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F.Y.I.

FYI45
October 27, 1994

HOW CALIFORNIA'S PROPOSITION 186 COULD TRIPLE STATE INCOME TAX RATES

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California's Proposition 186, to be voted on by electors this November, would create a "single-payer" health system in the state. This would replace the current employment-based system available to most working families in the state. Californians would be guaranteed a comprehensive set of medical benefits, financed by new taxes, including a sliding-scale payroll tax (with the rate based on size of workforce) and a 2.5 percent income tax surcharge on all taxpayers (5.0 percent for those earning above $250,000 per year).

Paying for the Revenue Shortfall: 1998

		Costs as Mandated by Proposition 186	Employers Pay for All Shortfall		Individuals Pay for All Shortfall	
			Banks	Spectrum	Banks	Spectrum
Shortfall			$32,500,000,000	$50,700,000,000	$32,500,000,000	$50,700,000,000
Increase to Proposition 186 Payroll Tax			7.1%	11.0%	0.0%	0.0%
New Business Wage Taxes	**Rate**					
Under 10 Employees	4.4%	$2,415,577,808	$6,301,134,198	$8,477,045,777	$2,415,577,808	$2,415,577,808
10-20 Employees	6.0%	$2,173,481,919	$4,737,314,386	$6,173,060,567	$2,173,481,919	$2,173,481,919
20-49 Employees	7.0%	$4,046,144,403	$8,137,132,348	$10,428,085,597	$4,046,144,403	$4,046,144,403
50+ Employees	8.9%	$20,212,613,959	$36,286,368,663	$45,287,671,298	$20,212,613,959	$20,212,613,959
Total*		$28,847,818,089	$55,461,949,595	$70,365,863,239	$28,847,818,089	$28,847,818,089
Direct Tax to Individuals						
Increase to Personal Income Tax Rate		2.5%	2.5%	2.5%	9.3%	13.2%
Average Tax Increase (Both Private and Public Sector Workers)		**$813**	**$813**	**$813**	**$3,026**	**$4,295**

Note: * Only the private sector share of the increases is reflected. State and local public sector entities would also pay the new payroll tax.

Recent studies suggest, however, that the financing in the Proposition is not sufficient to pay for the promised medical benefits. An analysis by Spectrum Economics, for instance, estimates that the revenue shortfall would be $50.7 billion in 1998.[1] An analysis by Dwayne Banks of the University of California, projects the revenue shortfall at $32.5 billion in 1998.[2] These shortfalls arise, according to such studies, mainly because of doubtful assumptions made by the architects of the proposition. These include questionable administrative savings, unduly optimistic projections for long-term care costs and general medical costs, and doubtful transfers of federal funds and waivers from federal rules.

Assumptions of Heritage Analysis

1) 1991 *County Business Patterns* was the source for employment, wages, and firm size.
2) Bureau of Labor Statistics was source for information on wage growth.
3) Census Bureau population growth projections were used to estimate change in size of employement for 1998.
4) The cutoff for size of firm was 20 instead of 25 because of limitation of *County Business Patterns* data.
5) California wage projections were applied to 1991 data to estimate 1998 data.
6) California successful in getting ERISA waiver.
7) Business would eventually pass through 88% of health care costs to employees.
8) Shortfalls are based on estimates made by Professor Dwyane Banks of the University of California - Berkeley and Dr. Richard Carlson of Spectrum Economics.

Taking these two estimates of the shortfall, Heritage Foundation Senior Fellow David Winston has calculated the potential impact on business and taxpayers in the state. Winston uses standard databases, including the U.S. Census Bureau's *County Business Patterns* and population growth statistics and the Bureau of Labor Statistics reports on job growth. The results are presented in the table on page 1. To summarize the table:

If the shortfall in 1998 were to be funded entirely by an increase in the payroll tax levied on firms, the payroll tax would have to be raised 7.1 percent beyond the level in Proposition 186 (that is, would be about double the level in 186) using the Banks estimate of the shortfall ($32.5 billion), or 11.0 percent higher using the Spectrum estimate ($50.7 billion).

If the shortfall were to be financed entirely by an increase in the income tax surcharge, the surcharge rate would not be the 2.5 percent envisioned in Proposition 186 but instead it would be 9.3 percent if the Banks estimate is accurate and 13.2 percent if Spectrum's estimate is closer to the actual shortfall. Given the current structure of the state income tax, this means that the state tax rate for middle-income Californians would more than double under the lower estimate of the shortfall and triple if the higher estimate is correct.

The Current California State Income Tax

0 to $9,332	1 percent
$9,332 to $22,118	2 percent
$22,118 to $34,906	4 percent
$34,906 to $48,456	6 percent
$48,456 to $61,240	8 percent
$61,240 to $212,380	9.3 percent
$212,380 to $424,760	10 percent
$424,760 and over	11 percent

1 Richard C. Carlson, "Proposition 186: Alternative Estimates of Costs and Revenues," Spectrum Economics, Palo Alto, California, August 15, 1994. Also Carlson, "Economic Impacts: 1994 California Health Initiative," Spectrum Economics, June 28, 1994.

2 Dwayne A. Banks, "The California Single-Payer Initiative: Revenue and Expenditure Projections, 1996-2000," Graduate School of Public Policy, University of California, Revised version September 1994.