



California Pan-Ethnic Health Network



Investing in a Future for All Californians

A Primer on California Budget
and Tax Policy



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The California Pan-Ethnic Health Network

CPEHN works to ensure that all Californians have access to quality health care and can live healthy lives. We gather the strength of communities of color to build a united and powerful voice in health advocacy. You can find more information about our advocacy campaigns on the state budget and tax policy at the Policy Center on our website at www.cpehn.org/policycenter.php.

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California has one of the most diverse populations in the country, with a rich tradition of multiple cultures and languages. People of color make up more than half of the state's population, and more than 40% of Californians speak a language other than English at home. While each community of color is unique, we all share a common commitment to safe, healthy lives for our families. This includes access to quality childcare and education for our children; security and good wages in our jobs; safety and dignity for our aging parents; clean air and water inside and outside our homes; and affordable health care for our families. As the most populous state in the U.S., California faces significant challenges in providing these opportunities for all residents, and at the same time holds the potential to do so by drawing on the strengths offered by such a diverse population. Creating the conditions in which our families, communities, and our state as a whole can thrive requires an investment in strong public systems and structures, as well as policies that ensure everyone benefits.

California is facing some of the worst economic conditions since the Depression. At a time when most Californians are hurting, policymakers' main response has been to cut important public services. In the last four years, the state has cut nearly 20% from our public systems,¹ including early childhood education programs, services for seniors and people with disabilities, aid to local school districts, public health services, and vision and dental benefits for adults on Medi-Cal.² We are ranked 45th among the 50 states for per student spending in public schools, and fees for state universities have more than tripled since 1990-91.³ Cash assistance grants have been cut to 1989 levels and only buy half of what they did twenty years ago.⁴ All of this comes at a time when families are facing high unemployment rates, home foreclosures, and skyrocketing health care costs.

While everyone is feeling the effects of the recession, a disproportionate number affected by the state's economic challenges are people of color, making up 85% of California's non-elderly population living below 133% federal poverty level (\$27,464 for a family of four)**⁵ and 76% of California's uninsured population.**⁶ At a time when our families are struggling to make ends meet, our communities have been among the hardest hit by cuts to programs and services.

* Calculation uses inflation-adjusted fees

** As of 2007

*** As of 2008

The current economic crisis is more than a result of the national recession; it has been aggravated by policy factors unique to California, where lack of investment in the well-being of all residents has made it hard for our state to recover. A revenue shortfall built into our budget and a broken tax and budget process are the primary factors intensifying the crisis brought on by the national recession. To help you understand California's ongoing budget challenges, this policy brief will provide a general overview of some of the state's budget and tax policies and outline factors fueling our current budget crisis. As part of CPEHN's effort to advocate for a tax system that promotes the health of all Californians, the brief also poses key questions to help you analyze new budget and tax proposals based on the impact they would have on communities of color.



I. BRIEF BACKGROUND ON CALIFORNIA'S BUDGET

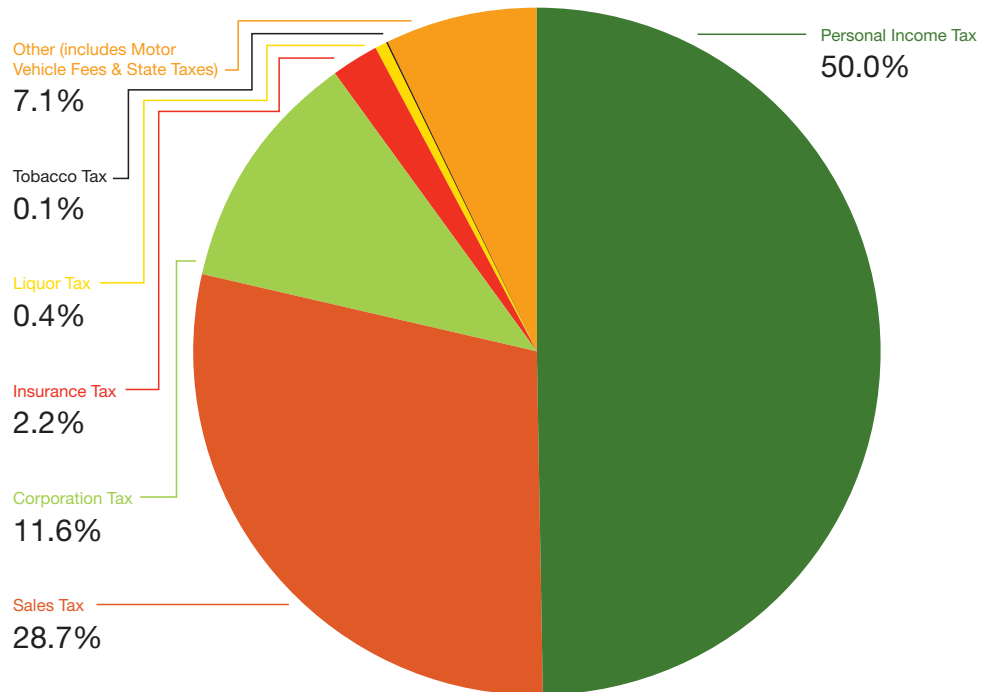
California's state budget is the largest in the country, with \$86.6 billion in expenditures for the 2010-11 General Fund. It is passed annually and, unlike the federal government, must be balanced every year (though what the state considers "balanced" is often based on a variety of assumptions, such as how much the state will receive from the federal government). In addition to the General Fund, the state also manages special funds, bond funds, and federal funds that provide benefits to all Californians, such as highways, child and youth programs, and clean water projects.

A. Where Our State Money Comes From:

Personal income tax is the largest single state revenue source, making up 50.0% of the state's revenue. Other large revenue streams include sales tax (28.7%) and corporation tax (11.6%), as shown in the chart below.⁷

California is a "moderate" tax state when all state and local taxes are taken into account, balanced by ranking relatively high in terms of personal and corporate income taxes but ranking relatively low in terms of taxes on sales, property, vehicle fuel, and alcohol.⁸

General Fund Revenue 2010-11



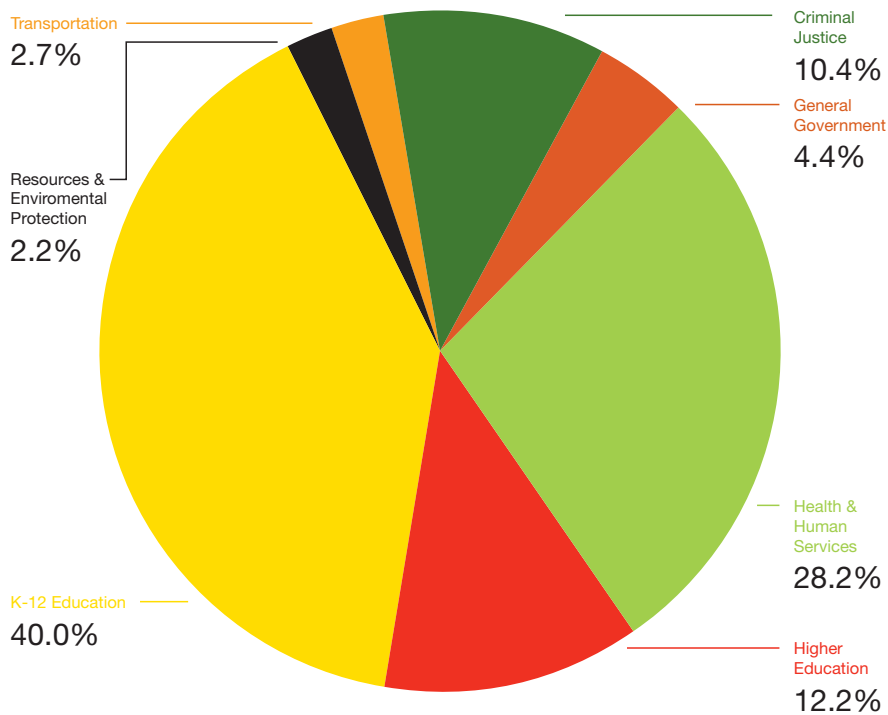
Source: California Department of Finance. October 12, 2010.

B. Where Our State Money Goes:

In the Governor's 2009-10 budget, the largest share of our state taxes goes toward education: K-12 education accounts for 40.0%, and higher education (UC, CSU, and community colleges) makes up an additional 12.2% of General Fund spending. The next two largest expenditures are Health and Human Services (28.2%)—which includes expenditures in public structures such as hospitals and clinics, home care for seniors, childcare, foster care, and basic needs grants for children and seniors—and Criminal Justice (10.4%)—which oversees prisons, probation, and parole.⁹

2009-10 General Fund Expenditures

Total: \$86.5 Billion



Source: Legislative Analyst's Office

II. FACTORS FUELING STATE AND LOCAL BUDGET CHALLENGES

In 2010-11, the state faced its ninth year of a budget shortfall with a \$17.9 billion deficit, the largest budget gap in the nation. In addition to the ongoing recession nationwide, two core factors specific to California are causing our huge budget challenges:

- A. A structural shortfall in revenue built into our budget system, caused by policy choices and economic trends in recent years.
- B. A broken process for updating our tax and budget policy to reflect a changing economy and population.

A. Structural Shortfall in Revenue

A significant factor in the \$17.9 billion deficit is an ongoing revenue shortfall, which is embedded in California's budget. This means there is now a deficit built into the budget: each year, the amount of revenue approved is always short of the spending needed to maintain the current level of public services. The structural shortfall is due in large part to a series of policy decisions in recent years, which have eliminated the revenue needed to maintain even the most basic state services.

These policy decisions include:

- ***Reductions in the Vehicle License Fee (VLF)***: this constitutes the largest portion of the structural deficit, costing an estimated \$6.1 billion in 2008-2009.¹⁰
- ***Cuts to corporate income taxes***: for example, the state would have collected an additional \$8.4 billion in corporate taxes in 2006 if corporations had paid the same percentage of their profits in corporate taxes that year as they had in 1981.¹¹
- ***Decrease in revenue from commercial property taxes, due to Proposition 13, passed in 1978***: although property taxes go to city and county governments, Proposition 13 has impacted the state budget because the state has had to offset the revenue gap by increasing funding to local governments, particularly for education.
- ***Reductions to income and sales taxes***: in the late 1990s, during a time of budget surplus, income taxes were reduced. In 2009, the state legislature temporarily increased income and sales taxes, but this increase is set to expire in 2011.

Several other factors contribute to the structural shortfall as well, including increasing bond debt, which is expected to comprise an unprecedented 9% of General Fund spending by the end of the 2014-15 budget year;¹² and economic trends, such as a shift from the production of goods to services, most of which are not taxed (e.g., going to the movies, visiting the doctor), and the rise in Internet and mail-order sales, transactions where sales tax is not collected by vendors.¹³

B. A Broken Tax & Budget Process

Over the last four years, the state legislature has responded to the gap between revenues and services almost entirely by making cuts to spending. Instead of seeking a balance of cuts and increased revenue, they have slashed the General Fund by nearly 20%. In addition, budgets are almost always passed well beyond the beginning of the new fiscal year (July 1), causing delays in state payments and other financial challenges.

As a result, there have been dramatic cuts across state structures, with substantial consequences for all Californians. For example, in the past the Governor has proposed major cuts to education, the Medi-Cal and Healthy Families programs, and the complete elimination of CalWORKS, the Cash Assistance Program for Immigrants (CAPI), and the California Food Assistance Program (CFAP), all of which would have had a devastating impact on people of color.

These cuts come at a time when California's core state systems like schools and health care are experiencing incredible pressures to grow due to a combination of population increases, demographic changes, and inflation trends. By 2020, the population of California is expected to increase by 10 million people, roughly the equivalent of the state of Michigan.¹⁴ The number of Californians age 65 or older is expected to increase the fastest of any segment of the population (by 75.4% between 2000 and 2020),¹⁵ requiring increased utilization of health care, home care, and other services.

The increased demand for public services further illuminates the glaring holes caused by the legislature's severe spending cuts. Why is California caught in this repeated cycle of deep cuts, shortfalls, and delays? Why does this process continue even across changes in political leadership and economic circumstances? The short answer is that California's tax and budget system is broken. Two major factors are often presented as the root of our paralyzed, dysfunctional system.



1. A Budget Held Hostage by the Minority

California is the only state in the nation with a “double” two-thirds vote requirement: a two-thirds vote is needed in the legislature to both 1) raise revenue and 2) pass a budget. In contrast, tax cuts can be made with a simple majority of legislators—meaning that it is much easier to chip away at our budget than to raise revenues. Both of these two-third requirements were put in place by voter-approved propositions:

- In 1933 Proposition 1 was passed requiring two-thirds of the legislature to pass a budget.
- In 1978 Proposition 13 was passed requiring two-thirds of the legislature to increase taxes.

The stringent requirement for two-thirds approval has not resulted in improved negotiations and democratic compromises among our policymakers. Instead a small handful of policymakers—33% plus one—have the power to make big demands in exchange for a handful of their votes.

2. Budgeting by the Ballot

Ballot propositions give voters the opportunity to decide on major policy proposals. Unfortunately, there is often limited or confusing information available; the propositions are voted on by a small percentage of citizens (those who voted in that particular election); and the campaign that is most heavily financed often wins. While individual ballot measures may have merit, the sum total of rules and regulations put in place by propositions ties the hands of the legislature, making it difficult for the state to address economic challenges and crises.

How can we transform our state to one that invests in both the present and the future of all of California’s families and communities? How can we make sure that new budget and tax policies address factors that disproportionately affect communities of color? The good news is that many experts, organizations, and coalitions invested in the well-being of the state have recognized the clear and urgent need for fundamental reform and are now circulating proposals for an effective budget and tax system. Continuing a cuts-only approach or waiting for an economic recovery miracle are simply not options.

III. LOOKING FORWARD

Analyzing Proposals to Ensure a Thriving State

An effective budget process is central to resolving the state’s tax and budget challenges. As communities of color, we need solutions that ensure that all of our families have the opportunity to live safe, healthy, and dignified lives. Evaluating whether a new proposal will move our state and our communities forward or backward can seem—and sometimes is—complicated. In an effort to promote a tax system that benefits everyone, the five questions below are presented to help you analyze new proposals that come to the ballot or legislative floor. Specific examples are provided to help illustrate the issues involved.



1. How does the policy achieve the desired goal, and is this the best method for doing so?

Any policy proposal—for tax or spending—must be evaluated on how effectively it will achieve its goal. For example, will a proposal for a tax credit for low-income families improve access to affordable childcare, when these families may not have the means to pay the full cost up front and wait to receive the credit later?

In addition, tax proposals should be compared with other available policy options that would achieve the same goal. In the case of expanding access to childcare, another option would be for the state to subsidize public childcare programs, making them more affordable from the outset. Which proposal would provide greater benefit to families? What would be the difference in cost to the state?

2. Is the tax distributed fairly?

The terms “progressive” or “regressive” are often used when describing how a tax will impact households across various incomes. A progressive tax is one in which the tax rate increases as the amount subject to taxation increases. In California, one of the most prominent examples of a progressive tax is our income tax: an individual’s income tax is based on how much they make, with wealthier Californians paying a higher percentage of their income than those with lower incomes.

A regressive tax is one where everyone pays the same amount regardless of income, resulting in a greater burden on low-income people. A good example of a regressive tax in California is our sales tax: everyone going to the store to buy a toothbrush or a bar of soap pays the same sales tax on those items. If someone has a lower income, that sales tax represents a larger percentage of their income and has a greater impact on their personal budget than on the budget of someone who is wealthier.

Although our income tax structure is progressive, low-income families still pay a higher share of their income in all taxes combined, because of regressive sales taxes and excise taxes (indirect taxes on a particular good such as gasoline or alcohol). Identifying whether a tax is progressive or regressive will help determine whether the tax will be distributed fairly, and who will be most impacted.



3. Does the policy put restrictions on the use of funds?

Over the years, ballot initiatives have put restrictions on how current, as well as new revenue streams, can be spent. For example, Proposition 42 (2002) mandated that gasoline taxes could no longer be used to pay for General Fund budget obligations such as schools and health care but had to be used specifically for transportation services. Proposition 63 (2004) imposed a new tax on high-income earners that could only go towards funding mental health services. Many propositions passed by voters designate taxes for needed programs, and while it can seem like a good idea to ensure funding for programs by tying them to specific revenue sources, restrictions on how money can be spent limit the overall flexibility legislators have in responding to economic crises. These restrictions can also divert sources of funding away from other critical programs. As a result, when it's time to balance the budget, the programs without designated funding streams—such as most human services, funded by the General Fund—are more vulnerable to cuts and often less able to generate support for new revenues.



4. Does this proposal help us plan for our state's long-term future?

The current budget process is distorted by a narrow focus on short-term solutions, due to a combination of pressures: term limits for legislators, sharp party discipline on tax positions, and the need to pass a budget every year. In addition, policies have been proposed that severely limit legislators' flexibility to make spending decisions for future years. These proposals include a requirement that the legislature increase the amount of money set aside into a "rainy day fund" (also known as budget stabilization funds) even when the state can't afford it; give the Governor unilateral power to make cuts in cases of fiscal emergency without any public accountability; and put a cap or limit on future spending. Each of these proposals already exists to some degree in current law, but new proposals would redefine the parameters. They often have great political appeal because they are seen as a way to impose tighter controls on the budget system. Yet these very proposals can contribute to the tangle that makes it difficult for legislators to respond to a budget crisis with a range of comprehensive solutions.

5. Will this proposal strengthen democracy in California?

As mentioned above, a key dynamic contributing to California's broken system is the double requirement for a two-thirds vote to pass a budget and to raise revenues. The federal budget, budgets in almost all other states, and other California laws only require a majority vote. Two proposals for changing California's strict tax and budget requirements include:

- Make passing the budget (but not increasing taxes) a majority vote. Proponents believe that this will lead to passing the annual budget on time and decrease negotiations needed for a two-thirds vote, a process that often results in inclusion of unrelated policy priorities of the minority party to secure their vote for the budget.
- Make passing both the budget and increasing taxes a majority vote. Proponents, some of whom also support the first proposal, agree that the system needs to return to majority, democracy rule, and that we need to change the two-thirds vote requirement for tax increases to put an end to the cuts-only approach that is so negatively impacting our state.

These proposals would strengthen our democracy by improving legislators' ability to pass a budget on time; allowing for a mix of spending and tax policies; and excluding other policies aimed at appeasing individual legislators. In short, it would allow the majority to govern, while still respecting minority voices, as in all other political debates and negotiations.

CONCLUSION

California's budget and tax policy solutions need to lead to outcomes that benefit all Californians, particularly those most vulnerable to changing economic conditions. Proposals must allow our government to have a certain degree of flexibility while also being held to high standards by ensuring that all financial decisions are made openly and with public input.

The stakes are high for California, especially for communities of color who are among the most impacted by budget cuts to schools, health care, and other vital services. State policymakers need to keep the interests of our families and communities at the forefront of their minds as they vote on budget proposals and decide on new legislation. We, too, need to get more people in our communities registered to vote; make sure we are all well-informed about the issues; and help greater numbers of people bring their friends, family members, and neighbors to the polls for each election. The non-partisan League of Women Voters' Easy Voter Guide Project works to strengthen civic engagement by offering multilingual guides to state elections, including elected offices, propositions, political parties, and voting issues in California: <http://ca.lwv.org>.

Establishing a policy environment inclusive of all Californians requires an investment in public systems and structures. Transforming the state's broken tax and budget process is a critical component in ensuring a successful outcome, one in which communities of color, the bedrock of our state, have the opportunity to grow and flourish.



ENDNOTES

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