

## House-Passed 2017–19 Operating Budget Would Increase Spending by \$6.4 Billion

### 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.

### Briefly

- The House-passed operating budget would increase revenues by \$2.981 billion in 2017–19.
- It would impose a 20 percent B&O tax surcharge on various activities while reducing B&O taxes for small businesses, and it would impose a tax on capital gains, among other changes.
- NGFS+ appropriations would increase by 16.7 percent over 2015–17.
- NGFS+ spending would be \$44.685 billion for 2017–19.
- Policy level spending would account for \$3.252 billion of that.
- Policy spending for public schools would increase by \$1.873 billion.
- The unrestricted ending fund balance would be \$1.196 billion.
- The budget would make appropriations from the rainy day fund in 2015–17 and 2017–19.
- We’ve previously written about the [Senate budget](#) and [compared the Senate and House budgets](#).

The House has passed a 2017–19 operating budget. It would increase near general fund–state plus opportunity pathways (NGFS+) spending by \$6.438 billion over 2015–17 (a 16.7 percent increase). New policies would account for \$3.252 billion of the increased spending, including the House’s proposal to comply with the state Supreme Court’s McCleary decision on school funding. The House also proposes increasing taxes by \$2.981 billion in 2017–19.

### Balance Sheet

**Revenues.** The House-passed budget would increase revenues by a net of \$2.981 billion in 2017–19. These new revenues come largely from changes that would be made under HB 2186 (\$2.836 billion), including a [new capital gains tax](#) and changes to the business and occupation (B&O) tax. The budget

also assumes passage of HB 1764 (\$128.3 million), which would make changes to the property tax growth limit, and HB 1904 (\$18.9 million), which would tax the sale of personal information.

**Other Resource Changes.** The budget would transfer \$75 million from other funds to the NGFS+ in 2017–19. This includes \$42.0 million from the disaster response account and \$12.0 million from the state treasurer’s service account. (The state treasurer’s service fund is used to pay for costs incurred by the state treasurer’s office and is funded with 1 percent of earnings generated from investing state funds.)

**Spending.** According to the House budget, NGFS+ maintenance level spending (the cost of continuing current services, accounting for caseload, enroll-

ment and inflation changes) is \$41.638 billion for 2017–19. New policy level spending under the House budget would increase that by \$3.252 billion. Accounting for reversions (appropriations not spent), NGFS+ spending would total \$44.685 billion for the biennium.

*Reserves.* The House budget would leave an unrestricted ending fund balance of \$1.196 billion and total reserves (including the budget stabilization account, or rainy day fund) of \$2.328 billion. The House proposal would appro-

priate funds from the budget stabilization account (BSA) in both the 2017–19 biennial budget and the 2017 supplemental. First, the House proposal would appropriate from the BSA \$35.4 million for wildfire costs in 2015–17 and \$12.5 million for the disaster response account in 2017–19. (These appropriations would be made in HB 2191, which has not been passed by the House.) Second, under the state constitution, three-quarters of any extraordinary revenue growth must be transferred to the BSA. Legislation in 2015 specified that up to \$75 million of any extraordinary revenue growth in 2015–17 must be transferred to the general fund from the BSA (RCW 43.79.496). The enacted 2015–17 budget transferred that \$75 million. The House proposal would increase that transfer by \$793 million. (HB 2190, which would allow for this change, has not been passed by the House.)

### Revenue Details

The budget assumes enactment of HB 1764, which would replace the current 101 percent statutory property tax growth limit. Currently, levies are limited to the *lesser* of the previous year's revenues (adjusted for inflation) or 101 percent of the previous year's revenues. Under the bill, property taxes would be limited by the *greater* of 100 percent plus population change and inflation (but not more than 105 percent) and 101 percent. It would increase state revenues by \$128.3 million. (And it would increase local government revenues by \$228.4 million.)

The budget also assumes enactment of HB 2186, which would make numerous tax changes. Altogether, the bill would increase NGFS+ revenues by \$2.836 billion in 2017–19. Of that, \$2.099 billion would be transferred to the education legacy trust account (part of NGFS+). The bill would increase revenues by:

- Imposing a 20 percent B&O tax surcharge for numerous business activities (including, for example, retailing, wholesaling, manufacturing, and ser-

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

	2015-17	2017-19
Beginning Balance	1,011	1,596
Revenue		
March 2017 Revenue Forecast	38,962	41,597
<b>House Budget</b>		
<b>Revenue Legislation</b>		<b>2,984</b>
<b>Budget Driven and Other Revenue</b>	<b>(1)</b>	<b>(3)</b>
<i>Total Revenue</i>	<i>38,961</i>	<i>44,578</i>
Other Resource Changes		
Transfer to Budget Stabilization Acct.	(382)	(409)
Transfer to BSA (Extraordinary Revenue Growth)	(868)	
Transfer from BSA (Extraordinary Revenue Growth)	75	
Other Enacted Fund Transfers	207	
Actual/assumed prior period & CAFR adjustments	69	41
<b>House Budget</b>		
<b>Transfer from BSA (Extraordinary Revenue Growth)</b>	<b>793</b>	
<b>Fund Transfers</b>	<b>(42)</b>	<b>75</b>
<i>Total Other Resource Changes</i>	<i>(147)</i>	<i>(294)</i>
<i>Total Resources</i>	<i>39,825</i>	<i>45,881</i>
Spending		
2015-17 Appropriations	38,454	
<b>House Budget</b>		
<b>Actual/Assumed Reversions</b>	<b>(227)</b>	<b>(206)</b>
<b>Maintenance Level Changes</b>	<b>(105)</b>	
<b>2017-19 Maintenance Level</b>		<b>41,638</b>
<b>Policy Changes</b>	<b>107</b>	<b>3,252</b>
<i>Total Spending</i>	<i>38,229</i>	<i>44,685</i>
Unrestricted Ending Fund Balance	1,596	1,196
Budget Stabilization Account Balance	513	715
Transfers from GFS, Interest Earnings, Reversions	1,294	429
Transfer to the GFS	(75)	
Appropriations from the BSA	(189)	
<b>House Budget</b>		
<b>Appropriations from the BSA</b>	<b>(35)</b>	<b>(13)</b>
<b>Transfer to the GFS</b>	<b>(793)</b>	
Projected BSA Ending Fund Balance	715	1,132
<i>Total Reserves</i>	<i>2,311</i>	<i>2,328</i>

Note: Totals may not sum due to rounding.

*The House would increase spending for public schools by \$1.873 billion.*

- vice and other activities); fully exempting from B&O tax businesses with taxable revenues of \$250,000 or less, and exempting from tax \$100,000 of revenue for businesses with otherwise taxable amounts between \$250,000 and \$500,000; and repealing preferential B&O tax rates for warehousing and reselling prescription drugs and for international investment management services (\$1.197 billion);
- Imposing a new 7 percent capital gains tax (\$715.1 million);
- Imposing the real estate excise tax (REET) at a graduated rate through 2032 and limiting the REET foreclosure exemption (\$435.4 million);
- Requiring remote sellers, marketplace facilitators and referrers to either collect and remit sales taxes or comply with notice and reporting requirements to the customer and the Department of Revenue (\$329.2 million);
- Applying the sales tax to bottled water (\$57.1 million);
- Changing the nonresident sales tax exemption to a refund program (\$49.2 million);
- Applying the use tax to extracted fuel (except biomass) (\$30.8 million);
- Requiring local governments to supply subcontractor information to the state (\$7.8 million);
- Expanding individual liability for unpaid taxes (\$10.2 million); and
- Reducing interest on tax refunds (\$4.4 million).

The way the B&O small business exemption is structured would create notches at \$250,000 and \$500,000. For example, a service business, with a 1.8 percent rate, would pay no tax if its revenue is \$250,000.00, but \$2,700 if its taxable revenue is \$250,000.01. A business with taxable revenue of \$499,999.99 in revenue would pay \$7,200; a business with taxable revenue of \$500,000.00 would pay \$9,000. Tax writers generally try to avoid

jumps such as these, which are arbitrary and unfair. The credit system currently used to provide small business relief from the B&O tax does not create notches.

None of the tax bills have been passed by the House. Additionally, the proposals related to capital gains and remote sellers may not be allowed under state or federal law. (For more on the capital gains proposal and remote sellers, see our recent reports: "[Proposals for a State Capital Gains Tax](#)" and "[Washington's Steady Move to an Economic Nexus Standard for Taxes.](#)")

### Spending Details

Maintenance level spending in the House budget would increase by \$3.185 billion over 2015–17. In addition to that, the House would increase policy level spending by \$3.252 billion. The items discussed below are NGFS+ policy changes.

*Public Schools.* The House budget would increase state spending for public schools by \$1.873 billion. To respond to the state Supreme Court's McCleary decision, the House budget would fund HB 2185 (which has not been passed by the House). HB 2185 would be funded in place of HB 1843, which the House passed in February. (We wrote about HB 1843 in "[Education Funding Plans: The Governor and House Want Significant New Spending.](#)") HB 2185 is very similar to HB 1843. It would keep the current method of funding public schools (the prototypical school model), and it would increase the minimum salary for teachers to \$45,500. The budget would increase spending for compensation for teachers and other staff by \$1.765 billion. Local effort assistance spending would increase by \$117.1 million.

*Higher Education.* Spending on higher education would increase by \$197.9 million. Resident undergraduate tuition would be frozen at 2016–17 school year levels and \$56.4 million would be appropriated for the institutions to make up for the resulting lost revenue. The House

would also spend \$72.7 million to maintain and expand the state need grant. It would provide \$10.0 million for the new College of Medicine at Washington State University and \$5.0 million for additional students at the University of Washington's Washington, Wyoming, Alaska, Montana, and Idaho (WWAMI) medical program. Another \$6.0 million would be spent to expand computer science and engineering degrees at the University of Washington.

*Human Services.* The House budget would transfer community mental health and substance use disorder programs from the Department of Social and Health Services (DSHS) to the Health Care Authority (HCA). This represents a shift of \$991.6 million to the HCA. Within the HCA, the budget would save \$77.7 million by using marijuana tax revenue in lieu of general fund dollars for low-income health care purposes. It would save \$32.1 million from implementing a single preferred drug list and having the HCA operate as a pharmacy benefits manager. It would increase spending by \$61.0 million to restore savings that were not achieved by the Healthier Washington program. Expanding treatment for Medicaid clients with Hepatitis C would

cost \$40.9 million. Medicaid managed care rates would increase by 2 percent (\$58.8 million).

The House would create a new Department of Children, Youth, and Families (HB 1661, which has been passed by the House). To fund the new agency, \$351.4 million would be transferred from Children's Administration (currently housed in DSHS) and \$195.8 million would be transferred from the Department of Early Learning.

In DSHS, the House would increase spending by \$42.2 million to bring Western State Hospital into federal compliance. Funding for the state hospitals would increase by another \$20.0 million to cover overspending of appropriation authority by DSHS. The budget would increase supported living rates (\$39.6 million). It would spend \$136.1 million to fund collective bargaining agreements with adult family homes and in-home care providers (and agency parity) and family child care providers.

*Governmental Operations.* In the Department of Commerce, spending would increase by \$10.0 million on programs to reduce homelessness. Another \$5.8 million would add 300 beds for individuals

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

	2017-19 Biennium					
	2015-17 Biennium		Maintenance Level		House-Passed	
	NGFS+	All Funds	NGFS+	All Funds	NGFS+	All Funds
Legislative	156,347	176,454	165,696	186,945	169,137	191,351
Judicial	269,241	340,990	281,570	315,781	299,831	373,366
Governmental Operations	509,927	3,891,226	539,865	3,815,423	590,028	4,021,487
DSHS	6,405,389	14,184,650	6,963,849	15,134,312	5,910,453	12,484,554
Health Care Authority	4,016,072	16,553,505	4,327,268	16,731,048	5,376,179	20,625,488
Other Human Services	2,091,361	4,645,866	2,173,201	4,724,041	2,839,677	5,987,852
Natural Resources	287,107	1,748,041	307,707	1,779,445	320,506	1,829,234
Transportation	83,338	201,704	85,331	193,183	92,802	206,594
Public Schools	18,197,434	20,110,525	20,151,182	22,084,718	22,024,343	23,960,306
Higher Education	3,557,824	13,902,354	3,645,932	14,103,624	3,843,828	14,253,467
Other Education	349,134	747,193	373,032	768,743	235,305	486,143
Special Appropriations	<u>2,529,840</u>	<u>2,896,345</u>	<u>2,623,701</u>	<u>2,818,145</u>	<u>3,188,473</u>	<u>3,870,676</u>
<b>Total Budget Bill</b>	<b>38,453,014</b>	<b>79,398,853</b>	<b>41,638,334</b>	<b>82,655,408</b>	<b>44,890,562</b>	<b>88,290,518</b>
Other Appropriations	500	189,986	0	0	50	12,550
<b>Statewide Total</b>	<b>38,453,514</b>	<b>79,588,839</b>	<b>41,638,334</b>	<b>82,655,408</b>	<b>44,890,612</b>	<b>88,303,068</b>

with mental illness. In the Department of Revenue, \$22.5 million would be spent to implement new revenue legislation.

*Special Appropriations.* The House would fund all the collective bargaining agreements negotiated by the governor with state employees, increasing spending by \$534.9 million. (This is in addition to the compensation increases for human services providers noted above.) Separately, the budget would also fund salary increases for elected officials. These increases are spread throughout the budget and would total \$3.1 million.

Debt service on new bonds would increase spending by \$51.8 million. Like the governor and the Senate, the House budget would suspend the scheduled 2017 transfer of \$50.0 million to the local public safety enhancement account.

### Outlook

The House budget would balance over four years. It would leave an unrestricted ending fund balance of \$13 million and total reserves of \$1.659 billion in 2019–21. The estimated effects of revenue legislation assumed in the budget would increase from \$2.984 billion in 2017–19 to \$4.757 billion in 2019–21. The jump is attributable largely to the capital gains tax (which would bring in \$1.609 billion in 2019–21) and the requirement that remote sellers and others collect or report sales tax (which would bring in \$644.8 million in 2019–21). Spending related to McCleary compensation would increase from \$1.765 billion to \$5.123 billion in 2019–21, but the budget would save \$1.914 billion in 2019–21 by suspending Initiative 1351 (class-size reductions) for two years.

The House budget would require the Office of Financial Management (OFM) review the accuracy of revenue estimates in the official outlooks and report back to the Legislature. For example, OFM would have to compare the revenue estimate made in the November 2012 outlook for 2015–17 to the actual revenues collected in 2015–17.

### Comment

The House-passed budget would spend \$1.577 billion more than the Senate-passed budget. In keeping with the need to comply with the state Supreme Court's McCleary decision, spending for public schools would account for 57.6 percent of all policy changes in the House budget. Another big-ticket policy change is the funding of the collective bargaining agreements with state employees.

The House would fund its proposals with a substantial tax package. This is a sticking point in the budget negotiations—the House doesn't plan to vote on the taxes until there is an agreement on the spending, and the Senate won't negotiate the spending until the House demonstrates that it is willing to vote for the taxes (Camden 2017). But even if the tax package is passed by the Legislature, it is not clear that all of the estimated revenues would materialize. The capital gains tax and requirement that remote sellers collect or report sales taxes may be unconstitutional.

### References

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