Washington Research Council

Policy Brief

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The State Should Avoid Tapping Reserves While Revenues Are Growing

Briefly

A potential recession is a major risk to the state revenue forecast, but Washington's strong budget sustainability practices—including the budget stabilization account (BSA, or the rainy day fund)—will help the state through a downturn. However, in 2021, despite not facing a revenue shortfall, the Legislature swept the BSA. (Pursuant to the constitution, this required only a simple majority vote because employment growth was expected to be less than 1%.)

Of the BSA funds, $1 billion was transferred to the new Washington rescue plan transition account (WRPTA). Although the stated intent was for the WRPTA to serve as transition funding for programs as federal pandemic relief money ramps down, the state now considers the WRPTA to be a reserve account like the BSA. The credit rating agencies have also recognized the WRPTA as a reserve account. They point to Washington's healthy reserves—including the WRPTA—as a credit strength for Washington.

WRPTA funds are estimated to make up 71.6% of total reserves in 2021–23 and 61.6% in 2023–25. Although reserves are expected to grow in 2023–25, they would still be well below 2019–21 reserve levels.

Nevertheless, Gov. Inslee has proposed transferring the WRPTA balance to the state general fund and using it to help pay for his 2023–25 spending proposals. Given the state's low level of traditional reserves and the high economic uncertainty, legislators should not follow suit. Instead, they should continue to treat the WRPTA as a reserve account and avoid using it until such time as revenues actually fall short of expectations.

Gov. Inslee's 2023–25 operating budget proposal benefits from $3.078 billion more in revenues than the Legislature had when it adopted the current budget earlier this year. Revenues from funds subject to the outlook (NGFO) are now expected to grow by 20.4% in 2021–23, 3.5% in 2023–25, and 7.1% in 2025–27. 2023–25 and 2025–27 revenue growth is estimated to be below the average growth rate of 10% over the past 10 biennia and a potential recession is a major risk to the forecast.

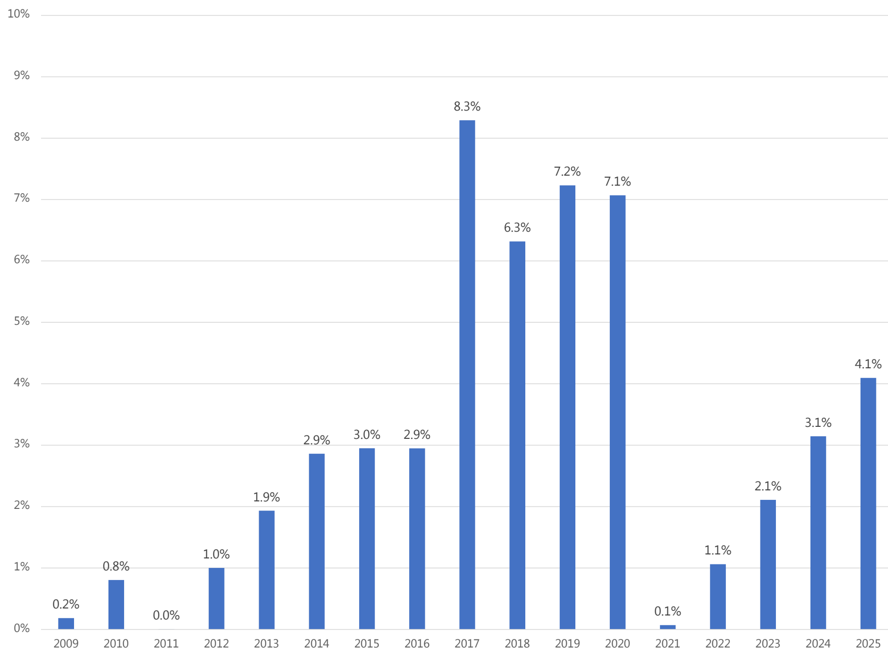
Washington's strong budget sustainability practices will help the state through a downturn. (For more on Washington's budget sustainability practices, see WRC 2019.) Unfortunately, the Legislature swept the budget stabilization account (BSA, or the rainy day fund) in 2021, taking advantage of constitutional safety valves that are meant to make it easier to use reserves in recessionary periods.

As a result, the state has relatively little saved in the constitutionally protected BSA. Instead, most reserves are in an unprotected account—the balance of which Gov. Inslee proposes using to fund new spending.

The BSA is Restricted by the State Constitution

Washington's reserves have traditionally consisted of the unrestricted NGFO ending balance and the

Chart 1: BSA Ending Balance as a Percentage of General State Revenues (History and Nov. 2022 Forecast)



BSA. The unrestricted NGFO ending balance is the difference between resources and spending in a year. The ending balance in one year becomes the beginning balance in the next year.

The BSA was established by a constitutional amendment in 2007 (Article VII, section 12). Each year, 1% of general state revenues must be transferred from the general fund–state (GFS) to the BSA. The state has made the constitutionally-required deposits to the BSA each year. Additionally, if there is extraordinary revenue growth (which is defined in the constitution), three-quarters of it must be transferred to the BSA at the end of the biennium (to the extent that it exceeds the amount of the 1% transfer). The state experienced extraordinary revenue growth in 2013–15, 2015–17, and 2017–19.

Generally, a three-fifths vote of the Legislature is required to make withdrawals from the BSA. However, when employment growth is forecast to be less than 1%, withdrawals may be made with a simple majority. Simple majorities also suffice when the governor declares a state of emergency resulting from a catastrophic event and the appropriation is made in separate legislation and is limited to use for the emergency.

Table: State Reserves (Dollars in Millions)

	2007-09	2009-11	2011-13	2013-15	2015-17	2017-19	2019-21	2021-23	2023-25
Budget Stabilization Account									
Beginning Balance	$303	$21	$1	$270	$513	$1,638	$1,618	$19	$609
Deposits	$118	$248	$269	$359	$1,316	$2,126	$585	$589	$638
Withdrawals	($400)	($268)	$0	($115)	($191)	($2,145)	($2,185)	$0	$0
Ending Balance	**$21**	**$1**	**$270**	**$513**	**$1,638**	**$1,618**	**$19**	**$609**	**$1,247**
WRPTA									
Beginning Balance							$0	$1,000	$2,100
Deposits							$1,000	$1,100	$500
Withdrawals							$0	$0	$0
Ending Balance							**$1,000**	**$2,100**	**$2,600**
Unrestricted NGFO Ending Balance	**$193**	**($92)**	**$156**	**$1,011**	**$785**	**$1,880**	**$4,161**	**$222**	**$374**
Total Reserves	**$214**	**($91)**	**$426**	**$1,524**	**$2,423**	**$3,498**	**$5,180**	**$2,931**	**$4,222**

Note: Figures for 2021-23 and 2023-25 are from the April 2022 outlook

These provisions make it easier to withdraw BSA funds during recessions or other emergencies. However, even under normal circumstances the BSA is not inaccessible. Of the 12 times withdrawals have been made, five were accomplished under the supermajority requirement. (The appendix includes a table describing each appropriation.)

Legislature Took Advantage of BSA Rules to Move Funds to an Unrestricted Account

In 2021, despite not facing a revenue shortfall, the Legislature transferred $1.820 billion from the BSA to the GFS. (At the time, $1.820 billion was the BSA's estimated balance.) Because the March 2021 economic forecast from the state Economic and Revenue Forecast Council projected that FY 2021 employment would be 3.6% less than FY 2020 employment, only a simple majority vote was required to sweep the account. (WRC 2021)

Then, the Legislature transferred $1.0 billion from the GFS to the new Washington rescue plan transition account (WRPTA). According to statute, the WRPTA may be used to respond "to the impacts of the COVID-19 pandemic including those related to education, human services, health care, and the economy" and "to continue activities begun with, or augmented with, COVID-19 related federal funding" (RCW 43.79.555). Essentially, WRPTA funds can be used for anything, with just a simple majority vote.

The Legislature used the recession safety valve to gain easier access to BSA funds even though state coffers were flush and the state had no immediate need for the funds.

The State Has Treated the WRPTA Like a Reserve Account

Although the stated intent was for the WRPTA to serve as transition funding for programs as federal pandemic relief money ramps down, the state now considers the WRPTA to be a reserve account like the BSA.

By our estimate, budget writers had a four-year NGFO surplus of about $14 billion to work with during the 2022 legislative session (WRC 2022). Of that, the 2022 supplemental budget saved 14.3%. Those savings included a transfer of $1.1 billion in 2021–23 from the GFS to the WRPTA. (Further, the official April 2022 budget outlook assumes that another $500 million will be transferred to the WRPTA in 2023–25.) With these transfers, 71.6% of the state's total reserves are held in the WRPTA at the end of 2021–23.

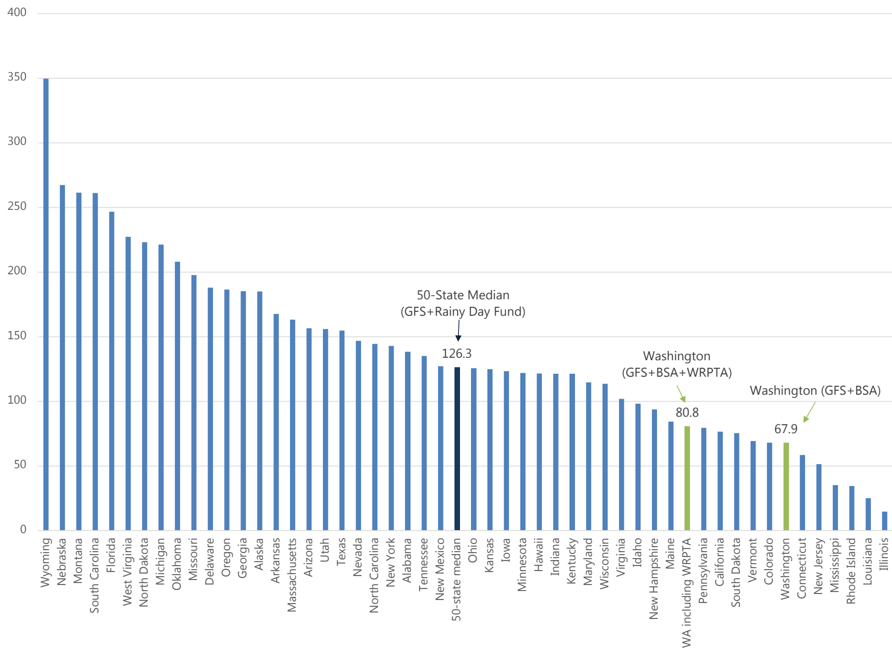
Given this, the April 2022 outlook includes the WRPTA as a reserve account and a component of total state reserves. The credit rating agencies have also recognized the WRPTA as a reserve account. They have noted that Washington's healthy reserves—including the WRPTA—are a credit strength for Washington (Moody's 2022, Fitch 2022, S&P 2022).

For example, S&P wrote in July that the estimated BSA balance for 2021–23 is "comparatively low at 1.8% of annual near general fund expenditures for fiscal 2023" (S&P 2022). However, when including the WRPTA, S&P considers the level of reserves to be "good" (S&P 2022).

Washington's Reserves Are Relatively Low, Especially When Excluding the WRPTA

Reserves help states maintain spending in periods when revenue drops unexpectedly, whether because

Chart 2: Days States Could Run on Reserves (General funds and rainy day funds, 2022)



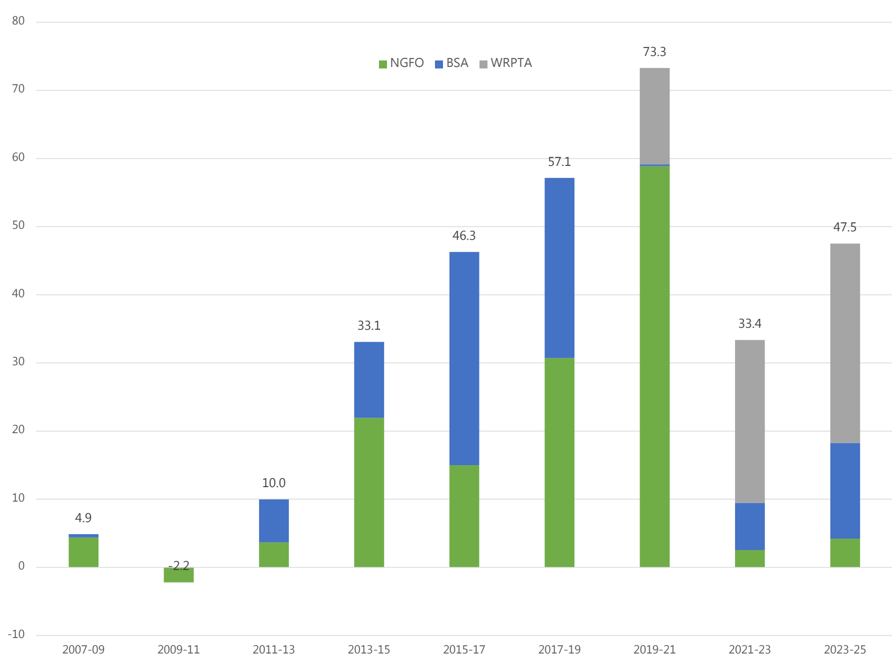
the state's taxes are volatile or because of an economic downturn.

Pew compares states' reserves by calculating how many days states could run (in terms of general fund spending) using only their reserve funds. In fiscal year 2022, based on data from the National Association of State Budget Officers (NASBO), we estimate that Washington could have run 4.0 days on the BSA, which was the second fewest days any state could have run on its rainy day fund. (In 2017, Washington ranked 13th highest, with 30.9 days.) (NASBO 2022, Pew 2022)

NASBO also reports total reserve balances, which it defines as the states' rainy day funds plus general fund ending balances. Washington's total reserve balances could fund 67.9 days in 2022 (the 7th fewest in the country). (NASBO 2022) But that doesn't include the WRPTA balance, which was $1.0 billion in 2022. Altogether, the WRPTA, BSA, and GFS balances could fund 80.8 days in 2022 (the 12th fewest).

Chart 3 shows the evolution of reserves in Washington over time, in terms of the number of days of state NGFO spending. WRPTA funds are estimated to make up 71.6% of total reserves in 2021–23 and 61.6% in 2023–25. Although reserves are expected to grow in 2023–25, they would still be well below 2019–21 reserve levels. Total reserves would fund an estimated 47.5 days of NGFO spending in 2023–25, compared to 73.3 days in 2019–21.

Chart 3: Days Washington Could Run on Reserves (NGFO, BSA, WRPTA)



However, that is based on spending in the 2022 supplemental and assumes that the WRPTA funds are not tapped. Gov. Inslee's proposed budget would transfer the WRPTA balance to the GFS in 2023–25 to help fund increased spending. Consequently, under his proposal, total reserves would fund 76.5 days of spending in 2021–23 but only 27.4 days in 2023–25.

Comment

State revenue estimates have increased since the current budget was enacted. Some agencies have asked the state to continue to fund (with state dollars) programs that were started with federal relief money. The WRPTA could be used for that purpose. But consider Fitch's warning that it could downgrade Washington's credit in the event of "[a]n unanticipated shift in fiscal management that materially weakens fiscal resilience, such as sizable and continuing draws on reserves to support operations, particularly during times of economic expansion" (Fitch 2022).

Instead, the state should continue to treat the WRTPA as reserves. The state's level of reserves is a critical question given the potential for a recession that could reduce state revenues. Recognizing the recession risk, the Economic and Revenue Forecast Council assigned its pessimistic alternative revenue forecast a 35% probability in November. Revenues in the pessimistic forecast are 2.2% below the adopted forecast for 2021–23 and 8.4% below the adopted forecast for 2023–25.

The Office of Program Research (OPR) produced an unofficial and very preliminary outlook for the House Appropriations Committee in December. It uses the November revenue forecast and updates enacted spending levels to account for current estimates of maintenance level (the cost of continuing current services, adjusted for enrollment and inflation). It does not include any new policy spending. Under the OPR analysis, total reserves (including the WRPTA) at the end of 2023–25 would be $6.38 billion. Using the pessimistic revenue forecast, total reserves would be *negative* $640 million. (OPR 2022)

Given the state's low level of traditional reserves and the high economic uncertainty, legislators should avoid spending the WRPTA down until such time as revenues actually fall short of expectations.

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Appendix: BSA Withdrawals

Bill	Enacted	Purpose of BSA Use	Amount	Vote Tally	3/5 Vote Required?
ESHB 1244 (operating budget)	5/19/2009	Transfer to general fund-state (GFS)	$400.0 million for FY 2009, $45.1 million for FY 2010	H: 54-42, S: 29-20	No (March 2009 forecast estimated -2.7% employment growth in FY 2009 and 0.5% growth in FY 2010)
HB 3197	4/27/2010	Transfer to GFS (to minimize K-12 reductions in 2010 supplemental)	$229 million for FY 2011 (this amount was reduced to $223.2 million by ESHB 1086 in 2011)	H: 69-28, S: 30-14	Yes (Feb. 2010 forecast estimated 1.7% employment growth in FY 2011)
SHB 1105 (2015 early action supplemental budget)	2/19/2015	Appropriations for fire costs	$77.2 million for FY 2015	H: 89-8, S: 46-0	Yes (appropriations weren't made in separate legislation)
EHB 2286	6/30/2015	Extraordinary revenue growth back to GFS	up to $50 million in FY 2015, up to $75 million in 2015-17, up to $550 million in 2017-19	H: 89-9, S: 44-1	Yes
EHB 2988	4/18/2016	Appropriations for fire costs	$189.5 million in FY2016	H: 88-7, S: 39-4	No (state of emergency declared regarding 2015 wildfires)
EHB 2190	7/7/2017	Transfer to pension funding stabilization account, appropriations for fire costs, appropriations for disaster response, repealed EHB 2286 transfer for 2015-17, increased EHB 2286 transfer for 2017-19	$925.2 million in 2017-19, $38.1 million in 2015-17, $19.0 million in 2017-19, new GFS transfer for 2017-19 is $1.078 billion	H: 90-4, S: 46-3	Yes
SHB 3002	3/27/2018	Appropriations for fire costs	$22.5 million in FY 2018	H: 51-47, S: 48-0	No (Governor declared state of emergency due to wildfires)
SHB 2159	5/21/2019	Appropriations for fire costs	$42.3 million in FY 2019	H: 80-18, S: 46-3	No (Governor declared state of emergency due to wildfires)
ESHB 2163	5/21/2019	Transfer to GFS for K-12	$58.4 million in FY 2019	H: 93-3, S: 41-7	Yes
EHB 2965	3/17/2020	Appropriations for coronavirus response and unemployment insurance	$200.0 million in FY 2020	H: 96-0, S: 48-0	No (Governor declared state of emergency)
HB 1367 (early action appropriations bill)	2/19/2021	Appropriations for coronavirus response (tempory rate enhancements)	$164.3 million in FY 2021	H: 97-0, S: 49-0	No (Nov. 2020 forecast estimated -1.9% employment growth in FY 2021)
ESSB 5092 (2021 supplemental budget)	5/18/2021	Transfer to GFS	$1.820 billion in FY 2021	H: 57-40, S: 27-22	No (Mar. 2021 forecast estimated -3.6% employment growth in FY 2021)