Washington Research Council

ePOLICY brief

ePB 00-24 September 26, 2000

Initiative 728: More Money for Schools, Poor Fiscal Policy

BRIEFLY

To increase public school spending, Initiative 728 would amend Initiative 601, earmark state property tax and lottery revenues, and create a new dedicated fund.

The initiative violates several important fiscal policy principles and would reduce the prospects of future relief from the state property tax

Supporters of Initiative 728, also known as "K-12 2000" want to increase public school spending. And with the state's growing budget surplus, they believe they have found a way.

In their initiative, which is similar to a plan proposed by Governor Locke and rejected by the legislature last session, they ask the voters to amend Initiative 601, earmark property tax and lottery revenues, and create a new dedicated fund.

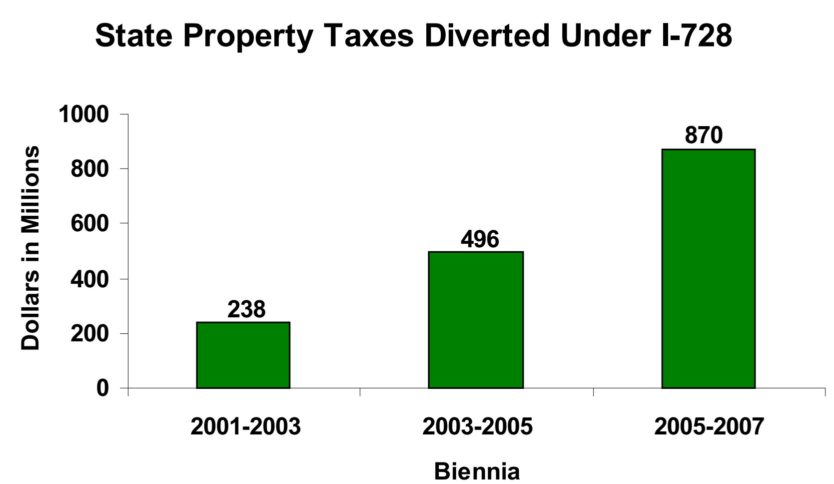
The initiative violates several important fiscal policy principles and will reduce the prospects of future relief from the state property tax.

It also comes without guarantees. Proponents seek to reduce class sizes and to fund pre-kindergarten programs, professional development, and "extended learning opportunities." But although the initiative identifies these goals, local communities would retain "flexibility" to determine how the new money is spent.

Below, we'll look at the specific provisions of the initiative, beginning with how the money gets to the local schools.

Spending the Money

The Student Achievement Fund. Voter-approved Initiative 601 currently limits expenditures from the state general fund, which funds most public school



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spending. To avoid the 601 cap, the initiative establishes a new dedicated fund, the Student Achievement Fund (SAF). This fund will receive most of the earmarked revenues and pay for the expanded programs envisioned by the Initiative. The SAF will be distributed to public school districts based on enrollment.

The initiative authorizes six uses for the money: class size reductions in grades K-4; selective class size reductions in grades 5-12; extended learning opportunities (e.g., lengthened school day/year, tutoring programs, summer school, all day kindergarten); additional professional development for teachers, including paid planning time, training, and reimbursement for higher education costs; early assistance for children requiring prekindergarten support; and, building improvements associated with class size reductions and extended learning opportunities.

None of the money is to be used to increase teacher pay for existing duties.

Proponents point up specific provisions for local accountability for the funds. Each year, the school board must hold a public hearing on the proposed use of the SAF. Later, the district must present to the public a report detailing the money received, how the funds were used, and the progress made in boosting student achievement.

School construction: The initiative also changes the way money is channeled to the Education Construction Fund (ECF) established by Initiative 601. Currently funded by excess balances in the reserve fund, the ECF would under I-728 receive revenue from the state lottery.

Finding the Money

I-728 mostly affects the distribution of state property taxes. It also, however, dedicates a stream of lottery revenues and uses fund balances in excess of the emergency reserve fund limit of five percent of annual general fund revenues.

Under the provisions of I-601, and as clarified by the legislature last session, such transfers and fund diversions should result in a corresponding lowering of the state spending limit. I-728 amends I-601, specifying that the lottery and property tax deposits into the SAF and ECF do not reduce the expenditure cap.

State Property Tax. Washington's state property tax, currently levied at a rate of \$2.93 per thousand dollars of assessed value, generates about 13 percent of state general fund revenues, or \$2.8 billion. I-728 would divert a share of that money to the SAF for distribution to school districts based on enrollment.

Out of taxes collected for calendar years 2001 – 2003, the initiative would take \$140 per each full-time equivalent student (FTE). Beginning in 2004 that increases to \$450, and is adjusted for inflation in subsequent years.

Because of the interplay between calendar years, school years, and fiscal years, there is a staggered phase-in in the distribution of revenues. And, the further into the future the projection, the less precise will be the forecast. However, the current projections of earmarked property taxes are as follows: For the 2001-2003 biennium, \$238 million; 2003-2005, \$496 million; and, 2005-2007, about \$870 million. (See chart on page 1.)

State Lottery. Currently, lottery revenues not paid out in prizes or otherwise obligated are deposited in the state general fund. Under I-728, these “unobligated” revenues would be placed in the ECF and SAF. In FY 2002, half the money would go to the ECF and half to the SAF. For FY 2003 and FY 2004, one-fourth of the money would go to the ECF and three-fourths to the SAF. After 2004, all of the money would be placed in the construction fund.

State analysts assume the lottery money will be distributed from the SAF to school districts based on enrollments.

Emergency Reserve Fund. Last session, the legislature amended I-601 to limit the emergency reserve fund (ERF) to five percent of annual revenues, with the excess balance transferred to the education construction fund. I-728 would transfer 75 percent of the excess balance to the student achievement fund and 25% back to the general fund.

Further, the initiative states that when state per student funding hits 90 percent of the national average of total per pupil funding from all sources, further transfers from the ERF will be required only to the extent necessary to maintain the 90 percent funding level. The remaining balance is to be transferred to the general fund, subject to the terms of Initiative 601.

The Role of State Funding

The 90 percent target will not be reached anytime soon, if ever. Washington is already among the states providing the greatest share of public education funding from the state budget, rather than local levies. According to the most recent data from the National Center for Education Statistics, 66 percent of the funding for the public schools in Washington came from state government; nationally, only about 48 percent came from the state.

In the 1997-98 school year, according to the same NCES data, per pupil spending from all sources in Washington was $6,040, about 98 percent of the US average of $6,189. State funding represented, however, represented roughly 64% of the national average from all sources.

Fiscal Impact

For the 2001-2003 biennium, the estimated cost to the state general fund is $414 million. State budget analysts calculate about $204 million of lottery revenue will be diverted to the ECF and SAF and $238 million of state property tax revenues will be deposited to the SAF. A $28 million transfer from the ERF slightly mitigates the loss.

From the SAF, according to state analysts, $451 million will be directed to local school districts: $238 million from the property tax, $128 million from the lottery, and $85 million from excess reserve funds.

Also for the 2001-03 biennium, $77 million of the lottery revenues will be dedicated to school construction. This represents a net reduction in construction money of $465 million, because under current law (adopted last legislative session) all of the excess reserve funds were to be placed in the education construction fund.

Long-term, the property tax impact will be far greater than the 2001-2003 biennial figure suggests. Remember, in the first couple of years, only $140 per FTE is transferred. From 2004 on, at $450 per FTE the biennial hit begins to grow dramatically, as noted earlier.

For 2001-2003, state property tax collections amount to about $2.8 billion. Over time, it's likely that the initiative will result in nearly one-third of the state property tax being diverted to the student achievement fund.

Comments

Several provisions of I-728 violate generally accepted fiscal policy principles.

As the Washington Research Council has repeatedly observed (see *Too Much Earmarking, Dedicating Funds*, July 31, 1996), earmarking general fund taxes and creating dedicated funds outside the state general fund should be avoided. The National Conference of State Legislatures put it well several years ago: "For most fiscal analysts and budget experts, there is little, if anything, to be said in favor of earmarking taxes."

The practice is particularly egregious when the tax being earmarked is a major revenue source for the state general fund and the purpose for which it is being tagged is the major expenditure item in the state budget.

Diverting property tax revenues to a new general fund account is simply an attempt to skirt the provisions of Initiative 601. In addition, by earmarking the property tax, the initiative makes it more difficult for the legislature to ease the property tax burden by reducing the state property tax rate.

In criticizing Governor Locke's proposed Learning Improvement Tax Credit, we said, "It's as if the state has created a new dedicated fund supported by an earmarked tax. The spending is taken outside the general fund. There is less accountability for the expenditure than if the money had been directly appropriated." Here, the initiative removes the pretense. It earmarks the tax. It creates the new fund. And, in so doing, it weakens the legislative budget process and erodes the effectiveness of the expenditure limit.

Finally, although the initiative proclaims a goal of improved student achievement, the money is distributed with very few strings. The additional funding amounts to a sizeable discretionary grant to local school districts, something many people might find desirable, to be sure. But if there is a specific policy objective proponents and voters want to achieve, I-728 fails to establish an unambiguous blueprint for achieving it.

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