

A PRIMER ON LOCAL GOVERNMENT FINANCE

Excerpted from "Perspectives on State and Local Finance" prepared by the Senate Office of Research, January 1984, Chapter II.

## CHAPTER II:

### I. A PRIMER ON LOCAL GOVERNMENT FINANCE

To date, the local government finance debate has centered around broad notions of "where we are today" and "where we ought to be", yet these discussions have occurred with a somewhat surprising paucity of data about the players involved. Generalities about the state's excessive influence over local financing and expenditures, the loss of local control and accountability, and the concomitant increase in local dependence upon the state have been made with little information to support the contentions.

Proposition 13 clearly represents a watershed in local government finance and has been a major reference point in discussions on this issue. Because of the magnitude of the revenue loss (\$7 billion in the first year, offset to some degree by a state bailout), local governments have been forced to cut expenditures and to search for new revenues. Many have suggested returning control, accountability and responsibility to local jurisdictions, using pre-Proposition 13 years as a model. The following information provides a detailed description of the revenue and expenditure status of cities, counties and special districts in the year prior to Proposition 13 and in succeeding years. The intent is to provide the background necessary to evaluate the existing local government finance structure and the numerous proposals for reform.<sup>1</sup>

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<sup>1</sup>Much of the data utilized in this section are from the Controller's annual reports of financial transactions concerning cities, counties and special districts. These data compilations are not audited and are thus subject to accounting and reporting variations between individual local entities; they should not be considered exact, but instead indicative of general trends. (The California Taxpayers Association is conducting an intensive field survey of 12 local agencies, to be published early next year, in an attempt to improve the existing data base and illuminate differences between individual jurisdictions. Additionally, the Controller's office has appointed an advisory subcommittee to improve the reporting formats used for city, county and special district financial transactions.)

THE STATE-LOCAL GOVERNMENT RELATIONSHIP SINCE 1978

<u>WHEN</u>	<u>WHAT</u>	<u>HOW IT WORKS</u>
June, 1978	Voter adoption of Article XIII A (Proposition 13)	Limits the countywide property tax to 1% of full cash value plus rates for pre-1978 voter-approved indebtedness. Defines full cash value with a 1975-75 base, with reassessment only upon change of ownership and completion of new construction.
Summer, 1978	SB 154	One year "bailout" funding of \$4.4 billion for schools, cities, counties, and special districts; included increased school apportionments, state assumption of many county program costs, block grants to cities, counties and special districts.
Summer, 1979	AB 8	Long-term local financing package which: shifted a large portion of schools' share of the property tax to cities, counties and special districts with the state making up the school loss; made permanent state assumption of certain county program costs; established the AB 8 deflator.
June, 1981	SB 102 and clean-up bills	Suspension of deflator; three small subventions repealed; and VLF subventions cut--\$21.5 million to counties and \$109.8 million to cities.
June, 1982	AB 21, SB 1326, AB 799	VLF subvention cuts to counties: \$40.2 million; cities: \$222.5 million. Local Agency Reimbursement Fund established to offset cuts; \$10 million distributed to cities and counties. Medically Indigent Adult Transfer to counties. Numerous other minor provisions.
February, 1983	AB 28X	An additional \$28.6 million cut in local assistance funds, distributed equally among cities and counties.
July, 1983	AB 223	Elimination of Business Inventory COLA (\$19.6 million savings); Suspension of the deflator for schools for 1983-84; suspension of deflator for other local agencies from July 1 - September 30, 1983 and cuts of \$69.5 million to cities, \$17.5 million to counties, by allowing the deflator to trigger in October, special districts cut \$34.3 million, cities cut \$384.2 million, counties \$450 million.
September, 1983	AB 895	Suspension of the deflator for the entire 1983-84 year; restoration of \$607 million in subventions (a \$358 million cut).

### Notable Revenue and Expenditure Trends

A summary of particularly salient trends in local government finance, detailed in this chapter is presented below:

#### Counties

- County general purpose revenue has declined an inflation adjusted 16% between 1977-78 and 1983-84.
- State aid accounted for 23% of total county revenue in 1977-78 and had increased to 33% in 1981-82.
- Public protection and debt service expenditure are the only county expenditure categories which have experienced an inflation-adjusted increase in support since the passage of Proposition 13.

#### Cities

- City general purpose revenue has declined an inflation-adjusted 9.1% between 1977-78 and 1983-84.
- City reliance upon the state for general purpose revenues has declined since 1977-78: state subventions made up 12% of city general purpose revenues in 1977-78, and 6% in 1983-84.
- City expenditures for public safety have increased more rapidly than any other expenditure category. Most categories have suffered a real (inflation-adjusted) decline in support.

#### Special Districts

- Enterprise revenue has increased 15% in real terms since 1977-78 while non-enterprise revenue has declined 6% when adjusted for inflation.
- The number of special districts has increased less than 1% since Proposition 13 passed.

## I. COUNTIES

California's 58 counties are the focal point in the current state-local fiscal debate. Counties are intimately involved with the state by virtue of their role as the state's legal "subdivisions": the state has almost unilateral authority (though certain constitutional limitations exist) to regulate their powers and duties. Of the state's various local entities, counties depend most on the state for revenues, and possess the most limited flexibility to decide how their revenues are expended.

A. Revenue-raising Authority

Because Article XIII A of the State Constitution (Proposition 13) limits the local countywide property tax rate to 1% of full cash value plus rates for pre-1978 voter-approved indebtedness, counties no longer possess flexibility and control over a large, stable and growing source of revenue. Prior to Proposition 13, counties could protect their revenue base from reductions in state and federal aid or downturns in the economy by raising property tax rates; the post-13 era provides few means for adapting to cuts in their overall revenue base, save reducing expenditures.

Counties have little independent general revenue-raising authority; the Legislature has granted them the power to impose hotel and motel taxes in their unincorporated areas, business license taxes solely for the purpose of regulation, and several taxes specified in statute in lieu of the property tax (e.g., timber yield and cotton). Additionally, Article XIII A grants counties the authority to raise or impose special taxes (i.e., taxes used for a specific purpose) with a two-thirds vote of the electorate. However, this authority has yet to be tested because of legal

hesitations, because all local agencies are prohibited (either by statute or the Constitution) from imposing most taxes presently levied by the state, and because obtaining a two-thirds vote of the electorate for new taxes in other jurisdictions has proven to be quite difficult.

Counties may also raise revenues through charging fees for services, licenses, permits and franchises and by imposing fines, forfeits and penalties. Effective January 1, 1984, AB 151 (Hannigan), Chapter 295, Statutes of 1983, will allow counties to adjust most fees where state law has fixed the fee or charge. (Legislative Counsel has opined that regulatory fees and user charges are not "special taxes" under the provisions of Article XIII A if they are limited to the cost of the service or regulatory activity.) County benefit assessment powers are discussed more fully in Chapter V.

#### B. Revenue Trends Since Proposition 13

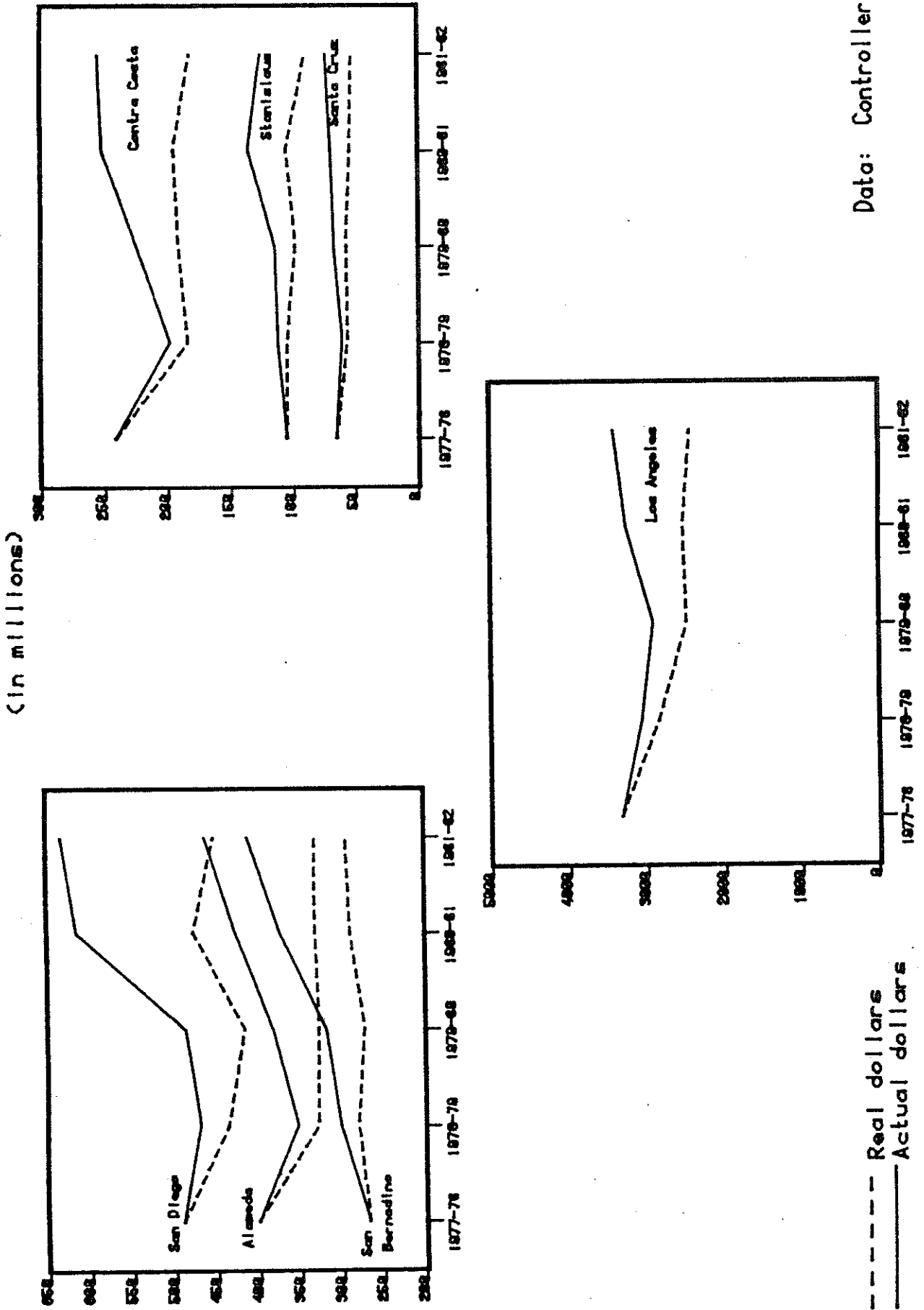
1. Total County Revenue -- Clearly the most significant change in the makeup of county revenue sources since the passage of Proposition 13 has been a dramatic decrease in property tax revenues and a large increase in shared state revenue. In 1977-78, the year prior to the passage of Proposition 13, county property tax revenues totalled \$3.01 billion, representing 34% of general revenues excluding county-owned enterprises such as hospitals, parking structures and golf courses. In 1981-82, the last year for which complete figures are available, property tax revenues totaled \$2.37 billion, or 22% of total county revenues, a 21% actual decline over 1977-78, and a 44% inflation-adjusted decline. During the same period, state aid to counties increased from \$2.09 billion in 1977-78 to \$3.58 billion in 1981-82, a 71% for inflation. State aid accounted for 23% of total county

revenue in 1977-78; this percentage has increased to 33% in 1981-82. Other high growth revenue sources after adjusting for inflation during this period, although relatively small portions of total county revenue, include fines, forfeits and penalties, which grew 27%, revenue from use of money or property (interest, rent, royalties), which increases 119%, and other revenue (sale of fixed assets, revenues from discontinued district, etc.), which grew 24%. Total county revenues (excluding county-owned enterprises) increased by 22% between 1977-78 and 1981-82, but actually declined by 13% when adjusted for inflation.

On an individual county basis, the numbers vary significantly. Figure 1 depicts the total general revenue for seven California counties in both actual and real (adjusted for CPI) dollars from 1977-78 through 1981-82. As the figure illustrates, of the seven counties, San Bernardino is the only one which has experienced an increase in real revenue in the years since Proposition 13. Los Angeles County has suffered the most, as its revenue has increased by only 3% in actual dollars and has decreased 27% when adjusted for inflation. (The Los Angeles figures are somewhat skewed, however, by a large transfer of revenues from the county general fund to an enterprise fund in 1978-79).

No single factor seems to explain why some counties have experienced greater revenue declines than others. Five of the seven counties have experienced revenue declines at a faster rate (when adjusted for inflation) than the overall statewide rate. The two counties which have experienced the largest revenue declines among the seven, Los Angeles and Contra Costa, were more dependent upon property tax revenue prior to the

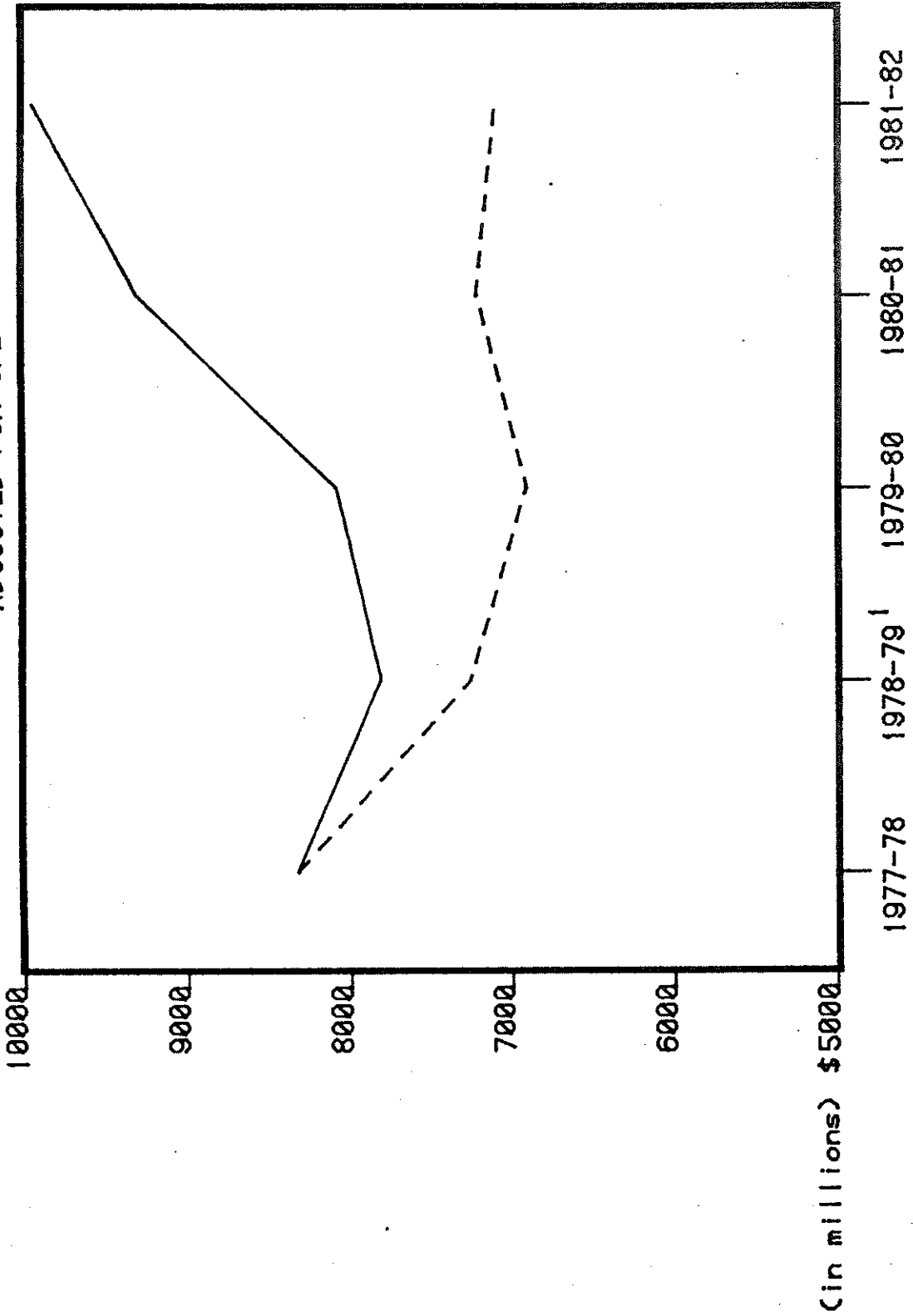
INDIVIDUAL COUNTY REVENUE, 1977-78 THROUGH 1981-82  
IN ACTUAL AND REAL CADJUSTED FOR CPI> DOLLARS



passage of Proposition 13 than the other five (35% and 34% of total revenue, respectively). However, the county least dependent upon the property tax prior to Proposition 13, Santa Cruz (28% of total revenue), has also experienced a fairly rapid decline in inflation-adjusted revenue.

Figures 2 and 3 on the following pages illustrate total county revenue growth from 1977-78 through 1981-82 and compare county revenue sources during the same period. Table 1 compares revenue sources in 1977-78 and 1981-82. All four figures and tables represent county revenues excluding county-owned enterprises and bond funds.

TOTAL COUNTY REVENUE, 1977-78 THROUGH 1981-82  
ADJUSTED FOR CPI

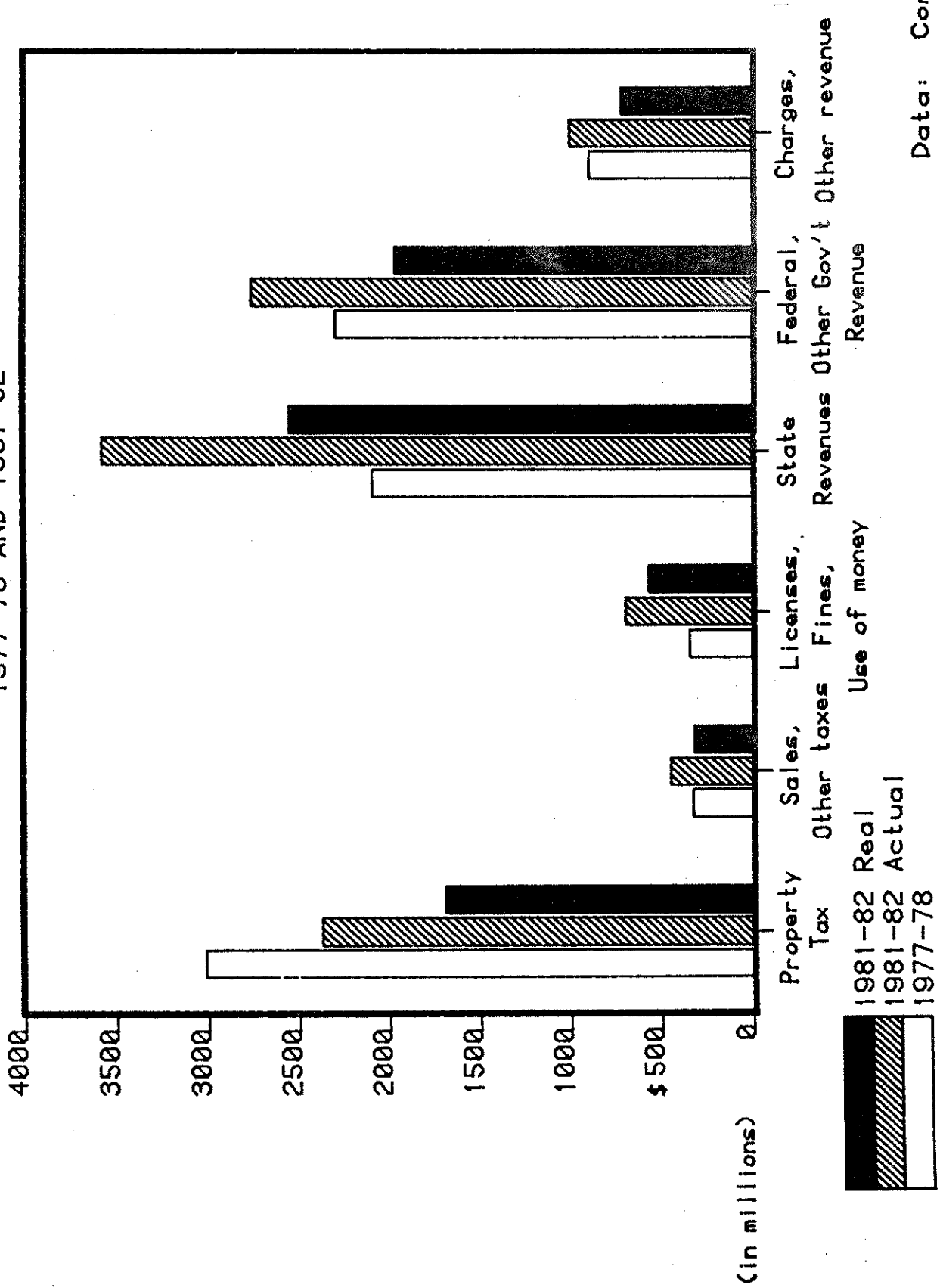


Data: Controller

--- Real dollars  
— Actual dollars

1. \$638.8m. transferred from general to enterprise operations

COMPARISON OF COUNTY REVENUE SOURCES  
1977-78 AND 1981-82



Data: Controller

TABLE 1

Comparison of County Revenue Sources<sup>1</sup> - 1977-78 and 1981-82  
(Excluding County-owner Enterprises)

Source	77-78 Revenue (in millions)	Percent of Total Revenue	81-82 Revenue (in millions)	Percent of Total Revenue	81-82 Revenue Adjusted for Inflation <sup>2</sup> (in millions)	Percent of Total Revenue	Percent Change (77-78 to 82-81)	Percent Change Adjusted for Inflation <sup>2</sup>
Property Tax	\$3,013.5	33.6%	\$2,374.5	21.7%	\$1,693.3	21.7%	-21.2%	-43.8%
Sales Tax	242.6	2.7	310.0	2.8	221.1	2.8	27.8	- 8.9
Other Taxes <sup>3</sup>	86.1	1.0	138.1	1.3	98.5	1.3	60.4	14.4
Licenses, Permits Franchises	77.8	.9	98.0	.9	69.9	.9	26.0	-10.0
Fines, Forfeits Penalties	93.7	1.0	167.1	1.5	119.2	1.5	78.3	27.2
From Use of Money or Property	173.3	1.9	532.7	4.9	379.9	4.9	205.4	119.2
From Other Government Agencies:								
State <sup>4</sup>	2,093.4	23.3	3,577.9	32.6	2,551.4	32.6	70.9	21.9
Federal	2,285.8	25.5	2,743.1	25.0	1,956.1	25.0	20.0	-14.4
Other	10.1	.1	14.9	.1	10.6	.1	47.5	5.0
Charges for Current Services	796.0	8.9	832.1	7.6	593.4	7.6	4.5	-25.5
Other Revenue	98.3	1.1	171.1	1.6	122.0	1.6	74.1	24.1
TOTAL	\$8,971.7	100.0%	\$10,959.5	100.0%	\$7,815.4	100.0%	22.2%	-12.9%

<sup>1</sup>Includes City and County of San Francisco.

<sup>2</sup>Using the Implicit Price Deflator for Gross National Product.

<sup>3</sup>DOF estimate, excluding taxes levied by San Francisco which are not available to other counties.

<sup>4</sup>Includes Homeowner, Business Inventory subventions.

Source: Judi Smith,

Assembly Ways and Means

2. General Purpose Revenues -- General purpose revenues -- those funds which are not restricted to a specific use -- provide a meaningful measure of the revenue over which a jurisdiction has some flexibility in determining program priorities. (Functional revenues, on the other hand, are those raised either for a direct service through charges and fees, or earmarked for a specific purpose by external requirements such as grant conditions or bond sale agreements.) Difficulties arise when comparing the growth of county general purpose revenues between 1977-78 and 1981-82 due to state assumption of a large share of county health and welfare costs, which were previously paid out of general purpose revenues, in AB 8 of 1979.

By adjusting for the county costs of state-defined health and welfare programs, general purpose revenues show a slower rate of growth than total revenues, indicating that programs funded from general purpose revenues (e.g., recreation, general government) have fared less well than state mandates (e.g., welfare, court costs) and other county programs. While total revenues declined 13% when adjusted for inflation between 1977-78 and 1981-82, general purpose revenues declined by 16%.

Table 2 illustrates county general purpose revenues from 1977-78 through 1983-84, and Figure 4 compares total general purpose revenues adjusted by state-defined health and welfare programs for those years, and adjusted for inflation.

TABLE 2  
COUNTY GENERAL PURPOSE REVENUE  
(in millions of dollars)

	1977-78	1978-79	Percent Change	1979-80	Percent Change	1980-81	Percent Change	1981-82	Percent Change	1982-83 <sup>a</sup>	Percent Change	1983-84 <sup>a,b</sup>	Percent Change
Property Tax <sup>c</sup>	\$3,210.9	\$1,394.4	-56.7%	\$1,842.5	32.1%	\$2,238.2	21.5%	\$2,475.8	10.6%	\$2,769.8	11.9%	\$2,952.2	6.6%
Sales Tax	192.5	220.4	14.5%	255.4	15.9%	272.7	6.8%	289.5	6.1%	282.2	- 2.5%	310.7	10.1%
Other Taxes <sup>d</sup>	74.0	83.8	13.3%	89.4	6.6%	84.0	- 6.0%	75.2	-10.4%	73.5	- 1.9%	84.3	14.3%
State Subventions	282.7	740.7	--	386.9	-47.8%	397.2	2.7%	362.1	- 8.8%	370.1	2.2%	387.1	4.6%
Fines and Penalties	86.4	95.5	10.6%	104.5	9.3%	120.9	15.7%	144.7	19.7%	161.1	11.3%	179.5	11.4%
Use of Money and Property	174.4	265.4	52.2%	368.9	39.0%	375.2	1.7%	481.0	28.2%	366.8	-23.7%	290.5	-20.8%
Federal Revenue Sharing	319.0	314.2	- 1.5%	319.3	1.6%	266.7	-16.5%	268.0	.5%	268.0	--	268.0	--
Other Revenue	83.0	82.0	- 1.1%	81.7	- .4%	118.2	44.7%	98.8	-16.4%	92.8	- 6.1%	92.8	--
Subtotal	\$4,422.0	\$3,196.4	-27.7%	\$	7.9%	\$3,873.2	12.3%	\$4,195.1	8.3%	\$4,384.3	4.5%	\$4,565.1	4.1%
Less State-Defined Health and Welfare Programs	1,477.1	506.4	-65.7%	461.6	- 8.8%	552.3	19.7%	663.0	20.0%	675.3	- 1.8%	668.8	- 1.3%
TOTAL	\$2,944.8	\$2,690.1	- 8.6%	\$2,986.9	11.0%	\$3,320.9	11.2%	\$3,532.1	6.4%	\$3,709.0	5.0%	\$3,898.3	5.1%

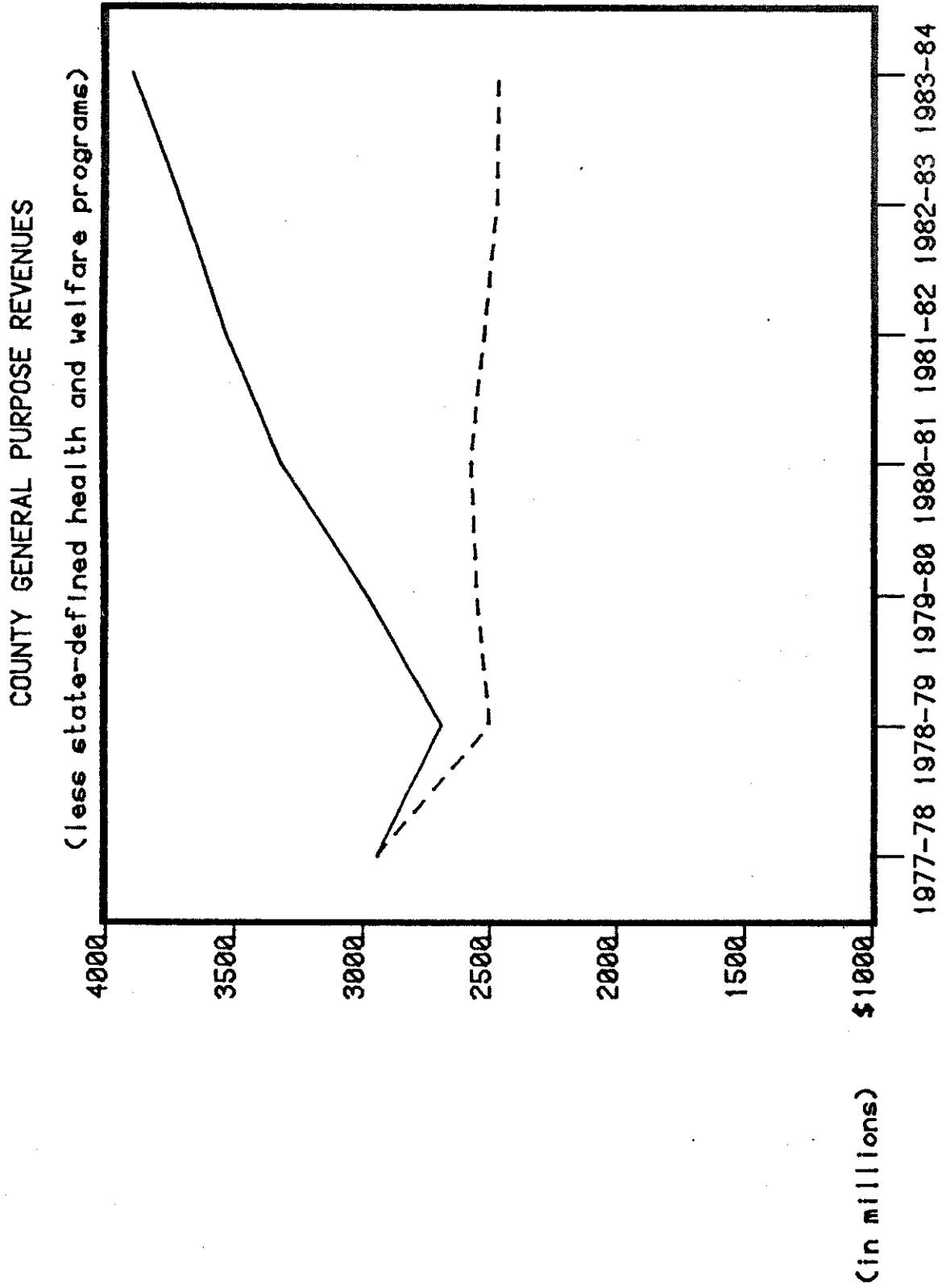
<sup>a</sup> Estimate.

<sup>b</sup> Reflects the Budget as adjusted by AB 895 (Chapter 983), Statutes of 1983.

<sup>c</sup> Includes HOE and B.I. Subvention.

<sup>d</sup> Does not include San Francisco municipal taxes which cannot be levied by other counties.

Source: Judi Smith, Assembly Ways and Means Committee



----- Real dollars  
\_\_\_\_\_ Actual dollars.

Data: Judi Smith,  
Assembly Ways and Means

Figure 4

### C. Expenditures

Counties typically play three distinct roles in the provision of services:

1. State Administrative Units

Counties run the trial courts, elections, and health and welfare programs;

2. Service Deliverers

Counties act as municipalities in their unincorporated areas by furnishing community services such as local parks, animal control and fire protection;

3. Countywide Agencies

Counties provide some countywide local services such as airports, sanitary waste dumps and libraries.

Generalizations about the nature of county expenditures can be difficult due to the variance in demographics, needs and service delivery structures between individual counties; however a large percentage of their functions are determined by the state and federal governments through mandated programs.

### D. State-mandated Local Programs

State mandates -- services and benefits which local agencies must provide pursuant to state law -- have always caused a certain amount of friction between the state and local governments in general, and between the counties as the state's administrative units, in particular. With the declining fiscal condition of counties and the state in the past several years, this friction has increased markedly.

Since 1972, the state has been statutorily required to reimburse local agencies for the full costs of new state-mandated programs. SB 90 (Gregorio) of 1977 established a claims procedure through the State Board of Control whereby local agencies may receive reimbursement for mandated costs even if the initial mandated legislation failed to include an appropriation for that purpose (the so-called SB 90 claims process). Article XIII B of the State Constitution (Proposition 4), adopted in November 1979, made state reimbursement to local governments for new and increased state-mandated costs a constitutional requirement, with specified exceptions. This reimbursement can be achieved either through a direct appropriation or through the SB 90 claims process.

Local governments have been increasingly critical of the Legislature for what they claim is a disregard of both SB 90's reimbursement provisions and the California State Constitution, Article XIII B. Of the nearly 2400 mandate bills passed since 1975, only 106 have contained appropriations. Additionally, in the past several years the Legislature has deleted revenue from bills containing appropriations for SB 90 claims approved by the Board of Control.

State (and federal) mandates severely limit county flexibility to determine funding levels of particular programs. Health and welfare programs have many eligibility standards and benefit minimums which are determined at the state or federal levels; court costs, probation services and even jail capacity are determined in large part at the state level. Health, welfare and law enforcement programs make up almost 80% of each county budget, yet when counties must reduce expenditures, their flexibility to do so in these areas is severely restricted.

State-mandated local programs have been divided into two administrative categories for purposes of definition: "capitated" or "capped" programs, which are limited by the state in either the number of clients to be served or the amount of funds appropriated; and, "entitlement" programs, which are "unlimited". Capped programs include those for alcohol and drug abuse, county health services, medically indigent adults, local mental health and county public health. Entitlement programs include Medi-Cal, SSI/SSP, AFDC, IHSS and general relief. The primary distinction between the two categories is that capped programs theoretically lend themselves to more flexibility in administration (e.g. method of service delivery, eligibility, etc.), whereas entitlement programs are more structured in their benefit levels and eligibility requirements. This categorization of county/state programs has been used during discussions this legislative session on program realignment between counties and the state.

#### E. Expenditure Trends

Because county flexibility over state-mandated local programs is quite limited, expenditures for those categories of expenditures over which counties have a significant amount of control have grown very slowly or have actually been reduced since the enactment of Proposition 13. Programs over which local control is limited -- health, welfare and, to a lesser extent, law enforcement -- have grown more rapidly or have declined at a slower rate than county discretionary programs.

Difficulties arise in making expenditure comparisons between pre- and post-Proposition 13 years due to the massive 1979 AB 8 funding shift, in which the state assumed all of the county share of SSI/SSP and Medi-Cal costs and a major portion of county costs of AFDC and county health programs. Additionally, \$856 million in

county expenditures for hospitals has been transferred from county general purpose revenues to enterprise funds, making comparison of health and sanitation expenditures somewhat difficult. Health and sanitation expenditures have grown very slowly primarily because of the transfer in funds and thus do not accurately reflect actual growth. The Controller's reports are the only statewide compilation of local expenditure information, and the 1981-82 data used to compile Table 3 and Figure 5 are the most recent available.

In comparing 1977-78 to 1981-82 expenditures, the most notable change in spending is a 39% reduction in general government expenditures, when adjusted for inflation. General expenditures comprised 19% of total 1977-78 expenditures (excluding enterprises); that figure had declined to 13% in 1981-82. During the same period, expenditures for public protection increased an inflation-adjusted 16%, and their relative importance in county expenditures increased from 19% to 26%. Public protection and debt service expenditures are the only county expenditure categories which have experienced a real (inflation-adjusted) increase in support since the passage of Proposition 13.

Table 3 and Figure 5 illustrate the growth and comparative importance of the various categories of general county expenditures from 1977-78 to 1981-82.

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Table 3 and Figure 5 illustrate the growth and comparative importance of the various categories of general county expenditures from 1977-78 to 1981-82.

TABLE 3  
Comparison of County Expenditures - 1977-78 and 1981-82  
(Excluding County-owner Enterprises)

General County	77-78 Revenue (in millions)	Percent of Total Revenue	81-82 Revenue (in millions)	Percent of Total Revenue	81-82 Revenue Adjusted for Inflation <sup>1</sup> (in millions)	Percent of Total Revenue	Percent Change
							Adjusted for Inflation
General Government	\$1,515.6	18.7%	\$1,305.0	13.3%	\$ 930.6	13.3%	-38.6%
Public Protection	1,559.4	19.3	2,528.5	25.9	1,803.1	25.9	15.6
Public Ways and Facilities	387.7	5.0	469.0	4.8	334.4	4.8	-13.7
Health and Sanitation <sup>2</sup>	1,122.5	13.9	974.5	10.0	694.9	10.0	*
Public Assistance	3,247.7	40.2	4,217.4	43.1	3,007.4	43.1	-7.4
Education	105.2	1.3	119.9	1.2	85.5	1.2	-18.7
Recreation and Culture	105.8	1.3	126.7	1.3	90.3	1.3	-14.7
Debt Service	20.1	.3	42.7	.4	30.4	.4	31.2
TOTAL	\$8,064.0	100.0%	\$ 9,783.7	100.0%	\$6,976.6	100.0%	-13.5%

<sup>1</sup>Using the Implicit Price Deflator for Gross National Product.

<sup>2</sup>\$856 million was transferred from general county operations to enterprise operations in 1978-79; the revenue figures for this category therefore do not accurately reflect growth.

Data: Financial Transactions Concerning Counties, 1977-78 and 1981-82, Controller.

Figure 5

