A MONTHLY REPORT FROM STATE CONTROLLER BETTY T. YEE

California Fiscal Focus

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CA Controller Reports 2018 State Revenues Behind February Estimates, Ahead for Fiscal Year

California's total revenues of $6.51 billion for February were slightly lower than estimates in the governor's 2018-19 proposed budget by 6.3 percent, and under 2017-18 Budget Act projections by 8.7 percent, State Controller Betty T. Yee reported.

For the fiscal year overall, the "big three" sources of General Fund revenue, personal income tax (PIT), retail sales and use tax, and corporation tax, are beating estimates in the enacted budget. For the first eight months of the 2017-18 fiscal year, total revenues of $81.07 billion are 3.1 percent higher than expected in the January budget proposal, 6.0 percent above the enacted budget's assumptions, and 10.6 percent higher than the same period in 2016-17.

For February, PIT receipts of $2.99 billion were 14.4 percent below the proposed budget's projections. The decrease of $505 million in February's PIT revenues is due to the net impact of lower receipts and higher refunds, which were $293 million above estimates in the governor's proposed budget. For the fiscal year, PIT receipts are higher than anticipated in the 2017-18 Budget Act by $2.92 billion.

Corporation taxes for February of $164.3 million were 23.1 percent higher than expected in the proposed budget. For the fiscal year to date, corporation tax receipts are 28.1 percent above assumptions in the 2017-18 Budget Act.

Sales tax receipts of $3.24 billion for February were $22.6 million higher than anticipated in the governor's budget proposal unveiled in January. For the fiscal year, sales tax receipts are $421.6 million higher than the enacted budget's expectations.

Unused borrowable resources through February exceeded revised projections by 28.3 percent. Outstanding loans of $9.72 billion were 27.9 percent less than the proposed budget assumed the state would need by the end of February. The loans were financed entirely by borrowing from internal state funds.

For more details, read the monthly cash report.

Inside this issue

The Evolution of the Earned Income Tax Credit

An Earned Income Tax Credit (EITC) is a federal or state credit that provides cash back to working individuals and families. The credits are part of the federal income tax code and the tax codes of 29 states, plus the District of Columbia. These tax credits can help lift many working people out of poverty.

Federal EITC

Enacted in 1975, the federal EITC initially was a temporary refundable credit for lower-income workers to offset the social security payroll tax and rising food and energy prices. The credit was made permanent in 1978. The federal EITC has been expanded by legislation on a number of occasions, including the Tax Reform Act of 1986 (TRA), which increased the EITC from 11 percent of the first $5,000 of earnings to 14 percent of the first $5,714 of earnings. During the TRA debate, it was said that the liberalization of the earned income tax credit would help to assure low-income citizens are no longer taxed into poverty.

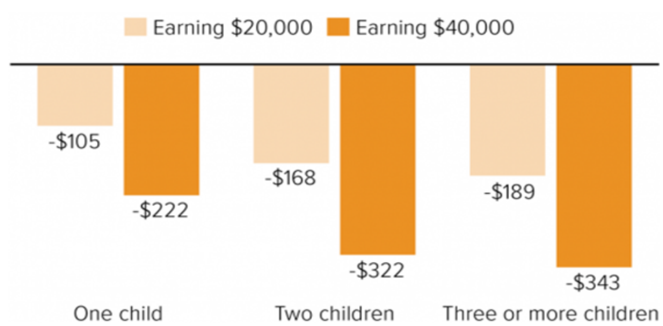
In 2001, legislation was enacted to allow the EITC to phase out at higher income levels for married couples than for single people. The American Recovery and Reinvestment Act of 2009 (ARRA) increased the phase-out for married couples and increased the maximum EITC for workers with at least three children. The American Taxpayer Relief Act of 2012 made the 2001 changes permanent, while the Protecting Americans from Tax Hikes Act of 2015 made ARRA changes permanent.

Lifting People Out of Poverty

The Internal Revenue Service has reported that for the 2016 tax year, approximately 27 million eligible workers and families received $65 billion in the federal EITC. The average federal EITC received nationwide was about $2,445. During this same time period, approximately 2.9 million Californians received the federal EITC for an average credit amount of $2,379.

Federal Tax Bill Erodes EITC

Change in credit relative to current law for a married couple in 2027



Source: Center on Budget and Policy Priorities
Calculations based on Congressional Budget Office inflation projections

"And if you can't help them, at least don't hurt them."—Dalai Lama

Although the EITC is one of the largest antipoverty tools in the United States, the recent federal Tax Cuts and Jobs Act (TCJA) did not seek to expand the federal EITC. Not only did the TCJA fail to further help lift working families out of poverty, it hurts many families by eroding the value of the EITC over time. The TCJA changed the measure used to adjust tax brackets and other tax provisions from the consumer price index (CPI) to the chained CPI. Since the chained CPI grows more slowly than the CPI, the maximum EITC will rise at a slower rate over time.

According to the national Center on Budget and Policy Priorities, a married couple making $40,000 with two children will see their EITC shrink by $322 in 2027 (from $4,974 to $4,652).

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Accounting Changes Define OPEB Shortfall, Set Reform Path

The challenges faced by the state government's primary public pension fund, the California Public Employees' Retirement System (CalPERS), have been well-documented in recent years. While changes have been made that should set a course toward a healthy, fully-funded state pension system, the reality is CalPERS currently is only funded at 68 percent.

That shortfall only reflects the "cash payment" portion of a retiree's pension. It does not include the other postemployment benefits, better known as OPEB, that state government retirees and their family members are eligible to receive.

OPEB costs include health (medical and prescription drug) and dental benefits. Life insurance, long-term care, and vision benefits also are available to retirees, but because retirees must pay for 100 percent of those benefits themselves, there is no state taxpayer liability.

As State Controller Yee reported in January, the state's total cost to cover its OPEB obligations is $91.51 billion, up from $77 billion one year ago. About 33 percent of that increase stems from a change dictated by the Governmental Accounting Standards Board (GASB) in how accounting is done.

Regardless, CalPERS' OPEB costs have more than doubled since 2003. With a price tag of $2.06 billion this year, they now account for 1.6 percent of Governor Jerry Brown's annual budget and are one of the state's largest long-term debts.

The accounting change noted above stems from GASB Statement No. 75, which took effect at the beginning of Fiscal Year 2017-18. GASB 75 overhauled the standards for accounting and public disclosure of OPEB information, most significantly the reporting of net pension liability.

Having a true picture of California's obligations is critical...

Previously, under GASB 45, the unfunded actuarial accrued liability of the plan was buried in the notes of financial statements. Under GASB 75, the unfunded actuarial accrued liability must be reported on the balance sheet of individual employers. The increased transparency gives lawmakers and California taxpayers a more accurate picture of how troublesome the current situation is, but it will not make it any easier to pay down the debt.

Other changes include requiring biennial valuations for all plans instead of doing the valuations every two or three years depending on plan size, and requiring plans to use the same cost method to determine the liability instead of allowing each plan sponsor to choose from six actuarial cost methods.

Having a true picture of California's actual OPEB obligations is critical, but the next question is how the government is going to cover its liabilities.

Prior to 2010, the state funded its OPEB costs primarily on a pay-as-you-go basis, setting aside in its annual budget only the money needed to cover that year's health and dental insurance premiums.

Since then, California has been pre-funding its OPEB

(See OPEB, page 4)

(EITC, continued from page 2)

California EITC

The California version of the credit (CalEITC) was established in 2015. The credit is modeled after the federal EITC and includes requiring the earned income to be subject to California withholding. For 2016, approximately 385,910 filers claimed the CalEITC for a total of $204.9 million. The average CalEITC is $531. For the 2017 tax year, CalEITC includes self-employment earnings, and the maximum income levels are higher.

Re-examine Age and Income Limits?

For both federal and California purposes, individuals without children are only eligible for the credit if they are between 25 and 65 years old. Should the minimum age limit be reduced to assist young adults living on their own and attending college? If there was a change, the EITC could help cover the cost of books, school supplies, and travel to and from school and work. What about at-risk young adults between the ages of 18 and 21 who are part of the extended foster care system? As these individuals transition to living and working on their own, the EITC could be a valuable safety net. What about senior citizens who have insufficient retirement savings and must work part-time jobs? Increasing the age limit and income levels could provide great assistance in preventing seniors from living their golden years in poverty.

(OPEB, continued from page 3)

costs via employee and employer contributions paid into a trust fund administered by CalPERS. The money will sit in the trust fund until either OPEB is considered fully funded or July 1, 2046, whichever comes first. At that point, California can begin paying for its OPEB costs from the trust fund instead of the state's General Fund, which will free up money for other critical programs in the state.

While 28 years may seem a long time to wait, shortening that timeframe is not easily done. It is akin to trying to pay off your home mortgage sooner: For every dollar you spend reducing debt, you have one less dollar to spend on other needs.

State leaders have worked hard to balance California's budget, build reserves, and reduce the crushing debt load built up under prior administrations. The small steps taken toward paying down OPEB obligations are significant, but the road to full funding is long and will require continued due diligence.

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