

Research Article

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No New Gimmicks: Continued Budget Challenges in Washington State**

Abstract: As with many states, Washington faced multiple economic challenges between 2010 and 2011. In the 2011 legislative cycle, the state had to close a \$4.6 billion shortfall for the 2011–2013 biennium. This budgetary challenge was accomplished through a combination of budget cuts and revenue enhancements. Primarily, the legislature adopted a series of additional cuts to the governor’s already-reduced original budget proposal, and implemented some revenue-producing options such as going to the voters for a tax increase. In this report, we explore these budget shortfall issues and characterize the political context within which they occurred.

Keywords: budget cuts; economic challenge; revenue; shortfall; special session

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1 Introduction

Washington State experienced continued economic challenges throughout the 2011 regular legislative session and subsequently held a 30-day special session to close budget shortfalls that had not yet been resolved. In December 2010, Governor Christine Gregoire released a budget proposal to the legislature that estimated a \$4.6 billion shortfall for the 2011–2013 biennium, which runs July 1, 2011, through June 30, 2013. By March 2011 – in the middle of the regular session – this projected shortfall grew to \$5.1 billion. In addition to closing the growing budget gap for the

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new biennium, the legislature was also tasked with closing a \$201 million budget shortfall for the remainder of the 2009–2011 biennium, which ended June 30, 2011. These shortfalls were addressed primarily through program cuts for both biennia. Even as both sessions progressed, continued negative economic forecasts released by the state added to the already difficult circumstances and led the legislature to consider new and different possible forms of revenue.

2 Governor’s Budget Proposal: 2011–2013 Biennium

In December 2010, Governor Christine Gregoire released her proposed 2011–2013 biennial budgets for the state of Washington. The state is one of 20 that operates on a 2-year, biennial budget schedule; each biennium consists of two fiscal years running from July 1 of one year through June 30 of the following year (Snell 2010). The state also operates using three different biennial budgets – operating, transportation, and capital. The operating budget is the largest of the three and is used for day-to-day functions of state government and usually receives the most attention because education and most social programs are funded out of this budget. The transportation budget is the second largest budget and is used for transportation purposes throughout the state such as designing and maintaining roads and supporting public transit and transportation planning. The smallest of the three, the capital budget, is used to maintain the state’s infrastructure, including acquiring and maintaining state buildings, public schools, higher education buildings, public lands and parks, etc. (Senate Committee on Ways and Means 2011b). Table 1 shows an overview of budget totals for the 2009–2011 biennium.

Each December, the governor is required by law to submit proposed supplemental operating, transportation, and capital budgets to the legislature for the remaining 6 months of the current fiscal year, and in even-numbered years, as with 2010, the governor submits budgets for the upcoming biennium that begins on July 1 of the following year, in this case, 2011–2013. The outlook

| Budget | Total ^a | Percentage |
|----------------|--------------------|------------|
| Operating | 60.6 | 81.0 |
| Transportation | 8.7 | 11.6 |
| Capital | 5.6 | 7.4 |

Table 1: 2009–2011 Biennial Budget Totals, Washington State.

^a Figures are in billions of dollars.

for the upcoming two fiscal years was riddled with challenges, as was the case for the 2009–2011 biennium. Governor Gregoire’s overall proposal to the legislature reflected “increasing caseloads, rising costs, and decreasing revenues” (Washington Office of the Governor 2010) in Washington State, and it forced state government to shift its priorities. In fact, the governor’s report captured, in her words “how government, by necessity, will be smaller, do less and focus on core functions.” This also meant that further program cuts were proposed, which in Washington has become a commonplace feature of budget negotiations; large cuts were made just last year in the 2010 supplemental budget (see Figure 1 for an overview of the governor’s budget proposal).

The governor’s office emphasized Priorities of Government in the biennial budget proposals, protecting programs in the operating budget that are most important for the state government to provide and reducing or completely eliminating programs that are not considered essential in tough economic conditions. Among those programs protected were K-12 education, state health care, safety and protection of property, economic development, and efficiency in state government services. Funds for K-12 education comprise the largest single apportionment of the state operating budget, a fact that reflects Washington’s constitutionally directed priorities. However, even the state’s most protected and valued program area was at risk for proposed cuts that would reduce the number of services provided by narrowing the constituencies that are reached by public funds. For instance, the governor’s proposal included reprioritizing state-run preschool services to exclude 3-year-olds and instead include only 4-year-olds. Also, the proposal included elimination of funds aimed at reducing class size in K-4 classrooms and reductions in support for higher education by authorizing large tuition increases.

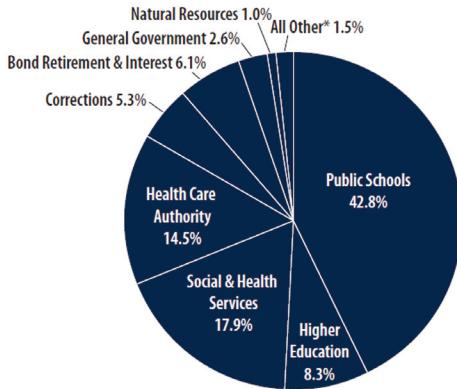
In the area of Health and Human Services, among the programs preserved in the proposal were in-home support programs for up to 50,000 elderly or disabled individuals, temporary cash assistance for the economically disadvantaged, and funding for foster children. However, this area of public funding was also not immune to cuts. In a sweeping policy change, the governor’s proposal included elimination of the Basic Health Care Plan, which is a state-sponsored program that provides low-cost health-care coverage through publicly subsidized private health plans (Washington Basic Health 2011).

In 2010, the legislature managed to accomplish closing a \$2.8 billion budget shortfall for the 2009–2011 biennium. However, several of the budget-closing strategies used then were no longer available options to help address the shortfall for the 2011–2013 biennium. For instance, the federal government provided Washington State with \$3.6 billion in stimulus funds in 2010, which the legislature used to limit program cuts statewide, which involved potential layoffs and job losses. However, the US Congress provided no such additional funds in 2011,

PROPOSED BUDGET EXPENDITURES

General Fund-State: Operating

Distribution of 2011–13 General Fund-State Expenditures

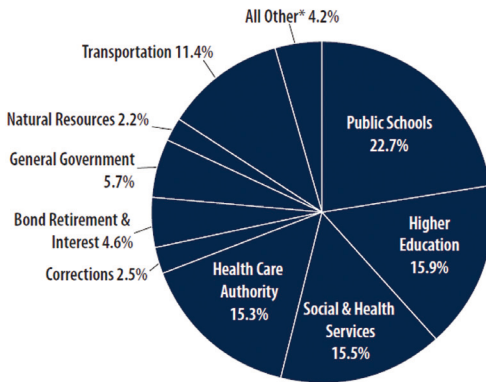


| Dollars in Millions | |
|----------------------------|-----------------|
| Public Schools | \$13,746 |
| Higher Education | 2,677 |
| Social & Health Services | 5,768 |
| Health Care Authority | 4,650 |
| Corrections | 1,693 |
| Bond Retirement & Interest | 1,952 |
| General Government | 829 |
| Natural Resources | 332 |
| All Other* | 477 |
| Total | \$32,124 |

*All other includes Other Education, Transportation, Contributions to Retirement Systems and Other Appropriations

All Funds: Operating Plus Transportation Capital

Distribution of 2011–13 All Funds Expenditures



| Dollars in Millions | |
|----------------------------|-----------------|
| Public Schools | \$16,126 |
| Higher Education | 11,262 |
| Social & Health Services | 11,012 |
| Health Care Authority | 10,860 |
| Corrections | 1,768 |
| Bond Retirement & Interest | 3,233 |
| General Government | 4,057 |
| Natural Resources | 1,530 |
| Transportation | 8,117 |
| All Other* | 2,959 |
| Total | \$70,924 |

*All other includes Other Education, Contributions to Retirement Systems and Other Appropriations

Figure 1: Proposed Budget Expenditures.

Source: Proposed 2011–2013 Budget and Policy Highlights, Office of the Governor.

which removed a sizable source of anticipated revenue from new budget decision making in the legislature (Leachman et al. 2011). Also, the legislature passed a “menu-based” sales taxes last year that increased the price of many convenience items for individual consumers (LaCorte and Woodward 2010; Senate Committee Services 2010). For example, candy, gum, and bottled water became subject to

the state's 6.5% sales tax, cigarette taxes were raised one dollar per pack, a six-pack of beer was taxed an additional 28 cents, and 12-oz. cans of soda were taxed an additional 2 cents. The taxes provided \$761 million in revenue enhancements that were used last year to maintain state programs such as all-day kindergarten, gifted program and levy equalization for public schools, state need grants for college students, maintenance of then-current levels of Basic Health, and the Apple Health for Kids program for children from low-income families and assistance for needy families, and restoration of certain nursing home funds, among others (Camden 2010). However, these so-called menu-based taxes were repealed by an initiative to the people in the Fall 2010 midterm elections, and an additional initiative (I-1053) passed placing a 2-year constraint on the legislature holding that any new tax increases once again must be passed by a legislative supermajority (two-thirds vote) in each chamber as had been the case under the provisions of I-960. This virtually removed tax increases as a viable budget-solving strategy for the governor and state legislators in the making of the 2011–2013 biennial budget.

3 Political Context 2010

Political party support for Democrats and Republicans in Washington State is largely split geographically by the Cascade mountain range (LeLoup and Herzog 2004). The west, which includes the Seattle area, is urban and more densely populated than the other side of the state and is usually supportive of the Democratic Party. This is in contrast to the east, which is more rural, less densely populated, contains most of the state's farms and wineries and is usually more supportive of the Republican Party. For the past decade, Democrats in Washington State have largely controlled the political scene despite this split in party support statewide. Between 1999 and 2001, Democrats and Republicans were nearly evenly matched in the legislature, but Democrats have controlled both chambers since. This Democratic legislative prevalence, coupled with Democratic Governors Locke and Gregoire, has characterized state politics for at least the past 10 years. During the 2010 legislative session, the party composition in Olympia was no different, with the Democrats holding majorities in both the House (61–37) and the Senate (30–18). In that session, legislators were unable to close the \$2.8 billion budget deficit for the 2009–2011 biennium in the 60-day session, which ran from mid-January to mid-March. This forced a 30-day extended session, and even with additional time, a budget was not passed until the last day of the extended session. The budget gap was closed through a combination of new taxes, spending cuts, the cancelation of some tax incentives, and federal aid (see Table 2).

| | |
|---------------|------------------------------------|
| \$5.1 billion | Cuts and savings |
| \$3.6 billion | Federal aid |
| \$2.5 billion | Fund transfers and use of reserves |
| \$761 million | Revenue enhancements |

Table 2 : Funds Used to Close a \$12 Billion Shortfall, 2009–2011 Biennium.

Figures come from the 2011–2013 governor’s proposed budget.

Important to the discussion of the tax structure in the state of Washington is Initiative 960, which was passed in 2007 and required that any tax increases passed by the legislature must pass by a two-thirds supermajority vote in both the House and the Senate. The impact of initiatives in Washington can be rather short-lived; the state constitution does not allow for the legislature to amend or repeal an initiative for 2 years after initial passage; however, the legislature has the prerogative to suspend, nullify, or amend an initiative passed by the people of Washington after 2 years. In 2010, the Democrat-controlled legislature did just that and temporarily suspended the two-thirds threshold required by Initiative 960 to raise sales taxes statewide to help close the budget gap. Almost immediately after this action was taken, Tim Eyman, the initiative’s sponsor in 2007, filed Initiative 1053 to be placed on the midterm election ballot in autumn 2010, which would reinstate the two-thirds supermajority threshold for tax increases for the next 2 years. In addition, Initiative 1107 was placed on the ballot, which would repeal many of the taxes created in spring 2010. Initiative 1053 passed by an overwhelming majority, nearly 2 to 1. In fact, the initiative passed in almost all counties in Washington, including King, arguably the state’s most liberal county (Martin 2010). This means that raising taxes in the 2011 and 2012 legislative sessions is effectively off the table. Thus, the state had to make up a budget deficit without the help of sales tax revenue increases relied upon in the previous year. In November of that year, it was unclear whether the Democrats would face some backlash due to the spring legislative session. After the 2010 midterms, the Democrats still retained control of both chambers, but they lost several seats in both chambers so that the new makeup of the legislature for the 2011–2013 cycle is 55–42 in the House and 27–22 in the Senate.

4 Budget Options in 2011?

As part of the plan to close the looming budget gap in Washington State, the legislature considered numerous strategies to increase state revenues and cut program costs. Although the regular session ran for a full 90-day period, only

the transportation budget had passed by the end of this session. A special 30-day session was called by the governor to finish the negotiations and pass the remaining operating and capital budgets, extending the work of the legislature into May. Closing the increased budget shortfall was an uphill battle – in fact, some legislators even joked that they were purposely planning on holding their 4th of July celebrations in Olympia because they still expected to be in session. Some of the specific plans that were considered and an update on their status are given next.

4.1 Taxes and/or New Fees

- Going to the voters for a tax increase: A citizen-approved tax increase was an option provided in Washington, and perhaps looked rather attractive to legislators who realized a two-thirds vote in both chambers to increase taxes is unlikely. However, Governor Christine Gregoire stated that legislators would be foolish to consider this option as realistic, given the citizens' 2010 midterm votes to (1) repeal the sales tax increases of last year, (2) vote down a tax on high-wage earners, and (3) repress the two-thirds vote threshold for tax increases (Governor's Response, March 2011). As such, going to the voters for tax increases was not pursued in either session in 2011. However, the ability of voters to impose a two-thirds vote threshold for tax increases in the legislature is currently being challenged. In July, a group of House Democrats and education interests filed a lawsuit requesting that the initiative be deemed unconstitutional because it prevented from proceeding to the Senate an education-related tax bill that passed in the House with a simple majority (Camden 2011).
- Converting temporary tax increases to permanent tax increases: House Bill (HB) 1997 was proposed to change temporary tax increases into permanent tax increases, which specifically applies to King County (Seattle area). In this area, sales taxes were imposed on restaurants and the use of rental cars to fund the construction of Safeco Field. Now that construction is complete, these taxes would remain and the funds would be used for other purposes (Washington State Legislature 2011). Although considered, this bill was reintroduced in the special session where it remained with no further action until the conclusion of same session.
- Capturing sales taxes from online purchasing: The online sale of merchandise is an ever-growing industry that is affecting the Washington state economy. In 2001, online sales as a share of retail sales, excluding food and automobiles, were about 5%; in 2010, online sales were 9% of that figure. Over the past year, online sales have increased and account

for more than 20% of total retail sales growth. However, state officials estimate the state only collects about half of the taxes coming from online retail sales. Based on a 1992 US Supreme Court ruling, businesses only have to collect sales tax on behalf of a state if the business has a physical presence in that state. However, the state changed its tax system for shipped goods from “origin-based” to “destination-based”, meaning taxes are now collected based on the location of the buyer, not the seller. Also, individuals in Washington who buy products online from out-of-state stores are expected to pay a “use tax” via the honor system, although most ignore or have never heard of the levy. As of 2011, legislators were supporting the creation of a uniform online tracking system, which would capture additional revenue [Economic and Revenue Forecast Council (ERFC), April 2011], although no changes were made by the end of the special legislative session. This may be an issue that resurfaces in the near future as legislators continue to consider new, evermore creative sources of state revenue.

4.2 Possible Cost-Cutting Methods

- Privatization of state services: The privatization of state functions is a potential cost-saving method that was under consideration. Essentially, the state would contract out to private companies the management of the state ferry system and some state parks. Ultimately, the legislature passed a new state parks fee, which includes a \$30 annual vehicle fee and \$10 one-day vehicle fee (Associated Press 2011), although the privatization of ferry management was left behind in the 2011 special session (HB 1119).
- State worker concessions: Due to budget issues last year, state workers had to make concessions on several fronts. In 2010, the legislature cut salaries by 3%, largely through furloughs, and raised the employee share of health insurance premiums from 12% to 15%. In 2011, concessions were achieved primarily through straight cuts to state worker salaries, some most notably in the area of K-12 education. This included a 1.9% cut in teacher salaries and a 3% cut in salaries for other K-12 employees over the next 2 years (Associated Press 2011).
- Twenty-fifth month: In an infamous move, legislators in 1971 adjusted the biennial calendar for revenue purposes; they added projected revenues from July 1973 to the 1971–1973 biennial budget, which ended in June 1973. This gave them 25 months of revenue to cover 24 months of state operations and bridged the budget gap. However, this meant that the 1973–1975

- biennial budget only had 23 months of revenue to utilize, which was not enough to cover all necessary expenses. The consequences of this one-time, one-month adjustment were long lasting – it took the legislature 16 years to get the budget caught up. There was some talk of using the so-called 25th month “gimmick” as one option to help close the budget shortfall; however, Governor Gregoire stated rather early on that she would veto any budget proposals that created a similar scenario (Smith 2011a). This idea was rejected during the 2011 legislative session (Goodman 2011).
- Increasing state debt (borrowing): Washington State borrows funds to cover its capital budget. As a result, part of the current budget goes to paying principal and interest on state bonds. The percentage of revenue used to pay back bonds is on average 3% for other states; for Washington State, it is 6% and trending toward 7% (Editorial Board, 04/12/11). During the next biennium, \$1.7 billion will be required to cover the debt service. The Washington State Constitution limits the state’s ability to borrow funds to finance government capital programs. The state cannot sell general obligation bonds if the debt service from that sale will cause total debt service to exceed 9% of the average of general state revenues for the preceding three fiscal years. Over the last 2 years, general-fund borrowing has been more than 1.8 billion, but based on current laws, the legislature will be limited for the next 2 years to a half billion dollars. Senate Bill (SB) 5181 passed in the special session created a commission that will reevaluate the use of debt in the state and determine a working debt limit, set to reduce down to 7.75% by FY 2022 (Bill Summary SSB 5181, 2011a).
 - The budget stabilization account: The voters of Washington passed the Budget Stabilization Account (ESSJR 8206) in November 2007, otherwise known as the state’s “rainy day fund” (Washington House of Representatives 2007). This fund was created as a reserve nest egg that the legislature can tap into in cases of emergency or economic downturn. Despite the safety net that the rainy day fund provides, legislators were reluctant to use the account because it would result in a decrease of the state’s credit rating. However, these funds were used to help close the budget gap, and the account is expected to have a zero balance by the end of the new biennium (Office of the Governor 2011).
 - Cash payouts for labor and industries claims: Washington State is one of six states that does not provide a cash payout option in which injured workers can settle their claims through large, one-time cash payouts. The implementation of one-time cash payouts would save the state money because this option costs the equivalent of 80% of the value of a long-term full pension (Smith 2011b). Therefore, if workers were allowed to choose between either a one-time upfront payout or a pension, the estimated savings would be \$1.2

billion during the first 2 years alone. After that, the system would save an additional half billion dollars in its long-term liabilities every 2 years. The state did, in fact, pass a significant reform to the workers' compensation system by creating a "structured settlement" option that provides older, permanently disabled workers the option for voluntary one-time settlements instead of a lifelong pension, a plan that will save Washington \$1.1 billion over the next 2 years (*Associated Press* 2011; Shannon and Schrader 2011).

4.3 Possible New Revenue Sources

- Franchising state services: The privatization (leasing) of the state's liquor distribution center has been proposed as a way to raise additional funds. This proposed change would net an additional \$300 million in revenue for the state (Ramsey 2011). This proposal was passed and signed into law by the governor, and the Office of Financial Management is currently accepting proposals from private companies bidding for a contract with the state (Senate Bill Summary 5942, 2011b). Also, the legislature decided to standardize the hours of operation for all 166 liquor store locations in the state starting July 1, 2011 (hours varied by location before that date), and the standardized hours are longer than most locations initially operated (closing time is 9 PM Monday through Thursday, 10 PM Friday and Saturday, and 5 PM on Sundays). This standardization and increase in hours is expected to provide about \$800,000 in additional revenue for the 2011–2013 biennium (Washington State Liquor Control Board 2011).
- Securitization of state revenue: Another option to raise revenue is for the state to use future revenue from specific sources, such as tobacco sales, to back bonds that the state can use now. This idea did not garner much support because it relies on future projections that estimate a healthy state economy, which is a risky choice at this point (Smith 2011c).
- Third-party advertising on state web sites: In an unconventional move, a state legislator proposed a bill in February (HB 1288) that would allow third parties to advertise on state web sites. To minimize conflicts of interest, the legislator proposed that advertising should only be allowed on consumer-oriented state sites such as the Department of Licensing, Department of Transportation, and Washington State Lottery (as opposed to web sites whose departments and agencies serve regulatory roles, such as the Department of Revenue). This would provide additional funding directed toward those agencies that provide advertising, and the remaining fund would go toward college scholarships for children in foster care (Nolasco 2011).

This bill, however, did not make it to a vote in the regular session and was reintroduced in the special session, although no further action was taken.

5 Economic Outlook, June 2011

As mentioned earlier, the legislature was tasked with closing a budget deficit for the remainder of FY 2010–2011, which ended June 30, 2011. It also addressed a forecasted deficit of \$5.1 billion for the new biennium, which begins July 1, 2011. Certainly, the effects of the initial state recession, which officially took place between February 2008 and July 2009, still loom large far afterward (ERFC, October 2010).

In February 2011, the state's unemployment rate was 9.1%, which is down from 9.2% the previous month. This figure held steady as of June 2011. More importantly, the unemployment rate remained down nearly 1 percentage point from the last peak of 10.0% between December 2010 and February 2010 (US Bureau of Labor Statistics 2011). In comparison to the rest of the USA, Washington State has typically experienced a low unemployment rate. In the 1990s and early 2000s, the unemployment rate stayed at about 4.0%, but the unemployment rate has been much higher since 2007, remaining between 8.0% and 9.0%. In March, the housing market was worse than the national average, down 6.6% compared with the same month 1 year earlier (ERFC, March 2011). New home construction decreased 26% from the last quarter of 2010 through the first quarter of 2011, and the housing market remains weak in most areas of the state. For example, housing prices in the Seattle dropped 74% over the last year, more than twice the national average of 3.5% (ERFC, June 2011).

However, there were some areas of the state economy that seemed to pick up. As of June 2011, the state experienced a net gain of 8400 jobs (11,100 public sector job gains, although 2700 public sector job losses). This was fewer than the projected net gain of 14,800 jobs in the March revenue forecast; nonetheless, a gain. Of these job gains, for example, 1800 were in the aerospace industry (ERFC, June 2011). State exports (excluding transportation equipment) increased by 17.8% in 2010, which is sizable given the 22.6% decrease in 2009 (see Figure 2). And, in the first quarter of 2011, state exports increased 12.4% compared with the first quarter of 2010, another promising sign (ERFC, June 2011). However, transportation exports for goods such as Boeing airplanes, which comprise 50%–60% of all state exports, declined by 10.9% in 2010, and at the end of the first quarter of 2011, Boeing exports remained flat compared with the previous year. The impact of the earthquake and tsunami in Japan in March is thought to be a large contributor to this slow economic recovery, as Japan is Washington's third largest export partner (ERFC, June 2011).

On a rather positive note, Boeing, one of the state’s two largest employers along with Microsoft, continued to add to a backlog of orders extending to 8 years, which is beneficial for the manufacturing industry in Washington. In fact, manufacturing has been adding jobs slowly throughout the past year, again a promising trend. The software industry – ever so important in Washington – was healthy in early 2011, as the business division of Microsoft grew 24% over year and software employment grew 1.7% in 2010 (after tremendous layoffs in 2009). Washington’s ERFC expects software employment to grow 1.6% in 2011, growing over the next 2 years to 3.6% in 2012 and 4.4% in 2013 (ERFC, June 2011).

6 Budget Update, June 2011

In the end, the Washington State Legislature closed a \$5.1 billion budget shortfall for the 2011–2013 biennium primarily through cuts in state services that totaled \$4.8 billion over the next 2 years. These cuts affect education, health, and social services (Chew 2011). Some of the largest changes came in the area of K-12 education, which experienced salary reductions for both teachers and administrative staff over the next 2 years. This also means increases in class size for kindergarten through fourth-grade elementary school classes. In the area of higher education, the legislature gave universities the power to set their own tuition rates, which are expected to increase between 11% and 16% (*Associated Press* 2011). In public health, the legislature continued an enrollment freeze in Washington Basic Health, the state’s subsidized health-care insurance for adults, and limited eligibility for state health-care coverage for low-income immigrant children. For

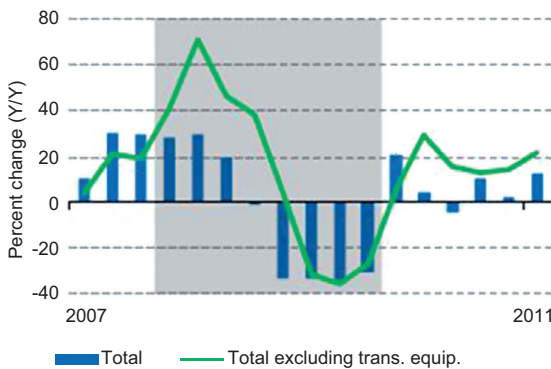


Figure 2: Washington State Exports, 2007–2011.

Source: WISER: data through Q1 2011.

state government, public management and administration experienced 7%–10% cuts for the new biennium (Schrader 2011). As more official government documents are made available, a more complete picture of these types of cuts used to close the budget shortfall will be made clear. Ultimately, Washington State is still battling a slowly recovering economy, which has meant extended special sessions for the legislature in both 2010 and 2011. The economic conditions for the last half of the year are likely to remain troubled, which means more difficult decisions awaiting legislators and the governor in 2012.

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