WashACE
Washington Alliance for a Competitive Economy

COMPETITIVENESS BRIEF

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THE BOTTOM LINE

With the adoption of the March revenue forecast, legislative attention turns to the budget. Revenue for 2009–11 Is forecast to exceed that for 2007–09 by a scant 0.2 %. The shortfall between revenue and carry forward expenses exceeds $4 billion.

BIENNIAL REVENUE STILL GROWING—BARELY

On March 19 the Economic and Revenue Forecast Council met in Olympia to officially revise the forecasts of state revenues for the current 2007–09 and upcoming 2009–11 biennia. With the adoption of the March forecast, legislators' attention turns to the major task of the session, writing a budget for 2009–11. Budget writers now face a shortfall of at least $4 billion. We detail the calculation of this shortfall below.

The new forecasts reduced expected general fund–state revenues by $735.6 for 2007–09 and by $2,125.1 million for 2009-11. For the broader near general fund state (NGFS, a group of eight accounts, including the general fund, from which most of the state's general expenditures are funded), the 2007–09 forecast was reduced by $776.5 million to $30,437 million, while the 2009–11 forecast was reduced by $2,262.0 million to $30,503 million. Combined with the downward revisions in November ($506.4 million for 2007–09 and $1,428.2 million for 2009–11), expected NGFS revenues for the two biennia are $4.97 billion less than they had been last September.

Table 1: The New Forecasts Compared with the Old, Dollars in Millions

	March 2009 Forecast	November 2008 Forecast
General Fund-State		
2007-09	**$27,891.0**	$28,626.6
2009-11	**$27,945.3**	$30,070.4
Growth	**$54.3**	$1,443.8
Percent	**0.2%**	5.0%
Near General Fund-State		
2007-09	**$30,437.4**	$31,213.8
2009-11	**$30,503.4**	$32,765.5
Growth	**$66.0**	$1,551.7
Percent	**0.2%**	5.0%

The first legislative budget proposal is expected to be released next week. The session is scheduled to end by April 26.

THE ECONOMIC SITUATION

The official recession arbiters at the National Bureau of Economic Research recently declared that the nation as a whole moved into recession in December 2007. While a year ago many economic forecasters thought that a recession was likely as a result of the subprime mortgage meltdown, the consensus was that it would not be severe. For example, the consultancy Global Insight predicted that the downturn in gross domestic product would last for only two quarters (the 1st and 2nd quarters of 2008) and that the peak unemployment rate would be a low 5.65 percent.

State economists thought Washington's economy would slow but avoid recession. For example, the September 2008 state economic forecast anticipated that Washington would experience only one quarter of employment decline (the second quarter of 2008, see Chart 1). Employment growth would average better than 1 percent in 2009 and better than 2 percent in 2010. While residential construction was clearly poised for a

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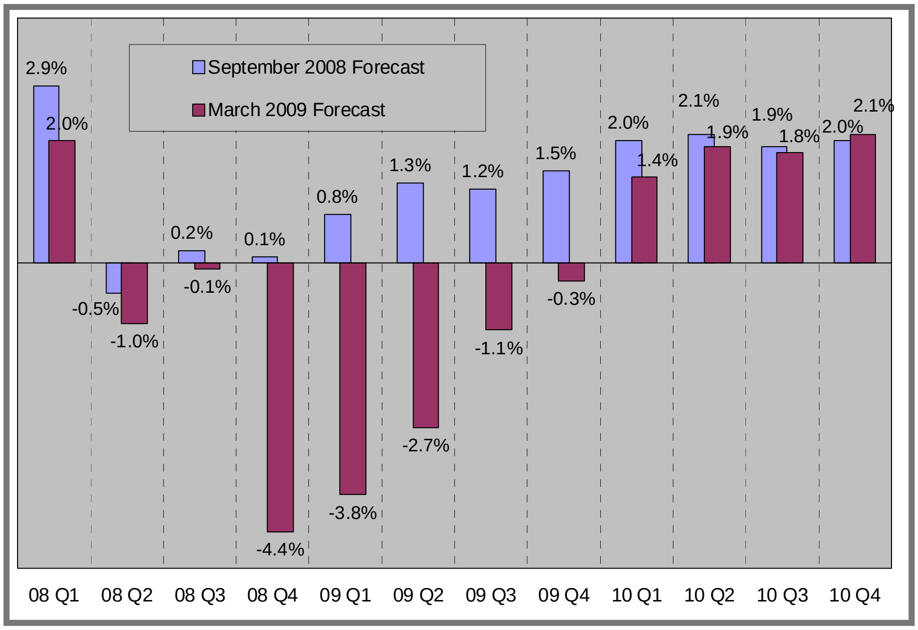
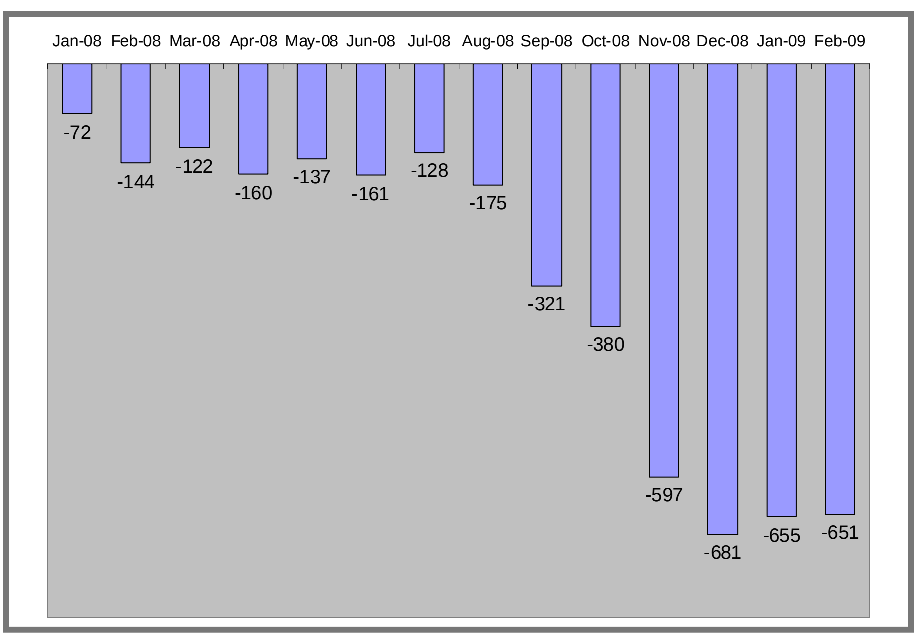
Chart 1: Wage and Salary Employment Growth, Seasonally Adjusted Annual Rates



downturn, housing-market problems appeared to be less severe in Washington than in other parts of the country. Employment in the central Puget Sound's critical aerospace and software sectors looked to be strong going forward. In addition, the low value of the American dollar (down 25 percent over 5 years) was a special advantage for Washington state, which perennially ranks among the top states in international exports per capita.

The national economy drifted downward through the spring and summer of 2008, losing an average of 140 thousand jobs per month over the first eight months of the year. (See Chart 2.) In September the situation took a dramatic turn for the worse with the failure of five large financial institutions. On September 7, the Federal Housing Finance Agency placed both the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (Fannie Mae and Freddie Mac) into conservatorship. Early on the morning of September 15, Lehman Brothers Holdings Incorporated, unable to arrange a rescue from either the federal government or from other banks, filed for bankruptcy. Federal officials' decision to allow Lehman Brothers to fail threw the credit markets into crisis. The spreads between the rates of return on risky and risk-free assets began to widen dramatically, as institutions became scared to lend to each other. On September 16, the Fed authorized $85 billion in funding to rescue the insurance giant AIG (American International Group). On September 25, the federal Office of Thrift Supervision closed Washington Mutual Bank—the largest bank failure in U.S. history—and transferred its banking assets to JPMorgan Chase.

Chart 2: Jobs Lost Nationally by Month, Seasonally Adjusted in Thousands



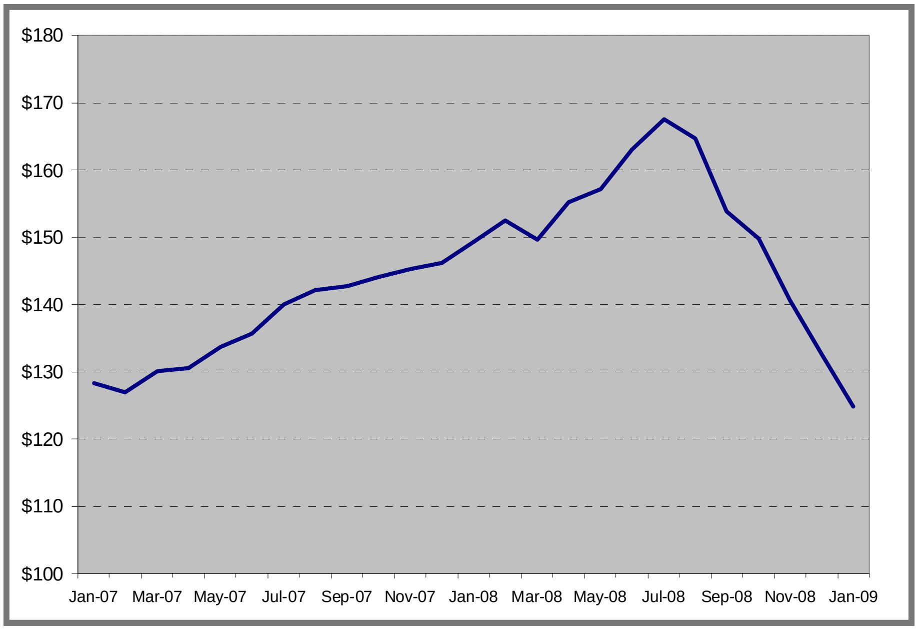
The world-wide freeze-up of credit markets had an immediate, dramatic impact on economic activity. For the last four months of 2008 and the first two months of 2009, the U.S. economy lost nearly 3.3 million jobs, an average of 547,000 per month.

Washington could not avoid this maelstrom.

On January 9, Boeing announced that it would cut 4,500 direct jobs and contract positions from its Commercial Airplane division during 2009. Most of these cuts will come in Washington. On January 28, the company announced that a further 5,600 jobs would be eliminated from divisions other than Commercial Airplanes. It's thought that most of these cuts will come outside of Washington. Overall, it's believed the state will lose more than 5,000 Boeing jobs this year. If the company is forced to reduce commercial airliner production rates in 2010, more jobs will be lost.

On January 22, Microsoft announced that it would eliminate up to 5,000 jobs in research and development, marketing, sales, finance, legal, human resources, and IT over the next 18 months. The company indicated that hiring would continue in other areas so that on net its employment would fall by 2,000 to 3,000.

Chart 3: Monthly U.S. Exports, Billions of Seasonally-Adjusted Dollars



The prospects for exports are no longer so rosy. Most of the U.S.'s major trading partners are also in recession, while the dollar has risen 19 percent against other currencies (trade-weighted) since the middle of July. These two factors combine to reduce the demand for U.S. exports, and seasonally adjusted U.S. exports fell by 26.5 percent from July 2008 to January 2009 (from $120.7 million to $88.7 million). See Chart 3.

The most recent state economic forecast indicates that employment will decline for seven straight quarters, with job growth not returning until the first quarter of 2010. (See Chart 1.) On March 17 the state Employment Security Department released preliminary estimates for February that showed seasonally-adjusted employment falling by 28,200 (1.0 percent) from January to February. This is an unusually large one month change in employment, and we expect that the data will eventually be revised to show a smaller February employment drop. As the data now stand, however, the state has lost 97,100 jobs from the peak in February 2008. During the 2001–03 recession, the state lost 86,400 jobs from peak to trough.

Revenue Collections

Monthly revenue collections have been down year-over-year in nine of the last 11 months, with the degree of shortfall generally increasing. Taxes on consumer purchases have been weak since December of 2007, and have been particularly weak for automobiles. Over the last 12 months, real estate excise tax receipts were down 45 percent compared to the previous year. Since the November revenue forecast (four months), collections have been $239.8 million (5.2 percent) less than that forecast.

The Shortfall

The new forecasts increase the shortfall facing legislative budget writers. While some have claimed that the shortfall approaches $9 billion, the actual number is closer to $4 billion.

The left-hand panel in Table 2 (on page 4) summarizes the situation as seen at the start of the session by the House Ways and Means Committee's Operating Budget Briefing Book.

November's downward revision to the revenue forecast resulted in a $331 million gap between available resources and budgeted expenditures for 2007–09. In addition, the governor's December budget recommendation identified $174 million in unbudgeted costs for 2007-09 (primarily medical assistance, K–12 education, corrections and forest firefighting). Together

Shortfall As Calculated in House Ways and Means Committee Operating Budget Briefing Book (January 2009) Millions of Dollars		Adjustments to the Shortfall (March 2009) Millions of Dollars	
Budgeted 2007-09 NGFS Shortfall (November Forecast)	(331)		
Unbudgeted 2007-09 Maintenance Costs	(174)		
		(777)	March Forecast Revision, 2007-09
		635	HB 1694 Reduction to Appropriations
		91	HB 1694 Transfers to GF-S
2007-09 Shortfall	**(505)**	**(555)**	**Adjusted 2007-09 Shortfall**
November Forecast, 2009-11	32,769		
Budget Stabilization Account Transfer	(263)		
		(2,262)	March Forecast Revision, 2009-11
Available Revenue, 2009-11	32,506	30,244	Adjusted Available Revenue
Maintenance Level 2009-11 Spending	36,906		
		175	March Caseload Forecast
		(327)	Projected Carryforward Savings from HB 1694
		(2,762)	Federal Stimulus Funds
		33,992	Adjusted Maintenance Level 2009-11 Spending
2009-11 Shortfall	**(4,401)**	**(3,748)**	**Adjusted 2009-11 Shortfall**
Total Shortfall Both Biennia	**(4,906)**	**(4,303)**	**Adjusted Total Shortfall Both Biennia**
Selected Policy Items Identified by HWM	(1,075)		
Shortfall If Policy Items Are Funded	**(5,981)**	**(5,378)**	**Adjusted Shortfall If Policy Items Are Funded**
Addendum:			
Projected Budget Stabilization Account Balance	699		
Governor's Recommended Ending Balance	408		

Numbers don't sum to totals due to rounding

Table 2: Calculating the Shortfall

this gave a $505 million NGFS shortfall in the current biennium.

The November forecast pegged 2009–11 NGFS revenues at $32,769 million; of this, $263 million must be transferred to the budget stabilization account. The cost of maintaining in 2009–11 was projected to be $36,906 million, which fell short of available revenues by $4,401 million. By this measure, the total shortfall over the two biennia was $4,906 million as of late January.

This calculation, however, does not account for either the ability to tap the budget stabilization account or the need to leave a reserve in the general fund. At the time they prepared the Briefing Book, Office of Program Research staff projected that $699 million would be available in the budget stabilization account (BSA). In her 2009–11 budget proposal, Gov. Gregoire recommended a general fund ending balance of $408 million. Tapping $699 million from the budget stabilization account while leaving $408 million in reserve in the general fund would reduce the NGFS shortfall by $291 million, to $4,615 million.

The Budget Briefing Book identifies $1,075 million in “selective policy increases” in spending that might be included in the calculation of the shortfall. Mostly these policy increases are expenditures for state employee compensation (both wages and health benefits) and human service vendor rate increases. Including these increases would raise the basic shortfall to $5,981 million. Tapping the BSA while leaving $408 million in reserve in the general fund would reduce this shortfall to $5,690.

Since late January, the situation with respect to the shortfall has changed somewhat. The biggest negatives are the recent revisions to the revenue forecasts, which subtracted $3 billion from 2007–09 and 2009–11 revenue.

The biggest positive is the federal stimulus bill (the American Recovery and Reinvestment Act), which should provide the state with at least $3.1 billion in operating budget support.

The right-hand panel on Table 2 summarizes some of the adjustments to the shortfall calculations.

The March forecast reduced 2007–09 revenues by $776.5 million and thus added that amount to the 2007–09 shortfall. The supplemental budget bill (HB 1964) reduced 2007–09 NGFS appropriations by $634.7 million and reduced the 2007–09 shortfall by that amount. Of this $634.7 million reduction in NGFS appropriations, $338.2 million was replaced by federal funds coming to the state from the federal stimulus bill, so the true decrease in state spending is only $296.5 million. HB 1994 also transferred $91 million into the NGFS from other state accounts, reducing the 2007-09 shortfall by that amount. Netted together, these adjustments added $50 million to the 2007-09 shortfall.

The March revenue forecast reduced 2009–11 revenues by $2,262.0 million. The March caseload forecast increased 2009–11 maintenance level spending by $175 million. We assume that the 2007–09 spending cuts in HB 1694 reduce 2009–11 maintenance level spending by $327 million. (We base this estimate on OPR's estimate of the effect on 2009–11 maintenance level spending of Gov. Gregoire's August and October administrative reductions to 2007-09 spending, which were largely codified by HB 1694.) HB 1694 applied $338.2 million of the state's $3.1 billion in federal stimulus funds to 2007–09. The remaining $2,762 million is available to reduce the 2009–11 shortfall. Netted together, these adjustments reduce the 2009–11 shortfall by $653 million.

Totaled over the two biennia, these adjustments reduce the basic shortfall by $603 million, to $4,303 million. As before, tapping $699 million from the BSA while leaving $408 million in reserve in the general fund would reduce the NGFS shortfall by $291 million, in this case to $4,012 million.

Given the great economic uncertainty the nation faces at the present time, some will argue that the reserve should be much larger than this calculation has assumed. Increasing the reserve to $1.4 billion would add $1 billion to the shortfall. Likewise, some will argue that the selective policy increases identified in the House Ways and Means Committee Briefing Book are sufficiently important that they should be included in the shortfall. Doing so would add $1 billion to the calculation.

Altogether this suggests that reasonable estimates of the shortfall will fall in the $4 billion to $6 billion range. We would put the number at the lower end of the range.

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