state-local fiscal reform—will we know it when we see it?
by diane cummins
LETTER FROM THE INSTITUTE DIRECTOR

The state-local fiscal relationship has been the subject of much concern, analysis, debate, and policy making for about as long as anyone can remember. The past two and a half decades have witnessed the passage of Propositions 13 and 218, the enactment of realignment legislation, the advent of the educational revenue augmentation fund (ERAF), and numerous other events that have shaped the often troubled relationship between the state and local governments.

In this edition of CICG Perspectives, Diane Cummins discusses the difficulties in addressing the state-local fiscal relationship. Specifically, Ms. Cummins points out that the challenges are so difficult to address because there are nearly as many views of the problem as there are observers. Ms. Cummins also offers some explanations for how and why we ended up in the current situation. Finally, she shares with us some thoughts for how to proceed productively in addressing the challenges that remain.

In writing about the state-local fiscal relationship, Ms. Cummins draws on her impressive career in public service. Ms. Cummins worked for the Department of Finance for 21 years, holding a variety of positions in the local government, health and human services, and education budget areas. She is also a 1997 recipient of the California State Association of Counties President’s Award of Merit. Ms. Cummins currently serves as Chief Fiscal Policy Advisor to the President pro tempore of the California State Senate. In this capacity, she serves as the Senate’s key budget staff person.

It is my hope that this essay can serve to stimulate a healthy and productive debate about how to address these important challenges. Please look for other views on these issues in forthcoming editions of CICG Perspectives.

Matthew Newman, Director
California Institute for County Government
October 2001
THIS PART OF THE TEST IS MULTIPLE CHOICE. CIRCLE THE OPTION WHICH BEST ANSWERS THE QUESTION.

State-Local Fiscal reform is:
  a) A complete restructuring of program responsibilities
  b) A return of taxing authority to locally elected officials
  c) A cap on the growth of ERAF
  d) A new definition of mandates
  e) All of the above
  f) None of the above

THIS PART OF THE TEST IS TRUE/FALSE. CIRCLE EITHER T OR F.

1. The State has little understanding of the problems facing local government. ..........................................................T F
2. Local government has little understanding of the problems facing the State. ...............................................T F
3. The 1991 Realignment is a good example of state-local fiscal reform. ..................................................T F
4. A cap on the Educational Revenue Augmentation Fund (ERAF) is essential for state-local fiscal reform. .............T F
5. One percent property tax is sufficient to fund all essential local services. ....................................................T F
6. The local fiscal problem started with the transfer of property tax to ERAF ....................................................T F
7. The local fiscal problem started with Proposition 13.....T F
8. If the State allocates general purpose revenue to local governments, state officials will be pleased by the fiscal choices locals make. ......................................................T F
9. The State cannot return ERAF because its own revenue picture is so volatile. .............................................T F
10. There is an easy, simple answer to reforming the state-local fiscal relationship. ........................................T F
This test could go on for pages. And there are no right or wrong answers. The answer you give, or even whether you care about the issue, depends on your perspective, your gestalt. In other words, where you stand is where you sit. Therein lies the dilemma.

In part because there are so many different views of this problem, the state-local fiscal relationship has been a source of discussion and debate for years. According to one report,

In recent years there have been significant changes in the relationship between the State and local government. While local government is generally perceived to be closer to and more responsive to the people, a trend has developed which has resulted in a centralization of power at the state level. Instead of cities, counties, and special districts working together with the State to serve the people, the relationship has changed, requiring local government to look first to the State to ensure its fiscal ability to function.¹

I helped craft those words in 1983. I’ve been involved in a lot of task forces on the state-local fiscal relationship since then. And I’ve read numerous reports on the crisis confronting this relationship. However, the dialogue has not changed. Why hasn’t the problem been solved?

WE ALL KNOW THE HISTORY (OR WE SHOULD, SO WE CAN LEARN FROM IT)

...In the beginning there was Proposition 13, a property tax limitation measure passed by voters in 1978. To assist local governments in addressing the impact of this measure, the state passed a “bailout” measure designed to partially replace the revenues lost by local governments by transferring additional property tax to cities, counties, and special districts and assuming a larger share of K-14 funding requirements. All of this seemed particularly reasonable given the earlier Serrano decision regarding K-12 school equalization. And it seemed reasonable at the time to take over the counties’ share of SSI/SSP and Medi-Cal as well as a larger share of costs for other social services programs.

But there was this nagging doubt...which led to a formula in the bailout measure, AB 8, dubbed the “Deflator.” The Deflator contained provisions for reducing subventions to local governments if the State couldn’t afford to continue the bailout. That didn’t take long! By the time the New Partnership Report was out in 1983, the State had reduced subventions to local governments in lieu of “pulling the Deflator,” and local governments were angry about it. In response, the Task Force recommended eliminating the Deflator and constitutionally protecting the Vehicle License Fees (VLF; if there was a VLF) so that local governments could have a stable and predictable flow of revenue.

Sound familiar?
WHY IS IT THAT WE SPEND SO MUCH TIME TALKING ABOUT THE STATE-LOCAL RELATIONSHIP YET SEEMINGLY CHANGE SO LITTLE ABOUT IT?

I could identify the problems not only with the state-local relationship, but also the state fiscal picture, as we marched to the downward spiral of the early 1990’s. (Indexing of the Personal Income Tax, elimination of the Inheritance Tax, Proposition 98, Proposition 99, Proposition 62, Proposition 218, etc., etc.) The exercise may not be very productive, but it does provide a context for the budget/fiscal decisions that have been made each year. These decisions have largely been incremental, a response to get through a year or an immediate crisis, and have never confronted the issues of the state-local fiscal relationship head on.

I have some observations that may prove instructive and might spark some thoughts or suggest a framework for approaching this issue.

One. The ideas about what each level of government is responsible for have changed. Some may call this the “new federalism.” We have the federal government funding cops on the street and talking about class size reduction. Interesting…we have state government funding cops on the street and incentives for class size reduction. Yet local government is responsible for the associated costs of cops on the street (e.g. new equipment needs, higher jail cost), as well as the on-going costs when the higher levels of government have to tighten their belts and reduce or eliminate funding. Local schools may like the money
for class size reduction but, gee, they really don't have the space for more classes and that means the childcare center has to go and….

Two. Based on number one, it appears that the higher level of government believes it knows best.

Three. Actually, what one and two mean is that issues that are popular with the voting public are popular with decision-makers at every level of government. This has been exacerbated by term limits.

Four. Speaking of term limits, it is important for legislators to get “credit” for things they do for their districts. This may be a park, a swimming pool, or funding for a local museum. These projects end up being more popular than returning discretionary money to local governments. And, by the way, they were requested by locals.

Five. This is a subset of two. State officials have their own ideas of what’s important to fund and what they want counties to spend money on. In the “discretionary versus program” funding, program funding wins hands down. That way, state priorities get met.

Six. The return of property tax or capping the growth of ERAF would give local governments some sense of justice and perhaps “level the playing field” for a better discussion. But neither option constitutes fiscal reform; it’s just moving money around.

Seven. This may seem evident from the test at the beginning – but we don’t all agree on the problem. And, if I may paraphrase Senator Steve Peace, if we don’t agree on the
problem, we certainly won’t agree on the solution. Is the problem lack of discretionary money from the state to the local level? The way programs are structured? The fact that local officials have no ability to raise their own revenues to meet locally determined priorities and needs? Or, is it one problem for counties and different problems for cities and special districts? Are local governments defining the problem only in terms of what they want versus the broader needs of the state?

Eight. State and local governments are tied in knots by significant fiscal constraints, fiscal volatility and voter requirements. We really don’t know if there is enough money in the system, if it’s in the right place, or if we’re spending it on the right things. Notwithstanding the constraints, government copes. At the same time, government does not do a very good job of telling the taxpayers where their money goes and what needs are not being met. Of course, another dilemma is that the programs government runs may not be the most popular with taxpayers.

SO, WHAT IS FISCAL REFORM?

Given the above (and there are probably lots more observations), should we reconsider our view of what constitutes state-local fiscal reform? Consider some of our accomplishments over the last ten years.

Realignment. A fundamental shift of program responsibility with a stable source of revenue and flexibility in providing services.

Property tax loan program. Additional revenue as long as outcomes are met and, most significantly, a recognition by
the State that it benefits from the effective administration of this tax.

**CalWORKs.** Welfare reform with program flexibility and an incentive program so counties that meet performance goals receive more money.

**Trial Court Funding.** Capping of county costs for trial courts with the State assuming all new costs. Buyout of some costs provides discretionary money to counties. Achieves a significant public policy goal – access to justice that is not dependent on an individual county's fiscal health.

Don't these major program revisions (as well as other, more specific program changes) represent real change and reform in the way the state and counties relate to each other? Most importantly, they achieve important policy and program goals in providing services to the people of California. Can they be used as examples for change in other areas?

We need to think about reform in the broadest possible context so we recognize it when we see it. I know discretionary revenue is important. Local governments have programs to run, employees to pay, and communities to serve. But if we continue to think about reform *only* in the context of additional revenue for local government, we’re bound to be frustrated because it is unlikely to happen.

Here are some suggestions:

1. Quit blaming “the state” for the problem. Believe it or not, the state has its own problems which are difficult to deal with.

2. Be creative and think of every situation as an
opportunity for change in the state-local relationship.

3. Focus attention on real community needs.

4. Stop thinking narrowly along artificial jurisdictional lines. Think regionally about important state goals that should be achieved. It doesn't just have to be “smart growth” involving housing, transportation, and jobs. It could be regional juvenile facilities, substance abuse facilities, job training, technology centers, specialized care residential facilities.

5. Suggest how the state can allocate its money to achieve important goals whether it be incentives for energy conservation, incentives for economic development, incentives for housing.

6. Work together to set goals, guidelines and standards for programs, then be willing to be held accountable. If these goals and objectives can't be met, then technical assistance and support are needed, not sanctions.

California faces significant future challenges, and we are going to need lots of ideas and suggestions and everyone's effort to meet these challenges. There are no easy answers, but every once in a while an idea takes hold and we make progress in altering the state-local fiscal relationship. Hopefully, services to the community benefit as well. Be on the lookout so you don't miss the change!
ABOUT CICG

The California Institute for County Government (CICG) is an independent research organization dedicated to improving county government in California through research and analysis. CICG is a joint program of the California State Association of Counties, the California State University system, and the California State University, Sacramento. CICG conducts empirical research projects in a broad range of public policy areas relevant to county government in California. The Institute also maintains a database of local government financial, economic, and demographic statistics, which provides researchers, county officials, and state-level policy makers with access to accurate, reliable data for use in research, public policy analysis, and decision making.
For more information or to request additional copies of this report, please contact THE CALIFORNIA INSTITUTE FOR COUNTY GOVERNMENT

CSUS Office
6000 J Street
Sacramento, CA 95819-6081

or
Capital Office
1107 9th Street, Suite 1011
Sacramento, CA 95814
(916) 324-0796

or visit the CICG website:
www.cicg.org