Prop. 13 doesn't fit California's new economy

FUNDING CALIFORNIA Old tax system can't support government of the 21st century

By RUSSELL HANCOCK and EMMETT D. CARSON | Published: February 12, 2012

Ever since its passage, Proposition 13 has been the "third rail" of California politics: Political leaders touch it at their peril.

We think it's time to take a fresh look.

Our two organizations released last week the 2012 Silicon Valley Index, a comprehensive analysis of our region's health. The report is filled with encouraging news about our regional economy, including a rebound in the tech sector and the revving up of our innovation engine.

But the same report shows local governments in a state of crisis, with decreasing revenues and rising expenses, no longer able to provide the essential social services and capital investments we need to sustain vibrant communities.

Even a stunning economic recovery won't address our fiscal woes. That's because our state's tax system, geared toward an early 20th century economy, no longer tracks with the 21st century economy that is being invented in Silicon Valley.

Our current system is based on taxing sales in brick-and-mortar establishments, on the most volatile sources of personal income (stock options and capital gains), and - increasingly - on property taxes.

However, today's knowledge economy increasingly provides goods and services through the Internet without providing needed tax revenue for state and local governments.
As a result, property taxes bear a disproportionate share of the burden for supporting government investment in capital improvements, education and services.

Prop. 13, passed in 1978, dramatically lowered property taxes and limited increases in the assessed value of our homes, so long as the property did not change ownership.

By design, public revenues plummeted 60 percent the first year after the law took effect. In the years afterward, however, two things happened that were unanticipated.

First, home prices surged, well outpacing inflation, as the economy skyrocketed in the 1980s and 1990s and population growth exceeded the supply of housing.

Second, voters enacted a large number of new fees and special-purpose taxes, many of them on retail sales, but also on commercial construction, hotels and utilities.

So, even though public revenues from property taxes initially came crashing down in 1978, the revenue stream continued to grow incrementally in every succeeding year. Californians came to think of this as normal.

It was not.

We have now entered into a new normal. It arrived in 2008. The Great Recession jolted us from a world in which new construction and soaring home prices generated ongoing tax revenue gains to a world that is the polar opposite:

New construction has ground to a halt, and median housing prices have fallen dramatically.

We're seeing downward valuations when properties change hands. In fact, the number of properties purchased more than 20 years constitutes a small proportion of total properties in most cities. More people bought their houses at peak prices, and as those turn over, the valuations come in at low levels that can't come close to sustaining our old rate of tax revenue.

Special-purpose taxes are mostly played out and have worn out their welcome with voters.

The upshot is that we have arrived at a new set of realities that require us to rethink how we finance state and local government. Yes, the economy will come back in some form, but home prices will take many years to reach prerecession levels. The supply of housing will probably remain flat.

If our strategy was to fund public goods through property taxes, it is no longer sustainable.

Meanwhile, sales taxes, our other major revenue source, are growing much more slowly now, because people are spending more of their income on the Internet, or on services instead of goods. So what we have here is a double whammy.

Californians need to understand this.
Now, there's an important ideological discussion to be had about taxes and spending and what the appropriate levels should be. But that is a different conversation altogether (and a vitally important one).

But we're making a completely separate observation here, and a very simple one: At one point in our history, Californians judged it important to generate revenue through property taxes; they also enacted retail sales taxes. Today, neither of these provides the revenue they once did, and they are unlikely to do so in the foreseeable future.

There appears to be some political will to talk about the sales-tax issue, and meaningful proposals are being discussed. However, discussion about property taxes seems to be off limits.

That doesn't make sense. Taxes are a necessary requirement for government to function on our collective behalf. Our responsibility is to collect them in a way that confirms to current realities.

It's clearly time to talk about reform, and when we do, Prop. 13 needs to be squarely on the table.

**Special report on prop. 13**
The 2012 Silicon Valley Index, which includes a detailed analysis of Prop. 13, can be downloaded at jointventure.org or siliconvalleycf.org.

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*Russell Hancock is president and CEO of Joint Venture Silicon Valley. Emmett D. Carson is CEO and president of Silicon Valley Community Foundation.*