

***Representation Without Taxation:
Proposition 13 and Local Government
in California***

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**Public
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Before I discuss our improved understanding of the circumstances of local government in California, I'd like to turn the clock back four years to 1994 and take a look at the economic and political climate that, in part, motivated the creation of the Public Policy Institute of California.

We were in the fourth year of the longest and deepest recession in California history—500,000 people had lost their jobs. The State of California was having trouble paying its bills, and Governor Wilson's economic advisors were suggesting that a tax cut was necessary to get the economy out of the recession and moving once again. In December, Orange County declared bankruptcy.

These economic and financial shocks were intensified by the fact that the state had grown by 6 million people in the 1980s—nearly two-thirds of whom had come from somewhere else—either other states or other countries. This was, and still is, the largest increment of population growth any state has experienced in the history of the United States.

The urgency of the need for public policy analysis suffered a setback in 1990 with the passage of Proposition 140—term limits were established, and a 40 percent across-the-board reduction in the legislative budget seriously diminished the policy analytic capacity of Sacramento. Staff levels in the Legislative Analyst's Office were cut in half, the Senate Office of Research was reduced to only a few research staff, and, ultimately, the Assembly Office of Research was eliminated.

Thus, the capacity within the state to conduct policy research was significantly reduced at the very time that tremendous economic, demographic, and political changes were pointing to the need for more, not less, of such research.

In June 1994, William R. Hewlett, co-founder of the Hewlett-Packard Company, announced the creation of the Public Policy Institute of California. Its mission was to conduct rigorous, non-partisan research on the crucial public policy issues facing the state, its many levels of government, and its people.

It was this economic and political environment that my wife and I entered when we returned to the Bay Area in 1994 to build this new research institution, generously endowed by Mr. Hewlett, and to work for the man who was Chancellor of Berkeley when we were grad students in the 1960s—Roger W. Heyns, the first Chairman of the Board of Directors of PPIC. Roger conceived of the Institute and convinced his close friend and colleague William Hewlett to endow it with enough assets to make it truly independent and objective. In the past two years, we have begun to harvest the fruits of that investment.

As we were shaping the Institute's initial research agenda, we talked with many leaders throughout the state, asking them which public policy issues they thought most needed our attention. The area most frequently mentioned was governance and public finance. And no matter how it was stated, the issue always came down to Proposition 13 and its progeny—Prop. 4, Prop. 62, Prop. 98, 111, 172, and 218—a bevy of statewide initiatives seeking to limit the taxing and spending decisions of elected officials—all of which seemed to have unintended consequences that even their framers did not or could not have imagined.

There seemed to be very little anyone could agree on, except that the state-local relationship had become strained after the passage of Proposition 13 ... and that every addition to the package of constitutional amendments only seemed to make matters worse. It was soon clear to us at PPIC that most of the disagreements resulted from a lot of confusion about what was known and not known about local public finance in the state. We set out to reduce that confusion. I'd like to summarize for you today the questions we have answered so far, and give you some indication of the overall conclusions.

Each of these questions and its full answer is documented in a report that has been published by PPIC or, in one case, by the University of California Press. There are nine questions and nine reports. A folder containing research briefs summarizing these reports will be available at the back of the room as you leave.

Let's turn to the questions:

1. Are the revenue data collected by the Department of Finance and the State Controller accurate?
2. Has Proposition 13 reduced the California revenue burden?
3. Has the disparity between the market value and assessed value of property increased or decreased over time?
4. Has Proposition 13 increased fragmentation in local government?
5. Has the increased use of development fees and other forms of exaction been passed on to the home buyer by developers?
6. Are redevelopment agencies responsible for all of the growth in property value in their project areas, or is this growth partly the result of general economic trends?
7. Has the placing of property tax allocation authority at the state level and service delivery responsibility at the local level made local government more vulnerable to fiscal crises and potential bankruptcy?
8. Does the initiative process tend to serve high-stakes economic interests at the expense of broad-based citizen interests?
9. How do California residents feel about the individual provisions of Proposition 13?

Question No. 1: Are the revenue data collected by the Department of Finance and the State Controller accurate? The collection of fiscal data was a contentious issue because some observers believed that local governments had so aggressively turned to special fees and charges to make up for the shortfall in property taxes that many of the charges would be lost in the shuffle and not be reported to the state. Others argued that even some of the entities collecting revenues might not appear in the aggregate statistics—for example, Mello-Roos districts.

Conclusion: After comparing the revenue reported by more than 7,000 entities in the state with the State Controller's annual report, the study team concluded that the Controller's data are

comprehensive and accurate. Some of the Mello-Roos districts were not included in the Controller's data, but their revenues represent such a small share of the total revenues that their exclusion is insignificant. Once we knew the data were sound, we could proceed to more in-depth studies of public finance.

*Question No. 2: **Has Proposition 13 reduced the California revenue burden?***

Proposition 13 not only restricted the ability of local governments to raise revenue through property taxes but also mandated that a supermajority vote was necessary to pass any special taxes. Thus, this initiative set the stage for an ongoing tug-of-war over public finances between voters and public officials, with state and local governments seeking creative ways to increase their revenues and taxpayers frequently using the initiative process to prevent it. One of the central questions that has arisen in the debate over public finances is whether Proposition 13 has indeed succeeded in reducing the tax burden of Californians.

Conclusion: Prop. 13 did contribute to a significant rollback in the public revenue burden on a statewide basis. State and local governments took 15 percent of Californians' personal income in 1978, the year Prop. 13 was passed. The revenue burden declined to 11 percent of personal income by 1981, and although it climbed back up to 12.5 percent in 1995, this is still significantly lower than in 1978. Measured in dollars, per capita revenue collections have doubled since 1978 in nominal dollars—from \$1,400 to \$2,900. But in "real" or inflation-adjusted dollars, they have declined significantly—from \$3,300 dollars in 1978 to \$2,900 in 1995 (measured in 1995 dollars). Not all of this reduction can be attributed to the tax limitation movement—the state experienced economic downturns over this twenty-year period that also contributed to some of the revenue slippage.

*Question No. 3: **Has the disparity between the market value and assessed value of property increased or decreased over time?*** Under Proposition 13, the assessed value of property cannot increase by more than 2 percent per year until the property is sold, at which time the property is reassessed at its full market value, usually the selling price. This has created a statewide tension between those who have owned their homes for many years and those who have purchased properties in more recent years. Even though the properties might be identical, new owners will pay much higher property taxes than someone who has owned his home for many years.

Conclusion: The disparity ratios in two representative California counties—Los Angeles and San Mateo—have actually declined over time. This has been due in part to the recession in the early 1990s, which led to a decline in property values, and in part to the continual turnover and subsequent reassessment of properties, which brings the assessed value closer to the market value. There will always be some disparity, simply because some homeowners have lived in the same home for two decades or more. Nonetheless, this study found that the gap between assessed value and market value for properties sold after 1980 is not much different from that found in states that don't have Prop. 13 type legislation.

*Question No. 4: **Has Proposition 13 increased fragmentation in local government?*** Many observers believe that Prop. 13 has led to a proliferation of new cities and special districts, thus creating additional levels of government. The argument is that by "seceding" from its financially strapped county, a new city could capture more locally generated

revenue for local use, and special districts could generate additional revenue because they are less constrained than counties in their ability to issue debt or levy fees and service charges.

Conclusion: Although Prop. 13 played havoc with many local governments' finances, it did not decisively alter the state's overall local government structure. There is no dramatic break, in the post-1978 period, from historical trends of city incorporation. In fact, California's public sector is less fragmented than the national average. The state has many times fewer counties and cities and significantly fewer politically independent special districts per capita than the nation as a whole. The creation of new special districts has been offset, to a large extent, by the abolition of others.

*Question No. 5: **Has the increased use of development fees and other forms of exaction been passed on to the home buyer by developers?*** Historically, cities and counties have used property taxes and bonds to finance the infrastructure necessary for new residential development—for example, roads, lighting, and schools. In the wake of Prop. 13, however, local governments have increasingly turned to development fees to finance such infrastructure. Unlike bonds, these fees are invisible because the home buyer doesn't know what kinds of fees were levied against the builder or how much of the costs have been passed on to the buyer in the form of higher home prices.

Conclusion: The authors of this study conducted a detailed analysis of development fees in Contra Costa County and found that government fees imposed on new construction were significant—typically in the range of \$20,000 to \$30,000 per dwelling. In one community, fees and bond assessments accounted for 19 percent of the mean sales price of a new home. However, the degree to which the fees were passed on varied widely over the county—primarily due to disparate economic conditions. In softer housing markets, the developer absorbs most of the cost. In stronger markets, he can pass it on to the buyer.

*Question No. 6: **Are redevelopment agencies responsible for all of the growth in property value in their project areas, or is this growth partly the result of general economic trends?*** Redevelopment agencies have flourished in the aftermath of Prop. 13 because they have the authority to retain a substantial portion of the property taxes generated by new development. True, the agencies "pass through" some of the property tax revenue to the governments that would receive the property taxes in the absence of the redevelopment agencies—counties, cities, schools, and special districts. But many believe that the agencies are keeping more than their fair share and that the agencies are thus, in a sense, being subsidized by other government entities.

Conclusion: Few projects generate enough increase in assessed value to account for their share of property tax revenues. Those projects that came closest defined blight broadly and included large amounts of vacant land in the project area, suggesting that they were engaged more in development than in redevelopment. The author offered several recommendations to state lawmakers that might help resolve the controversy surrounding redevelopment, noting, for example, that "if the legislature intends redevelopment to be self-financing rather than heavily subsidized, the pass-through rate should be increased significantly."

*Question No. 7: **Has placing the property tax allocation authority at the state level and service delivery responsibility at the local level made local government***

more vulnerable to fiscal crises and potential bankruptcy? Section 1 of Proposition 13 states that the 1% tax rate is to be “apportioned according to law.” After a court interpretation of what this phrase meant, AB 8 was passed in 1979. This legislation established a statewide formula for the allocation of property taxes collected at the local level. The creators of Prop. 13 placed the allocation powers squarely in the hands of the state government, but perhaps they did not fully anticipate the consequences of that action. It has been one of the most troubling and controversial aspects of Prop. 13—a constitutional change that placed ultimate decisionmaking authority solely with the state. Substantial bailouts were given to local governments in the 1980s in order to hold them harmless in terms of service provision. However, when the recession of the 1990s came, the state took back its money, and local governments suddenly found themselves facing serious shortfalls in the revenues they needed to fund local services.

Conclusion: In the PPIC study of the Orange County bankruptcy, the author warns that “local officials should be wary about citizens’ pressures to implement local fiscal policies that are popular in the short run but financially disastrous over time.” In effect, county supervisors are under continuous pressure to deliver services they can't pay for—or they have no idea whether or not they *can* pay for them until a new allocation of funds is forthcoming each year from the state’s coffers. This separation of authority and responsibility was found to be one of the underlying causes of the Orange County bankruptcy.

Question No. 8: Does the initiative process tend to serve high-stakes economic interests at the expense of broad-based citizen interests? Professor Elisabeth Gerber of UC San Diego answers this question in a study funded in part through our Extramural Research Program, which supports research outside PPIC. Progressive Era reformers designed the initiative process around the turn of the century to circumvent the power of wealthy economic interests in the state legislature. However, many critics of the initiative process argue that it has now been captured by these very same sorts of special interests. Dr. Gerber characterizes this as the “Populist Paradox.”

Conclusion: In her analysis of the initiative process, Dr. Gerber finds that economic groups do not have the unbridled influence commonly claimed by critics of direct legislation. Special interest groups, such as the insurance or tobacco industries, are generally unable to enlist the sympathy of a sufficiently large number of people to pass new laws through the ballot box. In contrast, citizens groups, which often deal with social issues that involve strong emotional appeal and which rely on a coalition of support from many diverse interests, have a comparative advantage in mobilizing people. This makes it relatively easier for them to pass ballot measures. Economic interest groups are able to pass only 22 percent of the initiatives they support, whereas citizen groups have a success rate of 60 percent. Not surprisingly, economic interests spend the bulk of their resources trying to defeat initiatives rather than launching their own.

Question No. 9: How do California residents feel about the individual provisions of Proposition 13? While scholars and policymakers have identified many problems with the implementation of Prop. 13, few believe that it has any chance of being significantly modified in the near future. At PPIC, we wanted to get a better sense of how the public feels about this controversial initiative, since its fate, ultimately, lies in their hands; so we included several questions about the features of this proposition in our latest statewide survey.

Conclusion: The survey revealed that 38 percent of the population believe the property tax cap imposed by Prop. 13 has had a good effect on local government services, and another 27 percent think it has had no effect—in other words, twenty years later, 65 percent of the state’s population are comfortable with the consequences of this dramatic change in the way we finance local government in California. Furthermore, over half of those surveyed think it’s a good idea that the state, under AB 8, controls the allocation of property tax revenues, while local governments are responsible for service delivery. And 60 percent oppose using a simple majority, rather than the supermajority required by Prop. 13, to approve local special taxes. Proposition 13 remains a very popular piece of constitutional reform with the state’s residents.

I have a tenth question about this controversial measure. And at this point, I do not have an answer. *Why have Proposition 13 and its progeny been so positively accepted by the citizens of California, while most decisionmakers, pundits, and academics remain so adamantly opposed to the concepts that direct democracy has wrought?*

In a fundamental fashion, Prop. 13 and the initiative process have pitted the Madisonians against the Jeffersonians—those who are more comfortable with a centralization of power through representative government against those who favor a much stronger voice for the electorate. The initiative process is messy, relatively few measures pass, and many of those that do pass are overturned in the courts. Yet some do get through—to the satisfaction of one group of voters and the dissatisfaction of another. The players in each case may vary. For every Proposition 209 (the measure banning preferential treatment of minorities, which was troublesome to liberal interests) there is a Proposition 20 (the measure creating the California Coastal Commission, which made developers unhappy).

In conclusion, I'd like to return to the title of my presentation, *Representation without Taxation*. We do have an environment in which state government is playing an ever-stronger role in the finances of local government. It has become more difficult for local representatives to determine their own fate when it comes to revenues, especially tax revenues. But for all kinds of reasons, this is what the citizens of California asked for and, since the passage of Proposition 13 in 1978, this is what they have received.

In sum, it appears that some of the major criticisms of Proposition 13 are unfounded, given these early findings of our research at PPIC. Yet, there are many other troubling aspects relating to our political institutions and procedures in California that require closer scrutiny. What is very clear is that the rules for public policy are increasingly shifting from conference rooms in Sacramento to the neighborhood ballot box. In the past twenty years, 106 statewide initiatives have been placed on the ballot, compared to 29 in the previous twenty years. To understand the implications of this shift from representative government toward direct democracy, we not only need to tap the mood of the voters over time but also to understand the effect of the state's changing demographic profile on the outcomes. Many eligible voters are not at the polls today because they don't understand the choices on the ballot—36 percent of our survey respondents offered this as an explanation for failing to vote. If we can't redress the imbalances between representative and direct democracy in California, we can at least help improve the public's understanding of the measures they are asked to vote on when they stand before the ballot box.

Thank you for your time and interest.

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