

W A S H I N G T O N
**Competitiveness
Council**



Phase II: Final Report

January 2004

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1.0 OVERVIEW

Governor Gary Locke convened the Washington Competitiveness Council to examine Washington's ability to compete in the global economy. During the summer and fall of 2001, Council members identified competitiveness issues of greatest concern and developed recommendations to address them.

The final report, issued in January of 2002, contained 99 separate recommendations for improving the business climate in Washington State. Following completion of the final report, the Economic Development Task Force also issued recommendations related to the state's direct role in economic development.

Since then, the Council has strongly advocated implementation of these recommendations. Its members have repeatedly met with the Governor and the Washington State Legislature to emphasize the importance of this agenda to the economic vitality of Washington State. They have also participated in press conferences, met with editorial boards and worked with advisory groups in support of these recommendations.

Extraordinary effort led to remarkable results. The Governor and the Legislature have taken steps to implement most of these recommendations. This is a significant achievement given the considerable cost associated with many of these proposals and the state's current budget problems. Governor Locke has carried out many of these recommendations via executive order or through instructions to his cabinet agencies. Many others were adopted in the 2002 and 2003 legislative sessions.

Despite this success, there is much to be done. Recent gains in Washington's competitiveness could easily be lost without vigilance. Furthermore, we must take additional steps to ensure that we do not fall behind. Other states and nations are examining their own ability to attract and grow the companies and industries that will provide a high standard of living for their citizens. Washington's competitiveness remains in danger if we do not keep up as our competitors take steps to improve their ability to grow and prosper.

Governor Locke convened Phase II of the Washington Competitiveness Council to ensure that we continue to make progress. The Governor asked the Council to focus on issues related to human capital and innovation. These issues are critical to the future of Washington's economy. Yet, compared to the other issue areas examined by the Council during 2001, we have made the least progress in this area. Of the 38 original Competitiveness Council recommendations related to human capital and innovation, only a handful has been fully implemented. Nevertheless, the Council recognizes the need to continue to progress in other areas as well. Thus, the Council's Phase II recommendations also address taxation, infrastructure and regulatory reform.

1.1 Objectives and Vision

The Washington Competitiveness Council (WCC) in Phase II seeks to secure Washington's future in the 21st century, technology-driven economy. The Council has recommended and will advocate specific steps to improve the quality of Washington's human capital, its capacity for innovation and its business climate.

The main objectives are to:

- Identify the most urgent competitiveness issues left undone from the 2001 WCC agenda, particularly in the area of human capital and innovation.
- Design specific recommendations for the Legislature and the executive branch for addressing these issues.
- Link the WCC effort to other groups working on similar issues.
- Drive policy and budget changes that will lead to measurable improvements in Washington's future competitiveness.

Washington must build its future upon its strengths. Rather than imitating another state's or another nation's strategy for economic vitality, Washington must identify opportunities to leverage its strengths, while shoring up its weaknesses to produce a unique climate of opportunity and vitality. Some of Washington's strengths include:

Trade – Washington has remarkable advantages in international trade, particularly with the Pacific Rim. Located at the center of today's global economy, Washington is 30 hours closer to Asian markets by ship than other West Coast ports. Washington is one of the most trade-dependent states in the nation, with one in four jobs linked to international trade. Washington ranks fourth in origination exports and has an incredible network of deep-water ports linked to the Columbia-Snake river system that serves the second largest dry bulk cargo export industry in the nation.

Technology, research, and innovation – Washington is home to some of the most important companies in the technology economy. Our technology strengths include software, biotechnology, wireless communications, aerospace technology, energy, environmental technology and nanotechnology. In 2001, Washington had the highest rate of technology industry employment.¹ Washington's citizens are more technology-literate than most, with the fourth highest percentage of households with computers.² Washington State ranked highest in the nation for use of technology in providing government services for three straight years.³ The University of Washington receives more federal research and development funding than any other public university in the nation.⁴

Entrepreneurship – Washington is one of the most entrepreneurial states in the nation – a place where people are willing to take risks. New businesses are being

¹ Corporation for Enterprise Development, *2003 Development Report Card of the States*. www.drc.cfed.org

² Progressive Policy Institute, *2002 State New Economy Index*. www.neweconomyindex.org

³ Center for Digital Government

⁴ National Institutes for Health

started every day. In fact, Washington has the highest rate of new business formation in the United States.⁵ Some of the most famous and successful entrepreneurs in the world live and work here.

Livability – Washington is known as a great place to live. Its ethnic diversity, cultural activities, geographical variety, recreational opportunities, and moderate climate attract a diverse and productive workforce.

Building on these strengths requires that we invest in our assets and remove impediments to greater economic productivity. The Competitiveness Council is committed to recommending and advocating policy changes and investments that will maximize the value of our natural advantage in trade, our innovation assets, our entrepreneurial environment and our quality of life.

1.2 Follow-up

The Competitiveness Council will actively pursue implementation of the recommendations described in this report. As appropriate, members of the Competitiveness Council will individually and collectively meet with state legislators, the Governor and local leaders to articulate the need for and urgency of these recommendations.

The Council will convene again in early 2004 to review plans for implementing these recommendations and the status of key legislative and administrative proposals. In addition, the Council will reconvene annually to accomplish the following:

- Evaluate progress made to date on implementation of the recommendations in the report.
- Assess changes in the competitiveness of Washington State, using the performance measures published in the original Competitiveness Council report and other measures as appropriate.
- Consider whether the recommendations provided in this report should be revised, given the status of Washington's competitiveness at that time.

⁵ Corporation for Enterprise Development, *2003 Development Report Card of the States* www.drc.cfed.org



2.0 HIGHER EDUCATION: ACCESS, FUNDING, AND WORKFORCE TRAINING

2.1 Introduction

Washington's colleges and universities fuel the economic engine of our new economy through research, innovation, access to new technology and an educated workforce. Science and technology from our research institutions renew our current industrial clusters and create the foundation for industries and companies of the future by supporting new business formation and growth. Further, economic development strategies across the state are linked to the strength of all our colleges and universities.

As the U.S. continues its migration into the Information Age, the need for higher education and specialized workforce training is accelerating. The ability of Washington businesses to remain competitive in this quickly changing environment depends in large part on their ability to hire a well-trained and educated workforce. Investments to train and educate our citizens will ensure that they remain competitive for family wage jobs in the state, and will ensure that the state's economic health remains strong. As shown in Figures 1 through 4, investments in a well-educated and trained population provide social and economic benefits from higher incomes, reduced welfare expenditures and unemployment, lower employee absenteeism, and lower crime rates.

Figure 1. Average Earnings by Education Levels

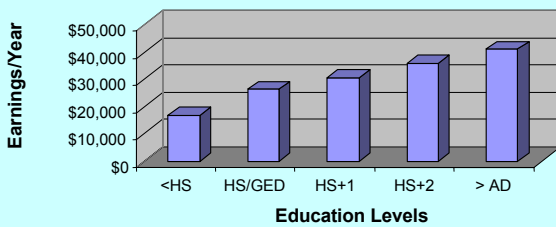


Figure 2. Welfare and Unemployment

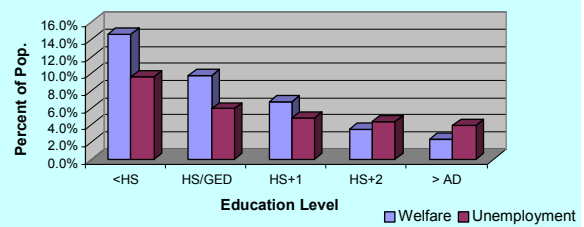


Figure 3. Days of Absenteeism by Education Levels

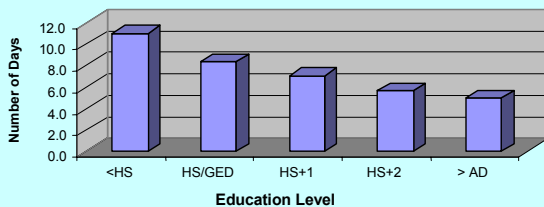
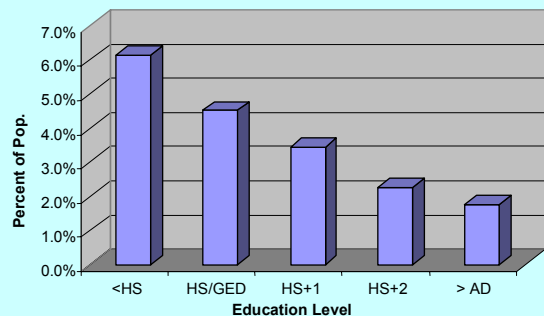


Figure 4. Incidence of Incarceration



Education and training are necessary for high skill jobs such as nursing, teaching, computer and network technical support, financial services and construction trades. Training Washington residents will ensure that we retain the family wage jobs created by a vibrant economy. Under-training our residents will likely result in a polarization of our workforce into high- and low-wage jobs. A shortage of top-quality graduates with associate, bachelor and master degrees in high-demand and high-skill fields also requires Washington companies to recruit more extensively from out of state, resulting in fewer opportunities for Washington citizens.

Yet, even as the need for a highly skilled workforce has increased, funding for and access to higher education and workforce training has not kept pace. Washington currently ranks 33rd out of the 50 states in its production of students with bachelor degrees. The largest high school class in Washington history will graduate in 2008, but the number of positions available to these students in higher education is not sufficient to meet demand. Additionally, changes in our economy require retraining for many of our experienced workers. Without such retraining, existing workforce skill gaps will be exacerbated and valuable human potential squandered.

2.2 Long-term Vision

A strong state college and university system is a sound investment for taxpayers for many reasons. Public and private colleges and universities enrich the lives of their students and communities, reduce the demand for taxpayer-supported social services, and contribute to the vitality of local and state economies. Greater access to higher education, and increased funding for state colleges and universities, will ensure that new business development and innovation continue to generate economic growth in the future. To solve the access issue, the state must utilize all resources available in public and independent colleges and universities.

The Competitiveness Council continues to recognize human capital and innovation as the fundamental source of competitive advantage in the modern economy. To that end, we need a higher education system in Washington that:

- Enhances the competitiveness of our state's businesses by providing a highly trained and educated workforce that will meet employer needs now and in the future.
- Improves the competitiveness of our state's citizens by providing access to the quality education and training needed for high skill, family wage jobs.
- Values the important role that research plays in providing a catalyst to create and expand Washington businesses.

2.3 Recommended Strategies

The Competitiveness Council focused on two basic strategies for attaining its goals for higher education. They include:

Increasing access to our colleges and universities sufficient to cover current over-enrollment and projected demographic increases.

- Invest first to increase the number of state supported enrollment slots by 15,752 to cover students who are currently enrolled in our state colleges and universities without state funding.
- At a minimum, provide 18,000 more state supported enrollment slots (including both general and high demand enrollments) by 2010 to sustain current participation rates and meet workforce training needs.
- Build upon the successes of our 2+2 system by increasing access to lower-division classes at our community and technical colleges and to upper-division classes at our four-year colleges and universities, both state-supported and independent.

Securing funding sufficient to meet access, quality, workforce training and competitiveness goals.

- Prioritize the state's existing resources.
- Ensure that state colleges and universities are accountable, competitive and responsive to the needs of students and employers.
- Provide incentives and flexibility to enhance the efficiency and cost-effectiveness of higher education.
- Raise new revenues specifically for higher education.

Access

There are currently 213,000 full-time slots funded for students in our state's public colleges and universities. The cost of educating those students is a shared responsibility; the state provides a per-student subsidy to cover a portion of instructional costs and students contribute additional funds in the form of tuition. In recent years, however, our state colleges and universities have responded to tremendous student demand by enrolling nearly 16,000 students for whom they receive no state funding. These over-enrolled students pay tuition, but the state does not provide a per-student subsidy.

Colleges and universities are to be commended for continuing to serve students in spite of this lack of state support. However, over-enrollments have reached the breaking point. The quality of education the schools are able to provide is at risk as per-student state funding declines. Future access to quality educational opportunities cannot be addressed without additional state support.

An already stretched higher education system threatens to burst at the seams with the demographic pressures the state faces in coming years. Assuming the current percentage of high school graduates and adults seeking education and training continues, the system will need to accommodate an additional 18,000 students by 2010. Further, as the economy rebounds, we must be prepared to respond to increased workforce needs for highly skilled employees.

Students attempting to enroll in programs that provide specific job skills and training in high-demand fields are often turned away. In many cases, these students are adults who have lost their jobs and are seeking retraining in fields that offer the chance for employment and for which employers are having difficulty finding skilled workers. In recent years, these areas have included nursing and other health professions, teaching in

certain fields such as math and science, computer and network technical support, financial services and construction trades.

Washington has a strong and vibrant community and technical college system. In addition to offering occupational training for students with career goals that do not require a bachelor degree, or to students who require training to change careers or advance in their current careers, a primary mission of the system is to provide lower-division coursework for students who intend to transfer to four-year schools to complete bachelor degrees. In fact, 41 percent of students completing bachelor degrees in our state start their coursework in the community and technical college system.

This 2+2 system, on which the state relies heavily to meet the needs of students wishing to complete bachelor degrees, is beginning to break down. Student demand exceeds existing capacity at both the two- and four-year levels. Lack of access to required lower-division classes at community colleges means that it takes students longer to complete the requisite coursework needed to transfer as juniors to universities. Lack of access to upper-division programs at our four-year schools has created a logjam for students who complete their lower-division coursework at community and technical colleges.

Community and technical colleges have also experienced enrollment increases over the last several years as a result of the success of the state's Running Start program. Through Running Start, qualified high school students take classes at community colleges (and some universities) free of charge and earn college and high school credit simultaneously. Currently, about 12 percent of high school juniors and seniors participate in this dual-credit program, earning an average of 30 college credits before high school graduation. The program saves families and taxpayers millions of dollars each year because students earn college credit free while they are enrolled in high school.

Population trends suggest that we need to provide more opportunities for students to take dual-credit courses on high school campuses. As the "baby-boom echo" generation moves through the education system, physical capacity needs decline in K-12 and increase in colleges and universities. Developing more opportunities for students to take dual-credit classes on high school campuses via College in the High School and Tech-prep programs can relieve some of the physical capacity issues at community and technical colleges.

The Council applauds the efforts of Governor Locke and the legislature to provide additional funding for capital construction at our colleges and universities during the 2003 legislative session. We encourage them to continue to fund the 10-year construction and maintenance plan proposed by Governors Evans and Gardner.

Washington's independent colleges and universities also have an important role to play in the competitiveness of our state. Utilizing existing capacity in private colleges and universities, particularly for high-demand programs like nursing, teaching and business, could help alleviate capacity needs in public colleges and universities. The Higher Education Coordinating Board should investigate various options and develop a plan for the state to purchase capacity available at these institutions.

Funding

Funding to accommodate higher education and workforce training is crucial to ensuring our state's competitiveness. Employers already report difficulty finding employees with specific types of education and training needed for many of their job openings. If the current funding trend continues, the state will not be able to meet student demand or respond to workforce needs of the state in the future.

As funding for higher education has declined and enrollment demand has increased, both access to postsecondary education and training, and the quality of what is offered in state colleges and universities, has suffered. Students are often turned away from classes and program majors required for jobs in high-demand fields. Class sizes have increased, student services are stretched to the limit, and access to state-of-the-art equipment and technology has been jeopardized. In some cases, faculty members and administrators at our colleges and universities have been lost because their salaries are not competitive, their workloads have increased and their concerns about quality have not been addressed. Looking ahead, access and quality problems will only worsen as more Washington residents seek higher education and training and employers demand additional skilled workers due to the economic recovery.

The decline in state funding for higher education has been exacerbated in recent years by increasing demands on the general fund for other mandatory programs and services. Currently, 72 percent of the state General Fund is allocated to K-12 education, corrections, and health care. In comparison, higher education is viewed as discretionary and consequently becomes the budget balancer. Prioritizing existing state revenue to increase funding for higher education will pay dividends to taxpayers by helping alleviate future health care and incarceration costs, and costs associated with high unemployment.

However, prioritizing existing state revenue will only take us so far. New and stable sources of revenue are necessary to meet this funding gap to ensure that our businesses remain competitive and our citizens are able to get the education and training required for high-skill, family wage jobs. Revenue sources for higher education under consideration by various groups and individuals include an income tax on higher earning individuals, such as a 1 percent flat tax on individuals with income exceeding \$100,000 annually, and a one-cent sales tax increase for education from pre-school through higher education (a portion of which would be specifically dedicated to higher education). Should the latter revenue stream be considered, the Council recommends that modifications to the tax base be made to address regressivity.

In addition to new state revenue for the higher education and training system as a whole, increasing tuition-setting authority at our universities, perhaps through a graduated subsidy model, may help some institutions maintain high quality instructional opportunities for students, increase access and increase the percentage of low-income students enrolled. Graduated subsidy models allow institutions to set a relatively high tuition rate for higher-income students and families, but discount that tuition rate by providing financial aid to middle- and lower-income students and families. Under this model, the state would maintain responsibility for providing financial aid to the lowest income group.

If a graduated subsidy model is employed, it will be important to ensure that state support for our public colleges and universities continues, and the additional revenue from higher tuition supports additional access. Otherwise, this could result in reduced access to middle- and low-income students without addressing the increasing demand for graduates.

2.3.1 Short-term Strategies

Access

Create a thoughtfully developed and designed plan to expand higher education in the two- and four-year sectors that recognizes the needs of students, that supports statewide and regional economic development strategies, and that takes into consideration forecasts of labor market supply and demand. The expansion plan should include:

- General enrollment increases to accommodate current over-enrollments.
- General enrollment increases to sustain at least the current participation rate.
- High-demand enrollment increases via competitive grants to colleges and universities, recognizing the higher cost of providing these programs.
- Expanded access to upper-division courses to accommodate transfer students from community and technical colleges.
- Strategies for improving the efficiency of student articulation between the K-12, two-year and four-year systems.

Specific elements of the expansion plan could include:

- Increased apprenticeship opportunities in demand fields.
- Expanded Worker Retraining Program for dislocated workers.
- Expanded Job Skills Program for customized training.
- Enhanced acceleration opportunities via Running Start, College in the High School and Tech-prep.
- Increased financial aid and scholarships for qualified students.
- Increased funding for graduate assistantships in areas of need, allowing students to pursue Ph.D. degrees in selected high technology areas.
- Alternative service delivery modes.

Direct appropriate boards to develop and maintain supply and demand forecasts to anticipate demographic changes and workforce needs. This information should also include the types of coursework, apprenticeships, certificates, and degrees required to meet student and employer demand, given statewide and regional economic development strategies.

Provide funding for capital construction at state colleges and universities, as envisioned by the Evans-Gardner plan, to create instructional space to accommodate

increased enrollments and research capacity to support statewide and regional economic development strategies.

Funding

Prioritize the state's existing resources to provide funding to support additional general and high-demand enrollments.

Raise public awareness about the vital role higher education and research play in the social and economic health of our state, and educate citizens about the real cost of instruction (i.e., state subsidy and tuition).

Provide incentives and management flexibility for state colleges and universities to constrain higher education costs through innovative and cost-effective strategies.

Establish compacts between the state and its public colleges and universities that hold the institutions accountable for meeting specific performance goals in exchange for additional funding and flexibility.

Explore additional tuition-setting authority for institutions, which could include a graduated subsidy model at universities provided that additional financial aid is guaranteed for low- and middle-income students.

2.3.2 Medium-term Strategies

Access

Increase enrollments and acceleration opportunities consistent with the expansion plan designed in the short-term.

Direct the Higher Education Coordinating Board to develop a plan to utilize existing capacity in private colleges and universities. The plan should include provisions that hold the institutions accountable for meeting specific performance goals.

Funding

Secure sufficient revenues to support the higher education expansion plan. A combination of sources will likely be needed, including funds derived from prioritizing existing resources, savings generated by institutional reforms, tuition flexibility, and new state revenue.

Propose a source of revenue to the Legislature for higher education. This revenue source should have the following attributes:

- Primarily derived from individuals (in light of our state's disproportionate tax burden on business at present).
- Non-regressive (impacting individuals who benefit from higher education most, such as those with higher income).
- Responsive to inflation and growth.

Minority views: There was considerable discussion among Council members as to whether new revenue should come from a dedicated source or should be part of a larger discussion around tax reform. If new revenue were specifically dedicated to higher education, the state would lose the flexibility that an annual appropriation process

provides. On the other hand, because higher education funding is a discretionary expense, it often becomes the target of cuts necessary to balance the budget.

2.3.3 Long-term Strategies

Access

Monitor and adjust enrollments and acceleration opportunities, in keeping with student and workforce supply and demand reports.

Expand physical capacity, distance learning opportunities and extended use of existing facilities to accommodate increased access.

Funding

Periodic review of the performance goals established in the short-term.



3.0 K-12 EDUCATION

3.1 Introduction

Washington’s leaders have long recognized that an excellent K-12 education is a key component of a long-term strategy to improve the lives of Washington residents.

More recently, improvements in the K-12 system have become more urgent as leaders and residents alike recognize the importance of education to the quality of Washington residents’ lives and to the competitiveness of Washington’s businesses.

In 1993, the Washington State Legislature enacted the 1993 Education Reform Act, ESHB 1209. The central premise of the Education Reform Act was that that all students—not just those on the traditional, college-bound track—needed to be challenged to master core subjects like reading, writing, mathematics and science. A high school diploma based on process requirements (seat time) was no longer a ticket to a world of opportunities and options; it was skills and knowledge that mattered.

The Legislature created the Certificate of Mastery in ESHB 1209 to apply the principle that all students, not a select few, should achieve a common set of academic standards in core subjects. Almost 10 years have passed since this landmark legislation, and while schools have made steady progress, the Certificate of Mastery has not yet been implemented and achievement remains too low.

Given the incredibly high stakes for young people who lack skills once they leave school, this in no time to grow complacent. Clearly, public schools have not sufficiently adjusted from the 20th century “skills for some kids” model to the 21st century “higher skills for all kids” requirements. Several recent studies peg the state’s public school graduation rate at about 70 percent, meaning 30 percent of entering 9th graders don’t graduate in four years, and a high percentage of students are still not meeting the state’s reading, writing and mathematics standards, particularly in 10th grade.

Meanwhile, the outlook for well-paying opportunities for people without sufficient skills and knowledge continues to deteriorate. While the skill demands in new “high-tech” sectors have contributed, many new skill requirements have resulted from substantial shifts in “traditional” jobs. Employees in most sectors have had to incorporate new technologies and new organizational processes into their jobs. There will be jobs available for the low skilled in the future, but these jobs will pay poorly and offer few opportunities for advancement.

A decade into education reform efforts, it is clear that more work remains if Washington is to meet state and federal achievement and improvement goals. As the Seattle Times editorial board noted on Dec. 17, “Education is not done. The state has set goals, but we have not achieved them.” If Washington does not improve its high school graduation rates and college degree attainment rates, it is quite clear that vast numbers of residents will be excluded from participation in the innovation economy. For example:

- Only 38 percent of 10th graders passed all three WASL portions last year. If these students had been in the class of 2008, 62 percent of them would not have been on track to graduate. Mathematics is the subject that gives students the most trouble.

- Disaggregating the data makes it quite clear we have not broken the cycle of educational disadvantage that persists with low income and minority children.
- Of 100 children who enter the 9th grade, only 71 will graduate from high school, only 32 will go on to either a 2 or 4 year college, and only 16 will attain a degree.

The first Competitiveness Council report, published in January 2002, recognized that “human capital and innovation are the fundamental source of competitive advantage in the modern economy.” Among many other recommendations, the report urged that steps be taken to ensure that Washington students graduate from high school with the knowledge, skills and competencies necessary to prepare them for higher education, lifelong learning and rewarding careers.

Since the first report was published, several advances have been made in K-12 education. Scores on the Washington Assessment of Student Learning (WASL) continue to increase, showing continuing progress within the K-12 system. In addition, Washington has initiated several efforts to support greater student learning opportunities. The state has increased its efforts to assist low-performing schools by adding the capacity to assist 30 more schools in the Focused Assistance Program. The state is providing support to the Washington State Achievers Scholarship Program, which was created to address the disparity in college completion rates between children from low-income and high-income families by working with students in 16 high schools serving large low-income populations. Finally, the state has provided funding to support the development phase of the Digital Learning Commons, a technological means to improve access to educational opportunities and learning resources.

Clearly, K-12 reform is a continuous process. To improve the performance of our K-12 system, a wide variety of reforms are still needed, including better alignment with higher education and employer-led efforts, reform of state funding for schools and changes in the way teachers are compensated.

In this chapter, the Washington Competitiveness Council focuses primarily on the short-term changes that provide building blocks for more comprehensive reform in the future. If implemented, these changes will maintain momentum and continue the state’s progress toward making the K-12 system a source of competitiveness for Washington’s businesses and its citizens.

3.2 Long-term Vision

Washington State’s world-class education system provides every child an environment in which to learn and thrive, from early learning through higher education. This system is accountable for its impact not only on learning, but also for increasing the state’s competitiveness and decreasing poverty.

3.3 Recommended Strategies

3.3.1 Short-term Strategies

Advance an education reform agenda that includes the following components:

Certificate of Mastery/WASL

In 1993, the Legislature required the development of student academic content standards, also known as the Essential Academic Learning Requirements (EALRs), which define what K-12 students should know and be able to do. EALRs have been adopted in the content areas of reading, writing, communication, mathematics, science, social studies, arts, and health and fitness. The Legislature required the development of assessments to measure student attainment of the EALRs. Assessments, known as Washington Assessment of Student Learning, or WASLs, are currently available at 4th, 7th and 10th grades for reading, writing, listening and mathematics. Science assessments are at 8th and 10th grades. In addition, OSPI is developing reading and mathematics assessments for grades 3, 5, 6 and 8 to comply with the federal No Child Left Behind Act of 2001.

Currently, WASL results are used to measure progress in the K-12 system. The statewide results have identified differences in achievement for students of color, low income, English language learners and special needs. These differences are known as the achievement gap. Students' work on the WASLs is measured against state academic standards, but meeting those standards is not a specific requirement for grade matriculation or for graduation.

Recommendation: Include a Certificate of Mastery as a high school graduation requirement. Define Certificate of Mastery as passage of high school WASLs in reading, writing and mathematics in 2008, and add science in 2010. Offer multiple opportunities for students to pass the WASLs and provide for alternative and/or appeal means to demonstrate required mastery.

Learning Assistance Program Changes

Washington's Learning Assistance Program (LAP) is designed to help students needing additional time and assistance to achieve basic skills in reading, mathematics, language arts and readiness. School districts apply to the Office of Superintendent of Public Instruction for program funds, submitting a program/activity plan to the agency. The program funds are distributed to school districts using a formula that includes both student achievement on norm-referenced tests and a poverty factor.

Much of the structure of this program was established in 1989, including the activities that may be supported with program funds. With many states adopting education reform efforts in the 1990s, education research has further defined best practices for closing the achievement gap and assisting low-achieving students.

Recommendation: Focus LAP to target resources more efficiently, provide incentives for improvement, and offer technical assistance for struggling schools and districts.

Charter Schools

Under current law, public schools are publicly financed, governed by elected school boards, and subject to state laws and rules. Since 1991, 39 states have passed charter school legislation. Generally, charter schools are publicly financed but operate under a written contract with the charter sponsor, independent of many state laws and rules. The contract, or charter, details how the school will be organized and managed, what students will be taught and expected to achieve, and how success will be measured. Charter schools can be closed for failing to satisfy these contract terms.

Recommendation: Create a new class of independently operated educational units within the common school system. School districts, educational service districts and state or regional universities can sponsor these schools. Hold these schools to the same academic standards and WASL requirements as are required for other public schools.

Minority Views: The representatives of the Competitiveness Council representing Labor disagree with this recommendation. Creating charter schools will not improve the competitive environment of the state, so their endorsement is not appropriate in this report. Furthermore, voters have twice rejected charter schools proposals (1996 and 2000). Under present law, Washington's school districts are allowed the flexibility to provide various forms of alternative educational opportunities; other states may not have had this flexibility. There is little accountability for charter schools. They are not required to have the same transparency as public schools. They will not have publicly elected boards even though they will use public funds. The local school districts can be forced to accept a charter school but have no control over it.

Finally, charter schools do not live up to their promise. In a comprehensive study of existing charter schools, the American Federation of Teachers found, for instance, that "charter school students generally score no better (and often do worse) on student achievement tests than other comparable public school students." Furthermore, 10 percent of these schools fold because of fraud or mismanagement, perhaps because so many of the accountability measures that exist for public schools are waived. These schools are generally not required to follow health and safety regulations that are mandatory for public schools. They are often incapable of providing help for Spanish speaking students, do not have the economy of scale to provide free hot lunch programs, and do not have the funding to provide transportation—all of which disproportionately and negatively affect low-income disabled or non-English speaking students.

Levy Changes

In 1977, when the state assumed additional responsibility for funding schools, the Legislature limited school district maintenance and operation levy authority by enacting the levy lid law. This law determines the maximum amounts school district can collect through local maintenance and operations levies. Under current law, most districts may raise 24 percent of the district's levy base, which includes most state and federal revenues received by the district in the prior school year. When state K-12 program funding is reduced, the maximum school maintenance and operations levies are also reduced.

Recommendation: Expand the calculation of the levy base to account for state funding downturns for the purpose of determining school district maximum levy authority.

Reform/Consolidation of Early Learning Programs

In 2001, the Governor’s Office took administrative action to consolidate childcare and early learning programs in the state, the primary component of which was the creation of the Division of Child Care and Early Learning within the Economic Services Administration in the Department of Social and Health Services (DSHS).

Currently, childcare and early learning programs in the state are administered through three state agencies: the Department of Social and Health Services (DSHS), the Department of Community, Trade, and Economic Development (CTED), and the Office of the Superintendent of Public Instruction (OSPI).

Recommendation: Examine how existing early childhood education programs, including Head Start, Early Childhood Education and Assistance Program (ECEAP), the Working Connections Child Care Program and child care quality investments can become more efficient and effective by better coordinating their services.

3.3.2 Medium-term Strategies

Education Funding

The League of Education Voters’ Foundation has received a grant to develop a proposal for implementing a P-16 system in our state that would better integrate early childhood and higher education with the K-12 system, and better fund all three parts.

Recommendation: Members of the Competitiveness Council should be engaged in the dialogue about changes in the system for funding education from preschool to graduate school. The Council should ensure that competitiveness be one of the criteria for identifying priority needs and potential effective funding sources.

Math and Science Instruction

Mathematics is the subject area where the fewest students are meeting standard on the Washington Assessment of Student Learning. In the 2003 WASL, 39.4 percent of 10th graders met the standard in mathematics. The results from the first year of the science assessment show that there will be equal challenges in this subject area. As the state moves to implement the Certificate of Mastery graduation requirement, additional attention to math and science strategies will be required.

Recommendation: The Council should continue to support additional preparation and incentives for math and science instruction and additional student learning opportunities.

3.3.3 Long-term Strategies

In addition to the state requirement for all students to meet the Certificate of Mastery for graduation beginning in 2008, the federal “No Child Left Behind Act of 2001” requires schools and districts to get every child to state standards in reading and mathematics by 2014. The federal legislation describes a formula for getting children to the standards—called “adequate yearly progress” or AYP—and describes consequences for schools using federal Title I funds that fail to meet AYP over several years.

Recommendation: The following efforts, along with other best practices for closing the achievement gap, should be supported:

- Increased student access to advanced coursework in science, math and English.
- Smaller, more personalized learning environments and extended learning opportunities for students.
- Increased attention to shortages of teachers in selected subject areas and/or regions.



4.0 RESEARCH, DEVELOPMENT, AND COMMERCIALIZATION

4.1 Introduction

As one respected observer of state economic development has said, “The elements that make a state or regional economy vibrant and prosperous today are fundamentally different from those of the past. The new economics of place are driven by ability of states and regions to attract and expand science and technology assets and leverage them for economic development.”⁶

For Washington, this reality represents both an opportunity and a threat. It is an opportunity in that the state has a solid research base on which to build. Washington’s universities, federal laboratories and non-profit research institutions spend well over \$1 billion dollars on research and development (R&D) annually. Industry R&D in Washington totals more than \$7 billion per year, fourth among all states nationally. The state is home to many excellent research institutions, including the University of Washington, Washington State University, Pacific Northwest National Laboratory (PNNL) and the Fred Hutchinson Cancer Research Center—to name just a few.

Washington is home to major research centers for industry leaders such as Microsoft, Boeing, Weyerhaeuser, Intel, Sharp and Amgen, and innovators in global health such as the Bill & Melinda Gates Foundation, Program for Appropriate Technology in Health, (PATH) and the Seattle Biomedical Research Institute. Research and the resulting technologies have been an engine of economic growth and competitiveness for the state.

The threat lies in the newly competitive national and international environment in which we now operate. Other states and regions around the world are working night and day to amass science and technology assets of their own through carefully planned, government-supported, coordinated strategies. Our universities, federal laboratories and non-profit research institutions must compete ever more vigorously for federal and private research funding, and for the top scientists who attract such funding. Other states and regions effectively compete for our industrial research as well.

In this environment retention, much less expansion, of Washington’s research base is at great risk. In fact, Washington ranks 46th among all the states in per capita state spending on R&D in a period when visible state strategy, support, and matching contributions are deemed essential. Washington needs to do more to maximize the leverage from R&D for economic development by strengthening our means to effectively carry research results to commercial applications.

4.2 Long-term Vision

Washington’s university, federal, and non-profit research institutions, as well as their private sector counterparts, are recognized as world-class in their fields of excellence and

⁶ Ross DeVol with Rob Koepp and Frank Fogelbach, State Science and Technology Index: Comparing and Contrasting California, (Santa Monica: Milken Institute, September 2002).

actively participate in a strategically coordinated approach for attracting, leveraging and collaborating on important scientific and technological opportunities. The intellectual property they generate renews our current industry clusters and lays the foundation for the companies and industries of the future by supporting new business formation and growth. Excellence in research, development, and technology commercialization is an enduring source of our state's competitive advantage.

4.3 Recommended Strategies

4.3.1 Short-term Strategies

Substantially Increase State Support for Research and Development

As one committee member has noted, the research enterprise is a three-legged stool, relying on a combination of federal, industry and state funding. In Washington, the third leg—state support for R&D—is essentially missing. Some have questioned whether spending scarce resources in this area is worthwhile when Washington's research institutions can attract federal funding without state support. However, Washington's lack of support for R&D is becoming a critical competitive disadvantage. That is because growth in federal R&D budgets is flattening, federal funding agencies increasingly require "hard match," and investments by other states in their research institutions is increasing.

Invest in our Top-Ranked University Research Capacity. Foremost among our recommendations is for the state to more aggressively support the research enterprises at the University of Washington, Washington State University and other academic institutions in our state. We must continue to protect our current strengths and lead with them. The Competitiveness Council is not suggesting that the state become a "mini-NIH" or "mini-NSF," funding the types of research projects that would be suitable for federal funding. Rather, what is needed is strategically coordinated state funding of research capacity, making investments, for example, to attract and retain top scientists, build key facilities, purchase necessary equipment, provide hard match for federal funding, shore up competitively important areas of weakness, and provide seed funding to break into new fields. Such state support of academic research also helps to attract substantial federally funded programs, as many local and national examples suggest.

Bio 21. This approach is exemplified by the Bio 21 initiative now under development. As currently envisioned, this initiative would leverage our state's more than \$1 billion dollars of federal funding in the biological sciences to build a stronger economy and a healthier population. The Bio21 initiative will award grants to consortia of universities, federal laboratories, non-profit research institutions, health-care organizations and/or companies to build capacity for interdisciplinary research and development with high potential for commercialization and improvement in health care. The Competitiveness Council endorses the Bio21 concept and urges the state to develop additional programs to strengthen Washington's statewide research capacity for economic development.

Provide Tax Incentives for Research, Development and Commercialization

In its original report, the Competitiveness Council found that “taxes and fees significantly affect Washington businesses’ ability to compete. As businesses become increasingly mobile, they decide where to locate or expand based increasingly on the tax burden in a given locale.” It also concluded “Washington State’s initial tax burden on business is one of the highest in the nation.” Therefore, the Council recommended that “Washington should . . . maintain existing [tax] exemptions and incentives,” including research and development tax incentives.

Extend R&D Deferrals, Exemptions and Tax Credits for R&D. Two such exemptions are critical. In 1994, the Legislature enacted two tax incentives to stimulate private sector R&D. Chapter 82.63 RCW allows a deferral/exemption from retail sales and use tax for qualified investment in R&D facilities and machinery. RCW 82.04.4452 provides a credit against state B&O tax for qualified expenditures in R&D. Both incentives are restricted to firms in one of five designated “high technology” industries: advanced computing; advanced materials; biotechnology; electronic device technology; and environmental technology. Under current law, the sales tax deferral/exemption terminates on July 1, 2004, and the B&O tax credit expires on December 31, 2004. The committee strongly urges the Legislature and the Governor to extend these incentives and to clarify that the universities are “persons” eligible for the R&D sales and use tax deferral/exemption.

Exempt SBIR and STTR awards from B&O Tax. In addition, under current law, recipients of funding provided by the federal government to qualified companies under the Small Business Innovation Research (SBIR) Program and the Small Business Technology Transfer (STTR) Program must pay the B&O tax on funds received. According to the journal, “Red Herring,” Washington is the only state that taxes SBIR awards. The committee urges the legislature and the governor to exempt SBIR awards from the B&O tax.

4.3.2 Medium-term Strategies

Develop a Comprehensive Strategy for University Technology Transfer

Technology developed at the state’s research universities is a major source of innovation for creating, expanding and retaining the companies that are building Washington’s future. For example, research conducted at the University of Washington has led to the creation of more than 170 new companies. To achieve this, research results must move through a challenging sequence of technology transfer activities beginning with invention disclosure, followed by patent application, issuance of a patent, execution of licenses or options and finally new company creation. In addition to the legal process, technology transfer requires the interaction among scientists that allows for the transfer of knowledge and expertise.

While the quantity and quality of research with commercial potential clearly influences the number of technologies with potential for commercialization, a variety of other

factors threaten to restrict the number of resulting licenses and companies. These factors include the following:

- Resources available to university technology transfer offices for undertaking such costly tasks as making and prosecuting patent applications and identifying matches between companies and technologies are insufficient to take advantage of applied and basic research being developed at the universities.
- State ethics law interpretations and university personnel policy limit the human interaction necessary to share the knowledge required for successful commercialization. These constraints include limits on faculty consulting for outside companies, restrictions on faculty and the universities from taking equity positions in new products and companies, and limits to mobility of faculty between the private sector and universities.

The factors mentioned above may also limit the universities' ability to recruit and retain outstanding faculty with interests and proven track records in technology commercialization.

The Competitiveness Council believes that this area is of critical importance, and that the state, in partnership with the universities and industry, should develop a comprehensive strategy for the transfer of university-developed technology for commercialization. We believe such a strategy can be developed within a 12- to 18-month time frame.

Develop an Enterprise Infrastructure to Support Startup Companies

Companies in emerging industries benefit strongly from facilities that are economical and in close physical proximity to the researchers who are developing related technology. Biotechnology companies in particular require wet-lab space, which the speculative real estate market is not always prepared to provide, especially for short-term lease. In addition, such companies often need access to management, marketing and financial expertise.

The Council recommends that the existing state-sponsored technology organizations, in partnership with the state, universities, industry, and other stakeholders, undertake a "gap analysis" to determine how this infrastructure might be strengthened and expanded. This analysis should be conducted in close coordination with the development of the technology transfer strategy recommended above, or could be combined with it into an overall "Commercialization Strategy" for the state.

4.3.3 Long-term Strategies

Leverage Health Care Infrastructure to Attract Federal Resources

Communities and organizations in eastern Washington have made an extensive investment in an integrated, technologically advanced health care infrastructure. Utilizing this infrastructure, hospitals and physicians across the region are able to electronically collect and exchange complete patient information, resulting in more efficient delivery of care and better clinical outcomes. This integrated information network is unique in the United States and provides health care researchers, biotechnology companies, and research and development organizations with an

unprecedented opportunity to develop and test new models, products and services that will enhance the public's health.

The Council recommends that the state develop measures to inform researchers and investors of the opportunities afforded by this infrastructure to maximize limited state and federal resources, promote job creation in eastern Washington, and improve healthcare.

Expand, Coordinate and Market our Statewide Academic, Private and Federal Research Capacity

We underscore the urgent near-term priority for state support for research capacity in the state's universities and private research institutions. However, a longer-term, strategically balanced R&D infrastructure that continues to include prominent industry research centers, as well as federal laboratories, is also critical to Washington's competitive future.

Industry R&D in Washington totals over \$7 billion annually, placing Washington ninth overall (and fourth per capita) among all states. Much of this is performed at Microsoft and Boeing. While often less noticed than university, non-profit, and federal R&D, industrial R&D is a key contributor to Washington's competitiveness and is a significant engine for job growth, as documented by the Department of Revenue. Other states have recently landed major new private R&D facilities, such as Novartis in Massachusetts.

Similarly, Washington is home to PNNL, a major state asset with a staff of 3800 and business volume of \$550 million. PNNL's assets include such world-class instrumentation as the nation's fastest super computer performing unclassified work and the world's largest and most stable magnetic imaging system for chemical, biological and materials research. However, since PNNL is the only major federal laboratory based in Washington, the state's share of federal R&D is much smaller than that of other states such as Maryland, Virginia and California.

Accordingly, the Competitiveness Council recommends that the state find ways to encourage the retention, expansion, coordination and promotion of Washington State's wide-ranging capacity in academic, federal and private sector research. Strategies to support research in our state could include recruitment of new R&D facilities and expansion of PNNL programs in strategically important fields, as well as pursuing additional federal research facilities for Washington.



5.0 TAXES, REGULATIONS, AND INFRASTRUCTURE

5.1 Introduction

When the Competitiveness Council first convened in August 2001, the Council chose to focus on four areas for competitive analysis:

- Taxes and fees.
- Environmental regulatory and permitting system.
- Physical infrastructure.
- Human capital and innovation.

In Phase II, the Competitiveness Council is focusing primarily on human capital and innovation issues. However, the Competitiveness Council is still concerned about the three other competitiveness areas.

A great deal has been accomplished since the Council issued its original recommendations. In October 2003, the Council issued a summary of its accomplishments related to the original recommendations. Of the 58 recommendations relating to taxes, regulation and infrastructure, 17 have been accomplished and 27 have significant work underway. Only 14 have yet to make significant progress⁷.

While this is an impressive start, additional progress and vigilance are clearly required. We must continue to monitor the benchmarks recommended in the original Competitiveness Council report to ensure that our competitiveness continues to improve as other states and nations challenge our position and struggle to improve their own competitiveness.

This Competitiveness Council has identified a short-term, medium-term, and long-term agenda for ensuring that we continue to improve our business climate related to taxes, regulations and infrastructure.

5.2 Long-term Vision

The original Competitiveness Council developed a competitiveness vision for Washington that included the following:

- A tax system that balances revenue needs for essential services with a competitive tax environment that provides ease of application and consistency with other states.
- A regulatory environment that values protection of the environment, worker safety and consumers while providing regulatory certainty for business and a positive attitude about customer service.

⁷ A summary of progress made on each of the initial recommendations is found at <http://www.governor.wa.gov/wcc/scorecard.pdf>

- Transportation, water and energy infrastructure that support a thriving and growing economy.

This Competitiveness Council reaffirms this long-term vision and recommends a number of steps that can be taken by state and local leaders, business and labor communities, and voters, to realize this long-term vision.

5.3 Recommended Strategies

5.3.1 Short-term Strategies

Transportation Funding

In January 2002, the Competitiveness Council's Phase I final report made a strong statement that the most important competitive investment the state of Washington can make is to improve its transportation infrastructure. That report pointed out that while population, employment, vehicle miles traveled and tonnage of goods and freight moved on Washington's roads have grown a great deal over the previous 20 years, annual investments in transportation have actually declined in real terms. The Council called for a transportation solution that included new statewide funding, performance measures and regional funding.

In 2003, the Legislature passed, and the Governor signed, a 10-year transportation improvement plan that provides \$4.2 billion in new transportation investments across the state, clarifies regional transportation authority and includes reforms, efficiencies and greater accountability. That was a great start, but more is needed. The Blue Ribbon Commission estimated that \$50 billion in new transportation revenue is required to meet Washington's transportation needs. These needs include freight mobility projects that are critical for the competitiveness of our ports and our export- and import-dependent industries.

Taxpayers across the state cannot be expected to pay for all of these improvements, particularly those that will primarily benefit citizens and businesses in the Puget Sound area. Thus, these needs must be met by a combination of statewide and regional funding sources.

In 2002, the Legislature provided the citizens of King, Pierce and Snohomish Counties an opportunity to make direct investments in the region's transportation system. In 2003, the Legislature made changes to improve the equity of the regional transportation plan. Subject to voter approval, the Regional Transportation Investment District could tap specific local revenue sources, including a local option gas tax of up to 10 percent of the state gas tax, or 2.8 cents per gallon.

A 26-member planning committee is working toward putting a regional transportation investment plan before the voters in these counties. The executive board has selected a preliminary list of projects to be considered for inclusion in the transportation investment plan. The transportation investment plan will include a detailed financial plan that will identify specific types and levels of taxes and fees being proposed.

Recommendation: The Competitiveness Council supports additional statewide and local funding solutions for transportation problems. The Council recommends: (1)

passage of a regional transportation investment and finance plan; (2) that the Legislature provide greater local government authority for local-option gas tax, including direct approval; (3) flexibility and authority to develop other financing mechanisms, such as user fees and public/private partnerships; and (4) an increase in the state gas tax of 3 to 5 cents for the 2004 legislation session, and additional increases thereafter. Some of this gas tax should be dedicated to freight mobility projects.

Taxation of Research and Development

In 1994, the Legislature enacted two measures designed to help offset the impact of state taxes for firms that conduct research and development in specific technology areas: advanced computing; advanced materials; biotechnology; electronic device technology; and environmental technology. RCW 82.04.4452 provides a credit against state B&O tax for qualified expenditures in R&D. Chapter 82.63 RCW allows deferral/exemption from retail sales and use tax for qualified investment in R&D facilities.

These exemptions are scheduled to expire during 2004. The sales tax deferral/exemption terminates on July 1, 2004, while the B&O tax credit expires on December 31, 2004.

When the Legislature passed these incentives, they also required an assessment of and report on these programs in the years 1997, 2000 and 2003. The most recent of these reports includes the following findings:⁸

- 1,311 firms have taken the B&O tax credit for a total of \$204 million.
- 393 projects have accounted for \$323.9 million in sales tax deferrals.
- Most of these credits and deferrals are claimed by companies in urban counties.
- 39 percent of firms taking the B&O tax credit and 27 percent of firms taking the sales and use tax deferral/exemption report that they are new businesses in Washington. However, very few report that they relocated to Washington to take advantage of the incentives.
- 10 percent of the firms taking the credit say they have built new facilities in the past five years.
- 44 percent of the firms taking the credit have expanded because of creating a new product or service.
- Washington's share of high technology jobs has remained about the same over the last decade.
- R&D spending by firms taking the B&O tax credit has increased as a percentage of national R&D spending from .8 percent in 1995 to 2.3 percent in 2002.
- Patents for firms in Washington's high technology sectors have increased 180 percent after enactment of the incentives. Almost half of the increase is attributable to the data processing/software patent class.

⁸ See http://www.dor.wa.gov/docs/reports/2003/High_Tech_RandD_Study_2003/stats_contents.asp for the full text of the study.

- Rural county high technology employment has declined somewhat for three years for which data are available – 1997, 1998 and 1999.
- The Department of Revenue also developed an econometric model to estimate the employment impact of the incentives. The model compared the employment of firms in the 1993-94 period (before incentives were enacted) with the same firms' employment in the 1997-98 period (after incentives were enacted). Some of these firms took both the R&D B&O tax credit and the R&D sales tax exemption. Some of the firms took only one incentive; some took no incentives. The econometric equations held all other factors constant (such as firm size and industry), so that the effect of the incentives on employment could be isolated. The results showed the following:⁹
 - ✓ For the study years 1997-1998 there was a strong association between the R&D sales and use tax exemption and growth in jobs for the firms included in the study.
 - ✓ During that same period and for the same firms, the analysis did not demonstrate a connection between the R&D B&O credit and growth in jobs.

Recommendation: Support the extension of statewide tax credits for R&D and rural-area sales tax exemptions in the 2004 legislative session. Include the universities as beneficiaries of the sales tax exemption. This legislation should include the following provisions to allow for evaluation of the impact of the credits:

- Clear identification of the public purpose of the exemption as well as measurement standards to gauge whether the purpose is met.
- Information about employment, wages and benefits.
- A sunset of the exemption.
- Claw-back provisions similar to that in the existing law¹⁰.

Minority Views: The members of the Council representing Labor do not support an extension of the R&D tax exemption unless the following public protections and conditions are included, in addition to those listed above:

- Proof that the company actually needs the exemption in order to carry on the R&D.
- Job quality standards, which require wages of at least the county, average wage and employer paid health care and pension benefits.
- Time limitation on individual companies receiving the exemption.

⁹ The Department of Revenue offers the following caveats to these results: (1) The 1997 - 1998 period may be a unique period because of the high economic growth in the high tech sector. The magnitude of these results would change if applied to different time periods because of different economic circumstances. (2) Results are based on 467 firms that were engaged in business both before and after enactment of the high tech incentives. The results are specific to these 467 firms only.

¹⁰ 82.63, the deferral for sales taxes on R&D facilities, requires that taxes be repaid if the facility is used for purposes other than qualified research and development or pilot scale manufacturing for the first year the exemption is claimed or during any of the seven succeeding calendar years. The amount of the payback is tied to the number of years during which the nonqualifying use occurs.

- Redefinition of proprietary information and public disclosure of companies receiving the exemption and their track record in achieving the purposes of the exemption.

Budget Process: Need for Vigilance

In August of 2002, Governor Locke initiated a budget process to identify results that Washington residents most want from state government, provide strategies for achieving those results and allocate spending within existing resources. This government-wide assessment and evaluation of state services had several purposes:

- Establish a clear set of results that citizens expect from state government.
- Reprioritize state spending to focus on services that matter most in achieving those goals.
- Use this prioritization process to guide the Governor's December 2002 budget proposal to the Legislature.

The result was a budget proposal that was disciplined and creative in delivering the results that matter most to Washington citizens.

The Legislature responded to the Priorities of Government (POG) process by passing a budget that closely reflected the results of the POG process. This proposal did not include a general tax increase.

Plans are underway to put in place the systems and processes needed to institutionalize the POG process and to ensure that future budgets can be developed in this way. For example:

- State agencies are improving the activity inventories that were essential to determining the relationship between spending and results.
- Indicators of success for each of the ten critical results have been identified and plans are in place to collect and publish the data over time.
- Computer systems are being redesigned to enable the activity-level budget process.

Recommendation. Develop the tools needed to continue the Priorities of Government budgeting process. Ensure that this approach is used in the 2005-07 budget.

Minority Views: The labor community could consider institutionalizing the POG process if Labor and groups representing various community interests were included in the assessment and evaluation process, and if the process also included an assessment and evaluation of state tax expenditures (exemptions). The 2002 process included only government and some businesses and only looked at one side of the fiscal equation.

Regulatory Performance Measurement

When the Competitiveness Council issued its Phase I final report in January of 2002, many of its 99 recommendations focused on regulatory reform. The Council was especially interested in reform at the Department of Ecology because the council believed that Ecology's procedures introduced unnecessary uncertainty, delay and costs to projects that were needed to boost economic vitality throughout Washington State.

The Department of Ecology has instituted an agenda to transform the agency to improve the timeliness and predictability of its permitting and regulatory processes, as well as to cultivate a supportive and problem-solving culture built on helpful, responsive and knowledgeable governmental service—without lowering environmental standards. Ecology’s actions toward this agenda include the following:¹¹

- Establish and meet timeliness performance targets to focus on timely permit decisions.
- Clarify permit processes through flowcharts, guidance materials and better information on the Internet.
- Institute pre-application conferences in Ecology’s regional offices to provide information to applicants in a face-to-face setting and to clarify expectations.
- Continuously improve permitting processes, including those for transportation projects.
- Improve customer service based on information gathered from members of the Regulatory Performance Advisors’ Group and customer surveys.

While progress that has been made, there is much more to be done, and the progress that has been made must not be lost. To ensure continued progress, permitting agencies must set targets for permit processing time and be held accountable for meeting them. Although the Legislature created an Office of Regulatory Assistance in the 2003 session, this office does not have the authority to require that permitting agencies set performance benchmarks and hold them accountable. Furthermore, other state, federal, and local agencies should follow Ecology’s lead by instituting their own measures for permit streamlining and customer service.

A model for sharing these best practices currently exists in Snohomish County, where the Economic Development Council uses a loaned executive from the Boeing Company to assist cities with system analysis and quality improvements processes in their permit departments. These improvements have led to dramatic reductions in permit process times and re-submittals for three jurisdictions in Snohomish County.

Recommendation: In the short-term, amend the powers of the Office of Regulatory Assistance to include establishment and monitoring of permit timeliness benchmarks for permitting agencies. On an ongoing basis, continue to monitor the Department of Ecology’s process for improving customer service. Support their benchmarking process and insist on explanations for underperformance relative to benchmarks. Adopt regulatory performance benchmarking for other agencies. Develop a method for sharing best practices among state agencies and local governments.

Tax Increment Financing

Tax increment financing (TIF) is a method for funding economic development infrastructure based on the principle of “pay as you grow.” It funds necessary public

¹¹ For a complete summary of Ecology’s progress toward these goals, see <http://www.ecy.wa.gov/quality/service/transform.htm>.

infrastructure for economic development with the tax revenue generated by the resulting economic activity. TIF exists in many forms in 48 states.

Washington has experimented with TIF several times over the past few decades, but has not been able to fully implement TIF. In 1995, the court ruled in *Leonard vs. Spokane* that diversion of state property taxes from school funding was unconstitutional. A limited form of TIF, one that does not include state funding, was passed in 2001 and is currently being used in Spokane.

Governor Locke proposed a partnership between the state and local TIF projects. This proposal, called Economic Development for a Growing Economy (EDGE), will provide up to \$5 million per year in state matching funds for local governments that use TIF to invest in publicly owned infrastructure projects that promote economic development and increase state revenue. The matching funds are delivered to local governments through credits against the state sales tax. The proposal passed the Senate in the 2003 session as ESSB 5364.

Recommendation: Support the passage of the Governor's EDGE proposal in the 2004 legislative session. This proposal should include several safeguards including an open public process for TIF projects and protection of school district tax revenues.

Minority Views: The members of the Council representing labor will only consider the EDGE legislation if the following additional public protections are included:

- TIF infrastructure development performed at prevailing wages.
- Disclosure of company-specific data on wages by wage bands and employer provided health and retirement benefits for all companies benefiting from the TIF.
- Anti-displacement language to protect local businesses and workforces.
- Local hire agreements.

Rural Technology Development

Washington's rural economy lags the metropolitan economy on a number of measures.¹²

- **Employment, unemployment and employment growth.** Although unemployment in metropolitan areas has been relatively high since the beginning of the recession, some of the most persistently high unemployment rates are found in the most rural areas such as Ferry, Klickitat, Skamania, Pend Oreille and Grays Harbor counties. Employment growth from 1980 to 2000 was about 75 percent in metropolitan counties, but only about 40 percent in nonmetropolitan counties.
- **Income.** Per capita income in metropolitan counties in 2001 was \$33,722, while in nonmetropolitan counties it was only \$23,304.

At least some of this difference is due to the differences in the industrial makeup of rural and metropolitan areas. Rural areas tend to be dominated by educational and other services and natural resource-based industries, while employment in metropolitan areas is

¹² Unemployment statistics from the Washington Department of Employment Security, <http://www.wa.gov/esd/lmea/lmeahome.htm>. Data on employment growth and personal income are from Northwest Income Indicators Project, <http://niip.wsu.edu/>.

more varied and includes the technology companies that pay typically higher wages than do service industries. According to the Department of Employment Security, the five highest paying occupations are management, computer and mathematical, architecture and engineering, legal, and healthcare. Thus, increasing the rural economy's share of employment in these areas could improve wages and income for rural residents.

The rural-urban gaps in income and employment have existed for many years. Many steps have been taken by the Legislature and the Governor to narrow the rural-urban prosperity gap. These include:

- Sales tax exemption for manufacturing and technology facilities in rural areas (this tax exemption expires in July 1, 2004).
- B&O tax credits for help-desk and software development in rural areas (scheduled to expire December 31, 2003).
- Infrastructure development programs, such as the Community Economic Revitalization Board and the Rural County Sales tax credit program.
- The WSU Rural Telework project.

In some cases, these programs have generated considerable success. Examples include:

- The Satsop Development Park, where infrastructure investments have led to the creation of hundreds of technology industry jobs.
- Klickitat County, where a CERB investment in an industrial building has facilitated the growth of two high technology aerospace-related businesses.
- Mount Vernon, where investments in telecommunications have allowed for the location and expansion of Web EKG.

Despite this success, rural areas continue to struggle to attract and grow technology-based companies. These companies tend to want to cluster with other technology companies and to locate close to sources of capital and the opportunity to network with other entrepreneurs. To encourage companies to bring good-paying jobs to rural communities, we must ensure that those communities have the infrastructure and services required for these companies to prosper and grow. Tax incentives can provide additional motivation to companies to locate and grow their companies outside the urban areas.

Recommendation: Support the extension of the rural tax credits for construction of manufacturing and technology facilities in rural areas.

5.3.2 Medium-term Strategies

Workers' Compensation

According to the report published out by the Washington Alliance for a Competitive Economy, Washington had the fourth highest workers' compensation benefits level in the nation in 2001. Data developed by the Oregon Department of Consumer and Business Services show that Workers Compensation premiums in Washington ranked 44th in the

nation in 2002.¹³ Other states have raised their rates by an average of 50 percent nationally over the past three years.

Although it appears that the comparative cost of workers' compensation insurance is not a serious competitiveness issue, the Council is concerned about the trend in workers' compensation premiums and other factors that could lead to greater increases in the future. In 2002, L&I proposed a 40.5 percent increase in rates for 2003. During a series of public hearings, employers explained that the increase was too much to absorb in a single year and should be phased in. The agency eventually adopted a 29 percent general rate increase, warning that it was inadequate to cover liabilities, and that another rate increase would be needed in 2004. The Department of Labor and Industries proposed a 19.4 percent rate increase in 2004. However, the actual increase, effective January 1, 2004, will be 9.8 percent.

In addition, several recent court cases have expanded or threaten to expand benefits and therefore to increase the cost of the system. The *Cockle* decision called for inclusion of the value of employer-provided medical insurance in the calculation of wages for the purpose of determining the appropriate amount of time-loss benefits. A pending case seeks to expand the wage definition to include employer-provided retirement benefits. Another recent court case, *Avundes*, ruled that the department must consider the worker's intent, among other criteria, in determining whether a worker's employment pattern is "seasonal or intermittent." To determine the level of time-loss compensation benefits, seasonal or intermittent workers' wages are calculated based on the monthly average for a representative year, while other workers' benefits are based on their wage at the time of injury.

In 2003, the Legislature passed, and the Governor signed, a bill that addressed an additional issue that threatened to increase the cost of workers' compensation. Prior to this law, there was no effective time limit on the filing of claims for hearing loss. Late filing of claims made it virtually impossible for L&I to determine the percentage of hearing loss that was job-related versus the normal ageing process. SB 5274, proposed by the Department of Labor and Industries, requires that workers file hearing loss claims within two years of their last injurious exposure to qualify for a permanent partial disability award.

Despite this progress, it is important to work toward additional reforms that will address the cost of the system, including those highlighted in the recent *Avundes* and *Cockle* decisions.

Recommendation: Develop a forum to discuss further reform of the workers' compensation system. Through that forum, develop a package of proposals agreed to by labor and business to be brought forward in the 2005 legislative session.

¹³ Statistics on workers compensation benefits and premiums compared to other states are provided in the 2004 WashACE Competitiveness Redbook, which can be obtained from the Association of Washington Business.

Minority Views: The labor members of the Competitiveness Council are open to discussing changes to the workers' compensation system with the business community but we believe that the Competitiveness Council is not the forum for this discussion given the makeup of the Council and the narrowness of the Council's perspective.

Taxes and Revenue

The Competitiveness Council's report of January 2002 stated, "Taxes and fees are significant factors that impact Washington State's ability to promote and maintain economic vitality and business competitiveness in the state." Washington's tax system has been identified as a negative factor in the state's competitiveness due to its comparatively high business tax burden. Total state and local tax collections per \$1,000 of personal income in Washington is relatively low—\$107.53 in 2000, compared with the national average of \$112.28. However, the percentage of the tax burden collected from business is relatively high. The Department of Revenue estimates that in Fiscal Year 2000, businesses directly paid 46 percent of major state and local taxes compared to a western states' average of 30 percent.¹⁴

This relatively high business tax burden can have a negative effect on economic growth and state revenue. If companies choose to invest elsewhere due to the tax burden, the state may collect less revenue. Thus, addressing the business tax burden is not only a competitiveness issue, but also an issue of fiscal stability.

Washington State will continue to face serious budget issues for the 2005-07 Biennium. Current projections estimate that the budget gap for this two-year period is approaching \$1 billion. This budget gap assumes baseline expenditure, plus several expected policy changes. It does not anticipate many of the policy changes sought by the Competitiveness Council, including increased funding for research and higher education. It also does not address the relatively high business tax burden in the state of Washington.

The ongoing fiscal problems facing Washington reflect, in part, a structural imbalance in our tax system. The Washington State Tax Structure Study Committee was created by Engrossed Substitute Senate Bill (ESSB) 6153 to report to the Legislature by November 30, 2002, on "how well the current tax system functions and how it might be changed to better serve the citizens of the state in the twenty-first century." The Commission concluded that Washington's tax system causes sharp fluctuations in revenue, is inequitable for low- and middle-income people, and is unfair to many businesses, noting that "serious and fundamental changes are warranted." The Commission recommended a number of alternatives to the current tax structure. They offered suggestions for major replacement alternatives as well as incremental changes to the current tax structure that will improve its viability.¹⁵

Recommendation: Examine alternative state and local tax structures, including personal and corporate income tax, with the goals of developing a distribution of taxes more similar to other states, decreasing the business tax burden and increasing the stability of the revenue system.

¹⁴ Washington State Tax Structure Study Committee. *Tax Alternatives for Washington State: A Report to the Legislature*. P. 42. http://dor.wa.gov/content/WAtaxstudy/Final_Report.htm.

¹⁵ Washington State Tax Structure Study Committee. *Tax Alternatives for Washington State: A Report to the Legislature*. http://dor.wa.gov/content/WAtaxstudy/Final_Report.htm.

Minority Views: Labor has long supported a progressive income tax in Washington State, but has not taken a position on a flat-rate income tax. More importantly, Labor is not in agreement that the purpose of considering an income tax is to lower the share of taxes paid by businesses. A discussion about an income tax must be part of a larger discussion about revenue needs and fairness.

5.3.3 Long-term Strategies

Competitiveness of the Ports

A healthy maritime industry creates and sustains family-wage jobs throughout the economy of Washington State. Aside from the direct jobs associated with cargo shipping, the maritime industry supports jobs in warehouses, distribution centers, export and import services, and export-dependent industries such as agriculture and manufacturing. At least one in four jobs in Washington State is linked to international trade. According to a recent economic impact study, maritime commerce along the Columbia-Snake river system sustains 40,000 jobs directly and another 59,000 jobs indirectly. Another study indicates there are over 87,000 direct trade-related transportation jobs in central Puget Sound.

Many factors determine how and where trade happens. Although Washington's geographic position is a natural economic asset, much of the trade that comes in to our ports is discretionary. Major employers such as shippers, distributors and manufacturers make daily decisions based on the speed, reliability, and overall cost of moving cargo. These decisions affect the volume of cargo passing through our ports and along our railroads and highways, support many thousands of jobs, and sends hundreds of millions of dollars into state and local treasuries. Major employers engaged in trade also determine the site of a major distribution center or manufacturing facility, or whether to move business elsewhere due to cost, congestion, customers, supply chain, regulations or other reasons.

It is essential, therefore, to identify the obstacles to the competitiveness of our ports. One is the development of land adjacent to port property in a way that is incompatible with port and airport operations or port-designated uses. This often creates demands for mitigation, adds to the costs of port operations, and depletes resources needed for infrastructure investment.

Recommendation. Ensure the continued competitiveness of the ports. Guard against government or private attempts to pursue land use changes on property adjacent to ports that would lead to incompatibility with port operations or intended port use, or would otherwise result in additional port burdens and costs. Protect ports and airports of statewide significance from user fees, unreasonable mitigation costs, or other burdens potentially damaging to ports' competitiveness and ability to attract trade, passengers and economic development.