Washington Alliance for a Competitive Economy

WashACE

Association of Washington Business
Washington Research Council
Washington Roundtable
Washington Association of REALTORS®

2002 Competitiveness REPORT

Will Washington Shrug?

Washington's plunge from prosperity to recession caught many policymakers by surprise – and radically refocused the competitiveness debate.

The slowdown has affected all parts of the state and no major sector of our economy remains unscathed. Our unemployment rate is among the nation's highest. Laid-off workers wonder if there will be jobs for them to return to; some see little prospect of re-employment here and plan to leave the state. Business owners worry that the recovery will occur too late for them. Public officials see declining tax revenues that are throwing state and local budgets out of balance.

Eighteen months ago, the Washington Alliance for a Competitive Economy (WashACE) wrote: "At first glance, our state's economy would seem to be the envy of the nation, or even the world. But there are signs of clouds gathering on the business climate horizon."

Although the warning signs were clear, policymakers were slow to react, seemingly shrugging off business concerns with an "it can't happen here" denial.

The storm blew in with unforgiving force.

Although the terrorist attacks of September 11 rapidly accelerated the decline, the nation slid into recession the previous March. Even earlier, our state economy had begun to slow, and many communities never experienced the job and income growth that the Central Puget Sound region enjoyed in the nineties.

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While major events marked the landscape – energy crisis, earthquake, relocation of Boeing headquarters, dot-com implosion, national recession and terrorist attack – Washington's competitiveness story is better understood as one of slow erosion. This erosion is, in large part, a result of our collective failure to address successfully the business climate challenges identified in the earlier WashACE report.

During the last six months, we interviewed industry leaders to learn of their concerns with the state's business climate. Together with statistical information published by WashACE in the 2002 Competitiveness Redbook, their observations provided valuable insight into the state's ongoing challenges.

The following discussion will be framed around the categories used in the October 2000 WashACE report, *Keeping Washington Competitive*. Areas we examine include transportation and infrastructure, education and workforce preparation, taxation, regulation, housing, and quality of life.

A Solid Framework for Economic Development

Washington has a lot going for it. We have dominant industries in several critical economic sectors, including aerospace, natural resources, and technology. Entrepreneurial talent abounds. Despite energy setbacks, the state will continue to tap abundant hydroelectric power. Education reform and accountability measures are improving our public schools. Our research institutions provide the intellectual infrastructure to sustain advances in science and technology. Furthermore, the state's celebrated quality of life continues to enthrall natives and newcomers.

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Nonetheless, public policy has impeded economic expansion. Too often, hurdles in the form of uncompetitive tax policies, unnecessary regulation, or inadequate infrastructure stand in the way of business development. As the economy slowed in the last year and a half, the challenges represented by these barriers loomed larger.

Significantly, there are reasons for optimism today. Last summer, Governor Gary Locke created the Washington Competitiveness Council (WCC) "to help make Washington State the nation's leader in business development." In December, WCC released more than 70 recommendations for executive and legislative action that, if implemented, will lead to enduring improvements in the state's business climate. The WCC also proposed performance benchmarks to measure progress and competitiveness. It is critical that the Governor, lawmakers, agency directors, and local elected officials quickly implement these recommendations.

Many of WCC's recommendations reflect and build upon the work of WashACE and other business organizations. As well, legislative leaders of both parties have been actively engaged with constituents and business leaders in discussions of economic competitiveness.

It is critical that the Governor, lawmakers, agency directors and local elected officials quickly implement these recommendations.

While a political consensus – essential if we are to achieve success – is beginning to emerge, the coming months will determine if the consensus can be matched by the political will. If it is, Washington will emerge from the current recession stronger and businesses here will be better able to compete in the global economy.

Uneven Prosperity

From the outside, Washington initially may appear to be an ideal place to do business. For example, the state received "straight A's" on the 2001 *Development Report Card* published by the Corporation for Economic Development. Washington scored top marks in each of the three major categories: performance, business vitality, and development capacity. Further, Seattle ranked third in the nation on the April, 2001, *Metropolitan New Economy Index*, behind only San Francisco and Austin.

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A closer look at the data, however, reveals what most Washingtonians know: Prosperity is very unevenly distributed throughout the state, and the prosperous Seattle metropolitan area remains highly dependent on the fortunes of The Boeing Company. The technology boom of the last decade offset our Boeing dependence for a time. As the tech industry simultaneously contracts and matures, however, we approach this latest Boeing downturn without a cushion sufficient to absorb the shock.

Statewide data paint a very rosy picture of Washington's recent economic history. Consider Washington's performance on nine economic measures tracked by the Office of the Forecast Council and reported in the September 2001 *Washington State Economic Climate Study.* Washington ranked in the top half of the nation on the following six measures and in the top ten on three:

- 5th on total employment growth rate at 2.6 percent
- 11th on per capita personal income at $28,515
- 7th on annual earnings per job at $36,661
- 1st on annual earnings per job growth rate at 6.6 percent
- 3rd on percentage of foreign exports as a percentage of personal income exclusive of transportation equipment

- 13^{th} in migration rate at 0.6 percent

The "two Washingtons" phenomenon significantly skews this picture, however.

As Figure 2 shows, 44 percent of the state's nonagricultural jobs are located in King County, which has 29 percent of the state population (Figure 1). Taken together, King, Pierce, and Snohomish Counties account for 51 percent of the state population and 61 percent of the jobs.

Since 1970, population growth in Washington has been steady, both in the metropolitan Puget Sound region and outside it (Figure 3). The pace of growth in the last decade has been greater outside the Central Puget Sound (Figure 4).

Unemployment climbed dramatically in 2001 as the national recession took hold here. In the last several months, the unemployment rate in Washington has ranked among the top five in the nation.

Employment growth statewide slightly exceeds the rate of population growth, approaching 30 percent in both parts of the state. The aerospace slowdown in the early nineties in the Central Puget Sound region was followed by a quick run-up in 1996 and 1997 (Figure 5). As employment increased, the state enjoyed a consistently declining unemployment rate. Although throughout the decade, unemployment was higher outside the Central Puget Sound region (Figure 6).

Unemployment climbed dramatically in 2001 as the national recession took hold here (Figure 7). Projected Boeing layoffs presage a continuation of this trend. In the last several months, the unemployment rate in Washington has ranked among the top five in the nation.

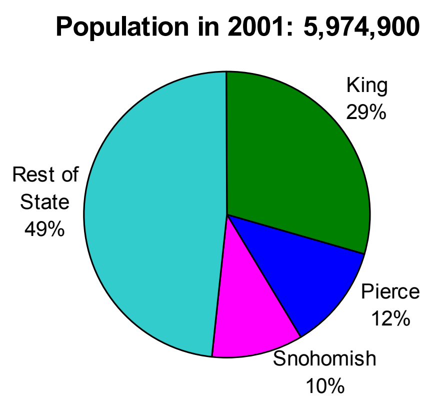
Although employment and population growth outside the Central Puget Sound region showed some strength, personal income growth outside the metropolitan core has steadily lost ground since 1975 (Figure 8). While the Central Puget Sound region saw a 30 percent increase in per capita personal income (PCPI) relative to the national average, the balance of the state saw relative income levels drop to about 80 percent of the national average, reflecting the loss of high-paying natural resource jobs. The sharp increase in Central Puget Sound region PCPI in the late nineties reflects the income growth generated by the technology sector, particularly software stock options.

Within the three contiguous urban counties, the extreme wealth associated with the success of the software industry exerted a powerful – and distorting – force on personal income statistics.

Within the three contiguous urban counties, the extreme wealth associated with the success of the software industry exerted a powerful – and distorting – force on personal income statistics. Average wages in King County were $47,241, with software included; without software, the average drops to $40,926. King County wealth pulls up the statewide average, taking it above the average wage levels in Pierce and Snohomish Counties (Figure 9).

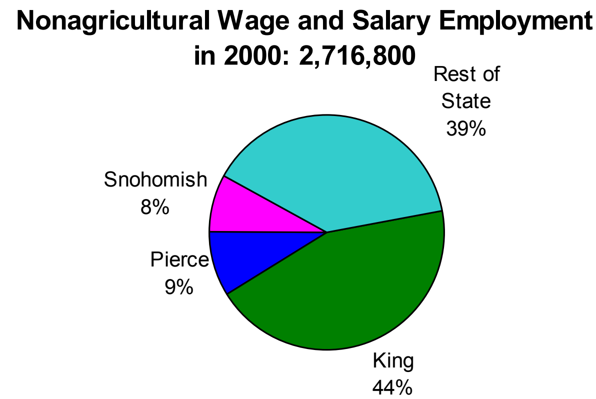
More tellingly, transfer payments contribute about 16 percent of personal income outside the three-county metropolitan Seattle region, nearly double the share they represent in the core (Figure 10). This is important because transfer payments (primarily retirement income, unemployment payments, and welfare)

Figure 1



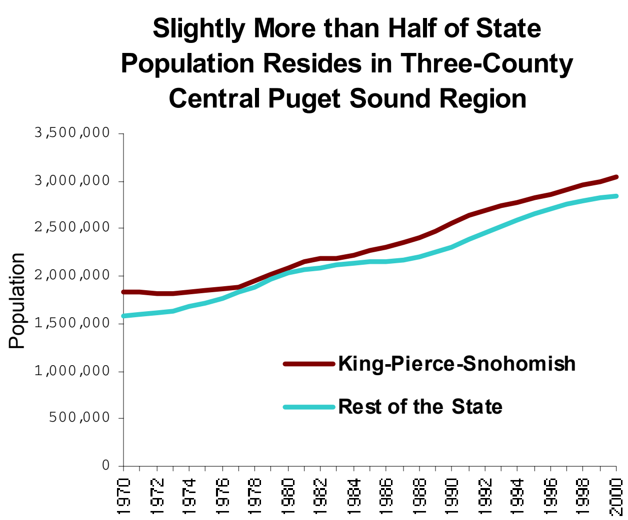
Source: Office of Financial Management

Figure 2



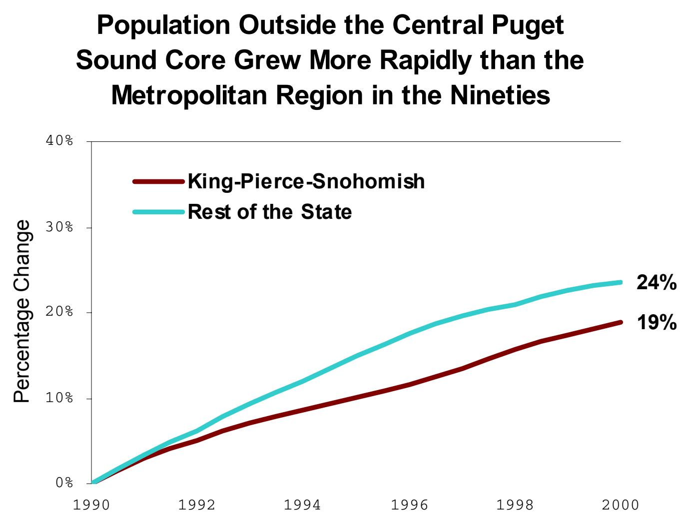
Source: Employment Security Department

Figure 3



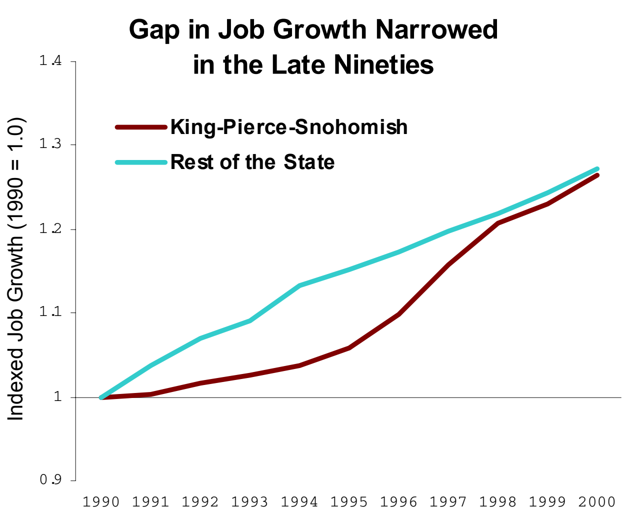
Source: Office of Financial Management

Figure 4



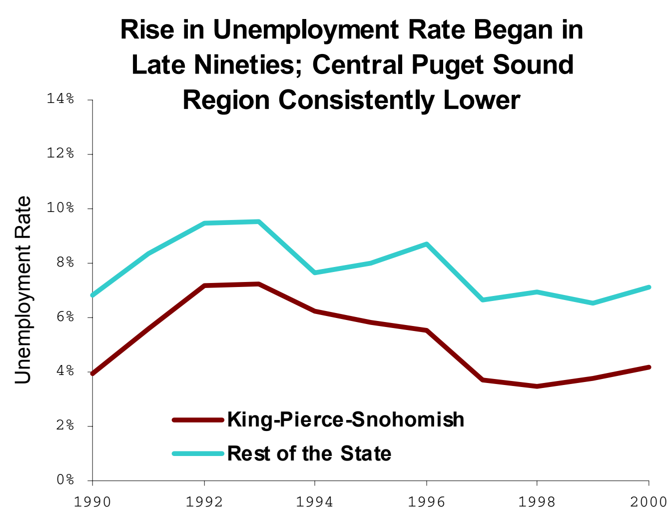
Source: Office of Financial Management

Figure 5



Source: Employment Security Department

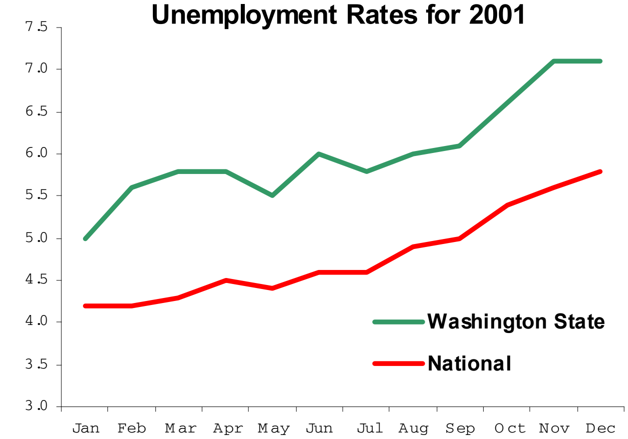
Figure 6



Source: Employment Security Department

Figure 7

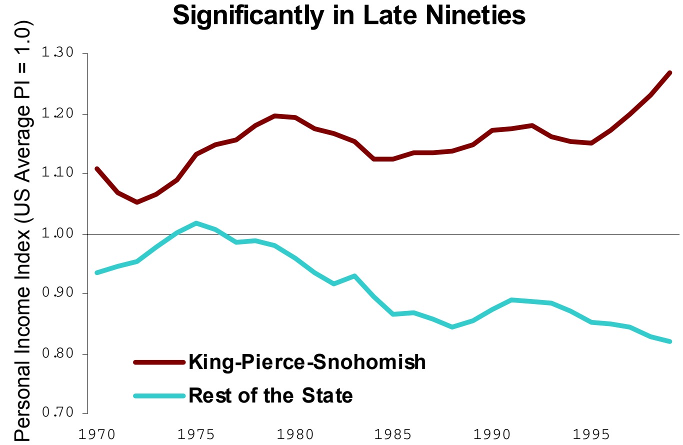
Seasonally Adjusted Unemployment Rates for 2001



Source: Bureau of Labor Statistics

Figure 8

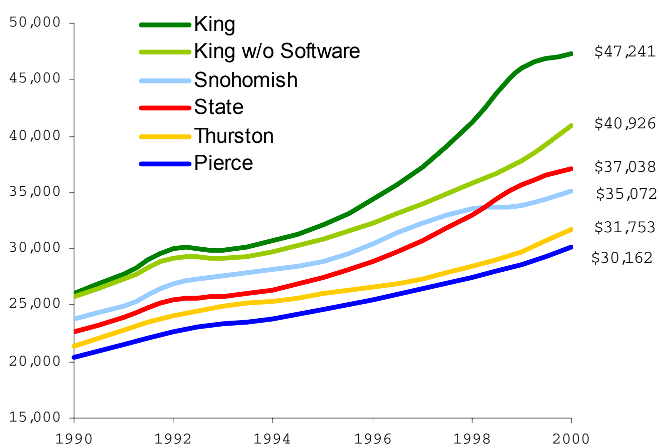
Wealth Gap, Always Great, Widens Significantly in Late Nineties



Source: Employment Security Department

Figure 9

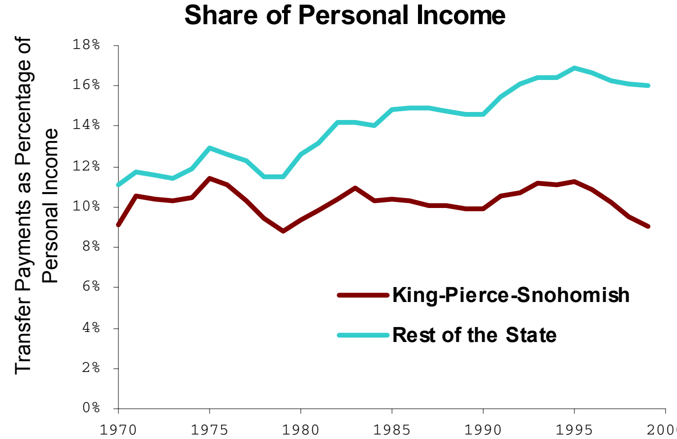
Annual Average Wage in Covered Employment



Source: Employment Security Department

Figure 10

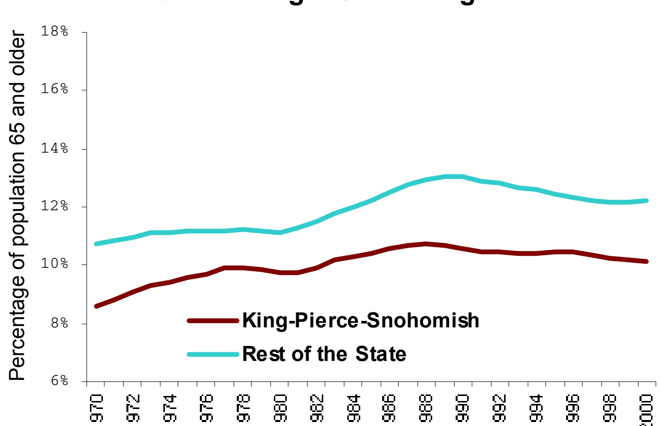
Outside Central Puget Sound Region Transfer Payments Represent a Major Share of Personal Income



Source: Employment Security Department

Figure 11

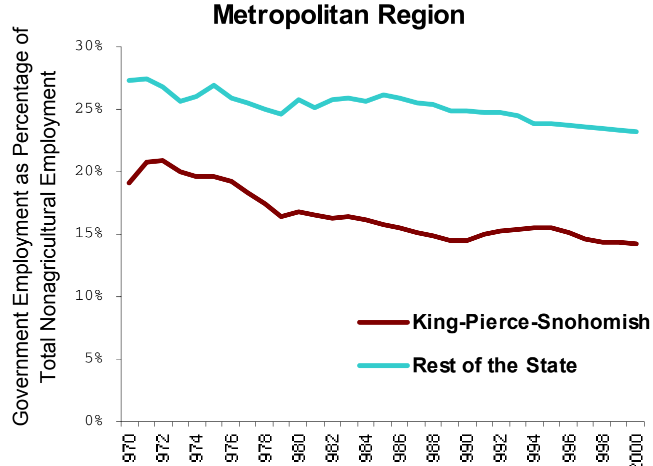
A Grayer Population Outside the Central Puget Sound Region



Source: Office of Financial Management

Figure 12

Government is a Major Employer Outside Metropolitan Region



Source: Employment Security Department

represent income from nonproductive activity, the rewards often of previous productive work. In contrast, the declining share of personal income from transfer payments in the Central Puget Sound area is another demonstration of the region's productive strength in the nineties. One explanation for the relatively higher level of transfer payments outside the metropolitan core might be the aging of the population there. But throughout the nineties, when transfer payments were growing, the share of the population aged 65 and older actually declined (Figure 11).

In addition to relying more on transfer payments, the economy outside the Central Puget Sound region relies heavily on government employment (Figure 12). Although the share has dropped in recent years, government jobs still make up nearly one-fourth of all nonagricultural jobs outside the metropolitan region, compared with about 15 percent in the Central Puget Sound area.

Policies that may appear benign in the Puget Sound region can have harsh effects in the more depressed rural counties.

Much of the state's economic activity, then, occurs in the Central Puget Sound region. For more than a decade, the prosperity of the region has masked the magnitude of economic stress the rest of the state experiences.

Policies that may appear benign in the Puget Sound region can have harsh effects in the more depressed rural counties, particularly in border communities. The voter-approved minimum wage laws, for example, increase labor costs statewide; the wage gap becomes particularly sharp in the rural cities close to Idaho or Oregon. Similarly, the recently adopted cigarette tax boost increases the likelihood that smokers will not stop smoking; rather, they will cross state lines to buy tobacco products, placing convenience stores and other retailers in Washington at a competitive disadvantage.

While some state laws, like that governing the determination of prevailing wage, take into account the difference in regional economies, those outside the urban core believe policymakers generally leave them behind.

When the state's most prosperous region stumbles, the consequences are profound.

As one banker we interviewed says, "the economy in the Eastern half of the state is in a whole lot different state of affairs. … From a public policy point of view, we've not begun to address this in a way that's meaningful."

"Even in New York," says another, "there seemed to be a better understanding between the urban and rural parts of the state."

It is too simple to think of the economic disparity as a function of some "east-west" divide. It falls more along the lines of a rural-urban split. For example, the counties of the Olympic Peninsula face the same struggles as those of Eastern Washington.

This year, however, the economic challenges confront the metropolitan Puget Sound region as well. When the state's most prosperous region stumbles, the consequences are profound. Problems papered over by a surging, if concentrated, economy become painfully apparent as recession sets in.

The themes are familiar, but now inaction cannot be accepted.

Transportation and infrastructure problems top the list of issues to be addressed. Business leaders also cite concerns with education, tax policy, regulation, housing, and other quality of life factors. We consider each of these issues in the following pages, concluding with a set of recommendations.

Transportation

Transportation remains the dominant infrastructure concern in the state, particularly in the Central Puget Sound region. Congestion is also the principal business climate issue. Commute times and highway safety are increasingly harming our quality of life. The Boeing Company has made repeated calls on lawmakers to fix the problem, identifying transportation costs as the primary, although not the only, factor in assessing the desirability of the region for future investment.

Commute times and highway safety are increasingly harming our quality of life.

Many others agree.

As one Seattle-based retailer says, "Transportation is the number one issue, bar none. Period. Fix it." He notes that the issue touches all aspects of doing business in the state, from intermodal systems required to get goods from the ports to stores and distribution centers to getting customers to the stores and employees to work.

A banker in Spokane with operations statewide sums it up neatly:

"Transportation is an umbrella that covers quality of life, infrastructure and economics," she says. "At a social gathering, you can talk to a business owner who can't get goods to market, someone else about getting around town and someone else about government responsibilities. Everyone can relate to it, and everyone relates to it in a different way."

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Longstanding safety considerations also fuel conversations about state transportation, with frequent references to "killer highways."

A transportation executive in Seattle says, "It's a quality of life issue – too many people in too little space. Ask yourself: Would you move to the heart of LA? We are LA when it comes to transportation."

An Eastern Washington executive who travels to Seattle regularly on business says, "On the west side, I plan my agenda 100 percent, totally, on traffic."

The data are well known.

- Congestion in the Seattle-Everett Corridor ranks second only to Los Angeles, according to the Texas Transportation Institute. Tacoma ranks 24th; Spokane, 59th. (Redbook, Table 33)

- Washington ranks 32nd on per capita state disbursements for highways and local roads. (Redbook, Table 34)

- Washington's 23-cent gas tax, unchanged since 1991, ranks 14th in the nation. (Redbook, Table 32)

- Seattle ranked just 64th on *Expansion Management* magazine's September 2001 evaluation of the "100 Most Logistics Friendly Cities."

The data confirm the experience of state business leaders. As the statistics suggest, the problem is concentrated in the Central Puget Sound region.

Business is moving to where transportation problems are lighter.

A business owner in Central Washington notes that his region is "blessed" with good transportation routes, "not like the west side." Similarly, a Clark County manufacturer concludes, "It's a relative thing, [we've] no problem relative to the Bay Area or Seattle."

Even in these regions where traffic flows more smoothly, businesses and employees are frustrated. They are often unable to move product to market reliably and quickly. The trucks roll more slowly once they hit the congestion in the Central Puget Sound.

Consequently, business is moving to where transportation problems are lighter. A shipper in Seattle says he has moved some operations to Portland where the logistics are better.

For some urban employers, good transit systems remain as important as additional highway or interstate capacity.

"Sixty percent of our people take mass transit," says one Seattle technology executive. "[But] people will only take transit if it's frequent and faster than driving." She is concerned that recent cutbacks in transit funding will jeopardize employees' ability to count on reliable bus service.

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Whether or not they are directly affected, nearly everyone interviewed believes that transportation investment must be increased. Most support a regional solution for the Central Puget Sound area and acknowledge system shortfalls throughout the state, particularly in the Spokane and Clark County areas.

"The most important competitive investment the state of Washington can make is to improve its transportation infrastructure," finds the WCC.

Congestion has been an acute problem for many years and at the top of the business agenda since the mid-nineties. The WCC correctly identifies the problem as a responsibility of state government. Businesses – inside and outside the state – look at the transportation infrastructure as an indicator of the state's ability to meet its basic obligations. With most business in Washington eventually involving the movement of goods and people through the congested metropolitan Puget Sound corridor, gridlock puts the economic competitiveness of all communities at risk.

As the following observation by an East King County technology executive makes clear, little patience remains:

"The major challenge is the transportation problem. It's gotten so much publicity and the reality is it's pretty ugly. And the community seems to have decided to do nothing about it."

After the 2001 Legislature's failure to deliver a transportation revenue package, an executive who was involved with the Blue Ribbon Commission on Transportation says he is "beyond anger."

If the legislature again decides to "do nothing," business leaders agree more investment will leave the state.

Other Infrastructure

While transportation tops the list of concerns, the state suffers from other infrastructure shortfalls. In 1999, the state Public Works Board documented $8.2 billion in funding needs for the 1998-2003 period. About half of the projects were related to transportation with the balance involving domestic water, sewers and storm water systems. The Public Works Board cited a funding deficit of about $3 billion.

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What one business leader calls "the simple old stuff" is often not a political priority. It is not very visible ("out of sight, out of mind"), often very costly, and involves difficult choices about the future.

A software executive describes the problem this way: "The state has difficulty – lots of states have difficulty – when it comes to infrastructure. … Leadership … carries with it a risk, so they're dodging it. It's having a serious impact on the competitiveness of the US. With infrastructure you have to make decisions, to do some things and not do others. People will be disappointed."

Some examples:

Water. An Eastern Washington banker observes, "In agriculture water is the 800-pound gorilla. In the same sense transportation is a statewide issue, water's going to become a statewide issue."

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The WCC concurs: "Water laws and infrastructure do not adequately provide the capacity to meet 21st century demands and responsibilities." Clearly, increasing water conservation, storage, and transmission capacity is a key competitiveness factor that cannot be ignored.

Energy. Although the energy crisis has fallen from the front pages, the need for an effective, long-term energy policy remains. A big part of the solution last year came about because aluminum plants shut down production. That "throw-the-guy-out-of-the-lifeboat strategy" increased energy availability while sacrificing jobs.

Without a long-term plan for increased generation and transmission, too many executives wonder if their firms could be the next businesses tossed from the lifeboat. In addition to the aluminum industry, Washington is home to many energy-intensive manufacturing firms. Much of the state's agriculture also depends on abundant, reliable, and affordable energy.

Even those businesses not directly distressed by rising costs support a long-term energy strategy for the state.

An agribusiness executive in Eastern Washington indicates how his business is affected. His firm, which ships most of its product east, has a major freight disadvantage as a result of its Northwest location. "In the past," he says, "we had energy offsets. We're losing that."

Even those businesses not directly distressed by rising costs support a long-term energy strategy for the state. They believe the shortages of last year were caused by political and regulatory shortcomings.

Washington relies, to a disproportionate extent, on hydroelectric power. Diversification to include gas turbines, wind, and other power sources would provide important insulation in the event of another extended drought or diversion of hydro power to other states.

"We've not built adequately with infrastructure," says one executive. "Nobody's bending over backward to build a new natural gas pipeline. Same thing applies to power plants."

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He cites past frustration with the state's efforts to resolve the problem: "EFSEC (the state's Energy Facility Site Evaluation Council) was set up to be a one-stop center. Instead, it ends up being additive. Another stop."

New leadership at EFSEC, however, has engendered some optimism that the state will step up to its responsibility and expedite the development of new energy facilities.

Education

The collective commitment of the last decade to improve the state's education system is paying off, say most business leaders we interviewed. They hasten to add that the job is not yet done; the work must continue. As an Eastern Washington manufacturer points out, we will "never get there" because requirements will continue to change.

Yet even by current benchmarks, we have a long way to go. The WCC reports, "Washington's children are far from achieving high academic standards." Only 29.5 percent of 10th grade students met the Washington Assessment of Student Learning (WASL) standard in all four subjects (math, reading, writing, and listening).

"We try to be the kind of employer people want to work for, so we don't have problems with recruitment and retention."

A Puget Sound area manufacturer expresses guarded confidence that "moves are being made in the right direction." He contends, "Enough people are angry that something's going to happen – there will be improvement."

Perspectives vary.

Stable firms that dominate their markets seem to have the least difficulty finding competent personnel. An agribusiness owner, the largest employer in his area, says, "We try to be the kind of employer people want to work for, so we don't have problems with recruitment and retention." His experience is unusual, however, in that he has had little turnover and an average employee tenure of fifteen years.

More typical is the experience of a small manufacturer in the Seattle area, who says, "finding able bodies is real hard." His problems are two-fold. First, he says, is the challenge of finding people with appropriate work habits and the willingness to work. "Anybody you talk to in manufacturing [says] it's hard to find general workplace skills." Second, if they want to work, they often don't have the skills you'd expect from a high school diploma.

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A banker in Southeastern Washington comments that the public schools and community college in his community are particularly strong, enabling the bank to hire well-qualified people locally.

At the other end of the personnel spectrum, rapidly expanding technology firms face a severe labor shortage. Science and engineering graduates are in great demand. Yet, the Washington Technology Center reports, "The number of science and technology degrees granted by Washington's 4-year higher education institutions actually declined between 1996 and 1999."

The *Redbook* shows the state ranking just 33rd in the number of science and engineering doctorates awarded per capita.

A chip manufacturer observes that the state colleges and universities are not geared to serve the semiconductor industry. An executive with a major software firm notes that the technology sector regularly has "to go to DC to get the level of visas we need raised because we can't get enough educated students."

These observations are supported by the WCC, which urges greater support of research and development and upper-level degree programs in science and engineering.

The *Redbook* confirms that the state performs well on many educational benchmarks. Washington ranks first in the nation (tied with South Dakota) in the percentage (91.8 percent) of the adult population completing high school and 11th in the share of the population with at least a bachelor's degree (28.6 percent).

"I don't know a business person alive who believes the B&O is a good tax."

Taxation

Washington's unique tax system finds few champions among the business leaders we interviewed. As a Spokane banker says, "I don't know a business person alive who believes the B&O is a good tax." While she is clearly overstating the case, the high level of business taxation in Washington continues to be a concern for many industry executives.

According to data from the state revenue department, Washington businesses pay 51 percent of all state and local taxes.

"Washington imposes one of the highest initial tax burdens on business in the nation," finds the WCC, with the state typically ranked among the top six.

A more limited sample of states, conducted by the Utah State Tax Commission, shows Washington business taxes amount to 4.15 percent of Gross State Product, second only to Wyoming among the 11 states surveyed (*Redbook,* Table 15). Oregon business taxes, on the other hand, amount to just 2.03 percent of that state's GSP.

Because business pays a large share of the tax obligation, household taxes in the state are relatively low.

Overall, the state's tax burden is higher than the national average. The *Redbook,* relying on Census Bureau data, ranks Washington 13th in per capita state and local taxes and 20th when tax burden is measured as a share of the economy.

Because business pays a large share of the tax obligation, household taxes in the state are relatively low. The Utah study cited above found household taxes here amounted to just 5.68 percent of personal income, compared to 7.87 percent in California or 7.11 percent in Oregon.

Several of the executives we interviewed think the balance has tipped too far, that the state relies too much on business taxes.

"I worry about the way the tax base is evolving and who's footing the bill," said one, noting that repeal of the Motor Vehicle Excise Tax had further narrowed the base, increasing the share of taxes paid by business.

"There have to be different ways to tax different entities. The New Economy is a whole arena we haven't thought through very well."

Perhaps surprisingly, several call for a shift to the income tax.

"If it's not good for them, it's not good for me. If our customers aren't competitive, then we're not competitive."

"Very few people like paying it, so it doesn't come up," says a manufacturer from Eastern Washington.

Another manufacturer simply states: "This state will never have a personal income tax and we'll always be paying the price for it."

For many businesses, though, the current burden is manageable, barely. They don't want to see current exemptions repealed or other taxes shifted to business. One Puget Sound area small manufacturer says that the tax system doesn't affect his business, because all of his competitors are local and pay the same taxes he does. Yet, he says, his customers, often large multi-state concerns, increasingly find that the tax system places them at a competitive disadvantage. He adds, "If it's not good for them, it's not good for me. If our customers aren't competitive, then we're not competitive."

Employers identified unemployment insurance (UI) taxes as being a major business cost issue. A spokesman for a major manufacturing firm describes the tax as "hugely deterrent and unfair."

"The existing workers' compensation system is not in the interests of the economy. [The state] would be better off with a privatized system."

According to the *Redbook*, Washington has the second highest average UI tax cost per employee in the nation, $470 compared with a US average of $199. The high tax cost is a consequence of two factors. The average weekly UI benefit paid in Washington of $320 is second highest in the nation, and the 16-week average duration of benefit receipt ranks third.

When asked how costly the unemployment insurance is, Boeing Commercial Airplane President Alan Mulally told members of the House Commerce and Labor Committee that tax rates for UI in Washington are the highest of any place Boeing has operations.

The WCC reports, "The Washington State Unemployment Insurance system has developed a number of inequities in its tax structure, a primary one being the character and scale of the costs spread among all employers."

The state-run workers' compensation system also comes in for criticism. Washington is one of a handful of states that does not allow private insurers to sell workers' compensation coverage. Employers here either self-insure or participate in the state plan.

Workers' compensation comparisons among the states are complicated by Washington's dissimilarity with most other states. A good benchmark can be found by looking at benefit levels, which over time will approximate system costs. The *Redbook* shows the state ranking third highest in the nation in benefits paid.

A business leader in Seattle says, "The existing workers' compensation system is not in the interests of the economy. [The state] would be better off with a privatized system. Study after study shows that you get better premiums with more coverage with competition."

In addition to the generally high level of business taxes, Washington offers little in the way of tax exemptions or incentives compared to other states.

"If we were to put up another facility," says one technology executive, "I'm not sure we would here. People are looking for a tax break, a tax incentive."

"First, tackle the efficiency of government itself. Second, look at services. Then, third, look for how to fund the services."

Those incentives are not offered in Washington. A manufacturer on the Oregon border says the lack of exemptions places his firm at a disadvantage. In particular, he cites the imposition of sales and property taxes during construction as a problem.

"We pay a lot more taxes," he says, "and it doesn't allow us to be competitive with the people across the river [in Oregon]."

With the legislature now confronting a major budget shortfall, the perspective of one software executive may be useful. He says the focus should be less on the allocation of the tax burden and more on the size of the tax obligation.

"First, tackle the efficiency of government itself. Do we need all of these people, for example? Second, look at services. What do you need to keep doing? Then, third, look for how to fund the services.

"Often politicians start at the other end of the spectrum. That's an entitlement mentality; it causes countries to be uncompetitive. Business pays a huge share. [But] we don't look at it that way. We look at where's the best place to operate."

Increasingly, he maintains, that place is not Washington.

"In the Midwest, the state was my supporter in major decisions relative to federal regulators. Here, I go to the feds for help in dealing with the state."

Regulation

When it comes to regulation, most of the men and women we interviewed find Washington a tough place to operate.

Tellingly, executives interviewed for this report challenge the regulatory culture, at least as much as they do specific regulations. When they speak of cultural factors, business leaders cite an apparent hostility to development and a regulatory tendency to micromanage.

"I almost think the culture of the regulators in Washington is anti-manufacturing," says one large manufacturer with multi-state experience.

"In the Midwest, the state was my supporter in major decisions relative to federal regulators. Here, I go to the feds for help in dealing with the state."

Another manufacturer says Washington's regulatory system is "much more command and control" than other states. Rather than identifying the desired outcome and working collaboratively with business to meet the objective, as had regulators he had worked with in other places, Washington regulators tend to be more prescriptive.

Of course, as one agribusiness executive says, the rules themselves can change, even in the middle of a project. Sometimes, neither the process to be followed nor the outcome to be achieved is clearly identified. In his experience, the lack of guidance can be extraordinarily expensive in both time and money.

"In business, we look for the win-win, the way to say 'yes.' These folks look for the way to say 'no.' When did we become the enemy?"

"They say, 'It's not our job to tell you what to do; it's to approve or disapprove what you're doing,'" he contends. Disapproval at the end of a costly attempt to comply with regulations makes no sense, particularly when the firm is keen to collaborate on a reasonable solution.

"In business, we look for the win-win, the way to say 'yes,'" says another manufacturer. "These folks look for the way to say 'no.' When did we become the enemy?"

The WCC refers to "a complicated and fragmented system of regulatory protections implemented by numerous regulatory agencies. … [a] vast uncoordinated patchwork of laws … with a negative impact on business development." Further, the group says the Department of Ecology requires a "cultural change" to address its "generally poor or specifically anti-development attitude."

"There is a place for regulation in our lives, but it's not coming from where it should come from, from the legislature."

An Eastern Washington financial services executive says problems are exacerbated because the legislature has ceded too much policy-making latitude to agency regulators.

"There is a place for regulation in our lives," she says, "but it's not coming from where it should come from, from the legislature."

A large manufacturer similarly contends that regulators have too much ability to interpret statutes and rules. "You can force a different interpretation," he says, "but it takes a judge. It's very expensive and it [irritates the regulators]."

"It's not good business to have an adversarial relationship with the state," he concludes, saying court challenges are a last resort.

A Western Washington banker says that, when it comes to his industry, "the state is pretty good to work with, a good regulatory body that is reasonable." He goes on, however, to say, "We will probably never build and own a branch bank ourselves, primarily because of the cost of regulation." The last branch the bank built took more than four years between acquiring the land

and opening the branch, during which time regulatory interpretations changed, forcing them to buy additional land for water run-off.

He concludes, "If I had any issue with the competitiveness factor, it's that the legislature and governor will pass legislation and it's left to the bureaucrats to write the rules. And in the process, they can re-write the law, often on the basis of bad science."

The "bad science" theme comes up often.

"Some of the regulations do good," says a Puget Sound area developer, "others just feel good."

"Some of the regulations do good, others just feel good."

"Employees are your greatest assets," points out a biotech executive, saying the firm often exceeds regulatory standards, and frequently sets the pace for the industry. All they ask is that there be a reasonable basis for regulations.

In the case, most recently, of proposed ergonomics standards, that basis appears to business leaders to be lacking. The uncertainty associated with a major new set of rules and mandates can be troubling as the regulations themselves.

Asked what factors are most likely to influence the performance of the economy, a technology executive cited the "overall regulatory environment" as a key negative. He says, further, "flirting with an ergonomics program that industry estimates would cost $725 million is worrisome."

The cost of regulation extends beyond the business community. For example, both public and private sector employers went to court to combat the Department of Ecology's proposed shorelines regulations. Similarly, opposition to ergonomics regulation is led by a coalition co-chaired by leaders of the Association of Washington Business and the Association of Washington Cities. They are joined by dozens of local governments, trade associations, and businesses.

To those with experience in other states, Washington regulators seem unusually reluctant to collaborate.

"I get real nervous about doing business in the state because the state's not trying to help you and in other parts of the country, they are. They're trying to attract business."

"I get real nervous about doing business in the state because the state's not trying to help you and in other parts of the country, they are. They're trying to attract business," says a major distributor.

A utility executive compares Washington to other places he has worked and says, "We still have in this state a mentality of regulation … more an emphasis on keeping consumer prices as low as possible without considering the ramifications for investment."

In this respect, regulatory policy mirrors a tax environment that pushes a significant share of costs on business while providing maximum protection for households.

The Initiative Squeeze

A common thread runs through conversations with business leaders. Many of them volunteer their belief that the business climate has been damaged by initiatives adopted by the voters in recent years. The effect has been widespread, touching on transportation, tax policy and the state budget. One Olympia business leader said it best: "On one side, anti-tax folks are taking tax dollars away from state and local governments, while on the other side folks who want the legislature to spend more money for education and home health care are putting lawmakers in a bind by mandating more spending. It is leading to fiscal chaos and poor decision making!"

Transportation. They cite a more than five-year delay in transportation funding brought about by a complicated stutter step. First, the legislature referred Referendum 49 to the voters to dedicate the MVET to transportation; the voters passed it. Second, the next year Initiative 695 repealed the MVET; voters adopted I-695 and the legislature repealed the MVET after the initiative was found unconstitutional. Third, lawmakers seem poised to defer future transportation revenue decisions to the voters, assuring another year of uncertainty.

Tax Policy. Through MVET repeal, the benefits of which largely accrued to households, the share of the tax burden borne by business increased. As the tax base shrinks, many businesses feel particularly vulnerable to future tax increases. Other successful initiative campaigns to limit property taxes have led to conditions favoring locally imposed tax and fee increases that will fall disproportionately on business.

The State Budget. Passage of a pair of education initiatives has increased spending pressure on the state budget, while reducing revenues. In the current legislative session, the diversion of property taxes to a special account for public schools and the mandated increases in teacher salaries limit legislative flexibility in addressing the budget shortfall. The property tax loss will mount in the 2003-2005 budget cycle.

In addition to the direct effects of the initiatives, business leaders say the process creates uncertainty, making a difficult competitive environment increasingly volatile. More effective political leadership at all levels of government might temper the populist resurgence, say some.

"The alternative [to effective political leadership] is this initiative mania," says a manufacturer in the Puget Sound region. "It's not an alternative that's going to lead to solutions."

Consistently, business executives say that they recognize the need for regulation to protect the environment, the consumer, and the workforce. To be effective, however, regulations must be clear, consistent, and firmly grounded in science or fact. Decisions should be rendered quickly. Policymakers should emphasize outcomes, not micromanage processes.

While there will always be tension between the regulators and the regulated, most business believe the relationships in Washington are too adversarial. More collaborative approaches work successfully in other states to accomplish the shared goals of environmental protection and worker safety. These same approaches, they believe, can work here, but it will require a change in the regulatory culture.

Quality of Life

For most of us, quality of life begins with a good job and a home in a place we want to live. To recruit and maintain an adequate workforce, Washington has to be a place people want to come to and stay.

For many Washingtonians, environmental quality defines the state's quality of life. That's true of business leaders, as well. As a technology executive says, "This region is blessed with wonderful natural advantages. Physical beauty and recreational opportunities."

"The quality of life here is a major plus," says another. "It helps to recruit talent from out of state."

An executive in Spokane boasts of affordable housing and having access to 80 lakes within 90 miles.

"It's a great place to live! We appeal to a broad range of people and within our area you can have any kind of life you want," says a South Sound manufacturer.

While conditions around the state vary dramatically, most Washingtonians treasure the state's geographic diversity and environmental quality.

Housing. Yet, many people who want to live here have difficulty finding suitable housing they can afford. The state's celebrated quality of life is jeopardized when workers are unable to find reasonably-priced housing near their place of employment.

Washington ranks 41st in home ownership according to the Fannie Mae Foundation Homeownership Database (see *Redbook)*. Housing affordability continues to be a major problem, particularly in the Central Puget Sound region.

Data from the third quarter of 2001, compiled by the National Association of Home Builders, show that the Seattle-Bellevue-Everett area ranked 139th of 186 cities in housing affordability (1st is most affordable). Tacoma ranked 151st, and the Portland-Vancouver area ranked 163rd.

The Growth Management Act reduced land availability. Impact fees, slow permitting, and environmental regulation also increased costs and slowed the pace of development.

For some Seattle area employers, housing affordability ranks with transportation congestion as a major recruiting challenge. They point out that they have to increase compensation to recruit candidates from other communities where housing costs are lower.

An executive new to the state estimates, “This place costs two to three times to replace what I had in Chicago.”

Although population growth certainly played a role in driving up housing prices in the Central Puget Sound region, regulation also had a significant effect. The Growth Management Act reduced land availability. Impact fees, slow permitting, and environmental regulation also increased costs and slowed the pace of development.

To secure the housing they want, people are willing to buy homes far from their place of work. As a Snohomish County manufacturer says, “The people don’t look at the drive as much as they do the house payment.” Or, as developers frequently comment, “buyers drive until they qualify.” The relationship between housing affordability and transportation congestion in the metropolitan region is direct and substantial.

Other. Some quality of life factors can be measured. The *Washington State Economic Climate Study* contains several quality of life measures. For 1999, the most recent year for which data are available, Washington ranked as follows (in all cases, 1st is best):

“The people don’t look at the drive as much as they do the house payment.”

- 11th in homicide rate
- 24th in violent crime rate
- 19th in arrest rates for violent crime
- 22nd in air quality index
- 24th in drinking water index
- 19th in toxins released
- 11th in state health
- 4th in parks and recreational areas (per capita visits)
- 4th in public library services (circulation per capita)

In each of these rankings, Washington is among the top half of the states but only in the top five in parks and libraries. The state ranks 6th nationally in the number of parks areas managed, with 125 developed parks covering 260,000 acres, according to the *Economic Climate Study*.

Conclusions and Recommendations

If the governor and legislature act to implement the recommendations of the Washington Competitiveness Council, many of the concerns expressed in this report will be resolved. For too long, policymakers have failed to heed the alarms sounded by a succession of key executives in the state – men and women who want to do business here, expand the labor force, invest in plant and equipment, and increase opportunities for Washingtonians. Yet, the state seemed to be doing well despite unfriendly tax policy, difficult regulation, and the far-from-benign neglect of essential infrastructure, especially transportation.

Circumstances have changed, dramatically.

Complacency now comes with a high cost. While the immediate causes of the downturn here – a national recession and terrorist attacks – were beyond the control of state and local policymakers, their response to clear and urgent competitiveness challenges will determine how Washington emerges from the slump.

Here are a few short-term recommendations to guide current decision-making.

Taxation: In addressing the current budget shortfall, lawmakers must, at a minimum, maintain the current balance of business and household taxes. Existing tax exemptions and incentive programs should be preserved. Infrastructure funding mechanisms that make use of revenues generated by growth, like tax increment financing, should be authorized and expanded. The application of user fees (e.g., gas taxes, tolls, licensing fees) to support specific transportation investments represents sound fiscal policy and is an appropriate response to the present crisis.

Regulation: The regulatory process in state and local government must be streamlined and simplified. Contradictory, redundant, and unnecessary regulations have grown out of a fragmented, patchwork process with too much authority ceded to regulators and too many jurisdictions claiming responsibility. Regulators should focus on outcomes rather than processes. Cost-benefit analysis should be an integral part of the regulatory equation with a conscious emphasis on scientific justification for new regulation.

Education and Workforce Development: The state must sustain its commitment to K-12 education reform and accountability. Institutions of higher education should have increased management and tuition-setting authorities, allowing them to expand programs to meet the demands of both the student population and the employer community.

Transportation and Infrastructure: For state government, an expanded highway and road system must be the top priority. Regional financing and governance systems should be authorized for metropolitan centers. In addition, taxes and fees should be increased to fund significant construction projects statewide. Energy infrastructure must be expanded and diversified, as must the ability to transport and store water to meet both agricultural and urban demand.

Housing and Quality of Life: To increase the supply of housing affordable to workers at all income levels, compact and infill development should be encouraged. Because regulation and permit fees inflate the price of housing, efforts should be made to provide adequate, broad-based financing for necessary infrastructure rather than imposing extraordinary costs on new development.

Already, the nation has begun to recover from the recession. Washington will soon join in that recovery. We have an uncommon opportunity to direct our energies and resources toward creating a competitive business climate. As we do so, we will build on a remarkably solid foundation of entrepreneurial talent, diverse natural resources, healthy industrial and technology sectors, and dynamic research institutions.

We now must establish the public policy framework to assure our prosperity for the future. Elected officials will need to summon the political courage to adopt policies that will improve our competitive position, enhance our advantages, and correct our weaknesses.

While there is never a perfect time to tackle these challenges, there will never be a better time than today. With other states and nations aggressively recruiting our job-creating businesses, failure to act now risks our future economic security.

The Washington Alliance for a Competitive Economy is a non-profit research institute focused on improving the state's economy and business climate. It was founded in 2000 by the Association of Washington Business, the Washington Roundtable and the Washington Research Council. Its first report, released in October 2000, served as the starting document for the Washington Competitiveness Council formed by Gov. Gary Locke in 2001.

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