POLICY brief

Washington Research Council

PB 02-16 December 20, 2002

Governor's Budget Sets Priorities, Lives Within Means

BRIEFLY

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Governor Gary Locke's proposed budget for 2003-2005 reflects the fiscal realities confronting a state in recession. Last summer, the governor embarked on an innovative budget strategy, the "Priorities of Government" (POG) process, to focus state spending on high priority programs of demonstrated effectiveness. And the budget reflects that new approach.

In presenting his plan, the governor said, "With our identified priorities and our results-oriented funding, this proposal provides a vision for our state. … We're funding what matters most in getting the results that people want from their state."

Preserving existing services and accommodating projected growth in caseloads, enrollments, and program costs would have required $2.4 billion more than current revenues. Consequently, he faced difficult choices.

Governor Locke acknowledged that while he likes much about the budget, "there's also a lot I do not like." But he says his proposal is "not a Trojan horse for a tax increase."

Raising taxes when the economy remains fragile would jeopardize recovery and increase the burden on individuals and families struggling to get by.

The cuts in the budget proposal are receiving a lot of attention. To present a balanced budget, the governor proposed reductions in virtually every area of state spending. Education, social services, parks, health care, employee compensation, and corrections would all be affected. The budget plan also requires suspension or amendment of three popular ballot initiatives and eliminates 2,500 state jobs. These are real cuts, not simply reductions in proposed growth.

More important, however, are the positive choices made through the budget process. The proposed budget maintains the core functions of government and delivers on the governor's stated priorities.

He calls it a "a return to fundamentals." And, it's what the times require.

Overview

Under the governor's budget, the state would increase spending from $22.5 billion in the currently authorized biennial budget to nearly $23 billion. Forecast revenues increase from $22.1 billion to $22.7 billion. So, revenue growth of 7.4 percent permits an increase of spending

Washington Research Council
108 S Washington St., Suite 406
Seattle WA 98104-3408
206-467-7088
fax: 206-467-6957
www.researchcouncil.org

Priorities of Government

The POG budget process began by asking four basic questions:

1. How much revenue will we have for 2003-05 from whatever source?
2. What results form the core of what we must do and do well to serve the citizens of Washington?
3. How much can we/ will we spend to achieve each result?
4. How best can we spend that money to achieve our core results?

In essence, the process casts state government as a prudent buyer, purchasing services for the citizens to achieve the best outcomes within available revenues. To begin the process, budget staff and a management team identified ten categories of governmental activity (e.g., education, health, environmental protection, public safety). Agency experts, budget staff, and the management team set goals tied to measurable outcomes within each category.

Multi-agency staff teams evaluated programs and services, developing a set of priorities for spending within a defined budget ceiling. Inevitably, the process also resulted in recommendations for program reduction, elimination, and consolidation.

The results of this process informed the governor's budget preparation.

The POG represents a sharp departure from "business as usual," which typically begins with a baseline budget consisting of everything the state currently funds, and then increases it for caseload and enrollment growth, inflation, and "enhancements."

That's the approach that gives you a $2.4 billion shortfall in the current budget.

With the POG process, budget writers focus on buying the best outcomes, rather than simply wrestling with the incremental growth of existing programs. And by breaking down agency and departmental boxes to consider the broader functional activities of government, budget writers identify opportunities for increased synergy and efficiency.

The creative use of the POG this year helped the governor and his budget team make the choices required by the state's fiscal condition.

As the governor said, "We can't keep doing things the way we have in the past."

of just 2.4 percent. (See the balance sheet on, page 3.)

Spending in the 2001-2003 biennial budget exceeded spending by about $1.3 billion. (A 2003 supplemental budget, which will affect the 2001-2003 shortfall, will be considered in the coming session.) While spending in the governor's 2003-2005 budget continues to exceed current revenues, the $290 million gap represents considerable improvement.

The general shape of state spending does not change: the public schools would receive 44 percent of general fund spending; higher education, 12 percent; and social and health services, 28 percent.

With the governor's proposed supplemental appropriations, the projected general fund balance at the end of the current 2001-2003 biennium is $133 million. Including the Emergency Reserve Fund, overall projected reserves total $188 million.

The November revenue forecast pegs 2003-05 revenues at $22,700 million. During the 2003-05 biennium five tax incentive programs are scheduled to sunset: the sales tax deferral/exemption for manufacturing and R&D in counties with high rates of unemployment, the B&O reduction for environmental remediation, the B&O credit for high tech research and development, the B&O credit for software development and help desk services, and the B&O and public utility tax credits for small water districts. The revenue forecast assumes that these tax incentives will not be extended. Extending them all would reduce 2003-05 revenues by $99 million.

Under the terms of Initiative 728, the diversion of money from the general fund to pay for class size reductions is scheduled to jump up in FY 2005. The Governor proposes to eliminate this increase, thus increasing resources in the general fund by $221 million.

SB 6835, enacted by the 2002 legislature, extended the use tax to direct mail advertising printed and mailed from out of state, repairs performed out of state, and shipping and other freight charges. Due to a drafting error, the bill inadvertently extended the tax to the use of replacement machinery equipment that is exempt from the sales tax under the manufacturing machinery and equipment exemption. The Department of Revenue has thus far not collected use tax in these instances, anticipating that corrective legislation will be passed during the 2003 session. The governor's budget assumes that such legislation will not be enacted, and that the state will collect $60 million in additional taxes over the biennium.

General Fund-State Balance Sheet

GENERAL FUND	2001-03	2003-05
Beginning Fund Balance	599.1	133.3
November 2002 Revenue Forecast	21,126.2	22,689.7
2001-03 Transfers and Other Adjustments	1,094.6	
2003-05 Revenue Adjustments:		
Elimination of I-728 Increase		220.7
SB 6835		60.0
Other Adjustments		(5.0)
2003-05 Transfers		94.3
Total Resources (Revenue/Fund Balance)	22,819.9	23,193.0
Current 2001-03 Appropriation	22,451.4	
Governor's 2003 Supplemental Budget	235.1	
Governor's Proposed 2003-05 Budget		22,979.4
Spending	22,686.5	22,979.4
Projected Ending Fund Balance	133.4	213.6
EMERGENCY RESERVE FUND		
Beginning Fund Balance	462.1	55.1
Transfers and Appropriations	(420.0)	
Actual/Estimated Interest Earnings	13.0	1.9
Projected Ending Fund Balance	55.1	57.1
Total Reserves	188.4	270.7

Source: OFM

In other revenue adjustments, a program of limited tax exemptions for local government infrastructure investments subtracts $10 million and technical adjustments add $5 million.

Finally, $94 million is transferred to the general fund from other state accounts.

With the Governor's $22,979 million proposed 2003-05 budget, projected general fund reserves at the end of the biennium are $214 million and total reserves are $271 million. This represents 1.2 percent of biennial revenues.

K-12 Education

Under the governor's proposed budget, appropriations from the general fund for K-12 education would increase by 3.0 percent from $9,840 million in 2001-03 to $10,137 million in 2003-05, while spending from the student achievement account, established by I-728, would increase by 9.5 percent from $385 million to $422 million.

Under the terms of Initiative 732, teachers and other school staff are supposed to receive annual cost-of-living increases scaled to the rate of increase in the Seattle area consumer price index. Governor Locke proposes to eliminate those increases, saving an estimated $212 million. Under the provisions of Initiative 728, school districts currently receive $220 per student per year from the student achievement account. This is scheduled to jump up to $450 per student for the 2004-05 school year. Governor Locke proposes to hold the capitation at $220 for 2004-05. This reduces projected payment to school districts by $221 million.

Other major reductions include: The method of calculating state pension contributions is changed, reducing state pension allocations for school employees by $64 million. School districts will no longer receive State Flexible Education Funds. This saves $41 million. The program provided school districts $21.55 per student. The levy equalization formula is changed to reduce aid to "less needy" school districts. (Aid to districts in the lowest quartile of assessed value per student is not affected.) This saves $33 million. The state flexible education funds program is eliminated, saving $41 million.

The governor also proposes to eliminate a number of smaller programs.

The learning assistance program receives the most notable increase – $14 million from the state general fund and $177 million in additional federal monies. These funds will be allocated to school districts based on poverty indicators.

Higher Education

Governor Locke's proposed budget includes $2,685 million for higher education, a 2.6 percent reduction from the $2,757 million in 2001-03. State support for non-instructional activities is reduced by 2.5 percent.

The institutions will be allowed to raise tuition to offset the reduced state support. Increases for resident undergraduate students are to be capped at 9 percent per year. Institutions have complete flexibility with respect to tuition rates for all other students. The governor proposes to increase funding for the state need grant by $32 million, in recognition of the higher tuition rates that the institutions are likely to set.

The governor's budget provides $20 million to increase enrollments by 1,550 students in high-demand fields. The Higher Education Coordinating Board will allocate these funds through a competitive process.

The governor's budget provides no general cost-of-living increases for faculty or other higher education employees. The four-year schools, however, receive $10 million for selective pay increases to retain and recruit key faculty and staff.

Social Services

Governor Locke proposes to spend $3,883 million on social services under the priority to "improve the security of Washington's vulnerable children and adults." Most of this spending occurs through the Department of Social and Health Services. Other agencies addressing the social services goal include the Department on Community Trade and Economic Development, the Department of Veteran's Affairs, the Human Rights Commission, the Department of Services for the Blind, and the Home Care Quality Authority.

The budget focuses on basic needs while cutting $215 million. Among the notable reductions are elimination of the Family Policy Council, the Washington Council for the Prevention of Child Abuse and Neglect, Crisis Residential centers, and the prevocational training program for the developmentally disabled.

The Regional Health Network's mental health funding is cut, and grants are eliminated under the General Assistance Unemployable program.

Health

Increasing health care costs have been a major factor in state spending growth through the medical assistance program and the basic health plan. The governor's stated priority is to provide health care to children, and his budget reflects that priority.

The governor's budget proposes to spend $2,460 million GF-S on medical assistance in 2003-05. This is 11.5 percent more than current 2001-03 appropriations, but 8.7 percent less than the maintenance level projection.

Three Spending Initiatives Add to Budget Problems

Governor Locke proposes suspending or amending three initiatives approved by voters in recent years: Initiatives 728, 732 and 773.

Here's why.

Initiative 728 diverts property tax and lottery revenues from the state general fund to a couple of special accounts, the Student Achievement Fund and the Education Construction Fund. Most of the money goes to the SAF, from which it is then transferred to local school districts.

Passed in November 2000, when the tax revenues continued to grow and the state budget enjoyed a healthy surplus, I-728 offered a way to increase school spending without a tax increase and without asking legislators to amend the Initiative 601 spending limit. In passing I-728, voters themselves provided an exemption to the expenditure cap and provided for dedicated and escalating funding for class size reduction (among other authorized uses).

The initiative cost the state general fund $440 million in the 2001-2003 biennium. The governor proposes canceling a projected increase of $221 million. (For more information see Washington Research Council, *Initiative 728: More Money for Schools, Poor Fiscal Policy*, ePB 00-24, September 26, 2000.)

Initiative 732, also passed in 2000, provided an automatic annual cost-of-living increase for public school teachers. The initiative did not provide funding for the raises, which in the next biennium would have cost the state $229 million under the interpretation used by lawmakers last year. The Washington Supreme Court ruled December 19, however, that the state's interpretation was too narrow. The state had held that the initiative required payment of state funds only to employees paid by the state, leaving out the 25,000 school employees whose salaries are paid from other sources (e.g., local levies and federal funds). The court's decision could increases the cost of I-732 by $100 million in the coming biennium. The governor is proposing to freeze salaries for state employees in the next year, and he says that it would be inappropriate to give the I-732 pay raise to a single category of state-funded employees. (For more information see Washington Research Council, *Initiative 732: Expensive COLA,* ePB 00-25, September 27, 2000.)

Initiative 773, adopted by the voters in November, 2001, raised cigarette taxes by 60 cents per pack and boosted other tobacco taxes. The new revenues flowed to the Health Services Account, primarily to support expansion of the Basic Health Plan. The initiative required that the money supplement enrollment of 125,000 in the BHP. With enrollment in the BHP falling below 125,000, the governor wants to amend the initiative to permit the money to be used to sustain current BHP services. (For more information see Washington Research Council, *Initiative 773 – Fiscal Smoke and Mirrors*, PB 01-25, October 22, 2001.)

The two initiatives passed in 2000 can be amended by a simple majority vote. To amend I-773, the legislature must muster a two-thirds majority.

The governor's budget eliminates the medically indigent program, the healthcare for workers with disabilities program, and optional dental, vision, and hearing benefits. To further restrain medical assistance spending, the governor proposes linking increases in managed care payments to the Seattle consumer price index, increased scrutiny to assure those enrolled in medical assistance truly meet eligibility standards, and implementing a long term care management project.

The medical assistance administration would join with the Health Care Authority and the Department of Labor and Industries to consolidate purchasing and establish a preferred drug list.

The governor proposes to repeal the expansion of basic health plan (BHP) enrollments called for in Initiative 773 and redirect the tobacco taxes imposed by the initiative to support existing enrollees.

To hold down BHP expenditures, childless adults will no longer be covered by the plan and, managed care rates will be tied to the Seattle CPI.

The governor increases funding for community health clinics by $22 million as a safety net for those who have been dropped from medical assistance and the BHP.

Discussion

There's a lot of detail left to be examined in the governor's budget, which simply begins the long legislative conversation leading to a balanced 2003-2005 biennial budget. Amending popular citizen initiatives, cutting spending for education and social services, laying off state employees, and holding the line on compensation are tough decisions.

But, they are the realistic responses to present budget realities.

The budget process – the POG – embraced by the governor has been widely praised, as it should be. It provided a rigorous framework for evaluating spending and determining what programs and services yield the best return on the public investment.

Often, however, process substitutes for product in public policy discussions. The results of the process are what matter. After all, the POG is simply another budget tool.

The governor used the tool effectively. His proposed budget is disciplined and decisive, challenging past spending, confronting the erosion of fiscal control resulting from "ballot-box budgeting," and establishing his spending priorities.

It's better than a good start.

Of course, the governor proposes and the legislature disposes. The details of his plan will be debated, additional information will be revealed, and there will be honest disagreement on priorities.

As the process unfolds, we will be well served if the legislature subjects itself to the same discipline, focusing on achieving the best results for the citizens of the state within current revenues.

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