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Asimow and Stark: Temporary tax hike is best state budget solution

By Michael Asimow and Kirk Stark - Special to The Bee
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"Tax, Budget Woes Grow"

"Financial Illness Could Kill Local Government"

"State Budget Is a Fiscal Time Bomb"

Do these headlines sound familiar? If so, you were probably reading California newspapers in 1967, 1971 or 1991. In each of those years, the state faced a budget crisis eerily similar to the one now upon us. What distinguishes those years from the current mess is that each time a Republican governor – Ronald Reagan in 1967 and 1971, then Pete Wilson in 1991 – joined with state lawmakers to raise taxes to bridge the budget gap. And in each case, taxes were reduced after the budget crisis had passed. Why not continue the tradition and enact a temporary tax increase today?

In the twisted world of California budget politics, a temporary tax increase has a compelling logic. The state constitution requires a balanced budget, but legislators can't agree on how to get there. Democrats want tax increases, but the public fears an ever-expanding public sector. Republicans prefer spending cuts, but voters don't want to slash essential state programs. Back-door borrowing and other budget gimmicks only put off the inevitable and dump the burden of current spending onto future generations. What a mess! The irresistible force meets the immovable object.

A temporary tax increase could help break the stalemate. The idea is that the Legislature would enact an increase in income taxes with bipartisan agreement. Critically, however, the legislation would include a sunset clause to ensure the tax hike's eventual demise.

The idea has much to recommend it, even apart from its bipartisan pedigree.

Most important, a temporary tax increase would allow the state to avoid drastic spending cuts for vital public services, especially in education.

According to a recent poll from the Public Policy Institute of California, 86 percent of respondents expressed concern that state budget problems will cause significant spending cuts in K-12 education, with 56 percent describing themselves as "very concerned."

These polling results suggest that most Californians oppose a cuts-only budget and the havoc for public services that such an approach would entail.

In addition, because of its preplanned expiration, a temporary levy changes the usual cost-benefit calculus associated with tax increases. One of the chief arguments against tax increases of any sort is the adverse effect on business climate and market incentives. Republicans rightly point out that California needs to attract business and not drive it away by excessive taxes. In the case of a temporary tax increase, however, these concerns are mitigated by the inclusion of a sunset provision specifying a precise date for the levy to expire – say two or three years out. Unlike a permanent tax increase, this approach signals that the state is serious about keeping its financial house in order without using the budget crisis as an excuse to ratchet up tax revenues over the long term.

How would a temporary tax increase work? In the past, lawmakers have relied upon an increase in the top personal income tax rate, ensuring that only the wealthiest Californians would be subject to higher taxes. For example, the temporary tax increase signed into law by Wilson in 1991 raised the top personal income tax rate to 11 percent.

An alternative approach would be a surcharge added to the state income tax. For example, assuming an income tax surcharge of 10 percent, a taxpayer with state income tax liability of \$2,000 would owe an additional \$200 in taxes, while someone with a \$5,000 liability would owe \$500 in taxes. Under this approach, the distribution of the surcharge burden would mimic the distribution of current state income tax.

A temporary 10 percent surcharge on the personal income tax would raise about \$5.5 billion, with an additional \$1 billion coming from a comparable levy on corporations. Significantly, however, much of the increased burden for taxpayers would be offset by a reduction in their federal tax liability. Taxpayers who itemize their deductions could recoup as much as 35 percent of the increased cost via itemized deductions on their federal income tax returns. Thus, the federal government would share in the overall cost of addressing California's budget crisis.

To be sure, the idea of increasing taxes – even temporarily – won't please everyone. Liberal Democrats will complain that it's not enough and that the state's structural deficit needs a permanent increase in taxes. Conservative Republicans will fight the idea of any new taxes, temporary or otherwise. But political leadership is not about satisfying everyone. As Reagan and Wilson showed us many years ago that sometimes compromise is required to get the state through a crisis without doing lasting damage.
