Washington State Budget Options

September 28

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This document is a collection of thoughts on the set of budget decisions to be made in the fall of 2010 and over the next few years. Getting a handle on how we run the overall government is crucial if we wish to have funds available for educating children, taking care of the needy and all the other things we do.

Structural Reset

State Representative Ross Hunter

Overview

We have three budget problems – short-term, 2011-13, and long-term. Solving any of them requires that we have a shared set of priorities that we act on. This is more difficult than it seems at first blush. The world is going through an economic reset similar to the one we experienced in the 1930s and the long slump of the 1870s. There is widespread belief that just as after the great depression, an entire generation of people will be more frugal and will spend less. This will change the relationship between income and sales tax revenue in structural ways, and we should prepare for it.

There will be many structural changes as a result of the “reset,” and we need to make structural changes in what we do as a state to prepare ourselves for the future. Choices we make today will set the basis for our future prosperity.

Your beliefs about what the post-reset economy will look like color your decisions about investments we make as a state. Most rational observers believe that if we want to be competitive we will need to add a lot of productivity to our labor pool – highly educated and innovative workers produce better goods and services more cheaply than low-wage, low-skill workers. We want to be a region that attracts a high-skill workforce so that we outcompete regions with a lower-skill workforce.

Here’s a reasonable set of overall priorities:

1. We must invest in the education of children and the re-tooling of adults. The practical decision this drives is following the investment plan created under HB 2261 – the new constitutional definition of basic education and making sure our higher education system meets the economic needs of the state.
2. Basic human decency means we must provide a safety net for those unable to help themselves. We want to make sure we’re providing people with the skills to become economically self-sufficient. If we have to prioritize here then our most important investment is in children and fragile seniors.
3. We must make investments in physical infrastructure as well. Living in a highly connected region enables economic competitiveness. This means transportation (both roads and transit,) sewers, streetlights, etc.
4. The quality of our environment is one of the key elements that attracts high-skill workers to the region and we need to make sure we’re protecting and improving the place where we live.

Our future economic prosperity depends on a balance between providing the physical and social infrastructure necessary to enable job creation and income increase and the level of taxation necessary to pay for the infrastructure created. Ensuring the correct balance is what we are hired by the people to do. The correct answer is not at either end of the spectrum.

We have to pay attention to making sure we are efficient in what we do so that the maximum amount of money is available to fund the things we care about – education, the safety net, physical infrastructure, and our environment.

This document assumes no increase in the rate of taxation in Washington State over the next biennium.

Short term – 2009-11 Second Supplemental Budget

This is the budget for the remainder of the fiscal year. As the economy changes under us we have to take the most responsible set of actions to wind up with a balanced budget.

- The amount of revenue we expect to receive was reduced by $770 million in the September 2010 forecast. This will be a cumulative decline of almost $1 billion since the 2010 session ended.
- In order to respond most quickly to the problem the governor plans to make across the board cuts of about $520 million, effective October 1st. This will bring the current budget back into balance.
- The legislature and governor should work together to craft a supplemental budget that we adopt very early in the 2011 session. This would include additional cuts of perhaps $150 million to provide cushion and an ending fund balance. These numbers will change as the November revenue forecast changes.

Revised Estimates of 2009-11 GFS & Related Projected Ending Balances (Dollars, In Millions)	GF-S	Education Legacy Trust	Budget Stabilization Account	Total
Current Official Projections				
Budget As Passed Legislature	484.4	2.1		**486.5**
Governor Vetoes	(27.5)			**(27.5)**
June Revenue Forecast	(202.8)	(0.7)		**(203.5)**
September Revenue	(770.0)			**(769.9)**
All Other Balance Sheet Changes	(6.3)		5.8	**(0.5)**
Projected Ending Balance (June Forecast Balance Sheet)	**(522.2)**	**1.4**	**5.8**	**(514.9)**
FMAP Related Items				
Back Out Original FMAP Assumption	(478.9)			**(478.9)**
Revised FMAP	338.4			**338.4**
Net FMAP Change	(140.5)			**(140.5)**
Intermediate Collections & Caseload Updates				
Caseload Updates (June Caseload Forecast)	41.0			**41.0**
Subtotal	41.0			**41.0**
FY 2010 Reversions (Underspending - Phase I)	89.0			**89.0**
Current Estimate	**(532.7)**	**1.4**	**5.8**	**(525.4)**

Medium term – 2011-13 regular budget.

In approaching the 2011-13 budget we have time to be more strategic. We will be unable to do this with the current way of viewing the budget, and particularly the 6-year outlook prepared by OFM.

- We currently expect about $2.5 billion in new revenue, but
- The standard model predicts $6.5 billion in new expenditures.
- Healthcare inflation estimated at 7.5% per capita annually, 1.5 times long-term growth in revenue. This is not sustainable.

These numbers will change, perhaps significantly, at each revenue forecast until we write the budget. (Nov, Mar, Jun…) To start, we need to recast the 6 year budget outlook to expose major decisions buried in the maintenance and carry-forward layers.

The basic solution here is to not do all the planned expenditure increases. In order to understand what choices we do have to make we need better information. First, we should create a new budget outlook structure that captures 10-15 major activities of government with 5 columns:

Category	2009-11 base	Caseload Adjustments	Inflation	Policy Changes	2011-13

Also take vertical slices of the budget and review compensation, benefits, etc. This would break out the budget by type of expense. These don't foot because many categories overlap, but it is useful and instructive to examine the budget from different angles.

- Employee compensation, benefits, pension contributions, etc.
- Vendor Payments (hospitals, drugs, outsourced services, etc.)
- Administrative overhead charged out to agencies (legal, admin, payroll, DIS, etc.)
- IT projects and management (about $2 billion in 2009-11)

The goal is to have a 4-5 page overview of the budget that daylights all the critical decisions we will need to make, even (especially) if they are currently buried in the maintenance or caseload layers of the budget. Being buried in maintenance is the holy grail of program advocates – your expense is never looked at again. To get something out of maintenance you typically have to change current law. We change current law all the time so we should not view this as an obstacle to a rational budget.

Major Policy Choices

To get to a balanced budget with no new revenue we will have to make many very unpleasant decisions. The following is a list of the kind of cuts that we will need to make.

- Set a goal that healthcare costs grow no faster than long-term revenue growth (4.8% per year.)
  - Hold all other medical expenses constant – no inflation, no policy adds
- Identify source of funding for all or part of $2 billion in Medicaid expenses covered by ARRA funds. Either new funding appears (which seems unlikely,) or we will have make reductions in

the level of service in healthcare and human services to match the reduced spending. There are legal constraints that make this difficult.

- There are about $1.7 billion in proposed education increases in the outlook. These cannot all happen.
  - Eliminating 728 and 732 is about $1 billion.
  - $710 million is the 2011-13 portion of the funding stream for our new definition of "basic education." This will be difficult to eliminate.
- It will be difficult to make further reductions to higher education budgets without seriously damaging our ability to compete economically. Consider recasting this budget into two streams – student aid and performance contracts based on the number and distribution of graduates with certain expensive degrees, degrees that improve the economy. We are likely to have to allow the institutions significant flexibility on tuition policy.
- Growth in payment streams for the unfunded liability for PERS/TERS plans 1 is unsustainable. We must reduce the cost of this stream. The planned increase in 2011-13 is in the $700 million range. Our choices cannot be to push this one particular stream further into the future.
- Reflecting the private economy, no raises for anyone. No COLA, no step increases. Change to 80-20 premium share for state employees as part of healthcare cost containment strategy. The healthcare cost changes can net us $150 million/yr. There is legislation required here.
- All fee for service programs become self-supporting. Manage with clear database and reporting system. Consider moving fee/program analysis to another committee to ensure adequate focus. If the fee does not cover the cost of the activity eliminate the activity.
- We will need to stop or delay some long-term IT and capital projects that are underway. There are contractual obligations to consider, but longer-term projects will be difficult to support in this environment.

Budget Framework For 2011-13 (GFS + ELTA + Opportunity Pathways)

(Dollars in Millions; Numbers Will Change As Estimates Are Updated -- Information Most Reliable Only At The Aggregate Levels)

Resources	2011-13
2011-13: Beginning Balance (Uses OFM's Six Year Outlook Number)	247.0
2011-13: GFS	34,082.9
2011-13: ELTA	396.9
2011-13: Opp. Pathways	227.0
2011-13: Less Transfer to BSA	-306.7
	34,647.1

Expenditures	2005-07	2007-09	2009-11	2011-13 CFL	2011-13 ML	2011-13 M/L Base	Policy	Change to M/L Base vs 2009-11
Education								
K-12 Education	11,737.5	13,297.8	13,442.3	205.0	1,275.1	14,922.4		11.0%
Higher Ed: Fin Aid/HECB	394.4	471.9	512.1	41.9	xx	554.0		8.2%
Higher Ed: Comm. & Tech. Colleges	1,193.7	1,404.6	1,356.6	-12.7	19.6	1,363.5		0.5%
Higher Ed: Four Year Inst.	1,514.1	1,704.6	1,299.8	96.6	xx	1,396.4		7.4%
Early Learning	32.9	131.5	121.6	4.4	xx	126.0		3.6%
Human Services								
Medical: HCA (primarily BHP)	464.2	562.1	365.1	-102.4	22.1	284.8		-22.0%
Medical: MAA DL	151.0	180.1	175.7	-84.6	39.5	130.6		-25.7%
Medical: MAA Kids	1,316.2	1,347.7	1,265.0	439.3	106.2	1,810.6		43.1%
Medical: MAA Other	2,193.9	2,282.6	2,046.5	764.4	142.1	2,953.0		44.3%
Mental Health	882.4	902.4	806.7	113.5	34.0	954.2		18.3%
Long Term Care & DD	2,054.0	2,232.2	2,031.9	639.4	124.6	2,795.9		37.6%
Children & Family	554.8	671.8	622.7	23.3	0.0	646.0		3.7%
Econ Svcs (GAU/Lifeline)	26.7	17.4	42.5	-5.6	15.0	51.9		22.1%
Econ Svcs (All Other)	1,026.4	1,041.4	1,103.2	33.4	2.0	1,138.6		3.2%
Human Svcs: All Other	619.3	729.0	627.0	11.3	xx	638.3		1.8%
All Other								
Public Safety	1,956.5	2,468.4	2,188.2	178.6	26.8	2,393.6		9.4%
Environment/Nat. Resources	463.4	510.2	375.2	33.0	xx	408.2		8.8%
Debt Service	1,373.5	1,569.6	1,793.8	74.6	32.7	1,901.1		6.0%
Pensions: LEOFF & Judicial	87.8	117.1	129.3	0.0	xx	129.3		0.0%
Pensions: Other Increases					715.0	715.0		
Special Approps	211.9	181.9	111.3	-111.3	80.0	80.0		-28.1%
All Other	703.0	772.7	668.5	-11.4	**50.0**	707.1		5.8%
	28,957.6	**32,597.0**	**31,085.0**	**2,330.7**	**2,684.7**	**36,100.5**		16.1%

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Potential Policy Items		
K12: Phase in of HB 2776 (Same assumption as OFM's Six Year Outlook)		710.0
Debt: Assume 2011-13 Capital Budget		97.0
BHP: Assume Feds Don't Approve BHP Waiver		57.6
Medical: Assume Feds Don't Approve D/L Waiver		105.0
DD: Somewhat Constrained Waiver Growth		30.0
Estimated TANF Shortfall		200.0
Human Svcs: CBAs (Home Care, AFH, Child Care, etc.)		175.0
DSHS: Vendor Rate Increase (Assume same rate as K-12 employees are entitled to under statute, no other increases)		65.3
Higher Ed Tuition Increase: Financial Aid Impacts (assumes 3% tuition per year)		23.1
Health Benefits: 88/12 For State Employees (Funding rate of $912 in FY12 and $978 in FY 13)		200.0
Health Benefits: K-12 Parity (Same Funding Rates)		335.0
COLA For State Employees (Assume same rate as K-12 are entitled to under statute, no other increases: 1.2% and 2.5%)		137.2
		2,135.2
Estimated GFS Shortfall At M/L (Approx. $300m left in BSA)	**-1,453.4**	
Estimated GFS Shortfall At Policy Level (Approx. $300m left in BSA)		**-3,588.7**
Notes:		
Estimates are much more accurate in aggregate than they are at the detailed level. Also, these categories do not correspond one-to-one with Apps. Committee jurisdictions		
All estimates are very preliminary and will likely change very significantly with updated per capita and caseload information.		
The beginning balance is the same as the OFM Six Year Outlook from June. Revenue estimates based on the June 2010 Revenue Forecast.		
Accounting for the FMAP changes (and other ARRA fund source issues) is part of CFL.		
Accounting for the restoration of I-728 and I-732 is part of Maint. Lvl.		
Maint. Lvl. estimates with XX are rolled into "All Other" rather than displayed individually.		
In 2005-07, Appropriations made from one NGFS to another NGFS account are excluded (totals $1.214b)		

Note – this framework is based on the June 2010 revenue forecast and will need to be adjusted for the September and November forecasts.

Long-Term Structural Changes

In order to ensure adequate funding for the parts of the budget that we want to invest in we will need to make significant changes in the long-term structure of how we deliver services in Washington.

One of the biggest problems is medical cost inflation at 1.5 times growth rate of revenue. We cannot allow this. We must put healthcare in its own box and manage it separately so that we have clarity around the decisions made. It must not be allowed to eat up the rest of the budget. Defining the box as the growth rate of the state's revenue stream is a reasonable start.

- Education becomes the investment plan, including all three levels. We will not be one of the winning regions in the new economy without investing in the education and training of our workforce. There is policy work we need to do here as well, but that is outside the scope of this document.
    - Quality early learning for all at-risk kids so that they are prepared for kindergarten by 2018.
    - Meet 2261 step-up with a smooth trajectory to 2018 – no miracle at the end.
    - Higher ed to meet job requirements in state. We should aim to produce graduates in-state in the same proportions as our immigration stream so that in-state kids have the same opportunities for quality jobs as immigrants from New Jersey.
    - Workforce training focused on job categories expected to grow. Aerospace, healthcare, etc. This will require changes in the mix of degrees produced, with more 4-year technical degrees. Consider converting some CCs into 4-year institutions focused on workforce needs.
- Managing implementation of the federal healthcare plan is a huge issue that requires much work and thought. It is difficult to plan for this today – we simply do not have enough information about the federal law and implementation. Work is under way here.
- Long-term care has a caseload problem that is unsolvable with current revenue streams. We need to address this. There is both a demographic bulge coming and a higher utilization rate as the population ages and is more susceptible to diseases (Alzheimer's, etc.) that require long-term care.

The other big problem is structural inefficiency due to decades of incremental growth. This applies not just to the state level but to our interaction with local governments. We need some organizing principles to be able to talk about it effectively. An initial set could include:

- **Customer-focused "one touch**." The goal would be to re-organize to have one organization responsible for touching each "customer." This eliminates duplication of effort. Examples:
    - Consider combining Revenue, L&I, and Employment Security into one org to collect taxes from businesses. One set of auditors go after underground economy cheaper and more effectively. Include parts of DOL that do business licensing.
    - Consider combining Ecology, Agriculture, and Fish and Wildlife. One regulator for the environment. One guy with waders per stream, not 3. Figure out how to manage different stakeholders. Cheaper for us, better for business, clarity of purpose for the environment.
    - A big idea is to re-organize DSHS to be a regional organization, with small HQ units to design program. One case-management computer system, not 17. We might consider

using counties as the case management agency. This is a large movement of staff from state to county/regional management.

- **Paperless**. A methodical program to eliminate the use of paper in transactions. Electronic filing of taxes, payments, applications, permits, etc. For example, centralized permit tracking website across all agencies and levels of government. This is a 6-10 year effort.
- **Rightsize**. Caseloads have changed across the system in structural ways that cause us to have inefficient usage of facilities. Close some institutions: prisons, juvenile facilities, RHCs that we no longer need. These have some closing costs up front, but this is paid back in the long run.
- **Fee-Supported programs pay for themselves.** No general fund subsidy of economic programs that serve non-indigent narrow segments.

We must address multiple levels at once – we can combine functions across local government too. For example, centralized B&O, telecom, and utility tax collection makes sense. Revenue can be redistributed to the cities as we do with sales and property tax today. This makes everything simpler for businesses.

This works for permits too. There should be one place to file and manage permits across local, state and federal agencies. Cheaper for us, better for business. This is a long-term tool to identify bottlenecks and target them for elimination. To be serious about this is to eliminate the staff managing process flow in each of the departments and combine them in one organization that provides this service.

It's worth a serious look across our panoply of local governments to find the overlaps that can be fixed. In some cases this means annexations. Change here is very difficult. We will need to match revenue with responsibilities – who does public health and how is it paid for? This doesn't work very well today and if we want to convert all of DSHS case management to this model there has to be a re-balancing of responsibilities and revenues. This is a huge opportunity for a performance-based system as we are exploring in foster care today.

If we are thoughtful and very, very serious about this effort we can have a state government that has fewer people with less overlap of responsibilities. This will make it easier for business in the state to get things done, AND it will make it easier to deliver services to our population. The proposals here are not an ending point for the discussion – but they are significant proposals that can be the starting point for a difficult conversation about our overall priorities.

No matter what we do there will be significant reductions in staffing at the state level over the next few years, and possibly for as long as a decade. We should ensure that these reductions serve our priorities, because they will happen no matter what.

Conclusion

Washington faces both an opportunity and a challenge – how to react to an economy in the middle of a complete behavioral adjustment. The budget can act as a lens to view our entire strategy as a state, and should be the organizing principle for the strategic changes we must undergo.

It turns out that the world isn't flat at all – it's made up of regions that are more or less prosperous. Regions will prosper in the new economy because they add value, create new things, and are places smart people want to live in. The budget choices we make today will set the stage for future prosperity.