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Governor's Proposed Budget Pushes the Limit

BRIEFLY

Governor Locke's proposed biennial budget for 2001-2003 boosts general fund spending by nearly $2 billion. To accommodate some of the new spending, the legislature is asked to amend I-601 to lift the spending limit by $325 million, reflecting the cost of I-732, which mandated a cost-of-living adjustment for school employees.

The budget also significantly reduces the state's cash reserves.

Besides the general fund budget, the governor also released his plans for transportation, calling for nearly $10 billion in new spending without identifying specific tax and fee increases to support the plan.

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Gov. Gary Locke released his proposed biennial state budget Tuesday, recommending $22.7 billion in General Fund – State (GFS) spending, an increase of nearly $1.9 billion over current biennial expenditures of $20.85 billion. Further, he proposes an increase of $156 million in the supplemental budget for 1999-2001.

In addition, he proposed nearly $10 billion in new state and local spending for transportation, without specifying the revenue sources. Nearly all transportation spending is outside the state general fund and unaffected by the I-601 spending cap.

The budget proposals begin the budget debate in Olympia, setting the stage for what most observers expect to be a long and difficult negotiation.

Two elements of Tuesday's budget release suggest points on which resolution may be difficult.

First, in order to accommodate his GFS budget, the governor proposes to lift the I-601 expenditure limit by $325 million – the amount of the "cost-of-living adjustment" for school employees mandated by Initiative 732. The governor argues that I-601 was intended to be a limit on government, not on the voters themselves. Hence, he believes that voter-approved spending should result in corresponding increases in the spending limit and will propose an amendment to that effect.

Without question, his interpretation will be contested by some in the legislature.

As the Research Council noted previously (see ePB 00-36, *Lawmakers Face Toughest Budget Challenge Since 1993*, December 14, 2000), without amendment and with no 2001 supplemental budget, the I-601 limit for the next biennium leaves little room for increased spending. The limit would hold GFS spending to just $22.3 billion, nearly $500 million less than the governor proposes to spend.

Second, by proposing substantial transportation investment without calling for specific tax and fee increases, the governor tosses the issue to the legislature without publicly signaling his preferences. While he said he wanted to work with legislators to develop a bipartisan revenue package that could go to the voters next year, legislative leaders said they had hoped for more direction from him.

Balance Sheet. As Figure 1 shows, the governor's proposed expenditure plan substantially reduces reserves. At the beginning of the biennium, the state would have $471 million in an unrestricted beginning balance, which would drop to $157 million at the end of the period. As well, the governor proposes transferring $100 million from the Emergency Reserve Fund (ERF) to support

Governor's Proposed 2001-2003 Budget
General Fund Balance Sheeet
General Fund State (Dollars in Millions)

		2001-03
Beginning Fund Balance	$	471
November 2000 Revenue Forecast	$	22,301
Budget-driven Revenue	$	113
Proposed revenue legislation	$	(1)
Total Resources	$	22,883
Expenditures		
Governor's Proposed Budget	$	22,726
Unrestricted Ending GFS Balance	$	157
Emergency Reserve Fund		
Beginning Balance	$	539
Interest Earnings		*64*
Transfer to Transportation		*(170)*
	$	433

FIGURE 1

FIGURE 2

Adjustments to Initiative 601 Expenditure Limit

Balesline Expenditure Limit (November 2000)	$	22,321.6
Program Transfers from Other Funds to the General Fund		
Judicial Information Systems programs in Administrator for the Courts	*$*	*11.2*
Water Quality Account programs	*$*	*8.8*
Selected tuition programs in higher education	*$*	*51.2*
Local Toxics Account programs	*$*	*4.7*
State Toxics Account programs	*$*	*34.1*
Federal program shift for resident and marine fish management	*$*	*1.8*
Federal program shift for Core Salmon Recovery	*$*	*1.3*
Fire protections from Forest Fire Protection Account	*$*	*4.4*
Transfer of program costs to GFS due to lower federal match (FMAP)	*$*	*40.8*
Reduction in federal Disproportionate Share revenues	*$*	*5.5*
Community Supervision workload from Cost of Supervision Account	*$*	*0.9*
Increased State Match for Forest Legacy Support	*$*	*0.4*
Sub-total Transfers In	$	165.1
Program Transfers from General Fund to Others		
Shift of responsibility for certain transit programs back to locals	$	(193.4)
Transfer of Fair support from General Fund to Fair Fund	$	(4.0)
Sub-total Transfers Out	$	(197.4)
Effect of Governor's Proposed 2001 Supplemental Budget Expenditure	$	187.2
Adjustment for Initiative 732	$	324.7
Subtotal of All Changes in I-601 Limit	$	479.6
Revised Expenditure Limit	$	22,801.1

transportation investments. A $70 million transfer of ERF interest earnings for transportation purposes was approved by the legislature last session as part of I-695 mitigation. The fund, then, is expected to drop from $539 million to $433 million.

The balance sheet also shows modest increases in “budget-driven revenue” and a slight decrease from “proposed revenue legislation.”

Budget-driven revenue, in this context, refers primarily to projected increases in collections from the state revenue department’s discovery and compliance work, plus a $5 million transfer of excesses from the Treasurer’s Account to the GFS.

Proposed revenue legislation refers to revenue losses from a number of small tax relief proposals, several aimed at stimulating energy generation and providing relief from high energy prices. As well, the governor calls for property tax relief in the form of a value-averaging mechanism to avoid steep assessment hikes and an exemption from the state property tax for qualified seniors and people with disabilities; the value-averaging plan would require a constitutional amendment. The biggest tax hike ($3.7 million) is a proposed extension of the business and occupation tax to pick up tax revenue from visiting professional sports teams.

Changes to I-601. The spending limit may be raised or lowered for a number of reasons, primarily to reflect shifts of spending responsibility to or from the state general fund. Last session, the legislature acted to revise and clarify the terms under which the limit would be adjusted. The governor proposes a number of transfers into the GFS from other dedicated state accounts. The limit is increased to accommodate the incoming funds. The limit is also increased to reflect a decline in federal social services matching funds, which increases the state's funding obligation.

Also, as shown in Figure 2, the limit is lowered by $193.4 million to reflect the shift of transit funding responsibility back to local governments. Last year, the limit was raised by a corresponding amount to reflect one-time state assistance to transit districts in partial mitigation of the revenues lost as a result of the legislature's response to the passage of I-695. The initiative would have repealed the motor vehicle excise tax. When its constitutionality was challenged, the legislature repealed the tax, reducing transit funding.

The most controversial of the proposed adjustments to the spending limit is the $325 million increase to reflect the mandated COLA spending under I-732.

Spending Highlights. Most of the increased GFS spending is aimed at education, including the $325 million salary increase. In addition to the COLA, the governor provides nearly $50 million for a variety of public school programs, including school safety, alternative certification, technology enhancements, and performance-based compensation.

The $470 million diverted by I-728 from the general fund to a new "Student Achievement Fund" is, of course, not included in the GFS budget. That money ultimately goes to local school districts to support a variety of activities, including class size reduction, additional training and education for teachers, and extended programming.

The budget proposes $128 million in salary hikes for other state employees not covered by I-732, $49 million for salary upgrades in selected job classifications, and $107 million in inflationary adjustments to the amount the state pays private vendors for services. The COLA for vendors and state employees is pegged at 2.5 percent and 2.2 percent for the two years of the biennium, compared to a 3.7 percent and 2.6 percent COLA for beneficiaries of I-732.

The governor continues to provide funding for higher education enrollment increases, including $101 million for additional slots in the public colleges and universities, Promise Scholarships and the State Need Grant. As well, the money will expand workforce training programs, including a technology institute at the University of Washington's Tacoma campus. Plans for the institute require private funding to match state dollars.

Social services funding is increased by $84 million, including funds to reduce Child Protective Services caseloads, improve foster care, and supervise sex offenders in civil commitment programs.

Much of the budget growth represents the increased cost of maintaining current services. Specifically, the budget proposal notes that maintaining health care services for low-income groups costs about $588 million. Increasing public school enrollments, social service caseloads and prison populations add another $440 million.

The budget also assumes nearly $800 million in budget savings. A Senate Ways and Means analysis indicates the greatest share come in three areas: $207 million by assuming a better return on pension investments, $107 million by using federal money to supplant general fund spending, and $90 million by shifting some costs from the general fund to other accounts.

The budget also anticipates savings of $75 million by having the employee-paid share of health care premiums increase from 6 percent in 2001 to 8 percent in 2002, reaching 10 percent in 2003. That's on top of an increase of $137 million in the state share of health benefit costs.

Other cuts include a reduction in the state-funded medically indigent program ($34 million) and eliminating Medicaid dental services for most adult clients ($20 million).

Transportation. The governor endorses many of the recommendations of the Blue Ribbon Commission on Transportation. Among them are recommendations for increasing the efficiency and accountability of the transportation department, including making the transportation secretary a gubernatorial appointment. He also sets out an expenditure goal of $9.6 billion in new funding, of which $5.9 billion would be provided at the state level. But, as mentioned above, specific revenue sources are not spelled out, pending legislative negotiation and action on reform recommendations. The governor has also said that he wants to submit the final revenue package to the electorate for approval.

Comments. Adopting the biennial budget represents the single "must-do" item on the legislative agenda, closely followed by the need to address the state's transportation problems. Neither will be easy.

The I-601 limit, as we've noted, limits flexibility in budget development. And, presumably, the voters intended for it to constrain expenditure growth. Lifting the limit to accommodate the COLA mandated by I-732 certainly eases the constraint, but there are problems with the argument.

Twice before voters approved ballot measures subject to the provisions of the expenditure limit. Referendum 49, in 1998, transferred MVET funds to the transportation budget. Without an amendment to I-601, the general fund limit would have been reduced. The legislative authors of the referendum specifically amended I-601 to avoid the reduction. Similarly, this year, the drafters of I-728 faced the same issue and they incorporated an amendment to I-601 in their initiative. Presumably, the backers of I-732 recognized the issue. They chose, however, to avoid any amendment to I-601. It's not clear that the voters intended to lift the limit when they approved I-732. Others may argue that the voters just wanted to express themselves on a funding priority within existing budget restrictions.

Most likely, I-601 will receive considerable legislative attention this year. And the limit will probably be increased. Along the way, however, there must also be recognition that reserves in the governor's budget drop significantly. The unobligated reserve of $157 million is very low – upcoming revenue forecasts may improve the picture some – and the ERF is not easy to tap. If the economy slows during the biennium, the outlook for 2003-2005 could be stark.

Future policy briefs will look with more detail at some of the issues associated with developing a long-term budget solution to transportation problems.

As always, the governor's budget begins, rather than ends, the budget debate.

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