



County Fiscal Distress

A Look at Butte County

Our review indicates that Butte County is faced with a serious structural budget problem. The seriousness of this problem and its effect on service levels in state-interest programs argue for a long-term fiscal solution to the county's difficulties.

Background

Earlier this fall, Butte County officials announced that the county was \$3.5 million short of balancing its 1989-90 budget. Attributing the problem to increasing mandated program costs coupled with stagnant revenue, the county's administrative officer stated that the county had already cut services to the maximum extent possible. County officials believed that any further budget reductions would impede their ability to maintain a viable county government. Consequently, county officials announced their intent to seek bankruptcy protection in federal court.

The Department of Finance responded by authorizing the county to defer payment of \$2.8 million for fire services provided by the Department of Forestry and Fire Protection. The county also: (1) cut back library hours and (2) reduced its general reserve to \$71,000 (0.05 percent of the annual budget). These actions allowed the county to finance its projected 1989-90 expenditures.

In addition, the state Department of Finance conducted a fiscal review of the county, and is currently examining options for a more permanent solution to the county's fiscal problems. The department's findings will likely be presented with the 1990-91 Governor's Budget.

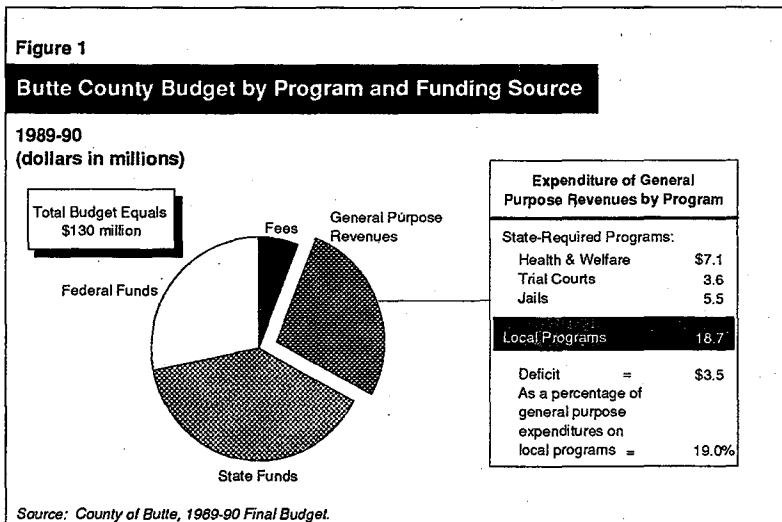
The purpose of this policy brief is to provide the Legislature with a context for considering proposals to address Butte County's fiscal problems. The analysis is based on a review of Butte County's past financial transactions and its 1989-90 final budget. Our intent is to explain the basic fiscal trends underlying Butte's current condition, not to evaluate management of the county or past policy decisions made by county officials.

What Is the Magnitude of the County's Budget Problem?

Butte County's total budget for 1989-90 is approximately \$130 million. Thus, the

county's original \$3.5 million shortfall represents about 3 percent of the county's overall budget. Figure 1 shows that the shortfall is even more substantial relative to the portion of the budget over which local officials have direct control.

Approximately two-thirds of Butte's budget is supported by a



Adjusting for inflation, per capita general purpose revenue available for local uses declined by 21 percent between 1984-85 and 1987-88.

combination of state and federal funding which is tied to specific program requirements. An additional 6 percent is supported by fees, which bear a direct relationship to the services provided and cannot be diverted for general purposes. This means that any budget reductions would have to come out of the remaining \$35 million in general purpose revenues, which include locally raised funds and general purpose subventions. Almost one-half of this general purpose revenue, however, is used to pay for state-required programs over which the county has very limited budgetary control, such as health and welfare, the trial courts, and jails.

Taking these factors into account, the 1989-90 shortfall represented about 19 percent of the general purpose revenue available for local uses. Thus, in the absence of state assistance, the county would have had to make sizable service reductions to balance its 1989-90 budget.

What Factors Contribute to Butte's Fiscal Difficulties?

Our review indicates that Butte County, like many counties, is characterized by a structural budget problem--high growth in county costs for the state-required programs mentioned above, and relatively slower growth in local general purpose revenue. Figure 2 shows that between 1984-85 and 1987-88, the county's costs for health and welfare programs, the courts, and jails increased by \$4.7 million. During the same period, county general purpose revenue increased by only \$4.0 million.

Because the cost of state-required programs increased faster than the growth in general purpose revenue, the county had to divert an increasing share of its general purpose revenue to these programs. Thus, the portion of general purpose revenue available for discretionary local purposes declined by \$700,000 between 1984-85 and 1987-88. Adjusting for inflation, per capita general purpose revenue available for discretionary programs declined by 21 percent during this period.

As we have discussed in prior analyses (for example, see our discussion of trial court funding in *The 1989-90 Budget: Perspectives and Issues*, p. 337), California's counties generally are subject to increasing program costs and low general purpose revenue growth. However, Butte County is worse off than many other counties because it has relatively slow general purpose revenue growth, while its costs for state-required programs are growing at the same pace as the rest of the state. For example, between 1984-85 and 1987-88, Butte County experienced general purpose revenue growth of approximately 15 percent, while general purpose revenue grew 26 percent statewide. During the same period, Butte County's statewide expenditures for state-required programs grew by 38 percent.

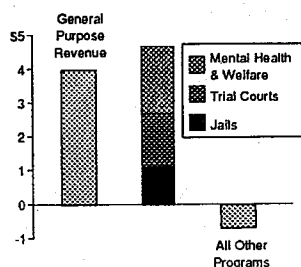
Factors underlying rapid cost increases. The data reveal that the county is experiencing the brunt of its cost increases in the health and welfare area. Between 1984-85 and 1987-88, the net county costs for state-required health and welfare programs increased 66 percent, relative to statewide cost increases of 35 percent. Two factors appear to have driven this rapid increase: (1) the county is under court order to meet minimum standards in its general assistance program and (2) the county has experienced immigration of welfare recipients due to its low cost of living.

During the same period, Butte County's growth in court expenditures was slightly below the statewide average. The county's jail operating expenditures, however, grew at a much slower pace--29 percent, compared to a statewide increase of 44 percent. The rapid statewide increase in jail operating expenditures is due, in large measure, to the fact that most counties are updating facilities and increasing capacity. Butte County reports that, despite an ongoing problem with jail

Figure 2

Change in General Purpose Revenues and Expenditures for State-Required Programs

1984-85 through 1987-88
(dollars in millions)



Source: State Controller, Department of Mental Health, Department of Social Services. Welfare costs estimated based on estimated state sharing ratios.

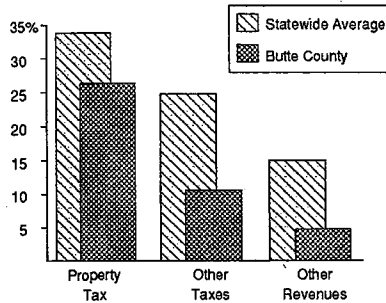
overcrowding, it cannot generate the local match required to obtain state financing for a new jail. This may, in part, account for Butte's slower growth in jail operating costs.

Factors underlying slow general purpose revenue growth. Figure 3 compares growth in Butte County's primary general purpose revenue sources to the statewide trend for the period 1984-85 through 1987-88. These sources include the property tax, other taxes (including sales tax, transient occupancy tax, and the like), and other general purpose revenue sources (including state and federal general purpose subventions, fines, franchise fees, and revenue from use of money and property). This figure shows that Butte experienced lower- than-statewide growth in all general purpose revenue sources during this period.

Figure 3

**Growth in Major Revenue Sources
Butte County v. Statewide Average**

1984-85 through 1987-88



Source: State Controller. County comparisons exclude San Francisco.

Due to the restrictions imposed by Proposition 13, counties generally have difficulty increasing their overall general purpose revenue base. Thus, Butte County, like other counties, relies on growth in its existing base to fund increasing program costs. Because its economy is primarily agricultural, Butte County experiences low growth in property values and retail sales, the bases for property and sales taxes. Moreover, the economic growth that does occur in the county is primarily centered in the City of Chico, and frequently occurs in redevelopment project areas. In such cases, the county receives relatively little benefit from the resulting increases in property and sales tax revenue.

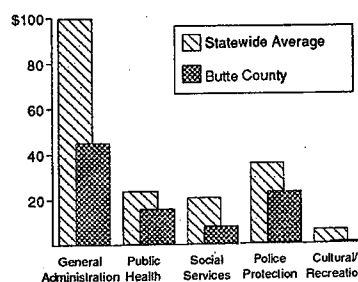
Butte County also has a limited general purpose revenue base. In addition to having low revenue growth, the county has a small general purpose revenue base relative to many other counties. This is due in part to local economic conditions and partly to funding choices made by the county prior to Proposition 13. First, the county reduced its property tax rate several times in the years prior to the passage of Proposition 13. Due to the way in which property taxes were allocated following Proposition 13, the county's earlier actions resulted in the county receiving a low share of countywide property taxes--22 percent, compared to 33 percent statewide. In addition, the county historically depended on federal revenue sharing to help fund local operating costs. Consequently, the county was hard hit when this funding was withdrawn.

County actions in response to past budget constraints. Over the past decade, Butte County has generally limited service levels in response to its budgetary constraints. As Figure 4 shows, Butte's 1987-88 per capita expenditures for a variety of local service areas were lower than the average statewide figures. In recent years, the county has imposed across-the-board cuts in general fund departments, placed restrictions on cost-of-living increases for employee salaries, and deferred maintenance of roads and other infrastructure.

Figure 4

County and State Per Capita Expenditures on Local Programs

1987-88



Source: State Controller. County comparisons exclude San Francisco.

It is beyond the scope of our review to determine whether Butte County has achieved all possible efficiencies in response to its fiscal dilemma. Nor can we determine how county management or policy decisions have affected Butte's fiscal problems. The

In 1987-88, Butte spent less per capita than the state average on administration, public health, social services, police protection, and cultural recreational programs.

data clearly indicate, however, that Butte County is plagued with a structural fiscal problem stemming from factors that are largely beyond local control.

What Is the Outlook For the Future?

In recent years, Butte County has maintained a balanced budget in part because it benefitted from various state assistance programs designed to assist all counties or groups of counties. In 1987-88, for example, Butte received \$1.3 million in one-time general assistance block grants, and an additional \$360,000 in general criminal justice block grants. In the absence of this assistance, the county would have had difficulty avoiding a budget deficit. State assistance in 1989-90 includes \$500,000 in state subventions for revenue stabilization and \$1.8 million in Trial Court Funding. These amounts are in addition to the \$2.8 million deferral provided specifically to Butte (described above).

Although state aid has kept Butte County solvent to date, it is likely that future increases in required program costs will rapidly erode this assistance. Moreover, the county's agreement with the Department of Finance currently calls for the payment of the \$2.8 million deferral in 1990-91. (It is our understanding, however, that the department intends to waive repayment of \$500,000 of this amount.) Therefore, in the absence of increased state assistance, the county's fiscal condition will worsen next year and in the future.

What Are the County's Plans For Dealing With Its Fiscal Problem?

Local options. Because county officials are reluctant to undertake any additional service reductions, they are currently reviewing options for alternative financing

mechanisms. These options are outlined in Figure 5.

The county reports that it is examining the possibility of including some or all of these options on the June 1990 ballot. The potential success of these measures is uncertain, however, given that they all rely on local voter support. County voters have been reluctant in the past to raise local general purpose revenue. For example, a half-cent sales tax override proposed last year received less than 30 percent approval. In the event that these measures do not pass, the county may choose to file bankruptcy action in federal court.

What does bankruptcy entail? Chapter 9 of the Federal Bankruptcy Act allows governmental entities to seek bankruptcy protection in a special federal bankruptcy court. This law would give the county protection from its creditors while it restructures its finances to regain stability.

There is no precedent, in California or nationally, for a bankruptcy action involving a general purpose government. Because Butte County is, by constitutional law, an arm of the state, its case is likely to raise a variety of difficult issues regarding the relative responsibilities of California and its counties in providing and financing state programs. Consequently, the state faces considerable uncertainty with regard to the possible outcome of the action.

Conclusion: A County In Distress

In sum, the data indicate that Butte County is faced with a serious structural budget problem. While this problem is common to most counties, Butte County is worse off than many others due to its extremely slow general purpose revenue growth. In our view, the local options currently considered by Butte County are unlikely to resolve the county's long-term structural problem. In the absence of state intervention, the county's fiscal condition probably will continue to deteriorate over time.

At least in part due to its fiscal difficulties, Butte County spends less per capita on a variety of programs than do counties statewide. Many of these programs are of statewide interest, including public protection, public health, and social services. The seriousness of Butte's budgetary problem and its apparent effect on levels of service in state-interest programs argue for a long-term solution to the county's fiscal dilemma. ❖

Figure 5

Local Options to Finance Butte County Budget

Option	Annual Amount	Vote Requirement
Establish county services area to finance fire protection with benefit assessments	\$2.1 million	Majority
Establish county services area to finance animal control services with assessments	250,000	Majority
Establish special tax to finance library services	2 million	Two-thirds
Increase sales tax by one-half cent for general purposes [pursuant to Ch 277, Statutes of 1989 (AB 999, Farr)]	6 million	Majority