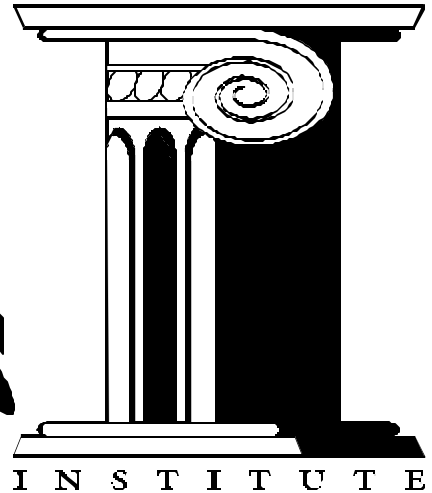


LIMITS



On Power and the Use of Coercion

Why Constitutional Constraints on Government are Necessary

by Daniel Sutter

Oklahoma Council of Public Affairs (OCPA) recently proposed a Taxpayers' Bill of Rights (TABOR) for Oklahoma to limit the growth of state expenditures to the sum of the rates of inflation and population growth. TABOR is a type of constitutional constraint imposed by citizens on government, similar to term limits or balanced budget amendments. Such constitutional constraints change the rules of the political game; they are necessarily inflexible.

Setting aside for a moment the particular merits of TABOR, why should citizens want to limit government via rules?

Some commentators charge that constitutional constraints on government are undemocratic. Victor Kamber, for example, titled his book against term limits *Giving Up*

on Democracy. And indeed, if democracy means totally unconstrained majority rule, then limits on government are, strictly speaking, nondemocratic. But nobody really believes in unlimited majority rule. For instance, the majority party should not be able to jail its political opponents and cancel future elections. Nobody worries about the 13th Amendment to the U.S. Constitution being undemocratic by preventing a democratically elected government from reinstating slavery.

The question then becomes, "What are the appropriate limits on democracy?" The case for constitutional constraints on government has been articulated by Nobel Prize-winning economist James Buchanan and is based on a careful analysis of the infirmities of representative

government.¹ When government performs its core functions of national defense, protecting law-abiding citizens against criminals, providing courts for peaceful resolution of disputes and enforcement of contracts, and supplying infrastructure, we all benefit. But nobody benefits disproportionately or at the expense of others.

By contrast, many of the additional tasks that governments undertake in the U.S. today — tasks that go beyond these core functions — provide large benefits to some individuals at the expense of the majority who have to pay higher taxes. As a result, political activity tends to focus on these actions of government that benefit some citizens at the expense of others — what public choice economists call "rent seeking."

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President

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Study Shows Big Savings from Competitive Sourcing of Government Functions

by Sean Parnell

A recently released study shows competitive sourcing of government activities has led to significant savings for the federal government. Using baseline costs, the average savings to the federal government was 44 percent over 10 years, for a total savings of \$11.2 billion. The report also found few government employees lost their jobs, contrary to the fears of opponents of competitive sourcing.

The study was issued by the IBM Center for the Business of Government. It examined nearly 1,200 cases of competitive sourcing in the U.S. Department of Defense from 1994 through the first quarter of 2004. The activities that were competitively sourced included payroll services, maintenance, and printing.

Competitive sourcing occurs when both government and private-sector providers are allowed to bid on performing government activities. It differs from privatization, where government employees are not given an opportunity to compete for the work.

Began During Clinton Era

The Clinton administration was an early proponent of competitive sourcing. In a

report titled "From Red Ink to Results," presented by then-Vice President Al Gore, the Clinton administration announced it would "make agencies compete for their customers' business. Wherever feasible, we will dismantle government monopolies."

Most of the Clinton administration's efforts focused on the Department of Defense. Clinton also signed the Federal Activities Inventory Reform Act of 1998, which required federal agencies to report to the Office of Management and Budget (OMB) on the number of positions that could be put up for competitive sourcing. In early 2001, OMB reported nearly half of all civilian jobs in the federal government, approximately 850,000, could be competitively sourced.

Bush Expanded Competition

President George W. Bush has continued and expanded the Clinton administration policy of competitive sourcing.

The average savings of 44 percent for competitively sourced activities is largely a result of increased efficiency and fewer employees needed to perform the work. Compared to the number of positions initially studied for competitive sourcing, the average bid had

39 percent fewer employees.

Geoffrey Segal of the Reason Foundation cited one example of improved efficiency in a July 27 commentary on competitive sourcing, published on Reason's Web site. He wrote that in 2002, OMB "offered the job of printing the fiscal 2004 federal budget to competitive bidding. The Government Printing Office (GPO) turned in a bid that was almost 24 percent lower than its price from the previous year. That was \$100,000 a year that GPO could have saved taxpayers any time it chose, but it never chose to do so until it was forced to compete."

Few Jobs Lost

Opposition to competitive sourcing has come primarily from government employee unions concerned about major job losses and some department managers concerned about losing control of the work. The research, however, showed those fears to be unfounded.

Of the approximately 68,000 civilian employees at the Department of Defense who faced competitive sourcing, the report found only 5 percent, or about 3,300, lost their jobs. The total number of government positions reduced through competitive sourcing, approximately 25,000, was achieved largely through retirements and transfers into other, vacant positions.

The study also found government employees were able to compete effectively with

private contractors when their positions were put up for competitive sourcing. Over the 10-year period, private contractors won 56 percent of the competitions, while government employees won the remaining 44 percent.

In recent years, government employees involved in competitive sourcing have become more efficient, according to the report, and have been winning an increasing number of bids. In 2003, government employees were winning nearly two-thirds of all competitively sourced jobs.

Opposition Remains Firm

Regardless of the research results, however, government employee unions and their members remain firmly opposed to competitive sourcing. Carlus Ellerbe, a member of the American Federation of Government Employees, who faced competitive sourcing in his Department of Labor printing shop, voiced his displeasure to *Federal Computer Week*. Competitive sourcing amounts to outsiders telling the government "they can do it for less, or we're not doing it efficiently," he said. "That to me is offensive."

While not addressing the issue of whether competition is offensive to unionized workers, proponents of competitive sourcing cite the tremendous savings and improved services sourcing brings. A July 9, 2004

letter to Congress signed by the U.S. Chamber of Commerce and the taxpayer advocacy group Citizens Against Government Waste, among others, stated, "Regardless of whether the government continues to perform the service or a private company takes over, cost savings are achieved" through competitive sourcing, and "free market forces [in] government services [are] a catalyst for cost reduction."

Sean Parnell is Vice President of The Heartland Institute.

This article originally appeared in the January 2005 issue of Heartland Institute's Budget & Tax News. Reprinted with permission from the author.

The Heartland Institute's mission is to help build social movements in support of ideas that empower people. Such ideas include parental choice in education, choice and personal responsibility in health care, market-based approaches to environmental protection, privatization of public services, and deregulation in areas where property rights and markets do a better job than government bureaucracies.

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Why Constitutional Constraints on Government are Necessary

by Daniel Sutter

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Consider, for example, the purchase of advertising by state government (using tax dollars) to promote tourism in Oklahoma. Although this might seem like a service for the entire state, the additional tourism (if any) will benefit primarily businesses tied to the tourism industry, such as hotels, resorts, and the operators of tourist destinations. These businesses in effect have taxpayers pay for some of their advertising. This is just one example; for a host of others one need only consult the 2004 Oklahoma Piglet Book, published by OCPA and Citizens Against Government Waste.

Concentrated Benefits, Diffuse Costs

Only a minority of Oklahomans own or work for tourism-related businesses. So how can this minority prevail in a democracy? The answer lies in the logic of concentrated benefits and diffuse costs, an aspect of democracy not covered in high school civics

classes. The full cost of rent seeking or pork barrel spending (which includes the taxes paid plus the distortion of marketplace activity due to the taxes and spending) exceeds the benefit to recipients. But typically a relatively small number of people benefit, while the costs are spread over the remainder of the population. Thus, the beneficiaries of pork barrel spending typically have a lot more at stake on this issue than the taxpayer. After all, your share of the extra taxes used to fund tourism ads or the Heartland Flyer or state golf courses is really pretty small, even if you pay your fair share of state taxes and even if pork barrel spending in total is quite costly.

As a result, the beneficiaries tend to be a lot more vocal than taxpayers when specific budget items are considered. Only the beneficiaries have enough at stake to write their Legislator or attend a committee hearing or make campaign contributions based on this one issue. Taxpayers hardly notice the extra couple of dollars annually for this spending project.

Now consider this from the Legislator's perspective. When another spending measure comes up for a vote, almost all the letters, phone calls, and lobbying contacts will favor the measure. The people who will vote or make campaign

contributions based on this one issue almost all favor spending. In his book *The Culture of Spending*, James Payne examined the overwhelming pro-spending bias in the opinions Congressmen receive about spending. Legislators hear only about the good things accomplished by government spending, never about the cost to taxpayers. Whether Legislators come to believe citizens generally favor all this spending or whether they are merely trying to win elections, representative democracy in practice allows special interest spending to persist.

Opponents of constitutional constraints argue that proponents are trying to impose their preferences for limited government against the will of the majority. Yet the Law of Concentrated Benefits shows how representative democracy could in fact produce a level of spending greater than what the majority desires.

Some opponents admit that we probably have too much pork barrel spending. But rather than enact constitutional remedies, they say citizens should elect better representatives or get more involved in politics. Yet this democratic faith that more political participation will cure all the problems of politics ignores the incentives that voters and politicians face. Yes, occasionally a politician

**of individuals like you who believe in individual liberty and free-market
aid envelope to make your tax-deductible contribution to this effort today.**

like William Proxmire or former OCPA trustee Tom Coburn will win office despite exposing wasteful pork barrel spending. But Republicans and Democrats most often win elections by accommodating the culture of spending. And voters will not go to the barricades over programs that cost them a few dollars per year. Economics teaches that incentives matter for individual behavior, and we cannot count on widespread behavior contrary to interests to correct bad policies or remedy the problems of democracy.

A growing body of evidence documents that constitutional constraints can improve the performance of government. Research has shown that constitutional debt limitations reduce the level of state indebtedness and state borrowing costs, binding expenditure limits reduce spending and borrowing costs, and rainy day funds with strict deposit and withdrawal rules reduce borrowing costs.² Lower borrowing costs indicate that investors believe a state's fiscal house is in order and that the state is poised in the long run for economic growth. This shows that citizens as a whole benefit from these limits on government, not just conservatives who favor smaller government. One study of balanced budget provisions concluded "the

preponderance of evidence from empirical studies of fiscal institutions and budget outcomes suggests that tightly drawn anti-deficit rules, especially when coupled with limits on government borrowing, induce smaller deficits and more rapid adjustment of taxes and spending to unexpected fiscal shortfalls."³

In the end, TABOR is not just an instrument for limiting the size of government. Like other constraints on government, it helps correct the inefficiencies of democracy and improves the quality of government for all Oklahomans.

Endnotes:

¹ See James M. Buchanan, "The Constitution of Economic Policy," *American Economic Review*, Volume 77, Number 3, 1987, and Geoffrey Brennan and James M. Buchanan, *The Reason of Rules*, Cambridge, England, Cambridge University Press, 1985.

² See James Poterba and Kim Rueben, "State Fiscal Institutions and the U.S. Municipal Bond Market," in *Fiscal Institutions and Fiscal Performance* (edited by J. Poterba and J. von Hagen), Chicago, University of Chicago Press, 1999, D. Roderick Kiewiet and Kristin Szakaly, "Constitutional Limits on Borrowing: An Analysis of State Bonded Indebtedness," *Journal of Law, Economics and Organization*, Volume 12, Number 1, 1996, and

Gary A. Wagner, "The Bond Market and Fiscal Institutions: Have Budget Stabilization Funds Reduced State Borrowing Costs?" forthcoming in the *National Tax Journal*.

³ James Poterba, "Balanced Budget Rules and Fiscal Policy: Evidence from the States," *National Tax Journal*, Volume 48, Issue 3, 1995, p. 330.

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OCPA's mission is to accumulate, evaluate, and disseminate public policy ideas and information for Oklahoma consistent with the principles of free enterprise, limited government, and individual initiative.

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When “Tax Fairness” Means a Tax Hike

by Institute for Policy Innovation

Be careful! The spending lobby — otherwise known as the government — is trying desperately to promote consumption taxes on services as their new revenue source. Most states that have a sales tax exclude consumer, professional, or business services in their base. But that would change if the big-spenders have their way.

Proponents say that such an expansion isn't really a tax increase. It's just applying the same tax consumers pay on most retail items to services that are escaping the tax. But going from zero to something is a tax increase in anyone's definition.

Proponents have an answer — they can apply the new tax in a revenue-neutral manner by reducing the tax rate on items that are currently taxed. Everyone pays less on more goods and services.

While there is nothing inherently wrong with expanding a tax base to include all goods and services and lowering the rate, the advocates' new-found fondness for revenue neutrality is, in fact, only a ruse designed to hide their intention to raise revenue.

Of course, business will adjust to this kind of increase in the cost of doing business.

Any number of small businesses — the ones that would be most affected by this tax expansion — would have to

adapt to the cost of the collection process. By some calculations, the cost to a business of collecting taxes from the customer and remitting them to the state cost the business up to 3.75 percent of taxes collected.

For the small business person, an increase in their costs for the services they buy to run their business of up to 10 percent and the added cost of complying with the collection of taxes from their customers of 3.75 percent of taxes collected can become unmanageable and jeopardize their very ability to continue.

While it is perfectly legitimate — indeed, necessary — to look for ways to make taxes fairer, tax equity should not become a smokescreen for a tax hike. And it will if we aren't careful and give in to the big-spenders whose definition

of tax fairness is everyone paying more taxes.

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Question of the Quarter:

Do you support or oppose Governor Vilsack's proposal to apply the state sales tax to additional services such as accounting and engineering that are not currently taxable?

Send your thoughts on this issue to us at public.interest.institute@limitedgovernment.org.

We may publish some of your ideas in the June 2005 issue of *LIMITS*.

Proposition 13 Has Saved Local Government

by Jon Coupal

Real estate in California has proven to be an extraordinary investment. And these high returns have not simply been reserved for the wealthy. Indeed, young families just starting out can virtually guarantee themselves of an investment return usually associated with risky stocks or commodities futures merely by purchasing the roof over their heads. The icing on the cake — here in California — has been that rapid increases in the value of property are not accompanied by huge tax increases. But that wasn't always the case.

In the late 1970s in California, those who had taken the advice to buy property saw tremendous increases in the value of their homes. But these increases came with a price. Double digit inflation in the housing market — home prices increased 28.1 percent in 1978 alone — translated into comparable double digit increases in taxes.

Many, especially those on fixed incomes, were forced to sell their homes to avoid having their property seized by the tax collector. Their profits were on paper only and high taxes robbed them of their homes. Citizens took to the streets, marched to polls, and the California Tax Revolt was born. Much to the horror of the political establishment, who believed that only elite office holders were qualified to solve the problem, the people rose up

and passed Proposition 13 which established a uniform one percent tax rate and capped annual increases in assessed value at two percent.

Ironically, the local government “enemies” who refused to lower taxes during the crisis and were beside themselves at the thought of its passage are now major beneficiaries of the system. Since Proposition 13 passed, increases in property tax revenues have averaged nearly 10 percent annually. This is because, when property is sold, it is assessed at current value, as are improvements, although the cap on annual increases is reinstated.

Honest County Assessors (yes, there are some) will tell you that Proposition 13 has had a beneficial, stabilizing effect on revenue, even when economic growth generally has stalled. But when the economy improves, local governments cash in big time. The total value of assessed property in Los Angeles County went up \$55.3 billion last year alone. Alameda County's property tax base went up 7 percent. Total assessed property in Sacramento is now \$92.4 billion, up 12 percent from last year. Taxed at one percent, one can readily see how locals have cashed in on a system created by Howard Jarvis and Paul Gann primarily intended to save homeowners.

While government has benefited from this most

dependable source of revenue, at the individual homeowner level, there are not the huge spikes in tax liability as there were in the pre-Proposition 13 days. Although many homeowners are still hard-pressed to pay their taxes, at least, due to Proposition 13, individuals know what their tax bill will be when they buy a house and, thanks to the cap on annual increases, they can predict their future tax liability.

In most other states, homeowners lack this advantage and many feel they are about to be dropped into the volcano as a sacrifice to rapidly increasing government spending. For example, in Hawaii, on the island of Oahu, the assessed value of residential property has risen 26 percent in the past year, meaning homeowners face significantly higher tax bills unless officials are willing to provide relief. Property owners are clinging to hope because Oahu politicians are feeling some heat after voters on Kauai approved a county charter amendment in November that rolled back property taxes to 1999 levels and, taking a page from Proposition 13, limited increases to two percent a year.

In Texas, residents are paying some of the highest real estate taxes in the nation. In 1980 most Texans paid about one percent of the value of their homes. Today, they pay from

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Proposition 13 . . .

by Jon Coupal

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2.5 percent to 3.5 percent. Property taxes are increasing much faster than income, which is creating a situation similar to the one that existed in California before the passage of Proposition 13. However, lacking the initiative process, property owners are barred from acting on their own behalf and must rely on the questionable mercy of Legislators.

Then there is Massachusetts, where, in 1980, voters who were paying the highest property taxes in the world granted themselves tax

relief with Proposition 2-1/2. This limited communities to levying a total tax of no more than 2.5 percent of the value of all property within their borders. This brought Massachusetts down to 11th in the nation by 1991, but the burden is rising again relative to other states because voters in many communities have been persuaded to pass overrides to be added to property tax bills.

These examples of what property owners are going through across the nation provide a chilling lesson for Californians. Even though Proposition 13 generates more than sufficient — and stable — revenue to government, there are groups like the Silicon Valley-based Taxpayers for School Improvement who are working

to change Proposition 13 to make it easier to increase taxes. But the more the voting public learns about Proposition 13 and the way it works, the less likely they are to change it.

Jon Coupal is an attorney and President of Howard Jarvis Taxpayers Association — California's largest taxpayer organization with offices in Los Angeles and Sacramento.

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