

June 23, 2020

## WORKING PAPER

# Resetting Inequity in California

*We can never cut our way to the schools our students deserve*

## SUMMARY

As we navigate the global COVID-19 pandemic, Californians are experiencing crises that reach far beyond the immediate public and personal health emergencies. The poorest Californians, disproportionately people of color in the service, hospitality, and healthcare sectors, have either lost their jobs, resulting in a spike to unemployment unlike anything we have seen in our lifetimes, or are risking their health performing essential frontline services.

In April, the Bureau of Labor Statistics reported that **half of the state and local job losses nationwide were in public education**, exceeding the education job losses during the Great Recession. By stark contrast, other segments of our society are thriving under the conditions of this pandemic: between March and May, while most of us were sheltering in place and economic activity slowed dramatically, billionaire wealth grew exponentially. News feeds are markedly silent about the windfall gains the country's wealthiest are enjoying.

Our current system is turning billionaires into multi-billionaires while teachers are using their paychecks to purchase school supplies. We need our elected leaders to include the mega-profits and accumulated wealth in any plan to help our state weather this storm. The state budget must not be balanced on the backs of our communities, our students, the most vulnerable, and the essential workers that have helped California mitigate the pandemic.

This working paper is the product of a review of tax revenue options that could help fill the gaps of our current budget crisis and provide a progressive revenue source to address the economic changes that California needs.

## SNAPSHOT

- 1 in 4 of the country's billionaires call California home.
- The deadly COVID-19 pandemic and the recession it sparked has created an unprecedented budget deficit totaling more than \$50 billion. In this way, the virus is also threatening lives indirectly through deep cuts proposed to the state's critical social services that are often life-saving for the state's most vulnerable populations.
- Neither the Governor nor the Legislature has included serious revenue proposals in their state budget plans, despite precedent for doing so. For example, in 2009 a republican

governor called for temporary tax increases, providing 21% of total budget solutions, yet under the 2020 May Revision temporary tax increases are only at 8%.

- The Great Recession has had long-lasting consequences for California’s public schools and colleges and our education system had not even recovered when the pandemic began. That recession hurt a generation of students, critically needed teachers were pushed out of the classroom, and our schools, colleges, and universities lost thousands of classified professionals and faculty whose jobs were cut. (In fact, school funding has not rebounded since the corporate property tax loophole was created in 1978<sup>1</sup>; CA’s per-student spending on instruction ranked 7th in the nation in 1977 and 41st by 2016).
- The pandemic has been a boon for billionaires around the world, and as ordinary Californians were sheltering in place and losing employment, California’s billionaires were getting wealthier by the day--obtaining \$140 billion from March through May of 2020.
- Our state budget must not be balanced on the backs of our communities, our students, the most vulnerable, the essential workers, and the crucial public services that have helped California mitigate the pandemic.
- We need Governor Newsom and our legislators to include the mega-profits and accumulated wealth in any budget plan to help our state weather this storm and repair decades of financial damage to our school system. Californians deserve a budget that uses the untapped resources of those who can afford to share their pandemic profits.
- A net worth tax of 1% on individuals with net worth over \$50 million and an additional 0.5% tax on worth over \$1 billion would bring roughly \$18.5 billion to the state each year.

## **CALIFORNIANS DESERVE A FAIR RECOVERY**

As the world navigates its way through the global COVID-19 pandemic, Californians are experiencing crises that reach far beyond the immediate public and personal health emergencies related to the coronavirus. The effects are social, economic, educational, environmental and more; the consequences are stratified along the same racial and socio-economic lines as our society is stratified, with inequitable impacts on our communities. In addition, as this pandemic continues, the number of “deaths of despair” (deaths due to drug, alcohol, and suicide) which have been on the rise for the past few years, could overtake the number of deaths from the virus.<sup>2</sup>

The lowest income and most disenfranchised groups of our society – overwhelmingly people of color and women – are staffing the front lines as essential workers. They are taking the greatest risks as they keep supermarkets and pharmacies open, ensure deliveries keep arriving to homes and businesses, clean spaces that have remained open, and of course, provide healthcare for COVID-19 and non-COVID-19 patients alike. They are also suffering disproportionately high mortality rates from the disease.

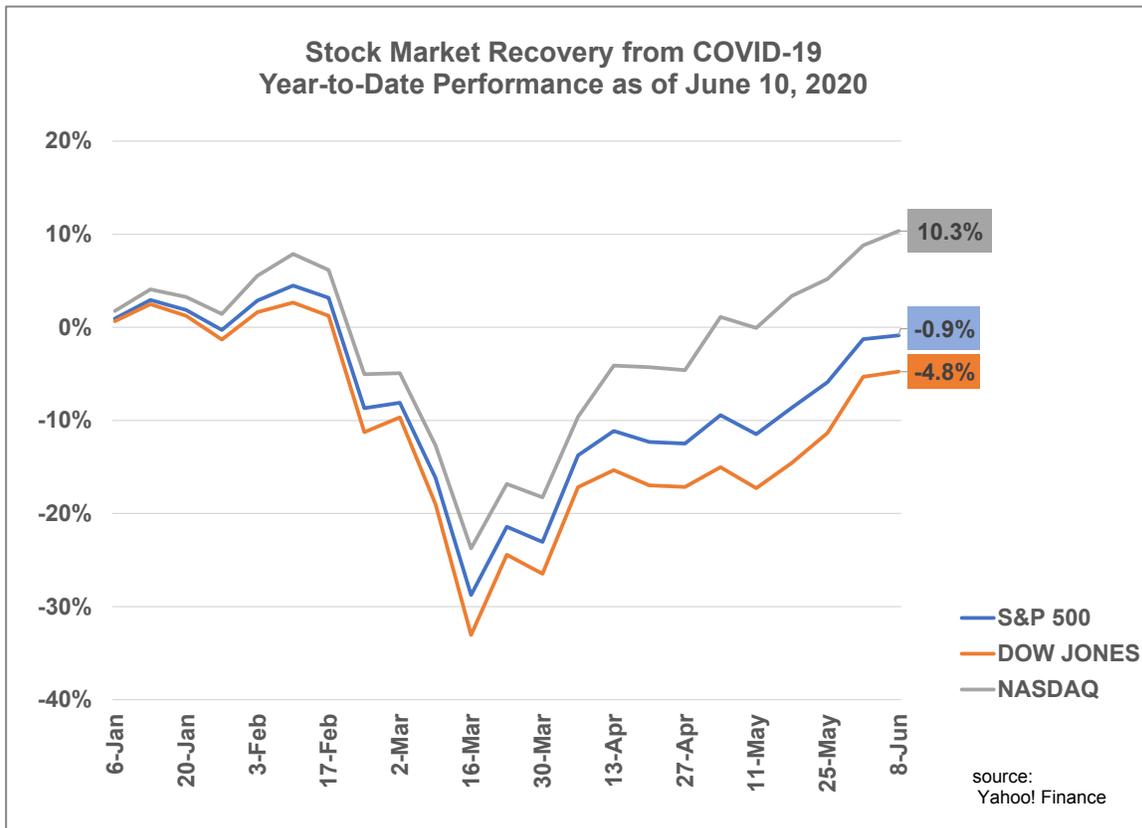
Low-wage workers who live paycheck to paycheck are also being devastated by the mass layoffs that have resulted in a spike to unemployment unlike anything we have seen in our lifetimes. Though unemployment is affecting workers across most demographic groups, it is disproportionately Black, Latinx, and API workers, and women who are employed in the sectors

that were not able to transition to remote telecommuting, were dependent on foot traffic, or otherwise shut down as part of shelter in place restrictions. In April, the Bureau of Labor Statistics reported that half of the state and local job losses were in public education, exceeding the education job losses during the Great Recession.<sup>3</sup>

By stark contrast, there are other segments of our society that are thriving under the conditions of this global pandemic. While the national media attention has largely focused on the economic pain and uncertainty driving budget deficits and unemployment numbers, the news feeds are relatively silent about the windfall gains the country’s wealthiest are enjoying.

### RECOVERY WELL UNDERWAY FOR THE WEALTHIEST

(At the start of June) California is now twelve weeks since the first statewide shelter in place ordinances were announced on March 19, and nineteen weeks since the state’s first COVID-19 case was confirmed on January 26. And though financial markets around the world experienced severe shocks and crashes earlier this year, they have largely recovered. This showing of how resilient stocks and investments can be, when paired with governmental and support intervention, also reveals the perverse effect of a marketplace that generates profit from suffering and tragedy. Wall Street observers agree that the federal CARES Act provided a disproportionate amount of relief to large corporations at the expense of small businesses, and far greater and longer-term bailout than did the working people who need it most. Martens and Martens (2020) contrast the pandemic unemployment benefits that expire after four months with the \$454 billion that CARES



provides to Wall Street emergency aid programs that will continue for the next five years.<sup>4</sup> A Forbes contributor laments, “Too much of the support is going to large companies when it should be going to the small ones. And far too many of the benefits are flowing to shareholders and creditors, rather than to the underlying enterprise and the people it employs.”<sup>5</sup>

Markets are now well on their way to full recovery and are even surpassing pre-COVID-19 levels. A *Yahoo! Finance* headline on June 5 read, “Stocks surge, Nasdaq Composite ends near record high as US economy adds 2.5M jobs in May.”<sup>6</sup> Below a *New York Times* headline on June 8, “Stocks Recoup 2020 Losses,” the article reported, “The S&P 500 erased its losses for 2020, rising more than 44 percent since its low in March.”<sup>7</sup>

#### Market Indices: June 5 vs Jan 2, 2020

Dow Jones: - 6% or -1,758 points    S&P 500: -2% or -64 points    NASDAQ: +8% or +722 points

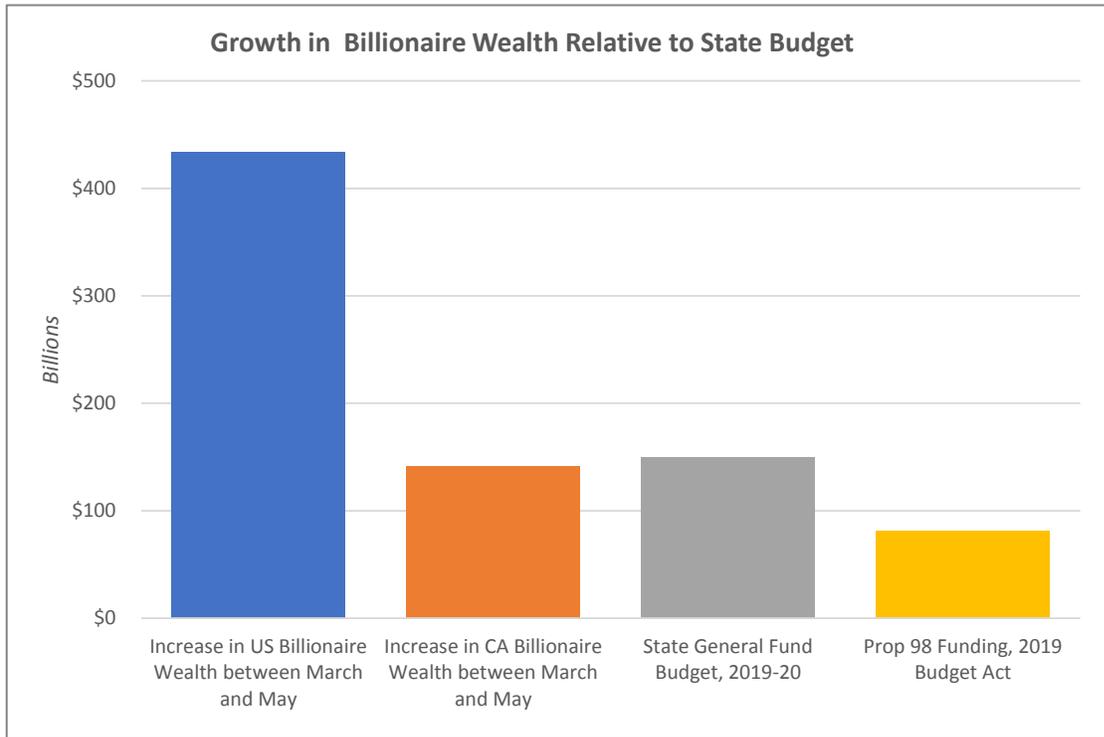
## PANDEMIC PROFITS

Also unprecedented is the accumulation of wealth over the past few months; there has been a shocking amassing of ever-more wealth by the richest people in the world during this period. Pandemic profits are off the charts. Introducing “Billionaire Bonanza 2020: Wealth Windfalls, Tumbling Taxes, And Pandemic Profiteers,” an April 2020 report from the Institute for Policy Studies, the authors write:

*“The current pandemic is exposing our central economic and social reality: Extreme wealth inequality has become America’s “pre-existing condition.” In this report, we show how billionaire wealth has grown astoundingly over the last few decades — and, for some “pandemic profiteers,” even more dramatically since the COVID-19 crisis — even as billionaire tax obligations have plummeted. If this inequality isn’t treated with both short and long-term tax reforms and oversight, America’s “pre-existing condition” of extreme inequality could overwhelm not only our economy, but our democracy itself.”<sup>8</sup>*

The research also found:

- US billionaire wealth soared 1,130 percent between 1990 and 2020 (in 2020 dollars), while the median wealth in the US grew by just 5 percent during the same period.
- Billionaire wealth rebounded quickly after the 2008 financial crisis, taking less than 30 months to attain its pre-recession levels. Since 2010, US billionaire wealth increased 81 percent.
- Before the current economic crisis, 1 in 5 US households had a zero or negative net worth (they owed more than they owned). Rates of negative wealth are even higher for people of color: one-third of Latino families and 37 percent of black families have zero or negative wealth.
- Since 1980 taxes paid by America's billionaires decreased by 79 percent, measured as a percentage of their wealth.



In California, the net worth of the 161 billionaires in the state now exceeds \$829 billion. The net worth of this tiny group increased by \$141 billion – or 20.5 % – between March and May. This is more than \$876 million per capita billionaire. That this wealth was accumulated during the same two-month period that has financially crippled millions of families, thousands of communities, and untold numbers of small businesses is astounding.

For comparison: The entire California State General Fund Budget for 2019-20 was \$149.7 billion – about the same as the two-month increase in California billionaire wealth. In 2019

<b>Growth in Billionaire Wealth and Unemployment during Pandemic</b>	
Number of US Billionaires during COVID-19 Pandemic	632
Number of CA Billionaires during COVID-19 Pandemic	161
CA Billionaires as Percent of US Billionaires	25%
Net worth of CA Billionaires in March	\$688,300,000,000
Net worth of CA Billionaires in May	\$829,366,758,000
Increase in Net Worth of US Billionaires (March 18 – May 19, 2020)	\$434,420,000,000
Percent Increase	14.7%
Increase in Net Worth of CA Billionaires (March 18 - May 19, 2020)	\$141,066,758,000
Percent Increase	20.5%
Per Capita Increase (per CA Billionaire)	\$876,191,043
Californians filing for Unemployment (through May 21, 2020) <sup>9</sup>	5,100,000
Percent Unemployed (Estimated) <sup>10</sup>	25%

Budget Act, the Proposition 98 funding to support the public education of 6 million K-12 and 2.1 million community college students across the state was only \$81 billion. During this period, total billionaire wealth in the US *grew* by \$434.4 billion and California billionaire wealth gains during this period accounted for one-third of that amount (32.5%).

## REVENUE OPTIONS FOR CALIFORNIA

*The urgency for California lawmakers to act is high and the time is now.*

The 2020-21 budget plan Governor Newsom proposed in May anticipates a budget shortfall of \$54.3 billion. In addition to many other painful program cuts, the plan includes \$14 billion in budget cuts if the federal government fails to pass another federal stimulus funding: to essential public services including public education, the social safety net upon which millions depend, and to state worker pay. Even though the \$2 trillion CARES Act is expected to provide \$8 billion to help fill the state's budget deficit, it is highly inadequate and falls far short of what the states need to begin an economic recovery that reaches beyond the billionaires. In the Great Recession, the ARRA (2009) provided *over 5 times more* funding to education than the CARES Act does.<sup>11</sup> Economists estimate state and local governments will need an additional trillion dollars or more to avoid a massive depression.<sup>12</sup>

The budget solutions currently under consideration by the Governor and Legislature include only very modest revenue tools and proposals. Governor Newsom's proposal assumes approximately \$4 billion in revenue through suspension of net operating loss tax credits and limiting business incentive tax credits. The early June 2020 Legislative package uses largely the same revenue assumptions as the Governor's May Revision, including the major revenue proposals. Both approaches rely on either draconian program reductions or deferrals to deal with the projected shortfall. As history and research indicates, now is the time to make bold and progressive revenue proposals. Current events related to COVID-19 make these actions even more urgent, indeed (in)action will be a matter of life or death.

A review of revenue proposals that have been pursued by legislators and advocacy groups over the past few years reveal numerous options that California could consider. They range from closing loopholes, a soda tax, new taxes on services, such as financial services, to bringing back an inheritance or estate tax, an oil severance tax, and raising taxes paid by large corporations.

In order to realize sustainable revenues for California, the criteria for selecting a viable pandemic revenue vehicle must be:

- **Progressive** and levied on those Californians whose lives will not be endangered by making a larger contribution to the public good. A regressive tax would further devastate the communities that are already most adversely affected by the pandemic.
- **Substantial** and capable of enough revenue to avoid catastrophic cuts to public services.
  - There is an estimated \$18 billion funding deficit for Education and an overall budget deficit of \$54 billion for the coming year.

- **Equitable.** The pandemic’s toll is stratified across our society along the same racial and socio-economic strata that shape Californian’s wellbeing, life expectancy, education, etc. An equitable tax measure will be unevenly distributed such that those who can afford it and who are already ahead and not at risk of falling further behind.

The wealthiest one percent of families hold about 40 percent of all US wealth, and the top five percent holds 65 percent.<sup>13</sup> US billionaires’ share of wealth grew throughout the past four decades. Between 2006 and 2018, nearly 7 percent of the real increase in America’s wealth went to the country’s 400 wealthiest households.<sup>14</sup> We believe now more than ever, **extreme wealth should be on the table and part of the solution** for addressing the unprecedented social and economic crises we are facing.

We considered various revenue options and three stand out as fitting these criteria.

Revenue	Revenue Potential	Terms
Billionaire Wealth Tax (Net Worth Tax)	\$18.5 billion per year	Assumes 1% tax on net worth above \$50 million and 1.5% above \$1 billion
Unrealized Capital Gains Tax (Annual withholding tax)	\$10 billion per year	1% withholding on unrealized gains over \$10 million
Highest Income Earners Surtax	\$3.4 billion per year	Progressive 1% surtax on income over \$2.5 million

**1. A Net Worth Tax** is an annual tax on the wealth a family owns. This “billionaire wealth tax” is a tax on people who own assets, like securities, yachts, multiple homes, jets, etc. It is not a corporation tax.<sup>15</sup> California economists estimate *a net worth tax could generate roughly \$18.5 billion per year in California*, assuming a 1% tax on net worth above \$50 million and 1.5% above \$1 billion. In California, only 0.1% of households (approximately 15,000) would be affected by the 1% tax<sup>16</sup>.

Multi-millionaire households with up to \$50 million in wealth would pay nothing additional; the first dollar above \$50 million would trigger a one cent tax.

There are over 70,000 millionaires in California and they comprise 20 percent of the country’s wealthiest residents. This group collectively enjoys \$246 billion in net worth. Over the course of ten years, a modest wealth tax like this could raise \$275 billion over the next decade.<sup>17</sup>

Though other countries have a net worth tax<sup>18</sup> (such as Spain, Norway, Switzerland, and Belgium) the US does not.

**2. A tax on unrealized capital gains** is an annual withholding tax on the wealth accumulated by the ultra-wealthy that would be credited back when the “gains” are realized, to avoid double taxation of that wealth. Capital gains are the main form of wealth storage for this ultra-wealthy class, and since it is untaxed, they pay far less in taxes than the middle class.

In places like California where there is no unrealized capital gain tax, this wealth is untaxed until it is cashed out; such a system creates an incentive for the wealthiest to leave the state where the wealth was accumulated without paying their fair share of their fortune. By contrast, ordinary people must pay taxes on their paychecks in real time, and are unable to defer taxes like the wealthy do.

A withholding tax of 1% of the stock of unrealized capital gains in excess of \$10 million would be a modest contribution of the wealth accumulated by California's ultra-wealthy. UC Berkeley economists Saez, Yagan, and Zucman<sup>19</sup> estimate only the top 0.2% of families (roughly 40,000) would be liable for this tax and it *would generate about \$10 billion per year* from those who can best afford it. Their analysis shows it would improve tax justice, reduce tax avoidance opportunities, raise substantial revenue, and reduce tax revenue volatility.

In practice, the withholding tax would be part of the CA individual income tax and be credited back when capital gains are realized. It would require wealthy taxpayers to report both the basis of their assets and the market value of their assets to estimate their stock of unrealized capital gains. The authors explain with an example: consider a family with \$10 million in unrealized gains. Up to this point, they never paid any withholding tax. If their accumulated gains go up to \$11m the following year, they would pay withholding tax on 1% of the amount above \$10 million (\$11m-\$10m=\$1m), or \$10,000. If the next year they realize another \$100,000 in capital gains. Normally, they would pay \$13,300 in taxes on this but because they have already paid \$10,000 in withholding tax, they only owe \$3,300 in taxes. If their unrealized gains are still above \$10 million, they will continue paying the withholding tax.

**3.** The April 2020 report from the Institute for Policy Studies, "Billionaire Bonanza 2020: Wealth Windfalls, Tumbling Taxes, and Pandemic Profiteers" recommends an emergency **surtax on the highest income earners** as one of the measures to address the current crisis. A surtax on the richest 0.2 percent of taxpayers would affect those who have enjoyed enormous gains in wealth over the past few decades while benefiting middle- and working-class families who are still trying to recover from the Great Recession.

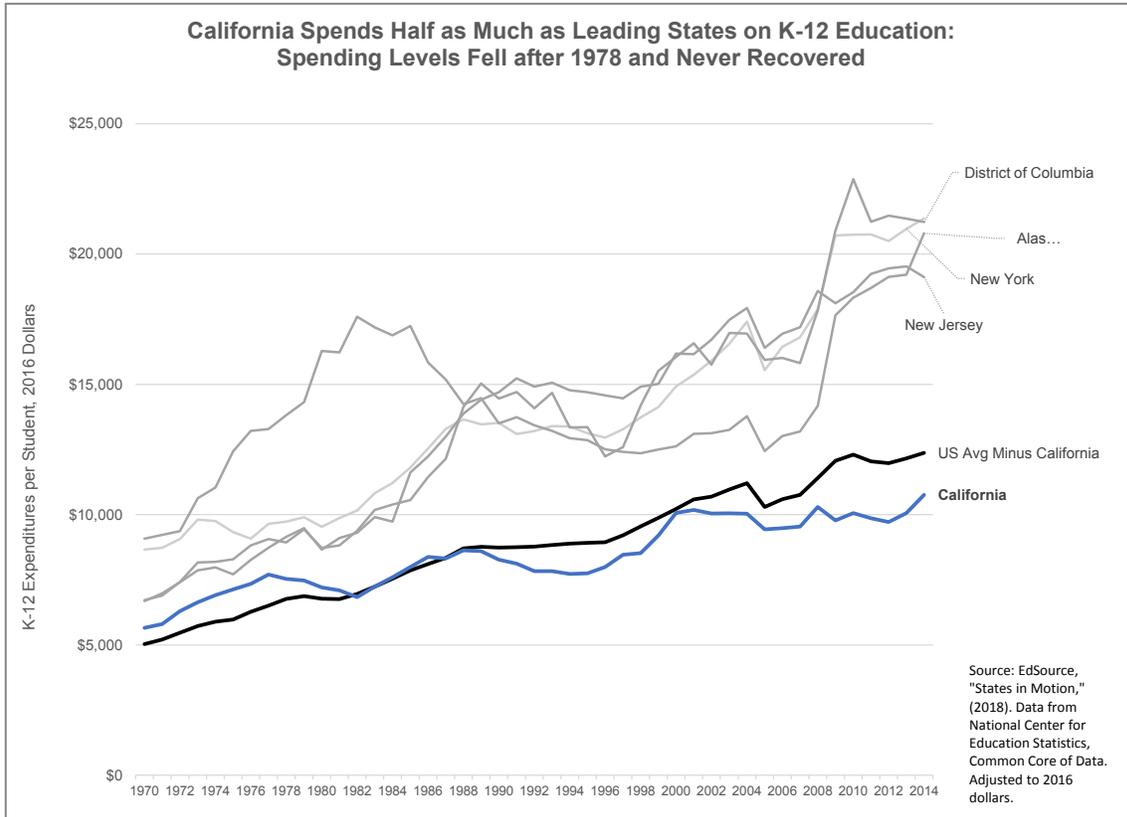
An advantage of such a tax is that it would not be a new tax, but could be built into the existing tax system. The IPS study calls for a federal surtax of 10% on income over \$2 million that would raise \$635 billion (nationally) over the next decade. It would apply equally to income from wages and investment returns. For California, a more modest surtax would be an effective way to increase the contribution of the ultra-rich to the state's economic recovery.

California currently taxes the highest income at 13.3% for income over \$1 million. A surtax on the income over \$2.5 million is estimated to generate \$3.4 billion per year using the following assumptions for the tax:

- Income of \$1-2.5 million at 13.3% (no change)
- Income of \$2.5-\$5 million at 14.3% = \$1.5 billion
- Income of \$5-\$10 million at 15.3% = \$1.1 billion
- Income of \$10 million or more at 16.3% = 0.8 billion

## RECESSIONS ARE THE RIGHT TIME TO RAISE REVENUE

During the Great Recession, new revenue played a significant role in restoring states' economic health and preventing even deeper cuts to critical programs and services. Between 2008-09 and 2010-11, only 10 states did not enact new taxes or fee hikes to mitigate the impacts of the economic downturn.<sup>20</sup> The majority of states also raised new revenue during the downturns of the early 2000s (more than 30) and mid-1990s (more than 40) in all regions of the country.<sup>21</sup>



Economists argue that including revenue solutions to recession-induced budget crises avoids negative ripple effects that cuts to spending and wages have, which in turn jeopardize recovery. Taxes, especially when affecting higher-income households and corporations, averts the contraction of economic activity that follows from deep spending cuts.

Stiglitz and Orszag argued in 2001 that tax increases are better for state economies than budget cuts because some of the new taxes are paid from savings that would otherwise not be spent, thereby increasing money into circulation. As such, tax increases on the higher-income households that save more are the least damaging.<sup>22</sup>

This recession is different in that it was brought on suddenly by the global pandemic, but as Chris Hoene of the California Budget and Policy Center notes, this makes austerity a potentially deadly solution.

*Drastic austerity measures could endanger the public health response to the COVID-19 pandemic and increase the intensity of the economic downturn. Worse, they would likely prolong the impacts of the crisis and make it harder for Californians and their governments to regain their financial footing. What's more, austerity measures would exacerbate income inequality and systemic inequities that permanently leave people of color, undocumented residents and households with low-incomes locked out of our state's prosperity.<sup>23</sup>*

Recent polling of likely voters (May 19-21, 2020) finds strong support for raising taxes on the wealthiest Californians. Overall, 70% of respondents say they would support a Millionaire's tax to protect vital public and community services at risk due to the COVID-19 recession. Nearly all are concerned about cuts to public services and programs. Support spans the state's regions and demographic; it is strongest among those with the highest incomes.<sup>24</sup>

## **CALIFORNIANS DESERVE AN EQUITABLE RECOVERY**

During the last recession, too many states and regions made choices that worsened racial and socio-economic inequities – balancing budgets with deep cuts to public education, spiking tuition for college students who are graduating with crippling levels of debt, and allowing public infrastructure to deteriorate. These actions left our communities less prepared to withstand the impacts of the current recession.

California has a drastic wealth inequality problem that is exacerbated by the COVID-19 crisis. Rather than placing the burden of the economic fallout on California's most vulnerable, the state can achieve sea changing revenues from billionaires who have enjoyed astonishing levels of pandemic profits.

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## NOTES

<sup>1</sup> California's spending on instruction ranked 7th in the nation in 1977; today CA ranks near the bottom of the states on many indicators of education funding indicators. See: EdSource, [States in Motion: Visualizing how education funding has changed over time](#) [November 2018] and CA Budget and Policy Center, [California's Support for K-12 Education Is Improving, but Still Lags the Nation](#) [January 2017].

<sup>2</sup> A report from the Well Being Trust estimates deaths of despair related to COVID-19 ranging from 27,644 (with a quick recovery) to 154,037 (with a slow recovery). The increased numbers would be related to the economic failure with massive unemployment, mandated social isolation for months and possible residual isolation for years, and uncertainty caused by the sudden emergence of the novel coronavirus. See: [Projected Deaths of Despair](#) [May 2020]

<sup>3</sup> "Economic Policy Institute, ["Public education job losses in April are already greater than in all of the Great Recession,"](#) [June 3, 2020].

<sup>4</sup> ["American Workers Get a 4-Month Safety Net; Wall Street Gets a 4 to 5-Year Bailout"](#) [April 2020]

<sup>5</sup> ["The Design Flaw At The Heart Of The CARES Act"](#) [April 2020].

<sup>6</sup> ["Stock market news live updates: Stocks surge, Nasdaq Composite ends near record high as US economy adds 2.5M jobs in May"](#) [June 5, 2020].

<sup>7</sup> *New York Times*. [www.nytimes.com/2020/06/08/business/stock-market-today-coronavirus.html](http://www.nytimes.com/2020/06/08/business/stock-market-today-coronavirus.html) [June 8, 2020]

<sup>8</sup> Institute for Policy Studies. "Billionaire Bonanza 2020: Wealth Windfalls, Tumbling Taxes, And Pandemic Profiteers," [Report: Billionaire Bonanza 2020](#) [April 2020]. See also updates and data: [Billionaire Bonanza Updates: Pandemic Profiteers in 2020](#) [June 2020].

<sup>9</sup> [California lawmakers say coronavirus unemployment help is lacking](#) [May 22, 2020].

<sup>10</sup> [California Unemployment Rate Approaches 25% – NBC Bay Area](#)

<sup>11</sup> Learning Policy Institute, "State Education Funding In The Age of COVID-19." [May 8, 2020].

<sup>12</sup> Economic Policy Institute. [As economic forecasts worsen, up to \\$1 trillion in federal aid to state and local governments could be needed by the end of 2021](#) [May 2020].

<sup>13</sup> Washington Center for Equitable Growth, [Wealth taxation: An introduction to net worth taxes and how one might work in the United States](#) [January 23, 2019].

<sup>14</sup> IPS. Billionaire Bonanza. <https://ips-dc.org/wp-content/uploads/2020/04/Billionaire-Bonanza-2020.pdf> [April 2020].

<sup>15</sup> Washington Center for Equitable Growth, [Wealth taxation: An introduction to net worth taxes and how one might work in the United States](#) [January 23, 2019].

<sup>16</sup> E. Saez and G. Zucman, University of California Berkeley, personal communication [May 28, 2020].

<sup>17</sup> California Tax Reform Association, Communication to Governor [no date].

<sup>18</sup> see: Business Insider. [4 European countries still have a wealth tax. Here's how much success they've each had.](#) [November 7, 2019].

<sup>19</sup> Emmanuel Saez, Danny Yagan, and Gabriel Zucman. "Taxing the Richest Californians Timely: A Withholding Tax on Unrealized Capital Gains," UC Berkeley, unpublished manuscript [May 2020].

<sup>20</sup> Brookings Institute. [State and Local Budgets and the Great Recession](#) [December 2012].

<sup>21</sup> Center for Budget and Policy Priorities. [State Tax Changes in Response to the Recession](#) [March 2010].

<sup>22</sup> Center for Budget and Policy Priorities. [Budget Cuts or Tax Increases at the State Level](#) [April 2010].

<sup>23</sup> Chris Hoene. [Commentary: What Californian needs to move forward – it doesn't start with austerity](#) [May 16, 2020].

<sup>24</sup> Build Affordable Faster California, "Strong Majority of Californians Support a Millionaire's Tax," Press Release, [June 8, 2020].

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