OPEN SEASON ON ANOTHER $509 MILLION

Brown's austerity budget: $620 million held in reserve

CARL MUECKE

By ED SALZMAN

For months, the word emanated from Sacramento that the Proposition 13 axe was finally going to fall on state and local government in California. State employees were bracing themselves for a proclamation from Governor Jerry Brown that no money was available for a pay raise this year. Local government feared that the so-called Proposition 13 deflator would be put into operation, drastically reducing state bailout assistance to schools, cities, counties and special districts. But when the Proposition 13 axe finally fell, it sounded more like Proposition 6½.

Governor Brown's budget is tight, to be sure. It contains virtually no money for substantial new programs. It falls far short of keeping pace with the cost of living. It employs a couple of gimmicks to make ends meet. But it also:

- **Actually increases** state aid to local government by a token amount.
- **Provides some increases** to keep pace with the cost of living, although not enough to meet all formulas now in state law.
- **Provides a kitty** of $509 million for the Legislature to employ for pay raises and other unspecified purposes. Brown's goal is to increase almost everyone tied to the cost of living about 5 percent next year.
- **Still leaves the state** with a $620 million surplus for economic uncertainties. This reserve is bound to be the target of public employees, welfare recipients and others seeking to keep pace with inflation which the administration estimates will run about 11.4 percent this year.

This is the first budget in recent years that is balanced within itself and does not depend on the state's once-huge surplus to stay in the black. In fact, economic conditions fell below expectations in 1980, forcing the state to dip into its reserve for economic uncertainties. In addition to keeping government rolling at about the same pace next year, Brown's spending plan would employ about $250 million to replenish the reserve.

Into the bone

Brown and his director of finance, Mary Ann Graves, estimate that the state and local governments have been absorbing about $10 billion a year in tax reductions since the passage of Proposition 13. Should the voters approve a measure to eliminate the state inheritance tax, they say, the net loss would be about $500 million. That would force the Legislature to make extremely hard choices — either cut into the bone of government or increase other taxes. It appears from Brown's 1981-82 budget that the state may be able to maintain the fiscal status quo over the next couple of years if the economy turns around in the next few months. Otherwise, those who depend on government to maintain their standard of living will undoubtedly start pushing for some kind of a tax increase, with an increased property levy on business the leading candidate.

The state's surplus was about $4 billion in 1978. That has been eradicated in the provision of bailout funds for local government. In the current fiscal year, the state estimated that its income will grow about 6 percent "This is not healthy," observed Graves. "It is only half what it used to be." Graves said that Brown's $24.5 billion budget — with an increase of only about 1 percent from the current level of spending — will be balanced only if the economy improves toward the end of this calendar year. She is forecasting a 10.3 percent increase in revenues during the next fiscal year. That is based on a 14 percent hike in sales taxes, a 7.4 percent boost in personal income taxes and a 13.4 percent rise in the bank and corporation tax.

Here are the increases in economic factors that provide the basis for the revenue side of the budget:

Personal income, up 11.9% (compared to 12.5% in 1980)
Corporate profits, up 11.9% (5.1%)
Taxable sales, up 12.4% (8.8%)
Unemployment rate, 6.7% (6.8%)
Housing starts, up 25% (-33%)
Auto sales, up 2.6% (-15.7%)
Cost of living, up 11.4% (15.7%)

Brown was able to pull off a status quo budget and even go part way toward meeting the increase in the cost of living because he cut some $146 million in expected state expenditures, juggled funds between elements of local government and captured a $500 million property-tax bonanza won by local government in a state Supreme Court case.

The total price of cost-of-living adjustments (COLAs) under current law would be some $1.3 billion. Brown placed $742 million in the budget and asked legislators to suspend the current laws for one year. In addition to the $742 million, there is the unallocated pot of $509 million, over which various interest groups will commit mayhem. Brown proposed that welfare recipients, who already suffered a cutback on

January 1st, get 4.75 percent increases (instead of the 11.2 percent in current law) and that schools get a 5 percent funding increase (compared to 7.2 percent under current formulas). In addition, Brown placed no money in the budget for additions to special school (categorical) programs. Those funds would have to come from the $509 million, the governor indicated.

The dirty work

The main fight this year will not be over the budget bill itself. Instead, the legislative combat will be over the details of a companion bill to be introduced by Senate Finance Committee Chairman Alfred Alquist and Assembly Ways and Means Committee Chairman John Vasconcellos. That measure would do all the dirty work that will make the governor's budget balance. It would shift property-tax revenues to the schools, wipe out the deflator, capture the tax windfall, suspend all automatic cost-of-living increases for one year, make some cutbacks in welfare, day-care, school-meal and driver-training programs, increase fines for crimes, and eliminate some minor areas of regulation by the state Public Utilities Commission. Normally, such an omnibus bill would not be considered by the Legislature because it covers so many subjects. But these are unusual times, and it will probably be framed as a budget "trailer" or "leader" bill and win the blessings of the legislative counsel.

Probably the most controversial aspect of Brown's spending program will be his treatment of local government. In effect, Brown said he set the example for austerity by cutting state operations to the bone. And he expects local officials to share the burden of Proposition 6½. If the administration figures are right, local government will actually be better off than the state. The main reason is that property tax revenues have been increasing at the rate of 18 percent a year — three times as rapidly as state tax receipts are now growing. Finance director Graves, an economic forecaster by training, indicated that county income should rise 9 percent next year, city revenue by 7 percent and school receipts by 4 percent. (School enrollment has been dropping.)

Instead of cutting local appropriations drastically, as would be required under the "deflator," Brown proposes a small increase: from $5.5 billion this year to $5.6 billion next year. But the state is also taking away the $500 million windfall from local government and using half the money to replenish the reserve fund. Another $147 million would be used to repair schools and the remainder for two of Brown's pet programs:

- **Crime control.** In his state-of-the-state message on January 8th, Brown gave the impression that the state was about to launch a crime-prevention crusade with a new allocation of $120 million to help local police. But examination of the budget gives an entirely different picture. Most of the $120 million goes to build jails and prisons already on the drawing board, to care for increased prison caseload, to take over the cost of some federal safe-streets-act programs, and even to provide more personnel for the courts (which have a larger civil than criminal caseload).
- **Electronics industry.** Brown budgeted $7 million — an insignificant amount in a $24.5 billion budget — to help the University of California and private industry develop a microelectronic research facility. Brown said it is vital that California maintain its lead in the "information revolution" and not lose ground to Japan and such other states as Minnesota and North Carolina.

Keeping schools afloat

In addition to taking the $500 million windfall away from local government, Brown also was forced to make adjustments in property-tax distributions to prevent the schools from going into the red. (Brown's explanation for confiscating the windfall: "We're all in this together.") In recent years, schools happily gave up property-tax revenues in exchange for state aid. That's because the state looked like a more reliable source of money during the heyday of Howard Jarvis. But now property-tax revenues are rising more rapidly than state income. So Brown has proposed that $420 million be taken from cities ($240 million), counties ($150 million) and special districts ($30 million) to help keep the schools afloat. The cities are especially upset about the prospect of losing funds, but Brown feels that they have more revenue flexibility at present than any other element in the government mix.

Higher education was hit especially hard by the Brown budget. The governor proposed that the state college and university system be kept level at $937 million, that community colleges suffer a loss from $1.06 billion to $937 million and that the University of California be given a modest increase from $1.06 to $1.1 billion. These totals do not include any pay-increase funds. Those funds would be added following negotiations between the administration and representatives of state workers.

At the other extreme is the state Legislature, which determines its own level of spending. Governors don't dare touch the lawmakers' proposal for fear of retribution. "It's a co-equal branch of government," explained Brown. In the current year, legislative expenditures are expected to total $89 million. The allocation for 1981-82 is $103 million, an increase of 16 percent.

Laden with gimmicks

In assessing the overall budget, it is virtually impossible to compare Brown's proposal with expenditures for the current year because the new spending program is so laden with gimmicks (the $509 million unallocated fund, the $500

Budget facts and figures

Total: $24.5 billion, up 1 percent from the current level of spending and up 2 percent from the budget submitted a year ago. (These figures do not include retroactive pay for state workers.)
Taxes: No tax increases or decreases.
Economic forecast: Return to normal growth by the end of 1981.
Local-government Proposition 13 bailout: $5.6 billion, up $112 million.
Where money goes: education, 43%; health and welfare, 29%; business, transportation and housing, 6%; property tax relief, 5%.
Where money comes from: sales tax, 34%; personal-income tax, 31%; transportation taxes, 9%.
Projected year-end surplus: $620 million for economic uncertainties.
State employees: 226,743, up 270 from the current year.
Pay raises: To be negotiated, with $509 million allocated to provide pay raises and various other increases tied to the cost of living.
Companion bill — Eliminates automatic cost-of-living increases and makes a variety of other changes in the law that will help balance the budget.
Federal funds: $10.6 billion, up from $10.4 billion in the present year.
Outstanding bonded debt: $6.3 billion at the end of 1980, up from $6.1 billion the previous year.

The governor's message

The following is the complete text of Governor Brown's budget message to the Legislature:

Tax cuts supported by my administration such as income tax indexing, increased credits for renters, special credits for conservation and solar energy, and a reduction in the inheritance tax, have significantly reduced the revenue base which created past surpluses. (State income tax cuts this year alone will total about $2.5 billion.)

For this reason, the moment of truth is upon us. Cutbacks are required in state and local government. California, once at the top of the list among states in taxes, has dropped dramatically to the middle. Our spending must reflect this leaner diet of public funds.

Even in an era of limited resources, however, government must be prepared to meet new challenges. This budget proposes new or revitalized efforts in the following key areas:

1. Technological innovation to strengthen the economy;
2. Crime prevention, law enforcement, jails, and prisons;
3. Energy and resource investments.

I have tried to make the reductions as thoughtful as possible. None are in concrete and I intend to work cooperatively with you to write a final budget that satisfies both our principles and the available revenue.

million windfall, the $420 million property-tax shift, plus all the elements in the Vasconcellos-Alquist omnibus bill). But it is possible to see how the budget is divided between state and local government. All of state operations total only $5.8 billion — less than the amount of taxes lost each year through Proposition 13. Local assistance is $17.7 billion. Capital outlay and bond funds total $514 million. The other major item is the $509 million Brown put up for grabs.

In actuality, the entire budget is up for grabs. Brown made it clear he views his huge fiscal plan as "not final by any means" — just a starting point for discussions. He warned that economic conditions might dictate even deeper cuts in May, when the final estimates are presented to the fiscal committees of the Legislature. The governor indicated that there is probably enough money around to prevent any layoffs in state government and perhaps none in local government. In terms of cash available, the state can provide about a 5 percent increase for almost anything affected directly by the cost of living — and still keep $620 million in reserve. But in terms of real dollars, that would represent a loss of some 6 percent for public employees, welfare recipients, health-care providers and all others who have traditionally kept pace with the consumer price index.

There is no chance that state revenues will increase sufficiently to provide for a substantial increase in allocations during the May revisions. This means that all of the interest groups which depend on the state for nourishment will be competing among themselves for the favor of the Legislature. Cities, for example, have established a good working relationship with lawmakers; they may succeed in reducing their loss of property-tax revenues. Even before Brown's proposed cut in cost-of-living allocations, welfare organizations were at work trying to restore the reductions in benefits that went into effect on January 1st. And public employee organizations, with their enormous political clout, are expected to push for maximum pay increases.

The state apparently will muddle through without a true crisis this year. But how many years will governors be able to balance budgets using tideland oil revenues, property-tax windfalls, shifts between elements of local government and other one-time tactics? Eventually, there will either be cuts in government programs or changes in the revenue structure. Within the next 16 months, three major tax decisions must be made:

- **Should the inheritance tax** be abolished, as proposed in two initiatives that have already qualified for the ballot? If the voters approve that, the loss cannot be absorbed without significant impact on state programs, aid to local government or other elements of the revenue mix.
- **Should full cost-of-living indexing** of state income taxes be continued? Or should partial indexing be restored? Or should indexing be lifted completely? Partial lifting of indexing would probably allow the state to prevent a serious Proposition 13 crisis. But there is strong pressure, within the Legislature and elsewhere, to maintain full indexing, and the issue may qualify for the ballot by initiative. Brown wants the Legislature to keep indexing options open as a safety valve should the Proposition 6½ problem escalate into a Proposition 13 crisis next year.
- **Is the solution** to all of the state's fiscal problems the adoption of a separate property-tax system for homes and for businesses? This split-roll approach has strong supporters within the government community. It can raise large sums of money and has built-in inflation factors. Perhaps its greatest virtue is that it can be sold to voters as a tax increase that applies only to businesses which have been paying a smaller percentage of property taxes since the enactment of Proposition 13.

The inheritance-tax issue is already before the people. Indexing initiative petitions are being circulated. And several groups are at work drafting split-roll measures. It is not beyond the realm of possibility that all three issues will find their way to the ballot in June of 1982. Imagine the conditions in the Capitol next June with so much at stake just a few weeks before the start of the next fiscal year. By comparison, the Legislature this year is merely engaged in a minor skirmish over the Proposition 6½ budget.

Frank Mesplé internship fund

The Frank Mesplé Internship Fund was created to help support students working for the *California Journal*. The interns observe state and local government and prepare articles for publication in the *Journal*.

The fund was founded by the *Journal's* board of directors in memory of Frank Mesplé, who had served as a government professor, legislative advocate, gubernatorial aide and wit-about-Sacramento. The purpose of the fund is to carry on Mesplé's commitment to the youth of California and to the democratic process.

Recent contributors to the fund, whose support the *Journal* gratefully acknowledges, include:

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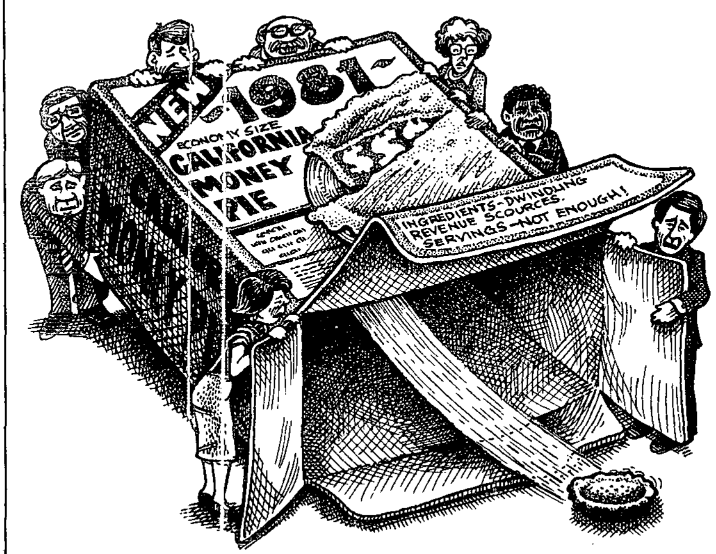
TIME FOR MAJOR SURGERY

A local-government view of the moment of fiscal truth



CARL MUECKE

Over the next few months, the Brown Administration and the state Legislature will be grappling with the tight-money consequences of Proposition 13. Various interest groups will be pleading their cases for allocation of state funds before legislative committees. In the following article, the chief administrative officer of Alameda County gives his views on how the state should proceed.

By MEL HING

The twice-delayed "moment of truth" has arrived for Proposition 13. For the first time since the 1978 vote, the governor and the legislative budget writers do not have a huge surplus on hand to cushion revenue losses.

Something has to give. It could signal the beginning of the end for California's almost unique non-partisan form of local government. Or it could be the beginning of a new era of cooperation, rather than rivalry, between state government and the counties, cities, special districts and schools.

A cynical state financial expert recently observed that local government folk who have been "bailed out" for two years now want to become statesmen — now that the state's surplus money has dwindled.

True. Change is inevitable. Government is going to be restructured in California as a result of our actions — or in spite of them. The Legislature and the governor still have time to guide the change along constructive lines. If they fail, the changes will be chaotic, fragmentary and wasteful beyond the already-pronounced horrors of the tax revolters. And, given recent history, it is not too far-fetched to suggest that the change will be accomplished by another voters' initiative if it is not accomplished by government.

Realistically, we know there is a limit on the size of the money pie, plus the greed factor to be dealt with. Not only have the revenue sources been diminished, but spending has been restricted by law. Given these facts, the time has come for a genuine cooperative relationship to replace the traditional adversary bickering.

Mandates and revenue cuts

From the county point of view, there are four main factors that will have to be dealt with by the Legislature and the governor — or by the electorate:

- ***A recognition*** *that most county programs are* mandated. Counties are required to run the welfare program, to provide for the sick and the needy, to operate the courts, and to carry out numerous regulatory programs.
- **A realization** that the state earmarks a great deal of the revenue that it subvenes to the counties. Road funds are earmarked, public health funds are earmarked, criminal justice system funds are earmarked, and welfare expenditures are earmarked. After one gets through counting up all the earmarked revenues, there is very little discretionary money available.
- **The fact that** voters have ordered elimination of the traditional means of dealing with money problems. We can no longer increase property taxes — and even if we could, we are limited by Proposition 4 of 1979 in the expenditures we can make.
- **The built-in cuts** that appear to be inevitable in 1981 - 82. The hastily enacted AB 8 deflator mechanism certainly will be replaced this year by another state control device. Until it is, a Catch-22 condition prevails for local operations.

This then is the situation: 1981 will be a year of change, and any change will have to deal with mandated programs, earmarked revenues and expenditure limitations. The short-term goal in 1981 - 82 should be stability in financing for local government. This means that the state should make every effort to see that there are no drastic cuts in one fiscal year.

A corollary of this goal is that care should be taken in reacting to forecasts. No nonreversible decisions should be made on the basis of early forecasts.

The long-term goal for dealing with the financial problems of the '80s should be a restructuring of state and local fiscal relationships. If we begin now, the change can be orderly. It should start with an analysis of which level of government ought to be doing what, and how resources should be allocated to pay for the work to be done.

Whatever the new structure looks like at the end of this period of change, it should have, as one of its main goals, the preservation and strengthening of the ability of local government to plan the allocation of their resources. Stability in financing is the key to effective planning.

No one at this point can draw a picture of what California government will look like three years hence, but it is possible to foresee three main paths that can be taken in the restructuring process.

The first possible path is that of greater control by the state of local government expenditures. If this path is taken, eventually there will be a combined state-local government