



## RECOMMENDATIONS ON THE BUDGET AND BUDGET PROCESS

### CALIFORNIA WORKING FAMILIES POLICY SUMMIT JANUARY 13, 2009

#### **POLICY OBJECTIVE #1**

**Allow the legislature to pass the state budget and measures increasing state taxes by a majority vote.**

#### *Background*

California is the *only* state in the nation that requires more than a majority vote of its legislature to approve the budget *and* any measure increasing state taxes. The double supermajority vote requirements have led to long budget stalemates and ongoing imbalances between revenues and expenditures. Just three states – California, Arkansas, and Rhode Island – require a supermajority vote to approve a state budget plan under all circumstances and twelve states – not including either Arkansas or Rhode Island – require a supermajority vote for any tax increase. Moreover, California is the only large, diverse state to require a supermajority vote.<sup>i</sup>

The impact of California's supermajority vote requirements is magnified by the discrepancy between the vote required to cut and the vote required to raise state taxes. Since 1993, lawmakers have enacted tax cuts that cost California \$12 billion in lost revenues in 2007-08. During the same period, there have been virtually no ongoing tax increases.<sup>ii</sup> Changing the vote requirement for passage of a budget alone would leave the disparity for tax measures in place and would create even more pressure for budgets to be balanced solely on the spending side of the ledger.

#### *Recommended Action*

Amend the state constitution to require a majority vote of the legislature to pass a budget and any tax increase needed to balance the budget.

#### **POLICY OBJECTIVE #2**

**Raise significant new revenues in 2009 to address the state's widening budget gap from sources that take into account a) the fact that lower-income Californians pay the largest share of their incomes in state and local taxes and b) the differential impact of various revenue proposals on the state's economy.**

#### *Background*

Recent years' budgets have been largely balanced using a combination of spending reductions, borrowing, one-time measures, and accounting gimmicks. While the 2008-09 budget agreement included a temporary tax increase, the measure enacting that increase will result in a net tax cut beginning in 2010-11, worsening the state's ongoing budget gap.<sup>iii</sup> The legislature has not enacted a permanent tax increase of measureable magnitude since 1991.<sup>iv</sup> As a result of the ongoing tax cuts described above and trends in the state's population which is growing, aging, and becoming more diverse, California faces a structural gap between revenues and expenditures, that even in good economic times, leaves the state facing deficits of approximately \$10 billion per year.

The structure of any tax increase used to help balance the budget is important for several reasons. First, economic modeling shows that low- and middle-income Californians pay the largest share of their income (11.7 percent for the lowest quintile in 2007, after taking into account the deductibility of some state taxes for federal tax purposes) in state and local taxes, while the highest income Californians pay a much smaller share (7.1 percent for the wealthiest one percent in 2007, again taking federal deductibility into account). Potential tax increases should be evaluated by the extent to which they would widen or minimize this disparity. Second, economists argue that carefully targeted tax increases, and specifically income tax increases on high-income earners, are the best approach during an economic downturn.<sup>v</sup>

### ***Recommended Action***

Efforts to close the widening budget gap should include a sizeable tax increase that is targeted to those with the greatest ability to pay and who currently pay the lowest share of their income in taxes and that minimizes the impact of any such increase on the economy.

## **POLICY OBJECTIVE #3**

### **Adopt a comprehensive approach for evaluating state spending and tax policies.**

#### ***Background***

Each year, the Legislative Analyst's Office (LAO) and Budget Subcommittees of each house conduct a thorough review of state spending. The LAO prepares its "blue book" examining each area of spending in detail, with a particular emphasis on proposed changes in funding levels. The Budget Subcommittees, in turn, review each line item in the budget, taking testimony from state department and agency staff, the Governor's Department of Finance, the Legislative Analyst, and stakeholders and advocates. State tax expenditures – credits, deductions, exemptions, and other deviations from the state's basic tax structure – in contrast, are not reviewed on a regular basis and, in particular, are not evaluated in the context of "on budget" spending with similar policy goals. For example, the state's child and dependent care tax credit is not reviewed as part of the Budget Subcommittees' review of other state child care programs, and the effectiveness of the state's enterprise zone tax benefits is not compared to the impact of other state spending aimed at addressing the needs of low-income communities. Integrating the evaluation of tax policies with on budget spending would enable lawmakers and the public to more effectively target state policy goals and to make better use of scarce resources.

#### ***Recommended Actions***

- A. Integrate review of state tax policies with the Budget Subcommittee process and allow resources to be reallocated between on budget spending and tax expenditures.
- B. Equalize the vote requirements for increasing and decreasing state taxes.

**For more information about these recommendations, visit the California Budget Project's website at [www.cbp.org](http://www.cbp.org).**

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<sup>i</sup> In 2007, California's population was 36.6 million, the next largest state to require a supermajority vote for any state tax increase is Washington, with a 2007 population of 6.5 million.

<sup>ii</sup> In 2008, lawmakers voted to tighten the use tax requirement for vehicles and vessels purchased out of state, which would raise 2008-09 revenues by an estimated \$16 million. In 1993, lawmakers voted to increase the cigarette tax by 2 cents per pack to support breast cancer research and education, raising approximately \$23 million in 2006-07.

<sup>iii</sup> Changes made as part of the 2008-09 budget agreement will reduce corporate tax collections by an estimated \$650 million in 2010-11 and \$965 million in 2011-12.

<sup>iv</sup> During the intervening years, voters have approved several measures, notably Proposition 10 of 1998 and Proposition 63 of 2004 that dedicated new tax revenues to early childhood and mental health programs respectively.

<sup>v</sup> California Budget Project, *Budget Cuts or Tax Increases: Which Are Preferable During an Economic Downturn* (July 2008).