Washington Research Council

Policy Brief

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2015–17 Budget Preview: McCleary Not the Only Cloud on the Budget Horizon

Briefly

The Legislature faces a significant budget challenge for 2015–17, even before making additional education funding under the McCleary decision. If Initiative 1351 is approved by voters, the outlook will substantially worsen.

The 2015–17 legislative session was always going to be a difficult one for budget writers. As Governor Inslee said in 2013, the 2014 session was a "get-ready year" before the storm of the state Supreme Court's McCleary decision hit in 2015 (Garber 2013).

There are indications that the budget challenge may be worse than the governor anticipated a year ago.

The McCleary decision (which found that the state has not made ample provision for education) has been looming over the Legislature since 2012. After failing to decide on an implementation plan for the basic education program in 2014, as ordered by the court, the Legislature could be held in contempt at a September hearing (McCleary 2014). It seems clear that the Legislature will not be able to avoid a significant effort at compliance in the upcoming session.

The Office of Financial Management (OFM) has been pointing to an additional budgetary gap that will complicate efforts to put more resources toward education.

According to OFM, the 2015–17 budget "could be more challenging than the 2013–15 budget" (OFM 2014a). The Legislature must provide more state funds for basic education. Even setting that aside, though, OFM estimates that there's about a $1 billion gap between projected revenue and spending needs.

That figure is likely an overestimate, based on new information and the likelihood that adopted policy enhancements will not be as high as OFM expects. Still, the Legislature is facing quite the challenge next session, as within currently projected revenues there is not room for many policy enhancements, let alone additional education spending.

Initiative 1351, if passed in November, would substantially worsen the bleak projections.

In this brief, we review fiscal conditions heading into development of the 2015–17 budget, beginning with a look at where we stand now.

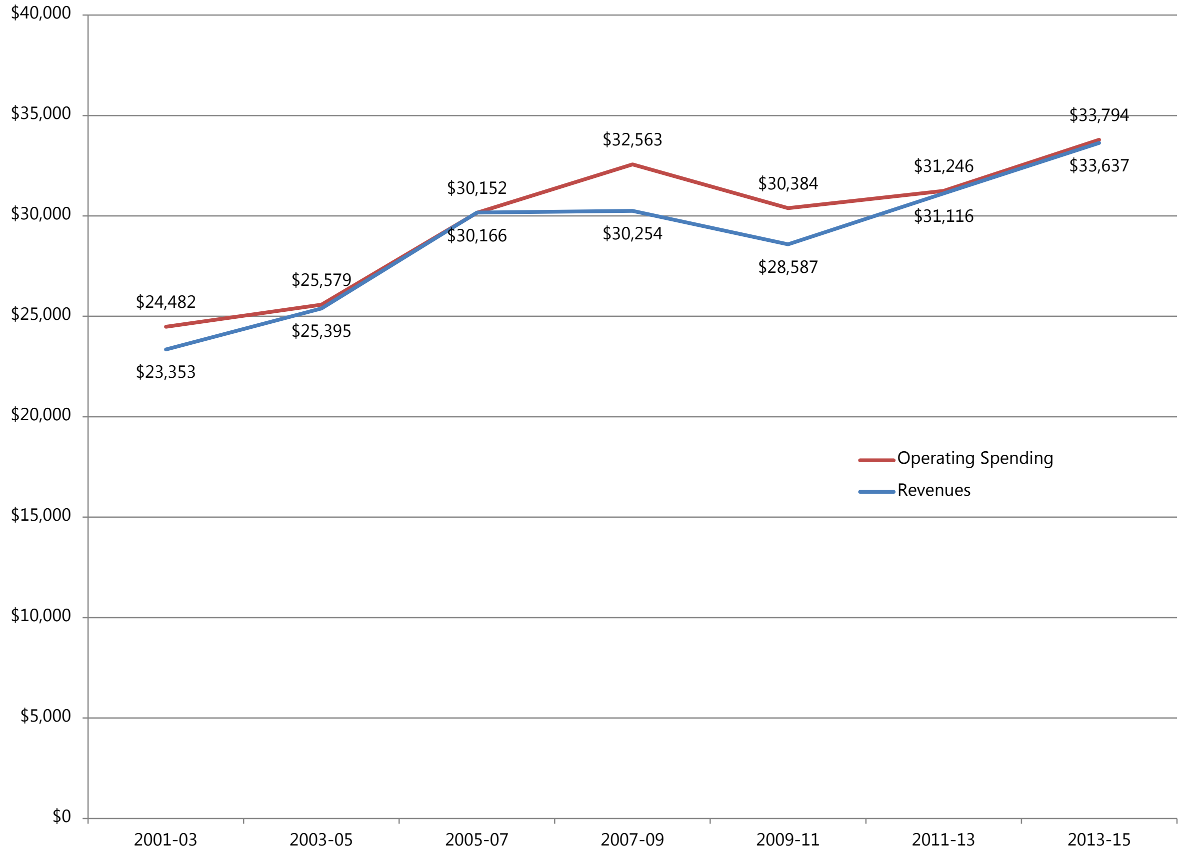
2013–15

The 2013 Legislature faced a shortfall of about $900 million for 2013–15 (WRC 2013a). The Legislature managed to increase basic education funding by about $1 billion without increasing general taxes.

Many of the solutions used in 2013–15 were one-time deals. These included transfers from capital budget funds to the near general fund–state plus opportunity pathways (NGFS+) account, savings realized due to expanding Medicaid under the federal Affordable Care Act, and temporarily extending the hospital safety net assessment. With these additional resources, the official four-year budget outlook indicated a positive ending balance for 2015–17 (ERFC 2014). (The outlook does not include McCleary funding needs.)

But as we concluded of the 2013–15 budget,

Chart 1: NGFS+ History (Dollars in Millions)



Non-policy level spending is made up of the carry-forward level and the maintenance level.

The carry-forward level is "the biennialized cost to continue the workload or services already authorized through legislative budget decisions" (OFM 2014b).

Maintenance level is the "additional mandatory caseload, enrollment, inflation, or other legally unavoidable costs not contemplated in the current budget" (OFM 2014b). "Like the carry-forward level, maintenance level is a reference point for budget consideration. It is not a guarantee of that amount of funding" (OFM 2014b).

> The legislature prioritized education spending in 2013–15, but it will have to ramp up the funding in the years ahead. And although the budget balances on paper over four years, it relies heavily on transfers from the public works assistance account. Altogether, this budget is probably the best compromise possible this year, but long-term sustainability is far from assured. (WRC 2013b)

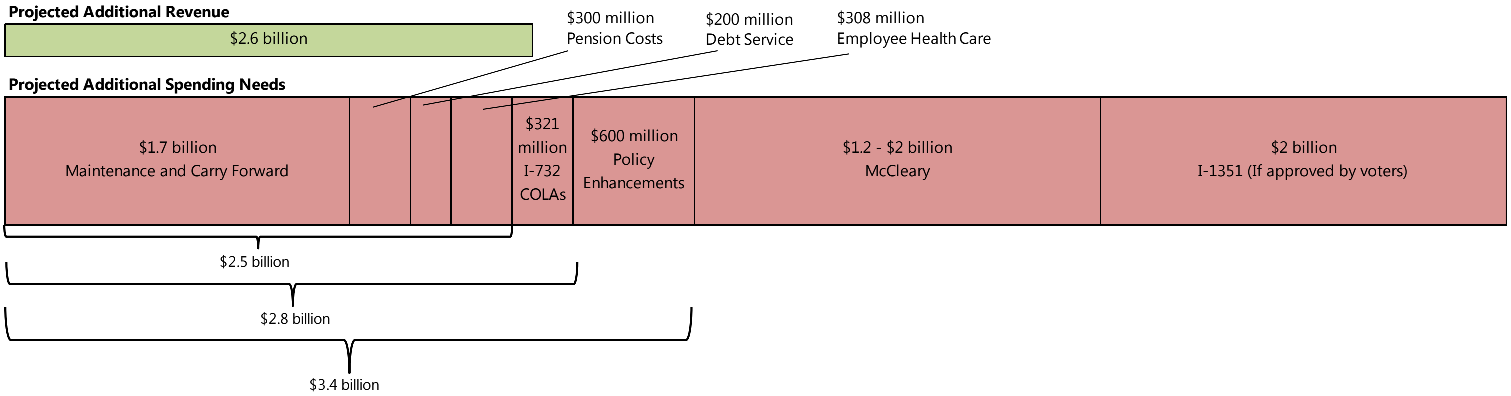
Indeed, spending has consistently exceeded revenues in recent years. The last time revenues exceeded spending was during the 2005–07 biennium. (See Chart 1.) Legislators have made up the difference by transferring funds and drawing down reserves, for example.

OFM's 2015–17 Outlook

OFM has been registering concern about the 2015–17 budget in a budget outlook presentation (OFM 2014a). OFM estimates that projected additional NGFS+ spending needs in 2015–17 will total about $3.6 billion and projected additional NGFS+ revenue will total $2.6 billion—leaving a shortfall of about $1 billion. That's before considering any additional funding for McCleary (which OFM anticipates will require $1.2–$2 billion in 2015–17). (Note that the $2.6 billion in revenues includes the June 2014 revenue forecast and accounts for transfers the Legislature is required to make—to the budget stabilization account, for example. Thus, the $2.6 billion represents the additional revenues actually available to the Legislature.)

The $3.6 billion in additional spending includes $1.7 billion in maintenance and carry-forward costs, $432 million in new pension costs, $200 million in debt service, and $308 million in employee health care. These are all programs that are currently in the budget. In addition, the $3.6 billion includes $321 million for funding the Initiative 732 cost-of-living adjustment (COLA) for teachers and $600 million in policy enhancements.

Chart 2: 2015–17 NGFS+ Outlook



Note: This chart is based on the original from OFM, with adjustments to the pension costs numbers (reflecting new information), and adding I-1351.

Some adjustments to these numbers are made in Chart 2. First, the $432 million in new pension costs that OFM originally estimated should actually be closer to $300 million, due to a July 2014 decision by the Pension Funding Council to phase in increased employer contribution rates over three biennia rather than all at once (DRS 2014). Second, OFM recently released a fiscal impact statement for Initiative 1351, which would reduce class sizes for grades K–12 and which will appear on the ballot in November. If approved by voters, it would increase state spending by $2.0 billion in 2015–17 (WRC 2014).

The gap between revenues and spending—accounting for the pension adjustment, taking OFM's policy enhancements as given, and before additional education spending—is about $800 million.

Policy enhancements may not reach the $600 million estimated by OFM, but *any* policy enhancement would increase spending over available revenues.

Salary increases are likely this year. As Gov. Inslee said in December 2013,

> Teachers have not gotten their voter mandated cost-of-living adjustments since 2008. That situation is untenable and I fully intend to rectify it . . . in the next biennial budget. State employees have also gone without COLA increases since 2008. That is just too long to wait. (Shannon 2014)

The I-732 COLA is on the books (though it has been suspended in recent years). Increases for state and higher education employee compensation are included in the $600 million of policy enhancements estimated by OFM. Until OFM certifies the collective bargaining agreements in October, it is unknown how much increased employee compensation will cost. (As an example, though, according to OFM, a 1 percent general wage increase would cost about $107 million.)

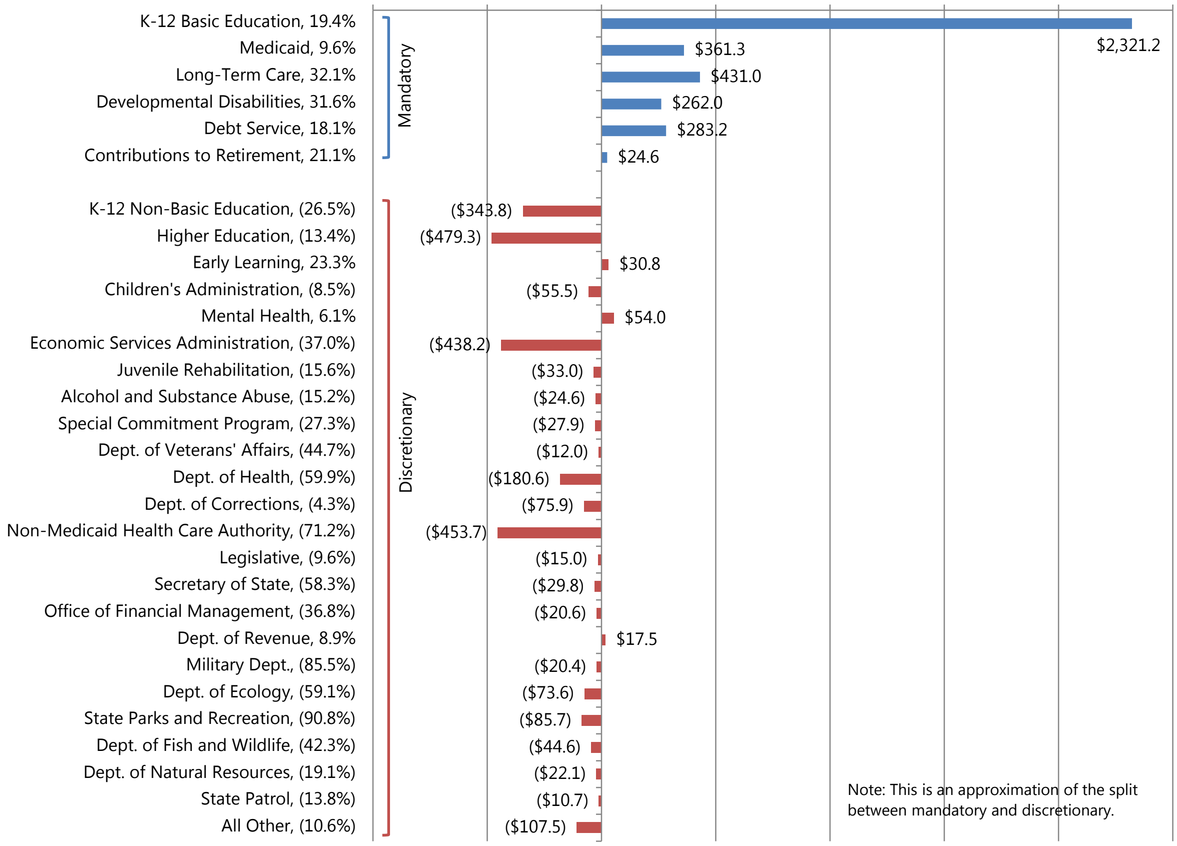
In order to increase compensation and make any other policy increases, other programs will have to be cut or taxes will have to be increased. And that's before even considering McCleary or I-1351.

Mandatory vs. Discretionary Spending

The Legislature is thus likely to cut spending for many programs—again. About two-thirds of the NGFS+ operating budget is spending that is mandated by the constitution or federal requirements. This includes basic education, debt service, and retirement contributions, along with Medicaid, long-term care, and developmental disabilities programs.

Consequently, spending cuts must take place among the one-third of the budget that is discretionary. This includes, for example, human services programs, higher education, the Department of Corrections, and levy equalization. Since the pre-recession spending height, these

Chart 3: Change in State Operating Spending, 2007–09 to 2013–15 (NGFS+, Percent Increased or Decreased, Millions of Dollars)



discretionary programs have been cut significantly. (See Chart 3.)

Governor's Budget Instructions

Because he is required to propose a budget balanced within current revenues, Gov. Inslee has asked state agencies to identify where additional discretionary program cuts could be made. (We expect this "book one" budget to be supplemented by a "book two" budget that calls for tax increases.)

The instructions to agencies on how to prepare their 2015–17 budget proposals note:

> For the 2015-17 budget, OFM is asking agencies to re-base state program budgets to a level below the Maintenance Level budget request for programs not protected from reduction by either state constitutional provisions or by federal law. . . . In addition, OFM is asking all agencies to identify, describe and prioritize budget reductions equal to 15 percent of unprotected Near-General Fund Maintenance Level budgets. . . .
>
> Budget reductions identified in the first step of the agency reduction process will result in a re-based Near GF-S budget, below the levels necessary to sustain currently authorized services and programs as they are currently delivered.
>
> Agencies are then asked to submit budget requests for funding building off of this lower budget base. (Schumacher 2014)

Further, "Whenever possible, agencies are encouraged to request new fees or increase existing fees to make programs self-supporting. This applies both to programs currently not supported by fees, as well as those partially supported by fees" (OFM 2014b).

Governor Inslee will release his budget proposals in December.

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