families – traditional "welfare") were residents of California in 2009 as were 38% of the expenditures on the program. Those figures are up from 21% and 26%, respectively, in 2000. Sixteen percent of workers' compensation recipients were residents of California in 2008. That figure is down from 20% in 2000, due to major changes enacted in the program designed to bring down costs. But at 20%, the percentage remains disproportionate. Interestingly, while more generous with aid through government than average, Californians are *not* notably more generous with their own money; they accounted for about 12% of private charitable donations in 2008 in keeping with their 12% share of the population.[3]

In 2009, a family of three living in Los Angeles would have paid 10-11% of its income in state and local taxes combined, a rate somewhat higher than the average in other urban areas around the U.S.[4] Nonetheless, the state budget has a structural deficit which - through the interconnections between state and local governments in California - shows up also in local fiscal stress. What seems to have occurred is that the public generosity of the golden era has carried on after the circa 1990 inflection point.

The result is an impasse between voter expectations and willingness to pay. With the shift in the non-worker/worker ratio post-1990, voters tend to feel burdened, both with taxes they must pay and with the intra-family transfers they must make. Thus, there has been only a limited willingness to raise taxes or to relax the constitutional constraint that there must be a two-thirds vote in the legislature to raise taxes. In fact, in 2008, voters tightened the definition of "fees" (which are not subject to the two-thirds requirement) to prevent the legislature from substituting fees for taxes. They also rejected an $18 per car hike in motor vehicle fees that would have prevented state parks from closing or other service cuts (although the $18 would have made park admission to California cars free). To the extent that Californians are willing to raise taxes, it is often on others.

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[2] http://www.census.gov/govs/apes/

[3] U.S. Bureau of the Census, *Statistical Abstract of the United States: 2012* (Washington: GPO, 2011), pp. 363, 365, 372

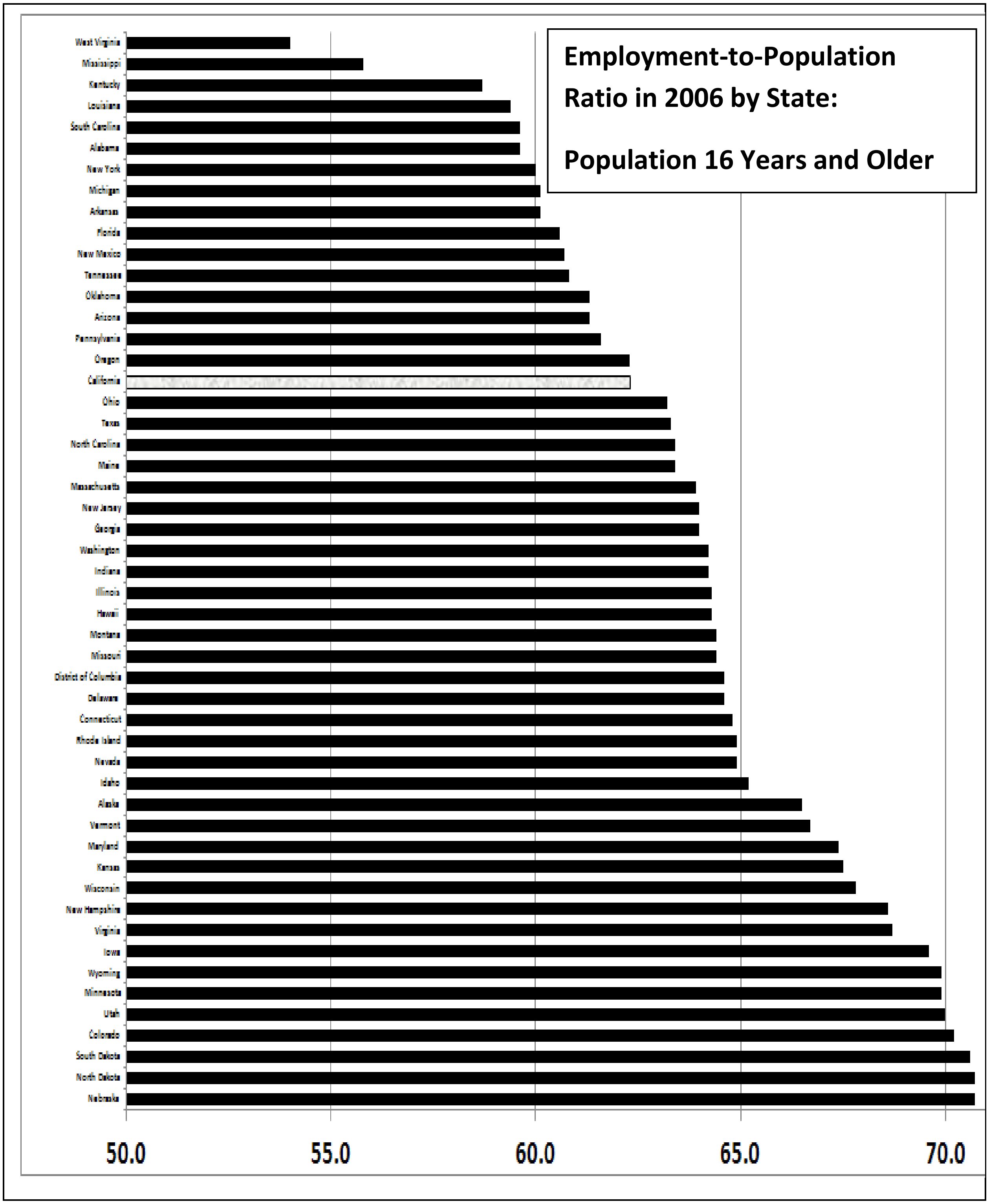
[4] U.S. Bureau of the Census, *Statistical Abstract of the United States: 2012* (Washington: GPO, 2011), p. 284.

For example, in 2004, voters approved an added 1% surcharge on millionaires with the funds earmarked for mental health. Most voters, of course, had incomes nowhere near $1 million. This week, a tobacco tax is on the California ballot with the funds earmarked for cancer research. Tobacco companies have mounted a major TV blitz against this initiative and recent polls suggest public support for it is dropping. Nonetheless, the measure is thought to have a chance at passage precisely because most voters don't smoke.

In short, when viewed in a labor-market context, underlying the fiscal problem in California is a gap that has opened after 1990 between voter expectations for public services and the revenue they are willing to provide to support such services. Voter expectations are based on the golden era in California pre-1990. But voters tend to feel they pay enough taxes and have their own family burdens with which to cope. Polls suggest they are not keen to cut services – with the exception of prisons which are viewed as spending money on criminals. (As a result of prison fiscal problems, however, federal courts have mandated increased spending and/or prisoner releases to relieve overcrowding.)

As the Appendix chart on the next page shows, the conventional employment-to-population ratio was not particularly high in California relative to other states in 2006, the peak of the business cycle *before* the impact of the Great Recession. A boost in that ratio would go a long way toward injecting additional revenue into the public sector and relieving the structural gap between voter expectations and fiscal reality. California, as a subnational region, cannot adjust monetary policy and thus has very limited fiscal discretion. Undoing the aftermath of the Great Recession is a national challenge, not something a single state, even the largest state, can handle on its own. Nonetheless, California could take positive steps to foster long-term growth and job creation through a focus on its priorities for physical and educational infrastructure maintenance and improvement. Political polarization, aggravated by the difficult post-1990 shift to a more normal growth path, has so far prevented rational discussion of such issues.

Appendix



Source: http://www.bls.gov/lau/staadata.txt