POLICY brief

Washington Research Council

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With Senate Budget, State "Lives within its Means"

BRIEFLY

The Senate's proposed 2003-2005 general fund budget increases state spending by just 1 percent. The proposal responds to the challenge of managing state spending within current revenues, as economic recovery remains elusive.

Senate budget writers worked with the "priorities of government" framework established by Governor Gary Locke, reordering priorities in education and health care spending, and identifying additional opportunities for savings and expenditure control.

Introduction

The Senate's recently adopted 2003-2005 General Fund-State (GFS) budget recognizes the importance of expenditure control, providing a good foundation for final budget deliberations. The Senate incorporated many of the ideas introduced in Governor Gary Locke's budget plan, introduced last December (see "Governor's Budget Sets Priorities, Lives Within Means," PB 02-16, December 20, 2002, http://www.researchcouncil.org/Briefs/2002/PB02-16/budgetlives.htm).

Most important, the Senate budget reinforces the commitment to manage the budget shortfall without resorting to new general tax increases. Acknowledging that the budget reflected "tough choices," Senate Ways and Means chairman Dino Rossi said, "It's possible for the state of Washington to live within its means and I think this budget does that."

Sen. Rossi called the Governor's "priorities of government" budget plan "a great starting point," while emphasizing that the Senate had different priorities in some areas. In particular, the Senate budget plan differs from the Governor's plan by providing for more money for beginning teachers and class size reduction, maintaining more adult health care benefits while cutting about 40,000 children from state health programs, and extending tax incentive programs for high technology and research and development programs.

GFS spending increases about $220 million to $22.8 billion, about 1 percent higher than 2001-2003 appropriations. Even that tiny spending increase is about $355 million below the March forecast of state revenues. To bridge the gap, the Senate drains the emergency reserve fund, modifies Initiative 728, transfers revenues into the GFS and expenses out, and leaves reserves at a scant $252 million.

Revenue Overview

As shown in Figure 1, the Senate plan anticipates total resources of about $23 billion, including use of an unrestricted beginning balance of $280 million. The Senate picks up $188 million by reducing the Initiative 728 diversion of property tax money from the GFS to the initiative-created Student Achievement Fund. Several tax relief measures reduce revenues by about $116 million, of which $75 million is attributable to extension of a pair of technology-related incentive programs scheduled to expire this biennium. The $98 million in revenue increases stems primarily from a nursing home fee ($82 million), ex-

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FIGURE 1
General Fund-State Balance Sheet

	2001-2003	2003-2005
Beginning Fund Balance	599.1	280.2
Revenues		
March 2003 Revenue Forecast	21,163.2	22,451.5
Transfers & Other Adjustments	1,104.7	157.5
Reduce I-728 Diversion		188.2
Tax Reduction Measures		(116.4)
Revenue Increase Measures		91.6
Budget Driven Revenue		6.8
Revenue Sub-total	22,267.9	22,779.2
Total Resources	22,867.0	23,059.4
Appropriations		
2001-03 Appropriation	22,451.4	
2003 Supplemental Budget	135.5	
2003-2005 Proposed budget		22,807.4
Total Spending	22,586.9	22,807.4
Projected Ending Balance	280.1	252.0

Source: Senate Ways and Means Committee

panded liquor sales, and accelerated tax collections.

Initiative 728. Under I-728, spending from the Student Achievement Fund would jump from $220 per student to $450 per student in the 2004-2005 school year. The Senate budget would lower the transfer of property tax money from the scheduled $450 to $254. The change saves the GFS $188 million, which would otherwise have been channeled from the general fund to the SAF for distribution to local schools. Governor Locke's budget would have kept the funding at $220, retaining $221 million for the GFS.

Tax Relief. The Senate budget assumes passage of a number of tax relief measures, most designed to either stimulate expansion of a targeted industry or to encourage development in rural communities.

Two major economic incentives intended to spur technology investment are scheduled to sunset in the 2003-2005 biennium. The Senate budget assumes the two are extended indefinitely. The projected revenue losses, of course, do not recognize any estimate of the increased economic activity generated by the program.

· The high-technology sales and use tax exemption/deferral program allows businesses engaged in certain technology research and development (R&D) to defer sales and use taxes on buildings, machinery and equipment, and installation labor. If the investment continues to be used for its intended purpose for eight years after completion, the deferred taxes do not need to be repaid. Estimated revenue decrease: $62.9 million.

· High technology R&D is also eligible for a Business and Occupation (B&O) tax credit under certain conditions for firms spending at least 0.92 percent of gross income on R&D. Estimated revenue decrease: $12.1 million.

Expenditure Overview

The legislature faces an even bleaker budget picture than did the Governor in December. By Senate estimates, the shortfall - that is, the gap between projected revenues and the cost of maintaining current state responsibilities - approaches $3 billion.

The March revenue forecast came in about $200 million below the November estimate, on which the Governor based his projections. The Supreme Court ruled that Initiative 732 (teachers' cost of living allowance) extended state responsibility for paying the COLA extended to school employees not funded by the state. And the union negotiating for home health workers came up with a contract that would increase state costs by nearly $100 million. (See "No Rush to Fund Collective Bargaining Agreement for Home Care Workers," PB 03-04, March 17, 2003, http://www.researchcouncil.org/Briefs/2003/PB03-04/collectivebargaining.htm) By using fund transfers, reserves and boosting revenues (for example, the reduced I-728 funding shift), the Senate budget fills about $913 million of the hole (including the Health Services Account). The expenditure solution is described as a combination of compensation savings, budget reductions, and transfers to other funds.

Compensation Savings. Simply, the Senate does not fund cost-of-living adjustments (COLA) for most state employees. The Governor did not, either. By not paying for the I-732 COLA, a corresponding COLA for employees not covered by I-732, or the collective bargaining agreement, the Senate avoids cost increases of $822 million. An additional $175 million is avoided by requiring state employees to pay an average of 20 percent of the cost of their health care benefits and increasing office co-payments from $10 to $15 per visit.

Budget Reductions. A total of $884 million in budget reductions further reduces the shortfall. Major cuts include: $154 million in management savings (reduced state employment, travel and equipment, and personal services contracts), $111 million in medical assistance, $101 million in pension savings, $73 million in public school spending, $41 million in general assistance benefit changes, $40 million by limiting tort liability, and $40 million in corrections supervision.

Fund Transfers. The Senate budget also shifts $262 million of general fund obligations to other parts of the state budget. Among the measures incorporated into the budget are a 9 percent higher education tuition increase, offsetting $123 million in state spending, and a transfer of higher education preservation and maintenance spending from the GFS to the capital budget to save the general fund $53 million.

Major Spending Areas

Figure 2 breaks down the major areas of GFS spending. These patterns change little from biennium to biennium, with the public schools representing the largest single expenditure commitment. The 43 percent shown for public schools represents an understatement, because I-728 money flows to the schools from the Student Achievement Fund, not the GFS. The Department of Social and Health Services (DSHS) represents nearly 30 percent of state spending, including medical assistance (remember, some Medical Assistance, about $600 million, is also provided through the Health Services Account), and higher education receives about 11 percent of GFS spending.

Public Schools Following the Governor's lead, the Senate suspends the Initiative 732 COLA for public school teachers and selected community college employees. Raises are provided for beginning teachers. First- and second-year teachers would receive an average increase of 3

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FIGURE 2

2003-2005 GFS Spending				
			Senate	
Category	**Governor**	**Senate**	**% of Total**	**Difference**
Public Schools	10,124,000	10,049,831	44.1%	(74,169)
DSHS	6,464,660	6,528,979	28.6%	64,319
Higher Education	2,679,698	2,596,856	11.4%	(82,842)
Special Appropriations	1,420,303	1,324,360	5.8%	(95,943)
Other Human Services	1,290,403	1,315,826	5.8%	25,423
Governmental Operations	392,450	394,347	1.7%	1,897
Natural Resources	308,703	295,412	1.3%	(13,291)
Legislative	132,778	126,033	0.6%	(6,745)
Judicial	80,895	80,655	0.4%	(240)
Transportation	49,757	49,172	0.2%	(585)
Other Education	38,606	38,930	0.2%	324
Other	0	7,045	0.0%	7,045
TOTAL	**22,982,253**	**22,807,446**	**100.0%**	**(174,807)**
Source: Senate Ways and Means Committee				

percent; third year teachers, 2.5 percent; fourth year teachers, 1.5 percent; fifth year teachers, 1 percent; and sixth and seventh year teachers, 0.5 percent. The estimated cost of the increases is $29.9 million. Also, classified employees are scheduled to receive a 1 percent increase in each of the next two school years, at a cost of $18 million.

The budget also provides start-up funding for charter schools of $1.7 million, to accommodate the anticipated enrollment increase as private school and home school students enroll in the new public charter schools (legislative authorization is pending). The budget eliminates "State Flexible Education Funds" of $41.4 million and GFS funding for class size reduction in kindergarten through fourth grade. Additional reductions are made in levy equalization, school bus replacement funds (it is assumed that competitive bidding will reduce replacement costs), and other non-basic education activities.

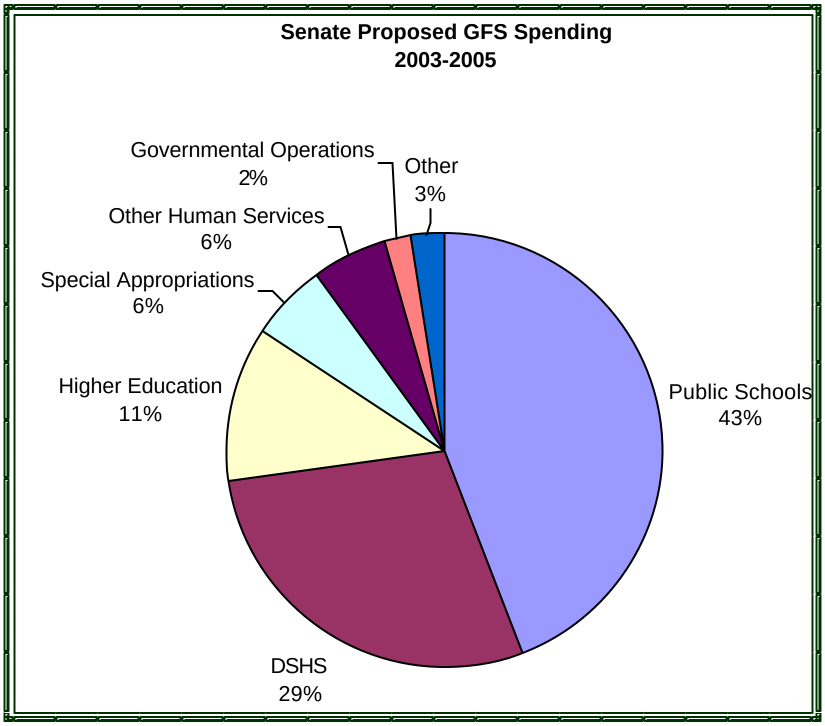
Human Services The Senate budget includes several significant and controversia l reductions in health care spending.

The Medically Indigent program, currently an open-ended entitlement, will be replaced by two capped programs, one providing $3.1 million annually for rural hospitals and the other providing $20 million annually for all other hospitals. The change would save the GFS $111 million.

The Senate budget also would require families with incomes above the poverty level to pay premiums for their children's medical coverage. The premiums would be imposed on a sliding scale, averaging $25 per child for families with incomes between 100 and 150 percent of federal poverty level and $35 per child for families with incomes up to 175 percent of the poverty level. No family would pay more than 5 percent of income and premiums would be capped at three children per household.

The state would no longer pay for prenatal coverage for illegal immigrants, saving $46.5 million in GFS funds. Washington is one of only twelve states providing such coverage. The budget does provide $5 million for community clinics for pre-natal services.

Children whose family incomes exceed 175 percent of the federal poverty level ($32,200 for a family of four) would no longer receive medical coverage under Medicaid or the State Children's Health Insurance Program (SCHIP). Currently, Washington covers children in families with incomes up to 250 percent of the federal poverty level ($46,000 for a family of 4). In Montana and Idaho, the cutoff is a 150 percent; in Oregon, 170 percent. The change, which would save the



GFS $5.8 million and the Health Services Account $40 million, would leave the state covering 540,000 children monthly, 40,000 fewer than would be covered under the higher standard.

The Senate further would reduce GFS expenditures by limiting managed care rate increases, tougher enforcement of eligibility standards, consolidated drug purchasing, reducing adult dental coverage (the Governor's budget eliminated non-emergency dental service), and requiring co-payments for adult vision and hearing services (eliminated under the Governor's budget).

Health Services Account Initiative 773 raised tobacco taxes to extend Basic Health Plan coverage beyond a base enrollment of 125,000. The BHP, which is funded from the Health Services Account, does not have sufficient funds to cover the 125,000, so the Senate would amend the initiative to use the funding provided by the tax increase to maintain BHP services. The Health Services Account also realizes savings from the changes made in eligibility standards for children's health care services described above. The Senate does not eliminate coverage for childless adults, as proposed by the Governor, but rather redesigns the benefit package and freezes enrollments through January 2004, limits future subsidized BHP enrollment to about 93,000, and imposes higher deductibles and co-payment requirements.

Higher Education. Two lump sum appropriations, totaling $20.1 million, are provided to support new enrollments in high demand/high cost programs: $5 million would support 250 community and technical college enrollments; $15.1 million would support 1,050 full-time equivalent students in the other state colleges and universities. The state need grant receives a $32.3 million boost to offset expected tuition increases. Those school employees affected by Initiative 732 would not receive their COLA, but the Senate provides $10 million to recruit and retain faculty and professional staff.

The budget assumes that tuition for resident undergraduates would increase 9 percent, the maximum allowed, except for those resident undergraduates who have accumulated more than 125 percent of the credit hours required to graduate. Those students would no longer be eligible for state-subsidized tuition. By promoting more rapid graduation, the Senate budget assumes colleges would be able to support an additional 1,648 FTEs within available revenue. The colleges would be free to set tuition for other students.

The Senate reduces operating support for higher education by $122 million, and assumes the reduction can be offset by tapping part of the revenue generated by tuition increases. In addition, the Senate reduces base support for non-instructional programs by $45 million in an attempt to drive increased operating efficiencies.

Discussion

When the Governor released his budget in December, the Research Council commended the "priorities of government" process, noting that there would be honest disagreement on priorities. With passage of the Senate budget, critics have focused on some of the policy choices. Reductions in children's health care, for example, allowed restoration of some adult services. Changing the BHP benefit package and raising prices preserves enrollments.

Given the current economic uncertainty, the Senate budget leaves too little in reserve, particularly as some of the revenue and savings assumptions may be too aggressive (e.g., Medicaid changes requiring federal approval and tort reform savings). When the March revenue forecast was released (see "Revenue Forecast Reduced," PB 03-05, March 3, 2003, http://www.researchcouncil.org/Briefs/2003/PB03-05/forecast0303.htm), the Research Council suggested a reserve of $575 million. The Senate leaves just $252 million. While it's appropriate to use emergency reserve funds in a fiscal emergency, the Senate leaves virtually no margin for error.

Overall, however, the Senate successfully addresses the state's major fiscal challenge: maintaining essential state services without jeopardizing economic recovery by increasing general taxes.

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