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National Review

June 08, 2009

LENGTH: 2525 words

HEADLINE: Mitch the Knife - At OMB they called him 'The Blade' -- and now he's taking a scalpel to Indiana's budget.

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BODY:

If you look up Indiana's Gov. Mitch Daniels on YouTube, you'll find a video from late March of him sitting in a rural diner, sleeves rolled up, buttering a biscuit and relating in detail how a new, cutting-edge clean-coal plant will benefit the state. "We spend more than a billion dollars a year to pay for coal from out of state," Daniels says. As the Hoosier hunched over the lunch counter nods in agreement, Daniels methodically explains that the plant will employ a process called "coal gasification" to exploit the state's coal reserves more efficiently, creating jobs and lowering utility bills.

The video is typical of Governor Daniels: not exactly thrilling, but full of substance and detail. It's a refreshing performance in the Age of Obama, which has seen soaring rhetoric elevated over the less dramatic business of competent governance. Rather than a gift for lofty oratory, Daniels has a résumé with "technocrat" written all over it. He was the head of the Office of Management and Budget from 2001 to 2003, the CEO of the Hudson Institute think tank, a top executive at the Eli Lilly pharmaceutical company, and an aide to Sen. Richard Lugar of Indiana. It turns out that a lifetime spent learning to grasp and elucidate complicated policy and technological details is pretty good preparation for public office.

Indiana's voters seem to appreciate Daniels's careful attention to detail: The most recent poll, released on April 7 -- Daniels's 60th birthday -- shows the governor with an approval rating of 69 percent. More telling, the same poll shows that his approval rating has climbed five points since the end of September, while nearly all the nation's other governors, Republicans and Democrats alike, saw their popularity decline with the ailing economy. And last November, as Obama became the first Democratic presidential candidate to win Indiana in 44 years and Republicans nationwide suffered an electoral bloodbath, Daniels was elected to a second term by an 18-point margin. He earned 24 percent of the Democratic vote, representing a significant crossover of Obama supporters. He even won in his Democratic opponent's home county.

For those wondering how a conservative Republican governor is achieving success in the face of the prevailing political and economic headwinds, the short answer is this: Daniels has been extraordinarily successful at implementing innovative and effective public policy. His inventive, results-driven approach has been complemented by genuine fiscal discipline, and that combination has produced a dramatic turnaround for a state whose fiscal woes seemed insurmountable only a few years ago.

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When Daniels became Indiana's first Republican governor in 16 years, the state was running an \$800 million deficit. The financial situation was dire, but there was deep resistance to reform. "In Indiana, there are nine deadly words: 'But we have never done it that way before!'" says Richard Mourdock, Indiana's treasurer. "That's all we heard the first two and a half years: 'He wants to change everything!'"

The biggest change was dealing with Indiana's poorly managed toll road, which runs across the northern part of the state and connects Chicago to Ohio. The turnpike frequently had operated at a loss, and had generated a paltry \$130 million of income above operating expenses over 50 years.

"We looked at every option," Daniels explains. "I remember starting with over 30 options. We didn't even rule out a gas-tax increase. But it was obvious to me that the single best way to do this, if we could pull it off, was what we finally did." And what they finally did was sell a 75-year lease to a European company to operate the toll road, putting \$3.85 billion into Indiana's coffers in the process. Daniels called it the "Major Moves" plan.

"On the day we got the bid, I really thought this thing was so obviously in the public interest that it would not be controversial," Daniels says. "I guarantee that when I said, 'And the high bid was \$3.85 billion,' all the air went out of the room, and people clapped their hands. At that moment there wasn't a journalist, politician, road builder, union guy -- we had them all in the room -- who didn't think this was going to be an absolute slam dunk." Daniels was wrong. Leasing a major thoroughfare to a foreign company was something the state had never done before. Just 14 months into his term, there was a major public outcry over the deal. But Daniels held firm as his approval rating dropped 18 points, to 37 percent.

Slowly, the public and the legislature came around to what Daniels calls the "screaming obvious business sense" of the deal -- that \$3.85 billion would throw off more money in interest in one year than the toll road had earned in the previous 50 years. "People still look at me and say, 'Was that a good deal?'" Mourdock says. "Yeah, I think that was a damn good deal."

Major Moves was only one part of the state's financial turnaround. Old-fashioned fiscal discipline has ensured that the state is now running a \$1.3 billion budget surplus -- not counting the toll-road windfall. "None of that money went to cure our budget issues," Daniels explains. "That was done with spending restraint. Like the federal government, we had a twin deficit, too: a fiscal deficit and a transportation deficit." In Indiana, transportation projects are funded separately from the general budget, with a dedicated gas tax and motor-vehicle license fees. The Major Moves money will erase the transportation segment of the state's deficit and fund major investments in public infrastructure, with \$500 million set aside to generate revenue in a permanent trust.

It may throw some light on Indiana's newfound spending discipline to know that Daniels earned the nickname "The Blade" while running OMB, and he hasn't been afraid of flashing a little steel at Indiana's legislators to get drastic spending cuts. Since 2005, more than \$250 million in unnecessary spending has been trimmed from state government, and \$190 million was saved by renegotiating 30 state contracts. Daniels has more than halved the state's rate of spending growth, from 5.9 to 2.8 percent.

Rejecting what he calls financial "gimmickry," Daniels says that the state has now had three "honestly balanced" budgets in a row. As the governor tells it, Indiana had been "stuffing money in the side drawer -- in essence postponing payments into the next fiscal year, so it looked like you were closer to balance -- and raiding pension funds and things like that." In the last three years, the state has repaid \$760 million to schools and local governments that had been appropriated to finance the state's deficit spending. Last year Standard & Poor's raised Indiana's credit rating to AAA for the first time.

That dislike of gimmicks is a big part of why Daniels resents the \$787 billion federal stimulus bill. "There are oceans of dollars in there that have nothing to do with stimulating the economy. I recognize that stuff -- it's been in David Obey's bottom drawer for 20 years. He finally got a chance to pull it out and inflict it on us," he says, referring to

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the Wisconsin congressman who authored the stimulus bill. Daniels recently called together state officials to outline strict accountability measures for the money from the bill that will come to Indiana.

But even with all this improvement, Indiana is not out of the economic woods. According to the Center for Budget and Policy Priorities, the worsening economic climate means that 47 states -- including Indiana, despite its current surplus -- face potential budget shortfalls in the coming years. Daniels has rolled out a plan designed to keep the state in the black, including a 3 percent across-the-board spending cut for state agencies and a moratorium on pay increases for state employees. So far, he's been able to do this without raising taxes or gutting government services. On the contrary, he has overseen the creation of new state health-care initiatives, including a subsidized prescription-drug program and new health savings accounts designed to get people off of Medicaid. Indiana has added 800 child-welfare caseworkers and put 250 more state troopers on the road.

Another piece of the recovery puzzle is economic growth: Over the last two years, Indiana has attracted \$15 billion in foreign investment -- more than any other state -- with two Toyota plants, a Honda factory, a \$500 million Nestlé facility, and a British Petroleum project that will bring \$3.8 billion to the state as part of an effort to harness fuel from the tar sands of western Canada.

Neil Pickett, a health-care executive in Indianapolis, says that implementation is something of an obsession with Daniels. Pickett should know: He worked with Daniels in state government, at Eli Lilly, and at the Hudson Institute. He says the governor has a gift for "leveraging what he's learned from all kinds of places to apply his knowledge in interesting ways." He also says Daniels has a wonky command of policy details down to the "granular level" -- a governor who knows off the top of his head how many cars are in Indiana's state fleet.

But Daniels is an experimenter, and some of the governor's innovations might give conservatives pause. "In his first term, he came up with a proposal to add a surtax to people earning over \$100,000 a year," says one observer close to Daniels. "Once he got into office, I think he realized the severity of the financial difficulties facing the state. And he, in his usual way, wanted to act quickly and decisively. So he made a proposal that in retrospect I think he would probably agree wasn't the best approach. He never seemed able to live that down in certain conservative circles. Cato and the Wall Street Journal have seemed to hold it against him in way that I think is very unfair and shortsighted." The 2008 Cato Institute Fiscal Policy Report Card on America's Governors gave Daniels a B, noting, "In his first year in office, he proposed a temporary increase in the top income tax rate."

Wonky competence goes only so far in politics, and Daniels, though far from your typical glad-handing politician, is not without a certain low-key charisma. His speeches are exceedingly well crafted and he employs his dry Midwestern wit to great effect. And Daniels has not neglected retail politicking, covering the state's 92 counties on his motorcycle, accompanied by a motor home that carries his campaign staff. That 18-point landslide last November incorporated more than the traditional GOP constituencies: Daniels is a Republican who won 20 percent of the black vote -- up from 7 percent in his first election -- and led in every age group, winning the under-30 vote 51-42 percent. By contrast, McCain carried just 35 percent of that age group in Indiana. Daniels won the 65-and-older demographic by a whopping 36 percentage points.

Politics is usually less ideological at the state level, but Daniels has taken care nonetheless to distinguish himself from Washington's Republican establishment. "I think we have defined the Republican party in a different way out here," he says. "I've always spoken of us as a party of purpose. If we lose our energy, if we lose our claim to be the reform party and the party of new ideas, then we'll be excused from duty. We have operated on the principle that you have to be defining the issues, and offering the next idea, and trying to force the advocates of the status quo to react to you."

But there's also a lesson in Indiana for Washington Republicans, Daniels argues. "I do think the Indiana experience of the last few years, including right now, does demonstrate that principles we have always labeled 'conservative' are still very viable. I guarantee that the principles of fiscal caution and conservatism have not gone out of style," he says.

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And he argues that his major reforms are conservative at their core. "Our health-care plan is health savings accounts for poor people. Our telecommunications policy is deregulation. Our infrastructure policy was the biggest privatization in state history." But he avoids using the words "conservative" and "liberal" to characterize his innovations. "We just talk about change and progress, and it happens to always be animated by a belief in limited government and the principle of freedom. But we don't express ourselves in ideological terms," Daniels says. "We try to never miss a chance to define what we're doing in terms of the least fortunate citizens or the average taxpayer. In this state, at least, it has been a formula for the only success that matters to us -- real change and real results. Incidentally, we got reelected." As Michael Barone observes, "Daniels talked about 'change' in 2003 before 'change' was cool."

Daniels suggests the national Republican party has put the political cart before the policy horse -- the most effective advertisements for conservative ideas are results. "I have always believed and argued measured provable performance and effective spending ought to be a goal that unites advocates of limited government and advocates of expansive government. To me, it's a completely philosophically neutral objective," he says. "If you're a committed limited-government person as I am, then I suppose it's obvious you would want to do this. But I argue to my most liberal friends: 'You ought to be the most offended of anybody if a dollar that could help a poor person is being squandered in some way.' And some of them actually agree."

Daniels has received relatively little national attention for his work in Indiana, but his successes haven't gone entirely unnoticed. A handful of shrewd political observers, such as Michael Barone and Bill Kristol, have floated his name for higher office. But Daniels says that is off the table. His final campaign ad from last year begins with him looking straight at the camera and declaring: "Whatever your outlook on politics, here's some good news. This is the last time you'll have to watch me in an ad like this. See, governor is the only office I've run for, or ever will." And he remains firm when asked about presidential aspirations, or even about replacing his old boss, Richard Lugar, in the Senate. He responds that he still has plenty of work to do as governor: Indiana is the country's most manufacturing-intensive state, and its unemployment rate has hit double digits. Daniels says that this problem, and not the White House, is occupying his attention. "I sought to be hired for a four-year job and I'm duty-bound to do that," he adds.

Mourdock, the Indiana treasurer, is among those who would like to change Daniels's mind. The governor's skills are needed beyond Indiana, and the national Republican scene isn't exactly ablaze with rising stars. "There are a lot of us that hate that ad," Mourdock says, "and have frankly suggested to him, 'You know, the nation could use you, Mitch.'" And the governor's response? "He said, 'Richard, I thought you were a friend. No friend would ask another to do such a thing.' He's really not looking to be in the spotlight. But I ended the conversation by noting that he didn't say no."

LOAD-DATE: May 26, 2009