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The Reaction and Reform of Local Governments
in Response to Proposition 13

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There have been two major types of fiscal limitation measures lumped together under the Proposition 13 rubric:1) limitation on property taxes as exemplified by Proposition 13 in California, and similar measures in Idaho, Alabama and North Dakota; and 2) limitation on expenditures as exemplified by the Headlee Amendment in Michigan and similar measures in Arizona, Nevada, Michigan, Texas and Tennessee, (See Table 1). The two types of measures are, in fact, quite different. The former type does not limit expenditures and may result in simply shifting the fiscal burden of government away from the property tax to other sources of revenue, most noticeably sales and income taxes and user charges of various sorts. There is little direct incentive in this type of measures for improvements in government efficiency. The second type of measure-- those limiting expenditures --<u>can</u> (but not necessarily will) produce improvements in efficiency and/or reductions in certain types of government services.

Let us deal with the true Proposition 13 measures first. Probably few economists would object to greater use of user charges in financing at least the more peripheral services of governments. The only major objections come about from: 1) concern over equity--i.e., the effect on low-income people who may, by virtue of the user charges, be cut off from some services; and 2) the administrative costs of implementing user charges. To the extent that Proposition 13 type measures limit only property taxes, which are more important generally to local rather than state governments, and do not limit other types of taxes, particularly sales and income taxes that, by virtue of inflation, are swelling state treasuries, we are getting increases in intergovernmental transfers

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from states to local governments. That, apparently has been the principal approach in California. As a matter of principle, greater reliance on such transfers reduces the autonomy of local governments, makes budget planning more inefficient because of the political uncertainties about continuation of such transfers, and, perhaps, undermines responsible local government arising from those who make decisions to expend funds also having to take political responsibility for raising those funds. In addition, in many states, there may be a tendency to increase sales taxes to make up for lost property tax revenues, with the effect of making the overall tax system more regressive.

The second type of measure--i.e., the spending limitation measures of the Headlee type--may be of greater nominal than real significance. In Michigan the Headlee Amendment will limit State expenditures to about 9.9 percent of total personal income, and preliminary analysis shows that this tax revenue/ personal income ratio is higher than actual state expenditures have been during the last eight years (Gale & Hauge). Only when the economy is in recession will the Headlee Amendment contribute an effective limitation on state expenditures in Michigan. The Arizona limitation is 7 percent of total personal income and current state spending in Arizona is only 6.5 percent of personal income. In general, therefore, the spending limitation measures are apt to be nothing more than periodic nusiances to "big spenders" in state governments.

When the limitations are effective, however, what will be the effect? One can do a little more than speculate. Remember that for the most part the limitations will be effective only in times of recession, times when the Federal government may initiate countercyclical expenditures, some of which mandate certain expenditures by states. That being the case, these mandated Federal programs, together with the State spending limitations, will tend to reduce the proportions of state monies going to non-mandated programs--i.e., reduce

State and local discretionary power over expenditures--and further centralize decision making in Washington. Since these years will (one hopes) be infrequent, state and local officials may not feel pressured to initiate managerial efficiences that must be practiced year in, year out. Overall, therefore, the end result may be an ironic one--a reduction in local and state government discretion and power in favor of the Federal government and no significant improvements in governmental efficiencies.

There is one final point that needs to be made. Not all the effects of the Proposition 13 movement have been confined to the states where specific limitations on either taxes or expenditures have been enacted into law. One way for voters to engage in a tax revolt is to throw the rascal out--meaning, in this case, those elected officials who are, or are perceived to be, "big spenders." Realization of this has made a lot of politicians nervous. In my own state of South Carolina, we have been involved in a thorough review of local government financing with a particular view toward holding the line or reducing property taxes. How many other states are doing the same sort of thing, stimulated by Proposition 13, I do not know. But tax increases are widely perceived not to be politically acceptable in the present climate and budgets are being more critically examined than in previous years, I am sure.

Table 1

Tax Revolt States

State	Nature of Amendment	Vote in Favor
Alabama	Limit property tax increases for local government	55.3%
Arizona	State spending limit	78.2%
Colorado	Spending lid for state and local governments	41.5%
California	Proposition 13	64.0%
Hawaii	State spending limit	66.8%
Idaho	Proposition 13-style amendment	58.4%
Illinois	Advised reduction in state spending	82.0%
Michigan	Proposition 13-style amendment Spending limit	37.3% 52.5%
Nebraska	Local spending limit	44.8%
Nevada	Proposition 13-style amendment	77.8%
North Dakota	Income tax cut for individuals and an increase for corporations	65.1%
Oregon	Proposition 13-style amendment	48.3%
South Dakota	Raise requirements to approve state taxes	53.0%
Texas	Limits on state spending	84.0%

Source: Congressional Quarterly, November 18, 1978, p.3300; Los Angeles Times, June 7, 1978, p. 1; and the Chicago Tribune, November 9, 1978, p. 10 (following McNitt and Goodrick).

REFERENCES

1. Gale, J. R., and V. W. Hauge, "Tax Limitation in Michigan: Some Economic Effects of the Headlee Amendment", paper presented at meeting of Mid-Continent Regional Science Association, Minneapolis, June 1, 1979.

2. McNitt, A. D., and R. Goodrick, "The 1978 Tax Revolt: Rhetonic or Revolution", paper presented at meetings of Mid-Continent Regional Science Association, Minneapolis, June 1, 1979.