



FACTS & OPINIONS

On Public Interest Issues

Quotes

To compel a man to furnish contributions of money for the propagation of opinions which he disbelieves is sinful and tyrannical.

—Thomas Jefferson

The great ideological divide is between those who believe that theories should be adjusted to reality and those who believe that reality must be adjusted to fit their theories. Many of the horrors of the 20th century were created by the latter. And such people are still with us, in many movements.

—Thomas Sowell
Syndicated Columnist

Everything that is really great and enterprising is created by the individual who can labor in freedom

—Albert Einstein

Iowa Cities, Taxing, and Spending

David Hogberg

Earlier this year the Iowa League of Cities released a study entitled “An Investigation of City Finances in Iowa and the Nation.” In an editorial from June 30, 2002, the *Des Moines Register* played up the study’s finding that per capita revenue for Iowa cities is 30% below the national average to argue that Iowa cities do not receive enough revenue. The editorial also hinted that tax increases could be a remedy.

Before Iowa goes down that path, it would be wise to turn to a study by the Cato Institute titled “The Myth of America’s Underfunded Cities,” by Stephen Moore and Dean Stansel. This study examined the economic and population growth rates of seventy-six large cities in the U.S. Although the study is almost ten years old, it provides useful lessons on the effect that taxing and spending have on urban growth rates.

Moore and Stansel found that cities that had large population losses had higher rates of city-government employees than cities that had large population gains. “The highest growth cities had 107 employees per 10,000 residents versus 217 in the lowest growth cities. Those findings suggest that cities with high taxes and service costs are driving people away.”¹

They also examined job-growth rates in these cities. They found that per capita government spending in cities with low job growth was much higher than cities with high job growth rates. Moore and Stansel claimed, “The cities with the lowest growth in employment spend almost \$1.40 for every \$1.00 of municipal expenditures in the highest growth cities. It would appear that high taxes and spending are driving businesses and jobs away from shrinking cities.”²

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Dr. Don Racheter

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What's New at Public Interest Institute?

David Hogberg

In July, Public Interest Institute released a new book *POLITICS, TAXATION, AND THE RULE OF LAW*. The book is edited by Dr. Donald P. Racheter, President of Public Interest Institute, and Dr. Richard E. Wagner, Economics Professor at George Mason University and Chairman of the Institute's Academic Advisory Board. *POLITICS, TAXATION, AND THE RULE OF LAW* looks at the balance between providing government with the power to operate while preserving and protecting our rights of person and property. To order a copy of *POLITICS, TAXATION, AND THE RULE OF LAW*, contact Public Interest Institute at the information provided on this page.

On September 9, Research Analyst David Hogberg was interviewed on "Iowa Talks" on WSUI 910 AM, out of Iowa City. David debated Social Security reform with noted financial analyst William J. Bernstein. They discussed various options for reforming the Social Security system, the risks of switching to a system of private accounts, and the drawbacks of maintaining the present system.

Also, the Institute recently released a policy study by Research Analysts David Hogberg and Amy K. Frantz

titled "Iowa's State Budget: Spending Our Way to a Crisis." This study found that during Governor Vilsack's first two years in office, Iowa went on a spending binge. Total state spending increased \$434 million, or 8.6%. Indeed, the average spending increase over the first two years was 4.23%, which is more than twice the rate of inflation and nine times the rate of Iowa population growth for that same period. For a copy of the study, see the information below.

Iowa's State Budget: Spending Our Way to a Crisis

*A new POLICY STUDY
by David Hogberg and
Amy K. Frantz of
Public Interest Institute.*

"The state of Iowa has faced a budget crisis for more than a year. One cause of this crisis that has not received proper attention is spending. This is a major oversight because in the first two fiscal years of the Vilsack Administration, the state went on a spending binge."

To read Iowa's State Budget: Spending Our Way to a Crisis, visit Public Interest Institute's web site at www.limitedgovernment.org or contact the Institute to request a copy.

Iowa Cities, Taxes, and Spending

David Hogberg

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Finally, they found an interesting relationship between growth and the combined city-state tax burdens. They discovered that low-growth cities tend to be located in states with high city-state tax burdens, while high-growth cities tend to be in states with much lower burdens. “State and city taxes are about \$360 per person higher in cities with population losses of 15 percent or more since 1965 than in cities with population gains of 100 percent or more.”³

The Cato study should serve as a warning to Iowans. Cities that have high rates of taxes and expenditures are cities that experience low rates of growth. Given that recent economic growth in Iowa has been lackluster, we should not embark on a new wave of taxing and spending for Iowa’s cities.

This leaves open the question of what Iowa cities should do? One answer can be found less than thirty miles east of the Iowa/Illinois border. The city of Monmouth, Illinois has saved a good deal of money by privatizing important city functions. In “Small Towns Benefit Through Privatization,” Robin A. Johnson of the Cascade Policy Institute examined the decision by the Monmouth city council in 1998 to

privatize water and wastewater services, street maintenance, garbage collection, and billing. The city contracted these services to Environmental Management Corporation (EMC). EMC improved the quality of the city services, and cost savings were projected at over \$300,000.⁴

If the officials of Iowa’s cities need to find ways to provide adequate services, they should consider the example of Monmouth. They should examine which services can be privatized. What they should not do is return to the old remedy of increasing taxes and spending.

ENDNOTES:

¹Stephen Moore and Dean Stansel, “The Myth of America’s Underfunded Cities,” Cato Institute, *Policy Analysis*, No. 188, February 22, 1993, p.11.

²Ibid.

³Ibid, p.15.

⁴Robin A. Johnson, “Small Towns Benefit Through Privatization,” Cascade Policy Institute, *Cascade Commentary*, No. 2001-23, July 2001.

David Hogberg is a Research Analyst at Public Interest Institute.

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A Good Time to Cut Taxes on Jobs

Paul Kersey

Like the rest of the country, Michigan is working its way out of what turned out to be a relatively mild recession, with unemployment still rather high. For thousands of Michigan families, the recession won’t end until new jobs open up — and job creation usually doesn’t pick up until the very end of a recession.

Fortunately there is something Congress can do to speed the process.

The Federal Unemployment Tax Act (FUTA) requires employers to pay a tax of 0.8 percent on the first \$7,000 earned by their employees. This tax does not fund unemployment insurance — the actual funds that go to the unemployed are collected through a separate state tax. Funds collected under FUTA are returned to the states to cover the costs of administering their unemployment insurance systems.

At least that’s what supposed to happen. As it turns out, the federal government is keeping most of this FUTA revenue. Researcher William B. Connerly, Ph. D., of the American Institute for Full Employment in Klamath Falls, Oregon, recently discovered that only 47 percent of FUTA taxes actually go to running state unemployment insurance programs. The rest stays in

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The Role of Private Property in Protecting Liberty

Tom Bethell

Recent initiatives in Virginia, such as the move toward urban planning and “smart growth,” will weaken property rights in the commonwealth, and this in turn will undermine our liberties.

People who live in societies where private property has historically been well protected often fail to see the advantages of such a system, because they take them for granted. They are as inconspicuous as the taste of water. But such people are also good at visualizing some more perfect condition — one in which they do not have to spend so much time in traffic jams, for example. In using the political system to advance such a goal, therefore, they may fail to anticipate the loss of benefits they had never considered in the first place.

Before the fall of the Berlin Wall, the many advantages of a private property system were hardly analyzed at all. You might say that private property was attacked — by Karl Marx and by many intellectuals since — before it was defended. Among those benefits are justice, peace, liberty

and prosperity.

Consider justice, briefly. A group of people goes to a restaurant and orders a meal. If the bill is shared equally, those who ate hamburger will subsidize those who ate steak. Separate checks would be a more just arrangement. Diners are billed in proportion to their consumption. In short, a communal system has been privatized, and justice has been introduced. “To each his due” was the classical definition of justice, used by St. Thomas Aquinas before the dubious notion of “social justice” was introduced into Western thought.

Americans now pay about forty percent of their earnings to government at all levels.

When Plymouth colony was founded in Massachusetts in 1620, the Pilgrims at first held their property in common. They were on the verge of starvation when ownership was privatized in 1623. The change succeeded. It “made all hands very industrious, so much more corn was planted than otherwise would have been,” William Bradford reported. The communal arrangement had not worked because it “was thought injustice.”

More recently, a vast experiment in life without private property was conducted in the

Soviet Union. It lasted for seventy-four years, and it conclusively showed that transferring the control of property to the state is a formula for social impoverishment. There wasn’t much in the way of justice either. As for liberty, that was lost completely. An Iron Curtain had to be constructed north-to-south in Eastern Europe, and a wall divided Berlin.

At tax time, it is worth reflecting that for the average Virginian the most burdensome abridgment of property rights is probably the income tax. Our income is our property, and for young people and those with few assets, it may be the only way of saving enough to buy real property. The tax burden is a matter of degree. Americans now pay about forty percent of their earnings to governments at all levels. In most Western democracies it is higher than that. If the tax burden were to rise to one hundred percent, we would labor wholly for the state and would have been entirely deprived of our liberty. Under such conditions, of course, work would be minimal and society impoverished.

Over the centuries, neighbors and strangers have often posed a more serious threat to life and liberty than governments. It was for that property rights were instituted — to provide individuals and their families with zones of

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believe in individual liberty and free-market solutions to today's public-policy
aid envelope to make your tax-deductible contribution to this effort today.

Free the Universities, Fund the Students

Nick Weller

Presidents of Oregon's public universities recently informed the Board of Higher Education that their schools need greater freedom from state regulations. The presidents also suggested that budget difficulties might reduce access to higher education. Last year the Oregon Institute of Technology considered an opportunity to separate from the state system, in part because of the promise of autonomy and stable funding. Both goals could be realized if Oregon began providing money directly to the students, rather than the institutions.

Oregon taxpayers funded the Oregon University System to the tune of more than \$738 million in state general fund money in the 1999-2001 budgets, not including millions in lottery and federal funds. Funding is allocated directly to institutions, subsidizing tuition for all students. Thus, students with a family income of \$150,000 pay tuition — subsidized by taxpayers — equal to that paid by students with incomes below the poverty line.

In the 1997 Cascade Policy Institute report "Power to the

Student," economist Randall Pozdena, Ph.D., writes that although many justify government support of higher education for egalitarian reasons, current funding benefits relatively well off students more than those with less income. He explains that in the aggregate, families with less income do not use public universities enough to recoup in tuition subsidies what they pay in taxes to fund the universities.

Many would be surprised to learn that private universities in Oregon are more low-income friendly than public universities. The Oregon Independent College Association's 1994 study of

Many would be surprised to learn that private universities in Oregon are more low-income friendly than public universities.

students attending Oregon colleges and universities found average family income was higher at state public schools than private schools. The percentage of low-income students was also higher at independent institutions than at public schools. Despite higher tuition, private schools are able to provide greater assistance to low-income students because they allocate financial aid based largely on need.

Across-the-board tuition subsidies may lower the overall

quality of education at government universities. Because tax-financed universities appear to be less expensive, students logically accept lower quality, according to Carleton College economics professor Jenny Wahl in her report "A bigger bang for the public buck: Achieving efficiency and equity in higher education." Of course, Wahl writes, not all private schools are better than their public counterparts, but studies reveal that students are willing to accept a lower-quality education in exchange for lower tuition.

An alternative funding method could be more effective for both students and taxpayers. Pozdena proposes that Oregon provide direct aid to students instead of funding institutions. Universities would be able to set their own tuition, and it would likely rise in response to the elimination of institutional funding. However, lower income students would be better off. Because direct aid targets only those who actually need financial assistance, the state could provide greater support for them even while reducing total higher education spending.

Pozdena further argues that aid should be available to low-income students attending private universities to create greater competition and quality in higher education. Higher nominal tuition may also spur quality in demands

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**Free the Universities,
Fund the Students**

Nick Weller

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from students at public universities as Wahl's research suggests.

Each student is worth more to a university when the sticker price better reflects real cost. By placing these student-consumers in the driver's seat, the Legislature can remove higher education mandates without fear of adverse consequences. Greater autonomy coupled with accountability to students is a recipe for success at Oregon's institutions of higher learning.

*Nick Weller is
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Facts & Opinions
Question of the Quarter:

How should Iowa cities solve their
revenue problems?

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A Good Time to Cut Taxes on Jobs

Paul Kersey

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Washington, where it has the effect of making the budget surplus look larger than it actually is.

Michigan fares better than most states on this deal, but of the \$246.6 million Michigan employers pay in FUTA taxes annually, only \$134.9 million—a little more than half—comes back to Michigan's unemployment insurance system.

The Bush administration has proposed a hefty funding cut for FUTA, from 0.8 percent down to 0.2 percent. In effect, this would leave the states to cover the costs of their own unemployment insurance systems, while the remaining FUTA funding would cover functions such as loaning money to states that exhaust their unemployment funds, or providing money for 13-week benefit extensions in states with high unemployment.

The FUTA tax cut would save Michigan employers over \$184 million annually. Even if the state government were to hike unemployment taxes to make up its administrative costs, employers would still come out ahead, to the tune of around \$50 million annually (the \$184 million saved minus the \$134.9 million it costs to run Michigan's system).

What would be even better would be to eliminate FUTA altogether. The reason: Making the states come up with the funds to run their own unemployment insurance systems is likely to make those systems more efficient.

A basic tenet of sound public policy is that nobody spends someone else's money as carefully as he spends his own. And the Michigan Unemployment Agency (MUA) is a perfect example. In 2001, the MUA paid out more than \$1.6 billion. If past years are any guide, more than 10 percent of the funds paid out

Now is the perfect time for Congress to cut the cost of hiring new workers.

were not properly payable under Michigan's unemployment law. According to the U.S. Department of Labor, 10.35 percent of the monies paid out of the state's unemployment insurance funds in 2000 were overpayments. Because states like Michigan administer their unemployment insurance with Federal FUTA tax money, there is no pressure to use the money efficiently.

Making the state legislature responsible for funding the Michigan Unemployment Agency would mean that the agency and its budget would be under the control of elected officials from Michigan, rather than being monitored from afar by one-size-fits-all-minded bureaucrats in Washington. State lawmakers are

more in touch with the employment situation in Michigan, and are more responsive to the needs of job seekers and employers. This would translate into closer scrutiny and more flexibility in how the fund is administered.

As things now stand, Michigan's unemployment insurance program is being run in a way that wastes taxpayer dollars. Being laundered through a large federal bureaucracy weakens accountability and provides little incentive for efficiency or innovation in the handling of state unemployment insurance funds.

While it is a relatively small item in Michigan's budget, the FUTA tax is aimed at the heart of Michigan employment. It is levied directly on employers and goes up every time new workers are hired.

Now is a perfect time for Congress to cut the cost of hiring new workers. Lowering or abolishing the FUTA tax would be a good way to start.

Paul Kersey is labor research associate with the Mackinac Center for Public Policy.

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**The Role of Private
Property in
Protecting Liberty**

Tom Bethell
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privacy where they could pursue their own initiatives free from interference. That is the essence of liberty. "There can be no liberty without private property," the economist Milton Friedman has said. For this reason, the protection of property rights has historically been among the most important functions of government, and to that end laws and police forces were instituted. If governments ceased protecting property rights, liberty would be gravely threatened; at least until citizen groups formed their own protective militias.

Despite the failure of socialism, however, governments

at all levels continue to abridge our freedoms almost as much as they protect them. And just as the inflation of the 1970s moved people into higher tax brackets, so the environmentalism of the 1990s gave government new rationales for controlling the use of our property. We may believe that cleaner air or less traffic congestion will be the good effect, but we may be sure that our liberties are also being restricted. Production and prosperity will also tend to decline, and in the case of those people who bought land anticipating that they would be able to develop it, but now find that they have paid a high price to keep it idle, there is also manifest injustice. When our property rights are restricted, prosperity, liberty, and justice will all decline together.

Tom Bethell is an editor of the American Spectator and a member of the Board of Governors of the Virginia Institute for Public Policy. Reprinted with permission from the Virginia Institute for Public Policy.

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