



California Assembly Speaker Karen Bass visits with Senator Abel Maldonado, one of the few Republicans in either chamber who broke ranks and voted with Democrats to pass a budget deal aimed at closing a \$42 billion shortfall for FY 2009 and FY 2010.

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CALIFORNIA COMPROMISE

The wrenching effort to forge a budget deal put a spotlight on the political impasse at the statehouse.

BY DANIEL WEINTRAUB

After years of bitter partisan battles over taxes, spending and the condition of the state's finances, the California Legislature in February adopted a compromise plan aimed at eliminating most of a \$42 billion gap between revenues and expenditures through June 2010.

The plan was supported unanimously by Democrats and by just enough Republicans—three in each house—to attain the two-thirds majorities needed to enact a budget in California. Republican Governor Arnold Schwarzenegger, who had been calling for such a grand compromise since last summer, signed the plan into law after rejecting nearly \$1 billion in spending with his line-item veto.

California's experience is important on several fronts. It shows that bipartisan agreements are possible even in the most polarized political environment. It demonstrates that determined lawmakers can set aside ideology and parochial interests and cast tough votes, in some cases putting their careers in jeopardy. But it also shows just how difficult all of that can be amidst what may be the deepest recession since the Great Depression.

Although the budget approved in February was officially early—it covered the remainder of this fiscal year and all of the next—it felt very late to many Californians, because the state has been grappling with budget shortfalls for most of this decade.

The plan includes about \$12.5 billion in new taxes, \$15 billion in spending cuts and \$5 billion in borrowing. It was linked to the federal stimulus plan and to a series of ballot

Editor's note: This is one in a series of in-depth state fiscal profiles as legislatures grapple with the recession, deep budget shortfalls and painful decisions on how to cut spending and increase revenue.



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measures that voters will weigh in a special election.

"Californians got a chance to see a Legislature that put the state's interest ahead of the interest of any individual," Senate President Pro Tem Darrell Steinberg told reporters after the vote. "If we can solve a \$42 billion budget deficit, we can solve anything in this state."

TAX HIKES, DEEP CUTS

The package increases a variety of taxes. It hikes income tax rates, already the highest in the nation, by 0.25 percent. It lowers an income tax credit for children and dependents from \$300 to \$100. It raises the sales tax by 1 cent on the dollar, putting it close to 10 percent in some counties. And it nearly doubles the state's car tax, from 0.65 percent of the value of a vehicle to 1.15 percent, adding about \$100 a year to the cost of registering a \$20,000 car.

The car tax increase was especially telling because that levy was the emotional touchstone of Schwarzenegger's first campaign for governor in 2003, when voters recalled Governor Gray Davis in a historic election. Schwarzenegger lowered the tax by two-

thirds with an executive order on his first day in office, as he had promised during the campaign. But the move cost the treasury more than \$4 billion annually, and the governor and legislators have been struggling to balance the budget ever since.

Democrats had been pushing for higher taxes, but Republicans held steadfast against them. Last year, however, Schwarzenegger abandoned his opposition to higher levies and began to work with Democrats to try to fashion a bipartisan plan. But Republican lawmakers continued to hold out, with all but one signing a written pledge to oppose all tax increases. The turning point came in December, when Democrats passed a plan that sought to raise new revenue using majority-vote bills, mostly by enacting a new "fee" on gasoline and using the revenue to boost the state's beleaguered general fund.

But that plan fell short of solving the entire problem, and it was controversial. Republican leaders told Schwarzenegger privately that if he vetoed the package, they would work with him on a truly bipartisan solution and help him get the handful of Republican votes needed to pass it. It took nearly two months to complete those negotiations, but they eventually bore fruit.

Democrats made many concessions to get those Republican votes. They agreed to far deeper spending cuts than they originally wanted, especially in education. K-12 education budgets will drop by more than \$2 billion this year, then be essentially frozen for another year. By the time the agreement expires in June 2010, the schools will be short more than \$8 billion from the amount they were expected to receive when the last budget was enacted in September.

There were also deep cuts in higher education, in services for the developmentally

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disabled, and in public assistance programs. Welfare recipients and the elderly, blind and disabled lost their cost-of-living increases and could see grant reductions if hoped-for federal funds don't come through. State employees will be furloughed one day a month and lose two holidays a year to cut overtime costs. And the state prison system, where costs have been growing rapidly, will take a big cut as more nonviolent inmates are released without parole.

NEW RULES

Republicans demanded more concessions beyond the spending cuts. They won new rules to streamline the process to obtain permits for infrastructure projects and allow more private engineers, rather than state employees, to design new highways. The plan also eliminates state environmental reviews before selling surplus property, and it gives local schools new discretion in deciding how to spend their budgets.

Even with all of those elements, only three Republicans in each house voted for the plan. And the deal cost Senate Republican Leader Dave Cogdill his job. He was dumped by his caucus in the middle of the night as negotiations hung in the balance.

"There's no question that this vote has been the hardest decision of my political career," Cogdill says. "If Republican votes alone could deliver a budget, there's no doubt this solution would look different. However, this budget compromise recognizes the political realities that we face."

Assembly Republican Leader Mike Villines also voted for the package. He said it was necessary to prevent the state from going over "a cliff" into insolvency.

"While I do not support everything in this budget, it was a step that we had to take to end the immediate crisis and get our state back on track," he says.

Schwarzenegger offered some political cover to the Republican members. "They've done a terrific job," he said. "They are, in my opinion, great heroes and I will always support them."

GOING TO THE VOTERS

Most of the agreement took effect immediately, but there were two major contingencies. One was the use of federal stimulus money. The parties agreed that the first \$5 billion the state receives from Washington will be used to prevent another round of borrowing from Wall Street, and the next \$2 billion will be used to rebuild the budget's short-term reserve. Any money that comes in above and beyond those levels can be used to roll back the tax increases in the plan or prevent deeper cuts in spending.

But even all of the cuts, taxes and federal money in the plan were insufficient to close the massive gap between anticipated revenues and spending, which on a one-year basis amounts to more than \$20 billion in a general fund that stands at about \$100 billion this year. To help close the rest of the shortfall, voters will be asked to pass a measure expanding the state lottery and then allowing the state to borrow against its future earnings from the numbers game.

Several other measures that were part of the budget deal will appear on the same ballot. The linchpin was a proposed spending limit that is designed to smooth out California's famously volatile revenue flows. It would require the state to set aside the first 1.5 percent of each year's tax receipts, plus any amount that exceeds the average revenue growth during the previous 10 years. That money would be placed in a rainy day fund that could be tapped only when revenues fall short of what is needed to allow the budget to grow at the same pace as population and inflation.

Republicans insisted on the spending limit but were fearful that Democrats, once the vote for the tax increases was in hand, would try to kill the rainy day fund at the ballot box. So the taxes and the spending limit were linked in a way that might seem odd to many voters. The tax hikes will initially last two years, but if the spending limit is approved, most of the tax increases will be extended another two years. The potential extra revenue for state programs is supposed to give Democrats an incentive

to support the spending limit, or at least not oppose it with a heavy advertising campaign.

Voters will also consider two measures to undo, temporarily, two ballot-box budgeting measures approved years ago. One raised tobacco taxes and dedicated the money to programs for children. The other placed an income tax surcharge on millionaires and earmarked the money for mental health programs. Some money from those measures would be redirected to the general fund, saving about \$500 million a year.

While the compromise linking the spending limit to the taxes made perfect sense inside the Capitol, it presents the voters with a tough choice. If they vote for the spending limit, they will extend the taxes by another two years. If they reject the spending limit, they will give themselves a tax cut after two years. A rejection of the spending measure would not unravel the entire deal, however, since the cuts and taxes enacted for the first two years would still take effect. But the governor and the Legislature would soon be forced to find an entirely new solution to the problem, even if the economy began to recover.

The deal could also have long-term repercussions for the state's political system because of the demands of Republican Senator Abel Maldonado. Maldonado won approval of a constitutional amendment to create an open primary system. The measure will appear on the ballot in 2010 and, if approved, would allow voters to choose any candidate in a primary regardless of party affiliation, with the top two vote-getters moving on to a general election.

"I don't want anything for my district," Maldonado told reporters before the vote. A moderate, he said the open primary would give legislators like him a better chance of ascending to higher office. He lost a primary race for state controller in 2006 to a more conservative Republican.

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