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State-Local Fiscal Conflicts in California: From Proposition 13 to Proposition 1A

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Contents

Summary iii

Acknowledgments vii

Introduction 1

STATE-LOCAL BALANCE OF POWER AFTER PROPOSITION 13 3
State Bail-Out Legislation Establishes a Fiduciary Relationship 3
ERAF Ends the State Government's Fiduciary Relationship 5
School Finance and the State-Local Relationship 6

LOCAL GOVERNMENTS SINCE PROPOSITION 13 9
County Finance Since Proposition 13 13
Cities After Proposition 13 15

CONFLICTS REACH THE BREAKING POINT: THE PATH TO PROPOSITION 1A 19
Growth Concerns Come to the Forefront 19
A Window Opens for Reform of the State-Local Relationship 20
Local Governments Enter a New Age: Proposition 1A 22

Conclusion 27

References 31

Summary

Over the past several decades, intergovernmental relations in California have been characterized by conflict, primarily over fiscal issues. The disputes trace back to Proposition 13 and subsequent state ballot initiatives that have fiscally constrained the state and local governments.[1] By giving the state government more control over local revenue and also limiting state and local taxing and spending power, the voter measures have engendered a "zero-sum" political atmosphere in which fiscal considerations have dominated intergovernmental policymaking. However, many of the problematic aspects of the post-Proposition 13 local fiscal system have been the product not of ballot initiatives but of government action. Within voter-imposed fiscal constraints, California's state and local governments have had substantial room to shape fiscal and governance outcomes.

This paper traces the evolution of the state-local relationship in California since Proposition 13 was approved by state voters in 1978. It considers the externally-imposed constraints and pressures that have most influenced the state-local relationship, few of which are actually unique to California. Although voter-imposed fiscal constraint looms large in this picture, other factors also have been important, including court-imposed and voter-imposed mandates for equitable education spending, environmental mandates, and conflicting pro-growth and anti-growth development pressures.

The paper considers how California's governments have adapted to, but also worked to circumvent, the constraints. As state-local finance became more intertwined, it also became more convoluted and contested. In the wake of Proposition 13, the state government adopted ad hoc measures to reorganize local finance that helped smooth over a difficult transition period. However, over time, the measures became ossified, and the result was a fiscal system opaque to voters, many local officials, and fiscal experts alike. The new system disconnected local revenue capacity from service needs and set dysfunctional incentives for local development choices, in particular by disfavoring housing.

During the early 1990s, the state government compounded these structural problems with political problems, when it diverted property tax revenue away from local governments to schools to help resolve a state budget crisis. Local governments grew so resentful by the end of the decade that intergovernmental negotiations on topics from housing and land use policy to health and welfare programs were stymied by the fiscal impasse.

Conflict also increased among local governments after Proposition 13, as competition and entrepreneurship intensified to maximize revenue sources over which local governments maintain control. Fiscal constraint deepened differences between city and county revenue structures and intensified conflicts between cities and counties. Fiscal constraint also eroded community-wide general purpose taxing capacity for both of these types of local government.

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[1] This paper considers the relationship between the state government and general-purpose local governments, namely cities and counties. General-purpose governments provide a range of services in response to voter preferences. Other local government entities such as school districts and special districts provide *specific* services; many special districts are dependent agencies of cities or counties.

By the 1990s, state leaders had to contend with consequences of local land use and development choices induced by the post-Proposition 13 fiscal regime. They worried in particular whether fiscal constraint had led local governments to limit housing production, especially in older communities. As a growing state population strained infrastructure facilities and natural resources, state leaders also looked to land use policy as one lever in more coordinated development strategies. But any efforts to redirect local land use policy met with stiff resistance from local governments, still angry because of the state government's earlier diversion of property tax revenue toward schools. Thus, inasmuch as the post-Proposition 13 fiscal regime created dysfunctional incentives for land use and development, it also undermined the chances of altering the incentives.

By the late 1990s, the governor and legislative commissions were calling for an overhaul of the local government finance system for the sake of governmental accountability, public engagement, and economic development. Most major reform proposals would have operated within the parameters of voter-imposed fiscal constraints, underscoring the conclusion that there was considerable room to improve the state-local relationship even within those constraints. Reformers sought to address problems caused not by the voter measures themselves, but instead by the fiscal measures the state government took in response.

The reform effort of the late 1990s fizzled out, however, producing no major changes. Policymakers could not resolve certain fundamental dilemmas—in particular, how to reconcile policy-driven reform with local governments' insistence on revenue neutrality (no net revenue loss for any jurisdiction). Within a zero-sum fiscal framework, reforms that would create new winners and losers proved hard to adopt.

A major reform of the state-local relationship did occur in 2004, although not in response to the reform deliberations. Instead, when local revenue was threatened once again during a state budget crisis, local governments took matters into their own hands. They mounted a state ballot campaign that resulted in the passage of Proposition 1A, a constitutional amendment that protects rates and/or allocation methods for major local revenue sources—property taxes, sales taxes, and vehicle license fees. Proposition 1A represents a new stage in the state-local fiscal power struggle in which local governments acted collectively to regain a portion of the autonomy they had lost after passage of Proposition 13. By preventing further "raids" by the state government on local revenue, Proposition 1A also settled the sorest point in the state-local conflict. This outcome ended the policy impasse on related topics such as land use and housing reform.

However, Proposition 1A, no matter its perceived necessity among local government advocates, also extended the dynamics of the state-local fiscal power struggle. Faced with an imminent threat, local governments found it easier to unite to protect the existing finance system, in spite of its flaws, than it would have been to devise a new one. Proposition 1A failed to resolve a number of problematic aspects of the fiscal system that had been the focus of reform proposals. Local governments gained no new local revenue-raising authority to enable them to better connect service needs to revenue capacity. On the contrary, the measure placed the state's rigid, arcane local finance system into the constitution, which will make future efforts to reorganize the system even more difficult. Furthermore, by keeping in place dysfunctional fiscal incentives for local land use, Proposition 1A will hamper efforts to improve development

planning at a time when the state faces substantial challenges on this front. Thus, Proposition 1A reinforces the troubling conclusion that some of the more dysfunctional constraints on the local fiscal system have been imposed by government itself.

For this reason, a central focus of this paper is not just how individual governments have reacted to external factors (even considering reactions in the aggregate), but also how the state and local governments – the latter acting collectively through lobbying organizations – have renegotiated basic terms of the relationship in response to external constraints. Focusing on central debates in the state-local power struggle – the intergovernmental story within the wider context of changing conditions – helps elucidate how and why government itself shapes outcomes. The protracted state-local fiscal drama of recent decades shows that the intergovernmental power struggle can trump many other considerations.

State-local fiscal conflict in California has gained little media or public attention. The issues debated, such as how to allocate property and sales tax dollars among local governments, can seem esoteric. Reform goals such as enhancing fiscal "transparency" or local government "responsiveness" can seem highly abstract. But consequences are evident in such areas of local government responsibility as housing regulation, community health and welfare programs, and governance of K-12 schools. In these policy areas, the disconnect that has been introduced between local revenue-raising authority and program responsibility aggravates accountability problems and skews incentives in a fashion counterproductive to certain state policy goals. When the fiscal system does not promote policy goals, government cannot perform as effectively as it should.

What is more, the protracted state-local power struggle stalled progress in various policy arenas for more than a decade. The very aspects of the state-local relationship that gave rise to calls for change by the late 1990s—in particular, competition for resources and lack of clear guidelines to clarify intergovernmental responsibilities and authority—also made it more difficult to achieve. With fiscal control the main focus of debate in the state-local relationship, policymakers paid less attention to intergovernmental issues that could actually help clarify fiscal responsibilities, such as promoting more efficient development patterns and infrastructure investment.

Intergovernmental relations characterized by fiscal conflict and confusion rather than policy focus and coordination erode public trust in government, even if only indirectly through lack of effective, concerted action. The effectiveness and welfare of state and local governments is a collective, not just individual, concern. To help restore trust, California governments will need to move beyond a fight over fiscal resources and focus instead on addressing policy goals and objectives to enhance California's future.

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Introduction

Tension between the state and local governments in California is nothing new (Silva and Barbour, 1999). It is probably inevitable, because by law, local governments are "creatures of the state," but they have long sought to carve out a degree of independent political and fiscal authority.

> The ability of local governments to act on their own behalf, or "home rule power," ends where the state expresses an interest in the uniform application of a statewide policy interest. And therein lies the dilemma—where should the line be drawn? (Silva and Barbour, 1999, p. 1)

Until Proposition 13 was passed by state voters in 1978, the framework of the state-local relationship had been stable since the early 1900s, when local government reformers established two key legal principles: home rule power and the separation of revenue sources (Silva and Barbour, 1999). Home rule power—exerted by cities within their borders and by county governments in unincorporated areas—includes considerable discretion over land use decisions and the authority to build and operate public works. Local fiscal authority—the ability to levy taxes locally and set rates that reflect local preferences for services—has long been viewed as a critical underpinning of home rule. According to this principle, political accountability is enhanced when government responsibilities are aligned with the fiscal power needed to carry them out, and voters can adjust policy outcomes in response to changing needs and preferences. Local fiscal authority had been secured in 1910 through passage of a state ballot measure known as the Separation of Sources Act. The measure granted local government exclusive control over property taxes, the main public revenue source at that time.

The property tax remained the mainstay of local public finance until Proposition 13. More than just providing a stable source of local income, the property tax has appealed to theorists because it gives a highly visible tax price for public services and links the cost of services to tangible economic development benefits in a community (Berman, 2003). The visibility of the property tax also made it a target for voter frustration about government spending. Even as Americans generally rate confidence in local government higher than in the federal or state governments, they also consistently rate the property tax as their least favored after the federal income tax (Cole and Kinkaid, 2006).

Although it is widely understood that Proposition 13 limited property tax receipts,[2] few Californians understand that the measure also profoundly undermined local government fiscal autonomy. Proposition 13 set a uniform statewide property tax rate and transferred control of allocation to the state government. It thereby essentially transformed the property tax from a locally-controlled revenue source to a state-controlled resource, and in the process, substantially undid the separation of sources doctrine. Understanding this development is critical to understanding why California's state and local governments have spent the last thirty years

[2] Proposition 13 limited the general property tax rate to 1 percent of property value and reassessment to no more than 2 percent annually, except for new ownership or construction. It mandated a two-thirds vote in both state legislative houses to approve state tax increases and a two-thirds local popular vote for local special taxes (which were not defined).

locked in a conflict about local fiscal autonomy. Local governments have sought to re-establish the autonomy from state control they enjoyed before 1978.

Although Proposition 13 profoundly reshaped the state-local government relationship, many of its most important effects emerged only over time and indirectly through governments' responses to the measure. The first chapter of this paper considers how the state government reshaped the terms of the state-local relationship in the first two decades after Proposition 13. The state government's actions were conditioned by various pressures, including, in particular, legal mandates for equitable education spending.

The second chapter picks up the story at the local level, evaluating how individual governments adapted to the new constraints and the aggregate effects on intergovernmental relations. The third chapter returns to a state-level perspective, from which, by the 1990s, state leaders had to contend with negative consequences of those local government responses. The chapter discusses a state-level reform effort that emerged by the late 1990s to systematically redesign the local finance system, and why it failed to achieve more than marginal changes.

Finally, the chapter traces the events that led to the passage of Proposition 1A in 2004. Although that measure substantially altered the terms of the state-local power balance, it did not accomplish all that reformers had hoped for. For example, although many had called for a restoration of the underlying principles of the separation of sources doctrine, Proposition 1A represents something more like the opposite.

The paper concludes by discussing consequences and implications of the failure of the state and local governments, thirty years after passage of Proposition 13, to address certain shortcomings in the local government fiscal system—in particular, a disconnection between fiscal responsibility and policy authority that undermines some state policy goals.

State-Local Balance of Power After Proposition 13

The passage of Proposition 13 launched a thirty-year struggle between the state and local governments in California about how to reorganize local finance. By setting a uniform statewide property tax rate and transferring control of allocation to the state government, Proposition 13 substantially undid the separation of sources doctrine. However, the protracted struggle that followed would not have occurred if Proposition 13 had instituted a new local fiscal system to replace the old. Instead, by providing the state government with the power to establish the system for allocating property taxes, Proposition 13 ensured that the state government's choices would reshape the state-local relationship as much as gaining the authority per se.

This chapter traces how state government chose to exercise its new authority, and the consequences for the state-local relationship. It also traces another set of developments that had a major influence on the outcome, namely, court-imposed and voter-imposed mandates on the state government related to K-12 school spending.

State Bail-Out Legislation Establishes a Fiduciary Relationship

The immediate effect of Proposition 13 on local tax receipts was dramatic: Property tax revenue statewide dropped by more than half (Silva and Barbour, 1999). Because of Proposition 13, local own-source revenue (revenue raised locally, a measure of fiscal independence) dropped as a share of total government revenue in California, while state own-source revenue rose (Figure 1).[3] Before Proposition 13, California's fiscal system reflected its strong "home rule" tradition; afterwards, the state's basic fiscal composition resembled the rest of the nation's. In 1977, property taxes formed 28 percent of state and local general revenue in California, and they were controlled and levied locally. Since Proposition 13, property taxes have formed 13 to 15 percent, and the revenue is state-controlled and highly contested.

The profound changes wrought by Proposition 13 were not immediately apparent, however, to voters or even to the state and local governments. That is because in the immediate aftermath, the state government used its budget surplus to fund a relief package that smoothed over the transition to the new fiscal regime. State legislators passed emergency "bailout" legislation, Senate Bill 154 (SB 154), a few weeks after Proposition 13 was approved. SB 154 attempted to restore the status quo ante for local governments. Property tax revenue would be allocated based on proportional shares in place before Proposition 13 for property tax revenue generated in a given area, divided among the county, city, special districts, and schools serving the area. Multiplied across all jurisdictional configurations across the state, this method produced an arcane system of local finance. SB 154 also provided fiscal relief, replacing most of the lost revenue to cities, counties, and special districts. The state government's cost of K–12 education increased by the amount of the shift. Assembly Bill 8 (AB 8), enacted in 1979, made

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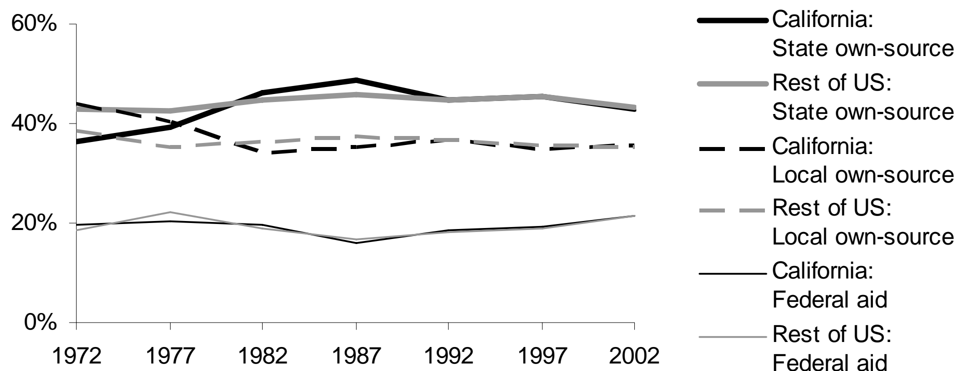
[3] Calculations in the paragraph and in Figure 1 are from data from the U.S. Census of Governments (COG), *Annual Survey of State and Local Government Finances*, multiple years. Pivot data tables produced by the Public Policy Institute of California based on COG data are available at http://www.ppic.org/main/datadepot.asp. General revenue excludes insurance trust revenue, utility charges, and liquor charges.

principal features of SB 154 permanent, and assured that revenues from increases in assessed valuation would accrue to the communities in which the growth occurred.[4]

Figure 1
Revenue by Level of Government as Share of State and Local General Revenue[5]



The bailout legislation glossed over the profound alteration of the state-local relationship that had occurred with Proposition 13. In adopting the AB 8 system, the state government reassured local governments by signaling that it would act something like a fiduciary agent: The state would restore a large portion of the lost funds and allocate them on the traditional basis, namely local voter preferences. However, over time it became clear that the AB 8 system had not restored the status quo ante; instead, it had restored only a false facsimile of the traditional system. As communities grew and developed, their AB 8 allocation shares remained basically frozen in time, so that today Californians have become locked into community revenue structures reflecting 30-year-old voter decisions. The rationale for the separation of sources depends on benefits derived from adjusting local revenue levels in response to local service needs and preferences. The AB 8 system, however, disconnected local revenue from such needs and preferences. What was in 1978 a small, low-tax suburb dependent on the county government or special districts for services such as fire protection, may today have grown into a crowded city with diverse service needs, now more fiscally capable of providing them locally. However, the rigidity of the AB 8 system has made it much harder for such a city to reorganize services.

Could the state government have created an allocation system that better preserved the separation of sources doctrine? Such a system is challenging in concept, because the state government is ill equipped to allocate revenue in response to myriad local preferences and conditions. In the immediate aftermath of Proposition 13, the dire need for an expedient solution to stabilize local revenue made such an endeavor politically infeasible. However, by

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[4] Legislators made some further modifications to the AB 8 system. For example, in 1987, some property taxes were shifted from counties to selected cities that had either no shares or very small shares of the tax.
[5] Applying the COG convention, property taxes are considered local own-source revenue because they are levied locally. However, the constraints imposed by Proposition 13—and subsequent manipulation of property tax revenue by the state government—means that this calculation tends to over-represent locally-controlled revenue in California.

the 1990s, as the shortcomings in the state's approach became more apparent, many reformers advocated a restoration of fundamental principles of the separation of sources doctrine. Reformers even believed this could occur *within* the parameters of Proposition 13.

ERAF Ends the State Government's Fiduciary Relationship

Local government complacency about the post-Proposition 13 system of finance came to an end when the state's economy slid into severe recession during the early 1990s. Facing court-imposed and voter-imposed constitutional mandates related to education spending (discussed in the next section), the state government balanced its own budget at the expense of local governments, especially counties. This action signaled the start of a second, highly contentious stage in the post-Proposition 13 state-local relationship, during which the full measure of Proposition 13's effects came home for local governments.

In fiscal years 1992–93 and 1993–94, the state government ordered county auditors to transfer about 25 percent of property taxes (over $3.5 billion) to schools that before had been allocated to cities and counties, thereby reducing the state general fund commitment to K–14 education. Transferred revenue was placed into a so-called Educational Revenue Augmentation Fund (ERAF) in each county; the action came to be known as the "ERAF shift." In essence, the shift undid post-Proposition 13 relief to cities and counties, reducing the non-education share of property taxes from 65 to 48 percent (Legislative Analyst's Office, 2004b). The amount of funds transferred from each jurisdiction reflected its AB 8 share.

The state replaced about half of the lost revenue with funds earmarked for public safety.[6] However, the formulas for allocating new revenue did not match the AB 8 system, and as a result, differences in net tax shift losses had only a distant relationship with earlier post-Proposition 13 relief.[7] The Legislative Analyst's Office estimated that 13 of 58 counties and about 20 percent of cities actually came out better off than before ERAF (Legislative Analyst's Office, 1999).

With ERAF, the state government shifted its responsibility as fiduciary agent away from local governments toward schools, understandable given constitutional mandates for school spending imposed by the courts and voters (discussed later in more detail). Local governments, alarmed that the governor and legislature had resolved state budget problems at their expense, grew resentful when lost funds were not replaced after the fiscal outlook improved. However, from the state government's perspective, accusations about "stealing" funds were unfounded. State and local finance had become closely intertwined, and local needs now competed with

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[6] Proposition 172, passed in 1993, increased state sales taxes one-half cent for public safety. The revenue, about $2 billion annually, went mainly to counties. Growth in Proposition 172 funds is restricted to public safety purposes; thus, the state traded local discretionary revenue with earmarked funds. The Citizens Option for Public Safety (COPS) program also was established, providing about $100 million annually for law enforcement—another earmarked revenue stream. In 1997 and 1998, the state replaced more lost revenues when it assumed all trial court costs for the 20 least-populous counties and capped contributions for the other 38.

[7] Proposition 172 sales taxes are distributed based on the county in which the sale occurs. Trial court relief reflects county population and historic court funding formulas. COPS funding is allocated by population.

many interests for state general fund revenue. Why should local governments not share in budget cuts affecting needed programs and services?

By 2006-07, the cumulative total cost of the ERAF shift, less Prop 172 public safety funds, came to $35.9 billion, according to a fiscal expert for the League of California Cities (Coleman, 2006b). The ERAF shift brought home to local governments the undoing of the separation of sources. Although AB 8 had not reconstituted local fiscal autonomy, it took ERAF to demonstrate local governments' vulnerability.

Over time, the AB 8 system had become ossified into an arcane, rigid fiscal system unresponsive to local variation and change. The accretion of related, ad hoc state actions was also making reform more difficult. Local government anger about the ERAF shift and distrust of state interference stymied discussions on a host of policy topics, from local housing mandates to county health and welfare programs, during the 1990s and early 2000s (Legislative Analyst's Office, 1999; Senate Local Government Committee, 1999; Fulton, 2003). Yet even as local governments demanded that "stolen" revenue be restored, the establishment of new state programs made the proposition problematic. Much lost revenue had been restored, but to varying degrees among different communities, and often with new program requirements attached.

School Finance and the State-Local Relationship

The ERAF shift demonstrated to city and county governments that some local interests—specifically, schools—had more successfully secured a stable share of the state's general fund dollar. K-14 school finance in California has undergone even more radical change since the 1970s than local government finance, with important outcomes for local governments.

Proposition 13 altered school finance dramatically because property taxes had been the traditional main revenue source for school districts. But other factors also had major effects. In particular, in 1971, as a result of a class-action lawsuit (*Serrano v. Priest*), the California Supreme Court called on the legislature to equalize school funding per pupil irrespective of differences in the property wealth of school districts. Courts in about half of U.S. states have forced legislatures to address inadequacies in school quality or spending from reliance on property taxes (Berman, 2003). As a result, many states now finance education from other state taxes.

The Serrano ruling provided a policy framework that guided the state's response to school finance after Proposition 13—a framework largely absent in the case of the state-local government relationship. Legislative reforms of school finance helped produce a more equitable distribution of funds across school districts. However, in conjunction with Proposition 13, the system also resulted in lower per pupil spending compared to other states, and legislative reforms did not address needs of disadvantaged children in a significant way (Sonstelie, Brunner, and Ardon, 2000).

Observers raise concerns about the system of school finance similar to those about local government finance. Some argue that the complex post-Serrano system is hard for voters to understand, and that state-controlled finance combined with locally-controlled governance disconnects responsibility from authority. Such a system produces neither the merits of state

control (such as rational performance-based or equity-based criteria and oversight) nor of local control (such as accountability and local responsiveness) (ibid.).

A third reform with major consequences for California school finance was Proposition 98. Passed in 1988, Proposition 98 established a constitutional mandate for minimum state spending for K-14 education. A school advocacy coalition had mounted the initiative, concerned about funding in the wake of voter fiscal initiatives. The political lesson was not lost on city and county governments, who would emulate the political approach (namely, going to voters for approval of an initiative to earmark revenue) fifteen years later. In the short run, Proposition 98 hurt local government finance, as ERAF was implemented largely in response.

In 2002, schools won another victory with passage of Proposition 39, which lowered the voter threshold for passing local school bonds from 66 to 55 percent. Approval of local school bonds shot up dramatically afterward (Hanak and Baldassare, 2005). Just as with Proposition 98, local governments viewed Proposition 39 as a model; in recent years, local government lobby groups made lowering super-majority requirements for passing local infrastructure spending a legislative priority.

Local Governments Since Proposition 13

How have local governments fared since Proposition 13, and how has their relationship with the state government changed? The general pattern in California is not unique to the state. A tax and expenditure limitation movement caught hold across the nation after Proposition 13; 46 states have measures in place which limit local government revenues and/or spending (Mullins, 2004). As local governments' ability to raise revenue, particularly property taxes, was constrained and as many state governments took more control of education, the power of state government increased relative to local governments. At the same time, the slowdown of federal aid to localities, and federal devolution to states in policy areas such as welfare, also empowered state governments, relatively speaking (Berman, 2003).

The trend has not been solely toward greater centralization at the state level, however (ibid.). Local governments have responded to fiscal limits by maximizing revenue sources over which they retain control in order to replace losses in property taxes and federal aid. Some states have provided new local revenue-raising authority; an important California example is counties' ability, provided since 1987, to raise sales taxes by one-half cent for transportation purposes, subject to voter approval. These funds form about one-third of local transportation revenue in California. State aid to localities also has increased, especially in states such as California that vest considerable authority over welfare programs at the county level; in these states, federal devolution over programs such as welfare translated into further devolution (ibid.).

Because of these trends, tax and expenditure limitations in California as elsewhere have generally had less effect on total local government spending than on the composition of local revenue—in particular through increased reliance on state aid and locally collected fees and taxes (Mullins, 2004). In spite of Proposition 13, California per capita local government revenue has increased over time and remains higher than the average in other states (Table 1).

However, these general trends mask stark contrasts in the way that revenue composition has changed for different types of government in California as compared to the rest of the nation—in particular, for cities and counties. In California, unlike the rest of the nation, structural differences between city and county finance have deepened profoundly since the 1970s. From 1972 to 2002, city own-source revenue in California took on a larger role over time as a share of all state and local revenue, but county own-source revenue diminished. In the rest of the U.S., the reverse occurred (Table 2).[8]

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[8] By contrast, revenue patterns for school districts and special districts were similar in California and the rest of the nation, with own-source revenue from school districts declining over time as a share of state and local revenue and own-source revenue from special districts increasing in share.

Table 1
Per Capita Local Government General Revenue, California and Rest of U.S. (2002 $)

	1972	1977	1982	1987	1992	1997	2002
			California				
Counties	1,268	1,232	998	1,181	1,404	1,296	1,569
Cities	895	1,058	989	1,151	1,202	1,228	1,395
Special Districts	193	267	322	419	438	491	558
School Districts	1,214	1,305	1,011	1,127	1,230	1,245	1,617
			Rest of U.S. (excluding California)				
Counties	482	580	561	677	763	828	935
Cities and Townships	946	1,080	980	1,133	1,215	1,276	1,372
Special Districts	102	146	181	222	236	263	301
School Districts	790	827	764	883	994	1,075	1,199

SOURCE: Data for Tables 1 through 4 and Figures 2 and 3 are from the U.S. Census of Governments (COG).

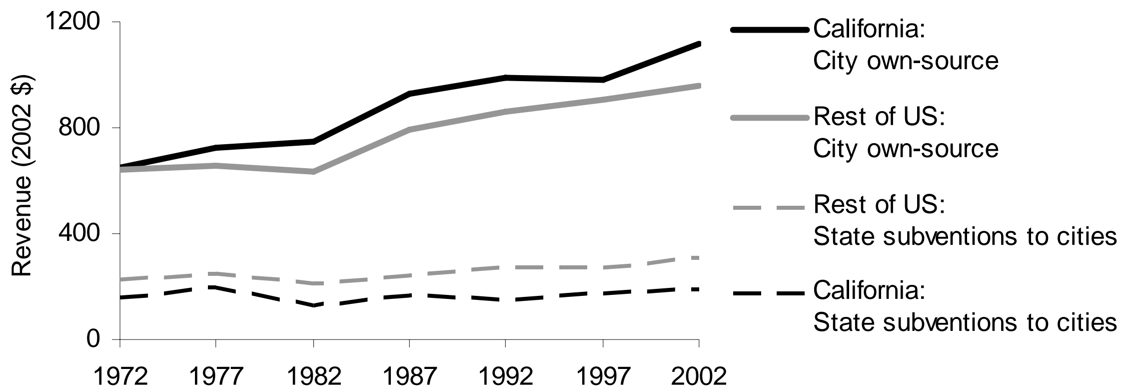
NOTE: In per capita tabulations, the population denominator varies by level of government. For city revenue, it is the population living in municipalities and townships; for county revenue, it is the population living in counties included in COG financial data; and for special and school districts, it is the total population. Population values are from COG government organization files for the years shown.

Table 2
Revenue by Level of Government as Share of Total State and Local General Revenue

	California				Rest of U.S.			
	1972	1982	1992	2002	1972	1982	1992	2002
Federal Subventions to States	17%	16%	17%	18%	16%	14%	16%	19%
Federal Subventions to Localities	2	4	2	3	3	5	2	2
State Own-Source Revenue	36	46	45	43	43	45	45	43
Local Own-Source Revenue	44	34	37	36	38	36	37	35
Counties	14	9	10	8	7	8	9	10
Cities and Townships	11	13	14	14	17	15	14	13
Special Districts	4	5	6	6	2	3	3	3
School Districts	16	7	7	8	12	10	10	9
Total State and Local Revenue	100%	100%	100%	100%	100%	100%	100%	100%

California cities became more fiscally independent, raising more own-source revenue than in the rest of the nation, but receiving less in state subventions (Figure 2).

Figure 2
City Per Capita Revenue, Own-Source and from State Subventions



Meanwhile, California counties became more dependent on the state. Their own-source revenue plummeted from a high level to below the national average (Figure 3). State subventions more than made up the difference, reaching a level more than three times higher than in the rest of the nation by 2002 (Table 3). By then, California cities raised four-fifths of their revenue independently, but counties only about one-third (Table 3). In contrast, in the rest of the nation, city and county finance was much less dissimilar, and both types of local government raised most revenue independently.

Figure 3
County Per Capita Revenue, Own-Source and from State Subventions

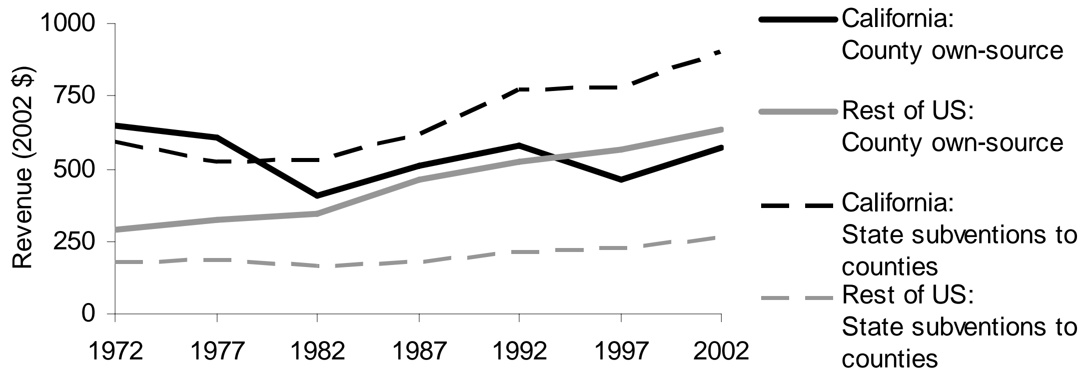


Table 3
Per Capita City and County General Revenue by Source (2002 $)

	1972	1977	1982	1987	1992	1997	2002	Pct. in 1972	Pct. in 2002
				California: Cities					
Own-source Revenue	648	724	746	926	990	982	1,121	72%	80%
Property Taxes	232	251	149	181	235	184	232	26%	17%
Sales Taxes	118	139	140	150	134	144	168	13%	12%
Other Taxes	93	116	125	177	176	192	212	10%	15%
Charges and Fees	119	136	161	213	245	287	311	13%	22%
Other	87	83	171	206	200	176	198	10%	14%
Federal Subventions	71	125	104	43	45	54	69	8%	5%
State Subventions*	176	208	139	182	167	191	205	20%	15%
Total General Revenue	895	1,058	989	1,151	1,202	1,228	1,395	100%	100%
				Rest of U.S.: Cities and Townships					
Own-source Revenue	641	655	635	794	861	909	955	68%	70%
Property Taxes	335	316	248	283	333	327	346	35%	25%
Sales Taxes	39	49	53	67	67	76	83	4%	6%
Other Taxes	107	116	111	149	151	167	176	11%	13%
Charges and Fees	96	112	124	154	192	222	228	10%	17%
Other	64	62	98	141	118	118	122	7%	9%
Federal Subventions	62	153	113	73	53	63	67	7%	5%
State Subventions*	243	272	232	266	301	305	350	26%	26%
Total General Revenue	946	1,080	980	1,133	1,215	1,276	1,372	100%	100%
				California: Counties					
Own-source Revenue	647	604	407	513	582	465	571	51%	36%
Property Taxes	487	447	215	264	307	169	205	38%	13%
Sales Taxes	15	19	22	20	19	19	24	1%	2%
Other Taxes	13	17	12	19	20	21	25	1%	2%
Charges and Fees	93	83	88	121	138	163	218	7%	14%
Other	39	38	70	90	96	93	98	3%	6%
Federal Subventions	8	77	40	31	22	29	57	1%	4%
State Subventions*	612	551	550	637	800	803	941	48%	60%
Total General Revenue	1,268	1,232	998	1,181	1,404	1,296	1,569	100%	100%
				Rest of U.S.: Counties					
Own-source Revenue	290	326	347	460	523	568	636	60%	68%
Property Taxes	173	172	156	191	224	227	252	36%	27%
Sales Taxes	18	26	28	46	51	63	68	4%	7%
Other Taxes	17	22	22	31	36	42	51	4%	5%
Charges and Fees	61	79	91	108	138	166	182	13%	19%
Other	20	27	51	84	73	70	83	4%	9%
Federal Subventions	10	56	39	26	18	22	26	2%	3%
State Subventions*	183	198	174	191	222	238	274	38%	29%
Total General Revenue	482	580	561	677	763	828	935	100%	100%

* Also includes local intergovernmental revenue

County Finance Since Proposition 13

What accounts for these differences in city and county finance in California, and why do they matter? Cities and counties became very different types of government after Proposition 13, leading to considerable conflict between them. The main effects on counties of the post-Proposition 13 fiscal regime have been greater dependence on the state government and a decline in their general-purpose role. Counties have three main roles: acting first as "agents of the state" administering mandated federal and state programs such as welfare and health care; second, providing countywide services such as airports and jails; and third, providing municipal-type services in unincorporated areas. Counties rely on general purpose revenue to fund their general purpose role and for the local "match" often required to obtain state or federal funds. Counties cannot fulfill or expand almost any responsibility without general purpose revenue (Legislative Analyst's Office, 1998).

Counties have a binary fiscal structure reflecting their multipurpose role, heavily reliant on two revenue sources—property taxes and state subventions (Table 3). With Proposition 13, counties effectively lost control over how their revenue is raised, because of their reliance on these two state-dominated sources. California counties depend more on property taxes for general purpose revenue than counties in the rest of the nation. Other than that tax, California counties have limited countywide taxing power, with their power to raise general-purpose revenue from sales taxes, utility users taxes, and transient occupancy taxes restricted to unincorporated areas. Counties elsewhere raise more revenue from sales and "other" taxes, both as a share of total revenue and in per capita terms (Table 3). Because of their heavy dependence on property taxes, California counties were harder hit than cities by Proposition 13. Per capita county own-source revenue dropped by about one-third from 1977 to 1982, while city own-source revenue actually increased. Counties were harder hit again by ERAF; own-source revenue dropped by 20 percent between 1992 and 1997 (Table 3).

Since Proposition 13, the state government has adopted various strategies in relation to county "agency" responsibilities. Some of the measures were adopted to help address state budget problems, but many also were undertaken to help rationalize the state-county relationship. The strategies provide useful lessons about realigning state and local roles and responsibilities. As part of post-Proposition 13 relief, the state "bought out" or reduced the mandated county share of various health and welfare programs.[9] Then, in response to state budget problems in the early 1990s, the state reversed course, adopting a "realignment" strategy to help rationalize the state-county relationship. Various program responsibilities were shifted to counties, and new revenue was provided through earmarked increases in the state sales tax and vehicle license fees.[10]

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[9] Transferred programs included Medi-Cal, indigent health, the SSI portion of SSI/SSP, and AFDC.
[10] Some cost-sharing changes were substantial. For example, AFDC-Foster Care went from 95 percent state-funded to 40 percent, In-Home Supportive Services from 97 to 65 percent, and the state welfare-to-work program (GAIN) from 100 to 70 percent (Chapman, 1998). However, the state retained authority to set eligibility criteria. The total increase in county expenditures was about $2.2 billion. During the late 1990s, the state adopted more program changes that aided counties. In 1997, as part of the state's welfare reform, counties were given increased flexibility as providers of last resort for indigents, and also fiscal incentives to move aid recipients off welfare and/or reduce fraud. In 1997 and 1998, the state bought out

Some observers criticized realignment for shifting responsibilities to counties without providing adequate revenue to fund them (Roush and Romero, 2000). Others contend that realignment has provided steadier revenue and should be considered positive overall in clarifying state-county relationships (Chapman, 1998; Legislative Analyst's Office, 2001). Principles of the realignment effort—successfully implemented in some instances, such as for mental health programs—are held up as a model for future changes in the relationship (Legislative Analyst's Office, 2001). These principles include dedicated state revenue streams outside the annual budget appropriation process, ability to alter historical allocations (such as by equalizing funding based on changing caseloads or poverty incidence), greater county flexibility (in regulation and in shifting revenue across programs), fiscal incentives for efficiency (in particular, by altering revenue growth formulas to reward cost-cutting), and state oversight through performance measurement (ibid.).

Although the state "bought out" or realigned county agency responsibilities after Proposition 13, there was no similar effort to aid counties' general-purpose functions. County services funded through general purpose revenue and not targeted by state aid—such as library services—suffered (California State Association of Counties, 2004). Some counties were forced to sell assets, increase debt, or cut services, employment, or compensation (Swenson, 1999; Saxton, Hoene, and Erie, 2002).

California counties' agency functions, reflecting their most restricted role, comprise over half of county expenditure (Table 4). In the rest of the nation, the same functions account for only about one-third, but the absolute level is much lower. When public safety expenditure (also subject to state restriction) is added in, only about one-third of California county expenditure reflects other general purpose functions. In 2002, per capita spending for those other functions in California counties was lower than the average for counties in the rest of the nation, in spite of the fact that a higher share of California's population lived in unincorporated areas.

In addition to constraining countywide general services, cuts to general-purpose revenue affected municipal-type services provided for residents of unincorporated areas, and especially in counties in which new cities incorporated after Proposition 13. Under the AB 8 system, counties lost property tax revenue when new cities incorporated, and they had no effective means to increase tax rates to compensate. This situation led to much conflict between cities and counties as city incorporations rose after Proposition 13. Although 19 new cities were incorporated during the 1970s, during the 1980s and early 1990s (to 1992) another 46 were incorporated. Counties complained that incorporations allowed the new cities to capture sales tax revenue from retail activity in the formerly unincorporated areas. In 1992, to address these concerns, counties gained passage of a "revenue neutrality" law, which requires that a newly incorporating city demonstrate it would leave the county government fiscally unharmed (Fulton, 2002b). Since then, incorporations slowed down, with only 10 new cities having been established, because in practice, incorporations now depend on new cities turning over some tax money to counties (ibid.).

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responsibility for trial court funding, providing counties with over $700 million in annual relief (Roush and Romero, 2000).

Table 4
Per Capita County Direct General Expenditure by Category (2002 $)

	California				Rest of U.S.			
	1972	1982	1992	2002	1972	1982	1992	2002
Agency Role (California)								
Social Services	539	322	450	385	78	54	79	89
Health	161	165	266	326	84	108	136	160
Judicial	0	42	114	120	0	18	33	42
Other Services								
Public Safety	110	123	193	243	31	53	95	128
Education	59	75	75	136	104	95	131	164
Transportation	65	46	49	63	70	63	73	80
Environment and Housing	68	56	83	76	30	39	58	78
General Government (except judicial)	124	73	54	59	52	42	54	63
Interest on General Debt	12	12	42	37	13	24	51	46
Other	53	43	58	80	36	49	64	88
Total Expenditure	1,191	958	1,384	1,524	499	544	775	936
"Agency Role," % of Total	59%	55%	60%	55%	33%	33%	32%	31%
"Agency" and Public Safety, % of Total	68%	68%	74%	70%	39%	43%	44%	45%

Cities After Proposition 13

Fiscal constraint has also constricted cities' general-purpose role, but in a different manner than for counties. California cities have become more independent, relying more than in the past, and the rest of the nation, on own-source revenue. However, many of the faster-growing city revenue sources are more closely linked to specific services rendered—for example, revenue from charges and fees. Community-wide taxes and services have declined as a share of city finance. Thus, even as structural differences between cities and counties have deepened since Proposition 13, in both cases their general-purpose government roles were constrained.

While the main effect on counties of Proposition 13 was to increase dependence on the state, cities instead became more entrepreneurial about identifying new revenue sources—with major consequences for land use and development—and more aggressive about imposing user charges and fees. Unlike counties, cities faced a decline in subvention funding until recently, and they turned to other revenue sources to make up for the losses (Table 3).

Before Proposition 13, cities had become more fiscally self-reliant than counties, diversifying their own-source revenue base so that by 1972, property taxes constituted only one-quarter of city revenue, compared to 38 percent for counties (Table 3). However, most community-wide discretionary revenue came from two sources—property and sales taxes. These sources declined from 39 percent of city revenue in 1972 to 29 percent in 2002 (Table 3). In their place, cities turned to revenue sources that more closely link payments to services received, such as charges, fees, and benefit assessments. Although California city officials rate the sales tax and property tax most desirable overall, most still would elect to raise or impose

new user fees instead (Baldassare and Hoene, 2004a). Revenue from charges and fees increased by 162 percent in California cities from 1972 to 2002, faster than for California counties and cities in the rest of the nation. Per capita revenue from benefit assessments in California nearly doubled from 1987 to 2002, reaching a level more than twice as high as in the rest of the nation.

As a result, the cost of city services has become increasingly "internalized," based on a "user pays" principle. Such financing may be efficient economically if services can be treated independently (Sexton and Sheffrin, 1997). However, when interdependencies such as shared infrastructure exist, residents should take them into account. As community-wide taxing power declines, voters may be less apt to engage in or understand decisionmaking for their community's future. In that case, the general-purpose character of local government is eroded. Also, "particularized" services may become inefficient if revenue structures are rigid, as with the AB 8 system in regard to services provided by special districts.

Fiscal constraint also affected local government choices about land use and development, an important element of home rule power. Land use choices became increasingly "fiscalized," scrutinized with an eye to budget impacts. One consequence is that city governments strongly favor retail development over housing and industry—land uses generally less able to "pay their way" in terms of the cost of services (Lewis and Barbour, 1999; Coleman, 2006a). Cities compete to attract retail development and associated sales tax revenue, which in California is allocated on a "situs" basis (to the jurisdiction in which the sale occurred).

California cities earn about twice as much in per capita sales tax revenue as cities in the rest of the nation, and about seven times more than California counties (Table 3).[11] Still, sales tax as a share of city revenue has declined since 1972 (Table 3). With the hierarchy among cities for sales tax dollars rather stable over that time, it appears that cities have been competing over a relatively fixed pot of money. Inducements offered to retailers may serve mainly, in the aggregate, to divert public resources to the retail sector (Lewis and Barbour, 1999; Legislative Analyst's Office, 2007).

In spite of complaints about ill effects of competition for retail development, city governments themselves have not been strong advocates for reforming the system. To the contrary, many of them have been more apt to resist such reforms (California Budget Project, 2004). For example, a bill introduced in 2002 would have introduced a modicum of sales tax sharing among jurisdictions in the Sacramento region. It was defeated by stiff opposition from suburban cities which feared they would lose out to the City of Sacramento (CP&DR Staff, 2002; Fulton, 2002a). Such controversies demonstrate the difficulty—especially if competition over a resource is intense—of changing the system in a way that creates new winners and losers (ibid.).

As voter-imposed fiscal constraints have limited the ability to raise community-wide funds, another result has been to transfer the costs of infrastructure for new development onto the development itself. For example, local officials impose fees and exactions on developers and create community facilities districts.[12] These techniques facilitate development in

[11] However, many states do not impose local sales taxes.
[12] In 1982, the state authorized "Mello-Roos" financing. Within designated areas, two-thirds of the voters, or landowners representing two-thirds of the land area, can issue debt for capital improvements, and levy

"greenfields" areas more than "infill" development in built-up areas.[13] However, one state development tool that does aid inner-city areas—redevelopment financing—has gained importance. Authorized since 1951, this technique facilitates improvements in designated "blighted" areas by allowing local governments to borrow funds to be paid back from increased property taxes generated by the improvements.[14] Most of the state's 422 redevelopment areas are managed by cities, which capture most of the growth in property tax receipts (the "tax increment" revenue) that otherwise would have been parceled out among all local government entities serving that area.

From 1980 to 2006, the number of redevelopment agencies in the state more than doubled to 422, and the number of project areas more than tripled to 759 (California State Controller's Office, 2007). According to the Legislative Analyst's Office, redevelopment agencies captured 10 percent of state property tax revenues in 2003-04, up from 2 percent in 1977-78 (Legislative Analyst's Office, 2005). Concern about abuse led to 1993 reforms that tightened the statutory definition of "blight" and allocated a portion of tax increment to all local agencies servicing a redevelopment area. However, no state agency regularly reviews redevelopment proposals.

Even as cities looked for new revenue sources, frustrated anti-tax advocacy groups sought to rein them in. In 1996, voters passed Proposition 218, the "Right to Vote on Taxes Act." The constitutional amendment culminated a decade-long effort by anti-tax groups to establish vote requirements for local taxes and sought to prevent local governments from turning to other revenues sources without gaining voter approval. Proposition 218 established that majority voter approval is required to impose or increase any local tax for general purposes, and two-thirds voter approval is required for taxes designated for special purposes. Vote requirements for property assessments and property-related fees and charges also were specified.[15]

In spite of Proposition 218, per capita city revenue from "other taxes," charges, fees, and assessments increased from 1997 to 2002 (although for the latter categories, at a slower rate than from 1992 to 1997). And although more local tax measures were placed on the ballot after 1996, passage rates did not change much (Rueben and Cerdán, 2003). Thus, overall, California cities have been able to increase revenue in spite of voter constraints. However, these general trends mask differences among cities. Less than one-third are "full-service," meaning they are

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taxes to pay for it. In practice, governments often work with developers to establish such community facilities districts for new neighborhoods.

[13] Developer fees do not require voter approval.

[14] Redevelopment agencies' tax allocation bonds do not require voter approval.

[15] New benefit assessments must meet extensive requirements for determining proportionate benefits and weighted voting according to benefit. A detailed report by a registered engineer is required to demonstrate the special benefit for each land parcel. To levy assessments, local governments must first hold a mail-in election with ballots weighted by the proposed assessment, and with a weighted majority required for passage. Thus, the vote of a corporation (located anywhere) can outweigh votes of resident property owners (Tranter, 2006). To set a property-related fee or charge, a majority vote of affected property owners or two-thirds of voters within an affected area is required. Fees for sewer, water, and refuse collection are exempt. Fees for a general service are specifically disallowed (e.g., police, fire, ambulance, and libraries).

responsible for a full set of municipal services including police, fire, parks and recreation, libraries, streets, and land use planning (Coleman, 1999).[16] Partial-service cities rely on special districts and/or county governments for some services and generally receive smaller shares of property taxes. Thus, they are more dependent on sales taxes. City revenue levels vary not only because of differing service responsibilities, but also depending on voter willingness to pass new taxes. Research in California and nationally suggests that voter constraints have widened historical revenue differences among cities, limiting poorer and more fiscally constrained cities the most.[17]

Thus, although some cities have maintained or increased revenues in the more competitive post-Proposition 13 context, others have fallen behind. Propositions 13 and 218 were blunt instruments, imposing a one-size-fits-all constraint on local taxing and spending. Although voters apparently find such seemingly straightforward mandates appealing ways to curb government excess, they most probably do not understand how such measures affect localities individually and differentially. Most voters indicate a low level of understanding about fiscal issues in the state (Baldassare et al., 2007).

Local officials feel constrained by both voters and the state government. In contrast to state voters, seven in ten California city officials say that Proposition 13 has mainly been a bad thing for the state (Baldassare and Hoene, 2005).[18] They are more apt than city officials in other states to consider tax and expenditure limits to be sometimes or always a bad idea (Baldassare and Hoene, 2004b). Only one in three California city officials consider it possible to spend less and still maintain the city's service levels; in other states, a slim majority consider it possible. In looking ahead, California city officials are more likely than officials elsewhere to see the largest challenges coming from cuts in federal or state support for cities and federal or state preemption of local authority, and to be more concerned about effects of voter pressure to limit taxation and public perceptions of waste in government (ibid.).

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[16] However, full-service cities serve a majority of the state's population.

[17] See Rueben and Cerdán (2003) and Mullins (2004). From 1980 to 2000, about half of California cities proposed at least one ballot measure to increase taxes; one-third of cities were successful in gaining passage (Rueben and Cerdán, 2003). Various factors relate to cities' likelihood of placing a measure on the ballot, and the chances of success. For example, cities that did not propose ballot measures had more diversified tax bases to start with and became increasingly reliant on fees and assessments. Cities more apt to attempt and to pass new tax measures historically relied more on property taxes. Those with higher income, fewer special districts, and lower nonwhite household shares also were more likely to gain passage. The group of cities that tried and failed to pass new taxes had lower property tax and overall revenues before Proposition 13, and those differences widened over time. These cities had lower Democratic voter registration shares and lower household income than those that passed a tax measure.

[18] A majority (57%) of California residents polled in 2003 said that passing Proposition 13 has turned out to be mostly a good thing, and that its property tax limitations have had either a good effect (27%) or no effect (29%) on local government services (Baldassare, 2003). However, a year later a majority (60%) also indicated that local government did not have adequate funding for infrastructure projects needed to prepare for future growth, and a majority (56%) would have been willing to pay higher taxes to maintain current funding for local government services (Baldassare, 2004 a and c). California residents also consider local governments inefficient; in 2004, 58 percent believed that their local government could spend less and still provide the same level of services, and 71 percent that the state government could do so (Baldassare, 2004b).

Conflicts Reach the Breaking Point: The Path to Proposition 1A

By the late 1990s, state-local fiscal conflict in California had grown heated. State policymakers were concerned about growth-related problems—in particular, lack of affordable housing and strains on public infrastructure systems. These concerns forced state leaders to face consequences for land use and development of the post-Proposition 13 fiscal regime. However, efforts to enact growth policy reform were stymied by local government anger over the ERAF shift of the early 1990s. The impasse in state-local relations led state policymakers to consider a systematic overhaul of the state-local relationship.

Growth Concerns Come to the Forefront

By the late 1990s, state policymakers had grown alarmed about a housing affordability "crisis" in the state and its potential effect on economic health. At the same time, they worried about the need for new investment in infrastructure to support projected population growth. With real costs increasing for building and maintaining public infrastructure facilities, and various facilities reaching capacity limits, numerous policy reports called for more strategic state planning and investment.[19] Meanwhile, environmental mandates posed another growth-related constraint. For example, most of the state's metropolitan regions remain out of compliance with federal air quality standards, and mobile sources such as cars and trucks form the largest source of polluting emissions (California Air Resources Board, 2007). California is also a "hot spot" for biological diversity, leading to protracted legal battles over new development projects on the fringe of urban areas, as proposed developments collided with legal mandates for preserving natural habitat for threatened and endangered species.

In a context of growth-related pressure and fiscal and environmental constraint, state leaders scrutinized local land use and housing policy more closely. The issue strained state-local relations because land use decisions had long been considered a home rule prerogative. While a principal concern was whether local governments were doing enough to facilitate housing production, policymakers also viewed land use as a potential lever for promoting more efficient infrastructure investment and meeting environmental mandates. For example, more compact "transit-oriented" development might help address environmental, housing, and infrastructure imperatives simultaneously.

In considering these issues, California was not unique. Concerns about problems associated with uncoordinated sprawl development, such as higher transportation costs and air pollution, have induced a number of state governments to adopt stronger growth management policies—thereby provoking resentment from local governments (Berman, 2003). However, California, traditionally a planning innovator, has been behind that curve during recent decades. Although many bold reform efforts have been advanced—for example by Governor Wilson during the early 1990s—they frequently failed because of local government resistance. For example, local governments walked away from the negotiations with Wilson because of anger about the ERAF shift (Fulton, 1993; Innes et al., 1994).

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[19] See Hanak and Baldassare (2005) for a discussion.

Thus, inasmuch as the post-Prop 13 fiscal regime imposes dysfunctional incentives for land use and development, it also directly undermines the potential for negotiating reforms to improve the system. Discussions on reforming fiscal relations, growth management, housing mandates, tax base sharing, and a host of county health and welfare programs, stalled after ERAF because of local officials' resistance to any new system that would create "winners" and "losers," and because of entrenched distrust of state interference (Legislative Analyst's Office, 1999; Senate Local Government Committee, 1999; Fulton, 2003).

Regarding policy areas such as land use, which have traditionally been considered the prerogative of local governments, the image of centralized state control in post-Proposition 13 California is inaccurate. Voters generally support local control over development decisions, giving local governments something of a veto over state policies they do not like.[20] However, local officials' relationship with their voters is tricky, because even as voters voice support for local control, they also support tax and expenditure limitations that rein in local governments. Voters believe that local control means themselves, not their elected officials.[21] Voters' desire to retain control seems somewhat ironic, given that Proposition 13 constrained local choice over property tax levels and helped create a more opaque finance system difficult for most fiscal experts—let alone voters—to understand.

A Window Opens for Reform of the State-Local Relationship

By the late 1990s, a window opened for reform of the state-local relationship, considered by many to be fundamentally out of whack. Calling the property tax allocation system "seriously flawed," the legislature and Governor Davis indicated their intent to reform the system in order to increase taxpayer knowledge, provide better incentives for land use and development, and provide greater local control (Chapter 94, Statutes of 1999). The governor directed the legislature to consider fundamental reform (Carpenter, 2001). The Assembly Speaker created a Commission on State and Local Government Finance, and the Senate Budget and Fiscal Review Committee held statewide forums (Legislative Analyst's Office, 1999).

Numerous reform proposals circulated. Their common themes included addressing the lack of accountability in a system so arcane that few could understand the relationship between taxes and the services they paid for, and ameliorating the constraints and realigning incentive structures that rendered local governments unable to respond effectively to the needs of an expanding economy. Reform proposals addressed accountability, intergovernmental

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[20] In 2001, three-quarters (74%) of California residents indicated that city and county governments should decide local growth and development, rather than have the state government take a more active role (Baldassare, 2001). In 2004, a majority of adults (51%) and of likely voters (59%) reaffirmed that local governments, rather than the state, should decide how much and what kinds of new housing to build in their communities (Baldassare, 2004d). On the other hand, in 2004 and 2006, a majority of residents indicated that the state government should provide guidelines for local land use and development, rather than not be involved (Baldassare, 2004c and 2006).

[21] When asked who should make the important decisions at the local level, nearly three-quarters (73%) of state residents surveyed replied that local voters should do so at the ballot box, while about one-quarter (23%) replied that local elected officials should make the most important decisions (Baldassare, 2004c).

coordination, revenue stability, skewed development incentives, and local inability to finance services from locally levied taxes.[22]

Revenue stability was a major concern. Many advocated a constitutional amendment to prevent the state government from shifting property taxes to address its own budget needs. There was tension between reforms to ensure *aggregate* local revenue stability, by precluding state "raids" of local revenue, versus revenue stability for *individual* local governments, by guaranteeing no net loss to any government. "Revenue neutral" reform was considered politically paramount, but applied at the individual government level, it made systematic change difficult.

Regarding fiscal structure, many argued that the state government should shift more property tax revenue to cities, even as it reduced sales taxes revenue to cities, in order to create better land use incentives. Some proposals would have addressed the problem of situs-based competition for sales taxes by distributing the revenue on a different basis, such as by population or to counties. Others would have swapped substantial portions of existing sales and property tax revenue, and still others would have swapped only new revenue growth from these sources. However, the assumption that a revenue swap of this sort would improve land use incentives was not systematically tested.[23] As with Proposition 13 itself, a one-size-fits-all approach could produce unintended and non-uniform effects, and it would perpetuate the disconnection between local service choices and revenue streams.

To address this concern, some proposals would have increased local authority over the property tax, for example by lowering the rate to provide a certain amount of "room" for local choice within the 1 percent property tax rate cap, or by allowing local governments to allocate property taxes based on agreed-upon service plans. The latter reform could have promoted reorganizing responsibilities for the sake of efficiency and accountability. For example, if cities, counties, and special districts collectively developed compacts for reallocating property tax revenue, subject to voter approval, they might consolidate operations in the process. Along similar lines, some advocated allocating all property taxes to cities and allowing them to establish contracts with other agencies.

Some reforms would have required altering key provisions of Proposition 13—for example, by lowering vote requirements on special taxes to 55 percent or by treating assessment of residential and commercial property taxes differently (thereby creating a "split roll"). The split assessment roll would address concerns that because corporate buildings and commercial and industrial property are sold less often than is residential property, they are thus reassessed less frequently. Reforms could include regular reassessments regardless of whether a sale

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[22] See California Constitution Revision Commission (1996); Legislative Analyst's Office (1993 and 2000); California State Controller's State Municipal Advisory Reform Team (1999); Speaker's Commission on State and Local Government Finance (2000); California State Association of Counties (2000); League of California Cities (2000).

[23] A consultant to the League of California Cities argued that under the scenario proposed by the Commission on State and Local Government Finance—to reduce local sales taxes by half in exchange for equivalent property tax revenue—many cities would still find retail development more lucrative than housing in relation to service requirements (Coleman, 2000 and 2003).

occurred, or redefining change in ownership. However, most proposals would have operated within the provisions of Proposition 13.

Some proposals focused on clarifying responsibilities, for example, in relation to the county role. County "municipal" functions might be transferred to other entities, such as inter-city joint powers authorities. The realignment process might be strengthened by devolving to counties certain programs for which innovation, local responsiveness, and efficiency are paramount, for example inter-related public health, mental health, and child welfare programs (Legislative Analyst's Office, 2001 and 2003).

The reform debates brought out underlying questions at the heart of the state-local relationship regarding the balance between state and local interests. There is an inherent tension between the state's interest in achieving consistency for statewide policy—for example, to enhance equity in the allocation of resources or promote efficient development patterns—and increasing local accountability and control to promote responsiveness to local needs and preferences. In the debates, tension over increased state control arose especially in regard to the proposals to alter the allocation of sales taxes so as to reorient development incentives. In spite of wide consensus about the negative consequences of the current allocation system, local governments have resisted efforts to reallocate sales taxes because this general-purpose revenue source is one of the few over which they retain some discretion.

Also at stake in the debates was how the state government could frame a local fiscal and governance system responsive to local needs and preferences. With over 6,000 units of local government in California, the very complexity of local government today serves as a constraint on state policymaking. The traditional answer—to establish separate spheres of influence and fiscal authority—is difficult to reconstruct, not just within current fiscal constraints but also now that prerogatives once considered local—such as land use—are subject to state scrutiny.

The reform debate indicated widespread agreement among policymakers that the state-local relationship needed repair. Most proposals would have operated within the parameters of Proposition 13, indicating that reformers viewed major problems—and their solutions—as advancing within its constraints. However, although over 50 ERAF relief bills were introduced in the 1999 and 2000 legislative session, and a joint conference committee deliberated major reform proposals, the outcome was the passage only of one-time ERAF relief, not thoroughgoing reform. Difficulties in achieving "revenue neutrality" while also accomplishing substantial reform, and in addressing variation in local government circumstances and needs, were cited as primary obstacles (Senate Local Government Committee, 1999; Carpenter, 2001).

Local Governments Enter a New Age: Proposition 1A

In 2004, the state-local relationship in California underwent substantial change. But just as in the previous decade, this change was not the result of a careful effort to systematically reform the relationship, so much as it was a response to a state budget crisis that brought conflicts to the fore. And also, as with the ERAF shift, the 2004 reform exacerbated some underlying problems.

Already angry about ERAF, local governments became more wary about state interference when, starting in 1999, the state government began phasing in reductions of the vehicle license fee (VLF) as tax relief for voters. The VLF, a substitute for property taxes on vehicles, has long been a substantial local revenue source.[24] The fee was reduced to one-third its earlier level by 2001. Local government losses were backfilled from the state general fund, which, at full implementation, cost about $4.1 billion annually (California Budget Project, 2004). The legislature created a trigger mechanism allowing the VLF to be restored during lean fiscal times. But the VLF move raised uneasy memories of AB 8 and ERAF, because the state could reverse its commitment.

Feeling constrained by voters on the one hand, and the state government on the other, local governments organized to protect their own interests. Cooperation between city and county governments had been a while in the making because of past conflicts over redevelopment finance, new city incorporations, and annexations of areas with lucrative retail development. However, reforms of incorporation and redevelopment law allowed cities and counties to put aside differences and face what they perceived as a common threat.

By the 2000s, local government lobby groups were among the most vocal at the state level. The League of California Cities (LCC)—the association representing California cities—was considered among the most aggressive of such groups in the nation (Berman, 2003). From 2001 to 2006, non-education local government entities and their associations spent about $38 million annually to lobby the state government. Counting school districts and public offices of education as well, local government lobbying accounted for 20 percent of total lobbying expenditures in the state. Table 5 shows the expenditures for 2003-04, the years leading up to passage of Proposition 1A.

After the high-tech bubble burst in the early 2000s, the state government faced severe budget problems because its revenue depended heavily on personal income taxes that dropped dramatically as stock earnings plummeted (Sheffrin, 2004). Governor Davis was trapped between constraints on spending cuts resulting from constitutional commitments and resistance from the Democratic legislative majority and interest groups such as public employee unions, on the one hand, and Republican veto power over tax increases (because of the two-thirds legislative vote requirements for passing budgets and state tax rates) on the other (Schrag, 2006). As a result, constitutionally unprotected areas of the budget were vulnerable to cuts; these included higher education and local governments.

By 2004, local governments felt their heads were on the chopping block. In 2003, Governor Davis had pulled the VLF trigger, faced with few politically acceptable alternatives in addressing a $38 billion deficit. Payment of a portion of the VLF backfill to local governments, totaling $1.3 billion, was deferred (Legislative Analyst's Office, 2004a). In 2002, 2003, and 2004, the state deferred mandate reimbursements to local governments; the total exceeded $1.5 billion by late 2004 (Legislative Analyst's Office, 2004c).

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[24] All VLF revenue is dedicated to local governments pursuant to the state constitution. Statutes provide 75 percent to cities and counties on a per capita basis, and 25 percent to counties for health and welfare programs pursuant to the 1991-92 realignment (Roush and Romero, 2000).

Table 5
California Lobbying Expenditures by Employer, Government-Related Categories, 2003-04[25]

	$	%
GOVERNMENT (EXCEPT EDUCATION)		
Associations of Governments	12,400,994	3.0%
Transportation Agencies and Authorities	6,617,265	1.6%
Utility and Natural Resource Districts	16,022,985	3.9%
City and County Governments	36,906,246	8.9%
Indian Tribes	2,956,756	0.7%
Redevelopment Agencies	302,802	0.1%
Sheriff/Fire Departments or Districts	1,026,841	0.2%
Other	1,358,695	0.3%
Total	77,592,586	18.8%
PUBLIC EMPLOYEES (EXCEPT EDUCATION)		
Associations and Unions	11,426,929	2.8%
EDUCATION (PRIVATE AND PUBLIC)		
School Districts and District Associations	6,691,504	1.6%
County Superintendents, Offices of Education	1,868,620	0.5%
Other (includes unions)	20,748,982	5.0%
Total	29,309,107	7.1%
OTHER EMPLOYERS	294,892,516	71.4%
TOTAL LOBBYING EXPENDITURES	413,221,137	100.0%

SOURCE: California Secretary of State Cal-Access data.

Governor Davis' VLF rate increase was among the actions that prompted angry voters to elect Arnold Schwarzenegger in his place in the recall election of November 2003. After taking office, Schwarzenegger immediately reversed the VLF increase. He announced he would shift $1.3 billion in property taxes (about 10 percent of local government property taxes) to the schools to reduce the state's funding obligations (California Budget Project, 2004). ERAF funds also were traded as part of a complex mechanism by which the state could pay off $15 billion in economic recovery bonds, passed in March 2004, without raising taxes.[26]

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[25] The totals shown by category do not match those tabulated by the Secretary of State. In that data, employers' type categorization is self-designated; the result is inconsistency both within years (for employers of the same type, such as resource districts) and across years for given employers. For these calculations, the data was re-evaluated and each employer assigned to one of the categories shown.
[26] Through this mechanism, called the "triple flip," the state share of the sales tax rate was increased by one-quarter cent and dedicated to repaying the bonds. The local government share was reduced accordingly, to be replaced by property tax revenue. Schools were made whole from the state general fund. This mechanism will expire after the bonds are repaid.

Local governments raised a battle cry. The LCC, the California State Association of Counties (CSAC) and the California Special District Association formed LOCAL (Leave Our Community Assets Alone), a statewide coalition of over 300 agencies and groups representing health care, law enforcement, fire and emergency services, park districts, utility districts, labor, chambers of commerce, and others (Tranter, 2006). In March 2004, the coalition qualified a state ballot initiative, Proposition 65, for the upcoming November election. As a constitutional amendment, Proposition 65 would have prohibited reductions in local receipts from the property and sales taxes and VLF fees without statewide voter approval, and it would also have prohibited any effort to swap sales taxes for property taxes—in other words, to alter the current allocation system for these taxes. It would have immediately and retroactively blocked a proposed ERAF transfer of $1.3 billion in property taxes for 2004-05, and again for 2005-06, pending approval by state voters. Unfunded mandates would have been prohibited; local governments could ignore any state requirement not fully reimbursed or could carry it out and obligate the state. Proposition 65's protections would have applied to cities, counties, special districts, and redevelopment agencies.

As Schwarzenegger surveyed the prospects for passing the 2004 state budget, he proposed increasing state borrowing to pay off the deficit. He also negotiated agreements with teachers unions, the 4-year university systems, prison guards unions, and Indian tribes—and local governments. Schwarzenegger offered local governments long-term gain in exchange for short-term pain. He would support a ballot measure to protect local revenues, but in return he asked local governments to give up $1.3 billion in each of two years (2004-05 and 2005-06). Many Democrats balked at putting local revenues off limits and placing in the constitution the existing systems for allocating property and sales taxes. But local governments stood firm.

Negotiations resulted in Proposition 1A being placed on the November ballot as an alternative to Proposition 65. The constitutional amendment would ensure that after the two-year ERAF shift was complete, the state could only borrow local property taxes under certain conditions, including repayment within three years.[27] Any reduction in the VLF rate would require reimbursement to local governments of lost revenues. At the cities' insistence, the legislature also would be barred from reducing the amount of sales tax that local governments collect or from redistributing it among local entities.[28] The LCC indicated that it would not accept any deal without this provision (Vellinga, 2004). Furthermore, any change in how property tax revenues are allocated among non-education local governments within a county would require approval by two-thirds of both houses of the legislature. Unfunded mandates could not be forced on non-education local governments, but if they chose to carry them out anyway, the state would not be liable. Unlike Proposition 65, Proposition 1A exempted redevelopment agencies from its protections.

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[27] The state could borrow up to 8 percent of total property tax revenue if the governor proclaimed a "severe fiscal hardship" and if the legislature, by a two-thirds vote in each house, enacted an urgency measure and legislation providing full repayment plus interest within three years. This temporary property tax shift could occur no more than twice in a ten-year period, and only if all previous borrowing had been repaid. Voter approval would not be required.

[28] The only exceptions would be if a change were required by federal law or if it were necessary to participate in an interstate agreement (for example, one that addresses payment of sales tax for internet purchases).

Local leaders threw their support behind Proposition 1A, raising $9.4 million for the measure (in addition to $3 million to gather the signatures necessary to qualify the initiative). The measure passed with 85 percent of the vote in favor. To put the campaign spending in perspective, average per-measure spending in support of ballot initiatives in California from 2002 to 2006 was $11.8 million, and median spending was $7.1 million.[29] Within a national context, spending for Proposition 1A was at 95 percent of the average, and 266 percent of the median, for per capita spending per ballot measure nationally for those measures related to taxation and state budgets during the years 2003 and 2004.[30] More than half of the contributions to the Proposition 1A campaign committee came from government-related organizations or employees, and about 11 percent from real estate/finance/insurance sector contributors.[31] The two largest contributors, LCC/CitiPac and CSAC, together raised more than $4 million.

Proposition 1A reflected the evolving politics of the state-local relationship. In cutting a deal on a ballot initiative, Schwarzenegger and local governments combined forces to make an end run around the legislature. That tactic signaled a change in power and approach vis-à-vis the legislature by both the governor and local governments. On Schwarzenegger's part, it reflected his clout not just as an individual, but also the systematic strengthening of the governor's role in relation to the legislature since Proposition 13, as a result of such measures as term limits and legislative redistricting. Schwarzenegger's use of ballot measures to achieve policy aims has been unprecedented.

On the part of local governments, using the initiative process to achieve their aims signaled a new approach toward the state government, one in which they act more overtly like an interest group than an intergovernmental partner. The strategy shows that they have come of age politically; they marshaled collective resources and devised a winning strategy to protect their interests. However, Proposition 1A exhibits some unfortunate aspects of initiative-based policymaking in California—protecting narrow interests, often inflexibly. The proposition also protected—by placing into the state constitution—dysfunctional aspects of the current state-local finance system, in particular, rigid and arcane financing rules that hamper flexibility and transparency in addressing growth concerns facing the state.

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[29] This estimate is based on the author's calculations from campaign spending data from the California Secretary of State's Office, in 2004 dollars. If a campaign committee registered support or opposition for more than one initiative, spending for that committee was split among all initiatives supported or opposed by the committee excluding initiatives for which no spending occurred, for or against.
[30] Author's calculations from data from the National Institute on Money in State Politics, excluding initiatives for which no spending occurred. The number of initiatives nationally pertaining to taxation or state budgets during 2003 and 2004 was small, including only 12 initiatives. To provide a broader comparison, spending on Proposition 1A was at 56 percent of the average, and 140 percent of the median, of per capita spending for *all* 104 state ballot measures during 2003 and 2004 for which spending occurred.
[31] Based on data from the National Institute on Money in State Politics.

Conclusion

The passage of Proposition 1A represents a sort of bookend to the drama in state-local relations that played out after passage of Proposition 13, with local governments shifting the power balance back toward themselves vis-à-vis the state government. By ending the decade-long stalemate in state-local relations precipitated by the ERAF shift, Proposition 1A may have opened the door for more productive negotiations on various policy topics. However, it also perpetuates the system that helped make local governments more vulnerable in the first place—one in which constraints imposed by sometimes narrow interests (often through ballot initiatives) serve to reduce the power and flexibility of government to deliberate, balance, and trade off interests and integrate policies across needs, rather than apply ad hoc responses to the same pressures and needs.

Proposition 1A prevents the state government from using local governments as a fiscal "shock absorber," and this will constrict the state's options when facing tight budgets. In addition to limiting government revenue through Propositions 13, 218, and other measures, California's electorate also has voted to protect K-14 education, after-school programs, transportation funds, and "three strikes" as a de facto minimum for the prison system. With more and more of the state budget earmarked through voter initiatives, systematic changes may be more difficult to accomplish and government all the more impenetrable to voters. Programs that lack constitutional protection will be more vulnerable during economic downturns. These include higher education, resource and environmental protection, health, social services, and public safety (California Budget Project, 2004). While schools are protected by Proposition 98, its spending guarantees are easier to suspend than Proposition 1A's.[32] Thus, Proposition 1A also may threaten K-14 spending, an ironic outcome given that, traditionally, local governments and voters were responsible for school spending choices.

However, Proposition 1A constricts not only the state but local governments as well. In some important ways, local governments traded control for stability. Proposition 1A seems to strengthen the separation of sources by erecting a firewall between state and local revenue, but it provides no greater local revenue-raising authority. Instead, Proposition 1A perpetuates the disconnection between local revenue and local service needs and preferences instituted with the AB 8 system. In this sense, Proposition 1A parallels AB 8 in establishing a distorted—and ultimately false—facsimile of the original separation of sources doctrine.

Local governments supported this outcome because of the urgency they felt in 2004 (when faced with an imminent threat of losing revenue) to oppose state interference and achieve revenue stability. They found it much easier to unite around that simple theme than to negotiate a new, more rational system of local finance, even one that might have provided greater local discretion over revenues. Reordering fiscal priorities and arrangements would have inevitably entailed creating new winners and losers among them, a basic sticking point to reform ever since Proposition 13 created a zero-sum fiscal system. Within a zero-sum equation, systematic reforms are difficult to achieve politically, especially in the absence of some

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[32] Proposition 98 can be suspended by a two-thirds vote of the legislature. The state government must restore funding to the level absent suspension over time, but it is not required to repay schools for lost funds.

compelling external pressure. Going forward, systematic reforms will now be even more difficult to enact, requiring not only a two-thirds vote in both legislative houses but also convincing voters to amend once again the state's constitution.

In post-Proposition 13 California, state and local finance and policymaking is more intertwined. Conflict, more than cooperation, has characterized intergovernmental relations. Debates between the state and local governments center far more on fiscal resources than on other governance or policy concerns. However, in their decades-long fight over slicing the property tax pie, the state and local governments may have done themselves a disservice. The state government was politically unable to devise an effective system for local finance within Proposition 13's constraints, one that could reassure local governments about revenue predictability while setting rational incentives for land use and development, and matching revenue to responsibility. The state lacked a set of policy goals to help guide such a system. The state government's own recurrent budget crises—resolved by burdening local governments—reflect the same lack of effective mechanisms for matching revenues to service demands over the long term. This failure of leadership and vision came back to bite the state government with Proposition 1A.

Although Proposition 1A may have shifted the pendulum back toward local governments, underlying fiscal concerns remain unresolved, for which local governments may pay a price. Public finance is a mystery to most Californians, and this confusion undermines public confidence in government. Service needs are disconnected from revenue capacity. Community-wide taxing power is limited, with consequences for local governments' ability to engage residents in community-wide decisions about the future. These outcomes of the post-Proposition 13 regime undermine basic general-purpose governance capacity at the local level. To address these concerns, local governments must consider their welfare collectively, not just individually. Putting policy goals first might entail difficult fiscal consequences. However, without that leadership, public distrust of government may only worsen.

In the end, the state and local governments need to work as intergovernmental partners rather than as separate, independent realms. California needs effective government, and local finance and land use decisions are not strictly local matters (Berman, 2003). Although systematic reform may currently lie dead in the water, more incremental improvements may be possible. For example, some have advocated that sales taxes be applied to services, as well as goods, purchased in the state. If the state government were to pursue such an option, it should seek to ensure that the allocation method does not exacerbate dysfunctional land use incentives.

Proposition 13 and the state government's response spelled the demise of the traditional framework for the state-local relationship (in particular, of the separation of sources doctrine). The state and local governments' response ever since has resembled a model of path dependence, with the virtue of providing stability, but at the price of some loss of policy coherence. The state government smoothed over the transition to the post-Proposition 13 era by replicating pre-1978 property tax allocation shares, but the method was only an artifice of the traditional system. With Proposition 1A, local governments reinforced the path dependence, placing into the state's constitution an ossified system of local finance considered dysfunctional in certain respects.

A basic problem is that no clear framework of goals and principles has been agreed upon to help guide the distribution of authority and responsibility under a new framework for the state-local relationship. Rather than prop up an artifice of the old system, elected leaders—both state and local—would do better to focus on devising, with and for the public, a better policy framework to guide decisions about public investment and services, along with related fiscal incentives and choices. To help restore public trust, public officials at all levels must define clear priorities and objectives, and track progress in achieving them. California's governments themselves need to rise to the challenge of improving governance, notwithstanding the often formidable barriers to achieving comprehensive reform.

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