Washington Research Council

Policy Brief

April 18, 2019 PB 19-09

House- and Senate-Passed Operating Budgets Would Increase Taxes to Pay for Billions in New Policy Spending

Briefly

State revenues from current sources are estimated to reach $50.555 billion in 2019–21, enough to cover the 2019–21 maintenance level (the cost of continuing current services). On top of the maintenance level, the House has passed a 2019–21 operating budget that would increase appropriations by $2.421 billion from funds subject to the outlook and the Senate has passed a budget that would increase appropriations by $1.697 billion.

To fund the new policy spending, the House would impose a capital gains tax, and both the House and Senate would change the real estate excise tax so its rate is graduated and increase taxes by repealing tax preferences (the state's term for exemptions, exclusions, deductions, deferrals, credits, and preferential rates).

Some of the major spending items in both budgets include school employee health benefits and the collective bargaining agreements with state employees. Substantial increases would also be made in human services.

The proposed spending increases are historically large at 19 percent in the House and 17 percent in the Senate. They rank among the highest spending increases of the last 25 years. Given the likelihood of an economic downturn, the Legislature should carefully consider whether this level of spending is sustainable and build adequate reserves.

The House and Senate have each passed 2019–21 operating budgets. The House would appropriate $52.934 billion from funds subject to the outlook, and the Senate would appropriate $52.181 billion. Both budgets assume passage of several tax increases, but their approaches differ.

Balance Sheet

Revenues. Both the House- and Senate-passed budgets would increase taxes. The House budget would increase revenues from funds subject to the outlook (NGFO) by a net of $779.5 million in 2019–21 and $2.011 billion in 2021–23. The Senate budget would increase NGFO revenues by a net of $500.9 million in 2019–21 and $556.1 million in 2021–23. Both tax proposals include changes to the real estate excise tax and tax preferences (the state's term for exemptions, exclusions, deductions, deferrals, credits, and preferential rates). The House proposal also includes a capital gains tax. (The balance sheet does not include the revenue effects of a business and occupation tax surcharge proposed by the House or an increased tax on property and casualty insurance premiums proposed by the Senate, as they are outside of the NGFO. Nor does the balance sheet include the effects of the Senate's proposed capital gains tax, as it would be used to reduce other taxes rather than increase the operating budget.)

Other Resource Changes. The House would transfer $202.4 million from other funds to the NGFO in 2019–21. This in-

Funds Subject to the Outlook (NGFO)

In recent years, legislative fiscal committee staffs have based budget presentations on a synthetic "account" that rolls up the general fund–state (the state's primary budget account) with the education legacy trust account and the opportunity pathways account, because they believe that it better reflects the entire budget situation. Previously called the near general fund–state plus opportunity pathways (NGFS+), it is now more simply called "funds subject to the outlook" or the near general fund–outlook (NGFO). (Under the four-year balanced budget requirement, a positive ending balance is required in both the current and following biennium on an NGFO basis.)

cludes $160.0 million from the public works assistance account to the education legacy trust account (ELTA) and $28.0 million from the disaster response account to the general fund–state (GFS). The Senate would transfer $73.0 million from the state and local toxics control accounts to the GFS in 2017–19 and $74.6 million from other funds to the GFS in 2019–21, including $52.6 million from the disaster response account.

Spending. 2019–21 maintenance level spending (the cost of continuing current services, adjusted for caseload, inflation, and enrollment changes) is estimated to be $50.514 billion in the House budget and $50.484 billion in the Senate budget (both estimates are about 13 percent higher than enacted 2017–19 appropriations). For new policy, the House would increase appropriations by $2.421 billion and the Senate would increase appropriations by $1.697 billion.

Reserves. The House budget would leave a relatively low unrestricted ending balance of $225 million in 2019–21 and $141 million in 2021–23. The Senate would leave an unrestricted ending balance of $555 million in 2019–21 and $70 million in 2021–23. Neither budget would appropriate funds from the budget stabilization account (BSA, or rainy day fund) in 2019–21, but both would do so in 2017–19 for wildfire costs ($38.9 million in the House and $40.7 million in the Senate). The Senate would also appropriate $744,000 from the BSA in 2017–19 for public health costs in Clark County related to the recent measles outbreak. Additionally, the House would transfer $58.4 million of 2017–19 extraordinary revenue growth from the BSA to the GFS. Total reserves (including the BSA) in the House budget would be $2.571 billion in 2019–21 and $3.191 billion in 2021–23. Total reserves in the Senate budget would be $2.964 billion in 2019–21 and $3.188 billion in 2021–23.

Table 1: NGFO Balance Sheet (Dollars in Millions)

	House Passed		*Senate Passed*	
	2017-19	*2019-21*	*2017-19*	*2019-21*
Beginning Balance	1,149	1,787	1,149	1,809
Revenue				
March 2019 Revenue Forecast	46,106	50,555	46,106	50,555
Proposal				
Graduated REET		**133**		**421**
Capital Gains		**781**		
Tax Preferences		**48**		**102**
Budget Driven and Other Revenue	**(2)**	**(182)**	**(3)**	**(22)**
Total Revenue	*46,104*	*51,334*	*46,103*	*51,056*
Other Resource Changes				
Transfer to Budget Stabilization Account	(441)	(495)	(441)	(497)
Transfer to BSA (Extraordinary Revenue Growth)	(1,760)		(1,759)	
Transfer from BSA (Extraordinary Revenue Growth)	1,078		1,078	
Other Enacted Fund Transfers	162		162	
Prior Period & CAFR Adjustments	85	41	85	41
Proposal				
Transfer from BSA (Extraordinary Revenue Growth)	**58**			
Fund Transfers		**202**	**73**	**75**
Total Other Resource Changes	*(818)*	*(252)*	*(802)*	*(381)*
Total Resources	*46,436*	*52,867*	*46,451*	*52,484*
Spending				
2017-19 Appropriations	44,661		44,661	
Proposal				
Actual/Assumed Reversions	**(195)**	**(293)**	**(198)**	**(252)**
Maintenance Level Changes	**87**		**87**	
2019-21 Maintenance Level		**50,514**		**50,484**
Policy Changes	**96**	**2,421**	**91**	**1,697**
Total Spending	*44,649*	*52,642*	*44,641*	*51,928*
Unrestricted Ending Fund Balance	1,787	225	1,809	555
Budget Stabilization Account Balance	1,638	1,738	1,638	1,794
Transfers from GFS and Interest Earnings	2,242	608	2,241	614
Transfer to the GFS	(1,078)		(1,078)	
Transfer to the Pension Stabilization Account	(925)		(925)	
Appropriations from the BSA	(41)		(41)	
Proposal				
Transfer to GFS (Extraordinary Revenue Growth)	**(58)**			
Appropriations from the BSA	**(39)**		**(41)**	**1**
Projected BSA Ending Fund Balance	1,738	2,346	1,794	2,409
Total Reserves	*3,525*	*2,571*	*3,603*	*2,964*

Note: Details may not sum due to rounding.

Revenue Details

The March 2019 revenue forecast estimates that NGFO revenues will be $50.555 billion, an increase of 9.6 percent over 2017–19 (as of the March revenue forecast). Still, both budgets would increase taxes.

Capital Gains Tax. Both budgets would impose capital gains taxes, but only the House uses the revenues in its budget proposal. As proposed in HB 2156, the 9.9 percent tax on certain capital gains over $100,000 for individuals and $200,000 for joint filers would increase revenues by $780.7 million in 2019–21 and $1.907 billion in 2021–23 (DOR 2019). The revenues would be dedicated to the education legacy trust account (thus avoiding payments to the BSA).

The Senate would use the revenues from its tax to reduce other taxes; the impacts are not included in the balance sheet. (We wrote about the proposals in "A Capital Gains Tax Would Not Improve Budget Sustainability.")

Real Estate Excise Tax. Both budgets would increase revenues by graduating the real estate excise tax (REET). This would result in tax increases for some taxpayers and tax reductions for others. The tax rate is currently a flat 1.28 percent on sales of real property. Under HB 2156 (assumed in the House budget), the rate would be 0.9 percent for properties with selling prices less than or equal to $500,000. For properties with selling prices above $500,000, the rate would be 1.28 percent for the portion of the price less than or equal to $1.5 million; 2.0 percent for any portion of the price between $1.5 million and $7 million; and 3.0 percent for any portion of the price that is greater than $7 million. The Department of Revenue estimates that this would increase revenues by $132.8 million in 2019–21 and $188.0 million in 2021–23 (DOR 2019). (Additionally, the bill would increase the portion of REET revenues that are dedicated to the education legacy trust account, thereby avoiding contributions to the BSA.)

The Senate's REET proposal, SB 5991, would reduce the rate to 0.75 percent if the selling price is less than $250,000. For properties with selling prices of $250,000 or more but less than $1 million, the tax rate would stay at 1.28 percent. The rate would increase to 2.0 percent if the selling price is between $1 million and $5 million and to 2.5 percent if the selling price is $5 million or higher. This would increase revenues by $421.1 million in 2019–21 and $457.3 million in 2021–23. (This bill would also increase the portion of REET revenues that are dedicated to the education legacy trust account, thereby avoiding contributions to the BSA.)

Tax Preferences. The House and Senate would each make several tax preference changes. Both proposals would change the sales tax exemption for nonresidents to a refund program, which would increase revenues by $54.0 million in 2019–21 (HB 2157 and SB 5997). Both would increase the business and occupation (B&O) tax for travel agents and tour operators ($9.8 million in HB 2157 and $9.7 million in SB 5997). Additionally, the House proposal (HB 2157) would increase the B&O and sales taxes for bullion ($4.6 million in 2019–21) and expand the senior citizen property tax reduction (-$20.2 million in 2019–21). The Senate (SB 5988) would increase the B&O tax on warehousing and reselling prescription drugs ($38.5 million in 2019–21).

Tax Increases for Dedicated Accounts. The House would impose a "workforce education investment surcharge" of 20 percent, in addition to amounts owed on current B&O tax rates, on businesses in certain sectors in the service and other activities category (e.g. doctors, lawyers, and accountants). The surcharge would be higher for certain advanced computing businesses: 33.3 percent for those with worldwide gross revenue of between $25 billion and $100 billion a year and 66.7 percent for those with worldwide gross revenue of more than $100 billion. A preliminary fiscal note estimates that the bill (HB 2158) would increase revenues by $427.4 million in 2019–21. All revenues would be deposited in a new "workforce education investment account" that would technically be outside of the NGFO, even though it would fund various higher education and career connected learning programs that are typically funded in the NGFO.

The Senate would increase the tax on property and casualty insurance premiums from 2.0 percent to 2.52 percent. This would increase revenues by $90.6 million, which would be deposited in a new wildfire prevention and suppression account outside of the NGFO.

Spending Details

The estimated 2019–21 maintenance levels in both the House and Senate budget proposals are about $5.8 billion higher than enacted 2017–19 appropriations. Driving that exceptionally large maintenance level increase are increases in state spending on public schools related to the McCleary decision. The state's response to the decision was completed last year, but the spending increases will be fully funded for a full biennium for the first time in 2019–21.

In addition, both budgets would increase NGFO appropriations for new policy, by $2.421 billion in the House and $1.697 billion in the Senate. The House would separately appropriate $389.6 million from the proposed workforce education investment account (WEIA); including that, policy changes in the House budget would be $2.810 billion. Below are details of the policy changes, in terms of funds subject to the outlook (unless otherwise noted).

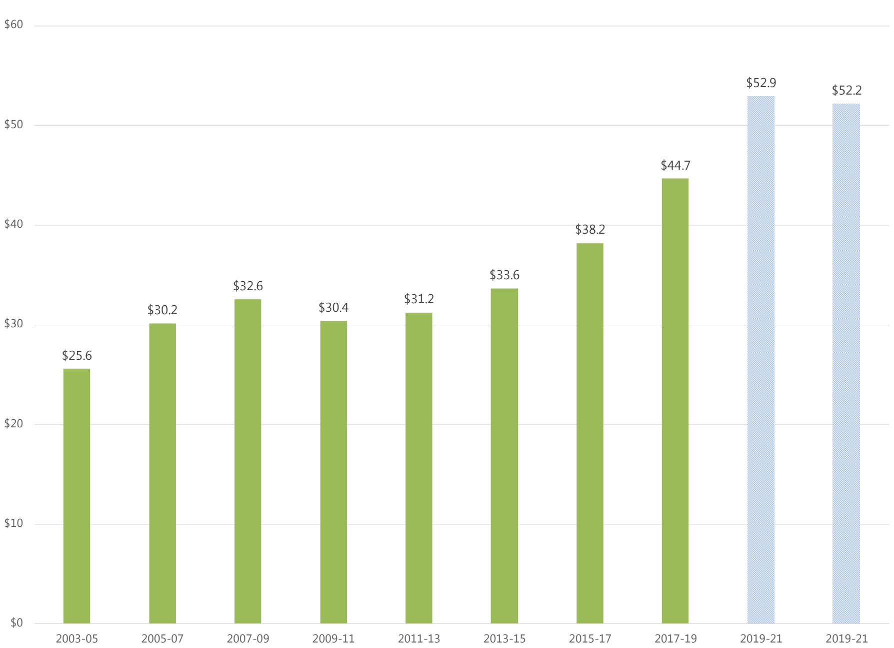
Public Schools. Although the McCleary response is officially complete, both budget proposals would significantly increase policy spending for public schools. As part of the McCleary response in 2017, the Legislature decided to provide health insurance benefits to school employees via a central School Employees Benefits Board (SEBB). The House budget would provide $453.4 million to fund rates of $1,079 per employee per month for 2020 and $1,106 for 2021. The Senate would provide $328.5 million to fund rates of $994 for 2020 and $1,056 for 2021.

For special education, the House would spend $69.7 million to increase the excess cost multiplier (the method by which the state allocates special education funds to districts) to 0.9925. The Senate would increase special education spending by $155.9 million, including $85.7 million to increase the multiplier to 1.0, $34.3 million for safety net awards, and $29.6 million to remove federal funds from the safety net.

The House budget assumes passage of PSHB 2140, which would increase local levy authority to either 20 percent of school district revenues or the lesser of $1.50 per $1,000 of assessed value or $3,000 per pupil. In conjunction with that, the House budget would increase local effort assistance for districts by $77.1 million. (In the Senate, 2SSB 5313 would increase levy authority to the lesser of $2.50/$1,000 or $2,500 per pupil for districts with fewer than 40,000 students; and to the lesser of $2.50/$1,000 or $3,000 per pupil for districts with more than 40,000 students—i.e. Seattle Public Schools. The Senate budget does not increase local effort assistance accordingly.)

The House budget would provide $58.4 million to hold districts that receive less funding in school year 2018–19 and 2019–20 than they did in SY 2017–18 harmless (this would be contingent on passage of HB 2163, which would transfer $58 million from the BSA to the GFS). Under a rule change from the Office of Superintendent of Public Instruction, state forest and other local deductible revenues no longer reduce state allocations to school districts. Both budgets would increase state allocations to districts to account for this ($26.4 million in the House and $23.7 million in the Senate). Both would provide training days

Chart: Actual and Proposed Spending from Funds Subject to the Outlook (Dollars in Billions)



for paraeducators ($12.0 million for two days in the House and $21.1 million for four days in the Senate).

Higher Education. For operating support for the institutions, the House would increase appropriations by $45.1 million and the Senate would increase appropriations by $35.9 million. Both the House and Senate would provide $10.8 million for the WSU medical school, and the House would add $10.0 million for the UW hospital. From the WEIA, the House would appropriate $55.1 million for the Guided Pathways program, which expands advising and support at the community and technical colleges to improve student success.

To maintain the State Need Grant (SNG) at current service levels, the House would appropriate $25.1 million and the Senate would appropriate $17.0 million. The Senate would appropriate $80.5 million to reduce the SNG waitlist in FY 2020 and FY 2021 (and the outlook assumes the waitlist would be eliminated in FY 2022, when it would become an entitlement). The House would appropriate $152.9 million from the WEIA to reduce the SNG waitlist by half in SY 2019–20, eliminate it in SY 2020–21, and convert it to a new "Washington College Grant." The House would then spend $65.8 million from the WEIA to expand eligibility for the Washington College Grant. The state match for the Opportunity Scholarship would be funded at $12.0 million in the House budget and $7.5 million in the Senate budget.

Early Learning. To increase the subsidy rate for child care centers, the House would appropriate $24.6 million and the Senate would appropriate $28.0 million. Both budgets would increase the Early Childhood Education and Assistance Program (ECEAP) rate ($15.4 million in the House budget and $13.0 million in the Senate). Both would expand ECEAP: The House would spend $23.0 million to add 1,464 new slots over the biennium and the Senate would spend $12.4 million to add 760 new slots.

Human Services. A 2018 settlement in Trueblood et al v. Washington State Department of Social and Health Services (DSHS) means that fines in the case are suspended, saving $96.0 million in both budgets. DSHS had been found to be unconstitutionally delaying competency evaluations and restoration services for jailed individuals (DSHS n.d.). To implement the settlement, the House budget would spend $76.3 million and the Senate would spend $69.4 million.

Both budgets would increase funding for state hospital operations ($86.2 million in the House and $55.0 million in the Senate), add community long-term inpatient beds ($42.8 million in the House and $58.0 million in the Senate), enhance community residential rates ($105.4 million in the House and $17.7 million in the Senate), and increase assisted living facility rates ($48.3 million in the House and $10.0 million in the Senate). The House would appropriate $55.0 million to restore savings in the Healthier Washington program that are not expected to materialize.

Both the House and Senate would save $101.8 million in the Health Care Authority due to program integrity activity recoveries from managed care plans. The Senate would save $49.0 million by increasing the withholding rate of managed care organizations and $74.8 million by assuming federal funding for disproportionate share hospitals will be restored.

Compensation. Both budgets would fund the collective bargaining agreements with state and higher education employees and extend them to non-represented employees (generally, employees would receive 6 percent raises over the biennium). The House would appropriate $426.8 million for this purpose and the Senate would appropriate $462.0 million. One reason the House amount is lower than the Senate is that the House would use $97 million of surplus funds for employee health benefits in 2021, saving NGFO dollars. (The benefits rate would be $938 per employee per month in FY 2020 and $971 in FY 2021 in the House budget, and $972 in FY 2020 and $973 in FY 2021 in the Senate budget.)

In addition to the $426.8 million, the House would increase appropriations by $7.2 million for a 2 percent biennial wage increase for University of Washington employees. In the CBA, UW employees received a 4 percent raise. This additional 2 percent would be contingent on UW and the unions negotiating amendments to the CBA.

The House would also appropriate $38.3 million to provide a one-time 3 percent benefit increase for Public Employees' and Teachers' Retirement Systems Plans 1 retirees and $12.7 million to increase the subsidy for Medicare-eligible retirees.

Both budgets would equally fund CBAs with in-home care providers ($72.4 million) and provide parity for agency providers ($22.8 million). They'd both also fund CBAs with family child care providers ($52.8 million), adult family homes ($37.6 million), and language access providers ($635,000).

Finally, the House budget would provide $40.8 million from the WEIA to increase nurse educator salaries in the community and technical colleges and $20.0 million from the WEIA to increase high-demand faculty salaries in the community and technical colleges.

Other. For debt service on new capital projects, the House would appropriate $37.5 million and the Senate would appropriate $45.7 million. Both budgets would increase spending for housing and homelessness programs in the Department of Commerce ($35.0 million in the House and $24.6 million in the Senate).

Both budgets would save $50.0 million by eliminating the local public safety transfer scheduled for Sept. 30, 2019. The local public safety enhancement account (RCW 41.26.800) contributes funds to an account within the Law Enforcement Officers' and Fire Fighters' Plan 2 retirement fund and distributes funds to local governments for public safety purposes. Transfers are required to be made to the local public safety enhancement account from the GFS in odd-numbered years (if general state revenues have increased by more than 5 percent), but the 2013, 2015, and 2017 transfers were suspended by the Legislature. (HB 2144 and SB 5983 would eliminate the transfer permanently.)

The Senate would save $52.4 million by cutting overtime costs, professional ser-

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

	2017-19 Biennium		2019-21 Biennium			
			House Passed		Senate Passed	
	NGFO	All Funds	NGFO	All Funds	NGFO	All Funds
Legislative	166,592	194,781	182,146	211,721	182,545	212,588
Judicial	289,218	372,713	327,028	411,285	323,414	406,510
Governmental Operations	543,004	4,175,900	682,507	4,546,078	668,476	4,468,498
DSHS	6,418,005	14,141,800	6,452,644	13,910,635	6,176,460	13,524,557
Health Care Authority	4,662,347	19,160,021	5,838,001	21,122,983	5,676,160	20,920,031
Other Human Services	2,853,320	6,163,607	4,188,483	8,388,630	4,129,954	8,300,461
Natural Resources	341,509	1,918,445	409,647	2,030,194	358,287	2,079,607
Transportation	94,295	225,808	117,012	253,175	114,595	251,662
Public Schools	22,691,351	24,786,560	27,361,521	29,402,254	27,182,970	29,225,911
Higher Education	3,713,656	14,506,977	4,017,769	15,137,346	4,054,233	15,180,314
Other Education	223,408	481,251	64,377	135,374	62,068	134,880
Special Appropriations	2,650,899	1,926,720	3,293,357	4,073,560	3,251,711	4,068,687
Total Budget Bill	**44,647,604**	**88,054,583**	**52,934,492**	**99,623,235**	**52,180,873**	**98,773,706**
Appropriations in Other Legislation	13,621	980,245	0	389,567	0	0
Statewide Total	**44,661,225**	**89,034,828**	**52,934,492**	**100,012,802**	**52,180,873**	**98,773,706**

vice contracts, travel, goods and services, and capital outlays across many agencies by 1.5 percent in 2020 and 3 percent in 2021.

2019 Supplemental

Both budgets would increase spending in 2017–19. Revenues for the biennium are now estimated to be $46.106 billion ($1.116 billion higher than anticipated when the 2018 supplemental was adopted). The House would increase appropriations for the biennium by $183.3 million and the Senate would increase them by $178.0 million.

Appropriations for state hospital operations would increase by $45.4 million in the House budget and $43.1 million in the Senate budget. For emergency fire suppression in the Department of Natural Resources, the House would spend $10.9 million from the NGFO and $38.9 million from the BSA, and the Senate would spend $14.4 million from the NGFO and $40.7 million from the BSA. Both budgets would spend $10.7 million to remove the forest revenue reduction from allocations to school districts.

Comment

Washington's recent run of strong state revenue growth won't last forever. Indeed, the Economic and Revenue Forecast Council expects revenues to grow more slowly in the coming years, and many economists expect a recession sometime in the four-year budget window. With that in mind, the Legislature should carefully consider whether proposed spending levels are sustainable and build adequate reserves.

Unfortunately, the budgets passed by the House and Senate fall short. The high spending levels in both budgets would require new taxes, which the House and Senate have yet to vote on. The House budget depends on a capital gains tax that will be challenged as unconstitutional. Even if it is found to be constitutional, the state would not be able to collect revenues while the case is ongoing, meaning that there would not likely be any collections in 2019–21. This would put the House budget out of balance for the biennium.

Even including the capital gains revenue, both budgets would leave low unrestricted ending balances. Additionally, because revenues from the capital gains tax in the House and the graduated REET in both budgets are directed to the education legacy trust account rather than the general fund, those revenues would not be subject to constitutionally-required transfers to the rainy day fund—exacerbating the sustainability problems their volatility would wreak on the budget.

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