Rhode Island Policy Reporter

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Budgeting for disaster

Throughout the disaster of a budget season we've just endured, funding education remained at the center of attention. The final budget saw plenty of other victims, but the most dramatic and tragic last stands were about school funding. In the Governor's original budget proposal the state-run public schools were all to get twice the increase in state aid as the local districts.[1] Could there be a clearer acknowledgement that state aid wasn't rising as fast as school expenses?

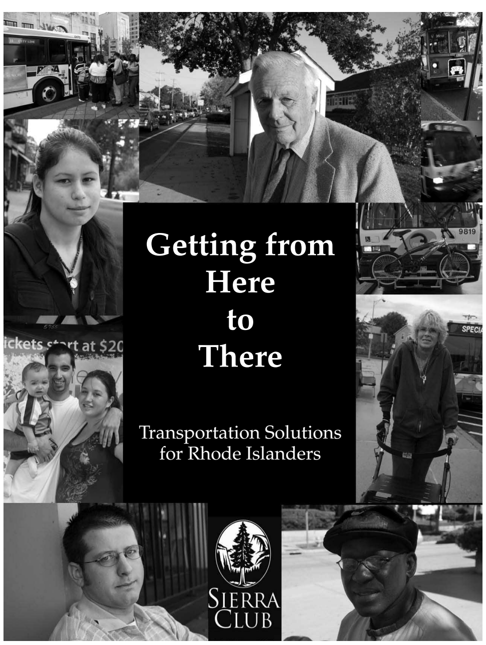
The Governor's proposed underfunding wasn't nearly the blow dealt by the House Finance committee. For several years now, local districts have been able to count on the committee to talk about holding the line against the Governor's depredations, if not actually to do it. This year, though, they decided to top him, and provide no increase at all.

There were two really remarkable features of the performance of the General Assembly leadership this spring. One is how valiantly they defended their budget against amendments, especially amendments to restore the Governor's meager level of funding to schools. All such amendments went down to defeat. One amendment would have restored the state tax on capital gains income to its 2006 level, and another that would have financed the cost by re-amortizing the unfunded liability of the pension system.[2] Both failed. Another bill, to allow towns to fund schools with a tax on cable-TV services, also went down to defeat.

The other remarkable feature of the Assembly's performance is that this wholesale slashing of funding for education came *after* the release of a report about education funding—commissioned, staffed and overseen by the very same Assembly. (And led by Rep. Edie Ajello of Providence and Sen. Hannah Gallo of Cranston.) The conclusions of the report were roughly the opposite of what was done. The report's intent was to establish a baseline level of funding necessary to provide an "adequate" education in Rhode Island right now. It used a variety of different pricing strategies: looking at the cost of successful schools (local and out-of-state), making up budgets for model schools, and looking at the costs of successful programs in schools everywhere. The different pricing strategies lead to different overall conclusions, but not so terribly different. Converted to per-pupil costs, the estimates ranged from $9,150 to $10,112. The

[1]See **RIPR** issue 24, page 3 for details, at *whatcheer.net*.

[2]This was offered by Art Handy (D-Cranston), in response to issues raised here (see **RIPR** issue 9). By failing to understand the point of our pension funding policy, the state and all the municipalities are falling victim to dramatically escalating pension costs—the very thing the policy is supposed to prevent. The failure this year was especially remarkable, since it is as close to free money as you'll ever get in conversations about the state budget.



On June 28, the Rhode Island chapter of the Sierra Club released a report, written by me, about our state's bus system and possible ways to improve it. The report describes some ways the state could begin to improve bus service. The first obvious way is to support the system with the resources it needs to meet the demand it has today. No surprise there. The second most important thing we could try is to stop making RIPTA's job harder.

To be a bus-rider or a pedestrian in Rhode Island is to be considered a second-class citizen. You're constantly climbing over some guard rail, wading through bushes, running out of sidewalk to walk on or dodging death in oncoming traffic. Plus, there isn't a "walk" light in the state that perceptibly changes when you push the button.

Moving traffic to buses is crucial if we want to reduce air pollution, both the particulate kind or the global-warming kind. About half of our smog comes from cars, and a third of the CO_2. But if we want to persuade people to shift to buses, we have to do a lot more than we do now to make that alternative appealing.

We need to plan our state better, to stop making decisions that make it difficult or impossible to get around without a car. Every new business at Quonset Point, or at one of the Blackstone Valley industrial parks sends a message: you need a car if you want a job. Every suburban Wal-Mart or Stop 'n Shop, surrounded by acres of blacktop and remote from public transit sends another: you need a car if you want to shop. RIPTA's funding is important, but these messages are part of the problem, too.

Find the report at *ri.sierraclub.org* or at *whatcheer.net*. –TS report also contained ways to account for the extra costs associated with special-education students (about twice as much), very poor students (50% more), and students whose English is limited (20% more). What you learn from the report is that ensuring an adequate education for *all* Rhode Island's students is within our grasp, but it will require substantial increases in education funding.

The adequacy study was preliminary to another battle, about creating a predictable formula for distributing state aid to schools. Before 1995, there was a formula in place, so that school officials knew what to expect each year. That formula is no longer used, and since 1995, districts have gotten some money, based on whatever they got the year before. Some years it goes up, some years it goes down, and districts don't know what it will be until after the budgets that depend on it are approved, which is awkward, at best. The debate about what kind of a funding formula will be established and how it will be funded is only just beginning. Optimists hope something concrete will be settled this fall or next winter. The rest suspect we'll have a replay of the 1994-1995 discussions of the "Guaranteed Student Entitlement" (GSE).

Thirteen years ago, no one was willing to say how *to fund education, so reform died. Will history repeat?*

The GSE was a proposal, similar to the adequacy study, to make sure that every student in the state had available a certain amount of money to fund their education. The problem was that the GSE was going to cost a lot more than the status quo. Policy makers would praise the concept, but no one in a position of influence was willing to propose a plan to fund it. When asked about funding, they would say, "We need a plan," but would never exactly suggest what it should be. It was quite obvious that any realistic plan would require new tax money, and no one wanted to be first to propose such a thing—even for educating children. What little discussion there was cloaked dirty words like "taxes" in ambiguous and generic language like "resources."

With everyone waiting for someone to make the first move, no one moved. Without a plan to fund the thing, or anyone clamoring for one, the GSE was easy to endorse, but it was even easier to ignore. So after a year or so in policy limbo, it faded gently from sight.

Now we have the Ajello/Gallo funding study—a widely respected study that produced a set of perfectly reasonable conclusions that have been thoroughly ignored by the Assembly leadership and the Governor for this year's budget. Do they think the children will wait? Do they think that no one will be hurt to put this off yet one more year? Now it's time to begin debate about the funding formula. Who will stand up this time?[3]

Trouble on the way

Besides education funding there is, of course, plenty of other fodder for criticism in this budget: changes in prison policy meant not to help young offenders, but to save money: minor cuts in nursing home funds that will lose us a tremendous amount of federal matching funds; a decimation of funds for child care and heating assistance for poor families; new and increased fees for virtually everything; approval to build yet another new suburban court building; and many more.

Among my favorites is a plan to borrow $2.5 million to build a "data warehouse" for the tax division. This is just a central data store for tax data, something we don't currently have. It is a useful and essential facility, and it's astonishing that our state has made it to 2007 without such a thing, but rather than hire people who know how to build such a thing, we're going to hire a contractor to do it at a highly inflated cost, and likely be left with a system that needs that contractor in order to change anything. The state currently spends *$5 million* each year to Northrop Grumman, the contractor who built the "InRHODES" computer system that sends out welfare checks. (See **RIPR** issue 8.) Developing that system in the way we did it was a mistake, pure and simple. Now if we're not careful we're going to repeat it for the Tax Division.

Budget secrecy One of the biggest problems with state fiscal policy now is that so few people are involved in making it. Maybe that doesn't sound like a problem as big as, you know, not having enough money to pay the bills, but it's an important problem nonetheless. Between the Governor's introduction of the budget each winter and its eventual reappearance months later, most members of the legislature know as little about the final shape of the budget as you do. There are

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[3]Besides this newsletter, whose editor believes that the bulk of the funding should come from a dedicated income tax surcharge.

even members of the House Finance Committee who share the predicament. When a budget bill, "Sub A," finally emerged from the shadows earlier this month, some members were as surprised as I was by the new provisions.

The people who control the process, the chair of House Finance, the House Speaker, the Majority Leader, and a very small number of others, *own* the budget as produced. They make no show of bowing to public pressure. Indeed they make a virtue of resisting it. If they were to claim that public pressure forced them to add some budget provision, no one would believe them. This is, of course, not very democratic of them and we're supposed to be a democracy and so on, but the real problem is that the process is held so closely that it's all personal. For members of the House leadership, to rescind a budget decision they've made would be to admit a mistake, in public.

The leadership owns the tax cuts they've passed, and can't repeal them without admitting error. So they won't.

Last year, as has been amply bemoaned in these pages, the House originated and passed a tax cut only for the very richest of the rich taxpayers. When ultimately phased in, in 2012, this will benefit fewer than 10,000 taxpayers, many of whom live out of state. By that time, the cost of the cut will be upwards of $100 million, possibly as much as $140 million.[4] Right now, the cut costs only about $15-20 million, and in a year when the deficit is numbered in the hundreds of millions, this isn't a big number. But ultimately it will be a lot of money, and in the not-very-distant future it will become another huge burden on the state budget. At that point, the House leadership will not be able to back down without admitting in some small way that they were wrong. Our prediction: they'll bankrupt the state and all its cities and towns first.

How much better would it be to have real public deliberation of the budget? The public aspect of Finance Committee deliberations sometimes seem little more than pro-forma charades, but if the committee was only somewhat more fractious, the chair could allow himself to be swayed or even outvoted from time to time. We could change policy without the leadership having to admit they were wrong. But as it is, state fiscal policy is what they say it is, and until we have leaders strong enough to admit error from time to time, we will keep digging ourselves deeper and deeper into the hole we're in. ■

[4]These are **RIPR** calculations. The tax division weighed in last year, saying that had the tax cut been in effect in 2005, it would have cost the state $75 million. It's only wishful thinking to imagine that the ultimate cost will be so low. By 2012, inflation and income shifts will swell this number—a lot.

BOOK REVIEW

Divining the Future

Boomsday
A Novel
Christopher Buckley, Twelve Press, 2007, 318pp

Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds
Henry Paulson, Elaine Chao, Michael Leavitt, et al., US GPO, 2007, 218pp

Would Social Security be saved by encouraging retired seniors to commit suicide? Cassandra Devine, the blogger heroine of Christopher Buckley's new novel, *Boomsday* wants to encourage "Voluntary Transitioning" of the over-65 crowd with promises of massive tax cuts for their heirs. In a fairly zany send-up of Washington involving ruthless PR firms, policy-innocent elected officials, greedy high-tech billionaires and craven evangelical leaders, the proposal gets a serious hearing in Congress, where it... Well, it wouldn't be fair to go on.

Cassandra, who apparently writes for an audience of millions on her eponymous blog, works at said ruthless PR firm, whose clients include North Korea, along with the "toxic waste dumpers, dolphin netters, unzipped politicians" and so on. Blogging here is described as a self-indulgent activity: Cass writes for comfort and to make trouble. She is grudgingly allowed a core of good intentions, but it's never quite clear if this is her primary motivation. She gets off best. Randy Jepperson, the randy Senator, hears his calling to public service while on a youthful acid trip in Boston's JFK library. Gideon Payne, the director of the Society for the Protection of Every Ribonucleic Molecule (SPERM) and owner of a huge chain of nursing homes, follows mammon more than morality. President Riley Peacham only wants to stay in office after the next election.

How a bunch of leaders can, by not listening to each other, achieve an outcome no one thinks is a good idea.

The book is funny: a quick, light, read that even contains some interesting insights about how a group of small-minded and stubborn "leaders" who, by disagreeing and refusing to speak to each other constructively, can conspire to achieve an outcome that none of them thinks is a good idea. But that's not to say it's pure pleasure to read. All the marks he hits are pretty easy shots: serious and unfunny activists, cowardly elected officials, self-indulgent baby boomers. Applauding this kind of wit is like applauding a virtuoso rendition of "Mary Had a Little Lamb." You didn't buy a ticket to hear easy stuff.

A more substantial irritant is the underlying premise on which the story is founded: Social Security is an impending disaster, greedy baby-boomers will ruin it for everyone who follows. This, of course, is what everyone "knows" about Social Security. Too bad it's not true.

It's not as if Buckley's is a minority view. You can find confirmation of the crisis in all kinds of reports, from the Cato Institute,[5] the Heritage Foundation,[6] the US Chamber of Commerce,[7] and even in the introduction to the 2007 Social Security Trustees' report. They all agree: the system is headed for trouble in only a few short years. According to the Trustee's report, in 2017, the Social Security taxes collected won't be enough to pay the benefits owed, forcing the system to rely on interest from the trust fund. By 2027, the interest earned by the trust fund won't be enough, either, and they will have to spend the capital. This will require redeeming the bonds in the trust fund, and, according to a helpful aside on page 8, this will "require a flow of cash from the General Fund of the Treasury" that will increase "pressures on the Federal Budget." By 2041, the trust fund will run out completely, and the taxes collected will only be able to pay three-fourths of benefits.

The story *sounds* dire, but how dire? Three-fourths of benefits isn't the same as being flat busted; there's an opportunity for minor adjustments now to make a big difference later. What's more, redeeming the bonds in the Social Security trust fund isn't going to be a drain on the Treasury. Those bonds are a small part of the trillions of dollars of bonds that make up our national debt. They sit in a locked filing cabinet in a Social Security administration building in West Virginia,[8] but in effect are no different than the bonds held by banks in New York, Berlin or Tokyo. Bonds have a term, and when the term is up, the bearers of the bonds redeem them, and that's the way they work. Managing the national debt involves a never-ending "flow of cash" as borrowed money flows into the Treasury and repaid funds flow out. When the Social Security Administration seeks to redeem its bonds, all it means is that the outflow will be directed to US citizens instead of banks, foreign citizens, or other investors. This isn't a *bad* thing. In fact it's a very good thing, and to the extent that our own citizens can finance our own national debt, we should let them. As a matter of both economics and national security, it is better to borrow from you and me than from China or Great Britain.[9]

Our nation would be in better shape if the things that everyone "knows" were also true.

So, right there on page 8, the Trustees' report contains a gratuitous and misleading statement about the federal budget. Unlike *Boomsday*, it's not complete fiction, but it's not what you'd call "just the facts," either. The passage announces that the report is a political document, with a perspective to sell. This is hardly surprising, since the Social Security trustees are all Bush appointees, several of whom are on record expressing disappointment over the failure of the President's plans to turn over the Social Security funds to private investment managers.

The Trustees' Report isn't complete fiction, but it's not just the facts, either.

So what about the rest of the story? The weakening in 2017, the decline after 2027, the exhaustion in 2041? Time for some history: For the first fifty years of its existence, the Social Security system paid its benefits out of the taxes it collected, accumulating a very small fund for cash-flow management.[10] In the early 1980's, the Social Security trustees pointed out that the retirement of baby boomers was going to make it difficult to continue in this way. So Social Security taxes were increased to create a more substantial trust fund to get us over the baby-boom bump. Now, we learn that the trust fund will be exhausted in 2041, when the last of the Boomers are in their 80's. In other words, the reforms of the early 1980's seem to be working just as they were intended to. Where's the crisis?

The Crisis As usual in cases like this, it's right in front of our eyes. But it's not a Social Security crisis, it's an employment crisis. Over the past 30 years, public and private policy decisions have made life harder and less

[5]There are 33 different articles about the Social Security crisis and how to solve it on the Cato Institute web site. Find them at *cato.org/pubs/ssps/sspstudies.html*.

[6]There are over 200 articles in the "Retirement Income and Social Security" section of the Heritage web site, dating back to 1977.

[7]See *uschamber.com*, look under "Issues Center."

[8]Courtesy longtime Senator Robert Byrd's ability to bring home the bacon to his home state.

[9]China sells us a great deal of stuff they manufacture, which means that they have many more dollars than they need or want. The current state of affairs has them sending those dollars back by buying our bonds. Unfortunately, this is only a temporary solution, since those purchases have to be repaid when the bonds are redeemed. Since we manufacture so little of what the Chinese want to import, there is currently no solution to this trade imbalance, and it will continue to get worse until either the Chinese allow their currency's value to float or a crisis intervenes. Stay tuned.

[10]This is to say that, in the parlance of pension funds, its "funding ratio" was very low, a matter of a few percent. (See **RIPR** issue 9.) In fact, keeping reserves *down* was an important policy goal, at first, since influential senators feared a reserve fund would simply finance big deficits. In fact, they turned out to be quite correct on the point, as was proven in the 1980's. (Source: "Social Security: A Program and Policy History," by Patricia Martin and David Weaver, Social Security Bulletin, 66(1), 2005. Find it at *ssa.gov*.)

secure for everyone on the lower end of the income spectrum. These range from decisions to outsource manufacturing production to Mexico or China, erosion of labor protections and the right to organize, tax policy changes to favor the wealthy at the expense of the not-so-wealthy, the shifting of salary resources away from workers and toward CEOs and other upper management, and much more.

The results are entirely predictable:

- Income is stratified in ways that haven't been seen since the 1920's. The richest 1% of people now command 22% of all the income, up from 8.9% in 1979.[11]
- We have millions fewer workers making things than we had 30 years ago. In 1980, we had 24.9 million people employed in "goods-producing" industries. In 2007, there were 22.6 million. Over the same period, the non-farm workforce grew from 90 million to 137 million.[12]
- Adjusted for inflation, wages for anyone below the middle have hardly changed since the 1970's.[13]
- Long-term unemployment is almost 20% of unemployed workers today. In 1979, it was 8.6%.
- The share of temp agency workers who've been temping for more than a year has risen from 24.4% in 1995 to 33.7% in 2005. Contract employees who'd been on the job for more than a year increased from 50.9% to 65.2%.

Scattered throughout the notes in the Trustees' report is evidence that these changes are the real source of trouble for the Social Security system. For example, the projections about when this or that funding crisis will occur are based on estimates for wage growth in the future. If, over the next few decades, we get wage growth like we had in 1995-2000, Social Security will be fine. If we get it like in 2000-2005, or (worse) what we had in the 1980's, we'll be sunk. If we get wage growth that all accrues to rich people, we're also in trouble.

The tax that funds the Social Security system is a regressive tax. We all pay the same percentage of our income (12.4%, shared between employer and employee) into the system, but people who earn more than about $100,000 per year all pay the maximum ("cap") amount. "Fairness" is a matter of opinion. We can differ about whether a regressive tax is fair or not. But the math isn't subjective: if you have a regressive tax and shift income so that the rich get richer, your tax collections will go down if everything else stays the same. All the policy changes of the last 30 years that have increased income inequality in America have had the effect of reducing the collections of the Social Security taxes.

Is this a Social Security crisis, or a crisis of income distribution?

Another intriguing note in the report (page 12) points out that the projections assume that income from the Social Security tax will decline in part because the actuaries expect future employee compensation gains to be largely provided in fringe benefits. This is a technical way to say that ever-increasing health care costs will suck up any possible wage gains to workers for many years to come. Another, more provocative, way to say the same thing: real health care reform will render all these assumptions irrelevant *if health care is no longer related to employment*.

So here at last is the real "Social Security" crisis. The changes we've seen over the past 30 years, in employment and income, in labor law and trade relations, have all conspired to shift income *up* the scale, which tends to reduce the collections of the Social Security tax. When America's corporate managers chose to send our industrial jobs overseas, they eliminated the jobs that were going to keep Social Security afloat when they retired. When our President signed trade agreements that allowed those jobs to be sent away, they were jeopardizing the most effective anti-poverty program our nation ever enacted.

[11] Thomas Pinketty and Emmanuel Saez, "Income Inequality in the United States, 1913–1998," Quarterly Journal of Economics, 118(1), 2003. Updated to 2005 at *emlab.berkeley.edu/users/saez*.

[12] BLS statistics, available from *bls.gov*.

[13] This and the next two points are from the Economic Policy Institute's "State of Working America 2006/2007." See *epinet.org*.

Fixes The Trustees' report contains several suggestions for fixing the funding issues. They point out that increasing the Social Security tax less than two percentage points, to 14.35% now would solve the problem, as would raising taxes by five points in 2041. We could also raise (or eliminate) the cap, making the tax less regressive, and solve a big part of the problem that way. So there are solutions, and they're not necessarily great ones, but they aren't huge disasters, either.

Health care reform could solve the Social Security "crisis." The Trustees' Report says so.

The real problem is that confining your analysis to the Social Security system is a guaranteed way to get short-sighted and parochial answers to policy issues. If you ask the pension system managers how to fix the pension system, they're going to answer in terms within their realm. They'll talk about adjusting the tax rate, or the benefit rate, or finding some other way to invest the trust fund balance. For a system as intricately linked with our economy as Social Security, this kind of blinkered analysis is inexcusable. If you look up from the system itself, a whole panoply of possible policies appear. Any one of the following would increase the collections of Social Security taxes beyond the predictions of the Trustees' report:

- Health care reform that de-links this "fringe benefit" from employment and makes it into a basic provision to all citizens.
- Raising the minimum wage.
- Reducing the obstacles to union organizing.
- Immigration reform *without* the "guest worker" provisions that will only create an employment underclass and depress wages further.

In other words, what we need is a wage policy—tax provisions, labor law changes, trade agreements, interest rate manipulations—that focuses on reducing the income inequality that has been allowed to rise so much over the past three decades. With that, the future of Social Security can be assured forever.

So, in a way, the crisis at the center of *Boomsday* and the *Trustees' Report* is real. But the crisis is in the employment and income trends, and construing this as a Social Security crisis is as crazy as Cassandra Devine's "Voluntary Transitioning" proposal that even included a two-week all-expenses-paid farewell vacation for people who choose to take the big step at age 65. The coming imbalance between tax revenue and benefits is the symptom of a problem we desperately need to solve, not the problem itself. ■

So could raising the minimum wage. But you don't hear much about that, do you?

Check out the RIPR column, now appearing every other Friday in the Woonsocket Call and Pawtucket Times!

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