

## **SHELL GAMES WITH TAX DOLLARS**

The recent controversy regarding Orange County's attempt to protect its revenues from a midnight raid by the state legislature is an instructive and cautionary tale about the dysfunction in Sacramento and threat to local control and fiscal stability.

Our story begins back with the Orange County bankruptcy of 1994. By 1996, the county had devised a financing strategy to pay back its investment pool participants that involved the issuance of bonds. Since the county was no longer considered a strong credit, it was required to specifically pledge a portion of its Vehicle License Fees (VLF) as a designated security source for the bonds. \$54 million in annual VLF revenues was used for the bonds.

In 2004, the state, in a desperate effort to appear to balance its own budget, enacted a funding swap that took VLF revenues from counties and exchanged them with property tax revenues that would have otherwise gone to schools. Under the requirements of Proposition 98, the state was required to backfill the funds lost to school districts so they did not suffer due to the fund swap. However, because Orange County's funds were uniquely pledged to service the bankruptcy debt, the state was required to "carve-out" \$54 million and not swap it with property tax. Using debt encumbrances to protect local revenues is a time-honored strategy, as we saw with the rush to the market with many redevelopment financings last year.

By 2005, the county's credit was much improved, the bankruptcy debt was refinanced at a substantial savings and the VLF pledge was removed. Since property taxes were rising and VLF was declining, the state did nothing to try to impose the VLF/property tax shift on the excluded funds, now down to about \$48 million annually. In fact, compared to other counties, Orange County forfeited approximately \$25 million per year as what had been a protection for the county, turned into a windfall for the state.

But as we see, things can change. Flash forward to this past summer, as the legislature once again fails to enact an honest budget. In what can only be characterized as an attempt to specifically penalize Orange County by reallocating funds from the county to the state, language is amended into a bill to take the un-swapped \$48 million from Orange County on June 27, passed on June 28 and on June 30 it is signed by the Governor.

The architects of this taking likely thought all they were doing was redirecting \$48 million of county funds to the state. A bi-partisan effort to address the impacts of the VLF taking was introduced and passed in the Assembly 60-3; however the state Senate, where the taking idea originated, failed to consider the bill.

In their haste however, they failed to realize that now the county was eligible to redirect property tax going to school districts and the state was obligated to backfill this amount. Furthermore, because property taxes had grown while the VLF was declining, the county was eligible under the formula used for every other county to receive not \$48 million but \$73.5 million.

Accordingly, the county, under guidance from its attorneys, did what any responsible public agency would do and implemented the law as it applied to all other counties and withheld property tax that would otherwise have gone to schools, triggering the state's legal responsibility to backfill the loss.

The state, as only the legislature can do, actually made its own budget situation worse by its attempt to raid Orange County.

What are the lessons of this slow moving train wreck of a budget process? First and foremost, the state needs to get out of the funding loop with local government. The People, in numerous constitutional amendments and ballot measures have tried to protect local property, sales and gas tax revenues. Even with the passage of Proposition 22 last year, the legislature was not dissuaded from redirecting redevelopment funds. The state needs to live within the means of its own revenues.

We are currently seeing a shift of correctional responsibility to counties under the guise of "realignment". Watch as the money soon dries up and counties are left with a growing prisoner population and no resources to pay for them. Several so called "reform" plans are being floated, but at their core, they involve shifting state responsibilities to local government and local funding to the state or school districts. I predict a massive shell game in the next budget cycle.

Secondly, we must have legislative reform to bring accountability, transparency and procedural fairness to the legislature. We must end the midnight "gut and amend" budget raids. There is a reason the legislature polls with a single digit approval rating and it's because of the pervasive special interest dominance of both chambers. In an effort to protect their campaign contributors, they have utterly failed to control state spending. I have a hard time seeing the Governor being successful in persuading Californians they need to pay more taxes without first reforming the mess in the legislature.

*The opinions expressed herein are those of the author and do not necessarily reflect those of Concordia University, its Board of Regents or the Directors of the Center for Public Policy. Keith Curry can be reached at keith.curry@cui.edu.*