Prevention Alliance

BUDGET MEMO: SEPTEMBER 2020 REVENUE FORECAST

September 2020

On September 23rd the Economic and Revenue Forecast Council (ERFC) released the official quarterly revenue forecast. This was the second official forecast to capture the impact of the COVID-19 pandemic. The change from the June forecast was significant. With the economy gradually reopening, adjustments in revenue and consumer confidence, and changes made to personal income estimates, the September forecast added back about half of the revenue shortfall that was projected in the June forecast. While this is positive news to have a substantially smaller shortfall, the state is still facing a significant budget shortfall as a result of the pandemic. Legislators who sit on the ERFC all made comments saying that this the forecast isn't necessarily good news given there is still a significant shortfall and the landscape remains very unstable, but it is less bad news than a couple months ago. From the ERFC report, "While the COVID pandemic has had a significant negative impact on state revenues, the impact has not been as bad as forecasted in June."

This memo will provide an updated overview of the changing operating budget and revenue landscape in Washington and some context for potential options that lie ahead.

September Revenue Forecast

In Washington, the Economic & Revenue Forecast Council (ERFC) releases and adopts four official revenue forecasts each year: spring during session (February in short session years; March in long session years), summer (June), fall (September), and winter before the governor releases their proposed budget (November). These revenue forecasts look at the various revenue sources (sales tax, property tax, real estate excise tax, business & occupation tax, tobacco/marijuana/liquor tax, etc.) and the projected impact of economic factors such as unemployment, sales, airline travel (including the ripple effect on Boeing having reduced demand for planes), housing construction, exports, etc. Looking at all of these factors, the ERFC builds a forecast for what the state's estimated revenue will be and how much larger/smaller it is than the previous forecast.

The spring quarterly revenue forecast released in February 2020 painted an optimistic picture for Washington's economy and fiscal outlook including a revenue forecast showing the current 2019-21 biennium increasing by an estimated $606 million. This forecast provided the assumptions that the legislature based the 2020 supplemental budget on. Then on June 17th, the official summer quarterly revenue forecast was released by the ERFC and the picture was extremely stark with estimated revenue loss coming in at the significant amount of $8.9 billion over the next three years.

The September forecast continues to capture the extensive impact the COVID-19 pandemic has had on our economy, but also highlights the instability and unpredictability of the landscape. In the forecast, **Near General Fund State (NGF-S) revenue is forecasted to decrease by $2.4 billion in the current 2019-21 biennium and $2.1 billion in the 2021-23 biennium** *(see Table 1 for detail)***.** This puts the three year shortfall for the remainder of the current biennium and upcoming 2021-23 biennium at about $4.5 billion. When compared to the three year shortfall of $8.9 billion that was projected in June, the numbers are much improved. However, that large of a shortfall is still a lot for legislators to grapple with.

Table 1: Forecast Changes for Near General Fund-State (NGF-S)

Biennium	February 2020 Forecast (baseline)	June 2020 Forecast	June 2020 Projected Shortfall*	September 2020 Forecast	September 2020 Projected Shortfall*
2019-21 Biennium *(Current)*	$52.339 billion	$47.8 billion	**($4.5 billion)**	**$50.022 billion**	**($2.317 billion)**
2021-23 Biennium	$55.69 billion	$51.3 billion	**($4.3 billion)**	**$53.737 billion**	**($1.953 billion)**

**The projected shortfall is the change in revenue compared to the February 2020 revenue forecast, on which the budget passed by the legislature is based.*

There are several contributing factors to the improved revenues since June:

- Employment continued to rise in June, July, and August following the historic decline in March and April. As of August, nearly half of the jobs lost in those early months of the pandemic had been recovered.
- There were fairly significant changes made to the personal income estimates made by the ERFC in June following an update from the U.S. Department of Commerce releasing updated estimates that put personal income 5.4% higher in Washington than had been projected. The revision was largely due to higher-than-expected stimulus payments.
- The real estate market has been much stronger than expected due to low mortgage rates, which means that real estate excise tax (REET) collections are higher than had been projected.
- Auto and most other retail trade sector activity was stronger than expected, which has resulted in higher cumulative Revenue Act collections than was forecasted.

The state economist continues to caution that there is substantial uncertainty in the forecast going forward. On the optimistic upside, Congress could pass additional federal stimulus which in turn could result in increased consumer spending; and COVID infection rates could continue to decline, leading to increased reopening of businesses, greater consumer confidence and spending, and increased employment. On the pessimistic downside, COVID-19 infection rates could start increasing and lead to a slower pace of economic reopening, or even closing back down, and a corresponding reduction in consumer spending and employment; Congress might not pass additional fiscal stimulus legislation; and there is potential that Boeing could consolidate the 787 production in South Carolina, which would have a negative impact on state revenue collections.

What's Next

The budget landscape is improved from June estimates due to this smaller projected budget shortfall coupled with savings generated earlier this year from Gubernatorial vetoes, cancellation of state wage increases, and furloughs for most state employees. However, the magnitude of the budget shortfall our state is facing is still significant. While a lot remains unknown, it is clear that the impact the COVID-19 continues to have on our state and economy.

It remains unknown whether the legislature will convene for special session at some point during the 2020 interim to consider options and determine a path forward. But whether it is during a special session or once regular session begins in January, a lot of budget scrutiny, tough discussions about reduced spending, and the potential of new revenue will all be in play.

[See Appendix A for a refresher on what is and isn't protected in the operating budget]

Prepared for the Prevention Alliance by:
Carrie Glover
Carrie Glover Consulting
carrie@carrieloverconsulting.com

For more information about the Prevention Alliance, contact:
Julie Peterson
Executive Director
Foundation for Healthy Generation
juliep@healthygen.org

This publication was supported by National Center for Chronic Disease Prevention and Health Promotion of the Centers for Disease Control and Prevention under award number NU58DP004830. The content of this publication is solely the responsibility of the authors and does not necessarily represent the official views of the Centers for Disease Control and Prevention.

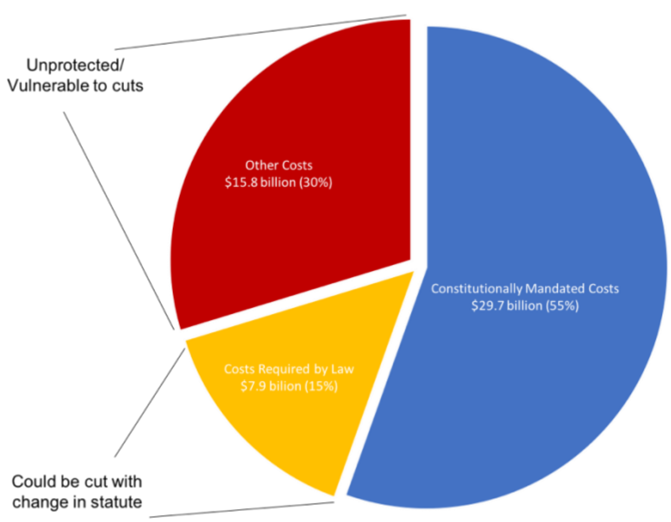
Appendix A. *What Is and Isn't Protected in the Operating Budget*

Based on a preliminary analysis, OFM has estimated that about 70% ($37.6 billion) of the 2019-21 operating budget is required by law or protected from cuts in the state constitution *(see chart 1 for more detail)*. This means the portion of the budget most vulnerable to cuts is the remaining 30% ($15.8 billion). Items in this 30% bucket aren't protected by the constitution or state law so while there might be important and beneficial programs that are undesirable to cut, they are logistically easier to cut, which makes them very vulnerable during such an economic downturn as we are facing.

Under the 70% that OFM has labelled 'protected', there are two buckets – 55% are items protected in the state constitution (such as basic education, debt services, etc.), and 15% are items required under state law (such as Medicaid expansion, foster care, etc.). Programs and services in the 'required by law' bucket could potentially be cut, though it would require a change in statute and therefore those items are more difficult (but not impossible) to cut. In addition, a lot of programs and services come with a federal match, such as Medicaid, so a cut to the state funding for those programs would result in a loss of federal dollars coming into the state, which makes them undesirable to cut them. While OFM labeled the 'required by law' bucket as protected, legislators could choose to change the relevant statute needed to make a cut, and it is a very real possibility that items in this bucket could be vulnerable given the extent of the current revenue shortfall. In fact, during [the June 2020 budget exercise] where OFM directed state agencies to comprise a list of potential cuts to achieve 15% in reduced spending, many items [identified by agencies] did fall under the 'required by law' bucket.

Of note, the percentage of what is required by law or protected in the constitution from cuts is higher than it was a few years ago, in part due to the increase in funding for basic education as a result of the McCleary lawsuit. In 2014, OFM estimated that 66% of the 2013-15 budget was protected, compared to 70% in the current budget. This means the percent of the budget that can be cut is smaller than it has previously been.

Chart 1: Unofficial OFM Estimate of What is Protected in the 2019-21 Operating Budget



Constitutionally Mandated Costs (Protected):

- K-12 Basic Education
- Debt Service/Pensions
- DSHS Constitutionally Required (state hospitals, residential habilitation facilities)

Other Costs Required by Law (Could be cut with change in statute):

- Various DSHS Required Costs
- HCA Required Costs (Medicaid)
- DCYF Required Costs (Adoption Support, Foster Care, etc)
- Courts

Other Costs (Unprotected/Vulnerable to cuts):

- Higher Education
- Department of Corrections
- Other Human Services
- Other K-12 Flexible
- Other (Legislative Agencies, Governmental Operations, Natural Resources, Transportation, Other Education, etc.)