CALIFORNIA'S POLICY EUREKA ECONOMICS, AND POLITICS

Issue 1503 California's Revenue Conundrum July/August

## INTRODUCTION

# California's Up-and-Down Revenue Stream: Is State Tax Reform Up, Down, . . . or Out?

By Bill Whalen

California may be parched and arid, thanks to a historic drought. Meanwhile, Sacramento is awash with money—about $6.7 billion more than government bean counters were counting on as recently as January.

And whom to thank for this windfall? Try a surge in capital gains tax revenue, plus a temporary tax increase on upper-end earners—Proposition 30—that voters approved in November 2012.

As such, California faces something of a conundrum. On the one hand, money will continue to pour into Sacramento in the immediate future, prompting more budget debates, such as the one last month when the argument wasn't whether to spend, but instead which rosy revenue estimate to enact (in the end, it was Governor Jerry Brown's less enthusiastic projection that prevailed).

Now, the bad news: revenue forecasts are the California state government's version of yo-yo dieting. What you see today isn't what you saw five years ago—and may not be the case five years from now.

So what's California's problem? In a nutshell, it's a revenue system that's overly reliant in personal income taxes. In 1950, 10 percent of the Golden State's fiscal take came from the income tax. Today, that figure is closer to two-thirds (nearly double what it was a quarter of a century ago).

Moreover—and alarming for a nation-state of over 38 million residents—a select few Californians are driving the revenue train. Almost half of California's income taxes come from the state's top 1 percent of earners (as compared to 41 percent and 40 percent, respectively, in Connecticut and New Jersey).

This is why one of the more important ballot fights to watch next year will be the anticipated effort to extend or make permanent some or all of Proposition 30. Take away that measure, which raised income taxes on those earning more than $250,000 until 2019 (to 13.3 percent, the nation's highest rate) and imposed a sales tax increase until 2017, and America's biggest blue state could be looking at red ink.

There are two things we know about California and spending for the foreseeable future.

First, no one's looking to trim spending. Although Governor Brown coaxed lawmakers into spending $2.1 billion less than they desired, the $115.4 billion general fund budget signed by Governor Brown last month is still $7.4 billion more than the previous year's spending plan.

## TABLE OF CONTENTS



A Publication of the Hoover Institution

Second, lawmakers don't lack for new spending ideas. This summer, California's State Legislature will engage in two "extraordinary" legislative sessions—one to figure out what to do about the current $1 billion hole in the state's Medi-Cal health program, the other to create permanent and sustainable funding (i.e., a push for taxes and fees) for infrastructure repair and maintenance.

This leaves Sacramento with one of two paths to take, the first being to continue with the status quo: relying on boom-or-bust revenue and raising taxes. In 2016, that could include an increase in California's tobacco tax and maybe a run on the state's fabled Proposition 13 and its cap on business and residential property taxes. In fact, Democratic lawmakers already have proposed going after the business side of Proposition 13.

The other course of action: reforming California's tax system so as to make the revenue stream more reliable. In theory, that shouldn't be difficult; in April, State Controller Betty Yee announced a nine-member "expert panel" to analyze tax-reform proposals from varied perspectives. Such analysis would begin with the September 2009 report published by Governor Arnold Schwarzenegger's Commission on the 21st Century Economy, which listed numerous ways to modernize, stabilize, and simplify what it deemed to be "an outdated tax system."

Of course, that report went nowhere with the State Legislature. Six years later, it remains to be seen if there's a genuine appetite for tax reform under the capitol dome—though there are at least two promising ingredients: a pair of ambitious lawmakers touting the idea (Controller Yee and State Senator Robert Hertzberg) and, not to be overlooked, a lame-duck governor on the prowl for legacy items.

In this issue of *Eureka,* we explore California and its yo-yo-like revenue system of ups and downs. That includes:

- Gerald Parsky, chair of the Commission on the 21st Century Economy, on the sensible thing for Sacramento to do: reform the tax system;
- Autumn Carter, executive director of California Common Sense, on the volatility of capital gains and its impact on California revenue forecasting;
- Joel Fox, president of the Small Business Action Committee and editor of FoxandHoundsDaily.com, on the political fates of Propositions 13 and 30;
- And Carson Bruno, a Hoover research fellow and California specialist, examining the relationship between Golden State voters and the "Taxifornia" perception.

Additionally, the **FACTS ON THE ISSUE** ☑ for this issue of *Eureka* have been provided by California Common Sense, a nonpartisan nonprofit think tank dedicated to opening government to the public, developing data-driven policy analysis, and educating citizens about how their governments work.

CALIFORNIA COMMON SENSE

And before all of that, we have this podcast offering an insight on California's revenue picture and what the immediate future may hold given voters' whims and the partisan divide in Sacramento.

CALIFORNIA'S REVENUE UPS AND DOWNS: WHAT TO DO NEXT?
Participants: Carson Bruno and Bill Whalen
Recorded July 20, 2015.

We hope you enjoy this latest installment of *Eureka*—and that it gets you thinking about where California stands and if we're moving in the right direction.

Bill Whalen is a Hoover Institution research fellow, primarily studying California's political trends. From 1995 to 1999, Bill served as Chief Speechwriter and Director of Public Affairs for former California Governor Pete Wilson.

## FEATURED COMMENTARY

# Fixing California—the Need for Tax Reform

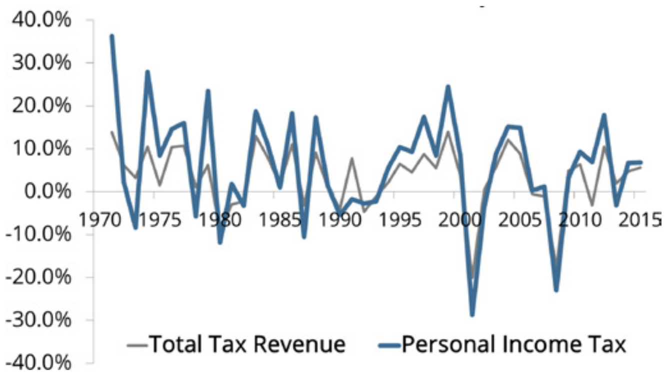
By Gerald Parsky

From 2008 to 2009, California experienced its worse economic recession (dubbed by some as the Golden State's "Great Recession") since the tax system was first created in the 1930s.

During this period, state tax revenues dropped precipitously, resulting in months of political struggle in Sacramento. Consequently, critical publicly provided goods and services were curtailed and many Californians personally suffered as a result of the state's budget predicament. Memories often fade, but I suggest this situation be kept in mind as we assess what has happened since, where we are now, and where we need to go in the future.

One response to the 2008–2009 situation by the legislative leaders and then Governor Arnold Schwarzenegger was to establish the Commission on the 21st Century Economy to recommend reforms to the California tax system. That commission, on which I served as chairman, was bipartisan: seven

**ANNUAL PERCENTAGE CHANGE IN CA'S PERSONAL INCOME TAX & TOTAL TAX REVENUE, 1970–71 AND 2014–15 (INFLATION-ADJUSTED)**




Source: *"Schedule 3: Comparative Yield of State Taxes, 1970–71 through 2015–16," California Department of Finance.*

FACTS ON THE ISSUE ☑

Republicans balanced by seven Democrats. The mission was clear-cut: recommend reforms that would (a) lead to more reliable and stable revenue, (b) energize economic growth and job creation, and (c) help California compete in the new economy.

After months of deliberation and public hearings, the commission came to the broad policy conclusion that California's revenues had become too dependent on personal and corporate income taxes, which are generally more sensitive to fluctuations in the economy, and the stock market, rather than other taxes.

Moreover, we identified the following deficiencies in California's current tax system:

1. It lags economic changes. While California's economy has changed dramatically from manufacturing and agriculture to services, the basic tax system has not responded and has become increasingly dependent on a small percentage of high-income earners.
2. It produces revenues that are volatile, depending on fluctuations in housing and financial markets.
3. It discourages economic growth and investment.

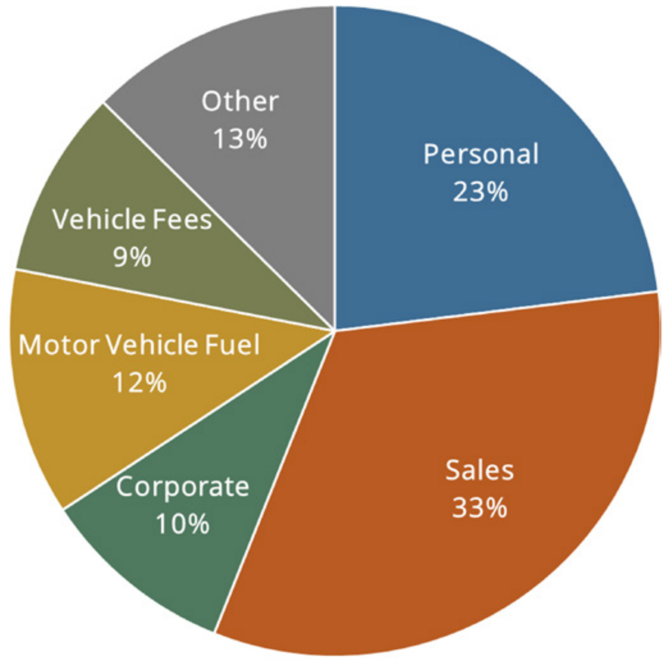
These deficiencies have resulted in an uncompetitive business environment. To address each of these problems, the commission's recommendations included:

1. Reducing the personal income tax rates and reducing or eliminating many deductions.
2. Eliminating the corporate tax and the sales and use tax.
3. Establishing a broad new business net receipts tax.

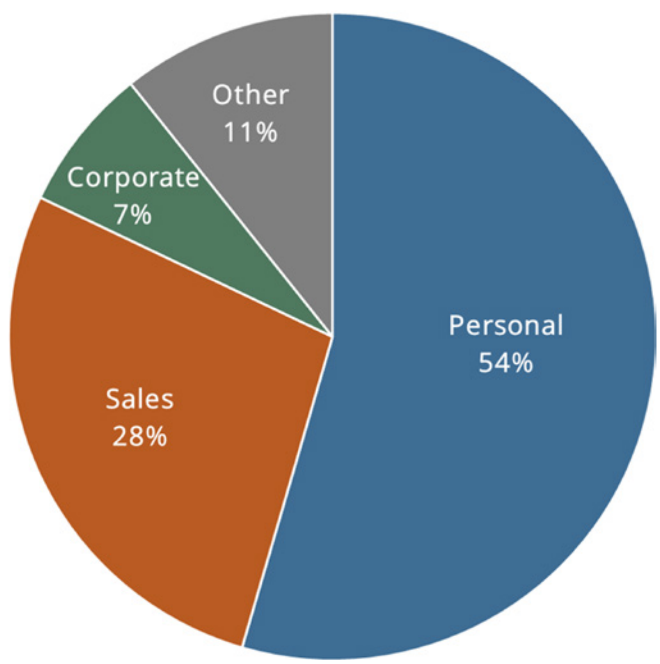
A 400-page report including many other suggested reforms was produced, as was draft legislation that included a careful transition from existing tax policy to these reforms, and testimony before the State Legislature.

So what happened to these recommendations, you might ask? Despite the best efforts to make tax reform bipartisan, commonsense, and user-friendly for lawmakers not versed in economics and tax policy, no action was taken. Excuses were

**1970: THE BIG FIVE TAXES**




**2015: THE BIG THREE TAXES**




Source: *"Schedule 3: Comparative Yield of State Taxes, 1970–71 through 2015–16," California Department of Finance.*

FACTS ON THE ISSUE ☑

given, such as a certain new tax was too complicated or the timing was not right. Again, no action was taken.

Sadly, this isn't the end of the story. Two years later, in 2011, another bipartisan group of sixteen citizens came together under the Think Long Committee. After a year of study, these citizens unanimously came to the same conclusion regarding tax reform—we need to *reduce the dependence* on the personal income tax by reducing tax rates, eliminating most deductions, reducing the sales tax on goods, and establishing a broad-based tax on services.

In response to the recommendations of both the commission and Think Long's independent citizens' group, on both of which I served, what did our elected officials do? Exactly the opposite.

Given the chance to reduce rates and establish a more stable revenue system, they instead raised an extraordinary amount of money, created and passed a ballot initiative—namely, Proposition 30—that retroactively and temporarily increased personal income tax rates, which will hurt business, especially small business, and will make an already volatile tax system even more unpredictable.

With tax revenues increasing, these officials now are claiming victory. In fact, many of them are saying that California provides a game plan for the country. My response: "Are you kidding?"

The main reason there appears to be a revenue "surplus" in California is that many taxpayers realized capital gains in 2012—in part, because they knew the federal rate was increasing in 2013—and the stock market has continued to outperform expectations.

However, Proposition 30 makes California more dependent on the most volatile tax form: the personal income tax. As history has shown, any short-term gains in revenue will give way to shortfalls as the stock market slows, the economy softens, and business sees that such tax policy helps create a climate that discourages investment in California.

Plus, Proposition 30 only increases the personal income tax rates through 2019. What then? Because the elected officials have not controlled spending, there will be another revenue hole that will put us back to the crisis of the past.

Supposedly, the timing wasn't right for tax reform back in 2009, when the commission released its report, because California was in a recession. Now, we're told we can't do it because we're in a recovery. So when, if ever, will tax reform actually happen? I suggest the time has come for the public to demand that their elected officials do their job—take the cobwebs off both the commission's and the Think Long's reports, and address tax reform.

The lesson I learned from delving into this topic is that, in the area of taxes, it's easier for elected officials to do nothing or raise taxes "on the rich" than it is to reform our antiquated tax system. California deserves better. We need a government that sees this issue for what it is—critical to our children's future—and has the courage to do what is best for the Golden State.

Gerald L. Parsky is Chairman of the Aurora Capital Group and former Assistant Secretary of the Treasury for International Affairs. In 2009, Gerald served as Chairman of California's Commission on the 21st Century.

**CALNOTES:**
**COMMISSION ON THE 21st CENTURY ECONOMY**

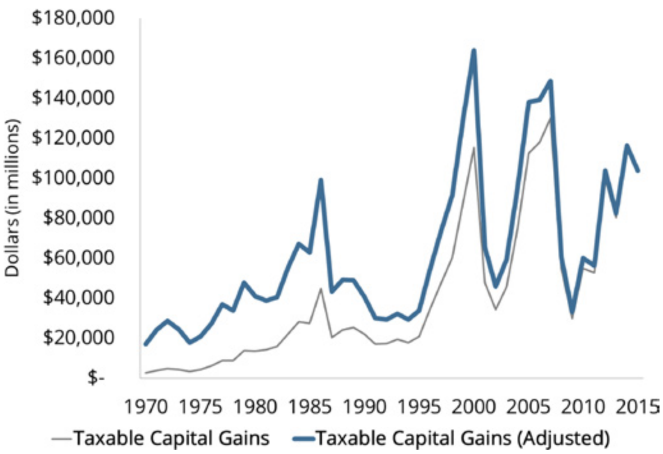
*Created by Governor Arnold Schwarzenegger, the bipartisan commission consisted of seven members appointed by the governor and seven by the State Legislature. It was directed to develop a fair and equitable tax reform plan to stabilize revenues, promote economic growth, and improve California's competitiveness. Nine members (six gubernatorial and three legislative appointees) endorsed the final report, which included detailed analysis of California's current tax system, a reform plan, and draft bill language. The State Legislature took no action on their recommendations.*

## Capital Gains Taxes: More Than a "Rich Person's Problem"

By Autumn Carter

It may seem easy to dismiss CAPITAL GAINS taxes as just a "rich person's problem." Popular wisdom holds the wealthiest among us generate essentially excess wealth largely through well-timed investment trades, making capital gains nothing more than icing on their income cakes. Thus in a climate that has zeroed in on income gaps between the higher- and lower-wealth individuals, capital gains became rich targets in progressive tax systems.

### TAXABLE CAPITAL GAINS, 1970–71 TO 2015–16




*Source: "Governor's Budget Summary, 2015–16, Figure REV-02," California Department of Finance.*

**FACTS ON THE ISSUE ☑**

However, when we consider the incredibly volatile nature of capital gains and their prominence within California's boom-and-bust budgeting cycle, it becomes clear that capital gains taxes are actually everyone's problem.

Today, California's budget relies much more heavily on personal income than it did several decades ago. In 1970, personal income accounted for 23 percent of total state revenue. At the time, that was the second largest source behind sales tax revenue, but it was also balanced by the corporate tax, motor vehicle fuel tax, vehicle fees, and other taxes. However, personal income alone now accounts for 54 percent of total revenue, meaning the budget is essentially beholden to personal income's variance around economic cycles.

But the more frightening reality is that the budget is truly beholden to capital markets. Unlike most states, California treats capital gains as personal income. This means the state taxes capital gains at the same rate as it taxes personal income. It also means that particularly high capital gains one year may place an individual or couple in a higher tax bracket that year, or that particularly low gains may place them in a lower bracket. At California's highest tax bracket, this means both traditional and capital gains personal income are taxed at a rate of 13.3 percent, the nation's highest rate.

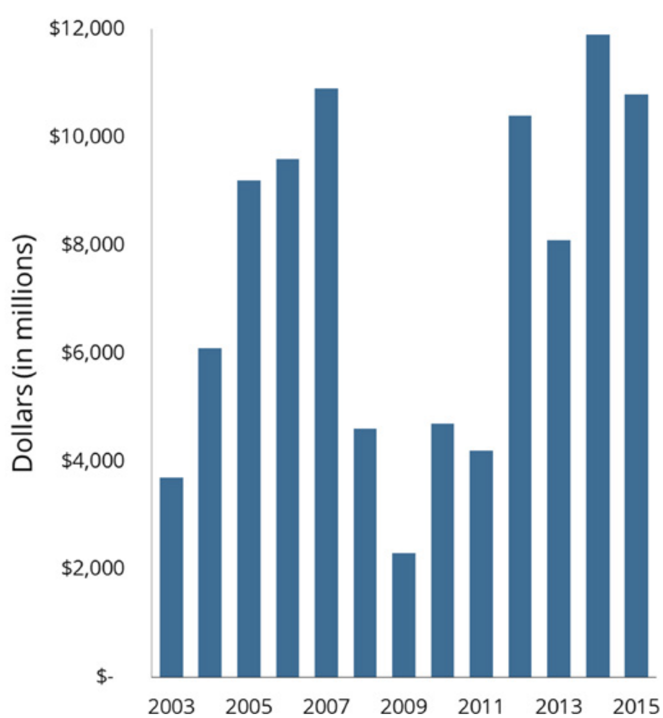
Traditional personal income is a volatile revenue source, as it declines significantly during economic downturns as unemployment rises. But capital gains are extremely volatile, as they vary with investor behavior and market performance, in addition to economic cycles. Their proportion of personal income revenue does not remain steady over the course of economic cycles. Rather their proportion spikes in growth years and plummets in contraction years.

For instance, since 2003–2004, capital gains taxes have accounted for an average 13 percent of all state personal income tax revenue. But they accounted for as much as 20 percent in 2007–2008 ($10.9 billion) and as little as 5 percent in 2009–2010 ($2.3 billion).

Separated by only one fiscal year, these precrash spike and postcrash plummet years presented the public with some of the starkest realities of boom-and-bust budgeting. In 2007–2008, the state's General Fund spending was at its highest at the time, $103 billion. That was a 7.5 percent increase over the previous year. When markets crashed in 2008, capital gains tax revenue was more than halved to $4.6 billion in 2008–2009 and was halved again to $2.3 billion in 2009–2010.

The $8.6 billion decline in capital gains tax revenue levels between 2007–2008 and 2009–2010 was the equivalent of losing nearly a tenth of previous General Funds. During the period, actual General Fund spending declined $15.8 billion,

### CAPITAL GAINS TAX RECEIPTS, 2003–4 TO 2015–16 (UNADJUSTED)




*Source: "Governor's Budget Summary, 2015–16, Figure REV-02," California Department of Finance.*

**FACTS ON THE ISSUE ☑**

meaning capital gains losses accounted for more than half of the expenditure cuts.

Too often, we wrongly reduce the capital gains tax debate to a simple question of capacity. To what extent *can* we tax the uber-wealthy few? But given that California's budget now routinely relies heavily on capital gains taxes, the better question is to what extent are we balancing the entire budget on just a few?

Two key revenue trends have coincided with Proposition 30's passage in 2012. First, personal income consistently and firmly comprises the majority of state revenue. Second, in 2014–2015, $11.9 billion in generated revenue counted for its greatest share (17 percent) of personal income tax revenue post–Great Recession. Together, this means that for the first time capital gains comprise this large of a share of personal income as personal income shoulders the bulk of the budget. The state's budget—its ability to provide public services, maintain infrastructure, educate students—are at an even greater risk due to the compounded risk of volatility.

To be fair, Proposition 2 (2014) did strengthen California's Rainy Day Fund to some extent. It mandated that the state set aside 1.5 percent of the General Fund and capital gains revenue in excess of 8 percent of the General Fund (until the Rainy Day Fund is equivalent to 10 percent of the General Fund). Since 2003–2004, this would have meant the state would have set aside excess capital gains revenue in six fiscal years at an average $2.3 billion.

However, under Proposition 2, the Rainy Day Fund would reach legal capacity at about $11 billion. That is an achievable benchmark during stock market boom years, but recent history has illustrated that a similar (or even milder) downturn could easily wipe out that fund with capital gains revenue losses, let alone overall personal income losses.

This reinforces a more important point: Merely adjusting for and reacting to volatility provides very limited stability, especially as the state budget comes to rely more on volatile revenue sources. An inverted pyramid can only balance on a steadily narrowing base for so long; constantly leaving it exposed to storms only increases its chance of toppling altogether. That is certainly everyone's problem.

Autumn Carter is the Executive Director of California Common Sense, a nonpartisan think tank dedicated to opening government to and educating the public and developing data-driven policy analysis.

**CalNotes:**

**CAPITAL GAINS INCOME**

*Capital gains income is the profit generated from the sale of an asset held for the purpose of investment. Such assets include real estate, land, machinery, vehicles, furniture, jewelry, patents and trademarks, and securities like stocks and bonds. For a capital gain to occur, the sale price must exceed that of the purchase price. This difference between the sale price and the purchase price is then considered taxable income by the state and federal governments.*

## The Uncertain Futures of Propositions 13 and 30

By Joel Fox

Two of California's historical ballot initiatives—one brought by government outsiders to limit government revenue, the other brought by government insiders to expand government revenue—face an uncertain future if changes to these laws appear on the 2016 ballot.

The legendary **Proposition 13**, passed overwhelmingly by the voters in 1978, was a tax revolt heard round the world. While limiting property taxes in California—to 1 percent of the acquisition price of property with annual tax increases of up to 2 percent depending on inflation—and setting strict vote requirements before other taxes could be raised, Proposition 13 also served as a springboard for centering the tax issue in national politics. The late Martin Anderson, a Hoover Institution Senior Fellow and top advisor to Ronald Reagan, told me that following the passage of Proposition 13, "the idea of Reagan cutting taxes was now politically viable and rolling. Proposition 13 was a clear political signal that the public was fed up with taxes."

In the nearly four decades since Proposition 13 passed, it has been declared the "third rail" in California politics—any politician who touches it risks defeat at the hands of voters. But now, SCA 5—introduced by state senators Holly Mitchell and Loni Hancock and supported by public labor unions and grassroots liberal organizations—is geared to alter the piece of Proposition 13 that covers commercial property. Proposition 13 treats commercial and residential property the same, just as they were treated prior to its passage.

The proposal would phase in full assessment of most commercial property requiring annual reassessments to full market value. In an attempt to quell small business opposition, SCA 5 allows for a $500,000 exemption on personal property taxes used for business purposes, such as machines. While small business might be pleased with the latter provision, substituting the exemption for the uncertainty of an annual, subjective, reassessment is no bargain for them.

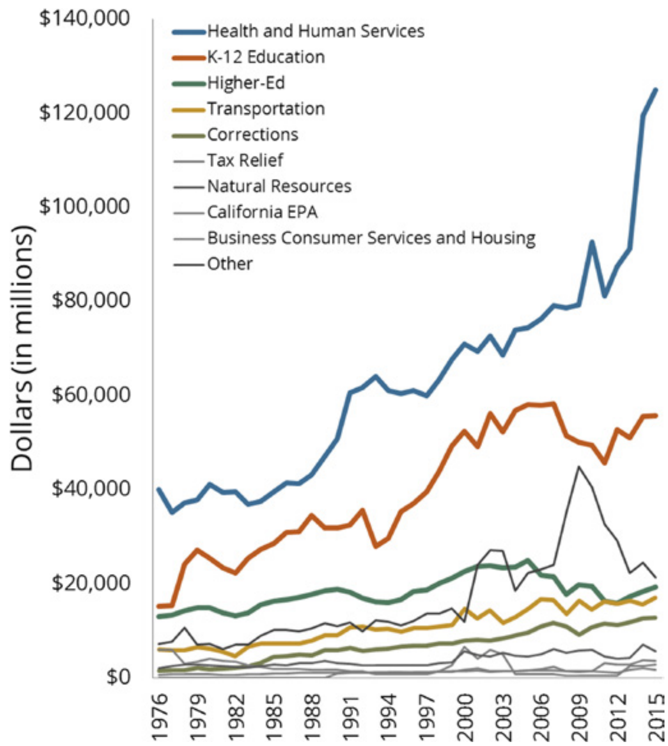
Proponents claim it is only fair to close so-called loopholes dealing with business. They often refer to property deals constructed where no one owner takes possession of 50 percent of a commercial property, so that the property is not reassessed as required by Proposition 13 when change of ownership occurs. The provision determining change in ownership was set by the legislature; hence, it can be changed statutorily. But last legislative session, when an effort to do so was proposed by Democratic assemblymembers, it stalled. There is renewed interest in pursuing this option again, but the outcome likely won't be different. Certain interests—particularly public employee unions—do not want to fix this problem; they want to reassess all commercial property.

There is little chance that the proposed constitutional amendment will receive the two-thirds legislative vote necessary to make the ballot. Republican legislative leaders have stated that their caucuses oppose the change. There is doubt about how many Democrats would be willing to touch the "third rail" given that the measure's fate in the legislature seems preordained.

Even so, voters may have an opportunity to approve or reject a change to Proposition 13. The same public unions and grassroots groups that hailed SCA 5 are preparing to file their own initiative if it fails in the legislature. If the proposal makes the ballot, it is sure to face a well-funded opposition from both the business and taxpayer advocate communities. In a recent PPIC poll, the idea of changing Proposition 13 to annually reassess commercial property while leaving the residential property tax as is (called the split roll) found favor with only 50 percent of respondents. Even without arguments offered about possible negative consequences—such as thousands of lost jobs—a split roll doesn't start from an encouraging position for proponents.

In 2012, Governor Jerry Brown led a coalition of public unions and government program advocates with some business support to pass Proposition 30, a $6 billion-a-year tax increase. Proposition 30 raised personal income taxes for seven years on taxpayers with taxable incomes of $250,000 or more. It also increased sales taxes by a quarter cent for four years. Key to the "Yes on 30" argument was that the tax increase was

### EXPENDITURES BY PROGRAM TYPE, 1976–77 TO 2015–16 (INFLATION-ADJUSTED)




*Source: Program Expenditures Chart: "Chart C-1: Program Expenditures by Fund," California Department of Finance.*

**FACTS ON THE ISSUE ☑**

needed to help the state recover from the Great Recession, a focus on funding education, and the text of the initiative stating that the funding would be temporary.

However, current discussions led by teachers' unions are to extend or make permanent the Proposition 30 taxes. They argue California school funding would be jeopardized if Proposition 30 were allowed to expire, with advocates talking about falling off a "fiscal cliff" if Proposition 30 ends. Analysis by both Standard and Poor's and the Legislative Analyst's Office determined that the state's economic growth would avert this "fiscal cliff" scenario. Governor Brown, publicly, is keeping to his pledge not to delay the temporary tax's expiration.

However, there are two scenarios in which the taxes could continue. One would be another initiative measure to lengthen or make permanent the temporary status of Proposition 30. The second is to change some of the details of Proposition 30—say, eliminate the sales tax increase and cut a percentage off the income tax increase—and introduce it as a new tax, not as severe, but something needed to fill the hole created by the end of Proposition 30, which could open a loophole in Governor Brown's pledge to gain his support. Proponents, though, may run into problems with voters on extending Proposition 30. The same PPIC poll found that 47 percent of respondents would oppose extending the tax with another 16 percent saying they'd oppose efforts to make it permanent.

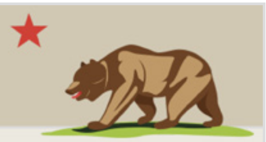
One of the unusual aspects driving the Proposition 13 split roll and Proposition 30 extension discussions is the difference of opinions and strategies among public unions. Teachers' unions have been the biggest beneficiaries of Proposition 30. But other unions, such as the SEIU, feel left out. A property tax increase would benefit its members, especially on the local government level. Some of the effort behind the Proposition 13 split roll may be a maneuver by these public unions to force the teachers' unions to work together on one tax issue that would benefit all public labor groups. If two tax increases end up on the ballot, there is less likelihood either would pass.

With little hope of either of these tax provisions passing out of the legislature, thanks to the Democrats losing their two-thirds majority in 2014, any action will take place on the ballot. But first, proponents must get the measures onto the ballot, which will be the first test of the issues' public sentiment.

Joel Fox is president of the Small Business Action Committee, former president of the Howard Jarvis Taxpayers Association, and copublisher/editor of *Fox and Hounds Daily*, named by the *Washington Post* as one of California's top political websites.

**CalNotes:**

**PROPOSITION 13**



*Taxpayer advocate Howard Jarvis's 1978 Proposition 13 campaign was the reaction to a decade of rapidly rising property tax reassessments. Passed with 65 percent of the vote, it sought to stem property tax growth and impose strict tax restrictions on elected officials by capping property tax rates at 1 percent of assessed value, limiting assessed value increases at 2 percent per year (or to market value at change of ownership), and imposed a two-thirds vote requirement for elected officials to increase tax rates or create new taxes.*

## "Taxifornia" and "Left Coast"—Public Opinion or Just Politics?

By Carson Bruno

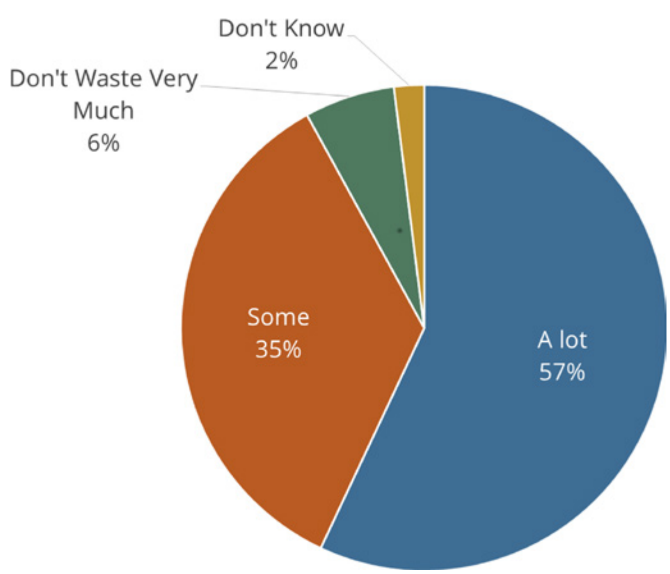
The "Left Coast" and "Taxifornia" are two common nicknames for the Golden State. And it isn't surprising why.

California hasn't voted for a Republican presidential or US Senate nominee since 1988 and hasn't elected a Republican to a statewide office since 2006. The Golden State's congressional delegation is currently 74 percent Democratic, and the legislative Democrats continue to flirt with a legislative supermajority. Across a range of hot-button policy issues—the environment, abortion, gun control, and immigration—Californians continuously hold left-leaning opinions.

Additionally, the Golden State has the highest personal income tax rate in the country, the highest corporate tax rate west of the Mississippi River, and among the highest sales taxes in the nation. In 2015, California had the 4th latest "Tax Freedom Day"—the date on which Californians have earned enough to pay off their federal, state, and local taxes for the year—and collects the 7th highest income taxes per capita.

That said, however, California is also home to nation's most defining antitax movement—the Proposition 13 campaign. Riding the wave of antitax sentiment amid years of out-of-control property tax assessments, Howard Jarvis showed the

**HOW MUCH TAX REVENUE DOES THE STATE GOVERNMENT WASTE?**




*Source: PPIC, May 2015.*

FACTS ON THE ISSUE ☑

California political establishment, as well as the nation, why being antitax could also be good politics. Ever since Governor Brown—then in his first term—flip-flopped on the issue in his 1978 re-election campaign, Proposition 13 has been the "third rail" of California politics.

While it seems impossible that "Taxifornia" and the "Left Coast" can also be the same as the birthplace of antitax politics, examining ballot measure results and public polling suggests Californians have decidedly more centrist—even right-of-center—views on taxation. And this has important political and policy implications for those in Sacramento.

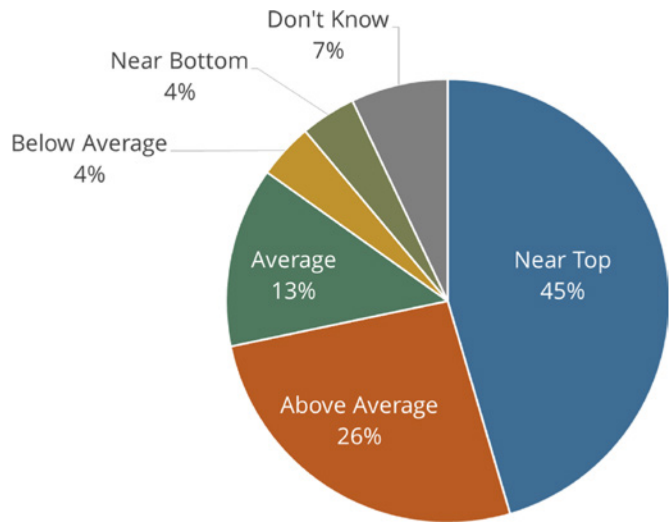
Exploring how Californians actually vote when presented with tax-related ballot measures shows that the passage of Governor Brown's—then in his third term—signature tax increase measure, Proposition 30, is more the exception than the rule. In aggregate, between 1990 and 2012, Californians have rejected tax-related propositions 52 percent to 48 percent.

Examining the details of these measures, however, presents a more nuanced approach Californians have toward the tax issue. For instance, many of these ballot measures decrease taxes in some manner—a position antitax proponents would champion. Between 1990 and 2012, Californians have supported tax decrease propositions with almost 57 percent of the aggregate vote while rejecting tax increases and new taxes (43 percent in support). And while Californians have trended left on this issue (support for new taxes and tax increases between 1990 and 2000 was an aggregate 39 percent compared to 47 percent between 2007 and 2012), Californians, despite leaning significantly Democratic in elections, still remain resistant to protax measures.

Moreover, the tax type presents further nuance. Overall, sales and excise taxes and fees, personal income taxes, and corporate income taxes all tend to fail—likely because 81 percent of these ballot measures were tax increases or new taxes. On the other hand, however, property tax measures overwhelmingly succeed—here, because all but one of such measures were tax decreases.

While Californians' tendency to support tax decreases and oppose new taxes/tax increases appears to run counter to California's "Left Coast" and "Taxifornia" personality, a look at public opinion polling explains this seemingly sudden shift. When asked to choose between spending cuts and tax increases to address the budget deficit, just 9 percent of likely voters over a decade of public opinion surveys said Sacramento should deal with the deficit via mostly tax increases. Moreover, when asked to choose between higher taxes and more government services or lower taxes and fewer services, a plurality of likely voters (47 percent) have sided with the lower tax option.

**WHERE DOES CALIFORNIA'S TAX BURDEN PER CAPITA FALL?**




*Source:* *PPIC, March 2015*.

**FACTS ON THE ISSUE ☑**

Driving these sentiments are two issues: trust in Sacramento to use taxpayer money wisely and personal belief of their tax burden level. By 12 to 1, likely voters believe Sacramento wastes a lot of the tax revenue Californians pay. This by itself would be a major inhibitor toward passage of new taxes or increasing current taxes. When presented with such options on the ballot, Californians ask themselves why Sacramento should get more money if they are already wasting the revenue they get. But add on top of this sentiment the fact that 53 percent of likely Californian voters believe they pay more in state and local taxes than they should, and it becomes clear just how steep tax-related measures face at the polls.

The only solace protax advocates have in seeking public support for more tax revenue is that Californians are concerned about their tax burden more than they are about California's overall tax environment. For instance, while 68 percent of likely Californian voters oppose raising the state personal income tax and 65 percent oppose raising vehicle licensing fees, clear majorities are okay with raising corporate taxes or income taxes on California's wealthy. Moreover, while Californians generally think their tax burden is unfair, a slight majority consider the tax system in totality to be fair.

This has implications, then, for how antitax and protax proponents approach Californians on tax-related issues. For one, despite Californians holding decidedly more Republican-leaning attitudes on taxes, just 32 percent of likely Californian voters have a favorable impression of the Republican Party. While it is possible that the Republican Party's positions on other issues outweigh their antitax position in the mind of centrist Democrat and Independent voters, the party's struggle on the tax issue could also be framing. Being decidedly purist on tax issues could be off-putting to voters wishing Sacramento would negotiate lasting fixes to California's many problems. Instead, leading on tax reform in lieu of a doctrinally antitax platform could enable the party to capitalize, politically, on Californian public opinion, while also improving California's inherently volatile tax system, which would be good public policy. For instance, 59 percent of likely Californian voters, including 51 percent of self-identified Democrats and 59 percent of self-identified Independents, believe the state's tax system needs major changes.

For state Democrats, the situation is just as ominous. While, for the most part, Californians support many of the state Democratic positions, Democratic leaders cannot count on voter support when it comes to their knee-jerk tax increase solutions. While they have had some luck on supporting tax increases for either targeted (and popular) policy areas—like Proposition 30's focus on K–12 education funding—or on specific demographics, like Proposition 39's focus on out-of-state corporations, a divide-and-conquer approach to tax increases has its political and policy limits.

In Sacramento—for the foreseeable future—there will continue to be a public battle between the protax Democrats and the antitax Republicans. Meanwhile Californian voters will likely continue to confound California's "Left Coast" and "Taxifornia" nicknames.

*Note: Ballot measure analysis aggregates all tax-related ballot measure results between 1990 and 2012 using data from the California Secretary of State's Office. Public polling analysis aggregates likely voter responses from Public Policy Institute of California surveys between January 2004 and May 2015.*

Carson Bruno is a Hoover Institution research fellow, studying California's political, electoral, and policy landscapes. Prior to joining Hoover, Carson structured municipal bond issuances at J.P. Morgan Securities, Inc.

**CalNotes:**

**PROPOSITION 30**

*Championed by Governor Jerry Brown to replenish budget crisis-era K–12 education funding cuts, voters passed the $6 billion-a-year tax increase by 11 points in November 2012. It retroactively to January 2012 increased income tax rates through fiscal year 2018–2019 by between 11 percent and 32 percent on those making more than $250,000 and increased the state sales tax rate through fiscal year 2016–2017 by a quarter cent. The sunset provisions, Governor Brown's popularity, and state leaders' threats to further cut education funding were key to its passage.*

# EUREKA

## ABOUT THE PUBLICATION

*Eureka* was created to serve as an occasional discussion of the policy, political and economic issues confronting California. Like the Golden State motto from which this forum's title was borrowed, the goal here is one of discovery—identifying underlying problems and offering reasonable and common-sense reforms for America's great nation-state.

Ever since Archimedes supposedly first uttered the word, *eureka* has meant joy, satisfaction and a sense of accomplishment. Drawing on the combined wisdom of Hoover's policy experts and leading California thinkers, we hope that you'll find enlightenment in these pages. Hoover research fellow Bill Whalen, who has nearly two decades of experience in California politics and public policy, serves as this forum's editor.

For additional information and previous issues, visit *www.hoover.org/eureka*.



HOOVER INSTITUTION