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HOUSE AND SENATE TURN ATTENTION TO THE 2008 SUPPLEMENTAL BUDGET

BRIEFLY

The House-passed supplemental budget would increase Near General Fund –State spending for 2007-09 by $305 million. For the Senate-passed supplemental budget the increase is $327 million. By historical standards, these are small supplemental increases. But, coming on the heels of the large increases enacted in 2007, the proposed spending will not be sustainable in 2009–11. Under either budget, NGFS spending for the 2007–09 biennium would reach nearly $33.7 billion.

The 2008 regular session of the Washington legislature is scheduled to end on Thursday, March 13. The state is now in the ninth month of the 2007–09 biennium, operating under a two-year budget enacted during the 2007 legislative session. The key remaining task for the legislature is to enact a supplemental budget making mid-course adjustments to this spending plan. The House passed its version of a supplemental budget on February 25; the Senate, its version on February 28.

As we noted in our earlier brief on Governor Gregoire's budget proposal:

> Until recently, most discussions of the operating budget focused on spending from the general fund–state (GFS), which is the account that receives most of the state's general tax revenues. To provide a more transparent accounting of state spending, legislative fiscal committees have begun to report spending for a composite "account"—dubbed (rather inelegantly) the near general fund–state (NGFS)—that includes the GFS and seven "related" accounts: the health services account, the student achievement account, the education legacy trust account, the public safety and education account, the violence reduction and drug enforcement account, the water quality account, and the pension funding stabilization account. When the accounts have excess revenues, the surpluses are transferred to the GFS; when the accounts run short of funds, money is transferred to them from the GFS. . . .
>
> With the 2007–09 budget, it is particularly important to look beyond the GFS. The related accounts entered the 2007–09 biennium with roughly a billion dollars in reserves. The enacted budget draws these reserves down almost completely, increasing appropriations from the related accounts by 55 percent, from $2.4 billion in 2005–07 to $3.7 billion for 2007–09. This level of spending from the related accounts will not be sustainable in 2009–11 without large transfers from the GFS. (WRC 2008a)

The House-passed supplemental budget would increase NGFS spending for 2007-09 by $305 million, of which $241 million is from the GFS. For the Senate-passed supplemental budget, the NGFS increase is $327 million, which includes $246 million GFS. By historical standards, these are small supplemental increases. But, coming on the heels of the large increases enacted in 2007, the proposed spending will not be sustainable in 2009–11. Under either budget, NGFS spending for the 2007–09 biennium would reach nearly $33.7 billion.

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GFS Balance Sheet

The table below compares 2007–09 GFS balance sheets for the House and Senate budgets.

The February revenue forecast lowered expected GFS revenue for the 2007–09 biennium by $423 million, to $29,463 million as shown. The House balance sheet reflects 18 pieces of revenue legislation that would result in a net reduction of $6.2 million. The most fiscally significant of these bills are HB 2380 ($2.0 million reduction), which would provide relief to small businesses for compliance costs associated with the Streamlined Sales and Use Tax Agreement, and HB 3275 ($1.1 million reduction, which would extend the current B&O tax exemption for grocery cooperatives to cooperatives that are sold to other cooperatives. Only one of the 18 bills would increase GFS revenues. This is SB 6799 ($147,000 addition), which authorizes the continuation of origin-based sourcing for sales by florists (so that sales tax is paid to the jurisdiction where flowers are ordered rather than the jurisdiction where they are delivered).

2007–09 Balance Sheets
House and Senate Proposed 2008 Supplemental Budgets
General Fund-State
Dollars in Millions

	House	Senate
RESOURCES		
Beginning Fund Balance	780.5	780.5
February 2007 Forecast	29,462.9	29,462.9
Legislation with Revenue Impacts	(6.2)	(5.2)
Budget Driven Revenue	-	(0.2)
Current Revenue Totals	29,456.7	29,457.5
Transfer to Budget Stabilization Account	(136.1)	(136.1)
Net Transfers to/from Other Funds--2007	39.8	39.8
Net Transfers to/from Other Funds--2008	28.3	35.0
Total Resources (including Beginning Fund Balance)	30,169.3	30,176.7
EXPENDITURES		
2007–09 Enacted Budget	29,622.9	29,622.9
2008 Supplemental	241.4	246.4
Total Expenditures	29,864.3	29,869.3
RESERVES		
Projected General Fund Ending Balance	304.9	307.4
Emergency Reserve Fund Transfer To Budget Stabilization Account	302.4	302.4
Interest	7.1	7.1
New Deposits	136.1	136.1
Projected BSA Ending Balance	445.7	445.7
Total Reserves	750.6	753.1

The Senate balance sheet reflects 11 pieces of revenue legislation that would altogether reduce GFS revenues by $5.2 million. The largest of these are SB 6828 ($1.7 million reduction), which would extend the existing aerospace tax incentives to additional aerospace activities; HB 3275 ($1.1 million reduction), the extension of the grocery cooperative exemption; and SB 6323 ($1.0 million reduction), which liberalizes the existing rural tax incentive programs. As was the case with the House budget, the only bill that increases revenue is SB 6799 ($147,000 addition), which continues origin-based sourcing for florists.

Both balance sheets show net transfers of $39.8 million from other accounts to the GFS in 2007. The House 2008 budget transfers an additional $28.3 million (net) to the GFS. (The largest transfer in is $60 million from the education legacy trust account; the largest transfer out is $53.5 to the health services account.) The 2008 Senate budget transfers $35.0 million (net) to the GFS. (Here, the largest transfers in are $40 million from the education legacy trust account and $28.0 million from the convention & trade center account; the largest transfer out is $53.0 million to the health services account.)

The projected transfer at the end of the 2007–09 biennium from the GFS to the budget stabilization account (BSA), the new constitutional rainy day fund approved by voters in November, is $136.1 million. With the rollover of $302.4 million to BSA from the emergency reserve fund and $7.1 million in interest, the projected BSA ending balance is $445.7 million.

The House budget increases GFS spending by $241.4 million. The projected GFS ending balance is $304.9 million; including the BSA, total reserves are $750.6 million. The Senate Budget increases GFS spending by $246.4 million. The projected GFS ending balance is $307.4 million; total reserves are $753.1 million.

SUPPLEMENTAL SPENDING FROM NGFS

The table below compares the House and Senate supplemental NGFS spending adjustments.

House and Senate Passed Supplemental Budgets
NGFS
(Dollars in Millions)

	House	Senate	Difference
Maintenance Changes	188.9	188.9	0.0
Policy Changes			
PEBB Rate Reduction	(115.5)	(115.5)	0.0
K-12 Education	58.7	66.0	(7.3)
Higher Education	11.2	8.4	2.8
Long Term Care, DD, and Mental Health	19.5	32.8	(13.3)
Health Care	2.2	(2.2)	4.4
Other Human Services	20.5	31.9	(11.4)
Corrections and Other Criminal Justice	32.7	30.5	2.2
Lawsuits	27.3	27.1	0.2
Natural Resources	4.1	8.5	(4.5)
Housing Related	17.0	16.6	0.4
All Other	38.3	33.8	4.5
Total Policy Changes	116.0	137.9	(21.9)
Grand Total	304.9	326.8	(21.9)

Generally, changes in appropriations are classified to be either maintenance level—changes that are necessary to fund entitlements and other legally unavoidable costs—or policy level—new programs, and additions or reductions to existing programs. For both the House and the Senate budgets, maintenance-level changes total $188.9 million. In the House supplemental, policy-level additions and subtractions on balance increase spending by $116.0 million. In the Senate budget, the policy-level net increase is $137.9 million.

PEBB Rate Reduction, $115.5 million reduction, both House and Senate. The largest policy decrease is a $115.5 million reduction in the appropriation to the Public Employee Benefits Board (PEBB) to fund state employee healthcare benefits. The state employer contribution rate is reduced from $732 million to $561 million per month, while benefits are unchanged. This is possible due to lower than anticipated health plan costs.

K-12 Education, $58.7 million House, $66.0 million Senate. Under this grouping, there are several major funding differences between the House and Senate bills. The first is a $35 million COLA increase included by the House and not the Senate. Updated consumer price index numbers increase the COLA required by I-732 from 2.8 percent to 3.9 percent, which is included in both supplemental budgets at the maintenance level. The House provides an additional 1 percent. The House budget include $13 million for non-employee related K-12 education costs such as books, supplies and computers. The House suspends the phase in of all-day kindergarten for the top 20 percent high-poverty schools, saving $8 million.

The Senate bill includes $12.5 million to reduce the classified staffing ratio from one classified staff member for 59 students to one staff member for 58 students, $11.7 million (or $12 per student) to improve and maintain library materials and $27 million to help struggling students meet graduation requirements, meet standards on the WASL and learn English. The Senate cancels the Indigenous Learning pilot program, saving $1.0 million.

Changes in the WASL lead to savings of $11.7 million and $14.2 million in the House and Senate budgets respectively. These changes include shortening the WASL in grades 3–8, decreasing the number of open-ended responses and decreasing the number of items utilized in the assessment.

Higher Education, $11.2 million House, $8.4 million Senate. In this grouping, significant appropriations in the House includes $3.4 million for a 1 percent COLA for I-732 eligible employees at community and technical colleges and $1.5 million so community and technical colleges can purchase licenses that will allow students to access periodicals, journals and books online.

Both bills make appropriations for health care career advancement grants to be used to create and expand training programs for careers in the health care industry. The House appropriation is $1 million, while the Senate's appropriation is $3 million.

The Senate appropriates $1 million to provide technical support and capacity building to low-income communities to help them make effective use of digital technologies and $2 million for construction trade apprenticeships to provide family-wage jobs in an industry facing shortages of skilled workers. Funding for the opportunity grant program, which provides financial aid to low income community college students, is decreased from $11.5 million to $6.5 million.

The Senate reduces NGFS spending by $3.0 million by shifting funding for the job skills program at the community and technical colleges from GFS to the administrative contingency account.

Long Term Care/Developmental Disabilities/Mental Health, $19.5 million House, $32.8 million Senate. The Senate provides $12.3 million in additional funding to maintain and improve delivery of non-Medicaid mental health services such as crisis response, counseling, case management, acute care, and residential services for children and adults who are not eligible for Medicaid.

The House provides $3.0 million in nursing home funding increases while the Senate allocates $6.8 million. The overall vendor rate increase for 2007-09 is 7.3 percent.

Health Care, $2.2 million House, $2.2 million reduction Senate. The major difference in this category is a $2.7 million increase in the House bill for the health insurance partnership, while the Senate bill decreases funding by $1.7 million. This program provides subsidies to low-income employees of small employers participating in the program beginning March 2009.

Other Human Services, $20.5 million House, $31.9 million Senate. The House provides $1.8 million for the Children's Administration to contract with nonprofit organizations to facilitate bi-monthly visits of siblings living apart in out-of-home care and $3.7 million for various other foster care improvements.

The Senate includes $6.2 million for administration of the newly enacted family leave insurance program. The Senate provides $5.8 million compared to the House's $2.4 million to extend the integrated crisis response and intensive case management pilot programs, which are intended to reduce the high use of hospital and jail services by individuals with drug and alcohol addictions.

The Senate provides $4.9 million to implement SB 6931, which would impose a surcharge on liquor to be deposited in an account used to increase DUI patrols as well as drug and alcohol treatment programs. (SB 6931 failed to achieve the supermajority required by Initiative 960 and so did not pass out of the Senate.) The Senate appropriates $1 million to implement SSB 6479, which establishes a pilot program in Clark County to identify and treat Reactive Attachment Disorder in children under 9 who are currently receiving services from the Division of Children and Family Services. Lastly, the Senate provides $1.8 million for the Office of Crime Victims Advocacy to provide grants to community sexual assault programs aimed at helping children.

Corrections and Other Criminal Justice, $32.7 million House, $30.5 million Senate. The House budget allocates $2.3 million to implement the Criminal Street Gang Initiative, which will provide grants to local law enforcement agencies to target gang violence and graffiti control efforts.

The House provides $2.4 million for custody overtime expenditures, while the Senate provides $216,000. The House provides $3.7 million for correctional staff compensation increases, while the Senate provides $1.0 million.

The Senate provides $3 million for grants to establish four Community Transition Coordination networks that will identify released offenders' needs and connect the offender with resources and services to allow for successful transition back into the community.

Natural Resources, $4.1 million House, $8.5 million Senate. The House provides $609,000 to fund an agreement with the Confederated Tribes of the Colville Reservation and the Spokane Tribe who agree to allow 132,500 acre-feet of water to be released from the Lake Roosevelt reservoir annually. One-third of the water will be diverted to streams for fish habitat and the remaining two thirds will be divided among land irrigation and other uses. Six million dollars will be distributed to the Confederated Tribes of the Colville Reservation and $2 million will be allocated to affected counties adjacent to Lake Roosevelt. The Senate bill allocates $2.7 million for the agreement.

All Other, $38.3 million House, $33.8 million Senate. The House provides $12.1 million towards the Public Employee Benefit Board's share of the cost of Health Care Authority's insurance accounting system replacement project, while the Senate provides $4.0 million. The House provides $1.3 million to implement the Family and Juvenile Court Improvement Plan, which will provide family court coordinators, additional judicial officer training, and planning and improvement grants to participating courts.

The Senate reduces by $2 million the amount of funds provided for implementing a reporting system at the Department of Ecology to track, manage and credit entities that report emissions and emissions reductions, as well as a cap and trade system and other related emissions programs. In addition, the Senate provides $1.0 million for the Washington New Americans program which provides naturalization assistance to permanent residence eligible to become citizens. Lastly, the Senate allocates $2.3 million to fund ESSB 6809, which would establish a state sales tax exemption in the form of remittance, equal to a percentage of the federal Earned Income Tax Credit.

SUSTAINABILITY

Last April, as legislators finalized the 2007–09 budget, we complained that their spending plans left too little in reserve against a downturn in the economy and made commitments that are unsustainable in the long run. In

January we found the same faults in Governor Gregoire's supplemental budget proposal (WRC 2008a), and now we find them in the House and Senate supplementals.

Approximate Six-Year GFS Outlook
(With Governor Gregoire's Proposed Supplemental Budget)
Dollars in Millions

	2007–09	2009–11	2011–13
RESOURCES			
Beginning Fund Balance	781	257	(2,379)
November 2007 Forecast	29,886	0	0
February 2008 Update	(423)	31,918	0
Projection at Average Rate of Growth	0	0	35,127
Revenue Changes in Governor's Budget Proposal	(10)	(46)	(73)
Current Revenue Totals	29,453	31,872	35,054
Transfer to Budget Stabilization Account	(136)	(292)	(322)
Net Transfers to/from Other Funds 2007	40	0	0
Net Transfers to/from Other Funds 2008	(34)	0	0
Total Resources (including Beginning Fund Balance)	30,103	31,837	32,354
EXPENDITURES			
2007–09 Enacted Budget	29,623	0	0
Baseline Expenditures	0	32,221	34,958
Governor's 2008 Supplemental Budget	212	421	500
NGFS Backfill	12	1,440	1,800
Additional Pension Costs	0	132	180
Total Expenditures	29,847	34,215	37,438
RESERVES			
Projected General Fund Ending Balance	257	(2,379)	(5,084)
Emergency Reserve Fund Transfer To BSA	293	0	0
New Deposits	136	292	322
Projected Budget Stabilization Account Ending Balance	429	722	1,043
Total Reserves	686	(1,657)	(4,041)
Budget Gap			
Current Revenue less (Expenditure plus Transfer to BSA)	(530)	(2,635)	(2,706)
Percent of Current Revenue	1.8%	8.3%	7.7%

Source: Senate Ways and Means Committee, WRC

The balance sheet to the left illustrates the long-run sustainability problem. It presents an approximate 6-year outlook for the GFS which was prepared by Senate Ways and Means committee staff after the February revenue forecast. The outlook incorporates the governor's supplemental budget proposal. (Substituting either the House or the Senate supplemental budget for the Governor's supplemental would make little difference to the analysis.)

Revenues for 2007–09 and 2009–11 incorporate the new ERFC forecast. Revenue for 2011–13 is projected using the standard rule for these exercises, 5 percent growth per year.

The line *Baseline Expenditures* shows the enacted 2007–09 budget and the cost of carrying forward the programs it funds to the 2009–11 and 2011–13 biennia, with allowances for increasing costs, caseloads, and enrollments.

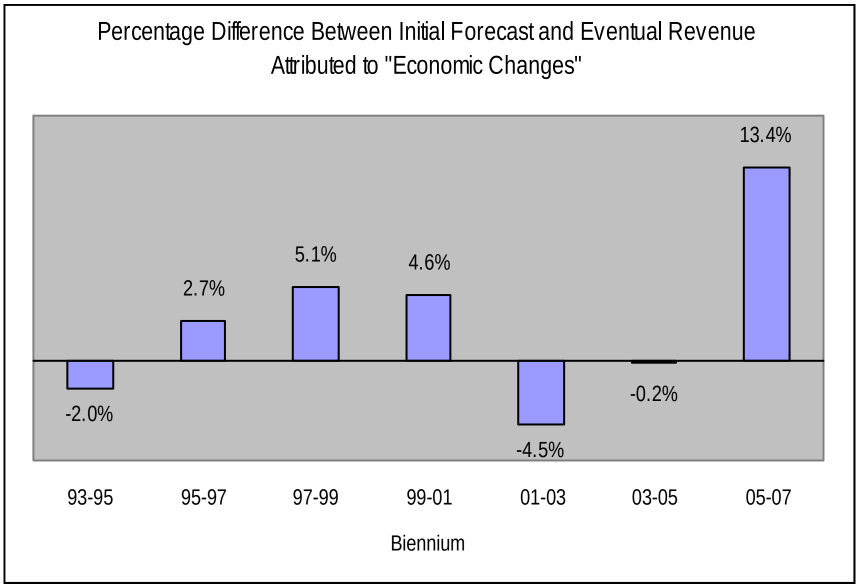
The line *Governor's 2008 Supplemental Budget* shows the cost of that proposal in the current biennium and the "bow wave" it casts as new programs carry forward into 2009–11 and 2011–13.

We have written extensively about the problems the state faces with respect to unsustainable spending commitments that have been made in accounts outside of the general fund (WashACE 2006, 2007a; WRC 2007a, 2007c, 2008). The line *NGFS Backfill* reflects the drain on the GFS of such commitments, which ultimately must be fulfilled from the GFS. NGFS backfill is projected to exceed $1.4 billion in 2009–11 and reach $1.8 billion in 2011–13.

We define the "budget gap" to be the difference between current GFS revenues and the sum of expenditures and the constitutionally required transfer to the budget stabilization account. The projected budget gap for 2009–11 exceeds $2.6 billion, while the gap for 2011–13 exceeds $2.7 billion. Such large gaps between available revenues and expenditures quickly drain GFS reserves. By the end of the 2009–11 biennium the GFS has a shortfall of nearly $2.4 billion; by the end of 2011–13 the shortfall exceeds $5 billion. The shortfalls might be offset somewhat by funds from the budget stabilization account. Under the current economic forecast, however, employment growth will remain above the 1 percent threshold that triggers access to those funds.

The 2009–11 gap is so large as a share of the current forecast of 2009–11 revenue (8.3 percent) that it is highly unlikely that future revisions to the forecast will erase it.

The Forecast Council began its current practice of issuing the first forecast of revenues for a biennium at the February meeting 16½ months before the beginning of the biennium in February 1992, when it issued the first forecast for 1993-95. There are thus 7 biennia (1993–95 through 2005–07) for which we can compare these initial February forecasts to actual revenue. The chart to the left shows, for these seven biennia, the percentage difference between eventual GFS revenue and the initial February forecast with changes due to legislation (e.g.. tax hikes or cuts) factored out. A positive (negative) percentage indicates that, correcting for impacts of legislation, eventual revenue was greater (less) than the indicated forecast by that percentage.



In four of the seven cases eventual revenue was above the initial forecast; in the other three cases it was below the initial forecast. The anomalous biennium is 2005–07, when eventual revenue exceeded the initial forecast by more than 13 percent. This biennium saw an unanticipated, once in a generation construction boom, a condition that is unlikely to be repeated soon. With the exception of 2005–07 eventual revenues have been within about 5 percent of the initial forecast.

RISKS

The Forecast Council's baseline economic forecast for the state assumes that the U.S. economy will experience a recession during the first half of 2008. Last week's report on national employment appears to have validated at least that part of the forecast.

In addition to its baseline economic and revenue forecasts for the state, the Forecast Council also adopts alternative optimistic and pessimistic forecasts. The optimistic forecast, assumed that the U.S. economy would avoid recession, increasingly appears irrelevant.

The pessimistic forecast is described:

> The pessimistic scenario assumes that the housing recession deepens even more than in the baseline, and that near-term oil prices spike above $90 per barrel. This fatal combination sends the economy into a recession similar in depth and duration to the 1991 recession. . . The pessimistic scenario produced $819 million (2.8 percent) less revenue in the 2007–09 biennium than did the baseline forecast. (ERFC 2008)

Last month the Forecast Council assigned a 30 percent probability to the pessimistic forecast. Last week oil hit $105 per barrel. This week the legislature appears poised to pass a budget with only$750 million in reserves.

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