The Impact of Proposition 13 in California: Implications for Oregon and Measure 3

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THE IMPACT OF PROPOSITION 13 IN CALIFORNIA: IMPLICATIONS FOR OREGON AND MEASURE 3

by

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In June 1978, Californians approved Proposition 13, a tax limitation initiative which reduced 1978-79 property taxes in California by $6.1 billion (a 53 percent reduction). If the state had not provided "fiscal relief" to local governments, local government revenues from all sources would have declined by 28 percent the first year.

Because the state had a large surplus and a strong economy, state government was able to fashion a program of fiscal relief for local governments which held local revenue reductions to less than 10 percent the first year. By the second year after passage of the measure (1979-80), local government revenues including state aid were above pre-Proposition 13 levels.

This report describes the impact of Proposition 13 on state and local finance in California and identifies factors which enabled the state to continue to fund state and local governments after 1979 at higher than pre-Proposition 13 levels. The current economic and fiscal situation in Oregon is compared with that of California prior to passage of Proposition 13. The report concludes by identifying alternative ways Oregon could adjust to the estimated $767 million reduction in 1983-84 property taxes that would result from passage of Measure 3.

IMPACT OF PROPOSITION 13 ON STATE AND LOCAL GOVERNMENT IN CALIFORNIA

Passage of Proposition 13 in California led to a significant adjustment in sources of local government funding and state-local division of responsibilities.

In the weeks after passage of Proposition 13, the California legislature fashioned a one-year $4.4 billion relief program in which the state (1) almost doubled categorical aid to schools (Figure 1); (2) assumed responsibility for certain health and welfare costs which had previously been the responsibility of the counties; and (3) provided a one time block grant to cities, counties and special districts to partially replace reduced property tax revenues (Figure 1).

The following year, the legislature adopted a long-term local financing measure which transferred a portion of school district property taxes to cities, counties, and special districts and increased state aid to schools to make up for lost property tax revenue. In the adjustment to Proposition 13, the burden of school finance was significantly shifted from property taxes to the state general fund. State support of regular primary and secondary education in California increased from 33 percent in 1977-78 to 69 percent in 1981-82.

Because of substantial state relief to schools and the state assumption of certain county costs, local services were not reduced significantly in California following the passage of Proposition 13. This is not to suggest that individual localities did not have to cut services or increase fees, or both. State and local services were reduced by Proposition 13 both absolutely and relative to what they would have been without the measure. The adjustments were, however, much less painful than many expected because of state aid during the first four years after the measure passed.

After the initial 9.6 percent drop in local revenues in the first year after passage of Proposition 13, local government revenues grew at an average rate of more than 8 percent during the next three years.

If the measure did not significantly reduce local revenues, it did greatly increase state general fund expenditures (Figure 2). These expenditures jumped 39 percent between 1977-78 and 1978-79 and grew at an average annual rate of more than 10 percent for the next 3 years.

FACTORS AFFECTING THE ABILITY OF CALIFORNIA GOVERNMENTS TO ADJUST TO PROPOSITION 13

The State of California was able to provide substantial long-term fiscal relief to local governments without increasing tax rates or instituting new taxes for three reasons:

(1) An elastic state tax system and a recent history of growth in state personal income had allowed the state to accumulate a $3.9 billion beginning fund balance ("surplus") as of the beginning of the 1978-79 fiscal year. This surplus, equal to 24 percent of the state general fund expenditures for that year, was available for local fiscal relief in the wake of Proposition 13 (Figure 3). The legislature used this surplus to finance part of its local government aid package.

(2) A strong and growing economy generated sufficient state tax revenues that California could continue to finance local government aid without instituting new state taxes or seriously reducing state services. Personal income grew in California 14 percent during 1978 and 1979 and has continued to grow at annual rates in excess of 10 percent since then (Figure 4).

(3) Proposition 13 rolled back most assessments to 1975-76 values and allowed assessed values of individual properties to increase by 2 percent per year, *unless there was a change in ownership or new construction.* Newly constructed property or property on which ownership changed was to be reassessed at current "fair

market value." Because of new construction and property transfer in California after Proposition 13, this provision of the measure has allowed total assessments to increase at rates exceeding 9 percent per year each year since 1978. Property tax revenues therefore have risen at an average annual rate of more than 10 percent each year.

The first two of these factors allowed the state to initiate and sustain a program of local fiscal relief that grew from $4.4 billion the first year to $5.9 billion in 1981-82 and that cost the state general fund a total of $20.7 billion during the first four years.

The last factor enabled local governments to supplement growing state aid with even faster growing property taxes.

OREGON'S ECONOMIC AND FISCAL SITUATION AND MEASURE 3

There are significant differences between the economic and fiscal situation of Oregon in 1982 and that of California in 1978 that would affect the ability of Oregon state and local governments to adjust to Measure 3. Measure 3 is also more restrictive than Proposition 13 with regard to increases in assessments and therefore in property taxes.

(1) The State of Oregon enters the 1983-85 biennium with a very small projected beginning general fund balance ("surplus"). At the start of the 1979-81 biennium, the beginning balance of $285 million represented 10 percent of the total budget. This amount was drawn down to $7 million during 1979-81 by a combination of the property tax relief program passed by the 1979 legislature and an economic downturn which reduced tax revenues below what had been anticipated (Figure 3). Oregon entered the 1981-83 biennium with a

general fund "surplus" of 0.2 percent of the budget. The projected $3.9 million beginning balance for the 1983-85 biennium is about 0.1 percent of projected general fund revenues.

(2) The estimated growth rate of personal income in Oregon in 1982 is 4.8 percent (Figure 4). Because this is less than the rate of inflation, real personal income will decline in Oregon in 1982. The official state economic forecast projects a slow recovery during the 1983-85 biennium, with growth in personal income projected at 7.1 and 9.4 percent for 1983 and 1984, slightly higher than the rate of inflation. Even with the projected recovery, employment is not expected to return to 1979 levels until 1986, after the close of the 1983-85 biennium.

(3) Ballot Measure 3 does not provide that transferred property and new construction be assessed at current market values. Instead, the measure specifies that all property in 1983 be assessed at its 1979 assessed values. Assessed values thereafter could grow at a rate of 2 percent per year or at the growth rate of the Consumer Price Index (CPI) if this were less. New construction would be assessed at 1979 values increased by 2 percent per year (or the CPI) for 1984 and thereafter. Therefore, assessed values and property taxes would not grow at the 10 percent growth rates observed in California following Proposition 13. Rather they would grow at much lower rates, ultimately approaching 2 percent per year plus growth in new construction valued at 1979 levels.

OPTIONS FOR OREGON STATE AND LOCAL GOVERNMENTS UNDER MEASURE 3

Under Measure 3, property tax revenues would be reduced in 1983-84 by an estimated $767.4 million, or 43 percent. The estimated reduction in 1984-85 property taxes is $878.2 million for a total reduction in property taxes during the 1983-85 biennium of $1.646 billion.

Without a state general fund surplus, there are only four places where the property tax reductions could be realized:[1/]

(1) cuts in local government service expenditures,

(2) increases in local government non-property taxes and fees,

(3) cuts in state expenditures in order to finance local government aid,

(4) increases in state government taxes in order to finance local government aid.

Local Government Options

(1) If all of the $767 million reduction were taken out of local service expenditures, 1983-84 local government budgets would be reduced an estimated 17 percent.[2/] It is highly unlikely that local governments could withstand the loss of more than one sixth of their revenues without substantial reductions in services.

1/ It is possible that property tax reductions could also come out of local surpluses. The fiscal stresses experienced by local governments during the past several years because of federal and state cutbacks make this an unlikely source of significant funds.

2/ This is based upon a local government general revenue projection for 1983-84 of $4.4 billion. This projection is based on most recent U.S. Bureau of Census *Governmental Finances* data available (1979-80) for Oregon local governments. These data are projected to 1983-84 assuming a $50 million reduction in federal aid, an 8 percent annual growth in state aids, a rate of growth of charges and fees and miscellaneous equal to 1.65 times the growth in state personal income (which averaged 9% per year) and using Legislative Revenue Office's estimate for property tax revenues with and without Measure 3.

(2) Alternatively, local governments could attempt to raise all or part of the $767 million 1983-84 property tax reduction through increased fees and user charges and additional non-property taxes. Since total fees, charges, local non-property tax revenues and miscellaneous revenues for 1983-84 are expected to yield only an estimated $1.2 billion,[3/] $767 million would represent a 64 percent increase in these sources. Since there is a legal limit to the ability of local governments to raise fees, and since certain types of services (primary and secondary education, streets, police, fire) do not lend themselves to service charge financing, non-property taxes (local income, sales or payroll taxes) would come to be given serious consideration as sources of replacement revenue. Under Measure 3, voter approval would be required for passage of new local non-property taxes or assessments.

State Government Options

Even with the slow projected economic recovery, and even without Measure 3, the state general fund faces a large deficit. The low expenditure estimate in the tentative general fund budget for 1983-85 (expenditures necessary to continue 1982-83 levels of service based on budgets following the first 1982 special session) exceeds the moderate revenue forecast by $658.2 million.[4/] The $3.9 million anticipated beginning balance will reduce the expected deficit to $654.3 million.

In other words, the state faces a situation in which anticipated available resources (including the beginning balance) fall 19 percent short of the amount needed to finance even the reduced levels of service established in the first 1982 special session of the legislature.

3/ See Footnote 2.

4/ The low expenditure estimate exceeds even the high revenue forecast by $417.2 million (or 12 percent of the low expenditure estimate).

Because of a large surplus and a strong economy, the California general fund was able to increase general fund expenditures by 39 percent the first year after Proposition 13 to finance a $4.4 billion program of local fiscal relief without new taxes or large reductions in state agency expenditures. Faced with a large deficit and a sluggish economy, the State of Oregon would have to either increase taxes substantially or make large cuts in state agency operations in order to finance a $1.6 billion program of local fiscal relief during the 1983-85 biennium.

(3) Complete replacement of property tax reductions experienced by local governments as a result of Measure 3 would require a biennial expenditure of $1.645 billion, equal to 48 percent of the low expenditure projection for the state general fund. The opportunities for significantly increasing aid to local government from the general fund can be appreciated by looking at the composition of expenditures in the 1981-83 general fund, as of the end of the first 1982 special session:

	Percent of General Fund
Property tax relief (PTR and HAARP)	17
Aid to local government	32
State agency operations	51
Total General Fund Budget	100.0

One third of the general fund is already committed to local government aid. Completely eliminating the Property Tax Relief (PTR) program would only free up about 11 percent of the budget. If the legislature eliminated PTR and chose not to eliminate the Homeowner and Renter Relief Program (HAARP),

the remaining funds necessary to fully replace lost local property taxes without new state taxes would equal almost three-quarters (73 percent) of the amount needed to support state agency operations at reduced 1982 first special session levels.

(4) If the legislature attempted to fund the entire $1.646 billion in lost property tax revenues under Measure 3 without cutting anything from the tentative 1983-85 budget except the $378 million for PTR, the estimated state deficit would increase to $1.922 billion. Substantial increases in existing taxes or new taxes would be required in order to raise this revenue. Under Measure 3, any law increasing state taxes requires a 2/3 majority vote of the legislature or a majority vote of the voters. Any new "special tax," such as a state sales tax, would require voter approval.

The $1.6 billion reduction in property taxes over the 1983-85 biennium obviously would not be realized in any single one of the four alternatives described here. Rather, some combination of tax increases and service cuts at the state and local levels would probably be used to adjust to Measure 3 if the measure passes in November.

By requiring the state legislature to allocate the reduced property taxes among cities, counties, schools and other special districts, Measure 3 would transfer to state government decisions about funding levels for local services now made locally, and it would impose new limits on the ability of voters to approve taxes to finance services desired locally. To the extent that the state was able to increase its aid to local governments, local decisions would increasingly be influenced by state legislative actions. However, the Oregon Legislature, because of the projected deficit and a sluggish economy,

has significantly fewer resources for assisting local governments to adjust to Measure 3 than the California Legislature had under Proposition 13.

Like the situation in California under Proposition 13, passage of Measure 3 in Oregon would move the balance of state-local control of local government affairs toward the state level. Unlike the situation in California under Proposition 13, adjustment to Measure 3 in Oregon would require some combination of significant increases in existing non-property taxes, new taxes or major cuts in state and/or local services.

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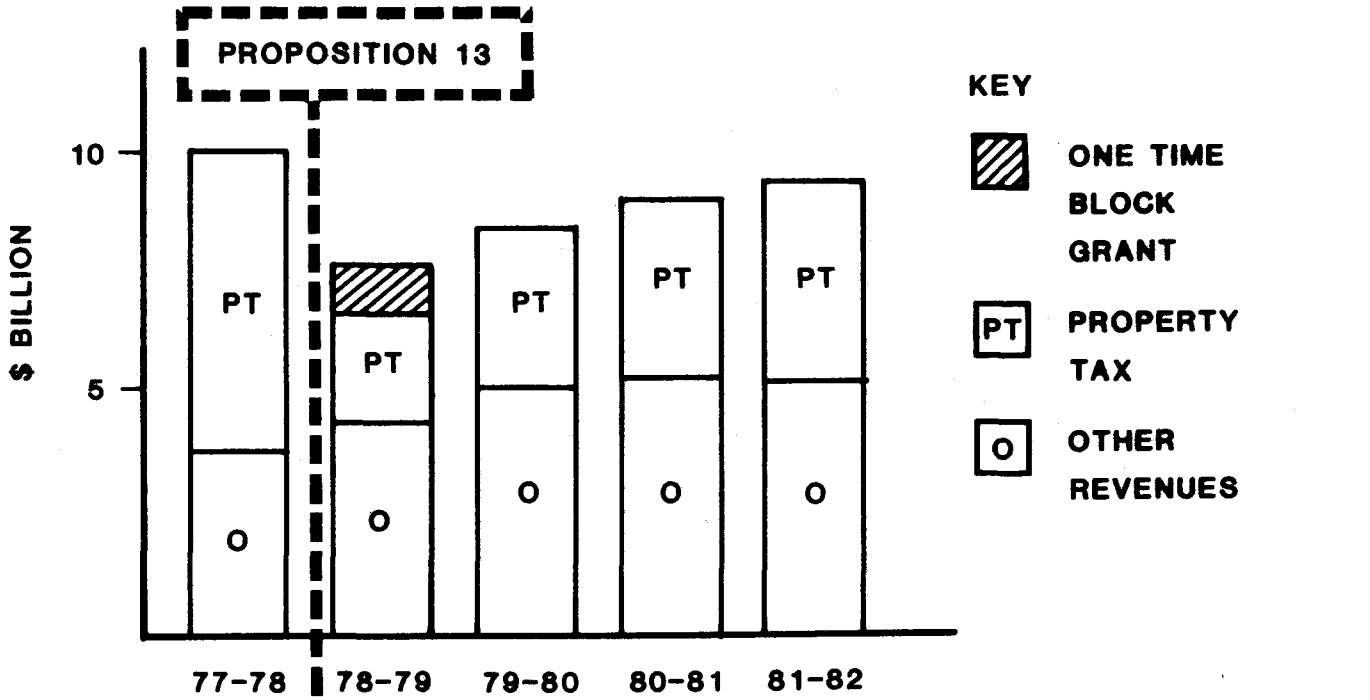
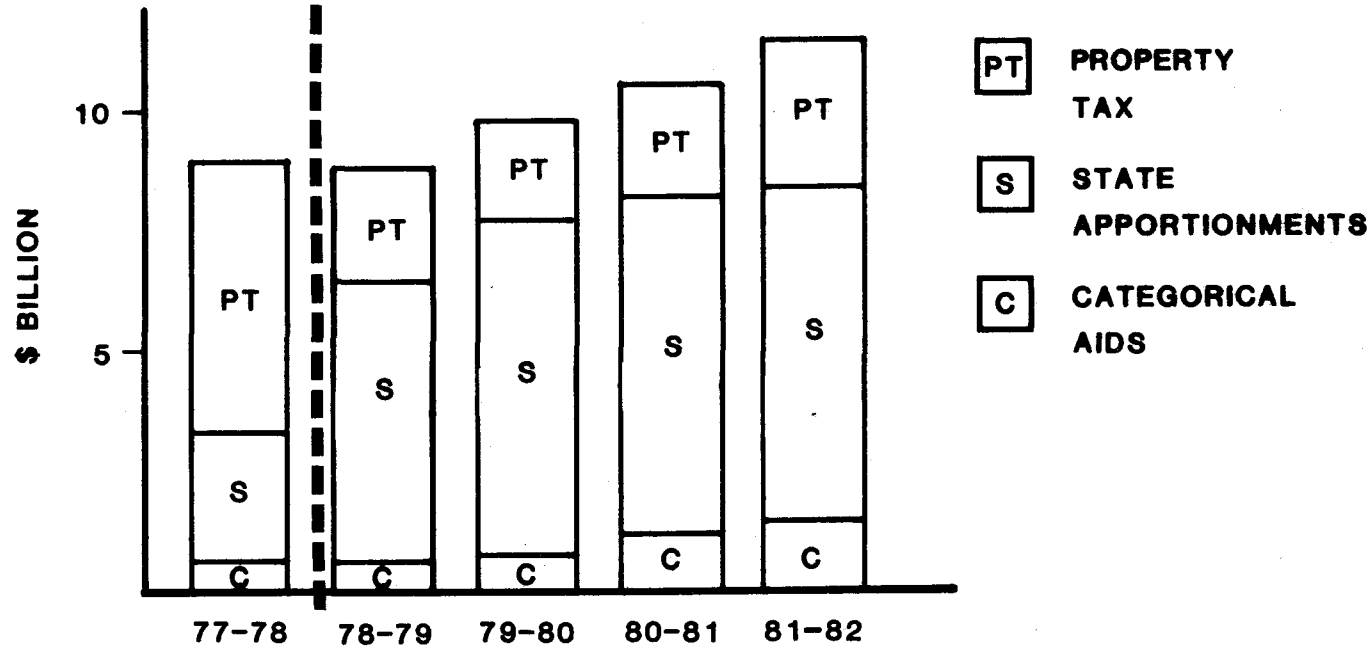


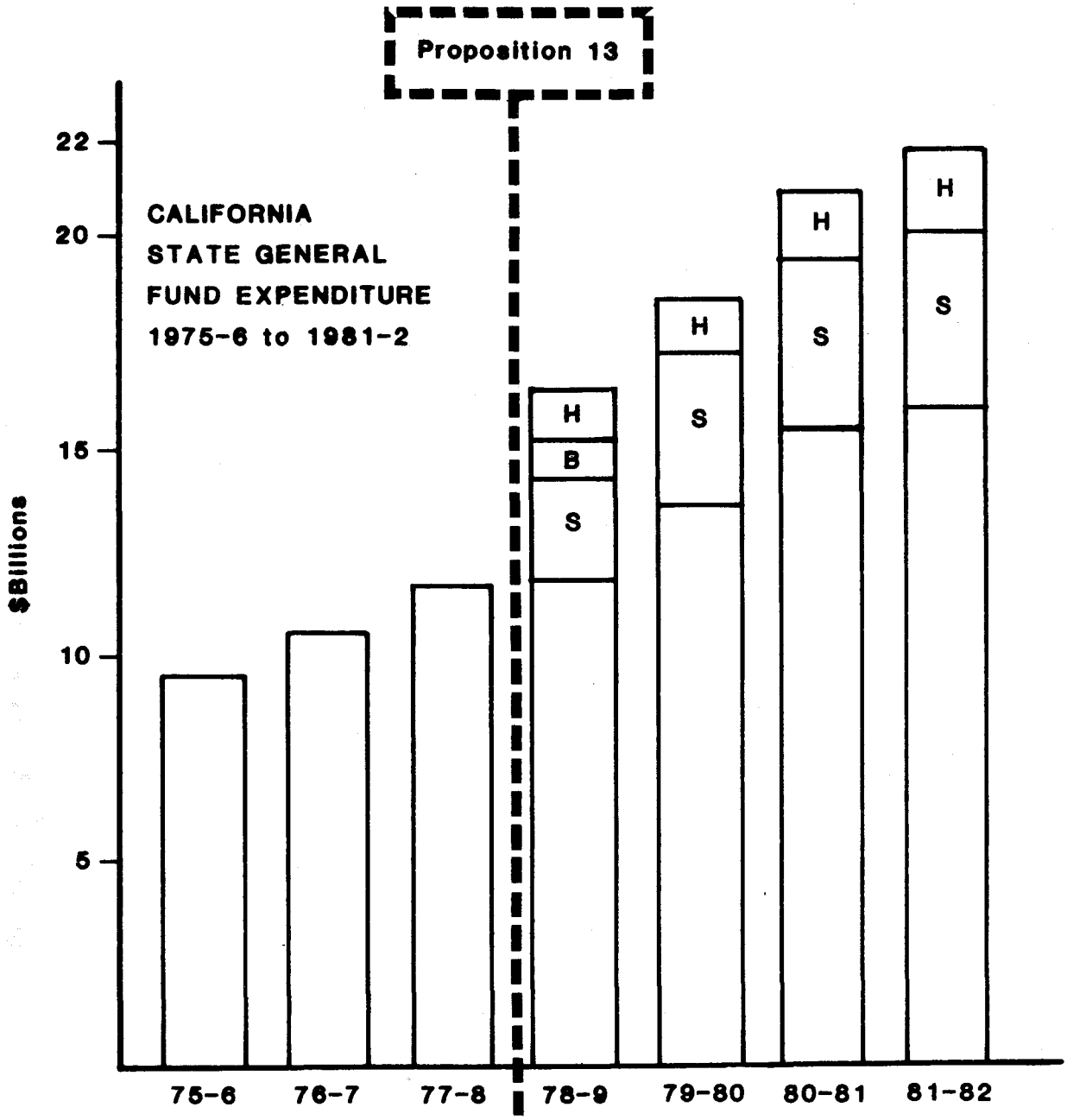
CALIFORNIA CITY, COUNTY AND SPECIAL DISTRICT REVENUES



CALIFORNIA SCHOOLS (K-12) AND COMMUNITY COLLEGE REVENUES

Source: State of California, Governor's Budget Summary 1982-83

Figure 1



KEY

Expenditures Not Related to Proposition 13

Local Fiscal Relief Associated With Proposition 13

H State Assumption of Certain County Health and Welfare Costs

B One Year Block Grant

S Increases in State Aid to School Districts

Source: State of California, Governor's Budget Summary 1982-83

Figure 2

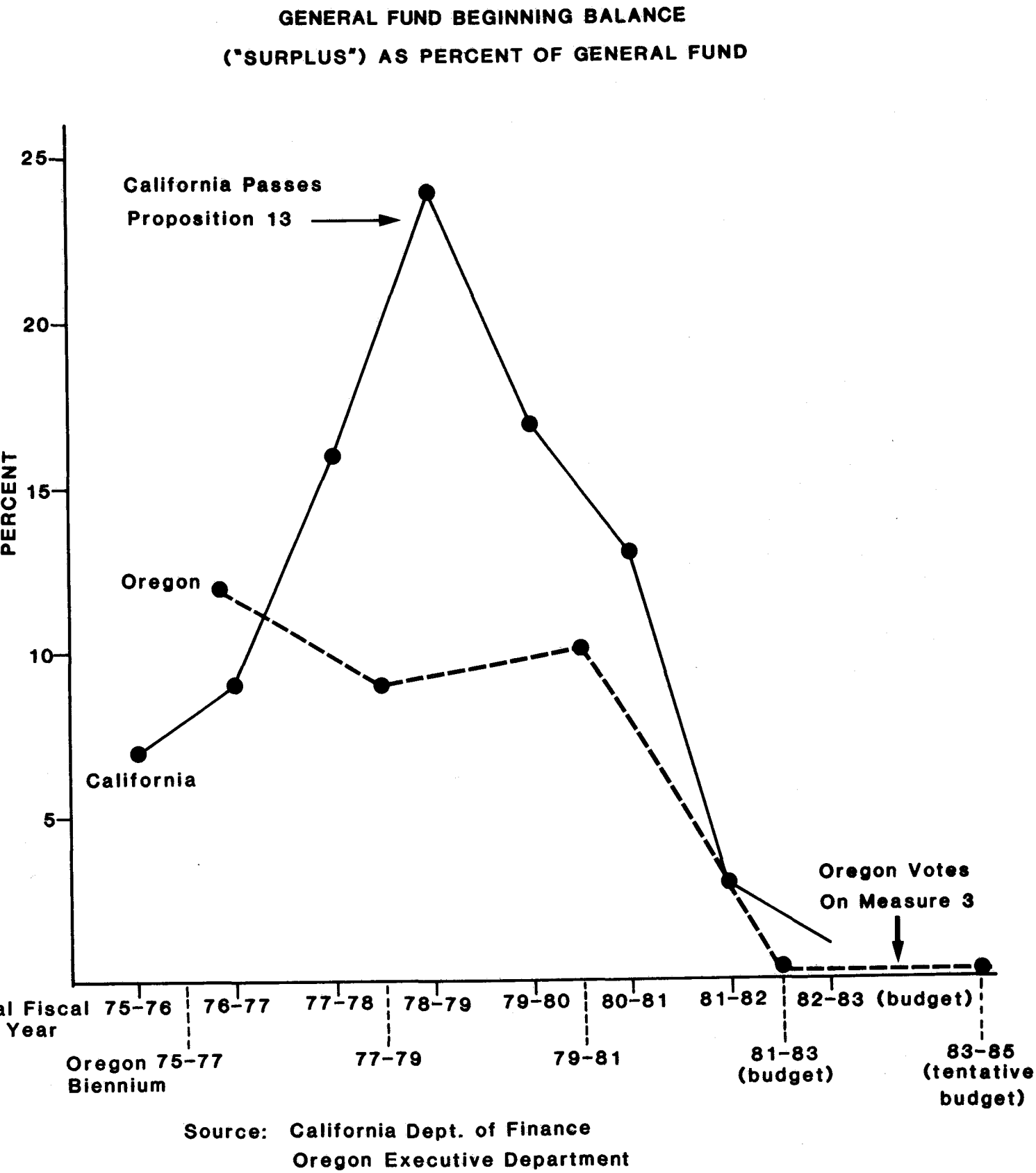
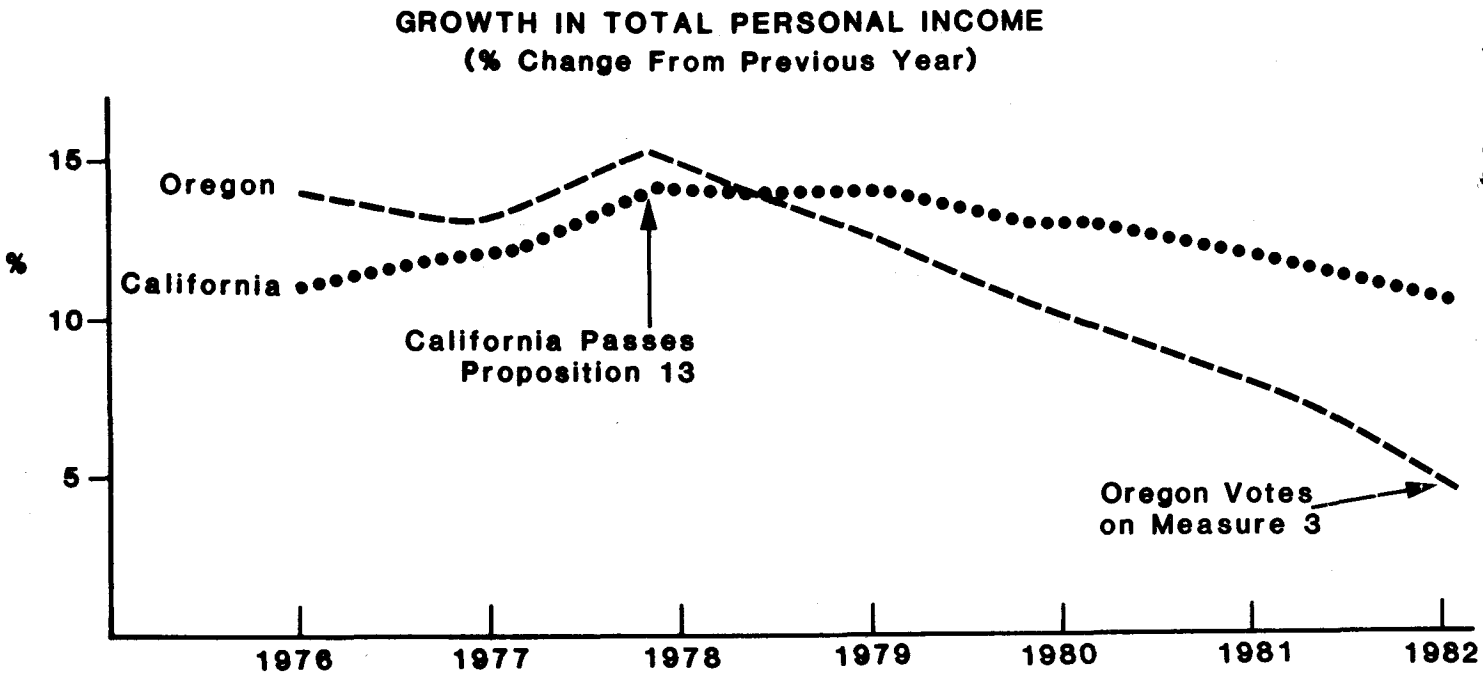

GENERAL FUND BEGINNING BALANCE
("SURPLUS") AS PERCENT OF GENERAL FUND
PERCENT
25
20
15
10
5
California Passes
Proposition 13
Oregon
California
Oregon Votes
On Measure 3
al Fiscal Year
75-76
76-77
77-78
78-79
79-80
80-81
81-82
82-83 (budget)
Oregon 75-77
Biennium
77-79
79-81
81-83
(budget)
83-85
(tentative
budget)
Source: California Dept. of Finance
Oregon Executive Department

Figure 3



Source: Bureau of Economic Analysis, U.S. Department of Commerce
1982 Forecast (Oregon), Oregon Economic and Revenue Forecast (9/8
1982 Forecast (Calif.), California Department of Finance (in 1982-83
Governor's Budget Summary)

Figure 4