

State budget stabilizes, but major challenges loom

After five years of weathering a turbulent economy, Washington’s budget situation has stabilized. But there are significant challenges on the near horizon. While our economy continues its slow recovery, that growth is not generating enough revenue to keep pace with rising mandatory costs and the ever-increasing number of people the state serves — let alone fund our court-mandated basic education obligations over the next two biennia.

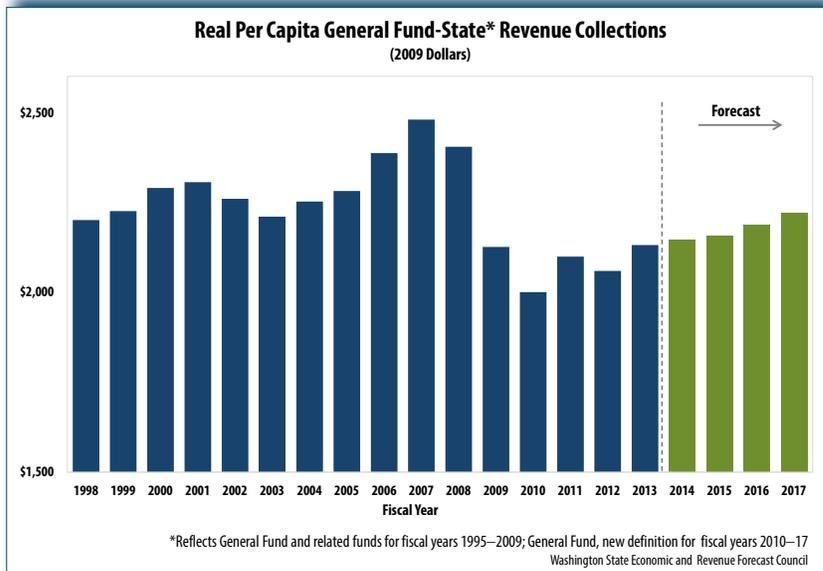
In light of these realities, Governor Jay Inslee is proposing only modest adjustments to the 2013–15 budget — primarily to address mandatory spending increases, cover costs or fill holes that were not anticipated when the budget was approved six months ago, and meet a small number of high-priority needs.

By sticking to a minimal supplemental budget, we will be better positioned to address the much greater challenges of the 2015–17 budget.

Slow recovery means slow revenue growth

There are encouraging signs in Washington’s economy. Home sales are up. In 2014, the state’s personal income is expected to grow at a slightly faster pace than for the nation as a whole. And reliance on unemployment compensation is expected to decline by more than 12 percent.

Still, Washington continues to climb out of the Great Recession at a much slower pace than it did from previous economic downturns. It’s been nearly six years since the start of the downturn and we still have not recovered all the jobs that were lost. By comparison, it took the state about three years to regain the jobs lost during the recession of the early 1980s.



As a state largely dependent on sales tax revenues, Washington has been particularly hard hit by the recession’s lingering effect on consumer confidence. In fact, as of this fall, real per capita state revenue collections remain well below where they were prior to the recession.

The slow pace of our recovery is expected to continue. Indeed, over the next four years, total state revenue collections are projected to grow at a significantly slower rate than during previous recoveries.

Caseloads, costs eat up revenue gains

The \$33.6 billion 2013–15 budget was signed into law on June 30, just in time to avoid a state government shutdown. Besides addressing a projected \$1 billion shortfall, the budget put nearly \$1 billion into K-12 education to begin meeting the state’s constitutional obligation to adequately fund basic education.

It also protects funding for programs that serve the most vulnerable citizens and ensures public safety. And it tackles critical shortfalls in a few areas, such as for state parks.

At the time it was passed, however, the budget was projected to leave only about \$50 million in unrestricted reserves. (The rest of the projected reserves — about \$580 million — are in the state’s constitutionally protected rainy day fund.)

Revenue projections for the biennium have since grown slightly. But so have the state’s costs. Governor Inslee’s proposed supplemental budget includes \$150 million in General Fund-State “maintenance level” spending to cover a variety of mandatory cost increases and continue delivering services at current levels.

About one-third of the mandatory cost increases are driven by rising caseloads and school enrollment. For example, by the end of the biennium we are expected to have about 10,200 more K-12 students than initially projected, and 900 more students than previously forecast will qualify for the state’s College Bound scholarship program. Meanwhile, the state’s prison system — which is already at capacity — is projected to have 336 more inmates than were forecast at the start of the biennium.

The mandatory increases also include nearly \$11 million to cover wildfire costs, primarily last season’s. And, as is typical with a new budget, the 2013–15 spending plan relied on some assumptions that are not panning out. For example, the budget assumed that the state would qualify for a 100 percent federal match to cover 20,000 individuals in one of the state’s Medicaid

programs. But the state has since been informed that it will instead get a 75 percent match, which means the state’s share will now be \$26 million.

Besides covering the mandatory increases, the Governor’s supplemental budget would increase General Fund spending by a net \$55 million to meet other state obligations or address high-priority needs in several areas. It includes nearly \$7 million for our prison capacity problem, most of which will be used to open a medium-security unit at the Washington State Penitentiary and \$8.2 million to begin complying with a legal settlement requiring the state to significantly expand mental health services for children.

It also includes \$13 million for critical information technology infrastructure upgrades, including \$737,000 to continue building the state’s Business One-Stop Portal that will provide a single, online resource to make it easier for small businesses to apply for permits, licenses, make payments and handle all other interactions with state government.

The budget makes several small but important education investments, such as \$3 million for a new teacher mentoring program, \$300,000 to develop new curricula that will provide students multiple paths to meet math and science graduation requirements, and \$250,000 for an early warning dropout prevention program. It also enhances STEM education in our K-12 and community college systems.

A new strategy on high tech R&D investment

Governor Inslee proposes a temporary, one-year extension of two tax preferences aimed at encouraging private sector investment in high tech research and development (R&D). During the period of the extension, the Governor will convene a work group of industry experts and higher education leaders to make recommendations on prioritizing state investment in the high tech sector.

The work group will discuss the tax treatment of high tech companies — with the dollars currently provided in tax incentives — and develop strategies

for future tax incentives and/or ways to invest directly in higher education institutions to produce engineering, computer science and other majors to support our high tech future.

The current tax preferences promote investment in advanced computing, advanced materials, biotechnology, electronic device technology and environmental technology. Both — a business and occupation tax credit on R&D spending up to \$2 million annually and a sales/use tax deferral on the construction of R&D facilities — are scheduled to expire Jan. 1, 2015.

Finding a more sustainable approach for future budgets

The Governor originally proposed to extend expiring taxes and close tax loopholes to help solve the 2013–15 budget shortfall and fund basic education. But instead, the budget that passed relies on one-time fixes, unspecified reductions and assumed savings, including:

- ◆ \$387 million in transfers from capital funds and one-time General Fund cost shifts to dedicated funds;
- ◆ \$320 million by again suspending Initiative 732 teacher cost-of-living raises;
- ◆ \$190 million in unspecified spending reductions and assumed savings, including \$140 million in assumed “reversions”; and
- ◆ \$94 million in one-time fund balance transfers from dedicated accounts.

Unfortunately, more one-time solutions are needed to balance the proposed supplemental budget. This approach is not sustainable. Barring an unforeseen dramatic rise in economic activity and revenue collections, we will face another sizable shortfall next year when work begins on the 2015–17 budget.

For starters, we will have to fill holes left by the one-time fixes used to balance the 2013–15

budget. Meanwhile, caseloads, enrollments and demands for services will continue to grow. We face a backlog of compensation issues — the state has not funded cost-of-living raises for teachers or state employees since 2008. And there is a growing need to provide resources for certain local law enforcement and firefighter pensions and increase payment rates for those who care for our most vulnerable residents.

On top of this, we will need to take another big — and expensive — step toward meeting our basic education obligations, as required by the State Supreme Court in its 2012 McCleary decision. The Legislature in 2009 and 2010 passed measures that committed the state to increase public school funding by \$3.7 billion or more between now and 2019.

Governor Inslee proposed making a \$1.3 billion down payment in the current budget. The Legislature, however, pared that down to slightly less than \$1 billion. To stay on track toward meeting our obligation, the state will need to make a substantially larger basic education investment during the next biennium while also protecting vital services to vulnerable children and adults, higher education and communities.

Investing in Washington’s aerospace future

Governor Inslee’s proposed supplemental budget funds key elements in his plan to invest in the state’s aerospace future and, ultimately, convince The Boeing Company to assemble its new 777X jetliner — and its carbon fiber wing — here in Washington.

During a special session the Governor called in November, lawmakers overwhelmingly approved legislation to expand the state’s investment in aerospace-related education and workforce development. That legislation — and the Governor’s operating and capital supplemental budgets — provide funds to:

- ▶ Create 1,000 additional community college enrollment slots in high-demand

aerospace fields such as composite materials manufacturing, machine maintenance and pre-engineering.

- ▶ Complete construction of the Central Sound Aerospace Training Center in Renton.
- ▶ Develop composites fabrication training programs at the Washington Aerospace Training and Research Center at Edmonds Community College.
- ▶ Design a new School of Advanced Manufacturing and Aerospace at Washington State University’s Everett campus.
- ▶ Support the University of Washington’s business operations plan for an advanced manufacturing and product development facility in conjunction with local municipalities and private industry.