POLICY brief

Washington Research Council

PB 01-30 December 19, 2001

The Governor's Recession Budget

BRIEFLY

The governor's supplemental budget proposal demonstrates the magnitude of the problem facing the state legislature next month. His plan relies on new revenues, spending cuts and rainy day funds. The assumptions underlying each element of the plan are certain to provoke substantial debate in the coming months.

Governor Gary Locke's proposed supplemental "general fund – state" (GFS) budget, released Tuesday, generally lives up to its advanced billing – there's plenty for critics to dislike. The budget cuts spending, increases revenues, and drains reserves.

FIGURE 1

2001-03 Balance Sheet

Including Governor's 2002 Supplemental Budget

General Fund - State (GFS)

(Dollars in Millions)

Revenues	
November 2001 Revenue Forecast	21,208.7
Proposed Revenue and Fee Changes	165.6
Total Revenue	**21,374.3**
Expenditures	
Current 2001-03 Appropriations	22,783.2
Governor's Proposed 2002 Supplemental	(252.9)
Revised 2001-03 Budget	**22,530.3**
Unrestricted General Fund Reserve	
Beginning Fund Balance	599.0
Revenue less Expenditure	(1,156.0)
Current Budget: Money Transfers into GFS	228.0
2002 Supplemental: Money Transfers into GFS	250.1
Transfer from the Emergency Reserve Fund	78.9
Ending Fund Balance	**0.0**
Emergency Reserve Fund	
Beginning Balance	461.9
Emergency Reserve Transfers to Transportation	(70.0)
Interest Earnings	15.5
Earthquake/Drought	(25.0)
Transfer to General Fund	(78.9)
Emergency Reserve Balance	**303.5**

Source: OFM

Most of the cuts come from social services and aid to local governments; most of the new revenues come from increased tax collection efforts, a new lottery game and gambling taxes. He avoids general tax increases, protects public education and provides salary increases for state employees and teachers. Reserves fall to just $304 million in the emergency reserve fund.

The proposal represents the first step in what's likely to be a protracted and difficult legislative session. The problem has been well documented. The governor addresses a $1.25 billion shortfall in the current biennium, which he attributes to an $813 million reduction in forecast revenues (see PB 01-28, November 20, 2001, *State Revenue Forecast Reduced*); $321 million in required spending for public school enrollment, prisons, caseloads, voter-approved salary increases, and fires; and $125 million related to ferries and other transportation costs.

As Figure 1 shows, the governor possibly understates the magnitude of the shortfall. The gap between total revenues of about $21.2 billion and the $22.8 billion in currently authorized spending amounts to $1.6 billion. New spending of about $300 million further expands the gap.

A report by Senate Ways and Means Committee staff members aptly describes a gap of just under $1.9 billion, saying, "Of this amount $1.2 billion has occurred since June due to lower revenues … and higher supplemental

108 S. Washington St., Suite 406

Seattle WA 98104-3408

PH 206-467-7088

FX 206-467-6957

www.researchcouncil.org

expenditures. The existing $665 million deficit was covered in the original 2001-03 biennial budget through a combination of reserves and money transfers."

Without question, the budget challenge facing the governor and lawmakers exceeds any experienced in recent years. The discussion below draws on the governor's budget documents, as well as analyses conducted by legislative staff working for the House Appropriations Committee and the Senate Ways and Means Committee.

FIGURE 2

Proposed Revenue, Fee Changes and Transfers

(Dollars in Millions)

Budget-driven Revenue	
Additional revenue due to improvements in tax collection	46.4
Lottery "Big Game"	24.9
Liquor tax surcharge	4.7
	76.0
Proposed legislation	
New state gambling tax of 10 percent on card rooms, pull tabs, punch boards	73.7
Use tax applied to shipping charges	20.0
Community Economic Revitalization Board Account to retain interest earnings	(1.7)
Investment Income Business and Occupation tax deduction	(4.2)
	87.8
Total Legislation & Budget-driven Revenue	***163.8***
Fee Changes	
Fish and Wildlife-Hydraulic Project (HPA) Fee Increase	4.3
Fish and Wildlife-Fishing and Hunting License Fee Increase	1.0
GF-S Loss due to Licensing Fee change for Adult Family Homes and Nursing Homes	(3.4)
Total Fee Changes	**1.9**
Total Revenue and Fee Changes	**165.7**
Money Transfers to General Fund	
Pro-share Revenue	200.0
Tobacco Prevention and Control Account	21.2
Health Services Account	12.2
Other	16.7
Total Transfers	**250.1**

Source: OFM

Revenue Highlights. Total resources used to offset the shortfall amount to about $573 million. Included in the total is money from revenue increases (tax and fee hikes and a new lottery game), fund transfers (including additional federal funding), and reserves

Taxes, Fees and the Big Game. The governor proposes about $166 million in new revenues (see Figure 2).

Most of the new tax money, $73.7 million, would come from a ten percent gambling tax on card rooms, pull tabs and punch boards. Now, local governments can levy up to twenty percent in gambling taxes. The governor would cap local taxes at fifteen percent, making the maximum combined tax rate twenty-five percent. Those local governments levying taxes higher than fifteen percent could continue to do so, and the state rate would be reduced to hold the total to twenty-five percent.

More aggressive tax collection is projected to produce an additional $46.6 million. To accomplish this, the state would increase staff in the department of revenue.

The governor also proposes that Washington join the seven states participating in a multi-state lottery known as "The Big Game," which has higher jackpots and is expected to increase participation. The estimated gain to the general fund from the game is $25 million in Fiscal Year 2003 and $32 million annually in succeeding years. It's likely that a supermajority vote would be required to add the game.

An additional $20 million is expected from new legislation that makes shipping charges on out-of-state purchases subject to the use tax, ending a competitive disadvantage experienced by some Washington businesses. When purchasing from an in-state supplier, businesses pay a sales tax on shipping charges; no such tax is collected on these charges when buying from an out-of-state supplier.

A surcharge of thirty cents per liter on liquor (distilled spirits) would generate an additional $5 million in revenues. The governor proposes that the surcharge take effect March 1, 2002.

The governor proposes other minor tax and fee changes that have the effect of reducing revenue by about $4 million.

Money Transfers. A total of $250 million is anticipated from transfers into the general fund.

About $200 million is expected from “Pro-share” Medicaid transfers, associated with federal reimbursement for nursing home expenses. The federal government has not agreed to the funding. The revenue would be transferred from the Health Services Account to the general fund.

Of the remaining $50 million in transfers, $21 million comes from the Tobacco Prevention and Control Account.

Reserves. In the governor’s budget, reserves are reduced by a total of $222 million. He proposes using $78.9 million from the emergency reserve fund (shown as a transfer to the unrestricted general fund reserve in Figure 1) and reducing the unrestricted ending balance to zero, an additional reserve draw down of $143 million.

Expenditure Highlights. As shown in Figure 1, the governor’s supplemental budget reduces GFS spending by $252.9 million. Reductions of $566 million are partially offset by $313 million in new spending.

Spending Cuts. About half of the $566 spending reduction, $235 million, would come from human service programs, which account for nearly one-third of the state budget. Included in the social services cuts are reductions in Medicaid payments to pharmacies, cuts in nursing home payment rates, reductions in some alcohol and drug programs, elimination of state supplemental payments to SSI recipients, and a host of other small program reductions and eliminations.

A combination of three compensation adjustments would result in a savings of $117 million. Requiring all state employees to pay at least ten percent of their monthly health premium, increasing co-pays from $10 to $20 per visit, and reducing prescription drug costs would result in health care benefit savings of $45 million. Actuarial changes in state retirement plans would save $59 million. And deferring cost-of-living increases for state and higher education employees from July 1, 2002 until September 1, 2002 would save $8.5 million; a similar deferral for vendor rate increases would save $4.5 million.

An additional $72 million GFS savings would be achieved by eliminating assistance to local governments to replace revenues lost from the repeal of the motor vehicle excise tax in the wake of voter approval of Initiative 695. City and county assistance would be ended July 1, 2002; public health districts would receive money for an additional six months.

The governor also proposes to reduce spending for higher education by $54 million, but would allow the institutions to replace the lost revenue with tuition increases.

K-12 education, the largest share of the state budget, comes in for a relatively modest expenditure reduction of $29 million. The block grant program would be eliminated, saving $14.2 million. Various other grant programs would be eliminated to save an additional $11.8 million. And Educational Service Districts would be cut back by half, saving $2.5 million.

Thirty state programs, including the state library, are targeted for elimination. Increased efficiencies at agency headquarters are expected to generate $22 million in savings.

With program reductions will come layoffs. The governor's proposal would eliminate 835 full-time jobs. Retirements, transfers to other positions in state government, and normal turnover would reduce the number of employees involuntarily laid off. In addition, the governor proposes adding 559 jobs, primarily in the areas of criminal justice and social services. The net reduction is expected to be 276 jobs.

Finally, the governor returns $125 million in costs tied to ferries and multi-modal transportation to the transportation budget.

Spending Increases. The governor's budget provides about $313 million for new spending.

The public schools are expected to receive an additional $123 million, $97.5 million of which is for enrollment and workload changes (more students showing up than expected). Additional spending is required for levy equalization and the cost of voter-approved cost-of-living increases for teachers.

Medical assistance costs climb $50 million in the general fund (and $41 million in the Health Services Account). The increase is attributable to higher caseloads, a slight reduction in the federal reimbursement rate, and higher prescription drug costs.

Corrections spending increases by $39 million, primarily to reflect inmate and community supervision caseload increases.

The 2001 fire season added a total of $21 million in new GFS costs.

Higher education picks up $12 million: $3 million for state need grants and $9 million for worker retraining programs at community and technical colleges. The program expansion would permit training of an additional 1,500 students.

Comments. The governor's budget, in several respects, can be treated as a best-case scenario for hard times. By the end of the session, things could look worse.

The expenditure reductions fall primarily on social service programs, and advocates can be relied on to contest many of them. Nonetheless, social service cutbacks will be required to bring the budget into balance without general tax hikes, and many of the cuts will doubtless stand.

Some of the program eliminations, like the state library, are powerful symbols, but represent relatively small savings. In public budgeting, it often happens that the toughest fights are over the smallest programs, which can mobilize impressive constituencies to defend them. When the money isn't substantial, lawmakers frequently bow to external pressure.

Deferring cost-of-living raises saves just $13 million, and state employees can consider themselves fortunate if a slight delay in a scheduled salary hike is the worst news they receive when the final budget is written. The governor's proposal to increase the employee-paid share of health care benefits is a relatively modest cost-shifting, and still leaves state workers with a benefit package considerably more generous than that received by many private sector employees.

The expenditure cuts of $566 million represent less than half the $1.25 billion gap the governor identified. The governor avoided deeper cuts by accepting revenue projections that appear fragile. The additional $200 million in federal reimbursement may not appear on time, if at all. A new lottery game will require a supermajority vote of the legislature, and many lawmakers are dubious of any expansion in gambling. The revenues assumed to flow from the tax on card rooms may well be optimistic; the gambling industry is volatile, and these operations face stiff competition from tribal casinos, as well as opposition from state and local officials who object to gambling. Further, transfer of certain costs to the transportation budget will not be possible without passage of the governor's transportation plan.

By leaving just $300 million in reserves, the budget leaves little room to chance. If the revenue increases fail to pan out, or the February forecast drops again, the state will again move to a deficit position. Of further concern is the degree to which the supplemental budget relies on one-time revenues. Should the economic slump extend eighteen months, as some believe possible, even greater budget shortfalls can be anticipated for the 2003-2005 biennium.

Still, the governor has laid out a good initial proposal. He makes clear the magnitude of the problem, and the kind of response that will be required to solve it. In January, the legislature will need to improve upon it.

◆ ◆ ◆