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THE 2010 SUPPLEMENTAL BUDGET

BRIEFLY

The enacted supplemental budget simply rolls the state's fiscal difficulties forward another year. When, next year, the legislators sit down to write a budget for the 2011–13 biennium, they will most likely again face a multi billion dollar gap between revenues and expenses.

Governor Chris Gregoire signed the supplemental operating budget bill on May 4. With projected ending reserves of \$453 million, the budget is technically in balance. This balance, however, is achieved through heavy reliance on one-time resources such as federal stimulus funds and fund balances. As a result, budget writers will face another large budget gap in 2011.

2009–11 BALANCE SHEET

On page 2 we present a 2009–11 balance sheet that rolls up three accounts, the general fund–state (GF-S), the education legacy trust account (ELT) and the opportunity pathways account (OP).

For the past several years our analyses of state spending have made use of a synthetic “account” called the near general fund–state (NGFS), which rolls together GF-S, the state’s main budget account, with eight smaller accounts that have functioned as adjuncts to the GF-S (see the box on page 9). Last year, in a victory for fiscal transparency, the legislature consolidated six of those smaller accounts into the GF-S, effectively reducing the NGFS to two accounts, the GF-S and the education legacy trust account. (The eighth related account, the pension funding stabilization account is inactive.) This year, however, in a step backward, the Legislature created a new account, the opportunity pathways account, from which it funds educational programs that had previously been funded from the NGFS. Ignoring spending from the opportunity pathways account would give an incomplete picture of the supplemental budget. We will refer to the rollup of the GF-S, the ELT and the OP by the abbreviation NGFS+OP.

We have based our NGFS+OP balance sheet on the NGFS balance sheet presented by the Senate Ways and Means Committee in its overview of the budget passed by the legislature (SWM 2010), with adjustments to include revenues to and spending from the OP, and to reflect the partial vetoes made to the legislative budget by the governor.

The GF-S and ELT began the current biennium with a combined balance of \$399 million.

The February forecast pegs GF-S and ELT revenue for the biennium at \$29.2 billion. The bill that established the opportunity pathways account (E2SSB 6409) dedicates to it lottery revenues that had previously been dedicated to the education construction account. These revenues are expected to total \$114 million for the remainder of 2009–11. The state Supreme Court decision in the DOT Foods case is projected to reduce revenues by \$154 million (see WRC 2010). The two major revenue bills passed by the legislature (ESSB 6143 and ESHB 2493) will provide \$769 million in new revenue over the remainder of the biennium, while seven other bills altogether reduce 2009–11 revenue by \$12 million (WRC 2010b). The state constitution re-

quires that \$252 million be transferred from the GF-S to the state’s rainy day fund (the budget stabilization account). After this transfer, net revenue to the NGFS+OP is \$29.70 billion.

The original 2009–11 budget (enacted in 2009) transferred \$45 million to NGFS+OP from the rainy day fund. Adjustments and other fund transfers added \$831 million, net. The enacted 2010 supplemental budget transfers to the NGFS another \$207 million from the rainy day fund, \$187 million from

capital-related accounts, and \$274 million from other state accounts. The supplemental budget also reverses a \$102 million transfer that the original budget had scheduled to be made in FY 2011 from the education construction account to the GF–S. This transfer is no longer feasible due to the rededication of lottery revenues from the education construction account to the opportunity pathways account. This brings net transfers for the biennium to \$1.44 billion. Summing together the beginning balance, revenue and transfers, total state resources are a bit more than \$31.5 billion.

The original budget appropriates \$31.39 billion for the biennium. State budget analysts have identified an additional \$660 million in spending needed to maintain existing NGFS programs. In part, these maintenance level increases are due to increased forecasts for K–12 enrollments and various human service program caseloads and greater than expected per-client medical assistance costs. Also contributing to the maintenance level increases is the failure to achieve certain spending reductions called for in the original budget. (In some cases the reductions were judicially blocked.) Funding these maintenance level changes would in-

crease spending for the biennium to more than \$32 billion.

In February the legislature passed and the Governor signed an “early action” supplemental budget bill, ESHB 2921, which cut \$45 million from 2009–11 spending.

The main supplemental budget passed by the legislature (ESSB 6444) included \$710 million in policy-level reductions to spending and \$403 million in policy-level additions. Vetoes by the Governor add \$7 million to spend-

2009–11 Balance Sheet

Roll Up of General–Fund State, Education Legacy Trust and Opportunity Pathways Accounts

(Thousands of Dollars)

Beginning Balance	399
Revenue	
February General Fund–State and Education Legacy Trust Revenue Forecast	29,238
Dedication of Lottery to Opportunity Pathways	114
DOT Foods, Inc. v. Dept. of Revenue	(154)
Revenue Increase Legislation	769
Revenue Decrease Legislation	(12)
Budget Driven Revenue	(1)
Transfer to Budget Stabilization Account	(252)
Net Revenue	29,701
Transfers	
2009 Fund Transfers	831
2009 Budget Stabilization Account Transfer	45
2010 Budget Stabilization Account Transfer	229
2010 Capital-Related Transfers	187
2010 Other Fund Transfers	248
2010 Reversal of 2009 Lottery Transfer to GF-S	(102)
Net Transfers	1,438
Total Resources	31,538
Spending	
2009 Enacted Budget	31,389
2010 Maintenance Level Changes	660
ESHB 2921 - Early Action	(45)
Policy Level Reductions	(710)
Policy Level Increases	403
Governor's vetoes	7
Federal Funds Replace State Funds	(618)
Total Spending	31,085
Ending Balance & Reserves	
Unrestricted Ending Fund Balance	453
Budget Stabilization Account Balance	-
Total Reserves	453

Source: WRC compilation from state budget documents

ing. The budget assumes that the Federal Government will provide the state with an additional \$618 million in stimulus funds, which will be used to replace state funds. Total NGFS+OP spending is then \$31.01 million.

The projected NGFS+OP ending balance is \$453 million and the rainy day fund's ending balance is zero.

SPENDING

The table on page 4 summarizes the changes to the 2009–11 operating budget made during the 2010 session. (Note, this table is based on the budget as passed by the Legislature and does not include the effects of the governor's vetoes, which added \$7 million net to spending.) The top panel of the table shows the original operating budget enacted in 2009. The middle panel shows the supplemental changes made during the 2010 session, combining the early action (ESHB 2921) and main (ESSB 6444) supplemental budget bills. The bottom panel shows the totals with those changes.

NGFS+OP

The leftmost column shows spending NGFS+OP spending. (Recall that NGFS+OP combines the general fund–state, education legacy trust and opportunity pathways accounts.) The second column shows spending from all appropriated state accounts. (This includes the NGFS+OP accounts.) The third column shows appropriations of moneys the state receives from the federal government, while the fourth column shows all budgeted spending.

(In addition to the appropriated state and federal moneys shown in columns two and three, total budgeted spending includes spending from accounts that do not require explicit legislative appropriation [e.g. college and university tuition accounts] and appropriations from local accounts. Local accounts are accounts under the direct control of a state agency, rather than under the control of the state treasurer. The \$60.5 billion total budgeted statewide total in the revised budget includes \$8.8 billion in spending not requiring appropriation and \$200 million in appropriations from local accounts.)

Looking at the last row in the middle panel, several things stand out. First, while the supplemental budget reduces NGFS+OP spending by \$311 million, spending from all appropriated state accounts is down by only \$14 million. Appropriations from state accounts other than NGFS+OP are up \$297 million. Second, appropriations of federal funds are up by \$1.6 billion. Finally, all budgeted spending is up by \$1.8 billion. (Of this, \$56 million is appropriated from local accounts and \$171 million does not require appropriation.)

Other state accounts

Of the \$297 million increase in appropriations from state accounts other than NGFS+OP, the lion's share, \$264 million, is accounted for by a new state account, the hospital net safety account, which is funded by assessments paid by hospitals. Much of the money is returned to hospitals (along with federal matching funds) in the form of higher Medicaid reimbursements. We will discuss this in a bit more detail below. Here is a sample of supplemental appropriations from local accounts for activities that would properly be funded from the general fund:

State Efficiency and Restructuring Account. The supplemental budget creates this account, transfers \$39.5 million to it from the cleanup settlement account and then appropriates these moneys for transition expenses associated with closing corrections and juvenile rehabilitation facilities. The gen-

2009–11 Omnibus Budget — 2010 Supplementals

(Thousands of Dollars; Does Not Reflect Governor's Vetoes to ESSB 6444)

Original 2009-11 Budget	Appropriated			Total Budgeted
	NGFS+OP	Total State	Total Federal	
Legislative	156,095	159,384	0	160,456
Judicial	229,184	269,541	0	269,541
Governmental Operations	478,581	1,535,178	702,990	3,885,747
Other Human Services	2,295,199	3,123,805	1,448,301	4,958,187
DSHS	8,955,615	9,040,033	10,705,298	19,916,679
Natural Resources	379,918	968,032	244,112	1,463,500
Transportation	85,214	171,831	11,401	192,771
Public Schools	13,311,962	13,311,962	2,186,460	15,649,042
Higher Education	3,262,624	3,276,310	98,897	9,491,726
Other Education	165,778	165,778	300,814	476,200
Special Appropriations	2,068,266	2,261,860	0	2,261,860
Total Budget Bill	31,388,436	34,283,714	15,698,273	58,725,709
Appropriations in Other Legislation	160	160	0	160
Statewide Total	31,388,596	34,283,874	15,698,273	58,725,869
2010 Supplementals (ESHB 2921 & ESSB 6444)				
Legislative	-2,195	-2,179	0	-2,179
Judicial	-865	2,860	979	3,839
Governmental Operations	-14,399	-53,769	43,730	35,668
Other Human Services	-77,752	-41,744	146,746	232,107
DSHS	-194,047	78,446	1,239,474	1,346,437
Natural Resources	-7,773	13,611	9,871	30,114
Transportation	-7,218	-4,292	4,392	2,181
Public Schools	130,590	130,590	130,247	260,804
Higher Education	-94,112	-75,503	19,226	-38,216
Other Education	-332	-332	20,455	20,123
Special Appropriations	-42,730	-62,016	-4,780	-68,585
Total Budget Bill	-310,833	-14,328	1,610,340	1,822,293
Appropriations in Other Legislation	0	325	0	325
Statewide Total	-310,833	-14,003	1,610,340	1,822,618
Revised 2009-11 Budget				
Legislative	153,900	157,205	0	158,277
Judicial	228,319	272,401	979	273,380
Governmental Operations	464,182	1,481,409	746,720	3,921,415
Other Human Services	2,217,447	3,082,061	1,595,047	5,190,294
DSHS	8,761,568	9,118,479	11,944,772	21,263,116
Natural Resources	372,145	981,643	253,983	1,493,614
Transportation	77,996	167,539	15,793	194,952
Public Schools	13,442,552	13,442,552	2,316,707	15,909,846
Higher Education	3,168,512	3,200,807	118,123	9,453,510
Other Education	165,446	165,446	321,269	496,323
Special Appropriations	2,025,536	2,199,844	-4,780	2,193,275
Total Budget Bill	31,077,603	34,269,386	17,308,613	60,548,002
Appropriations in Other Legislation	160	485	0	485
Statewide Total	31,077,763	34,269,871	17,308,613	60,548,487

NGFS+OP rolls up the general fund–state, education legacy trust and opportunity express accounts.

Source: fiscal.wa.gov, adjusted to eliminate double counting of spending from the opportunity express account.

eral fund is to repay the \$39.5 million, with interest, to the cleanup settlement account over a term of eight years.

Home Security Fund. The supplemental budget increases funding from this account to the Department of Commerce by \$2.0 million and to the Department of Social and Health Services (DSHS) by \$1.8 million. At Commerce the money is used for housing programs. At DSHS the money replaces GF-S support for secure crisis residential centers and HOPE beds.

Community and Economic Development Fee Account. The Department of Commerce receives an additional \$5.1 million from this account, with the money to be spent on housing programs.

State Toxics Control Account. The supplemental budget increases appropriations from this account by \$6.1 million. Of this, \$4.9 million is used by the Department of Ecology to replace GF-S funding of various pollution-related activities.

State Wildlife Account-State. The supplemental budget provides \$3.7 million from this account to the Department of Fish and Wildlife's fish program, replacing GF-S funds.

Fingerprint Identification Account-State. The supplemental budget provides the Washington State Patrol's criminal history section with \$2.8 million from this account to replace funding from the GF-S.

Federal funds

The Senate Ways and Means Committee's overview of the legislative budget identifies \$618 million in federal moneys that are used to replace funding originally budgeted from the NGFS, as the balance sheet shows. This \$618 million includes: \$480 million in Federal stimulus funds, mostly in the form of a six-month extension (to June 30, 2011) of the enhanced Federal Medical Assistance Percentage (FMAP, the share of Medicaid expenses paid by the federal government), \$87 million from a reduction in the "clawback" by the federal government of state savings due to the Medicare Part D drug benefit; \$39 million from federal waivers making portions of state Basic Health and Security Lifeline expenditures eligible for Medicaid matching funds; and \$12 million from two other sources.

Most of the \$1.6 billion in new federal money falls in three areas; DSHS, \$1.2 billion; other human services, \$147 million; and public schools, \$130 million.

Within DSHS, federal funds for medical assistance payments increase by \$874 million. Of this \$281 million is due to the six-month extension of enhanced FMAP and roughly \$175 million maintenance-level matching funds. A third large source of new federal funds is the hospital safety net program. Under this program, each hospital will be assessed a hospital safety net fee, mentioned above, based on the hospital's number of non-Medicare inpatient days. The revenue from these fees, which is expected to total \$263.5 million over the remainder of the 2009–11 biennium, will be deposited in the hospital safety net account. The supplemental budget uses \$196.7 million from the hospital safety net account to increase the rates paid to hospitals for serving medical assistance clients. The federal government will provide \$259.3 million in matching funds, so that hospitals in the aggregate get back more in higher reimbursements than they pay in assessments. The supplemental budget also uses \$66.8 million from the hospital safety net account to replace GF-S funding for medical assistance.

The reimbursement rate paid to federally qualified health centers for services provided to Healthy Options managed care clients is increased by indexing these rates to a new Washington state specific index of medical cost inflation rather than the Medicare Economic Index. This increases GF-S spending by \$39.9 million, which is matched by \$54.4 million in new federal dollars.

Also within DSHS, federal funds for long-term care increase by \$147 million. Of this, \$90 million is the result of the FMAP extension, and \$62.5 million are federal matching funds for higher state payments to nursing homes, which are 4 percent more than originally budgeted due to a court decision in the Washington Health Care Association v. Dreyfus case. The enhanced FMAP adds \$56.8 million in Developmental Disabilities and \$27.1 million in Mental Health.

The supplemental budget adds \$62 million in federal money for the Temporary Aid for Needy Families (TANF) program in anticipation of federal legislation that would allocate additional emergency TANF funds in FY 2011.

In other human services, the Department of Health gets \$83.6 million in additional federal moneys, and the Washington State Health Care Authority gets \$28.4 million.

Public schools receive \$110 million in additional federal funds for food services, \$20 million for Transitional Bilingual Education and \$10 million for the Learning Assistance Program.

Compensation

Engrossed Substitute Senate Bill 6503 directs state agencies to achieve a reduce in employee compensation costs through mandatory and voluntary furloughs, leave without pay, reduced work hours, voluntary retirements and separations, layoffs, and other methods. Agencies that do not develop their own plans will be subject to closure on ten specified days. The supplemental budget expects this to save \$38 million. In addition the supplemental budget provides \$64.8 million from the GF-S and \$53.2 million from other accounts to increase the per employee per month contribution for health insurance for FY 2011 from the originally budgeted \$768 to \$850.

Public Schools

The supplemental budget provides \$130.6 million in additional NGFS+OP funds and \$130.2 million in additional federal funds for public schools. Maintenance level K-12 costs from the NGFS+OP have increased by \$252.1 million since the enactment of the original 2009–11 budget. The supplemental budget funds maintenance increases to “basic education” and makes cuts in “non-basic” programs by \$120 million net.

Substitute House Bill 2893 increases the lid on local school property tax levies from 24 percent of district’s state and federal revenues to 28 percent, and increased local effort assistance percentage (LEA), by which the state provides matching grants to property-poor districts, from 12 percent to 14 percent. The supplemental budget provides an additional \$29.8 million in funding for LEA.

The supplemental budget also provides \$2.4 million for implementation of Engrossed Second Substitute Senate Bill 6696, which is intended to improve the state’s competitiveness in the competition for federal “Race to the Top” money, and \$2.5 million to reprogram systems that the state uses to make general and student transportation payments to school districts.

Among the major program cuts, the supplemental budget saves \$79 million by eliminating the \$99 per student Initiative 728 allocation funded in the original budget, saves \$30 million by decreasing certificated instructional staffing/FTE student ratios from 53.17/1000 to 47.4/1000 for grade 4, saves \$22 million by postponing payments made to school districts related to the depreciation of school buses until the final year of the bus's expected useful life, and saves \$16 million by eliminating funding for the learning improvement day for teachers and other certificated staff.

Higher education

The supplemental budget reduces state appropriations for higher education by \$75.5 million. Total budgeted spending falls by a lesser amount, \$38.2 million, in part because the state shifts \$19.2 million in federal stimulus funds to the University of Washington.

The ESSB 6503 compensation reductions described above reduce NGFS+OP higher education funding by \$17.2 million. In addition, the direct appropriation to each college and university is reduced by 6 percent, a total of \$73.1 million.

Funding for a number of financial aid programs administered by the Higher Education Coordinating Board is reduced or suspended, for a total savings of \$16.5 million. In dollar terms the three largest reductions are to the state work study program, which is reduced by 30 percent, saving \$7.4 million; to the health professional conditional scholarship and loan repayment program, which will accept no new applicants, saving \$4.4 million; and to the educational opportunity grant program, which will accept no new applicants, saving \$2.6 million.

The Community/Technical College System receives \$17.6 million to fund 3,800 full-time equivalent enrollments for unemployed workers training for jobs in high-demand fields and \$1.0 million for financial aid for such students.

General Assistance

The state has two General Assistance welfare programs: General Assistance–Unemployable, which serves persons who are physically or mentally incapacitated, unemployable, and ineligible for any form of federal aid other than food stamps; and General Assistance–Expedited Medical, which supports individuals with pending applications for the federal Supplemental Security Income program. Engrossed Second Substitute House Bill 2782 reformed the General Assistance and renamed it Disability Lifeline.

Under 2009 legislation, Disability Lifeline clients are transitioning to a medical managed care system, which adds mental health and care coordination services to the package of health benefits. Per client costs are \$72 per month greater than originally budgeted, adding \$23.9 million to program costs at the maintenance level. Additionally, caseload growth has been greater than originally budgeted, adding \$222 million at the maintenance level.

E2SHB 2782 limits participation in the unemployable program to 24 months within a five-year period and prohibits individuals from participating if they refuse needed chemical dependency treatment. These two provisions are expected to result in a 13 percent caseload reduction, saving \$28.2 million.

Health Care

Significant increases in health care spending include the increased reimbursement rates for hospitals and federally qualified health centers described above. Also, \$19.1 million is provided for administration of the medical assistance program, offsetting administrative cuts made in the original budget.

Major savings in health care come from the extension of the enhanced FMAP, waivers which make portions of state Basic Health and Disability Lifeline expenditures eligible for Medicaid matching funds, reductions in dental expenditures and elimination of the use of state money to purchase vaccines.

Corrections and Juvenile Rehabilitation

Because of excess capacity at adult and juvenile corrections facilities, several state facilities can be restructured or closed.

The McNeil Island Corrections Center will be downsized from 1,250 medium and minimum custody prisoners to 250 minimum custody prisoners. The Larch Corrections Center will be downsized from 480 to 240 beds. The Pine Lodge Corrections Center for Women and the Ahtanum View Corrections Center will be closed. Altogether, restructuring or closing these four facilities will save \$49 million from the GF-S. Transition expenses of \$34.5 million associated with the McNeil Island restructuring are funded from the state efficiency and restructuring account.

The Juvenile Rehabilitation Administration will close the Maple Lane School by the end of the 2011–13 biennium. This will provide \$5.8 million in GF-S savings in FY 2011. Transition expenses of \$5.0 million are funded from the state efficiency and restructuring account. Staff reductions at other JRA facilities and offices will save another \$7.6 million.

Natural Resources

In the Department of Natural Resources, \$11.5 million is added to cover the cost of fighting forest fires in FY 2010. The Puget Sound Partnership expects additional federal grants totaling \$3.6 million for the effort to restore Puget Sound. The Department of Agriculture gets additional federal grants totaling \$6.7 million related to food safety, organic agriculture and specialty crops, detecting sudden oak death, and Spartina removal.

SUSTAINABILITY

The enacted supplemental budget simply rolls the state's fiscal difficulties forward another year. When, next year, the legislators sit down to write a budget for the 2011–13 biennium, they will most likely again face a multi billion dollar gap between revenues and expenses.

In February the Office of Financial Analysis prepared an "Outlook" for 2011–13 based on Governor Gregoire's supplemental spending and tax proposals, which projected a \$2.2 billion negative balance for the general fund at the end of the biennium. Besides the normal growth in the cost of state programs, factors contributing to this gap included the need to replace federal stimulus funds, pension costs, and catch-ups for Initiatives 728 and 732 (WRC 2010b).

The enacted supplemental budget uses more stimulus funds than the Governor proposed, but nevertheless ends the 2009–11 biennium with \$60 million less in reserves. In addition, the enactment of Substitute House Bill 2776, which modified the distribution formulas for K–12 education, adds \$765.2 million to public school costs in 2011–13.

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THE NEAR GENERAL FUND

Sound fiscal policy minimizes the amount of tax earmarking.

The Research Council has long lamented the proliferation of special accounts through which the legislature has funded general government programs (WRC 1995). In recent years, eight specific accounts (the "general fund related accounts") have functioned as adjuncts to the general fund: the health services account, the student achievement account, the education legacy trust account, the public safety and education account and its equal justice sub-account, the violence reduction and drug enforcement account, the water quality account, and the pension funding stabilization account. Moneys have been freely transferred back and forth between these accounts and the general fund as needs arise. In 2006, the Washington Alliance for a Competitive Economy, of which we are a member, called for these accounts to be consolidated into the general fund (WashACE 2006).

For several years, legislative fiscal staffs have been reporting state spending in terms of a synthetic "account," the near general fund-state (NGFS), which aggregates the general fund and the eight related accounts. This has improved transparency and accountability, and we have generally chosen to use the NGFS in our discussions of the state budget (WRC 2007).

During the 2009 session, the legislature passed and the governor signed Senate Bill SB 5073, which consolidates six of the eight related accounts (all but the education legacy trust account and the pension funding stabilization account) into the general fund. We applaud this, but believe that the education legacy trust account should likewise be consolidated into the general fund. (As no taxes are dedicated to it, the pension funding stabilization account is effectively dead.)

This year, in a step backward, the Legislature created a new account, the opportunity pathways account (OP), from which it funds educational programs that had previously been funded from the NGFS. This account also should be folded back into the general fund.