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August 22, 2012

MEMORANDUM

TO: Legislative Education Study Committee

FR: David T. Craig

RE: STAFF BRIEF: SEQUESTRATION AND THE FEDERAL BUDGET CONTROL ACT

INTRODUCTION

During the June 2012 interim meeting of the Legislative Education Study Committee (LESC), Mr. Paul Aguilar, Deputy Secretary, Finance and Operations, Public Education Department (PED), provided an update about federal education funding, including the timeliness of reimbursements and directions to school districts to budget only 90 percent (rather than 95 percent) of federal funds. As part of that testimony, Deputy Secretary Aguilar said that the instruction to budget only 90 percent of federal funds was due, in part, to a concern regarding having to claw back federal funds in the event of budget sequestration and the possibility of not receiving a forest reserve fund appropriation.

This staff brief gives an overview and update on the following:

- an explanation of the *Budget Control Act* (BCA) and sequestration;¹
- guidance from the US Department of Education (USDE); and
- the potential effects on New Mexico of budget sequestration and USDE guidance.

¹ *Sequestration* is the process by which caps are lowered on discretionary spending to levels outlined in the *Budget Control Act* and automatically canceling or reducing budgetary resources for some programs and activities financed by mandatory spending. For FY 13, these automatic reductions will take the form of across the board cuts.

AN EXPLANATION OF THE *BUDGET CONTROL ACT (BCA)* AND SEQUESTRATION

According to a January 2012 Congressional Budget Office publication on the BCA of 2011 (Public Law 112-25):

- the BCA specifies automatic procedures to reduce both discretionary and mandatory spending over the next decade if legislation originating from the Joint Select Committee on Deficit Reduction is not enacted to reduce projected deficits by at least \$1.2 trillion;
- because no such legislation was enacted by January 15, 2012 those procedures are scheduled to go into effect;
- the automatic reductions will take the form of equal cuts (in dollars) in funding for defense and non-defense programs in FY 13 to FY 21;
- for 2013, reductions will be achieved by automatically canceling a portion of budgetary resources for mandatory and discretionary spending in an action called “sequestration”; and
- for 2014 to 2021 reductions will be achieved by lowering the caps on discretionary spending and by sequestration of mandatory spending.

The law exempts a significant portion of mandatory spending (Medicare, Social Security, and Medicaid) from sequestration.

GUIDANCE FROM THE UNITED STATES DEPARTMENT OF EDUCATION (USDE)

According to a July 2012 letter to Chief State School Officers by USDE Deputy Secretary Anthony Miller (Attachment 1):

- sequestration goes into effect January 2, 2013 unless Congress sends the President a deficit reduction plan that avoids sequestration;
- four accounts become available for advance funding in October of 2012 for school year 2012-2013. These include:
 - Education for the Disadvantaged (Title I, *Elementary and Secondary Education Act*);
 - School Improvement Programs (Title II, *Elementary and Secondary Education Act*);
 - Special Education (*Individuals with Disabilities Education Act, Part B*); and
 - Career, Technical, and Adult Education;
- regular appropriations for these accounts also become available in July 2013 for school year 2013-2014; and
- if Congress does not act to avoid sequestration and appropriations are similarly structured then USDE will
 - take the sequester from the regular appropriations that become available in July 2013; and
 - *not* take the sequester from the advance appropriations that become available in October 2012.

The amount of the reduction will be calculated by applying the sequester percentage² to the amount of both the advance and regular appropriation and reducing the July 2013 funding by this amount.

Also, according to the July 2012 letter:

- states have urged holding back spending for the school year 2012-2013;
- if Congress enacts a 2013 appropriation similar to pending House and Senate bills there is no reason to think sequestration will affect the school year 2012-2013; and
- the potential for sequestration should not upset planning and hiring decisions for the immediately upcoming school year 2012-2013.

The letter acknowledges that the “major exception where the BCA sequester could reduce funds for school year 2012-2013 is the \$1.2 billion Impact Aid program.”

In his July 25, 2012 testimony before the Senate Labor, Health and Human Services, and Education Appropriations Subcommittee (Attachment 2), Secretary of Education Arne Duncan said that:

- Title I funding would be reduced by \$1.1 billion, cutting off funding for 4,000 schools serving 1.8 million disadvantaged students;
- funding for special education would be decreased by \$900 million, causing the layoff of more than 10,00 teachers and staff;
- starting January 2, the Impact Aid program would face immediate cuts;
- 100,000 low-income children would be denied access to the Head Start program; and
- 80,000 children would lose access to high-quality care through the Child Care Development Block Grant.

THE POTENTIAL EFFECTS ON NEW MEXICO OF BUDGET SEQUESTRIAN AND USDE GUIDANCE

An approximately \$29.6 million in reductions across all federal elementary, secondary, and vocational programs in school year 2013-2014³ is estimated by LESC staff by using the 7.8 percent sequester estimate developed by the Congressional Budget Office and comparing it to the FY 12 estimates for federal funds developed by USDE, and assuming funding for programs remains at similar levels. A matrix of the estimated impact to New Mexico is provided as Attachment 3.

According to the Federal Funds Information for States (FFIS), an approximately \$96.6 million decrease in federal funds is the estimated *total* impact to the state for projected across the board cuts to covered programs using the 7.8 percent sequester amount developed by the CBO. FFIS estimates a \$33 million impact to the state to *all* programs administered by the USDE, but this includes programs for higher and general education as well as programs administered by the

² As determined by the Office of Management and Budget, the estimated percentage (7.8) was developed in a September 2011 Congressional Budget Office publication.

³ With the exception of the cuts to the Impact Aid program which, as mentioned above, would take place in FY 13.

USDE under the *Higher Education Opportunity Act*, the *Rehabilitation Act*, the *Workforce Investment Act*, and other programs not traditionally associated with elementary, secondary, or vocational education. The FFIS indicates that the only exempt program is the Pell Grant program. Twelve of the other federal programs that would face reductions have maintenance of effort requirements. A matrix of the estimated impact to New Mexico as calculated by FFIS is provided as Attachment 4.

The actual percentage amount of potential across the board cuts is unknown. A July 2012 FFIS publication indicates that the Center for Budget and Policy Priorities is estimating the possible sequester percentage may be closer to 8.0 percent for nondefense mandatory programs and 8.4 percent for nondefense discretionary programs. All education programs beside the Pell grants and Rehabilitation Services State grants would be classified as nondefense discretionary programs.

Also, according to the FFIS, on August 7, 2012, President Obama signed the *Sequestration Transparency Act of 2012* (P.L. 112-155), which requires:

- the White House's Office of Management and Budget (OMB) to produce a report within 30 days detailing spending cuts that will take place beginning January 2, 2013, under the sequestration process of the *Budget Control Act of 2012*; and
- to provide estimates for cuts in defense spending and nondefense discretionary spending, as well as the exact amounts to come from discretionary and mandatory spending at the start of each calendar year through 2021.

As indicated in Deputy Secretary Miller's letter (Attachment 1), the largest impact in school year 2012-2013 would be to the Impact Aid program. Using the same methodology to calculate the estimated impact to all funds, the impact to New Mexico is an estimated \$7.9 million reduction in Impact Aid funds. Because the State takes credit for 75 percent of the Impact Aid due to the equalized funding formula, the net impact on the funding formula would be approximately \$5.9 million.

Currently, projected credits in the State Equalization Guarantee for FY 13 are \$69.0 million. Although this figure includes all federal funds that the state may take credit for (Forest Reserve and Impact Aid funds), it is still less than 75 percent (or \$6.9 million) of the total amount of \$101.3 million that the USDE projects New Mexico will receive in FY 13, or \$75.9 million.

Because PED has continued its traditionally conservative approach to the amount budgeted for projected credits, if Impact Aid is reduced by the \$5.9 million in school year 2012-2013, then the conservative estimate will allow the State to avoid the impact of sequestration. In the event that the conservative estimation of projected credits would not cover the reduction, and there are no funds to be used from the State-Support Reserve Fund, the Legislature included language in the *General Appropriation Act of 2012* that allows PED to transfer up to \$4.0 million from the Appropriation Contingency Fund.

Despite these measures, the remaining estimated \$2.0 million reduction in Impact Aid funds that flows to school districts would not be avoided.

During his testimony in June, Deputy Secretary Aguilar also said that if the federal cuts do not happen, PED will ensure that districts will have the resources PED has withheld, and they will reconcile budgets based on the third quarter federal budgets.

Deputy Secretary Aguilar reaffirmed these points in correspondence with LESC staff on July 31, 2012, adding that PED expects to issue new allocation tables for districts and charter schools sometime in October as soon as it receive final allocation tables from the federal government. In the email, Deputy Secretary Aguilar said no specific guidance was sent out to districts and charter schools other than to direct them to the Administrative Services Division webpage on the PED website where all allocation tables reside.

ATTACHMENT 1

GENERAL

Letters from the Education Secretary or Deputy Secretary

July 20, 2012

Memorandum to:
Chief State School Officers

From:
Anthony W. Miller
Deputy Secretary
U.S. Department of Education

Subject:
Clarification of Sequester Impact on Four Accounts with Advance Funding

The Budget Control Act (BCA) of 2011 established a Joint Select Committee in Congress charged with the task of developing a proposal to achieve at least \$1.2 trillion in deficit reduction. Unfortunately, last November, the Joint Committee announced that it could not reach agreement on a deficit reduction plan. This failure triggered enforcement via automatic funding cuts, called sequestration, for fiscal year 2013, unless Congress prevents this from taking place by sending the President a balanced deficit reduction plan that does away with sequestration before it goes into effect on January 2, 2013.

Many of you have asked technical questions about how the Department of Education would implement the BCA sequestration in our four appropriations accounts that receive fiscal year 2013 budgetary resources from both 2012 advance appropriations and 2013 regular appropriations. The 2012 advance appropriations become available in October 2012 for school year 2012-13. The 2013 regular appropriations become available in July 2013 for school year 2013-14. Most of the funds in the four accounts with advance appropriations—Education for the Disadvantaged (Title I, ESEA), School Improvement Programs (Title II, ESEA), Special Education (IDEA Part B), and Career, Technical, and Adult Education—get distributed by formula to States and then to local school districts or other entities.

If Congress does not act to avoid sequestration, and assuming the 2013 appropriations for these four accounts are structured similarly to past appropriations (which they are under the pending House and Senate appropriations bills), the Department will take the sequester from funds that would become available in July 2013 for school year 2013-14, *not* from the 2012 advance appropriations available in October 2012. The amount of the reduction will be calculated by applying the sequester percentage (to be determined by the Office of Management and Budget) to the fiscal year 2013 budgetary resources from both the 2012 advance appropriations and the 2013 regular appropriations that are available for the four accounts. The calculated sequester amount will then get subtracted from the July 2013 funding. The net effect will be to cut the funding level for the programs in the four accounts with advance funding by the same percentage as all other programs, projects, and activities.

It has come to our attention that some States may have urged school districts to hold back on spending for the 2012-13 school year because of the possibility of sequestration.

SOURCE: US Department of Education <http://www2.ed.gov/policy/gen/guid/secletter/120720.html>

Assuming Congress enacts a 2013 appropriations bill that is structured similarly to the pending House or Senate bills—a reasonable assumption based on past practice—there is no reason to believe that a sequestration would affect funding for the 2012-13 school year.

While a large sequestration of education appropriations would decrease funding for schools and students across the country, the potential for sequestration should not upset planning and hiring decisions for the immediately upcoming 2012-13 school year. Federal funds have already been appropriated and will be provided for this school year, through grants made in July 2012 and advance funds that will be obligated in October 2012.

Most other Department elementary and secondary programs award funds late in the fiscal year for the following school year, either through a formula or following a competition for discretionary grants, so the impact of the BCA on these programs will not be felt until the 2013-14 school year as well. However, the major exception where the BCA sequester could reduce funds for the 2012-13 school year is the \$1.2 billion Impact Aid program. Impact Aid provides funds to some 1,192 school districts serving about 949,000 students. About 52,000 of those students are in districts that rely heavily on Impact Aid for a large share of their funds. These districts could experience more significant short-term funding problems due to sequestration than other districts.

Although most of the harm from the sequestration would not be felt in education programs until the 2013-14 school year, the damage from across-the-board cuts in that year would be severe. The Administration has submitted a balanced plan to Congress to avoid a sequestration, and continues to urge Congress to act on that policy. The sequestration was not meant to be implemented; it was meant to drive Congress to enact a balanced deficit reduction plan through the threat of destructive cuts. Time remains for Members of Congress to produce such a balanced plan, and we urge Congress to do so. Secretary Duncan will be testifying on July 25th before the Senate Appropriations Subcommittee on Labor, Health and Human Services, Education, and Related Agencies on the potential harmful impact of sequestration on schools, teachers, and students and will be urging Congress to take action to avoid the deep and indiscriminate cuts in education and other Federal programs that sequestration would entail. However, while we wait for Congressional action, based upon past practice in appropriations, there is little reason to delay hiring for school year 2012-13 due to the threat of sequestration.

ATTACHMENT 2

Testimony of Secretary Duncan before the Senate Labor, Health and Human Services and Education Appropriations Subcommittee JULY 25, 2012

Contact:

Press Office, (202) 401-1576, press@ed.gov

I want to thank the Chairman, the Ranking Member, and other Members of this Subcommittee for your support. Over the past three years, we've protected students at risk while investing in education reform that supports bold and courageous leadership at the both state and local level.

I welcome the opportunity to discuss the potential devastating impact of sequestration. We hoped that the prospect of deep, indiscriminate, across-the-board cuts would spur Congress to take a balanced approach to deficit reduction. So far that hasn't happened. Clearly, there is still time to act, and we remain hopeful that we can avoid these cuts.

Fiscal year 2013 is a little more than two months away and sequestration kicks in three months after that on January 2nd -- so it's critically important that we -- and the American people -- fully understand the consequences of sequestration and take steps to avoid it now.

As all of you know, sequestration will force across-the-board budget cuts on almost every discretionary program. Education, defense, public safety and all other federal agencies would indiscriminately cut services that are essential to every state and community.

The sequestration will put at risk all that we've accomplished in education and weaken programs that help children, serve families, send young people and adults to college and make the middle class American dream possible.

Sequestration is absolutely the wrong way to make policy. It does not let Congress or the administration set priorities. It attacks both ineffective and effective programs with the same budget knife.

Perhaps, worst of all, it is another short-term fix to our long-term budget challenges. If sequestration happens, it simply means we didn't do our jobs in Washington -- we shirked our collective responsibility -- and the people of America will pay the price.

Essentially, we're playing chicken with the lives of the American people -- our schools, communities, small businesses, farms, public safety, infrastructure and national security. It further erodes what little faith remains in our elected leadership to put partisan politics aside and do the right thing for children and families.

SOURCE: US Department of Education <http://www.ed.gov/news/speeches/testimony-secretary-duncan-senate-labor-health-and-human-services-and-education-approp>

Clearly, it is time for Congress to work together with the administration to create a long-term plan to reduce the deficit while simultaneously supporting the economic recovery that is underway.

We have had 28 straight months of private sector job growth because we have been thoughtful and ambitious in the way we balance new investments with spending cuts. Today, in fact, domestic discretionary programs are at their lowest level as a share of G.D.P. since the Eisenhower Administration.

Congress has five months to work together to create a deficit reduction plan. President Obama has proposed a responsible way to do that when he submitted a plan that includes more than \$4 trillion in deficit reduction. It maintains the Budget Control Act caps, and calls for significant, yet targeted, cuts in discretionary spending. We've tightened our belts in a responsible way.

Most importantly, the President's plan is a long-term fix. It will put an end to the see-saw budgeting that leaves state and local officials wondering if they can count on the federal government to be a partner with them on education and other vital programs.

Let's begin with education:

The President and I – and many, many members of Congress – recognize that education is the cornerstone of our economy. A good education leads to a good job and a lifetime of higher earnings. A strong education system and a strong economy are inextricably linked. Over the past three years, we've made investments in Race to the Top, the Investing in Innovation Fund, and other efforts to reform our schools so today's students are truly prepared to succeed in the global economy and keep high-wage, high-skill jobs in America.

Sequestration sends a signal that the United States is backtracking on its commitment to reform and its long-standing promise to promote equity through Title I and the Individuals with Disabilities Education Act, or IDEA.

Education is also essential for our military preparedness. A staggering 75 percent of young Americans are unable to enlist in the military today because they have either failed to graduate from high school, they have a criminal record, or they are physically unfit.

I've met with military leaders who recognize that the best way to address the dropout crisis is to start early and invest in early childhood education. They don't want to see cuts in Head Start, Child Care Development Block Grants and other programs serving children.

The biggest impact in K-12 education will be felt starting in the fall of 2013. In a recent poll of school district leaders, 80 percent of them said they would not be able to use state and local funding to replace lost federal funds.

Based on the Congressional Budget Office's projection that sequestration will reduce programs by 7.8 percent, here's what we know will be at risk:

- Title I funding would be cut by \$1.1 billion, cutting off funding to more than 4,000 schools serving an estimated 1.8 million disadvantaged students. The jobs of more than 15,000 teachers and teacher aides would be at risk. Students would lose access to individual instruction, afterschool programs, and other interventions that help close achievement gaps.
- Funding for special education would be reduced by \$900 million. That could translate into the layoffs of more than 10,000 teachers, aides, and other staff who provide essential instruction and other support to 6.6 million children with disabilities in every one of your states.
- On January 2nd, schools serving our military families through the Impact Aid program would have immediate cuts to their budgets. For example, the Killeen Independent School District in Texas would lose \$4.6 million – directly affecting 18,000 children from military families. Military families make so many sacrifices for our country. Their children deserve a world-class education.
- In higher education, the Department would need to slash spending on contracts to support the processing and origination of student loans, which could cause delays that will hurt students as they make decisions about college and could reduce services for borrowers seeking to repay their loans.

In addition to these cuts at our Department of Education, other agencies will have to be forced to reduce spending in ways that will slow our nation's educational progress.

- Up to almost 100,000 low-income children would be denied access to the Head Start program, which is critical to preparing them for success in kindergarten and beyond.
- 80,000 children would lose access to high quality care through the Child Care Development Block Grant.
- The National Institutes of Health would issue 700 fewer grants to medical researchers, slowing progress in the search for treatments and cures to cancer, diabetes, Alzheimer's, and other diseases in research labs at hospitals and universities across the country. Up to 1500 grants would be cut from the National Science Foundation.

While it is absolutely our hope and intention to avoid sequestration, the Department of Education, along with all other agencies, will be ready to implement cuts if sequestration happens. But we all know that there are steps we can take so we don't have to start down this path that puts so many critical services to students, families and communities at risk. As everyone knows, sequestration does not have to happen and should not happen.

President Obama and all of us on his team are ready to work with you to create a long-term path to reduce the deficit while investing in the programs that will secure our country's economic prosperity and global leadership. Together, let's do the right thing.

ATTACHMENT 3

Sequestration Reduction Estimate (In Actual Dollars)

Program	2012 Estimate ¹	7.8% Sequestration Estimate ²
College- and Career-Ready Students (Title I, Grants to LEAs)	119,499,159	(9,320,934)
School Turnaround Grants (School Improvement State Grants)	4,143,996	(323,232)
State Agency Program--Migrant Student Education	953,105	(74,342)
State Agency Program--Neglected and Delinquent Children and Youth Education	360,409	(28,112)
Subtotal, Accelerating Achievement & Ensuring Equity	124,956,669	(9,746,620)
		0
Impact Aid Basic Support Payments	98,167,406	(7,657,058)
Impact Aid Payments for Children with Disabilities	3,165,542	(246,912)
Impact Aid Construction	0	0
Subtotal, Impact Aid	101,332,948	(7,903,970)
Effective Teachers and Leaders State Grants	0	0
Improving Teacher Quality State Grants	19,147,373	(1,493,495)
Mathematics and Science Partnerships	1,269,260	(99,002)
21st Century Community Learning Centers	8,729,513	(680,902)
Assessing Achievement (State Assessments)	4,505,467	(351,426)
Rural and Low-income Schools Program	1,236,240	(96,427)
Small, Rural School Achievement Program	562,416	(43,868)
Indian Student Education--Grants to Local Educational Agencies	8,913,722	(695,270)
English Learner Education (English Language Acquisition)	4,047,474	(315,703)
Homeless Children and Youth Education	534,853	(41,719)
Subtotal, All of the Above Programs, which were or are proposed to be authorized by the Elementary and Secondary Education Act	275,235,935	(21,468,403)
		0
Special Education--Grants to States	91,005,697	(7,098,444)
Special Education--Preschool Grants	3,126,461	(243,864)
Grants for Infants and Families	2,970,033	(231,663)
Subtotal, Special Education	97,102,191	(7,573,971)
		0
Career and Technical Education State Grants	8,127,523	(633,947)
Subtotal, Vocational and Adult Education	8,127,523	(633,947)
Subtotal, All Elementary/Secondary Level Programs	380,465,649	29,676,321

Source: LESC Analysis of USDE figures

¹ From the USDE website: <http://www2.ed.gov/about/overview/budget/statetables/index.html>

² From the September 12, 2011 Congressional Budget Office Publication Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act

FFIS Sequestration Reduction Spreadsheet (In Thousands of Dollars)

Covered Programs	FY2012 Enacted	FY 2013 (Hypothetical Covered Program Estimates)	7.8% Sequestration Estimate	Maintenance of Effort (MOE)	MOE or State Match Notes
21st Century Community Learning Centers	8,730	8,049	681	X	MOE not less than 90% of prior-year level
Adult Education Basic Grant	3,966	3,657	309	X	25% of total funds spent; MOE not less than 90% of prior-year level
Assistive Technology State Grant Program	433	399	34		
Byrd Honors Scholarships	0	0	0		
Centers for Independent Living	857	791	67		
Client Assistance State Grants	124	115	10		
College Work-Study	6,783	6,254	529		Institution pays between 25% and 50% of total cost
Comp Ed (Title I) - Local Education Agencies	119,435	110,119	9,316	X	MOE not less than 90% of prior-year level
Comp Ed (Title I) - Migrant	953	879	74		
Comp Ed (Title I) - State School Improvement Grants	4,125	3,803	322		
Comp Ed (Title I)- Even Start	0	0	0		Match increases each program year by 10% (10% to 50% of total cost)
Comp Ed (Title I)- State Agency Neglect & Delinq.	271	250	21		Sub-grantees have matching requirements
Drug - Free Schools & Communities State Grants	0	0	0	X	MOE not less than 90% of prior-year level
Education For Homeless Youth	544	501	42		
Education Technology State Grants	0	0	0		
English Literacy and Civics Education State Grants	251	231	20		
Impact Aid - Basic Support Payments	98,167	90,510	7,657		

Impact Aid - Construction	0	0	0	0	0			
Impact Aid - Special Education Payment	3,166	2,919	247					
Independent Living	312	287	24					10% of total cost; in-kind allowed
Indian Education - Grants to Local Educ. Agencies	8,914	8,218	695	X				MOE not less than 90% of prior-year level
Innovative Educ. Prog. Strategies State Grants	0	0	0					
Language Acquis. Grants	4,047	3,732	316					
Leveraging Educational Assistance Partnership	0	0	0	X				Match based on MOE level but not less than one-to-one basis; MOE not less than prior-year level
Mathematics and Science Partnerships	1,269	1,170	99					
Protection & Advocacy Individual Rts	175	162	14					
Reading First State Grants	0	0	0					
Rehab. Services - Basic State Grant	24,728	22,799	1,929	X				21.3% of total cost; MOE based on non-federal spending in previous two years
Rural and Low-Income Schools Program	1,236	1,140	96					
Services for Older Blind Individuals	225	207	18					10% of total funds
Small, Rural School Achievement Program	562	519	44					
Special Education Basic State Grant	91,006	83,907	7,098	X				MOE based on expenditures from previous year
Special Education Infants & Toddlers	2,970	2,738	232	X				MOE not less than prior-year level
Special Education Preschool Grants	3,126	2,863	244	X				MOE not less than prior-year level
State Grants for Improving Teacher Quality	19,147	17,654	1,493					
State Grants for Workplace and Community Transition Training for Incarcerated Individ.	0	0	0					
State Library Program	1,452	1,338	113					34% of total cost
State Testing Funds	4,505	4,154	351					

Supplemental Educ. Opportunity Grants	3,639	3,355	284	Institution pays 25% of cost
Supported Employment State Grants	300	277	23	
Voc Ed - Basic State Grant	8,128	7,494	634	50% of admin. cost; MOE not less than prior-year level
Voc Ed - Technical Prep	0	0	0	MOE not less than prior-year level

Totals 423,547 390,510 33,037

Exempt Programs			
Pell Grants	236,400	NA	NA