Computing the Extent of Circumvention of Proposition 13: A Response

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A Response

By Gary M. Galles and Robert L. Sexton*

ABSTRACT. Galles and Sexton (1998) showed that California state and local revenues exceeded their previous real per capita levels as did the sum of property taxes plus charges and miscellaneous revenues within a decade after Proposition 13 passed, and concluded that Proposition 13 was only temporarily successful at shrinking California state and local governments. Khoury and Pal (2000) challenge this conclusion. However, their conclusion that Proposition 13’s circumvention “has been only marginal” results from using per $1000 of income comparisons rather than real per capita comparisons and from using growth rate changes, which fail to adjust for U.S. fiscal trends, instead of changes in the levels of variables as their primary measure.

I

Introduction

Galles and Sexton (1998) found that Proposition 13’s restrictions on property tax revenues to California state and local governments did not permanently reduce the governments’ size. Since real per capita state and local government revenues as well as the sum of property taxes plus fees and miscellaneous charges were once again greater than their pre-Proposition 13 peaks within a decade, we concluded that those restrictions were completely circumvented in that time frame. Khoury and Pal (2000), however, conclude that Proposition 13 was only marginally circumvented by subsequent increased growth rates in other revenue categories in per $1000 of income terms.

The difference between these conclusions in large part reflects the use of different evaluation measures, which generate substantially different results. Therefore, which view is more accurate depends on whether, for the question at hand, real per capita measures or per

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$1000 of income measures are considered more appropriate, and whether the levels of the variables in question or their growth rates are more appropriate indicators of the effects of Proposition 13 on California state and local governments.

II

Using Per $1000 of Income Measures Rather than Real Per Capita Measures

The primary question Galles and Sexton (1998) asked was: Had revenues to the combined levels of California government been so squeezed in the post-Proposition 13 era that state and local governments had been rendered unable to maintain their levels of services? Since even without any increase in government productivity, a government with the same level of real per capita revenues and expenditures should be able to provide its constituents with the same level of services, real per capita measures seem most appropriate for addressing this question.

Such measures also accord better with Proposition 13’s language, the rhetoric of its supporters, and the critics of its effects, all of which focused on the size of California government, not its share of California’s income. They also better reflect many voters’ expressed desire in surveys taken at that time to shrink the size of government, not just to slow its growth or its growth relative to the economy. (If such surveys accurately reflected Californians’ sentiments, a government that then shrank in real per capita terms would not be a fiscal crisis to be “solved” with additional taxes, fees or charges, but would be the solution to the previous fiscal crisis of an overexpanded government.)

In contrast, the per $1000 of income measures used by Khoury and Pal look at the question of whether state and local governments consume a larger share of total California income than before. Their conclusion that California state and local governments are still smaller than before Proposition 13 in per $1000 of income terms does not negate our demonstration that those governments’ revenues are greater in real per capita terms than before Proposition 13. Therefore their conclusion that “Proposition 13 has indeed delivered the lower tax-burden that the majority of voters had sought,” is, in fact, incorrect.
This increase in governments’ revenues simply reflects growing real per capita income in the state, not state and local governments’ reduced ability to provide a given level of services. In fact, since real per capita revenues exceeded their previous peaks by the late 1980s, those governments should have been able to provide increasing levels of services to their citizens, whether or not they re-attained their previous sizes in per $1000 of income terms.

III
Using Growth Rates to Measure Proposition 13’s Success

Rather than focusing on per $1000 of income revenue levels of California state and local governments, Khoury and Pal use the growth rates of those variables as their main measure of Proposition 13’s success. They find that the annual growth in California revenues per $1000 of income was 40% slower during the post-Proposition 13 1978 to 1995 period than the preceding 1963 to 1978 period, and conclude that Proposition 13 was a continuing success at reducing the size of those governments. This reflects the earlier conclusions in Cebula (1999), who showed that the growth rates of California revenues were substantially lower over the 1978 to 1990 post-Proposition 13 period than over the previous 1966 to 1978 period, and judged these propositions to be longer-term successes as a result.

However, neither of these reduced growth rates in revenues demonstrates that California state and local governments are smaller and are forced to cut back the services they can provide. A reduced but still positive growth rate in California state and local revenues per $1000 of income does not indicate a cutback in the size of government. It instead means that the size of government is still increasing over the period in question, although it is growing less quickly as a share of the economy than previously. For example, as Galles and Sexton (1998) show in Table 1, California’s real per capita expenditures on welfare, police, and fire services all exceeded their pre-Proposition 13 levels by 1990, and its education spending was only slightly smaller ($991 versus $1015, in 1982 dollars).

Further, while we recognize that before and after growth rate comparisons provide an alternative to real per capita levels as a measure
of Proposition 13’s effects, these comparisons are subject to an additional complication. Khoury and Pal attribute all of the difference in these growth rates to the effects of Proposition 13, although other important determinants were also at work. In particular, such measures ignore the fact that there was a major nationwide tax revolt in the post-Proposition 13 period that substantially reduced state and local government revenue growth rates throughout the country. Adjusting for this national pattern by comparing California revenue growth rates to U.S. revenue growth rates dramatically changes the conclusions.

IV
Adjusting for U.S. Trend Changes after Proposition 13’s Implementation

Galles and Sexton (1999) showed that, adjusting for the one-time reductions during Proposition 13’s implementation period and for trends in the U.S. as a whole over this period, there was very little evidence that Proposition 13 significantly reduced the long-term growth rates of real per capita revenues or expenditures, as hypothesized by Cebula (1999). Much the same result holds for Khoury and Pal. Making similar adjustments, which they fail to do, results in very little evidence that Proposition 13 significantly reduced the growth rates of California state and local revenues relative to the U.S. as a whole. This is illustrated in Table 1 for real per capita measures and Table 2 for per $1000 of income measures.

In terms of pre-Proposition 13 versus post-Proposition 13 growth rate comparisons, two patterns stand out from Tables 1 and 2.

First, for the U.S. as a whole, there was a substantial nationwide reduction in the growth rates of every included variable in real per capita terms and for every variable except property taxes in per $1000 of income terms during the post-Proposition 13 period. Therefore, the entire fall in California revenue growth rates following Proposition 13 cannot be attributed to it alone, but a large part must be attributed to a national trend.

In terms of total general revenue, California and the U.S. had nearly identical percentage reductions in growth rates over our comparison period, whether measured in real per capita or per $1000 of income
terms. (U.S. growth rates actually fell more in absolute terms for both measures and more in percentage terms for the per $1000 of income data.) This indicates almost no effect of Proposition 13 in reducing general revenue growth rates compared to the rest of the country, although those growth rates fell sharply in California.

In terms of own-source general revenue, the measure Khoury and Pal (2000) emphasize, California growth rates fell more in percentage terms but less in absolute terms than U.S. growth rates in both real per capita and per $1000 of income terms. If the absolute reductions are considered the relevant measure, Proposition 13 actually resulted in a smaller reduction in California state and local governments than was
the case in the rest of the country. If percentage reductions in growth rates are considered the relevant measure, Proposition 13 did reduce growth rates, but only slightly more than in the U.S. as a whole. The percentage reduction in own-source general revenue was roughly 14% greater in California than in the U.S. in real per capita terms, and roughly 11% greater in California in per $1000 of income terms. By this measure, roughly 86% to 89% of the fall in California own-source general revenue growth, which Khoury and Pal attribute to Proposition 13 alone actually reflected a nationwide change in state and local government growth trends.

Second, while national trends led Khoury and Pal to dramatically overstate the reduction in California state and local government revenue growth rates due to Proposition 13, those same trends led them to understate the ensuing increase in the growth rates of other revenues (miscellaneous charges and fees) that it led to.

California growth rates for other revenues were higher after Propo-

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sition 13 than before in both real per capita and per $1000 of income terms, although they were lower for the rest of the U.S. The national trend therefore masked a substantial amount of the increase in that category that could be attributed to Proposition 13. In real per capita terms, other revenue growth rates rose 8.7% in California after Proposition 13, while falling 30.2% in the U.S. The result was that California’s growth rate went from 74% to 115% of the U.S. growth rate. In per $1000 of income terms, that growth rate rose 34.7% in California while falling 33.4% in the U.S.; California’s growth rate went from 68% to 135% of the U.S. growth rate. Measured by the deviation from before and after growth rate trends in the U.S., Proposition 13’s effect of increasing other revenue growth rates was roughly double that measured by Khoury and Pal in per $1000 of income terms, and far greater in real per capita terms.

V

Conclusion

Khoury and Pal (2000) claim to “examine the extent to which the growth in non-tax revenues has circumvented the reduction in taxes produced by Proposition 13,” and find “this circumvention has been only marginal.” They therefore conclude that Proposition 13 continues to successfully restrain the size of California state and local governments today, and do not agree with Galles and Sexton’s (1998) conclusion that it only temporarily shrunk their size.

However, in this note, we have argued that:

1. The real per capita measures we used are more appropriate for the questions we were asking than the per $1000 of income measures that Khoury and Pal use, but do not justify.
2. Nothing in their article refutes our major 1998 conclusions that California state and local government grew larger in real per capita terms within roughly a decade after Proposition 13 was passed, and that the same was true of the sum of property taxes and fees and miscellaneous charges.
3. Their use of pre- and post-Proposition 13 revenue growth rate changes as their major indicator of its success ignores trends in
the U.S. as a whole and dramatically overstates the reductions in California own-source general revenue growth that can be attributed to Proposition 13. At the same time it dramatically understates the ensuing increase in the growth rates of other revenues (miscellaneous charges and fees).

As a result, we would reject their claim that the evidence is inconsistent with our 1998 article’s conclusions. Further, we would argue that their failure to adjust for the dramatic post-Proposition 13 changes in U.S. growth rate trends introduces such large biases that their conclusion that at most 9.2% of the effects of Proposition 13 have been circumvented is extremely unreliable.

References


