PROP. 1A: FR INTERVIEW WITH ECONOMIST BEN ZYCHER WHO SAYS THE MEASURE DOES NOT DELIVER ON A PROMISE OF A REAL SPENDING LIMIT

Ben Zycher, a senior fellow with the Pacific Research Institute, thoroughly reviewed the text of Proposition 1A before the voters this May, and was underwhelmed by alleged spending reforms, and critical of tax increases in the proposal.

FR Publisher Jon Fleischman interviews noted economist Ben Zycher

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A few weeks ago, the California State Legislature rather tragically passed a revision in this fiscal year's budget and adopted a budget for the next fiscal year that produced the single largest tax increase at the state level every passed in our nation's history. It sounds dramatic to say it that way, but words can't really do justice to the fact that every family in California (yes, millions of households) will see their tax burden raise well over $1000 a year. This tax increase, which was voted against by 39 of the 45 Republicans in the legislature, represented the worst possible response to years of chronic overspending in state government -- with over 40% growth in state spending over just the last four years alone. Given that any budget package was going to include going to the voters with ballot measures, this meant that virtually all options were on the table to reform state government, and that simply did not happen.

Governor Schwarzenegger, legislative Democrats, and a handful of Republicans who supported the massive tax increase say that there is an opportunity for meaningful, permanent reform of how the state's finances operate. They say that if voters pass Proposition 1A in the upcoming May special election, that it will impose a new "spending limit" that would force the state to put away money into reserves in times of feast, allowing the state to draw upon those times during times of famine. Sounds good, right? Well -- there is a "poison pill" in attached to Proposition 1A that will give all voters pause -- if it is passed, it will automatically trigger an extension of that tax increase I mentioned above for another couple of years. Yes, unbelievably, voters are tantalized with a supposed common-sense fiscal reform, but are told they have to vote to tax themselves more in order to pass it. But wait, the issue gets more thorny -- the same folks who raised your taxes, and are bringing you this "tax yourself for a spending limit" proposal are trying to pull a fast one on voters, literally omitting from the title and summary of Proposition 1A that appears on the ballot, any clear mention that by voting for it, there are significantly tax consequences to the voter.

When you consider that anyone who is willing to participate in a scheme of placing a major potential tax increase before the voters without making it abundantly clear to them what it is they are voting on is clearly being deceitful, then it draws into question their credibility in asserting whether the actual "spending limit" provisions in the measure will deliver the kind of spending constraints that they promise.

It was very instructive to me that shortly after Proposition 1A was passed and placed on the ballot, in an emergency meeting of their Board of Directors, the venerable Howard Jarvis Taxpayers Association came out strongly against the measure -- citing not only the large level of proposed tax increases, but also concerns about the effectiveness of the spending limit contained in the measure.

I decided that I would reach out to noted economist Ben Zycher, who is a senior fellow with the Pacific Research Institute, who has had an opportunity to fully review the language of Proposition 1A, and who is considered to be a policy expert on these matters, and engage him in a dialogue about the measure. Our interview is below, where Zycher is quite critical of this measure, but before you read it, I think it is helpful for you to see some highlights of Zycher's background, which is pretty impressive...

In addition to his association with PRI, Zycher is the President of his own economics consulting firm, and an Adjust Professor at the Martin V. Smith School of Business and Economics, California State University, Channel Islands. He was a senior fellow at the Manhattan Institute for Policy Research, a senior economist at the RAND Corporation, a member of the Board of Directors of the Western Economic Association International, an adjunct professor of economics at the University of California, Los Angeles, the vice president for research at the Milken Institute, the founding editor of the quarterly public policy journal Jobs & Capital, and a senior staff economist at the President's Council of Economic Advisers for the first two years of the Reagan Administration. Zycher has a Ph.D. in economics from U.C.L.A. He is pictured below.

THE INTERVIEW WITH BEN ZYCHER:

Fleischman (Flash): Mr. Zycher, thank you so much for taking the time to participate in a question and answer session with me to help FlashReport readers gain some understanding of the complex issues presented on the ballot in Proposition 1A. As our lead-off question...Is it clear that a constitutional spending limit is needed for California?

Zycher: Yes. In a highly centralized political system such as that characterizing our state, it is always the case that concentrated interests---in this context, the direct and indirect recipients of budget outlays---have crucial political advantages over the diffused taxpayers, both present and future, who must bear the economic burden of financing public spending programs. This is true for two reasons. First, concentrated interests have a natural advantage over diffused interests in terms of applying pressures both overt and subtle upon public officials; such pressures range from the mere ability to command attention to the ability to offer various forms of (wholly legal) quids pro quo in exchange for favorable budget decisions. Second, because of such policies as term limits and campaign finance "reforms" that have weakened the political parties, the effective time horizons of public officials have been shortened dramatically; this means that the longer-term economic effects of current policies, already diffused over large numbers of future taxpayers, politically are discounted even more than otherwise would be the case. Accordingly, the absence of a spending limit, within which public officials would have to make the same kinds of hard choices always confronted by individuals and families, yields a political environment in which the dominant bias is toward spending greater rather than smaller, and in which the dominant outcome is a sharply wasteful allocation of resources between the private and public sectors.

Flash: Do the taxpayers have a right to place a limit on the ability of our elected representatives to make budget decisions?

Zycher: Yes. Just as individuals and families have the right to allocate their limited budgets among such needs as housing, food, medical care, entertainment, and the other myriad categories of goods and services, taxpayers have the right to decide how much of their limited budgets may be allocated to public spending programs.

Flash: How is Proposition 1A designed to limit spending?

Zycher: Revenues would be projected for future fiscal years based upon the growth trend for the previous ten fiscal years. General-fund spending for a given fiscal year would be limited to the revenue projection for that year; any actual revenues above the trend projection would be shifted into a budget stabilization fund (BSF), which could reach a maximum of 12.5 percent of the general fund. Revenues falling short of the projection would be augmented by transfers from (or reduced transfers to) the BSF, up to the current services baseline, that is, the previous fiscal year budget adjusted for inflation and population growth.

Flash: How effective as a spending constraint would Proposition 1A prove?

Zycher: Not very effective. The language allows the governor to suspend or reduce transfers into the BSF for any fiscal year upon issuance of an executive order, and there is no limit on that power; given the spending pressures that exert themselves upon any California governor, it is likely that such executive orders will become the norm rather than the exception.

Flash: Would Proposition 1A operate at least to slow the growth in spending?

Zycher: No; and it may have the opposite effect. Proposition 1A allows the (assumed) revenues from any tax increase to be included in the revenue projection for the current fiscal year, thus increasing allowable spending. But it proscribes any consideration of the adverse economic effects of---and thus the reduction of the tax base caused by---the tax increase in future fiscal years over the ten-year projection horizon. This means that a tax increase yields more allowable spending immediately without any recognition of the future adverse revenue effects, so that future transfers out of the BSF become more likely. Because Proposition 1A treats tax increases in this unrealistic way, it biases the future revenue projection upward, and with it allowable spending under the terms of the proposition. The central conclusion, therefore, is that Proposition 1A may actually strengthen spending pressures rather than reduce them.

Flash: Would Proposition 1A make tax reduction more or less likely?

Zycher: Much less likely, for the same reason that it introduces the bias in favor of tax increases just discussed. A reduction in tax rates would yield an assumed reduction in revenues for the current fiscal year; but the favorable future effects in terms of the economy and the tax base would be excluded from the revenue projection methodology for ten years.

Flash: But isn't the "extra" spending in any given fiscal year---to be financed by reduced transfers into or transfers out of the BSF---limited to an adjustment for inflation and population growth?

Zycher: Yes and no. Yes in the sense that the explicit language of the proposition says that. No, in the more relevant sense that the inflation and population data needed to make the relevant determinations for the current or immediately subsequent fiscal year simply are not going to be available. This means that estimates based upon assumptions will have to be made, and they will not be made by neutral scholars. Accordingly, the "inflation and population" constraint will be quite elastic, subject to manipulation and other machinations, processes hardly unknown in Sacramento. The population parameter in particular will be the focus of enormous political pressures for "corrections" of innumerable purported "errors"; that the Obama Administration apparently will attempt to move the 2010 census into the white House is an indicator of the potential scope of such mischief. Note also that the inflation and population growth parameters often have been discussed as a constraint on spending; under Proposition 1A, transfers out of the BSF are designed to maintain spending growth in accordance with the inflation/population parameter. Therefore, it actually will operate as a spending floor, from which allowable spending might increase if taxes are raised (see above).

Flash: Are there other problems with Proposition 1A?

Zycher: Yes. In particular, the tax increases recently enacted by the legislature will be preserved for additional periods of one to three years, depending on the tax, if the proposition is approved. Tax increases are unlikely to prove effective as a tool with which to impose fiscal discipline in the absence of a serious limit on spending, and the tax increases just passed will not prove salutary in terms of extricating the state from the economic downturn in which it finds itself. In that broad context, lengthening the period of ever-higher taxes would be economically destructive.

Flash: Is there a better alternative?

Zycher: Yes. A spending limit should be simple. It should be difficult to circumvent. And, above all, it should provide public officials with powerful incentives to adopt policies yielding economic growth stronger rather than weaker; in particular, a limit should discourage attempts by the legislature to substitute regulations in place of spending or to impose regulatory regimes for purposes of political grandstanding. (AB32, the climate change legislation championed by the Governor and by many in the legislature, is a classic example, and now is starting to make its adverse effects felt at precisely the wrong time.) A limit defined as some specific percentage of state gross output would further all of those goals, the last in particular. This would be very similar to the spending limit proposed by Governor Ronald Reagan in 1973---Proposition 1---which was defeated narrowly.

Flash: Mr. Zycher, in concluding our Q & A dialogue, do you any final observations?

Zycher: Yes, unsurprisingly. First, a secondary (but not trivial) reason that Proposition 1A should be defeated is the blatant dishonesty with which it is being marketed, one manifestation of which is the organization of the ballot arguments, both sides of which were written by proponents, so that the tax-extension provisions were not mentioned at all. Accordingly, a good reason to defeat Proposition 1A is to provide future disincentives for such mendacity. Second, at a more general level, Proposition 1A simply will not work as the spending limit that the state needs, and it will introduce a bias in favor of tax increases, even apart from the explicit extensions of the new tax increases just enacted, which the proponents have attempted to hide from the electorate. It should be defeated, and a new approach to spending limitation should be pursued.

Flash: Thank you for taking the time to share your considered thoughts on Proposition 1A. It sure sounds like, from your perspective, that the legislature really has missed an opportunity to present a substantive spending limit measure to the voters, which is a missed opportunity. This state really needs one!