Thrive WASHINGTON
Strategies to move our state forward

Charting a New Course

The time has come for Washington state to transform government and build a foundation for enduring economic prosperity.

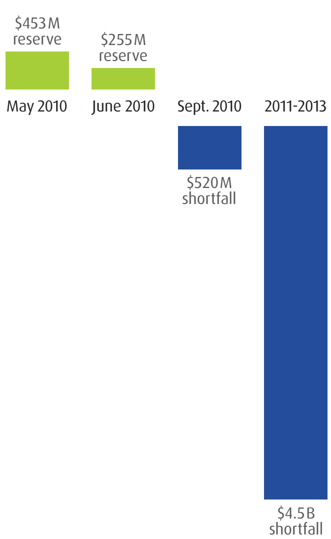
A joint research series from the Washington Roundtable and Washington Research Council

THE THRIVE WASHINGTON PROJECT

The Great Recession dramatically changed fiscal conditions in Washington state, possibly forever. 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—will provide 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.

> "We must make a dramatic shift in what can be expected of state government."
> —Governor Chris Gregoire

WASHINGTON STATE BUDGET



The revised state revenue picture presented by Washington state's economic forecaster in mid-September made one thing clear: Our state's fiscal crisis continues unabated.

Since the beginning of the Great Recession in 2007, Washington state has reduced revenue expectations for the current biennium (which runs through June 2011) nine times, slicing the level of projected revenues by $6.4 billion in total. Such reductions are to be expected during a recession of this magnitude, though many hoped the state would have turned the corner by the middle of this year.

Many were taken aback on September 16 when Dr. Arun Raha, head of the state Economic and Revenue Forecast Council, reduced estimated state tax collections by another $1.4 billion for the remainder of the current fiscal year and the next two-year budget cycle. That reduction left a $520 million hole in the current budget and a projected deficit of $4.5 billion for 2011-13.

The response from lawmakers has been nearly universal. Leaders from across the political spectrum, both chambers of the legislature and the executive branch agree: Change is needed.

As Governor Chris Gregoire said, "We must make a dramatic shift in what can be expected of state government." Noting that additional federal funding would not fill the gap, she added, "To be fiscally responsible, we must transform the way we provide services."

Democratic legislative leaders agree. In a joint statement, House Speaker Frank Chopp and Senate Majority Leader Lisa Brown said, "The current budget situation clearly demonstrates that state government must be rescaled to fit the new fiscal reality."

Republicans have sounded a similar call, asking state employees for ideas in hopes of learning "directly from those who carry out the policies we make, what's working and what isn't working and how government might maintain or improve service delivery for less cost."

With a desire for change and improved service delivery from across the political spectrum, Washington sits on the precipice of meaningful government and budget transformation.

Success will require leaders from both political parties, the private sector, labor and civic groups to come together not only to reset spending, but to forge a better, more efficient and stable delivery of services that will enable citizens and businesses to thrive in Washington state.

As a first step, the governor has invited public participation in "transforming the state budget." She held public hearings, set up a website soliciting budget ideas, and established a commission to work with her administration in evaluating alternatives.

"By necessity, government must be smaller," Governor Gregoire concluded in August.

This shift does not require Washingtonians to lower their expectations. Smaller government can be more responsive, efficient, productive and accountable. Budget transformation can preserve essential services, create new opportunities for investment and

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job creation, and lay the foundation for a sustainable pattern of public spending and economic growth.

The Washington Roundtable is pleased to participate in the extended budget transformation discussion undertaken by the governor and legislative leadership. Thrive Washington—a policy, communications and research project developed by the Washington Roundtable with support from the Washington Research Council—will offer actionable recommendations for addressing the reset most effectively.

In a series of reports, Thrive Washington will examine key budget issues, highlight best practices from other states, and unveil opportunities for reform, efficiency and improved service delivery in Washington state. Areas of focus will include: sustainable budget practices, competitive sourcing, collective bargaining, mandatory spending programs, management reform, economic development, business costs, education finance and regulatory policies.

Central to the Thrive Washington approach is a conviction that by setting state spending at a sustainable level, state officials can spur investment and job creation, thus stabilizing revenues to support essential public services.

Investors and entrepreneurs require certainty in tax policy and the provision of public service. Unsustainable public spending creates uncertainty as employers must consider: Will lawmakers rethink economic incentives, raise taxes, defer infrastructure investments, cut higher education or otherwise rewrite the state's fiscal plan? When employers locate or expand, they look for predictability and stability in state and local government to minimize this kind of uncertainty. As they establish sustainable fiscal policy, policymakers will encourage private sector investment and expansion and define a path to a more dependable, prosperous future for citizens.

The competitiveness of Washington's private sector will be critical. The recession has forced every state to rethink how it does business. In a global marketplace characterized by mobile capital and labor, regions that succeed will be those offering stability and opportunity, well-managed government, and competitive tax and regulatory policies.

With critical strengths in the "innovation economy" of software development and biosciences, as well as global leadership in everything from coffee to online commerce, airplanes and forest products, Washington can emerge from the recession a national leader. But the state cannot underestimate its competitors' resilience or ability to adapt to changed conditions and, thereby, position themselves for success in the recovery.

ACCEPTING A NEW NATIONAL REALITY

In the three years since the nation plunged into recession, Washington state fiscal conditions have changed, possibly forever. There will be no quick return to the economic growth that seemed normal just a few years ago. As Governor Gregoire said in her response to the September 16 revenue forecast, "I don't see us returning to the good budget times we've enjoyed anytime soon."

In a prescient report released last February, the National Governors Association warned of a "lost decade."

"State revenues (in real terms) may not reach 2008 levels until late in fiscal 2012, at the earliest. Moreover, with the cost of services continuing to rise and investments in infrastructure and pensions largely deferred, state budgets may not fully recover until near the end of the decade."

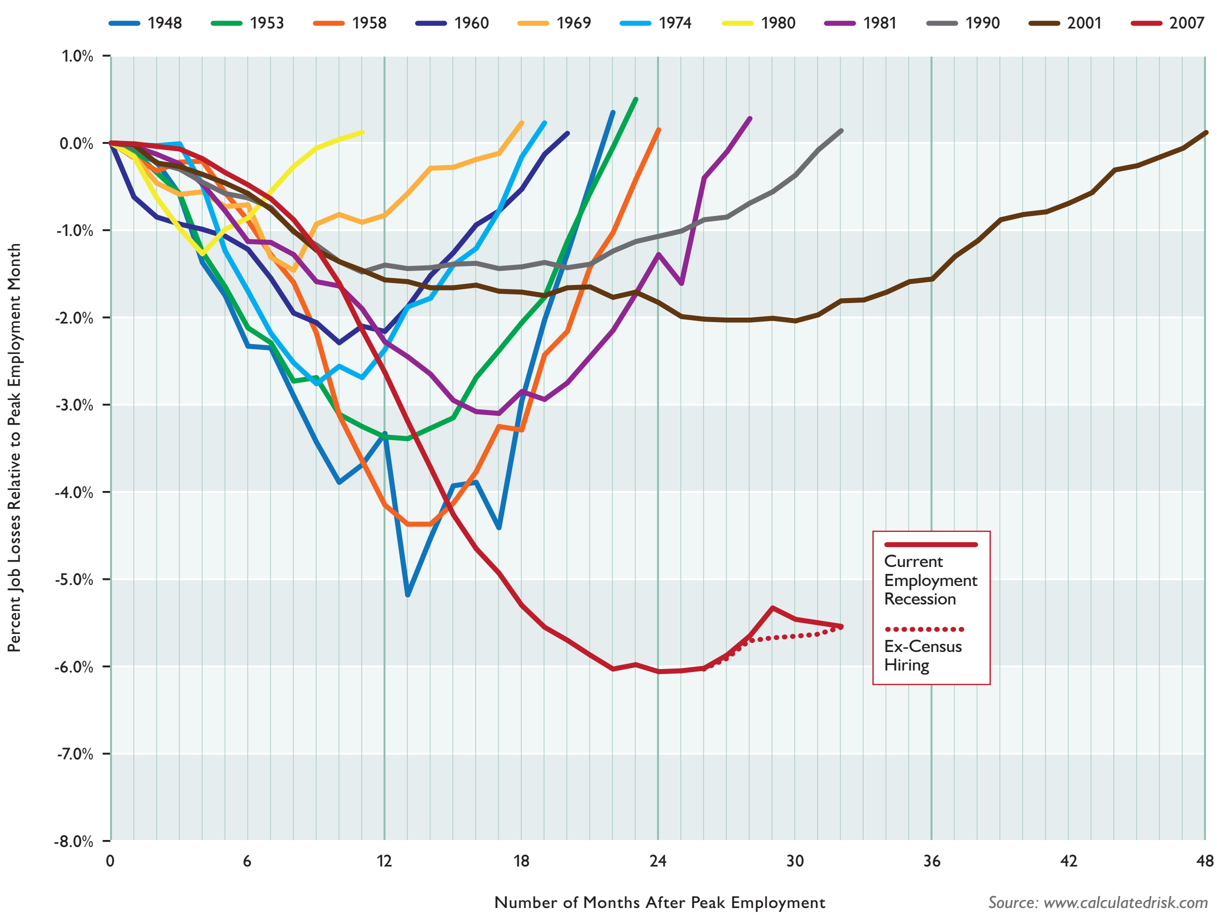
Accepting the new reality has been wrenching. Initially, state officials—like many economists—underestimated the duration and depth of what is now acknowledged to be the deepest recession since the 1930s. Across the country, early responses relied on familiar techniques used to handle temporary shortfalls: tapping reserves, cutting spending, freezing compensation and raising taxes.

Washington state fiscal conditions have changed, possibly forever.

Washington took this approach as well. In the spring of 2009, the state faced a $9 billion shortfall for the balance of the 2007-2009 budget cycle and the coming 2009-11 biennium. Lawmakers avoided tax increases by relying on nearly $5 billion in one-time money (most notably from the federal stimulus package) and incremental cuts. In the spring of 2010, again facing a growing deficit—this time a $2.8 billion shortfall for the last half of the biennium—lawmakers relied on a mixture of cuts, federal aid and $800 million in new taxes.

In a normal cyclical turndown, these measures might have worked. We now know this recession is unlike anything we've experienced since World War II. A graph prepared by economists at Calculated Risk shows job losses in the 11 recessions since the war. The recent downturn, beginning in 2007, clearly exceeds all of the post-war downturns in its employment effects.

JOB LOSSES IN POST WORLD WAR II RECESSIONS



Source: www.calculatedrisk.com

52% of voters believe that "state government is broken and we need major, fundamental reforms to get state government functioning the way it should be."

Behind the job losses are millions of people and businesses dramatically impacted by the recession. Families have reduced spending, moved into smaller homes, struggled to pay off debt and relocated in search of employment. Employers have restructured operations, revised salary and benefits, sharpened focus on core functions, and, as needed, reduced employment.

In short, they adapted. Washington state government must also adapt.

THE PUBLIC IS READY FOR THE RESET

Voters recognize the changed reality. A September survey of Washington voters commissioned for Thrive Washington confirms the public is ready for fundamental change.

Voters prioritize economic issues. They want state government to work with employers to increase investment and hiring. They are leery of tax increases, preferring spending restraint and reform.

More than half (52 percent) of voters believe "state government is broken and we need major, fundamental reforms to get the state government functioning the way it should be."

Two-thirds agree with the proposition that "Here in Washington state, we should move toward an economic model that generally favors lower taxes; even if that means fewer state government services are available to the public."

Overwhelmingly, voters believe the current crisis results from overspending rather than an inadequate revenue system.

These results are consistent with national polls depicting an electorate concerned with rising deficits, persistent unemployment and increasing taxes. Voters welcome political leadership that addresses their priorities, values and concerns. They recognize the need for transformational change.

STATE RESET EFFORTS

Washington is not alone in acknowledging the need for a fundamental reset. In December 2009, Raymond Scheppach, National Governors Association Executive Director, told Stateline.org that unlike previous recessions, "states are heading into a permanent retrenchment."

Oregon Governor Ted Kulongoski, a Democrat, this spring received the report of his Reset Cabinet, which concluded that "the government we have is too expensive to maintain in the wake of the Great Recession. And just as important: Too prone to failure when the next recession arrives." The cabinet outlined alternative paths to achieve stability, sustainability and continue to provide essential services. The menu of options includes limiting increases in employee compensation, reducing prison sentences to curb corrections costs, restructuring education governance, and controlling health care costs.

New Jersey Governor Chris Christie, a Republican elected in 2009, said in February,

VOTERS SUPPORT BELT TIGHTENING OVER HIGHER TAXES

66% Favor **lower** taxes and **fewer** government services

26% Favor **higher** taxes and **more** government services

8% Don't know

"Our conscience and common sense require us to fix the problem in a way that does not raise taxes on the most overtaxed citizens in America. Our love for our children requires that we do not shove today's problems under the rug only to be discovered again tomorrow. Our sense of decency must require that we stop using tricks that will make next year's budget problem even worse."

From Michigan to Louisiana, New York to California, Washington to Florida, governors and legislators grapple with the changed dynamic, appointing task forces, marshalling commissions, issuing executive orders, raising taxes and cutting spending. Even gubernatorial candidates have weighed in with detailed plans. In New York, Andrew Cuomo, the Democratic candidate, released a 224-page "New NY Agenda," calling for a spending cap, tax freeze and a freeze on employee salaries.

Often, their efforts parallel private sector initiatives. Florida Tax Watch identified more than $3 billion in cost savings; the recommendations of a task force of senior business and political leaders in the Sunshine State. Business Leaders for Michigan, an organization similar to the Washington Roundtable, developed the Michigan Turnaround Plan: a five-step program for revitalizing the state economy. The plan includes recommendations for resetting state spending and spurring private sector job creation and investment.

Unlike most private sector institutions, state government is institutionally designed to resist reform. Complex governance structures make it difficult for even the most well-intentioned and committed political leaders to affect change.

While most states—including Washington—have a proud history of public and private groups working together to improve civic life, streamline government operations and invigorate the economy, these efforts have taken on an imperative urgency.

Yet, often, problems persist, fixes fail and public confidence wanes.

One reason: Unlike most private sector institutions, state government is institutionally designed to resist reform. Complex governance structures make it difficult for even the most well-intentioned and committed political leaders to affect change.

In 1983, former Governor Dan Evans framed the problem by asking a Washington Research Council audience:

"How would you like to be the chief executive of a major corporation where you had eight vice presidents who were totally independent, as the separated elected officials of this state are, and a number of other vice presidents appointed by separate committees, as occur with various boards and commissions directors? How long would you last when the board of directors is often controlled by the malcontents or the opposition, as is our legislature?"[1]

That is not an excuse for inaction. It is a summons for change. In the dynamic economy of the 21st Century, the structure must be reconsidered—as it will be in this series.

PREPPING WASHINGTON'S RESPONSE

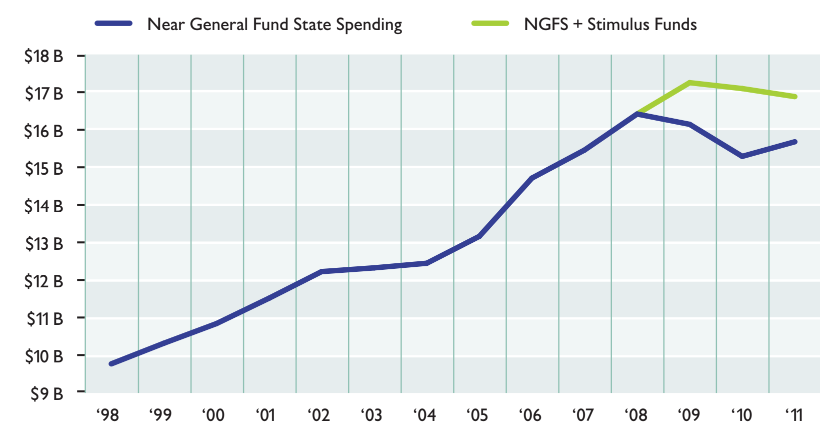
Our state begins its transformation effort with an impressive array of tools and experiences.

Priorities of Government: In 2002, the state pioneered the Priorities of Government (POG), an outcomes-based budgeting process centered on setting priorities within the confines of projected revenues. Used by former Governor Gary Locke to develop a state budget without raising taxes during the 2001-03 recession, the POG gained national recognition. The effort generated case studies, a book, *The Price of Government* (co-authored by Peter Hutchison, the consultant who developed the process), and became a model for state and local governments.

The Priorities of Government process continues to inform Washington state's budget development, though it has been most utilized when revenues were constrained.

[1] The Reorganization of Washington State Government: The Power to Govern, Washington Research Council, February 1987

WASHINGTON STATE NEAR GENERAL FUND SPENDING



Source: Washington Research Council

Increases in state spending during the boom exacerbated the problems Washington is now facing.

Washington is a national leader in the use of performance auditing to increase accountability and spur reform.

As state revenues rebounded during the boom following the 2001-03 recession, the state relaxed its commitment to long-term sustainability.

From 2004 to 2008, spending increased by 32 percent (nearly $4 billion over five years). The revenue losses during the last few years have been unprecedented and account for most of the state's current fiscal distress. However, increases in state spending during the boom exacerbated the problems Washington is now facing (see chart above).

In part, that growth rate gave rise to citizen support for the next government reform tool: performance audits.

Performance Audits: Washington is a national leader in the use of performance auditing to increase accountability and spur reform. When voters approved Initiative 900 in 2005, they authorized the independently elected state auditor to conduct performance audits of state and local governments. They directed a slice of the sales tax (0.16 percent) to fund the program.

State Auditor Brian Sonntag moved swiftly to implement the program. In January 2010, Sonntag released "Opportunities for Washington," reviewing several state operations and making recommendations for cost savings. At the time, Sonntag noted, his office had conducted "23 performance audits identifying billions of dollars in unnecessary spending, potential cost savings and economic benefits" and recommended ways to improve performance.

GMAP: Governor Gregoire launched an intense performance review system in 2005. The Government Management Accountability and Performance (GMAP) program is based on programs put in place in New York City and Baltimore, where agency performance is measured against clearly defined metrics. Washington was the first state government to adopt the technique.

In 2008, the Council of State Governments selected the GMAP program for recognition

The state budget director expects a **$4.5 billion shortfall** for 2011-13.

as the first recipient of the Governance Transformation Award. Also that year, the GMAP program was selected as a Top 50 program by Harvard's Kennedy School.

Clearly, Washington state government has the capacity to manage a smart reset of state government—protecting priority programs, improving performance, and shedding ineffective, duplicative, or less important activities.

DEFINING THE IMMEDIATE AND LONG-TERM PROBLEM

State government is currently broke. When the governor signed the 2010 supplemental budget May 4, the balance sheet showed total reserves of $453 million, about 1.5 percent of biennial spending. (As a benchmark, the Washington Roundtable has consistently urged lawmakers to maintain a reserve equal to five percent of the general fund budget.)

Just one month later, the state revenue forecast sliced more than $200 million from estimated tax collections. With a few additional adjustments, the balance sheet in June showed only $255 million in reserves for the balance of the biennium ending June 30, 2011.

As already noted, the bottom fell out in September 2010. The $1.4 billion reduction in forecasted revenues included a cut of $770 million from anticipated collections for the current fiscal year, putting the state $520 million in the red. Across-the-board cuts will erase the immediate shortfall, barring more negative revenue news in November, but the long-term outlook remains dire.

The Office of Financial Management, the governor's budget staff, foresees greater challenges ahead. The state budget director told the Olympia press corps he expects a $4.5 billion shortfall for 2011-13. That estimate that will change over the next few months. There will be another revenue forecast in November and it will take time to determine the effects of the across-the-board cuts.

This much is certain: The state confronts a massive gap between revenues and expenditure commitments and a multi-billion dollar structural deficit must be closed. The call for budget transformation could not be more imperative.

THE CHALLENGES AHEAD

Building on that call, Thrive Washington will present a proactive, research-based agenda for moving Washington forward. It will examine best practices and results in other states and the private sector and determine how Washington can not only improve service delivery, but compete and win in the global economy.

As a framework for this effort, we believe two responses are required from state officials:

Spending must be set at a sustainable level.

Controlling spending is essential to erasing the structural deficit. The effort will requires rethinking what state government does and how it does it: priorities and operations. The governor's bipartisan effort to transform the state budget in this way offers a promising opportunity. Thrive Washington will complement and expand upon that effort.

Changing the budget culture also requires extensive support from the public and an array of stakeholders. The magnitude of the structural deficit means a variety of strategies must be employed. Restructuring and capturing efficiencies will be essential elements of the reset. Efforts to root out "waste, fraud, and abuse" will pay dividends, but those efforts will not be enough.

No matter how well run or effectively structured state government becomes, it can no longer deliver everything it has promised over the years.

No matter how well run or effectively structured state government becomes, it can no longer deliver everything it has promised over the years. The transformation will inevitably entail a redefinition of the scope and mission of state government itself.

Thrive Washington will evaluate—issue by issue—many of the most critical policy challenges facing Washington state and provide concrete recommendations for action.

A sustainable budget rests on a vibrant economy. Our state must do more to improve business conditions. No state or region is immune to contagion from a depressed national or global economy; however, even in this recession, some of our competitor states are adding jobs and fostering opportunity. This tells us that tax and regulatory policies matter, as does maintaining essential intellectual and capital infrastructure.

Washington does not have to accept high levels of unemployment and a declining economy as the new reality. Stimulating investment and job creation must be a priority. We cannot assume prosperity as a natural condition. In a globally competitive marketplace, prosperity must be won.

Executing a fundamental—and ultimately successful—reset of state government will not be easy. It will require political will and intense collaboration, compromise and sacrifice. If we do this right, if Washington realigns government to more efficiently deliver high priority, high value services and create a more competitive environment conducive to job creation and long-term economic growth, then families, businesses and our state as a whole will not only recover, but will thrive for years to come.

Thrive Washington will evaluate—issue by issue—many of the most critical policy challenges facing Washington state and provide concrete recommendations for action. It is our hope this research and subsequent policy recommendations put forth by the Washington Roundtable will build upon activities already underway at the state level and help accelerate and advance the public discussion. With the right policy decisions over the short- and long-term, Washington can position itself among the most desirable places in the world to invest, create jobs, build community and raise families.

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