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California's economy

Bark if you don't like deficits

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The Golden State's recovery is real but shakier than it looks

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IT WAS vintage Jerry Brown. On January 22nd California's governor (pictured) delivered a snappy state-of-the-state address, his 11th, covering climate change, healthcare, the budget, immigration policy and much more. He quoted George Santayana, a dead philosopher, then joked that his pet dog was calling on Californians to "bark if you don't like deficits!"

Interviewed in his office afterwards, Mr Brown allowed himself to veer further off-base, citing Wittgenstein, Matthew Arnold and Buddhism as he explained his governing philosophy. A lifelong Democrat, he is nonetheless wary of politicians' centralising or Utopian impulses. He frets about legislation that expresses "an intolerance of difference". He agrees that if he were European he would be a Euroseptic.

The 75-year-old Mr Brown, America's oldest governor, is not new to this. But during his first stint in charge of California, between 1975 and 1983, "Governor Moonbeam" was distracted by grandiose schemes or his own ambitions, including failed presidential bids. He made bad appointments and ignored legislators.

The second incarnation of Mr Brown, which some date to an energetic period as mayor of Oakland (1999-2007), by contrast, has been marked by a relentless pursuit of the

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possible and a serene neglect of everything else. He governs without regard to ideological consistency. His first marriage, nine years ago, is said to have grounded him. Mr Brown likes to bolster his talk with quotes from Demosthenes but sometimes only the demotic will do: the governor has said he likes to "get shit done".

For the first three years of his second governorship, that has meant fixing California's books. Mr Brown's first budget, in 2011, faced a deficit of \$25.4 billion. Such figures, says Darrell Steinberg, head of the state Senate, "sucked the oxygen from the room"; they made it impossible for politicians to think about anything else. Not any more: this year the state is looking forward to a surplus of \$4.2 billion.

That is largely thanks to America's bull market, which boosts the income of the rich people California relies on to pay a huge share of taxes. But Mr Brown can take some credit: in November 2012 voters approved Proposition 30, a measure he placed on the ballot that hikes income taxes on the rich and nudges sales taxes up. It expires in 2018, just before Mr Brown is expected to leave office. And state government now works properly; budgets pass on a simple majority rather than a two-thirds vote, and big Democratic legislative majorities make it easy to get things done.

Refreshingly, Mr Brown refrains from overselling the recovery he has overseen. But the mood has lifted. Bond-rating agencies are more upbeat; on January 14th Standard and Poor's upgraded its outlook to "positive" from "stable" (though it still rates California's debt worse than any other state's bar Illinois, thanks to the "ballot-box budgeting" that ties legislators' hands.) California's reputation has improved. Less than 18 months ago Mitt Romney compared the Golden State to Greece. Today Mr Brown travels to Washington, DC dispensing good-governance lessons.

But more than most people realise, California's fortunes depend on the stockmarket. The state relies heavily on individual income taxes—this year they are expected to be two-thirds of general-fund revenues—and in particular, the capital gains of the rich. (Prop 30 aggravated this problem.) This makes the state's revenues highly volatile (see chart 1); and this is why Mr Brown resists calls to open the spending spigots.

Many argue that California must reform its tax structure: sales taxes should be broadened to some services and income taxes flattened. (A commission appointed by Arnold Schwarzenegger, Mr Brown's predecessor, recommended this but was ignored.) For Mr Brown, however, the political difficulties make this "a non-starter". His alternative is

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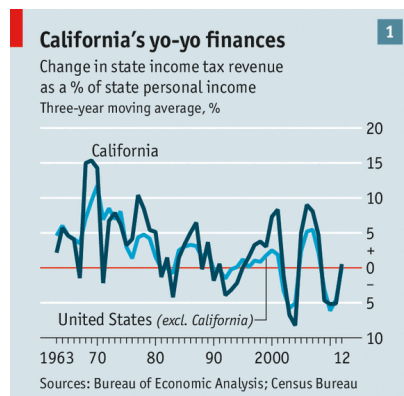
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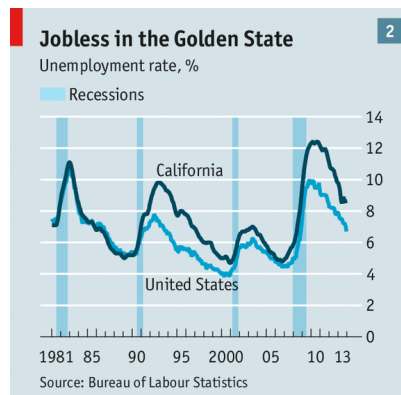
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a palliative: a rainy-day fund filled when capital gains are high.

In the same eat-your-broccoli vein, Mr Brown wants to start reducing California's \$355 billion debt pile, a combination of short-term debt incurred in the bad years and unfunded pension and retiree health-care costs. That is good so far as it goes, but David Crane, a former adviser to Mr Schwarzenegger, worries that Mr Brown is leaving the biggest problem to a successor. California is not meeting its annual required contribution to CalSTRS, the retirement fund for teachers, let alone tackling the unfunded debt. The fund is running out of money but Mr Brown proposes only to begin discussing the problem this year.

The two Californias

California's economy is recovering: it is piling on jobs and is emerging from the huge debt overhang left by the housing collapse of 2007-08. A strong bounceback is normal for California; its booms and busts have historically been more extreme than America's. At its post-recession peak in October 2010 Californian joblessness was 12.4%, behind only Nevada and Michigan. Today it is 8.5%, still the fifth-worst in America; that is 1.6m people looking for work who can't find it (see chart 2).



Parts of California are being left behind. Many inland areas still face double-digit unemployment rates and continuing foreclosures. (Two inland cities, Stockton and San Bernardino, went bust in 2012.) The Census Bureau's supplemental poverty measure, which takes public benefits and the cost of living into account, finds that California's poverty rate, at 24%, is the highest in America. Latinos, soon to be California's biggest ethnic group, suffer disproportionately. Mr Brown mentions increased healthcare coverage and a hike in the minimum wage (to \$10 an hour, from 2016), but doubts government can do much more. "Jobs' is a very abstract term," he muses; easy to demand, hard to create.

On January 21st Neel Kashkari, a Republican who ran the bank bail-out under George W Bush, announced his candidacy for governor. His concise pitch—"Jobs and education. That's it!"—is designed to highlight Mr Brown's neglect. Yet barring a miracle Mr Brown will sail to re-election in November (he has not formally declared, but no one doubts he will). For if his fiscal stewardship has been competent, his political manoeuvrings have been masterful. He has kept a lid on spendthrift Democratic legislators. Unions and corporate interests know that nothing gets done except through him. This opens up political space.

How will Mr Brown use it? Second-term Californian governors traditionally have a rough time, says Tony Quinn, an analyst, and pitfalls abound. A drought is testing the state's ancient water infrastructure and threatening farms. A row with federal judges over prison overcrowding drags on. Fierce arguments loom over two infrastructure projects Mr Brown has championed, despite hefty price tags: a high-speed rail link between Los Angeles and San Francisco, and a water-diversion project in the Sacramento-San Joaquin Delta.

If Mr Brown can weather these challenges (and maintain good fiscal order) he may confound observers one last time: by seeking a quiet legacy. In his address he emphasised the theme of "subsidiarity": pushing power down to local officials. California is a huge and diverse state, yet decision-making is heavily centralised in Sacramento. Mr Brown has pioneered this approach, first in prisons policy and then schools funding. He is

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not clear about where it may next be applied—implementation of current policies will be hard enough—but says he wants to stop the “headlong rush to more state intervention”. It's unusual for politicians to curtail central power, he notes. But Mr Brown is not your usual politician.

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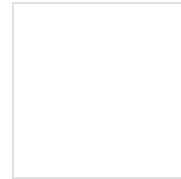
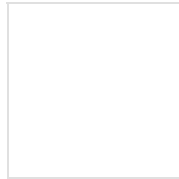
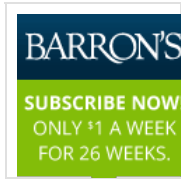
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