Financial FAQs

California vs. Kansas

By **Harlan Green** / Special to CASA

IN THE GREAT BATTLE BETWEEN PRO-GOVERNMENT AND ANTI-GOVERNMENT POLICIES, California vs. Kansas is a great lesson on economic policy.

As highlighted by Nobelist Paul Krugman, among others, California's government has a Democratic majority, while Kansas is run by its Republican Governor Sam Brownback, with a Republican-dominated legislature.

Kansas has practiced by the book conservative policies—cut taxes for business and the highest income brackets, while cutting government spending (policies that haven't worked in Europe either). While ultra-liberal California Governor Jerry Brown (though he claims to be a fiscal conservative) has both hiked taxes and spending.

The results of their policies are now in – and California has won, at least for the moment. Austerity policies don't work, period.

California now has a budget surplus and better than average job growth. At the same time, growth has stopped in Kansas and it is suffering from a looming budget deficit.

The math is simple. Jobs are created by a demand for something. Businesses don't hire more people if they don't see a rising demand for their products. But some products and services can't be produced by the private sector, such as public works, most educational facilities, environmental regulation, education, and much of research and development of new technologies that private industry doesn't see an immediate profit from, such as space travel.

That is where government hiring fits in and creates those jobs that fill the unemployment void, thus increasing the demand for private sector jobs where employed workers shop and spend their increased incomes.

Even ultra-pro business Forbes Magazine admits that the Kansas economic experiment has failed. "The business boom predicted by tax cut advocates has not happened, and it certainly has not come remotely close to offsetting the static revenue loss from the legislated tax cuts."

As Forbes recounts, "From 2013 to 2014, income tax revenue dropped by far more– $713 million. Since the first round of tax cuts, job growth in Kansas has lagged the U.S. economy. So have personal incomes. While more small businesses were formed, many of them were merely individuals taking advantage of the newly tax-free status of those firms by redefining themselves as businesses."

Whereas California has a budget surplus and has increased both jobs and revenues that have enabled it to hire back at least half of the teachers laid off from the Great Recession. Employment is up 3.6 percent in the past 18 months, compared with a national average of 2.8 percent. At this point, California's share of national employment, which was hit hard by the bursting of the state's enormous housing bubble, is back to pre-recession levels, according to Krugman.

Krugman cites a recent David Cay Johnston article, an authority on corporate finance that highlighted what is behind the California improvements; in particular that higher taxes aren't always bad—in fact, may benefit growth, when applied correctly.

"People may work harder, trying to make more money to achieve a desired after-tax income and may slough off if tax rates are lowered," says Johnston. "This is known to be the case for people who have a savings target for money to leave their children and are subject to estate taxes – they save more to leave the after-tax sum they prefer, but save less when the tax is lowered or no longer applies to them."

But the problem is what to do with those savings, as during the Great Depression. Money sits unused during such times. Financial institutions and individuals hold some $10.8 trillion in basically zero interest assets. Banks and corporations, with record amounts of cash, have put it in speculative investments or ridiculously high executive compensation, and very little is spent in the public sector for needed improvements. For instance, we know low capital tax rates shelter much of hedge fund income. It is one reason there has been so much market volatility that has tended to destabilize financial markets.

The bottom line is that both governments and the private sector have to work together to bring back jobs lost during the Great Recession.

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