

# Agenda2005

The Guide to Public Policy Issues in Washington State



Edited by Paul Guppy



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in Washington State

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**Foreword**  
by  
**Daniel Mead Smith, President**

Major changes are happening in our state. With a new governor and a newly-elected legislature, Washington's leaders face many challenges in the upcoming legislative session. Policymakers will be looking for fresh ideas backed by solid research. That is the basis for Washington Policy Center's first book, *Agenda 2005: The Guide to Public Policy Issues in Washington State*.

The ideas and recommendations presented in this policy guide are centered on the core principles that have guided our work since our founding, and assist us in our mission to promote free-market solutions through accurate research and education. The goal of our organization, and this publication, is to present ideas so policymakers can make wise and lasting policy choices to improve the lives of the people of our state.

The principles of free markets outlined in the Introduction provide the organizing framework for the book. *Agenda 2005* offers innovative ideas, ranging from incremental to sweeping, for reforming and improving government performance.

The theme of the book centers around the concepts of smaller, more efficient government, tapping the power of the market to improve quality and lower costs of public services, letting taxpayers keep more of what they earn, improving access to and lowering the cost of health care for citizens and state workers, improving the business climate and streamlining government rules and regulations.

Each chapter is divided into a number of topical subsections for easy reference. Each subsection includes background on the issue, policy analysis and specific policy

recommendations, as well as listing additional resources for further information on each issue.

I encourage you to contact us at (206) 937-9691 or [wpc@washingtonpolicy.org](mailto:wpc@washingtonpolicy.org) with your comments or to order additional copies of this book, the accompanying CD-Rom, or any of our individual studies.

I also encourage you to use our legislative website, [www.WashingtonVotes.org](http://www.WashingtonVotes.org) as a resource during the legislative session. This free website summarizes every bill and allows users to search bills by issue, track bills during session and keep track of how legislators vote, all in an easy to use, plain-English format.

For policymakers, we thank you for your service to our state and hope you will find this guide useful as a resource during the upcoming legislative session; and for citizens, we encourage you to keep our recommendations in mind as the new governor and legislature outline their plans for 2005.

Our special thanks go to the M.J. Murdock Charitable Trust in Vancouver, Washington for providing the initial grant funds and the majority of the support for this project. This book would not have been published without their enthusiastic and early support.

On behalf of our board of directors, advisory boards and staff (all of which are listed at the end of the book), thank you for your interest in our work and in making Washington a better place to live, raise a family and run a business.

*Note on sources. Most sources for the facts presented in this Policy Guide are given in notes at the end of each chapter. Additional sources and information are available by contacting Washington Policy Center.*



## INTRODUCTION

### **Seven Principles of Sound Public Policy for Washington**

by Lawrence W. Reed  
Adjunct Scholar

Washington's elected leaders, as well as ordinary citizens who care about the direction of the state, are rightly concerned about the specific pressing issues of the day. From transportation to education to health care and countless other important topics; each issue requires informed debate, careful deliberation and practical solutions. To help make sense of the immense volume of information and the broad range of policy choices, policymakers and citizens need to be guided by certain enduring principles.

That is why it is important to step back from the minutiae of any particular issue and consider the core standards that are applicable to *every* issue. These are the critical fundamentals, bedrock concepts that derive from centuries of experience and economic knowledge. They are, in my view, eternal principles that should form the intellectual backdrop to what we do as policymakers inside and outside of government.

It is fashionable for policymakers to tell people they approach all questions with an open mind. Whatever that may mean, to me it does not equate with an *empty* mind. We have learned a few things over the centuries. It is not uninformed bias that prompts us without debate to accept the notion that the sun comes up in the east. It isn't blind ideology that tells us that a representative republic is superior to dictatorship or monarchy. Washington Policy Center approaches issues with the core assumption that private property and free market economies are superior to state ownership and central planning.

That's not just one man's superficial opinion; rather, it is now one of the settled truths among people who have their eyes and ears open and for whom reason, logic, facts, evidence, economics and experience mean something.

The “Seven Principles of Sound Public Policy for Washington” described here are pillars of a free economy. Reasonable people can differ on exactly how any one of them may apply to a given issue of the day, but the principles themselves, I believe, are settled truths. They are not original with me; I have simply collected them in one place. They are not the only pillars of a free economy or the only settled truths, but they do comprise a pretty powerful package. In my belief, if every cornerstone of every state and federal building were emblazoned with these principles – and more importantly, if every legislator understood and attempted to be faithful to them – we would be a much stronger, much freer, more prosperous, and far better governed people.

**Principle #1:** *Free people are not equal, and equal people are not free.*

First, I should clarify the kind of “equalness” to which I refer in this statement. I am not referring to equality before the law – the notion that you should be judged innocent or guilty of an offense based upon whether or not you did it, and your race, sex, wealth, creed, gender or religion should have nothing to do with it. That's an important foundation of Western Civilization and though we often fall somewhat short of it, I doubt that anyone here would quarrel with the concept.

No, the “equalness” to which I refer is all about income and material wealth – what we earn and acquire in the marketplace of commerce, work, and exchange. I am speaking of *economic* equality. Let's take this first principle and break it into its two halves.

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*Free people are not equal.* When people are free to be themselves, to be masters of their own destinies, to apply themselves in an effort to improve their well-being and that of their families, the result in the marketplace will not be an equality of outcomes. People will earn vastly different levels of income; they will accumulate vastly different levels of wealth. While some lament that fact and speak dolefully of “the gap between rich and poor,” I think people being themselves in a free society is a wonderful thing. Each of us is a unique being, different in endless ways from any other single being living or dead. Why on earth should we expect our interactions in the marketplace to produce the same results?

We are different in terms of our talents. Some have more than others, or more valuable talents. Some don’t discover their highest talents until late in life, or not at all. Magic Johnson was a talented basketball player. Should it surprise anyone that he made infinitely more money at basketball than I ever could?

We are different in terms of our industriousness, our willingness to work. Some work harder, longer, and smarter than others. That makes for vast differences in how others value what we do and in how much they’re willing to pay for it.

We are different also in terms of our savings. I would argue that if the President could somehow snap his fingers and equalize us all in terms of income and wealth tonight, we would be unequal again by this time tomorrow *because some of us would save it and some of us would spend it*. These are three, but by no means the only three, reasons why free people are simply not going to be equal economically.

*Equal people are not free*, the second half of my first principle, really gets down to brass tacks. Show me a people anywhere on the planet who are indeed equal economically, and I’ll show you a very *unfree* people. Why?



The only way in which you could have even the remotest chance of equalizing income and wealth across society is to put a gun to everyone's head. You would literally have to employ force to make people equal. You would have to give orders, backed up by the guillotine, the hangman's noose, the bullet, or the electric chair, that would go like this: Don't excel. Don't work harder or smarter than the next guy. Don't save more wisely than anyone else. Don't be there first with a new product. Don't provide a good or service that people might want more than anything your competitor is offering.

Believe me, you wouldn't want a society where these were the orders. Khmer Rouge Cambodia in the late 1970s came close to it, and the result was that upwards of two million out of eight million people died in less than four years. Except for the elite at the top who wielded power, the people of that sad land who survived that period lived at something not much above the Stone Age.

What is the message of this first principle? Don't get hung up on differences in income when they result from people being themselves. If they result from artificial political barriers, then get rid of those barriers. But don't try to take unequal people and compress them into some homogenous heap. You'll never get there, and you'll wreak a lot of havoc trying.

Confiscatory tax rates, for example, don't make people any more equal; they just drive the industrious and the entrepreneurial to other places or into other endeavors while impoverishing the many who would otherwise benefit from their resourcefulness. Abraham Lincoln is reputed to have said, "You cannot pull a man up by dragging another man down."

**Principle #2:** *What belongs to you, you tend to take care of; what belongs to no one or everyone tends to fall into disrepair.*

This essentially illuminates the magic of private property. It explains so much about the failure of socialized economies the world over.

In the old Soviet Empire, governments proclaimed the superiority of central planning and state ownership. They wanted to abolish or at least minimize private property because they thought that private ownership was selfish and counterproductive. With the government in charge, they argued, resources would be utilized for the benefit of everybody.

What was once the farmer's food became "the people's food" and the people went hungry. What was once the entrepreneur's factory became "the people's factory" and the people made do with goods so shoddy there was no market for them beyond the borders.

We now know that the old Soviet Empire produced one economic basketcase after another, and one ecological nightmare after another. That is the lesson of every experiment with socialism: while socialists are fond of explaining that you have to break some eggs to make an omelet, they never make any omelettes. They only break eggs.

If you think you're so good at taking care of property, go live in someone else's house, or drive their car, for a month. I guarantee you neither their house nor their car will look the same as yours after the same period of time.

If you want to take the scarce resources of society and trash them, all you have to do is take them away from the people who created or earned them, and hand them over to some central authority to manage. In one fell swoop, you can ruin everything.

**Principle #3:** *Sound policy requires that we consider long-run effects and all people, not simply short-run effects and a few people.*

It may be true, as Keynes once declared, that “in the long run, we’re all dead.” But that should not be a license to enact policies that make a few people feel good now at the cost of hurting many people tomorrow.

I can think of many such policies. When Lyndon Johnson cranked up the Great Society, the thought was that some people would benefit today from a welfare check. We now know that over the long haul, the federal entitlement to welfare encouraged idleness, broke up families, produced intergenerational dependency and hopelessness, cost taxpayers a fortune, and yielded harmful cultural pathologies that may take generations to undo. Likewise, policies of deficit spending and government growth – while enriching a few at the start – have eaten at the vitals of the nation’s economy and moral fiber for decades.

This principle is actually a call to be thorough in our thinking. It says that we shouldn’t be superficial in our judgments. If a thief goes from bank to bank, stealing all the cash he can get his hands on, and then spends it all at the local shopping mall, you wouldn’t be thorough in your thinking if all you did was survey the store owners to conclude that this guy stimulated the economy.

We should remember that today *is* the tomorrow that yesterday’s poor policymakers told us we could ignore. If we want to be responsible adults, we can’t behave like infants whose concern is overwhelmingly focused on self and on the here-and-now.

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**Principle #4:** *If you encourage something, you get more of it; if you discourage something, you get less of it.*

You and I as human beings are creatures of incentives and disincentives. We respond to incentives and disincentives. Our behavior is affected by them, sometimes very powerfully. Policymakers who forget this will do dumb things like jack up taxes on some activity and expect people to do just as much of it as before, as if they are sheep lining up to be sheared.

Remember when George Bush (the first one) reneged under pressure on his 1988 “No New Taxes!” pledge? We got big tax hikes in the summer of 1990. Among other things, Congress dramatically boosted taxes on boats, aircraft and jewelry in that package. They thought that since rich people buy such things, we should let ‘em have it with higher taxes. They expected \$31 million in new revenue in the first year from the new taxes on those three things. We now know that the higher levies brought in just \$16 million and we laid out \$24 million in additional unemployment benefits because of the people thrown out of work in those industries by the higher taxes. Only in Washington, D.C., where too often lawmakers forget the importance of incentives, can you aim for 31, get only 16, spend 24 to get it and think that somehow you’ve done some good.

Want to break up families? Offer a bigger welfare check if the father splits. Want to reduce savings and investment? Double-tax ‘em, and pile on a nice, high capital gains tax on top of it. Want to get less work? Impose such high tax penalties on it that people decide it’s not worth the effort.

Lawmakers in Olympia will have to deal with a budget deficit because increases in revenues haven’t kept up with increases in spending. The Washington Policy Center believes that government ought to deal with such circumstances the way families all across the state deal with similar circumstances: curtail spending. That is especially true if we want to stimulate

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a weak economy so it will produce more jobs and more revenue. When the patient is ill, the doctor doesn't bleed him.

**Principle #5:** *Nobody spends somebody else's money as carefully as he spends his own.*

Ever wonder about those stories of \$600 hammers and \$800 toilet seats that government sometimes buys? You could walk the length and breadth of this land and not find a soul who would say he would gladly spend his own money that way. And yet, it often happens in government and sometimes in other walks of life too. Why? Because invariably, the spender is spending somebody else's money.

Economist Milton Friedman elaborated on this when he pointed out that there are only four ways to spend money. When you spend your own money on yourself, you make occasional mistakes but they are few and far between. The connection between the one who earned it, the one who is spending it, and the one who is reaping the final benefit is pretty strong.

When you use your money to buy someone else a gift, you have some incentive to get your money's worth but you might not end up getting something the intended recipient really needs or values. When you use somebody else's money to buy something for yourself, such as lunch on an expense account, you have some incentive to get the right thing but little reason to economize.

Finally, when you spend other people's money to buy something for someone else, the connection between the earner, the spender and the recipient is the most remote – and the potential for mischief and waste is the greatest. Somebody spending somebody else's money on yet somebody else – that's what government does all the time. Nobody – repeat, *nobody* – spends someone else's money as carefully as he spends his own.

**Principle #6:** *Government has nothing to give anybody except what it first takes from somebody, and a government that's big enough to give you everything you want is big enough to take away everything you've got.*

This is not some radical, ideological, anti-government statement. It is simply the way things are. It speaks volumes about the very nature of government. And it is perfectly in keeping with the philosophy and advice of America's Founders.

George Washington once said, "Government is not reason. It is not eloquence. It is force. Like fire, it can be a dangerous servant or a fearful master." Think about that for a moment. Washington was saying that even if government is no bigger than he wanted it to be and even if it does its work so well that it indeed is a *servant* to the people, it is still a dangerous one! As Groucho once said of Harpo, "He's honest, but you've got to watch him." You've got to keep your eye on even the best and smallest of governments because, as Jefferson warned, the natural tendency is for government to grow and liberty to retreat. At the risk of adding yet another quote to this paragraph, it was Alexander Hamilton who wisely told us that "Control of a man's subsistence is control of his will."

The so-called "welfare state" is really not much more than robbing Peter to pay Paul, after laundering and squandering much of Peter's wealth through an indifferent, costly bureaucracy. The welfare state is like feeding the sparrows through the horses, if you know what I mean. Put another way, it is like all of us standing in a big circle, with each of us having one hand in the next guy's pocket. Somebody once said that the welfare state is so named because in it, the politicians get well and the rest of us pay the fare.

A free and independent people do not look to government for their sustenance. They see government not as a fountain of "free" goodies but rather as a protector of their liberties, confined to certain minimal functions that revolve

around keeping the peace, maximizing everyone's opportunities, and otherwise leaving us alone. There is a deadly trade-off to reliance upon government, as civilizations at least as far back as ancient Rome have painfully learned.

When a congressman comes home and says, "Look what I brought for you!" you should demand that he tell you who is paying for it. If he is honest, he will tell you that the only reason he was able to get you something was that he had to vote for the goodies that other congressmen wanted to take home – and you're paying for all that too.

**Principle #7:** *Liberty makes all the difference in the world.*

Just in case the first six principles didn't make the point clearly enough, I have added this as my seventh and final one.

Liberty is not just a luxury or a nice idea. It is much more than a happy circumstance or a defensible concept. It is what makes just about everything else happen. Without it, life is a bore at best. At worst, there is no life at all.

Public policy that dismisses liberty or does not preserve or strengthen it should be immediately suspect in the minds of a vigilant people. They should be asking, "What are we getting in return if we are being asked to give up some of our freedom?" Hopefully, it is not just some short-term handout or other "mess of pottage." Ben Franklin went so far as to advise us that "He who gives up essential liberty for a little temporary security deserves neither liberty nor security."

Too often today, policymakers give no thought whatsoever to the general state of liberty when they craft new policies. If it feels good or sounds good or gets them elected, they just do it. Anyone along the way who might raise liberty-based objections is ridiculed or ignored. Today, government at all levels consumes more than 42 percent of all that we produce, compared to perhaps six or seven percent in 1900. Yet, few

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people seem interested in asking the advocates of still more government such cogent questions as “Why isn’t 42 percent enough?,” “How much more do you want?,” or “To what degree do you think a person is entitled to the fruits of his labor?”

I think these seven principles are profoundly important. Our past devotion to them, in one form or another, explains how and why Americans fed, clothed, and housed more people at higher levels than any other people in the history of the planet. And they are key to preserving that crucial element of life we call liberty. Hopefully, lawmakers and all people participating in the governing of Washington state will work to put them into practice.

*Lawrence W. Reed is an Adjunct Scholar of Washington Policy Center and President of the Mackinac Center for Public Policy in Michigan. Washington Policy Center and the Mackinac Center are members of The State Policy Network.*





# Chapter 1: State Budget Reform

## 1. Structural Budget Reforms

### Recommendations

1. Restore reasonable limits on the growth of public spending.
2. Enact into law the Priorities of Government process to set clear standards for state spending and to slow the rate of spending increase.
3. Adopt a constitutionally protected emergency reserve fund with a well-defined trigger mechanism.
4. Sell non-essential real-estate holdings.
5. Allow the state auditor to conduct performance audits.

## Background

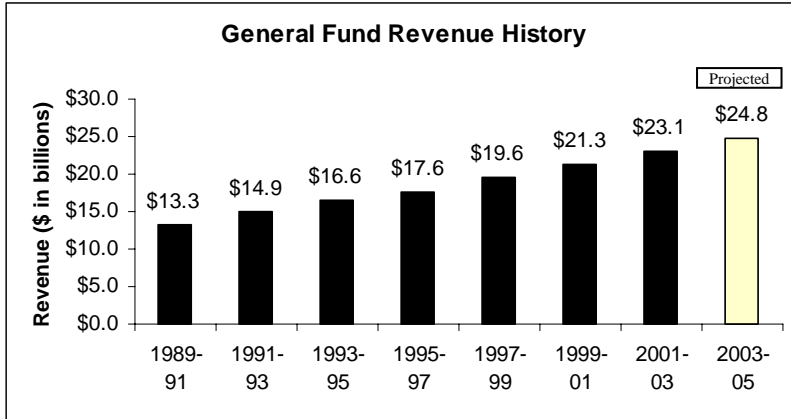
State legislators and the new governor will face another serious budget deficit for the current biennium. A sluggish economy, coupled with temporary budget fixes enacted in past legislative sessions, regularly leave the state with a budget shortfall. Lawmakers face a projected budget deficit for the next biennium of over \$700 million.<sup>i</sup>

Yet tax revenue flowing into the state treasury is steadily increasing. Tax revenue collected by the state has grown 5.4 percent in 2004, and is projected to increase again in 2005.<sup>ii</sup> General fund revenues in the 2003-05 biennium are estimated at \$23.1 billion, and for 2005-07 revenues are projected to grow to just under \$24.8 billion. The resulting boost of \$1.7 billion in revenues represents an increase of 7.3 percent, or roughly

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twice the rate of inflation.<sup>iii</sup> The steady rise in state tax revenues is shown in figure 1.

Figure 1.



Although the amount of money the state collects from citizens is increasing, the rate of state spending is rising at an even faster rate. The projected deficit is the gap between the increased level of planned spending and the actual increase in tax revenues.

During the 1990s, a time of unprecedented economic prosperity when there was less pressure on social services, state government spending still rose at a rapid pace. Instead of controlling spending and preparing for the downturn that was certain to come, state policymakers sharply increased spending and left the treasury with few reserves to help maintain services during difficult economic times.

The result of this approach to fiscal policy is an ongoing financial crisis in which recurring deficits have become an endemic part of the budget process.

## Policy Analysis

In 1993 voters passed Initiative 601 to limit the annual growth of state spending to inflation plus population growth.<sup>iv</sup> The limit worked for a time. In the four legislative sessions prior to 1993 state spending grew by an average 12 percent each biennium. Following the adoption of spending limits, growth in the cost of government slowed to an average of 8.6 percent per biennium.<sup>v</sup> But over the years legislators gradually suspended those restrictions and the rate of annual spending growth again increased.

Returning to effective spending limits would provide Washington taxpayers with the kind of protection the people of Colorado have enjoyed since 1992, when they enacted the Taxpayers Bill of Rights (TABOR).<sup>vi</sup> The TABOR law limits the amount of tax revenue the state can keep each year to the sum of inflation plus population growth. Any taxes collected above this amount must be returned to taxpayers in the form of rebates.

The Colorado legislature must seek voter approval before it can collect taxes above the TABOR limit. In addition, voters made the limit part of Colorado's constitution, so it cannot be weakened in the ordinary budget process. Colorado lawmakers do not harbor unrealistic expectations about how much tax money they will be collecting in the years ahead. This in turn serves to keep unsustainable government spending in check.

A separate effort to rationalize Washington's budget structure was initiated by Governor Gary Locke in 2002 when he established his Priorities of Government process.<sup>vii</sup> The process requires each agency, in putting together its proposed budget for submission to the legislature, to rank program activities in order of their importance to the public.

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The process is centered on three strategies: 1) View state government as a single enterprise; 2) Achieve results, at less cost, through creative budget solutions; and 3) Reprioritize spending, eliminating programs by consolidating similar activities in different agencies.<sup>viii</sup> As the governor described it, Priorities of Government means “focusing on results that people want and need, prioritizing those results, and funding those results with the money we have.”

Permanently reforming the budget process based on this approach would create a finance system that is durable, fair and flexible, and provides needed government services at lower cost to taxpayers. Participants at Washington Policy Center’s 2003 Statewide Small Business Conference chose Priorities of Government as their number one recommendation for lowering the tax burden and reforming the overall budget process in our state.

As a protection against future budget shortfalls, policymakers should consider implementing a constitutionally protected emergency reserve fund, as was recommended by the Washington State Tax Structure Study Committee.<sup>ix</sup>

A reserve fund protected by constitutional safeguards and a well-defined spending trigger would help protect state services against unforeseen revenue downturns. As with any source of funding, there will be significant pressure for legislators to appropriate money from the fund to spend on politically popular programs.

For an emergency fund to be effective, then, it must be protected from the normal appropriations process until the state actually has a fiscal emergency. To accomplish this a number of mechanisms can be used. One is to require a supermajority of 60 percent of the legislature to authorize use of the fund. This is a common tool used in many states, but it often proves difficult to maintain. Washington has a reserved fund, but legislators temporarily lifted the requirement of a 60 percent

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majority vote to spend money from it. Ironically, the vote to lift the restriction was approved by a simple majority.

Another alternative is to set a trigger that allows the legislature to appropriate money from the fund when certain economic indicators are met. For instance, the trigger could be set to allow appropriations out of the fund when state tax revenue drops more than 10 percent from the previous biennium. Like Colorado's TABOR, the reserve trigger should be part of the state constitution so it cannot be easily disregarded by legislators.

Another structural budget savings would be for the state to sell its non-essential real estate holdings. State government owns approximately nine percent of the land in the state, totaling almost 3.9 million acres. Much of the state's portfolio consists of essential lands that serve the public interest: forest trusts that help pay for public schools and universities, the state's network of 125 parks and of course hundreds of public buildings.

Since 1889, however, the state has acquired properties that never did or no longer serve a public purpose, or which it could lease back at much lower cost. In an example from the private sector, Zymogenetics, a Seattle-based biotechnology company, sold its headquarters building in 2002, then leased it back for a term of 15 years. The move allowed the company to get out of a business – real estate – that is not its core competency and at the same time raise \$52 million in cash. Through a simple leaseback arrangement the firm made money, saved itself the headache of owning and managing a large corporate campus, and retained use of the building for its own needs.<sup>x</sup>

A regular system of performance audits is another structural way the state can save taxpayer money. In Colorado, performance audits completed in June 2000 identified over \$12 million in savings from easily adopted policies, and \$41 million

in additional near-term efficiency improvements.<sup>xi</sup> In Florida, an audit of the budget system helped the legislature and the governor enact changes that will significantly improve efficiency.<sup>xii</sup> In Texas, performance audits over an eight-year period identified total savings of \$8.1 billion.<sup>xiii</sup>

In Washington the Joint Legislative Audit and Review Committee (JLARC) conducts a limited number of performance audits. The quality of JLARC research is excellent, but it only audits specific programs as directed by the legislature, which significantly restricts its effectiveness.

In 2002, the governor approved three limited audits, but only one was to be conducted by the independently-elected State Auditor: a review of the state's claims and benefits systems, comprising industrial insurance, food stamps and other programs.<sup>xiv</sup> The governor's Office of Financial Management was directed to perform the other two audits.<sup>xv</sup> While a promising start, three strictly-limited performance audits are not enough to effectively track down waste and inefficiency in the state's many multi-billion dollar programs.

Resolving recurring budget deficits requires a new approach to government reform. To avoid a seemingly constant state of crisis, Washington policymakers should adopt practical policy changes, like those suggested here, that fundamentally alter the way the state manages its budget. Reducing the long-term structural costs of government will ease the burden placed on taxpayers and ensure that future economic slowdowns do not force the state into yet another financial emergency.

Structural budget reforms make state government become more efficient, provide higher-quality services to the public and help control the high tax burden shouldered by Washington citizens.

## Recommendations

**1) Restore reasonable limits on the growth of public spending.** Returning to reasonable budget limits similar to those of Initiative 601, but as part of the state constitution, would bring greater discipline to public finances. It would also ensure that future levels of public spending are sustainable and, most importantly, help restore citizens' confidence in their government's willingness to manage costs.

**2) Enact into law the Priorities of Government process to set clear standards for state spending and to slow the rate of spending increases.** The Priorities of Government standard initiated by Governor Locke has proved successful, and it should be legally enacted as a permanent part of the budget process. Priorities of Government is an effective guide to executive branch budget officers as they prepare their spending requests for the legislature.

**3) Adopt a constitutionally protected emergency reserve fund with a well-defined trigger mechanism.** The legislature has easily tapped into "emergency" funds in the past to boost routine spending. For that reason it is important for the fund to be constitutionally protected, with a specific trigger, so it contributes to budget continuity and stability, and ensures emergency reserves are available for use in a true emergency.

**4) Sell non-essential real-estate holdings.** Policymakers should evaluate the real estate holdings of each state agency to determine if taxpayers would be better served by selling the property. Those that are not of benefit to the public should be sold to raise revenue and to reduce costs to the state. In other cases the state may benefit from leasing facilities that it needs, rather than owning them outright.

**5) Allow the state auditor to conduct performance audits.** The auditor should be allowed to conduct comprehensive performance audits of agency programs to identify waste and

overlapping regulations, and to help restore the public’s trust in state government.

## 2. Public Workforce Policy

### Recommendations

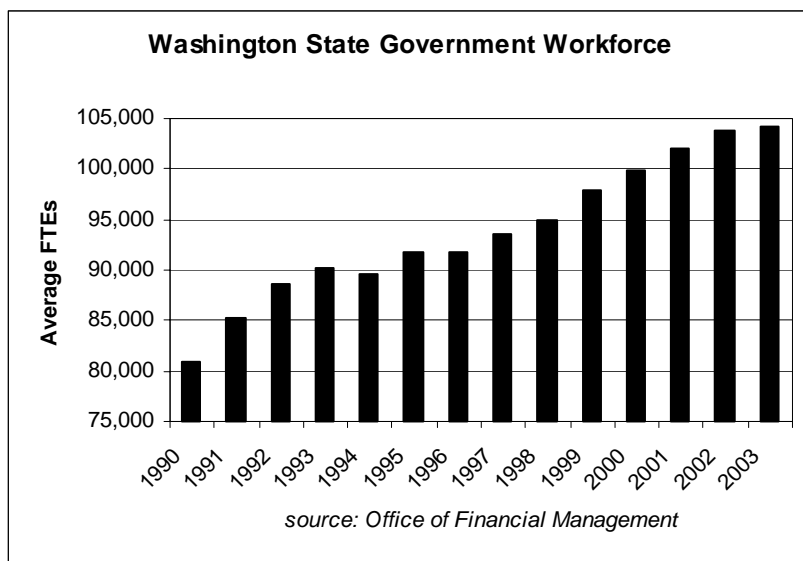
1. Adopt a flexible freeze on state hiring.
2. Eliminate positions vacant more than six months.
3. Achieve savings through employee incentive “gainsharing” program.
4. Reduce the number of state boards and commissions.

### Background

Since 1990 state employment has grown by over 23,000 employees, rising faster than the state’s population and reaching more than 104,000 FTEs (full-time equivalent positions) in 2003,<sup>xvi</sup> making the state by far the largest employer in Washington. The steady rise in state public employment in recent years is shown in figure 1.



Figure 1.



## Policy Analysis

Maintaining the present growth rate in the state workforce will eventually push the cost of government beyond what taxpayers can bear. A change in workforce policy is needed to reduce the pressure a rising permanent payroll places on public budgets. A number of ideas for achieving this goal are presented here.

### Flexible freeze and eliminating vacant positions

Adopting a flexible freeze on state hiring would reduce state employment growth, while allowing agency managers to maintain existing staffing levels – by prioritizing new hiring where it is most needed – while ensuring the overall size of state government does not continue to grow. This approach maintains the flexibility necessary for agency managers to focus on the most important programs and maintain adequate service levels.

Average annual compensation for full-time state employees tops \$53,000. This includes a salary of more than \$42,000, a generous benefits package including medical and dental insurance, a 401(k) retirement plan, minimum 12 days paid vacation and 10 paid holidays each year, combined with protective union rules that virtually guarantee lifelong employment.<sup>xvii</sup>

At the same time, the average annual salary for a typical Washington state resident is about \$33,000.<sup>xviii</sup> During an economic downturn many people in the private sector face a reduction in pay or the loss of their jobs, while government workers are generally assured employment with regular raises.

A major cost driver of state government is the number of people on the public payroll. These are desirable, good-paying jobs with excellent benefits. But taxpayers expect government to be about more than providing good jobs to those in the state workforce. A starting point in reducing built-in personnel costs would be to eliminate the hundreds of positions that have been vacant for six months or more.

### **“Gainsharing”**

Organizations in the private sector often develop innovative compensation tools to help retain quality workers and to reward them for coming up with ideas that save money. Government agencies consistently struggle to offer performance incentives that match those available in the private sector – programs that increase morale, reward high performance and help reduce the cost of running state government. Budget constraints, fractured, short-term planning and strict civil service laws form a barrier to incentive programs that can improve worker performance and boost flagging morale.

In the late 1990s Baltimore County, Maryland faced a similar problem and as part of the solution the county

government implemented an idea called Gainsharing.<sup>xix</sup> The Gainsharing program encourages frontline employees to recommend and implement projects that reduce cost and improve customer service. Fifty percent of approved savings are distributed to the employees who implemented the proposal and the other fifty percent is returned to the general fund. In one example, employees in the Dietary Division of the Bureau of Corrections found ways to streamline and improve the meal preparation system, saving the county more than \$150,000. As a result, the thirteen employees that designed and carried out the changes received one-time checks of more than \$5,000 each.<sup>xx</sup>

### **State boards and commissions**

Washington state government includes over 400 appointed boards and commissions.<sup>xxi</sup> Most boards and commissions advise agencies and policymakers on constituent interests or industry practices, or serve as professional oversight or certification bodies. Some were created years ago to serve a legitimate public need, but have long since outlived their purpose.<sup>xxii</sup>

In many cases, the services provided by the board or commission can easily be turned over to private organizations and professional partnerships. A fee on a particular industry or type of business provides funds for many commissions. In these cases, there is no need for the industry group to be accredited by the government. Instead, such commissions should be organized as private entities and funded by the businesses concerned. Often state commissions are created only to satisfy certain political constituencies. Eliminating some of these boards and commissions may anger some influential interest groups, but will not jeopardize, and in fact may improve, vital services to Washington residents.

## Recommendations

**1) Adopt a flexible freeze on state hiring.** Under a flexible freeze the state workforce could be reduced without state employees losing jobs. In most circumstances, unfilled positions are eliminated and retirees are not replaced.

**2) Eliminate positions vacant more than six months.** If a position remains open for more than six months, it is reasonable to assume the agency can do its work without an employee in that position. By eliminating these vacant positions the state can cut budgeted payroll in areas that are obviously not critical to public safety or the basic functioning of state government. This policy would provide more accurate budget information for the legislature and would lower costs to taxpayers.

**3) Achieve savings through employee incentive “gainsharing” program.** While this program may not be feasible for all government agencies, those that effectively implement it can achieve significant cost savings, improve services and reward workers for creative thinking, with no risk to state operations or budgeting.

**4) Adopt a five-year sunset and review period for state boards and commissions.** The legislature should establish a mandatory five-year sunset review for all boards and commissions. Those that are no longer needed would automatically expire. Those the legislature determines are still needed could be re-authorized for a further five-year term.

### 3. Competitive Bidding for Public Services

#### Recommendations

1. Encourage state agencies to save money and improve service to the public by using competitive bidding authority.
2. Protect agency competitive bidding authority from being restricted or bargained away during mandatory collective bargaining negotiations.

#### Background

The state's tight financial situation lends fresh urgency to the use of competitive bidding as a long-term way to bring rising spending under control. Competitive bidding allows state agencies to open work normally performed only by in-house employees to bids from a variety of sources. Public employees are allowed to bid for contracts along with contractors from the private sector. Introducing competition allows government managers to provide improved services at lower cost to taxpayers.

Until recently state law, based on a court ruling in the 1978 Spokane Community College case that was later codified by the legislature, held that any work historically performed by state workers had to always be performed by state workers.<sup>xxiii</sup> Private companies were not allowed to submit bids to see if the same amount and quality of work could be done at lower cost.

In 2002 the legislature, as part of a larger collective bargaining and civil service reform measure, enacted a law which gives state agencies, starting in July 2005, the authority to open work contracts to competitive bidding.<sup>xxiv</sup>

## Policy Analysis

Washington Policy Center research has identified four key benefits that show how competition can successfully improve quality and ease the budget strain of a core government program. These are presented below.

### Four Benefits of Competitive Bidding

- 1) Lower cost. Private companies are disciplined to seek efficiencies through the need to operate at a profit while providing superior service at a competitive price. By employing the techniques of competition, public managers find efficiencies within their operations and lower the cost of performing a service.
- 2) Higher service levels. Monopolies, whether public or private, frequently lack the stimulus to innovate and improve service delivery. By opening services to competition governments can upgrade services and achieve cost savings.
- 3) Better management. Government can streamline its operations by using the same accounting procedures and productivity measures that the private sector uses, which are more accurate and comprehensive than traditional government methods.
- 4) Changed government culture. When a government seeks dynamic competition over a monopoly status quo its culture changes. Instead of performing many functions with limited expertise, governments that are open to competition liberate themselves to perform a smaller set of core functions better than ever before, while leaving much of the routine work to contractors.

Across the country, more state governments are opening services that were once performed exclusively by government

agencies to competitive bidding. Taxpayers are becoming less satisfied with public leaders who deliver declining levels of service while calling for ever-higher levels of taxation.

## **Recommendations**

### **1) Encourage state agencies to save money and improve service to the public by using competitive bidding authority.**

Many opportunities for competitive contracting exist throughout state government. Experience from other states shows typical cost savings of 10 to 25 percent when agency managers introduce open competition for government work. Chapters 10 and 7 give some examples of public services in Washington that could be opened to competitive bidding.

### **2) Protect agency competitive bidding authority from being restricted or bargained away during mandatory collective bargaining negotiations.**

The same law which authorized competitive bidding also makes it subject to negotiations between management and labor in the collective bargaining process. Policy makers should insure that this valuable efficiency tool is not blocked by public sector unions.

#### 4. The State Liquor Monopoly

##### Recommendation

Privatize the state's liquor sales and distribution monopoly while retaining current alcohol taxes, health and safety regulations, and public education programs.

##### Background

Founded in 1934 in response to the repeal of Prohibition, the Liquor Control Board is a three-person board whose members are appointed by the governor to six-year terms. The Board oversees the sale and distribution of alcoholic beverages in the state. Its budget for the 2001-2003 biennium was a little over \$140 million, with 1,265 employees.<sup>xxv</sup> In 2004 the Board collected more than \$209 million in taxes and license fees.

Seventy-five percent of the Board's employees work in the Product and Retail Sales Division. The Division is a monopoly business owned and run exclusively by the state, selling more than 1,000 liquor products through a network of 157 state-owned retail stores. In addition to its own outlets, the Board contracts with independently-owned liquor stores to sell its products.<sup>xxvi</sup> The Board also oversees a Licensing and Regulation Division, and an Enforcement and Education Division which employs 85 Liquor Enforcement Agents.

##### Policy Analysis

Prohibition was strongly supported in Washington state, and when the 18th Amendment was repealed state leaders responded to the public's desire for as much government control over liquor as possible by creating the current monopoly system. Since then, however, the public's attitude toward the



consumption of hard spirits has changed and the Liquor Control Board's original rationale no longer exists.

Since its original mission has long since disappeared, the state should get out of the liquor sales business and allow the Board to focus efforts on inspection, enforcement and public education. The state could then do a better job of policing alcohol sales, because it would not at the same time be trying to profit from the sale of alcohol.

A further advantage of privatization is that the state would no longer shoulder the financial risk and responsibility of purchasing, storing, distributing and selling liquor to Washington residents. For example, the Board's new 160,000 square foot warehouse was completed months behind schedule at more than \$5 million over budget.<sup>xxvii</sup>

Taxes on liquor sales would continue to be collected, but taxpayers would no longer be required to support a sprawling distribution and sales network.<sup>xxviii</sup> In return, tax revenue once used to pay for large storage warehouses, delivery trucks, storefronts, long-term capital expenses and future state employee retirement benefits could be redirected toward increased enforcement and balancing the state budget.

Privatizing the sales and distribution of liquor would generate new tax revenue in two ways. First, existing stores that start selling liquor would pay Business and Operating tax on those sales. Second, where private operators assume ownership of a formerly state-owned liquor store, the new owners would begin paying property and business taxes on a commercial activity that is currently tax exempt.

## **Recommendation**

**Privatize the state's liquor sales and distribution monopoly while retaining current alcohol taxes, health and safety regulations, and public education programs.** Privatizing the

sale and distribution of liquor would bring a number of advantages to the people of Washington. Innovation and competition in the marketplace would lead to more revenue for the state, better service and wider choice for consumers. The Liquor Control Board would then be free to concentrate on alcohol tax collection, license enforcement and public health and safety.

## 5. Activity-Based Costing

### Recommendation

Adopt activity-based costing to enable state agency managers to identify the true cost of government services and to find ways to identify unnecessary expenses.

### Background

To create the 2003-2005 budget proposal, Governor Locke used a new Priorities of Government budgeting process that relies on consolidating detailed agency activity information and prioritizing each different activity based on pre-established criteria.<sup>xxix</sup> To establish the most effective use of scarce public resources, it is important for program managers and budget planners to have the most accurate and timely cost data for each agency activity.

Agency managers are consistently faced with difficult decisions about the best way to administer state services. Often managers simply do not have access to the information they need to make important decisions – such as whether to provide a service in-house or through a contractor, or whether the cost of a service outweighs the benefits.

### Policy Analysis

Lawmakers can strengthen the Priorities of Government process by implementing Activity-Based Costing (ABC).<sup>xxx</sup> ABC is a method of cost analysis designed to describe all the cost elements of a certain activity, not just the major factors like labor, benefits, supplies and depreciation. In the private sector ABC is used to account for every hour of work and each piece of equipment involved in a project, including capital, facility and overhead costs for an organization, allowing managers to make informed decisions about the use of scarce resources.

Activity-Based Costing is not a novel, untested concept. It has proven effective in cities and states across the nation. Texas Comptroller of Public Accounts Carole Keeton Rylander found, in a 1998 pilot program, that, in a government setting, Activity Based Costing can:

- Help agencies identify ineffective and wasteful activities.
- Reveal the cost of individual services.
- Encourage changes that improve efficiency.
- Prompt reviews of organization procedures when costs appear to be out of line.
- Provide reliable data for making comparisons with the private sector.
- Help to establish reasonable rates for paying private-sector contractors.

In 1992, Indianapolis Mayor Stephen Goldsmith implemented activity based costing in agencies throughout the city. Using the new analysis tool city workers reduced the cost of plowing snow from \$117 per mile to \$38 per mile and cut the cost of sealing cracks along the highway from \$1,200 per lane-mile to \$737 per lane-mile.<sup>xxx1</sup>

In another example, ABC helped the Iowa Department of Transportation generate \$200,000 in new revenue in 1996 and reduced the time needed to paint stripes on state highways. By developing a comprehensive cost analysis of three major activities – center line and no-passing marks, edge-line markings and curb, island and miscellaneous markings – the Department reduced unproductive down-time and began performing work for other governments during the time they saved.<sup>xxxii</sup>

With similar planning and organization, and a new focus on Activity-Based Costing, state agencies can achieve similar efficiencies in the way they provide public services.

## **Recommendation**

**Adopt activity-based costing to enable state agency managers to identify the true cost of government services and to find ways to identify unnecessary expenses.** In recent years voters have repeatedly displayed their lack of trust in the way government spends their money. New programs that clearly show how state government can do more with less will give citizens the confidence to approve funding for the legitimate infrastructure and service needs of the state.

## **Additional Resources**

### Washington Policy Center Research

“A Policy Guide for Budget Reform: Strategies for Improving State Government Services and Reducing the Deficit,” by Eric Montague, January 2003

“Ideas for Balancing the State Budget Without Raising Taxes,” by Eric Montague, January 2002

“25 Commonsense Ways To Implement Initiative 695,” by Paul Guppy, December 1999

### Other Resources

Reason Public Policy Institute Los Angeles, CA, [www.rppi.org](http://www.rppi.org).

“The California Performance Review,” managed by Reason Public Policy Institute and published by the California State Government, offers comprehensive budget reform recommendations, many of which would be effective here in Washington state. For more visit [www.rppi.org](http://www.rppi.org) or [report.cpr.ca.gov](http://report.cpr.ca.gov).

Privatization.org - This website offers a wealth of information about cost-saving ways to deliver high quality government services through privatization.

Mackinac Center for Public Policy - A pioneer in the development of responsible state budget policy. For more on the success they have seen in Michigan and recommendations that would work for Washington state, visit [www.mackinac.org](http://www.mackinac.org).

“The Other Path: the Economic Answer to Terrorism,” by Hernando De Soto, Basic Books, New York, NY, 1989.

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Mercatus Center at George Mason University - A research institution focusing on regulatory reform. [www.mercatus.org](http://www.mercatus.org).

“Using Activity Based Management for Continuous Improvement: 2000 Edition, A Step-by-Step Approach,” by Tom Pryor, published by ICMS, Inc.

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<sup>i</sup> “Summarized Six Year Outlooks – Summary of Potential Budget Gaps,” Office of Financial Management, September 2004, <http://www.ofm.wa.gov/fiscal/outlook/outlooks.pdf>.

<sup>ii</sup> “Revenue Collection Report,” Economic and Revenue Forecast Council, Olympia, October 10, 2004, <http://www.ercf.wa.gov/pubs/oct04.pdf>.

<sup>iii</sup> Ibid.

<sup>iv</sup> Under Initiative 601 state expenditures were limited to a growth rate at or below the average of the sum of inflation and population change during the previous three years.

<sup>v</sup> “Spending Limits” policy paper, Association of Washington Business, Washington Business 2004 Legislative Agenda, January 2004, [www.awb.org](http://www.awb.org).

<sup>vi</sup> “The TABOR Legislative Handbook,” The Independence Institute, Golden, Colorado, January 2000, <http://i2i.org/articles/1-2000.PDF>.

<sup>vii</sup> “Gov. Gary Locke announces ‘Priorities of Government’ Strategy for Lean, Results-Oriented State Budget,” news release, Office of the Governor, Olympia, November 14, 2002, <http://www.governor.wa.gov/press/press-view.asp?pressRelease=1222&newsType=1>.

<sup>viii</sup> Ibid.

<sup>ix</sup> “Tax Alternatives for Washington State: A Report to the Legislature,” Washington State Tax Structure Study Committee, Olympia, Washington, November 2002, Appendix D.

<sup>x</sup> “Biotech Cashes in on Real Estate: Zymogenetics Sells, Leases Back HQ,” by Luke Timmerman, *The Seattle Times*, October 8, 2002, p. C-1.

<sup>xi</sup> “A Report for Creating a More Efficient and Effective State Government,” Washington State Auditor Brian Sonntag, Olympia, Washington, March 7, 2001, Appendix C. The report highlights examples of savings from other states.

<sup>xii</sup> Ibid.

<sup>xiii</sup> Ibid.

<sup>xiv</sup> 2002 Supplemental Operating Budget, passed in April 2002. In October 2002 the State Auditor published the “Claims and Benefits Performance Audit,” with a detailed analysis of seven state systems: WorkFirst, food stamps, Medicaid, Basic Health, unemployment insurance, workers’ compensation and vocational rehabilitation. The report grades each system and offers recommendations for improvement.

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<sup>xv</sup> Washington Policy Center recommends that the State Auditor conduct performance audits because this office is independent of the agencies to be examined.

<sup>xvi</sup> This figure includes staff and faculty at state-funded universities and colleges. It does not include K-12 teachers and staff, who are considered employees of local school districts. See “How Many Budgeted Full Time Equivalent (FTE) Staff Are There? All Budgeted and Higher Education Funds,” Office of Financial Management, at [www.ofm.wa.gov](http://www.ofm.wa.gov).

<sup>xvii</sup> “State of Washington Salaries, Benefits and FTEs: FY 1988 to FY 2001,” Office of Financial Management, Olympia, Washington, March 22, 2001. See also, “State payroll continues to grow,” Policy Highlighter, Evergreen Freedom Foundation, Volume 12, Number 2, February 12, 2002, [http://www.effwa.org/highlighters/v12\\_n2.php](http://www.effwa.org/highlighters/v12_n2.php).

<sup>xviii</sup> “Per Capita Personal Income: 1998-2001,” Bureau of Economic Analysis, U.S. Department of Commerce, at [www.bea.doc.gov](http://www.bea.doc.gov). Per capita annual personal income for Washington residents was \$32,661 in 2002, the most recent year available.

<sup>xix</sup> “Gainsharing in Baltimore County, Maryland,” by Melissa Boone, Better Government Competition, The Pioneer Institute, Boston, Massachusetts, January 1998, <http://www.co.ba.md.us/Agencies/humanresources/gainsharing/aboutprog.html>.

<sup>xx</sup> *Ibid.*, pp. 5 and 6.

<sup>xxi</sup> “2001 Boards and Commissions Report,” Office of Financial Management, Olympia, Washington, January 2001, at [www.ofm.wa.gov](http://www.ofm.wa.gov).

<sup>xxii</sup> For examples of specific boards and commissions the legislature should review, see “Ideas for Balancing the State Budget Without Raising Taxes,” Washington Policy Center Policy Brief, January 2002.

<sup>xxiii</sup> *Washington Federation of State Employees v. Spokane Community College*, 90 Wash. 2d 698, 585 P. 2d 474 (1978) and codified by the legislature in RCW 41.06.380.

<sup>xxiv</sup> The “Personnel System Reform Act of 2002.”

<sup>xxv</sup> “A Control State System Regulating Alcohol Responsibly,” Agency Overview, Washington State Liquor Control Board, 2004. <http://www.liq.wa.gov/publications/Agency%20Overview%201%202002.pdf>.

<sup>xxvi</sup> *Ibid.*

<sup>xxvii</sup> “Liquor’s Quicker...at Wasting our Tax Dollars, That Is,” by Michael Zuzel, *The Columbian*, May 18, 2001.

<sup>xxviii</sup> One argument in favor of the state-run system is that it appears to generate revenue for the general fund. The problem with this view is that the true cost of operations is likely not considered in the state’s analysis. Things like deferred maintenance on state-owned buildings, inventory, long-term capital and employee retirement costs are not included on the state’s balance sheet. As a result, the current expense budget does not account for the full cost of running the public liquor sales and distribution system. Any



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privatization plan should include a thorough and complete business analysis conducted by the Office of Financial Management to determine the true cost of operating the state's liquor business. For more information see, "Liquor Control Board: A Case for the State Giving Up the Booze Business," by Hans A. Zeiger, Evergreen Freedom Foundation, *In Brief*, Volume 12, Number 2, October 4, 2002.

<sup>xxix</sup> The priorities are: K-12 student achievement, workforce quality and productivity, higher education value, health of Washington citizens, security of vulnerable citizens, business and personal economic vitality, mobility and transportation, safety of people and property, environmental protection and cultural and recreational opportunities. "Governor Gary Locke Announces 'Priorities of Government' Strategy for Lean, Results-oriented State Budget," Office of Governor Gary Locke, Olympia, Washington, November 14, 2002.

<sup>xxx</sup> For an in-depth overview of Activity Based Costing see "Challenging the Status Quo: Toward Smaller, Smarter Government," Texas Performance Review, Comptroller of Public Accounts, Austin, Texas, March 1999, at <http://www.window.state.tx.us/tpr/tpr.html>.

<sup>xxxi</sup> "A Dollars Worth of Government," by Jonathan Walters, *Governing* magazine, July 1996, pp. 45-46.

<sup>xxxii</sup> "Activity Based Costing: Illustrations from the State of Iowa," by Mark D. Abrahams and Mary Noss Reavely (Reprinted with permission of the Government Finance Officers Association), April 1998, [http://www.dom.state.ia.us/state/budget\\_proposals/files/Activity\\_Based\\_Costing\\_Article.pdf](http://www.dom.state.ia.us/state/budget_proposals/files/Activity_Based_Costing_Article.pdf).



## Chapter 2: Tax Policy

### 1. Guiding Principles of Taxation<sup>i</sup>

#### Recommendations

1. Adopt guiding principles based on equity and economic neutrality to shape changes in Washington’s tax system, so the tax system is focused on raising needed revenue for government, not directing the choices and behavior of citizens.
2. Policymakers should seek to lower the overall tax burden to promote prosperity and opportunity in the economy for the benefit of all citizens.

*(This section is adapted from the publications listed in the first endnote.)*

### Background

The people of Washington pay over 50 different kinds of taxes at the state and local level.<sup>ii</sup> The largest single revenue source for state and local government is the general sales and use tax, representing about 46 percent of all taxes. The next largest revenue source is the property tax.

In historical terms Washington’s level of taxation is perhaps the highest ever, and state residents in Washington are among the most highly taxed in the nation. Today, Washingtonians pay more money to meet their tax obligation than they do for food, clothing and transportation combined.

Our state also has one of the latest “Tax Freedom Days” in the country, the date each year on which citizens have earned enough money to pay their tax obligation to all levels of government and can begin working for themselves. In 2004 Washington’s Tax Freedom Day was April 15, the seventh highest ranking in the nation.<sup>iii</sup>

The proper function of taxation is to raise money for government, not to direct the behavior of its citizens. This is true regardless of whether government is big or small, and this is true for lawmakers at all levels of government. Many lawmakers think of the tax code as a way to penalize “bad” behaviors and reward “good” ones. They have sought incessantly to guide, micromanage and steer the economy by manipulating the tax laws.

Taxation will always impose some damage on an economy’s performance, but that harm can be minimized if policymakers resist the temptation to use the tax code for social engineering, class warfare and other extraneous purposes. A simple and fair tax system is an ideal way for advancing Washington’s economic interests and promoting prosperity for its residents.

### **Policy Analysis**

The fundamental principles presented here provide guidance for a fair and effective tax system; one that raises needed revenue for government, while minimizing the burden on citizens.

- **Simplicity** – The tax code should be easy for the average citizen to understand, and it should minimize the cost of complying with the tax laws. Tax complexity adds cost to the taxpayer, but does not increase public revenue. For governments, the tax system should be easy to administer, and should help promote efficient, low-cost administration.
- **Accountability** – Tax systems should be accountable to citizens. Taxes and tax policy should be visible and not hidden from taxpayers. Changes in tax policy should be highly publicized and open to public debate.

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- Economic Neutrality – The purpose of the tax system is to raise needed revenue for the government, not control the lives of citizens. The tax system should exert minimal impact on the spending and business decisions of individuals and businesses.
- Equity and Fairness – Fairness means all taxpayers should be treated the same. The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to “soak the rich.”
- Complementary – The tax code should help maintain a healthy relationship between the state and local governments. The state should always be mindful of how its tax decisions affect local governments so they are not working against each other – with the taxpayer caught in the middle.
- Competitiveness – A low tax burden can be a tool for Washington’s economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states.
- Balance – An effective tax system should be broad-based, without relying too heavily on a few sources of revenue. For the same reason, an ideal tax system should avoid special exemptions, preferring a low overall tax rate with few loopholes.
- Reliability – A high-quality tax system should be stable, providing certainty in taxation and in revenue flows. It should provide certainty of financial planning for individuals and businesses.

While these guiding principles are important, there are inherent problems with any system of taxation. Basically, taxation reduces spending on private sector goods and services traded in the free market. The benefits of free exchange – to both the purchaser and seller – are reduced when trade is restrained by taxation. The way that taxes restrain private trade varies.

Income and property taxes reduce incomes to taxpayers, lowering their demand for goods and services. Sales and excise taxes increase costs to suppliers, reducing their willingness to provide goods at any given prices. In any case, taxes reduce private trade and curtail job creation.

Since taxes lower the economic welfare of citizens, policymakers should try to minimize the economic and social problems that taxation imposes. Citizens then directly gain the benefits of a low tax burden. These benefits are summarized below:

#### Benefits of a low tax burden

- Faster economic growth. A tax system that allows citizens to keep more of what they earn spurs increased work, saving and investment. A low tax burden will mean a competitive advantage for Washington over states with high-rate, overly progressive tax systems.
- Greater wealth creation. Low taxes significantly boost the value of all income-producing assets and help citizens maximize their fullest economic potential, thereby broadening the tax base.
- End micromanagement and political favoritism. A complex, high-rate tax system favors interests that are able to exert influence in Olympia, and who can negotiate narrow exemptions and tax benefits. “A fair

field and no favors” is a good motto for a strong tax system.

- Increased civic involvement. A complex, high-rate tax system makes it nearly impossible for the average citizen to understand how and why the state is collecting money. Citizens become cynical and alienated from their government. At some point, most citizens come to feel the state government no longer represents their interests. A simplified, broad-based, low-rate system encourages citizens to become re-engaged with government and to seek greater civic involvement.

The people of Washington work hard for what they earn. Money paid in taxes is by definition not available to meet other needs. As a matter of respect to citizens, policymakers should work to keep the overall level of taxation to the absolute minimum needed to pay for the core functions of government.

## Recommendations

**1) Adopt guiding principles based on equity and economic neutrality to shape changes in Washington’s tax system, so the tax system is focused on raising needed revenue for government, not directing the choices and behavior of citizens.** Basic to the concept of a fair tax system is that the state should take no more from citizens than it needs to pay for the essential functions of government. This consideration goes beyond the need to balance the budget; it is a matter of fundamental respect and trust between citizens and their government.

**2) Policymakers should seek to lower the overall tax burden to promote prosperity and opportunity in the economy for the benefit of all citizens.** Washingtonians require and expect basic government services, and taxes must be collected to pay for these services, but government revenue should be limited to real public needs, so the tax system itself does not become one

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of the major problems of life. A fair and efficient tax system is a matter of having respect for the citizens of our state.

## 2. State Income Tax

### Recommendation

Avoid enacting a state income tax.

### Background

Washington is one of only seven states that do not tax citizens' incomes. Doing so would fundamentally alter the state's tax structure, changing it from one that mainly taxes consumption to one that also taxes productivity.

Each state levies a different combination of taxes on the people who live, do business or travel within its borders. These different types and levels of taxation have a profound impact on the actions of residents and businesses and can significantly impede economic growth. More than any other type of tax, an income tax can stifle a state's economic growth, create instability in public revenues and limit people's take-home income.

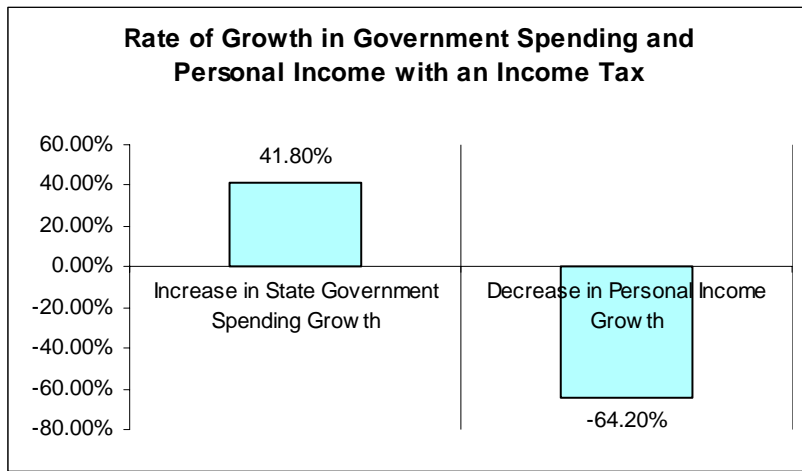
### Policy Analysis

Examination of long-term economic trends in states that have adopted income taxes indicate how a state tax on incomes may affect Washington. Since 1967, nine states have imposed an income tax.<sup>iv</sup> In those states, government spending growth increased an average of 41.8 percent and personal income growth decreased an average of 64.2 percent after enacting the new tax.<sup>v</sup> If an income tax causes the same trends to occur in Washington state, government spending would increase by an inflation-adjusted \$48 billion over ten years. Over the same period growth in personal incomes would be reduced by some \$210 billion, and the average salary of Washingtonians would be \$5,740 lower than what they would expect to earn without an income tax.<sup>vi</sup> Figure 1 illustrates that the rate of government



spending growth increases and personal income growth slows in states that impose an income tax, based on economic changes since adoption of an income tax through 1998.<sup>vii</sup>

Figure 1.



Why does personal income growth fall off and government spending increase faster in states that tax personal incomes? There are a number of reasons. Personal income growth is largely a function of market incentives. When government imposes a tax on earnings, individuals lose incentive to work harder and increase their wages. Similarly, when a share of interest earnings from savings is lost each year to taxation, individuals have less incentive to save.

A comparison among states also shows that states without an income tax consume a significantly smaller portion of their citizens' earnings and tend to be better stewards of the taxes they do collect. In states that do not have an income tax, taxes account for an average of only \$89 per \$1,000 of household income.<sup>viii</sup> In contrast, the eight states with the highest income tax rates collected an average of \$131 per \$1,000 of household income.<sup>ix</sup>

Government spending tends to increase faster under a state income tax for two primary reasons. First, it adds one more way policymakers can incrementally increase tax revenues to fuel a faster rate of government growth. But over time, even small increases combine to stifle economic growth, transferring more money out of the productive economy and into the government sector.

Second, an income tax is not as transparent as other taxes. The tax is automatically deducted from workers' paychecks each month. The only time citizens may be aware of how much they pay in income tax is when they complete a tax return once a year, and even then they may be more interested in any refund they might receive than in the amount of tax they paid in the first place. The obscure nature of an income tax increases the temptation for elected officials to increase the tax rate with less chance of a public reaction.

State income taxes tend to reduce personal income growth, increase the rate of government spending and lower the competitiveness of the business climate. Avoiding an income tax allows people to spend more time working for themselves and their families, and less time working to pay for government.

## **Recommendation**

**Avoid enacting a state income tax.** A state income tax would have an important negative effect on the Washington economy. Comparisons among states shows that income taxes reduce state competitiveness, deepen deficits during a recession, add cost and complexity to the tax code, and reduce the incentive for people to work, save and invest. Absence of an income tax is one of the few clear advantages Washington's business climate has in relation to those of other states.

### 3. Sales Tax Deductibility

#### Recommendation

Encourage Congress to promote equal tax treatment among states by making state sales tax deductibility permanent.

#### Background

In 1986, as part of a major overhaul of the tax code, Congress ended the deductibility of state sales taxes. Since then, as residents of one of the seven states without a state income tax, Washington residents have not been able to deduct what they pay in state sales taxes from their federal income tax. Since state income taxes are fully deductible, residents of other states received more favorable treatment under the code.

#### Policy Analysis

This inequity has recently been resolved with passage of H.R. 4520, the American Jobs Creation Act in October 2004.<sup>x</sup> A provision of the bill again makes state sales deductible from the amount of personal income subject to the federal income tax. By one estimate the provision will save Washington residents \$450 million a year.<sup>xi</sup>

In practice, Washingtonians will not have to keep track of all their sales receipts through the year to calculate how much they paid in state taxes. The IRS will issue a table which will estimate, based on income, what dollar amount taxpayers may claim as sales tax costs on federal income tax forms. Additional deductions are allowed for sales tax paid on major purchases, such as automobiles. However, the recently-enacted sales tax deductibility provision is only good for two years, 2004 and 2005.<sup>xii</sup>

## **Recommendations**

**Encourage Congress to promote equal tax treatment among states by making state sales tax deductibility permanent.**

The sales tax deductibility provision expires in two years. Unless Congress extends the provision or makes it permanent, residents in Washington and six other states will again be subject to unequal treatment under the federal tax code.

#### 4. Car Tab Taxes

##### Recommendations

1. Retain \$30 car tabs at the state level.
2. Use the lessons learned since passage of Initiative 695 as a guide when considering other tax cut proposals.

#### Background

In 1999, the people of Washington approved Initiative 695, the “\$30 License Tab Initiative.” The measure passed by a vote of 56 percent to 44 percent.<sup>xiii</sup> At a stroke the voters repealed the state Motor Vehicle Excise Tax (MVET) and replaced it with a flat \$30 annual fee on private cars and trucks. The voters’ decision was later confirmed in law by the legislature after a judge ruled to overturn the initiative.

During the political campaign against Initiative 695, opponents made a number of specific predictions, all of them dire, of what would befall the state if the measure became law. Their central argument was that government could not afford to trim the car tax, and that if this source of revenue were reduced major cutbacks in essential public services would result.

The passage of time puts us in a position to coolly assess the actual outcome of Initiative 695. The sky did not fall as opponents predicted. In general, state and local governments have adjusted well to the revenue reduction and vital public services have not been disrupted. On the whole these programs have continued as before, and in many cases have been improved and expanded, since Initiative 695 passed. Nor has the measure seriously crimped public revenues, since overall spending by the state, counties and cities continues to rise.

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Research staff at the Washington Policy Center examined specific predictions made about what would happen if Initiative 695 passed, and compared them with actual outcomes. All predictions are direct quotes taken from “No on I-695” publications; they are paraphrased here.<sup>xiv</sup>

**Prediction:** Funding would be lost for up to 1,000 police officers.

**Outcome:** Most police departments have as many or more officers than before Initiative 695 passed. Also the crime rate has dropped.

**Prediction:** The state Crime Lab would lose \$2 million.

**Outcome:** Funding for the Crime Lab increased after the initiative passed.

**Prediction:** More than 70,000 transportation jobs would be lost.

**Outcome:** The state added transportation positions after Initiative 695 passed.

**Prediction:** Funding for traffic congestion and highway safety would be eliminated.

**Outcome:** The state has increased spending for highway safety and for traffic congestion relief, and the legislature has increased gas tax revenues. Also, traffic fatalities have fallen more than eight percent since the initiative passed.

**Prediction:** Funding for basic county health services would end on January 1, 2000.

**Outcome:** County health services received an additional \$11 million in 2000 and \$22.1 million more in 2001.

**Prediction:** Child immunization and flu shots will be cut.

**Outcome:** Nearly two million child immunizations were distributed in 2000, a rate consistent with

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previous years. Barring disruptions in supply, flu immunizations are as plentiful today as they were before the initiative passed.

- Prediction: Restaurant and day care inspections will be cut.  
Outcome: State day care inspections increased from 341 to 375 the year after the initiative passed. Standards for restaurant inspections have been fully and consistently maintained.
- Prediction: Initiative 695 would allow cars to be taxed as property.  
Outcome: Passage of Initiative 695 has not led to a property tax on cars.
- Prediction: Initiative 695 will lead to a state income tax.  
Outcome: Washington does not have a state income tax.

Initiative 695 has been a successful tax-cutting policy. In its first year the measure enabled Washington citizens to keep over \$750 million more of their own money, and it has saved them millions more since then.

It has also contributed to the overall economic well-being of the state by partially easing Washington's high tax burden and allowing more money to remain in the private sector to foster savings, investment and job growth.

**Recommendations**

- 1) Retain \$30 car tabs at the state level.** In some counties the policy of \$30 car tabs has been eroded by the addition of local taxes. To help preserve the benefits of a low, yearly car tax, state policymakers should resist increasing the car tab tax.
- 2) Use the lessons learned since passage of Initiative 695 as a guide when considering other tax cut proposals.** State elected leaders and the public can learn important lessons from

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the positive experience with Initiative 695. The measure's success indicates that by setting clear budget priorities, state and local leaders can respond effectively to the people's strong desire to ease the growth of the tax burden while maintaining essential government services.



## 5. Property Tax Limitation

### Recommendation

Enact property tax relief to reduce the financial burden government places on citizens, to promote economic growth, job creation and greater personal freedom.

### Background

In recent years Washington voters have approved three popular measures to ease the growth of the property tax burden state and local governments place on their citizens.<sup>xv</sup> Each measure set progressively more stringent limitations on how much state and local elected officials could increase the basic property tax each year. The relatively easy passage of these measures indicates public support for limiting property taxes increases has remained stable over time.

The latest of these measures to become law was Initiative 747, passed by voters in 2001. It provides that a taxing district may not increase the total amount it collects in regular property taxes by more than one percent from one year to the next. Initiative 747's one percent limit replaces the earlier Referendum 47 limit, which held annual property tax increases to the lower of the rate of inflation or six percent.<sup>xvi</sup>

Under Initiative 747, local officials have three options when considering whether and how much to increase yearly property tax collections: 1) they can increase the amount collected by up to one percent; 2) they can increase the amount collected by more than one percent by drawing on unused taxing authority they banked in previous years; or 3) they can ask voters to approve a higher increase. There are no statutory limits on tax increase proposals sent to the voters. Such proposals need only a simple majority to pass.

Many people believe their property value alone determines how much property tax they must pay, and when the county assessor updates home values to reflect market trends, their taxes automatically go up. This is not the case.

County assessors do not levy property taxes. Elected state legislators and the local board and council members of Washington's 39 counties, 268 cities and 1,436 other taxing districts decide how much property tax citizens must pay. Once elected officials in each taxing district decide the total dollar amount they feel they need to fund public operations for the following year, the assessor apportions that amount among the district's property owners, based on each land parcel's assessed value. It is a budget-based tax system, and that is the source of most of the confusion over who is responsible for rising property taxes.

Most people are familiar with rate-based tax systems, like the state sales tax or the federal income tax. Under a rate-based system elected officials first set a percentage rate which determines the fraction of each dollar of a given tax base that must be paid to the government. The revenue the government will receive from such a tax cannot be known in advance; it can only be estimated.

A budget-based system like the property tax begins at the other end. Elected officials *first* decide how much money they feel is needed for their government budget, then divide this among the tax base to determine what rate is needed to raise that amount of revenue. The rate is expressed as so many dollars per \$1,000 of assessed value. Under this system, the amount of revenue the government will collect is known from the beginning. It is the tax *rate* that is unknown until the assessor calculates it. The difference between the two systems can be expressed this way:

- Rate-based system:  $\text{rate} \times \text{tax base} = \text{revenue}$ .
- Budget-based system:  $\text{revenue} \div \text{tax base} = \text{rate}$ .

Once the rate is determined, the county assessor applies it to the value of each owner's property. One piece of land may fall under the jurisdiction of as many as ten separate taxing districts.<sup>xvii</sup> The assessor adds the budget demands of the different districts together, calculates the tax rate, and then mails the final bill to each property owner. Tax payments are due twice a year.

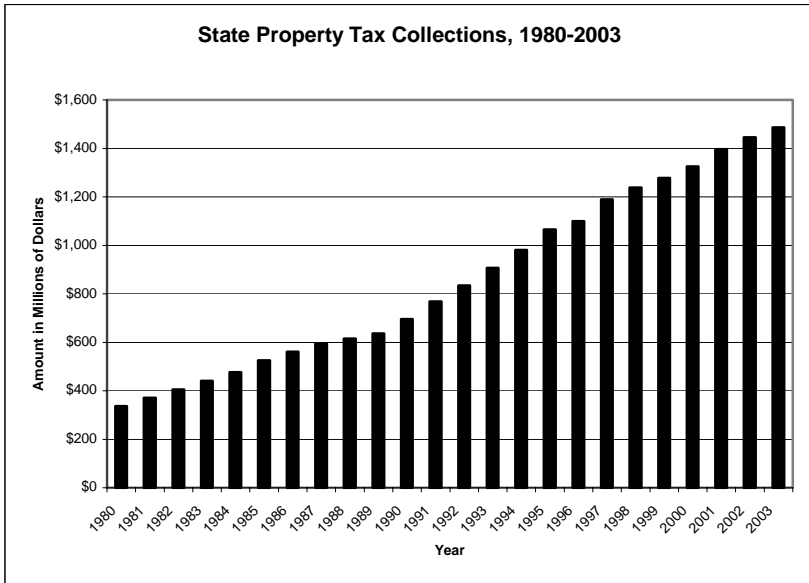
## Policy Analysis

Washington Policy Center research staff have tracked the results of voter-enacted property tax legislation for six years. Our annual studies examine the extent to which elected leaders in Washington's 39 counties and 22 major cities restrict increases in regular property taxes collections to voter-approved limits, or whether they choose to enact higher increases.

Our latest research finds that voter-passed initiatives have been successful in restricting how much the regular property tax burden grows each year. Well over 90 percent of Washington counties and major cities now limit their annual increase in regular property tax collections to one percent or less. This is a considerable change from 1998, when only six counties and two cities did so. Initiative 747 has markedly eased the yearly increase in the tax burden.

The average total property tax increase for Washington counties was 4.7 percent in 1998, today it is one percent. Similarly, in 1998 the average total property tax increase for Washington's 22 major cities was 3.5 percent, today it is one percent.<sup>xviii</sup> Yet while the annual rate of property tax increase has slowed, the amount of money collected by the state from this revenue source has sharply increased since 1980 (see figure 1).

Figure 1.



Because of tax limitation property taxes are much lower today than they would have been under previous law, resulting in significant tax savings to Washington citizens, but the overall the rate of property taxation remains high.

## Recommendation

**Enact property tax relief to reduce the financial burden government places on citizens, to promote economic growth, job creation and greater personal freedom.** Initiative 747 and the other tax limitation initiatives were not tax cuts; they did not reduce or even freeze the total amount of property taxes Washington citizens pay, especially since many categories of property tax are not subject to the current one percent limit. Enacting property tax relief would actually reduce the existing financial burden on citizens, and free up money for investment in economic growth and job creation, and would give Washingtonians greater personal freedom.

## **Additional Resources**

### Washington Policy Center Research

“Guiding Principles of a Fair and Effective Tax System,” by Paul Guppy, January 2002.

“Property Tax Limitation in Washington State,” by Paul Guppy, August 2003.

“The Economic Case Against an Income Tax in Washington State,” by David G. Tuerck, John S. Barrett, Sorin Codreanu, May 2003.

“A Policy Guide for Budget Reform: Strategies for Improving State Government Services and Reducing the Deficit,” by Eric Montague, January 2003.

“An Overview of Referendum 51,” by Eric Montague, September 2002.

“State Income Taxes Increase Government Spending and Reduce Personal Income Growth,” by Eric Montague, June 2002.

### Other Resources

Tax Foundation - This national think tank provides detailed analysis of local and national tax policy, calculating Tax Freedom Day each year. [www.taxfoundation.org](http://www.taxfoundation.org).

Streamlined Sales Tax Project - This project will allow states to charge sales tax on purchases from out of state. [www.streamlinedsalestax.org](http://www.streamlinedsalestax.org).

“The Internet Tax Solution: Tax Competition, not Tax Collusion,” by Adam D. Thierer and Veronique de Rugy, Cato Institute, October 23, 2003. [www.cato.org](http://www.cato.org).

Washington Tax Structure Study Committee Final Report: Tax Alternatives for Washington State,” Washington State Department of Revenue, November 2002.

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<sup>i</sup> The text in this section is adapted from: “Principles of Sound Tax Policy,” by Dan Mitchell, Heritage Foundation, Washington, D.C., November 2001, “Guiding Principles of Taxation,” Tax Policy and Research, Montana Department of Revenue, October 2001, and “Some Underlying Principles of Tax Policy” by Richard K. Vader and Lowell E. Galloway, Joint Economic Committee, United States Congress, Washington, D.C., September 1998.

<sup>ii</sup> “Tax Reference Manual, Information on State and Local Taxes in Washington State,” Revenue Research Report, Department of Revenue, Olympia, January 2002, p. I.

[http://dor.wa.gov/content/statistics/2002/Tax\\_Reference\\_2002/default.aspx](http://dor.wa.gov/content/statistics/2002/Tax_Reference_2002/default.aspx).

<sup>iii</sup> Table 2, “Tax Freedom Day by State and Rank,” from “America Celebrates Tax Freedom Day,” Special Report, The Tax Foundation, Washington, D.C., April 2004, No. 129, p. 10, <http://www.taxfoundation.org/sr129.pdf>.

<sup>iv</sup> These states are Connecticut, Illinois, Maine, Michigan, Nebraska, New Jersey, Ohio, Pennsylvania and Rhode Island.

<sup>v</sup> “Economic Impact of the Adoption of a State Income Tax in Washington,” by Dr. Thomas R. Dye, Lincoln Center for Public Service, published by the National Taxpayers Union, Washington, D.C., June 2000.

<sup>vi</sup> Ibid.

<sup>vii</sup> Ibid.

<sup>viii</sup> Based on data from the U.S. Census Bureau and “America Celebrates Tax Freedom Day,” Special Report, The Tax Foundation, Washington, D.C., April 2002.

<sup>ix</sup> Ibid.

<sup>x</sup> H.R. 4520, “To amend the Internal Revenue Code of 1986 to remove impediments in such Code and make our manufacturing, service, and high-technology businesses and workers more competitive and productive both at home and abroad,” Passed by Congress and sent to the President, October 11, 2004, <http://thomas.loc.gov/cgi-bin/bdquery/z?d108:h.r.04520>.

<sup>xi</sup> “Promoting State Sales Tax Deductibility,” Office of Congressman Brian Baird, October 2003, <http://www.house.gov/baird/tax.htm>.

<sup>xii</sup> Conference Report on H.R. 4520, *The American Jobs Creation Act of 2004*, Committee on Ways and Means, United States Congress, October 7, 2004, <http://waysandmeans.house.gov/media/pdf/hr4520/hr4250confreptshortsummary.pdf>.

<sup>xiii</sup> “Initiative 695,” Elections and Voting, Initiatives to the People: 1914 through 2003, Washington Secretary of State, [http://www.secstate.wa.gov/elections/initiatives/statistics\\_initiatives.aspx](http://www.secstate.wa.gov/elections/initiatives/statistics_initiatives.aspx)

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<sup>xiv</sup> For details see “Initiative 695 One Year Later: The Sky Didn’t Fall,” by Paul Guppy and Brett Wilson, Washington Policy Center Policy Brief, January 2001, <http://www.washingtonpolicy.org/TaxLimitation/PBGuppyTaxLimit695OneYearLater.html>. The full version of opponents’ quotes is available on request from Washington Policy Center.

<sup>xv</sup> The three measures are: Referendum 47, passed November 1997 by 64% to 36%; Initiative 722, passed November 2000 by 56% to 44% (this initiative was later invalidated by the courts); and Initiative 747, passed November 2001 by 58% to 42%.

<sup>xvi</sup> The Implicit Price Deflator, the inflation measure used when Referendum 47 was in force, is 1.16% in 2003.

<sup>xvii</sup> Examples of taxing districts include, the state, county, city, road, school, public utility, library, port, water, fire, sewer, parks, flood zone, hospital, airport, ferry, cemetery, mosquito control, park-recreation, emergency medical, irrigation, cultural-arts, agricultural pest and urban apportionment. In all there are 1,744 taxing districts in Washington.

<sup>xviii</sup> “Average Increases in Regular Property Tax Collections by County, 1998-2003,” and “Average Increases in Regular Property Tax Collections by Major Cities, 1998-2003,” Property Tax Limitation in Washington State, Washington Policy Center, August 2003, <http://www.washingtonpolicy.org/TaxLimitation/PBGuppyTaxLimit747PropertyTaxLimitation2003.html>.



## Chapter 3: Protecting the Environment

### 1. Free Market Conservation

#### Recommendations

1. Encourage cooperative, rather than coercive, solutions to environmental problems.
2. Whenever possible, use voluntary incentives instead of mandatory regulation.
3. When regulation is needed, focus on results, not process.

### Background

Recent environmental policy changes proposed by the Bush Administration have many environmentalists up in arms. Instead of using traditional environmental restrictions that limit land use with strict government regulations, the Administration is proposing solutions that protect the environment while also protecting private property rights. The Administration's approach, however, merely reflects a broader, ongoing shift to a new type of environmentalism – free-market conservation.

Some extreme environmental groups dismiss free-market organizations as pawns of “big business” or members of a radical property rights activist network, but the encouraging facts show their solutions simply work. Species are being saved, land is being conserved and new supporters are being converted to the free-market environmental movement every day.

One important example of national importance is located here in Washington. Stewardship Partners is working with private landowners in the Nisqually River Basin to preserve



natural habitat along the river. By providing incentives for local landowners to voluntarily protect undeveloped land, this private, non-profit organization is achieving conservation goals without additional government regulation.<sup>i</sup>

## Policy Analysis

This and other examples of non-regulatory environmental solutions contrast with the adversarial relationships created by traditional environmental regulations. Instead of lining up big, politically powerful environmental organizations against local landowners and rural businesses, free-market conservation offers opportunities for traditionally competing interests to work together to conserve land for future generations.<sup>ii</sup>

The reaction of the old-line environmental movement is predictable. As power is shifted away from central commissions and federal regulatory agencies where they have strong influence, traditional environmental groups issue dire forecasts about the imminent demise of the earth's ecosystem and the future destruction of large swaths of pristine natural treasures.

Fortunately, these wild projections are without factual basis. The free-market model for environmental conservation continues to gain support because it successfully protects property rights, encourages development and prosperity and also maintains a vibrant natural environment that can be enjoyed for generations to come.

## Recommendations

**1) Encourage cooperative, rather than coercive, solutions.** As the work of Stewardship Partners shows, working with, instead of against, landowners can produce much-needed success in protecting the environment by bringing together parties who were once on opposing sides.

**2) Whenever possible, use voluntary incentives instead of mandatory regulation.** Shifting the power of conservation decisions away from the government and into the hands of local landowners and private conservation organizations better balances the needs of business, individual landowners and the environment. Policymakers can use market mechanisms as a tool to bring all interests together for a common solution.

**3) When regulation is needed, focus on results, not process.** Much of existing regulation is process-based, creating perverse incentives that are often contrary to the end goals of effective conservation. A focus on results-based regulation allows policymakers to unleash the innovative capabilities of business and private citizens in the service of protecting the environment.

## 2. The Growth Management Act

### Recommendations

1. Reduce the regulatory burden for new development in urban areas.
2. Establish acceptable criteria for determining Best Available Science (BAS).
3. Preserve fundamental private property rights.

### Background

In 1991 the State Legislature approved a plan to manage urban growth in Washington state. The Growth Management Act (GMA) placed new restrictions on urban, suburban and rural growth with the intent of limiting the expansion of urban development in rural and agricultural areas.

In the late 1980s and early 1990s strict growth management regulations were seen as the only way to slow the urbanization of rural areas and prevent environmental damage to the air, water and other natural resources. Today, state mandated growth management remains hotly contested and the practical implementation of GMA presents continuing problems for local government.

Under GMA, the state establishes growth management standards, then local governments develop growth plans based on those standards. Local governments are not given complete control, however. State-appointed regional Growth Management Hearings Boards oversee local growth plans and can intervene to advance the state's objectives.

GMA has two primary components. The first is the Comprehensive Plan. This is an all-inclusive 20-year overview

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of the planned growth for a county or local community. It stipulates the location of all planned development and infrastructure improvements necessary to meet those growth needs.

The second major component is the Critical Areas Ordinance (CAO). Local governments must adopt a CAO to protect ecological resources that are considered critical to the proper function of the environment – areas like wetlands, salmon-bearing streams and old growth forests. All new protections must be based on what is called Best Available Science (BAS). The definition of what constitutes BAS is hotly contested and often results in costly and time-consuming litigation.<sup>iii</sup>

Every county must adopt a CAO, but not all are required to adopt a Comprehensive Plan. Under GMA, large urban counties are required to plan. Smaller counties with less than 20 percent growth over the 10 years prior to implementation are not required to plan. Smaller counties are not prohibited from planning and can opt-in if they so choose. Eighteen of Washington's 39 counties are required to develop a plan, 11 counties chose to plan and 10 counties do not plan under GMA.

Of the counties that plan under GMA, each is required to establish an Urban Growth Area (UGA), or a demarcation line prohibiting most development outside the boundaries established by local planners. Except under certain circumstances, the housing needs of a community must be met primarily by building inside the UGA.

### **Effects of Growth Management**

GMA tends to drive up the cost of housing. When housing prices increase, young families find it harder to buy a home, and workers are forced farther away from the urban core in search of affordable housing. Some growth management policies actually accelerate urban sprawl by pushing growth out

to areas with fewer growth restrictions. One recent study shows that growth management planning reduced housing affordability for Washington families by an average of 26 percent.<sup>iv</sup>

## **Policy Analysis**

In counties with fast growth patterns, limiting the supply of buildable land (and thus available housing) increases the cost of housing. It is not the only cause of housing price increases, but it does contribute heavily to driving up building costs.

In King County, for example, housing prices have increased much faster in the last ten years than the average income for local workers. In 1990 a median priced house sold for \$140,000. By 2000, the price was up to \$245,000, an increase of 75 percent. During the same period median household income increased from \$36,200 to \$55,200, a rise of only 52 percent. By this measure, housing prices increased almost 50 percent faster than income, sharply reducing the ability of average income families to buy a home.<sup>v</sup>

Other counties, like Clark and Lewis, saw similar reductions in housing price affordability. Combining income and housing price statistics shows that, with all other variables held constant, GMA planning reduced housing affordability by up to six percent statewide. The areas that were hardest hit are high-growth areas where demand for housing is the highest and buildable land is scarce.<sup>vi</sup>

## **Contradictory Goals**

A central problem with GMA controls is the 14 contradictory goals established by the law. For example, state and local government are required to protect private property rights, but also directly regulate property uses. The law says GMA is supposed to increase housing affordability, while at the same time it strictly limits the amount of land available for building.<sup>vii</sup>

## Recommendations

**1) Reduce the regulatory burden for new development in urban areas.** To ensure an adequate supply of high quality, affordable housing state and local policymakers need to reduce the regulatory burden faced by city developers. Even when building within the urban growth boundary contractors often struggle through months of regulatory red tape. The increased time and effort required to navigate the regulatory labyrinth increases cost for the homebuyer and discourages many builders from starting new projects in many areas.

**2) Establish acceptable criteria for determining Best Available Science.** Growth management regulations are supposed to be based on the Best Available Science (BAS). Because BAS is a subjective evaluation, however, the decisions of regulators often lead to controversy and litigation. With a better definition of BAS and how it is to be applied, local governments can avoid costly litigation and move forward with their growth management plans.

**3) Preserve fundamental private property rights.** The preservation of private property rights is critical to the stability of our economic and social systems. While it is important to protect our shared natural resources from degradation it is also important to achieve environmental goals without sacrificing essential Constitutional protections of private property. Through cooperative, incentive-based policies, elected leaders can protect the environment without infringing on the basic rights of citizens.

### 3. State Forest Trust Management

#### Recommendations

1. Expand active management of Washington state-owned forests.
2. Allow trust beneficiaries to sell forest trust assets for other more stable funding.
3. Restore timber harvest as a sustainable, economic development option.

#### Background

An important part of Washington's economy centers on the commercial development of public and private forestland. Trees cover more than 21 million of the state's 42 million total acres.<sup>viii</sup> Washington forests enhance water and air quality, shelter salmon-bearing streams and provide unmatched recreational opportunities. Forests are also an important economic resource, supporting thousands of private-sector jobs and providing hundreds of millions of dollars to fund public schools and local government through state timber harvests.

In the early days of settlement the state's forests were valued more for their economic productivity than for their environmental or recreational uses. Over time Washington residents, policymakers and businesses recognized the balance necessary for maintaining a healthy environment and a healthy timber economy. But policy changes introduced in the 1990s included an unhealthy reliance on restrictive, cookie-cutter regulations designed to protect the environment. Those regulations place unnecessarily heavy restrictions on one of the state's most productive assets.

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At the heart of the debate over logging restrictions is state-owned timberland managed by the Department of Natural Resources (DNR). The state owns over 2.1 million acres of timberland, 1.4 million acres west of the Cascade Divide and another 700,000 acres in Eastern Washington. The state acquired this resource through a combination of land grants from the federal government, tax foreclosures during the Great Depression and purchases over the past one hundred years.

The Board of Natural Resources, made up of representatives from DNR, state schools and universities, county governments and the governor's office, oversee the management of state-owned timberland. Revenue from DNR land totaled \$140 million in 2003.<sup>ix</sup> Nineteen counties, K-12 schools and public colleges and universities financially benefit from our state's most productive renewable resource.

In 2004 the Board adopted a new Sustainable Harvest Calculation. The new plan marks a return to a better balance between environmental protection and economic productivity. The plan uses key scientific advances in timber harvest planning and technology, allowing state land managers to increase timber harvests while improving the health of Washington forests.

Over the next 10 years harvest levels on west-side forest trust land will be increased to 597 million board feet per year. The last sustainable harvest calculation, approved by previous Lands Commissioner Jennifer Belcher in 1997, set annual harvest levels at 575 million board feet. Environmental regulations adopted after the calculation further reduced harvests to the current level of about 470 million board feet. A revised approach proposed by Lands Commissioner Doug Sutherland and adopted in 2004 will boost west-side trust revenue by more than \$40 million a year, from \$107 million in 2003 to an estimated \$150 million when the plan is fully implemented.<sup>x</sup>



## Policy Analysis

During the early 1980s timber harvest on state owned timberland reached a peak of over 900 million board feet per year. Then came the timber wars in the late 1980s and early 1990s that pitted environmental activists against loggers trying to protect their livelihood. The result was a massive reduction in timber harvest on state land, cutting production to fewer than 400 million board feet per year by 1995.

The new environmental restrictions sharply cut revenue for state schools and local governments. Logging restrictions, coupled with lower world timber prices and rising harvest costs, have reduced the value of state managed forests from between \$7 and \$8 billion in 1997 to just over \$3 billion today. Proposed changes to the state's timber harvest plan will provide a much-needed revenue boost of about \$750 million over 20 years, while continuing to increase the number of trees in state forests.<sup>xi</sup>

Also raising concern are the practical results of the no-touch environmental restrictions imposed on many areas of state land. New research shows that an active management approach, similar to the one recently adopted by the Board of Natural Resources, will dramatically improve habitat for endangered species like the spotted owl, marbled murrelet and pacific salmon. Previous policy resulted in a largely monolithic forest environment, choked with tightly packed trees and excessive underbrush. A shift to more active management, careful thinning and selective clear cutting will improve ecological diversity, prevent deadly forest fires and help restore endangered species habitat.

## Recommendations

**1) Expand active management of Washington's state-owned forests.** New science and planning technology allow forest managers to predict growth patterns and manage ecological

development with precise accuracy. New logging equipment and road-building techniques reduce the environmental impact of timber harvests even further. Well-managed timber harvests are no longer a threat, but a tool for improving environmental quality and reducing the threat of wildfire.

**2) Restore timber harvest as a sustainable economic development option.** The current approach of the Board of Natural Resources will improve the environment, provide more funding for schools and local governments and help revitalize rural communities dependent the forests for jobs and economic stability. Research by DNR and University of Washington scientists shows that additional harvest increases – beyond those approved this year – can boost revenue for schools and local government while maintaining, and in many cases improving, environmental quality.

**3) Allow trust beneficiaries to sell forest trust assets for other more stable funding.** Policymakers should allow trust beneficiaries – public schools, colleges and universities – to sell their timber assets and reinvest the money in a more stable, long-term investment. More diversified investment would give public education budgets greater stability and increased funding. This is the successful strategy employed by the State Investment Board.

## 4. Wildfire Prevention

### Recommendations

1. Expand thinning operations in state forests to reduce the threat of devastating wildfires and insect infestations.
2. Reduce legal roadblocks to sound management of national forests.
3. Restore local control of public forests in Western states.

## Background

Fire season is always a time of concern in Washington. Nowhere is the fire danger more evident than in our nation's national forests. Federal officials estimate 190 million acres of federal forest and rangeland face a high risk of catastrophic fire.<sup>xii</sup> Here in Washington, poorly managed federal forests threaten the millions of acres of state and private forests on their borders.

The risk of fire is particularly acute in threatened communities surrounded by public forests. Cities like Winthrop, Cle Elum and Roslyn are at the heart of the debate over how best to protect communities from fire risk. But there is more to the debate than just protecting communities from fire damage. Years of misguided forest management have left our national forests in a degraded state. Massive fires far from human development still cause unnecessary damage to the environment and pollute the air for residents that live miles away from the actual fire.

## Policy Analysis

Addressing the risk of wildfire requires a comprehensive approach – one that protects communities, reduces the risk of

high-intensity wildfires in remote areas and returns control of forest management to the local managers who know the forest best. Two of these objectives are effectively addressed in the Healthy Forest Restoration Act of 2003. The Act received strong bipartisan support in Congress, winning 80 votes in the Senate before being signed in December of 2003 by President Bush. It promises to improve conditions in federal forests throughout the western United States.

The Act includes important provisions that promote ecological diversity and health in more than 9 million acres of federal forests in Washington. It allocates new resources for reducing fuel loads in more remote areas of national forests: Reducing the accumulation of highly flammable material and thinning densely packed forests will not only lower the risk of wildfire, but will improve the overall health of forests in desperate need of attention. In many areas, thinning the forests can enhance the development of old growth habitat, freeing the trees from the over-crowding that is the result of decades without regenerative fire.

## **Recommendations**

### **1) Expand thinning operations in managed forests to reduce the threat of devastating wildfires and insect infestations.**

By focusing mechanical clearing and selective timber harvest in what is called the urban-wildland interface, land managers can significantly reduce the risk of fire damage for many communities. Coordination between all levels of government is key to success in this effort.

### **2) Reduce legal roadblocks to sound management of national forests.**

Over the years forest scientists have developed a general consensus that actively managing the state forests will improve fish and wildlife habitat and significantly reduce the risk of massive wildfires. But when forest managers plan new timber harvests their efforts are often blocked by environmental activists who, at the last minute, file frivolous

and costly lawsuits to delay a project. Streamlining legal procedures would reduce contentious legal battles that cost money, property and sometimes lives.

**3. Restore local control of public forests in Western states.**

State policymakers should encourage our federal representatives to return decision-making responsibility to local and regional managers who know the forest best. State-owned forests face much lower risk of devastating wildfire than the national forests in the region. One reason for this is the direct economic interest Washington taxpayers have in maintaining a healthy forest ecosystem. State timber harvests support schools and local government, so if those forests are at risk of wildfire, so is the support provided to many social services.

## 5. Land Trusts

### Recommendations

1. Rescind the requirement that easements be granted in perpetuity.
2. Avoid using land trusts as an arm of government.
3. Encourage a cooperative relationship between land trusts and members of the local community.

### Background

To avoid repeating the intense controversies created by top-down regulatory environmentalism, some conservation groups are turning to land trusts as a way to encourage landowners to protect sensitive ecological areas. Here in Washington, there are over 30 working land trusts, and that number is growing every year. Land trusts are private, non-profit organizations that raise money to purchase land for preservation. In its best form, a land trust raises private money to buy the land it wants to protect. This approach contrasts with the coercive practice of filing lawsuits or lobbying local, state and federal policymakers for greater restrictions on private property and public land use.

Part of the reason land trusts have become so popular is the tax benefits granted by Congress to encourage landowners to donate their land or establish a trust-managed conservation easement.<sup>xiii</sup> While this approach may be preferable to traditional regulation, by controlling the types of conservation that receives tax benefits, the federal government can pick winners and losers.

Private landowners who choose, of their own free will, to limit development on their land without working with a land

trust receive no tax benefit, but those who cede control to a land trust do receive a tax advantage. Both types of property owners accomplish the same conservation objective, but in one case, the federal government offers a financial reward.

## **Policy Analysis**

Many land trusts are growing increasingly reliant on government subsidies to fund the purchase of land and easements. New federal programs offer financial support to local land trusts, but reliance on federal money builds dependence on government. This can discourage private participation and funding, which is key to gaining community support.

For a landowner to receive a tax benefit the IRS requires that an easement be granted in perpetuity. As most landowners understand, land values and uses change over time. An area that was once best used for timber production or livestock grazing, may later be best used for agriculture or housing. By extending the term of an easement indefinitely, future generations will have little ability to adjust the use of the land to that which best fits the needs of society.

The land trust approach is subject to abuse. One tactic employed by some activists is coordinated government coercion. With increased frequency, non-profit land trusts are plotting with local and state governments to zone or otherwise restrict the use of private property. By doing so, they reduce the value of that property, making it less expensive for the land trust to purchase. The landowner, on the other hand, has little recourse once his land value is reduced through regulation. In many cases, the only alternative is to negotiate a deeply discounted purchase agreement with the land trust.

While it is important to be aware of the problems with land trusts, landowners in Washington can also look to many examples of success. Across the country, land trusts are

working closely with local landowners to cooperatively achieve the conservation goals of the community. In many cases, ranchers and farmers voluntarily establish land trusts to protect their community from approaching development. In other circumstances, timberland owners have worked with land trusts to reduce their tax burden and maintain timber harvest as a viable land use.

## **Recommendations**

**1) Rescind the requirement that easements be granted in perpetuity.** Conservation easements would be more attractive to land owners if they were not required to be permanent. Long-term easements (99+ years) would achieve much the same conservation goals, but would allow the legal status of the land to be reconsidered at some future time as the needs of society change.

**2. Avoid using land trusts as an arm of government.** The great advantage of land trusts is they are voluntary. As a matter of public policy, voluntary land transactions are preferable to regulatory coercion, which sometimes results in citizens being unjustly deprived of the ownership or use of their property.

**3. Encourage a cooperative relationship between land trusts and members of the local community.** Failure to abide by these core principles undermines the mutual trust necessary for a successful voluntary conservation program and distorts the environmental-protection interests of the broader community.



## 6. Climate Change and Global Warming

### Recommendations

1. Fully evaluate both cost and benefits of any new global warming policy.
2. Encourage economic growth to limit effects of climate change.
3. Develop market incentives for limiting potential pollutants.

*(This section contributed by John A. Charles, Jr.)*

### Background

The global warming debate can be broken down into three simple questions:

- First, is human activity causing the earth's climate system to become warmer (or cooler) beyond what would occur naturally?
- Second, if we are altering world climate, is that bad?
- And third, if it is bad, is there anything we can do about it?

The answer to the first question is that no one really knows how human behavior is affecting climate. The growing use of fossil fuels since the dawn of the Industrial Revolution has raised the ambient concentrations of carbon dioxide (CO<sub>2</sub>) by about 30 percent, and since CO<sub>2</sub> absorbs infrared radiation, this increase has the potential for warming the earth's atmosphere. But no definitive causal link has ever been established, and as recently as 1975 many scientists were actually worried about catastrophic global cooling.

## Conflicting Trends

The evidence from monitoring stations produces trend lines going in multiple directions, depending on where, when and how climate parameters are measured. For instance, in the report, “Climate Change 2001: The Scientific Basis,” published by the Intergovernmental Panel on Climate Change (IPCC), the authors note that,

“Surface, balloon and satellite temperature measurements show that the troposphere and Earth’s surface have warmed and that the stratosphere has cooled. Over the shorter time period for which there have been both satellite and weather balloon data (since 1979), the balloon and satellite records show significantly less lower-tropospheric warming than observed at the surface. In the upper troposphere, no significant global temperature trends have been detected since the early 1960s.”<sup>xiv</sup>

In addition to conflicting trends, there is a serious problem of measurement error. Measurement stations are relied upon to provide temperature information representing large areas that may be hundreds or thousands of square miles, but climate parameters can vary widely even at the most local level. Perhaps nothing illustrates this more than a news story that appeared in the *Portland Tribune* on December 20, 2003. The headline read, “Snow? Depends on where you live.” The article pointed out that even though most of Portland had been pounded with heavy snow the previous day, the “official” government measurement site at the Portland airport recorded no snow.

So if a team of climate scientists arrived in Portland tomorrow and began using the airport weather measurements as part of a global climate study, their statistical data base for December 19, 2003 would not just be biased; it would reflect

the exact opposite of what was experienced by virtually everyone in the Portland region on that day.

Multiply this aberration by the billions of other dates and locations on the earth where measurement errors could occur, and it becomes apparent that “global” averages are virtually meaningless for policy analysis.

### **Policy Analysis**

Notwithstanding these severe data gaps, climate alarmists claim that global temperature averages are increasing and that this poses substantial threats to human civilization. Among other gloomy outcomes, they predict that increased CO<sub>2</sub> will lead to rising sea levels and an increase in the severity or frequency (or both) of extreme weather events such as floods, hurricanes and droughts. But this is all speculation based on computer models; the IPCC has stated, “There is no compelling evidence to indicate that the characteristics of tropical and extra-tropical storms have changed.”

A more realistic outlook would take into account the known benefits of CO<sub>2</sub>. Carbon dioxide is an essential element for the process of photosynthesis by plants. Literally thousands of empirical studies have shown that most plants thrive under conditions of increased CO<sub>2</sub>. Many experts believe that perhaps 10 percent of the increased agricultural production the world has experienced during the 20th century can be attributed to the fertilization effects of man-made CO<sub>2</sub>.

### **High Cost, Few Benefits**

The benefits of increased CO<sub>2</sub> concentration are important to keep in mind, because there is little evidence that we can actually reduce global warming anyway. Moreover, even if we felt confident that reducing CO<sub>2</sub> locally would slow warming, a pound of CO<sub>2</sub> has the same effect on climate whether it is produced in the Pacific Northwest or China, and

any actions we take here could (and probably would) be negated by off-setting actions elsewhere. So thinking globally and acting locally in this case would be an all-pain, no-gain proposition for taxpayers.

Notwithstanding these concerns, in 1997 Oregon passed the nation's first law regulating CO<sub>2</sub> from new electrical generating facilities.<sup>xv</sup> A similar law was recently enacted by Washington' own Energy Facility Site Evaluation Council (EFSEC), the organization that approves most major new power plants in the state.<sup>xvi</sup> Under Oregon's law, emissions from most natural gas fired power plants are capped at a rate 17 percent below the cleanest known facility in the country. To obtain a state permit a plant developer has two choices: Either install the costly equipment mandated by state regulations or pay a state-sponsored non-profit group, called the Climate Trust, to "offset" any excess emissions.

In its first two years of operation the Trust received more than \$6 million in revenue. One of the projects it sponsored was an internet-based carpool program run by the city of Portland. The Trust ranked this program very high for its potential to reduce single occupant driving, but after the first year of implementation so few people had signed up that each new carpool formed had cost electricity ratepayers about \$29,000.

The high costs and limited results of the Oregon program highlight a problem with the regulatory approach: once money is taken from taxpayers, there is no guarantee it will be spent wisely. To the extent it is wasted, the tax program simply destroys wealth while having no impact on the climate.

## **Recommendations**

**1) Encourage economic development in poor countries.** Wealth creation is the key to mitigating any impacts from climate change. Richer societies are better able to anticipate

change and invest in better infrastructure. Spending ourselves into poverty in the pursuit of unobtainable goals will demonstrably make most people worse off, both now and for generations in the future.

**2) Fully evaluate both costs and benefits of any new global warming policy.** The costs of implementing many CO<sub>2</sub> emission controls far outweigh any potential benefit. It would be far more cost effective to focus our energies on improving technology and reducing emissions in parts of the world where few controls exist today. In places like China, Russia and other developing countries we can achieve significant emission reductions for a relatively low cost. It is also important to consider the benefits of increased atmospheric CO<sub>2</sub> before embarking on a costly global campaign.

**3) Develop market incentives for limiting potential pollutants.** Emission trading plans implemented in the eastern United States have successfully limited pollution while maintaining private industry's ability to allocate resources efficiently. This approach should be pursued for any government attempt to limit CO<sub>2</sub> emissions.

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## 7. New Source Review and Air Pollution

### Recommendations

1. Bring Washington laws into compliance with federal guidelines.
2. Establish certainty in the regulatory process to encourage development of new power generating capacity.

### Background

In 2002 the U.S. Environmental Protection Agency (EPA) announced changes to federal air pollution regulations that would update current laws to better accommodate technology improvements and facility repairs without threatening environmental quality. The regulation in question is called New Source Review, or NSR, and it governs industrial emissions from facilities like power plants and factories under the federal Clean Air Act. Because of Washington's large manufacturing base and growing power needs, changing federal air regulations can have a big impact on our economy and environment.

Under the old version of NSR, any changes made to existing facilities were often interpreted to be new sources of pollution, even if the total emissions from the facility did not increase as a result of the improvements. Under that program, many old, inefficient power plants delayed upgrading their facilities so they could avoid costly federal review. In effect, the strict requirements prevented many old, inefficient power plants and manufacturing facilities from adopting new, cleaner technology.

In the mid-1990s federal regulators recognized the need to update the NSR process. After almost 10 years of public comment and scientific analysis, the EPA announced the new

rules in 2002.<sup>xvii</sup> The changes allow power plants and manufacturers to upgrade their facilities, making them more efficient and often times reducing pollution, without going through the costly process of New Source Review, as long as pollution levels do not exceed their existing permitted level. The fundamental concept of the new law is to make NSR what it is meant to be – a thorough review of any new sources of pollution – not a hindrance to regular plant maintenance and improvements.

### **Policy Analysis**

Here in Washington we have a comprehensive, two-tiered NSR program. Under Washington law, the Department of Ecology (DOE) has the authority to enforce federal NSR regulations. Projects that affect large facilities and meet certain federal thresholds are considered a “major” emission source and are subject to federal NSR requirements. These projects are usually large, industrial projects that require a Prevention of Significant Deterioration (PSD) permit, which ensures that any facility upgrades do not increase pollution or harm the environment.

A separate program managed by the state that covers all “minor” new sources of air pollution regulates any project that does not meet the federal threshold. Under the state’s NSR program, the Department of Ecology requires the installation of Best Available Control Technology (BACT) for even small increases in pollution.<sup>xviii</sup> County or regional air pollution authorities administer most minor new source regulations with oversight from DOE.

The combination of major and minor New Source Review in Washington offers a unique and effective protection against increased air pollution. The vast majority of projects are regulated by state, not federal guidelines. Of the few projects that do qualify for federal oversight, the system is currently in limbo. State regulations currently incorporate the old, out-of-

date EPA guidelines by reference. The state also has been given the authority to implement the new federal rule announced in 2002. Court challenges being pursued by some east coast states and environmental groups have delayed full implementation of the federal changes.

Ensuring cheap and reliable power is a vital function of state government. The existence of two sets of rules, one based on an outdated federal standard, adds significant uncertainty to the business climate and drives up the cost of power and other manufactured products. Observers are optimistic that ongoing negotiations between industry, environmentalists and state regulators will resolve the existing conflict between state and federal guidelines. Eliminating the regulatory conflict will help reduce uncertainty and allow power producers to plan for new projects that can deliver abundant, clean energy to Washington customers using the most efficient and environmentally friendly technology available.

## **Recommendations**

**1) Bring Washington laws into compliance with federal guidelines.** Changes proposed to New Source Review by the federal government will clarify confusing and outdated standards adopted by the Clinton Administration. Under Washington law minor emission increases, which make up the majority of all projects, will still be subject to the state's BACT requirements, and any major emission increases will be covered by the EPA's updated PSD permitting program, which protects against environmental damage while clarifying regulations on routine maintenance and repair work.

**2) Establish certainty in the regulatory process to encourage development of new power generating capacity.** It is in the state Department of Ecology's best interest, both environmentally and economically, to adopt the EPA's changes in New Source Review. Without the new rules, the life of old, inefficient power plants and manufacturing facilities will be



unnecessarily prolonged and the cost of power for Washington residents and businesses will continue to increase.

## **Additional Resources**

### Washington Policy Center Research

“An Alternate Framework to the U.S. Commission on Ocean Policy,” by Michael DeAlessi, July 2004

“Smart Growth and Housing Affordability: Evidence from Washington State,” by Samuel R. Staley, Leonard C. Gilroy, April 2003

“Private Land Trusts: A Free-Market Forest Conservation Tool,” by Eric Montague, October 2002

“Saving Our Salmon: Using the Free Market to Protect the Environment,” by Travis W. Misfeldt, March 1999

### Other Resources

“Free Market Environmentalism,” by Terry L. Anderson and Donald R. Leal, Palgrave, January 2001, New York, NY

“The Skeptical Environmentalist: Measuring the Real State of the World,” by Bjorn Lomborg, Cambridge University Press, Cambridge, United Kingdom, 2001

Property and Environment Research Center - A national think tank based in Bozeman, Montana that provides free-market solutions to environmental problems. [www.perc.org](http://www.perc.org)

Foundation for Research on Economics and the Environment - A national think tank that applies economics and scientific analysis to generate and explore alternative and innovative solutions to environmental problems. [www.free-eco.org](http://www.free-eco.org)

*Environment & Climate News* provides a monthly overview of national and international environmental news with a market-oriented perspective. [www.heartland.org](http://www.heartland.org)

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<sup>i</sup> For more information about the work of Stewardship Partners, visit [www.stewardshippartners.org](http://www.stewardshippartners.org).

<sup>ii</sup> For more on cooperative conservation and the relationship between new environmentalists and old-line regulators see, “Interior Design: An Interview with Department of Interior’s Lynn Scarlett, one of the architects of Bush’s New Environmentalism,” in *Grist Magazine*, January 12, 2004.

<sup>iii</sup> In 1995 the Legislature adopted language stating that, “In designating and protecting critical areas under this chapter, counties and cities shall include the best available science in developing policies and development regulations to protect the functions and values of critical areas.” RCW 36.70A.172. For an example of the legal controversy surrounding best available science, see *Whidbey Environmental Action Network vs. Island County*, Washington State Court of Appeals, Division I, September 9, 2003.

<sup>iv</sup> “Smart Growth and Affordable Housing: Evidence from Washington State,” by Samuel R. Staley, Ph.D., and Leonard C. Gilroy, AICP, Reason Public Policy Institute and Washington Policy Center, May 2003, <http://www.washingtonpolicy.org/GovtRegulations/PBRPPIGrowthManagement.html>.

<sup>v</sup> Data on income from Washington State Office of Financial Management, at [www.ofm.wa.gov](http://www.ofm.wa.gov); data on home prices from Washington Center for Real Estate Research at Washington State University, [www.cbe.wsu.edu](http://www.cbe.wsu.edu).

<sup>vi</sup> For more see, “Smart Growth and Housing Affordability: Evidence from Washington State,” by Samuel R. Staley and Leonard C. Gilroy, May 2003, available at [www.washingtonpolicy.org](http://www.washingtonpolicy.org).

<sup>vii</sup> Find a list of GMA planning goals at RCW 36.70A.020.

<sup>viii</sup> Data provided by Washington Forest Protection Association (WFPA) in “Forest Facts and Figures,” a study of forestland in Washington state published in March 2002, available at [www.forestsandfish.com](http://www.forestsandfish.com). The WFPA is an organization representing private forestland landowners across Washington.

<sup>ix</sup> “Annual Report for Fiscal Year 2003: July 1, 2002 - June 30, 2003,” Washington State Department of Natural Resources, available at [www.dnr.wa.gov](http://www.dnr.wa.gov).

<sup>x</sup> More information on DNR’s adopted Sustainable Harvest Calculation is available online at [www.dnr.wa.gov](http://www.dnr.wa.gov).

<sup>xi</sup> Critics of the new Sustainable Harvest Plan often claim that the increased logging proposed by the Board of Natural Resources is unsustainable in the long term. This is simply incorrect. Even with the more aggressive harvest plans adopted by the Board, timber inventory on state forests will continue growing every year that the plan is in place. For more see, “Alternatives for Sustainable Forest Management of State Trust Lands in Western Washington: Final Environmental Impact Statement,” July 2004, available online at [www.dnr.wa.gov](http://www.dnr.wa.gov).

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<sup>xii</sup> More information on the threat of wildfire on our national forests is available from the USDA Forest Service at [www.fs.fed.us/projects/hfi](http://www.fs.fed.us/projects/hfi).

<sup>xiii</sup> Land trust contributions are governed by 26 USC § 170(c)(2) and Internal Revenue Code § 170(h).

<sup>xiv</sup> To review the IPCC report, visit [www.ipcc.ch](http://www.ipcc.ch).

<sup>xv</sup> For more details on Oregon's Carbon Dioxide Standard for new energy facilities, visit the Oregon Department of Energy at [www.energy.state.or.us](http://www.energy.state.or.us).

<sup>xvi</sup> For more information on Washington's Carbon Dioxide mitigation requirements for new energy facilities, visit the Energy Facility Site Evaluation Council at [www.efsec.wa.gov](http://www.efsec.wa.gov).

<sup>xvii</sup> An in-depth explanation of new federal New Source Review regulations is available from the Environmental Protection Agency at [www.epa.gov/nsr/](http://www.epa.gov/nsr/).

<sup>xviii</sup> Washington Administrative Code 173-400-141 governs the requirement for Best Available Control Technology.



## Chapter 4: Health Care

### 1. Health Care Mandates

#### Recommendations

1. Legalize basic health insurance.
2. Create an independent review commission to determine the true cost of mandates.
3. Adopt a moratorium on enacting new health care mandates.

### Background

Paying for health care coverage is one of the fastest-rising costs facing businesses and families in Washington. At the same time health insurance is one of the most heavily regulated sectors of our state's economy. These two trends are linked, with increasing state regulation playing a major role in driving up the cost and reducing the accessibility of health care coverage.

Nationally, health care spending grew almost eight percent in 2003, to an estimated \$1.6 trillion. Health care spending now makes up about 15 percent of the national economy. Employers routinely see their cost of providing health care coverage increase by double digits every year, while annual general inflation is only about two percent.

Health care costs are rising for a number of reasons which are clearly beyond the control of state policymakers, but there is one key factor which state policymakers directly control; the cost and impact of state-imposed mandates. Mandates are state laws that list certain medical procedures that every health insurance policy sold in the state must cover,

whether insurance customers have requested the coverage or not.

State-imposed mandates interfere directly in the normal voluntary relationship between buyer and seller. Mandates mean insurance customers are forced to pay for medical coverage they may not otherwise choose. This leads inevitably to a “crowding out” effect, by which other types of coverage are not available because insurers must offer the benefits mandated by the state instead.

Beginning with a single access-to-provider mandate in 1963 (for chiropody), the number of new mandates and enacted changes to existing mandates in Washington has now grown to 47. During two distinct periods the number of new mandates surged. Between 1982 and 1990 the number of mandates tripled from 10 to 30, and from 1993 to 2001 their number increased a further 50 percent.<sup>i</sup> Such an extensive set of legal restrictions on what consumers can buy would have a substantial impact on any industry. It is not surprising, then, that mandates have a substantial impact on health insurance prices and availability.

Research by the Congressional Budget Office (CBO) has found that “government regulation at both the state and federal levels can also increase the costs of health insurance and lead to higher premiums.” CBO reported that “mandates to cover specific benefits such as chiropractic services or minimum hospital stays for births” as examples of such high-cost insurance regulations.<sup>ii</sup>

Mandates and their associated cost contribute to the number of uninsured people in Washington. Since 1992 the number of new mandates and changes to existing mandates rose, as noted, by more than 50 percent, increasing from 30 to 47. Over the same period the uninsured rate in Washington increased by almost a third, rising from 10.4 to 13.7 percent.

Today, Washington has one of the highest uninsured rates in the country.

The authors of one national study found that state-imposed mandates may account for as many as one in four Americans who are uninsured. “Mandates are not free,” they report, “They are paid for by workers and their dependents, who receive lower wages or lose coverage altogether.”<sup>iii</sup>

Another study found a strong correlation between higher health coverage costs and increases in the uninsured population. Professors Frank A. Sloan and Christopher J. Conover of Duke University found that, “...the higher the number of coverage requirements placed on plans, the higher the probability that an individual was uninsured, and the lower the probability of people having any private coverage, including group coverage. The probability that an adult was uninsured rose significantly with each mandate present.”<sup>iv</sup>

## **Policy Analysis**

The number of mandates and other state-imposed regulations means that basic health insurance is no longer legally available in Washington. The state code contains a “value” or “bare-bones” insurance provision dating from 1990, but it includes so many detailed regulatory requirements it is clearly not “basic” insurance.<sup>v</sup>

A policy allowing true basic health insurance free of state-imposed mandates would confer the following advantages:

- Advance the public interest – the public benefits when government policies allow greater, rather than fewer, choices in the health care market.
- Promote personal freedom – citizens would have greater say in one of the most personal and sensitive areas of life.

- Enhance market efficiency – health care consumers would be able to seek the coverage they need at a price they are willing to pay.
- Reduce the number of uninsured – individuals, families and small business owners who are currently priced out of the market would have new opportunities to gain access to health insurance.

## Recommendations

**1) Legalize basic health insurance.** Such insurance should be made available to individuals and to firms with up to at least 100 employees, should be exempt from state-imposed mandates, and should allow pricing that reflects its actual value to consumers.

**2) Create an independent review commission to determine the true cost of mandates.** As has been done in other states, such a commission, independent of the legislature, could more accurately determine the role of mandates in driving up the cost of health coverage.

**3) Adopt a moratorium on enacting new health care mandates.** A moratorium on new mandates would create a much-needed “time-out” in the growth and complexity of health insurance regulations. This in turn would give policymakers and the public the opportunity to learn more about the long-term impact of mandates on the price and availability of health care coverage.



## 2. Health Savings Accounts (HSAs)

### Recommendations

1. Offer Health Savings Accounts as a benefit option to state and local government employees.
2. Encourage insurance companies to enter the Washington HSA market to promote choice and price competition that benefits consumers.
3. Urge Congress to make premiums for the catastrophic insurance policies that accompany HSAs tax deductible.

### Background

The current system of employer-based health care coverage dates to the period of wage controls the federal government imposed during World War II. Since they could not offer higher wages to attract workers, employers began offering non-monetary benefits such as free health care. An October 1943 ruling by the IRS said the cost of these benefits was a legitimate business expense, making health coverage fully tax deductible for businesses, but not for individuals.

That ruling, later confirmed by Congress, in turn creates three major, interconnected distortions in the health care market:

- 1) It keeps patients from knowing the true cost of the care they receive.
- 2) It creates the notorious third-party payer problem, causing patients to demand care that is not always needed or affordable. As anyone with an expense account knows, the menu in an expensive restaurant

looks a lot different when someone else is paying the bill.

3) It undermines the true understanding of health insurance. People tend to see their health benefits as a pre-paid service, not as a way of mitigating risk. People reason, “It’s a free benefit. I’ll use as much as I can.”

The law changed on December 8, 2003 when President Bush signed the Medicare Prescription Modernization and Improvement Act. The following January 1, individual Health Savings Accounts became legal which, for the first time in 61 years, allowed consumers to purchase health coverage with the same tax advantage as businesses.

Workers in Washington and throughout the country can now make pre-tax deposits into a secure account that can be used to pay for routine health care expenses. The accounts must be accompanied by a catastrophic health insurance policy with a deductible of at least \$1,000 for an individual or \$2,000 for a family policy.

Annual HSA deposits cannot exceed the amount of the health insurance deductible, with a maximum limit of \$2,600 for individuals and \$5,150 for families. These limits are indexed to inflation and will increase in future years. Account balances can earn interest or be invested in stocks or mutual funds. Interest and investment earnings are tax-free. HSA balances belong to individual account holders and remain theirs if they change jobs, become unemployed or retire. The funds can be used to pay expenses not covered by insurance, insurance premiums while unemployed and health expenses during retirement. The following points summarize how HSAs work.

### **How Health Savings Accounts Work**

- Each HSA must be accompanied by a high-deductible catastrophic health care plan.
- Allows annual tax-free contributions equal to the amount of the catastrophic insurance deductible.
- Minimum annual contribution is \$1,000 for individuals and \$2,000 for families.
- Maximum annual contribution is \$2,600 for individuals and \$5,150 for families; limits are indexed to inflation.
- Contributions to an HSA may come from any source: self, parent, spouse, grandparent, employer.
- Funds may be spent tax-free on qualified medical expenses.
- Investment earnings in the account accumulate tax-free.

The idea behind HSAs is simple. Congress intended that individuals should be able to manage some of their own health care dollars through accounts they own and control. They should be able to use these funds to pay expenses not paid by third-party insurance, including the cost of out-of-network doctor and diagnostic tests. They should be able to profit from being careful consumers of medical treatment by having account balances grow tax free and eventually, at retirement, be available for non-medical purchases.

### **Policy Analysis**

Health Savings Accounts carry several additional advantages for employees. On top of making health coverage more affordable, Congress intended them to serve as another way for working people to build financial assets. The money in an HSA is private property; it is not controlled by the

government or employers. HSAs are legally available to 260 million people - all Americans under age 65. Congressional researchers estimate that over the next 10 years, as the market develops, some 40 million people will acquire HSAs. Any HSA funds not spent on qualified medical expenses before retirement are subject to full taxation plus a 10 percent penalty. Unlimited annual rollover is allowed – unspent funds in the account can accumulate year to year.

At retirement HSA funds can be used for any purpose. Although normal income taxes are due on money spent for non-medical purposes, no 10 percent penalty is levied. There are never taxes or penalties for health costs, including long-term care expenses. Funds in existing Medical Savings Accounts can be rolled into an HSA. And finally, because they are private property, money in HSAs can be inherited by heirs or a surviving spouse.

HSAs also carry advantages for employers. The accounts provide flexible service to employees that meets their needs. There is no take-it-or-leave-it requirement as with traditional employer-provided plans. There are lower administrative costs, less paperwork and less record-keeping. HSAs are managed by workers or their chosen financial advisors, not by the employer.

There is no need for annual negotiations with insurers, unless employers choose to do so. HSA contribution limits are set by law, and employers can provide the accompanying catastrophic coverage, or employees can shop for their own. Total annual expenses to employers are limited. Whether the employer chooses to provide catastrophic coverage, or make full or partial contributions to each employee's account, total annual health care costs to the employer are known on January 1st each year.

The advent of consumer-based Health Savings Accounts will bring true price and service competition to the health care

market. Doctors, clinics and hospitals will have to meet the expectations of consumers, rather than simply satisfying the requirements of insurers or government regulators. People will start to shop for basic health care. Providers will get questions they usually don't hear from patients such as, "So, doctor, how much are you going to charge me for that?" Patients will be less willing to sit in a clinic waiting room until 9:45 for a 9:00 a.m. appointment, or pay for six x-rays when three may be enough. Some providers will respond better than others, and a significant shake-out in the medical provider market is to be expected.

In addition to making coverage more accessible, Health Savings Accounts carry a number of civic and social advantages. They make people more independent and self-reliant, rather than dependent on government or employers for a vital life necessity. HSAs encourage people to be more accountable and responsible in their own lives. When choices about health coverage are made by employers or government, citizens become the passive recipients of decisions made by others.

HSAs promote medical privacy. Many people are concerned about their employer or a large insurance company having access to their medical records. When medical bills are paid through a personal HSA, perhaps using a debit card tied to the account, the private, confidential relationship between patients and doctors is maintained.

Finally, HSAs represent a major shift of assets from corporate employers to individuals. Over time the money held in Health Savings Accounts will add significantly to the \$45 trillion Americans currently hold in household net worth.

Nearly all insurance carriers currently in the Washington market are offering some type of HSA product. Premera BlueCross (through its subsidiary LifeWise), Regence BlueShield, KPS Health Plans, Cigna Health Care, Aetna and

PacifiCare of Washington all offer HSAs. Group Health Cooperative has announced it also plans to enter the market.

## **Recommendations**

**1) Offer Health Savings Accounts as a benefit option to state and local government employees.** Governments are often slow to take advantage of innovations that develop in the private marketplace. In this case, however, early adoption of HSAs as a choice for public employees can improve the quality of benefits and significantly reduce the rising cost of health coverage for the state and local governments.

**2) Encourage insurance companies to enter the Washington HSA market to promote choice and price competition that benefits consumers.** Over the years insurance companies have steadily left the state, leaving consumers with fewer choices. The advent of HSAs offers a way to reverse that trend. The legislature and Insurance Commissioner should encourage insurers from around the country to enter the state's emerging HSA market.

**3) Urge Congress to make premiums for the catastrophic insurance policies that accompany HSAs tax deductible.** Under current federal law, money paid for the catastrophic insurance that must go with each Health Savings Account carries no tax advantage, yet all other financial aspects of HSAs – contributions, earnings and payouts – are tax free. State policymakers should encourage Washington's congressional representatives to make catastrophic health insurance premiums fully tax deductible.

### 3. Medical Liability Reform

#### Recommendations

1. Change state medical liability law to place a reasonable limit on non-economic damages.
2. Place a cap on how much of a medical liability award can be claimed by lawyers, to insure that injured patients receive just compensation.
3. Encourage the use of voluntary mediation and alternative dispute resolution processes to increase the number of medical liability claims that are settled before they go to court.

#### Background

The cost of health care is rising across the nation. Washington is one state where it is rising the fastest. A major component of growing costs is Washington's tort system, which allows juries to award unlimited non-economic damages to patients injured by the negligence of a doctor.

The growing prospect of multi-million dollar payouts has spawned tremendous growth in the size of claims against our state's doctors, forcing them to spend millions of dollars each year to defend themselves against costly and often frivolous lawsuits.

A recent report by the American Medical Association places Washington on a list of 12 states facing a medical malpractice crisis that threatens the viability of the medical community and the health of patients.

As a direct result of continually rising costs, doctors are retiring and leaving the state in record numbers. Between 1998 and 2002 more than 500 doctors left the state, according to the

Washington State Medical Association, an increase of 31 percent from previous years. Between 1996 and 2001 the number of doctor retirements increased 50 percent over previous years, and the average age of retirement dropped from 63 to 58. Some counties in the state no longer have doctors who can provide women with obstetrics and gynecological services.

In addition to doctors leaving their practices, two major insurers recently ended their physician insurance businesses in Washington. CNA left more than 1,100 doctors searching for new insurance in 1997, and in late 2001 Washington Casualty Company, the state's second largest physician insurance company, eliminated coverage for more than 1,300 physicians and doctors.

At the same time, the annual premium required by the few companies that continue to offer coverage is skyrocketing. Over the last five years, the average insurance cost for a family physician increased 29 percent to almost \$10,000. Orthopedic surgeons have seen a similar 30 percent increase to \$39,000 a year, and obstetricians have been forced to absorb a staggering 39 percent average increase, from \$37,000 in 1998 to almost \$52,000 today. Some specialists, like neurologists, must pay close to \$100,000 a year for medical liability coverage.

## **Policy Analysis**

Seventeen other states have adopted some form of limitation on non-economic damages, many with broad bipartisan support. Two states in particular offer useful examples of successful reform. In 1975 the California legislature passed the Medical Injury Compensation Reform Act, or MICRA.

The wide-ranging reform limits the size of non-economic damage awards and controls the fees collected by plaintiff's attorneys. It has restored balance to the malpractice system, reducing costs for both patients and doctors, while



maintaining the necessary protections against doctor negligence and patient harm.

Under MICRA, malpractice claims in California are settled in one-third less time than the national average of more than five years, and malpractice insurance rates have dropped by 40 percent since MICRA's inception. The result is a system that better serves the needs of patients by reducing the cost of litigation and speeding compensation payments.

Reforms in Colorado have enjoyed similar success. Since adopting a MICRA-like system, average premiums in Colorado have gone from increases of between 20 and 70 percent a year, to average increases of between one and nine percent today. Malpractice insurance costs for many medical professionals have actually dropped since the mid-1980s, reflecting the success of placing reasonable limits on the non-economic damages juries can award defendants.

Nationally, about one out of every six practicing doctors face a malpractice claim every year. In some high-risk fields, like orthopedics, obstetrics and trauma surgery, every doctor faces on average one claim every two and a half years. The cost of defending against these lawsuits averages more than \$20,000 per defendant. Fully 70 percent of all malpractice claims are thrown out before ever reaching the courtroom. For those that do go to court, a trial that results in the doctor's vindication costs an average of \$85,000.

Washington needs reforms similar to those in other states that are successfully reducing costs while protecting patients. Practical reforms include reasonable limits on non-economic damages, encouraging the use of mediation, alternative dispute resolution and a cap on plaintiff attorney fees. Under these reforms the law would still permit unlimited court awards for measurable economic damages such as medical bills and lost lifetime earning. With intelligent changes in medical liability law, policymakers can increase affordability

and access to health care, and assure that doctors in Washington are able to continue practicing medicine.

## **Recommendations**

**1) Change state medical liability law to place a reasonable limit on non-economic damages.** A common limit on non-economic damages used in other states is \$250,000. Whatever figure policymakers in Washington may consider appropriate, the point is to have some reasonable limit in law so insurers can more accurately assess risk when selling liability coverage to doctors, clinics and hospitals.

**2) Place a cap on how much of a medical liability award can be claimed by lawyers, to insure that injured patients receive just compensation.** Often, by the time the court costs, researchers, expert witnesses and lawyers involved in a case are paid, little money remains for the injured person who brought the suit in the first place. Limits on attorney fees would insure that medical malpractice awards are distributed fairly.

**3) Encourage the use of voluntary mediation and alternative dispute resolution processes to increase the number of medical liability claims that are settled before they go to court.** Settling claims out of court would reduce costs, speed the resolution of pending cases, and secure fair compensation more quickly for injured patients.

## 4. State Formulary Lists

### Recommendation

Policymakers should avoid mandatory formulary lists and allow medical decisions to be made by patients and doctors.

### Background

Medicaid provides medical care assistance to four distinct populations:

- The impoverished elderly, many of whom are in nursing homes;
- People who are eligible due to disability;
- Children with eligible disabilities, and;
- Adults, primarily pregnant women, who are near or below the poverty level.

Over the last four decades, state and federal officials have continuously expanded the scope of state Medicaid programs and consistently underestimated the associated costs. Medicaid began in 1966 with an expenditure of less than \$1 billion nationally. By 1971, annual spending nationwide was \$6.5 billion, more than twice the projected figure.

In 2001, total expenditures were \$228 billion, not including spending on children's health insurance. Long-term care, primarily for the elderly, consumes almost half of current Medicaid budgets. With the baby boomers beginning to retire in 2009, some experts predict that without fundamental changes in the program's structure, a quadrupling of long-term care costs will bankrupt state governments by 2020. At present, Medicaid is second only to education in most state budgets.

In Washington, authorized Medicaid spending for the 2003-2005 biennium is over \$7 billion. The program covers

about 866,000 eligible recipients and requires 981 full-time equivalent staff positions at the Washington Medical Assistance Administration to manage it.<sup>vi</sup>

In Washington, Medicaid spending on hospital stays is almost three times as large as spending on prescription drugs and other nondurable medical supplies. Payments for other professional services, health practitioners other than doctors and dentists, grew much faster than either hospital stays or prescription drugs.

Masquerading as preferred drug lists, formularies, brand name drug restrictions, and “therapeutic consultation services,” prescription drug price and quantity controls are the latest fad in the continuing struggle to control Medicaid expenditures. Like the construction moratoriums and certificates of need that were the fashion in the 1970s, and the mandatory managed care, block grants, and capitated care that were the rage of the 1990s, centralized control of prescription drug purchases replaces the decisions made by people intimately familiar with the problem at hand with the ill informed dictates of bureaucrats.

Opportunistic politicians put the blame for higher costs on the pharmaceutical industry, arguing it is more profitable than other industries and therefore must be taking advantage of its customers. What these public leaders fail to explain is that it takes an average of fifteen years and \$880 million to develop a new drug.<sup>vii</sup>

For every 5,000 chemical compounds researchers test for use as a treatment of medical needs, on average only one makes it to final approval. Only three of ten drugs that reach final approval actually recover initial research and development costs. Of those three, only one is highly profitable in the marketplace. Earnings from the few successful drugs must pay for the years of scientific study and research that eventually led to their discovery and approval.<sup>viii</sup>

## Policy Analysis

To understand why giving prescription drug boards control of state policy on prescription drugs poses a danger to patients, one must understand that treatment decisions for those who are seriously ill can be an excruciatingly complex balancing act. It is theoretically and practically impossible for government to gather and analyze all the information required to do an even adequate job of making those decisions.

Patients who do not do well on the drug chosen by government bureaucrats, but who might do better on one of the other compounds in a particular class, are simply out of luck. When government formularies respond to a lower price by substituting one medication for another, patients must change their medication regimes. This can cause problems. In one survey, 27 percent of doctors in British Columbia reported admitting patients to hospitals as a result of problems created by government mandated prescription drug substitutions.<sup>ix</sup>

The poor experience in other states with closed and heavily restricted formularies shows that these programs often fail in the primary object – to reduce cost while providing quality care to patients. A 1993 study by W. J. Moore and R. J. Newman looked at formulary restrictions in 47 Medicaid programs. They concluded that:

“ . . . a restricted formulary may reduce prescription drug expenditures by approximately 13 percent, on average. Because of service substitution, however, such a policy does not translate into reductions in total program expenditures. Savings in the drug budget appear to be completely offset by increased expenditures elsewhere in the system.”<sup>x</sup>

In addition to increasing costs by withholding treatment, restrictive formularies are expensive to administer. Researchers S. Sudovar and S.D. Rein compared California’s rule-bound

Medicaid prescription policies with the less restrictive ones in Texas. They concluded that California could have saved \$14 million by switching to the Texas system and that \$5 million of the savings would have come from reduced administrative overhead.<sup>xi</sup>

This estimate does not include the pain and suffering imposed by long waits for more effective medicines. Grabowski et al. looked at the experience of nine states with Medicaid formularies between 1979 and 1985. They found that during the first four years a drug was on the market, Medicaid patients had access to new drugs less than 40 percent of the time. This was true for all drugs, even those highly ranked for therapeutic importance.<sup>xii</sup>

Delays cause deaths and suffering. Dr. Louis Lasagna, director of Tufts University's Center for the Study of Drug Development, estimated that 119,000 Americans died during the seven years it took to study beta blocker heart medicines. Although estimates are not available, an earlier approval of the atypical antipsychotics would almost certainly have prevented some of the suicides and deaths by misadventure that plague people tormented by schizophrenia.

Attempts to control health care expenditures by imposing tough restrictions on drugs have also had negative effects on the patients in state programs. When New Hampshire officials sought to control Medicaid costs by limiting prescriptions to three per person per month, schizophrenia patients made more visits to community mental health centers and hospitals. Soumerai et al. estimated that the additional service cost was 17 times higher than the reduction in drug costs.<sup>xiii</sup>

## Recommendations

**1) Policymakers should avoid mandatory formulary lists and allow medical decisions to be made by patients and doctors.** Such lists restrict access to the latest drug treatments, often fail to realize promised savings, and reduce the quality of health care patients receive. Like every other human institution, government has limits. Bureaucracies run government, and the people who staff them are neither omniscient nor necessarily disinterested. Harm done by business bureaucracies is limited by the fact that consumers generally have the ability to find other suppliers or can appeal to the government if they feel they are being treated unfairly.

Companies that refuse to consider their customers' wants and their suppliers' needs soon go out of business. Government bureaucrats face no such limits. They can force people to buy from them regardless of cost, and force suppliers to sell to them regardless of payment. They can force people to accept their choices. As a practical matter, they are limited only by the legal or regulatory restrictions that they choose to obey.

## 5. Drug Re-Importation

### Recommendations

1. Avoid enacting state prescription drug programs that depend on re-importing drugs from Canada.
2. Take advantage of Drug Assistance Programs offered by most major pharmaceutical manufacturers.

### Background

In recent years Americans have sought low-priced, subsidized prescription drugs available under Canada's socialized health system. Here is how it works. The Canadian government fixes the price of the drugs it buys for its publicly-funded medical system. That means any drugs that do not make the government formulary list are virtually unavailable in the country. Those that do appear on the government list have a lower sales price than available elsewhere. By ordering by mail, over the internet or by traveling to Canada, Americans can take advantage of prices for certain drugs that have been negotiated for Canadian patients.

Buying drugs in Canada may not always result in savings. Generic drugs actually cost more in Canada, because the government sets their price at 70 percent of the brand name drug it is replacing. Many generic drugs are sold on the internet to Americans who think they are getting a bargain but may not be.

So far there have been few complaints from Canadians. But over time they may not feel so tolerant about Americans buying up subsidized prescription drugs and exporting them to the United States. In 2003, for instance, Canadians spent \$14.6 billion on prescription drugs while Americans spent more than \$160 billion. If carried out on a large enough scale, re-



importation would eventually undermine the Canadian national health service, since there are more Americans over 60 than there are Canadians of any age.

The Canadian health care system, after decades of centralized control, is having trouble caring for its own citizens. The average time Canadians must wait between getting a referral from their doctor and receiving hospital treatment is now 16.5 weeks, according to the Vancouver, B.C.-based Fraser Institute. The arrival of thousands of Americans seeking to use the country's drug benefit only adds to the pressure on the system.

### **Policy Analysis**

Of course Americans may not necessarily care what Canadians think. Why not get cheaper drugs through the Canadian system of price controls while supplies last? Buying drugs in a foreign country, though, even familiar Canada, has its risks.

The Food and Drug Administration (FDA) is advising patients that they are taking chances when purchasing prescription drugs outside the U.S. FDA officials say that Americans who buy in other countries should know that the drugs are not FDA approved and their safety cannot be assured. The agency is urging groups that help their members buy drugs in Canada to include warnings about the risks of unregulated importation.

Those risks are real. Years ago, thalidomide was banned in the U.S., but was widely available in other countries until its propensity to cause severe birth defects was tragically demonstrated beyond doubt. In 1999, an 18-month old girl died when she was given an injection of an anti-fever drug that had been illegally imported into this country. In spring 2002 prosecutors in New York confiscated 25,000 fake Viagra pills, each one falsely stamped with Pfizer's logo. Some had small

amounts of the anti-impotence medicine's active ingredient and some had none. Considering they were ingesting a substance from a questionable source, users should have been relieved when the compound produced no reaction at all.

Drugs bought off Canadian websites may actually be from Iran, Argentina, South Africa or Brazil. Drugs from such countries may be counterfeit and contaminated. In Brazil, for instance, over 50 percent of some classes of drugs are counterfeit.

Prescription drug fraud is a serious world-wide problem. The World Health Organization estimates that some 10 percent of branded medicines are counterfeit. Canada may seem a safer source for illegally-imported drugs than Mexico or Asia, but not all north-of-the-border outlets are reputable. In May 2002, charges were filed against a Toronto company called The Canadian Drug Store, Inc. for operating an unaccredited pharmacy and filling prescriptions without the supervision of properly-licensed pharmacists.

Yet even tough Canadian law enforcement is designed to protect Canadians, not Americans. Drugs manufactured by Canadian companies for export only are not regulated by health authorities. Drugs sold in Canada may actually come from an unknown third country, and may only be shipped to Canada so they can be sold to Americans, thereby bypassing both U.S. and Canadian health standards.

Copycat drugs may carry labels similar to those of U.S. prescription drugs, but may be far less effective than the brand-name products they imitate. University of San Francisco professor Rick Roberts, who has AIDS, at first responded well to innovative drug therapy, but after a few months he began to have complications with the treatment. His pharmacist told him, "You may have gotten some of the fake stuff."<sup>xiv</sup> After months of intensive lab work, they discovered that he had received two different types of counterfeit medicine – the first

was the hormone that women produce when they are pregnant. The second was one-sixth the strength of the growth hormone that he was supposed to be taking, and it had been contaminated. Given the efforts of counterfeiters to slip phony drugs on to the U.S. market, patients are even more likely to receive counterfeits when drugs are brought in illegally from another country.

U.S. citizens may have no recourse to Canadian courts if they become victims of a counterfeit drug scam. Americans are among the sharpest shoppers in the world, but to shop smart we need accurate information about what we are being asked to buy.

The solution to high prescription drug costs will not be found in another country. The long-term answer lies in open competition, reasonable regulation and market-based pricing. That is the surest and fairest way to provide all Americans with safe, effective and affordable prescription drugs.

Despite federal law to the contrary, some states, like Illinois, have sought to pass laws allowing drug re-importation. In Washington a bill to legalize prescription drugs from Canada, HB 2469, passed the state House on February 13, 2004, but did not come to a vote in the Senate.

## Recommendations

**1) Avoid enacting state prescription drug programs that depend on re-importing drugs from Canada.** Under current federal law such state programs are illegal. More importantly, such programs could endanger public safety. U.S. health officials have announced they cannot assure the safety of unmonitored drugs that come from another country.

**2) Take advantage of Drug Assistance Programs offered by most major pharmaceutical manufacturers.** Pfizer, Eli Lilly, GlaxoSmithKline and most other major drug companies offer programs that help low-income people gain access to their products. State policymakers should take full advantage of these programs before imposing a restrictive, mandatory state program that will undermine the development of new drugs.

## 6. An Appointed Insurance Commissioner

### Recommendation

Consider making the Insurance Commissioner an appointed position under the Governor.

### Background

Insurance is one of the major financial service industries in our state. Each year the people of Washington spend more than \$19 billion on insurance of all kinds to protect their homes, families and businesses from unforeseen disaster.<sup>xv</sup> It is also one of the most heavily regulated industries in the state. As a senior state official, the Insurance Commissioner is entrusted with enforcing the state's insurance laws and protecting the public interest.

The Insurance Commissioner is responsible for regulating the financial well-being of the 1,374 insurance companies, Health Maintenance Organizations (HMOs) and Health Care Service Contracts that are active in Washington's insurance market.<sup>xvi</sup> About fifty of these are "domestic" insurers with their headquarters in Washington state, while the rest are based outside the state. Domestic insurers must be examined by the Commissioner's office at least once every five years.

The Commissioner promulgates rules that cover the sale and services of policies sold to provide all types of life, health, auto, home and other property, casualty and marine insurance.

The work of the Insurance Commissioner is an essential part of our state government. A high-level official has been assigned to oversee the state's insurance industry since the state was founded in 1889. Reflecting the primary concern for the

fiscal soundness of the industry, responsibility for enforcing the state’s insurance laws was initially assigned to the Treasurer.

In 1907 the legislature created the Office of the Insurance Commissioner as a separate, directly-elected position. Since then eight commissioners, three Republicans and five Democrats, have held the office. The term of office for Insurance Commissioner is four years.

There is a question about whether this is the most effective way to structure our state government. One viewpoint holds that the best approach involves voters using the “long ballot” to institute the greatest amount of direct democracy by requiring election of a large number of high-level state officials, including Insurance Commissioner.

Another view is that a “short ballot” approach is superior because the people choose a limited number of top officials, who are then held uniquely responsible for the proper functioning of government. Proponents of this view say elected officials are then subject to greater public scrutiny because there are fewer of them. In the area of insurance, all agree that the state must regulate this vital industry in a way that serves the best interests of consumers.

Given the current state of the health insurance market – about 30 insurers have left the state in recent years – an elected Commissioner may not best serve the interest of consumers. For example, in its current form the office could be used as a political stepping stone to higher office.

## **Policy Analysis**

The Insurance Commissioner is one of nine elected officials in Washington. They are Governor, Lieutenant Governor, Secretary of State, Treasurer, Auditor, Attorney General, Superintendent of Public Instruction, Commissioner of Public Lands and Insurance Commissioner. All of these offices,

except Insurance Commissioner, are established by the state constitution. Washington is one of only eleven states that have an elected Insurance Commissioner.

All but one of the other 15 high-level officials in state government are appointed by the governor. The exception is the Secretary of Transportation, who is appointed by the Transportation Commission.

In states with appointed insurance regulators, these officials are insulated from the incessant pressures of everyday politics. They are relieved of the need to raise re-election funds, to maintain a campaign organization, or to hire political consultants and advisors. They are not beholden to campaign donors or to special interests that provide them funding. In short, they do not have to invest all the time and energy needed to run for elective office.

As Oregon's insurance regulator puts it, "the professional insurance regulatory staff and the appointed director of the department (who is also the insurance commissioner) are more insulated by virtue of their appointed or civil service status from inappropriate pressure by interest groups or regulated entities."<sup>xvii</sup> As an appointee such a Commissioner is "not subject to the self-imposed pressure that many elected commissioners appear to be under to keep their name in the public eye constantly and be perceived as a crusader or champion of certain issues."<sup>xviii</sup>

A few years ago the people of Florida adopted a constitutional reform plan with the purpose of creating greater effectiveness and accountability in the executive branch of their state government. The reform reduced the number of elected cabinet positions in state government from seven to four. A central element of the reform was to make the state Insurance Commissioner an appointed position.

Direct authority over an appointed Insurance Commissioner in Washington would strengthen the accountability of the Governor to the people. When a candidate runs on a promise of, for example, making insurance more affordable, and extending coverage to more low-income people, there would be a system in place to test the effectiveness of the Governor's time in office.

Under the current system, the governor has little or no control over insurance policy, rates, legal mandates or regulations. In this important policy area he must defer to the independently-elected Commissioner, who may be more interested in securing re-election than in carrying out the Governor's program. Today the governor cannot be held responsible for the failings, nor can he or she take credit for the successes, in this area of regulation.

## **Recommendation**

**Consider making the Insurance Commissioner an appointed position under the governor.** Making the Insurance Commissioner an appointed position would increase the accountability of the Governor to the people and would take campaign money out of the process of selecting the Commissioner. Any transition should be scheduled to take place at the end of the normal four-year term.



## **Additional Resources**

### Washington Policy Center Research

“Health Care 2004: Opportunities for Reform and Innovation,”  
Presentation binder and Policy Note by Melissa Lambert  
Milewski, 2004

“Health Savings Accounts Will Revolutionize American Health  
Care,” by John C. Goodman, 2004

“Ten Tools for Achieving Consumer Driven Health Care,” by  
Greg Scandlen, June 2003

“Treatment Denied: State Formularies and Cost Controls  
Restrict Access to Prescription Drugs,” by Linda Gorman,  
February 2003

“An Analysis of the Impacts of the Medical Malpractice  
System,” by Eric Montague, 2003

“How Mandates Increase Costs and Reduce Access to Health  
Care Coverage,” by Paul Guppy, June 2002

“The Ten Billion Dollar Entitlement: Assessing the Cost of  
Single-Payer Health Care,” by Paul Guppy, November 2000

### Other Resources

Galen Institute - A free-market think tank focusing on state and  
national health care reform and tax policy. [www.galen.org](http://www.galen.org)

National Center for Policy Analysis - Offers health policy  
research emphasizing consumer driven reforms.  
[www.ncpa.org/iss/hea/](http://www.ncpa.org/iss/hea/)

“A Legislators and Consumers Guide to Prescription Drug  
Importation.” Published by the American Legislative Exchange

Council and Institute for Policy Innovation. Available online at [www.alec.org](http://www.alec.org) or [www.ipi.org](http://www.ipi.org).

“FDA faults quality of drug imports, by Gardiner Harris, *The New York Times*, September 30, 2003.

“Fake drugs show up in U.S. pharmacies,” by Julie Appleby, *USA Today*, May 15, 2003.

“Fakes in the medicine chest,” by Leila Abboud, Anna Wilde Mathews and Heather Won Tesoriero, *Wall Street Journal*, September 22, 2003.

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<sup>i</sup> “How State Imposed Mandates Increase Costs and Reduce Access to Health Care,” by Paul Guppy, Washington Policy Center Policy Brief, June 2002, <http://www.washingtonpolicy.org/HealthCare/PBGuppyHealthCareMandates.html>

<sup>ii</sup> “Health Care Costs and Insurance Coverage,” testimony by Dan L. Crippen, Director, Congressional Budget Office, before the Committee on Education and Workforce, United States House of Representatives, June 11, 1999.

<sup>iii</sup> “Mandated Benefit Laws and Employer-Sponsored Health Insurance,” by Gail A. Jensen, Ph.D., Wayne State University and Michael A. Morrissey, Ph.D., University of Alabama-Birmingham, Health Insurance Association of America, January 1999.

<sup>iv</sup> “Effects of State Reforms on Health Insurance Coverage of Adults,” by Frank A. Sloan and Christopher J. Conover, *Inquiry* 35, No. 3, Fall 1998, pp. 280 – 293.

<sup>v</sup> RCW 48.44.023(b), “Mandatory offering providing basic health plan for employers with fewer than twenty-five employees – Exemption from statutory requirements – Premium rates – Requirements for providing coverage for small employers.”

<sup>vi</sup> “2003-05 Biennium Funding, Medical Assistance,” Department of Health and Human Services, October 1, 2003, [http://www1.dshs.wa.gov/pdf/FSA/2003\\_2005Biennium\\_Funding/080MAA\\_Sep03.pdf](http://www1.dshs.wa.gov/pdf/FSA/2003_2005Biennium_Funding/080MAA_Sep03.pdf). “Medicaid” is a blanket term for all programs outlined in Title 19 of the federal Social Security Act.

<sup>vii</sup> “Health Care 2002; Improving Cost, Quality and Choice,” a summary of the Washington Policy Center Health Care 2002 conference, Seattle, Washington, August 14, 2002, <http://www.washingtonpolicy.org/HealthCare/PNHHealthCareForum2002-14.html>.

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viii Ibid.

ix “Memo to Al Gore: Canadian Medicine Isn’t Cheap or Effective,” by William McArthur, *The Wall Street Journal*, January 21, 2000.

x “Drug Formulary Restrictions as a Cost-Containment Policy in Medicaid Programs,” by W.J. Moore and R.J. Newman, *Journal of Law and Economics*, 36, 71-97, 1993.

xi “Managing Medicaid Drug Expenditures,” by S. Sudovar and S.D. Rein, *Journal Health Human Resource Administration*, 1:200-230, 1978.

xii “The Effect of Medicaid Formularies on the Availability of New Drugs,” by H.G. Grabowski, S.O. Schweitzer, and S.R. Shiota, *Pharmacoeconomics*, Suppl. 1, 32-40, 1992.

xiii “Effects of a Limit on Medicaid Drug-Reimbursement Benefits on the Use of Psychotropic Agents and Acute Mental Health Services by Patients with Schizophrenia,” by S.B. Soumerai, R.J. McLaughlin, D. Ross-Degnan, C.S. Casteris, and P. Bollini, *New England Journal of Medicine*, 331(10), 650-5, September 1994.

xiv “Health Care 2004: Opportunities for Innovation and Reform,” Washington Policy Center health care conference, Seattle, Washington, April 22, 2004, <http://www.washingtonpolicy.org/HealthCare/PNHealthCare2004Summary04-09.htm>.

xv “Insurance Factsheet,” Office of the Insurance Commissioner, Olympia, Washington, October 2004, [http://www.insurance.wa.gov/factsheets/factsheet\\_detail.asp?FctShtRcdNum=1](http://www.insurance.wa.gov/factsheets/factsheet_detail.asp?FctShtRcdNum=1)

xvi Ibid.

xvii “Responses to interview questions about state regulation of Oregon’s insurance market,” Oregon Department of Consumer and Business Services, Insurance Division, Michael Greenfield, Director, October 5, 1999.

xviii Ibid.



## Chapter 5: Education

### 1. K-12 Education Spending

#### Recommendations

1. Return the education system to its core function by focusing on classroom instruction.
2. Reduce personnel costs by offering flexible health benefits.
3. Competitively contract out services that are not essential to classroom instruction.
4. Hold education leaders accountable for student improvement.

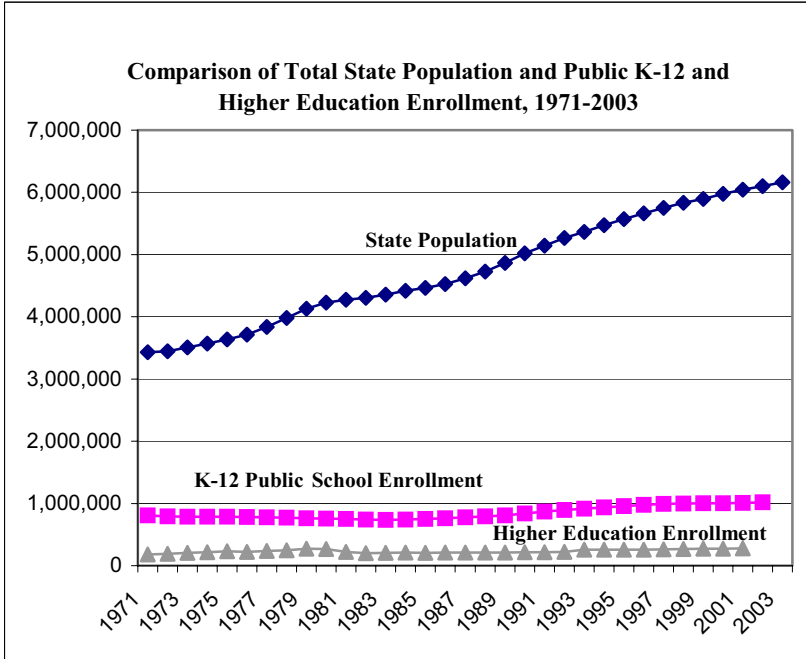
### Background

Common schools were established in Washington in 1854 by the first territorial Legislature. The system started with 53 schools and about 2,000 students.<sup>i</sup> A century and a half later there are just over a million K-12 public school students in Washington.<sup>ii</sup> Public school enrollment has increased slightly in Washington since 1984, following a long decline in enrollment starting in 1970. The gains in the number of public school students since 1984 are due to net migration into the state, more juniors and seniors remaining in school and a slight increase in the birth rate beginning in 1995.<sup>iii</sup>

The state's total population, however, has grown at a much faster pace than the number of students, creating a larger tax base to pay for educating a proportionately smaller number of students. Between 1971 and 2001, the state population increased by about 2.5 million people (74 percent),<sup>iv</sup> while K-12 public school enrollment increased by only about 201,277

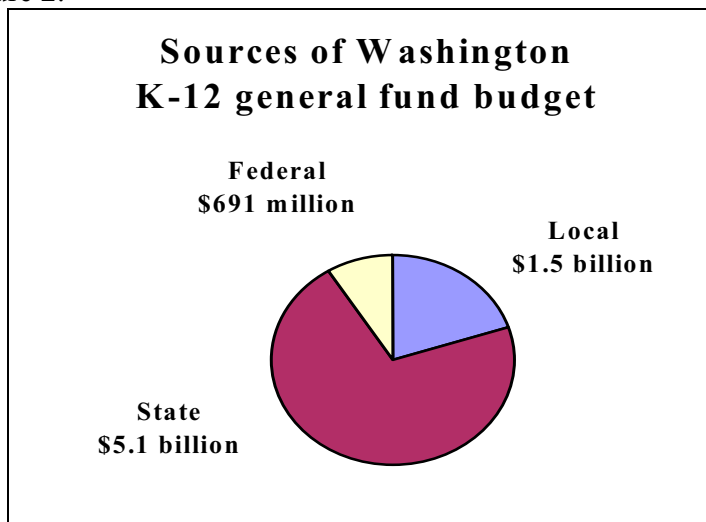
students (25 percent).<sup>v</sup> These trends are shown in the graph below.<sup>vi</sup>

Figure 1.



In the 2002-03 school year, about \$5.1 billion of the K-12 general fund dollars came from state revenue (state tax dollars), about \$1.5 billion from local revenue (primarily property taxes), and about \$691 million came from federal grants. Thus, approximately 70 percent of the K-12 general fund money was from the state, 20 percent from local government, and 9.5 percent from the federal government (see chart). Other K-12 public education costs not paid for from the general fund, such as maintaining buildings and buying school buses, are funded from separate state, local and federal budgets.<sup>vii</sup>

Figure 2.



K-12 education is the largest single expenditure in the state budget, with the total amount spent by school districts in Washington totaling over \$9 billion in the 2002-03 school year. In the 2002-03 school year, the average cost per public school student was \$9,454.<sup>viii</sup>

Of the money for operating schools, \$3.9 billion, or 42.5 percent of the total spent on education, went towards basic classroom instruction. Other general fund education spending went to special education, transportation, food services, interest on debts and compensatory education.

Several other funds beside the general fund help pay for the total cost of schools in Washington. In 2002-03, the purchase, construction and remodeling of school sites totaled \$1.1 billion. In addition, \$708 million was spent to repay the principal and interest from districts' bond debt, \$34 million was spent to purchase school buses and \$117 million was spent for student body activities.<sup>ix</sup>

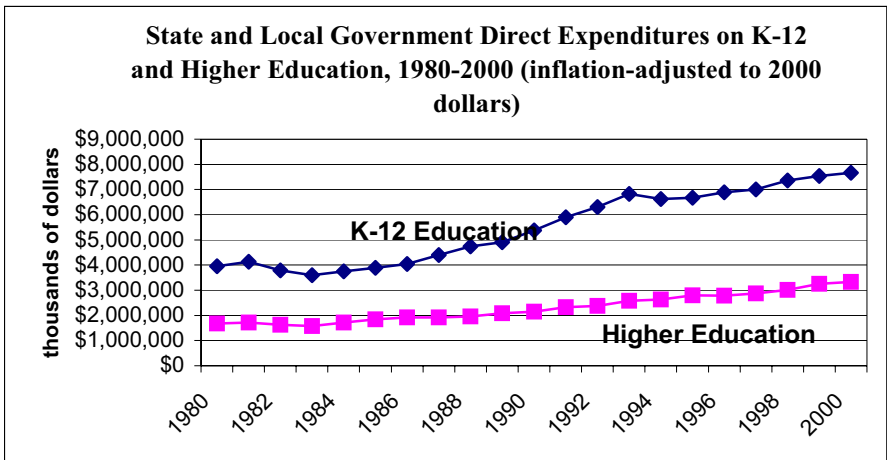
### Policy Analysis

The education establishment consistently argues that K-12 public education in Washington is under-funded. Yet by most measures K-12 public education in Washington is well funded. The problems that continue to plague the public education system can best be solved by internal change, before new money is allocated to an unreformed system.

### Rising trend in spending

K-12 education funding in Washington has increased significantly in the past decades, even after accounting for inflation. Between 1980 and 2000, state and local spending on K-12 education increased by 94 percent in inflation-adjusted dollars, from \$3.96 billion in 1980 to \$7.67 billion in 2000. Yet while spending almost doubled, the number of K-12 public students over the same period increased only 32 percent, rising from 756,572 K-12 students in 1980 to 1,000,960 students in 2000. See Figure 3.

Figure 3.



### Education spending compared with other states

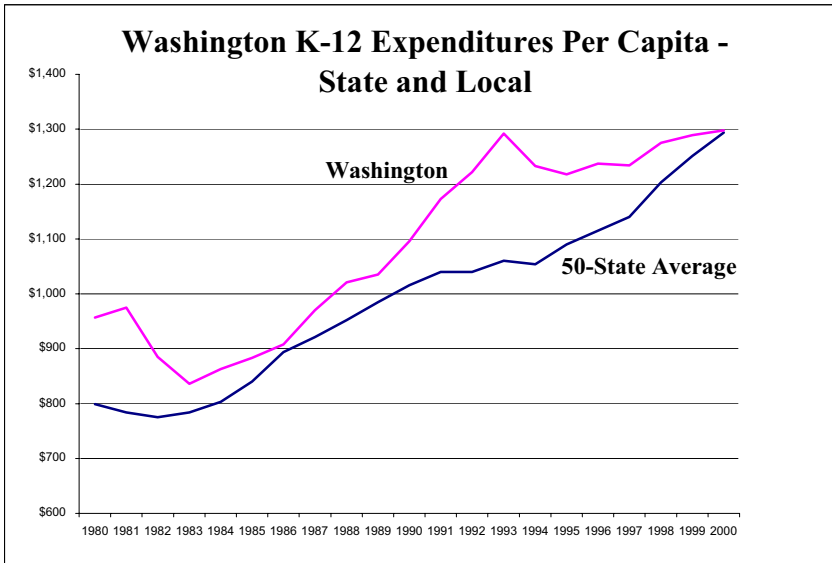
Advocates for increasing education spending often point to statistics about how Washington compares with other states. Their choice of statistics is often selective, however, and it is only by looking at several measures that an accurate picture emerges.

One measure is the amount of money spent per student. According to the National Education Association, in 2002-03 Washington ranked 34th in the nation in per student funding. However, in another measure – state and local K-12 education spending per capita – Washington ranked 15th out of the 50 states. Education spending can also be measured by dividing overall state and local K-12 spending by each \$1,000 of personal income earned in the state. By this standard, Washington ranked 36th.<sup>x</sup> Measuring spending based on income, however, may be less reliable because it is skewed by the very high incomes of certain residents.

Over the long term, per capita K-12 spending in Washington has been above the 50-state average every year between 1980 and 2000 (the last year for which the comparison is available). While the figure has gone up and down over the years, education spending per capita in Washington has not fallen below the national average for two decades, as shown in Figure 4.<sup>xi</sup>



Figure 4.



### More spending does not always lead to better outcomes

Education spending in Washington has increased sharply in recent decades, while there has been little or no increase in student performance. Nationally, the money spent on K-12 schools has also been dramatically increasing, even after figures are adjusted for inflation. Between 1960 and 2000, real expenditures per student in the U.S. more than tripled from \$2,235 in 1960 in inflation-adjusted dollars to \$7,591 in 2000.<sup>xii</sup> Yet national tests during this period show no significant change in student performance.<sup>xiii</sup>

International comparisons also show that educational achievement is not necessarily related to spending. While the United States ranks among the highest in the world for education spending, we lag behind other developed countries in student achievement. The Organisation for Economic Co-operation and Development (OECD) ranked U.S. schools third highest among developed countries in primary school

spending,<sup>xiv</sup> but in international tests American students ranked near the bottom in 12th grade math and science.<sup>xv</sup>

## Recommendations

**1) Return the education system to its core function by focusing resources on classroom instruction.** Over the years the schools system has been given more and more tasks to make up for failures in other policy areas. Schools should be allowed to focus their resources on academics and not be asked to solve other problems facing society.

**2) Reduce personnel costs by offering employees more flexible health benefits.** Replacing the current restrictive and expensive health benefits system with tax-free individual health accounts backed by low-cost, high-deductible catastrophic insurance would reduce costs for school districts and give employees greater control over their own health care dollars.

**3) Competitively contract out services that are not essential to classroom instruction.** Less than 40 percent of K-12 employees are teachers. Contracting out maintenance, accounting and other routine services would allow school districts to focus on their core mission – educating students.

**4) Hold education leaders accountable based on actual student improvement.** Principals and school superintendents should receive raises and promotions based on educational results, not seniority or skill in working within a bureaucratic system.

## 2. Teacher Pay

### Recommendations

1. Make the most of current education spending by rewarding teachers based on performance.
2. Give local principles control over budget and teaching staff.
3. Establish separate oversight to provide safeguards and an appeals process.

### Background

In 2003-04, there were approximately 58,123 public elementary and secondary teachers in Washington, about 38.5 percent of the 150,815 total school district personnel. The average salary of public K-12 teachers for a nine-month work year was \$45,429 in 2003-04. In addition, the average 2003-04 salary of public school central administrators in Washington was \$89,027 and the salary of local school administrators was \$80,826.

Washington ranks 18th in the country for the salaries of K-12 public school teachers in the 2002-03 school year, falling roughly mid-way between the highest average salary in the country of \$56,283 (California) and the lowest average salary, \$32,416 (South Dakota).

### Policy Analysis

The current pay structure for public school teachers, which bases pay increases on the number of years of experience and the number and level of education credits and degrees, was established in the 1920s to “ensure fair and equal treatment for all.” There have been few changes to this salary structure during the last 80 years. During that time, the world has

changed, becoming more innovative and competitive, yet teacher pay today is based on seniority and training level, not actual effectiveness on the job.

Because pay is not linked with performance, as it is in almost every other profession, there is no chance to reward success in the classroom and teachers are not held accountable for failure. This gives teachers little incentive to become better teachers over time and to help their students learn more effectively.

In one survey, 85 percent of teachers and 72 percent of principals said that providing financial incentives would ‘help a lot’ when it comes to attracting and retaining good teachers. To determine performance fairly, teachers should be assessed with frequent evaluations of student achievement, teaching skills, subject knowledge, classroom management and lesson planning. Several states, including Tennessee, Arizona, Colorado, Ohio, Florida, and North Carolina, have adopted performance-based pay for teachers.

## **Recommendations**

- 1) Make the most of current education spending by rewarding teachers based on performance.** The pay schedule should be changed to reward and retain top-performing teachers and attract talented teachers to high-need schools.
  
- 2) Give local principals greater control over their own school’s budget and teaching staff.** Currently it is almost impossible for principals to get rid of low-performing teachers. Using fair and objective measures of job performance, principals should be given the authority to hire, fire and promote teachers, and be held accountable for the quality of their teaching staff.
  
- 3) Establish separate oversight to provide safeguards and an appeals process.** Teachers and other school employees should

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have the right to contest unfair treatment. Third-party oversight is needed to avoid favoritism, unmerited raises and management abuse of individual teachers.

### 3. Class Sizes

#### Recommendations

1. Class size reduction should not be imposed as a blanket, one-size-fits-all policy.
2. Reduce barriers that keep talented people from entering the teaching profession.

#### Background

When compared to other states, Washington has one of the highest ratios of students enrolled per teacher in public K-12 schools. In fall 2002, Washington ranked fifth highest, having an average of 19.1 students per teacher. The national average in fall 2002 was 15.7 students per teacher. Recent trends, however, reveal that class sizes have declined slightly in Washington over the past decade. In 1992-03, Washington had the third highest teacher-student ratio in the nation, with a ratio of 20.3 students per teacher.

Yet the focus on class size may be misplaced. Research shows that good teachers are more important than small class sizes. Economist Eric Hanushek of Stanford University's Hoover Institution gives three reasons why class size reduction generally does not improve student learning:

1. Class size reductions are usually not targeted to the specific situations where they would be effective.
2. Class size reductions require hiring more teachers and the new teachers hired are often less experienced than current teachers. Students may be worse off in a smaller class if they have a less experienced teacher.

3. Class size reduction is expensive and alternative programs might be a better use of scarce education dollars.

A new study found that California's class-size reduction program did not result in significant test score gains. California's class-size reduction also had certain unintended consequences. New teaching jobs opened up as a result of the class-size reduction policy, leading qualified teachers in urban areas to leave their jobs and take positions in the suburbs. Urban schools then had a large teacher shortage and were forced to hire less-experienced teachers. The study found that because teacher quality is more important than class size for student achievement, many urban students were worse off after class sizes were reduced.

## **Policy Analysis**

Improving teacher quality, rather than simply trimming class sizes, is a more effective way to maximize the effectiveness of education spending. Traditionally, to become a teacher in Washington state one must complete a designated teacher preparation program at a college or university. Prospective teachers can sometimes get a conditional or emergency certificate that will allow them to teach for a limited amount of time.

Also, in 2001, the Washington State Legislature created some alternative ways teachers can gain certification. Instead of attending a traditional teaching program at a university, or going back for a masters or post-baccalaureate teaching degree, candidates can attend an intensive summer teaching academy, followed by a full year employed by a district in a mentored internship. This is followed, if necessary, by a second summer at a teaching academy.

Despite this greater flexibility, many of the brightest students are still discouraged from entering the teaching profession because of the many bureaucratic requirements

necessary to gain a teaching certificate. The additional year required to complete the certification program is a significant barrier to college graduates who did not major in teaching and who have other promising career opportunities that are open to them right away.

Studies find that teacher's knowledge of the subject matter, not formal certification, is most strongly correlated with how well students learn. This important aspect of teaching is not adequately accounted for in the rigid teacher certification process. For example, under current restrictions, Bill Gates is not certified to teach computer science in Washington high schools, nor would Gary Locke meet the requirement to teach a Washington state civics class.

## **Recommendations**

**1) Class size reduction should not be adopted as a blanket, one-size-fits-all policy.** Class reduction funds should be targeted to over-crowded schools. Other schools should be allowed to use class size reduction funds in alternative ways that lead to improved academic outcomes.

**2) Reduce barriers that keep talented people from teaching.** Content knowledge and professional experience should be the standard for hiring teachers rather than outdated bureaucratic requirements. Teacher certification should focus on mastery of subject matter, not on process.



#### 4. Student Testing and Achievement

##### Recommendations

1. Maintain consistent WASL standards, so students are judged equally from year to year.
2. Improve test-taking skills, so the WASL test is a reliable measure of students' true academic knowledge.

##### Background

The quality of education in a state is not necessarily related to the level of education spending. This can be seen in both national and international test scores, which show that high academic achievement is often not parallel to high levels of education spending. Similarly, measures such as spending per student, number of students per teacher, average teacher salary, and level of spending by local school district are not reliable predictors of high academic performance. For reference, how Washington ranks among states based on various education measures is shown in Figure 1.

Figure 1. Washington's Rankings on K-12 Education Compared To Other States – based on 2002-2003 data, the latest available.

Measure	Washington's rank in U.S.	Explanation of Measure
K-12 spending per student	34th	K-12 education spending in 2002-03 divided by the number of students in the state.
K-12 spending per capita	15th	K-12 spending divided by the number of people in the state.
K-12 spending per \$1000 in personal income	36th	K-12 spending divided by each \$1,000 of personal income earned in the state.

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Number of K-12 Students in Public Schools	13th	In 2002-03, there were 1,015,968 K-12 public school students in WA.
Total Population of state	15th	In 2001, the total resident population of Washington was 5.99 million.
Total K-12 Public School Teachers	19th	In 2002-03, Washington had approximately 53,111 public school teachers.
K-12 Students Enrolled Per Teacher	5th	In Fall 2002, there was an average of 19.1 students per teacher in Washington.
Average K-12 Teacher Salary	18th	The average salary of public school teachers in 2003-04 in WA was \$45,429.
Capital spending by state and local governments on K-12 education – per capita	4th	Per capita spending on new school buildings, land, remodeling school buildings, and improvements of grounds.
Percentage of K-12 revenue from state	9th	The proportion of the revenue for K-12 education from state governments
Percentage of K-12 revenue from local governments	43rd	The proportion of the revenue for K-12 education from local governments.

To state that academic achievement in Washington is inherently linked to the levels of education spending in the state is a flawed premise. Only though dramatic, internal changes, not increased spending, will the academic achievement of Washington students significantly improve.

### Policy analysis

With that in mind, in recent years, Washington students have done well on some education measures and poorly on others. National tests show that Washington students often do better than the national average. The average score of Washington high school graduates who took the Scholastic Assessment Test (SAT) in 2002-03 was 1062 (out of 1600), 42 points higher than the national average of 1020. In addition, the average score of Washington high school graduates who took the American College Testing (ACT) was 22.5 (out of 36), 1.7

points higher than the national average. The scores of 4th and 8th grade students in Washington on the reading and math national assessment tests were also above the national average in 2003. In addition, the number of high school graduates in Washington between 1992-93 and 2002-03 increased by 29.2 percent, the 10th highest increase in the nation.

While Washington may compare favorably in certain national measures, the 2002-03 Washington Assessment for Student Learning (WASL) results show that there is significant room for improvement in student performance. In fourth grade, only 67 percent of Washington students met the WASL reading standard and 55 percent met the math standard. In seventh grade, 48 percent met the WASL reading standard and 37 percent met the math standard. Finally, in tenth grade, 60 percent of students met the reading standard and 39 percent met the math standard.

## **Recommendations**

- 1) Maintain consistent WASL standards, so students are judged equally from year to year.** Test standards should not be lowered to make it appear that more students are passing. Lowering standards is not fair to students who have met the higher standard, and leaves policymakers with a moving target, making it difficult or impossible to accurately assess changes in the system.
- 2) Improve test-taking skills, so the WASL is a reliable measure of students' true academic knowledge.** Not all students are good at taking tests, but practice, preparation and careful instruction from teachers can insure all students have an equal chance to perform well.

## 5. Charter Schools

### Recommendations

1. Allow start-up charter schools to receive an equal share of local education levy funds.
2. Broaden charter school opportunities beyond communities with disadvantaged students.
3. Remove the cap on the number of charter schools that can be founded each year.

### Background

Charter schools are public schools that are privately run and are exempt from many state and federal rules governing traditional public schools. Like other public schools, charter schools are funded by public education money, must accept all students and do not charge tuition.

Proponents say charter schools allow educators to escape the bureaucracy entangling other public schools and find creative solutions for struggling students. Opponents say such schools drain money from traditional public schools and lack accountability. In the midst of this debate, the charter school movement has grown rapidly since it began a little over a decade ago. Currently, there are 2,967 charter schools throughout the United States, enrolling about 687,000 students.

Unlike public schools, charter schools will close if students are not learning at satisfactory levels. A sponsor can revoke a charter before it expires for emergency health and safety issues. If a warning is given and the school does not correct its deficiencies, charters can also be revoked for contract violations or for poor fiscal management. In addition, charters are not renewed if the academic progress of charter school

students is inferior to the progress of similar students in the area.

While charter schools are free of most bureaucratic restrictions, they must meet certain basic standards:

- Conduct annual self-assessments and report on progress at least annually to the school district and to parents.
- Comply with state and federal rules about health, safety, parents' rights, nondiscrimination and civil rights.
- Participate in free and reduced-priced lunch programs.
- Participate in the WASL, ITBS, and other measures of academic success.
- Be subject to financial, performance, and accountability examinations.

## **Policy Analysis**

In March 2004 the legislature passed a charter schools law, making Washington the 41st state to authorize charter schools. As approved by the legislature, charter schools in Washington operate under some limitations that don't exist in other states.

In Washington a charter consists of a detailed five-year plan which must meet state academic standards. A nonprofit board operates the school according to the terms of the contract. Most charters are reserved for schools that primarily serve disadvantaged students: those with limited English, special needs or disabilities or who are at risk of failing state and federal academic standards.

In Washington, only nonprofit organizations may apply for charters, not religious groups or for-profit companies as in other states. Also, charter schools in Washington may not receive existing local levy money. They may only receive funds from local levies that pass after they have been established.

A legal cap limits the number of charter schools that can open each year. Consequently, the number of local groups interested in starting charter schools in the state far outstrips the number of schools that can be authorized.

## **Recommendations**

**1) Allow start-up charter schools to receive an equal share of local education levy funds.** Charter schools should not be discriminated against in the allocation of local education dollars. All public schools should be equally eligible to receive money from all existing federal, state and local funding sources.

**2) Broaden charter school opportunities beyond communities with disadvantaged students.** While charter schools in Washington are targeted toward disadvantaged students, they offer educational benefits to other students as well. Many community schools are in urgent need of reform, but do not meet the legal definition for disadvantaged students. Parents in these areas should have an equal chance of starting a charter school, if that best meets the needs of local students.

**3) Remove the cap on the number of charter schools that can be established each year.** Any arbitrary cap on the number of charter schools unfairly denies some communities a chance to participate in education reform. The number of charter schools should be allowed to increase each year to match public demand for such schools.

## 6. Higher Education

### Recommendations

1. Contract out campus maintenance services.
2. Return to a more vigorous, shared core curriculum for all students.
3. Increase academic focus on teaching basic skills in science, technology, engineering and math (STEM).

### Background

The public higher education system in Washington consists of 34 community and technical colleges, six four-year universities and colleges, and five branch campuses. In fall 2002, there were 102,868 students enrolled in public four-year colleges and universities and 260,488 students enrolled in community and technical colleges in Washington.<sup>xvi</sup> There are 30 reported private higher education institutions in Washington, as well as a number of private institutions that focus on workforce training.<sup>xvii</sup>

### Higher Education Spending

Public higher education is primarily funded through the state's general fund and student tuition, but also receives revenue from higher education grants and contracts, dedicated local revenues and the University of Washington Medical Center.<sup>xviii</sup> In fiscal 2003-04, public higher education institutions received about \$514 million from tuition and about \$1.165 billion from the state general fund (tax dollars).<sup>xix</sup> The total operating expenditures of public four-year colleges were \$2.75 billion and the operating expenditures of public community and technical colleges were \$939.7 million in the 2003 fiscal year.<sup>xx</sup>

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Instruction and research are the two largest expenses for both two and four-year higher education. For public four-year colleges and universities, research was the highest cost in fiscal 2003 (\$996 million) and instruction was the second highest cost (\$724 million). In contrast, for public community and technical colleges, instruction was the highest cost (\$399 million) and research was the next highest cost (\$151 million) in fiscal 2003. A breakdown of spending for four-year and community and technical colleges and universities is shown in Figure 1.

Figure 1. Operating Expenditures for Public Higher Education in Washington in Fiscal 2003 <sup>xxi</sup>

<b>Programs</b>	<b>Four-Year Colleges and Universities 2003</b>	<b>Community and Technical Colleges 2003</b>
Instruction	\$724,045,000	\$399,499,000
Research	\$85,147,000	
Public Services	\$36,784,000	
Primary Support	\$120,312,000	\$43,260,000
Libraries	\$68,002,000	\$23,272,000
Student Services	\$70,788,000	\$86,462,000
Hospitals	\$398,061,000	
Institutional Support	\$169,353,000	\$124,544,000
Plant Operations & Maint.	\$165,270,000	\$76,978,000
Sponsored Research	\$911,266,000	\$151,343,000
Other	\$3,551,000	\$34,295,000
<b>Total</b>	<b>\$2,752,579,000</b>	<b>\$939,653,000</b>

### Tuition Costs

In the 2003-04 academic year, resident tuition paid for approximately 51 percent of the cost of instruction at research universities, 39 percent of the cost at comprehensive institutions



and 36 percent of the cost at community colleges. The remaining portion of instruction costs is primarily paid for through the state general fund (state taxes). Tuition for nonresident undergraduate students is higher and covers the entire cost of instruction.<sup>xxii</sup>

Tuition rates for Washington higher education remain below average when compared to similar public schools in other states. The average tuition at comparable public schools is \$1,027 more than the tuition at the University of Washington, for example, and \$562 more than the tuition at Washington State University. The average tuition at comparable community and technical colleges in the U.S. is virtually the same, only \$13 more, than the tuition at community and technical colleges in Washington.<sup>xxiii</sup>

Although tuition rates remain below average, during the past decade the percentage of instruction costs paid for by tuition has risen in Washington. While today tuition pays for 51 percent of instruction costs at research universities and 36 percent of instruction costs at community colleges, between 1981-82 and 1992-93 tuition at research universities paid for 33.3 percent of instruction costs and tuition at community colleges paid for 23 percent of instruction costs.<sup>xxiv</sup>

Undergraduate tuition and fees have increased 89 percent in non-inflation adjusted dollars during the past decade at the state's public research universities, increasing from about \$2,532 in 1993-94 to about \$4,793 in 2003-04. Tuition increased 90 percent at community colleges during the same time period, from \$1,126 in 1993-94 to \$2,142 in 2003-04. During that time, inflation increased about 20 percent and per capita personal income in Washington increased 51 percent.<sup>xxv</sup> At the same time, Washington's state and local government spending on higher education has greatly increased in inflation-adjusted dollars, rising from \$2.14 billion in 1990 to \$3.33 billion in 2000.<sup>xxvi</sup>

## Policy Analysis

### Spending Ranked with Other States

For the past two decades, per capita spending on higher education by Washington state has “consistently been above the U.S. average.”<sup>xxvii</sup> In fiscal year 2000, per capita state and local government spending on higher education was \$80 more than the U.S. average. In that year, Washington ranked 17th among the states in per capita spending (when state and local government spending on higher education is divided by the number of people in the state) and 28th when higher education spending was divided by each \$1,000 of income.<sup>xxviii</sup>

In addition, Washington’s per capita spending on the land and buildings of its higher education institutions is higher than in most other states. In 1999-2000, Washington ranked 8th in the nation for per capita state and local government capital spending on higher education.<sup>xxix</sup>

Figure 2.

#### Washington’s Higher Education Rankings Compared to Other States in U.S.

Measure	Ranking	Explanation of Measure
State and local higher education spending per capita	17th	Higher education spending divided by the number of people in the state.
State and local higher education spending per \$1,000 income	28th	Higher education spending divided by each \$1,000 of personal income earned in the state.
Capital higher education spending by state and local governments - per capita	8th	Spending on new school buildings, land, remodeling school buildings, and improvements of grounds.
Total Population of state	15th	In 2001, the total resident population of Washington was

		5.99 million
Participation in public higher education	17th	Percentage of population aged 17 and over enrolled in public higher education. <sup>xxx</sup>

### Assessing need for more enrollment slots

According to the Higher Education Coordinating Board (the statewide body overseeing higher education) by 2010 an additional 4,000 students are projected to graduate from high school per year in Washington. Currently, “about 61 percent of Washington’s high school graduates continue directly to an institution of higher education and most enroll in colleges and universities within this state.” As a result, the state will need an estimated 33,517 more enrollment slots by 2009-10 to maintain the same proportion of the state’s population enrolled at public higher education institutions.<sup>xxx</sup>

Yet according to other data the need does not seem as immediate as it may at first appear. A recent study released by the state government examined the number of qualified students who were being turned away by public higher education institutions in Washington. This study found that in fall 2002 between 1,090 and 1,531 qualified undergraduate applicants were “denied admission to a public four-year institution and not enrolled in any other public or private Washington higher education institution during that same term.” As a group, the unserved applicants generally had “grade point averages and/or admission index scores toward the lower end of the admissible ranges.”<sup>xxxii</sup>

According to the study, not all of these applicants were necessarily unserved. Since over 6,000 Washington resident freshmen enrolled in out-of-state institutions for fall 2000, some of the students that were denied admission in Washington may have simply gone elsewhere. In addition, the study states that supposedly unserved students may have attended one of the independent institutions in the state for which no enrollment

data are available. Also, many unserved applicants enroll in or are admitted by higher education institutions in subsequent terms. Between fall 1991 and fall 1999, for instance, about 60 percent of qualified undergraduate applicants to higher education institutions who were denied admission the first time they applied were admitted or enrolled later on.<sup>xxxiii</sup>

## Recommendations

**1) Contract out campus maintenance services.** In recent years, college costs have been soaring. Polling data indicates that most Americans worry “about their ability to afford higher education for their children.” Sixty percent of Americans agree that “colleges should do a better job of keeping costs down.”<sup>xxxiv</sup> One important way for colleges to keep costs down is to contract out certain services to private contractors, as is done in other states. Private sector workers can often perform the same service more efficiently and at a lower price than public employees.

At the University of Washington alone, the cost of plant operations and maintenance has increased 60 percent over the past 10 years, rising from \$39 million a year in 1992 to \$63 million in 2002.<sup>xxxv</sup> Experienced private firms could competitively bid to provide these services, reducing the cost of education for taxpayers and students. Some of the program budgets for public institutions across the state are listed below:

- University of Washington Plant Operations  
2001-03 Budget: \$151 million, 945 Full Time Employees
- Eastern Washington University Plant Operations  
2001-03 Budget: \$18 million, 129 Full Time Employees
- Central Washington University Plant Operations  
2001-03 Budget: \$17.6 million, 118 Full Time Employees
- Western Washington University Plant Operations  
2001-03 Budget: \$21.6 million, 147 Full Time Employees

**2) Return to a more vigorous, shared core curriculum for all students.** Many American students are graduating from college with only a rudimentary understanding of the history and literature of their country and the world they live in. A 2001 survey found that only three of the 55 highest ranking colleges and universities in America “require a course in Western civilization. None of the 55 requires a course in American history.”<sup>xxxvi</sup> In addition, only 10 percent of top institutions require students to take a history class to graduate.<sup>xxxvii</sup> Clearly, universities need to re-examine the importance of required history courses in their curriculum.

In the realm of literature, some American universities have turned their back on the classics of Western culture. While universities should teach students in the context of the international world we live in, they should do this by continuing to require classes on classic works that have shaped Western culture while at the same time teaching students “the greatest works of other civilizations as well.” Scholar Dinesh D’Souza explains: “In practice this means that Homer, the Bible, Shakespeare and Faulkner would be read in conjunction with the Bhagavad Gita, the Koran and the ‘Tale of Genji.’ Young people must be familiarized with the fundamental texts of their own civilizations.”<sup>xxxviii</sup>

**3) Increase academic focus on teaching basic skills in science, technology, engineering and math (STEM).** The 20th century was a time when great industries were established and flourished, such as the auto, steel, pharmaceutical and biotech industries. Similarly, new ideas will spawn the great industries of tomorrow. Yet so many of these concepts rely on educated individuals, especially people proficient in Science, Technology, Engineering and Math (called STEM).

For example, 55 percent of the CEOs at Fortune 100 companies have a STEM background. Major innovation depends heavily on individuals who earn degrees at the PhD level because of the inherent expertise associated with the degree.

U.S. students currently lag behind their international counterparts in basic science and math skills. When comparing the 8th grade test scores of American students with their international counterparts, the U.S. is in the 32nd percentile in math and the 59th percentile in science. These figures worsen when comparing 12th grade advanced math and physics students around the world: American students are in the lowly 6th percentile in math and at a bleak zero percent in science. These figures portray the stark reality that, when compared to other countries, American students are failing.

In order for the U.S. to remain a global economic power, K-12 education must change, thereby sustaining and maintaining the great strength of our science and engineering capabilities, and the ability of our free-market economy to create great industries.

## **Additional Resources**

### Washington Policy Center Research

“Creating New Opportunities to Learn: Charter Schools and Education Reform in Washington,” by Melissa Lambert Milewski, September 2004

“A Citizen's Guide to the \$1 Billion Education Initiative: An Analysis of Initiative 884 and public education funding in Washington,” by Melissa Lambert Milewski, July 2004

“K-12 Public Education Spending in Washington,” by Melissa Lambert Milewski, 2004

“Innovative School Facility Partnerships: Downtown, Airport, and Retail Space,” by Matthew D. Taylor and Lisa Snell, Introduction by Eddie Reed, M.S., December 2001

### Other Resources

“Voucher Wars: Waging the Legal Battle over School Choice,” by Clint Bolick, Cato Institute, Washington, D.C., 2003

Milton and Rose D. Friedman Foundation - A national foundation dedicated to improving education through parental and student choice. [www.friedmanfoundation.org](http://www.friedmanfoundation.org).

*School Reform News* published by Heartland Institute. Offers a monthly review of market-based education reform around the nation. [www.heartland.org](http://www.heartland.org)

“School Choice in 2003: How States are Providing Greater Opportunity in Education,” by Krista Kafer, Heritage Foundation, [www.heritage.org](http://www.heritage.org)

*Teaching at Risk: A Call to Action*, The Teaching Commission, 2004, at [www.theteachingcommission.org](http://www.theteachingcommission.org). This is the final

report of the Teaching Commission, chaired by former IBM Chairman, Louis V. Gerstner, Jr.

*Common Sense School Reform*, by Frederick M. Hess, Palgrave Macmillan, 2004.

*A Qualified Teacher in Every Classroom? Appraising Old Answers and New Ideas*, by Frederick M. Hess, Andrew J. Rotherham and Catherine Walsh (Harvard Education Press, 2004).

*The Failure of Input-based Schooling Policies*, by Eric A. Hanushek, Stanford University and National Bureau of Economic Research, July 2002.

*What the Research Reveals About Charter Schools: Summary and Analyses of the Studies*, The Center for Education Reform, September 2003, at [www.edreform.com](http://www.edreform.com).

*Sustaining the Nation's Innovation Ecosystem: Report on Maintaining the Strength of Our Science and Engineering Capabilities*, President's Council of Advisors on Science and Technology, May 2004.

*An Education Agenda: Let Parents Choose Their Children's School*, John C. Goodman and Fritz F. Steiger, editors, see chapter on "Education by Charter: The New Neighborhood Schools," by Jeanne Allen, National Center for Policy Analysis and Children First America, 2002.

*Apples to Apples: An Evaluation of Charter Schools Serving General Student Populations*, by Jay Greene, Greg Forster and Marcus Winters, Manhattan Institute, July 2003.

"Key Facts about Higher Education in Washington," January 2004, Washington Higher Education Coordinating Board.



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- <sup>i</sup> “Organization and Financing of Schools,” Office of Supt. of Public Instruction, 2004, pp. 127-9.
- <sup>ii</sup> “Public School Enrollment by Grade and County for October 2003,” Office of Supt. of Public Instruction, [www.k12.wa.us/DataAdmin/pubdocs/GradeCounty/R1809AOct03.pdf](http://www.k12.wa.us/DataAdmin/pubdocs/GradeCounty/R1809AOct03.pdf).
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- <sup>iv</sup> In 1971, the total population in Washington was 3,436,300. By 2001, the total population had increased to 5,974,910. “State Population By Age and Sex: 1970-2030 From November 2003 Forecast,” Office of Financial Management, [www.ofm.wa.gov/pop/stfc/4CAST2003.xls](http://www.ofm.wa.gov/pop/stfc/4CAST2003.xls).
- <sup>v</sup> “K-12 Enrollment,” Office of Financial Management, [www.ofm.wa.gov/trends/data/fig406.xls](http://www.ofm.wa.gov/trends/data/fig406.xls); “Public Higher Education Enrollment,” Office of Financial Management, [www.ofm.wa.gov/trends/data/fig416.xls](http://www.ofm.wa.gov/trends/data/fig416.xls).
- <sup>vi</sup> “State Population By Age and Sex: 1970-2030 From November 2003 Forecast,” “K-12 Enrollment,” and “Public Higher Education Enrollment,” Office of Financial Management.
- <sup>vii</sup> “Organizing and Financing of Washington Public Schools,” Office of Supt. of Public Instruction, pp. 3-4, 88-97.
- <sup>viii</sup> *Ibid*, p. 120.
- <sup>ix</sup> *Ibid*, pp. 89, 97, 120-1.
- <sup>x</sup> These figures are for fiscal year 2000. “K-12 Education Expenditures Per Capita,” Office of Financial Management, [www.ofm.wa.gov/trends/htm/fig541.htm](http://www.ofm.wa.gov/trends/htm/fig541.htm).
- <sup>xi</sup> “K-12 Education Expenditures Per Capita,” Office of Financial Management.
- <sup>xii</sup> “The Failure of Input-based Schooling Policies,” by Eric A. Hanushek, Stanford University and National Bureau of Economic Research, July 2002, pp. 5-6.
- <sup>xiii</sup> *Ibid*, pp. 6-7.
- <sup>xiv</sup> “Education at a Glance: OECD Indicators,” Organisation for Economic Co-operation and Development, [www.oecd.org](http://www.oecd.org); “Spending More While Learning Less: U.S. School Productivity in International Perspective,” by Herbert J. Walberg, Thomas B. Fordham Foundation (2003).
- <sup>xv</sup> “Sustaining the Nation’s Innovation Ecosystem: Report on Maintaining the Strength of Our Science and Engineering Capabilities,” President’s Council of Advisors on Science and Technology (2004).
- <sup>xvi</sup> “Key Facts about Higher Education in Washington,” Washington Higher Education Coordinating Board, January 2004, pp. 5-6, [www.hecb.wa.gov/docs/reports/KeyFactsJanuary2004.pdf](http://www.hecb.wa.gov/docs/reports/KeyFactsJanuary2004.pdf).
- <sup>xvii</sup> *Ibid*, p. 3.
- <sup>xviii</sup> *Ibid*, p. 64.
- <sup>xix</sup> “2003-04 Washington State Tuition and Fee Report,” Washington Higher Education Coordinating Board, January 2004, p. 20.

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- <sup>xx</sup> “Operating Expenditures By Program All Budgeted and Higher Education Funds Public Four-year College and Universities,” and “Operating Expenditures By Program Public Community and Technical Colleges,” 2003 Washington State Data Book, [www.ofm.wa.gov/databook/education/et14htm](http://www.ofm.wa.gov/databook/education/et14htm), and [www.ofm.wa.gov/databook/education/et21.htm](http://www.ofm.wa.gov/databook/education/et21.htm).
- <sup>xxi</sup> “Operating Expenditures by Program Public Four-Year Colleges and Universities,” and “Operating Expenditures by Program Public Community and Technical Colleges,” 2003 Washington State Data Book.
- <sup>xxii</sup> “2003-04 Washington State Tuition and Fee Report,” Washington Higher Education Coordinating Board, January 2004, p. 19.
- <sup>xxiii</sup> *Ibid*, pp. 15-16.
- <sup>xxiv</sup> *Ibid*, p. 20.
- <sup>xxv</sup> “Key facts about higher education in Washington,” Higher Education Coordinating Board, pp. 58-9.
- <sup>xxvi</sup> “State and Local Direct General Expenditures (inflation-adjusted to 2000 dollars),” Office of Financial Management. [www.ofm.wa.gov/trends/data/fig526.xls](http://www.ofm.wa.gov/trends/data/fig526.xls).
- <sup>xxvii</sup> “Higher Education Expenditures Per Capita,” Office of Financial Management, [www.ofm.wa.gov/trends/htm/fig546.htm](http://www.ofm.wa.gov/trends/htm/fig546.htm).
- <sup>xxviii</sup> *Ibid*.
- <sup>xxix</sup> “Per Capita State & Local Government Capital Spending for Higher Education Institutions, 1999-2000,” Rankings of the States 2003, National Education Association, p. 57.
- <sup>xxx</sup> “Higher Education Trends and Highlights,” Forecasting Division, Office of Financial Management, June 2003, p. 8.
- <sup>xxxi</sup> “Key facts about higher education in Washington,” Higher Education Coordinating Board, pp. 15-16.
- <sup>xxxii</sup> “Applications Match Study: A Perspective on Unmet Demand” Office of Financial Management, November 2003, pp. 1-5.
- <sup>xxxiii</sup> *Ibid*, pp. 3-4.
- <sup>xxxiv</sup> “Higher Education,” Issues ‘04, The Heritage Foundation, [www.heritage.org](http://www.heritage.org).
- <sup>xxxv</sup> “University of Washington GOF Expenditures by Campus and Program – Fiscal Years 1992-2002,” at [www.washington.edu/admin/factbook/budget](http://www.washington.edu/admin/factbook/budget).
- <sup>xxxvi</sup> “Colleges Don’t Require History,” *Daily Policy Digest*, November 27, 2001.
- <sup>xxxvii</sup> “Higher Education,” Issues ‘04, The Heritage Foundation, [www.heritage.org](http://www.heritage.org).
- <sup>xxxviii</sup> “Combating Political Correctness on Campus,” by Dinesh D’Souza, *Making Government Work: A Conservative Agenda for the States*, The Texas Public Policy Foundation, pp. 82-4.



## Chapter 6: Business Climate

### 1. The Overall Business Climate in Washington

#### Recommendations

1. Review laws and regulations that impede business innovation and entrepreneurship.
2. Streamline the business-licensing process.
3. Repeal laws and regulations that no longer serve a public purpose, but only work to keep competitors out of the marketplace.
4. Ease unreasonable restrictions on home-based businesses.

#### Background

Most of the United States is enjoying a steady economic recovery, with job growth and productivity increases spurring growing gains in economic activity. The Washington economy, while showing signs of improvement, has been much slower to rebound, suffering from restrictive policies adopted by local and state government that create unnecessary barriers to business success. The Boeing Company's decision to move its headquarters out of state raises concern about Washington's ability to attract and retain large companies. But more worrisome is the state's generally hostile environment for small businesses, and the drag this imposes on job creation and general economic prosperity.

The health of large businesses is of course important to economic recovery, but small businesses are a major catalyst for job growth and revitalization. Washington's small enterprises provide over 55 percent of private sector jobs, make up more

than 95 percent of all businesses and are a vital part of the state's growing high-tech and knowledge-based economy.<sup>i</sup>

## Policy Analysis

Standing between entrepreneurs and their dreams of economic success are innumerable state, county and municipal regulations. The staggering amount of regulatory red tape amounts to more than 100,000 requirements that a small business owner must follow in order to run a business legally in Washington. State and local regulators have placed significant barriers between these would-be successful entrepreneurs and their dreams. The regulatory structure strangles small businesses, driving up the cost of entering the market and thereby increasing costs to consumers.

Ongoing research through the Washington Policy Center's Small Business Project has identified eight issues small business owners say are the primary barriers to their success.<sup>ii</sup> Those issues are:

- Workers' compensation and unemployment insurance.
- Employment regulation (minimum wage, work rules).
- The rising cost of health insurance.
- Workforce training.
- Access to technology and telecommunications.
- Environmental regulations.
- Tax burden.
- Liability and tort reform.

Many of these issues are discussed in other chapters of this policy guide. This chapter provides recommendations to improve the overall business climate and addresses unemployment insurance, affordable health care for small businesses, and liability reform issues. By reducing barriers to entry for Washington entrepreneurs, state and local policymakers can enhance economic opportunity and ensure a

healthy and vibrant business climate today and for future generations.

## **Recommendations**

**1) Review laws and regulations that impede business innovation and entrepreneurship.** Over the course of the state's 116-year history literally thousands of laws have been enacted that make it more difficult to start and run a small business in Washington. Policymakers should set up a systematic code review process to identify outdated laws in need of amendment or repeal.

**2) Streamline the business-licensing process.** Licensing fees and the complicated permitting process discourage many new businesses from starting, and drive others into the underground economy.

**3) Repeal laws and regulations that no longer serve a public purpose, but only work to keep competitors out of the marketplace.** The for-hire vehicle, taxicab, and moving industries are examples of where antiquated or overly-strict regulation actually works against the public interest by reducing price competition and consumer choice.

**4) Ease unreasonable restrictions on home-based businesses.** Starting a business at home is often the only way immigrant and low-income families can earn a livelihood and become economically independent. State and local rules should allow small family-run businesses to operate without disrupting the character of residential neighborhoods.

## 2. Unemployment Insurance

### Recommendations

1. Reduce benefits to be more in line with the national average.
2. Provide better incentives for workers to get back to work by requiring job training or community service.
3. Increase benefit compliance audits.
4. Implement personal unemployment accounts.

### Background

Washington's unemployment insurance system carries the second highest cost per employee in the country, behind only Alaska. While the tax *rate* is not higher than most states, businesses in Washington must pay that rate on the first \$30,200 of salary for each employee, the highest base wage in the nation. Businesses in most other states only pay unemployment taxes on the first \$7,000 to \$10,000 of an employee's salary. Washington's maximum weekly unemployment benefit is also very high, ranking second in the nation behind only Massachusetts.<sup>iii</sup>

To help slow cost increases, in 2003 the legislature passed major reforms to the system, most of which took effect in January 2004.<sup>iv</sup> The reforms include: returning the maximum weekly benefit to \$496, or 63 percent of the state's current average weekly wage, reducing the maximum time an employee can collect unemployment benefits from 30 to 26 weeks (at the national level, Congress recently approved up to 13 weeks of additional unemployment benefits for workers who exhaust their state benefits), changing the benefit calculation to include a full year of work, not just the two highest paid quarters, and allowing certain people to work part-time without losing their

benefits. The new law also creates a new tax schedule for businesses and caps the tax rate at 6.5 percent for most businesses and 6.0 percent for certain seasonal industries.

## **Policy Analysis**

It is important to note that even with these changes, the cost of the Washington system will remain almost twice the national average. In addition, some small businesses will actually see an increase in Unemployment Insurance costs as the tax burden is redistributed. For this reason, state policymakers should consider other incremental changes to further reduce cost and improve the performance of the existing system.

Also, given the overall high costs of Washington's unemployment benefits system and the costly burden it places on small businesses, policymakers should consider an alternative system based on personal, portable worker benefit accounts.

Such an approach has worked in other countries. In 2002 Chile pioneered a new system in which workers pay 0.6 percent of their wages into a personal account administered by a private fund. Employers contribute an additional 2.4 percent. A portion of the funds go into the general fund to cover young workers and those who cannot contribute enough into their account to meet the minimum level of benefits.<sup>v</sup>

Key to the success of Chile's program is individual control of personal benefits. Unemployed workers can receive tax-free benefits of up to 50 percent of their previous wages for up to five months. In contrast to the Washington system, unemployed workers can collect benefits whenever they are out of work for any reason, whether they are laid-off, fired or chose to leave a job. Strict qualification limits and enforcement are not required because workers control their own benefits.

Perhaps the most promising part of Chile's system is the long-term incentive for saving unemployment benefits. At retirement, workers can keep any money remaining in their account. Washington's system has no such provision. Employees here receive no benefits or savings at retirement. Retired workers who never file a claim receive no benefits at all, even though they paid into the system their entire working lives.

## Recommendations

**1) Reduce benefits to be more in line with the national average.** History shows high unemployment benefits increase unemployment. At a certain point the incentive to remain on unemployment is greater than the incentive to work. Further study illustrates that job-finding activities and formal job placement rises dramatically in the final few weeks of benefit eligibility.

One way to establish a more reasonable level of benefits is by tying Washington's benefit levels to a national average. By targeting a more consistent national standard for average weekly benefits and maximum weekly benefits, Washington policymakers can reduce the cost of the unemployment insurance system and help ensure a competitive business climate while maintaining necessary worker protections.

**2) Provide better incentives for workers to get back to work by requiring job training or community service.** Part of the attraction of staying on unemployment while only satisfying the state's minimum job search requirements is the opportunity to pursue personal interests uninterrupted. Introducing new service or training requirements for unemployed workers will increase their job skills and encourage them to return to work. As an example, unemployed workers could volunteer for non-profit organizations or attend state-sponsored job training.



**3) Increase benefit compliance audits.** In a recent performance audit, the State Auditor praised the Employment Security Department for its fraud protection practices, pointing to the Department's automated claims management system as a model of efficiency. Ironically, many small business owners feel it is this system that is encouraging employable workers to stay home. Increasing audits of people receiving benefits would help ensure they are complying with job search requirements.

**4) Implement personal unemployment accounts.** Under the current system, Washington workers receive no refund or benefit when they retire, and workers who have never been unemployed receive no benefits at all. A system based on individual accounts would promote personal responsibility, give workers an additional financial asset, encourage saving for retirement, and would relieve the state of much of the cost and complication of the current system.

### 3. Small Business Access to Health Insurance

#### Recommendations

1. Cap non-economic damages for medical malpractice awards.
2. Allow basic health insurance for small businesses.
3. Allow health insurers to adjust insurance rates based on the industry, age and wellness activities undertaken by the covered business.
4. Encourage access to individual Health Savings Accounts.

#### Background

Paying for health care coverage is one of the fastest-rising costs facing businesses and families in Washington. At the same time, health insurance is one of the most heavily regulated sectors of our state's economy.

Small business owners who participated in Washington Policy Center's Small Business Project identified the cost and availability of health care as the number one concern of small business. Business owners voiced particular concern about the way state-imposed mandates drive up health coverage costs for small firms. Health insurers in Washington are required by law to cover a broad range of illnesses and treatments, meaning employers are often paying for coverage their workers do not need. The large number of state-imposed mandates means basic, low-cost health coverage is currently illegal in Washington.

#### Policy Analysis

The health care system in Washington is governed by a complex and confusing combination of state laws, rules and

regulations. Small businesses are the first to suffer from the confusing web of red tape. Increases in health insurance costs are forcing many small business owners to reduce or eliminate health care coverage for their workers and themselves. According to a recent National Federation of Independent Business (NFIB) survey of small business owners throughout Washington, the number of employers who offer health care coverage for all employees has dropped from 65 percent in 1993 to only 47 percent today.<sup>vi</sup> Many small employers report double-digit increases in health insurance rates every year for the past several years.

Business owners deal with competition every day. They understand that reducing barriers to entry will increase competition in the marketplace. For this reason, small business owners support reforms that would streamline state regulations, increase competition among insurers, improve small business access to basic health insurance and encourage the option of individual Health Savings Accounts that give workers control over their own health benefits. These accounts are described in detail in the chapter on health care.

## **Recommendations**

### **1) Cap non-economic damages for medical liability cases.**

Court decisions involving large medical malpractice awards are one of the greatest cost drivers of health care coverage. Unlike many states, Washington law allows juries to award an unlimited amount of money to patients injured by the negligence of a doctor. Under most liability reform proposals, collection of economic damages, such as loss of past and future earnings and the full cost of medical care would remain fully funded, but skyrocketing non-economic damage awards would be reasonably limited. Further recommendations on medical liability reform are presented in the chapter on health care.

**2) Allow basic health insurance for small business.** Current law mandates almost fifty different types of treatment for any

health insurance plan issued in Washington state. Many small business owners cannot afford the “Cadillac” health plan that the state requires. By reducing the coverage requirements for the lowest cost plan, small business owners could purchase a bare-bones plan at a low cost and with few mandates, rather than offering no health insurance at all.

**3) Allow health insurers to adjust insurance rates based on the industry, age and wellness activities undertaken by the covered business.** This reform would reward small businesses for maintaining a safe and healthy working environment and would better allocate cost to those industries that place the highest burden on the health care system.

**4) Encourage access to individual Health Savings Accounts.** Individual Health Savings Accounts (HSAs) offer small employers an affordable way to provide health coverage to their employees when traditional first-dollar coverage is beyond their resources. Money placed in HSAs belongs to individual account holders and remains theirs if they switch jobs, become unemployed or retire. Funds in the account earn interest tax free and can be accumulated from year to year. HSA funds can be used tax free to pay any qualified medical expenses. An accompanying catastrophic insurance policy covers costs for major illness or injury.

#### 4. Liability and Tort Reform

##### Recommendations

1. Implement joint and several liability reform.
2. Allow evidence about the use of seat belts to be considered in auto accident court cases.
3. Cap non-economic damages for liability lawsuits.

#### Background

Skyrocketing health insurance costs, multi-million dollar court awards and a growing public awareness of the economic costs of uncontrolled litigation have forced tort reform to the front of small business owners' agenda. Doctors, whose practice is often run as an independent business, are among the hardest hit. Since 1998, the Washington State Medical Association has seen 31 percent of its physician members move out of state.<sup>vii</sup> Since 1997, the average cost of malpractice liability insurance for a family physician has increased 29 percent to almost \$10,000.<sup>viii</sup> Orthopedic surgeons have seen a similar 30 percent increase, to \$39,000 a year, and obstetricians have been forced to absorb a staggering 79 percent increase in typical coverage, from \$29,000 in 1997 to almost \$52,000 today.<sup>ix</sup>

Growing liability costs are also having a surprising effect on the state's growth management objectives. Many contractors with experience in constructing multi-family buildings are finding it nearly impossible to obtain even reasonably affordable liability insurance. Lawsuits for defects, mold and asbestos are forcing insurance companies to raise rates or pull out of the market for apartments and condominiums, leaving growth management planners with few options for increasing density while also providing affordable

housing. Liability insurance rates are also driving up the cost of single-family houses, adding thousands of dollars to the already rising cost of buying a new home.

Adding to the economic burden, liability costs have a direct effect on the cost of government. In 2002, plaintiffs filed 125 liability cases against state agencies, bringing the total number of court cases being defended by the Attorney General's office to 750 separate claims. This does not include the out-of-court settlement of approximately 250 cases each year. During fiscal years 2001 and 2002, the state paid out over \$106 million in tort claims, with the largest increase coming in lawsuits filed against Department of Social and Health Services social workers.<sup>x</sup>

## **Policy Analysis**

Finding solutions to the rising liability costs of Washington's small businesses is vital to restoring the health of the state's business climate. Policy reforms are needed to restore a business climate that encourages reasonable risk taking while maintaining necessary protections for workers and consumers.

One costly legal loophole allows lawyers to collect large cash settlements from business people who are only marginally involved in a case. In situations where the person primarily responsible for damage does not have much money, the plaintiff's lawyer will often go after businesses that may have only a slight association to the root cause of the civil action. Under the legal concept of joint and several liability, each defendant in a lawsuit, even those with only minimal or partial responsibility, must pay the full amount of a damage award if the other defendants in the case are unable to pay, fail to carry insurance, or have limited insurance coverage.

Another weakness in current liability law is that in auto accident cases judges and juries are not allowed to consider a

driver's irresponsible actions, like not wearing a seatbelt, which may have contributed to his or her own injuries. The law offers considerable opportunity for injured people to gain generous financial rewards in court for injuries that they could have easily prevented.

There are a number of commonsense ways to reform joint and several liability law, all of which would provide small business owners with much-needed protection against aggressive trial lawyers.

**1) Implement joint and several liability reforms.** Joint and several liability should be limited only to those parties found to be more than 50 percent responsible for the damages caused. Further useful reform would be to limit the application of joint and several liability only to economic damages, and to restrict damage awards to no more than double the percentage of fault assigned to a defendant.

**2) Allow evidence about the plaintiff's use of a seatbelt in auto accident cases.** Many small business owners must use the state's roads and highways to conduct their business, and are very sensitive to increases in the cost of corporate auto insurance. Under current law, a defendant is not allowed to present evidence showing the plaintiff was not wearing his or her seatbelt at the time of the accident. That is true even though not wearing a seatbelt is against the law. By allowing the jury to know if people who file claims did everything they could to limit their own injuries, juries would be better able to establish true liability in auto accident cases.

**3) Cap non-economic damages for liability lawsuits.** Implementing a reasonable limit on non-economic damages – such as pain and suffering awards – in liability lawsuits is an important component of tort and liability reform. A growing number of unreasonably large injury awards is driving up the cost of all types of liability insurance and threatens to deprive small businesses of the ability to buy affordable coverage.

Without liability coverage most companies would simply go out of business. Reasonable limits on non-economic damages would reduce the cost of starting new businesses and would significantly enhance the overall business climate in the state.



## 5. Regulatory Reform

### Recommendations

1. Regulate for results, not process.
2. Create an office of regulatory reform to identify regulations that duplicate or contradict each other, are outdated, or do more harm than good.
3. Institute regulatory sunset provisions. Submit all regulations to review by the legislature every five years.
4. Create a regulatory fast track for companies and individuals with a good track record of complying with regulations.

### Background

The right to live where we choose, the right to own property, the right to make a living, the right to enter into voluntary agreements with others, the right to control our own lives, are all fundamental aspects of what it means to be human. Respect for our natural rights is essential to maintaining civil life in a free society, and the central function and purpose of government is to protect the basic freedoms of its citizens.

Yet government itself often poses a grave and immediate threat to those rights. One of the most pressing public issues today is the ever-expanding scope and burden of government regulations, and the implications this trend has for people's economic liberties.

The overall problem can, perhaps, best be summarized by a statement from an editorial from *The Seattle Times*, "Sometimes, the government simply doesn't know when to leave the marketplace alone."<sup>xi</sup> Today, Washington citizens,

small businesses, and major industries alike face an expanding array of regulations at all levels of government.

Total state regulation has expanded to fill 32 phonebook-sized volumes, which together form a stack of paper over five feet high. These rules have the force of law, and they strictly control and limit the day-to-day activities of every person in the state.

The fundamental policy question facing the people of Washington and their elected representatives is, How much regulation is enough? What is the right balance of government intervention versus economic freedom, which will assure public health and safety and protect the basic rights of consumers, without choking off the oxygen the economy needs to thrive?

The drafters of Washington’s constitution provided guidance in answering these questions by recommending “a frequent recurrence to fundamental principles,” which is, “essential to the security of individual rights and the perpetuity of free government.”<sup>xii</sup> Within the limits of ordered liberty it is the right of citizens to live their lives as they see fit, not as the government directs. When state government oversteps its bounds by regulating the smallest details of everyone’s lawful activities, it hinders the vibrant economic and social life of the community.

Over the past 20 years, state government has grown to become larger than any private employer in the state, and government as a whole is now one of the largest industry classifications in the state. Washington ranks among the highest states in per capita tax burden, and is among the highest in the overall cost of government it places on its citizens. One national study has ranked Washington as the fifth most regulated state.<sup>xiii</sup>

## Policy Analysis

The numbers provide ample warning that state government is becoming too large and expensive, and is moving too slowly to adapt to the changing world around it. In combination with the burgeoning cost and size of government, the regulatory burden on Washington residents has increased substantially. As small business owners, non-profit groups, homeowners, farmers, and other ordinary citizens work to realize their dreams they find they are increasingly frustrated, as people encounter ever-growing resistance from government regulators.

One builder of affordable housing calls the detailed permit reviews required by the Growth Management Act “ridiculous,” and says the process plods along and adds significant costs, such as inventory carrying costs, fees for sophisticated engineering and legal fees. In the end, these costs must be passed along to homebuyers in the form of higher prices, pushing many low-income families out of the housing market.<sup>xiv</sup>

In another example, the owner of a potato-production facility in Eastern Washington was told by the state Department of Agriculture to label its see-through mesh shipping bags, at a total added cost of \$50,000 a year. However, the smaller five-pound retail bags, which were inside the temporary see-through outer bag, were already labeled clearly and could easily be read without opening the larger bag. In addition, the new wire labels required by the state often damaged the product by puncturing the skin of the potatoes, forcing the company to pass a higher cost of spoilage on to the consumer.<sup>xv</sup>

In New York the governor created a Governor’s Office of Regulatory Reform (GORR) to work with all agencies to reduce the number and complexity of state regulations. The Office’s message to citizens is explicit: “If you’re getting the runaround or being unnecessarily hounded by one of our state

agencies call us...”<sup>xvi</sup> GORR says it will intervene and take care of the problem – fast. The Office’s goal is to make New York more attractive to business growth, and it has been credited with helping to create thousands of new jobs.

In streamlining regulations Washington does not need to re-invent the wheel. By following the successful example of New York, and of similar efforts in states such as Texas, Massachusetts and New Jersey, policymakers can work to reform and modernize the state’s Byzantine regulatory system.

## Recommendations

**1) Regulate for results, not process.** By adopting a policy of measuring the results of the regulatory process, rather than the process itself, state policymakers would free agencies, businesses and individual citizens to find the best way to achieve a desired public good.

**2) Create an office of regulatory reform.** As recommended by the Washington Research Council, the legislature should create a permanent office of regulatory reform within the executive branch. The mission of this office would be to review all state regulations and determine which ones duplicate or contradict each other, are no longer needed, or do more harm than good to the public interest.

**3) Institute regulatory sunset provisions.** Under the current system most state regulations are written as if they will last forever. Policymakers should require all agency rules and regulations to carry a sunset provision, and every five years be reviewed and, if still needed, re-authorized by the legislature.

**4) Create a regulatory fast track.** To focus enforcement where it is needed, state regulatory agencies should authorize companies and individuals who have a good track-record in following environmental and regulatory rules to approve their own applications and permits. The results would be

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periodically audited by oversight agencies, and failure to comply would result in penalties and revocation of self-monitoring authorization.

## **Additional Resources**

### Washington Policy Center Research

“Reforming Washington's Workers' Compensation System,” by Allison Demeritt, May 2004

“Entrepreneurship in The Emerald City: Regulations Cloud the Sparkle of Small Businesses,” by Jeanette Peterson, August 2004

“Agenda for Reform: Priority Solutions for Improving Washington's Small Business Climate,” by Eric Montague, January 2004

“The Small Business Climate in Washington State,” by Eric Montague, March 2002

“Consumer, Not Corporate, ‘Greed’ is Ultimately Behind Layoffs,” by Mark J. Perry, 2002

### Other Resources

The Washington Competitiveness Council - A state government sponsored council of community and business leaders charged with recommending policies for making Washington state more competitive. [www.governor.wa.gov/wcc/wcc.htm](http://www.governor.wa.gov/wcc/wcc.htm)

“2004 Washington ACE Report: Accelerating out of the Turn?” published by Washington Alliance for a Competitive Economy (WashACE), a partnership of the Association of Washington Business, Washington Research Council and Washington Roundtable. The report is available online at [www.awb.org](http://www.awb.org).

U.S. Small Business Administration Office of Advocacy - Publishes research reports and lobbies Congress and state legislatures on behalf of small business. [www.sba.gov/advo/](http://www.sba.gov/advo/)

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Mercatus Center at George Mason University - A research institution focusing on regulatory reform. [www.mercatus.org](http://www.mercatus.org)

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- <sup>i</sup> “Small Business Profile: Washington,” published by the U.S. Small Business Administration, Office of Advocacy, January 2004, at [www.sba.gov](http://www.sba.gov).
- <sup>ii</sup> For more information about the Small Business Project see, “Agenda for Reform: Priority Solutions for Improving Washington’s Small Business Climate,” January 2004, and “The Small Business Climate in Washington,” March 2002, both by Eric Montague and available at [www.washingtonpolicy.org](http://www.washingtonpolicy.org).
- <sup>iii</sup> Information from, “Unemployment Insurance Data,” and analysis prepared by the Commerce and Labor Committee staff, Washington House of Representatives, May 9, 2003, Olympia, WA.
- <sup>iv</sup> For a more detailed explanation of the changes made to the state’s unemployment insurance system, see a summary and the full text of SB 6097 at [www.washingtonvotes.org](http://www.washingtonvotes.org).
- <sup>v</sup> Data about the Chilean system from “Chile Will Privatize a New Span of Its Noted Social Safety Net,” by Larry Rohter, *The New York Times*, June 24, 2002, available at [www.nytimes.com](http://www.nytimes.com).
- <sup>vi</sup> “Health Care Issue Overview,” produced by National Federation of Independent Business, Washington Chapter, January 2003.
- <sup>vii</sup> “Washington’s Ailing Health Care System, Continued Decline, Guarded Prognosis,” Washington State Medical Association – Education and Research Foundation, 2002, p. 4, [http://www.wsma.org/01\\_whitepaper.pdf](http://www.wsma.org/01_whitepaper.pdf).
- <sup>viii</sup> *Ibid.*, p. 7.
- <sup>ix</sup> *Ibid.*
- <sup>x</sup> “2002 Annual Report: Attorney General of Washington,” published by Washington Office of the Attorney General, Olympia, WA, p 47.
- <sup>xi</sup> “Restaurant Smoking Ban is Needless Regulation,” editorial, *The Seattle Times*, January 27, 1997.
- <sup>xii</sup> Washington state constitution, Article I, Section 23.
- <sup>xiii</sup> “Economic Freedom in America’s 50 States: A 1999 Analysis,” by John Byars, Robert McCormick and Bruce Yandle, Clemson University, January 2000. According to “A Regional Economic Vitality Agenda,” published by the Washington Research Council, Washington businesses carry 54 percent of the tax burden, highest of any of the seven nearest western states.
- <sup>xiv</sup> Cited in “Ease the Regulatory Burden,” testimony before the House State Government Committee by Eric Montague, Washington Policy Center Policy Analyst, February 19, 2001, <http://www.washingtonpolicy.org/LaborPolicy/TestimonyRegBurdensFeb01.html>.
- See also, “In Depth: To Build a House,” by Joe Nabbefeld, *Puget Sound Business Journal*, March 31, 2000.

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<sup>xv</sup> Ibid, and “Labeling to the Extreme,” by Don C. Burnell, Association of Washington Business news release, 1997.

<sup>xvi</sup> Governor’s Office of Regulatory Reform, State of New York,  
<http://www.gorr.state.ny.us/gorr/>.





## Chapter 7: Criminal Justice & Prison Services

### 1. General Prison Services

#### Recommendation

Authorize a pilot program allowing for the contracting out of state prison services to a private company.

#### Background

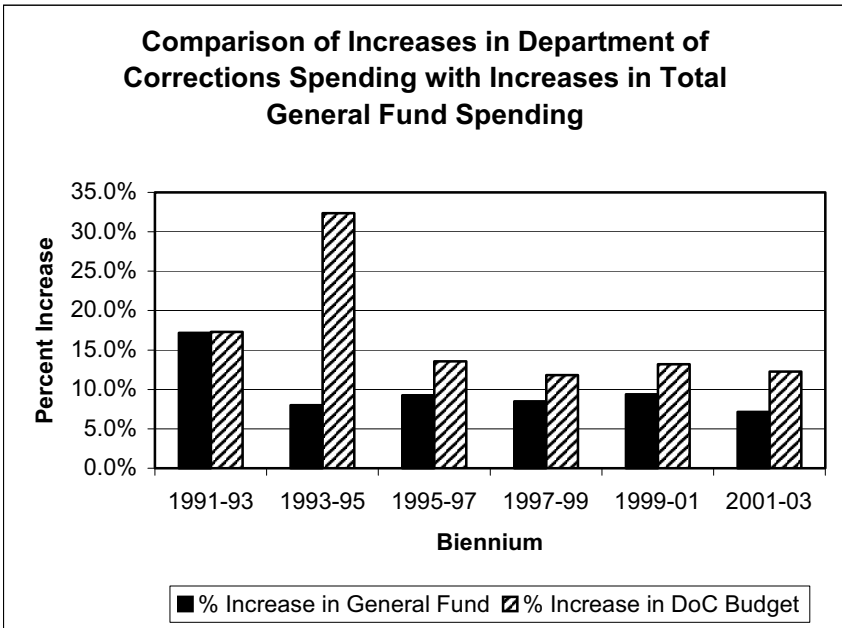
The primary function of government is to protect the lives, liberty and property of its citizens. Public safety is thus essential to the continuance of civil society. Public safety depends on a reliable and effective criminal justice system, and central to the administration of justice is a humane, secure and efficient prison system.

At first glance building and operating prisons would appear to be a natural and exclusive function of government. On closer inspection, however, there is really no reason operating a prison system should remain a government monopoly. Like many essential public services, the government's responsibility is to see that a sustainable, high-quality corrections system is provided, not that the government itself should build and operate it.

In the United States police powers are largely exercised by the states, and citizens look to their state and to local governments to protect them from domestic crime. State prisons and local jails are where most criminals serve their sentences, and state corrections policy mainly determines how the nation's criminal justice system functions.

In Washington, the burden of maintaining the state-run prison system is becoming increasingly costly. The state Department of Corrections budget has more than doubled over the last ten years, rising from \$502 million in the 1991-1993 biennium to \$1,164 billion in the most recent biennium.<sup>i</sup> Corrections costs rose more than 12 percent over the last two years, a rate more than four times higher than inflation. The increasing cost of operating the state prison system has outpaced the rise in total General Fund spending in every biennium in the 1990s, and is now one of the fastest growing areas of state spending (see figure 1).

Figure 1.



Rising prison expenditures are a major cost driver for state government, and are one reason overall spending is increasing considerably faster than the rising level of tax revenues. Estimated tax revenues are expected to increase by some \$500 million in the 2003-2005 biennium, yet state

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legislators are still facing a serious deficit compared to what they had planned to spend in 2003-2005.

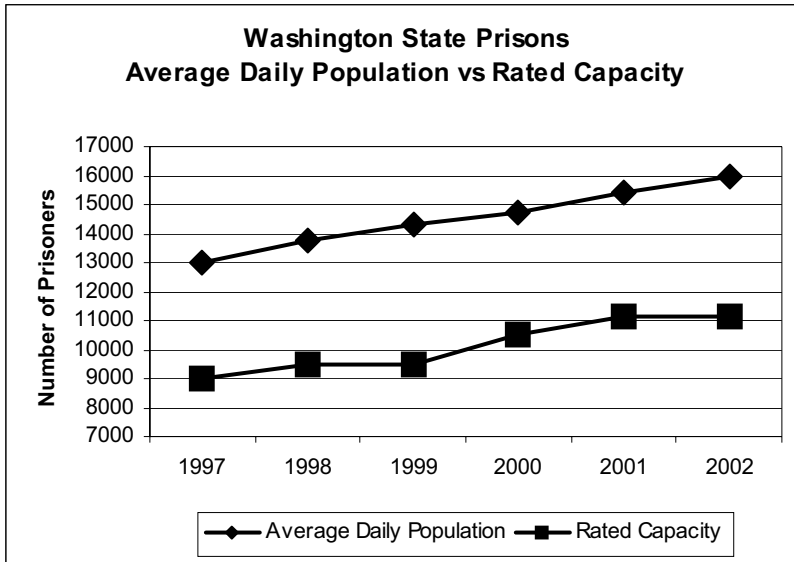
Over the last fifteen years the population of Washington has increased to over six million people.<sup>ii</sup> Over the same period the overall crime rate, especially for violent crime, has dropped dramatically. Much of that success is the result of voter-approved sentencing laws that ensure the most dangerous criminals stay behind bars.

Improved public safety measures have placed increased demand on the state prison system. Every facility, with the exception of the Cedar Creek Correction Center, is overcrowded, some by as much as 50 percent.<sup>iii</sup> Only the Work Release and the Work Ethic Camp programs have significant space available, but because of the seriousness of their crimes many prisoners are not eligible for these programs.

The present over-capacity at Washington's state prisons is part of an ongoing trend. The average daily population of offenders housed by the Department of Corrections, from 1991 to 1996, increased by 38 percent. From 1997 to 2002 the state prison population rose 24 percent (see figure 2). While this is an improvement over the previous reporting period, such recurrent and dramatic increases in the number of prisoners housed in state facilities cannot be sustained over time.

Figure 2.

### Trends in Average Daily Prisoner Population Compared to Institutional Rated Capacity



Overcrowding is also evident at Washington's 39 county jails. Together county jails are designed to hold 8,770 prisoners, but instead house an average daily population of around 10,000, resulting in an average over-capacity of more than 113 percent throughout the system.<sup>iv</sup>

The Department of Corrections is having trouble maintaining an adequate workforce necessary for managing these perennially over-crowded facilities. According to employees of the Monroe Correctional Facility, state workers earn lower wages than employees of local city and county jails, but are typically better trained and educated.

As a result, they often leave their state jobs for higher paying positions at local jails.<sup>v</sup> Were a private company faced with the same problem, their flexible labor practices would allow them to offer innovative compensation packages, combining wages and medical benefits with stock options and

advancement opportunities, thereby providing ample incentive for employees to stay at their jobs.

Washington's state prison system is well beyond its designed capacity, but for the next 10 years the DOC budget only allows for construction of an additional 1,500 beds. Approximately 60 percent of those beds will be medium and low security – attractive candidates for competitive contracting. In 1996 the Legislative Budget Committee outlined the potential cost and efficiency benefits inherent in competitive contracting, in which private companies would bid to build, maintain or operate state prisons, thus providing high-quality service to the public at less cost.

Yet many people oppose competitive contracting for state and local prison services. They feel the government has a fundamental responsibility to actively manage and control prisoners who are sentenced for punishment by the courts. This view overlooks the equally important responsibility of the government to perform services as efficiently and cost effectively as possible, while providing for the general welfare.

## **Policy Analysis**

The traditional corrections model based on government-run prisons is clearly outmoded and is having difficulty keeping up with the growing needs of public safety. The conventional answer is for lawmakers simply to put more money into the current system. Given budget constraints and the public's strong anti-tax sentiment, however, that approach is no longer feasible.

Without change, the state prison system will continue to struggle with over-crowded and under-funded prisons, and local law enforcement will be forced to send potentially dangerous criminals back onto the streets of the community. A well-structured privatization program would expand options for state

policymakers, enhance public safety and put the benefits of competition to work for taxpayers.

Recent research compared two groups of states to measure the effectiveness of privately run prisons over four years, 1997 through 2001.<sup>vi</sup> States that made a greater investment in private prisons enjoyed far lower expenses per day per inmate than other states. These states had an average daily cost of \$82.59 per inmate in 2001, compared with an average daily cost of \$123.43 for states with few or no privately run prisons.

In Washington, with little prison privatization, per diem costs in 2001 were \$104.25. Yet in neighboring Idaho, where state leaders made a significant investment in private prisons, per diem costs were 42 percent lower, just \$60.21. Other Western states that greatly benefited from lower per day costs because they had a significant number of private prisons were Montana (\$80.93), New Mexico (\$85.89) and Colorado (\$67.05).

Privately-operated prisons in other states are cost effective, provide education and job training for prisoners, and reduce overall recidivism rates. During a Washington Policy Center conference, representatives from three prison companies showed how they consistently realize operational savings of 10 percent to 20 percent, and construction savings of around 15 percent, while maintaining the high level of service and quality taxpayers want from government.

Limited correctional privatization is already working in our state. Security Specialists Plus has owned and operated a 50-bed work release facility for Whatcom County since 1991. The firm charges \$28 a day to house and care for each inmate. The cost of keeping the same prisoner in the county jail is \$60 a day. With an average of 38 inmates a day over ten years, the arrangement has gained documented savings of over \$4 million.<sup>vii</sup> This small Washington firm is a realistic indicator of

what could be achieved if privatization were adopted at the state level.

Opponents of contracting out prison services say private prisons can only save money by cutting the wages of guards and staff. Washington Policy Center research has identified several management areas where private companies routinely reduce costs without cutting employee wages or benefits:

- **Efficient construction.** Private firms can often build prison facilities for 15 percent to 25 percent less than is usual with public works projects.
- **More efficient use of staff time.** Flexible schedules, fewer work rules and worker incentives that are often banned in the public sector allow private companies to put staff time and skills to the most effective use.
- **Superior design.** The layout of private prisons is often more innovative and efficient than public ones and usually require fewer guards to safely monitor the same number of prisoners.
- **Lower administrative cost.** Freed from cumbersome civil service requirements, private prisons often spend up to one-third less on administrative expenses.
- **Streamlined purchasing.** Private companies are not bound by uneconomic purchasing rules, and can often buy equipment and supplies at much lower cost than the government.

Extensive research and real-world experience show that prison privatization serves the public interest by offering state leaders a proven way to lower costs, while maintaining a safe, humane and high-quality corrections system.

## **Recommendation**

**Authorize a pilot program allowing for the contracting out of state prison services to a private company.** Following successful completion of the pilot program, competitive contracting, if it proves successful, could be used to expand competition throughout the state and local corrections system, reducing costs and increasing the quality of corrections in Washington. By tapping into the competitive advantages of private prison management, state and local governments can provide safe incarceration of convicted prisoners without raising taxes or cutting essential public services.



## 2. Prison Medical Services

### Recommendation

Open state and municipal prison health systems to competitive contracting.

### Background

A key component of the high cost of incarceration is inmate health care. Throughout the 1990s, for each dollar spent on corrections in America, an average of eleven cents went towards health care, which includes physical, mental and dental services. With the growing number of physically and mentally ill people entering the criminal justice system, and the increasing focus on treatment and rehabilitation for substance abusers, that number is likely to grow.

In Washington state the high cost is particularly apparent. The State Department of Corrections spends more than \$60 million each year to provide medical care for about 15,000 inmates, roughly \$4,000 per inmate. At the county level, costs are similarly high. In King County inmate health care costs taxpayers more than \$22 million a year, far greater than the cost of the County's entire public parks system.

The rising cost of health care is not the only factor threatening the viability of the state's monopoly prison system. The quality of health services are also suffering as a result of overstretched facilities, inadequate staffing and an inflexible work environment common to government bureaucracies. Faced with similar problems, prison officials in other states are turning to the private sector for quality, cost effective alternatives for managing the health care needs of the growing inmate population.

The practice of working with private health care organizations is not new. At the beginning of 1997, 12 states had contracts with private firms to provide health care to their entire prison system, and another 20 states had contracted health care for part of their systems -- a total of 498 prisons in the 32 states. By 2000, 34 states had some privatized health care for inmates while in 24 states inmate health care systems were run completely by private contractors.

In one example, prison officials in Illinois began contracting for health care services in the early 1980s to help contain growing corrections costs. Today, three competing companies run the entire state system. As a result, the state's health costs, at just under \$1,700 per inmate a year, are lower today than they were in 1991 and are the second lowest in the nation. Mississippi, Indiana, New Jersey and Washington D.C. also began using private health care providers during the 1990s, all with similar positive results.

In the federal system, private doctors are being used to supplement the similarly overstretched prison infrastructure. In a 1996 study, six large federal facilities with similar prison populations were analyzed. Between 1989 and 1990 five had health care cost increases of more than 15 percent a year, while the sixth, using private competition for health care services, saw an average increase of only three percent a year. As a result, nearly every federal prison now has some level of competition for health care services.

## **Policy Analysis**

Unfortunately, state prison officials do not take full advantage of private competition. While the Department of Corrections regularly contracts with private medical professionals for some services, it is only an option of last resort. Prison officials continue to maintain a costly workforce of full-time doctors, nurses, psychologists, counselors and

dentists to meet the demanding medical requirements of the inmate population.

Some critics claim that private companies may have little incentive to provide quality care. Indeed, in at least one case, prison officials terminated a contract with a private company because of poor care. But this is the exception rather than the rule. In fact, several cases of government medical care were so bad that courts found they violated inmates' rights and ordered jails to hire a private company. Recognizing this concern, many states require private contractors to achieve and maintain accreditation through the highly regarded National Commission on Correctional Health Care.

The promising results of prison health care privatization do not mean that full privatization of all correctional health care is always best, but encouraging prison officials to tap into the benefits of market competition is preferable to the current state monopoly.

## **Recommendation**

**Open state and municipal prison health systems to competitive contracting.** Under competition, state officials would likely find savings of 10 to 20 percent. Opening state and municipal prison health services to competition would reduce costs and improve quality at all levels of the corrections system.

### 3. “Three Strikes You’re Out” Law

#### Recommendations

1. Retain the full force and integrity of Washington’s successful “Three Strikes You’re Out” law.
2. Build on the success of Three Strikes legislation by considering additional offenses that could be counted as strikes.

#### Background

In November 1993, voters in Washington passed Initiative 593, the nation’s first “Three Strikes You’re Out” law by a majority of 76 percent.<sup>viii</sup> The law lists more than 40 violent felonies as “strikes” and requires mandatory life sentences for offenders who commit three such violent crimes. Since then 23 other states and the federal government have enacted some form of “Three Strikes You’re Out” laws to deal with repeat serious criminals.

Since enactment the Three Strikes law has proven remarkably effective in reducing violent crime. By 1995 violent crime had declined by 4.8 percent. Based on previous trends, this means there were 256 fewer rapes, 171 fewer robberies and 845 fewer violent assaults than would likely have occurred without the new law. The trend of lower crime rates, and of fewer violent crimes committed, has continued through to the present.

When the law was passed critics said many hundreds if not thousands of people would be committed to life sentences in Washington’s prisons. The state Sentencing Guidelines Commission estimated the law would put as many as 80 people in prison for life in the first year. Instead the highest number of offenders sentenced to life in any one year was 36, in 1995.<sup>ix</sup> Since then the figure has declined. In 2003, 17 offenders

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received life sentences under the law. In all the law has resulted in 229 life sentences as of December 2003, far few than predicted.<sup>x</sup>

Police officers, prison officials and others in law enforcement have noticed that many criminals have changed their behavior because of the Three Strikes law.

- One police detective reported that “I get very few questions about Three Strikes anymore, because the inmates are now as aware of the law as I am.”
- Seattle police report that as the Three Strikes initiative was going to the ballot, 17 registered, two-strike sex offenders decided to leave the state.
- A suspected forger informed police that he switched from robbery to passing bad checks because he already had two strikes on his record and forgery was not a strike.
- A typical comment police hear from career criminals is “Three Strikes made me realize it's time to clean up my act.”

### Policy Analysis

The Three Strikes law is designed to stop two kinds of criminals: violent predators and offenders who commit lesser but a far greater number of crimes than other offenders. The law's chief benefit is the number of repeat crimes it deters that would otherwise be committed by felons with one or two strikes already on their record.

Prosecutors, defense attorneys and judges carefully explain to strike-one and strike-two offenders what will happen after the third conviction for violent crime. When a third conviction means life behind bars, many felons resist the

temptation to commit that last offense. In the past they may not have minded serving periodic terms in prison, but passage of Three Strikes appears to have caused many of them to rethink their behavior, rather than run the risk of a life sentence. In addition, many two-strike criminals who feel they will likely hurt someone again, may have simply decided to move out of state.

Recently, this important criminal justice reform has come under attack from critics for supposedly targeting certain racial groups in our society.

In 2003 the legislature considered a bill (HB 1881) to provide that second degree robbery and second degree assault, both of which involve the use or threat of violent force in the commission of a crime, would no longer count as strikes. While the bill did not pass, it would have resulted in a significant weakening of the state's Three Strikes law.

## **Recommendations**

**1) Retain the full force and integrity of Washington's successful "Three Strikes You're Out" law.** The list of serious, violent crimes covered by the law should not be reduced. Research shows that Three Strikes is working to hold criminals accountable for their repeated decisions to victimize their innocent neighbors. The result has been lower crime, safer streets and better communities for all Washington residents.

**2) Build on the success of Three Strikes legislation by considering additional offenses that could be counted as strikes.** Policymakers should examine other areas of criminal law, such as serious drug offenses, that should be counted as strikes, to further reduce the kind of crimes that do the most harm to society.

#### 4. Hard Time for Armed Crime Law

##### Recommendations

1. Preserve the effectiveness of the Hard Time law.
2. Build on the success of Hard Time legislation by considering ways to strengthen the law.

#### Background

The Hard Time for Armed Crime law was enacted by the legislature in 1995 to close loopholes in existing law and increase prison sentences for armed criminals.

Confrontational crimes have a high risk of unintended violence to the victim. By passing the Hard Time law the legislature intended to reduce or prevent serious injury to crime victims by deterring the use of deadly weapons. To effect that deterrence, the Hard Time law requires an added amount of time to the sentences for crimes committed while armed with a firearm: five years for a class A felony, three years for a class B felony, and 18 months for a class C felony. The added penalties are doubled for a second armed conviction.

Lesser, but still significant time enhancements are required if an offender is armed with any other type of deadly weapon, such as a knife or a club, while committing a crime: two years for a class A felony, one year for a class B felony, and six months for a class C felony.

Hard Time split existing firearms law into two distinct crimes: theft of a firearm and possession of a stolen firearm. The beginning sentencing range for theft of a gun increased to 12 to 14 months and the maximum sentence doubled to 10 years. The starting sentencing range for possession of a stolen firearm remained at six to 12 months, but the maximum

sentence doubled to 10 years. Each firearm stolen or possessed under these crimes is considered a separate offense.

The different scales between the use of a firearm and other deadly weapons recognize the reduced risk of harm from knives and similar implements. Regardless of the type of weapon enhancement applied at trial, the time added to an offender's sentence under the Hard Time law is not eligible for time off for good behavior.

Washington state has strict qualifications for a murderer to qualify for a death sentence. Not only does the murder require malice and forethought, but also aggravating circumstances. Hard Time expanded the list of aggravating factors to include murders committed during drive-by shootings or when attempting to join, remain in, or advance in any criminal organization such as a gang or mob.

Furthermore, any criminal who commits murder in an effort to avoid a life sentence without parole under the Three Strikes law is similarly covered by the Hard Time statute. Under the law, this class of murderer must now receive either a life sentence without parole or a death sentence upon conviction. The intent of the legislature was that there be no repeat offenders for aggravated murder.

The most innovative aspect of Hard Time made Washington the first state in the nation to track the sentencing practices of individual judges. The provision allows the public to examine how each Superior Court judge sentences serious felons. The judge's record can then be compared to the expected sentencing range to get an assessment of which judges are lenient and which are strict.

Prosecutors are also held accountable under Hard Time. Plea agreements are recorded on each judgment and sentencing document. If the final sentence is either lenient or harsh, the prosecutor's recommendation is listed along with the judge's



final ruling to see if they concurred. Sentencing and plea agreement reports are released on September 1st of each year.

## Policy Analysis

Hard Time dramatically increased sentences for violent armed criminals. Contrary to predictions of opponents, these longer sentences did not usually require lengthy and costly trials.

The Sentencing Guidelines Commission studied a total of 173 deadly weapon enhancements from July 23, 1995 to mid-May, 1996. One hundred eleven of them were for crimes committed while armed with a firearm and 62 were for use of other weapons such as knives and clubs. In spite of the tougher penalties for carrying a deadly weapon, over 67 percent of the firearm enhancements and over 70 percent of the other deadly weapon enhancements were included as part of a guilty plea, resulting in shorter court proceedings, less police, prosecutor and defense attorney time and lower cost to the criminal justice system.

The Hard Time law has proved successful in making citizens safer by removing dangerous, convicted criminals from the streets before they can hurt someone again. King County Prosecutor Norm Maleng summed up the benefit of the law this way, “The Hard Time law has, day in and day out, served to ensure longer sentences for the type of armed criminal the public fears the most. It has quietly become the most significant criminal justice measure of the 1990s.”

## Recommendations

**1) Preserve the effectiveness of the Hard Time law.** The list of serious, violent crimes covered by the law should not be reduced. Research over the years shows that Hard Time for Armed Crime is a principle reason violent crime dropped sharply in the 1990s. The law is working today to physically

separate violent criminals from innocent citizens, resulting in safer neighborhoods across Washington.

**2) Build on the success of Hard Time legislation by considering ways to strengthen the law.** Policymakers should consider requiring that sentences for unlawful possession of a firearm, theft of a firearm and possession of a stolen firearm be served consecutively. They should also consider other areas of criminal law that can be strengthened by the addition of Hard Time sentence enhancements.

## **Additional Resources**

### Washington Policy Center Research

“Private Prisons and the Public Interest: Improving Quality and Reducing Cost through Competition,” by Paul Guppy, February 2003.

“Prison Health Care: Healing a Sick System through Private Competition,” by Eric Montague, 2003.

“Private Prisons: A Sensible Solution,” by Eric Montague, August 2001.

“The Three-Strikes Law Works,” by John Carlson, 2001.

“Hard Time for Armed Crime: A Review” by R. David LaCourse, 1997.

### Other Resources

Reason Public Policy Institute’s Competitive Corrections Research Project - This project includes detailed data about the expanding market for private correctional facilities across the nation and worldwide. [www.rppi.org/privatization/ccrp](http://www.rppi.org/privatization/ccrp).

Association of Private Correctional and Treatment Organizations - [www.apcto.org](http://www.apcto.org).

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<sup>i</sup> “Historical Reports: General Fund Expenditure History – Operating,” published regularly by the Legislative Evaluation and Accountability Program Committee, (LEAP), at [www.leap.wa.gov](http://www.leap.wa.gov), Olympia, Washington, February 2003.

<sup>ii</sup> “Population Change and Net Migration,” Washington Trends: Economy, Population, Budget drivers, Revenue, Expenditures, Office of Financial Management, Olympia, Washington, September 4, 2002, at [www.ofm.wa.gov/trends/htm](http://www.ofm.wa.gov/trends/htm).

<sup>iii</sup> “Institution Offender Population,” Washington State Department of Corrections, Olympia, Washington, December 31, 2002, at [www.wa.gov/doc/planningresearch/pop.htm](http://www.wa.gov/doc/planningresearch/pop.htm).

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<sup>iv</sup> “Counties, Rated Capacity, ADP, and Percent Use,” Jail Statistics, Washington Association of Sheriffs and Police Chiefs, December 2001, at [www.waspc.org/jails/adp\\_county.shtml](http://www.waspc.org/jails/adp_county.shtml).

<sup>v</sup> Information obtained during tour of Monroe Correctional Facility provided by Community Relations Coordinator Charlotte Headley and interview with Associate Superintendent Mike Williams, May 04, 2001.

<sup>vi</sup> “Meeting the State Budget Challenge, How Private Prisons Help States Restrain Corrections Spending and Keep Overall State Budgets Under Control,” report by Lattimore Black Morgan & Cain, P.C. accounting firm, October 6, 2002.

<sup>vii</sup> Interview with Greg Rustand, Security Specialists Plus, Bellingham, Washington, July 5, 2001.

<sup>viii</sup> Elections and Voting, Initiatives to the People, 1914 through 2003, Office of the Secretary of State, Olympia,

[http://www.secstate.wa.gov/elections/initiatives/statistics\\_initiatives.aspx](http://www.secstate.wa.gov/elections/initiatives/statistics_initiatives.aspx)

<sup>ix</sup> “Three-strikes life terms fewer than expected,” by Maureen J. O’Hagan, *The Seattle Times*, August 17, 2004. The figure is based on data from the Sentencing Guidelines Commission.

<sup>x</sup> Ibid.



## Chapter 8: Labor Policy

### 1. Workers' Compensation

#### Recommendations

1. Ensure that workers' compensation trust funds are used only for workers' compensation benefits.
2. Require annual financial audits of workers' compensation accounts.
3. Legalize private insurance.
4. Direct rehabilitation for injured workers towards job placement rather than "employability."
5. Clarify the calculation of benefits.
6. Bring benefit levels more in line with those in other states.

### Background

The complex state workers' compensation program is often confusing and tedious for employers, workers, citizens and policymakers alike. Yet workers' compensation insurance is a topic of prime importance. High insurance costs contribute to job losses, layoffs and wage cuts, and have a harmful effect on the economic vitality and business climate of the state.

The Department of Labor and Industries, the state agency that runs the workers' compensation program, adopted a 29.4 percent rate increase in 2003 and a further 9.8 percent increase in 2004.<sup>1</sup> Annual inflation for each of these years is around two percent. Since each year's increase compounds

previous ones, the average employer's costs in 2004 were 42 percent higher than in 2002.

All states except Texas require employers to provide workers' compensation insurance.<sup>ii</sup> Washington is one of only five states that forbids private insurers from underwriting policies. A few large companies can afford to self-insure. All others businesses are forced to buy insurance from the sole legal provider: the Department of Labor and Industries.

Labor and Industries is the third largest agency in state government, with more than 2,600 full-time staff and a budget of almost half a billion dollars.<sup>iii</sup> Since the Department is the sole insurer for almost all businesses, the insurance program it administers is also extremely large: the program provides insurance to over 160,000 employers, covers roughly 1.9 million workers, and collected about \$1.2 billion in premiums in 2003.<sup>iv</sup>

Washington's system pays one of the highest levels of benefits in the country. Injured workers receive more money per week here than they would in all but five or six other states. In 1999, the system paid a maximum weekly time-loss payout of \$870 a week, or more than \$45,000 a year.

## **Policy Analysis**

The original purpose of workers' compensation was to provide sure and certain relief for workers in the event of an on-the-job injury. In return for joining a legally-mandated program, employers gained protection against the uncertainty of individual lawsuits brought against them by injured employees. For employers and workers the system is intended to provide security, financial predictability and fair treatment.

Yet the "exclusive remedy" aspect of workers' compensation has been eroded. Workers routinely sue the Department in court to gain a higher level of benefits, and,

while they are not suing employers directly, employers must bear the full cost of lawsuits and any resulting awards through higher workers' compensation taxes. In addition, employers must pay the long-term cost of litigation when court decisions result in a permanent higher level of benefits for all claimants.

Injured workers and their lawyers who sue and win realize an immediate economic gain, while the system as a whole is undermined and risks becoming fiscally unsustainable, to the ultimate detriment of all employers and workers.

Major reforms are needed to bring the workers' compensation system back to its original purpose; a true insurance plan which mitigates risk for employers, provides fair and reliable benefits for injured workers and contributes to a stable business environment for all Washington citizens.

## **Recommendations**

**1) Insure that workers' compensation trust funds are used only for workers' compensation benefits.** The Department uses money from the trust fund to pay for programs that have no relation to collecting premiums or paying out benefits to injured workers. All Labor and Industries activities not directly related to managing the workers' compensation program should be funded through the regular state budget.

**2) Require annual financial audits of workers' compensation accounts.** Currently the system is not subject to regular financial audits. Annual independent audits would build greater accountability into the system, build up public trust and let employers see whether the taxes they pay are being managed wisely.

**3) Legalize private insurance.** Washington is one of only five states that make it illegal to buy private workers' compensation insurance. Legalizing private insurance would bring choice,

quality service and price competition to the system, and would benefit both employers and workers.

**4) Direct rehabilitation for injured workers towards job placement rather than “employability.”** Currently rehabilitation for injured workers is devoted toward helping them meet the state standard of “employable.” But workers recovering from an injury do not really care whether or not a government agency considers them conceptually employable; they care whether or not they have a source of income. The Department should re-focus its efforts on helping workers return to their jobs or find new ones suited to their skills and physical condition.

**5) Clarify the calculation of benefits.** The original idea behind a state-managed workers’ compensation fund was to keep costs low by eliminating the need for lawsuits. Yet this approach is not working. Recent lawsuits have built new fixed costs into the system. Policymakers should make the way benefits are calculated clearer and simpler to avoid legal disputes.

**6) Bring benefit levels more in line with those in other states.** Reducing the maximum benefit cap to match the national average would save money and establish a more reasonable level of benefits.



## 2. Minimum Wage

### Recommendations

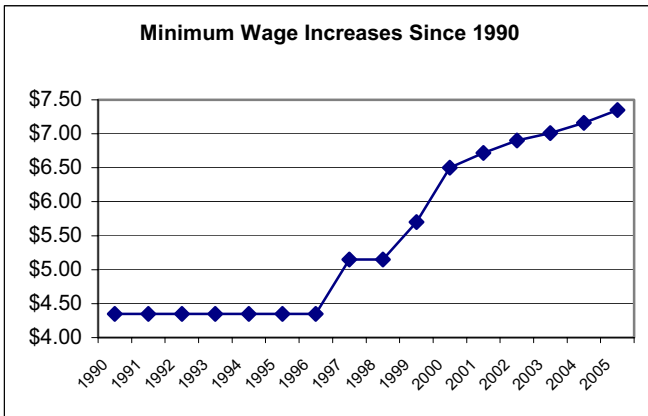
1. Return control over minimum wage increases to the legislature. Take this government-set wage off “auto pilot” so increases do not automatically occur every January 1st.
2. Delay automatic increases in years when Washington state unemployment is higher than the national average.
3. Allow employers to pay a temporary training wage to create more entry-level jobs, so new employees can gain valuable work experience.
4. Allow teenage workers to earn a starting wage closer to the federal minimum to increase job opportunities for young people.

### Background

Washington has the highest state minimum wage in the country.<sup>v</sup> At \$7.16 an hour it is fully 39 percent higher than the federal minimum of \$5.15.<sup>vi</sup> On January 1, 2005 the wage is set to increase 19 cents to \$7.35 an hour, or almost 43 percent higher than the federal minimum. Washington also routinely has the highest or second highest unemployment rate in the nation.

That is no coincidence. When a state law artificially increases the cost of creating jobs, fewer jobs are created. Low-skill, low-income workers are the first to be priced out of the job market. Two researchers at Cornell University recently concluded, “A 10 percent increase in the minimum wage causes four times more employment loss for employees without a high school diploma and African American young adults than it does for more educated and non-black employees.”<sup>vii</sup>

Washington's present minimum wage law was enacted by voters with passage of Initiative 688 in 1998. The measure enacted a two-step boost in the state minimum wage from \$4.90 to \$6.50, and for the first time created regular yearly increases tied to inflation.<sup>viii</sup> The state minimum wage now automatically increases every January 1st and is pegged to the Puget Sound region's cost of living, the highest in the state. Previously, the legislature had increased the minimum ten times since the first state-mandated wage was enacted in 1959.



Washington has some 73,300 minimum wage jobs, or about 3.5 percent of all industry jobs. They tend to be concentrated in certain industries: food services, retail sales, health care, agriculture, forestry and fishing. The majority of minimum wage workers are employed by small businesses.<sup>ix</sup>

Minimum wage jobs usually supplement other income; very rarely is it the sole financial support for a family. Eighty-five percent of those earning the minimum wage either live with a parent or relative, are part of a two-income couple or are single and have no children.<sup>x</sup>

## Policy Analysis

Washington's high minimum wage law falls hardest on those who can least afford it. The poor, the homeless, teenagers and other young workers trying to enter the workforce and low-income families are the first to be impacted by a rising unemployment rate. A high minimum wage deprives poor people of what they need most: a steady job. It also deprives school graduates of what they need most: real-world work experience. Most jobless people are only looking for a chance to prove themselves. For many on the bottom rungs of society, Washington's high minimum wage denies them that chance.

The high minimum wage creates a ripple effect through the economy by pushing up all wages, which is one reason powerful unions always support minimum wage increases. Supporters of an ever-higher minimum wage grew weary of the public debate needed to argue for increases. So they included a provision in Initiative 688 that linked the wage to inflation, insuring it would go up automatically every January 1st, with no debate, no additional vote and no discussion. Politically the strategy is brilliant. It avoids all that messy public discussion about the harmful effects of raising the minimum wage – it just happens and most people don't notice.

The result is a higher cost of living for everyone. While most people can pay a little more for a hamburger or a house, the burden again falls heaviest on those who can least afford it; the poor and the unemployed.

Many of these effects were foreseeable. An analysis of Initiative 688 conducted by economist David Macpherson of Florida State University predicted the measure would cost the state over 7,400 jobs.<sup>xi</sup> His study found workers under 25 and black and Hispanic workers would be disproportionately affected. Overall, Dr. Macpherson estimated Washington workers would lose about \$64 million in income. Events since then indicate these forecasts were largely true.

The high minimum wage alone is not responsible for our state's weakened economy, but it is a strong contributing factor. Washington has been slower to recover from the national recession than other states. Policymakers should ask: Is our high minimum wage helping out, or is it part of the problem?

## **Recommendations**

**1) Return control over minimum wage increases to the legislature.** The government-set minimum wage should be taken off “auto pilot” so increases do not automatically occur every January 1st. The level of the mandatory minimum wage has a strong impact on job creation and the general business climate, so the legislature should consider when increases make sense in light of what is happening with the state's economy.

**2) Delay automatic increases in years when state unemployment is higher than the national average.** If full control over minimum wage policy cannot be returned to the legislature, a mechanism could be created which suspends automatic increases when the unemployment rate is high and people are most in need of access to work opportunities.

**3) Allow employers to pay a temporary training wage to create more entry-level jobs,** so new employees can gain important work experience and people between jobs can reduce the time they must go without work.

**4) Allow teenage workers to earn a starting wage closer to the federal minimum to increase job opportunities for young people,** to give them access to valuable work experience, to let them make contacts and earn recommendations to better jobs, and to help them learn personal responsibility. Currently, employers seeking low-cost workers have an incentive to hire the most experienced workers available, and thus tend to exclude teen workers.

### 3. The Temporary Labor Market

#### Recommendation

Minimize state regulation of the temporary labor market to promote job opportunities for low-income and part-time workers.

#### Background

Policymakers and the public tend to place much emphasis on the economy producing permanent, full-time jobs, yet one valuable segment of our state's workforce is often overlooked; temporary workers. They are students and homemakers, recent immigrants and new citizens, people between jobs and permanent part-timers.

For many laid off workers, a temporary job is the best path back to full-time employment. For others, a temporary position frees up time for other interests. The temporary labor market is a reflection of how free citizens pursue their own goals in life. Everyone has the right to work, not work or work less, as they choose. The temporary labor market makes these highly personal economic choices possible.

The key to the temporary labor market is the job-finding agencies that bring workers and employers together for the benefit of both. For example, one company headquartered in Washington operates some 750 neighborhood storefront offices across the country where anyone can walk in and sign up for work. As requests from employers come in, workers are matched with specific jobs and sent to the business or jobsite. Typical jobs include construction, homebuilding, food packing, landscaping and light manufacturing. At the end of the day workers return to the placement company's office and receive a paycheck.

Private temporary placement companies make this labor market possible because they handle all the paperwork, insure workers comply with federal and state regulations and make the required payroll deductions. People seeking quick employment need only show up on time, be legally eligible to work, and be drug-and-alcohol free. Employers get reliable workers with a minimum of red tape. Workers get the chance to work where they want and when they want. The system is entirely voluntary and, like most good ideas, is elegantly simple: people can work and get paid the same day.

### **Policy Analysis**

The temporary labor market, however, has its detractors. Traditional labor unions in particular don't like flexible work arrangements, because these jobs exist outside the conventional union structure. Their ideal is that every employer should use unionized workers and no others. Rather than accept a vibrant temporary workforce, unions try to use the force of government to foreclose what they see as inconvenient labor competition.

Opponents of voluntary temporary labor seek to burden this market with as many regulatory barriers as possible. One lawsuit in another state sought to bar workers from paying a minimal fee to cash their paychecks in the dispatch office at the end of the day. The purpose of the lawsuit was to force workers to wait a day and go to a bank or to a costly check-cashing store. Many temporary workers, however, are low-income and do not have bank accounts. Many of them prefer to pay a small fee and cash their paychecks right away.

Temporary labor opponents also sought to force closure of heated waiting rooms where workers gather to seek work. They claimed that workers should be paid while they wait for job assignments. Since few businesses can afford to pay people for not working, temporary labor offices would have had to close their waiting rooms, and job seekers would have been left to congregate on street corners.

Temporary placement companies often provide workers with hard hats, work boots, dust-masks and eye-protection for free. Temporary labor opponents say workers should not be held responsible for lost or broken equipment, meaning that workers would have to provide important safety gear themselves. Opponents are also lobbying for new regulations to require that any short-term temporary worker sent to a company receive the same pay and benefits as that company's permanent, long-time employees.

Together these hostile efforts add up to a coordinated assault on the temporary labor market. Adverse rulings by the courts or onerous regulations imposed by government would come with a high cost. Employers would lose information about where to find able and willing workers and thousands of job opportunities would disappear. Washington's economy would become even more difficult for struggling small businesses and innovative start-ups.

Worst of all, the most vulnerable in our communities would lose vital job opportunities, forcing them onto public assistance or leaving them vulnerable to the underground labor market.

## **Recommendation**

**Minimize state regulation of the temporary labor market, to maximize job opportunities for low-income and part-time workers.** Letting the temporary labor market operate as freely and efficiently as possible is the quickest way to stimulate our state economy, while creating choice and opportunity for thousands of hard-working men and women. For example, placement agencies should be able to offer paycheck cashing services for a minimal fee, so low-income workers are not forced to first open bank accounts as a condition for finding work.

## Additional Resources

### Washington Policy Center Research

“An Overview of Initiative 841: Repeal of State Ergonomics Regulations,” by Paul Guppy, October 2003.

“Reforming Washington's Workers' Compensation System,” by Allison Demeritt, May 2004.

### Other Resources

Public Service Research Foundation - A national think tank that studies the impact of unions on government. Publishes an informative quarterly newsletter called, “Government Union Review.” [www.psr.org](http://www.psr.org).

“In the Dark on Job Training: Federal Job-Training Programs Have a Record of Failure,” by David Muhlhausen, Ph.D., and Paul Kersey, Heritage Foundation, July 6, 2004. [www.heritage.org](http://www.heritage.org).

“Exploding the Myths of Offshoring,” by Martin N. Baily and Diana Farrell, *McKinsey Quarterly*, July 2004, [www.mckinseyquarterly.com](http://www.mckinseyquarterly.com).

“In Defense of Globalization,” by Jagdish Bhagwati, Oxford University Press, New York, NY, 2004.

“Union Members’ Attitudes Toward their Union’s Performance.” A study conducted by the Mackinac Center for Public Policy and Zogby International analyzing union members’ perspective on performance. Available online at [www.mackinac.org](http://www.mackinac.org).

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<sup>i</sup> “L&I adopts 9.8% rate increase for 2004...” Department of Labor and Industries press release, December 1, 2003, [www.lni.wa.gov/news/2003](http://www.lni.wa.gov/news/2003).



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- <sup>ii</sup> “Type of Law and Insurance Requirements for Private Employment,” Benefit Tables, Table 1, U.S. Department of Labor, January 2003, at [www.workerscompresources.com](http://www.workerscompresources.com).
- <sup>iii</sup> “All Budgeted Funds – Employment, FTE Staff Years by Function, Activity, and Agency,” 2003 Budget Summary, Table 19, Office of Management and Budget, [www.ofm.wa.gov/budget03/summary/table19htm](http://www.ofm.wa.gov/budget03/summary/table19htm).
- <sup>iv</sup> “About L&I Today: Regionally Delivered Customer Service,” Department of Labor and Industries, and “L&I adopts 29% rate increase...” news release November 27, 2002, [www.lni.wa.gov/news/2002/pr021127b.htm](http://www.lni.wa.gov/news/2002/pr021127b.htm).
- <sup>v</sup> “State Minimum Wage Rates,” Jobs Wages and the Economy, AFL-CIO, <http://www.aflcio.org/yourjobeconomy/minimumwage/staterates.cfm>
- <sup>vi</sup> “Federal Minimum Wage,” Wage and Hour Division, U.S. Department of Labor, October 3, 2004, <http://www.dol.gov/dol/topic/wages/minimumwage.htm>
- <sup>vii</sup> “Why Raising the Minimum Wage is a Poor Way to Help the Poor,” by Dr. Richard Burkhauser and Dr. Joseph Sabia, (both of Cornell University), published by the Employment Policies Institute, July 2004, [http://www.epionline.org/study\\_detail.cfm?sid=71](http://www.epionline.org/study_detail.cfm?sid=71)
- <sup>viii</sup> Office of the Secretary of State, Index to Initiative History and Statistics, 1914 – 2003, Initiative No. 688, passed November 3, 1998, [http://www.secstate.wa.gov/elections/initiatives/statistics\\_initiatives.aspx](http://www.secstate.wa.gov/elections/initiatives/statistics_initiatives.aspx)
- <sup>ix</sup> “Minimum Wage Workers in Washington State,” by Krista Glenn, Chief Economist, Washington State Employment Security report, figures are for the 2001 calendar year, [http://www.workforceexplorer.com/admin/uploadedPublications/988\\_MinimumWageArticle.pdf](http://www.workforceexplorer.com/admin/uploadedPublications/988_MinimumWageArticle.pdf)
- <sup>x</sup> “Distribution of Workers Affected by Proposed \$7.00 [national] Minimum Wage,” Minimum Wage Statistics, Employment Policies Institute, [http://www.epionline.org/mw\\_statistics\\_state.cfm](http://www.epionline.org/mw_statistics_state.cfm)
- <sup>xi</sup> See “Effects of the Proposed 1999-2000 Washington Minimum Wage Increase,” by Dr. David A. McPherson, Washington Policy Center Policy Brief, October 1998, <http://www.washingtonpolicy.org/GovtRegulations/PBGRMacPhersonMinimumWage.html>.



## Chapter 9: High-Tech Policy

### 1. Cyber-Security and Identity Theft

#### Recommendations

1. Establish standards for consumer authentication for online transactions and sensitive data exchanges.
2. Maintain privacy laws, based on consumer notice, consent and security, that limit how companies share sensitive customer information with outside organizations.
3. Pass new laws as needed to specifically combat cyber crime, rather than re-interpreting old laws to apply to new offenses.
4. Keep burden on government, not citizens, to justify when private information must be shared.

### Background

As fast as electronic technology develops for legitimate and legal purposes, so too does technology designed or used for malicious reasons. In a sense it is a game of leapfrog. As quickly as someone produces software designed to enhance security, someone else seeks a way around it.

A steadily-increasing number of individuals and organizations are relying on electronic and web-based means of storing and exchanging information, and the security of this information is more important than ever before. Cyber-security affects virtually everyone in society, as more financial and medical records are stored on potentially vulnerable computer systems, and an increasing amount of shopping and other business transactions take place over the internet. Electronic

crimes cost businesses nationwide an estimated \$660 million in 2003 alone.<sup>i</sup> The tables below show the rapid increase in cyber-related crime since 1988.

Figure 1.<sup>ii</sup>

Year	1988	1989	1990	1991	1992	1993	1994
<b>Incidents Reported</b>	6	132	252	406	773	1334	2349

Year	1995	1996	1997	1998	1999	2000	2003
<b>Incidents Reported</b>	2421	2573	2134	3734	9859	22,000 (est.)	70,000 (est.)

These figures are likely on the low side, since the number of incidents that actually occur is probably greater than the number reported to authorities. Part of the rise in incidents is explained by the huge increase in internet traffic in recent years, but even so these figures indicate a rising threat. More internet use means increased opportunities for fraud, and advanced technology allowing automated attacks means that today one person can cause greater damage faster than in the past.<sup>iii</sup>

According to the U.S. Department of Justice, 41.5 percent of all prosecutors' offices in the U.S. prosecuted some type of computer-related crime, the most prevalent of which being credit card fraud, bank card fraud and identity theft.<sup>iv</sup>

In the wake of the September 11th attacks, cyber-security has taken on an important role in national security affairs, as opposed to simply being a matter of personal privacy or corporate security. The USA Patriot Act of 2001 gave law enforcement agencies broad powers in the monitoring of electronic communication for the purposes of detecting terrorist activities.<sup>v</sup> For fiscal year 2005, the U.S. Department of Homeland Security is spending \$67.4 million for cyber-security.<sup>vi</sup> Congress also made appropriations to the National

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Science Foundation and the National Institute of Standards and Technology for a variety of grants pertaining to cyber-security.<sup>vii</sup>

Figure 2 shows congressional appropriations from FY 2003 to FY 2007, and reflects the increasing concern federal officials feel about cyber crime.

Figure 2.<sup>viii</sup>  
(figures in millions)

<b>FUNDING PURPOSE</b>	<b>FY 2003</b>	<b>FY 2004</b>	<b>FY 2005</b>	<b>FY 2006</b>	<b>FY 2007</b>
Research Grants	\$35	\$40	\$46	\$52	\$60
Computer and Network Security Centers	\$12	\$24	\$36	\$36	\$36
Educational Improvement Grants	\$16	\$21.25	\$21.25	\$21.25	\$21.25
Graduate Trainee Grants	\$10	\$20	\$20	\$20	\$20
Intramural Security Research	\$26	\$46.2	\$61.4	\$76.6	\$91.8
<b>Totals</b>	<b>\$99</b>	<b>\$151.45</b>	<b>\$184.65</b>	<b>\$205.85</b>	<b>\$229.05</b>

Figures 3 and 4 compare the most common and effective methods of electronic privacy protection and electronic crime prevention, as surveyed by Carnegie Mellon University. Clearly, the most common methods of control involve system boundaries based on software firewalls and encryption.

Figure 3.<sup>ix</sup>

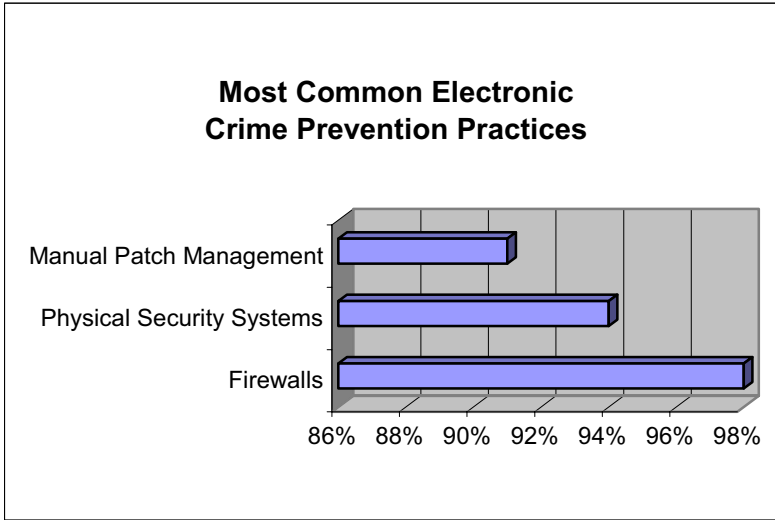
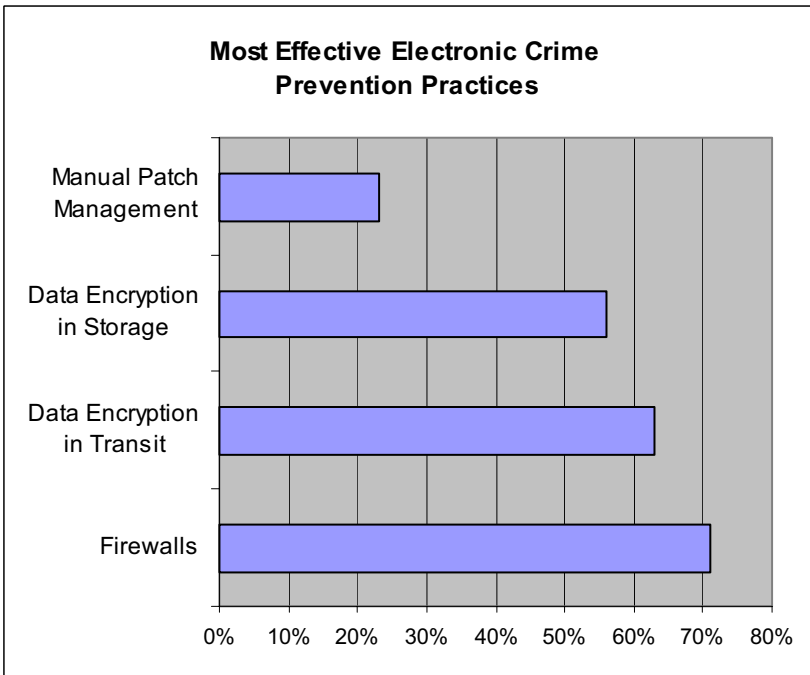


Figure 4.<sup>x</sup>



## Policy Analysis

Federal and state governments have been active on the cyber-security issue. Federal law covers a broad spectrum of cyber-security issues. An industry group, the Business Software Alliance, recently published an information security governance report indicating that “[g]overnment and industry should recognize that a significant regulatory regime already exists for information security.”<sup>xi</sup>

These laws are aimed at creating electronic infrastructure that will prevent cyber-crimes. They also seek to increase awareness of cyber-security problems in the business and government worlds. As the software industry itself points out, information security is not just a technical issue, but a matter of government policy and corporate governance.<sup>xii</sup> Just as cyber-security increasingly effects all aspects of citizens’ lives, so too has it taken on greater importance in all levels of corporate and government organization.

In Washington state, most cyber-crimes are prosecuted under pre-existing criminal statutes. For the most part, lawmakers have not created new legal definitions. For example, “unauthorized use of a computer,” “interruption of computer services,” and “computer tampering” are all prosecuted under existing malicious mischief statutes. “Cyberstalking” is prosecuted as harassment. Lawmakers did, however, venture into new territory when they created a law against computer trespass crafted specifically to target cyber-crimes.<sup>xiii</sup>

In 2000 the state Attorney General’s office created a High-Tech Unit in response to the growing need for special attention to crimes and civil complaints involving computers and the internet.<sup>xiv</sup> Since its inception the High-Tech Unit has filed lawsuits against several companies and websites for violations of consumer protection statutes. Typical cases involved fraudulent auction websites, non-delivery of promised

services and refunds, unsubstantiated claims about medical remedies, and phony work-at-home schemes.<sup>xv</sup>

## Recommendations

**1) Establish standards for consumer authentication for online transactions and sensitive data exchanges.** Such laws would afford greater guarantees of consumer privacy and protection of information.

**2. Maintain privacy laws, based on consumer notice, consent and security, that limit how companies share sensitive customer information with outside organizations.**

Individual consumers who voluntarily give their private information to a company should be informed about that company's policies regarding use of that information and whether it will be given or sold to a third party.

**3) Pass new laws as needed to specifically combat cyber crime.** State policymakers should not rely on re-interpreting old laws to apply to new offenses. The state should build the legal and regulatory framework needed to protect individual electronic privacy. An increasing amount of personal information is stored by and transferred between businesses, all made faster and easier because of the internet. Government officials have a responsibility to update criminal justice rules as required to protect citizens' identity and other personal information.

**4) Keep the burden on government, not citizens, to justify when private information must be shared.** Government has legitimate reasons to have limited and carefully defined access to information about private citizens, especially for law enforcement purposes. But the burden must remain on the government to show when such access is justified, not on citizens to explain why sensitive personal information should remain private.

## 2. “Phishing”

### Recommendations

1. Policymakers should avoid interfering with effective private development of anti-phishing technologies and practices.
2. Law enforcement officials should be given the legal tools they need to locate and prosecute online criminals.

### Background

Phishing (pronounced “fishing”) is a type of computer fraud designed to steal a person’s identity and other personal information. The culprit, posing as a legitimate business representative, deceives the consumer into revealing personal information such as credit card numbers, social security numbers, passwords, or other account-related information. The most frequent forms of phishing are e-mails posing as legitimate inquiries from companies with which the consumer holds an account or may wish to do business, and pop-up windows that occasionally appear when a consumer is using the internet. Such windows pose as legitimate websites. In both cases, the consumer is tricked into entering personal information into the false website, believing he is giving the information to a legal business for legitimate purposes.

The Federal Trade Commission reports 516,740 people registered complaints in 2003 of identity theft and fraud as a result of phishing.<sup>xvi</sup> E-mail and internet contacts accounted for 58 percent of fraud complaints, where the consumer reported the method of contact.<sup>xvii</sup> As a result of illegal phishing tactics, U.S. consumers were defrauded of nearly \$200 million.<sup>xviii</sup>

Figure 1 shows trends in internet fraud in 2002, as reported by the FBI.

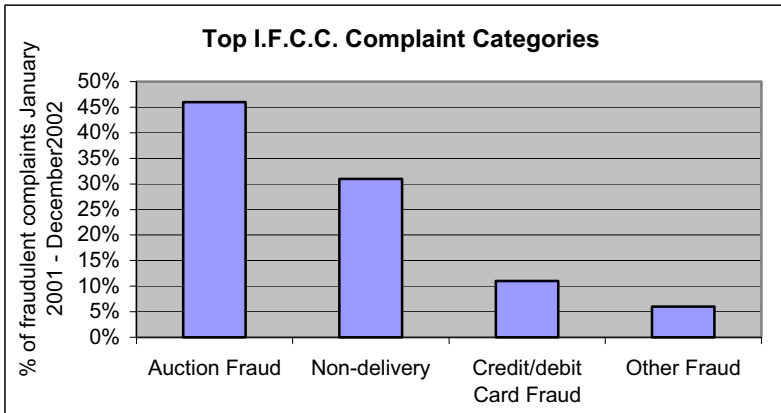


Figure 1.<sup>xix</sup>

Complaint Type	Percentage of complainants who reported dollar loss	Average (median) dollar loss per typical complaint
Auction Fraud	87 %	\$320
Non-delivery	82 %	\$176
Credit/debit Card Fraud	62 %	\$120
Investment Fraud	75 %	\$570
Business Fraud	75 %	\$220
Confidence Fraud	58 %	\$1,000
Identity Theft	15 %	\$2,000
Check Fraud	56 %	\$1,100
Nigerian Letter Fraud**	<1 %	\$3,864
Communications Fraud	36 %	\$174

\*\*Of 16,164 complaints, 74 individuals lost money totaling \$1.6 million.

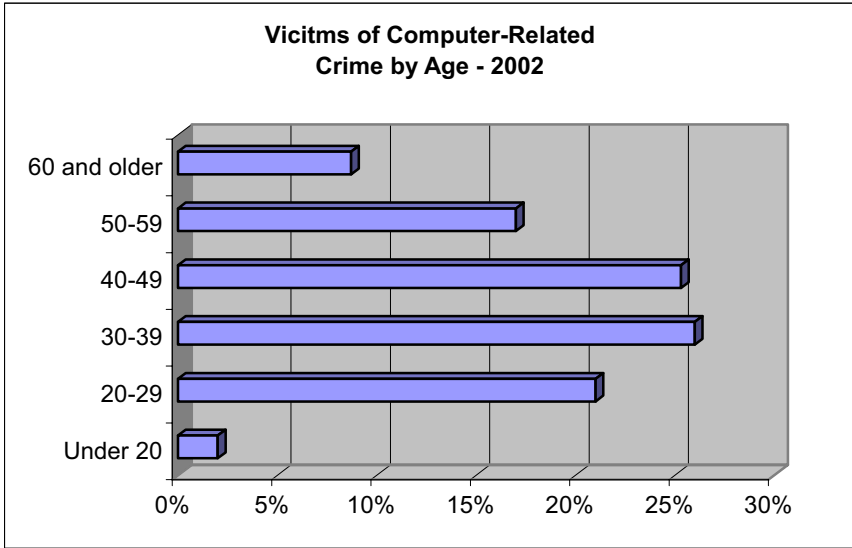
Trends indicate phishing, and resulting fraudulent activities, is a growing problem. Identity theft and fraud complaints have increased steadily each year since 2001. Complaints registered with the Federal Trade Commission increased from just over 220,000 in 2001 to more than 500,000 in 2003.<sup>xx</sup> In 2002, the Internet Fraud Complaint Center also received a large number of complaints, with online auction fraud being the chief culprit (see figure 2).

Figure 2.<sup>xxi</sup>

### Phishing Demographics

Washington is proudly on the cutting edge of world software development, but unfortunately it is also distinguished for its high rate of computer-related crime. In 2003, the Seattle-Bellevue-Everett metropolitan area ranked second nationally for highest per capita instances of fraud-related complaints.<sup>xxii</sup> Overall, Washington state consumers registered 12,076 complaints of fraud and identity theft, with a total reported loss of \$6,943,701.<sup>xxiii</sup>

Nationwide, perpetrators and victims tend to be overwhelmingly male, by ratios of three to one.<sup>xxiv</sup> But, as figure 3 shows, no age group is immune to attack.

Figure 3.<sup>xxv</sup>

In 2004, the United States hosted the highest percentage of phishing websites, with 27 percent of the total. South Korea and China came next, with 20 percent and 16 percent, respectively.<sup>xxvi</sup> Between December 2003 and June 2004, phishers primarily targeted a handful of websites to use for defrauding purposes – Citibank, eBay, U.S. Bank, Paypal, and Fleet – and they chose these sites over others overwhelmingly. Banks and other financial service companies are the most frequent targets, for obvious reasons.<sup>xxvii</sup> The Anti-Phishing Working Group concluded that at least one “well-orchestrated, systematic criminal organization” is responsible for much of the phishing activity on the internet.<sup>xxviii</sup>

## Policy Analysis

Software companies, internet service providers and information technology personnel are working to develop innovative and effective solutions to combat online fraud. Given the evasive and fast-changing nature of internet crime, early detection of fraud attempts is the primary goal.

Cooperation between government, business and consumers is essential.

The first line of defense is adaptive technology designed to detect and filter out fraud attempts via e-mail and internet “pop-up” messages. Software security experts recommend several approaches: monitoring the internet for phishing websites, utilizing anti-virus, anti-spam and filtering software to screen out potentially hostile sites and e-mail. For example, online businesses can require less sensitive information from customers logging on to company websites so criminals have fewer opportunities to steal personal information.<sup>xxix</sup>

The next line of defense is consumer education. Consumers can choose e-mail and internet providers that utilize strong anti-phishing practices. A vast array of software products exist that allow consumers to protect their privacy. Simple vigilance and awareness can also protect consumers against fraud and identity theft. Numerous consumer education websites inform consumers about common phishing ploys, as well as of specific early warning signals. Cyber-criminals are instantly defeated when consumers refuse to go along.

Some advocates insist that such measures are insufficient in and of themselves. They argue for rigid, mandatory regulation by government and industry associations. They say that financial service companies may come to view identity theft as no more than a routine cost of business, instead of criminal acts perpetrated against their customers.<sup>xxx</sup>

The danger of this approach is that heavy-handed action by the state could actually stifle the speed and creativity needed to defeat the rapidly expanding online threat. Cyber-criminals move fast. Government, in general, does not. Code-writers and technicians at private software companies, who, after all, designed the underlying operating systems in the first place, have proven adept at developing defenses against online attack.

Their efforts would quickly become pointless if their work were made subject to costly and plodding government regulatory oversight.

Government does have a role, however, in locating and prosecuting people who use computers to victimize others. State law enforcement officials need specific, clearly defined legal authorization to go after identity thieves and computer criminals. Such legislation, like all criminal statutes, must be crafted so it respects software copyrights, and preserves the privacy and other civil rights of law-abiding citizens.

## **Recommendations**

**1) Policymakers should avoid interfering with effective private development of anti-phishing technologies.** This field holds tremendous potential for innovation through healthy market competition. Countless software products and consumer alerts and education services exist, and more are developed every day. Consumers can choose from a variety of e-mail and internet services, software products and resources available on the internet. The quality and effectiveness of such services will steadily improve through private initiative and market competition.

**2) Law enforcement officials should be given the legal tools they need to combat phishing and to locate and prosecute online criminals.** Software industry specialists can guide policymakers about what approaches work best and are technically feasible.

### 3. Spyware

#### Recommendations

1. Ban the use of deceptive and fraudulent spyware and unwanted “pop-up” software to send unsolicited advertisements to internet computer users.
2. State agencies should bar unauthorized access to government-owned computers for the purpose of sending unwanted advertisements.
3. Encourage the computer industry to continue developing anti-spyware and anti-adware technologies that benefit consumers.

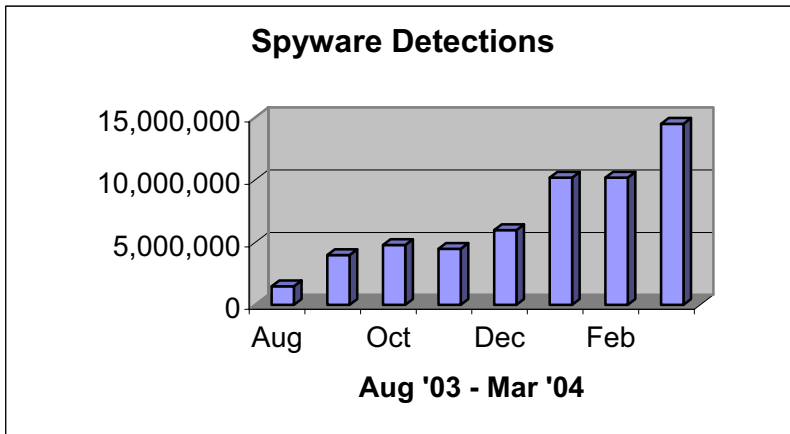
#### Background

Spyware is software downloaded onto a computer for the purpose of tracking the user’s movement through the internet. This type of software can be used in two ways. Legitimate online companies can automatically install it on a users computer to see what websites the user visits, and then analyze that data to target advertisements to that user. Those advertisements are commonly referred to as “pop-up” advertisements, and this form of spyware is often referred to as “adware.”

Alternatively, dishonest people can install spyware on a person’s computer to gain unauthorized access to that person’s information. Such spyware can monitor computer keystrokes and record the typing of addresses, phone numbers, credit card numbers, birth dates, social security numbers and a variety of other personal information. Criminals then use the information for illegal purposes.

In 2004 McAfee, Inc., a manufacturer of privacy software, released a survey of over 14,000,000 of its customers. The survey results are listed below in figure 1.

Figure 1.<sup>xxxi</sup>



These numbers, however, are just a sample, and merely serve to illustrate the growing problem of spyware. Spyware is most often downloaded unknown to the user. The software can be bundled with the desired programs a user downloads, and installed automatically, again without the user's knowledge. Adware often, but not always, carries with it an electronic request of consent to install and run. When prompted on the screen, the user can choose whether or not to use the software.

## Policy Analysis

In response to the malicious use of spyware, federal and state governments are working to make such software illegal. Two federal bills provide ideas on how state policymakers might approach the problem. H.R. 2929 (introduced in July 2003), would "protect users of the internet from unknowing transmission of their personally identifiable information through spyware programs." The bill would make it illegal for companies or individuals, without first getting approval, to send

spyware to computers used by financial institutions or the federal government.<sup>xxxii</sup>

Another bill, H.R. 4661 (introduced July 2004) and titled the Internet Spyware Prevention Act, would criminalize the unauthorized intentional access of a protected computer by copying software onto that computer.<sup>xxxiii</sup>

An outright ban on spyware may prove technically impractical. Another federal bill, S.B. 2145, the Software Principles Yielding Better Levels Of Consumer Knowledge Act or SPYBLOCK (introduced March 2004), takes a milder approach. It would require a spyware program to give users an on-screen notification before it installs itself on their computer, and also must afford computer users the ability to remove the program at any time.<sup>xxxiv</sup>

At the state level, New York, Iowa, and Virginia are considering legislation limiting the use of spyware. The California legislature recently (September 2004) enacted a bill criminalizing the installation of spyware on another user's computer within the state.<sup>xxxv</sup>

In March 2004, Utah enacted a bill making the use of spyware illegal.<sup>xxxvi</sup> One Utah company (supported by a group of other businesses), sued to stop the law and the Utah District Court blocked its enforcement.<sup>xxxvii</sup> The judge based his ruling on the following reasoning: The law was vague; spyware companies would have trouble complying with laws that vary from state to state; spyware companies would lose money; the economic injury to the companies outweighs any potential injury to computer users.

A further problem with Utah's law was that it infringed on companies' rights under equal protection and freedom of expression in the Utah Constitution, as well as the Commerce Clause and First and Fourteenth Amendments of the U.S.



Constitution. H.B. 323, they argued, prohibited their lawful competition with internet merchants by making it illegal to advertise through adware software.<sup>xxxviii</sup>

Government attempts to define, regulate or ban spyware are proving cumbersome and slow. In the meantime, the efforts of private industry to solve the problem may prove more fruitful. In general, public policy should protect the ability of legitimate online companies to engage in commerce, and insure that internet users can “opt-out” or otherwise have a say in what unsolicited commercial advertising they receive.

## Recommendations

**1) Ban the use of deceptive and fraudulent spyware and unwanted “pop-up” software to send unsolicited advertisements to internet computer users.** Companies should not be able to track a user’s movement through the internet for the purpose of targeting them with deceptive unsolicited advertisements.

**2) State agencies should bar unauthorized access to government-owned computers for the purpose of sending unwanted advertisements.** Unsolicited advertisers should not be able to use taxpayer-funded computer networks to distribute messages for commercial advantage.

**3) Encourage the computer industry to continue developing anti-spyware and anti-adware technologies that benefit consumers.** Several such technologies exist and are in use today. Technology also exists for consumers to consent to using spyware before it is installed and activated on their computers by others working over the internet. Both approaches give consumers greater control over who can gain access to their computers.

## 4. Open Source Software

### Recommendation

State and local laws should remain neutral regarding the procurement of Open Source Software by government agencies.

### Background

Most computer software is sold like any other commercial product and is protected by U.S. copyright law. Such software products are sold under defined legal controls and customers without prior permission cannot see or change the program's basic source code.<sup>xxix</sup> High-tech companies that develop software and sell it under license have a strong economic incentive to stand behind their product, to create improved versions of it and to search continually for ways to protect it from attack by viruses and hackers.

Open Source Software is different. With various types of Open Source Software, of which Linux is the best known, users can access and alter the source code at will. Its promoters describe the basic idea as follows:

“When programmers can read, redistribute and modify the source code for a piece of software, the software evolves. People improve it, people adapt it, people fix bugs. And this can happen at a speed that, if one is used to the slow pace of conventional software development, seems astonishing.”<sup>xi</sup>

The defining attributes of Open Source Software include free or low-cost distribution, access to source code, the ability to redistribute modifications, technology neutrality and equal availability to people in all technical fields.<sup>xii</sup> Supporters say Open Source Software is superior to traditionally-developed

software because it benefits from constant improvements supplied by code writers around the world

Increasingly, Open Source Software is being picked up by high-tech companies and used for commercial purposes. Examples of such companies are Hewlett-Packard, Red Hat, IBM and SuSE. These companies make money by selling additional software to run with Open Source, sell computer equipment on which to run it, or provide clients with long-term service contracts to maintain their systems. Like proprietary software, Open Source Software is made available to users under different types of licensing arrangements, of which the General Public License (GPL) is one of the most common.

### **Policy Analysis**

Many governments are attracted to Open Source Software because it is often available free or at very low cost. But this is only the start. Software acquisition managers must also consider other factors that could add to the cost of using Open Source Software for government applications. Public-sector managers must weigh whether this type of software is capable of doing the required work, how well it fits with existing computer systems, whether they can get technical support, and what additional time and training is required to teach agency personnel how to use it.

While the initial acquisition cost may be low, inability to connect with existing computer systems and the need to train staff may add substantially to the total cost government agencies must pay to make an Open Source Software system meet their particular needs. Also, it may not include the same protections against viruses and unauthorized entry as commercially-available software.

There is a strong ideological component in the ongoing debate over Open Source Software. Its strongest advocates are

critical of free market capitalism in principle and believe that software should be considered community property that is freely available to everyone, regardless of who created it. They see standard commercial software as “bad” because customers must pay for its use, resulting in profits for private companies. They ignore the fact that a substantial portion of software company profits, just as in any industry, are used to fund further research, which results in the constant improvement of existing products and the invention of new ones.

The development of software code is like any other innovative human activity. It is the result of the mental labor of the people working for the companies that created it. Software development, like any writing, results in a form of intellectual property and the natural ownership rights of those who create it should be respected in law and in the marketplace.

The programmers who contribute to changing and improving Open Source Software choose to give the product of their time and talents away voluntarily, motivated by the idea that they are contributing to the common good. They are certainly well within their rights to do so. But people who choose to retain control of what they have made are equally acting within their rights, and they should be allowed to benefit commercially from their efforts.

These broader points, however, only form the backdrop to the practical decisions policymakers must make when setting rules about how government agencies can select, assess and buy different software products. While policymakers may at first find that Open Source Software seems to have certain attractive ideological qualities, they should be aware that it also comes with potentially serious technical weaknesses and hidden costs.

Washington policymakers should avoid adopting procurement rules that mandate the use of Open Source Software to the exclusion of all other options. Such a policy

does not result in the best use of taxpayer money, because it ties the hands of public managers who are responsible for running their agencies efficiently and within budget.

### **Recommendation**

**State and local laws should remain neutral regarding the procurement of Open Source Software by government agencies.** Policymakers should not restrict or predetermine the technical support needs of government by arbitrarily setting procurement policy so that only acquisition of Open Source Software can be considered.

## 5. Voice Over Internet Protocol (VoIP) Phone Service

### Recommendations

1. Allow consumers and businesses to take advantage of new voice technology with minimal government oversight or regulation.
2. Avoid burdening new internet voice technologies with traditional telephone taxes.
3. Government agencies should consider adopting VoIP technology when it makes sense to replace more costly traditional telephone service.

### Background

The latest advance in voice communication is technology that lets telephone users make calls over the internet. Called Voice over Internet Protocol (VoIP), the new service allows a person to talk to anyone in the world for a fraction of the cost of a traditional long distance call.

An adapter attached to a standard telephone converts voice transmissions into digital data, which is then sent over the internet just like any other type of computerized information. When it arrives the transmission is converted back into audible speech that the recipient hears over a regular telephone. A VoIP call is essentially an e-mail that talks – the technology for sending both kinds of message is the same.

Currently VoIP connections are limited. Programmers are working to expand the system so VoIP users can call anyone in the world who has a telephone number, combining local, long-distance and cell phone connections in one digitalized service.

VoIP technology brings major advantages to both consumers and businesses. Personal and public phone directories can be kept on computer. Clicking on a phone number instructs the computer to dial that number and make the connection. Businesses can consolidate phone, e-mail and fax systems into one network, resulting in major savings and increased efficiency. Businesses could include “call us now” boxes on their websites. Clicking the box would establish immediate voice contact with a salesperson, making routine shopping faster and easier.

The computer can also act as an answering machine, recording messages and letting people check messages from anywhere in the world by dialing into their home phone over the internet. VoIP includes conference calling, call waiting, call forwarding and many other features available through traditional phone service. VoIP technology, however, is expected to cost 30 to 40 percent less, making worldwide voice communication more affordable for everyone.

## **Policy Analysis**

The ability to talk over the internet represents a major improvement in telephone communication. There is a risk, though, that government may smother the idea before it gets established. Some policymakers are already eyeing VoIP services as a potential new source of tax revenue.<sup>xliii</sup> They want to apply all state and local telephone taxes to the internet, thus “capturing lost revenue” from citizens who might otherwise make a phone call without paying a tax.

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Tax proponents argue a telephone conversation is a “taxable event” and that any new technology that lets people talk to each other should be taxed. They estimate a “loss” of up to \$9 billion a year.<sup>xliii</sup> As one tax advocate put it, “there's a real risk that the future of telecommunications becomes tax free.”<sup>xliv</sup>

The outcome of this approach would be to shift one hundred years of regulations onto an emerging technology. VoIP users would have to pay:

- Federal excise tax
- State sales tax
- Local sales tax
- Special district sales tax
- City occupation tax
- State 911 tax
- Local 911 tax
- Federal Universal Service Fund tax
- TRS Excise Funds Federal ADA tax
- Telephone Assistance Program tax

Such a policy would artificially drive up costs for consumers, and scare away investors who provide the financing needed to perfect the technology. Without early and substantial investment, fast, reliable low-cost worldwide calls over the internet would remain an unrealized dream.

An additional problem is that new taxes tend to become permanent. Once government budget makers get used to a steady revenue stream they are reluctant to give it up. For example, telephone customers are still paying a federal tax enacted to pay for the Spanish American War.

VoIP technology, like the internet itself, is a case of innovation and inventiveness advancing faster than government regulation. Deliberative government certainly has its place, but



in this case it is best for the regulators to stay out of the way and let a new idea reach its full potential.

## **Recommendations**

**1. Allow consumers and businesses to take advantage of new voice technology with minimal government oversight or regulation.** When new technologies are in their infancy is when they are most vulnerable to government interference. Allowing the ViOP system to mature will give policymakers the opportunity to determine what regulations, if any, should apply to it.

**2. Avoid burdening new internet voice technologies with traditional telephone taxes.** Applying the full weight of all the taxes and regulations that have grown up around the existing telephone network risks smothering VoIP systems before they can get established, thus denying consumers the full benefits of this emerging technology.

**3. State agencies should consider adopting VoIP technology when it makes sense to replace more costly traditional telephone service.** As VoIP technology matures it offers an opportunity for state government to streamline operations, save money and improve service to citizens.

## **Additional Resources**

### Washington Policy Center Research

“A New Way to Make a Phone Call,” by Paul Guppy, May 12, 2004.

“It's Time for Consumer Choice in Local Phone Service,” by Paul Guppy, 2002.

“When Government Enters the Telecommunications Market: An Assessment of Tacoma's Click! Network,” by Paul Guppy, June 2001.

### Other Resources

Discovery Institute Technology and Democracy Project - A research project designed to evaluate the role of technology in modern democracy and how it can help sustain economic prosperity and social development, [www.discovery.org/technology/](http://www.discovery.org/technology/).

“Finding and Fixing Vulnerabilities in Information Systems: The Vulnerability Assessment and Mitigation Methodology,” by Philip S. Anton, Robert H. Anderson, Richard Mesic and Michael Scheiern, Rand Corporation, 2003.

Progress and Freedom Foundation - A market-oriented think tank that studies the digital revolution and its implications for public policy, [www.pff.org](http://www.pff.org).

“Antitrust after Microsoft: the Obsolescence of Antitrust in the Digital Era,” by David B. Kopel, Heartland Institute, Chicago, Illinois, 2001.

“Spyware Regulation,” by James L. Gattuso, Research Fellow in Regulatory Policy, Regulation in Brief No. 18, October 4,

2004, The Heritage Foundation, Washington, D.C,  
[www.heritage.org](http://www.heritage.org).

“Trends in Competitiveness of Telecommunications Markets: Implications for Deregulation of Retail Local Services,” by Richard O. Levine, Joseph S. Kraemer and Randolph J. May, Progress and Freedom Foundation Special Report, December 2003.

<http://www.pff.org/publications/communications/121103specialreportcontestability.pdf>.

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<sup>i</sup> “2004 E-Crime Watch Survey Shows Significant Increase in Electronic Crimes,” Carnegie Mellon Software Engineering Institute, Computer Emergency Response Team, May 25, 2004, p. 1.

<sup>ii</sup> William Yurcik, David Loomis, Alexander D. Korzyk, “Predicting Internet Attacks: On Developing An Effective Measurement Methodology,” 2000. Each incident reported may involve one site or hundreds (or even thousands) of sites, and some incidents have ongoing activity for long periods of time (i.e., more than a year). See also, “Information Security Governance: Toward a Framework for Action,” Business Software Alliance.

<sup>iii</sup> Yurcik, et al, “Predicting Internet Attacks.”

<sup>iv</sup> “Computer-related crime prosecuted by prosecutors’ offices, 2001,” Bureau of Justice Statistics, U.S. Department of Justice.

<http://www.ojp.usdoj.gov/nij/sciencetech/slides/fromBJSNCJ193441.pdf>.

<sup>v</sup> HR 3162. Its full title is, “Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001,” see <http://www.epic.org/privacy/terrorism/hr3162.html>.

<sup>vi</sup> “Department of Homeland Security Appropriations, Fiscal Year 2005,” McConnell International, June 3, 2004.

[http://www.mcconnellinternational.com/reports/fy\\_05\\_dhs\\_funding.pdf](http://www.mcconnellinternational.com/reports/fy_05_dhs_funding.pdf).

<sup>vii</sup> Public Law 107-305, “Cyber Security Research and Development Act,” section 4.

<sup>viii</sup> *Ibid.*, sections 2-11.

<sup>ix</sup> “2004 E-Crime Watch Survey Shows Significant Increase in Electronic Crimes,” May 25, 2004, p. 2.

<sup>x</sup> *Ibid.*

<sup>xi</sup> “Information Security Governance: Toward a Framework for Action,” p. i.

<sup>xii</sup> *Ibid.*, p. 2.

<sup>xiii</sup> The statutes are RCW 9A.52.110 and 9A.52.120 – computer trespass. Institute for Security Technology Studies, Dartmouth College.

<http://www.ists.dartmouth.edu/TAG/ajt/osi-juris-project.htm>.

<sup>xiv</sup> “Upholding the law in cyberspace, High-Tech Unit,” Washington State Attorney General’s office, <http://www.atg.wa.gov/safetynet/law1.shtml>.

<sup>xv</sup> For details see Attorney General’s office news releases, “AG’s High-Tech Unit files first cases,” October 18, 2000; “Manager of firm sued by AG is target of new lawsuit,” September 10, 2001; “Internet-based work-at-home scam sued by AG’s High-Tech Unit,” September 19, 2001.

<sup>xvi</sup> “National and State Trends in Fraud and Identity Theft, January – December 2003,” Federal Trade Commission, January 22, 2004, p. 3. [www.consumer.gov/sentinel/pubs/Top10Fraud2003.pdf](http://www.consumer.gov/sentinel/pubs/Top10Fraud2003.pdf).

<sup>xvii</sup> *Ibid.*, p. 7.

<sup>xviii</sup> *Ibid.*, p. 8.

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- <sup>xix</sup> “IFCC 2002 Internet Fraud Report, January 1, 2002 – December 31, 2002,” National White Collar Crime Center and the Federal Bureau of Investigation, p. 7.
- <sup>xx</sup> National and State Trends in Fraud and Identity Theft, January – December 2003,” p. 4.
- <sup>xxi</sup> “IFCC 2002 Internet Fraud Report, January 1, 2002 – December 31, 2002,” p. 6.
- <sup>xxii</sup> “National and State Trends in Fraud and Identity Theft, January – December 2003,” p. 12. In the Seattle metro area there were a total of 3,254 complaints. That is 134.8 complaints per 100,000 people.
- <sup>xxiii</sup> *Ibid.*, p. 63.
- <sup>xxiv</sup> “IFCC 2002 Internet Fraud Report, January 1, 2002 – December 31, 2002,” pages 7 and 9.
- <sup>xxv</sup> *Ibid.*, p. 9.
- <sup>xxvi</sup> “Phishing Attack Trends Report, June, 2004,” Anti-Phishing Working Group, p. 4. [http://www.antiphishing.org/APWG\\_Phishing\\_Attack\\_Report-Jun2004.pdf](http://www.antiphishing.org/APWG_Phishing_Attack_Report-Jun2004.pdf).
- <sup>xxvii</sup> *Ibid.*, p. 2.
- <sup>xxviii</sup> *Ibid.*, p. 5.
- <sup>xxix</sup> Greg Tally, Roshan Thomas, and Tom Van Vleck, “Anti-Phishing: Best Practices for Institutions and Consumers,” March 2004, p. 8. [http://www.networkassociates.com/us/\\_tier2/products/\\_media/mcafee/wp\\_antiphishing.pdf](http://www.networkassociates.com/us/_tier2/products/_media/mcafee/wp_antiphishing.pdf).
- <sup>xxx</sup> “Tech Firms Band Together on ID Theft,” by Alorie Gilbert. CNET News.com. [http://news.com.com/2100-1017\\_3-5070601.html](http://news.com.com/2100-1017_3-5070601.html).
- <sup>xxxi</sup> “Spyware: A Hidden Menace,” *The Economist*, June 3, 2004.
- <sup>xxxii</sup> Bill Summary and Status for HR 2929, 108th Congress, <http://thomas.loc.gov/cgi-bin/bdquery/z?d108:HR02929:@@L&summ2=m&>.
- <sup>xxxiii</sup> *Ibid.*, HR 4661.
- <sup>xxxiv</sup> Senate Bill 2145, <http://thomas.loc.gov/cgi-bin/query/z?c108:S.2145:>.
- <sup>xxxv</sup> California Senate Bill 1346, [http://www.leginfo.ca.gov/cgi-bin/postquery?bill\\_number=sb\\_1436&sess=CUR&house=B&author=murray](http://www.leginfo.ca.gov/cgi-bin/postquery?bill_number=sb_1436&sess=CUR&house=B&author=murray)
- <sup>xxxvi</sup> Utah State Legislature, House Bill 323, <http://www.le.state.ut.us/%7E2004/htmldoc/hbillhtm/HB0323S04.htm>.
- <sup>xxxvii</sup> “Transcript of Preliminary Injunction Ruling, *WhenU.com, Inc., v. The State of Utah*, June 22, 2004. <http://www.benedelman.org/spyware/whenu-utah/pi-ruling-transcript.pdf>.
- <sup>xxxviii</sup> Plaintiff filing in *WhenU, Inc., v. Utah*, April 12, 2004, pp. 1, 2. <http://www.benedelman.org/spyware/whenu-utah/complaint.pdf>.
- <sup>xxxix</sup> for a more detailed discussion see “Should Government Encourage Open-Source Software Development?” American Enterprise Institute

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[http://www.aei.org/news/newsID.15168,filter./news\\_detail.asp](http://www.aei.org/news/newsID.15168,filter./news_detail.asp)

<sup>xi</sup> “Open Source Initiative,” <http://www.opensource.org/>

<sup>xli</sup> Ibid., “Open Source Definition.”

<sup>xlii</sup> “Just when you thought the Internet was safe from taxation...” news release, American for Tax Reform, December 2003, [www.atr.org](http://www.atr.org).

<sup>xliii</sup> Senator Lamar Alexander, R-TN, quoted from Senate floor speech of October 22, 2003 in CNET News.com, [http://news.zdnet.com/2100-3513\\_22-5101346.html](http://news.zdnet.com/2100-3513_22-5101346.html).

<sup>xliv</sup> David Quam, Director of State-Federal Relations, National Governors Association, quoted in “Are taxes on the way for Net access,” by Declan McCullagh, CNET News.com, November 3, 2003, [http://news.zdnet.com/2100-3513\\_22-5101346.html](http://news.zdnet.com/2100-3513_22-5101346.html).



## Chapter 10: Transportation

### 1. Transportation Spending

#### Recommendations

1. Implement regular, independent performance audits of the state transportation system.
2. Tie increases in spending to measurable performance improvements.
3. Change the Transportation Secretary from a board-appointed position to one appointed by, and directly responsible to, the governor.
4. Reform the costly and artificial prevailing wage system.

### Background

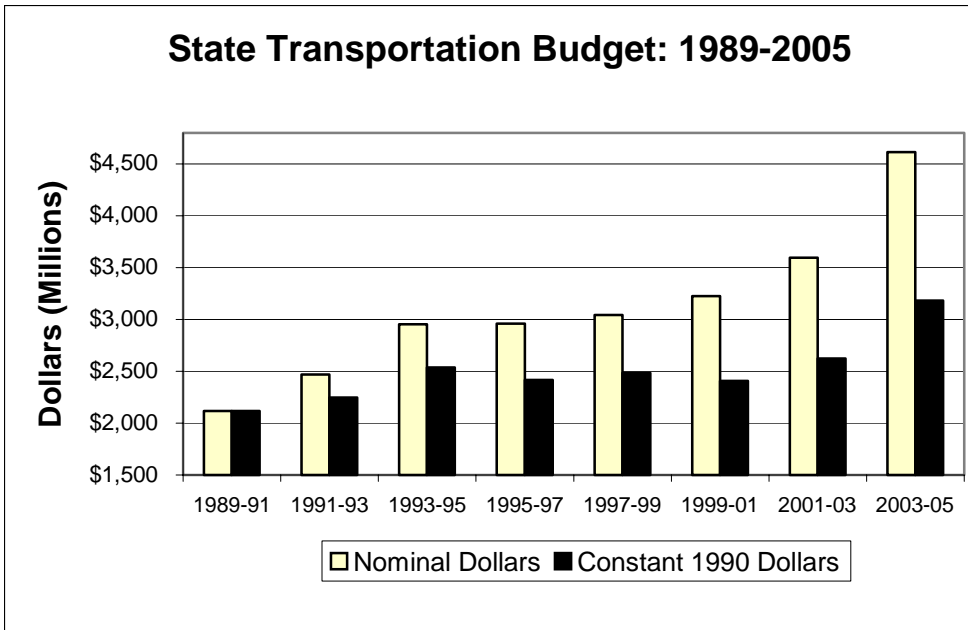
Over the last 20 years, Washington's population has increased almost 40 percent, yet our road network has not kept pace. As a result the Puget Sound area has gained a reputation as one of the most congested metro areas in the nation. National rankings consistently list Washington as one of the worst states in the nation for traffic congestion and clogged roadways.

Much of the debate over transportation improvements revolves around tax revenue and spending levels. In 1999 voters approved Initiative 695, which brought Washingtonians tax relief by eliminating the state car tab tax and reduced state transportation funding by \$764 million each year. In 2002 voters rejected a proposed 9-cent increase in the gas tax – designed to increase funding for transportation related projects.

In 2003, the state legislature passed a 5-cent gas tax increase that will fund more than \$4 billion in new state spending.<sup>i</sup>

Revenue for state roads is generated from a complicated system of taxes, fees and general fund appropriations. Before the 2003 gas tax increase, state transportation spending had been relatively stable, in inflation-adjusted dollars, rising from \$2.1 billion in 1989-91 to \$3.6 billion in 2001-03. With the addition of the new 5-cent gas tax, transportation spending in 2003-05 is expected to top \$4.6 billion. See figure 1.

Figure 1.



## Policy Analysis

For three generations the people of Washington shared a single vision for meeting our state's transportation needs: build and maintain a road network sufficient to allow people to get where they need to go in a reasonable amount of time. In the mid-1970s that vision broke down under increasing pressure from radical environmentalists and no-growth activists. For the



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last 30 years or so, a combination of little or no expansion in highway capacity plus a steadily growing population has resulted in massive traffic gridlock throughout the region.

Failed programs and cost overruns have severely harmed the region's transportation system. Sound Transit, approved by voters in 1996, scaled back its original light rail plan from 21 to 14 miles, and for a while action in Congress threatened the survival of the plan. The new Seattle Monorail, narrowly passed by voters in 2002, despite its dedicated tax base, is already short of money. Even if both of these massive projects were built and fully operational they would do little to relieve traffic congestion – 95 percent of daily trips are made by private automobile. Significant increases in road capacity, once commonly understood as the best way to move millions of people, has been at a virtual standstill since the late 1960s.

Planning a transportation system that meets the needs of Washington residents requires strong leadership from public policymakers and a renewed insistence on results over process. Washington Policy Center's research highlights some of the structural changes that can be made to improve our road network and recapture the vision of a transportation system based on freedom of movement. Key aspects of this vision include reducing structural barriers that drive up the cost of delivering major transportation projects and improving transparency and accountability at the Department of Transportation. Some practical suggestions are presented here.

### Recommendations

**1) Implement regular, independent performance audits of the state transportation system.** Currently the State Auditor is only allowed to investigate whether public money was spent legally, not whether it actually achieved anything effective. Independent performance audits would allow transportation managers to identify waste, use the savings to improve roads, and thereby shore up public trust and awareness.

**2) Tie increases in spending to measurable performance improvements.** After years of inaction and delay, public trust in the Department of Transportation is low. Putting in place clear, measurable performance benchmarks, including permit streamlining and competitive contracting, before enacting increases in funding, would help restore public trust in the state's ability to spend tax money wisely.

**3) Change the Transportation Secretary from a board-appointed position to one appointed by, and directly responsible to, the governor.** One of the primary complaints of many voters is the lack of accountability in today's transportation system. The state's elected chief executive has little control over the leadership of the Department. Changing the Secretary of Transportation's position to one appointed by the governor would help restore direct accountability for the failure or success of the state's transportation plan.

**4) Reform the costly and artificial prevailing wage system.** Prevailing wage is defined as the wage paid to the majority of workers in the applicable trade. In practice the rate is not interpreted as the true market wage but as the going union rate for the largest city in the region.<sup>ii</sup> The effect of this interpretation is to reverse the meaning of "prevailing wage." Normally, open market forces determine the prevailing price of labor, not a pre-determined, government-fixed price. By interfering in the natural function of the labor market the government artificially drives up how much it must pay to build and maintain the public roads network.

## 2. Congestion Relief

### Recommendations

1. Reduce spending on costly, ineffective fixed-route mass transit.
2. Adopt a modest plan to increase capacity on major arterials combined with implementation of a flexible, cost effective bus-based public transit system.
3. Let the public re-vote on Sound Transit to secure citizen approval for its scaled-back light rail plan.

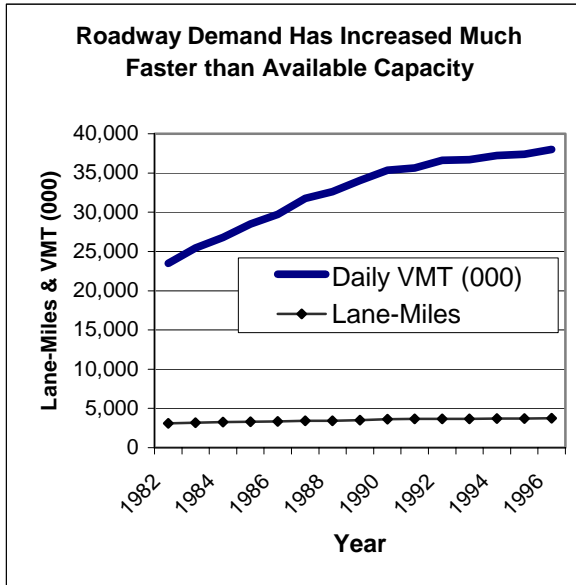
### Background

Traffic congestion in the Puget Sound area affects businesses and individuals everywhere in the state. Agricultural producers need reliable access to ports in Everett, Seattle and Tacoma because of their reliance on international trade. For business owners around Puget Sound, congestion hampers their competitiveness by delaying delivery of goods and increasing money spent on gas and other travel expenses. Families are also affected. As more time is needed to commute to work, less time is available for activities with family and friends. Due to traffic congestion, 55 percent of families with children say they are normally late, or miss entirely, at least one family-related function per week.

There is broad agreement among policymakers and the general public that Washington's transportation system is in desperate need of upgrade and expansion. The current road network has not kept pace with population growth and the building patterns of development (see figure 1). An interstate highway system designed in the 1950s and built in the 1960s continues to form the core of the overall road network. Many of

these essential arteries remain essentially unchanged since the day the ribbon was cut at the opening ceremony.

Figure 1.



(VMT = Vehicle Miles Traveled)

The present interstate system was originally designed to meet traffic needs for twenty years and it is now operating far beyond its original capacity.<sup>iii</sup> It is being pressed into service to handle the daily traffic load of one of the fastest-growing metropolitan areas in the country. The population of Pierce, Snohomish and King Counties is 60 percent larger today than it was when Interstate 5 opened. The result is fairly obvious; and lack of capacity is the primary cause of the chronic overcrowding we see on our roadways today.

## Policy Analysis

The region's transportation stresses will only grow in the future. There are now as many daily commutes from one suburb to another as there are from the suburbs into a central urban core, and the old "spokes of the wheel" planning model

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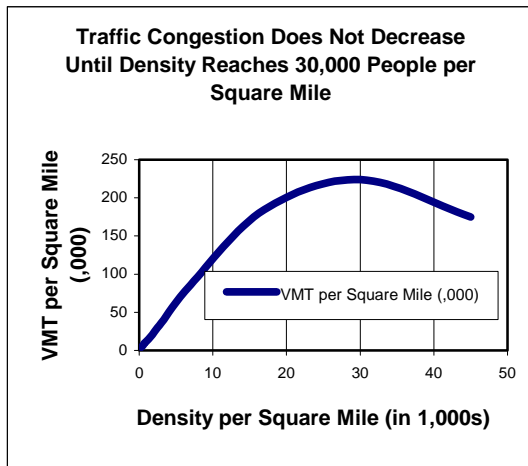
no longer applies. The number of vehicle miles traveled in Washington has been growing faster than the rate of population growth since the mid-1980s. The number of daily vehicle miles traveled today stands at more than 150 million.<sup>iv</sup>

Despite the growth in vehicle miles traveled in the region, transportation planners remain focused on improving multi-modal, or mass transit options at the expense of new road construction. Not only is this approach costly, it is ineffective. Simply put, mass transit does not reduce congestion.

Dense, built-up cities like New York, Tokyo and London are often put forward as examples of transit-dependent communities that the Puget Sound should imitate. Our region does not have nearly the population density necessary to make similar mass transit systems work. Research shows that fixed-route mass transit only begins reducing congestion in population centers of 30,000 or more people per square mile.<sup>v</sup>

Only one census tract in the state, on the west side of Capital Hill in downtown Seattle, has the necessary population density to justify heavy mass transit spending in an effort to reduce congestion – hardly a strong argument for city or region-wide light rail system or monorail.<sup>vi</sup>

Figure 2.



The Puget Sound is not unique. Over the 60 years since World War II, even as total population has increased, transit ridership nationwide has fallen dramatically in absolute numbers. Over the same period, spending on transit increased significantly. Federal funding, which began in the mid-1960s, has not increased transit's share of the daily commute, but may have stabilized its decline. Today, despite millions of tax dollars spent every year, public transit still only accounts for about three percent of daily trips.<sup>vii</sup>

The region does need to provide transportation options – not everyone is able to travel by car. But fixed-route public transit, like light rail, is not a wise choice. Instead, transportation planners should adopt a balanced plan that includes an effective increase in lane capacity on the region's most heavily traveled expressways and a practical, flexible and cost effective bus-based public transit system.

In transportation policy the misguided principle that all competing interests must be accommodated has resulted in a lack of strong leadership. Any plan that reduces congestion, improves freight mobility and enhances transportation choices is certain to draw heavy criticism from some environmentalists

and anti-growth groups. The job of elected leaders is to resist special interest pressures and revive a floundering transportation system with a united plan based on manageable cost, high quality service and solid results for the public.

## **Recommendations**

**1) Reduce spending on costly, ineffective fixed-route mass transit.** Two major fixed-route transit projects, Sound Transit's Link Light Rail system and the Seattle Monorail, are being planned for completion sometime within the next 10 years. Both face considerable financial problems and program revisions. Refocusing the money spent on these systems into a program that will have a real impact on congestion is a better option for policymakers.

**2) Adopt a modest plan to increase capacity on major arterials combined with implementation of a flexible, cost effective bus-based transit system.** People make choices about what is best for their lives, and the vast majority of people choose to travel by car when they need to get around. A consistent policy of modestly expanding road capacity would recognize this reality, while adequately funding bus-based services would serve those who depend on public transit.

**3) Let the public re-vote on Sound Transit to secure citizen approval for its scaled-back light rail plan.** The light rail system Sound Transit is building today is considerably smaller than what voters originally approved, yet the level of taxation is the same. Now that Sound Transit has settled on a scaled-back plan, the public should have an opportunity to vote on it.

### 3. Competitive Contracting

#### Recommendations

1. Establish clear oversight guidelines for managing any new competitive contracting system.
2. Encourage an atmosphere of healthy competition where private companies compete with state employees and other contractors to perform public work, like highway maintenance.
3. End state funding for research designed to derail the competitive contracting process.

#### Background

In 2002 the Washington legislature passed the Personnel System Reform Act which, among other things, allows state agencies to competitively contract for services historically provided by state employees. The competitive contracting provision of the Act, which takes effect in July 2005, offers new flexibility to state transportation managers facing tight budgets and the urgent need to maintain service levels while reducing overall cost.<sup>viii</sup> In many other states, competitive contracting is used to boost the quality of services, while ensuring the best value for taxpayers.

In Washington, highway maintenance is one area of government that has been recommended for competitive contracting.<sup>ix</sup> An independent audit commissioned by the legislature in 1998 found that competitive contracting for highway maintenance could save state taxpayers up to \$250 million a year, without reducing the high level of service expected by state motorists.<sup>x</sup>

The state highway maintenance program covers nearly 18,000 lane-miles of state highways, ten major mountain



passes, 45 rest areas and dozens of other transportation-related systems. Basic maintenance operations include road repair, roadside and landscape maintenance, snow and ice control, rest area operations and many others.

## **Policy Analysis**

The findings of the legislature’s audit reflect the generally positive experiences other states have had with contracting out. These states use highway maintenance contracting to increase flexibility, ensure high quality and reduce cost in keeping up vital highway infrastructure. Similarly, competitive bidding would allow Washington policymakers to serve the public while getting the most out of scarce transportation dollars.

Competitive bidding does not mean privatization. In other states public employees compete for, and often win, competitions to perform government work. It is competition, not privatization, that achieves higher efficiency by allowing managers to choose the best-cost option while delivering improved services to the public. Even when government workers continue to provide a given public service, the very possibility of competition drives down costs and encourages excellence.

In a government agency the size and scope of the Department of Transportation – it is larger than most businesses in the state – one would reasonably expect there to be areas where its work could be done more efficiently. Long-standing programs in states like Massachusetts, Texas, Florida and Virginia demonstrate that competition for highway maintenance can be effectively implemented with minimal impact on state workers and significant improvement in cost savings and work quality.<sup>xi</sup>

## Recommendations

**1) Establish clear oversight guidelines for managing any new competitive contracting system.** Key to the success of any competitive contracting program is strong oversight and a transparent contract award process. State managers can enhance public support by building on the practical experiences of other states in designing oversight and accountability into any contracting out program.

**2) Encourage an atmosphere of healthy competition where private companies compete with state employees and other contractors to perform public work.** By rewarding state employees for good work, and incorporating the best innovations of the private sector, competitive contracting can help to build up morale and enhance the culture of excellence within the Department of Transportation. Based on the successful experiences of other states, highway maintenance is a good place for the Department to start a vigorous contracting out program.

**3) End state funding for research designed simply to derail the competitive contracting process.** Recent efforts by Department of Transportation staff have attempted to cast a negative light on the competitive contracting process. Considering the proven success of competition and contracting across the nation, state managers should avoid wasting resources on research that has already been done elsewhere.

## 4. Permit Streamlining

### Recommendations

1. Implement a permanent and expanded Integrated Permitting System.
2. Allow the Department of Transportation, with reasonable oversight and safeguards, to operate its own permit process.

### Background

Today's permitting process is virtually impossible for the average citizen to understand, let alone navigate unaided. The system is disjointed, uncoordinated and complicated by the overlapping jurisdictions of multiple local, state and federal agencies. The problem is particularly acute with environmental permitting for transportation projects, but can also impact qualification for state contracts, major capital projects and agricultural certification programs, among economic development activities.

Permitting decisions are typically based on agency administrative rules and procedures, not the project's final objective. Instead of working toward results, state agencies issue permits based on process. Consequently, the original purpose of the permitting system often gets lost in needless, mind-numbing paperwork, resulting in differing project definitions to satisfy different agencies' standards, and a staggeringly inconsistent administrative record.<sup>xii</sup>

### Policy Analysis

With sensible reform, the state could reduce the cost and complexity of its permitting process, improve the pace of transportation projects and boost the general business climate in Washington. One practical idea is creation of an Integrated

Permitting System (IPS).<sup>xiii</sup> The system combines the requirements of different agencies into one centrally-managed document for each project. If a Department of Ecology permit is required, the information needed is included in the IPS Document. Similarly, if a Department of Natural Resources lease is required, the information to support lease issuance is also found in the completed IPS Support Document.

## Recommendations

**1) Implement a permanent and expanded Integrated Permitting System.** The legislature approved a limited Integrated Permitting System as a pilot project. This program should be expanded and made permanent. By consolidating the permit management system into one comprehensive document, a new focus is placed on the completion of projects, not moving paperwork. Relying on one central document eliminates conflicting requirements and breaks the bureaucratic gridlock that typically results from the uncoordinated actions of different agencies.

**2) Allow the Department of Transportation, with reasonable oversight and safeguards, to operate its own permit process.** Under this proposal, the Department of Transportation would receive approval from the Department of Ecology (DOE) and the Department of Fish and Wildlife (WDFW) to conduct its own reviews and issue permits without seeking independent approval from the separate agencies. DOE and WDFW would implement an oversight program that would ensure compliance with state regulations, but actual permitting processes would be conducted by the DOT. This approach would improve coordination and reduce the time needed to navigate complicated state permitting rules, resulting in more time and money spent on construction and less on process.

## 5. Private Passenger Ferries

### Recommendation

Encourage private companies to invest in and operate passenger ferries in Puget Sound.

### Background

Washington State Ferries are an integral part of the state highway system, providing over 27 million passenger trips each year. Prior to 2003, more than one million of those trips were on passenger-only ferries, where fare-box revenue covered less than 20 percent of the operating cost. Washington Ferry officials ended passenger-only operations in the fall of 2003, leaving the state without any such service to important destinations like Bremerton and Kingston. A bill passed by the legislature in 2003 lifted the 1950s-era ban against running private ferries on the Sound.<sup>xiv</sup> Previously it was against the law to operate a private ferry within ten miles of any state route, an area that essentially covers all of Puget Sound.

### Policy Analysis

After intense debate over the role of government and the capabilities of the private sector to provide the service, Kitsap Ferry Company launched the first private passenger ferry service in August 2004. The run, from Bremerton to Seattle, takes approximately 40 minutes and costs \$7, in comparison with the state car ferry route that costs \$5.70 and takes 60 minutes for the crossing. Another private passenger ferry is planned for the Seattle to Kingston route, this one operated by Aqua Express and slated for opening in fall 2004. Repealing the ban has opened the way for new ideas, new investment and more efficient operations, at no risk to the public. But much policy work must still be done to ensure private passenger ferries are more than a passing fad.

## Recommendation

**Encourage private companies to invest in and operate passenger ferries on Puget Sound.** Kitsap County is fortunate to have aggressive leaders willing to take risks to encourage private development of passenger ferry routes. Other routes are possible throughout the Puget Sound and on Lake Washington and Lake Union. The Utilities and Transportation Commission, which grants permits for any new routes, should be liberal in granting new permits to potential ferry operators, to encourage private investment and further diversification of the state's water-borne transportation system.

## **Additional Resources**

### Washington Policy Center Research

“Great Rail Disasters: The Impact of Rail Transit on Urban Livability,” by Randal O’Toole, February 2004.

“Competitive Contracting for Highway Maintenance: Lessons Learned from National Experience,” by Geoffery F. Segal and Eric Montague, January 2004.

“An Overview of Referendum 51,” by Eric Montague, September 2002.

“Roads in the Right Places: A New Plan to Ease Congestion,” by Eric Montague, 2001.

“Proven Ways to Pay for Transportation Without Raising Taxes,” by Eric Montague, 2001.

“Traffic vs. Kids: How Puget Sound Gridlock Hurts Families,” by Jeff Kemp and Paul Guppy, with Dawn Wilson and Kai Hirabayashi, October 2000.

“Competing for Highway Maintenance: Lessons for Washington State, Parts I & II,” by Dennis Lisk, September 1998 and January 1999.

### Other Resources

Cascadia - A project of Discovery Institute that produces research on transportation and commerce solutions for the I-5 Corridor between Eugene, Oregon and Vancouver, British Columbia. [www.discovery.org/cascadia](http://www.discovery.org/cascadia).

Texas Transportation Institute - This research institute located at Texas A&M University publishes annual assessments of regional congestion. <http://tti.tamu.edu/>.

“A Guide to Smart Growth: Shattering Myths, Providing Solutions,” by Jane S. Shaw and Ronald D. Utt, Heritage Foundation/PERC, Washington, D.C. and Bozeman, MT, 2000.

“Digest of Transportation Research,” published by Reason Public Policy Institute. This monthly compendium offers a comprehensive list of major transportation research completed by academic, government and other private entities. Access the digest at [www.rppi.org/surfacetransportation](http://www.rppi.org/surfacetransportation).

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<sup>i</sup> “Washington State: Gas tax to climb 5 cents,” by Joseph Turner, The Tacoma News Tribune, May 20, 2003.

<sup>ii</sup> Revised Code of Washington, 39.12.010.

<sup>iii</sup> “The Federal-Aid Highway Act of 1956: Creating the Interstate System,” by Richard F. Weingroff, Federal Highway Administration, Washington, D.C., p. 12.

<sup>iv</sup> “Daily Vehicle Miles Traveled,” Transportation Data, Washington State Department of Transportation, July 30, 2004, <http://www.wsdot.wa.gov/mapsdata/tdo/annualmileage.htm>

<sup>v</sup> “Reduce Congestion Now: A Customer Oriented Approach to Traffic Congestion Relief,” prepared by TDA, Inc., October 1999.

<sup>vi</sup> “2004 Population Trends,” Office of Financial Management, September 2004, [http://www.ofm.wa.gov/pop/poptrends/poptrends\\_04.pdf](http://www.ofm.wa.gov/pop/poptrends/poptrends_04.pdf).

<sup>vii</sup> “Reduce Congestion Now: A Customer Oriented Approach to Traffic Congestion Relief,” prepared by TDA, Inc., October 1999, p. 7.

<sup>viii</sup> While competitive contracting is scheduled to begin in July 2005, collective bargaining began in July 2004, creating the possibility that state negotiators and union officials may bargain away or significantly restrict opportunities for competitive contracting.

<sup>ix</sup> See, “Competing for Highway Maintenance: Lessons for Washington State,” Parts I and II, published by Washington Policy Center, September 1998 and January 1999, available at [www.washingtonpolicy.org](http://www.washingtonpolicy.org).

<sup>x</sup> “Department of Transportation Highways and Rail Programs Performance Audit,” prepared for the Joint Legislative Audit Review Committee by Cambridge Systematics, Inc., March 13, 1998.

<sup>xi</sup> More examples and details are discussed in Washington Policy Center Policy Brief, “Competing for Highway Maintenance: Lessons for Washington State,” by Dennis Lisk, January 1999, and, “Competitive Contracting for Highway Maintenance: Lessons Learned from National Experience,” by Eric Montague and Geoffrey Segal, January 2004, available at [www.washingtonpolicy.org](http://www.washingtonpolicy.org).



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<sup>xii</sup> Examples of staggering administrative gridlock can be found at every level of government. At the state level, agencies involved in the New Hood Canal Bridge project maintain at least five different project descriptions.

<sup>xiii</sup> “Environmental Streamlining: Integrated Permitting System,” by Carl Kassebaum of CRK Environmental Management, ACEC Washington *Impact* newsletter, November 2002, pp. 1 and 2.

<sup>xiv</sup> “Officials seek expanded passenger ferry network,” by Steve Wilhelm, Puget Sound Business Journal, June 20, 2003, <http://seattle.bizjournals.com/seattle/stories/2003/06/23/story5.html>



# Chapter 11: Energy

## 1. Energy Production

### Recommendation

1. Work towards eliminating government regulations that create market and operational inequalities between private and public power producers.
2. Allow private producers to respond effectively to changes in demand in the electricity market.
3. Give electricity providers the flexibility to build diversified energy portfolios without restrictive government mandates.

### Background

Washington derives most of its electricity from hydroelectric dams scattered throughout the region. At a distant second place is natural gas, followed by nuclear power and various lesser sources. Hydroelectric power has long been Washington's leading source of power, although the importance of other sources, especially natural gas, have increased in recent years. Figure 1 shows hydroelectricity's overall importance and the general trend in state power sources between 1993 and 2002.<sup>i</sup>

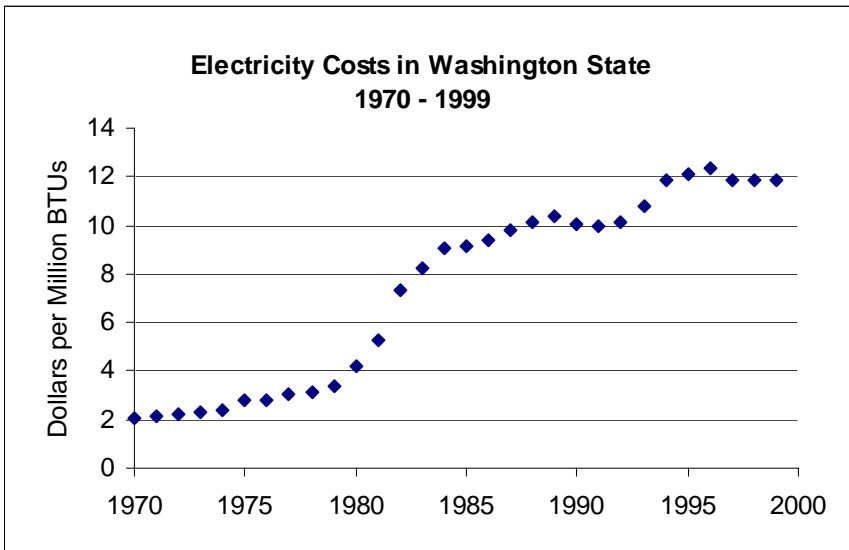
Figure 1.

Power Source	Total Electricity Production in Washington		
	1993	1997	2002
Hydroelectric	84.2%	83.2%	83.3%
Natural Gas	1.3	2.8	4.6
Nuclear	4.4	4.5	4.1
Dual Fired	2.9	3.2	3.8
Other Renewables	.8	.9	1.9
Petroleum	.7	.2	0.1

Washington's abundance of hydroelectric power, a relatively inexpensive way to generate electricity, has translated into user power rates consistently lower than the national average. It has also enabled Washington to sell excess power to other states. In 2002 Washington's average retail electricity price was 5.8 cents per kilowatt hour, while the national average rate was 7.09 cents.<sup>ii</sup> In 2002 Washington had the 12th lowest average retail electricity prices, out of all 50 states plus the District of Columbia.<sup>iii</sup> By April 2004, the average retail price in Washington had fallen to 5.5 cents per kilowatt hour, while the national average dropped slightly to 7.07 cents.<sup>iv</sup>

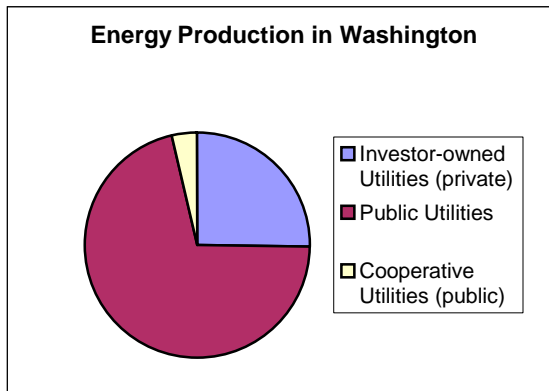
The cost of electricity in Washington state, though, has risen faster than the rate of inflation since 1970. That year the cost was \$2.02 per million BTUs (British Thermal Units).<sup>v</sup> By 1999 the cost had risen to \$11.83.<sup>vi</sup> The 586 percent rise in electricity costs outpaced the 442 percent rise in general inflation over the same period. Figure 2 illustrates the growth in the cost of electricity between 1970 and 1999.<sup>vii</sup>

Figure 2.



Washington's retail electricity is sold and distributed primarily by government and cooperative utilities. Three private, investor-owned companies (Puget Sound Energy, PacifiCorp, and Avista Corp) provide electric power to approximately 1.3 million customers in Washington,<sup>viii</sup> and 59 public and private consumer-owned, non-profit utilities (municipal utilities, public utility districts, rural cooperatives) supply the remaining 4.8 million Washington residents with power.<sup>ix</sup> Figure 3 shows the proportions from 2002.<sup>x</sup>

Figure 3.

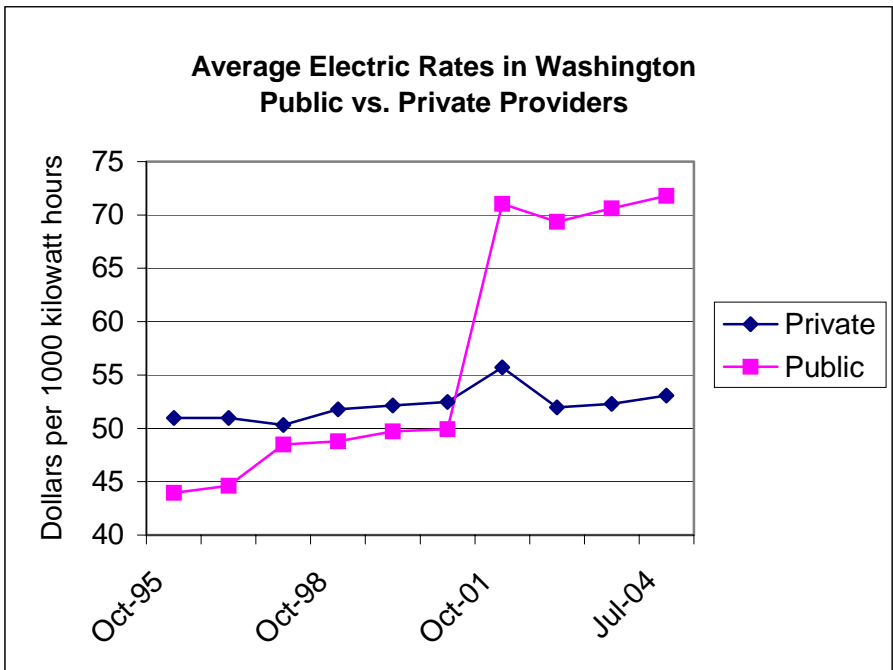


### Policy Analysis

Government subsidy also contributes heavily to Washington's lower electricity costs. In the wake of Congress's Public Utility Regulatory Policy Act of 1978 and the Energy Policy Act of 1992, many states have opened their retail electricity markets to competition. While Washington has resisted moving towards retail deregulation, the state's wholesale electricity market is open to competition.<sup>xi</sup>

Municipal and public utilities, and to a lesser extent power cooperatives, operate with market advantages not available to investor-owned utilities. For example, they receive preferential power purchasing options, tax exemptions and exclusive financing, and they are not subject to regulation by the Washington Utilities and Transportation Commission (WUTC). The state's private power companies fall under WUTC's jurisdiction and must request permission for rate increases. As figure 4 shows, public utilities increased rates at a much faster pace than private utilities.<sup>xii</sup>

Figure 4.



Market and regulatory advantages give public utilities the ability to sell electricity at rates lower than they would have to were they subject to the same operating conditions as investor-owned utilities. Much of the increased cost of electricity, as well as other operating costs, is absorbed by taxpayers as a result.

Yet another factor that poses a challenge to the electricity industry in Washington is the issue of production portfolio diversification. As figure 1 shows, Washington relies primarily on hydroelectricity. This has proven a two-edged sword. On the one hand, reliance on hydroelectricity has provided a relatively inexpensive power source. On the other hand, one year of reduced precipitation, or pressure from environmentalist groups to reduce dam flow for salmon runs, can reduce hydroelectric supply, thereby increasing both wholesale and retail electricity rates.

Washington's three private electricity providers, Puget Sound Energy, PacificCorp, and Avista, have all taken steps to diversify their portfolios, and industry executives are optimistic about accomplishments thus far and what will be done in the future. In the summer of 2004, Avista Utilities reported an energy portfolio consisting of 59 percent hydroelectric, 25 percent natural gas-fired, 13 percent coal-fired, and approximately three percent biomass (unusable agricultural or forest products burned to create heat, steam, and thus electricity).

In addition, Avista generates 35 megawatts of wind power.<sup>xiii</sup> PacificCorp also boasts a wide range of power sources, including hydroelectric, coal, natural gas, wind, and geothermal.<sup>xiv</sup> Puget Sound Energy is aggressively pursuing a range of renewable resources and utilizes "Green Power" pricing, where customers pay 10 percent more on their electric bills so the company can purchase alternative power sources such as biomass, wind, and solar. Avista and PacificCorp have similar programs in place.<sup>xv</sup>

## Recommendations

**1) Work towards eliminating government regulations that create market and operational inequalities between private and public power producers.** Unequal treatment introduces artificial distortions into the power market and hinder true competition that would, ultimately, lower electricity rates and improve service for all citizens.

**2) Allow private producers to respond effectively to changes in demand in the electricity market.** Private companies generally respond much more quickly, and usually at lower cost, to market fluctuations in power supply and demand. The public interest is served when power producers are allowed to invest in, upgrade and improve power supplies to keep up with the energy needs of an expanding economy.

**3. Give electricity providers the flexibility to build diversified energy portfolios without restrictive government mandates.** Both public and private electricity providers need to have a variety of sources from which they purchase or generate electricity. Fluid environmental factors as well as shifting market and economic conditions can do extensive damage to electricity customers and their providers who rely on few sources. This is especially true for Washington's private companies, who fall under WUTC regulation and thus are not able to respond to supply and price fluctuations as quickly.



## 2. Energy Regulation

### Recommendation

Fundamentally restructure the power production permitting process (EFSEC) to insure the state's energy needs are met.

### Background

In 1970, after analyzing electricity supply and demand trends and forecasts, the Washington legislature realized that in the future the state would require increased energy production. The legislature created a legal and regulatory framework for the design and construction of energy production facilities, the Energy Facility Site Evaluation Council (EFSEC).

The Council's authorizing statute describes its intended purpose:

“The legislature finds that the present and predicted growth in energy demands in the state of Washington requires the development of a procedure for the selection and utilization of sites for energy facilities and the identification of a state position with respect to each proposed site.

“It is the policy of the state of Washington to recognize the pressing need for increased energy facilities, and to ensure through available and reasonable methods, that the location and operation of such facilities will produce minimal adverse effects on the environment, ecology of the land and its wildlife, and the ecology of state waters and their aquatic life.”<sup>xvi</sup>

Thermal electric power plants producing 350 megawatts or greater and their dedicated transmission lines, new oil refineries or large expansions of existing facilities, large natural

gas and oil pipelines, and underground natural gas storage fields fall under EFSEC's licensing jurisdiction.<sup>xvii</sup> When EFSEC was established, its original jurisdictional threshold was 250 megawatts. Environmental activists have pushed to lower the threshold to 50 megawatts and bring more power projects under EFSEC's regulatory control. In response to the urgent power needs of the state, however, the elected leaders have moved in the opposite direction. In 2001 the legislature raised the threshold for projects that must pass through the EFSEC process to 350 megawatts. Smaller projects, both thermal and renewable, can also voluntarily opt into the EFSEC process.

The original idea behind ESFEC was to bring the confusing array of agencies and state requirements needed to build a major power plant within one agency. When reviewing a permit application EFSEC consolidates the analysis and input of the following state agencies:

- Department of Ecology
- Department of Fish and Wildlife
- Department of Community, Trade and Economic Development
- Utilities and Transportation Commission
- Department of Natural Resources
- Department of Agriculture
- Department of Health
- Military Department
- Department of Transportation

The typical permit application process is long and difficult. Once a formal application is submitted, EFSEC holds land use hearings, seeks reviews by independent consultants, considers separate air and water permit applications, conducts adjudicative hearings, commissions environmental impact statements, and conducts additional consultant reviews and hearings as it deems necessary.<sup>xviii</sup> The process can take 12 to 14 months, after which EFSEC submits a recommendation to the governor that the proposed power plant site application be

accepted or rejected. All EFSEC's costs for this process are paid by the entity seeking a permit, and can easily run in to the hundreds of thousands of dollars.<sup>xix</sup>

Since its inception 34 years ago, EFSEC has considered 19 separate site applications (not including re-submissions), of which it has approved 13. Only two of the 13 facilities have been built and are actually producing power for customers. The other projects have either been cancelled since approval, have had their permits expire, or the applicants have simply taken no action since approval. Companies often find EFSEC's permitting process so expensive and laborious that their original proposal no longer makes economic sense once they finally receive permission to build. While the regulatory process advances at its own slow pace, market prices change, competitors enter the market, investors become discouraged or financing arrangements expire. EFSEC currently has three site applications under review.<sup>xx</sup>

The barriers created by EFSEC are most aptly illustrated by the Sumas 2 natural gas plant that was proposed by Sumas Energy 2, Inc. In 1999 the company applied for a permit to build a 660 megawatt natural-gas fired electricity plant in the town of Sumas, Washington.

After more than two years of review, EFSEC rejected the Sumas 2 project even though the application met all federal and state pollution regulations. EFSEC denied Sumas 2 for a number of arbitrary reasons, the details of which are described in the Washington Policy Center Policy Brief "A Case of Energy Over-Regulation."<sup>xxi</sup>

In spite of no clear legal right to do so, EFSEC also insisted that the application failed to demonstrate a need for additional energy production in Washington. In short, EFSEC acted outside of its own legal mandate, as laid out in its original authorizing legislation. EFSEC finally approved a revised and resubmitted Sumas 2 application in 2002, four years after it was

first submitted. Other regulatory problems have, however, prevented the project from proceeding. The process is summarized in figure 1.

Figure 1.

### **Timeline of Sumas 2 Permit Process**

- January 1999 – Sumas Energy 2, Inc., proposes a 660 megawatt natural-gas powered electricity-generating plant on a 37 acre site in the town of Sumas, Washington. The company requested expedited review of its EFSEC application under RCW 80.50.075.
- July 1999 – In response to needed changes in the application Sumas Energy 2, Inc., withdraws its request for expedited processing.
- January 2000 – Sumas Energy 2, Inc., submits a revised application.
- February 2001 – EFSEC recommends to Gov. Locke that that he deny the application. Sumas Energy 2, Inc., requests that EFSEC reconsider its decision and delay recommendation to the governor. Sumas Energy 2, Inc., states it will revise the project plan. EFSEC grants request.
- June 2001 – Sumas Energy 2, Inc., submits another revised application to EFSEC.
- May 2002 – EFSEC recommends the governor approve the second revised application. The governor accepts the recommendation.
- March 2004 – Canadian National Energy Board denies Sumas Energy 2, Inc., permit to build necessary transmission lines from the U.S./Canadian border to an Abbotsford, B.C. substation.

- Sometime in 2005 – Canadian court set to hear case in lawsuit filed by Sumas Energy 2, Inc., against National Energy Board.

## Policy Analysis

The Sumas 2 facility, as originally proposed, would have generated enough electricity to power 500,000 homes.<sup>xxii</sup> As Washington's electricity demands wax and wane throughout the weather seasons, increased production benefits the people of the region whether the power is used in this state or sold elsewhere as surplus.

As the Sumas 2 timeline demonstrates, the process to get permission from the government to build a new power plant is agonizingly long and burdensome. A proposed facility can meet all state and federal pollution regulations, have the official approval of local leaders, have secured all necessary arrangements for property and water use, and still permission to build can be denied for purely subjective reasons.

In 2003, a new EFSEC director took steps to make the process more efficient, and in October 2004 the agency amended WAC 463-42, acknowledging the need for increased energy production in the state. More importantly, the new regulations no longer require applicants to demonstrate a need for the proposed facility.<sup>xxiii</sup>

## Recommendation

**Fundamentally restructure the power production permitting process (EFSEC) to insure the state's energy needs are met.** EFSEC was created because of the pressing need for increased energy facilities, yet only two high-production facilities have been built since EFSEC assumed control of the permitting process. Rising energy prices and unmet consumer demand testify to the need for a greater supply

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of energy. EFSEC has made significant progress in streamlining its permitting process. Policymakers should encourage and build on this improvement in the way EFSEC does business or, if it proves necessary, they may want to consider eliminating the agency and starting again.

### 3. Alternative Power Sources

#### Recommendations

1. Retain fair and accurate rates for power from alternative energy sources.
2. End legal mandates that require electric utilities to provide power from specific alternative energy sources.
3. Support broad tax and regulatory relief for all power producers, instead of narrow, source-specific tax credits for politically favored technologies.

#### Background

In 2001 the legislature passed a law that required, beginning on January 1, 2002, 16 major power utilities to provide to retail electricity customers “a voluntary option to purchase qualified alternative energy resources.”<sup>xxiv</sup>

Avista, PacificCorp, Puget Sound Energy and a number of Washington’s public utilities created programs in accordance with the law. These programs are known generally as “Green Power.” The law exempts public utilities with fewer than 25,000 meters in service, or those with an average of seven or fewer customers per mile of power distribution line.<sup>xxv</sup>

Qualified alternative energy sources as defined in the law include power from:

- wind
- solar energy
- geothermal energy
- landfill gas
- wave or tidal action
- gas produced during the treatment of

wastewater

- qualified hydropower and
- biomass energy from animal waste or solid organic fuels, or dedicated energy crops.

Energy from wood waste that has been treated with chemical preservatives such as creosote, pentachlorophenol, or copper-chrome-arsenic does not qualify as “green.”<sup>xxvi</sup> “Qualified hydropower” refers only to hydroelectric sources that have met specific state modernization guidelines for the protection of fish species.

Although the sale of “Green Power” is growing in absolute terms, as a percentage of total kilowatt-hour sales it makes up well under one percent of Washington’s total power supply.

Of the utilities required to provide power from alternative sources Orcas Power and Light Cooperative in San Juan County reported the highest percentage of “Green Power” sales; 0.81 percent in 2002. PacificCorp took a distant second place, reporting “Green Power” as 0.28 percent of total kilowatt-hour sales.<sup>xxvii</sup> In 2003, just 17,795 electric utility customers statewide chose to participate in “Green Power” plans. The great majority of alternative power comes from one source – wind power constitutes 95.8 percent of “green” electricity sales.<sup>xxviii</sup>

Alternative-energy electricity production is increasing in Washington, but still provides only a tiny percentage of the state’s general electricity needs. The state went from no wind-generating capacity in 2000 to more than 23 megawatts in 2003, and from approximately eight megawatts of power generation from landfill-gas that year to 25 megawatts in 2003.<sup>xxix</sup> Between 1987 and 2000, output from general biomass sources (ethanol, landfill gas, municipal solid waste, wastewater treatment, waste wood combustion, waste wood processing)



barely doubled in 13 years, rising from 58,996 to 121,166 BTUs.<sup>xxx</sup>

## Policy Analysis

Energy from alternative sources is more expensive than that produced by more efficient traditional methods, and power customers who choose “Green Power” pay higher utility rates as a result. Environmental advocates have called for subsidizing “Green Power” by combining it for pricing purposes with power from traditional sources, so all customers would pay the same, whether they choose alternative energy or not.

The Washington Utilities and Transportation Commission’s 2003 Green Power Programs report to the legislature said that unnamed utility representatives made several suggestions for the future of the program. They stated that “Green Power program participants feel penalized by having to pay more for doing the right thing to support a cleaner environment and request that all customers share the responsibility.”<sup>xxxii</sup> Other comments by utility representatives point to the same conclusion: general power rates and “Green Power” rates should be combined, so as to allow for an across-the-board absorption of increased production costs.

While alternative energy sources such as wind and biomass are growing in use, electricity from solar generation will likely be the focus of debate in the upcoming legislative session.

In 2005 the legislature will likely consider a bill similar to Substitute Senate Bills 6131 and 6132, both introduced, but not passed, in the last session. SSB 6131 would have provided “investment cost recovery incentives” for purchasing and using solar power components made in Washington.<sup>xxxii</sup> SSB 6132 would have imposed a tax on solar electricity producers unless they locate in a county that has an unemployment rate greater than 12 percent. In addition, only businesses that maintain at

least 75 percent of “full” employment would have qualified for the exemption.

The Washington State Employment Security Department would decide on a case-by-case basis what constitutes “full” employment.<sup>xxxiii</sup> These bills aimed at further developing Washington’s solar-power technology industry. Proponents of these bills, as well as the text of 6132 itself, cite Washington State University (WSU) Energy Program’s publication “The Washington Solar Electric Industry: Sunrise or Sunset,” which concludes that, without tax incentives, the solar technology industry in Washington will continue to decline.<sup>xxxiv</sup>

SSB 6131 amounts to little more than subsidization and protectionism. By providing a tax incentive for purchasing solar technology produced in Washington, the government is, essentially, penalizing people who purchase goods from outside Washington, even if those goods are of superior quality or value. SSB 6132 aims to locate industry based on factors not necessarily related to that industry’s success. Since the state decides what “full” employment is, if a business seeks the tax incentive it must submit to further regulation that hampers its ability to adapt to market and environmental fluctuations.

Proponents of solar electricity generation argue, as do proponents of other alternative and renewable energy sources, that Washington’s reliance on hydroelectric and fossil-fuel electricity generation poses grave risks to the environment. In addition, they point to the solar technology industry’s formidable presence in Washington.

That presence, combined with an assumed future economic “boom” in solar technology, proponents argue, would greatly aid Washington’s economy. The WSU Energy Program’s report concluded, “the dramatic growth in Washington’s solar electric market cannot be maintained without further incentives.”<sup>xxxv</sup> If using targeted tax incentives is the only way a certain industry in the state can survive, it is

questionable whether using special tax benefits to prop up that industry makes economic sense or serves the public interest in the long run.

## Recommendations

- 1) Retain fair and accurate rates for power from alternative energy sources.** Power customers who choose not to buy power from more expensive alternative power sources should not be forced to subsidize those who do. Policymakers should resist proposals to combine prices for “Green Power” with those of traditional power sources, which would artificially increase costs of power for all consumers, including low-income people.
  
- 2) End legal mandates that require electric utilities to provide power from specific alternative energy sources.** Power utilities should be left as free as possible to respond to the natural operation of the marketplace. Utility executives can gain timely and accurate information about the most desirable and cost-effective sources of power by listening to their customers.
  
- 3) Support broad tax and regulatory relief for all power producers, instead of narrow, source-specific tax credits for politically favored technologies.** Policymakers who favor subsidies and tax credits for alternative energy sources often refer to these costs as “investments” in future “boom” industries. Actually, people in government are usually not very good at economic predictions about what industries will prosper and which will fail. Instead elected leaders should set broad policies that favor power production of all kinds, and let the efficient working of the market determine what forms of generation best serve power customers.

## **Additional Resources**

### Washington Policy Center Research

“A Responsible Approach to Climate Change,” by Peter Geddes, September 29, 2004.

“Global Warming: Implications for State Legislators,” by John A. Charles, Jr., 2004.

“Clearing the Air on New Source Review,” by Eric Montague, 2004.

“A Case Study in Energy Over-Regulation: Denial of the Sumas 2 Generating Facility,” by Scott Fallon, May 2001.

“The Governor’s Energy Proposal: An Independent Analysis,” by Scott Fallon, March 2001.

“Paying for Power: Taxpayer-Subsidized Electricity in Washington State”, by Elaine R. Davis, 1997.

### Other Resources

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