

To: Economic and Revenue Forecast Council

From: State Budget Outlook Work Group

Subject: Preparation of the November 2016 Outlook

In this document, the State Budget Outlook Work Group (work group): (1) notes several analytical approaches it is taking for the November 2016 Outlook for concurrence by the Economic and Revenue Forecast Council (ERFC); and (2) raises several questions for the ERFC to provide guidance on in the preparation of the November 2016 Outlook.

## **(1) Methodology Notes**

### **Resource Updates**

- The November 2016 Outlook will be updated for the November 2016 revenue forecast. However, the Budget Stabilization Account (BSA) transfer and the extraordinary revenue growth (ERG) calculation based on the November 2016 forecast will not be available. The work group will use the BSA transfer and ERG calculation from the September 2016 forecast.
- Reversions for fiscal year 2016 will reflect actuals. Future year reversion assumptions will not be changed.

### **Maintenance Level Updates**

The November 2016 Outlook will begin with a preliminary estimate by the Office of Financial Management of the 2017-19 projected maintenance level costs (with some possible adjustments by the workgroup if necessary). These estimates reflect projected expenditures based on the estimated cost of providing ongoing services currently authorized in the 2015-17 budget and any mandatory items that start in 2017-19. The 2017-19 maintenance level projection will be the basis for the 2019-21 projection using the outlook growth factors and adding any mandatory items that start in 2019-21. This estimate of the Governor's projected maintenance level is not final.

### **Outlook Growth Factors**

At its September 21, 2016 meeting, the ERFC adopted updated growth factors for the Outlook. These updated growth factors will remain constant for Outlooks prepared during the 2017-19 biennium, from November 2016 through the Outlook on the enacted 2018 supplemental budget, unless otherwise modified by the ERFC.

## **(2) Questions posed by the Workgroup for guidance on how to proceed with preparing the draft November 2016 Outlook**

## **2017 Supplemental Budget**

A 2017 supplemental budget will affect the beginning balance in FY 2018 for the 2017-19 biennium. For the November 2016 Outlook: (1) should the Work Group include a proxy for 2017 supplemental appropriations such as agency requested FY 2017 supplemental budget items that appear at maintenance level; or (2) ignore the 2017 supplemental?

## **Ballot Initiatives**

There are six initiatives on the statewide ballot. The fiscal impacts for these initiatives indicate that three would have a quantifiable impact on NGF-P resources and/or expenditures; one would have an indeterminate impact, and two would have no impact. The election results will not be officially certified until November 29th, after the November Outlook is presented to the ERFC on November 16<sup>th</sup>. The Outlook Work Group needs guidance from the ERFC on whether the November Outlook should reflect the initiative costs based on initial election results.

If the ERFC would like to include initiatives which appear to be passing based on initial election results and have a quantifiable fiscal impact, the Work Group proposes the November Outlook would reflect the fiscal impact statement as prepared by the Office of Financial Management. It should be noted that there is discretion regarding the phase in of costs and other funding levels; actual funding levels would be determined through the Legislative process.

Following is a breakout of the six initiatives on the November 2016 statewide ballot:

Initiatives with quantified fiscal impacts based on the fiscal impact statements:

- Initiative Measure No. 732 concerning taxes (\$834 million net loss)
- Initiative Measure No. 1433 concerning labor standards (\$21 million net gain)
- Initiative Measure No. 1464 concerning campaign finance laws and lobbyists (\$1.8 million net gain)

Initiative with indeterminate fiscal impact based on the fiscal impact statements:

- Initiative Measure No. 1491 concerning court-issued extreme risk protection orders temporarily preventing access to firearms

Initiatives with no fiscal impacts based on the fiscal impact statements:

- Initiative Measure No. 1501 concerning seniors and vulnerable individuals
- Initiative Measure No. 735 concerning a proposed amendment to the federal constitution

## **Other Items**

The Outlook on the Enacted 2016 Supplemental budget included items affecting the ensuing biennia, both 2017-19 and 2019-21, that are not fully reflected in either carry-

forward or maintenance level for 2017-19. In addition, there are potential new items that have not been previously included.

Should the November 2016 Outlook separately reflect these items:

- Early Childhood Education and Assistance Program (ECEAP) entitlement and phase-in. ECEAP costs are part of the November Outlook because it includes costs at the current funded level through FY 2021. There are currently 11,691 funded ECEAP slots. Under current law, ECEAP becomes an entitlement in FY 2021. Current caseload projections estimate the demand for ECEAP slots in FY 2021 at over 19,000 slots. The annual cost of each 1,000 ECEAP slots is approximately \$7.6 million.

RCW 43.215.456 requires a phase in of ECEAP funding but does not specify how to phase in the program. Should the November 2016 outlook reflect funding growth for the entitlement only in FY 2021 or assume some phase-in and if so what level of phase in?

- Hepatitis C Medications. Prior to recent court rulings, authorization for new medications which provide treatment for Hepatitis C required some documentation that the virus was having a clinical impact on the patient such as evidence of liver scarring. Preliminary injunctions enjoining this practice were ordered by judges in cases involving both the Medicaid program (May 2016) and the Public Employee Benefits Program (August 2016.) Assuming these injunctions are not overturned on appeal, the costs associated with the Medicaid program would typically be considered maintenance level and therefore included in the November 2016 outlook. The costs associated for PEBB would typically be considered policy level and not included in the November 2016 outlook. Should the November 2016 outlook reflect the costs associated with eliminating restrictions to Hepatitis C treatment based on liver scarring for the Medicaid program and/or the PEBB program?
- Elimination of school district dependency on local levies for implementation of the state's program of basic education (compensation element of *McCleary*). During the 2016 session, language in the enacted operating budget as well as language incorporated in E2SSB 6195 provided general legislative commitments for legislative acts in 2017 to eliminate school district dependency on local levies to fund the program of basic education. To be implemented, these changes would require additional specific policy action during the 2017 legislative session.

This summer the *McCleary* court requested that the state provide it with information on the full cost of implementing basic education in the 2017-19 biennium. The state explained that due to the need for additional research and legislative policy decisions to determine appropriate compensation allocations, the state could not provide the court with an amount certain. The court's October 6 order did not require the state to fund any specific expenditures. Instead, it

required the state to fully fund the program beginning with school year 2018-19, with appropriations and revenue sources in place by the adjournment of the 2017 legislative session.

For that reason, questions arise about how to treat this upcoming compensation obligation in the outlook. Beginning with the 17-19 outlook, the *McCleary* exception in RCW 43.88.055 does not apply to the ensuing biennium. RCW 82.33.060, which governs what costs must be included and excluded from the outlook, requires that estimates for ensuing biennium expenditures exclude the costs of policy items for legislation that has not yet been enacted by the legislature:

*The estimate of ensuing biennium expenditures must include maintenance items including, but not limited to, continuation of current programs, forecasted growth of current entitlement programs, and **actions required by law**, including legislation with a future implementation date. **Estimates of ensuing biennium expenditures must exclude policy items including, but not limited to, legislation not yet enacted by the legislature**, collective bargaining agreements not yet approved by the legislature, and changes to levels of funding for employee salaries and benefits unless those changes are required by statute. RCW 82.33.060(2)(a) (emphasis added)*

Actions required by a court could potentially be included under “actions required by law,” but the court at this stage has not required any specific actions or expenditure levels, and the state did not provide the court with any estimates. Because future *McCleary* compensation costs will be determined by upcoming legislative policy decisions, these costs would typically be considered policy level and not included in the November 2016 outlook.

As a policy level item, staff have no way to estimate new *McCleary* costs for the 17-19 and 19-21 biennia. (*McCleary* costs attributable to the remaining K-3 step are included, as they are both known and required by statute.) If the ERFC wants to include the *McCleary* compensation costs in the November 2016 Outlook, the ERFC would need to provide staff with a clearly stated set of compensation allocation assumptions that could be used to cost out an estimate as part of the official outlook.