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General Interest

Coping with State Tax and Expenditure Limitation: The Oregon Experience

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Since the passage of California's Proposition 13 in 1978, tax and expenditure limitation measures (TELs) have been widely used for altering the revenue systems of state and local governments (Joyce and Mullins 1991). Oregon's Ballot Measure 5, a TEL passed in 1990, provides an opportunity to (1) identify some of the effects of a TEL on local governments and (2) examine how local officials try to cope with such measures.

Oregon's public sector has considerable experience with tax and expenditure limitations. A cap on the annual percentage increase in the yield of the property tax for local governments has existed for many years, and state law limits increases in the state government's general revenues and expenditures. A growing displeasure with the property tax culminated in November 1990 with the passage of Ballot Measure 5, an initiative limiting property taxes.

Ballot Measure 5 set a 1½ percent property tax rate ceiling. The measure immediately imposed a 1 percent cumulative rate limit on Oregon cities, counties, and special districts (except school districts) and a five-year, phased reduction in the rate limit for school districts down to ½ percent. Hence, after five years, the cumulative tax rate for all local governments ratcheted down to 1½ percent.[1] In the two years following Ballot Measure 5, state per capita property tax revenues fell almost 5 percent, and property taxes lost to cities, counties, and school districts totaled over $600 million, with school districts suffering the biggest losses (Oregon Department of Revenue 1994, 1).

Surveys of Oregon Managers

In the first stage of this study, we reported how managers in Oregon's cities and counties viewed their jurisdictions' situation shortly after Ballot Measure 5's passage (O'Toole and Stipak 1994). Many managers expected to face an increasingly bleak fiscal and political situation, including lower general fund revenues, decreased intergovernmental aid, and increased state mandates and control. They also anticipated increased use of various strategies and management tools to cope with deteriorating revenues.

This article focuses on the second stage of this study, which examines how managers in Oregon's cities and counties dealt with Ballot Measure 5 during the three years after its passage. As in the first-stage study, a mail questionnaire was sent to all 274 Oregon cities and counties in the second stage. The

total response rate was 81 percent, and respondents included city and county managers (37 percent), recorders (29 percent), finance and budget directors (17 percent), and other officials (17 percent).

The Oregon Local TEL's Effects

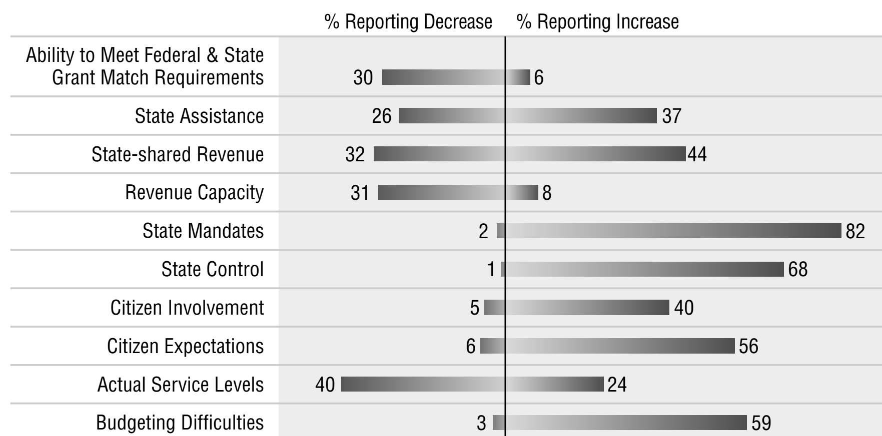
Based on the reports from local managers, this study examines the key effects of the TEL on Oregon cities and counties during its first three years and what managers did to cope with these effects. The following three areas are analyzed: local revenues, the state response, and the local policy process.

Local Revenues

The results show that the TEL fiscally impacted many Oregon cities and counties. Approximately half of the managers indicated that during the past three years, the TEL reduced their jurisdictions' revenues, consistent with the overall statewide loss in property taxes of $18 million to cities and $10 million to counties (Oregon Department of Revenue 1994). The reductions so far appear to be considerably less than managers predicted in the stage-one study (O'Toole and Stipak 1994), reflecting changes in assessed property values during this period. Large increases in property values occurred in many areas of Oregon,[2] thus attenuating the fiscally constrictive effect of the ratcheting down of the maximum tax rate. The fiscal effect of the ballot measure, however, may continue to increase in the future as more jurisdictions reach the 1 percent limit.

Reductions in local governments' general fund revenues were the most common fiscal impact of the TEL. One-third of all managers indicated that the TEL also reduced non-general fund revenues. For example, following Ballot Measure 5, the legislature restructured the timber severance tax, substantially reducing revenue for some local governments. Fiscally, the TEL extended beyond reduced own-source revenues for some Oregon cities and counties and affected the ability of local governments to attract intergovernmental aid. As Figure 1 shows, 30 percent of the managers reported a decreased ability to meet match requirements on federal and state grants.

Figure 1: Tax Limitation Effects on Local Governments



Note: For each impact criterion, the numbers indicate the percent of the managers who reported a decrease and the percent reporting an increase over the past three years. These percentages sum to less than 100 because some managers reported no change.

The State Response

The state's response to the passage of a local TEL could either exacerbate or mitigate its impact. Previous research suggests that increased state financial aid usually follows a local TEL (Mullins and Joyce 1996; McCaffery and Bowman 1978), thereby decreasing local fiscal independence (Lovell 1981, 189) and control (Eribes and Hall 1981, 108). Oregon managers predicted that after Ballot Measure 5's passage, the state would exacerbate local governments' problem by *decreasing* state financial assistance and increasing state mandates and control (O'Toole and Stipak 1994, 113).

Three years later, Oregon local managers report that the state did not greatly change the overall level of financial assistance (Figure 1), a picture consistent with the 5 percent and 8 percent nominal increases (from 1991–93 to 1993–95) in state assistance and shared revenues, respectively, to cities and counties.[3] Despite these modest nominal increases, 31 percent of the managers perceived a trend of reduced overall fiscal capacity of cities and counties.

One factor contributing to managers' negative assessments of fiscal capacity might include the widespread view of the increasing burden of state mandates. Specific examples of new mandates in the aftermath of Ballot Measure 5 include fiscally burdensome legislation that requires local governments to provide funding for retirement benefit increases, for 911 dispatcher training, and for employment mediation services. Other examples of new mandates enacted during 1991–94 that increase state control include a requirement that cities and counties allow siting of manufactured homes on single family-zoned properties, legislation preempting local government regulation regarding discrimination, and increased regulations on the treatment of local government employees hired from other public agencies. This increase in state control occurred without a significant increase in state financial assistance—the factor other researchers consider to be the major impetus for more state control (Eribes and Hall 1981, 108). Frustration with the increased mandate burden led to passage of a state referendum (Ballot Measure 30) in 1996 that now requires the state to pay local governments for costs of new state-mandated programs.

The Local Policy Process

Reduced local discretion is only one of the developments local managers reported as having adversely affected the policy process since the TEL's passage. Many managers reported increases in citizen involvement and expectations for service levels (Figure 1), a result counter to previous research suggesting that fiscal stress may reduce citizens' expectations (Glassberg 1981; May and Meltsner 1981). However, managers were more likely to report decreases in actual service levels since passage of the TEL.

Coping with Fiscal Stress

A more difficult local government budgeting process has certainly resulted from the TEL's effects on revenues, state control, and the local policy process. The first manager survey predicted this development (O'Toole and Stipak 1994, 114), and the second survey supports it. How, then, have Oregon managers dealt with the increased fiscal stress arising from the TEL's passage?

Fiscal Stress Strategies

The manager surveys asked about the use of four main strategies for coping with fiscal stress identified in the literature (Murray and Jick 1981; Straussman 1981; Lewis and Logalbo 1980).

1. Reducing services
2. Increasing revenues
3. Improving productivity
4. Shifting service responsibility to other organizations

Table 1 compares the use of the four fiscal stress strategies by cities and counties im-

pacted by the Oregon local TEL with those not impacted during 1991–94. The modest overall use of these strategies (1.3–2.7 on the 5-point rating scale) supports the view that maintaining the status quo is the typical response to fiscal stress (Schwadron and Richter 1984, 40; Levine and Rubin 1980).

However, a closer look reveals a more interesting picture. Table 1 shows that in jurisdictions impacted by the TEL, managers report considerably greater use of these strategies than in nonimpacted jurisdictions. Not only did they make statistically significantly greater use of all four strategies ($p < .02$ for each of the four strategies), but also 71 percent of the managers in impacted jurisdictions (compared to only 53 percent in the nonimpacted jurisdictions) used at least one of these strategies a fair amount or more ($p = .004$). Looking specifically at the multiple use of these strategies, 23 percent of the impacted jurisdictions used three or more of these strategies ($p < .001$) compared to only 3 percent of the nonimpacted jurisdictions. Finally, in impacted jurisdictions, the mean number of strategies used is 1.45, compared to .72 for nonimpacted jurisdictions ($p < .001$). These comparisons indicate that TEL-induced fiscal stress can encourage managers to depart from the status quo by reducing or shifting services, increasing revenues, and improving productivity.

Table 1 also suggests that fiscal stress may stimulate some strategies more than others. Productivity improvements, such as increased automation and interagency cooperation, and service reductions (especially personnel cutbacks and elimination of nonessential services) were the most common strategic responses. Efforts to increase revenues, usually through fee increases, were also common. "Shifting of services" was rarely used.

The emphasis on productivity improvement belies the relatively low importance that Oregon managers placed on that strategy immediately following the TEL's passage as a way of dealing with the TEL's impact (O'Toole and Stipak 1994, 115). That Oregon managers from impacted jurisdictions reported greater use of this strategy during the post-TEL period suggests the potential importance of productivity improvement as a response to fiscal stress. As one unnamed local official stated in an interview, "Ballot Measure 5 changed the psyche. It was a shock to many people, so they felt they needed to try to be more efficient."

Although others have suggested that increasing productivity may have limited application in a fiscally stressed environment (e.g., Ammons and King 1983, 119), the post-TEL Oregon findings fit better with Poister and Streib's finding that municipal managers place a high priority on improving productivity (1989b, 10). However, without the stimulus of fiscal stress, managers' push for productivity improvements may diminish. One Oregon manager put it rather bluntly:

> When the fiscal situation looked bad, we were looking at any possible improvements in efficiency. We had boxes full of innovative ideas. I went back to look at them after the revenue situation had improved [for that city], and there wasn't interest in them any longer.

Table 1: Managers' Responses to Tax Limitation in Impacted and Nonimpacted Jurisdictions

	Mean Score		
Response Strategy	**Impacted (*N*=92)**	**Nonimpacted (*N*=128)**	***p*-value**
Improve productivity	2.74	2.13	<.001
Increase revenues	2.37	2.03	.006
Reduce services	2.17	1.3	<.001
Shift services	1.55	1.33	.019
Total strategies used	**1.45**	**.72**	**<.001**
Percent using at least one strategy a fair amount	71	53	.004
Percent using three or more strategies	23	3	<.001

Notes: Numbers in the first four rows are the mean responses to items on the 1–5 scale. Higher numbers indicate greater use of that response strategy. Impacted jurisdictions are those whose managers reported that Ballot Measure 5 reduced revenues for each of the three years. *p*-value is the one-tailed probability value for test of difference in means or percents. *N*s for each cell vary slightly due to missing data.

Implementing Tactics

What tactics did local managers emphasize in order to implement strategies for dealing with fiscal stress? For improving productivity, popular tactics included coordinating with other agencies; for example, one county started selling jail beds to the federal marshal to generate revenue. Another popular tactic was improving employee performance: one city replaced electrical and plumbing inspectors with "combination" inspectors. Receiving some attention were automating services, modifying staffing patterns, and shifting workloads to service users. Examples of modifying staffing patterns included eliminating some middle management positions and reducing the size of water service crews.

The tactics most frequently used for increasing revenues were increasing the level of current fees, improving revenue collection, and implementing new fees. This emphasis on fees for raising revenue is consistent with other research on responses to TELs (Mullins and Joyce 1996). Eliminating nonessential services and reducing personnel were the most popular tactics for reducing or eliminating services. In a somewhat different example, the employee union for one county agreed to voluntarily accept a wage freeze. "Contracting for services" received only modest use, and relatively few cities and counties consolidated organizational units.

Managing with Less

Those Oregon cities and counties facing service reductions following the TEL's passage had to cope with a cutback setting. The second-stage survey focused on which approaches the managers preferred and the management tools they adopted in responding to a cutback environment.

Preferred Cutback Approaches

The most obvious cutback approach—cutting services across the board—has had both advocates (Biller 1980, 607) and detractors (McGowan and Stevens 1983, 134). Other possible approaches include cutting expenses temporarily in the hope that conditions will improve, making targeted cuts, and basing cuts on public opinion.

In the Oregon survey, managers expressed least support for across-the-board cuts, favoring instead rational, goal-oriented cutback approaches.[4] Developing goals as the basis for cuts was the most preferred approach, followed by cutting nonbasic services. Less popular were cutting expenditures until conditions improve and making cuts based on public opinion.

Management Tools Emphasized

The literature on fiscal stress contains examples of organizations that have responded to this condition by adopting strategic planning and total quality management (Suttenfield and Wharton 1993, 62). The second-stage survey of Oregon managers provides an opportunity to explore whether a cutback setting can stimulate such changes in the use of management tools.

Table 2 compares the use of various management tools—including sophisticated budgeting practices, output measures, and strategic planning—by impacted and nonimpacted jurisdictions. In the three years following the passage of Oregon's TEL, the use of a number of management tools increased. For all of these tools, the level of increased use in impacted jurisdictions was statistically and significantly greater than in nonimpacted jurisdictions ($p < .05$ for all 11 tools). In Oregon, TEL-induced fiscal stress has apparently stimulated the use of management tools.

These results support the view that retrenchment fosters budget reform (MacManus 1984). Impacted jurisdictions made significantly greater use of each of the three sophisticated budget formats ($p < .05$). About one-third (32 percent) increased their use of program budgeting; one-quarter made greater use of performance budgeting; and 14 percent gave zero-based budgeting a larger role.

Table 2: Increased Use of Management Tools in Impacted and Nonimpacted Jurisdictions

	Percent of Increased Use		
Management Tool	**Impacted *N*=92**	**Nonimpacted *N*=128**	***p*-value**
Strategic planning	53	38	.019
Performance budgeting	25	14	.014
Program budgeting	32	21	.049
Zero-based budgeting	14	5	.021
Workload measures	47	22	<.001
Effectiveness measures	42	22	.002
Efficiency measures	52	30	.001
Revenue/Expenditure forecasting	59	40	.003
Revenue/Expenditure monitoring	63	44	.005
Position control	31	9	<.001
Performance auditing	22	6	.001

Notes: Impacted jurisdictions are those whose managers reported that Ballot Measure 5 reduced revenues for each of the three years. *p*-value is the one-tailed probability value for test of difference in percents. *N*s for each cell vary slightly due to missing data.

The increased use of these budget formats represents a shift toward greater reliance on output-oriented formats, which other studies have identified as a trend among U.S. local governments (O'Toole and Stipak 1988; Poister and McGowan 1984).

When asked which management tools received the most additional use, managers cited those pertaining to managing revenues and expenditures.[5] Approximately 60 percent of the managers reported greater use of revenue and expenditure forecasting and monitoring, which a 1993 nationwide study of municipal managers found were among the most commonly used tools by municipal governments (Poister and Streib 1994, 118). This emphasis on forecasting revenues and expenditures is consistent with research indicating that a major cause of fiscal strain is overestimation of income (Martin 1982).

Managers also reported greater use of planning and evaluation. About half of the managers from impacted jurisdictions (42–53 percent) reported increased use of effectiveness measures, workload measures, efficiency measures, and strategic planning.[6] The increased use of measurement tools, despite the strain of fiscal stress on staff resources, was identified in a survey of Government Finance Officers Association membership as the most significant concern among local officials implementing a performance assessment system (Tigue 1994, 44). Support for these planning and evaluation tools fits the Oregon managers' emphasis on improving productivity and their preference for rational, goal-oriented cutback approaches.

Conclusion

Although voter-enacted tax and expenditure limitations can reduce revenue available to local governments, local officials may tend to overestimate their fiscal effects. In Oregon, the TEL's fiscal effect was considerably less than local government managers predicted. In retrospect, some statements by the TEL's opponents seem alarmist, such as the governor's remark that "people would die" if Ballot Measure 5 passed.[7] Hale's investigation of the effects of Massachusetts' Proposition 2½ found that the lobbying efforts of local officials resulted in legislative action that mitigated the TEL's fiscal effects (1993, 122). Marando's study (1990) of the termination of general revenue sharing found that the resulting fiscal effects were lessened by other legislation. Thus, the most dire predictions of fiscal scarcity may prove overly pessimistic because of the mitigating effects of growth in property values, political actions, and coping strategies such as productivity improvement. Perhaps, as Marando speculates (1990, 104-5), officials may at first emphasize the negative consequences of proposed fiscal restrictions, and after passage, may shift to defusing the effects of revenue losses.

Although the TEL's initial fiscal effects were not as severe as expected, the post-TEL environment has posed other difficulties for many Oregon cities and counties. The state government's response during this time has included little additional financial assistance

but more mandates and increased control over local jurisdictions. Simultaneously, greater citizen involvement—coupled with tension between the service levels citizens expect and what jurisdictions can provide—has developed in many Oregon cities and counties. These developments have created a more constrained and difficult local policy and budget process.

In the post-TEL environment, managers in cities and counties impacted by the TEL have turned primarily to targeted revenue increases and to productivity improvement. Revenue increases based on targeted fees and charges, as opposed to broad-based taxes, can increase regressivity—a common result of local governments' response to TELs (Mullins and Joyce 1996, 95). Efforts to improve productivity have increased the use of sophisticated management practices such as revenue and expenditure forecasting and monitoring, strategic planning, and output-oriented budget formats. These results support the view that retrenchment can foster rather than inhibit management innovation (Poister and Streib 1989a; Brecher and Horton 1985; Cope and Grubb 1982).

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Notes

1. Voter-approved general obligation bond issues/levies can exceed the limit. Ballot Measure 5 also required the state to reimburse school districts for lost property tax revenues during the five-year period. For an initial analysis of the effects on school districts, see Stipak, O'Toole, and Guo (1993).
2. For example, the average assessed value of a single family home in Oregon's most populous county, Multnomah County, increased from $58,322 to $80,566 from fiscal year 1990/91 to fiscal year 1992/93 (Tax Supervising and Conservation Commission 1997, 29).
3. Computed from figures obtained by personal communication with a budget analyst, Budget and Management Division, Department of Administrative Services, State of Oregon.
4. This finding is the same as that of the first-stage survey (O'Toole and Stipak 1994, 116).
5. The relative rated importance of these tools generally agrees with the first-stage survey findings (O'Toole and Stipak 1994, 116).
6. This is close to the level predicted by the 1991 survey (O'Toole and Stipak 1994, 116).
7. Comment made on the "Town Hall" television program, Public Broadcasting System, Channel 10, Portland, Oregon, 3 November 1990.

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