

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



**Phase II: Final Report**  
**Executive Summary**

January 2004

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## EXECUTIVE SUMMARY

Governor Gary Locke convened the Washington Competitiveness Council for a second phase to focus on competitiveness issues that required additional study and follow-up. Despite substantial progress in implementing the recommendations contained in the original Competitiveness Council report of January 2002, Governor Locke and the Council chairs felt that additional work was required to ensure that Washington State continues to improve its business climate and its ability to attract and grow jobs.

During the first meeting of Phase II, held in October of 2003, the members of the Competitiveness Council agreed to focus on the human capital and innovation issues critical to the economic recovery and to establishment of Washington as a leader in the innovation economy. Many of the recommendations of the original Competitiveness Council in this area have not been implemented. The Council, therefore, chose to revisit those recommendations, refine them, and reinforce the importance of investing in human capital and innovation for the future of Washington's economy.

In addition, the Council felt that much of the progress made on the original 99 recommendations was in peril without continued progress and vigilance. Thus, the Council chose to identify additional steps related to taxation, infrastructure, and regulations that must be taken to ensure that Washington continues to improve its business climate.

The council divided its work into four issue areas:

- Higher education including access, funding, and workforce training
- K-12 education
- Research, development, and commercialization
- Taxes, regulations, and infrastructure

This executive summary contains the primary findings and recommendations of the Council within these four areas. It also provides minority opinions where consensus could not be reached.

A complete list of the Council's recommendations concludes the Executive Summary.



# **Higher Education: Access, Funding and Workforce Training**

## **Council Long-Term Vision**

Washington State provides a higher education system that enhances the competitiveness of our state's businesses by providing a highly trained and educated workforce that will meet employer needs now and in the future.

State colleges and universities improve the competitiveness of our state's citizens by providing access to the quality education and training needed for high skill, family wage jobs.

Washington's higher education system and its residents value the important role that research plays in providing a catalyst to create and expand Washington businesses.

## **Council Findings**

Demographics and increasing educational requirements of many professions are creating greater demand for postsecondary education and training. Washington's higher education system does not currently have the capacity to meet that demand. The lack of sufficient capacity in Washington's higher education system is a result of insufficient resources and ineffective allocation of existing resources.

## **Council Recommendations**

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

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

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

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

## **K-12 Education**

### **Council Long-Term Vision**

Washington State's world-class education system provides every child an environment in which to learn and thrive, from early learning through higher education.

Washington State provides its citizens a public school system that is accountable not only for learning, but also for increasing the state's competitiveness and decreasing poverty.

### **Council Findings**

Washington's leaders have long recognized that an excellent K-12 education system is a key component of a long-term strategy to improve the lives of Washington residents. Recently, improvements have become more urgent as leaders and residents recognize the importance of education to the quality of lives and to the competitiveness of Washington's businesses.

Although several advances have been made in K-12 education since the first Competitiveness Council report, the Council reiterates its call for K-12 reform and advances a short-term agenda that must be accomplished to ensure continued momentum in K-12 reform.

The Competitiveness Council does not dismiss longer-term goals for K-12 education that have been advanced by a variety of groups. The Council will continue to consider longer-term issues while promoting a short-term agenda that provides the building blocks for future reform.

### **Council Recommendations**

- Include a Certificate of Mastery as a high school graduation requirement. Define Certificate of Mastery as passage of high school WASLs in Reading, Writing, Mathematics in 2008 and add Science in 2010. Offer multiple opportunities for students to pass the WASLs and provide for alternative and/or appeal means to demonstrate required mastery.
- Focus the Learning Assistance Program (LAP) to target resources more efficiently, provide incentives for improvement, and offer technical assistance for struggling schools/districts.
- Create a new class of independently operated educational units within the common school system. School districts, educational service districts and state or

regional universities can sponsor these schools. Hold these schools to the same academic standards and WASL requirements as are required for other public schools.

- Expand the calculation of the levy base to account for state funding downturns for the purpose of determining school district maximum levy authority.
- Examine how existing early childhood education programs, including Head Start, Early Childhood Education and Assistance Program (ECAP), the Working Connections Child Care Program, and child care quality investments can become more efficient and effective by better coordinating their services.
- Engage members of the Competitiveness Council in the dialogue about changes in the system for funding education from preschool to graduate school. The Council should ensure that competitiveness be one of the criteria for identifying priority needs and potential effective funding sources
- Continue to support additional preparation and incentives for math and science instruction and additional student learning opportunities.
- Support in the long run the best practices for closing the achievement gap, including increased student access to advanced coursework in science, math, and English; smaller, more personalized learning environments and extended learning opportunities for students; and increased attention to shortages of teachers in selected subject areas and/or regions.

# **Research, Development and Commercialization**

## **Council Long-Term Vision**

Washington's research institutions are recognized as world-class in their fields of excellence, and are actively engaged in attracting, leveraging and collaborating on important scientific and technological opportunities.

The intellectual property created in Washington State renews our current industry clusters and lays the foundation for the companies and industries of the future by supporting new business formation and growth.

Excellence in research, development and technology commercialization is an enduring source of our state's competitive advantage.

## **Council Findings**

Washington invests very little state funding in research and development. This can become an impediment to our competitive position in the innovation economy as other states and regions invest to acquire science and technology assets through carefully planned, government-supported strategies.

Washington's tax structure provides a difficult environment for innovation, because the B&O tax requires that taxes be paid before a company is profitable.

Technology transfer from the state's research universities to the private sector is an important source of innovation, new products, and new, fast-growing companies. But many factors currently hamper the effectiveness of Washington's universities in maximizing the commercial potential of their technologies and in recruiting scientists that excel at finding commercial markets for their work.

Washington needs a strategy for ensuring that the physical facilities required by technology companies are available and for expanding its existing federal R&D assets.

## **Council Recommendations**

- Washington must substantially increase state support for research at the academic research institutions. State funding should be coordinated to accomplish specific strategic objectives such as attracting and retaining top scientists, funding key facilities and equipment, and providing match to increase federal funding.
- Washington should extend the two R&D exemptions scheduled to expire in 2004: the sales tax deferral/exemption and the B&O tax credit for R&D. Washington should also stop taxing federal grants provided to small businesses through the SBIR and STTR programs.

- Washington should develop a comprehensive strategy for improving the transfer of university-developed technology to the private sector.
- Washington needs to assess whether start-up technology companies have access to sufficient specialized physical infrastructure and technical assistance to accommodate their growth, and if not, determine how this infrastructure might be expanded.
- Washington needs to disseminate information about its unique assets in health care information infrastructure as a vehicle for attracting additional federal resources.
- Washington should develop a plan for strengthening its existing research capacity by attracting additional federal laboratories or expanding existing programs.

# **Taxes, Regulations, and Infrastructure**

## **Council Long-Term Vision**

Citizens and businesses in Washington benefit from a tax system that balances revenue needed for essential services with a competitive tax environment that provides ease of application and consistency with other states.

Washington's regulatory structure reflects its residents' values, including protection of the environment, worker safety, and consumers, while providing regulatory certainty for business and a positive attitude about customer service.

Transportation, water, and energy infrastructure in Washington support a thriving and growing economy.

## **Council Findings**

Despite significant progress, Washington must continue to improve its business climate or Washington's business competitiveness will suffer.

The 10-year transportation package passed by the legislature in 2003 was a good start, but it covers only a fraction of Washington's transportation needs. Without new revenue, critical competitiveness issues, including freight mobility, cannot be fully addressed.

Washington's existing tax incentives for research and development have contributed to the growth of the industry.

The Priorities of Government approach used to craft the 2003-2005 state budget reduced the magnitude of the budget crisis in Washington compared to many other states. However, the process was new and has not yet been fully accepted or institutionalized.

The Department of Ecology has taken many positive steps toward improving the regulatory environment in Washington State. However, these gains could be short-lived. Furthermore, other agencies have yet to progress as far as the Department of Ecology.

Washington's economic development leaders lack many of the tools that other states routinely use to attract and retain business. Furthermore, Washington's rural areas face inevitable disadvantages in developing a diversified economy with high-paying jobs.

Workers' compensation costs in Washington are comparatively low, but recent cost increases pose a potentially dangerous competitive disadvantage that must be addressed.

Washington's tax system places a greater share of the tax burden on business compared to many other states; this can have a negative impact job creation and retention.

Washington's ports are an important source of competitive advantage and we must identify and eliminate any obstacles to the competitiveness of our ports.

## **Council Recommendations**

- Provide additional statewide and local funding solutions for transportation problems, including greater local government authority and flexibility for local-option tax and public/private partnerships. Increase the state gas tax by 3 to 5 cents in the 2004 legislation session. Some funding should be dedicated to freight mobility.
- Support the extension of statewide tax credits for R&D and rural-area sales tax exemptions in the 2004 legislative session. Expand the sales tax exemption to include university research facilities.
- Develop the tools needed to continue the Priorities of Government budgeting process. Ensure that this approach is used in the 05-07 budget.
- Strengthen existing efforts at permit streamlining and regulatory reform by providing greater authority to the Office of Regulatory Assistance to establish and monitor benchmarks and share best practices among agencies and levels of government.
- Support the passage of the Governor's EDGE proposal in the 2004 legislative session. This proposal should include several safeguards including an open public process for TIF projects and protection of school district tax revenues.
- Support the extension of the rural tax credits for construction of manufacturing and technology facilities in rural areas.
- Develop a forum to discuss further reform of the workers' compensation system. Through that forum, develop a package of proposals agreed to by labor and business to be brought forward in the 2005 legislative session.
- Examine alternative state and local tax structures, including personal and corporate income tax, with the goals of developing a distribution of taxes more similar to other states, decreasing the business tax burden, and increasing the stability of the revenue system.
- Ensure the continued competitiveness of the ports. Guard against government or private attempts to pursue land use changes on property adjacent to ports that would lead to incompatibility with port operations or intended port use or would otherwise result in additional port burdens and costs. Protect ports and airports of statewide significance from user fees, unreasonable mitigation costs, or other burdens potentially damaging to ports' competitiveness and ability to attract trade, passengers and economic development.

## Minority Views

**Creating charter schools, or independently operated education units, will not improve the competitive environment of the state.** Furthermore, voters have twice rejected charter schools proposals (1996 and 2000). Under present law, Washington's school districts are allowed the flexibility to provide various forms of alternative educational opportunities; other states may not have had this flexibility. There is little accountability for charter schools. They are not required to have the same transparency as public schools. They will not have publicly elected boards even though they will use public funds. The local school districts can be forced to accept a charter school but have no control over it.

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

**Public protections should be required before the R&D tax incentives are reinstated.** The protections should include:

- Clear identification of the public purpose of the exemption as well as measurement standards to gauge whether the purpose is met;
- Information about employment, wages, and benefits;
- Claw-back provisions if the exemption or deferral is not used as specified in law;
- Proof that the company actually needs the exemption in order to carry on R&D;
- Job quality standards which require wages of at least the county average wage and employer paid health care and pension benefits;
- Time limitation on individual companies receiving the exemption; and
- Redefinition of proprietary information and public disclosure of companies receiving the exemption and their track record in achieving the purpose of the exemption.

**The POG process was not representative of all interest groups.** The labor community could consider institutionalizing the POG process if labor and groups representing various community interests were included in the assessment and evaluation process and if the process also included an assessment and evaluation of state tax expenditures (exemptions). The 2002 process included only government and some businesses and only looked at one side of the fiscal equation.

**Any expansion of tax increment financing must include public protections.** The members of the Council representing labor will only consider the TIF legislation if the following additional public protections are included:

- Open public process for establishing TIFs.
- Protection of local school revenue.
- TIF infrastructure development done at prevailing wages.
- Company specific disclosure of wages by wage bands and employer provided health and retirement benefits.
- Anti-displacement language to protect local businesses and workforces; and
- Local hire agreements.

**The Competitiveness Council is not the appropriate venue for discussing changes to workers compensation.** A workers compensation forum must include a more balanced representation of labor, business, and other interested parties.

**A discussion about an income tax must be part of a larger discussion about revenue needs and fairness.** Labor has long supported a progressive income tax in Washington State. We have not however taken a position on a flat rate income tax. More importantly, labor does not agree that the purpose of considering an income tax is to lower the share of taxes paid by businesses. A discussion about an income tax must be part of a larger discussion about revenue needs and fairness.



# COMPETITIVENESS COUNCIL RECOMMENDATIONS

## Higher Education: Access, Funding, and Workforce Training

Issue	Recommendations
Increase access to colleges and universities sufficient to cover current over-enrollment and projected demographic increases.	<p><b>Short-Term</b></p> <ul style="list-style-type: none"><li>• Create a plan to expand higher education in the two- and four-year sectors that recognizes the needs of students, supports statewide and regional economic development strategies, and considers forecasts of labor market supply and demand.</li><li>• Direct appropriate boards to develop and maintain supply and demand forecasts to anticipate demographic changes and workforce needs. Boards should also include information about the types of coursework, apprenticeships, certificates and degrees required to meet student and employer demand, consistent with statewide and regional economic development strategies.</li><li>• Provide funding for capital construction at state colleges and universities, as envisioned by the Evans/Gardner plan, to create instructional space to accommodate increased enrollments and research capacity to support statewide and regional economic development strategies.</li></ul> <p><b>Medium-Term</b></p> <ul style="list-style-type: none"><li>• Increase enrollments and acceleration opportunities consistent with the expansion plan designed in the short-term.</li><li>• Direct the HECB to develop a plan to utilize existing capacity in the private colleges and universities. The plan should include provisions that hold the institutions accountable for meeting specific performance goals.</li></ul> <p><b>Long-Term</b></p> <ul style="list-style-type: none"><li>• Monitor and adjust enrollments and acceleration opportunities, in keeping with student and workforce supply and demand reports.</li><li>• Expand physical capacity, distance learning opportunities, and extended use of existing facilities to accommodate increased access.</li></ul>



## COMPETITIVENESS COUNCIL RECOMMENDATIONS

Issue	Recommendations
Secure funding sufficient to meet access, quality, workforce training, and competitiveness goals.	<p><b>Short-term</b></p> <ul style="list-style-type: none"><li>• Prioritize the state’s existing resources to provide funding to support additional general and high demand enrollments.</li><li>• Raise public awareness about the vital role higher education and research play in the social and economic health of our state, and educate citizens about the real cost of instruction (i.e., state subsidy and tuition).</li><li>• Provide incentives and management flexibility for state colleges and universities to constrain higher education costs through innovative and cost-effective strategies.</li><li>• Establish compacts between the state and our public colleges and universities that hold the institutions accountable for meeting specific performance goals in exchange for additional funding and flexibility.</li><li>• Explore additional tuition-setting authority for institutions, which could include a graduated subsidy model at universities provided that additional financial aid is guaranteed for low- and middle-income students.</li></ul> <p><b>Medium-Term</b></p> <ul style="list-style-type: none"><li>• Secure sufficient revenues to support the higher education expansion plan. A combination of sources will likely be needed including funds derived from prioritizing existing resources, savings generated by institutional reforms, tuition flexibility, and new state revenue.</li><li>• Propose a source of revenue to the legislature for higher education. This revenue source should have the following attributes:<ul style="list-style-type: none"><li>✓ Primarily derived from individuals (in light of our state’s disproportionate tax burden on business at present);</li><li>✓ Non-regressive (impacting individuals who benefit from higher education most, such as those with higher income);</li><li>✓ Responsive to inflation and growth.</li></ul></li></ul> <p><b>Long-Term</b></p> <ul style="list-style-type: none"><li>• Periodically review the performance goals established in the short-term.</li></ul>

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# COMPETITIVENESS COUNCIL RECOMMENDATIONS

## K-12 Education

Issue	Recommendations
<b>Short-Term</b>	
Certificate of Mastery/WASL	<ul style="list-style-type: none"> <li>• Include a Certificate of Mastery as a high school graduation requirement.</li> <li>• Define Certificate of Mastery as passage of high school WASLs in reading, writing, and mathematics in 2008 and add science in 2010.</li> <li>• Offer multiple opportunities for students to pass the WASLs and provide for alternative and/or appeal means to demonstrate required mastery.</li> </ul>
Learning Assistance Program	<ul style="list-style-type: none"> <li>• Provide greater focus to LAP to target resources more efficiently, provide incentives for improvement, and offer technical assistance for struggling schools and districts.</li> </ul>
Charter Schools	<ul style="list-style-type: none"> <li>• Create a new class of independently operated educational units within the common school system, sponsored by school districts, educational service districts, or the state or regional universities. Hold these schools to the same academic standards and WASL requirements as are required for other public schools.</li> </ul>
Levy Changes	<ul style="list-style-type: none"> <li>• Expand calculation of the levy base to account for state funding downturns for the purpose of determining school district maximum levy authority.</li> </ul>
Reform/consolidation of early learning programs	<ul style="list-style-type: none"> <li>• Examine how existing early childhood education programs can become more efficient and effective by better coordinating their services.</li> </ul>
<b>Medium-Term</b>	
Education funding	<ul style="list-style-type: none"> <li>• Engage members of the Competitiveness Council in the current dialogue about changes in the system for funding education from preschool to higher education. Ensure that competitiveness is one criterion for identifying priority needs and potential funding sources.</li> </ul>
Math and science instruction	<ul style="list-style-type: none"> <li>• Support additional preparation and incentives for math and science instruction and additional student learning opportunities.</li> </ul>
<b>Long-Term</b>	
Compliance with No Child left behind act of 2001	<ul style="list-style-type: none"> <li>• Increase student access to advanced coursework in science, math and English</li> <li>• Provide smaller, more personalized learning environments and extended learning opportunities for students.</li> <li>• Increase attention to shortages of teachers in selected subject areas and/or regions.</li> </ul>



# COMPETITIVENESS COUNCIL RECOMMENDATIONS

## Research, Development, and Commercialization

Issue	Recommendations
<b>Short-term</b>	
State support for research and development	<ul style="list-style-type: none"> <li>• Provide more state funding for strategic R&amp;D investment in scientists, facilities, equipment, and match for federal funding.</li> </ul>
Tax treatment of research activity	<ul style="list-style-type: none"> <li>• Extend the retail sales tax deferral/exemption on research facilities and the B&amp;O tax credits for R&amp;D.</li> <li>• End the taxation of federal SBIR and STTR grants.</li> </ul>
<b>Medium-term</b>	
University technology transfer	<ul style="list-style-type: none"> <li>• Develop a comprehensive strategy for technology transfer within 12 to 18 months.</li> </ul>
Startup company infrastructure	<ul style="list-style-type: none"> <li>• Conduct a gap analysis to identify needs for specialized infrastructure and facilities for startup technology companies.</li> </ul>
<b>Long-term</b>	
Leveraging existing health-care infrastructure	<ul style="list-style-type: none"> <li>• Inform researchers and investors of the opportunities afforded by Washington’s health care information infrastructure as a vehicle for attracting federal funding.</li> </ul>
Expanding and marketing existing research capacity	<ul style="list-style-type: none"> <li>• Encourage the retention, expansion, coordination, and promotion of Washington State’s wide-ranging capacity in research, including recruitment of new R&amp;D facilities and expansion of existing federal programs.</li> </ul>



# COMPETITIVENESS COUNCIL RECOMMENDATIONS

## Taxes, Regulations, and Infrastructure

Issue	Recommendations
<b>Short-term</b>	
Transportation Funding	<ul style="list-style-type: none"> <li>• Pass a regional transportation investment and finance plan.</li> <li>• Provide greater local government authority and flexibility for local-option gas tax and other financing mechanisms.</li> <li>• Increase the state gas tax 3 to 5 cents during the 2004 legislative session and provide additional increases thereafter.</li> <li>• Dedicate some portion of new transportation funds to freight mobility.</li> </ul>
Taxation of R&D	<ul style="list-style-type: none"> <li>• Renew the R&amp;D sales and B&amp;O tax incentives set to expire in 2004</li> <li>• Include university research facilities as eligible beneficiaries of the sales tax exemption.</li> </ul>
Budget process	<ul style="list-style-type: none"> <li>• Develop the tools needed to continue the Priorities of Government budget process. Ensure that this approach is used in the 2005-07 budget.</li> </ul>
Regulatory Performance Measurement	<ul style="list-style-type: none"> <li>• Amend the powers of the Office of Regulatory Assistance to include establishment and monitoring of permit timelines and benchmarks for permitting agencies.</li> <li>• Monitor the Department of Ecology's progress for improvement of customers service and for permit benchmarking.</li> <li>• Adopt regulatory performance benchmarking for other agencies.</li> <li>• Share best practices among state and local agencies.</li> </ul>
Tax Increment financing	<ul style="list-style-type: none"> <li>• Support the passage of the Governor's EDGE proposal in the 2004 legislative session. This proposal should include several safeguards including an open public process for TIF projects and protection of school district tax revenues.</li> </ul>
Rural Technology Development	<ul style="list-style-type: none"> <li>• Renew the tax exemption expiring 12/31/2003.</li> </ul>
<b>Medium-Term</b>	
Workers' Compensation	<ul style="list-style-type: none"> <li>• Develop a forum to discuss further reform of the workers' compensation system. Through that forum, develop a package of proposals agreed to by labor and business to be brought forward in the 2005 legislative session.</li> </ul>
Taxes and Revenue	<ul style="list-style-type: none"> <li>• Examine alternative state and local tax structures, including personal and corporate income tax, with the goals of developing a distribution of taxes more similar to other states, decreasing the business tax burden, and increasing the stability of the revenue system.</li> </ul>
<b>Long-Term</b>	
Competitiveness of the Ports	<ul style="list-style-type: none"> <li>• Ensure the continued competitiveness of the ports. Guard against government or private attempts to pursue land use changes on property adjacent to ports that would lead to incompatibility with port operations or intended port use or would otherwise result in additional port burdens and costs. Protect ports and airports of statewide significance from user fees, unreasonable mitigation costs, or other burdens potentially damaging to ports' competitiveness and ability to attract trade, passengers and economic development.</li> </ul>