AN ANALYSIS OF PROPOSITION 4
THE GANN "SPIRIT OF 13" INITIATIVE

DECEMBER 1979

LEGISLATIVE ANALYST

STATE OF CALIFORNIA

925 L STREET, SUITE 650

SACRAMENTO, CALIFORNIA 95814

79-20

ACKNOWLEDGEMENTS

This report was prepared by Peter Schaafsma and Mac Taylor, with the assistance of Jeff Rudolph, David Walrath and others in the the Legislative Analyst's office. The authors also wish to acknowledge the assistance given by the staff of the Legislative Counsel's office.

TABLE OF CONTENTS

CHAPTER I

INTRODUCTION AND DESCRIPTION OF THE INITIATIVE

On November 6, 1979, California voters overwhelmingly approved Proposition 4, the "Spirit of 13" Initiative sponsored by Paul Gann. The proposition, which places Article XIIIB in the California Constitution, limits the growth in appropriations of both state and local governments to changes in the cost of living and population in order to control the spending levels established by California governments. Proposition 4 also attempts both to clarify the fiscal roles played by the various branches (legislative, judicial and executive) and levels (federal, state and local) of government, and to insure that any surplus funds are promptly returned to the people.

Proposition 4 (which is also referred to as "the initiative" in this report) is a sweeping measure which will dramatically affect both the state government and the vast majority of California's 6,600 local governments. Precisely how it will affect these governments, though, is not clear because the measure raises many questions and problems regarding how it is to be interpreted. Chapter II of this report analyzes these uncertainties and offers some suggestions on how they might be clarified. Chapter III examines the proposition's fiscal impact on the state and on local governments. The rest of this chapter is devoted to a description of the initiative.

DESCRIPTION OF THE INITIATIVE

Proposition 4 has been labeled as a spending or expenditure limitation on government. However, the initiative is more accurately described as an appropriations limit. The distinction between the two terms is crucial for understanding and working with the initiative's provisions.

At the state level, an appropriation is an authorization by the Legislature, State Constitution or the people to spend public funds. Expenditures represent obligations (in some cases, disbursements) made against an authorization to spend public money. Thus, expenditures may not exceed, and often fall short of, appropriations. For example, in the 1977 Budget Act the Legislature appropriated $5,542,942 for support of the Department of Savings and Loan during fiscal year 1977-78. By June 30, 1978, however, the department had expended only $5,130,089 of its total appropriation, realizing unplanned savings of $412,853. Thus, Proposition 4 limits expenditures only by way of limiting the authorizations from which expenditures are made.

Furthermore, Proposition 4 does not limit all appropriations of state and local governments. Rather, the initiative controls a defined subset of total appropriations, which the initiative calls "appropriations subject to limitation." In any given year, this subset of total appropriations cannot exceed an entity's "appropriations limit," which is determined independently. Figure 1 shows how "appropriations subject to limitation" is determined.

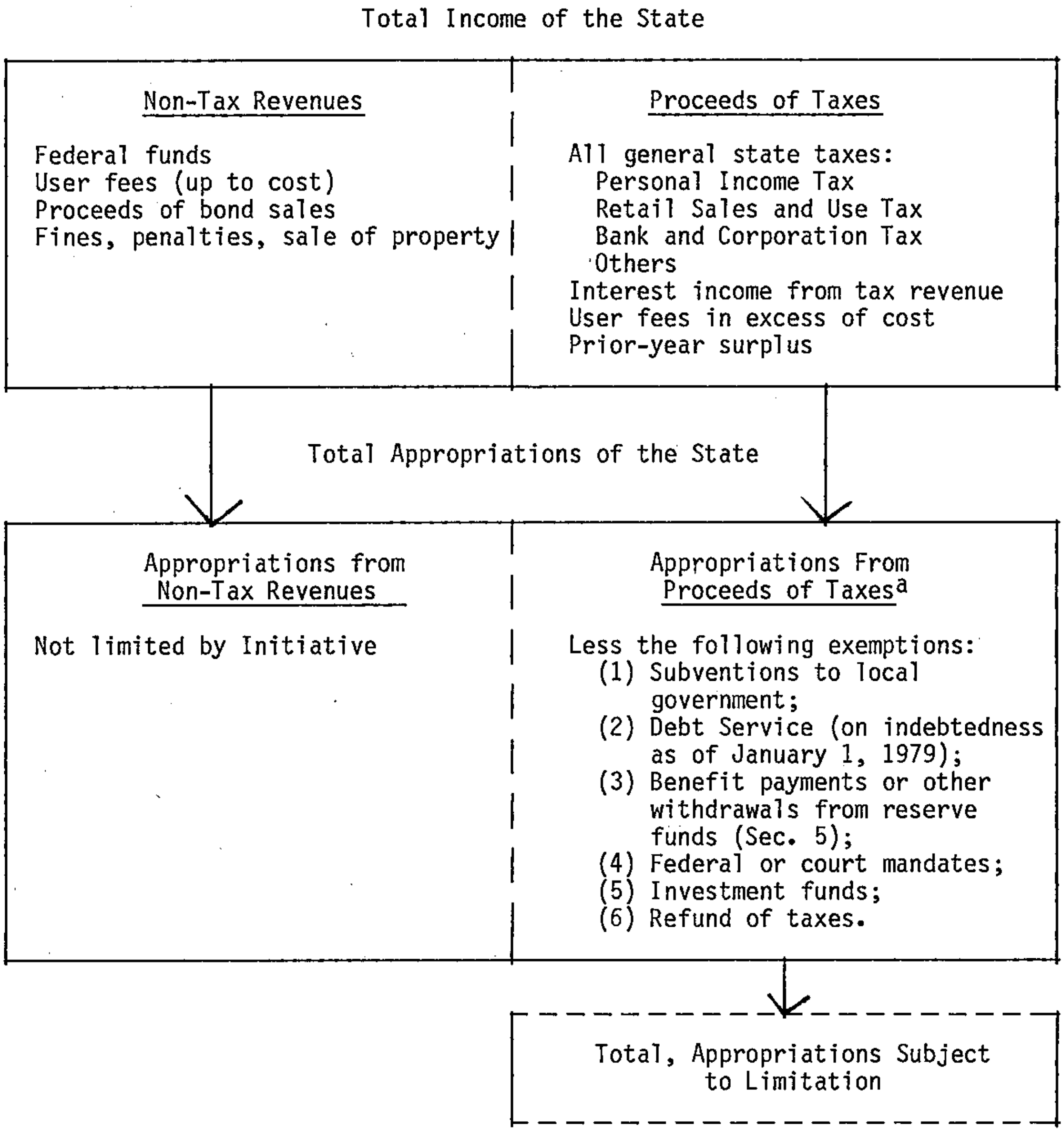
The top box in Figure 1 represents the total income or resources of the state. This amount has been divided into two categories, "proceeds of taxes" and "non-tax revenues." "Proceeds of taxes," one of the initiative's most important terms, determines the base from which "appropriations subject to limitation" must be calculated. Included in "proceeds of taxes" are the revenues from general tax levies, such as the personal income, retail sales and use, and bank and corporation taxes. While there are other general taxes, these three comprise the bulk of state tax revenues. Proposition 4 also includes in "proceeds of taxes": (1) investment income from tax revenues, (2) the portions of user fees which are in excess of the cost of providing the related services, and (3) prior-year unappropriated fund balances originating from tax revenues.

All income to the state which is not classified as "proceeds of taxes" (that is, non-tax revenues") is not directly addressed by the initiative. The most significant source of income in this category is money from the federal government. Whether in the form of grants, formula aid or general revenue sharing, federal funds are outside the "proceeds of taxes" pool. Other significant exclusions are: (1) user fee revenues (to the extent that they do not exceed the cost of providing the related services), (2) income from the sale of tideland oil, (3) the proceeds of bond sales, and (4) such non-tax revenues as fines, penalties, and the sale of property.

Similarly, state appropriations can be divided into two categories, depending on the source of funds. As Figure 1 shows, those appropriations

FIGURE 1

Determining "Appropriations Subject to Limitation"
For State Government



a. Any "proceeds of taxes" not appropriated (that is, surplus funds) would be subject to Section 2 of the initiative, which requires that surplus funds be returned to the people.

which are from non-tax revenues are not covered by the initiative; that is, they are not included in "appropriations subject to limitation." Thus, Proposition 4 has created obvious incentives for governmental units to increase revenues in this category because these funds can be spent without limitation.

Appropriations made from "proceeds of taxes," however, <u>are</u> subject to control. (The box labeled "appropriations from proceeds of taxes" in Figure 1 is equal in amount to the total of "proceeds of taxes," <u>less</u> any such funds which are not appropriated.)

The final step in deriving "appropriations subject to limitation" at the state level is to exclude from "appropriations from proceeds of taxes" those amounts appropriated for the following specified purposes:

(1) <u>State subventions to local government</u>. Under Proposition 4, appropriations made for the purpose of providing assistance directly to local governments are excluded from "appropriations subject to limitation" at the state level, and instead are treated as "proceeds of taxes" at the local level where they are subject to limitation if appropriated.

(2) <u>Debt service</u>. Appropriations for debt service on any indebtedness existing as of January 1, 1979, or on any voter-approved bonded indebtedness incurred after that date are not subject to limitation.

(3) <u>Withdrawals from reserve funds</u>. Because appropriations from the proceeds of taxes <u>into</u> reserve funds such as those established for emergency, contingency, or retirement purposes, are subject to limitation (for example, when state agencies make contributions for their employees' retirement), the

initiative does not limit appropriations from these funds (for example, when retirement benefits are paid), in order to prevent double-counting.

(4) Federal and court mandates. The initiative also excludes those appropriations which are needed to comply with mandates of the courts or the federal government. The apparent intent of this provision is to exclude spending over which the state and local governments have no control.

(5) Investment Funds. The initiative also exempts appropriations of local agency loan funds or investment funds. This exemption was probably included in the initiative for two reasons. First, it avoids artifically raising state appropriations in the base year. It does this by excluding the $900 million in one-time local agency loan monies appropriated by the Legislature in 1978-79 following the passage of Proposition 13. Second, it allows the investment of temporarily idle cash balances without requiring offsetting cuts in state programs. Since under the California Constitution (Article XVI, Section 7), money may be drawn from the Treasury only through an appropriation, investing idle cash balances technically involves appropriations. Section 8(i) specifically excludes these appropriations from "appropriations subject to limitation."

(6) Refund of taxes. Finally, Proposition 4 excludes from the "appropriations subject to limitation" total those monies appropriated for the refund of taxes, thereby avoiding any constraint on the return of excess tax collections.

One type of state appropriation which is subject to limitation is an appropriation to reimburse local governments for the cost of complying with a state mandate. Because these appropriations are counted against the state's limit, they are not counted against the limits applicable to local governments.

After reducing "appropriations from proceeds of taxes" by the amount of exempt appropriations (refer to Figure 1), what remains is the sought-after amount "appropriations subject to limitation." To summarize the process:

Proceeds of Taxes

Less

Unappropriated Proceeds of Taxes

Equals

Appropriations from Proceeds of Taxes

Less

Exempted Appropriations

Equals

Appropriations Subject to Limitation

The amount of "appropriations subject to limitation" could vary greatly from year to year, depending primarily on the actions of the legislative body and the chief executive, as well as on the availability of revenues. However, under Proposition 4 such appropriations for any fiscal year cannot exceed the entity's "appropriations limit" for that same year. Figure 2 summarizes the way in which the limits are calculated, using a hypothetical local government in 1980-81 as an example.

FIGURE 2

Calculation of a Hypothetical Local Appropriations Limit
Fiscal Year 1980-81

	Example (in millions)
1978-79 Appropriations Limit[a]	$ 10.0
Multiplied by Changes in CPI and Population Equals	x 1.10 (10%) =
1979-80 Appropriations Limit[b]	$ 11.0
Multiplied by Changes in CPI and Population Equals	x 1.11 (11%) =
1980-81 Appropriations Limit	$ 12.21

(Process Continues)

This amount is the limit or "ceiling" for the entity in 1980-81. The amount of "appropriations subject to limitation" in 1980-81 (refer to Figure 1) cannot exceed this 1980-81 "appropriations limit."

a. The base year (1978-79) "appropriations limit" is equal to the total of "appropriations subject to limitation" for 1978-79. From then on, the limit is adjusted annually by changes in CPI and population, and thus is determined independently of any legislative authorizations or actions.

b. Since Proposition 4 does not go into effect until 1980-81, there is no binding 1979-80 limit. A hypothetical limit is shown for illustrative purposes only.

The appropriations limit contained in the initiative will not become operative until 1980-81. In establishing the limit for 1980-81, the measure starts with the actual amount of "appropriations subject to limitation" (determined in accordance with the methodology detailed in Figure 1) in 1978-79, which is deemed to be the "appropriations limit" for that year. Thereafter, the appropriation limit is determined independently of the appropriations process. The limit for any fiscal year will be simply the limit of the prior year, adjusted for changes in the cost of living and population.

As Figure 2 illustrates, if an entity's 1978-79 appropriation limit was $10.0 million (meaning that its 1978-79 "appropriations subject to limitation" total was $10.0 million), and if changes in inflation and population were 10 percent in 1979-80 and 11 percent in 1980-81, the 1980-81 "appropriations limit" for the entity would be $12.21 million. In this example, "appropriations subject to limitation" in 1980-81 could be as high as but could <u>not</u> exceed $12.21 million.

Once an "appropriations limit" has been established, certain adjustments to that amount--both permanent and temporary--are allowed by the initiative.

A permanent adjustment occurs whenever the financial responsibility for providing a service is transferred from one entity of government to either another entity of government or a private enterprise. For example, if garbage collection services were discontinued by a local government, leaving residents to depend on private business for these services, the amount of money appropriated for garbage collection would have to be subtracted from the local government's appropriations limit. Without this adjustment, an entity of government could create room within its appropriation limit forcing citizens to depend on another entity for services, so as to allow for the provision of new or expanded services.

A similar adjustment occurs when the responsibility for financing a service is transferred from a government's general tax revenues to user fees. For example, if instead of discontinuing garbage collection services, the local government shifted the revenue source for these services from general fund monies to user charges, the initiative would also require a downward adjustment in the "appropriations limit."

Under Proposition 4 a governmental entity may also exceed its limit in the event of an "emergency." However, in the following three years appropriations must be reduced so that no aggregate increase in appropriations occurs over the four-year period. Table 1 illustrates how this provision might work. In the example, an entity chooses to exceed its 1980-81 limit by $21,000 in order to appropriate funds for a declared emergency. However, it must then reduce its limits during the next three years by a total of $21,000. (In Table 1, the reductions have been distributed equally over the three years following the emergency; however, nothing in the initiative precludes a different distribution.)

Finally, a permanent adjustment to a limit can be made when any "appropriations category" is added to or removed from "appropriations subject to limitation" by a judicial body. If, for example, a court ruled that a local government had improperly included in its limit appropriations for what the court ruled to be debt service, then a downward adjustment would have to be made.

TABLE 1

Hypothetical Case: Adjustments Allowed By the Emergency Provision

	1980-81	1981-82	1982-83	1983-84	Total
Appropriations Limit[a]	$100,000	$105,000	$110,250	$115,763	$431,013
Emergency Adjustments	+21,000	-7,000	-7,000	-7,000	-0-
Total Appropriations[b]	$121,000	$ 98,000	$103,250	$108,763	$431,013

a. The 1980-81 limit has been increased by 5 percent for changes in CPI and population.
b. It is assumed that the entity appropriates monies up to its limit.

Proposition 4 also allows a temporary adjustment in the limit for up to four years provided the change is voter-approved. If an entity of government voted to exceed its limit, say, to finance a new service, it would have to: (1) vote again at the end of four years to continue the higher limit, (2) terminate the program, or (3) accommodate the additional appropriations within its "old" limit.

In addition to assuring that "appropriations subject to limitation" do not exceed Propositions 4's limits, governmental entities must also be concerned with the initiative's excess revenue provision. Section 2 of the proposition requires that, for any fiscal year, the excess of "revenues received" (which is an entity's total income from all sources less total appropriations, including those not subject to limitation) be returned to the people within the next two years by revising tax rates or fee schedules. This provision is intended to prevent surplus funds from being retained by government.

The initiative applies to all types of local governments, including any city, county, city and county, school district, special district, authority, or other political subdivision of or within the state. Specific governmental units, however, are exempted from the initiative if they meet one of two tests. First, a special district existing on January 1, 1978, is exempted if it had a 1977-78 tax rate of 12½ cents or less per $100 of assessed valuation. This exemption may exclude from Proposition 4's control over one-third of California's 4,800 special districts. Secondly, Proposition 4 excludes appropriations of those special districts which are funded entirely by other than proceeds of taxes.

CHAPTER II

THE PROPOSITION'S PROVISIONS: PROBLEMS AND UNCERTAINTIES

In order to accomplish its broad objectives of expenditure and excess revenue control, Proposition 4 necessarily uses language which is general rather than specific in nature. However, the lack of specificity (especially with regard to the definition of terms) has led to ambiguity and uncertainty as to how some provisions of the initiative will be interpreted and, in turn, implemented.

In interpreting the language of Proposition 4, we have relied heavily on the Legislative Counsel's legal opinions as to the definition of key terms, the operation of certain provisions, and other matters. The Counsel's opinions also provide some general principles which we have incorporated wherever possible within our analysis. For example, we have assumed that the major thrust of the initiative is to "freeze" real (that is, inflation-adjusted), per capita governmental spending from proceeds of taxes at the 1978-79 level. This assumption is helpful not only in providing a general perspective but also in interpreting specific provisions of the measure such as Section 3, which provides a method for adjusting the appropriation limits under certain conditions. However, in certain cases, these principles provide insufficient guidance to resolve the initiative's ambiguity. Where the literal interpretation of the language would result in either a diminution of the initiative's impact or an impossibly complex administrative chore, we have attempted to suggest a more common-sense approach to the problem, recognizing that the Legislature has considerable latitude in devising reasonable solutions to the problems and uncertainties of Proposition 4.

This chapter examines each of the major issues in an effort to resolve or place in perspective the questions which will confront the Legislature in the coming months. We have offered recommendations only on those matters where a specific solution seems preferable to others. On issues less easily resolved, we have provided policy alternatives from which the Legislature may choose.

PROCEEDS OF TAXES

Section 8(c) of Proposition 4 defines proceeds of taxes to include:

(1) all tax revenues;

(2) investment income from tax revenues;

(3) regulatory licenses, user charges and user fees <u>to the extent that they exceed</u> the costs reasonably borne in providing the service; and

(4) in the case of local governments, state subventions.

Section 8(c) makes an important distinction between revenues generated by taxes, which are covered by the initiative, and "reasonable" user fees and charges, which are not. A tax has been described as a "compulsory exaction that a government enforces generally on persons or property within its jurisdiction for the purpose of supplying public necessities."[1] This is a broad definition, since a tax is not restricted

1. Legislative Counsel opinion #7981, page 3.

by either the purpose of its levy or by the incidence of its burden. Consequently, there need be little or no direct relationship between the payment of a tax and the use to which the money is put.

In contrast to a tax, a user fee (or user charge or regulatory license) is a payment to cover the costs of providing a particular service or product. It is this direct linkage between the payment for and the consumption of a service which distinguishes a user fee from a tax.

In most cases, the classification of revenue-generating devices is clear-cut. For example, proceeds from the state's personal income, sales and use, bank and corporation, inheritance, and gift taxes, and from local property taxes are clearly limited by the initiative. Likewise, revenues generated from such sources as fishing licenses, public utility charges (for electricity, water, etc.) and regulatory licenses for professionals (doctors, dentists, engineers, etc.) are excluded from the limitation imposed by the initiative.

However, there are several revenue sources which are not as easy to classify. For example, the registration and other fees paid by vehicle owners are used to finance the state Department of Motor Vehicles (DMV) and the California Highway Patrol (CHP). Consequently, it could be argued that such revenues are user charges, in that motorists receive services from the DMV and the CHP. The argument is a strong one with regard to DMV, as all car owners pay the same flat fee ($11 per year) to receive essentially the same service--the right to lawfully operate their vehicles on public roadways. The argument is weaker with regard to the CHP, because its services (that is, actual assistance by a CHP officer) are not linked directly with fee payment. Of course, it can be argued that the fee all motorists pay for the support of the CHP is similar to an insurance charge, in that security and safety are the commodities actually being purchased. In any case, the example illustrates the difficulty in distinguishing between fees and taxes.

Since the initiative has defined proceeds of taxes in an open-ended fashion (Section 8(c): "...shall include, but not be limited to..."[1]), it is easier to identify those revenues which are clearly not proceeds of taxes than it is to prepare a definitive list of those revenues which are subject to the appropriation limitation. What follows is a list of those revenues which we feel are outside the initiative's purview.

1. Federal Funds. According to Section 8(a), only those taxes "levied by or for" (emphasis added) an entity of government are subject to the control provisions of the initiative. Because federal aid to state and local governments is not levied "by or for" California entities per se, it would seem that this large source of revenue is exempted from the initiative's provisions. Of course, it could be argued that federal taxes (such as the federal income tax) are imposed solely to aid local governments. However, history fails to support such reasoning, as federal intergovernmental assistance has been a significant outlay only in the last two decades, whereas the federal income tax, the major source of federal revenue, has been levied since 1913.

2. User Fees Not in Excess of Costs. Section 8(c) implies that all user fees not exceeding reasonable costs are excluded from proceeds of taxes. After distinguishing between fees and taxes (as discussed above), a determination must be made as to what are reasonable costs. Legislative

1. See Appendix 1 for complete text of Proposition 4.

Counsel has opined that virtually any cost which is reasonable in nature and related to the provision of a service supported by a user fee could be deemed a reasonable cost, and therefore the user fee supporting it would be excluded from proceeds of taxes.

In order to clarify this issue, however, we recommend that the Legislature enact guidelines for identifying the types of costs which would be considered "reasonable." The following are examples of costs which user fees should be allowed to recover:

(a) debt service on any indebtedness (primarily revenue bonds) incurred to provide related capital facilities;

(b) reserves required or needed for debt service;

(c) proper charges for administrative services provided by other agencies; and

(d) year-end balances in those user fee funds with cash-flow problems (for example, most of the state's consumer affairs funds require annual surpluses in some years because fees are not collected annually).

3. Proceeds From Bond Sales. When an entity of government receives money from a financial syndicate for the sale of bonds, it is not receiving "tax" funds. Since the revenue from bond sales is not proceeds of taxes, the appropriation of these funds should not be subject to limitation.

4. Benefit or Improvement Assessments. Due to the passage of Proposition 13 in 1978, these assessments, which are property-related user charges, may become a far more significant revenue-generating device for local governments. This is because assessments are considered a payment for a benefit conferred entirely on the payee as opposed to a general tax

on property, a distinction recently validated by a state appellate court ruling.[1] For the purposes of Proposition 4, then, these assessments should not be considered proceeds of taxes.

5. Fines and Penalties. Legislative Counsel has informed us that there is a clear legal distinction between fines and penalties (which are monetary punishments for unlawful acts) and taxes.[2]

6. Proceeds from the Sale of State Property. Legislative Counsel has stated that proceeds from the sale of government property are not tax monies.[3] However, it is not clear whether a capital gain realized by an entity on the sale of property originally purchased with tax revenues would be subject to the investment provisions of Section 8(c). For instance, if the state purchased with proceeds of taxes a piece of land for $100,000 in 1965 and sold it in 1979 for $150,000, would the $50,000 gain constitute proceeds from the investment of revenues?

The initiative expressly defines income from the investment of tax revenues as the "proceeds of taxes." We interpret this to refer to the interest earnings of temporarily idle cash balances and not to the increase in book value of an entity's fixed assets. Consequently, we believe that a gain realized from the sale of public property should not be considered proceeds of taxes.

7. Proceeds From Unclaimed Property. Counsel has also concluded that escheat to the state of unclaimed personal property would not be considered tax revenue.[4]

1. County of Fresno v. Maelstrom.
2. Legislative Counsel opinion #7981, page 4.
3. Ibid.
4. Ibid.

8. Transfers and Gifts. Again, neither one of these revenue sources is a tax. In the case of transfers (between funds or governmental entities), there is no circumvention of the intent of the initiative since the transferor must accommodate within its limit the amount appropriated to the transferee.

9. Investment Income from Non-Tax Revenues. By including in proceeds of taxes investment income from tax revenues, Proposition 4 implicitly excludes investment income from non-tax revenue. While it is doubtful that investment income can be precisely separated into these two categories, an approximate percentage could be used for purposes of determining "proceeds of taxes."

One source of funds which is not easily classified is a surplus carried forward from a prior year. It can be argued that the category "proceeds of taxes" was intended to include only current year resources, an interpretation which excludes consideration of any carry-over unappropriated surplus. Legislative Counsel has opined, however, that since Section 8(c) does not limit proceeds of taxes to those revenues received during any fixed period of time, there is no reason to exclude prior-year unappropriated fund balances, to the extent that these balances were derived from proceeds of taxes.[1] Because it is not possible to identify what portion of the prior-year surplus was derived from proceeds of taxes, an estimate would have to be made using the proportion of total revenues received by the fund that represents proceeds of taxes over the period during which a surplus accumulated. (For example, if 95 percent of

1. Legislative Counsel opinion #6416, page 7.

all General Fund revenues over this period were derived from proceeds of taxes, that same percentage could be applied to the surplus amount to be carried into the next year.)

As far as the state is concerned, all of its "proceeds of taxes" are deposited in the state's governmental cost funds, which consist of the General Fund and over 90 special funds. These are the funds which historically have been of the most concern to the Legislature. In contrast, most of the non-tax proceeds are deposited into the state's nongovernmental cost funds, which are mainly enterprise, retirement, revolving and trust funds.

There are two funds, however, which do not fall cleanly into either of the categories. They are the Unemployment Fund and the Unemployment Compensation Disability Fund. The payments made by employers and employees into these funds could be classified as taxes, since they are levied on a broad base and do not provide for an entitlement to a specific level of future benefits. On the other hand, monies in these funds can be expended only on unemployment benefits, which is why the state now classifies them as nongovernmental cost funds. Furthermore, a case can be made that unemployment taxes are really levied by the federal government, not by the state. But most importantly, the fluctuating income and expenditure patterns of unemployment funds do not lend them to the control provisions of Proposition 4.

Legislative Counsel has opined that, if unemployment funds were subject to the Proposition 4 appropriations limit, the level of appropriations would have to be the amount of funds <u>available</u> for expenditure because these funds are continuously appropriated. That is, for any one fiscal year the total of incoming unemployment taxes and prior-year fund balances would constitute appropriations subject to limitation, regardless of how much is actually expended on benefits. Thus, in 1978-79 approximately $4.3 billion was, in effect, appropriated from the two funds, even though only $1.5 billion was expended.

The problem with applying Proposition 4 to the unemployment fund is that the amount available for appropriation--and thus the amount appropriated--can vary significantly with fluctuations in the economy. For instance, a recession would dramatically decrease funds available by reducing current year employment contributions, and by potentially reducing fund balances at the end of the prior year by requiring the payment of increased unemployment benefits. In this case, the decline from one year to the next in unemployment funds available (and therefore appropriations) would give the state additional room within its limit to spend, even though the expenditure of these funds had risen sharply. Conversely, a large increase in funds available following the onset of economic recovery might force the state to cut other appropriations in order to accommodate within its limit the rapid rise in unemployment appropriations, even though actual unemployment expenditures had dropped sharply.

For these and other reasons,[1] we recommend that revenues received by these two funds not be treated as proceeds of taxes.

APPROPRIATIONS

As discussed in Chapter I, the source of funds for an appropriation is crucial in determining which appropriations are subject to limitation

1. Legislative Counsel opinion #13022, page 5.

under Proposition 4. As this section will show, there are different types of appropriations, and some of these may create problems for the state in complying with the initiative's provisions.

Most of the appropriations subject to Proposition 4's control are made in the annual Budget Act. There are over 500 line-item appropriations in the 1978-79 Budget Act, most of which are available to be spent for a period of only one year (capital outlay authorizations normally are for three years).

The Budget Act, however, is not the only source of state appropriations. Large sums of tax proceeds are appropriated on an ongoing basis by either the Constitution (for example, the payment of $120 per ADA in educational aid) or by statute (for example, school apportionments and AFDC grants). The specific amounts of these appropriations, which are referred to as continuous appropriations, are often determined by some eligibility factor (the number of homeowners, welfare recipients, etc.) which is subject to change throughout the fiscal year. Therefore, the actual amount of a continuous appropriation may not be known until several months after the end of a fiscal year. In contrast, the amount of nearly all Budget Act appropriations is fixed by the Legislature at the beginning of the fiscal year, although it may be changed by subsequent legislation.

Continuous appropriations create two obvious problems for the state in complying with Proposition 4. First, they reduce the options available to the Legislature's fiscal committees in putting together a state budget that is within the appropriations limits. Second, state officials will not know the precise amount that can be appropriated on other items subject to limitation because the amount of many continuous appropriations is not fixed. To some extent, the state can mitigate the problems regarding continuous statutory[1] appropriations in one of three ways:

(a) eliminate them in favor of Budget Act appropriations;

(b) control them through the use of in-lieu appropriations; or

(c) control them through limitations imposed by control section language (as is currently done with the AFDC program).

In effect, each of these options would place ceilings on the amount which can be distributed through a continuous appropriation.

Each of these methods of controlling continuous appropriations could cause other problems in the process of facilitating compliance with Proposition 4. For instance, placing a cap on an entitlement program (such as AFDC or SSI/SSP) would make it difficult for administrators to handle an unanticipated increase in caseload. With a fixed amount of money for grants and such an increase, they would have to either (1) reduce the grant level to accommodate the increase or (2) refuse grant payments to new eligibles.

We recommend that the Legislature adopt one of the three options for controlling continuous appropriations. Provisions should be made for unanticipated increases in caseload using a contingency reserve fund.

In addition to Budget Act and continuous appropriations, monies can be appropriated by financial legislation. This is usually done for new programs, program expansions, or for projects of a limited duration. Financial legislation can appropriate funds in any one of three ways:

---

1. There are only two constitutional continuous appropriations: basic educational aid and debt service, and these can only be altered by constitutional amendment. The latter is sufficiently predictable and does not present problems with respect to Proposition 4. Unanticipated variations in the former (basic educational aid) can be compensated for by limiting the total of K-12 apportionments to a fixed sum.

1. Designated Years. Some fiscal measures tie the appropriation to specified years. For example, a bill might appropriate $100,000 in both fiscal years 1980-81 and 1981-82. For purposes of Proposition 4, $100,000 would be counted as appropriations in each year.

2. Unspecified Years. For financial legislation with no specified time period, Section 16304 of the Government Code limits the availability of the appropriation to a period of three years. In this case, the entire amount of the appropriation would have to be considered as an appropriation for the fiscal year in which it was initially made available for expenditure.

3. Open-Ended. Section 16304 also provides that an appropriation containing the term "without regard to fiscal years" is available until expended. Here again, the entire amount appropriated would have to be considered as an appropriation for the year in which it was initially available for expenditure.

APPROPRIATIONS SUBJECT TO LIMITATION: EXCLUSIONS

Proposition 4 establishes seven basic categories of exclusions from "appropriations subject to limitation." Except as noted below, each of the exclusions is applicable at all levels of government.

Subventions

Section 8(a) of Proposition 4 excludes from the state's "appropriations subject to limitation," and includes within the limitations of local government, "state subventions for the use and operation of local government" (emphasis added). While the term "subventions" is not defined either in the initiative or in statute, it is generally understood to mean a form of assistance given to local jurisdictions by the state. By itself, however, this understanding does not provide adequate guidance for determining whether a specific appropriation is excluded from the limit.

As a starting point, subventions could be considered as appropriations for "local assistance", a category used in the Governor's Budget to describe nonstate operations. This view of subventions, which is the most expansive one possible, would place over three-fourths of state spending from proceeds of taxes in the local base.

However, within the local assistance category are certain appropriations which do not represent assistance given directly to local governments. For instance, appropriations for Medi-Cal are paid to fiscal intermediaries, and appropriations for SSI/SSP are paid to the federal government. If subventions are instead defined as state payments to local entities, a substantial amount of "local assistance" would be included within the state base, thereby reducing to about 55 percent the amount of state spending subvened to local entities. Additionally, this definition provides a relatively uncomplicated basis for administration of the limits and reflects the fact that most state money is actually administered by local governments.

Subventions could, however, be considered in a totally different light. The phrase "for the use and operation of local government" could be interpreted in such a way as to distinguish between types of subventions, based on the degree of actual control possessed by local entities over the way funds are spent. This alternative would reduce even further the amount of funds being treated as subventions, given that much local assistance is accompanied by extensive program involvement. For example, state aid for education, which presently represents over 70 percent of total school spending, is accompanied by far-ranging requirements on curriculum, class size, teacher certification, etc. Therefore, it could be argued that the $6.5 billion distributed in 1978-79 to school districts did not represent subventions, but rather appropriations for what is basically a state responsibility.

Taken to this extreme, no state education funds, and only shared revenues, certain tax relief payments and block grants could be considered as subventions. Under this alternative only about 14 percent of the state's appropriations from proceeds of taxes would be subject to limitation at the local level, thereby reducing--drastically for schools and significantly for counties--the local limits. (It should not be assumed that this would work to the disadvantage of all local school districts; some of them would fare much better if state aid were controlled at the state level.)

The problem with this alternative is how to define "control." For example, should control be based on: (1) the determination of eligibility for program benefits? (2) the extent of financial responsibility? and/or (3) the source of program guidelines and regulations? Whereas the use of the "payment" principle to classify subventions would be a fairly straightforward, mechanical process, the use of a "control" criterion would probably require program-by-program legislative declarations.

Another question relating to the subvention issue is: How should contracts between the state and local governments be treated? The Legislative Counsel has determined that a contractual arrangement exists between the state and counties with regards to the provision of mental health services. On this basis, he has concluded that state appropriations for the program would be subject to limitation at the state level.[1] Thus, the Legislature may be able to use contracts in order to fund and maintain some control over locally administered programs without placing the bulk of the program costs in local appropriations limits.

1. Legislative Counsel opinion #16827, page 6.

The definition of the term "subventions" is one of the most important tasks confronting the Legislature in implementing Proposition 4. While we do not at this time favor one view of subventions over the other, we recommend that the Legislature define the term so that state and local governments can treat state aid consistently.

In addressing this issue, the Legislature will find advantages and disadvantages associated with each alternative. On the one hand, it may be preferable to restrict the number of programs determined to be subventions, as a large 1978-79 state appropriations limit would give the Legislature much greater flexibility in eliminating old programs, creating new ones, and in correcting inequities in the distribution of funds to local agencies and school districts.

On the other hand, a case can be made that Proposition 4 was intended to limit the level of government where program costs are actually incurred, regardless of the funding source of those expenses. This interpretation would call for an expansive definition of subventions, thereby placing a higher proportion of state payments to local governments in local limits.

The Legislature may also want to consider where the various definitions of subventions place the faster growing government programs. Any alternative which places most of these programs in either the state or local base would place a heavy burden on that level of government, as it would be forced to curtail the growth in other appropriations subject to limitation. (For a further discussion of the subventions issue, see Chapter III.)

Withdrawals From Reserve Funds

Section 5 of the initiative seems fairly clear-cut on the subject of reserve funds. Appropriations into such funds are counted towards the limit for the year in which they are made, and payments out of the funds are excluded from limitation, regardless of when they are made.

There may be some confusion, though, as to what constitutes a reserve fund. For example, many local governments refer to their year-end balances as reserve funds. However, these monies have not normally been specifically appropriated into a separate fund, so they would not appear to qualify as reserves under the provisions of Section 5.

Section 5 also provides a way in which governments can increase their fiscal flexibility. By appropriating monies into a contingency or emergency fund, an entity would have the funds available to expend at a future date without regard to the appropriations limit at that time. For instance, a reserve fund could be used to provide for emergency expenditures by insuring that not only funds but authority to spend them will be available. Section 5 provides the Legislature with much more flexibility than the emergency provision of Section 3(c), which allows an appropriations limit to be temporarily exceeded but does not guarantee that funds will be available for such emergencies.

Federal and Court Mandates

Proposition 4 also excludes from limitation those appropriations required by federal and court mandates. Section 9(c) defines these mandates as directives "which, without discretion, require an expenditure for additional services or which unavoidably make the providing of existing services more costly" (emphasis added). The phrase "without discretion" implies a lack of choice on the affected government's part and would appear to have little applicability to federal mandates, since most state and local participation in new federal programs is on a voluntary or permissive basis. If a local government does not want to incur the cost of the federal mandate, it can simply forego the federal monies as the price of refusal.

The word "unavoidably" may, however, suggest a slightly different meaning. Legislative Counsel has opined that it implies a "lack of choice as a practical matter" (emphasis added).[1] For example, the Aid to Families with Dependent Children (AFDC) program receives substantial federal support. If a new federal regulation or law required the state to extend eligibility to an additional group of people at a cost of $2 million, the state would then be faced with the choice of either: (1) providing the new service or (2) refusing to extend eligibility and risk losing $1 billion in federal aid (a loss which would drastically curtail the program). The new regulation could, as a practical matter, be considered a directive which unavoidably makes the AFDC program more costly, thereby excluding from the limit those appropriations made to fulfill the mandate.

With regard to court mandates, it could be argued that any funds appropriated in direct response to a judicial decision are exempt from the limit. For example, expenditures by a school district for a court-ordered busing plan would clearly seem to fall under the purview of the mandate provision.

1. Legislative Counsel opinion #16625, page 10.

There are, however, some perverse incentives and rewards which result from the exemption of court-mandated costs. First, the provision might encourage improper or illegal actions by an entity of government so as to invite a lawsuit that will result in a subsequent court order mandating exactly what the entity would otherwise do. For example, a county which would like to replace an aging jail, yet is unable to do so under its limit, might allow a portion of the facility to deteriorate in the hope that a lawsuit would result in a mandate to improve its prison facilities.

Second, exempting any court-mandated costs from the appropriation limit may encourage the judiciary to assume what are more properly legislative functions: allocating public funds, defining the public interest, and determining the appropriate scope of government.

Third, it will encourage interest groups to bring what are essentially political disputes before the courts, rather than before the Legislature or the voters, for resolution.

A related issue is: How will the exclusion of court-mandated costs be applied to entities which were not a party to the dispute? Virtually all judicial rulings are limited just to the litigating parties; therefore, a court directive--for example, that a county conduct hearings before revoking parole--is technically binding only on the county being sued. For purposes of the initiative, however, we recommend that the Legislature provide a method whereby all other similarly situated entities are authorized to exclude from their limits appropriations for similar purposes, thereby eliminating the need for hundreds of additional suits.

Another policy question to be answered is whether the state should establish a process for determining which appropriations can properly be considered to be in response to federal and court mandates. There are three possible methods for making such determinations:

(a) Legislative Action. The Legislature could require that all requests for appropriation exclusions under the court and federal mandate provision be approved in legislation. While these requests may raise policy issues which are deserving of the Legislature's attention, it is not clear that the Legislature is equipped to handle the potentially burdensome administration of the task.

(b) Rulings by a Quasi-Judicial Body. As an alternative, the Legislature could create an independent body to rule on state and local requests. If such a body qualified as a "court of competent jurisdiction" (as provided by Section 11), it could also make the appropriation adjustments necessary to correct the problems discussed above.

(c) Self-Enforcement. The decision on what constitutes a federal or court mandate could be left to the discretion of the state and individual local governments. The problem with this approach is that it may result in appropriations for similar purposes being treated differently by various entities. This, in turn, may lead to pressure on the courts to ensure uniformity, thereby narrowing the options open to elected representatives.

We recommend that the Legislature opt for the self-enforcement alternative (c), as this method of determining mandates minimizes the Legislature's involvement in local affairs.

Finally, it is not clear whether the mandate exemption applies to all mandates or just new mandates. The initiative is silent on the matter. Legislative Counsel has opined that appropriations made in compliance with federal and court mandates are exempt from the limit, regardless of when the mandates are imposed.[1] In other words, if it can be shown that a 1903 court decision led to costs which are still being incurred, appropriations for these costs would not be subject to limitation.

We believe that the problems posed by this interpretation may be insurmountable. First, there may be thousands of federal and court directives issued during the past century which have imposed costs on California governments, and the difficulties involved in identifying these directives would be immense.

Second, even if all federal and court mandates could be identified, it would be exceedingly difficult to determine the costs incurred as a result of these mandates in 1978-79 and later years. For example, court decisions in the 1960's concerning individuals' due process rights probably led to significantly increased government costs, especially in public safety (police and prisons) and welfare departments. Yet it would be difficult for administrators to quantify the added costs imposed by the various rulings, and it would probably require significant expenditures (which would be subject to limitation!) to do so.

1. Legislative Counsel opinion #15982, page 13.

Finally, excluding the costs of all prior year directives would also serve to diminish the coverage of the proposition. There is no way of determining the extent to which these mandates would lower the base year limits, but given the recent federal and judicial involvement in such areas as criminal justice, health, welfare, and education, the amounts would be substantial.

Given these problems, we recommend that the Legislature provide for the exclusion of only those appropriations made pursuant to federal and court mandates which first impose costs in the base year of 1978-79 or thereafter. This policy would not (except in certain situations) penalize entities which incurred costs due to pre-1978/79 mandates, as the costs of those would be incorporated into their original appropriations limits. However, the the Legislature could make special allowances for the cost of "old" mandates not fully reflected in the base year (for example, if a mandate was imposed in 1976-77 but implemented gradually, an entity might have only 75 percent of the ultimate annual cost of the mandate reflected in its base year limit).

A 1978-79 cut-off date would obviously result in more spending being subject to the appropriations limits. However, it is not clear whether this would result in a tighter limit on government spending. To the extent that the costs imposed by pre-1978/79 federal and court mandates grow less slowly than inflation and population, the inclusion of these mandated costs in an entity's appropriations limit may be to its advantage, in that it would allow other spending to grow at rates which exceed changes in inflation and population.

Investment Funds

As noted in Chapter I, the language of Section 8(i) has two apparent purposes. First, it prevents the 1978-79 state base from being artificially inflated by the inclusion of the $900 million in one-time local agency loan funds provided after the passage of Proposition 13. Second, it avoids counting as appropriations the investment of temporary surplus funds.

However, the language is written in such a way as to cast doubt on whether the provision can accomplish the intended goals. As it now stands, the provision would exclude from the initiative's control certain funds (that is, accounting units) rather than the appropriations from those funds.

In order to clarify the situation, we recommend that the Legislature adopt a measure which states that Section 8(i) should be construed as follows:[1]

> (i) Except as otherwise provided in Section 5, "appropriations subject to limitation" shall not include appropriations to local agency loan funds or indebtedness funds~~,~~ or the investment of (or authorizations to invest) funds of the state, or of an entity of local government, in accounts at banks or savings and loan associations or in liquid securities. (Strikeout (/) indicates material to be deleted; underscoring (__) indicates material to be read into the measure.)

In exempting investments of local agencies from limitation, the initiative refers to funds which are in "liquid securities." This term is not defined in the initiative; however, as commonly used, liquid securities are short-term debt instruments which have a maturity of less than one year. Presently, local governments are authorized to invest only in those securities designated by Section 53601 of the Government Code, many of which have

1. The language which follows was suggested by Legislative Counsel; see opinion #6997, page 4.

maturity dates of more than one year. In order to avoid any uncertainty with regards to this provision, we recommend that the Legislature define "liquid securities" to include any of the investments currently authorized by the Government Code 53601.

Refunds of Taxes

Sections 8(a) and 8(b) provide that appropriations subject to limitation do not include authorizations to refund taxes. This exemption pertains primarily to the return of overpayments made during the tax collection process. Technically, the state must appropriate monies when it makes refunds of personal income and bank and corporation tax overpayments. However, these refunds are not counted as appropriations for budget purposes, and they are in no sense a cost of government. Consequently, the initiative has excluded these appropriations from limitation.

The exclusion of appropriations for refunds might also be construed to apply to such state tax relief programs as senior citizens' and renters' relief. Persons eligible for these programs receive credits against their tax payments, so in a sense money is returned or refunded to these individuals.

However, we recommend that the term "refund" be linked with the notion of overpayments, as with the return of excess income tax withholdings or with the return of monies under the excess revenue provision of Section 2. It should not be applied in those cases where a specific program objective (such as relieving the tax burden of renters and senior citizens) is achieved through the return of monies via the tax system.

Special Districts

Finally, the initiative excludes from appropriations subject to limitation:

(1) "Appropriations of any special district which existed on January 1, 1978, and which did not as of the 1977-78 fiscal year levy an ad valorem tax on property in excess of 12½ cents per $100 of assessed value;" and

(2) "Appropriations of any special district then existing or thereafter created by a vote of the people, which is totally funded by other than proceeds of taxes".

The language of number two (2) is really superfluous since other provisions of the initiative work to exempt those districts having no proceeds of taxes.

The first exemption, however, is highly significant. The intent of this provision was most likely to exclude those districts having small appropriations levels, since the costs they would incur in implementing the initiative would not be justified by the benefits of including them. It has been estimated that this provision could forever exclude from the initiative's control as many as 40 percent of California's special districts.

However, there is not always a direct relationship between the tax rate of a district and its level of spending. Given two districts whose only source of funds was the revenue from a property tax rate of 10 cents per $100 of assessed valuation (AV), the district with an AV of $500 million would have five times as much to spend as the district with an AV of $100 million.

Furthermore, the appropriations of a district which is exempted under this provision are forever excluded from limitation, even if such district were to obtain a dramatic increase in its proceeds of taxes in future years. This lifetime exemption not only allows the district to expand in future years (even beyond what a limit would have authorized), but it also makes these exempt districts prime candidates for taking on new services which general purpose local governments cannot accommodate within their own appropriations limits. However, most of these new services would be financed by special districts through non-tax revenues.

Section 9(c) is silent on the matter of how special districts with more than one tax rate should be treated. For example, many flood control districts are divided into zones, each of which has a separate tax rate. And, to complicate matters further, there are districts in which some of these zones had tax rates above and below the 12½ cent limit. We recommend that these problems be addressed by basing the determination on a weighted average of the tax rates charged within the district.

Similarly, the initiative does not state whether the secured or unsecured tax rate is to be the basis for granting the special district exemption. This problem is by no means an academic one, for there are several districts which had one rate above and the other rate below the 12½ cent level. Since most property is on the secured roll, we recommend that the secured rate be used.

Finally, it is not certain whether the language of Section 9(c) requires a special district to have levied a tax in 1977-78 in order to qualify for the 12½ cent exemption, or whether the exemption would also apply to:

(1) those districts which were authorized to levy a property tax but did not do so in 1977-78; and

(2) those districts which were not authorized to levy a property tax.

We recommend that the Legislature clarify that special districts characterized by either of the above situations are eligible for the 12½ cent exemption.

ADJUSTMENTS TO THE LIMIT

Annual Adjustments

The appropriations limit of an entity of government is the prior year limit as adjusted for changes in the cost of living and population. Cost of living is defined as the lesser of:

(1) the change in the United States Consumer Price Index (CPI) as reported by the Labor Department; or

(2) the change in California per capita personal income.

And, population is defined in the following ways:

(1) for school districts, as the average daily attendance as prescribed by the Legislature; and

(2) for all other entities, as determined by a method prescribed by the Legislature.

As noted before, these adjustments are allowed so that governments can maintain the real purchasing power of their 1978-79 spending levels on a per capita basis. However, it is not clear how well the specified indices can perform this task. For example, the CPI is constructed to measure the rise in the general price level of consumer goods, not the increased costs associated with providing public or governmental services. A more appropriate index might have been the implicit GNP Deflator for State and Local Government, which is a special price index compiled by the federal government to measure inflation in commodities and services purchased by governments. A comparison of these two indices reveals that the state and local deflator has increased by 96 percent in the past decade while the CPI has risen by 78 percent. If public costs continue to increase at a rate faster than the adjustment allowed by the initiative, real per capita government spending will in fact decline below the 1978-79 level.

Cost of Living. Proposition 4 does not answer some important questions as to how specific adjustment factors are to be determined. For instance, there is the question of whether estimates of CPI and per capita personal income changes, or actual changes, should be used.

Estimates would adjust for the inflation which will occur in the fiscal year to come, thereby allowing entities to raise appropriations limits to compensate for their eroded purchasing power. However, estimates of inflation can vary significantly from the price increases which actually occur. For instance, in January of 1978 the Department of Finance estimated that during calendar year 1979, the CPI for the United States would increase by 6 percent over the prior calendar year. It now appears as if the change will be approximately 11 percent. In this instance, if the appropriations limit had been based on the estimated CPI, it would have been 5 percent lower than the amount allowed by the actual increase in CPI.

Of course, the Legislature could provide for corrective adjustments in later years to account for such forecasting errors. When estimates are lower than actual CPI figures, entities could be allowed to increase their limits and their spending accordingly. However, when estimates are higher than actuals, entities could end up appropriating more than their "corrected" limits would allow. In such cases, the Legislature could require entities to adjust their limits downward in the following years.

In order to avoid the problems that would result from the use of inaccurate estimates, we recommend that actual CPI figures be used to adjust the appropriations limit for inflation.

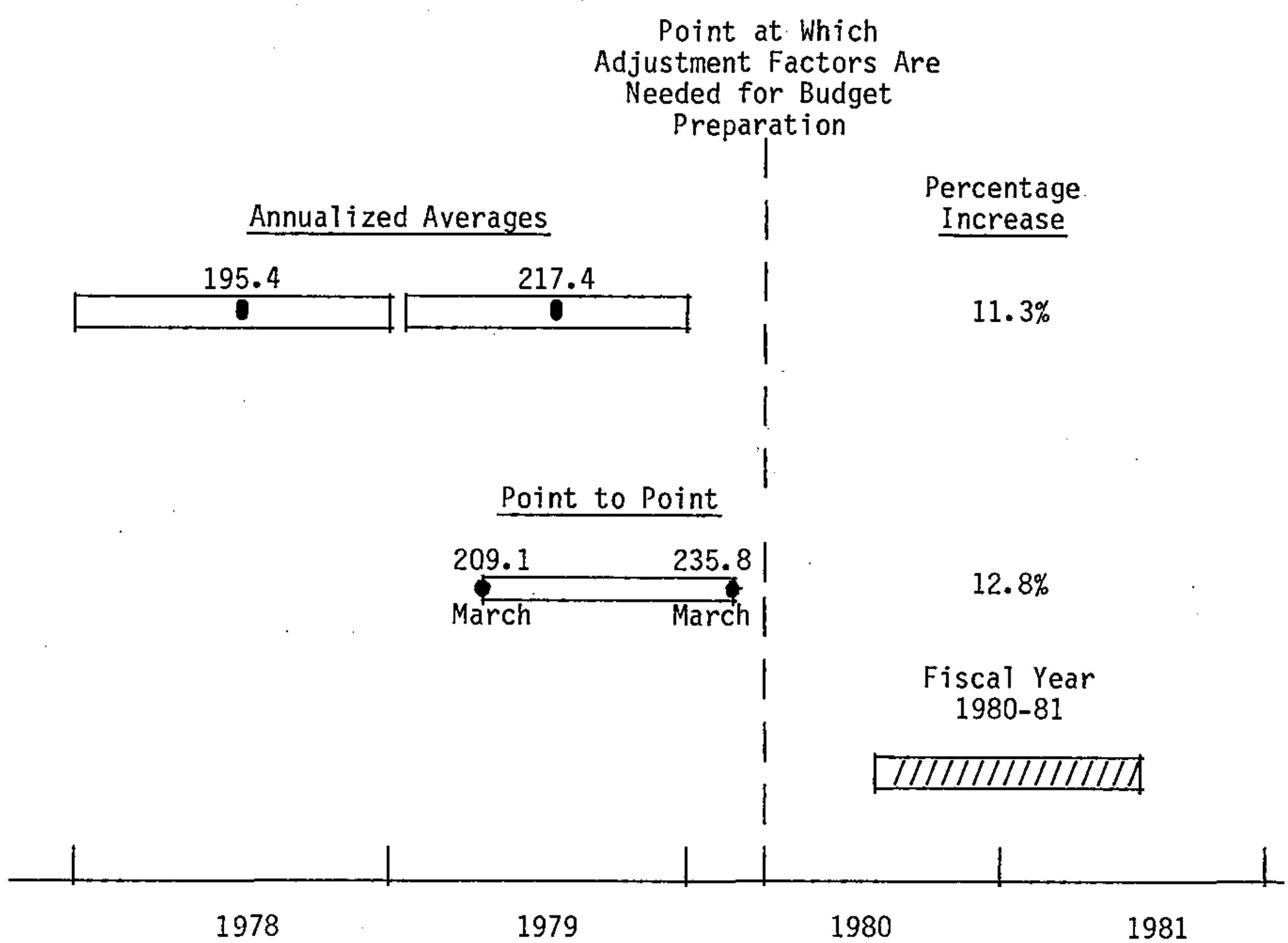
If the Legislature decides to use actual CPI figures, it must still select the time period over which the change in indices would be measured. In making its Proposition 4 calculations, the Department of Finance has used the annualized averages for the two calendar years prior to the start of the fiscal year involved. (For example, the department bases its inflation adjustment for fiscal year 1980-81 on the change between the average CPI for 1978 and the average for 1979.) This method takes into account the inflation which has occurred over a 24-month period.

Alternatively, CPI changes could be measured using a point-to-point method. This method measures the actual change in prices over a 12-month period (for example, from March of one year to March of the next).

Figure 3 provides an example of how the two alternatives can result in different inflation adjustments. Using the point-to-point method, the inflation adjustment for fiscal year 1980-81 is 12.8 percent, whereas the use of annualized averages results in a CPI adjustment of only 11.3 percent. This is because the point-to-point calculation captures the higher rate of inflation in 1979 while the annualized average method encompasses the lower rate of inflation in 1978. Consequently, by reducing

FIGURE 3

Alternatives for Calculating
the Change in CPI for Fiscal Year 1980-81[a]



a. CPI figures are either actuals or Department of Finance estimates of the United States CPI.

the time period covered, the point-to-point method yields a more current measure of the inflation rate (though it would still reflect the rate of change in prices occurring 3 to 15 months prior to the start of the budget year). Therefore, we recommend that the Legislature use the point-to-point method in determining cost-of-living changes.

State and local officials will want to know the annual adjustment factors to be used prior to the start of the budget year (indicated by the vertical dashed line in Figure 3). If the point-to-point method is employed, we recommend that the Legislature use March-to-March figures. Since CPI numbers are reported by the U.S. Department of Labor within 30 days after the end of the reporting month, the use of a March index would give local entities plenty of time to develop their budgets within the context of an already fixed appropriations limit.

With regard to the state per capita personal income calculation, we also recommend that actual change figures be used, as calculated on a point-to-point basis. Since personal income figures are reported on a quarterly rather than a monthly basis, we recommend that fourth quarter calendar year personal income figures be used. (For instance, the state per capita personal income adjustment for fiscal year 1980-81 would be the change between fourth quarter figures in 1978 and 1979.) Fourth quarter numbers are published by the United States Department of Commerce in May, giving the state and local entities time before the start of the new fiscal year in which to finalize their budgets. In order to aid entities at the early stages of their budget planning, the Department of Finance should issue in February preliminary estimates of changes in CPI and per capita personal income.

Table 2 shows how the different methods of calculating inflation and population changes can lead to large differences in the adjustments. The two sets of numbers are based on exactly the same economic and population assumptions; they differ solely because of the time periods involved.

Revisions to Actual Cost-of-Living Figures. Use of "actual" cost-of-living data does not always result in firm adjustment factors. Subsequent revisions to data will sometimes occur in order to correct for errors. It seems clear that appropriations limits for future years should be adjusted to reflect these revisions. However, it is not clear whether entities should be held accountable for any overspending resulting from revisions in the appropriations limit required after the close of a fiscal year. For example, if a CPI revision results in a downward adjustment to a past year's appropriations limit, thereby causing an entity's appropriations subject to limitation to exceed its limit, is the entity required to reduce appropriations in future years to compensate for the overspending? The Legislature can either require entities to reduce appropriations in subsequent years (as they must do whenever the emergency provision of Proposition 4 is employed), or it can allow entities the one-time spending excess. Since the revisions are small and entities have no control over the adjustment factors, we recommend that the Legislature select the latter course.

TABLE 2

Two Methods of Computing Annual Adjustment Factors[a]
Fiscal Years 1979-80 Through 1981-82

Annualized Averages Method	Percentage Changes For: 1979-80	1980-81	1981-82
Cost of Living:			
CPI[b]	7.7%*	11.3%*	11.6%
State Per Capita Personal Income[b]	11.5	12.0	9.1*
Population[c]	1.9	1.7	1.7
Adjustment Factor (Compounded basis)	9.7%	13.2%	11.0%
Point-to-Point Method			
Cost of Living:			
CPI[d]	10.2%*	12.8%	9.4%*
State Per Capita Personal Income[e]	11.7	10.5*	9.4
Population[e]	1.8	1.7	1.7
Adjustment Factor (Compounded basis)	12.2%	12.8%	11.3%

a. All numbers are based on estimates of the Department of Finance. The numbers with asterisks represent the cost-of-living factor which is to be used.
b. Percentages represent the change between the annual averages for the prior two calendar years.
c. Percentages represent the change in total resident population from July 1 to July 1. For example, for 1979-80 the change in population reflects the change between July 1, 1977 and July 1, 1978.
d. Percentages represent the change between the prior two monthly March indices.
e. Percentages represent the approximate change occurring during the prior calendar year.

Population. The initiative appears to give the Legislature wide discretion in determining how the appropriations limit is to be adjusted for population changes. Instead of just counting the change in an entity's human population, the Legislature might wish to recognize changes in service-related units of population. For example, the costs of most special districts are determined by the number of users of the service, not by the number of people in the district. Consequently, an irrigation district might experience a 2 percent growth in population, but if this growth did not result in additional users of irrigation water, the district would have no increased demand for services. Conversely, a fire district experiencing a rapid rise in the number of industrial and commercial buildings could have increasing demand for service while having no population growth.

It is not clear that the language of Proposition 4 will allow the use of service-related units of population. Section 8(f) requires that the determination of population "be revised...to reflect the periodic census conducted by the United States Department of Commerce," a requirement which might not be met by a service unit definition of population. Even so, we recommend that the Legislature allow the use of service-related units in calculating population changes for single-function special districts.

Whenever special districts use traditional population figures to adjust their limits, we recommend that they use the percentage change in population for their respective counties (or as otherwise provided in Section 2228 of the Revenue and Taxation Code). These population change figures, which are calculated on a January 1 to January 1 basis, are now determined by the Department of Finance. The department could also provide special population estimates for those districts requesting them.

Alternatively, several private concerns offer annual population change estimates for zip code areas, and these estimates could be used to more closely approximate special district boundaries.

For the state, counties and cities, population change figures probably serve as fairly accurate indicators of increased demand for services. Again, to the extent that they do not, the Legislature could make adjustments. For those cities with declining populations, yet no accompanying decreases in costs, the Legislature could require, for example, that population reductions exceed a certain minimum percentage before downward adjustments in the limit are necessary, on the basis that small population losses provide no opportunity for cost savings.

Combining Population and Consumer Price Index (CPI) Changes. There has also been a question as to whether the cost-of-living and population factors should be added or multiplied in order to derive a total adjustment factor. If the factors are added, an entity would receive an inflation adjustment only on the costs of providing services to the existing population. (Although costs of providing services to new residents would be included, they would not be adjusted for inflation.) By multiplying the factors, however, an entity would also be allowed an inflation adjustment for the cost of providing services to its new residents. Therefore, to account accurately for the combined effect of inflation and population, we recommend that the factors be multiplied in adjusting the limits.

Table 3 summarizes our recommendations regarding the annual adjustment factors:

TABLE 3

Recommendations on Adjustment Factors
(Using Fiscal Year 1980-81 as an Example)

Adjustment Factor	Index	Point to Point		Data Source
Consumer Price Index	All Urban Consumers	March (1979)	March (1980)	U.S. Dept. of Labor
California Pesonal Income	--	4th Quarter (1978)	4th Quarter (1979)	U.S. Dept. of Commerce
Population	Standard Population	January 1 (1979)	January 1 (1980)	Dept. of Finance

One-Time Adjustments

Proposition 4 also provides for adjustments to an appropriation limit: (1) when the financial responsibility for providing a service is shifted from one government to either another government or a private entity, and (2) when the source of funding for a governmental activity is shifted from proceeds of taxes to user fees. Sections 3(a) and 3(b) provide for these adjustments so that the governments transferring responsibility for providing services will not be able to evade the limit on the size of government, and the governments receiving this responsibility will have limits large enough to accommodate the additional appropriations required.

In the case of transfers between governments, which may be due to annexations, incorporations, consolidations, etc., the initiative provides that the entities must "mutually agree" to the shift in limits. This provision in effect gives the entity losing territory a virtual veto over the proposed annexation, even though the affected residents strongly support it. For example, a county wishing to prevent some of its land from being annexed by a city could halt the annexation by refusing to give up any of its appropriations limit.

Consequently, the Legislature may wish to provide a means for resolving impasses over limit changes. (The mutual agreement provision of Proposition 4 is quite similar to language in AB 8-Chapter 282, Statutes of 1979--requiring cities and counties to agree to the transfer of property tax revenues when annexations occur. We recommend that the means adopted for addressing the impasse problem also be available for disputes over property taxes as well.)

One possible method of resolving intergovernmental disputes is suggested by AB 8. That measure gives the local agency formation commissions (LAFCO's) a prominent role in the transfer of property tax revenues in connection with incorporations. We recommend that the Legislature also involve LAFCO's in the Section 3(a) process. These commissions seem ideally suited for both factfinding and mediation purposes in intergovernmental service and boundary disputes. In fact, the "mutually agree" clause of Section 3(a) might be satisfied if both entities affected by a transfer of responsibility agreed to binding arbitration by the LAFCO.

Of all the provisions of Proposition 4, Section 3(b) may pose the most difficult to implement. Section 3(b) requires downward limit adjustments where "the financial source for the provision of services is transferred, in whole or in part, from other revenues...to user fees..." (emphasis added).

To begin, we recommend that the Legislature define "other revenues" as used in Section 3(b) to mean "proceeds of taxes." If the section is interpreted literally, an entity will have to adjust its limit downward for shifts in financial responsibility between user fees and all other revenues, including non-tax revenues. For instance, a transit district which experiences a loss in advertising revenues (which are "other revenues" but not proceeds of taxes) might have to lower its appropriations limit even if its revenue amounts from proceeds of taxes and user fees remained unchanged. Since advertising revenues are not otherwise limited by the initiative, the inclusion of such funds in the calculations required by Section 3(b) seems incongruous. For this reason, it would be more consistent to define "other revenues" as proceeds of taxes.

Section 3(b) would pose few problems if all financial responsibility shifts were completely from proceeds of taxes to user fees. However, a large number of user fees cover only a portion of the total costs of providing a service, and in these cases the financial responsibility for the service is split between proceeds of taxes and user fees. Difficult problems will occur when an entity of government moves to recover a greater percentage of costs through user fees. (There are significant incentives to do so since once a function is 100 percent user fee supported, revenues may be raised to cover all reasonable costs without regard to the appropriations limit.)

Consider first the simple case presented in Table 4 where: (1) a single function special district wishes to increase the percentage of user fee support from 60 to 80 percent, and (2) there is no annual adjustment for CPI and population. As Table 4 shows, in this case the limit would decrease by $20, regardless of whether an absolute dollar amount or a percentage change is used.

Table 4

Case 1: Shift from Proceeds of Taxes to User Fees;
No Annual Adjustments to Limit in Year Two

Source of Appropriation	Year One Amount	Year One Percent	Year Two Amount	Year Two Percent
Proceeds of Taxes	$ 40	40%	$ 20	20%
User Fees	60	60	80	80
Appropriations	$100	100%	$100	100%
Appropriations Limit:				
Before Shift	$ 40		$ 40	
After Shift	--		20	

Assume now the hypothetical situation illustrated in Table 5. The same district experiences a huge influx of new people in "year two" thereby increasing its costs and its annual adjustment factor (CPI and population) by 50 percent. Proceeds of taxes, however, remains at the prior year's level because of, say, fire-related property losses. Under these circumstances, in order to keep <u>real</u> spending at a constant level, the district must almost double its user fees (from $60 to $110). As the table shows, there has been a dramatic shift--viewed in percentage terms--in the financial responsibility for the provision of this district's service, even though the dollar amount financed by the proceeds of taxes is unchanged.

TABLE 5

Case 2: 50 Percent Increase in Annual Adjustment
And in Program Costs, No Change in Proceeds of Taxes

Source of Appropriations	Year One Amount	Year One Percent	Year Two Amount	Year Two Percent
Proceeds of Taxes	$ 40	40%	$ 40	26.7%
User Fees	60	60	110	73.3
Appropriations	$100	100%	$150	100.0%
Appropriations Limit:				
Before Shift	$ 40		$ 60	
After Shift	--		40[a]	

a. The limit change is calculated as follows:
   (1) The change in the amount of appropriations made from proceeds of taxes is 13.3 percent (40% - 26.7%) or .133.
   (2) The change in the limit is the difference between what the limit would have been in year two ($40 x 1.50 = $60) and the shift in responsibility (.133 x $150 = $20).
   (3) The new limit, then, is $60 - $20 = $40.

Both a literal reading of Section 3(b) and what we understand to be the intent of the intiative leads us to believe that "transfers of financial responsibility" should be viewed in terms of percentage changes. Given that costs, annual adjustments, and revenue sources can all grow at different rates, the use of percentage changes is not only the cleanest way conceptually to think of limit shifts; it is, perhaps, the only practical way of calculating those shifts.

The use of percentage changes, however, will lead to problems in cases where costs are increasing faster than the allowable annual adjustments. In Case 3, as presented in Table 6, the special district has increased costs in Year Two of 20 percent, even though its limit increase is only 10 percent.

TABLE 6

Case 3: 10 Percent Increase in Annual
Adjustment and 20 Percent Increase in Costs

	Year One		Year Two	
Source of Appropriations	Amount	Percent	Amount	Percent
Proceeds of Taxes	\$ 40	40%	\$ 44[a]	36.3%
User Fees	60	60	76[a]	63.7
Appropriations	\$100	100%	\$120	100.0%
Appropriations Limit:				
Before Shift	\$ 40		\$ 44	
After Shift	--		40[b]	

a. These are the amounts which the district could spend prior to thelimit adjustment from \$44 to \$40.

b. The decrease in the limit is calculated as follows:
(1) The shift in proceeds of taxes is 40 % - 36.3% = 3.7%, or .037.
(2) .037 x \$120 (total appropriations) = \$4.

If the district is to maintain a constant level of real spending, it must increase appropriations to $120. Since the proceeds of taxes can increase only 10 percent (from $40 to $44), the remainder must come from user fees, which Table 6 shows as increasing from $60 to $76. The greater reliance on user fees, however, necessitates a downward adjustment to the limit (from $44 to $40) and to the level of appropriations from proceeds of taxes. This, in turn, requires a further increase in user fees (from $76 to $80) in order to maintain the level of services, resulting in yet another shift in financial responsibility and the need for another downward limit adjustment. This process would continue until the only way the district could reach the $120 level would be to raise the entire amount from user fees.

There do not appear to be easy solutions to the problems raised by Section 3(b). The Legislature could adopt guidelines providing for the use of percentages in deriving transfers of financial responsibility. At the same time, it could allow entities to maintain their existing limits in those instances where (1) a percentage shift to user fees was the result solely of an effort to maintain a given level of services (as in Case 3, above) or (2) a percentage shift was the consequence of increased fees offsetting an unchanged dollar amount of proceeds of taxes so that spending could rise by just the increase in the annual adjustment factor (as in Case 2).

Adjustments of a Limited Duration

Proposition 4 also allows for adjusting appropriations limits for up to four years when they are approved by the electorate (Section 4).

However, since the provision is imprecise on exactly how referenda will modify limits, we recommend that the Legislature require each such referendum to clearly state the following:

(1) the first fiscal year in which the change is effective;

(2) the number of fiscal years for which the change is effective (not to exceed four); and

(3) the amount of the change (which can then be appropriated each year in addition to what would have been the limit in each year).

With the formation of any new tax-supported local government, Section 4 virtually requires an election in order to establish an appropriations limit, even if the creation of the district does not require one in and of itself. For a new entity which is also taking over responsibility for providing services previously provided by another government, Section 3 would require it to propose a limit which is at least as high as the amount of limit being transferred. However, since it would be impossible for an entity not yet in existence to negotiate the transfer of services as provided in Section 3, we recommend that LAFCO's, which are already involved in these proceedings under current law, be empowered to negotiate for the agency-to-be.

Proposition 4 also allows for adjustments to appropriations subject to limitation in the case of an emergency. An entity's appropriation may exceed its limit in one fiscal year if in the following three years it reduces its limit so that there is no aggregate increase in appropriations.

This provision would be helpful if, at the time of the emergency, the entity is spending at its limit yet has (or will have) excess proceeds of taxes which could be used in responding to an emergency. There are no incentives, however, to invoke needlessly the emergency provision since the entity is not allowed an increse in overall appropriations subject to limitation. Since the provision appears to be self-limiting, we see no need for the Legislature to define the term "emergency."

STATE MANDATES

Under the provisions of SB 90 (Chapter 1406, Statutes of 1972), the state must reimburse local governments for increased costs that it imposes on them. However, through the use of disclaimers, the Legislature has chosen not to fund state mandates in cases where the "spirit" of SB 90 calls for reimbursement. The validity of these disclaimers is based on the principle that one Legislature cannot be limited by the action of a prior Legislature (in this case, the one that passed SB 90). Therefore, as long as the reimbursement requirement was merely statutory (and not constitutional) law, the Legislature could adopt measures and mandate costs without making any provisions for reimbursement.

Proposition 4 raises the reimbursement principle contained in SB 90 to the level of a constitutional guarantee. In so doing, it invalidates the use of certain disclaimers. In addition to establishing the principle of reimbursement, the initiative also requires the state to accommodate these reimbursements within its own appropriations limit.

While Section 6 of the initiative requires the Legislature to reimburse local agencies for a mandated "new program or higher level of service," the Legislature has the option to reimburse for: (1) mandates requested by a local agency and (2) legislation which defines a new crime or changes the existing definition of a crime. These exceptions are similar to two of the eight exemptions specified in current law under the SB 90 process. Legislative Counsel has opined that "the Legislature would not be precluded...from disclaiming responsibility for reimbursement in additional circumstances consistent with the intent of Section 6"[1] (emphasis added).

The other six "circumstances" under which disclaimers previously were justified under the SB 90 process are listed below and discussed in terms of their validity under Proposition 4:

(1) The chaptered bill affirms that which had been declared existing law or regulation by action of the courts. This disclaimer would appear to be valid under Section 6 because no new program would be mandated by such legislation.

(2) The chaptered bill implements a federal law or regulation. This disclaimer should still be valid for the same reason.

(3) The chaptered bill provides for self-financing authority. Provision of self-financing authority may no longer be a valid reason for disclaiming reimbursement of mandated costs, for several reasons.

First, if the "self-financing authority" involved a revenue source that generated "proceeds of taxes," appropriations from this source would count towards the local appropriation limit. Under these circumstances,

1. Legislative Counsel opinion #7165, page 5.

the new financing mechanism would not by itself help an entity accommondate the cost of a state mandate within its limit. Hence, it seems that the disclaimer would not be valid.

Second, and more importantly, Proposition 4 seems to require the state to actually provide reimbursement rather than merely authorize local entities to raise new revenues. If this is the case, the "self-financing authority" disclaimer may be considered inappropriate under all circumstances because the mandate would unavoidably impose a burden on local agencies--that of raising additional revenues--even if it could be funded outside of the appropriations limit. We do not know whether the courts would uphold a "self-financing authority" disclaimer even when the "authority" involved non-tax proceeds.

The self-financing disclaimer has not been used extensively in the past. Only 9 of the 228 disclaimers included in legislation chaptered in 1978 specified the provision of self-financing authority as the reason for the disclaimer. Generally, these bills imposed minor duties on local government and provided for collection of fees to cover the cost of the service provided. Some examples of the use of self-financing disclaimers are:

(1) A bill which requires county treasures to send a series of notices to property owners who have become delinquent with their street assessment bonds and provides that costs incurred can be recovered by assessing fees;

(2) A bill which requires county assessors to disclose information and permit access to their records on request of inheritance tax referees, and which allows them to impose a charge; and

(3) Bills which require counties to collect assessments imposed by cities and special districts when the property tax is collected, and which allow the county to charge the cities and districts the cost of assessment and collection.

If self-financing disclaimers are no longer valid, the state would be required to reimburse publicly-owned utility districts for any mandated costs. Although current law does not make clear whether such districts are to be reimbursed for mandated costs, the Legislature generally has refused to provide such reimbursement because it would result in a subsidization of public utility customers at the expense of private customers who pay for the mandate in the form of higher service charges. We do not believe it was the intent of Proposition 4 to require reimbursement of mandated costs imposed on publicly-owned utility districts.

Thus, the continued validity--and even appropriateness--of self-financing authority disclaimers is still uncertain. On the one hand, such disclaimers could provide a means for the Legislature to impose substantial mandates on local entities and not fund them. This might cause the courts not to honor them. On the other hand, use of self-financing authority disclaimers would give the Legislature needed flexibility in responding to state problems, and allow it to avoid having to subsidizing one group of utility customers at the expense of all others. Further legal advice is needed in order to establish the Legislature's options with regard to this type of disclaimer.

(4) <u>The chaptered bill provides for offsetting savings to local governments which result in no net costs to such governments</u>. Legislative Counsel has indicated that it would be consistent with the purpose of Section 6 to conclude simply that there are no <u>new</u> costs in such cases.

(5) The chaptered bill imposes duties which were expressly included in a ballot measure approved by the voters in a statewide election. This disclaimer should still be valid because Section 6 only requires reimbursement when "the Legislature or any state agency mandates a new program...." Therefore, if the duties were required by the voters, they would not be reimbursable.

(6) The claim is for $200 or less. Generally, we believe that the courts will uphold the concept of a minimum claim if it can be determined that the administrative costs associated with processing the claim exceed the amount of the reimbursement requested by the local government. However, we cannot estimate the amount which would be considered an acceptable minimum.

In sum, we believe that, except for the self-financing authority disclaimer, all of the current statutory SB 90 disclaimers are likely to be valid under Section 6, although their use may be more restricted than in the past.

A more troublesome aspect of Section 6 concerns the provision stating that the Legislature need not reimburse for mandates, executive orders or regulations initially implementing legislation enacted prior to January 1, 1975 (Section 6(c)). This implies that the Legislature must reimburse for such mandates enacted after January 1, 1975. However, Legislative Counsel has opined that the Legislature would be required to provide subvention of funds only for new programs or higher levels of service mandated on or after July 1, 1980.[1]

1. Legislative Counsel opinion #7165, page 1.

Counsel's conclusion is based in part on the principle of nonretroactivity of statutory and constitutional provisions. That is, such provisions "are not to be considered retrospective in their operation unless the intent to make them so clearly appears from their terms."[2] Consequently, the Legislature is not in any case responsible for reimbursing disclaimed or still unrecognized costs incurred prior to the effective date of the initiative.

Section 6(c) could then be interpreted as requiring the Legislature to subvene funds to local entities for costs incurred after July 1, 1980, (the effective date of the initiative) pursuant to mandates imposed after January 1, 1975. However, this interpretation could result in situations which appear to be contrary to the intent of the initiative. Table 7 illustrates the problem. Assume that, in 1978-79 the state provided $5 million in subventions to cover a local entity's cost of complying with a mandate enacted in 1975. According to counsel this $5 million would be included in the local, rather than the state, base. If in 1980-81 these subventions were then considered to be state mandates within the meaning of Proposition 4, the state would have to count the resulting appropriations towards its own limit even though that limit would remain unchanged (at $1,000, in the example). Consequently, the state would have to reduce its appropriations subject to limitation by $5 million. At the same time, the local entity would gain $5 million within its limit to spend on new or expanded programs, because (according to counsel) it would no longer have to count the appropriation of these subventions against its limit.

It is this anomaly which led Counsel to his conclusion that Section 6(c) would apply only to mandates imposed on or after July 1, 1980.

1. Legislative Counsel opinion #7165, page 2.

TABLE 7

Legislative Counsel's Interpretation of Section 6(c): An Example (in millions)

	1978-79		1980-81	
	State	Local Entity	State	Local Entity
Appropriated Proceeds of Taxes	$1,000	$10	$1,000	$10
SB 90 Subventions	(5)	5	---	---
Proposition 4 State Mandates	---	---	5	(5)
Total Appropriations for Own Purposes	$1,000	$15	$1,005	$10
Limit	$1,000	$15	$1,000[b]	$15[b]

a. Assumes no cost-of-living or population adjustments.
b. By shifting state mandates from the local entity to the state without accompanying limit changes: (1) the state must now reduce its normal appropriation by $5 million and (2) the local agency has $5 million of room within its limit to start new services or extend existing programs (if it has the revenue, of course).

An alternative to the approach advanced by the Counsel is to place within the state's base-year limit the cost of mandates imposed after January 1, 1975. This is, perhaps, the only way to impute meaning to the January 1, 1975 date without causing the anomaly noted above. The main problem with this alternative is that the state would not have included in its base year limit the costs of funded mandates begun in 1979-80. The state would simply have to accommodate the future costs of these mandates within its limit.

If the Legislature also decided to pay for the future costs of unfunded mandated imposed between January 1, 1975 and June 30, 1980, it could adjust the state's limit to accommodate the additional appropriations. Since the state would be assuming the financial responsibility for costs previously paid by local governments, it could invoke the transfer provision of Section 3(a), which would require a shift to the state of that portion of the local government base year limit dedicated to unfunded costs. The treatment of state mandates imposed between January 1, 1975 and June 30, 1980, is another of the important policy questions raised by the initiative. We do not at this time have any basis to favor one alternative over the other.

There are still questions as to how unfunded mandates (that is, state directives which are not accompanied by appropriations to pay for the local costs) imposed after July 1, 1980 will be handled. In the case of an unfunded mandate, local agencies would face a requirement that they provide a particular service, but they would neither receive the funds needed to carry out the mandate, nor be granted a higher limit to accommodate the cost of complying with the mandate. Thus, compliance would tend to require offsetting reductions in other existing programs.

In this situation, local agencies may seek to have the requirement deemed unconstitutional by the courts in order to avoid the adverse consequences of an unfunded mandate. Legislative Counsel has stated that a court could either excuse the local government from complying with the mandate until reimbursement was provided by the state or declare the mandate to be unconstitutional, but it could not order the Legislature to appropriate the funds to pay for the mandated costs. The Counsel also believes the courts could require local agencies to exhaust all available administrative remedies before providing any judicial relief. This suggests that the current Board of Control claims process could be continued under the Gann Initiative. This process would not necessarily provide any relief to local agencies, though, because current Board of Control regulations (not state law) require that claims be based on actual, as opposed to estimated costs. Thus, local agencies would still have to implement the new program with their own funds and within their existing appropriations limit.

On the other hand, if the Board of Control regulations were changed to permit the filing of claims based on estimated costs, the board could determine whether the program was indeed a mandate requiring reimbursement prior to the expenditure of local funds. If the program were determined to be a mandate, the Legislature could then take action to either provide funds or repeal the mandate. This would tend to minimize the use of legal actions, while providing a means to equitably resolve the issues. Therefore, we recommend that the board be required to accept claims for the estimated costs of mandates enacted after June 30, 1980.

INDEBTEDNESS

Proposition 4 excludes from limitation any appropriations for debt service, which is defined in Section 8(g) as spending:

> ...required to pay the cost of interest and redemption charges, including the funding of any reserve or sinking fund required in connection therewith, on indebtedness existing or legally authorized as of January 1, 1979 or on bonded indebtedness thereafter approved according to law by a vote of the electors of the issuing entity...(emphasis added).

The most important word in Section 8(g), "indebtedness," is not further defined in the initiative. Legislative Counsel has opined that indebtedness would include "any legally binding obligation."[1] This interpretation has the practical effect of potentially excluding the expenditure of billions of dollars from state and local appropriations limits.

For instance, the unfunded liability of the two giant public retirement systems, PERS and STRS, was approximately $13 billion as of June 30, 1978. As the state reduces this liability (or debt), it can exclude appropriations for that purpose from its spending which is subject to limitation. For PERS (Public Employees' Retirement System), the annual excluded amount should be readily obtainable, since the unfunded liability has been amortized through higher state contribution rates. The difference between the total state retirement contribution and the contribution which would be necessary to provide benefits solely to present employees could be considered "debt service."

For STRS (State Teachers' Retirement System), however, the situation is more complicated, as the system's unfunded liability has not been amortized through the present rate structure. Consequently, the scheduled future payments provided in AB 8 (Chapter 282, Statutes of 1979) could be treated as either contributions for the now-accruing benefits of presently employed members (in which case the payments would not be excluded as debt service) or as contributions for the payment of the already accrued but still unfunded benefits (in which case the payments would be excluded). We believe the scheduled STRS contributions in AB 8 should be excluded from future appropriation limits since these monies will be used first to retire existing obligations.

1. Legislative Counsel opinion #7240, page 5.

Another type of indebtedness which might be excluded from limitation is the lease payment for a public leaseback. Leasebacks, which involve a contractual arrangement between a local agency and a special purpose corporation, are used solely for the financing of public facilities. The corporation actually floats the debt, builds the facility, leases it to the agency, and turns over the ownership to the agency when the debt is retired. For leasebacks in force as of January 1, 1979, we believe that the lease payments should be excluded from the local agency's appropriations limit since these payments represent the debt service on the outstanding bonds. After July 1, 1980, it may be difficult to issue leaseback bonds since debt service appropriations for these nonvoter-approved bonds would not be excluded from limitation.

In order to clarify these debt service issues, we recommend that the Legislature adopt a definition of indebtedness similar to that provided by Legislative Counsel. Allowable types of indebtedness, such as unfunded liabilities and lease payments, should be listed.

While the initiative excludes from limitation appropriations to repay all indebtedness existing as of January 1, 1979, after that date only appropriations for voter-approved bonded indebtedness can be excluded from appropriations subject to limitation. However, the initiative makes no direct provision for nonvoter-approved indebtedness incurred in the gap between the January 1, 1979 deadline and the proposition's effective date of July 1, 1980. Section 7, though, does state that:

> Nothing in this Article shall be construed to impair the ability of the state or of any local government to meet its obligation with respect to existing or future bonded indebtedness (emphasis added).

Except for the last phrase, Section 7 appears to be a superfluous restatement of Section (1), Article 10 of the United States Constitution, which prohibits the state from impairing contracts. Both constitutional provisions could be invoked in cases where the provisions of the initiative prevent an entity of government from meeting its obligation with respect to indebtedness incurred in the gap (January 1, 1979 to July 1, 1980). Counsel has concluded that the debt service on such indebtedness could exceed an entity's appropriations limit to the extent necessary to avoid a contract impairment.

For example, if a redevelopment agency sold a tax allocation bond (these do not require voter approval) on March 30, 1979, it could not exclude its debt service appropriations under Section 8(g) of Proposition 4. However, under Section 7 the agency would give its debt service payments first priority within its appropriations limit and, if necessary, it could exceed its limit in order to fulfill its debt obligation. In certain cases, this safety valve of being able to exceed a limit may be helpful, both to entities desirous of maintaining their credit ratings, and to creditors, who would have a greater assurance of repayment.

The unusual aspect of Section 7 is the inclusion of the phrase "future bonded indebtedness." As counsel has noted, there was no need to include the word "future" if the intent was simply to avoid conflict with the U.S. Constitution. After the effective date of the initiative (July 1, 1980), everyone undertaking a contractual agreement with a California government would be fully aware of the provisions of Proposition 4. Consequently, the initiative could not be seen as impairing obligations after that date.

There must, then, be some meaning which can be attributed to the word "future." Since the initiative already provides for the exclusion of future voter-approved bonded debt, the term logically refers to future nonvoter-approved bonded debt. Counsel has concluded that such indebtedness would be treated like the obligations incurred in the January 1, 1979 - July 1, 1980 period (the gap). That is, appropriations for the debt service would be given priority over other appropriations and, if necessary, could exceed the limit.

We recommend that the Legislature adopt statutory language implementing counsel's interpretation of Section 7, with regard both to indebtedness issued in the "gap" and to nonvoter-approved debt issued after June 30, 1980. Such a legislative declaration may help restore some confidence in the California municipal bond market, especially with regard to redevelopment agency debt. (In the wake of Proposition 4, both major national bond-rating agencies suspended ratings on redevelopment agencies' tax allocation bonds. The future use of these debt instruments is an uncertainty at this time.)

Table 8 summarizes how indebtedness incurred at different times would be treated under the initiative.

TABLE 8

Treatment of Indebtedness Under Proposition 4

Appropriations for Debt service:	Indebtedness: As of January 1, 1979	Incurred Between January 1, 1979 and June 30, 1980	Incurred After June 30, 1980
Excluded from Limit	All Indebtedness	Voter-Approved Bonded Indebtedness	Voter-Approved Bonded Indebtness
Priority Spending	---	All Other Indebtedness	Non-voter Approved Bonded Indebtedness

ENTITIES OF GOVERNMENT

The appropriations limits imposed by Proposition 4 apply only to "entities of government." While this term is not defined in the initiative, it clearly encompasses both state and local governments, with the latter defined as:

> ...any city, county, city and county, school district, special district, authority, or other political subdivision of or within the state.

As of fiscal year 1977-78, there were (according to reports issued by the Controller) a total of 6,579 local governments in the state, which fall into the following four categories:

Counties	58
Cities	417
Schools:	
K-12	1,211
Community Colleges	70
Special Districts	4,823
Total	6,579

The Controller has included within the special districts category virtually all California governmental entities which are not counties, cities or schools. (Appendix 2 lists the 55 types of special districts covered by the Controller's report.) This catchall definition is not derived from statute, for there is no single definition of the phrase "special districts" provided in law. Instead special districts are described in several codes, with the defintion varying slightly in each case according to the needs of the particular program involved.

A precise definition of special districts is needed for two reasons. First, those entities which are deemed to be special districts are eligible for the Section 9(c) 12½ cent exemption. For instance, Legislative Counsel has opined that county service areas (CSA's) and maintenance districts, which comprise one quarter of all special districts, would not be considered entities of government (which means that they also would not be considered special districts, since the latter is a subset of the former).[1] Absent any future legislative declaration to the contrary, appropriations of CSA's and maintenance districts would be counted toward counties' appropriations limits. If, on the other hand, these two governmental types were defined as special districts, the spending of a substantial number of them would be forever excluded from Proposition 4's limiting provisions through the 12½ cent exemption.

This determination is even more significant for redevelopment agencies (RA's). If they are considered special districts, then the spending of all RA's existing as of January 1, 1978, could be exempted from the initiative under Section 9(c). This is because, technically, redevelopment agencies do not levy a tax rate. Instead, they use their respective county

1. Legislative Cousnel opinion #8276, page 4.

tax rates and apply them to their own assessed valuations. If, however, redevelopment agencies are not considered special districts but are considered entities of government, they may be greatly restricted in their ability to appropriate monies in the future (see Chapter III for more detail on redevelopment agencies).

In determining whether a body is a separate entity of government, as opposed to being simply a part of a city or county, the Legislature may want to consider the following criteria:

(1) Does the governmental unit have a separate legal existence?

(2) Does it have an autonomous elected board of directors?

(3) Does it have broad powers (for example, the powers to acquire and hold land, sue and be sued, incur debt and contract in its own name) to carry out its objectives?

There is one other type of governmental unit which deserves mention: assessment districts. We have assumed that appropriations of these districts are not subject to the initiative since: (1) assessment districts are funded entirely from other than proceeds of taxes, and (2) assessment districts do not meet the above criteria for entities of government (even the Controller, who uses a liberal interpretation of special districts, does not include these districts in its special district report). We recommend that the Legislature specifically exclude assessment districts from the category "entities of government."

MISCELLANEOUS

Effective Date

Proposition 4 is effective "commencing with the first day of the fiscal year following its adoption." This means entities will be subject to the initiative's provisions begining in 1980-81.

There are, therefore, no limits on government for the current fiscal year (1979-80). Of course, entities will be hesitant to appropriate funds for new ongoing programs at a higher level than the initiative would allow if it were in effect in 1979-80, since doing so might require them to cut back services in 1980-81 to stay within their limits. However, one-time spending (say, for capital projects or for the establishment of Section 5 reserve funds) in excess of that hypothetical 1979-80 limit would not bring about the need for cuts in later years.

Return of Excess Revenues

In addition to placing appropriations limits on California goverments, Proposition 4 also provides for the return of excess or surplus monies to the state. Section 2 states:

> Revenues received by any entity of government in excess of that amount which is appropriated by such entity in compliance with this Article during the fiscal year shall be returned by a revision of tax rates or fee schedules within the next two subsequent fiscal years.

The term "revenues received" is another phrase not defined in the initiative. Counsel has concluded that all income--whether from proceeds of taxes or not--to an entity in a given fiscal year would be considered revenues received, regardless of when the funds first accrued.[1] Therefore, prior year unappropriated surpluses would also be included in the total.

Proposition 4 requires that the difference between revenues received and all appropriations--again, regardless of the source of funds--made during the same fiscal year be returned to the people within the next two years. Consequently, Section 2 provides a major incentive for governments

1. Legislative Counsel opinion #2944, page 2.

to appropriate (but not necessarily spend) annually the entire amount of revenues other than the proceeds of taxes in order to limit the amount which must be returned to the taxpayer. For instance, if the state anticipates having at the end of 1980-81 excess revenue derived from sources other than the proceeds of taxes (for example, revenues deposited in the General Fund from the sale of state property, tidelands oil sales or transfers), and foresees a need for these funds in subsequent years, the state could reduce the amount subject to Section 2 by appropriating these funds before the close of the fiscal year.

The state could appropriate, without irrevocably committing, excess non-tax revenues by establishing a General Non-Tax Proceeds Fund, into which all such monies could be funneled and then immediately appropriated without regard to fiscal year. For example, incoming license fees, most of which are now deposited in the state's Consumer Affairs funds, could instead be deposited in a single non-tax fund and appropriated without regard to fiscal year. This alternative would ensure that surplus license fees, which are needed for cash flow reasons, would not be subject to Section 2.

Actually, the state has already taken action to protect its largest source of non-tax proceeds--federal monies--from the requirements of Section 2. AB 3322 (Chapter 1284, Statutes of 1978) established a depository for all federal funds, the Federal Trust Fund, from which <u>all</u> monies are appropriated <u>without</u> regard to fiscal year. In effect, AB 3322 ensures that no federal funds will be subject to the excess revenue provision of Section 2.

The initiative ostensibly allows only a revision of tax rates or fee schedules as a way of returning excess revenues. However, in the opinion of Legislative Counsel any other method (such as a direct refund or a tax credit) which achieves the intended result would be acceptable.[1]

<u>Budgeting and Enforcement</u>

Passage of Proposition 4 will undoubtedly lead to modifications in the budgetary and accounting systems of state and local governments. At the very least, entities may have to provide some basic accounting for "revenues received," "total appropriations," and "appropriations subject to limitation" to show that they have complied with the operative provisions of the initiative (Sections 1 and 2). However, in order to derive these basic figures, entities may have to change their fiscal accounting practices.

For instance, governments may want to change their fund structures to accommodate the distinction between revenues which are proceeds of taxes and those which are non-tax proceeds. As we mentioned earlier, entities might redirect certain monies now deposited in general funds (such as transfers, revenue from property sales, oil revenues, etc.) into one or more non-tax proceeds funds. The separation of monies at this stage would make subsequent Proposition 4-related calculations concerning appropriations, excess revenues, and prior-year balances much simpler.

Proposition 4 may also encourage a return to special fund or "cookie jar" financing. This involves an entity having, for each fee-supported service, an individual fund into which fees are deposited and out of which costs are paid. With respect to the state, the Legislature has in past years moved away from special fund financing in order to maximize flexibility in the use of state monies. However, the initiative's emphasis on user fees may spark new growth in the number of special funds.

1. Legislative Counsel opinion #15558, page 11.

Similarly, the proposition's exclusion of appropriations resulting from "costs reasonably borne" in the provision of fee-financed services is certain to lead to increased cost accounting. Entities will have an obvious incentive to identify all the costs (especially such expenses as administrative overhead and other pro rata charges) associated with a function since revenues generated by the related user fee are not covered by the initiative and can, therefore, be increased to cover such costs. Some local entities have already acted on this matter by hiring accountants with expertise in cost accounting.

With regard to the budgetary process, Proposition 4 has created new informational needs. For example, when state legislators work on the 1980-81 budget during the coming spring, they will need to know what appropriations are subject to and not subject to limitation, as well as where total appropriations stand in regard to the limit at any given time.

The state may soon have a means of providing this information, as it is now in the process of establishing the California Fiscal Information System (CFIS), a data management system intended to improve the state's accounting and budgetary systems. CFIS should be adapted so that it can track all enacted appropriations (authorized by either the budget or financial legislation) and pending appropriations, and provide the summary information required by Proposition 4.

Ideally, the state would also like to know where local governments are in relation to their limits, in order to maximize the use of state subventions. However, existing data systems will not yield this information; consequently, the state will not know whether local entities will be able to accommodate state assistance within their limits. To the extent, then, that state subventions result in excess proceeds of taxes to an entity, the citizens of that jurisdiction may be receiving tax refunds courtesy of taxpayers in other jurisdictions.

With regard to enforcement, Proposition 4 provides no specific means for ensuring adherence to its provisions. Apparently, the proponents assumed that it would be self-executing--that is, state and local governments would be responsible for fulfilling the constitutional requirements of Proposition 4. To the extent, then, that citizens disagree with an entity's actions with respect to the measure, they may challenge those decisions in court.

Consequently, the state judicial system could become the arbiter of hundreds of suits questioning the validity of Proposition 4 determinations made by the state and local governments. We do not believe that inundating the court system with cases primarily involving administrative calculations is desirable. One way to limit the amount of Proposition 4 litigation would be for the Legislature to adopt some basic principles and guidelines to be used in implementing the intiative. The recommendations made in this chapter are designed to do just that. With some legislative direction, local governments may be able to execute Proposition 4's provisions without the constant threat of lawsuits.

Furthermore, legislative guidance might also lessen the need for state oversight and enforcement of local government's implementation of the proposition. If local entities are provided the means to adhere to the initiative's provisions, there would probably not be the pressure on the state from either the citizenry or the courts to guarantee enforcement.

If, however, the Legislature feels that some oversight is needed, the State Controller's office (SCO) is the existing agency best suited for the job. Through its involvement with the enforcement of SB 90

Chapter 1406, Statutes of 1972) tax rate limitations; the allocation of Proposition 13 fiscal relief and the concomitant auditing of reserve funds; and the annual compilation of city, county, school district and special district financial reports, the Controller's office has gained much experience in local government fiscal affairs. Therefore, whether the Legislature simply desires additional information or demands strict enforcement, the Controller's office seems capable of accomplishing the task.

CHAPTER III

FISCAL IMPACT ON STATE AND LOCAL GOVERNMENT

Given the different interpretations of Proposition 4's provisions, it is impossible to make a reliable estimate of what the initiative's fiscal impact will be on California governments. In order to give the Legislature a sense of the initiative's potential impact on the state, we have analyzed it based on the assumption that our recommendations for resolving the various policy issues raised in Chapter II are accepted. We have not attempted to calculate the limits for individual local governments. Instead, we have tried to address, for each of the primary types of local government (counties, cities, special districts and school districts), some of the major fiscal issues posed by the proposition.

STATE GOVERNMENT

Since the Gann Initiative is intended to freeze real, per capita government spending from tax proceeds at the 1978-79 level, the determination of "appropriations subject to limitation" for 1978-79 is crucial. Table 9 and the schedules that accompany it show our calculation of the amount of "appropriations subject to limitation" on which the state's limit will be based in future years.

In general, appropriations for a given fiscal year can be financed either by revenues accruing to the state during that year or by surplus funds carried over from prior years. As Table 9 shows, 1978-79 General Fund and special fund appropriations were financed by $17,499 million in new revenues and $2,475 million in surplus funds carried over from 1977-78. This

TABLE 9

Calculation of the State's 1978-79 Appropriations Limit
(in millions)

Refer to Schedule		General Fund	Special Funds	Total
	Current Revenues and Transfers[a]	$15,096	$2,403	$17,499
A	Appropriation of Surplus Funds	1,584	891	2,475
B	Less: Non-Tax Proceeds	-568	-311	-879
	Total, Appropriations from Proceeds of Taxes	$16,112	$2,983	$19,095
	Less: Appropriations Not Subject to Limitation			
	Debt Service:			
	Bond debt	$ -186	$ --	$ -186
	PERS debt	-140	-35	-175
C & D	Subventions:			
	Budget	-5,514	-1,209	-6,723
	Fiscal Relief	-3,701	--	-3,701
	Total, Appropriations Subject to Limitation and 1978-79 Appropriations Limit[b]	$ 6,571	$1,739	$ 8,310

a. Source: Department of Finance's June, 1979 revision.
b. For 1978-79 only, the appropriations limit is equal to "appropriations subject to limitation."

latter amount is a residual. As Schedule A shows, 1978-79 revenues ($17,499 million) were not adequate to finance total appropriations ($19,974 million); consequently, the remaining appropriations had to be financed from prior-year surplus.

SCHEDULE A

Appropriation from Prior-Year Surplus
(in millions)

	General Fund	Special Funds	Total
1978-79 Appropriations	$16,680	$3,294	$19,974
1978-79 Revenues and Transfers	-15,096	-2,403	-17,499
Appropriations from Prior-Year Surplus	$ 1,584	$ 891	$ 2,475

Not all General Fund and special fund revenues are proceeds of taxes, however. Schedule B lists the major categories of non-tax funds and the amount collected in each during 1978-79. Since the appropriation of non-tax revenues is not limited by the provisions of Proposition 4, we have deducted the amount shown in Schedule B--$879 million--from General Fund and special fund revenues to arrive at the Appropriations from Proceeds of Taxes figure shown in Table 9. This results in $19,095 million in tax-supported appropriations.

SCHEDULE B

Non-Tax Proceeds: General Fund and Special Funds[a]

	1978-79 Collections (in millions)
Federal Revenue Sharing	$276.2
Fees	182.8
Receipts from the Health Care Deposit Fund	103.6
Oil and Gas Revenues	91.1
Penalties	49.3
Sale of State and Unclaimed Property	41.2
Other Revenues	40.0
Not Otherwise Classified	94.8
Total, Non-Tax Proceeds	$879.0

a. Estimates as of June 1979.

A large amount of this $19.1 billion, though, is not subject to limitation. As Table 9 shows, appropriations for debt service on indebtedness existing as of January 1979, and for state subventions must be deducted from the $19,095 million figure, since the initiative specifically excludes such appropriations from limitation.

The calculation of total state subventions is displayed in Schedule C. The local assistance portion of total appropriations is the sum of local assistance in the budget ($10,297 million) plus fiscal relief ($4,342 million). "Local assistance," as used in the Governor's Budget, refers to state spending which is not for the direct operation of state programs or for capital outlay. Local assistance includes payments to such diverse recipients as local governments, individuals, the federal government and private organizations.

SCHEDULE C

Calculation of 1978-79 State Subventions
(in millions)

Budget	General Fund	Special Funds	Total
Local Assistance	$9,088	$1,209	$10,297
Less: Nonlocal Payments	-3,574[a]	-0-	-3,574[a]
Total, Budget Subventions	$5,514	$1,209	$ 6,723
Fiscal Relief			
Local Assistance	$4,342	$ -0-	$ 4,342
Less: Nonlocal Payments	-641	-0-	-641
Total, Fiscal Relief Subventions	$3,701	$ -0-	$ 3,701
Total Subventions	$9,215	$1,209	$10,424

a. See Schedule D.

Under Proposition 4, though, not all local assistance qualifies as subventions. In accordance with Legislative Counsel's opinions on this issue (see Chapter II), we have excluded from the total those appropriations which do not result in direct payments to local governments, and those which finance payments to local entities under the terms of a contract between the state and local entities. Schedule D identifies the excluded appropriations by programs. These programs accounted for $4,215 million in appropriations during 1978-79. Thus, actual subventions (that is, local assistance net of excluded payments) amounted to $10,424 million in 1978-79, or 55 percent of all appropriated tax revenues.

SCHEDULE D

Local Assistance Not Classified as Subventions

Program	Reason Excluded	1978-79 Appropriations (in millions)
Medi-Cal	Payments to intermediaries	$1,591.2
SSI/SSP	Payments to federal government	766.7
Developmental Services	Payments to state hospitals and privately-run regional centers	359.1
Mental Health	Payments to state hospitals; contracts	353.5
STRS	Payments to state fund	144.3
Renters' Relief	Payments to individuals	135.0
Senior Citizens Property Tax and Renters' Relief	Payments to individuals	94.0
Alcohol and Drug Abuse	Contracts	52.3
Public Health	Contracts	36.1
Salaries of Superior Court Judges	Payment to individuals	22.5
Social Services: Facilities Evaluation	Contracts	12.3
Judges Retirement System	Payments to state funds	7.3
Total, "Nonlocal" Local Assistance (Budget)		$3,574.3
"Nonlocal" Assistance (Fiscal Relief)		640.7[a]
Total		$4,215.0

a. Consists of state payments for the bought-out county shares of the Medi-Cal ($459 million) and SSI/SSP ($181.7 million) programs.

Therefore, using the Legislative Counsel's definition of subventions, the amount of "appropriations subject to limitation" during the base year was $8,310 million, as shown on the bottom line of Table 9. (Appendix 3 provides additional detail on the major program components of the state's base.)

As noted in Chapter II, the payment criterion which we have used in identifying subventions is only one of several approaches to this key task. If subventions were instead defined to exclude programs over which local entities have little or no control, payments for AFDC, social services and K-14 categoricals would be shifted into the state's base. This would increase the total of "appropriations subject to limitation" during the <u>base year</u> by $2.6 billion, to approximately $10.9 billion.

In Table 10, the state's 1978-79 base using the payment criterion in determining subventions--$8,310 million--has been adjusted for projected annual changes in inflation, personal income and population for the 1979-80, 1980-81, and 1981-82 fiscal years. We have also included in Table 10 projections of "appropriations subject to limitation" at the state level, using the best available assumptions regarding workload growth and inflation, so that the cost of <u>current</u> state services can be compared to the limit.

TABLE 10

Estimated Impact of Proposition 4 on the State
Fiscal Years 1978-79 Through 1981-82[a]
(in millions)

	1978-79 Amount (Actual)	1979-80 Amount (Estimate)	1979-80 Percent Change	1980-81 Amount (Projected)	1980-81 Percent Change	1981-82 Amount (Projected)	1981-82 Percent Change
Appropriations Limit	$8,310	$9,324	12.2%	$10,480	12.4%	$11,664	11.3%
Appropriations Subject to Limitation	8,310	9,446[b]	13.7	9,846	4.2	11,063	12.4
Additional Appropriations Allowed	--	$(-122)[c]		$ 634		$ 601	

a. The major assumptions underlying these projections are as follows:
   (1) Figures for 1978-79 and 1979-80 are approximations of the amounts actually appropriated.
   (2) Figures for 1980-81 and 1981-82 are based on 1979-80 appropriations, adjusted only for inflation and workload changes in existing programs.
   (3) Annual adjustments to the appropriations limit are based on actual cost-of-living changes, as calculated on a point-to-point basis.

b. Reflects appropriations made through December 31, 1979.

c. Since the limits are not binding until 1980-81, the Legislature may appropriate in 1979-80 any funds which are available.

Because Proposition 4 will not become effective until July 1, 1980, there is no binding appropriations limit for 1979-80, and the only constraint on appropriations for the year is provided by the amount of funds available.

For illustrative purposes, a hypothetical appropriations limit can be calculated for 1979-80 and compared to appropriations subject to limitation for that year. As Table 10 shows, appropriations subject to limitation during the current year exceed the hypothetical appropriations limit by $122 million. This is because appropriations subject to limitation in 1979-80 (estimated at $9,446 million) amount to 13.7 percent more than in the base year, while the "limit" has increased by only 12.2 percent. The 13.7 percent increase reflects large one-time appropriations in 1979 for employee compensation ($666 million), housing (AB 333--$100 million), and an increase in the renters' credit (at a 1979-80 cost of $216 million).

The projections of appropriations subject to limitation for current state services in fiscal years 1980-81 and 1981-82 fall far below the appropriation limits for those years. This is primarily due to two factors. First, the Department of Health Services believes that appropriations for Medi-Cal, the single largest component of the state base, will grow at rates that are considerably below historical levels. Second, it does not appear that the cost of maintaining existing service levels in other programs will grow as fast as the cost-of-living and population factors estimated for 1980-81 and 1981-82.

Given the size of the gap between the limit and projected appropriations for current state services ($634 million in 1980-81), it does not appear as if state appropriations will be constrained by Proposition 4's limits in the short run. However, the initiative may have a significant impact on the level of appropriations thereafter. The measure's impact over time will depend on (1) the strength of the economy (and the tax revenues it generates), (2) the rate of inflation, (3) how existing tax laws are changed, and (4) citizen preferences for new or expanded government services.

Another way of analyzing the impact of Proposition 4 on state appropriations is by comparing the appropriations limit with the revenues available to fund programs covered by the limit. To the extent state revenues are not adequate to fund the level of appropriations permitted by Proposition 4, revenue availability--rather than the limit--will constrain state appropriations.

The relationship between state revenues and the appropriations limits for 1980-81 and 1981-82 will be analyzed following the release of updated revenue estimates by the Department of Finance.

To the extent "appropriations subject to limitation" fall short of the appropriations limit, the limits for future years will not be affected. This is because each year's limit is based on the prior year's limit, not on actual appropriations. Thus, the measure does not encourage the state (or local entities) to increase appropriations above what they otherwise would be by reducing the limits in future years whenever there is a shortfall.

Excess Revenues

If, in any year after 1979-80, total state revenues exceed total appropriations, the excess revenues will be subject to the return clause of Section 2 (regardless of whether the state is spending at its limit). This section provides that excess revenues be returned to the public by a revision of tax rates or fee schedules within two years. In effect, the state could retain the excess revenues but would have to reduce its future revenues by an equivalent amount. The return clause also applies to local entities.

It may be impossible to determine in advance the extent to which a lower tax rate or fee schedule will actually reduce revenues because other factors (for example, inflation, population changes, unemployment) also affect tax revenues. A much easier way of returning excess funds would be to rebate or refund monies directly to taxpayers. Appropriations for refunds of taxes are not subject to limitation (see Section 8(a) and (b)).

If the state were able to anticipate having excess revenue and wished to avoid having to return funds under Section 2, it could take steps to prevent the excess from materializing. For instance, if the state anticipated an excess and were at its own appropriations limit, it could increase subventions to local entities since these appropriations are excluded from the state's limit. It is possible, however, that some local governments might not be able to spend the increased subventions because they would be at their own appropriations limits. This would make it difficult to distribute equitably additional state assistance.

Of course, if the state were under its limit, it could appropriate the excess funds in categories subject to limitation. In fact, the state could even provide additional aid to those local entities already at their appropriations limit by:

(1) mandating programs and providing for reimbursement, or

(2) providing the assistance through contracts with local entities.

Both methods would keep the appropriations in the state base even though they would be spent by local governments.

Finally, the state could broaden existing tax expenditures or enact new ones as a means of eliminating excess revenues, if it were able to anticipate being in an excess revenue situation. Tax expenditures benefit specific groups of taxpayers by reducing their tax liabilities, but not those of other taxpayers. One example of a tax expenditure program is the solar energy devices tax credit. Instead of making a cash payment to each person installing a solar device (which would be treated as an "expenditure"), the state allows individuals to reduce their income tax payments by a given amount, thereby reducing state revenues. State revenue losses associated with tax expenditures are not appropriations, and consequently, they do not come under the limits of Proposition 4. If, then, the state were at its appropriation limit but still had revenue that it wished to allocate for public purposes, it could do so through the use of tax expenditures.

It is possible that the enactment of any new tax expenditures after July 1, 1980, could be viewed as a circumvention of the initiative's intent, and thus could be subject to legal challenge. For instance, if the state were to stop appropriating the renters' credit for those with income tax liabilities, which in 1980-81 will account for about $200 million of the state's appropriations subject to limitation, and instead continued state assistance to renters using a tax expenditure, the state would create that same amount of "room" ($200 million) within its appropriation limit without reducing the level of services significantly.

We believe that tax expenditures generally are not the best means for achieving public objectives. Since tax expenditures need not be appropriated annually, the Legislature finds it more difficult to give them the same kind of oversight and control that it gives to expenditures provided for in the Budget Act. By appropriating funds directly for such purposes, as is done for the renters' relief program, the Legislature is in a much better position to allocate state resources among competing needs. Accordingly, we do not recommend that the Legislature use tax expenditures to prevent excess revenues from being subject to the return clause of Section 2.

LOCAL GOVERNMENT

As a result of Proposition 13 and Proposition 4, California local governments will be operating in a fiscal environment that is considerably different from what it was 18 months ago. Most significantly, Proposition 13 has reduced property tax revenues, formerly local governments' largest source of funds, by approximately 55 percent. While the state has provided substantial fiscal relief in 1978-79 and 1979-80 to replace a portion of these lost revenues, it is not clear how much longer state resources will be sufficient to maintain the current level of aid without requiring sharp cutbacks in state operations.

Because of this uncertainty, regular state subventions to local entities have been made subject to the "deflator" clause of AB 8 (Chapter 282, Statutes of 1979) in 1980-81 and thereafter. If state resources fall below specified levels, local subventions (such as school apportionments, and city and county gas and cigarette funds) will be automatically reduced unless the Legislature acts by resolution to cancel the reductions. The deflator could be activated either by a shortfall in revenues, such as might occur in the event of a recession, or if state spending (including local assistance) is higher than anticipated.

The uncertainty surrounding state aid is compounded by the uncertainty surrounding federal aid to local government. The loss of federal aid may be especially damaging to local entities because these funds are not subject to limitation by Proposition 4.

Given the constraints on the growth in state subventions to local governments (which finance a sizable amount of local "appropriations subject to limitation"), and given the large increases projected in the next few years for the annual adjustment factors (population and cost-of-living), the appropriations limits established by Proposition 4 may not significantly impact most local entities within the near future. That is, at least, the concensus of those local officials we canvassed.

There are still concerns regarding how the initiative will affect over time the various types of local governments: cities, counties, special districts and school districts. Some of the more significant concerns are discussed below.

Cities

The Proposition 4 issue that most concerns city officials involves the cities' ability to provide services for new residential, industrial and commercial development. Since the initiative freezes spending from the proceeds of taxes at the 1978-79 level, adjusted only for inflation and population, local entities may not be able to accommodate the additional public costs resulting from new development.

While local governments now have the ability to recover most of the capital costs of new development either through fees or exactions, no similar devices exist for recovering the ongoing costs of providing basic services (primarily police and fire protection) other than general revenues--which are usually proceeds of taxes. In the case of residential development, the adjustment to the appropriations limit for population increase might permit entities to cover these additional costs. No such adjustment, however, is authorized for meeting the additional ongoing costs of nonresidential development.

For an entity that is appropriating at its limit, there are a limited number of ways in which it can accommodate the costs of new development. First, a city could ensure that it incurs no additional costs which would have to be covered within its limit. It could, for example, charge fees (which are not covered by the initiative) for police and fire services. However, Legislative Counsel has opined that it would be unconstitutional for an entity to charge the owners of new structures a fee for the same services provided through general tax revenues to other property owners.[1] A city could also avoid new costs by having certain services provided by newly-created special districts. For instance, instead of a city appropriating funds to provide street lighting to a new development, a special district could be formed, with the costs of the service to be accommodated from within its newly established limit.

Second, a city could absorb the ongoing costs of new development by: (1) cutting other appropriations subject to limitation, or (2) voting to increase its limit temporarily. There would always be a danger, of course, that a temporary increase in the limit would not be renewed at the end of four years, thereby requiring cuts in other services. An election would also require more lead time before services could be provided to new projects.

The initiative may make certain types of development projects preferable to others, from a city's perspective. For instance, construction in

1. Legislative Counsel opinion #5581, page 6.

already developed areas--such as a downtown condominium project or a new plant in an existing industrial park--might not impose significant new costs on an entity, whereas construction in undeveloped fringe areas might result in both capital costs (for new infrastructure) and operating costs which could not be accommodated within a city's appropriations limit.

The issue discussed above is solely the result of Proposition 4, and is separate from the issue of whether or not new construction pays for itself. In many cases, the real constraint on the willingness of officials to approve new development projects will be the availability of resources to finance the services required by the new development, rather than the city's ability to spend within its limit. Local officials will generally be concerned about the impact of Proposition 4 on their ability to spend only if the availability of sufficient revenue to finance new services is assured.

Other issues which are of particular concern to cities include:

(1) Declining Population. The Department of Finance has estimated that 85 California cities, including such large municipalities as San Francisco and Oakland, experienced declines in population during 1978. If these cities' appropriations limits are adjusted to fully reflect the population declines, they may not be able to maintain their existing level of services. To the extent a decline in population permits a corresponding decline in service requirements, this will not be a problem. There is no guarantee, however, that the decrease in costs will correspond to the loss of population. For instance, when the population of a city declines, the entity generally must spend the same amount to maintain its capital facilities (such as roads and parks), even though the number of people using them has declined.

(2) State Mandates. To the extent that Section 6 of the initiative prevents the state from imposing unreimbursed costs on cities and other local entities, local governments will be better off than they are now. However, two key issues raised by the mandate provision need to be resolved. First, will local entities be reimbursed for mandates imposed between January 1, 1975 and July 1, 1980, as they would like, or will the requirement apply only to new mandates, as the Legislative Counsel's opinion holds? Secondly, what changes will be made in the present Board of Control reimbursement process to address the problem of unfunded state mandates? (Both of these issues are discussed in Chapter II.)

(3) Section 3(b) Transfers. Since cities impose a large number of fees, many of which do not cover the full costs of the related service, how Section 3(b) is interpreted will have a significant impact on them. In our analysis of this issue in Chapter II, we assumed that: (1) each fee would be considered separately and that (2) changes in the percentage of total revenue derived from each source would indicate that a transfer of financial responsibility from "other revenues" to "user fees" had occurred. Representatives of cities and counties, however, would prefer that: (1) they be able to group fees by program areas, and (2) only absolute dollar changes (and not percentage changes) be considered for purposes of determining shifts in financial responsibility.

Counties

Those issues of concern to city officials are also of concern to county officials. There are two additional matters in which counties have a special interest.

Most significantly, the counties are concerned about the treatment of state payments for such programs as AFDC, boarding homes and institutions, mental health and social services. Again, using Legislative Counsel's interpretations of state subventions, all state aid for these types of programs--except for contract programs--would be included in the local bases. Thus, if costs for these programs grow at rates which are higher than the annual adjustments to the appropriations limits, the counties will be forced to curtail other types of appropriations.

Since these programs were established by the state to meet state goals, a case can be made that their cost should be financed within the state's, rather than the local's, base. As noted earlier, this would place substantially more funds in the state base. This matter will have to be addressed in defining "state subventions" for purposes of the initiative.

Counties also want the Legislature to determine how those special districts which are governed by a board of supervisors are to be treated under Proposition 4. As of 1977-78, almost 2,000 of the state's 4,800 special districts were board-governed. According to Legislative Counsel, such agencies as county service areas (CSA's) and maintenance districts (MD's), which comprise over 60 percent of board-governed districts, would not be considered as special districts for purposes of the initiative.

Alternatively, all board-governed districts could be treated as separate entities of governments. If the Controller's (rather than the Counsel's) definition of special districts is accepted, CSA's and MD's would have their own appropriations limits, totally distinct from those of their respective counties.

Special Districts

As noted above, the basic issue involving most special districts is whether individual districts will be considered as separate entities or as parts of a city or county. For some special districts, however, there may be an even more basic question: Are they subject to the initiative's appropriation limitation at all?

Some officials have argued that redevelopment agencies should not come under the provisions of Proposition 4. Because the level of activity undertaken by these agencies fluctuates widely, they do not lend themselves to the type of controls established by the measure. In fact, because they tend to have large debt service obligations and are heavily dependent on property tax increments, many redevelopment agencies may have had no appropriations subject to limitation in the base year. This would preclude them from financing projects on a pay-as-you-go basis. It would not, however, affect programs supported by bonds authorized prior to January 1, 1979, as appropriations for these programs would not be subject to the limitations.

As we have noted, redevelopment agencies existing as of January 1, 1978, might not be subject to the appropriations limitation as a result of the 12½ cents property tax exemption provided in Section 9(c). It is not clear whether the Legislature could also exempt redevelopment agencies created after January 1, 1978, since the language of the initiative provides no specific basis for doing so.

If redevelopment agencies are considered entities of government, they still may be able to finance projects through the continued use of tax allocation bonds. For them to do so, however, the Legislature would have to adopt Legislative Counsel's interpretation of Section 7, which would allow a redevelopment agency to exceed its limit (even if it were zero) in order to retire nonvoter-approved debt issued after January 1, 1979 (see Chapter II, under Indebtedness).

School Districts

School districts, like counties, will be significantly affected by the definition of state subventions, especially with regard to categorical programs. As noted above, Legislative Counsel's definition of subventions includes all state categorical aid, thus making it subject to control at the local level.

As with the county welfare programs, though, a case can be made for including appropriations for categorical programs in the state base. First, the state created these programs, established regulations governing the use of state monies, and provides program funding. Consequently, it can be argued that school districts exercise limited control over the categorical programs, and therefore should not have the appropriations in their base. (If however, the AB 8 provisions relating to the "sunset" of categorical program regulations are allowed to stand, this argument would not be as persuasive, as districts would have total control over the implementation of the programs.)

More importantly, including appropriations for these programs in the school districts' base would raise equity issues. Since the categorical programs have not been uniformly implemented statewide, controlling these funds at the local level would tend to perpetuate the current distribution of categorical assistance, and would limit the state's ability to expand participation in these programs. Those districts which received aid in 1978-79 would have it reflected in their appropriations limits, whereas districts which had not yet entered the program would not. Thus, efforts by the state to bring new districts into the program would come up against the requirement that these districts either cut other programs to stay within their limits or vote to increase their limits.

Another concern of school districts involves the treatment of changes in district population. Section 8(f) of the initiative provides that population shall be a district's average daily attendance (ADA), "as determined by a method prescribed by the Legislature." A definition of ADA is presently provided in statute, although Legislative Counsel has concluded that the state is not precluded from modifying it for purposes of Proposition 4.[1] For example, a <u>weighted</u> ADA system could be used in order to account for any differences in the costs of providing education services to various categories of students.

Table 11 illustrates how the concept of weighted ADA might be employed. A hypothetical unified school district has an ADA of 1,000 and an appropriations limit of $1,350,000 in year one, with per ADA spending averaging $1,200 for elementary students and $1,500 for high school students. In year two a new area is added to the district, increasing regular ADA by 200, or 20 percent, with <u>all</u> of the increase occurring in high school enrollment. If the district is to maintain per ADA spending at the same levels as in year one, it must spend a total of $1,650,000, as shown in Table 11. However, a 20 percent ADA adjustment would only permit total

1. Legislative Counsel opinion #6264, page 2.

spending in year two of $1,620,000, leaving the district $30,000 short of what it needs to maintain services at existing levels.

If, however, ADA is defined in such a way as to reflect the fact that high school students cost more to educate than elementary students, the existing level of service could be maintained.

Table 11

A Unified School District Experiencing a 20 Percent Increase in ADA[a]

	Year One			Year Two		
	ADA	Appropriations Per ADA	Total Appropriations	ADA	Appropriations Per ADA	Total Appropriations
Total	1,000	$1,350[b]	$1,350,000	1,200	$1,375[b]	$1,650,000
Elementary	500	1,200	600,000	500	1,200	600,000
High School	500	1,500	750,000	700	1,500	1,050,000

a. Assumes no inflation adjustment in Year Two.
b. Weighted Average.

The language of Proposition 4 appears to permit the use of weighted ADA. However, there would be significant fiscal and administrative problems involved in moving from the current definition to a weighted ADA concept. For instance, there would have to be determinations (probably at the state level in order to ensure uniformity) of both the categories to be weighted and the amounts of each weight.

School districts are also concerned with how compliance with Serrano v. Priest would be affected by Proposition 4. Some persons believe that expenditures for Serrano equalization purposes might be excluded from appropriations limits under the court mandate provision of the initiative.

It is by no means clear, however, that any increases in spending could be attributed to a court mandate. The Serrano decision requires only that wealth-related expenditure differences be less than $100 per ADA by August, 1980; it does not mandate increased expenditures. If the state chooses to increase spending in the future as a means of achieving equalization, it is quite possible that the increases would have to be financed within either the state or local limits.

It appears as if the initiative will diminish the equalizing impact of current school funding law, as provided in AB 8. AB 8 allows low expenditure districts greater-than-average increases in their annual revenue limits in order to close the expenditure gap between high and low spending districts. To the extent that appropriations limits preclude low expenditure districts from taking advantage of the full increase in their revenue limits, the equalizing effect of current law will be weakened.

Proposition 4 does not prevent the Legislature from achieving Serrano equalization. For instance, the state could prevent high expenditure districts from spending up to their limits in order to reduce wealth-related expenditure differences. Eventually, low expenditure districts would catch up with their counterparts, although the time period needed to equalize spending would be longer. Alternatively, the state could provide for increased ADA weighting for low expenditure districts in order to allow higher levels of spending. Or, the state could place most, if not all, school expenditures in its own base and continue to fund the school finance allocation process contained in AB 8.

Finally, there is an issue regarding how community colleges and county offices of education are to be classified under Proposition 4. With regard to community colleges, it is not clear that they should be considered <u>school</u> districts for purposes of calculating population change figures. Although the initiative allows <u>schools</u> to use changes in ADA, rather than population, in adjusting their appropriation limits, the 1976-77 reorganization of the Education Code separated community college districts from <u>school</u> districts. Because community colleges are still funded on an ADA basis, <u>we recommend</u> that they be treated as school districts under Proposition 4.

The treatment of county offices of education (COE's) pose more difficult problems. Some COE's are independent of county government while others have their superintendents appointed and their budgets approved by the board of supervisors. Thus, the former could be considered as separate entities of government, while appropriations of the latter could be incorporated into the county bases. Since all COE's are funded primarily on the basis of ADA, <u>we recommend</u> that for the purposes of Proposition 4 they be considered as separate entities, and with regard to population changes, as school districts.

APPENDIX 1

TEXT OF PROPOSITION 4

Section 1. The total annual appropriations subject to limitation of the state and of each local government shall not exceed the appropriations limit of such entity of government for the prior year adjusted for changes in the cost of living and population except as otherwise provided in this Article.

Section 2. Revenues received by any entity of government in excess of that amount which is appropriated by such entity in compliance with this Article during the fiscal year shall be returned by a revision of tax rates or fee schedules within the next two subsequent fiscal years.

Section 3. The appropriations limit for any fiscal year pursuant to Section 1 shall be adjusted as follows:

(a) In the event that the financial responsibility of providing services is transferred, in whole or in part, whether by annexation, incorporation or otherwise, from one entity of government to another, then for the year in which such transfer becomes effective the appropriations limit of the transferee entity shall be increased by such reasonable amount as the said entities shall mutually agree and the appropriations limit of the transferor entity shall be decreased by the same amount.

(b) In the event that the financial responsibility of providing services is transferred, in whole or in part, from an entity of government to a private entity, or the financial source for the provision of services is transferred, in whole or in part, from other revenues of an entity of government, to regulatory licenses, user charges or user fees, then for the year of such transfer the appropriations limit of such entity of government shall be decreased accordingly.

(c) In the event of an emergency, the appropriation limit may be exceeded provided that the appropriation limits in the following three years are reduced accordingly to prevent an aggregate increase in appropriations resulting from the emergency.

Section 4. The appropriations limit imposed on any new or existing entity of government by this Article may be established or changed by the electors of such entity, subject to and in conformity with constitutional and statutory voting requirements. The duration of any such change shall be as determined by said electors, but shall in no event exceed four years from the most recent vote of said electors creating or continuing such change.

Section 5. Each entity of government may establish such contingency, emergency, unemployment, reserve, retirement, sinking fund, trust, or similar funds as it shall deem reasonable and proper. Contributions to any such fund, to the extent that such contributions are derived from the proceeds of taxes, shall for purposes of this Article constitute appropriations subject to limitation in the year of contribution. Neither withdrawals from any such fund, nor expenditures of (or authorizations to expend) such withdrawals, nor transfers between or among such funds, shall for purposes of this Article constitute appropriations subject to limitation.

Section 6. Whenever the Legislature or any state agency mandates a new program or higher level of service on any local government, the state shall provide a subvention of funds to reimburse such local government for the costs of such program or increased level of service, except that the Legislature may, but need not, provide such subvention of funds for the following mandates:

(a) Legislative mandates requested by the local agency affected;

(b) Legislation defining a new crime or changing an existing definition of a crime; or

(c) Legislative mandates enacted prior to January 1, 1975, or executive orders or regulations initially implementing legislation enacted prior to January 1, 1975.

Section 7. Nothing in this Article shall be construed to impair the ability of the state or of any local government to meet its obligations with respect to existing or future bonded indebtedness.

Section 8. As used in this Article and except as otherwise expressly provided herein:

(a) "Appropriations subject to limitation" of the state shall mean any authorization to expend during a fiscal year the proceeds of taxes levied by or for the state, exclusive of state subventions for the use and operation of local government (other than subventions made pursuant to Section 6 of this Article) and further exclusive of refunds of taxes, benefit payments from retirement, unemployment insurance and disability insurance funds;

(b) "Appropriations subject to limitation" of an entity of local government shall mean any authorization to expend during a fiscal year the proceeds of taxes levied by or for that entity and the proceeds of state subventions to that entity (other than subventions made pursuant to Section 6 of this Article) exclusive of refunds of taxes;

(c) "Proceeds of taxes" shall include, but not be restricted to, all tax revenues and the proceeds to an entity of government, from (i) regulatory licenses, user charges, and user fees to the extent that such proceeds exceed the costs reasonably borne by such entity in providing the regulation, product, or service, and (ii) the investment of tax revenues. With respect to any local government, "proceeds of taxes" shall include subventions received from the state, other than pursuant to Section 6 of this Article, and, with respect to the state, proceeds of taxes shall exclude such suventions;

(d) "Local government" shall mean any city, county, city and county, school district, special district, authority, or other political subdivision of or within the state;

(e) "Cost of living" shall mean the Consumer Price Index for the United States as reported by the United States Department of Labor, or successor agency of the United States Government; provided, however, that for purposes of Section 1, the change in cost of living from the preceding year shall in no event exceed the change in California per capita personal income from said preceding year;

(f) "Population" of any entity of government, other than a school district, shall be determined by a method prescribed by the

Legislature, provided that such determination shall be revised, as necessary, to reflect the periodic census conducted by the United States Department of Commerce, or successor agency of the United States Government. The population of any school district shall be such school district's average daily attendance as determined by a method prescribed by the Legislature;

(g) "Debt service" shall mean appropriations required to pay the cost of interest and redemption charges, including the funding of any reserve or sinking fund required in connection therewith, on indebtedness existing or legally authorized as of January 1, 1979 or on bonded indebtedness thereafter approved according to law by a vote of the electors of the issuing entity voting in an election for such purpose.

(h) The "appropriations limit" of each entity of government for each fiscal year shall be that amount which total annual appropriations subject to limitation may not exceed under Section 1 and Section 3; provided, however, that the "appropriations limit" of each entity of government for fiscal year 1978-79 shall be the total of the appropriations subject to limitation of such entity for that fiscal year. For fiscal year 1978-79, state subventions to local governments, exclusive of federal grants, shall be deemed to have been derived from the proceeds of state taxes.

(i) Except as otherwise provided in Section 5, "appropriations subject to limitation" shall not include local agency loan funds or indebtedness funds, investment (or authorizations to invest) funds of the state, or of an entity of local government in accounts at banks or savings and loan associations or in liquid securities.

Section 9. "Appropriations subject to limitation" for each entity of government shall not include:

(a) Debt service.

(b) Appropriations required for purposes of complying with mandates of the courts or the federal government which, without discretion, require an expenditure for additional services or which unavoidably make the providing of existing services more costly.

(c) Appropriations of any special district which existed on January 1, 1978, and which did not as of the 1977-78 fiscal year levy an ad valorem tax on property in excess of 12½ cents per $100 of assessed value; or the appropriations of any special district then existing or thereafter created by a vote of the people, which is totally funded by other than the proceeds of taxes.

Section 10. This Article shall be effective commencing with the first day of the fiscal year following its adoption.

Section 11. If any appropriation category shall be added to or removed from appropriations subject to limitation, pursuant to final judgment of any court of competent jurisdiction and any appeal therefrom, the appropriations limit shall be adjusted accordingly. If any section, part, clause or phrase in this Article is for any reason held invalid or unconstitutional, the remaining portions of this Article shall not be affected but shall remain in full force and effect.

APPENDIX 2

Special Districts by Governing Body and Type
Fiscal Year 1977-78

Type of District	Board of Supervisors	City Council	Other	Total
Air Pollution Control	37	--	5	42
Airport	--	--	4	4
Bridge and Highway	--	--	2	2
Cemetery	--	--	263	263
Community Services	7	2	203	212
Drainage	4	--	22	26
Fire Protection	67	2	381	450
Flood Control and Water Conservation	29	--	6	35
Flood Control Maintenance	--	--	11	11
Waste Disposal	9	--	2	11
Harbor and Port	1	--	13	14
Health	--	--	1	1
Joint Highway	--	--	2	2
Hospital	--	--	76	76
Municipal Improvement	--	1	5	6
Levee	--	--	15	15
Library	--	--	13	13
Highway Lighting	315	2	1	318
Maintenance	443	25	1	469
Memorial	--	--	26	26
Mosquito Abatement	--	--	53	53
Parking	3	16	1	20
Pest Control	--	--	8	8
Citrus Pest Control	--	--	7	7
Police Protection	--	--	3	3
Reclamation	--	--	151	151
Recreation and Park	25	2	91	118
Road Maintenance	11	--	--	11
Permanent Road Divisions	51	--	--	51
Sanitary	--	2	91	93
County Sanitation	59	5	46	110
Sanitation and Flood Control	--	--	3	3
Separation of Grade	--	--	1	1
County Service Areas	700	--	1	701
Sewer and Sewer Maintenance	22	9	1	32
Resource Conservation	--	--	135	135
Storm Water Drainage and Conservation	46	--	5	51
Transit	1	--	13	14
Municipal Utility	--	--	4	4
Public Utility	--	--	55	55

APPENDIX 2 (Continued)

Type of District	Board of Supervisors	City Council	Other	Total
California Water	--	--	161	161
County Water	2	1	189	192
Metropolitan Water	--	--	1	1
Municipal Water	--	--	47	47
Water Agency or Authority	11	--	18	29
Water Conservation	--	--	15	15
Water Replenishment	--	--	1	1
Water Storage	--	--	8	8
County Waterworks	50	2	32	84
Joint Exercise of Power	--	--	267	267
Community Redevelopment & Housing	1	93	33	127
Irrigation	1	--	98	99
Toll Tunnel Authority	2	--	--	2
Nonprofit Corporations	--	1	147	148
Transportation Planning	3	--	22	25
TOTAL	1,900	163	2,760	4,823

APPENDIX 3

State 1978-79 Appropriations Subject to Limitation, by Program

Program	1978-79 Appropriations Amount (in millions)	Percent of Total
Medical Assistance Program (Medi-Cal)	$2,111	25.4%
SB 620 Reserve[a]	813	9.8
University of California	769	9.3
California State University and Colleges	695	8.4
SSI/SSP[b]	658	7.9
Capital Outlay	547	6.6
Department of Mental Health	402	4.8
Department of Development Services	367	4.4
Department of Transportation	300	3.6
Department of Corrections	257	3.1
Department of California Highway Patrol	227	2.7
Department of Motor Vehicles	149	1.8
State Teachers' Retirement System (STRS)	144	1.7
Renters' Relief	135	1.6
Youth Authority	110	1.3
Senior Citizens' Property and Renters' Tax Relief	94	1.1
Department of Forestry	89	1.1
Department of Justice	75	0.9
Student Aid Commission	74	0.9
Franchise Tax Board	65	0.8
Department of Parks and Recreation	58	0.7
Department of Industrial Relations	55	0.7
Board of Equalization	55	0.7
Other	236[c]	2.8
Public Employees' Retirement System (PERS)	-175[d]	-2.1
Total, Appropriations Subject to Limitation	$8,310	100.0%

a. SB 620 (Chapter 161, Statutes of 1979) appropriated approximately $728 million into a reserve account in the state highway account. In addition, the measure appropriated $85 million for specific purposes. Both authorizations constitute appropriations subject to limitation in the base year.

b. Reflects the use of federal revenue sharing funds to finance a portion of total SSI/SSP costs.

c. Some of the appropriations listed above were financed by non-tax revenues, which could not at this time be attributed to specific programs. However, an adjustment has been made in the "Other" category to account for these appropriations.

d. Included in the appropriations for the departments listed above are payments for debt service of the public retirement systems, which are not subject to limitation. If these appropriations were prorated and excluded from the department's totals, the "Other" category would be increased by $175 million.