Occasional Papers

Changing the Order of Things: Six Proposals for Local Finance Reform

Fred Silva
Paul G. Lewis

Prepared for the Center for State and Local
Taxation Conference on Local Finance Reform
University of California, Davis
May 19, 2000

**Public
Policy
Institute *of*
California**

1. Introduction

At one time, California's system of state and local finance was relatively simple. State taxes financed state responsibilities and services and local revenues were used for local purposes. Since 1978 and the enactment of Proposition 13, however, local finance has been largely controlled by forces outside of community-based local government. The property tax, once controlled by local governments and school districts, is now controlled by the state. As a result, the sales tax has figured more prominently in local government finance, particularly in city finance. This change, in turn, has affected a range of land-use decisions as local governments seek to increase sales tax revenue. These and other changes have complicated the relatively straightforward arrangement that once characterized the state-local fiscal relationship.

In the aftermath of the 1998 gubernatorial election, few seemed to care about this relationship. What a difference a year makes. In 1999, commissions and task forces sprang up and capitol watchers noted renewed interest in the subject. Now, a year later, six reform proposals are ready for consideration by the legislature and the governor. The legislature has appointed a conference committee made up of legislators from the Senate and the Assembly to begin considering these proposals.

This paper summarizes and reviews these six major proposals for state-local fiscal reform. Although their origins and specifics differ, these proposals have similar objectives: namely, to increase the responsibility and capacity of local communities to finance local services and to alter the fiscal incentives that often drive local land-use decisionmaking.

2. Major Proposals for State-Local Fiscal Reform

Speaker's Commission on State and Local Government Finance

(Website: www.speaker.metroforum.org)

This commission was created by Assembly Speaker Antonio Villaraigosa, who asked it to recommend changes that would enhance community power over the financing and delivery of local services. Its central themes were to increase citizen and local control over local taxation and local services, to neutralize the incentives for particular land-use choices, and to promote sustainable statewide economic growth.

The commission itself consisted of 36 community leaders from around the state, including environmentalists, business leaders, taxpayer groups, labor advocates and community activists. In a departure from the typical composition of such commissions, this one did not consist predominantly of "stakeholders," who represent the interests affected by the issue. Instead, about one third of the members could be classified as "stakeholders" and the other two-thirds were local community activists involved with the "regional collaboratives" sponsored by the James Irvine Foundation.

The commission's primary objectives included establishing a local finance system that would facilitate balanced state, regional, and local conservation and development; avoiding dependency by local government on one revenue source; and enhancing the transparency of state and local government. These objectives generated specific recommendations in the following areas.

Fiscal Reform

The commission's primary fiscal recommendations were to change the current fiscal incentives in local land-use decisions and to increase the amount of discretionary revenue available for community and countywide services. It proposed to neutralize the effects of the local sales tax on local land-use decisions by reducing the reliance of local government on the sales tax and by increasing its reliance on the property tax. In particular, the commission recommended the following measures.

- *Swap a portion of the locally levied sales tax for an equivalent amount of the property tax*

  Within each county, the county and cities would trade a portion of their locally levied sales tax to the state for an equal amount of the property tax that would be shifted from K-12 schools. The locally levied 1 percent sales tax rate would be reduced to .5 percent and the state rate would be raised by .5 percent. The state, using the new revenue from the .5 percent of the sales tax, would backfill educational programs through the state school aid system.

- *Settle the issues from 1992-93 and 1993-94 property tax shift*

  This measure would revise the allocation of the property tax by shifting $1 billion of property taxes to counties, cities, and special districts from the Education Revenue Augmentation Fund (ERAF). This shift would take place over time in annual installments of not less than $100 million, provided that the growth in any year of per capita non-Proposition 98 general fund revenue exceeds the statewide consumer price index for the prior year.

- *Place the existing Vehicle License Fee subvention in the state constitution*

  Existing law requires the state to replace the reduced fee revenue with other state resources. The commission recommends that a constitutional obligation be created on the part of the state to replace the revenue lost due to the reduction in the Vehicle License Fee.

- *Place the existing .5 percent countywide sales tax authority in the state constitution*

  Current law provides for a .5 percent "transactions and use" taxing authority for counties to use for countywide services. Voters must approve any such tax. This proposal would move the current authority from statute into the constitution so that voters, upon approving this proposal, would have the assurance that the resultant revenues could not be used to supplant state spending. The allocation of those revenues would be based on an agreement between counties and the cities within them.

Governmental Accountability

The commission was especially interested in finding ways to strengthen the connection between government and the people it serves. The commission concluded that introducing performance measures into state and local government decisionmaking and clarifying roles and responsibilities would increase that connection. It therefore recommended the following measures.

- *Develop performance measures for state and local services*

Both local agencies and the state would establish a similar system of performance measures as part of a continuing policy evaluation process and to assist in the annual budget process.

- *Establish a new model for the state-county relationship*

  A common, bilaterally written compact would spell out the roles, responsibilities, duties, work programs, finances, community outcomes, performance indicators, and evaluation systems that would govern each state-county partnership service program within the confines of existing statutory obligations. Such a compact would be established for each state program in which the county acts as an agent of the state.

- *Revise the county budget requirements to distinguish the various roles of county government*

  Counties would be encouraged to implement budgets that distinguish their roles in providing countywide services from their "urban service" responsibilities for unincorporated areas.

- *Institute an annual reporting requirement for property tax allocation*

  Each county auditor or appropriate state agency would be required to report annually the amount and relative share of the property tax revenues for each agency. This report would also indicate how special districts use property tax revenues to fund municipal services in a way that allows for comparison between these special districts and full-service cities. Finally, the report would portray allocations for redevelopment, county, and educational jurisdictions.

Issues for Further Study by the Legislature and the Governor

Recognizing that some communities have tax bases that allow them to maintain higher levels of service than others, the commission urged the legislature and the governor to study, develop, and implement new forms of local finance that advance equity, environmental, and economic objectives. In particular, public finance measures should reduce the gap between affluent and low-income Californians. The legislature and governor should study the transportation finance system, including the gas tax, in an effort to improve its stability.

Additionally, the commission recognized disparities among the economic and environmental regions of the state. It therefore recommended a joint legislative and executive branch process for developing state, regional, and local growth and development policies as well as a governance structure that links fiscal powers with specific roles and responsibilities.

The State Controller's State Municipal Advisory Reform Team (SMART)

(Website: www.sco.ca.gov)

In August of 1999, the State Controller, Kathleen Connell, released the results of a six-month task force study she convened to assist California's local governments in identifying reliable sources of revenue to help meet local demands. This task force, the State Municipal Advisory Reform Team (SMART), was composed of representative from business, labor, and academia, as well as elected officials. The objectives of the task force were: 1) Identify stable sources of local-government revenue that are not susceptible to preemption by State government; 2) Identify budgetary and auditing processes that will ensure the delivery of local government services and mitigate the expanse of complying with State-mandated programs; and 3) Recommend local government land-use policies that can promote long-term growth without jeopardizing local government finances. To support these objectives, the State Controller has recommended the following actions.

- *Restructure state and local property and sales taxes*

  The primary recommendation is to gradually end the situs (i.e., "point-of-sale" distribution of local sales and use taxes and shift to a formula that distributes local sales taxes among various local jurisdictions on a per capita basis. Under this approach the 1 percent locally levied Sales and Use Tax would be converted into a tax levied locally but allocated by stature. In the first year, 90 percent of local sales taxes would be apportioned based on situs. The remaining 10 percent would be allocated based on population. In subsequent years, the plan calls for any growth in local sales tax revenue to be allocated based only on population.

  The State Controller also recommended that the Education Revenue Augmentation Fund (ERAF) be "capped" at $3.2 billion, with the State's General Fund backfilling the difference between what ERAF would have been and the "capped" amount. This difference was estimated at $450 million a year. Thus, the effect of this property tax restructuring would be to allow the growth in property tax revenues, as well as the $450 million a year in State General Fund, to be allocated to local governments based on their statewide share of ERAF contributions.

  Finally, there is a mechanism to deal with intra-county equity issues that arise from moving from a situs based allocation to a per capita allocation. This intra-county allocation also involves the redistribution of ERAF.

- *Eliminate unfunded state mandates to municipalities*

  The system for reimbursing local governments, including schools, for the cost of state-mandated local programs should be revised. In particular, new state- mandated local programs or increases in levels of service for an existing program should include funding to cover the cost of compliance when the mandate is enacted.

- *Establish bilateral compacts between the state and local governments*

  These compacts would specifically define the expectations and obligations of each entity and would set clear accountability for each entity's responsibilities. By incorporating performance-based budgeting and performance auditing, these compacts would increase the efficiency and effectiveness of the state and local governments.

Commission on Local Governance for the 21st Century

(Website: www.clg21.ca.gov)

The Commission on Local Governance for the 21st Century was established by statute in 1997 (Chapter 943 of the Statutes of 1997). The legislation called on the commission to complete a study of potential revisions to the policies, practices, and statutes that govern city, county, and special district boundary changes. The commission also examined related causes of boundary change controversies, including the need for local fiscal stability and its effects on regional coordination and rational land-use decisions.

The commission focused on organizing and reorganizing local governments and the effects on growth and development. It suggested several changes in the local finance system.

- *Reduce local reliance on the sales tax*

  The local sales tax allocation on a point-of-sale basis should be revised to reduce its incentive effect. Property tax allocations to general-purpose local governments should be increased.

- *Initiate a state-local fiscal realignment*

  A process should be initiated between the state and local governments to comprehensively realign state and local fiscal resources. This realignment would be implemented through a constitutional amendment.

- *Revise the funding for state-mandated local programs*

  A state law that enacts a state-mandated local program should be accompanied by an appropriation to reimburse local governments for costs incurred in implementing a state mandate.

League of California Cities

(Website: www.cacities.org)

The League of California Cities appointed a task force to develop a plan for fiscal reform. The plan, approved by the League's board of directors, deals with three related issues: unpredictability in city revenues, increased reliance on the sales tax, and unfunded state mandates. One objective of the plan was to protect existing revenues constitution-ally in order to prevent further narrowing of the local revenue base without voter approval. A second goal was to address concerns about fiscalization of land-use decisions by trading a portion of sales tax revenue from new projects for a larger share of the property tax generated from those projects. The proposal includes three recommendations.

- *Increase the allocation of the property tax to cities, counties, and special districts*

- *Authorize cities to swap sales tax with property tax for future growth*

  Beginning in 2002, the 1 percent local sales tax rate would be reduced to .5 percent for all new development. The state would pick up the remaining .5 percent in the basic state sales tax rate. The share of the property tax arising from new development would increase by 11 percent. The increased share of the property tax would come from the school's portion of the property tax

- *Provide additional constitutional protection against unfunded state mandates*

California State Association of Counties

(Website: www.scac.counties.org)

Over the last year, the California State Association of Counties (CSAC) developed and adopted a proposal for local fiscal reform. Like other proposals, this one addresses the local finance base as well as the effects of the sales tax on land-use decisionmaking. Some of the following recommendations would be implemented by constitutional amendment, others by statute.

- *Revise the allocation of the locally levied sales tax*

  This proposal seeks to neutralize the role that the sales tax plays in land-use decisions and to equalize the distribution of the growth of sales tax revenue within each county. The locally levied sales tax would be transformed into a tax allocated in part on a situs basis and in part on a per capita and "equity" basis. Specifically, this proposal would leave Bradley-Burns sales tax revenues from existing retail in place but allocate all growth above this base into three pools for allocation:

  Situs pool: Reduce situs-based growth to 50 percent the first year and reduce the percentage of the sales tax attributable to the current situs allocation over a period of five years. At the end of five years, the amount of sales tax revenue allocated on a situs basis would be 10 percent.

  Per capita pool: Within each county, city, and county unincorporated area would receive a portion of the growth in sales tax revenue based on population. Although regional agreements would be authorized, the non-situs amount of the sales tax would be allocated within the county on a per capita basis. Twenty-five percent of the growth would be dedicated to the per capita pool in the first year and would increase (along with the equity pool) as the amount of the sales tax attributable to situs declines.

  Equity pool: The remaining portion of the growth would be allocated on a per capita basis to each entity in order to bring them closer to the county average. Twenty-five percent of growth would be dedicated to this equity pool in the first year, and would increase (along with the per capita pool) as the situs pool decreases. To ensure that situs is neutralized and not simply diminished, this pool would be distributed to below average sales tax entities within each county, including the county itself if appropriate.

- *Exchange non-realignment Vehicle License Fees for a percentage of personal income tax*

  This proposal would transform the current Vehicle License Fee subvention into a new constitutionally guaranteed subvention funded by the income tax. Local governments would receive a percentage of the income tax equivalent to the actual dollar amount of VLF. This percentage amount would remain fixed over time, allowing for growth. The allocation formula would remain the same as the current VLF allocation formula.

- *Return property tax revenue shifted to schools in the early 1990s*

  California State Association of Counties has consistently supported efforts to return the property tax shifted to education agencies in the early 1990s. As part of its strategy, it is relying on the judiciary to settle the issue. In Sonoma County's lawsuit against the Commission on State Mandates, CSAC has argued that the property tax shift from local governments to the schools amounted to a reimbursable mandate under Article XIII B of the constitution.

- *Place the existing 1/2-cent transaction and use tax in the constitution*

  This proposal would move into the constitution the existing statutory authority for 1/2-cent transactions and use tax to be levied countywide with the approval of county voters. This existing authority could be modified to allow for local agreements on allocation of the revenues, but the funds would be constitutionally protected for local government.

- *Swap vote requirements for general and special taxes*

  Currently, the constitution requires tax increases used for particular purposes by a two-thirds vote. Tax proceeds used for "general" purposes require a majority vote. California State Association of Counties is recommending that the vote requirement for special taxes be changed to a simple majority and the vote requirement for general taxes be changed to a two- thirds majority.

- *Require the state to pay for the schools' proportional share of property tax administration*

  Generally, the state should provide financial assistance for state services that are administered by counties. For example, this proposal would require the state to pay counties for the schools' share of the costs of administration of the property tax.

- *Create compacts for the state-county programs*

  California State Association of Counties is proposing a new state-county relationship for programs administered by counties on behalf of the state. All state programs run by counties would be governed by a common bilateral, written compact that would spell out roles, responsibilities, duties, work programs, and finances. These compacts would also allow for innovative, creative, flexible, and more efficient service delivery at the local level by means of waivers, block grants, or other means. Each compact would contain outcome measurements, performance goals, and accountability measures.

- *Create a secretary for local government affairs*

  It has been argued that counties, as agents of the state, should be part of the state executive decisionmaking process. As partners with the state either in the direct delivery of state services or by providing countywide services (such as district attorneys or child protective services), the performance of California's counties is a direct measure of the state's performance. This cabinet-level position would improve the coordination of services and provide a focal point for services administered by the state. In addition, the secretary would be responsible for maintaining compacts and other agreements with counties.

- *Update the Commission on State Mandates*

  This recommendation would revise the membership of the Commission on State Mandates and appoint authorities to provide independent judgments on mandate claims. It would also change the commission's procedures in an effort to ensure more timely review and payment of claims.

Legislative Analyst's Office

(Website: www.lao.ca.gov)

In 1999, the legislature requested the Legislative Analyst's Office to provide a set of options for rethinking the current property tax allocation system. In *Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes* (February 3, 2000), the LAO provided five alternative approaches to revising the property tax system. The options have varying effects on such problems as limited accountability to taxpayers, lack of local control, skewed development incentives, barriers to new businesses, reliance on nondeductible taxes, and inefficient intergovernmental program coordination. The following is a summary of the alternative approaches.

- *Set uniform property tax rates*

  Each jurisdiction would be allocated a share of the property tax based on the services it provides. Based on a statewide standard for the cost of various municipal services, state statute would provide a fixed share of the property tax for each service. Under this approach local agencies, school districts, and special districts within each county would receive a set share of the property tax based on a statewide standard.

- *Provide local control over Education Revenue Augmentation Fund*

  Cities and counties would be given direct authority over the rate and allocation of a share of the property tax. Under this approach, the state would lower the property tax rate from 1 percent of market value to .9 percent. The Education Revenue Augmentation Fund would be reduced by the property tax reduction. The state would backfill the school districts for the loss. Cities and counties would be authorized to "raise" the tax rate back to the 1 percent tax rate limit if they chose to do so.

- *Set property taxes for municipal services and schools*

  The allocation of every property tax bill would be identical: half to local municipal services and half to schools. For the school share, the property taxes would be allocated from a countywide fund. The remaining property tax would be allocated to the city in which the property is located. The county would receive all of the non-school property tax in the unincorporated area. The county property tax funds could only be used for municipal services in the unincorporated area of the county. Cities or counties could elect to contract for the services of other local agencies such as special districts, the county, or redevelopment agencies. In effect, the city or the county would have complete control over the property tax dedicated for municipal services.

- *Revise the tax burden*

  Under this alternative, four basic changes would be made in the mix of local revenues.

  1. The state and local sales tax would be lowered.
  2. Local governments would increase their share of the property tax by trading a portion of the Vehicle License Fee backfill.
  3. Local governments would be allowed to raise the property tax over the current 1 percent limit under a new limit.
  4. Nonresidential property would be assessed at market value.

  These changes would reduce the state's reliance upon nondeductible taxes, provide a more balanced set of local government fiscal incentives for land-use decisions, give communities more control over the property tax rate and allocation, and reduce the barriers to entry for new businesses under an acquisition-based system.

- *Realign state and local programs and finance*

  In 1993, the Legislative Analyst recommended a plan for reforming the state- local relationship. Under that plan, the responsibilities of state and local government would be realigned to improve program coordination. The guidelines for this realignment included maximizing the separation between state and local duties; transferring program responsibility to the level of government closest to the people; opting for state responsibility for programs where uniformity is important; placing program funding and control at the same level of government; relying on financial incentives to promote intergovernmental coordination; and matching state goals for economic development with fiscal incentives for local communities.

COMPARING TWO ELEMENTS OF FISCAL REFORM

	Revising Fiscal Incentives in Land Use Decisions			Revising the State/Local Relationship	
Agency	**Decrease reliance on sales tax**	**Increase local gov. share of the property tax**		**Revise the state/local program relationship**	**State Mandate Reimbursement**
Speaker's Comm. On State/Local Finance	Swap 1/2 local sales tax for an equal amount of property tax. Local rate drops .5%, state rate increases .5%. Property tax shifted from schools would be backfilled with the state general fund.	Reduce the ERAFproperty tax shift by $1billion over 10 years @ no less than $100 million/ yr.		Establish a county/state compact to govern the funding and operation of state programs administered by counties.	
Controller Connell SMART Task Task Force	Convert the situs based locally levied sales tax to a per capita allocation for all future growth and 10% of the existing base. Within each county include a system for bringing low per capita sales tax cities up to the county average.	Cap the ERAF shift by reducing shift by $450 million.		Establish a county/state compact to govern the funding and operation of state programs administered by counties.	Appropriate reimbursement with the enactment of a state mandate.
Comm. Local Gov. for 21st Century	Revise the current situs based sales tax to reduce the negative effects and increase property tax allocations.			Initiate a process for a comprehensive realignment of state and local fiscal resources.	Appropriate reimbursement with the enactment of a state mandate.
League of California Cities	Swap .5% of the sales tax on future development for an 11 % increase in the share of the property tax arising from the new development.	Increase allocation of property tax to cities, counties and special districts.			Provide additional constitutional protection against unfunded state mandates.
Calif. State Assoc. of Counties	Convert the situs sales tax system to a per capita system including a pool in each county to equalize the per capita allocation in the county.	Return property tax shifted to schools, to local governments on the basis of the original shift.		Establish a county/state compact to govern the funding and operation of state programs administered by counties.	Revise the membership of the mandate commission and the current administrative process.

3. Legislative Proposals

At last count, 27 bills before the legislature would change the current local finance system. Over half of these bills would revise the property tax allocation among local governments. The legislature has tinkered with this allocation since 1979, one year after receiving the power to allocate the property tax. The current plans range from adjusting Education Revenue Augmentation Fund allocations of specific jurisdictions to addressing the plight of the cities with a small share of the property tax. Seven legislators, including Senate President Pro Tempore John Burton, have introduced proposals to limit or reduce the 1993 and 1994 property tax shift from local governments to school districts.

Over the last year, State Senator Steve Peace, Chairman of the Senate Budget and Fiscal Review Committee, conducted a series of local finance forums around the state. Senator Peace's primary objective was to gather the affected parties (cities, counties, and special districts) to see if there was a common denominator on the issue. Acknowledging the divergent views of local governments on the issue, Senator Peace has suggested that the discussion of the state-local fiscal structure recognize the role that the federal tax structure plays in the state and local finance system. California relies heavily on the sales tax to finance services. Unlike the property tax, however, sales tax is not deductible against federal income tax liability.

Other proposed legislation focuses on increasing state reimbursement for certain local fiscal obligations, such as property tax administration costs and homicide trial costs, and changing procedures for reimbursing state-mandated costs. Finally, the idea of per capita allocation of the local sales tax is addressed in one current bill. There are also "spot bills" that, when fleshed out, may become the basis of more comprehensive reform. A list of current legislation is provided in the Appendix.

4. Future Trends and Challenges

As the legislature begins considering reform proposals, the broader context of local governance and intergovernmental relations in California could make or break any single reform effort. That broader context includes eight general trends and challenges.

Growth

According to an estimate by the State Department of Finance, the state's population is expected to grow to 45.4 million people by 2020. Given that local governments provide the bulk of community services and infrastructure, will the local finance base be sufficient to keep pace with the state's needs? Which levels of government will enjoy revenue streams that increase with the growth in the state's economy? Which levels will get stuck with slow-growing revenue streams? Will the revenue system respond to geographical shifts in population and social need without accelerating such shifts?

Localism

Voters and many local governments are reluctant to become involved in the problems of others. How will new local finance systems deal with tension between affluent and low-income communities? Will they help communities with insufficient tax bases to provide local services? Do reform proposals recognize and deal with the unwillingness to share "local" revenues to better balance fiscal resources and responsibilities?

Whither home rule?

California's tradition of home rule has been eviscerated over the last 20 years. Will reform options protect and advance meaningful local autonomy and decisionmaking? Should the constitution be amended to guarantee an alignment of revenue-raising authority with responsibility for services? Can and should counties be restored as local governments with real independence for local and countywide functions?

Regional challenges

Jurisdictional boundaries are increasingly irrelevant for the scale of development and investment California is experiencing. The state economy is made up of regions, not local governments. Do reforms improve the current skewed land-use incentives for local governments? Do they provide greater incentives to meet regional housing needs? Does the finance system allow for regional infrastructure needs and desired growth patterns? What role should counties have in planning for regional growth?

Citizen distrust

Voters are both apathetic and extremely distrustful of "official California." Both qualities are compounded by the complexity of the financing system and the arcane nature of the specialists' debate. Many voters may feel that any proposed reform is likely a tax increase in disguise. How can reformers reassure voters about the suggested changes? Can guarantees against tax increases be provided? Can revenue-shift proposals be made fiscally neutral? How will reforms improve the transparency of public finance and residents' understanding of who receives their tax money and why?

The changing role of the state

Since World War II and particularly in recent decades, the state's former role as a builder and growth promoter have shifted to a different set of main roles: educational financier, law enforcer, social and health service provider, environmental regulator, and guarantor of individual rights. This shift has led to state budget strains, to a greater proportion of "uncontrollable" elements in the state budget, and to major load shifting to local governments. How will local finance proposals clarify the roles of state and local government? Do reforms maintain the state's ability to set statewide standards? Do they ensure counties the capacity to carry out their functions as agents of the state?

The changing role of cities

City governments today are more entrepreneurial than in the past. City leaders want to position their communities in a competitive, globalizing marketplace and to control their economic destinies. Do reforms give cities the fiscal resources, stability, and incentives to be able to pursue good visions? Do reforms allow them to compete for solid, wealth-producing investment without encouraging "wasteful competition" and zero-sum games with nearby communities?

Intergovernmental partnerships

Because cities and counties increasingly approach Sacramento as claimants, they are often viewed as just another interest group seeking a cut of the pie. The relationship between the state and local governments is rarely one of cooperative partnership. Can a sense of partnership be restored and persistent antagonism reduced? Are there any uncompensated state mandates in the proposals? Should the state create a cabinet-level Department of Community Affairs to give local governments an official voice in the administration?

5. Fiscal Effects of Major Fiscal Reform Proposals

The sales tax-property tax swap (Speaker's Commission, League of California Cities)

The Speaker's Commission proposes to swap a portion of the locally levied sales tax for a larger share of the property tax. As proposed, the swap is revenue neutral to the state general fund in the first year of implementation. The local rate would decrease by .5 percent and the general state sales tax rate will increase from 5 percent to 5.5 percent. Revenue would be shifted from the school's portion of the property tax to each city and county in an amount equal to the amount of sales tax lost. If this proposal were implemented in 2000, the first year fiscal effect would be to trade approximately $2 billion in local sales tax revenue statewide for $2 billion in property tax. The amount of property tax going to counties would be relatively small since most retail development is within cities. Although there is wide variation in the share of the property tax going to cities, on average this transaction would increase the cities share of the property tax from 11 percent to over 20 percent.

The League of California Cities proposes to swap a portion of future sales tax revenue on a specific retail project for a larger share of the property tax generated from the project. Each city would increase its share of the property tax from the new development by 11 percent.

Because the growth in the property tax allocated to school districts is a direct offset to the amount of state general fund revenue going to the schools, the state general fund will pick up the amount of the growth that would have otherwise gone to the schools were it not for the swap. As confirmed by data provided by the Public Policy Institute of California and analysis done by the California Research Bureau, it can be argued that the property tax will grow at a faster rate than the sales tax over time, which will increase the state cost of K-12 education.

Revising the local sales tax allocation (State Controller, California State Association of Counties)

The 1 percent locally levied sales tax is collected by the Board of Equalization along with all the other sales tax rates and remitted to the local agency that levied it. Two proposals have been made to redistribute the growth in the sales tax within each county. This proposal would simply reallocate an existing local tax and would not affect state revenue.

Reversing the 1992-93 and 1993-94 property tax shift from local government to schools (Speakers Commission, State Controller, California State Association of Counties, League of California Cities)

The base property tax allocations would be changed in each county by shifting property taxes currently allocated to school districts to other local governments. Although no specific local government allocation method has been recommended, the property tax shares of schools would be decreased and allocations to local government would be increased. This action is a direct cost to the state general fund because the loss of property tax incurred by the schools would be made up by the state general fund through the state school aid program. The amount of state cost would depend on the amount of property tax shifted from school districts to other local governments.

Place the existing Vehicle License Fee subvention in the state constitution (Speakers Commission, California State Association of Counties)

Since the late 1940s, the state has levied a license fee on all vehicles that is en lieu of the property tax. In effect, the license fee is a state tax used to fund local services. In the late 1990s, the state initiated a process for reducing the fee by statute and reimbursing local governments for the lost revenue. Because one legislature cannot bind the rights of the next, the legislature and the governor are free to enact a new statute that reduces the reimbursement and maintains the lower license fee. Placing the reimbursement requirement in the constitution will make it more difficult for the legislature and governor to spend the reimbursement funds on other state programs.

Place the existing .5 percent countywide sales tax authority in the state constitution (Speaker's Commission, California State Association of Counties)

Existing law authorizes a .5 percent sales tax to be levied countywide and used for county purposes. A vote of the people in the county is required. If the proceeds of the tax are used for purposes specified in the measure, the tax requires a two-thirds vote. If the purposes are not specified, the tax would require a majority vote.

Appendix

Legislation currently being considered

Bill	Author	Subject
SB 165	Rainey	Intent statement on state/local finance reform
SB 225	Rainey	State reimbursement of booking fees for special districts
SB 815	Chesbro	State reimbursement of homicide trial costs
SB 1581	Escutia	No and low property tax cities
SB 1637	Burton	Caps the growth of the ERAF
SB 1883	Sher	No and low property tax cities
SB 1919	Chesbro	ERAF allocation for fire districts
SB 1982	Alpert	State/local finance, ERAF,& sales tax allocation
SB 2000	Polanco	Local sales tax allocation
SB 2024	Lewis	ERAF spot bill
SB 2048	Leslie	$250 million for local public works
SB 2080	Leslie	$250 million reduction in ERAF
SCA 6	Rainey	State-local finance
AB 1036	Wesson	State reimbursement of counties' property tax administration costs
AB 1195	Longville	Caps the growth of the ERAF
AB 1396	Villaraigosa	Intent statement on state/local finance reform
AB 1757	Oller	$12 billion ERAF shift
AB 1806	Pacheco	Caps the growth of the ERAF
AB 1821	Mazzoni	Excess ERAF revenues
AB 1867	Papan	ERAF allocation of the Broardmoor Police Protection District
AB 1880	Brewer	Caps the growth of the ERAF
AB 2146	Bates	ERAF allocation for the City of Laguna Niguel.
AB 2549	Strickland	Intent to repeal state mandates when creating new ones
AB 2624	Cox	Changing procedures for reimbursing state
AB 2658	Baugh	Caps the growth of the ERAF
ACA 11	Briggs	Caps the growth of the ERAF
ACA 17	Leonard	Caps the growth of the ERAF

Source: Senate Local Government Committee, March 13, 2000

Sources

Final Report, Speaker's Commission on State and Local Finance, April 2000.

Report of the State Municipal Advisory Reform Team, State Controller Kathleen Connell.

Report of the State Municipal Advisory Reform Team: Enhanced Report, State Controller Kathleen Connell.

Growing Within Bounds, Report of the Commission on Local Governance for the 21st Century, January 2000.

California State Association of Counties website (www.csac.org).

Western Cities Magazine, February 2000. League of California Cities.

Legislative Analyst Office, "Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes" February 3, 2000.

Cal-Tax Digest, February and March 2000.

Related Publications of the Public Policy Institute of California

(These and all other PPIC publications can be found on the PPIC website at www.ppic.org)

California in the New Millennium: The Changing Social and Political Landscape
Mark Baldassare, 2000

Risky Business: Providing Local Public Services in Los Angeles County
Mark Baldassare, 2000

When Government Fails: The Orange County Bankruptcy
Mark Baldassare, 1998

Subsidizing Redevelopment in California
Michael Dardia, 1998

Who Pays for Development Fees and Exactions?
Marla Dresch (California State University, Hayward), Steven M. Sheffrin (University of California, Davis), 1997

*Interest Group Influence in the California Initiative Process**
Elisabeth R. Gerber (University of California, San Diego), 1998

California Cities and the Local Sales Tax
Paul G. Lewis, Elisa Barbour, 1999

Deep Roots: Local Government Structure in California
Paul G. Lewis, 1998

*Fiscal Rules and State Borrowing Costs: Evidence from California and Other States**
James M. Poterba (Massachusetts Institute of Technology), Kim S. Rueben, 1999

*Proposition 13 in Recession and Recovery**
Steven M. Sheffrin (University of California, Davis), Terri Sexton (California State University, Sacramento), 1998

Patterns in California Government Revenues Since Proposition 13
Michael A. Shires, 1999

Has Proposition 13 Delivered? The Changing Tax Burden in California
Michael A. Shires, John Ellwood, Mary Sprague, 1998

* This study was supported by PPIC through an Extramural Research Program contract.

A Review of Local Government Revenue Data in California
Michael A. Shires, Melissa Glenn Haber, 1997

The State-Local Fiscal Relationship in California: A Changing Balance of Power
J. Fred Silva, Elisa Barbour, 1999

For Better or For Worse? School Finance Reform in California[*]
Jon Sonstelie (University of California, Santa Barbara), Eric Brunner (San Diego State University), Kenneth Ardon (Pomona College), 2000

[*] This study was supported by PPIC through an Extramural Research Program contract.