

## POLICY NOTE

# Review of 2013-15 Operating Budget Passed by Legislature

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### Key Findings

1. *It took more than 150 days for lawmakers to adopt a budget that projects to balance in compliance with the state's new four-year balanced budget requirement.*
2. *Washington Policy Center encouraged lawmakers to utilize five essential budget building blocks to create a spending plan that serves the public interest. On the whole, the budget was built utilizing these recommendations.*
3. *Lawmakers kept their promise to allow several temporary tax increases they enacted in 2010 to sunset.*
4. *Challenges in the balance sheet and potential Court actions calls into question the long-term sustainability of state spending .*
5. *Legislative transparency reforms are needed to provide more time for meaningful budget review before adoption.*

### Introduction

It took two special sessions, the threat of a historic government shutdown and a process that largely cut the public out of the final deal but, the Legislature by large bipartisan votes finally approved a \$33.5 billion (\$66.5 billion including all funds) 2013-15 state operating budget. As with all budgets there are good and bad items included, though the biggest policy success was that lawmakers allowed the 2010 “temporary” tax increases to remain temporary and to expire as promised on July 1st. The enacted budget also includes revenue and spending projections that balance in compliance with the state’s new four-year balanced budget requirement.<sup>1</sup>

#### *Washington Policy Center budget priorities*

To help provide the framework for the state’s budget debate, Washington Policy Center encouraged lawmakers to utilize these five essential budget building blocks to create a spending plan that serves the public interest.<sup>2</sup> The following points describe our budget policy recommendations and reports on their success or failure:

1. Keep the promise that “temporary” taxes will be temporary – Success. Lawmakers allowed the 2010 “temporary” tax increase to sunset as originally planned.
2. Listen to the clear will of voters on taxes - Largely successful. Though the 2010 temporary taxes were allowed to expire, representing a reduction in taxes, lawmakers did enact a retroactive death tax provision.
3. Avoid budget gimmicks - Partial failure. Lawmakers relied on tactics like agency reversions in excess of the unrestricted ending fund balance and significant fund transfers to make the budget balance.
4. Save the protected emergency reserve for a true budget emergency – Success. Lawmakers did not raid the emergency reserve fund.
5. Adopt a performance-based budget that really balances over four years – Success or failure to be determined. Numerous performance-based provisos were included in the budget and the four-year outlook shows growing total reserves by 2015-17. Still, lawmakers seem poised to add major new spending in response to the K-12 McCleary funding ruling that is not accounted for in the four-year budget outlook.

1 “Budget Outlook Based on 3ESSB 5034,” July 2013 at <http://www.erfc.wa.gov/forecast/documents/20130729BudgetOutlook.pdf>

2 “Five Items Lawmakers Should Include in the 2013-15 budget,” by Jason Mercier, May 2013 at <http://www.washingtonpolicy.org/publications/opinion/five-items-lawmakers-should-include-2013-15-budget>

On the whole, the 2013-15 budget was built utilizing these guiding policy recommendations.

### **2013-15 budget (SB 5034)**

On June 28, by a vote of 81-11 in the House and 44-4 in the Senate the Legislature approved SB 5034: Making 2013-2015 operating appropriations.<sup>3</sup> Governor Inslee signed the budget on June 30, narrowly averting a government shutdown; most state operations would have ceased had a budget not been approved by July 1 (beginning of new fiscal year for the biennium). There were many interesting provisions amongst the operating budget's 483 pages. A few of the highlights:

- A study of growing higher education costs;
- A study of whether the state's economic development programs are effective;
- A study of how teachers actually spend their time during a typical school day;
- A pilot program to modernize the state's antiquated financial management system;
- A provision requiring the state's expansion of Medicaid under Obamacare to terminate if the level of federal matching dollars drops;
- Funds are provided to enhance the K-20 technology network for video conferencing efforts (implications for remote testimony options);
- The state assumes it will generate \$30 million in savings from LEAN management reforms;
- Washington State University is required to study whether citizens are harassing government officials with public records requests;
- State employees are granted a conditional 1% pay raise if certain economic conditions are met, plus a new step on the wage-increase ladder is created; and
- The budget continues to take money from the dedicated voter-approved Initiative 900 performance audit account set aside for the State Auditor.

Before signing the budget into law Governor Inslee issued several vetoes.<sup>4</sup> Among the vetoes was honoring the request of State Auditor Troy Kelley to maintain at least some of the intent of Initiative 900 (voter approved performance audits). Kelley wrote the Governor requesting a veto of several legislative directed performance audits which threatened to interfere with the independence of the State Auditor's Office. The Auditor wrote:<sup>5</sup>

*"The precedence of the Legislature requesting audits of the independent State Auditor through budget legislation raises several issues, including issues regarding the independence of this office. This budget already diverts almost \$10 million from the voter-approved Performance Audit of Government Account, \$5.6 million of which is diverted to fund the audit function of the Joint Legislative Audit and Review Committee (JLARC). JLARC is directed by the Legislature, and is the appropriate venue for legislatively directed audits.*

3 "SB 5034: Making 2013-2015 operating appropriations," at <http://apps.leg.wa.gov/billinfo/summary.aspx?bill=5034&year=2013>

4 Governor Insee Veto Message for SB 5034, June 30, 2013 at <http://governor.wa.gov/news/billaction/2013/veto/5034.pdf>

5 Letter from State Auditor Troy Kelley to Governor Jay Inslee, June 28, 2013 at [http://www.washingtonpolicy.org/sites/default/files/Auditor\\_request\\_to\\_Governor.pdf](http://www.washingtonpolicy.org/sites/default/files/Auditor_request_to_Governor.pdf)

*Initiative 900, which established the performance audit account, is supported by a broad majority of Washingtonians because of the role played by the independent auditor's office."*

While it is encouraging to see the Governor veto those provisos that further undermined the intent of Initiative 900, some of his other vetoes are troubling.

As noted by the State Auditor, JLARC exists so the Legislature can direct audit reviews of state programs. The Legislature requested several performance audits by JLARC in the 2013-15 budget that were vetoed by the Governor including:

- A study of the "integration of performance measurements into the state budgeting process and the ability of the legislative fiscal committees to use effective performance indicators in developing the state budget" and
- A study of the "electricity cost impacts for each qualifying utility to meet the 2016 and 2020 renewable resource and conservation targets under chapter 19.285 RCW. The study must also include an analysis of the impacts on each utility's commercial, industrial, and residential customers, including an additional analysis of the impacts on low-income residential customers."

Both of these vetoed JLARC studies would have provided important information to lawmakers and the public about how performance measures could improve spending accountability in the state budget and how excluding hydro power from the calculations for meeting renewable energy regulations contributes to higher costs for consumers.

### **Balance sheet for 2013-15 budget**

Here is the balance sheet for the 2013-15 operating budget:

<b>2013-15 NGFS-P Balance Sheet (With Anticipated Reversions)</b>	
Total resources	\$33.540 billion (includes \$520 million of transfers)
Total spending	\$33.487 billion
Unrestricted ending fund balance	\$53 million (0.2% of spending)
Constitutional rainy-day account	\$578 million
Total reserves	\$630 million (2% of spending)

The 2013-15 budget shows total spending of \$33.487 billion, but the actual budgeted authority for agency spending is \$33.627 billion. This is because the 2013-15 budget assumes \$140 million in agency reversions (approximately \$70 million per fiscal year), money agencies are authorized to spend but are not expected to, based on historical experience. Lawmakers assume state agencies will not use all their budgeted spending authority, resulting in actual spending of \$33.487 billion for the 2011-13 budget period. Should agencies, however, spend to their full legally appropriated amount, the unrestricted ending fund balance would be a negative \$87 million (not counting total reserves).

<b>2013-15 NGFS-P Balance Sheet (Without Anticipated Reversions)</b>	
Total resources	\$33.540 billion (includes \$520 million of transfers)
Total spending	\$33.627 billion
Unrestricted ending fund balance	Negative \$87 million
Constitutional rainy-day account*	\$578 million
Total reserves	\$491 million

\*Requires supermajority vote of lawmakers to access or employment growth of less than 1%

## **Evolution of the tax increase proposals**

Despite projected revenue growth of \$2 billion for the 2013-15 biennium, proposals for significant tax increases dominated the budget debate and contributed to the Legislature going into two special sessions to finish its work on the budget.<sup>6</sup> The final tax increase package included in the 2013-15 budget was a fraction of what was proposed by legislative Democrat leaders and the Governors. Below is a description of major tax increases proposed by out-going Governor Gregoire, the Democrats in the House, the Majority Coalition in the Senate, and newly-elected Governor Inslee.

### **Democrat Proposals**

*Out-going Governor Gregoire (12/12): Total tax increases- \$1.2 billion<sup>7</sup>*

- Cancel planned sunset and extend the 2010 “temporary” B&O tax increase: \$534 million
- Impose an excise tax on wholesale gasoline and other fuels: \$368 million
- Cancel planned sunset and extend the 2010 “temporary” beer tax increase: \$101 million\*
- Repeal sales tax exemption on candy and gum: \$69 million
- Repeal fuel tax exemption: \$63 million
- Impose soda tax: \$57 million

*Governor Inslee (3/13): Total tax increases - \$1.2 billion<sup>8</sup>*

- Cancel the planned sunset and extend the 2010 “temporary” B&O tax increase: \$534 million
- Cancel the planned sunset and extend the 2010 “temporary” beer tax increase: \$128 million\*
- Limit trade-ins exemption for cars: \$95 million
- Repeal sales tax exemption on home telephones: \$83 million

6 Washington State June Revenue Forecast, June 18, 2013 at <http://www.ercf.wa.gov/forecast/documents/rev20130618color.pdf>

7 Governor Gregoire’s 2011–13 and 2013–15 Budget Balance Sheet at [http://www.ofm.wa.gov/budget13/highlights/balance\\_sheet.pdf](http://www.ofm.wa.gov/budget13/highlights/balance_sheet.pdf)

8 Governor Inslee’s 2013-15 Budget Balance Sheet at [http://www.ofm.wa.gov/budget13inslee/balancesheet\\_detail.pdf](http://www.ofm.wa.gov/budget13inslee/balancesheet_detail.pdf)

- Impose the state sales tax on custom computer software: \$79 million  
Across the board reduction in preferential B&O rates by 25%: \$66 million
- Repeal sales tax exemption on non-residents purchases: \$64 million
- Repeal sales tax exemption on bottled water: \$52 million
- Repeal use tax exemption for extracted fuel: \$41 million
- Eliminate preferential rate on resellers of prescription drugs: \$29 million
- Repeal B&O exemption on long-term commercial rental property: \$28 million
- Narrow tax exemption on import commerce: \$24 million
- Repeal sales tax exemption on equipment bought at farm auctions: \$6 million

*House (4/13): Total tax increases - \$1.3 billion<sup>9</sup>*

- Cancel the planned sunset and extend the 2010 “temporary” B&O tax increase: \$534 million
- Impose a retroactive death tax increase (based on the Bracken state Supreme Court ruling): \$160 million
- Repeal sales tax exemption for residential telephone service, other tax changes: \$110 million
- Repeal sales tax exemption on non-residents purchases: \$64 million
- Repeal public utility tax exemption on interstate transport of goods for the in-state portion: \$63 million
- Extend and lower “temporary” beer tax increase: \$59 million\*
- Repeal high-tech research and development sales & use tax exemption: \$56 million
- Repeal sales tax exemption on bottled water: \$52 million
- Repeal preferential B&O tax rate on insurance agents: \$46 million
- Repeal extracted fuel exemption: \$41 million
- Repeal sales tax exemption on janitorial services: \$36 million
- Repeal preferential B&O tax rate on resellers of prescription drugs: \$29 million
- Repeal preferential B&O tax rate on stevedoring services: \$28 million
- Narrow B&O and sales tax exemptions on import commerce: \$24 million
- Narrow Cut the high-tech research and development B&O credit: \$23 million
- Repeal preferential B&O tax rate on travel agents and tour operators: \$15 million

<sup>9</sup> House Democrats summary of revenue options, April 10, 2013 at <http://housedemocrats.wa.gov/tmp/2013/04/RevenuePackageDescriptions-vs4-4-9-13-Press.pdf>

\*Different amounts due to various exemptions granted

- Repeal handling losses fuel-tax deduction: \$5 million

### *Majority Coalition Caucus*

*Senate (6/13): Total tax increases-\$64 thousand<sup>10</sup>*

- Taxation of commuter air carriers: \$64 thousand

### *Final budget*

*Enacted budget (6/13): Total tax increases - \$269.4 million <sup>11</sup>*

- Imposes a retroactive death tax increase (based on the Bracken state Supreme Court ruling): \$159 million
- Repeal sales tax exemption for residential telephone service, other tax changes: \$110 million
- Leasehold excise tax credit repeal: \$312,000
- Taxation of commuter air carriers: \$64,000

Though other tax increases were proposed, the details above reflect the ones that received serious consideration or were adopted for use in the 2013-15 budget.<sup>12</sup>

## **Budget transparency again suffers**

Up against the July 1 deadline to avoid a first-ever government shutdown, lawmakers wasted no time in voting on the 2013-15 budget once they had reached an agreement. Unfortunately this meant the public had little time to digest the details of the 483 page, \$66.5 billion dollar proposal before lawmakers voted on it. If they were completely frank with the public, lawmakers would admit that few of them had time to read the budget before they voted on it. This lack of a transparent process was best summed up by veteran Tacoma News Tribune columnist Peter Callaghan, when he sent a tweet after the 45-second press conference at which lawmakers and Governor Inslee announced the final budget but provided no details:

*“All say this is how it has to be done, how always done. I have more time in than any of them and they’re wrong. Least transparent budget yet.”<sup>13</sup>*

Washington Policy Center recommends the minimum time provided for budget transparency before a vote should be at least 24 hours.<sup>14</sup> Lawmakers should provide more legislative transparency protections to ensure the public and legislators have adequate time to review and comment on proposed changes to law before the final vote occurs. Recommended policy changes include mandatory waiting periods for legislation, subjecting the legislature to the Open Public Meetings Act like every other government entity (except the courts) and banning the use of title-only bills.

<sup>10</sup> Proposed Senate 2013-15 Operating Budget, June 8, 2013 at [http://leap.leg.wa.gov/leap/Budget/Detail/2013/soOverview\\_0608.pdf](http://leap.leg.wa.gov/leap/Budget/Detail/2013/soOverview_0608.pdf)

<sup>11</sup> 2013-15 Operating Budget, June 27, 2013 at [http://leap.leg.wa.gov/leap/Budget/Detail/2013/soHighlights\\_0627.pdf](http://leap.leg.wa.gov/leap/Budget/Detail/2013/soHighlights_0627.pdf)

<sup>12</sup> “Bills By Topic Results – Taxes,” at <http://apps.leg.wa.gov/billsbytopic/Results.aspx?letter=T&year=2013>

<sup>13</sup> “Budget announcement in tweets,” by Jason Mercier, June 27, 2013 at <https://www.washingtonpolicy.org/blog/post/budget-announcement-tweets>

<sup>14</sup> “Michigan shows need for Washington legislative transparency reforms,” by Jason Mercier, December 7, 2012 at <http://www.washingtonpolicy.org/blog/post/michigan-shows-need-washington-legislative-transparency-reforms>



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## Conclusion

It took more than 150 days (one regularly scheduled 105-day session and two special sessions) to complete their work on the 2013-15 operating budget but lawmakers finally succeeded in adopting a budget that complies with the state's new four-year balanced budget requirement, while keeping their promise to allow several temporary tax increases they enacted in 2010 to sunset. The relatively small level of reserves, assumption of reversions in the balance sheet, significant fund transfers and uncertain expectations from the State Supreme Court on its K-12 McCleary ruling, however, will continue to create uncertainty over the state's budget outlook and its long-term sustainability. Additional vigilance will be required to ensure future spending increases in non-education spending are sustainable, as well as recognizing the reality that unfunded programs should be repealed rather than suspended to remove their projected costs from future budget outlooks.

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