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William Voegeli

The Big-Spending, High-Taxing, Lousy-Services Paradigm

California taxpayers don't get much bang for their bucks.

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In 1956, the economist Charles Tiebout provided the framework that best explains why people vote with their feet. The "consumer-voter," as Tiebout called him, challenges government officials to "ascertain his wants for public goods and tax him accordingly." Each jurisdiction offers its own package of public goods, along with a particular tax burden needed to pay for those goods. As a result, "the consumer-voter moves to that community whose local government best satisfies his set of preferences." In selecting a jurisdiction, the mobile consumer-voter is, in effect, choosing a club to join based on the benefits that it offers and the dues that it charges.

America's federal system allows, at the state level, for 50 different clubs to join. At first glance, the states seem to differ between those that bundle numerous high-quality public benefits with high taxes and those that offer packages of low benefits and low taxes. These alternatives, of course, define the basic argument between liberals and conservatives over the ideal size and scope of government. Except for Oregon, John McCain carried every one of the 17 states with the lowest tax levels in the 2008 presidential election, while Barack Obama won every one of the 17 at the top of the list except for Wyoming and Alaska.

It's not surprising, then, that an intense debate rages over which model is more satisfactory and sustainable. What is surprising is the growing evidence that the low-benefit, low-tax alternative succeeds not only on its own terms but also according to the criteria used by defenders of high benefits and high taxes. Whatever theoretical claims are made for imposing high taxes to provide generous government benefits, the practical reality is that these public goods are, increasingly, neither public nor good: their beneficiaries are mostly the service providers themselves, and their quality is poor. For evidence, look to the two largest states in the nation, which are fine representatives of the liberal and conservative alternatives.

One out of every five Americans is either a Californian or a Texan. California became the nation's most populous state in 1962; Texas climbed into second place in 1994. They are broadly similar: populous Sunbelt states with large metropolitan areas, diverse economies, and borders with Mexico producing comparable demographic mixes. Both are "majority-minority" states, where non-Hispanic whites make up just under half of the population and Latinos just over a third.

According to the most recent data available from the Census Bureau, for the fiscal year ending in 2006, Americans paid an average of $4,001 per person in state and local taxes. But Californians paid $4,517 per person, well above that national average, while Texans paid $3,235. It's worth noting, by the way, that while state and local governments in both California and Texas get most of their revenue from taxes, the revenue is augmented by subsidies from the federal government and by fees charged for governmental services and facilities, such as trash collection, airports, public university tuition, and mass transit. California had total revenues of $11,160 per capita, more than every state but Alaska, Wyoming, and New York, while Texas placed a distant 44th on this scale, with revenues of all governmental entities totaling $7,558 per person.

What might interest Tiebout is that while California and Texas are comparable in terms of sheer numbers, their demographic paths are diverging. Before 1990, both states grew much faster than the rest of the country. Since then, only Texas has continued to do so. While its share of the nation's population has steadily increased, from 6.8 percent in 1990 to 7.9 percent in 2007, California's has barely budged, from 12 percent to 12.1 percent.

Unpacking the numbers is even more revealing—and, for California, disturbing. The biggest contrast between the two states shows up in "net internal migration," the demographer's term for the difference between the number of Americans who move into a state from another and the number who move out of it to another. Between April 1, 2000, and June 30, 2007, an average of 3,247 more Americans moved out of California than into it every week, according to the Census Bureau. Over the same period, Texas saw a net gain, in an average week, of 1,544 people. Aside from Louisiana and Mississippi, which lost population to other states because of Hurricane Katrina, California is the only Sunbelt state that had negative net internal migration after 2000. All the other states that lost population to internal migration were Rust Belt basket cases, including New York, Illinois, New Jersey, Michigan, and Ohio.

As Tiebout might have guessed, this outmigration has to do with taxes. Besides Mississippi, every one of the 17 states with the lowest state and local tax levels had positive net internal migration from 2000 to 2007. Except for Wyoming, Maine, and Delaware, every one of the 17 highest-tax states had negative net internal migration over the same period. Conservative researchers' technical explanation for this phenomenon is: "Well, duh." Or, as Arthur Laffer and Stephen Moore wrote in the *Wall Street Journal* earlier this year: "People, investment capital and businesses are mobile: They can leave tax-unfriendly states and move to tax-friendly states."

Summarizing the findings of a report they wrote for the American Legislative Exchange Council, Laffer and Moore pointed out that between 1998 and 2007, the states without an individual income tax "created 89 percent more jobs and had 32 percent faster personal income growth" than the states with the highest individual income-tax rates. California's tax and regulatory policies, the report predicts, "will continue to sap its economic vitality," while Texas's "pro-growth" policies will help it "maintain its superior economic performance well into the future." The clear implication is that California should become more like Texas.

At this point, defenders of the high-benefit, high-tax paradigm push back. Remember the other half of Tiebout's equation, they say. There's no need for a state to be like Texas if its high taxes and extensive regulations are part of a package deal that yields more and better public goods and an attractive quality of life.

But that, it turns out, is a big "if." It's true that many people are less sensitive to taxes and more concerned about public goods, and these consumer-voters will congregate in places with extensive services. But it's also true, all things being equal, that everyone would rather pay lower than higher taxes. The high-benefit, high-tax model can work, but only if the high taxes actually purchase high benefits—that is, public goods that far surpass the quality of those available to people who pay low taxes.

And here, California is decidedly lacking. The biggest factor accounting for California's loss of population to the other 49 states, bond ratings that would embarrass Chrysler or GM, and state politics contentious and feckless enough to shame a banana republic, has to be its public sector's diminishing willingness and capacity to fulfill its promises to taxpayers. "Twenty years ago, you could go to Texas, where they had very low taxes, and you would see the difference between there and California," Joel Kotkin, executive editor of NewGeography.com and a presidential fellow at Chapman University in Southern California, told the *Los Angeles Times* this past March. "Today, you go to Texas, the roads are no worse, the public schools are not great but are better than or equal to ours, and their universities are good. The bargain between California's government and the middle class is constantly being renegotiated to the disadvantage of the middle class."

Similarly, the CEO of a manufacturing company in suburban Los Angeles told a *Times* reporter that his business suffered less from California's high taxes than from its ineffectual services. As a result, the company pays "a fortune" to educate its employees, many of whom graduated from California public schools, "on basic things like writing and math skills." According to a report issued earlier this year by McKinsey & Company, Texas students "are, on average, one to two years of learning ahead of California students of the same age," though expenditures per public school student are 12 percent higher in California.

State and local government expenditures as a whole were 46.8 percent higher in California than in Texas in 2005–06—$10,070 per person compared with $6,858. And Texas not only spends its citizens' dollars more effectively; it emphasizes priorities that are more broadly beneficial. In 2005–06, per-capita spending on transportation was 5.9 percent lower in California than in Texas, and highway expenditures in particular were 9.5 percent lower, a discovery both plausible and infuriating to any Los Angeles commuter losing the will to live while sitting in yet another freeway traffic jam. With tax revenues scarce and voters strongly opposed to surrendering more of their income, Texas officials devote a large share of their expenditures to basic services that benefit the most people. In California, by contrast, more and more spending consists of either transfer payments to government dependents (as in welfare, health, housing, and community development programs) or generous payments to government employees and contractors (reflected in administrative costs, pensions, and general expenditures). Both kinds of spending weaken California's appeal to consumer-voters, the first because redistributive transfer payments are the least publicly beneficial type of public good, and the second because the dues paid to Club California purchase benefits that, increasingly, are enjoyed by the staff instead of the members.

Californians have the best possible reason to believe that the state's public sector is not holding up its end of the bargain: clear evidence that it used to do a better job. Bill Watkins, executive director of the Economic Forecast Project at the University of California at Santa Barbara, has calculated that once you adjust for population growth and inflation, the state government spent 26 percent more in 2007–08 than in 1997–98. Back then, "California had teachers. Prisoners were in jail. Health care was provided for those with the least resources." Today, Watkins asks, "Are the roads 26 percent better? Are schools 26 percent better? What is 26 percent better?"

The steady deterioration of California's public services hasn't gone unnoticed. Shortly after his stunning ascension to the governor's office in 2003, Arnold Schwarzenegger established an advisory commission, the California Performance Review (CPR), to recommend ways to make governance in California smarter, cheaper, and better. The commission labored through 2004 before delivering a doorstop report with more than 1,200 recommendations for streamlining this and consolidating that, along with an assessment that implementing the full list of changes could save California $32 billion over the first five years.

And then . . . nothing, really. The 2,500-page report was "dead on arrival," according to Bill Whalen of the Hoover Institution, "because it was too complicated for voters to rally behind and legislators didn't want to see it enacted." Citizen Schwarzenegger may have assumed that his personal star power and the CPR recommendations' plodding good sense would make a politically irresistible combination. Such reckoning failed to account for the formidable ability of even the most obscure and otiose governmental body to hunker down, defend its turf, and outlast mere politicians.

The CPR, for example, recommended abolishing dozens of California's commissions and advisory boards, either outright or by folding their activities into a simpler and more rational organizational structure. Five years later, few of these vestigial organs have been removed. The many that remain include the Commission on Aging, whose lead accomplishment for 2009 is getting the legislature to declare a Fall Prevention Week (which began on the first day of autumn, naturally); the Apprenticeship Council, "which has been in place since the 1930s," according to the CPR, and "is no longer needed to perform regulatory and advisory responsibilities"; the Board of Barbering and Cosmetology; the Court Reporters Board; and the Hearing Aid Dispensers Bureau.

The point is not that turning a flamethrower on every item in the Museum of Governmental Anachronisms would have saved California a great deal of money. It is, rather, that abolishing these boards and commissions, whose names are talk-radio punch lines, would have been the easy calls, the obvious first steps toward giving California's taxpayers a decent return on their surrendered dollars. Yet even the low-hanging fruit proved out of reach. The path of least resistance was to do the same old thing, not the sensible thing.

The resistance comes from the blob of interest groups, inside and outside government, that like California's public sector just fine the way it is and see reform as a threat to their comfortable, lucrative arrangements. It turns out, for example, that all the pointless boards and commissions are bulletproof because they provide golden parachutes to politicians turned out of the state legislature by California's strict term limits. In the middle of the state's most recent budget crisis, State Senator Tony Strickland proposed a bill to eliminate salaries paid to members of boards and commissions who, despite holding fewer than two formal hearings or official meetings per month, had received annual compensation in excess of $100,000. The bill died in committee.

James Madison would have to revise—or possibly burn—Federalist No. 10 if he were forced to account for the new phenomenon of the government itself becoming the faction decisively shaping its own policy and conduct. (See "Madison's Nightmare" in *City Journal*'s 2009 special issue, "New York's Tomorrow.") This faction dominates because it's playing a much longer game than the politicians who come and go, not to mention the citizens who rarely read the enormous owner's manual for the Rube Goldberg machine they feed with their dollars. They rarely stay outraged long enough to make a difference.

Take entitlements and public-employee pensions, which are, Watkins says, "the real source of the state's fiscal distress." A 2005 study by the Legislative Analyst's Office (California's version of the

Congressional Budget Office) found that pensions for California's government employees "surpassed the other states—often significantly—at all retirement ages." California government workers retiring at age 55 received larger pensions than their counterparts in any other state (leaving aside the many states where retirement as early as 55 isn't even possible). The California Foundation for Fiscal Responsibility periodically posts a list of retired city managers, state administrators, public university deans, and police chiefs who receive pensions of at least $100,000 per year. The latest report shows 5,115 lucky members in this six-figure club. The state's annual bill for polishing their gold watches is $610 million.

Again, the most vivid part of the problem is not the most important. California would move only slightly closer to regaining fiscal health if it scraped the gilding off the pensions and health benefits of its most lucratively retired employees. But when even a flagrant example of a government's serving its workforce better than its citizens is politically unassailable, it's hard to be hopeful about the mundane reforms needed to change the rest of the economically debilitating public-employee retirement system. The California Performance Review suggested the sensible thing: gradually substituting defined-contribution for defined-benefit pension plans. (According to a report by the Pew Center on the States, just 20 percent of the nation's private-sector employees are enrolled in a defined-benefit pension plan, compared with 90 percent of public-sector employees.) To no one's shock, the state legislature has rejected all proposals to curb the state's financial obligations to its retired and retiring employees.

If California doesn't want to be Texas, it must find a way to be a better California. The easy thing about being Texas is that the government has a great deal of control over the part of its package deal that attracts consumer-voters—it must merely keep taxes low. California, on the other hand, must deliver on the high benefits promised in its sales pitch. It won't be enough for its state and local governments to spend a lot of money; they have to spend it efficiently and effectively.

The optimistic assessment is that things are going to get worse in California before they get better. The pessimistic assessment is that they're going to get worse before they get much worse. As is often the case, hanging around with the pessimists is less fun but more instructive. The current recession has driven California's state government into what amounts to a five-month budget cycle, according to Dan Walters of the *Sacramento Bee*. He estimates that the budget deal tortuously wrought in July should start falling apart in October, because it was predicated on pie-in-the-sky revenue estimates and because so many of its spending cuts are being challenged, often successfully, in the courts.

The recession will eventually end and California's finances will improve, say the optimists. Given the state's pervasive political bias against efficient and effective public services, however, the question is whether its finances will ever get truly well. States that have grown accustomed to thinking of the engine that drives their economies as an inexhaustible resource—whether it's Michigan and the auto industry, New York and Wall Street, or California and the vision of the sunlit good life that used to attract new residents—find it tough to compete again for what they thought would be theirs forever, and to plan budgets for lean years that turn into lean decades. Instead, they invest their hopes in a deus ex machina that will rescue them from the hard choices they dread.

For California's governmental-industrial complex, a new liberal administration and Congress in Washington offer plausible hope for a happy Hollywood ending. Federal aid will replace the dollars that California's taxpayers, fed up with the state's lousy benefits and high taxes, refuse to provide. Americans will continue to vote with their feet, either by leaving California or disdaining relocation there, but their votes won't matter, at least in the short term. Under the coming bailout, the new 49ers—Americans in the other 49 states, that is—will be extended the privilege of paying California's taxes. At least they won't have to put up with its public services.

William Voegeli is a contributing editor of The Claremont Review of Books *and a visiting scholar at Claremont McKenna College's Salvatori Center. His book on the American welfare state will be published by Encounter in 2010.*