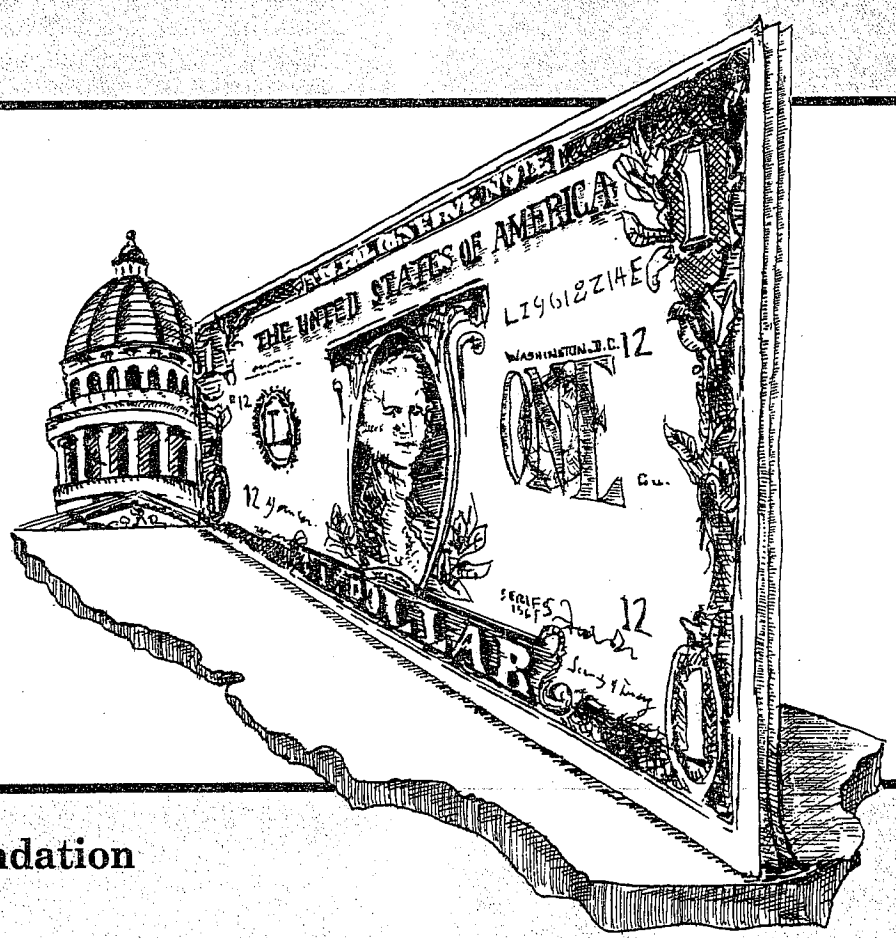
California Local Government Finance:

Issues For The 80s



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Part 1 Summary

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California Local Government Finance: Issues For The 80s

April 1984

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California Tax Foundation
Sacramento, California

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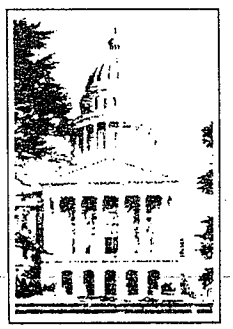

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Executive Summary
Findings

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1. **Local government revenues are recovering from the recent recession.**

   Our investigation found that the "fiscal bottom" for local government revenues has been hit. However, continued recovery is heavily dependent upon a steadily improving economy, moderate growth in inflation, and no new reductions in remaining revenue sources. **(Chapter X)**

2. **Revenue constraints have had a positive impact.**

   Revenue constraints resulting from Proposition 13, the recession, and other fiscal changes have forced local governments to become more efficient in a wide range of activities.

   Local policy-makers have re-examined spending policies and priorities in making changes to reduce costs.

   Reforms have occurred in public employee retirement, disability programs, incentive pay plans, productivity improvement programs, consolidation of units and activities, contracting for services, self-insurance, energy conservation, and a variety of other areas in order to reduce costs. **(Chapters III, IV, X)**

3. **Real spending reductions have occurred.**

   Examination of fiscal data and field study confirms that real reductions in local government spending have occurred since 1977-78. Evidence of this includes:

   - *Inflation-adjusted per capita revenues are down in most jurisdictions.*
   - *Inflation-adjusted per capita expenditures are down in most jurisdictions.*
   - *Population-adjusted staffing levels are down in non-enterprise activities in all jurisdictions.*
   - *Capital spending, parks, and libraries were most directly affected by spending cuts.*
   - *Public safety programs were given top budget priority in almost every jurisdiction.* **(Chapters III, IV, V, VI)**

4. **The labor-intensive nature of local government makes compensation policy central to cost containment.**

   Local agencies are service operations, and labor costs are one-half to two-thirds of their budget appropriations. Cost control efforts must focus on compensation costs.

   Local government employment, relative to population, has declined in almost all jurisdictions surveyed.

Salary and benefit increases paid to employees since 1977-78 have generally been less than the increase in the California Consumer Price Index (CCPI).

Fringe benefit costs have risen at a rate that exceeds the CCPI in some cases.

Generous public employee retirement programs and significant increases in the number of disability retirements are major factors in rising benefit costs.

State legislative policy in employee relations and benefits can have a major impact on local government costs because it affects a large expenditure area.

(Chapters III, IV, X)

5. Enterprise activities: the part of government that is run like a business.

Enterprise activities, the fee-supported functions of water, power, sewers, water treatment, landfills, ports, and airports, play a big role in local government, chiefly in cities. Fees from these functions constitute 35% of total city revenues, and can exceed as much as half of a city's total revenues.

Enterprise functions and capital plant survived the recession in reasonably good shape, generally for three reasons: separation from general fund budgets, self-support in operating and capital requirements, and a price structure that could be adjusted to meet service costs (but not without constraints — local resistance and the Gann limit). **(Chapter VII)**

6. Capital and maintenance outlays are inadequate.

With a few notable exceptions, most sample jurisdictions reported that their recent and current levels of capital and maintenance spending were inadequate. Nearly every manager interviewed felt this was a critical need that must be addressed in future budgets. This problem arose, and will be hard to solve, because:

- *Capital and maintenance spending cuts are "invisible" and have no constituency. As a result, these items were among the first to be cut after Proposition 13.*
- *Most managers stated it is impossible to squeeze more capital and maintenance funds from operating budgets that have already been cut to meet fiscal constraints.* **(Chapter VIII)**

7. There is considerable diversity among city and county revenue bases.

There is wide diversity in the revenue bases of local governments, as well as in the service expectations of local residents.

This study reviewed the wealth of cities on the basis of per capita sales tax, assessed valuation, and median income. For counties, we considered median income, per capita assessed valuation, and AFDC caseload per 1,000 population. Our results, as shown in charts at the end of Chapter 2, disclose wide variations in the relative wealth of cities and counties.

This diversity means that any statewide revenue actions that either reduce or increase local revenues in an across-the-board manner can have a sharply differential effect among jurisdictions at the wealth extremes in terms of "windfalls" or "wipe-outs."

This diversity, in turn, argues strongly for maximum flexibility in the management of local government functions, an exercise of restraint by the Legislature in the passage of mandates, full reimbursement of mandated costs, and use of own-source revenues for local functions, consistent with appropriate consultation of local voters. **(Chapters II, V, VI)**

8. The fiscal differences between cities and counties have become more distinct since the passage of Proposition 13.

Cities have become less reliant on state and federal aid and property taxes. Own-source revenues have become much more important.

Counties have been made much more reliant on state aid due to cuts in the property tax and the nature of the bail-out system.

The fiscal health of counties is more closely tied to that of the state than is the case with cities. **(Chapters V, VI)**

9. Cities primarily have benefited from court expansions of local taxing authority.

Court rulings (San Francisco v. Farrell; Carman v. Alvord) have expanded local tax-raising authority, particularly benefiting cities.

Local officials maintain that reduced state subventions made local tax increases necessary particularly in 1983. A restoration of subventions would provide opportunities for 1) roll-back or reductions of tax increases; 2) new attention to deferred public works expenditures; or 3) increased operational expenditures, depending on local priorities, as determined by local councils and boards and the voters. **(Chapter IX)**

10. Local officials are concerned about state and court actions that increase local costs.

Local officials were unanimous in their concern about the local fiscal impact of state policies. Chief concerns focused on:

- *County health and welfare costs that are state-mandated but not adequately funded by the state.*
- *Added costs and loss of local control caused by binding interest arbitration for public safety employees.*
- *Tort liability costs resulting from the concept of joint and several liability.* **(Chapter X)**

POLICY CHOICES FOR LOCAL GOVERNMENT FINANCE

As we completed this study, it became clear that local government finance issues revolve around a few central policy questions:

- **How can expenditure control be improved?** *What can be done at state and local levels to encourage and facilitate management efforts to provide services more economically and thereby reduce the demands for added revenues?*
- **Statewide Tax Limits vs. Local Control.** *In an era of statewide fiscal control can local government autonomy and home rule survive?*
- **What kind of majority rule?** *Who should decide questions of local tax increases, and what should the approval requirement be? Should approval be by majority vote of governing boards, or should approval be from local voters by a majority or two-thirds vote?*
- **What should the local tax base consist of?** *What should constitute the local government tax base? Should cities continue to have the ability, by simple majority vote of the council, to levy new or increased business license and utility users taxes? Should, after the present moratorium expires, cities and counties regain the authority to raise property taxes to fund public employee pension plans on a simple majority vote of the governing body? Should property taxes for long-term capital debt be raised by less than a two-thirds majority, as some would propose?*

On the other hand, should the court-awarded authority to increase business, utility, and property taxes be altered, as proposed by the new Jarvis initiative? Should the present ability of local government enterprise activities to base fees on the cost of service and allocate costs to the users of services be limited to the growth in cost of living or two-thirds voter approval as proposed under the new Jarvis initiative? Should it be possible to use property taxes for general obligation bonds on a two-thirds popular vote as before Proposition 13? Or should existing, pre-1978 authorization for general obligation bonds be further limited to only those bonds sold before June 6, 1978, as proposed by the new Jarvis initiative?

The basic question raised by these opposite poles of opinion is this: Is it possible to fashion a local finance system that begins to restore home rule, that permits efficient response to local cost problems, and yet retains local popular control over growth in local tax burdens? *How that simple question is answered in 1984 could affect the shape of local government finance for decades, perhaps as profoundly as Proposition 13.* **(Chapter XI)**

I

Introduction

A majority of California's 25 million residents depend on the state's 435 cities and 58 counties for important public services, such as police and fire protection, water and sewer services, streets, parks, other public works, libraries, and public health and welfare. Because of the critically important role these services play in the personal and economic well-being of Californians, concerns regarding financing local government have received increasing attention in recent years.

The prominence of local government finance as an issue goes back to the 1978 political earthquake known as Proposition 13. This major change in the state's tax system permanently and deeply reduced local governments' biggest local revenue source, the property tax. In doing so, Proposition 13 made sweeping changes in the way local governments finance the variety of services provided.

Immediately after passage of Proposition 13, the state government moved in with a massive local government bailout program, so large a commitment that it became a contributing factor in the state budget running annual deficits in the post-Proposition 13 period.

Court decisions on Proposition 13 have made major changes in the way the measure is interpreted, generally providing greater freedom for local governments to raise local taxes. In reaction to court decisions, Howard Jarvis — coauthor of Proposition 13 — has circulated a new initiative intended for the November 1984 general election.

All of these separate threads have come together, along with the promise by the Legislature and the Governor, to make local government finance a top priority in 1984.

The California Tax Foundation

In surveying last year's legislative debates over local finance issues, directors and staff members of the California Taxpayers' Association observed a lack of factual, in-depth information about actual conditions, problems, and opportunities facing cities and counties. Available information on local finance issues was inadequate as evidence of any clear problem or for purposes of testing and evaluating proposed changes. In addition, there was insufficient information and attention given to potential spending reforms in local government finance.

The California Taxpayers' Association turned to its research arm, the California Tax Foundation, to study these issues.

A Case Study Approach

Recognizing the difficulty of conducting a comprehensive statewide study of local government finance with limited resources and the limited time available, the Foundation decided to use a case-study approach. Its first decision was to focus solely on city and county governments, rather than on the entire range of local agencies, which includes school districts and special districts. School districts had already been examined in depth during the Legislature's exhaustive school finance and reform debates in 1983. Special districts, important providers of many services, were simply too diverse and numerous to be dealt with in this study.

The chief advantage of the case study approach was the ability to develop a deeper understanding of how individual jurisdictions made revenue and expenditure choices they faced in recent years.

This study is based on a sample of ten cities and seven counties. While every effort was made to fairly sample the economic, demographic, and geographic mosaic that is California, it is impossible to reflect every significant variable in this sample. These case studies have raised most leading issues in the future of state and local finance.

Methodology

To conduct these case studies, the Foundation retained the international auditing and consulting firm of Price Waterhouse. Price Waterhouse was selected for three reasons: 1) their experience in and understanding of local government finance; 2) to help ensure a totally objective review of the subject matter; and 3) because of the presence in that firm of Kevin Bacon, an analyst of local government finance with excellent individual background in studies such as these.

Before deciding finally to undertake this major study, the survey design was field-tested and refined in the City of Sacramento. This two-week pilot study resulted in a decision to proceed on the project by the Cal-Tax Foundation.

All relevant criteria were used in the selection of sample cities and counties: geographic location (north/south, valley/coast); urban/rural; population (large, medium, small-sized jurisdictions); rich, poor, and average revenue bases; new and old; charter and general law.

The jurisdictions were selected with the assistance of the staffs of the County Supervisors Association of California (CSAC) and the League of California Cities. The project commenced with an orientation session in which all cities and counties in the survey participated. The study itself consisted of two major components:

- A review of local budgets and financial statements for the period of fiscal 1977-78 to 1983-84, supplemented by a questionnaire covering certain non-financial data.
- In-depth interviews with 85 local government management staff members and officials based on a structured interview questionnaire. (See Appendix 1)

Data gathered from these activities was supplemented with statistical information about local governments drawn from a variety of state and federal government sources.

At the conclusion of the field work, final drafts of the report were reviewed by each survey participant and mutually acceptable draft revisions were made.

The California Tax Foundation wishes to express its gratitude to the surveyed cities and counties for their cooperation in this project. We come away from this effort much better informed on the nature of the local government fiscal condition. We also find ourselves impressed with the generally

high level of management talent and commitment to public service that we found in these cities and counties. We are also grateful to the League of California Cities and the County Supervisors Association for their facilitation of the project. Without a grant from the California Roundtable, this project would not have been possible, and we express our appreciation to them not only for the financial assistance, but for their foresight in recognizing a problem that needed investigation.

All findings in this report are solely those of Price Waterhouse, and do not necessarily reflect the views of the California Taxpayers' Association, its directors or staff, or the California Tax Foundation's trustees or staff. Given the limited nature of the review of financial information provided by sample jurisdictions, the discussion that follows should not be construed to represent the professional opinion of Price Waterhouse concerning the adequacy of audited financial statements of local governments studied in this project.

This summary report highlights important findings and an analysis of the full 174-page report done by Price Waterhouse. Together with the full report, this summary is the first part of a two-part study, *California Local Government Finance: Issues for the 80s.* Part 2 of the study, a product of Cal-Tax staff, focuses on specific local government tax and spending issues providing important additional information and recommendations for needed changes.

Larry McCarthy
Staff Director
Cal-Tax Foundation

II

Diversity Among Cities and Counties: Averages Can Be Deceiving

There is wide diversity among the revenue bases of local governments as well as in service expectations of local residents.

The wide variations among city and county revenue bases mean that statewide revenue actions that increase or reduce revenues across-the-board can have a sharply differential effect, producing "windfalls" or "wipe-outs."

A tendency of state-level analysts and policymakers is to homogenize cities and counties into uniform local entities with similar resources, service demands, and constituents. But in fact, local governments face a wide variety of circumstances affecting their ability to meet such service demands. This study attempts not only to account for these differences, but to emphasize that the geographic, economic, and demographic diversity in local governments should be a compelling consideration in developing a long-term state-local fiscal relationship.

Location

Ten cities and seven counties were selected for this study. They cover the length, breadth, and character of California's diverse geography, ranging from rural Mendocino County on the North Coast, through large and small Central Valley cities, to urban megalopoles in Southern California (Table 1).

Table 1
Population Change in Sample Cities and Counties, January 1978 to January 1983

	Population		
City	**1978**	**1983**	**% Change**
Farmersville	4,840	5,900	21.9%
Fresno	202,700	252,600	24.6
Irvine	44,500	72,900	63.8
Los Angeles	2,900,700	3,071,100	5.9
Montebello	50,700	55,400	9.3
Oakland	334,000	347,300	4.0
Pacifica	36,850	36,550	-0.8
San Diego	826,200	925,000	12.0
San Francisco	683,500	705,700	3.2
Sunnyvale	106,900	108,600	1.6
County			
Mendocino	62,300	70,400	13.0%
Merced	127,400	146,300	14.8
Riverside	595,800	731,200	22.7
San Diego	1,744,000	1,986,000	13.9
San Mateo	583,500	593,500	1.7
Santa Barbara	292,300	313,500	7.3
Santa Clara	1,244,100	1,343,100	8.0
State total	22,614,600	24,959,000	10.4%

Source: Department of Finance

Population

Total 1983 population of the ten cities was 5.6 million, some 29% of the total population of California's 435 cities. The seven counties in the study had 5.2 million residents in 1983, some 21% of the state's total population. Compared with the 10.4% increase in state population from 1978 to 1983, growth in those cities studied varied widely, county growth less so (Table 1).

Economic Characteristics

The sample jurisdictions are also quite diverse in their economic characteristics. For cities (Table 2 and Figure 1):

Sales tax. Cities varied widely around the state average sales tax of $70.43 per capita; from Farmersville, at 77% below the average, to Irvine at 66% above average. (Local governments receive one cent of the six cent sales tax, or 6½ depending on the county, on the basis of location of sales. Variation reflects intensity of sales activity.)

Assessed property values. This generally determines the ability of local governments to raise revenues through the property tax. However, these figures do not necessarily directly translate into measures of property tax strength relative to strength before passage of Proposition 13, because post-Proposition 13 revenue distribution is based on the pre-1978 tax rate for a jurisdiction. For example, since Irvine's tax rate pre-1978 was below average, the property tax that the city has received since Proposition 13 is not as great as its above-average assessed valuation per capita would indicate.

While most cities vary consistently about the average, economic indicators for several cities (Fresno, Pacifica, and San Francisco) vary in opposite directions. This displays varying levels of dependency on different revenue sources, which in turn determines the ability of cities to benefit from various funding solutions.

For counties, economic variation is just as dramatic (Table 2 and Figure 2)

AFDC/1,000 residents. This measure reflects a demand for county services and, in all but one case, is associated with below-average median income, low taxable sales, and low assessed value. This characteristic helps explain pressure on the state to create categorical aid programs that provide equal access in counties that have below-average resources. This measure, which determines the proportion of a county population which is "poor" because its people are on welfare, shows the most variation among counties.

For counties, the range of variation is less on each economic

Table 2
Economic Diversity Among Sample Cities and Counties

City	1982-83 Sales Tax Per Capita	% Variance From Average	1983-84 Assessed Value Per Capita	% Variance From Average	1979 Median Family Income	% Variance From Average	1979 % Below Poverty	% Variance From Average
Farmersville	$ 16.00	-77.3%	$ 8,826	-72.0%	$ 9,893	-54.1%	40.9%	-258.8%
Fresno	84.01	19.3	25,020	-20.5	17,720	-17.7	15.7	-37.7
Irvine	116.85	65.9	78,554	149.6	33,881	-57.3	3.6	68.4
Los Angeles	61.78	-12.3	28,178	-10.5	19,476	-9.6	16.4	-43.9
Montebello	67.03	-4.8	22,476	-28.6	20,090	-6.7	11.9	-4.4
Oakland	58.51	-16.9	25,064	-20.4	17,651	-18.1	18.5	-62.3
Pacifica	18.73	-73.4	22,280	-29.2	26,560	23.3	5.8	49.1
San Diego	62.85	-10.8	29,436	-6.5	20,134	-6.5	12.4	-8.8
San Francisco	83.92	19.2	37,258	18.4	20,911	-2.9	13.7	-20.2
Sunnyvale	99.20	40.8	48,522	54.2	27,270	26.6	4.8	57.9
State average	$ 70.43		$31,469		$21,541		11.4	

County	1982-83 Taxable Sales Per Capita	% Variance From Average	1983-84 Assessed Value Per Capita	% Variance From Average	1979 Median Family Income	% Variance From Average	1979 % Below Poverty	% Variance From Average	1983 AFDC Persons /1,000	% Variance From Average
Mendocino	$5,433	-14.4%	$31,923	-0.1%	$16,563	-23.1%	15.7%	-37.7%	86.7	-34.2%
Merced	4,335	-31.7	26,931	-15.7	16,563	-23.1	14.7	-28.9	116.4	-80.2
Riverside	5,151	-18.9	32,496	1.7	18,682	-13.3	11.3	0.9	72.0	-11.5
San Diego	5,527	-12.9	30,218	-5.4	20,306	-5.7	11.3	0.9	57.1	11.6
San Mateo	8,081	27.3	41,756	30.7	27,279	26.6	6.1	46.5	19.5	69.8
Santa Barbara	6,105	-3.8	35,271	10.4	21,630	0.4	10.6	7.0	34.8	46.1
Santa Clara	7,921	24.8	36,285	13.6	26,662	23.8	7.1	37.7	48.5	24.9
State average	$6,348		$31,947		$21,541		11.4		64.6	

Note:
Variances are calculated from the state average. A negative measurement for AFDC persons/1,000 and % below poverty reflects higher than average populations in these categories.

Sources: Taxable sales and assessed value (A.V.) from the state Board of Equalization. Family income and percentage of population living below the poverty level from the Bureau of Census.

indicator than is the case for cities. This may be because counties are larger units of state population and economic activity, and therefore will tend to aggregate closer to the state average.

Form of government. Cities and counties were also selected on the basis of their organization — whether chartered or general law. Charter agencies, especially cities, have greater organizational flexibility than do general law jurisdictions. Of the seven counties studied, three are chartered (San Diego, San Mateo, and Santa Clara). Of the ten cities, three are general law (Farmersville, Pacifica, and Montebello). Charter cities were emphasized because almost all of California's largest cities have charters. Voters in these cities have had chances to vote on measures that would have a significant impact on their cities' revenues and expenditures. Such voter-approved measures have played an important role in shaping current fiscal conditions of some cities under study.

Figure 1
Economic Diversity Among Cities

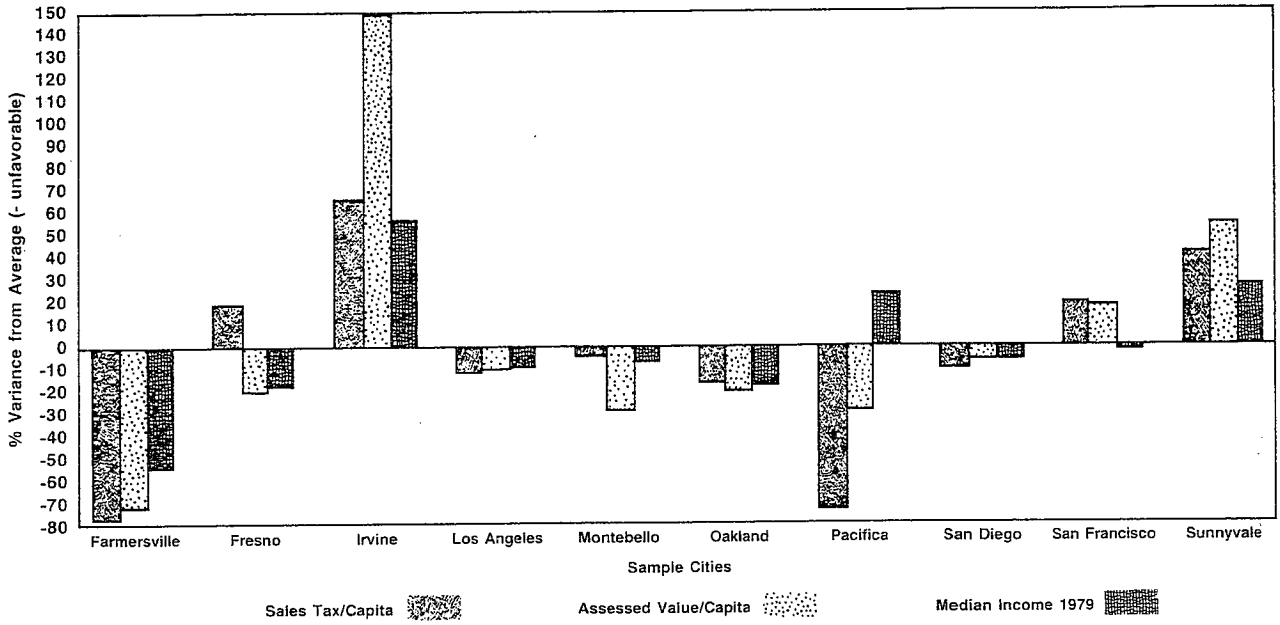
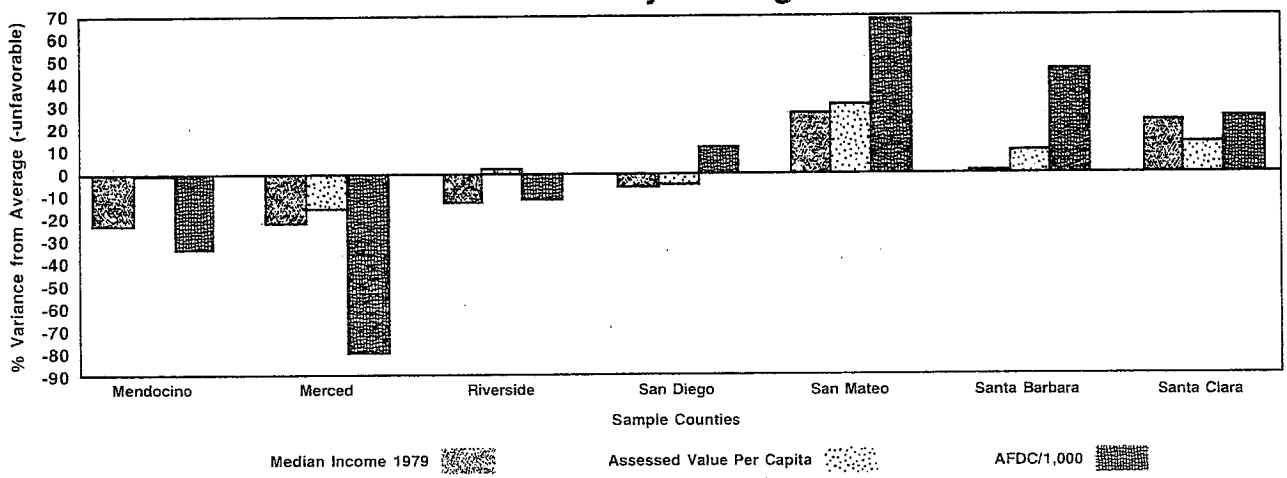


Figure 2
Economic Diversity Among Counties



III

Trends in City and County Employment

Local government employment relative to population declined in all cities and counties surveyed.

Employment in fee-supported enterprises (utility operations, airports, etc.) generally increased.

Staffing for police protection increased in some jurisdictions, and otherwise declined proportionately less than for other functions. Similarly, fire protection staffing was less likely to decline than employment in public works, parks and recreation programs, and general government.

Employment Declines

Providing government services at the local level is labor-intensive. Up to 60% of city expenditures and 50% of county spending is to pay costs of employing city and county workers.

Total employment in 11 of 17 sample cities and counties declined between fiscal 1977-78 and 1982-83. Seven of ten cities showed no growth, or declining employment; four of five counties with populations over 300,000 had a decline in staffing. (Table 3)

Two small counties indicated staffing increases; however, Mendocino reported its intention in 1983-84 to cut back to 1977-78 levels, and Merced projected a return in 1983-84 to 1982-83 staffing levels for general government positions.

CETA Termination

An important cause for decline in the number of employees was termination of public service jobs under the federal Comprehensive Employment and Training Act (CETA) program. Yet, in no case did the increase in non-enterprise employment

Table 3
Percentage Change in City and County Employment, 1977-78-1982-83

City	Total Employment 1977-78	Total Employment 1982-83	% Change in Total Employment	% Change Total Staff/ 1,000 Pop.	% Change Non-CETA Staff/ 1,000 Pop.	% Change Non-CETA Non-Ent. Staff/ 1,000 Pop.
Farmersville	40	28	-30.0%	-42.6%	4.4%	-21.7%
Fresno	2,711	2,481	-8.5	-26.6	-18.9	-21.6
Irvine	259	384	48.3	-9.5	-9.5	-9.5
Los Angeles	46,062	39,156	-15.0	-19.7	-9.5	-12.1
Montebello	354	354	0.0	-8.5	2.2	-2.3
Oakland	4,291	3,241	-24.5	-27.4	-13.0	-13.0
Pacifica	153	133	-13.1	-12.4	-12.4	-12.4
San Diego	6,072	6,077	0.1	-10.6	-3.6	-5.2
San Francisco	22,774	22,745	-0.1	-3.8	3.8	2.1
Sunnyvale	826	808	-2.2	-3.7	13.9	11.4
County						
Mendocino	775	795	2.6%	-9.2%	-9.2%	-9.5%
Merced	1,749	1,986	13.6	-1.1	5.6	0.5
Riverside	6,062	6,563	8.3	-2.9	-0.3	-0.7
San Diego	12,076	11,034	-8.6	-19.8	-16.0	-17.1
San Mateo	4,571	3,792	-17.0	-18.4	-14.7	-15.1
Santa Barbara	2,970	2,679	-9.8	-15.9	-15.9	-10.0
Santa Clara	12,115	11,055	-8.7	-15.5	-10.9	-17.6

Source: Survey questionnaire.

Notes:
1. San Francisco data is for 1979-80, earlier data not available. Per capita analysis based on January 1980 population.
2. Riverside data is for 1979-80, earlier data not available. Per capita analysis based on January 1980 population.

Key:
Ent. — Enterprise employment
CETA — Comprehensive Employment and Training Act employment
Non-Ent. — Non-enterprise employment

offset the decline in CETA-funded positions, even in five cities reporting increases in employment in self-financed enterprise activities and in general government.

General Government Employment

Five cities showed a decline in general government employment (non-enterprise employment), even after excluding the effect of CETA termination: Farmersville, Fresno, Los Angeles, Oakland, and Pacifica.

County non-enterprise employment, adjusted for the increase in population since 1977, declined in all jurisdictions. Considerable decreases were experienced in San Diego (-20.1%) and Santa Clara (-23.3%) counties (Figure 4).

Staffing Trends

Employment in self-financed enterprise activities increased in all reporting sample cities, and in five of the seven counties surveyed. Growth in city enterprise activities was attributed to service demands of a growing population, and to expanded operation of facilities such as airports. The increase in county enterprise operations was chiefly in county hospital and solid waste operations.

Staffing for police protection increased in three of ten cities, and in one of seven counties. Where it did decline, it dropped proportionately less than employment in other functions. (Figures 3 and 4)

Similarly, fire protection staffing was less likely to decline than employment in public works, parks and recreation programs, and general government.

Increases in public protection positions, and proportionately smaller declines in this area, were explained by local officials as evidence of high priority local officials placed on public safety programs — and also an inability to cut back because of rising crime rates and stiffer criminal penalties.

Employment in county health and welfare programs generally declined relative to population growth. However, no clear staffing pattern emerged from the survey.

Figure 3
Change in City Staffing By Function

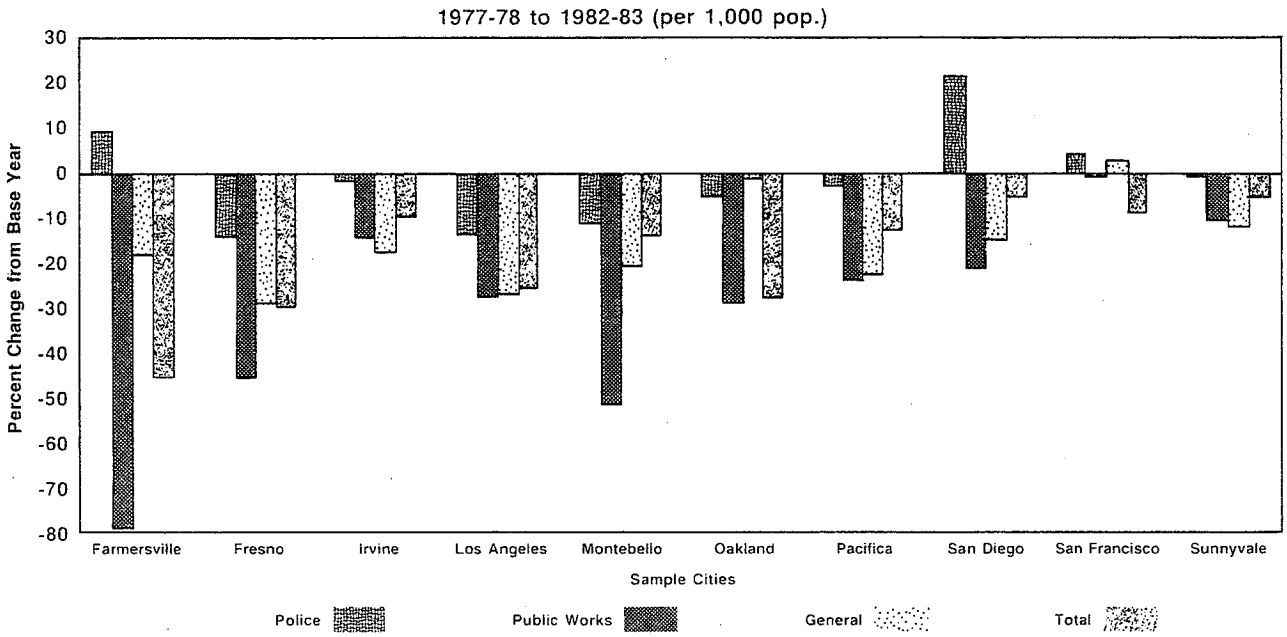
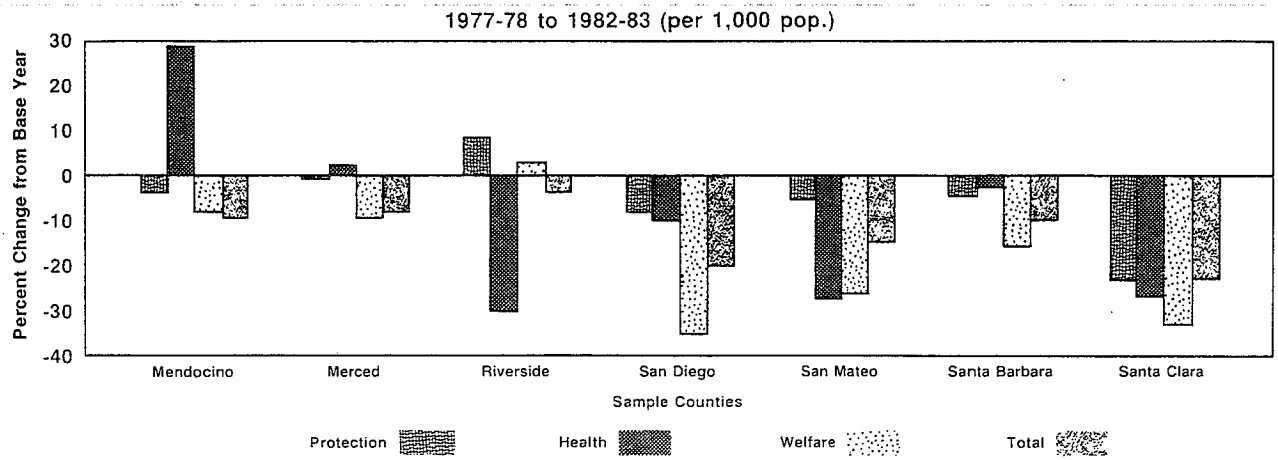


Figure 4
Change in County Staffing By Function



IV

Public Employee Compensation

Increases in total salaries and benefits paid local government employees since fiscal 1977-78 have generally been less than the rise in California CPI. However, fringe benefit costs have risen at a rate that in some cases far exceeds the CPI.

Substantial increase in the number of disability retirements contributes to rising benefit costs.

Local government efforts to control escalating benefit costs include alternative retirement benefits and rehabilitation programs for injured employees. Cost containment of retirement, however, could be limited by the courts.

Local governments seldom implemented cuts in pay or pay freezes as a way of dealing with fiscal restraints.

Containing rising local government personnel costs requires that local management control not be constrained by binding interest arbitration or Public Employee Relations Board administration of labor disputes.

Legislation is needed to permit alternative, lower-cost retirement benefits.

Reforms are needed to enable local governments to control escalating workers' compensation and disability retirement costs.

Salaries and Benefits

Total salaries and benefits paid local government employees in sample jurisdictions since fiscal 1977-78 have generally increased less than the California Consumer Price Index (CPI) (Figures 5 through 10.)

As the same charts indicate, fringe benefit costs during this period have risen at a rate that in some cases far exceeds the CCPI.

Reasons cited by local government officials for these escalating benefit costs include:

- Employee organization efforts to bargain retirement and insurance contributions which, as non-taxable payments, maximize funds employers are willing to spend.
- Increased cost of employee retirement, Social Security, and health care.

Adding to the benefit costs is a trend of increased disability retirements. Los Angeles had a 563% increase in disability retirements of police officers between 1970 and 1982. A contributing factor to this increase is the advent of psychological-related disability claims that grew from zero in 1970-71 to 23% of claim awards in 1981-82. (The cost of a single disability retirement is estimated to be a minimum of $350,000.)

Cost Containment Measures

In order to control retirement costs, Los Angeles, Oakland, San Francisco, and other jurisdictions have capped extremely generous cost-of-living adjustment provisions, but the obligation to already-vested employees means high employer costs will continue to be borne for a number of years. The right to cap future benefits for current employees is being tested in court.

To lessen costs of future retirement benefits, several counties operating under the County Employees Retirement Law of 1937 have implemented alternative, reduced retirement formulas known as "two-tier" plans. Other jurisdictions not under this law await legislative authorization of alternative, less-costly retirement options.

An additional approach to controlling disability costs is used by San Mateo County, with a program designed to return injured workers to county service.

Pay cuts and pay freezes were seldom employed by sample jurisdictions as a way to control personnel costs during the recent fiscally-tight period. The major argument against these measures was the need to stay competitive in the labor market.

Local Labor Relations

Among sample jurisdictions, unanimous opposition was expressed to binding interest arbitration as a way to settle negotiation disputes. Local officials urged rejection of arbitration because it takes decision-making on wages and benefits — a major portion of local government budgets — away from local control.

On a second labor-management topic, there was also consensus that decisions by the Public Employment Relations Board would unnecessarily constrain local labor relations, and that the board should not be given authority to adjudicate local labor disputes.

Conclusions

Containment of rising local government employee benefit costs requires these things: local management control should not be constrained by binding interest arbitration or PERB administration of labor disputes; authority to negotiate two-tier retirement plans must be legislated; and the Workers' Compensation system must be reformed.

Figure 5
% Change in County Deputy Sheriff Pay

1977-78 to 1983-84

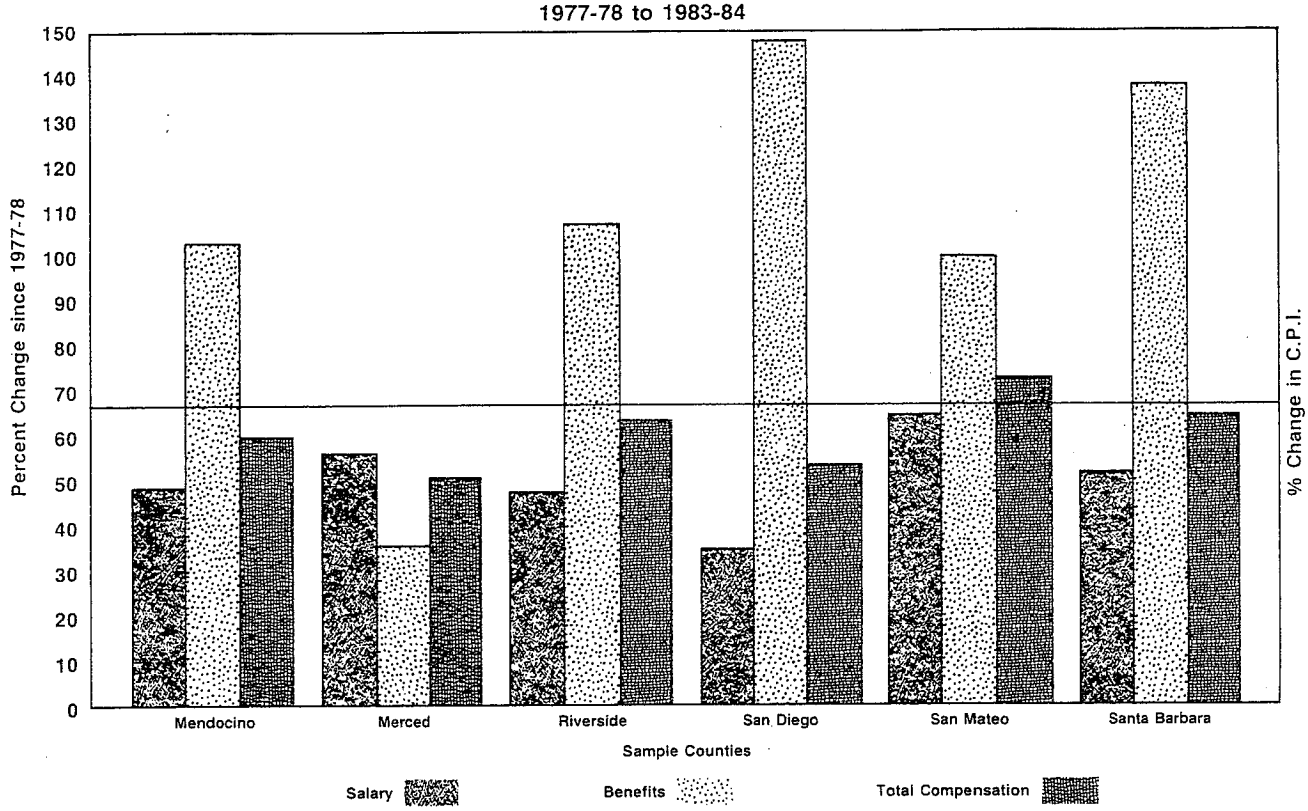


Figure 6
% Change in County Social Worker Pay

1977-78 to 1983-84

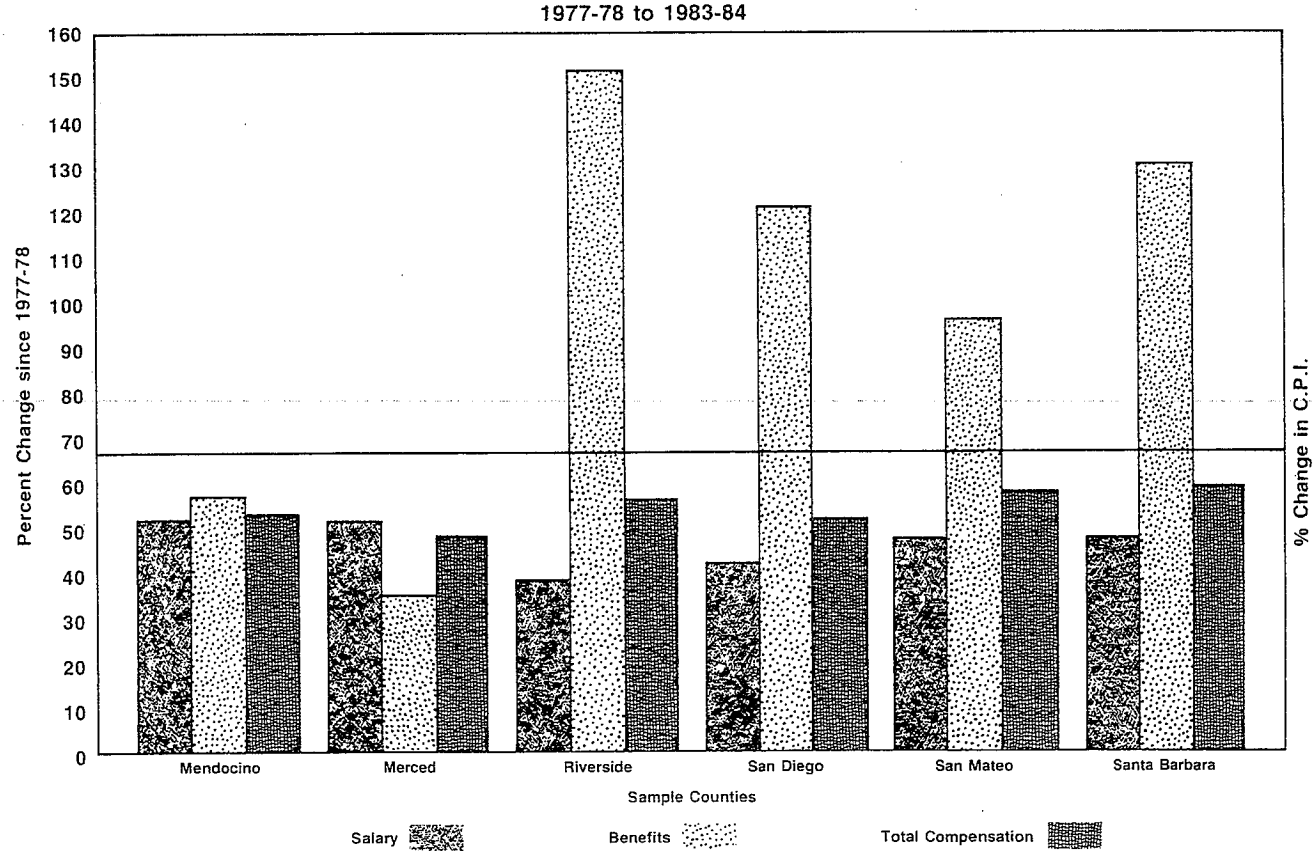


Figure 7
% Change in County Clerk Typist Pay

1977-78 to 1983-84

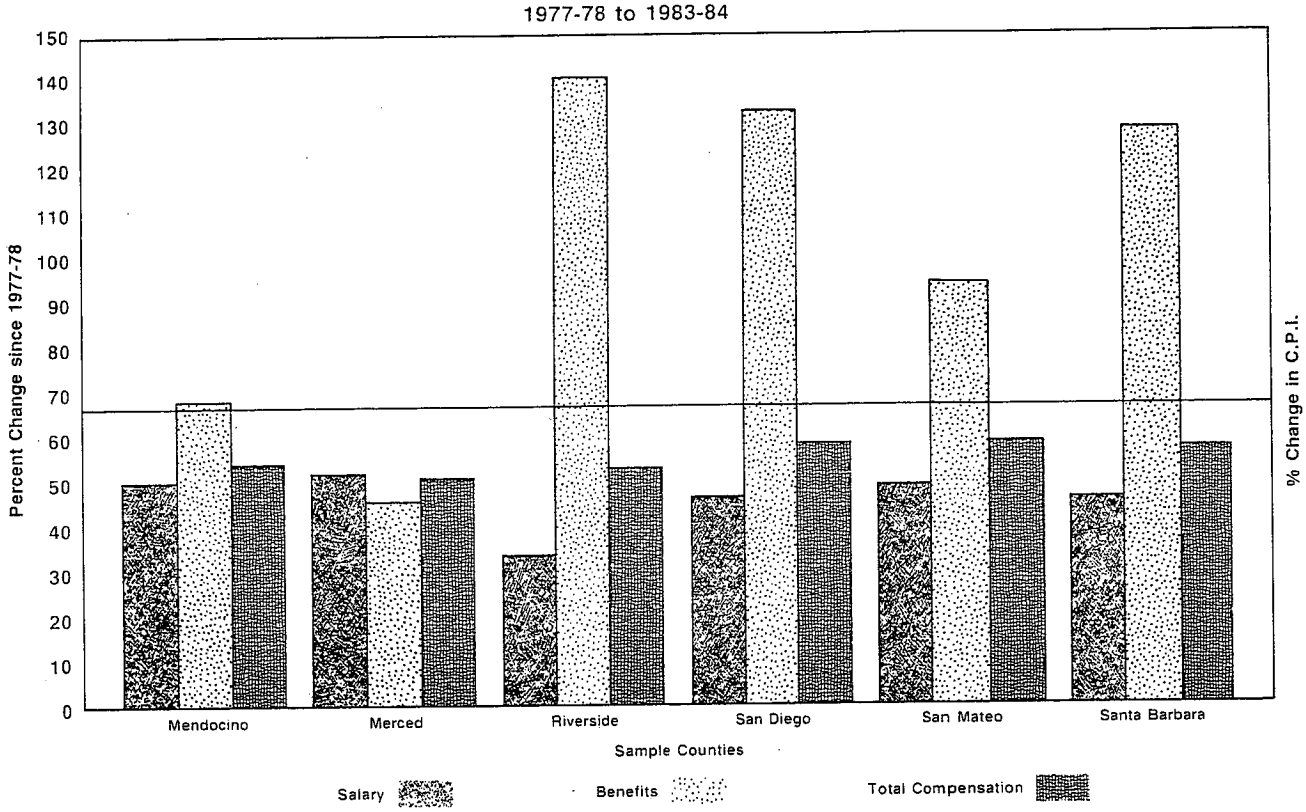


Figure 8
% Change in City Clerk Typist Pay

1977-78 to 1983-84

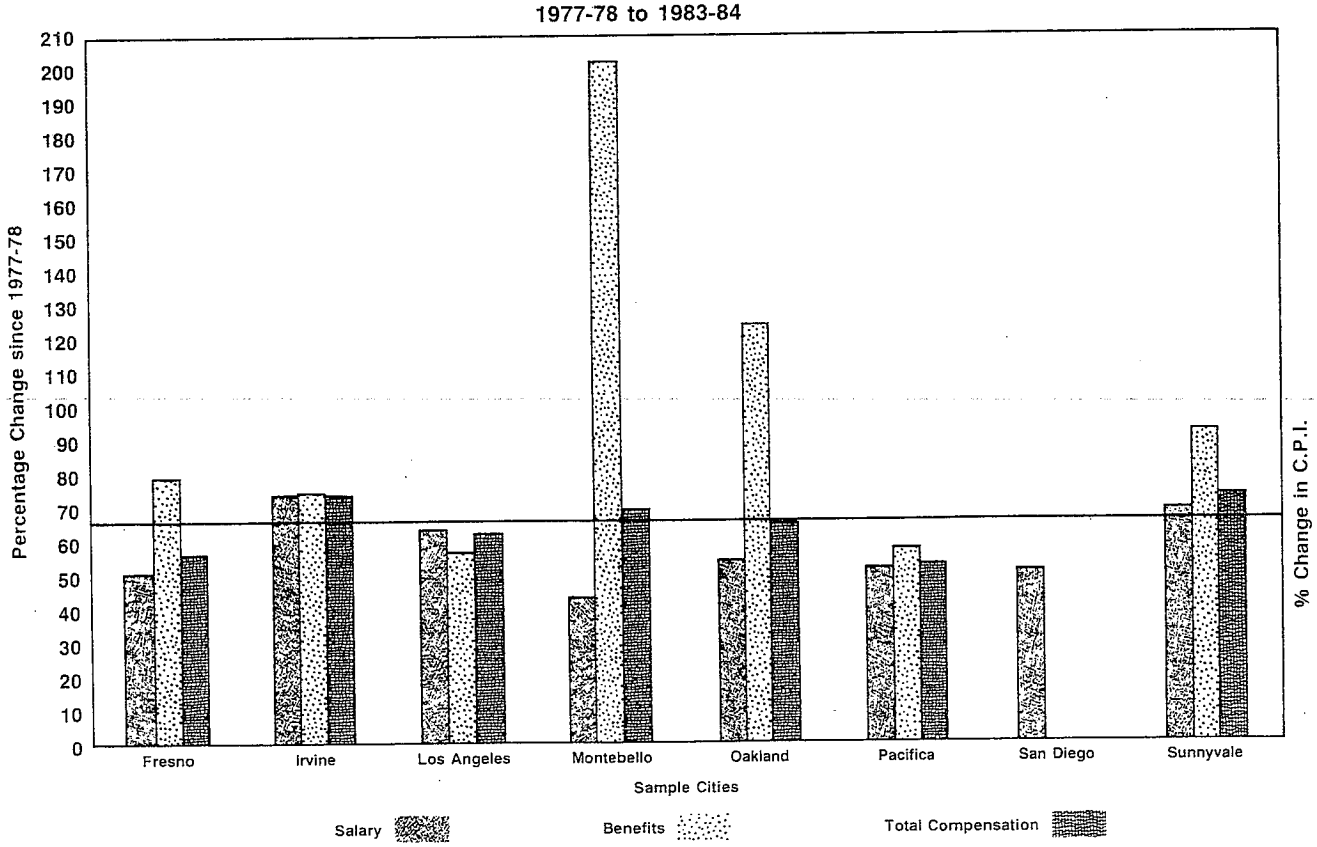


Figure 9
% Change in City Police Officer Pay

1977-78 to 1983-84

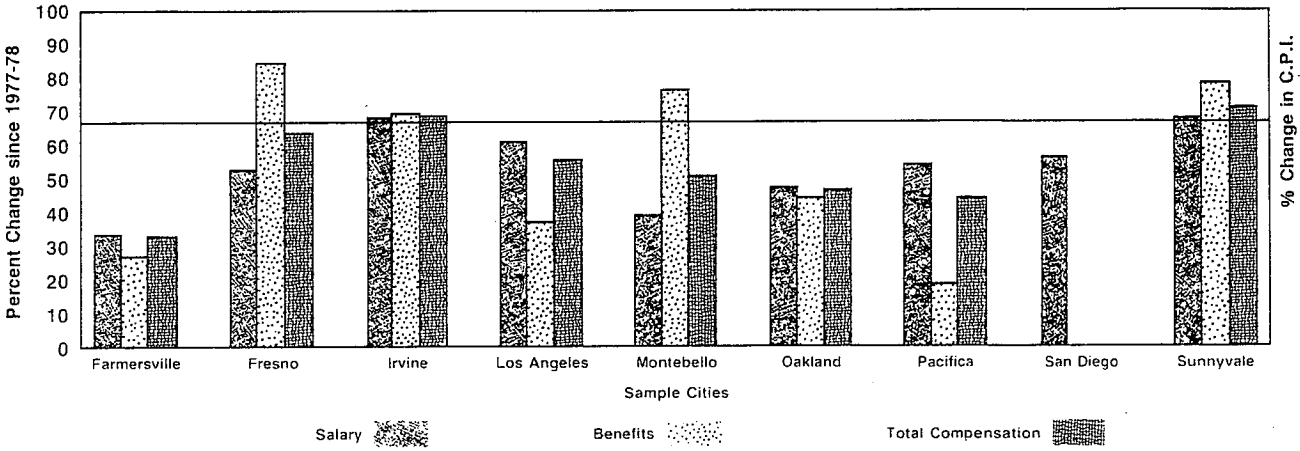
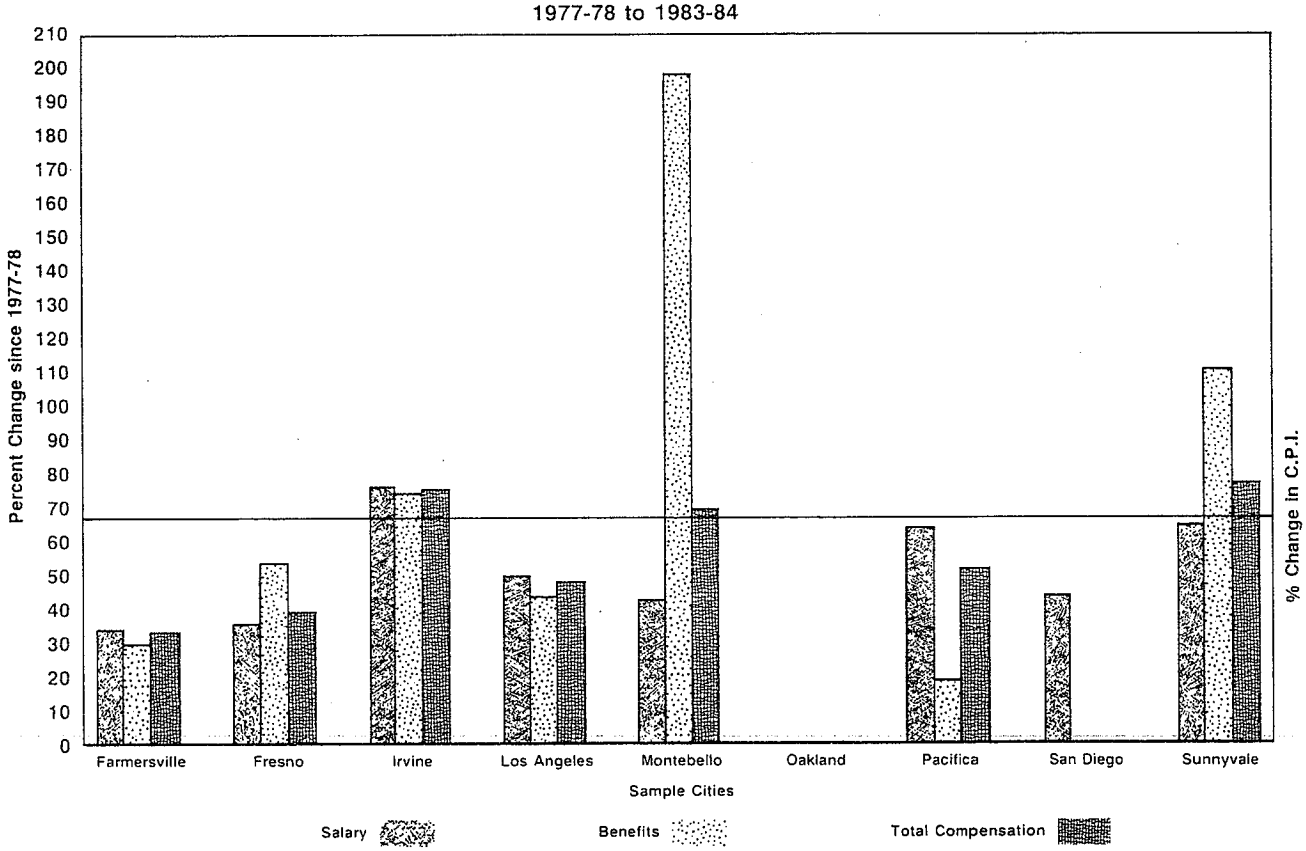


Figure 10
% Change in City Maintenance Worker Pay

1977-78 to 1983-84



V

County Revenue and Expenditure Trends

County revenues have grown significantly in recent years, but inflation-adjusted revenues per capita are lower than in 1977-78.

County expenditures have also grown significantly in recent years, but inflation-adjusted spending per capita is lower than in 1977-78.

The mix of county revenues has changed. Counties are more dependent on state aid today than they were in 1977-78 while property taxes provide a smaller share of total county revenues.

Counties' increased dependence on state assistance explains their concern with stable and predictable funding, especially when the state faces fiscal difficulties of its own.

The mix of county expenditures has changed. Health and welfare programs have tended to keep pace with inflation and population growth better than have other county programs.

Public safety programs, including the courts, were cut the least of all locally-financed programs.

Capital spending, maintenance, parks, and libraries were cut the most.

Revenues

Growth. County revenues have increased rapidly since 1977-78: gross revenues for six of the seven sampled counties exceeded a 35% rate of growth over the five-year period (Figure 11). While total revenue growth has been sizable, real purchasing power — gauged by adjusting for effects of inflation and population growth — in each county studied showed a decline in real per capita revenues. The fastest growing revenue source for counties has been state aid, which has grown an average of 98% since 1977-78. The property tax has already reached its 1977-78 dollar level; this growth has resulted from the property tax shift from schools and continued increase in assessed property values.

Mix. Not only has counties' purchasing power declined over the past five years, but their sources of revenues have changed, resulting in changing dependencies between counties and other levels of government (Table 4).

Revenues available to counties are limited. They rely primarily on property taxes, state subventions, and federal funds. Since 1978, the share of revenues counties received from property taxes declined about 10 percentage points, while the state assistance share increased, also by about 10 percentage

Table 4
Percentage Shares of County Non-Enterprise Revenues, 1977-78 to 1982-83

1977-78

County	Property Tax	Other Tax	Fees	State	Federal	Other	Total
Mendocino	29.2%	7.9%	5.5%	29.3%	22.9%	5.2%	100.0%
Merced	27.2	5.3	4.4	22.8	35.5	4.8	100.0
Riverside	27.7	5.9	6.5	27.0	29.1	3.9	100.0
San Diego	27.2	3.4	7.9	27.7	28.9	4.9	100.0
San Mateo	40.2	4.4	6.3	22.6	20.8	5.7	100.0
Santa Barbara	32.4	6.4	13.8	22.8	17.7	6.8	100.0
Santa Clara	34.5	3.7	4.3	26.6	24.0	6.2	100.0

1982-83

County	Property Tax	Other Tax	Fees	State	Federal	Other	Total
Mendocino	19.9%	7.8%	5.3%	39.9%	20.3%	6.7%	100.0%
Merced	15.0	7.4	6.5	37.2	27.4	6.6	100.0
Riverside	17.1	6.6	8.7	35.6	26.0	5.9	100.0
San Diego	19.1	3.6	8.9	37.9	25.5	5.0	100.0
San Mateo	26.1	6.6	9.2	33.2	16.1	8.7	100.0
Santa Barbara	22.2	5.1	18.0	33.7	13.6	7.4	100.0
Santa Clara	23.0	4.2	6.6	31.7	25.7	8.7	100.0

points. The increased state presence in the revenue mix is because of state post-Proposition 13 "bail-out" funding, mostly through assumption of previously county-funded health and welfare costs.

Counties have few local tax opportunities (again compared with cities). "Other taxes," which are mostly sales taxes, have changed little in the county revenue mix since 1977-78.

Fees, charges, and miscellaneous revenues, though a small proportion of overall county revenues, have increased markedly since 1978. Where costs of providing services could be recovered by imposing fees or charges, counties usually made those adjustments, resulting in substantially increased fees.

Other miscellaneous revenues, mostly interest earnings and property management, have also increased in proportion to other county revenues. This was mainly because county officials improved their investment practices.

Expenditures

County spending has grown substantially since 1978, ranging from 19% to 71% in the sampled counties. Adjusted for inflation and population growth, every county studied decreased its spending. Further adjusted for shifts in program responsibility between the state and counties (state buy-out of county Medi-Cal and welfare costs), counties still show a drop in real per capita spending (Tables 5 & 6).

Table 5
Percentage Change in County Non-Enterprise Expenditures, 1977-78 to 1983-84

County	Total Expenditures[1] 1977-78 Total	Total Expenditures[1] 1982-83 Total	% Change	Growth in Total Before Adjustment[2]
Mendocino	$26,098,866	$40,208,368	54.1%	45.9%
Merced	48,744,636	83,435,547	71.2	57.2
Riverside	187,606,806	341,404,983	82.0	70.9
San Diego	447,902,125	684,354,683	52.8	45.1
San Mateo	154,399,705	202,098,968	30.9	19.1
Santa Barbara	89,324,827	128,837,807	44.2	35.2
Santa Clara	354,673,700	486,058,654	37.0	29.1

1. Total expenditures have been reduced to reflect state assumption of county costs for Medi-Cal and SSI/SSP in succeeding years.
2. Growth in total expenditures without any adjustment to reflect state assumption of county costs for Medi-Cal and SSI/SSP during the period.

Table 6
County Inflation Adjusted Per Capita Expenditure by Function, 1977-78 and 1982-83

1977-78

County	General & Capital	Law Enforcement	Roads	Health	Social Services	Parks & Libraries	Total
Mendocino	$116.02	$77.62	$54.96	$30.83	$130.09	$9.42	$418.92
Merced	43.91	76.29	32.99	28.68	189.06	11.68	382.61
Riverside	55.97	79.16	17.96	33.55	121.85	6.40	314.88
San Diego	57.39	53.10	15.29	24.63	101.53	4.89	256.82
San Mateo	41.00	80.58	13.32	45.19	75.19	9.32	264.61
Santa Barbara	42.21	107.25	17.16	56.30	69.96	12.71	305.59
Santa Clara	56.92	67.53	12.22	33.07	109.32	6.03	285.08

1982-83

County	General & Capital	Law Enforcement	Roads	Health	Social Services	Parks & Libraries	Total
Mendocino	$68.01	$75.88	$42.35	$43.83	$144.72	$6.72	$381.50
Merced	39.77	83.31	22.88	27.34	197.22	10.42	380.94
Riverside	42.74	77.46	18.16	45.48	123.34	4.69	311.88
San Diego	41.10	46.98	10.68	27.76	100.75	2.90	230.17
San Mateo	25.00	80.51	9.60	37.95	65.82	8.58	227.45
Santa Barbara	36.64	106.20	13.14	43.58	66.61	8.34	274.51
Santa Clara	50.30	52.12	10.05	25.52	98.03	5.71	241.73

Percent Change 1977-78 to 1982-83

County	General & Capital	Law Enforcement	Roads	Health	Social Services	Parks & Libraries	Total
Mendocino	-41.4%	-2.2%	-22.9%	42.2%	11.2%	-28.7%	-8.9%
Merced	-9.4	9.2	-30.7	-4.7	4.3	-10.8	-0.4
Riverside	-23.6	-2.1	1.1	35.6	1.2	-26.7	-1.0
San Diego	-28.4	-11.5	-30.1	12.7	-0.8	-40.6	-10.4
San Mateo	-39.0	-0.1	-28.0	-16.0	-12.5	-8.0	-14.0
Santa Barbara	-13.2	-1.0	-23.4	-22.6	-4.8	-34.4	-10.2
Santa Clara	-11.6	-22.8	-17.7	-22.8	-10.3	-5.3	-15.2

Note:
Health and welfare expenditures in 1977-78 have been adjusted to reflect the effects of the state assumption of Medi-Cal and SSI/SSP costs.

Objects of expenditures. County government is labor-intensive. Of major spending categories (Table 7) labor costs are by far the largest.

County government in California, compared with counties in other states, is relatively debt-free; capital outlay as a proportion of total outlays has been declining since 1978.

Counties act as "bankers" for state and federal welfare programs, as well as making substantial direct payments to individuals in the AFDC program, and in their own general assistance programs. A county's welfare burden will therefore be a strong determinant of its expenditure mix.

Expenditures by function. Growth in components of county expenditures varied as much as did county revenues (Table 6).

Health, welfare, and social services, mandated and primarily financed by federal and state governments, tended to increase in real terms. Counties' discretion over these programs — and therefore their ability to control expenditures — is minimal.

County functions financed primarily by local discretionary revenues dropped in real per capita spending. County officials attempted to reduce expenditures in areas "invisible" to the public — maintenance, capital outlay, and general government — rather than those directly affecting the general public.

Law enforcement. Law enforcement has had rapid growth. One reason for this has been mandates such as changing criminal penalties, activities of the judicial branch, and the perceived high public demand for better law enforcement.

Jail construction. In many counties the only capital facilities constructed during the past five years have been jails. These projects were funded to comply with court-ordered standards for housing inmates, tougher sentencing laws, and the rapid increase in the number of persons sentenced to jail.

Roads. County spending for road programs has also declined in real per capita terms. County officials claim they were unable to provide additional local revenues to supplement gas tax revenues earmarked for road projects. Constraints on available local discretionary revenues to finance non-mandated programs forced a shift in priorities away from road construction.

Welfare. While the average ratio of welfare recipients to the state population has not changed since 1978, individual counties have had wide variation in their own rates. Since counties are obligated to pay 5% of AFDC grants, 25% of administrative costs, and 100% of general assistance programs, rapid change in demands for welfare services can cause substantial hardship for small counties.

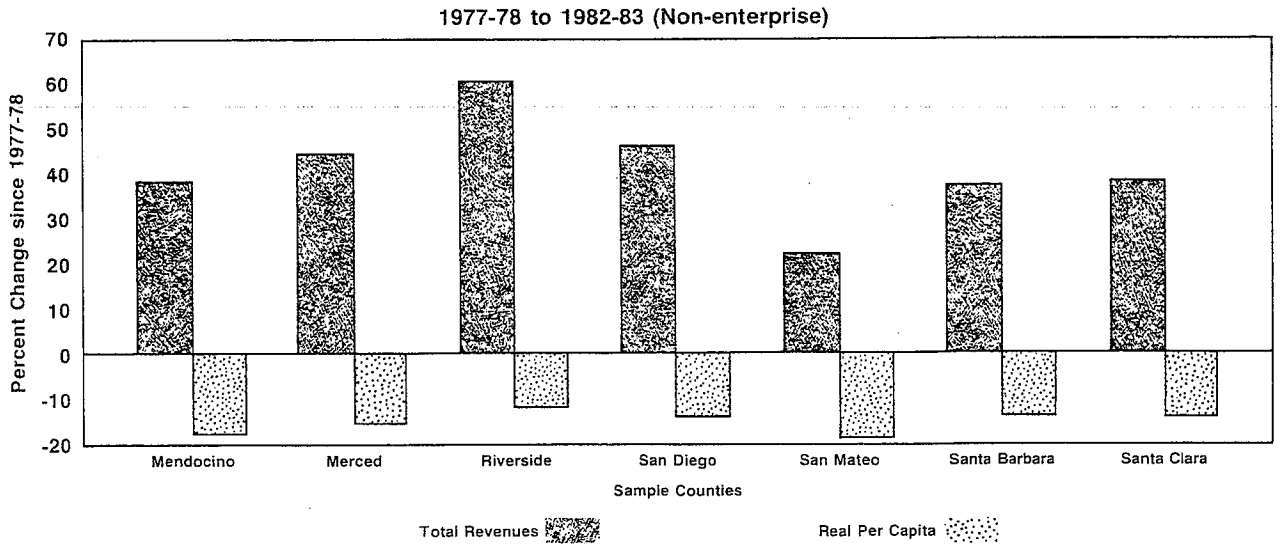
Even though California was caught in a serious economic downturn, the ratio of welfare recipients to the general population remained stable. Many county officials noted that, because of federal changes in welfare eligibility rules made in 1981, the welfare caseload and resultant state and county costs were substantially lower than they might have been otherwise.

Table 7
Percentage Shares of County Non-Enterprise Spending by Object, 1982-83

County	Labor	Debt Service	Supplies & Expenditures	Capital	Welfare	Total
Mendocino	47.4%	0.0%	25.1%	0.5%	27.0%	100.0%
Merced	40.5	0.3	20.1	2.2	36.8	100.0
Riverside	36.7	1.4	33.4	1.3	27.3	100.0
San Diego	39.2	1.2	25.2	2.6	31.8	100.0
San Mateo	53.2	0.0	31.3	4.1	11.4	100.0
Santa Barbara	54.4	0.0	28.4	1.7	15.4	100.0
Santa Clara	42.2	2.8	25.3	2.3	27.5	100.0

Figure 11
% Change in County Revenues

1977-78 to 1982-83 (Non-enterprise)



VI

City Revenue and Expenditure Trends

City revenues have grown significantly in recent years, but inflation-adjusted revenues per capita are lower than in 1977-78.

City expenditures have also grown significantly in recent years, but inflation-adjusted spending per capita is lower than in 1977-78.

The mix in city revenues has changed. Cities are more dependent on local-source taxes today then they were in 1977-78, while property taxes and intergovernmental aid provide a smaller share of total city revenues.

The mix of city expenditures has changed. Law enforcement has tended to keep pace with inflation and population growth more than have other city programs.

Capital spending, maintenance, and libraries were cut the most. State and federally mandated programs determined some expenditure priorities for local government.

Revenues

Growth. Every city studied had some growth between 1977-78 and 1982-83, ranging from 4% in Fresno to more than 56% in Sunnyvale. Average revenue growth exceeded 25% for eight of the ten cities (Figure 12). While total revenue growth has been moderate to good, real purchasing power, measured by adjusting for effects of inflation and population growth, in each city studied except Sunnyvale, showed a decline in real per capita revenue growth. Of major city revenue sources, the fastest growing has been local taxes. This is mostly due to growth in the utility users tax, driven by higher utility bills (the tax is based on the amount of the utility bill) and by an increase in the number of cities levying and raising the tax.

Even though property taxes to cities were reduced by half in 1978, some jurisdictions, by fiscal 1981-82, had attained their pre-Proposition 13 level in property tax revenues — mostly by the shift of schools' property taxes to cities and counties and by rapid growth in assessed valuation.

Mix. Not only has city purchasing power declined over the past five years, but the mix of city revenues has changed. With respect to locally-generated revenues, cities since 1977-78 have grown less dependent on the property tax and more reliant

Table 8
Percentage Shares of City Non-Enterprise Revenue

1977-78							
City	Property Tax	Sales Tax	Local Tax	Miscellaneous	Fees	State & Federal	Total
Los Angeles	29.64%	12.89%	17.53%	9.77%	7.55%	22.62%	100.0%
San Diego	21.90	16.40	7.77	11.64	6.86	35.42	100.0
Fresno	22.29	17.57	11.17	4.38	7.00	37.58	100.0
Oakland	20.76	8.69	10.05	5.70	4.63	50.18	100.0
Sunnyvale	23.27	18.55	12.94	6.53	4.70	34.01	100.0
Irvine	17.00	22.02	6.71	10.16	31.89	12.23	100.0
Pacifica	24.85	5.16	3.60	10.57	13.51	42.30	100.0
Farmersville	8.12	8.97	2.21	7.52	13.30	59.88	100.0
Montebello	24.14	25.37	6.19	17.28	6.08	20.94	100.0
San Francisco	35.78	5.54	11.98	6.41	13.97	26.32	100.0

1981-82							
City	Property Tax	Sales Tax	Local Tax	Miscellaneous	Fees	State & Federal	Total
Los Angeles	17.71%	14.02%	20.39%	13.41%	14.00%	20.47%	100.0%
San Diego	18.66	20.64	11.84	19.07	7.00	22.80	100.0
Fresno	22.58	26.64	10.43	8.60	11.29	20.47	100.0
Oakland	11.34	9.30	13.94	17.45	4.32	43.65	100.0
Sunnyvale	16.46	22.35	15.60	15.17	3.99	26.43	100.0
Irvine	12.55	29.89	11.57	24.63	10.50	10.87	100.0
Pacifica	20.17	7.49	4.29	15.05	23.77	29.23	100.0
Farmersville	6.02	10.39	4.60	20.66	3.69	54.63	100.0
Montebello	21.15	28.34	5.69	18.52	11.14	15.16	100.0
San Francisco	21.68	6.13	21.59	4.91	12.09	33.60	100.0

on the sales tax and other local taxes, such as business license, utility users, and hotel/motel taxes (Table 8).

Cities have also grown less dependent on intergovernmental revenues, especially federal funds. Revenue sharing and urban aid programs have been reduced, and the CETA program has been phased out. The increase in miscellaneous revenues is primarily from increased interest earnings — a combination of higher interest rates on investment instruments and increased attention to this revenue source by city officials. Some cities have also derived revenues by profitably disposing of surplus property, by lease or sale.

Expenditures

City expenditures have grown substantially since 1977-78 (Figure 13), from 10% in Oakland to 61% in Sunnyvale. The typical growth rate has been under 40%. (The 98% growth in Farmersville's spending is a result of federal community development and housing grants, rather than expenditures from general revenues.)

Adjusted for inflation and population growth, spending has declined in six of the eight cities for which comparison data was developed, ranging from -5.7% in Los Angeles to -47.2% in Irvine. (The large decline in Irvine's adjusted spending is mainly from reduction in capital outlay spending related to the slowdown in building activities during the recent recession.) The prosperous city of Sunnyvale, and Farmersville, with a large influx of federal grants, both showed adjusted increases in spending during the past five years. (Table 9)

Objects of expenditures. City government is labor-intensive. Of the major spending categories, labor costs are by far the largest outlay (Table 10), ranging from 44% of total spending in Irvine to 76% in Oakland.

More than in counties, efforts at controlling expenditures in cities must focus on labor costs: salaries, fringe benefits, number of employees, and growth in these factors. Fringe benefits in particular have grown rapidly in California cities.

Compared with cities elsewhere in the country, California cities are relatively debt-free in non-enterprise portions of their budgets. Capital outlay expenditures have also tended to decline since fiscal 1977-78.

Expenditures by function. Just as growth rates of the several revenue sources varied widely for cities, so they have for components in city expenditures (Table 11).

Based on data collected from the agencies and interviews with city officials, the major shift in city spending priorities was to increase spending for police and fire functions at the expense of public works, general government, parks, and library activities. The first two areas tend to be "invisible" to the general public; cuts in the latter two areas tended to be in park maintenance and in library service hours.

Officials from every city sampled emphasized that public safety programs have been given high budget priority since passage of Proposition 13, reflecting perceived public sentiment for greater efforts in crime control. Since employees in this category tend to be more expensive than typical city

Table 9
Percentage Change in Per Capita Inflation Adjusted Expenditures For City Non-Enterprise Functions, 1977-78 to 1981-82

City	Public Safety	Public Works	Parks & Libraries	General Government	Community Development	Miscellaneous	Total
Los Angeles	1.3%	-18.5%	-13.0%	20.4%	-1.5%	-20.4%	-5.7%
San Diego	12.5	-5.2	-17.1	-5.9	-23.4	-80.2	-25.9
Fresno	-13.0	-26.2	-12.7	-17.8	-91.7	431.8	-30.6
Oakland	-6.9	-46.1	-15.2	-55.9	51.8	-61.8	-23.7
Sunnyvale	9.8	49.1	-24.8	2.6	38.3	11.5	14.1
Irvine	7.7	-73.0	92.3	-47.8	6.2	-47.4	-47.2
Pacifica*	5.1	161.2	12.5	-8.9	14.6	102.3	32.2
Farmersville**	22.4	13.3	7.6	-61.6	1,611.8	-37.1	18.6
Montebello	11.1	-28.7	109.1	-41.5	-31.7	-61.1	-22.6
San Francisco	na	na	na	na	na	na	na

*Pacifica uses 1978-79 data in place of 1977-78 data.
**Farmersville was adjusted to remove enterprises from the non-enterprise activities.

Table 10
Percentage Shares of City Non-Enterprise Expenditure Spending by Object, 1982-83

City	Salaries	Benefits	Operating Expenses	Debt	Capital	Inter-fund Transfer	Total
Los Angeles	50.7%	21.4%	21.1%	0.9%	5.9%	0.0%	100.0%
Fresno	47.4	16.4	24.3	0.8	11.0	0.0	100.0
Oakland	49.2	27.0	23.0	0.6	0.3	0.0	100.0
Sunnyvale	39.9	16.9	22.5	6.3	14.4	0.0	100.0
Irvine	35.2	9.1	28.7	4.7	22.3	0.0	100.0
Pacifica	39.3	8.1	35.8	3.1	13.8	0.0	100.0
Montebello	42.0	18.0	38.8	0.3	0.9	0.0	100.0
San Francisco*	30.7	12.9	53.3	1.7	1.4	0.0	100.0
San Diego	42.5	12.2	33.4	1.2	10.7	-3.9	100.0
Farmersville	na	na	na	na	na	na	na

*San Francisco operating expense is large because it includes benefit payments made by the City and County.

Table 11
Percentage Shares of Non-Enterprise City Expenditures For Selected Functions

City	Public Safety	Public Works	Parks & Libraries	General Government	Community Development	Miscellaneous	Total
1977-78							
Los Angeles	48.05%	21.87%	8.03%	5.21%	6.18%	10.67%	100.0%
San Diego	23.09	18.97	11.08	11.46	5.59	29.82	100.0
Fresno	30.17	31.61	6.50	15.19	16.47	0.06	100.0
Oakland	36.20	13.94	10.64	15.09	8.96	15.18	100.0
Sunnyvale	31.44	25.63	18.22	7.12	2.82	14.78	100.0
Irvine	9.61	54.47	3.46	8.31	7.56	16.59	100.0
Farmersville*	30.07	32.98	2.07	26.23	1.62	7.04	100.0
Montebello	33.42	7.11	3.81	20.80	4.89	29.97	100.0
Pacifica**	36.80	10.82	5.80	10.49	27.22	8.87	100.0
1981-82							
Los Angeles	51.61%	18.89%	7.40%	6.65%	6.45%	9.01%	100.0%
San Diego	35.05	24.27	12.39	14.56	5.77	7.96	100.0
Fresno	37.82	33.61	8.17	17.98	1.97	0.44	100.0
Oakland	44.19	9.85	11.83	8.72	17.81	7.60	100.0
Sunnyvale	30.27	33.48	12.00	6.40	3.41	14.43	100.0
Irvine	19.61	27.84	12.60	8.22	15.20	16.54	100.0
Farmersville*	31.04	31.52	1.88	8.49	23.34	3.74	100.0
Montebello	48.01	6.56	10.31	15.74	4.32	15.07	100.0
Pacifica**	29.26	21.39	4.94	7.22	23.61	13.58	100.0

*Farmersville was adjusted to remove enterprises from the non-enterprise activities.
**Pacifica uses 1978-79 data in place of 1977-78 data.

employees — partly because of generous retirement benefits — the shift toward greater emphasis on public protection tends to make city work forces more expensive. The implications for long-term cost control for cities is enormous: since pension costs associated with public safety employees are higher than for other employees, the pension issue will become more pertinent to future discussions of expenditure control in local government.

Los Angeles Case Study

The City of Los Angeles was examined in detail because of its significance in the state, and like many other cities, it has used taxing authority under the *Farrell* decision.

Revenues. Los Angeles has not only become less dependent on the property tax since passage of Proposition 13, it has also become less dependent on state and federal revenues (Table 12). These sources have been replaced by increased dependence on higher local taxes and fees-for-services.

Business license and utility users taxes were increased by $116 million in 1983. This came on top of substantial increases in the utility users tax as a result of higher utility bills. New sewer service charges required to finance federally-mandated water quality improvements accounted for the bulk of fee increases.

Expenditures. According to Los Angeles city officials, municipal services have been cut significantly since Proposition 13. The city has reduced its work force by 2,000, and parks and library services, maintenance, and equipment purchases have all been reduced. While many of these activities achieved true efficiencies, there have also been real service reductions.

Paradox? After increases in local taxes and sewer fees, the real per-capita level of city revenues in 1982-83 was about at the level of 1977-78 revenues. How is it then, as city officials claim, that real expenditures have been cut and services cannot be restored?

Table 12
Inflation Adjusted Per Capita Revenues in City of Los Angeles, 1977-78 to 1982-83

Revenue Source	Actual 1977-78	Budget 1983-84	% Change 1977-78 1983-84
Property Tax	$104.99	$59.12	-43.7%
Sales Tax	45.64	44.03	-3.5
Local Tax	62.08	98.44	58.6
Miscellaneous	34.62	39.40	13.8
Fees	26.76	48.87	82.6
State & Federal	80.11	59.60	-25.6
Total	$354.20	$349.46	-1.3%

Note:
State subvention for homeowner in business inventory property tax relief are included in the state and federal funds category.

Pension costs. This apparent paradox can be explained by the pattern of expenditures in the Los Angeles city budget. The City Council can exercise direct control over most programs in the budget. However, federally-mandated water quality standards virtually require sewer fee increases. And while improved water quality is certainly an improved service, this was not a priority determined by local officials.

The other major cost beyond control of Los Angeles officials is the expensive police and fire pension system. Retired and active members were provided full annual cost-of-living increases, which have had extraordinary impact on city retirement costs. Appropriations for police and fire pensions rose from $116 million in 1977-78 to $204 million in 1983-84, an increase greater than that needed to match increases in

salaries and staff over this period. These costs do not produce tangible services for city residents, but nevertheless must be honored.

Los Angeles voters have since approved two charter amendments to replace these costly benefits with more reasonable ones. However, it will take the city several decades to fully outlive the effects of pension benefits earned by past and current employees at the more generous rate.

A recent Supreme Court action, however, casts doubt on whether the Los Angeles charter amendments will stand. The court refused to hear an appeal in a case in which a lower court said retirement benefits for Pasadena city employees could not be capped. The City of Los Angeles is currently involved in litigation which will determine whether the rollback will be allowed.

Figure 12
% Change in City Revenues

1977-78 to 1981-82 (Non-enterprise)

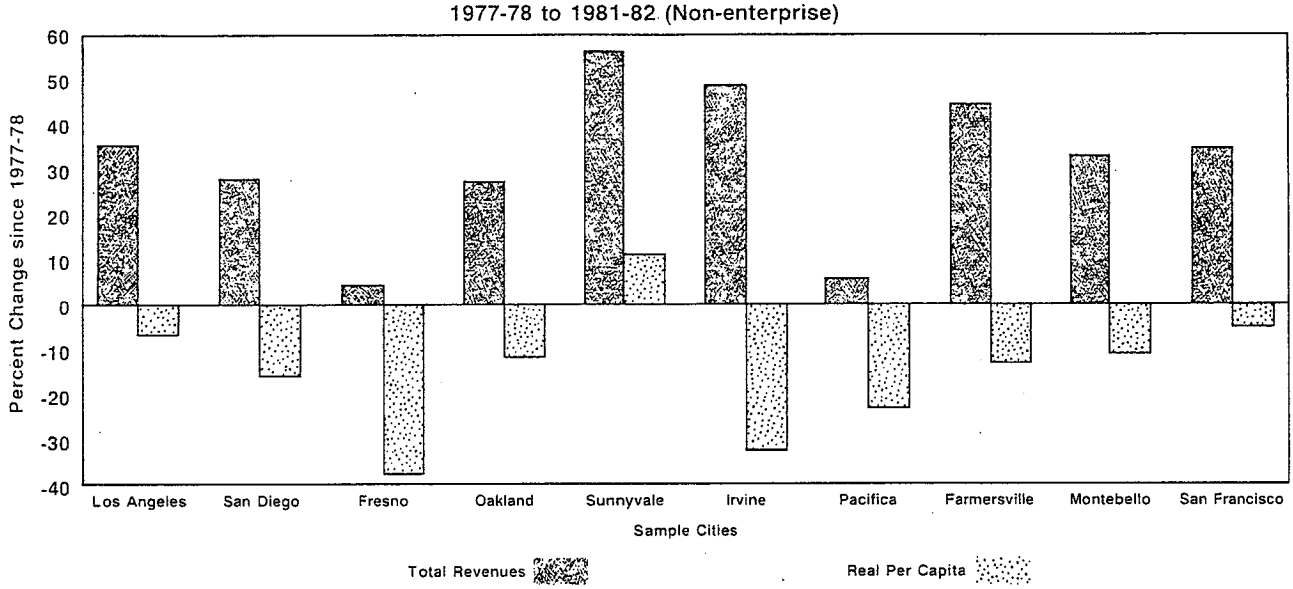
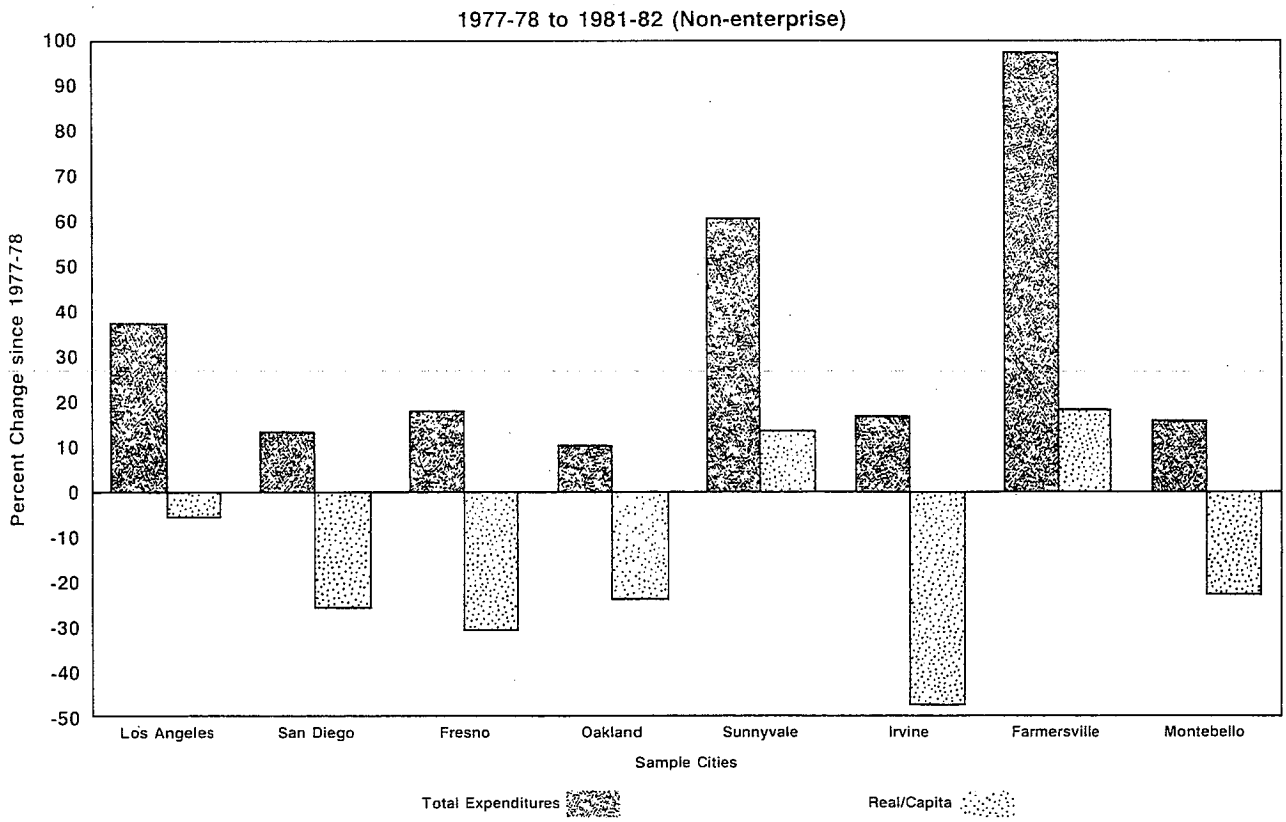


Figure 13
% Change in City Expenditures

1977-78 to 1981-82 (Non-enterprise)



VII

Enterprise Activities: The Part of Government Run Like a Business

Local government enterprise activities deliver services and are financed on a self-supporting basis through user charges.

In 1981-82, roughly 30% of city revenues and 13% of county revenues were generated by enterprises.

Enterprises are generally in good fiscal condition, with separate budgeting that imposes fiscal discipline.

Unlike other areas of local government, enterprises have been able to adequately finance their capital facilities.

The state constitution requires enterprises to treat surplus revenue from charges as taxes under their jurisdiction's spending limitation.

Enterprise activities of local government provide a variety of services financed by user charges. County enterprise activities among sample jurisdictions provide hospital, solid waste disposal, airport, recreation, and transit services. Enterprise activities in the sample cities provide water, sewer, airport, transport, solid waste disposal, port, and other services.

During fiscal 1981-82, city enterprises throughout the state accounted for 30% of city revenue, or $3 billion, and 13% of county revenue, or $1.5 billion. Among study jurisdictions, transit enterprises and wastewater treatment plants required federal, state, or local subsidies in addition to user charges to cover operating costs.

Officials in study jurisdictions described enterprise activities as in good fiscal condition because charges for services have been set to cover costs and could be increased as needed to keep up with rising prices. As an example, sharp increases in energy prices have forced utility enterprises to increase charges for service in recent years. Enterprises have also been able to cover overhead and capital costs through charge and rate structure.

Enterprise functions and capital plant survived the recession in reasonably good shape, generally for three reasons: separation from general fund budgets, self-support in operating and capital requirements, and a price structure that could be adjusted to meet service costs (but not without constraints — local resistance and the Gann limit).

VIII

Capital and Maintenance Issues

Capital spending, including spending for maintenance, with few exceptions has been reduced to levels local officials consider inadequate.

Capital spending has been best maintained for "self-supporting" enterprise activities.

Proposition 13 has reduced cities' and counties' capability to use current revenue to service debt or make direct payments for financing capital improvements.

Few officials foresee their jurisdictions increasing capital financing by reducing operating expenditures.

New financing techniques usually are not useful for funding community-wide facilities (such as jails) traditionally financed from broad tax revenues.

Public works spending began lagging prior to Proposition 13 — in part because, compared with other budget areas, cuts were less immediately visible and minimal constituency exists for public facilities.

As noted by a number of reports, California state and local governments have been part of a national trend of de-emphasizing capital and maintenance spending in annual budgets over the past 15 years. Evidence of that was found during this study. With a few notable exceptions, cities' and counties' capital and maintenance spending for general government activities was reduced.

Data indicates that capital spending as a percentage of total spending was lower in 1982-83 than in 1977-78 in six of the eight cities with complete data available, and in all five counties with complete data available.

Local officials said capital and maintenance projects were among the first items cut from local budgets in order to deal with fiscal limitations. They had difficulty funding new capital projects, equipment replacement programs, or major maintenance projects in the face of competing demands by operating budgets, such as police and fire services and employee compensation.

In cities, some important facilities are in good condition because, as part of enterprise activities, they have access to adequate capital and maintenance funds.

Capital Needs

County officials said that jails and related facilities were their highest priority capital need because of overcrowding and the prospect of even more demand for jail space to meet stricter sentences.

Other county capital needs were road and street construction and rehabilitation, non-hospital health facilities, general administrative offices, and vehicle fleet and heavy equipment replacement. These have no significant available funding through user charges and fees, but instead rely on support from taxes or intergovernmental revenues.

Cities' major categories of capital need included street construction and rehabilitation projects, storm drains, vehicle fleet replacement, major equipment replacement, and general government building — such as library, police, fire, and general city offices — construction and rehabilitation.

Road maintenance was a problem frequently mentioned. Gas tax revenue has not grown at a rate equivalent to inflation during the past 15 years. While they said the recent increase in the state gas tax will help, most local officials noted that the increase covers only a portion of their needs. In two sample counties this issue had been presented to the electorate: voters in Mendocino and San Diego counties failed to provide two-thirds majorities for "local option" one-cent increases in the gas tax to fund improved road programs.

Financing Alternative

Proposition 13 reduced pay-as-you-go and debt financing alternatives for facilities by eliminating use of new general obligation bonds and by reducing local revenues available to fund debt service or lease payments. Few jurisdictions showed a willingness to further reduce operating budget programs to free up money for public works financing.

As a result, local governments have looked much more closely at state and federal financing or private construction achieved through charges or developer agreements. These latter alternatives include: federal grants (a shrinking source) for such projects as sewage treatment plants or transit rolling stock; state bond act funds for jail facilities or parkland acquisition and development; use of federal tax incentives to involve private parties in sale and lease-back projects; and developer financing through fees, assessment districts, or a requirement of planning or zoning that developers build needed facilities and donate them to local governments. Local officials pointed out, however, that these techniques cannot usually be counted on to finance the earlier-mentioned communitywide facilities traditionally funded from tax-based revenues.

No Constituency for Capital Needs

A theme raised by city and county officials was the need to create a constituency for adequate public works funding. They said it was primarily their responsibility to be advocates for maintenance and capital funding.

Typical municipal and county financial statements do not

report an annual depreciation expense incurred against general fixed assets of local agencies. This reflects traditional, generally-accepted accounting approaches to local government financial reporting. As a result, decision-makers and the public are not shown the real costs when maintenance and capital spending are reduced or deferred. Several managers said that providing better information about these costs might be the first step toward building better public support and understanding of these unglamorous needs.

IX

On Carman, Farrell and Other Taxing Matters

Court rulings since Proposition 13 have resulted in major expansion of local revenue-raising powers.

Cities have greater immediate capability to use these new taxing powers than counties have, and have made greater use of them.

Business license, utility users, and transient occupancy taxes were taxes most frequently increased or newly-imposed under the decision (City and County of San Francisco v. Farrell) limiting application of Proposition 13's two-thirds vote requirement.

Cities maintain that tax increases would not have been necessary, or not as large, if state subventions had not been reduced under the threat of more drastic cuts triggered by the deflator.

Some local officials believe a property tax increase (authorized under Carman) is preferrable to a utility users or business license tax increase (authorized under Farrell), because the former is a broad-based tax capable of generating a relatively large amount of revenue with a relatively small rate increase while the latter requires a large (and potentially economically damaging) increase in order to become a significant revenue source.

Restoration of subventions, plus additional property tax funds from the new accelerated lien date law, would mean new money above city base expenditures — providing options of increased public works spending, reduced Carman or Farrell taxes, or increased operational expenditures.

Passage of Proposition 13 in 1978 marked a change in local government finance. It effectively removed the property tax from local control, and with this came reduction of local fiscal autonomy. The 1% property tax rate limit and two-thirds vote requirement for "special taxes" produced a drastic change in the way most local governments planned their fiscal affairs. Instead of totaling and approving or disapproving spending plans and then adjusting tax rates (if necessary) to finance them, local agencies had to shift to a system where revenues from uncontrollable tax sources were estimated, and spending plans shaped to fit the resources available.

State government's revenue system in the middle and late 1970s produced large annual surpluses or revenues over expenditures, enabling the state to begin massive fiscal assistance to local governments and schools to help fill the void created by Proposition 13.

In 1979, long-term fiscal relief legislation was enacted *(AB 8)* which included a so-called "deflator" clause requiring that state aid to local governments be reduced if the state's own revenues did not grow to meet specified targets.

This new finance system operated as expected during fiscal 1979-80 and 1980-81, but the recession made the "deflator" clause more than just a quaint piece of Sacramento jargon. The deflator clause threatened to reduce by a large amount the local revenues coming from the state. The cuts required by the deflator exceeded the amount required to balance the state's own budget, and the deflator was suspended. The cuts made in fiscal 1981-82, 1982-83, and 1983-84 were less than those the deflator formula required.

The annual exercise of making required cuts in local assistance has made city and county budget decisions dependent on the state's budget process. For cities in particular, this marked a dramatic change in their fiscal autonomy. The deflator mechanism forced them into the annual budget process in Sacramento because it made a portion of their revenues subject to redirection to the state in years when the state had fiscal difficulties.

Court Rulings Modifying Proposition 13

In 1982, two California Supreme Court rulings made important changes in limits on local taxing powers enacted by Proposition 13.

In *Carman v. Alvord*, the court ruled that the City of San Gabriel was entitled to levy a property tax above the 1% rate limit in Proposition 13 to pay its contributions to the state Public Employees Retirement System (PERS). The decision was based on the initiative's provision allowing a rate above the limit to pay costs of "any indebtedness approved by the voters" prior to passage of Proposition 13.

This ruling opened what many called a massive "loophole" in Proposition 13's limit on property taxes. Among the sample jurisdictions, seven of ten cities and five of seven counties believe they are eligible to increase property taxes under *Carman*. Two cities and one county in the sample (Montebello, Oakland, and Santa Clara County) are currently levying such a tax. In 1983, several jurisdictions in the sample planned to use their taxing powers under *Carman* to replace reduced state funds with property tax revenues. Los Angeles, for example, planned to raise $141 million this way.

Further action in using the *Carman* decision to raise

revenue was effectively blocked in 1983, after it was realized that the *AB 8* property tax allocation required cities eligible to levy a higher tax under *Carman* to reallocate a share of their basic 1% property tax revenues to other jurisdictions. The threat of this effect under existing law was enough to make the City of Los Angeles retreat from its earlier proposal and lead the state Legislature to declare a two-year moratorium *(AB 377)* on further use of the *Carman* property tax and block any refund shifts of prior-year property taxes local jurisdictions might otherwise be required to make. Given the extent of local pension obligations, the final resolution of this issue will have a major impact on local finances until the year 2000.

The *Carman* decision did not itself provide a full answer to two questions: (1) Which jurisidictions are entitled to use its added taxing authority? and (2) To what extent may the tax be applied to fund current and future pension costs?

What if a jurisdiction's voters had approved a system but not a tax? The answer came in *Valentine v. City of Oakland* when an appellate court said that a vote on the system alone was sufficient. How specific did the description of the pension plan have to be when presented to the voters in order to meet the court's test in *Carman?* Early in 1984, a superior court in Fresno rejected the City of Fresno's attempt to levy a tax under *Carman* because voters in 1957 had approved a charter amendment authorizing the council to establish a retirement fund, rather than the retirement system later established by ordinance.

These cases illustrate one set of problems stemming from the *Carman* decision. If the two-year *Carman* prohibition is simply lifted, how many additional court tests will be necessary to determine the varieties of voter approvals that qualify a jurisdiction to use the added tax rate?

Does *Carman* allow a tax increase to fund the benefit levels beyond those in existence at the time of voter approvals, or at Proposition 13's passage? In the subsequent *Watsonville* decision, the City of Watsonville was permitted to tax above the 1% cap to fund additional benefits granted after the proposition's enactment.

The potential of expanding the *Carman* rationale — that is, a contractual obligation raised to the status of indebtedness — is only beginning to be explored by local governments and the courts.

Before allowing the two-year moratorium on the use of *Carman* to lapse, the Legislature will have an opportunity to consider these uncertainties, and the issue of pension costs themselves, in determining how much legislative control should be restored in this area of taxation.

The Farrell Decision

In August 1982, the California Supreme Court issued an opinion that opened another "loophole" in tax limitations imposed by Proposition 13. In *San Francisco v. Farrell,* the court held that Proposition 13's two-thirds majority vote requirement did not extend to taxes producing revenue to the general fund for general governmental purposes. The court specifically rejected the argument that the term "special taxes" in Proposition 13 meant any change that produced additional tax revenue. San Francisco could levy its tax increase without any vote of the electorate. With Proposition 13 inapplicable, no other existing provision of law required the increase to be submitted to the voters.

The result of this ruling was a major expansion of local revenue-raising powers. Eight of the ten sample cities and two of the seven sample counties have increased or established new taxes under *Farrell* authorization.

Greater use of the new taxing authority might be expected among cities, because charter cities (and general law cities since 1982) have much broader revenue-raising options than do counties. Cities can increase lucrative business license taxes and utility users taxes under the *Farrell* decision, while counties cannot.

Among sample cities, only San Diego and Sunnyvale chose not to levy additional taxes. In San Diego's case, this was attributed to the City Council's choice to restrain local spending, rather than to increase taxes.

In Sunnyvale, strong growth in property and sales tax bases, and other local revenue sources made increases unnecessary. The city's voters gave two-thirds majority support to an increase in the hotel/motel tax, but the increase has not been levied. Sunnyvale was the only sample jurisdiction that gave local taxpayers a tax refund during the past five years, in this case a $1.1 million property tax refund.

Two sample jurisdictions reported tax rate reductions during the past five years: San Francisco eliminated residential utility users taxes after it was successful in the *Farrell* case; and Fresno approved an initiative repealing the city's utility users tax.

Apart from Santa Clara County, which increased property taxes to pay costs of pension obligations, only two counties reported they had increased *any* taxes since 1978 (Mendocino and Santa Barbara) and these were relatively minor taxes.

In several cases, city staff members thought property tax increases based on *Carman* authority would have been the preferred means of raising revenues. They said property taxes are a more broadly-based form of taxes than business or utility users taxes. They also said the deductibility of property taxes from state and federal income taxes helps reduce the effective tax burden on individuals, while utility users taxes on individuals are not deductible. Officials in most cities were concerned about business tax increases reducing the competitive position of their cities in attracting and retaining businesses.

Other Tax Issues of Concern

Several sample counties raised the issue of uneven distribution of local tax bases among cities and counties, pointing out that even if counties were allowed to levy utility users taxes and business license taxes, they would not necessarily prove to be significant revenue sources.

The two cities in the sample with weak tax bases, Farmersville and Pacifica, also raised the question of whether state policy would address revenue needs of communities such as theirs, which lack strong property and sales tax bases because they are primarily communities whose residents work and shop in neighboring cities.

Several sample urban counties were concerned about revenue effects on counties because of redevelopment by cities. The counties of Riverside, San Diego, and Santa Clara all had strong concerns about extensive redevelopment by certain cities in their areas.

Counties object to excessive redevelopment (particularly on vacant land that counties think would be developed without the economic incentives possible under redevelopment) which directly reduce their property tax revenue. Counties are also concerned about the potentially unlimited life of redevelopment agencies made possible by expansion or new projects.

Cities argue that while there may be individual abuses of redevelopment, most projects are legitimate efforts to rebuild blighted areas or develop land that could not otherwise be developed without public expenditures made possible by

redevelopment. They maintain that redevelopment is one of the few effective capital project financing tools available after Proposition 13.

The issue has been subject to extensive legislative debate in recent years and is likely to remain on the agenda for the foreseeable future.

New Revenue

Interviews and review of local budgets and financial statements showed that the jurisdictions which *did* raise taxes did so to prevent further reductions in local services rather than to restore services to pre-Proposition 13 levels. Cities often said such tax increases would not have been necessary or would not have been so large if it were not for the recent cuts in state subventions.

Elimination of the deflator and an end to cuts in traditional subventions would produce (all other factors held constant) an increase of between $280 million and $300 million in revenues for cities alone in 1984-85.

Such an increase raises the question of how local governments will use this additional revenue. Will all or part of it be used to reduce or repeal tax increases instituted under the *Farrell* decision? Will the "fiscal dividend" be used to expand services or improve employee compensation? Will some of it be used to address critical capital and maintenance needs?

X

Problems, Opportunities and Strategies: How Local Governments Adjusted to the New Fiscal Order

There is a general mood of optimism on the part of local officials in this study about the near future financial condition of their jurisdictions.

When these jurisdictions are divided into categories based on ease or difficulty of transition to revenue constraints, patterns emerge regarding tax and spending policy and managment style, as well as economic and demographic characteristics.

Local managers said Proposition 13 forced important spending reforms.

Actions by state government, the courts, and factors at the local level have continued to have serious impacts on local cost control efforts.

An important purpose of this study is to learn more about how local governments have dealt with the revenue constraints of recent years. The sample jurisdictions provided a variety of experiences.

A surprise finding from interviews in jurisdictions was a general mood of optimism about the future. This was because of the following reasons:

- Officials think that local fiscal conditions have hit bottom and will now show improvement.
- Revenue constraints of Proposition 13 have been accepted and adjustments have been made to live within available resources.
- An improved economy, together with moderation of inflation, have improved local budget outlooks.
- Local officials are heartened by commitment of the governor and Legislature to enact new and permanent local financing.

Hard and Soft Landings

For analytical purposes sample jurisdictions can be divided into two groups: one that has had a smooth transition to fiscal constraints — referred to as soft landings — and one finding greater difficulty making the transition — referred to as hard landings.

Characteristics of jurisdictions with soft landings are: below-average property tax rates before Proposition 13; a preference for leaner government; necessary adjustments to cope with revenue constraints implemented without delay; support for strong professional managers taking Proposition 13 seriously; and strong economic and demographic characteristics, such as low unemployment, low welfare populations, expanding business centers, and relatively affluent populations.

Characteristics common to some jurisdictions with hard landings are: higher-than-average property tax rates before Proposition 13, resulting in greater loss of revenue; hard-to-control cost structures; postponement of adjustments to new fiscal order through one-time revenue devices, such as use of fund balances, delay of maintenance and capital projects; and less favorable economic and demographic trends (e.g. rising unemployment and influx of refugees).

Positive Impacts of Revenue Constraints

Nearly every local manager interviewed said that revenue constraints resulting from Proposition 13 and the recession had a positive impact of forcing local decision-makers to re-examine spending policies and priorities. Los Angeles made important changes in its city charter, dealing with expensive safety employee pension benefits, and in prevailing wage requirements. Unless reversed by the courts, these measures have halted uncontrolled growth in key spending categories.

Every jurisdiction in the study pointed to productivity and cost-control efforts, as well as to strategies to raise revenue outside the tax system. Frequently mentioned in the area of productivity and cost control were: incentive pay plans, work measurement and productivity improvement programs, functional and organizational consolidations, contracting out services, control of disability retirement costs by rehabilitation and reemployment of disabled workers, self insurance, and energy conservation. Several jurisdictions have improved tax, fee, and debt collection, together with more productive investment of public funds and use of public assets.

Other Impacts on Local Cost Control

Actions by state government, court mandates, and factors at the local level have created serious obstacles for local managers as they attempt to control costs.

- Tort liability of local agencies has become an increasingly difficult financial problem as cities and counties are named in law suits because they are viewed as "deep pockets" able to pay generous awards.
- State mandates in health and welfare have become very expensive for counties. Unreimbursed workers' compensation, benefit level increases, rehabilitation costs, and presumptions relating to employee injury or illness have become significant

long-term costs.

- A threatened binding interest arbitration mandate for public safety employees was the basis of universal concern regarding higher costs and loss of fiscal control.

- Few jurisdictions in the sample indicated they were able to engage in any long-range fiscal planning because of sweeping fluctuations in federal and state subventions, as well as lack of analytical staff for forecasting.

- A view by some local governing boards that their role is more of ombudsmen than managers on many issues dealing with residents and public employees.

XI

Policy Choices for Local Government Finance

The current legislative session could be a major turning point in the structure of post-Proposition 13 government finance in California. Formally committed by *AB 895* in 1983, the Legislature has promised to enact a permanent system of local government finance during 1984. Governor Deukmejian has also indicated willingness to deal with this difficult issue. He created a task force to examine local government finance and has introduced a plan to provide a permanent solution to city and county financial problems. The Democratic leadership of the Legislature has also offered a proposal.

In addition to these formal proposals, other unresolved issues include disposition of property tax overrides for pension debt, an issue that was temporarily dealt with in *AB 377* of 1983. The improved state economy and increase in state revenue now permit the state to seriously consider a permanent solution to local government financial instability. Ironically, recovery also creates conditions to let solutions be postponed.

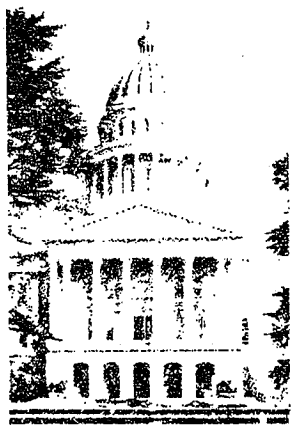
In the background is a new initiative constitutional amendment sponsored by Howard Jarvis. This measure is referred to as Jarvis IV, intended to address a number of court-created loopholes in Proposition 13. Specifically, it would repeal court-awarded ability to raise local taxes without a two-thirds vote, as authorized in the *Farrell* decision. It would also repeal the *Carman* decision, which allows local governments to increase property taxes to pay costs of voter-approved pension obligations. In addition, it would roll back assessed values for certain properties for the period from 1975 through 1978.

The legislative analyst has estimated that refunds with interest triggered by this roll-back would be $1.29 billion. The initiative would require ⅔ voter approval of any increases in local government fees exceeding the annual increases in cost of living. It would also prohibit sale of unissued general obligation bonds. The initiative, if approved by voters, would have major impact on how cities and counties finance local services.

In discussions with local government officials during this project, it became obvious that the issues this year revolve around a number of key policy questions, which are:

- In an era of statewide fiscal control, can local government autonomy and home rule survive?
- With local governments more reliant on "one big budget" at the state level, can — should — local jurisdictions be insulated from budget cuts and provided stable, predictable funding sources that are guaranteed in some manner?
- How should court-awarded authority to increase local taxes *(Farrell* decision) and levy additional property taxes to pay for public employee retirement costs *(Carman)* be altered?
- Who should decide questions of local tax increases, and what should approval requirement be? Should approval be by vote of governing boards, either majority or two-thirds? Or should approval be from local voters with a majority or two-thirds vote?
- Is it possible to fashion a system of local finance that begins to restore home rule, that permits efficient response to local cost problems, and yet retains popular control over growth in local tax burdens?
- What can be done at state and local levels to encourage and facilitate management efforts to provide services more economically and thereby reduce the demand for additional revenue?
- How should the question of economic differences between local jurisdictions be addressed in any new financing plan? Should financing plans recognize differences in local tax wealth and attempt to equalize — or at a minimum prevent — further disparity?

The purpose of these questions is to help determine basic outlines of policy preferences in local government finance. By answering these questions systematically, it is possible to arrive at a position with respect to various finance proposals being debated in California. These difficult questions are at the core of governmental policy in a federal republic. They bear on the issue of how the public can reconcile its desire for strict tax and expenditure limitation with its long-held beliefs in local autonomy and democratic majority rule.



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