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CALIFORNIA SPENDING BY THE NUMBERS: A HISTORIC LOOK AT STATE SPENDING FROM GOV. PETE WILSON TO GOV. ARNOLD SCHWARZENEGGER

By Adam B. Summers
Project Director: Adrian T. Moore, Ph.D.



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78

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Table of Contents

Introduction.....	1
The Problem Is Spending, Not Revenue	2
Per Capita Spending	4
Holding Spending Increases to Population Plus Inflation Growth	5
Massive Increase in Revenues	7
Large Increase in the Number of State Employees	8
Education Spending Increases	10
Transportation Spending Increases	12
Recommendations.....	13
About the Author.....	14
Endnotes	15

Part 1

Introduction

California is mired in perhaps its worst fiscal crisis ever and two questions are on the minds of policymakers and taxpayers: (1) “How did we get here?” and (2) “How do we solve the problem?”

The scope of this paper is primarily focused on the first question and will examine data covering the stewardship of the past three governors: Pete Wilson, Gray Davis and Arnold Schwarzenegger.¹ For a thorough list of solutions, I would direct the reader to Reason Foundation’s *Citizens’ Budget 2003-05: A 10-Point Plan to Balance the California Budget and Protect Quality-of-Life Priorities*, which provided a comprehensive analysis of the state budget and made numerous recommendations for plugging a budget hole nearly six years ago that was almost as large as today’s.²

With much fanfare, and after a record delay of nearly three months, the current state budget for the 2008-09 fiscal year was signed by Gov. Arnold Schwarzenegger on September 24, 2008. That budget addressed a \$15.2 billion budget shortfall,³ but did so largely by papering over the deficit with accounting gimmicks and pushing it onto next year. That, in conjunction with deteriorating economic conditions, has caused the projected deficit to balloon. According to the Schwarzenegger administration, the budget deficit is now projected at \$41.8 billion over the next 18 months,⁴ up from an already-staggering \$28 billion shortfall estimate made just weeks prior.⁵ Thus, the deficit has now eclipsed the massive deficit of 2003-04, which was estimated between \$26 billion and \$34.6 billion over a similar 18-month timeframe under then-Gov. Gray Davis.⁶

To make the state’s fiscal condition even worse, Standard and Poor’s recently cut California’s general obligation bond credit rating—tying the state with Louisiana for the worst credit rating in the nation—and placed it on a negative credit watch for another potential downgrade.⁷

The state government’s tendency to push tough fiscal decisions into the future, use accounting gimmicks to shift deficits, and to rely upon bonds to finance projects have resulted in today’s massive red ink. Before California’s leaders can reform the budget, they must admit the state has a spending addiction. The following state budget information shows in no uncertain terms that excessive spending is to blame for the \$42 billion deficit.

Part 2

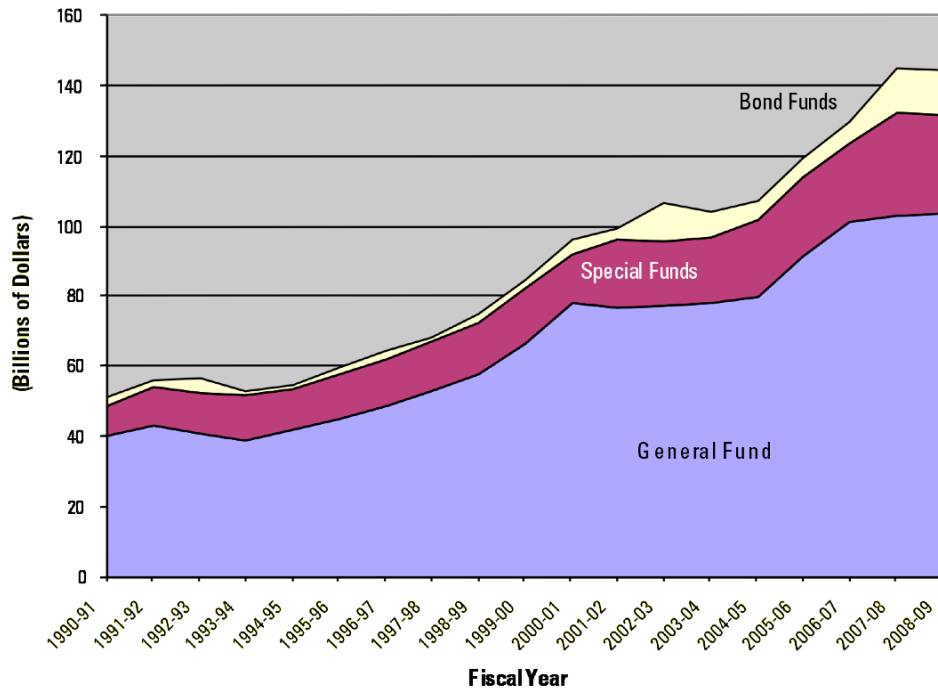
The Problem Is Spending, Not Revenue

While Gov. Schwarzenegger has at times characterized the state's budget problems as the result of runaway spending, he has changed his tune a bit recently. In a December 1, 2008 news release the Schwarzenegger administration claimed "...the dramatic deterioration in revenue projections since the signing of 2008 Budget Act presents an extraordinary situation which, combined with the volatility of our tax system, creates a revenue problem."⁸

Notwithstanding the fact that the state's revenue projections were far too optimistic to begin with, the reason California finds itself in its current fiscal mess is its profligate spending, not any lack of revenues.

Since former Gov. George Deukmejian's final budget in FY 1990-91, state spending—including the General Fund, special funds, and bond funds—has increased 180.9 percent, or an average of 5.91 percent a year. Spending increased from \$51.4 billion in FY 1990-91 to \$96.4 billion 10 years later in FY 2000-01. And spending continued to skyrocket to its current level of \$144.5 billion in FY 2008-09. Since FY 1990-91, General Fund spending alone has increased 156.8 percent, or 5.37 percent a year (see Figure 1).

Figure 1: State Spending, FY 1990-91 to FY 2008-09

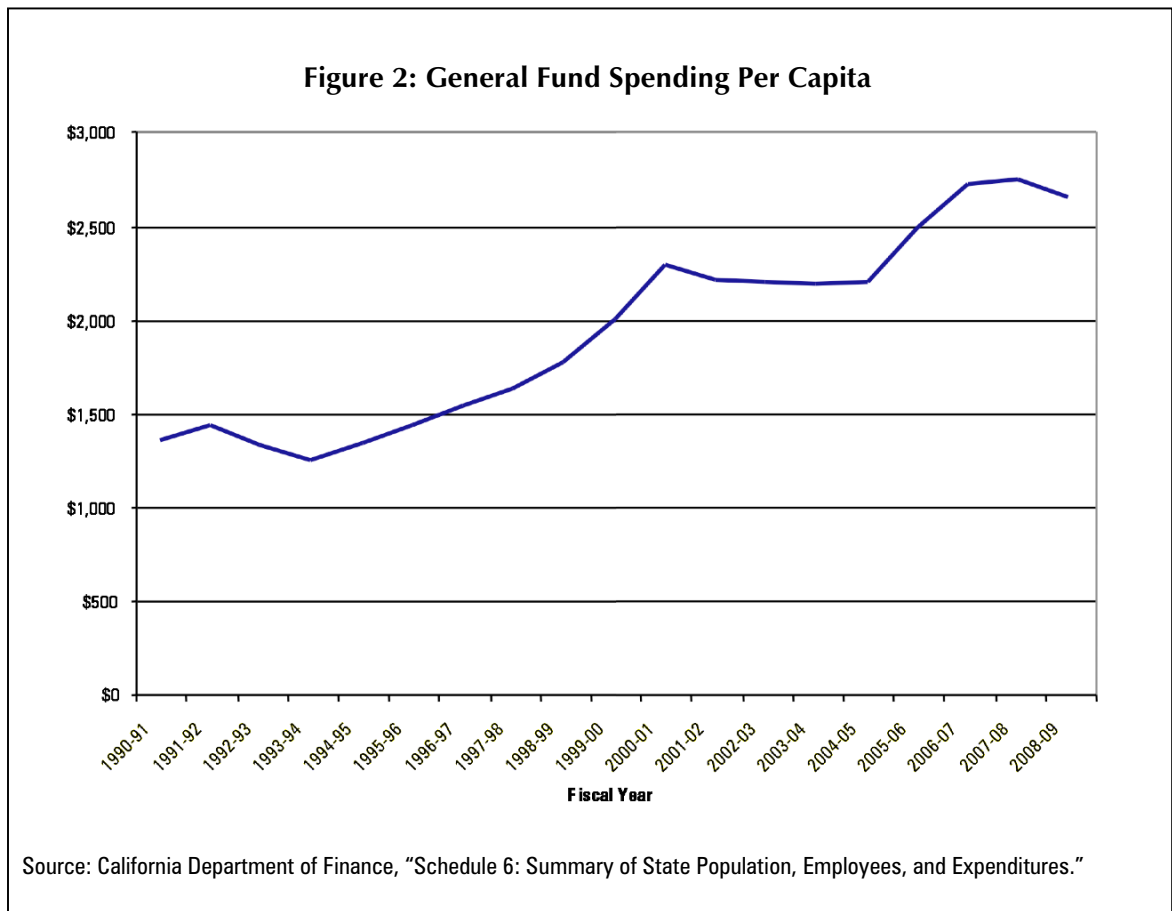


Note: Does not include federal funds. Source: California Department of Finance, "Chart B: Historical Data, Budget Expenditures"

Part 3

Per Capita Spending

A look at General Fund spending per capita reveals a significant increase of 95.9 percent from FY 1990-91 to FY 2008-09 (an average of approximately 3.81 percent a year). In FY 1990-91 the state spent \$1,350 per capita. In FY 2008-09 that number is \$2,644 (see Figure 2).



Part 3

Holding Spending Increases to Population Plus Inflation Growth

A good rule of thumb in government budgeting is that the rate of spending increases should not exceed the rate of population growth plus inflation. For the period under examination here, the state's population increased at an annual rate of 1.38 percent,⁹ and the California Consumer Price Index rose an average of 2.99 percent a year.¹⁰ The combined total of 4.38¹¹ percent a year is easily outpaced by the 5.37 percent average annual increase in General Fund spending.

California's last three governors have not fared so well by this metric. Gov. Pete Wilson managed best, holding average annual spending increases to 4.88 percent, compared to population plus inflation growth of an average of 3.72 percent a year.

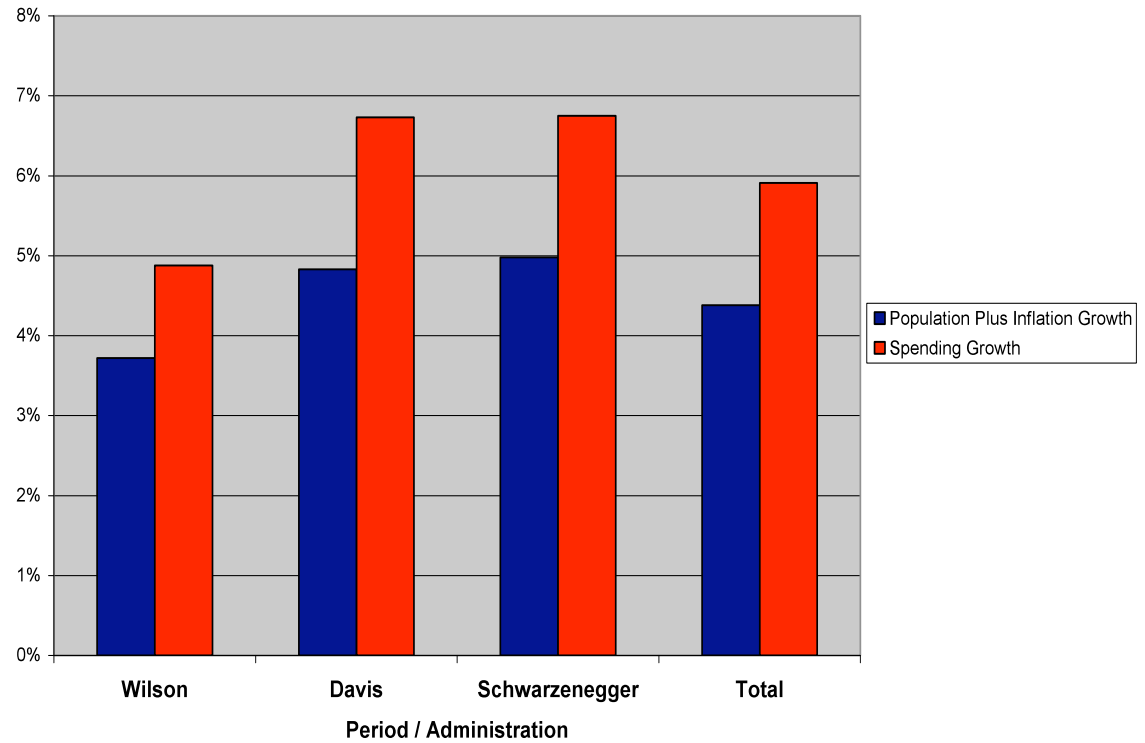
Under Gov. Gray Davis, spending rose an average of 6.73 percent a year versus population plus inflation growth of 4.83 percent.

Spending has grown slightly higher under Gov. Schwarzenegger—even considering that spending in the current fiscal year was basically held flat—increasing 6.75 percent a year, compared with population plus inflation growth of 4.98 percent a year.

Over the entire 18-year period, state spending grew at an average annual rate of 5.91 percent, while population plus inflation grew only 4.38 percent a year, on average (see Figure 3).

Since policymakers have demonstrated repeatedly that they cannot be trusted to restrain spending on their own, California should adopt a spending and/or revenue limit that would cap increases at the rate of population growth plus the rate of inflation.

Figure 3: Average Annual Population Plus Inflation Growth vs. Average Annual Spending Growth



Note: Spending growth data are derived from total state spending data (excluding federal funds).

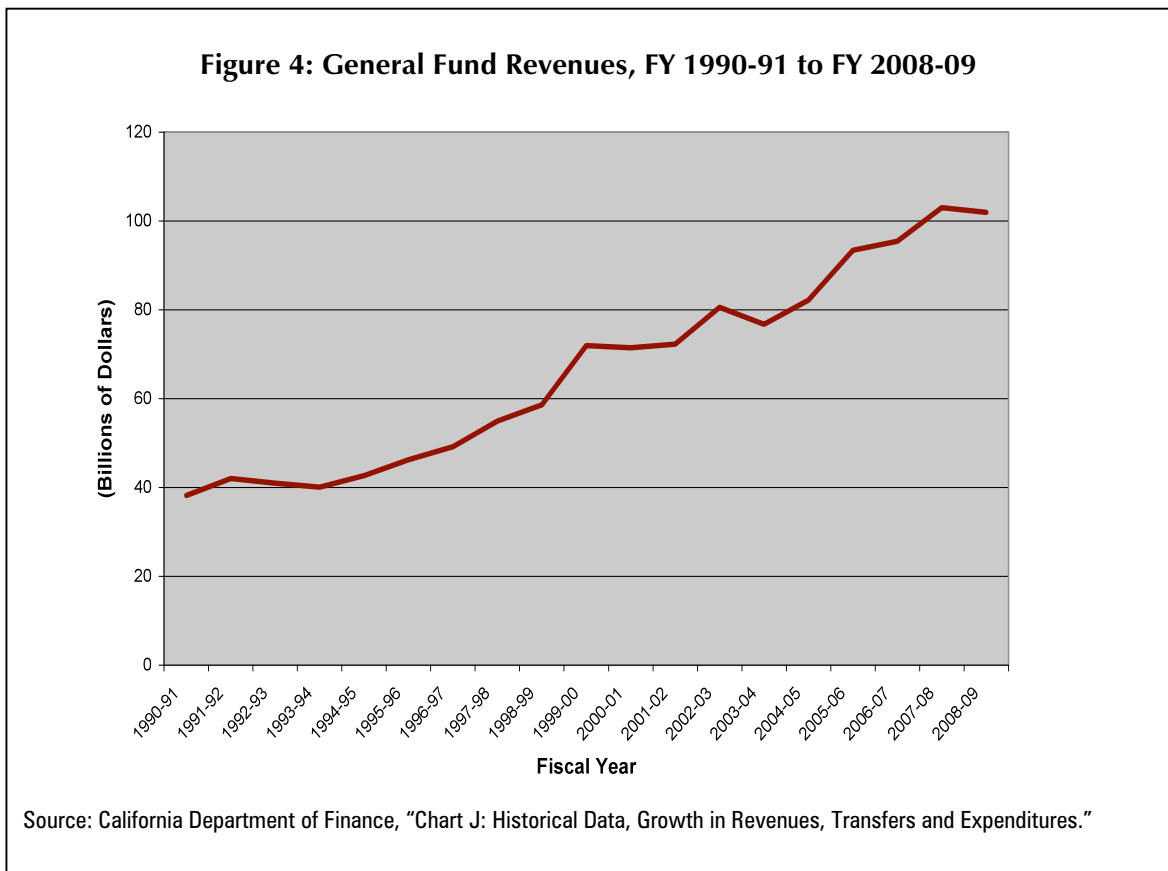
Sources: Population data are from the California Department of Finance (see Schedule 6: Summary of State Population, Employees, and Expenditures). Inflation data are for June of the year in question and were taken from the California Department of Industrial Relations (see "California Consumer Price Index (1955-2008)").

Part 4

Massive Increase in Revenues

Examining the state's revenues clearly demonstrates there is not a revenue problem. Since FY 1990-91, revenues have increased 166.9 percent, or 5.61 percent a year, and have risen rather steadily over this period (see Figure 4).

In FY 1990-91, the state took in over \$38 billion in General Fund revenues. In FY 2008-09 revenues are \$102 billion. Based on these revenues, if California had simply limited its spending increases to the 4.38 percent average increase in the state's consumer price index and population growth each year since FY 1990-91, instead of a \$42 billion deficit, the state would be sitting on a \$15 billion surplus this year.



Part 5

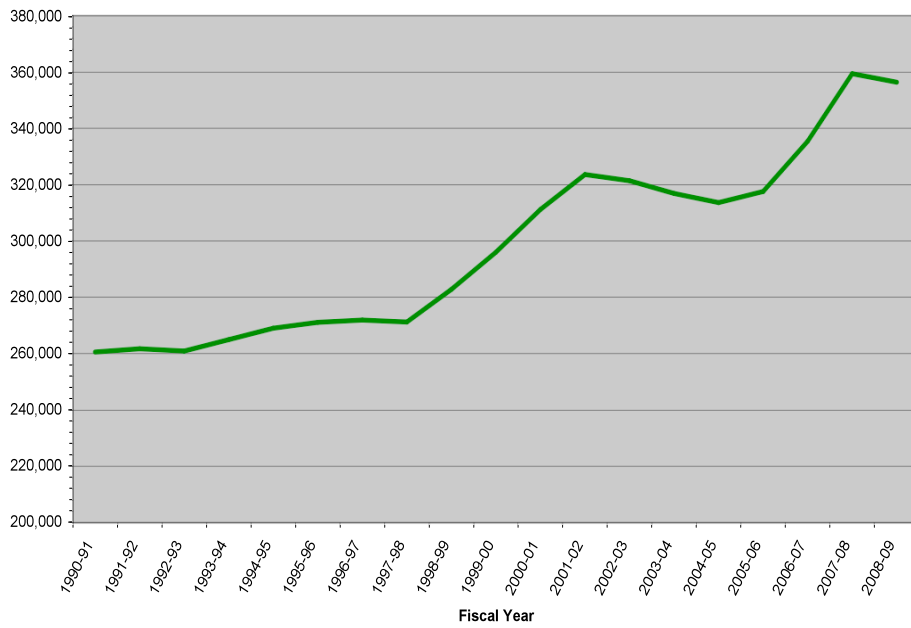
Large Increase in the Number of State Employees

The number of state government employees has risen 36.7 percent from FY 1990-91 to FY 2008-09 (see Figure 5). Today there are over 356,000 state employees. That is 9.3 state employees for every 1,000 people in California.

The level of state government jobs was fairly flat through Gov. Pete Wilson's administration, rose rapidly under the Davis administration until after the "dot-com" bust, retreated slightly at the end of the Davis administration and beginning of the Schwarzenegger administration, and then saw another significant increase in the last couple of years before being slightly lowered this year. The trend is similar when taking changes in the state's population into account (see Figure 6).

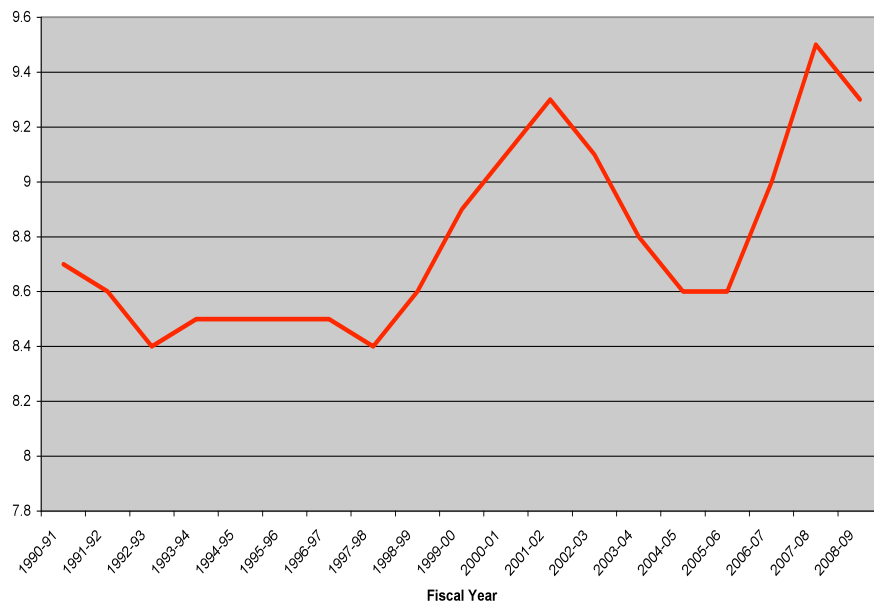
The large increase in state government employees over the years is important because so much of the budget is devoted to employees' wages and benefits, and the salary and benefit levels for public-sector employees are often significantly more generous than those of private-sector workers. California will have to bring its employee compensation into line with that of the private sector if it is to return to fiscal responsibility. Since pension benefits are locked into place for current state employees, any changes to benefit levels can only affect future hires. This means any reductions in benefits (either through the creation of a new benefit "tier" under the current defined-benefit retirement system or by switching to a less generous 401(k)-style defined-contribution system) will not have as much of an immediate impact, but over time the savings could be significant.

Figure 5: Number of State Employees



Source: California Department of Finance, "Schedule 6: Summary of State Population, Employees, and Expenditures."

Figure 6: State Employees per 1,000 Population

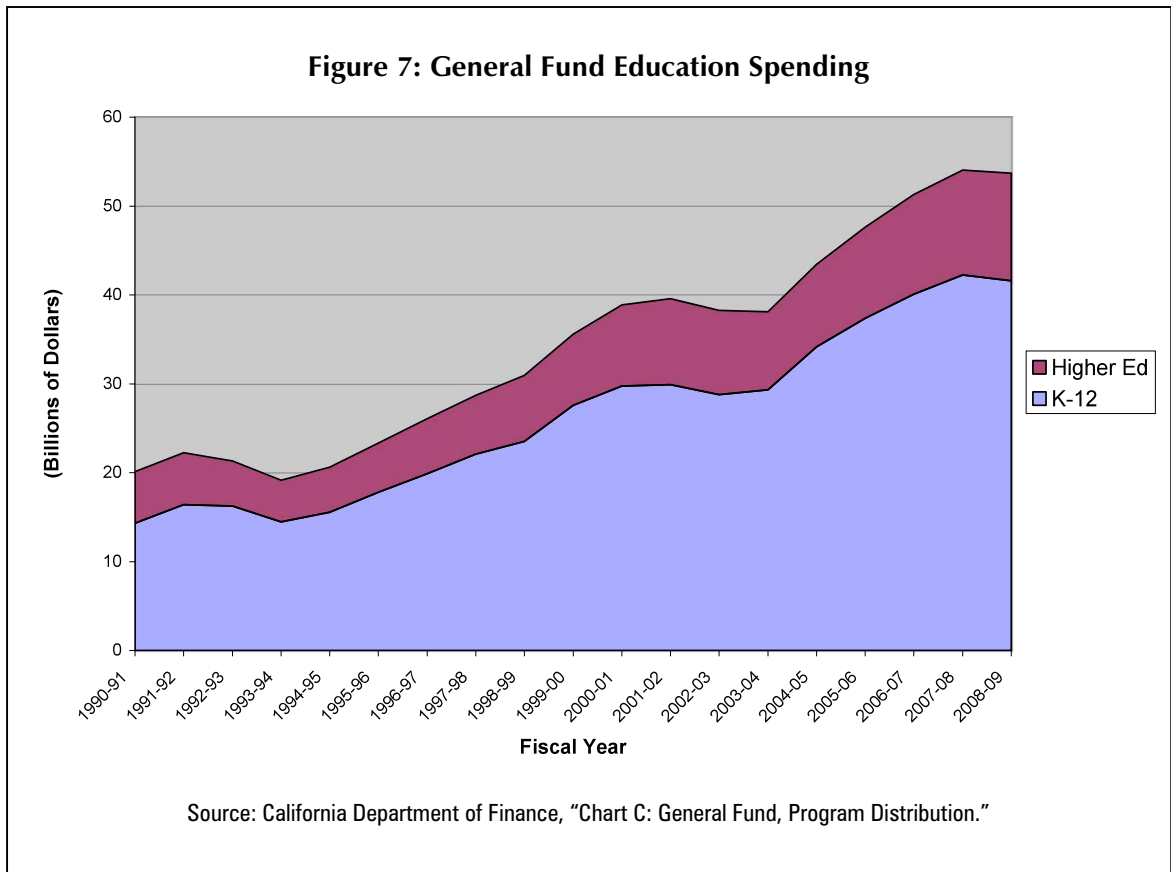


Source: California Department of Finance, "Schedule 6: Summary of State Population, Employees, and Expenditures."

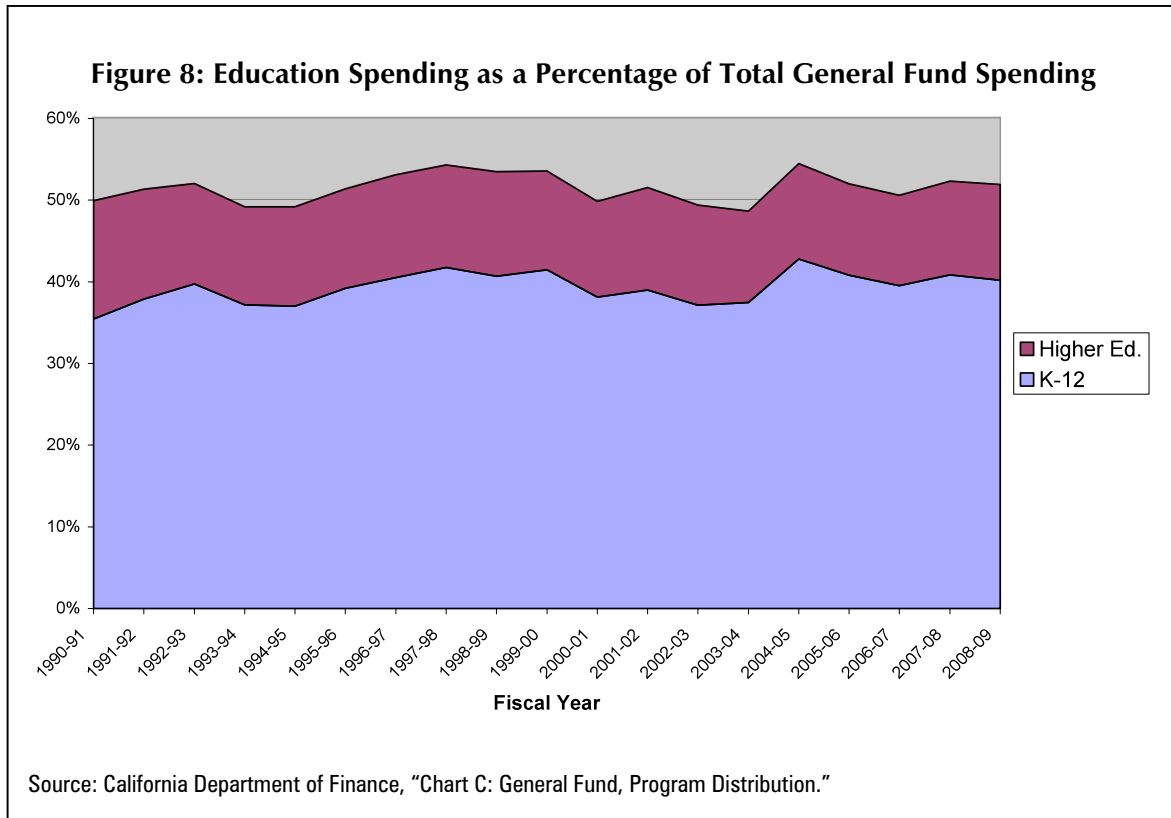
Part 6

Education Spending Increases

To read some reports in the media, one might think that education is the perpetual whipping boy of the state budget process. In fact, education spending—for both K-12 and higher education—has seen a steady and significant increase, especially in recent years. From FY 1990-91 to FY 2008-09, General Fund K-12 education spending increased 191.5 percent (6.11 percent a year on average)—a greater rate than the overall General Fund budget grew. Higher education spending rose 107.7 percent (4.18 percent a year) during the same period (see Figure 7).



Moreover, education spending as a share of the total General Fund budget has remained fairly constant over the years. K-12 education spending has remained between 35 percent and 43 percent of General Fund expenditures throughout the FY 1990-91 to FY 2008-09 period. Higher education spending has comprised between 11 percent and 14.5 percent of the General Fund budget during this time. Note that total education spending makes up more than half of the General Fund budget (see Figure 8).

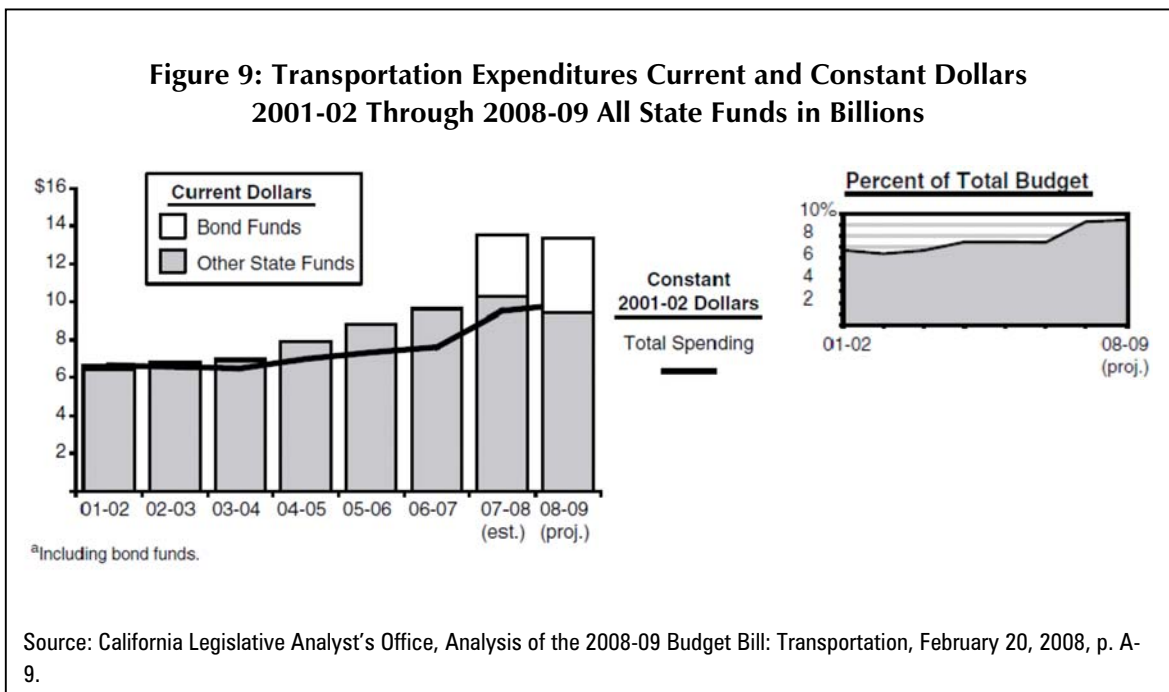


Part 7

Transportation Spending Increases

Despite its importance to the state’s economic health, transportation does not make up nearly as much of the budget one might think, comprising less than 10 percent of General Fund expenditures.¹² But transportation funding has risen significantly in recent years. According to the Legislative Analyst’s Office, state-funded transportation expenditures are projected to more than double from FY 2001-02 to FY 2008-09, increasing an average of about 10 percent a year.¹³ Transportation spending remained relatively constant from FY 2001-02 through FY 2003-04, but jumped significantly over the past couple of years due to the infusion of Proposition 1B money and a lack of raids on transportation funds that had plagued previous budgets (see Figure 9).

In the current economic climate, it is especially important that the government ensure that bond funds are spent wisely, and that the state undertakes only critical transportation and other infrastructure projects, eschewing unnecessary pork-barrel projects.



Part 10

Recommendations

For years, the state's leaders have avoided making the difficult decisions needed to reform the state budget. Those failures led California to its current state of fiscal crisis. The fault lies with both political parties. As the spending and revenue figures demonstrate, California has been on a long-term spending binge that is not sustainable. With the state, and much of the country, in the midst of a significant economic recession, families and businesses are cutting expenses to get by in these tough times. It is time for the state government to do the same.

California state government should finally address its spending addiction by adopting a watertight spending and revenue limit.

With politicians in Sacramento still wrongly suggesting that tax increases are a solution to the current budget crisis, it is clear that a revenue limit is needed. A revenue limit would serve as a way to impose some discipline on state spending, as well as limit the collection of taxes. It would stabilize tax revenues and provide taxpayer protections against excessive taxation.

California should also implement a reserve requirement. This "rainy-day fund" would be used to offset the fluctuations in the economy and business cycle, providing a more consistent expenditure path. When revenues are less than expected, the rainy-day fund would be there to compensate.

The state should also restore its Gann Spending Limit, which was passed in 1979 by over 70 percent of voters. The Gann Spending Limit basically prevented state spending from growing by more than the growth in population and inflation. Any state tax revenue collected above the Gann Limit was supposed to go back to taxpayers via tax rebates. Gann was effective until it was gutted in 1990 by the passage of Proposition 111.

The state should also revisit the *California Performance Review*, which detailed thousands of ways the state could eliminate unneeded programs, streamline duplicate agencies, and get value for state assets that are currently being wasted. There are also countless performance-based reforms, competitive sourcing, and privatization programs that could improve the quality of services the state provides taxpayers while reducing its costs.

There is no shortage of solutions to the state budget crisis, but serious reforms will take leadership and political willpower. The state budget process is broken. It is time for Sacramento to admit it has a spending problem and to undertake real reforms.

About the Author

Adam B. Summers is a policy analyst at Reason Foundation. He has written extensively on privatization, government reform, law and economics, public pension reform, occupational licensing, and various other political and economic topics. Mr. Summers' articles have been published by the *Los Angeles Times*, *San Francisco Chronicle*, *San Diego Union-Tribune*, *Orange County Register*, *Los Angeles Daily News*, *Baltimore Sun*, *Los Angeles Business Journal*, and many others. Summers holds an M.A. in Economics from George Mason University and earned his Bachelor of Arts degree in Economics and Political Science from the University of California, Los Angeles.

Endnotes

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- ¹ Gov. Pete Wilson's first budget was for FY 1991-92. Gov. Gray Davis's first budget was for FY 1999-00. Gov. Schwarzenegger's first budget was for FY 2004-05. For the purposes of calculating budget increases, I have used the data for the previous governor's last budget through the governor in question's last budget. Thus, the total period covers data from FY 1990-91 through FY 2008-09.
 - ² Carl DeMaio, Adrian T. Moore, Adam B. Summers, Geoffrey F. Segal, Lisa Snell, Vincent Badolato, and George Passantino, *Citizens' Budget 2003-05: A 10-Point Plan to Balance the California Budget and Protect Quality-of-Life Priorities*, Reason Foundation and The Performance Institute, April 30, 2003, <http://www.reason.org/citizensbudget.pdf>.
 - ³ Jordan Rau, "Arnold Schwarzenegger signs \$145-billion California budget," *Los Angeles Times*, September 24, 2008, <http://articles.latimes.com/2008/sep/24/local/me-budget24>.
 - ⁴ Judy Lin, "California sliding toward \$41.8B budget deficit," *Sacramento Union*, December 15, 2008, <http://www.sacunion.com/pages/california/articles/11114/>.
 - ⁵ "Schwarzenegger declares fiscal emergency in California," Agence France Presse (AFP), December 1, 2008, http://news.yahoo.com/s/afp/20081202/ts_alt_afp/financeeconomycaliforniaschwarzenegger_081202002605.
 - ⁶ At the time, Gov. Gray Davis's administration had estimated the budget deficit at \$34.6 billion, but then-Legislative Analyst Elizabeth Hill claimed that the administration had overstated the deficit, and pegged the shortfall at \$26.1 billion. Nine months later, Davis was recalled from office and Arnold Schwarzenegger was elected as his replacement. See James P. Sweeney and Michael Gardner, "State's pending deficit put at \$27.8 billion," *San Diego Union-Tribune*, November 12, 2008, <http://weblog.signonsandiego.com/news/state/20081112-9999-1n12deficit.html>.
 - ⁷ Tom Petrino, "S&P lowers California's credit rating," *Los Angeles Times*, December 12, 2008, <http://www.latimes.com/business/la-fi-caldebt12-2008dec12,0,1764754.story>.
 - ⁸ Office of the Governor press release, "Gov. Schwarzenegger Calls New Legislature into a Prop 58 Special Session and Second Special Session to Address State's Economy," December 1, 2008, <http://gov.ca.gov/index.php?/press-release/11159/>.
 - ⁹ For state population data, see California Department of Finance, "Schedule 6: Summary of State Population, Employees, and Expenditures," http://www.ebudget.ca.gov/pdf/BudgetSummary/BS_SCH6.pdf.
 - ¹⁰ For state inflation data, see California Department of Industrial Relations, "California Consumer Price Index (1955-2008)," <http://www.dir.ca.gov/dlsr/CPI/EntireCCPI.PDF>. The

calculations used in this paper used annual CCPI numbers for 1991-2007 and the October figure for 2008 (most recent data).

- ¹¹ This doesn't add up precisely due to rounding of the annual population and inflation growth figures.
- ¹² California Legislative Analyst's Office, *Analysis of the 2008-09 Budget Bill: Transportation*, February 20, 2008, p. A-10, http://www.lao.ca.gov/analysis_2008/transportation/trans_an108.pdf.
- ¹³ *Ibid.*, p. A-8.



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