Prevention Alliance

ISSUE BRIEF: WASHINGTON'S FOUR YEAR OUTLOOK

September 2016

EXECUTIVE SUMMARY

While Washington State operates on a two-year (biennial) budget cycle, legislation was passed (SSB 6636) in 2012 which requires that, beginning with the 2013-2015 biennium, operating budget bills passed by the legislature must leave a positive ending fund balance. In addition, the projected maintenance level for the budget in the ensuing biennium may not be greater than available fiscal resources. This collective requirement to have a balanced budget for the current and ensuing biennium is known as the 'Four Year Outlook'.

The four-year outlook requirement passed the legislature with bipartisan support. However, since implementation there has been mixed reviews of the effectiveness of four-year budgeting and the potential ripple effects. Proponents of the four-year outlook believe it is an effective tool for being more fiscally responsible while others have raised concerns that projecting revenue four years out is unreliable and hinders opportunities to fund new and existing programs through the state budget.

This brief will provide a summary of the passage of SSB 6636, an overview of the four-year outlook requirement, a brief summary of the first four years since implementation, and a summary of the ongoing discussions around this requirement.

PASSAGE OF SSB 6636

The impetus for legislation to require a four-year outlook stemmed in part from the fact that despite the Governor needing to *propose* a budget for each biennium that is balanced within the state's existing revenues, there is no requirement that the legislature *pass* a balanced budget, biennial or otherwise. However, there is not a known example of the legislature passing a biennial or supplemental budget that was not balanced for the period it was written.

The political climate in which this legislation passed is significant and important to note. While the Democrats were technically in control of both the House and Senate during the 2012 legislative session, the Senate was controlled by a very slim margin and in the process of working on the supplemental budget, three Democrats (Sens. Rodney Tom (D-48), Tim Sheldon (D-35), and Jim Kastama (D-25)) broke ranks with their Democratic colleagues and aligned with Senate Republicans. Later that same year following the 2012 elections, this split was formalized and the Majority Coalition Caucus (MCC) was established and assumed control of the Senate during the 2013 legislative session.

The relevance of this dynamic to the passage of SSB 6636 is that while the bill did pass with bipartisan support and was signed into law by Democratic Governor Christine Gregoire, it passed during a time when some members of the legislature, and the Senate in particular, were moving to a more conservative stance on fiscal matters. Two of the three bill sponsors for SSB 6636 were the same members who aligned with the Senate Republicans regarding the supplemental budget – Sens. Kastama and Tom. The third bill sponsor was Sen. Joseph Zarelli (R-18).

The bill that passed was a more measured compromise than the original bill proposed by the sponsors. In its original form the bill proposed the requirement as a constitutional amendment and outlooks (as explained below) would have been required four times per year. As passed, the bill put the balanced budget requirement in statute rather than a constitutional amendment and the outlooks are required three times per year rather than four.

SSB 6636 KEY DEFINITIONS[i]

There are three main terms that are key to understanding the four-year outlook requirement. See Figure 1 for an example of how these terms appear in the outlooks prepared by the ERFC.

Balanced Outlook or Budget means there is a positive ending fund balance in the state general fund and related funds for the current and ensuing biennium. A positive ending fund balance for the ensuing biennium requires that the *projected maintenance level* does not exceed the *available fiscal resources*.

Projected Maintenance Level is defined as the estimated appropriations necessary to maintain continuing the costs of programs and service levels that are either funded in the current appropriations bill or are required by state or federal law, plus the amount projected to be transferred to the budget stabilization account (aka the Rainy Day Fund). There are specific exceptions that are not factored into the *projected maintenance level*. These exceptions are outlined later in this brief.

Available Fiscal Resources is defined as forecasted revenues adjusted for the ***greater*** of either (i) the official revenue forecast for the ensuing biennium, or (ii) 4.5% annual growth for the next biennium based on the second year of the current biennium.

OVERVIEW OF FOUR-YEAR OUTLOOK REQUIREMENT

The four-year outlook requirement requires the legislature to adopt a budget that balances the current biennium as well as the ensuing biennium. For the current biennium, this means the State General Fund and relevant other funds must not exceed current revenue. For the ensuing biennium, the amount of available fiscal resources must be equal or greater than the projected maintenance level for the ensuing biennium (*see 'key definitions' box*). This is currently the strongest balanced budget requirement in the country.

WHAT IS REQUIRED – DETAILED BUDGET VS OUTLOOKS

While SSB 6636 requires the budget outlook to be balanced four-years out, the legislature is not required to produce a four-year *detailed* budget. The first two years of the four-year budget are written in detail via the regular budget process. The difference for years one and two under the four-year budget is that now the two-year budget is *required* to be balanced. For years three and four, a high-level outlook is required to ensure that the legislature is not projected to spend more than the expected revenue. The legislature produces outlooks as part of their budget releases to show the budget is balanced four years out. Unlike the outlooks discussed in the next section, the outlooks that accompany budget releases are not required under statute and they are not official Economic and Revenue Forecast Council (ERFC) outlooks, but they are the tool the legislature uses to show the budget they are passing meets the Four Year Outlook Requirement. These outlooks are found with other budget documents on the LEAP website (www.leap.leg.wa.gov) instead of on the ERFC Website with official outlooks.

THE OUTLOOK

As described above, SSB 6636 requires the ERFC to prepare and approve a budget outlook three times each year. The ERFC was first established in 1984 with the purpose of preparing an official state revenue forecast for use in budget preparation. SSB 6636 added the preparation and approval of the budget outlooks to the Council's duties. The council is made up of seven people: two persons appointed by the Governor (currently the Directors of the Department of Revenue and the Office of Financial Management), four persons representing the four political caucuses of the House and Senate, and the Washington State Treasurer.

The outlooks produced by the ERFC project the impact of the current enacted budget on the ensuing biennium. The three outlooks the ERFC is required to produce and approve are as follows:

- The first outlook is released in November in advance of the Governor's proposed budget. This outlook estimates revenue and expenditures for the General Fund and related funds. In odd-numbered years, the November outlook is for the current fiscal biennium and the next ensuing biennium. In even-numbered years, the November outlook is for the next two ensuing biennia.

- The second outlook is released each year in January and is based on the Governor's proposed budget. While the Governor is required to propose a balanced budget, his proposed budget is not required to be balanced four-years out. Only the legislature is subject to the four-year balanced outlook requirement.

- The third outlook is released within 30 days of the enactment of the legislature's budget. While one might assume this outlook should always balance four-years out, that is not necessarily the case. If the Governor uses his power of line-item veto or if the revenue forecast or caseload projection changes between the time the legislature passes their budget and when the outlook is prepared, it may not show as balanced in the outlook. This is why the legislature includes an outlook with their budget release even though it is not required in statute.

It is important to note that the outlook does not bind a future Legislature. The outlook is a projection that is a 'best guess' for how revenue and maintenance level spending will look four years out.

If the ERFC is unable to approve an outlook before a required deadline, the ERFC supervisor submits an outlook without approval. A member of the ERFC who does not cast an affirmative vote can request an alternative outlook based on assumptions specified by that member. For example, in May 2016 State Treasurer Jim McIntire requested an alternative outlook that included the estimated $3.5billion in additional funding needed to fully fund the McCleary obligation.

EXEMPTIONS

SSB 6636 exempted several items from needing to be factored into how a balanced budget or outlook is calculated.

> **Early Action Bills:** When calculating *available fiscal resources* and *projected maintenance level,* the outlook does not need to factor in "early action" budget bills that make net reductions in general fund appropriations and are enacted between July 1 and February 15 of any fiscal year.
>
> **McCleary Funding:** When calculating *projected maintenance level* for the 2013-15 or 2015-17 biennia, the costs related to funding basic education under the McCleary court case should not be included. There is some discrepancy as to whether McCleary should be included in the 2017-19 outlooks.
>
> **Policy Items:** Estimates for *projected maintenance levels* for the ensuing biennium must not factor in certain policy items including, but not limited to, legislation not yet enacted by the legislature, collective bargaining agreements that have not yet been approved by the legislature, and changes in funding levels for employee salaries and benefits unless the changes are required in statute.
>
> **Budget Stabilization Years:** A balanced outlook is not required for a biennium that follows a budget in which money is withdrawn from the budget stabilization account.

THE FIRST FOUR YEARS OF OUTLOOKS – 2012-2016

The ERFC has now been through four years of doing budget outlooks in compliance with SSB 6636. All of the official budget outlooks can be found on the ERFC website. In Table 1 you can find a summary of the projected ending balance that was calculated for each required outlook. From a high-level overview, we see that generally the outlooks reflected a positive ending balance more often than a negative ending balance. There are a few exceptions as noted in red in the table.

Some may ask why there are negative ending balances if the legislature is required to have a four-year balanced budget. While the legislature is required to pass a four-year balanced budget, the outlooks themselves are not required to be balanced. Line-item vetoes by the Governor, changes in caseload, and decreases in projected revenue can all result in outlooks where the available fiscal resources are less than the projected maintenance level. This was the case with the outlook produced in May 2016 when Governor Inslee vetoed several cuts in the budget, which means even though the legislature passed a budget that balanced four-years out, it almost immediately became unbalanced. The negative balance was reflected in the May 2016 outlook.

Table 1: Four Years of ERFC Outlooks – Projected Ending Balance
***Years with an unbalanced outlook are highlighted in red**

	2012	2013	2014	2015	2016
January	n/a	Book 1 ’13-15: $285m ’15-17: $1.2b Book 2 ’13-15: $307m ’15-17: $1.326b	’13-15: $228.9m ’15-17: $-406.3m	Current Law ’13-15: $619.2m ’15-17: $1.027b ’17-19: $216m New Law ’13-15: $619.2m ’15-17: $413.1m ’17-19: $618.9m	’15-17: $264m ’17-19: $-714b
Post-Budget Enactment	n/a	’13-15: $48m ’15-17: $388m	’13-15: $296.3m ’15-17: $19.5m	’13-15: $910m ’15-17: $343m ’17-19: $-23m	Without McCleary ’15-17: $474m ’17-19: $-314m With McCleary ’15-17: $474m ’17-19: $-3.814b
November	‘13-15: $-904m ’15-17: $-1.072b	’13-15: $214.9m ’15-17: $59	’13-15: $430.1m ’15-17: $-2.160b ’17-19: $-5.125b	’15-17: $359m ’17-19: $-473m	TBD

Source: Economic & Revenue Forecast Council, Budget Outlook Archives, *http://www.erfc.wa.gov/budget/budget_archives.html*

IMPACT ON BUDGET ASKS AND FISCAL NOTES

When looking at the fiscal impact of a bill or budget item, under the four-year outlook requirement the legislature must now factor in not only the impact on the current budget being written, but also the ensuing biennium. This creates what is called a *bow wave* effect. A *bow wave* is when there are additional costs (or savings) that occur in the future because a bill or budget item in the current biennium has not been fully implemented.[ii]

For example, let's consider a bill that passed with fiscal impact of $100,000, but it isn't being implemented until January 1, 2017. This means the fiscal note for that bill only reflects six months of impact on the biennial budget. Because the legislature has to balance the budget four-years out, the longer term fiscal impact of that bill must now be factored in. For the current biennium it is $100,000, but for the ensuing biennium the fiscal impact is $400,000, and that must be calculated into the outlook as *projected maintenance level* appropriations.

A great example of the impact the *bow wave* can have on the legislature's ability to secure new funding when forced to factor in the bow wave is the McCleary decision. In 2012, the full cost of the McCleary decision was unknown, but we will say it was believed to cost around $6 billion in additional funding. It would be nearly impossible for the legislature to pass a budget that balances four years out with that looming cost and no planned new revenue. That is exactly why the four-year outlook requirement excluded McCleary from having to be included when balancing the budget. But other programs, bills, or future court cases that may require a large investment that takes a few years to find the funding sources would not have a similar exemption and therefore are very unlikely to pass.

The result of a four-year outlook requirement is a more comprehensive projection of spending. However, given that revenue projections often become increasingly inaccurate the further out they project, factoring in future spending levels can make it significantly more difficult to secure new funding without having a balance of accurate revenue projections.

FIGURE 1. OVERVIEW OF KEY ITEMS ON AN OUTLOOK

Outlook for Enacted 2016 Supplemental Budget

(Near GF-S & Opportunity Pathways Account, Dollars in Millions)

	FY 2016	FY 2017	2015-17	FY 2018	FY 2019	2017-19
Beginning Balance	1,011	1,084	1,011	474	(115)	474
Current Revenues						
February 2016 Revenue Forecast	18,660	19,178	37,837	20,021	20,871	40,892
Additional Revenue Based on 4.5% Growth Rate Assumption	-	-	-	20	72	92
	18,660	19,178	37,837	20,041	20,943	40,983
Other Resource Changes						
GF-S Transfer to BSA (1%)	(184)	(188)	(372)	(197)	(205)	(401)
Extraordinary Revenue to BSA	-	(64)	(64)	-	(8)	(8)
Extraordinary Revenue from BSA to GF-S	-	64	64	-	8	8
Prior Period Adjustments	20	20	41	20	20	41
2015 Session Transfers and Other Resource Changes (Net)	96	82	178	51	51	101
Budget Driven Revenue	(3)	(3)	(5)	(1)	(1)	(2)
Proposed Fund Transfers	4	25	29	-	15	15
Other Legislation	-	(2)	(2)	(3)	(5)	(8)
AG Lawsuit Settlements	3	-	3	-	-	-
Total Revenues and Resources (Including Beginning Balance)	**19,608**	**20,196**	**38,720**	**20,385**	**20,703**	**41,203**
Enacted Appropriations	**18,639**	**19,580**	**38,219**	**20,494**	**21,036**	**41,530**
K-12 (excluding 2015 PL K-3 and All day K)	8,564	8,864	17,428	8,992	9,184	18,175
K-3 Class Size	83	268	350	524	590	1,114
All Day K	55	125	180	151	158	309
Everything except K-12 - all other items	9,937	10,324	20,261	10,827	11,105	21,931
2016 Supplemental Maintenance Level	**37**	**166**	**203**	**95**	**63**	**157**
K-12 Education	12	8	20	14	15	29
I-732	-	-	-	(37)	(67)	(104)
K-3 Class Size	(8)	(10)	(17)	(2)	-	(2)
Local Effort Assistance	10	13	24	(6)	(22)	(29)
Higher Education	(9)	(6)	(15)	(5)	(3)	(7)
Dept of Early Learning	(1)	(0)	(1)	1	1	2
Mental Health/Dev. Disabilities/Long Term Care	(19)	20	1	19	20	39
Corrections/JRA/SCC	13	12	25	10	10	19
Children's/Economic Svcs	(2)	9	8	9	9	19
Low Income Health Care	(9)	(18)	(26)	(19)	(10)	(28)
Hepatitis C Treatment	(22)	5	(16)	(3)	(3)	(6)
Managed Care Rates	61	135	196	139	144	283
FMAP Expansion Adjustments	-	-	-	(9)	(13)	(22)
Debt Service	(8)	(26)	(34)	(27)	(28)	(56)
All Other	17	23	39	10	10	20
2016 Supplemental Policy Level	**(49)**	**80**	**31**	**15**	**26**	**41**
K-12 Education	(0)	10	10	13	15	28
K-12 Recruitment and Retention	-	5	5	-	-	-
Higher Education	9	39	48	9	9	18
Dept of Early Learning	1	(3)	(2)	(5)	(5)	(10)
Child Care CBA	-	13	13	13	13	26
Mental Health/Dev. Disabilities/Long Term Care	(27)	4	(23)	4	4	7
IP Overtime	6	23	29	20	19	39
State Hospitals Enhancement	14	21	35	11	12	23
Community MH Enhancement	-	4	4	4	4	7
Corrections/JRA/SCC	2	1	3	5	6	11
Children's/Economic Svcs	(16)	(46)	(63)	(30)	(30)	(60)
Low Income Health Care	(2)	3	2	(2)	(2)	(4)
Healthier WA & Waiver Savings Restoration	20	8	28	9	9	17
Managed Care Rates	-	(13)	(13)	(29)	(30)	(59)
Low Income Health Care/I-502	(38)	(5)	(43)	(2)	4	2
Debt Service	-	1	1	1	1	3
All Other	4	14	18	(2)	5	3
Public Safety Enhancement Account	-	-	-	-	-	-
Pension Rate Changes	-	-	-	(5)	(6)	(10)
Fires	(21)	-	(21)	-	-	-
Actual/Estimated Reversions	(103)	(104)	(207)	(103)	(108)	(211)
Revised Appropriations	***18,524***	***19,722***	***38,246***	***20,500***	***21,017***	***41,517***
Projected Ending Balance	**1,084**	**474**	**474**	**(115)**	**(314)**	**(314)**
Budget Stabilization Account						
Beginning Balance	513	509	513	701	911	701
Transfer From GFS	184	188	372	197	205	401
Extraordinary Revenue to BSA	-	64	64	-	8	8
Extraordinary Revenue from BSA to GF-S	-	(64)	(64)	-	(8)	(8)
Appropriations from BSA for fires	(190)	-	(190)	-	-	-
Interest Earnings	1	3	5	14	27	41
Ending BSA Balance	***509***	***701***	***701***	***911***	***1,143***	***1,143***
Total Reserves	***1,593***	***1,174***	***1,174***	***796***	***829***	***829***

* Totals may not tie fiscal year due to rounding.

Projected 4.5% growth was greater than the official revenue forecast

Total Available Fiscal Resources

Total Projected Maintenance Level

Projected Budget Balance

Source: Economic and Revenue Forecast Council, May 2016 Budget Outlook, *www.erfc.wa.gov/budget/documents20160518_MeetingMaterials.pdf*

ONGOING DISCUSSION
Since the enactment of SSB 6636, the legislature has been compliant with the four-year outlook requirement. However, there are concerns from both proponents and opponents of the requirement.

SUPPORTERS OF THE FOUR YEAR OUTLOOK
Proponents of the four-year outlook believe it has made progress in stabilizing spending in Washington. The belief is that the four-year requirement stops 'budget gimmicks' that involve enacting budgets that immediately fall into shortfall at the end of the two-year budget period.

Some legislators who are supportive of the requirement do not believe it goes far enough and have expressed interest in having the requirement be a constitutional amendment rather than being in statute. This was how the original version of SSB 6636 was written, and after the 2016 supplemental budget was left unbalanced in the four-year outlook due to Governor Inslee's line-item veto of several items, Sens. Andy Hill and Joe Fain voiced an intent to bring a proposal to the legislature in 2017 to ask voters to weigh in on the proposal to make the four-year budget a constitutional amendment. [iii]

OPPONENTS OF THE FOUR-YEAR OUTLOOK
Other legislators and experts have become increasingly concerned that long-term revenue forecasts tend to be highly unreliable and become more and more uncertain over time. Sen. Marko Liias (D-Lynnwood) recently penned an opinion piece in the Seattle Times voicing his concerns with the four-year outlook requirement. Amongst his concerns he highlights that "The first four-year projection was made in 2013. Only now in 2016 have we learned it missed the mark by $3.1 billion."[iv]

During the 2012 legislative session, former ERFC Director Dr. Arun Raha shared concerns with Gov. Gregoire about the four-year outlook requirement. Among his concerns were that "a four year ahead forecast will have a far greater margin of error than a two-year ahead forecast, even if the distribution of risk were normal (at this time the environment is fraught with excess downside risk, which makes the potential error bigger). It's worth doing if the resources are available to gain an understanding of structural trends going forward, but it would be unwise to hang our hat on it for budgeting purposes."[v] When an outlook is based on forecasts during economic slowdowns, the result could be potentially unnecessary cuts in order to produce a balanced budget. Conversely, when an outlook is based on forecasts during economic upturn, the result could be an over-commitment of resources that may prove challenging to maintain if economic growth slows or moves into a decline. Some legislators who have concerns regarding the four-year outlook requirement have indicated they may attempt to roll back the requirement during the 2017 session.

CONCLUSION

Since the passage of SSB 6636, the legislature has complied with the requirement to adopt a budget that has a positive ending balance for the current and ensuing fiscal biennia. While some legislators believe this has brought stability to the budgeting process, others believe it has created uncertainty and makes it difficult to secure funding for new programs or pass legislation with fiscal impacts. While it is possible that the 2017 legislature may see attempts to both weaken and also further strengthen the four-year outlook requirement, it will certainly be at the center of budget discussions as the legislature works to invest billions in new funding in order to fully fund basic education.

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[i] SSB 6636, http://lawfilesext.leg.wa.gov/biennium/2011-12/Pdf/Bills/Session%20Laws/Senate/6636-S.SL.pdf

[ii] Office of Financial Management, **A Guide to the Washington State Budget Process**, http://www.ofm.wa.gov/reports/budgetprocess.pdf

[iii] Hill Andy, Fain Joe, **Constitutional amendment a must for balancing state budget,** The Seattle Times, April 28, 2016. http://www.seattletimes.com/opinion/constitutional-amendment-a-must-for-balancing-state-budget/

[iv] Liias Marko. **A Vote for Budget Gridlock in the Legislature We Should All Regret***,* The Seattle Times, March 28, 2016.

[v] Nelson, Dick, **Budget Uncertainties Ahead for Washington State,** Crosscut, April 19, 2012. http://crosscut.com/2012/04/budget-uncertainties-ahead-for-washington-state/