

California Taxpayers' Association Perspectives on the State Budget Deficit

In the face of yet another projected multibillion-dollar general fund deficit, California's state and local policy-makers have opportunities to make the state more competitive for jobs and at the same time meet priority spending needs of residents. Unfortunately, the budget process in Sacramento which allocates nearly \$100 billion is inadequate to the needs of Californians who depend on public services and to taxpayers who pay for these services.

The California Taxpayers' Association urges the Legislature, the Governor, and local elected officials to seriously consider the following:

- **Avoid new taxes and fees – and more budget gimmicks – keeping in mind that the largest revenue opportunity is an improving economy.** Higher taxes are high-risk gambles, particularly split-roll property taxes, schemes to tax high-income investors in the California economy, and other punitive taxes that target job creators. New taxes and fees will further destabilize the economy, slow its recovery, and reduce revenue to public agencies over time. Economists around the state are expressing concern about the impact of tax increases on the state's economic recovery.

California has tried and failed to raise revenue during a downturn by raising taxes. It produced disappointing results. The early 1990s effort to cover a deficit with higher taxes (such as the 10 percent and 11 percent increase in personal income tax brackets on high-income Californians imposed in 1991) produced only a fraction of the revenue expected. This is described in greater detail on page 4.

Review existing programs, reports of fraud, out-of-control spending, and lower-priority projects. There must be greater accountability in government spending. Cal-Tax has compiled more than 100 press reports that identify billions of dollars of fraud and waste in state and local public spending in California. These examples demonstrate the need for a complete review and evaluation of the spending base in California. Taxpayers deserve better management of public funds than these press reports indicate. To view the short compilation of articles, visit:

<http://www.caltax.org/member/digest/Dec2002/12.2002.FraudWaste.04.htm>. For the longer version, go to:

[http://www.caltax.org/Tax\\$\\$\\$Fraud&Waste.htm](http://www.caltax.org/Tax$$$Fraud&Waste.htm).

- **Take advantage of opportunities for positive steps to steady the state's financing system.** California must do a better job of managing its boom-and-bust revenue system. Surges in revenue can be invested to move the state forward instead of recklessly overcommitting taxpayers to ongoing programs. Improved financial management and planning will help protect this state from the impact of vast swings in revenue during economic turbulence. This lack of planning is a major contributor to deficits that result when the economy turns down.
- **Put All Spending on the Table.** The Legislature should also be willing to review every government spending program enacted during the run up in state tax revenue, including public employees' significant increases in salary and pension benefits in recent years. This was an unwise ongoing commitment of one-time revenues.
- **Avoid committing to new programs that will further obligate this state's taxpayers.** Until state finances are stabilized, policy-makers must avoid loading new obligations for taxpayers, like Family Leave, an enormously expensive new program paid for with new taxes that was enacted as the state faced a massive budget deficit last summer.
- **Apply economic stimulus to create jobs and expand the state's economy.** Private-sector jobs and investment result in increased revenue to state and local agencies. California's economic health and the flow of revenue to public agencies depend on the state's ability to attract investment. Unfortunately, policy-makers have gone the other direction by substantially increasing the cost of business operations in the state. Workers' compensation insurance, unemployment insurance, and numerous other employer costs have been increased dramatically. Piling on more taxes is short-sighted and further damages California's ability to compete for jobs.
- **Consider performance contracting to bring competition and performance measurements into public service delivery systems.** This strategy has produced savings ranging from 10 percent to 40 percent in jurisdictions that have used performance contracting. Jurisdictions around the country and in California are improving the quality of public services and controlling costs by bringing competition and performance measurements into delivery of services.

- **Beware of the “spending lobby.”** Special interest spending advocates resist financial management, including performance and cost-effective measures. The spending lobby refuses to be realistic about California’s financial problems. Regardless of the special-interest lobbyist protecting them, low-priority, wasteful government programs cannot be immune from review.

The following strategies describe in more detail the previously discussed points:

AVOID NEW TAXES AND FEES – AND GIMMICKS

California cannot tax itself out of this deficit. In large part, the California deficit results from spending one-time revenue on ongoing program commitments. Raising taxes can’t balance the budget and will retard the state’s economic recovery. It is disappointing to see new taxes and fees as the line of least resistance in responding to the budget deficit. In fact, raising taxes and fees simply makes it inevitable that future budget deficits occur – because tax increases sustain ineffective programs that are seldom reviewed and modified.

- Fees and taxes were imposed in response to earlier budget problems, but instead resulted in adverse economic effects or unintended consequences. These are examples from state actions in the early 1990s:
 - Smog impact fees on vehicles purchased in other states were ruled unconstitutional, resulting in a \$500-million refund program with adverse and costly side effects.
 - Snack foods taxation created a consumer backlash until it was rescinded by initiative.
 - A personal income tax increase produced a fraction of the expected revenue. In 1991, when the 10% and 11% brackets were enacted on a temporary basis in California, they were expected to yield \$1.2 billion in revenue per year. A Franchise Tax Board analysis shows that actual collections were almost 50% less than that over the next several years.

A study by the National Bureau of Economic Research, analyzing 1993 federal tax increases on upper-income taxpayers, found a similar result. Two new brackets for those

with incomes over \$140,000 produced less than half the revenue anticipated in the static analysis.

High state tax rates make it more difficult for small businesses to obtain capital, to expand operations, and employ more workers. Moreover, California businesses are already reeling from massive increases in costs of operations due to rising expenses for workers' compensation and unemployment insurance, energy, environmental regulations, a plaintiff-oriented civil tort system, and other costs.

- The maritime bunker fuel tax drove suppliers out of California and policy-makers were forced to rescind the levy.
- Financing and accounting gimmicks, also known as smoke and mirrors, artificially prop up ineffective spending and postpone cost-effective measures that the public expects to see enacted. A “two-year” budget cycle could be a gimmick to blur the distinction between a balanced and an unbalanced spending plan.

REVIEW FRAUD, OUT-OF-CONTROL SPENDING, AND LOWER-PRIORITY PROGRAMS

Policy-makers at the state level have an opportunity to eliminate ineffective, lower-priority, wasteful and fraudulent use of tax dollars, and they should encourage cities and counties to do the same. Programs that defraud taxpayers and recklessly spend tax dollars on ineffective programs should be reallocated to priority needs. Public opinion polls consistently show that voters have a low level of confidence for governments' ability to match available tax dollars with essential public needs

<http://www.ppic.org/publications/PPIC163/PPIC163RB.pdf>. Fiscal discipline and better management of state finances by the Legislature would be well received by voters. For example, state and local bond measures are routinely approved by voters who are persuaded by measures that meet priority needs, have provisions that promote accountability to taxpayers, and include cost-containment strategies.

Press Reports. The following link is to our report entitled “***Tax \$\$\$: Fraud & Waste***.” This document, compiled by Cal-Tax staff, consists of more than 100 press reports of major daily newspapers, identifying billions of dollars of fraud and out-of-control public spending in California. These examples demonstrate the need for a complete review and evaluation of the spending base in this state. Taxpayers deserve better management of

public funds than these press reports describe. To view the abridged list of articles, visit:

<http://www.caltax.org/member/digest/Dec2002/12.2002.FraudWaste.04.htm>. To see the comprehensive version, go to:

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Dozens if not hundreds of fiscal and policy analysts are employed at public expense to work for the governor's Department of Finance, the Legislative Analyst's Office, legislative fiscal committees and research organizations. These analysts should immediately begin a systematic, comprehensive review of the spending base for cost-effectiveness and performance to restore the public's confidence in the way public resources are spent.

TAKE ADVANTAGE OF OPPORTUNITIES FOR POSITIVE STEPS

Take action to stabilize the state's financing system. Improved financial management and planning will help protect this state from vast swings in revenue resulting from the tax structure. As predictable as rain in the winter, California's progressive tax structure produces windfall revenue when the economy is sound, and equally predictable is the drop in revenue growth when the economy turns down. Better financial management and planning of state spending must recognize the volatility of the revenue structure and the need for careful planning of spending obligations.

It is vital that policy-makers implement strategies that improve this state's economic cycle to boost California's financial position. Much the same way we try to protect communities from floods and drought, policy-makers need to provide a financial plan for public spending so that the state does not over-obligate taxpayers during unstable economic periods. California must budget its resources with greater understanding of our boom-and-bust economic cycle. It is critical that California make maximum use of surplus-revenue cycles to invest in infrastructure and a competitive tax structure.

APPLY ECONOMIC STIMULUS

Private-sector job growth is California's largest revenue increase opportunity the state of California has. Each new job created in California generates several thousand dollars of revenue to public agencies. The enormous growth in tax revenue in the 1990s directly relates to growth in jobs and the economy.

State and local policy-makers must work to assure that California sustains a reputation as a place where business and industry can operate profitable enterprises. California needs a competitive tax structure and a hospitable business climate that attract investment. Policy-makers must continually review the costs of doing business in California. With regard to tax structure and public infrastructure, the following should be implemented:

- Exempt investment in plant and equipment from the sales tax. This would make California sales-tax law more competitive with other states and encourage investment in plants and equipment here.
- As the federal government reduces taxes to stimulate the economy, California should move in the same direction. Conform to changes in federal laws that are designed to improve the economy.
- Foster an attitude of cooperation and assistance in tax administration and regulation. Administrators and regulators should no longer be allowed to chase jobs out of state because of hostile, adversarial attitudes that create uncertainty and unpredictability.

PERFORMANCE CONTRACTING IS A KEY STRATEGY

Performance contracting is a key strategy for state and local policy-makers to lower costs for the delivery of high-quality public services. Performance contracting encourages state and local governments to consider competition in the delivery of public services. Numerous opportunities exist to contract with private sector companies and other public agencies to reduce cost and increase quality. Estimates of savings range from 10 percent to 40 percent from performance contracting. A growing number of cities, counties, schools and state agencies are utilizing performance contracting for services that include fleet maintenance, parking enforcement, public transit, emergency medical services, county health care, golf courses, road maintenance and tree trimming. A 1997 report, summarized on Cal-Tax Online, describes some of the opportunities for performance contracting and competition in the delivery of public services: <http://www.caltax.org/MEMBER/digest/jul97/jul97-3.htm>.

BEWARE OF THE SPENDING LOBBY

The largest, best-financed group of lobbyists in Sacramento is known as the spending lobby – advocates and lobbying organizations hired by cities, counties, schools, other local agencies, public employee unions, and those who receive funding from state and local government. The job of the

spending lobby is to protect the current spending base regardless of program effectiveness. Spending lobbyists primarily seek to ratchet up spending and sustain prior-year spending levels as a floor upon which to pressure for increases. These lobbyists generally resist the most basic management, planning, cost-effective evaluation and performance measures. Although the spending lobby supports increases in spending and higher taxes, the Legislature must say “NO” to their requests when it is obvious that such actions would promote governmental inefficiency, burden taxpayers, and cause an additional drag on the economy.

Overstating the Problem. There have been some dramatic statements to measure the size of the state budget deficit, such as statements suggesting the deficit is so large that eliminating higher education and other state programs would not be sufficient to close the gap. This hyperbole is part of the spending lobby disinformation effort. No rational person would want to see closure of the higher education system or wholesale elimination of any programs that serve priority needs in a cost-effective manner.

Here’s another way to measure the problem: the more than \$70 billion in revenue expected to be received in 2003-04 would more than cover the state general fund budget for the 1999-2000 fiscal year. This was hardly a medieval state 48 months ago when we funded schools, prisons, higher education, and health care. Clearly costs and case loads have increased. However, the rise in spending growth from 1999-2000 through the current fiscal year is well above inflation. Taxpayers have been over-obligated by state budget actions in the past five years. It is necessary to better manage state finances on behalf of state taxpayers, residents, and those who depend on public agencies for vital services.