

LEGISLATIVE ANALYST'S OFFICE

Major Milestones: 25 Years of the State-Local Fiscal Relationship

The past 25 years in California have seen significant changes in the fiscal relationship between state and local government. The time line on the following pages highlights the major events that have altered the state-local fiscal relationship since 1972. The milestones illustrate a number of key themes that have emerged over the past quarter century:

■ Increased Voter Oversight of Revenue

California voters have increased their power over local government tax decisions. In the 1970s, the rapid rise in home values and the subsequent growth in property tax bills created the widespread desire to lower property taxes. This movement culminated in 1978 with the passage of Proposition 13, which reduced property tax revenues by more than 50 percent. In addition, Proposition 13 requires two-thirds voter approval for the passage of new local special taxes. Similar voter approval requirements have been extended over the past two decades for various other types of local revenue sources.

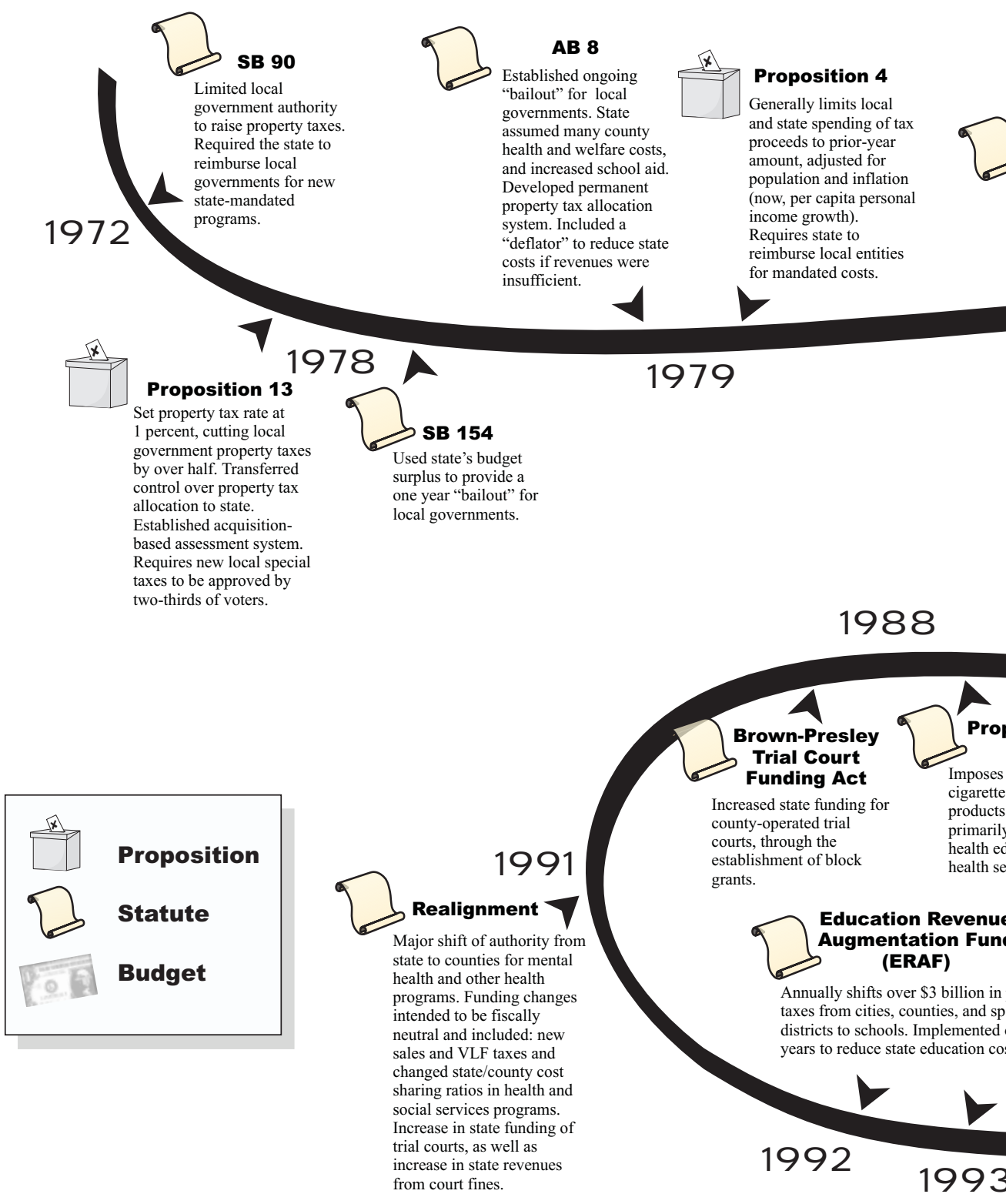
■ Shifts in Program and Funding Responsibility




The Legislature has enacted major shifts of program responsibility and program funding over the past 25 years. In areas such as trial courts and health and welfare, the administration and funding of programs have been altered in an effort to increase efficiency and provide greater flexibility.

■ Reduced Local Flexibility

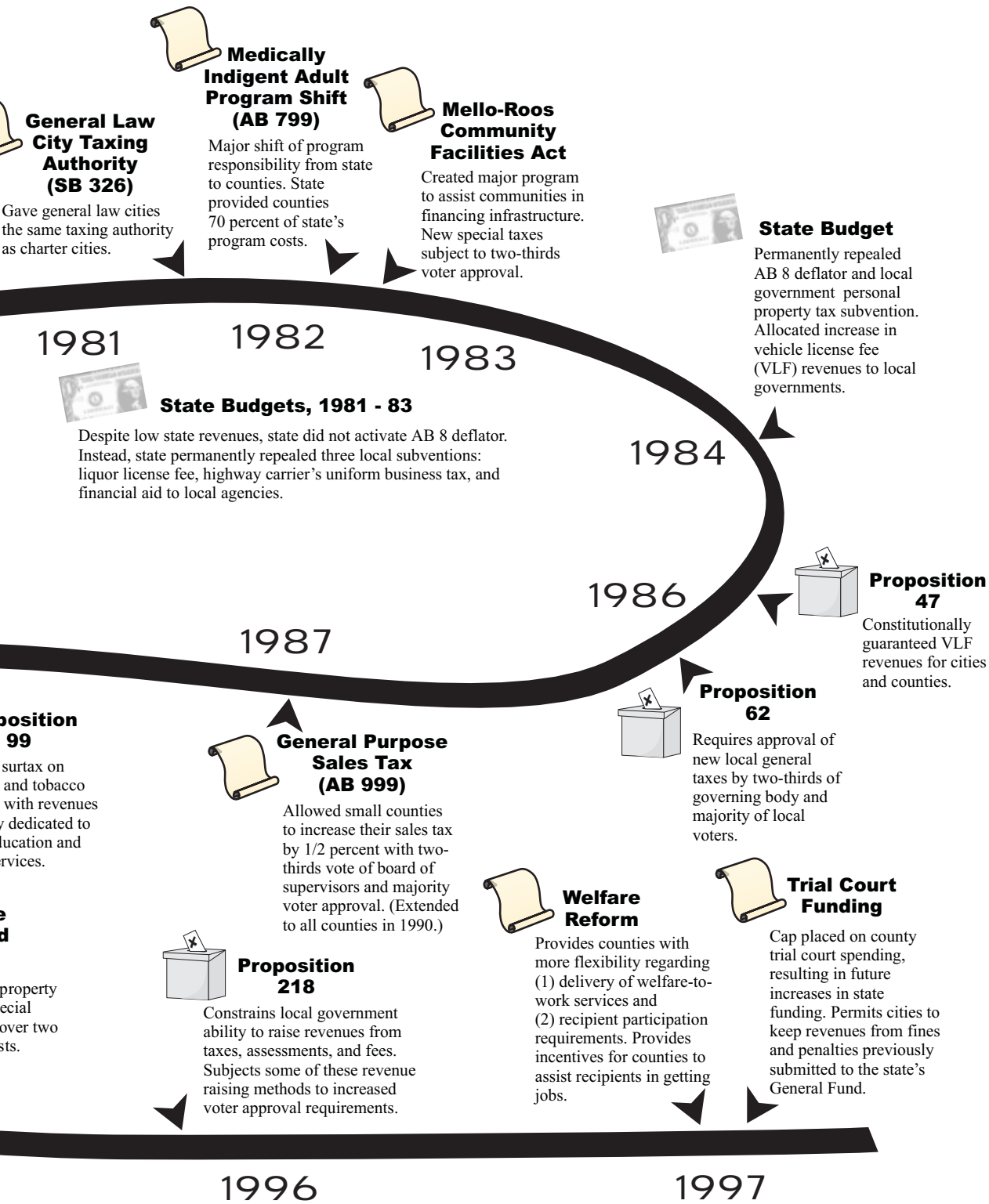
By giving state government the authority to allocate local property tax revenues, Proposition 13 placed the state in control of one of local governments' primary revenue sources. The two decades since the passage of Proposition 13 have seen the increasing interdependence of state and local fiscal policy and a significant loss of local flexibility. As a result, local governments must now try to respond to citizens' needs with limited fiscal flexibility.

Major Milestones 25 Years of the State-Local



	Proposition
	Statute
	Budget

Milestones: Local Fiscal Relationship



Economic and Revenue Developments

Healthy Economic Growth Continues

As of late 1997, California's economy is experiencing healthy and balanced economic growth. Wage and salary employment is up by over 3 percent this year, the largest gain of the 1990s, and other measures, including personal income and retail spending, are showing similarly healthy gains. Of particular importance, California's real estate markets are clearly rebounding. Home prices are up in most regions of the state, sales are at their strongest pace since 1988, and new construction activity is on the rise. In October, building permits for residential construction reached 134,000, which is up by nearly 30 percent from the prior year. Nonresidential building activity also is strong, reflecting large increases in industrial and office construction.

Slowdown in Asia Poses Risks

The much publicized economic and financial problems in Asia will have some impact on California in 1998, although the extent of the impact is difficult to determine at this time. Some exporters have already reported cutbacks in goods sold to these regions, and growth in total exports of California-produced goods slowed sharply in the first half of 1997, largely reflecting reductions in goods sold in Asia. While these slowdowns have thus far been offset by strength in other sectors of California's economy, a deepening crisis in Asia could have more significant impacts in this state. We will be monitoring these impacts in the months ahead.

Revenues Soft During First Five Months of 1997-98

Revenues collected during the July-through-November period are down \$407 million, or 2.2 percent, from the *1997-98 Budget Act* estimate. As we discussed in our November fiscal outlook report, the shortfall does not appear to be indicative of a fundamental weakness in the revenue trend. As noted above, California's economy is growing at a healthy pace, and collections that are closely tied to current economic activity, such as withholding and sales tax receipts, are running ahead of estimates.

The year-to-date shortfall is due to a combination of unusually large corporation tax refunds (which are mostly one-time in nature) and to lower-than-expected quarterly estimated payments from the personal income tax. We believe that the softness in quarterly payments is due to shifts in the timing of such payments, rather than an underlying slowdown in investment and business-related earnings. This is especially true given the current strength in the economy and the high financial-related earnings reported so far this year.

Given these factors, we believe that the underlying trend in revenues remains positive. We will have a better picture of the outlook in December and January. These months include both the last quarterly payments toward 1997 tax liabilities for individuals and corporations, and tax receipts related to retail sales during the key Christmas shopping period.