

GRASS ROOTS GOVERNMENT IN CALIFORNIA:  
WHERE SHOULD THE RESEEDING BEGIN?

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I. Introduction

A. What I'm Not Here to Talk About

1. Our recommendation to charge UC graduate students higher fees
2. Our recommendations from prior years that faculty salaries not be raised as much as the Regents proposed
3. That out of the way, let me summarize what it is that I do want to talk about.

B. Purpose of My Remarks

1. Focus of my remarks is on what has got to be one of the most difficult balancing acts since the Great Wallenda tried to make it between those two buildings in Puerto Rico: balancing the interests of the community against those of the state as a whole.
2. To do this effectively, I will have to address:
  - a. The current system of public finance in California
  - b. The way in which control over decisions at the local level is exercised

C. Thrust of My Remarks

1. Let me start by telling you where I end up
2. The public's perception of local government simply doesn't square with reality
3. For the most part, local governments have very little leeway in responding to the demands placed upon them by their citizens--even though the conventional wisdom holds local governments to be the most responsive level of government

4. This is because:
  - a. Local governments have been stripped of much of their ability to influence the amount of revenues available to satisfy public needs and demands
  - b. They have experienced a significant reduction in those revenues that can be spent most flexibly; and
  - c. The expenditure side of their budget is subject to demands over which they have no control
5. This is not a problem we ought to take lightly, or discuss simply in terms of gross revenues, expenditures, and percentage increases
6. The inconsistency between what the public expects of local governments and what local government is in a position to deliver is going to leave us with:
  - a. A frustrated and cynical public, and
  - b. A group of frustrated and demoralized local government managers
7. Under these circumstances, moreover, there is no way the textbook notion of government responsiveness and accountability can be achieved

D. Starting Point

1. I think it is appropriate to begin this discussion with a brief summary of how we got to where we are
2. Thus, let me give you a thumb-nail sketch of how local government finance developed in California

## II. Development of Local Government Finance in California

### A. Development prior to World War II

1. The state's first constitution (1849) was silent as to the rights and duties of cities, implying that cities enjoyed broad freedom of government
2. The constitution, however, declared that counties should be, in part, administrative agencies of the state
3. Through the years:
  - a. Counties were made responsible for most of the basic functions of government in California--public protection, public assistance, and road construction, etc.
  - b. The state's role was limited to the few matters of statewide import, such as higher education and unemployment insurance
4. By the late nineteenth century, both counties and cities had been accorded broad powers of self government
  - a. Cities were permitted to have their own charters, which enabled them to levy taxes and to legislate on all municipal matters, except in those instances where the Legislature had a compelling need for statewide uniformity
  - b. Counties were also permitted to have a kind of charter, although this was limited primarily to housekeeping matters
  - c. Today, while even general-law cities enjoy most of the same broad powers as charter cities, counties, whether chartered or not, remain under the direct authority of the Legislature

5. What puts the "self" in "self-government," of course is the ability to levy taxes so that the revenues required to respond to constituent needs and demands can be obtained
    - a. For most of California's history, this was not a problem
    - b. In fact, as late as 1936, local governments actually collected more tax revenues than the state did
  6. Both cities and counties came to rely heavily on the property tax to finance public services
    - a. It provided a flexible source of revenue to meet local needs brought about by growth
    - b. It also lent itself nicely to the local budget process
      - (1) The governments would determine how much they want to spend
      - (2) They would project their revenues from other tax sources, such as business license fees or their portion of the sales tax
      - (3) Finally, the governments would levy whatever amount of property tax was needed to make up the gap between other revenues and expenditures
      - (4) Thus, the property tax was a residual tax
- B. Developments Between World War II and Proposition 13
1. During the postwar era, two factors eroded the fiscal relationship that had developed between the state and its local governments prior to World War II
    - a. First, local expenditure demands began to rise sharply, partly because of the enormous population growth caused by immigration

- b. Second, local sources of revenue other than the property tax, were not as sensitive to economic growth as the sales and income taxes on which the state depended
  - 2. As a consequence, the state began to fund the costs of some of the more rapidly growing local responsibilities, such as pensions, aid to the aged, school apportionments, and school buildings
    - a. The state, with its greater access to funding, took on the responsibility for financing the higher levels of service that were desired by the public but that could not be financed by local governments
    - b. For the most part, however, the programs providing these services were left to local governments to operate
  - 3. Even with the growing state role in local government finance, local governments still enjoyed a considerable amount of fiscal autonomy due to the property-tax residual
- C. The Impact of Proposition 13
  - 1. In one fell swoop, Proposition 13 changed all this:
    - a. By capping the property tax rate and the growth in AV, Proposition 13 eliminated virtually all of the counties' fiscal autonomy, and much of the cities'
    - b. It also made it more difficult for local government to exercise what little remained of its fiscal discretion, by requiring all tax increases to obtain approval from two-thirds of the voters

2. Without the power to set property tax rates, local governments became heavily dependent upon the state to finance locally-conceived programs
3. The state responded with the so-called local government bail-out that's putting about \$2.7 billion in state money into cities, counties, and special districts this year (another \$3.0-\$3.6 billion goes to local school districts)

D. Action by the Courts

1. If I were giving this talk a year ago, I would end this brief discussion of how we got to where we are, right here
2. In the past year, however, the courts have taken matters into their own hands, as they do so frequently in California
3. In three decisions, the courts have enhanced the revenue-raising abilities of cities, some special districts, and some counties
  - a. First, the courts have ruled that Proposition 13 does not apply to some special districts--those not empowered to levy a property tax
    - (1) This has opened the way for the L.A. Transit Commission to levy a  $\frac{1}{2}$  percent sales tax to support regional transit
    - (2) It does nothing, however, for cities, counties, and those special districts with property-taxing authority
  - b. Second, the courts have ruled that under certain circumstances a local government can increase the property tax above the 1 percent constitutional ceiling to raise funds needed to payoff voter-approved pension obligations

- (1) This decision could--we can't be sure at this point--enable those California cities and counties with voter-approved pension obligations to raise approximately \$850 million in additional revenue, an amount equal to about 2 percent of local expenditures
- (2) The mayor of Los Angeles is attempting to use this new avenue for raising revenues in order to balance the city's budget
- (3) Here, again, the impact is selective. Those cities and counties with pension plans that were not voter-approved may not be able to derive any fiscal consolation from this decision

c. Third, the courts have ruled that, despite what Proposition 13 says about increases in special taxes requiring the approval of two-thirds of the electorate, it ain't necessarily so

- (1) Specifically, the court ruled that a "special tax," the proceeds of which are not used for a "special" purpose, is not "special"
- (2) This, theoretically, takes one of the heaviest shackles off local government
- (3) In practice, however, the decision only benefits cities, because other local governments do not have the statutory authority to levy new taxes

4. The second of these three decisions--the one enabling local governments to raise the property tax rate in order to pay off voter-approved pension obligations--is not all that surprising



5. The other two decisions, on the other hand, were complete surprises--at least to those of us familiar with law and involved in the analysis of Proposition 13 for the California voters' pamphlet
6. As an aside, I should mention that these decisions are typical of many that are coming out of the state courts these days. To me, they reflect a confusion between what is and what, in the judge's mind, ought to be.

### III. Analysis of the Current System of Public Finance

#### A. Introduction

1. Looking at the current system of public finance in California, two characteristics stand out
  - a. Counties (and many special districts) are, for all intent and purposes, fiscally impotent
    - (1) They have relatively little ability to affect the revenue side of their budgets since:
      - (a) The mainstay of their budget--the property tax--is not subject to their control, and
      - (b) They lack the statutory authority to impose new taxes such as utility users' tax or an occupation tax
      - (c) They are heavily dependent on state largess for money
    - (2) In addition, the expenditure side of their budget is, to a great extent, beyond their control, due to the mandates imposed by state law

- (3) Cities are alot better off, particularly given the court's decision on special taxes, but they also face problems in putting together a budget
  - (a) The two primary sources of revenue--the property and sales taxes--are fixed at the state level
  - (b) They are required by state law to make expenditures for which they are not always reimbursed
- b. The other primary characteristic of the current system is that the state is holding all of the fiscal cards, and frequently must play them without having very good information on what the bid is, what cards have already been played, or even who else is sitting at the table.
2. Let me give my evaluation of the current system, using the following five criteria:
  - a. Stability
  - b. Responsiveness
  - c. Efficiency
  - d. Equity
  - e. Accountability

B. Stability

1. By stability, I mean
  - a. The extent to which local officials can draw up fiscal plans with some degree of certainty regarding revenues
  - b. Since our interest is in the state's public finance system, rather than in the state's economy, we need to factor out the instability of the economy in applying this criteria

2. With respect to stability, the current system rates no better than a C
  - a. The reasons for this relatively low grade are two-fold:
    - (1) Both cities and counties depend on state aid to bridge the gap between revenues and expenditures, and the amount of state aid has not proven to be predictable in each of the last two years
    - (2) Secondly, decisions on state aid are not made until the last minute, making it difficult for local officials to do their fiscal planning.
    - (3) Example:
      - (a) Under existing law, cities and counties were led to believe that they could expect \$2.77 billion in fiscal relief during the current year
      - (b) In January 1982, they were told that it would be only \$2.27 billion
      - (c) In June, they were given another \$70 million
      - (d) In February, they lost another \$29 million
  - b. I grant you that, as a percentage of total expenditures, state aid to cities and counties is relatively small
  - c. If you know anything about budgeting, however, you know that in the short-run the budget is controllable only at the margin
  - d. And state aid is a significant source of revenue at the margin

- e. Consequently, it's hard to do fiscal planning when a key source of revenues is as unstable as fiscal relief has been

C. Responsiveness

1. By responsiveness, I mean the ability of local officials to respond to the desires for public services expressed by local citizens
2. On this score, the existing system rates a failing grade
  - (a) Lacking the ability to raise revenues, counties simply are unable to add items to the local public services menu, even when a majority of the community's residents so desire
  - (b) As a result, you have the following anomaly: the residents of Kern County, <sup>who</sup> ~~which~~ voted against Proposition 13, are unable to tax themselves more heavily to provide more public services, even if they want to, because the residents of 55 other counties do not want to pay higher property taxes
  - (c) Furthermore, cities and counties now lack the ability to issue general obligation bonds in order to finance needed capital improvements that are not revenue-producing
3. There is a safety valve to this pressure cooker--the state
4. While the Legislature can respond to desires brought to it by groups wishing more public services, it cannot be responsive to the desires of the community as a whole because it is not as close to the people as city councils and boards of supervisors

- The problems I've just described are*
5. ~~This is~~ less true in the case of cities because of their greater statutory powers to raise revenues. Still, the two primary sources of revenues--the property tax and the sales tax are cut off to them

D. Efficiency

1. By efficiency, I mean the extent to which the current system provides incentives to minimize the expenditure of public resources in accomplishing public purposes
2. With respect to this criterion, the current system rates a low C
3. The reasons for this low grade have to do with where decisions on expenditures are made, and how we move money from one level of government to another
4. The first of these reasons has to do with the safety valve mentioned earlier
  - a. Because local governments cannot respond to local desires, the state is constantly being asked to address these desires
  - b. In the process, it often is asked to make judgments that it is not really able to make effectively
  - c. This is because:
    - (1) State officials often lack the information needed to allocate funds among cities and counties in a rationale manner, and
    - (2) Regulation writers in Sacramento are so remote from <sup>persons</sup> those <sub>A</sub> in, say, Los Angeles charged with administering

state programs that they aren't really equipped to do their job effectively

5. The system for moving money around the state also contributes to the inefficiency of the current system of public finance in California

a. On the one hand, the incentives in the existing system are all wrong

(1) Why should a county executive try to initiate savings in those health and welfare programs that he administers but that the state funds

(a) Any savings that result from his efforts would not accrue to the benefit of his county

(b) The headaches, however, are felt only at the local level

(2) Similarly, why should state administrators seek to increase efficiency or productivity in locally-administered programs, when they get little or no credit for doing so?

b. On the other hand, because we recognize that the incentives for efficiency are not there, we waste a heck of a lot of money on program administration that comes at the expense of services to the public, and that would not be needed under a better system of financing local government

(1) The state has a bureaucracy to write rules

(2) The counties have one to interpret the rules

- (3) The state has still another to evaluate and monitor interpretations
- (4) The counties have a battery of lawyers to defend their interpretation of the rules against unhappy people seeking state funded benefits

E. Equity

1. By equity, I mean the basic fairness with which the services and the responsibility to pay for them are distributed to the citizens of California
2. This one is too subject<sup>ive</sup> for me to suggest a grade
3. In addition, the existing system of public finance has both good and bad points
4. On the one hand, by further centralizing fiscal decision-making at the state level, Proposition 13 paved the way for citizens throughout the state to have more-equal access to public services
  - a. I think this was an important consequence of the county health services block grant that was established in the wake of Proposition 13
  - b. Having the state take over a greater share of the rapidly growing health and welfare programs may also produce more-equal access
5. On the other hand, it is often hard for the state to fine-tune<sup>time</sup> the provision of state aid to reflect relative need
  - a. For example:

(1) A lot of words have been used to describe the current allocation of fiscal relief among counties and cities

(2) I don't ever recall hearing the word "equitable" so used

b. Furthermore, in some respects we have created a system that rewards grasshoppers and penalizes ants. For example:

(1) The construction and maintenance of local jails historically has been viewed as a local responsibility

(2) Because these facilities don't lend themselves to revenue bond financing, cities and counties have no way to upgrade or expand what they now have

(3) By default, the state has had to take on this responsibility

(4) This means, however, that:

(a) Those cities and counties who have done the poorest job in maintaining their incarceration facilities get the most money from the state, and

(b) Citizens of those counties which did a good job end up paying twice--once for their own facilities and once for their neighbors (through their state taxes)

6. On balance, I am hardpressed to give the existing system high marks for equity

#### F. Accountability

1. By accountability, I mean the extent to which the voters can make public officials answerable for the performance of government



2. On this score, the existing system flunks miserably
3. As I noted earlier, local governments have very little influence over how much money is made available to satisfy citizen needs and demands
4. When you get right down to it, they--or at least counties--don't have all that much of a say in where the money in their budget goes
  - a. Take Sacramento County as an example
  - b. The last time we looked at the county's budget (about 18 months ago), expenditures were about \$400 million
  - c. Out of that amount, only \$60 million (15 percent) goes for programs that are truly optional at the local level
  - d. The rest goes for programs that in one way or another are mandated by the state
5. Under these circumstances:
  - a. How can we hold local officials accountable for the provision of services at the local level?
  - b. Who do we hold accountable?
6. Furthermore, this sorry state of affairs has brought the state's court system rushing in to fill the void, and the courts are about as unaccountable to the public as you can get and still be part of the public sector.
7. As I said at the outset, this lack of accountability is producing:
  - a. A cynical and frustrated group of citizens, and
  - b. A disheartened group of public managers

#### IV. Means for Addressing the Problem

##### A. Introduction

1. What can we do to get the current system's grades up?
2. As I see it, there are two fundamental steps we need to take

##### B. Restoring Fiscal Accountability

1. First and foremost, we need to restore some fiscal accountability to cities and counties
2. There are many ways of putting more money in the hands of these entities

- a. <sup>First, we could</sup> Dedicate a <sup>larger</sup> portion of the state's revenue is one option
  - (1) This is being pushed by the cities and counties
  - (2) In terms of the criteria I used earlier, this approach would increase stability, but would not do much to improve responsiveness, efficiency or accountability
- b. In my view, the best way to improve the existing system of public finance in California is not to focus on the amount of dollars going to cities and counties, but instead on how this money is raised
  - (1) We can do this by making the hand that collects our dollars the same one that spends them
  - (2) Or put another way by better linking the ecstasy of expenditure with the agony of taxation
- c. We should do this in two ways
  - (1) First, we should give local governments access to a major revenue source to supplement their operating budgets

- (a) The option I prefer is to allow counties and cities to "piggy-back" on the state income tax, as local government does in Maryland
  - (b) This, however, would <sup>have to</sup> be a discretionary tax. For accountability to be restored, the decision to supplement revenues must be made at the local level. For the state to simply turn over part of its money to local governments would not do the job.
- (2) Second, we must give local governments access to the general obligation bond market
- (a) This can be done by allowing the voters in a community to authorize a temporary increase in the property tax to pay off voter-approved bonds issued to finance capital projects
  - (b) An amendment to the state's constitution would be needed for this to happen
- (3) These two steps, would, in my view, improve the current system in terms of stability, responsiveness, efficiency, and accountability
- (4) I leave it to you to decide whether it would improve the equity with which funds are raised and spent by government

### C. Sorting Out Roles

1. Secondly, I think we need to scrape off some of the barnacles that have collected on the state's hull so that it can carry its primary cargo more effectively

2. Specifically, I'm talking about functions that the state has taken on that can be left either to other levels of government or <sup>to</sup> the private sector
3. I'll give you three examples of what I mean:
  - a. Regulation of savings and local associations--can be left to the federal government
  - b. Determination of the benefits that ought to be paid to local police and firefighters--can be left to the cities and counties
  - c. Regulation of landscape architects--can be left to the consumer
4. This would enable the state to concentrate on problems of statewide importance, or which lend themselves better to state than to local action

#### V. Obstacles to Change

##### A. Financial Constraints

1. It is always easier to make changes when the size of the pie is growing
2. This is not the case right now, and may not be for several years
3. This will make it more difficult for the Legislature to increase local government's fiscal flexibility, for two reasons:
  - a. First, the perception in the Capitol is that even providing cities and counties with more access to the local tax base smacks of a state tax increase--the voters may hold the

Legislature responsible for any increase in taxes that occurs at the local level

b. Second, the tax base is limited, so that giving locals more access cuts down on the state's fiscal flexibility

B. Political Constraints

1. For the locals to have more fiscal flexibility, the Legislature will have to give up control--there is no way to create power without reducing somebody else's
2. Many members don't find this prospect appealing, for obvious reasons
3. They may, however, think differently if City Councils and Boards of Supervisors become successful at holding the Legislature responsible for unpleasant things that occur in their communities

VI. Conclusion

- A. Some of you may see an anomaly in all this--a state employee arguing for a transfer of power to the local level
- B. In my judgment, however, it's got to be done
  1. Howard Jarvis, in his attempt to reduce the size of grass roots government, used a dull blade
  2. The effect was to uproot, rather than lop off, the local fiscal capacity
  3. It's high time we began the reseeding process

THANK YOU