LOS ANGELES COUNTY

ECONOMY AND EFFICIENCY COMMISSION

ROOM 163 HALL OF ADMINISTRATION / 500 WEST TEMPLE / LOS ANGELES CALIFORNIA 90012 / 974-1491

April 5, 1978

STATEMENT ON PROPOSITION 13
THE JARVIS-GANN INITIATIVE

SUMMARY

The Economy and Efficiency Commission urges a NO vote June 6 on State Proposition 13, the Jarvis-Gann Initiative.

As a citizens commission that has been investigating government operations for 13 years we have continually fought to improve their economy, efficiency, and effectiveness. We would welcome any measure which would bring true tax relief and cost reduction. Jarvis-Gann will do neither. Rather, it is bound to bring severe tax inequities, serious economic dislocations, and government by the courts.

Jarvis-Gann will not achieve the tax relief and expenditure reform that proponents claim.

The fundamental weakness of Jarvis-Gann is that it addresses only one part of the problem of high taxes. It guarantees a revision of the governmental financing system, but does nothing to guarantee correction of the basic programs which generate the costs. Until the public understands that reducing governmental costs requires a thorough and radical revision of the service programs themselves and of the governmental structure and systems used to provide them, we will have no meaningful reform.

The tax relief that Jarvis-Gann promises is illusory, because the expenditure control required for tax relief is not present and is not likely.

If Jarvis-Gann passes, local governments will lose $6-$7 billion in property tax revenue. If the State Legislature does not act to replace these revenues or revise current law governing health, education and welfare, then vital services - including police, fire, and education - will have to be drastically cut. The result would be chaos. Thus, we will be fully dependent on the State Legislature to prevent local services from being emasculated. Decisions once made by local governments, where voter influence is more direct, will now be made by a State Legislature which has been notably unresponsive.

To compound the problem, the Legislature will be forced to operate under a new procedure requiring a two-thirds majority vote to raise the required alternative taxes. With all the competing interests in Sacramento, the Legislature is likely to settle on a compromise heavily influenced by special interest groups - whether those favoring cost cutting, those favoring more public spending, or those favoring a tax shift. Minority voting blocks would have the potential to defeat any proposal. Thus they could bargain with a high chance of success in their own interests.

One possible action, for example, is that the Legislature would increase sales and income taxes. In this case, business and industry would receive a $4 billion property tax cut to be paid for by homeowners and renters.

The notion that taking away some of the money from one level of government will lead magically to needed reforms is wishful thinking. It is fantasy to believe that limiting property tax revenue through Jarvis-Gann will force the State Legislature to reduce governmental expenditures, regardless of how difficult it becomes to finance them.

Jarvis-Gann will limpose artificial assessment control on real estate.

The initiative imposes an arbitrary 2% limit on assessment increases each year, until the property changes hands, at which time the property will be re-assessed at its market value. This is artificial assessment control, containing so many hazards and so much potential for tax inequities and economic dislocations that Jarvis-Gann deserves rejection on this aspect alone.

As just one example, two identical properties would generate substantially different property taxes for the same government services simply because one had not been sold and the other had.

Jarvis-Gann contains numerous ambiguities which will have to be settled in the courts.

It is not clear from the language in the initiative how major corporate utilities and common carriers are to be assessed, which governments will levy taxes, how taxes will be distributed, how "newly constructed" property is to be identified and assessed, how the rights of municipal bond investors will be protected, or how conflicts with existing constitutional provisions will be resolved.

These are the most obvious ambiguities and omissions among many. How the courts will settle them no one can tell. One thing is certain. JarvisGann will result in massive litigation. The State already has a sufficient supply of bad laws on the books which have forced litigation to clarify and resolve their intent. The last thing California needs is more government by the courts!

In summary...

• We share the strongly felt demand for property tax relief and reduced government expenditures.

• We are convinced that Jarvis-Gann is an extremely short-sighted and superficial attempt to deal with a very complex set of problems - and will simply replace the present system with one that is even worse.

• We are strongly opposed to Jarvis-Gann's shift of power from local government to Sacramento.

• We predict that if this ambiguous and incomplete initiative passes, we face an extended period of litigation. What this means is more government by the courts.

We strongly urge the voters to study Proposition 13 carefully - and we are convinced that those who do will join us in voting <u>NO</u>.

ANALYSIS

1. Jarvis-Gann will not achieve the tax relief and expenditure reform that proponents claim.

Jarvis-Gann proposes to cut \$6-\$7 billion out of a total property tax revenue source of \$11 billion. We are convinced from our past studies that substantial cost reductions can be achieved at both the local and State level by any number of means - controlling the size of the workforce and the use of supervision, eliminating archaic and costly salary and pension practices, eliminating the protectionism of Civil Service systems, increasing productivity, eliminating obsolete or unneeded services, and eliminating duplication between governments.

Nevertheless, there is no way that local government can cut expenditures by \$6-\$7 billion in a space of one year or less without cutting vital services, including police, fire, and education. Los Angeles County's property tax revenues would be reduced by \$755.6 million or 58% beginning the fiscal year 1978-79. Los Angeles City estimates that its property tax revenue would be reduced by \$235 million or 67%. If the Legislature did not replace all or part of the lost revenue, local officials would be forced to rearrange their priorities so as to continue some services and eliminate others. Just to preserve basic functions such as police and fire or keeping the schools open local jurisdictions would have to violate Federal and State statutes on health, education and welfare. Consequently, we consider inaction by the Legislature as unlikely, despite the Jarvis-Gann requirement for a two-thirds majority of all members of both houses to raise new taxes.

What then is the Legislature likely to do? Of the range of possible alternatives the least attractive to us would be simply to refinance the current expenditure system. This would continue local government spending on health, education, welfare, and the courts, but would also imply State financing and eventual control of essential local services, such as fire and police.

To us the most responsible alternative would be to transfer most or all of the costs of health, welfare, the courts and education to the State. This would shift approximately 70% of local government costs to the State, and under Jarvis-Gann leave sufficient property tax revenue at the local level to finance fire, police, flood control, sanitation, sewer maintenance, libraries, parks, beaches, museums and internal administrative functions. (This assumes that costs can be controlled within the 2% growth limitation in Jarvis-Gann, regardless of inflation factors. It also assumes that the Legislature could devise and agree on a formula to distribute the remaining revenue fairly among counties, cities, and special districts.)

Even this alternative could lead to serious problems. If the State assumes funding of all social welfare costs, then it will not be long before mandates follow to control program administration. Almost certainly the programs themselves eventually would be transferred to the State. In the light of the recent State performance in the health area, particularly at the Metropolitan and Camarillo State Hospitals, we question how well the State might administer the County's health services, including its nine hospitals. We also wonder what the effect would be on local control of our school systems.

Regardless of what the Legislature does to transfer costs to the State, there are basically only two ways to raise money to replace the lost property tax revenue.

First, the Legislature could use the current taxing structure, exclusive of property taxes, to replace all or part of the lost revenue. Major tax sources now are the sales, income, and bank and corporation taxes. The problem with this approach is that it will shift a major share of the taxes from business and industry to individuals, because business and commercial property pay 63% of the tax on all real property. Thus of the $6-$7 billion estimated reduction in property taxes, business and commercial property will receive $4 billion. To the extent that the Legislature increases sales and income taxes as presently structured - most of which individuals pay - homeowners and tenants will be forced to finance property tax reduction for business and industry.

It is to the credit of many of the business leaders in the State, whose companies would stand to receive massive property tax reductions, that they have organized to campaign against Jarvis-Gann. Pacific Telephone, Texaco, Atlantic-Richfield, Standard Oil, Lockheed and other large corporations, according to a report by the County Chief Administrative Officer would receive property tax reductions ranging from $6 to $47 million a year. Nevertheless, Howard P. Allen, Executive Vice President of Southern California Edison Company and President of the Los Angeles Area Chamber of Commerce, one of the leaders of the group, has stated, "Although business stands to receive at least $4 billion of the anticipated $6 billion in property tax relief, we felt it was time for the private sector, among others, to stand up for principle and fight this measure as financially unsound. What business, or others, might win in short-term gain they would lose in the long run through offsetting taxes."

Second, the Legislature could devise new forms of taxation and modify current rate structures to replace all or part of the lost revenue. While the goal in this case would be to preserve or improve the present balance between the share of taxes paid by individuals and by business, it is by no means certain that this would occur. With all the competing interests in Sacramento, the Legislature would have great difficulty in reaching agreement on an appropriate balance. To the extent that the Legislature creates new taxes on individuals rather than business, the individuals will subsidize the property tax reduction for business - as in the first option. On the other hand, to the extent that the Legislature taxes business, we risk making the State even less attractive to business and industrial investment than it is now.

Underlying whatever action the Legislature takes is the fact that Jarvis-Gann will pass a major share of decision-making from local governments to the State - decisions on which services will be provided, what the level of service will be, and who will pay. Why should the taxpayers feel that the Legislature's decisions will necessarily be to their advantage? In fact the two-thirds vote requirement in Jarvis-Gann may strengthen the influence of special interests. Some of the major obstacles to controlling local costs now are attributable to State law and the vulnerability of the Legislature to special interests. Public employee pension costs, certain aspects of workers compensation systems, and the duplication between the Sheriff and the Marshal are in this category. In another category, many of the fastest growing public service costs - such as the cost of mental health programs - are mandated by the State and are 90% funded by the State. Finally, a major share of local transfer costs, in health and welfare, result from State controls on who must receive services and how much must be locally financed.

In contrast, despite the overall current unresponsiveness of our governmental systems, local governments can and recently have responded to public pressure for expenditure reform. For example, Los Angeles County, responding to strong taxpayer pressure, has reduced its workforce by 7,800 in the past three years and plans to continue the effort. The Board of Supervisors has also placed an amendment on the June, 1978, ballot to delete the prevailing wage clause from the County Charter.

Cost reduction is a necessary element in any genuine tax relief. The way to achieve cost reduction is not by shifting responsibility to the State, the source of so many costly program requirements. Rather the taxpayers must put continuous pressure on all levels of government to correct the needless inefficiency and waste, the duplication of services, the bureaucratic empire building, and the catering to special interests which generate the costs and the high taxes.

Tax relief for homeowners is urgently needed. Without cost reduction, Jarvis-Gann will produce a tax shift, not tax relief. We consider it extremely unlikely that the tax shift will be to the homeowners' benefit.

2. Jarvis-Gann will impose artificial assessment control on real estate.

Jarvis-Gann provides that real property will be assessed at its 1975-76 full cash value, and that thereafter this value base "may reflect from year to year the inflationary rate not to exceed two percent [2%] for any given year or reduction as shown in the consumer price index or comparable data for the area under taxing jurisdiction." This limitation remains in effect until the property is sold, at which time it will be re-assessed at its market value.

What Jarvis-Gann does is to move away from the principle of free market value or ad valorem and to replace it with an arbitrary restriction limited to a 2% increase each year. This is artificial assessment control.

It would destroy the whole principle of equalization among individual properties, the most fundamental concept in existing property tax law. It is bound to have serious economic consequences.

According to the California Taxpayers' Association in its excellent analysis of Jarvis-Gann, "Homeowners in identical market value houses next door to one another could pay substantially different property taxes for the same government services simply because one house had not been sold and the other had." As long as a house is not sold, the assessed value and consequently the tax cannot increase more than 2% each year. If the house is sold, however, it will be assessed at its true market value and taxed accordingly. If the inflation in home prices continues to exceed 2% each year - as it has in recent years - then the tax on a newly purchased home would be substantially higher than on a similar home that had not been sold.

If, on the other hand, the market adjusts to eliminate these tax inequities, then the rate of price increase will move downward towards 2% a year. While the decrease is not likely to reach 2%, any downward pressure would erode the return on investment which sellers would realize under free market conditions.

Thus Jarvis-Gann will result either in severe tax inequities or substantial economic distortion.

The 2% limitation could produce still another serious consequence. It will result in extensive over-assessments of certain properties. Any property that has decreased in value since the 1975-76 base year will be overassessed. One can think of such areas in Los Angeles as Spring Street, where the value of major buildings has decreased substantially since 1975-76.

Finally, Jarvis-Gann carries a high potential for inequitable treatment of renters. There is no guarantee in Jarvis-Gann that owners of apartment houses and other rental property will pass on any part of their tax savings to tenants.

In addition, the market effects of the 2% limitation would be the same for rental property as for owner-occupied homes. Either the market place would adjust to reflect the 2% limitation, or it would continue its present behavior. In the latter case, the sale of an apartment house and its reassessment to current value, would force the new owner to increase rents. Thus the rents of sold rental property would be higher than rents of equivalent unsold property. Since tenants cannot affect the buy-sell decisions of owners, they will have no way of anticipating and planning for rent increases.

What effect these erratic consequences of assessment control will have on California's economic climate is difficult to predict. Our conclusion is that the assessment control feature carries such a potential for tax inequities and economic dislocations that Jarvis-Gann deserves rejection on this aspect alone.

3. Jarvis-Gann will move major decisions on the administration of government financing and taxation to the courts.

The implementation of Jarvis-Gann will affect so many diverse interests of different people, groups of people, and institutions that lawsuits over its ambiguities and omissions are inevitable. For example, among the many ambiguities in the initiative, one concerns a serious omission on how State assessed property is to be treated. Jarvis-Gann states that the tax on real property shall not exceed 1% of full cash value. Full cash value is then defined as "the County Assessors valuation of real property as shown on the 1975-76 tax bill." No mention is made of the large amount of State-wide property assessed by the Board of Equalization. This is property owned by public utilities and common carriers. In 1977-78 this property carried over $6.5 billion in assessed value, or 6% of the total State assessed value. What is to happen to this property and how is it to be assessed? The initiative does not say. The courts will have to decide.

Another serious omission in Jarvis-Gann involves the statement that the 1% tax is '1to be collected by the counties and apportioned according to law to the districts within the counties." Nowhere does the initiative identify which agency or agencies will levy the tax and what formula is to be used for dividing it among the various counties1 cities school districts and special districts. Most authorities have assumed that the Legislature will make this determination. But elsewhere, the initiative prohibits the State, cities, counties and special districts from imposing an ad valorem tax on real property. Thus, it appears that no jurisdiction would be authorized to impose an ad valorem real property tax. Though such an interpretation is obviously extreme, the issue undoubtedly would have to be settled in the courts.

It is not clear from the text of the initiative what is meant by "newly constructed" property. It is to be reassessed at current value, but does that mean everything ranging from minor alterations and repairs to major additions to a factory complex? Or does the phrase mean only new construction on vacant land? Is only the new construction to be reassessed or the entire complex including the land? It is not clear how the initiative allowance for "indebtedness approved by the voters" can protect the rights of the thousands who have invested in joint powers debt never approved by the voters. Local agency default would surely involve lawsuits. Nor is it clear the extent to which the initiative repeals, supersedes, or revises the twenty-odd existing constitutional provisions that it affects.

The first immediate effect of Jarvis-Gann will be to move one more area of government administration for final settlement to the costly, prolonged and inappropriate adversary process of the courts.

WARREN H. SCHMIDT
Chairperson