Thrive WASHINGTON

Strategies to move our state forward

Setting Priorities, Marking Progress

A joint research series from the Washington Roundtable and Washington Research Council

THE THRIVE WASHINGTON PROJECT

The Great Recession dramatically changed fiscal conditions in Washington state. The impact of falling revenues and structural budget deficits has elicited a near universal call for a transformative shift in state government. This research series—developed by the Washington Roundtable and Washington Research Council provides actionable state policy recommendations that, if enacted, will preserve essential services, lay a foundation for sustainable economic growth and create an environment in which Washingtonians can thrive.

Policy changes consistent with Thrive Washington recommendations include: unemployment insurance tax relief, workers' compensation and pension reforms, adjustments in public employee compensation, and expanded competitive contracting.

The Thrive Washington series began last November as a research and communications partnership between the Washington Roundtable and Washington Research Council. Since then, we released a series of eight reports examining the major challenges the Great Recession has presented for our state and its citizens, employers and taxpayers. Based on substantive policy analysis, our research identified a focused, integrated, and actionable set of recommendations for restructuring and reform.

We worked with executive and legislative leaders to promote the reform agenda. Consistently, we found common cause and shared objectives, laying the foundation for the important transformation that began during the 2011 legislative session.

In this final paper in the series, released as our economy continues to struggle, we review progress made this year and look to the short- and long-term, identifying priority recommendations for 2012 and beyond.

RECOMMENDATIONS

Two Fundamental Priorities:

1. Establish the public policy foundation for economic vitality.
2. Reset state spending to a sustainable level.

In a 2011 legislative session dominated by a budget shortfall and economic stagnation, the governor and legislature came together to adopt legislation that will, over time, spur job creation, preserve essential social programs, and place the state on a more sustainable budget trajectory. Policy changes consistent with Thrive Washington recommendations include: unemployment insurance tax relief, workers' compensation and pension reforms, adjustments in public employee compensation, and expanded competitive contracting.

Despite the progress made during the 2011 session, serious challenges remain. The state's June and September revenue forecasts, reflecting the persistence of the Great Recession, were sharply reduced. Lawmakers now confront a multi-billion dollar budget shortfall for the current biennium. Roiled by global and domestic financial upheaval, the national and state economies remain imperiled. The governor has already asked agency directors to prepare for reductions of 5 percent to 10 percent.

Last year, as we called on lawmakers to reset spending to a sustainable level, we emphasized that a sustainable budget rests on a vibrant economy. Clearly, how lawmakers realign state spending will affect policies important to economic vitality.

From the outset, the Thrive Washington series focused on policies that create the foundation for economic stability and growth. The Washington Roundtable's

> **The coming budget debate will be marked by many tradeoffs. Ultimately, legislative politics will require all parties to accept unwelcome compromise on the way to fiscal resolution.**

Benchmarks for a Better Washington, which complements the Thrive Washington series, identifies what constitutes success for our state. Simply, Washington should be among the top 10 states for quality of life and out of the top 10 for the cost of doing business. Benchmarks' quality of life metrics include job growth, patents, high school graduation rates, science and math education achievement, bachelor's degree production and infrastructure. Indicators of business costs include tax burden, unemployment insurance, workers' compensation costs and industrial electricity rates.

No one should underestimate the practical and philosophical difficulty of cutting as much as $2 billion in state spending from a $32.2 billion budget after the biennium has begun. Complicating an already daunting task is the reality that large components of state spending—basic education and Medicaid, for example—are protected by constitutional mandate or federal maintenance of effort requirements. That protection threatens discretionary education and human services spending, with clear and stark consequences. The coming budget debate will be marked by many such trade-offs. Ultimately, legislative politics will require all parties to accept unwelcome compromise on the way to fiscal resolution.

Increasing business costs now would worsen conditions for recovery. So, too, would ill-advised reductions in investments critical to economic vitality. Additional deep reductions in higher education spending, for example, would contribute modestly to the budget reset while undermining the educational initiatives that are critical to improving the state's economic vitality. Resolving the budget gap will require lawmakers to carefully weigh the consequences of choosing between unattractive alternatives.

Before legislators consider revenue increases, which we believe will exert an additional drag on the economy, they should first:

BENCHMARKS FOR A BETTER WASHINGTON

Ensuring Our State Is Among the Top 10 For Quality of Life And Not One of the 10 Most Expensive for Business.

Assessing Washington's economic vitality based on:

- Job Growth
- Patent generation
- High school graduation rates
- Science and math education achievement
- Bachelor's degree production
- Commute times
- Road and bridge quality
- Industrial electricity rates
- Tax burden
- Unemployment insurance costs
- Workers' compensation costs

www.waroundtable.com/benchmarks

- Adopt the fundamental expenditure and structural reforms outlined in the Thrive Washington series. In particular, they should act to control the size and compensation of the state workforce, expand competitive contracting, and contain growth in health care spending. Specific reform priorities are highlighted in the following pages.
- Produce a current revenue budget proposal that is sustainable through the next six years based on credible fiscal forecasts.

Such a long-term view will increase budget transparency and public confidence, while strengthening priority-setting processes and building bipartisan cooperation.

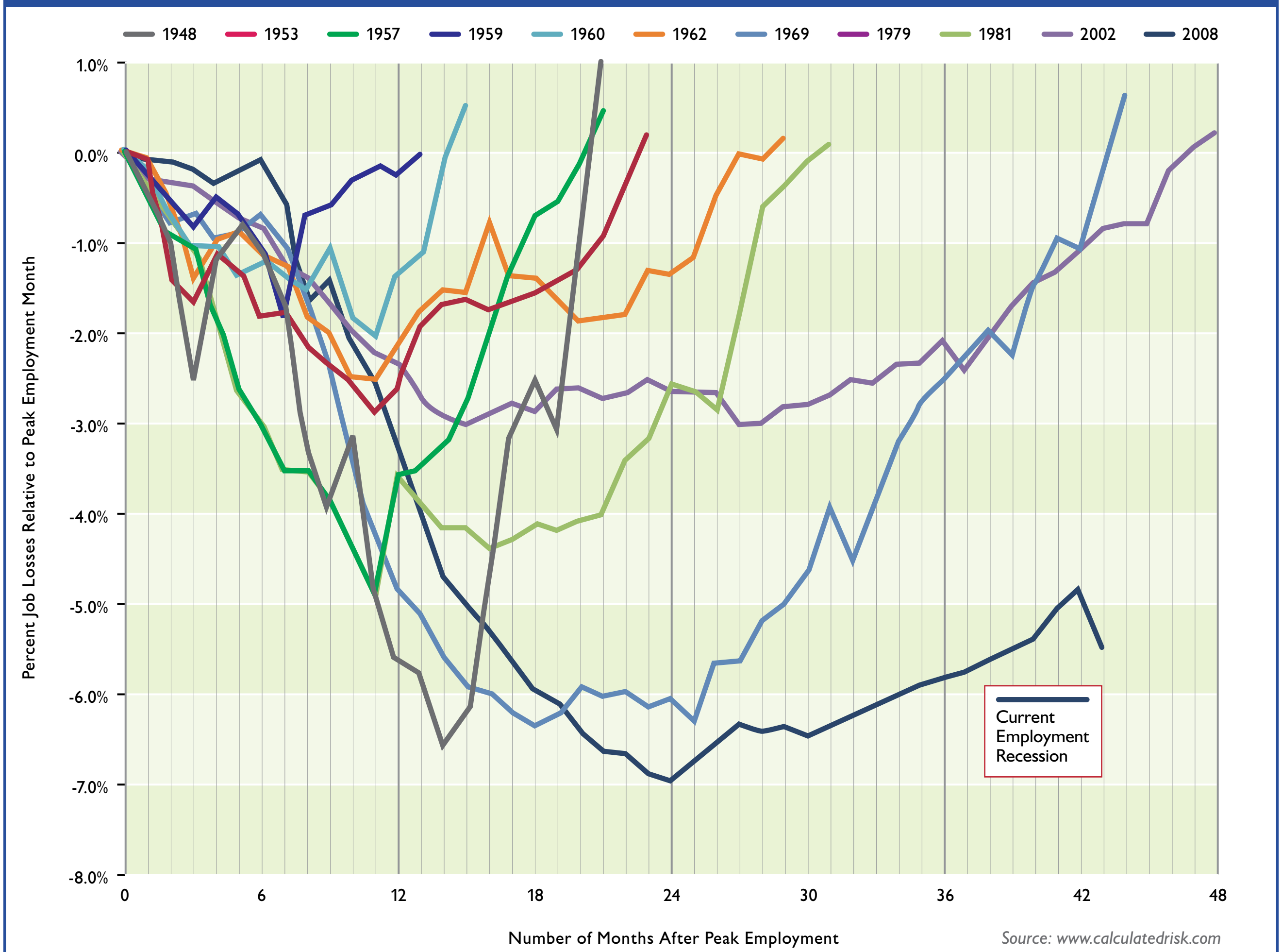
The current employment decline is the **deepest and most persistent** in more than half a century.

Economic and revenue deterioration accelerated in the summer of 2011, deepening the state's ongoing fiscal crisis. Nevertheless, there is no reason to lose sight of the long-term vision. Headway made during the 2011 session is both substantively and symbolically important. Although there is much more work to be done, policy decisions made earlier this year will lead to more sound financial footing. Adopted legislation will improve how state services are structured and delivered and how state policies influence job creation and investment. Further, by addressing significant problems in a collaborative, bipartisan manner, legislative leaders demonstrated a fundamental shift in attitude and approach, which, if maintained, will serve the state well as it tackles this next round of fiscal challenges.

THE CASE FOR REFORM

Moving forward, the first priority must be establishing the framework for economic growth. Although changes in early 2011 will improve our state's competitiveness, Washington still has significant ground to reclaim. Figure 1 shows job loss in Washington in

FIGURE 1: JOB LOSS IN WASHINGTON SINCE WORLD WAR II



Source: www.calculatedrisk.com

each recession since World War II. The current employment decline is the deepest and most persistent in more than half a century.

As Joel Kotkin, an internationally recognized expert on economic and political trends, writes in *Enterprising States*, a June 2011 report from the U.S. Chamber of Commerce and National Chamber Foundation:

"Ultimately, there is only one route to sustainable state economies, and that is through broad-based economic growth. The road to that objective can vary by state, but the fundamental goal needs to be kept in mind…"

States have limited means to spur job creation with public spending, a strategy that the federal government has pursued with mixed results. Lawmakers do, however, have the ability to craft public policies that make states more or less attractive for private sector investment and job creation. While the global and national economic crisis has delayed recovery, state policymakers must continue to position Washington to succeed over the long-term.

When state government operates efficiently, controls costs, delivers high quality services, and embraces competitive strategies for performing essential work, it creates the conditions required for economic growth. Several recent reports give Washington mixed reviews.

Enterprising States ranked Washington No. 10 in entrepreneurship and innovation and acknowledged the state's strong STEM (science, technology, engineering and math) job concentration and growth. Washington's tax incentive programs for investments in technology, biotech, and research and development get positive marks.

RECENT REVIEW OF WASHINGTON'S COMPETITIVENESS:

Ranks #10
in entrepreneurship and innovation
(Enterprising States)

Ranks #34
in best states for business
(Chief Executive)

The work of the governor and legislature to reorganize executive branch agencies, control pension costs, and increase opportunities for competitive contracting will save money and improve service delivery.

A March 2011 study for the U.S. Chamber of Commerce, *The Impact of State Employment Policies on Job Growth*, identifies critical challenges for policymakers, including high employment costs associated with collective bargaining, workplace regulations and workers' compensation.

"The direct costs associated with being an employer," the research concludes, "are much higher in Washington than in most other states."

These costs matter, as demonstrated in a May 2011 survey of more than 500 CEOs conducted by *Chief Executive* magazine. On the resulting list of "best states for business," Washington ranked a disappointing No. 34.

"Not surprisingly, states with punitive tax and regulatory regimes are punished with lower rankings, and this can offset even positive scores on quality of living environment," writes J. P. Donlon, editor of *Chief Executive*.

MAJOR ACCOMPLISHMENTS OF THE 2011 LEGISLATIVE SESSION

By reducing unemployment insurance taxes and reforming the state's costly workers' compensation system, legislators made it easier for employers to create and retain jobs. Bipartisan support for these measures reflects a growing legislative appreciation for the importance of improving Washington's competitive position with respect to employment costs. The governor's leadership was essential in moving the legislation for a successful resolution. As a result of these changes, the state's rankings in Benchmarks for a Better Washington will likely improve.

Although falling revenues have already jeopardized the adopted state budget, the governor and legislature deserve credit for their efforts earlier this year. Their work to reorganize executive branch agencies, control pension costs, and increase opportunities for competitive contracting will save money and improve service delivery.

As Governor Chris Gregoire, chair of the National Governors Association, pointedly observed at the NGA's summer meeting in July, all states face ongoing fiscal challenges. Noting that the federal government will no longer backstop state shortfalls, Gregoire said, "It's like falling off a cliff. And we're going to be at the bottom of that cliff for a long time in our relationship with the federal government."

She added that austerity represents the "new normal" for state governments, joining with other governors in urging Congress not to add to their problems by passing costs on to the states. Although the deficit reduction legislation passed by Congress in August 2011 protects Medicaid funding, governors and legislators across the country expect further tightening in federal aid in the coming months. The debt ceiling showdown last summer, the Standard & Poor's rating reduction, and the anticipated deliberations of the 12-member Congressional deficit reduction "super committee" guarantee that uncertainty is also part of state governments' new normal.

RANKING WASHINGTON'S COMPETITIVENESS:

15th based on the state and local business tax burden

Amounts to **5.4 percent** of private sector GSP

Above the U.S. average of 5 percent

Progress was made in 2011. Lawmakers avoided tax increases, including the repeal of tax incentives. Maintaining a competitive environment for business investment is critical.

REVIEW AND RECOMMENDATIONS FOR 2012

Fiscal Policy

In our paper, ***Nine Steps to Budget Sustainability in Washington State,*** we urged lawmakers to manage the size and compensation of the state workforce, reinstate a limit on spending, better manage debt service, and implement sound pension reforms. Current fiscal conditions reinforce the importance of these actions.

Progress was made in 2011. Lawmakers avoided tax increases, including the repeal of tax incentives. Maintaining a competitive environment for business investment is critical. The Roundtable's Benchmarks include keeping Washington "out of the top 10 states for high state/local business tax burden relative to private sector GSP [gross state product]." According to the most recent analysis by Ernst & Young LLP, prepared for the Council on State Taxation, Washington ranks 15th. The July 2011 study reports that Washington's state/local business tax level amounts to 5.4 percent of private sector GSP, above the U.S. average of 5.0 percent.

According to Washington state's Office of Financial Management (OFM), the state payroll will drop by 1,316 full-time equivalent positions, on average during the 2011-13 biennium, as compared to 2009-11. More reductions are likely. In addition, collective bargaining agreements negotiated by Gov. Gregoire include a temporary 3 percent salary reduction effective through June 29, 2013. Rather than reducing wages, the agreement provides for a furlough—up to 5.2 hours of unpaid time off per month—that must be used during the biennium. The agreements also include a slight increase in the employee share of health insurance coverage. We encouraged a tougher line in collective bargaining negotiations, but appreciate the governor's effort to reach agreement without the labor disruptions experienced in other states. More will be required in the future.

SMART REFORM:
2011 pension changes reduce the state's unfunded liability by nearly 60 percent, saving $2 billion over the current and next biennium.

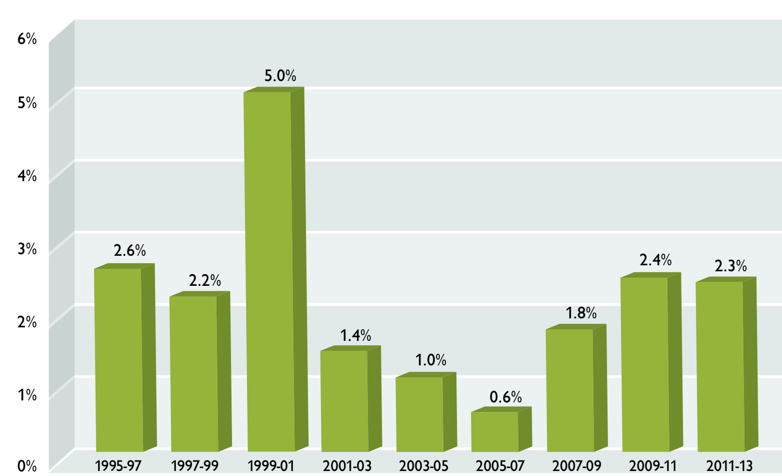
Progress was also made in pension policy, as the legislature suspended automatic benefit increases for members enrolled in the state's oldest and most generous Plan 1 programs. The increases were initiated years after enrollment in the plans had closed and were unrelated to the cost of living (instead, they were based on years of service). The suspension reduces the state's unfunded liability in these plans by nearly 60 percent, saving about $2 billion in state contributions over the current and next biennium. It was a smart reform. State government should swiftly follow-up by establishing a defined contribution plan for new hires, something common in the private sector.

Fiscal analysts commonly recommend that states maintain a reserve of funds equal to 5 percent of annual general fund expenditures. In the last decade and a half, Washington has only met this goal once.

Washington must take steps to more reliably build adequate reserves. As part of this research series, we recommended a constitutional amendment requiring that a share of exceptional revenue growth be put in the Budget Stabilization Account (BSA). Doing so will help control spending and allow for the growth of reserves. Consistent with our recommendation, SJR 8206 would require that 75 percent of extraordinary revenue collections (one-third or more above average biennial growth in the previous decade) be deposited in the budget stabilization account. The measure is on the November ballot. Had such a requirement been in place during the 2005-07 biennium, about $1.5 billion would have been deposited into the BSA, which would have reduced fiscal impacts when the recession took hold.

Another measure that would help to keep spending on a more sustainable path would be to reinstate a firm expenditure limit. Controlling spending in years of higher revenue growth softens the blow of recessions. As part of Initiative 601 in 1993, a spending limit was put in place, based on a population-plus-inflation growth factor. Amendments

FIGURE 2: WASHINGTON STATE ENDING FUND BALANCE AS A % OF GENERAL FUND



Source: Legislative Evaluation and Accountability Program & the Office of Financial Management

SMART REFORM:
Legislation controls taxpayer-supported debt by reducing the working debt limit to 7.75 percent by FY 2022.

SMART REFORM:
Reigning in costs of the state's workers' compensation system by:

- Creating a statewide medical provider network
- Expanding the Centers for Occupational Health and Education
- Requiring a study of the definition of occupational disease
- Suspending cost-of-living adjustments for one year

SMART REFORM:
Working to make costs more competitive by permanently capping employers' social tax rate for unemployment insurance.

in ensuing years (including changing the growth factor to a more generous one based on personal income) weakened the limit's effectiveness.

Legislators also acted to control taxpayer-supported debt. The adopted legislation, SSB 5181, establishes a commission to review current debt and issue recommendations on debt policy and limits. In addition, the legislation phases in reductions in the working debt limit until it reaches 7.75 percent in FY 2022. Washington ranks No. 7 in the nation in per capita net tax supported debt. Net tax-supported debt claimed 6.2 percent of 2010 personal income, also ranking the state No. 7. High debt burdens jeopardize Washington's bond rankings, make it more difficult to secure capital financing, and threaten our ability to invest in necessary infrastructure projects. In addition, debt service claims an increasing share of the state budget, adding to the state's difficult budget situation.

Fiscal Policy Recommendations

1. Continue to focus on establishing a sustainable spending plan.
2. Maintain a reserve fund equal to 5 percent of annual general fund expenditures.
3. Establish a defined contribution pension plan for new hires.
4. Reinstate a firm expenditure limit.
5. Better manage debt service.

The Case for Workers' Compensation and Unemployment Insurance Reform

A major improvement in controlling business costs came this year as lawmakers tackled Washington's high unemployment insurance (UI) taxes and workers' compensation costs. Benchmarks for a Better Washington sets a goal of getting the state "out of the 10 states with the highest" UI tax rates and workers' compensation benefits paid.

Based on 2010 data, Washington ranks third highest in unemployment insurance rates for employers in the nation. In a move that would have added to already high costs, in December 2010, the state Employment Security Department announced an average UI tax rate increase of 36 percent for 2011. The increase was not necessary to build trust fund reserves, which were robust despite the effects of the recession. The governor and legislature recognized the need to act swiftly to avoid increasing employer costs. For 2011, they capped the social tax rate (the costs spread across the entire employer community) at the 2010 level for all rate classes and set a permanent cap for subsequent years at a level dependent on the trust fund balance.

With job growth sluggish and renewed apprehension that the nation may be slipping into a double-dip recession, there will be additional pressure to increase UI benefits in 2012. Washington already offers among the nation's most generous benefits, with correspondingly high costs. Benchmarks reports Washington's UI taxes are nearly twice the national average.

The state's workers' compensation benefits are the highest in the nation, 91 percent higher than the U.S. average. Lawmakers this year enacted several major workers' compensation reforms recommended by Thrive Washington, long supported by employers, and common in most states.

Specifically, lawmakers adopted SSB 5801, creating a statewide medical provider network and expanding the Centers for Occupational Health and Education. Lawmakers also adopted EHB 2123, which includes a limited, structured settlement option for older workers. Other provisions include an occupational disease study and a one-year suspension of cost-of-living adjustments. Although this reform falls short of the voluntary settlement option we recommend, it represents an important improvement.

Over time, these reforms should reduce costs, though it remains to be seen if it will be enough to ensure Washington no longer ranks among the 10 states with the highest costs. More likely, the state will need to take additional steps to ensure a competitive system that does not compromise benefits for injured workers. As one step, the Thrive Washington series recommended the state permit private insurers to offer workers' compensation policies. Washington remains one of only four states operating a state monopoly.

UI and Workers' Compensation Recommendations

1. Refrain from expanding UI benefits.
2. Adopt a mainstream voluntary settlement option.
3. Act on recommendations to establish precise definitions of occupational disease.
4. Permit private insurers to offer workers' compensation policies.

Competitive Sourcing

In 2002, Washington adopted a sweeping civil service reform act. The major provisions enabled public employee unions to collectively bargain for wages and benefits. It also eliminated the prohibition on contracting with the private sector for services traditionally performed by state workers. The collective bargaining component greatly expanded the size and clout of public-sector unions as it reduced legislative control of employee compensation. The unions have actively resisted any efforts to expand contracting out (also called competitive sourcing). As a result, virtually no outsourcing, privatization, or contracting has occurred.

Thrive Washington identified substantial opportunities for the state to reduce costs and improve services by contracting with the private sector. Although some of the savings stems from reduced labor costs, contracting also provides greater access to specialized services and allows the state to avoid large capital outlays, minimize the cost of technology upgrades and benefit from economies of scale.

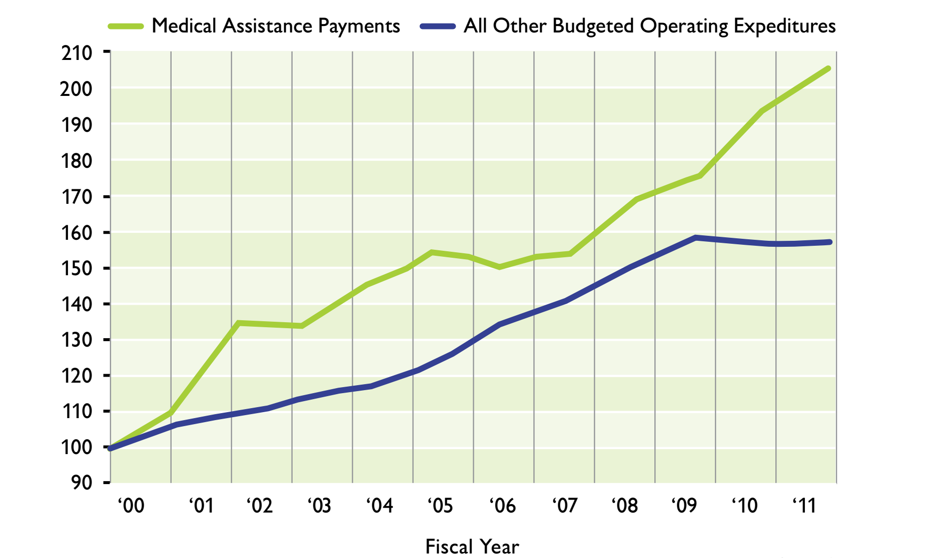
Lawmakers made progress on competitive contracting this year. Acting on the governor's proposal to create the Department of Enterprise Services (DES) and the Consolidated Technology Services Agency (CTS), the legislature passed ESSB 5931. In addition to the reorganization, the legislation specifically calls for periodic evaluation of DES services that might be "performed by the private sector in a more cost-efficient and effective manner than being performed by the department." The state's Office of Financial Management will perform these reviews at the beginning of each biennium until June 30, 2018. It also encourages contracting out by both agencies. With ESSB 5931, the state made important progress in bringing competitive business practices to executive branch operations.

Lawmakers should go further. Currently, competitive contracting is subject to collective bargaining, as noted in a report by the Joint Legislative Audit and Review Committee. Through the bargaining process unions can negotiate provisions that bar competitive contracting. As a result, very little contracting occurs. The appropriate reform: Amend the statute to assure that contracting out is not subject to collective bargaining.

In our report, ***"The Case for Contracting Out,"*** we urged lawmakers to direct the state auditor to survey state agencies to identify opportunities to reduce costs by contracting out. This remains a priority recommendation. To realize the savings, however, we also call on the governor and legislature to establish a commission charged with the responsibility to assure follow through. In every state where competitive sourcing has been successful, such a commission has been established.

SMART REFORM:
Periodic review of the Department of Enterprise Services to determine what services might be better performed by the private sector.

FIGURE 3: MEDICAL ASSISTANCE PAYMENTS



Source: fiscal.wa.gov

Until health care spending is brought under control, education—the largest share of state spending—will suffer in the budget process.

Competitive Sourcing Recommendations

1. Ensure contracting out authority is not subject to collective bargaining.
2. Direct the state auditor to survey all state agencies and identify opportunities for reducing costs through competitive contracting.
3. Create a commission focused on maintaining Washington's commitment to contracting out.

Containing Health Care Spending While Improving Outcomes

As the Washington Roundtable has frequently noted, persistent increases in health care spending crowd out funding for other important state services. Medical Assistance payments, shown in Figure 3, have grown at an annual average rate of 6.7 percent, significantly faster than the 4.1 percent annual growth rate for all other state spending. The trend is clearly unsustainable. Until health care spending is brought under control, education—the largest share of state spending—will suffer in the budget process.

Large shares of the state's health care budget are often treated as "off limits" in the priority-setting process. Medicaid, for example, is a partnership with the federal government, which imposed maintenance of effort requirements as part of the 2009 federal stimulus package. Additionally, public employee health care benefits are bargained collectively and, ordinarily, are not subject to unilateral alteration by the legislature or governor.

Nonetheless, in the Thrive Washington report, ***"Containing Health Care Spending While Improving Outcomes,"*** we identified several proactive options that would allow the state to gain more flexibility in Medicaid administration and achieve savings in the cost of employee benefits. And we are pleased that the 2011 legislative session resulted in some important gains.

Lawmakers passed, and the governor signed, E2SSB 5596, requiring the state to seek a federal Medicaid waiver that would

SMART REFORM:
Legislation requiring the state to seek a federal Medicaid waiver that caps eligibility group per capita payments while increasing flexibility in program design and benefits.

STEPS TOWARD BETTER POLICY: State Health Care Authority developing plan to consolidate public school employee health benefits purchasing.

cap eligibility group per capita payments while increasing flexibility in program design and benefits, streamlining eligibility determinations, and imposing limited cost sharing. Similarly, Thrive Washington recommended the state seek a waiver authorizing capped federal funding. Such waivers have successfully allowed greater cost control and better health care outcomes in other states.

We also recommended bringing K-12 health care coverage under the Public Employees Benefits Board or, alternatively, requiring school districts to purchase health care as a group, a recommendation consistent with one made by the state auditor.

After consideration, lawmakers directed the Health Care Authority to "plan the implementation of a system of consolidated public school employee health benefits purchasing" for the 2013–14 school year. A report on the proposed plan that considers several alternatives as well as costs and benefits is to be delivered to the legislature by December 15, 2011, for consideration.

We are also encouraged by state efforts to hold the rate of growth in health care costs to 4 percent a year, while improving patient outcomes. One promising strategy, the Intensive Outpatient Care Program (IOCP), is based on a pilot program launched by The Boeing Company with Regence Blue Shield in 2007. The program resulted in a 20 percent reduction in costs and 57 percent decrease in lost workdays. The proposal seeks multi-employer and multi-plan implementation of the program, aimed at improving the care and treatment of complex patients, who often have multiple chronic diseases.

Health Care Recommendations

1. Continue to seek Medicaid waivers to gain maximum program flexibility.
2. In future collective bargaining sessions, negotiate a benefits agreement approaching private sector parity.
3. Maintain commitment to strategies designed to reduce health care cost growth to a 4 percent annual growth rate.

Restructuring the Washington State Executive Branch

In our report, ***"Consolidation vs. Specialization: Restructuring the Washington State Executive Branch,"*** we recommended reducing the number of statewide elected officials from nine to six and pursuing additional executive branch reorganization. Eliminating elected positions faced expected resistance. It's now a discussion for another day.

Two gubernatorial proposals endorsed by Thrive Washington should not be abandoned. The governor proposed a sweeping restructuring of the state education agencies that would have put all aspects of the education system under one new Department of Education, with a secretary appointed by the governor. Her request legislation, SB 5639, was not enacted.

Similarly, the governor proposed to further consolidate natural resource agencies, building on a number of consolidations made in 2010. It, too, proved to be a bridge too far in a difficult legislative session.

The governor had more success with a reorganization of agencies primarily serving administrative functions. ESSB 5931 created DES and CTS. The legislation eliminated the Department of Personnel, moving its policymaking functions to OFM and its human resource functions that serve agencies to DES. The Public Printer and the Department of General Administration were moved to DES. The Department of Information Services' IT policy oversight functions were transferred to OFM, and administrative functions were moved to DES. IT delivery was transferred to CTS.

Restructuring Recommendations

1. Continue to pursue consolidation of education and natural resource agencies.

MISSED OPPORTUNITY FOR PROGRESS:
Proposed legislation to exempt minor projects from the State Environmental Protection Act would have simplified and reduced the regulatory burden without compromising the process.

SMART REFORM:
Legislature strengthens regulatory procedures by adopting 'least burdensome rule' provisions.

Confronting Washington State's Overlapping Regulatory Structures

Redundant and inconsistent regulatory regimes delay business investment and impose unnecessarily high costs on employers seeking to develop and expand operations. In addition, Washington often imposes regulatory requirements exceeding federal standards, with no demonstration that the higher standards achieve increased environmental benefits.

Regulatory reform and restructuring received relatively little legislative attention in 2011. A reorganization of natural resource agencies that may have reduced regulatory overlap failed to advance. Our report, ***"Confronting Washington State's Overlapping Regulatory Structures,"*** released late in the session, continues to provide solid guidance to lawmakers in promoting more efficient and effective regulatory policy.

We urged the legislature to exempt minor projects from the State Environmental Protection Act (SEPA) process and eliminate unnecessary compliance costs. A measure to streamline SEPA had bipartisan sponsorship in the House and Senate (E2SHB 1952). The Association of Washington Business, working with a broad business coalition and local government officials, led this reform effort. The legislation would have revised exemption levels for development projects, including residential and commercial construction. Despite broad support (it was passed by the House 95-2), the measure died.

Another bill consistent with our recommendations did pass. HB 1178 strengthens regulatory procedures. It requires an agency, when considering a rule, to clearly detail the goals of the statute, determine the rule is needed to achieve those goals, provide a preliminary cost-benefit analysis in the notice of proposed rulemaking, determine that the benefits exceed the costs, ensure the rule is the least burdensome option, determine the rule is not more stringent on private than public entities, determine if the rule differs from federal regulations, and coordinate the rule with other laws. This is consistent with our recommendation to "strictly apply and enforce the Significant Legislative Rule provisions in RCW 34.05.328 and require regulatory agencies to adopt only the 'least burdensome rule' which implements expressed legislative intent."

Regulatory Reform Recommendations

1. The Department of Ecology should adopt EPA regulatory standards, exceeding them only when the higher standards are unequivocally justified by increased environmental benefits.

2. The Department of Commerce should create a permanent task force monitoring legislative and gubernatorial rule-making to prevent conflicts.

3. Lawmakers should exempt minor projects from the SEPA process.

BENCHMARK RANKINGS FOR EDUCATION QUALITY IN WASHINGTON			
35th in bachelor's degree production per capita	**42nd** in high school graduation rates	**21st** in 8th grade science achievement	**9th** in 8th grade math achievement

MISSED OPPORTUNITY FOR PROGRESS: House failed to pass legislation making teacher effectiveness, not seniority, the primary factor in personnel decisions.

SMART REFORM: Legislature granted tuition-setting authority to four-year higher education institutions, providing much needed flexibility in dealing with budget cuts.

FORWARD LOOKING POLICY: State established scholarship endowment for students struggling with higher education tuition.

Microsoft	$25
Boeing	$25
+ WA state	$5
	$55 million to start

Economic Development: Moving Forward into Recovery

Our report, ***"Economic Development: Moving Washington State Forward Into Recovery,"*** reflected the perspective outlined in Benchmarks for a Better Washington: "To stay competitive, the state needs a balanced strategy that achieves both solid economic policies and a great quality of life." We urged lawmakers to focus on education accountability, provide for adequate higher education funding, preserve proven tax incentives, and expand infrastructure investment. In addition, we recommended the state improve coordination among various economic development agencies.

Washington has earned its reputation as a center for entrepreneurship and innovation. Retaining our comparative advantage will require continual improvement in education, particularly in the STEM disciplines. Yet, as Benchmarks reports, our state still has serious deficiencies. We rank 42nd on high school graduation rates and 35th in bachelor's degrees awarded per capita. Our 8th grade National Assessment of Education Progress scores rank 9th and 21st nationally in math and science, respectively.

On education issues, the legislative record is mixed. The math and science assessment requirements were challenged. A compromise was reached so students graduating in 2013 and 2014 must pass one math assessment; beginning in 2015, they will be required to pass two assessments. Efforts to delay the science assessment were blocked. Beginning with the 2015 graduating class, students will be required to pass a science assessment.

Recognizing that tight budgets will result in teacher layoffs, lawmakers considered, but ultimately did not enact, a performance-based approach to reductions in force. Currently, the vast majority of districts adhere strictly to seniority as the sole criterion when laying off teachers. Competence, not years on the job, should be the primary factor considered when personnel decisions must be made. Washington is in the midst of implementing a four-tiered educator evaluation system that incorporates multiple measures of student growth. Using this evaluation system to determine critical school staffing decisions will enable Washington to improve teaching and learning and advance student performance.

Another consequence of tight budgets is the continued reduction in state funding for higher education. Commendably, lawmakers enacted E2SHB 1795, granting tuition-setting authority to the state's four-year colleges and universities. This flexibility will help the higher education institutions mitigate the impacts of disproportionate reductions in state support as compared to other state services.

With higher tuition levels, it's vital that access be maintained by providing financial support to current and prospective students. With HB 2808, the state established a public-private partnership to create a scholarship and endowment program for students seeking bachelor's degrees. The state provided seed funding of $5 million. Boeing and Microsoft have already committed a combined $50 million to the program. This innovative partnership, combined with tuition flexibility, will help maintain high quality education and critical access to learning.

In a highly competitive global marketplace, tax incentives are important tools for lowering the burden on investment and job creation. Although there was some discussion aimed at tax preference repeal, no serious legislation was considered this year. In part, that may be due to passage of Initiative 1053 last November. The initiative requires a legislative supermajority for tax increases, including repealing preferences.

Legislators also provided for important transportation investments. SSB 5700 authorizes tolling on SR 520 and EHB

1382 extends tolling on I-405 express lanes. Both measures are threatened by anti-tolling Initiative 1125, on the ballot this November.

The fundamental transformation envisioned a year ago is evolving. The journey has begun, but there's far yet to travel.

Economic Development Recommendations

1. Expand STEM education and enhance math and science accountability.
2. Use the new four-tier evaluation system to guide K-12 personnel decisions.
3. Make performance, not seniority, the primary criterion in teacher layoffs.
4. Preserve access to higher education with scholarship and financial aid partnerships.
5. Retain tax incentives that promote investment and job creation.
6. Preserve tolling to support transportation investments.

CONCLUSION

As the debt ceiling and deficit reduction debate rocked the nation's capital in early August, reverberations were felt in the 50 state capitals. The debate underscored the ongoing fiscal distress accompanying the prolonged economic crisis. State governments, here and across the country, face several more years of budget austerity.

We began the Thrive Washington series joining Gov. Gregoire and legislative leaders in calling for a transformation of state government. Confronting an untenable status quo, state officials had no alternative: Fundamental change—in structure and policy—could no longer be avoided. The checks and balances of state government make rapid change difficult, yet in the midst of extraordinarily challenging fiscal pressures, policymakers acted with resolve. Working across the aisle, with the other chamber, and with the governor, legislative leaders began to proactively and productively change the course of state government.

Although we often hear talk about "government needing to act like a business," there's no private sector equivalent to the legislative process – a process designed intentionally to frustrate quick, unilateral action. The fundamental transformation envisioned a year ago is evolving. The journey has begun, but there's far yet to travel. And the fiscal crisis persists.

We remain confident in the future of the state economy and state government. We believe our recommendations can help policymakers achieve the common goal of preserving essential state services and laying the foundation for sustained economic growth.

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