**Budget Memo: June 2020 Revenue Forecast**

June 2020

As the COVID-19 pandemic persists, the impact our economy and state budget continue to worsen. On June 17th the Economic and Revenue Forecast Council released the official quarterly revenue forecast. This was the first official forecast to start capturing the impact of COVID-19, the abrupt halt to our economy, the surge in unemployment and business closures, and the ensuing downturn in state revenues collected. This forecast paints the picture for the budget landscape that legislators, state agencies, and the Governor are faced with balancing.

This memo will provide an updated overview of the changing operating budget and revenue landscape in Washington, a summary of the caseload forecast, a breakdown of what is and isn’t protected in the state budget, and some context for potential options that lie ahead.

**June 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 (for the ripple effect on Boeing), 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 optimistic forecast rapidly deteriorated in light of the COVID-19 pandemic and the impact of measures taken, such as Governor Inslee’s stay-at-home order, that were critical to slowing the spread of the virus.

As covered in the Prevention Alliance May 2020 Budget Memo, due to the unique landscape this year, in late April the Washington State economist produced an unofficial revenue forecast for the ERFC in order to start capturing the early impact of COVID-19 on state revenues. In that preliminary revenue forecast, the estimated loss in revenue alone is a significant amount at over $7 billion over the next three years.

On June 17th, the official summer quarterly revenue forecast was released by the ERFC and the picture was even more stark than the preliminary projections with estimated revenue loss coming in at the significant amount of $8.9 billion over the next three years. The forecast captures the extensive impact the COVID-19 pandemic has had and will continue to have on our
The state economist cautioned that there is substantial uncertainty in the forecast. On the optimistic upside, Congress could pass additional federal stimulus and there could be increased consumer spending and employment as states start to re-open, especially if COVID-19 infections remain low. On the pessimistic downside, as states re-open, a second spike in COVID-19 infections could lead to renewal of business closures and consumers could remain concerned and continue with reduced spending. Much remains to be seen, but even the optimistic forecast still shows a significant shortfall in revenue and a challenging budget landscape.

**June 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 also met on June 17th to discuss their June caseload forecast. A summary of the caseload forecast is available here. As anticipated, there are services and programs that are forecasted to increase in caseload (ex. Medicaid expansion; Temporary Assistance for Needy Families (TANF); Aged, Blind and Disabled Assistance Grant; Nursing Homes; etc) while others are expected to decrease (Working Connections Child Care; Common School Special Education; Washington College Grant Program; Licensed Foster Care; Department of Corrections Adult Inmate; etc). Budget writers will need to account for what the changes in forecast translate to in regard to budget impact.

**What Is and Isn’t Protected in the Operating Budget – Updated from May 2020 Budget Memo**

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 easy 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, but 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 it 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.

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

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.

As a reminder, Washington runs on a biennial cycle, which means the amounts listed are over a 2-year period. When looking at the projected $4.6 billion revenue shortfall or the $1.9 billion combined savings target from the OFM directive to state agencies compared to the portion of the budget that isn’t protected by the constitution, the extent of the potential looming cuts to
that unprotected bucket in the current biennium are significant, especially when you factor in that we are almost a year into the 2-year budget cycle.

**What’s Next**

While a lot remains unknown, it is clear that the impact of the COVID-19 impact on our state and economy will be significant.

In response to the severe downturn in revenue collections, Governor Inslee directed state agencies under his authority to cancel a scheduled 3% general wage increase for many of the state’s highest-paid general government employees and to begin furloughs for most state employees. Most state employees were scheduled to receive the general wage increase July 1 as approved by the legislature last year. But under the Governor’s directive, cabinet agencies will cancel the pay raise for nearly 5,600 general government employees. In addition to cancelling pay raises, more than 40,000 state employees will be required to take one furlough day per week through July 25. After July, employees will be required to take one furlough day per month at least through the fall. The two actions — cancelling the general wage increase and instituting furloughs through November — together will save the state Near General Fund about $55 million over the next year, according to preliminary estimates. The Governor urged other agencies not under his authority — including higher education institutions, the Legislature, courts and separately elected officials — to adopt similar measures. If they do, the state would save another estimated $91 million.

While these actions by the Governor generate some savings, they are still dwarfed by the magnitude of the budget shortfall our state is facing. More action will be needed – whether that is cuts to programs, new revenue proposals, pulling from the budget stabilization account (aka rainy day fund), federal stimulus from Congress, other to-be-determined solutions, or a combination of the above. It is widely believed that the legislature will convene for special session(s) at some point during the 2020 interim to consider options and determine a path forward. While no decisions have yet been made regarding when a special session might take place, there is a general assumption that at least one special session will take place this year.

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