Washington Research Council

*Policy Brief*

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# Senate- and House-Passed Operating Budgets Would Needlessly Drain the Rainy Day Fund

**Briefly**

*The Senate and House have passed broadly similar operating budgets. Both would impose a capital gains tax. Both would increase spending from funds subject to the outlook (NGFO) by double digits in 2021–23. Both would appropriate billions of dollars in federal relief funds. Both would drain the rainy day fund.*

*Across the 2021 supplemental and the 2021–23 biennial budgets, policy spending from the NGFO plus federal relief would increase by $10.067 billion in the Senate budget and by $10.817 billion in the House budget. Substantial spending differences between the two include:*

- *The Senate would appropriate $800.0 million from the NGFO to reduce the unfunded actuarial accrued liability of the Teachers' Retirement System (TRS) plan 1 (even though there are proposals to address this by combining retirement plans).*
- *For small business grants and the small business credit initiative, the Senate would appropriate $142.8 million in federal relief and the House would appropriate $392.8 million in federal relief.*
- *For rental assistance, the Senate would appropriate $495.2 million in federal relief and the House would appropriate $1.172 billion in federal relief.*

*In some cases, the two budgets would fund programs at similar levels but use different funding sources. For example, for the unemployment insurance relief account, the Senate would appropriate $500.0 million from the NGFO and the House would appropriate $600.0 million in federal relief dollars.*

*Given the high level of proposed spending, the use of one-time federal relief to start new, ongoing state programs, and the unnecessary use of the rainy day fund, sustainability is a concern with both budgets. Additionally, the proposed capital gains tax is not needed to balance the budget; instead, this revenue would be used to fund new programs. Both budgets would address the current economic uncertainty by effectively creating shadow reserve accounts. But because these reserves would not be subject to constitutional restrictions, both budgets would water down our constitutional rainy day fund.*

The Senate and House have passed broadly similar operating budgets. For the supplemental to the 2019–21 budget, the Senate would appropriate $52.704 billion from funds subject to the outlook (NGFO) and the House would appropriate $52.319 billion. (These proposals would increase spending compared to 2017–19 by 17.9% and 17.1%, respectively.) For 2021–23, the Senate would appropriate $59.282 billion and the House would appropriate $58.479 billion. (These proposals would increase spending compared

Table: NGFO Balance Sheet (Dollars in Millions)

| | Senate-Passed | | House-Passed | |
|---|---|---|---|---|
| | *2019-21* | *2021-23* | *2019-21* | *2021-23* |
| Beginning Balance | 1,981 | 3,938 | 1,981 | 2,245 |
| Revenue | | | | |
| March 2021 Revenue Forecast | 52,334 | 56,615 | 52,334 | 56,615 |
| **Capital Gains Tax** | **0** | **357** | **0** | **357** |
| **Other Revenue Changes** | **5** | **(2)** | **(2)** | **(60)** |
| *Total Revenue* | *52,339* | *56,970* | *52,332* | *56,913* |
| Other Resource Changes | | | | |
| Transfer to Budget Stabilization | (498) | (543) | (494) | (543) |
| Other Enacted Fund Transfers | 195 | | 195 | |
| **Proposed Transfer from BSA** | **1,820** | | | |
| **Other Proposed Fund Transfers** | **18** | **(969)** | **(233)** | **236** |
| CAFR/Prior Period Adjustments | 84 | 41 | 84 | 41 |
| *Total Other Resource Changes* | *1,620* | *(1,471)* | *(448)* | *(266)* |
| *Total Resources* | *55,940* | *59,436* | *53,865* | *58,891* |
| Spending | | | | |
| Enacted 2019-21 Appropriations | 53,700 | | 53,700 | |
| **Maintenance Level Change** | **(926)** | | **(926)** | |
| **Maintenance Level** | | **55,983** | | **55,983** |
| **New Policy** | **(69)** | **3,300** | **(455)** | **2,496** |
| Actual/Assumed Reversions | (702) | (282) | (699) | (293) |
| *Total Spending* | *52,002* | *59,001* | *51,620* | *58,186* |
| Unrestricted Ending Fund Balance | 3,938 | 436 | 2,245 | 705 |
| Budget Stabilization Account Balance | 1,618 | 0 | 1,618 | 0 |
| Transfers from GFS and Interest | 541 | 544 | 537 | 544 |
| Appropriations from BSA | (364) | | (364) | |
| Return of 2020 Appropriations | 25 | | 25 | |
| **Proposed Withdrawal** | **(1,820)** | | **(1,816)** | |
| Projected BSA Ending Fund Balance | 0 | 544 | 0 | 545 |
| *Total Reserves* | *3,938* | *980* | *2,245* | *1,249* |

Note: Totals may not sum due to rounding.

to the 2021 supplementals by 12.5% and 11.8%, respectively.)

The NGFO appropriations would be augmented with federal relief dollars. The state has already allocated $7.311 billion in federal relief for 2019–21, and the budgets would appropriate additional federal relief for the two biennia.

## Balance Sheet

The table to the left shows a state balance sheet in terms of the NGFO. It does not include the substantial federal relief that both the Senate and House would appropriate.

**Revenues**. The Senate would increase 2021–23 revenues by $355.0 million and the House would increase 2021–23 revenues by $297.5 million. Both proposals rely on a new capital gains tax (ESSB 5096), which is estimated to increase NGFO revenues by $357.0 million in 2021–23 and $719.0 million in 2023–25. Additionally, the Senate assumes passage of SB 5315 (imposing a premium tax on captive insurers), which would increase revenues by $34.2 million in 2021–23. (The House did not include the captive insurance revenues in its balance sheet, but the House has since passed the bill.) The House assumes passage of HB 1015 (creating a business and occupation tax credit for contributions to a new "equitable access to credit program"), which would reduce revenues by $19.0 million in 2021–23.

**Other Resources**. The Senate would transfer $1.820 billion from the budget stabilization account (BSA, or the rainy day fund) to the general fund–state (GFS) in 2019–21. Then, in 2021–23, the Senate would

**NGFO**

Under the four-year balanced budget requirement, a positive ending balance is required in both the current and following biennium for "funds subject to the outlook." This is a synthetic "account" that rolls up the general fund–state (the state's primary budget account) with the education legacy trust account, the opportunity pathways account, and the workforce education investment account. It is also called the near general fund–outlook, or NGFO.

transfer $800.0 million from the GFS to the disaster response account. Also in 2021–23, the Senate would transfer $142.2 million from the GFS to the new taxpayer fairness account (created in the capital gains tax bill), $50.0 million from the GFS to the developmental disabilities community trust account, and $26.0 million from the GFS to the forest resiliency account.

In 2019–21, the House would transfer $155.0 million from the GFS to the new "Washington rescue plan transition account" and $73.3 million from the GFS to the disaster response account. In 2021–23, the House would transfer $144.0 million from the public works assistance account to the education legacy trust account (ELTA).

Both budgets would transfer funds from the GFS to the workforce education investment account (WEIA). In 2019–21, the Senate would transfer $75.0 million from the GFS to the WEIA and the House would transfer $80.0 million from the GFS to the WEIA. The Senate would transfer another $9.0 million from the GFS to the WEIA in 2021–23.

**Spending**. In both proposals, maintenance level changes (the cost of continuing current services, adjusted for inflation and caseloads) would reduce 2019–21 appropriations by $926.0 million. New policy would reduce 2019–21 appropriations by another $69.4 million in the Senate and $454.9 million in the House. (The main difference between the two supplementals is that the Senate would appropriate $299.0 million for K–12 transportation emergency funding, offsetting other reductions.) The maintenance level for 2021–23 is estimated to be $55.983 billion. New policy in 2021–23 would add $3.300 billion in the Senate and $2.496 billion in the House.

**Reserves**. The Senate proposals would leave an unrestricted NGFO ending balance of $436 million in 2021–23 and the House proposals would leave $705 million. Both the Senate and House would drain the BSA, leaving a balance of zero in 2019–21. At the end of 2021–23, the BSA would have an estimated $544 million under the Senate proposal and $545 million under the House proposal.

## Revenue Details

**Capital Gains Tax**. Both the Senate and House budgets rely on a capital gains tax, but so far only the Senate has passed the capital gains tax bill (ESSB 5096). The 7% tax would apply to gains of more than $250,000. (Some gains would be exempt, including those from real estate, retirement savings accounts, and livestock.) Each year, the first $350.0 million collected from the tax would be dedicated to the ELTA, the next $100.0 million would be dedicated to the GFS, and the rest would go to a new "taxpayer fairness account." The fiscal note estimates that the taxpayer fairness account would receive $126.0 million in 2021–23 and $347.0 million in 2023–25. The Legislature intends to use the ELTA portion for early learning and child care and the taxpayer fairness account portion for the working families tax exemption. (Note that since passage of the budgets, the House Committee on Finance has approved a substitute version of SB 5096 that would dedicate all collections to the ELTA.)

**Recorded Document Surcharge**. The House has passed a bill (E2SHB 1277) that would levy a $100 surcharge on each document recorded. Collections would mostly go to the home security fund account to fund a new "eviction prevention rental assistance program." The fiscal note estimates that the surcharge would increase revenues for the home security fund account by $265.7 million in 2021–23 and by $271.6 million in 2023–25. These revenues do not appear in the NGFO balance sheet, but they would be used to fund housing programs that might otherwise be funded with the NGFO.

## Federal Relief

Since the pandemic began last year, Congress has appropriated more than $24 billion in relief funding that has or will be allocated by Washington's state and local governments (WRC 2021b). Of the federal relief, $7.311 billion has already been allocated by the state in 2019–21 (Makings 2021b).

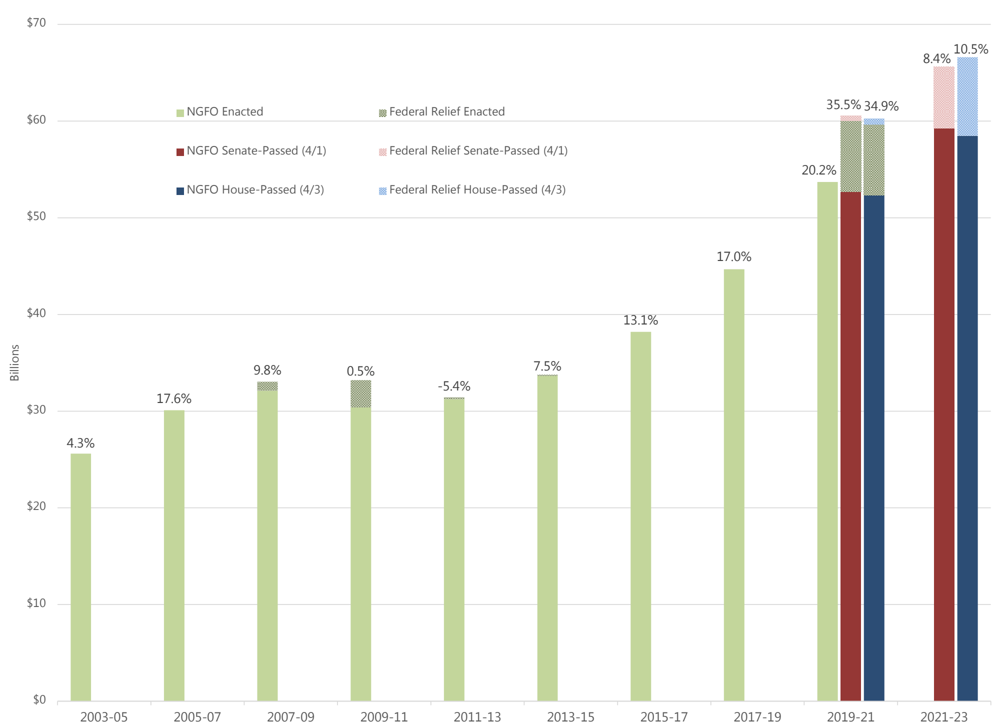
In addition to the $7.311 billion, the Senate would appropriate $514.0 million in 2019–21 and $6.323 billion in 2021–23 in federal relief. The House would appropriate $644.2 million in 2019–21 and $8.132 billion in 2021–23. Under the federal legislation, some of this funding must go to specific purposes (e.g., schools or COVID testing), but other funding is more flexible.

The Senate, by appropriating less federal relief than the House, is effectively keeping some funding in reserve. It is not yet known exactly how much federal relief the state will have to appropriate, but, as an example, Washington's share of the coronavirus state fiscal recovery fund (part of the most recent federal bill) is estimated to be $4.253 billion. Of that, the House would appropriate $3.493 billion and the Senate would appropriate $1.910 billion (across the operating, capital, and transportation budgets).

In terms of the NGFO plus federal relief, the Senate would appropriate $60.530 billion in 2019–21 (an increase of 35.5% over 2017–19) and $65.605 billion in 2021–23 (an increase of 8.4% over 2019–21). The House would appropriate $60.275 billion in 2019–21 (an increase of 34.9% over 2017–19) and $66.611 billion in 2021–23 (an increase of 10.5% over 2019–21). (See Chart 1.)

These proposed federal relief appropriations do not include the impact of the enhanced federal Medicaid match. The enhanced match supplants NGFO spending, so it is accounted for as NGFO savings. Altogether, over three years, the enhanced match saves the NGFO $1.264 billion in the Senate budget and $1.274 billion in the House budget.

Chart 1: Operating Budget Spending, NGFO+Federal Relief (Level and Growth from Prior Biennium)




## Spending Details

The spending details below combine the policy changes in the 2021 supplemental and 2021–23 biennial budgets. Chart 2 (on page 5) shows proposed policy changes from the NGFO and federal relief over the three-year period by budget area. (It does not include the $7.311 billion already allocated.) Over the three-year period, policy spending from the NGFO plus federal relief would increase by

$10.067 billion in the Senate budget and by $10.817 billion in the House budget.

**Special Appropriations**. Federal relief would fund $900.0 million for COVID testing and tracing in both budgets. For vaccines, the Senate would appropriate $100.0 million in federal relief and the House would appropriate $140.0 million in federal relief. For the public health workforce, the Senate would appropriate $100.0 million in federal relief and the House would appropriate $145.0 million in federal relief. For foundational public health, the Senate would appropriate $150.0 million from the NGFO and the House would appropriate $100.0 million NGFO.

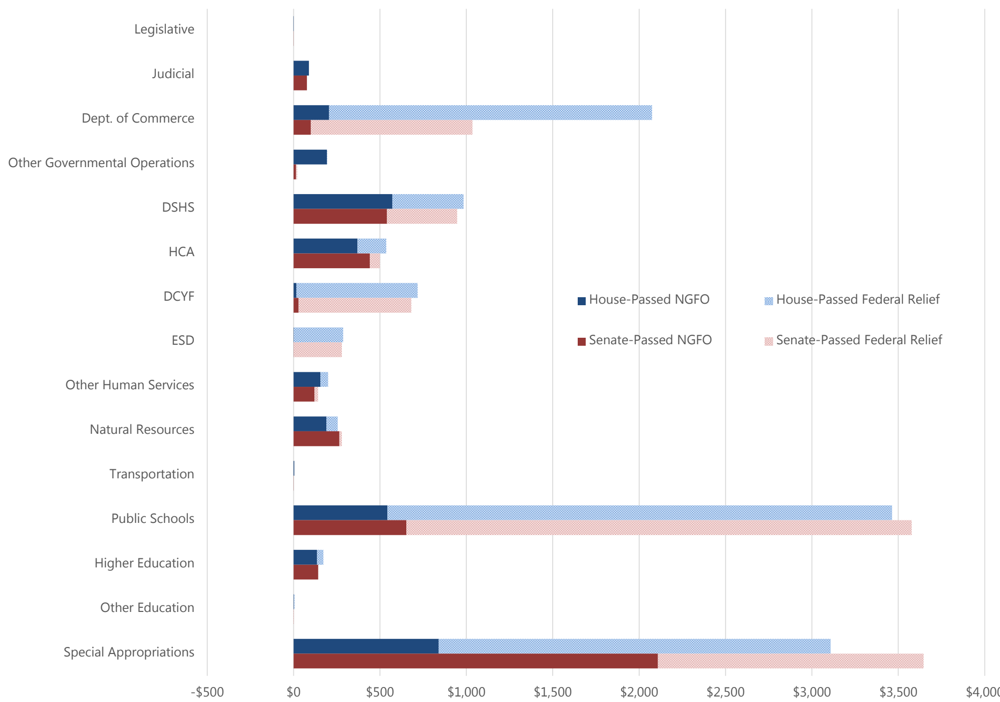
The Senate would appropriate $100.0 million from the NGFO to a new health care affordability account. (SB 5377 would provide premium assistance for individuals purchasing health care insurance on the Health Benefit Exchange.) The House would appropriate $146.5 million from the NGFO for Medicaid home and community-based services enhancements (similar funding is also provided in the Senate budget but is accounted for in the Department of Social and Health Services and the Health Care Authority).

The Senate and House would distribute $438.0 million and $483.4 million, respectively, to local governments from the federal coronavirus local fiscal recovery fund. The House would appropriate $144.0 million NGFO for city and county assistance. The budget bill notes that this appropriation includes funding for reimbursements under the unfunded mandates statute (RCW 43.135.060) "for the costs of new or increased services as a result of legislation enacted between January 1, 2020 and June 30, 2021." Those costs would include any reimbursements owed if a 2020 Superior Court ruling related to election costs is upheld.

For unemployment insurance, the Senate would appropriate $82.0 million from the NGFO to the unemployment compensation fund. Additionally, the Senate would appropriate $500.0 million from the NGFO to the state unemployment insurance relief account (SB 5478). The House would provide $600.0 million in federal relief for the unemployment insurance relief account.

The House would appropriate $125.0 million from the NGFO for the wildfire response, forest restoration, and community resilience account (HB 1168). (The Senate would also make this appropriation, but it is accounted for in the Department of Natural Resources.)

Chart 2: NGFO+Federal Relief Policy Changes, 2021 and 2021–23 (Dollars in Millions)




Note: The chart removes the impact of the enhanced federal Medicaid match (which supplants state funding) to better reflect proposed spending.

The Senate would appropriate $800.0 million from the NGFO to reduce the unfunded actuarial accrued liability of the Teachers' Retirement System (TRS) plan 1. Note that neither budget would take advantage of an idea included in earlier Republican budget proposals to merge TRS 1 with the Law Enforcement Officers' and Firefighters' System plan 1. This would eliminate the TRS 1 unfunded liability and save the state about $700 million in 2021–23 (Makings 2021a).

**Public Schools**. The Senate would increase NGFO spending for schools by $652.9 million and would appropriate $2.925 billion in federal relief. The House would increase NGFO spending by $542.9 million and would appropriate $2.921 billion in federal relief. The bulk of the federal relief is elementary and secondary school emergency relief (ESSER) funding for school districts. The latest ESSER round set aside $1.667 billion for school districts in Washington, of which $333.5 million must be used to address learning loss.

The Senate and House would appropriate additional funds for learning loss as well. The Senate would appropriate $27.4 million from the NGFO and $172.6 million in federal relief for general accelerated learning opportunities (plus $27.5 million in federal relief for specified summer reengagement and learning loss programs). The House would appropriate $105.9 million in federal relief for general learning loss (plus $37.1 million in federal relief for specified summer enrichment and afterschool programs). Additionally, the House would provide $278.1 million from the NGFO to cover five additional days of school. (The funds could also go toward staffing to support students most affected by the disruption of in-person learning, professional learning for educators focused on learning recovery and acceleration, assessment or data systems, or direct supports to students.)

Public schools have experienced a drop in enrollment related to the pandemic and remote learning. Because most school funding is tied to enrollment, both the Senate and House would appropriate funds to stabilize revenues for districts. The Senate would appropriate $258.0 million from the NGFO and $100.0 million from a new "public schools emergency transportation relief account" for transportation stabilization (SB 5128). Additionally, the Senate would appropriate $201.2 million from the NGFO for other stabilization funding. The House would appropriate $3.0 million for these purposes from the NGFO and $50.0 million in federal relief.

**Department of Commerce**. For small business grants and the small business credit initiative, the Senate would appropriate $142.8 million in federal relief and the House would appropriate $392.8 million in federal relief. For rental assistance, the Senate would appropriate $495.2 million in federal relief and the House would appropriate $1.172 billion in federal relief. For foreclosure assistance, the Senate would appropriate $190.0 million in federal relief and the House would appropriate $183.0 million in federal relief.

Additionally, the House would appropriate $150.0 million from the home security fund for eviction prevention rental assistance and $121.6 million from the home security fund for housing and homelessness assistance. (This funding comes from the recorded document surcharge discussed above; it is outside of the NGFO and not included in Chart 2.)

**Department of Children, Youth, and Families (DCYF)**. Both budgets would appropriate federal relief funds for child care provider stabilization grants ($391.0 million in the Senate and $400.0 million in the House).

Additionally, both budgets would fund the Fair Start for Kids Act (SB 5237). The bill would expand eligibility, increase provider rates, and make various other changes to child care programs. Under current law, the Early Childhood Education and Assistance Program (ECEAP) will be an entitlement beginning in SY 2022–23. The bill would move the date of full implementation to SY 2026–27. This would save the state $57.9 million NGFO in 2021–23. Net of those savings, the Senate would appropriate $16.3 million from the NGFO for the Fair Start for Kids Act and the House would save $40.6 million NGFO. To fund the bill, the Senate would use $214.2 million in federal relief funds and the House would use $240.4 million in federal relief funds. The cost to the NGFO for this bill is expected to be $316.9 million in 2023–25, and that's still before the entitlement kicks in.

The Senate and House budget bills note, "The legislature finds that the state lacked the fiscal capacity to make these investments and the additional federal funding has provided the opportunity to supplement state funding to expand and accelerate child care access, affordability, and provider support as the state navigates the COVID-19 pandemic and its aftermath." Thus, federal relief funding would be used to start up an ongoing state program. (The Legislature would use the capital gains tax to fund these programs going forward, assuming it's not overturned at the ballot or in the courts.)

**Department of Social and Health Services (DSHS)**. NGFO policy changes, including savings from the enhanced federal Medicaid match, total *negative* $167.4 million in the Senate and *negative* $136.9 million in the House. (Chart 2 removes the impact of the federal match to better reflect proposed overall spending.)

Both budgets would extend temporary COVID rate enhancements for long-term care and developmental disabilities service providers. The Senate would appropriate $150.5 million NGFO to extend them through December 2021 and the House would appropriate $245.1 million NGFO to extend them through June 2022.

The Senate would appropriate $92.3 million NGFO to expand home and community-based services (the House would also expand these services, as noted above).

A 15% increase to the Temporary Assistance for Needy Families (TANF) grant is funded by the Senate ($25.0 million NGFO and $27.2 million in federal TANF funds). The House would provide $34.8 million NGFO for a 10% increase to the grant. For the immigrant relief fund, the Senate would appropriate $300.0 million in federal relief and the House would appropriate $340.0 million in federal relief.

**Health Care Authority (HCA)**. NGFO policy changes, including savings from the enhanced federal Medicaid match, total *negative* $94.3 million in the Senate and *negative* $175.8 million in the House. Both budgets would increase funding for primary care provider rates: $56.2 million NGFO in the Senate and $33.5 million NGFO in the House. The Senate would appropriate $60.4 million NGFO to expand home and community-based services.

Both budgets would use federal relief funds for a mental health block grant ($20.6 million in the Senate and $19.2 million in the House) and for a substance use block grant ($38.0 million in the Senate and $35.4 million in the House). The House would appropriate $35.0 million in federal relief for grants for health care for individuals up to 200% of the poverty level, $40.4 million in federal relief for health care insurance premium assistance for child care facility employees, and $31.0 million in federal relief for payments to behavioral health providers with Medicaid clients.

**Employment Security Department (ESD)**. For "assistance to individuals who are ineligible for Paid

Family Medical Leave due to not meeting the hours worked threshold during the pandemic-related shutdown" (E2SHB 1073), the Senate would appropriate $200.0 million in federal relief and the House would appropriate $204.7 million in federal relief.

Additionally, for unemployment insurance administration (including fraud prevention and appeals caseload), the Senate would appropriate $78.2 million in federal relief and the House would appropriate $80.5 million in federal relief.

**Other**. In the Department of Natural Resources, the Senate would appropriate $125.0 million for long-term forest health (HB 1168). (As noted above, the House would also provide this funding, but the House accounts for it in special appropriations.)

In the Department of Revenue, both budgets would fund the working families tax exemption. The House would appropriate $142.2 million from the NGFO and $126.0 million from the new taxpayer fairness account. The Senate would appropriate $268.2 million from the new taxpayer fairness account, after transferring $142.2 million from the NGFO to the taxpayer fairness account for this purpose.

## Reserves and Outlook

Both budgets would balance over four years. The Senate would leave an unrestricted NGFO ending balance of $50 million at the end of 2023–25 and the House would leave $63 million. At the end of 2023–25, the BSA balance would be $1.125 billion in both budgets.

The budgets would impose a capital gains tax to pay for new programs, but collections may never materialize if the tax is deemed unconstitutional or if voters reject it via referendum or initiative. Implicitly recognizing the uncertainty of that revenue source, both budgets would appropriate less than they could, given projected resources.

Under the four-year balanced budget requirement, the budget must balance within available fiscal resources. Available fiscal resources include the greater of the official revenue forecast or 4.5% revenue growth in each year. The House proposal assumes less than 4.5% revenue growth; thus, it balances over four years without the benefit of an additional $1.443 billion on the revenue side of the ledger.

Both budgets would drain the BSA and deposit some or all the money in other funds. The House would appropriate the balance of the BSA in 2019–21 ($1.816 billion) to a new "Washington rescue plan transition account." According to the budget bill, the account could be used to respond "to the impacts of the COVID-19 pandemic including those related to education, human services, health care, and the economy. In addition, the legislature may appropriate from the account to continue activities begun with, or augmented with, COVID-19 related federal funding." (That is, the funding could be used to fund the child care enhancements if the capital gains tax doesn't pan out.)

There are no immediate appropriations from the account. Instead, at the press conference announcing the budget proposal, Rep. Sullivan said, "if there's a need that comes about that we weren't expecting, or if the economy declines over the next several months, we'll have that $2 billion in that transition account to help fund those needs" (HDC 2021).

Similarly, after transferring the balance of the BSA to the GFS, the Senate would park $800 million in the disaster response account "to be available for appropriation in case of unanticipated disaster and recovery efforts, for fiscal year 2022."

## Comment

We have shown that with the increased revenue forecasts over the past year and billions in federal relief funds, new taxes are not needed this year to balance the budget (WRC 2021a). But the budgets passed by the Senate and House would use one-time federal relief for at least one new, ongoing program (child care). Including federal relief funds, the spending increases in these budgets are the highest they've been going back to at least the mid-1990s. Overall, sustainability is a major concern.

Both budgets would needlessly drain the BSA. Funds taken from the BSA would be held as reserves in other accounts. But the funds could better serve that purpose if they remained in the BSA. Under the state constitution, a supermajority vote is required to tap the BSA unless the governor declares a state of emergency resulting from a catastrophic event (in which case the funds must be used for the emergency) or employment growth is estimated to be less than 1%. Because employment growth is forecast to be less than 1% in FY 2021, the Legislature currently needs only a simple majority to use the BSA for any purpose. Next year, if the economy continues to improve, they may need a three-fifths majority. The proposed Washington rescue plan transition account and the disaster response account are subject to no such restriction. The proposed budgets are playing a shell game with emergency reserves, which undermines the sustainability of the budget.

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