Research Brief

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Changes in State and Local Public Finance Since Proposition 13

In June 1978, California voters passed Proposition 13, the first in a long series of ballot initiatives that have constrained state and local governments' ability to raise, allocate, and spend public revenues. In a recent study, *Has Proposition 13 Delivered? The Changing Tax Burden in California*, Michael Shires, John Ellwood, and Mary Sprague found that the total amount of public revenues available to California governments has increased significantly, jumping from $58 billion in 1978 to $205 billion in 1995. However, the state's population has also grown by 41 percent, and inflation has driven consumer prices up nearly 150 percent. On a per capita basis, and adjusted for inflation, overall public revenues today are about 85 percent of their pre-Proposition 13 levels. In this follow-up study, *Patterns in California Government Revenues Since Proposition 13*, Michael Shires examines how California governments have fared in their competition for these dollars. The study focuses on three questions:

- How has the share of locally controlled revenues changed?
- How has the spending flexibility of state and local revenues changed?
- How has the composition of state and local revenues changed?

The study answers these questions for each level of government in California: the state, counties, cities, independent special districts, school districts, and public postsecondary education institutions.

Changes in Local Control of Revenues

The level of government that has the authority to generate revenues is the level that "controls" those revenues. Thus, if a city has the authority to implement a utility tax, it has control of the revenues. In some cases, the state raises revenues from its citizens and then transfers monies to local governments to fund specific services or provide general support. The state controls these revenues, even though the subordinate government may spend them. One major and paradoxical consequence of Proposition 13 is that although the property tax still continues to be assessed, levied, collected, and distributed at the local level, Proposition 13 made the state the final arbiter in deciding who receives the property tax and how much they receive. Thus, the state controls this substantial source of revenue.

As shown in the table, the share of *self-controlled* revenues has declined for all levels of local government. In effect, the transfer of the property tax allocation authority to the state has meant that subordinate governments have become more dependent on the state for the funds they need to fulfill their obligations.

Cities and public postsecondary education institutions have recaptured some control over their budgets by increasing various taxes and fees. Counties, however, lack the countywide revenue base and, in some instances, the revenue-raising mechanisms that might give them the same

Percentage of Total Revenues That Are Self-Controlled

	1978	1981	1988	1992	1995
Counties	50	18	19	19	20
Cities	66	36	43	45	43
Special districts	59	37	49	39	38
School districts	54	7	5	5	6
Higher education	30	15	18	21	24

NOTE: Public service enterprise revenues are excluded from total revenues in this analysis.

Proposition 13 severly diminished the control local governments have over their revenues.

resilience. The greatest decline in locally controlled revenues was experienced by school districts, as the property tax was shifted from the control of local school boards to the state legislature.

Many observers believe that the declining share of self-controlled revenues among local governments is unfortunate because it limits their ability to raise revenues for locally desired services. Before Proposition 13, locally elected bodies determined the property tax rate, based on the need to fund local programs and services. Thus, there was significant debate at the local level, both at the ballot box in terms of who was elected to these bodies and at public budget hearings about how the monies should be spent. Proposition 13 changed this scenario, removing the debate from the local arena. Many contend that accountability was also removed, because public officials now can argue that they cannot provide certain services because Sacramento is "calling the shots."

Changes in Spending Discretion

A second important element of fiscal flexibility is the discretion each level of government has in determining how to spend the money it receives. Revenue flexibility has declined for all levels of local government except special districts.

The decline in discretionary revenues represents an increasing presence of higher levels of government in the local community and growing constraint on the choices of local public officials, who must administer programs mandated by the state and federal governments. Unfunded or partially funded mandates are particularly onerous, because if the level of government mandating a particular program or service does not supply adequate funding, then additional pressure is placed on the receiving government's discretionary resources to meet the obligations of the mandate.

Changes in Revenue Composition

Proposition 13 changed the composition of state and local revenues in two ways. First, it capped the rate and growth of one of the most important sources of local revenues in the state. Second, it made it more difficult for local officials to raise new taxes by requiring a two-thirds majority vote at the ballot box. These constraints have forced local governments to turn to other revenue sources, and they have aggressively increased many of the revenue streams available to them, including enterprise revenues, assessments, regulatory fees and taxes, fines and penalties, and general service charges. Enterprise revenues, which are generated by the utility companies that sell water, electricity, natural gas, waste disposal services, and other services to the public, grew by nearly 400 percent between 1978 and 1995. Cities have also been able to raise revenues by increasing other types of taxes. For example, business license taxes, franchise taxes, real property transfer taxes, and transient lodging taxes rose 454 percent between 1978 and 1995.

Conclusions

Changes in public finance since 1978 have significantly expanded the state's role in the local arena. Some jurisdictions have been able to offset the shift in control of the property tax to the state by increasing local taxes and user fees. Others, most notably schools and counties, have become increasingly reliant on the state and hence are susceptible to its fiscal problems and budget cycles.

The constraints on local governments' ability to generate revenues may become increasingly problematic as they seek to provide services to a rapidly growing and changing population. Unfunded mandates may further hamper the ability of local governments to respond to local needs and preferences.

Changes in the control, discretion, and composition of public finance have led to considerable political tension between different levels of government, as well as between voters and their governments, as manifested by the limitations imposed on government behavior and spending over the past 20 years through the initiative process. Of course, not all of the changes in the state's fiscal landscape are attributable to Proposition 13 and its progeny; but most observers will agree that 1978 was a watershed year in the history of public finance in California.

This research brief summarizes a report by Michael A. Shires, Patterns in California Government Revenues Since Proposition 13. *The report may be ordered by calling (800) 232-5343 [mainland U.S.] or (415) 291-4415 [Canada, Hawaii, overseas]. A copy of the full text is also available on the Internet (www.ppic.org). The Public Policy Institute of California is a private, nonprofit organization dedicated to independent, nonpartisan research on economic, social, and political issues that affect the lives of Californians.*

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