

Will California Go Bankrupt?

[This is a question from an old H.S. classmate addressed to those of us now living in California, together with my reply. –S.H.]

----- Original Message -----

Sent: Friday, November 19, 2010 4:19:55 PM

The stock market stumbled this past week regarding Ireland's economic issues. But, I am troubled by news that the world's seventh (?) economy, California is on the verge of bankruptcy.

What you think? Will California fail?

Larry N.

Sent: Saturday, November 20, 2010 10:52:42 AM

Subject: Will California go bankrupt?

Hi Larry,

It's true that state and local governments are in general really hurting financially these days, and California has long been one of the most serious cases. I think eventually many states and large numbers of local governments will indeed go bankrupt (and in the course of that write off much of their debt). This sort of thing happened in the Great Depression of the 1930s, and in my opinion is bound to happen even more extensively this time around. But I think that will still take a few years to develop in a major way.

However, there have already been a few bankruptcies of cities in California, including Vallejo in the Bay Area, and a couple of small cities down in southern California. (One of them was in effect looted by its mayor and police chief!)

Even though I live in California and have been following the development of the overall U.S. and world economic crisis pretty carefully, I haven't been paying that much attention to the details of the string of budget crises for the state. In part, because a lot of the problems have been due to stupid political bickering. (I.e., self-inflicted.)

One major example of this was the law (only just repealed in the recent election) that required state budgets to be passed by a 2/3 majority of the legislature. This undemocratic law allowed the minority (which have usually been Republicans in recent years) to stifle the spending will of the majority (usually Democrats). But it was a major factor in keeping the legislature from agreeing on any sort of budget at all, for long periods of time.

That particular impediment will soon be removed (I'm not sure when the change goes into effect; probably on January 1st.) But of course the more fundamental problem still exists, the huge and still developing economic crisis itself. State tax receipts (from the state income tax and other sources) are much depressed right now, and will no doubt remain so for years.

Unemployment in California is even higher than the national average. Officially it is over 12% here, though adding in those who have given up looking for jobs and the forced part-timers brings it up around 22%. This is getting damned close to the worst national unemployment figure during the (last) Depression, of about 25% during 1933.

The housing crisis is still developing here too, though the worst regions in the country for that are now said to be in the Northwest and Midwest, which were relatively less affected earlier. In San Francisco, house prices have actually edged up a little bit recently. The city is so cramped for space, with lots of new immigrants (especially from Asia) that even during the crisis the demand for housing has remained pretty high. But most areas of California continue to see lots of new foreclosures.

There are huge cutbacks in education and public services in general. The University of California has raised tuition 6 times in the last 4 years. There have been quite a few layoffs of public school teachers, etc.

In addition a lot of the growing debt problem is still being hidden. For example, the state is borrowing massively from the Federal government in order to cover the huge amounts of unemployment insurance it needs to pay out.

The Federal stimulus packages (in the last days of the Bush administration and the early days of the Obama administration) did include considerable aid for the states, but not nearly enough to bail them out completely (as was done with the big banks and Wall Street!). It is possible that some new round of Federal stimulus will eventually forgive some of the Federal loans to the states, or otherwise provide more aid to them, but for political reasons that is very unlikely to happen any time soon.

So I would say that the short-term prospects for California are bleak, and the medium and longer-term prospects are considerably bleaker.

It is true of course, that the state could raise taxes and cut expenditures further, and to some considerable extent it will undoubtedly do so. But there is a political unwillingness to do these things until there is absolutely no other alternative and things are absolutely desperate. (Of course, cutting government programs harms the people and serves to aggravate the economic crisis. Raising taxes on the rich is the best course, but the rich run the state government so they won't do that to any significant degree.)

My guess is that in the short and medium term there is just barely enough political will to further cut expenditures and raise taxes (mostly regressive taxes like fees and the sales tax) to keep the state itself from actually going bankrupt. But I'll be quite surprised if they don't go bankrupt at some point further down the road.

Scott