Pataki Calls for Income Tax Cuts in NY
by David Pietrusza
New York Gov. George Pataki’s (R) proposed budget for 2006-07 calls for hefty spending increases, significant new personal and corporate income tax cuts, and a new state-funded property tax rebate for homeowners in school districts that agree to cap spending.

The governor has announced he will not seek a fourth term in office, so the

NEW YORK p. 18

Public-Sector Pension Crisis Worsens
by Adam B. Summers
While private-sector pension terminations and freezes are grabbing headlines, the situation is every bit as grave for government pension systems.

Like many of the remaining traditional defined-benefit pension plans in the private sector, government pension plans are swimming in red ink. As of January 25, 2006, the National Association of State Retirement Administrators and National Council on Teacher Retirement reported an aggregate unfunded liability

CRISIS p. 13

Oil Industry Posts Record Profits in 2005
by Steve Stanek
Record profits reported in January by ExxonMobil Corp. and other major oil companies have prompted renewed calls for a “windfall profits” tax on the oil industry ... but analysts say such a tax would harm an industry that is spending tens of billions of dollars on capital improvements and pollution controls.

“You need to make money to spend money,” said oil industry analyst John Parry, senior vice president of John S. Herold, Inc. of Norwalk, Connecticut. “If

PROFITS p. 16

Georgia Governor Gives up Tax ‘Windfall’
Welcome tax break gives residents lower winter heating costs
by Benita M. Dodd
One of the first actions of Georgia legislators when they convened for the 2006 session was to approve Republican Gov. Sonny Perdue’s executive order for a temporary cut of the state sales tax on natural gas and liquid propane gas for residential use. Perdue had issued the executive order on January 25.

The Georgia Public Service Commission, which monitors natural gas prices, had predicted a 23 percent increase in residential energy bills, and Perdue insisted, “State government should not reap a financial windfall because of unfortunate market conditions causing the cost of natural gas and liquid propane to rise.”

Natural gas prices in particular have soared because supplies are not keeping up with demand, an ongoing challenge exacerbated by hurricane-related damage from 2005.

Perdue’s executive order, issued in December, noted, “Under these circumstances, where a precipitous inflation in the price of essential commodities results in a windfall in tax revenues to the state, it is incumbent that such a surplus be returned to the taxpayers of Georgia.”

GEORGIA p. 4
**Education and Capitalism**

How Overcoming Our Fear of Markets and Economics Can Improve America’s Schools

By Herbert J. Walberg and Joseph L. Bast

“Walberg and Bast have written a scholarly, readable, and timely book that cogently explains how market competition can promote school improvement. I recommend it as a college-level text in economics, education or public policy, and to anyone who cares about the education of our children.”

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*Make a Difference* is both a compelling memoir and convincing proof that we now know important answers to help solve America’s poverty problem—without spending any more of the taxpayers’ money.

Author Gary MacDougal spent years working in Illinois inner cities and rural communities—talking with “ladies in the backyard,” befriending community leaders, and working with local organizations in his quest to find solutions that have long eluded academic researchers and politicians. As chairman of the Governor’s Task Force on Human Services Reform, MacDougal was the catalyst for the complete overhaul of the state’s welfare system, which included the largest reorganization of state government since 1900.

Eight years after MacDougal’s suggestions were implemented, Illinois now stands well ahead of California, New York, and other big-city states, with a spectacular 86 percent reduction in the welfare rolls since reform implementation in 1996, second only to Wyoming among all fifty states. The welfare rolls in Chicago’s Cook County have been reduced an amazing 85 percent, with studies showing that most who left the rolls are working, and at pay above minimum wage.

MacDougal’s extraordinary journey shows the way for the rest of the nation and proves there are ways we can all help provide a ladder of opportunity for those in poverty. We each can *Make a Difference* in the ongoing effort to end America’s poverty problem.
‘Stop Over Spending’ Initiative Rolls on in Oklahoma

by Tim Gillespie

Taxpayer advocates in Oklahoma started the new year by announcing they had gathered more than 300,000 signatures to put the Stop Over Spending (SOS) initiative on the November ballot, some 80,000 more signatures than they needed.

The SOS initiative is the proposed Oklahoma Taxpayer Bill of Rights amendment. The secretary of state must certify the signatures, and legal challenges are expected as soon as that process is completed. In the meantime, opponents of SOS are attacking the initiative.

The Oklahoma Education Association (OEA) states on its Web site (http://www.okea.org) that Oklahoma legislators are already bound by “comprehensive tax and spending limits.” The 12 percent limit—which the OEA refers to as “comprehensive”—allows state government spending to double every six years.

Growth Outstrips Economy

“The OEA’s claim that state government has ‘grown in line with the state’s economy’ simply is not accurate,” said Rick Carpenter, president of Oklahomans in Action, which supports the SOS initiative. “In 2001, [state] government grew at almost 10 percent. That same year the economy grew by only 4 percent. You cannot allow government to grow at two or three times the rate of the economy.”

According to Brandon Dutcher, vice president for policy at the Oklahoma Council on Public Affairs, a study commissioned by his organization and Americans for Prosperity found, “If a Taxpayer Bill of Rights (TABOR) amendment had been in place in Oklahoma between 1991 and 2005, we would have filled up the emergency and budget stabilization funds and still would have given $581 million back to the taxpayers of Oklahoma.”

SOS opponents claim the initiative, with its formula tied to the Consumer Price Index (CPI), will cause shortfalls in funding because the prices of goods and services purchased by the government rise faster than the CPI. Organizations such as OEA and Community Action Project (CAP) of Tulsa County claim the result will be declining government services and neglected infrastructure. They cite Colorado, which instituted a TABOR in 1992. Colorado voters last year approved a referendum to temporarily suspend the TABOR limits.

“In 2001, [state] government grew at almost 10 percent. That same year the economy grew by only 4 percent. You cannot allow government to grow at two or three times the rate of the economy.”

RICK CARPENTER
OKLAHOMANS IN ACTION

TABOR Falsely Blamed

“Higher Education,” according to OEA’s Web site, “has fallen from 19% of the Colorado budget in 1992 to just 11% in 2004. Meanwhile, Medicaid and Corrections, which are subject to statutory mandates, have consumed a growing share.”

Proponents of Colorado’s TABOR argue it gets blamed for problems actually caused by the state’s Amendment 23, which mandates that K-12 education receive yearly budget increases equal to the rate of inflation plus student enrollment plus 1 percent, resulting in higher education being squeezed out in the budget process.

Downturn Was Problem

According to the Cato Institute, the problems in Colorado after the 2000-2001 recession resulted from the state’s two major industries—tourism and agriculture—experiencing significant downturns at the same time. The problem was the revenue shortfall, not TABOR spending caps. Colorado did not raise enough revenue to reach the TABOR cap.

 Without TABOR limits, the state would have needed to make far deeper budget cuts, because the state budget would have been much larger. OEA claims SOS will cause Oklahoma to “sacrifice its ability to invest in progress.”

State Sen. Randy Brogdon (R-Owasso) disputes that claim. “Evidently OEA’s idea of investing in education is [that it is] best done through the courts, as demonstrated by their current lawsuit against the state legislature. This is backwards,” he said.

“Education has grown at a smaller rate than the rest of the budget. SOS will be more protective of education as a priority expenditure,” said state Sen. James Williamson (R-Tulsa).
Georgia

Continued from page 1

Sales Tax Cut in Half

The move drops the 4 percent sales tax to 2 percent for natural gas from January to April and for liquid propane from January to March, accounting for different billing cycles. It is expected to save Georgia households $15 million, according to the fiscal note attached to the legislation. The household savings would be $5 to $10 per month, the bill’s sponsor, Rep. Jay Roberts (R-Atlanta), told legislators.

The governor’s tax cut follows a one-month moratorium on the state sales tax on gasoline that was implemented after hurricanes Katrina and Rita hurt supplies. That moratorium was ratified by the General Assembly in a special session and saved motorists an estimated $77 million.

Want ‘Comprehensive Policy’

The ratification of the energy tax cut, House Bill 970, passed the House 169-2 before heading to the Senate for certain passage. Not everyone was satisfied with the governor’s tax cut, however. Democrats criticized it as a hand-aid and called for a “comprehensive energy policy” that includes renewable energy and targets energy efficiency instead of consumption.

Are we going to continue to give tax cuts to a problem that’s not going to go away?” asked Rep. Douglas Dean (D-Atlanta), one of the two Democrats who voted against the bill. The other, Rep. Bob Holmes (D-Atlanta), questioned the wisdom of a tax cut he said would benefit middle- and upper-income persons, instead of reassigning the funds to the state’s Low-Income Home Energy Assistance Program (LIHEAP).

This is about giving that surplus back to everyone,” responded Roberts, who noted Perdue’s proposed budget would fully fund LIHEAP for the first time in Georgia, benefitting low-income households by an average of $217 a month.

Bigger Solutions Sought

Rep. Nan Orrock (D-Atlanta) said the move was “a great campaign bumper sticker”—“I cut taxes on your heating bill—but this is no solution for Georgia families.”

Democrats weren’t alone in questioning the temporary tax cut. Kelly McCutchen, executive vice president of the Georgia Public Policy Foundation, which supports general tax and spending cuts, told Morris News Service, “I think elected officials have always looked for these kinds of gimmicks.”

Georgia industries, meanwhile, are also seeking relief from soaring energy costs. HB 209 proposes cutting the 4 percent state sales tax on energy costs for manufacturers, who say they are at a competitive disadvantage as compared with other states. Thirty-nine states—including Alabama, Florida, South Carolina, and Tennessee—exempt manufacturers from their state sales tax on energy.

Benita Dodd (benitadodd@gppf.org) is vice president of the Georgia Public Policy Foundation.

Utah Legislature Considers Tax Cuts

by Mike Jerman

The Utah Legislature convened on January 16 to discuss an issue that has been absent from the lawmakers’ agenda for several years: tax cuts.

Gov. Jon Huntsman Jr. (R) has proposed a $60 million tax cut, while House Republicans are proposing a $230 million cut. The House plan would be the single largest tax cut in Utah history. State Senate Republicans are suggesting $100 million in tax cuts. At press time, Democrats had not proposed any tax cuts.

After four years of little or no growth in general state tax revenues, the legislature now faces dramatically increasing revenues as a result of greater economic growth. The governor’s office projects a surplus of $844 million for the current fiscal year and $581 million for the upcoming fiscal year.

Worry About Revenues

Opponents of tax cuts have argued projected tax revenues may not materialize, and thus cutting taxes would be risky.

House Speaker Greg Curtis (R-Sandy) told attendees of the Utah Taxpayers Association’s annual pre-legislative conference on January 12 that if the legislature increases spending so all projected revenue increases are built into ongoing expenditures, the state will have problems if the projected revenue increases don’t materialize. He believes that route is more risky than cutting taxes.

“To prevent excessive and unsustainable government growth, we must significantly cut taxes this year.

Cutting taxes is as important as reforming taxes.”

GREG HUGHES

STATE REPRESENTATIVE

DRAPER, UTAH

Not everyone in the state supports tax cuts. The Provo Daily Herald, Utah’s most liberal newspaper, argued on January 17, “Putting the surplus into the transportation fund would benefit Utahns a whole lot more than a tax refund that won’t buy much more than a night on the town.”

On a per-capita basis, the House Republican proposal would come to about $370 per family of four for one year.

Several Proposals in Play

The legislature has no shortage of tax cuts to consider. The Tax Reform Task Force proposed more than $321 million in tax cuts on an annual basis, about half of which would come from elimination of the sales tax on food, before its adjournment in November 2005. The 15-member task force was created by legislation and consisted of 13 lawmakers and two gubernatorial appointees. House Republicans have proposed removing the sales tax on food but would increase local sales tax rates by 0.13 percentage points, to make sure local government revenues were unharmed.

Not protected from harm, however, would be Utah businesses. They would pay about $14 million more per year on their taxable purchases, according to the plan. Because sales tax rates would increase, businesses would have to pay more sales tax on items they purchase. And because businesses do not buy groceries, they would have a net tax increase. Consumers also would pay more for non-food items, but consumers can expect a net tax cut because the removal of the sales tax on food would be greater than the increase in taxes on nonfood items.

State Senate Republicans are supporting tax cuts targeted toward promoting economic growth. They propose to reduce individual income taxes and sales and corporate income taxes on businesses that invest, employ, and produce in Utah and export their products and services to other states.

Instead of completely removing the sales tax on food, Senate Republicans support a tax credit targeted to low- and middle-income households to offset the regressivity of the sales tax on food. Removing the sales tax on food would reduce state revenues by nearly $170 million, while the proposed sales tax credit would reduce state revenues by $50 million or less. Opponents of the sales tax credit say it is too complicated and too onerous for many low-income households.

“Tax cuts are as important as reforming taxes,” said Rep. Greg Hughes (R-Drafter), who served on the Tax Reform Task Force and is chairman of the House Conservative caucus.

Mike Jerman (mike@utahtaxpayers.org) is vice president of the Utah Taxpayers Association.
Private Consortium to Help Ease Atlanta’s Traffic Woes
by Benita M. Dodd and Robert W. Poole

Commuters in Georgia’s metro-Atlanta region are moving closer to congestion relief with the historic approval by the State Transportation Board of a letter of intent (LOI) to negotiate a public-private initiative (PPI) for transportation improvements in the crowded Interstate 75-575 corridor.

The LOI, approved in December 2005 with Georgia Transportation Partners, a private consortium, is non-binding on both sides, but it paves the way for the project to move forward on the specifics. The LOI outlines proposals for managed lanes, a Bus Rapid Transit (BRT) system, and barrier-separated truck-only lanes.

The project would not toll existing lanes, nor is the PPI consortium proposing that it be involved in the tolling of lanes. Toll revenues, however, would back the bonds to fund an expected $512 million debt for the $1.8 billion project. The tolls would come from the State Roads and Toll Authority or a private company tolling that stretch of road on any lanes added during the project, an initiative that will take form during the negotiations.

Without the PPI the project would cost an estimated $2.9 billion and take nine years longer to complete, according to the state Department of Transportation.

Supplements Other Funds
Atlanta is the nation’s fourth-most-congested urban area, with a travel time index of 1.44, meaning it takes 44 percent longer to get somewhere at rush hour than at other times. Even if the region’s current $53 billion long-range transportation plan is fully implemented, congestion will grow to a travel time index of 1.67 by 2030, according to Georgia transportation department estimates. Funding constraints mean the region’s current long-range plan adds little to the highway system’s capacity despite a projected population increase of 2.5 million by 2030.

Federal funding is unlikely to meet the challenge. The National Chamber Foundation of the U.S. Chamber of Commerce recently stated that to maintain the nation’s current transportation system, “all levels of government must invest $235 billion in 2006, $304 billion in 2015, and $472 billion in 2030.”

More importantly, the foundation pointed out, “Current revenue streams will fall far short of these levels—the cumulative shortfall through 2015 is $0.5 trillion.” The foundation added that even an unprecedented indexing of fuel taxes to inflation would be insufficient to address long-term funding shortfalls.

Aggressive Schedule a Must
Sam Olens wears three hats as he approaches this initiative. He is chairman of commissioners for Cobb County, whose commuters will benefit enormously from the corridor improvements. He also heads the region’s Metropolitan Planning Organization and chairs the Governor’s Congestion Mitigation Task Force, which must present Gov. Sonny Perdue (R) with a multi-agency proposal to prioritize traffic congestion relief in transportation-related projects.

Much is at risk with this first and most promising PPI, Olens warns. The Georgia DOT and the consortium “must fully commit to an aggressive schedule to satisfy the federal standards for highway design and safety as well as the DOT’s internal processes,” he said.

David Doss, chairman of the state Board of Transportation, is already looking to the future. “The I-75/575 toll is the first of what I hope is a series of PPIs forthcoming in the very near future to allow us to greatly accelerate congestion relief for the metro Atlanta area,” Doss said.

“Without the [public-private initiative] the project would cost an estimated $2.9 billion and take nine years longer to complete, according to the state Department of Transportation.”

Planning Organization and chairs the Governor’s Congestion Mitigation Task Force, which must present Gov. Sonny Perdue (R) with a multi-agency proposal to prioritize traffic congestion relief in transportation-related projects.

Looking at the work ahead, Doss acknowledges the project’s imposing scale. “I have been adamant that the first PPI in Georgia be a home run for both the public sector and the private partner; its success will make future proposals so much easier,” he said.

“In my opinion, the state’s first public-private partnership proposal, Georgia 316 [which faced public opposition because it proposed to toll existing lanes], didn’t meet that criterion,” Doss said. “The I-75/I-755 initiative is not just a home run, it’s a grand slam.”

In Other Words
“State and local officials need better strategies for a jittery census trend—Michigan has joined Detroit in losing population with no immediate turnaround in sight.

“The state’s economy, crippled by faulty public policy, is driving out businesses and jobs. Little wonder people are leaving, too, going elsewhere to find work.

“Downsizing governments, reducing taxes and controlling public spending are urgently needed.”

House Editorial
The Detroit News
January 21, 2006

Traffic crawls through downtown Atlanta along Interstate 75/85 during rush hour on May 9, 2005.
Washington’s Governor Wants to Spend Additional $503 Million

Supplemental budget tests commitment to spending limit

by Jason Mercier

WASHINGTON REPUBLICAN PARTY

With a $1.45 billion ending fund balance projected for the remainder of the 2005-07 budget biennium, Washington Gov. Christine Gregoire (D) is proposing $503 million in new spending in her 2006 supplemental budget request. If adopted, the supplemental budget would add more than 500 new state workers to the payroll. Approximately $900 million of the budget request is earmarked for savings.

“My goal is to sock away a good amount in savings. Any family would do that, and that’s what I’m asking the legislature to do as well,” Gregoire told the Seattle Times. “I don’t want to make draconian cuts in one year. I don’t want to have to look at taxes in one year. I want to keep the economy growing and make sure we’re destroying the illusion.”

Democrats in the legislature sounded positive about Gregoire’s proposal.

Senate Ways and Means Committee Chair Sen. Margaret Prentice (D-Renton) told the Seattle Times, “Overall, I’m very supportive of it.”

“We are right back on board the tax and spend merry-go-round. This year’s spending will inevitably lead to higher taxes down the road.”

CHRIS VANCE
WASHINGTON REPUBLICAN PARTY

Spending Exceeds Revenue Forecast

Despite the projected surplus earmarked for savings, the governor’s proposed spending actually exceeds forecasted revenue for the 2005-07 budget cycle by nearly $120 million, not including $591 million in appropriations to new accounts.

That is possible because the surplus includes funds left over from previous years, plus money transferred into the general fund from off-budget accounts that truly are in surplus. Since the 2003-05 biennium, the state has transferred approximately $948 million from off-budget accounts to the general fund to balance the budget. This is the bulk of the projected “surplus.”

The projected carry-forward costs of the additional spending, however, result in the state’s Office of Financial Management projecting a $1.7 billion deficit for the 2009-11 biennium.

“We are right back on board the tax and spend merry-go-round. This year’s spending will inevitably lead to higher taxes down the road,” warned outgoing state Republican Party Chairman Chris Vance.

Some in the business community believe the projected surplus should be used to repeal last year’s adoption of a new stand-alone estate tax, also known as the “death tax.” Washington previously had a “pick-up” death tax tied to the federal tax code. “We’re discouraged that the governor’s supplemental budget continues the unnecessary death tax passed last year, which can kill small business growth and survival upon the death of the owner,” said Carolyn Logue, Washington State director for the National Grange, Building Industry Association of Realtors, the “Saving I-601” Coalition and Washington Association of REALTORS. “We’re discouraged that the governor’s supplemental budget continues the unnecessary death tax passed last year, which can kill small business growth and survival upon the death of the owner,” said Carolyn Logue, Washington State director for the National Grange, Building Industry Association of Realtors, the “Saving I-601” Coalition and Washington Association of REALTORS. “We’re discouraged that the governor’s supplemental budget continues the unnecessary death tax passed last year, which can kill small business growth and survival upon the death of the owner,” said Carolyn Logue, Washington State director for the National Grange, Building Industry Association of Realtors, the “Saving I-601” Coalition and Washington Association of REALTORS.

I-601 Lawsuit Pending

In response to last year’s changes to I-601, a coalition was formed to challenge the legislature’s spending limit actions. Consisting of the Washington Farm Bureau, National Federation of Independent Business, Washington State Grange, Building Industry Association of Washington, Evergreen Freedom Foundation, and Washington Association of REALTORS, the “Saving I-601” Coalition last year filed a lawsuit to have the artificial increases in the spending limit invalidated.

One of the issues being challenged is the effect a $250 million “merry-go-round” fund transfer between three state accounts had on the spending limit. The state contends the transfers increased the limit. The coalition argues the transfers should have had no impact on the limit because each account had the same balance as before the transfer occurred.

Adding to the drama, in response to a coalition request for copies of state documents concerning the $250 million in fund shifts, the state is claiming executive and legislative privilege to deny disclosure. Those two privileges have not been previously recognized in Washington State.

The I-601 legal challenge is expected to be heard in Superior Court in March.

Jason Mercier (jmercer@effwa.org) is a budget research analyst for the Evergreen Freedom Foundation.
Bank Ends Loans to Developers Who Build on Land Seized by Government

by Steve Stanek

The nation’s ninth-largest bank will no longer loan money to real estate developers to build on land seized from property owners through eminent domain.

“The idea that a citizen’s property can be taken by the government solely for private use is extremely misguided, in fact it’s just plain wrong,” said John Allison, chairman and chief executive at Branch Banking and Trust Company (BB&T Corporation), in a January 25 statement announcing the decision.

BB&T is based in Winston-Salem, North Carolina and operates more than 1,400 financial centers in Alabama, the Carolinas, Florida, Georgia, Indiana, Kentucky, Maryland, Tennessee, Virginia, West Virginia, and the District of Columbia.

Won’t Undermine ‘Basic Right’

“One of the most basic rights of every citizen is to keep what they own,” Allison said. “As an institution dedicated to helping our clients achieve economic success and financial security, we won’t help any entity or company that would undermine that mission and threaten the hard-earned American dream of property ownership.”

Lawmakers Respond

At least 38 states recently have passed or are considering bills to ban eminent domain for private development. A federal bill that would ban the use of eminent domain for private development has passed the House of Representatives. The bipartisan Private Property Rights Protection Act would revoke for two fiscal years all federal economic development financing from local governments that condemn privately owned land and transfer it to private developers, unless the land is severely blighted. (See “Americans, Left and Right, Work to Counter Kelo Decision,” Budget & Tax News, Sept. 2005.)

“While we’re certainly optimistic about the pending legislation, this is something we could not wait any longer to address,” said Ken Chalk, BB&T’s chief credit officer, in a statement. “We’re a company where our values dictate our decision-making and operating standards. From that standpoint, this was a straightforward decision. It’s simply the right thing to do.”

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.

Positive Response Overwhelms Bank

“Since we made this announcement, we have received more than 600 internal email responses from our own employees, telling us they are proud to be a member of BB&T and thankful we have taken a stand, and saying it’s good to come to work.”

“We are a Southeast regional bank, yet we have heard from people in California, New Mexico, Michigan, Nevada, from all over the country,” Denham said. “They are saying either they want to buy our stock or they wish we had a bank in their area, because if we did they would put all their money with us. One person from Nevada just called to say he’s going to put $25,000 into our stock.”

“Instead of being stewards of taxpayer money, too many lawmakers truly want transparency (and that’s a big ‘if’), they’ll go one step further: Post all such bills online 24 hours before a final vote. And attach members’ names to every project they sponsor.”

“[I]n the race to reform, Democrats have proposed an idea with merit: All conference committees should meet in public and put any changes to a vote.”

“If lawmakers truly want transparency (and that’s a big ‘if’), they’ll go one step further: Post all such bills online 24 hours before a final vote. And attach members’ names to every project they sponsor.”

“Instead of being stewards of taxpayer money, too many lawmakers are stewards of corporate interests.”

“IT’s time Congress pulled back the curtain and threw open the doors. Vital decisions and far-reaching policy changes should be made in the public eye, not by sleight of hand.”

Bronwyn Lance Chester
The Virginian-Pilot
January 26, 2006

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In Other Words

More information about BB&T Corporation’s eminent domain policy is available on its Web site at http://www.bbandt.com/about/media/news/releases.asp.

The full text of the majority and dissenting opinions in Kelo is available through PolicyBot, The Heartland Institute’s free online research database. Point your Web browser to http://www.heartland.org, click on the PolicyBot button, and request documents #17418 (majority), #17419 (O’Connor dissent), and #17420 (Thomas dissent).
TIF Epidemic Infects Local Governments

by Daniel McGraw

In 2004, the city of Fort Worth approved an economic development initiative that seemed to have all the numbers on its side. A billion-dollar company would come to town, bringing more than 500 jobs and luring an estimated 2.5 million visitors to the city each year.

And the cost to the city didn’t seem that much: $30 million to $40 million in total tax breaks to be parcelled out over the next 20 to 30 years. The company receiving the tax breaks would be Cabela’s, a hunting/fishing megastore headquartered in Nebraska and now expanding across the country.

But when the numbers are peeled back, and the real costs of giving the tax breaks to Cabela’s are studied, Fort Worth’s economic development initiative isn’t all it appears. The economic development tool—tax increment financing, or TIF—is being used by cities big and small, and critics claim it is the latest form of corporate welfare, with hidden costs.

Overestimate Benefits

The facts are simple, according to the experts. Stores such as Cabela’s are already profitable, and incentives like TIF just make them extremely profitable.

Moreover, no one believes the original estimates of the number of visitors to the Cabela’s store were realistic. Cabela’s no longer offers firm visitor estimates, and Fort Worth officials admit the original estimates of tourist interest were overly optimistic.

“There is always this expectation with TIFs that the economic growth is a way to create jobs and grow the economy,” says Greg Le Roy, author of The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation.

“But what is missing here is that the cost of developing private business has some public costs. Roads and sewers and schools are public costs that come from growth. But private businesses need to pay their fair share, and then maybe the tax rate for the general public would not grow, or could be reduced.”

Use of TIF Explodes

Tax increment financing has been around for 50 years, but in the past 10 years it has become a development tool most cities and states use. In each case, city hall records show, the company made TIF a condition of its coming to or staying in Fort Worth.

“The plan has veered so far from its origins that it has become little more than welfare for the rich. Find the blight around the Texas Motor Speedway. Find it around Cabela’s. Find it in many TIFs around the country. What this is is a corporate giveaway, and the common tax-paying citizens are left paying for it.”

LOUIS MCBEE
FORT WORTH BUSINESSMAN

After a local government has designated a TIF district—most states say the area must be blighted—property taxes (and sometimes sales taxes) from the area are divided into two streams. The first tax stream is the original assessed value of the property before any redevelopment. The city, county, school district, and other taxing bodies still get that money. The second stream is the additional tax money generated after development takes place and the property values are higher. Typically that revenue is used to pay off municipal bonds that raise money for infrastructure improvements in the TIF district, for land acquisition through eminent domain, or for direct payments to a private developer for site preparation and construction.

The length of time the taxes are diverted to pay for the bonds can be anywhere from seven to 30 years. Local governments sell the TIF concept to the public by claiming they are using funds that would not have been generated without the TIF district. If the land was valued at $10 million before TIF-associated development and is worth $80 million afterward, the argument goes, the $40 million increase in tax value can be used to retire the bonds. Local government officials also like to argue the TIF district may increase nearby economic activity, which will be taxed at full value.

Given the competition between cities eager to attract new businesses, tax increment financing is not likely to disappear anytime soon. “Has it gone overboard?” asks University of North Texas economist Terry Clower. “Sure..., but the problem is that if a city doesn’t offer some tax incentives, the company will just move down the road.” According to Clower, “In a utopian world, there would be no government handouts, and every business would pay the same tax rate. But if a city stands up and says they aren’t doing TIFs anymore, they will lose out.”

Business Competitors Lose

Instead, it’s the competitors of TIF-favored businesses that lose. Academy Sports & Outdoors, which employs 6,500 people, has about 80 sporting goods stores in eight Southern states, including a store in Fort Worth. When the Fort Worth City Council was considering the TIF for Cabela’s, Academy Sports Chair- man David Gochman spoke out against the tax incentives.

“This is not a nonprofit, not a library, not a school,” Gochman said. “They are a for-profit business, a competitor of ours, along with Oshman’s and Wal-Mart and others.”

Daniel McGraw (danielmcgraw@shcglobal.net) is a Forth Worth-based freelance writer and author of First and Last Seasons: A Father, a Son and Sunday Afternoon Football (Random House).

Chicago Gives Up $1.6 Billion to Get $360 Million

The definition of blight—as it is used in eminent domain cases—has been expanded to include almost any property in the United States. Consequently, tax increment financing (TIF) districts are now being used in growing and affluent areas for big-box retailers, high-end condominium developments, sports stadiums and arenas, and anything else cities want to put money into.

Most local officials do not take into account development that would occur without TIF. In Chicago, the Neighborhood Capital Budget Group (NCBG), a coalition of 200 Chicago organizations that studies local public investment, looked at 36 of the city's TIF districts in 2002 and found property values were rising in all of them during the five years before they were designated as TIFs.

The NCBG projected that over the 23-year life span of Chicago's TIF districts, the taxing bodies in the city will lose $1.6 billion in property tax revenues due to TIF districts, while the city will gain $361.9 million of projected 'new' revenues attributable to TIF.

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— Daniel McGraw

INTERNET INFO

In March 2003, the Developing Neighborhood Alternatives project, a research effort in which The Heartland Institute participated, published The Right Tool for the Job? An Analysis of Tax Increment Financing. The executive summary and two-volume report are available online at http://www.heartland.org/Article.cfm?artId=11868.

Additional information on tax increment financing is available through PolicyBot™, The Heartland Institute’s free online research database. Point your Web browser to http://www.heartland.org, click on the PolicyBot™ button, and select the topic/subtopic combination Taxes/Tax Increment Finance.
Some Question Use of TIF

With thousands of cities and nearly all states offering tax increment financing, it has become a staple incentive many businesses now expect. But some analysts are beginning to sound warnings.

The Brookings Institution studied TIFs in Missouri and concluded they are “used extensively in high-tax-base Missouri suburban areas with little need for assistance in the competition for tax base. This is especially true in the St. Louis metropolitan area. There, TIF money very frequently flows to purposes other than combating ‘blight’ in disadvantaged communities, its classic purpose. In fact, less than half of the 21 St. Louis-area cities that were using TIF in 2001 were disadvantaged or ‘at-risk’ when evaluated on four indicators of distress. On another measure, just seven of the 20 suburban areas using TIF fell into the ‘at-risk’ category.”

Economists from Iowa State University concluded from a study that the state’s “existing taxpayers, its households, wage earners, and retirees are aggressively subsidizing business growth and population via this practice.” They also concluded, “The overall expected benefits [of TIFs] do not exceed the public’s costs.”

Lawmakers Question TIF Role

Last year’s U.S. Supreme Court ruling allowing eminent domain for economic development has caused some state legislators to rethink their TIF laws, where eminent domain is a vital component.

“We have questions about the way these TIFs have been justified,” said Texas state Rep. Lon Burnam (D-Fort Worth). “There’s a spaghetti bowl of issues here, but one thing seems clear: Not many blighted neighborhoods seem to have fallen into a TIF, but a lot of big corporations have. This is so typical of laws ostensibly designed to benefit poor and low-income people that become bird nests on the ground for the rich.”

Duluth, Minnesota Mayor Herb Bergson said, “The failure to reduce tax increment financing districts has not only burdened the taxpayers for years to come, it has also crippled our education system.”

Missouri state Sen. John Griesheimer (R-Washington), chairman of the state’s legislative committee studying TIFs, said they are “undeniably a valuable economic tool for local economies,” but he added states need to “improve the system to ensure they remain a positive development tool rather than devolving into a vehicle of abuse.”

Equal Work — Inequitable Compensation

The groundbreaking study, The Two Connecticuts, reports on the major national problem of how state and local public employees earn higher wages and benefits than their private-sector counterparts for equal work.

To download a free copy of The Two Connecticuts, go to www.yankeedinstitute.org.

For a hard copy, contact Dr. Lewis Andrews at (860) 297-4271 or email lew@yankeeinstitute.org.

—from top to bottom—

Texas state Rep. Lon Burnam, Duluth Mayor Herb Bergson, and Missouri state Sen. John Griesheimer have recognized the need for TIF reform.

LON BURNHAM
STATE REPRESENTATIVE
FORT WORTH, TEXAS

“Not many blighted neighborhoods seem to have fallen into a TIF. ... This is so typical of laws ostensibly designed to benefit poor and low-income people that become bird nests on the ground for the rich.”

— Daniel McGraw
Illinois’ Pension System: Woefully Underfunded, Scandal-Plagued

by Steve Stanek

By almost any measure, the Illinois government pension system is the nation’s worst, plagued by debt and scandal. Recent developments include: ■ The Illinois Teachers’ Retirement System (TRS), which has 330,000 current and retired teachers outside the city of Chicago, filed a lawsuit in January against three political insiders, including former TRS trustee Stuart Levine. The three men allegedly engaged in a multimillion-dollar kickback and extortion scheme against the pension fund. ■ Chicago attorney Joseph Cari and former TRS counsel Steven Loren, two of the three persons named in the TRS lawsuit, pled guilty in September 2005 to charges related to the pension kickback and extortion scheme. In his plea agreement, Cari said the scheme centered on sham consulting contracts with investment firms desiring to do business with the pension fund. He said much of the money collected through the sham contracts went to the political campaign of a person identified in the plea agreement as “Public Official A.” Several news organizations identified Public Official A as Illinois Gov. Rod Blagojevich (D). Blagojevich denies any involvement in pension fund corruption. ■ Lawmakers in 2005 agreed to divert some $4 billion of scheduled pension fund payments to other spending through 2010, including a combined $2.3 billion in 2005 and this year. ■ Blagojevich appointed the Governor’s Pension Reform Commission in 2004 to study the state’s pension system and recommend improvements. The 13-member commission’s recommendations went largely ignored by the governor and lawmakers. ■ The state issued $10.1 billion in pension obligation bonds in 2003 to reduce unfunded liabilities. The borrowing is a gamble because the state must repay the money with interest over 30 years. To do this without turning to taxpayers, the state will have to earn average annual returns on investments that exceed the 5.05 percent interest rate on the obligation bonds. There is no guarantee that will happen.

Unfunded Liability Is Huge Despite the infusion of borrowed money, the state’s unfunded pension liability stands at an estimated $38 billion, the largest unfunded liability in the nation, according to State Sen. Bill Brady (R-Bloomington), who served on the Governor’s Pension Commission. TRS Executive Director Jon Baum did not return calls for comment.

Decry Fund Diversions Candidates for governor from both major political parties are slamming Blagojevich and state lawmakers for the pension situation. “By diverting these billions of dollars from pensions, our governor has put thousands of pensions at risk, and all the state’s taxpayers at risk,” said Edwin Eisendrath, who is hoping to unseat Blagojevich for the Democratic Party nomination. “This is a governor who has awarded hundreds of millions of dollars of investments only days after [the recipients] gave thousands of dollars to his campaign. All this is going to cost us a fortune. We’ve been living well beyond what we can afford, and the day of reckoning is at hand.” Brady, one of four candidates seeking the Republican nomination for governor, expressed similar views.

“The governor has begun stealing $4 billion from the pensions,” Brady said. “$1.1 billion last year, $1.2 billion this year, and then smaller amounts in the later years. What the governor did is drop the numbers [the amounts for pension funding] now and through 2010. Now instead of putting in 20 percent of payroll over 40 years, we will pay 22 percent to his campaign.”

Mundelein, Illinois resident Bill Zettler has spent 35 years designing computer software, analyzing statistics, and giving himself mathematical challenges. Until a few years ago he considered himself a political liberal. Then he spoke with a neighbor, an Illinois school teacher who retired at age 55 and was receiving $9,000 a month in pension benefits. “I couldn’t believe it,” Zettler said. “So I looked into things.” What he saw from the Teachers’ Retirement System’s own numbers shocked him.

“Workers Get More Freedom” Brady also pointed out that a 401(k) gives workers total freedom to move from one job to another or change careers without losing any of their retirement money. “Because defined pensions are so back-end loaded, people are trapped financially,” Brady said. “With a 401(k), the money is theirs. They can take it wherever they go. There’s also greater inheritability with a 401(k). If a person dies prematurely, there’s more ability to leave money to their loved ones.”

“For the public, they’ll know we’re not digging a deeper hole, creating financial problems years from now,” Brady said. — Steve Stanek

‘Give ‘em a Million, Save a Billion’ A modest proposal for pension reform

Illinois state Sen. Bill Brady (R-Bloomington), who served on the Governor’s Pension Commission in 2004, has introduced legislation to create a voluntary 401(k) retirement fund, known as a defined contribution plan, for state employees. Brady’s proposal would extend to participants in all state retirement systems the option to participate in a voluntary, self-managed plan like the one already offered to state university employees. No pension benefits would be changed for those choosing to remain in the current defined benefit system, which pays retirement benefits based on years worked and salary and is outside the control of individual employees. A defined contribution plan is a retirement savings system in which employers and employees make tax-deferred contributions to accounts owned by employees themselves. The contributions are invested, and employees receive the amount their investments earned, when they retire or leave the system.

State Would Cut Checks Brady said his bill would allow an employee in the defined benefit pension system who wants to move into the 401(k) program to receive a check from the state for past employee contributions, past state contributions, and the investment return on that money. The employee could then put that money into the 401(k).

“Actuarially, the benefits work out the same to a large extent,” Brady said. “The benefit to employees is they know their retirement is funded. The state’s matching contribution comes from a dedicated fund. They also control their investments. There’s none of this deferring of payments and the potential for scandal that we’re seeing now.”

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Public Pension Systems Wield Clout to Twist Government, Corporate Arms

by Nicole Gelinan

This past winter, the New York news media focused its attention on public employee pensions when New York City transit workers went on strike and crippled the city's economy for three days in December. The strikers walked off the job to make sure the state-run Metropolitan Transportation Authority didn’t alter pension terms for new employees.

“Unions are using the massive public-pension assets they control to alter corporate and government policies from within the boardroom.”

Because of the spotlight the strike put on the subway and bus workers’ pensions, many citizens realized for the first time that their tax dollars subsidize the type of defined-benefit pensions—work 25 years and retire at age 55—that have been rapidly disappearing from the private sector.

But citizens should keep their eyes on public-sector pensions for another reason: Unions are using the massive public pension assets they control to alter corporate and government policies from within the boardroom.

Assets Climb Sevenfold

They certainly have the clout to do it. The public-sector funds are huge, accounting for an ever-greater share of the 20 to 25 percent of investments in the U.S. equity markets that pension funds—both public and private—constitute.

Public-pension assets have grown sevenfold in the past 20 years, to $2.3 trillion. Corporate assets have crept up more slowly, to $4.2 trillion—only about twice as high as public funds, currently at triple their size as big two decades ago.

The reason, of course, is that private-sector America largely has ceased to offer its employees traditional, corporate-controlled, “defined-benefit” pension plans. Instead, employers make “defined contributions” to each employee’s retirement account. 401(k)s immediately become the employee’s property and the employee’s responsibility for investing.

California, NY Flex Muscles

But public-sector America, as a result of the political power of its unions, has retained defined-benefit plans. Nearly one-fourth of these public pension fund assets are concentrated in two states: Some $300 billion in California’s Public Employees’ Retirement and State Teachers’ Retirement Systems (Calpers and Calstrs), $85 billion in New York City’s funds, and $200 billion in New York state funds.

This more than half-trillion dollars is the largest single special-interest bloc of money in the U.S. capital markets.

New York City’s pension funds first discovered their political heft when they teamed up with Ivy League and church-endowed pension funds to pressure companies with business in South Africa either to lobby against apartheid or to withdraw investments from that nation. When apartheid collapsed, the funds took much credit for the change.

More recently, since the collapses of Enron and WorldCom, public-sector pension funds have taken advantage of a hospitable political climate to push for even more shareholder activism. “Shareholders should start acting like the owners they are,” California treasurer and Calpers board member Phil Angelides said in 2002. “The age of investor complacency must be replaced by a new era of investor democracy.”

Trustees Beholden to Unions

It’s no mystery what issues public pension-fund trustees, most of them unionists or politicians beholden to unions, deem ripe for shareholder attention.

This is true of Calpers, for instance, whose board of directors was until December 2004 headed by Sean Harrigan, the regional executive director of the United Food and Commercial Workers Union, one of California’s most powerful private-sector unions. This tie got Calpers enmeshed in a major shareholder tangle in 2004 when the fund mounted a corporate proxy fight against the Safeway supermarket chain right after Safeway resolved a four-month strike by Harrigan’s union at its California supermarkets.

Calpers, coincidentally enough, decided this was an auspicious time to take up the cause of “shareholder value” against Safeway’s board of directors. The fund mounted an unsuccessful campaign in mid-2004 to oust Safeway’s chairman and CEO, purportedly to safeguard the pension fund’s shareholder interests.

It’s true Safeway stock was a dog at the time—but that’s partly because of an untenable labor-cost structure due in part to Harrigan’s union.

“Last year, the major [public-sector] labor unions … threw their money behind one key political objective: Ensuring major banks and investment firms didn’t push too hard for Social Security reform.”

A rational investor with no confidence in Safeway’s board of directors simply would have sold Safeway stock … and a graph of Safeway’s downward price trajectory over the time period shows investors sold in droves. But if Calpers didn’t own a large amount of Safeway stock, Harrigan (who says he resisted himself from the fight) wouldn’t have had a platform on which to stand and fight management. In the end, California’s taxpayers end up bearing the risk of Calpers’ continued investment in the dismal-performing Safeway, because they must guarantee the public-sector workers’ pensions.

Fighting Social Security Reform

Last year, the major labor unions (including the Service Employees International Union; American Federation of Government Employees; American Federation of State, County and Municipal Employees; American Federation of Teachers; and United Mine Workers, to name just a few) threw their money behind one key political objective: Ensuring major banks and investment firms didn’t push too hard for Social Security reform.

For more information on pension fund issues in Illinois, see “Illinois’ Public Pension Crisis,” a Heartland Policy Study by Steve Stanek, available online at http://www.heartland.org/Article.cfm?artId=17025.

CONTINUED from left

percent over 40 years, which dramatically increases the total cost but gives him short-term monies to do with what he wants.”

In a January 17 statement, businessman Ron Gidwitz, another candidate for the Republican nomination for governor, said, “Not only has [Blagojevich] cast the pensions of our state workers in jeopardy but he also has passed the pension back to our children, who will have to pay for this reckless move long after he’s left the Mansion. Illinois’s unfunded pension obligations are approaching $39 billion. The governor won’t talk about plans to reduce those liabilities because he’s intent on adding to them.”

General Assembly Agreed

The state’s General Assembly approved the pension funding moves; Blagojevich is a Democrat, and both chambers of the General Assembly are under Democrat control.

The pension fund is cooperating with federal investigators, and federal subpoenas have been served on other agencies under the governor’s control, but those steps are not enough for Eisendrath, even though he is a fellow Democrat. In a January 5 statement, he said, “Instead of waiting for the U.S. Attorney to do it for us, the governor should take four steps right away: “1. Investigate and determine how the fund investments and contracts were related to contributions. “2. Disclose the findings of that investigation. “3. Disclose those involved. “4. Return any contributions related to this pay-to-play scandal.”

Spokespersons for the governor did not return calls for comment.

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.

Steve Stanek's article was adapted, with permission, from whose Winter 2005 issue this article was adapted, with permission.
Bad Rules Have Led to Big Pension Problems
An interview with pension consultant Ron Ryan

by Steve Stanek

Ron Ryan is founder and chairman of Ryan ALM, Inc., an asset/liability management company in New York City that is nationally known for its pension fund consulting. Before founding the company in 2004, Ryan ran Ryan Labs, which specialized in solving financial problems through low-risk solutions. Before then, Ryan served as director of research at Lehman Bros., where he designed many of the popular Lehman bond indices that have become the key fixed-income benchmarks for asset management today. Ryan recently spoke with Steve Stanek, managing editor of Budget & Tax News, about the nation’s public employee pensions.

Stanek: How do you size up the government pension situation?
Ryan: It’s almost criminal. We’re going to have cities going bankrupt, a lot of it due to bad rules, which give bad results. That’s the theme: Bad rules lead to bad things. We have bad accounting and reporting rules, and pensions have behaved accordingly.

Stanek: Can you give some examples?
Ryan: Take the corporate side first. They’re under FASB, the Financial Accounting Standards Board. Corporations want to do anything that enhances earnings. Pensions hurt earnings. The offset is returns on pension assets. FASB allows corporations to forecast the return a year in advance. So they try to forecast a return that minimizes or wipes out the pension expense.

When they forecast a return on assets—say 9 percent—that return must be validated by the auditors. The way companies do that is to tell pension consultants they must come up with an asset allocation that suggests they can earn that 9 percent. They are allowed to use historical averages for everything except bonds, where they must use current returns. As a result, since the late 1980s allocations have been going less and less to bonds. When the stock market correction hit in 2000 and 2002, there was one of the highest allocations to equities in modern history.

But there is more. The asset side is not marked to market. It is smoothed over five years. This distorts the true economic value of assets. Imagine a bank not telling you your current balance, but your average balance over five years. Could you write a check on that? Smoothing overstated assets by 27 percent at the end of 2004, by 44 percent by the end of 2005, and by 63 percent at the end of 2002. Fortunately, for 2005 smoothing overstates assets by only 7 percent.

Now to the liability side. This is not marked to market either. What they do there is price liabilities at one interest rate. Not only is it a flat yield curve, it is a yield much higher than market. The higher the interest rate they use, the lower the present value of liabilities. For corporations, we’ve calculated a 10 to 15 percent error. When you add assets that are overstated and liabilities that are understated, the funded ratio naturally is way off.

Stanek: What about public plans?
Ryan: Here we’ll find the worst pension situation of them all. Why? Because we’re going to price liabilities at a return-on-assets assumption. If you think the asset side is going to grow at 8 percent, you’re going to use that same rate to price liabilities. Corporations are using a rate of 6 percent; public pensions are in the neighborhood of 8 percent.

To show the error, take the discount rate on liabilities and compare that to the market. The market is the Treasury bond yield curve, which is about 4.5 percent. Calculate the difference, multiply that by 10 to 15 years, and you get 30 to 45 percent understated liabilities. The funding ratio for public plans is 30 to 45 percent off. If they thought they were fully funded, they’re really maybe 70 percent funded. Most of them admit a deficit. Subtract another 30 to 45 percent off whatever deficit they admit.

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Stanek: So what does this mean for the plans?
Ryan: If you thought your plan was fully funded, you might increase benefits, right? That’s what every public plan did. We need a rule that public pension funds cannot increase benefits if they are underfunded on a true economic basis. In the late 1990s they thought they had a surplus, so they increased benefits at a time when they really didn’t have a surplus, but according to the rules they did.

It’s the rules that led them to this. I’ve never heard anybody talk about this. It’s because of smoothing, the discount rate being wrong, and increasing benefits when they can’t afford it.

Stanek: So what’s the solution?
Ryan: Until you mark to market, you will never know the truth. Financial lies should not be tolerated in America anymore. Fortunately, the rules have changed in Europe. FASB looks like it’s going to get rid of smoothing [in the United States], so corporations will begin marking to market.

GASB [Governmental Accounting Standards Board, which sets accounting and reporting rules for government entities] is going to be slow to do this. We’re going to have cities going bankrupt. San Diego, one of the nation’s largest cities, is on the verge because of its pensions.

Some places, like Illinois, have issued pension obligation bonds and put the proceeds into equities hoping for fast gains. This might work, but they made a bet that equities will grow faster than liabilities.

Stanek: Can actuaries figure out how much liabilities will be and how much money they need to put away to cover them?
Ryan: They can, but it doesn’t happen. You never hear of lotteries having a problem. They match assets and liabilities to market and go to bed. Pensions don’t focus on the objective, which is to meet the liabilities. It’s not to beat the S&P 500 or some other index. It’s to meet the liabilities, but too many pension funds tell their asset managers to outperform the market.

Las Vegas has built an empire on the principle that people play till they lose. If you beat your liabilities, you should take your chips off the table. In the late 1990s equities won big. Instead of taking their chips off the table, the pension funds kept betting. When the correction came, they lost everything they gained, and they had increased liabilities because of their pension sweeteners.

It’s so sad that we have corporations going bankrupt, and cities and states borrowing money, and budgets that are being crushed by pension obligations. Most people don’t have any idea how these things compound over time.

There is some good news. Interest rates are at the lowest levels in 40 years on the long end. That would suggest non-bond assets have a good chance to win the game, if given time. Many people believe interest rates will go up. If that happens, then liabilities will go down in present value. If interest rates go up in the next three years, and the present value of liabilities goes down, and the non-bond assets do well, they might catch up a lot. But these are all ifs.

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.
Crisis

Continued from page 1

of nearly $296 billion for the 103 pension systems and 127 total plans in their Public Fund Survey. A 2004 analysis by Wilshire Associates put the unfunded liability as high as $366 billion.

Problem Is Nationwide

Pension funding problems are hitting state and municipal governments across the country.

The City of San Diego is probably the worst example of pension mismanagement. The city is now embroiled in its worst financial crisis ever, with an estimated pension deficit of $2 billion threatening to consume as much as one-third of the city’s general fund.

In Illinois, taxpayers for a pension deficit estimated at $186 billion—the worst in the nation. “The City of San Diego is probably the worst example of pension mismanagement. The city is now embroiled in its worst financial crisis ever, with an estimated pension deficit of $2 billion threatening to consume as much as one-third of the city’s general fund.”

The state of West Virginia faces a $3.5 billion pension deficit and an additional $8.3 billion in unfunded workers’ compensation liabilities—a total deficit nearly three times the state’s annual $3.1 billion general fund budget.

In California, the teachers’ retirement system now faces a shortfall of more than $24 billion, and the state’s combined contributions to the public employees’ and teachers’ plans now exceed $3 billion per year.

Borrowing, Diversions Cause Trouble

In the public sector, politicians and bureaucrats frequently have blamed unfunded actuarial pension liabilities on factors outside their control, such as the stock market downturn that followed the “dot-com” boom of the late 1990s. While sagging returns certainly did not help pension investment portfolios, they account for a fairly small portion of the problem.

Governments have tried to borrow their way out of debt by issuing risky pension obligation bonds, which often end up landing them in even worse financial shape than before, because the bonds must be repaid with interest.

Illinois, for instance, issued $10.1 billion in pension obligation bonds in 2003, hoping annual returns on the invested money over the next 30 years will exceed the 5.05 percent interest rate on the borrowed money. Last year, though, Illinois lawmakers diverted more than $1 billion in scheduled pension payments to other spending. Illinois is diverting more than $1 billion in pension payments to other spending again this year, digging the hole deeper.

401(k)s Offer Solution

In response to their pension funding problems, some governments are following the example of the private sector and switching to 401(k)-style defined-contribution retirement plans, in which the employer and employee each make contributions to a retirement account the employee controls. Numerous states—including Colorado, Florida, Louisiana, Maine, Michigan, Montana, Ohio, Oregon, South Carolina, Vermont, Virginia, and Washington—offer defined-contribution plans to at least some of their state employees.

Defined-contribution plans offer a number of advantages over defined-benefit plans. The chief benefit to the employer is that their predictable costs allow for greater stability and accountability. Costs are known in advance (because they are simply a set percentage of payroll) and don’t change much from year to year. This is a sharp contrast to the volatility of required contributions experienced under defined-benefit plans.

For state governments, this is particularly helpful in the budgeting process, because legislators—and taxpayers on the hook for any funding shortfalls—do not have to worry about being surprised by greater-than-expected contribution requirements when the stock market sours and the pension fund’s investment returns plummet. This added predictability of government finances eliminates the risk of unfunded liabilities and thus guarantees full funding of the system.

Governments can still offer attractive compensation packages by increasing salaries or the level of the government’s contribution, but they must ensure those compensation increases are paid for up front.

Workers Benefit from 401(k)s

Defined-contribution plans offer a number of benefits to workers as well. They are portable, meaning they can be “rolled over” from one employer to the next when an employee changes jobs. This is particularly attractive considering the median job tenure in 2000 was only 4.7 years, and merely 2.6 years for employees aged 24 to 34, according to the U.S. Bureau of Labor Statistics.

Defined-contribution plans also offer individuals the freedom to invest their money as they see fit. As risk levels and investment strategies change with age, defined-contribution plans offer the freedom and flexibility that one-size-fits-all government-managed pension plans cannot.

No Cure-Alls Available

Another important step governments can take to stem the tide of ever-rising pension costs is to enact constitutional or charter amendments requiring voter approval of all government employee benefits. This strategy has helped politically liberal San Francisco keep retirement costs in check while conservative municipalities such as San Diego and Orange County, California, have been brought to the brink of financial ruin by their pension systems.

The conversion of government defined-benefit plans to defined-contribution plans, and the implementation of voter approval requirements, may help to reduce retirement costs, but they certainly are not cure-alls. These solutions will only stop the bleeding. Persistent pension underfunding, sometimes over the course of decades, has led to debts that will have to be paid one way or another.

State governments may minimize the resulting cuts to important government services by adopting strategies such as privatizing or outsourcing certain government functions, selling unused or underutilized assets, consolidating similar government agencies and functions, implementing performance reviews to identify waste and poor-performing programs, and eliminating lower-priority programs.

These actions will be necessary if governments are to return to a solid fiscal position and ensure that public employee retirees’ retirement costs are covered without soaking taxpayers in the process.

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INTERNET INFO


Pension Woes Caused by Incentives

State governments must address the structural problems and incentives inherent in political management if government pension systems are to be returned to sound financial footing.

One central problem is that public officials have incentives to put off debts, such as retirement benefits, because the bills will not come due until they are long out of office. Fiscal restraint typically does not win elections. New government programs and goodies for the home district do.

Pension fund investment returns were so strong in the 1990s that governments didn’t need to pay much, if anything, to cover pension costs. During those flush years, many governments took “contribution holidays,” meaning they did not contribute at all to their pension systems. Unfortunately, when the stock market inevitably corrected, governments discovered they had to make up for all the payments they didn’t make in years prior.

The sharp increase in tax revenues during the late 1990s also had impacts. Even after the stock market downturn had begun, most state governments could not resist the urge to spend the extra money they had recently accrued through higher tax revenues.

Public employee unions, which often play a major role in politicians’ election campaigns, wanted their piece of the pie, too. In California, the state and many municipal governments raised public safety workers’ pensions by 50 percent. Other government employees also saw significant benefit increases. This came at a time when workers in the private sector were seeing their benefits being scaled back.

— Adam B. Summers
Connecticut Public Employees Live On Easy Street

by D. Dowd Muska

“N”o layoffs are not something we would ever consider,” said former Connecticut House of Representatives Speaker Moira Lyons (D-Stamford) in November 2002, in response to a reporter’s question about laying off state employees in order to close the state’s budget deficit.

“I get 100 people applying for these jobs, and once someone is in, they don’t leave. They retire,” said John Boland, personnel director for the City of Milford, Connecticut, commenting in September 2005 on the availability of janitorial positions in his town.

“You’re talking about something that is not going to take place,” said Mayor Maryann Welcome of the Town of Winchester, Connecticut, responding in January 2005 to a taxpayer group’s request that the town ask its employees for benefit concessions.

Government Jobs Boom

While job creation in the nation has rebounded strongly since the recession at the turn of the century, in some states the employment picture remains grim. In Connecticut, private-sector employment has yet to regain its July 2000 peak. Looking back farther, the Federal Deposit Insurance Corporation recently found that since the early 1990s, “no other state in the country has had such stagnation in employment.” Even worse, median household income in the Nutmeg State appears to be falling.

But a recent study conducted by this author for the Yankee Institute, a free-market think tank based at Trinity College in Hartford, discovered the state and its 169 municipalities boosted their government workforces substantially in recent decades. Connecticut has lost half of its manufacturing jobs in the past few decades, but the public sector is a growth industry. Between 1970 and 2000, employment in state government grew six times faster than the general population, and municipal employment grew four times faster than population.

Compensation for most public-sector positions now outstrips that of similar work in the private sector. Benefits—health insurance, retirement income, paid leave, etc.—are also superior to those offered by the vast majority of private-sector employers.

This disparity parallels the dramatic difference in the rates of unionization between the government and private sectors. Just under 88 percent of state employees are covered by collective-bargaining agreements, and the percentage is similar for municipal work. By contrast, unionization in Connecticut’s private workplaces is 8 percent, down from a high of 24 percent in 1970.

Public Serves Public Servants

U.S. Bureau of Labor Statistics (BLS) data show that for the most part, state and local government employees in Connecticut receive higher pay than their counterparts in the private sector. In the Hartford Metropolitan Statistical Area (MSA), mean hourly earnings for public-sector employees are 37 percent higher than for private-sector workers. The story is the same in the New York City MSA, which includes numerous Connecticut cities and towns. There, the advantage is almost 15 percent.

Health care coverage in Connecticut government is also more generous: The public sector offers this benefit more commonly than private-sector employers do, and the employee-paid portion of health care premiums is significantly smaller. There is also strong anecdotal evidence that public employers in Connecticut offer higher quality plans—e.g., broader coverage of health problems and lower co-pays.

Pensions Pose Big Burdens

All state and most municipal employees participate in a defined-benefit pension plan—guaranteed income based on length of service and salary at the time of retirement. Defined-benefit pension plans are disappearing in the private sector, where 401(k) plans are now the norm, but in Connecticut government employment they are the norm. (Nationally, nearly half of all workers aren’t offered pension benefits of any kind.)

Connecticut’s teacher-retirement fund has a $5 billion gap between assets and liabilities. The unfunded liability for all state employees is $7 billion.

Unlike the use-it-or-lose-it policy of the private sector, it is common for unused sick and vacation days to be “purchased” by Connecticut’s government entities when employees retire. A 2005 investigation by the Republican-American, a major Connecticut daily newspaper, discovered retiring teachers in the City of Waterbury’s school district “are owed an average of $83,542 each for unused sick days. That money, to be distributed over three years, totals $7.2 million—enough to fund salaries of 182 entry-level teachers at $39,569.”

D. Dowd Muska (dowdmuska@cox.net), the Yankee Institute’s Philip Gressel Fellow for tax and budget policy, is the author of “The Two Connecticuts: Public and Private Employment in the Nutmeg State.”

INTERNET INFO

“The Two Connecticuts: Public and Private Employment in the Nutmeg State” is available online at http://www.yankeinstitute.org. A hard copy may be obtained by calling 860/297-4271 or emailing lew@yankeeinstitute.org.

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Opposing View: Public Pension Situation Not So Dire

by Keith Brainard

After functioning for years as obscure, back-office operations of state and local government, retirement systems for employees of state and local governments have become the focus of increasing attention from both the media and policymakers. Given the size and scope of the public pension community, this attention should come as no surprise. According to the U.S. Census Bureau, state and local governments employ 16 million workers—10 percent of the nation’s workforce—of whom nearly 90 percent have a defined benefit (DB) pension plan.

The nation’s state and local government retirement systems have combined assets of $2.66 trillion, and they distribute more than $130 billion annually to more than six million retired public workers and their beneficiaries. In 2004 (the latest year for which data are available), state and local governments contributed $61 billion to public pension plans. Public employees contributed another $31 billion, and public pension funds generated more than $300 billion in investment earnings.

“[S]tate and local governments employ 16 million workers—10 percent of the nation’s workforce—of whom nearly 90 percent have a defined benefit (DB) pension plan.”

Concerns Raised

The increased scrutiny of public pensions also reflects concerns brought about by other factors, including:

▪ public pension funding levels and costs;
▪ publicity surrounding corporate pension plan problems; and
▪ Social Security’s impending shortfall.

Concerns about DB plans have been hotly debated in some states by proposals to replace them with defined contribution (DC) plans. For example, Barry Poulson, a Colorado resident and scholar with Americans for Prosperity, an organization promoting limited government and free markets, says, “Reform of Colorado’s pension system should focus on designing a new defined contribution system for newly hired workers.” Poulson is pursuing a state ballot initiative to close the state DB plan to new entrants.

Three-Year Decline Hurt

A declining stock market in 2000, 2001, and 2002 marked the first time since the Great Depression that stock prices declined for three consecutive years. As a result, the combined value of public pension fund assets dropped by $360 billion, from $2.29 trillion at the end of 2000 to $1.93 trillion at the end of 2002. Pension plan funding levels also fell, from a peak of around 100 percent in 2001 to their current level of 87.5 percent. This means that for every dollar of liability pension funds have incurred to date, they have 87.5 cents in real assets.

With some exceptions, however, public pensions remain in reasonably good condition, thanks to diversified and professionally managed portfolios, an improving stock market, and a near cessation of benefit enhancements during the past few years. Assuming investment markets continue their return to historic norms, the current public pension funding level is projected to mark the low point and will begin to rise.

Most Reasonably Funded

Seventy percent of public pension plans are funded at 80 percent or higher, a threshold considered by many actuaries to indicate actuarial health. Of course, this leaves 30 percent funded at lower levels, with a higher unfunded liability to overcome.

Most plans with poor funding levels got that way through the chronic failure of legislatures (or city councils) to make required contributions.

Nationwide, taxpayer contributions make up one-fourth of all public pension revenue; investment earnings and worker contributions make up the rest. Generating investment earnings first requires contributions, and states and cities that failed to make required contributions have lost out on billions of dollars of potential earnings, thereby worsening their pension plan’s funding level.

Ending Pensions Has Costs

Some policymakers and interest groups have responded to declining pension funding levels by calling for an end to traditional defined benefit pension plans for public employees. Such an action, however, involves real costs:

▪ Terminating a pension plan under most circumstances not only yields little or no savings, but often will increase costs, at least for the first few years.

▪ Terminating a pension plan under these circumstances also necessitates huge staff turnover, including not only the workers needed to perform essential public services. Two-thirds of all state and local government employees work either in education, public safety, corrections, or the judiciary. These are chiefly career-oriented positions, the type DB plans are designed to retain.

▪ DB plans are a helpful workforce management tool, promoting the orderly turnover of personnel and enabling employers to reduce or adjust the size and cost of their workforce.

Costs Fell, Now Rising

Although every public pension plan has its own contribution rates and requirements, the accompanying chart illustrates DB pension spending on a national level by state and local governments in the United States as a percentage of total payroll and as a percentage of total spending.

As the graph shows, during the mid-1990s state and local governments were spending approximately 10 percent of their payroll on contributions to pension benefits. That figure declined steadily for five years, until it began rising in 2002. (2005 figures are not yet available.)

A significant portion of the 2004 contribution was a result of a single bond issuance by the State of Illinois to pay down its pension liabilities. Excluding that issuance, the 2004 figures would have been 8.9 percent and 2.5 percent, respectively.

“The nation’s state and local government retirement systems have combined assets of $2.66 trillion, and they distribute more than $130 billion annually to more than six million retired public workers and their beneficiaries.”

Rules Hurt Private Plans

Much of the decline in DB plan coverage for private-sector workers has been a result of federal regulations that complicate administering and funding a DB plan. Those regulations result in funding level volatility and uncertain contribution requirements. State and local government pension plans, however, are not subject to the federal regulations that vex corporate DB plans. Most of the problems experienced by corporate DB plans are not an issue with public pensions.

In light of Social Security’s impending problems, some analysts, applying Social Security’s problems to public pensions, have questioned the viability of state and local DB plans.

The two systems, however, are fundamentally different: While Social Security’s pay-as-you-go financing structure makes the program highly sensitive to demographic changes, public pension plans are primarily prefunded. As noted earlier, public pensions overall are funded at 87.5 percent, which is reasonably good.

Major Problems Remain

Underfunding in some states, however, has led to two major problems.

First, by skipping required contributions for years, states have foregone untold billions in investment revenue that otherwise would be available to fund pension benefits. Second, closing off DB plans will not necessarily improve the situation, and may well make it worse because (a) existing liabilities still must be paid, and (b) cutting off contributions from new workers shuts off an expected and important source of future revenue.

Since a state is going to pay for the retirement of these younger workers anyway, the best fiscal policy may well be to retain the DB plan, to take advantage of contributions from young workers, possibly coupled with a reduction in benefits for future workers to begin to reduce liability growth.

Keith Brainard (keithb@nasra.org) is research director at the National Association of State Retirement Administrators.
continued from page 1

We go back to the 1990s, the oil companies were making less than 5 percent on their capital. If you were to average profits over about a 10-year period, which is the cycle of investment, they have not earned excessive amounts. This is a cyclical industry. You may have seven or eight down years and two or three good years.

“It’s true they are making upwards of 20 percent now,” Parry said, “but this is an industry that is being asked to go through huge expenditures to reformulate gasoline, lower sulfur emissions, and reduce to absurdly low levels emissions from refineries. These all have huge costs.”

American Petroleum Institute senior tax policy analyst Mark Kibbe said, “On the earnings issue, the key message is that these companies are huge. They are dealing with big dollar numbers. What gets reported is aggregate earnings numbers. If you want to compare apples to apples, look at net income on each dollar of revenue. If you do that, we are right around the all-industry average. Our net income is 5.7 cents per dollar of revenue versus 5.5 cents per dollar for the all-industry average in 2005 to argue the oil industry should be hit with a windfall profits tax. Schum and Boxer made similar demands last fall.

“We tried a windfall profits tax in the 1980s and it was a failure,” Kibbe notes. “It caused domestic production to fall. The Congressional Research Service in 1990 said between 1980 and 1985, domestic production was reduced as much as 1.6 billion barrels. Imports increased up to 16 percent over that time, and the CRS attributed this to the windfall profits tax.”

“The ExxonMobils of the world are not owned by space aliens. ... A windfall profits tax comes out of the pockets of shareholders and consumers.”

MARK KIBBE
AMERICAN PETROLEUM INSTITUTE

Boxer issued a statement on January 27, just before the official release of Exxon’s profit report, in which she demanded “an end to gouging.” Schumer told reporters on January 30, “the federal government has a responsibility to make sure that these companies continue to innovate instead of just profiting from the status quo.”

Parry said they are innovating by responding to costly government pressures for cleaner fuels and less pollution in the refining process. According to the American Petroleum Institute, the oil industry last year spent about $86 billion on capital expenditures.

Profits Come and Go

Kibbe disputes the idea of windfall profits. “There are no windfall profits,” he says. “In 1999 we had $10 a barrel oil. The oil companies, at least the major ones we represent, weren’t out looking for handouts, were still making incredible investments that far exceeded their earnings. The ExxonMobils of the world are not owned by space aliens. People rely on the earnings and dividends they get from oil companies. They are not nameless, faceless entities that Congress can tax. A windfall profits tax comes out of the pockets of shareholders and consumers.”

Parry agrees. “An awful lot of the profits you see now tend to be the result of a lot of volatility in the market,” Parry said. “To the extent they plow back this money into capital investment, that’s a good thing. And while we talk about Exxon spending $17 billion on capital expenditures and $23 billion on dividends and stock buybacks, that directly and indirectly has a very significant influence on the country.

“Giving that money to widows and retirees and grandmothers is good,” said Parry. “This is a big help to smokestack America, which is holding big pension funds. If they want a windfall profits tax, taking 20 percent off the price of oil stocks, they’re going to drag down a lot of buying power and hurt a lot of people.”

Taxes Already High

Meanwhile, a Tax Foundation study released January 31 shows the oil industry paying high corporate income taxes, undercutting the case for a windfall profits tax, according to the study’s authors.

The Tax Foundation reports Exxon set aside $23.3 billion for income taxes from its 2003 earnings of $59.4 billion, or $3.80 tax per share. That’s an effective tax rate of 39.2 percent on its worldwide operations.

ConocoPhillips reported it expected to pay income taxes of $9.9 billion, or $7.11 per share, from its before-tax profit of $23.5 billion during 2005, yielding an effective tax rate of 42.1 percent. Chevron reported setting aside $11.1 billion from its before-tax earnings of $25.2 billion, or $5.17 per share. That’s an effective tax rate exceeding 44 percent, the Tax Foundation study notes.

“Many who propose taxing energy companies more heavily than other firms, with a ‘windfall’ tax, believe that these firms somehow escape normal taxpaying requirements, leaving other industries to carry a heavier load,” said Scott Hodge, president of the Tax Foundation and coauthor of the new study, in a statement. “But fourth-quarter financial statements show this isn’t true.”

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INTERNET INFO


Union Membership Rates Continue Slide

Decline has slowed, however, and public-sector unions wield serious power

by Bob Williams

The percentage of American workers who belong to a labor union continues to slide, according to an annual report released in January by the U.S. Bureau of Labor Statistics.

In 2005, 12.46 percent of wage and salary workers nationwide were union members—the lowest percentage in decades—down from 12.52 percent in 2004. While the number of union members grew, the growth failed to keep pace with the number of new jobs nationwide.

“Membership is stagnant despite massive restructuring with unionized labor,” said Michael Reitz, director of labor policy for the Evergreen Freedom Foundation (EFF) in Olympia, Washington.

“While union density in private industries is low (only 7.8 percent of workers), government workers are heavily unionized, at 36.5 percent.”

Decline Is Leveling off

The nation’s union membership has declined from 20.1 percent of all workers in 1983, the first year the federal government began tracking this data. The rate of decline has leveled off somewhat after high rates of decline in the past several years. Hence, some union officials hailed 2005’s all-time low with optimism. AFL-CIO President John Sweeney said in a statement he was “pleased,” citing the increase of 213,000 union members in the past year. “In a political climate that’s hostile to workers’ rights, these numbers illustrate the extraordinary will of working people,” Sweeney said.

Other union officials were more restrained. “The good news is that the annual hemorrhaging of union membership slowed last year. And that’s not really good news,” said Teamsters’ President James Hoffa in a statement.

According to the U.S. Bureau of Labor Statistics, 31 states had union density rates (percentage of union members to total wage earners) below the national average in 2005, and 19 states had higher rates. In five states, union density was over 20 percent: New York (26.1 percent), Hawaii (25.8 percent), Alaska (22.8 percent), Iowa (22.0 percent) and New Jersey (22.0 percent each). South Carolina and North Carolina ranked the lowest at 2.3 percent and 2.9 percent, respectively.

Government Unions Grow

A significant trend in organized labor is the growth of public-sector unions. While union density in private industries is low (only 7.8 percent of workers), government workers are heavily unionized, at 36.5 percent. More and more, state and local governments are assuming their policymaking authority to the collective bargaining process, Reitz said.

“Increasingly, unions are a little more than signatories for big government,” said Grover Norquist, president of Americans for Tax Reform in Washington, D.C. “When the majority of union members come from the beehive cubicles of government bureaucracy, it doesn’t take a genius to figure out that higher taxes, more government, and more dues-paying bureaucrats are good for increasingly desperate union bosses.”

Young Workers Reject Unions

The Bureau of Labor Statistics report also examined demographic trends in union membership, the findings of which are particularly alarming for union officials. Young workers are far less likely than those in any other age category to be unionized. In 2005, only 4.0 percent of workers aged 16-24 were unionized. The rate was 10.7 percent for workers aged 25-34. The age group with the highest rate of growth among union members is those 65 years and older.

Reitz blames this on labor’s inability to adapt to today’s economy.

“Unions are still making calls... CONTINUED on right
from a 50-year-old playbook written for this generation’s grandparents,” said Reitz. “Organized labor will continue to hemorrhage members so long as it spends hundreds of millions in member dues on political activity and uses heavy-handed organizing tactics.”

Tactics Raise Workers’ Ire
Reitz cited Washington state as an example.

Public-sector unions there recently negotiated collective bargaining agreements on behalf of state employees. Those contracts included a provision requiring workers to pay dues as a condition of employment. Public employee unions immediately increased their membership, but they aroused considerable ire among state workers who had no intention of joining. Several state workers are preparing a class-action lawsuit in response. (See “Union Demands Wash. Workers Be Fired,” Budget & Tax News, February 2006.)

The Change to Win federation’s highly publicized split from the AFL-CIO last year centered on the question of how to reverse organized labor’s shrinking numbers. The federation includes the Service Employees International Union (SEIU), United of Needle and Industrial Textile Employees, Hotel Employees and Restaurant Employees (UNITE-HERE), United Brotherhood of Carpenters, Laborers’ International Union of North America, Teamsters Union, and United Food and Commercial Workers (UFCW).

Reitz questions whether the strategy is working. “For years, union membership has been kept afloat by coercion. The AFL-CIO split is little more than union officials rearranging the deck chairs on the Titanic,” Reitz said.

Bob Williams (effwa@effwa.org) is president of the Evergreen Freedom Foundation.

Penn. Considers Property Tax Cuts
by Michael Coulter

In December 2005, Pennsylvania’s state House and Senate each passed plans to reduce school property taxes paid by homeowners. But the plans have significant differences, and it is unclear whether the General Assembly and Gov. Ed Rendell (D) will come to an agreement soon.

Property taxes, long a contested issue in the Keystone State, gained additional attention during 2005 when the governor called the legislature into special session to address the matter. Rendell had pledged during the 2002 campaign to reform property taxes.

Schools Have Tax Option
The call for a special session came little more than a year after the House and Senate each passed a property tax reduction program known as Act 72. Act 72 gave Pennsylvania school districts the option of accepting revenue from gambling enterprises and also allowed them to increase the local earned income tax. The new revenue would lead to reduction in property tax bills for homeowners in the school district.

If a school district adopted the program, however, that district would have to seek voter approval for future property tax increases that exceeded local inflation rates. Prior to Act 72, a local school district did not have to seek voter approval for any local property tax increase.

Just over 100 of the state’s 501 school districts opted into the program by the May 31, 2005 deadline. The complicated plan did not create a groundswell of support among Pennsylvania residents. Some objected to the plan because it used gambling revenues. School districts objected to the referendum requirement for future tax increases.

House Proposes Statewide Plan
In December 2005, the state House met as a Committee of the Whole for the first time in more than 40 years and dedicated 10 hours to discussing 26 different tax cut plans. On December 13 the House approved a plan that would lower property taxes for all owner-occupied homes by about 50 percent.

The plan is projected to replace about $2.8 billion in property taxes with revenue gained from an increase in the state personal income tax to 3.26 percent from its current 3.07 percent, from gaming revenues, and from a broadened sales tax.

The sales tax would be expanded to cover numerous items currently not taxed, such as local newspaper advertising, airline catering, amusement devices, automobile parking, candy, commercial sports admissions, horses, storage, and magazines.

All Districts Covered
Under the House proposal, all school districts would be subject to the referendum requirements contained in Act 72. Pennsylvania Department of Revenue Secretary Gregory Fajt, testifying before a Special Senate Committee on January 4, 2006, said the plan would fall about $400 million short of the revenue needed.

Jake Smeltz, policy director for state Sen. Noah Wenger (R-Lancaster), the majority caucus chairman, agreed with Fajt’s assessment. He added it was Wenger’s position that the broadened sales tax would have a negative impact on Pennsylvania’s economy.

Senate Wants Local Choice
The Senate passed its own plan on December 15. Known as SB 40, the measure would allow all but the largest school districts the option of letting voters choose an increased local earned income or personal income tax that would knock at least $200 off the tax bill for each owner-occupied home. Under the Senate plan, homeowners in Philadelphia would get a break on the city’s wage tax.

The Senate also has established a 23-member Special Committee on Legislation, chaired by Wenger. This committee will consider all legislation on property tax reform. During January the committee held six public hearings on reform measures.

The Senate plan, like the House plan, also would make use of gaming revenues and require local voter approval of any future property tax increases that exceed the rate of inflation.

“We think this should be a local decision because not everyone across the state sees property taxes the same way,” said Smeltz.

Smeltz, who is also a local school board director, said the larger problem is “the cost of public education is outpacing the ability to pay for it.”

Michael Coulter (mjcoulter@gec.edu) teaches political science at Grove City College in Pennsylvania.
nearly $111 billion state budget for the fiscal year that starts April 1 represents his last opportunity to secure a positive fiscal legacy before his term concludes at the end of 2006. The state will end the current fiscal year with a $2.7 billion surplus.

The “state funds” portion of the budget (excluding federal grants) would total just under $75 billion, a growth rate of 6.6 percent over the prior year. Even after adjusting for the state’s continuing takeover of locally funded Medicaid costs, the budget hike is the second-largest Pataki has proposed in his 12-year tenure as governor, according to E. J. McMahon, director of the Manhattan Institute’s Empire Center for New York State Policy.

$2.5 Billion Cuts Proposed

Pataki’s proposed state tax cuts would amount to $2.5 billion when fully implemented over the next three years. They include:

- eliminating the marriage penalty by increasing the standard deduction for married taxpayers and doubling the threshold where the rate table recaptures apply;
- cutting the top income tax rate from 6.85 percent to 6.75 percent;
- increasing the income threshold where the top income tax rate applies from $40,000 to $60,000 for married taxpayers and from $20,000 to $30,000 for single taxpayers;
- providing an educational income tax credit of up to $500 for qualified family expenses for students in school districts with underperforming schools;
- reforming the corporate and bank tax by eliminating the alternative minimum and capital bases;
- reducing the top corporate tax rate from 7.15 percent to 6.75 percent; and
- eliminating New York’s estate tax by increasing the exemption threshold and then eliminating the tax.

“This package is the natural sequel to the historic tax cuts enacted during the first half of Governor Pataki’s tenure,” McMahon said. “The governor has laid out a strong pro-growth, pro-investment tax policy agenda that could serve as a benchmark for his successor.”

“The governor has laid out a strong pro-growth, pro-investment tax policy agenda that could serve as a benchmark for his successor.”

E. J. McMahan

EMPIRE CENTER FOR NEW YORK STATE POLICY

Education Credits, Charters Gain

Pataki also called for an expansion of the state’s school tax reduction (STAR) program for homeowners—essentially a state-funded homestead exemption—to give $400 rebates in school districts that limit budget increases. The existing STAR exemption for senior citizens would be indexed to inflation.

The governor made two other significant proposals regarding education:

- an increase, from 100 to 250, in the existing statewide cap on the number of privately operated public charter schools; and
- a $500-per-child education tax credit, which would apply to qualified education expenses incurred by parents of private and public school students in school districts that have a failing school as certified by the federal No Child Left Behind Act. (The credit would be phased out for parents with incomes above $75,000.)

Choice Advocates Hail Gains

The governor’s proposed charter school cap expansion and education tax credit were hailed by New York school choice advocates.

“Governor Pataki’s proposal to create an education tax credit is a valuable, exciting development in education reform,” said Tom Carroll, president of New York State’s Foundation for Education Reform & Accountability (www.nyfera.org). “Parents who are most in need of choices in education have a new door opened to them. Programs such as this in a half-dozen other states have spurred millions of dollars in private investment in education and have made a huge difference in the lives of many low-income families.”

Teachers Oppose Reforms

Both proposals—the charter school cap expansion and the education tax credit—it appear to enjoy relatively strong support in the legislature, although they are by no means assured of approval in the face of strong opposition from teacher unions.

Pataki’s final budget proposal is $48.1 billion higher than the spending plan he inherited from former governor Mario Cuomo in 1995—a 76 percent increase during a period when the cost of living rose less than twice as fast. And that may be the best-case scenario, because the Republican-controlled Senate and Democrat-dominated Assembly customarily add significant spending to Pataki’s proposals.

“The ultimate viability of the tax cuts and other key priorities, such as the education tax credit and the new STAR rebate linked to a cap on school spending, will depend to a great extent on Pataki’s ability to hold the line on spending as a lame duck,” McMahon concluded.

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West Virginia Sees Some, Not Enough, Tort Reform

by Sean Parnell

There are two tort systems in West Virginia, or so it seems to observers of the litigation climate there. The first has been reformed in recent years, delivering the benefits of competition and choice to consumers, lowering prices, and luring companies and professionals.

The second tort system, however, continues to drag down the West Virginia economy, delivering verdicts against defendants that bear little relation to actual damages or a fair reading of liability. This second and unreformed tort system earned West Virginia the dubious distinction of being the only statewide area to be named a “judicial hellhole” by the American Tort Reform Association in its late 2005 report. The other areas named “judicial hellholes” were the Rio Grande Valley and Gulf Coast in Texas; Cook, Madison, and St. Clair Counties in Illinois; and South Florida.

The first West Virginia tort system addresses medical malpractice, automobile, and homeowners insurance. The reforms, enacted earlier in 2001 and 2003, have ended the exodus of doctors who could not afford skyrocketing malpractice insurance and led auto and homeowners insurance carriers who left the state earlier to return. Insurers who had remained have been filing for rate decreases with the state’s Insurance Commission.

“[T]hese reforms have worked, cutting medical malpractice lawsuits significantly and reducing the total amount of paid verdicts and settlements by over 50 percent.”

BOB MANCHIN III
GOVERNOR - WEST VIRGINIA

In sharp contrast to the insurance market, however, firms in other lines of business are not so lucky when it comes to West Virginia’s tort system. West Virginia was ranked 49th of 50 states in a survey of legal counselors and senior litigators at major corporations conducted for the U.S. Chamber of Commerce, beating only Mississippi. Their key concerns include lawsuits relating to asbestos and silica; a state supreme court that is openly hostile to corporate defendants against claims for medical malpractice, homeowners, and auto insurance, in order to “… build a stable and attractive business climate.”

Manchin also noted the success of those earlier reforms, led by previous governor and fellow Democrat Bob Wise. “Under the leadership of Governor Wise and the legislature, the state recently enacted significant reforms to address skyrocketing malpractice costs for our doctors,” Manchin said. “And these reforms have worked, cutting medical malpractice lawsuits significantly and reducing the total amount of paid verdicts and settlements by over 50 percent.”

A study prepared in 2003 by the Percyman Group, an economic research and analysis firm, found excessive litigation cost the West Virginia economy $300.6 million in 2001 alone, a figure expected to reach $626.3 million in 2006. The study also found an expected permanent loss of 16,306 jobs.

According to the report, the typical West Virginia household would lose about $1,519 per year through higher inflation, lost income, and decreased spending. In addition, the report noted West Virginians would face “substantially diminished job prospects” and a “less efficient judicial system to compensate for legitimate losses.”

“The civil justice climate has definitely had a negative impact on West Virginia,” said Karen Price, president of the West Virginia Manufacturers Association. “Companies look at the climate and it affects decisions on where they invest or reinvest.”

Asbestos, Silica Reforms Sought

Manchin and the state legislature are considering additional tort reforms this year. Price cited legislation to cap appeal bonds in civil lawsuits as a top priority. At the time she spoke with Budget & Tax News, legislation to accomplish that had passed the Judiciary Committee of the State House.

In its Policy Issues 2006 report, the West Virginia Chamber of Commerce cites the need for reforms in medical criteria for asbestos and silica claims. “Currently in West Virginia,” the report notes, “people with serious asbestos-related illnesses, who need immediate help, must get in line with thousands of plaintiffs who are not sick/impaired and may never be.” As a result, people who are sick with asbestos-related illnesses “are receiving reduced or delayed compensation” as the number of claims overwhelm the system.

An additional concern is that West Virginia companies “are facing significant challenges, including bankruptcy, because a few aggressive plaintiff attorneys are filing thousands of asbestos suits for non-impaired claimants.” The chamber fears similar concerns could arise over claims based on silica exposure.

The solution offered by the state chamber is to establish medical criteria based on standards developed by the American Medical Association for claims based on asbestos and silica exposure and require that there be a doctor-patient relationship between the claimant and the doctor making the diagnosis. Currently, doctors are allowed to diagnose patients they have never seen based on a brief examination of x-rays.

According to the chamber, passing medical criteria legislation would ensure that people who have asbestos- and silica-related illnesses have their day in court. Florida, Georgia, Ohio, and Texas have adopted similar legislation.

“Good Chance” of Reform

Price is optimistic about the chances of getting significant reforms passed in 2006 and beyond. “I think there is a good chance that we will make several reforms this year. Reforming civil justice isn’t something you solve in one year, it is going to take several years.”

“[E]xcessive litigation cost the West Virginia economy $300.6 million in 2001 alone, a figure expected to reach $626.3 million in 2006.”

She also said successful earlier reforms have made it easier to pass additional reforms. “West Virginians have seen the past reforms bringing doctors back into the state, and greater availability of automobile and homeowners insurance at lower rates than before,” Price explained.

“People ought to keep an eye on West Virginia. We’re going to make significant reforms over the next few years,” Price said.

Sean Parnell (parnell@heartland.org) is vice president - external affairs of The Heartland Institute.

INTERNET INFO


The report of The Percyman Group is available on its Web site at http://www.perrymangroup.com/.

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— Reprinted from Judicial Hellholes 2005, American Tort Reform Association
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