California's Tax Structure

Report to the

Commission on The 21st Century Economy

Jerry Nickelsburg
Senior Economist
UCLA Anderson Forecast

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California's Tax Structure

- Current Situation
  - Where are the revenue shortfalls
  - Implications beyond budget crises
- California Tax Analysis Summary
  - Sales and Use Tax
  - Property Tax
  - Income Tax
- Income Taxes -- a Closer Look
- Property Taxes and Prop. 13
- A Simple & Effective Change

Where are the Revenue Shorfalls: 2001 and 2008

($ Billions)

	FY '01/'02	FY '08/'09(e) DOF
♦ Sales / Use	-0.5	-1.6
♦ Corp. Income	-1.5	-1.6
♦ Pers. Income	-11.5	-7.2
♦ Total	-13.5	-10.4

e -- special session estimates November 2008

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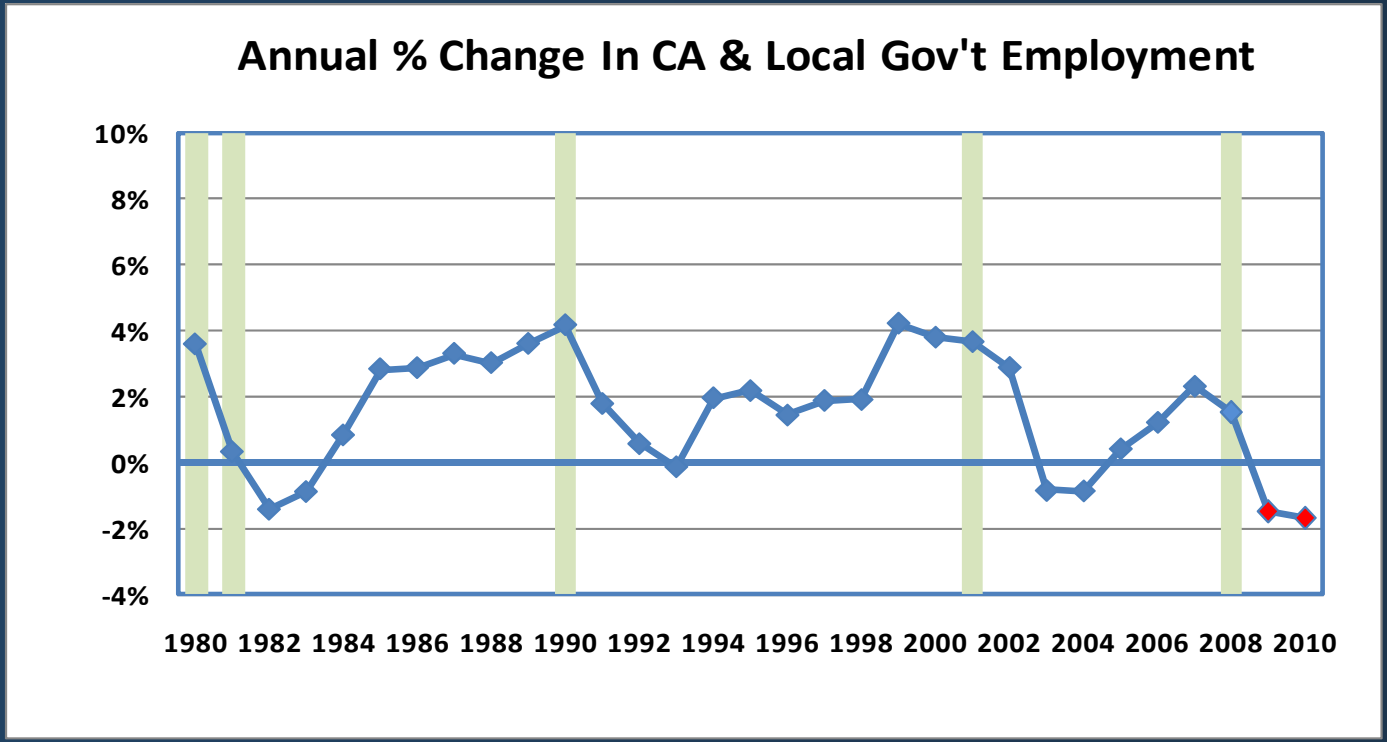
Implications Beyond The Crisis



- Budget Solutions May Mask Unemployment
- Cumulative Job Loss = -80,000 jobs
- Current Budget Problems Will Slow Recovery

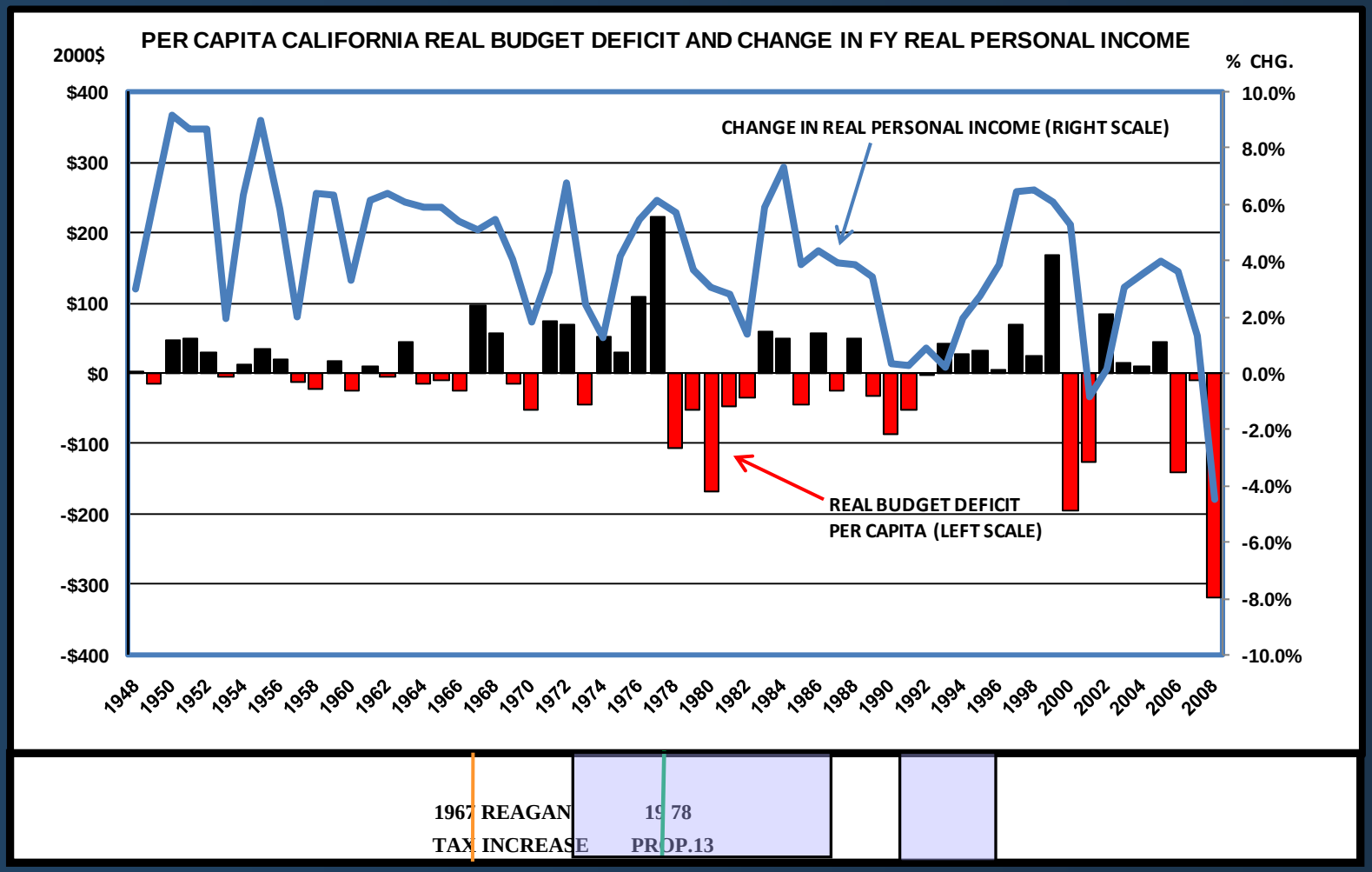
California Tax Analysis: Highlights

- Property Taxes:
  - CA Below U.S. Average P.T. burden, but not by much
  - No Correlation between reliance on Property Taxes and fiscal stress
  - No Correlation between State transfers to local governments and fiscal stress

- Sales and Use Taxes
  - CA Reliance on sales and use taxes in bottom 20%

- Income Tax
  - CA No. 5 in state reliance on income tax
  - CA in top 10 in variability of income

HISTORICAL ANALYSIS OF CALIFORNIA DEFICITS



SLOWING GROWTH ⟹ DEFICITS

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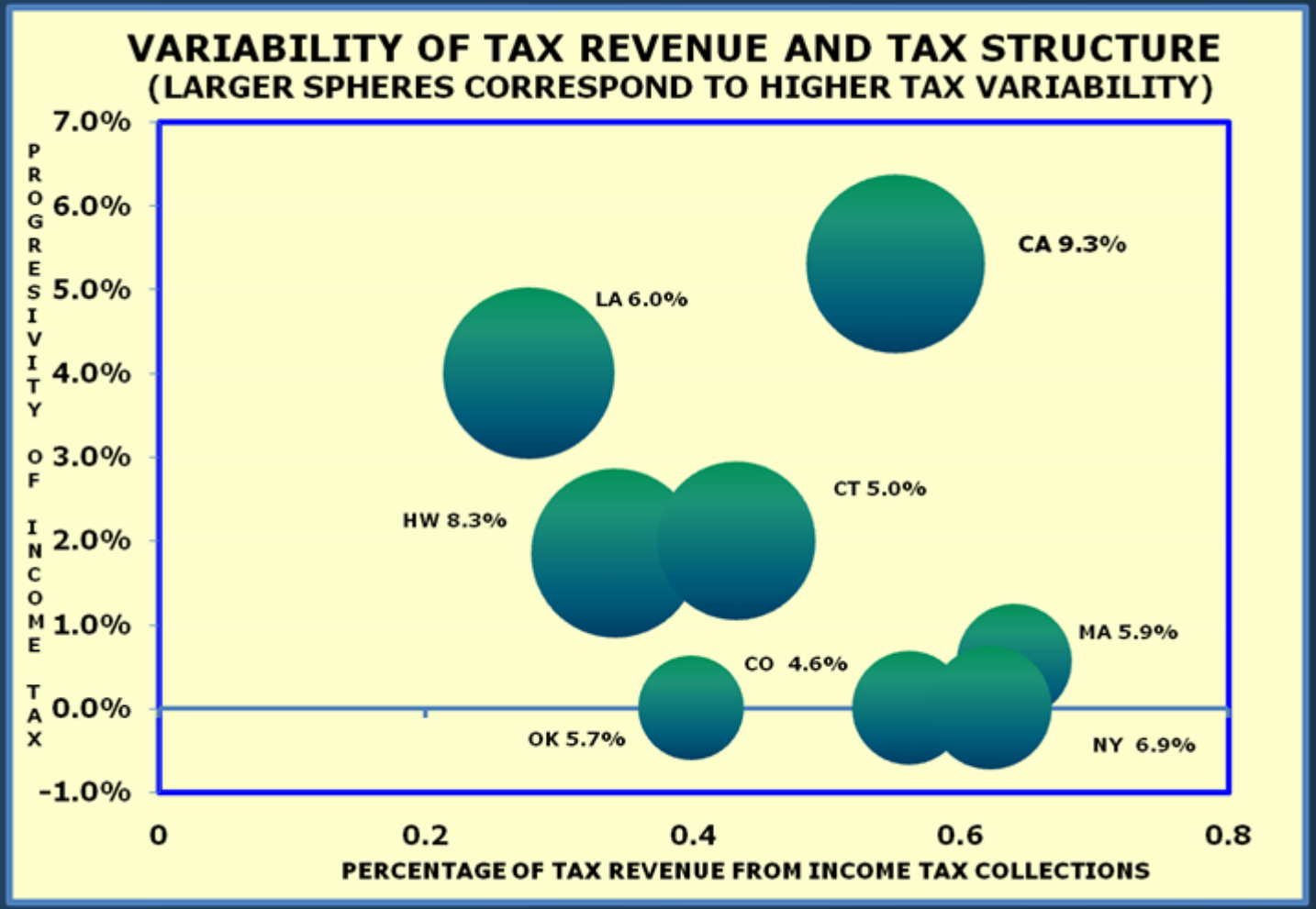
Income Variation: Cross Section Analysis



More Progressivity and Higher Top Bracket

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Larger Spheres

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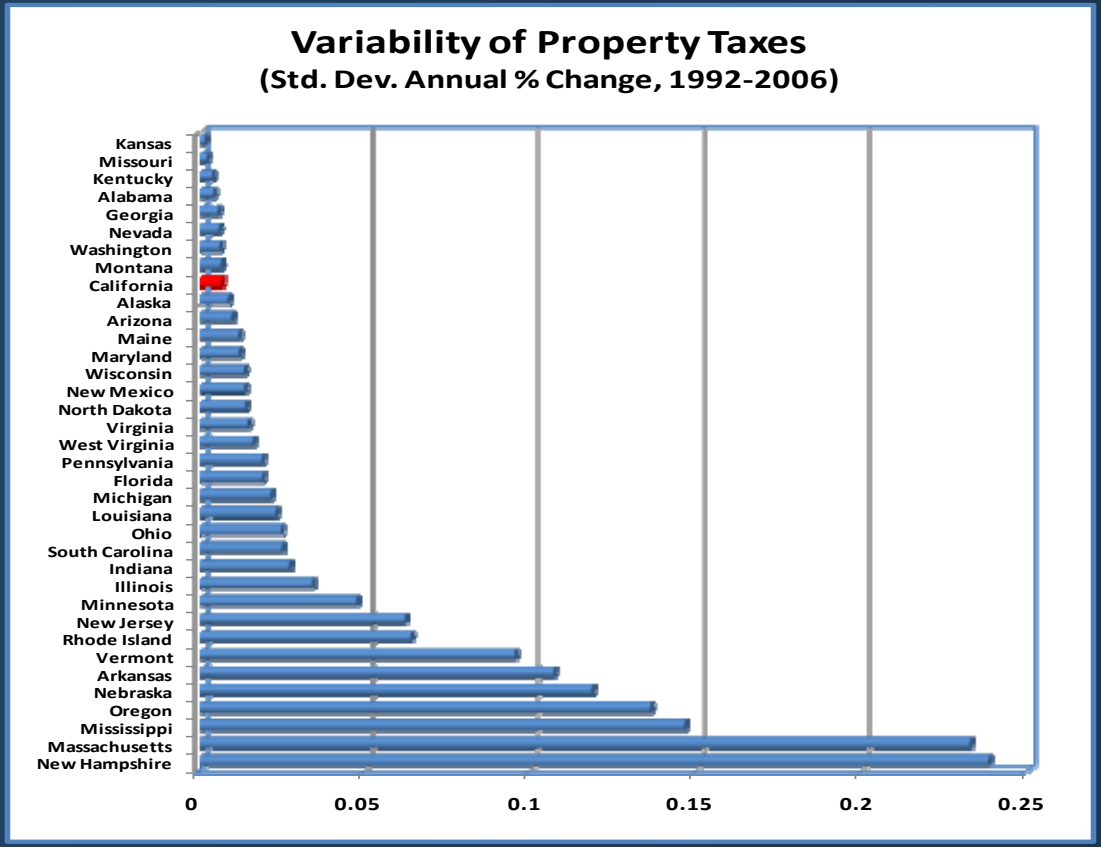
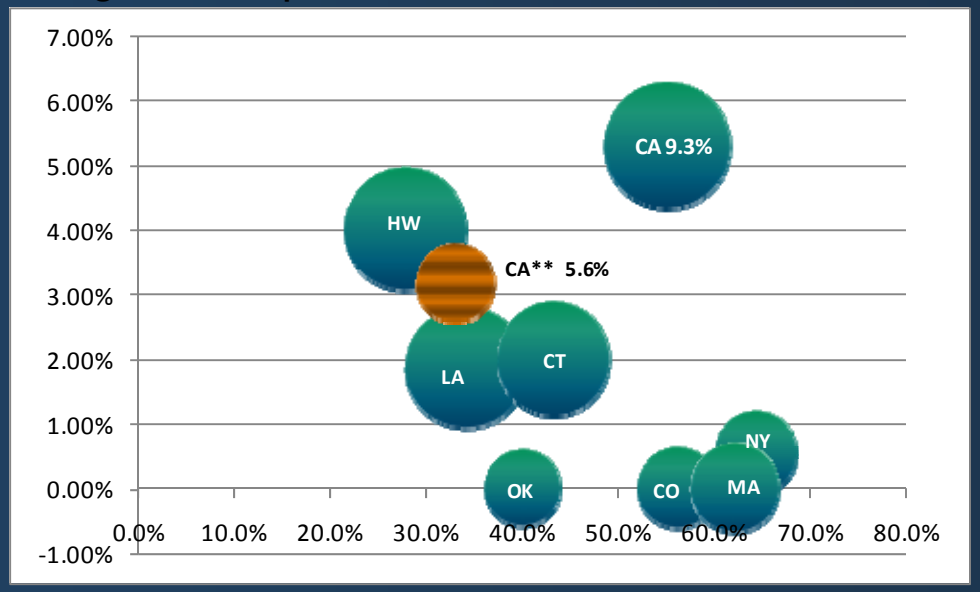
Prop 13's Impact on Volatility



- CA has periodic swings in property values
- But Prop. 13 Moderates their impact on property tax revenue

A Simple Alternative: Tax Wealth

- Assume:
  - 40% Reduction in Income Tax bracket rates
  - 70 mill increase in Property Taxes
  - No change in Prop 13 annual increase Limitations



- Issues
  - Need exemptions/credits to retain progressivity
  - Need to avoid unexpected consequences of sudden change

California's Revenue Mess

- Highly Progressive Income Tax
  + Highly Variable Income =
  Recurrent Budget Crises
- Crisis will happen again without a change in the tax structure.
- Prop. 13 makes Property Taxes more stable than income taxes
- The social goals of progressivity and justice can be achieved without the chaos of budgetary shortfalls inherent in the current system