Prevention Alliance

Budget Memo: November 2020 Revenue Forecast

November 2020

On November 18th the Economic and Revenue Forecast Council (ERFC) released the official quarterly revenue forecast. This was the third official forecast to capture the impact of the COVID-19 pandemic. It is also the revenue forecast that Governor Inslee will base his proposed budget on, which will be released next month. The forecast showed that revenue collections and other components of the economy continued to improve from the stark projections in the June 2020 revenue forecast, which projected an almost $9 billion revenue shortfall over the next three years. The September 2020 forecast cut that shortfall in half, and the November 2020 forecast continues to build on those improving economic and revenue trends. While this is again positive news to have an even smaller shortfall, the state is still facing significant budget challenges as a result of the pandemic. The ERFC continued to caution that the landscape remains unstable with "substantial uncertainty regarding the economy's path" and that "despite upward revisions, forecasted revenue remains well below pre-pandemic levels."

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

November 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 (November)before the governor releases their proposed budget (December). 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, aerospace industry, 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.

As a reminder, the spring quarterly revenue forecast released in February 2020 painted an optimistic picture for Washington's economy and fiscal outlook including a revenue forecast that showed growing revenues and a solid economy. This forecast provided the assumptions that the legislature based the adopted 2020 supplemental budget on. When we talk about budget shortfalls, we are looking at current revenue projections compared to that spring revenue forecast, and also caseload projections for state programs compared to what was budgeted for last session.

The November 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 increase by $634 million in the current 2019-21 biennium and $328 million in the 2021-23 biennium *compared to the September revenue forecast*.** This puts the three year shortfall for the remainder of the current 2019-21 biennium and upcoming 2021-23 biennium at about $3.4 billion compared to the February forecast *(see Table 1 for detail)*. When compared to the three year shortfall of $8.9 billion that was projected in June, the numbers are much improved. It is important to note that while the revenue forecast does take into account the new restrictions directed by Governor Inslee on November 16th in response to rising COVID-19 cases, the economic forecast, which looks at things like jobs/employment data, construction, exports, etc, did not factor in those restrictions.

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

Biennium	February 2020 Forecast (baseline)	November 2020 Forecast	November 2020 Projected Shortfall*
2019-21 Biennium *(Current)*	$52.69 billion	$50.995 billion	**($1.695 billion)**
2021-23 Biennium	$56.317 billion	$54.666 billion	**($1.651 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 the last forecast in September:

- Despite the expiration of most federal relief spending, retail trade activity was stronger than expected, resulting in cumulative Revenue Act collections that were $256 million higher than forecasted.
- House sales spiked in September and October due to record-low mortgage rates and people seeking accommodations better suited to working from home. As a result, real estate excise tax (REET) collections were $78 million higher than forecasted September.
- Washington car and truck sales continued to be higher than previously forecasted.
- October employment data showed an increase in 11,300 jobs.

In their meeting materials, the ERFC also provided a budget balance sheet for the 2019-21 biennium, which compares resources available to updated expenditure estimates. If you look at the bottom line of currently projected resources compared to updated expenditures, the adjusted shortfall for the current biennium is about $152 million. *(see table 2)*.

Table 2: Summary of 2019-21 Enacted Budget Balance Sheet

Total Resources Includes beginning fund balance (aka carry forward from previous biennium), current revenue, and other transfers & adjustments	$52.775 billion
Total Expenditures Includes the 2019-21 enacted budget passed last session as well as actual and assumed reversions	$52.927 billion
Projected Ending Balance	**($152 million)**

**Source: November 2020 Economic & Revenue Forecast Meeting Packet, page 56*

While a shortfall for the current biennium of $152 million is a much improved fiscal landscape for the legislature to navigate when writing the supplemental budget, there is still uncertainty and instability in both the current biennium and the longer term. The budget balance sheet for the 2021-23 biennium will not be made available until after the new year, so it is not known at this time what the total resources compared to expenditures is for the upcoming biennium.

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 an effective COVID vaccine could become widely available sooner than expected given recent announcements of progress on this front. On the pessimistic downside, COVID-19 infection rates continue to increase as we are in a fall surge of the pandemic, which can lead to a slower pace of economic reopening, reduced consumer spending, and an increase in unemployment.

November Caseload Forecast

Another factor that impacts the state budget landscape in Washington is projected changes in caseload for the various state-funded programs and services. The state Caseload Forecast Council (CFC) met on November 10th to discuss their November caseload forecast. A summary of the caseload forecast is available here. Overall, most caseloads are lower than the Caseload Forecast Council projected in the June caseload forecast. As anticipated, there are services and programs that are forecasted to increase in caseload *compared to June 2020* (ex. Medicaid expansion; Working Connections Child Care, Early Childhood Education and Assistance Program, and Charter Schools) while others are expected to decrease *compared to June 2020* (Common Schools Enrollment; Aged, Disabled and Other Medicaid; Common School Special Education; Temporary Assistance for Needy Families; Early Support for Infants & Toddlers; etc.). While some of these caseloads might be down compared to June 2020, many are still higher than the February caseload forecast, which is what the legislature based the adopted budget on. Budget writers will need to account for what the changes in caseload forecast translate to in regard to budget impact.

What's Next

The budget landscape has continued to improve over the past several months since the stark June projections. However, there does still remain a significant revenue shortfall and the overall budget landscape remains unstable with the ongoing impacts of the COVID-19 pandemic.

At this point it is very unlikely that the legislature will convene for special session within the next two months before the legislature convenes virtually in January for the 2021 legislative session. This means that when regular session begins, a lot of budget scrutiny, tough discussions about reduced spending, and the potential of new revenue will all be in play as the legislature works on both a supplemental budget for the current 2019-21 biennium as well as writing the full 2021-23 budget.

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

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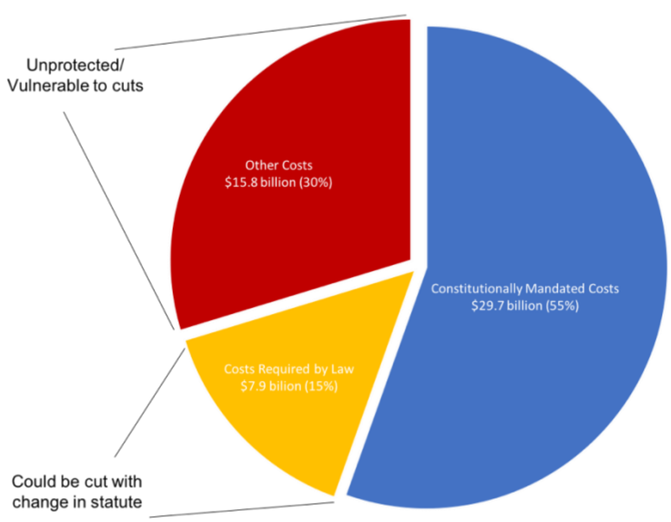
Appendix A. *What Is and Isn't Protected in the Operating Budget*

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.)