OCTOBER 2020

ISSUE BRIEF

2021-23 Operating Budget

Key takeaways

- Based on current revenue projections, the state will enter session with a four-year shortfall of -$3.8 billion.
- Even with the economic impacts of COVID, state tax collections continue to increase year-over-year.
- Significant uncertainties remain surrounding revenue collections, caseload growth, and additional federal aid.

Background

This brief is focused on the state's "flexible funds," known as the NGF-O accounts (Near General Fund-State + Opportunity Pathways + Workforce Education Investment accounts), which receive general tax revenue and are covered by the four-year balanced budget requirement.

- The **2019-21 budget** spends **$53.5 billion in state funds** ($102 billion in total funds), an increase of 19.7% over the 2017-19 biennium. Since 2013, state spending has increased by 73%.
- The current 2019-21 operating budget was enacted before the effects of COVID were fully understood and assumed a four-year *surplus* of $1.7 billion in state funds. However, after updating for the economic impacts of COVID, the state now projects a four-year *shortfall* of -$3.8 billion.
- While revenue projections remain below what was originally assumed in the budget, tax collections continue to increase year-over-year. Even with the impacts of COVID, state tax collections are 8.6% higher for 2019-21 as compared to 2017-19.
- By the end of the 2021-23 biennium, the Budget Stabilization Account is projected to contain about $2.5 billion.

The current budget picture

Due to its unprecedented nature, the economic impacts of COVID have been incredibly difficult to predict. For example, in June, the state projected a four-year budget shortfall of -$8.5 billion which shrank to -$3.8 billion when the forecast was updated in September, just three months later. While this was welcome news for the state budget, the actual shortfall continues to be a moving target and could change significantly, especially if there is another round of lockdowns or other disruptions to normal business activities. Other cost drivers include rising caseloads, the 2021-23 collectively bargained agreements, ongoing COVID-related costs, and wildfires.

While revenue is down compared to what was assumed in the enacted budget, state tax collections have continued to increase year-over-year. As shown in the ERFC chart below, despite COVID, revenue is still 8.6% higher than last biennium and is projected to grow another 7.4% in 2021-23.

Biennial Totals

07-09 Biennium	$29,817	0.1%	$437	14.8%	$30,254	0.3%	$0	NA	$30,254	0.3%
09-11 Biennium	$28,218	-5.4%	$269	-38.5%	$28,487	-5.8%	$99	NA	$28,586	-5.5%
11-13 Biennium	$30,657	8.6%	$215	-19.9%	$30,872	8.4%	$244	145.2%	$31,116	8.8%
13-15 Biennium	$33,666	9.8%	$405	88.0%	$34,071	10.4%	$234	-4.1%	$34,305	10.2%
15-17 Biennium	$38,317	13.8%	$467	15.4%	$38,785	13.8%	$266	13.6%	$39,050	13.8%
17-19 Biennium	$44,143	15.2%	$1,654	254.1%	$45,797	18.1%	$284	6.9%	$46,081	18.0%
19-21 Biennium	$48,189	9.2%	$1,535	-7.2%	$49,724	8.6%	$298	4.8%	$50,022	8.6%
21-23 Biennium	$52,181	8.3%	$1,241	-19.2%	$53,421	7.4%	$315	5.8%	$53,737	7.4%
23-25 Biennium	$55,917	7.2%	$1,041	-16.1%	$56,958	6.6%	$322	2.2%	$57,280	6.6%

*Education legacy trust fund excluding FY 14 and FY 15 lottery fund transfers. Includes pension stabilization fund interest in FY 08 and FY 09.

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What to expect in the 2021 session

Even with better than expected revenue collections, lawmakers should expect to enter the 2021 session (or an earlier special session) facing a multi-billion-dollar four-year shortfall. As budget writers grapple with this task, Democrats have already begun demanding new taxes. Likely options include a capital gains, personal income tax, payroll tax, and/or carbon tax. While taxes are one way to address a shortfall, there are a number of others:

- **Identify New Resources.** This could include new revenue but also encompasses the use of existing revenue from other accounts, redirecting existing revenue streams, supplanting state expenditures with Federal funds, or expanding user fees.
- **Utilize the Budget Stabilization Account (BSA).** The Legislature can withdraw funds from the BSA under three circumstances: for a declared emergency resulting from a catastrophic event; if annual state employment growth is forecasted to be less than 1%; or with a supermajority 60% vote of each house of the Legislature.
- **Shift Costs.** This could involve shifting costs currently paid by the state general fund to dedicated accounts, other entities (local governments), other budgets (capital or transportation), or by requiring client cost-sharing.
- **Reduce Spending.** Spending reductions may include targeted program cuts, across the board cuts, policy reforms, or long-term cost containment strategies. However, some parts of the budget must be funded, as discussed below.

Budget cuts: mandatory v. discretionary spending

A substantial portion of the operating budget must be funded by the Legislature as a result of constitutional, federal, or contractual requirements. Areas of the budget with little or no funding discretion include K-12 basic education, debt service, and pension obligations. To the extent the state agrees to participate in Medicaid, the Legislature has limited discretion in several caseload driven programs. When state law requires the confinement of prisoners, certain safety and health requirements must be met. And arguably the Legislature must fund some amount for constitutionally created agencies such as certain statewide elected officials, the Legislature, and the judicial system. The percentage of the operating budget considered mandatory depends on one's perspective and the caveat that the Legislature could change the underlying requirements in some cases but is likely between two-thirds and four-fifths.

Federal funding

- Washington received $2.953 billion in federal CARES Act funding. Of this amount, $786 million was distributed directly to large cities and counties (Seattle, Spokane, King, Snohomish, Pierce) and the remaining $2.2 billion was deposited into the Governor's Coronavirus Relief Fund (CRF).
- The Governor has fairly broad discretion over the CRF so long as he meets minimal federal spending criteria: generally speaking, it must be used for COVID-related expenses not already budgeted for and cannot be used as general revenue replacement for the state budget.
- From the $2.2 billion in the CRF, the Governor has spent approximately $1.5 billion. Of this amount, $500 million was for local governments that did not receive the direct distributions mentioned above; the vast majority of the remaining $1 billion went toward state government programs, not the private sector.
- The Governor has announced plans for additional CRF expenditures, some of which benefit the state budget. For example, the CRF will likely be used to repay the BSA for the $200 million provided for COVID response last session.
- The current best estimate for the amount of funding remaining in the Governor's CRF is $418 million.
- There have been federal discussions about increased federal aid and increased flexibility for using the CRF funds, but those conversations have yet to materialize into policy.

2021-23 budget development timeline

- **July-December:** Agencies submit budget requests to the Governor (including 15% budget reduction options).
- **December:** Governor releases his 2021-23 operating budget proposal based on the November revenue forecast.
- **January-April:** Legislature develops its 2021-23 budget proposal based on the March revenue forecast, which must be adopted before June 30 to avoid a government shutdown.