

2005-07 Omnibus Budget Overview

Operating Only

(includes 2005 Supplemental Budget)

Reasons for the Projected Budget Shortfall

Since September 11, 2001, Washington State has faced continuing budget deficits as the cost of current services has exceeded current revenues. When it built the 2003-05 biennium budget, Washington State was faced with a \$2.7 billion gap between revenues and the demand for spending. That shortfall was solved primarily by a combination of reductions and one-time savings but also included a modest level of new revenues.

In 2005, the Legislature faced a shortfall between available revenues and spending demand of approximately \$1.8 billion. The two-year growth in revenue for the 2005-07 biennium was projected to be \$1.6 billion, a 7 percent increase. The cost to maintain existing services, a 10 percent increase, and to provide proposed cost-of-living increases, additional higher education capacity, and other enhancements was estimated to be \$3.4 billion, a total increase of 15 percent.

This demand for increased spending arose from five primary areas:

1. Growth in entitlement programs;
2. Increased pension obligations;
3. Requests for employee and vendor cost-of-living increases;
4. Requests to expand higher education enrollments as the state experienced historically high growth in high school graduates; and
5. Proposals made by the Governor and some legislators to reverse reductions made in prior budgets and to add funding for new or expanded programs or services.

Entitlement Programs

The largest growth in entitlement programs has been in medical assistance. The General Fund-State cost of that program grew by more than \$650 million. Other mandatory cost increases included \$354 million for K-12 student enrollment and other cost increases in public schools; \$239 million for caseload and cost-per-case increases in long-term care, developmental disabilities, and mental health; \$152 million for debt services; and \$150 million for mandatory cost-of-living increases for staff in public schools and some community college staff.

Pensions

The projected cost of pensions for the 2005-07 biennium increased by \$513 million, a 300 percent increase over pension funding included in the 2003-05 biennial budget. Recognition of extraordinary investment returns in the late 1990's allowed the state to lower the pension contribution rates paid by both employer and employees in recent years. In the 2003-05 biennium, the Legislature also suspended the scheduled payments towards the unfunded liability. Another factor that increased the pension costs for the 2005-07 biennium was a finding by the State Actuary, who identified a 1998 pension enhancement (gain sharing) that was omitted from the valuation for calculation of the required level of pension funding.

Employee Cost-of-Living Increases

In 2002, cost-of-living adjustments (COLAs) were granted for public school and community college employees covered by Initiative 732 (I-732), but the budgeted COLA for state employees was rescinded. In 2003 and 2004 no COLAs were granted, although some teachers and classified staff did receive targeted raises.

The 2005-07 biennium marked the beginning of collective bargaining for wages and benefits by state employees. Under the new collective bargaining law, with one exception, unions negotiate agreements with the Governor by October of the even year preceding the biennial budget. The Governor is then obligated to include funding for the collective bargaining agreement in the proposed budget. By statute, the Legislature is required to either fully fund or completely reject the agreements.

For the 2005-07 biennial budget, \$306 million from General Fund-State would be required to fund the negotiated agreements and to provide similar increases for other state employees.

Prior Budget Reductions

Additional spending pressures resulted from requests to restore previous budget reductions. For example, changes made in 2003 that required co-payments for children's health premiums and more frequent eligibility reviews were reversed. In addition, a children's medical program for non-residents eliminated in the 2002 session was restored.

Finally, the federal government notified the state that almost \$82 million of federal funds used to support community based mental health programs would be eliminated on July 1, 2005. (The Legislature restored \$80 million of the lost funding.)

How the Legislature Solved the 2005-07 Biennium Budget Problem

The combined spending demands of increased costs for current services and priority enhancements would have resulted in a gap between expenditures and projected revenues of more than \$1.8 billion for the 2005-07 biennium.

The Legislature addressed this deficit in three ways: (1) increased revenues by \$482 million; (2) adopted program reductions and savings of \$557 million; and (3) used \$774 million of fund balances, transfers, and budget driven revenue. These changes resulted in a 2005-07 biennial General Fund-State appropriation of \$26 billion, an 11.6 percent increase, and a total funds operating budget of \$49.4 billion.

Revenue Increases

The majority of the new revenue, \$313 million, was targeted for funding education. The Legislature created a new Education Legacy Account dedicated to funding education programs. Revenue for the account is derived from two sources: (1) a re-enacted estate tax projected to raise \$139 million; and (2) an additional cigarette tax of \$0.60 per pack anticipated to generate \$174 million.

The Education Legacy Account is used in two ways:

1. \$138 million is used for a scheduled increase in the per-student amount for the I-728 class size initiative.
2. \$175 million is used to pay for new enrollments at the state's four-year and community colleges; provide financial aid for Washington residents to attend college; allow a \$25 million enhancement to the learning assistance program in public schools; and fund other education items.

An additional \$170 million of new revenue is raised through a variety of tax increases, including an increase in the liquor tax, application of the sales tax to extended warranties, one-time revenue generated by funding accelerated revenue collections, and changes in notification requirements for unclaimed property.

Program Reductions and Savings

Program reductions, along with one-time and ongoing efficiencies, generated \$557 million towards solving the budget deficit. Savings of \$325 million are achieved through three changes in pension funding policy:

1) deferring contributions to the pension funds for the unfunded liability for the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) 1; 2) deferring contributions for the gain-sharing benefit for the PERS and TRS 1 and 3 plans; and 3) delaying a portion of the rate increases.

Efficiencies and program reductions are expected to generate another \$232 million, including:

- Improving the purchasing process for goods and services;
- Enhancing the General Assistance program to convert clients more quickly to the federal Supplemental Security Income program and to help legal aliens attain citizenship;
- Not funding inflation for leases and equipment;
- Reducing middle managers throughout state government;
- Reducing funds for non-instructional costs at colleges and universities;
- Eliminating the Promise Scholarship program; and
- Reducing funding by \$25 million for levy equalization, school bus depreciation, and the Reading Corps.

Reserves, Fund Transfers, and Budget-Driven Revenue

To close the remaining gap, the Legislature used \$493 million of general fund reserves along with \$219 million of reserves from other funds, including \$102 million from the Public Employees' Benefit Account and \$45 million from the Health Services Account. In addition, the budget included specific activities to be conducted by the Department of Revenue and the Liquor Control Board which will result in an additional \$46.3 million for the general fund.

2005-07 Estimated Revenues and Expenditures
General Fund-State
(Dollars in Millions)

RESOURCES	
Beginning Balance	672.3
Revenue Forecast -- March 2005	24,885.3
Money Transfers from Other Funds	218.7
Budget Driven Revenue	46.3
Suspend Property Tax Diversion	138.2
Other Legislation Impacting Revenues	169.2
Total Resources (Including Fund Balance)	26,130.0
APPROPRIATIONS	
Total Appropriations	25,952.4
TOTAL RESERVES	
Ending Balance	177.6

2005-07 Washington State Omnibus Operating Budget
Cash Transfers to the General Fund
(Dollars in Thousands)

Fund	2005-07
Public Employees' and Retirees' Insurance Account Fund Balance	102,000
Health Services Account	45,000
Reduce General Fund-State Backfill to Water Quality Account	38,900
State Treasurer's Service Account	10,500
State Convention & Trade Center Account	10,300
Pollution Liability Insurance Program Trust	7,500
Department of Retirement Systems Expense Account	2,000
Waste Reduction, Recycling, and Litter Control Account	2,000
Financial Services Regulation Account	1,557
Natural Resources Equipment Revolving Fund	1,000
Flood Control Account	1,000
Secretary of State Revolving Account	500
Tourism Development and Promotion Account (Olympics)	-600
Violence Reduction and Drug Enforcement Account	-3,000
Total	218,657

**2005-07 Washington State Omnibus Operating Budget
Adjustments to the Initiative 601 Expenditure Limit**

(Dollars in Millions)

	FY 2006	FY 2007
Unadjusted Limit (Rebased to 2005 Appropriations)	12,564.17	13,211.49
<i>Program Cost Shifts To The General Fund</i>		
Office of Financial Management/Governor: Shared Services	0.84	0.01
Washington State Patrol: PSEA/GF-S Transfer	12.06	
Labor & Industries: Other Fund Adjustments	0.56	
Department of Licensing: Transfers	0.06	
DSHS: Community Mental Health (State/Federal)	37.70	
DSHS: Disproportionate Share Hospital (DSH) & Related	65.87	
DSHS: Childrens Carryforward Adjustments	2.21	
DSHS: Developmental Disabilities Carryforward Adjustments	0.24	0.07
DSHS: Medical Assistance Administration Medicaid Part D	1.58	
DSHS: Mental Health Patient/Ward Revenue Adjustment	0.42	
DSHS Children & Family: PSEA Shortfall	4.67	
DSHS Juvenile Rehabilitation: Mandatory Workload Adjustments	-0.13	0.01
DSHS Juvenile Rehabilitation: Co-Occuring Disorders Project	0.71	
DSHS Medical Assistance Admin: Non-Medicaid Services-Community	2.30	0.00
Department of Health: Center for Health Statistics Cost Shift	0.03	0.33
Dept of Veterans' Affairs: Carryforward Adjustments	0.00	0.00
Superintendent of Public Instruction: Special Ed Funding	0.04	0.07
Washington State University: Lidded Grant Compensation Funding	0.15	0.02
Department of Ecology: Transfers	0.15	
Department of Ecology: Streamflow	0.07	
Department of Ecology: Carryforward Adjustments	0.30	
Department of Fish & /Wildlife: Carryforward Adjustments	0.40	
Department of Natural Resources: Carryforward Adjustments	0.02	
Community & Technical Colleges: Carryforward Adjustments	3.50	
<i>Program Cost Shifts From The General Fund</i>		
Special Appropriations: K-20 Network	-1.50	
State Investment Board: Technical Correction	-0.10	0.10
Washington State Partrol: PSEA/GF-S Transfer		-5.06
Department of Labor & Industries: Other Fund Adjustments		-0.02
Department of Licensing: Business & Professions Account	-3.76	-0.17
DSHS: Basic & Basic Plus Waiver Growth	-0.25	-0.25
DSHS: Intergovernmental Transfers Redesign		-4.94
DSHS: Medical Assistance Administration Medicaid Part D		-3.38
DSHS: Medical Assistance Administration DSH and Proshare	-0.12	
Department of Veterans' Affairs: Federal Funds	-0.72	-0.80
Department of Corrections: Federal Funds	-0.16	
Higher Education: Maintenance and Operations to Capital Budget	-7.50	
Department of Ecology: Well Construction	-0.15	
<i>Revenue & Cash Transfers</i>		
<i>Cash Transfers from the General Fund</i>		
ESSB 6090, Section 805: To Violence Reduction & Drug Enforcement Account	-1.50	-1.50
ESSB 6090, Section 805: To Tourism Development/Promotion Account	-0.15	-0.15
ESSB 6090, Section 806: To Tourism Development/Promotion Account	-0.15	-0.15
HB 1457: Military Department Account Revenue Shift	0.00	-0.88
<i>Cash Transfers to the General Fund</i>	<u>133.63</u>	<u>88.63</u>
Total Adjustments	251.32	71.96
Limit (After Adjustments)	12,815.49	13,283.45

Note: Expenditure limit calculations are preliminary estimates only. Actual spending limits are established by the Expenditure Limit Committee each fall.

**2005-07 Washington State Operating Budget
Appropriations Contained Within Other Legislation**

(Dollars in Thousands)

Bill Number and Subject	Session Law	Agency	GF-S	Total
2005 Legislative Session				
EHB 1240 - Real Estate Excise Tax Fees	C 480 L 05	Department of Revenue	3,900	3,900
SHB 1509 - Veterans' Widows Tax Asst	C 253 L 05	Department of Revenue	276	276
SHB 2085 - Tire Waste & Removal	C 354 L 05	Office of Financial Management		150
SHB 2085 - Tire Waste & Removal	C 354 L 05	Department of Revenue		40
SB 5454 - Justice Funding	C 457 L 05	Administrator for the Courts		2,400
SB 5454 - Justice Funding	C 457 L 05	Public Defense		7,300
SB 5454 - Justice Funding	C 457 L 05	Civil Legal Aid		3,000
SB 5898 - Postpartum Depression	C 347 L 05	DSHS - Admin & Support Svcs	25	25
SB 5902 - Small Business Assistance	C 357 L 05	Community Trade & Economic Dev	45	45
ESSB 6103 - Transportation - Fuel Tax	C 314 L 05	State Auditor		4,000
Total			4,246	21,136