Loren Kaye: State tax hike talk must be linked to budget reform

By Loren Kaye - Special to The Bee
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Is it better to ask permission or beg forgiveness? The California Legislature must believe it is better to beg forgiveness since they never sought permission to raise taxes to pay for a spending spree that has increased outlays by 80 percent since 1998.

Now, faced with a deep budget deficit, many elected officials are advocating tax increases to pay for overspending.

Fiscal conservatives argue that such behavior should not be excused, let alone rewarded. But is this budget situation so grave as to warrant an exception? And does it present an opportunity to achieve permanent reforms that will prevent future fiscal mismanagement and enhance California's economic prospects?

A good analogy is the current liquidity crisis in the nation's financial markets. Many have convincingly argued that the government should not bail out investors who didn't do their underwriting homework, since it would reward recklessly risky investments and encourage future irresponsible behavior. Yet when the liquidity crisis threatens to engulf our overall financial system and places the U.S. economy at risk, the government must put principle to the side and find a practical solution that protects the economy.

In California, should the taxpayers step in and bail out elected officials who had to know someday that bill would come due?

New taxes can serve to bridge a temporary gap in resources, but the fundamental cause of this budget shortfall is an expenditure trajectory that outpaces revenues.

During the past four years, while state revenue growth has exceeded the long-term, sustainable average growth rate by about a half-percentage point a year – $2.9 billion over four years – spending has grown above the long-term average by more than 2 percentage points a year – $10.6 billion.

The governor is right: California does not have a revenue problem. We have a spending problem.

Tax increases are not long-term solutions for budget deficits, especially if they worsen the fiscal ups and downs. The most popular taxes are those levied on somebody else – usually the wealthy or out-of-favor businesses. But these taxes are
subject to profound behavioral changes by taxpayers and therefore are most likely to underproduce revenues.

Voters have usually rejected these new taxes – and measures making it easier to raise taxes – recognizing the effect they would have on the state's economy, jobs and the prices of goods and services.

The unavoidable risk in raising taxes today is to suggest that reckless behavior is not only condoned, but may be encouraged in the future. Yet, as with the securities markets, common sense must prevail against principle if critical public services are at risk.

It is simply implausible that we can solve in a single year a deficit problem unaddressed for years without devastating important education, public safety and safety net programs.

But at the same time, since the magnitude of the state's fiscal crisis has become known, discussion of new taxes has been untethered from consideration of spending reform or tax equity.

Any budget solution – but especially one purchased with new taxes – must unshackle elected officials to set priorities: repeal automatic inflation adjustments, cap guaranteed benefit programs, reopen union contracts that automatically boost wages (including in school districts) and at long last control future public employee health care and retirement obligations.

And a budget solution that includes tax increases must be accompanied by education reforms that improve performance of programs that spend half of state revenues and are critical to California's economy.

Any tax increase should be legislated as a stop-gap measure that would be temporary. Taxpayers should be made whole during the upside of an economic cycle if they have been tapped for help during the downturn.

Republican legislators and the governor understand the peril of raising taxes to solve what is fundamentally a spending problem. But if new revenues do eventually become part of the mix, these same Republican players are uniquely positioned to offer up the important spending reforms, education improvements and tax limitations that will ensure the next budget is not a papered-over version of the last one.

The price to be paid for the unpalatable bailout of previously unregulated financial markets will be new and possibly onerous accountability and oversight by federal authorities. Should the Legislature enact higher taxes, they must assure Californians that not only will they discipline their spending, but also enact systemic reforms throughout government as the price for the taxpayer bailout.