



## ***BUDGET MEMO: COVID-19 EDITION WITH UPDATED FINAL 2020 SUPPLEMENTAL OPERATING BUDGET & UNOFFICIAL REVENUE FORECAST***

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*May 2020*

After the end of the 2020 legislative session, the Prevention Alliance released a [Budget Memo on the Final 2020 Supplemental Operating Budget](#), which provided an overview of the budget and revenue landscape in the final days of the 2020 legislative session and a summary of funding levels in the final supplemental budget passed by the legislature. In a typical session, the budget by the legislature is pretty close to the budget that gets signed by the governor and implemented. There might be a few line-item vetoes by the governor here and there, but usually the changes don't have a significant impact on the budget bottom line. However, 2020 is a very unique and challenging year given the COVID-19 pandemic. Shortly after the 2020 legislature adjourned, economic activity in Washington came to an abrupt halt due to the stay-at-home order and other measures necessary to slow the spread of the virus. It was immediately clear that this cliff in economic activity would have a dramatic impact on the state budget – both with respect to revenue as well as caseload increases with safety net programs. As a result, Governor Inslee took decisive action and vetoed several bills with a fiscal impact and line-item [vetoed 147 separate expenditure items](#), reducing state spending from what was passed by the legislature by nearly \$445 million (from the General Fund) over the next three years — \$235 million in the current supplemental budget and \$210 million in the next 2021-23 biennium.

This memo will provide an updated overview of the changing budget and revenue landscape since the 2020 legislative session adjourned, including the following:

- A summary of funding levels in the final supplemental budget as signed by the Governor
- An overview of a preliminary unofficial forecast released by the Economic and Revenue Forecast Council
- A summary of the directive from the Office of Financial Management to state agencies to identify operating budget savings options for fiscal year 2021 appropriations
- An overview of what is protected versus not in the state operating budget

### ***Final 2020 Supplemental Operating Budget***

In the February 19th [spring revenue forecast](#), Near General Fund-State ([NGF-S](#)) revenue for the current 2019-21 biennium was forecasted to increase by \$606 million, bringing the total 2019-21 NGF-S to \$52.339 billion, which is 13.6% more than the 2017-19 biennium. It was with this revenue forecast in mind that the House and Senate compiled their respective budget proposals. The two proposals had some differences in what they funded for new policy spending, but both increased spending and there was just a \$49 million difference between them.

However, within days of the operating budget proposals passing each chamber, the budget and political landscape in Washington quickly changed because of the coronavirus (COVID-19) pandemic. In the final two weeks of the legislative session, Washington became a hot zone for the pandemic with the number of confirmed cases and deaths increasing significantly each day, social distancing measures went into place, and businesses and consumer spending started to plummet. The two chambers of the legislature worked to produce and pass a budget that walked back both chambers original proposed spending levels. However, in the days and weeks following the adjournment of the 2020 legislative session, it quickly became apparent that the walked-back version was not sufficient for the economic cliff the state and country had encountered. It was in this quickly deteriorating economic landscape that Governor Inslee took action and [vetoed 147 separate items](#) in the budget totaling \$235 million in reduced spending in the 2020 supplemental budget and \$210 million in the 2021-23 biennium. The vetoed items ranged broadly by issue and agency. Among the vetoes were the following Prevention Alliance strategies:

- Ambulance Cost for Secure Detox: \$846,000 General Fund-State (GFS) [Health Care Authority]
- Behavioral Health Provider Rate: \$1.857 mil GFS (\$5.003 mil total) [Health Care Authority]
- Family Connections Program: \$499,000 GFS (\$654,000 total) [Department of Children, Youth, and Families]
- WCCC Second Tier Eligibility & Copays: \$6 mil GFS [Department of Children, Youth & Families]
- ECEAP Rate Increase: \$6.903 mil GFS [Department of Children, Youth & Families]
- Extending coverage during the postpartum period: \$652,00 GFS [total amount between the Health Benefit Exchange, the Health Care Authority, and the Department of Social and Health Services]. *\*Note: the related legislation, [E2SSB 6128](#), was also vetoed by Governor Inslee.*
- Expanding Access to Nutritious Food through WIC: \$111,000 GFS [Department of Health] *\*Note: the related legislation, [2SSB 6309](#), was also vetoed by Governor Inslee.*
- No Child Left Inside: \$500,000 total [State Parks and Recreation Commission]
- Primary Care Provider Rate: \$9.922 mil GFS (\$28.994 mil total) [Health Care Authority]
- Counselors/High Poverty Schools: \$31.807 mil GFS [Office of Superintendent of Public Instruction]

The final 2020 supplemental operating budget ([SB 6168](#)) as signed by Governor Inslee on April 3<sup>rd</sup> still increased net new Near General Fund - State plus Opportunity Pathways (NGF-O) spending, but at the lower level of \$811 million increase over the original 2019-21 biennial budget. For comparison, the budget as passed by the legislature increased NGF-O spending by \$960 million (*see table 1 below for a full comparison of the budget passed by the legislature compared to signed by the governor*). This budget as signed by the governor brings NGF-O spending to \$52.89 billion in 2019-21.

In addition to the \$811 million in new spending that did pass, through [HB 2965](#) \$200 million was appropriated from the Budget Stabilization Account (Rainy Day Fund) for emergency response efforts related to the coronavirus (COVID-19) outbreak. [As of May 18<sup>th</sup>](#), state funds totaling \$171 million appropriated through HB 2965 have been distributed to state agencies and institutions to use to respond to the COVID-19 pandemic crisis.

The final budget left \$3.3 billion in total reserves at the end of the biennium, the largest balance in state history. Reserves are the combined amounts of the projected ending balance (total revenue & resources minus appropriations) plus the budget stabilization account ending balance. Over the four-year outlook, the reserves are expected to grow to \$4.3 billion.

**Table 1: Comparing the Operating Budget Passed by the Legislature with the Final Budget as Signed by the Governor**

	Operating Budget Passed by Legislature (March 12 <sup>th</sup> )	Final Operating Budget Signed by the Governor (April 3 <sup>rd</sup> )
<b>Appropriations total for 2019-21 biennial budget</b>	\$53.078 billion	\$52.890 billion
<b>Increase in General Fund spending</b>	\$961 million total increase. Of this, \$121 is maintenance level; and \$839 million is new policy level spending.	\$811 million total increase. Of this, \$121 is maintenance level; and \$690 million is new policy level spending.
<b>Ending fund balance</b>	The NGF-O ending fund balance for the 2019-21 Biennium is projected to be \$918 million this biennium; and \$859 million in 2021-23	The NGF-O ending fund balance for the 2019-21 Biennium is projected to be \$1.292 billion this biennium; and \$1.679 billion in 2021-23
<b>Budget Stabilization Account Balance</b>	The Budget Stabilization Account ending balance for the 2019-21 biennium is \$2.079 billion; and \$2.698 billion for 2021-23	The Budget Stabilization Account ending balance for the 2019-21 biennium is \$1.979 billion; and \$2.597 billion for 2021-23
<b>Total Reserves</b>	The total reserves for the 2019-21 biennium is \$2.997 billion; and \$3.558 billion for 2021-23	The total reserves for the 2019-21 biennium is \$3.271 billion; and \$4.277 billion for 2021-23
<b>Links to documents</b>	<a href="#">Operating Budget Bill (March 12) One Page Comparison Overview Summary and Agency Detail</a>	<a href="#">Final Operating Budget Bill Budget Outlook (April 2020) Operating Budget Veto Message Operating Budget Veto List</a>

***Evolving Revenue & Budget Landscape in Washington***

As stated above, the [spring 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. Circumstances have quickly deteriorated and legislators and advocates have shifted their mindset from what new should be started or increased to instead prioritizing the vital programs that they will work to protect from cuts.

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). This means that the next official revenue forecast will not be released until next month on June 17<sup>th</sup>. It is with that forecast that we expect to start seeing more of the impacts of the COVID-19 pandemic. Lost revenue from the stay-at-home order and other public health measures, increased caseloads from more people signing up for programs like Basic Food and Medicaid, and more will start to be reflected in that forecast.

While the official forecast won't be seen until June 17<sup>th</sup>, there are two documents that start to paint the stark picture of the fiscal landscape that lies ahead – an unofficial state revenue forecast from the state economist produced in early May, and an economic & revenue update produced by the ERFC on May 15<sup>th</sup>.

*Unofficial State Revenue Forecast:* On April 30<sup>th</sup> the Washington State economist produced an unofficial revenue forecast for the ERFC. The document was not posted on the ERFC's public website since it was not official and therefore not adopted by the Council. The purpose of the document was to start capturing the early impact of COVID-19 on revenues. It is important to note that this unofficial forecast is only looking at the early estimates for revenue loss. These numbers do not factor in caseload adjustments or other changes to maintenance level funding. The estimated loss in revenue alone is a significant amount at over \$7 billion over the next three years - \$3.8 billion in the current 2019-21 biennium and \$3.3 billion in the 2021-23 biennium. It is anticipated that the shortfall in revenue might increase by the time the official forecast is released on June 17<sup>th</sup>.

*Economic & Revenue May Update:* On May 15<sup>th</sup> the ERFC released their monthly [Economic & Revenue Update](#). The monthly update is provided by ERFC staff in order to promote the free flow of information and to update the members of the Council and the Work Group on current conditions. The May 15<sup>th</sup> update was the first to really start to capture some of the unprecedented impact of the COVID-19 pandemic. Some of the key numbers reflected in the update include:

- The unprecedented increase in unemployment over the four month period of January through April with private service sectors losing about 360,000 jobs, construction employment declining 47,200 jobs, manufacturing declining 27,700 jobs (including 8,300 aerospace jobs), and government payrolls declining by 11,100 jobs.
- Revenue Act taxes (which consist of sales, use, business and occupation (B&O), utility and tobacco taxes) show revenue collections reduced by \$406.9 million (25.6%) below the February forecast. However, approximately \$200 million of that shortfall is due to the Department of Revenue-approved deferrals of payments for many monthly filers and all quarterly filers. Without the deferred payments, collections would have been \$206.9 million (13%) lower than forecasted.

- Non-Revenue Act collections over the four month period of January through April is overall \$8 million (1.2%) higher than forecasted, but the April non-Revenue Act collections came in 8.2% lower than forecasted.
- Of note, two revenue sources that came in higher than forecasted include liquor taxes (0.6% higher than forecasted) and cigarette taxes (10.3% higher than forecasted).

### ***OFM Directive to State Agencies***

With the worsening economic landscape, the Office of Financial Management (OFM) has issued a [directive to state agencies](#) to start taking steps now to confront the fiscal crisis even though the official revenue forecast won't be released until June 17<sup>th</sup>. OFM Director David Schumacher has directed agencies to identify operating budget savings options for fiscal year 2021 appropriations (July 1, 2020 through June 30, 2021). The immediate savings target that OFM is aiming for from agency budget reductions is \$1.9 billion. In looking for savings, agencies are instructed to identify under-expenditures; reduce, delay, or eliminate programs; identify programs that do not meet the core mission of the agency; etc.

The OFM directive includes specific agency target amounts at 15% in reductions. The agencies most associated with health, prevention, and the social determinants of health include the following:

- Department of Social & Health Services – reduction target of \$506 million
- Washington State Health Care Authority – reduction target of \$462.4 million
- Department of Children, Youth & Families – reduction target of \$155.4 million
- Public Schools (non-basic education) – reduction target of \$96.8 million
- Department of Health – reduction target of \$12.5 million

The agency-identified savings options for fiscal year 2021 were due to OFM by June 1<sup>st</sup>.

In addition, OFM directs all agencies to plan on proposing reductions as part of their 2021–23 budget submissions.

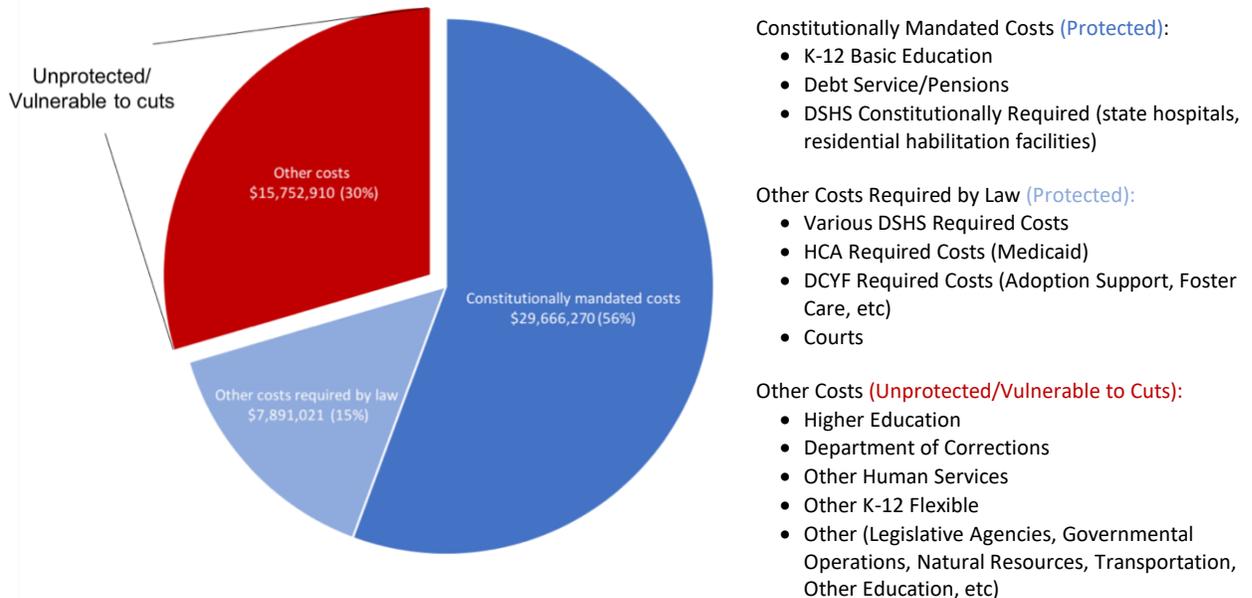
### ***What Is and Isn't Required or Protected in the Operating Budget***

Based on a preliminary analysis, OFM estimates that about 70% (\$37.6 billion) of the 2019-21 operating budget is required or protected from cuts, which means spending is either protected by the state constitution or required by law. This means any cuts will come from the remaining 30% (\$15.8 billion). There are some programs in the 'required by law' bucket that could potentially cut, but because they are required by law it would require a change in law and therefore are much more difficult 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 also would result in a loss of federal dollars coming into the state.

The percentage of what is required or protected 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 \$3.8 billion revenue shortfall or the \$1.9 billion combined savings target from the OFM directive compared to the portion of the budget that isn't protected by the constitution or law, the extent of the potential looming cuts to that unprotected bucket are significant, especially when you factor in that we are almost a year into the 2-year budget cycle.

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



**What's Next**

While a lot of the firm numbers and impact are currently unknown, it is clear that the impact of the COVID-19 impact on our state and economy will be significant. It is widely believed that the legislature will convene for special session(s) at some point during the 2020 interim to consider reductions in spending, if there is a need to pull from the budget stabilization account (aka rainy day fund), and other emergent issues that cannot wait until the 2021 session convenes in January to be addressed. 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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