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INSTITUTE OF INDUSTRIAL RELATIONS
(415) 642-0323

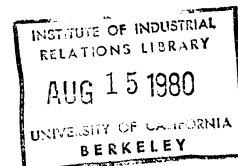
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RESEARCH REPORT

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JARVIS II

by Bruce Poyer, Coordinator



It is the intent of Jarvis II (Proposition 9) to require a 50% reduction in state income tax rates. If approved by voters in June, and if the state legislature does not change the effective date of January 1, 1980, it would become necessary to reduce the state budget proposed for fiscal 1980-81 by an estimated four to five billion dollars (or about 25%).

To prepare for that possibility, Governor Brown has asked all state agencies to submit alternative budgets indicating their priorities for cuts in jobs and services up to 30%. Then if Proposition 9 passes in June, it would be up to the legislature and the Governor to decide what priorities to accept and what cuts to make in the budget they are supposed to enact by July 1.

If the state legislature enacts the Campbell bill, the tax cuts proposed by Proposition 9 would become effective only when approved by the voters--i.e., as of June 3, 1980. The full 25% reduction in the state budget would not then be required until next fiscal year--and, of course, every fiscal year thereafter. (Only about half the full annual cut would be required this fiscal year.)

The net effect of passage of Proposition 9 would be the same in either case--only the timing would differ. Unless alternative tax levies were quickly legislated, thousands of state and local government jobs would soon have to be eliminated and government services of all kinds, throughout the state, would soon have to be drastically reduced.

1. Who Would Get the Proposed Tax Relief?

According to Legislative Analyst William Hamm, Californians in households with incomes of \$20,000 a year or less (the vast

majority of all Californians) would get only 23% of the total tax relief proposed in Proposition 9. That amounts to an average of only \$257 in reduced taxes. But households with incomes of \$30,000 a year or more would get 54% of the tax relief proposed in Proposition 9, which amounts to an average of \$4,239 in reduced taxes.

Those at the very top of the California income pyramid would benefit most from Proposition 9. More than one-third of the total amount of tax savings would go to the wealthiest 5% of this state's taxpayers. And there would be no change in corporate taxes under Proposition 9.

2. Is There an Alternative to Proposition 9?

The California Labor Federation has mounted an all-out campaign against Proposition 9, and all the major labor organizations of the state are urging union members to petition for and to support an alternative approach to tax relief. The alternative is the initiative of the California Tax Reform Association, proposed for the November ballot. This measure would provide more tax relief than Proposition 9, and would give most of it to households with \$20,000 or less in annual income. It would accomplish this change in the tax burden without requiring the loss of jobs or drastic cuts in needed public services. It would do so by raising tax rates at higher income levels, under both the personal and the corporate income tax, and by reducing personal income tax rates at lower personal income levels.

The CTRA initiative, called the "California Tax Simplicity Act," would therefore reverse the Jarvis II or Proposition 9 approach in the following respects:

- (a) by raising more state tax revenue from households with \$30,000 and more in income; and
- (b) by reducing or eliminating altogether the tax burden of households with \$20,000 or less in income; and
- (c) by increasing corporate income taxes.

The CTRA initiative not only provides greater tax relief than Jarvis II, but it is also a significant tax reform measure, which Jarvis II is not.

Jarvis II is getting all the current attention because it comes to a vote first. But passage of Jarvis II in June would render the CTRA "Tax Simplicity" initiative meaningless next November.

Therefore, if California voters are to have the chance to opt for more responsible tax reform, which would give more economic benefit to the majority of voters, then it becomes essential to understand more about what people expect from a major change in state tax policy--and whether they really want to get it by voting for Jarvis II.

3. What are the "Unessential" Jobs and Services to be Cut by Jarvis II?

The proponents of Proposition 9 encourage the belief that many government jobs and services are not important to the California economy, and that these can be identified and cut out of government budgets without being missed.

But Proposition 9 does not seek to identify or gain agreement on the "unessential" jobs and services to be cut. Instead, it requires broadside budget cuts, which would seriously affect both state and local programs in education, health care, housing and community development, industrial relations, urban transit, parks and recreation--among others. These programs are important to everyone in the state--and not just to some "other" voters.

In industrial relations, for example, workers would face cutbacks in the state's health and safety program, in state services to settle labor disputes without strikes or lockouts, in apprenticeship and other job training programs, and in funds for the enforcement of state labor laws--including child labor laws.

In college education, the tuition charges necessitated by Proposition 9 would exceed the possible tax savings of all families up to the \$30,000 annual income bracket. In primary and secondary schools, Proposition 9 would force cuts of teachers, student activities, subjects, materials, equipment and plant maintenance far exceeding the cuts already necessitated by Proposition 13.

In public transit, there would be sizeable cuts in the state subsidies now being given to local systems. And these cuts would occur just when state subsidies should be further increased to meet the needs of the growing number of people now being forced to limit their automobile transportation because of uncontrolled increases in the price of gasoline.

4. Will Prices Fall if We Stop "Inflationary" Government Spending?

Many people correctly believe that inflation is a primary domestic problem of our time, but mistakenly assume that state and local government spending is a chief cause of inflation.

The current national discussion of the possible inflationary effect of the federal government's budget deficit is not relevant to the California economy. Like its local jurisdictions, the state of California is legally required to balance its budget--and has never been involved in any kind of deficit spending.

Even in terms of the national economy, government spending is not the chief cause of current inflation. The most rapid

rates of inflation in recent years have been in the prices charged not for government services but for energy products--particularly gasoline--and for housing, food, and medical care. Prices charged for these four components of the Consumer Price Index (taking up two-thirds of the average family's budget) rose at the rate of 17.6% in 1979. All other prices in the CPI, including prices charged for government services, rose at the rate of only 6.8%.

The monetary policy of the federal government, ironically designed to check inflation, certainly does increase housing prices, by driving mortgage interest rates continually higher. But the state of California does not set that policy, and no one in California can cope with the inflation of housing prices by cutting our state's housing and community development services, as Proposition 9 proposes to do.

5. Can Private Enterprise Provide the Public Services to be Cut by Jarvis II?

Many people seem to believe that if public sector budgets are reduced, the private sector (or the "free enterprise business sector" of our economy) will move in to provide the same services. However, the nature of public goods and services does not permit the private sector of our economy to provide them. Most goods and services supplied by the public sector must be made available to all citizens if they are made available to any citizens. But the objective of the private sector is to supply only those who want to buy or can be persuaded to buy at a price that returns an acceptable profit to the businessman. The terms of such exchange are quite different than anything expected in the public sector of the economy.

One example is clean air. Presently each of us "purchases" clean air by paying taxes to support the government in its environmental regulation and its subsidies to public transit. There is no way for private business to sell "the right to clean air" in the private sector marketplace. Unless the large majority of citizens and businesses participate in a program to reduce air pollution, the actions of any one group to establish its own clean air will be futile. But if a drive by the majority to clean up the air is successful, then all citizens will benefit whether or not they helped to pay for this particular project. Also, a public transit system which reduces automobile use results in cleaner air, which is of equal benefit to everyone in the community--including those who would never think of using public transit.

There are many similar examples. A well-educated public results in better productivity and other public benefits which extend beyond the gains of those who learn in schools. Public programs for crime control, or for control of carcinogens, or for control of toxic wastes, or for control of infectious diseases, all result in special advantages when they are designed to protect everyone in the community. It is like an

ounce of prevention being worth a pound of cure. For the same amount of money, community prevention results in greater benefits than could possibly be made available to all the individuals who might otherwise be victims of crime, or of cancer, or of pesticide poisoning, or of polio or encephalitis.

Whenever the benefits of a good or service extend beyond the individual who is directly consuming the good or service, the private sector marketplace cannot be used to sell the good or service, because the individual consumer will not be willing to pay the businessman for the benefits accruing to the public at large. Therefore, if the government does not provide the public goods and services that make our state a more healthful, orderly, and desirable place to live, then these goods and services will not be provided at all. As a consequence, the standard of living for all of us will fall.

6. Once the "Economic Fat" is Gone, Won't Other Funds be Found?

It is an article of nearly absolute faith on the part of Jarvis II devotees that if state tax money is cut off for thousands of jobs and hundreds of important service programs, the "economic fat" will be quickly reduced, and somehow or somewhere other sources of funding will be found to preserve whatever it becomes essential to preserve.

That was not true of Proposition 13, and it is even less true of Proposition 9. The major cuts required by passage of Proposition 13 were delayed while the state used up its surplus funds to bail out the local governments. But that grace period is clearly over, and cities like San Francisco are now leading the agonizing cutback process. Even if Proposition 9 fails, that process will continue, and will soon affect all areas of the state. Some alternative revenue sources have been found at some local levels, but not enough to save deep cuts in important jobs and services. And no alternative revenue sources have even been proposed--let alone enacted--to permit the state to continue its bail-out role.

If Proposition 9 passes, some fiscal chaos will result in California, and from that will undoubtedly come some urgent new proposals to make up at least part of the lost income tax revenues by increases in sales taxes (including those sales taxes which are thinly disguised as "value-added" taxes). But these taxes are not progressive--that is, the tax rates do not increase as incomes increase. Therefore, the burden of these alternative taxes would fall more heavily on the same low and moderate income workers and consumers who would get the least amount of income tax relief from Proposition 9!

7. Isn't a Vote for Jarvis II Just Another Vote
Against "Big Government"?

The "close-out" argument for Proposition 9 relies again on the emotional appeal generated for Proposition 13, to the effect that any vote for any broadside tax cut is a vote against everything evil in "big government"--even if that vote just "sends a message" to Washington, D.C., where most of the evil of bureaucracy is supposedly concentrated.

But the vote for Proposition 13 in fact made government bigger in Washington, and less responsive to the voters of California, by shifting 22% of the savings from local property taxes to the federal tax structure. This happened because the state's taxpayers were unable to claim as much in federal deductions for the local property taxes they used to pay.

For the same reason, another 14% of the "savings" from local property taxes was shifted to the state tax structure--as a small part of the enormous amount of temporary bail-out funding provided to local governments by the state after passage of Proposition 13.

Thus a total of 36% of the "savings" from Proposition 13 was not a tax cut at all, but a shift in taxes from local to federal and state levels--which made these "bigger" governments still bigger. In exchange, the local owners of residential property got only 24% in tax relief from Proposition 13. The "big governments" got more--36%. But "big business" as usual got the most, because 40% of the tax relief of Proposition 13 finally went to businesses and other owners of commercial property.

Proposition 9 would make "big government" still bigger, by shifting another 1.5 billion dollars in annual taxes from the state to the federal government--again because the state's taxpayers would be unable to claim at least that much annually in federal deductions for state taxes. Is that the "tax revolt message" which California voters are being urged to send to the "big government bureaucrats" in Washington? Then these "bureaucrats" will be very happy to hear from our voters again, so soon after we sent back our enormous Proposition 13 donations to support their "big government bureaucracy."

Even more importantly, Proposition 9 would leave local government in California almost devoid of any real public responsibility, by completing the destruction of its tax base, and replacing it with nothing. With all the cuts that are in store if Proposition 9 passes, its author promises only to seek to restore a minimum level of police and fire protection--with a new tax revenue initiative expected to be on the ballot next November.

8. Summary and Conclusion

Proposition 9 proposes extensive tax relief for a minority of Californians in upper income brackets, and minor tax relief for the majority of Californians. It seeks to achieve all tax "savings" by requiring widespread job layoffs and service cutbacks which would sooner or later affect all Californians--especially through reduced support of education. And it would seriously weaken the most important and the most progressive source of tax revenues in California--the state income tax.

Contrary to the claims of its proponents, Proposition 9 does not cut only "unessential" jobs and services, or "economic fat"; instead it requires extensive broadside cuts that sooner or later would adversely affect everyone in the state.

Proposition 9 would not reduce inflation by reducing the deficit spending of California government--simply because there is no deficit spending in California. When budgets are short, government officials are legally required to cut jobs and services in California.

Proposition 9 would not pave the way for private business to move into the public sector to fill the jobs and perform the services that would have to be cut. In fact, the public sector has had to assume a great deal of responsibility (among other things) for services required to clean up the pollution left behind by private business. Does anyone now seriously expect private business to search out particular customers and try to "sell" them clean air, or meaningful protection from cancer or from chemical contamination in the workplace or in the food chain? It would be easier to sell the Brooklyn bridge to such customers!

If Proposition 9 passes, it might be possible for concerned legislators to pass other taxes to make up at least part of the revenue loss--whenever police or fire or hospital or mental health services are reduced to the point of unquestioned community danger. But most alternative sources of revenue either proposed or now in use are not as progressive as the income tax which Proposition 9 would cut back, and thus would put a greater burden on taxpayers in low and moderate income brackets.

Would those in higher income brackets, because of more favorable tax treatment, then be able to pay for private police service, for example, in order to reduce crime in their neighborhoods? Perhaps so, and their odds to prevent crime might even improve--if they were also willing to stay in their own neighborhoods in their own homes, and not venture elsewhere.

Finally, neither Proposition 13 or Proposition 9 can make any government at any level any more responsive to the angry dictates of California's "tax revolt" prototype. The opposite is true of the responsiveness of government. Both initiatives--especially Proposition 9--shift local responsibility and local control to the federal government. As a result of both propositions, the federal government ends up distributing to other states an enormous amount of revenue which the California taxpayer used to control much more directly by his own local vote.

If Proposition 9 is not approved in June, California voters can opt in November for the Tax Simplicity Initiative, proposing more significant tax relief for the vast majority of California households--those with incomes of \$30,000 or less. The savings for these taxpayers would be achieved by tax reform, rather than by cuts in government jobs and services. The tax reform proposed by CTRA would require increases in the income taxes of the minority of Californians who are in households with incomes of \$30,000 or more, and further increases in corporate income taxes. And the initiative would preserve and strengthen the most important and the most progressive source of tax revenue in California.

(Note on Sources: All data on the tax impact of Prop. 9 is from "IMPACT OF JARVIS II TAX REDUCTION INITIATIVE BY TAXABLE INCOME CLASS," compiled by the California State Legislative Analyst, William Hamm, and first published in the Legislative Analyst's November 8, 1979 letter to Senator Rodda.

All data on the tax impact of Prop. 13 is from an analysis by the Revenue and Taxation Committee of the California Assembly, as published in Consumer Reports, 1979, and reprinted in United Food and Commercial Workers Action, November, 1979.

See also various reports on Prop. 9 in the California AFL-CIO News, Feb. 22, 1980 et seq.)

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