LAO

October 11, 2017

Hon. Xavier Becerra
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative pertaining to the state sales tax and teacher compensation (A.G. File No. 17-0021, Amendment No. 2).

Background

Sales Tax Levied for Local and State Purposes. California's local governments and the state levy a tax on retail sales of tangible goods. This tax—called the sales and use tax—is a significant source of local and state revenue. The rate varies across the state, ranging from 7.25 percent to 10.25 percent, but averages 8.5 percent statewide.

State Guarantees a Minimum Level of Funding for Schools. Proposition 98 (1988) amended the State Constitution to provide K-12 schools and community colleges a minimum level of funding each year. Commonly referred to as the minimum guarantee, this funding level generally grows each year with the economy and the number of K-12 students. The guaranteed funding is provided through a combination local property tax revenues and the state General Fund (consisting primarily of personal income tax, state sales and use tax, and corporation tax revenue). Over the past few decades, the Proposition 98 guarantee has grown at an average rate of about 5 percent per year, though annual growth can vary considerably from year to year. Each year, the Legislature determines how to split Proposition 98 funds between schools and community colleges. (Historically, schools have received about 90 percent of total Proposition 98 funds.) The Legislature also determines how to allocate non-Proposition 98 General Fund monies among other state-funded entities (such as health and human services).

Traditional Route to Teaching Has Two Phases—Preliminary and Clear Credential. K-12 teachers typically enter the profession after completing a bachelor's degree and teacher preparation program, at which time they receive a preliminary teaching credential. Next, teachers must complete a state-approved mentorship program within their first five years of teaching. Teachers receive a "clear" teaching credential upon completion of their mentorship program, which authorizes them to teach for the duration of their career.

Teacher Salaries Are Determined Locally. State law requires schools to collectively bargain teacher salary levels with local unions. Salary levels are typically based on teachers' educational attainment and length of employment at a district, with higher educated and more experienced teachers earning more than other teachers. Teacher salaries in California tend to range from about $45,000 to $90,000 per year, with the average teacher earning $77,179 in the 2015-16 school year. Generally, teachers work on ten-month contracts.

Teacher Salaries Affect Retirement and Certain Other Benefit Costs for Schools and the State. As part of their compensation packages, teachers are entitled to a pension benefit upon retirement. The amount of a teacher's pension benefit is determined by a formula based on years of service and salary at retirement. School districts, the state, and teachers all have a role in funding teacher pension benefits. School districts and the state must currently pay 14.4 percent and 9.1 percent, respectively, of teachers' salaries toward their future retirement benefits. By 2020, this obligation will grow to 18.1 percent for schools and 10.1 percent for the state. Districts also must cover other salary-driven benefit costs (such as workers compensation and unemployment insurance), though these costs are much lower than pension costs.

Commission Sets Compensation Levels for State Legislators. Proposition 112 (1990) amended the State Constitution to create the California Citizens Compensation Commission. The commission establishes the annual salary for legislators (among other high-ranking state officials). Since 1990, legislative pay has increased on average by 2.5 percent per year. Effective December 4, 2017, non-leadership members of the Legislature will earn $107,242 per year.

California Constitution Limits Government Spending. Proposition 4 (1979) amended the Constitution to impose spending limits on local governments and the state. Proposition 4 limits spending from tax revenue (such as the sales tax) but not fee revenue (such as driver license fees). A few categories of spending are exempt from the limits, such as spending on buildings and other infrastructure. Governments may not spend beyond their limits. Current estimates indicate that the state has $6 billion of "room" under its spending limit.

Proposal

This measure changes state law in the following ways:

- ***Requires Teachers to Earn No Less Than State Legislators.*** Beginning in 2020, the measure requires teachers working full-time at schools to be paid no less than non-leadership members of the California Legislature. This provision only applies to teachers with a clear teaching credential.

- ***Increases State Sales Tax Rate by 2 Percent.*** Beginning in 2020, the measure increases by 2 percent the state sales tax on all retail goods sold in California. The proceeds from the tax would be deposited into a "California Achievement Trust Fund," which only would be available to schools to pay enhanced teacher salaries.

Fiscal Effects

Tax Increase Would Raise Roughly $14 Billion Annually for Teacher Salaries. The sales tax levied by the measure would generate between $13 billion and $15 billion in annual revenue.

Costs to Meet the Measure's Salary Requirement. We estimate that, statewide, it would cost schools about $10 billion to pay all eligible teachers at the legislative salary rate. Schools could use the remaining funds to raise certain teachers' salaries (such as more experienced teachers) beyond the required minimum level.

Teacher Salary Increases Would Result in Higher Benefit Costs to Schools and the State, Totaling at Least $4 Billion Annually. As discussed above, salary levels drive certain employee benefit costs. Assuming increased salary costs to schools of about $14 billion, we estimate that benefit costs to schools (pensions as well as certain other benefit costs) would increase by about $3 billion annually. We estimate that the state's share of pension costs would increase by about $1 billion annually.

Schools Could Respond to Increases in Benefit Costs in a Variety of Ways. Because the measure does not provide funding for higher benefit costs triggered by increased teacher salaries, schools could respond in a variety of ways to keep unfunded costs resulting from the measure in line with available resources:

- ***Reduce Non-Teacher School Workforce.*** Some districts might reduce the size of their non-teacher workforce. Non-teacher staff include administrators, librarians, and school janitors.
- ***Reduce Teacher Workforce.*** Districts could reduce their expenditures by employing fewer teachers. To educate the same number of students with fewer teachers, districts could increase class sizes or require teachers to work year-round.
- ***Reduce or Eliminate Benefits for Teachers.*** School districts could reduce the amount they contribute toward certain teacher benefits (such as medical and dental insurance) and require teachers to pay a larger share of costs.

State Could Respond by Providing Additional Funding to Schools. The state could respond in various ways as well. For example, the state could allocate new monies from any future growth in the Proposition 98 minimum guarantee to assist districts with higher benefit costs resulting from this measure. It also could increase funding for schools by reducing community colleges' share of Proposition 98 General Fund support.

More Likely State Reaches Spending Limit. As indicated earlier, the state currently has about $6 billion of room under its constitutional spending limit. The amount of room tends to fluctuate with the economy, and could be higher or lower than this amount upon the measure's effective date. Nevertheless, spending the approximately $14 billion in tax revenues raised by the measure generally would count against the state's limit, decreasing room from what it otherwise would be. The measure therefore would make it more likely that the state would reach its spending limit at some point in the future. If the state reached the limit, it would have to make choices about how to keep spending under the limit. These choices include reducing other spending currently subject to limitation, reducing taxes, and shifting existing spending on programs to categories exempt from the limit.

Summary of Fiscal Effects

This measure would have the following major fiscal effects:

- Increased state sales tax revenues of approximately $14 billion annually, with proceeds spent on higher teacher salaries.
- Additional costs to schools of about $3 billion per year to cover higher teacher pensions and certain other benefits costs resulting from—but not funded by—the measure. Schools and the state could take a variety of actions to bring required spending in line with available resources.
- Increased state costs of about $1 billion per year to cover higher teacher pensions.
- Potential state actions—such as lowering spending on other programs—to keep state spending from exceeding the state's constitutional limit.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance