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LOCAL GOVERNMENT AGREEMENT AT THE CENTER OF THE 2004-05 BUDGET DEBATE

As debate over the 2004-05 Budget draws to a close, the agreement between local governments and the Governor remains among the most controversial outstanding issues. The mid-May agreement between the Governor and the League of California Cities, California State Association of Counties, California Special Districts' Association, and California Redevelopment Association would provide the state $1.3 billion in savings in each of 2004-05 and 2005-06 by reducing local revenues.

Beginning in 2006-07, the agreement would prevent the state from diverting certain local revenues in order to achieve state savings; prohibit the state from changing the allocation of local sales and property tax revenues; require the state to reimburse local governments for mandated costs or repeal the mandate; and make a number of other changes to the fiscal relationship between the state and local governments.

The agreement would be codified in a constitutional amendment that the Legislature would place on the November 2004 ballot. In return, local governments would drop support of a separate initiative that will also appear on the November ballot.

The agreement poses significant questions for the future of the relationship between the state and local governments and for future state budgets. Local governments argue that state and local government finances should be separate and that the state should not have the authority to divert local revenues to achieve state savings or policy goals. Critics respond that the fiscal relationship between the state and local governments is complex, with a number of shared responsibilities, and that additional constraints will make it more difficult to reform a system that virtually all agree suffers from major flaws and inequities.

Issues Raised by the Agreement Date Back to Proposition 13

In 1978, voters approved Proposition 13, which reduced local property tax revenues by more than half by capping rates at 1 percent and rolling back property values to 1975-76 levels. Proposition 13 also gave the Legislature responsibility for allocating the remaining proceeds of the property tax; limited reassessment of property for tax purposes to when a property changes hands; capped annual increases in value to no more than 2 percent; imposed a two-thirds requirement for the Legislature to enact a state tax increase; and required any special-purpose local tax to be approved by a two-thirds vote of the electorate.

In the wake of Proposition 13, the state stepped in and assumed a larger share of responsibility for financing education. In 1979, the Legislature passed AB 8, which shifted property taxes from schools to cities, counties, and special districts in order to cushion the blow to these jurisdictions from the loss of property tax revenues due to Proposition 13. Since 1978, a series of voter-approved initiatives have further defined and confined the fiscal relationships among the state, education, and local governments. Proposition 98 of 1988, for example, established a guaranteed funding level for K – 14 education. Proposition 218 of 1996 required local governments to seek voter approval for any tax increase, among other changes.

After AB 8, the structure for allocating local property tax revenues remained generally con-

stant until the state budget crisis of the early 1990s. In 1992 and again in 1993, the state shifted property tax dollars from cities, counties, and special districts to K – 14 education in order to reduce the state's costs under the Proposition 98 guarantee. Proposition 172 of 1993 partially backfilled counties and cities for lost property tax revenues with the proceeds of a ½-cent sales tax rate. After the property tax shifts of the early 1990s, cities and schools had approximately the same share of property tax revenues as they received prior to the passage of Proposition 13. Counties received a smaller share and other districts received a larger share of the property tax dollar.

In 1998, the Legislature reduced the Vehicle License Fee (VLF) rate, which had been 2.0 percent since 1948. Since proceeds of the VLF went to counties and cities, the Legislature agreed to backfill counties and cities for their revenue loss. The original measure phased in a reduction in the VLF rate using a series of triggers tied to state revenue levels. In 2001, legislation made the 0.65 percent rate permanent, but retained a trigger that increased the VLF rate in the event the state lacked sufficient revenues to backfill counties and cities. The rate was increased in 2003 using this trigger; however, Governor Schwarzenegger reversed the increase on his first day in office.

In January 2004, Governor Schwarzenegger proposed a permanent transfer of $1.3 billion in property tax revenues from counties, cities, and special districts to schools in order to generate state savings by reducing education spending. In April 2004, a coalition of local government groups submitted signatures to place an initiative on the November ballot that would "lock in" local control over revenue streams, make changes to the state mandate process, and rescind any actions taken as part of the 2004-05 Budget to reduce certain local revenues, including the local property tax.

The State Would Bear the Full Brunt of Future Budget Balancing Efforts

The agreement would allow the state to achieve $1.3 billion in savings in both 2004-05 and in 2005-06 and then constitutionally prohibit similar actions in the future. The savings would be achieved by a combination of ending state VLF backfill payments to counties and cities and property tax shifts from local governments to schools that, in turn, allow the state to reduce spending on K – 14 education. By prohibiting similar shifts in the future, this provision would increase the likelihood of reductions in areas of the state budget without constitutional protection, such as higher education, most social services and health care programs, mental health, housing, environmental and resource programs, and public safety.

While the agreement protects property tax, sales tax, and VLF revenues, and reimbursements for state-mandated costs, it would not protect allocations for programs that are the shared responsibility of the state and county governments, including a number of health and social service programs. By reducing the options available for achieving savings in the event of future budget crises, the state could, and would likely be forced to, reduce funding for child protective services, CalWORKs, courts, adoptions assistance, In-Home Supportive Services, Medi-Cal, and other county-administered services.

The Agreement Would Severely Limit Efforts to Address Adverse Fiscal Incentives

In recent years, constituencies ranging from homebuilders to housing advocates to environmentalists have faulted current revenue allocation practices for encouraging local governments to seek sales tax-generating retail development over housing or other forms of commercial activity, such as manufacturing. The preference for sales tax-generating development is often called the "fiscalization of land use." Legislation aimed at addressing this issue has garnered broad support, but has stalled in the Legislature due to opposition from localities that would be "losers" under changes to the current system.

The local government agreement would lock in the current allocation of sales and property tax revenues, which could not be changed without subsequent statewide voter approval. By doing

so, the agreement would make it much more difficult, if not impossible, to change a system that is widely considered dysfunctional. Specifically, the Legislature would be barred from statutorily changing the allocation of sales tax dollars from a point of sale to a population-based system.

Many of the Governor's Agreements Would Result in Future Costs

The local government agreement, along with several others negotiated between the Governor and various interest groups, commit the state to higher costs in future years. These commitments are significant, in light of the continuing structural shortfalls. In May, the Legislative Analyst estimated that the policies outlined in the Governor's May Revision, including the local government agreement, would leave the state facing a shortfall of $8 billion in 2006-07. The local government agreement would significantly increase state costs beginning in 2006-07 by constitutionally requiring the state to repay various loans and other obligations, while at the same time requiring an increase in education spending to reflect the end of the $1.3 billion in temporary state savings. This constitutional protection would make it difficult, if not impossible, for the state to delay repayment even if state resources are not available to pay the added costs. While the higher education and other agreements also commit to higher costs, these deals did not provide for constitutional protection.

The Local Government Agreement Would Lock in Current Inequities

The proposed agreement would guarantee each local jurisdiction a future share of the local property tax at least as large as its January 1, 2004 share. In the future, the share could be increased, but only by reducing the share devoted to education, absent statewide voter approval. The current system for allocating local property tax dollars generally follows the relative allocation in effect in 1978. The post-Proposition 13 bailout and subsequent actions have largely frozen in place longstanding disparities. For example, individual counties' share of the property tax dollar varies significantly. Los Angeles County, for example, receives 24 percent of the local property tax, while Orange County receives just 10 percent. Similar disparities exist among cities. The local government agreement would make it difficult to remedy these disparities in the future.

Moreover, if enacted as proposed, the agreement would require statewide voter approval to shift dollars between jurisdictions in response to local concerns. For example, statewide voter approval would be needed to reduce the share of the local property tax dollar going to a water district, which has the ability to levy fees to cover their cost of services, in order to increase the share going to a library or police protection district with little or no fee-generating ability.

VLF Rate Would Be Capped in the Constitution

Finally, the agreement would cap the VLF tax rate at 0.65 percent effective January 1, 2005. In general, state tax rates are specified in statute, not in the Constitution, and the Legislature retains the ability to increase the rate by a two-thirds vote. The proposed cap would prevent future Legislatures from increasing the rate absent voter approval. This provision would also repeal the "trigger" included in the 1998 VLF reduction law that provided a rate increase if the state lacked resources to backfill lost revenues. Moreover, the proposed agreement would prevent an increase in the VLF rate as part of a revenue neutral measure or as part of a measure that actually reduced state taxes. For example, the Legislature would be prevented from cutting the sales tax by $5 billion, while increasing the VLF by $4 billion.

Differences Between the Agreement and the Local Governments' Initiative

The agreement is largely patterned after an initiative sponsored by local government associations and their allies. While the agreement between local governments and the Governor would allow the state to achieve $1.3 billion in savings in 2004-05 and in 2005-06, the local governments' initiative would prohibit such action absent statewide voter approval. The initiative would not cap the maximum VLF rate

in the Constitution and would require the state to maintain VLF backfill payments. The Governor's agreement, in contrast, ends the backfill, but increases the share of local property taxes going to counties and cities by an equal amount.

What Happens Next?

A number of lawmakers have called for changes in the agreement. Most opposition has focused on the fact that the agreement would substantially complicate efforts to minimize incentives for local governments to favor sales tax-generating retail development. The Legislative Analyst recommended that the Legislature consider alternatives that would protect local revenues in the aggregate, but avoid locking in the allocations of every city, county, and special district.

What Does the Local Government Agreement Do?

The agreement:

- Caps the Vehicle License Fee rate at 0.65 percent in the state Constitution effective January 1, 2005.
- Allocates the remaining proceeds of the VLF to maintain funding for the Local Revenue Fund. This fund supports program responsibilities transferred to counties in the 1991 realignment of responsibility for certain health, social services, and mental health programs. Cities would receive the remainder of the VLF.
- Specifies that cities, counties, and special districts must be annually reimbursed for the cost of any mandated services. Unreimbursed mandates would be repealed. Amounts appropriated by the Legislature to reimburse local governments for the cost of mandated services would be excluded from the Governor's line item veto authority. The agreement would repeal the existing provisions for processing mandate claims and reinstate new expedited procedures.
- Requires the state to reimburse local governments amounts owed for mandates determined to exist prior to January 1, 2005, approximately $1.6 billion, in five annual payments beginning in the 2006-07 fiscal year. This provision would apply to reimbursements deferred as part of recent years' budget agreements.
- Constitutionally "locks in" each local government's share of property tax proceeds as of January 1, 2004. The Legislature could not reallocate property tax revenues among jurisdictions or transfer revenues to any special fund without statewide voter approval. The Legislature could increase local governments' share of property taxes by shifting property tax dollars away from schools and community colleges to cities, counties, redevelopment agencies, or special districts.
- Makes a series of complex transactions aimed at generating $1.3 billion in state savings in each of 2004-05 and 2005-06. State savings would be generated by ending VLF backfill payments and by transferring property tax revenues to schools and reducing the state's school funding obligation by an equal amount. Specifically, the agreement would reduce city revenues by $350 million; county revenues by $350 million; redevelopment agency property tax revenues by $250 million; and independent special district property tax revenues by $350 million in each of 2004-05 and 2005-06. The agreement would eliminate the VLF backfill and provide each city and county with property taxes equal to the jurisdiction's prior backfill payment. Property taxes would be shifted from schools and community colleges to cities and counties and the state would backfill education for lost revenues.
- Requires the state to repay the VLF backfill loan, approximately $1.2 billion, no later than August 15, 2006.
- Requires the state to restore the ¼-cent sales tax rate used to repay the deficit reduction bonds authorized by Proposition 57 to counties and cities once the bonds have been repaid.
- Prohibits the state from changing the formula used to allocate the proceeds of the local sales tax. It specifically would not, however, preclude the state from changing the allocation of the local sales tax in a manner needed to participate in a multistate agreement, such as the Streamlined Sales Tax Project, which is designed to establish a mechanism for collecting sales tax attributable to electronic and mail order sales.

STRETCHED THIN: STATE BUDGET CUTS THREATEN CALIFORNIA'S HEALTH AND HUMAN SERVICES PROGRAMS

A new California Budget Project (CBP) report, *Stretched Thin: State Budget Cuts Threaten California's Health and Human Services Programs*, finds that the state's health and human services programs face a significant funding squeeze and that counties have reduced staff and services in response to state budget reductions.

Stretched Thin analyzes the impact of funding reductions on nine health and human services programs administered by California's counties, including the California Work Opportunity and Responsibility to Kids (CalWORKs) Program, the Foster Care Program, and the In-Home Supportive Services (IHSS) Program. The report is based on a survey of 11 urban, suburban, and rural counties conducted by the CBP and the County Welfare Directors Association of California (CWDA) in early 2004. The counties reported a range of impacts attributable to the funding squeeze. For example:

- Butte County reported that the elimination of preventive programs has reduced their ability to provide early intervention services to help keep children out of the child welfare system.
- Contra Costa County reported that because of inadequate staffing in the CalWORKs Program, the "average time a participant spends on aid will be extended because staff are not available to work proactively with participants" and "fewer participants will exit welfare due to employment."
- Orange County reported that children are "remaining in paid foster care many months longer than necessary" due to funding reductions and understaffing.
- San Bernardino County reported that limited contact with clients in the IHSS Program has put the frail elderly at risk of deterioration to the point of needing out-of-home placement.

State policymakers have not – by and large – eliminated services or changed eligibility requirements for these programs. Instead, the state has failed to provide counties with funding increases to cover the rising cost of basic operating expenses. In some cases, the state has also reduced funding, adding to the cost pressures faced by counties. These budget cuts have resulted in a slow funding squeeze on programs that is largely hidden from view, particularly in the context of the state's budget debate. Major findings of *Stretched Thin* include:

- **Services have been negatively affected in all programs included in the survey.** Counties reported increasing delays in response time, reduced quality of services, diminished access to services, and longer waiting periods to receive services.
- **State funding cuts not only threaten programs' core missions, but could lead to increased costs, as well.** Counties identified unintended consequences of the recent budget cuts, including increased risk of errors; diminished ability to provide preventive services, potentially resulting in higher long-term costs; delays and inefficiencies in the provision of services; diminished ability to provide services that could move individuals off aid more quickly; diminished ability to monitor and eliminate fraud or to evaluate program effectiveness; and loss of federal funds.
- **The current cutbacks may threaten the long-term viability of programs.** Budget cuts have eroded counties' ability to implement innovative program models. Funding reductions have also frayed the community-based safety net that supports many public programs for children, families, and vulnerable adults. In addition, the funding squeeze and the counties' need to "do more with less" have affected county workers who deliver services by contributing to staff "burnout" and rising turnover. To the extent that the quality of programs is diminished, public support for vital public services may decline as a result.

Surveyed counties account for nearly 60 percent of the state's population and more than half of the state's caseload in each of the programs surveyed. The survey examined the Adoption Assistance Program, the Adoptions Program, the Adult Protective Services Program, the Child

Welfare Services Program, the CalWORKs Program, the Food Stamp Program, the Foster Care Program, the IHSS Program, and the Medi-Cal Program.

STATE EMPLOYMENT: DISPELLING THE MYTHS

California's budget crisis has focused attention on state employment as policymakers search for ways to reduce the cost of public services. In an effort to hold down state spending, then-Governor Gray Davis issued an Executive Order in October 2001 imposing a hiring freeze on most of state government; several subsequent Executive Orders have extended the freeze. Thousands of vacant civil service positions have also been eliminated over the past several years in an effort to streamline state employment. Partially as a result, California public employment relative to population is among the lowest in the nation.

Where Do State Employees Work?

The majority of state employees work in higher education and public safety. State employment is highly concentrated in a small number of departments. In 2002-03, the top 10 departments in terms of employment accounted for 74.0 percent of state workers. More than half (57.4 percent) were employed by just four departments – the University of California (UC), the California Department of Corrections (CDC), the California State University (CSU), and the California Department of Transportation (CalTrans).

Differences Between Shares of State Spending and State Employment

There are significant differences between shares of state spending and state employment. For example, the Health and Human Services Agency employed only 9.3 percent of all state employees, but accounted for about one-third (33.7 percent) of total expenditures in 2002-03. Similarly, K-12 Education employed only 0.9 percent of state employees, but accounted for 26.1 percent of total 2002-03 spending. In programs where services are delivered locally, state spending is high relative to employment. Conversely, state employment is concentrated in areas where the state is responsible for service delivery, as in the UC, CSU, and prison systems.

Changes in the Composition of State Employment

Over the past 20 years, some departments have experienced major growth, as measured by personnel years (PYs), while others have remained stable or declined. As a result, the composition of the state workforce has changed. The most dramatic change was the growth of the CDC. Employment at the CDC grew by 350 percent between 1982-83 and 2002-03. In 1982-83, the CDC employed 9,870 PYs; by 2002-03, that number increased to 44,454. While CDC employment was less than one-third that of the CSU in 1982-83, employment at the CDC exceeded that of the CSU by 2002-03. The CDC accounted for well over one-third (42.1 percent) of the net employment growth in the top 20 departments during this period. The State Compensation Insurance Fund employment also grew substantially in percentage terms (290.0 percent) over the 20-year period, but the absolute growth (6,051 PYs) was much smaller than that of the CDC. In absolute numbers, the UC system was second after the CDC in the number of PYs (15,557) added, but the percentage increase (26.1 percent) in employment was lower.

Among the top 20 departments, the two biggest losers of PYs in both percentage and absolute terms between 1982-83 and 2002-03 were the Department of Developmental Services (DDS) and the Employment Development Department (EDD). The DDS shrank by 5,267 PYs and the EDD lost 3,134 PYs.

California's Per Capita Public Employment Is Among the Lowest in the US

While the state government has grown significantly, so has the population that it serves. State government added 92,905.0 PYs between 1982-83 and 2002-03, a 40.7 percent increase. However, the state employed 9.1 workers per 1,000 residents in 2002-03, just slightly less than the 9.2 state employees per 1,000 residents in 1982-83. California's state employment relative to popula-

tion also is low compared to other states. In 2001, the most recent year for which data are available, California ranked 49th out of 50 states in terms of state employment per 10,000 residents.

TAKING STOCK OF CALIFORNIA'S WORKFORCE DEVELOPMENT SYSTEM

The most recent recession reminded Californians of how quickly labor markets can change. Almost overnight, a vibrant high technology sector went from boom to bust, forcing thousands of workers to look for new careers, as well as new jobs. Helping workers make this kind of transition is only one of the roles of California's publicly funded workforce development system. More broadly, the various institutions that provide workforce services support the effective and efficient functioning of the labor market. "One Stop" career centers, community colleges, adult schools, and other workforce institutions offer labor market information, education, job training, and supportive services.

California's workforce development system receives between $4 billion and $5 billion annually in federal, state, and local funding. State and local funds account for approximately two-thirds of the total; federal monies for approximately one-third. Beginning in 2002-03, the state's budget crisis forced cutbacks in a number of workforce programs. Some federal funding also has declined, most notably for the Workforce Investment Act.

There are two major divisions within the workforce development system, programs for adults and programs for youth:

Adult Programs

For adults, there are four basic delivery systems:

- **Workforce Boards and One Stops:** The federal Workforce Investment Act (WIA) established a network of local Workforce Investment Boards (WIBs) charged with providing direction in their communities to over 19 federally-funded workforce programs. Each WIB must establish at least one full-service One Stop career center in its area where individuals and employers can access job training, education, and employment services.
- **Community Colleges, Adult Schools, and Regional Occupational Centers and Programs (ROCPs):** Community colleges and adult schools are the backbone of public adult education and training. There are 108 community colleges and numerous adult schools across the state. These educational institutions offer adults two principal programs: vocational and technical education, and adult basic education. In addition, California has 73 ROCPs that offer vocational training to adults, as well as youth. The adult schools and ROCPs are administered by the K-12 school system.
- **Programs for Special Populations:** The two most important programs for special populations are vocational rehabilitation and the CalWORKs welfare-to-work program. Others include employment and training programs for adult inmates in the state Department of Corrections, the Refugee Employment and Training Program, and the Food Stamp Employment and Training Program.
- **Economic Development Programs:** The two major workforce programs with a principal focus on economic development are the Employment and Training Panel (ETP) and the Economic and Workforce Development Program of the California Community Colleges. Both provide education and training for adult workers - especially employed workers - in close cooperation with employers.

Youth Programs

The youth system has two basic components:

- **Career Technical Education:** The California secondary school system, sometimes in partnership with community colleges, offers programs for young people aimed at promoting career and technical awareness and vocationally-oriented education and training. In general, these programs are targeted at non-college bound youth, but programs have an increasing emphasis on blending career education with the high school curriculum

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more broadly. Vocational programs are offered through high schools and ROCPs, and in some cases by the community colleges, as well.

- **Special Programs for Targeted Youth:** Some programs, including those funded by the Workforce Investment Act, Partnership Academies, the Job Corps, programs for wards of the California Youth Authority, and the California Conservation Corps are aimed at high-risk young people.

Reauthorization Provides Opportunity to Take Stock

The US Congress began the process of reauthorizing of several major pieces of federal legislation in 2003, including the Workforce Investment Act, the Carl D. Perkins Vocational and Technical Education Act, Temporary Assistance for Needy Families (the Personal Responsibility and Work Opportunity Reconciliation Act), and the Higher Education Act. Together, these programs account for much of the federal government's contribution to the nation's workforce development system.

The reauthorization of these programs provides an opportunity for California to step back and take stock of its current investments in workforce preparation and training. Reauthorization also offers an opportunity to learn from states that have made the most of their workforce investments by developing a set of overarching goals and standards to which all programs are held accountable.

The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the California Budget Project is provided by foundation grants and individual donations and subscriptions.

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