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Send Them a Message!

"Taxes," said Justice Holmes, "are the price we pay for civilized society." If that be true, Californians were in a downright uncivilized mood this week, for they voted overwhelmingly for a ballot proposal (the Jarvis-Gann initiative) which promises to reduce local property taxes 57 percent and to curb future tax increases of either the state or local variety.

Specifically, the electorate voted to limit taxes on all property — residential, commercial, and industrial — to one percent of the 1975-76 market value, and to limit increases in assessments generally to no more than two percent annually. Property taxes now run about two to three percent of market value, so this means a reduction of roughly $7 billion annually in local-government revenues. The initiative henceforth will require a two-thirds vote of the legislature to increase state taxes, and a two-thirds vote of the local electorate to raise local levies.

Next step

What happens next? The winning side expects the millennium, while the losing side predicts total chaos. The reality, however, may be closer to the purgatory long familiar to taxpayers, expecially since legislators throughout the state may now try to increase revenues from other sources in order to maintain accustomed levels of government services. One possibility is that the initiative will never become law, as has happened so frequently in the past. Between 1960 and 1976 alone, 148 proposals were submitted for the state ballot, but only 26 eventually qualified and only seven of those were approved by the voters. Moreover, five successful initiatives — anti-busing, anti-pay TV, political reform, anti-open housing, and the death penalty — were totally or partially overturned by the courts.

The same may happen in this case, because legal questions have been raised about the ambiguous wording of the brief (389 word) initiative. One section states that the lowered property taxes would be distributed "according to law" within the counties — but as yet there is no such law. Another section limits annual increases in the "fair market value" base to two percent on property that does not change hands, but it allows full reassessment of property when sold — which could violate the equal-protection clause of the U.S. Constitution. And another section says that special taxes may be imposed only by two-thirds of "qualified electors" — which is ambiguous because it could mean those voting, those registered to vote, or those of voting age.

Opposing views

But assuming the legal challenges are overcome, what will actually happen next? According to University of Southern California Professor Arthur Laffer, the favorable vote on the initiative will go a long way toward revitalizing the California economy, by reducing the heavy tax load on the state's residents. Moreover, he claims that harsh spending cuts are unlikely, because of the state's ability to borrow in capital markets and, in particular, utilize its now towering surplus. As of June 30, the surplus will approach $3.4 billion, and it could reach $4.8 billion at the end of fiscal 1979 if no calls were made upon it.

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Again, Laffer argues that revenues will fall by considerably less than the widely-quoted $7-billion figure, simply because property values will rise, encouraging more new construction and an expanded tax base. Also, tax revenues from other sources will expand. With property taxes lower, businesses will expand their activities within the state. This expansion will create more jobs, more investment , and higher real wages, so that sales and income taxes eventually will rise, creating future opportunities for tax relief or essential spending increases.

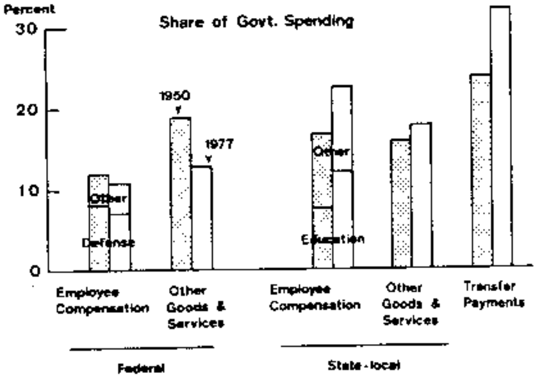
State Director of Finance Roy Bell takes a more skeptical view, arguing that the economic stimulus gained from lower property-tax rates will be considerably less than the $7-billion revenue loss. First, individuals will net only $1.5 billion of that $7-billion figure, because home-owners will receive only one-third of the tax cut and will experience higher federal and state income taxes as a result of reduced deductions. (According to a recent UCLA study, the U.S. Treasury will benefit from a $2.2-billion increase in Californians' income taxes, as well as a $500-million reduction in Federal payments to California local governments for jobs that will now be abolished.) Again, Bell claims that wage-and-salary losses associated with spending cuts and layoffs will amount to about $6 billion in 1979, leading to a potential reduction in consumer incomes of $4.5 billion ($6 billion minus $1.5 billion.)

One thing is certain — the next several months will be rather chaotic for state and local legislators, as they attempt to change tax structures and spending levels to make up for the missing property-tax revenues. The result might include a mixture of spending cutbacks, increases in fees for certain government services, increases in business taxes, and hikes in sales and individual income taxes. (But tax-increase packages may be hard to put together, given the Jarvis-Gann requirement of a two-thirds majority to pass tax measures.) Paradoxically, this result might go against the views of those, like Laffer, who argue that an optimal tax structure includes higher taxes on property than on income or sales.

Why the message?

Californians rejected several earlier (and milder) attempts to reduce their tax and spending burdens, so why did they vote so overwhelmingly this time to "send a message" to their governmental leaders? One reason may be the growing size of the state's burden of state-local taxation. California is outranked only by New York in this regard, with a per capita tax burden 30 percent higher than the U.S. average.

The tax burden has actually worsened because of the impact of several reform measures passed during the last decade. In 1966, the state legislature moved to standardize assessment practices by setting the assessment ratio at 25 percent of market value for all property throughout the state, with that goal to be reached by 1971. But when the 1970's brought its unique combination of several recessions, several housing booms, and rampant inflation, California experienced skyrocketing increases in home values but lagging increases in commercial and industrial property values. Thus, home-owners found themselves pay-



ing much higher property taxes, both absolutely and in relation to other property owners. They also found themselves paying much higher state income taxes, as inflation kept pushing them into higher and more graduated tax brackets, following 1971 tax legislation (Library – 1971 law?) designed to make the income-tax structure more progressive. Today every 10-percent rise in personal income leads to at least a 17-percent rise in state income-tax revenues.

The initiative still might not have triumphed, however, if state and local authorities had moved more expeditiously to return to the taxpayers the surpluses amassed during the inflationary boom of the past several years. Late in its last session, the legislature passed and placed on the ballot a measure (the Behr bill) to reduce homeowner and renter tax burdens. However, this complex measure failed to attract much support, in part because it could be read as threatening sharp tax increases in the future.

A national message
Jarvis-Gann has a message for more than Californians, and not simply because of California's role in setting national trends. (Actually, Tennessee voters approved a budget-limitation measure earlier this spring, and other states are also getting into the act.) The broader message may be a growing dissatisfaction with inflation and with what the voters perceive as government's contribution to that problem. Consumer prices have almost doubled over the past decade, and more and more voters have come to believe that the problem would be less severe if federal, state and local governments had demanded less of the economy's resources.

Government spending has increased more than ten-fold since 1950 – and has grown more than two and a half times in the past decade alone – to reach a total of $621 billion in 1977. Governments accounted for 21.4 percent of GNP in 1950, but their share has now risen to 32.9 percent of the total. Expenditures have soared at all levels, but state-local government spending has grown most rapidly of all, and now accounts for 14.0 percent of GNP – partly because more than one-fourth of those funds now come from federal grants.

Between 1950 and 1977, employee compensation at the federal level dropped from 12.0 to 10.7 percent of total government spending, while federal purchases of other goods and services dropped from 18.7 to 12.7 percent of the total (see chart). Meanwhile, employee compensation at the state and local level – especially for teachers – jumped from 16.7 to 22.5 percent of total government spending, while the state-local share of other spending for goods and services also increased. Most importantly, government transfer payments (primarily federal) jumped from 23.6 to 31.9 percent of total spending, to a total of $198 billion in 1977. Voters in California and elsewhere apparently are now reacting unfavorably to these figures – especially the rapid expansion of items such as transfer payments and teachers' salaries. As time goes on, we are likely to hear even more the question: How much government spending is enough?

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