Washington Research Council

Policy Brief

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Governor Inslee's 2015–17 Operating Budget Proposal

Briefly

Gov. Inslee's proposed 2015–17 operating budget would increase spending by $5.2 billion. It would also increase revenues over amounts already forecast by $1.6 billion.

Budget writers face several challenges this legislative session, including the state Supreme Court's McCleary decision and the approval by voters of Initiative 1351. In December, Governor Inslee opened by proposing an operating budget for 2015–17 that would increase near general fund–state plus opportunity pathways (NGFS+) spending by $5.2 billion over 2013–15, an increase of 15 percent. His budget documents note that "it is time to start reinvesting in Washington" (OFM 2014).

By law the governor is required to present a budget that balances with existing revenues—this is called the "book 1" budget. That proposal would increase NGFS+ spending by $3.9 billion over 2013–15. The governor prefers to offer his "book 2" budget, which would provide for new and increased taxes. This "book 2" proposal is the focus of this brief.

Table 1: NGFS+ Balance Sheet (Dollars in Millions)

	2013-15	*2015-17*
Beginning Balance	156	622
Revenue		
November 2014 Revenue Forecast	34,067	36,985
Governor's Proposal		
Revenue Increases		**1,136**
Tax Preferences		**(94)**
Carbon Pollution Accountability Act		**508**
Budget Driven Revenue	**(6)**	**1**
Total Revenue	*34,061*	*38,536*
Other Resource Changes		
Transfer to Budget Stabilization Acct.	(316)	(365)
Other Enacted Fund Transfers	441	41
Governor's Proposal		
Transfers from Budget Stabilization Acct.	**88**	**450**
Estimated Increased Transfer to BSA		**(16)**
Fund Balance Transfers	**17**	**217**
New Dedicated Labor and Industries Account		**(19)**
Total Other Resource Changes	*230*	*308*
Total Resources	*34,447*	*39,466*
Spending		
2013-15 Appropriations	33,794	
Actual 2014 Reversions	(80)	
Actual 2015 Reversions	(70)	
Governor's Proposal		
2015 Supplemental	**181**	
2015-17 Appropriations		**38,992**
Total Spending	*33,825*	*38,992*
Unrestricted Ending Fund Balance	622	475
Budget Stabilization Account Balance	270	499
Transfer from GFS and Interest Earnings	317	372
Estimated Increased Transfer to BSA		16
Transfer to the GFS	(88)	(450)
Projected BSA Ending Fund Balance	499	436
Total Reserves	*1,121*	*911*

Balance Sheet

Revenues. The governor's book 2 proposal would increase revenues by a net of $1.6 billion over the November revenue forecast. Components that would increase revenues include a capital gains tax and a cap and trade program. The proposal would also repeal some tax preferences while creating and extending certain others.

Other Resource Changes. The proposal would utilize $450 million from the Budget Stabilization Account and make $216.7 million in other transfers to the general fund–state (GFS). These include $132.7 million from the share of marijuana tax revenues that was to go to the Basic Health Plan account, $31.4 million from the Life Sciences Discovery Fund, and $20.0 million from the Treasurer's Service Account.

Spending. The proposal would increase

NGFS+ spending by $5.2 billion to total $38.992 billion. Of that, $1.7 billion are policy changes (costs associated with new legislation).

Reserves. The proposal would leave an unrestricted ending fund balance of $475 million and total reserves (including the Budget Stabilization Account) of $911 million. The proposal would transfer $450 million from the Budget Stabilization Account for 2015–17; state Treasurer Jim McIntire argues against such a transfer because those funds "would go a long way to help in a future economic downturn and ease concerns of investors who buy the state's bonds" (Brunner 2015).

Revenue Details

Capital Gains Tax. The 7 percent tax would be levied on capital gains above $25,000 for individuals and $50,000 for joint filers, increasing revenues by $798 million in fiscal year (FY) 2017. Capital gains from retirement accounts, farms and forestry would be exempt. Additionally, capital gains from the sales of homes that are owned for at least 20 years would be exempt, as would the first $250,000 gained on sales of other homes (that don't qualify for the long-term ownership exemption) by individuals ($500,000 for those filing jointly). When fully in effect in the 2017–19 biennium, the tax is estimated to increase revenues by $1.7 billion.

Carbon Pollution Accountability Act. Under this cap and trade program, major greenhouse gas emitters would be required to purchase allowances to emit. This is estimated to increase revenues by $947 million in FY 2017. Of that, $400 million would be used for transit and maintenance in the transportation budget. In the operating budget, $380 million would be used to support basic education (and going forward 40 percent of revenues would go to the GFS). $108 million would be used for the Working Families Tax Rebate, $15.5 million for a Housing Trust Fund, $20 million for the Forestry and Rural Community Economic Investment Program, and $20 million to provide a Washington Manufacturing Competitiveness tax credit. $3.5 million would be needed for administration.

Other Tax Increases. The state cigarette tax would be increased by 50 cents a pack to total $3.525, increasing revenues by $37.8 million. The governor's proposal would also impose a 95 percent excise tax on vapor products, including e-cigarettes, to increase revenues by $18.1 million. Additionally, the proposal would:

- Apply the sales tax to trade-in vehicles valued over $10,000, $105.3 million;
- Apply the use tax to extracted fuel (except hog fuel), $51.1 million;
- Require nonresidents to apply for a sales tax refund rather than receive an immediate exemption, $51.5 million;
- Apply the sales tax to bottled water, $44.4 million (the Legislature tried this in 2010 but it was repealed by voters as part of Initiative 1107 that year); and
- Increase the business and occupation (B&O) tax rate on royalties from 0.484 percent to 1.5 percent, $29.6 million.

Tax Reductions. The budget projections estimate that the following credits and exemptions will reduce revenues. The proposal would extend the high technology research and development B&O tax credit until July 1, 2025 (it expired January 1, 2015) and limit it to $500,000 per year, for a $51.3 million decrease. It would also reduce revenues by $15.4 million by extending and modifying the high technology R&D sales and use tax deferral program (the old deferral program expired January 1, 2015). Additionally, the proposal would:

- Create a B&O tax credit for carbon fiber and carbon-fiber composite manufacturing and wholesaling, $4.0 million decrease;
- Extend until July 1, 2025 agricultural (dairy, seafood, and fresh fruit and vegetables) processor tax exemptions

Table 2: Gov. Inslee's Book 2 Proposal (Dollars in Thousands)

	2013-15 Biennium		2015-17 Biennium: Maintenance Level		2015-17 Biennium: Governor's Proposal	
	NGFS+	All Funds	NGFS+	All Funds	NGFS+	All Funds
Legislative	141,131	155,187	158,360	166,899	159,828	168,367
Judicial	242,318	310,711	265,644	310,104	279,382	346,584
Governmental Operations	465,513	3,547,233	500,175	3,624,377	647,750	3,890,376
Other Human Services	6,208,248	17,516,415	6,491,213	20,360,803	6,502,273	21,225,047
DSHS	5,755,558	12,047,539	6,099,331	13,335,777	6,430,715	14,066,999
Natural Resources	270,444	1,603,606	287,062	1,627,614	317,422	1,741,350
Transportation	69,349	181,436	77,167	184,380	79,372	194,737
Public Schools	15,262,882	17,215,546	17,410,700	19,256,988	18,198,646	20,049,039
Higher Education	3,098,248	12,199,856	3,245,620	13,358,338	3,431,901	13,755,192
Other Education	204,565	592,735	213,931	600,839	386,610	783,053
Other Appropriations	2,075,816	2,240,373	2,509,980	2,724,017	2,557,830	2,762,953
Total	**33,794,072**	**67,610,637**	**37,259,183**	**75,550,136**	**38,991,729**	**78,983,697**

that are scheduled to expire July 1, 2015, $15.0 million decrease;

- Extend through June 30, 2020 the Commute Trip Reduction tax credit that is set to expire June 30, 2015, $3.5 million decrease;
- Extend to July 1, 2025 biofuel-related tax incentives that currently expire in 2015, $2.1 million decrease;
- Extend B&O tax exemption for energy conservation payments from the Bonneville Power Administration, $600,000 decrease; and
- Simplify taxation of amusement, recreation and physical fitness services, $2.0 million decrease.

Spending Details

NGFS+ maintenance level changes (the cost of extending current programs) increase spending by $3.5 billion for 2015–17. Policy level changes under the governor's "book 2" proposal would increase spending by $1.7 billion. The NGFS+ spending amounts discussed below are policy changes only.

Public Schools. The Supreme Court's McCleary decision requires the Legislature to increase funding for K–12 basic education—specifically by funding HB 2776 (2010), which required increases in materials, supplies and operating costs (MSOC); K–3 class size reduction; and full-day kindergarten. Under current law, the MSOC requirements must be funded by the 2015–16 school year (SY) and the other components must be fully funded by SY 2017–18. The governor's proposal would fully fund MSOC on schedule in SY 2015–16 ($751.8 million). It would fully fund K–3 class size reduction ($448.1 million) and full-day kindergarten ($107.6 million) a year early in SY 2016–17. The proposal would also increase funding for the Learning Assistance Program by $34.7 million and it would add $20.0 million for family engagement coordinators.

Higher Education. The proposal would provide $100.0 million for the Opportunity Scholarship, which is a public-private partnership that provides scholarships for students from low-income families who are earning degrees in science, technology, engineering and math (STEM) or health care fields. It would also increase spending for the College Bound Scholarship program and the State Need Grant by $25.5 million. It would provide $16 million to the various institutions to increase enrollments in STEM fields.

Additionally, the proposal would freeze resident undergraduate tuition for the biennium, and future tuition decisions would be made by legislators, not the institutions. Further, according to the Senate Ways and Means Committee (SW&M), regarding the negotiated employee salary increases, the governor's proposal "assumes that each institution will determine how to implement their portion of the increase without the ability to increase resident undergraduate tuition" (SW&M 2014).

Other Education. The proposal would add 6,358 new spaces in the Early Childhood Education and Assistance Program (preschool for low-income families) at a cost of $79.8 million. An additional $70.5 million would go to the Early Achievers child care rating program.

Department of Social and Health Services (DSHS). In order to comply with court rulings preventing boarding of mental health patients at medical hospitals, the proposal would increase spending by $24.7 million. It would also expand mental health services for youth pursuant to the T.R. settlement ($16.5 million). It would spend $19.1 million to help delay entrance to the Medicaid long-term care system.

Other Human Services. In the Health Care Authority (HCA), $90.2 million would fund a new treatment for hepatitis C. HCA spending would increase by $79.0 million to keep Medicaid primary care payments at Medicare rates. For the Health Benefit Exchange, the HCA budget would include $13.8 million for Medicaid-related costs.

The hospital safety net assessment phase-down that is currently scheduled to begin in 2016 would be eliminated, saving $60.2 million. This assessment was enacted in 2010 and is used to leverage federal matching funds through Medicaid, thereby reducing state general fund spending. The governor's proposal would also increase the amount of hospital safety net assessment funding used in lieu of GFS funds, saving an additional $82.4 million.

The Department of Health would get $9.1 million for infectious disease response. The Department of Corrections would receive $7.4 million for 256 medium custody prison beds. It would save $12.7 million by allowing earned time credits to be applied for weapons enhancement confinement and save $10.1 million by making possession of a controlled substance an unranked felony, both of which would reduce the prison population.

Natural Resources. For Puget Sound restoration, the proposal would spend $28.4 million. For the State Parks and Recreation Commission, the budget would provide $11.8 million to maintain core state parks operations.

General Government. For the Department of Revenue, the proposal would increase spending by $18.7 million to continue with the tax and licensing system replacement. Additionally, the Working Families' Tax Exemption, originally enacted in 2008, would be funded using a portion of the Carbon Pollution Accountability Act revenues ($106.4 million). The proposal would suspend the 2016 presidential primary, saving $11.5 million. The Department of Commerce would get $10.0 million for cancer research and $20.0 million to mitigate the impacts of the Carbon Pollution Accountability Act on forest products.

Special Appropriations. Debt service on new projects proposed in the capital budget would total $35.6 million.

Employee Compensation. Under the proposal, as negotiated through collective bargaining, state employees would receive salary increases of 3 percent in 2016 and 1.8 percent in 2017 ($332 million). The increases would be extended to non-represented employees ($149 million). (The collective bargaining agreements also continued the current health care premium split between the state and employees—employees will continue to pay an average of 15 percent of premiums.)

The proposal would fund the Initiative 732 cost-of-living adjustment for teachers that is current law (so this item is considered maintenance level) but had been suspended in recent years ($235.5

million). It would also give teachers a 3 percent raise for SY 2015–16 and a 1.8 percent raise for SY 2016–17 ($150.1 million).

Other

Initiative 1351, which reduces class sizes for grades K–12, was approved by voters in November. To comply with the initiative's phase-in schedule, it is estimated that $2.0 billion must be spent in 2015–17. Gov. Inslee proposes to change the phase-in requirements so they match the class size reductions the state already plans for grades K–3. The governor proposes fully funding I-1351 in the following biennium. Such a change would require a two-thirds vote of the Legislature.

Additionally, according to the SW&M, the governor "proposes to exempt Initiative 1351 fiscal impacts from the calculation of the four-year balanced budget requirements." Further, "he also proposes a four year suspension of the Initiative 601 spending limit" (SW&M 2014). Initiative 601 limits spending to that of the prior year multiplied by average personal income growth over 10 years. For 2015–17, the spending limit is $35.4 billion (ELC 2015).

Comment

Gov. Inslee's proposal faces significant challenges in the Legislature. The capital gains tax and cap and trade program proposals are highly controversial. Indeed, the Senate has adopted a rule that will require a two-thirds vote for any new tax to be brought to the floor. Before resolving to raise taxes, legislators will need to decide what policy choices are the most important—this is just the opening bid in the budget process.

References

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