

REPRINT

The 1991-92 Budget:
Perspectives and Issues

The County -State Partnership



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The County-State Partnership

What Adjustments to the County-State "Partnership" Are Needed to Ensure That It Will Best Serve the Needs of the People of California?

Summary

Over the past several years, many of California's counties have experienced increasing financial stress. Despite county reductions in discretionary spending and some state legislative action, our analysis indicates that the problem of county fiscal distress is relatively widespread and is a cause for concern. In addition, there are a number of other problems with the existing county-state partnership that reduce the effectiveness of partnership programs. These problems are of significant concern for the Legislature, as the state has a clear interest in maintaining the fiscal viability of county governments. This is because they not only provide basic municipal services to residences of local unincorporated areas, but also serve all Californians by providing services of statewide interest.

In an attempt to address some of the problems with the existing county-state partnership, the 1991-92 Governor's Budget proposes to realign the funding responsibility for AB 8 county health services and community mental health programs. Specifically, the state would remove existing state funding for these programs and provide counties with new revenues. Our assessment is that the Governor's proposal would not improve the overall effectiveness of these programs or necessarily improve the fiscal capacity of counties. It would, however, leave the state with additional resources to use to help address its budgetary funding gap.

While the process of reform is complicated due to the complex nature of the county-state relationship, it is important that the Legislature explore the opportunities for reforming it. We offer a framework that can provide a basis for approaching reform, and discuss various considerations and action steps involved in making changes in the county-state relationship.

Over the past several years, many of California's counties have experienced increasing financial stress. While Butte County is perhaps the most visible example of recent county financial troubles, our analysis indicates that the problem is inherent to the existing arrangement of state and county responsibilities and affects *all counties* to greater or lesser extent. The existing county-state partnership suffers from a variety of structural problems—such as program fragmentation, counter-productive fiscal incentives, and the inappropriate division of responsibilities—that both diminish the effectiveness of these programs and reduce the financial viability of county governments.

Clearly, the State of California also is facing significant fiscal problems, as we outline in Part One of this document. The state's budget funding gap is forcing a reevaluation of state spending priorities, and this will probably mean that less state funding will be available for many state programs operated by counties. As discussed in Part Three, reduced service levels and a shifting of program responsibilities are among the options for addressing the state's budgetary gap. These could have negative consequences for the financial viability of county governments, which is needed to ensure the effective operation of our "partnership" programs. The above concerns have led many to call for a basic overhaul of the county-state relationship in California.

The *1991-92 Governor's Budget* includes one major proposal to change the existing county-state relationship. Specifically, it proposes to replace existing state funding for the community mental health, the AB 8 county health services, and local health services programs with increased county revenues that result from proposed changes in the structure of the Vehicle License Fee (VLF) and an increase in the state's alcoholic beverage taxes. As of this writing, the administration's specific proposal for accomplishing this change has not yet been made available. As a result, it is not clear, for example, whether existing state controls over these programs would also be shifted to counties, or whether the state would continue to exert its influence over program service levels.

This analysis has several purposes:

- First, we examine the existing county-state relationship and assess its underlying problems.
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- Second, we identify the basic principles that are important in evaluating the structure of the county-state relationship, as well as proposals to change it.
- Third, we use these principles to evaluate the Governor's proposal to shift funding responsibility for county health and mental health programs to localities.
- Finally, we discuss additional considerations and action steps for the Legislature in approaching reform of the county-state partnership in the future.

WHAT IS THE BASIC COUNTY-STATE PARTNERSHIP IN CALIFORNIA?

This section describes the existing county-state partnership in California and identifies some of the problems with this relationship.

Background—Counties in California

Counties in California play a dual role in providing services to their residents.

First, counties are an administrative arm of the *state* and, as such, are charged with the responsibility to administer a variety of programs. These programs include welfare [such as the Aid to Families with Dependent Children (AFDC) and general assistance programs], indigent health services, social services [such as In-Home Supportive Services (IHSS) and Child Welfare Services (CWS)], community mental health, corrections, and the trial courts.

Second, counties administer a variety of *local* programs. These include some programs of general interest to the state (such as public health and local social services programs) and others of primarily local interest (such as the municipal-type services provided to residents of unincorporated areas, including fire and sheriff services).

Counties pay for local programs and for their share of state-required program costs out of the revenue they have available for general county purposes. County general purpose revenue (GPR) comes from a variety of sources, including the local property tax, state general purpose subventions, and the local sales tax. Due primarily to the constraints imposed by Proposition 13, counties have very limited power to increase GPR.

How Are the Major County-State Partnership Programs Structured?

As noted above, counties administer a variety of state-required programs in partnership with the state. The structure of the partnership varies from program to program, in terms of three basic characteristics:

- ***Who controls decisionmaking?*** The degree of relative decisionmaking control between the state and counties varies considerably among programs. In the case of AFDC, the state and federal governments establish most of the rules that determine eligibility and scope of services, leaving counties with little discretion over service levels. In contrast, counties have more control over the level of services provided in justice programs, mental health, and general assistance. For example, counties can reduce services provided under probation programs by decreasing the level of supervision provided, because the state has few formal requirements in this area.
- ***Who administers the program?*** California's counties are responsible for the day-to-day operation of many programs required by the state. Major examples of county administration of state-required programs include AFDC, general assistance, community mental health, and CWS, as well as the local courts, jails, and probation services. Other programs are administered by the state, such as state mental hospitals and the County Medical Services Program (for participating small counties).
- ***Who pays for the program?*** The county-state partnership programs have widely varying cost-sharing arrangements. For example, the state pays 100 percent of the nonfederal costs for Medi-Cal administration. The state also pays the majority of the costs for AFDC—roughly 93 percent of the nonfederal share of the grant costs and 50 percent of the nonfederal share of administration costs. Conversely, counties pay for 100 percent of the costs of general assistance and most of the costs of probation and operation of local jails.

Figure 1 shows the basic arrangements of funding, control, and administration for the major county-state partnership programs.

Figure 1

County-State Partnership Programs

Program ^a	Description	Policy Control	Administration	Funding
AFDC - Family Group (\$3,967 million)	Grants to single-parent families.	Federal and state governments set policy.	County administration, supervised by the state (supervision includes monitoring and oversight).	Federal - 50 percent State - 45 percent County - 5 percent
AFDC - Unemployed parent (\$733 million)	Grants to intact families with one unemployed parent.	Federal and state governments set policy.	County administration supervised by the state.	Federal AFDC-U program: Federal - 50 percent State - 45 percent County - 5 percent State only AFDC-U program: State - 89 percent County - 11 percent
AFDC - Foster care (\$1,013 million)	Payments to foster care providers.	Federal and state governments set policy.	County administration, supervised by the state.	Federal Foster Care program: Federal - 50 percent State - 47.5 percent County - 2.5 percent State only Foster Care: State - 95 percent County - 5 percent
AFDC - Child Support Enforcement (\$230 million)	Child support collection for AFDC and non-AFDC families.	Federal and state governments set policy; counties have discretion in organizing service delivery.	County administration, supervised by the state.	Federal - 66 percent County - 34 percent County costs partially or fully offset by state and federal incentive payments.
General Assistance (\$304 million)	Grants to individuals who do not qualify for other grant aid programs.	State requires counties to take care of indigents; county sets grant/service level; court actions have influenced level required.	County administration.	Entirely county-funded.

Figure 1—CONTD

Program	Description	Policy Control	Administration	Funding
Child Welfare Services (\$473 million)	Services to abused and neglected children and their families	Federal law sets broad guidelines for the program. State law is more stringent and there are fairly stringent state regulations.	County administration, supervised by the state	Primarily state- and federal-funded.
Community Care Licensing (\$50 million)	Licensing of out-of-home nonmedical facilities (i.e., family day care and foster family care)	State sets policy.	Some counties provide services on a contract basis.	Mostly funded through state funds, some federal money.
GAIN/JOBS (\$183 million)	Employment and training services	State and federal governments set policy; counties have some discretion to tailor program to suit local needs.	County administration, supervised by the state	State- and federal-funded.
In-Home Supportive Services (IHSS) (\$676 million)	Domestic and personal services to elderly and functionally disabled adults	State sets eligibility criteria. County has some discretion how services are provided.	County administration, supervised by the state.	State and federal governments fund almost all of the program. Total county share is frozen at \$19 million. Administration is entirely state-funded through the County Services Block Grant.
Adult Protective Services (\$23 million)	Protective social services for elderly and disabled	State requires counties to respond to cases of adult abuse, but sets no service level; counties set service level and mix of services.	County administration, supervised by the state	State-funded (as part of the County Services Block Grant).
Welfare programs administration (\$1,259 million)	Eligibility determination AFDC, Food Stamps, Foster Care, Medi-Cal	Federal and state governments set policy; counties have discretion in organizing service delivery.	County administration, supervised by the state.	Federal - 50 percent State - 25 percent County - 25 percent

Figure 1—CONTD

Program	Description	Policy Control	Administration	Funding
Mental health services: community-based Short-Doyle (\$781 million)	Inpatient and outpatient mental health services	Counties develop plans and state reviews plans, but there is little state control over county service delivery.	County administration, supervised by the state.	For Medi-Cal eligible services, 50 percent federal funds and 50 percent state funds. For non-Medi-Cal eligible services, State - 90 percent County - 10 percent (for counties with populations over 125,000); no county match for counties with populations under 125,000. County over-match was \$47 million for 1988-89. Hospitals: State - 85 percent County - 15 percent, regardless of county population.
Mental health services: state hospitals (\$261 million)	Acute, inpatient mental health services	State sets policy; counties have little or no policy control.	State administration.	State hospitals: State - 85 percent County - 15 percent (for counties with populations over 125,000); for counties with populations less than 125,000, the match requirement is 10 percent.
Mental health services: Institutions for Mental Diseases (\$85 million)	Inpatient mental health services	State sets policy.	State contracts with private providers.	Entirely state-funded.
Alcohol and drug programs (\$257.4 million, not including county funds)	Alcohol and drug treatment and prevention services	Federal and local governments set most of the policy; state does not have a strong policy role.	County administration supervised by the state.	There are several funding formulas using both state General Fund and federal funds. Counties are required to match General Fund with 10 percent county funds, except for counties with populations less than 100,000.

Figure 1—CONTD

Program	Description	Policy Control	Administration	Funding
Indigent health care (\$1.3 billion)	Health services to the medically indigent	Larger counties: Participate in the Medically Indigent Services Program (MISP) with indigent care systems established by the counties; state has little control over eligibility and scope of services. Smaller counties: Generally participate in County Medical Services Program (CMSP) run by the state with state-established eligibility and scope of services.	Generally county administration supervised by the state. CMSP (providing indigent health care for some clients in participating small counties) is state run.	MISP: State provides block grants to counties not participating in CMSP. Most counties supplement with county funds. CMSP: State-funded. Cigarette and Tobacco Products Surtax (C&T) Fund: State block grants to counties for a variety of health services; some funds must be distributed to private providers. AB 8-county health services: Per capita minimum state grant for indigent health care and public health services. Additional funding is generally 50 percent state and 50 percent county (with some county over-match). State Legalization Impact Assistance Grant (SLIAG): Federal reimbursements for services provided to newly legalized persons.
Public health programs (\$167 million)	Public health services	Counties have significant discretion regarding what services are provided and how they are provided.	County administration, supervised by the state.	AB 8: Per capita minimum state grant for indigent health care and public health services. Additional funding is generally 50 percent state and 50 percent county. Note: does not reflect variety of categorical programs from which some funds flow to county health departments.
Trial court operations (\$1.3 billion)	Operation of trial courts (Superior, Municipal and Justice courts)	Service level determined partially by the state and partially by the counties.	County administration, audited by the state.	State funding through the Trial Court Funding Program block grants and payment of judges' salaries (total for 1990-91 - \$501 million); local funding from county general revenues and fee collections.
Public defense (at least \$260 million)	Defense services, primarily for indigent persons	Service level determined primarily by local governments.	County administration.	County-funded (minor state funding). Greater state funding prior to 1990-91.
Prosecution (at least \$360 million)	Prosecution services through the District Attorney	County largely controls policy, but state actions affect local discretion.	County administration.	Primarily county-funded; state provides \$30 million for homicide trial reimbursement, training, and various grant programs.

Figure 1—CONTD

Program	Description	Policy Control	Administration	Funding
Incarceration-jails (at least \$1.5 billion)	Pre- and post-trial custody services (adult and juvenile)	County has little control over jail population; state and court actions limit discretion.	County administration	County-funded, with some state reimbursement for specified programs (for example, for counties housing state parole violators).
Incarceration (adults)-state prisons (\$2,111 million)	Custody services for adult felons	State sets policy.	State administration.	Entirely state-funded.
Incarceration (juveniles)-youth authority (\$350 million)	Custody and rehabilitative services for youthful offenders	State sets policy.	State administration.	Entirely state-funded.
Probation (at least \$350 million)	Probation services	State through enactment of criminal punishments; county through supervision policies.	County administration.	Primarily county-funded. State provides some funds through the County Justice System Subvention Program, training programs, and mandate reimbursements.
Jail construction (at least \$200 million)	Aid to counties for the cost of jail construction	Service level determined by the counties; county construction plans reviewed by the state Board of Corrections.	Primarily county administration.	Generally: State - 75 percent, County - 25 percent Amount varies substantially from year to year.
Parole (adults) (\$205 million)	Community supervision for persons released from state prison	State sets policy.	State administration.	Entirely state-funded.
Parole (youth) (\$41 million)	Community supervision for persons released from the Youth Authority	State sets policy.	State administration.	Entirely state-funded.
Police protection (\$1,201 million)	Basic county law enforcement	Service level determined primarily by county.	County administration.	Primarily county-funded. State provides about \$100 million for special grant programs and training.
<p>^a Program costs shown are estimated for 1990-91.</p>				

WHAT ARE THE PROBLEMS WITH THE CURRENT PARTNERSHIP?

Certainly, the most obvious problem with the county-state relationship in recent years has been the well publicized poor fiscal capacity of county governments. In addition, we have found the existing county-state relationship probably does not ensure that partnership programs are operated as *effectively* as possible. In this section, we discuss the basis for these findings.

County Fiscal Capacity

For purposes of our analysis, we define county fiscal capacity in broad terms—as the ability of a county to meet whatever public service needs may arise in its community with the resources it potentially has available to it. *Fiscal distress* occurs when an imbalance between resources and responsibilities leads a county to have severe difficulty addressing service needs.

Because county flexibility to raise GPR is limited, local service needs must compete with state-required programs for the growth in the existing GPR base. As counties have little (and sometimes no) control over the costs of state-required programs, counties may be unable to prevent these programs from commanding an increasing share of GPR over time. This can lead to a corresponding decline in the amount of GPR available for local services (referred to as local purpose revenues, or LPR), requiring counties to reduce service levels for these programs.

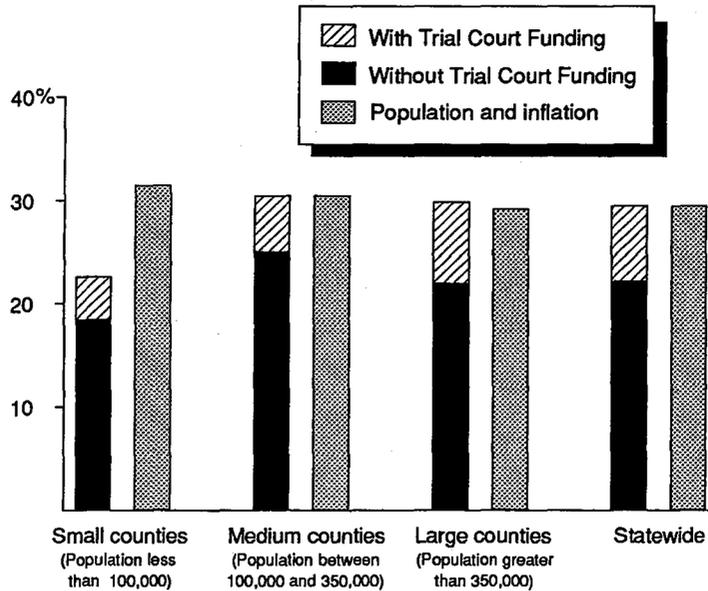
Previous Findings About Capacity. In last year's *Perspectives and Issues*, we presented an analysis of county fiscal capacity for the period 1984-85 through 1987-88. This analysis showed that county fiscal capacity, as measured by the change in LPR, did not keep pace with the growth in the cost of living and population over this period. On a statewide basis, county LPR increased by a nominal 12 percent between 1984-85 and 1987-88, but actually *declined* by 6.5 percent after accounting for inflation and population.

New Data Are Available. Data on county fiscal capacity are now available for the 1988-89 fiscal year. These data show a significant reversal of the prior trend, due to the implementation of the Trial Court Funding Program (TCF). In 1988-89, this program provided half-year state block grants to cover a portion of county costs for court operations. As shown in Figure 2, on a statewide basis, county fiscal capacity *improved* sufficiently to fully restore the 1984-85 level of LPR, after adjustment for inflation and population growth. Our review, however, indicates that this general conclusion does *not* apply in the case of smaller

Figure 2

**Percentage Change in Local Purpose Revenue
With and Without Trial Court Funding**

1984-85 through 1988-89



counties, because of their relatively lower levels of expenditure for court operations.

The advent of TCF clearly took some pressure off county budgets in 1988-89, and because the program expanded to provide full-year funding in 1989-90, our projections indicate further improvement through 1989-90. In addition, in 1989-90 counties began to receive additional funding for indigent health care expenditures from the new tobacco products taxes imposed by Proposition 99. These factors have combined to restore some of the county fiscal capacity that had been eroded in the years since Proposition 13. However, they have not affected the underlying conditions that gave rise to the decline in overall county fiscal capacity to begin with—high rates of growth in state-required program costs and low rates of growth in GPR.

Erosion of Gains Is Likely. Our analysis indicates that, beginning with the 1990-91 fiscal year, several additional factors will begin to erode the gains realized by counties in 1988-89 and 1989-90. First, in 1990-91 the state reduced the level of funding for TCF by \$61 million. This reduction appears to have been implemented by counties through a reduction in their expenditures for programs other than court operations.

In addition, other 1990-91 state funding reductions amounting to \$369 million occurred in the Medically Indigent Services Program (MISP), the Community Mental Health Program, the CWS Program, and several other programs. These reductions appear to be resulting in increased *county* expenditures for these programs, because many counties have chosen to replace some or all of the state funding reductions with local funds.

In order to help counties absorb these increased costs, the Legislature authorized them to begin charging other local agencies for the costs of certain county-provided services (property tax administration and jail booking), and to levy new taxes in county unincorporated areas. Recent information indicates that most counties will levy the charges, and increased revenue of \$220 million is expected from them in 1990-91. This will be insufficient to offset the \$430 million in state funding reductions discussed above. Moreover, with respect to these charges, there are a number of significant implementation issues which must be resolved. Until this occurs, it will not be possible to determine the actual amount of revenues counties will receive from these sources. With respect to county adoption of new unincorporated-area taxes, there is no information available yet, but the potential revenue gains are expected to be relatively limited.

Finally, counties will be increasingly affected by recent federal cutbacks in State Legalization Impact Assistance Grants (SLIAG) funding. In 1989-90, the state reduced its funding for the MISP by \$100 million, and justified this reduction on the basis of increased funding counties were expected to receive under the SLIAG program. It appears that SLIAG funds actually covered only about 80 percent of this funding reduction for 1989-90 and 1990-91. In addition, the level of SLIAG monies that will be available in 1991-92 is uncertain, and these funds will be unavailable in 1992-93. Thus, it is likely that county costs will increase due to the loss of these funds, or service levels will have to be reduced, beginning in 1992-93.

Local Fiscal Capacity Will Be Weakened. While the lack of current data precludes us from measuring the exact impact of these changes on county LPR, we do see some general trends. Based on the underlying growth rates for state-required program

costs and GPR, we estimate that the gains in county fiscal capacity during 1988-89 and 1989-90 will be temporary. For 1990-91 and beyond, we estimate that county costs for state-required programs will grow significantly faster than GPR—leading to erosions in local fiscal capacity.

Partnership Program Effectiveness

The effectiveness of county-state partnership programs is determined by a variety of factors, including the level of resources committed to them and the nature of the problems that these programs seek to address. In addition, however, they are affected by the way the partnerships for these programs have been *structured*. Program structure leads to reduced effectiveness when it causes decisions to be made that are *inconsistent* with the overall objectives for the program, or precludes actions that would lead to greater effectiveness. Our review has identified several of these structural shortcomings.

Counter-Productive Fiscal Incentives. As an example of this type of shortcoming, we previously have pointed out that the juvenile justice system is structured in such a way that, in many cases, the least effective treatment (the placement of juveniles in Youth Authority facilities) is the least costly alternative available to counties but the most expensive to taxpayers as a whole. (For more information on this issue, please see *The 1989-90 Budget: Perspectives and Issues*, page 319.) In this case, the effectiveness of the program is weakened by the *counter-productive fiscal incentives* inherent in the structure of the program.

Inappropriate Assignment of Responsibilities. The mental health program provides an example of a second type of structural problem that reduces effectiveness. In this case, the state is basically responsible for patients in need of long-term care, while counties take care of shorter-term needs and case management. In some cases, the inability of the state or the county to carry out its part of the program interferes with the overall system's ability to provide the most effective treatment at the least cost. For example, clients no longer in need of long-term care have sometimes been maintained in such facilities because of a shortage of community-based treatment capacity—even though the long-term care is more expensive. Thus, the *current assignment of responsibilities* in mental health programs works against program effectiveness because it imposes artificial barriers to the more efficient allocation of resources.

Failure to Avoid Duplication and Realize Scale Economies. Another example of how the structure of the relationship reduces effectiveness is found in the administration of the AFDC

and Medi-Cal programs. Each of the 58 counties conducts its own eligibility determination, needs assessment, and other administrative functions following general guidelines supplied by the state Departments of Social Services and Health Services. As a result, the counties often duplicate each other's efforts to interpret and implement new state regulations, and the state then expends additional resources to verify the county determinations. If these functions were consolidated at the state or regional level, some of the duplicative effort and verification costs could be eliminated. Further, the state might realize additional savings due to the *economies of scale* offered by consolidation.

Inappropriate Exercise of Administrative Oversight. Finally, a more general type of structural problem occurs across many of the county-state partnership programs, and relates to the state's interest in ensuring that counties run these programs as effectively as possible. Toward this end, the state's oversight activities seek to ensure that the programs are properly targeted, that administrative problems are corrected promptly, and that useful information is available on program performance. The oversight function is carried out generally by requiring counties to submit plans, reports, and case data to the state. However, in some cases the state appears to be making little or no use of this information for its intended purposes. Further, despite the volumes of information collected, there is often little information available at the state level as to who is being served by these programs and at what level. Thus, the *inappropriate exercise of administrative oversight* can reduce program effectiveness by diverting available resources from more productive uses.

These examples are by no means a comprehensive listing of all of the types of structural problems currently characterizing the state's partnership programs. Our review of these programs indicates that structural problems are widespread and significant, and they may fundamentally undermine the overall effectiveness of both state and county government in California.

Summary of Problems

The problems with the existing county-state relationship are generally long-term and structural in nature. They result from the basic structure of the relationship between the state and counties, as well as the revenue constraints imposed by Proposition 13. Given the complexity of factors involved and the diversity of California's counties, it will not be an easy task to find long-term solutions to these problems. Nonetheless, as discussed below, the Legislature should consider individual proposals for program realignment or other measures for addressing county fiscal distress in the context of a comprehensive review of the

county-state relationship. The next section discusses a framework for evaluating proposals to reform county-state relations in California.

A CONCEPTUAL FRAMEWORK: HOW SHOULD THE LEGISLATURE APPROACH MODIFYING THE PARTNERSHIP?

Over the past few years, there has been a growing interest in examining the broad relationships between state and local governments in order to assess whether the existing arrangements for providing services to the public are in need of revision. The term "program realignment" is often used in this context. This is a process for rationalizing (to the extent possible) the *entire county-state system*. This section discusses a framework for approaching this task.

Sorting Out Partnership Responsibilities

The first step in reforming the county-state relationship in California is deciding the extent to which "partnership" programs should be centralized or decentralized in terms of:

- **Decisionmaking control.** Should *state or local* officials be responsible for establishing service levels, or indeed determining whether a particular service is provided at all?
- **Funding responsibility.** Should a program be paid for primarily with state or local resources?
- **Program administration.** Who should control day-to-day program operations?
- **Service delivery.** Who should actually provide services: State or local government agencies? Private or nonprofit contractors?

Reforming the county-state partnership requires a clear understanding of these responsibilities and the relative capabilities of state and county governments to carry them out. It also requires understanding the fiscal constraints faced by both the state and county governments. Below, we present the basic principles which can guide the Legislature in considering the current and future proposals for reforming the partnership.

Basic Principles of Reform

We have identified six basic analytic principles that are helpful in considering reform of the county-state relationship. Each of these is shown in Figure 3 and discussed below.

Figure 3

Basic Principles of Reform

- Determine who will exercise program control
- Link program control and funding
- Pay attention to incentives
- Consider cost-effectiveness
- Address physical capacity
- Provide for fiscal capacity

Determine Who Will Exercise Program Control. The most important consideration in reforming county-state partnership programs is determining whether the state or the counties should have *primary* responsibility for setting program service levels.

One of the most fundamental requirements for achieving greater effectiveness and efficiency in partnership programs is to ensure that the “right amount” of services are provided. If *too much* is provided, resources are wasted that could have been used more effectively in another way. If *too little* is provided, then the service will not effectively address the problem at which it was directed.

Generally, economists argue that placing program control at the *lowest* level of government possible tends to minimize the potential for over- or under-provision of resources. Figure 4 summarizes four advantages of decentralization—recognition of local diversity, experimentation/innovation, information availability, and citizen access.

Economists also note that, in some cases, state intervention is needed to ensure provision of adequate service levels. There are a number of circumstances where it is appropriate for the state, instead of counties, to determine program requirements. Thus, the assignment of primary control over the setting of

Figure 4

The Advantages of Program Decentralization

Recognition of Local Diversity

If county officials are allowed to establish service levels, they are better able to reflect the service demands of county residents.

Experimentation and Innovation

If a large number of local agencies independently provide a service, it is likely that they each will approach problem solving differently, and in so doing generate more effective and efficient programs.

Information Availability

Given the number and diversity of California's counties, county officials may have better information about local conditions and citizen needs.

Citizen Access

Local control of a program may facilitate citizen access to the decisionmaking process.

program service levels should be based on an *assessment of the need for state intervention*, based on the extent to which the following criteria are true:

- **Costs or benefits of program operation are not restricted geographically.** In many cases, the costs or benefits of county action "spill over" into other counties. As a result, under local control a county can end up either paying too little or too much for a service, relative to the benefits it receives. For example, while county public health programs may reduce the threat of communicable disease for *all* state residents, counties may only provide a high enough level of service to address immediate local concerns.
- **Service level variation will create adverse incentives for migration.** In this case, local control can lead

to under-provision of services, as communities try to avoid attracting added caseloads due to the migrational impacts of relatively higher benefit levels in public assistance programs. For example, in some counties, general assistance is provided at very limited levels to discourage program usage.

- ***Uniformity is needed to promote state objectives.*** In some cases, the state may see a need to intervene to ensure that certain minimum services are provided for, or to ensure standard treatment under the law. Some types of problems are of a statewide nature and can only be effectively addressed with state control. This is especially true for programs whose purpose is to redistribute income, like AFDC.

Link Program Control and Funding. The government which has primary control over service levels and other program standards normally should also shoulder most, if not all, of the program costs. A strong link between program control and funding ensures that scarce fiscal resources are used in the most effective manner possible. In the absence of such a link, the government paying for the program may be vulnerable to uncontrollable growth in program costs. Moreover, the officials who establish service levels are not directly responsible for program tradeoffs or actual costs to their jurisdiction's taxpayers, so that *accountability* is weakened.

Pay Attention to Incentives. County officials respond to a variety of factors in making decisions about partnership programs, including fiscal incentives that are present in the program context. Some of these incentives are intentionally created by the state for good reasons. For example, sometimes state matching grants are provided which reduce the cost of a particular service from a county's perspective, in order to encourage its local officials to provide a higher level of those services than they would otherwise choose to provide. The state can use this type of incentive when a higher level of service will help to achieve state objectives. In some cases, however, program arrangements can create counter-productive fiscal incentives, encouraging counties to select higher-cost or less-effective program alternatives.

Consider Cost-Effectiveness. The state should consider the cost-effectiveness of alternative program arrangements, including the assignment of responsibility for day-to-day program administration and actual service delivery. Program realignments can offer opportunities to achieve better cost-effectiveness in a variety of ways. For example, in the case of decentralization:

- In some cases, if local officials are given increased discretion over service levels and program operations, they will choose varying approaches to providing services. Some of these program innovations may result in reduced costs or improved program outcomes. In contrast, if the state imposes program standards, there may be less experimentation and innovation, because of the need to have standardized approaches that are consistently applied throughout the state.
- Decentralization also may reduce costs through intergovernmental competition. For example, if one government undertakes cost-reducing measures, other governments may face pressures to undertake similar measures.

In some cases, however, increased centralization can provide benefits. For example, centralization may increase cost-effectiveness if the state government can provide services at a lower cost than counties due to "economies of scale." The state, for instance, might be able to achieve economies in such areas as the development of computer-based information systems that would not be available if each county were to develop its own individual system.

Address Physical Capacity. Some counties may not have the physical resources required to provide certain types of services. For example, small rural counties may not have the public and environmental health technicians needed to ensure adequate protection of public health and safety for residents and visitors. Thus, the state needs to assess their capabilities before decentralizing certain types of state-provided services.

Provide for Fiscal Capacity. In assigning program responsibilities, it is important to ensure that the responsible government (state or local) has adequate fiscal capacity to "take on" a program. For example, if a county has extremely limited fiscal capacity, it may not have the flexibility to make meaningful choices about service levels in discretionary local programs. A partnership system that does not provide for adequate fiscal capacity at both the state and local levels is imbalanced, and this imbalance will eventually undermine the achievement of both state and local goals.

Strategies for Reform

Given these principles, there are many different strategies that can be used to reform the existing county-state relationship, as shown in Figure 5. These include shifting program responsibility and/or revenue capacity from one level of government to another. As shown in Figure 5, there are different ways to

Figure 5

Strategies for Reforming the County-State Relationship

Shift Program Responsibility to Counties

- Provide complete local discretion
- Provide local discretion above mandatory minimum program requirements
- Provide local discretion with state assistance

Shift Program Responsibility to the State

- Completely state-operated
- State-operated with contract providers (may be counties)
- State-operated with local administration and delivery

Allocate Portion of State Revenue Base to Locals

Earmark a share of state revenues commensurate with new program responsibilities. For example:

- Alcohol tax revenue
- General sales tax revenue

Adjust Shared Revenues

- Shift property tax allocations
- Shift vehicle license fee revenue allocations

Provide New Local Revenue Authority

- Property tax override (requires constitutional amendment)
- Other new general or special taxes
- Additional sales tax authority

Provide Other State Grants

- Appropriate general purpose or categorical grants to all counties
- Appropriate fiscal assistance to distressed counties

structure responsibility for partnership programs, depending upon the Legislature's objectives for these programs. The "sorting out" of program responsibilities need not mean total separation of state and local governments; in many cases, they have mutual and compatible interests that can be best served in a *cooperative partnership arrangement* in which both participate but have different roles.

The other strategies shown in Figure 5 basically allow the partnership system to be adjusted to accommodate changes in program responsibility. For example, shifting control of a county program to the state level would increase state costs and lower county costs. This could be offset by reducing the county share of local property taxes and increasing school shares, thereby reducing state expenditures for school apportionments. Such adjustments, however, should be considered in the context of ensuring adequate fiscal capacity at both the state and county levels of government.

We next turn to the Governor's proposal regarding the county-state partnership, and examine its consistency with the basic principles of partnership reform shown in Figure 3.

THE GOVERNOR'S PROGRAM REALIGNMENT PROPOSAL

The 1991-92 Governor's Budget contains a proposal to transfer the funding responsibility for three existing programs from the state to the counties. Specifically, the proposal would:

- **Eliminate state General Fund support** for Short-Doyle local mental health, AB 8 county health services, and the local health services programs, which totals approximately \$942 million in the budget year.
- **Increase county revenues** by \$942 million, through an increase in state-levied alcohol taxes and Vehicle License Fees (VLF).

VLF. Existing law imposes a motor vehicle license fee equal to 2 percent of a vehicle's "market" value. Revenues from the VLF are distributed to cities and counties (according to a statutory formula) after state administrative costs are deducted. (State voters passed a constitutional amendment in 1986 dedicating VLF revenues to cities and counties, in response to several years in which the state used these funds to help balance the state's budget.) Vehicle market values are determined by adjusting the vehicle's *original purchase price* for depreciation, according to a statutory depreciation schedule. The budget proposes to change the existing depreciation schedule, and to revise the definition of original purchase price for newly purchased *used* vehicles. These

changes would raise an estimated \$781 million, and almost all of this amount would be allocated entirely to *counties*.

Alcohol Taxes. The budget proposes to raise the state's alcoholic beverage taxes and allocate \$173 million of the estimated total increase in revenues (\$190 million) to counties. (The remainder would be used to establish a new state drug education program.)

At the time this analysis was prepared, it was not clear (1) how the new revenues would be allocated between individual counties or (2) whether the revenues would be earmarked for local mental health and county health services. These questions have important implications for any assessment of the proposal, as discussed below.

Background—How Do These Programs Work Now?

AB 8. Under current law, the AB 8 (Ch 282/79, Leroy Greene) County Health Services Program provides block grants to counties for funding inpatient care, outpatient care, and public health programs. Most of these funds are used to assist lower-income persons. Each county's allocation is based on a formula consisting of (1) a per capita grant and (2) state sharing funds that must be matched by county funds. This allocation is capped at a maximum amount each year, adjusted annually for inflation and population growth. Counties have discretion as to how to allocate their AB 8 funds between (1) inpatient and outpatient care and (2) public health services, but must agree to maintain overall spending levels as a condition of receiving these funds. This state assistance helps counties meet their underlying obligations to provide health care services for indigent persons and to carry out local public health programs. The state also provides assistance for indigent health care through a number of programs, including the Medically Indigent Services Program (MISP), and the California Healthcare for Indigents Program (CHIP).

Local Health Services. The LHS Program provides public health nursing and environmental health services to 12 counties with populations of less than 40,000 each. The state contracts with these counties for basic preventive health and disease control services provided by state public health nurses and sanitarians. The LHS Program also implements the Public Health Nursing Liaison and Certification Program, which (1) provides general public health nursing consultation to local health departments and (2) receives and processes applications for public health nurse certification in the state.

The LHS Program was statutorily established in recognition of the difficulty that small, rural counties have in (1) attracting and retaining health personnel and (2) providing the variety of public and environmental health services required to ensure community health and safety.

The LHS Program provides the following specific services: sanitation and restaurant inspection, vector and rabies control, child health and family planning activities, communicable disease control, and immunizations. Counties participating in the LHS Program contribute a per capita (55 cents) county match to the state.

Short-Doyle (Community Mental Health Programs). Under the Short-Doyle Act, counties are responsible for planning local mental health programs and providing health services, and the state Department of Mental Health is responsible for overseeing the system. Short-Doyle mental health services are funded primarily from state funds and county matching funds, generally on a 90 percent state and 10 percent county basis. Inpatient hospital services, including state hospital services, generally are funded 85 percent by the state and 15 percent by counties. This state assistance program was created as part of the state's attempt to reduce the number of patients in state hospitals. The high level of state cost-sharing was intended to encourage counties to provide community-based treatment options for state hospital patients, in order to reduce overall system costs and improve effectiveness.

Evaluation of the Governor's Proposal

This section provides our evaluation of the Governor's program realignment proposal. We discuss whether the proposal is consistent with respect to the six basic principles of reform described in the previous section, and identify the likely effects of the proposal on the overall effectiveness of these partnership programs.

Determining Program Control. As described above, efficiency and concerns for maintaining minimum levels of basic services should be the basis for deciding which level of government should control program service levels. State intervention in local mental health and public health programs has been justified on both grounds, due to concern about variation in service levels between counties and access to services. The administration's proposal is at this point ambiguous about the extent of state involvement in these programs that would be present after the funding shift. If the proposal is to *eliminate* state involvement, then the proposal implicitly assumes state

acceptance of service-level variation between counties, including the potential reduction in access by individuals to these services. This may be acceptable to the Legislature if it finds that there is a sufficiently strong local interest in maintaining adequate service levels.

If, on the other hand, the administration's proposal continues the state's present involvement in these programs, then the proposal would not necessarily affect existing levels of service.

Even if the latter is the case, however, an important concern remains. In both of these program areas, there *already* is a substantial variation in service levels across counties. At least some of the existing variance is a reflection of the amount of state funding going to individual counties for these programs. For example, the existing AB 8 program allocations are based on historical spending by counties for inpatient and outpatient care and public health services in 1977-78, adjusted by inflation and population growth. As a result, AB 8 program allocations have not been sensitive to changes in the need for county health services. A similar situation exists with respect to mental health programs where funding levels vary, at least in part, based on when individual counties opted into the original Short-Doyle program. The Governor's current proposal, if allocations are based upon existing state assistance, will essentially "lock in" these inequities, thwarting one of the fundamental reasons for state intervention in the first place—ensuring uniform minimum access to basic services.

Linking Control and Funding. As described above, one of the fundamental principles of reform is that control and funding for a program should be linked. The governmental entity that has responsibility for setting program objectives and service levels in a program should also have primary responsibility for funding the program. Conversely, it can be inefficient and ineffective to vest responsibility for program goals with a government entity that does not pay for the services.

The Governor's proposal is relatively consistent with regard to linking control and funding—if it is implemented without earmarking the new revenues. That is, if the state repeals existing state requirements related to AB 8 and mental health *and* provides the counties with additional general revenues, the counties will have both (1) strong control over service levels and program standards and (2) a large stake in providing them in the most efficient manner, given that they will be responsible for funding them. Conversely, if the state wants to continue to have significant control over program objectives and service levels, then the proposed reliance on *local* revenues as the funding

source reduces the state's accountability for program results. As described earlier, VLF revenues have been clearly designated as a source of funds for local agency purposes by the state's voters.

The Use of Incentives. Incentives should be used to *further* the achievement of overall program objectives, not detract from them. The Governor's proposal poses a number of problems in this area. First, the current division of mental health program responsibilities results in counter-productive fiscal incentives because the prices faced by counties for alternative treatment options do not reflect the overall cost of providing these services. *The Governor's proposal would exacerbate this problem by establishing new counter-productive incentives.* Under the proposal, county costs for the most expensive and institutionalized forms of treatment would continue as at present to be 15 percent of the total costs for state hospitals and zero for treatment provided in Institutions for Mental Diseases (IMDs). In addition, placements in AFDC-FC group homes for children would continue to be available as an entitlement with a 5 percent county match. However, county costs for community-based services, which are less restrictive, generally more cost-effective, and used to prevent institutionalized placements in the first place, could only be provided at 100 percent county cost (versus 10 percent at present). Thus, counties would have a fiscal incentive to choose the most restrictive treatment option, all other things being equal.

Cost-Effectiveness. Program alignment decisions should be made to encourage cost-effective program administration and service delivery. This concept is closely tied to the idea, described above, that it is important to set fiscal incentives so that they encourage the most cost-effective administration and service delivery possible.

To the extent that existing program arrangements restrict local entities from achieving the most cost-effective management at the local level (for example, as the result of forced uniformity by the state in programs even when local conditions vary), then the Governor's proposal might provide some benefit by allowing counties increased flexibility. For example, if the proposed realignment were implemented in a fashion that accorded counties primary program control, then counties might be able to improve the overall cost-effectiveness of their programs through improved targeting of available funds toward the highest local priorities.

In our view, the Governor's proposal would have a limited impact on the cost-effectiveness of county health and mental health programs. It simply does not address the issues which could lead to the achievement of better effectiveness, such as

coordination of state and local program activities, changes in service delivery to achieve economies of scale (such as might come from regional or increased private provision of services), and the incentive issue discussed above.

Physical Capacity. As earlier noted, program alignment should also ensure that the level of government responsible for a program (or a particular part of a program) has the physical capacity to provide the services. For example, as described previously, some counties may not have the physical resources to ensure provision of certain services.

The Governor's proposal makes no direct attempt to ensure that the physical capacity to provide health and mental health services exists at the local level. While significant service delivery systems already exist in many counties, at least several of the smaller counties do not now have the delivery systems needed to ensure provision of medical and mental health services (because they cannot attract and retain providers). Thus, the realignment proposal may undermine the ability of the state and small counties to achieve the overall goals for the programs.

Fiscal Capacity. As discussed earlier, primary control and funding for a program should be vested with the same level of government, and that level of government should have sufficient fiscal capacity to carry out the program effectively. If a governmental entity has the responsibility for funding a program, but does not have the capacity to do so (or lacks the flexibility to improve local fiscal capacity independently), then potential program effectiveness will be compromised.

The effects of the Governor's proposal on county fiscal capacity will depend on whether the new revenues going to counties grow faster or slower than the costs of providing current levels of service in health and mental health programs. For example, to the extent that revenue growth exceeds increases in the costs of the programs, then improved fiscal capacity would occur. In contrast, if revenues grow more slowly than expenditures, fiscal capacity would be reduced.

As regards the Governor's proposal, our analysis indicates that it is unlikely that VLF and alcohol tax revenues will keep pace with the rapid cost increases for providing current levels of service in county health and mental health programs. Specifically:

- **Revenue growth.** Although VLF revenues increased relatively quickly during the 1980s, anticipated slower growth in the state's economy (including automobile sales) are likely to slow the rate of growth in VLF
-

revenues as well. With respect to the alcohol tax, alcohol consumption (and thus revenues from alcohol taxes) is generally on the decline, and is likely to decline further as consumers adjust to the increased prices that result from increasing the tax rates. We estimate that combined revenue from the two sources might grow in the range of 5 percent to 7 percent annually.

- **Expenditure growth.** Over the last five years, net county spending for county health and mental health programs (that is, what counties spent after subtracting state aid for those specific purposes) grew on the order of 12 percent to 13 percent annually, and we believe this to be a reasonable proxy for the underlying growth in demand for these services. We have no evidence to suggest that these growth rates are likely to decline over the coming years.

Given the above, growth in the level of program costs required to maintain service levels is likely to be greater than the growth in revenues under the Governor's proposal. This means that *improvements* in county fiscal capacity should not be expected as a result of the Governor's proposal, *except as a result of reductions in the level of services provided by counties*. It should be noted, however, that state General Fund support for these programs has grown relatively slowly (on the order of only 3 percent to 5 percent annually) over the last several years. Thus, the VLF and alcohol tax revenues, while not keeping pace with program costs, may provide a more stable source of funding for these programs than they have had in the past.

Overall Assessment. While the Governor's proposal provides relief from spending pressures at the state level by freeing up \$942 million in resources, we find that it is not likely to produce much improvement in the overall effectiveness of the partnership programs involved. With respect to mental health programs, the proposal may actually *reduce* the effectiveness of the existing system. This is because it would establish counterproductive fiscal incentives in the program, as described earlier. With respect to AB 8, it appears that the proposal would have *little* impact on effectiveness. This is because the AB 8 program is only one component of the overall indigent health care system, and improvements depend upon changes in the overall system. With respect to the LHS Program, it appears that the proposal may significantly affect 12 small rural counties' ability to provide public health services. This is because the size and scale of these counties' programs often cannot justify the personnel and resources necessary to ensure that minimum services are provided.

Figure 6

Summary Evaluation of Governor's Proposal

Realignment Principle	Mental Health	AB 8/LHS
Determine program control	- Locals may underprovide these services to the extent that they see the costs as localized but the benefits as widespread. This may occur, since counties cannot restrict migration into the county, and thus may have little control over growth in program costs.	
Link control and funding	+/- If existing mandates are removed, the proposal is relatively consistent with respect to linking control and funding. If mandates are not removed, the proposal is inconsistent.	+/- While control and funding for public health programs would be made consistent, the proposal would not improve the link between control and funding for the overall indigent care system.
Control of incentives	- Proposal continues (and may worsen) counter-productive incentives by "reducing the cost" to the counties of the most institutionalized (and costliest) options, while increasing county costs for less intensive, less costly treatments.	No impact on existing incentives.
Cost-effectiveness	- Proposal would likely not improve cost-effectiveness of the overall mental health system in the state because of the fiscal incentive for counties to push patients to costlier treatments paid almost entirely by the state.	No impact on existing cost-effectiveness, other than the potential for minor savings related to changing reporting requirements.
Physical capacity	No impact on capacity to deliver services.	No significant impact on capacity to deliver services, except for local public health programs in small counties.
Fiscal capacity	+/- The proposal only improves county fiscal capacity if the new revenues grow more quickly than costs grow, or if service levels are reduced. Since we estimate that new revenue growth will likely not exceed spending pressures, then improved fiscal capacity can only come about through reduced service levels.	

Figure 6 summarizes our basic findings with regard to the Governor's proposal.

STEPS FOR THE FUTURE

Looking beyond the Governor's proposal, what steps, if any, should the Legislature take in the future regarding the county-state partnership?

A Comprehensive Review Is Needed

We believe that a comprehensive review of the entire county-state partnership is needed, given the many problems with the current relationship. Such a review is complicated by the large number of programs that are involved in the partnership and their individual complexities. Nevertheless, we believe that a comprehensive review is merited and that any proposals to reform the current relationship should be developed, if possible, within the larger context of the entire county-state partnership. This offers the best chance for developing a well integrated and consistent set of partnership programs.

What Approach Should Be Followed?

The issue of reforming the partnership should be approached using the general framework and basic principles presented earlier and summarized in Figure 3.

As noted earlier, the most critical step in the whole process is the determination of who will have primary control over the setting of program service levels. In many ways, each of the subsequent steps in the process merely help to facilitate the exercise of this control and ensure that it is exercised effectively.

In actually undertaking this task and applying the partnership framework, there are two more general considerations to keep in mind:

Establish Clear Program Objectives. Many of the existing county-state partnership programs have poorly defined goals and objectives. Having such poorly defined objectives can compromise program effectiveness and reduce accountability. For example, the state requires counties to respond to any report of alleged abuse or neglect of elderly or dependent adults. However, there are no standards for what constitutes an acceptable county response. As a consequence, the level of response varies by county, and has become subject to intervention by the courts.

The Need for Local Fiscal Flexibility. The notion of a shared partnership between the state and counties requires that

adequate fiscal resources be available to each to carry out their responsibilities in providing services, however determined. This, in turn, requires that counties have the ability to select desired service levels and to correspondingly adjust their revenue levels to fund them. In recent years, many counties have faced severe fiscal constraints and have been unable to finance their desired local services. Resolving this problem is an essential aspect of partnership reform.

As a means of resolving the problem, county governments need to have a flexible and reliable discretionary revenue source. This is of vital importance for two reasons. First, a stable and flexible funding source is necessary to ensure the achievement of state and local objectives in partnership programs. This is because local conditions are likely to change over time, and county officials require funding sources adequate to address these changing needs. Second, counties also require adequate fiscal flexibility to respond to citizen preferences for local programs. As general purpose governments, counties need to be responsive to the expressed wishes of local voters. As a result, counties require a discretionary revenue base that local voters can draw upon to fund the programs they desire.

CONCLUSION

As we have described, county-state partnership programs in California are suffering from a variety of problems, including declining local fiscal capacity, program fragmentation, and lack of clear program objectives. These problems are long-term and structural in nature, and need to be addressed in a *comprehensive fashion*. While no process of reform is likely to be easy, following the basic framework presented in this piece can assist the Legislature in beginning the task of reforming the overall county-state relationship.

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