California’s budget crisis: a historical overview

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Recently elected California Governor Jerry Brown, a Democrat, is continuing the austerity policies of his Republican predecessor. As working class Californians brace themselves for deep cuts in education and social services, it is worthwhile to look back at how the state with the highest number of billionaires found itself in a situation of recurrent fiscal crises.

Contrary to many claims, California’s fiscal problems are not the result of administrative excess. Rather, the state has been at the center of the transformation of the American economy from a system of producing socially useful commodities to one in which wealth is transferred to the financial class without going through the intermediate process of production.

The total budget gap for California exceeds $25 billion for fiscal year 2011-2012. Brown is seeking to balance the budget through a combination of $12.5 billion in cuts to social services and $14 billion in regressive tax hikes, including increases to sales tax and vehicle license registration fees. The taxes are subject to voter approval, which Brown hopes to gain in a special election in June. The proposed cuts and taxes will disproportionately affect the state’s working class population.

Brown’s doomsday budget will attack all of the socially beneficial services that remain in California. The state’s colleges will lose $1.4 billion in funding: $500 million from the University of California system, $500 million from the California State University system, and $400 million from community colleges. These cuts to education come one year after tuition hikes drew protests from tens of thousands of students throughout the state.

Brown is proposing even deeper cuts, as much as $4.6 billion, from public K-12 education. The governor will cut $1.5 billion from the budget by lowering the pay and benefits of tens of thousands of state employees. Services for disabled persons will be cut by $750 million. Millions will be taken from parks, causing closures in California’s world-renowned parks system for the first time.

California is the most extreme example of the fiscal shortfalls facing virtually every state in the US. Despite the ongoing fiscal emergency, the Obama administration has insisted that Washington will not provide any money to aid state governments. Politicians and media pundits alike have portrayed the fiscal crisis as evidence of the wasteful state expenditures, invariably invoking the need for all Americans to “tighten our belts,” and begin “living within our means” (See: “The New York Times and ‘living within our means’“). The working class, however, has demonstrated its hostility to these attacks with protests throughout the country, most notably in Wisconsin.

Contrary to the claims of corporate media and politicians, California’s budgetary problems can only be understood as the end result of decades of transferring wealth from the working class to the financial elite. Beginning in the 1970s, the US economy underwent a transition from the world’s leading industrial producer to a so-called post-industrial society. This has entailed the deregulation of financial markets and a policy of cheap money that has facilitated the rise in equity prices beyond the value of the underlying stream of wealth to which they nominally lay claim. Those industries that have remained in California—like the movie industry, aerospace and software development—virtually hold the state hostage, threatening to go elsewhere unless they receive subsidies and tax write-offs.

Deindustrialization led to mass layoffs and declining tax revenue in California. In the 1990s, manufacturing in Los Angeles declined by 22 percent, resulting in the loss of 169,000 jobs. In 2010, New United Motor Manufacturing, Inc. (NUMMI) closed. NUMMI was the last auto manufacturing plant in the state. In California’s case, the structure of the tax system also changed with Proposition 13. The state began to rely more on income tax revenue, which tends to be cyclical and volatile.

By the middle of the 1990s, the US economy faced a serious crisis. Corporate profit rates stagnated as the layoffs and technology boom that had increased productivity for the past decade reached their limits. At this point, aided by the cheap money policy of the Federal Reserve, corporations began borrowing heavily to purchase shares of their own stock. This set off the stock market bubble of the late 1990s, which came to a grinding halt in 2001 with the collapse of the dot-com bubble.

Enron became the most notorious example of the Ponzi nature of the American stock market. Corporations cannot be the sole purchasers of their own stock, but rather draw investors into the process to inflate the value of the stock beyond the so-called fundamentals, or the profits to which the stock is nominally a claim. For this to succeed, corporations must at least present themselves to stockholders as profitable ventures. Throughout America, firms were accomplishing this through creative accounting practices.

Enron used an accounting technique known as mark-to-market, which allowed the company to claim as current revenue projects slated sometimes well into the future. When these projects began to fall through, Enron had to find a way to actually make money.

This is where California comes in. California is the largest economy in the US, and Enron, an energy trading company, deliberately sought out the loopholes in California’s recently deregulated energy markets in order to “game” Californians out of billions of dollars. Enron spent millions of dollars in the 1990s lobbying for deregulation of California’s energy market. Jeffrey Skilling, then-CEO of Enron, promised that deregulation would save the state billions of dollars a year in energy.

According to Bethany McClean and Peter Elkind, authors of *Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*, “In one appearance before the California Public Utilities Commission (CPUC) Skilling claimed that the state would save $8.9 billion a year: ‘Let me tell you what you can buy every year,’ he said. ‘You can triple the number of police in Los Angeles, San Francisco, Oakland, and San Diego, and you could double the number of teachers.’” Skilling’s claims stand in stark contrast to the current situation, in which thousands of teachers throughout the state face layoffs.

The deregulation of California’s energy markets took place within the context of a nationwide onrush of corporate and financial deregulation. This deregulation, a boon to the ruling class, had bipartisan consensus, beginning with the Reagan administration and culminating in Bill Clinton’s repeal of the Glass-Steagall Act in 1999, which abolished the 1933 legislation that had established a strict separation between commercial and investment banking.

After securing deregulation in 1996, the energy companies, including Enron, proceeded to loot the state’s energy markets. They used various strategies, with names such as “Death Star,” “Get Shorty,” and “Fat Boy,” to artificially raise the cost of energy. Although Enron became the face for the looting of California, all the energy companies were taking similar advantage of the deregulated energy markets.

The scheming of the energy traders led to an explosion in energy prices. At the peak of the “energy crisis,” itself a fabricated affair caused by traders such as Enron selling energy to themselves, prices rose from an average of $340 per megawatt hour to over $2,500 per megawatt hour. The price increase triggered rolling blackouts throughout the state.

The utility companies were on the hook for the money, because the deregulation laws did not allow them to pass on extra prices to the consumer. Meanwhile, major banks, looking to get in on the action, had loaned heavily to the California utilities. When the price of energy skyrocketed, due to speculation and gaming the market, the utilities were unable to pay back their loans. Bank of America alone had $1.2 billion in outstanding loans to the utilities. Looking to protect the interests of the financial aristocracy, and avoid financial meltdown spreading throughout the international system, California stepped in to bail out the utilities. All told, the energy crisis cost the state some $40 billion to $45 billion, most of which has never been recouped.

The looting of the California treasury to bail out the state’s largest privately owned public utilities—Pacific Gas and Electric, San Diego Gas and Electric, and Southern California Edison—set the stage for the budget-cutting regime that has persisted ever since. Then Governor of California Gray Davis responded to a $38 billion deficit, the product of the bailouts and the collapse of the dot-com bubble, with a combination of cuts to social services and regressive tax increases, including a hike in the sales tax and the wildly unpopular increase of automobile registration frees. The latter in particular hurt Davis’s popularity, opening the door for the right-wing, anti-democratic recall election of 2003. The recall campaign, funded by Republican Congressman Darrell Issa and far-right-wing elements within California’s political establishment, ultimately ended in the election of Arnold Schwarzenegger.

Schwarzenegger’s first act in office was to change California laws to push through the austerity regime desired by the right wing. In 2004, Schwarzenegger put two initiatives to the voters, Propositions 57 and 58. Proposition 57 authorized Schwarzenegger to sell $15 billion in state bonds to pay back $9.2 billion of state debt. Proposition 58 mandated that future state expenditures must match revenue, barring the state from further borrowing to repay debt. As the WSWS reported at the time: “The combined effect of Propositions 57 and 58 will be to drastically increase state indebtedness over the course of the next 14 years, while at the same time providing lawmakers with the legal authority to make unprecedented cuts in public services.” (http://www.wsws.org/articles/2004/mar2004/cali-m09.shtml)

After the collapse of the stock market bubble in 2001, the Federal Reserve Board responded by again lowering interest rates, pumping the market with liquidity and fueling a new asset bubble—this time in securitized debt, in particular subprime mortgages. Like the stock market and dot-come bubbles, the subprime mortgage bubble, which would ultimately bring the global economy grinding to a halt with its collapse in 2008, found its epicenter in California. The inflow of speculative capital into California was driven by the rise in housing prices. Between 2000 and 2005 home prices in California increased by 65 percent. With such a meteoric rise in home values, speculative capital flooded into California subprime markets. Three quarters of all mortgages issued in California in June 2005 were Adjustable Rate Mortgages (ARMs). In 2005, 60 percent of all mortgages issued in the state were either interest-only mortgages or ARMs.

The banks stood to lose trillions when the subprime mortgage market collapsed. The federal government, once again demonstrating an unmitigated willingness to prop up the financial aristocracy, stepped in with the Troubled Asset Relief Program (TARP) to bail out the Wall Street investors that had invested so heavily in California’s real estate markets, while refusing to take any steps to stem the tide of foreclosures throughout the state. Through TARP, the government took trillions of dollars of toxic debt onto its own balance sheet.

With the collapse of the housing bubble, tax revenues in California were seriously undermined. Many working class families, facing decades of stagnating wages, had subsidized their income by capitalizing on the equity realized by the rising value of their homes. When the bubble burst, these families found themselves underwater on their mortgages (owing more on their homes than the market value) and could no longer pay their bills. The year 2010 witnessed the highest rate of home foreclosures in US history, with as many as 2.8 million foreclosures nationwide. All predictions point to an equally devastating 2011.

The banks were made whole on their speculative investments in the California mortgage market. Meanwhile, the catastrophe that these social parasites have left in their wake has directly resulted in the current budget shortfalls for states throughout the nation, and in California in particular. The fiscal emergency at the federal and state levels is being used as a pretext for slashing government services that benefit the working class.