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Dan Walters: Unemployment tax increase looms as Capitol battle

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California's big tax battle will be waged next fall, as voters decide the fate of Gov. Jerry Brown's proposed hike in sales and income taxes and perhaps one or two competing tax increases.

The tax issue is going before voters via the initiative process because Brown pledged in 2010 that he wouldn't raise taxes without their permission and he couldn't persuade Republicans to have a tax election last year.

But Capitol politicians are not just bystanders in the tax game. This year, they will wrestle with a hefty increase in payroll taxes on employers to prop up the insolvent Unemployment Insurance Fund (UIF), and boosting taxes still requires a two-thirds legislative vote.

The UIF went underwater a couple of years ago as the economy tanked and the rolls of jobless workers hit their highest levels in decades. Since then, the state has borrowed from Uncle Sam to keep the checks for the first 26 weeks of unemployment insurance flowing, while the feds pick up the cost of up to 73 more weeks.

The debt is now close to \$10 billion, and California must soon begin paying interest. The state budget borrows \$362 million from the Disability Insurance Fund (financed by employees) for the first interest payment, and Brown's 2012-13 budget would borrow another \$417 million for next year's interest.

Borrowing money to pay interest on borrowed money is the height of fiscal gimmickry. But Brown wants to reverse this dangerous course by raising UIF payroll taxes on employers by \$472 million a year, beginning in 2013, to pay interest on the federal loans and repay the disability fund.

However, that tax hike would require at least some Republican votes, which is dicey given the GOP's no-new-taxes policy, and would come atop a \$21-per-employee federal surcharge being imposed on employers because the state hasn't repaid its loans.

Brown sweetens the political pot for employers and Republicans by also proposing a tightening of eligibility for unemployment insurance benefits – partially and indirectly rolling back a big increase in those benefits a decade ago that weakened the UIF's ability to cope with recession. But that is likely to be opposed by unions and their Democratic allies.

As difficult as it may be for Brown to gain approval of his proposed UIF tax hike, it's just a baby step

because it does nothing about the debt itself.

The Legislature's budget analyst, Mac Taylor, says it "does little to address either the insolvency of the UI Fund or the long-term structural imbalance between UI Fund revenues and expenditures."

A big fix for the UIF would be a pitched political battle of epic proportions, involving powerful and antagonistic interests. Although he deserves credit for opening the door, Brown apparently doesn't relish the larger battle, at least not yet.

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