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California Redeeming

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The inauguration of Arnold Schwarzenegger as the governor of California on Monday, November 17, 2003, provides the State with a golden opportunity for radical reform. A crisis and new leadership makes it possible to restructure the state and move towards sound public finances.

The governor wants to repeal the recently passed law enabling illegal immigrants to obtain a driver's license. It's best to mend that law so that there be a thorough background check on any non-citizen who gets a license, with different licenses for citizens and non-citizens.

The governor seems determined to repeal the car tax. That's fine, since the car tax is an economic and personal burden. The elimination of the car tax will increase the state's budget deficit, which is also a claim on the taxpayers, but combined with deep cuts in state spending, now is a good opportunity to eliminate the car tax, before it becomes politically entrenched.

The state legislature should pass the spending cuts recommended by the Reason Public Policy Institute's "Citizens' Budget." But the state government should go beyond mere cuts in spending, to restructure how the money is raised and spent. The best path towards reform is a radical decentralization of government.

California is a huge state, too big to have central planning and controls. Authority over the state's schools should be turned over to the counties, cities, and school boards. The financing of the government's schools can also then be shifted to local government. The state would also stop grabbing the county property taxes.

Constitutional changes would be needed to reform how the government schools are funded. The law should stop making schooling a gratis entitlement. A school district should be able to require tuition and fees. The state government's role would be confined to equalization, providing tuition vouchers for the poor. School districts would be authorized to levy special assessments or parcel taxes on land to pay for the schooling, with tax credits for parents who send their children to private schools or do home schooling.

State prisons are a huge budget drain for California. The new governor should boldly pardon those who are incarcerated for victimless crimes, such as possessing a bit of marijuana or nude sunbathing or playing poker for money. Let them do community service rather than be uselessly caged up at taxpayer expense.

To borrow money, the state should issue zero-coupon bonds that mature in five years. Instead of paying periodic interest, the bonds would be sold at a discount. For example, suppose the interest rate is five percent. A bond that matures in one year would be sold for \$95. Instead of receiving interest during the year, the bondholder would get the \$5 interest at the end of the year when he

redeems the bond for \$100. The same principle would be applied for five-year bonds. One would buy a bond for, say, \$70, and then in five years, obtain \$100 for the bond. The implicit interest of \$30 would be tax free for both the federal and state income tax.

With zero-coupon bonds and similar promissory notes, the state would buy time without having to pay interest during that time. With steep budget cuts, decentralizing education to school boards, the sale of some state property, and the reduction of victimless criminals, the state would be on the path towards sound public finances.

Proposition 13, passed in 1978, limits the state property tax, and, as Warren Buffett has pointed out, creates ever greater inequalities. The real estate tax can only be increased by two percent so long as owner does not sell the property, so new owners pay much more than old owners. It would require a change in the state constitution to remedy this inequality, which is politically difficult. But there is another remedy: privatization.

The new governor likes private enterprise, so why not privatize public services? Create neighborhood civic associations that would take over the operation of the streets, parks, recreation, policing, and fire protection. They would finance their operations the way that condominiums and residential associations do now, by assessments on the owners, in effect dues based on the value of the land.

These land dues would replace financing from sales taxes. The state sales tax would then be completely repealed. That would also eliminate the problem of Internet and catalog sales which do not pay the state sales tax.

California can be redeemed with bold, imaginative thinking that is grounded in sound economics. We have a golden opportunity in California. Let us hope the legislature will not turn this into fools' gold. Let California be once again the truly golden state.