Occasional Papers

Local Finance Reform from a Regional Perspective

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Purpose

The purpose of this paper is to provide a context for the preliminary recommendations of the State/Local Fiscal Committee of the Speaker's Commission on California Regions.

What Is the Problem?

There was a time when state/local finance was neat and simple. The state levied taxes for state purposes and local governments levied taxes for local purposes. For a 68-year period, from 1910 until 1978, the state relied on the "separation of sources" doctrine that separated local taxes from state taxes. During that time, the property tax was levied by local agencies and generally used for local purposes. The contemporary world of governance and taxation in California is far more complex.

As we begin the 21st century, the dominant topic has changed from degrees of separation to fiscal dominance by the state. In the words of one contemporary author, California has gone from a state characterized by home rule to one of fiscal rule. As local powers have receded, the state has grown into major economic regions, leaving local political boundaries as artifacts of another time. Today, regions are defined in economic and geographic terms without governance or fiscal powers to match. [Note: A more precise definition of what constitutes a region is the subject of work by the New Governance Committee of the Commission and will be addressed in the final report of the commission.]

Development of regional governance and fiscal powers faces two, interrelated problems. First, the existing local fiscal system is constructed by state law and organized on the specific political boundaries of each local government. The current local finance system is composed of two elements: state-controlled and locally controlled revenues. On the one hand, counties, due to their status as agents of the state, have few countywide locally controlled resources to be used for local government services. Cities, on the other hand, have a variety of revenue sources that are subject to community control, although the property tax is not one of them. Over the last several decades, as the state has reduced the amount of property tax allocated to cities, the reliance on the sales tax for discretionary revenue has grown. This has increased pressure on local governments to attract developments that will generate sales tax, skewing land-use decisions toward retail uses and away from housing and manufacturing land uses. This system of local finance is a barrier to considering the regional consequences of local actions.

Second, there is no context for local governments to consider the regional implications of their decisions. To the extent that local governments consider such implications, there is no method for financing the mitigation of regional impacts.

Preliminary Committee Objectives

To deal with these and related issues the State/Local Fiscal Committee has discussed five basic objectives:

- Improve fiscal stability and adequacy for local governments by providing greater independence to finance local services.
- Eliminate barriers to sustainable regional and local development through greater reliance on the property tax for local services and lower reliance on sales tax.
- Enable communities and regions to take control of their futures by establishing a locally adopted program of tax base sharing to address regional interests and revising vote requirements for local taxes, making it easier for voters to raise taxes for community services.
- Implement state strategies for local and regional sustainable development by dedicating state subventions to support capacity-building in local and regional planning through increased citizen involvement and increasing incentives for urban reinvestment.
- Link capital expenditures to local and regional sustainable development policies - State and local infrastructure investment should implement local and regional growth policies. Vote requirements for general obligation bonds that are consistent with regional capitol outlay plans should require 55% voter approval.

The following is a discussion of each objective and the steps needed to accomplish them.

State/Local Fiscal Committee Recommendations

1. Improve Fiscal Stability and Adequacy for Local Governments

The Problem: There is a lack of local power over the tax base for financing local government services, inhibiting sustainable development policies.

The Solution: Increase the power of local governments to finance local services and maintain sustainable development policies.

Strong regions are built from strong communities. A functioning local tax base is necessary to finance local services and a prerequisite to fiscal stability. The committee recommends, as a necessary precursor to collaborative regional action, a local finance structure that improves fiscal stability and is adequate to the task of providing local services in a regional context. The following actions should be taken.

a. Amend the Constitution to protect locally levied taxes from being reallocated for state purposes. That portion of property taxes allocated for local government services would be considered locally levied.

b. Reduce the ERAF property tax shift by $1 billion over ten years. This reduction should be conditioned on the adoption and implementation of regional and local "sustainable development" policies.

2. Eliminate Barriers to Sustainable Regional and Local Development

The Problem: Local economic and physical development approved by local governments is, in large part, driven by the tax policies of the state. These policies have resulted in development decisions based on fiscal needs as opposed to comprehensive local and regional urban growth policies.

The Solution: Revise the local finance system to neutralize the effects of fiscal considerations on urban growth policy choices.

The local finance system should be designed to have a neutral effect on local and regional development policy choices. Sustainable development policies adopted by local governments can reflect the need to balance regional economic and environmental needs only if fiscal barriers are eliminated and regional polices implemented. Since there are historical differences in the formation and financing of local governments among the states' regions, it is advisable to offer a range of options from which local governments could choose. To meet this objective the following actions should be taken.

Within each region, local governments should, within a specific period of time, choose one of the following fiscal systems for the purpose of reducing the fiscal impacts of growth policy choices:

a. Swap with the state a portion of the locally levied sales tax for a larger share of the property tax.

b. Transfer all or a portion of the 1% locally levied sales tax to the counties. While maintaining a minimum share of the property tax in each county, replace the reduced city sales tax with property tax from the county and the state through the state school finance system.

c. Establish a split property tax allocation by land use category by increasing the amount of property tax that a city receives for specific land uses. To implement this policy, state statute would increase the share of property tax from all residential development that would go to the city providing municipal services. The increased share would come from the school share of the property tax and would be made up through the state school finance system.

3. Enable Communities and Regions to take Control of their Futures

The Problem: There is limited legal basis for the governance and finance of California regions. Were regional policies adopted, there is no finance base for dealing with the regional impacts of local decisions.

The Solution: Provide a governance and finance framework for the enactment of regional urban development policies and establish a regionally based method for developing a finance base for implementing regional growth policies.

Issues of governance and fiscal choices converge in an effort to establish a fiscal framework for regional action. Establishing a locally based fiscal system to meet regional sustainability objectives will help insure that regions issues are addressed by local collaboration. To assist in accomplishing the objective of increasing community and regional control over their future the two-thirds vote requirement for approving the measures necessary to generate sufficient revenue for local and regional purposes should be reviewed. Thus, the committee recommends:

a. Within each region establish a Sustainable Development Regional Resource Allocation Fund. The fund would be financed by the following:

1. Set aside a portion of the year-to year growth in locally levied taxes. The tax used and the amount of growth set-aside would be locally determined. This regional set-aside would be matched with state funds

based on an expressed state interest, as adopted through a collaborative state, region, and local planning process.

2. Facilitate local tax sharing by ensuring that local governments within a region have the power to enter into tax sharing agreements.

b. Authorize through constitutional amendment the development and adoption a regional charter that would specify the governance and fiscal choices of the region including the choices offered. A comprehensive regional plan should be developed on a collaborative basis involving all of the regions communities.

1. If there is a unified capital expenditure plan, the voters may approve general obligation bonds for capital purposes and tax increases dedicated to specific purposes by a 55% vote.

2. Grant countywide revenue raising authority for counties to support countywide services at 55% voter approval.

4. State Strategies for Local and Regional Sustainable Development

The Problem: The state has made limited efforts to focus its attention on the need for sustainable development.

The Solution: The state should adopt sustainable development polices and commit to a long-term strategy to use its statewide finance base to finance such policies.

The following are intended to provide fundamental, and durable fiscal incentives and rewards for local and regional collaborative decision-making that results in more sustainable development. The regional and local planning process would include performance-based incentive, capacity-building for local planning departments to do more planning on a collaborative regional basis, the use of more sophisticated information tools, and the involvement of citizens through visioning projects and by other means. The following are options:

a. Expand the states' interest in local and regional planning and collaboration.

1. Enact a program of state support for capacity-building in local planning departments to expand and update general plans, with additional incentives for efforts that operate on a regional or sub-regional basis, and for support of community engagement through regional visioning projects.

2. Establish state support for broad and sustained public education on the challenges of growth, and the options available to accommodate it and protect our economic prosperity and quality of life.

3. Establish a permanent state urban reinvestment fund with a dedicated funding source to attract private capital to low-income communities, including a priority for land-banking and brownfield redevelopment.

b. The state should provide for a dedicated revenue source from state funds to increase incentives for producing workforce housing. This could be any or all of the following.

1. A state general obligation housing bond to be matched by local government commitments to local housing trust funds.

2. A Housing Incentive Program to cities and counties that provides resources to assist in meeting affordable housing needs.

3. Making permanent, with a dedicated revenue source, the Jobs Housing Balance Improvement Program.

4. Expanding the Inter-Regional Partnership program.

5. Capital Expenditures for Local and Regional Sustainable Development

The Problem: There is no relationship between capital expenditures and local and regional development policies.

The Solution: The state should require that all infrastructure projects be consistent with adopted regional and local comprehensive plans.

California is beginning to take steps necessary to provide major investment in infrastructure, maintain the existing investment, and plan for infrastructure development to support sustainable development in the face of the projected increase in the state's population. However, additional measures are needed. Among these are:

a. Linking state capital expenditures to voter-approved comprehensive regional plans as noted in #3 above.

b. Connecting state infrastructure bonds, such as for housing, for schools and universities, with sustainable development principles.

c. Changing the voter threshold for local general obligation bonds for capital purposes to 55%, provided it is consistent with a comprehensive regional capital outlay plan approved by the voters.