Final Report of

The Speaker's Commission on State & Local Government Finance

March 2000

Antonio R. Villaraigosa
Speaker of the Assembly

THE SPEAKER'S COMMISSION ON STATE AND LOCAL GOVERNMENT FINANCE

TABLE OF CONTENTS

A Message From The Speaker	**3-4**
A Message From The Chairman	**5-6**
Guiding Concepts	**7**
Recommendations—Summary	
Fiscal Reform	**9**
Increased Accountability	**11**
Other Issues Meriting Further Research & Investigation	**13-15**
History	**17-19**
The Commissioners	**21-24**
Recommendations With Commentary	**25-34**
Other Reviewed Issues With Commentary	**35-56**
Appendices:	
A) Commission Meetings	**57-60**
B) Charts & Graphs	**61-72**
C) Relevant Articles	**73-82**
D) Acknowledgments	**83**

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A MESSAGE FROM THE SPEAKER

***By* The Honorable Antonio R. Villaraigosa**

At various times during the 20th Century, the government and people of California have sought to make changes in the fiscal management of the state. These efforts, some of which led to actual amendments to State statutes or the Constitution and others which did not, often reflected the political and economic climates of their respective times. Always they were earnest attempts to address such real issues as tax policy, home rule and governmental accountability.

So the struggles of the Speaker's Commission on State and Local Government Finance to identify appropriate and viable fiscal reform measures for California at the end of the century have plenty of precedent. The charge given to the Commission included a strong recommendation that it give due consideration to work done in the recent past by others–both to show respect for that work and the people who did it, and to avoid, to the extent possible, duplication of effort.

The fundamental issues do not seem to change. There has been a growing consensus that key aspects of the way California collects and apportions tax revenues are greatly flawed, if not downright dysfunctional. There is agreement that the current system has devalued the role and power of local government, that it promotes a bias in land use decision making that, to some, is hurting our economy, raising the cost of living and making it difficult for communities to evolve in a balanced manner, and that it promotes a lack of public trust in governmental institutions that has been hurtful to our democracy.

The extent to which this agreement exists and what steps should be taken, predictably, varies depending on one's perspective. As with any aspect of government, there are institutions and groups who either benefit from the status quo or who feel secure in its familiarity. There are branches of government that enjoy their enhanced powers and jurisdictions that have learned to take fiscal advantage of the rules, just as there are those who suffer both loss of authority and wealth. In short, there are winners and losers at present, and there will be winners and losers if reforms are implemented in the future.

The Speaker's Commission was created at the end of 1998 with a different dynamic in mind. Looking at what had happened to California's finances in the '90s, I perceived that there had been few winners and many losers. Every level of government had been underfinanced during the economic recession of early and mid-decade. Local jurisdictions had, for many years, been ceding authority to the State while facing the wrath of constituents who didn't understand why their city councils and boards of supervisors could not provide better services and infrastructure. They wondered why their communities suffered from too much traffic, too little housing and too few high-paying jobs. Even when the economy bounced back, many of the problems persisted, defying even the will of both people and public officials to solve them.

The big losers in California's game of fiscal roulette, I determined, have been its communities and its people. In a place with such a rich past, whose future holds so much promise, this is unacceptable. If California is going to "incentivize" the behavior of its governmental institutions, as its current fiscal policies are doing in an unintended, *de facto*, manner, perhaps some thought should be given to just which behavior deserved such incentives. How far this process should go is always going to be subject to debate, but even some of those who object to the government trying to manage fiscal matters accept the fact that a form of mismanagement has already been imposed by accident.

Consequently, I asked this commission to take on these difficult challenges and suggest how California could best address them. I asked it to be both creative and realistic, to be bold in its thinking while acknowledging the political context in which its proposals would be judged. I purposefully chose its membership from a broad spectrum of philosophical and professional backgrounds so that any consensus it reached would be meaningful to an equally broad spectrum of Californians in general.

The Commission met for a little more than a year, traveling all over the state, engaging in a dialogue with leaders, experts and everyday people. Its process was public and open, and its inquiry carried on with admirable integrity. Every imaginable aspect of the state's fiscal life was discussed. Every recommendation of a decade's worth of prior commissions, task forces and legislatures was examined.

This report to the Legislature is the product of that rigorous process. It includes recommendations on fiscal policy and governmental accountability, and the relationship of these crucial matters to the economy, the environment and social equity. Further, it acknowledges other issues that were not yet "ripe" for resolution, including the growing impact of Internet commerce on retail activity throughout the state and the nation.

When I formed the Commission, I challenged it to help us achieve fairness and balance in the way the various levels of government work with each other to benefit all the people of California. They took that challenge seriously and, I believe, delivered in a manner that will substantially advance the dialogue on fiscal reform a giant step in the Legislature and around the state.

What happens next is up to all of us. For far too long, those who believe the public is not sufficiently interested in the complexities of fiscal life to motivate politicians to deal with the problems have held sway. But as the direct relationship between our fiscal imbalances and every aspect of our economic vitality, environmental health and quality of life becomes more apparent, I believe the public will demand that we engage at last.

The bases for that engagement can be found in these pages, and in the work of others who have explored these issues over the years. I congratulate the members of the Commission and thank them for a job well done. Now it is time for the rest of us to roll up our sleeves and get to work on behalf of the people and the future of California. Ð

A MESSAGE FROM THE CHAIR

***By* David A. Abel**

As the Speaker of the California Assembly understood when he appointed this diverse Commission, it is time for the Legislature to change the rules that govern the way communities finance their local services. Local governments live with a fundamentally flawed fiscal arrangement. Communities are dependent on the whim of the State and lack a stable and predictable revenue stream. This dysfunctional and irrational state/local fiscal system, as many have called it, effectively deprives locally elected representatives and their constituents of the ability to be the architects of their own neighborhood and community futures.

In the unanimous opinion of the Commission, more than two decades of neglect and band-aid responses to the unintended consequences of Proposition 13 need to end quickly. We must shift gears and return to our long held tradition of community independence and authority if the California we treasure is to be passed along to future generations better than we found and have experienced it. The following report of our Commission's yearlong work elaborates on our findings and spells out our uncontested recommendations.

Unquestionably, the struggle between the state and its local communities has been a constant in our history. But over the last 20-plus years State government has exercised more and more control over the ability of citizens to influence the quantity and quality of public services close to home. As a consequence, California voters have lost the power at the local level to make critical decisions on the very public services that affect the health and well being of their neighborhoods and communities. In addition, the tax base for supporting those local services now is influenced by constitutionally embedded fiscal incentives that distort local growth and development policies. In particular, shopping centers, auto dealerships, hotels, and other commercial developments are enormously attractive to local officials because they produce abundant sales tax revenue for the local agency where they are sited. Sales tax is king for local governments today; and run down school facilities, exorbitant housing prices and the proliferation of strip malls and big box retailers are the price to this sovereign.

California's tradition of local control over community services lasted for most of the 20th century. How did such a long tradition of a strong local government change in such a short period of time? The trend toward State control began in the early 1970s and increased substantially after the passage of Proposition 13 in 1978. The landmark law placed limitations on the amount of property tax that could be levied and gave control of its distribution to the state. Without a clear understanding of the situation, voters accepted the need to limit the power of state and local government to levy taxes and handed control of the primary source of financing local services to the State.

This was the backdrop for the work of the Speakers Commission on State and Local Government Finance. This report is presented to the Speaker of the Assembly, the Legislature and the Governor as an approach to begin to solve the problem of rebalancing the power of local officials to provide local services and to change the fiscal incentives that will produce more rational growth and development policies. The commission brings to bear several guiding concepts that best summarize the objective of the Commission's recommendations:

• The local finance system should facilitate balanced state, regional and local conservation and development policies as well as finance local and regional services.

• In order to avoid dependence on one revenue source, local governments should derive their revenues from a diversity of sources, including property tax, sales tax and general-purpose state subventions.

• The finance base for local and regional services should be a constitutionally protected, stable, and reliable and be sufficient to assure basic services.

• There should be greater accountability and transparency of state and local government.

Two recommendations are central to these objectives. The first is to change the mix of revenues available for local services by increasing local reliance on the property tax and decreasing reliance on the sales tax. Second, the commission brings a new issue to the Legislature and the Governor. The commission believes that California's regions matter. The dialogue between the state and local governments usually leaves out the regional perspective. Although it is obvious to most citizens, businesses and economists who study the issue, California is made up of a group of economic and environmental regions each with it's own particular characteristics.

Although statewide policy is important to provide a context for local action it is essential that we begin to consider the ***regional*** context of local action. That is why the commission urges the Legislature, with the cooperation of the Governor to initiate a process for the development of state, regional and local growth and development policies and a governance structure that connects fiscal powers with roles and responsibilities. This process must acknowledge that: 1) regions are the generators of our economic growth, and our ability to compete in the global economy; 2) natural resources, whether wilderness, working farm and forestlands, or neighborhood parks and open space need not be sacrificed, if development operates under better rules of the game; and 3) low-income and working families must share in the opportunity for prosperity.

The Speaker has thoughtfully and proactively involved citizen leaders from throughout the state on this commission. We have responded with one voice and agree with his initial charge to us: "The impacts of `topsy-turvy fiscal policy on governance and quality of life' in this state need to be addressed. We sincerely hope we have made a contribution to the Legislature and Governor's motivation and ability to lead such an effort. And we stand ready to support these efforts in the weeks and months to come. Ð

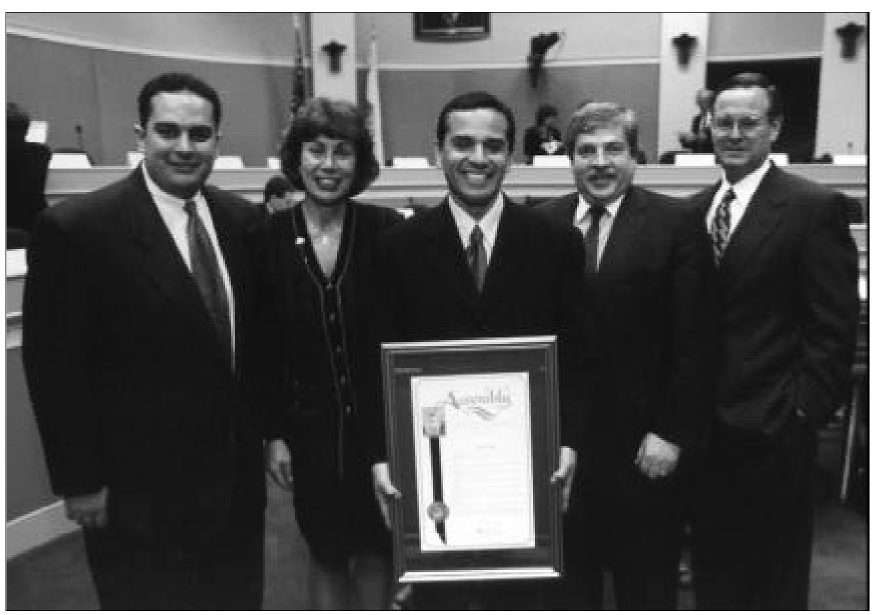
GUIDING CONCEPTS

- The local finance system should facilitate balanced state, regional and local conservation and development policies as well as finance local and regional services.

- In order to avoid dependence on one revenue source, local governments should derive their revenues from a diversity of sources, including property tax, sales tax and general-purpose state subventions.

- The finance base for local and regional services should be a constitutionally protected, stable, and reliable and be sufficient to assure basic services.

- Increase the transparency of state and local government.



Commissioner John Perez, Commissioner Sunne Wright McPeak, Speaker Antonio Villaraigosa, Commissioner David Abel and Commissioner William Hauck.

Speaker's Commission meeting.

RECOMMENDATIONS

A. PROGRAM FOR FISCAL REFORM IN CALIFORNIA 9

B. PROGRAM FOR INCREASEASED GOVERNMENTAL ACCOUNTABILITY 11

FISCAL REFORM

I. Program For Fiscal Reform In California

Goal: Revise the current fiscal incentives in local land use decisions and increase the amount of discretionary revenue available for community and countywide services.

Recommendation 1: The Swap

Within each county, the county and each city would swap a portion of their locally levied sales tax with the State for an equal amount of the property tax. The locally levied 1% sales tax rate would be reduced to .5% and the State rate would be raised by .5%. An equal amount of property tax would be shifted from K-14 entities (sources of these funds could come from ERAF, K-12 districts, community colleges, superintendents of schools, and/or county boards of education). The State, using the new revenue from the .5% of the sales tax, would backfill educational programs through the State aid system.

Recommendation 2: ERAF Settlement

Return $1 billion of property taxes to counties, cities and special districts from the Education Revenue Augmentation Fund (ERAF) in each county or other State sources over time in annual installments of not less than $100 million, provided that the growth in any year of per capita non-proposition 98 general fund revenue exceeds the statewide consumer price index for the prior year.

Recommendation 3: Permanent Vehicle License Fee Subvention

Existing law requires the State to replace the reduced fee revenue with other State resources. Create a Constitutional obligation on the part of the State to maintain the per capita subvention and replace the revenue lost due to the reduction in the Vehicle License Fee.

Recommendation 4: Permanent Countywide Sales Tax Authority

The existing .5% “transactions and use” taxing authority would be moved into the Constitution so that voters, upon their approval of this proposal, would have the assurance that the resultant revenues could not be used to supplant State spending. The allocation of those revenues would be based on local agreement. Ð

II. Program For Increased Governmental Accountability

Goal: Increase the transparency of government by introducing performance measures into State and local government decision-making and by clarifying the state/county relationship so that roles and responsibilities are clearly understood.

Recommendation 1: State & Local Performance Measures

Require all local agencies (including Redevelopment agencies) to develop (via a public process) performance measures for their community and a system for the community to evaluate their performance based on outcomes. The State should establish a similar system of performance measures to assist in the annual budget process as well as part of a continuing policy evaluation process.

Recommendation 2: State/County Service Compact

Adopt a "Compact Model" for the State/county relationship. A common, bilaterally written compact that would spell out roles, responsibilities, duties, work programs, finances, community outcomes, performance indicators, and evaluation systems would govern each State/county partnership service program within the confines of existing statutory obligations. For each State program where the county acts as an agent of the State, a compact would cover the program.

Recommendation 3: Revised County Budget Requirements

Encourage counties to implement county budgets that, to the extent feasible, distinguish the role of the county in providing countywide services from its "urban service" responsibilities for unincorporated areas of the county.

Recommendation 4: Property Tax Reporting Requirement

Require the county auditor or appropriate State agency to report annually the amount and relative share of the property tax revenues for each agency in a manner that facilitates understanding and comparability among cities and counties about how the property tax funds municipal services. It should indicate the rates levied by special districts providing services commonly provided by a full service city such as parks and recreation services, library services, fire services in a way which compares them to those levied by a full service city and should portray allocations for redevelopment, county, and educational jurisdictions. Ð

Carl Anthony of Urban Habitat and Speaker Antonio Villaraigosa

OTHER ISSUES

MERITING FURTHER RESEARCH & INVESTIGATION

I. EQUITY ANALYSIS 13

II. THE STRUCTURE OF TRANSPORTATION FUNDING 13

III. REGIONAL GROWTH & DEVELOPMENT POLICY 14

OTHER ISSUES*

Issues of Continuing Concern For The Legislature & The Governor

I. Equity Analysis

Goal: Study, develop and implement systems, through State and federal executive action, for assuring that equity objectives, as well as environmental and economic objectives, are supported by proposals concerning State and local government finance and resource distribution. Public finance measures should reduce, rather than exacerbate, the gap between affluent and low-income Californians. Transportation finance should also be studied to identify methods to improve the stability of funding, including the current gas tax system.

A. The Equity Issue
In order for reforms in the local finance system to improve the imbalance in the financing of local services the equity issues must be addressed. Fiscal reforms should:

- Create incentives for the development and maintenance of communities and regions to improve living standards, economic vitality, environmental protection, and assessable, efficient and effective governance for all their residents and workers.

- Allocate public resources according to community need and correct imbalances in funding of local governments with respect to cities and counties with inadequate funding and “low social health” and low tax bases.

- Reduce the gap between the “haves” and the “have-nots” and avoid exacerbating the gaps between population sectors.

B. Equity Implementation Measures
Provide an “Equity Impact Assessment” of proposals for State/local finance reform.

II. The Structure Of Transportation Funding

The legislature and the governor should undertake a study of the most efficient and reasonable way in which to stabilize the revenue stream from the gas tax at its present rate.

*The Commission is not forwarding these as recommendations, but rather as issues meriting further research and investigation by the Governor and Legislature.

III. Regional Growth & Development Policy

Goal: Initiate a joint legislative and executive branch process for the development of State, regional and local growth and development policies and a governance structure that connects fiscal powers with roles and responsibilities. This process must recognize the importance of regions as economic forces and that preservation of environmental resources within those regions is essential to the well-being of the state as well as insuring that equity considerations are a central part of this process.

A. Regional Growth Policies

Adopt in State law a regional growth policy as the environmentally preferred alternative for local land use decisions. At a minimum, a statewide regional growth policy objective should be sustainable development characterized by the interrelationship of economic, environmental and equity issues. State development policy would include the following:

- Maintain a healthy economy by promoting higher value job opportunities for people in each region.
- Accommodate housing, in both quantity and affordability, within each region or sub region to match population and job growth.
- Encourage efficient land use (which includes promoting strategies such as higher densities around transit hubs to establish transit villages, mixed-income and mixed-use projects, walkable 24-hour communities, recycling of "brownfields" and "grayfields," and "smart" conversion of closed military bases.
- Require local general plans, the development of which should include public involvement down to the neighborhood level, be linked to regional plans.
- Protect vital and valuable ecosystems and natural habitats.
- Conserve natural resources and preserve environmental assets.
- Protect and conserve prime and unique farmlands.
- Invest in infrastructure to ensure mobility and quality of life, especially in existing urban areas.
- Reduce dependency on single-occupant-vehicle trips.
- Reduce poverty and promote greater equity.

B. <u>Dealing With Regional Problems On A Regional Basis</u>

Concepts discussed by the Commission which could address these issues included:

• To reconfigure counties and delivery of regional services along regional lines.

• To establish a regional pool of resources that is allocated to local jurisdictions based on a formula that recognizes specific policy objectives. This approach envisions the state establishing a policy goal that each region is to strive to create (a) higher value job opportunities and (b) housing that accommodates all income levels, and that the jobs and housing be in proximity to each other. In achieving this policy goal, regions would be guided by "regional growth" principles. Regions would be required to develop performance standards and strategies to achieve the policy goal, design measures to track progress, and report progress annually to the residents of the region.

<u>Features</u>:

» Regional strategies developed with input from all potentially impacted sectors including social equity and environment.
» Pool funded from taxes raised within the region.
» State subvention funds to supplement the pool to achieve state policy goals.
» Regional governance structure clearly accountable to the voters of the region.
» Allocation rules clearly understandable to the voters. Ð