

CB 08-07 November 26, 2008

## REVENUE FORECAST CUT BY \$1.9 BILLION

### THE BOTTOM LINE

The November forecast cut estimates of state revenues by \$1.9 billion, sending projections of the looming state budget shortfall to \$5.1 billion. Although worsening economic conditions have deepened lawmakers' budget problems, unsustainable state spending dug the budget hole.

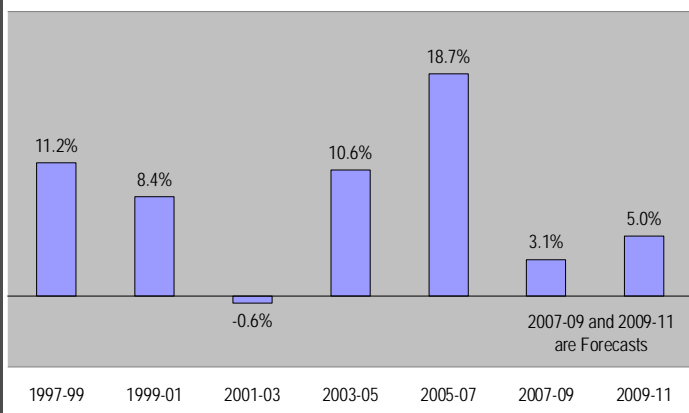
The budget gap just got much wider.

On November 19, the state economic and revenue forecast council (ERFC) met in Olympia to update the forecast of state general fund revenues for the current 2007–09 and upcoming 2009–11 biennia. The new 2007–09 forecast, \$28.63 billion, is \$503 million less than what had been forecast in September. The new 2009–11 forecast, \$30.07 billion, is \$1.43 billion less than September's forecast. The 2009–11 reduction is equal to 4.5 percent of the previous forecast.

These were the first forecasts to be overseen by Dr. Arun Raha, who in October became executive director of the EFRC staff.

Forecast revenue growth from 2005–07 to 2007–09 is 3.1 percent, while growth from 2007–09 to 2009–11 is 5.0 percent. These growth rates are not as good as the 18.7 percent growth enjoyed for 2005–07, but certainly are better than the 0.6 reduction in revenue from 1999–01 to 2001–03.

Chart 1: General Fund Revenue Growth by Biennium



The September forecast presumed that the U.S. economy would suffer the mildest of recessions, with gross domestic product falling 0.2 percent (seasonally adjusted annual rate) in the 4<sup>th</sup> quarter of 2008 and 0.1 percent in the 1<sup>st</sup> quarter of 2009. By the 4<sup>th</sup> quarter of 2009 GDP growth would be back up to 2.8 percent. The low point for employment would be the 2<sup>nd</sup> quarter of 2009, with 810,000 jobs lost from peak to trough. But this was before the credit markets froze and the stock market collapsed in September.

The revised national forecast sees negative GDP growth extending over four quarters, with GDP dropping 1.5 percent from the 2<sup>nd</sup> quarter of 2008 to the 2<sup>nd</sup> quarter of 2009. Employment is now expected to decline until the 4<sup>th</sup> quarter of 2009, with 2,950,000 jobs lost from peak to trough.

Under the old forecast, Washington avoided recession, with only one down quarter for employment, the 2<sup>nd</sup> quarter of 2008, and only 4,000 jobs lost. The state is not so lucky under the new forecast. Washington employment drops for five quarters, with the bottom occurring in the 2<sup>nd</sup> quarter of 2009. A total of 34,900 jobs are lost from peak to trough. Still, this would be a much milder recession than the state experienced earlier in the decade, when 86,400 jobs were lost.

### 2007–09 Balance Sheet

The table on page 2 includes a GFS balance sheet for the current biennium. The general fund began the biennium with a balance of \$781 million. With the November update, revenues for the biennium are forecast

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2007-09 Balance Sheet and Pro Forma 2009-2011 Outlook		
General Fund-State		
Dollars in Millions		
	2007-09	2009-11
<b>Resources</b>		
Beginning Fund Balance	781	(413)
September 2008 Forecast	29,129	31,498
November 2008 Update	(502)	(1,428)
<b>Current Revenue Totals</b>	<b>28,627</b>	<b>30,070</b>
Transfer to Budget Stabilization Account (BSA)	(130)	(272)
Net Transfers to/from Other Funds	147	0
<b>Total Resources Available</b>	<b>29,425</b>	<b>29,385</b>
<b>Expenditures</b>		
2007-09 Enacted Budget	29,838	-
Baseline Expenditures	-	32,936
Additional Pension Costs	-	132
Family Medical Leave	-	72
GFS-Related Accounts Backfill	-	1,365
<b>Total Expenditures</b>	<b>29,838</b>	<b>34,504</b>
<b>Reserves</b>		
Projected General Fund Ending Balance	(413)	(5,119)
Emergency Reserve Fund Transfer To BSA	307	-
New Deposits	130	272
Projected BSA Ending Balance	437	710
<b>Total Reserves</b>	<b>24</b>	<b>(4,409)</b>
<b>Budget Gap</b>		
Current Revenue /less Total Expenditure	(1,211)	(4,434)
Percent of Current Revenue	4.2%	14.7%
Source: WashACE from Senate Ways and Means Committee & Office of the Forecast Council		

to total \$28,627 million. It is projected that the amount of the constitutionally required transfer to the budget stabilization account at the end of FY 2009 will be \$130 million. Numerous transfers between the GFS and other state accounts have added \$147 million (net) to the GFS. With the 2008 supplemental budget, appropriations for the biennium stand at \$29,838 million, giving a \$1,211 million gap between expenditures and current revenues. The projected ending balance for the GFS is *negative* \$413 million., while the projected ending balance for the budget stabilization account is *positive* \$437 million. Combining the negative GFS balance with the positive BSA balance gives net reserves of \$24 million.

The balance sheet does not tell the full story, however. At the ERFC meeting OFM director Victor Moore stated that the new caseload forecast will add another \$50 million to the 2007-09 spending total and hinted that other unavoidable expenditures might add a further \$100 million. Offsetting these as yet unbudgeted expenses are \$590 million in spending cuts ordered by Governor Gregoire: In August the Governor imposed a freeze on hiring, the purchase of equipment, out-of-state travel and personal service contracts that her staff projects will save \$90 million this biennium. In October she announced that her staff had identified an additional \$240 million in potential savings for the biennium. Just yesterday she ordered agencies to find a further \$260 million in savings (Moore 2008a, 2008b).

By law the general fund cannot end the biennium with a negative balance.

### The Outlook for 2009-11 Is Bleak

The table also presents a pro forma outlook for the 2009-11 biennium. This outlook largely replicates the one published in September by Senate Ways and Means Committee staff; the major difference is that we have incorporated the revised revenue forecasts.

Pro forma resources available for 2009-11 are \$29,385 million, which equals the \$30,070 revenue forecast reduced by the \$272 million required transfer to the budget stabilization account and 2007-09's negative \$413 million ending balance.

Pro forma 2009-11 expenditures are \$34,504 million. This number is the sum of four parts:

- o Baseline expenditures for 2009-11 (the estimated cost of carrying forward the programs funded in 2007-09, with allowances for increasing costs, caseloads, and enrollments) total \$32,936 million.

- Additional pension costs (beyond those carried forward in the baseline) add \$132 million to expenditures.
- The family medical leave program adds \$72 million. This program, enacted in 2007, is scheduled to begin paying benefits in 2009. The Legislature has yet to specify a funding source for this employment benefit. The outlook assumes that funding will come from the general fund.
- Finally, \$1,365 million is required to backfill unsustainable spending commitments that have been made in certain accounts outside of the general fund (the *GFS-related accounts*). We have written extensively about the problem the state faces with respect to these commitments (WashACE 2006, 2007a; WRC 2007a, 2007c, 2008).

Pro forma expenditures for 2009–11 exceed revenues by \$4,434 million. The projected deficit in the general fund is a bit more than \$5.1 billion—this is the headline number for the emerging budget crisis. The projected ending balance in the budget stabilization account is \$710 million and total reserves are *negative* \$4,409 million.

This pro forma 2009–11 outlook does not reflect any of the actions taken to date, including yesterday’s order for an additional \$260 million in spending reductions, or those to be taken in the future to close the 2007–09 deficit. The beginning balance in the general fund will not be negative. OFM estimates that the steps ordered by Governor Gregoire in August and October, which are expected to cut 2007–09 expenditures by \$330 million, will result in further savings of \$604 million in 2009–11, relative to the baseline. (Moore 2008a).

### Comments

With last week’s forecast, the frame is set for Gov. Gregoire, who will release her budget proposal next month. She predicts that it will be “ugly” and few will disagree. The governor has also said that this is not the time for raising taxes. And, again, few will disagree. Tax increases would deepen the recession and delay recovery.

During the budget challenge earlier this decade, then-Gov. Gary Locke pioneered the Priorities of Government process to bring discipline to the priority-setting process inherent in budget development. Since then, voters mandated and funded performance audits through Initiative 900 and Gov. Gregoire initiated the Government Management, Accountability and Performance (GMAP) system. With these tools, lawmakers have a substantive foundation for making the difficult decisions required to rein in spending and balance the budget with available revenues.

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