

What Would the Delegates Talk About? A Rough Agenda for a Constitutional Convention

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Introduction

Let us start with some clichés. Constitutional conventions represent the possibility of a special kind of lawmaking. They rightfully do not happen often and, when they do, they are in response to an extraordinary crisis. California is currently in the midst of such a crisis it would seem, and there is a powerful movement for a constitutional convention.¹

There is, however, one big problem (at least), and that is that no one seems to have any particular idea what the delegates will talk about. There has been a lot of angst about what they ought *not* to talk about.² The most famous constitutional convention in American

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1. See Repair California: Californians for a State Constitutional Convention, <http://www.repaircalifornia.org/index.php> (last visited Feb. 11, 2010). These ambitious plans for a convention now seem to be on hold. See Sudhin Thanawala, *Group suspends push for Calif. constitution reform*, http://articles.sfgate.com/2010-02-12/news/17875146_1_constitutional-convention-repair-california-la-torre (last visited Mar. 20, 2010).

2. See The Call for a Citizens' Limited Constitutional Convention, http://www.repaircalifornia.org/Docs/repair_california_prop_2.pdf (last visited Feb. 11, 2010) Proposed Government Code Section 83130(a)(3) would allow the delegates to consider "the budget process and related requirements, the term and balancing of a budget, voting thresholds, mandated spending, and ways to increase fiscal accountability and efficiency." Most of the proposals herein would clearly qualify for inclusion, though they would also have to navigate proposed sub-section (b)(1), which forbids the convention from "directly impos[ing] or reduc[ing] any taxes or fees." The proposals herein are mostly procedural and would seem to escape this problem as well because it will still be up to Californians

history was blessed with a statesman who in large part set the agenda, James Madison.³ He offered a diagnosis of the issues to be solved and possible avenues of compromise, and in the end the American Constitution embodied many compromises (at least one that is morally repugnant).⁴ What is the analogous agenda of our proposed convention? We might have a lot more comfort voting for a convention knowing that the delegates will not stray into forbidden ground if there are clear outlines of what a grand California compromise might look like, especially in light of the possibility of morally catastrophic compromises.⁵

To be sure, lots of very smart people have good ideas for fixing California, but most of these ideas alone do not represent comprehensive compromises between what are perceived to be the various groups.⁶ This short Article is a very modest attempt at agenda setting. I will begin by diagnosing the problem to be solved, the two main positions at odds with each other and will then propose some compromises. These compromises are proposals that make some progress on the main issue while also appealing to the divided factions of citizens.⁷

whether or not to raise or reduce taxes; to the extent that any of the proposals herein (e.g., Proposal 3) might not be permitted by this language, then that does not augur well for a successful convention.

3. JACK N. RAKOVE, ORIGINAL MEANINGS 36 (1996).

4. *Id.* at 47–49, 57–58 (the morally repugnant compromise is the so-called 3/5 compromise).

5. There is real unease about the so-called limits of a constitutional convention—notoriously, the Philadelphia convention of 1787 arguably exceeded its limits in proposing a new constitution rather than amending the Articles of the Confederation. ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 10 (3d ed. 2006). Of course, if one has great confidence in the power of deliberation, then it might be that the conventioners themselves will arrive at a sensible agenda and new, yet unthought of, compromises. Speaking for myself, I should at least want to know what the possible compromises might look like before putting my faith in the deliberations of the convention, or trust that state courts will enforce the limits on the convention included in the proposed ballot language.

6. For a list of ideas not unlike the list here, see Peter Schrag, *How to Close the Budget Gap in Ten Steps*, CALIFORNIA PROGRESS REPORT, Jan. 4, 2010, <http://www.californiaprogressreport.com/site/?q=node/7290> (last visited Feb. 12, 2010). See also *The California Forward 2010 Reform Principles*, <http://www.caforward.org/tasks/sites/default/assets/File/CF-Reform-Principles-Fact-Sheet.pdf>.

7. As will become clear, many of these compromises would ideally be statutes—allowing for other compromises in the future. Sadly, since our constitution is already cluttered with statutory-type detail, it will be hard to take these elements out without making still more statutory-type additions. I yield to this necessity in what follows and assume that most changes will have to be constitutional, but it would be best of all if the

I. Diagnosis

California faces grave financial issues. The common refrain is that California spends too much, but a more nuanced diagnosis is required for an effective evaluation of this issue. Contrary to this refrain, California is about the middle of the pack in terms of state spending on a per capita basis and falls low on the list of per pupil spending.⁸

Another common refrain is that California taxes too much. In fact, California's total tax burden is also middling,⁹ but its tax base is different from most other states; it is more reliant on a progressive income tax and the sales tax—both taxes are highly sensitive to economic cycles. It could be that Californians pay higher taxes in total relative to other states if one includes the costs of regulations, which are supposedly greater here. And no doubt regulations and taxation can serve as substitutes.

Even if this were true, it is hard to imagine that the relative costs of these regulations makes California into a high tax state, especially since many of the measures of taxing and spending we are dealing with are crude. As Dan Shaviro has argued, what counts as spending can be misleading. If the government taxes you to provide a school that you would have paid the same money for in private tuition, then

constitution spoke in terms of broad principles that allowed our legislators to come up with the kind of sensible compromises outlined herein.

8. The most sophisticated analysis of state taxing and spending is based on what a state does relative to its "fiscal capacity," a concept that, to be sure, is not without controversy, but is more meaningful than just dividing total state expenditures or taxes by population. See Yesim Yilmaz et al., *Measuring Fiscal Disparities across the U.S. States: A Representative Revenue System/Representative Expenditure System Approach, Fiscal Year 2002*, 14 (New England Pub. Policy Ctr. Working Paper 06-2, 2006), http://www.urban.org/UploadedPDF/311384_fiscal_disparities.pdf. (California relatively middling in terms of tax effort); On California underinvestment in education, see, e.g., Susanna Loeb et al., *DISTRICT DOLLARS: PAINTING A PICTURE OF REVENUES AND EXPENDITURES IN CALIFORNIA'S SCHOOL DISTRICTS [RESEARCH SUMMARY]* 5 (2006), http://irepp.stanford.edu/documents/GDF/SUMMARIES/Loeb_Grissom.pdf.

9. See Yilmaz, *supra* note 8, at 16 (California's relatively middling expenditure effort). See also the data collected recently in Sharyn Lais Ortega, *A Way Out Of California's Public Finance Nightmare?*, 55 *STATE TAX NOTES* 39, 41–42 (2010). This is not to say that certain California taxes are not relatively high, resulting in relatively high total taxes for some taxpayers—nor is it to deny that this indicates a problematic tax system. See, e.g., CALIFORNIA COMMISSION ON THE 21ST CENTURY ECONOMY, *FINAL REPORT* 35 (2009), available at http://www.cotce.ca.gov/documents/reports/documents/Commission_on_the_21st_Century_Economy-Final_Report.pdf [hereinafter COTCE REPORT].

calling this an increase in government spending is not very helpful.¹⁰ So too, if a government requires clean water and, in the absence of this regulation, one would have spent money on their own filter, then labeling this action as a hidden tax that distorts market behavior also seems perverse. This is not to say that we should not make do with the crude figures of taxing and spending that we have, just that we have to use them with care.

Nonetheless, California residents feel that they receive less than they ought to from their government. In the school example, state and local governments impose taxes to support schools that many residents do not attend, and many more would prefer not to use. While this criticism is warranted, a more precise diagnosis of California's tax situation is required.

California's fiscal base is too narrow and too unstable.¹¹ We will get deeper into the how in a moment, but it is worth taking a moment to make sure it is clear that instability can be very expensive and to this end I will offer a rather domestic illustration.¹² Suppose I believe, reasonably, that my average income is going to be \$50,000 per year. All of my spending habits are calibrated to that and in fact I earn \$50,000 in Year 1. In Year 2, however, I only earn \$25,000. My first response, in denial of reality and unable to make a quick decision, is to survive on my credit card, but I will have to substantially diminish my spending habits eventually. I move to a smaller apartment, I cannot afford regular medical or dental check-ups, or routine maintenance on my car. In Year 3, I earn \$75,000. I pay off my credit card debt, I move back to my original apartment, and I catch up on my various deferred appointments, many of which are probably going to be more expensive for being delayed. Although I earned three times more in Year 3 than in Year 2, and fifty percent more than average, I am probably living little better than I was in Year 1 because the instability of Year 2 was expensive.

10. See DAN N. SHAVIRO, TAXES, SPENDING, AND THE U.S. GOVERNMENT'S MARCH TOWARD BANKRUPTCY 31–32 (2007).

11. Cf. David Scott Gamage, *Coping through California's Budget Crises in Light of Proposition 13 and California's Fiscal Constitution*, in AFTER THE TAX REVOLT: CALIFORNIA'S PROPOSITION 13 TURNS 30, 54 (Jack Citrin & Isaac Martin eds., 2009) [hereinafter Gamage 2009].

12. For a more sophisticated treatment, see generally David Scott Gamage, *Preventing State Budget Crises: Redefining "Tax Cuts" and "Tax Hikes"* 98 CAL. L. REV. (forthcoming 2010) [hereinafter Gamage 2010]; See also ARTHUR B. LAFFER ET AL., RICH STATES POOR STATES: ALEC-LAFFER COMPETITIVENESS INDEX 88 (2009) (politically conservative commentators agree on problem of volatility).

California's finances operate in a similar fashion. California relies on relatively unstable and cyclical taxes—namely the sales tax and the income tax—and most especially the capital gains portion of the income tax and the corporate income tax.¹³ When the economy is weak, tax collections of these taxes shrivel, even as the demand for many government services increase. This cycle leads to extreme belt-tightening in tough times, followed by attempts to catch up when times are better. As in my individual example, dithering about needed changes in the midst of a crisis only adds to the expense.

The domestic example above also illustrates the perils of definitions. What is a “deficit” and what is a “surplus”? From Year 1 to Year 2, did I run a \$25,000 deficit and then a \$50,000 surplus from Year 2 to Year 3? This seems an odd thing to say; it seems better to say that I had an uneven cash flow that averaged \$50,000 year, but that the uncertainly and unevenness turned out to be really expensive.

Suppose I had started my story with \$5,000 in debt in Year 1 because I always spend \$55,000 per year. This is a “structural deficit” because I am structurally spending beyond my means.¹⁴ In contrast, the one year decline from Year 1 to Year 2 would be called an “economic deficit” if I were a government because I have taken in less revenue, presumably for economic reasons. This is all reasonable, but limited in advancing our understanding. First, as to the original \$5,000 per year debt, we do not know what kind of debt it is. Suppose it represents payments on school loans and are a reasonable investment in the future to enable me to earn \$60,000 per year—this changes the analysis from my simply spending more money than I can afford on, say, rent. Furthermore, as to the economic deficit, we may feel that it is “structural,” and hence problematic, to the extent I have chosen to work as an independent consultant and so sharp cycles are to be expected, but I do not have a rainy day fund and instead live check to check.

California's debt situation is also similar to my domestic illustration.¹⁵ The state consistently spends more than it takes in, even

13. See Gamage 2009, *supra* note 11, at 54–55; see also LAFFER, *supra* note 12 at 29. It is important to note that this problem with stability is not limited to California nor is it a recent problem. See generally RANDALL G. HOLCOMBE & RUSSELL S. SOBEL, *GROWTH AND VARIABILITY IN STATE TAX REVENUE: AN ANATOMY OF STATE FISCAL CRISES* (1997).

14. See JONATHAN GRUBER, *PUBLIC FINANCE AND PUBLIC POLICY* 98–118 (2007).

15. See Gamage 2010, *supra* note 12 (manuscript at 7–19); COTCE REPORT, *supra* note 9, at 28–30 (California general fund variability is particularly egregious).

taking some kind of longer-term view, but some of this deficit spending is on long term investments that may make sense because they will make the state richer and better able to pay off the debt later.¹⁶ On the other hand, California's economic deficit is recurring and predictable because California's tax structure is reliant on unstable taxes. To the extent that it may be sensible for California to borrow money to smooth its spending during economic crises, it does not seem sensible for it to borrow so it can continue to sustain an unstable tax base.¹⁷

California may spend and tax more than other states on average, but the regular and extreme mismatch between taxing and spending that spurs crises seems to be a product of a poorly chosen tax base. Over-expenditures may exist beyond this underlying volatility, but this surmise is currently made speculative given the magnitude of the swings in resources caused by the poor design of our fiscal institutions. As such, I propose that fixing these institutions should be the California Constitutional Convention's foremost priority.

II. Our Two Models: Europe v. Texas

So now we have a problem to be solved and the question is how. There are two broad perspectives on this, and so, with apologies for the many brutal simplifications which follow, let us postulate two basic positions that need to be reconciled in order to solve our problem.¹⁸

A. 'Citizen A' Goes to Europe

This first perspective, that of "Citizen A," proposes that California become more of a high tax and high spending state, somewhat analogous to the popular image of European social democracies—or, at the very least, more similar to the California before the tax limitations were imposed on the state by Proposition 13 in 1978.¹⁹ California has a large and diverse economy which is largely built on high-technology industries. California can fund a large state government right now and can continue to do so—if only

16. See generally Neil H. Buchanan, *Is It Sometimes Good To Run Budget Deficits? If So, Should We Admit It (Out Loud)?*, 26 VA. TAX REV. 325 (2006).

17. See generally John Decker, *What Do Debt Loads Say About California's Fiscal Condition*, 1 CAL. J. OF POL. & POL'Y, 9 (2009).

18. Cf. Gamage 2009, *supra* note 11, at 51–52.

19. See generally PETER SCHRAG, *PARADISE LOST* (1998).

California invested more in itself, most particularly in education. The sorry condition of our public education institutions is not just a waste, but foolhardy penny pinching that guarantees further impoverishment in the future. This citizen would like to fix California's fiscal problems by raising taxes—or at least enabling them to be raised.

Now, it is bad form to quibble with one's own caricature, but we need to make a few tweaks to this citizen's perspective or little compromise is to be expected (and so much the worse for us!). First, though this citizen would on the whole prefer more taxes to more cuts, this citizen can be persuaded that certain taxes are not currently well-designed.²⁰ Second, though this citizen is committed to collecting more revenue, this citizen is willing to compromise on how this revenue is collected. This is really a specific implication of the first point of compromise, which is that a very progressive tax system is not particularly economically stable because it is particularly reliant on the prosperity of the relatively few people earning the most money. Furthermore, to the extent that this citizen would like a more European-style social contract, with more services, then this citizen should be open to more regressive taxes.²¹ And this makes sense—if more services are to be used by poorer people, then it is sensible that they pay more for them. Not only is this fair (at least in some sense), but in providing poorer citizens with the services they are now struggling to pay for, it is not entirely accurate to say that such expedients are really tax increases on them so much as better designed subsidies when considered holistically.

B. 'Citizen B' Goes to Texas

Our other citizen, "Citizen B," would like California to become a low tax and low spending state, more like Texas, a large state that has recently been compared very favorably to California.²² This citizen probably has philosophical reasons to prefer a smaller government

20. In particular, the examples we will discuss are the state sales tax, the state corporate income tax, and the state income tax on capital gains.

21. See generally SVEN STEINMO, *TAXATION, AND DEMOCRACY: SWEDISH, BRITISH AND AMERICAN APPROACHES TO FINANCING THE MODERN STATE* (1993). Needless to say, Steinmo's sophisticated argument does not rely on their having been one lucid moment of social contracting, but Steinmo does argue very convincingly that a vigorous social welfare state requires a robust tax base, which in actuality (and likely of necessity) is relatively regressive. See, e.g., *id.* at 196.

22. See, e.g., William Voegeli, *Failed State*, CLAREMONT REV. BOOKS 10 (Fall 2009); See generally LAFFER ET AL., *supra* note 12.

and is very likely incensed by California's public employee unions.²³ To this citizen, the basic solution is clear, California's government needs to become much smaller and, if it were, then California would become more economically competitive. This would mean both a smaller expenditure burden and larger tax base—fiscal problem solved.

As above with Citizen A, there is no possible compromise unless this citizen also accepts a few tweaks. First and foremost, our aspiring Texan should concede that, even if much money is wasted, there are huge and expensive challenges facing California. California's per pupil spending is low no matter how much unions may be taking out.²⁴ California's basic infrastructure requires hundreds of billions of dollars of investment just to be maintained.²⁵ Even Texas is acting to limit the uncontrolled growth of its prisons.²⁶ These challenges are also intimately connected to the future economic health of the state.

Second, there are other ways to limit the size of government besides the ones California currently uses. In particular, freeing local governments to raise revenue does not necessarily mean they will actually raise revenue. Traditional public finance theory suggests that local government competition serves to limit the total size of government. It is therefore possible that the total size of government would shrink if the state devolved more responsibilities to localities because they will compete with each other to offer low taxes (or at least high taxes that are providing desired services). Furthermore, when local governments borrow money, they generally make it clear (as they must) to the voters how the debt will be paid back to investors, often through tax increases—and this is one reason why local governments are not so keen to spend more of their constituents' money. The state can borrow without such disclosure to

23. See LAFFER ET AL., *supra* note 12, at 67.

24. See LOEB, *supra* note 8, at 5; See also Eric J. Brunner & Jon Sonstelie, *California's School Finance Reform: An Experiment in Fiscal Federalism*, in THE TIEBOUT MODEL AT FIFTY 68 (William A. Fischel ed., 2006).

25. Ellen Hanak, PAYING FOR INFRASTRUCTURE: CALIFORNIA'S CHOICES AT ISSUE (Pub. Pol'y Ins. Of Cal. ed., 2009), available at <http://www.ppic.org/main/publication.asp?i=863>. I do my best to provide some more detailed non-partisan means to build more infrastructure in Darien Shanske, *Putting the California Constitution (Back) to Work: A Blueprint for Clearing Legal Roadblocks to Proper Infrastructure Finance*, 54 STATE TAX NOTES 567 (2009).

26. ONE IN 100: BEHIND BARS IN AMERICA 2008, 17–18 (Pew Center on the States ed., 2008), available at http://www.pewcenteronthestates.org/uploadedFiles/8015PCTS_Prison08_FINAL_2-1-1_FORWEB.pdf.

voters. It is possible that requiring the state to tell voters how much it will raise taxes to finance a debt that the voters have the option of approving will be more effective at controlling the size of California government relative to the various two-thirds vote limitations, which have manifestly not done much to limit the size of California's government.²⁷ Indeed, there is strong evidence to suggest that the particular kind of tax limitation regime that California has adopted has increased fiscal volatility.²⁸

There are certainly many Californians who are simply more in agreement with Citizen A or Citizen B and part of what we must do is compromise with each other. On the other hand, to the extent that California has indulged in both increased spending *and* tax cutting, it may be that a lot of Californians have not really confronted the need to make a choice.²⁹ Many of the compromises discussed below are procedural, which is to say that Californians will be able to choose more spending and taxing or less taxing and spending, but they will have to choose one or the other coherent alternative.

III. A Menu of Specific Compromises

What follows is a menu of possible compromises—the list is partial and is particularly aimed at the problem we diagnosed, namely fiscal instability. Furthermore, this list attempts to choose compromises between the two broad perspectives outlined above.³⁰

27. For the continued growth of California's government despite Proposition 13, see Bruce E. Cain & George A. Mackenzie, *Are California's Fiscal Constraints Institutional or Political?* (Pub. Pol'y Ins. of Cal. ed., 2008), available at <http://www.ppic.org/main/publication.asp?i=865>. For the prediction that such single-issue tax cut propositions like Proposition 13 would not limit the size of government because voters could approve cuts without any corresponding consensus on cutting government services, see James M. Buchanan, *The Potential for Taxpayer Revolt in American Democracy*, 59 SOC. SCI. Q. 691 (1979). For a specific related proposal for changing the initiative process, see the Article by Robert Stern and Jessica Levinson in this volume.

28. Matthew D. McCubbins & Ellen Moule, *Making Mountains of Debt out of Molehills: The Pro-Cyclical Implications of Tax and Expenditure Limitations*, <http://www.taxpolicycenter.org/events/upload/McCubbins-Moule-Fiscal-Crisis-Paper.pdf> (last visited Mar. 20, 2010).

29. Cf. Jack Citrin, *Proposition 13 and the Transformation of California Government*, 1 CAL. J. POL. & POL'Y, 16, at 5 (2009). And, indeed, much of the tax raising and cutting that has landed California in its current predicament were largely bipartisan. See Decker, *supra* note 17, at 73. For a survey of some successful (technical) bipartisan tax reform efforts, see the contribution of Steven Sheffrin to this volume.

30. Thus, for instance, I do not include manifestly good ideas like criminal sentencing reform or pension reform because I could not divine a compromise that such reforms can meaningfully be part of; these are reforms we just simply have to do.

Finally, in choosing compromises, though many of them would not be my first choice, they all represent what I consider to be within the realm of reason and thus worth considering as part of a larger fiscal compromise.

Proposal 1: *More Local Control and Likely Greater Resources, but Accepting More Disparity in Resources.*

My longest proposed compromise has to do with local control and most particularly local control of education. This is because of this topic's potential importance, but also because I have not seen this particular compromise much discussed—especially in the context of education.³¹

As noted above, school funding in California has been below the national average for many years, particularly since the passage of Proposition 13's tax limitations in 1978.³² In 2000, California's voters passed Proposition 39. Proposition 39 lowered the threshold for school bond approval to fifty-five percent from two-thirds, provided certain conditions were met.³³ Lowering the threshold itself might be viewed as a type of compromise since each individual community decided whether or not to approve additional expenditures. In other words, it was not a giant state program imposed from above. However, Proposition 39 also contained other reasonable government limitations, including an oversight committee and absolute limits on the amount of money that can be raised using Proposition 39 bonds.

Despite, or perhaps because of, the compromises, the number of school bond measures more than doubled since the passage of Proposition 39, and almost half of the money finally approved (over \$20 billion) would not have been approved if not for the lower threshold.³⁴

The explosion in school bonds that Proposition 39 triggered was over determined. Twenty years after the passage of Proposition 13, there was pent-up demand for school improvements.

The most obvious next compromise is to lower the threshold for local financing for other local entities and other projects.³⁵ All entities

31. I did hear Kirk Stark make a similar suggestion in conversation.

32. I summarize Proposition 13 in Darien Shanske, *Public Tax Dollars for Private Suburban Development: A First Report on a National Phenomenon*, 26 VA. TAX REV. 709, 718–19 (2007).

33. CAL. CONST. art. 13A, § (1)(b)(3); CAL. EDUC. CODE § 15268 (2009).

34. See Hanak, *supra* note 25, at 8–9.

35. Similar proposals have been bouncing about the legislature for some time. See, e.g., ACA 9, 2009-10 Leg. Sess. (Cal. 2009); ACA 10, 2007-08 Leg. Sess (Cal. 2007).

should be able to raise taxes or to borrow—for services as well as capital facilities. Again, a lowered threshold does not indicate that all communities will approve new bond or tax measures; many Proposition 39 measures have failed. Furthermore, within education, Proposition 39 only applies to school *facilities*³⁶; citizens need to be able to fund an increase in school services as well without achieving a two-thirds majority.

At least at first, our Citizen A is going to like this proposal but what of Citizen B? Much like the Proposition 39 compromise, Citizen B should be mollified by the fact that these are procedural changes at the local level that empower citizens; it does not raise taxes or increase services and, indeed, may lower taxes on the whole because local citizens will keep a sharper eye on what is being spent.³⁷ This suggests how this compromise may be further operationalized. First, a fifty-five percent supermajority threshold could be retained for all local tax increases. Second, there could be further oversight procedures that these bonds or taxes require. Third, there could be some limit as to how much money these new taxes can raise, much like Proposition 39, though it is the advice of this observer to keep that limit generous and statutory to retain flexibility.³⁸

Finally, this increase in local government spending flexibility should be coordinated with diminishing the state's responsibilities, particularly for education. This increase in local spending power can be reasonably paired with loosening Proposition 98's guarantees as to state education finance and the lowering of state tax rates (particularly income tax rates). In essence, these changes would make the state a guarantor for a lower level of education spending,

36. CAL. EDUC. CODE § 15100 (2009).

37. Indeed, in Wisconsin, overrides of tax limitation regimes often fail. See Gary Young et al., *Efforts to Override School District Property Limitations*, in *EROSION OF THE PROPERTY TAX BASE* (Nancy Y. Augustine et al., eds. 2009). Furthermore, in Massachusetts, which also has its own property tax limitation regime, communities that strongly supported the statewide tax limitation have been especially likely to favor local overrides. See David M. Cutler et al., *Restraining the Leviathan: Property tax limitation in Massachusetts*, 71 J. PUB. ECON. 313 (1999). This indicates not only that there is money that we are neglecting to invest in ourselves, but also that there is a deeper principle at stake, namely that local communities should be allowed to invest in themselves.

38. Ideally, the system would simply be one in which local governments had discretion and there were no one-size fits all limits, and any local tax overrides were subject to some sharing arrangement, as many of the proposals from the 1970s would have required, but a maximum tax rate and the ability to override without sharing is still preferable to the current system. Cf. LEGISLATIVE ANALYST, PUBLIC SCHOOL FINANCE, PART V: CURRENT ISSUES IN EDUCATIONAL FINANCE 21–22 (Jan. 12, 1971).

and would free localities to spend more. In other words, the state of California would return to some of the disparities in resources that motivated the *Serrano* school finance litigation that required equalization to begin with. At this juncture, Citizen A will have second thoughts about this proposal but let us consider the education issue a bit further.³⁹

There is afoot a dominant explanation of Proposition 13 as having been caused by the *Serrano* school equalization decisions.⁴⁰ This explanation is probably not true, even assuming the notion of a “cause” for such a complicated event is sensible.⁴¹ However, the depth and speed with which this (at best partial) explanation has caught on suggests that the converse of this dubious causality may be true—that is, even though *Serrano* did not cause Proposition 13, relaxing *Serrano* might help with the relaxing of Proposition 13.

In order to understand, and maybe embrace, this paradox, we need to understand a few background facts. First, the *Serrano* decisions ultimately held that Californians had a fundamental interest in education and that deviations from providing each child the same quality education must pass a test of strict scrutiny—doling out education dollars based on property tax wealth did not pass constitutional muster.⁴² Second, the “*Serrano* caused Proposition 13” theory surmises that voters will refuse to pay the local property tax if the primary good the tax is used for, namely education, is equalized across the state (as was the case in *Serrano*). Third, even though this simple explanation is not true (e.g., because voters seemed far more concerned about a great deal of property value inflation and concomitant property tax inflation), it does reflect on the current political reality. That is, Californians now need to agree to spend

39. The same basic arguments apply to other facilities and services that would more likely be distributed more unequally, but the issue seems especially important in connection with education.

40. See generally WILLIAM FISCHER, *THE HOMEVOTER HYPOTHESIS* 98–128 (2001).

41. See Shanske, *What the Original Property Tax Revolutionaries Wanted (It Is Not What You Think)*, 1 CAL. J. OF POL. & POL’Y 18 (2009) (reviewing ISAAC W. MARTIN, *THE PERMANENT PROPERTY TAX REVOLT: HOW THE PROPERTY TAX TRANSFORMED AMERICAN POLITICS* (2008)).

42. See *Serrano v. Priest*, 557 P.2d 929, 952 (“[W]e have concluded that the state public school financing system here under review, because it establishes and perpetuates a classification based upon district wealth which affects the fundamental interest of education, must be subjected to strict judicial scrutiny in determining whether it complies with our state equal protection provisions.”).

more on education and they apparently will not do so unless some significant amount of the new revenue goes to their children.

Finally, it cannot be overstated how pitiable and unequal public education currently is in California despite *Serrano*.⁴³ We do not have space to plumb the depths, but a few points are essential for our purposes. California spends less than the national average per student, and this decline in spending is correlated with a decline in achievement.⁴⁴ Even more importantly for *Serrano* purposes, the distribution of education resources remains unbalanced in ways that are at least as problematic as before the one-two punch of *Serrano* and Proposition 13.⁴⁵ For instance, since the advent of Proposition 13 and the decline of California's public schools, private school attendance has increased,⁴⁶ as has the funding of private foundations to aid local public schools.⁴⁷ Furthermore, despite nominally equal funding from the state per pupil, there remain huge discrepancies as to the amount invested in school facilities; this is because, among other reasons, local communities can still pass bond measures that go toward local school facilities and increased services.⁴⁸

And so it is time to take a step back. Is more inequality acceptable—and there might not be more given where we are now—in order to have more of our schools adequately funded? The history of the *Serrano* litigation in California and the experience of other states are again instructive. The California Supreme Court's first *Serrano* decision was in 1971. In response, the California legislature put in place a scheme that went some way towards equalizing current resources, with an aspirational goal of “convergence” of resources. Such convergence, however, was always unlikely to happen because of the existence of local “overrides,” which were exactly what they

43. In considering the grim statistics that follow, it is worth remembering that in 1963-64, “California rank[ed] first [among states] in total [public elementary and secondary education] expenditures per capita and seventh in current expenditures per pupil....” SENATE FACT FINDING COMMISSION ON REVENUE AND TAXATION, STATE AND LOCAL FISCAL RELATIONSHIPS IN PUBLIC EDUCATION IN CALIFORNIA 23 (March 1965). It is notable that even at this time California paid its teachers well relative to rest of the country. *Id.* at 23-24.

44. Brunner & Sonstelie, *supra* note 24 at 72-73.

45. Large disparities in resources still exist between districts, though they are not strongly correlated with poverty level, race or urban status. Susanna Loeb et al., DISTRICT DOLLARS: PAINTING A PICTURE OF REVENUES AND EXPENDITURES IN CALIFORNIA'S SCHOOL DISTRICTS i-ii (2006).

46. Brunner and Sonstelie, *supra* note 24, at 75-76.

47. *Id.* at 77-80.

48. See *id.* at 80-83 (parcel taxes); Loeb, *supra* note 45, at 54-55 (disparity in facility funding).

sound like—a local community voting to override the minimum level of school funding and providing more.⁴⁹ As the California Supreme Court eventually held in 1976 in *Serrano*, because overrides stood in the way of there ever being true convergence and because overrides were overwhelmingly likely to happen in property tax base rich areas, as had already happened in 1976, the proposed reformed school finance system failed to deliver real equality of resources.

But, as just noted, *Serrano* has not done away with overrides, at least pragmatically—whether through paying to live in a more expensive home, sending one's kids to a private school, giving to a private foundation or approving a local bond measure (or parcel tax). This should not be surprising, as overrides were long a part of California school finance and remain a part of school financing around the country. Indeed, I do not read even the final decision of the California Supreme Court in *Serrano* as necessarily barring any such override structure,⁵⁰ but there is good reason to make this explicit in the new Constitution, especially since the Constitution must be amended anyway if overrides above the one percent ad valorem limit mandated by Proposition 13 are to be allowed (and without a two-thirds majority).

Education is by far the biggest expense under discussion and placing it on a firmer, more local footing takes a lot of the pressure off of the state budget. Giving local entities more funding power in general takes the sting out of state retreats from funding all manner

49. California had a system of maximum property tax rates and numerous possibilities for local overrides starting in 1931. Thus, this is not a new system and it does not simply date to the period between the Supreme Court's two *Serrano* decisions. LEGISLATIVE ANALYST, *supra* note 38, at 11–13; *Serrano*, 557 P.2d at 933 (“Nearly all districts [before 1971] . . . voted to override the statutory limits.”). It was understood when overrides were discussed in the 1970s that they would undermine equality, but might be required by “political necessity.” See, e.g., W. Norton Grubb, *The First Round of Legislative Reforms in the Post-Serrano World*, 38 LAW & CONTEMP. PROBS. 459, 467 (1973).

50. The availability of overrides undermined the likelihood that districts would “converge” in terms of overall spending per pupil, but at this point there has arguably already been a great deal of convergence and overrides might pose less of a problem—certainly, there is more of an argument that they are a necessity. *Serrano*, 557 P.2d at 937 (“The revenue limit feature of the new law has similarly serious defects. By taking 1972–73 revenues as its base figure, it perpetuates inequities resulting from property tax base differentials. More importantly, it will allow total ‘convergence’ between high-spending revenue limits and rising foundation levels only after many, perhaps as many as 20, years—even assuming no voted overrides.”). For related contemporaneous wondering as to the mandate of *Serrano*, see, e.g., Lee S. Friedman, *The Ambiguity of Serrano: Two Concepts of Wealth Neutrality*, 4 HASTINGS CONST. L.Q. 487 (1977).

of facilities and services. The next proposal addresses fiscal volatility more directly.

Proposal 2: *Split the Property Tax Roll and Impose (Gradually) a Statewide Tax on Commercial Property Based on Market Values, but Eliminate (Gradually) the Corporate Income Tax.*

Assuming that the state continues to fund some part of education and is particularly concerned with equalization, as it should be, how should it fund this commitment? One source of revenue should be a statewide tax on commercial property that is dedicated to education. As with all the proposals herein, such a change is just a good idea. The first part of this proposal allows the property tax limitation imposed by Proposition 13 on commercial property to wither away.⁵¹ Commercial property should be taxed based on its market value and the rate of tax should be up to the discretion of the Legislature. Applying Proposition 13's limitations to commercial properties distorts economic decisions, by leading local governments to favor retail business that generate sales tax revenue (instead of the stunted property tax) and encouraging taxpayers to use obscure tax limitation techniques (to prevent a change of ownership that will trigger property tax reassessment).

Making the commercial property tax a statewide tax will lessen the competition between communities to attract retail tenants, which is a zero sum game that hurts almost all involved.⁵² Since they lessen distortions of the economy and provide new revenue, these changes ought to be popular with many, but lest they be seen as too much of a tax increase, these reforms can be paired with a reform to lower or eliminate the state corporate income tax.

The California state-level corporate income tax is, simply based on tax principles, a poorly designed tax because it is so easy for corporations to play jurisdictions against each other or just leave.⁵³

51. There are many good arguments for such a change and estimates for possible revenue, but see especially Steven M. Sheffrin, *Economic Aspects of a Split-Roll Property Tax* (Feb. 2009), <http://www.cotce.ca.gov/documents/reports/documents/Economic%20Aspects%20of%20A%20Split.pdf> (last visited Mar. 20, 2010).

52. For a theoretical defense of a statewide commercial property tax base, see generally Kirk J. Stark, Note, *Rethinking Statewide Taxation of Nonresidential Property for Public Schools*, 102 YALE L.J. 805 (1992). For a recent example of such a program, see VT. STAT. ANN. tit. 32, § 5402 (2009). For the problem of the fiscalization of land use, see PAUL G. LEWIS & ELISA BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX (1999).

53. See, e.g., Kirk J. Stark, *The Quiet Revolution in U.S. Subnational Corporate Income Taxation*, 23 STATE TAX NOTES 775, 776 (2002). For another recent indictment of the state level corporate income tax, see James R. Nunns & Swaroop R. Chary, *A New Approach To State Corporate Taxation* 55 STATE TAX NOTES 259 (2010).

Furthermore, applying a corporate income tax is inherently extremely complex. Finally, the corporate income tax is another pro-cyclical tax, and so California would be replacing a less stable tax borne (at least initially) by business with a more stable tax also borne (at least initially) by business.⁵⁴ It would thus make sense for one to be ramped up while another is ramped down.⁵⁵

Proposal 3: *Expand the Current Sales Tax to Services, but Lower Its Rate and Allow Deficit Spending.*

The sales tax base has gotten narrower and narrower, which has caused, among other things, greater volatility.⁵⁶ The most common, and very reasonable, solution would be to broaden the sales tax base, but to do so in a manner that avoided “pyramiding”—that is, paying sales tax on sales tax for certain business inputs.⁵⁷

There are several issues with this solution. For one, as Citizen B would presumably note, if more goods and services are to be taxed, then this base broadening needs to be matched with lessening rates or this will be tantamount to a tax increase because the state will take in more revenue. This seems reasonable and there is precedent for this in the 1986 federal Tax Reform Act.

The traditional critique of greater reliance on the sales tax is that it is relatively regressive in its incidence. That is, poorer people will pay more in taxes than they do now because they spend more of their income—this is especially likely to be true if the sales tax base is broadened. We will assume this critique resonates with Citizen A. Citizen B might respond that, with a more stable tax base, there would be less need for draconian cuts to social services that disproportionately aid the less fortunate. To drive this point home,

54. See generally John L. Mikesell & Daniel R. Mullins, *State and Local Revenue Yield and Stability in the Great Recession*, 55 STATE TAX NOTES 267, 273 (2010) (finding that even during this last recession the property tax was much more stable than any other tax base, particularly the corporate income tax).

55. See COTCE REPORT, *supra* note 9, at 21, puts the figure for annual corporate income tax revenue at about \$9 billion. Estimates for revenue from a split roll range from \$2 billion to \$9 billion. See Sheffrin *supra* note 51. These estimates only assume that commercial property will be taxed at full value, but not that the tax rate on this property might be increased; I tend to think that the rate should be increased until the revenue from the new statewide split roll is of approximately the same magnitude of the corporate income tax.

56. COTCE REPORT, *supra* note 9, at 19–20, 33.

57. See generally Charles E. McLure, *How to Improve California's Tax System*, 52 STATE TAX NOTES 373 (2009). For a convincing critique of the COTCE approach to reforming California's tax system, see Charles McLure's contribution to this volume.

Citizen B might agree to some relaxing of the California Constitution's restrictions on financing economic deficits (perhaps on a simple majority vote of the Legislature).⁵⁸ So long as we have a more stable tax base, it makes sense to allow the state to borrow to smooth the volatility that will emerge nevertheless.

Proposal 4: *Retain the Tax on Capital Gains, but Place a Large Percentage of Resulting Revenues in the Rainy Day Fund.*

The capital gains tax portion of the income tax is particularly volatile; it makes up a significant, but ever changing, portion (between six percent and twelve percent) of income tax collected.⁵⁹ Rather than eliminate this (controversial) tax, one compromise would be to dedicate a significant portion of revenues from this tax (say forty percent) to a rainy day fund; this is especially appropriate because this tax is likely to result in much more revenue during good economic times. This is a way to keep relative progressivity in the tax code and lessen state budget volatility. The advent of a large rainy day fund should comfort Citizen B in lessening the state's borrowing restriction (per proposal #3 or #5). The ability of local government entities to raise more money should alleviate some of the concern of Citizen A that this revenue source will be taken partly off the table in regular years; it should also be comforting that this money will be committed to satisfying the commitments that the state makes even in rough economic times.

Proposal 5. *Allow State Borrowing, but Require Commitment of New Revenues to All Borrowings.*

It has now become a central tenet of fiscal federalism that subnational governments require a hard budget constraint so that each unit bears responsibility for its actions.⁶⁰ This understanding seems quite plausible, but this does not mean that states should not be allowed to borrow. As noted above, the ability to borrow to lessen the impact of an economic cycle seems like manifestly a good idea. Furthermore, it makes sense for states to be able to borrow for long-term capital projects.

That said, there has been a consistent tendency for voters in California to approve borrowings for specific projects at the state level without also approving either tax increases or spending decreases to fund these projects. California voters also tend to

58. For the current rule, see CAL. CONST. art. 16, § 1.

59. COTCE REPORT, *supra* note 9, at 17; Decker, *supra* note 17, at 124.

60. See, e.g., Barry R. Weingast, *Second Generation Fiscal Federalism: The Implications of Fiscal Incentives*, 65 J. URB. ECON. 279, 285 (2009).

approve tax cuts without spending cuts. Both Citizen A and Citizen B should agree that this practice should not be allowed. As noted above, we cannot be sure what it is Californians do want, but we need to restrain ourselves from continually trying to get something for nothing.⁶¹

Proposal 6: *Make it Easier to Raise Tax Rates, but Restrain Spending in Some Other Way.*

The California Constitution requires a two-thirds majority of the Legislature to raise taxes,⁶² and a two-thirds majority to pass a budget.⁶³ These provisions have not prevented the growth of California's government,⁶⁴ but they have (certainly recently) obstructed responding to volatile swings in California's budget situation.

Given that they are ineffectual except in causing gridlock, there is very good reason to change these rules, but Citizen B will ask, reasonably, for something in return given that these rules serve to give the minority party (currently the Republican Party) a lot of power.⁶⁵

There are several possible compromises we might adopt. First, some commentators, likely to be sympathetic with Citizen B's perspective, think it was a mistake for the voters to undo the limitations on state revenue growth added by the Gann Initiative in 1979.⁶⁶ There are other options. For instance, the two-thirds budget rule only originally kicked in when the proposed budget reflected a five percent increase in spending.⁶⁷ A similar rule could be reinstated for the budget and taxes, making it easier to raise tax rates during a crisis just to keep revenue at about the same level.

61. Cf. Gamage 2009, *supra* note 11, at 62. Again, this would require changing CAL. CONST. art. 16, § 1.

62. CAL. CONST. art. 13A, §3.

63. CAL. CONST. art. 4, §12(d).

64. See Cain & Mackenzie, *supra* note 27.

65. Cf. John Fund, *Proposition 13: A Watershed Moment Bridging FDR and Reagan*, 1 CAL. J. OF POL. & POL'Y 15, at 3-4 (2009), available at <http://www.bepress.com/cjpp/vol1/iss1/15>.

66. CAL. CONST. art. 13B. These limits were loosened by Proposition 111 in 1990. For a discussion of how the Gann initiative was to work and how it was undone by Proposition 111, see JOSEPH GRODIN ET AL., *THE CALIFORNIA STATE CONSTITUTION* 251-63 (1993). This is definitely a sore point for more politically conservative commentators. See, e.g., DAVID R. DOERR, *CALIFORNIA'S TAX MACHINE* 227-29 (2000).

67. Tony Quinn, *Origins of a Stalemate*, 1 CAL. J. OF POL. & POL'Y 7, at 1 (2009), available at <http://www.bepress.com/cjpp/vol1/iss1/7>.

It would also be possible just to suspend the two-thirds rules in case of crisis⁶⁸ or, alternatively, have the two-thirds rules only apply when there is a proposed *increase* in total revenue (or budget) and not merely an increase in tax rates.⁶⁹

The ultimate rationale for these changes is that no one gains when there is legislative gridlock in the midst of a crisis. The goal is to design a better way to respect the views of those who fear a growth in government while also enabling the government to at least function during a crisis. Having the sales tax rate go up 0.5% in a crisis is not as disruptive to the state economy as whether or not vital social services are going to be cut.⁷⁰ All of the expedients canvassed above do prevent the state from undertaking to provide expensive new social services without a two-thirds majority in the first instance.

Proposal 7: *Ease Residential Property Tax Limitations, but Institute Aggressive Circuit Breakers.*

I will not dwell too much on property tax limitations as they relate to *residential* property so as not to waste time on the politically impossible, but there are a few points worth noting if anyone cares to discuss it. First, as I have argued elsewhere, this is the time to move to a market-value assessment system since so many people have assessed values below the market value of their homes.⁷¹ Second, Proposition 13 is problematic as concerns the return of the property tax base after a precipitous fall in values; that is, if real estate values fall dramatically, as they have in California, but, per Proposition 13, these values can only be re-assessed upward at two percent per year, then it will take a very long time for California's anemic property tax base to even return to where it was.⁷²

Finally, if one is concerned about rapidly rising property taxes forcing people, especially those on fixed incomes, out of their homes, then there are much better ways to protect them—most especially through circuit breakers. Circuit breakers, as their name suggests, prevent the property tax burden from exceeding a set percentage of a household's income. In the past, the primary draw of circuit breakers was that they helped poor people more effectively. That is still true,

68. Cf. Gamage 2009, *supra* note 11, at 61.

69. Gamage 2010, *supra* note 12, at 35–50.

70. *Id.* at 17–35 (arguing that it makes more sense to have tax rates volatile relative to having spending volatile).

71. See Shanske, *supra* note 41, at 11–13.

72. *Id.*

but in the midst of this crisis it is also worth adding that blanket tax limitation regimes like Proposition 13 are also much more expensive.⁷³

Conclusion

The seven proposals above are very far from the only ones possible. These proposals do represent major changes to our fiscal constitution and all of them address what I believe to be our primary problem, fiscal volatility, while offering something of value to our imagined citizens with very different political perspectives. If some of these compromises—or compromises like them—gained traction, then this observer would be much more optimistic about a constitutional convention. Of course, if several such compromises did gain a lot of traction, then there would not even be a need for a convention.

73. See Terri A. Sexton, *Assessment Limits as a Means of Limiting Homeowner Property Taxes*, in *EROSION OF THE PROPERTY TAX BASE* at 117, 139 (Nancy Y. Augustine et al., eds. 2009) (concluding that assessment limits “are among the least effective, equitable, and efficient strategies available for providing property tax relief”).