Washington Research Council

Policy Brief

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Legislature Passes 2017–19 Operating Budget That Increases Spending by $5.3 Billion

Briefly

- The Legislature has passed a 2017–19 operating budget that appropriates $43.707 billion.
- This is an increase in NGFS+ appropriations of $5.254 billion or 13.7 percent over 2015–17.
- Revenues are estimated to increase by $1.614 billion due to an increase in the state property tax.
- Other tax changes are estimated to increase revenues by $456.4 million.
- The budget transfers $328.1 million to the NGFS+ from other funds.
- It transfers $1.842 billion from the rainy day fund to other funds.
- As part of the response to the McCleary decision, the budget appropriates $1.099 billion for school employee salaries.
- Appropriations for public schools account for 50.3 percent of the NGFS+ budget.
- Some of the rainy day funds will be used to pay for employer contributions to state employee retirement plans.
- Collective bargaining agreements between state employees and the governor are funded.
- As passed by the Legislature, the budget leaves an unrestricted ending fund balance of $985 million in 2017–19 and $42 million in 2019–21.

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.

On June 30, the Legislature passed an operating budget for 2017–19. It appropriates $43.707 billion for the biennium, which is an increase of near general fund –state plus opportunity pathways (NGFS+) spending of $5.254 billion (13.7 percent) over 2015–17 (including the 2016 supplemental). Appropriations for public schools increase by 20.7 percent over 2015–17 while appropriations for everything else increase by 7.3 percent.

Since the 2016 supplemental budget was enacted, the Economic and Revenue Forecast Council has increased its revenue estimates for 2015–17 and 2017–19 by $1.989 billion. In addition to those expected revenues, the budget increases the state property tax and makes other tax changes to increase revenues. It also uses rainy day funds.

Gov. Inslee vetoed some revenue and spending provisions. The numbers in this report do not reflect those vetoes unless otherwise noted (Inslee 2017).

Balance Sheet

Revenues. As passed by the Legislature, the budget increases revenues by a net of $2.079 billion in 2017–19. Of that, $1.614 billion comes from an increase to the state property tax.

Other Resource Changes. The budget transfers $328.1 million to the NGFS+ from other funds. This includes $254.0 million from the public works assistance account and $42.0 million from the disaster response account. (The 2017 supplemental transfers $42.0 million from the general fund–state to the disaster response account.) Additionally, $898 million must be transferred from the general fund–state (GFS) to the budget stabilization account (BSA, or the rainy day fund), pursuant to the constitution's requirement that three-quarters of any extraordinary revenue growth be transferred to the BSA. The budget transfers that $898 million right back to the GFS for 2017–19.

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

	2015-17	*2017-19*
Beginning Balance	1,011	781
Revenue		
June 2017 Revenue Forecast	39,041	41,677
Budget as Passed Legislature		
State Property Tax (HB 2242)		**1,614**
Revenue Increases (HB 2163)		**456**
Revenue Reductions (SB 5977)		**(16)**
Budget Driven and Other Revenue	**(1)**	**24**
Total Revenue	*39,040*	*43,756*
Other Resource Changes		
Transfer to Budget Stabilization Account	(383)	(430)
Transfer to BSA (Extraordinary Revenue Growth)	(925)	(898)
Other Enacted Fund Transfers	207	
Prior Period & CAFR Adjustments	70	41
Budget as Passed Legislature		
Transfer from BSA (Extraordinary Revenue Growth)		**898**
Fund Transfers	**(40)**	**328**
Total Other Resource Changes	*(1,070)*	*(61)*
Total Resources	*38,980*	*44,476*
Spending		
2015-17 Appropriations	38,454	
Budget as Passed Legislature		
Actual/Assumed Reversions	**(227)**	**(217)**
Maintenance Level Changes	**(106)**	
2017-19 Maintenance Level		**41,636**
Policy Changes	**78**	**2,071**
Total Spending	*38,199*	*43,490*
Unrestricted Ending Fund Balance	781	985
Budget Stabilization Account Balance	513	1,638
Transfers from GFS, Interest Earnings, Reversions	1,352	1,362
Transfer to the GFS		
Appropriations from the BSA	(189)	
Budget as Passed Legislature		
Appropriations from the BSA	**(38)**	
Transfer to the GFS		**(898)**
Transfers to Other Accounts		**(944)**
Projected BSA Ending Fund Balance	1,638	1,158
Total Reserves	*2,419*	*2,143*

Notes: The balance sheet does not reflect Gov. Inslee's vetoes.
Totals may not sum due to rounding.

Spending. For 2017–19, NGFS+ maintenance level spending (the cost of continuing current services, accounting for caseload, enrollment and inflation changes) is $41.636 billion (an 8.3 percent increase over enacted 2015–17 appropriations). On top of that, the Legislature adds policy level appropriations (the cost of new legislation) of $2.071 billion. Accounting for reversions (appropriations not spent), NGFS+ spending will total $43.490 billion.

Reserves. The budget leaves an unrestricted ending fund balance of $985 million and total reserves (including the rainy day fund) of $2.143 billion in 2017–19. EHB 2190 allows the Legislature to transfer up to $1.078 billion in extraordinary revenue growth from the BSA to the GFS in 2017–19—as noted above, the amount of extraordinary revenue growth is estimated to be $898 million, so the budget transfers that amount to the GFS. Also, EHB 2190 requires the transfer of $925.2 million from the BSA to the pension funding stabilization account and $19.0 million from the BSA to the disaster response account. (The extraordinary revenue growth transferred to the BSA in 2015–17 was $925 million.)

Revenue Details

To address basic education funding in response to the state Supreme Court's McCleary decision, EHB 2242 has been enacted. As part of that bill, the state property tax will increase to $2.70 per $1,000 of assessed value. (The effective rate was expected to be $1.86 per $1,000 in 2018 under prior law.) This is expected to increase state revenues by $1.614 billion.

Additionally, the Legislature enacted EHB 2163, which is expected to increase revenues by $456.4 million. This bill:

- Applies the sales tax to bottled water;
- Applies the use tax to fuel used by refiners that is a by-product of the refining process. For refinery fuel, the

use tax rate will phase in until it is 3.852 percent in 2021 (the same rate as the public utility tax) and local use taxes will not apply;

- Requires remote sellers (sellers without a physical presence in Washington), referrers (people who list or advertise items for sale for a seller and receive a commission) and marketplace facilitators (people who contract with a seller to facilitate the sale of items through a marketplace) to either collect and remit sales taxes or comply with notice and reporting requirements to the customer and the Department of Revenue. This is not settled law at the federal level—see our report, "Washington's Steady Move to an Economic Nexus Standard for Taxes";
- Extends economic nexus (a jurisdictional test based on a company's market rather than its physical presence in Washington) for purposes of the business and occupation (B&O) tax to retailers (see "Washington's Steady Move to an Economic Nexus Standard for Taxes");
- Eliminates payments to local jurisdictions that have mitigated negative fiscal impacts from the adoption of the Streamlined Sales and Use Tax Agreement in 2007; and
- Requires the distribution of public utility privilege taxes to the GFS and local jurisdictions to occur on July 1 rather than in June.

The Legislature also passed SSB 5977, which was expected to reduce revenues by $15.7 million. This includes extending by 10 years and modifying the Washington motion picture competitiveness program; extending a sales and use tax deferral program for manufacturing facilities; and extending by 10 years a lower B&O tax rate for semiconductor materials manufacturers. Gov. Inslee vetoed provisions of the bill that would have reduced the B&O tax rate for all manufacturers—accounting for that veto, the bill reduces revenues by $12.8 million in 2017–19.

Spending Details

In 2017–19, maintenance level changes increase spending by $3.182 billion over the enacted 2015–17 appropriation level. (Of the maintenance level changes, $1.966 billion is in public schools, $559.2 million is in the Department of Social and Health Services and $295.3 million is in the Health Care Authority.) Policy level appropriations that authorize new

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

	2015-17 Biennium		2017-19 Biennium: Maintenance Level		2017-19 Biennium: As Passed Legislature	
	NGFS+	All Funds	NGFS+	All Funds	NGFS+	All Funds
Legislative	156,347	176,454	165,753	187,041	173,344	196,666
Judicial	269,241	340,990	281,570	315,781	290,429	364,011
Governmental Operations	509,927	3,891,226	539,865	3,815,824	543,005	4,054,426
DSHS	6,405,389	14,184,650	6,964,539	15,135,639	6,990,634	15,374,964
Health Care Authority	4,016,072	16,553,505	4,311,361	16,744,251	4,191,058	17,343,844
Other Human Services	2,091,361	4,645,866	2,173,201	4,724,037	2,898,823	6,110,996
Natural Resources	287,107	1,903,162	307,707	1,779,442	315,433	1,848,973
Transportation	83,338	236,069	85,331	193,183	93,970	210,379
Public Schools	18,197,434	20,110,525	20,163,507	22,097,402	21,968,576	23,905,236
Higher Education	3,558,324	13,902,854	3,646,397	14,104,089	3,832,786	14,544,733
Other Education	349,134	747,193	373,032	768,743	225,823	480,679
Other Appropriations	2,529,840	2,896,345	2,623,701	2,818,145	2,183,273	3,837,982
Total	**38,453,514**	**79,588,839**	**41,635,964**	**82,683,577**	**43,707,154**	**88,272,889**

Note: The table does not reflect Gov. Inslee's vetoes

B&O: Business and occupation tax

BSA: Budget stabilization account

DSHS: Department of Social and Health Services

ECEAP: Early Childhood Education and Assistance Program

FY: Fiscal year

GFS: General fund–state

HCA: Health Care Authority

NGFS+: Near general fund–state plus opportunity pathways

RCW: Revised Code of Washington

TANF: Temporary Assistance for Needy Families

spending increase by $2.071 billion. The appropriations discussed below are NGFS+ policy changes.

Public Schools. In 2017–19, NGFS+ policy changes increase appropriations for public schools by $1.805 billion. Of that, $1.099 billion is for staff salary allocations, pursuant to EHB 2242 (the basic education funding bill). Another $110.4 million is appropriated to increase health benefit allocations and $26.4 million is appropriated for professional learning days. (A future report will detail the changes made in EHB 2242.) Additionally, learning assistance program hours will increase for students in high-poverty schools ($222.5 million), local effort assistance funding will increase ($165.3 million), and class sizes in career and technical education and skill center programs will be reduced ($82.0 million). Allocations will also increase for transitional bilingual instruction ($26.9 million), the highly capable program ($26.6 million), and special education ($22.7 million).

Higher Education. Policy spending will increase by $186.4 million. State need grant funding will be maintained at current service levels, award amounts will be increased for students at private institutions, and the number of students served will be increased ($49.5 million). The University of Washington will get $5.0 million for the Washington, Wyoming, Alaska, Montana, and Idaho (WWAMI) medical education program and $4.5 million for the Institute for Stem Cell and Regenerative Medicine. Washington State University receives $10.0 million for its new College of Medicine.

Department of Social and Health Services (DSHS). Appropriations increase by a net of $26.1 million. Appropriations are reduced by $372.9 million for DSHS due to the creation of a new Department of Children, Youth, and Families (see below under "Other Human Services and Other Education"). Child care center rates will increase by 6 percent ($20.8 million, plus $963,000 that is accounted for in the Department of Early Learning). Federal Temporary Assistance for Needy Families (TANF) funds would be used instead of the GFS to save $36.2 million in the WorkFirst program. The increase in the state minimum wage pursuant to I-1433 is estimated to reduce Medicaid, TANF and Food Assistance Program caseloads (some individuals may earn too much to continue to qualify), saving DSHS $8.3 million.

The budget adds $40.5 million to improve the situation at the state psychiatric hospitals in order to maintain federal funding. Also, DSHS has overspent its appropriation authority at state hospitals, so the budget appropriates $20.0 million to cover those costs in FY 2018. The budget appropriates $39.6 million to increase supported living rates for those with developmental disabilities.

Health Care Authority (HCA). Policy changes reduce appropriations for the HCA by $120.3 million. The budget increases appropriations by $40.9 million to expand treatment for Hepatitis C to more Medicaid clients. It saves $92.7 million in the NGFS+ by using marijuana tax revenue to pay for Medicaid clients in managed care plans and to pay community health centers for services provided to Medicaid clients. The impact of a higher state minimum wage on Medicaid caseloads is estimated to save the HCA $22.9 million.

By implementing a single preferred drug list and operating as the sole pharmacy benefits manager, HCA is expected to save $41.6 million in prescription drug costs. (Note, though, that Gov. Inslee vetoed the provision about being the pharmacy benefits manager—it is not clear how that will impact the savings estimate.)

Other Human Services and Other Education. The budget funds the new Department of Children, Youth, and Families (2E2SHB 1661) in fiscal year 2019 (the second year of the 2017–19 biennium). Its initial appropriations level is $597.8 million, including $364.8 million that is transferred from Children's Administration in DSHS and $180.9 million that is transferred from the Department of Early Learning.

For the Early Childhood Education and Assistance Program (ECEAP), 1,800 new slots are added ($25.1 million) and the rates increase by 6 percent ($12.7 million).

Other Appropriations. The budget increases appropriations by $47.2 million for debt service on new bonds.

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 and 2015 transfers were suspended by the Legislature. The 2017–19 budget eliminates the scheduled 2017 transfer of $50.0 million.

The budget uses transfers from the rainy day fund to pay for contributions to public employee retirement plans. As noted above, EHB 2190 transfers $925.2 million from the BSA to the pension funding stabilization account. Then the budget shifts funding for the employer contributions to public employee retirement plans from the GFS to the pension funding stabilization account, saving $462.6 million in the NGFS+ in 2017–19. The bill states that the Legislature intends to continue this policy in 2019–21 (this is also indicated in the outlook). Indeed, the amount transferred from the BSA is enough to make these payments in both biennia.

Compensation. The budget funds the collective bargaining agreements Gov. Inslee negotiated with state employee unions and extends them to non-represented employees. Appropriations are increased by $423.3 million to fund salary increases (in general, salaries will increase by 6 percent over three years). Another $50.6 million is appropriated to increase the funding rate for employee health benefits from $888 per member per month to $913 in FY 2018 and $957 in FY 2019.

Additionally, the budget funds collective bargaining agreements with family child care providers ($15.1 million), adult family homes ($28.2 million), in-home care providers ($77.3 million) and interpreters ($889,000). It provides parity for agency providers with individual home care providers ($21.2 million).

Funding of these collective bargaining agreements was contingent on enactment of SB 5969, which increases the transparency of the bargaining process. It has been enacted and will become effective Oct. 19, 2017.

There will be a 6 percent reduction in management positions throughout government in FY 2019, which is estimated to save $13.1 million in 2017–19.

2017 Supplemental

The budget bill also makes supplemental changes to the 2015–17 operating budget. It reduces 2015–17 appropriations by $28.0 million.

EHB 2190 appropriates $23.6 million from the BSA to the Department of Natural Resources and $14.5 million from the BSA to the Washington State Patrol for fire costs in 2015–17. Additionally, under EHB 2286 (enacted in 2015), up to $75 million of extraordinary revenue growth was supposed to be transferred from the BSA to the GFS in 2015–17. EHB 2190 eliminates that transfer.

Outlook

As passed by the Legislature, the budget balances over four years. It leaves an unrestricted ending fund balance of $42 million in 2019–21 and total reserves of $1.743 billion. (Note, though, that the governor's vetoes may affect the balance over the four-year window.) The outlook shows the effect of continuing the policies of the 2017–19 budget in 2019–21: The 2019–21 spending level expected in the outlook is $49.591 billion, a $6.101

billion increase over 2017–19. Policy spending for K–12 salary allocations is estimated to increase from $1.099 billion in 2017–19 to $4.212 billion in 2019–21. Appropriations are reduced in 2019–21 by $1.914 billion to reflect changes made to I-1351 (class size reductions) pursuant to EHB 2242. Meanwhile, the state property tax increase is estimated to bring in $2.494 billion (up from $1.614 billion) and the estimated revenues from EHB 2163 are estimated to increase from $456 million to $864 million.

Comment

The Legislature came to an agreement on the 2017–19 operating budget two days before the end of the 2015–17 biennium and the details were not publicly available until the morning of the last day of the fiscal year. This was very unfortunate, but to some degree it had been expected. The Legislature has spent the last several biennia ramping up state funding for public schools. With the deadline to comply with the state Supreme Court's McCleary decision looming, the Legislature needed to agree this year on the most difficult piece—salaries—while also determining the rest of the biennial budget.

The end result is a budget with an even sharper focus on education. NGFS+ appropriations for public schools are $21.969 billion in 2017–19, or 50.3 percent of the NGFS+ budget. (In 2015–17, public schools spending was 47.3 percent of the NGFS+ budget.) Of the NGFS+ spending increase from 2015–17 to 2017–19, 71.8 percent goes to public schools.

But the budget raises some concerns. It is unknown at this point whether the substantial new funding for education will be enough to satisfy the Supreme Court. Looking long term, this budget uses rainy day savings to pay for ongoing pension costs. It relies on several hundred million in revenues from a tax change that may not survive a challenge in the federal court system. And it was produced in a climate of extraordinary economic growth—the state will face an economic downturn at some point. A fair question to ask is: Will this level of overall spending be sustainable?

References

Inslee, Jay. 2017. SSB 5883 Veto Letter to the Legislature. June 30.

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