

Opinion: California budget surplus is misleading

By Autumn Carter and Adam Tatum

Apparently, all is well in California. However, politicians and average citizens probably disagree on that point.

Last month, a report by the California Legislative Analyst's Office said we should expect annual budget surpluses through 2019-20, including nearly \$10 billion surpluses each year starting in 2017-18.

Essentially, based on tenuous predictions that have traditionally missed the mark, the LAO is arguing that California's fiscal troubles are over. Nothing could be further from the truth.

One problem is that the optimistic forecasts rely too heavily on big assumptions while discounting the extent of existing problems.

For instance, they assume that from now to 2019-20, the economy and real estate markets will grow robustly, that the stock market will steadily improve each year, and that legislators will keep their spending under control. Perhaps most concerning, they assume that policymakers will continue ignoring the growing unfunded liabilities associated with public employee retirement benefits, thereby allowing those rising costs to further crowd out public services in the budget.

As Gov. Jerry Brown recently stated, "We have deferred maintenance on our roads, that is serious; we have unfunded and growing liabilities in our pension and retiree health – state, university and local level. That's real."

Indeed, it is real. Unfortunately, health, retirement, corrections and debt costs are expected to grow in the coming years, placing continued strain on any California budget – surplus or not.

There is an inherent problem with relying too heavily on long-term forecasts. While they provide value, they merely illustrate a picture of what the future would look like if all assumptions hold true. To their detriment, forecasts are fundamentally rooted in unreliable assumptions.

Further, the LAO took an outdated, 20th-century approach to budget forecasting. It restricted its forecast to money in the general fund, or main operating budget, and ignored special funds. Years ago, special funds accounted for only 20 percent of the state budget. Today however, they account for 33 percent of total state spending. Thus the forecasts completely ignore an increasingly significant portion of the budget.

The LAO has no economic crystal ball, so as with any long-term forecast, error is virtually inevitable. Yet, LAO's forecasting history is littered with inaccuracies.

For instance, in 2006, the LAO predicted that California would have \$128 billion in general fund revenue in 2012. In actuality, the state had only \$87 billion in 2012, reflecting a 32 percent shortfall. While the LAO's short-term forecasts have underestimated revenue by an average \$1.4 billion since it began three- to five-year forecasts in 1998, its long-term forecasts have overestimated them by an average \$8.8 billion.

Consistently inaccurate forecasts bring into question how well the LAO can claim to assess the condition of the underlying economy they reflect.

The report outlines a possible approach to using the forecasted surpluses. It suggests using the additional revenue to fund infrastructure, increase funding to existing programs, create new programs, pay down the state's "wall of debt,"

build an \$8 billion reserve by 2016-17, and reduce taxes.

While it acknowledges the state's massive outstanding retirement liabilities, the report suggests committing only an additional \$500 million each year – or \$3 billion by 2019-20 – to address them. That is nowhere near what's actually required to stabilize the state's severely underfunded retirement systems.

Today, the California State Teachers' Retirement System and the state's retiree health care program have unfunded liabilities of \$71 billion and \$64 billion, respectively. CalSTRS expects to deplete its money by 2043, and many estimate a date closer to the 2020s. To fully fund these plans, the state would have to begin paying an additional \$4.5 billion to CalSTRS and an additional \$4.9 billion for retiree health care each year starting today.

These retirement systems are expensive, but legally, the state is bound to pay the guaranteed benefits they provide to retirees. Finally funding the systems fully would consume the annual forecasted surpluses, transforming them into deficits. Leaving the systems chronically unfunded would raise their annual costs and crowd public services even more. Surplus or not, there is no painless solution here.

California still has serious obligations that its policymakers have ignored and neglected for too long. Californians now pay substantially more to receive substantially less, and repairing the extensive damage goes far beyond predicting higher revenue that may never materialize. Even if the forecasts prove true, all is certainly not well in California.

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