May 19, 2009, 4:00 a.m.

Bad Proposition

California needs serious fiscal reform. Prop 1A is not it.

By Michael J. New

Proposition 1A is the most important ballot measure that Californians will vote on when they go to the polls today. Though it has been touted as a way to impose limits on appropriations that will finally halt California's persistent budget shortfalls, it will actually do little either to limit government growth in the state or to solve California's persistent fiscal woes. Furthermore, it would result in yet another sizable tax increase for Californians.

Proposition 1A was placed on the ballot for the May 19 special election as part of the compromise budget passed in California this year. To their credit, Republican members of the state legislature held their ground through much of the winter and refused to support tax increases that were being promoted by Governor Schwarzenegger and the legislature's Democrats. However, in February a few Republicans bolted, creating the supermajority needed to pass a compromise measure that increased taxes by $12.8 billion. This measure included temporary increases in both the sales tax and the income tax.

The compromise included placing an appropriations limit on the May ballot. Those Assembly Republicans who defected should have used their leverage more wisely. Proposition 1A ties the appropriations limit to an additional $16-billion tax increase. If Proposition 1A is enacted, the one-cent sales-tax increase will be extended for one year, and the 0.25 percent increase in the income-tax rate will be extended for two years, through 2012. These tax hikes are among the highest in California history.

These tax increases, bad as they are, might actually have been worth it if they resulted in the enactment of a revenue limit that would effectively restrain government growth in California. Unfortunately, the limit contained in Proposition 1A does nothing of the sort.

Proposition 1A limits annual revenue growth to the ten-year rolling average of revenue growth — unlike the measures passed in a number of states, which limit government growth to some measure of personal-income growth. Most research indicates that limits like the one contained in Proposition 1A have only a marginal effect on state fiscal outcomes. As such, this limit might redistribute government growth, but it will do nothing to limit the growth of government in California.

Even worse, Proposition 1A requires that surplus revenues be deposited into a budget-stabilization fund. Regardless of the size of the surplus, excess revenues are always to be placed in either the budget-stabilization fund or a supplemental education account. They are never to be returned to the taxpayers. Furthermore, until 2011 the governor has the power to ignore the new requirement — and presumably spend the excess revenue. Proposition 1A always puts taxpayers last.

Furthermore, the enactment of Proposition 1A would make it much more difficult to enact a truly effective fiscal limit later on, as opponents could easily dismiss proposals on the grounds that California already has a revenue limit in place. But if Proposition 1A is defeated, a serious spending limit might be a real possibility in the foreseeable future. California voters are tiring of frequent fiscal shortfalls. Former eBay CEO Meg Whitman and Insurance Commissioner Steve Poizner are both reportedly interested in running for governor of California in 2010. An effective spending limit might be a winning issue for either or both of these candidates.

California is clearly in need of substantial fiscal-policy reform. It receives a large percentage of its revenues from a progressive state income tax and a corporate income tax, both of which are very sensitive to the strength of the economy. This largely explains why California consistently faces large fiscal shortfalls during economic slowdowns. As such, California desperately needs an effective revenue limit that can spur tax relief, limit the growth of government, and prevent future fiscal shortfalls.

California actually had something like this when the Gann Limit was in effect during the 1980s. The Gann Limit placed a low, constitutional limit on the annual growth of appropriations. Additionally, when surpluses accumulated, the state was required to issue tax rebates. The Gann Limit was substantially repealed by a subsequent initiative. However, between 1980 and 1991, California's rank in per-capita state expenditures fell from 7th to 16th. Furthermore, when tax receipts exceeded the Gann Limit in 1987, the state was required to refund $1.1 billion to the taxpayers.

Unfortunately for California residents, Proposition 1A falls well short of this standard.

— Michael J. New is an adjunct scholar at the Cato Institute, assistant professor at the University of Alabama, and a visiting fellow at the Witherspoon Institute in Princeton, N.J.

National Review Online - http://article.nationalreview.com/?q=MjgxY2E1MmZmYjViNGZmNWU2NzlhYWRmMjZmZGEzOTY=