CALIFORNIA BUDGET PROJECT

January 17, 2012

Looking Ahead to November 2012

To date, at least three "major" revenue measures have been filed with the Attorney General's office, along with a number of measures raising lesser amounts of money and/or that are targeted to specific purposes outside of the state's General Fund. This blog post briefly examines the three main proposals: what they tax and the extent to which they help narrow the state's budget gap.

First, some background. The Governor's Proposed 2012-13 Budget identifies a $9.2 billion budget gap and offers $10.1 billion in "solutions" to close the gap and provide a modest reserve. Both the Department of Finance (DOF) and the Legislative Analyst Office's more recent estimate project a shortfall in the range of $12 billion to $13 billion for the remainder of the current and upcoming fiscal years. The Legislative Analyst's estimate, which looks five years in the future, shows the gap slowly narrowing, but not closing over time. Significantly, this projection assumes that none of the spending cuts made in recent years are restored and that the trigger reductions included in the 2011-12 Budget become part of the "base" used to determine future years' spending. Thus, a key consideration in evaluating potential ballot measures must be the extent to which they do, or do not, help bring the budget into balance and limit additional spending cuts.

The three major proposals filed to date include:

- **The Governor's Proposal.** The Governor's proposal would impose three new tax rates on very high income Californians – married taxpayers earning $500,000 or above – and increase the state's sales tax rate by 0.5 percentage points on a temporary basis. The higher income tax rates would apply to 2012 through 2016; the sales tax would be increased from January 1, 2013 through December 31, 2016. The Department of Finance (DOF) estimates that the Governor's proposal would raise an estimated $6.9 billion towards the 2012-13 budget, with $5.8 billion from the tax rates on high-income individuals and $1.2 billion from the higher sales tax rate. Thereafter, the DOF estimates that the measure would raise $6.9 billion per year, with $2.4 billion from the higher sales tax rate and $4.5 billion from the high-income tax rates. The additional revenues would be earmarked for education, but would also count toward the Proposition 98 guarantee, thus "freeing up" General Fund resources to help close the budget gap. The Governor's measure also places the framework for the recent "realignment" of criminal justice and social services programs in the state's Constitution and clarifies that the revenues supporting realignment do not count toward the Proposition 98 guarantee. The Governor's Budget summary assumes that $2.5 billion of the 2012-13 revenues would go towards the higher school funding obligation.

  The Legislative Analyst's Office (LAO) estimates that the revenues raised by the high-income tax rates will be significantly less than the amount assumed by the Governor. Specifically, the LAO

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estimates that the Governor's measure would raise $4.8 billion towards the 2012-13 budget. The LAO does not estimate how much of the additional revenues would increase the Proposition 98 guarantee, but does note that, "the effect of the temporary tax increases would more than offset" the state savings generated by the exclusion of the realignment sales tax revenues.

The bottom line? More than half of the revenues raised by the Governor's proposal would come from the top 1 percent of state income taxpayers, while all Californians, including businesses, would pay the higher sales tax rate.

- **The Millionaire's Tax.** The so-called "millionaires tax," sponsored by the California Federation of Teachers (CFT), would permanently add two new rates to the state's personal income tax: an additional 3 percent on income in excess of $1 million but not over $2 million and an additional 5 percent on incomes of more than $2 million (the 1 percent mental health tax rate would still apply in addition to the two new rates). Revenues raised by the new tax rates would be allocated to K-12 education (36 percent), community colleges (8 percent), and the University of California (8 percent), and the California State University (8 percent), with the remainder allocated to counties for children's and senior services (25 percent), public safety (10 percent), and roads and bridges (4.9 percent). The new tax rates would raise an estimated $5 billion to $6 billion.

  Funds allocated to K-12 education and community colleges would be in addition to the amount guaranteed under Proposition 98, and the measure does not address the shift of revenues from the state to counties under the "realignment" included as part of this year's budget. Thus, it appears that the state would still be obligated to increase school funding as required by language included in the budget agreement. The CFT measure would not directly help close the budget gap, leaving the state facing a $9.2 billion shortfall over the next 18 months and continued gaps thereafter. To close the gap, the Legislature could potentially reduce funding to the UC and CSU or suspend the Proposition 98 guarantee to achieve savings. Due to "mandate" provisions in the state's Constitution, it is unclear whether the state could reduce funding or shift additional responsibilities to counties for public safety or children's and senior services in an amount commensurate with their new revenues. Significantly, none of the moneys for children's and senior services would go to support services wholly or primarily funded by the state or where state laws establish the framework for programs and services, such as SSI/SSP; CalWORKs grant levels and time limits; Medi-Cal benefits and co-payments; and Healthy Families.

- **The "Munger Proposal."** Advancement Project co-director Molly Munger has filed a two measures that would increase personal income for all California taxpayers, including some low-income households that currently earn so little as to have no tax liability. The new rates would be progressive – as is the state's existing personal income tax – that is a higher rate would apply to the incomes of higher-income individuals. The new tax rates would range from a low of a 0.4 percent rate on taxable incomes of married Californians between $14,642 and $34,692 to a high of $68,169 plus 2.2 percent of taxable income above $3,402,944. The measure would raise approximately $10 billion (note: this figure comes from the campaign; an official fiscal estimate has not yet been released). The new tax rates would take effect January 1, 2013 and the allocation of funds would begin in 2013-14.

  Ms. Munger's first measure would allocate 85 percent of the new revenues to K-12 education and 15 percent to early care and education. The new revenues would be in addition to amounts guaranteed under Proposition 98. The measure also includes detailed language governing how the new moneys would be allocated among programs and school districts. Since the new revenues would go to schools in addition to, and not as part of, the Proposition 98 guarantee, the measure would not help close the state's budget gap.

The new tax rates would be adjusted each year for inflation and remain in effect from 2013 through 2024. Similar to the CFT measure, the Munger proposal does not address the address the shift of revenues from the state to counties under the “realignment” included as part of this year’s budget. Thus, it appears that the state would still be obligated to increase school funding from General Fund revenues as required by language included in the budget agreement.

Ms. Munger’s second measure would allocate 30 percent of the revenues raised to payment of debt service owed on school, higher education, and children’s hospital bonds in 2013-14 through 2016-17, 60 percent to K-12 education, and 10 percent to early care and education. For the remaining eight years, 85 percent of the revenue would go to K-12 education and 15 percent to early care and education. Approximately $3 billion would be allocated to bond debt service during the measure’s first four years, which would reduce demands on the General Fund. The measure does not, however, address the exclusion of revenues shifted to counties as part of the 2011 “realignment” of public safety and social service programs, thereby requiring the state to increase the Proposition 98 guarantee through a series of annual “settle up” payments of $400 million. As a result, the measure would provide approximately $2.2 billion to the help close the budget gap in 2013-14, $1.8 billion in 2014-15, $1.4 billion in in 2015-16, and $1.0 billion in 2016-17. The measure would not help address the 2012-13 shortfall.