

REMARKS OF THE LEGISLATIVE ANALYST TO THE
CHANNEL COUNTIES DIVISION OF THE LEAGUE OF CALIFORNIA CITIES

APRIL 27, 1984

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REMARKS OF THE LEGISLATIVE ANALYST TO THE
CHANNEL COUNTIES DIVISION OF THE LEAGUE OF CALIFORNIA CITIES

I. INTRODUCTION

A. ICE BREAKER

B. PURPOSE OF MY VISIT

1. LAY OUT FISCAL PARAMETERS WITHIN WHICH THE LEGISLATURE WILL BE OPERATING AS IT ATTEMPTS TO PUT TOGETHER A BUDGET FOR 1984-85.
2. DISCUSS BRIEFLY THE OUTLOOK FOR LEGISLATIVE CHANGES IN THE STATE'S FISCAL RELATIONSHIP WITH LOCAL GOVERNMENTS IN CALIFORNIA.
3. ALERT YOU TO A NEWLY FORMED CLOUD ON THE FISCAL HORIZON.
4. RESPOND TO YOUR QUESTIONS

C. TRANSITION

II. THE FISCAL OUTLOOK FOR 1984-85

A. INTRODUCTION

1. FRANKLY, I'M SURPRISED YOU INVITED ME TO MEET WITH YOU A SECOND TIME.
2. IN PREPARING FOR THIS VISIT, I LOOKED OVER THE NOTES I SPOKE FROM WHEN I MET WITH YOU TWO YEARS AGO.
3. WHAT I HAD TO SAY THEN WAS PRETTY GLOOMY.
4. FORTUNATELY, MY MESSAGE WILL BE A LITTLE MORE UPBEAT THIS EVENING.
5. FOR THOSE OF YOU WITH A MASOCHISTIC STREAK, HOWEVER, DON'T WORRY -- I'LL HAVE SOMETHING FOR YOU AS WELL.

B. FROM A BUDGETARY STANDPOINT, 1984-85 IS SHAPING UP AS A VERY GOOD YEAR.

1. THE STATE'S ECONOMY SEEMS CERTAIN TO TURN IN A STRONG PERFORMANCE DURING THE BALANCE OF 1984, AND THE OUTLOOK FOR THE FIRST HALF OF 1985 IS GENERALLY POSITIVE.
2. AND AS THE ECONOMY GOES, SO GOES STATE REVENUES.
3. MANIFESTATIONS:
 - a. THE GOVERNOR'S BUDGET REPORTS THAT REVENUES WILL RISE BY \$2.5 BILLION IN THE UPCOMING FISCAL YEAR.
 - b. IF YOU ADJUST FOR SOME ONE-TIME REVENUES THAT THE LEGISLATURE BUILT INTO THIS YEAR'S BUDGET, THE UNDERLYING INCREASE IS PARTICULARLY IMPRESSIVE -- UP NEARLY 15 PERCENT.
 - c. THE LEGISLATIVE ANALYST'S OFFICE IS EVEN MORE OPTIMISTIC THAN THE GOVERNOR.
 - d. A BETTER WAY OF DEMONSTRATING JUST HOW BRIGHT THE REVENUE OUTLOOK IS, IS TO COMPARE THE AMOUNTS WE CAN EXPECT THE STATE TO TAKE IN NEXT YEAR WITH THE AMOUNTS THE STATE WOULD NEED TO CONTINUE THIS YEAR'S LEVEL OF SERVICES NEXT YEAR.
 - (1) THIS TAKES ACCOUNT OF RISING DEMANDS FOR SERVICES UNDER THE VARIOUS ENTITLEMENT PROGRAMS,
 - (2) THE AMOUNTS NEEDED TO OFFSET THE EFFECTS OF INFLATION ON PURCHASING POWER, PLUS.

(3) THE COST OF FULLY FUNDING SB 813 -- LAST YEAR'S
LANDMARK SCHOOL REFORM BILL.

d. WHEN WE MAKE THIS COMPARISON, WE FIND THAT THE STATE WILL
HAVE ABOUT \$1.75 BILLION MORE THAN IT WOULD NEED TO
MAINTAIN CURRENT SERVICE LEVELS.

e. THIS \$1.75 BILLION, THEN, WOULD BE AVAILABLE FOR:

- o EXPANDING EXISTING PROGRAMS,
- o LAUNCHING NEW PROGRAMS, OR
- o CUTTING TAXES.

C. WHAT DOES THIS IMPLY FOR THE EXPENDITURE SIDE OF THE BUDGET?

1. IT MEANS THAT FOR THE FIRST TIME IN THREE YEARS, THE CHOICE
FACING THE LEGISLATURE IS NOT BETWEEN RAISING TAXES AND
CUTTING SERVICES.
2. IN FACT, WE CAN UNDOUBTEDLY EXPECT THERE TO BE INCREASES IN
SERVICE LEVELS IN A NUMBER OF PROGRAM AREAS, AND LITTLE TALK
OF TAX INCREASES.
3. IT ALSO MEANS THAT THE LEGISLATURE HAS THE FISCAL WHEREWITHAL
TO PROVIDE THE FULL AMOUNT OF FISCAL RELIEF TO CITIES AND
COUNTIES CALLED FOR BY AB 8 WITHOUT HAVING TO REDUCE STATE
PROGRAMS.

C. WHAT THE REVENUE OUTLOOK DOES NOT IMPLY

1. INTRODUCTION

- a. IF I STOPPED HERE AND ENTERTAINED YOUR QUESTIONS, I
SUSPECT YOU'D ALL GO HOME HAPPY -- YOU MIGHT EVEN INVITE
ME BACK A THIRD TIME.

- b. WERE I TO DO SO, HOWEVER, I WOULD BE DOING YOU A GREAT DISSERVICE.
- c. THIS IS BECAUSE THERE ARE A COUPLE OF OTHER VERY IMPORTANT CONSIDERATIONS THAT WE NEED TO KEEP IN MIND IN ASSESSING THE PROSPECTS FOR 1984-85.
- d. SPECIFICALLY, IN ORDER TO UNDERSTAND THIS YEAR'S BUDGET CONTEXT, WE HAVE TO TAKE ACCOUNT OF TWO THINGS THAT FALL OUTSIDE OF FISCAL YEAR 1984-85.
 - (1) FIRST, WE NEED TO RECOGNIZE THE EXTENT TO WHICH STATE SPENDING HAS BEEN CURTAILED IN RECENT YEARS.
 - (2) SECOND, WE NEED TO CONSIDER WHAT PATH THE ECONOMY IS LIKELY TO TAKE BEYOND THE BUDGET YEAR.
- e. WHEN WE DO THIS, WE WILL FIND THAT THERE IS NOT QUITE AS MUCH SLACK IN THE FISCAL ROPE AS ONE MIGHT THINK.

2. RECENT TRENDS

- a. AS EACH OF YOU KNOWS, SIMPLY COMPARING THE AMOUNT SPENT IN ONE YEAR WITH THE AMOUNT SPENT IN ANOTHER YEAR DOES NOT NECESSARILY TELL US ANYTHING ABOUT THE CHANGE IN THE QUANTITY OR QUALITY OF PUBLIC SERVICES BEING PROVIDED.
- b. TO MAKE EXPENDITURE TOTALS MEANINGFUL, WE NEED TO ADJUST THEM FOR THE EROSION IN PURCHASING POWER THAT RESULTS FROM INFLATION.
- c. SUCH AN ADJUSTMENT TO THE EXPENDITURE DATA FOR THE LAST 10 YEARS TURNS UP A VERY SURPRISING FACT:

- (1) THREE YEARS OF RECESSION-INDUCED BUDGET CUTS HAVE TRIMMED STATE EXPENDITURES (IN INFLATION-ADJUSTED DOLLARS) BY 12 PERCENT.
 - (2) AS A RESULT, EXCLUDING THE BAIL-OUT MONEY THAT THE STATE PROVIDES TO LOCAL GOVERNMENTS AS AN OFFSET TO PROPOSITION 13-INDUCED REVENUE LOSS, GENERAL FUND EXPENDITURES IN THE CURRENT FISCAL YEAR ARE ABOUT WHAT THEY WERE WHEN GOVERNOR REAGAN LEFT OFFICE AT THE END OF 1974.
 - (3) THIS, IN TURN, SUGGESTS THAT THE LEVEL OF SERVICES BEING PROVIDED BY THE STATE THROUGH ITS GENERAL FUND, IN REAL TERMS, IS ABOUT WHAT IT WAS NINE YEARS AGO.
 - (4) OVER THIS SAME NINE-YEAR PERIOD, THE NUMBER OF CALIFORNIANS HAS INCREASED BY 20 PERCENT.
- d. THIS IS SIGNIFICANT BECAUSE IT IS INDICATIVE OF THE PENT-UP DEMAND FOR SPENDING INCREASES THAT THE LEGISLATURE WILL HAVE TO DEAL WITH AS IT PUTS THIS YEAR'S BUDGET TOGETHER.
- e. THESE PENT-UP DEMANDS ARE ESPECIALLY STRONG IN AREAS SUCH AS:
- (1) PUBLIC HEALTH;
 - (2) MEDI-CAL;
 - (3) STATE EMPLOYEE COMPENSATION;
 - (4) COMMUNITY COLLEGES; AND
 - (5) ELEMENTARY AND SECONDARY EDUCATION.

- f. THUS, THE LEGACY OF THE LAST RECESSION IS A KEY FACTOR IN THE 1984-85 BUDGET PICTURE.
3. THE OUTLOOK BEYOND THE BUDGET YEAR.
- a. AN EQUALLY IMPORTANT FACTOR IN UNDERSTANDING THE BUDGET PICTURE IS THE NEXT RECESSION -- THE RECESSION THAT COULD EASILY BEGIN IN THE SECOND HALF OF 1985.
- b. AS I INDICATED EARLIER, I GENERALLY SUBSCRIBE TO THE VIEW THAT 1984-85 WILL BE A GOOD YEAR FOR THE STATE'S ECONOMY . . . AND THEREFORE A GOOD YEAR FOR REVENUES.
- c. BEYOND 1984-85, HOWEVER, I AM NOT NEARLY SO OPTIMISTIC -- NOT BECAUSE OF WHAT IS LIKELY TO HAPPEN IN SACRAMENTO, BUT BECAUSE OF WHAT IS LIKELY NOT TO HAPPEN IN WASHINGTON.
- d. TO BE OPTIMISTIC REGARDING THE PROSPECTS FOR 1985-86 AND 1986-87, YOU'VE GOT TO BELIEVE ONE OF TWO THINGS:
- (1) THAT FEDERAL BUDGET DEFICITS IN THE \$200 - 300 BILLION RANGE WILL NOT JEOPARDIZE THE ECONOMY'S WELL BEING, OR
- (2) THAT THE PRESIDENT AND CONGRESS WILL ACT RESPONSIBLY TO BRING THE DEFICIT DOWN TO A SAFER LEVEL.
- e. MY LIMITED INSIGHTS INTO THE WORKINGS OF THE ECONOMY TELL ME THAT, WHILE WE MAY BE ABLE TO GET AWAY WITH A \$200 BILLION DEFICIT WHEN THE ECONOMY IS AT LOW EBB, WE CAN'T STAND SUCH DEFICITS AS THE ECONOMY MOVES CLOSER TO FULL EMPLOYMENT.

- f. I SAY THIS BECAUSE I DON'T SEE THE COMBINATION OF DOMESTIC SAVINGS AND FOREIGN INVESTMENT PROVIDING ENOUGH CREDIT TO SATISFY BOTH THE FEDERAL GOVERNMENT AND THE PRIVATE ECONOMY AT TODAY'S INTEREST RATES.
- g. AND IT'S NOT HARD TO SEE WHO COMES OUT THE LOSER WHEN THESE DEMANDS COLLIDE.
- (1) IT CERTAINLY ISN'T GOING TO BE THE BORROWER WHOSE DEMANDS FOR CREDIT INCREASES AS INTEREST RATES INCREASE, AND WHO NEVER COMES UP EMPTY-HANDED.
- (2) NO, IT WILL BE THE HOMEBUYER, THE CAR BUYER, THE SMALL BUSINESSMAN THAT DOESN'T HAVE THE CASH FLOW TO SUPPORT HIS CAPITAL PURCHASES, AND EVERYBODY ELSE WHO CAN BE DRIVEN FROM THE MARKET BY HIGH INTEREST RATES.
- h. WHEN THAT HAPPENS, WE WILL FIND THE STATE'S REVENUES ON THE "DOWN" ESCALATOR.
- i. SO WHAT DOES ALL THAT HAVE TO DO WITH THE 1984-85 BUDGET?
- j. JUST THIS:
- (1) THAT THE STATE MUST HAVE A HEALTHY RESERVE -- A RAINY DAY FUND -- TO CUSHION THE BUDGET WHEN REVENUES TAKE A TURN FOR THE WORSE.
- (2) NOT BECAUSE EVERYTHING IN THE BUDGET MUST BE PROTECTED FROM A DROP-OFF IN REVENUES; WHEN REVENUES DECLINE, EXPENDITURES SHOULD ALSO.
- (3) BUT IT TAKES TIME TO CUT BACK EXPENDITURES IN A SENSIBLE MANNER, AND A RAINY DAY FUND BUYS US THIS TIME.

- k. THUS, I SEE THE STATE'S RAINY DAY FUND AS HAVING ONE OF THE PRIMARY CLAIMS ON 1984-85 REVENUES.
- l. I'VE RECOMMENDED THAT BETWEEN \$950 MILLION AND \$1.25 BILLION BE SET ASIDE IN SUCH A FUND.
- m. TO PUT IT AS BLUNTLY AS I CAN, IF WE CHOOSE NOT TO BUILD-UP A SIZABLE "RAINY DAY" FUND IN 1984-85, WHEN WE CAN AFFORD TO DO SO, WE PROBABLY WILL FIND OURSELVES IN 1985-86 OR 1986-87 IN MUCH THE SAME BIND WE WERE IN LAST YEAR AND THE YEAR BEFORE.

III. OUTLOOK FOR CHANGES IN THE STATE'S FISCAL RELATIONSHIP WITH CITIES

A. INTRODUCTION

- 1. I'M SURE WHAT YOU'RE MOST INTERESTED IN IS NOT ALL THIS BIG-PICTURE STUFF, BUT RATHER WHAT'S GOING TO HAPPEN TO STATE SUBVENTIONS AND OTHER CITY-SPECIFIC POLICY MATTERS.
- 2. WELL, I'VE BROUGHT ALONG WITH ME OUR ANALYSES OF THE CORTESE AND MARKS BILLS . . . BUT I'M NOT GOING TO GO THROUGH THEM WITH YOU.
- 3. WHY? BECAUSE THE BILLS IN THEIR CURRENT FORMS ARE NOT NECESSARILY INDICATIVE OF WHAT THE EVENTUAL OUTCOME WILL BE.
- 4. AS IS TRUE OF MOST MAJOR BILLS, THIS ONE WILL BE WRITTEN IN A SENATE-ASSEMBLY CONFERENCE COMMITTEE.
- 5. INSTEAD, LET ME GIVE YOU A BRIEF SUMMARY OF WHAT I SEE AS THE STEPS THE LEGISLATURE IS LIKELY TO TAKE.

B. CHANGES WHICH APPEAR TO BE LIKELY

- 1. REPEAL OF THE DEFLATOR (APPLAUSE?)

2. TERMINATION OF THE BUSINESS INVENTORY SUBVENTION IN FAVOR OF SOME OTHER SOURCE OF FUNDING FOR LOCAL GOVERNMENTS.

C. CHANGES WHERE THE PROSPECTS ARE LESS THAN 50-50

1. CONSTITUTIONAL GUARANTEES FOR VLF AND CIGARETTE SUBVENTIONS (I'M NOT SURE WHETHER YOU SHOULD GREET THIS NEWS WITH GLEE OR SORROW)
2. CONSTITUTIONAL AUTHORITY TO INCREASE THE PROPERTY TAX RATE IN ORDER TO SERVICE VOTER APPROVED GENERAL OBLIGATION DEBT.
3. REPLACEMENT OF A CLAIMS-BASED REIMBURSEMENT MECHANISM FOR STATE-MANDATED COSTS WITH A BLOCK GRANT MECHANISM.

D. CHANGES THAT ARE NOT LIKELY TO OCCUR

1. GUARANTEES FOR ALL LOCAL SUBVENTIONS SO THAT STATE PROGRAMS MUST FULLY BEAR THE CONSEQUENCES OF REVENUE SHORTFALLS.
2. MORE AUTHORITY FOR CITIES AND COUNTIES OVER THE REVENUE SIDE OF THEIR BUDGETS.

E. CONCLUSION

IV. THE JARVIS INITIATIVE

A. INTRODUCTION

1. AS MOST OF YOU KNOW, HOWARD JARVIS HAS QUALIFIED A CONSTITUTIONAL INITIATIVE FOR THE NOVEMBER 1984 STATEWIDE BALLOT.
2. IF APPROVED BY THE VOTERS AND IMPLEMENTED, IT WOULD HAVE A DRAMATIC EFFECT ON BOTH STATE AND LOCAL GOVERNMENT FINANCES.

B. PROVISIONS

1. THE JARVIS INITIATIVE IS A LENGTHY AND EXCEEDINGLY COMPLEX MEASURE.
2. PROVISIONS CAN BE GROUPED INTO THREE CATEGORIES:
 - a. MOST OF THE MEASURE'S PROVISIONS ATTEMPT TO FURTHER RESTRICT THE USE OF THE PROPERTY TAX TO RAISE REVENUES FOR PUBLIC PURPOSES.
 - b. THEN, THERE ARE PROVISIONS THAT WOULD FURTHER RESTRICT THE IMPOSITION OF TAXES, OTHER THAN THE PROPERTY TAX.
 - c. FINALLY, THERE ARE PROVISIONS THAT WOULD LIMIT USER CHARGES AND FEES.
3. PROPERTY TAX PROVISIONS (4)
 - a. THE MEASURE WOULD APPLY THE 1 PERCENT-OF-FULL-CASH-VALUE LIMITATION TO ALL TAXES ON REAL PROPERTY -- NOT JUST AD VALOREM TAXES.
 - b. IT WOULD LIMIT THE EXEMPTION FROM THE 1 PERCENT CAP TO BONDED INDEBTEDNESS APPROVED BY THE VOTERS PRIOR TO JULY 1, 1978, THUS EFFECTIVELY PROHIBITING CITIES FROM USING AN OVERRIDE TO FUND ACCRUED PENSION BENEFITS.
 - c. THE MEASURE WOULD REDUCE THE ASSESSED VALUATION OF CERTAIN PROPERTY ON THE TAX ROLLS BY PROHIBITING RETROACTIVELY ANY INFLATIONARY ADJUSTMENTS TO THE 1975-76 ASSESSED VALUATION PRIOR TO 1979-80.
 - d. THE MEASURE WOULD ALSO REDUCE THE ASSESSED VALUATION ON CERTAIN OTHER PROPERTY (PROPERTY TRANSFERRED TO OTHERS, GOLF COURSES, NEW CONSTRUCTION).

4. PROVISIONS AFFECTING OTHER TAXES (2)
 - a. REQUIRE THAT ANY INCREASE IN STATE TAXES BE APPROVED BY A TWO-THIRDS VOTE OF BOTH HOUSES OF THE LEGISLATURE.
 - b. REQUIRE THAT ANY INCREASE IN LOCAL TAXES BE APPROVED BY A TWO-THIRDS VOTE OF THE LOCAL ELECTORATE.
 - c. THESE PROVISIONS WOULD APPLY TO ALL TAXES IMPOSED AFTER AUGUST 15, 1983.

5. PROVISIONS AFFECTING USER CHARGES AND FEES

- a. THE MEASURE WOULD LIMIT THE INCREASE IN FEES TO THE INCREASE IN THE COST OF LIVING, UNLESS A LARGER INCREASE IS APPROVED BY A TWO-THIRDS VOTE.
- b. IT WOULD ALSO PROHIBIT THE PROCEEDS OF ANY USER CHARGES OR FEES FROM BEING USED TO FUND PENSION OBLIGATIONS.

C. FISCAL IMPLICATIONS

1. IF YOU'RE LOOKING FOR A BOTTOM LINE ON THIS MEASURE, I CAN'T GIVE IT TO YOU.
2. CLEARLY, HOWEVER, THE FISCAL EFFECTS WILL BE MASSIVE.
3. ONE PROVISION ALONE (THE ONE REDUCING ASSESSED VALUATION BY PROHIBITING INFLATIONARY ADJUSTMENTS PRIOR TO 1979-80) WOULD:
 - a. COST THE STATE \$433 MILLION ON A ONE-TIME BASIS, AND UP TO \$20 MILLION ANNUALLY THEREAFTER.
 - b. COST THE CITIES, COUNTIES, AND SPECIAL DISTRICTS \$624 MILLION ON A ONE-TIME BASIS AND UP TO \$41 MILLION ANNUALLY THEREAFTER.

4. THE EFFECTS OF OTHER PROVISIONS ALSO COULD BE MAJOR, BUT WE CAN'T PUT A NUMBER ON THESE EFFECTS.

D. CONCLUSION

1. THUS, IN THE YEAR IN WHICH YOU FINALLY MAY GET RID OF THE HATED DEFLATOR, YOU MAY FIND OTHER HOLES BEING DRILLED IN YOUR BUDGETS.
2. AS ROSEANNE ROSANNADANNA WOULD SAY, "IF IT ISN'T ONE THING, IT'S ANOTHER!"

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