



POLICY BRIEF

What Works: Fixing State Budgets

Freeze or Slow Public Employee Salary Growth: Wages and salaries of public employees account for nearly half of all state and local government spending. Freezing state employee salaries, particularly during large recessions, is not only fair for taxpayers that are already cutting back, but can greatly help the state from overspending revenues. For example, the Empire Center for New York State Policy calculates that a pay freeze for state, local, and school district employees would save New York \$1.6 billion through fiscal year 2011 – nearly 22% of the entire size of the state’s budget deficit at the start of this year.ⁱ

The average state or local employee’s wages and benefits amount to \$39.66 per hour compared to \$27.42 in the private sector.ⁱⁱ As of December 2009, the average salary for federal public employees is \$71,206 and for state employees its \$54,101, while the average income for a private sector worker is \$40,331.ⁱⁱⁱ Additionally, the portion of federal government employees pulling in six figure salaries rose 5 percentage points during the first 18 months of the recent recession.

While higher incomes and benefits are certainly a good thing, the private sector often struggles to carry the weight of state employee salaries through higher taxation. An estimated 60% of business tax increases – which often pay for these higher state employee salaries – are covered through lower wages and benefits on private sector workers.^{iv}

Public employee compensation also grossly outpaces that of private sector employees in states with strong public employee unions. For example, according to the Cato Institute, public employees in Pacific region states, which are 64% unionized, are paid 59% more than those in the private sector.^v In contrast, public employees in the South Central region are only 13% unionized and are paid only 26% more than private workers.

Defined Contribution Plans provide each worker with his or her own individual, personal retirement account. Government employees can choose the blend of investment vehicles that best serve their unique situation. Best of all (for state budgets), the individual worker has already paid for his or her own retirement when retirement day comes. No structural problems occur as population growth declines. Unfortunately, most states and localities provide defined benefit pension plans for public employees, which finance retiree benefits with subsidized contributions from current workers. These plans are “baked in the cake” of many of today’s budget crises.

Privatization of Infrastructure and State Operations removes the taxpayer burden of paying for improvements and helps cities to save money and create jobs. For example, in 2006 Indiana began the lease of its toll road bringing in the state \$3.8 billion in new revenue.^{vi} Similarly, in 2005, Chicago leased the Chicago Skyway bringing the city \$1.8 billion in revenue.^{vii} In recent years states with the most severe budget shortfalls have found privatization to be an effective way to generate new revenue without raising taxes. This year Arizona will raise \$735 million through the sale of prisons and other state assets.^{viii} In July, California authorized the sale of 17 state office buildings and will generate hundreds of millions of dollars alone through the sale of the Orange County Fairgrounds.

In Virginia, policymakers are discussing plans to sell Virginia ABC stores as a source of revenue and an opportunity to save taxpayer dollars. The Wilder Commission has estimated that the

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privatization of state-run alcohol beverage stores (ABC stores) would generate more than \$500 million in revenue, not including savings from eliminating overhead.^{ix} The current overhead cost runs about \$115 million a year, taking into account the salaries and benefits of state employees.

Securitizing Tobacco Settlements allows states to sell the revenue stream of payments from the tobacco Master Settlement Agreement through bonds in return for large up-front payments. Since 2001, securitization has helped at least 6 states rectify overspending problems amounting to over \$9 billion by acquiring a large sum of cash in lieu of raising taxes. This measure can be critical to buy states the time they need for permanent structural changes.

Competitive Sourcing opens up jobs currently done by government employees to private sector competition to save states money and increase efficiency. For example, Gov. Jeb Bush (R-FL) saved taxpayers over \$550 million by outsourcing government services to private companies.^x

A similar Commission on Government Streamlining was also enacted by Gov. Bobby Jindal (R-LA) in the spring of 2009, which presented the governor and legislature with over 200 recommendations to save the state \$1 billion through privatization, consolidation, and elimination of government activities.^{xi} Reforms include a statewide spending limit, transitioning from defined benefit to defined contribution pension plans, and large-scale government overhauls. The Commission also recommended over a dozen privatization initiatives that are projected to save the state nearly \$90 million. Gov. Jindal also eliminated over 70 unnecessary or inactive state boards and commission.

Eliminate “Prevailing Wage” laws to save double digit percentages in state construction and maintenance, amounting to hundreds of millions of dollars. Prevailing wage laws require contractors to essentially pay workers no less than the union wage. As a result, unionized construction companies significantly inflate the cost of any government project.

Constitutional Limits on Taxes and Spending: If lawmakers wish to end the boom and bust budget cycles and eliminate structural deficits, they will need to promote policies that force the government to live within its means. The best way to do so is to prohibit government spending from increasing faster than the rate of population growth and inflation. Legislation that would require such is commonly referred to as the Taxpayer Bill of Rights. Colorado implemented TABOR in 1992, and as a result kept government growth in check during the boom years of the late ‘90s, allowing it to weather the first recession of the 2000s while other states were swimming in red ink. Unfortunately, TABOR was suspended in Colorado, and its effectiveness is muted during the current recession.

California has one of the most severe structural deficits in the country and is a model of unsustainable state spending. It also underscores the fact that overspending, not lack of revenue, is the state budget woe. California spending has nearly tripled since the early 1990’s, while revenues have increase 167%.^{xii} If California had simply limited spending to population growth and inflation since 1991, the state would be sitting on a \$15 billion surplus as opposed to the \$42 billion deficit that it started the year with.^{xiii}

Reoccurring non-tax revenue: Many states will continue to face budget shortfalls in the coming years. However, in too many state capitols across the country there is a lack of political will to make necessary reforms and spending cuts. In light of this reality it is important that lawmakers identify all sources of reoccurring non-tax revenue. Utilization and development of natural resources provides perhaps the most effective source of reoccurring non-tax revenue for states.

In California, the world's 8th largest economy, perennial budget deficits have had the Golden State mired in fiscal crises for years. Facing a record \$42 billion budget deficit in February, legislators raised taxes by \$16 billion on the already heavily burdened California taxpayers. However, utilization of the state's vast offshore energy reserves could have served as a pro-growth alternative to further tax hikes.

There are at least 9 billion barrels of oil off California's coast and at least 1 billion barrels are located in waters that are solely controlled by the state.^{xiv} Reserves found in state controlled waters alone could generate \$5 billion for the state right away via securitization. Furthermore, these reserves can be tapped using environmentally sensitive methods such as slant drilling, which requires no new rigs.

Development of all U.S. offshore energy resources that had previously been off limits would generate \$1.7 trillion in local, state, and federal tax revenue.^{xv} In fact, development of all U.S. oil and natural gas resources could yield more than \$4 trillion over the life of the resources. Greater state and federal profit sharing will serve to heighten this monetary benefit even further. Most importantly, the substantial injection of revenue will mitigate the prospect of further tax increase proposals on the already overly burdened American taxpayers.

The Marcellus Shale Formation in Pennsylvania, Barnett Shale Deposit in Texas, and Pebble Deposit in Alaska represent onshore examples of similarly lucrative sources of reoccurring non-tax revenue. Facing a sizable deficit this year, Pennsylvania lawmakers are planning to generate hundreds of millions of dollars in reoccurring non-tax revenue through the lease of state land for energy exploration. ATR advises lawmakers to utilize and leverage natural resources found in their state.

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ⁱ McMahon, E.J. and Josh Barro. "Blueprint for a Better Budget: A Plan of Action for New York State," Empire Center for New York State Policy, January 4, 2010.

<<http://www.empirecenter.org/Documents/PDF/Blueprint-Final6.pdf>>

ⁱⁱ Edwards, Chris. "Employee Compensation in State and Local Governments," *Cato Institute Tax & Budget Bulletin*, No. 59, January 2010.

ⁱⁱⁱ "For feds, more get 6-figure salaries", *USA TODAY*, December 11, 2009.

<http://www.usatoday.com/news/washington/2009-12-10-federal-pay-salaries_N.htm>

^{iv} Carroll, Robert. "The Corporate Income Tax and Workers' Wages: New Evidence from the 50 States," *Tax Foundation Special Report No. 169*, Tax Foundation, August 2009.

^v *ibid.*

^{vi} Gilroy, Leonard. "Annual Privatization Report: 2009," Reason Foundation, August 6, 2009.

^{vii} *Ibid.*

^{viii} Pitzl, Mary Jo. "Buildings sale nets \$735 million for Arizona." *Arizona Republic*. January 15, 2010.

^{ix} Scarborough, Melanie. "Picking Low Hanging Fruit from the State Budget: Sensible Reductions in State Spending." Thomas Jefferson Institute, pg. 9, December 2005.

<http://www.thomasjeffersoninst.org/pdf/articles/Low_Hanging_Fruit.pdf>

^x Gilroy, Leonard. "Annual Privatization Report: 2009," Reason Foundation, August 6, 2009.

^{xi} *Ibid.*

^{xii} ATR calculations of National Association of State Budget Officers, "Fiscal Survey of the States," Fall editions.

^{xiii} ATR Calculations.

^{xiv} Rohrabacher, Rep. Dana. "Testimony Before the Committee on Natural Resources," February 24, 2009. <<http://republicans.resourcescommittee.house.gov/uploadedfiles/RohrabacherTestimony02.24.09.pdf>>

^{xv} "Strengthening Our Economy: The Untapped U.S. Oil and Gas Resources," American Petroleum Institute. <http://www.api.org/Newsroom/upload/Access_Study_Final_Report_12_8_08.pdf>