

Surplus? California Is Running a Deficit

Werner Z. Hirsch and Daniel J.B. Mitchell. Los Angeles Times. Feb. 12, 2001. p. B7

As California's electricity crisis unfolded, there was much talk about using the state's "surplus" to fend off high energy costs. Indeed, in recent years the surplus has been regarded as the answer to just about any social need in California. There is just one problem, evident in the governor's budget documents but ignored by the public and the Legislature. In the current fiscal year ending June 30, California is running a deficit. And the budget proposals for the next fiscal year similarly project a deficit.

In common terms, a government runs a surplus when it collects more in revenue than it spends. And it runs a deficit when it spends more than it collects. In the current fiscal year, the state's general fund is projected to collect \$76.9 billion and to spend \$79.7 billion. That is a deficit. Next year, it is expected to take in revenue of \$79.4 billion and to spend \$82.9 billion. That is another deficit. Moreover, these projections are based on revenue estimates that, while assuming some slowdown, depict a California economy that largely escapes the negative forces afflicting the national economy.

The state's economic planners assume that the national economy will exhibit rising unemployment in 2001 and 2002, but that California will experience falling unemployment. In contrast, the UCLA Anderson Forecast predicts that California will see rising unemployment along with the overall U.S. economy. Of course, either or both of these forecasts could be wrong. Yet California has particular vulnerabilities, and a downturn is a real possibility. Electricity is one issue. But so is the fall of the dot-coms, the disappointing stock market, which will cut into tax receipts from capital gains, and a possible strike in Hollywood.

So where did all of the talk of a state surplus come from? Basically, during the late 1990s, the state's general fund did run a surplus (revenues greater than expenditures) and the state built up what can be thought of as a fat bank account, to the tune of \$9.4 billion left over from fiscal 1999-2000. Now the state is drawing down that account. If the economy softens more than projected, tax collections will lag and the account will be drawn down rapidly and disappear.

Unlike the federal government, which can run deficits for decades, state governments are constrained by credit markets. Excessive deficits will lead to downgrading of bond ratings and higher interest rates for borrowing. State governments are well advised to accumulate ample reserves in good times and save them for a "rainy day." At most, California has experienced an economic drizzle, not real rain, in the past few months.

What would a real rainy day look like? It would involve a clear national recession that dragged California down with it. It might entail oil shocks from the Middle East. Already Iraq is making bellicose statements, and the Israeli-Palestinian conflict is creating tensions in the region. Or some financial debacle abroad might spook Wall Street beyond Federal Reserve Chairman Alan Greenspan's control. Of course, there is no certainty that such events will occur. But they did in the early 1990s. California needs to maintain a prudent financial cushion as insurance against these contingencies.

It is important to stop sugar-coating the state's fiscal situation with talk of a phantom surplus. The governor's budget needs to be revised to take realistic account of the energy crisis, even before May when such corrections traditionally are made. That way, administrators of programs that receive state funds will have a chance to plan for possible cutbacks. The general fund shouldn't be running a deficit now when the money may well be needed later.

Credit: Werner Z. Hirsch is emeritus professor of economics and Daniel J.B. Mitchell is professor of management and public policy at UCLA.