Dan Walters: Governor's new stab at reform

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Were politics a rational process, the virtue of setting aside extra tax revenue during prosperous years to cushion the impact of income dips would be self-evident.

Politics is anything but rational, however, so Gov. Arnold Schwarzenegger's third stab at bringing discipline to the state's tortured finances has a less than 50-50 chance – probably a lot less – of gaining legislative and voter approval.

Republican Schwarzenegger's call for a spending limit was rebuffed by a Democratic Legislature shortly after he took office four years ago, and he settled for a weak substitute. Two years later, he tried to persuade voters to give governors more unilateral power to reduce spending when deficits appear, but his ballot measure was trounced at the polls.

On Tuesday, with the state facing a $14 billion-plus budget deficit over the next 18 months, Schwarzenegger renewed his plea for reform, this time with a measure to divert windfall revenue into a reserve that could be tapped only when income falls short of expectations.

"Professor Schwarzenegger is now going to explain the economics of our budget problem," Schwarzenegger told legislators in his annual State of the State address, citing the state's "binge and purge" budget process, driven by automatic spending mandates, and the need for predictability in state finances.

"When revenues jumped 23 percent in 1999-2000, or when they jumped 14 percent in 2005-2006, those were sugar highs," Schwarzenegger said. "I remember how everyone here was so enthusiastic and so hopeful and so creative about how to spend that money ... . Then the sugar is gone and we come down off our high. We spend it all one year and can't sustain it the next. We need to budget more evenly."

"When revenues spike upwards," Schwarzenegger said, "the amendment that I propose would not let us spend all the money that rushes in when the economy is good. Instead, we would set some of the good year money aside for bad years."

Schwarzenegger aides said he envisions a "rainy day fund" that could grow to as large as 15 percent of the state general fund, created from revenue that surpasses forecasts, to be tapped when revenue falls below expectations, plus automatic cuts in spending when revenue shortfalls threaten to create deficits. Conceptually that
would "smooth" the budget, avoiding both the spending binges when revenue climbs and deficits when it declines.

It may sound perfectly logical, but there are both philosophical and political pitfalls. Is it fair, for instance, to automatically reduce spending during shortfalls but leave any tax boost subject to an impossible-to-achieve two-thirds legislative vote? Democrats and major spending groups, such as educators, are likely to balk at such a one-sided approach to budget problems. They are already ramping up pressure for new taxes to ease chronic budget problems while Schwarzenegger stoutly resists new levies.

Educators, especially, are likely to oppose automatically diverting windfall revenue into the special reserve, thus denying schools their automatic share of those dollars, even if the administration says that in the long run, schools would benefit from having a more predictable revenue stream. It would indirectly tamper with the most cherished tool of the powerful "Education Coalition," Proposition 98, which voters enacted in 1988 to place a constitutional floor under school financing.

Schwarzenegger's proposal may be fine as far as it goes, but taking revenue off the table could be its fatal flaw, and a more comprehensive approach would include reforming the state's lopsided, loophole-ridden tax system that generates that boom-and-bust syndrome. Schwarzenegger referred to it obliquely during his address, but couldn't bring himself to address it directly.