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REPORT BY THE

Comptroller General

OF THE UNITED STATES

Will Federal Assistance To California Be Affected By Proposition 13?

With Colorado Funding Data

The effect that Proposition 13 will have on the amount of Federal funds that California receives will depend upon actions taken by Federal, State and local governments. These actions are (1) local budgetary decisions, (2) uses made of the State surplus, and (3) the waiving of certain Federal grant requirements.

Federal outlays in Colorado in fiscal year 1977 are included in this report.

GGD-78-99
AUGUST 10, 1978

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-146185

The Honorable Floyd K. Haskell
United States Senate

Dear Senator Haskell:

In your letter of June 22, 1978, you requested an analysis of Proposition 13's impact on Federal revenues and outlays. You expressed concern about the effect of State and local tax reductions on formula grant programs. In addition, you requested an analysis of the impact on Federal revenues.

Because we are doing a similar study for Representatives Glenn Anderson and Jim Lloyd, and for the California delegation task force on Proposition 13, your staff agreed that our report to them will fulfill your request. It was also agreed that Colorado's fiscal year 1977 outlays would be included in this report to you.

The impact of Proposition 13 on Federal funds received by California will depend upon actions taken by the Federal, State and local government. The level of Federal grant outlays will depend largely on local government budgetary decisions, on uses made of the State surplus, and on the waiving of certain Federal grant requirements.

The dollar impact on California will be uncertain until the reactive moves of the parties involved are known. Our report does, however, analyze situations where State and local expenditure fluctuations could affect Federal grant outlays to California and Colorado, and indicates areas of possible impact.

Similar reports are being sent today to Representatives Anderson and Lloyd. As agreed with your office, we plan to distribute copies of this report to appropriate Senate and House Committees; the Director, Office of Management and Budget; and heads of departments and agencies directly involved. We will make copies available to others upon request.

Comptroller General
of the United States

Contents

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CHAPTER I

INTRODUCTION

On June 6, 1978, California taxpayers voted overwhelmingly for a constitutional amendment to limit State and local taxation. Proposition 13, passed by two-thirds vote, limits realty tax to 1 percent of market value after July 1, 1978, limits assessment increases to 2 percent annually, and bases current property values on assessments as of March 1, 1975. In addition, Proposition 13 requires that any State tax increases be approved by a two-thirds vote of the State Legislature and that new local taxes be approved by a two-thirds vote of "qualified electors."

Property tax revenues of local governments will decline by an estimated $7 billion annually as a result of Proposition 13. To offset this revenue loss, the State will distribute from its accumulated surplus $4.1 billion during the fiscal year beginning July 1, 1978. The Proposition has both revenue and outlay implications for the Federal level.

There appear to be three areas where Federal grant outlays to California could be affected by reduced local spending brought about by the passage of Proposition 13. Federal outlays to Colorado could similarly be affected if State and local spending decreased. The biggest impact on Federal outlays probably lies with matching and maintenance of effort requirements associated with Federal assistance programs. Matching requirements indicate the maximum percentage the Federal Government will pay and the minimum grantee share. Maintenance of effort requirements stipulate either that the grantee maintain a specified level of fiscal effort to be eligible for Federal funds, or that Federal funds cannot be substituted for the grantee's own source funds. Chapter 2 discusses the matching and maintenance of effort requirements for those Federal grant programs funded at over $100 million nationally in fiscal year 1978.

The second outlay impact area is in Federal compensation programs. These programs reimburse State and local governments for revenues lost because Federal landholdings are exempt from State and local taxation. These programs are discussed in Chapter 3.

The third impact area is Federal formula grant programs. Some of the formulae use grantee expenditures or taxing effort as a factor in a[illegible]cating Federal funds. These programs are also discussed in Chapter 3.

At this time, Proposition 13's impact on Federal funds going to California cannot be determined because Federal funding is dependent on the actions of relatively independent actors. How individual local governments allocate total revenues will determine whether Federal matching and maintenance of effort requirements are met and whether the amount of funds received under some of the formula programs will be affected. The State's distribution of its budget surplus could mitigate much of the effect of Proposition 13 this year. Continued mitigation will depend heavily on the levels of fiscal support the State is able to provide its local governments in future years. Finally, the decisions of Federal agencies regarding waivers of program requirements will affect the amount of Federal funds received. The same holds true for Colorado if local spending is decreased.

We intend to monitor and review actions taken by Federal, State and local levels over a sufficient period of time to gain an understanding of the impact of Proposition 13 on Federal funds going to California. Results of our monitoring effort will be the subject of future reporting.

Various estimates have been made of the increase in Federal revenues resulting from Proposition 13 primarily due to reduced property tax deductions on Federal income tax returns. The various estimates and their assumptions are discussed in Chapter 4.

SCOPE OF REVIEW

We used the Office of Management and Budget's Fiscal Year 1977 Catalog of Federal Domestic Assistance to identify assistance programs funded at over $100 million nationally in fiscal year 1978 and to further identify those programs with matching and/or maintenance of effort requirements and formula distribution requirements. The Catalog's information on matching and/or maintenance of effort requirements was supplemented with a review of pertinent laws and regulations and with information obtained through interviews with Federal agency personnel. The Community Services Administration's Fiscal Year 1977 Geographic Distribution of Federal Funds was the data base used to determine the level of Federal funding in California and Colorado.

CHAPTER 2

MATCHING AND MAINTENANCE OF EFFORT REQUIREMENTS

Passage of Proposition 13 has aroused concern that California may lose Federal grant funds due to the effect of State and local spending reductions on compliance with matching and maintenance of effort requirements. Most Federal grant programs require State and local governments to match Federal funds allocated with a specified nonfederal share as a condition for receiving Federal grants.

In addition, many Federal programs try to assure that Federal funds will be used to supplement existing State and local programs, and not be used as a substitute for existing State and local resources. To achieve this purpose, Federal programs can incorporate one or both of the following maintenance of effort requirements:

--Fixed level of effort - requires grantees to maintain at least some prior year level of spending for the program area. Unless waivers exist, fixed level provisions penalize grantees for expenditure reductions regardless of the circumstances.

--Nonsupplant - requires that grantees use Federal funds to supplement, not to supplant, nonfederal funds that would otherwise be made available for the funded program in the absence of Federal funds. Unlike fixed level requirements, nonsupplant provisions take into account the reasons for the grantee's reduction in effort and would not be enforced where the expenditure reduction was bona-fide and not contrived to take advantage of Federal funds.

It is too early to tell the impact of matching and maintenance of effort requirements on Federal funds to California as a result of Proposition 13, or on Federal funds to Colorado if a similar tax reduction initiative existed. It is conceivable that, even if large local budget reductions were required, localities might avoid cutting back federally aided programs in order to minimize loss of Federal aid, forcing disproportionate cuts in services not receiving Federal funds. An in-depth evaluation of the actual impact must await final local decisions on the size and shape of budget reductions following distribution of the State surplus.

Nevertheless, a comprehensive overview of existing Federal matching and maintenance of effort requirements and the degree of discretion Federal officials have to adjust these requirements reveals significant features of Federal grants that may have an impact on local governments experiencing budget reductions.

We attempted to provide this kind of information in the chart on the following pages. The chart lists all Federal grant programs available to State and local governments that (1) exceed $100 million in total fiscal year 1978 obligations and (2) have matching and/or maintenance of effort requirements. We have excluded Federal grant programs primarily available for schools of higher education, for research institutions, and for direct payments to individuals where State and local cost sharing is not federally required. For the 52 programs listed, California's State and local governments received $8.3 billion in fiscal year 1977, which represents approximately 85 percent of the total Federal grant funds received. Colorado's State and local governments received $725 million in fiscal year 1977, which represents approximately 69 percent of the total Federal grant funds received.

Matching and Maintenance of Effort Requirements
of Federal Programs with Total Outlays over $100 million

Program title	CFDA number	Minimum nonfederal matching requirement	Can nonfederal share be reduced?	Maintenance of effort requirement	Base for fixed level requirement	Can MOE requirement be waived?	Sanctions for not maintaining effort	Outlays to California FY 1977 (000)	Outlays to Colorado FY 1977 (000)
Payments to Agricultural Experiment Stations under HATCH ACT	10.203	50%	No	None	N/A	N/A	N/A	$ 2,789	$ 1,385
Cooperative Extensive Service	10.500	50%	No	None	N/A	N/A	N/A	6,261	1,909
School Breakfast Program	10.553	None	N/A	Fixed level for State Administrative Costs	FY 1977	No	Total reduction	21,150	640
National School Lunch Program	10.555	75% for regular program 0% for free lunches	Yes-if State per capita income less than National average	Fixed level for State Administrative Costs	FY 1977	No	Total reduction	133,985	14,700
Special Milk Program for Children (School Milk Program)	10.556	None	N/A	Fixed level for State Administrative Costs	FY 1977	No	Total reduction	10,597	1,512
Child Care Food Program	10.558	None	N/A	Fixed level Non-supplant	Initial year N/A	No No	Total reduction Return supplanted funds	7,439	1,330
Summer Food Service Program for Children (Summer Program)	10.559	None	N/A	Fixed level Non-supplant	Initial year N/A	No No	Total reduction Return supplanted funds	23,766	549

Program title	CFDA number	Minimum nonfederal matching requirement	Can nonfederal share be reduced?	Maintenance of effort requirement	Base for fixed level requirement	Can MOE requirement be waived?	Sanctions for not maintaining effort	Outlays to California FY 1977 (000)	Outlays to Colorado FY 1977 (000)
State Administrative Matching Grants for Food Stamp Program	10.561	50%	Yes-to 40% for favorable error rate	None	N/A	N/A	N/A	$ 29,875	$ 2,655
Watershed Protection and Flood Prevention (Small Watershed Program)	10.904	50% for most projects 0% for flood control	No	None	N/A	N/A	N/A	7,781	642
Economic Development-Grants and Loans for Public Works and Development Facilities	11.300	50%	Yes-for distressed areas and exhausted revenue sources	Non-supplant of other federal funds	N/A	No	Return supplanted funds	7,063	1,304
Public Works Employment Act of 1976 (Title I-Local Public Works)	Not assigned	0%	N/A	Non-supplant	N/A	No	Return supplanted funds	725,544	42,794
Family Planning Projects	13.217	10%	Yes-to 1%	None	N/A	N/A	N/A	7,957	1,129
Community Health Centers (Public Health Service Act, Sec. 330)	13.224	Negotiated	Determined on case-by-case basis	None	N/A	N/A	N/A	20,101	9,652
Maternal and Child Health Services	13.232	"A"-50%	No	Fixed level	FY 1968	No	Proportionate reduction	11,493	2,479
Drug Abuse Community Service Programs, Drug Staffing, Drug Abuse Services	13.235 Grants	Increasing--Poverty areas 10-40% Non-poverty 20-40%	Yes-fiscal hardship	Fixed level	Prior year	No	Proportionate reduction	7,129	1,182
	Contracts	Increasing--20-40%	Agency uncertain	Non-supplant	N/A	Agency uncertain	Unknown		

Program title	CFDA number	Minimum nonfederal matching requirement	Can nonfederal share be reduced?	Maintenance of effort requirement	Base for fixed level requirement	Can MOE requirement be waived?	Sanctions for not maintaining effort	Outlays to California FY 1977 (000)	Outlays to Colorado FY 1977 (000)
Community Mental Health Centers-Comprehensive Services Support	13.295	Increasing--poverty areas 10-70% Non-poverty 30-75%	No	Non-supplant	N/A	No	Return supplanted funds	$ 9,902	$ 3,593
Bilingual Education (Title VII)	13.403	None	N/A	Non-supplant	N/A	No	Return supplanted funds	30,279	2,191
Educationally Deprived Children--Handicapped (Title I)	13.427	None	N/A	Fixed level	Preceding year compared to second preceding yr. 5% reduction permitted	Yes-for very exceptional circumstances	No reduction	100	-
						Yes-for exceptional circumstances	Proportionate reduction		
						If no waiver granted	Total reduction		
				Non-supplant	N/A	No	Return supplanted funds		
				Comparability	N/A	No	Total reduction		
Educationally Deprived Children--Local Education Agencies (Title I)	13.428	None	N/A	Fixed level	Same as above for fixed level	Same as above for fixed level	Same as above for fixed level	139,880	14,881
				Non-supplant	N/A	No	Return supplanted funds		
Educationally Deprived Children--Migrant (Title I)	13.429	None	N/A	Fixed level	Same as above for fixed level	Same as above for fixed level	Same as above for fixed level	54,059	3,458
				Non-supplant	N/A	No	Return supplanted funds		
Handicapped Preschool and School Programs (Part B, Education of Handicapped Act)	13.449	None	N/A	Fixed level (local level)	Prior fiscal year	No	Agency uncertain	18,609	3,261
				Non-supplant (statewide)	N/A	Yes	Agency uncertain		
				Comparability	N/A	No	Agency uncertain		

Program title	CFDA number	Minimum nonfederal matching requirement	Can nonfederal share be reduced?	Maintenance of effort requirement	Base for fixed level requirement	Can MOE requirement be waived?	Sanctions for not maintaining effort	Outlays to California FY 1977 (000)	Outlays to Colorado FY 1977 (000)
School Assistance in Federally Affected Areas (Impact Aid)	13.478	None	N/A	Fixed level	Second preceeding yr.	Yes	Proportionate reduction	$ 98,546	$14,816
Vocational Education-Basic Grants to States	13.493	50% 40% in fiscal year 1979	No	Fixed level	Preceeding year compared to second preceeding yr. 5% reduction permitted	Yes-for very exceptional circumstances	No reduction	18,803	4,208
						Yes-for exceptional circumstances	Proportionate reduction		
						If no waiver granted	Total reduction		
				Non-supplant	N/A	No	Return supplanted funds		
Libraries and Learning Resources (Title IV)	13.570	None	N/A	Fixed level	Same as above for fixed level	Same as above for fixed level	Same as above for fixed level	14,410	1,811
Educational Innovation and Support (Title IV)	13.571	None	N/A	Fixed level	Same as above	Same as above	Same as above	16,034	2,018
Emergency School Aid Act-Basic Grants to Local Education Agencies	13.525	None	N/A	Fixed level	Second preceeding year	Same as above	Same as above	15,684	1,520
				Non-supplant (State assistance)	N/A	No	Return amount supplanted		
Child Development--Head Start	13.600	20%	Yes	Non-supplant	N/A	No	Agency uncertain	32,042	6,840
Rehabilitation Services and Facilities--Basic Support	13.624							55,996	8,388
Services		20%	No	Fixed level	FY 1972	No	Proportionate reduction		
Facilities		20%	No	Fixed level	Prior three years average	No	Proportionate reduction		

Program title	CFDA number	Minimum nonfederal matching requirement	Can nonfederal share be reduced?	Maintenance of effort requirement	Base for fixed level requirement	Can MOE requirement be waived?	Sanctions for not maintaining effort	Outlays to California FY 1977 (000)	Outlays to Colorado FY 1977 (000)
Special Programs for the Aging-State Agency Activities and Area Planning (Title III)	13.633	25%	Yes-to 10% where plans are approved	Fixed level	Prior year	No	Proportionate reduction	$ 11,978	$ 1,295
Special Programs for the Aging-Nutrition Program for the Elderly (Title VII)	13.635	10%	No	None	N/A	N/A	N/A	17,725	1,845
Child Support Enforcement (Title IV-D)	13.679	25%	No	None	N/A	N/A	N/A	63,990	2,573
Medical Assistance Program (Medicaid)	13.714	17-50%	No	None	N/A	N/A	N/A	1,217,425	70,629
Public Assistance-Maintenance Assistance (State Aid)	13.761	17-50% or fixed share of average State Welfare payment	No	None	N/A	N/A	N/A	1,005,944	45,896
Work Incentive Program--Child Care (Title IVA)	13.748	10%	No	None	N/A	N/A	N/A	13,560	1,433
Social Services for Low Income and Public Assistance Recipients (Title XX)	13.771	25%	Yes-to 10% for Family Planning, to 0% for some day care	Fixed level	Lower of FY 1973 or FY 1974	No	Either total reduction or 3% reduction	262,060	31,484
Community Development Block Grants-Entitlements	14.218	None	N/A	Fixed level	Prior year for "public services"	Yes-for noncontrollable reductions	Federal funds cannot be used for "public services"	294,779	24,939
				Non-supplant	N/A	No	Return supplanted funds		

Program title	CFDA number	Minimum nonfederal matching requirement	Can nonfederal share be reduced?	Maintenance of effort requirement	Base for fixed level requirement	Can MOE requirement be waived?	Sanctions for not maintaining effort	Outlays to California FY 1977 (000)	Outlays to Colorado FY 1977 (000)
Community Development Block Grants--Discretionary	14.219	None	N/A	Fixed level	Prior year for "public services"	Yes	Federal funds cannot be used for "public services"	$ 19,119	$ 6,617
				Non-supplant	N/A	No	Return supplanted funds		
Outdoor Recreation--Acquisition, Development, and Planning	15.400	50%	No	Non-supplant	N/A	No	Return supplanted funds	16,975	3,197
Law Enforcement Assistance--Improving and Strengthening Law Enforcement and Criminal Justice	16.502	10% (Construc-tic 50%)	No	Fixed level (converted from a non-supplant provision)	Prior year plus average annual increase over past 2-5 yrs.	Yes	Total reduction	34,951	1,917
Work Incentive Program (WIN)	17.226	10%	No	None	N/A	N/A	N/A	16,922	4,710
Comprehensive Employment and Training Programs (CETA)	17.232	None	N/A	Fixed level (Public Service jobs)	Current year employment level	No	Total reduction in affected job title	899,117	79,939
				Non-supplant (Public Service jobs)	N/A	Yes-for "bonafide" reductions	Return supplanted funds		
				Non-supplant (Training)	N/A	No	Return supplanted funds		
Indian and Native American Employment and Training Programs	17.234	None	N/A	Same as above for public service jobs	Same as above for public service jobs	Same as above for public service jobs	Same as above for public service jobs	6,093	3,305

Program title	CFDA number	Minimum nonfederal matching requirement	Can nonfederal share be reduced?	Maintenance of effort requirement	Base for fixed level requirement	Can MOE requirement be waived?	Sanctions for not maintaining effort	Outlays to California FY 1977 (000)	Outlays to Colorado FY 1977 (000)
Senior Community Service Employment Program (Older Americans Act, Title IX)	17.235	10%	Yes	Non-supplant	N/A	No	Return supplanted funds	$ 2,183	$ 239
Airport Development Aid Program	20.102	25%	Yes-to 10% for other than high activity airports	None	N/A	N/A	N/A	30,119	4,553
Highway Research, Planning and Construction (Federal Aid Highway Program)	20.205	8 programs ranging from 10% to 30% depending on type of construction	No	Fixed level	June 18, 1934	No	Total reduction	432,400	109,311
Urban Mass Transit Capital Improvement Grants	20.500	20%	No	None	N/A	N/A	N/A	183,220	23,709
Urban Mass Transit Capital and Operating Assistance Formula Grants	20.507	20%-Capital projects 50%-Operating Assistance	No	Fixed level	Average operating subsidy of prior 2 yrs.	No	Total reduction	306,572	1,786
State and Community Highway Safety	20.600	30%	Yes-to 6% for Indian Tribes Yes-to 5% if State has large amount of public lands	Fixed level	Average of FY 19... and FY 1965	No	51-100% reduction	12,816	3,732

Program Title	CFDA Number	Minimum Nonfederal Matching Requirement	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Community Action	49.[illegible]	40%—if Federal grants exceed $100,000 30%—if Federal grants are under $100,000	Yes—to [illegible] for Counties with heavy poor family concentration Yes—to 20% for "severe economic problems"	Fixed level [illegible]	[illegible] N/A	[illegible] No	[illegible] [illegible]	$ [illegible]	$ [illegible]
Construction Grants for Wastewater Treatment Works	66.418	25%	Yes—to 15% if innovative use of alternate technology	None	N/A	N/A	N/A	[illegible]	[illegible]
Supplemental Security Income	13.[illegible]	None	N/A	Fixed level	[illegible]	No	[illegible]	[illegible]	[illegible]
General Revenue Sharing	None	None	N/A	Fixed level	[illegible]	No	[illegible]	[illegible]	[illegible]

MATCHING REQUIREMENTS

Nonfederal match is required in 32 of these 52 programs. While local budget cuts could lead to loss of Federal grant funds due to inability to match, the impact of matching requirements on fiscally distressed local governments may be softened for several reasons:

--In-kind resources - Most Federal programs allow the use of both public and private existing in-kind resources as a source of match. Such noncash resources as publicly-owned land, time of private volunteers, and the government's own internal overhead costs can be used as in-kind match, alleviating the burden placed on cash appropriations. Nevertheless, of the 32 programs in our list, 9 require cash match.

--Federal funds as match - Both the Community Development Block Grant and General Revenue Sharing programs authorize use of their funds by local grantees as match for other Federal programs.

--Overmatch - In many cases, State and local governments often provide match far exceeding their required minimum share. For example, while California is only required to provide $67 million to match the Federal Social Services program (Title XX of the Social Security Act, Catalog No. 13.771), California is reporting $107 million as its match. Similarly, while the average required minimum match for California is 40 percent for Initial Operations grants under the Community Mental Health Services program (Catalog No. 13.295), California is providing 52 percent of the costs. If these reported figures are not subject to maintenance of effort provisions, local governments in an overmatch situation could reduce their budgets down to the minimum required match and still retain their entire Federal grant.

--Statewide provision of match - Of the 32 programs with match, 20 are grants to the States which are then passed through to local governments. In all but 2 of these programs, the Federal Government allows match to be met in the aggregate by the State. The State has the option of providing the entire match itself or of varying the match for local governments within the State based on financial condition, thus relieving each local government of providing the minimum required share. Even for direct Federal grants to local governments that bypass the State, e.g. Wastewater

Treatment Construction program (Catalog No. 66.418). States often provide all or part of the match for their local governments.

--Waivers - While our chart indicates that the nonfederal share can be reduced in 11 programs, Federal agencies have discretionary authority to waive all or part of the nonfederal share for fiscally distressed grantees for only 3 of the programs.

MAINTENANCE OF EFFORT

Maintenance of effort is required in 37 of the Federal grant programs listed in the chart. Of these, 16 include fixed level only, 7 nonsupplant only, and 14 require both. Just as with matching, there are mitigating factors which may help to ease the impact on local governments:

--Waivers - 15 of the programs give Federal agencies discretionary authority to waive all or part of the required effort to be maintained. The applicability of waivers to California's situation is unclear for some programs. For example, although the Community Development Block Grant legislation (Catalog No. 14.218) authorizes waivers where the reduction in local funding for public services was beyond the grantee's control, the Department of Housing and Urban Development's regulations currently apply the waiver only to reductions in State-funded services to a local grantee. Also, while the legislation authorizing the Community Action program allows the Community Services Administration to issue waivers in cases of "unnecessary hardship," the agency has not yet moved to adopt waivers as part of their administration of the program.

--Nonsupplant - Agencies make the final judgment as to whether a reduction in nonfederal effort would have "otherwise" occurred "in the absence of Federal funds." In the Comprehensive Employment and Training Act (CETA) program, for example, if the Department of Labor rules that local layoffs were "bona fide" in nature, it can authorize local use of part of CETA public service funds to rehire laid-off civil servants.

--Outdated base periods - When base year level of effort required is not updated, inflation lessens the impact of the requirement. As the chart indicates, several programs have base years going back as far as 1934 for highway spending, 1968 for maternal and infant child care, and 1972 for vocational rehabilitation

--Sanctions - Of the 15 programs with fixed level, 13 allow for only a proportionate reduction in Federal funds if the grantee fails to maintain its effort (usually one Federal dollar is reduced for every nonfederal dollar reduced).

--Statewide compliance - Of the 26 pass-through grants listed in our chart with fixed level of effort requirements, 10 account for maintenance of effort on a Statewide, aggregate basis. Thus, for these 10 programs, it would be possible to maintain required effort even in the face of limited local budget reductions if the State itself increased its effort or if other local governments within the State were increasing their spending by an offsetting amount.

Nevertheless, some Federal maintenance of effort requirements are sufficiently stringent to potentially impose hardship on local governments undergoing large budgetary cutbacks. As a result, local governments could face the unenviable choice of losing all Federal funds during a time when they can least afford further service cuts or maintaining required effort by disproportionately cutting in areas not subject to those Federal requirements.

There are many programs listed in the chart where even a small reduction in stipulated grantee effort triggers total withdrawal of the entire Federal grant. For example, under the Urban Mass Transit Operating Assistance program (Catalog No. 20.507), if the average operating subsidy from State and local sources falls below the prior two years' average, the entire Federal subsidy is cut off. Furthermore, the agency cannot waive this requirement under current law. Under the CETA program, a single layoff of one regular employee could require the layoff of CETA participants in that job title. Furthermore, if government-wide "bumping rights" exist, layoff of a regular employee in one job title could lead to layoffs of less senior staff in other titles, thereby threatening CETA participants in these titles as well.

CHAPTER 3

FEDERAL COMPENSATION AND FORMULA PROGRAMS

FEDERAL COMPENSATION PROGRAMS

Federal landholdings impact on potential State and local tax revenues because the Federal Government is immune from State and local taxation. To compensate State and local governments for revenue losses resulting from Federal lands within their boundaries, the Congress has authorized various payment programs. These programs are commonly referred to as "payments-in-lieu-of-taxes."

The compensation is usually

--a per acre payment, or

--a sharing between Federal and state/local governments of receipts generated by use of the property, or

--an amount equal to the taxes that would have been earned from the land had it remained in private ownership.

We identified 23 Federal compensation programs, of which Colorado received funds under 14. The table on the following page lists the 14 programs and the payments made to Colorado in 1977. The table includes only those funds received under the payments-in-lieu-of-taxes section, the per acre payments section, or the receipt sharing section of the laws. It does not necessarily represent total program funding. As shown on the table, only 1 program in Colorado, Impact Aid, may be affected if a tax initiative similar to Proposition 13 existed, but not until 1980. The Impact Aid Program is discussed later in this chapter.

Federal Compensation Programs in Colorado

	1977 payments
1. Flood Control Act	$ 15,100
2. Bankhead-Jones Farm Tenant Act	105,000
3. Designated Watersheds	unknown
4. School Assistance to Federally Affected Areas (Impact Aid)	14,816,000
5. Federal Water Power Act	500
6. Mineral Leasing Act	
7. Mineral Leasing on State Selected Indemnity Lands	10,622,400
8. Mineral Leasing Act for Acquired Lands	
9. National Wildlife Refuge System Revenues	79,000
10. National Forest Revenues Act	263,900
11. Payment in Lieu of Taxes Act	7,483,600
12. Disposal of Materials on Public Lands	2,200
13. Sale of Public Domain Land	
14. Taylor Grazing Act	9,200

FEDERAL FORMULA PROGRAMS

There are 93 Federal programs which distribute money to State and local governments by formula. Of the different formulas used under the programs, 32 have grantee expenditures or tax effort as a factor, i.e., a higher level of expenditure or taxation results in higher Federal assistance. The table on the following pages lists these 31 programs.

Whether these formula programs will be impacted by Proposition 13 is difficult to assess. In some programs, for instance, State expenditures determine the amount of Federal funds received; while in others, local as well as, State expenditures control the amount of Federal aid. In still others, the amount of Federal assistance is directly related to taxing effort.

State spending is a factor in several formula grant programs. For example, the Gas Pipeline Safety program authorizes funds to develop and maintain State gas pipeline safety programs, and the amount of funds received is determined by actual State expenditures. The Cooperation in Forest Management and Processing grant program reimburses States at 50 percent of their expenditures.

These and other programs are awarded to the State and may not be affected if the State continues its prior expenditure levels. If the State, however, chooses to change the nature of its expenditures because of Proposition 13's effect on local governments, then Federal assistance to the State under these types of formula grant programs may be impacted.

State and local spending is a factor in other formula grant programs. The formula for the Educationally Deprived Children-Local Education Agencies program, for example, limits the local school district's entitlement to the number of eligible children multiplied by the State and local average per pupil expenditure. Many other education grant programs also use a per pupil expenditure factor in the formula. The Educationally Deprived Children-Special Incentive Grants program uses total State spending in excess of the National effort as a factor in determining Federal assistance.

Other programs may be affected because the formulas are based on taxing effort or on local revenues raised. The General Revenue Sharing program falls into the prior category because tax effort is a key factor in determining the amount of Federal funds received. However, because the data base lags by two years, any impact on California's funding will not be felt until 1980-81. Also, since the program is

Federal Formula Grant Programs With Grantee Expenditures as a Factor

CFDA Program No.	Program title	National totals FY 1977 funding	Outlays to California FY 1977	Outlays to Colorado FY 1977
		(000 omitted)		
10.202	Cooperative Forestry Research	$ 8,212	$ 279	$ 151
10.551	Food Stamps	5,400,294	375,584	51,305
10.553	School Breakfast Program	141,577	21,150	640
10.554	Nonfood Assistance for School Food Service Programs	26,728	3,149	253
10.555	National School Lunch Program	1,029,518	133,965	14,700
10.556	Special Milk Program for Children	150,411	10,597	1,512
10.558	Child Care Food Program	111,323	7,459	1,320
10.559	Summer Food Service Program for Children	132,893	23,766	549
10.560	State Administrative Expenses for Child Nutrition	13,633	1,162	160
10.656	Cooperative Forest Fire Control	18,494	1,173	350
10.657	Cooperation in Forest Management and Processing	6,037	126	74
13.269	Drug Abuse Prevention Formula Grants	40,000	3,904	437
13.428	Educationally Deprived Children - Local Education Agencies	1,700,489	139,880	14,891
13.429	Educationally Deprived Children - Migrants	184,338	54,859	3,458
13.431	Educationally Deprived Children in State Administered Institutions	29,398	1,729	25
13.478	School Assistance in Federally Affected Areas - Maintenance and Operation	745,698	98,546	14,816
13.512	Educationally Deprived Children - Special Incentive	29,146	-	148
13.534	Indian Education - Grants to Local Educational Agencies	33,474	4,377	146
13.714	Medical Assistance Program	9,942,541	1,217,425	70,629
13.771	Social Services for Low Income and Public Assistance	2,455,661	262,060	31,484
13.772	Public Assistance Training Grants - Title XX	46,323	1,197	589
13.748	Work Incentive Program - Child Care Employment Related Support Service	107,196	13,966	1,423
13.679	Child Support Enforcement	232,482	63,998	2,573
13.761	Public Assistance - Maintenance Assistance (State Aid)	6,490,227	1,005,944	45,496
13.724	Public Assistance - State and Local Training	28,672	3,866	131
20.004	Boating Safety - Financial Assistance	5,790	284	62
20.700	Gas Pipeline Safety	2,254	92	35
64.014	Veterans State Domiciliary Care	10,292	1,107	158
64.015	Veterans State Nursing Home Care	17,655	1,382	484
64.016	Veterans State Hospital Care	4,352	1,686	-
No CFDA Number	Anti-Recession Fiscal Assistance	1,698,711	254,999	9,474
No CFDA Number	Fiscal Assistance to State and Local Governments	6,757,693	709,018	73,394

scheduled for reauthorization action in 1980, any change in the formula could negate possible funding losses.

The Antirecession Fiscal Assistance program, which expires in September 1978, may also be affected because the distribution formula is based in part on the amount of Federal revenue sharing funds the State receives. Any decrease in revenue sharing funds will cause a reduction in antirecession funds if the program is continued without changes. On the other hand, an increase in California or Colorado's unemployment rate--which is also considered in the formula--will cause an increase in antirecession funds received.

The amount of Federal funds received under the School Assistance in Federally Affected Areas - Maintenance and Operation (Impact Aid) Program, depends on revenues derived from local sources. Therefore, the State surplus evidently could not be used by local school districts to offset local revenue losses. According to a Federal program official, however, whether California will experience a reduction in Federal funding will not be known until 1980 because the data base used to determine revenue-raising efforts lags by 2 years.

CHAPTER 4

EFFECT ON FEDERAL REVENUES

Federal income tax law permits amounts paid as property taxes to be deducted from income in computing taxable income. Business enterprises may treat property tax payments as business expenses in calculating profits or losses. Owners of owner-occupied housing may include property tax payments among their itemized deductions. Accordingly, a reduction in property tax burdens on businesses and individuals will be offset to a limited extent by an increase in Federal income tax payments from the same taxpayers, stemming from the decrease in their allowable deductions. This increase in Federal tax collections is called here the "direct Federal revenue effect" of the property tax reduction.

DIRECT FEDERAL REVENUE EFFECT

We have not attempted to make an independent estimate of the direct Federal revenue effect of Proposition 13. Instead we have prepared an explanation of the estimates that others have made, which we present in this section. The two estimates that we explain are those of the Congressional Budget Office and the Department of the Treasury.

All estimates of the direct Federal revenue effect of Proposition 13 begin with figures that were published in May 1978 by the Office of the Legislative Analyst of the State of California. In its study of the effects of Proposition 13, the office estimated that if the amendment were approved, property tax collections would fall by approximately 57 percent in California in fiscal year 1979. In their analysis, the authors set forth the sums that various classes of California taxpayers would have paid as property taxes in 1979 if the amendment had failed and the sums they estimate the same taxpayers will pay following its approval.

COMPUTING DIRECT REVENUE EFFECT OF PROPERTY TAX CUTS--GENERAL REMARKS

All methods of calculating the increase in Federal income tax collections from a fall in property tax collections are basically alike. The fall in property tax collections is equated to a decrease in income tax deductions. In the case of individuals, the decrease in income tax deductions is equated to an increase in taxable income. For each individual, the product of the increase in his taxable income and

and his Federal marginal income tax rate is the increase in the individual's Federal income tax liability.

The only modification that has to be made stems from the use by some individuals of the standard deduction in lieu of itemized deductions. Then a decrease in a taxpayer's property tax payments has no effect on the deductions he claims on his Federal income tax return and therefore no effect on his Federal tax liability.

Essentially the same method is followed to calculate the increase in Federal tax collections from business enterprises. In the case of businesses, however, a decrease in property tax payments may not lead to a permanent increase in business profits. It will probably lead to a <u>temporary</u> increase in profits; but if the decrease in property tax payments is general among all businesses in an area, it is to be expected that at least a part of the increase in profits will be competed away, i.e., passed on or "shifted" to customers in the form of lower prices. To the extent that shifting takes place, the decrease in property tax collections will not be matched by an increase in business profits and will not lead to as large an increase in Federal income tax collections as it would if no shifting occurred.

It is important to understand that all of the estimates of the direct Federal revenue effect that have appeared are based on the unstated but implicit assumption that no other deductible State or local taxes will be increased to make up the decline in local property taxes. To the extent that California state income tax rates, for example, are raised to offset the fall in property tax collections, the effect of Proposition 13 on Federal income tax collections will be lessened.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

The only published estimates of the direct Federal revenue effects that contain an explanation of how they were derived are ones that were compiled by the Congressional Budget Office (CBO). They appear in the CBO publication "Proposition 13: Its Impact on the Nation's Economy, Federal Revenues, and Federal Expenditures."

The CBO estimated that Proposition 13 would have the direct effect of adding $1,028 million to Federal income tax collections in Federal fiscal year 1979 and $1,311 million in Federal fiscal year 1980. These figures are the sums of estimates prepared separately for four classes of property: (1) owner-occupied residential housing; (2) renter-occupied housing; (3) commercial and industrial property; and (4) agricultural property. Accordingly, the total estimates are no more reliable than the estimates prepared for each individual class of property. A few remarks follow explaining the assumptions on which these estimates are based.

Property tax savings

The CBO used the estimates of property tax savings by class of property that were published in May 1978 by the Legislative Analyst of the State of California. The Legislative Analyst grouped commercial, industrial, and agricultural property into one class and published a single estimate of the tax savings accruing to all property in the class. The CBO divided the savings between commercial and industrial property, on the one hand, and agricultural property, on the other, giving two-thirds of the total savings to the former and one-third to the latter.

Marginal tax rates

No information is available concerning the marginal tax rates of various classes of California taxpayers who currently claim property tax deductions. CBO analysts were therefore forced to make educated guesses, based wherever possible on whatever published information about the characteristics of taxpayers was available. The marginal tax rates that the CBO assumed for each class of property owner are disclosed in the CBO document. A 20 percent tax rate for the owners of owner-occupied housing was obtained by assuming that half of them claim the standard deduction and therefore will pay no additional Federal income tax as a result of Proposition 13 (as if their marginal rate of income tax were zero) and the other half are subject to an average marginal rate of tax of 40 percent. The owners of commercial property were assumed to have a marginal income tax rate of 35 percent and the owners of industrial property a rate of 40 percent. The CBO assumed that the weighted average marginal income tax rate for the two was about 37 percent.

Shifting

The CBO assumed that certain portions of the property tax savings to commercial property owners would be shifted to tenants and customers. For example, it was assumed that in the first year following the property tax reduction 20 percent of the tax savings to commercial and industrial enterprises would be passed on to the customers of the businesses. In the second year and all years thereafter, 45 percent of the savings were assumed to be shifted.

The shifting values that the CBO analysts assumed are not implausible, but nevertheless are almost wholly arbitrary, as the authors of the analysis frankly concede. It is reasonable to suppose that some portion of the property tax savings will be shifted to consumers, but nearly impossible to say whether the fraction will be nearer 20 percent, 50 percent, or 80 percent. The final estimates of revenue gain are highly sensitive to the values assumed.

Timing

Because of the dates on which property tax payments are due in California from individuals and businesses, it was assumed by the CBO that only one-half of the Federal income tax increase from owners of owner-occupied housing would be paid in Federal fiscal year 1979, whereas 75 percent of the increase from owners of other classes of property would be paid in Federal fiscal year 1979.

DEPARTMENT OF THE TREASURY ESTIMATE

The estimate by the Treasury Department of the direct Federal revenue effect of Proposition 13 is rather higher than that of the CBO. The department estimated that Federal income tax revenues might increase by as much as $1.7 billion during the first year following passage of Proposition 13. The chief reasons for the higher Treasury department estimate appear to be the following.

--Marginal tax rates. The Treasury department evidently assumed slightly higher marginal tax rates than did the CBO.

--Shifting. The Treasury Department refrained from assuming that any part of the property tax savings attributable to Proposition 13 would be shifted forward to customers.

--Interrelationships with State income tax. The Treasury Department attempted to estimate the offsetting effect on Federal income tax revenues of larger California state income tax payments by taxpayers. The CBO did not. (Smaller property tax payments by California taxpayers normally lead to larger California state income tax payments by the same taxpayers, since property tax payments are a deduction from income for California state income tax purposes just as they are for Federal income tax purposes. Since a Federal deduction is allowed for state income tax payments exactly as one is allowed for local property tax payments, a part of the decrease in the property tax deduction is offset by an increase in the State income tax deduction.)

The first two differences between the CBO and Treasury Department methods tend to make the Treasury Department's estimate larger. The third tends to make it smaller.

The estimate prepared by the Treasury Department has nowhere been set forth in print. The explanation that follows is based on discussions with the analysts in the Department who prepared the figures.

Although the Treasury Department estimate, like those of the CBO, begins with the estimated property tax reduction figures of the California Legislative Analyst, it makes no use of the breakdown of property tax reductions by class of property owner. Instead Department analysts assumed that approximately one-half of property tax reductions would accrue to corporations in their capacity as owners of commercial property and the other half to individuals as owners of either commercial property or owner-occupied housing. On the basis of tax statistics compiled before for other purposes, the Department estimated that the average marginal tax rate among affected corporations would be about 35 percent and the average marginal tax rate among individuals approximately 24 percent. Neither figure can be compared with the marginal tax rates assumed by the CBO, since the CBO's rates were classified by the characteristics of the property owner. The Treasury Department assumed that the average marginal California income tax rates among these corporations and individuals were 9 percent and 8.5 percent respectively.

INDIRECT FEDERAL REVENUE EFFECTS

The CBO estimates of the Federal revenue effects of Proposition 13 also include an allowance for the so-called "indirect effects" of the amendment. The estimate of the Treasury Department does not. As the CBO document explains, Proposition 13 is expected to lead to a reduction in both State and local tax and other revenue collections and State and local public spending. But the reduction in revenue collections is expected to be greater than the reduction in spending, in part because the State of California is currently collecting more revenue than it requires for State needs and will use some of its surplus to assist localities. Normally the combination of a large decrease in taxes and a smaller decrease in public spending is expansionary and could be expected to generate a modest offsetting increase in income tax collections. The CBO states, however, that the tax cuts following from Proposition 13 will be concentrated among commercial enterprises, a claim supported by the Legislative Analyst of the State of California, and therefore in the short run will have little stimulative effect on either consumption or investment. According to CBO, the expansionary effect of the tax cut will be more than offset by the deflationary effect of the smaller cut in public spending, and the net result will be an additional fall in Federal income tax collections.

The property tax cuts will also have a minor effect in slowing the rise of the Consumer Price Index by lowering homeowners' costs slightly and reducing the prices of goods and services produced by firms that shift part of their tax savings to consumers. The CBO expects this effect to be deflationary too, without explaining why.

The CBO estimates that these indirect effects on Federal revenues will amount to an annual decline of about $400 million in Federal income tax collections in fiscal year 1979 and in fiscal year 1980. After the indirect effects are added to the direct effects, CBO estimates the net increase in Federal revenues attributable to Proposition 13 at about $600 million in fiscal year 1979 and $900 million in fiscal year 1980.

CONCLUSION

The CBO and Treasury Department estimates of the direct Federal revenue effect of Proposition 13 are similar enough to suggest that the actual increment to Federal revenues will not exceed about $1.5 billion in the first year following passage of the amendment. It may even be appreciably smaller if the indirect Federal revenue effects that the CBO attributes to the amendment materialize. Better estimates of the total Federal revenue effect would certainly be welcome, but in the current state of knowledge would be very difficult to prepare. The estimates are especially sensitive to the assumptions that are made concerning the shifting of the property tax savings, assumptions that at present we have no way of testing.

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