~~H548~~

BY THE COMPTROLLER GENERAL 110475

Report To The Congress

OF THE UNITED STATES

Proposition 13--How California Governments Coped With A $6 Billion Revenue Loss

Although Proposition 13 cut back property tax revenues by an estimated $6 billion, it has had only a minimal impact on local California government operations Federal grant outlays have not been significantly affected

Surplus State and local government funds, a strong economic climate, and increased charges for government services all served to avoid the dire consequences predicted for Proposition 13 However, reduced funds could impair the ability of local governments to participate in new or expanded Federal grant programs

~~007127~~

110475

GGD 79 88

SEPTEMBER 28, 1979

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D C 20548

B-146285

To the President of the Senate and the
Speaker of the House of Representatives CWD00001

This report discusses the effects of Proposition 13 on Federal grant outlays to California as well as its effects on local government operations.

We provided a preliminary evaluation of the possible impact of Proposition 13 in an earlier report to the California congressional delegation's task force on Proposition 13. That report, "Will Federal Assistance to California Be Affected by Proposition 13?" (GGD-78-101, Aug. 10, 1978), provided an analysis of how State and local expenditure fluctuations could affect Federal grant outlays to California. At that time, however, the specific impact of Proposition 13 on Federal funds could not be determined because Federal funding depended on many uncertain and contingent actions yet to be taken by Federal, State, and local governments. Because of these uncertainties, we monitored actions taken by California governments in order to assess the actual impact of Proposition 13.

Copies of this report are being sent to the Director, Office of Management and Budget.

Elmer B. Staats
Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

PROPOSITION 13--HOW CALIFORNIA GOVERNMENTS COPED WITH A $6 BILLION REVENUE LOSS

D I G E S T

BCK Although Proposition 13 in California reduced local government property tax revenues by an estimated $6 billion in fiscal year 1979, a GAO analysis shows it did not have a material impact on local government programs.

State and local government surpluses, a strong economic climate, and increased fees and user charges for things such as business permits and fire protection services, all contributed to local governments' ability to maintain and, in fact, increase their expenditures in fiscal year 1979. Because a recently enacted California law has provided for a multiyear replacement of funds to help offset revenues lost by local governments, the predicted dire consequences of Proposition 13 have basically been avoided.

AC Although all types of local governments--counties, cities, special districts, school districts, and community colleges--budgeted spending increases for fiscal year 1979, funding for certain activities was reduced. The most significant result of the fiscal uncertainties caused by Proposition 13 was the cancellation of summer school and reduction of adult education programs. These programs, however, are considered lower priority than regular instructional programs, which were generally maintained at pre-Proposition 13 levels. Other local government programs were moderately affected, principally library services, parks and recreation, and cultural activities. The effects on these activities varied greatly among the localities visited by GAO.

Cutbacks in public employment have been far less drastic than was predicted. Layoffs of from 300,000 to 450,000 public sector employees had been predicted, but less than 18,000 actually occurred. The accelerated rate of attrition since the proposition's passage has been more significant. Even so, total public service employment has declined by less than 4 percent in the State. (See p. 28.)

Because Proposition 13 has had only a minimal impact on local government operations, Federal grant outlays have not been significantly affected. When the proposition first passed, some observers were concerned that local governments would not be able to meet matching and maintenance of effort requirements associated with Federal assistance programs and therefore would lose large amounts of Federal aid. But partly because of favorable fiscal factors and partly because of careful actions taken by local officials, local governments have been able to avoid losing Federal aid in the first year after the proposition was passed. (See p. 33.) In fact, Federal assistance was expected to increase over the previous year's level. (See p. 12.)

GAO found that the most noticeable result of Proposition 13 has been a reduction in the growth rate of government spending. This reduced growth rate can be expected to affect local governments' fiscal ability to participate in new or expanded Federal grant programs. Local officials said that Federal programs requiring local fiscal participation would undergo more stringent assessments than they had in the past. This attitude was even extended to capital projects fully funded by the Federal Government because of the long-term operation and maintenance costs associated with such projects.

The more cautious attitude towards Federal grant programs in California since the passage of Proposition 13, and that can be expected in other States that have passed or are considering new or additional tax or spending limitations, carries long-term implications for Federal grant policies. Federal grant requirements that impose additional costs on State and local governments, such as matching and maintenance of effort requirements, can be expected to come under increased scrutiny.

Some local governments may find it difficult or impossible to meet the fiscal requirements of any major new Federal initiatives. This could constrain the Federal Government's ability to assure that national goals are met and could increase pressure on the Federal Government to assume larger responsibilities for the costs of new initiatives. (See ch. 4.)

California's experience has been unique because State resources were available to cushion Proposition 13's impact and the economic climate within the State is strong. The minimal impact on government operations observed by GAO does not necessarily portend results which could be expected in other States where similar measures have been or might be enacted.

Contents

CHAPTER 1

INTRODUCTION

On June 6, 1978, the people of California overwhelmingly passed Proposition 13, a controversial tax-limiting initiative that the State's Commission on Government Reform called the most significant fiscal act in California's modern history. Proposition 13 sweepingly cut property taxes by more than a half, set limits on future property tax growth, established more stringent requirements for legislative or voter approval of future tax increases, and forbade any future increases in property tax rates.

In the weeks before the election, Proposition 13's bold frontal attack on government spending aroused intense debate in the State and interest across the Nation. Supporters of Proposition 13 argued that government spending at all levels in California had mushroomed out of proportion and that drastic steps were needed to bring spending under control. Supporters also argued that the amount of property tax money lost by local government units could be absorbed by State and local governments without any curtailment of vital services and that the property tax revenue remaining after Proposition 13 would be more than enough to pay for police and fire protection and other services related to property.

Opponents of Proposition 13 argued that the reduction in property taxes would lead to governmental chaos in California. Unless new taxes were imposed, opponents contended, local governments would be unable to maintain their police, fire, and school programs. The property tax cut initiative, they also warned, would make local government units increasingly dependent on the State and Federal governments.

The subsequent decisive voter approval of Proposition 13 demonstrated a strong public reaction to escalating taxes and a growing public disillusionment with the quality and efficiency of government services and the return on their tax dollars.

We provided a preliminary evaluation of the possible impact of Proposition 13 in an earlier report to the California congressional delegation's task force on Proposition 13. That report, entitled "Will Federal Assistance to California Be Affected By Proposition 13?" (GGD-78-101, Aug. 10, 1978), provided an analysis of the possible effects that local governments' budget restrictions could have under

52 major grant programs. It also analyzed situations where State and local expenditure fluctuations could affect Federal grant outlays to California.

At the time that report was written, Proposition 13's specific impact on Federal funds going to California, however, could not be determined because Federal funding depended on many uncertain and contingent actions yet to be taken by Federal, State, and local governments. The level of Federal grant outlays depended largely on such factors as local government budgetary decisions, uses made of the State surplus, and the possible waiving of Federal grant requirements.

As a result of these uncertainties, and because new or additional taxing and spending limitation measures were proposed in almost every State shortly after Proposition 13's passage, we monitored actions taken by the parties involved. The purpose of our study was to gain a thorough understanding of Proposition 13's effect on Federal funds going to California as well as its effects on local government operations. This report provides the results of our monitoring effort through the end of May 1979. Most of our field work was completed by February 1979.

LOCAL GOVERNMENT IN CALIFORNIA

More than 5,000 units of local government provide services to California's 22.3 million people. Local government entities can be classified broadly as counties, cities, school districts, community colleges, and special districts.

California's 58 counties are political subdivisions of the State that act as agents of the State government in administering such mandated and delegated functions as local courts, jails, health care, and welfare services. Generally, mandated and delegated programs are provided to all residents of a county, while programs that originate locally are only available to county residents who do not live in cities.

California county governments reported aggregate revenues of $8.85 billion in fiscal year 1978--the fiscal year before Proposition 13--of which 23 percent came from the State. Expenditures were $8.64 billion.

Cities in California are municipal corporations that have broader powers and fewer constraints than counties. The State's 417 cities range in size from Amador City with 160 residents to Los Angeles with over 2.7 million residents.

Cities typically provide such services as fire and police protection and street maintenance, but the number and types of municipal services they provide varies widely. In fiscal year 1978, 372 of the State's 417 cities reported revenues of $4.88 billion and expenditures of $4.36 billion.

Special districts are limited-purpose governments created to fill needs for specific public facilities and services, often in areas which demand higher service levels than those ordinarily provided by the county. California's approximately 3,800 special districts can be classified as either enterprise or nonenterprise. Enterprise special districts typically charge fees for services such as water, waste disposal, or electric service. Nonenterprise special districts, on the other hand, rely heavily on property taxes for their revenues and provide services such as fire protection and recreation.

In fiscal year 1977, enterprise special districts had revenues of $3.18 billion and expenditures of only $2.35 billion. Nonenterprise special districts received revenues of $1.25 billion and spent $1.11 billion. 1/

California is also divided into 1,044 school districts which provide elementary and secondary education. In fiscal year 1978, local school districts received an aggregate income of $8.19 billion, of which 38 percent came from the State. Expenditures were $7.78 billion.

California's 70 community college districts provide postsecondary educational opportunities. In fiscal year 1978, the State's community colleges reported income of $1.43 billion, of which 41 percent came from the State. Expenditures were only slightly less than revenues.

The State government is involved in virtually every area of local public service--either as a direct provider, as a regulatory authority, or in a planning and coordinating role. Furthermore, the entire system of local government and the powers of local agencies are determined by the State through the constitution or by statute.

1/Complete financial data for fiscal years 1978 and 1979 was unavailable for California's special districts. Thus, the discussion of Proposition 13's fiscal impact on special districts in chapter 2 is based on information reported to the State Department of Finance by 77 percent of the special districts State-wide.

State government revenue totaled $15.75 billion in fiscal year 1978. Thirty percent of the $15.75 billion came from personal income taxes, and 32 percent came from sales taxes. The $15.75 billion does not include another $1.40 billion in sales taxes that the State collected for local governments. State expenditures in fiscal year 1978 were $13.85 billion, of which $9.68 billion were local assistance payments. In addition to rebating sales tax revenues, the State distributes funds to local governments to compensate for homeowners property tax relief and property tax losses incurred because of preferential assessments of agricultural and open space lands. The State also allocates motor vehicle license fees, liquor license fees, and cigarette taxes to local governments.

CHAPTER 2

PROPOSITION 13 HAD MINIMAL FISCAL

EFFECT ON LOCAL GOVERNMENTS

Proposition 13 slashed California's local government revenues by an estimated $6 billion, but a combination of factors basically compensated for this loss. The principal factor was the State's action in assuming the counties' share of mandated health and welfare costs and providing block grants to all categories of local governments. In total, the State provided approximately $4.2 billion to local governments in fiscal year 1979. Additional revenues were generated through increased fees and user charges, increased Federal aid, and increased revenue resulting from the strong economic climate prevailing in California.

Cost containment efforts, particularly the cancellation of summer school, eased the fiscal pressures on local governments. Also, many local government units had substantial surplus funds which could be drawn on if needed. The net result of these factors was a total revenue loss to local governments of less than one percent. Estimated expenditures for all local governments were projected to increase by 7 percent in fiscal year 1979.

ESTIMATED EFFECTS UPON LOCAL PROPERTY TAXES

Proposition 13 substantially limited local property tax revenues. It limited property taxes to 1 percent of market value after July 1, 1978, and limited assessment increases to 2 percent annually. It also rolled back assessed property values to their level as of March 1, 1975. In addition, Proposition 13 required that any State tax increases be approved by a two-thirds vote of the State legislature and that new local taxes be approved by a two-thirds vote of the voters.

Proposition 13 was projected to slash local government property tax revenues State-wide by an estimated $6 billion compared to the year before Proposition 13's passage. Virtually all discussions of Proposition 13's expected effect on local property tax revenues were based on figures published in May 1978 by California's Office of the Legislative Analyst. The Legislative Analyst estimated that Proposition 13 would cause local government property tax collections to fall to $5.4 billion from the $11.4 billion collected the year before Proposition 13, or more than 50 percent.

Property taxes on the average made up about 44 percent of local revenues from all sources--Federal, State, and local--in fiscal year 1978, the year before passage of Proposition 13. The Legislative Analyst estimated that the State's aggregate local government revenues for fiscal year 1979 would be cut by about 22 percent.

Property tax dependency varied widely among California's local government units. Enterprise special districts were by far the least dependent since property taxes made up only about 15 percent of their total revenues. On the other hand, property taxes constituted 74 percent of the State's nonenterprise special districts' total revenues.

School districts were also heavily dependent on property taxes; 58 percent of their revenues came from this source. Community colleges were only slightly less dependent as property tax collections represented 52 percent of their total revenues.

Other local government units were less dependent on property tax collections before the passage of Proposition 13. Only 37 percent of county governments' total revenues came from property taxes, and cities depended on property tax for only 23 percent of their revenues.

Property tax dependency varied considerably within each of the categories of California's local government units. The year before Proposition 13, for example, property taxes provided anywhere from 30 to 60 percent of the revenues raised by the school districts that we visited. Similarly, property taxes in fiscal year 1978 provided from 26 to 41 percent of the revenues raised by the counties visited.

According to the Legislative Analyst's projections, cities stood to lose about 9 percent of their total revenue from all sources as a result of Proposition 13. According to the projections, counties would probably suffer a 15-percent revenue loss, school districts and community colleges would lose about 21 percent, and special districts would lose anywhere from 5 to over 40 percent of their total revenue.

STATE SURPLUS GREATLY CUSHIONED PROPOSITION 13's EFFECT

The State's large surplus greatly cushioned the property tax revenue losses of local governments under Proposition 13.

By providing $4.2 billion from its surplus to offset the projected $6 billion cut in local property tax revenues, the State was able to replace about 70 percent of local governments' aggregate lost revenues for fiscal year 1979.

The State bailout thus reduced local governments' total estimated revenue losses to $1.8 billion for the fiscal year beginning July 1, 1978. The loss was further reduced because State-wide property tax losses were not quite as great as the original estimate made by the State Legislative Analyst. The estimate overstated the actual loss by about $100 million because property assessments State-wide increased more in fiscal year 1979 than expected. Thus, the actual revenue loss to local governments after the State bailout totaled $1.7 billion. This loss represents a 16-percent reduction from the previous year's aggregate property tax revenues and a 7-percent cut in total local government revenues from all sources.

Aid to local government

When the California legislature enacted laws to reduce the severity of Proposition 13's impact, it placed restrictions on the use of bailout monies. One of the laws provided that cities' and counties' first priority for using bailout monies had to be maintaining fiscal year 1978 levels of police and fire services. The State also initially denied bailout monies to any local government that gave employee pay raises in fiscal year 1979 exceeding cost of living salary increases provided for State employees.

Because many local governments had budgetary surpluses, the State also reduced the amount of bailout monies provided to local governments with sizable surpluses. The amount to be distributed to each local government unit was reduced if the recipient had a surplus in excess of 5 percent of its total fiscal year 1978 revenues.

California's county governments gained the most from the State bailout program. The State replaced about 94 percent of the aggregate property tax revenues lost by counties State-wide. In Los Angeles County, for example, property taxes fell $692 million from fiscal year 1978 levels, but the State replaced $628 million, or 91 percent, of the loss. In the other four counties we visited, State bailout monies replaced from 67 to 96 percent of the property tax losses.

The State took over the counties' share of mandatory health and welfare program costs for fiscal year 1979, totaling $1.04 billion, and allocated $436 million in block grants to the counties. The $436 million was allotted on the basis of each county's property tax loss in relation to the property tax losses of all counties State-wide, after taking into consideration the State's assumption of each county's mandatory health and welfare costs.

Presently, 48 of the State's 58 counties are receiving portions of the block grant totaling $420 million. Of the State's remaining 10 counties, 2 counties' share of the State's funds provided for mandatory health and welfare costs exceeded property tax revenue losses, and 8 counties had surpluses in excess of their bailout allocation.

School districts fared nearly as well as county governments under the State bailout program, recovering 90 percent of their property tax revenue losses. Community colleges, on the other hand, recovered only about 63 percent of their losses. School districts and community colleges were allotted $2.3 billion in State bailout aid.

Cities State-wide recovered about 40 percent of their aggregate property tax losses through the State bailout. The cities we visited recovered from 40 to 43 percent of their property tax losses. The city of Los Angeles, for example, lost $196 million in property taxes in fiscal year 1979 as a result of Proposition 13 and recovered $82 million, or 42 percent of its losses, through the State bailout.

The State initially appropriated $250 million to assist cities, but 97 cities did not receive assistance. Fifteen cities declined bailout monies, and 32 cities were ineligible because they did not levy property taxes in fiscal year 1978. Another 50 cities did not receive a share because they had excess surpluses. The remaining 320 cities received portions of the bailout totaling $228.5 million.

Special districts State-wide recovered an average of 31 percent of their lost property tax revenues from the State bailout. Nonenterprise special districts fared far better than enterprise special districts. While nonenterprise districts recovered 45 percent of their revenue losses, enterprise districts recovered only 5 percent of their losses.

The State provided $192 million for allocation on a formula basis to special districts. The bulk of the money was provided to nonenterprise special districts. Enterprise special districts received minimal assistance because the bailout legislation recognized their ability to raise revenue directly through user charges and fees.

On July 24, 1979, the Governor of California signed into law legislation providing for a multiyear replacement of revenues lost by local governments under Proposition 13. This legislation, with a first-year cost of $4.85 billion, provides for a portion of the property tax revenues previously received by schools to be allocated among the other local government entities, the State to replace the school's lost revenue with general revenue funds, and the State to permanently assume the majority of the non-Federal costs of mandated health and welfare programs. Furthermore, unlike the first-year bailout legislation, which required maintaining prior years' police and fire service levels, the current legislation does not place any restrictions on the use of the funds received.

LIMITED OVERALL DROP IN LOCAL REVENUES

Local government's aggregate revenues for fiscal year 1979 declined only a limited amount, largely because of the State bailout. Other local revenue changes also helped to compensate for the property tax decline. These changes included increased local fees and user charges, increased Federal aid, and higher local revenues resulting from favorable economic conditions. Additionally, large surpluses accumulated by many of the State's local governments were available to further lessen the effects of the drop in revenues.

Because of the State bailout and other compensating factors, most local government units were able to largely offset their property tax losses. Aggregate revenues were expected to be only 0.7 percent below the fiscal year 1978 level. Nonenterprise special districts and community colleges expected the largest revenue reductions, as the table on page 10 shows, while cities and school districts expected modest revenue cuts. Counties and enterprise special districts, on the other hand, expected small to moderate revenue increases for fiscal year 1979.

Local Government Revenues

	Fiscal Year 1978 Actual ($ millions)	Fiscal Year 1979 Budgeted ($ millions)	Dollar Change ($ millions)	Percent Change
Counties	8,847	9,017	170	+1.9
Cities	4,879	4,762	(117)	-2.4
Enterprise districts	2,111	2,312	201	+9.5
Nonenterprise districts	642	597	(45)	-7.0
Schools	8,189	7,971	(218)	-2 7
Community Colleges	1,429	1,265	(164)	-11.5
Totals	$26,097	$25,924	(173)	-0.7

The table's reported $218-million revenue decline for California's school districts is slightly misleading. School districts State-wide are experiencing declining student enrollments, and the monies available on a per-pupil basis actually increased compared to the fiscal year 1978 level. Student enrollment was expected to decline 7 percent in fiscal year 1979. Thus, although the school districts' total revenues declined, per-pupil revenues increased 4.6 percent this year. In fiscal year 1978 the per-pupil revenue figure in the State was $1,760, while for fiscal year 1979 the figure increased to $1,841.

Similarly, the reported 11.5-percent revenue cut for community colleges is misleading, since community colleges are also experiencing declining student enrollments--down nearly 6 percent compared to the fiscal year 1978 level. Thus, per-pupil revenues declined only 6.2 percent. In fiscal year 1978 the per-pupil figure for community colleges in the State was $1,989, while for fiscal year 1979 it dropped to $1,865. Moreover, State community college officials told us that the fiscal year 1979 revenue total shown in the table is probably understated.

Revenue losses partially offset by fees and charges

Local governments partially offset property tax revenue losses resulting from Proposition 13 by imposing new or increased fees and user charges. Local governments were expected to obtain an estimated $344 million in additional revenues in fiscal year 1979 from these sources, according to the State Department of Finance.

Since the passage of Proposition 13, local governments throughout California have raised such fees and charges as business permit fees, local planning fees, and fire protection service charges. About 60 percent of the cities and counties and many special districts raised fees or user charges either immediately prior to or following the passage of Proposition 13.

Planning and development fees related to new construction were an important source of local revenue increases. About half the State's counties and 30 percent of the State's cities were expected to raise fees charged to builders of new structures.

Utility service charges--such as local charges for sewer services--were expected to be the second most important source of local revenue increases. Other major categories of new or increased fees and charges expected to help offset local property tax losses included business license fees, park and recreation fees, and hotel and motel occupancy taxes.

Numerous other fees and charges were imposed or increased following the passage of California's property tax cutting initiative. Some of the more common were library use fees, ambulance service charges, parking and traffic fines, and animal control charges.

Cities were expected to gain nearly $103 million from new or increased fees and charges. Thus, such revenue sources were expected to replace 18 percent of the cities' aggregate property tax losses resulting from Proposition 13.

Cities that we visited replaced anywhere from 0 to 64 percent of their property tax losses by imposing new or increased fees and user charges. The $5.2 million the city of Sacramento expected to raise from such revenue sources, for example, would offset 35 percent of the city's $15 million property tax losses in fiscal year 1979. The State bailout was expected to replace another $6 million, or 40 percent, of Sacramento's fiscal 1979 property tax losses.

Similarly, the $8.3 million the city of Oakland expected to raise in fiscal year 1979 from new or increased fees and user charges would offset 38 percent of Oakland's $22 million property tax losses. The State bailout was expected to replace an additional $9 million, or 42 percent, of Oakland's property tax losses in fiscal year 1979.

In contrast, the State's counties were expected to raise a modest $27 million through new or increased fees and user charges. This amount represents about 2 percent of the property tax losses sustained by the State's counties.

The counties we visited typically replaced little of their property tax losses by increasing fees and charges. Sacramento County, for example, did not impose any new or increased fees and charges. The State bailout replaced $52 million, or 96 percent, of the county's $54 million property tax losses.

Enterprise special districts, on the other hand, more than offset their property tax losses by generating higher revenues from fees and charges. These entities were expected to raise $205 million from new or increased fees and charges as compared to their reported $99 million property tax loss. Nonenterprise special districts were expected to raise a modest $6 million from new or increased fees and charges.

Growth in federal aid and other local revenues

Proposition 13's impact on local governments has also been softened by increases in Federal aid, by expected higher local revenues produced by favorable economic conditions, and by increases in aid from various government sources. Local government units were expected to gain an estimated $495 million more than fiscal year's 1978 level from such sources.

The State's county governments were expected to receive $156 million more in Federal assistance than they received the year before Proposition 13. Furthermore, because of California's strong economic conditions, other county revenues--such as sales tax revenues--were expected to contribute an additional $66 million to county governments. When this $222 million increase is added to the State bailout funding, the total amounts to 110 percent of county governments' aggregate property tax losses.

The State's city governments also reported expected increases in revenues from local sources due to strong economic conditions. Aggregate revenues from various local sources, including sales taxes, were up about $92 million compared to fiscal year 1978.

As with county governments, Federal assistance to California cities is expected to increase in fiscal year 1979 But the amount of the expected aggregate increase is unknown because most cities follow the budgetary practice of incorporating Federal grants into their budgets only as these funds are received throughout the year.

As a result of their budgetary practices, city government budgets showed a 23-percent drop in expected Federal assistance from fiscal year 1978 to 1979. This reported decrease distorts the situation, though, since Federal assistance to cities in fiscal year 1979 will probably increase by 10 to 15 percent.

For example, the City of Los Angeles' fiscal year 1979 budget shows a large drop in Federal assistance when in fact the city will probably get 18 percent more than its fiscal year 1978 revenue from Federal programs. The city received $276 million in fiscal year 1978 from Federal programs, but only included $112 million in its fiscal year 1979 budget. The city has estimated that throughout fiscal 1979 it will actually receive Federal assistance totaling $326 million, or 18 percent more than it received the previous year.

Revenue increases from all sources in fiscal year 1979--State bailout, new or increased fees and user charges, local revenue increases due to strong economic conditions, and Federal assistance--will likely offset about 88 percent of the cities' aggregate property tax losses. As a result, cities State-wide in fiscal year 1979 will likely experience a 2-percent decrease in total revenue compared to the year before Proposition 13.

Special districts expected to gain $103 million more in fiscal year 1979 than in fiscal year 1978 from increases in intergovernmental aid other than State bailout assistance. Enterprise special districts reported a $66-million revenue gain over fiscal year 1978 levels from such sources Similarly, nonenterprise districts reported a $38-million increase over 1978 levels in aid from various government sources other than the State bailout assistance.

LOCAL SURPLUSES AVAILABLE TO OFFSET PROPOSITION 13 TAX LOSSES

Most local government units in California had surplus funds which could be tapped to help offset their property tax losses. Aggregate local government surpluses available at the beginning of fiscal year 1978 were estimated to total $2.5 billion. Thus, aggregate local surpluses alone were more than sufficient to offset local governments' estimated $1.7 billion in property tax revenue losses still remaining after the State stepped in and provided bailout monies.

State-wide county and city surpluses at the beginning of fiscal year 1979 were reported to total nearly $1.3 billion. As of June 30, 1978, counties had accumulated aggregate surpluses of nearly $521 million, and cities had aggregate surpluses of $776 million.

School district and community college surpluses were estimated at $690 million and $190 million, respectively. Special district surpluses State-wide were estimated to total $346 million. Enterprise special districts had accumulated $303 million of this total.

Generally, the localities we visited had accumulated sufficient surpluses at the end of fiscal year 1978 to offset property tax losses not compensated for by State bailout monies and increased revenues from other sources.

Santa Monica, a city that received no State bailout monies and that offset $1.6 million of its $3 million property tax loss with revenue increases, for example, had accumulated surplus funds of $7.8 million as of June 30, 1978. Similarly, Stockton, which had $3 million in losses after receiving new revenues and State bailout funding, had a $7-million surplus at the end of fiscal year 1978. And the city of Sacramento, which replaced 93 percent of its $15 million property tax losses through increased revenues and the State bailout, had nearly $16 million in surplus funds to cover its remaining $1 million revenue loss.

STATE ACTION TO CONTAIN LOCAL GOVERNMENT COSTS

In addition to providing direct fiscal relief to local governments, the State also took steps aimed at containing local government costs. In a successful attempt to assure adequate funding for regular education programs, the State Department of Education encouraged school districts to cancel nonmandated summer school classes. The State also attempted to contain local government costs by imposing a pay freeze as a condition of obtaining bailout funds. This attempt proved unsuccessful, however, because of a subsequent State Supreme Court ruling.

Districts regular education programs

Proposition 13's impact on California's school districts' regular education programs was softened by steps taken to hold down costs in fiscal year 1979. The State's school districts contained costs by eliminating most summer school classes and by cutting back some adult education programs. The resultant savings in salaries, supplies, and utility costs reduced the school districts' State-wide revenue needs this year by $370 million, according to State school officials.

These cost reduction actions, taken together with the additional monies provided by the State bailout, more than offset the property tax revenues lost by the school districts in fiscal year 1979. The $370 million cost reduction represents 17 percent of the property tax revenues lost by the school districts. As previously discussed, the State bailout alone replaced about 90 percent of the school districts' property tax losses.

The State's 1,044 school districts canceled about 90 percent of their 1978 summer school classes. The State Department of Education encouraged this cutback because summer school is considered one of the least essential instructional services provided by the school districts. The school districts allocated monies saved by this cutback to higher priority educational programs during the regular school year. Similarly, California's school districts eliminated or curtailed the lowest priority adult education programs in the 1978-79 academic year.

Unsuccessful attempt to contain payroll costs

The State legislature unsuccessfully attempted to further contain local governments' costs by imposing a pay freeze on local government employees. The State bailout legislation enacted in the aftermath of the property tax cut initiative provided that:

--No State funds would be given to local governments that gave cost-of-living pay raises in the 1978-79 year in excess of the pay raises provided for State workers.

--Any contracts between local public agencies and employee groups that provided for cost-of-living pay raises exceeding that provided for State workers were null and void.

The State then froze pay raises for State workers which resulted in a pay freeze for most local government employees. A pay freeze for fiscal year 1979 could have contained local governments' payroll costs by about $850 million, according to State calculations.

However, the California State Supreme Court nullified the pay freeze provisions of the State bailout law. The court ruled that local governments had to honor contractual agreements to give salary increases where the contracts were in effect before the bailout legislation was passed.

The ruling, however, will have minimal effect on local governments' budgets this fiscal year. Virtually all local jurisdictions anticipated the ruling and set aside sufficient funds to pay any salary increases agreed to before the bailout legislation was passed.

In Oakland, for example, 2,600 of 3,900 public employees were scheduled to receive pay raises of about 6 percent in July 1978. In anticipation of a decision that would mandate the increases, Oakland set aside sufficient funds to pay for the contracted pay raises.

Other jurisdications we visited also budgeted funds in anticipation of the pay freeze ruling. Alameda County reserved $6.8 million to pay a 4-percent pay raise to 6,500 county workers covered by contracts. Similarly, Los Angeles County reserved $50 million to pay for salary increases.

NET EFFECT--SPENDING GROWTH RATE SLOWED THIS YEAR

The immediate net effect of Proposition 13 was a slowed rate of spending growth. Most local government units in California expected to spend more in fiscal year 1979 than they spent the year before the passage of Proposition 13, according to data compiled by the State Department of Finance. The growth in spending by local governments State-wide was expected to slow to 7 percent, though, from an annual growth rate of over 10 percent in the previous 3 years.

Fiscal year 1979 total spending increased by approximately $1.7 billion, or from $24.6 billion in fiscal year 1978 to $26.3 billion. All types of local governments' budgets reflected spending increases for fiscal year 1979.

--Enterprise special districts projected the largest spending increase. Spending was expected to climb from $1.8 billion in fiscal year 1978 to $2.3 billion in fiscal year 1979, a 27-percent increase.

--Nonenterprise special districts planned a 14-percent increase, or an increase from $599 million to $685 million.

--County governments projected a 9.5-percent increase, or an increase from $8.6 billion to $9.5 billion.

--Cities and community colleges budgeted modest increases. Both categories planned 3.8-percent increases. City budgets increased State-wide from $4.4 billion to $4.5 billion, and community college budgets increased from $1.43 billion to $1.48 billion.

--School districts' 1-percent budget increase, or from $7.78 billion to $7.84 billion, was the smallest increase.

Seven of the 11 cities and counties we visited budgeted more spending for fiscal year 1979 than they spent in the year preceding the passage of Proposition 13. However, the rate of the budgeted spending increases was generally lower than the rate at which their budgets had increased over recent years. The seven governments budgeted spending increases for fiscal year 1979 ranging from 1 to 17 percent.

San Joaquin County's budget had increased an average of about 11 percent over the past 3 years but grew only 5 percent for fiscal year 1979. Similarly, spending in Sacramento County had climbed about 8 percent annually over the past 4 years, but the county's fiscal year 1979 budget was only 2 percent above last year's level.

In contrast, Lake County's budget this year was 17 percent higher than its pre-Proposition 13 spending level, or 2 percentage points higher than the county's annual spending growth rate of 15 percent in the preceding 3 years. The city of Stockton's budgeted expenditures grew a less dramatic 9 percent over last year's level. Since 1974, Stockton's budgets had grown about 15 percent a year.

Four jurisdictions, on the other hand, budgeted overall expenditure cuts from fiscal year 1978 levels. Budgeted expenditures in the city of Sacramento fell 12 percent, and in Alameda County fell 11 percent. The cities of Oakland

and Santa Monica budgeted cuts of 4 and 3 percent, respectively. Oakland's expenditures had grown about 12 percent annually during the 3 years preceding the passage of Proposition 13.

CONCLUSIONS

Proposition 13 reduced local government revenues by an estimated $6 billion without having a material impact on local government finances. Existing State and local government surpluses, increases in fees and user charges, and the strong economic climate in California all contributed to local governments' ability to maintain and, in fact, increase their level of expenditures. For fiscal year 1979 however, the tax-cutting initiative slowed the rate of growth of California's local government sector and in some cases caused absolute spending cuts.

CHAPTER 3

MINIMAL IMPACT ON LOCAL PROGRAMS AND SERVICES

Because Proposition 13's fiscal effects were mostly mitigated, local governments avoided having to make the widely predicted large program or service cuts in fiscal year 1979. Local governments also avoided having to make the predicted massive layoffs of public employees.

Welfare, health, public safety, and education (in terms of regular instructional programs) were generally the least affected local programs. These programs were minimally affected, in part, because the State mandated continuing the same service levels in these areas as were provided the year before Proposition 13. Hence, library, parks and recreation, cultural activities, summer school, and adult education programs absorbed the largest budget reductions. Except for summer school and adult education programs, however, fiscal year 1979 was more a period of moderate or minimal cuts than of sharp budget reductions.

CITY AND COUNTY PROGRAMS MOST SEVERELY AFFECTED

Library services, parks and recreation services, and cultural activities were the most severely affected county and city programs on a State-wide basis, according to data compiled by California's Department of Finance. Counties planned to reduce fiscal year 1979 spending for library services by 12 percent on the average and planned to cut recreation and cultural service budgets by 18 percent. City budgets showed an average reduction of about 8 percent for both libraries and parks and recreation.

Cities and counties generally devote small portions of their expenditures to library, parks and recreation, and cultural services. In fiscal year 1978 library spending represented only 0.4 percent of total county expenditures in California, and monies spent on recreation and cultural activities that year amounted to less than 2 percent of total county expenditures. Somewhat larger portions of city expenditures were devoted to such services. Libraries accounted for 2 percent of total city spending in the State, while monies spent for parks and recreation activities made up 10 percent of the total spent by cities.

The localities that we visited generally had also cut back budgeted spending for general administration and public safety programs. But, on a State-wide basis, aggregate city and county budgets for fiscal year 1979 showed spending increases for general administration and public safety programs, except for one local public safety program. City budgets for fire protection were the exception because planned expenditures for fire protection services showed a modest 0.1-percent decline compared to the prior year's level.

Parks and recreation reductions

Nine of the 11 cities and counties we visited reduced their budgets for parks and recreation services by 4 to 75 percent. Even the largest budget reductions, though, were not expected to force cities and counties to close parks. Instead, park maintenance was expected to suffer, and some recreational activities were expected to be reduced or eliminated.

Alameda County is a representative case. It planned to cut its recreation budget to bring its maintenance expenditures in line with the revenues received from renting nine county-owned buildings to the public. The county expected that public groups renting the facilities for various recreational or social events would be willing to absorb more of the actual custodial and maintenance costs.

Following are examples of how other cities and counties planned to cut back on parks and recreation services in fiscal year 1979.

City of Los Angeles

To reduce its parks and recreation budget by $5 million, or 18 percent, the city of Los Angeles made plans to operate and maintain municipal recreation and senior citizen centers with 12 percent fewer city personnel. The city also expected to cut maintenance and eliminate certain municipally supported sports events such as winter swimming. In addition, the city planned to eliminate night security forces at the zoo, some ethnic festival programs, and some cultural programs such as arts, crafts, dance, drama, and costume workshops. And finally, the city planned to shorten swimming pool operating hours by about 2 hours on Saturdays and to close the pools four out of the five nights they were previously open. The city planned to keep most other parks and recreation facilities open the same days and hours they were open before Proposition 13 passed.

Santa Monica

The city of Santa Monica cut its parks and recreation budget by 11 percent and cut its staffing by 16 percent. As a result, the city planned to reduce its maintenance of city facilities, close a rifle range, and close one of two municipally supported swimming pools. The city also expected to cut back such night recreational activities as basketball tournaments. The city expected to keep all its parks open the same days and hours they were open before the passage of Proposition 13.

Los Angeles County

To reduce its parks and recreation budget by 17 percent, Los Angeles County planned to decrease its grounds and facilities maintenance and to discontinue cleaning parks on weekends. The county also planned to cut its recreation program hours from 8 to 6 hours daily and swimming pool hours by 3 hours daily.

Changes in library services

Six cities and counties we visited planned to reduce their fiscal year 1979 library budgets. The planned spending reductions ranged from 7 to 33 percent but were generally expected to have only a moderate impact on library services. Alameda County and the city of Sacramento illustrate Proposition 13's impact on library services; these localities planned library budget reductions of 27 and 25 percent, respectively.

Alameda County

Immediately following the passage of Proposition 13, Alameda County closed its libraries for one month. Otherwise, the most notable service impact since the county's libraries have reopened has been delays in obtaining books requested from other branches of the library system and the establishment of a limit on the number of books a person can request from other branches. Previously, one person could request an unlimited number of books, but under the new limit no more than two books can be requested daily. In addition, the books requested were previously made available within 3 days while after Proposition 13's passage providing the books was expected to take up to 2 weeks.

City of Sacramento

The city of Sacramento planned to reduce its library system's operating hours by 19 percent. The weekly operating hours were to be cut from 1,356 to 1,098. Hence, some libraries were scheduled to be closed on Saturdays, and evening hours during the week were expected to be reduced.

Reduced support of local cultural activities

Six cities and counties we visited planned to reduce their cultural activity budgets for fiscal year 1979. The planned reductions varied greatly, ranging anywhere from 7 to 57 percent.

Several jurisdictions planned to curtail their support of local civic or cultural organizations. San Joaquin County's budget, for example, eliminated contributions to the local symphony orchestra. As a result, the symphony expected to cancel one off-season concert.

Los Angeles County's fiscal year 1979 budget for cultural activities was reduced by $1 million from the previous year's level of $14.4 million. Basic cultural services were expected to be minimally affected in part because more volunteers and private organizations were expected to step in to help compensate for the planned decrease in county expenditures. However, some low enrollment art classes and some music performances were scheduled to be eliminated. In addition, the county's six cultural centers expected to provide fewer art exhibits as well as fewer educational and informational services. One cultural center also expected to reduce its operating schedule from 9 to 7 hours daily.

General administration budget reductions

Six of the cities and counties we visited planned to reduce their general administration budgets. Five cities planned general administration budget reductions ranging from 5 to 27 percent. Los Angeles County's budget for general administration was also cut by 13 percent. Some of the more extensive general administration budget cuts occurred in programs and activities not providing direct public services.

The city of Sacramento's 27-percent budget reduction for general administration from fiscal year 1978 levels was the largest budget cut we found in the five cities. Sacramento's budget cut was expected to cause master planning delays, data processing error rate increases, and year-end, city book closing delays.

Los Angeles County reduced its budget for general administration by $28 million. The county did not expect this reduction to affect services directly provided to the public. County departments planned instead to curtail or eliminate certain internal services or programs. The county controller, for example, planned to curtail the amount of accounting assistance given to other county departments and to cut back on audit activities. The personnel department planned to eliminate the training services it had been providing to other departments and to drop its productivity monitoring program. The county also planned to delay building maintenance and alterations. And finally, the county planned to cancel the scheduled replacement of all nonemergency county vehicles.

Changes in public safety services

Five of the cities and counties we visited planned to moderately reduce their public safety budgets from fiscal year 1978 levels. Local officials stated that the planned reductions were mostly being made in areas which would not directly affect public safety.

The city of Los Angeles, which planned the largest police and fire department budget reductions, cut public safety expenditures by 8 percent. City officials maintained that the expected spending cuts would not lower the level of protective services provided city residents. The Assistant Chief of Police, for example, said that by making such internal adjustments as reassigning personnel from community relations to patrol duty, the city would be able to maintain the same level of police protection for its citizens as it did prior to the passage of Proposition 13.

Similarly, the Los Angeles City Council concluded that, although the number of firefighting positions had been reduced by 10 percent, the fire department would provide substantially the same service levels it provided the year before Proposition 13 passed. The fire department planned to make staffing and procedural changes and to emphasize fire inspection and prevention activities to increase the fire department's efficiency and offset the budget cuts.

MINIMAL IMPACT ON REGULAR SCHOOL PROGRAMS

Proposition 13's impact on California's regular instructional programs has been minimal. The greatest program impact has been on summer school and adult education classes. Minor reductions have occurred elsewhere.

According to a State Department of Education survey, California local school districts have been able to carry out their regular instructional programs because the State replaced a substantial portion of the revenues lost at the local level. Local school district officials who we interviewed echoed the department's conclusion. They described Proposition 13's impact on regular instructional programs as minimal. While some reductions were made, officials stressed they occurred in areas having the least direct impact on students.

Summer school cutbacks

In contrast to regular instructional programs, summer school classes were drastically reduced due to Proposition 13. With the exception of mandatory courses, most school districts cancelled 1978 summer classes. Cancellations resulted in a 90-percent reduction from the State-wide average daily attendance of the previous summer.

Summer school classes at community colleges were also reduced, although not as pervasively. Average daily attendance at these classes was down 50 percent State-wide from the preceding summer.

Summer class reductions reflect both the timing of Proposition 13 and the priority of these classes. When Proposition 13 first passed, the State Department of Education encouraged local school districts and community colleges to reduce summer classes in order to avoid expenditures that could further reduce resources available for the regular academic year. Officials in the four districts we visited added that summer class reductions also reflected the lower priority such classes have in relationship to regular instructional programs.

Summer classes cancelled by the State's local school districts had a variety of objectives. Many of the cancelled classes had been designed to provide enrichment activities. One district we visited, for example, cancelled a program in which students had previously staged a musical each summer. Another district cancelled a yearly reading camp at a nearby lake. Other cancelled summer classes provided remedial or makeup opportunities. Reading classes and an arithmetic class for students needing special assistance were cancelled in one district we visited. Another district cancelled many summer classes designed to help students make up for missed or failed classes.

Certain summer school classes mandated by the State were offered in all the districts we visited, however. These mandated classes included classes for graduating seniors and for the handicapped. The State Department of Education is proposing that these mandated classes be continued and expanded to include remedial classes for the summer of 1979.

Adult education reductions

Many school districts also eliminated or curtailed their adult education programs. One district, for example, reduced the number of adult classes by 40 percent from the previous year. This district was also charging fees for its remaining adult classes, except for its mandated classes. A significant portion of the eliminated classes had provided activities for the elderly and home economics skills for the poor.

The magnitude of adult education class reductions in another district is shown by an expected decline in attendance from about 4,500 students in fiscal year 1978 to about 2,000 in fiscal year 1979.

All four districts we visited, however, offered the adult classes mandated by the State. These included classes in elementary and secondary basic skills, English as a second language, citizenship, vocational skills, and various classes for the handicapped.

Regular instructional programs largely unaffected

California's school districts' budget cuts in the wake of Proposition 13 have affected some school operations, but have generally not affected the regular instructional programs. The most severe budget reductions for fiscal year 1979 in the four school districts we visited were expected to result in the following kinds of changes:

--Two districts planned to increase their average class sizes to reduce staffing needs. One district expected to increase the average class size by one student. This change would result in 30 students being taught in the average class in grades kindergarten through 9 and would lead to 28 students being taught in the average class in grades 10 through 12. The other district planned to increase the average class size by two students. This increase would result in an average of 29 students for grades kindergarten through 9 and 33 students for grades 10 through 12. Officials in both school districts commented that these increases were not large enough to adversely affect the average class in their districts.

--Two school districts planned to cut back on transportation services. Thus, some students were expected to walk as much as 1 mile further to school if their parents could not furnish transportation.

--One school district planned to significantly reduce expenditures for classroom supplies. Reductions in spending for supplies ranged from 30 to 50 percent among the schools in this district. A district official commented that this would result in schools providing only the bare essentials in classroom.

--All the districts we visited planned to defer some capital expenditures. For example, one district planned to save about $80,000 by delaying equipment purchases. The delay could result in the district using old equipment like movie projectors and lawn mowers for an additional academic year. Another district expected to defer a roof repair program scheduled to cost $100,000 annually over the next few years.

--Similarly, all districts planned to reduce maintenance budgets. Planned reductions ranged from a slight cutback in one district to a 25-percent cutback in custodial staff positions in another. In another district, scheduled preventive maintenance was expected to be eliminated, and only absolutely necessary daily maintenance was to be done. Another district planned to delay some scheduled preventive maintenance projects, such as painting and roof repairs. A district official told us that less clean school buildings could have a negative impact on student attitudes toward learning.

The reductions discussed above should be viewed in the context of the declining student enrollment at three of the four school districts we visited. As a matter of course, budget reductions occur in school districts experiencing a loss of students because most State school aid monies are allocated on the basis of average daily student attendance. Hence, declining enrollment causes a drop in State funds provided to school districts. Local school officials pointed out that declining student enrollment as well as Proposition 13 contributed to these reductions.

PERSONNEL REDUCTIONS ATTRIBUTABLE TO PROPOSITION 13

Personnel cutbacks in public employment have been far less dramatic than the dire predictions made prior to the passage of Proposition 13. Opponents of Proposition 13 claimed the property tax cut would necessitate a massive layoff of 300,000 to 450,000 public employees. Public employment data developed by the State, however, showed that 26,500 employees lost their jobs as a result of Proposition 13 and that approximately 9,500 of these employees were subsequently rehired. Larger personnel reductions in public employment, over 90,000, occurred through attrition. Thus, public service employment was cut back by a far smaller amount than was predicted, and as is discussed below, the reduction figures now being used may be somewhat inflated.

State data on Proposition 13 related layoffs

The State's Employment Development Department (EDD) has developed data on local government layoffs resulting from Proposition 13. EDD acquired the data by direct contact with local officials, and the EDD official in charge of summarizing the data has noted several weakness in the process. He noted that jurisdictions have sometimes (1) refused to provide the State with information or (2) reported positions eliminated rather than persons laid off. Although it is impractical to measure the net effect local jurisdictions' reporting practices have had on the accuracy of EDD's figures, some distortions have definitely occurred. For example, one local official responsible for providing EDD these statistics told us the State's dogged persistence in requesting data became annoying. As a result, the official stated he was reporting meaningless figures in order to satisfy State requests with a minimum of effort.

In some of the jurisdictions we visited, State EDD figures on the number of laid off employees did not agree with data we obtained from local officials. EDD, for example, reported 119 layoffs in Sacramento County as of October 1978, but records kept by the County Personnel Department showed that only 9 employees were laid off. County officials suggested the State was reporting the number of filled positions to be eliminated rather than actual layoffs. Alameda county officials said that EDD's data on employees laid off in the county was inaccurate. EDD reported that the county had rehired only 295 employees as of November 1978 while a county personnel officer claimed they rehired about 600 persons. Thus, according to the county, the State figure on the net number of layoffs in the county was overstated by more than 300 employees.

Personnel reductions resulted mainly from attrition

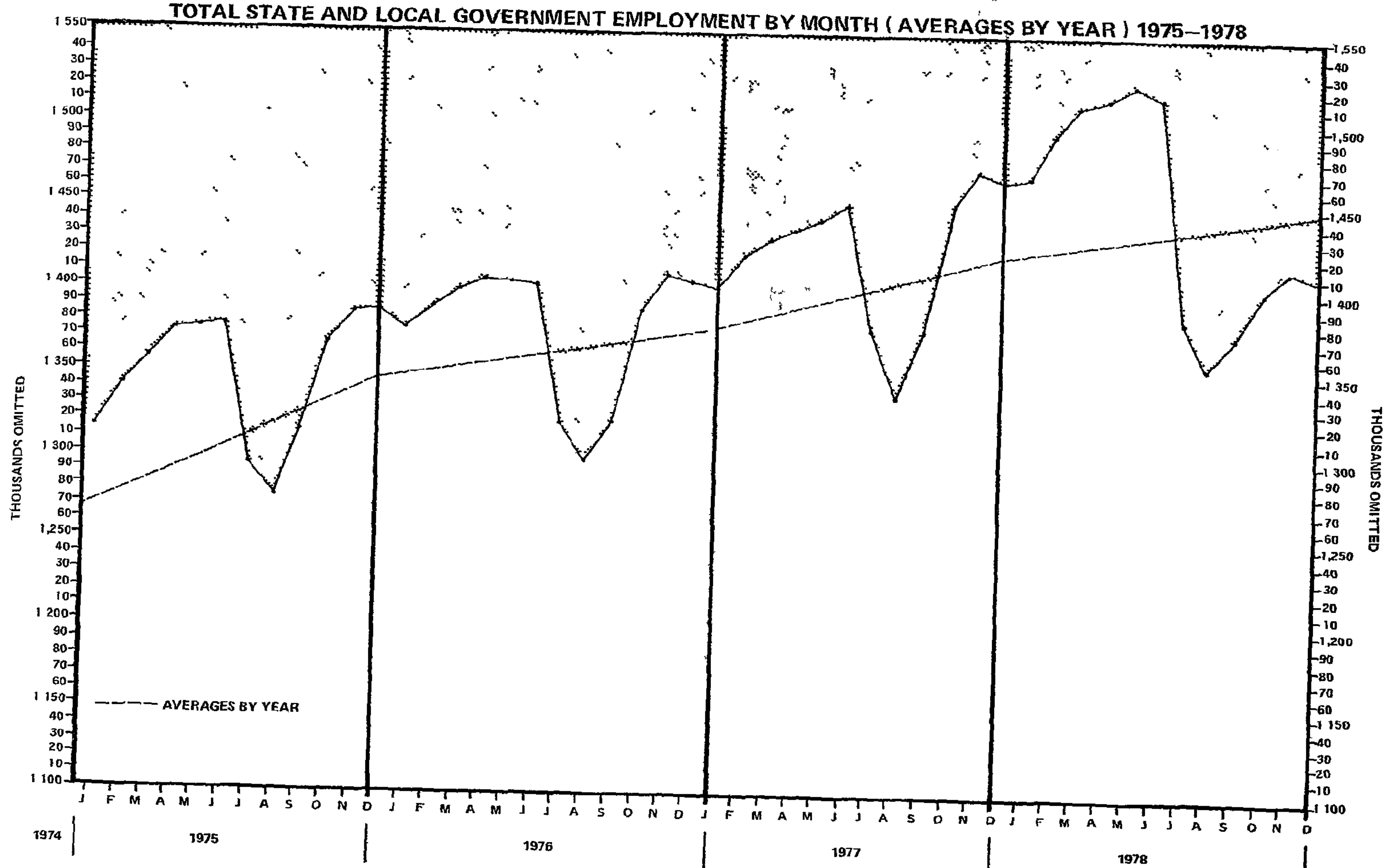
State data indicates that most personnel reductions resulted from attrition rather than layoffs. According to that data, public employment declined by about 112,000 jobs between May and December 1978. Of the 112,000, 94,000 resulted from attrition and 18,000 from layoffs. Although a review of the State's public employment data confirms the employment decline between May and December 1978, it should be noted that public employment in California follows a cyclical annual pattern shown by the graph on page 29.

As the graph shows, a cyclical downturn in employment occurs during the summer months each year. Thus, a portion of the personnel reductions following the passage of Proposition 13 can be attributed to the normal cyclical fluctuation. Furthermore, the annual high point in public employment (May or June) has increased each year until in May 1978 employment reached over 1.5 million, up nearly 82,000 (6 percent) from May 1977 levels. Likewise, the annual low points have consistently risen. Employment in August 1978 stood at 1,356,000, while in August 1977, 1,336,500 persons were employed.

While cyclical fluctuation may account for the decline through August or September, employment did not completely rebound in the fall months as it has in preceding years. Therefore, total public employment apparently has been affected to some extent by Proposition 13, though not to the full magnitude some predicted. A comparison of year-end employment data for 1977 and 1978 is useful in attempting to judge the impact of Proposition 13. Public employment at year-end receded from 1,465,900 in 1977 to 1,409,800 in 1978, a decline of 56,100. This represents less than a 4-percent reduction in the total number of public employees in the State.

Regardless of the immediate impact, it is clear that the rate of growth in public employment has ebbed. The growth in average annual public employment in recent years is shown by the table on page 30.

TOTAL STATE AND LOCAL GOVERNMENT EMPLOYMENT BY MONTH (AVERAGES BY YEAR) 1975–1978



Source California Employment Development Department

Year	Average Annual Public Employment	Percentage Change
1972	1,176,400	-
1973	1,213,300	3.1
1974	1,265,500	4.3
1975	1,345,500	6.3
1976	1,376,200	2.3
1977	1,421,200	3.3
1978	1,447,700	1.9

The 1.9 percentage increase for 1978 is lower than the figure which could have been expected if the cyclical pattern demonstrated in prior years had continued.

Future impact on public service employment

A number of public administrators are concerned that one of the long-term effects of Proposition 13 will be a decline in the caliber of public service employees. Those who have raised this concern contend that it will be brought about by the combined effects of the voters' evident lack of confidence in the public sector as was expressed in the Proposition 13 election, the limitations on funds available for salaries and program innovations, and the general instability of public service employment.

The local officials we contacted repeatedly voiced particular concern about two immediate impacts. Officials pointed out that Proposition 13 restraints on local governments' abilities to function as they have in the past are having a negative impact on their ability to recruit qualified employees. For the same reason, local governments are losing capable employees to the private sector, the officials said.

Public employees are seeking private sector jobs because morale was adversely affected by

--the initial dire predictions of massive layoffs made prior to the passage of Proposition 13,

--the uncertainty prevailing prior to passage of the State bailout bill that caused many localities to issue large scale termination notices, and

--the pay freeze imposed as a condition for receiving bailout aid.

According to local officials, these factors have prompted many public service employees to begin looking at the private sector as a viable career alternative and have caused potential new employees to be far more hesitant about entering public service. It is difficult to assess this potential impact; however, particularly in a period of rising private sector employment, these factors may well have contributed to the increased attrition since Proposition 13 passed.

CONCLUSIONS

In relation to local government programs the most significant result of the fiscal uncertainties caused by Proposition 13 was the cancellation of summer school and the reduction of adult education programs. State Department of Education and local school district officials, however, pointed out that these programs are considered lower priority than the regular instructional programs, which were basically maintained at pre-Proposition 13 levels. Other local government programs were moderately affected, principally in the areas of library services, parks and recreation, and cultural activities. The degree to which these activities were affected, however, varied greatly in the localities we visited.

Similarly, personnel cutbacks in public employment have been far less drastic than was predicted. Proposition 13's opponents had predicted massive layoffs of from 300,000 to 450,000 employees, but less than 18,000 layoffs have actually occurred. More significant has been the accelerated rate of attrition since Proposition 13's passage. Even so, total public service employment has been reduced by less than 4 percent in the State.

CHAPTER 4

EFFECTS OF PROPOSITION 13

ON FEDERAL GRANT OUTLAYS

Initially, the passage of Proposition 13 aroused fears that California could lose significant Federal aid each year because of projected local spending cuts. Such fears, however, have proved to be unfounded. Proposition 13 will actually have little short-term effect on Federal spending primarily because the measure's fiscal effects on local government have been mostly mitigated. Moreover, local government entities have been careful not to trigger the loss of Federal aid by failing to allocate sufficient funds to satisfy matching and maintenance of effort requirements.

In our earlier report on the potential impact of Proposition 13 on Federal assistance to California (see p. 1) we described how State laws limiting taxation and expenditures could affect Federal grant outlays because of the following three features of the Federal grant system.

1. Matching requirements--Sixty percent of Federal grant programs require that State and local governments provide a specified non-Federal share of grant costs as a condition for receiving Federal assistance.

2. Maintenance of effort requirements--Many Federal grant programs require grantees to maintain a prior fixed level of fiscal effort. Other programs require that Federal funds be used only to supplement non-Federal funds that would be available in the absence of the Federal grant. Thirty-seven of the 52 Federal grant programs with over $100 million in fiscal year 1978 funding have maintenance of effort requirements.

3. Formula allocations--Thirty-two of the 93 Federal formula grant programs increase funding in response to higher grantee expenditures or taxing efforts. Thus, a lower level of expenditures or tax effort could result in lower Federal assistance.

Although these features of the Federal grant system did not materially come into play during the first year following the passage of Proposition 13, they very likely will have some effect in the future. Proposition 13 has had a dampening effect on California local governments' enthusiasm for expanded participation in federally assisted programs which would place additional demands on their already constrained budgets. Mounting fiscal pressures can be expected to cause State and local officials to become more cautious about participating in new or expanded Federal grant programs.

AVOIDING THE LOSS OF FEDERAL AID

Local governments fully realize that they must allocate sufficient revenues to meet matching and maintenance of effort requirements of Federal assistance programs. Consequently, most localities have taken pains to maintain pre-Proposition 13 levels of local funds allocated to federally aided programs so as to insure that Federal aid is undiminished.

Oakland city officials, for example, said their federally aided programs would not have been adversely affected by Proposition 13 even if the State had not provided surplus funds to offset the revenue loss. The city's response would have been to make every effort to continue to qualify for Federal aid.

A majority of the other California cities and counties we covered in our review followed similar revenue allocation policies. Local governments generally were careful to avoid triggering the loss of Federal aid by failing to allocate sufficient funds to satisfy Federal matching or maintenance of effort requirements. An Alameda County official remarked that it would be foolhardy for local governments to do otherwise, because in many cases three Federal dollars are provided for each local dollar spent.

In many cases, State and local governments provided matching funds far exceeding their required minimum share. For example, while California is only required to provide $87 million to match the amount received from the Federal Social Services program (Title XX of the Social Security Act), the State is providing $107 million as its matching funds. Similarly, while the average required minimum amount of matching funds for California is 40 percent for Initial Operations grants under the Community Mental Health Services

Program, the State is providing 52 percent of the costs. Local governments that have regularly spent more than their required minimum amount of matching funds could reduce their amount of funding to the minimum required and still retain their entire Federal grant.

ACTUAL IMPACT EXPECTED TO BE MINIMAL

Because of the compensating fiscal factors discussed in chapter 2 and the careful actions taken by local officials Proposition 13 has had little impact on Federal aid programs in California. Federal spending will be increased slightly for unemployment insurance and food stamp programs and decreased for employment and training, welfare, and child nutrition programs. Other Federal programs (impact aid and revenue sharing) could be affected, but reductions in Federal outlays would not occur until fiscal year 1981. The following sections discuss the primary program areas expected to be affected by Proposition 13.

Unemployment insurance

The Federal Government will share the cost of unemployment benefits paid to some public employees laid off as a result of the passage of Proposition 13. Unemployment insurance was extended to State and local government employees by the Unemployment Compensation Amendments of 1976 (Public Law 94-566). As part of the transition provisions the Federal Government will pay part of any benefits based on employment prior to the full implementation of the law.

Under the procedures followed by California in implementing the law, The Federal Government was responsible for paying benefits for most public employees laid off before July 31, 1978.1/ But the Federal share was reduced by 25 percent each succeeding 3-month period, thus ending after April 1979.

The Federal budget impact could amount to as much as $9 million for every 10,000 public employees laid off before July 31, 1978. The past experience of unemployed workers in

1/Twenty-three percent of the local entity employees in California were covered by unemployment insurance prior to January 1, 1978, the effective date for the related provisions of Public Law 94-566, and the Federal Government will not have to contribute to the benefits paid if these employees are laid off.

California shows that an average public employee might receive unemployment benefits totaling $900 over a 10-week period.

The Federal share of unemployment benefit costs resulting from the passage of Proposition 13 should not exceed $20 million and could be appreciably smaller. Costs to the Federal budget could total $18.3 million for the 20,327 public employees laid off through July 31, 1978. This cost could be increased by nearly $900,000 for the 1,264 additional public employees reportedly laid off in August and September of 1978.

A downward trend in the total number of public employees laid off because of Proposition 13, though, will likely make the Federal share somewhat smaller than the $20 million high figure. A total of 21,965 layoffs were reported at the end of August 1978. Only 17,000 layoffs were reported 5 months later at the end of January 1979. This drop occurred because some localities rehired laid off workers.

Some of the laid off employees probably have also found jobs outside of the public sector as a result of California's booming private economy. California's unemployment rate fell to a 5-year low of 6.5 percent in October 1978. The unemployment rate stayed at 6.5 percent through March 1979.

Employment and training

Proposition 13 apparently has had a negligible effect on the Comprehensive Employment and Training Act (CETA) program. Department of Labor officials in California have stopped trying to determine the impact of the amendment because they believe it is insignificant.

Proposition 13 caused only a 2-percent reduction in the number of CETA employees in California, according to data compiled by the State Employment Development Department. As of the end of September 1978, layoffs stemming from Proposition 13 totaled 1,856 out of 75,700 CETA program employees. These layoffs represent a possible $18.6-million reduction in CETA funds allocated to California.

A more significant 5-percent drop in the number of CETA employees in California occurred for a reason unrelated to Proposition 13. Department of Labor officials attributed a 4,000 drop in the number of CETA employees from May through July 1978 to a normal year-end phasedown of the program. Most of these employees were dropped because of the expiration of their 12-month period of CETA employment.

Welfare

California's more than 2 million welfare recipients lost cost-of-living increases this year as a result of Proposition 13. The freeze on cost-of-living increases will likely reduce Federal outlays for the Aid to Families with Dependent Children (AFDC) Program by about $72 million in fiscal year 1979, according to State estimates. This represents about a 7-percent reduction in AFDC outlays in California.

Food stamps

Federal outlays for the Food Stamp Program are expected to increase slightly because California withheld cost-of-living increases in the AFDC Program. The decision not to adjust AFDC payments for increases in the cost-of-living will reduce the income of recipients below what it otherwise would have been. The income levels could drop enough for AFDC recipients to qualify for additional food stamp benefits. Thus, Federal outlays in California might increase by about $25 million, according to a Congressional Budget Office estimate

California also eliminated increases for the State payment portion of the Supplemental Security Income (SSI) Program This increased Federal outlays by about $31 million because 260,000 SSI recipients then became eligible to receive food stamp benefits of $10 a month. Federal outlays for the Food Stamp Program then could increase by roughly $56 million as a result of Proposition 13.

Child nutrition program

One child nutrition program was directly affected by Proposition 13. Federal outlays for the Summer Food Service Program for children were reduced by about $8 million as a result of most school districts cancelling summer sessions.

Department of Agriculture and State officials agree that other Federal child nutrition programs will not be affected because California's spending levels are well in excess of Federal matching or maintenance of effort requirements. Part of the National School Lunch Program, for example, requires California to spend $10.8 million in matching funds in fiscal year 1979, but California's spending level actually will approach $35 million.

Education

No immediate reductions in Federal outlays for most education programs are expected by the Department of Health, Education, and Welfare, State, or local school officials as a result of Proposition 13. The State and local average per-pupil expenditures are key factors in the formulas used for many Federal education grant programs. As was previously discussed (see p. 10), overall average per-pupil expenditures were expected to be higher the first year following the passage of the amendment than they were the year before.

The amount of Federal outlays for the School Assistance in Federal Affected Areas--Maintenance and Operation (Impact Aid) Program may decline because this program's Federal funding depends on revenues obtained from local sources. Thus, State bailout funds cannot be used by local school districts to offset local revenue losses. Federal outlays for this program will not be affected until fiscal year 1981, though, because the data base used to determine revenue-raising efforts lags by 2 years.

Revenue Sharing

Tax effort is a key factor in the formula used to determine the amount of Federal payments under the General Revenue Sharing Program. Thus, Proposition 13 could result in reduced revenue sharing allocations to California. A reduction will not occur until fiscal year 1981, though, because the data base used to compute Federal outlays lags by 2 years. According to State estimates, allocations to California could be reduced by $70 million in fiscal year 1981 if the revenue sharing program is reauthorized in 1980 with no changes in the formula or the funding level.

INCREASING RELUCTANCE TO PARTICIPATE IN NEW FEDERAL INITIATIVES

While Proposition 13's immediate impact in California so far has been small, growing fiscal pressures can be expected to cause State and local officials to become less willing to participate in new or expanded Federal program initiatives which would place additional strains on their budgets. Moreover, the passage of similar measures limiting taxes and spending in other States and the attitude of the taxpaying public suggests that the rapid growth in State and local spending may have ended.

Federal aid to State and local governments increased nearly fourfold over the 9-year period from 1969 to 1977, or from $19 billion to $70 billion. Federal funds accounted for 27 percent of total State and local expenditures in fiscal year 1978, compared with 10 percent in 1955. The growth in Federal outlays has encouraged large increases in State and local spending In fact, for some time the growth in State and local expenditures and employment was higher than that of any industry in the private sector.

The public is pressuring all levels of government to reduce taxation and spending. After the passage of Proposition 13, tax and expenditure limiting measures were proposed in almost every State. Taxpayers in 12 States approved measures designed to ease tax burdens. Attempts have also been made at the Federal level to adopt budget-limiting measures.

Proposals limiting taxes and spending create fiscal restrictions that make State and local officials less willing to participate in new or expanded Federal aid programs. In fact, bona fide monetary restraints may eventually preclude some governments from participating in Federal programs because of matching or maintenance of effort requirements.

California's local governments have less enthusiasm for getting involved in Federal initiatives that could lead to future budgetary pressures on their resources. In particular, local officials expressed concern over federally assisted capital projects--regardless of local contribution requirements--because of the fiscal pressures created by the future operating and maintenance costs of such projects. Similarly, local officials pointed out that they would apply for few, if any, new Federal grant programs because of reduced local resources available to meet matching or maintenance of effort requirements.

CONCLUSIONS

Because Proposition 13 has had only a minimal impact on local government operations, Federal grant outlays have not been significantly affected. When Proposition 13 first passed, some observers were concerned that local governments would not be able to meet matching and maintenance of effort requirements associated with Federal grants. But partly because of favorable fiscal factors and partly because of careful actions taken by local officials, local governments have been able to avoid triggering the loss of Federal aid in the first year following the passage of Proposition 13.

The fiscal restraints placed on local governments by Proposition 13 have resulted in local officials taking a more cautious attitude towards new or expanded Federal programs. This attitude which has emerged in California since the passage of Proposition 13 and can be expected in other States that have passed or are considering new or additional taxing or spending limitations carries long-term implications for Federal grant policies.

Federal grant requirements that impose additional costs on State and local governments, such as matching and maintenance of effort requirements, can be expected to come under increased scrutiny. Some local governments may find it difficult or impossible to meet the fiscal requirements of any major new Federal initiatives. This might constrain the Federal Government's ability to assure that national goals are met and increase the pressure for the Federal level to assume larger responsibilities for the costs of new initiatives.

CHAPTER 5

SCOPE OF REVIEW

We interviewed officials and reviewed fiscal data and program information related to Proposition 13 at the State of California Departments of Education, Finance, Health Services, and Social Services, the Employment Development Department, the Controller's Office, the Franchise Tax Board, and the State Board of Equalization. We also obtained information from the League of California Cities, the California Teachers Association, the California School Employees Association, the Governor's Commission on Government Reform, the Assembly Office of Research, and the offices of the Legislative Analyst and Auditor General.

In addition, we reviewed fiscal, program, and personnel decisions made following Proposition 13's passage by the State of California, 5 counties in the State, 6 cities, and 4 school districts. A listing of the local governments we visited follows.

COUNTIES:	Population	Fiscal Year 1979 Budget
Alameda	1,092,800	$ 378,936,940
Lake	26,850	15,610,613
Los Angeles	7,083,431	3,506,468,651
Sacramento	706,300	313,322,691
San Joaquin	304,400	149,237,098
CITIES:		
Lakeport	3,690	1,130,294
Los Angeles	2,727,399	1,051,470,416
Oakland	338,000	153,019,867
Sacramento	261,500	105,676,254
Santa Monica	93,200	48,731,481
Stockton	122,000	39,349,009
SCHOOL DISTRICTS:	Average Daily Attendance	
Berkeley Unified	12,164	44,487,168
Fremont Unified	29,733	55,668,732
Marysville Joint Unified	8,366	16,976,130
Stockton Unified	24,192	68,903,315

(017550)

Single copies of GAO reports are available free of charge Requests (except by Members of Congress) for additional quantities should be accompanied by payment of $1 00 per copy

Requests for single copies (without charge) should be sent to

U S General Accounting Office
Distribution Section, Room 1518
441 G Street, NW
Washington, DC 20548

Requests for multiple copies should be sent with checks or money orders to

U S General Accounting Office
Distribution Section
P O Box 1020
Washington, DC 20013

Checks or money orders should be made payable to the U S General Accounting Office NOTE Stamps or Superintendent of Documents coupons will not be accepted

PLEASE DO NOT SEND CASH

To expedite filling your order, use the report number and date in the lower right corner of the front cover

GAO reports are now available on microfiche If such copies will meet your needs, be sure to specify that you want microfiche copies

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D C 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE,$300

POSTAGE AND FEES PAID
U S GENERAL ACCOUNTING OFFICE

U S MAIL

THIRD CLASS