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Should the Sales Tax on Gasoline Be Constitutionally Dedicated to Transportation?

Proposition 42, which will appear on the March 2002 ballot, would amend the state's constitution to permanently dedicate the sales tax paid on gasoline to transportation. The proceeds of this tax are currently deposited in the state's General Fund where they help support the diverse array of programs and services that rely on the state's general purpose revenues. This measure was placed on the ballot by the Legislature as ACA 4, which was passed as part of the 2001-02 budget agreement.

What Would Proposition 42 Do?

If enacted by the voters, Proposition 42 would:

- Permanently dedicate the sales tax paid on gasoline to transportation.
- Allocate transferred revenues to highways, streets and roads, and public transit. Specifically, the measure would allocate 20 percent of the funds toward public and mass transportation; 40 percent to transportation capital improvement projects; 20 percent to street and highway maintenance and repair conducted by cities; and 20 percent to street and highway maintenance and repair conducted by counties. The allocation of funding could only be modified by a two-thirds vote of each house of the Legislature.
- Require a two-thirds vote of the Legislature to suspend the transfer and a proclamation by the Governor that continuing the transfer would have a significant negative impact on other state programs.
- Take effect in 2003-04.
- Require voter approval for any subsequent change.

Where Do the Sales Taxes Paid on Gas Go Now?

Before 2000-01, the proceeds of the sales taxes paid on gasoline were deposited into the state's General Fund.[1] General Fund revenues, including revenues from the sales tax levied on gasoline, support K-12 and higher education, health care, social services, and other programs and services supported by the state's general purpose revenues.

AB 2928 of 2000 (Chapter 91, Torlakson), part of the 2000-01 budget agreement, transferred revenues from the sales tax paid on gasoline to a new Traffic Congestion Relief Fund for the period July 1, 2001 through June 30, 2006. However, the transfer was deferred for two years (2001-02 and 2002-03) as part of the 2001-02 budget agreement in order to help address the deficits anticipated in the 2001-02 and 2002-03 budgets. The delay returned \$1.1 billion to the state's General Fund in 2001-02 and \$1.2 billion in 2002-03. Under the measure passed as part of the budget agreement, the transfer would be extended to 2006-07 and 2007-08.

The original 2000-01 measure also specified how the transferred revenues would be spent. Proposition 42 maintains the funding allocation adopted in that original measure.

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What Does it Mean to Constitutionally Dedicate a Revenue Source?

Under current law, the Legislature has the authority to spend the revenues collected from the sales tax on gasoline for any purpose. These revenues can be deposited in the General Fund to help pay for programs and services that rely on the General Fund, or the Legislature can choose to dedicate the proceeds for transportation or any other specific program. The Legislature can also choose to spend the proceeds one way in one year (i.e., for transportation in 2000), and a different way the next (i.e., to help eliminate a deficit in the state's General Fund in 2001).

Proposition 42 would permanently dedicate the proceeds of the sales tax paid on gasoline to transportation, unless:

- The Governor issues a proclamation stating that the transfer would cause a significant negative impact on programs funded by the state's General Fund; and
- The Legislature suspends the transfer by a two-thirds vote of each house.[2]

Proponents of Proposition 42 argue that the state's unfunded transportation needs are substantial and that additional investment is needed to address this need. Moreover, proponents argue, unless funding for transportation is "locked in" by the constitution, lawmakers will divert the proceeds to other purposes. Proponents also argue that fuel-related taxes have traditionally been dedicated to transportation and that it is appropriate to use sales taxes paid on gasoline for transportation, as well.

Opponents argue that earmarking revenues in the constitution limits the ability of future Legislatures to respond to changing fiscal conditions and policy priorities. In general, dedicating or "earmarking" revenues for specific purposes in the constitution limits the ability of the Legislature to address future budget shortfalls. This year's budget situation illustrates the importance of flexibility. Had the Legislature not had the ability to redirect the proceeds of sales taxes paid on gasoline back to the General Fund, an additional $1.1 billion in reductions would have been needed to bridge the state's 2001-02 budget gap. Programs at risk of additional reductions would have included education, health, local government, environmental protection, housing, and public safety.

Other Revenue Sources are Already Dedicated to Transportation

The state constitution already dedicates the proceeds of fuel (gas, diesel) taxes to transportation. These taxes are anticipated to raise $3.2 billion for transportation in 2001-02. In addition, vehicle registration fees are earmarked for transportation-related public safety and regulatory activities. Vehicle registration fees will raise an estimated $1.95 billion in 2001-02.

Proposition 111 of 1990 amended the state constitution to dedicate the sales taxes paid on the 9-cent per gallon gas tax increase imposed by that measure to public transportation. This provision will raise an estimated $293 million in 2001-02. In addition, many counties have local-option sales tax rates that fund transportation programs.

Ballot Measures Earmark an Increasing Share of State Revenues

Since 1988, a series of ballot measures have dedicated revenue sources for specific purposes. Revenue sources earmarked at the ballot box include:

- Proposition 99 of 1988 – Dedicates the proceeds of a $0.25 per pack tax on tobacco to health and tobacco education activities ($355 million in 2001-02).

- Proposition 172 of 1993 – Dedicates the proceeds of a ½-cent sales tax rate to local public safety programs ($2.4 billion in 2001-02).
- Proposition 10 of 1998 – Dedicates the proceeds of a $0.50 per pack tax on cigarettes and tobacco products to child development programs ($662 million in 2001-02).

How Much of the Budget is Already Locked In?

In order to evaluate the impact of earmarking additional state General Fund resources, it is useful to examine how much flexibility the Legislature currently has over state spending. State revenues include those dedicated to special funds, which must be spent for specific purposes, and General Fund revenues that can be spent for any purpose. Based on revenue estimates prepared at the time the 2001-02 Budget was adopted, General Fund revenues will account for 82 percent of total 2001-02 revenues.

Another approach would look at how the state spends General Fund revenues. There is no precise definition of which state expenditures are mandatory and which expenditures are discretionary. At a minimum, mandatory expenditures would include those required by or specified in the state constitution (including revenues dedicated to specific purposes in the constitution), expenditures mandated by voter approved initiatives, or expenditures used to meet federal matching requirements. Even this definition is difficult to apply. For example, voters approved the "Three Strikes" initiative (Proposition 184 of 1994) imposing stiff prison terms on repeat offenders. While longer sentences increase state costs for Corrections, there is no way to determine how much of the Corrections budget goes for costs related to the "Three Strikes" initiative and how much goes for costs related to prisoners who committed crimes with sentences which could be modified by the Legislature.

Using a very minimal definition of mandatory spending, 41 percent of the state General Fund expenditures are discretionary, i.e., expenditures over which the Legislature has control through the annual budget act. However, this estimate treats all expenditures for programs as fundamental to the operation of the state, such as the court system, transportation (including the Highway Patrol and Department of Motor Vehicles), higher education (other than Community College expenditures covered by the Proposition 98 guarantee), and Corrections, among others, as "discretionary."[3] In reality, the Legislature has the ability to reallocate a far smaller share of the budget.

A modestly expanded definition of "mandatory" that includes costs for Legislative, Judicial, and Executive branch functions, tax collection, the Highway Patrol, corrections, and benefits paid to retired state employees leaves 30 percent of state General Fund expenditures as discretionary. Even this "expanded" definition treats all state expenditures for the University of California and California State University system, environmental protection, housing, and resources, among others, as discretionary.

Proposition 42 Also Specifies the Distribution of Funds Within Transportation

As noted above, Proposition 42 would allocate the proceeds of the sales taxes paid on gasoline to public transit (20 percent); transportation projects funded through the State Transportation Improvement Program, which provides a five-year blueprint for transportation investment priorities (40 percent); and local street and road improvements (20 percent to cities, 20 percent to counties). A two-thirds vote of each house of the Legislature would be required to modify the distribution formula.

By specifying an allocation formula, Proposition 42 makes it difficult for the Legislature to respond to changing priorities in future years. A minority of the Legislature could, for example, prevent an increase in the share of funds for mass transit.

Fiscal Impact

The Legislative Analyst estimates that Proposition 42 would allocate approximately $1.4 billion for specified transportation programs beginning in 2008-09.[4] State law currently allocates these revenues to the state's General Fund in 2001-02 and 2002-03 and to transportation programs in 2003-04 through 2007-08.

Conclusion

California's transportation infrastructure is in need of substantial public investment. However, a constitutional amendment would unduly tie the hands of future Legislatures, limit the ability of the Legislature to respond to changing transportation priorities, and force deep reductions in other essential services in the event of an economic downturn.

Endnotes

[1] A small portion of the sales taxes paid on gasoline, the portion attributable to the tax on the 9-cent per gallon increase in the gasoline tax approved by the voters in 1990, is already constitutionally dedicated to transportation.
[2] Proposition 42 also requires that the bill suspending the transfer does not contain unrelated provisions, so that the suspension could not be done as part of the annual budget act.
[3] Expenditures classified as mandatory were state contributions to employees' retirement plans; state funds used to match federal Medicaid (i.e., Medi-Cal), Foster Care, Child Welfare Service, Child Support, and Temporary Assistance for Needy Families dollars; Proposition 98 spending; debt service; and reimbursement to local governments for property taxes lost as a result of the homeowners' exemption. Based on estimated 2000-01 General Fund expenditures from the *2001-02 Governor's Budget Summary.*
[4] Legislative Analyst's Office, *Proposition 42 Assembly Constitutional Amendment 4 (Resolution Chapter 87, Statutes of 2001) Dutra. Transportation Funding: Sales and Use Tax Revenues* (November 2001) downloaded from http://www.lao.ca.gov/initiatives/2002/42_03_2002.htm.

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