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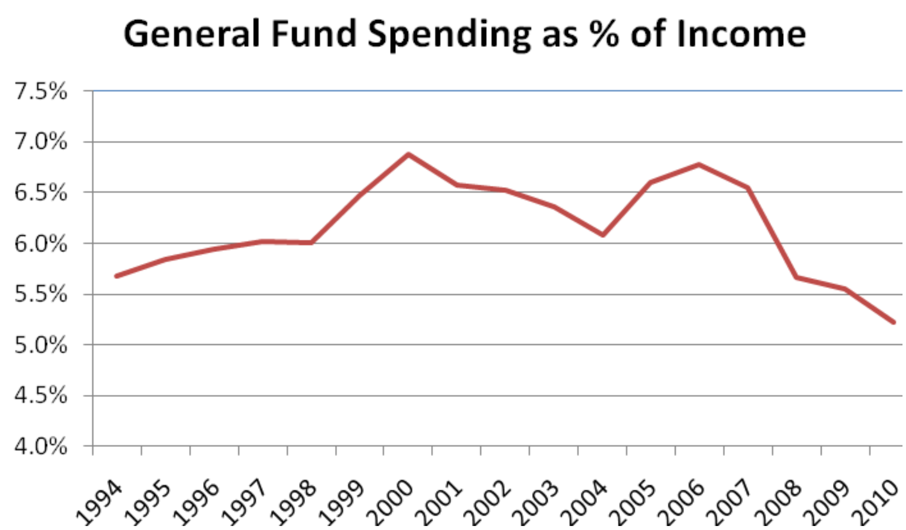
Budget Myth 3 — California's State Budget Has Too Much Spending

Californians regularly hear that the budget is out of balance because the state has a "spending problem". The implication is that spending has grown too fast relative to some objective and measurable standard.

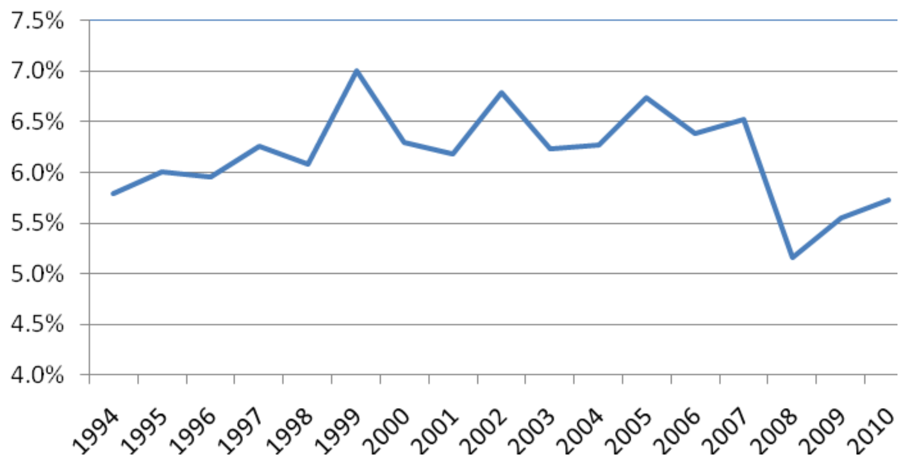
This *Numbers in the* News examines the data. The chart below shows General Fund spending as a percent of total personal income in California. Total personal income is a good measure of the size of the California economy. Keeping state spending as a relatively constant share of the economy is one standard often suggested for the appropriate size of state government spending.



General Fund spending relative to the size of the economy has returned to levels last seen in the 1990s recession and is expected to decline further in this year's and next year's state budgets.

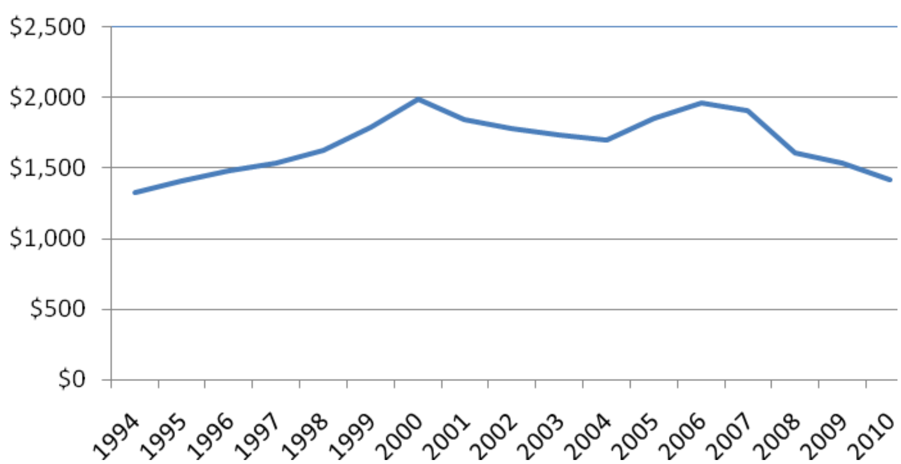
The spending trends mirror the trends in revenues. Revenues as a percent of income reached record lows in the 2008-09 budget. Revenues as a percent of income are expected to increase in the 2009 and 2010 budgets as a result of the temporary tax increases enacted in 2009 but will remain near historically low levels.

General Fund Revenues as % of Income



The data below examine per capita General Fund spending adjusted for inflation as measured by the California consumer price index. Having state spending grow to keep pace with population and inflation growth is another standard often suggested for the appropriate size of state government.

Per Capita Spending Adjusted for Inflation



Real (i.e. inflation adjusted) per capita spending in the proposed 2010-11 General Fund budget is nearly the same as in the 1994-95 budget 16 years ago. Real per capita spending did increase during the dot.com boom and again briefly after 2003 but current per capita spending is below the recent long-term average.

Setting a Standard for How Fast State Spending Should Grow

The charts on pages 1 and 2 illustrate the data relative to the two theories that are often put forth as guides to the appropriate growth rate for state spending:

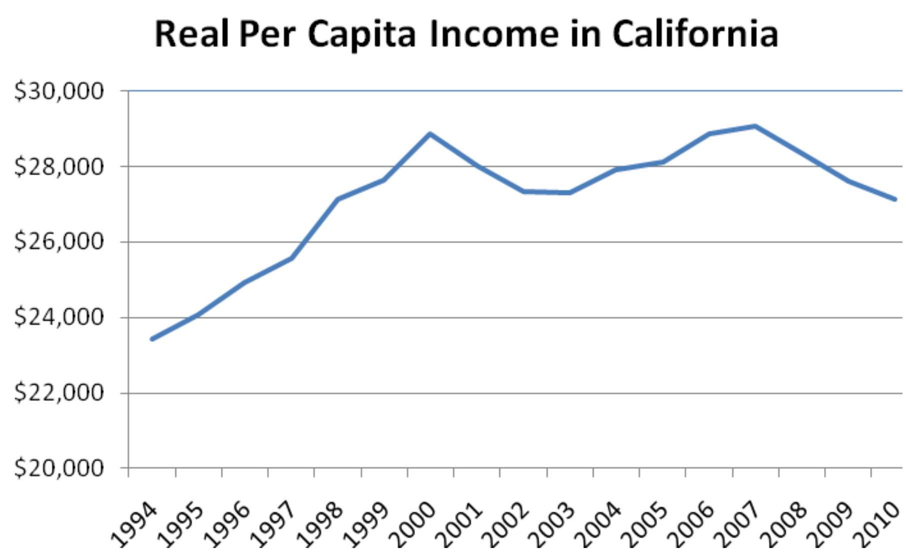
- State spending should grow in line with the economy
- State spending show grow at the same rate as population plus inflation

Both of these standards are artificial in that they aren't based on considerations of supporting the economy, improving quality of life or considerations of fairness. In addition any arithmetic standard based on total population growth cannot take account of the fact that caseloads (e.g. the number of students or prisoners or social service recipients) may grow faster or slower than total population.

The discussion below explains that these two standards produce different results and helps readers understand the differences.

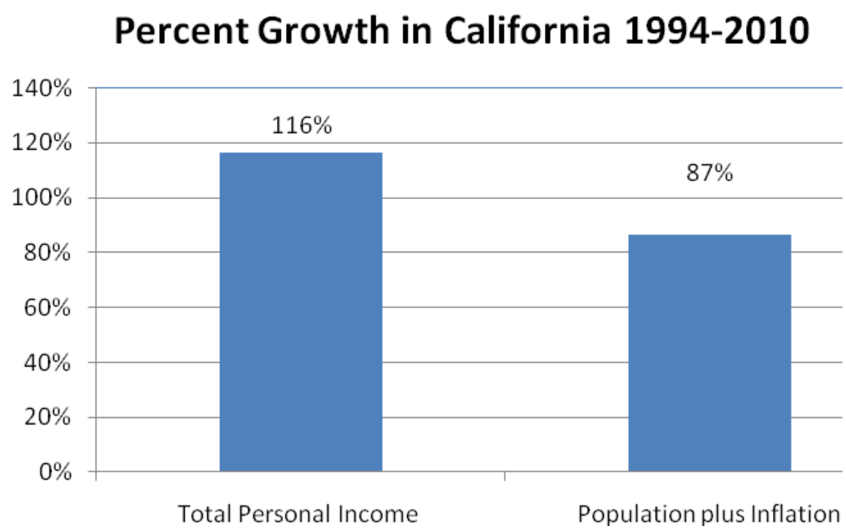
The economy measured by total personal income of residents normally grows faster than population plus inflation. Another way of saying this is that real (i.e., inflation adjusted) per capita income increases over the long term because the economy normally experiences rising productivity. Rising productivity produces increases in income that we associate with a rising standard of living.

Even after taking into account sharp declines in real per capita income in 2008, 2009 and 2010, real per capita income has grown over the past 16 years.



One major difference between the two guides for state spending is whether state services should benefit from increases in real income in the economy.

How much difference is there between the two arithmetic guides to state spending growth? The chart below reflects the growth in total personal income in California compared to the growth in population and the California consumer price index for the period 1994-2010. Both 1994 and 2010 are recession years.



Total personal income increased by 116% during this period while population and inflation combined increased by 87%. State spending growth over this period under the standard of keeping pace with the economy would have been 1/3 higher than if spending matched population and inflation growth.

If state spending only increases as fast as population plus inflation, over the long term state spending will fall as a share of the economy. This is one choice facing elected leaders and residents.

The Starting Point Matters

If an arithmetic standard is ever adopted for the growth of state spending, the choice of a starting point matters a lot. If the 1999-2000 budget were selected, that would lock in the peak dot.com boom spending. Similarly, if the 2009-10 or 2010-2011 budgets are chosen, that locks in the recession-depressed current spending levels.

In order to avoid locking in peak or recession spending patterns, some other starting point for imposing a budget growth rule must be chosen.

Data Sources

The revenue, spending, income and population estimates are from the Governor's 2010-11 budget prepared by the California Department of Finance (DOF). The California consumer price index estimates are also from DOF.