What is a Structural Budget Deficit?

Many experts believe that California faces a "structural budget deficit." This means that with the current revenue structure (e.g., taxes, fees, and other sources), the state has insufficient income to maintain services at the current level.

Each year, the Legislative Analyst's Office (LAO) publishes a forecast of the California fiscal situation for five years into the future. In November 2003, the LAO's estimate was that without corrective action, the ongoing gap between revenue and expenditures is about $14 billion dollars, assuming that the state continued funding the Vehicle License Fee backfill, as Governor Schwarzenegger has promised it will.

The LAO has also analyzed the budget the governor has proposed for 2004-2005. This budget proposes significant reductions in expenditures. These included reduced expenditures for education, transportation, social services and a ten percent reduction in Medi-Cal reimbursement rates. There are increases in fees, such as increased tuition for higher education, but no increase in general taxes. According to the LAO, about 37 percent of the budget savings are one-time savings. The office concludes that even if the budget were enacted as proposed, the General Fund would face a shortfall of about $88 million for 2004-05, and a continuing structural deficit of about $7 billion dollars.

In its analysis of the 2004-05 budget, the California Budget Project (CBP) attempted to refute the governor's assertion that, "If the government had simply spent at the same rate that California's economy has grown, the state budget would be balanced today." According to the CBP, state spending has not kept pace with growth in personal income. In addition to the loss of revenues from the decline in collection of the personal income tax, the CBP identifies several other areas of revenue loss. These include sales tax (service consumption is growing and not taxed), Internet, mail order sales and the phase-out of federal estate taxes. Moreover, corporations are paying a smaller percentage of their net incomes in corporate income taxes. Shifting costs to local governments also account for some of the savings in the 2004-05 budget.

In its publications the Public Policy Institute of California (PPIC) is essentially in agreement with the CBP and the LAO about the reasons for the current budget situation. It also identifies the drop-off in revenues from personal income tax on stock options and capital gains as the major factor in the decline in General Fund Revenues, and asserts that these revenues are "unlikely to return to peak values in the foreseeable future." The PPIC also points out that voter initiatives limit the flexibility of the state's legislature.

An ongoing activity of the PPIC has been a series of statewide surveys of Californians. A recent survey showed widespread support for the governor but widespread distrust of state government in general. Respondents are generally committed to funding education, local governments, and health and human services. In the responses to the survey about 64 percent stated they would be willing to pay higher taxes to maintain current levels of support for K-12 education. They overwhelmingly opposed an increase in the Vehicle License Fee or state sales tax. They support "sin" taxes—although even doubling the state's tax on cigarettes would have only a very small effect on the state's revenue stream.

With the proposals being considered and the acclaim a state budget agreement will engender, it appears that California's structural budget deficit will continue.