CALIFORNIA BUDGET PROJECT

Updated March 6, 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 that would raise 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 $10.3 billion in "solutions" to close the gap and provide a modest reserve. Both the Legislative Analyst's Office (LAO) November five-year forecast and the Department of Finance's (DOF) "baseline" forecast that underpins the Governor's Proposed 2012-13 Budget project continued shortfalls over the next five years absent additional spending reductions, revenue increases, or a combination of both. Significantly, both projections assume 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 one-half cent 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 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 and $4.4 billion would be available to help close the budget gap.

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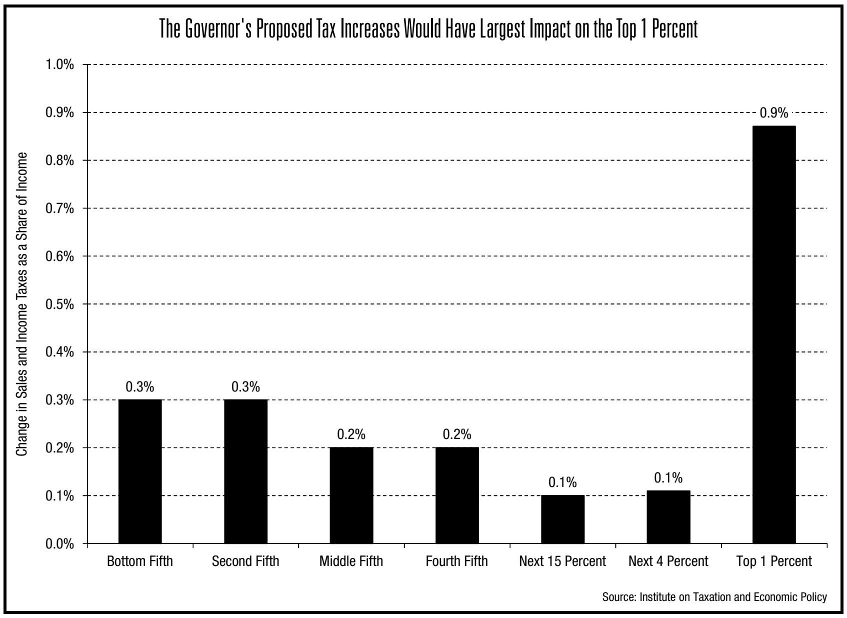
The LAO estimates that the revenues raised by the high-income tax rates would be significantly less than the amount assumed by the Governor. Specifically, the LAO estimates that the Governor's measure would raise $4.8 billion towards the 2012-13 Budget. The LAO does not estimate how much of the additional 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.

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 California Federation of Teachers' Proposal.** The "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), 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). As with the Governor's measure, the DOF and LAO disagree on the amount that would be raised by the new tax rates. The LAO estimates that the proposal would raise about $6 billion in 2012-13 and $4 billion in 2013-14. The DOF estimates that the measure would raise $9.5 billion in 2012-13 and $6 billion in 2013-14.

  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.

Significantly, the Legislature could not direct the expenditure of funds for children's and senior services, including funds that 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. Due to the restriction that funds support services provided to seniors and children, but not adults who are not seniors and/or disabled, the new revenues could not be used to restore cuts to services provided to adults, such as cuts to CalWORKs' welfare-to-work services or restore dental benefits for adults, except for seniors, affected by the elimination of dental coverage for adults who receive health coverage through Medi-Cal. Finally, due to provisions of the State's Constitution that require the state to reimburse local governments for a "new program or higher level of service," the Legislature could not require counties to use the additional revenues to backfill particular programs or services. Moreover, the CFT measure states "funds…shall not be subject to appropriation, reversion, or transfer by the Legislature, the Governor, the Director of Finance, or any other state official or agency."

- **The "Munger Proposal."** The "Our Children, Our Future" proposal sponsored by Advancement Project co-director Molly Munger would increase personal income tax rates for all California taxpayers, including some low-income households that currently earn so little as to have no tax liability, and allocate the new revenues to K-12 education, early childhood education, and, for four years, to repayment of General Obligation bond debt. The new tax 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 $14,632 and $34,692 to a high of $50,149 plus 2.2 percent of taxable income above $5 million. The LAO projects that the measures would raise approximately $10 billion in 2013-14, and approximately half that amount in 2012-13, while the DOF projects that the measure would raise about $11 billion in 2013-14 and half that amount in 2012-13. The new tax rates would take effect January 1, 2013. The measure could not be amended by the Legislature and subsequent changes would require voter approval.

  The Munger proposal would allocate 30 percent of the revenues raised to payment of debt service owed on school, higher education, children's hospital, and other General Obligation bonds until the end of 2016-17, 60 percent – $6 billion to $6.5 billion – to K-12 education, and 10 percent – $1.1 billion to $1.2 billion – to early care and education. For the remaining years, 85 percent of the revenue would go to K-12 education and 15 percent to early care and education. Approximately $1.5 billion in 2012-13 and $3 billion to $3.3 billion per year until 2016-17 would be used to pay debt service costs that would otherwise paid out of the state's General Fund, thus generating commensurate savings. 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 savings to the General Fund would be reduced by $400 million in 2012-13, $800 million in 2013-14, $1.2 billion in 2014-15, $1.6 billion in 2015-16, and $2.0 billion in 2016-17.