

Initiative 601 and the Spending Limit

Enactment of I-601

I-601 was approved by voters as an initiative to the people on November 2, 1993. The initiative came in the wake of a large state budget shortfall that was closed in the 1993 Legislative Session through program reductions, fund shifts, and major tax increases.

As enacted, I-601 had the following main features:

- An annual limit on state general fund expenditures, tied to inflation and state population growth, with adjustment of the limit for fund or cost shifts.
- A new “rainy day fund” named the Emergency Reserve Fund.
- A new fund for education construction into which money would be deposited when the amount in the Emergency Reserve Fund reached a certain cap.
- Supermajority vote requirements for passing revenue legislation.
- A limitation on fee increases, also tied to inflation and population growth.
- A prohibition on imposing costs on local governments without reimbursement.

Most provisions of the law took effect December 2, 1993. The spending limit first applied to the state budget for fiscal year 1996.

Amendments to I-601

Several changes were made to the I-601 statute, whether by the Legislature or ballot measures, before the major changes made by legislation in 2005.

1997. Referendum 49, which reduced the motor vehicle excise tax and provided new funding for transportation and local governments, had three provisions affecting I-601:

- Exempted the revenue shifts made in Referendum 49 from the requirement that the spending limit be lowered for such shifts.
- Allowed state reimbursement for costs imposed on local governments to be made through revenue distributions as well as specific appropriations.
- “Reaffirmed and re-enacted” I-601, with the effect of requiring a two-thirds vote of House and Senate for any further amendment of I-601 for two years.

2000. SBHB 3169 made the following changes:

- Established a State Expenditure Limit Committee, with legislative representation, to adjust the spending limit and project ensuing limits. I-601 gave this authority to the Office of Financial Management.
- Clarified that the spending limit must be lowered for any state legislative action that results in the reduction of revenues to the state general fund and the deposit of those revenues in another state or local government account, for example through local-option tax credits.
- Provided that the limit would be *increased* if money or program costs are shifted *into* the state general fund from other funds and accounts, in the same way as the law already provided for the limit to be *decreased* for such shifts *out of* the state general fund. This became known the “two-way street” provision.
- Provided that excess money in the Emergency Reserve Fund would “spill over” to the Education Construction Fund when the balance in the ERF reached 5 percent of annual, rather than biennial, revenues.

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2000. SB 6876 provided for the transfer of \$35 million per year from the Emergency Reserve Fund to the Multimodal Transportation Account for use by state transportation programs. This was part of the effort to mitigate impacts of I-695 on state programs.

2000. Initiative 728 exempted its transfers of state property tax and lottery revenues from the state general fund to other accounts from the requirement that the expenditure limit be reduced for such transfers.

2002. SB 6819 amended I-601 for purposes of the 2002 supplemental budget:

- Allowed the Legislature, during the 2001-03 biennium only, to take actions that raise revenue by a simple majority vote of each house, rather than a two-thirds vote of each house as required by I-601.
- Allowed the Legislature, during the 2001-03 biennium only, to spend money from the Emergency Reserve Fund by a simple majority vote of each house, rather than the two-thirds vote of each house required by I-601.

The State Expenditure Limit Law Before 2005 Changes

Spending Limit

- The percentage annual increase in General Fund-State expenditures is limited to a “fiscal growth factor” (FGF), defined as the sum of the rolling averages of the percentage change in state population and the percentage change in inflation (IPD) during the prior three years. The expenditure limit equals the previous year’s limit increased by the fiscal growth factor.
- *The limit does not apply to spending from accounts other than the state general fund.* About 49 percent of the total operating budget was subject to the limit.
- Future expenditure limits are adjusted for actual expenditures in the previous year. The limit is calculated by applying the fiscal growth factor to the previous year’s spending level, not the previous year’s limit.
- The limit is calculated and approved by the State Expenditure Limit Committee. Each November, the Committee “re-bases” the limit to actual expenditures, adjusts the limit for any changes in the fiscal growth factor, and projects limits for the next two years.
- The limit is decreased for the transfer of a state program or function from the state general fund to another fund or account, and for the transfer of moneys from the state general fund to another fund or account.
- Correspondingly, the limit is increased for the transfer of state programs or functions to the state general fund from another fund or account, and for the transfer of moneys to the state general fund from another fund or account.
- The limit is adjusted upward or downward, as the case may be, for transfers of program costs between the federal or local governments and the state.

Reserve Funds

- Any revenue collected in excess of the limit in any year is deposited in the Emergency Reserve Fund. A two-thirds vote of each chamber is needed to appropriate money from the Emergency Reserve Fund, and then only if the appropriation does not cause total appropriations to exceed the limit.
- Interest earnings in the Emergency Reserve Fund are transferred quarterly to the Multimodal Transportation Account, up to \$35 million per year.

- Money in the Emergency Reserve Fund is capped at 5 percent of annual GF-S revenues as projected by the official state revenue forecast, with any amount in excess “spilling over” into the Education Construction Fund.
- Money in the Education Construction Fund may be appropriated only for K-12 or higher education construction.

Restrictions on Revenue Legislation

- A two-thirds vote of each house is required for approval of “any action or combination of actions by the legislature that raises state revenues or requires revenue-neutral tax shifts.” Voter approval is required as well if the revenue action would result in expenditures above the state expenditure limit.

Restriction on Fee Increases

- No state fee may be increased in any fiscal year by a percentage in excess of the fiscal growth factor without “prior legislative approval.” This phrase was not defined, enabling the Legislature to meet this condition by authorizing agency fee increases in excess of the FGF in the biennial budget act.

Restriction on Passing Costs on to Local Governments

- The Legislature is prohibited from imposing responsibility for new programs or increased levels of service under existing programs on any political subdivision unless it is reimbursed by the state for the costs imposed.
- The Legislature, in consultation with OFM, determines the cost of any such new programs or increased levels of service. Reimbursement may be by appropriation or by distribution of state revenue.

The New Spending Limit: SSB 6078, 2005 Session

In the 2005 session the Legislature passed SSB 6078, which made far-reaching changes to the spending limit enacted by the voters in 1993.

- Replaced the I-601 *inflation plus population growth* formula used to calculate the state expenditure limit with a new formula that limits annual increases in spending to the average annual growth in *state personal income* during the prior ten years.
- Extended the expenditure limit from the state general fund to certain “related accounts.” These included the Health Services Account, the Violence Reduction and Drug Enforcement Account, the Public Safety and Education Account, the Water Quality Account, and the Student Achievement Fund (I-728).
- Corrected the improperly drafted “two-way” street provision that had allowed the spending limit to be increased for the transfer of money to the state general fund from another account. The limit now is adjusted upwards only for the shifting of program costs to the state general fund or related funds from another account.
- Added the ranking members of the House Appropriations and Senate Ways and Means Committees to the State Expenditure Limit Committee.
- Eliminated the transfer of interest earnings in the Emergency Reserve Fund to the Multimodal Transportation Account.

- For the 2005-07 biennium, permitted actions by the Legislature that raise state revenue to be taken by a simple majority vote of each house of the Legislature, rather than by the two-thirds requirement of I-601.

All provisions above except the last took effect July 1, 2007.

Impacts of 2005 Changes

The new, personal income-based limit that took effect with the 2007-09 biennium permits much larger spending increases than the original inflation/population formula approved by the voters in I-601. The fiscal growth factor rose from 2.82 percent in FY 2006 and 3.38 percent in FY 2007, under the old formula, to 5.53 percent in FY 2007 and 5.57 percent in FY 2008, under the new formula. An analysis by the Office of Program Research during the 2005 session showed that had the new, personal income-based FGF been in place at the beginning of FY 2006, it would have allowed \$1.1 billion more spending in 2005-07 than the I-601 formula, and \$3.6 billion more through 2007-09.

The suspension of the two-thirds vote requirement for revenue actions, the second such suspension in three years, frustrated the will of the voters that it should take more than a simple majority vote to raise taxes, and made clear that this protection for taxpayers could be rendered null and void anytime the Legislature chose.

6078 had some positive impacts as well. The errant “two-way street” provision, added in 2000 in the hope of reducing the number of dedicated funds and covering more spending under the limit, had been exploited repeatedly to artificially raise spending limits simply by transferring cash in other accounts to the General Fund. Through this device the limit was made to fit desired spending, rather than the other way around. By incorporating language in Republican-sponsored proposals in 2003 and 2005, SB 6078 fixed that unintended loophole in the limit. It made other changes sought by Republicans, too, adding minority members to the State Expenditure Limit Committee and broadening the coverage of the limit to most “Near General Fund” accounts.

HB 1835, sponsored by Representative Alexander, would have made the needed changes to strengthen I-601 without dismantling key provisions, as SSB 6078 ended up doing. HJR 4209, sponsored by Representative McDonald, proposed to add a 60 percent vote requirement for tax increases to the state constitution. Neither bill passed.

Recent Spending Limit Legislation

Experience had shown that statutory spending limits are only as good as the will of the governor and legislature to abide by them. Republicans proposed in the 2006 Session that restrictions on spending and tax increases be placed in the state constitution, as 16 other states had done, where they are protected from being put aside by legislation.

HJR 4219 proposed a constitutional spending limit with the following major provisions:

- Limit the increase in expenditures from the state general fund and related funds in any year to a fiscal growth factor calculated as the average of the sum of inflation and state population growth during the prior three years (the I-601 formula).

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- Allow the limit to be exceeded pursuant to an emergency declared in law by a 3/5 vote of each house of the legislature.
- Require adjustment of the limit for cost shifts or revenue transfers from the state general fund or related fund to another account, for shifts of program costs and the revenue to support those costs from another account (incorporating the SSB 6078 fix of the “two-way street” provision), and for transfers of the cost of a federal or local government to or from the state.
- Prohibit the legislature from imposing responsibility for new programs or increased levels of service under existing programs on any political subdivision unless the legislature makes provision for their costs (original I-601 provision).

HJR 4219 was coupled with implementing legislation, **HB 3008**. Among other provisions, HB 3008 defined “related fund,” for the purpose of coverage of the spending limit, to include the Education Legacy Account created in the 2005 session. It also required the State Expenditure Limit Committee to adjust the expenditure limit for cost shifts and revenue transfers before final passage of the omnibus operating budget bill, so legislators would have known what the spending limit would be when they voted on the budget, not when the ELC officially sets it several months later.

Neither measure received a public hearing in the 2006 Session. Similar legislation was offered in the 2007 Session in an effort to continue the debate about appropriate spending limits.

ESSB 6896, 2006 Session

The spending limit was an obstacle to the plans of the governor and Democrat majority for a 2006 supplemental budget. Both looked for ways to fit a great deal of planned new spending into a limited amount of capacity under the limit projected by the Expenditure Limit Committee the previous fall. The governor proposed to amend the I-601 statute in the back of the budget bill to exclude \$640 million in GF appropriations to other accounts from the law’s provisions.

Legislative Democrats proposed separate legislation to amend the expenditure limit law to accommodate their spending plan. In ESSB 6896 (C 56 L 06) they appropriated a total \$825 million in FY 2006 from the state general fund to other accounts and declared the 2006 limit to be increased by the amount of those appropriations. Because the limit is “re-based” to actual expenditures, this action enabled them to spend \$468 million in new policy adds in FY 2007, though starting with only \$180 million in limit capacity. The “limit” fashioned by ESSB 6896 in fact allowed the 2006 supplemental budget to end with about \$450 million in *additional* spending in the biennium.

SB 5691, 2007 Session

Whether through accident or intent, the newly created Education Legacy Account, into which the 2005 tax increases were deposited, was excluded from the definition of “related funds” covered by the spending limit when SSB 6078 passed that year. This is a glaring omission, as it would be difficult to imagine an account more “related” to the General Fund than the “Ed Legacy,” which supports hundreds of millions of dollars of K-12 and higher education spending that had long been a core function of the General Fund. In the current biennium the state will spend \$554 million from the account for purposes including higher education enrollments and financial aid and the Pupil Transportation, Special Education, Education Reform and Learning Assistance programs in K-12.

SB 5691 was introduced in 2007 by the chair and ranking member of the Ways and Means Committee to correct this oversight and ensure that a key intent of the 2005 changes to the spending limit law – that the General Fund and all closely related funds be brought under the limit -- was followed. SB 5691 amended the 2005 legislation to define the state General Fund and five “related funds,” including the Education Legacy Account, as “Near General Fund” accounts subject to the expenditure limit, effective July 1, 2008. It also directed the state Economic and Revenue Forecast Council to make official revenue forecasts for all Near General Fund accounts. A bill sponsored by Representative Alexander, **HB 2360**, would have made similar changes.

SB 5691 passed the Senate unanimously in both the 2007 and 2008 session, but was refused a hearing in the House Appropriations Committee both years.

The Expenditure Limit Committee, 2007

The November 2007 meeting of the State Expenditure Limit Committee was the first, under the law passed in 2005, at which the minority caucuses in the Legislature were represented. Representative Alexander and Senator Zarelli, the ranking members of the House Appropriations Committee and Senate Ways and Means Committee, respectively, took the opportunity to bring two major concerns about the committee’s treatment of the spending limit law to the attention of their new colleagues:

1. Appropriations from the General Fund to other accounts that are not spent in the fiscal period in which they are made should not be counted as expenditures for the purpose of re-basing the next spending limit to “actual expenditures” in the prior year. These appropriations are in purpose and effect simply transfers: the moving of money from one place to another without an increase in spending. They pointed to the appropriation of \$825 million in 2006 from the General Fund to other NGF-S accounts, all but \$105 million of which lay unspent to provide reserves for 2007-09, as an example. These appropriations had the effect – and apparent intent – of artificially inflating the GF expenditure level for FY 07 so as to vastly increase spending capacity under the re-engineered limit in the next biennium, facilitating the double-digit increase over these two years.
2. Enhancements to programs supported by accounts subject to the expenditure that the Legislature makes from an account not covered by the limit constitute a shift of the cost of a state program or function, and require the limit be lowered for the shift under RCW 43.135.035(4). Since 2005 the Legislature has opted to fund new higher education enrollments, increased financial aid, and major enhancements to K-12 programs from the newly created Education Legacy Account rather than from the General Fund, where all the spending for those programs was heretofore located. If these actions are not treated as a shift under the law, it negates this critical protection of the spending limit, and leads to the absurd result that the spending limit covers everything but new spending.

Under the law, the state Attorney General serves as a member of the Expenditure Limit Committee, and adjusts and projects the spending limits if a majority of the committee members do not reach agreement. The Attorney General did not agree, at least in whole, with the positions set out by Representative Alexander and Senator Zarelli. He did, however, secure the consent of the

committee to a downward adjustment in the limit for one expenditure item in the Education Legacy Account, on the basis that it constituted a cost shift. Representative Alexander voted against adopting the proposed spending limit calculations, stating that moving a major cost such as higher education enrollments outside the limit violated the integrity of the state's spending limit law.

See the State Expenditure Limit Committee website for additional information at:
<http://www.elc.wa.gov/default.htm>

Issues and Outlook

The major question for the Legislature with regard to the state spending limit is whether it any longer has much relevance, in light of how it has been applied in recent years. As the law that originated with I-601 has been modified, interpreted, and manipulated to achieve desired outcomes, it simply has not been a practical restraint on state spending for some time. It has become more of an accounting chore, something one attends to so the budget "works," rather than a real consideration in how much the state spends.

Can the spending limit be restored so it again helps protect the state from the boom-and-bust budget cycles we have seen so often, including the one that precipitated I-601 in 1993 and the one we seem to be going through now? The debate about spending limits is almost certain to be revisited in the 2009 session, as the state contends with a budget problem for the next biennium estimated at \$2.5 billion.

The 2007-09 biennial budget that will be enacted next year will be the first governed by the new, personal income-based expenditure limit created by 2005's ESSB 6078. In November the State Expenditure Limit Committee will project the first limit under the new law. Issues for the 2007 session pertaining to the spending limit include:

- ⇒ How effectively will the new, much higher limit restrain state spending so as to avert the periodic, spending-driven budget crises the voters hoped to prevent in passing I-601?
- ⇒ What changes may be needed to the new spending limit law in 2007 to correct deficiencies identified by lawmakers in 2005 and 2006?
- ⇒ Can any statutory spending limit, however written, be effective in slowing spending growth, when it is so dependent for its viability on the political will of the governor and legislators to abide by it? Or should the Legislature, given the lessons of the last years, look closely at the adoption of constitutional fiscal controls?