POLICY brief

Washington Research Council

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Senate Budget: Not Quite Restrained Enough

BRIEFLY

The Senate recently passed a supplemental budget which boosts spending by more than $500 million and holds about $900 million in reserves. While the Senate showed restraint in the face of revenue growth, the increased spending aggravates the state's existing structural deficit.

The state budget outlook improved some last week: The revenue forecast boosted estimates of available revenues and the state Senate passed a budget keeping about $900 million in reserves. Still, although the Democrats who drafted the budget proposal exercised restraint, the supplemental budget passed by the Senate increases net spending by more than $500 million. Only about a tenth of the new spending is required to deal with maintenance level spending, the balance going for policy-level programs.

As we said with respect to the governor's proposed supplemental, the Senate showed restraint in the face of temptation, but the increased spending aggravates the state's existing structural deficit. Protecting reserves must be a priority, and the Senate places about $900 million dollars in various reserve accounts. Yet, this spending pattern cannot be sustained over the long term. More restraint will be required before the state settles on a sustainable budget trajectory.

The current pace of revenue growth will slow, inevitably and perhaps quickly, as the growth relies heavily on real estate sales and construction activity. And the state's ongoing obligations for health care spending and pension costs will consume available reserves within a few years.

REVENUES

The February 15 revenue forecast gave the Legislature another $107.3 million to spend in the 2005-2007 biennium. That brings the total to $26,443.0 million. The forecast also estimated about $29,027.7 million in revenues available for the 2007-2009 budget period, an increase of 9.8 percent. Generally, the economic outlook continues to be favorable, with strong population growth, continued increases in aerospace employment through mid-2008, and nonresidential building picking up some of the slack created by a decline in housing.

The Senate budget includes a number of tax cuts that reduce General Fund revenues. The largest reduction, about $10.6 million in the remaining year of the biennium, trims the business and occupation (B&O) tax for cutting timber, manufacturing timber and timber products into wood products, and sales of timber and wood products at wholesale. The rate reduction would expire in 2024. As well, the Senate provides tax relief for aerospace businesses, dairy product manufacturing, motion picture production, and adjusts due dates for monthly excise tax filers and elimi-

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2005-2007 State General Fund Balance Sheet

$ in Millions

Beginning Balance	**869.7**
November 2005 forecast	26,335.7
February 2006 Update	107.3
Total Revenue	26,443.0
2005-07 Enacted Fund Transfers	216.8
2006 Revenue Legislation	1.7
2006 Transfers	(9.5)
Total Revenues and Resources	27,521.7
Appropriations	
2005-2007 Appropriations	25,952.4
2006 Senate Supplemental	710.5
Appropriations in other bills	5.1
Appropriations in SB 6896	600.0
Revised Appropriations Total	27,268.1
General Fund Balance	**253.7**

Source: Senate Ways and Means Committee (2/17/2006)

nates an assessment penalty for qualified taxpayers.

The total single year impact of the tax reductions amounts to about $51 million in tax relief. Increased revenues of $52 million from clarification of existing practice with respect to insurance premiums are projected, largely offsetting the tax cuts shown on the balance sheet.

SPENDING

The Senate supplemental budget adds $1.3 billion to the 2005-2007 general fund spending level. The number requires explanation.

About $50 million of the new spending amounts to the traditional adjustments for changed conditions, such as increases in entitlement caseloads, school enrollments, and prison populations. This maintenance level is about $100 million below what the governor anticipated in her budget released last December, primarily because of lower-than-expected medical assistance enrollments. More than $400 million in additional spending represents policy choices – new or enhanced programs funded at the discretion of the Legislature.

In addition, the Legislature makes a number of unusual appropriations to reserves: $100 million to debt reserves, $300 million to a new pension funding stabilization account, $100 million to the common school construction account, and $150 to the Health Services Account. In making these appropriations, the Senate also lifts the spending limit to accommodate the new spending. Republican critics of the budget say the “spending” to reserves has been used to inflate the spending limit. Even with the changes in the Initiative 601 expenditure limit adopted last year, extraordinary measures had to be taken to allow the spending desired by the Senate. Republicans say that if the spending to reserves is to be treated as expenditures in order to game the limit, it should also be considered as spending when assessing the budget. Democrats prefer to exclude the reserve appropriations when measuring spending growth.

Setting aside such disagreements on how to benchmark the budget, there can be no dispute about this: The Senate substantially increases spending beyond what would ordinarily be considered the routine minor adjustments common to supplemental budgets. Nor is there any serious argument about the nature of the impending budget shortfall.

Although no “official” six-year budget outlook has been published, analysis by legislative staff shows that the state will be as much as $400 million in the red by the end of the 2007-2009 budget cycle, assuming normal increases in state spending. That’s consistent with an up-dated six-year outlook of the governor’s budget by the Office of Financial Management, which also shows a shortfall in the coming biennium.

Health and Social Services. The Senate follows the governor's lead and provides about $18 million to cover the cost of prescription drug co-pays for low-income, elderly, and disabled people affected by the federal Medicare legislation. Previously, the state Medicaid program covered these costs in full; the new Medicare policies require the recipients to pay part of the costs.

The general fund is also tapped to fund grants for community-based groups to increase access to health care ($3.1 million), expand medical and dental care for children unable to receive Medicaid because of their immigrant status ($3.2 million), screen for breast and cervical cancer ($1.4 million), handle higher-than-budgeted long-term care enrollments ($16.4 million), increase nursing home payment rates ($6.2 million), and increase homecare agency payment rates ($5.5 million).

Foster care and adoption program spending is increased by $12.8 million from the general fund, with higher per person costs partially offset by lower-than-expected caseloads. To comply with a court ruling, $14.5 million is appropriated to open two wards at Western State Hospital and pay the judgment. Another $20 million is appropriated to implement a strategy for improving delivery of mental health services, plus an additional $11 million to improve community mental health services.

Nearly $54 million is provided to cover a shortfall in the WorkFirst program.

Education. To cover increased enrollments and a higher inflation factor for I-732 teacher salary increases, the Senate provides $92 million in General Fund money plus $1.2 million from the Student Achievement Fund.

The Senate also provides $21.7 million for WASL assistance, $13.2 million for an additional teacher planning day, and $4 million for the Navigation 101 counseling and mentoring program. Funding is also provided to address energy costs, replace vocational equipment, math remediation, levy equalization and enhancements to the school breakfast programs.

Following the governor's lead, the Senate provides $1.5 million for a new department of early learning.

Increased access to higher education is addressed in several ways by the Senate. The supplemental provides $3 million to fund 180 high demand enrollments at four-year institutions and 125 slots at community and technical colleges. The University of Washington Tacoma branch campus receives $200,000 to fund 25 additional slots.

Life sciences research is supported by a $2.4 million appropriation to the University of Washington, $1 million to Washington State University, and $0.9 million in start-up funding for the Life Sciences Discovery Fund.

Pensions. The Senate pays $49 million to reduce the Plan I unfunded liability and sets up a $300 million pension stabilization account for the next biennium. The state's gainsharing problems go unresolved. (See Misguided Pension Benefit May Cost Billions, http://researchcouncil.blogs.com/weblog/files/gainsharing_report_jan_26_2006.pdf).

Other. The Senate provides $10 million for minor league baseball parks.

Reserves. As mentioned above, in addition to $253.7 million in the unobligated balance in the General Fund, the Senate places some $650 million other accounts.

DISCUSSION

Continued revenue growth has provided opportunities for lawmakers to bolster reserves while increasing spending. With $900 million plus in reserves, the Senate hews to the line set by Governor Chris Gregoire. Some in Olympia figure that reserves in excess of $1 billion may be difficult to sustain. They hark back to the initiative repealing the motor vehicle excise tax, attributing some of the campaign's success to the argument that the state "could afford it," because reserves were high. Similar arguments supported initiatives to reduce class size and increase teacher salaries. No new revenue sources were required; ample reserve funds would pay for them.

A constitutional rainy day fund would protect reserves from easy raids, either by tax-cutters or spenders. Yet, when presented with a proposal for a viable rainy day fund, the Senate declined the offer.

With economic growth, the state risks returning to a revenue-driven budget process, a departure from the priority-driven model that worked well during lean times. While every budget must begin with an appreciation of available resources, a revenue-driven process leads to overspending in the good times and retrenchment or tax hikes when the economy slows down. The discipline of Gov. Gary Locke's Priorities of Government process – a discipline effectively reinforced by a state spending limit – helps promote sustainable budgeting. The cavalier treatment of the spending limit in the supplemental budget reinforces concern with the long-term consequences of the increased spending.

Further, the state's budget process assumes that the heavy lifting is done during the first year of the biennium, with only minor adjustments made during the second year. The Senate's spending increases magnify when poured into the coming two-year budget. When shortfalls can already be reasonably foreseen, discretionary spending should be boosted only sparingly.

The Senate has typically received high marks for its fiscal restraint. We're inclined to agree that the supplemental contains a number of good items. But by failing to address gainsharing and by increasing the shortfall for the biennial budget to be written less than a year from now, Senate leaders missed an opportunity to stabilize the state's fiscal footings.

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