



TRANSFORMING WASHINGTON'S BUDGET

- ◆ **FISCAL RESPONSIBILITY**
- ◆ **EFFICIENCY**
- ◆ **PERFORMANCE**

**OFFICE OF THE GOVERNOR
JUNE 2010**

TRANSFORMING WASHINGTON'S BUDGET

INTRODUCTION

The process for building the next budget traditionally begins in the spring, when we send instructions to each state agency to explain how it must justify spending for each activity. We use a process called Priorities of Government — or POG — that starts at zero, not with what an agency has been spending. POG requires agencies to categorize proposed spending by its importance to the mission of the agency. When the requests are returned to the budget office in September, we look first at funding those items that are essential. Items that aren't as important aren't funded. And when times are tough, even some essential items aren't funded.

Given both immediate and longer-term projected shortfalls, we are proposing a new budget-building process that features eight questions that agencies must answer to satisfy us that the spending proposal is, in fact, related to an essential service. These questions build upon and reinforce the POG process:

FISCAL RESPONSIBILITY

1. Is the activity an essential service?
2. Does state government have to perform the activity, or can it be provided by others?
3. Can the activity be eliminated or delayed in recessionary times?
4. Does the activity need to be paid for with state general funds? Should users pay a portion of the costs?
5. Are there federal funds or other fund sources available to support this activity?

EFFICIENCY

6. Are there more cost-effective, efficient ways to do the activity?

PERFORMANCE

7. Can the activity be the subject of a performance contract?
8. Can the activity be the subject of a performance incentive?

To help us evaluate spending proposals from agencies, we have invited a panel of leaders to pose their own hard questions and lend other perspectives. The Governor's Committee on Transforming Washington's Budget will consult with budget staff and participate in public hearings we are scheduling this summer.

Based on this new process, the Governor's proposed budget for 2011–13 will be presented to the Legislature mid-December.



June 2010

Dear Fellow Washingtonian:

We have been navigating our way through some very tough times even while the economy is showing signs of improvement. I am looking ahead to the state's next budget cycle and another sizable shortfall we must address in the 2011–13 budget. Of equal concern is that our projections out to 2015 indicate continuing revenue shortfalls.

The information that follows explains how we are developing a budget for the evolving economy. I am launching reforms now to shape how we build our budget and decide what programs it will fund with shrinking revenues.

First, we are going to challenge every program in state government with a series of tough questions to ensure we are getting the best value and paying for the most essential functions of state government.

Second, we will conduct several public hearings this summer in locations across the state. We will show you the decisions we face and the money that will be available to us. At the same time, we want to hear from you about what services you expect state government to deliver.

Finally, I have invited leaders from all walks of life to serve on the Governor's Committee on Transforming Washington's Budget. I have asked these individuals to jumpstart the questioning of assumptions underlying the current budget — in effect, to serve as a sounding and advisory board for hard budget decisions.

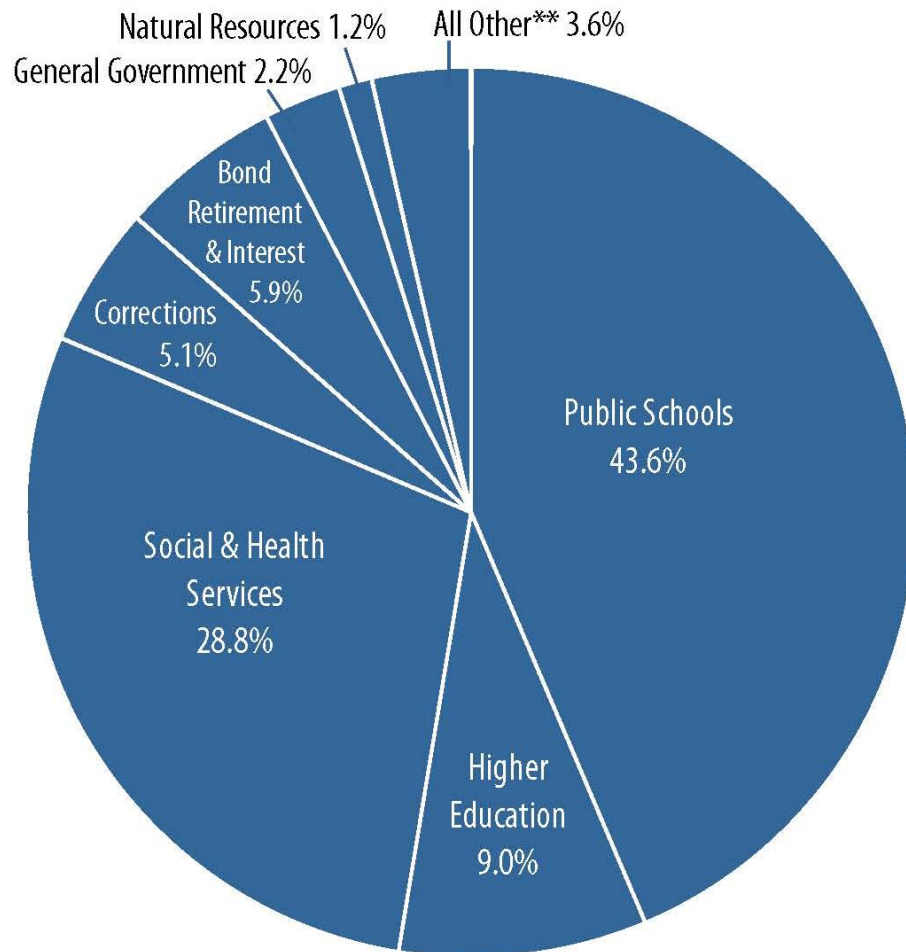
With your help, I will construct a budget that best reflects the values of our great state.

Sincerely,

Governor Chris Gregoire

2009-11 DISTRIBUTION OF GENERAL FUND-STATE SPENDING

STATE BUDGET SPENDING BY PROGRAM AREA* (BY PERCENTAGE)



* Transportation is in another budget.

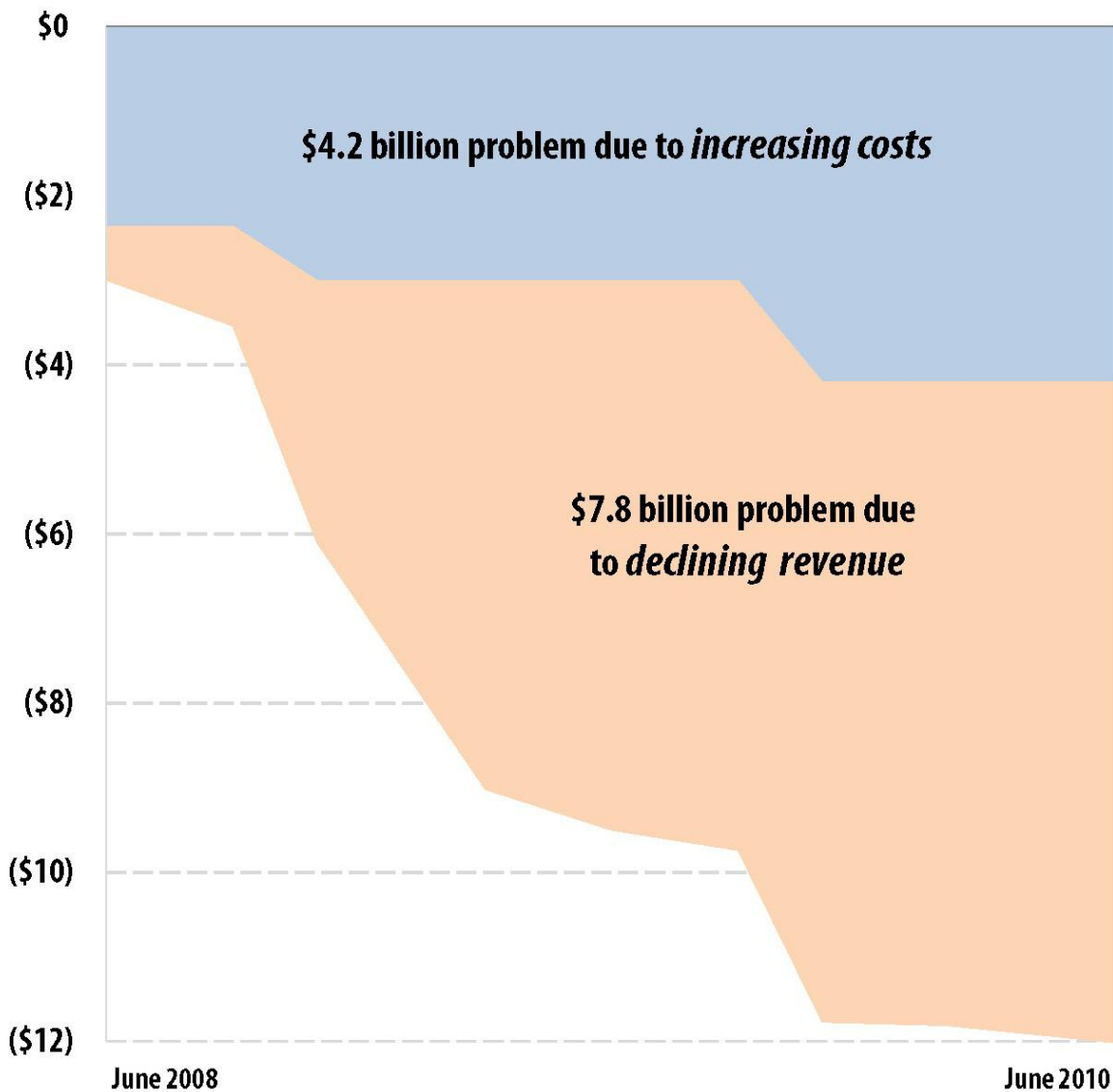
** All Other includes other education agencies (such as Early Learning), contributions to retirement, other items.

\$12 BILLION PROBLEM FOR 2009-11 BUDGET

CAUSES OF THE BUDGET GAP

(DOLLARS IN BILLIONS)

- Even before the recession, the state faced a significant shortfall due to health care inflation, K-12 education growth, prison population growth and increasing state employee pension obligations.
- The recession compounded this problem with a \$7.8 billion loss in state revenues. Revenue declines were due to lower consumer spending, dropping home values and sales, and other factors due to the greatest recession since the 1930s.

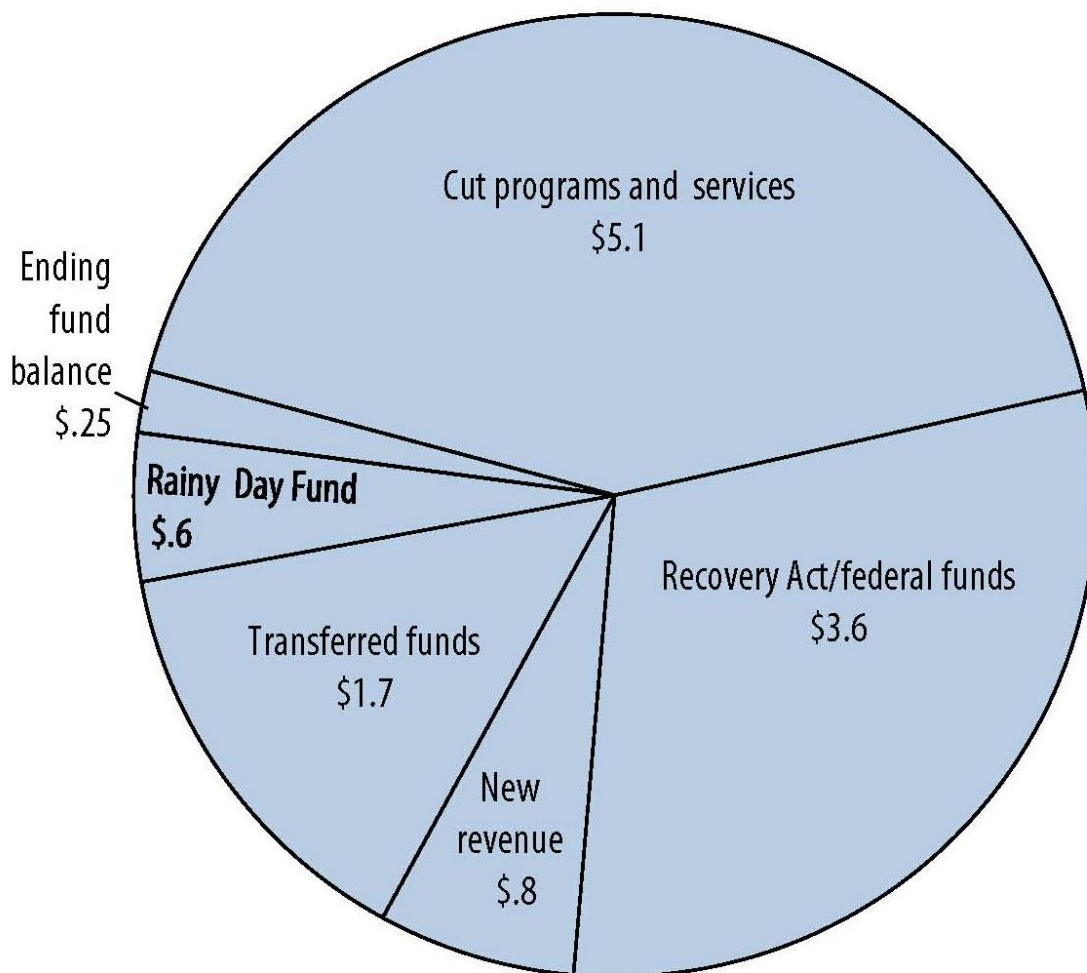


SOLVING THE BUDGET GAP OVER 3 YEARS

ACTIONS WE HAVE TAKEN TO BALANCE THE STATE'S BUDGET

(DOLLARS IN BILLIONS)

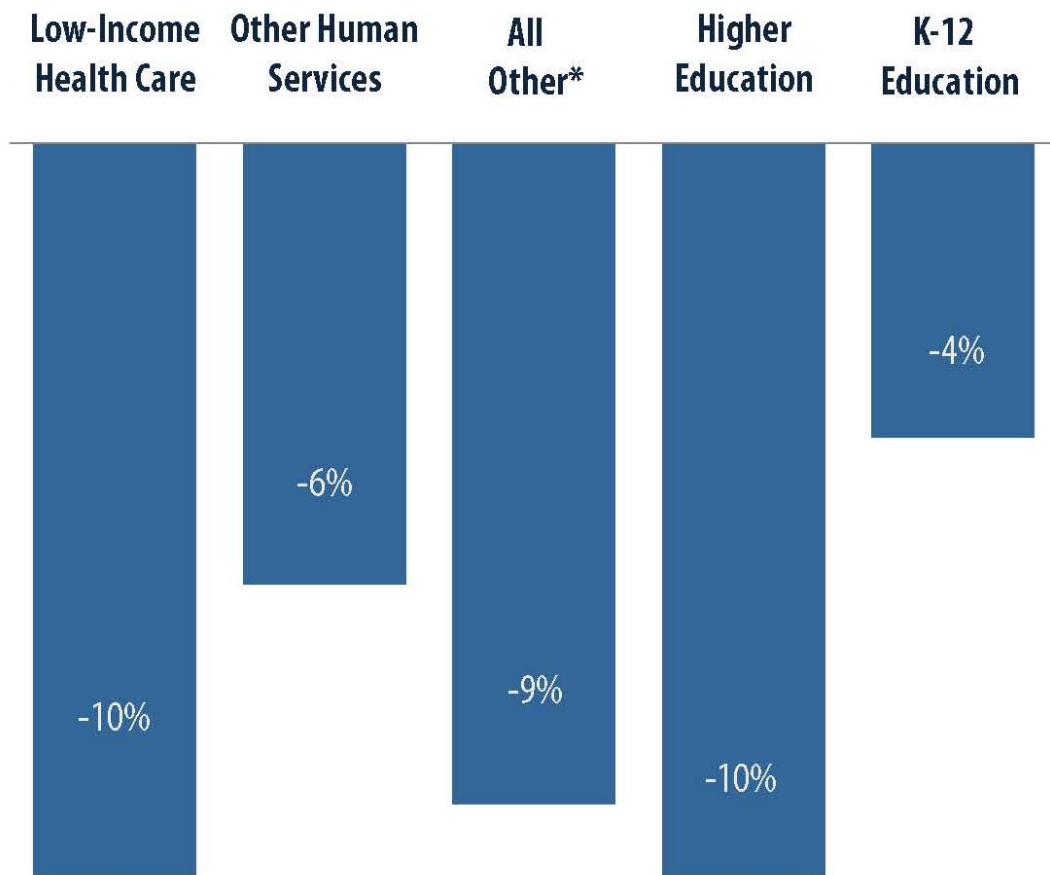
- Since 2008, the \$12 billion shortfall has been closed through a combination of actions instituted by the Governor and Legislature.
- Cuts to services and programs filled 40% of the gap, new revenue filled 7% of the gap.



EFFECT OF 2009-11 BUDGET CUTS ON KEY AREAS OF STATE BUDGET

(PERCENT REDUCTION FROM 2007-09 TO 2009-11)

- In cutting \$5.1 billion in services and programs, every part of the budget was affected. Even parts of kindergarten through 12th grade that are not part of Basic Education were reduced.



* Includes legislative and judicial agencies; natural resources; some transportation; Department of Early Learning; others.

TRANSFORMING WASHINGTON'S BUDGET

JUNE 2010 ECONOMIC CONDITIONS SHOW SLOW RECOVERY IN WASHINGTON

National experts agree that Washington is in a better position than most states to emerge more quickly from the recession. For instance, the President's Council of Economic Advisors says that certain health care jobs are expected to grow at four times the rate of all other occupations. Another field expected to experience rapid growth is "green jobs," or those that reduce pollution, increase efficiency or produce renewable energy. Washington has already invested in these areas and is positioned to be a leader in both fields.

Despite our potential to emerge strongly from the recession, our state's path to recovery will be bumpy. Material from the state Economic and Revenue Forecast Council explains some of these factors:

GOOD NEWS

- Economy slowly improving overall
- Washington will outperform the nation in the economic recovery because of our export intensity, aerospace and software publishing industries
- Moderate rebound in business investment in equipment and software
- Personal income growing moderately
- Consumer confidence slowly improving

BAD NEWS

- Slow housing recovery
- Slow and modest rebound in household wealth
- Slow hiring so continued high unemployment
- Consumer spending still moderate
- Banking industry still recovering, so consumer and business credit more costly
- Unlikely improvement in commercial real estate construction until 2012

While there are signs that the economy is improving, we are not out of the woods yet. As long as consumer spending remains soft and construction starts are slow, the recovery will take time. That's why we expect budget challenges to be in place for at least the next four years, as the chart on the next page explains.

COSTS ARE GROWING FASTER THAN REVENUE

WILL RESULT IN PROJECTED \$3 BILLION SHORTFALL FOR 2011-13

(DOLLARS IN MILLIONS)

	2011-13	2013-15
BEGINNING BALANCE	\$247	(\$3,053)
REVENUE	\$33,574	\$36,107
EXPENDITURES	\$36,874	\$41,815
2009-11 Budget Plus Expected Caseloads and Other Mandatory Costs	\$32,034	\$33,432
Other Expected New Costs	\$4,840	\$8,383*
PROJECTED SHORTFALL	(\$3,053)	(\$8,761)

	2011-13	2013-15
Replacement of Federal Funds	\$2.0	\$2.1
Medical Inflation	\$0.4	\$1.0
Pension Obligations	\$0.7	\$1.2
K-12 Basic Education Obligations	\$0.7	\$1.8
Class Size (I-728) and Teacher Salaries (I-732)	\$1.1	\$2.2
TOTAL	\$4.8	\$8.3

* 2013-15 shortfall will drop significantly after 2011-13 budget is adopted.

TRANSFORMING WASHINGTON'S BUDGET

IMPROVING UPON PRIORITIES OF GOVERNMENT

We will continue to use the Priorities of Government — or POG — budget process as the framework for a zero-base new budget. No state activity gets a free pass. However, we are strengthening POG to reflect the values that we hold as a state:

- We value world-class achievement in early education, elementary, middle and high schools, and postsecondary education.
- We must improve the health of Washingtonians, and support and keep safe our children and adults who are unable to care for themselves.
- We hold the responsibility to provide for the safety of people and protection of property.
- We must protect natural resources and cultural and recreational opportunities.
- We must promote economic development in a growing competitive environment.
- Efficient state government services are important to the people of our state.

But POG alone does not provide enough guidance for making difficult choices. So we are asking a series of tough questions in three themes to help us decide how to invest scarce dollars among so many competing demands. This will lead to better decisions about how we re-set a budget with far less money while meeting the state's most critical needs during this historic recession.

FISCAL RESPONSIBILITY

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Explanations of these questions are on the following pages.

TRANSFORMING WASHINGTON'S BUDGET

1. IS THE ACTIVITY AN ESSENTIAL SERVICE?

Many of the services the state provides, such as education, incarcerating and supervising felons, and providing support services for vulnerable individuals with significant disabilities, are absolutely critical to protecting the safety and well-being of the people of Washington. The state must continue to fund these essential services.

Given current budget realities, and the need to continue providing essential services, the state must scale back the level of its services in other areas.

→ **End Funding to Train New Local Government Officials**

In the past, the state has provided funding to the Washington State Association of Counties and to local fire districts to provide training to newly elected local government officials. This funding has been discontinued.

→ **End Career Services for Some Low-Income Families**

The WorkFirst program provided career services for families eligible for food stamps, but who were not eligible for the federal Temporary Assistance for Needy Families program. These services provided a small cash grant and additional support to help parents secure better-paying jobs. This program was eliminated to give priority to helping the lowest-income families.

Even within essential service areas, the state has reduced spending on items that are not as necessary as others.

→ **Correctional Facilities**

We have already closed and begun consolidating several correctional institutions. We have shut down Pine Lodge and Ahtanum View, and are downsizing McNeil Island, Larch and the juvenile offender facility Maple Lane. We will save \$53 million in the state general fund over the next two years as a result.

We must continue to assess whether all current state activities are necessary for achieving core outcomes. For example, in addition to our work to consolidate prison facilities, we should reassess the need to continue to operate expensive human services facilities, too.

→ **Residential Centers**

In the area of developmental disabilities, we have provided services in large, state-operated residential centers to many of those requiring care. In the early 1970s, six state centers served more than 4,000 residents. Today, five centers serve 900 residents and contain a number of underused buildings. We may be able to reduce the number of people in state-operated residential services by leveraging the skills and experience of our employees to build capacity and quality through a lower-cost, home- and community-based system of care.

TRANSFORMING WASHINGTON'S BUDGET

2. DOES STATE GOVERNMENT HAVE TO PERFORM THE ACTIVITY, OR CAN IT BE PROVIDED BY OTHERS?

We will determine whether there is a compelling reason for the state to deliver a service or whether it can be handled by another entity. We have already begun a number of initiatives to see how we can deliver better services more efficiently, including:

→ **State Parks Transfers to Local Governments**

The state park system has been streamlined to cut costs. However, instead of closing parks, we transferred parks selected by the Washington State Parks and Recreation Commission to local and tribal governments willing to keep them open. Two parks have already been transferred — Wenberg State Park to Snohomish County and Osoyoos Lake State Park to the city of Oroville. Three more parks are being considered for transfer in the next year — Fort Okanogan State Park to the Confederated Tribes of the Colville Reservation, and Fort Ward and Fay Bainbridge State Parks to the Bainbridge Island Metropolitan Park & Recreation District.

→ **Child Welfare Case Management Pilot Projects**

In 2012, the Department of Social and Health Services will transfer case management responsibilities in two pilot areas from state employees to private child welfare agencies. We will evaluate whether there are fewer out-of-home placements, greater stability for children who are placed in out-of-home care, and improved quality outcomes for children and families.

We are looking to build upon these ideas and collaborations. For example, the state could:

→ **Transform the Ferry System**

Washington State Ferries could get out of the ferry business. A private entity could decide what service to offer, or the state could subsidize the system and establish performance requirements. Ten of the 21 ferry systems in the United States and British Columbia are privatized in some manner. The closest model is BC Ferries, which is privately owned but receives government subsidies. We will analyze the pros and cons of new ownership.

→ **Transform Operation of the State Data Center**

The Department of Information Services is requesting information for a vendor to finance, build and operate the state's computing operations in the State Data Center.

TRANSFORMING WASHINGTON'S BUDGET

3. CAN THE ACTIVITY BE ELIMINATED OR DELAYED IN RECESSIONARY TIMES?

We will ask whether the state can truly afford an important service in these very tight times. In the past, we made choices to fund services whose costs are harder to justify today. In some instances, we may be able to shrink the scope of the service to target it to the very neediest or delay delivery of the service until the recovery is stronger. We may find, too, there is no alternative but to eliminate the service. The state has already suspended some services, including:

→ **Health Care for the Working Poor**

The state created the Basic Health Plan to provide partially subsidized health insurance to low-income families who are not eligible for the Medicaid insurance program. In 2009, the state reduced funding due to the souring economy. Today, program enrollees have been asked to pay a higher share of costs, and 40,000 fewer people are now enrolled in the program. In addition, more than 100,000 are waiting for slots in the program to open up.

→ **I-728 Class Size Reductions**

In 2001, voters approved Initiative 728 which directed the state to provide additional funding to school districts to reduce class sizes, enhance professional development of teachers and extend learning programs for students. This money was provided to school districts for several years above and beyond state funding of basic education programs. This supplemental funding has been suspended, which saves \$479 million.

There may be other state activities that could be suspended during these difficult times. For example:

→ **Wildlife and Recreation Land Acquisition**

The Wildlife and Recreation Program began in 1990 as a 10-year, \$500 million program to acquire wildlife and recreational lands before these key landscapes were lost to development. Over the past 20 years, the state has provided \$610 million in bonds for this program. If this program were to be suspended and purchases delayed, some acquisition and protection of important lands in Washington might continue through the state's Trust Land Transfer and other programs.

TRANSFORMING WASHINGTON'S BUDGET

4. DOES THE ACTIVITY NEED TO BE PAID FOR WITH STATE GENERAL FUNDS? SHOULD USERS PAY A PORTION OF THE COSTS?

Many state services are fully paid for by users, such as license fees for those in the health professions, and the banking and credit union industries. Other programs are being transitioned to a user-supported basis, so consumers are charged instead of having the costs passed on to taxpayers, including:

→ **Universal Vaccinations**

The state purchases children's vaccines for medical providers from the federal government at reduced rates, leveraging federal bulk purchasing contracts. The cost of purchasing the vaccines has been covered by the state general fund. This subsidy by the state ended in May 2010, and was replaced by an assessment charged to insurance carriers. The state will use proceeds from the assessments to purchase vaccinations to continue the program.

→ **College Tuition**

The boards of regents and trustees have authority to raise tuition under ceilings set by the Legislature. In the 2009–11 budget, the public four-year universities faced cuts in state funding of around 20 percent. However, with tuition increases of 14 percent per year, the cut to their total budget was less than half of what it was projected to be for 2009–11.

The state should consider whether other services could be more user-supported. For example:

→ **Adult Family Home Licensing Cost Recovery**

Adult family homes provide care to people with developmental disabilities or who are elderly. These facilities maintain a license and charge their residents — or their residents' insurance providers — for care services. The Department of Social and Health Services licenses and monitors these businesses to ensure client safety. The licensing fees charged by the state cover only 4 percent of the costs the state incurs for licensing and monitoring activities. These fees could be raised to cover the full costs of licensing.

→ **Water Rights Services Cost Recovery**

Currently, the state funds about 98 percent of the Department of Ecology's costs to process applications for new, changed or transferred water rights. In addition, the department provides other water-management services at no cost to water-rights holders and other beneficiaries. If comprehensive water management fees could be charged to all water rights holders, or if applicants paid the full cost of processing their water rights requests, the program would be self supported.

→ **Highway and Bridge Tolling**

Tolling imposes a fee directly on users to fund major transportation projects and ease congestion. Washington now has two tolled facilities: the Tacoma Narrows Bridge and the State Route 167 high occupancy toll lanes pilot project. Tolling on SR 520 will begin soon to pay for bridge replacement. The Department of Transportation will consider whether to use tolls to cover portions of other upcoming large projects.

TRANSFORMING WASHINGTON'S BUDGET

5. ARE THERE FEDERAL FUNDS OR OTHER FUND SOURCES AVAILABLE TO SUPPORT THIS ACTIVITY?

We will pursue every possible avenue for funding. While the economy has been tight, the state has looked for appropriate opportunities for financing, including leveraging other funding sources. This includes the following:

→ **Hospital Safety Net Assessment**

In 2010, the Legislature established a safety net assessment fee on services provided by hospitals in Washington, which pay this fee to the state. Fee proceeds allow the state to increase the Medicaid rates it pays to hospitals for services provided to low-income patients. As the federal government matches state funding for the Medicaid program, net public funding to hospitals has increased.

→ **Developmental Disability Employment Services**

The Department of Social and Health Services contracts with private providers for employment support services for nearly 7,700 people with developmental disabilities. Before 2009, the employment services for roughly one-third of these clients were funded exclusively with state money. These individuals were enrolled in a Medicaid waiver services program, which allowed the state to receive federal matching funds.

→ **WaKIDS**

The Department of Early Learning and the Office of Superintendent of Public Instruction have partnered with Thrive by Five of Washington and the Bill & Melinda Gates Foundation to leverage \$493,000 in private funds for this statewide pilot of a kindergarten assessment process.

We will continue to aggressively explore funding from other sources, including private entities, foundations, the federal government and citizens. For example:

→ **Race to the Top**

Washington has applied for \$250 million through this competitive grant program administered by the federal government to kick-start implementation of our own education reform plan. Successful states will be those able to demonstrate how they are implementing meaningful and cohesive reform in their elementary and secondary school systems. Notification of first round winners is expected this summer — those states will then provide additional information to aid in the determination of final winners.

→ **Naming Rights for State Assets**

After agreement upon guidelines, naming rights could be sold for such things as highways, bridges, ferries, public buildings, rest areas and other state-owned or -operated assets.

TRANSFORMING WASHINGTON'S BUDGET

6. ARE THERE MORE COST-EFFECTIVE, EFFICIENT WAYS TO DO THE ACTIVITY?

To save money, many private businesses have consolidated their back office functions. The state, too, is trying new ways of operating. For instance, the state budget office now performs the accounting and bookkeeping functions for 44 small state agencies. We are using new service delivery models, too, to drive down costs and continue to give good customer service. We are looking to expand upon these successes in other areas as we gain experience. These successes include:

→ ***New Licensing Service Options***

The Department of Licensing is projected to save more than \$4 million in 2009–11 because it closed or modified 21 licensing service offices and launched new licensing service options, including expanded online services, by-mail renewals and self-serve kiosks around the state.

→ ***“Lean” Approaches to Service Delivery***

The Department of Social and Health Services has transformed its Community Services Offices through “lean” principles used by a number of top companies, including Boeing, to streamline business processes to achieve high customer service standards with fewer staff. In spite of significant increases in the demand for services for food stamps and other services during the recession, the results of this approach have been a 65 percent reduction in application processing times (from 16 days to 6 days) and a 99.6 percent reduction in interview wait time.

→ ***Water Quality Assistance Program***

The Department of Ecology has used intensive process-improvement techniques to improve its Water Quality Financial Assistance Program, which provides grants, low-interest loans and technical assistance to restore and protect water quality. Customers had expressed concern about the time and steps involved in completing a water-quality project. The agency identified ways to shorten the number of process steps by 51 percent; reduced the number of decision points by 79 percent; cut the time to negotiate and sign agreements with recipients from 12 to six months; and halved the payment-request process from six to three weeks.

We are looking to expand upon these successes in other areas as we gain experience. This includes:

→ ***Examining Worker Benefits Programs***

We will review worker benefits to ensure we are providing them in the most cost-effective, efficient manner possible. In health care, we will examine how to best distribute the cost of benefits between employees and the state to build accountability for healthy lifestyle choices and effective use of health care benefits. In the delivery of workers compensation, we will continue to ensure that injured workers receive effective, high-quality health care with the goal of reducing duration of disability for workers and ensuring low, stable premium costs for our business partners — a task force is working on this now. Our retirement programs will be reviewed for ways to reduce costs, such as taking advantage of a new federal health care program for retirees not yet eligible for Medicare. Finally, our Temporary Assistance for Needy Families — or TANF — program must be re-cast to ensure that those willing to move in new directions get the training they need to find gainful employment.

TRANSFORMING WASHINGTON'S BUDGET

7. CAN THE ACTIVITY BE THE SUBJECT OF A PERFORMANCE CONTRACT?

We will ask how we can tie positive outcomes to what we spend. By tying spending to results, we will ensure that taxpayer money buys services that are proven to work. This will also encourage innovation and efficiency by funding activities that are delivered as designed. Examples of new performance contracts the state is planning include:

→ **Child Welfare Performance-based Contracts**

By July 2011, the Department of Social and Health Services will consolidate more than 1,800 individual contracts to fewer than 100 master service contracts. Current contracts pay providers for services delivered. These new contracts will include clear performance expectations for better outcomes for children and families, and payments to contractors will be ultimately contingent upon achieving outcomes.

→ **Expedited Client Benefit Enrollment**

In 2010, the Governor signed into law a bill to reform the state's General Assistance program — the Disability Lifeline — that provides health care and cash assistance to temporarily disabled adults. The law authorizes the Department of Social and Health Services to contract with private providers to help individuals in applying for federal Supplemental Security Insurance benefits. Contractors will be paid only if clients are successfully enrolled in a benefits program.

The state will continue to explore how to make more effective use of performance contracts. For example:

→ **Consolidated Health Care Purchasing**

If state agencies go together — or pool — their health care purchasing, they could receive lower rates and better benefits. The state is exploring the consolidation of all health care purchasing done by several agencies on behalf of their clients in the Health Care Authority, which now purchases health services for state employees and for the low-income families enrolled in the partially subsidized state Basic Health Plan. If private or other employers were to join the pool, even greater benefits could result. This will drive down costs for the purchasers and lead to higher quality health care for us all.

TRANSFORMING WASHINGTON'S BUDGET

8. CAN THE ACTIVITY BE THE SUBJECT OF A PERFORMANCE INCENTIVE?

U.S. Secretary of Education Arne Duncan recently invited the 50 states to compete for limited Race to the Top funds by demonstrating how they would achieve lasting changes in their education systems. In the same vein, we want to promote and reward the successful delivery of services throughout our state government as well. Several innovative approaches are under way, including:

→ **Student Achievement Initiative**

In 2007, the State Board for Community and Technical Colleges launched a performance-based funding system to provide financial rewards to colleges for increasing student achievement. It represented a shift from funding entirely for enrollments to funding for meaningful outcomes. Between the 2006-07 baseline year and 2008-09, the first performance year, the colleges served 4 percent more students, but increased student achievement by 19 percent, with the greatest gains occurring in basic skills acquisition. All 34 colleges have earned a portion of the \$1.8 million in incentive funding.

→ **Completion of More Highway Projects On-time**

Washington uses incentives that encourage contractors to deliver highway construction projects ahead of schedule and under budget. For each highway project, the Department of Transportation issues a contract that has the right balance of bonuses and penalties. These incentives produce great results. Over the past seven years, 76 percent of contractors finished early or found a cheaper way to deliver more than 1,000 projects. When projects are finished early and contractors get a bonus, it's a win for everyone. Tax dollars are saved, the business gets money that is passed on to workers and we all spend less time sitting in traffic.

→ **Farm-to-Market**

The Farm-to-Market initiative is a new Washington State Department of Agriculture campaign to improve the competitiveness of the state's agricultural enterprises. Nearly 20 Department of Agriculture programs will compete for the director's discretionary portion of federal Specialty Crop Block Grant funding — about \$500,000 per year — by developing proposals that deliver measurable value to Washington's agricultural sector.

The state will continue to explore ways to provide performance incentives. For example:

→ **Incentives for programs**

The Governor launched her program Government Management, Accountability and Performance — or GMAP — in 2005. GMAP collects performance data on a number of key state activities. In some programs that have been reviewed, there is clear variation among outcomes in different regions of the state even though the objectives are the same. Performance might be improved if incentives were made to regional offices with the best outcomes.

TRANSFORMING WASHINGTON'S BUDGET

2011-13 BUDGET DEVELOPMENT TIMELINE

Date	Action
Spring 2010	Committee on Transforming Budget formed
July 19, 2010* Early September 2010	First budget hearing (Tacoma) Agency budget requests due
Sept. 16, 2010	Updated revenue forecast adopted
Nov. 18, 2010	Updated revenue forecast adopted
Mid-December 2010	Governor's proposed budget released
Jan. 10, 2011	Legislature convenes

*Other dates and locations will be added when confirmed.

THE GOVERNOR'S COMMITTEE ON TRANSFORMING WASHINGTON'S BUDGET

A number of leaders drawn from across the state in a host of fields have been invited to serve on this panel that will serve in an advisory capacity to the Governor during the budget development process. The committee's charge is to question budget assumptions, serve as a sounding board and lend guidance. A number of members will be present at each budget hearing to participate in discussions from staff on recommendations and to hear from citizens who offer comments.