



BRIEFLY

Lawmakers will serve taxpayers best by writing a budget that can be sustained without tax increases or dramatic cuts from an elevated expenditure base.

Projections Reveal Budget Challenges Ahead

The adopted Senate budget sets general fund spending at a level of \$22.84 billion. In our discussion of the budget, the Washington Research Council warned of problems in the next biennium (see ePB 01-11, March 29, 2001, *Senate Introduces \$22.8 Billion 2001-2003 Budget Plan: Creative, Generous and Unsustainable*). By relying on more than \$600 million in one-time revenues, the budget establishes ongoing spending commitments that we believe will substantially exceed revenues in the 2003-2005 period.

In this *Policy Brief*, we examine the risks inherent in the nearly 10 percent budget increase passed by the Senate.

We start by examining estimated 2003-2005 revenues. The Office of the Forecast Council will not make an official estimate of revenues for 2003-2005 for another year. Nonetheless, it makes sense at this time to attempt such an estimate, as the current budget deliberations will have significant consequences for the future.

Revenues. Three different revenue estimates are provided, using the current estimate of revenues for FY 2003 (\$11,378 million) as the starting point. Our estimates incorporate the loss to the general fund of \$285 million as a result of the Initiative 728 fund diversion. For the optimistic and pessimistic revenue estimates, we apply the same percentage adjustments as the Forecast Council used in the March 2001 revenue forecast for 2001-2003.

- ❑ The baseline revenue forecast of \$24,206 million assumes 5 percent annual growth for FY 2004 and FY 2005. This is consistent with the current growth rate.
- ❑ The optimistic forecast increases the baseline by 3.5 percent, to \$25,044 million.
- ❑ The pessimistic forecast shows revenues coming in 4.2 percent below the baseline, at \$23,187 million. Note that even the pessimistic forecast shows revenue growth of nearly \$1 billion over 2001-2003.

Expenses. To estimate state spending for 2003-2005, we applied three different assumptions regarding expenditure growth. All estimates use the Senate budget of \$22.84 billion as a starting point. First, we used the Initiative 601 fiscal growth factor. Second, we estimated budget growth at 90 percent of average personal income growth for the three preceding years (using Forecast Council estimates of personal income). Some state lawmakers have advocated this alternate method. Third, we assumed “maintenance level” spending continues to grow at about the current rate.

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- ❑ The estimated I-601 growth factor would permit expenditures to grow by 3.1 percent for FY 2004 and 3.25 percent for FY 2005, to \$24,236 million.
- ❑ The 90 percent of personal income growth factor provides for greater growth, 5.48 percent for FY 2004 and 4.55 percent for FY 2005, allowing biennial spending to reach \$24,769 million.
- ❑ The maintenance spending estimate provides for overall budget growth of about eight percent, lifting spending to \$24,677 million. Remember that the components of state spending grow at markedly different rates. Changes in health care costs, caseloads and school enrollments, compensation, etc., can affect this figure dramatically. The eight percent estimate is, we believe, conservative.

Comments:

Under six of the nine scenarios, the revenues fall short of projected spending. Only the optimistic revenue projections result in positive net income for the general fund. In five of the negative net income projections, the shortfall exceeds the roughly \$253 million the Senate budget leaves in the unobligated reserve, requiring use of the nearly \$500 million in emergency reserves. To be sure, the Senate budget also contemplates an additional \$250 million transfer from the pension surplus in 2003-2005. Should that

money be available, only under the pessimistic revenue projections does spending exceed reserves.

With regard to the expenditure projections, several additional factors should be considered.

The I-601 growth factor, based on population and inflation, represents just one element in determining the spending limit. With liberal use of revenue and expenditure transfers, the limit can be set considerably higher than the level established by the growth factor, as is the case in the Senate budget. With adjustments, the Senate’s 2001-2003 expenditure limit is increased by nine percent over the previous biennium. And, even with increased spending of \$1.8 billion, the Senate has about \$160 million in expenditure capacity left below the limit. Given recent experience, it’s much more likely that carry-forward 2003-2005 spending can be expected to come in at or above the maintenance level. And of course, additional transfers to the general fund will result in an increase in the I-601 limit.

Similarly, the revenue projections must be viewed with caution. The five percent growth adopted for our baseline estimate, while reasonable, may well be too aggressive. Erring on the side of pessimism – if not quite so pessimistic as the “pessimistic” forecast – seems prudent. While we don’t assign probabilities in this exercise, the next several years are much more likely to be characterized by

General Fund Net Income (Loss) Under Nine Scenarios

(Dollars in Millions)

		Revenues		
		Baseline	Optimistic	Pessimistic
		\$24,206	\$25,044	\$23,187
Expenditures	I-601			
	\$24,236	(\$30)	\$808	(\$1,049)
	90% PI			
	\$24,769	(\$563)	\$275	(\$1,582)
	Maintenance			
	\$24,677	(\$471)	\$367	(\$1,490)

Source: WRC



slow growth than by the extraordinary economic performance of the latter part of the past decade. There can be no justification for relying on the optimistic forecast. The energy crisis, the slowing of the national economy, the ongoing churn in the technology sector, and the decline in key manufacturing sectors will exercise a drag on the state economy that will not be swiftly resolved.

These projections argue for a conservative approach to the state budget. Although there is considerable pressure to increase spending to satisfy the often-legitimate demands of various constituent groups, lawmakers will serve taxpayers best by writing a budget that can be sustained without tax increases or dramatic cuts from an elevated expenditure base.



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