Washington
Research Council

Policy Brief

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Referendum 49: Tax Relief Plus Transportation Funding

Background

Referendum 49 was placed on the ballot by the 1998 legislature and will be decided by the voters November 3.

Since passage of Initiative 601 in 1993, a strong economy and conservative legislative budgets have allowed the state to build a reserve of more than $800 million dollars. This reserve is the key to the referendum's Motor Vehicle Excise Tax (MVET) cut and, through a fund transfer, the source of most of the funding stream for a $1.9 billion transportation bond issue. To get at the money without squeezing other state programs, voters are asked to amend and reaffirm the spending limitation.

Transportation issues dominated the recent legislative session, with general agreement on the need for additional investment in roads, streets and highways. There agreement ended; the revenue discussion — how to pay for the improvements — was often contentious. R-49 represents the solution crafted by legislative Republicans. The Governor favored increasing the state gas tax. In response to questions from our members, the Washington Research Council provides this overview of the referendum's major provisions.

As we said of an earlier version of the plan ("Transportation Finance Plan Moves Forward," PB 98:3), Referendum 49 represents a viable first step toward addressing the state's transportation problems.

Introduction

> **Briefly**
>
> Referendum 49 will deliver general tax relief to owners of cars and trucks, provide an immediate source of revenue to begin a $2.4 billion five-year construction program, and modestly increase support to local government. If the referendum passes, the combination of reserves and income to the GFS will allow the legislature to spend to the I-601 expenditure limit in the foreseeable future without jeopardizing the state's fiscal health or denying necessary revenue to important state programs.

Referendum 49 arrived on the ballot after a tortuous journey through the state legislature. Republican leaders stated at the outset of the session that they would not raise the gas tax to pay for transportation improvements. Their alternative appeared quickly, as the House passed HB 2894 in late January. The bill became the basis for R-49 when EHB 2894 passed both houses of the legislature March 5.

If adopted by the voters, R-49 will increase funding for highway and road construction by redirecting motor vehicle excise tax (MVET) revenues from the General Fund to the Motor Vehicle Fund to support a $1.9 billion bond issue to be retired over twenty-five years. With other revenues, the money is intended to pay for a five-year, $2.4 billion, transportation program.

The referendum is more than that, however.

Although the details shifted several times during legislative negotiations, the broad outlines of the measure were established early: a reduction in the MVET, the transfer of MVET revenues from the General Fund to transportation funds, assistance to local governments, and a one-time amendment to Initiative 601 to permit the transfer without lowering the spending limit.

Before examining each of these features, however, let's take a look at the effect of the referendum on the state budget.

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Three Biennia Balance Sheet

(Dollars in Millions)

	1997-1999	1999-2001	2001-2003
Resources			
Unrestricted Beginning Balance	513	524	328
Revenue Forecast	19,428	20,864	22,870
Referendum 49 Impact	(34)	(469)	(518)
Narrows Bridge tax deferral	0	(7)	(7)
Adjusted Revenue Forecast	19,394	20,388	22,345
Total Resources	**19,907**	**20,912**	**22,673**
Appropriations/Spending Limit			
Current Appropriation	19,084	-	-
Projected 601 Spending Limit	19,158	20,587	22,144
Reserves*			
Emergency Reserve	296	296	497
Unrestricted Ending Balance	524	328	328
Total Reserves	**820**	**624**	**825**

*Reserves for 1997-99 are reduced by a $3.5 million loan to Fish and Wildlife, which is repaid in 1999-01.

Note: Revenue for 1997-99 and 1999-1 from June forecast. For 2001-2003 estimated 4.7% growth.

Source: House and Senate Fiscal Committees

Setting the Budget Context

Much of the current discussion on the referendum concerns its impact on other state programs. There is no cause for alarm. Sufficient reserves remain after accounting for the referendum's tax reductions and transfers for the legislature to spend the maximum permitted under the expenditure limit without jeopardizing the state's fiscal health or threatening current spending programs.

Consider the accompanying balance sheet, projecting through the 2001-2003 biennium.

Several items on the balance sheet deserve special attention. First, the increase in the emergency reserve (ER) in the 2001-2003 biennium represents the effect of the I-601 requirement that revenues above the spending limit must be placed in ER. Second, in the 1999-2001 biennium, with passage of R-49, revenues fall about $199 million below authorized spending under the limit. When the unrestricted beginning balance of $524 million is added to revenues, total resources available for spending are $20,912 million, allowing the legislature to spend to the limit and still maintain reserves of $624 million, or about 6 % of annual spending. Were R-49 to be defeated, reserves would exceed $1.0 billion, nearly 11% of annual expenditures. Third, revenue forecasts are estimates and are up-dated quarterly. There will be one more forecast (September) before the general election. And, of course, the I-601 spending limit is also subject to periodic revision.

The Washington Research Council, along with many other budget analysts, has in recent years suggested a target reserve of about 5% of *annual* (not *biennial*) spending, which would be about $525 - $550 million, below the amount left in reserves assuming passage of the referendum. (Initiative 601 says: "The emergency reserve fund balance shall not exceed five percent of biennial General Fund - State revenues ... ." The initiative, then, sets a maximum; it does not describe a minimum or suggest a target.)

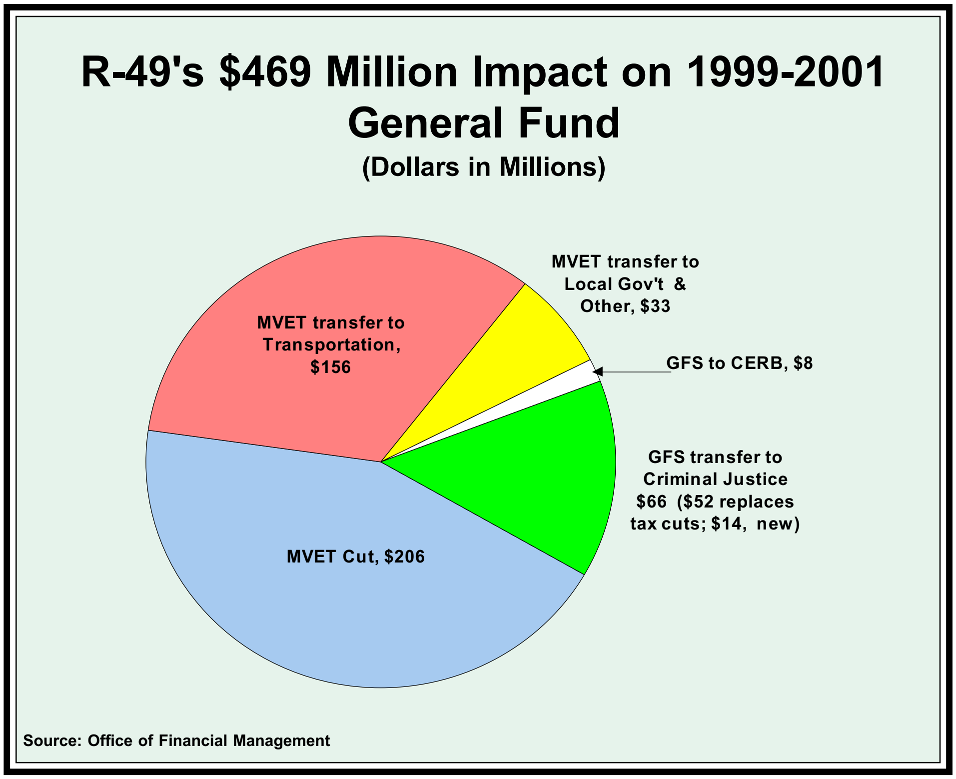
Identifying the GFS Impact

The Office of Financial Management (OFM) in late April published a useful analysis of the fiscal impacts of the referendum. As the balance sheet showed, the 1999-2001 loss to the GFS is estimated to be $469 million. The distribution is shown in the pie chart.

The MVET cut accounts for $206 million, just under 45 percent of the lost GFS revenue. The transfer of MVET money to the Motor Vehicle Fund reduces the General Fund by about $156 million (one-third of the lost revenue); and the aid to local governments accounts for the balance, $107 million (including $52 million which replaces money lost through the MVET cut).

$30 MVET Credit; Change in Depreciation Schedule

The MVET is based on the manufacturer's suggested retail price of a vehicle and is levied in lieu of a personal property tax. Tax relief under the referendum comes in two ways: First, a credit of up to $30 is authorized against the MVET on vehicles, effective with July 1999 car tab renewals. Second, the depreciation schedule on which the MVET is based is changed to begin depreciation in the second year of service.



Currently, Washington's MVET burden ranks among nation's highest. A study published by the National Conference of State Legislatures (NCSL) in January, 1998, found that most states levy a sales tax based on purchase price. Many then add an annual "car tax" - a "value-based" tax (like our MVET), a weight-based tax, a registration fee, or some combination. Nineteen states levy no such tax. An analysis of the NCSL data by *State Budget & Tax News* pegged Washington's car tax burden at seventh. (Virginia, which had the highest car tax, recently cut the tax dramatically.)

The referendum also changes the MVET depreciation schedule. Currently, Washington assesses vehicles at full value for their first two years of service. The initiative drops the assessed value to 95% in the second year and 89% in the third year. The balance of the schedule remains unchanged.

Changing the Depreciation Schedule

Year Of Service	Current Percentage	Proposed Percentage
1	100	100
2	100	95
3	91	89

The $30 credit is expected to reduce biennial revenues by $241 million in 1999-2001; the depreciation change, by about $17 million. Of the $258 million tax savings, remember, $206 million would have gone to the state General Fund and $52 million to local criminal justice programs.

MVET Shift from GFS to Motor Vehicle Fund

The shift of General Fund MVET revenue to the Motor Vehicle Fund provides the means to increase transportation funding for road and highway construction without raising the gas tax. The General Fund impact of this transfer in the 1999-2001 biennium is $156 million.

The MVET pays for local criminal justice programs, ferry operations, public health programs, transportation and transit services. As well, about 22% of the MVET is deposited in the state General Fund without earmarks. R-49 transfers this share of the tax (about $156 million in 1999-2001) to the Transportation Fund, providing most of the funding for a $2.4 billion spending package. Of the $2.4 billion, $1.9 billion is associated with the bond sale authorized by the referendum.

The MVET transfer will cover most of the bond issue. Additional revenues for debt service, as well as for the balance of the $2.4 billion plan, will come from stemming fuel tax evasion, shifting some programs from the Transportation Fund to the General Fund, and obtaining greater efficiencies in the Department of Transportation.

Support for Local Governments

While amounting to a relatively small portion of the funding authorized by R-49, the local government portion received considerable attention in legislative debate. The result represents a potpourri of activities receiving formula distributions. Local criminal justice programs**,** according to OFM estimates, will receive a net increase of $14.2 million in the coming biennium. The $52 million in MVET funds lost to the programs will be replaced with a $66.2 million transfer from the GFS. As well, about $68 million in current MVET funding will continue. The referendum also calls for using $13.4 million in Violence Reduction and Drug Enforcement (VRDE) funds to pay for local criminal justice programs. According to the OFM report, most VRDE money already supports local programs, so this rule change would not increase local funding.

The latest revenue forecast, released as we went to press, left excise tax estimates "essentially unchanged." Absent changes resulting from legislation, the General Fund-State (GFS) forecast was $7.3 million higher for the 1997-1999 biennium and $26.3 million higher for 1999-2001. Although there may be slight adjustments made as a result of additional analysis in the coming weeks, the numbers presented here, drawn from earlier OFM and legislative reports, represent a fair estimate of the referendum's impact on the state budget. Updates will be available on our web site as they become available.

While the criminal justice programs were directly affected by changes in MVET distribution, the other local government assistance provided for by R-49 has no such clear connection. Included in the referendum is a $20.7 million transfer to a new Distressed County Assistance Account, about $8 million in additional funding for the Community Economic Revitalization Board (CERB), and $8 million for cities with small sales tax bases.

Amending and Affirming Initiative 601. To avoid a reduction in the Initiative 601 limit, R-49 asks for a one-time amendment to assure that "other programs funded from the General Fund are not adversely impacted" by the transfers. Voters are then asked to reenact and reaffirm the limit.

Because Initiative 601 limits expenditures only from the General Fund, it creates an incentive to shift funds to unlimited, non-General Fund accounts. To discourage such transfers, I-601 states:

"If the cost of any state program or function is shifted from the state General Fund on or after January 1, 1993, to another source of funding, or *if moneys are transferred from the state General Fund to another fund or account*, the office of financial management shall lower the state expenditure limit to reflect the shift." (Emphasis added.)

Without the exemption provided in R-49, the MVET transfer would result in a lower expenditure limit and further tighten budget constraints on the General Fund.

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