It’s time to take a hard look at tax reform for California’s future

By Guest Commentary
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The coronavirus pandemic is sending shockwaves through the global and national economy, and, without a doubt, reverberations from the pandemic will have a huge impact on state budgets across the country.
While the coronavirus crisis and response is front and center for California lawmakers, a fiscal crisis, driven mainly by the state’s uniquely volatile revenue system, is brewing in the background.

The state’s general fund is largely reliant on personal income and capital gains, and both are extremely sensitive to economic downturns. With more of the workforce unemployed for the foreseeable future, reduced demand will lead to lower sales tax revenue, as well as lower corporate tax revenue – the other main pillars of revenue for the state.

Lawmakers looking to respond to the challenges from the pandemic, deal with declining revenue, and balance the state budget will be met with another major challenge: California’s relatively high fixed costs.

The state is home to two of the nation’s largest pension systems, CalPERS and CalSTRS, both of which are expected to have multibillion-dollar losses, and the state will need to make up a portion of the loss. Other fixed cost pressures – such as the rising cost of retiree health care – will further limit the options lawmakers have to balance the budget.

Meanwhile, the state will have to figure out how to support the growing number of unemployed workers. In the short term, lawmakers may be able to draw from the state’s rainy day funds and federal funding from the CARES Act, but those resources will only stretch so far.

If the state’s fiscal response mirrors that of the Great Recession, we may see lawmakers solve the budget shortfall by drastically cutting or delaying payments for vital programs, such as education. In 2008, many of these changes happened in spite of $31 billion in assistance from the federal government. California could again resort to fiscal triage of sorts: scrambling to plug budget holes and pay fixed costs in the short-term, while sacrificing programs that benefit future generations.

But we can also learn something from how California responded during the Great Recession. Arguably, California could not return to stable footing without new sources of revenue. The state enacted temporary personal income tax, sales tax and motor vehicle tax increases, and Californians voted to raise income taxes on top earners to increase funding for schools through Proposition 30.

History tells us that the state needs to find new, reliable revenue sources to fund our social safety net and public programs in the long run. While one proposal to reform commercial property tax will be on the November 2020 ballot, if passed, it may not be sufficient to fund the state during or after the pandemic, and it would restructure just one component of the state’s complex tax infrastructure.
Gov. Gavin Newsom should immediately launch a statewide committee on tax reform, working with the Legislature to act on reform before this legislative session comes to an end.

The good news is that several ideas for comprehensive tax reform already exist. During the 2008 recession, two committees were formed to address the state’s fiscal challenges: the state-sponsored Commission on the 21st Century Economy and the public-private partnership of The Think Long Committee for California. More recently, the state Controller’s office reviewed the state’s tax landscape and released its own recommendations for comprehensive tax reform. Lastly, the California Budget and Policy Center recently highlighted $63 billion in tax breaks to corporations and high-income households that should also be reviewed as potential revenue for the state.

California is long overdue for an honest conversation about tax reform. Policymakers need to ensure that we have a tax system that can withstand downturns such as this one, while generating more stable revenue for public programs and services that are vital to the well-being of future generations of Californians.

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Changing Prop. 13 will generate a tax bill that will harm small businesses, especially those owned by minorities