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Spirit of 13

Sixteen months have elapsed since the landslide passage of Proposition 13 — the California property-tax-reduction amendment of Messrs. Howard Jarvis and Paul Gann. To voters, the Proposition became a clarion call to send their message to government. The concept, or spirit, of the proposition has mattered most, for its actual fiscal effect has been modest compared with its role in the larger tax-reduction movement. Measures to restrict government have had varying success among other states as well as California, and the same spirit has been behind the continuing effort to limit spending at the Federal level through constitutional amendment.

Within California, many champions of government limitation believe that Proposition 13 has major loopholes, principally because it has allowed state surplus revenues to be channeled to the local level. Thus it has reduced total government spending only slightly. Accordingly, several bills to pare government have sprouted within the state legislature, and only last week several tax-reduction measures were sent to the governor. On a broader front, however, Messrs. Jarvis and Gann each has proposed a new initiative going beyond their joint Proposition 13 effort.

Mr. Jarvis has been busily collecting signatures for what has become known as "Jarvis II," a plan to index state personal-income tax rates to inflation and reduce them permanently to one-half of the 1978 rate. At present it appears that Jarvis II will easily gain the needed signatures for inclusion on the June 1980 ballot. However, Mr. Gann's competing proposal has already qualified and will appear as Proposition 4 on the upcoming November 6 ballot. This more comprehensive but less drastic "Limitation of Government Appropriations," often referred to as the "Spirit of 13," received almost twice the required 554,000 signatures, and is presently favored by a two-to-one margin, according to a recent Field Institute poll. Like Proposition 13, it is a far-reaching proposal that is worth examining in light of the changes already imposed by its predecessor.

In the wake of 13

There is no doubt that Proposition 13 has slowed the growth of government in California. But supporters of the amendment believe that it hasn't achieved all that was intended or desired. Admittedly, the amendment by itself resulted in a $6.4 billion (57 percent) property-tax cut, and a temporary $1-billion cut in state income taxes was enacted in its aftermath. At the same time, the accumulated surplus in the state budget totalled more than $5.0 billion in fiscal 1978, and there was an additional current surplus of $3.0 billion in fiscal 1979. Those funds provided $4.4 billion last year and $4.9 billion this year in "bail-out" funds to local governments, school districts, and special districts, in addition to some emergency loans. Thus the effective cut in government expenditures in the first two post-Proposition 13 years was far smaller than the reduction in property taxes.

State-and-local tax revenues have been rising faster than Proposition-13 proponents had anticipated. In view of the progressive nature of state income taxes and the structure of state sales taxes, these items have increased significantly faster than personal income. In addition, local property-tax assessments climbed 9.5 percent last year on a statewide basis — far in excess of the 2-percent ceiling in the amendment — because of transfers of ownership, new construction, and reassessments of properties to correct for underassessments in the 1975-76 base year. Furthermore, local governments have increased and extended fees for services.

The irony of Proposition 13 — perhaps its redeeming feature — is that it neither drastically reduced the size of government (as desired by many proponents) nor led to statewide economic chaos (as predicted by staunch opponents). In fact, in its first year it strongly stimulated the state's economy, because taxpayers experienced a permanent reduction in property taxes while the state government simultaneously was spending its surplus.

During 1978, California's personal income jumped 15 percent — one of the highest increases in the nation — while the California unemployment rate dropped much more rapidly than the national rate. Since enactment of Proposition 13, employment in local government has declined by 100,000 workers, or 7 percent, with three-fourths of the decline in education. (Only 17,000 workers were actually laid off; other positions were reduced through vacancies and attrition.) In contrast, 552,000 new jobs were created in California's private sector — partly because of this fiscal stimulus, and partly because of the nationwide business boom, both of which may be largely temporary.

In the aftermath of Proposition 13, we are left with some noteworthy effects, beginning of course with a large reduction in property taxes and a large short-term spending stimulus. In addition, we have experienced a substantial shift of tax revenues from local to state sources as well as some redistribution among localities, plus a modest reduction in the size of local government. As a consequence, political power has shifted toward the state level.

Reenter Mr. Gann

Advocates of smaller government, such as Mr. Gann, believe that a modest reduction in local government is not sufficient. His Proposition 4, if passed, would take effect in the 1980-81 fiscal year, and would limit the annual growth of government appropriations to the 1978-79 fiscal-year level plus an annual adjustment for consumer-price increases and local population growth. ("Appropriations," which are legal authorizations for spending, are closely correlated with expenditures over time, but not necessarily for individual years.) The appropriations ceiling would apply *individually* to the state, every county, city, and school district, and many special districts. The measure essentially would limit each government unit's appropriations to the 1978-79 real per capita level (or per pupil level for school districts). The new amendment specifically addresses the issue of the state surplus, which provided the bail-out funds that took much of the venom out of Proposition 13. Any general state transfers to a local government (e.g., bail-out funds) would fall under the latter's limits, while any state-mandated programs would have to be funded by the state and would fall within its own limit. Direct fees for government services would not be subject to the limitation, at least up to a point. To the extent that a user charge of this type exceeded the cost of providing the service, the excess would be considered an appropriation subject to the limitation.

Other sections of the initiative are designed to assure its effective implementation while preventing circumvention. Surplus revenues are to be returned "by a revision of tax rates or fee schedules" within the following two years. Adjustments are to be made to account for changes in governmental boundaries and for transferral of functions from government to private enterprise. Also, a government could spend beyond its limit for emergencies, so long as appropriations in the following three years were reduced accordingly. More importantly, any governing body could increase its appropriations limit with a majority vote of the electorate — but not for more than four years without a reconfirmation vote by the electorate. Thus, a "permanent" increase in the appropriations ceiling would not be allowed.

Implications of 4

Despite the initiative's apparent thoroughness, it would pose some serious economic and legal problems. Perhaps the greatest economic problem hinges on the individual application of the limit to each governmental unit. When coupled with Proposition 13's reduction in property taxes, it might seriously restrict desired growth within many cities (particularly outside dense urban areas). By restricting property taxes, Proposition 13 has already reduced local government's economic incentive to permit new home building, thereby giving local governments reason to block growth. If these homes are also more costly to service than existing homes (as could be the case in growing towns and suburbs), then Proposition 4 would provide added incentive to restrict growth, since the additional population must be supported within the predetermined real per capita appropriations limit.

Furthermore, Proposition 4 may force cities to adopt restrictions leading to less than optimal growth patterns. Such growth patterns may dictate that one town add shopping centers and office space, while the next town add residences (population). Under the proposition, the latter's inflation-adjusted appropriations limit would rise while the former's would not. Thus the limit may have some effect on what kind of growth is allowed within a city or county.

An additional legal uncertainty surrounds the determination of the 1978-79 appropriations base. According to a report of the Assembly Revenue and Taxation Committee, the initiative does not spell out how existing budget surpluses are to be treated. Indeed, the ceiling for all future years is sharply affected by whether or not these funds are treated as appropriations subject to the ceiling in the base year. This legal tangle would have to be resolved in the courts.

Proposition 4 essentially would tighten the lid first clamped on by Proposition 13. It would effectively contain California government activities at the level set by 1978-79 real per capita expenditures, thus reducing the relative economic size of government as real per capita expenditures rise in the private sector. But in addition, it would continue the Proposition-13 policy of restraining the flexibility and responsiveness of local government. It is ironic that the movement to restrict government has been aimed foremost at local government — the level that in principle is the most responsive to the people it serves.

Jack Beebe

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 9/12/79	Change from 9/5/79	Change from year ago @ Dollar	Percent
Loans (gross, adjusted) and investments*	132,815	452	+ 18,556	16.24
Loans (gross, adjusted) — total#	109,781	570	+ 18,126	19.78
Commercial and industrial	31,591	– 112	+ 4,433	16.32
Real estate	40,253	227	+ 8,315	26.03
Loans to individuals	22,531	42	NA	NA
Securities loans	2,146	162	NA	NA
U.S. Treasury securities*	7,708	58	– 1,315	– 14.57
Other securities*	15,326	176	+ 1,745	12.85
Demand deposits — total#	46,323	– 54	+ 4,053	9.59
Demand deposits — adjusted	30,988	– 204	– 11	– 0.04
Savings deposits — total	30,452	– 56	– 16	– 0.05
Time deposits — total#	53,488	735	+ 5,888	12.37
Individuals, part. & corp.	45,075	655	+ 7,463	19.84
(Large negotiable CD's)	19,894	633	+ 673	3.50

Weekly Averages of Daily Figures	Week ended 9/12/79	Week ended 9/5/79	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	– 10	23	52
Borrowings	60	142	11
Net free reserves (+)/Net borrowed(–)	– 70	– 119	41
Federal Funds — Seven Large Banks			
Net interbank transactions [Purchases (+)/Sales (–)]	+1,449	– 61	+1,932
Net, U.S. Securities dealer transactions [Loans (+)/Borrowings (–)]	– 154	– 292	+ 697

* Excludes trading account securities.
\# Includes items not shown separately.
@ Historical data are not strictly comparable due to changes in the reporting panel; however, adjustments have been applied to 1978 data to remove as much as possible the effects of the changes in coverage. In addition, for some items, historical data are not available due to definitional changes.

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