INTRODUCTION

Despite the fact that in 2007 the Washington state economy had largely remained immune to the consequences of the housing and subprime mortgage crisis, by 2008, two traditional characteristics of budgeting in the state threatened to return: a roller-coaster ride of deficits and surpluses, and the latest version of “ballot-box budgeting.” With its biennial budget, odd-numbered years are where most of the action on taxing and spending is in Washington State. 2008 was the year for the mid-biennium supplemental budget, but it was also an election year. In the November 2007 elections, Washington voters once again seemed cranky about taxes and adopted Initiative 960, requiring a two-thirds majority to raise taxes and requiring that the legislature approve all fee increases, no matter how small. By February 2008, the billion dollar surplus that had been projected the year before suddenly dropped by $450 million. These two events, plus an impending rerun of the closest gubernatorial in American history between Governor Chris Gregoire (D) and challenger Dino Rossi (R), made 2008 more interesting than the normal off year budget.

THE WASHINGTON ECONOMY: AN “ISLAND OF ECONOMIC BLISS?”

In September 2007, a newspaper headline proclaimed that the “state is an island of economic bliss” (Roesler, 9/15/07). The state’s top revenue forecaster, Chang Mook Sohn, projected that revenues in 2009 would grow an addition $281 million. While the rest of the country began to see a spiral in defaults and foreclosures and a credit shortage, Washington State’s economy was humming along. The rate of job growth was more than double the national average in 2007. In addition, as the state most dependent on foreign trade, Washington exports were booming, from aircraft to software to agriculture products. Finally, although home prices had risen steadily during the 2000s, particularly in the Seattle region, the state never had the run of speculation that states like Arizona, Nevada, and California had. As a result, the effects of the subprime mortgage crisis were barely visible throughout the state. Prices leveled off but did not decline in 2007 in the Seattle area and also in eastern Washington, with prices holding steady in Spokane County as well. There were simply fewer subprime loans that had been made in the state.

The last time the U.S. went into recession, the state was hit hard. The negative effects of the September 11 attacks on the aerospace industry and the high tech meltdown in the late 1990s and 2000 had devastating effects on the Northwest. Oregon and Washington were two of the states most hurt. Washington’s economy had been more cyclical than the national economy, with higher highs and lower lows. Figure 1 shows annual changes in employment in Washington compared to the U.S. as a whole since 1990.
By 2006, the economy had fully recovered. Many business leaders pointed to the fact that the Washington economy was more global and more diverse, and less vulnerable. One CEO said, “We won’t see anything like the nation is seeing. Seattle is in a wonderful position because it is truly at the edge of the global market” (James, 1/2/08). Even as the state began to feel the first effects of the national economic slowdown in early 2008, Washington was approaching a record low level of unemployment. With 5800 new jobs in January 2008 alone, the state unemployment rate dropped to 4.5 percent, below the national average and the lowest since the state started keeping track in 1976 (La Corte, 2/27/08). Governor Gregoire issued a statement saying, “These positive job numbers are further evidence that Washington’s economy is still healthy, despite what’s happening in other parts of the country” (La Corte, 2/27/08).

Despite the good news in September, legislators were warned that if the national economy continued to turn down or went into a technical recession, Washington State would eventually be affected. Eventually it did, but not enough to throw the budget into deficit. Despite the good economic news in the state, voters in Washington would prove to be nervous about the economy and leery about taxes.

THE POLITICAL CONTEXT: A 2008 GUBERNATORIAL RERUN

The 2006 elections had cemented Democratic Party control of Washington State. After a decade of close partisan divisions and two legislative sessions with the House tied 50-50, Washington State looked to be solidly in the Democratic camp. But Washington voters are notoriously independent, do not like political parties in general, and have a record of throwing incumbent parties out if they are unhappy. During the February 2008 presidential primary, as
many as 30 percent of ballots were invalidated because voters refused to sign a pledge that they were a member of either party. Soon after, however, the U.S. Supreme Court upheld the new “top two” primary approved by voters, which is more like a first round general election than a primary. That system would be used for the first time in August 2008. Democrats remembered 1994, when, after a big tax increase in 1993 under their watch, voters dumped them and elected Republican majorities in both the House and Senate. That nervousness among Democrats was still very visible in 2007-2008 and explains some of the rather conservative policy actions that were taken.

Governor Gregoire won the 2004 election by 133 votes after the third recount. Republicans have tried to keep the anger and resentment from this allegedly “stolen” election alive for four years. Perhaps they have succeeded. Despite the strong economy, productive legislative sessions in 2005 and 2007, and national recognition for some of her achievements, Chris Gregoire’s job approval hovered around 50 percent throughout her term. This was certainly an improvement over the mid-30 percent approval ratings she showed in 2005, right after the election, but seemed to be below where one might expect. As Rossi announced that he would be a candidate for the Republican nomination again, a rematch of the 2004 cliffhanger seemed apparent. One of the issues Rossi continued to promote on the hustings was that when he was Senate majority leader, he was able to write a balanced budget without raising taxes despite a $2 billion deficit. He claims that Gregoire has raised taxes and that spending has grown 33 percent since she took office.

One would expect that 2008 would be a much easier election for Gregoire than before. With support for the Iraq war and the approval rating of President Bush in the teens – among the lowest of any state – and record turnout in the caucuses won by Barack Obama, one would expect that she should have an easy re-election. However, an independent poll conducted by Washington Conservation Voters found that in February of 2008, Gregoire was leading Rossi 43-41, a statistical dead heat (Connelly, 2/15/08). Rossi was leading among independents, 41-30 percent, but with 29 percent undecided. Despite the fact that 2008 looks like a great year for Democrats nationally, the Governor and her staff have been extremely careful in anticipation of attacks from Rossi and the Republicans about their “tax and spend” proclivities. These political calculations help explain how the governor and legislature reacted to a court decision and some initiatives passed by the voters.

THE 2007 NOVEMBER ELECTIONS

As usual, Washington voters faced a number of initiatives and referenda on the November 2007 ballot and many of them dealt with taxing and spending. On the ballot was Initiative 960, the latest in anti-tax crusader Tim Eyman’s series of tax and spending limitations going back to the 1990s. I-960 required that all tax increases must receive a two-thirds vote in order to go into effect, and that all fee increases around the state, no matter how small, had to be approved by the state legislature. Also on the ballot was a resolution to require one percent of all state revenue to go to a “budget stabilization account” (rainy day fund) that would take supermajority votes by the legislature to be able to spend. Governor Gregoire supported that measure. The third budget-related measure would reduce the 60 percent majority required to pass
school bond levies to a simple 50 percent majority. This measure, favored mostly by Democrats, had been around for decades. Proponents felt that with the strong Democratic tide in the state, 2007 might be the year it would finally win. Several local budget issues were on the ballot as well, including an $18 billion tax hike for citizens in the three-county Seattle region to support transportation infrastructure, an issue that has remained unresolved and is approaching crisis proportions.

When the votes were counted, Washington voters appeared to revert to traditional form. Veteran state political journalist, Dave Ammons, wrote that, “the 2007 election showed a surprisingly clear anti-tax, anti-establishment message” (Ammons, 11/8/07). A “cranky electorate” said “we’re tapped out.” I-960 passed 51 percent to 49 percent despite opponents significantly outspending proponents. A transportation measure for King, Pierce, and Snohomish counties failed by a substantial margin. The reduction in the majority needed for school levies also appeared to be failing after election day, but late returns pushed it over the top by a narrow margin. The constitutional amendment supported by Governor Gregoire requiring that one percent of state revenues be set aside in a rainy day fund garnered 68 percent of the vote. Rossi and the Republicans immediately began spinning the election result claiming that it was a repudiation of Governor Gregoire and the Democrats. It would set a tone for consideration of the 2008 budget.
WASHINGTON SUPREME COURT OVERTURNS PROPERTY TAX CAP

One of the earlier Tim Eyman initiatives was I-747, enacted in 2001 with 58 percent of the vote. I-747 capped total property tax increases at one percent per year unless specifically approved by voters (LeLoup, 2004). Before 2001, increases were generally limited to the rate of inflation but smaller taxing units could raise taxes up to 6 percent per year. After 2001, many local governments struggled financially because of I-747 and the earlier Eyman initiative, I-695, that had radically reduced revenues they had received from auto registration. Two days after the November 6, 2007 elections were completed, the Supreme Court of the State of Washington ruled 5-4 that I-747 was unconstitutional. Judge Bobbe Bridge wrote that I-747’s flaw was that “the text of the initiative misled voters about the substantive impact of the initiative on existing law” (Roesler, 11/9/07).

Governor Gregoire’s first reaction was to ask cities, counties, and other local governments not to rush to raise taxes. Her next action was to call a special session of the legislature to consider reinstating some kind of cap on property taxes. “We have heard loud and clear on Tuesday evening that voters are concerned about their tax burden,” Gregoire said (Roesler, 11/9/07). Eyman’s reaction was that the Court had dropped a powder keg in the lap of the governor and legislative leaders. Apparently they thought so as well.

When the legislature met for a one day session on November 29, legislators were presented with two proposals by the governor. The first was to reinstate the one percent annual cap on property tax increases. The second was a bill to defer property tax payments for families making less that the state median income ($57,000 per year) (McGann, 11/26/07). Even though the election results were somewhat of a mixed bag, Democrats did not want to take the chance of handing Republicans an election issue in 2008. As a result, both bills were enacted into law and signed by the governor the same day. Legislators further promised to take a more thorough look into the issue of property tax relief when the legislature reconvened in January.

THE GOVERNOR’S 2008 BUDGET PROPOSALS

On December 18, Governor Christine Gregoire released her proposal for a $144 million supplemental budget that left the majority of the state’s then-estimated surplus of $1.4 billion in savings (Office of the Governor, December 2007). Her emphasis on fiscal restraint had several motivations. The first was political – the upcoming re-election campaign with Dino Rossi. The second was policy related. The governor wanted the state to get off the “budget rollercoaster” that had plagued Washington State budgeting for a decade. The Washington tax structure, even though lacking an income tax, was highly sensitive to changes in the economy producing cycles of revenue boom and bust. Figure 2 shows the state budget surpluses and deficits since 2005.
The governor’s budget contained only minor policy changes and additions to the budget passed the year before – only $144 million in additional spending in a total budget of almost $65 billion, including all sources. However, Dino Rossi criticized the governor’s plans as insufficiently prudent. “It’s time to take steps now to rein in spending and show some fiscal restraint,” Rossi said (Ammons, 12/19/07). Her central theme in presenting the additional spending was “safety and security;” flood relief, campus security, and children’s safety were emphasized in her budget press conference. In other words, only the most essential new spending would be added. In contrast, most of the emphasis was on saving the surplus – $1.2 billion of the projected $1.4 billion would be saved. Of that, $430 million would go into the rainy day fund that voters had approved the month before. Figure 3 shows the governor’s emphasis on savings, targeted investments, and mandatory new spending such as from federal Medicaid changes or caseload increases.

Of the $144 million in new spending, $99 million was for mandatory spending increases and only $45 million for new spending projects. Her proposed new spending included education and campus safety, following the Virginia Tech shootings the previous spring. Other safety initiatives included disaster response and recovery, health care and patient safety, and community safety, particularly from sex offenders. The overall effect of the governor’s proposed budget did little to change overall expenditure patterns in the state as shown in Figure 4. The two pie charts in Figure 4 show where spending from the general operating funds goes (totaling just under $30 billion), and the second shows the distribution of all funds (totaling just under $65 billion) which includes federal transfers and fees (such as tuition).
FIGURE 4

Proposed Budget Expenditures

General Fund-State: Operating
Distribution of 2007-09 General Fund-State Expenditures, including Proposed 2008 Supplemental Budget

<table>
<thead>
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<th>Category</th>
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<td>Corrections</td>
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<td>Governmental Operations</td>
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<td>Natural Resources</td>
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<td>All Other*</td>
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<td><strong>TOTAL</strong></td>
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*All Other includes Legislative, Judicial, Other Human Services, Transportation, Contributions to Retirement Systems, Other Education, and other appropriations.

All Funds: Operating Plus Transportation Capital
Distribution of 2007-09 All Funds Expenditures, including Proposed 2008 Supplemental Budget

<table>
<thead>
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<td>All Other*</td>
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<td><strong>TOTAL</strong></td>
<td><strong>$64,763</strong></td>
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*All Other includes Legislative, Judicial, Other Human Services, Contributions to Retirement Systems, Other Education, and other appropriations.

Source: Office of Financial Management
THE SHRINKING SURPLUS

While Gregoire and Rossi continued to spar over their respective budget records, the national economic slowdown finally hit Washington. On February 15\textsuperscript{th}, the Forecast Council informed the legislature that revenues would be $423 million less than had been projected in November (McGann, 2/16/08). Much of this decline came from reductions in revenues that would be raised by the state’s real estate excise tax as home sales slowed, and the rest from slowing consumer spending. Another $100 million hit to the budget came when projections for caseload growth and higher than expected raises pushed up mandatory spending. Reserves would drop from $1.4 billion to under $1 billion. However, even with the reductions, legislators still had $200 million more than had been projected when they adjourned in May, 2007. Democrats were quick to note that this represented just a 1.4 percent drop in the $29 billion revenue forecast and that no recession was forecast for the state. Although it would not be possible to save as much as the governor had originally proposed, she promised to save as much as possible. Meanwhile, one of the state’s progressive think tanks, the Washington State Budget and Policy Center, urged state officials to spend more and save less to protect the poor. “Making the right investments now can minimize the effects of the economic downturn on families, communities and the regional economy. Rather than knee-jerk reactions such as budget cuts, there are better choices that are known to foster economic security” (McGann, 2/16/08).

THE HOUSE AND SENATE BUDGETS

The House reported its budget the third week of February and the Senate reported its budget the next week. Both proposed more spending than the governor. The House budget added $297 million in spending while the Senate budget appropriates added an additional $325 million, leaving a total of $755 million in reserve (Ammons, 2/29/08). The new rainy day fund would receive $446 million and the other $309 million would remain in the fund balance (Senate, 2/26/08). Both houses generally agreed in the overall dimensions of the budget but had a number of disagreements on specific policy measures.

- The House budget included an extra one percent for teachers pay at a cost of $39 million. The same measure failed in the Senate and was not included in their budget.
- The House budget froze the implementation of day-long kindergarten to save $8 million, which is fully funded in the Senate budget.
- The House budget increased state housing programs by $90 million while the Senate version only added $50 million.
- Neither House nor Senate included funding for campus safety.

The Senate passed the budget on a party-line vote 31-17. Republicans put up large signs in the chamber with the number “33,” in reference to the percentage that spending has increased since 2005 under the Democrats. The Senate also turned down Republican efforts to require a study of how much the state is spending on services for illegal immigrants.
A COURT CHALLENGE TO I-960

In addition to the negotiations over the state’s 2008 supplemental budget, legislative Democrats decided to take aim at I-960. It was clear that the Democrats were sick of Tim Eyman’s efforts to reduce the power of the legislature, an underlying theme in virtually all of his initiatives over the years. Since I-601 passed in 1993, Democrats had believed that the supermajority requirements to raise taxes in these initiatives were unconstitutional. But they never had an actual vote that received a majority but failed to get the supermajority that would give them standing to sue. The Senate laid the groundwork for a legal challenge on February 29 when they took up a $10 million liquor tax proposal to pay for substance abuse treatment, which required a two-thirds majority to pass under I-960. The bill passed the Senate 25-21 but was not adopted. The Senate majority Leader, Lisa Brown (D-Spokane), rose to argue that I-960 was unconstitutional because it amended the state constitution’s provision that bills pass the Senate by a simple majority vote, and that I-960 was an initiative, not a constitutional amendment (La Corte, 3/1/08). On March 3, Senator Brown filed suit in the Washington Supreme Court to have I-960 overturned. Political observers felt that this could be one of the important issues in the fall elections.

FINAL BUDGET AND LINE-ITEM VETOES

The Democratic-controlled legislature reached final agreement on the supplemental budget before the constitutional deadline and without a lot of controversy. In response to I-960, legislators passed legislation that increased 260 fees at a cost of $86 million over two years. This was a figure pared down from some 400 fee increases at a cost of over $100 million that were requested.

The final budget agreement between House and Senate increased spending by $306 million for a two-year budget total of $33.4 billion and put $835 million in the rainy day fund. This was more new spending than the governor had asked for but they had saved two and one half times as much as the new spending authorized. The bill was debated and passed on the last day of the session. One of the main differences in the House and Senate versions was a cost-of-living increase for teachers, with the House proposing a one percent “catch-up” increase, and the Senate adding nothing. They split the difference, approving a .5 percent increase. (McGann, 3/12/08) The budget included $17.7 million for assistance to students who are at risk of dropping out and funding to continue to transition to all day kindergarten. Legislators approved $70 million for affordable housing and helped flood victims with $15.5 million in assistance. Several high profile budget items had failed to pass. The city of Seattle and Microsoft CEO Steve Ballmer failed to convince the legislature to authorize $75 million to help remodel Key Arena and keep the Seattle Sonics NBA franchise in town. Seattle lost the team to Oklahoma City a few months later.

The final budget agreement was shaped by Democrats with Republicans largely excluded from participating. With the election only months away, Republicans were left with nothing to do but excoriate the Democrats and their budget. They denounced that 44 percent increase over the past 4 years and had held up signs in the capitol plastered with the number 44. Democrats
argued that the state was positioned to ride out tough times despite the downward revenue forecast of $423 million that had been issued a few weeks earlier. Rep. Marko Lilas (D-Mukilteo) noted that Washington had added 77,000 new jobs in 2007, had a growth rate double the national average, was way behind the national average in foreclosures, and had put the largest amount ever into savings (Lilas, 3/19/08).

The governor signed the budget largely as passed but exercised her line-item veto on $15 million worth of items. With total new spending authorized of $291 million, that works out to about 5 percent of the new spending that was eliminated by the governor (Ammons, 4/1/08). The $15 million in vetoes raised the total amount put into budget savings at $850 million, the largest amount ever saved by the state. Governor Gregoire also signed into law a $118 million supplemental construction bill, bringing the total in the biennial budget to $4.5 billion. In April, Republican gubernatorial candidate Dino Rossi proposed a $15.4 billion transportation plan that would divert money directly from sales tax. How this shortfall would be made up in the rest of the budget was not addressed.

CONCLUSION: A CRITICAL ELECTION AND IMPENDING DEFICITS

Despite the fact that the state of Washington, as late as the fall of 2007, was called an “island of economic bliss” there were storm clouds on the horizon for the upcoming 2009-2011 biennial budget. By the summer of 2008, there were indications that the state could face a shortfall as high as $2.7 billion for the next two years and as much as $5.1 billion in the following biennium (Ammons, 2/25/08). In June 2008, the state Economic and Revenue Forecast Council reported another $167 million drop in state revenue (La Corte, 6/20/08). This dropped the $850 million in reserve approved a few months earlier down to just over $800 million. Particularly hard hit were real estate excise tax collections. Although home prices held up better in Washington than in the rest of the nation with few foreclosures, sales volume was down significantly.

While revenues fall, outlays continued to rise without any action by government. There is no such thing as a “stand-pat budget,” with rising health care costs, rising case loads and prison populations. Just to stay even, revenue has to grow at a vigorous pace. The Speaker of the House, Frank Chopp (D-Seattle) acknowledged that it may be necessary to consider tax increases to balance the budget in 2009. Rossi and the Republicans were making this a campaign centerpiece. Governor Gregoire said that the state economy was resilient and if there is a deficit, “we will manage our way out of it.” (Ammons, 4/1/08). Of course, much of the direction of next year’s Washington state budget will be determined by the outcome of the election in November 2008 for governor, half the Senate, and the entire House. While the legislature looks to stay safely democratic, Governor Gregoire only outpolled challenger Dino Rossi by two percent in the August 19, 2008 “top two” primary. Just like the Obama-McCain contest in 2008, the Rossi-Gregoire race was much closer than one might have imagined given the unpopularity of George W. Bush, the Republican Party generically, and the weak economy. An upset win by Republican Rossi would likely throw the state back into a divided government and have quite different budget outcomes than would be the case with unified Democratic Party control of state government. It looked like the state could easily get back on the budget roller coaster.
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