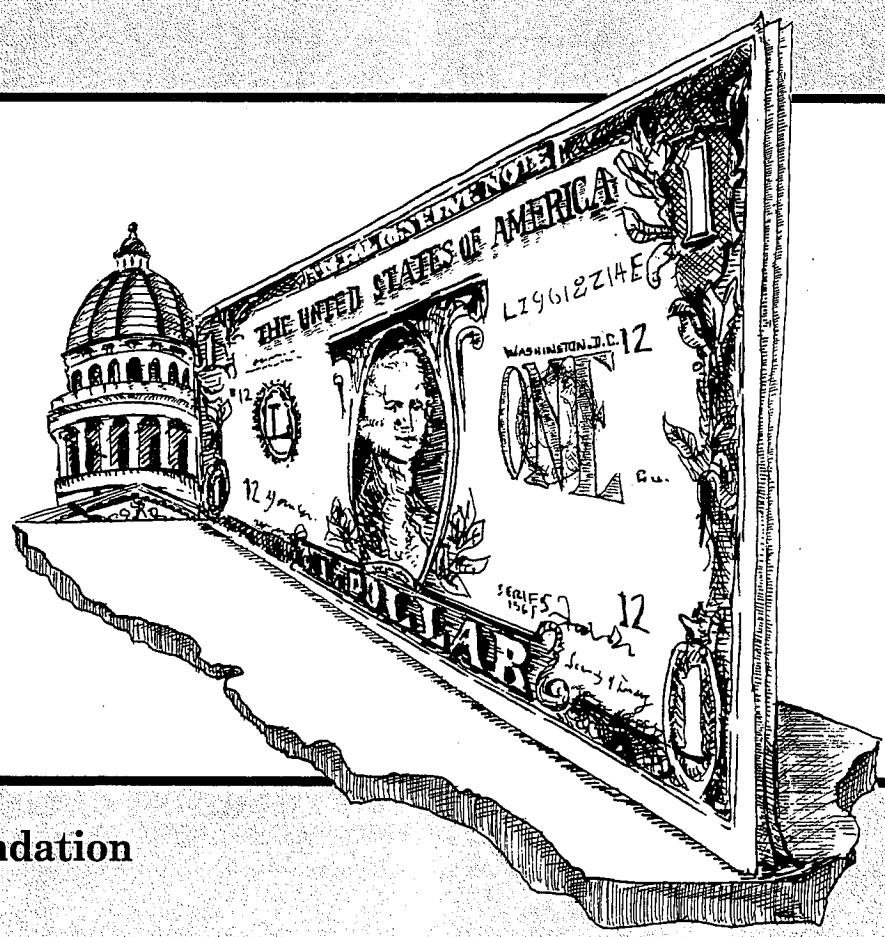
California Local Government Finance:

Issues For The 80s



California Tax Foundation Study

Sponsored by The California Roundtable

Part 2

California Tax Foundation

Officers

C.S. Reenders, President

Glen M. Furlow, Vice President

William G. Combs, Secretary

Arthur T. Cooke, Jr., Treasurer

Larry McCarthy, Director

Trustees

Miles H. Bresee, Jr.*
Bechtel Power Corporation
San Francisco, California

Richard Carpenter
League of California Cities
Sacramento, California

William G. Combs
Longs Drug Stores
Walnut Creek, California

Arthur T. Cooke, Jr.
Bank of America, N.T. & S.A.
San Francisco, California

Wallace A. Erickson
J.G. Boswell Company
Los Angeles, California

Glen M. Furlow
United States Steel Corporation
San Francisco, California

Robert C. Kirkwood
Hewlett-Packard Company
Palo Alto, California

Lewis D. Lawrence
Union Oil Company of California
Los Angeles, California

Eugene C. Lee
Institute of Governmental Studies
Berkeley, California

Malcolm A. MacKillop
Pacific Gas & Electric Company
San Francisco, California

C. Erwin Piper
Studio City, California

C.S. Reenders
Southern California Edison Company
Rosemead, California

Richard P. Simpson
California Taxpayers' Association
Sacramento, California

Dayton G. Southard
The Copley Press, Inc.
La Jolla, California

Oliver A. Thomas
Walnut Creek, California

*Mr. Bresee resigned from the Foundation January 1984.

The California Tax Foundation is a publicly supported, non-profit, non-partisan statewide organization which conducts research and provides education on behalf of the California Taxpayers' Association. The Foundation performs, commissions, and supports independent fiscal and economic research and analysis of government revenue and expenditure policies.

Opinions and conclusions expressed in the Foundation's publication are those of the authors and do not necessarily reflect the views of the Cal-Tax Foundation, its Officers or Trustees, or organizations and individuals supporting its research.

California Local Government Finance: Issues For The 80s

May 1984

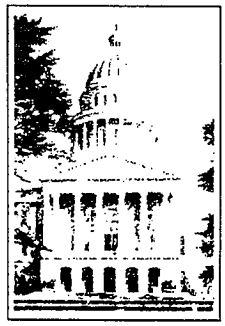
This publication was funded by a grant from the California Roundtable.

California Tax Foundation
Sacramento, California

© Copyright 1984 by the California Tax Foundation

Table of Contents

		Page
	Introduction	i
Section 1: Local Government Spending Issues		
	Executive Summary Findings	iii
I	Public Employee Retirement	1
II	Workers' Compensation and Disability Trends	11
III	Collective Bargaining Trends	19
IV	Trial Court Costs	29
V	Public Works: An Unmet Local Priority	33
VI	Reimbursement of State Mandates	35
VII	Tort Liability: Cost Climbs as Exposure Expands	39
Section 2: The Power to Tax — Local Government Taxing Authority and Experience in California		
	Preface	41
	Executive Summary Findings	43
I	Overview of Taxing Authority	47
II	Voting in California	51
III	National Survey of Local Tax Enactments Procedures	55
IV	Utility Users Tax	59
V	Business License Tax	63
VI	Non-Ad Valorem Property Tax	67
VII	Transient Occupancy Tax	69
VIII	Property Tax Overrides (Carman Tax)	71
IX	Other Taxes	75
Section 3: Jarvis IV Initiative		
	Introduction	77
	Local Government Finance and the New Jarvis Initiative	79



Copies of this publication may be purchased from the
California Tax Foundation for $5.00
Address orders and inquiries to the
Cal-Tax Foundation
921 11th Street, Suite 903
Sacramento, California 95814
(916) 441-0490

Introduction

Publication of Part 2 of *California Local Government Finance: Issues for the 80s* concludes a research project started by the California Tax Foundation in April 1983. This second installment of the study done for the Foundation by the staff of the California Taxpayers' Association contains specific additional information on important city and county tax and spending issues. Many problems covered in this report were identified in Part 1 of the study, which looked closely at financing problems facing a sample cross-section of California cities and counties. Information in this report provides full discussion and background information on these problems as well as proposals for responding to problems, that have been identified.

Part 2 contains three sections:

Section 1 — Local Government Spending Issues describes spending reforms that offer an opportunity for closing potential local revenue gaps.

Section 2 — The Power to Tax: Local Government Taxing Authority and Experience in California explores local taxing authority, especially related to court decisions interpreting Proposition 13's restrictions.

Section 3 — Jarvis IV Initiative analyzes and assesses the impact on local governments of an initiative by Proposition 13 co-author Howard Jarvis, to be voted on November 6, 1984.

Most local government finance studies are devoted to the revenue side of the budget equation. They ignore the possibility that there can be management options available for dealing with revenue shortfalls. With most attention focused on revenue trends and the revenue loss of Proposition 13, the perception is that fiscal problems are solved only by more revenue. The first section of this report looks at seven major local cost issues that represent high-priority spending problems cities and counties face. Numerous recommendations for lower-cost solutions to these problems are identified.

Sections 2 and 3 bring together in a comprehensive manner important information on city and county tax authority. Changes resulting from Proposition 13, and court decisions, are discussed in detail, together with modifications that would be made by the Jarvis initiative. Although not part of the original study design, analysis of the Jarvis initiative is included in this report because it is the most important local government finance issue to be decided this year. Approval of this initiative would have an enormous impact on local governments' ability to finance many essential services now provided.

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 the 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. Of major concern to Cal-Tax was the insufficient information and inattention given to the potential of spending reforms for resolving local government finance problems.

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

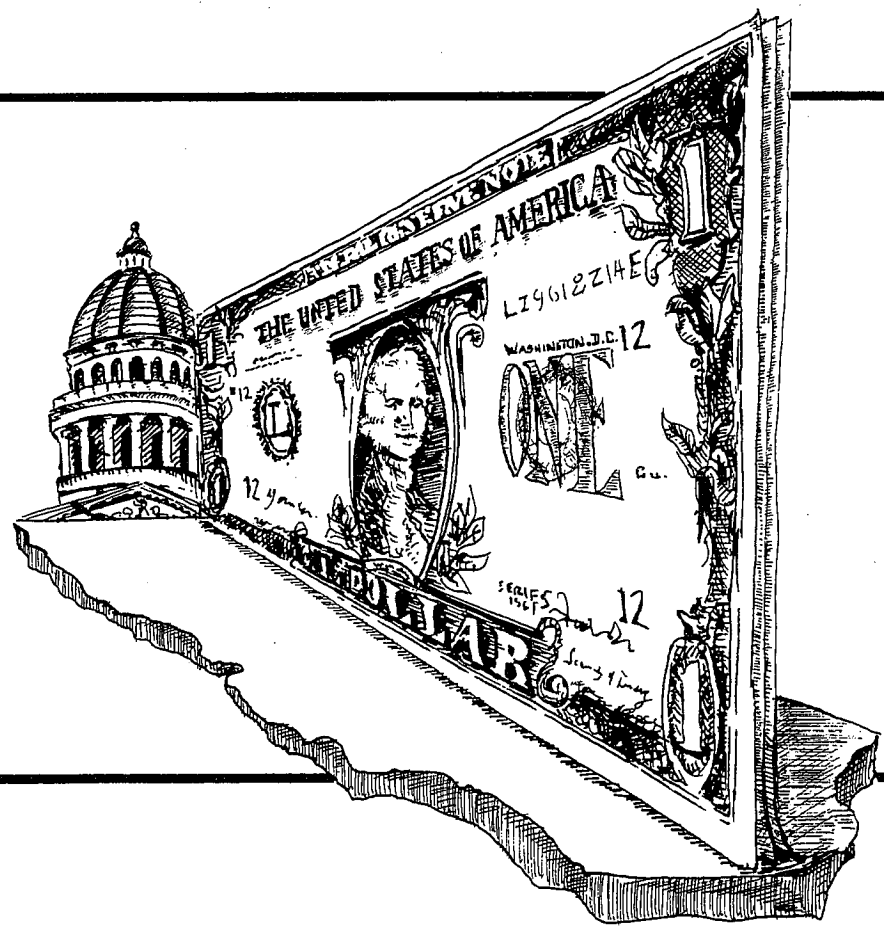
Part 1 of this study is a comprehensive, in-depth review of the financial condition of 17 cities and counties. This 174-page report was done for the California Tax Foundation by the accounting and consulting firm of Price Waterhouse. Jurisdictions included in the study were chosen as a cross-section of local government in the state. They were selected in consultation with the League of California Cities and County Supervisors Association of California. The study jurisdictions represent a variety of sizes; young and old; rich, poor, and average revenue bases; from each geographic region; and charter and general law governments.

Study jurisdictions provided seven years of financial information as well as information requested by supplementary questionnaires. After an analysis was done of this information, interviews were conducted with 85 local officials in these jurisdictions to gain a deeper understanding of reasons for budget choices made during this period. It is important not only to know the financial conditions of the jurisdictions, but to recognize the forces working upon local policy-makers deciding budget issues. Part 1 of this study provides this information.

Funding for this research project was provided by the California Roundtable, Tenneco West, and Chevron USA, Inc. We express our appreciation to them not only for the financial assistance, but for their foresight in recognizing a problem that needed examination.

Larry McCarthy
Staff Director
Cal-Tax Foundation

Local Government Spending Issues



Section 1

Executive Summary
Findings

Chapter I. Public Employee Retirement

Local government retirement plans provide benefits considerably richer than benefits available in private employment, and, according to retirement experts, are more generous than necessary to maintain employees' pre-retirement standard of living. General employees who work a full career for a city or county and retire at age 65 can receive more than 100% of salary from the local retirement system and Social Security. Safety employees (police and fire personnel) are encouraged to retire with full benefits (50% of salary) as early as age 50. Local government contributed $1.3 billion for these benefits in 1982.

Reduced retirement benefits for prospective employees have been successfully implemented in three counties and in Los Angeles County, the new benefit structure resulted in a reduction of $175 million in the county's unfunded liability. Employees have shared in savings resulting from adoption of alternative plans. The second-tier benefit, as alternative plans are called, was either non-contributory or at a reduced cost to employees as well as to the local jurisdiction.

Legislative authorization is necessary before reduced alternative benefits can be made available to the 1,220 local jurisdictions that contract with the Public Employees Retirement System (PERS) for benefit administration. A similar law change is required for other non-PERS counties to be able to offer second-tier plans. Recent attempts to enact such legislation have not been successful due to employee organization opposition.

Chapter II. Workers' Compensation and Disability Trends

Local government injured worker costs have gone out of control. The City of Los Angeles, for example, faces a $63.3 million obligation to 34 law enforcement personnel retired for disability in a single year. Estimates of total annual expenditures for local government workers' compensation and injury-related costs range as high as $1 billion — and disability retirement costs, at $300,000 to $500,000 per case, are in addition to that amount.

Benefits available to injured local government safety employees and some miscellaneous employees can be a disincentive to return to the workforce because

payments exceed 100% of salary. Certain illnesses — heart trouble, hernia, tuberculosis, pneumonia, and cancer for firefighters — are presumed to be work-related and therefore compensable, even though the condition may have pre-dated public employment or be the result of normal aging.

Several cities and counties have attempted to control escalating workers' compensation and disability retirement costs by retraining and reassigning injured workers, by screening job applicants for potential health problems, and by promoting safety at the work site. According to local government risk-management officials, however, effective management of disability costs will be acheived only when existing legislative barriers are removed.

Chapter III. Collective Bargaining Trends

In the past 20 years, major changes have occurred in local government employer-employee relations with enormous cost consequences for local taxpayers. The right to negotiate wages, hours, and terms and conditions of employment was granted local government employees in 1968. Many jurisdictions that had pre-existing prevailing wage requirements were faced with granting employees either the surveyed prevailing wage or a higher, negotiated increase. Further, bargaining rights were in addition to tenure and other employment rights already guaranteed by local government civil service systems.

Additional legislation and court interpretations of the 1968 collective bargaining law have imposed a full-blown negotiation obligation on local governments, many of whose management personnel also have bargaining rights, and whose elected officials sometimes view their role not as management but as arbitrators between management and employees. In addition to management constraints, agency shop, to insure the position of employee organizations, can be negotiated. In local elections, these employee organizations are often the only active campaigners, contributing time and financial support to candidates who act favorably in their interests.

Proposals to modify the relationship between public employees and employers continue to be submitted to the Legislature. Enactment of these proposals — binding interest arbitration, agency shop for management personnel, and administration of labor disputes by the Public Employment Relations Board — would have yet greater cost consequences for local agencies.

Chapter IV. Trial Court Costs

Administration of trial courts represents a serious underfunded mandate for counties that is becoming a major strain on their budgets. County funds represent $9 out of every $10 going to operate trial courts.

Three approaches can be taken to reduce the burden of trial courts for counties. First, costs can be held down through procedural and other reforms of the judicial process. Second, court revenues can be increased by raising fees, surcharges, and fines from those using the court system and retaining of a greater share of these revenues for court financing. Third, state funding of courts can be increased.

Additional state funding for trial courts should be pursued, but only where the additional state cost is held to a minimum by enactment of efficiency reforms and state receipt of court fines and forfeitures to the extent that local law enforcement and collection incentives are not adversely reduced.

Chapter V. Public Works: An Unmet Local Priority

California's public works systems represent an enormous investment in public funds that is not being maintained, rehabilitated, and expanded to meet current and future needs. Adequate public facilities are vital to the state's continued economic health.

Problems of financing public facilities have developed in recent years because spending cuts in this area are invisible in the short-term, and thus are easily made by

local elected officials to adopt, and fiscal constraints make it nearly impossible to squeeze more funds for public facilities out of operating budgets.

Solutions to the problem require restoration of a public works priority in local budgeting by focusing attention on the importance of investment in this area and the damage done by funding deficiencies. Private sector cooperation on this matter and authorization of various additional local and state funding methods for public works are also vital for resolution of the problem.

Chapter VI. Reimbursement of State Mandates

Despite the nation's most highly developed, elaborate, and systematic process for reimbursement of costs mandated upon local agencies by the state, fewer than 10% of such mandates are funded in California. Mandate reimbursement started 12 years ago in California, and now includes constitutional as well as statutory requirements, and an appeal process before an administrative board.

Two recent court decisions side with local agencies on the mandate issue, one calling an unfunded mandate void, and the other requiring the state to fund the mandate.

A partial solution to the unfunded mandate problem would be achieved by statute or constitutional amendment making mandates permissive for local agencies, unless funded. Such a requirement would provide clear direction for the courts and a remedy for local agencies.

Chapter VII. Tort Liability: Costs Climb as Exposure Expands

Local governments have become increasingly vulnerable to "deep pocket" law suits in recent years. Due to the operation of the rule of "joint and several liability," these local agencies have had to shoulder the lion's share of judgments in cases where they are only partially to blame.

Surveys show that costs of lawsuits have escalated at a rapid rate in recent years. Operation of transportation and recreation facilities, as well as other services provided by local agencies, result in tremendous liability.

The solution to the problem is to protect local agencies by statutorily defining their liability in specified areas, and establishing that damages be allocated based on share of fault.

I

Public Employee Retirement

Local government retirement benefits are excessive. Compared with pensions available to private sector workers who are employed 30 years with the same employer, benefits for the public worker employed by a city or county for an equivalent period can be 50% more generous. In some situations, the retirement benefit can be 120% to 130% of salary.

Reducing retirement benefits is one way to cut government expenses without cutting government services. Three counties have implemented alternative retirement benefits equal to the best private sector pension plans, and savings already realized are in the millions; no services have been cut.

In counties where reduced alternative retirement benefits have been made optional to current employees, many workers have switched to the new basic plan because it is non-contributory and they received their retirement contributions plus interest upon joining the new plan.

The current unfunded liability for California local government retirement systems is more than $10 billion, which works out to approximately $27,000 per member.

Alternative reduced retirement benefits for local government systems can only be established by the Legislature, although richer benefits may be — and are — granted by local jurisdictions without legislative approval.

The Problem

In the years since the 1930s and 1940s, when retirement benefits for California local government employees began to be widely offered, benefits levels have increasingly become separated from policy considerations about adequacy or appropriateness. Instead, pensions have come to be viewed as a fringe benefit, and enhancements that have little to do with pension theory have been negotiated or legislated.

The result: retirement plans which provide benefits far in excess of what many retirement experts believe is needed for adequate retirement income.

For example, a Los Angeles County employee retiring in 1981 at age 65 with 30 years service, and whose final monthly compensation was $2,500, received a total of $2,319.85 per month from Social Security and the county retirement system. That was 93% of the employee's monthly salary.

For lower wage earners, the return ratio was even greater. An employee earning $1,500 per month (age 65, 30 years service) received combined Social Security and retirement payments of $1,548.15, 103% of final compensation.

The Los Angeles County example is not unique. Most of the other 19 county retirement systems that are governed by the 1937 Retirement Act have benefits equal to or better than the basic Los Angeles County plan. By way of comparison, the Los Angeles County plan providing the benefits in the above examples values each year of service at 2.61% for those retiring at age 65. Thus, for 30 years service, the county pays the individual 78.3% of salary. This is *exclusive* of Social Security benefits. Table 1 shows the percentage of final pay due an employee retiring at age 65 after 30 years of service from counties under the 1937 Retirement Act. The right column indicates if Social Security is available due to county service.

Benefit Administration

The 20 counties covered by the 1937 Retirement Act account for 32% of all members of California local government retirement systems. In addition, a number of large cities (including Los Angeles, Oakland, San Francisco, San Jose, San Diego, Fresno, Richmond, Pasadena, and Sacramento) and two counties (San Luis Obispo and Trinity) maintain independent retirement systems. These separate systems, together with virtually every major transit district, comprise 36% of active members of local government. For the remaining jurisdictions, the administration of retirement benefits is by the Public Employees Retirement System (PERS). In 1983, there were 1,220 public agencies under PERS contract in the general classes indicated in Table 2.

The basic benefit package available to contracting public agencies for general employees of local government is a 2% at 60 formula, the same PERS benefit formula available to state employees. Under it, an employee, age 60 with 25 years of service, will receive 50% of final compensation; at 65, after 30 years service, the benefit is 72.5% of final compensation, *exclusive* of Social Security payments.

Social Security

At its inception in 1935, Social Security was scheduled to be one leg of a three-legged pension stool. Social Security income was supposed to supplement the pension from the work place and also the employee's personal savings.

Today there is confusion about which pension — Social Security or the public worker's pension — supplements which. The most frequent 1937 Retirement Act formula targets a 78% replacement rate at age 65, exclusive of Social Security. The Social Security replacement rate projected for single workers at that age ranges from 25% to 58% (Table 3).

Table 1
Benefits as a Percent of Final Pay
1937 Act Counties

County	Number of Active Employees	% Benefit age 65 after 30 years service	Social Security Coverage
Alameda	7,897	78.6%	Y
Contra Costa	5,976	78.3	Y
Fresno	5,534	78.6	Y
Imperial	969	78.3	—
Kern	5,232	72.9	Y
Los Angeles	66,936	78.3 (Plan A)	Y/N*
Marin	1,822	78.3	—
Mendocino	806	78.3	Y
Merced	1,752	78.3	Y
Orange	12,673	78.6	—
Sacramento	6,595	72.9	Y
San Bernardino	8,045	93.9	—
San Diego	11,016	78.6	Y
San Joaquin	3,261	78.3	Y
San Mateo	3,700	72.9	Y
Santa Barbara	2,845	72.9	Y
Sonoma	2,521	78.6	Y
Stanislaus	2,580	78.6	Y
Tulare	1,970	78.3	Y
Ventura	4,646	78.3	Y

*Effective 1/1/84, Los Angeles County no longer covered by Social Security.

Source: SCO Annual Report of Financial Transactions, Public Retirement Systems, 1981-82.

Table 2
Public Agency Contracts

	Total
County Superintendents of Schools (for 1,118 school districts)	57
Los Angeles City Schools and Community College Districts	2
Los Angeles and San Diego County Superintendent of Schools - School Service Fund	2
Cities	377
Counties	35
Districts and Other Agencies	747
Total Public Agency Contracts	1,220

Source: PERS Annual Report, 1983

Combining these projected rates, the initial benefit levels are often in excess of earnings (Table 4).

Private Sector Plans

Private sector plans avoid such excessive benefit levels by integrating Social Security and the company plan. Table 5 compares 1982 replacement rates of six integrated company plans available in California with the most frequently used 1937 Retirement Act formula for non-safety employees.

Table 3
Social Security Replacement Rates*

Year of Retirement	Minimum Wage Earner	Average Wage Earner	Earnings Equal Social Security Base
1984	57.6%	43.7%	26.5%
1985	56.0	42.5	25.6
1986	55.4	42.1	25.3
1987	55.4	42.2	25.3
1988	55.3	42.1	25.4
1989	55.0	41.9	25.4
1990	54.7	41.7	25.3
1995	54.2	41.4	25.3
2000	54.2	41.5	25.7

*Assume employee worked from age 21 through 64.

Source: Social Security Administration

Table 4
County Benefit Plus Social Security

Year of Retirement	Minimum Wage Earner	Average Wage Earner	Earnings Equal Social Security Wage Base
1984	135.6%	121.7%	104.5%
1985	134.0%	120.5%	103.6%
1986	133.4%	120.1%	103.3%
1987	133.4%	120.2%	103.3%
1988	133.3%	120.1%	103.4%

Sources: Social Security Administration, Local governments

An additional distinction between public and private plans is that only public plans guarantee cost-of-living adjustments to their pensions, as is reflected in Table 5.

The relative difference in benefits available in certain local government systems is the subject of Table 6 prepared by the actuarial firm of Coates, Herfurth and England.

The "equivalent level" percent per year is actuarially determined to take into account differences in (1) Social Security offset, (2) final average salary, (3) employer-paid continuance to spouses, and (4) future COLA increases, if any.

Any private sector plan equivalency would rank lower than the last entry, Los Angeles County's Plan E, because a typical private plan has neither COLA nor survivor continuance (without an employee-subsidized reduction) and will have fuller Social Security offsets. (Like Plan E, private plans are often non-contributory.)

Local Safety Formulas

Local government safety formulas currently offered by PERS and the number of local safety employees covered by each as of 1982 are shown in Table 7.

The vast majority of jurisdictions contracting with PERS for safety service (71%) opt for the 2%-at-50 formula. This allows a local government safety employee to retire after 25 years of service at age 50 with 50% of pay.

(While slightly over 2,000 of 30,000 plus PERS local government safety employees are eligible for Social Security as a result of their safety service, the rest must earn Social Security credits elsewhere through at least 40 quarters covered employment, or be eligible because of their spouse.)

Table 5
Assuming Final Salary of $2,000 Per Month and 30 Years of Service, Age 65

Retirement Plan	Pension @ Age 65	+ Social Security	Total Retirement Income	% of Final Salary	COLA (Not including SS)
Aerojet	$540.00	$575.73	$1,115.73	56%.	No
IBM	900.00	575.73	1,475.73	74%	No
Pacific Telephone	691.20	575.73	1,266.93	63%	No
General Motors	558.00	575.73	1,133.73	57%	No
Kaiser	720.00	575.73	1,295.73	65%	No
US Steel	660.00	575.73	1,235.73	62%	No
Local Government Plan					
without SS	1,560.00	0	1,560.00	78%	2%
with SS	1,456.79	575.73	2,032.52	102%	2%
with SS @ $1,500 FS	1,170.00	550.97	1,720.97	115%	2%
with SS @ $1,000 FS	780.00	438.96	1,218.96	122%	2%

Sources: Department of Personnel Administration, Local governments

The benefit available for safety employees in 1937 Retirement Act counties is determined by the same 2%-at-50 formula. By applying the full formula percentage to 1983 pay rates for Los Angeles County safety personnel at the journey level, we find the initial benefit for the two classes listed in Table 8.

After age 50 or 55, it is not unusual for persons who have held safety jobs to seek other employment. In such cases, the county is then paying full retirement benefits to an employed worker who is also drawing either a full or partial salary.

Costs

In fiscal 1981-82, cities, counties, and special districts in California contributed over $1.3 billion to employee retirement systems. Employer rates for safety and miscellaneous employees are summarized in Table 9.

These rates notwithstanding, a considerable unfunded obligation of cities, counties, and special districts remains, as can be seen in Table 10.

Certain systems are in particularly poor fiscal health. The Los Angeles city police and fire retirement system is so deeply in debt that in 1976 a normal 40-year funding schedule (the private sector funding maximum) would have had the city paying *120% of payroll* to fund the retirement obligation. Because it is so burdensome, the city is funding the system over 70 years instead, but still contributed 76% of payroll in 1982. According to the city, just funding the plan equaled 14.4% of the *total* city budget in 1979.

In an effort to contain future pension costs, Los Angeles residents voted in 1981 to cap annual cost-of-living adjustments for annuitants at 3%, in lieu of full CPI; the city of Pasadena approved a similar limitation at the same time.

Court rulings have cast doubt on whether the Los Angeles limitation will be allowed. In October 1983, the Supreme Court refused to review an appellate court decision declaring the Pasadena COLA cap invalid.

According to Los Angeles Chief Administrative Officer Keith Comrie, a similar adverse decision in the Los Angeles case that is still before the courts will cost the city $12 *billion.*

In San Francisco, the city system required employer contributions in 1982 of 88.30% and 90.40% (down from 1980 rates of 102.05% and 105.56%) for certain police and fire benefits whose costs had gotten so far out of line by 1976 that the retirement system had to be closed to new members.

Alternatives

Alternative retirement plans providing less generous benefits at less cost to employees and local jurisdictions can reduce the cost of government with minimal impact on ongoing services. What kind of alternative plans? Most retirement planners assess a retirement plan in terms of how well it replaces pre-retirement income. The objective of a good plan would be to provide career employees at age 65 an income sufficient to allow them to maintain their pre-retirement standard of living.

Meeting this objective does not require retirement benefits equivalent to the active employee's gross income due to significant changes in circumstances when an individual retires:

- Retirees no longer pay Social Security taxes or contribute to their employer-sponsored retirement plan.
- Certain expenses such as job-related transportation, meals, and clothing will no longer be required.
- The expense of supporting children is probably no longer borne by the retiree, and housing expenses are often reduced — either because home mortgage expenses have ended or the retiree has moved to a smaller, less expensive dwelling.
- Any general savings programs have probably ended.
- Finally, and perhaps most importantly, income taxes are sharply reduced because Social Security benefits are not subject to federal or state income tax unless income is over $25,000 (singles) or $32,000 (couples), in which case one-half of the Social Security benefit becomes taxable. In addition, double exemptions available to persons over age 65 further reduce tax liability.

The President's Commision on Pension Policy, established by the Carter administration in 1980, developed information showing what percentage of a retired family's or individual's gross pre-retirement income would be needed to maintain the same living standard (Table 11). The Commission's estimate takes into account that a retired family will spend less and be taxed less.

Model Benefits Plan

A plan for meaningful pension reform with a replacement target of 70% of final compensation, at the high end of the 51%-78% range identified by the President's Commission, would include the following elements:

Table 6
Estimated Ranking of the 1937 Act Counties and California PERS Pension Plans by Size of "Equivalent Level Percent" Service Retirement Benefit from Plan and Social Security

General Members

Rank	Political Unit	Social Security Coverage	Percent per Year of Service	Final Average Salary	Automatic Continuance	Automatic Future COL	"Equivalent Level" Percent per Year from: Plan*	Social Security**	Both
1	San Mateo County	Yes	2.20%	1	60%	5%	3.78%	1.53%	5.31%
2	Alameda County (Tier 1)	Yes	2.62	1	60	3	3.41	1.53	4.94
	Fresno County	Yes	2.62	1	60	3	3.41	1.53	4.94
	San Diego County (Tier 1)	Yes	2.62	1	60	3	3.41	1.53	4.94
	Stanislaus County (Tier 1)	Yes	2.62	1	60	3	3.41	1.53	4.94
3	Contra Costa County (Tier 1)	Yes	2.44	1	60	3	3.17	1.53	4.70
	Mendocino County (Tier 1)	Yes	2.44	1	60	3	3.17	1.53	4.70
	Merced County	Yes	2.44	1	60	3	3.17	1.53	4.70
	San Joaquin County	Yes	2.44	1	60	3	3.17	1.53	4.70
	Tulare County (Tier 1)	Yes	2.44	1	60	3	3.17	1.53	4.70
	Ventura County	Yes	2.44	1	60	3	3.17	1.53	4.70
4	Sacramento County (Tier 1)	Yes	2.20	1	60	4	3.15	1.53	4.68
5	Santa Barbara County	Yes	2.20	1	60	3	3.10	1.53	4.63
6	Mendocino County (Tier 2)	Yes	2.44	3	60	3	3.00	1.53	4.53
7	Stanislaus County (Tier 2)	Yes	2.20	3	60	3	2.71	1.53	4.24
8	Kern County	Yes	2.20	1	60	2	2.62	1.53	4.15
9	Sonoma County	Yes	2.62	1	60	None	2.61	1.53	4.14
10	PERS (Local Government)	Yes	2.42	3	25	2	2.54	1.53	4.07
11	Marin County (Tier 1)	No	2.62	1	60	4	4.06	0	4.06
12	Alameda County (Tier 2)	Yes	2.20	3	60	2	2.48	1.53	4.01
	San Diego County (Tier 2)	Yes	2.20	3	60	2	2.48	1.53	4.01
	Tulare County (Tier 2)	Yes	2.20	3	60	2	2.48	1.53	4.01
13	San Mateo County (Tier 2)	Yes	2.20	1	60	None	2.38	1.53	3.91
14	San Bernardino County	No	2.93	1	60	2	3.78	0	3.78
15	Los Angeles County (Tier 1)	No	2.62	1	60	3	3.70	0	3.70
16	Orange County (Tier 1)	No	2.62	1	60	3	3.69	0	3.69
17	Sacramento County (Tier 2)	Yes	2.20	3	60	None	2.07	1.53	3.60
	Ventura County (Tier 2)	Yes	2.20	3	60	None	2.07	1.53	3.60
18	Marin County (Districts Only)	No	2.44	1	60	3	3.44	0	3.44
19	Contra Costa County (Tier 2)	Yes	1.14	3	60	4	1.67	1.53	3.20
20	Los Angeles County (Tier 2)	No	2.44	3	60	3	2.98	0	2.98
21	Orange County (Tier 2)	No	2.20	3	60	3	2.95	0	2.95
22	Marin County (Tier 2)	No	2.20	3	60	2	2.70	0	2.70
23	Los Angeles County (Tier 3)	No	2.20	3	60	2	2.69	0	2.69
24	Imperial County	No	2.44	1	60	None	2.64	0	2.64
25	San Mateo County (Tier 3)	Yes	1.60	3	50	None	.81	1.53	2.34
26	Los Angeles County (Tier 4)	No	2.20	3	60	2	2.15	0	2.15
27	Los Angeles County (Tier 5)	No	1.60	3	50	None	1.63	0	1.63

Assumptions:

1. Interest rate — 8% per year; inflation and salary increases — 5% per year.
2. All members retire at age 63 with a final average salary of $1,500 per month.
3. The "basic" percent from Social Security is assumed to be 1% per year; the Social Security Consumer Price Index increases are assumed to be 5% per year.

*"Equivalent Level" Percent per Year is actuarially determined to take into account the differences in (1) Social Security offset, (2) the final average salary, (3) continuance to spouse, and (4) future COLA increases, if any, for each System.

**For entities having terminated Social Security coverage, members with residual Social Security coverage will have a higher "Equivalent Level" Percent per Year than the figure shown for their plan.

Note: This exhibit was intended to rank only the benefits provided by the Systems. It does not take into account the differences in the size of member contributions required to pay for these benefits.

Source: Coates, Herfurth & England, Inc.

Table 7
Local Safety Formulas

Two percent at age 50 Formula. (21,637 employees)

Age	Percent Per Year Of Service
50	2.000%
52	2.280
54	2.560
55 to 60	2.700

Eligibility — Age 50 and 5 years of Service.

Two percent at age 55 Formula. (4,139 employees)

Age	Percent Per Year Of Service
50	1.426%
52	1.628
55 to 60	2.000

Eligibility — Age 50 or 55 (depending on agency's contract) and 5 years of service.

Source: SCO Annual Report of Financial Transactions, Public Retirement Systems, 1981-82.

Table 8
Los Angeles County 1983 Benefit Level

Class	Salary Top Step	Retirement at 55, 30 Years Service
Law enforcement officer	2,189	1,720.55
Firefighter	2,183	1,715.84

Source: LCC 1983 Benchmark Salary Survey

Table 9
Employer Contribution Rates by Median Values

Safety	77-78	78-79	79-80	80-81	81-82
Counties	15.53%	16.18%	19.00%	22.46%	22.40%
Cities	23.27%	23.27%	23.25%	23.25%	23.75%
Special Districts	-	-	-	-	-
Miscellaneous					
Counties	12.84%	12.93%	13.95%	14.90%	16.01%
Cities	14.96%	15.89%	15.69%	15.98%	16.75%
Special Districts	10.13%	10.17%	9.67%	9.95%	9.46%

Source: SCO Annual Report of Financial Transactions, Public Retirement Systems, 1981-82.

Table 10
Summary of Unfunded Obligations

	Unfunded Obligations	Members	Average Per Member
Counties	$3,305,751,798	223,061	$14,819
Cities	6,661,061,350	122,286	54,471
Special Districts	99,773,604	18,341	5,440
Totals	$10,066,586,752	363,688	$27,679

Source: SCO Annual Report of Financial Transactions, Public Retirement Systems, 1981-82.

Eligibility

Ideally, the alternative benefit structure, typically known as Tier Two, would be mandated for all new employees. Additionally, it should be made optional for current employees, in exchange for refund of all past contributions plus interest, and no future employee contributions.

Vesting

The period of service after which an employee would have a non-revocable right to a retirement benefit should be 10 years, which is the standard private sector provision.

Savings from a change in the usual 5 years vesting period are such that Santa Clara County estimated a post-retirement COLA feature could be financed from them.

Employee Contributions

None. Again, this squares with the private sector model. Also, it compensates to some degree for the difference in ultimate benefit between old and new benefits.

For those who leave public employment after vesting in the system, but before retirement, some form of return payment may be necessary. Otherwise, all vested employees who depart from the system will remain as part of the system's liability. Vested employees could be offered the option of a lump sum payment based on contributions (plus interest) made on their behalf by the employer in return for withdrawal from the system.

Employer Contributions

Under a proposal from Santa Clara County employer contributions for Tier Two would have moved downward from a range of 10% to 14% of salary to 5% to 6%, *even without an employee contribution.* (State legislation to amend the PERS system, would have made this option available to any PERS contract agency.) Los Angeles County's Plan E rate, not including past unfunded liability, is 5.10%, compared to a 10.59% cost of Plan A, to which employees in 1982 contributed another 5% to 6½%.

Benefit Formula

Instead of 2.62% of final compensation times years of service (less a token "integration" with Social Security) at age 65, the formula would be 1% of final compensation times years of service for plans which also include Social Security, up to maximum of 70% of final pay.

The significance of the connection of the retirement plan with Social Security cannot be overstated. Social Security must be viewed as the base of the total retirement plan, just as it is in private retirement plans. The key reason some public retirement plans are so generous is the lack of coordination between the retirement plan and Social Security, and because there is no offset in these plans for the projected Social Security benefit.

What has occurred over the past 20 years is a subliminal, but very substantial overall pension benefit increase. *Improvements in Social Security benefits have been virtually ignored by many public retirement systems in the ongoing modification of their benefits.*

Final Compensation

The basis for calculating the retirement benefit should be the three best consecutive years, still less than the private sector's best five years standard.

Normal Retirement Age

Advancing the date for retirement on full benefits from age 60 to age 65 is a big factor in reducing the cost of public pension plans. It also recognizes a significant improvement

Table 11
Equivalent Retirement Income

The last column of the table below shows the income required after retirement to maintain pre-retirement living standards. These figures were calculated by the President's Commission on pension Policy in 1980 for people at various income levels.

Gross Pre-retirement Income	Taxes[1]	Work-Related Expenses[2]	Savings and Investments[3]	Net Retirement Income[4]	Post-Retirement Income Taxes[5]	Equivalent Retirement Income[6]
			Single People			
$10,000	$ 2,008	$ 480	$ 240 (3%)	$ 7,272	—	$ 7,272 (73%)
15,000	3,703	678	678 (6%)	9,941	—	9,941 (66%)
20,000	5,783	853	1,280 (9%)	12,084	$ 198	12,282 (61%)
30,000	10,355	1,179	2,357 (12%)	16,109	1,282	17,391 (58%)
50,000	22,249	1,665	4,163 (15%)	21,923	3,752	25,675 (51%)
			Married Couples			
$10,000	$ 1,444	$ 513	$ 257 (3%)	$ 7,786	—	$ 7,786 (78%)
15,000	2,860	728	728 (6%)	10,684	—	10,684 (71%)
20,000	4,488	931	1,396 (9%)	13,185	—	13,185 (66%)
30,000	8,047	1,317	2,634 (12%)	17,999	$ 63	18,062 (60%)
50,000	17,824	1,931	4,826 (15%)	25,419	1,965	27,384 (55%)

1. Includes Federal income tax, Social Security taxes, state and local income taxes (calculated at 19% of Federal income taxes). Does not include property taxes.
2. Estimated at 6% of income after taxes.
3. Estimated at a percentage (shown) of income after taxes.
4. Gross pre-retirement income less taxes, work-related expenses, and savings and investments.
5. Post-retirement taxes are on income in excess of Social Security benefits, which are not taxable. Retirees without Social Security benefits would need higher retirement income.
6. Equivalent retirement income as a percentage of pre-retirement gross income shown in parentheses.

in life expectancies in recent years, and the earlier people enter retirement, the greater the cost of financing pension benefits. Similarly, minimum retirement ages at actuarially-reduced benefit levels should be moved forward from age 50 to age 55.

COLA

Local government plans currently provide automatic cost-of-living adjustments of 5% down to zero. A 5% COLA, which San Mateo County eliminated cost the county 12.51% of salary or 61% of the total employer contribution. In 1981, Los Angeles County's contribution rate was increased to 9.54% of payroll *above* the regular cost for general retirement, and 15.05% for safety retirement, to fund its COLA commitments.

The expense of these automatic adjustments calls for innovative approaches. To discourage early retirement, Santa Clara County envisioned a 4% COLA for persons retiring at age 65, but only 2% for those retiring early at 62. Los Angeles County is working on a thrift plan under which the county will match some portion of savings set aside by the employee; otherwise there is no guaranteed COLA for their Plan E participants.

One other element to be considered in providing a COLA is ad hoc benefit increases. In the past, ad hoc increases conferred by elected officials, or sometimes by non-elected retirement boards, have been granted to retirees of 1937 Retirement Act counties as a one-time bonus or on a year-to-year basis. For example, San Joaquin County granted a 5% increase in February 1982 and funded the additional benefit from "excess" earnings of the retirement fund. "Excess" earnings are generated as the difference between investment earnings credited employer and employee accounts and the net earnings rate of the retirement portfolio. Because the "excess" fund balance at PERS and in some county systems became embarrassingly large — more than $1 billion at PERS in 1982 — legislative action was taken to curb the ability of retirement boards to assign "excess" earnings (that investment earnings are "excess" is a fiction) to unallocated contingency reserves.

Out of legislative actions have come reserve accounts, IDDA (Individual Dividend Disbursement Account) at PERS and the 1937 Retirement Act County Supplemental Retiree Benefits Reserve, (for which no equally melliflous acronym has been suggested.) The function of these reserve accounts is to provide future, supplemental benefit increases to annuitants to enable them to achieve and maintain some percentage of purchasing power of the initial retirement benefit. Clearly, these accounts must be taken into consideration in addressing alternative COLA provisions.

Disability Benefits

In designing a second tier plan, it is important to adjust disability benefits so there will be no incentive to seek disability retirement as a more remunerated option than service retirement. The definition of disability should also be changed to the Social Security definition, which applies to inability to perform *any* job, rather than the job held by the employee at the point of disability.

The advantages of administering disability as an insurance program separate from retirement should also be considered, and Los Angeles County's experience with its new long-term disability plan could be instructive.

Benefits

The savings that result from adoption of reduced, alternative retirement plans accrue to employers and employees. Robert Drisco of the actuarial firm of Coates, Herfurth and England, who has been personally involved in all 1937 Retirement Act plans, indicated the savings seven counties his firm services have experienced in reducing their original benefit levels (Table 12). Savings are defined by Drisco as the difference between contribution rates for Tier One and Tier Two, recognizing that the second tier also bears some cost for any past unfunded liability.

The startling point about this information is that with the exception of Contra Costa, San Mateo, and Los Angeles coun-

Table 12
Second Tier Savings as Percent of Salary

County	Employer	Employees
Alameda	1.1%	2.6%
Contra Costa	3.2%	3.5%
Mendocino	.3%	.5%
Sacramento	2.6%[1]	1.2%
San Mateo		
Tier II	4.9%	0
Tier III (Plan E)	2.7%[2]	5.8%
Stanislaus	4.1%	2.3% increase[3]
Plan E (legislation pending)	2.6% - 4.5% (est)	6.5% (est)
Tulare	3.9%	.9%[3]

1. Employer picks up ½ of employee rate in Tiers I and II.
2. Employer savings from both rollbacks equal 7.6%.
3. Employer pick-up of ½ of employee rate dropped.

Source: Coates, Herfurth & England, Inc.

ties (about which there is more below) these counties really have not implemented revolutionary changes in their second tier benefit plans.

The counties that have achieved modest changes in their existing plans are Marin, San Diego, Alameda, Fresno, Merced, Orange, Stanislaus, Mendocino, Tulare, Ventura, and Sacramento. They have all gone to a 3 year final average salary for miscellaneous employees (only seven have done so for safety employees), seven have reduced guaranteed COLA's, and seven have changed to a somewhat lower benefit formula, (72.9% maximum in lieu of 78.6%)

Plan E, Contra Costa Plan

By comparison, Contra Costa, Los Angeles, and San Mateo counties (which has implemented Los Angeles County's Plan E) have achieved fundamental revision in their retirement programs. In Table 13, old and new plan features are compared.

Participation

Realizing that dramatic savings from the new plans depended on having employees switch from existing plans into Plan E, Los Angeles and San Mateo counties made the new benefits available to those already on staff who preferred reduced benefits at no employee cost. Plan E was also optional to new hires.

During an open enrollment period in 1982, 16,600 employees (29% of the workforce) made the switch and received from the county $80,720,000 in returned contributions plus interest. Of new employees, two-thirds have selected Plan E, with the others choosing a more generous, but contributory Plan D. In 1983, the county and employee organizations negotiated a new open period to allow additional switching into Plans D and E.

San Mateo's experience was similar. During a March to September window in 1983, 17% of existing staff selected Plan E benefits, as have 43% of all new hires.

In Contra Costa, the new plan was administered differently. It was made mandatory for prospective employees, although those already on staff could elect its coverage. Only 10% did so, however, because no return of contributions and interest, only reduced employee rates, were involved. Accordingly, the retirement benefit for these persons is to be calculated in proportion to the time served under each formula. By contrast, persons opting for Plan E have all county service rated under the new reduced formula.

Savings

Savings to employers and employees have been immediate, and the long range projections are for continued and growing savings. Tables 14 and 15 give estimated savings during each year following adoption of a new plan. For example, in the seventh year of San Mateo's tiered benefits, 1990, savings for the non-safety workforce of 3,350 employees will be $2.29 million. Cumulative savings at that point will be $14.4 million.

Unfortunately, similar actuarial data for Los Angeles County is not available. The county did engage an actuary in the late seventies, when it first contemplated an alternative retirement plan, and at that time it was estimated that the unfunded liability for the county retirement system would be

Table 13
Benefit Comparison

	Los Angeles County		Contra Costa County		San Mateo County	
	Original Benefit	New Plan	Original Benefit	New Plan	Original Benefit	New Plan
Final average salary	1 year	3 years	1 year	3 years	1 year	3 years
Normal retirement age	60	65	60	65	60	65
Earliest retirement age	50	55	50	50	50	55
Vesting	5 years	10 years	10 years	10 years	5 years	10 years
Credit per year as percent of pay at age:						
50	1.47	-	1.24	.49*	1.18	-
55	1.95	.73	1.67	.68	1.49	.73
60	2.44	1.18	2.18	.88	1.92	1.18
65	2.61	2.00	2.61	.96	2.43	2.00
Maximum normal retirement benefit	100% plus	80%	100% plus	96%	100% plus	80%
COLA	3%	0	3%	4%	5%	0
Contributory	Yes	No	Yes	Yes	Yes	No

*Includes Social Security

Table 14
Estimated Effect on County Rates During Transition from Current Plan To Alternative Plan Membership for Miscellaneous Members

County of San Mateo				
	County Rate			Estimated Total Savings During the Year
Number of Years from the Valuation Date	Plan 1	Plan 2	Plan 3	Transition from Current Plan to Plan 3
0	16.98%	12.12%	9.45%	$1,375,000
1	16.98	12.12	9.45	1,484,000
2	16.98	12.12	9.45	1,600,000
3	16.98	12.12	9.45	1,725,000
4	16.98	12.12	9.45	1,849,000
5	16.98	12.12	9.45	1,992,000
6	16.98	12.12	9.45	2,133,000
7	16.98	12.12	9.45	2,285,000
8	16.98	12.12	9.45	2,447,000
9	16.98	12.12	9.45	2,619,000
10	16.98	12.12	9.45	2,790,000
15	16.98	12.12	9.45	3,821,000
20	16.98	12.12	9.45	5,130,000
25	16.98	12.12	9.45	6,735,000

Assumptions used — 8% interest; 6½% total salary scale (5½% for inflation, 1% for merit and longevity).
Total number of active members remains the same. Fifty percent of new members are assumed to elect

Source: Coates, Herfurth & England, Inc.

Table 15
County of Contra Costa

Number of Years from the Valuation Date	County Rate		Estimated Annual Savings
	Tier 1	Tier 2	
0	16.51%	13.19%	$ 1,014,000
1	16.51	13.19	1,354,000
2	16.51	13.19	1,700,000
3	16.51	13.19	2,064,000
4	16.51	13.19	2,430,000
5	15.51	13.19	2,809,000
6	16.51	13.19	3,182,000
7	16.51	13.19	3,587,000
8	16.51	13.19	3,987,000
9	16.51	13.19	4,420,000
10	16.51	13.19	4,865,000
15	16.51	13.19	7,414,000
20	16.51	13.19	10,536,000
25	16.51	13.19	14,435,000

Assumptions used

1. 8% interest; 6¼% total salary scale (5¼% for inflation and 1% for merit and longevity).
2. Inflationary salary increases are graded from 6% during the first year to 5¼% over the next five years.
3. Total number of active members remains the same.
4. County continues to pay half of members' basic rate.
5. Based on the 12/31/82 salary level.

Source: Coates, Herfurth & England, Inc.

reduced by *$175 million* by adoption of a less generous, non-contributory benefit plan (Plan E). In 1983-84, the estimated savings of all rollbacks in benefits (in Plans B, C, D and E) total approximately $26.5 million.

Employee Reaction

Contra Costa's experience with the alternative benefit structure has been the most positive from a employer-employee relations perspective, possibly because employees initiated the change when they suggested — pre-Proposition 13 — that the county consider getting out of Social Security. Their reasoning was that the employer's pension and Social Security combined required too much in retirement contributions from workers.

A task force of twenty labor and five management officials was formed under then retirement administrator Ben Russell, which subsequently recommended the new retirement benefit structure, and a tightening of the disability program. Local employee organizations cooperated in this effort.

In Los Angeles and San Mateo counties, Plan E was negotiated. In the former, early resentment about the plan was linked to the county's decision to get out of Social Security, a move employee organizations sought in vain to stop in the court. Today, with a 70%-80% retirement benefit available at absolutely no cost to employees, that disfavor has been tempered.

San Mateo County had the more typical experience, one shared by other 1937 Retirement Act counties that have adopted alternative benefit tiers. In most counties, employee organizations have objected to the proposed new tier (opposition was strong in Orange County and still is in Fresno County, which wants Plan E), and local retirement boards which administer benefit plans have not been supportive. In San Mateo, however, all parties are said to have "come around" since plan implementation. Elsewhere the changes were more or less viewed as faits accomplis.

Conclusions

- By reducing retirement benefits, local government can reduce the cost of government with minimal impact on ongoing services.
- The alternative retirement formula proposed in the model benefits plan is equal to the best private sector pension programs.
- In spite of widespread recognition of policy considerations of ever earlier retirement ages, and awareness of high benefit costs associated with retirement plans providing full benefits at 50 or 55 years of age, 229 local government agencies contracting with PERS amended their contracts in 1981-82 for additional benefits and improvements in the benefit formula.
- Local government employees who do not intend to work 20 to 30 years for the same jurisdiction are better served to contribute nothing from their paychecks toward a basic but adequate retirement, and instead invest funds in IRAs or other personal savings instruments.
- In particular, low income wage earners and women who do not plan to work extended periods for the same public employer stand to benefit from non-contributory, alternative benefit plans. Currently, many of these workers contribute 3%-8% of their after-tax earnings to a retirement system from which they probably will not receive a benefit. PERS indicates only 1 in 14 employees receives a benefit, and the ratio for low wage earners is thought to be even greater.

Employers' contributions are essentially deferred compensation for the worker. Single parents and persons with

marginal incomes would conceivably prefer some of those monies to flow to them during their active employment, especially if they do not intend to spend their full working life with the local jurisdiction.

Legislative Recommendations

- Authorization of alternative retirement benefits along the lines of Plan E or the model benefits plan described above should be enacted in the County Employee Retirement Act of 1937 and the Public Employee Retirement Law.

- A moratorium on extension of additional safety benefits or enriched safety formulas for local government employees should be imposed pending review by a blue ribbon task force of retirement needs of local safety workers.

II

Workers' Compensation and Disability Trends

In the past decade and a half, local governments have been hit with escalating disability costs. Estimates of expenditures for disability programs range as high as $1 billion per year.

Salary continuance programs provided in lieu of workers' compensation temporary disability benefits allow local government safety employees and some general workers to receive more than 100% of regular pay while temporarily disabled.

The law to compensate injured local government safety employees "presumes" that all injury or illness in any way involving heart trouble, tuberculosis, hernia, pneumonia, and cancer for firefighters is job-related and therefore compensable.

Benefits for many injured local government employees, including safety personnel, pyramid so that the employer provides for full salary continuance (tax free), sick leave, workers' compensation benefits, and life-long disability retirement benefits at 50% of final pay (tax free) which are augmented annually.

The Legislature has established a Joint Study Committee on Workers' Compensation, the purpose of which is to recommend reform of compensation law for injured public and private sector employees. A committee report is anticipated late 1984, and reform legislation could not be enacted before 1985.

The Problem

California laws governing compensation for workers injured on the job rest on a two-part foundation: employers should be responsible for injuries to their employees, irrespective of fault, and compensation should be provided quickly to injured workers. Their medical expenses should be fully covered and they should be eligible for compensation sufficient to avoid financial hardship, but still leaving an economic incentive to return to work as soon as possible.

The reality in California, however, is far removed from this statutory theory. Private-sector employees complain that benefits are so low that the current maximum weekly benefit ($224) is only 59% of the statewide average weekly wage ($377), less than the replacement target of two-thirds of gross wages lost. Yet some local government employees may receive benefits exceeding 100% of salary. Further, on a "best case" basis, indemnity benefits replace less than 40% of post-injury wage loss sustained by permanently disabled private-sector workers. For local government employees, however, permanent disability awards are often in addition to generous disability retirement benefits.

For injured private workers — but not public employees, as will be shown below — there is an average one-month wait for the first temporary disability benefits, and a delay of 18 to 22 months if a claim is litigated.

Timeliness, or lack of it, is not the only problem. Every eighth workers' compensation claim is litigated and 73% of permanent disability claims — almost three of every four — are contested. According to California Workers' Compensation Institute, the San Francisco-based non-profit research organization that is source for these statistics, it costs 35 cents to deliver $1 in benefits in litigated cases. This is the amount that goes to attorneys and forensic physicians, and for support to the Workers' Compensation Appeals Board that adjudicates claims.

What are the specific features of private and local government practices to compensate injured employees that contribute to these differences? Using the City of Los Angeles as an example, miscellaneous employees there are *guaranteed* 90% of salary for up to one year after an injury on the job, and safety members (police and fire employees) receive 100%. (In Berkeley and Richmond, salary continuance programs are for two years and five years, respectively.) These benefits are considered "in-lieu" benefits, instead of workers' compensation temporary disability payments, and are payable from date of injury.

Because payments are for disability, the 90% - 100% salary is not subject to income tax. Thus, city employees effectively receive 114% to 122% of salary (assuming incomes in the 30% tax bracket), because only retirement contributions of 6% to 8% are withheld from their pay. This means these public employees' benefits are 53% to 70% *greater* than the average 59% of wages replaced by workers' compensation benefits noted above.

At the end of the year, any Los Angeles city employees still unable to return to work qualify for the $224 workers' compensation weekly benefit, which is supplemented by sick leave or vacation credit to equal two-thirds of pay. Or, if approved by the Board of Pension Commissioners, injured workers receive a disability retirement.

In the City of Los Angeles, disabled miscellaneous employees with at least five years' service are eligible for a retirement benefit equal to 33⅓% of salary. For safety employees, benefits equal 30% to 90%. According to one city analyst, it is a "rarity" for safety employees ever to get

"state" workers' compensation payments, because they retire for disability after exhauting in-lieu benefits.

A further distinction in private and public workers' compensation programs is "pyramiding" benefits public safety employees enjoy. According to the Institute of Local Self Government, which between 1975 and 1981 reported on escalating workers' compensation costs in California cities and counties, 57% of local government employees with serious injuries (greater than $5,000 in 1968-69 benefit levels) returned to the same job. For many of these employees, any workers' compensation award for permanent disability was a "windfall:" they suffered no loss of earnings, because of salary continuance programs such as the City of Los Angeles has. These benefits, generally referred to as "4850" benefits after the controlling government code section, are available to safety employees in all but a handful of cities and counties, and also to general employees in numerous jurisdictions.

Sixteen percent of employees with serious injuries also received generous industrial disability retirements of at least half-pay, and with no restriction on subsequent employment. Those employees ready to retire anyway suffered no loss of earnings, so their workers' compensation permanent disability benefit constituted a similar windfall.

Duplicative Benefits

A former provision of the County Employees' Retirement Law of 1937, repealed in 1951, provided that workers' compensation permanent disability benefits, paid as a lump sum or on a monthly basis, could be deducted from retirement payments. With its repeal, workers' compensation payments in the affected counties became duplicative.

Similarly, employees approved for disability retirement but with accumulated sick leave are typically compensated for these balances. This means the jurisdiction pays double benefits for essentially the same illness or injury.

Local government safety employees' benefit pyramid looks like this:

full salary,
tax-free for one year,
plus sick leave, plus vacation
pay, plus Workers' Compensation,
plus 50% of final pay, tax-free, for
life. Plus annual cost-of-living adjustments

Presumptive Illness

Advantages to injured public workers do not stop at more generous benefit levels. Labor Code Section 3212, enacted in 1937, and subsequently expanded, establishes a "presumption" that certain illnesses (hernia, tuberculosis, pneumonia, heart trouble, and cancer for firefighters) affecting law enforcement and firefighting employees are work-related and therefore compensable under workers' compensation law.

Duncan Davidson, Workers' Compensation Appeals Board judge, writes of these presumptions in the August 1981 California State Bar Journal:

"Still another vestige of 1939 'presumption' case lawmaking is the provision of those statutes relating to 'heart trouble,' a term that would fit perfectly into a novel by Anthony Trollope or a poem by Emily Dickinson. A presumption arises that those who are subject to the statute and who have heart trouble acquired the condition because of industrial causes. Heart trouble includes any malady that 'troubles the heart.' It obviously includes a myocardial infarction. It also includes hypertension that troubles the heart such as enlargement that arises from longstanding, untreated hypertension . . . However, no such benefit within the statutory provisions is given a fireman or law enforcement officer who suffers a cerebral vascular accident or 'stroke.' "

Non-line police and fire employees, those not actively involved in police protection or fire suppression, are also entitled to presumptions, even though their jobs as trainers, managers, administrators, etc. are no different than those performed by other local government employees not eligible for "presumptive" benefits.

Cumulative Trauma

While presumptive illnesses, especially heart disease, have increased program costs, the foremost reason for cost escalation in the workers' compensation program, according to the Institute for Local Self Government, is the increase in cumulative trauma injuries. Case law — not the Legislature — has established the principle that virtually any casual connection between employees' physical or emotional condition and the job, however remote, becomes compensable.

Examples of benefit eligibility attributable to cumulative trauma abound. A 28-year-old San Francisco policeman claimed psychic trauma because he had to carry a gun. He is retired on half-pay.

A police officer in the City of San Mateo sued for industrial disability retirement, alleging high blood pressure because his employer refused to grant industrial disability retirement. A second San Mateo policeman claimed stress from "my mother, my family, my job, working overtime, and the people on the street." He was awarded $25,300 for his workers' compensation claim, placed on disability retirement at an expected cost of $204,000, and now runs his own business as a private investigator.

The normal aging process, or pre-existing conditions, do not absolve employers of obligation to provide benefits. For example, arteriosclerosis, which medical science believes is the cause of about 90% of all "heart trouble," begins to develop early in life (before employment age) and is generally associated with natural aging. Yet, in a Los Angeles case, arteriosclerosis in a retired fireman's legs was ruled "heart trouble," on the basis that it was related to coronary artery disease *which had not otherwise manifested itself.*

Stress and Strain

Cumulative trauma, or stress, has become a concern of immense proportions, as the following case study of events in the City of Los Angeles reveals.

Unlike many smaller and less sophisticated jurisdictions, this city identified stress as an employment problem and developed personnel management tools to control stress-related disability. In the police department, for example, job applicants undergo two psychological pre-screenings and a clinical interview. Then, during police academy training, each recruit attends stress management lectures and is given instruction in crisis intervention, communications, community relations, and interpersonal relations.

After the academy, employee assistance continues. Four full-time psychologists are available for counseling and five more part-time psychologists train supervisors to identify and respond to early signs of stress in the work force of 6,900.

Although not supported by city funds, two other programs — peer counseling and a home visitation program — provide additional support to emotionally troubled officers. The services are volunteered to the city by officers and by a local university.

The fire department provides assistance to troubled

firefighters through an employee assistance program sponsored by the firefighters union and financial assistance from the city.

In the fall of 1983, the Task Force on Psychological Disability Pensions presented the city council recommendations for additional stress management and physical fitness training for police and fire personnel. Why? The city Fire and Police Pension System had a dramatic increase in psychologically-related disability pensions. In 1970-71, there were none; in 1981-82, the number was 34, or 23% of service-connected disability pensions awarded (Table 16).

Table 17 identifies the 34 employees receiving pensions for a psychological disability. These workers first qualified for in-lieu workers' compensation benefits of 100% of salary, then were approved for disability retirement.

Table 16
Los Angeles City Psychological Disability Pensions

Fiscal Year	Total Disability Pensions	Psychologically-Related Disability Pensions	Psych-Related Pensions as a Percentage of Disability Pensions
1970-71	22	0	0%
1971-72	39	1	2.5
1972-73	72	3	4.2
1973-74	44	2	4.5
1974-75	69	5	7.2
1975-76	67	16	23,9
1976-77	108	16	14.8
1977-78	88	9	10.2
1978-79	77	2	2.6
1979-80	90	12	13.3
1980-81	109	23	21.1
1981-82	146	34	23.3

Source: City of Los Angeles

Costs

Estimates based on an assumption that all of these 34 disabilitants attain age 72 project the costs indicated in Table 18.

Cause of Increase in Psychological Disability Pensions

Los Angeles city officials are unable to pinpoint any single reason for the increase in psychological disability pensions. Reduced public support for police in general, frustration about the criminal justice system, and reduced staffing in the face of increased criminal activity — were reasons cited by police professionals as adding to the stress and anxiety of officers. Many police personnel and officials in other city departments also believe that some of the psychological-related disability pensions have been awarded by the pension board to employees who were essentially tired, frustrated, and unwilling to cope with daily job frustrations. According to city officials, the difficulty with this type of disability is that much of the cause — and cure — is *completely in the hands of the applicant.*

Benefits

Service-connected disability pensions for police and fire personnel provide 30% to 90% of salary, depending on the extent of disability. This benefit is tax-free, and is for life. Surviving spouses (until remarried) are eligible for one-half of the benefit upon the member's death. The Board of Pension Commissioners — with five members recommended by the mayor and approved by the City Council, plus one police member and one fire member of the system — makes the determination of eligibility and benefit level.

Table 17
1981-82 Psychologically-Related Disability Pensions

Employee	Age at Retirement	Years of Service	Rank	% of Award	Annual Pension
1	33	11	P II	50	$14,689
2	36	13	P III	50	15,480
3	29	6	P II	50	14,292
4	35	9	P II	50	14,292
5	39	15	P III	60	19,055
6	34	10	P III	50	15,483
7	31	9	P II	50	14,292
8	36	14	P II	50	14,835
9	32	11	P II	50	14,689
10	34	4	P II	50	14,292
11	31	6	P II	50	14,292
12	39	6	P II	50	14,685
13	43	17	P II	50	15,086
14	41	17	Sgt I	50	17,758
15	31	9	P III	50	13,718
16	35	13	P III	50	15,483
17	33	12	P II	50	16,328
18	35	11	P II	50	14,689
19	31	9	P II	50	14,292
20	48	21	Det II	50	17,758
21	41	18	Det II	50	17,758
22	41	18	Sgt II	50	18,750
23	40	13	P II	50	13,353
24	33	10	P III	50	15,489
25	38	12	Det I	50	16,819
26	38	12	P II	50	16,328
27	33	8	F F II	50	14,234
28	34	10	P III	50	12,799
29	35	11	P II	50	14,689
30	40	13	P III	50	15,483
31	41	12	P III	50	15,483
32	34	12	P III	60	18,687
33	38	13	P III	50	15,483
34	36	15	Sgt I	50	16,140

Source: City of Los Angeles

Table 18
Psychological Disability Pension Costs

Total Cost	Average/Pensioner
$18.7 million	$552,817
If anticipated COLA increases based on an estimated 6% CPI are included:	
$63.3 million	$1,864,477

Persons retired for disability who find themselves recovered after being away from work for a year or two may undertake other non-city employment and continue receiving the pension.

According to city officials, benefit levels for safety officers have historically been set high (50% or more of salary), because it was assumed that most injured police officers and firefighters would be unable to find employment elsewhere. No one contemplated stress-related disability pensions for per-

sons who might have been unable to function in their former safety positions but are fully able to undertake a new career.

San Francisco Disability Pensions

After a *129% increase* in the number of city police and fire disability pensions between 1968 and 1978, San Francisco Examiner reporter James A. Finefrock researched a five-part series on who was getting disability pensions, and at what cost to San Francisco. The newspaper series related to a proposal before the Board of Supervisors to shift retirement costs outside the property tax limitations set by Proposition 13. In certain departments, for example, the police department, the cost of employee retirement benefits made the retirement system the *largest* single recipient of city tax funds. (Supervisors considered increasing the property tax rate from $4.97 to $8.30 to pay retirement costs, but decided to raise business taxes instead.)

During a 12-year period preceding 1979, the Retirement Board — consisting of the president of the Board of Supervisors, three mayoral appointees, and three elected employee members — approved 84% of 900 petitions put before it. In one year, 50 of 51 petitions were granted.

In 1978, the retirement system surveyed disability pensioners to determine post-retirement employment among former police and fire employees. Results of the voluntary survey show that 45% of former policemen had been employed since retirement, and 15% of these were under no medical care.

Types of employment held by these pensioners: lawyer, dentist, security guard, welfare-fraud investigator, warehouseman, highway equipment operator, salesman, chauffeur, saw operator, construction worker, private investigator, public safety officer, and ferryboat pilot. All these retired city employees received a minimum pension of half-pay, and that pension is increased annually by one-half of any salary increase granted active employees.

In one Southern California city, a similar employment picture was disclosed for safety members retired for disability between 1978 and 1980 (Table 19).

Disability Costs

Annual costs of all disability compensation and disability retirement benefits for local government in California are unknown. Few local jurisdictions distinguish expenditures for "4850" benefits, vocational rehabilitation, workers' compensation benefits, litigation costs, and disability retirement expenses.

The City of Los Angeles was one of few cities able to respond to a 1984 survey of disability costs conducted by the League of California Cities. Data in Table 20 is for the last three fiscal years.

These figures do not reflect expenditures for disability retirements during this period, because retirement is paid by the city as of a percentage of employees' salaries. The number of disability retirements just for safety employees in the last three years and the employer safety contribution rate are indicated in Table 21.

Table 19
Employment of Disabilitants

Former Job	Years of Service	Retirement Age	Current Employment
Firefighter	23	54	Owns and maintains apartments
Police Officer	4	28	Owns and operates polygraph company
Police Lieutenant	25	47	Works for private security service
Police Officer	9	30	Manages private security service
Police Officer	6	27	Jewerly store salesman
Police Officer	5	28	In vocational rehabilitation for computer program
Police Officer	22	28	Jr. College teacher
Police Sergeant	21	49	Manages private security service
Fire Captain	20	51	None
Fire Captain	25	58	Working, job unknown
Police Sergeant	25	50	None
Fire Captain	31	55	None
Police Officer	5	31	Unknown

Source: California Public Employee Retirement: More Than A Gold Watch

Table 20
City of Los Angeles Workers' Compensation Costs

	Total Employment			Workers' Compensation Costs			
Fiscal Year	Police	Firefighters	Miscellaneous	Total	Police	Firefighters	Miscellan
1980-81	7,146	2,871	20,344	$28,043,264	$12,675,720	$5,472,309	$9,895
1981-82	7,146	2,878	17,850	37,743,842	17,014,638	7,171,035	13,558
1982-83	6,900	2,692	17,913	32,554,912	13,645,018	6,875,6]7	12,034

Source: City of Los Angeles

Table 21
Incidence and Rates for Los Angeles Disability Retirement

Fiscal Year	Disability Retirement	Rates (as % of salary)
1980-81	91	62.0%
1981-82	146	58.5%
1982-83	137	58.5%

Source: City of Los Angeles

If Los Angeles' city workforce of 27,500 expends over $30 million annually for injured employees' benefits — excluding disability retirement costs — what is the total cost for the 409,000 employees of all cities and counties in California?* It could be $484.9 million annually, if all jurisdictions followed Los Angeles' pattern. Disability retirement costs would be on top of this amount, at an estimated $300,000 to $500,000 per case.

According to estimates from a task force on disability prevention for counties under the 1937 Retirement Act, that figure is low. The task force estimated that each year 12% of city/county employees are temporarily disabled, and/or require medical treatment for job-related causes, and receive workers' compensation benefits. At an average cost of $2,400 each (1979 estimate), city/county costs were estimated at $300,000 per 1,000 employees. That adds up to $1.2 billion for the 400,000-plus city/county workforce in 1983.

In a first-ever survey of the twenty 1937 Retirement Act counties, conducted in 1979 and concentrating on disability retirements, the task force further identified annual costs to all counties in excess of $80 million for disability retirement. This amount is funded primarily from counties' general fund revenues. The cost per case used by the task force was $75,000, considerably less than today's estimate.

Alternatives

Under pressure of managing in an era of funding limits, cities and counties have become well aware of high costs of disability, and have devised various approaches to deal with the problem.

San Mateo County Modified Work Program

Without a change in legislation, San Mateo County has dealt with its disability costs in very productive fashion. In July 1980, San Mateo County implemented a back-to-work program so effective, according to county officials, that no retirement for disability has occurred since that date, even though six cases per year were the average prior to the program. In addition, at the outset, three injured county employees, all already off work for more than one year, were returned to modified work positions instead of receiving disability pensions.

How it Works

The program, termed Modified Work Program, applies to all county employees, safety as well as non-safety. The county workforce of 3,700 has 350 deputy sheriffs and other peace officers; there are no county firefighters.

The back-to-work plan has provisions for temporary and permanent work assignments. Employees temporarily unable to perform normal work because of injury — no distinction is made between work-related and non-work-related injury — are seen by a county physician who discusses with the injured worker's supervisor an appropriate light-work assignment. Employees able to perform alternative tasks are compensated at full salary for up to 90 days. Employees still unable to function in their regular assignments after 90 days are reviewed under the permanent modified work program.

Employees who refuse modified assignments are ineligible for disability or workers' compensation benefits. Those who disagree with the physician's assessment of their ability to work may appeal to the Workers' Compensation Appeals Board.

The county unit with responsibility for the program, the Risk Management Division of General Services, reviews cases where physicians do not approve temporary modified assignments and is authorized to seek independent medical advice.

In cases where an injury requires a permanent job change, an outside vocational/rehabilitation counselor analyzes the injured worker's skills and recommends appropriate alternative employment. The modified work program coordinator then finds a position for the individual in the original department or elsewhere in county service.

As an incentive to departments to place and retrain injured workers, the modified work program office will pay an individual's full salary costs for up to one year. Funds are from the Workers' Compensation and Long-Term Disability Trust Fund reserves, which otherwise would be used to compensate injured employees off the job. This aspect of the program means departments are not financially penalized for retraining employees.

In situations where a new assignment fails to work out, the modified work program office locates another position for an injured worker. In 1984, one individual was placed in three different positions before acceptable employment was found. At any one time, the modified work program office, with its staff of two coordinators, is working with some 20 injured county employees. Some eventually go to different departments, although most safety officers find alternative employment in the sheriff's department.

Pay for permanently retrained workers is maintained at least at the former rate, unless, of course, the new job is at a higher salary. The retirement fund, which otherwise would have to pay for disability retirement benefits, supplements pay levels where necessary.

According to Don Blum, county risk manager, the minimum cost of a single service-connected disability retirement is $350,000. Six times this amount, or $2,100,000, is the savings the county has realized by turning around the trend of six disability cases per year.

In addition, county workers' compensation litigation costs have been dramatically reduced because employees returned to work by project coordinators do not need attorney services.

Why it Works

Is there something unique about San Mateo County that makes its modified work program non-applicable to other jurisdictions? This is why the county thinks its program is successful:

- **Top management backing.** The program has full and complete support of the Board of Supervisors and the county manager.
- **Cooperative atmosphere.** Even though the program cuts

*1983 Employment Development Department estimate which includes CETA and other employment programs.

across department boundaries, county officials have raised no "turf" arguments. The treasurer-tax collector (retirement administrator), personnel director, and district attorney are credited with promoting the program, and the sheriff, whose office finds alternative employment for injured deputies, is given especially high marks for assistance.

- **Communication.** Before the program was implemented, briefings for county employees, union representatives, physicians, attorneys, and personnel employees were conducted to take any mystery out of the program.

- **Funding.** The "carrot" to operating departments of full salary subsidy for retraining injured workers is thought to be critical to getting department support.

- **Use of contract personnel.** Use of outside vocational counselors lends credibility, is economical, and gets administrators' attention.

Note: As enthusiastic as San Mateo County officials are about the modified work program, they ruefully admit the employer lacks sufficient authority to block workers intent on claiming half-pay for an injury and leaving the county for other employment. The success of their back-to-work program may stem from the philosophy of the retirement board which closely monitors potential disability cases.

Alternative Solutions

Other jurisdictions have tried other approaches. Contra Costa County conformed its definition of disability to the Social Security definition which is inability to perform *any* job, and increased benefit levels, but even so, has reduced disability costs.

In Los Angeles County, no disability retirement benefits are available to members of alternative retirement Plan E, adopted in 1982. There is, however, a long-term disability and survivor's benefit plan, under which injured workers wait a six-month qualifying period before becoming eligible for 60% of salary, an amount offset by sick pay, vacation, outside income, and disability payments from other publicly-funded sources.

Eligibility for the first 30 months of disability is defined as inability to perform in the employee's former position. Thereafter, injured workers must meet Social Security's total disability standard to be eligible to receive benefits.

Alameda County Disability Prevention Program

Before it was stopped by court action, Alameda County reduced its salary continuance program for miscellaneous employees from 100% of salary to 80%. Within a year, the system realized a 36% reduction in work days lost, and the county saved almost $138,000.

Alameda County, with an employee disability prevention program since 1973, subsequently modified procedures to offer the 80% benefit. At the same time, the county continued to focus on pre-employment medical screening, employee safety, and workers' compensation claims management in order to minimize incidence of employee injury and disability.

In addition, the county provides professional counseling to employees whose personal problems adversely affect job performance, and vocational rehabilitation to injured workers able to return to productive service with the county. It also actively challenges questionable disability retirement claims. Savings resulting from these efforts in fiscal 1979-80 were more than $15 million (Table 22).

Note: Alameda County officials believe their efforts are constrained by current laws that allow employees unwilling to retrain to claim costly disability benefits.

Table 22
Disability Program Savings in Alameda County

Employee Safety and Health Programs. Accident costs (other than workers' compensation) avoided due to the maintenance of accident frequency rates substantially below those typically experienced by local public agencies.	$6,000,000
Workers' Compensation Claims Management Programs. Projected savings compared to the cost of an insured program at basic insurance rates.	$6,800,000
Employment Medical Examination Program. Savings in disability retirement costs due to the identification of pre-existing medical conditions.	$233,000
Employee Rehabilitation Program. Disability retirement costs avoided through the successful rehabilitation and placement of disabled county employees.	$720,000
Employee Assistance Program. Estimated savings due to the avoidance or resolution of employee performance problems due to deteriorating physical or emotional health, substance abuse, etc.	$297,068
Disability Retirement Claims Management Program. Savings realized on disability retirement claims which were avoided or filed but subsequently denied or reduced to the less costly non-service connected category.	$1,000,000

Source: Alameda County

Some California cities have been equally innovative. Napa and Eureka have experimented with wellness programs to identify safety employees prone to hypertension and heart problems, then worked to change these employees' diet, exercise, and stress management patterns. Numerous jurisdictions have developed pre-employment screening to preclude or lessen potential future disabilities.

Public Employee Safety Contract

Hercules, a small San Francisco Bay Area city, has an employment relationship with public safety officers dealing with disability and retirement in an entirely different way. Like military personnel, Hercules police employees sign on for "hitches" of four years, with additional three-year commitments possible. As part of the individual contract between an employee and the city, Hercules pays 16% of gross monthly salary into a deferred income plan which permits employee choice of investment and withdrawals. There is no traditional retirement system. Life insurance and long-term disability insurance are available at employees' option and expense. The city provides workers' compensation coverage.

The public employee safety contract is the brainchild of John C. Houlihan, former mayor of Oakland, and former executive director of the Institute for Local Self Government, in which capacity he oversaw a study to find alternatives to traditional public safety employment practices. The public safety employees contract was presented as an alterna-

tive to traditional pension programs and tenure-inducing retirement.

The Hercules experiment, begun in 1977, has not been without problems. Police officers have not always accepted that Hercules' system is not business-as-usual civil service, and have presented legal challenges to contracts. Notwithstanding, Hercules has *no* unfunded pension liabilities, and *no* employees on disability retirement. On the other hand, employees earning $15,790 annually (1979 data), have been able to accumulate deferred compensation bank accounts, after ten years service, equal to $41,235 (Table 23).

Table 23
Hercules (California)
Public Safety Employee Contract
(10-Year Projection)

Year	Monthly Salary*	Contribution at 16%	Cumulative Interest†	Deferred Totals
		Sergeant		
1	$1,323.00	$2,540.16	$130.84	$2,671.00
2	1,415.61	2,717.97	528.46	5,786.59
3	1,415.61	2,717.97	1,226.58	9,202.68
4	1,415.61	2,717.97	2,254.17	12,948.25
5	1,415.61	2,717.97	3,643.03	17,055.08
6	1,415.61	2,717.97	5,427.99	21,588.01
7	1,415.61	2,717.97	7,647.26	26,495.25
8	1,415.61	2,717.97	10,342.73	31,908.69
9	1,415.61	2,717.97	13,560.32	37,844.25
10	1,415.61	2,717.97	17,350.40	44,352.30
		Patrolman		
1	$1,230.00	$2,361.90	$121.64	$2,483.24
2	1,316.10	2,526.91	491,31	5,279.82
3	1,316.10	2,526.91	1,140.35	8,555.78
4	1,316.10	2,526.91	2,095.72	12,038.05
5	1,316.10	2,526.91	3,386.95	15,856.19
6	1,316.10	2,526.91	5,046.43	20,042.59
7	1,316.10	2,526.91	7,109.70	24,632.77
8	1,316.10	2,526.91	9,615.69	29,665.67
9	1,316.10	2,526.91	12,607.10	35,184.00
10	1,316.10	2,526.91	16,130.76	41,234.57

*Monthly salary reflects 7% cost-of-living adjustment (COLA) in first year; remaining years at base without COLA.

†Interest on money market certificates at 9.645%.

Source: City of Hercules

Florida's Wage-Loss Program

Other states, faced with many of California's problems, have also found workable solutions. In 1979, Florida moved away from a system of compensating injured workers based on impairment ratings, to a system basing compensation for permanent partial disability on after-the-fact information about economic loss.

Florida went to the new system after 1978 statistics indicated 60% of almost $1 billion in benefits went to only 2% of injured workers. These were persons claiming permanent partial injuries, and research indicated 89% of the recipients had disability ratings of 10% or less.

According to testimony before the Florida legislature, there were a number of contributing factors to Florida's spending so much for so few. (Florida at that time was second to California in total outlay for work-related injuries.) Those factors included liberal eligibility and liberal benefits, high attorney involvement, "doctor-shopping" to find the best impairment rating, lump sum future medical payments (seldom used for medical treatment), and guessing about future diminished earning capacity.

In moving to wage-loss reimbursement for permanent partial claims, Florida also upgraded its existing payment schedule for medical benefits, and increased temporary disability benefits, payable after seven days off work, to 66⅔% of salary, not to exceed 100% of the statewide average weekly wage. Rehabilitation benefits were also liberalized.

Under wage-loss, employees permanently impaired and unable to make 85% of former wages receive 95% of the difference from the workers' compensation system. No benefits are due unless physical impairment is present. However, if there is at least 1% impairment, injured workers may be able to collect benefits up to 525 weeks.

Upon enactment of the new compensation approach, Florida employers received an immediate 15% reduction in premiums worth approximately $140 million. By January 1982, total reduction in workers' compensation rates was 43.5%. Florida's success has led Oregon and Delaware to draw up similar legislation.

A joint legislative Committee on Workers' Compensation, established pursuant to *ACR 49* (Young), has been charged with recommending reform of the existing workers' compensation system. A committee report is expected late 1984.

Conclusions:

- Local governments are becoming increasingly aware of full costs of employee disability.
- Local jurisdictions able to redefine "disability" have developed innovative, effective programs to manage disability costs.
- Legislative barriers must be eliminated if local management efforts are to be truly successful.
- The lack of adequate data on incidence, cause, and expense of injuries to local government employees impedes reform efforts.

Recommendations for the Legislature

Efforts to control local government disability costs cannot be successful until the following legislative barriers to disability prevention are eliminated:

- Perhaps the most important legislative change: eligibility for disability retirement benefits should be "inability to perform any work," the Social Security standard.
- Liberal construction of Section 3202 of the California Labor Code should be repealed and workers' compensation law should be "fairly and equitably" construed.
- Only injury that substantially contributes to disability should be compensable; no illness or injury should be presumed to be work-related.
- Disability pay should not serve as a disincentive for employees to return to work. Compensation should be for actual wage loss and in no case more than an injured employee's take-home pay.
- Benefit payments to local government employees should not be duplicative for the same illness or injury ("4850" time, permanent disability awards, disability retirement, sick leave).
- Workers' compensation claims should be apportioned to non-industrial factors contributing to disability.
- Disabled employees gainfully employed should be ineligible to continue to receive a disability pension.

- Local governments should be obligated to retrain or offer other employment to injured persons unable to function in their former positions. Compensation in alternative work should be no less than prior pay.

Recommendations for Local Government Management

- Disability prevention and back-to-work programs along the lines of those developed in Alameda and San Mateo counties should be promoted.

- Pre-employment screening and on-going medical evaluation should be provided.

- Data must be developed and maintained for the following:

  -Total workers' compensation costs by category (example: police, fire, miscellaneous employees).

    a. Benefits paid by category of injury (example: heart, psychological).

    b. Frequency of injury type.

    c. Workers' compensation litigation costs.

  -Number and type of retirement (example: industrial, normal).

  -Employee profiles (example: age, length of service at time of disability).

  -Frequency and cost of sick leave, "4850 time."

  -Incidence and cause of emotional behaviorial problems (example: alcohol abuse, stress).

III

Collective Bargaining Trends

Collective bargaining in local government is very similar to private sector negotiations, even though bargaining with elected bosses has a political dynamic that would seem to call for different procedures. Pending legislative change would conform public bargaining even more with private sector practices. There is a push for binding arbitration of negotiation disputes, described as a trade-off for the right to strike, but experience in California cities that have arbitration argues forcefully for its rejection.

"Agency shop" authority, which obligates employees to contribute financial support to employee organizations, should not be extended to employee organizations representing local government managers, supervisors, and confidential employees, because these employees tend — and should be encouraged — to identify with management.

Placing local government labor disputes under jurisdiction of the Public Employment Relations Board (PERB) will saddle local governments with unwanted PERB precedents, particularly regarding a protected right to strike. Pending legislation (SB 1440 - Torres and McCorquodale) should be rejected.

Prevailing wage requirements mandate that local governments grant salary increases at least equal to raises in survey jurisdictions. Such prevailing wage obligations are inconsistent with the bargaining obligation, result in artificially high compensation levels, and should be abolished.

Local government personnel expenditures, which may account for 60% - 70% of their budget, could be better controlled if management used a total compensation approach in arriving at compensation levels. Using this approach, local government would calculate all costs — for health care, retirement, vacation, holidays, uniform allowances, and other benefits — in determining competitive and comparable pay packages.

A Short History of California Local Government Labor Relations

January 1, 1969, is a watershed date for local government employer-employee relations. That is the effective date of the Meyers-Milias-Brown Act requiring local management to meet and confer in good faith with representatives of recognized employee organizations.

Until that date, local governments had a different legal obligation vis-a-vis employee organizations. Legal framework was provided by the George Brown Act, enacted in 1961, which applied to all public employees, not just local government workers. This legislation granted employees the right to join organizations of their choice and required employing agencies "to meet and confer" with representatives of employee organizations on request. Management was required to consider employee presentations as fully as deemed reasonable.

Before passage of the George Brown Act no state statute governed public employer-employee relations. Rules concerning employee organization rights, representation, and grievances were at the discretion of management.

Prior to legislation guaranteeing representation rights, local government employee organizations were, nevertheless, a force to be dealt with. The State Conciliation Service reported in 1957 that 23 "collective bargaining agreements" were in effect covering approximately 5,000 California local government employees. A 1963 survey of independent local public employee organizations indicated 49 of the 58 counties had a general employee association. A 1961 survey of 227 city and county employee organizations revealed 116 independent general associations, 27 police associations, and 19 independent firefighters units. Five additional associations combined police and fire personnel. The remaining 70 were union locals.

Independent Employee Associations

Independent employee organizations were the major form of employee organization until the early 1970s. Originally set up as social and welfare entities, they provide credit unions, group insurance, and discount purchasing arrangements. Over time, they evolved into organizations concerning themselves with employer-employee relations.

Typically, the independent employee association had as members any local government employee, so that department heads, supervisors, professionals, technical, clerical, and blue collar workers formed a common community. When more narrowly focused professional or occupation-related organizations (e.g. peace officers) were established, it was not unusual for employees to maintain membership in the general association as well as the occupation group.

During this stage of California public employer-employee relations, employee association effectiveness was achieved in several ways. The organizations provided representation to members in grievances and disciplinary actions, and lobbied civil service bodies, governing boards, and managers. They concentrated heavily on salary, seniority, and job protection issues. On a more formal level, some of them also brought court action on behalf of members, and via the initiative process, sought to amend local charters — often successfully — to establish retirement and civil service systems, and to obligate the jurisdiction to pay prevailing wages and submit salary disputes to arbitration.

Most of these associations shied away from openly endorsing candidates in local elections, but tended to maintain close contact with elected officials and members of the critical personnel commissions.

In general, a non-adversarial attitude prevailed. Managers often turned to the employee association as a means of communicating with workers, and, as noted above, all employees, from top management down, tended to join associations. They sought a variety of employee welfare objectives (health care and retirement benefits, promotional and career opportunities) and advocated gradual, incremental change. Winston W. Crouch, in *Organized Civil Servants,* describes typical behavior of a general public employee association in this period as "prudent in its demands . . . for salaries and benefits; the staff director and officers often advised . . . members to temper their demands to match current economic conditions."

Civil Service

When the retirement and disability need around which many independent employee associations had organized began to be met by employer-maintained retirement systems, many of these groups exhibited interest in stabilizing government employment conditions, and lobbied governing bodies for civil service systems. In some cases, they achieved this goal by going to voters with initiative petitions.

Civil service systems had as a primary objective the elimination of the use of public jobs as a political payoff, and also to insulate public employees from pressure for contributions and support from their elected bosses. Overseen by commissioners, civil service commissions developed objective criteria about jobs and examinations for these jobs, and sat as an appellate body to referee management personnel practices.

As an interested party, employee associations took part in civil service decision-making by making presentations before the commissions regarding job duties and promotional opportunities and also by representing individual employees on exam appeals and disciplinary actions. They also typically consulted with governing bodies regarding appointment of civil service commissioners.

Many civil service commissions conducted salary and benefit surveys, and often made recommendations about the amount of increase needed to keep a jurisdiction on par with other localities. Authority to grant increases, however, was restricted to elected legislative bodies and executives.

Collective Bargaining

The non-adversarial mood characterizing most California public employer-employee relations began to change in the early 1960s, as national unions and independent employee organizations lobbied for the extension of Wagner Act rights (private sector collective bargaining rights) to public employees. The reasons behind this effort were varied. There was rising frustration over compensation and benefit levels, employee organizations complained they had no legal authority to make management do much more than listen to their pleas — and under the George Brown Act for only so long as management deemed appropriate.

General employee organizations were also beginning to be challenged by professional and occupation groups. The bigger threat, however, came from national unions. The 1961 AFL-CIO convention, recognizing the growth of white collar workers, a significant portion of whom were in public employment, approved a national recruitment drive aimed in part at organizing government employees. A Government Employees Council was established to prepare legislative programs.

President Kennedy, in his 1961 Executive Order defining labor relations for federal employees, lent legitimacy to the labor movement in the public sector. (Wisconsin had already established a collective bargaining law in 1959.) In California, passage of the Meyers-Milias-Brown Act meant that local government employees were the first focus of union organizing.

Meyers-Milias-Brown Act

The bill passed in 1968 was described at that time as a limited "meet and confer" law, a compromise between doing nothing and passing a "negotiations" bill. Local government representatives, the League of California Cities and the County Supervisors Association, had for a number of years successfully opposed efforts to push public agencies into private-sector style collective bargaining. In 1968, when it was obvious that change was imminent, management representatives worked to achieve a law that would treat all local government employees similarly — collective bargaining statutes solely for police and fire personnel were also under discussion in 1968 — and which would recognize distinctions between public and private bargaining and between public and private employers.

As enacted, the bill required local governments (state and school employees were no longer covered together with local government employees) to meet and confer in good faith with representatives of recognized employee organizations. The parties had the mutual obligation to endeavor to reach agreement on matters within the scope of representation. However, "consideration of the merits, necessity, or organization of any service or activity provided by law or executive order" was excluded from negotiability.

From the start, the law was thought to be vague and ambiguous. Legislative Counsel opined that exclusive recognition of employee organizations was impossible under the Act. Joseph Grodin, prominent labor law attorney and now a member of the California Supreme Court, wrote in CPER, a periodical about California public employee relations: "The Act itself is both sketchy and vague;" he also stated that absent an administrative agency to interpret the Act, the job would fall to the courts.

Court Interpretation

Justice Grodin was correct. The courts have rendered a number of decisions about the law, the cumulative effect of which has been to make it a full-fledged collective bargaining obligation for local public employers. At the same time, local employers have remained without some of the protections provided to management in a private sector negotiating environment.

Glendale City Employees Association v. City of Glendale (1971) established that a negotiated contract was binding on the local jurisdiction. In *Los Angeles County Employees Association, Local 660 v. County of Los Angeles* (1971), management was required to bargain the size of caseloads car-

ried by eligibility workers, even though the number of cases per employee conditions how management organizes the work force.

Firefighters Union Local 1186 v. City of Vallejo, decided in 1974 by the Supreme Court, is the decision that caused the biggest reverberation within the local government employer community. That case determined certain issues management had maintained were management rights and therefore not negotiable were indeed within the scope of bargaining. They included personnel reductions, vacancies and promotions, scheduling, and manning procedures.

The *Vallejo* case also established the principle that experiences under the National Labor Relations Act in the private sector could be precedent-setting for local government practices. Effectively this meant that arguments about the unique nature of public employment, that its scope of negotiations should differ from private sector, were disposed of by the court.

A corollary subject addressed by the court in this decision dealt with binding interest arbitration, that is, settlement by a third party of a negotiation dispute at the bargaining table about what provisions were to be included in the labor contract. *Vallejo* conveyed the court's support for arbitration, which was described as a trade-off for public employees' right to strike.

Strikes

Like most other public employee labor legislation in California, the Meyers-Milias-Brown Act handles prohibition against striking — or the right to strike — obliquely. The law declares that provisions of Section 923 of the Labor Code, which deals with protected rights of private sector employees to engage in concerted activities, are *not* applicable to local government employees.

Case law, not legislation, has established that public employees have no protected right to strike. That at least was the legal view until 1979, when the Supreme Court determined that PERB, the Public Employment Relations Board that administers bargaining acts for school, state, and higher education employees, has the authority to determine that a job action as the result of an unfair labor practice could be a protected activity. Since the court's ruling in *San Diego Teachers Association v. San Diego County Superior Court,* PERB has judged seven other cases involving striking school employees. In some of these cases, employee actions were deemed provoked by improper management actions, in others the employee activities were viewed as illegal because unprovoked.

PERB has no authority over local employer-employee relations — although legislation proposed in the state Senate in 1983 and 1984 would establish PERB as the local government labor relations administrative agency. The prevailing view continues to be that absent legislative authorization, local employees currently have no right to strike. What may change that view is a case to be heard in 1984 by the Supreme Court dealing with striking employees of a special district *(County Sanitation District, No. 2 of Los Angeles County v. Los Angeles County Employees Association, Local 660, SEIU).* These employees are covered under Meyers-Milias-Brown.

MMB Amendments

There have been two substantive amendments to the original Meyers-Milias-Brown Act. In 1970, Section 3507 was amended to clarify that recognized employee organizations, pursuant to a vote, had the *exclusive* right to represent employees in a unit. Of considerably more import, however, was legislation enacted in 1981 authorizing "agency shop" provisions. What this meant is that local government employees in a bargaining unit, but not dues-paying members of the employee organization or union, could be required, as a condition of employment, to pay an "agency shop" fee to the bargaining agent to defray costs of representation at the table and in grievances.

Local government officials expected "agency shop" authorization. The Rodda Act, the collective bargaining bill for school employees passed in 1975, contained such a provision, and bills to enact it for local government were a regular feature in the Legislature. However, representatives of local government had consistently argued that "agency shop," to strengthen employee organizations, should only be agreed to as part of a trade-off for removing management employees (management, supervisors, and confidential employees) from coverage of the Act. Notwithstanding, the "agency shop" bill that passed *(AB 1693,* Tucker) in 1981 did nothing to alter management representation rights.

Efforts to amend MMB in additional major ways set the stage for annual skirmishes between representatives of the League of Cities and the County Supervisors Association and advocates of local government employee organizations, particularly police and fire representatives. The two biggest issues are binding interest arbitration and PERB administration of local labor disputes. The former, about which more is reported below, is opposed as authorizing a non-elected official, an arbitrator, to make binding decisions that commit major portions of local government budgets.

Opposition to authorizing PERB to adjudicate unfair labor practice charges is equally strong. Local management believes a general administrative body to regulate employer-employee relations is not needed (employee relations commissions are permitted under MMB by local option), and even if it were, PERB would not be their choice. To be even partially acceptable, any board would have to be limited to local government issues solely, unlike PERB, which administers labor law for school employees and state workers. In addition, some of PERB's rulings, as in strike cases and in negotiability determinations, have been found unacceptable by local officials.

Where Does Management Fit In?

Negotiations in a private sector setting involve two distinct and identifiable parties, labor and management. In local government settings, however, determining management is not simple. Collective bargaining laws, for the first time, made distinctions between employees based on bargaining rights. Yet since management employees also have guaranteed representation rights — MMB authorizes managers, supervisors, and confidential employees to bargain, so long as they do not represent rank and file workers — management at the bargaining table can suffer from identity problems.

Confusion about who is management is further complicated because separate management classes have never been well defined in civil service, perhaps because civil service rules encourage promotion from the bottom up and little distinction attends progression into next higher classes. Certainly no special pay or benefit provisions distinguished management and non-management classes in the past; benefits for top management were normally identical to those offered beginning clerks. Further, the public and elected officials tend to make few distinctions among "public" employees.

Employee organizations, too, have pressed for narrow definitions of management classes. For example, a long-standing issue in on-going legislative labor relations battles has been whether or not police sergeants are management or rank and file.

Elected Officials as Management

Another trend in the development of local government labor relations over the past 10 - 15 years is the changing role of local elected officials. In two cities surveyed for this study, the conclusion could clearly be drawn that a majority of the city council in each jurisdiction did not view itself in a traditional management role. In one city the council once viewed itself — a decade ago — as a sort of board of directors of a municipal corporation, and viewed itself on the management side in negotiations. Now the council views itself as an independent arbitrator, between city management staff and employees. In another city, the council has been viewed for many years as having a strong labor bias, and city management staff has consistently operated at a disadvantage in labor negotiations, which, incidentally, involve more than a dozen bargaining units, and are non-stop throughout the year. The impression gained in these two cities is that there is also considerable direct involvement of city council members in employee relations.

By contrast, in a third city in the study, the role of the council in labor relations was described as "hands off," particularly during the annual negotiation season of almost four months when staff is locked up in discussions with the four bargaining units. In this city, the objectives of the council, its management staff, and its negotiators are mutual, and it is recognized that management is strong because of it.

How can these different management roles of a city council be explained? As much as anything, they seem to be a function of basic differences in a community's view of itself, its expectations of its public officials, and its labor relations traditions. What's stricking about these differences is that they involved major cities in the same state, operating under the same set of labor relations statutes. What this indicates is that within the existing framework of statute and case law, there is a wide range of possible labor relations results. More importantly, the course of local labor relations seems largely in the hands of local voters and the people they elect to conduct their public business.

Civil Service Systems and Collective Bargaining

Historically, employee organizations argued before civil service commissions for regulations that advantaged their members in competing for civil service positions. With collective bargaining, however, areas that once were determined by civil service bodies are now often negotiated. Civil service commissions still exist, albeit as appellate bodies. What this arrangement often means is employee organizations may have two bites at the apple, once at the bargaining table, then again before civil service bodies.

Public Employee Unions

Realistically speaking, three bites may describe the situation more accurately. Employee organizations are politically active, especially those representing police and fire personnel. Frequently, employee associations and unions (synonymous terms as far as legal representation rights are concerned; AFL-CIO affiliates generally call themselves unions, whereas employee organizations that grew out of early social and welfare — insurance — entities have tended to prefer the term association) are often the only substantial contributors during elections, and their involvement translates into both money and time, the latter spent walking precincts and distributing campaign literature.

Did enactment of MMB facilitate the development of activ[illegible] it did. National union officials trying to bolster lagging membership rolls looked to where legislatures had authorized public employee bargaining, and in California that meant first local government, whose bargaining law preceded negotiations authority for school and state employees.

To some extent one can speak of a two-way street: with enactment of MMB, local government employee organizations began to seek out affiliation with national labor unions. One reason was protections afforded by Article XX of AFL-CIO constitution, the prohibition to other AFL-CIO affiliates against "raiding" or trying to decertify (replace) an existing AFL-CIO bargaining representative.

There were other reasons as well. Identification with established national labor unions, such as AFSCME (American Federation of State, County, and Municipal Employees) and SEIU (Service Employees International Union), and various traditional craft unions, such as IBEW (International Union of Electrical Workers), Operating Engineers, Teamsters, Laborers (Laborers International Union of North America), and MEBA (Marine Engineers Benevolent Association), among others, was thought to provide negotiation expertise to independent associations. More important, however, was clout both in central labor councils when strike sanctions would be sought, and in political circles.

What Next?

Efforts are annually made by employee organizations to use this clout to expand MMB. For the past two years, the legislative push has been in three areas: binding interest arbitration, PERB administration of local labor disputes, and agency shop for the remaining employees not covered under the Tucker bill of 1981: managers, supervisors, and confidential employees.

These proposals are unacceptable to local government officials and their representatives, the League of California Cities and the County Supervisors Association. They perceive that authorization of arbitration and PERB administration would result in further, even final, loss of management control at the local level. They hold agency shop for employees whose interests are wholly or partially identified with management to be bad policy.

Local Government Compensation Issues for the Eighties

The following is a discussion of critical local government compensation issues that are — or should be — part of the discussion about local government finance. The choice of subjects was determined in part from interviews with local government officials during field work in the Local Government Finance Study, in part by proposals regularly before the Legislature that could impact existing practices. Cal-Tax conclusions and recommendations regarding MMB and local government compensation practices are found at the beginning of this study.

Binding Interest Arbitration

There have been tremendous efforts to use the clout employee organizations and unions enjoy to legislate binding interest arbitration, at least for police and fire employees. Binding interest arbitration involves authorizing a third party, an arbitrator, to impose settlement of a negotiation dispute between local management and employee representatives. This arbitration is compulsory for the parties, and the arbitrator's decision is binding.

Local government management is strenuously opposed, in

had with this process. The cities are Vallejo, Oakland, Hayward, Alameda, Palo Alto, and San Jose, and the range of arbitration among them is indicated in Table 24.

Table 24
Binding Interest Arbitration In California Cities

City	Employees Covered	Type of Arbitration
Alameda	Firefighters	Last-best-offer, issue-by-issue
Hayward	Firefighters	Standard
Oakland	Police and firefighters	Standard
Palo Alto	Police and firefighters	Last-best-offer, issue-by-issue
San Jose	Police and firefighters	Last-best-offer, issue-by-issue
Vallejo	All	Standard

Source: CPER

Arbitration of negotiation disputes involves determining what goes into the labor contract, the memorandum of understanding, between local government and the employees' representatives. Once the parties are at impasse, the arbitrator decides such questions as salary levels, fringe benefits, and other terms and conditions of employment.

State-mandated binding interest arbitration has the following problems:

- *Binding arbitration allows an outside non-elected individual, an arbitrator, to make decisions that may affect up to 70% of a jurisdiction's budget.*
- *It is documented that arbitrated settlements are more costly than negotiated settlements.*
- *The state general fund would be liable for procedural costs of local government arbitrations, as well as awards in excess of a local government's salary and benefit offer.*
- *Binding arbitration does not stop strikes.*
- *Arbitration proceedings are expensive and cause inordinate delay in budget adoption.*
- *Binding arbitration has a chilling effect on negotiations.*
- *Arbitration decisions often impinge on management's ability to manage.*
- *Public employee organizations in California have adequate means other than arbitration to achieve their objectives.*

Impact on Negotiations

Experience in California jurisdictions that have a binding interest arbitration provision appears to confirm the "chilling or narcotic" effect arbitration has on negotiations. In Vallejo, for instance, there has been *no* voluntarily agreed-to settlement for firefighters since arbitration was approved there in 1970. Similarly, more than one-half of the agreements with Oakland and exactly 50% of the agreements with Palo Alto police and fire personnel have been imposed settlements since arbitration became an option in these two cities.

In Alameda, where voters enacted arbitration in 1980, distinguishes this city's arbitration provison from that of the other five cities is the requirement to submit for voter approval any award by an arbitrator that is in excess of that agreed to by the city.

The tendency for stalled negotiations and arbitrated settlements evident in Vallejo and Oakland can be attributed to attitudes the parties bring to the table when they know arbitration is an option. Management officials, for example, believe they must have a different bargaining strategy when arbitration looms as the end process, and they are usually hesitant to show all their cards during negotiations. On the other side, labor is inclined to try its luck with arbitration, expecting to do no worse than what management has already offered.

Costs

Two kinds of costs are involved in binding interest arbitration: procedural costs (arbitrator, transcript, staff time) and the cost of the award.

The procedural costs for Oakland for the four arbitrations conducted between 1974 and 1981 are shown in Table 25.

Table 25
City of Oakland Arbitration Costs

Fiscal Year	Costs
1974-75	$30,000
1976-77	$150,000
1978-79	$25,000
1980-81	$200,000

In Vallejo, the first arbitration cost the city $40,000, and subsequent expenses, including cost of lost productivity of employees' attending arbitration proceedings, have reached $200,000.

The second cost is figured as the amount in excess of what management offered, plus any lost savings the jurisdiction might otherwise have realized. Oakland, in its first arbitration, was required by the arbitrator's award to tack on an additional 3% salary increase, shorten the firefighter work week, and maintain five-person fire crews. Cost: $2.5 million annually.

In this case, however, the real cost to the city was $4.0 million, because Oakland never realized a $1.5 million savings from eliminating 36 sworn positions, a cut the arbitrator prevented.

In Palo Alto, where two out of three awards exceeded the city council's position, those salary differences have to be added to the savings the city missed out on by being prevented, by the arbitrator's award, from adopting alternative, reduced retirement benefits. To these costs must further be added a $1.4 million extra annual expense the city has to bear because the arbitrator granted firefighters one year "final comp" for determining retirement benefits, in lieu of a three-year salary average.

Proving extra costs as a result of arbitration is not always this straightforward. A jurisdiction that consciously increases its final offer in bargaining to avoid arbitration may not be able to prove extra costs, but will have them. Such an offer is easily made because of fear that an arbitrator's decision could erode management flexibility, as occurred in Vallejo and Oakland where arbitration decisions affected fire truck

Advisory Arbitration

The extent in California local government of arbitration that is advisory — not binding — is not well documented. What is known about the experience in two jurisdictions, Sacramento and Huntington Beach indicates how difficult it is for local elected officials not to be as bound by an advisory opinion as by a binding award.

In the city of Sacramento in 1981, impasse was declared when firefighters refused to accept management's 7.03% offer. The union's demand of 19.01% (14% in wages, up to 7.5% in equity adjustments) was considerably higher than the 7% to 10% increases already granted other city employees. Increases in education incentives and uniform allowances, paid time off for union representatives, and a no-strike provision were some of the other issues before the arbitrator.

The arbitrator's recommendation was for a 12.68% package with a 10% across-the-board raise and 5% additional equity increases for one-fourth of the bargaining unit, plus fringe benefit enhancements. He also recommended 12% interest payments retroactive for six months.

Even though city staff did not recommend approval of the advisory opinion, the city council voted to accept the full award minus retroactive interest payments.

In Huntington Beach, advisory arbitration has produced similar results. In 1975, three advisory awards were issued affecting miscellaneous, police, and fire employees. The arbitrator's awards were accepted *in toto* for the safety units. The only changes made by the council in the award for miscellaneous employees were in different implementation dates for improvement in health and vacation benefits. In all three cases, the arbitrator granted salary increases and benefit improvements greater than the council had offered.

Collective Bargaining and Prevailing Wage

Arbitration is only one reason why some local government salaries are higher than they otherwise might be. Prevailing wage obligations, required by various city and county charters or personnel ordinances, have also boosted wages in two ways. Prevailing wages become the floor for negotiations; from there the only direction is up. In addition, the list of jurisdictions to be surveyed for prevailing wages typically includes some of the best paying localities, even though they may have little bearing on the local labor scene.

That is why the city of Los Angeles asked voters to remove the prevailing wage clause from its charter in 1978, and again in 1983, at which time the prevailing wage obligation was finally deleted. Backers of the 1983 charter amendment argued that the prevailing wage clause had pushed city salaries far above those in private industry and other government agencies.

One anomaly of a prevailing wage approach is that nonmetropolitan jurisdictions often end up with salary rates linked to pay scales in San Francisco, Los Angeles, San Diego, or other areas in the state where rates are higher than those generally paid in the locality.

Fresno is a case in point. Section 809 in the city charter requires that the prevailing wage of eight cities (Pasadena, Glendale, San Jose, Stockton, Sacramento, Berkeley, Richmond, and Alameda) be paid Fresno police and fire personnel, unless the employees negotiate something greater.

Private Sector Union Wage

Section 809.2 is the prevailing wage requirement for [illegible] union scale to city painters, carpenters, heavy equipment operators, and similar classes. Because the union wage rate reflects intermittent employment typical of private sector skilled trades, it is considerably higher than the average hourly rate normally paid skilled workers employed year-round. Equally important, public employees' richer retirement and generous fringe benefits are left out of the comparison.

Union scale is the rule for Fresno's skilled workers and Section 809.2 is thought to cost the city one-third to one-half more than necessary to recruit and retain good craft employees.

The extra costs don't stop there. More funds — $200,000 in 1983 — have to be expended to alleviate compaction on supervisory pay caused by granting prevailing wage increases to represented employees. According to city officials, there is a compounding effect which applies to the supervisors of supervisors, all the way up to assistant department heads.

In San Francisco in the early 1970s, a prevailing wage mandate raised salaries of street sweepers and craft workers to extremely high levels because the rate used in San Francisco, as in Fresno, was the private sector union scale, a pay schedule that ignores differences in private and public employment and is therefore overly generous when applied without modification to public sector classes.

In 1976, the charter was amended so that general prevailing wages — not union scale — were the order. Even under this policy, the city has had costly settlements. In 1981, as a result of the prevailing wage formula (which looks to salary increases in five cities, only two of which are in the immediate area), a 13.25% increase was granted police officers and firefighters. Several trade-offs negotiated by the parties equaling an additional 1.2%, an amount determined to be the additional cost-of-living increase for San Francisco, were then added to this amount. (Such additional increases are at the discretion of the Board of Supervisors under the city prevailing wage requirement.)

The total increase to San Francisco safety employees that year was 14.45%, or 6.85% higher than average increases in California for all workers during the same period (U.S. Department of Labor data).

In addition to these experiences, San Francisco has discovered that the prevailing wage formula can act to artificially limit salary increases that may be paid. In 1981, the formula called for a pay increase of 4.8% for nurses, an amount the employee organization and subsequently management agreed was insufficient to attract and retain qualified personnel. Because city officials were precluded from paying any more than this surveyed amount, they finally resorted — after a strike threat by the nurses' bargaining representative — to creating a new, higher-paying classification. The city promoted all nurses into the new class — and paid them 14% to 25% more.

El Dorado County, which is obligated to pay its deputy sheriffs a specified prevailing wage, has had a different kind of problem. In 1983, when the county suffered a fiscal squeeze and froze pay for all other county employees at the 1981-82 pay level, it was nevertheless forced to grant a 5.5% pay hike to deputies, because of the prevailing wage obligation.

The city of Sacramento also has an example of why the prevailing wage approach means loss of local fiscal control. Sacramento has no prevailing wage amendment in its charter, but must, per its employee relations ordinance, give consideration to pay in six cities: Oakland, Long Beach, Anaheim, Santa Ana, San Jose, and Fresno. On its face, there seems to be nothing relevant about the six cities as far as Sacramento's

rates, the prevailing wage obligation of that city, which looks to the eight cities listed above, creeps into Sacramento's salary setting. And because San Jose is included on both lists, Sacramento could have interjected into its negotiations the "comparable worth" approach that has been mandated on that city.

Total Compensation Bargaining

Statistics indicate that local government salary increases since Proposition 13 have been above average. According to the Department of Industrial Relations, Division of Labor Statistics and Research, the majority of employees of cities and counties received wage increases in 1981-82 (latest DIR data) of 7% to 8%, down from the 9% to 10% salary increases bargained in 1980-81 — two years after Proposition 13. The U.S. Bureau of Labor Statistics reports that California workers received wage increases of 6.6% in 1982, and 7.6% in 1981, appreciably lower than local government's raises.

Similarly, the average California local government wage of $21,996 in 1981 was higher than the $15,696 average annual wage for U.S. workers surveyed by the Bureau of the Census. The local government average was $441 per month higher than what the average Californian earned during the same period.

One reason for the salary levels is that few jurisdictions take a total compensation approach at the bargaining table. Total compensation bargaining means all employer expenditures must be taken into consideration in establishing pay and benefits. Employer expenses for employees' health care, insurance, retirement, education incentives, vacation, holidays, etc. become part of the salary discussion.

Employees typically don't understand that the employer is paying, minimally, 30-50 cents for every payroll dollar for fringe benefits over and above what they see in their pay checks. (Employees can hardly be expected to appreciate this fact because public management seldom gives employees benefit statements describing total benefit expenditures.) By failing to take these costs into consideration, jurisdictions that compare only salaries from private sector and other government agencies often end up with skewed data.

Some examples make this point clear. In 1983, Baldwin Park, a city in Los Angeles County, paid its journey-level law enforcement officers $2,126 per month at top step, adjusted for vacation and holiday pay. Hawthorne, a near-by city of comparable size and functions, paid a salary of $2,153. Pay in the two jurisdictions would appear to be comparable.

Not so. Total funds expended by Baldwin Park each month for its law enforcement position added up to $3,129, since that city paid $1,003 or another 47% for health and dental insurance, uniform allowance, holidays and vacation. Hawthorne, by comparison, expended $1,863 or 86.5% of the basic law enforcement officer salary for its fringe benefits.

Thus the true comparison for the two compensation packages shows that total monthly compensation is $3,129 for Baldwin Park, $4,015 for Hawthorne. This means that law enforcement is 22% more expensive in Hawthorne, or put another way, it costs Baldwin Park 78% of Hawthorne's cost to employ a peace officer.

Table 26 indicates total compensation, by category, paid police and fire journey-level personnel in 1983 in most of the jurisdictions researched in Part 1 of the Local Government

Table 26
1983 Total Compensation for Law Enforcement Officer

City	Adjusted Salary	Retirement	Education	Medical	Uniform	Other (Vacation, Holiday, Insurance)	Wage Supplement	Wage Supplement as % of Salary	Total Compensation
Farmersville	$1,028	$93		$94	$60	$224	$471	46%	$1,499
Fresno	2,043	901	$140	131	30	202	1,419	69%	3,462
Irvine	2,154	478		216		324	1,018	47%	3,172
Los Angeles	2,286	938		227		279	1,444	63%	3,730
Montebello	1,859	719	60	217	200	236	1,432	77%	3,291
Oakland	2,177	390	121	157	37	281	986	45%	3,163
Pacifica	1,971	287	87	136	19	211	740	38%	2,461
San Diego	1,846	318	105	62	29	253	767	42%	2,613
County									
Mendocino	$1,742	$249		$109	$27	$339	$724	42%	$2,466
Merced	1,836	356		77	37	123	593	32%	2,429
Riverside	1,400	444		75		266	785	56%	2,185
San Diego	1,631	509	136	116	31	311	1,103	68%	2,734

1983 Total Compensation for Firefighter

City	Adjusted Salary	Retirement	Education	Medical	Uniform	Other (Vacation, Holiday, Insurance)	Wage Supplement	Wage Supplement as % of Salary	Total Compensation
Fresno	$2,035	$896		$112	$13	$211	$1,232	61%	$3,267
Los Angeles	2,273	934		185		284	1,403	62%	3,676
Montebello	1,834	709		217	200	231	1,357	74%	3,191
Oakland	2,170	390		198	12	297	897	41%	3,067
Pacifica	1,891	278		117	14	254	663	35%	2,554
San Diego	1,731	272				294	566	33%	2,297
County									
Merced	$1,444	$308		$124	$25	$202	$659	46%	$2,103

Finance Study; data from all were not available. These two classes were selected because public safety and public protection represent such a large part — in cities 28%, in counties 26% — of local government budgets.

Fringe Benefit Extras

A further reason to concentrate on these safety classes is to focus on high retirement and salary incentive costs such as extra compensation for additional education (Figures 1 and 2). In Hawthorne's case, the maximum $500 incentive added to pay of safety personnel who get some training is 27% of the fringe benefit cost, and 12.5% of total compensation.

In Hawthorne, police officers are eligible for a 2½% raise upon attainment of an intermediate POST (Peace Officer Standards and Training) certificate, another 2½% for the advanced certificate, then 5% each for an AA, BA, or masters degree. For firefighters, the total of incentives is 17½%: 2½% for 30 units in fire science, 5% for each of three degrees. Eligibility for incentive pay is immediate upon passing probation and increases are compounded, that is, the 20% incentives for police officers raises salaries by 21.6%.

A review of benefits and costs for non-safety local government classes reveals the disparity in fringe benefit costs for the two groups. Using the same jurisdictions in Part 1, it ap-

Figure 1
% Change in County Deputy Sheriff Pay
1977-78 to 1983-84

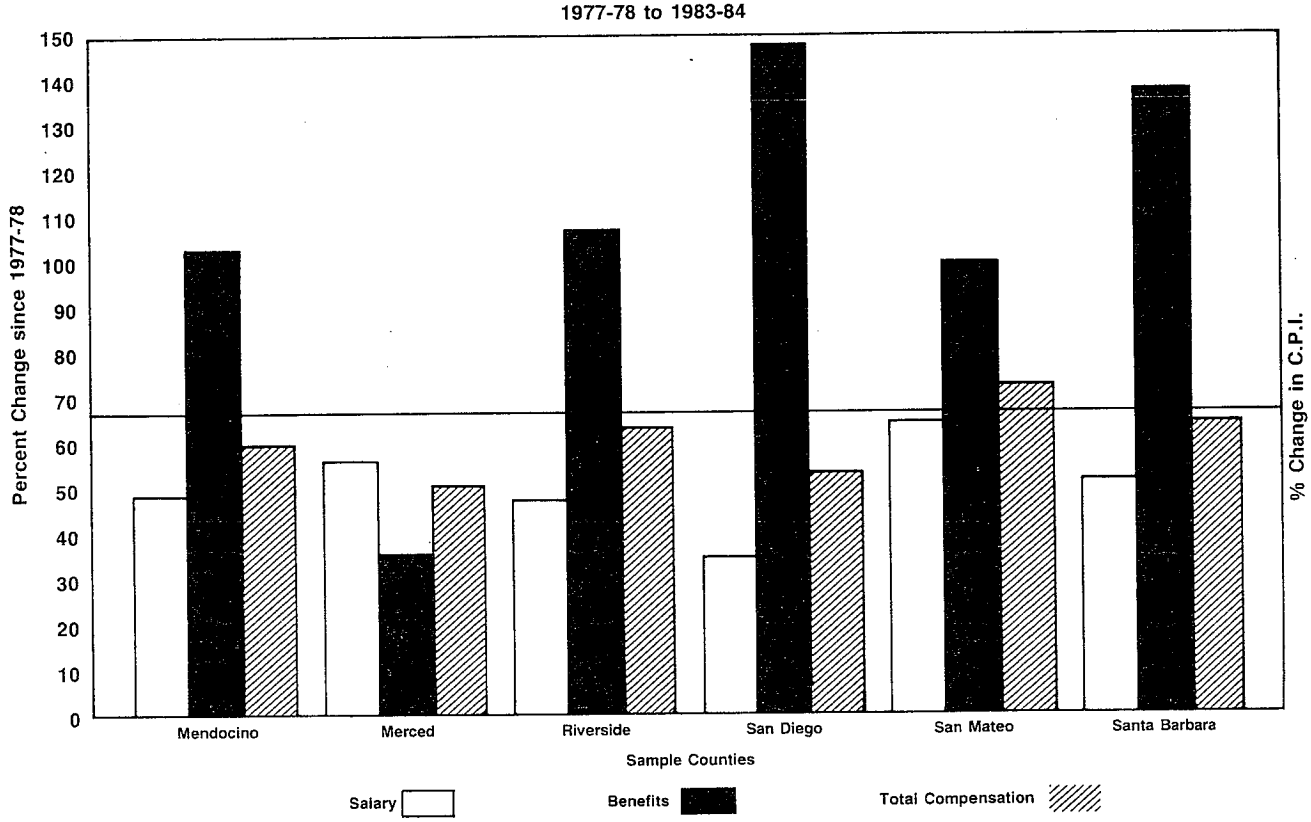
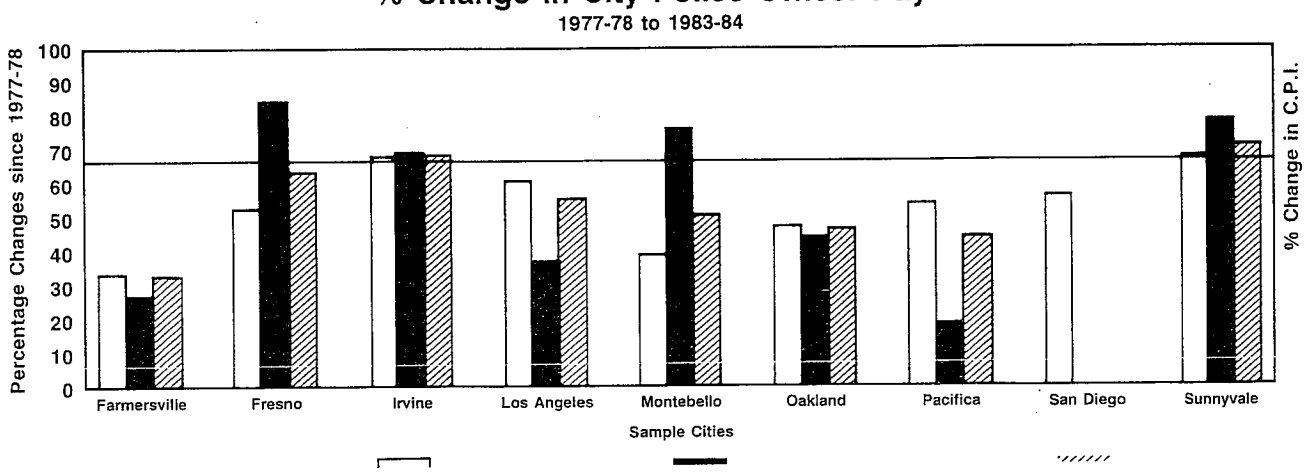


Figure 2
% Change in City Police Officer Pay
1977-78 to 1983-84



pears that cost for fringe benefits is 5% to 10% less for these classes compared to safety classes (Table 27). (This is not to suggest these costs are negligible and should not be included in total compensation bargaining!)

Other statistics suggest that the high compensation schedule for safety employees does not relate to market forces in the sense that premium pay and benefits are required to attract and retain personnel — the usual justification for special compensation. As Table 28 indicates, an eager labor force stands ready to fill available police and fire positions.

Table 27
1983 Total Compensation for Maintenance Worker

City	Adjusted Salary	Retirement	Education	Medical	Uniform	Other (Vacation, Holiday, Insurance)	Wage Supplement	Wage Supplement as % of Salary	Total Compensation
Farmersville	$1,081	$97		$94	$45	$235	$471	44%	$1,552
Fresno	1,331	237		143		140	520	39%	1,851
Irvine	1,501	200		216		228	644	43%	2,145
Montebello	1,302	241		217	200	351	1,009	78%	2,311
Oakland	1,548	300		157		213	670	43%	2,218
Pacifica	1,483	234		136		225	595	40%	2,078
San Diego	1,153	126		62		157	345	30%	1,498
San Francisco	1,436	299		218	10	292	819	57%	2,251
Sunnyvale	1,618	270		112		236	618	38%	2,236
County									
Mendocino	$1,334	$191		$183		$260	$634	48%	$1,968
Merced	1,258	272		77		239	588	47%	1,846
Riverside	1,165	151		50		222	423	36%	1,588
San Diego	1,078	268		116		384	589	55%	1,667
San Mateo	1,673	324		138		363	825	49%	2,498

1983 Total Compensation for Clerk Typist

City	Adjusted Salary	Retirement	Education	Medical	Uniform	Other (Vacation, Holiday, Insurance)	Wage Supplement	Wage Supplement as % of Salary	Total Compensation
Fresno	$1,013	$180		$131		$107	$418	41%	$1,431
Irvine	1,250	166		216		197	579	46%	1,829
Los Angeles	1,140	228		151		144	523	46%	1,663
Montebello	1,124	208		217		309	734	65%	1,858
Oakland	1,168	226		157		167	550	47%	1,718
Pacifica	1,215	191		136		194	521	43%	1,736
San Diego	1,084	118		62		148	328	30%	1,412
San Francisco	1,217	230		55		140	425	35%	1,642
Sunnyvale	1,423	237		112		209	558	39%	1,981
County									
Mendocino	$1,025	$146		$183		$199	$528	52%	$1,553
Merced	962	208		77		181	466	48%	1,428
Riverside	1,015	236		135		130	501	49%	1,516
San Diego	975	243		116		185	544	56%	1,519
San Mateo	1,215	147		123		378	648	53%	1,863

Source: LCC 1983 Benchmark Salary Survey

Table 28
Sample Applicant Pool for Police and Fire Positions

Jurisdiction	Examination	Examination Date	Openings	Applicants
City of Sacramento	Firefighter	2/84	30-40	3,000
Sacramento County	Deputy Sheriff	2/84	20	1,089
Fresno County	Deputy Sheriff	3/84	6	250
City of Los Angeles	Police	Continuous (1983 data)	70	23,000
Los Angeles County	Deputy Sheriff	3-4 times monthly	300-400	9,600
San Francisco	Police	9/82	165 (hired to date)	1,912
	Firefighter	9/79	200	6,500
	Deputy Sheriff	4/84	6	1,000
City of San Diego	Firefighter	8/82	30	3,000

IV

Trial Court Costs

Administration of trial courts represents a serious underfunded mandate for counties that is becoming a major strain on their budgets. County funds represent $9 out of every $10 going to operate trial courts.

Three approaches can be taken to reduce the burden of trial courts for counties. First, costs can be held down through procedural and other reforms of the judicial process. Second, court revenues can be increased by raising fees, surcharges, and fines from those using the court system and keep a greater share of these revenues for court financing. Third, state funding of courts can be increased.

Additional state funding for trial courts should be pursued, but only where the additional state cost is held to a minimum by enactment of efficiency reforms and state receipt of court fines and forfeitures to the extent that local law enforcement and collection incentives are not adversely reduced.

The Problem

Strained county budgets, underfunded state mandates, and court delays in some areas have led to support for significant changes in the financing of trial courts.

Present Financing

County funds account roughly for nine dollars of every 10 dollars going to operate the trial courts. At the trial court level state money is earmarked specifically for:

- judges' retirement contributions;
- superior court judges' salaries (85% to 91.3% of total, depending upon county size);
- $60,000 annually for each superior court judgeship established since 1973;
- legislative mandates.

Court fees offset a small part of appellate level costs. In the trial courts, fees are a more significant funding factor, contributing roughly one dollar to every six coming from tax sources.

In addition, trial courts play a part in generating a large amount of revenue from fines — nearly three dollars for every four dollars spent running the courts. This money, however, is not directly applied to court funding.

Alternatives

Three approaches can be described for reducing counties' burden in operating the trial courts. The three can operate in combination:

1. Reduce costs or hold down pressure to increase expenditures by procedural and other reforms which reduce the number of cases at various points in the judicial process, reduce the demands cases put on the court system, and increase the system's efficiency.

2. Increase fees and surcharges on fines.

Efficiency and Workload

Within days of Proposition 13's passage, the Judicial Council solicited from throughout the legal system ideas for coping with reduced funding. The resulting six-page check list[1] remains as a menu of efficiencies worth working on. Among the ideas which appeared there or elsewhere — some of which have been adopted to some degree — are, in no particular order:

- a tight no-continuance policy and accelerated settlement time frames designed to reduce backlogs.
- further expand arbitration and require complex cases to go to arbitration.
- expand use of telephones and two-way television for handling judicial matters.
- allow litigants to hire "private" judges.
- charge non-indigent convicted felons the cost of trial court transcripts.
- allow counties to contract out for service of process.
- allow electronic equipment to be used in making official record of superior court proceedings.
- restrict the use of discovery.
- make rules of court more uniform statewide.
- expand the use of commissioners to handle judicial matters.
- unify trial courts.
- expand collection of partial defense fees from indigents who have some ability to pay.
- expand efforts to collect parking fines.
- merge sheriffs and marshals.
- contract for court security and information management services where feasible.
- expand neighborhood justice centers where effective in diverting cases from the courts.
- reduce jury size.

tested in economic litigation pilot projects.

- reduce the use of motions at preliminary hearings and make it more difficult to postpone hearings.

- permit judges to assume responsibility for questioning prospective jurors.

- permit judges to promptly revoke probation when an individual commits a new crime.

Much of the work on court improvements and efficiency has been aimed at dealing with the increased workload encountered by the courts over the past decade.

Even defining "judicial workload" is difficult. Tracing the causes of workload increases and framing appropriate responses involve complex analysis. Some legislators have stated that whatever else, they no longer want to address the problems by creating more judgeships.

The following observations can be made:

- Paperwork, though important paperwork, makes up a large part of the workload; many actions are filed, fewer than one in ten reaches the contested stage, and of these about one in eight involves a jury trial.

- In superior courts the number of judgeships has increased at a rate roughly matching the increase in filings, civil cases awaiting trial, and criminal cases calendared for trial; however, analysis of this situation is complicated by the number of judgeships which have remained vacant and the increased use of commissioners and retired judges.

- Although much statewide concern has been registered over clogged court calendars and long waits for trials, the problem is centralized in Los Angeles County and there within the district where a relatively heavy volume of complex civil cases are filed.

- Whether measured by cases awaiting trial or elapsed time to trial, it is inaccurate to view delay as entirely "court-caused;" much of the pace of litigation is determined by attorneys.

- Workload is greatly affected by statutory changes: diverse examples are harsher penalties for drunk driving and the increase in the limit on civil cases in municipal courts from $5,000 to $15,000.

- By some measures, the workload pressure is easing: filings in Courts of Appeal decreased by 2% in 1981-82; the first decrease in recent history; in the larger metropolitan superior courts, the number of criminal cases set for trial declined in 1982 and the number of civil cases awaiting trial and the time to trial declined for the second year in a row.

- At the appellate and Supreme Court levels, criminal cases are extremely time-consuming: Rules of Court require superior court judges to inform convicted defendants of a right to appeal with free representation provided — making appeal a virtual certainty; death penalty cases which automatically receive the highest level review are being singled out as the major reason for the Supreme Court's case backlog.[2]

Fees and Fines

"We believe that it is time for an overhaul of the state's non-tax revenue policy. The balance between the taxpayer and user financing should be improved to favor the taxpayer." *Report on the Court System — Los Angeles County,* Los Angeles County Economy and Efficiency Commission, October 1981.

"Ultimately, the concept of a user-funded trial court system under the law and equal access to our court system. In effect, it threatens to block access to that system for the vast majority of our population, the middle class." — *State of the Judiciary Address,* Chief Justice Rose Bird, September 11, 1983.

In practically every judicial activity there is some degree of direct service to a "user" and a general benefit to the public. Courts, like fire departments, are "there in case you need them." Translating this obvious relationship into a cost-sharing plan — either general or based on type of action — could involve endless study and debate.

Total trial court fee revenue has more than doubled from 1977-78 to 1981-82. Some of the increase is due to increased volume. As elsewhere in government, some of the changes are a result of adjustments to existing fees in light of inflation in the 1970s. Evidence of new and higher fees is easy to find. (For example, Los Angeles County supervisors in late 1982 approved a new $27 a day charge for all defendants serving weekend jail sentences.) But beyond that, the lack of total trial court cost data makes it difficult to gauge the degree to which courts have increased their reliance on fee financing.

Although some revenue descriptions class fines and penalties as "trial court revenue," state and local law enforcement agencies and sometimes other segments of local government are essential participants in fine activities. Vehicle Code fines, the Judicial Council estimates, will make up half of 1983-84's $452 million in fine collections.

Cities, which play no part in court funding, receive on a statewide basis about half of the fine revenue distributed locally. But cities are quick to point out that they collect fines as well as enforce traffic laws and other statutes resulting in fines. Cities once operated police courts and the current fine allocation was designed when these courts were combined with the county-financed system.

Fine revenue runs between 1% and 2% of total statewide city revenue, but plays twice that role when viewed as own source, semi-discretionary money. City fine revenue from CHP arrests for misdemeanor traffic violations is earmarked for the city Traffic Safety Fund, exclusively used for street construction and maintenance and for traffic control devices. City fine money resulting from city officer arrests is available for general fund use.

Because an offsetting county cost reduction would result from a state takeover of trial court funding, the state's laying claim to fine revenue received by counties would appear to be non-controversial. However, there is a degree of revenue earmarking which must be taken into consideration. County fine money resulting from sheriff and CHP arrests for misdemeanor traffic violations is deposited in the county road fund; however, supervisors may divert up to half this amount to the county general fund. There are other earmarking examples: part of all fish and game fines is deposited in a county Fish and Game Fund and restricted to wildlife-related use.

If state trial court funding is seriously pursued, a fine distribution compromise might be worked out. One suggestion calls for freezing the dollar amount of current allocations and allowing all future increases to flow to the state. If local governments are still to collect fines, the loss-of-incentive problem will have to be addressed.

State Funding

The rationale for state assumption of trial court costs was summarized in 1981 by Ralph N. Kleps, California's first administrative director of the courts: "In other states the two principal motivations for increasing state level funding for trial courts have proved to be the need to relieve local

a lever to secure needed trial court improvements. Both motivations have been at work in California during the past 10 years..."[3]

Most current discussion of state funding assumes takeover of county costs for salaries and benefits of judicial and non-judicial personnel (including various court-related employees in county clerk offices), court reporters, bailiffs, services and supplies, and a share of support costs (utilities, maintenance, etc.).

This is but one of the options considered in the past. On the narrow side, the state could expand its funding only to judicial compensation. Or, takeover could extend to probation and public defender activities — and beyond.

The 1983-84 costs of the trial courts as defined above is estimated by the Judicial Council at $650 million.[4] The state's share of this amount was $63 million. Thus a total state takeover of trial court funding can be viewed in general terms as a two-thirds of a billion dollar increase on the expenditure side of the state General Fund.

Assemblyman Richard Robinson is carrying a measure *(AB 3108)* sponsored by the Judicial Council to increase state funding through annual block grants to counties.

The proposal calls for:

- providing counties with annual block grants of $473,703 per superior court judicial position and $461,185 per municipal court judicial position, with a requirement that block grant money must be spent on the courts.
- placing the state in the role of collecting most fines, forfeitures, and court fees, with a reimbursement mechanism to keep cities from encountering a revenue cutback.
- making court fees uniform statewide and increasing them annually by the percentage pay increase given state employees.
- offering the plan as an option to counties, to go into effect only after the 10 largest counties choose to participate.

The sponsors calculate a first year shift to the state of $152 million in court-related revenue otherwise going to cities and $263 million which would have gone to counties. The resulting $415 million in new revenue to the state, offsetting the increased court costs to the state of $584 million, would mean an estimated net first-year cost of $169 million to the state General Fund.

Pro and Con Arguments

Supporters of the state takeover argue that:

- local initiatives to save money or increase revenue in the court system require legislative approval, making it preferable to shift pressure to economize to the political level which must adopt changes;
- counties see their court financing as an unfunded state mandate — they cannot control court workload or budgets;
- state codes specify salary schedules, fees for transcripts, staffing standards, etc., leaving counties little discretion over these administrative matters;
- because of dependence on local funding, the administration of justice can vary greatly throughout the state;
- state financing will allow uniform cost classification and procedures for collecting actual cost data for long-range planning.

Opponents and non-supporters contend that:

- a bureaucracy could develop that would be less efficient than the current system;
- costs in a number of areas, such as fees paid to court-retained attorneys and non-judicial salaries, vary greatly from county to county, and a state takeover would result in higher costs through "leveling up" or result in an administrative morass by requiring a system to continually cope with the differences in 58 counties;
- a state-funded system would lead to restricting existing local power to assign judges and make other administrative changes to improve efficiency and administration of justice;
- state funding will eventually bring control of local courts under the Judicial Council, which cannot adequately oversee day-to-day operations;
- local non-judicial employees would become state employees, and some would receive reduced benefits by being forced to join the state retirement system.

Supporters and Non-Supporters

Backers of state funding of trial courts are more visible than opponents. The state Judicial Council[5] is a consistent supporter, headed by Chief Justice Rose Bird, who in an annual "state of the judiciary" address the year of Proposition 13 said, "It is clear that state funding of the trial courts is an idea whose time has come," and on the corresponding occasion in 1983 said, "The principle of state funding of the trial courts should be adopted without delay and the implementation of that principle should be made a part of the state budget as soon as possible."

The Cobey Commission[6] established by the Legislature in the mid-Seventies recommended a broad state takeover. The Post Commission formed after Proposition 13 recommended a "buy-out." *Assembly Bill 1820* (Berman) was introduced in 1981 to advance the proposal. The bill attracted supporters to an interim hearing[7], but did not attract the votes to move it through committees. The Assembly Office of Research's less-expansive recommendation[8] last spring appeared in *AB 2100* (Farr), a broad proposal to "realign" state-local program and funding responsibilities. The County Supervisors Association of California has been in support of a court system "funded by the state and administered by the counties."[9] Similarly, the California Judges Association has supported state funding as long as some degree of control is left with local jurisdictions.

The California Trial Lawyers Association has backed the two most recent legislative proposals for state funding.

Non-supporters fall mainly into the "fear and skepticism" category. One exception are court reporters, whose representatives at the *AB 1820* interim hearing stated opposition to the concept of a shift of control away from local government.

Fear of administrative inefficiencies and detrimental loss of local control has been expressed by superior court judges, the County Clerks' Association, and the Superior Court Administrators Association. Cities, which are not involved in running or funding courts, have a stake in protecting the fine revenue historically received and approach state funding proposals as a possible threat.

The preliminary recommendation of Governor Deukmejian's "new partnership" task force on state-local finance recommended funding and program shifts between the state and counties in health and welfare but was silent on the issue related to the courts.

Notes

1. "Suggestions received for effecting economies in and im-

proving operations of the trial courts," letter from Ralph M. Campbell, director of the Administrative Office of the Courts to presiding judges of the trial courts, July 7, 1978.

2. "Backlog of Cases in High Court Tied to Death Penalty," *Los Angeles Daily Journal,* November 22, 1983, p.1.

3. Penal Code Sec. 1463 sets forth specific fine distribution among cities and counties.

4. "1983-84 Trial Court Cost and Revenue Estimates," Judicial Council of California, March 1983.

5. The constitutionally-established Judicial Council is a 21-member administrative body chaired by the Chief Justice and made up of judges, legislators, and attorneys. With assistance from its staff agency, the Administrative Office of the California Courts, the council adopts court rules, makes recommendations on court administration, compiles statistics, and runs education programs.

6. The "Advisory Commission to the Joint Legislative Committee on the Structure of the Judiciary" was headed by Associate Justice James A. Cobey and published its recommendations in an October 18, 1975, report.

7. Testimony at the November 18, 1981, hearing was published in "State Funding of the Trial Courts," Assembly Publication No. 941.

8. "Realigning State and County Responsibilities," Assembly Office of Research, Assembly Report No. 968, transmitted March 24, 1983.

9. See Note 6. above, p. 264.

V

Public Works: An Unmet Local Priority

California's public works systems represent an enormous investment in public funds that is not being maintained, rehabilitated, and expanded to meet current and future needs. Adequate public facilities are vital to the state's continued economic health.

Problems of financing public facilities have developed in recent years because spending cuts in this area are invisible in the short-term, and thus are easily made by local elected officials, and fiscal constraints make it nearly impossible to squeeze more funds for public facilities out of operating budgets.

Solutions to the problem require restoration of a public works priority in local budgeting by focusing attention on the importance of the investment in this area and damage done by funding deficiencies. Private sector cooperation on this matter and authorization of various additional local and state funding methods for public works are also vital for resolution of the problem.

The Problem

Public works — the "infrastructure" — is a high-priority issue among most local government managers. But that does not mean they have been able to gain from elected officials and the public sufficient support to increase the share of spending on public facilities.

Among the reasons local managers are concerned about this problem are: (1) the enormous amount of public dollars invested in public facilities, (2) the huge sums and obligations in some current proposals for new funding. (3) the significance of capital funding questions in the state-local government financing issue, (4) the importance of adequate public facilities to the state's economic health, and (5) the opportunities for significant reduced costs attainable through many public works rehabilitation and expansion decisions.

A 1983 Cal-Tax Foundation report, *"Planning to Preserve California's Public Works Investment,"* was among the earliest of a number of publications documenting the extent of the public works problem in California. The Foundation's study, *"California Local Government Finance: Part 1,"* produced fresh, specific evidence: capital and maintenance budgets of non-enterprise activities were judged inadequate by most local officials.

These studies show that the problem has developed over a number of years and will not be quickly or easily solved for two reasons: First, capital maintenance and spending cuts are easily made by elected officials because their impact is "invisible" during the short term; second, local managers believe it is impossible to squeeze more capital and maintenance funds from existing operating budgets.

Alternatives

Solutions must address two general areas: rehabilitation and maintenance of existing facilities; and expansion and new construction as necessary to match the needs of population growth, economic activity, and natural resources protection.

Steps are needed to:

1. Restore public works' priority in local budgeting by:

- local governments, either on their own initiative or at the insistence of individuals and organizations, structuring their budget process to highlight public facilities deficiencies and funding needs. One approach would be to report an annual depreciation expense incurred against general fixed assets — an approach not taken under traditional, generally-accepted local government accounting practices.

- elimination of automatic cost-of-living adjustments which give some non-public works programs a head start in the budget process and skew the determination of priorities.

- a cooperative business-local government effort to inform citizens of the broad negative effects of public facilities deterioration and failure to provide for expansion of public capital.

2. Enhance local ability to plan and finance public facilities by:

- restoring (through a constitutional amendment) local government's ability to approve higher property tax rates in order to use lower-cost general obligation bonds for capital improvements.

- permitting (through legislation) local governments to use lower-cost, limited obligation bonds repayable out of property tax proceeds within the existing 1% limit and from existing tax revenue.

- permitting local governments to use special districts, with appropriate voter approval requirements, to focus efforts on public works rehabilitation and expansion.

- as soon as possible treating "supplemental roll" property tax revenue as general property tax revenue to be available to all local governments sharing the property tax.

- establishing at the state level the capacity to assist local governments desiring to reduce their financing costs by allowing them to participate in bond pooling and bond insurance. (This should be accomplished with no involvement of the state's credit, a minimal amount of state funding, and minimum increase in state administrative structure — the latter accomplished by contracting for much of the unit's activities with the private sector.)

- establishing within an existing state administrative structure a unit responsible for identifying and informing local governments about design, maintenance, and use options which can result in lower construction and maintenance costs. (Information developed by such a unit would also be of use to the state and in identifying and working to change federal design mandates which increase state and local costs.)

VI

Reimbursement of State Mandates

Despite the nation's most highly developed, elaborate, and systematic process for reimbursement of costs mandated upon local agencies by the state, fewer than 10% of such mandates are funded in California. Mandate reimbursement started 12 years ago in California, and now includes constitutional as well as statutory requirements, and an appeal process before an administrative board.

Two recent court decisions side with local agencies on the mandate issue, one calling an unfunded mandate void, and the other requiring the state to fund the mandate.

A partial solution to the unfunded mandate problem would be achieved by a statute or constitutional amendment making mandates permissive for local agencies, unless funded. Such a requirement would provide clear direction for the courts and a remedy for local agencies.

The Problem

Despite constitutional and statutory requirements that the state fund mandates it imposes on local government and a thorough process for reimbursement of mandates, less than 10% of state mandates are funded each year. According to the Legislative Analyst, approximately 2,800 state-mandated local-cost bills have been enacted by the Legislature since 1975. Only 108 of these bills contained an appropriation. The Board of Control determined that another 52 statutes require reimbursement, but only 15 of these have been funded by the Legislature.

"The California mandate reimbursement system, although it has come under fire from various factions over the years, is clearly the best-defined, most extensive, and most serious effort to reimburse local government entities for state mandated expenditures." — *Fiscal Notes and Mandate Reimbursement,* by Catherine H. Lovell and Hanria R. Egan, Graduate School of Administration, University of California, Riverside.

The above quote from the report on a national survey raises an obvious question: After landmark legislation, development of a thorough cost-estimating process, and finally a constitutional amendment requiring funding of mandates, why does anything else need to be done?

Background

To answer that question, it is necessary first to recount the history and procedures of mandate funding in California. The paper quoted above provides the following summary:

"Mandate reimbursement was first enacted by the Legislature as *SB 90* in 1972, and was made a part of the state constitution in November 1979 as a part of Proposition 4 (the Gann Initiative) which set expenditure limits on state and local governments. Since January 1, 1981, administrative regulations with significant local cost implications have also been considered reimbursable mandates.

"Mandate reimbursement in California is actually two separate processes, one for those mandates which are funded from the outset (i.e. as soon as they are passed), and another for those mandate bills which are passed unfunded and are then brought before the Board of Control (an appeals body) for further review.

"In the first case, the Department of Finance determines approximate reimbursement amounts, and the process is fairly straightforward. The State Controller's Office, which administers the claims, prepares instructions for the local government claimants, who then submit claims for costs incurred. After aggregating these, the Controller determines whether there are sufficient monies available to reimburse at the requested levels. If not, this is reported to the Department of Finance, where a deficiency bill is prepared and submitted. While the bill for the deficiency funds is pending, the money is disbursed on a pro-rata basis. Local governments generally receive reimbursement within a year of incurring costs, and within three months of submitting their claims forms.

Board of Control

"This funded category, however, accounts for only about 10% of the mandate bills passed each year. Securing funding for the remaining 90% involves a fairly long, extended series of steps. In some cases, reimbursement is never obtained. Form requests are made by local governments to the Board of Control to review and reconsider the bills in question (the Board is composed of two state statutory officials, two local government representatives, and one public member who is appointed by the Governor). Hearings are held, testimony is presented on both sides, and for those bills on which the Board takes favorable action, statewide dollar estimates are determined. Finally, a separate appropriations bill is brought before the Legislature for consideration. (Passage is not automatic, even for bills the Board of Control has deemed to have local cost implications).

"At present more than 75% of the appeals brought before the Board are won by the local claimants. This high success rate on claims is due to the fact that local governments normally bring only claims they expect to win. Because the entire process is cumbersome and time-consuming, however, it takes about three years for locals to receive reimbursement for these initially unfunded bills.

"The County Supervisor's Association of California, which

evaluates legislation and lobbies on behalf of county governments, has an active subcommittee comprised of a group of county auditors and analysts who work continuously and intensively on mandate reimbursement problems. *Senate Bill 90* is reserved every session to introduce amendments and revisions to California's mandate reimbursement law towards making it more responsive to, and usable by, local governments.

Disclaimers

"The process, although the most advanced among the states, is somewhat less effective than it would appear. Since the law was first passed, and continuing after the constitutional amendment, the Legislature has often attached what have come to be called "disclaimers" on bills. A disclaimer is a statement saying that the bill will not have significant fiscal impacts on local governments, or the Legislature *(SB 90* and the amendment not withstanding) will not fund any costs. Local governments have, of course, been fighting the disclaimer usage through negotiations with legislative leaders and court actions. Although disclaiming has reduced in frequency in the past few years, counties, in particular, are still incensed enough about the practice to have filed a major suit on behalf of a majority of the counties."

Enforcement

So again, what *is* the unfunded mandate problem in California? As described above, the basic law is in place — in both the constitution and the codes. The necessary cost data on each piece of legislation or administrative rule can be developed. From their survey, authors Lovell and Egan conclude that California's mandated cost estimating process "is undoubtedly the most highly developed, elaborate, and systematic of any state." The existence of a cost estimating system itself, the survey found, helps prevent mandating activities on local governments without reimbursement.

Mark Twain once said: "There is no end to the making of laws and no beginning to their enforcement." This description certainly fit the mandate situation in California until very recently.

Local governments' prime complaint is the Legislature's refusal to appropriate reimbursement funds even after the Board of Control has reviewed a mandate, determined the extent of underfunding, and notified the Legislature of the need to place the missing money in a claims bill.

"Where there's wrong, there's a remedy," an old legal saw goes, and local governments cannot be faulted for lack of effort in looking for that remedy. The Attorney General's Office in March 1984 identified 26 cases in which it was defending the state against local entities suing on mandate issues.

Article XIII B of the state constitution, added by Proposition 4 of 1979, does not specify a remedy if the state fails to provide a "subvention of funds" to reimburse a local government for a mandated program.

Court Decision

A court finding a failure to comply with the reimbursement requirement has two general options in ruling on a remedy. It may order the state to provide funding, or it may declare the mandate null and unenforceable.

The latter was the Sacramento Superior Court's choice in *Contra Costa County, et. al., v. State of California.* In that March 4, 1984, oral statement of intended decision from the bench, Judge James Ford said that Article XIII B discloses "a clear intent on the part of the people of this state to bar the Legislature from enactments which create new programs of enactment that they intend to bind local governments to such higher level of service or such new program; that failing such determination of mandate within that definition, such enactments are void and violate the Constitution of this state."

Judge Ford also said that: "The determination of the Legislature to require expenditures of money by local governments must be borne by them, and the Legislature must determine whether a particular enactment is in fact a mandated program at the time of its enactment. It must then provide appropriate legislation to allow for a subvention of funds to reimburse local governments."

The judge went on to rule that the Board of Control is prevented by the constitution from determining whether a local government should be paid reimbursement funds. It may only determine the *amount* to be paid once the question of the payment requirement has been answered.

"With respect to those enactments of the Legislature which county governments assert in fact require a new program or a higher level of service, and where the Legislature has not so determined, then it will be up to local government to either seek redress in the Legislature, or, failing that, redress in the courts," Judge Ford said.

A written statement of decision has not yet been signed. In any case, appeal by the state is almost certain.

In what is evidently the only appellate level decision on mandates under Article XIII B, the remedy issue was not discussed. The case, *(County of Los Angeles and County of Santa Barbara v. State of California)* addresses the question of whether Article XIII B applied to a mandate statute adopted by the Legislature prior to the constitutional amendment's enactment, but amended after it. In affirming the trial court's ruling that Article XIII requires reimbursement, the Second District Court of Appeal in its March 23, 1984, decision upheld the judgment requiring the state to reimburse the two counties for the cost of implementing a mandate.

The trial court's reimbursement order did not describe how the reimbursement was to be accomplished. This is an important question, in light of the "separation of powers" doctrine set out in Article III of the state constitution. As interpreted over the years, this provision reserves to the Legislature the power to appropriate funds. In a 1981 case *(Mandel v. Meyers),* the state Supreme Court found a way to adhere to the separation of powers doctrine yet still order payment of funds which the Legislature had specifically refused to appropriate. The court ordered payment of a state agency's operating budget, a source of money already appropriated.

This theory has not been raised in the Los Angeles and Santa Barbara counties case, and it is not likely to be useful for counties in most mandate disputes. Even in situations where an existing appropriation can be identified, it may not be in local governments' long term interest to pursue reimbursement by a means requiring confrontations between the Legislature and the Judiciary.

Remedies

While the question of remedies is a central issue, there are other uncertainties related to procedures. A number of active cases deal with the Board of Control's role in determining whether mandates exist and whether a local entity must exhaust its remedies by going to the board to recover reimbursement or may go into court directly.

Remedies and procedures were addressed in local government finance measures introduced early in 1984. The Deukme-

posal to make unfunded mandates permissive and require the state to budget funds in advance for reimbursements expected to be approved by the Board of Control. This was revised to require a two-thirds vote of a house to pass out a state mandate bill if that house's fiscal committee determined that the bill would result in a local government claim for reimbursement.

The Assembly Democrat proposal *(AB 2468,* Cortese) included a provision stating that a mandate determined by the Board of Control to be unfunded would be inoperative unless a claims bill covering it was adopted or the Legislature provided funds in the following Budget Act. This proposal was dropped at a later hearing.

Alternatives

The basic legal structure is in place in California to protect local governments from unfunded state mandates. However, the courts should be given clearer instructions as to what should happen if a final determination is made that a mandate was enacted but not funded. The alternative of ruling such a mandate to be optional is the better choice. It has the effect of giving the Legislature a second chance to decide how badly it wants a particular activity conducted statewide by local governments. It avoids the confrontation of separate branches over the issue of appropriations.

A provision making unfunded mandates permissive could be enacted as a statute or as a constitutional amendment. The latter would have the obvious advantage of establishing a requirement that could not be suspended by a future Legislature on a bill-by-bill basis. This result might also be achieved by a statutory initiative, which would place the requirement in statutes protected by specified language making repeal by the Legislature difficult.

If a constitutional amendment is chosen, it would be appropriate at the same time to fine tune existing mandate language in Article XIII B. State funding is now required whenever the state mandates "a new program or higher level of service" on any local government. Nothing is said of mandating an increased level of activity which is not a "new program" and does not result in a higher level of service, but nevertheless results in increased costs.

This was the situation in a mandated dispute in Missouri — one of the few state mandate cases to reach the top court in any state. The case *(Boone County Court v. State;* 631. 2nd 321; April 6, 1982) involved the state requiring a salary increase for county tax collectors. Missouri's constitution requires state funding for "new activity or service or an increase in the level of any activity or service beyond that required by existing law." The Missouri Supreme Court found the pay increase to be an increased level of activity.

It would have been more difficult for that or any court to find such a pay increase to be a new program or a higher level of service. The same difficulty would exist if the mandate involved, for example, a requirement for better safety clothing for local firefighters — one of the mandates at issue in the counties' suit against the state in California.

As the reimbursement process becomes more complex, more legally-oriented, and more used, the Board of Control's role and powers must be re-examined.

Replace the Board of Control

The Legislative Analyst took note of this situation in "The 1984-85 Budget: Perspectives and Issues" and recommended that the Legislature consider establishing a new adjudicative body to replace the Board for mandate matters. This solution is worth further investigation. Whatever new costs arise might be partially offset by charging local governments fees for filing with the new body, similar to the court fees charged individuals filing in county courts.

The Legislative Analyst's discussion of this recommendation is reprinted below:

"Our review of the existing system for reimbursing state-mandated local costs, along with our review of the number and breadth or reimbursement-related cases currently pending in court, indicates that the existing system needs to be altered. The Board of Control has functioned, since the time it was assigned its responsibility for *SB 90* matters in 1979, as an *advisory body.* Its role has been to report to the Legislature its determinations as to which mandates qualify for reimbursement, and the amount of funding necessary to reimburse local agencies for carrying out these requirements. The board's approach to decision-making has not been constrained by the strict interpretation of legal issues which now appears to be necessary.

"Our analysis indicates that the advisory role is no longer appropriate. Recent judicial decisions indicate that the courts will hold the board accountable to a *judicial* standard. Further, we believe that an adjudicative body's decisions would provide a better basis for legislative determinations as to its ultimate liability for reimbursement of mandates not currently funded and those not yet enacted. Such a body would, in the course of its operations, clarify many of the circumstances under which reimbursement may be disclaimed. Finally, the creation of such a body might prevent the judicial system from subsuming the resolution of state-mandated local program issues within its ever-spreading jurisdiction. Accordingly, we recommend that the Legislature consider establishing an adjudicative body, along the lines of the Workers' Compensation Appeals Board, to replace the State Board of Control in all matters relating to state-mandated local programs."

No mandate system can work if there is not some trust and cooperation between the parties.

The state cannot at will disconnect mandate law when it is convenient. Local governments cannot be unreasonable in seeking reimbursements. Some added costs — especially for counties, which operate as agents of the state — are going to be incidental to statutory or regulatory changes which should not reasonably be construed to be mandates.

VII

Tort Liability: Costs Climb as Exposure Expands

Local governments have become increasingly vulnerable to "deep pocket" law suits in recent years. Due to the operation of the rule of "joint and several liability," these local agencies have had to shoulder the lion's share of judgments in cases where they are only partially to blame.

Surveys show that costs of lawsuits have escalated at a rapid rate in recent years. Operations of transportation and recreation facilities, as well as other services provided by local agencies, result in tremendous liability.

The solution to the problem is to protect local agencies by statutorily defining the liability in specified areas, and establishing that damages be allocated based on share of fault.

The Problems

Jurisdictions participating in the Cal-Tax Foundation study, "California Local Government Finance: Part 1," repeatedly described the growing costs related to governmental entities' increasing vulnerability to lawsuits. Of particular concern are negligence suits where a local government is but one of a number of defendants — a situation calling into play the rule of "joint and several liability."

Joint and several liability claims against local governments have become an increasing problem in recent years for local managers. These claims can require public agencies to shoulder the lion's share of costs of liability judgments in cases where the public agency is only partially to blame. The concept of joint and several liability also encourages lawsuits against public agencies that must be defended at great cost to local governments.

Costs result in many ways other than the outright payment of judgments and settlements. Simply responding to claims and complaints, regardless of their merit, consumes time and is very expensive. Local governments are forced to allocate resources on the basis of minimizing exposure to suits by having public safety factors override other issues concerning the provisions of services in an equitable, cost-efficient manner.

There is general acceptance of some shift away from "sovereign immunity," the long-standing concept denying persons recovery from government regardless of the damage done or the degree of malfeasance causing it. However, in the process the concept of fault has been so diluted that the quarry in negligence cases today is the defendant most able to pay, not the defendant most at fault. Governments are named in lawsuits because they have the "deep pockets." It matters not that the plaintiff himself may have been more at fault than anyone else.

Local governments have tremendous exposure to these kinds of suits. They build and maintain the facilities used in all sorts of transportation. Hardly an accident can occur involving pedestrians, private vehicles, or commercial and public transportation without some factor of local government participation present.

As massive as transportation is, it is not the only area of exposure. Local governments are finding themselves more and more at risk in maintaining recreational facilities — including park, natural areas, and even open spaces.

A 1983 League of California Cities survey of 20% of the state's cities found that these cities (encompassing 18% of the state's population) paid out $4 million in 1980 and 1981 in "deep pocket" suits and $12 million in 1982. Cases pending at that time included claims totalling $87 million in multiple defendants, "deep pocket" cases.

The League reports that in the year following the survey, four cities, not among the sample, encountered "deep pocket" judgments or settlements in five cases totalling $8 million.

In each situation, the costs of the claims represent a great deal of overhead which does not help the injured party and is not then available for pressing public needs.

Alternatives

Attempts to hold down the public entity cost of tort liability fall into two main categories. One is the targeted approach, aimed at dealing with a particular class of factual situations usually brought into issue because of a specific court decision. Proposals to better define the California Highway Patrol's duty and potential liability in dealing with automobile accidents are an example.

The second category involves procedural change, aimed more at the general effect of court decisions expanding government liability. The fairest, most workable of these appears to be a logical extension of the case *(Li v. Yellow Cab)* establishing the principle that damages be allocated between a plaintiff and a defendant on the basis of percentage of fault attributable to each.

Such a plan would have multiple defendants share in the cost of damages to the extent that each is liable. For example, if two parties are liable for damages — an individual and a county — a jury might find the individual 70% liable and the county 30%. If damages total $100,000, a judgment would be for $70,000 against the individual and $30,000 against the county. Current law leads to this result where both parties are equally able to pay the judgment.

But where the individual is not determined to be a good

target for recovery, the plaintiff can proceed against the county solely and gain a judgment for the total $100,000. The same result could follow even if the county's share of fault was determined to be only 5%.

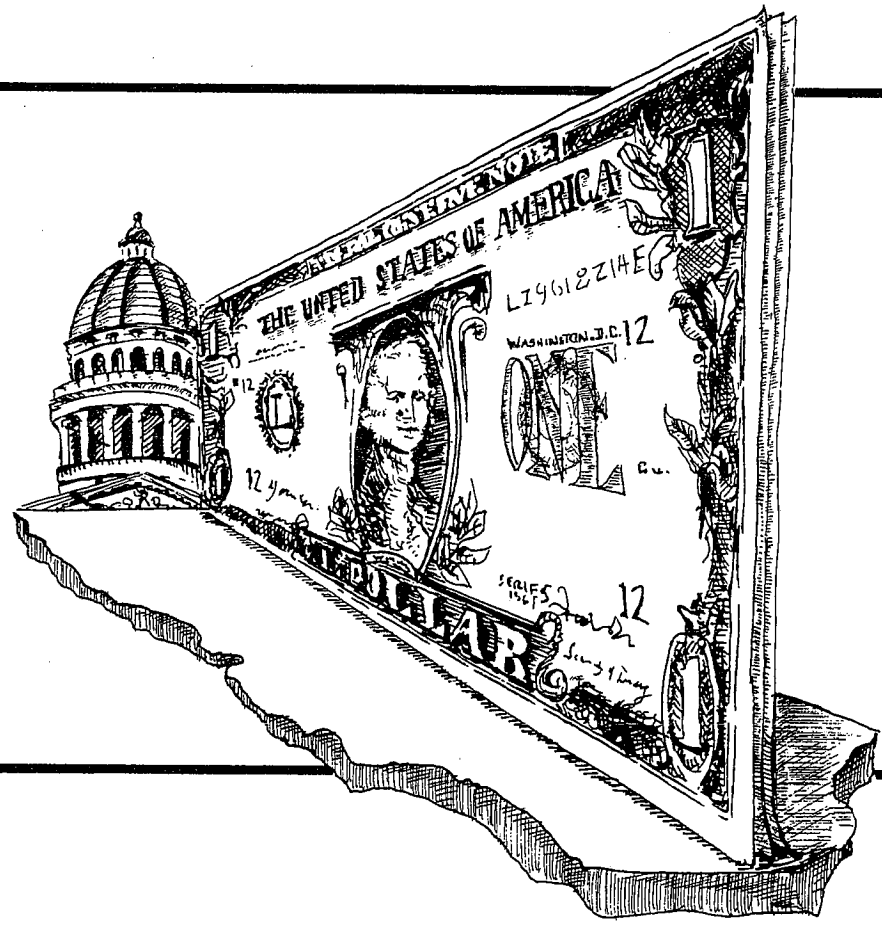
Under the simplest alternative the so-called rule of "joint and several liability" would be modified so that a defendant would never pay more than dictated by its share of fault. This could operate to provide little or no recovery to plaintiffs when the defendant with the largest percentage of fault is insolvent or otherwise judgment-proof.

Modifications of this approach have been proposed to achieve much of the desired protection for public entities, yet meet the essential medical and other direct costs of an injured plaintiff.

A revision of the joint and several rule and some statutory revisions aimed at court interpretations in specific factual settings are unavoidable if some degree of cost control in the liability area is ever to be restored.

The Power to Tax

Local Government Taxing Authority and Experience in California



Section 2

Preface

This study was conducted and written by Loren Kaye, Cal-Tax senior research analyst, during a six-month period in late 1983 and early 1984, and strives to capture the most up-to-date information on city and county taxing authority and experience.

The study could only have been completed with the assistance and cooperation of many local officials, businessmen and businesswomen, researchers, and consultants from throughout California.

The Los Angeles Taxpayers Association conducted a study of local taxation in Los Angeles County during the same period as the Cal-Tax study. Paul Shay, executive vice president of LATAX, and Donald Winkler, associate professor at the USC School of Public Administration, were generous in sharing the survey data they collected.

Constance Miller, currently employed by the California Legislature conducted most of the basic research for Chapter III, National Survey of Local Tax Enactment Procedures, under a contract with the California Tax Foundation. This original research was thorough and lends an important perspective on California local tax enactment policy.

John H. Sullivan, Cal-Tax vice president and general counsel, who represented Cal-Tax in the *Carman* case, accomplished most of the original work in untangling the legislative and case law trails of the *Carman* taxes, described in Chapter VIII.

Cal-Tax surveyed 52 individual cities and realized a remarkable response rate of 90%. City managers and finance directors throughout California were patient and cooperative in filling out yet another questionnaire.

A number of California corporations took the time to explain the effects of various taxes and taxing policies, as well as share hard data on the jurisdiction-by-jurisdiction impact on their companies. Pacific Telesis Group, J.C. Penney Company, Xerox Corporation, Pacific Gas and Electric Company, Sears Roebuck and Company, TRW, and many others were invaluable for their assistance in contributing to our understanding of a complicated subject.

Executive Summary
Findings

Chapter I. Overview of Taxing Authority

There are important differences in taxing authority among charter cities, general law cities, counties, and school districts.

Changes in the state constitution, statutes, and Supreme Court decisions have significantly altered local taxing authority.

Chapter II. Voting in California

27% of local agencies (not including school districts) that have attempted to raise a tax with a two-thirds vote have succeeded:

- *Cities succeeded on 30% of their attempts.*
- *Counties succeeded on 17% of their attempts.*
- *Special districts succeeded on 29% of their attempts.*

If a majority vote had been required, the passage rate would have been 64%.

Virtually all taxes proposed for a local vote have been broadly-based property taxes. Virtually all taxes levied or raised under Farrell *have been targeted at business taxpayers, utility users, or lodging establishments.*

The passage rate since 1982 has not changed. Although there have been fewer attempts since 1982 to increase taxes with voter approval, more attempts are failing than are succeeding.

Most attempts by school districts to raise taxes by a two-thirds vote have failed.

Most communities that have succeeded in passing special taxes are small, residential, homogeneous, and better off in terms of residents' per capita income.

Since the Farrell *decision, fewer special taxes requiring two-thirds voter approval have been attempted.*

Under the Farrell *authority, more than a hundred cities have raised more than 130 taxes:*

- *32 utility users taxes have been raised or levied.*
- *At least 44 transient occupancy taxes have been raised.*
- *At least 55 business license taxes have been raised.*

More than $300 million in new taxes has been levied since 1982 under the Farrell

Chapter III. National survey of local tax enactment procedures

Some form of voter approval of local taxes is required in 39 of the 50 states.

California is the only state in the nation where the state constitution establishes a maximum tax rate above which the property tax cannot be increased.

In 4 states the property tax is raised by action of the state legislature.

The remaining 45 states all have procedures by which locally-elected officials or the voters can enact or increase the property tax.

In 35 states property taxes can be raised by action of the local legislative body; however, in 15 of those states that body's authority is limited to a certain percentage increase each year.

3 states require property tax increases above a certain amount to be approved by a supermajority vote — i.e., a majority greater than 50% plus one — of the governing board.

*California public schools may not increase property taxes, except a levy for bonds approved prior to June 1978 but not yet issued. Schools may raise "special" non-*ad valorem *property taxes by a two-thirds vote of the local electorate.*

19 states have different — usually more rigorous — procedures for raising school property taxes than for increasing general government property taxes.

California prohibits counties from raising their sales tax above the present 1% rate. (Cities and counties levy a 1% rate in addition to the 4.75% state sales tax.) Cities are discouraged from raising additional local sales taxes by state statutes.

20 states authorize their local governments to raise local sales taxes.

*Cities in California are authorized to raise most non-property or sales taxes by a vote of the council as long as it is a general purpose tax for deposit in the general fund of the city (so-called "*Farrell*" criteria). Otherwise a two-thirds vote of the electorate is required to enact a "special tax."*

21 other states reported that local governments are authorized — usually by action of the governing board — to raise other taxes, including income, business license, motor vehicle fuel, and others.

Chapter IV. Utility users tax

70 cities in California levy a utility users tax, up by 22 since 1982. Another 9 cities have increased their tax during the past 2 years. One city has repealed its tax since 1982, and at least 3 others are contemplating repeal.

Statewide, the utility users tax is the largest revenue source over which cities have direct control. The tax will raise more than $490 million in fiscal 1983-84.

Cities have also increased their dependence on the utility users tax, from 5.5% of general revenues in 1978 to 7.3% in the years following.

Utility users tax revenues have increased more than twice as fast as the rate of inflation since 1978.

Some cities have chosen to repeal, cap, or not levy a utility users tax when presented with evidence of the adverse effect it would have on business.

Chapter V. Business license tax

Cities and counties are both authorized to raise business license fees or taxes, but counties may levy them only for regulation purposes, while cities may levy the tax for revenue purposes.

Cities have wide authority over how and on whom the tax may be levied. There are few constitutional or statutory restrictions.

Most cities use some form of gross receipts method as a means of taxing businesses, primarily because it provides the most predictable and greatest revenue flow.

It is conservatively estimated that business license taxes will raise some $419 million in 1983-84: a 14% increase in one year, a 64% increase since 1982, and a 175%

Of the 107 cities surveyed that have raised taxes since 1982, 55 raised their business license tax.

Business license tax increases made possible by Farrell *account for $230 million in cumulative tax increases since 1982.*

Cities' dependence on business license taxes has grown from 4.2% of general revenues in 1977-78 to 7.2% in 1983-84.

With a few exceptions, cities have worked cooperatively with the local business community when proposing to raise the business license tax.

On the other hand, the few cities with the highest business taxes account for the lion's share of the tax receipts.

Chapter VI. Non ad-valorem property tax

Property taxes based on size, ownership, and other characteristics are increasingly being used as local government revenue sources.

Counties and schools may increase these taxes under the "special tax" authority of Proposition 13, requiring two-thirds approval of the local electorate; however, the few agencies that have tried this method usually have been unsuccessful.

Cities may raise these taxes either by a vote of the city council, if used for "general purposes," or as special taxes. Few cities have attempted the former; cities successful in the latter usually have been small, residential, homogeneous, upper income communities.

Chapter VII. Transient occupancy tax

The transient occupancy tax is the only significant tax county boards of supervisors can levy or increase without a vote of the electorate.

The transient occupancy tax is one of the least unpopular (to the general electorate) taxes to increase because it is paid mostly by tourists and other non-residents.

At least 55 cities and a dozen counties have increased the transient occupancy tax since 1982.

Chapter VIII. Property tax overrides (Carman tax)

The only case where a local government may levy a property tax in excess of the 1% rate is if indebtedness was authorized by the voters prior to June 6, 1978.

Cities and counties may levy an override for voter-approved pension plans.

A tax override may be levied for a pension plan even if no tax rate to finance the plan was authorized by the voters.

The tax rate may be increased without voter approval to finance increased employee benefits.

Special districts contracting for water from the State Water Project may levy a property tax override to pay those contract obligations.

Some cities are levying a property tax override for other voter-approved purposes, but those taxes have not yet been tested in court.

New property tax overrides for non-bonded debt will bring in some $58 million in city and county revenue in fiscal 1983-84.

Depending on the ultimate definition of "voter approval," the total taxpayer exposure to these city and county overrides could be as much as $850 million.

The Legislature has prohibited cities and counties from levying any new overrides for non-bonded, voter-approved debt until July 1985.

Chapter IX. Other local taxes

The power of cities to levy taxes is limited only by the state constitution, state pre-emption under the doctrine of "statewide interest," and their own political climates.

Cities will raise some $400 million in property transfer, franchise, admission, parking, and other taxes statewide in 1983-84. However, less than half of that amount is from taxes that cities have the discretion to levy or increase on an annual basis.

I

Overview of Taxing Authority

Californians will pay more than $119 billion in taxes in fiscal 1983-84 — $4,710 per resident. Of this amount, 63% will be paid to the federal government, 26% for support of state government, and the balance for support of cities, counties, special districts, and local revenues to the public schools.

Californians will pay $3.7 billion more in state and local taxes in 1983-84 than they did in fiscal 1982-83, an increase of nearly 12% in one year. By comparison, in 1983-84 inflation in California is estimated to increase by 3.6%, and personal income by 10.4%.

This study reviews the authority of cities and counties to levy taxes, discusses the changes in local taxing authority since Proposition 13 of 1978 and the major 1982 Supreme Court decisions interpreting it, analyzes the extent to which local cities and counties are utilizing local taxing authority, and calls attention to the major issues arising from this authority.

Jurisdictions

The two types of general purpose local governments in California are cities and counties. Under Article XI of the California Constitution, counties are legal subdivisions of the state, and act as its administrative agencies, carrying out state programs such as health care, public assistance, elections, and criminal justice (courts, jails, and probation). It is no accident that 60% of county revenues come from other levels of government.

Counties also serve as municipal governments, delivering such services as police and fire protection, land use planning, and parks to their unincorporated areas. They also deliver countywide services such as solid waste dumps, libraries, and public health.

Cities, on the other hand, are creatures of the local citizenry. They spring organically from the desire of local residents to exercise more control over their own affairs. In contrast to counties, only 15% of city revenues come from other levels of government.

But all cities are not alike in the degree of control they exercise over their own affairs. Only one of every five cities is chartered; that is, "empowered to make and enforce laws and regulations in respect to municipal affairs, subject to restrictions" in the charter itself. Unless there is a "statewide interest" in limiting the power of a charter city, such as statewide sales tax rates, labor relations, or traffic signal colors, the state may not by statute limit charter cities' activities.

General law cities, on the other hand, are organized under the general laws and statutes of California, and are so limited. Some 349 of the 429 California cities are general law, mostly small- and medium-sized cities.

Taxation

The state constitution provides the framework on which the state's tax structure is built.

- Local governments are authorized to levy property taxes, but the rate and method of valuation are strictly limited.
- The Legislature has the sole authority to levy taxes on personal income, alcoholic beverages, corporations, banks, and other financial institutions. (Los Angeles city is challenging the statutory restriction against levying a business license tax on financial institutions.)
- The Constitution levies a tax on insurance companies and prohibits local governments from levying such a tax.
- Counties are limited in the types of taxes they may levy. Because counties lack the constitutional grant of authority over their "municipal affairs," they must operate under the general statutes. The Legislature has authorized counties to levy on their own only property transfer and transient occupancy taxes.
- Charter cities have broad taxing authority, limited only by the constitutional provisions outlined above, their own charters, and the doctrine of statewide interest.

Various statutes also have the effect of limiting charter city taxing authority. Proposition 6 of 1982, an initiative statute repealing inheritance and gift taxes, precludes local governments from levying those taxes. The mechanisms by which the sales, cigarette, and motor vehicle in-lieu taxes operate — with their sharing formulas and subventions — strongly discourage charter cities from enacting their own versions.

Apart from the above exceptions, charter cities are free to enact any other tax not prohibited or limited by their charters.

Because general law cities operate under the authority of the general statutes of the state, they must receive specific authorization from the Legislature to levy local taxes. Before 1982, general law cities had the authority to levy only business license, transient occupancy, and property transfer taxes. But in the trailer bill to the state Budget Act of 1982, the Legislature authorized "the governing body of any city (to) levy any tax which may be levied by any charter city, subject to the voters' approval pursuant to Article XIII A of the Constitution of California (Government Code Section 37100.5)." This law became known as "Section 88" powers of general law cities.

But the Section 88 authority is not as settled or as simple as is its language. On the one hand — certainly as it is now being practiced — the authority apparently gives general law cities the power not only to raise any tax already levied by charter cities, but any tax a charter city *could* levy, as long as it does not conflict with the constitution. Since *constitutionally* the power of charter cities to tax is virtually unlimited, and since the *charters* of many of those cities do limit the taxing authority, the power of general law cities is arguably now broader than that of charter cities.

On the other hand, since the authority is based on the authority granted charter cities, and since general law cities do not have charters, it may very well be that general law cities do not constitutionally have the power to levy the new taxes they are levying.

Proposition 13

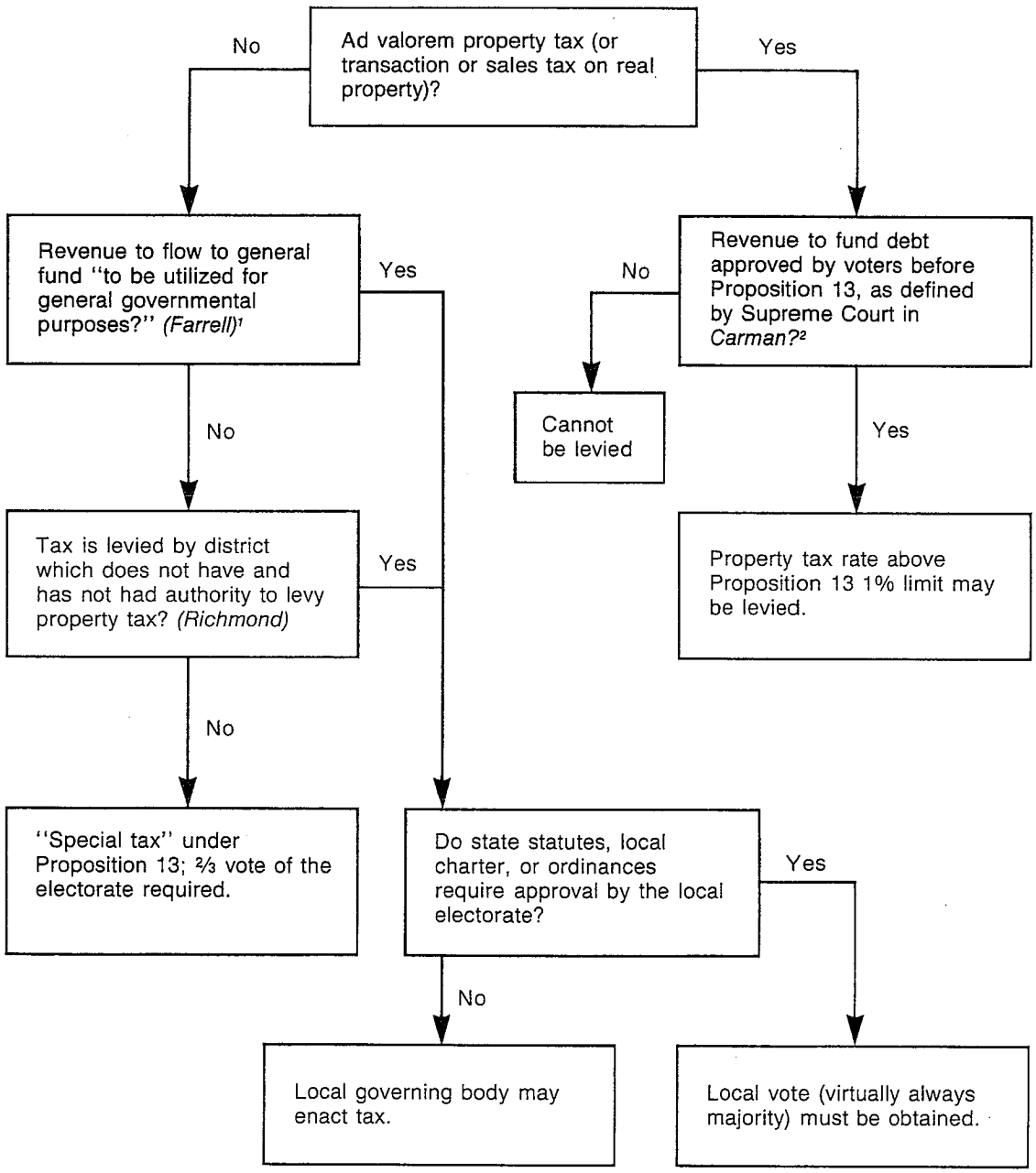
Property taxation in California is authorized by Article XIII and limited by Article XIII A, the latter added by Proposition 13 in 1978. In brief, Article XIII A:

- caps countywide *ad valorem* property tax rates at 1% of market value, plus an amount for indebtedness approved by voters prior to 1978. (*Ad valorem* property taxes are based on the value of property, as opposed to property taxes based on area, use, or ownership of property);
- limits increases in assessed valuation to a maximum of 2% a year;
- permits reassessment only upon change of ownership or new construction;
- prohibits the Legislature and local governments from im-

Figure 1
Proposition 13

Determining permissible local levies under Proposition 13, as interpreted in:

Carman v. Alvord
City and County of San Francisco v. Farrell
Los Angeles County Transportation Commission v. Richmond



1. *Farrell* decision does not define general fund or general governmental purposes; Legislative Counsel has opined that school district funds and purposes meet this definition, but require legislative authorization to collect tax.
2. *Carman* authority suspended by Legislature until July 1, 1985.

posing any *ad valorem,* sales, or transaction taxes on real property; and

- requires a two-thirds vote of the local electorate in order to raise "special taxes."

Proposition 13 not only reduced the total amount of property taxes and the rate at which they grow, but it eliminated the authority of local governments to raise property taxes to secure general obligation bonds and required a higher standard of approval for enacting or increasing non-property taxes.

Supreme Court Decisions

The California Supreme Court three times in 1982 interpreted Article XIII A to broaden the ability of local governments to raise taxes (Figure 1).

- The "*Farrell* decision," discussed in Chapter II, permits local governments — primarily cities — to raise general purpose taxes without a vote of the people (if there is no statutory provision otherwise requiring a vote). As a result of this decision, hundreds of taxes — amounting to hundreds of millions of dollars annually — have been raised.

- The "*Carman* decision," discussed in Chapter VIII, construed voter-approved pension plans to be "debt" within the meaning of Proposition 13, thereby permitting cities and counties to raise property taxes by up to $1 billion without a vote of the electorate. Legislation passed in 1983 placed a moratorium on such tax increases until July 1985.

- The "*Richmond* decision," not discussed in this study, permits some state-established special districts which have never levied a property tax to raise statutorily-authorized taxes without a two-thirds vote of the people. The one percent sales tax levied by the Los Angeles County Transportation Commission and proposed to be levied by the Orange County Transportation Commission is authorized by statute and not prohibited under Proposition 13 because of *Richmond.*

Types of Taxes Available

Voter initiatives, court decisions, and changes in state law have left local governments with the following options for raising taxes locally (Table 1):

Table 1
Local Government Taxing Authority

	Cities	Counties	School Districts
Business license tax	MB		
Utility users tax	MB		
Transient occupancy tax	MB	MB	
Admissions tax	MB		
Parking tax	MB		
Non-AV property tax	MB		
"Carman" tax	MB	MB	
"Special" tax	⅔	⅔	⅔

MB — Majority of governing body
⅔ — Two-thirds of local electorate

Utility users tax. Discussed in Chapter IV. Cities are the only agency authorized to impose this tax, which has become the largest discretionary local tax, raising more than $490 million in 1983-84.

Business license tax. Discussed in Chapter V. Counties may only levy business license fees for purposes of regulation. Cities may raise this tax for revenue purposes. This tax has been the most frequently raised tax since the *Farrell* decision in 1982. The business license tax will bring in more than $400 million in 1983-84.

Non-ad valorem property tax. Discussed in Chapter VI. These are the taxes which counties and school districts generally attempt as "special taxes," as provided for in Proposition 13. They must receive a two-thirds vote of the electorate. Cities may raise these taxes by vote of the council.

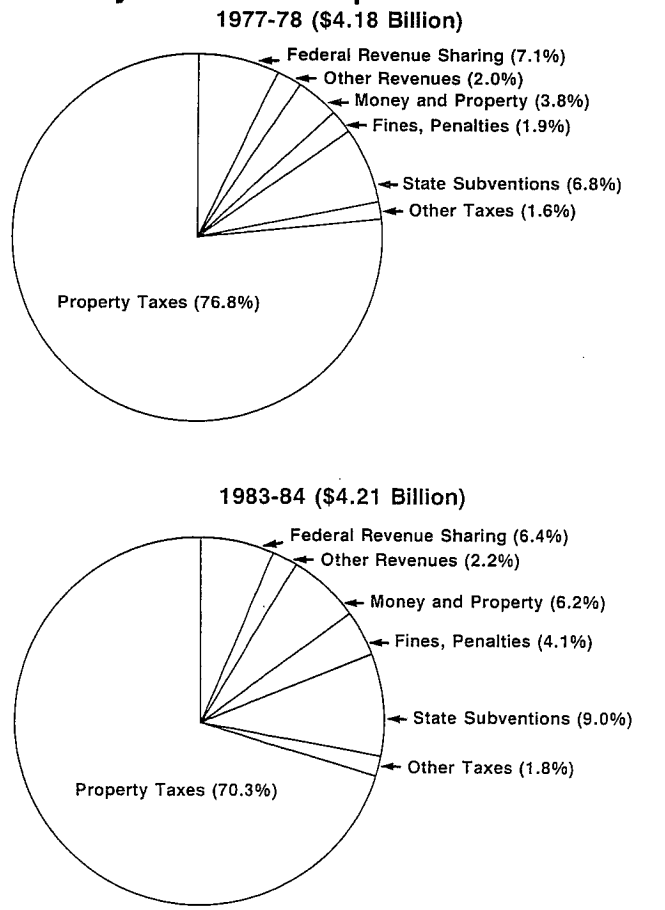
Transient occupancy tax. Discussed in Chapter VII. Cities and counties may both raise this tax by a vote of the governing body. They are popular taxes because they are usually paid by non-residents. Transient occupancy taxes will generate more than $190 million in 1983-84.

Other discretionary local taxes. Discussed in Chapter IX. Limited to cities, these taxes include admissions, parking, property transfer, severance, construction, and other taxes not otherwise prohibited by the state constitution. These taxes will raise some $400 million in 1983-84.

Revenues

City and county revenues have not only grown in recent years but the mix of revenues has also changed. Net county general revenues have increased 31% since 1977-78, compared with a 49% increase in inflation for government purchases. At the same time, counties have become less reliant on revenues from property taxes and more dependent on state aid, fines and penalties, and property and interest income. Local discretionary taxes play an insignificant part in county budgets (Figure 2).

Figure 2
County General Purpose Revenue Mix



Sources: Assembly Ways & Means Committee, Cal-Tax Foundation

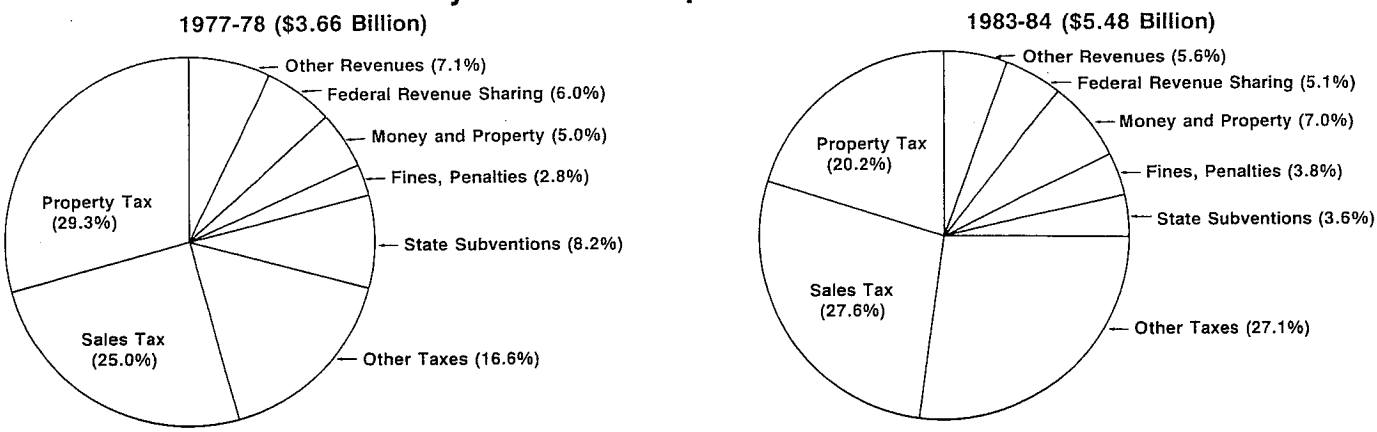
The picture is quite different for cities (Figure 3). Their general revenues have increased by 50% since 1977-78. But revenues from utility users and business taxes have increased 146% and 158%, respectively (Figure 4). While cities have also become less reliant on property taxes since 1978, they have become significantly more dependent on local discretionary taxes and, for a time, on interest and property income. Sales taxes are the single most important source of revenues, compared with property taxes six years ago.

Limitations of Study

The scope of this study covers only those taxes which are locally controlled, levied, and increased. As such, it will not dwell on property and sales taxes, since they are determined by the state's constitution and statutes. Nor will this study investigate fees, fines, forfeitures, or other charges because these revenues often are earmarked for special purposes and are scheduled according to the cost of a particular service or function.

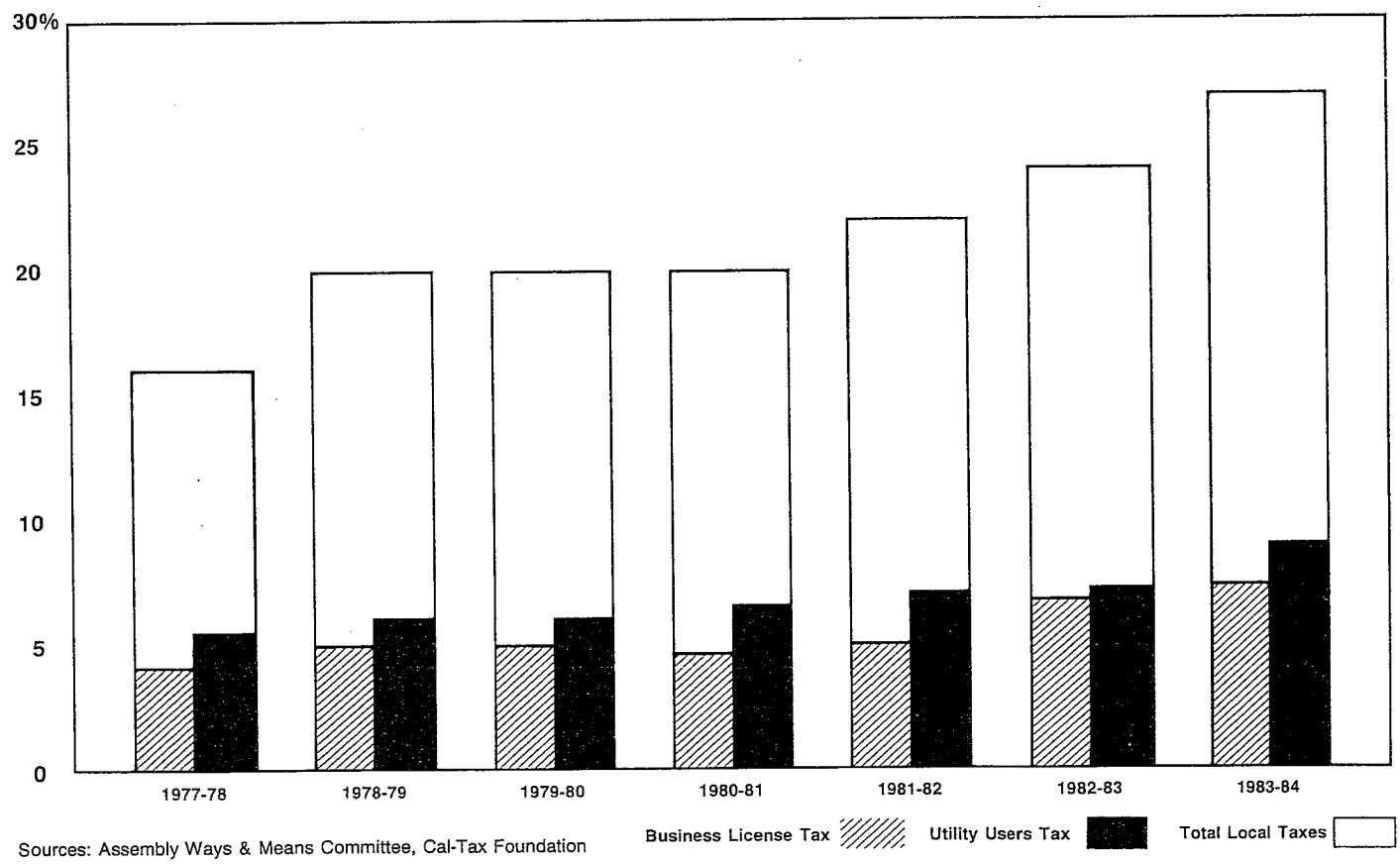
Neither will this study investigate the use of benefit assessments, which are becoming a more popular method of financing local government public works and which are taking on more of the characteristics of taxes. While these assessments are becoming a more important source of local revenues, they are not usually deposited into an agency's general fund, as are the other taxes under consideration.

Figure 3
City General Purpose Revenue Mix



Sources: Assembly Ways & Means Committee, Cal-Tax Foundation

Figure 4
Local Taxes as a Proportion of Total City General Purpose Revenues



Sources: Assembly Ways & Means Committee, Cal-Tax Foundation

II

Voting in California

Findings

- *27% of local agencies (not including school districts) that have attempted to raise a tax with a two-thirds vote have succeeded:*
  - *Cities succeeded on 30% of their attempts.*
  - *Counties succeeded on 17% of their attempts.*
  - *Special districts succeeded on 29% of their attempts.*
- *If a majority vote had been required, the passage rate would have been 64%.*
- *Virtually all taxes proposed for a local vote have been broadly-based property taxes. Virtually all taxes levied or raised under* Farrell* *have been targeted at business taxpayers, utility users, or lodging establishments.*
- *The passage rate since 1982 has not changed. Although there have been fewer attempts since 1982 to increase taxes with voter approval, more attempts are failing than are succeeding.*
- *Most attempts by school districts to raise taxes by a two-thirds vote have failed.*
- *Most communities that have succeeded in passing special taxes are small, residential, homogeneous, and better off in terms of residents' per capita income.*
- *Since the* Farrell *decision, fewer special taxes requiring two-thirds voter approval have been attempted.*
- *Under the* Farrell *authority, more than a hundred cities have raised more than 130 taxes:*
  - *32 utility users taxes have been raised or levied.*
  - *At least 44 transient occupancy taxes have been raised.*
  - *At least 55 business license taxes have been raised.*
- *More than $300 million in new taxes has been levied since 1982 under the* Farrell *authority.*

**City and County of San Francisco v. Farrell* (August 5, 1982)

Pre-Proposition 13

Prior to 1978, with one exception, local officials were not required to obtain voter approval for local tax increases, except in the rare instances of *SB 90* property tax limit overrides. Property taxes, business, utility, and transient lodging taxes were all raised by action of the city council or, if so authorized, the board of supervisors. School districts would set their expenditures and the county auditor would set the appropriate tax rate to meet that budget, subject to the district's staying within the state-determined revenue limit.

The one exception to this control by local officials was for long-term indebtedness. The state constitution required any long-term indebtedness — usually in the form of general obligation bonds backed by a dedicated increase in the property tax — to be approved by two-thirds of the local voters.

Post-Proposition 13

In addition to cutting property taxes, Proposition 13 attempted to constrain the tax-raising ability of local government officials. The apparent intent of the framers of the amendment was to prevent the property tax from ever again increasing above the rate of one percent of value, plus a rate for voter-approved bonded indebtedness, as well as requiring all other tax increases to be approved by a two-thirds vote of the local electorate.

Article XIII A, Section 4 of the state constitution, as added by Proposition 13, provides that "Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except *ad valorem* taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district."

This section has worked to limit increases in city, county, and school property taxes, with certain exceptions (see Chapter VIII). Between 1978 and 1982, this limitation was effective in restraining most local tax increases.

Experience with the Two-Thirds Vote

Cal-Tax and the League of California Cities each conducted informal surveys of local tax elections between June 1978 and November 1982. The surveys determined that approximately 180 elections were held asking for two-thirds voter approval of special taxes. The breakdown of these elections appears in Table 2.

In only 27% of those elections requiring a two-thirds vote

Table 2
Local Tax Elections, 1978-1982

	Number of elections	Passed with more than ⅔	Rate	Received more than 50%	Rate
Cities	88	26	30%	54	61%
Counties	29	5	17%	10	34%
Special districts	63	18	29%	51	81%
Total	180	49	27%	115	64%

through November 1982 did the ballot measure succeed. If the threshold of success had been a simple majority, the rate of passage would have been closer to two out of three.

Success of two-thirds vote tax proposals has not improved since 1982. Elections to impose a per parcel property tax failed in Fairfax (twice), San Anselmo, Atherton, Palos Verdes Estates, Belvedere, El Cerrito, Menlo Park, and Pacifica. All except El Cerrito received more than a simple majority but less than two-thirds voter approval.

Communities which have passed per parcel taxes since 1982 include Del Rey Oaks, Monte Sereno, Belvedere, and Atherton, the latter two on their second tries.

Similar elections for schools have met the same fate. Since 1982, at least eight school districts have asked voters for authority to levy a parcel tax. Only two received the requisite two-thirds vote (and only one of those taxes current residents), four received a simple majority, and two fell short of that mark.

The handful of cities and school districts that have passed special taxes generally have been smaller, wealthier, and more residential communities. Because these communities tended to be more homogeneous in their demographic and socio-economic characteristics, it was easier for them to reach a consensus on both the tax increase and the expenditure of those taxes. Larger, urbanized, and more diverse communities encountered more difficulty in gaining voter approval for tax increases; in fact, many of these heterogeneous cities and school districts chose not to put these proposals on the ballot at all.

Farrell Decision

The passage of Proposition 13 and the resistance of local jurisdictions, particularly charter cities, to a two-thirds vote requirement, as well as the general failure of local officials to obtain such a majority for tax increases, motivated a test of the phrase "special taxes," as it is used in Section 4 of Article XIII A. Does the term apply to all locally-levied taxes or only certain taxes under specified conditions?

Proponents of the broad interpretation argued that "(T)o effectively provide protection (from withdrawal or depletion of tax savings), it is necessary that Section 4 apply to all local taxes, not merely to "special purpose" taxes or "special purpose property taxes." They argued that "special taxes" means taxes supplemental to those mentioned in Section 4 (ie., *ad valorem* property taxes).

Proponents of the narrow interpretation argued that the term "special taxes" applies only to taxes earmarked for a specific purpose, and that any tax not so designated would not be subject to the two-thirds vote requirement.

The issue was joined in the case of *San Francisco v. Farrell.* In April 1980 the San Francisco Board of Supervisors approved a temporary ordinance raising the business license tax from 1.1% to 1.5%. San Francisco voters later approved an extension of the tax by a majority vote of 55%. In August 1982, two years after the commencement of friendly litigation, the Supreme Court ruled that San Francisco's increase in its business license tax did not require approval by a two-thirds majority because it was "placed in the general fund to be utilized for general governmental purposes." The court did not rule on whether this decision was limited to charter cities or extended to general law cities and counties, as well.

Perhaps the strangest consequence of this decision is, in the words of dissenting Justice Otto Kaus, "that the ability of local entities to levy traditional, run-of-the-mill revenue raising taxes for general municipal purposes (is unlimited), but — quite perversely — only makes it more difficult for such entities to levy much more unusual and more limited 'special purpose' taxes . . . I can think of no plausible reason for the drafters to have intended such an irrational and ineffectual scheme."

A striking illustration of this practice has appeared in the city of Los Angeles. Improved law enforcement and fire protection are at the top of every survey of what citizens want from their local governments. In November 1980 Los Angeles voters gave 54% of their votes in support of a tax dedicated to increased fire protection. Because it was a dedicated tax, it required a two-thirds vote, and therefore failed. In the summer of 1983, after the *Farrell* decision, the Los Angeles City Council was able to raise local taxes — to be used for *any* purpose — by some $116 million.

The *Farrell* decision re-opened the door for a variety of tax increases that Proposition 13 had briefly restricted by the two-thirds voter approval requirement.

Present Voting Requirements

Below are the present requirements for increasing taxes in California cities and counties:

Property tax. Cities and counties may raise property taxes above the one percent limit only for purposes of retiring pre-1978 voter-approved debt. This debt need not be limited to bonded indebtedness, but may include pension obligations (*Carman* decision) and state and federal water contracts in effect before 1978. Voters need not be consulted for these tax increases.

"Special" taxes. These are taxes levied for a special purpose and placed either in the general fund or in a special fund of a jurisdiction, such as assessments for road maintenance and any taxes earmarked for a certain purpose. Special taxes require approval by two-thirds of the local voters. Following the *Farrell* decision, special tax levies and elections are rare.

"Farrell" taxes. Taxes levied by cities and counties for general purposes and deposited in the agency's general fund need not be approved by a two-thirds vote of the electorate. Usually, this means the only approval required is majority vote of the governing board. Combined with the broad authority given general law cities to raise local taxes, the *Farrell* decision gives cities the greatest increase in taxing powers. Typical city *Farrell* taxes are utility users, business license, and transient lodging taxes.

County taxing authority under *Farrell* is limited only to transient lodging taxes. Schools have not yet been affected by the decision because they require legislative authorization to levy local taxes, which has not yet been forthcoming. Legislative Counsel has opined that schools, even though they are a single-purpose entity, do fall into the general purpose-general fund category and would be eligible to receive such taxing authority if the Legislature chooses to grant it.

Extent of Farrell Use

A Cal-Tax survey of more than 150 California cities with more than 80% of the state's population has uncovered widespread use of the *Farrell* decision — combined with the change in state law granting full taxing authority to general law cities — resulting in tax increases in more than a hundred cities in just the past two years (Table 3).

The most common tax increased was the business license tax, which was raised by 55 of the cities surveyed. Revenues attributable to these tax increases is conservatively estimated at $230 million over the past two years.

Utility users taxes were increased or enacted by 32 cities,

Table 3
Selected Cities Exercising Authority Under Farrell to Levy or Increase Taxes

City	Utility Users Tax	Transient Occupancy Tax	Business License Tax	Other Taxes
Alhambra	X		X	
Anaheim		X		
Antioch	X		X	
Arcadia			X	
Avalon		X		
Bakersfield		X		
Bell Gardens		X		
Benicia	X			
Berkeley	X		X	
Buena Park		X		
Burbank		X	X	
Calistoga			X	
Capitola			X	
Carson			X	
Cerritos			X	
Concord	X			
Covina		X	X	
Culver City	X(2)			
Daly City			X	
Delano	X			
Downey			X	
El Cerrito				X
El Monte			X	
El Segundo		X	X	
Emeryville			X	
Eureka		X	X	
Fairfax				X
Fairfield			X	
Farmersville			X	
Foster City		X		
Fountain Valley		X		
Fremont			X	
Fresno		X	X	X
Gardena	X			
Glendora		X		
Grass Valley		X		
Hawthorne	X	X	X	
Hillsborough				X
Huntington Beach		X		
Inglewood			X	
Irvine		X	X	
La Mirada		X		
La Verne		X		
Lakewood			X	
Lancaster		X		
Lawndale		X	X	
Livermore	X			
Los Angeles	X	X	X	
Los Gatos		X		
Manhattan Beach		X	X	
Martinez	X			
Monrovia		X		
Montebello	X	X	X	
Monterey Park	X	X		
Morgan Hill	X			
Morro Bay			X	
Mountain View			X	
Mount Shasta			X	
Napa			X	
Nevada City		X		
Newport Beach		X		
Oakland			X	
Orange			X	
Oxnard			X	
Pacifica	X			
Palos Verdes Estates	X		X	
Pasadena			X	
Placentia	X			
Placerville			X	
Pleasant Hill	X			X
Pleasanton			X	
Redondo Beach	X	X	X	
Redwood City	X			
Rialto			X	
Richmond	X		X	
Riverside			X	
Rolling Hills Estates			X	
Ross				X
Sacramento	X	X		
San Bernardino	X			
San Dimas		X		
San Francisco		X	X	
San Jose			X	
San Juan Capistrano		X		
San Mateo			X	
San Pablo	X			
Sanger	X			
Santa Ana		X		
Santa Clara			X	
Santa Cruz			X	
Santa Monica		X	X	
Seaside	X			
Simi Valley			X	
Sonora		X		
South El Monte		X		
South Gate		X		
South Pasadena	X			
South San Francisco			X	X
St. Helena		X		
Stockton		X		
Torrance		X	X	
Union City			X	
Vernon			X	
Waterford	X			
Westminster		X		
Whittier	X(2)			
Yorba Linda		X		
Total taxes — 138	32	44	55	7
Total cities —107				

including previously unauthorized general law cities, and repealed by at least one. Taxes attributable to these increases are estimated at $75 million over the past two years.

Transient occupancy taxes were increased by at least 44 cities and a dozen counties. There is no estimate for the dollar increase attributable to these increases.

The interaction of the *Farrell* decision on "general" tax increases and the two-thirds vote requirement on "special" tax increases has created an interesting taxing behavior on the part of local governments, especially cities. Since virtually all taxes proposed by cities, counties, and school districts under the special tax authority have been non-*ad valorem* property taxes, and since very few of these taxes have achieved the required two-thirds vote, there is a built-in bias against the most broadly-based taxes available.

On the other hand, since cities are able to increase "general" taxes by a vote of the council, and since virtually all taxes raised under authority of the *Farrell* decision have been business license, utility users, or transient occupancy taxes, there is a bias — in the case of cities — in favor of taxes targeted toward a specific class of taxpayer.

III

National Survey of Local Tax Enactment Procedures

A 50-state survey was conducted by the California Tax Foundation to identify procedures local governments across the country use to enact new taxes or increase existing taxes.

The type of tax available to local jurisdictions is set forth in each state's constitution and statutes. With few exceptions, each state imposes a rate or other limit on local taxes, usually property taxes (Table 4). (Property taxes for cities and counties in Georgia, towns and boroughs in Alaska, and counties in Hawaii have no state-imposed limits).

Findings

- *Some form of voter approval of local taxes is required in 39 of the 50 states (Table 5). Only Alaska, Hawaii, Maryland, New York, Pennsylvania, South Carolina, South Dakota, and Virginia do not require any local voter approval of locally-levied taxes. Mississippi, New Hampshire, and North Dakota have no local authority over any local taxes, even by the elected boards.*

Property Taxes

- *California is the only state in the nation where the state constitution establishes a maximum tax rate above which the property tax cannot be increased.*
- *In 4 states (Mississippi, New Hampshire, North Dakota, and Wyoming) the property tax is raised by action of the state legislature.*
- *The remaining 45 states all have procedures by which locally-elected officials or the voters can enact or increase the property tax.*
- *In 35 states property taxes can be raised by action of the local legislative body; however, in 15 of those states that body's authority is limited to a certain percentage increase each year.*
- *3 states (Florida, Kansas, and New Jersey) require property tax increases above a certain amount to be approved by a supermajority vote — i.e., a majority greater than 50% plus one — of the governing board.*
- *10 states require majority voter approval of all property tax increases; another 14 states require a majority vote of the electorate when the increase is more than a certain amount.*
- *3 states (Idaho, Massachusetts, and Washington) require a supermajority of the electorate to approve property tax increases when the increase is more than a specified amount. Ohio requires supermajority approval by the voters when the increase is requested at a special election. No state requires supermajority approval of property tax hikes under every circumstance.*

Table 4
Authority Over Local Tax Increases: Nationwide Comparison

	Property Tax			
	Cities and Counties	Schools	Sales Tax	Other Taxes
Majority vote board	20	1	9	13*
Supermajority vote board	-0-			
Majority vote electorate	10	15	10	3
Supermajority vote electorate	-0-			
State legislature	4		1*	
No authority	1*	1*		
Majority board & electorate	9	2	1	4
Majority board & supermajority electorate	2			1
Majority board & supermajority board & majority electorate	2			
Majority board & majority electorate & supermajority electorate	1	1		
Majority board & supermajority electorate	1			1*
Total	50	20	21	22

*Case for California

Table 5
Ultimate Responsibility for Tax Increases

State	Property tax — cities and counties: Majority board	Super-majority board	Majority voters	Super-majority voters	Schools	Sales tax
Alabama			X			MB
Alaska	X					
Arizona			X			MB
Arkansas			X			
California						Legislature
Colorado			X			MV
Connecticut	X					
Delaware	X				MV	
Florida	to 8%	8%-15%	15% +			
Georgia	X				MV	MV
Hawaii	X					
Idaho	to 5%			5% +	MV 5% +	
Illinois	X				MV	MB
Indiana	X				MV	
Iowa	X				MV	
Kansas	to limit	limit +			MV	MV
Kentucky	to 4%		4% +			
Louisiana	to limit		limit +		MV	MV
Maine	X					
Maryland	X					
Massachusetts	to limit		limit +	limit +		
Michigan	to limit		limit +		MV	
Minnesota	to limit		limit +		MB	MV
Mississippi	Legislature			Referendum		
Missouri			X		MB,MV,SMV	MV
Montana	X				MV	
Nebraska	to limit		limit +			
Nevada			X			
New Hampshire	Legislature					
New Jersey		to limit	limit +		MV	
New Mexico	to limit		limit +			MB
New York	X					MB
North Carolina			X			MB
North Dakota	Legislature					
Ohio	to limit		limit +		MV	MB,MV
Oklahoma			X			MV
Oregon	to limit		limit +			
Pennsylvania	X					
Rhode Island	X					
South Carolina	X					
South Dakota	X					MB
Tennessee	X					MV
Texas	to limit		limit +		MV	MV
Utah	X				MV	
Vermont			X		MV	
Virginia	X					
Washington	to limit			limit +		MB
West Virginia	X				MV	
Wisconsin			X			MB
Wyoming	Legislature				MB,MV	MV
Total	38	3	22	3	19	21

MB = majority vote of board or council
MV = majority vote of voters
SMB = supermajority vote of board or council
SMV = supermajority vote of voters

• *17 states graduate the voting authority depending on the amount of the property tax increase.*

Taxes for Schools

• *California public schools may not increase property taxes except a levy for bonds approved prior to June 1978 but not yet issued. Schools may raise "special" non-*ad valorem *property taxes by a two-thirds vote of the local electorate.*

• *19 states have different — usually more rigorous — procedures for raising school property taxes than for increasing general government property taxes. 10 states have a voter approval requirement for schools but not for cities and counties. Missouri requires supermajority voter approval for increasing property taxes above a certain limit; no analogous provision exists for Missouri local government. Only in Minnesota and Idaho is the approval requirement for schools less rigorous than for local government.*

Sales Taxes

• *California prohibits counties from raising their sales tax above the present 1% rate. (Cities and counties levy a 1% rate in addition to the 4.75% state sales tax.) Cities are discouraged from raising additional local sales taxes by a law removing state administration of the one cent local levy and removal of the retailers' credit against the county-levied sales tax.*

• *20 states authorize their local governments to raise local sales taxes. In 9 states the governing board has the authority, in 10 the voters must authorize, and in Ohio the voters must authorize any levy above a certain amount.*

Other Taxes

• *Cities in California are authorized to raise most non-property or sales taxes by a vote of the council as long as it is a general purpose tax for deposit in the general fund of the city (so-called "*Farrell*" criteria). Otherwise a two-thirds vote of the electorate is required to enact a "special tax." County boards are limited to raising a small number of statutorily-authorized taxes under the* Farrell *criteria, otherwise, a two-thirds vote of the electorate is required to raise special taxes.*

• *21 other states reported that local governments are authorized — usually by action of the governing board — to raise other taxes, including income, business license, motor vehicle fuel, and others. Often these taxes are limited to larger cities in the state.*

Examples

Supermajority voter approval is required in six states: Idaho, Massachusetts, Washington, Missouri, Ohio, and California. A brief description of each state's supermajority procedure for enacting or increasing local taxes follows:

Idaho. Idaho's tax limitation measure provides that city and county property taxes may be increased to 5% by a simple majority of the governing body. To exceed 5%, approval by two-thirds of the electorate is needed. Schools require only a simple majority approval by the voters for the 5%-plus increase.

Massachusetts. Proposition 2½, Massachusetts' tax limitation initiative, provides that the governing board of cities and special districts (but not counties or school districts) may enact an increase in property taxes up to the state limit. To override the limit, approval by either a simple majority or a two-thirds majority of the electorate is needed, depending on the amount of increase.

Washington. "Excess" levies of the property tax for general purpose local governments and school districts must be approved by a 60% majority of the electorate. There is a single-year limit on general government excess levies and a two-year limit on school district excess levies.

Missouri. A property tax increase for school districts requires one of three enactment procedures, depending on the amount of increase. To increase from $1.25 per $100 of assessed value, the governing body enacts by a simple majority. To increase to $3.75 per $100, approval by a simple majority of the voters is needed. To increase beyond $3.75 per $100, a two-thirds majority of the voters is needed.

Ohio. Property taxes for all local jurisdictions in Ohio may exceed the 1% limit upon approval of a simple majority of the electorate. However, if a special election is held, a 55% majority is needed to pass the increase (except for school districts).

California. A two-thirds majority vote is required to enact "special taxes," which include taxes (except *ad valorem* property taxes) other than those producing revenue placed in the local government general fund to be utilized for general governmental purposes. Proposition 13 of 1978 removed the power of local voters to increase *ad valorem* property taxes.

The following states use variations of majority voter approval procedures:

Alabama. To increase property taxes, the governing body enacts the increase; public hearings are held; the state legislature passes a bill; and a simple majority of local voters must approve the increase.

Colorado. To increase property taxes up to 7% over the prior year, all local jurisdictions appeal to a state-designated board or official for permission to enact the excess levy; if not approved, the governing body places the increase on the ballot for simple majority voter approval.

In order for a city or county to escape the 7% limit, public notice is given, a comparison of past and proposed budgets is published in general circulation newspapers, and a vote is cast by the governing board.

Florida. To increase city and county property taxes annually: up to 8%, governing body enacts by simple majority; 8% to 15%, governing body enacts by simple majority plus one; beyond 15%, approval by simple majority of voters.

Kansas. To exceed state lid for city and county property taxes, the governing body must exempt its jurisdiction from the lid by a supermajority vote of the body — two-thirds for the county and four-fifths for the city.

New Mexico. In order to augment the municipal gross sales receipts tax, capped by the state at .75%, the first .25% is added by governing body action; the second .25% is added by the adoption of an ordinance subject to referendum.

North Dakota. Home rule cities may impose a property tax if they so choose, but none has yet enacted the tax. Approval by a simple majority of the electorate would be necessary to enact.

Oregon. The governing body may enact an increase in the property tax levy up to 6%. To increase the levy beyond 6%, either the tax base must be changed by simple majority voter approval at a regular election, or a levy for up to three years may be enacted by a simple majority vote of the electorate held on one of four designated dates.

Rhode Island. Cities and towns establish their own property tax rate up to the state-determined limit. Beyond that limit, the budget is submitted to the state for review and approval of the increase, and the local governing body enacts. In smaller jurisdictions a vote to approve the budget is taken at town meetings.

IV

Utility Users Tax

Findings

- *70 cities in California levy a utility users tax, up by 22 since 1982. Another 9 cities have increased their tax during the past 2 years. One city has repealed its tax since 1982, and at least 3 others are contemplating repeal.*
- *Statewide, the utility users tax is the largest revenue source over which cities have direct control. The tax will raise more than $490 million in fiscal 1983-84.*
- *Cities have also increased their dependence on the utility users tax, from 5.5% of general revenues in 1978 to 7.3% in the years following.*
- *Utility users tax revenues have increased more than twice as fast as the rate of inflation since 1978.*
- *Some cities have chosen to repeal, cap, or not levy a utility users tax when presented with evidence of the adverse effect it would have on business.*

A utility users tax is levied by 70 California cities on consumers of utility services (Table 6). Nearly half of all Californians who live in cities are subject to the tax. Counties are not authorized to levy the tax.

Statewide, the utility users tax is the largest revenue source over which cities have direct control. The tax is the third largest revenue source for cities, behind property and sales taxes, which are set by the state constitution and statutes.

Farrell Decision and "Section 88" Amendment

The utility users tax has become the most popular revenue raising tool for cities since the 1982 *Farrell* decision. During the 12 years preceding that decision, the number of jurisdictions levying the tax ranged between 47 and 50. But today, 70 cities collect a utility users tax (Figure 5).

Government Code Section 37100.5 — the "Section 88" provision of the 1982 state budget trailer statute, which allows general law cities the same tax raising powers as charter cities — also contributed to this jump in the use of the utility users tax. Of the 23 jurisdictions which levied a new utility users tax since July 1982, 19 were general law cities. Currently, one-quarter of the cities levying a utility users tax are general law cities.

This recent rash of new or increased utility users tax levies — 32 in the past two years — has provoked widely differing

Figure 5
Cumulative Number of Cities Levying and Increasing Utility Users Tax
(Includes six repeals)

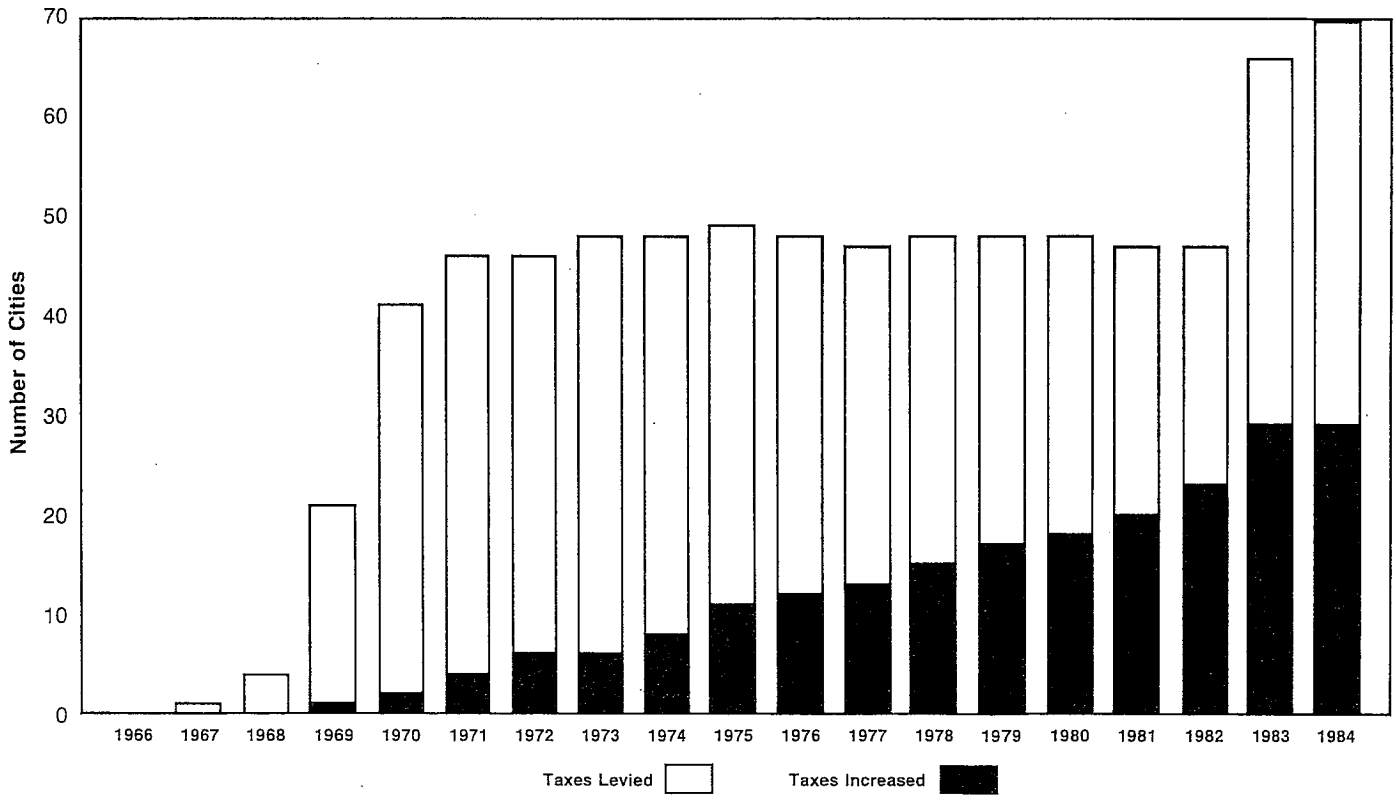


Table 6
Utility Users Tax

City	1984 Rate	Service[a]	Date Effective[b]
Alameda	5.00%	g,e,t	1970
Albany	4.50%	g,e,t	1971
Alhambra	5.00%	g,e,t	n1983
Antioch	3.50%	g,e,t,w	n1984
Arcadia	5.00%	g,e,t,w	1980
Benicia			r1984[c]
Berkeley	3.00%	g,e,t	n1984
Burbank	7.00%	g,e,t	1972
Chico	5.00%	g,e,t,w	1970
Chula Vista	5.00%	g,e,t	1978
Compton	5.00%	g,e,t,w	1969
Concord	2.00%	g,e,t	n1983
Culver City	11.00%	g,e,t,w,c	i1983[d]
Delano	3.00%	g,e,t,c	n1983
Gardena	5.00%	g,e,t,w	n1983
Gilroy	5.00%	g,e,t,c	1971
Glendale	5.00%	g,e,t	1969
Hawthorne	3.50%	g,e,t	n1984
Huntington Beach	5.00%	g,e,t,w,c	1971
Inglewood	10.00%	g,e,t,w,c	1975
Irwindale	5.00%	g,e,t,w	1977
Livermore	3.00%	g,e,t,w,c	n1983
Long Beach	5.00%	g,e,t,w	1970
Los Angeles	10.00%[e]	g,e,t	i1983
Martinez	4.00%	g,e,t,c	n1983
Modesto	5.00%	g,e,t,w	1970
Montebello	3.50%	g,e,t	n1983
Monterey	5.00%	g,e,t,w	1970
Monterey Park	4.50%	g,e,t	n1983
Morgan Hill	5.00%	g,e,t,c	n1983
Mountain View	3.00%	g,e,t	1971
Oakland	5.50%	g,e,t	1972
Oroville	5.00%	g,e,t,w,c	1969
Pacific Grove	5.00%	g,e,t,w,c	1969
Pacifica	6.50%	g,e	n1983
Palos Verdes Estates	10.00%	g,e,t,w	n1983
Pasadena	7.58%	g,e,t,w,c	1979
Piedmont	7.50%	g,e,t,w	1978
Placentia	3.00%	g,e,t	i1982
Pleasant Hill	1.00%	t	n1984
Pomona	7.00%	g,e,t,w	1976
Porterville	3.00%	g,e,t,w,c	1981
Redondo Beach	5.25%	g,e,t,w,c	i1983
Redwood City	5.00%	g,e,t,c	n1983
Richmond	4.00%	g,e,t	n1983
Riverside	5.00%	g,e,t,w,c	1970
Roseville	5.00%	g,e,t	1971
Sacramento	9.00%	g,e,t	i1983
Salinas	5.00%	g,e,t,w,c	1969
San Bernardino	8.00%	g,e,t,w	i1983
San Francisco	5.50%[f]	g,e,t	1983
San Jose	5.00%	g,e,t,w	1971
San Leandro	5.00%	g,e,t	1970
San Luis Obispo	5.00%	g,e,t,w,c	1973
San Pablo	5.00%	g,e,t	n1983
Sanger	5.00%	g,e,t	n1983
Santa Ana	3.00%	g,e,t	1975
Santa Barbara	6.00%	g,e,t,w,c	1978
Santa Monica	5.00%	g,e,t	1969
Santa Rosa	5.00%	g,e,t,c	1970
Seal Beach	5.00%	g,e,t	1973
Seaside	6.00%	g,e,t	n1983
South Pasadena	5.00%	g,e,t	n1984
Stockton	6.00%	g,e,t,w,c	1974
Sunnyvale	2.00%	g,e,t	1975
Torrance	6.00%	g,e,t,w,c	1979
Tulare	6.00%	g,e,t,w,c	1981
Vallejo	7.50%	g,e,t	1974
Ventura	5.00%	g,e,t,w,c	1970
Waterford	6.00%	g,e,t,w	n1983
Whittier	3.00%	g,e,t,w,c	i1983[g]

Total Increases — 9
New — 23

Total *Farrell* taxes — 32

a. g = gas service
e = electric service
t = intrastate telephone service
w = non-municipal water service
c = cable television service

b. n = new tax since 1982
i = increased tax since 1982
r = tax repealed

c. Tax enacted in 1983 at 1% rate.
d. Tax increased in 1982 to 8%.
e. 12.5% rate for electric bills for business, as of 1983.
f. Tax applies only to business, as of 1983.
g. Tax increased in 1982 to 2%.

levels of public outcry in the affected locations. In some cities, such as Martinez, Morgan Hill, and Antioch, strong public outcry was registered. In Delano two city councilmen were recalled largely because of their support of a utility users tax. Two council members in Pacifica narrowly escaped recall over the same issue. In Antioch and Richmond the tax is limited to a year. Benicia repealed its tax after 12 months on the books. At least a dozen other cities, including San Anselmo, Rohnert Park, and Tracy, have considered the tax but rejected it based on public outcry or uncertainty over future revenue sources. A number of other cities are still considering whether to levy or raise a utility users tax.

Characteristics

The tax is a popular revenue source for several reasons:

Stability. The utility users tax increases with population, local economic growth, and as energy costs rise.

Incidence. The tax can be broadly based, minimizing the effect on any one group of constituents or taxpayers. The tax can be spread among virtually all of the city's residents, or can be classified to exclude residents based on age, wealth, use, or other criteria.

Administration. The tax is easy and inexpensive to collect because the utility companies do the collection as part of their monthly billings. There is an added political benefit because the tax goes out on the utility bills — not city letterhead — which may deflect some taxpayer resentment against city officials.

Revenues

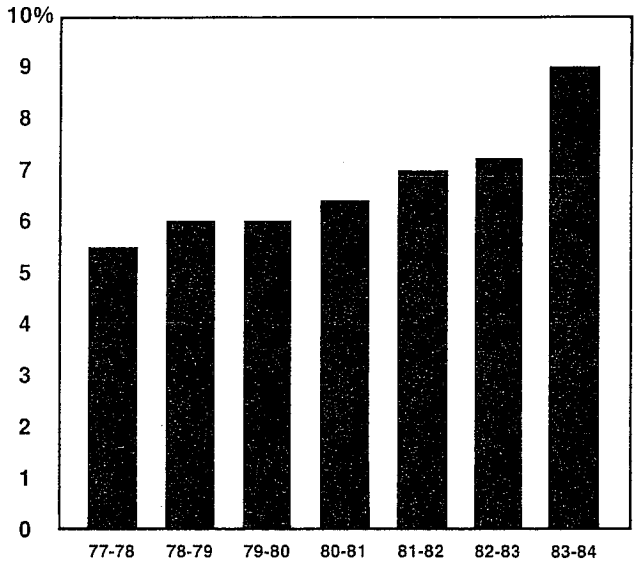
Utility users taxes raised $353 million in fiscal 1981-82, and will bring in an estimated $490 million in 1983-84. This is a 158% increase in the six years since Proposition 13. Per capita revenues for the utility users tax climbed from $24.05 in 1977-78 to $58.17 in 1981-82, a 2½-fold increase, compared with a 50% rate of inflation over that period.

Dependence

Cities have increased their dependence on utility users

taxes since Proposition 13 (Figure 6). Utility users tax revenues accounted for 5.5% of city general revenues in 1977-78. In the six years since 1978, revenues from that tax have accounted for an average of 7.3% of total general revenues. The latter figure includes the 1982-83 and 1983-84 fiscal years, when 23 new taxes were levied and nine existing taxes were increased.

Figure 6
City Dependence on Utility Users Tax
(UUT as a Percentage of Total General Revenues)



Sources: Assembly Ways & Means Committee, Cal-Tax Foundation

Rates

Rates for residential use range from 1% to 11% with 5% being the median and most common rate. Five cities tax residential users at a rate of 9% or more; three cities tax at a rate less than 3%.

All cities except Pleasant Hill levy the tax on gas and electricity, and all except Pacifica levy it on intrastate telephone services. Somewhat less than half levy the tax on non-municipal water service, and a third on cable television service.

The tax is based on the amount billed for each service and is collected by the utility as part of its monthly billing process. The utility generally remits the tax to the city based on the amount billed, not the amount collected; the utility usually does not receive any "float" from collection of the tax.

Classifications

Nearly a third of the cities which impose a utility users tax developed classes of taxpayers for purposes of differential rates, caps, and exemptions. Most of these special rates are designed to give relief to elderly or low income utility customers, but several ordinances are aimed directly, though very differently, at the business sector.

In 1983, San Francisco repealed its utility users tax for residential consumers only, with commercial and industrial taxpayers remaining subject to the 5.5% levy. Los Angeles, which recently doubled its tax to 10% for residential customers, is taxing electricity bills of businesses at a 12.5% rate.

On the other hand, at least two cities have moved in the other direction. Chula Vista and Santa Ana have placed a monthly cap on the tax bills of businesses, recognizing the Public Utilities Commission's policy in the recent past of shifting a higher burden of the utility rate structure onto the business sector.

The tax can also be levied to take advantage of high utility use by some commercial and industrial firms relative to the population at large. For example, Richmond's largest industry, an oil refinery, will pay in 1983-84 some $2 million of the estimated $3.2 million in total revenues from the tax. Similar distributions of the tax burden occur in Martinez and Benicia. In Benicia the city council decided to repeal the tax largely because of its inequitable distribution. In El Monte the city council scrapped a proposed 4% tax when apprised of the impact it would have on a major telecommunications operation of a financial institution.

Location

Utility users taxes tend to cluster in selected counties. Of the 58 counties in California, only six account for two-thirds of the cities which levy the tax. Cities in the San Francisco Bay area levy 23 taxes — 12 of those new in the last two years. In Monterey County cities comprising 76% of the county's incorporated population levy utility users taxes on their citizens.

Other counties are relatively devoid of these taxes: of San Diego County's 16 cities, only one levies a utility users tax; San Bernardino, one of 17; Riverside, one of 18; San Mateo, two of 19; and Orange, four of 26.

Part of this phenomenon can be explained by the overall attitude of an area toward taxation. But it could also be due to a "critical mass" of cities, already having levied the tax, making it easier for other cities in the area to follow suit.

Size

While utility users taxes tend to be levied by the larger cities in the state, that trend is changing. Of the 27 cities in California with population of more than 100,000, only six do not levy a utility users tax. Through 1977, three times the number of cities of more than 40,000 population levied the tax than did smaller cities. But since 1978, more cities of less than 40,000 population have levied the tax than have larger ones.

V

Business License Tax

Findings

- *Cities and counties are both authorized to raise business license fees or taxes, but counties may levy them only for regulation purposes, while cities may levy the tax for revenue purposes.*
- *Cities have wide authority over how and on whom the tax may be levied. There are few constitutional or statutory restrictions.*
- *Most cities use some form of gross receipts method as a means of taxing businesses, primarily because it provides the most predictable and greatest revenue flow.*
- *It is conservatively estimated that business license taxes will raise some $419 million in 1983-84: a 14% increase in one year, a 64% increase since 1982, and a 175% increase since 1977-78.*
- *Of the 107 cities surveyed that have raised taxes since 1982, 55 raised their business license tax.*
- *Business license tax increases made possible by* Farrell *account for $230 million in cumulative tax increases since 1982.*
- *Cities' dependence on business license taxes has grown from 4.2% of general revenues in 1977-78 to 7.2% in 1983-84.*
- *With a few exceptions, cities have worked cooperatively with the local business community when proposing to raise the business license tax.*
- *On the other hand, the few cities with the highest business taxes account for the lion's share of the tax receipts.*

Counties

Counties may only issue business licenses for purposes of regulation. That is, the cost of a business license may be no more than the county's cost of regulating the business. The fee schedules, then, do not necessarily reflect the business' size, revenues, profitability, or ability to pay, but the intensity of government supervision. A nightclub, massage parlor, or hazardous waste dump would therefore pay a higher business license fee than would a supermarket, law firm, or travel agency.

Revenues derived from the county business license are a miniscule portion of counties' general purpose budgets — less than one percent in 1983-84. Counties have attempted to obtain legislative authorization to levy business license taxes for revenue raising purposes in unincorporated areas, but have not yet mobilized sufficient support for the idea.

Cities

Cities are authorized to levy business license taxes for revenue as well as regulation purposes: for the "privilege of conducting business in the city." Cities are able to levy the tax on a wide variety of businesses using a number of different taxation methods, but there are some limitations on what or how cities may levy the tax:

- Cities may not levy the tax on net income of the business. The state has reserved the right to tax net personal income and corporate profits.
- Cities may classify businesses according to some reasonable schedule and tax them at different rates, but businesses within those classifications must be taxed uniformly.
- Cities may not tax banks, insurance companies and their agents, or other financial institutions. (Los Angeles has challenged the latter proscription as a conflict with its charter powers.)
- Cities may not tax businesses which manufacture, sell, purchase, possess, or transport alcoholic beverages.
- Cities may not discriminate against or place an unreasonable burden on businesses engaged in interstate commerce.

Apart from these restrictions, charter cities are limited in levying business license taxes only by their own charters.

General law cities are subject to various statutory restrictions:

- General law cities may not tax cafe musicians, peddlers of wholesale merchandise, peddlers who are military veterans, or itinerant real estate auctioneers.
- General law cities are also limited to using certain methods to tax contractors from outside the city, leased or rented laundry equipment, and vending machines.

These statutory restrictions, which never applied to charter cities, may no longer be valid for general law cities in light of the expanded taxing authority granted the latter by the 1982 budget trailer bill. This has not yet been tested in the courts, however.

Basis

There are a number of generally accepted methods by which cities tax businesses:

Gross receipts. This method taxes businesses based on total receipts. It is the most popular method; cities are changing their means of taxation from other methods to gross receipts. The major advantage to a city of a tax based on gross receipts is that it reflects rising prices and changes in productivity. A major disadvantage — common with all the methods of business taxation — is that it does not reflect the profitability of the business. For example, a business with a very low net profit margin, such as a retail grocery or department store, could be taxed at the same percentage of gross receipts as high profit margin businesses, such as professional services.

Average number of employees. This method taxes businesses on the basis of their total average number of employees. The major advantage to the city is that as employment in the city rises, so do tax revenues. The disadvantages include the difficulty of assessing a tax on a business which uses a large sales force which does not work out of a central location, the insensitivity of the method to changes in the

economy (except during a recession), and its tendency to penalize labor-intensive businesses.

Flat rate. This method charges all those engaged in the same class of business the same rate, regardless of size, volume, or profitability. This method had been popular in the days when cities taxed businesses for regulatory purposes, but cities are now switching to methods which can guarantee them larger and more predictable revenues. The major advantage of this method to cities is ease of administration. The major disadvantage is its arbitrary and regressive nature.

Gross payroll. This method is used by a handful of cities — notably Los Angeles, San Francisco, and Oakland — usually as an alternative to computing a gross receipts tax. The tax levies a certain rate on the amount of a business' payroll within the city. It is used as a way of taxing companies which may have their administrative headquarters in the city, but which do not generate much in the way of sales.

Other methods of business license taxation include levies on the number of vehicles, number of locations, square footage, and number of leased machines, among others. These tax bases are usually used for certain business classifications which would most appropriately fit the tax bases.

Employee License Tax

Another method of taxing "businesses" is the employee license tax, which would tax each employee of a business for "the privilege of holding employment in the city." The only city to enact the tax was Oakland, which suspended the tax soon after it was levied, never collecting any revenues. Other cities have considered the tax, including Los Angeles, San Francisco, Berkeley, and Pasadena, but none has yet levied it.

The California Supreme Court, in *Weekes v. City of Oakland,* upheld the validity of the employee license tax in 1978 against contentions that it was a local income tax, which is prohibited by the state constitution. The court held that the tax "is a valid occupation or license fee and not a municipal tax upon income. The city's tax differs from typical income taxes . . . it reaches only one source of income, earnings, and does not allow deductions for business-related expenses. . . The tax more closely resembles the traditional business license tax because it is levied on the privilege of doing business as an employee; it is based on gross receipts, and continued employment within the city is conditioned upon its payment."

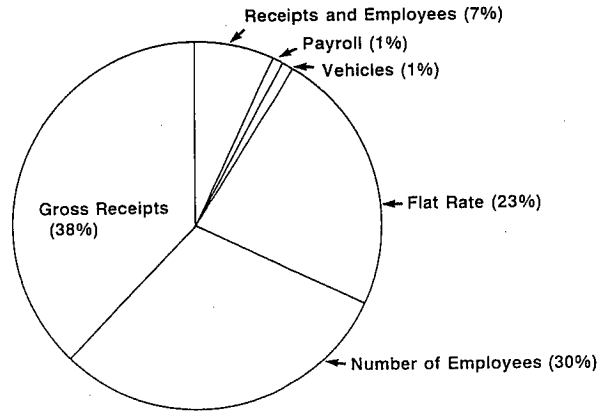
City Experience

By far the most widely used method of taxing businesses is by gross receipts or some combination which includes gross receipts. This method is considered the most equitable and flexible, especially if businesses are separated into classes with graduated rates according to profitability. The classes typically include retail sales, wholesale sales, professions, manufacturing, contractors, property rentals, and others.

A Cal-Tax survey of 354 cities in 1983 found that 97% levied a business license tax. Of those that levied the tax, most used the gross receipts method (38%), followed by average number of employees method (30%), flat rate (23%), a combination of gross receipts and number of employees (7%), payroll (1%), and number of vehicles (1%) (Figure 7).

One of three cities surveyed uses a combination of methods to assess the tax. Many cities use a flat rate as a base and utilize a per employee or gross receipts schedule to determine the marginal rate. Some use a combination of different taxation methods depending on the type of business taxed. Labor-intensive businesses might be taxed on an employee basis, while businesses that make deliveries might be taxed on the number of vehicles.

Figure 7
Mix of Business License Tax Methods
Proportion of California Cities



In Oakland, for example, a gross receipts tax is levied at a rate of $0.60 per $1,000 of gross sales for grocery stores, $1.20 for manufacturing, $3.60 for professional services, and $13.95 for rental of commercial and certain residential property. In addition to the gross receipts tax, a $1.20 per $1,000 of gross payroll is levied on companies with administrative headquarters in Oakland. Finally, a per vehicle charge is levied on operators of taxi and ambulance services, and a per employee tax is levied on transportation and hauling companies.

In San Francisco, a business must pay either a tax based on gross receipts or on payroll, whichever would result in the greatest amount due.

While only a handful of cities has enacted new business license taxes in recent years, many have changed their methods of assessment, most commonly from a flat rate method to a gross receipts, or some combination, method. This has occurred because cities have chosen to increase their income from the business license tax and to depend on the tax for a predictable and growing source of annual revenues.

A flat business license tax, while easy to administer and predictable from year to year, will not yield large revenues. A gross receipts tax, and to a lesser extent a per employee tax, is designed to bring in increasing revenues as the economy improves. It allows cities to increase their dependence on a locally-levied tax.

Business License Tax and the Farrell Decision

The California Tax Foundation has conservatively estimated that business license taxes will raise $419 million in 1983-84. This is a 14% increase in one year, a 64% increase since the *Farrell* decision of 1982, and a 175% increase since Proposition 13. Virtually all of the increased revenue came as a result of city council action or economic activity.

Business license taxes have been the most widely used method of raising taxes since the *Farrell* decision. A Cal-Tax survey of the 175 California cities comprising 85% of the state's population found that 107 had raised taxes, and more than half of them had raised the business license tax. It is estimated that more than $230 million has been raised in business license taxes attributable to the *Farrell* decision.

Because the business license tax is levied in so many different ways, it can be increased in many ways, as well:

- Santa Monica increased the business license tax so that

it affected only a handful of businesses. The tax was more than doubled for those businesses with gross receipts of more than $500,000 a year.

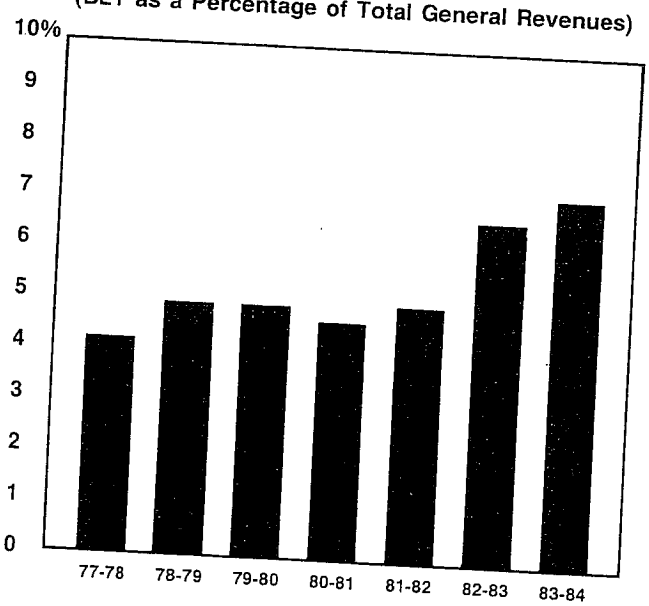
- Montebello increased the flat rate 18%, doubled the marginal rate, and increased the cap by 20%.
- The City of Orange increased the flat fee by 50% and the marginal rate by 30%.
- El Segundo changed its tax structure from a flat fee of $100 a year to a $20 charge per employee. Five major employers in El Segundo, which together employ several hundred thousand personnel, will pay the overwhelming share of this tax.
- Los Angeles enacted a new payroll tax levied on businesses that had previously been exempt from the gross receipts tax, including airline and transportation companies, among others. Los Angeles also enacted a 7.5% surcharge on all business license taxes for fiscal 1983-84.

All but a very few cities in California levy a business license tax (Glendale and Palo Alto are the most notable non-taxers). But while most California cities tax businesses, statewide revenues are dominated by a very few cities. Los Angeles, San Francisco, and Oakland together account for two-thirds of the business license tax revenues collected statewide. Ten cities account for three-quarters of all business license tax revenues collected. The remaining 400-plus cities that levy a tax account for only $100 million of the $419 million raised in 1983-84.

City Dependence on Business License Tax

Cities have increased their dependence on business license taxes in recent years (Figure 8). As with the utility users tax, dependence on this source corresponds with reduction in importance of property tax revenues and increased taxing authority since the *Farrell* decision.

Figure 8
City Dependence on Business License Tax
(BLT as a Percentage of Total General Revenues)



Sources: Assembly Ways & Means Committee, Cal-Tax Foundation

In 1977-78 business license taxes accounted for 4.2% of city general purpose revenues; by 1983-84, the proportion had increased to 7.2%.

Business Taxes and the Business Climate

More than fifty California cities have raised their business taxes since 1982. What effect will this flurry of tax increase activity, probably unequaled by any other time in recent California history, have on the business climate of these communities?

This paper will not attempt to answer this question, because it will be several years before the effects of these new taxes on business siting, expansion, and closure decisions will be known. But some clues can be found by examining some of the different ways cities and businesses came together in raising these taxes.

Most individuals interviewed — both in the public and private arenas — claimed that the city and the local business community worked together closely to devise a business license tax which would be equitable as well as raise more revenues. Virtually all of the smaller cities worked with their chambers of commerce or local business task forces to come up with a satisfactory plan. In fact, in many cities, the business community used the city's desire to raise the business license tax as a means to modernize the tax and make it more equitable.

There were also larger cities that worked closely with their business community. San Jose formed a business task force, hired outside consultants, and held numerous public hearings in order to devise a tax that was as acceptable to the business community as possible, and still raise the requisite revenues. Burbank engaged in the same process, and while the controversy there has not died, observers claim that the tax was improved by the participation of the business community.

There are some cities, however, where the business community and city council have not worked closely together in devising a new or increased business license tax ordinance. There could be several reasons for this. In larger cities, the interests tend to be much more diverse, and the voice of businesses in city hall is not as unified as in smaller communities. Also, larger cities have large professional staffs with expertise in taxation, which improves their ability to overcome business resistance.

Los Angeles and San Francisco both have imposed large business tax increases in the past several years. Los Angeles, with its 7.5% surcharge during the current year, levies one of the highest business taxes in the state. In fact, a number of businessmen surveyed by Cal-Tax observed that, if given a choice, they would locate outside the city limits of Los Angeles in order to avoid payment of the tax. They also observed, however, that Los Angeles is one of only a handful of cities in the state where the tax is so high as to motivate that type of decisionmaking. On the other hand, they also observed that because Los Angeles is such an important center of commerce, it is impossible to avoid locating major operations there.

San Francisco, of course, was the city that opened the door for general business tax increases with its successful levy of its gross receipts and payroll expense tax increases. In 1981, San Francisco levied another tax, which opponents — mostly downtown real estate interests — are calling a tax. The tax would levy a five dollar per square foot "transit fee" on new downtown office construction to finance improvements to the city's public transportation system. On the other hand, while many business leaders oppose this and the other taxes they also cherish the "San Francisco address."

In 1983, the city of El Segundo was faced with a budget shortfall due to reduction of sales tax revenues from an oil

refinery. The council chose to make up these revenues by raising the business license tax, which had been set at a flat rate of $48 a year for most businesses. The city originally proposed to change the tax to a $95 per employee rate. This provoked an outcry among many of the large aerospace employers, which together employ hundreds of thousands of personnel. The tax was eventually negotiated down to $20 per employee.

Some business people interviewed commented that as the town of El Segundo has changed, so has the relationship between the city officials and the local businesses. They observed that El Segundo "has changed from a company town to a town capturing the companies." They warn that in towns such as El Segundo, where the voters are so separated from the taxpayers, there will undoubtedly be further efforts to shift the city's tax burden onto the business sector.

VI

Non-Ad Valorem Property Tax

Findings

- *Property taxes based on size, ownership, and other characteristics are increasingly being used as local government revenue sources.*
- *Counties and schools may increase these taxes under the "special tax" authority of Proposition 13, requiring two-thirds approval of the local electorate; however, the few agencies that have tried this method usually have been unsuccessful.*
- *Cities may raise these taxes either by a vote of the city council, if used for "general purposes," or as special taxes. Few cities have attempted the former; cities successful in the latter have been small, residential, homogeneous, upper income communities.*

Proposition 13 limits the amount of money that can be raised from *ad valorem* property taxes — taxes based on the assessed value of the land and its improvements. But Proposition 13 made no mention of taxes using other characteristics of property as a basis.

A slowly-growing phenomenon in California local government is the use of these non-*ad valorem* property taxes as a revenue-raising tool. These taxes, which are closely akin to benefit assessments, base the tax on the size of the parcel — square footage, front footage, or acreage — or on ownership: a straight parcel tax. Some of the taxes are classified according to use: residential, commercial, industrial, agricultural, or vacant.

These taxes differ from benefit assessments, though, because no showing of "benefit" need be made, and the strict notice, challenge, and voting requirements in the assessment laws need not be followed. The only laws that need be followed are those governing the particular jurisdiction's taxing authority.

Counties. Counties may levy non-*ad valorem* property taxes only with the approval of two-thirds of the county's voters. This is a "special tax," under the terms of Proposition 13, and has been attempted a number of times — usually unsuccessfully — to finance police and fire services, jail construction, and other county services.

School districts. School and community college districts may only levy non-*ad valorem* property taxes with the approval of two-thirds of the district's voters, again, a "special tax." Most school districts that have attempted to levy this tax, both for capital outlay and operating purposes, have failed. Schools have twice attempted to receive authorization from the Legislature to raise these taxes under the *Farrell* decision, but were twice rebuffed.

Cities. Depending on the legal authority and political climate, a city has several options should it desire to levy a non-*ad valorem* property tax. A city could submit the tax to a vote of the electorate, like any other special tax. A number of cities — primarily small, residential, and above average income — have tried this, with a success rate of about one-third. Recently, the cities of Atherton and Belvedere passed such a tax; but other cities, such as Palos Verdes Estates, Fairfax, San Anselmo, and Larkspur, were unsuccessful.

The handful of cities and school districts that have passed special taxes generally have been smaller, wealthier, and more residential communities. Because these communities tended to be more homogeneous in their demographic and socioeconomic characteristics, it was easier for them to reach a consensus on both the tax increase and the expenditure of those taxes. Larger, urbanized, and more diverse communities encountered more difficulty in gaining voter approval for tax increases; in fact, many of these heterogeneous cities and school districts chose not to put these proposals on the ballot at all.

A two-thirds vote is not the only way for a city to raise this tax, however. A city council may vote to approve a per parcel or per bedroom tax upon its own vote, like any other *Farrell* tax. Both the cities of Ross and Hillsborough have done this, as did El Cerrito when a similar tax was voted down by its residents.

Compared with the now common incidence of cities raising business license, utility users, and other taxes, asking voters to approve special property taxes is relatively rare. However, if a city council is particularly nervous about levying a tax itself, this method provides a perfect opportunity to let the voters decide. On the other hand, when the voters have turned down these taxes, a common reaction by city officials has been that "the voters just did not have enough information — were not adequately educated — to make the right decision."

VII

Transient Occupancy Tax

Findings

- *The transient occupancy tax is the only significant tax county boards of supervisors can levy or increase without a vote of the electorate.*
- *The transient occupancy tax is one of the least unpopular (to the general electorate) taxes to increase because it is paid mostly by tourists and other non-residents.*
- *At least 55 cities and a dozen counties have increased the transient occupancy tax since 1982.*

The transient occupancy tax (also known as transient lodging and hotel/motel tax) was first enacted in 1958, and was the sole province of charter cities until 1963, when legislation was passed giving authority to levy the tax to general law cities and counties. The tax is levied on the "privilege of occupying a room or rooms in a hotel, inn, tourist home or house, or other lodging" for a period up to 30 days. There is no cap on the tax rate nor is their any requirement for the use of the revenues. Counties may levy the tax only in their unincorporated areas.

The transient occupancy tax is a relatively "painless" tax for local juridictions to enact or increase. In the past, many cities and counties earmarked revenues from this tax to tourist promotion, chambers of commerce, and convention centers, thereby drawing support from the local business communities. The tax is popular among the local taxpayers because it is paid by tourists. The only group which consistently opposes the tax is owners and operators of lodging properties, who object to the expense and trouble of collecting the tax, the loss of competitive position with nearby jurisdictions which do not impose the tax, and the inequity of being one segment of the business community singled out to collect a local tax.

While many cities and counties utilize transient occupancy tax revenues for chambers of commerce or convention centers, the vast majority of the revenues flow into the jurisdiction's general fund. A survey by the California Motel Association found that only 19% of the revenues from the tax are dedicated to tourist promotion activities.

An irony of the *Farrell* decision is if a chamber of commerce itself requests the transient occupancy tax be raised — on the condition the new revenues be used solely for tourist promotion — that increase would need approval by two-thirds of the jurisdiction's voters. However, if the tax were to be raised for the general operation of the city, no vote of the electorate would be required.

More than 50 cities and a dozen counties have raised their transient occupancy taxes since 1978, nearly all of them under the *Farrell* authority (Table 3). The total revenue increase attributable to these taxes is not precisely known, but it is at least several million dollars.

As with other local taxes, the transient occupancy tax is becoming a more important source of revenues to cities compared with other sources. In fiscal 1977-78 cities received 1.7% of their discretionary revenues from the transient occupancy tax. In 1983-84 it is estimated that proportion will rise to 3.6%.

Between 1979-80 and 1981-82 22 cities added a transient occupancy tax and revenues grew from $116 million to $174 million (an increase of 50% in only two years). It is estimated that by 1983-84 revenues will increase to nearly $200 million. During that same period cities were increasing their tax rates. In 1980 some 25% of cities had a tax rate above 6% (the median). In 1982 that figure was 28%.

VIII

Property Tax Overrides (Carman Tax)

Findings

- *The only case where a local government may levy a property tax in excess of the 1% rate is if indebtedness was authorized by the voters prior to June 6, 1978.*
- *Cities and counties may levy an override for voter-approved pension plans.*
- *A tax override may be levied for a pension plan even if no tax rate to finance the plan was authorized by the voters.*
- *The tax rate may be increased without voter approval to finance increased employee benefits.*
- *Special districts contracting for water from the State Water Project may levy a property tax override to pay those contract obligations.*
- *Some cities are levying a property tax override for other voter-approved purposes, but those taxes have not yet been tested in court.*
- *New property tax overrides for non-bonded debt will bring in some $58 million in city and county revenue in fiscal 1983-84.*
- *Depending on the ultimate definition of "voter approval," the total taxpayer exposure to these city and county overrides could be as much as $850 million.*
- *The Legislature has prohibited cities and counties from levying any new overrides for non-bonded, voter-approved debt until July 1985.*

The only condition under Proposition 13 where a property tax can exceed the 1% countywide rate is to pay "interest and redemption charges on any indebtedness approved by voters" prior to the passage of the initiative. The initiative's sponsors have said this provision was intended to apply to bonded debt only — for the purpose of protecting outstanding general obligation bonds from default.

However, omission of the modifier "bonded" in describing "indebtedness," enabled the California Supreme Court to rule that indebtedness also includes contractual obligations in the form of a city's or county's contribution to its employee retirement program, non-bonded payments in water contracts under the State Water Project, and even voter-approved taxes for paramedics, lease purchases, and libraries, as long as those contracts or obligations were "approved by the voters" prior to June 6, 1978.

Ad valorem property taxes permitted by these decisions currently amount to some $58 million annually. However, depending on the interpretation given this loophole by the courts and the Legislature, this authority could reach as high as $850 million, the estimated cost of pension plans approved directly by the voters prior to Proposition 13.

Because of a dispute over how this "pension tax" authority should be accounted for in the 1979 bailout legislation, if at all, the Legislature in 1983 placed a two-year moratorium on new use of this expanded taxing authority.

This chapter will describe the current state of the law for property taxes for non-bonded, voter-approved indebtedness, the extent to which local agencies have and are able to levy such property taxes, and the 1983 legislation placing a two-year moratorium on this authority.

Case Law

The courts have taken the lead in determining the circumstances under which a city, county, or special district can levy a property tax greater than the 1% rate permitted by Proposition 13. Because the factual issues are so diverse, in the absence of legislative policy, many court tests will be required to determine what type of voter approval and what type of indebtedness will qualify jurisdictions to use the added tax authority.

Pension Debt

Potentially, the most expensive non-bonded, voter-approved debt approved by the courts for a supplemental tax rate is for employee retirement plans.

Carman v. Alvord, May 10, 1982. The Supreme Court held that the term "indebtedness" covered obligations arising under a city's pension plan, and that the phrase "interest and redemption charges" in the context of Proposition 13 denotes the sums from time to time necessary to avoid default on obligations to pay money, including pension obligations.

While *Carman* established voter-approved pension plans as qualifying debt, it did not fully answer which jurisdictions are entitled to use the added taxing authority, and to what extent the tax may be applied to fund current and future pension costs. In *Carman*, the voters had approved both participation in the pension system and the tax to fund it. But what if a jurisdiction's voters had approved a system but not a tax?

Valentine v. City of Oakland, October 20, 1983. The appellate court ruled that a vote on the system alone was sufficient to validate the city's additional property tax even though the pre-Proposition 13 voter approval did not include a special tax to fund the system.

While approval of a system was deemed sufficient to qualify a jurisdiction to raise an override tax, the court in *Valentine* did not answer how specifically the pension plan must be described.

Fresno v. All Persons Interested . . ., May 10, 1984. The appellate court validated the City of Fresno's attempt to levy a tax under *Carman* even though the voters had approved a general retirement fund only, rather than the retirement system later designed by ordinance.

The cases cited above involved funding pension benefits last adjusted prior to Proposition 13. It did not address the question of using the added tax rate to pay for benefit increases granted after the initiative's passage. The *Carman* court seemed to limit its expanded notion of indebtedness to one akin to fixed debt. Such an extension could allow the tax to fund benefit levels only up to those in existence at the time of the voter approval, or even at the time of Proposition 13's passage.

City of Watsonville v. Merrill and *City of Watsonville v. All Persons Interested*. . . ,November 4, 1982. The appellate court ruled that *Carman* is not limited to public employee retirement contribution levels existing prior to Proposition 13. The opinion stated that "the change in the amount of the employer's contribution was both envisaged and approved by the voters when the city joined the retirement system" and that the additional tax "qualifies as a voter-approved prior indebtedness."

The *Watsonville* decision has the practical result of giving a portion of employee benefits a priority claim on the property tax dollar above all other budget items.

Water Contracts

The second major area of non-bonded, voter-approved debt qualifying for a property tax override is for special districts that transport, distribute, or sell water purchased under state or federal water contracts. There are 31 water agencies that have entered into binding water delivery contracts with the state that are directly affected by this section of Article XIII A, including the six-county Metropolitan Water District of Southern California.

Kern County Water Agency v. Board of Supervisors of the County of Kern, September 13, 1979. In 1960 the voters approved the California Water Resources Development Bond Act. In 1961 voters in the water agency approved a contract to purchase water from the State Water Project. One contract provision required the agency to levy a tax sufficient to make the payments under the contract if the agency failed to otherwise raise sufficient funds. The appellate court found that the taxes levied by the district were necessary to meet the bond indebtedness approved by the voters in 1960 and re-approved by Kern County voters in 1961.

Goodman v. County of Riverside, March 16, 1983. The appellate court upheld a ruling that property taxes levied by a local agency to raise money due under State Water Project contracts are to pay an "indebtedness" approved by voters prior to Proposition 13's passage and are therefore exempt from the 1% tax rate limit. The court ruled that the indebtedness covered not only the bonds approved at the 1960 election, but "the cost of maintaining, operating, and replacing the system and of repaying the California Water Fund."

Metropolitan Water District of Southern California, et al. v. Dorff, October 9, 1979. The appellate court ruled that property annexed by Metropolitan after the passage of Proposition 13 was subject to the *ad valorem* tax in excess of the 1% rate even though that property was not included within territory served by Metropolitan at the time the indebtedness was approved.

Las Virgenes Municipal Water District v. Dorgelo, April 13, 1984. The appellate court ruled that a water district may levy an override tax to fund bonds authorized but not yet issued by the district. Although the bonds were not actually "approved" by "the voters" of the district, the court held that the failure of landowners to exercise their protest option provided under the then-applicable special district law satisfied the "voter approval" requirement under the terms of Proposition 13.

The court in *Dorgelo* made an interesting distinction between "approval," as used in Proposition 13, and "election," which is the common connotation of voter approval: " 'Approval' is clearly a more inclusive notion than 'election.' The drafters of Proposition 13 indicated that they understood the difference. Section 4 of Article XIII A provides that special taxes may be imposed 'by two-thirds vote of the qualified electors' of a district. The drafters knew how to require an election when they desired to do so." *Dorgelo* opens the *Carman* exception to some non-voted taxes; it is not known what further non-voted taxes may be considered.

Other Voter-Approved Debt

The potential of expanding the *Carman* rationale — that is, a contractual obligation raised to the status of indebtedness — is just beginning to be explored by local governments and the courts. Cases are pending on the issue of expanding the *Carman* authorization to funding libraries *(Patton v. City of Alameda)* and paramedic services *(City of Napa v. Board of Supervisors).* A superior court judge has approved the Napa paramedic tax — approved by the voters in 1976 — as a valid extension of the *Carman* decision.

Finally, property tax overrides are being levied by two cities for special lease-purchase authority, but have not yet been tested in court.

Current Exercise of Carman Taxes

Thirty-two cities and one county have reported to the State Controller that they are levying or have levied property taxes for non-bonded, voter-approved debt. Of the 32 cities, 25 levy the tax for pension plans, 4 for paramedic programs, 2 for lease-purchase of public facilities, and one for libraries. Santa Clara County levies a tax under this authority for a pension plan.

The 32 jurisdictions levying a *Carman* tax in fiscal 1983-84 (San Anselmo levied the tax in 1982-83 only) raised a total of $58 million (Table 7). As is the case with many other local taxes, most of the revenues are concentrated in a very few jurisdictions. In the case of *Carman* taxes, Santa Clara County and the City of Oakland together account for nearly half of the $58 million levied. Virtually all of the taxes levied under this authority (96%) are for pension debts.

The controller reports another 16 cities claim voter-approved authority to levy *Carman* taxes — 15 for pensions, one for paramedics — including Los Angeles, Long Beach, and Riverside. Depending on the ultimate definition of "voter-approved indebtedness," this list may by no means be exhaustive.

Total growth in revenues from pension tax overrides from fiscal 1978-79 to 1983-84 was 473%. Average collection per city nearly tripled, from $485,000 in 1978-79 to $1.3 million in 1983-84 (Figure 9).

Figure 9
Carman Taxes: Total Revenues and Levying Jurisdictions

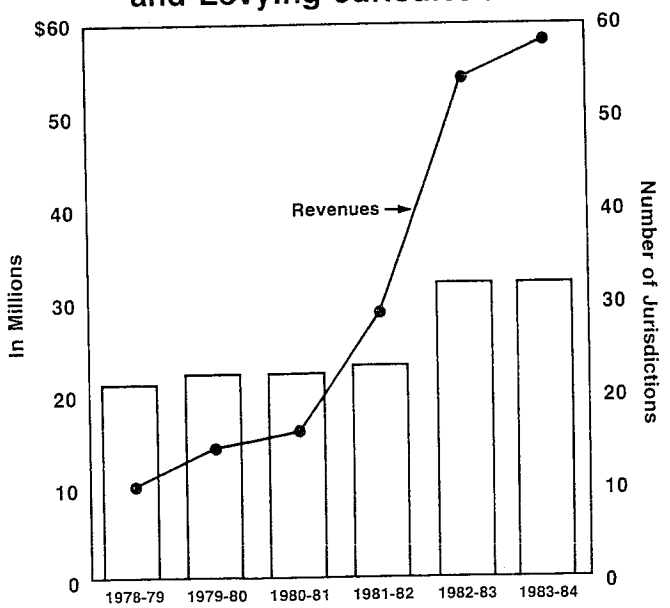


Table 7
Jurisdictions Levying "Carman" Taxes, Amount of Levy, and Selected Pension Benefits
(in thousands)

Pension Taxes	1978-79	1982-83	1983-84	CHP Formula	One Year Final Compensation-Police
Santa Clara County	$ 0	$12,358	$16,905	X	X
Albany[1]	0	249	347	X	
Bell	298	517	507	X	X
Beverly Hills	700	1,300	1,570	X	
Cloverdale	22	119	114		X
Coalinga	0	62	0[2]		
Compton	1,283	4,676	3,844	X	X
El Monte	857	2,631	2,800	X	
Eureka	654	1,593	1,743		
Fairfax	0	170	135	X	
Glendora[1]	126	274	299		
Huntington Beach	1,177	2,797	3,102	X	X
Huntington Park	380	1,073	868	X	X
Lynwood	407	653	680	X	X
Maywood	0	453	248		
Monrovia	480	795	804		
Montebello[1]	1,221	1,480	1,507	X	X
Monterey Park	367	1,094	1,185		
Oakland	0	11,236	11,050	X	
Oxnard	0	1,860	1,900	X	
Rialto	0	999	1,111	X	
Richmond	0	3,554	3,212	X	X
San Anselmo	0	200	0		X
San Fernando	374	804	720		
San Gabriel	527	717	829		X
Watsonville	268	722	696	X	
Paramedic taxes					
Brea	154	465	475		
Garden Grove	391	586	628		
Napa	0	0	170		
Vacaville	155	272	285		
Lease-purchase taxes					
Chino	262	332	373		
Fremont	76	75	74		
Library taxes					
Alameda	0	225	260		
Total taxes	$10,179	$54,341	$58,441		
Total jurisdictions	21	32	32		

1. Estimated. Tax rate for pensions combined with rate for general obligation bonds.
2. Revenues not yet determined due to reassessment of earthquake-damaged property.

Sources: State Controller, PERS

Pension Reform Issue

A central concern with the override issue is expenditure control, especially regarding public employee benefits, and the likelihood that cities and counties will take the opportunity granted by *Carman* to shift all retirement costs away from other taxes and onto an open-ended, earmarked property tax.

If the *Carman* and *Watsonville* decisions remain unchanged by legislation or initiative, local government employee benefits could receive a priority claim on the property tax dollar above all other budget items. Given a protected, increasing share of the property tax, the pension plans would no longer have to compete among other budget priorities, and an important incentive to control costs would vanish.

A policy issue that has not yet been directly addressed is whether retirement spending generally is an area where Proposition 13's limit properly should be eased. Several of the override cities, in fact, offer some of the most costly benefits in their pension plans.

For example, 15 of the 25 cities and Santa Clara County have gone to the very generous California Highway Patrol retirement formula (2% at age 50) for their police and fire personnel; 11 of the cities in the group and Santa Clara County base safety member retirement benefits on the final year's salary rather than averaging the final three year's pay (Table 7).

Water Districts

The 31 special districts that have contracts with the State of California for delivery of water from the State Water Project are able to levy a property tax rate above the 1% countywide

rate for purposes of meeting the contract obligations. The authority is derived from the statewide vote in 1960 approving the $1.75 billion general obligation bond issue to develop the State Water Project.

The total *authority* of these districts to levy a property tax override is $310 million in 1983 and $415 million in 1984. However, most of the districts are levying a tax considerably below that authorized. For example, in 1984 the Metropolitan Water District will collect $91 million (41%) of its total authorized taxing authority of $223 million.

Moratorium

The combined effects of the 1981-82 recession, reduction in state bailout assistance, and uncontrolled local spending growth led many cities to consider local tax increases in 1982. Property tax overrides to fund pension costs became an attractive option due to their broadly based impact and relatively high income at a relatively low rate. Several large jurisdictions, including Contra Costa County and the cities of Los Angeles and Sacramento, among others, considered imposing a *Carman* tax levy.

Los Angeles Mayor Tom Bradley proposed closing the city's budget shortfall with a $142 million *Carman* tax. Rather than solving his problems, though, the proposal set off a chain of events that culminated in state legislation freezing further *Carman* taxes for two years. Opinions from the Los Angeles County Counsel, Legislative Counsel, Cal-Tax, and the League of California Cities, and pressure to solve the 1983 budget and education fights, led to a postponement of any further city and county property tax overrides until July 1985.

How could this have happened?

Proposition 13 replaced a system of widely differing property tax rates with a maximum 1% tax rate in every county, except for an additional rate to pay for debt (later defined to include employee pensions) approved by voters before July 1, 1978. Since the property tax was limited to 1% countywide, it was left to the Legislature to determine how the pot would be split.

The Legislature decided to divide the money according to the share of property tax that each jurisdiction in a county had received during the three years before the passage of Proposition 13, thereby requiring each jurisdiction to share proportionately in the cutback.

But a city that had been levying part of its tax rate to pay off a voter-approved bond could still use Proposition 13's exception to the 1% limit. It could impose an added tax and have the revenue returned to it directly, irrespective of the sharing formula. The Legislature assumed, understandably, that any jurisdiction able to qualify for this extra revenue would go after it, and that it would be unfair to let such a city also include this money in the three-year formula, because doing so would swell its share of the 1% rate in future years.

To prevent this, the first Proposition 13 bailout bill passed by the Legislature stated that property taxes that had been used to pay off prior voter-approved debt would not be considered "property taxes" for purposes of the sharing formula.

The *Carman* decision upset a very delicately balanced apple cart. When this ruling was plugged into the bail-out bill's definition of what are and are not property taxes for sharing-formula purposes, it became logically arguable that a whole reshuffling of the shares, beginning in 1975, was required. Many jurisdictions falling under the *Carman* ruling would find that their share of tax revenue had been overstated under the formula and therefore that they had been getting more than they had been entitled to, even though not all of them had levied the tax.

If forced to readjust, most "*Carman* jurisdictions" would have had to turn money over to other governments in their county. Counties, other cities, special districts, and school districts would have picked up money.

The Legislature found itself unable to answer some far-reaching questions in the short time available:

- Should bailout assistance be reallocated from *Carman* jurisdictions to other jurisdictions?
- Should such reallocation, if any, be retroactive?
- Should amendment of the allocation formula include a provision impelling *Carman*-eligible jurisdictions to raise their property taxes?
- Should the tax override authority under *Carman* be limited, broadened, or left as is?

The uncertainty of the interaction of *Carman* and the bailout legislation virtually forced the Legislature to freeze all prospective *Carman* taxes and study the issue while the economy recovered. Under the 1983 legislation *(AB 377 —* Roos), no city or county will be able to receive increased revenues from increased property taxes under *Carman* until July 1985, at which point the Legislature presumably will have devised a solution to this "web of uncertainty."

IX

Other Local Taxes

Findings

- *The power of cities to levy taxes is limited only by the state constitution, state pre-emption under the doctrine of "statewide interest," and their own political climates.*
- *Cities will raise some $400 million in property transfer, franchise, admission, parking, and other taxes statewide in 1983-84. However, less than half of that amount are taxes that cities have the discretion to levy or increase on an annual basis.*

Cities may levy a number of other taxes based on the "municipal affairs" powers granted charter cities by the constitution and the taxing powers granted general law cities by the Legislature. It is estimated that cities will raise some $400 million in taxes not previously discussed in this paper. While these taxes are not individually a significant portion of statewide revenues to cities, they may be important to individual cities.

Admissions tax. A tax on the privilege of attending theaters, concerts, movies, sporting events, horseracing meets, circuses, museums, and other performances is levied by some cities in California. The tax is either a flat rate, ranging from two to 50 cents a ticket, a percentage of the ticket value, or a sliding rate depending on the cost of the ticket.

Use of this tax is not widespread in the state: a Cal-Tax survey found only two cities have raised their admissions tax since 1982. The tax is opposed by owners and operators of entertainment facilities for many of the same reasons that hotel/motel operators object to the transient occupancy tax. This tax is particularly important to cities with large stadiums or sports arenas.

Parking tax. Cities may levy this tax on off-street parking lots or garages. The tax is usually collected as a portion of the stall rental fee. The tax is sometimes earmarked for downtown business district improvement. Only a few cities in the state levy this tax, although it can be an important source of revenues for cities with large numbers of tourists or shopping facilities.

Property transfer tax. This tax is levied on sellers of real property whenever real property changes hands. In incorporated areas cities and counties share the revenues; in unincorporated areas the county receives the entire amount. Most jurisdictions levy the tax at the statutory rate of 55 cents per $500 of sale price. Prior to 1978 cities could increase the tax above the statutory rate, but lose the amount they shared with the county. Only very few cities levy a rate higher than the statutory rate. The tax was originally levied by the federal government; when they ceased levying it in 1968, it became available for local levy.

The adoption of Proposition 13 precludes cities or the state from increasing the property transfer tax or enacting a new one. The revenues — some $68 million statewide — are therefore dependent entirely on the health of the real estate industry.

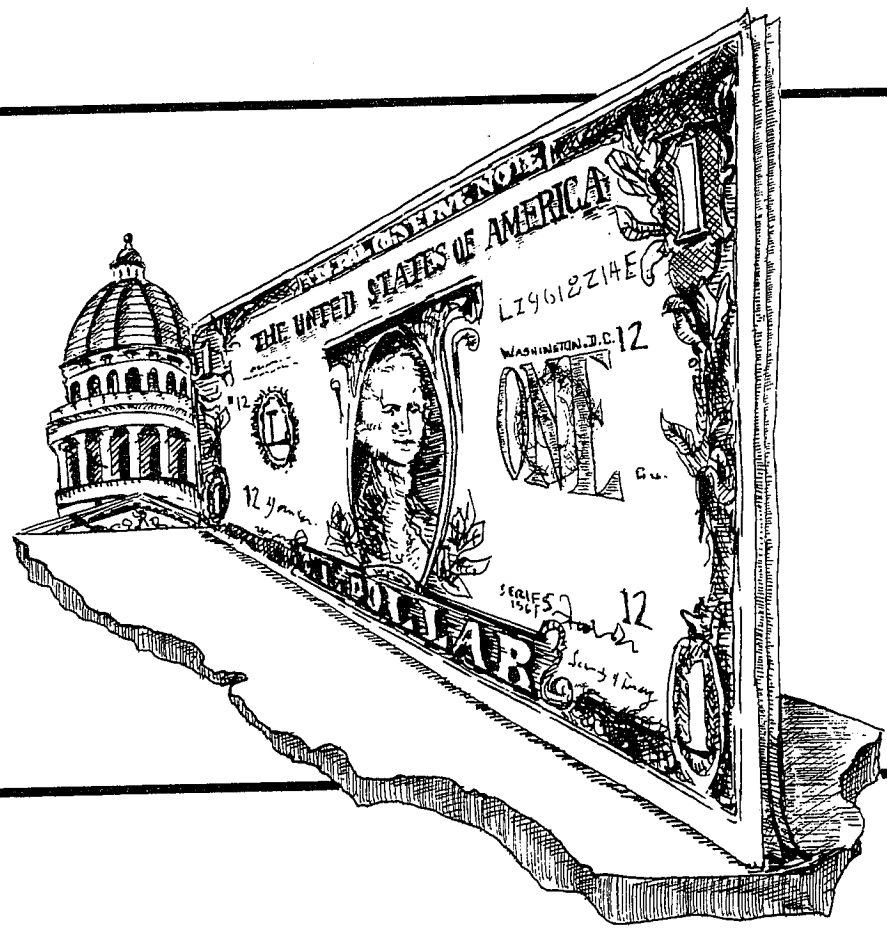
Franchise tax. Franchises are agreements between cities and private utilities or common carriers for the privilege of those enterprises using city streets and easements. These are not taxes as much as they are negotiated, long-term contracts. Franchises are usually computed as the greater of 1) a percentage of gross receipts or 2) a formula using gross receipts, the company's investment in plant, and the miles of distribution lines in the city's streets and highways.

Businesses subject to franchises are private gas, water, electricity and cable television utilities, pipelines, and taxis, ambulance, and trash hauling companies. Telephone companies, railroads, and wharves are exempt. Revenues from franchises raised some $187 million in 1983-84.

Other taxes. Apart from the constitutional and statutory proscriptions described in Chapter I, the only limit to a city's taxing authority is its imagination. As long as it does not conflict with constitutional law or a statewide interest — and is judged not too objectionable by the local residents — a city may tax it. Developers are taxed extensively for various public facilities, including parks, streets, and sidewalks.

A survey by the Construction Industry Research Board revealed that development fees and taxes in 28 Southern California jurisdictions increased by 219% between 1975 and 1983. Taxes for parks, schools, roads, flood control, and other public facilities ranged from $400 to $4,000 per single family housing unit. Many of these taxes are designated as "fees" or "developer charges," but the charges go beyond a fee for services provided directly to the developers.

Jarvis IV Initiative



Section 3

Introduction

It is either ironic or appropriate, depending on one's point of view, that questions of local government finance now come full circle, back to another initiative sponsored by Howard Jarvis, the co-author of Proposition 13, which established new ground rules under which local governments have been funded over the past six years.

It is appropriate that this study concludes with an analysis of the major single proposal likely to affect local government finance and, to some extent, economic growth and development in California over the next several years. And it is appropriate that it be analyzed in the context of all that has been learned in the past year in this study.

This review has found that local government revenues are recovering from the recent recession, that revenue constraints have had a positive impact, and that real spending reductions have occurred. Continued recovery depends on a steadily improving economy, moderate inflation, and no new reductions in remaining revenues. The review also has found that enterprise activities of local government — water, power, landfills, airports, and ports — have functioned well through the recession. A major indirect result of Proposition 13 is that funding of these services more closely reflects their costs, and they are no longer subsidized by other tax bases. In short, the user pays.

On the other hand, a variety of problems remains. Capital and maintenance outlays have been, and continue to be, inadequate. While there is some risk of overstating the "infrastructure" problem, review shows public works funding shortfalls everywhere the study looked, and there is a need to get moving on these problems under a rational set of priorities, if the past public works investment is to be protected from permanent loss, and if capital plant is added for further economic growth and development needs.

On the spending side, much remains to be done with respect to controlling the biggest single cost of local government — labor. Reforms of excessive pension and disability benefits are essential, and soon. Major cost increases have occurred in fringe benefits since passage of Proposition 13, and "total compensation" approaches to salary-setting must be adopted. The state government — Legislature and administration — needs to exercise restraint in any further erosions of management's ability to bargain effectively with employees. Similarly, the state should curb its tendency to mandate programs that increase local costs — and it should pay the full costs of what it does mandate. There is also a need for a close look at how the new *Farrell*-type taxes get approved, and processes for appropriate consultation of the voters need review.

Local government finance has become more complicated since passage of Proposition 13. In addition to the long-standing diversity among city and county revenue bases, the fiscal differences between cities and counties have become more distinct. Cities, partly through court decisions, have become more reliant on local revenues, and counties have become more dependent on the state. Any action having a statewide fiscal impact is, therefore, likely to have a "windfall" or "wipe-out" impact upon jurisdictions at the fiscal extremes. What seems called for in this setting is maximum local management flexibility, state restraint on mandates, and own-source revenues for local functions, consistent with review by the voters.

Earlier in this study it was concluded that local government finance issues revolve around just a few central policy issues. Of key importance is improvement of local governments' ability to control costs. Another issue is whether tax burdens are controlled on a statewide basis, or locally. And another is what kind of majority rule do Californians want on state and local tax issues. Still one more issue is what local tax base should consist of.

The new Jarvis initiative touches most of these questions. Specifically, it overturns the *Carman* and *Farrell* decisions, discussed in earlier parts of this study. It effectively eliminates most parcel taxes added by the Legislature, and it strengthens the legislative two-thirds vote requirement for tax increases. All of these issues relate to the original language of Proposition 13.

The new Jarvis initiative, then, goes beyond these original Proposition 13 "loophole-closing" issues and sets new limits on fees, prohibits use of fee revenues for public pensions, possibly invalidates $4.5 billion in voter-approved but unissued general obligation bonds, reassesses and refunds $1.29 billion in taxes to properties with a pre-1977 lien date, causes a $158 million tax increase for properties with a post-1977 lien date, and expands conditions under which change-of-ownership reappraisals would not occur.

That the new Jarvis initiative goes beyond amending changes in Proposition 13 made by the courts and Legislature is an important point only in understanding the full scope of the proposal. In terms of public fiscal policy, it is more important to consider the measure's impact on some basic issues.

For example:

1. Would Jarvis IV strengthen local government, or make it more dependent on the state?

2. What would be the impact of Jarvis IV on the ability of local governments to finance public services and capital improvements needed to accommodate economic growth?

3. Could $1.3 billion in added tax relief be taken without adverse impact on functions?

4. If a later economic downturn generates needs for new local revenues, which of these potential sources would likely be targeted:

   Sales Tax?
   Personal Income Tax?
   Bank and Corporation Tax?
   Split Roll?
   Oil Severance Tax?

5. Would Jarvis IV improve property tax equity, or would it widen tax disparities between properties with similar market values?

Local Government Finance and the New Jarvis Initiative

Summary of Major Provisions

1. Requires that no *ad valorem* real property tax and any other tax on, or based upon, real property ownership shall exceed one percent of full cash value.

2. Provides one override of the one percent limit: *ad valorem* taxes or special assessments to pay interest and redemption charges on bonded debt approved by voters before July 1, 1978, and for which debt was fixed and certain at time of approval and evidenced by issuance of bonds in a specified amount, payable in a specified time.

3. Eliminates, in effect, the local government use of voted indebtedness override provisions for public employee retirement costs allowed in *Carman v. Alvord.*

4. Requires that any new fee or any fee increase at state or local level in excess of growth in USCPI for past 12 months must receive a ⅔ legislative vote for increases in state fees, or ⅔ of qualified electors for local fee increases.

5. Defines a fee as *any* charge by state or local governments to pay *direct* costs of services; requires that fees shall not contribute *any* amount toward employee pension payments.

6. Strengthens the requirement for a ⅔ vote in the Legislature for any new or increased tax.

7. Appears to require that any new or increased local tax be approved by ⅔ of the qualified voters, and defines a tax as "any levy or charge, however labeled or structured . . . which does not constitute a fee, an assessment, or a fine."

8. Overturns, in effect, the *Farrell* decision by the new definition of a tax and the new ⅔ vote requirement. May, however, permit legislative authorization of local Farrell-type taxes.

9. Rolls back 2% inflationary adjustments for properties with pre-3/1/77 lien dates. Requires refunds of over assessments and revaluations of these properties.

10. Provides for no reappraisal of real property in an intra-family transfer; defines "immediate family" broadly.

11. Defines "assessments" as a charge upon real property within a limited area for payment of cost of local capital improvement to land which directly and "specially" benefits the property.

Legislative Analyst's Summary of Fiscal Effects

Assuming this measure is on the November 1984 ballot, the *one-time* fiscal effects would be as follows:

1. A potential cost of approximately $1.29 billion to pay property tax refunds to taxpayers. The state government would bear $508 million of this cost. Local property taxpayers would bear up to $158 million of this cost (through higher levies for debt service). Local governments would bear the remaining $624 million.

2. Because these property tax refunds and interest payments could be counted as income for personal and corporate income tax purposes, the state would gain about $75 million in revenues over the two-year period 1985-86 to 1986-87.

The *ongoing* fiscal effects would be:

1. Annual revenue losses beginning in 1985-86 of at least $41 million to local governments and $25 million to school districts (revenue losses to schools would be offset by a comparable amount of increased funding). These revenue losses result from the provisions of the initiative relating to inflationary adjustments to assessed valuations.

2. Unknown, but probably major, ongoing gain in state income tax revenues, due to the reduction in property tax payments noted above.

3. Unknown annual costs and revenue losses to the state and local governments in 1984-85 and subsequent years, due to the provisions relating to tax rate limitations, assessment practices, voting requirements for tax legislation, and definitions of taxes, fees, and assessments. These costs and revenue losses, in the aggregate, would be in the multimillion dollar range.

New Jarvis Initiative Analysis

1. All Taxes on Real Property Limited to 1% of Full Cash Value

Proposition 13 required that any ad valorem tax on real property shall not exceed 1% of the full cash value of property. This amendment would extend the 1% limit to include "...*any other tax* on or based upon the ownership of real property... ."

This would bring within the 1% limit all non-ad valorem property taxes now being levied, such as parcel and square footage taxes. Since ad valorem taxes are generally levied at the full 1% rate, this provision would effectively eliminate all current non-ad valorem property taxes.

The Legislative Analyst has noted in his analysis of the new Jarvis initiative that this provision would result in "unknown but probably major" annual revenue losses to local governments.

State Controller data on levies of non-ad valorem taxes show that cities collected $47.8 million and special districts received $181.5 million from these sources in 1981-82. Although data is not yet available from counties for these revenues, it would appear that total non-ad valorem property taxes could reach at least the $300 million mark by 1983-84, and maybe more. It is not known how many of these levies would qualify as constitutionally-legal benefit assessments under the new Jarvis initiative.

The more encompassing 1% limit in the new Jarvis initiative could in some instances invalidate some non-ad valorem property tax levies that have been approved since 1978 by a two-thirds popular vote. A study by Cal-Tax in November 1982 showed that of 59 local revenue measures needing a two-thirds vote in that month's general election, 14 succeeded. Of those that passed, most were property related. It seems clear that in the future, no non-ad valorem property taxes in excess of 1% of full cash value could be levied by local voters,

regardless of the margin of local vote, without further constitutional amendment.

2. Bonded Debt Override Authority Clarified and Significantly Tightened

The new Jarvis initiative allows one ad valorem override of the 1% limit: ad valorem taxes or special assessments to pay interest and redemption charges on bonded indebtedness approved by the voters before July 1, 1978. A similar provision in Section 1(b) of Article XIII A has produced considerable debate regarding its interpretation since 1978.

Carman: a major loophole. Section 1(b) was generally assumed to permit property tax overrides only for voted, bonded debt (although it did not specify "bonded"), to protect outstanding general obligation bonds from default. However, several cities interpreted the provision to apply also to contractual obligations in the form of a city's contribution to its employee retirement plan. This was disputed by the auditor of Santa Cruz County who impounded funds from a tax levy by the City of Watsonville for employee retirement costs. Meanwhile, a similar case, *Carman v. Alvord*, was proceeding in Los Angeles County.

Cal-Tax joined as *amicus curiae* on behalf of the plaintiff in both the *Watsonville* and *Carman* cases. Although defendants lost at the appellate level in both cases, the State Supreme Court decided, in *Carman* (1982), that an override of the 1% limit for employee retirement contributions was allowable under Article XIII A. This decision validated about a dozen city retirement plan overrides and opened the potential for major increases in property taxes, involving more than 100 cities and counties that may have voted prior to 1978 merely on the establishment of a retirement plan for their employees.

Prior to this activity in the courts, Cal-Tax sponsored legislation to prevent the use of Section 1(b) for public employee retirement cost overrides through a statutory clarification of the intent of the section. In *SB 1584* (M. Garcia), Cal-Tax sought to amend the Revenue and Taxation Code to state that the indebtedness for which an override was permitted "... does not include pension obligations unless the voters have specifically authorized the use of debt to finance such obligations." Although unsuccessful in securing passage of *SB 1584* in 1980, and again in the *Carman* decision in 1982, Cal-Tax was successful in its support of *AB 377* (1983), which placed a two-year moratorium on the further use of *Carman*-related property taxes.

The Legislative Analyst is currently studying the potential impact of the *Carman* decision. The issue is expected to be back before the Legislature in 1985, when the moratorium expires. Among the issues for review at that time (unless this initiative passes) will be the built-in mechanism whereby any jurisdiction implementing *Carman* loses some of its share of the current property tax.

On, beyond Carman. The new Jarvis initiative would, in effect, make the *AB 377* moratorium permanent and force cities to repeal any current *Carman* tax levies. In fact, it would go beyond this and impact some general obligation debt approved by the voters prior to July 1, 1978. This occurs as a result of a new paragraph that would be added to Section 1(b):

> ...bonded indebtedness is limited to indebtedness which was fixed and certain at the time of voter approval and which is evidenced or represented by the issuance of bonds in a specified amount and payable within a specified time.

A major question arising from this language is whether general obligation bonds approved by the voters before July 1, 1978, and as yet unissued could still be issued. A case in point involves the Metropolitan Water District (MWD) which has $365 million remaining from an $850 million general obligation bond issue authorized by district voters in 1966. MWD is the State of California's largest water contractor, taking 48% of the water shipped by the State Water Project (SWP), and paying about 60% of all SWP contract revenues. If MWD is prohibited from issuing any of its remaining general obligation bonds it could issue lower grade (from AAA to AA) revenue bonds in order to continue funding its construction program. Resort to revenue bonds would result in higher interest costs. The district has estimated this increase of debt service costs, under current market conditions, at $1,800,000 annually in interest payments on the entire amount of the debt.

The MWD is just one district involved in this general obligation bond question, and it has the availability of revenue bond financing at higher interest rates. Statewide, the total of general obligation bonds that could be invalidated is reliably estimated at $4.5 billion. It is impossible to know how much of this authorization would ever be fully utilized, but if only half of it was affected, the measure could result in a substantial deferment or elimination of planned public works in a wide variety of local entities.

State Water Project capital funding. Retaining MWD as an example, there is another aspect of water development financing that has a bearing on the bonded debt provisions of the new Jarvis initiative. This relates to the ability of the district to levy property taxes to make payments to the state for its share of the capital costs related to the SWP.

The Attorney General opined in 1978 that since the Burns-Porter Act (the State Water Project) was approved by the state's voters, district contract payments to the state for apportioned capital costs fell within the Proposition 13 exception for debt approved by the voters. The opinion was later affirmed in the decision *Goodman v. County of Riverside* (1983). The MWD General Counsel believes that the new Jarvis initiative would override the *Goodman* case, thereby prohibiting special property tax levies for some, or all, of the payments under the state water contract. The 1982-83 MWD levy for this purpose was $32 million. State water contract capital costs are projected to increase 24% in 1984-85 and 10% in 1985-86, according to MWD, and prohibition of the property tax levy, coupled with the contract increases, would put strong pressure on water rates, which would in turn be limited under new Jarvis initiative provisions discussed immediately below.

3. New Limits on the Structure and Use of Fees

Proposition 13 did not mention the word "fee." The new Jarvis initiative contains four provisions which define and limit the use of fees:

- A "fee" is *any charge* by state or local government entities that is imposed to pay *direct* costs of services provided or under which a person charged is regulated;
- Any fee exceeding direct service costs shall constitute a tax. Any person who pays an excessive fee is entitled to a refund, plus 13% interest from date of payment;
- Any new fee, or the increase in an existing fee, enacted after August 15, 1983, which exceeds USCPI growth in the past 12 months, requires a ⅔ vote of each house of the Legislature or of those voting in local elections;
- Fees shall not contribute any amount toward the payment of pension liabilities.

Fees play a significant role in overall local government

revenues. Fees, as broadly defined in the new Jarvis initiative, provide the operating, maintenance, and capital revenues for those functions of local government classified as enterprise activities. The major enterprise activities include water and power distribution, sewers, water treatment, landfills, ports, airports, hospitals, and transit.

While the costs of some enterprise activities, such as hospitals and transit, are usually only partially offset by service charges, other activities, especially water, power, waste disposal, and sewers, are usually offset entirely by service charges.

Because cities provide most of the enterprise services, most of the enterprise revenues are found in cities. In Part 1 of this study, it was found that cities received enterprise operating revenues in amounts from 30% to almost 100% of non-enterprise revenues. In counties, enterprise operating revenues were rarely found to be higher than 20% of non-enterprise revenues. In 1981-82, enterprise activities provided 30% of all city revenues and 13% of total county revenues.

Enterprise operations: running government like a business. In Part 1 of this study, we discovered city enterprise operations to be generally in good fiscal condition, especially by comparison with the general fund operations of some cities. During the recent recession, the one area of city government least affected was the enterprise activity. We also found, in contrast to local government facilities in general, that capital plants supported by enterprise activities were generally in good condition.

We concluded that there were at least three reasons why enterprises fared better than general fund activities. One was the separation of enterprise activities from general fund budgets. Another was the objective of being self-supporting in operating and capital requirements. Finally, enterprises avoided the problems afflicting some local general fund activities in recent years because the price for service could be adjusted to meet costs. At the same time, enterprise activity managers were not without constraints in their ability to adjust rates from the local voters and businesses who must pay the charges. In addition, there is Article XIII B (Gann) which directs that fees cannot exceed reasonable costs of providing a service without the excess being considered a tax subject to constitutional limits.

Under the new Jarvis initiative, fees would no longer cover what has heretofore been regarded as the full cost of providing a service. Jarvis proposes to exclude from any fee structure its employee pension costs. The most labor-intensive enterprise activities would be particularly affected by this because employee pension costs run from 15% to 20% of payroll. This provision means that, wherever possible, pension costs would have to be shifted from enterprise budgets to general fund. Such shifts are possible in the enterprise functions of general purpose governments, like cities and counties, provided there is no local charter or other bars to doing so. If such shifts could occur, they would become new burdens for general taxpayers, and force a shift in priorities for general fund budgets.

The payment of employee pension costs in independent special districts, where costs are totally supported by fees and where they can't be shifted, would pose a serious legal problem with potential contract impairment implications.

Less clear, on the face of the new Jarvis initiative, is what is meant by the limitation of fees to the "direct costs" of providing a service. Is this meant to exclude overhead charges to an enterprise activity by a city or county general fund? Does the computation of "direct cost" exclude capital costs? Does it exclude provision for depreciation? Does it exclude repayment of loans?

Great reliance is placed on fees for financing capital costs. For example, in an opinion on the validity under Article XIII A of the use of property taxes levied by water districts to provide payments to the state under state water supply contracts, Attorney General Younger said, in August 1978:

> ...the Burns-Porter Act itself interpreted in light of Article XIII A imposes certain general limitations: (1) it is clear that the portion of the local water district taxes necessary to make the state water contract payment is exempt from the one percent limit under Section 1(b). *In determing that portion, the local district should rely first on water charges wherever* feasible... (emphasis added).

An understanding of the potential impact of the new Jarvis initiative upon the use and structure of fees can be gained from review of examples of specific fee-supported governmental functions.

Sacramento Metro: not a burden upon the general taxpayer. One such example is the Sacramento Metropolitan Airport, a fiscally independent department of Sacramento County government. Sacramento Metropolitan Airport is the 8th largest in California, based on total passenger volume. The 1983-84 Sacramento County Airport Department operating budget is $34.3 million, and the capital outlay budget for the year is $4.7 million. The budget annually includes funds for repayment to the Sacramento County general fund for previous advances. The budget is totally offset by fees and charges, which include a variety of revenues: landing fees, rents, building leases, tiedown fees, agricultural leases, parking fees, concession leases, fuel and utility charges, and natural gas royalties. These fees and charges are billed to air carriers, aircraft owners, concessionaires, farmers, and natural gas producers. Most of these costs are subsequently reflected in costs to the air travel consumer, rather than the general Sacramento County taxpayer.

The new Jarvis initiative would appear to bring these fees and charges within the initiative's limit, because a fee means...

> any charge by the state, (or) any local government entity . . . which is imposed upon persons or property . . . to pay for the direct costs of the services provided to . . . the particular persons or property subject to the charge . . .

The adjustment of fees and charges by the Sacramento County Department of Airports between 1983-84 and 1984-85 was as follows:

Table 1

Item	1983/84	1984/85	Percent Change
Scheduled Airlines Landing Fees	$0.56/Mlbs	$0.63	12.5%
Monthly Aircraft Tiedown Fees	38.00	40.00	5.3
Monthly Aircraft T-Hangar Rentals	102.00	108.00	5.8
Aviation Gas Mark-up	43.3 cents	41.2 cents	(-4.8)
Airline Ticket Counter Rentals	29.50	33.50	13.5
Fuel Delivery Handling Fee	3.0 cents	3.3 cents	10.0

In some years, depending on CPI growth, some of the

above increases would have to be submitted to the county's voters and secure a two-thirds approval in order to be effective.

Clean water and the California economy. Construction and upgrading of sewage and water treatment facilities is important to the continuing growth and development of California. It is also important to the ability of the state to continue to attract business and industry and provide jobs for those entering the labor market in the future.

Up to now, the financing of water treatment facilities has been shared by the federal government, the state, and local governments. The federal government has provided grants of 75% of the costs of facilities, and the state and local shares have been 12½% each. In August 1984, the federal share of water treatment financing will drop to 55%, leaving the state and local governments with a 45% share. To address this problem, *AB 1732*, the 1984 Clean Water Bond Act, supported by the Deukmejian Administration, would provide for a new system of state loans to local entities which would cover up to 12½% of the state cost of new water treatment facilities. Under *AB 1732*, the financing would involve a 55% federal grant, a 12½% state grant, a 12½% state loan, and a 20% local share. Since, under Article XIII A, the cheapest method of public capital outlay financing, general obligation bonds, is unavailable, any local costs will have to be absorbed by revenue bonds and within the sewer rate structure. With local governments moving to a much larger short- and long-term share of clean water costs, strong pressures will be placed on local rate structures, particularly in those medium- and small-sized California communities that are the most attractive areas for some new businesses. Given the size of the increase in the local share under this program, a local vote clearly would be called for. This example merely illustrates that factors beyond local control — in this case, *shifts in intergovernmental financing arrangements* — are at work and can drive rates higher than CPI in a given year. Another case in point is the recent announcement by the federal government that the price per acre foot for Central Valley Project water would triple in 1985. Water district rates could significantly exceed an increase in CPI.

The introduction of a new limit on fees raises a number of ancillary considerations, including the cost of elections, the possibility that an election cost may be higher than the fee increase that is sought, the lag time between the need for a fee increase and an election, the allocation of election costs among jurisdictions, and the relationship of a fractional CPI growth rate to the practical need for a fee increase rounded off to the nearest nickel or dime, as in parking meter fees and transit fares, among others. With respect to the contracting out of services, since pricing of services includes a *profit* factor, does the *direct* cost provision preclude such contracts?

4. New Local Two-Thirds Vote on "Any" Tax Increase

The new Jarvis initiative states the following with respect to two-thirds votes on local taxes:

> On and after August 15, 1983, *any* new tax or *any* change in any tax enacted or authorized by *any* governmental entity, exclusive of the state, which increases the amount of *any* tax levied upon *any* taxpayer, including but not limited to the imposition of a new tax, an increase in the rate of a tax, a change in the method of computation of a tax or a change in the taxpayers subject to such tax, may be imposed only by a measure approved by two-thirds of the qualified electors of the governmental entity voting on the measure at a public election, . . .

This section is apparently intended to eliminate the proval of certain local taxes by city councils and boards supervisors that was permitted under the *Farrell* decision. thrust of this section of the new Jarvis initiative is that a August 15, 1983, business license, utility user, and other l taxes that have been raised by simple majority vote of governing body would now have to face a two-thirds vot the qualified electors in order to be enacted.

5. New Legislative Two-Thirds Vote on "Any" Tax Increase

This section contains language similar to the local t thirds vote provision, and relates to any tax "enacte authorized by the Legislature." This section could provi possible loophole with respect to future local taxes. It rel to the fact that the Legislature *enacts* state and local ta but *authorizes* a tax only in the instance of permitting a l levy. The language on the legislative two-thirds vote uses word "authorize," which would appear to present an op tunity for subsequent legislative *authorization* of new l taxes. The *local* two-thirds vote language, noted above *cludes* new or higher taxes enacted or authorized by the s from a local two-thirds vote. Thus, it would appear that a l tax authorized by a two-thirds legislative vote might not a subsequent two-thirds vote by local voters.

The new language on a legislative two-thirds vote for increases would appear to halt a recent legislative practi attempting to increase taxes by a simple majority vot combining tax increases with tax decreases. The Legisl Counsel has opined that the resulting no net tax incr requires only a simple majority for legislative passag recent example is *AB 3* (Bates), which combines a ne severance tax with a decrease in the personal income tax which passed the State Assembly on a simple majority

The all-inclusive approach to stopping tax increases by than a two-thirds vote may also have the effect of requ two-thirds votes of tax *reductions*. This is because when is reduced, an increase in another tax can occur as a r of tax interaction. Thus, if the Legislature wished to re the state sales tax, a two-thirds vote would appear to b quired because this action would *increase* state and fe income tax liabilities.

The two sections on local and state two-thirds votes sl be read in conjunction with a new definition of the term which is "any levy or charge, however labeled or struc . . . which does not constitute a fee, an assessment, or a f Fees have been discussed above. A "fine" is simply defin "an amount paid to a governmental entity as a pecu punishment for engaging in unlawful activity." The "assessment" is defined in some detail:

> "Assessment" means a charge which is levied upon particular real property within a limited area for the payment of the cost of a local capital improvement to land which directly and specially benefits said particular real property, and which meets all of the following criteria:
>
> - It is levied exclusively on land.
> - It is based wholly on and limited in amount to direct and special benefits to the land upon which it is levied.
> - It creates no personal liability for the person whose land is assessed.
> - It is limited both as to time and locality by the duration and scope of application of the capital improvement.

This language appears to be designed to eliminate some of the "benefit assessment" approaches to raising local revenues which have involved simple majority votes by local governing bodies.

New Valuation Standards

6. Rollback of Inflationary Adjustments and Reduction in Values of Certain Properties

Proposition 13 provided that the assessed valuation of property not otherwise subject to reappraisal may be increased to reflect inflation, not to exceed 2% annually. It did not specify in what base year this inflationary adjustment was to commence. The State Board of Equalization and implementing legislation tied the inflationary adjustment to the Proposition 13 base year, 1975-76.

The question of the appropriate base year for the 2% annual adjustment was first raised in two consolidated suits, *Barrett et al. v. County of Santa Clara et al.* and *Armstrong v. San Mateo et al.* The Superior Court held that Article XIII A's annual 2% inflationary adjustment factor for property assessments "applies to the fair market value base commencing July 1, 1978, and not prior to that date." The First District Court of Appeal (Div. 2) on August 26, 1983, overturned the San Mateo Superior Court ruling. The new Jarvis initiative incorporates the trial court decision.

The new provision on the 2% annual adjustment ("new because Article XIII A is silent on it) specifically requires that "the full cash value shall not include any annual adjustment" for the 1976-77 through 1978-79 assessment years. For any assessee who received an adjustment for any of those years, the new Jarvis initiative requires a refund or (if the Legislature so provides) a credit against taxes next due, plus 13% interest from the date of payment. In effect, the initiative requires a reappraisal of all properties with a pre-1977 lien date.

Under the new Jarvis initiative, the greatest share of the proposed refunds, and the deepest cuts in assessed values would go to the properties with the oldest appraisals. Properties with the higher, more current, post-1977 appraisals would receive no refunds, and no reduced appraisals, but would generally receive a property tax increase as a result of the shift in tax burden for debt purposes.

The Legislative Analyst, in his October 12, 1983, report to the Attorney General on the measure, estimated the taxpayer refunds and credits at $1.29 billion. This would provide $850 million in tax refunds and $435 million in interest payments. Due to reassessments, there would be an ongoing reduction in property taxes, estimated at $66 million for 1985-86, and declining thereafter. Additionally, there would be a reduction of $56 million in current *Carman* property tax overrides, and unknown impacts due to new change of ownership and new construction appraisal provisions. Since there is no reimbursement for local government costs mandated by a vote of the people, the adminstrative costs of the reappraisals and providing the refunds would be borne by the counties.

The property tax refund and assessment rollback provisions of the new Jarvis initiative would also necessitate a tax increase for properties with a post-1977 lien date. This is because an override for debt purposes is still permitted. When valuations of certain properties within a taxing entity *decline,* a fixed debt burden is shifted to those properties with no change in value. The local property tax increase from this shift is estimated by the Legislative Analyst at $158 million.

The refund and reassessment provisions would cause a tax increase on all properties that have changed ownership since March 1, 1977, unless the property is in a jurisdiction that (1) has no debt; or (2) levies an override for employee retirement; or (3) there has been a change in ownership to a relative (which would be exempt from reassessment under a new provision discussed below).

While the property tax shifts under the new Jarvis initiative would affect all classes of property, it is with respect to residential properties that some concerns may be raised. One of the controversial issues to spring from Proposition 13 is the effect that the acquisition value approach had in creating inequities among residential properties with similar market value. Over time, a property with a 1975 appraisal will receive preferential property tax treatment in two ways: there will be a widening of the ratio of assessed value to real market value (because of the 2% lid on assessment growth, there will be an annual relative decrease within the 1% rate limit), and there will be a decline in the share of total taxes paid on the property. This is substantiated in recent data from the Los Angeles County Assessor's office on residential property taxes. In Los Angeles County, 53.5% of owner-occupied homes are appraised at the 1975 level, and pay 32.9% of residential property taxes. On the other hand, 46.5% of Los Angeles County homes that have been reappraised since 1975 pay 67.1% of residential property taxes.

7. New Change in Ownership Reassessment Provisions

Article XIII A provides for reappraisal of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment. It did not provide an exception to change in ownership reappraisal with respect to an interspousal transfer. The Legislature subsequently exempted interspousal transfers from reappraisal under the theory that a husband and wife is an economic unit and a transfer between them is not a transfer between economic units.

The new Jarvis initiative, in effect, provides that a change in ownership does not trigger a reappraisal of real property when the transfer occurs between a property owner and members of the immediate family of that owner. "Members of the immediate family means: "parents, grandparents, stepparents, uncles, aunts, spouse, stepchildren, siblings, and lineal descendents of the owner, or the guardian or trustee for any of the foregoing persons."'

The new intra-family change in ownership provision applies to all real property, regardless of use. Thus any transfer of business or corporate properties on an intra-family basis — as defined by the new Jarvis initiative — would also be exempt from reappraisal.

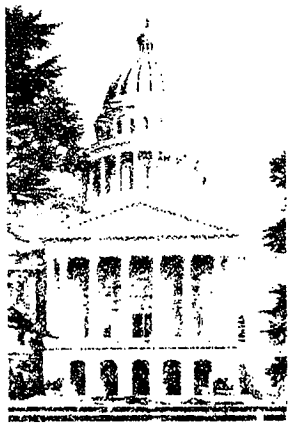
8. New Construction Valuation

There may or may not be a new appraisal standard with respect to new construction in the new Jarvis initiative. The valuation of new construction has involved considerable debate since passage of Proposition 13. The issue relates to the valuation of construction in progress over several assessment years. State Board of Equalization Rule 463 is the low-tax interpretation. It directs that portions of a project be placed on the assessment roll as they are completed. Conversely, some assessors contend that after final completion of multi-year projects, there must be summary reappraisal. The issue was settled in December 1983 when the Supreme Court let stand an appellate court decision in *Pope v. Board of Equalization,* which upheld the State Board of Equalization. The potential taxpayer refund resulting from the case could be $30 million in Los Angeles County, and perhaps $50 million statewide.

Apparently, the court's decision does not preclude a legislative interpretation of Proposition 13's new construction language that would, in effect, reverse the *Pope* decision. There is currently such a proposal, *AB 3358* (Floyd), that would provide for summary reappraisal.

The new Jarvis initiative states that new construction will be placed on the assessment roll at "the direct cost of any new construction on the real property since the sale or valuation date." There is no definition in the proposal of direct cost (or indirect cost).

Here is an issue which arose out of Proposition 13. Two clear-cut policy positions developed out of it. The new initiative presented an opportunity to resolve it in favor of a low-tax result. Instead, the new construction valuation issue remains ambiguous and would appear to remain an item for future debate.



California Tax Foundation
921 11th Street, Suite 903
Sacramento, CA 95814