

REMARKS TO THE MUNICIPAL MANAGEMENT ASSISTANTS

APRIL 6, 1984

LEGISLATIVE ANALYST

STATE OF CALIFORNIA

925 L STREET, SUITE 650

SACRAMENTO, CALIFORNIA 95814

REMARKS TO THE MUNICIPAL MANAGEMENT ASSISTANTS
(LEAGUE OF CALIFORNIA CITIES)

I. INTRODUCTION

A. PURPOSE OF MY REMARKS: TWOFOLD

1. LAY OUT THE FISCAL PARAMETERS WITHIN WHICH THE LEGISLATURE WILL BE OPERATING AS IT ATTEMPTS TO:
 - a. PUT TOGETHER A BUDGET FOR 1984-85, AND
 - b. RATIONALIZE THE WAY IN WHICH STATE POLICIES AFFECT LOCAL GOVERNMENT BUDGETS.
2. TELL YOU A LITTLE ABOUT WHAT WE SEE WHEN WE LOOK DOWN THE BARREL OF HOWARD JARVIS' LATEST INITIATIVE.

B. IN BOTH CASES, I'LL TRY TO BE BRIEF SO THAT THERE WILL BE PLENTY OF TIME TO DISCUSS WHATEVER'S ON YOUR MINDS.

II. THE FISCAL OUTLOOK FOR 1984-85

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

1. THE STATE'S ECONOMY IS LIKELY 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, OR 10½ PERCENT, 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 EVEN MORE IMPRESSIVE -- UP NEARLY 15 PERCENT.
- c. A BETTER WAY OF MAKING THE POINT, PERHAPS, IS TO COMPARE THE AMOUNTS WE EXPECT TO TAKE IN NEXT YEAR TO THE AMOUNTS WE WOULD NEED TO CONTINUE THIS YEAR'S LEVEL OF SERVICES.
- (1) THIS TAKES ACCOUNT OF RISING DEMANDS FOR SERVICES UNDER THE VARIOUS ENTITLEMENT PROGRAMS, PLUS
 - (2) THE AMOUNTS NEEDED TO OFFSET THE EFFECTS OF INFLATION ON PURCHASING POWER.
 - (3) WHEN WE MAKE THIS COMPARISON, WE FIND THAT THE STATE WILL HAVE ABOUT \$1.25 BILLION MORE THAN IT WOULD NEED TO MAINTAIN CURRENT SERVICE LEVELS.
 - (4) THIS \$1.25 BILLION, THEN, WOULD BE AVAILABLE FOR:
 - o EXPANDING EXISTING PROGRAMS,
 - o LAUNCHING NEW PROGRAMS, OR
 - o CUTTING TAXES.

B. WHAT DOES THIS IMPLY FOR THE BUDGET GENERALLY, AND FOR AID TO LOCAL GOVERNMENTS SPECIFICALLY?

1. FIRST, IT MEANS THAT FOR THE FIRST TIME IN THREE YEARS, THE CHOICE FACING THE LEGISLATURE IS NOT BETWEEN RAISING TAXES AND CUTTING SERVICES.
2. SECOND, THE REVENUE OUTLOOK MEANS THAT THE LEGISLATURE CAN PROVIDE THE FULL AMOUNT OF LOCAL FISCAL RELIEF 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.
- b. WERE I TO DO SO, HOWEVER, I WOULD BE DOING YOU A GREAT DISSERVICE.
- c. THERE ARE A COUPLE OF OTHER CONSIDERATIONS, HOWEVER, THAT YOU 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 KNOW, 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) 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.
 - (2) 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.
 - (3) OVER THIS SAME NINE-YEAR PERIOD, THE NUMBER OF CALIFORNIANS HAS INCREASED BY 20 PERCENT.
- d. PLEASE NOTE THAT I AM NOT WRINGING MY HANDS OVER THIS -- JUST POINTING OUT A FACT.
- e. IT'S AN IMPORTANT FACT, HOWEVER, 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.
- f. AFTER THREE YEARS OF RECESSION-INDUCED BUDGET CUTS THAT HAVE TRIMMED STATE EXPENDITURES (IN INFLATION-ADJUSTED DOLLARS) BY 12 PERCENT, THESE PENT-UP DEMANDS ARE ESPECIALLY STRONG.
- g. THEY ARE MOST EVIDENT IN AREAS SUCH AS:
- (1) PUBLIC HEALTH, WHERE FUNDING LEVELS HAVE BEEN FROZEN FOR SEVERAL YEARS;

- (2) MEDI-CAL, WHERE PROVIDERS HAVE GOTTEN LITTLE OR NO INCREASES SINCE 1981;
 - (3) STATE EMPLOYMENT, WHERE EMPLOYEES WENT TWO AND ONE-HALF YEARS WITH NO INCREASES;
 - (4) COMMUNITY COLLEGES; AND
 - (5) ELEMENTARY AND SECONDARY EDUCATION.
- h. 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 I EXPECT TO BEGIN IN THE SECOND HALF OF 1985.
 - b. MY COLLEAGUES AND 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 EITHER GOT TO BELIEVE:
 - (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. I DON'T BELIEVE THE FORMER, AND I'M HAVING GREAT DIFFICULTY FINDING ANY REASON TO BELIEVE THE LATTER.
- f. 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 BEGINS TO APPROACH FULL EMPLOYMENT.
- g. 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.
- h. 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.
- i. WHEN THAT HAPPENS, WE WILL FIND THE STATE'S REVENUES ON THE "DOWN" ESCALATOR.
- j. SO WHAT DOES ALL THAT HAVE TO DO WITH THE 1984-85 BUDGET?
- k. JUST THIS:

- (1) THAT THE STATE MUST HAVE A HEALTHY RESERVE 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.

1. THUS, I SEE THE STATE'S RAINY DAY FUND AS HAVING ONE OF THE PRIMARY CLAIMS ON 1984-85 REVENUES.
- m. I'VE RECOMMENDED THAT BETWEEN \$950 MILLION AND \$1.25 BILLION BE SET ASIDE IN SUCH A FUND.
- n. 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.

D. SUMMARY

1. IN SUM, 1984-85 LOOKS LIKE A GOOD YEAR, AND THE THREAT TO THE CITIES' SHARE OF LOCAL FISCAL RELIEF FROM THE REVENUE SIDE OF THE BUDGET IS A LOT LESS THAN WHAT IT WAS IN RECENT YEARS.
2. BECAUSE THE YEARS PRECEDING AND FOLLOWING 1984-85 DO NOT LOOK QUITE AS GOOD IN TERMS OF RESOURCE AVAILABILITY, HOWEVER, THERE'S A LOT LESS ROOM IN THE 1984-85 BUDGET THAN APPEARS AT FIRST GLANCE.

III. 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!"

* * * * *