Prevention Alliance

BUDGET REPORT: FALL 2024 STATE BUDGET LANDSCAPE

An Opening Note: For the Prevention Alliance budget forecast memos, we typically focus on the release of the quarterly revenue forecasts from the Economic & Revenue Forecast Council. There are a lot of components that factor into the state budget landscape, but these quarterly forecasts provide one of the more tangible and transparent tools we have given there are actual projected numbers that accompany the forecasts. However, the rapidly evolving budget situation this fall warrants looking at some of the other components in that budget landscape. While we don't have specific numbers for budget impact of all these components, it would be remiss to not bring those pieces into the discussion in this memo.

As indicated by its name, the revenue forecast looks at the money coming to the state from various state revenue sources (business & occupation taxes, sales and use tax, real estate excise taxes, capital gains taxes, etc.). The Economic and Revenue Forecast Council looks at the amount coming in for those revenue sources compared to what was previously projected, and then also looks at economic factors that might impact those revenue sources (up or down). A budget shortfall could result from less revenue coming in than was projected. But even if revenue collections were increasing, it could be at a slower pace than previously projected. And if costs outpace revenue, then that can also create a budget shortfall. It is this broader landscape of increased costs that is having some of the most significant impact on the budget landscape heading into the 2025 legislative session.

The following pages will provide our normal analysis of the September 2024 revenue forecast as well as an overview of some of the other factors that impact the state budget landscape.

Overall Budget Landscape – Fall 2024

In every aspect of state budget work – whether you are a legislator, an advocate, a state agency, or a member of the public – there is a recurring theme this fall that the combined impact of the various budget components show that we are in a very tight state budget landscape. While there is no firm number publicly available, the projected budget shortfall amount being discussed ranges from $5 to $10 billion down over the four-year budget outlook[1].

This shortfall is not due to changes in projected revenue alone (though that is a contributing factor), but also due to other components such as increased maintenance level funding needs, caseload adjustments, and collective bargaining agreements. In addition, there are two initiatives on the ballot in the upcoming November election that could have a significant impact on the state budget depending on the outcome.

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[1] Funds subject to the budget outlook include the state general fund (GF-S), the Education Legacy Trust Account (ELTA), the Opportunities Pathways Account (OPA), and the Workforce Education Investment Account (WEIA). Chapter 8, Laws of 2012, requires the legislature to adopt a four-year balanced budget. Since the 2013-2015 biennium, the legislature has been required to enact a balanced operating budget that leaves a positive ending fund balance in the general fund and related funds (ELTA, OPA, and WEIA). For more background on the Four-Year Outlook, see the Prevention Alliance policy brief on Washington's Four Year Outlook.

September 2024 Revenue Forecast

On September 27th, the Economic and Revenue Council (ERFC) released the September 2024 Quarterly Economic & Revenue Forecast. The forecast showed a continued unstable trend in our state revenue collections and budget projections compared to the last quarterly forecast that was released in June. The September forecast projects that when compared to the June forecast, total net state revenue subject to the budget outlook is expected to *decrease* by $49.2 million in the current 2023-25 biennium, increase by $79.1 million in the 2025-27 biennium, and *decrease* by $686 million in the 2027-29 biennium. *See table 1 for more detail.*

The projected *decrease* of $608 million total over the current and ensuing two biennia (2023-2029) is largely due to forecasted economic changes (consumer spending, unemployment rates, real estate activity, etc.).

Overview: The Economic & Revenue Forecast Council

In Washington, the Economic & Revenue Forecast Council (ERFC) releases and adopts four official revenue forecasts each year: spring during legislative 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/cannabis/liquor taxes, etc.) and the projected impact of economic factors such as unemployment, sales, airline travel (for the ripple effect on Boeing), housing construction and sales, exports, etc. Looking at all 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.

These numbers show that overall, the September 2024 economic and revenue forecast projects a continued concerning downward trend for the current and ensuing biennia. While there were some positive economic trends (there is less inflation pressure and employment growth continues), there were also major factors that drove the downward forecast (U.S. employment growth has slowed, and WA revenue collections growth continues to be slow).

Table 1: State Revenue Forecast March 2023 Compared to June 2023

Biennium	**February 2024 Forecast (baseline)**	**June 2024 Forecast** *(compared to Feb)*	**September 2024 Forecast** *(compared to June)*	**Cumulative Impact: February 2024 to September 2024 comparison**
2023-25 Biennium	$67.005 billion	$66.528 billion *(-$476.7 million)*	$66.479 billion *(-$49.2 million)*	**-$526 million decrease**
2025-27 Biennium	$71.721 billion	$71.532 billion *(-$189 million)*	$71.611 billion *(+$79.1 million)*	**-$110 million decrease**
2027-29	$76.948 billion	$77.044 billion *(+$96.1 million)*	$76.976 billion *(-$68.6 million)*	**$28 million increase**

When the ERFC produces the quarterly forecast, they include both potential upside and downside risks that could impact the forecast as released, for better or for worse. Some concerning potential landscape shifts for economic and revenue projections include:

- Elevated interest rates could push the economy into recession.
- The ongoing Russia-Ukraine and Middle East conflicts could intensify.
- The Boeing Labor dispute could extend for a long amount of time

- I-2109 could pass in November, which would repeal the capital gains tax and therefore result in the ending of that revenue source and a resulting impact the budget forecast.[2]

The pessimistic September 2024 alternative forecast produced by the ERFC projects an additional *decrease* of $1.962 billion for the current 2023-25 biennium and an additional *decrease* of $6.037 billion for the 2025-27 biennium.

Another budget indicator that is tracked is the amount in ‘reserves’. Reserves are comprised of the projected ending balance (projected revenue and other resources minus estimated expenditures) combined with the amount in the Budget Stabilization Account, which is also known as the Rainy-Day Fund. The total reserves are estimated at $3.199 billion for the 2023-25 biennium.

It is important to remember that all these numbers are simply projections, or the ‘best guess’, based on available data and the economic landscape. Budget writers, the Governor’s office, state agencies, and advocates will be tracking actual revenue collections in the coming months to see which way the economic and revenue climate goes – more toward the optimistic or pessimistic projections.

<u>Other Budget Landscape Indicators</u>

As stated above, the revenue forecast is a very important component of the budget landscape, and one that there is consistent and transparent reporting for due to the existence of the Economic & Revenue Forecast Council in Washington. However, it is not the only piece of the budget puzzle. Below is an overview of some of the other components of our state budget landscape in Washington. While we don’t have firm numbers to share for all of these components, the narrative about their current projected impact is important to understand in the broader budget landscape.

June Caseload Forecast

Projected changes in caseload for the various state-funded entitlement programs and services is a significant factor in the budget landscape. The caseload forecast tracks things like Apple Health (Medicaid), common school enrollment, subsidies for childcare, basic needs programs, etc. Entitlement programs are things that the state must provide if a person is eligible. In other words, they can’t cap enrollment due to lack of funding. They must provide adequate funding to ensure that service is provided to all who are eligible.

The state Caseload Forecast Council meets three times a year – in the spring during session, in June, and in November. Unlike the Economic & Revenue Forecast Council, the Caseload Forecast Council doesn’t meet in September, so we do not have new caseload projections to

[2] The ERFC speaks only to the potential impact of Initiative 2109 (attempting to repeal of the capital gains tax) in the revenue forecast and not Initiative 2117 (attempting to repeal the Climate Commitment Act). This is because revenue from the capital gains tax revenue is included as part of the quarterly revenue forecasts while revenue from the Climate Commitment Act (CCA) is not. Therefore, if I-2117 were to pass and CCA revenue were to be repealed, the impact of losing that revenue source will not be accounted for in the quarterly revenue forecasts, but will be something the Governor and legislature will need to account for in their respective budgets.

report on for this brief. Looking back at the June 2024 caseload forecast, there were 15 caseloads that saw an increase, 6 that were lower, and 10 that had a negligible change. In presenting the caseload forecast, staff noted that the June forecast is the one that captures the impact of changes made by the legislature in the previous session, so it is not uncommon to see a higher level of caseload increases in the June forecast. A summary of the caseload forecast is available here. While the caseload forecast gives a good indication of the utilization of state-funded programs and services, it is important to note that it does not assign dollar amounts to the changes in forecast.

Maintenance Level Funding Needs

While the caseload forecast looks specifically at entitlement programs and services, there are other funding adjustments needed to maintain the status quo. This includes the entitlement caseloads discussed above, non-entitlement investments, state agency operations, etc. Reasons for increased maintenance level funding needs can include things like higher than anticipated utilization, increased cost of a project due to inflation, higher agency staffing needs, cost to implement something previously directed by the legislature (such as something with a phased-in implementation), etc.

Getting a rolled-up number for the maintenance level funding needs isn't something that is readily available to the public. However, we can see what some of the state agency recommendations are for maintenance needs in the agency decision packages turned into the Office of Financial Management (OFM) each fall. As an example, the following image is a snapshot of the maintenance level funding needs requested by the Department of Children, Youth & Families as listed in their agency decision package summary for the 2025-27 budget that was submitted to OFM in September.

Image 1: Agency Maintenance Level Recommendation Summary Example – Department of Children, Youth & Families for 2025-27 Operating Budget

(Dollars in Thousands)[3]

Maintenance – Other Changes					
ML 8L	Lease Adjustments	0.0	0	0	0
ML 93	Mandatory Caseload Adjustments	0.0	0	0	0
ML 98	General Inflation	0.0	1,754	852	2,606
ML 9F	Federal Funding Adjustment	0.0	0	38,826	38,826
ML 9S	Equipment Replacement Costs	0.0	1,273	0	1,273
ML AC	AGO Costs	0.0	7,013	870	7,883
ML B1	Technical Corrections	1.5	21,924	(1,816)	20,108
ML C1	FFPSA Backfill	0.0	22,850	(22,850)	0
ML C2	Rate Adjustments	0.0	35,948	5,934	41,882
ML F4	WCCC Eligibility 75% SMI & Dual Lan	40.0	230,567	186	230,753
ML F5	ECEAP Entitlement	23.5	451,082	334	451,416
ML F7	Child Care Subsidy Base Rates	0.0	275,095	0	275,095
ML FL	JR Food and Medical Costs	0.0	1,696	0	1,696
ML FM	JR Facility Maintenance Costs	0.0	8,065	0	8,065
Maintenance – Other Total		**65.0**	**1,057,267**	**22,336**	**1,079,603**

***Source**: Office of Financial Management – Department of Children, Youth & Families Recommendation Summary for the 2025-27 Operating Budget.*

[3] You may notice that some rows have '0' in all columns. Those typically do not mean that there is no cost impact, but rather often indicate that the item is a placeholder, and specific amounts will be determined closer to the Governor's budget and/or the legislative session. If that is the case, then it is explained in the narrative summary and/or detailed decision package.

Collective Bargaining Agreements

One area that can have a big impact on the budget is the outcome of collective bargaining agreements (CBAs). Collective bargaining is a process where a labor organization and an employer negotiate the terms and conditions of employment for a group of employees. The things that are typically negotiated include wages, hours, benefits, leave, working conditions, etc. The Office of Financial Management (OFM) manages the collective bargaining process on behalf of the Governor with three types of union groups:

- ***State employees:*** General government employees, higher education employees, WSDOT/WA state ferries employees, and Department of Fish and Wildlife and WA state patrol
- ***Certain non-state employees:*** Adult family home providers, childcare providers, and language access providers
- ***Healthcare for K-12 education unions*** through the School Employees Benefits Board (SEBB).

This year in particular, the budget impact of the CBAs that were released at the beginning of October[4] is particularly significant with a total impact of $2.849 billion GF-S[5] ($4.169 billion total) for the 2025-27 and 2027-29 biennia combined. The breakdown of estimated costs of the CBAs by type is summarized in Table 1 below.

Table 1: Cost Estimate of Collective Bargaining Agreements by Employee Type

	2025-27 Biennium		**2027-29 Biennium**		**Total Four-Year Cost**	
	GF-S	***Total***	***GF-S***	***Total***	***GF-S***	***Total***
State Employees	$646.2 million	$1.092 Billion	$774.1 million	$1.291 Billion	$1.42 Billion	$2.384 Billion
Non-State Employees	$160.6 million	$328.3 million	$173.1 million	$355.1 million	$333.8 million	$683.4 million
K-12 Employee Health Care	$569.4 million	$572.7 million	$526.4 million	$529.4 million	$1.095 Billion	$1.102 Billion
Total	$1.376 Billion	$1.993 Billion	$1.473 Billion	$2.176 Billion	$2.849 Billion	$4.169 Billion

***Source**: Office of Financial Management.*

Initiatives on the November Ballot

In addition to the normal budget landscape components discussed above, this year there is added complexity due to two initiatives that will be on the ballot for the November election this fall. Both initiatives propose repealing a revenue source that has been passed by the legislature in recent years: Initiative 2109 would repeal the state capital gains tax if passed, and Initiative 2117 would repeal the state Climate Commitment Act if passed.

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[4] 2025-27 Collective Bargaining Agreement details available through the following links: *state employees*, *non-state employees*, *and health care for K-12 education unions*.

[5] GF-S is shorthand for 'General Fund-State', which is the largest and main account for the state budget where the majority of state funding is appropriated from. The 'total' amount includes funding from both the GF-S account as well as any other funding sources such as federal dollars, other state accounts, etc.

If either or both initiatives pass in November, then the revenue sources would be eliminated with a resulting budget shortfall. The specific impact of each is outlined below. The information provided is from the fiscal impact statement for each initiative from the Secretary of State's Voters Pamphlet.

> ***Initiative 2109 (Would repeal the state Capital Gains Tax):*** "If approved by voters, Initiative 2109 will result in an estimated state revenue loss of $2.2 billion over five state fiscal years. This would reduce funding dedicated for K–12 education, higher education, early learning and child care. Future reductions to funds dedicated for K–12 school construction are possible but not currently forecasted. The estimated net savings for administrative expenses for two state agencies are $10.1 million over five state fiscal years. No local government fiscal impacts are known."[6]

> ***Initiative 2117 (Would repeal Climate Commitment Act):*** "If approved by voters, Initiative 2117 will reduce state revenue from carbon allowance auctions by $3.8 billion and reduce state expenditures by $1.7 billion between the effective date of the initiative and June 30, 2029. This would reduce or eliminate funding for numerous programs and projects, including for: transportation emissions reduction; transit, pedestrian safety; ferry and other transportation electrification; air quality improvement; renewable and clean energy; grid modernization and building decarbonization; increasing the climate resilience of the state's waters, forests and other ecosystems; fire prevention and forest health; and restoring and improving salmon habitat. Local government fiscal impacts are indeterminate."[7]

From these fiscal impact statements, we can see that if both initiatives were to pass, the state would be facing an *additional* $6 billion shortfall in revenue over five state fiscal years on top of the components discussed in the previous sections of this report.

What's Next

As we get closer to the 2025 legislative session, there are a lot of knowns in relation to the budget landscape, and a lot of unknowns. For the unknowns, it will be important to see the outcome of the initiatives that are on the ballot in the general election, and we will also need to see how state revenue and other economic factors evolve when the ERFC releases the next quarterly revenue forecast on November 20th.

It is clear from the known components that the state is currently in a very tight budget climate, and the unknowns have the potential to increase the current budget shortfall. While recent years have seen a growth in new investments by the legislature (much of which was funded with one-time federal COVID relief dollars), the projected budget shortfall paints a very different landscape heading into the 2025 session. Rather than growth and new investments, it is anticipated that the legislature will have minimal opportunity for new spending and in fact

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[6] Secretary of State Washington Voters' Pamphlet. General Election November 2024. https://www.sos.wa.gov/sites/default/files/2024-09/Voters%20Pamphlet%202024%20-%20Edition%2006%20-%20King%20-%20Seattle_0.pdf

[7] *Ibid*

could be faced with the scenario where there are not enough resources available to pay for current investments and therefore could be faced with needing to do either cuts to existing programs and services, or consider new revenue options. When looking at the possibility of cuts, it is important to remember that about 70% of the state's General Fund spending is essentially off limits for cuts, such as basic education, debt service and federally funded programs that have strict maintenance-of-effort requirements. That means most spending cuts typically have to come from the remaining 30% of the budget.

The last time the state was faced with such a significant budget shortfall was during the 2008-2011 recession, and during that time the Governor and legislature reduced existing and projected spending by $11 billion. Much of this reduced spending was achieved by significant cuts to many programs and services.[8] For additional reading about the budget landscape and decisions made during the recession, see the Office of Financial Management's 2012 Report, [Guiding Washington Through the Great Recession: How Governor Gregoire and the Office of Financial Management Addressed a Relentless State Budget Crisis]

The extent of the budget shortfall and whether or not the Governor and legislature will be faced with cuts and/or considering new revenue is still to be determined. What is clear at this point is that the budget landscape is currently very challenging and will continue to evolve in the coming months.

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