

A Review of Washington State's 2011-13 Budget and Recommendations for Structural Reform

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Key Findings

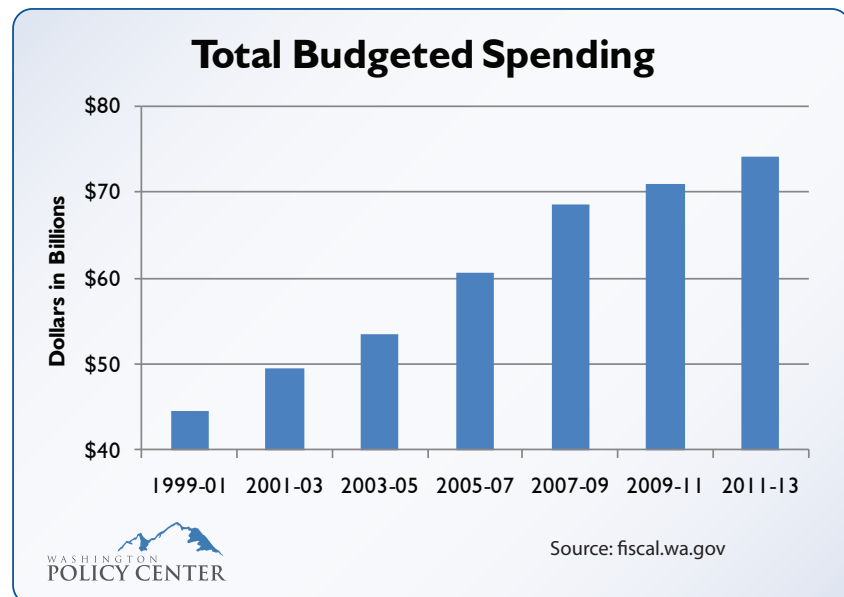
1. The legislature took positive steps this year to put the state on a more sustainable budget path.
2. An inadequate reserve fund, coupled with ongoing economic uncertainty and projected future spending pressure leaves the state's budget outlook on tenuous ground.
3. Total budgeted spending is set to increase \$3.2 billion for 2011-13.
4. Near General Fund State spending is set to increase \$1.7 billion for 2011-13.
5. After years of flat or declining revenue, state revenues are projected to grow again by \$3.5 billion for 2011-13.
6. State government employment is projected to decrease by 1,578 full-time equivalent (FTE) employees for 2011-13.

Introduction

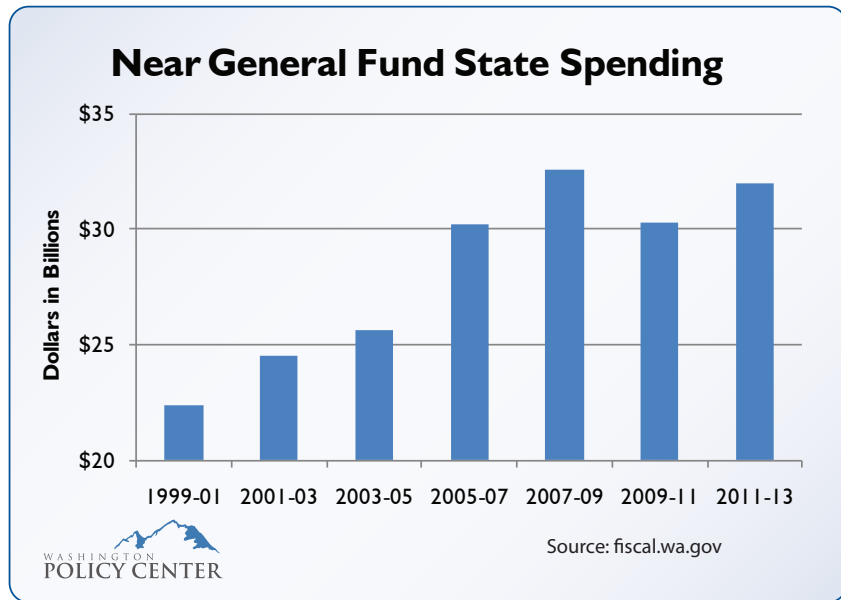
Though it took a special session to finish its work on the 2011-13 budget, the legislature took positive steps this year to put the state on a more sustainable budget path. Despite progress, however, an inadequate reserve fund coupled with ongoing economic uncertainty and projected future spending pressure leaves the state's budget outlook on tenuous ground highlighting the need for additional structural reforms and spending restraint.

State Spending Trends

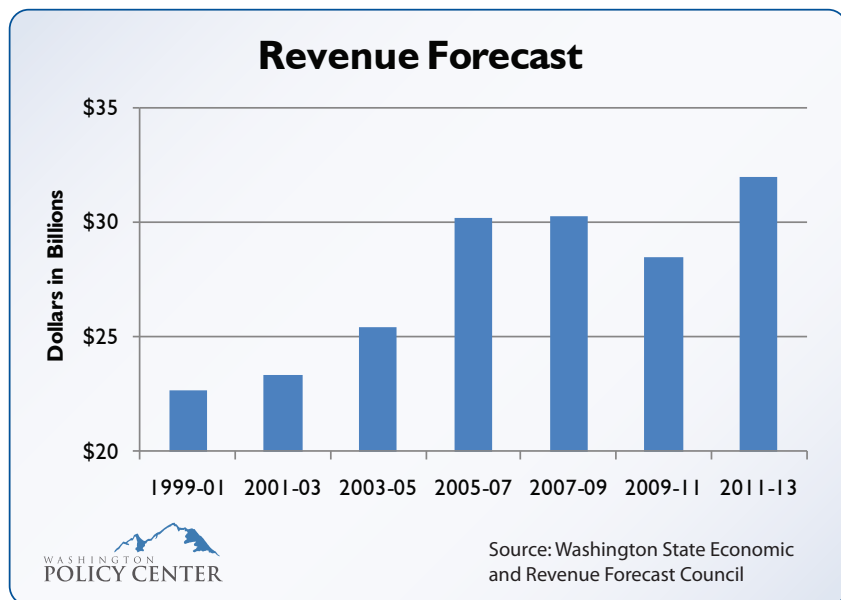
While the discussion focused on spending cuts during the 2011 Legislative Session, state spending is projected to increase both for "Total Budgeted" spending and the "Near General Fund State" (NGFS). Although this increase in spending for the NGFS follows a 2009-11 budget cycle that saw a significant decrease in spending, Total Budgeted spending has not decreased since the onset of the "great recession." Total Budgeted spending includes the transportation, capital and operating budgets including federal funds and grants. Near General Fund State is the account that principally supports the operation of state government and is funded primarily by state sales, property, and business and occupation taxes.



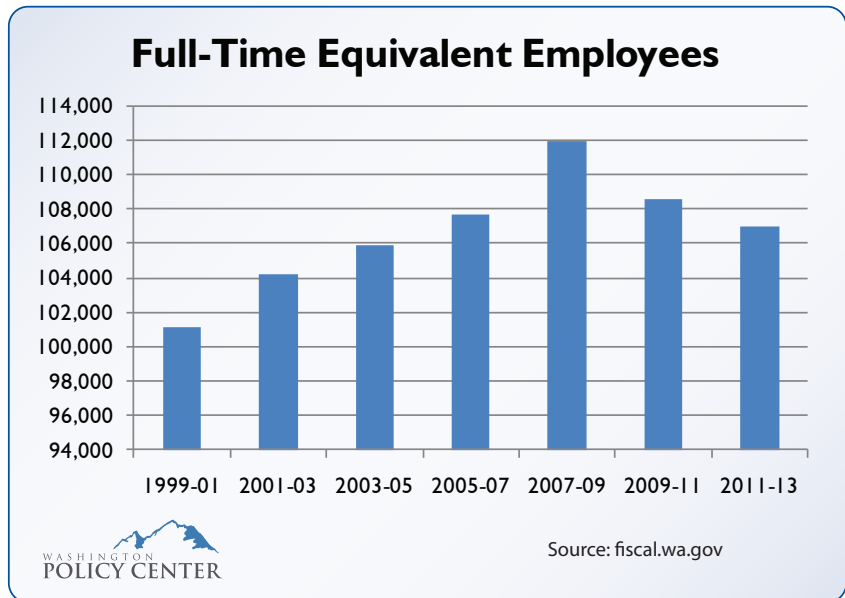
Total Budgeted spending is set to increase \$3.2 billion for 2011-13. This builds on increases of \$2.4 billion for 2009-11, \$8 billion for 2007-09 and \$7 billion for 2005-07. Since 1999-01, Total Budgeted spending has increased 66 percent.



Near General Fund State spending is set to increase \$1.7 billion for 2011-13. This follows a decrease of \$2.3 billion for 2009-11 and increases of \$2.4 billion for 2007-09 and \$4.6 billion for 2005-07. Since 1999-01, NGFS spending has increased 43 percent.



After years of flat or declining revenue, state revenues are projected to grow again by \$3.5 billion for 2011-13. This follows a decrease of \$1.8 billion for 2009-11 and increases of \$88 million for 2007-09 and \$4.8 billion for 2005-07. Since 1999-01, state revenues have increased 41 percent.



State government employment is projected to decrease by 1,578 full-time equivalent (FTE) employees for 2011-13. This is down 4,989 from the peak of 111,984 FTEs in 2007-09. Since 1999-01, FTEs have increased 6 percent.

Understanding the \$5 Billion Shortfall

With increases in both revenues and spending for 2011-13, why all the discussion of budget cuts and a \$5 billion plus budget “deficit”? This question can be answered by understanding the components of what is more appropriately referred to as the budget “shortfall” lawmakers were tasked with closing. The distinction between a “deficit” and a “shortfall” is the difference between current appropriations and revenues and projected future spending and revenues.

State spending is projected to be around \$30.3 billion for 2009-11. Revenues are projected to be around \$32 billion for 2011-13. So why the need to solve a \$5 billion shortfall? The first part of this answer lies in the fact that revenues for 2009-11 were approximately \$28.5 billion yet spending was \$30.3 billion. This means that the 2009-11 budget was “balanced” with one-time funding sources for ongoing spending. Thus despite nearly a \$3.5 billion increase in revenue for 2011-13, lawmakers were already approximately \$2 billion in the hole.

The remainder of the \$5 billion shortfall comes from assuming that the 2009-11 budget would continue without reductions and adjusting for inflation and caseloads as well as funding the two “free” education initiatives from 2000 (I-728 and I-732; when passed they both promised voters to not require a tax increase or hurt the budget; subsequent ballot measures to raise taxes to pay for these measures were rejected by voters) to the tune of nearly \$2 billion more in spending, making \$700 million in pension catch-up payments, and providing state employees pay raises among other policy additions. Essentially this means lawmakers initially wanted to bring state spending for 2011-13 to around \$37 billion, up from \$30 billion despite revenues of only \$32 billion.

2011-13 Balance Sheet

While the majority of the \$5 billion shortfall was due to the need to replace one-time funding sources and reduce projected future spending increases, lawmakers were forced with making real reductions in some programs in 2011-13 to account for the fact they failed to align spending to the revenue forecast in 2009-11 and 2007-09. One of the major positive developments this year was at the time of its adoption, the 2011-13 budget was the first budget since 1997 that spent less than forecasted revenue.

It is important to note lawmakers accomplished this “Budgeting 101” feat of spending within the revenue forecast without raising general taxes. This primarily occurred as a result of voters framing the budget debate last November by rejecting Initiative 1098 (creation of a high earners income tax) and adopting Initiative 1107 (repeal of various tax increases) and Initiative 1053 (restoring the two-thirds vote requirement for tax increases). The budget does, however, rely on \$517 million in fee increases. The vast majority of these fee increases are for higher education tuition (\$369 million).

Unfortunately lawmakers did not leave a big enough reserve which became apparent the day after the budget was signed by the governor when most of the ending fund balance was wiped out by the June revenue forecast – leaving only \$163 million in total reserves for 2011-13 or less than 0.5% of spending (prior to the June 2011 forecast there was \$723 million in total reserves or 2.3% of spending). This scant remaining reserve increases the possibility of a special session being necessary later this year should the economic outlook worsen.

Next Steps: Recommendations for Structural Reform

Along with putting the state’s budget a step closer to sustainability, lawmakers also enacted many important reforms. Among the improvements adopted this year:

- Consolidation of the state’s administrative agencies into a new Department of Enterprise Services as well as improvements to the state’s competitive contracting process (expected to save approximately \$19 million).
- Reducing the state’s unfunded liability in older pension plans by ending automatic benefit increases. This is expected to save over \$300 million in the next two years and nearly \$8 billion over the next 25 years.
- Passage of a proposed constitutional amendment (SJR 8206) that, if ratified by voters in November, would help ensure “extraordinary” revenue growth is saved in the state’s constitutionally protected reserve account instead of spent.

While these are important changes, additional reforms are needed as the state continues down the path toward sustainable budgeting.

Among the changes needed:

- Structural requirement that lawmakers set aside at least a 5% reserve (not counting constitutional rainy-day account) when adopting the initial

biennial budget (for a \$32 billion budget this would be reserves of around \$1.6 billion versus the \$723 million initially set aside).

- Commitment to repeal versus suspend programs the state cannot afford, in order to avoid pressure on future budget writers. For example, I-728, I-732, paid family leave, and the ending of the temporary 3% salary reduction for state employees will have significant projected costs for the 2013-15 budget outlook.
- Protections for dedicated accounts and user fees to help avoid these accounts and fees from becoming targets for fund sweeps.
- A constitutional tax and spending limit (modeled after the voter approved Initiative 601 framework adopted in 1993).
- Legislative control over state employee compensation policy as part of the public budget process, versus merely an up or down vote based on union negotiations conducted secretly and exclusively with the governor.
- Proactive competitive contracting.
- Performance-based budgeting.

Many of these recommendations are explained in greater detail in our January 2011 publication “Ending the Spending Crisis: Structural Reforms for a Sustainable State Budget.” Though challenges remain, the legislature took important steps this year by limiting spending to within the state’s revenue forecast. The failure to leave an adequate reserve coupled with the ongoing economic uncertainty, however, means additional structural reforms and spending restraint will continue to be necessary as the state recovers from the impact of past overspending combined with the “great recession,” and embraces the path of sustainable budgeting.

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