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Daniel Weintraub: Spending limit likely key to any state budget deal

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As he so often does, Gov. Arnold Schwarzenegger now finds himself in the middle between his fellow Republicans and the Democrats in the Legislature, this time on the question of whether California government needs a new spending limit to end its cycle of boom-and-bust budgeting.

Republicans say yes, emphatically. They want a strict limit that would shrink the size of government over time. Democrats say no, just as firmly.

They want no artificial constraints on the power of the purse and say the state's problem is not reckless spending but a chronic shortage of tax revenue.

Schwarzenegger has taken a position that is more nuanced than the legislators' stances from either party, arguing for a measure that would smooth out the volatility in the state's revenue flows. His position is not so much ideological as practical: He wants to end the persistent deficits with a device that's nearly neutral on the ultimate size of government.

How Schwarzenegger is able to navigate between the polar opposites in the Legislature on this question might largely determine not only whether the state gets a spending limit but how the Legislature resolves the immediate crisis presented by a budget shortfall estimated to be in excess of \$15 billion. It appears more and more likely that any budget deal to address the short-term problem, especially if it involves new revenue, is going to have to also include some sort of long-term reform that satisfies Republican demands of "never again."

"This state has a spending addiction, and we need to treat it," Senate Republican Leader Dave Cogdill said last week. "We need to find a way to move forward with our budgeting processing in this state so ... we don't have to face the prospect of either increasing taxes or slashing services."

Cogdill's proposal wouldn't slash spending, but it would tighten a vise around government that would slowly shrink it as a share of the state's economy. His proposal, also backed by Assembly Republican Leader Mike Villines, would limit the growth in government to the combination of population growth and inflation.

Any tax revenue greater than that amount would be split between debt repayment and a rainy day fund that could only be tapped in years when revenue fell short of the annual growth allowed by the measure. If the new reserve reached a certain

amount, any additional surplus would be refunded to taxpayers with a temporary reduction in the sales tax.

Cogdill and Villines estimate that their plan would still allow government to grow by about 5 percent per year. But since the economy tends to grow, on average, at a faster rate than that, the measure would eventually shrink government relative to the private sector.

The inevitable effect of that trend would be offset somewhat by the requirement that half the surpluses be used for repaying debt. As the state's debt load shrunk, more money would be available in the budget to finance current programs.

But Democrats, at least so far, want no part of any new restrictions on state spending or revenue. Assembly Speaker Karen Bass has called the Republican proposal a "diversion" and says the state does not need another formula in the budget. "The issue," she said last week, "is raising revenue, and that's what we need to do."

The Democrats in the Assembly have put together a budget proposal that would require a tax increase of about \$6 billion. Their Senate counterparts would go further, raising revenue by an estimated \$11 billion a year. Neither group has said yet which taxes it wants to increase to collect that revenue. Currently, the state spends about \$100 billion a year from its general fund.

Then there is Schwarzenegger. He is not proposing any taxes to solve the short-term problem, preferring a combination of spending cuts, borrowing and deferrals. For the long term, he has proposed a budget reform that would limit the growth in spending each year to the average growth in tax revenue over the previous 10 years. Any amount beyond that would go into a new reserve and could be spent only in years when revenue growth fell short of the 10-year trend line.

That might sound similar to the Republican legislators' plan. But there is a crucial difference. Schwarzenegger's proposal would not limit the growth of government so much as smooth out the pace of that growth.

Eventually, all the money that comes into the state treasury would be spent. It would just be spent on a different time line than it is today.

But neither Democrats nor Republicans in the Legislature like the governor's proposal. Democrats complain that it would slow spending growth during the next boom cycle, when they would want the state to use new tax revenue to replenish programs that are being squeezed during the downturn.

Republicans don't like the plan because it would allow government to grow, eventually, to whatever level can be supported by the tax system, even allowing tax increases.

Watch this issue. It will likely be the closer in any budget deal, whether that happens next week, next month or sometime later this year.
