

WASHINGTON STATE
**BUDGET
& POLICY
CENTER**

SOUND RESEARCH. BOLD SOLUTIONS.

FRAMEWORK FOR PROSPERITY



Creating A Strong Economy For All Washingtonians

LETTER FROM THE EXECUTIVE DIRECTOR

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Friends,

This is a crucial time in Washington state's history. There are choices to be made by our newly elected Governor and state Legislature that will impact millions of Washingtonians.

- > How to fulfill the requirements of the McCleary school funding decision, which will touch not only education but all areas of the budget?
- > How to implement the Affordable Care Act, to provide access to health coverage?
- > What should our priorities be for investing in the building blocks of a strong economy?
- > How will we pay for all these things?

When I think of the kind of state I want my young son to grow up in, I know every Washingtonian wants the same: a state with safe, thriving communities, healthy people, an environment with clean air and water, jobs that offer economic security for families, and an education that provides opportunities for the next generation. But those values are in jeopardy right now. All of this comes together in one place—the state budget. It's a powerful tool for social change and a reflection of our values.

In this document, we lay out specific recommendations for targeted investments that would bring our state closer to providing prosperity for all Washingtonians. We also provide revenue options to help pay for those investments.

The measure of our success is a state with the financial resources to invest in what reflects Washingtonians' values—a state that can create shared prosperity during good times, and during bad times maintains our commitment to progress. This document is a framework to help get us there.

The Washington State Budget & Policy Center staff and I look forward to working with elected officials, advocates, community members, and everyone else who cares about tomorrow's Washington state to realize this vision.

Sincerely,



Remy Trupin
Executive Director



INVESTMENTS

INVESTMENTS SUMMARY

Widely shared prosperity does not happen by accident. It happens when we deliberately invest in the foundations of a strong economy—broad and equal opportunity to build knowledge and skills, adequate compensation and support for workers, and targeted investments in conditions that foster economic growth.

Washington state's investments should:

- > **Provide opportunity for all.** Opportunities that most Washingtonians need to prosper—access to high-quality education, health care, transportation, clean environment, and work supports—are cost-effective and improve long-term outcomes for families, communities, and the economy.
- > **Create better jobs.** A thriving middle class is dependent on having enough jobs that allow Washingtonians to get ahead, and policies that reward workers for their productivity. In addition, jobs that maintain our physical infrastructure (construction and maintenance on schools, roads, bridges, transportation) and build knowledge and skills (teachers, job trainers, social workers) strengthen the foundation of a strong economy.



Bottom Line

When more people have a chance to reach their full potential and enough economic security to make investments in their future, our economy will grow.

EDUCATION & OPPORTUNITY

Provide all children with an affordable, high-quality education from preschool through higher education

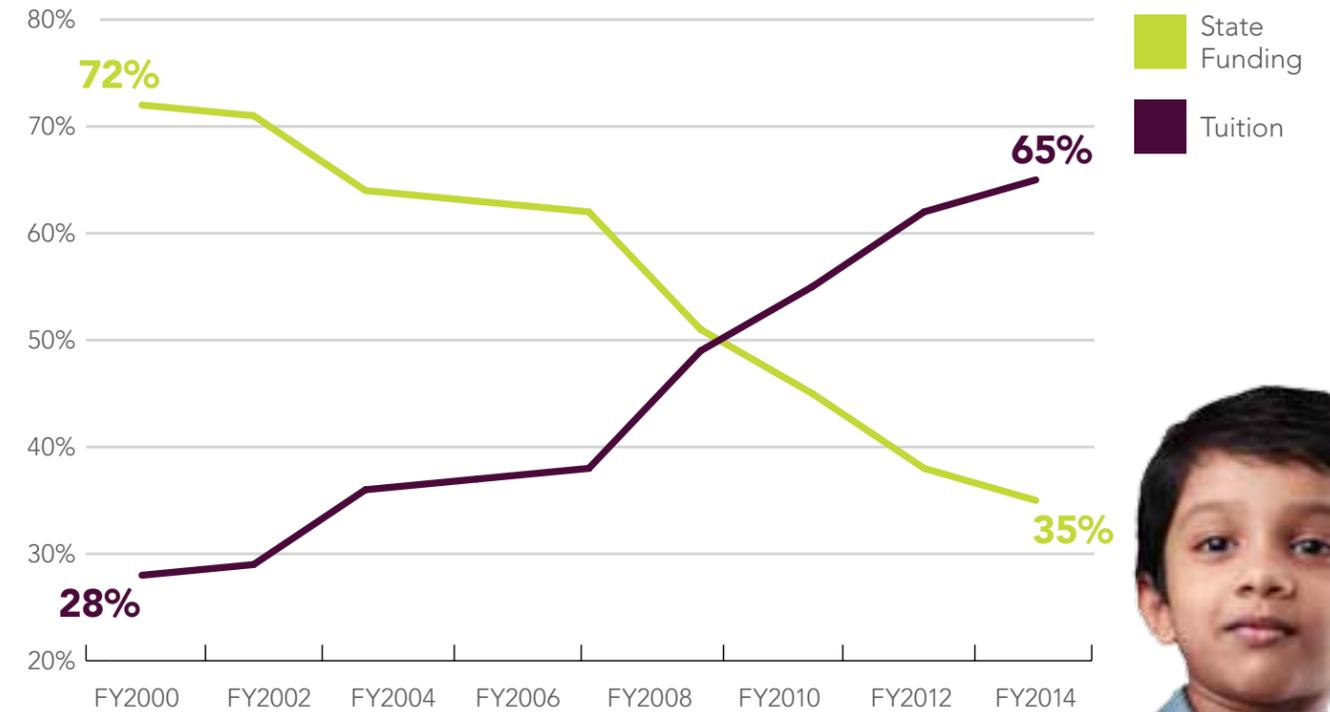
A high-quality education system—from early learning through higher education—is fundamental to Washington state’s economy and well-being. A high-quality early learning system sets the stage for lifelong learning and social development. A strong K-12 system prepares children for higher learning and career opportunities. Our higher education system serves as the bedrock of our economy, preparing students to be critical thinkers with diverse skills and driving the innovation necessary to keep Washington state nationally and globally competitive.

Our Recommendations:

- > **Expand slots in the Early Childhood Education Assistance Program** so more children are kindergarten-ready.
- > **Fund basic education & close the achievement gap** to make progress on funding commitments for K-12 as required by *McCleary v. State*. While doing so, direct resources toward closing the achievement gap so that all kids can reach their full potential.
- > **Increase the state’s share of higher education funding to cover at least 50 percent of the cost** at four-year colleges so that higher education remains an affordable and accessible option for all Washingtonians.
- > **Increase support for the State Need Grant** so that lower- and moderate-income students can access opportunity at our four-year universities, and community and technical colleges.

Students Are Paying Over Half Of Higher Education Costs

Share of funding by source at four-year institutions



Source: Budget & Policy Center calculations, data from Legislative Evaluation & Accountability Program (LEAP)



FAST FACTS

MCCLEARY V. STATE

2011 Supreme Court decision that ruled Washington has failed to meet its constitutional obligation to fully fund basic education.

\$1.4 BILLION

The amount cut from higher education since 2009.

65%

The share of tuition students at four-year public universities will pay in 2013, compared to just 28 percent in 2000.

7 in 10

The number of students currently eligible, but not receiving the State Need Grant who are attending community and technical colleges.

THRIVING COMMUNITIES

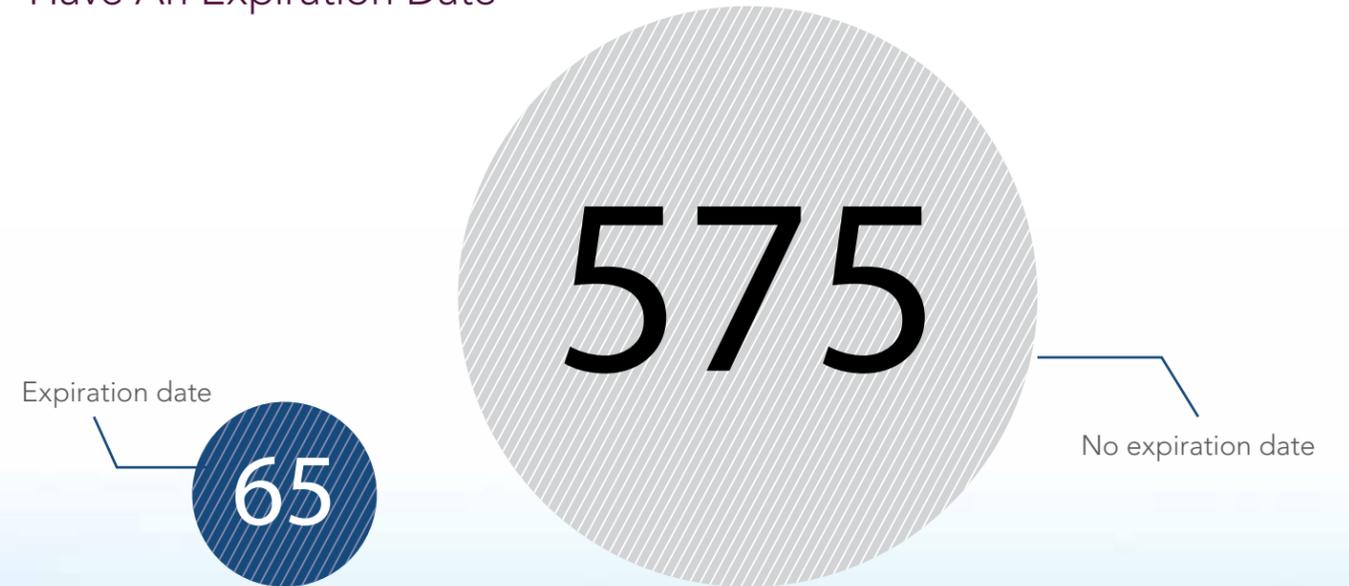
Ensure efficiency and transparency in state government

Vibrant communities depend upon sustainable investments achieved through open and informed processes that ensure state government decisions are based on public priorities. To make sure public investments are made wisely and managed efficiently, decision makers and the public need access to a wide range of information. The impacts of budget decisions should be disclosed before they are made.

Our Recommendations:

- > **Disclose the full economic, social, and fiscal impact of policy decisions** so that lawmakers make evidence-based choices through the fiscal note process.
- > **Establish routine oversight by requiring tax breaks to expire or "sunset"** periodically to ensure they receive thorough and regular reviews by the Legislature.
- > **Require the Governor to submit a tax expenditure budget** to provide greater transparency of state spending during the budget process.
- > **Ensure tax breaks are cost-effective by enhancing audit and review structures**, which would allow policymakers to weed out wasteful, ineffective, or obsolete tax breaks.
- > **Enact strict eligibility requirements for businesses that receive tax breaks** so that they are accountable to taxpayers.

Most Washington Tax Breaks Do Not Have An Expiration Date



Source: Budget & Policy Center analysis; data from Department of Revenue (DOR)

FAST FACTS

Tax breaks contain
\$8 BILLION
in hidden spending.

640
special tax breaks
on the books.

Legislators should consider
ALL COSTS
associated with proposed cuts.

Majority of tax breaks go
DECADES
without legislative review.

HEALTHY PEOPLE & ENVIRONMENT

Strengthen the health care system and protect our investments in clean air, water, and land

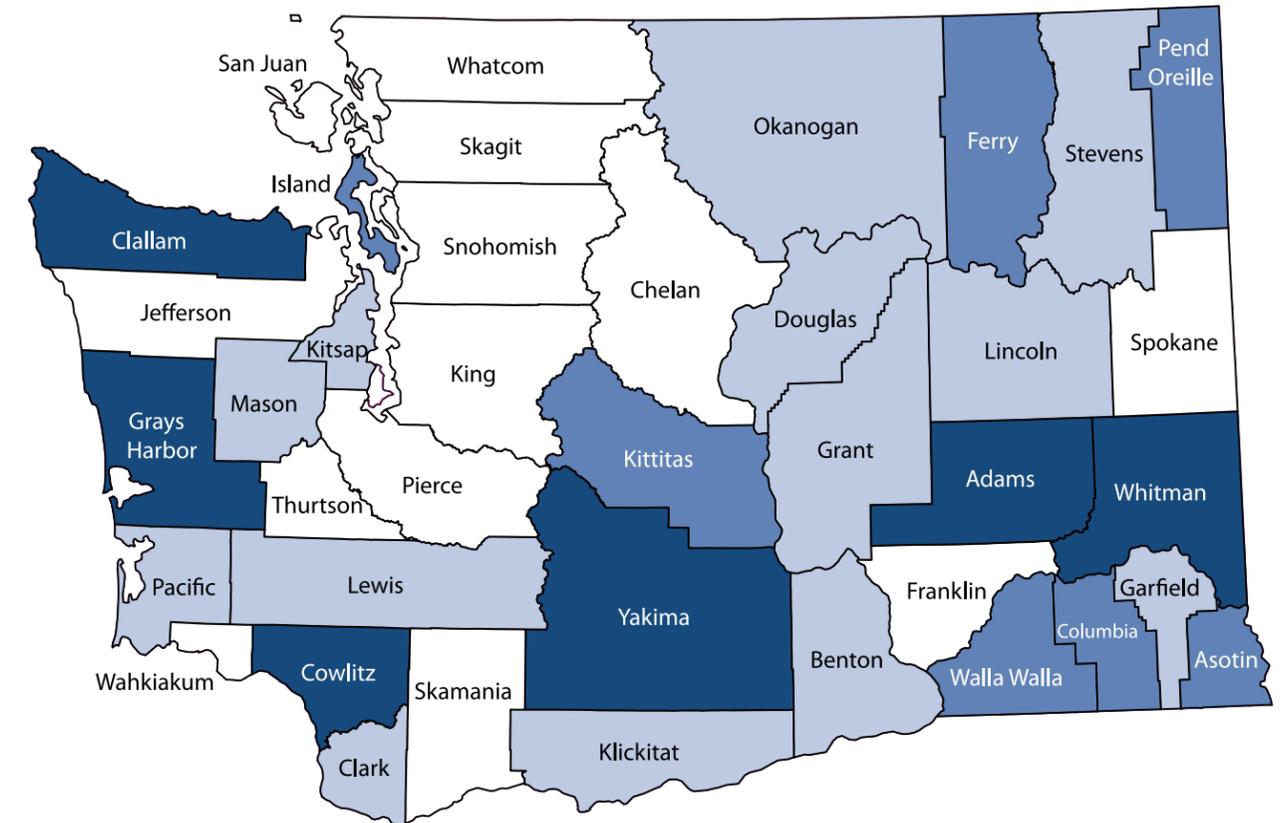
A healthy population is essential to Washington state's long-term economic growth and success. A healthy workforce is critical to compete in the global economy and healthy kids learn better in school. Wise investments in a high-quality health care system, as well as investments in clean air, water, and land protect public health and enhance quality of life for everyone.



Our Recommendations:

- > **Fully expand Medicaid under the Affordable Care Act (ACA)** which would provide health care for 261,000 people in Washington state and save approximately \$200 million in 2014-15.
- > **Ensure affordability and continuity of care for low-income working families** by pursuing options, such as the Federal Basic Health Option, that make coverage affordable.
- > **Protect the health care Exchange**, which will create a new marketplace for insurance companies to offer affordable health insurance to individuals and small businesses. The Exchange needs a stable and predictable source of revenue to allow it to be self-sustaining.
- > **Restore funding for cleanup of toxic sites** around the state that threaten air, water, and land quality in our communities.

One-Third Of Uninsured Will Gain Coverage Under Medicaid Expansion



Percent of Uninsured Eligible by County

- 20- 29%
- 30- 34%
- 35- 39%
- 40-50%

Source: Budget & Policy Center calculations of data from the Office of the Insurance Commissioner (OIC). This map is for illustrative purposes only—the percentages are based off of the OIC's estimated number of uninsured people eligible under the expansion, which differs from Urban Institute estimates.

FAST FACTS

261,000

The number of additional people covered under Medicaid expansion by 2020.

1 in 6

The number of Washingtonians under age 65 who lack health insurance.

-74%

The estimated reduction in uninsured Washingtonians due to the passage of the Affordable Care Act.

12,000+

The number of confirmed and suspected toxic sites in Washington state, most of which are near Puget Sound and other major waterways.

ECONOMIC SECURITY

Restore and strengthen programs that help families find and keep a job

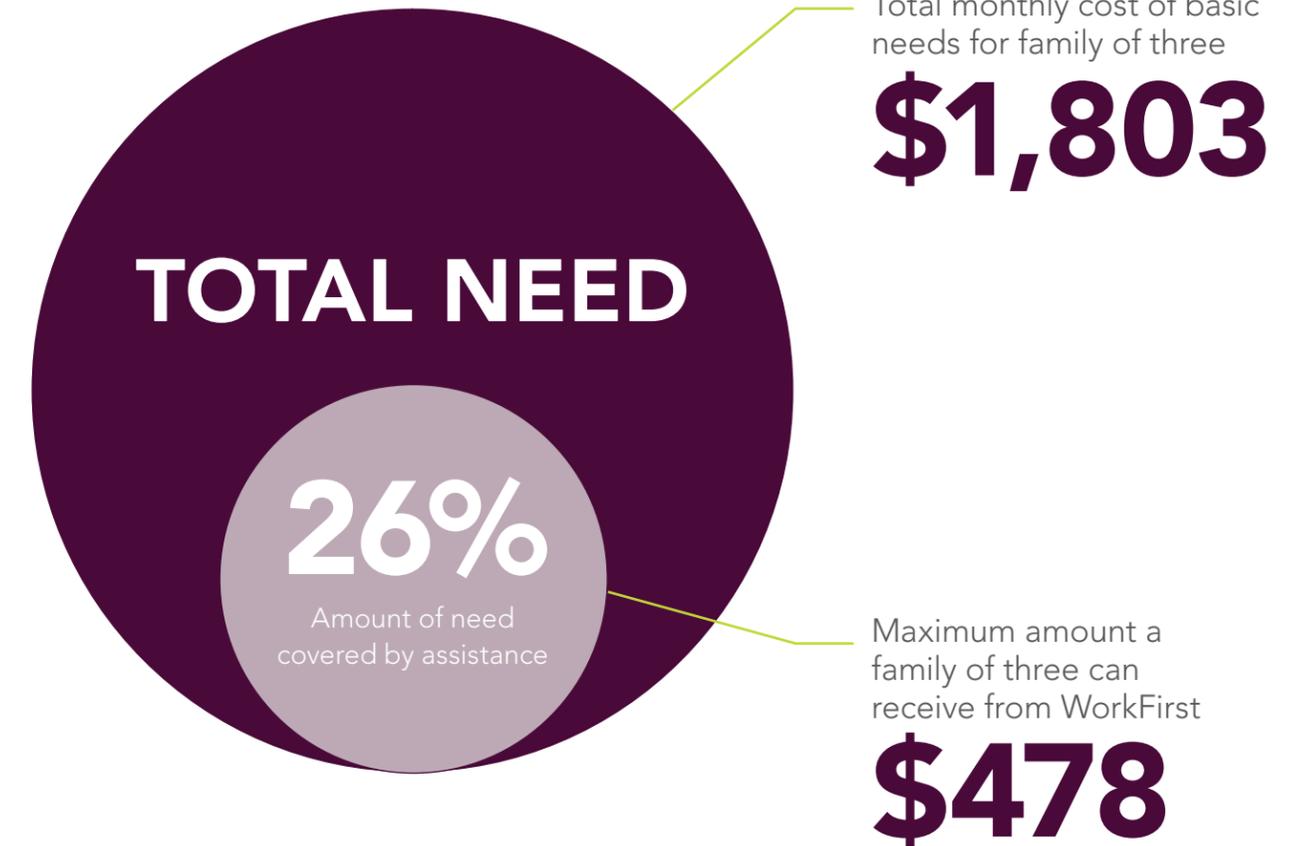
It's crucial that hard-working Washingtonians have pathways to enter and stay in the middle class. Helping low-income people meet basic needs while they work or look for a job saves money in the long run and provides greater stability for children and families. Strengthening policies that reward work is critical to our recovery and an essential part of a strong future economy.



Our Recommendations:

- > **Restore WorkFirst cash assistance to 2010 levels to help families meet basic needs while they work** at low-paying jobs or look for employment.
- > **Suspend the 60-month time limit** for families receiving WorkFirst in areas with high local unemployment.
- > **Increase the subsidy rate for Working Connections Child Care** to improve the quality of our early learning system and promote work.

Current Cash Assistance Covers Just One-Quarter Of A Family's Basic Needs



Budget & Policy Center analysis of Federal Poverty Guidelines and WAC 388-478-0015

FAST FACTS

WorkFirst

is Washington state's program for helping low-income parents with children find and keep a job.

2 OUT OF EVERY 3

people kicked off WorkFirst is a child.

\$127 MILLION

The amount cut from WorkFirst, the largest single cut to the entire budget in 2012.

300,000+

The number of children living in poverty in Washington state.

-40%

The decline in value of WorkFirst cash assistance since 1996.

REVENUE

REVENUE SUMMARY

After the worst recession of our lifetime, rebuilding Washington state's economy must be policymakers first priority. To build a strong state, we need reforms that will create a more robust and stable revenue system that is able to meet the demands of the 21st century economy.

Washington state's revenue system is:

- > **Behind the times.** Our state revenue system hasn't substantially changed since 1935. Seventy-seven years ago Washington state's economy was based on agriculture, manufacturing, and purchases of tangible goods. Today our state produces advanced software and other high-tech goods and services that weren't even imagined in the 1930s.
- > **Losing pace.** Just 40 years ago, our revenue system generated 6.9 cents of every dollar of personal income produced in the state. Today it generates only 4.9 cents per dollar of personal income. That's a 30 percent decline that won't abate without changes.
- > **Upside-down.** State taxes take a much larger bite out of family incomes among lower- and middle-income households compared to the richest households. As a share of their incomes, ordinary Washingtonians can pay up to *eight times* more in state and local taxes than those at the top of the income scale.



Bottom Line

Instead of de-funding our values with deep budget cuts, Washington state lawmakers should focus on making changes to our revenue system that will rebuild the economy to work for everyone.

BUILDING A 21ST CENTURY REVENUE SYSTEM: TAXING CAPITAL GAINS

We need long-term structural reform to help fuel economic recovery and stabilize Washington state's public resources. A tax on some of the profits from the sale of corporate stocks, bonds, and other high-end financial assets would bolster health care, education, and other investments proven to build a strong economy.

Our Recommendation:

Enact a **6.5 percent excise tax on capital gains over \$10,000 a year (\$5,000 for an individual)**. This would generate about \$700 million a year for education and other vital public priorities.

What Are Capital Gains?

Capital gains are profits from the sale of corporate stocks, bonds, and other financial assets. The proposal holds to federal law, which says capital gains taxes *do not* apply to assets held in retirement accounts, retirement income, or gains from the sale of a family home or primary residence.

Only the Richest Few Would Pay

Capital gains overwhelmingly go to the richest households making more than \$537,000 a year in Washington state. Exempting the first \$10,000 in gains means **98 percent of families would pay no additional taxes**.

A More Resilient Source of Revenue

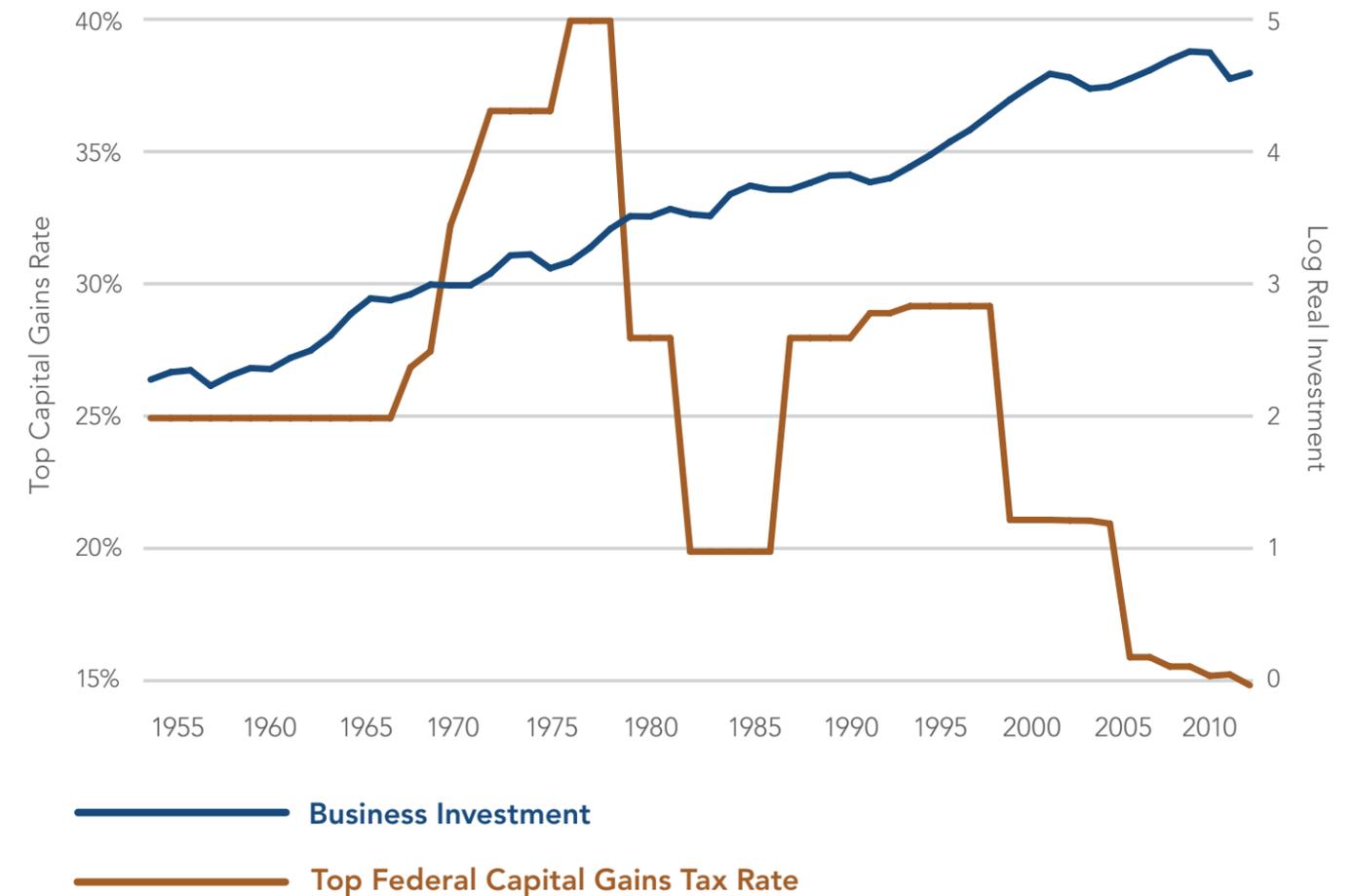
Washington state's tax system doesn't keep pace with the modern economy. Capital gains do; they recover far more quickly than other parts of the economy, helping to avoid the deep shortfalls of recent years. While employment, wages and salaries, and consumer spending have yet to recover, the stock market has grown 51 percent since the depth of the Great Recession.

Mirrors Sales Tax Rate

Our state's sales tax rate is 6.5 percent, under this proposal capital gains would be taxed at the same rate.

No Relationship Between Taxing Capital Gains and Investment

Top Capital Gains Rates Over Time Against Real Business Investment



Source: Budget & Policy Center analysis; data from Bureau of Economic Analysis (BEA), Center on Budget and Policy Priorities (CBPP) & Tax Policy Center (TPC).

FAST FACTS

42

other states benefit from capital gains taxes. **So should Washington state.**

98%

would not pay any capital gains taxes. Everyone benefits.

\$700 MILLION

per year in new resources.

Not a tax on **RETIREMENT SAVINGS.**

Not a tax on **FAMILY HOME SALES.**

Will not impact **GIFTED OR INHERITED ASSETS.**

MODERNIZING THE SALES TAX

Washington state's sales tax is way behind the times. When the sales tax was enacted in 1935, consumers spent most of their incomes on tangible goods—like cars, appliances, tools, and clothing. Today, consumers spend most of their incomes on services, such as massages and spa treatments, investment advice, satellite and cable TV, and hair styling. Yet, our aging sales tax hasn't been updated to reflect these changes in the state economy. As a result, our sales tax has become a much less efficient tool for financing public services.

Our Recommendation:

Policymakers should extend the sales tax to include a broad array of modern consumer services.

Generate new resources for vital public investments

Extending the sales tax to consumer services would create at least \$100 million per year in new public resources, depending on the number and type of services added.

Create a more adequate revenue system

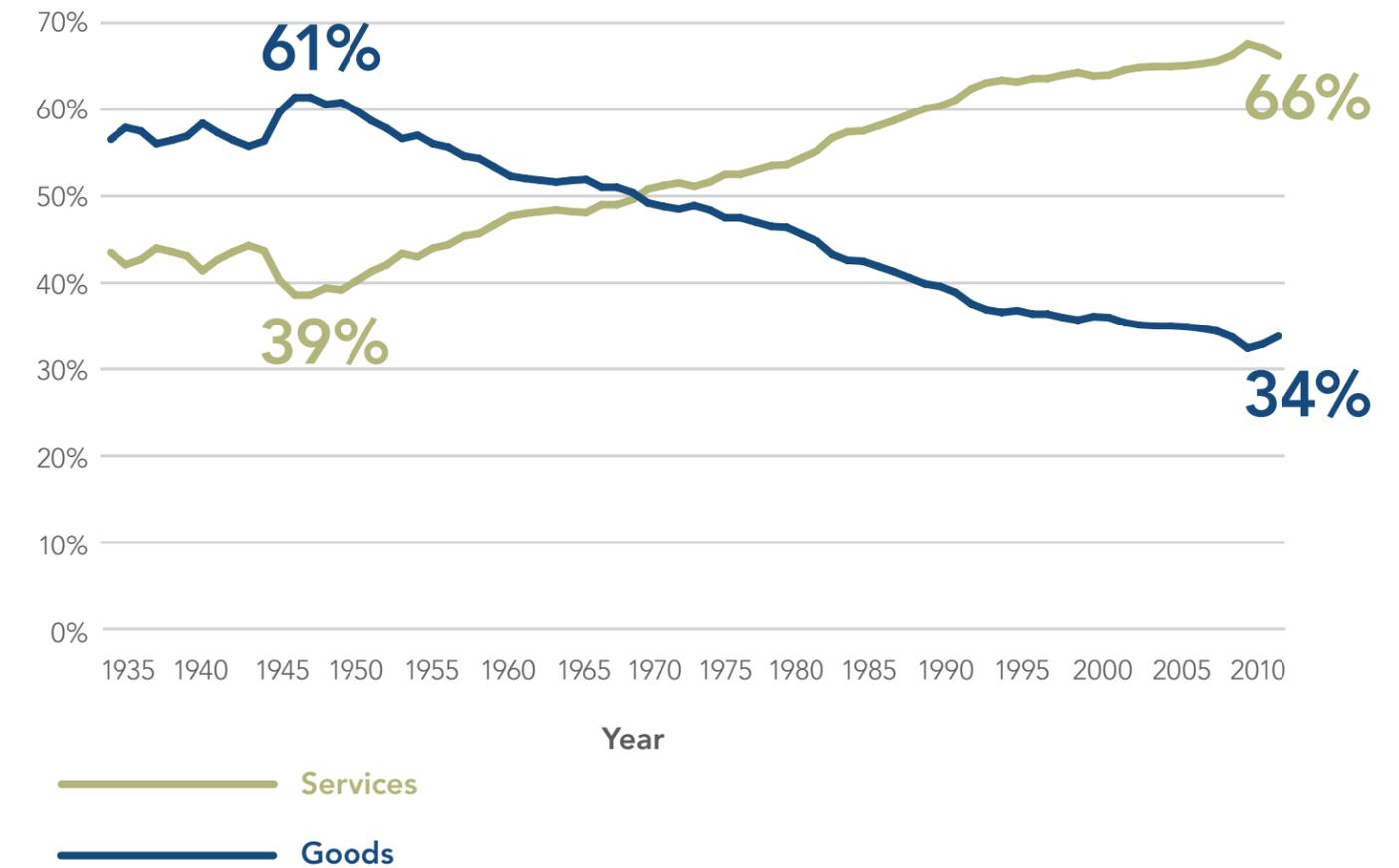
In 1979, taxable retail sales—that is, the scope of products included in the sales tax—represented about 60 percent of the total state economy. Today, the sales tax covers less than 40 percent of our state economy. Taxing services would help address this imbalance.

Level the playing field

Consumers who prefer to spend their incomes on durable goods pay taxes on those purchases while consumers who prefer to spend their money on services get a sizable tax break. Extending the sales tax to consumer services would even the playing field so that everyone helps to pay for shared investments in health care, education, and safe communities.

Consumers Now Spend Much More On Untaxed Services

Goods and services in the U.S. as a share of personal consumption expenditures, 1935-2010



Source: Budget & Policy Center calculations; data from the U.S. Bureau of Economic Analysis (NIPA 2.3.5)



WHAT'S TAXED

Goods

- Clippers
- Massager
- Toothpaste
- Jewelry
- DVD

Services

- Hair Styling
- Spa Treatment
- Teeth Whitening
- Body Piercing
- Cable and Satellite TV

WHAT'S NOT

WORKING FAMILIES TAX REBATE

In 2008, policymakers enacted the Working Families Tax Rebate (WFTR), which would help rebalance our tax system by reducing taxes for working families with children. Unfortunately, funding has not been allocated to get the program up and running. The WFTR is based on the federal Earned Income Tax Credit (EITC), our nation's most successful anti-poverty program.

Our Recommendation:

Fully fund the Working Families Tax Rebate at 10 percent of the federal EITC (Earned Income Tax Credit).

Provide a tax cut for 400,000 hard working families in Washington state

Annual WFTR funds would provide additional money to working families with children in every corner of the state.

Create a more equitable tax system

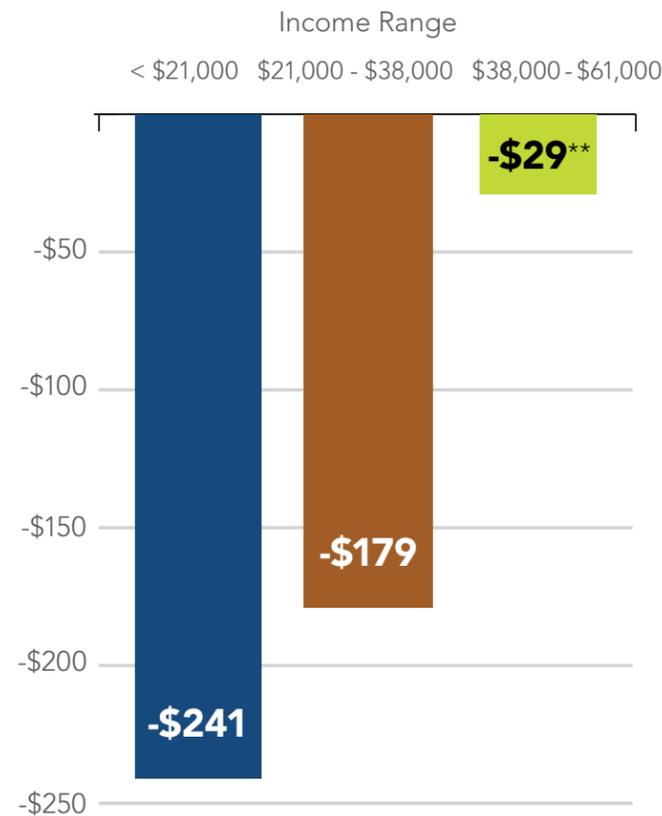
The WFTR would refund a portion of sales tax paid by hard-working families. It is only available to those who work.

Help children prosper

Nationwide, the EITC has been shown to boost academic success among children, leading to better careers later in life.

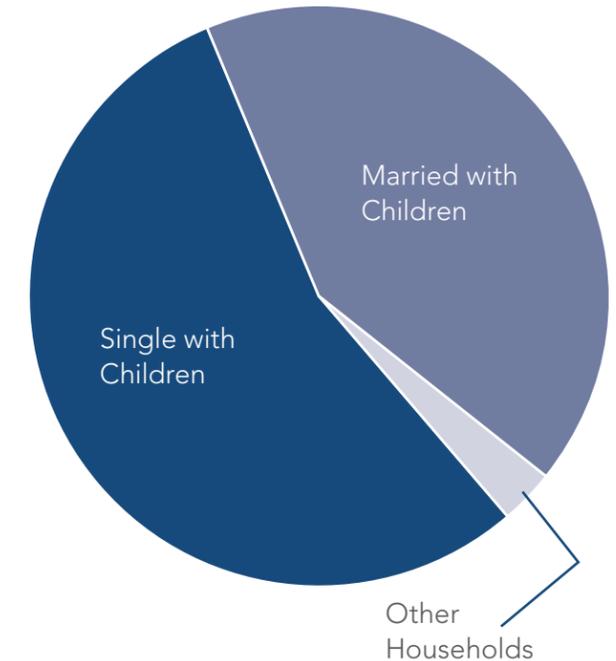
Working Families Tax Rebate Would Improve Our Upside-Down Revenue System

Average tax change by household income, fully funding the Working Families Tax Rebate, 2011*



Source: Institute on Taxation and Economic Policy (ITEP);
 * Assumes funding at 10% of federal EITC; average tax change among households with children.
 **Minimum rebate is \$50, this assumes not all households will receive the credit.

97 Percent Of Working Families Tax Rebate Goes To Families With Children



Source: Budget & Policy Center analysis; data from ITEP

FAST FACTS

LOW
administration costs.

Tax cut for
400,000
working families.

Rebates up to
\$589
per year.

Only goes to those who
WORK.

Promotes future success among
CHILDREN.

STRENGTHENING THE RAINY DAY FUND

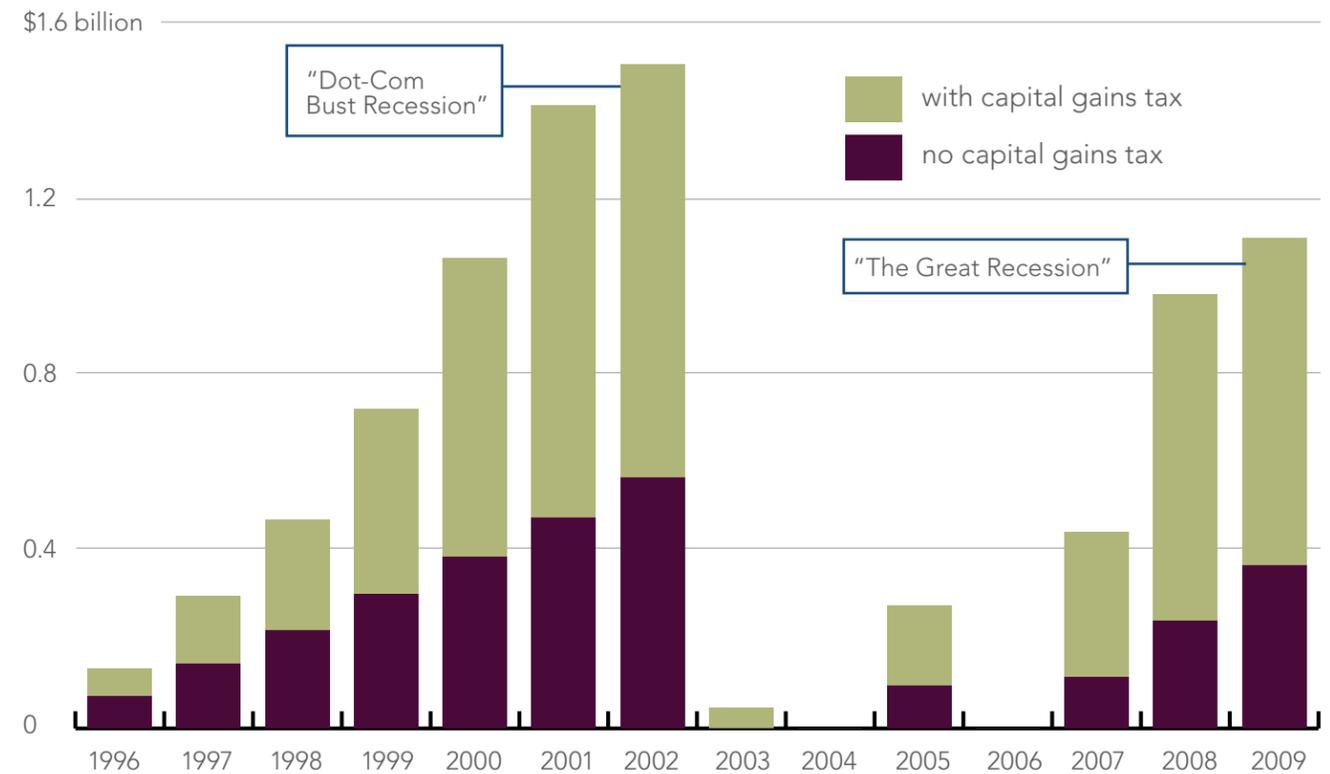
Rainy day funds (RDF) are a critical tool used by states to maintain job-creating public health and education services during recessions. But Washington state’s own RDF “Budget Stabilization Account” doesn’t provide an adequate backstop during difficult times. Even during good economic times, Washington’s revenue system doesn’t generate the kind of large surpluses needed to build a robust rainy day fund. In addition, the fund’s utility is hampered by limitations—including an onerous supermajority vote requirement needed to access the fund and counterproductive deposit rules.

Our Recommendations:

- > **Foster improved access and accountability:** Reserves should only be used to maintain core public services during recessions and other state emergencies; they should not be used to fund new spending programs or new tax breaks. Policymakers should ensure the funds are accessible and used responsibly by repealing the onerous supermajority (three-fifths legislative vote) requirement. They should also stipulate that the RDF is only to be used when tax revenues are projected to fall short of the amount needed to maintain current levels of services.
- > **Ensure the rainy day fund does not hinder recovery efforts by modifying deposit requirements:** Contributions to the Budget Stabilization Account should be suspended during economic downturns and only be allowed to resume when conditions improve. This could be accomplished by establishing an economic “trigger”—such as when total personal income is projected to grow by more than 11 percent in the coming fiscal year.
- > **Use proposed capital gains tax revenues to build a more robust rainy day fund:** Dedicating up to 35 percent of the revenue from our capital gains tax proposal would create a true rainy day fund in Washington state—one that provides sufficient resources during recessions to maintain core public services while the economy improves.

Capital Gains Tax Savings Would Have Helped During Previous Recessions

Cumulative Rainy Day Fund balances had 35 percent of capital gains tax revenues dedicated to the Budget Stabilization Account, fiscal years 1996-2009*



Budget & Policy Center analysis; data from ITEP, ERFC, and LEAP.

*Revenues from a 5 percent excise tax on capital gains with a \$10,000 exemption (\$5,000 for single filers)

FAST FACTS

STABILIZES REVENUE.

Helps maintain vital investments during **EMERGENCIES.**

PROMOTES far-sighted budgeting.

Bolsters state’s **CREDIT RATING.**

OUR MISSION

To use research and analysis to advance the well-being of Washington communities, improve the economic security and social opportunity of all in the state, and support the essential role of government in promoting a just and prosperous society.

SUPPORT OUR WORK

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The Budget & Policy Center operates solely within Washington state. We limit our fundraising focus to Washington state, and we do not target other states for fundraising. budgetandpolicy.org/donate

SOURCES

All of our analysis in this document can be found in previously published policy briefs and other materials on our website at budgetandpolicy.org

Investments

Education and Opportunity

"Declining Support for Education Threatens Economic Growth."

"Maybe When You're Older: Prosperity and Young Adults in Washington State."

Thriving Communities

"A Truly Balanced Budget Would Account for All Costs."

Tax Break Reform

"Every Dollar Counts: Why It is Time for Tax Expenditure Reform."

Healthy People and Environment

"Series on Health Reform: Increase Care, Reduce Costs."

"Senate Budget Cuts Put Our Environment and Health at Risk."

Economic Security

"In Pursuit of Prosperity: Eight Strategies to Rebuild Washington State's Economy."

Revenue

Capital Gains Tax

"A Capital Reform: Using Capital Gains to Fuel Job Creation and Economic Prosperity in Washington State."

Expanding the Sales Tax

"Increasing and Modernizing the Sales Tax."

Working Families Tax Rebate

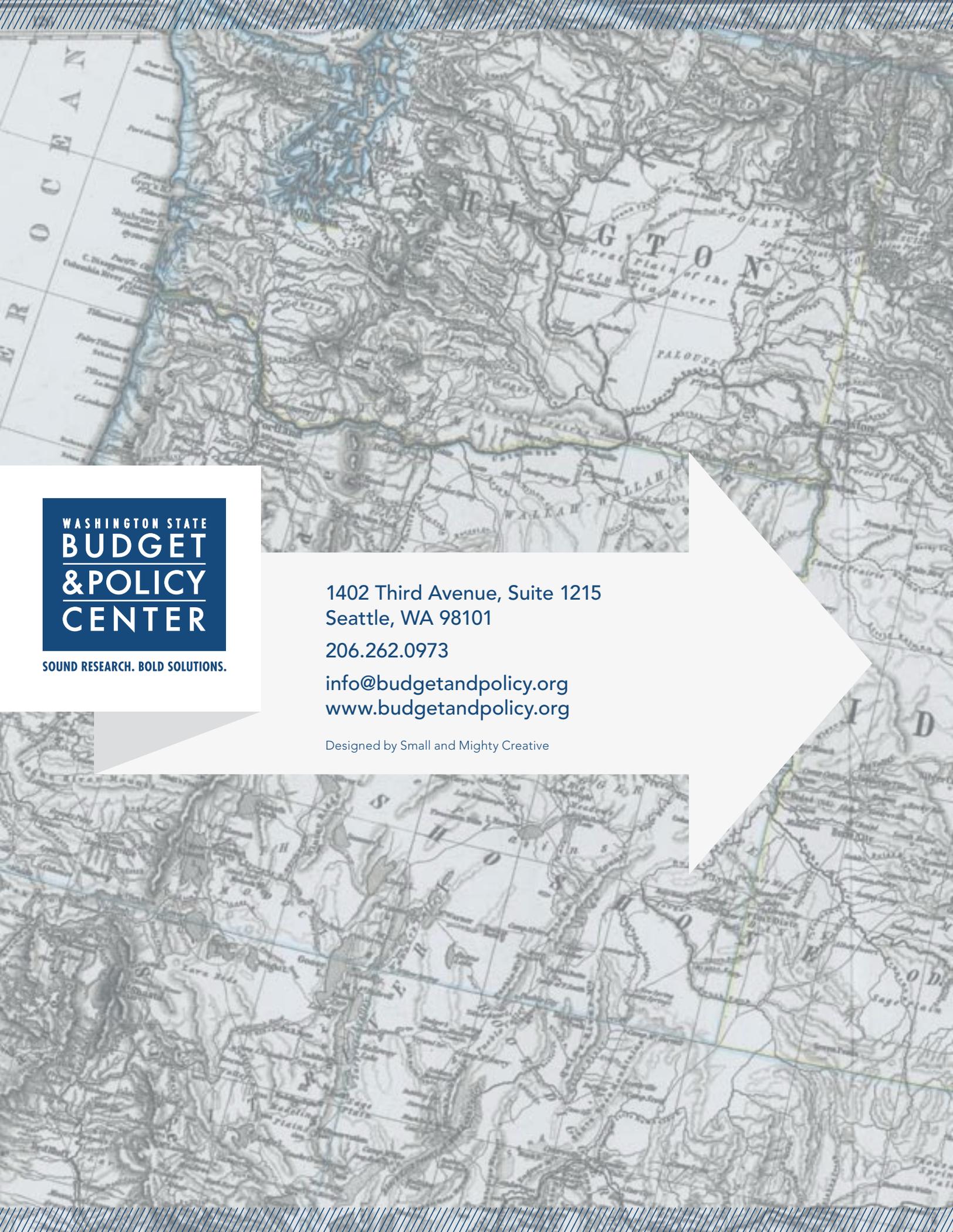
"Why the Working Families Tax Rebate Would Work for Washington."

Rainy Day Fund

"Strengthening Washington's Rainy Day Fund."

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