



BRIEFLY

The Senate Ways and Means committee has produced a budget that lifts state spending to \$22.8 billion. The plan relies heavily on one-time revenues and budget reserves. The long-term sustainability of the increased spending must be questioned.

Senate Introduces \$22.8 Billion 2001-2003 Budget Plan

Creative, Generous and Unsustainable

The 2001-2003 budget proposed by the Senate Ways and Means Committee takes advantage of a one-time pension fund revenue windfall to lift spending to \$22.8 billion. As a result, the budget avoids some of the controversial social

services cuts proposed earlier by Gov. Gary Locke, while providing more generous salary increases to most public employees. Resting as it does on windfall dollars, the budget poses greater risks for taxpayers and those relying on state funding.

Operating revenues for the biennium increase by just 4.3 percent, and state spending jumps about 8.5 percent from the 1999-2001 level after the Senate's proposed \$198 million supplemental budget is incorporated. (See Figure 1.) The \$22.8 billion budget is nearly \$2 billion and 10 percent higher than currently authorized spending.

While benefiting substantially from a \$250 million transfer from the Law Enforcement Officers and Fire Fighters Retirement System (LEOFF) Plan 1, the budget still relies heavily on budget reserves. Unobligated reserves drop from \$462 million (the 1999-2001 beginning balance) to \$253 million (ending 2001-2003 balance). In Figure 1, the "changes in balance" line incorporates a transfer of \$123 million from the Health Services Account as well as the \$250 million pension transfer.

FIGURE 1

General Fund State Balance Sheet

	<u>1999-2001</u>	<u>2001-2003</u>	<u>Change</u>
Revenues			
November Revenue Forecast	21,169	22,339	1,170
March Up-date	143	(124)	(267)
Tax Reductions	0	(15)	(15)
Budget-driven Revenue	0	28	28
Revised Revenue	21,312	22,228	916
Appropriations & Limit			
Beginning Spending Limit	20,916	22,195	1,279
Net Adjustments	136	808	672
Revised Spending Limit	21,052	23,003	1,951
1999-2001 Approps.	20,850		
2001 Supplemental	198		
Total Appropriations	21,048	22,843	1,795
GFS Balance			
Beginning Balance	462	606	144
Changes in Balance	387	(353)	(740)
Transfer to ERF	(243)	0	243
Ending Balance	606	253	(353)
Emergency Reserve Fund			
Beginning Balance	536	506	(30)
Transfer from GFS	243	0	(243)
Interest Earnings	63	61	(2)
Transfer to Transportation	(35)	(70)	(35)
Transfer to Ed. Construction	(223)	0	223
LIHEAP/Earthquake	(2)	0	2
Earthquake/Drought	(75)	0	75
Ending ERF Balance	507	497	(10)

Source: Senate Ways and Means Committee



Activity in the Emergency Reserve Fund includes paying for damages due to the earthquake and drought, as well as continued transportation support.

Perhaps the clearest way to view the budget picture is to disregard reserves and transfers and simply compare current revenues with current spending. On this basis, the numbers to consider are the \$22.228 billion revised revenue forecast and the \$22.843 billion in spending proposed for 2001-2003. The budget, then, carries with it an operating deficit of about \$615 million, most of which is covered by reserves and transfers that are not ongoing.

Given the recent announcement by the Office of the Forecast Council that the risk of recession has increased since the beginning of the year, the Senate budget proposal must be considered extremely aggressive and of doubtful sustainability.

Revenues. The March revenue forecast (see ePB 01-7, *March Revenue Forecast Released*) reduced projected revenues for the 2001-2003 biennium by \$124 million below the level anticipated in the November 2000 forecast. While the forecast increased projections for the current biennium by \$143 million, the longer term forecast reflects the slowing economy and increased risk of recession. The budget also contains estimated tax reductions of \$15 million, reflecting a number of relatively small tax exemptions, including support for energy assistance programs and rural economic development.

The budget includes \$28 million in new tax receipts as a result of more aggressive tax collection efforts by the state revenue department. The largest revenue reduction affecting the General Fund is the transfer of about \$470 million as a result of Initiative 728, which directs \$393 million to the Student Achievement Fund and \$77 million to education construction.

The budget also incorporates and reallocates budget savings estimated to be about \$545 million. More than a third of the savings result from two pension-related actions. First, budget writers assume that investment earnings for the state pension system will increase from 7.5 percent to 8 percent, reducing the required state contribution, an aggressive assumption in this marketplace. Second, the budget would postpone repayment of unfunded pension liabilities from 2016 to 2024.

Initiative 601. Under the Senate budget, the Initiative 601 spending limit increases substantially. Again, the “two way street” mechanism is used (see ePB 01-03, *I-601 Not Dead Until Legislature Declares It So*). A pair of transfers combines to raise the limit by \$765 million in 2001-2003.

First, in the Senate’s supplemental budget for the current, 1999-2001 biennium, \$123 million is transferred to the general fund from the health services account. The effect of this transfer is to increase the limit by \$123 million in 2001 (Note: I-601 prescribes an annual limit.) and by \$257 million in the 2001-2003 biennium (see Figure 2). Second, the budget anticipates a transfer of \$250 million to the general fund from the State Surplus Assets Reserve Fund (SSARF), money from the LEOFF plan. This transfer lifts the limit by \$507 million for the 2001-2003 biennium.

Additional transfers, relatively minor and routine, amount to about \$38 million for the biennium.



FIGURE 2

Adjustments to the Initiative 601 Expenditure Limit

	2001	2001-2003
Beginning Spending Limit	10,712.9	22,380.0
Transfer of program costs to GFS due to lower federal match		40.8
King Street Station	(15.0)	(31.3)
Shift of responsibility for certain transit programs back to locals		(188.1)
Sub-total	10,697.9	22,201.4
Major Revenue Shifts		
Health Services Account	123.3	257.4
LEOFF Plan I Surplus		507.3
Sub-total	123.3	764.7
Other Adjustments	11.9	38.4
Revised Spending Limit	10,833.1	23,004.5

Source: Senate Ways and Means Committee

The revised spending limit of \$23 billion resulting from these transfers exceeds the limit proposed in the governor’s budget by about \$200 million.

Spending Highlights. As usual, the budget includes numerous adjustments, important to various constituencies but often amounting to relatively minor changes in current funding levels. Most of the testimony in yesterday’s hearing supported the higher spending level, while hoping for a bit more.

K-12 Education. The public schools fare well, primarily as a result of the funding provided by I-728. In addition, public school employees are scheduled to receive salary increases of 3.7 percent for the 2001-02 school year and 3.1 percent for 2002-03. The Seattle Consumer Price Index dictates the amounts. In addition, the Senate budget provides means by which corresponding salary increases can be provided for school employees supported by federal funds and local levies. An additional \$76 million is provided to support health care benefits. The Senate eliminates the staff development portion of the Better Schools Program for a savings of \$40 million, trims block grant funding by \$17.6 million, and eliminates the general state subsidy for driver education programs.

Higher Education. An additional \$29.4 million is provided from the general fund to support 3,409 new enrollments in the state colleges and universities – 2,677 of them in the community and technical colleges. The Senate also provides \$8.5 million in operating and capital funds (\$4.1 million from the general fund) to create a Technology Institute associated with the Tacoma branch campus of the University of Washington. In addition, \$1 million is targeted for a Spokane-based Inland Northwest Technology Education Center. Financial aid is increased through the state need grant, Promise Scholarships and work study programs. As well, all state-funded higher education employees will receive the same percentage increase established by I-732. Additional funds are set aside to boost compensation of part-time faculty and to selectively increase pay to enhance recruitment and retention efforts.

Some limited tuition setting authority is given to the colleges. Tuition may rise by 6.7 percent in 2002 and 6.1 percent in 2003 for residents (undergraduates and most graduate students) attending the research institutions, 5.2 percent and 4.6 percent for residents attending the regional schools (except Evergreen), and 3.7 percent and 3.1 percent at the two-year schools. Tuition for medical, dental, law, pharmacy, nursing, veterinary, and MBA students is expected to increase to reflect that charged by peer institutions in other states.

Social Services. Reflecting the substantial increase in health care costs, a \$570 million in general fund support for low-income medical assistance programs is provided – the largest increase in social service funding. Funds are also

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provided to expand immunization for children, and a number of smaller program innovations and enhancements. Nearly \$6 million is targeted for community residential and support services for individuals who would otherwise be institutionalized. This allows the state to close four hospital wards for a net savings of \$3.4 million. Overall, the Senate reduces many of the cuts proposed earlier by the governor – spending about \$106 million more.

Other. The budget also maintains the assistance to local governments provided last year as mitigation for the repeal of the Motor Vehicle Excise Tax.

Compensation. All state employees are targeted to receive salary increases at the level established by I-732 for public school employees. The costs of the increases are \$124 million for state employees, \$94 million for higher education employees, and \$318 million for K-12 employees. Additional compensation is provided to various classes of state employees for which there are particular recruiting and retention problems. Increases in the cost of health insurance add \$48 million to the budget. The employee-paid share of the premium will increase from about 6 percent in 2001 to 8 percent in 2002 and 10 percent in 2003. In assuming a long-term investment return of 8 percent and salary growth of 4.5 percent, the budget would also lower the employees' required pension contributions.

Comments. The Senate budget, if adopted, would create a high baseline of ongoing costs for future biennia. While the budget successfully preserves many programs, enhances others, and provides more generous compensation for public employees than did the governor's proposal, the measure of success must be sustainability. And on that measure, this budget does not meet the test.

While changing the LEOFF 1 Plan and distributing the surplus may be appropriate, using one-time money to sustain ongoing programs is imprudent. To use \$250 million from LEOFF and \$350 million in reserves to fund on-going operations creates significant risk. To live within existing resources in the future, even deeper budget cuts will be required.

As the state economy is experiencing the greatest uncertainty in a decade, with prospects for a continued slowdown likely, lawmakers should adopt a more conservative approach to writing the state budget.



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