POLICY brief

Washington Research Council

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Too Little Discipline

BRIEFLY

Governor Gregoire and the state Senate have each introduced budget plans that rely heavily on fund transfers, reserve drawdowns, and sin taxes. The budgets extend spending trends that cannot be sustained, assuring future shortfalls.

Last week, Governor Christine Gregoire introduced her admittedly unsustainable budget proposal that relied on $200 million in new taxes. This week, the Senate passed its own version of an unsustainable budget with a $500 million tax hike. The House will offer its budget plan next week.

Neither the budget adopted by the Senate nor that proposed by the Governor attempts to control spending to avoid a serious budget shortfall in the next biennium. Both continue the now familiar pattern of bridging the gap between available revenues and desired expenditures with fund transfers, reserve drawdowns, sin taxes, and similar gimmicks. Such tactics guarantee a continuation of what some have called the "structural deficit" plaguing state government. While state revenues fail to keep pace with state expenditures, the structural problem is, in fact, simply a failure to trim spending – particularly the policies driving health care spending – to match available resources.

TOO MUCH SPENDING

The math is straightforward. According to the March revenue forecast, without tax increases state government will take in about $24.9 billion in the 2005-2007 biennium (that's after allowing for the effects of the state Supreme Court decisions on estate taxes and taxes on meat products). That's about $1.7 billion more than the $23.2 billion expected in the current biennium, an increase of 7.3 percent.

The governor wanted to spend $25.8 billion in the 2005-2007 budget cycle; the Senate proposes $26.0 billion. (See the table on page 2.) Without a 2005 supplemental budget, the state would spend about $23.2 billion this biennium. So, the governor's budget would increase spending by 11.2 percent and the Senate would bump it 12 percent.

The additional money would buy a number of things: expanded higher education enrollment, more financial aid for students, salary increases and liberal health benefits for public employees, full funding of the class size reduction and teacher pay initiatives, expansive medical assistance programs, and so on. Although the two budgets differ in some of the details, their thrust is the same. Each tries to maintain and expand the current course of state spending. Neither makes any serious run at spending reform.

Both budget proposals rely primarily on stop gap fiscal maneuvers. They defer necessary contributions to the state pension fund (the Senate is slightly better on this), they sweep money in from other accounts (a tactic that also allows them to lift the spending limit), and they reduce reserves. Nearly a billion of Gregoire's solution to a $1.5 billion

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shortfall involves such one-time tactics. The Senate budget, which paints the shortfall as $1.7 billion, similarly leans on one-time money to plug around two-thirds of the hole.

There are cuts, but they are modest. Gregoire intends to get rid of 1,000 middle managers (mostly nonunion employees), limit some vendor rate increases, "trim" some public school programs, and make other relatively small-ticket reductions. The Senate cuts the Washington Reading Corps, eliminates annual bonuses to teachers for national board certification, requires prescription drug co-pays for medical assistance recipients, shaves some health care spending, and makes similarly low impact reductions in a variety of programs. Both budgets assume savings from "increased efficiency and accountability."

Balance Sheet, General Fund–State
(Dollars in Millions)

	2003-2005*	2005–07 Governor	2005–07 SWM
Beginning Fund Balance	404.6	617.8	676.0
November 2004 Revenue Forecast	23,172.7	24,721.8	24,721.8
Estate Tax and Meat Packing Tax losses	(242.9)	(274.8)	(274.8)
March 2005 Forecast Economic Update	301.1	438.3	438.3
March 2005 Revenue Forecast	23,230.9	24,885.3	24,885.3
Suspend I-728 Property Tax Diversion	-	138.2	138.2
Excess Revenue - Student Achievement	-	64.1	165.2
Budget-driven Revenue	-	26.0	31.1
Revenue Package		115.4	178.6
Fund Transfers - Other	446.2	179.5	178.1
Total Resources (including beginning fund balance)	24,081.7	26,026.3	26,252.5
Proposed Budget	23,246.2	25,824.0	26,038.7
Projected Ending Fund Balance	835.5	202.3	213.7

*Assumes no 2005 supplemental and aggregates 2003 and 2004 fund shifts, grants, reserve changes, and other.

IMPRACTICAL REVENUE PACKAGES

One-time money and paper cuts alone can't balance the budget. This year, the governor and Senate offered a package of sin taxes, if we may expand the definition to cover the sins of dying with money or eating canned meat.

The Gregoire budget, probably destined to be the lowest of the tax proposals this session, would fund the Initiative 728 class size reduction with two tax increases. She would raise cigarette taxes by 20 cents a pack, generating about $73 million for the 2005–2007 budget (she'd add another 60 cents a pack July 1, 2007). She also reinstates the estate tax on non-farm estates worth more than $2 million, gaining another $129 million for 2005–07.

The Senate budget proposal – the senators haven't approved the tax package yet – moves more aggressively. The plan reinstates the estate tax for estates valued at more that $1.5 million in 2005, at $2 million from 2006 on, putting the expected $135 million into the Student Achievement Fund for I-728. The cigarette tax also gets stepped up from the governor's plan, starting with a 60 cent a pack increase July 1, 2005, followed by a 20 cent increase on July 1, 2007. The anticipated $173.5 million also goes to fund I-728. Using the money this way relieves the general fund of the need to increase the amount of property tax money transferred to the Student Achievement Fund.

In addition, the Senate plan would reinstate a tax on canned meat (good for about $11 million), add a $1 per liter tax on liquor ($24 million), extend the retail sales tax to cover extended warranties (another $11 million, though they drop the seller's B&O rate), and they pick up another $24 million with a 5 percent tax on mini-casinos (the money is placed in a new dedicated fund, the Public Benefit Account, to pay for a hodgepodge of programs, ranging from breast cancer screening to arts programs to criminal indigent defense).

What these plans have in common is a reliance on narrow tax bases to extend general fund obligations. The money may allow the state to stumble through the next two years, but it provides no long-term guarantee of sustainability.

AN UNSUSTAINABLE BUDGET

No one pretends that these budgets solve the state's fiscal imbalance. And few argue that the solution lies in higher taxes or a restructured tax system. Health care spending, which claims about one-fifth of general fund spending, currently increases at nearly twice the pace of economic growth. There's no imaginable revenue solution to that problem.

The state budget office recently released the six-year outlook for the governor's budget. This useful document lets policymakers understand the consequences today's budget decisions will have in the future. State analysts forecast revenue growth of about 5 percent annually and make reasonable estimates of general fund spending through the 2007-2009 biennium. They consider the cost of employee health insurance (growing about 11.3 percent a year – 10 percent inflation and 1.3 percent population growth), medical assistance increases, and a 1.2 percent annual increase in baseline operations (excluding pensions, cost-of-living increases and health care).

Without a dedicated funding source for I-728, they project a $1.6 billion shortfall in the 2007-2009 biennium. With a dedicated source, as proposed by both the governor and Senate, they estimate the shortfall to be $987 million. Either way, the prospects are bleak, foreseeable, and avoidable.

DISCUSSION

As we have written before, health care policy drives state spending. Without policy change affecting recipients of medical assistance programs and state employees, it's hard to see how the state can produce a balanced and sustainable budget. The cost savings would be immediate; the benefits long-term. Taxpayers should not be expected to pay for health care benefits for public employees that are about twice as generous as those provided in the private sector. Medicaid costs can be stemmed by tightening up on eligibility standards and opting out of benefits that exceed federal requirements. The best thing lawmakers can do for those who rely on these programs would be to act now to assure that their benefits are not jeopardized by a funding crisis.

Two years ago, Governor Gary Locke and the Legislature used the Priority of Governments budget model to bridge the budget gap without tax increases. The process, which the Research Council has praised, may have received too much credit. Certainly, the budget adopted in 2003 bought time with fund transfers and other one-time tactics (e.g., delayed funding increases for class size reduction), some of which compounded the problems faced in this budget. Nonetheless, the process began what has apparently been a short-lived commitment to an intense, outcome-focused scrutiny of state spending.

There's too little innovation in the two budget proposals we've seen so far. The dedication to fiscal discipline that defined the Priorities of Government cannot readily be found. If it is not rekindled, a rare opportunity to restructure the state's fiscal landscape will have been lost.

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