



Improving Economy Allows for Significant Spending on Education Without New Taxes

Briefly

- The 2015–17 operating budget appropriates \$38.219 billion.
- Spending is increased by \$4.425 billion, or 13.1 percent, over 2013–15.
- An improving economy means that the state has about \$3 billion more revenues than in 2013–15.
- Taxes are increased by a net of \$180.1 million.
- Fund transfers add \$178.1 million to available resources.
- The budget leaves total reserves of \$1.257 billion.
- Public schools spending increases by 19.0 percent.
- \$1.3 billion is appropriated in response to the Supreme Court's McCleary decision.
- I-1351 is delayed for four years, saving \$2.043 billion.
- College tuition is reduced, and funding for the institutions is increased to make up for the lost revenues.
- Collective bargaining agreements with state employees are funded, and teachers get a salary increase.

Washington has three budgets:

- The operating budget funds day-to-day operations.
- The capital budget funds acquisition and maintenance of buildings, public lands, etc.
- The transportation budget funds construction and maintenance of transportation projects.

Budgets are adopted on a biennial basis. Supplemental budgets make changes to the adopted biennial budget to account for caseload or economic changes.

It took three special sessions, but the Legislature finally agreed on a 2015–17 operating budget. It was signed into law by Gov. Inslee on June 30, just in time to avoid a government shutdown. Going into the regular session, education was expected to be a major theme, and it was. The Legislature significantly increased funding for early learning, public schools, and higher education, while reducing college tuition. The public schools increase builds on last biennium's initial efforts to respond to the state Supreme Court's McCleary decision on school funding.

As enacted, 2015–17 appropriations are \$38.219 billion on a near general fund-state plus opportunity pathways (NGFS+) basis. This is a 13.1 percent in-

crease over 2013–15. All funds (total budgeted funds, including all state, federal, and local accounts) appropriations will total \$78.895 billion (a 16.7 percent increase).

Balance Sheet

Revenues. The state's economy is improving, resulting in \$3 billion more in revenues for 2015–17 than in 2013–15. Enacted revenue legislation further increases revenues by a net of \$180.1 million, as some tax exemptions are repealed while others are extended or created.

Other Resources Changes. Transfers to the NGFS+ from other funds total \$178.1 million. These include \$73.0 million from the public works assistance account,

\$51.4 million from the tobacco settlement account, \$20.0 million from the treasurer's service account, and \$11.0 million from the life sciences discovery fund.

Spending. The budget increases NGFS+ appropriations by \$4.425 billion over 2013–15, to \$38.219 billion. Maintenance level changes (the costs of continuing current services) increase spending by \$5.360 billion. By not funding Initiative 1351, \$2.043 billion is saved this biennium. (I-1351 effectively reduces class sizes

for grades 4–12. See our report, "[Initiative 1351 Class Size Reduction: A \\$4.7 Billion Unfunded Mandate with Dubious Educational Merit.](#)") Additional net policy changes (costs associated with new legislation) increase spending by \$1.108 billion. The balance sheet assumes passage of a 2016 supplemental that would increase spending by \$36 million, and it assumes that reversions (authorized spending that does not take place) will reduce spending by \$173 million.

Reserves. The budget leaves an unrestricted ending fund balance of \$363 million and total reserves (including the budget stabilization account) of \$1.257 billion.

Revenue Details

Revenue Decreases. ESSB 6057 reduces revenues in 2015–17 by \$35.2 million. Its main provisions include:

- Manufacturers of processed fruits and vegetables, dairy products, and seafood products are not subject to the business and occupation (B&O) tax. This exemption was scheduled to expire July 1, 2015; the bill extends it until July 1, 2025. This provision is estimated to reduce revenues by \$13.2 million.
- Sales and use taxes will not apply to up to eight computer data centers that are constructed between July 1, 2015 and July 1, 2019, and up to 12 that are constructed between July 1, 2015 and July 1, 2025. This provision is estimated to reduce revenues by \$12.5 million.

Revenue Increases. ESSB 5681 and ESSB 6138 increase revenues by \$200.5 million in 2015–17. ESSB 5681 directs that if unclaimed lottery prizes total more than \$10 million, the excess must be transferred to the opportunity pathways account, increasing NGFS+ revenues by an estimated \$15.2 million. ESSB 6138 includes several provisions:

- Currently a state may not require an

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

| | 2013-15 | 2015-17 |
|----------------------------------------------------|---------------|----------------|
| Beginning Balance | 156 | 929 |
| Revenue | | |
| May 2015 Revenue Forecast | 34,280 | 37,451 |
| 2015 Legislation | | |
| Revenue Legislation | 7 | 180 |
| Budget Driven Revenue and Other | 1 | 37 |
| Total Revenue | 34,288 | 37,669 |
| Other Resource Changes | | |
| Transfer to Budget Stabilization Acct. | (356) | (374) |
| Other Enacted Fund Transfers and Other Adjustments | 441 | 41 |
| 2015 Legislation | | |
| Fund Transfers | 2 | 178 |
| Transfers to Budget Stabilization Acct. | (0) | (2) |
| Transfers from BSA to GFS | 38 | 4 |
| Total Other Resource Changes | 125 | (153) |
| Total Resources | 34,569 | 38,445 |
| Spending | | |
| Enacted 2013-15 Budget | 33,794 | |
| 2015 Early Supplemental | 66 | |
| 2015 Legislation | | |
| 2015 Supplemental Maintenance Level | (71) | 39,154 |
| I-1351 Policy Change | | (2,043) |
| Other Net Policy Changes | | 1,108 |
| 2015-17 Appropriations | | 38,219 |
| Anticipated 2016 Supplemental Assumed Reversions | (150) | (173) |
| Total Spending | 33,640 | 38,082 |
| Unrestricted Ending Fund Balance | 929 | 363 |
| Budget Stabilization Account Balance | 513 | 894 |
| Total Reserves | 1,442 | 1,257 |

NGFS+

In recent years, legislative fiscal committee staffs have based budget presentations on the near general fund–state (NGFS), a synthetic “account” that rolls up the general fund–state (the state’s primary budget account) with the education legacy trust account, because they believed that the NGFS better reflected the entire budget situation. They are now using a broader rollup, the NGFS+.

In 2010 the legislature established the opportunity pathways account, and dedicated proceeds from the lottery to this account with the stipulation that the funds be spent for education. The NGFS+ combines the NGFS and the opportunity pathways account.

In 2012 legislation was enacted requiring four-year balanced operating budgets. A positive ending balance is required in the current biennium on an NGFS+ basis. Additionally, projected resources must be sufficient to cover projected maintenance level expenditures in the second biennium.

out-of-state business to collect sales taxes unless the business has a substantial nexus (physical presence) in the state. Under the bill, a remote seller (who has insufficient physical presence in Washington) would have to collect sales taxes for Washington if the seller has an agreement with a Washington resident through which the Washingtonian refers potential customers to the seller (e.g., via a website link). This would only apply if a remote seller’s gross receipts from sales to Washingtonians referred by the Washingtonian exceed \$10,000 a year. This “click-through nexus” is estimated to raise \$28.3 million.

- Additionally, under the bill, wholesalers without a physical presence in Washington would be considered to have nexus in Washington and therefore be subject to the B&O tax if they have more than \$267,000 of receipts from Washington (this figure is inflation-adjusted). This is estimated to increase revenues by \$45.4 million.
- Currently sales and use taxes do not apply to machinery and equipment (M&E) used in manufacturing or related research and development. The bill redefines “manufacturer” to include those “engaged in the development of prewritten computer software that is not transferred to purchasers by means of tangible storage media.” However, sales and use taxes will apply to M&E used by companies that registered to do business in Washington on or before July 1, 1981, that have at least 40,000 employees as of August 1, 2015, and that primarily develop, sell, and license computer software and services—namely: Microsoft. This provision is estimated to increase revenues by \$57.2 million.
- The bill increases the B&O tax rate for royalty income from 0.484 percent to 1.5 percent, increasing revenues by \$31.4 million.
- It also increases penalties for late payment of taxes. If the payment is not

received by the due date, the penalty increases from 5 to 9 percent of the tax amount. If the payment is not received by the end of the next month, the penalty increases from 15 to 19 percent. If the payment is not received by the end of the second month, the penalty increases from 25 to 29 percent. This provision is estimated to increase revenues by \$23.0 million.

Marijuana Regulation. 2E2SHB 2136 makes changes to Washington’s marijuana market. These include collecting marijuana excise taxes at the point of retail sale only (previously it was also levied on producers and processors), and increasing the tax rate from 25 percent to 37 percent. Also, sales and use taxes would not apply to marijuana purchased for medical use, and the bill provides for receipts from the tax to be distributed to local governments. The bill is estimated to increase general fund revenues by \$14.8 million in 2015–17.

Spending Details

Public Schools. Including maintenance and policy level changes, NGFS+ spending on public schools is increased by \$2.894 billion (19.0 percent) over 2013–15. The share of the NGFS+ budget devoted to public schools increases to 47.5 percent from 45.2 percent. Of the increase, \$1.3 billion responds to the McCleary decision. This includes \$741 million for materials, supplies and operating costs (considered part of maintenance level); \$350.2 million for class size reductions in kindergarten through third grade; and \$179.8 million to expand full-day kindergarten.

The maintenance level includes the spending required to implement I-1351, but, as noted above, the Legislature decided not to fund the initiative this biennium, saving \$2.043 billion.

The Initiative 732 cost-of-living adjustment for teachers is funded as part of maintenance level. In addition to that, the budget provides \$152.3 million for a one-biennium salary increase (1.2 per-

| | 2015-17 Biennium | | | | | |
|-------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | 2013-15 Biennium | | Maintenance Level | | Enacted Budget | |
| | NGFS+ | All Funds | NGFS+ | All Funds | NGFS+ | All Funds |
| Legislative | 141,131 | 155,187 | 159,424 | 167,905 | 153,796 | 173,930 |
| Judicial | 242,318 | 310,711 | 255,704 | 298,232 | 267,132 | 337,921 |
| Governmental Operations | 465,513 | 3,547,233 | 498,373 | 3,553,990 | 510,107 | 3,793,678 |
| Other Human Services | 6,208,248 | 17,516,415 | 6,358,531 | 20,705,642 | 5,952,628 | 21,335,460 |
| DSHS | 5,755,558 | 12,047,539 | 6,060,312 | 13,210,293 | 6,381,151 | 13,932,885 |
| Natural Resources | 270,444 | 1,603,606 | 286,769 | 1,625,652 | 308,873 | 1,716,926 |
| Transportation | 69,349 | 181,436 | 76,468 | 180,732 | 80,821 | 195,568 |
| Public Schools | 15,262,882 | 17,215,546 | 19,513,633 | 21,419,651 | 18,156,830 | 20,008,166 |
| Higher Education | 3,098,248 | 12,199,856 | 3,234,980 | 13,595,311 | 3,525,134 | 13,826,980 |
| Other Education | 204,565 | 592,735 | 214,007 | 600,829 | 347,928 | 736,946 |
| Other Appropriations | <u>2,075,816</u> | <u>2,240,373</u> | <u>2,495,685</u> | <u>2,709,725</u> | <u>2,534,988</u> | <u>2,836,614</u> |
| Total | 33,794,072 | 67,610,637 | 39,153,886 | 78,067,962 | 38,219,388 | 78,895,074 |

Table 2: NGFS+ and All Funds Appropriations (Dollars in Thousands)

cent in school year 2015–16 and 0.6 percent in SY 2016–17).

Other policy level spending increases include \$5.0 million for teacher mentoring, \$3.2 million for grants to lowest achieving school districts, and \$2.9 million for the Washington Achievers Scholars and College Bound Scholarship programs.

Higher Education. The budget maintains higher education’s share of the NGFS+ budget at 9.2 percent. NGFS+ spending for higher education increases by \$426.9 million, of which \$290.2 million is policy

changes.

As part of the College Affordability Program (2ESSB 5954), resident undergraduate tuition is reduced by 15 percent at the University of Washington (UW) and Washington State University (WSU); 20 percent at Eastern Washington University, Central Washington University, Western Washington University, and The Evergreen State College; and 5 percent at community colleges (see table 3). The budget provides \$158.7 million to the institutions to make up for the lost tuition revenue. Because tuition is reduced, less financial aid is needed, so financial aid funding is reduced by \$45.3 million.

The budget also provides \$106.8 million for higher education employee compensation and \$41.0 million for the Opportunity Scholarship. UW gets \$6.0 million for computer science enrollments, \$8.0 million to expand medical residencies, and \$9.0 million for continued operation of the Washington, Wyoming, Alaska, Montana and Idaho (WWAMI) medical school. WSU gets \$2.5 million for a new medical school.

Other Education. Spending is increased by \$143.4 million. The Department of Early Learning’s funding increases by \$138.1 million, to \$301.1 million (an 84.8 percent increase). Of that, \$40.9 million is for the Early Childhood Education and

Table 3: College Affordability Program (Dollars in Thousands)

| | Tuition | | Additional State Support |
|---------------|------------|------------|--------------------------|
| | SY 2015-16 | SY 2016-17 | |
| UW | -5% | -10% | 44,071 |
| WSU | -5% | -10% | 33,980 |
| EWU | -5% | -15% | 11,557 |
| CWU | -5% | -15% | 13,389 |
| TESC | -5% | -15% | 4,296 |
| WWU | -5% | -15% | 17,743 |
| CTCS | -5% | 0% | 33,699 |
| Financial Aid | | | -45,297 |
| Total | | | 113,438 |

Assistance Program (ECEAP, preschool for low-income children), \$48.0 million is for the Early Achievers (EA) quality rating and improvement system (a voluntary child care rating system), and \$21.7 million is to implement 2E2SHB 1491, the Early Start Act, which makes changes to ECEAP, EA, and Working Connections Child Care.

Department of Social and Health Services (DSHS). Spending is increased by \$625.6 million; policy changes account for \$320.8 million of the increase. Funding is provided for compensation to in-home care providers and to increase compensation for home care agency providers (\$115.5 million). Spending for mental health programs is increased by a net of \$63.3 million, including funding for 60 competency restoration beds at Western State Hospital and 30 beds at Eastern State Hospital. Temporary Assistance for Needy Families grants are increased by 9 percent (\$30.6 million).

Other Human Services. Spending is reduced by \$255.6 million. This is the only budget area for which appropriations are reduced (on net) over 2013–15. Most of the reductions come in the Health Care

Authority. The Hospital Safety Net Assessment program is maintained and increased (this is a way to leverage more federal funds and reduce state spending), saving \$152.1 million. The budget takes advantage of a higher federal match rate for the Children’s Health Insurance Program, saving \$114.7 million in state funds. Initiative 502 (recreational marijuana) directed some tax revenues to the Basic Health Trust Account; they are used in lieu of general fund dollars for Medicaid clients in managed care plans, saving \$201.4 million.

Natural Resources. Spending is increased by \$38.4 million. The State Parks and Recreation Commission receives \$16.0 million for state parks operations and \$4.4 million to increase park services.

Other. The budget funds the collective bargaining agreements that Gov. Inslee negotiated with state employees, increasing wages by 3 percent in fiscal year 2016 and 1.8 percent in 2017 (\$172.8 million).

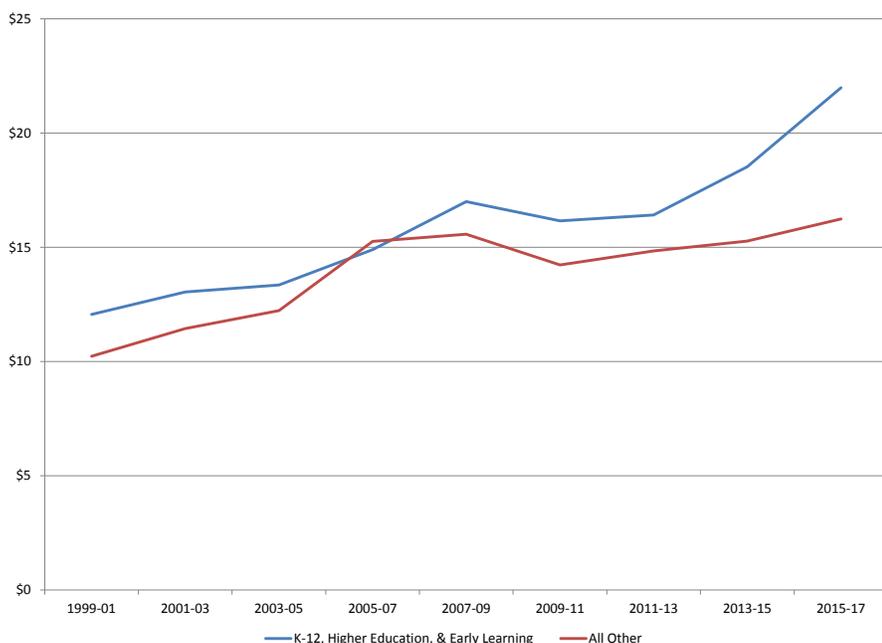
Debt service costs make up 5.8 percent of the 2015–17 operating budget, including \$36.8 million that results from the new debt issued in the 2015–17 capital budget. The budget provides \$14.0 million in emergency drought funding and \$12.0 million for marijuana enforcement by local governments. It creates an information technology pool, funded with \$25.0 million, through which funds will be allocated to state agencies for technology projects.

The budget books savings of \$25.0 million from implementing additional LEAN management practices (higher education is excluded from the reductions). By shifting some programs to funds outside of the NGFS+, the budget saves \$46.4 million.

Comment

The 2015–17 operating budget agreement involved concessions from all sides. It balances over four years, leaving an ending fund balance of \$1.414 billion after the 2017–19 biennium.

Chart: NGFS+ Spending History (Dollars in Billions)



Before the regular session began, Gov. Inslee proposed increasing taxes by \$1.6 billion (including by imposing a brand new capital gains tax and cap and trade program). Instead, taxes are increased by only \$180.1 million. Meanwhile, NGFS+ spending increased by 13.1 percent over 2013–15. This is a substantial amount—it is the highest spending increase since 2005–07 (17.9 percent). That said, 2015–17's increase is smaller than the maintenance level indicated (again, maintenance level is the costs of continuing current services). But the spending in 2015–17 is more focused on education than it has been recently—education's share of NGFS+ spending is the highest since 1993–95.

Throughout the sessions this year, the main items of disagreement seemed to be employee compensation and tuition. Early Senate majority proposals did not fund the collective bargaining agreements or the additional salary increase for teachers, but they are funded for the biennium. Early proposals from the House leadership would have frozen tuition instead of reducing it, but tuition will be reduced.

Of the major budget provisions, I-1351 was probably the least controversial item throughout the sessions. None of the proposals would have funded it. But as it turned out, this was the item that almost derailed the budget compromise. In the end, the Legislature delayed implementation of the initiative for four years.

The Legislature owes the state Supreme Court a report this month on the progress it made during the legislative sessions towards meeting its obligations under the McCleary decision. If the Court finds that the Legislature's progress is inadequate, it could impose contempt sanctions. Although the budget prioritizes spending for education, the question of how to increase state funding and reduce local funding of teacher compensation remains unresolved.

This budget shows how, in a good economic environment, the state can spend more on its paramount duty—education—without imposing new taxes. But calls for new taxes have not been completely silenced, and the remaining McCleary and I-1351 issues loom.

Major Court Mandates Impacting the Budget

- *McCleary*. In 2012, the state Supreme Court ruled that Washington was not fulfilling its constitutional obligation to amply fund basic education. The Court has been monitoring the Legislature's progress toward that end, and it found the Legislature in contempt in 2014.
- *Mental Health*. In 2014, the state Supreme Court ruled that the state's practice of boarding psychiatric patients in hospital emergency rooms on a temporary basis due to a lack of beds at psychiatric treatment facilities was illegal.
- *Culverts*. In 2013, a federal court said that Washington must fix culverts that are barriers to fish passage by 2016 for culverts on recreational lands and by 2030 for those under the jurisdiction of the Department of Transportation. (These costs mainly affect the capital budget.)