

## WHAT WOULD PROPOSITION 63, THE MENTAL HEALTH SERVICES ACT, MEAN FOR CALIFORNIA?

Proposition 63, the Mental Health Services Act, will appear on the November 2004 ballot. Proposition 63 would impose an additional 1 percent tax on individuals' taxable income over \$1 million to provide dedicated funding to expand mental health services for children, adults, and seniors. Proponents of the measure include physicians, nurses, mental health service providers, hospitals, and public safety organizations.

The following analysis examines the potential fiscal and policy impacts of Proposition 63. The California Budget Project neither supports nor opposes this measure. This analysis is designed to highlight the potential impacts of Proposition 63 to help voters make informed policy choices.

### WHAT DOES PROPOSITION 63 DO?

Proposition 63 would impose an additional 1 percent tax on individuals' taxable income over \$1 million to provide dedicated funding to expand mental health services for children, adults, and seniors. The Legislative Analyst's Office (LAO) estimates that the measure would generate approximately \$275 million in 2004-05, \$750 million in 2005-06, \$800 million in 2006-07, and "probably increasing amounts annually thereafter."<sup>1</sup> The estimated 2005-06 revenues are about 26 percent of 2004-05 Budget Act funding for county mental health programs.

Proposition 63 specifies that the new revenues must be used to provide:

- *Services for children with severe mental illness through the existing Children's System of Care model.* Proposition 63 would increase funding for community-based services provided through the existing Children's System of Care model. This model requires interagency collaboration to improve the planning and delivery of services to children with mental illness.<sup>2</sup>
- *Services for adults and seniors with severe mental illness through the existing Adult and Older Adult System of Care model.* Proposition 63 would increase funding for community-based services provided through the Adult and Older Adult System of Care model. This model requires a comprehensive and coordinated system of care, including community-based treatment, outreach services, early intervention strategies, and case management. In 1999, the state established and funded a pilot program to serve homeless adults with serious mental illness to test this system of care model.

- ***Innovative programs.*** Innovative programs would include services that increase access for underserved groups, increase the quality of services, promote interagency collaboration, and increase access to services.
- ***Prevention and early intervention programs designed to prevent mental illness from becoming severe and disabling.*** Services would include conducting outreach to detect the early signs of potentially severe and disabling mental illness and providing access to medically necessary care. In addition, this program would aim to reduce the stigma associated with being diagnosed with a mental illness and seeking mental health services, as well as to reduce discrimination against people with mental illness.
- ***Education and training programs to address the shortage of qualified mental health service providers.*** The Department of Mental Health (DMH) would be required to develop a five-year education and training plan to address the shortage of staff who provide mental health services.
- ***Capital facilities and technology needed to provide mental health services.*** All plans for proposed facilities with restrictive settings would have to “demonstrate that the needs of the people to be served cannot be met in a less restrictive or more integrated setting.”<sup>3</sup>

Proposition 63 would create a Mental Health Services Oversight and Accountability Commission to oversee the Children’s System of Care, Adult and Older Adult System of Care, education and training, innovation, and prevention and early intervention programs included in this measure.<sup>4</sup>

Proposition 63 specifies that the proposed Mental Health Services Act may only be amended by the Legislature to further the intent of the initiative and that any legislated changes must be approved by a two-thirds vote of the Legislature.<sup>5</sup>

## **HOW ARE MENTAL HEALTH SERVICES CURRENTLY PROVIDED?**

In California, counties administer local mental health programs.<sup>6</sup> Current law requires counties to provide services to individuals who have a severe mental illness, to the extent that resources are available. There are no income eligibility requirements for individuals to receive services.

## **California Moves Toward Community-Based Treatment**

Over the past several decades, California’s mental health system has moved increasingly toward a community-based service delivery system. The Short-Doyle Act of 1957 supported the development of community-based mental health services as an alternative to institutionalization. Prior to 1957, many individuals requiring mental health services were treated in state hospitals. Subsequently, California passed other laws to facilitate the use of community-based mental health services. Community-based services include short- and long-term treatment and case management.

## Current Mental Health Funding

In 1991, the state significantly changed the governance structure for mental health programs to support local delivery of services. Under “realignment,” the state shifted 100 percent of program and funding responsibility for certain mental health services to the counties, including community-based services.<sup>7</sup> Counties were given the flexibility to allocate resources based on program effectiveness and local priorities. Realignment provided counties with a dedicated funding source to finance the new program responsibilities consisting of an increase in both the sales tax rate and the Vehicle License Fee.

Counties receive federal and state General Fund dollars to cover the costs of mental health services provided to low-income individuals under the state’s Medi-Cal Program.<sup>8</sup> Counties also receive federal dollars for mental health services provided to children under the Healthy Families Program.<sup>9</sup> Other sources of funding for county mental health services include federal and state funding for specific projects and the Traumatic Brain Injury Fund (Table 1).<sup>10</sup>

<b>Table 1: Funding for County Mental Health Programs 2004-05 Budget (Dollars in Thousands)</b>	
County Realignment Funds	\$1,128,258
Federal Funds	\$1,091,347
General Fund	\$669,119
Traumatic Brain Injury Fund	\$1,219
Total Funds	\$2,889,943

Source: Department of Mental Health Summary of 2004-05 Budget Act

There have been a number of efforts at the state level to increase funding for mental health services due to a concern that the need for services is not being adequately met.

## How Would Proposition 63 Increase Revenues?

Proposition 63 would impose an additional 1 percent tax on taxable income over \$1 million. These revenues would be deposited into a new Mental Health Services Fund.

### One Percent Tax on Incomes over \$1 Million

Proposition 63 would impose an additional 1 percent tax on the portion of taxpayers’ personal taxable income that exceeds \$1 million in tax years beginning on or after January 1, 2005. For example, a taxpayer with \$1.5 million of income would pay an additional \$5,000 – equivalent to the 1 percent rate applied to \$500,000. The \$1 million threshold would not be adjusted annually for inflation and could not be reduced by any of the state’s various tax credits.

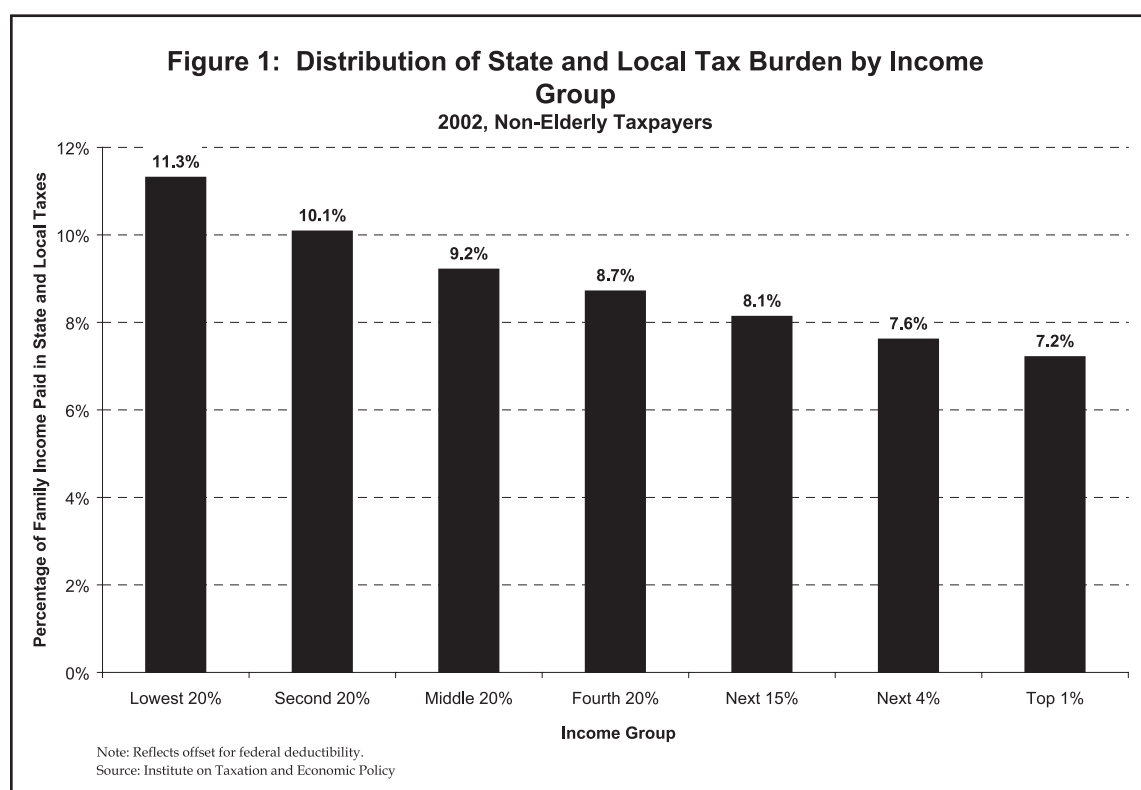
The additional tax rate would be in addition to the state’s six current tax brackets.<sup>11</sup> Currently, the state’s highest tax rate is 9.3 percent, which applied in 2003 to that portion of a taxpayer’s income exceeding \$39,133 for single persons, \$78,266 for married taxpayers, and \$53,267 for heads of household.

California's current income tax law allows married taxpayers to file either joint or separate returns. Married taxpayers filing separate tax returns are taxed on the income reported on their separate return. Proposition 63 would apply the 1 percent tax to the portion of the combined income of a married couple that exceeds \$1 million.

Proposition 63 provides a mechanism for distributing funds to the Mental Health Services Fund on a monthly basis and a reconciliation process for matching actual annual revenue collections with the monthly allocations.

## Who Pays Taxes in California?

California has a progressive personal income tax: higher-income households pay a larger share of their income in taxes. Overall, however, the state's lowest income households pay a larger share of their income in state and local taxes. This apparent discrepancy results from the fact that low-income households pay little or no personal income tax, but pay a larger share of their income in sales and excise, such as fuel or cigarette, taxes (Figure 1).



In 2002, the most recent year for which data is available, taxpayers with incomes of \$1 million or more accounted for 0.2 percent of personal income tax returns, reported 10.2 percent of the Adjusted Gross Income (AGI), and paid 21.6 percent of the personal income tax.

## Opponents' Arguments

The opponents of Proposition 63 argue that the income tax is a volatile revenue source that shouldn't be relied upon and that millionaires have been leaving the state. In fact, the personal income tax has posted the strongest growth over time of the state's major taxes and the number

of millionaires in California rose during the early 1990's when California imposed higher tax rates on high-income taxpayers.

- *Is the personal income tax a volatile revenue source?* Critics argue that the personal income tax is unreliable and that the state should not increase its reliance on revenues from this tax source. While revenue did drop significantly earlier in the decade, the personal income tax has historically posted the strongest growth of any of the state's major taxes. Between 1971-72 and 2004-05, the average annual increase in personal income tax revenues was 11.4 percent. In contrast, sales tax revenues for each 1 percent rate increased by 7.4 percent; corporate income tax revenues increased by 9.0 percent; and insurance gross premiums tax collections increased at an average annual rate of 9.2 percent during the same period.
- *Are millionaires leaving California?* Critics of increasing taxes on high-income individuals frequently argue that it will encourage these individuals to leave California. Tax return data suggests that this is not the case. In 1990, the year prior to the imposition of 10 percent and 11 percent tax rates on high-income individuals, 9,580 personal income tax returns reported AGI in excess of \$1 million. In 1995, the last year that the 10 percent and 11 percent rates were in effect, 11,585 tax returns reported AGI in excess of \$1 million. The number of millionaires increased through the 1990s and then fell in 2001 when the national economy entered a recession.

## HOW WOULD THE STATE ALLOCATE PROPOSITION 63 FUNDS?

The state would allocate most of the increased revenues to county mental health programs.<sup>12</sup> Proposition 63 would require each county mental health program to develop and annually update a three-year plan for these programs with local stakeholders.<sup>13</sup> The DMH would approve the county plans after review and comment by the proposed Mental Health Services Oversight and Accountability Commission.

Monies from the Mental Health Services Fund would be allocated as follows:

In 2004-05:

- 45 percent for education and training programs;
- 45 percent for capital facilities and technology;
- 5 percent for local planning; and
- 5 percent for state implementation.

In 2005-06 through 2007-08:

- 10 percent for education and training programs;
- 10 percent for capital facilities and technology;
- 20 percent for prevention and early intervention programs; and
- 60 percent for the Children's System of Care and Adult and Older Adult System of Care programs.

In 2008-09 and each year thereafter:

- 20 percent for prevention and early intervention; and
- 80 percent for the Children's System of Care and Adult and Older Adult System of Care programs.<sup>14</sup>

## HOW WOULD PROPOSITION 63 FUNDS BE TREATED IN THE BUDGET PROCESS?

Proposition 63 establishes mechanisms to ensure that additional revenues raised by the measure are used exclusively to expand mental health services:

- *Proposition 63 funds would not be subject to the regular budget process.* All monies from the Mental Health Services Fund would be automatically appropriated. This means that the funds generally would not be subject to appropriation by the Legislature through the regular budget process.<sup>15</sup>
- *Proposition 63 funds could not be used to supplant existing funds.* The funds would have to be used to expand mental health services, and could not be used to generate budget savings by replacing existing state or county funds for mental health services.<sup>16</sup>
- *Proposition 63 funds could not be loaned to support non-mental health programs.* The funds could not be loaned to a state or county fund for any purpose beyond those included in the proposed Mental Health Services Act. For example, the funds could not be loaned to the General Fund to support other state programs, such as transportation.

## HOW WOULD PROPOSITION 63 AFFECT THE STATE BUDGET?

Proposition 63 could have several impacts on the state budget, depending on how counties implement the proposal:

- *Significant savings in certain non-mental health program areas.* This could occur to the extent that more persons with mental illness receive effective treatment. The LAO estimates the state and local agencies could save hundreds of millions of dollars annually due to reduced costs for state prison and county jail operations, medical care, homeless shelters, and social services programs.<sup>17</sup>
- *Potential state costs in other programs.* The expansion of mental health services could increase state costs in the Medi-Cal Program for general health coverage or the Supplemental Security Income/State Supplementary Payment (SSI/SSP) Program.<sup>18</sup> The state pays the non-federal share of costs in the Medi-Cal Program and the SSP portion of the SSI/SSP payment. The increased costs could occur to the extent that providing more mental health services leads to higher referrals and subsequent enrollment in SSI/SSP or Medi-Cal health coverage.
- *Additional federal funds.* The LAO suggests that the proposed expansion of county mental health services could result in the receipt of additional federal funds for mental health services under the Medi-Cal Program.<sup>19</sup> The LAO estimates that, depending on



how the state and counties implement the proposal, the amount of additional federal funds could exceed \$100 million annually.<sup>20</sup>

## WHAT POLICY ISSUES DOES PROPOSITION 63 RAISE?

Proposition 63 would create a new set of spending obligations with a new dedicated funding source outside the budget process. This raises some policy considerations:

- *How should existing mental health funding be treated?* Proposition 63 would require the state to maintain the same level of General Fund support for mental health programs as provided in 2003-04. Thus, the initiative would essentially earmark a portion of the General Fund for mental health programs. This does not take into account potential needs in other programs that rely on the General Fund, such as an increased demand for higher education or other health and human services programs due to population growth. In tight fiscal years, the state would have to reduce spending in these other programs or find another source of funding in order to maintain state General Fund dollars for mental health services as required by Proposition 63.
- *How should funds be allocated?* Proposition 63 specifies that fixed percentages of the proposed new revenues be used for various purposes. Under realignment, however, counties were given broad flexibility to use realignment funds to meet local priorities. If program needs or priorities change, it would not be possible to adjust the allocation percentages without subsequent voter approval or a two-thirds vote of the Legislature.

## WHAT DO PROPONENTS CLAIM?

Proponents claim that Proposition 63 could “save taxpayers hundreds of millions of dollars annually by reducing expenses for medical care, homeless shelters and law enforcement.” According to proponents, Proposition 63:

- Provides comprehensive mental health care for children, adults, and seniors;
- Helps individuals and families without insurance, or whose insurance doesn’t pay for needed services;
- Includes mental health treatment, general medical care, housing, job training, and prescription drugs;
- Is paid for by a 1 percent tax on income over \$1 million – people earning less than \$1 million per year won’t pay anything extra;
- Supports innovative programs that are proven to work; and
- Requires annual oversight and accountability procedures to ensure funds are properly spent.<sup>21</sup>

## WHAT DO OPPONENTS CLAIM?

Opponents claim that Proposition 63 “is a flawed attempt to fix a serious problem.” Opponents claim that the measure “forces the Legislature to continue funding existing mental health programs at their current levels, regardless of effectiveness or efficiency,” and “pins the hopes and needs of thousands of Californians upon a narrowly-drawn segment of a few taxpayers’ incomes.”<sup>22</sup>

## CONCLUSION

Proposition 63 would provide new funding for mental health services through a dedicated new revenue source and maintain existing funding for similar services. Proposition 63 funds would be appropriated and allocated outside the regular budget process. On the one hand, the initiative would ensure that the funds are only used for specified purposes. On the other hand, the initiative locks in the allocation of the new funds and the use of existing funds for similar services. In assessing Proposition 63, voters should consider how these issues might affect policy outcomes.

## ENDNOTES

<sup>1</sup> LAO analysis of Proposition 63, downloaded from [http://www.ss.ca.gov/elections/bp\\_nov04/public\\_display/06\\_pub\\_dsply\\_prop\\_63b.pdf](http://www.ss.ca.gov/elections/bp_nov04/public_display/06_pub_dsply_prop_63b.pdf) on August 16, 2004.

<sup>2</sup> Proposition 63 would also make changes to a section of state law that authorizes counties to provide children with alternatives to group home care through expanded family-based services that include “wrap-around” intervention services. The measure would require the Department of Social Services (DSS) to seek federal approval to maximize the number of children eligible for federal funding and eliminate any regulatory limitations on the number of children who can be served by these programs. Proposition 63 would also allow DSS to use a portion of the new revenues for technical assistance to counties in establishing and administering wrap-around services programs.

<sup>3</sup> The initiative does not define “capital facilities,” “technology,” “restrictive setting,” or “more integrated setting.”

<sup>4</sup> The Commission would include 16 members: the Attorney General, the Superintendent of Public Instruction, the chairperson of the Senate Health and Human Services Committee or another member of the Senate, the chairperson of the Assembly Health Committee or another member of the Assembly, two persons with a severe mental illness, a family member of an adult or senior with a severe mental illness, a family member of a child who has or has had a severe mental illness, a physician specializing in alcohol and drug treatment, a mental health professional, a county sheriff, a superintendent of a school district, a representative of a labor organization, a representative of an employer with fewer than 500 employees, a representative of an employer with more than 500 employees, and a representative of a health care services plan or insurer.

<sup>5</sup> Proposition 63 also allows the Legislature to add provisions to the proposed Mental Health Services Act to “clarify procedures and terms” by majority vote, rather than a two-thirds vote.

<sup>6</sup> The Department of Mental Health also operates state hospitals that provide inpatient care to persons with serious mental illness.

<sup>7</sup> In addition to mental health services, California realigned the state and local relationship for various health and human services programs by shifting program responsibilities to local governments and changing cost-sharing requirements.

<sup>8</sup> Medi-Cal is California’s version of Medicaid, a federal-state program that provides health coverage for low-income families and individuals. The federal government provides matching funds for mental health services provided to individuals under Medi-Cal. The state provides General Fund dollars to counties to match the federal Medicaid funds. The General Fund allocation for certain Medi-Cal mental health services is capped.

<sup>9</sup> The Healthy Families Program provides low-cost health coverage to children with family incomes too high to qualify for Medi-Cal, up to 250 percent of the federal poverty level.

<sup>10</sup> The Governor vetoed \$19.7 million of the \$20 million provided by the Legislature for the Children’s System of Care in the 2004-05 Budget. The Traumatic Brain Injury Fund includes revenues from penalties on traffic violations.

<sup>11</sup> The additional rate would apply in addition to the bracket structure specified in state law. For example, if the Legislature added 10 percent and 11 percent rates on high-income taxpayers, as has been proposed as part of recent budget debates, Proposition 63’s 1 percent rate would apply in addition, resulting in a 12 percent rate on income exceeding \$1 million.

<sup>12</sup> A portion of the new revenues could also be used for state administration of mental health services.

<sup>13</sup> The plan would cover programs for prevention and early intervention; Children’s System of Care; Adult and Older Adult System of Care; innovation; capital facilities and technology; and education and training. The plan would also address the establishment and maintenance of a prudent reserve.

<sup>14</sup> The actual allocations in 2005-06 and beyond could vary because up to 5 percent of total annual revenues received starting in 2005-06 may be used for state and local administration, and the 20 percent allocation for prevention and early intervention could be increased under specified circumstances. In addition, there are specific requirements within some of the allocations: 5 percent of the total allocations for prevention and early intervention, Children’s Sys-



tem of Care, and Adult and Older Adult System of Care would have to be used for innovative programs in 2005-06 and beyond; an unspecified portion of the funds for Children's System of Care and Adult and Older Adult System of Care could be used for capital facilities, technology, human resources, and a reserve after 2007-08; and up to 5 percent of the allocations must be used for development of the three-year county plans and subsequent updates in 2005-06 and beyond.

<sup>15</sup> Proposition 63 also states that if there are still additional revenues available in the Mental Health Services Fund after the Mental Health Services Oversight and Accountability Commission has determined there are prudent reserves and no unmet needs for any of the programs, the Legislature may appropriate the additional revenues for any purpose consistent with a plan adopted by the Commission.

<sup>16</sup> Specifically, the state must continue to provide "financial support for mental health programs with not less than the same entitlements, amounts of allocations from the General Fund and formula distributions of dedicated funds as provided in the last fiscal year which ended prior to the effective date of this act."

<sup>17</sup> LAO analysis of Proposition 63, downloaded from [http://www.ss.ca.gov/elections/bp\\_nov04/public\\_display/06\\_pub\\_dsply\\_prop\\_63b.pdf](http://www.ss.ca.gov/elections/bp_nov04/public_display/06_pub_dsply_prop_63b.pdf) on August 16, 2004.

<sup>18</sup> The SSI/SSP Program provides combined federal (SSI) and state (SSP) cash payments to low-income individuals who are aged, blind, or have a disability to help them meet basic needs and living expenses.

<sup>19</sup> This assumes the federal government would match new local funds for certain eligible mental health services.

<sup>20</sup> LAO analysis of Proposition 63, downloaded from [http://www.ss.ca.gov/elections/bp\\_nov04/public\\_display/06\\_pub\\_dsply\\_prop\\_63b.pdf](http://www.ss.ca.gov/elections/bp_nov04/public_display/06_pub_dsply_prop_63b.pdf) on August 16, 2004.

<sup>21</sup> California Secretary of State, *Official Voter Information Guide – Public Display*, downloaded from [http://www.ss.ca.gov/elections/bp\\_nov04/public\\_display/06\\_pub\\_dsply\\_prop\\_63c.pdf](http://www.ss.ca.gov/elections/bp_nov04/public_display/06_pub_dsply_prop_63c.pdf) on August 30, 2004.

<sup>22</sup> California Secretary of State, *Official Voter Information Guide – Public Display*, downloaded from [http://www.ss.ca.gov/elections/bp\\_nov04/public\\_display/06\\_pub\\_dsply\\_prop\\_63e.pdf](http://www.ss.ca.gov/elections/bp_nov04/public_display/06_pub_dsply_prop_63e.pdf) on August 30, 2004.

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*Agnes Lee and Jean Ross prepared this Brief. The California Budget Project (CBP) neither supports nor opposes Proposition 63. This Budget Brief is designed to help voters reach an informed decision based on the merits of the issues. The CBP was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. Support for the CBP comes from foundation grants, publications, and individual contributions.*

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