Gov. Arnold Schwarzenegger unveiled a slash-and-burn state budget nearly two months ago, saying drastic action was needed to close the state's chronic ever-growing deficits and seemingly rejecting new taxes to do it.

From the onset, however, it remained uncertain how serious he was about erasing the deficit without new revenue demanded by Democrats, even though his aides kept insisting that he would, indeed, be willing to sign such a budget.

Then Schwarzenegger dropped a big hint that he wasn't quite as determined as he had portrayed himself, telling The Bee's editorial board that his budget was meant to "rattle the cages" of legislators, impressing them with the gravity of the situation in hopes that they'd agree to some kind of long-term budget reform.

That comment raised suspicions that he might be willing to trade some kind of revenue package for a tightly written spending limit, with more extra revenue going into reserves during prosperous years.

On Thursday, Schwarzenegger dropped another strong hint that he'd trade multibillion-dollar revenue for budget reform when, as he spoke to business leaders in Los Angeles, he seemingly endorsed a $2.7 billion package of revenue proposed by Legislative Analyst Elizabeth Hill, eliminating or narrowing a series of business and personal tax breaks – "loopholes" in the common parlance.

"Now, may I remind you, you see here – even though I'm a Republican, but I'm a big believer that when we have a financial crisis like this that we all should chip in. And this is why I totally agree with the Legislative Analyst's Office when she says that we should look at tax loopholes," Schwarzenegger said. "We should look at those seriously. She has identified $2.5 billion of tax loopholes, including the yacht tax is one of them. I think that we should go after those tax loopholes, because we would need the extra $2.5 billion. This is $2.5 billion we can give straight to education. I am totally for that. We should go for it, and we should do it, because everyone has to give something in order to make this work."

Bingo. Schwarzenegger had crossed the Rubicon into closing the deficit with new revenue of some kind that isn't a general tax rate boost – loophole closures to Democrats, tax increases to the GOP.
As Schwarzenegger's words spread through the Capitol, Democrats rejoiced and Republicans – almost all of whom had signed a no-new-taxes pledge – fumed. But even as the reaction began, Schwarzenegger backed away slightly, saying he was not specifically endorsing Hill's list of loophole closures but still wanted to explore that avenue.

"I think the key thing that we have to also do at the same time is, as I said in there, to take Liz Hill's recommendation and to look at – have Democrats and Republicans come together – and look at all the ideas that are available and where we can, you know, close some of those tax loopholes," he said. "Because I'm sure there is tax loopholes out there that we can close that will give us additional money for our budget so we don't have to make just cuts, that we can look at those revenues, and I think that's the important thing. I'm not for the recommendations she made, necessarily. I just think that Democrats and Republicans should work together on this and, you know, work on the budget as quickly as possible."

So there it is – an oblique but unmistakable invitation from the governor to the Democrats to swallow hard and accept some version of his budget reform plan in return for raising enough revenue to balance the budget without the draconian cuts in his initial budget. And a nudge to Republicans to trade some new revenue for the kind of spending limit they've long advocated.

Will it happen? Stay tuned.