CALIFORNIA BUDGET PROJECT

BUDGET WATCH

MARCH 2006

ADDITIONAL REVENUES IMPROVE 2006-07 BUDGET PICTURE, STATE STILL FACES LONG-TERM PROBLEMS

Substantially higher than anticipated revenues have significantly improved the state's 2006-07 fiscal picture. The Governor's Proposed Budget uses the additional revenues to increase spending for education and transportation and to pre-pay a portion of the state's outstanding debt. The Governor's proposal also outlines an ambitious public works plan (see page 4) and reduces spending for programs for low-income and other vulnerable Californians.

The Governor's Proposed Budget assumes General Fund spending of $97.9 billion in 2006-07 and $92.0 billion in General Fund revenues. The $5.9 billion operating shortfall – the gap between budget year revenues and expenditures – would be covered by a $7.0 billion carry in balance from 2005-06. The state would end the year with a $613 million combined reserve and Budget Stabilization Account under the Governor's budget assumptions.

The Governor's budget assumes that 2004-05 revenues will be $2.3 billion above previous estimates, that current year revenues will be $3.2 billion higher, and that 2006-07 revenues will be $3.7 billion above prior estimates. The Legislative Analyst's Office (LAO) February review of the budget projects even stronger revenues, with a forecast that is $2.3 billion above the Governor's combined estimate for 2005-06 and 2006-07. Under the LAO's forecast, based on the Governor's policy proposals, the state would spend $5.0 billion more than it collects in revenues in 2006-07 and end the year with a combined reserve and Budget Stabilization Account of $2.6 billion.

IN THIS ISSUE

Major Proposals in the Governor's Spending Plan

The Governor's Proposed Budget:

- Boosts spending for K-14 education by $1.7 billion above the constitutional minimum and "buys out" student fee increases at the University of California and the California State University at a cost of $129 million. The budget also allocates $426 million for after school programs as required by Proposition 49.
- Claims it does not include any tax increases, yet suspends the teacher's tax credit for an additional year, increasing 2006-07 revenues by an estimated $210 million. The Governor also proposes to extend the collection of use taxes on certain vehicles, boats, and aircraft purchased outside of California and brought into the state for an additional $35 million in revenues.
- Asks the voters to "lock in" certain transportation spending and the Legislature to give governors the ability to make unilateral mid-year budget cuts. Voters soundly rejected Proposition 76, which included similar provisions, in November.
- Does not include funding for additional salary or benefit costs for 18 of the state's 21 collective bargaining units that have expired or soon-to-expire agreements.

Despite a significantly improved revenue picture, the Governor proposes significant reductions in spending in a number of programs that serve low-income Californians, vulnerable children, the aged, and those with disabilities. The Governor:

- Further delays a federally-funded cost-of-living adjustment (COLA) in the SSI/SSP Program, which provides cash assistance to aged and disabled Californians to help meet basic living expenses. The Governor would delay the January 2007 COLA until July 2008. The monthly SSI/SSP grant level for an individual would be $836 in 2007 and would have 21.3 percent less purchasing power than in 1990.

- Continues to suspend COLAs for CalWORKs grants included in the 2005-06 budget and withholds the October 2003 CalWORKs COLA, pending the outcome of the state's appeal of a court decision that ruled that CalWORKs grants should have been increased when the Governor reduced Vehicle License Fees (VLF) when he assumed office in 2003. The Governor assumes $460 million in savings from withholding the October 2003 COLA.

- Cuts current-year child care funding for the CalWORKs Program by $114.6 million, arguing that the funds are not needed because fewer than expected CalWORKs recipients have moved into the workforce. Opponents of the proposed reduction note that these funds can be used to provide employment and other supportive services, as well as child care, and that the stiff work requirements contained in the recent federal budget reconciliation bill will place substantial new demands on county welfare-to-work programs.

- Diverts $379.7 million in federal TANF funds in 2005-06 and 2006-07 to replace state funds in Child Welfare Services, Foster Care, and Developmental Services, and does not fund inflation adjustments for county-administered human services programs.

Court Decisions and Federal Budget Policies Could Increase State Costs

While recent forecasts will significantly ease pressures on the budget, a number of factors could offset the surge in revenues. Several lawsuits could add $1.5 billion in costs to the budget. In addition to the Guillen case addressing CalWORKs COLAs discussed above, a case involving contributions to the State Teachers' Retirement System (STRS) contributions could boost state costs by $500 million, and the state's loss of an appeal of a case regarding the legality of a proposed pension obligation bond could increase 2007-08 pension costs by $525 million.

Federal budget actions will also affect the state's finances. The recently enacted federal Deficit Reduction Act of 2005 (DRA) could increase state costs by over $680 million dollars annually when fully implemented and would take a significant toll on programs that affect low-income families and children. While Republican leaders have defended the proposed reductions as necessary to reduce the federal budget deficit, the savings from the DRA are significantly less than the costs of tax cuts under consideration in both the House and the Senate. Provisions of the DRA affecting California include those which:

- Reauthorize the Temporary Assistance for Needy Families (TANF) block grant for five years, continuing funding at a level that has not been increased since 1996. At the same time, states would be required to implement costly new requirements with minimal additional child care funding. The California Budget Project estimates that the new requirements would increase costs by more than $400 million in the first year after the new requirements become effective. These new costs would dwarf California's share of additional child care funding, estimated at $25.7 million per year. California could be subject to federal penalties if it is unable to meet the new work requirements. The penalties could cost the state approximately $160 million in the first year that the state fails to meet the new requirements. In addition, federal law would require the state to increase its maintenance of effort (MOE) spending by $180 million per year if it does not meet the new requirements.

- Prevent the state from imposing its current Medi-Cal managed care provider tax beginning in federal fiscal year 2010. Under the DRA, states would be required to tax all providers, not just those in the Medicaid program. This would result in an annual loss of approximately $166.5 million in federal funds. This tax has allowed California to increase reimbursement rates for managed care organizations without additional General Fund spending.

- Allow states to impose or increase cost sharing requirements on many Medi-Cal beneficiaries and restrict benefits provided to children. The new authority would allow states to impose co-payments and premiums on children with incomes modestly above the federal poverty level (FPL).

- Decrease federal funding for child support collection activities by prohibiting states from using certain "incentive" funds as a match for federal funds. As a result, California stands to lose $270 million in federal funds over five years. The DRA also assesses a $25 annual fee on states for each family that does not receive cash assistance, but that does receive child support services beginning in federal fiscal year 2007. The LAO estimates this would reduce federal funding to California by $5 million per year.

- Overturn a 2003 9th Circuit Court of Appeals decision in *Rosales v. Thompson*. The Rosales decision requires officials to consider the income of the relatives with whom a child is placed, rather than the income of the home from which a child was removed, when determining eligibility for foster care. The DRA would result in some California children losing eligibility for foster care services. The LAO estimates that this would result in a loss of $5 million per year. Alternatively, if the low-income family members caring for these children are no longer able to do so, these children would be at risk for placement with strangers at a higher reimbursement rate and thus higher cost to the federal, state, and county governments. The DRA also limits the amount of administrative funds that states can claim when children are placed in facilities that do not meet federal standards. The LAO estimates that this provision would cost California $15 million to $20 million in federal funds annually and $90 million over five years.

President Bush's proposed 2007 budget would result in further cuts to California of more than $3.9 billion over the next five years. Proposed cuts would affect schools, as well as critical services for children and families. If enacted, the California impact of the President's budget would include:

- A reduction in federal funding for K-12 education of $729.6 million from 2007 to 2011, and by $355.2 million in 2011 alone and by $1.2 billion in 2011 alone relative to 2006. Special education would experience the largest share of these cuts, losing $574.5 million between 2007 and 2011 and $178.9 million in 2011. Federal funding for vocational education state grants would be eliminated.

- A loss of funds for the Head Start Program and programs for abused and neglected children of $446.1 million between 2007 and 2011. This reduction corresponds to a loss of at least 10,100 Head Start slots.

- A reduction in support for the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) of $415.4 million between 2007 and 2011 and $129.5 million in 2011. The proposed reduction would result in WIC serving an estimated 77,300 fewer California children and pregnant and breastfeeding women in 2011.

- A reduction to California's Child Care and Development Block Grant of $114.3 million over five years, and by $35.0 million in 2011.

- Funding for the Community Services Block Grant (CSBG) would be eliminated in 2007 resulting in reductions of $304.1 million between 2007 and 2011 and $63.4 million in 2011 alone. The CSBG distributes funds primarily through community action agencies to provide services for low-income families and individuals.

- Funding for the Social Services Block Grant (SSBG) would be reduced by $60.7 million in 2007. The SSBG provides states with discretionary funds for human service programs such as reducing dependency and maintaining self-sufficiency for low-income families, preventing or remedying child maltreatment, and providing community-based care for individuals with disabilities. California uses SSBG funds to support services for children and adults with disabilities and Community Care Licensing.

Outstanding Budget Related Debt Totals Approximately $20 Billion

California's reliance on debt to help close recent budget gaps will burden future years' budgets. While the Governor's Proposed Budget pre-pays some of the state's outstanding debts, including early repayment of some transportation loans ($920 million) and an additional payment toward outstanding deficit financing bonds ($460 million), the state still faces significant debt. The LAO estimates the state will owe $20 billion at the end of 2006-07 in debts related to budget balancing efforts, with $15 billion borrowed from investors using deficit financing bonds and from borrowing against the state's proceeds from the national tobacco settlement, and $5 billion owed to schools, local governments, and special funds. The state will incur annual debt service costs of approximately $3.7 billion in 2006-07 and more than $5 billion in 2008-09.

Future Budget Challenges

While the state's near-term fiscal situation has improved substantially, California faces a number of challenges in 2007-08 and beyond. As noted above, spending is expected to exceed revenues through at least the end of the decade and federal budget reductions will worsen anticipated shortfalls. A slowdown in the economy and, in particular, state housing markets could reduce revenues and increase state costs for education. By official national measures, the current economic expansion began in November 2001. Economists point to the nation's rising trade deficit, mounting consumer debt, and increases in energy prices to suggest an increased likelihood of a downturn.

Despite the strength of recent and anticipated revenue growth, the state still faces a sizeable and growing budget gap beginning in 2007-08. The LAO estimates that the state will face shortfalls of $4 billion in 2007-08 and nearly $5 billion in 2008-09. These gaps could widen if the state's economy stalls. Both the LAO and the Governor assume continued, although modestly slower, economic growth. The LAO notes that an economic slowdown could "easily reduce General Fund revenues by as much as $4 billion from our projected level in 2006-07." A $4 billion drop is equivalent to more than a 40 percent reduction in state support for community colleges or, alternatively, an elimination of state funding for In-Home Supportive Services, Foster Care, the Healthy Families Program, Community Mental Health Services, and Child Welfare Services.

Moreover, lawmakers will have fewer options available for coping with future budget gaps than during the budget crisis of the early 1990s or during the worst of the crisis of the early 2000s. A series of court decisions have limited the Legislature's ability to use some of the approaches used during the early 1990s. More recently, ballot measures sanctioned the current use of various budget balancing strategies, while severely limiting the ability of future legislatures to use similar provisions. For example:

- Proposition 1A of 2004 allowed the state to reallocate property taxes for two years to generate savings in state education costs, while severely limiting the ability of future Legislatures to do the same. Proposition 1A also requires the state to promptly reimburse local governments for costs related to mandated programs and services. Previously, the state had deferred reimbursement to hold down state spending. Finally, Proposition 1A locks in the state's reimbursement of local governments for lost VLF revenues. In 2003, then-Governor Davis used the so-called trigger mechanism linked to the reimbursement of local governments' loss of VLF revenues to trigger an increase in the VLF rate. Governor Schwarzenegger reversed the increase upon assuming office later the same year.
- Proposition 42 of 2002 shifted sales taxes paid on fuel sales to increased transportation spending. The state suspended the transfer several times during the depths of the recent budget crisis. The Governor proposes to eliminate the state's ability to suspend the transfer during future budget crises.
- Proposition 162 of 1992 made it more difficult for the state to defer contributions to state employees' retirement plans. In 1991, the state deferred $667 million in pension costs.
- Courts ruled that "loans" used to reduce the state's school funding obligations during the early 1990s violated Proposition 98's constitutional school funding guarantee. Under the terms of a 1996 settlement agreement, the state phased in an increased funding level.

While Proposition 58 requires the state to fund a budget reserve, the balance in the reserve may not be sufficient to offset a significant shortfall at least for the near future. Public works proposals currently under consideration in the Legislature would also restrict the ability of future legislatures to address a shortfall by increasing the state's debt service obligations. As a result, future years' shortfalls are more likely to require significant spending reductions and/or tax increases to resolve.

PAVING THE WAY: MASSIVE PUBLIC WORKS EFFORT MOVES FORWARD

In January, the Governor jump-started a debate about infrastructure when he proposed a 10-year public works plan as part of his Proposed 2006-07 Budget. As this newsletter goes to press, negotiations are in progress and details are changing on a daily basis.

A bipartisan, two-house conference committee, chaired by Senator Kevin Murray, began meeting in late February to consider the various proposals. Legislative policy committees reported their findings to the conference committee in early March in the form of majority and minority reports. The official deadline for the Legislature to pass measures intended for the June 2006 ballot is March 10, although there is some talk of a slight extension.

What Proposals Are Currently Before the Legislature?

As of early March, debate centered on three general proposals:

The Governor. Governor Schwarzenegger's public works plan proposes $222.6 billion in spending for transportation, air quality, K-12, higher education, flood control, water, public safety, courts, and other public projects over the next 10 years. The plan would be funded by existing funds, general obligation (GO) and lease-revenue bonds, and new funds (such as new fees). More than one-third (39.1 percent) of the Governor's funding would come from various forms of borrowing, such as GO bonds. About one-fifth (21.1 percent) of funds are proposed to come from local governments.

The Governor has asked the Legislature to approve his entire plan as a single package, but the proposed GO bonds would be placed before the voters in a series of elections between 2006 and 2014.

Assembly and Senate Republicans. ACA 27 (McCarthy), the Assembly Republican Caucus's proposal, would implement "pay-as-you-go" financing for public works by earmarking 1 percent of the General Fund for public works projects beginning in 2007-08. Assembly Republicans have expressed concerns about "incurring billions of dollars in unnecessary interest payments" related to bonds. Senate Republicans also support a "pay-as-you-go" financing approach, such as setting aside a share of ongoing revenues for infrastructure. The Senate Republican Caucus has stated its priorities as transportation, levee repair, water storage, and reform of the California Environmental Quality Act (CEQA) process. Senate Republicans do not oppose bond financing entirely, but argue that "any general obligation bond for infrastructure must only be invested in capital projects that provide the highest priority bricks and mortar infrastructure to meet the needs of a growing population and economy."

Assembly and Senate Democrats. Senate President pro Tempore Don Perata and Assembly Speaker Fabian Núñez reached a conceptual agreement on a Democratic bond plan in early March. Reports suggest that this plan would include $30 billion to $50 billion in general obligation bonds. According to press reports, the plan includes additional funds for public transit and low-income housing, while excluding funds for jails, prisons, and courts.

How Big a Role Do Bonds Play in State Public Works Spending?

Conventional wisdom holds that state spending on public works has dropped significantly in recent years. Although most of the state's public works projects were built in the 1950s through the 1970s, state spending on public works has actually increased over the past 20 years. The 2005-06 budget agreement included nearly $1.7 billion in public works expenditures (excluding highways and transit), with approximately 88 percent of this spending coming from GO and lease-revenue bonds. The budget appropriated an additional $3.5 billion for transportation projects.

Why Does the State Use Bonds to Pay for Public Works?

Bonds are long-term loans. The state raises money from investors that it pays back, with interest. Bonds provide financing for projects such as highways, University of California and California State University campuses, schools, and water projects that it cannot afford, or does not want to pay for, on a "pay-as-you-go" basis. Long-term borrowing allows the state to spread the cost of long-lived facilities over time and share the cost of paying for facilities among the individuals who benefit from these investments over a number of years or generations. The use of bonds to finance major investments in public facilities is similar to a family who uses a mortgage to purchase a home.

What Types of Bonds Does the State Issue?

The state has traditionally issued three types of bonds to finance public works:

- **General Obligation (GO) Bonds.** The state uses GO bonds to finance a variety of public works projects (Table 1). The state Constitution requires GO bonds to be approved by a two-thirds vote of the legislature and a majority of the voters. GO bonds are backed by the state's General Fund. The 2005-06 Budget appropriated $3.2 billion out of the state's General Fund for debt service on GO bonds (3.5 percent of total General Fund spending) and appropriated $11.8 billion in GO bond proceeds for various capital projects.

- **Lease-Revenue Bonds.** Lease-revenue bonds, also called lease-payment bonds, were authorized by the legislature for the first time in 1983-84. Lease-revenue bonds require a majority vote of the legislature but do not require voter approval. The state typically uses lease-revenue bonds to finance the construction and renovation of state facilities, such as the recent expansion of the Franchise Tax Board and the new State Library building. State agencies and departments make annual lease payments to bond holders, funded primarily through General Fund appropriations. Unlike GO bonds, lease-revenue bonds are not backed by the full faith and credit of the state. As a result, lease-revenue bonds carry

The Infrastructure Debate: Key Policy Questions

The debate over the appropriate size and allocation of public works priorities raises a number of critical policy questions:

- How much funding should be included for operating and maintenance costs? Legislative and LAO analyses have pointed out that some of the proposals would require significant additional staff to operate once built.

- How heavily should voter preferences be weighed? In the January 2006 Public Policy Institute (PPIC) of California poll, only one-quarter (25 percent) of residents agreed with the Governor that transportation should be the state's top priority; nearly half (48 percent) felt that education facilities should receive the largest share of funds.

- What is the right balance between debt-financed investment and "pay-as-you-go" financing? The Governor's plan would borrow against future revenues earmarked for transportation, meaning that fewer dollars would be available in the future to meet emerging needs.

- Will the cost of a large bond package worsen future budget deficits? With the state facing ongoing budget deficits, it is unclear how the state would meet debt service costs in addition to maintaining support for education, health, and other budget priorities. Policymakers should carefully consider both the amount and types of funds needed to meet the state's public works needs.

- Can current infrastructure be used more efficiently? For example, the LAO notes that by implementing year-round operation, the state could reduce the number of new university facilities needed to meet enrollment growth.

higher interest costs than GO bonds. The 2005-06 Budget included $622.3 million for the General Fund's debt service obligations on lease-revenue bonds (0.7 percent of total General Fund spending) and allocated $1.2 billion in lease-revenue bond proceeds for various projects.

Table 1: General Obligation Bond Ballot Proposals, 1972 to Present (Dollars in Millions)			
	Proposed	Approved by Voters	Share Approved
Public Safety (Prisons/Jails)	$5,462	$4,087	75%
Seismic Retrofit	$4,800	$2,800	58%
K-12 Education	$39,575	$38,025	96%
Higher Education	$11,435	$9,935	87%
Environmental Quality/ Resources	$19,525	$15,086	77%
Transportation	$15,940	$2,990	19%
Housing	$3,560	$2,750	77%
Other*	$12,556	$10,741	86%
Total	**$112,853**	**$86,414**	**77%**

*Other includes veterans' home loans, health facilities, senior centers, libraries, and more.
Source: CBP analysis of Department of Finance data

- **Revenue Bonds.** The state uses revenue bonds to finance revenue-producing projects such as toll bridges or parking structures. Revenue bonds are repaid with the revenues produced by the projects. Revenue bonds are authorized by the legislature and generally are not subject to voter approval.

How Do Bonds Work?

GO bonds must be approved by the voters. Many GO bonds are put before the voters by the legislature using a bill that must be approved by a two-thirds vote and signed by the governor. GO bonds can also be placed on the ballot through the initiative process. Once authorized by the voters, the state treasurer sells bonds based on project needs and market conditions. When the state issues a bond, it borrows money from investors and then repays this money, plus interest, over a period of years. The annual amount the state pays to investors (principal plus interest) is called "debt service."

How Much Do Bonds Typically Cost?

Once bonds are sold, the state makes regular debt service payments to investors, usually over a 30-year period. Currently, each $1 billion of bonds sold costs the state approximately $65 million per year to repay the amount borrowed along with interest. At an interest rate of 5 percent, the state will pay $2 for each $1 it borrows over a 30-year period. After adjusting for inflation – since a dollar will be worth less in the future than it is today – each dollar borrowed will cost the state approximately $1.30, according to estimates by the LAO.

How Much Does the State Currently Pay for Bonds?

According to the LAO, as of November 2005 the state had almost $53 billion of outstanding General Fund debt, including $42 billion in bond debt related to public works (roughly $35 billion in GO bonds and $8 billion in lease-revenue bonds). In addition, about $30 billion in bonds have been authorized, but not yet issued, for projects that are in progress or not yet begun. The LAO estimates that General Fund debt payments for GO and lease-revenue bonds for public works purposes will total about $3.9 billion in 2005-06 and $4.3 billion in 2006-07.

GAP BETWEEN RICH AND POOR WIDENED FOLLOWING RECENT FEDERAL TAX CUTS

The gap between California's rich and poor widened between 2002 and 2003, and recent federal tax cuts have exacerbated this disparity. Recent data from the Internal Revenue Service (IRS) show that average adjusted gross income (AGI or "income" below unless otherwise stated) – the income reported for tax purposes – of low- and middle-income taxpayers declined, while that of high-income taxpayers increased, after adjusting for inflation. Low- and middle-income taxpayers' inflation-adjusted average *after-tax* income also fell, while that of high-income taxpayers rose. However, the income gains for high-income California taxpayers were nearly four times greater *after* taxes than before. In other words, the gap between the state's rich and poor was even wider after taking the taxes each group owed into account.

Average Income Increased Only for the State's Highest Income Taxpayers in 2003

While the average income of most Californians decreased between 2002 and 2003, that of high-income taxpayers increased. After adjusting for inflation, the average income of California's very high-income taxpayers - those reporting incomes of at least $200,000 - rose by $6,062 (1.1 percent) (Table 2). In contrast, average income fell for taxpayers in all other income groups. For example, the average income of taxpayers with incomes between $30,000 and $50,000 declined by 2.3 percent, after adjusting for inflation. Even the inflation-adjusted average income of taxpayers with incomes between $100,000 and $200,000 decreased by 2.1 percent.

Nationally, the average income of US taxpayers in low- and middle-income brackets – those with incomes under $200,000 – also declined. However, unlike in California, the average income of very high-income US taxpayers, those who reported at least $200,000 in income, decreased. Still, the income drop, by half a percent, was notably smaller than that of low- and middle-income taxpayers.

Average Income of Highest Income Taxpayers Increased More Substantially After Taxes

Between 2002 and 2003, average after-tax income increased only for high-income taxpayers – those with incomes of at least $200,000. In California, the average after-tax income of high-income taxpayers rose by $16,957 (4.2 percent), after adjusting for inflation – almost four times the average pre-tax income gain of high-income taxpayers (Table 3). Average after-tax income declined for all other income groups. The same pattern held true in the nation as a whole, although the average after-tax income gain of very high-income individuals in the US was somewhat smaller ($12,120 or 3.1 percent) than that of comparable California taxpayers.

Recent Tax Changes Benefited Wealthy Taxpayers, Widened Gap Between Rich and Poor

High-income California taxpayers' after-tax income gains exceeded their pre-tax gains between 2002 and 2003 because of recent tax policy changes that disproportionately benefited the wealthy. Studies by the Tax Policy Center of the Urban Institute and the Brookings Institution show that the four key tax cuts enacted during the Bush Administration – the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the Job Creation and Worker Assistance Act of 2002 (JCWA), the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), and the Working Families Tax Relief Act of 2004 (WFTRA) – reduced the average federal tax rate paid by the very wealthy to a greater degree than they reduced the rate paid by lower income groups. The average 2005 tax rate for taxpayers with incomes above $1 million dropped, for example, by 3.5 percentage points. In contrast, the average tax rate for taxpayers with incomes between $40,000 and $50,000 dropped by 1.8 percentage points, and that for taxpayers with incomes under $10,000 was relatively unchanged.

Recent tax changes have also increased high-income taxpayers' share of total income. The share of total after-tax income attributable to California taxpayers with incomes of at least $100,000 increased from 42.1 percent to 44.2 percent between

Table 2: Average Income Increased Only for Highest Income Taxpayers in California

Average Income by Income Bracket (2004 Dollars)						
	Less Than $30,000	$30,000 to Less Than $50,000	$50,000 to Less Than $75,000	$75,000 to Less Than $100,000	$100,000 to Less Than $200,000	$200,000 or More
California						
2002	$12,438	$41,078	$64,457	$90,577	$139,591	$540,466
2003	$12,291	$40,150	$63,016	$88,585	$136,714	$546,528
Percent Change, 2002 to 2003	-1.2%	-2.3%	-2.2%	-2.2%	-2.1%	1.1%
United States						
2002	$12,916	$41,043	$64,415	$90,309	$138,125	$531,380
2003	$12,687	$40,123	$63,007	$88,356	$135,137	$528,902
Percent Change, 2002 to 2003	-1.8%	-2.2%	-2.2%	-2.2%	-2.2%	-0.5%

Note: Average income was calculated by dividing the total amount of adjusted gross income (AGI) reported by all taxpayers by the total number of individual tax returns filed. Data were adjusted for inflation using the CPI-U-RS. Although data reported in this table are in 2004 dollars, the income brackets are not. For 2002 data, the income brackets correspond to 2002 dollars and for 2003 data to 2003 dollars.
Source: Internal Revenue Service

Table 3: Average Income Gains of Highest Income California Taxpayers Was Nearly Four Times Greater After Taxes Than Before

Average After-Tax Income by Income Bracket (2004 Dollars)						
	Less Than $30,000	$30,000 to Less Than $50,000	$50,000 to Less Than $75,000	$75,000 to Less Than $100,000	$100,000 to Less Than $200,000	$200,000 or More
California						
2002	$12,468	$38,198	$58,437	$80,440	$119,039	$404,892
2003	$12,368	$37,588	$57,620	$79,860	$118,780	$421,849
Percent Change, 2002 to 2003	-0.8%	-1.6%	-1.4%	-0.7%	-0.2%	4.2%
United States						
2002	$12,912	$38,007	$58,276	$79,637	$116,472	$392,578
2003	$12,751	$37,405	$57,476	$79,252	$116,287	$404,698
Percent Change, 2002 to 2003	-1.2%	-1.6%	-1.4%	-0.5%	-0.2%	3.1%

Note: After-tax income was calculated by summing total adjusted gross income and the refundable portion of total earned income tax, then subtracting total income tax. Data were adjusted for inflation using the CPI-U-RS. Although data reported in this table are in 2004 dollars, the income brackets are not. For 2002 data, the income brackets correspond to 2002 dollars and for 2003 data to 2003 dollars.
Source: Internal Revenue Service

Table 4: High-Income Taxpayers Increased Their Share of Total After-Tax Income Between 2002 and 2003

Share of Total After-Tax Income Attributable to Taxpayers with Adjusted Gross Income (AGI) of $100,000 or More			
	2002	2003	Percentage Point Difference
California	42.1%	44.2%	2.1
United States	35.3%	37.1%	1.8
Taxpayers with AGI of $100,000 or More as a Percentage of All Taxpayers			
	2002	2003	Percentage Point Difference
California	10.6%	11.1%	0.4
United States	8.3%	8.7%	0.4

Note: Figures are not adjusted for inflation.
Source: Internal Revenue Service

cbp CALIFORNIA BUDGET PROJECT

1107 9th Street, Suite 310
Sacramento, California 95814

Return Service Requested

NONPROFIT ORG
US POSTAGE
PAID
PERMIT NO. 341
SACRAMENTO, CA

2002 and 2003. Similarly, high-income US taxpayers increased their share of total after-tax income from 35.3 percent in 2002 to 37.1 percent in 2003 (Table 4).

By favoring wealthy taxpayers, recent tax changes have exacerbated the disparity between the rich and poor. In 2002, the average after-tax income of California taxpayers with incomes of at least $200,000 was 32.5 times greater than the average after-tax income of taxpayers with incomes under $30,000. By 2003, the average after-tax income of high-income taxpayers had increased to 34.1 times that of very low-income taxpayers. Similarly, in the nation as a whole, the average after-tax income of very high-income taxpayers rose from 30.4 to 31.7 times that of very low-income taxpayers between 2002 and 2003.

Current and Proposed Tax Cuts Will Further Widen the Gap Between Rich and Poor

The gap between the rich and the poor will likely widen in coming years as recently approved tax cuts favoring high-income taxpayers are phased in. By one estimate, three major tax changes enacted in 2001 – the EGTRRA, JGTRRA, and WFTRA – will grant the top one percent of US taxpayers an average tax cut in 2005 that is 47.1 times greater than that of the middle 20 percent of taxpayers. Furthermore, tax cuts currently under consideration in Congress, including the proposed extension of lower tax rates on dividends and capital gains, would further skew the benefits of recent tax cuts toward the wealthy and exacerbate the already unequal distribution of income between high- and low-income taxpayers.

The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the California Budget Project is provided by foundation grants and individual donations and subscriptions.

The California Budget Project can be reached at 1107 9th Street, Suite 310, Sacramento, CA 95814, by phone at (916) 444-0500, by fax at (916) 444-0172, or by email at cbp@cbp.org. Budget Watch is published quarterly. Subscriptions are $25/year. Visit CBP's website at www.cbp.org.