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War and famine. Peace and milk. – *Somali proverb*

Crisis in the States and Cities: What Should Be Done? Symposium

"This recession pales in comparison to any that has gone before: through 2011, about $430 billion of total state shortfalls and counting... because when the economy collapsed, it took state revenues down with it."

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Opening Remarks

James K. Galbraith

Good afternoon, and welcome to this Bernard Schwartz Symposium sponsored by Economists for Peace and Security. I'm James Galbraith, chair of the board of EPS. I want to start with a word of thanks, as always: to our partners at the New America Foundation, who helped us to organize this event, and a great thanks to Bernard Schwartz, whose support makes it possible.

We meet today at a moment when the normally useful distinction between sense and nonsense seems to have disappeared on a bipartisan basis. All around us key points of principle have been given up. The political struggle is over what to cut and what to save, over how to bargain; and not over what to do. In economic policy, magicians and necromancers have taken charge, brewing a toxic vat of program cuts and deregulation, from which they promise that somehow jobs will emerge. Serious people cite serious people on the subject of what serious people permit themselves to think. Meanwhile the crisis in the country deepens, and hopes for a coherent strategic response to it recede.

You can see this in the content, just revealed, of the latest budget deal. It targets the Environmental Protection Agency and the transportation system in the service of deficit control and debt reduction, as we face increasing environmental challenges and an energy crisis. On this subtle technical and deservedly obscure topic, today everyone is an expert, adhereing to the one true thought. We're witnessing one of the greatest waves of mass hysteria of all time, the fruits of one of history's most intense and successful propaganda campaigns. As a professional economist with a background in political work – I was here on Capitol Hill for many years, worked for Congress – I'm impressed; I'm even in awe. Practically every avenue of debate has been closed off: not by argument; not even (as was the case 30 years ago, when a few of us tried to stand in the way of the juggernaut of the Reagan economic policies) by the convinced philosophical positions of effective public intellectuals; but rather by endless repetition of the same slogans, repeated and barely detectible changes in the foundation of the argument, and silence in the face of criticism.

There are many economists, experienced people with impeccable credentials, who don't buy the line. The fact that history and comparative experience contradict it is a secret to most people. We are hidden in this discussion behind a wall of invisibility.

To be frank, as an economist I'm not excessively worried at the moment by the recent rounds of short-term budget cuts. The lost income, after all, will be offset by falling tax revenues and increasing unemployment insurance, applications for disability, and so forth. The overall effect on total income will not be that large, just as the effect even of the financial crisis was not all that large. The deficit will not decline very much and things will go on much as before.

The regret here is that, in most cases, we needed to do what we are not going to do. The environment and transportation are good things, even if an extra engine for a fighter aircraft can be dispensed with. It's merely foolish to give these things up on the pretense that you are accomplishing something, when you're not.

What worries me more is the prospect that I think hangs over us all, that there will be a bipartisan compromise on so-called long-term deficit

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Contact us:
EPS at the Levy Institute
Box 5000
Annandale-on-Hudson, NY
12504
USA

Tel: +1 845.758.0917
Fax: +1 845.758.1149
Email: info@epsusa.org

Contact the editor:
catcohen@epsusa.org

Opening Remarks (continued)

reduction, which even people who consider themselves sensible and progressive concede must be dealt with at some point. This compromise would irreparably damage the well-being of large parts of the American population, what remains of the basic social infrastructure supporting what remains of the American middle class: Social Security, Medicare, and Medicaid.

The idea that there is an economic rationale for dismantling these most successful and effective social insurance programs (that the capital markets, for example, demand such an overthrow of these institutions) is plainly absurd. They have performed well and efficiently at very low administrative cost for many decades: Social Security close onto 70 years; and in Medicare's case, since 1965. The capital markets tell you every morning at what rate they are prepared to lend to the government of the United States for 10, 20, and 30 years into the future. If people who had their own money on the line were seriously worried about the prospect that the United States government could not service its debts, or the prospect that the United States dollar will fall victim to a massive inflation, they would not be willing to lend to the United States government on the extremely favorable terms that everybody can see are now available.

There's something wrong with the story. The idea that we should frame policy around a set of computer forecasts produced even by so lofty and irreproachable an organization as the Congressional Budget Office, when the capital markets don't take those forecasts seriously, and when anybody who examines them (as very few people do) can see that they are internally inconsistent and not reflective of any history of our economy, is even more absurd.

Meanwhile, bringing us to the reason we are here today, it's out in the country, out in our states and cities, that the immediate consequences of this policy are being felt. I live in Texas, and in my home state, which is far from being the worst affected by the financial crisis and the recession, my daughters regularly bring home from school reports of teachers in their public schools who will not be there next year, who have been laid off because the school district is facing a massive budget shortfall. What will that do? Of course it will degrade the quality of the public programs that our children, many children, are in. What will the teachers do? They will apply for jobs in the private schools, to which middle-class parents will feel forced to flee. They will be hired, and they will teach what they taught before, but for lower pay and at higher cost. This is supposed to be an economic improvement? Someone should explain to me where it comes from.

Cuts in Medicaid, I'm told by nurses, will produce closures of nursing homes. Many of the people in those homes don't have another place to go, so they will go to emergency rooms and will end up filling hospital beds. Will this be very good for the economy? No, because the hospital beds are much more expensive than the nursing home beds. I ask you, where is the rationality in this? Where is the sense of organized purpose? Where is the goal of improving the performance of our economy or the living standards of the American people? It's nowhere to be seen in our rush to achieve things which are driven by some metaphysical notions that have become attached to accounting concepts.

Looming over these issues really is the ugly question – so vividly played out in the state of Wisconsin recently but present in many places in the country – of power, of whether our public servants, our public employees have any rights to negotiate the terms of their employment.

Is there hope? I suggest that there is hope only if some of the people we have assembled today are finally heard from, if the proposals that they offer at this symposium are able to reach out, find a base of support in the country, and if their voices can cut through the fog of propaganda and really of indifference to what is happening in the country that clouds so much of our policy dialogue today. It's not an easy task, but, as was said 50 years ago, let us begin.

Session One Summary – Workers' Rights, Workers' Pay, and Local Public Services: Are workers and unions the cause of state budget crises?

Chaired by James Galbraith

KERRY KORPI

Thank you for holding this session at this critical time. My name is Kerry Korpi, and I'm director of research and collective bargaining for AFSCME, the American Federation of State, County, and Municipal Employees. We represent about 1.6 million mainly state and local government employees in jobs, as we say, from accountant to zookeeper, and everything in between.

This panel is on the question of whether workers and their unions are the cause of state budget crises. We've heard the common narrative: public employees are a privileged elite; they're coddled and spoiled rotten; they've got Cadillac health care plans and extravagant pensions.

I'd like to introduce you to a typical AFSCME member. She is about 48 years old, and I say "she" because 56% of our members are women. She might work as a child welfare worker, a clerk at a county courthouse, a custodian at a university, or a librarian. She makes about $44,000 a year. She does in fact have a pension – guilty as charged – to which she contributes about 5% of her pay every year. After about 20 years, she gets a pension of roughly $19,000 a year.

When private sector employees were granted the right to bargain in the 1930s, public employees were excluded, so laws had to be passed state by state. About half of the states have public employee collective bargaining, whereas almost all states with projected FY12 shortfalls do. Not a lot of correlation between the two.

This recession pales in comparison to any that has gone before: through 2011, about $430 billion of total state shortfalls and counting. This happened because when the economy collapsed, it took state revenues down with it. States saw decreases in every single revenue source. The decreases were greater than ever before, and far greater than even the most pessimistic projections. There was a perfect storm of a collapse in revenues and an increase in need for services. State employee compensation has actually declined slightly as a share of state budgets in the last couple of decades, so it's obviously not the cause of the problem. Simultaneously, as demand for services increases, the number of state and local government employees has declined by about 450,000 since the beginning of the recession.

> **The reaction from elected officials...is that instead of dealing with the real, serious problems of a collapse in revenues... they are moving in a number of places to restrict or even take away the right of public employees to collectively bargain.**

I would submit to you that the 48-year-old child welfare worker is not the cause of our state budget crises. She is, however, being used as a scapegoat. The reaction from elected officials and politicians out in the states is that instead of dealing with the real, serious problems of a collapse in revenues – and an increase in demand for services – they are moving in a number of places to restrict or even take away the right of public employees to collectively bargain. Wisconsin is the most well-known example, but a similar bill has passed in Ohio. Florida is likely to pass a similar bill this week, and a number of other states are considering bills that would restrict or completely take away the bargaining rights of public employees.

They take various forms. Some completely prohibit the deduction of union dues from a state employee's paycheck. Some, like Wisconsin, require that every year a union, at its own expense, hold an election to be recertified to represent employees. Some limit what unions can bargain over. A number of other states take away what's called agency shop or fair share, allowing free riders to get the benefit of a union contract without paying a fair share fee – one of my colleagues calls it representation without taxation.

In addition to the attacks on collective bargaining, there are a number of attempts in states to silence public employees' political voice by not allowing union dues be used in any way for political purposes. In some cases, there are gag rules being set up, where employees cannot talk to elected officials; public employees are not allowed to have their own PAC [political action committee].

At the same time, when they're in a hole, a lot of states dig deeper. In many states, governors are proposing extreme tax cuts to corporations and wealthy individuals, and moving from there to take away bargaining rights, to cut aid to schools, to cut the earned income tax credit – you name it. This exacerbates the crisis that they've inherited and directly transfers wealth from poor people and the middle class into the hands of corporations and the wealthy.

A collapse in revenues combined with a decrease in services in the worst economy in my lifetime has caused some serious budget crises. The question at hand is whether public employees and their unions are the cause of it; my answer, not shockingly, is no.

DEAN BAKER

Why are we here? Why is the country in the shape it's in? A housing bubble

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Session One — Workers' Rights, Workers' Pay, and Local Public Services (continued)

Session One panel, left to right: Jeffrey Keefe, Dean Baker, Kerry Korpi, James Galbraith

fueled by Wall Street greed collapses – blows up the economy – and what do we do? We chase after schoolteachers and firefighters. It's really close to crazy, but it has become a serious discussion in this country.

I should confess that my mother is a retired public employee. She gets a pension of $3,000 a month. She worked 30 years for the state of Illinois, retired at 61 or 62, and doesn't get Social Security, so I do have a direct personal stake in this.

I'm going to talk about three aspects of the pension crisis. First off, the origins; how did we get to this crisis? Second, the extent of the crisis; there's been a real effort to exaggerate it. And thirdly, a little bit about the principle of defined benefit pensions, because the very principle has come under attack in the context of public employees; to my mind it's a really an incredible story.

The reason we have a shortfall in pension funds around the country is overwhelmingly the collapse of the economy and the fall in the stock market. There's been a real scare effort to blame this shortfall on the irresponsible pensions, but it's just not true. Many of the numbers used in the pension accounting are from 2009, the trough of the downturn. More up-to-date numbers show that much of that shortfall's going to go away simply because markets have recovered much of the lost ground. Of course, pensions are paid over a long period of time, so looking at this as a share of the economy over the next 30 years, it comes to about a quarter of 1%.

Part of the story is about what sorts of rates of return should be assumed on the assets in the pension fund, in particular its stocks. During the height of the bubble, in 2000, many were assuming that a nominal rate of 10% was a reasonable expectation. Many analysts are now arguing that public pension funds should only assume a nominal rate of return of 4.5% on the stock they hold. This is the rate of return on 30-year government bonds and is considered the risk-free rate of return; however, there are few plausible scenarios where stocks will only produce the 4.5% risk-free rate many policy analysts now suggest using to assess returns on stock holdings.

The element of risk that applies to an individual, however, is not applicable to governments for the simple reason that they don't die or retire. An individual is at some point going to retire, going to need that pension money. If the market's down at that point, that individual's in really bad shape, but the state of Illinois or the city of "Whatever" doesn't have that risk. They're going to be there, for practical purposes, for the indefinite future. It makes sense for them to use the expected return from holding stock, as opposed to that of holding risk-free bonds, which is about 10% a year.

My last point is about the defined benefit pension plan. In the late '70s, somewhere around 40% of the workforce had defined benefit pensions. Today, it's under 16% and falling like a rock. It's really unfortunate. A big company – at that point we didn't think that General Motors could ever go bankrupt – is going to be here next year, and the year after that. They don't care if the stock market is down in a given year. They can get through a rough period; whereas individual workers can't. The companies could pay lower wages than otherwise would be the case because they're giving something of great value to their workers, a defined – guaranteed – benefit pension.

This was absolute orthodoxy in the economics profession 30 years ago; that's why companies and governments gave defined benefit pensions. It was something of value to the workers that basically was costless to the company or the government. That's largely gone away in the private sector, while we still have it in the public sector. If you look at total compensation for public sector workers, including health care, pension, and wages, they're not more highly compensated than their private sector counterparts when you adjust for education and experience. Taking away their pension in order to get the same workers means having to pay them more money; or maybe we'll get worse workers.

This is just totally neoclassical economics; this is absolute orthodoxy. Why would we want to do that? Why do we

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want to make governments pay more for their workers than necessary, in a way that hurts the workers? If we know it's something that workers value, and it saves state and local governments money, why on earth would we want to get rid of defined benefit pensions?

Flipping back to the private side, it is really unfortunate that workers in the private sector don't have that security. That's not something we should be boasting about; that's something that we should be trying to do something about, with policy. We have to reestablish some sort of security, something on top of Social Security, or we can make Social Security more generous – I don't care which – but one or the other, so that people who spend their lifetime working can count on a secure retirement. I'm really glad my mother gets her $3,000 a month.

JEFFREY KEEFE

Last summer I wrote a paper for the Economic Policy Institute called *Debunking the Myth of the Overcompensated Public Employee*. Since then we've been witness to mass demonstrations in Wisconsin; but the battle began with the election of Chris Christie as governor of New Jersey. During his campaign in 2009, he began making allegations that public employees were overpaid. Once he was faced with a massive budget deficit when he took office, he really ramped up the attacks.

Christie is belligerent, angry, and outrageous; but he's good TV. He displayed anger towards teachers, public amenities, and public services, and portayed himself as the man who is going to straighten things out. He's the one that originated the phrase "There are two classes of people in New Jersey: public employees who receive rich benefits, and those who pay for them."

Public employment overall actually has been declining since the mid-'70s. It kicked up slightly with the stimulus package and the rising private sector unemployment.

Other Republican politicians have picked this up and reiterate it; Mitch Daniels is saying something similar in Indiana; Tim Pawlenty, in Minnesota. We also have a more moderate figure, like Governor Romney of Massachusetts (the founder of "Obama Care"), basically now kvetching about how overpaid public employees are. It was bad enough that the Republican politicians were doing this, but then we had the media frenzy that joined in.

New Jersey public employees do make a lot of money. But everybody in New Jersey makes a lot of money. We're the wealthiest state in the nation. In fact, there are very few occupations that New Jersey does not rank near the top of the pay scale.

Some things were selectively omitted, and this became part and parcel of the whole campaign against public employees. The Star Ledger omitted local government employees, who constitute three-quarters of the employees in the public sector. It turns out local government employees, had that data been included, make $684 a year less than their private sector counterparts on average; but that doesn't get you to the nuclear option, which was what they called their plan to change collective bargaining rights.

From this discussion you would think that public employment was running through the roof. Public employment overall actually has been declining since the mid-'70s. It kicked up slightly with the stimulus package and the rising private sector unemployment, but it's been pretty constant between 16% and 17% of the workforce since the mid-1970s.

The central question is: are public employees overpaid? There are a number of problems in comparing public and private wage and benefits. You can compare either workers with similar education, or workers with similar jobs; but the first thing you encounter when you look at the public sector versus the private sector is they don't have the same jobs.

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EPS now has a group page on LinkedIn. If this is your preferred social network, check in with us.

Join us on Facebook. Become a fan and keep up with our latest activities and upcoming events.

EPS mourns the passing of our former Fellow, Susan Willett, Friday, May 13, from pancreatic cancer. She had been a Defense Economist at the Centre for Defense Studies, University of London; and a Senior Research Fellow at the United Nations Institute of Disarmament Research (UNIDIR). She will be greatly missed.

Session One — Workers' Rights, Workers' Pay, and Local Public Services (continued)

K through higher education makes up 53% of state and local government employment. Police and firefighters are also very anomalous to the private sector.

We don't have great data sets with benefits; plus, when you look at the private sector benefit structures, it's really a tale of two worlds. There are large corporations, and there's everybody else. It turns out large corporations and government look pretty much the same, so a data set that controls for organization size is needed. I looked at the differences by education.

The majority of state and local workers have college degrees, whereas only 39% of private employees do. Education is really the critical determinant of earnings. Graduating high school on average yields a 28% return; a bachelor's degree, an 84% return; a law degree or a medical degree, at least 145% return in terms of education.

When a median private sector worker (with a high school diploma) is compared to a median public sector worker (with a college degree), the median public sector worker earns more. However, if you compare apples to apples, there's a substantial wage penalty in the public sector: the more educated you are, the more substantial the wage penalty [see below].

What kind of crazy people make a career of earning less? Well, people who get better benefits. When we look at total compensation the public sector still isn't doing as well as private. It also turns out that public sector employees do work fewer hours, and this is one of the reasons I think public sector employment is attractive to women who are trying to raise families – because there are fewer hours, and the hours are more stable.

Regarding after-tax earnings, the public sector does a lot better in terms of providing health and pension benefits than even the largest employers in the United States. That means that when we look at wages and benefits that don't control for hours, public employees earn 14% less wages, and 6% less in total compensation. Put that into a total compensation controlled for hours, and wages – while substantially lower – are now getting into being very close to parity, although still less in the public sector.

We now face an environment with more than 700 bills in various state legislatures to restrict, eliminate, or greatly modify collective bargaining. The public doesn't want that, but at the same time, we haven't been very effective at coming up with a solution to the states' fiscal crises. You could say, "Of course we did: three years ago we vigorously supported a stimulus bill that would have restored full employment." That now seems to have fallen off the agenda completely.

New Jersey last year, I'm not happy to report, ranked 50th out of fifty states in job creation. The Chris Christie solution to the fiscal crisis has not moved us any closer to solving the revenue problem that produced the fiscal crisis in the first place. As Kerry pointed out, without getting more people back into the labor force – and reducing the increased demand for social services while we have reduced tax revenue – the solutions we're headed toward (both in Washington and at the state level) will only prolong the problems we confront.

Average earnings and total compensation by education level in the US: Private sector vs state and local government employees

LEVEL OF EDUCATION	PRIVATE WAGES ANNUALLY	PUBLIC WAGES ANNUALLY	COMPARED DIFFERENCE	PUBLIC PENALTY
All workers	$55,132	$49,072	-$6,061	-11%
Less than high school	29,135	24,378	-4,757	-16
High school	38,269	36,640	-1,630	-4
Some college	43,152	42,108	-1,044	-2
Associate's degree	47,894	45,247	-2,647	-6
Bachelor's degree	71,781	48,874	-22,906	-32
Professional degree	152,733	88,629	-64,105	-42
Master's degree	93,918	60,263	-33,655	-36
Doctorate	119,878	88,625	-31,253	-26

Sources: Bureau of Labor Statistics ($US); National Compensation Survey; "Employer Costs for Employee Compensation, December 2009" with unpublished detailed compensation data for the Middle Atlantic Census division. (New Jersey, New York, and Pennsylvania; unpublished Bureau of Labor Statistics figures.

Keynote Address

Congresswoman Lynn Woolsey

JAMES GALBRAITH
I can't resist opening my introduction of our speaker with a small story about an evening out on the town in Austin that happened to be the 14th of July, 2003. My wife and I took a dear friend, Elspeth Rostow, the widow of distinguished economist Walter Rostow (National Security Advisor for the Johnson administration), to a bistro. It was deserted. This was not a season in which US relations with France were particularly warm, and especially in Texas.

But there was one other table that had a festive group of ten or twelve people. I looked over, and sitting at the head of the table, in her wheelchair, obviously having a wonderful time, was none other than Lady Bird Johnson. So I got up, and I walked over and said to her, "Mrs. Johnson, I am shocked to see you here tonight! I am going to call the White House tomorrow morning and report that you were observed celebrating Bastille Day in public." She looked up at me – she had had some strokes and her speech was not easy – but she smiled from ear to ear, and she put her fist up in the air, and said, "Ye-e-e-e-e-s!"

I mention that because our keynote speaker, Congresswoman Lynn Woolsey, was from the very beginning one of the clearest, most direct and outspoken opponents of the war in Iraq. She was the one who saw most clearly from the start that this was something whose cost was going to exceed by enormous amounts what people were being told, and that its results were going to be far less than was promised. She is now the president of an organization that was founded in 1947 by a group that included my father (John Kenneth Galbraith), Arthur Schlesinger, and also another distinguished Californian (an actor at the time) by the name of Ronald Reagan, who later went on to dabble in politics. So as a vice president of ADA, I'm particularly delighted to welcome my president, Lynn Woolsey here.

She is a ten-term congresswoman from the Sixth District, north of San Francisco. She has a distinguished record on labor and education issues,

Congresswoman Lynn Woolsey

and is one of our nation's greatest defenders of the rights of workers and the position of families, particularly in the labor force. The ability to maintain the balance between work and family life is, I think, one of her deepest concerns and one of her greatest contributions.

So it's with particular pleasure that I welcome her today to this session, which is concerned with those levels of government that I think interact most directly with the issues on which you have the deepest concern, Congresswoman Woolsey.

CONGRESSWOMAN LYNN WOOLSEY
Thank you very much, Jamie. It is a true honor to be here with such a distinguished group today. I was thinking, "Oohhhh, economists, what do I know?" I have a six-year-old grandson that's probably going to be one of you some day, and he's way ahead of me. So know that. But I just want to thank you for thinking that my voice would bring meaning to your meeting today.

I want to acknowledge Michael J. Wilson, our national director of Americans for Democratic Action. Michael J. has been such a great partner in leading ADA and making it a strong voice for progressive values.

Before coming to Congress in 1993, I was in city government for eight years, so I have the fullest appreciation for the crisis you're addressing with this conference. The many pressures facing local budgets and the dedicated public servants of our country whose jobs have been eliminated because of cutbacks – those pressures are building. Democrats in Congress have, I believe, done just about everything in our power to ease the burden with support through the Recovery Act in 2009 and many other measures; and we continue to defend public employees and the service that they provide, especially in light of the relentless attacks they've endured in Wisconsin, Indiana, Ohio, and elsewhere around this country of ours.

Of course you can't separate state and city budgets from what's happening right here in Washington. We're in the midst of the red-hot argument over the size and the scope of the federal government. It's one of those situations where the leg bone actually is connected to the ankle bone; although local governments don't have military budgets, the set of choices is fundamentally the same. Are we going to invest in our people – in their health, their education, and their quality of life – or are we going to use budgets to continue lifting the playing field in favor of the privileged, while scapegoating working people for our nation's problems?

I want to give you my perspective as a member of Congress about the national budget debate. I want to demonstrate to you that progressives are fully engaged in this battle and fighting every day for the priorities that we all share.

We had a lot of drama late last week in Washington, and while I truly am glad that we don't have the disruption of a government shutdown – I voted against the CR on Friday – I also believe that the cuts included in the final deal are far too steep and fall too much on the backs of working families. I fear there will be future threats to shut down the government when the Republicans aren't getting their way.

This really is just round one of a much bigger struggle. The deal struck Friday

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Keynote Address (continued)

night merely funds the government through the end of September. Now we're about to start a huge debate over federal spending and the relationship of the people to their government for 2012 and the next 10 years.

The chairman of the House Budget Committee, Paul Ryan, has offered his blueprint, and it's even worse than I thought it would be. It's one of the most radical, reckless proposals I've seen during my 18 years in Congress. They're talking about cutting more than $6 trillion over the next decade. Who gets the back-of-the-hand treatment, assumes the burden and bears the sacrifice? Working families and the middle class.

Their budget ends the Medicare guarantee for seniors. It voucherizes the program. I think I just coined a new word, didn't I? They would essentially put older Americans at the mercy of insurance companies, which of course are known for their compassion and their willingness to keep premiums affordable, while taking on high-risk policy holders – right?

Their budget also slashes health support for seniors in nursing homes, cuts K-12 education, and raises college costs for nearly 10 million students. Guess who makes out like bandits: the same wealthy and powerful interests whose nests always get feathered under Republican proposals. The money being taken from these core domestic programs is not being stored away for a rainy day. It's being given away: to big oil subsidies, as tax breaks for companies that send jobs overseas, and as bigger tax cuts for those in the very top tax brackets.

I don't think they're genuinely interested in closing the budget deficit at all. If they were, to give just one example, they would embrace the public option on health care. That's my bill, the Robust Public Option Bill, which would save us $68 billion, maybe more, over seven years. The public option was even embraced by the president's Deficit Budget Commission. But will they consider it? No. Government spending isn't as important to them as serving an ideological agenda. Wall Street wins, Main Street loses; austerity for ordinary Americans means windfalls for the wealthy.

There is a choice though: there will be a Democratic budget alternative, and members of the Congressional Progressive Caucus have our own proposal. We're calling it the "People's Budget," and it proves you can tame the deficit without shredding the safety net. By making our tax code more equitable,

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Volume 6, Issue No. 1 of the Economics of Peace and Security Journal is now available online. This issue contains articles by Keisuke Nakao and Sun-Ki Chai on criminal conflict and collective punishment; David Zetland on intra-organizational conflict: origin, persistence, cost, and closure (parts I and II); and Christopher Westley, William L. Anderson, and Scott A. Kjar on Mises, Hayek, war, and the Austrian School (part II of a series on war and the Austrian School).

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For a list of media outlets by state, with tips on how to write a letter in your own words including important points for the listed topics, visit http://action.aclu.org/site/PageServer?pagename=LTE_SOTU_2007 &JServSessionIdr001=3bu4 9o8t91.app20a.

Session Two Summary – State Governments: How bad is it? The role of state governments in infrastructure, science, and education

Chaired by Scherle Schwenninger

Session Two panel, left to right: Katherine Newman, Robert Ward, Gary Dymski, Scherle Schwenninger

SHERLE SCHWENNINGER

Our second session is "State Governments: How bad is it? The role of state governments in infrastructure, science, and education." It alternatively could be subtitled, "How much has the crisis and response to it stolen from the future?" because we're talking about investments that prepare the way for a better future.

ROBERT WARD

I am going to talk about the broad picture for state and local governments. Contrary to what some people think, state and local tax revenues have risen quite nicely over the long term. Whether you put those in nominal terms, or adjust for inflation, or adjust for inflation plus population – when you look at taxes as a share of the economy, it's really striking how the figure has remained pretty constant for a long period of time now.

Starting at the end of 2008 we had five straight quarters of decline. Overall tax revenues fell by 12% during 2009, and in a normal year states had revenues rise by somewhere in the range of 5% to 6%; that's a combined 17% to 18% shortfall in resources.

However, tax collections did rise modestly by about 4% in 2010, so the crisis is over in terms of further decline for states; but viewing that 4% gain in the context of a 12% drop, it's still down some from the heights. We have early data now for the first couple of months of 2011. It looks like the first quarter revenues will be up something in the range of 9% compared to a year ago, so perhaps by the end of this year most states will be back up to where they started. Some states are still climbing out of the hole.

Local governments have a very different picture. State taxes are based primarily on income tax and sales tax. These revenues are fairly closely tracked in the economy, so they're relatively contemporaneous with the state of the economy. Local government revenues are much more heavily reliant on property tax. Since that tends to lag the economy by two to three years, right now we are seeing the impact on local government revenues. In fact, in the last quarter of 2010 property tax collections nationwide declined by 3%, the first decline in property taxes in almost 10 years. The other main source of revenue for local governements is state aid, which is likely to be reduced in most states this year.

In the long term, if you believe the Government Accountability Office, state and local governments face continued very serious fiscal problems over the next several decades. This primarily will be a result of rising health care costs, both for publicly funded health care and Medicaid and other programs, as well as for health care costs for public employees.

How are states responding to these challenges? One key point that I want to leave with you today is that states respond to these things in very different ways. A lot of states are enacting very significant cuts to education and other programs at a time when in many jurisdictions the local property tax base is weakening. It appears unlikely that we're going to have, at least in the near future, a major national response to these fiscal problems facing the states and localities. There is some national debate over the relationship between the federal government and the state and local governments. People come down on different sides, but it's the sort of discussion that we need to have periodically in this country.

At least for the near future, there won't be any major federal assumption of costs in Medicaid, or any major new form of federal revenue sharing with the states. There will likely be a reversal of the social contract that has existed in this country for the last 50 years or so.

Starting in the 1960s, the role of government expanded in many ways in the private sector while a lot of costs also

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shifted to the federal level. I think we are facing a period that may very well be a reversal of that. This raises the question: what is the overall balance of revenue and expenditures?

We're going to have to convince the electorate that the tax levels we've had for a long time need to go up. If that does not happen, I suspect that the ultimate resolution of this will be some kind of combination of revenues and spending actions. On the spending side, choices will have to be made among the various programs that states and localities fund: education, health care, transportation, public safety, the social safety net.

An opportunity for new thinking can arise. The question for the progressive community is: what are the choices that can be made on both the revenue and the expenditure side? These choices are far too important to leave to the other side of the agenda.

KATHERINE NEWMAN

I'm going to ask the question: what happens if we raise revenue in different ways in different states, in particular if we rely on regressive taxation (as opposed to progressive taxation) for revenue-raising? Who gets hurt if the answer to the problems in the states is fees and sales taxes, as opposed to property tax or income tax?

There's a big difference, even if the revenue is the same, in the consequences of those different methods for raising revenue. It's not neutral, and it has huge consequences for the poor. Unfortunately, I don't have time to take you through the ways in which tax regimes are related to things like health outcomes, educational attainment, teenaged childbearing, crime, and so on; but I'm going to walk you through some of the more significant differences by region.

States began instituting very severe limits and supermajority rules that make it very difficult to raise any kind of progressive taxes as early as the 1870s in the post-reconstruction Deep South. This left things like sales tax the only real instrument for raising tax at all. These supermajority rules started to spread in the Great Depression. The Civil Rights movement led other Southern states to erect barriers to taxation, knowing full well that greater political power in the black community would mean increased demand for tax expenditures for the public sector. In the 1970s, California passed Proposition 13 [Initiative to Limit Property Taxation]. Other Western states followed suit.

> **[M]any ... instruments that have created a more progressive picture (especially the earned income tax credit) are under threat as the state and local governments respond to fiscal pressures.**

Government spending per capita at the state and local level has nearly doubled over the last 25 years, after adjusting for inflation. A lot of this has been driven by social expenditures on education, public welfare, health, and hospitals. Federal spending on these programs has increased as well; but a lot of that federal funding comes with very heavy matching requirements at the state and local level.

Where does the revenue come from to meet increased federal matching requirements? There are huge regional differences: the Northeast turned to income tax, and the South was definitely not doing so. Property tax doesn't seem to be a very popular source in the South either. Throughout the country, with the exception of the Northeast, the regressive solution appears to be the favored choice for increasing revenue, with the West and the South leading the way in using sales taxes as the major mechanism for increasing revenues. In both of those regions the presence of those supermajority rules makes it very hard to raise any other kind of revenue.

As a scholar interested in poverty, I'm particularly concerned in the role of taxation on food. Maps of obesity, heart disease, and hypertension show a big cloud hovering over the Southern states. One of the reasons it's hovering there is that taxing food like any other good causes poor people to shift their diets in a negative direction, and you end up with a stroke belt wrapped around the South. There are huge health and health expenditure consequences that follow from the use of regressive taxation, especially food tax.

Sales tax liabilities differ dramatically by region, and this is especially important for people at the poverty line. In Southern states there has been a strong increase in sales taxes at the poverty line over the last 25 years. In the Northeast there have been huge declines in income tax liabilities at the poverty line; the Northeastern states have been using the tax code as a redistributive mechanism. They have been following the federal government in enacting state earned income tax credits and depressing income tax to far below zero, creating a rebate system. A family at the poverty line in Massachusetts gets a rebate equivalent to $2300 a year more compared to a family in Mississippi. That's an enormous difference at the poverty line. No Southern state goes below zero or is creating a rebate system; whereas in the Northeast, most of them are.

What worries me most in the current context is that many of the Northeast's instruments that have created a more progressive picture (especially the earned income tax credit) are under threat as the state and local governments respond to fiscal pressures. For example, Rick Snyder in Michigan has proposed eliminating entirely the state-earned income tax credit. In Kansas, lawmakers have proposed cutting the state's earned income tax credit by about 75%. Lawmakers in Utah are working to restore the state sales tax on food. Georgia is considering a state sales tax increase on a lot of goods including groceries. Thirteen cities in the state of California have already adopted increases in sales tax rates that are slated to go into effect this month. Sales tax-increases are being debated in

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localities all across the country, from Arizona, to Nebraska, to North Carolina.

At the end of the day, what this means is a repeal of the very instruments that separated progressive states from more regressive ones, and probably a real depression in what is available to support the household expenses of poor families. This of course is not having a neutral effect on federal expenditures. Revenue flow from the federal government to the South is climbing. But this federal rescue has not been enough to reverse or stem the tides of poverty.

The overall political context where the fiscal crisis of the states is being discussed is one of extreme limits on the states' powers, because of this very long history of invoking supermajority rules. However we solve the revenue versus deficit problem, it will mean a change in the mix of the ways we achieve that revenue, which will have severe consequences for the most disadvantaged American families.

GARY DYMSKI

I think people are tending to panic a little bit in thinking about the current situation. The subprime crisis hit California quite early resulting in about a 20% decline in revenues between FY2007 and 2008. We then had Governor Brown come into office, inheriting a two-year budget problem of $27.6 billion. He solved half of that through cuts, and we've got the other half to go. His hope was that there could be consensus to do something about those cuts by giving back some government services to localities. In California, you need a two-thirds vote, the supermajority that Kathy was talking about, either to pass a budget or a tax increase. Republicans who voted for the temporary tax increases in 2008 were rewarded with defeat at the polls in November 2008, so the remaining Republicans are unlikely to support any new revenue measures.

California had been blessed with faster GDP growth than the rest of the country. We built infrastructure; we created water transfer systems; we had an exemplary K-12 education system; we had the so-called Master Plan for higher education, which assures that the number of seats available for our young people will grow as the population grows. In science and technology we had the conjuncture of the Department of Energy; Xerox and other labs in what came to be known as Silicon Valley; and Berkeley, Stanford, SJSU that led to the development of theories of industrial clusters and synergies and agglomeration.

We had a surplus, and we're continually growing faster and importing wealth and people from the rest of the world, including the United States. That led to a kind of chronic growth economy, where the big problem is all these new people looking for jobs. That's going to put a depressing effect on wages. In turn, people will be looking for houses, putting upward pressure on your housing prices. The challenge is to build real assets, especially houses and communities, fast enough to keep pace with the inflow of people; otherwise there will be an asset price explosion.

After that period of happy growth, we became very much a boom-bust economy with a lot more bust. We had disinvestment with a decline, an IT bubble followed by a crash, followed by a housing bubble and a crash. This has led to population outflow and stress, huge revenue swings which have not been used wisely, and the growth of a politics of insecurity.

How bad is what happened? Well, employment in Silicon Valley never really came back. There was a collapse in housing price values, which in turn led to a destruction of our construction industry. We've got an employment crisis: aerospace, information, financial activities – all the jobs are tailing off. The only thing that's really been growing is education and health services [see below], which of course are lower income and highly dependent on public budget.

In preparation for this presentation, I talked to a lot of people in leadership

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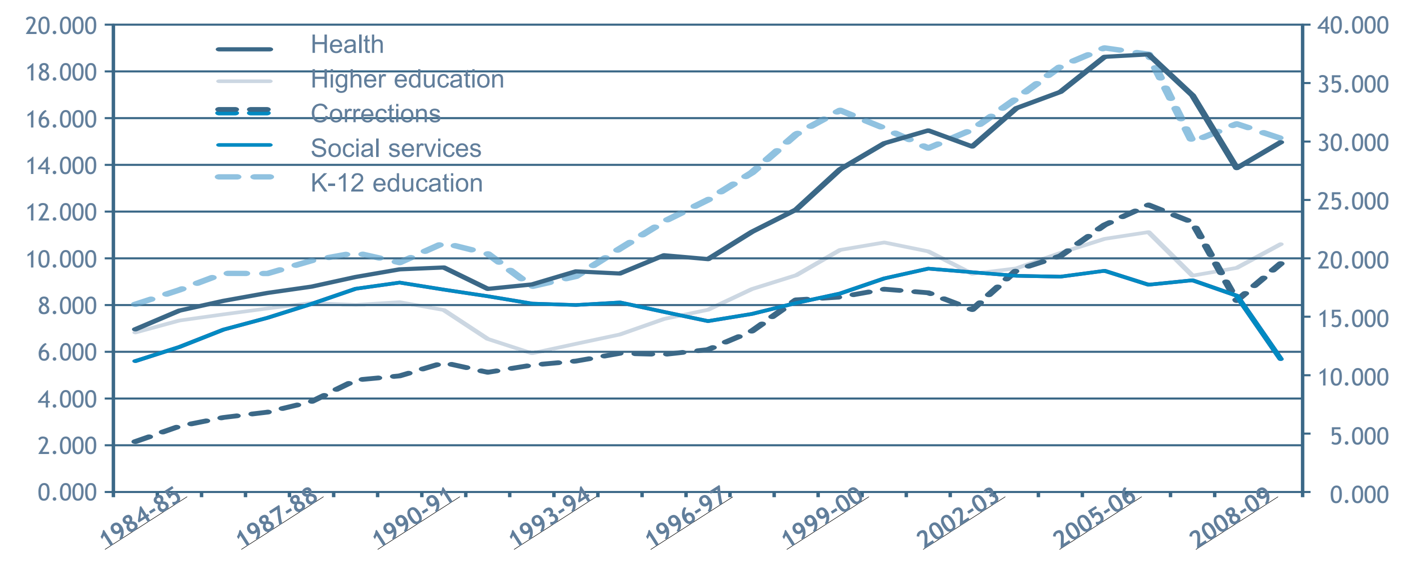
General Fund Expenditures by Category, California in Billions of 2005 Dollars, 1984-85 to 2010-11



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in California, and they're not counting on very much from the federal level at this point. We're talking about re-engineering our politics: to decentralize through a realignment that will push revenues and responsibilities downward so that people can feel and touch the government services that they're going to have to pay for; and then to really rethink budgetary priorities.

Policy recommendations include: initiative reforms for more transparency and a higher threshold for constitutional change; an end to the two-thirds rule for state budgets and tax increases (likely impossible); holding the line on discretionary spending caps; and extending moratorium on unemployment insurance trust fund loan interest payments. Diane Cummins, with Governor Brown's Department of Finance, is angry about the failure to make banks pay for what they did to cause our crisis. California really needs to pay attention to the foreclosure crisis. A disproportionate number of Californians are affected, and many of those are of color. Foreclosure is destroying middle class wealth, and eliminating the next generation of business startups. Unless that's reversed, it's not going to be pretty.

Lastly, let's take a hard look at general revenue sharing. If the solution is greater creativity at the state and local level, why don't we have federal programs that go along with that? Let's reimagine federal aid to schools; let's recruit scientists and technicians for creative solutions; and let's pay attention to culture and the arts.

If we can't accomplish these, then let's at least maintain whatever transfers the federal government can give us. Help us have access to borrowing markets. Help us figure out the bankruptcy law for localities so when the cities start to go belly-up on their pension and other obligations, we can figure out what it means and what to do about that. And let us prepare for a vastly more unequal future in which the fiscal composition and living standards resemble the member states of the European Union more than the states of the American Union.

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responsibly reducing defense spending, and implementing a public option, this budget eliminates the deficit within 10 years and puts us on a path to budget surplus.

We also make substantial cuts to defense spending, starting with ending the wars in Afghanistan and Iraq. We provide a year's worth of funding to provide for a safe and orderly redeployment of our troops and our contractors out of Afghanistan, and then that's it; we're out of there. We cut the Pentagon's base budget by more than $600 billion over 10 years by eliminating weapons systems and reducing fleet sizes, but without reforming military health benefits or compensation.

Of course the Republican budget has practically nothing to say about 10 years of war spending that has morally and fiscally bankrupted the United States of America. This military occupation of Afghanistan is costing taxpayers nearly $7 billion every single month. Why? The Taliban hasn't been defeated; democracy hasn't taken root; we've undermined rather than advanced our national security interests. This war hasn't accomplished a single thing that it was supposed to. Plus we still have boots on the ground in Iraq, and our military is further over-extended by the operation in Libya.

Under Republican logic, we should cut all of the programs that save and enrich people's lives – Medicare, Medicaid, Head Start programs, and so on – but we should continue to throw billions every month at the war that has killed 1500 Americans and left thousands more with physical and mental wounds that may never go away.

It's not that I don't think we should be engaged with Afghanistan or other developing countries around the globe. We must. It's just that we have to fundamentally alter our mindset about how we engage. Instead of a military surge in Afghanistan, what we need is a civilian surge. That's the whole philosophy behind the Smart Security platform that I've been pushing for many years now here in the House. Let's reduce our nuclear arsenal; let's finally cut off all those Cold War weapons systems designed to fight an enemy that no longer exists; and let's reinvest that money in a cost-effective way at pennies on the dollar in humanitarian and debt relief, democracy promotion, and other efforts that improve people's lives in the countries that have known so much poverty and so much hardship. Then we can win the hearts and minds of the people we're trying to work with.

In conclusion, my good friends, let me just say that I don't accept the Republican premise – I guess you heard that – because it's fundamentally bogus. I don't buy the idea that our fiscal woes are the fault of teachers, or public employees, or nurses trying to make ends meet through a difficult recession. I don't buy the idea that a decade-long foreign war halfway around the world somehow promotes our values as Americans, but that guaranteeing education at the same time for schoolchildren and health care for seniors somehow weakens America.

The good news is that I think they've overreached. The Republicans have not only lost their moral compass, they're losing the American people as well. The polls clearly show that there's no public clamoring for deep cuts in Medicare and education. By contrast, two-thirds of Americans want no part of the war in Afghanistan.

It's up to us, all of us, to go on the offense. That's why the Congressional Progressive Caucus has been aggressively promoting its own budget principles. We can't cede ground in this debate. We have to push back against the dangerous set of priorities, and we'll be counting on people like you to help us make the case. We need your help, and I thank you for hearing.

Session Three Summary — The National Responsibility and a Course of Action

Chaired by Richard Kaufman

RICHARD KAUFMAN

Before our panelists begin, I want to make a very brief comment about why it is so difficult for the federal government to respond in the sensible ways outlined by the last speaker on the last panel; and also why policy has gotten so crazy, as was detailed by Jamie and our first group of panelists.

My explanation has two basic factors. First, severe economic downturns are historically a devil's playground for extreme and irrational solutions to common problems; it is no comfort to know that we are in the midst of a recurring phenomenon. Second, there is in particular a brooding omnipresence, to borrow a phrase [from Oliver Wendell Holmes, Jr.], in Washington. It began with the election of Barack Obama, when the Republican minority in the Senate managed to use the spongy definition of a filibuster to slow down the policy process and defeat a number of administration initiatives. This process has been accentuated with the election of a Republican majority in the House of Representatives. As Representative Woolsey said, the House Republicans threaten to shut down the government when they don't get their way, a phenomenon we all witnessed last week, and will continue to witness for the foreseeable future.

I now turn to our panelists, who will discuss the national responsibility to the crisis and present some very interesting ideas about possible courses of action.

STEVEN ATTEWELL

The unemployment problem as I see it is that we're stuck in a really big hole. We've got 13.5 million officially unemployed; we've got another 15 million unofficially unemployed, which would be a huge hole to climb out of in any economic situation. We also have a long-term problem in our labor market which means that any time we try to do something about it we're always running against the current, and our automatic stabilizers are fundamentally broken.

Unemployment insurance basically has a flaw in its very design. In 1935, to get Social Security past the Supreme Court, the Committee on Economic Security passed a federal regulatory tax, and then forgave it against states that set up their own unemployment insurance programs. That was deemed a constitutional exercise of the federal government's authority to tax. This creates a dangerous vulnerability within the unemployment insurance system which can't be expunged. Forty-nine states have a constitutional ban on deficit spending; 26 have borrowing limits; and as a result, 32 states in this last recession have had to borrow billions of dollars from the Department of Labor because they underfunded their systems.

States also have an incentive to exclude workers from unemployment insurance and to keep benefits down. As a result, only about 40% of workers in America are actually eligible for unemployment insurance, and only about a third actually receives it. Another way states try to deal with their problem is by keeping the benefits really, really low. The national average is about $300 a week – well below the poverty line for a family of four [see below]. This is a huge social cost to people on unemployment. It also has an economic impact. Instead of acting as an automatic stabilizer to fallen consumer spending, we just drop down to a lower level of equilibrium. Ultimately, the solution is to nationalize unemployment insurance. A decentralized system will not work; it simply

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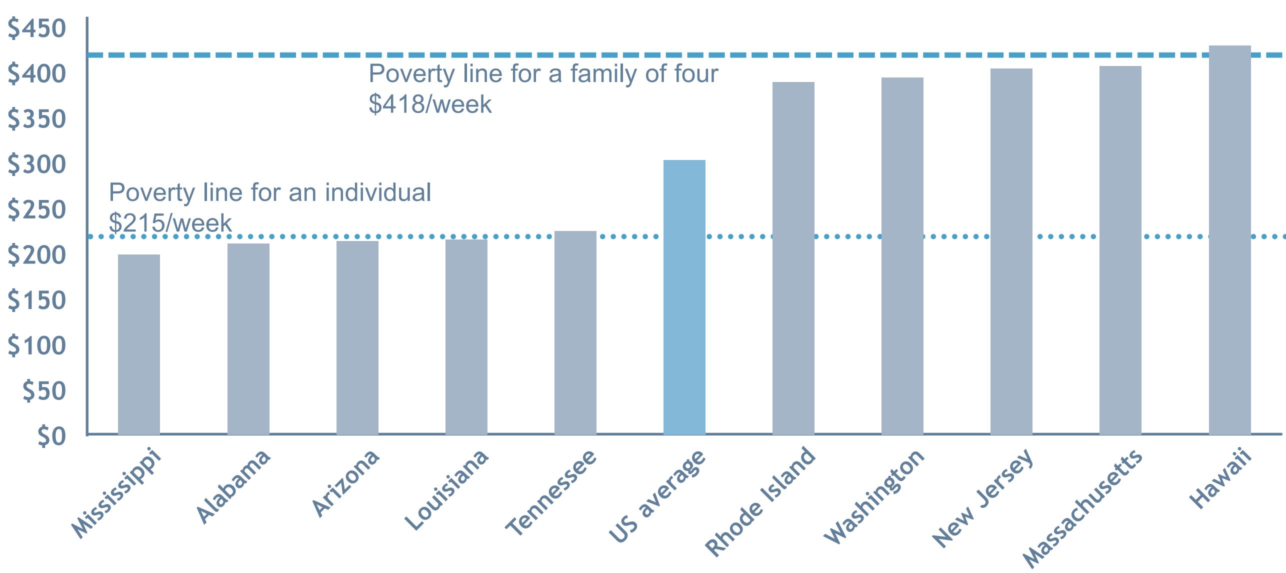
Average Weekly Unemployment Insurance Benefit by State and the National Poverty Line



Source: Department of Labor, US Census Bureau

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creates way too much incentive for a drive to the bottom.

There's also a missing link in our welfare state. We have no way of keeping people from losing their jobs, providing new jobs when the private sector isn't hiring, or cushioning people against the social costs of unemployment. We only react after people have lost their jobs. We could provide job insurance and a general work program. A million jobs roughly works out to $35 billion per year, which actually looks pretty good compared to the stimulus, which cost about $195 billion per million jobs. The federal government could easily employ everyone officially unemployed; it would cost about 60% of what the stimulus costs.

Workers on job programs would be seen to have earned their public jobs, so we wouldn't see the same kind of shaming of the unemployed that we see today. The program could be deficit-neutral, so we wouldn't have to fight the deficit hawks on every last penny. A 1% equivalent of a payroll tax would provide about $36 billion a year to go into a central fund. After about three or four years, this fund would be large enough to immediately respond even to pretty big job losses. It would take 7 years to be ready to handle the great recession on its own. If this seems implausible to you, this is how Sweden operated from 1930 through 1990, maintaining an unemployment rate of less than 2.5% that entire period. That's better than the US has ever done.

Unemployment carries social ills as well: losing a job can become a barrier to getting another job. It can quickly lead to homelessness when dealing with a massive mortgage that suddenly balloons in your face. COBRA is incredibly expensive; a better long-term strategy is to let people buy into either Medicare or Medicaid. There would be fewer situations in which people lose their health insurance, don't get checkups, and don't deal with medical conditions. Then they're disabled; then they can't work. Finally, I think we have to allow unemployment insurance recipients to attend job training in lieu of a job search.

In the end I think that this dual approach of nationalizing unemployment insurance and creating a federal employment assurance system is both a moral act and a necessity. It's a moral act because it is simply wrong for people who want to work to be denied that chance to contribute to our nation's economy. Work means more than just a paycheck; it determines our very social identity. It's when we wake up in the morning; it's why we read the newspaper. The simple process of going through a commute and into your workspace and meeting with your colleagues creates a sense of identity. It's a mass experience, and without it people are left behind in residential neighborhoods, each day being reminded that they are useless, that they aren't needed. At the end of the day, even with that unemployment check, people still are being told by society that they're surplus to requirements.

Since health care inflation historically has been much more rapid than general inflation, it's all but certain that the amount of money available for states to spend on Medicaid would decline relative to the costs that they'd be facing.

We have to respect the value of labor that the unemployed represents; 28 million unemployed workers equals $3 trillion in output each year that we never see. There is a way to do this, if we look beyond traditional ways of dealing with unemployment and seek a new path.

GREG ANRIG

I'm going to focus on Medicaid. Many of my ideas are similar to those Steve suggested for unemployment insurance. My main argument is that we should do the inverse of what Congressman Paul Ryan recommended last week in his plans for reforming the budget, and particularly Medicaid. His proposal would shift to a block grant; states would be given a fixed amount of money, and even more leeway to do as they please with that money in providing health care for the same group of people. The amount of the block grant that states receive would not be allowed to increase any higher than the rate of general inflation in the economy. Since health care inflation historically has been much more rapid than general inflation, it's all but certain that the amount of money available for states to spend on Medicaid would decline relative to the costs that they'd be facing.

The existing Medicaid system is very flawed; its shortcomings arise from its dual federal-state nature. Congressman Ryan's plan really exacerbates the existing problems. First, federal payments for Medicaid under the proposal would be substantially smaller than currently projected amounts. Even with additional flexibility, the reduction of payments would probably require states to decrease payments to Medicaid providers, reduce eligibility for Medicaid, provide less extensive coverage to beneficiaries, or pay more than would be the case under current law. Another certain outcome under a block grant system is that we would have even wider variations from state to state.

Ryan says that the existing Medicare reimbursement structure encourages states to extend coverage to those who are not truly needy. Studies have found that about 25% of those eligible for Medicaid or CHIP [Children's Health Insurance Program] are not enrolled for a variety of reasons, including the states' own failure to recruit people into the programs. Under a block grant system, in which states are pressured to continually cut their spending, you can imagine the eligibility requirements will decline, and efforts to reach out and enroll people likewise could be expected to be reduced.

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Session Three panel, left to right: Michael Lind, Greg Anrig, Randall Dodd, Steven Attewell
Not shown: Richard Kauffman

Another likely upshot of the Ryan proposal is reduction in covered services. States are currently mandated to cover physicians' services, in-patient and outpatient hospital services, and home health care services for individuals entitled to nursing facility care. If states get greater flexibility in determining what services they pay for, there's every reason to expect the menu of covered services to be reduced.

In addition, reimbursement rates to health care providers, which states already have wide latitude to set, would be sure to drop even lower. That obviously discourages providers from taking on Medicaid patients, which in turn leads to poor health care outcomes for many Medicare beneficiaries. In New York, even though the menu of options covered by Medicaid is broader than in most other states, health care outcomes are among the poorest in the country. That's largely because high numbers of Medicaid patients end up going into highly institutionalized settings that provide very limited individual attention because they are so overcrowded.

The opposite approach would entail increasing the federal government's control of the program and ultimately taking it over. The Patient Protection and Affordable Care Act takes important steps in the direction of federalization. The goal under that law is to expand the program's enrollment from today's roughly 60 million to about 84 or 85 million by 2019. The main expansion would come through extending eligibility to all non-elderly Americans, up to 133% of the poverty level across the country. Congress has passed this.

For those who say, "We can't imagine Medicaid becoming federalized," this is a big step in that direction, and if the courts don't shoot it down, it looks likely to happen. Here are four arguments for federalization that have the potential to carry significant political weight going forward.

1) Americans will have to pay Medicaid's costs one way or another. Moving toward federalism would shift the cost burden to a greater extent towards those who can most afford to bear it.

2) America's interrelated problems of soaring medical inflation, mediocre care, and a huge uninsured population are an outgrowth of our highly fragmented health care system. Federalizing Medicaid would reduce that fragmentation, giving the federal government much greater leverage to control overall health care costs.

3) During recessions, if state-balanced budget requirements were to lead to Medicaid cutbacks, the federal government would have greater flexibility to make sure low-income individuals were adequately covered.

4) Reducing the gaps between Medicaid and Medicare reimbursement levels, which would be much more likely under federalization, would help to end Medicaid's status as a second-tier welfare-type program, improving the quality of care to beneficiaries.

Back in 1982, Ronald Reagan actually supported the idea of federalizing Medicaid. Even today, some conservative commentators have endorsed Medicaid federalization, in part because they recognize the idea's potential to liberate states from their suffocating budgetary burdens. I really believe that the attention that Congressman Ryan has called to Medicaid presents an enormous opportunity to try to turn his idea on its head and get people to see that the direction he's taking is wrong, that we need to move in the opposite direction.

RANDALL DODD

I'd like to pick up where Gary Dymski was talking about how we finance municipal debt. I want to focus on two things: the traditional inefficiencies of the municipal bond market, and how they led to the fragility that became part of the financial crisis. Then I would like to suggest some remedies.

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The municipal bond market is not like a stock market. It's traded over the counter rather than on an exchange, which means it's much less efficient and less transparent. One of the results is that it costs more to buy and sell a bond. Aggravating that problem is that there are a large number of issuers and with a large number of issues each. Additionally, tax advantages limit the effective market for these securities to high net-wealth individuals subject to US personal income taxes. State and local governments do most of the public investing in infrastructure. Higher interest costs to borrow for these capital projects puts pressure on current budgets and competes for other categories of expenditures such as payrolls.

Muni debt is systematically underrated by credit rating agencies. They evidently overrated many structured products leading up the financial crisis, but they also did the financial system a disservice by underrating muni debt [see below]. Underrating them pushed them into seeking a "credit wrap" or bond guarantee from the monoline insurers. When these monolines went bankrupt for the exposures to non-muni related credit risks – namely structured credit products – it spread the financial crisis to the muni debt market.

I would like to offer a couple of suggestions for solutions. The stimulus bill created the Build America Bonds, BABs. These bonds were not tax exempt and, because part of the coupon on the bond was paid by the federal government, there was an implicit federal guarantee. So you get a bump up in your credit worthiness, and you get access to a much greater capital pool, but these were only available until the end of 2010.

Electronic trading makes listing instruments easier and very inexpensive, so why not put these bonds on electronic exchange? That would make prices more transparent, make the bid-and-ask quotes tighter together, so people could buy them and sell them more actively.

Another improvement could be the creation of centralized bond banks, like that in Maine. Instead of having every little village in Maine issue a municipal bond, they apply to the State of Maine's bond bank for credit, and the State of Maine's bond bank actually issues the bond. This system has a number of advantages that make a more standardized, homogenous product that attracts more investor interest: a smaller number of larger issuances of standardized bonds, a common accounting standard, a clear credit rating, and scheduled auctions. That could be done for the 50-plus states and possessions, or regionally, or even federally. This reorganization of the market would create higher credit-worthiness, a higher standardization, and hints of greater liquidity and lower borrowing costs for these cities and governments.

My last recommendation is to require competitive bids for the underwriting services, instead of a negotiated bid. Broker dealers can be required to have fiduciary responsibility to the municipality, to act as though they're acting in the interest of the municipality. This would make the dealers liable for sharp deals in which the bond goes off at 1-, 2-, 3% or more of its value in the market a couple of days after the issuance.

MICHAEL LIND

One of the problems with our politics is that there is no national budget. This would show how much we spend on particular functions, such as health care,

10-Year Average Cumulative Default Rates for Municipal and Corporate Bonds 1970 – 2009

RATING	MUNICIPAL	CORPORATE
Aaa	0.00%	0.50%
Aa	0.03	0.54
A	0.03	2.05
Baa	0.16	4.85
Ba	2.80	19.96
B	12.40	44.38
Caa	11.60	71.38
All investment grade	0.06	2.50
All speculative grade	4.55	34.01
All rated	0.09	11.06

Source: Moody's Investors Services, February 2010, at http://www.advisorperspectives.com/newsletters10/Identifying_Opportunities_in_the_Municipal_Bond_Market.php

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policing, the environment, unemployment, and so on, as part of a single pie chart with federal, state, and local expectations in each of these. If policymakers, policy analysts, and the general public got in the habit of thinking in this way, we would realize that the division of labor among the federal, state, and local levels of government is, to a large extent, a result of an accident of history.

I think that the Ryan plan is not actually cutting costs; they're shifting costs. They're shifting it to the states and to individuals. That's like stopping the hole in one part of the water hose, and then it just squirts out somewhere else. You actually haven't solved the problem of leakage. Thinking of it in this comprehensive, integrated manner of a national budget could lead to real cost control.

We've already heard from Steven Attewell and Greg Anrig that federalizing Medicaid and unemployment insurance, among other things, would be more efficient. It's actually cheaper, makes a lot more sense. You free both of these programs from reliance on volatile state or local budgets, which crater much more than the federal budget does during recessions. We are going to have recessions in the future; it's part of the regular business cycle.

There also is an entire area of a hidden welfare state. These are activities which, in order to make government look smaller than it is, are essentially delegated to the private sector with tax subsidies. Without those bribes from the taxpayer, this would not be done; it's called the market or privatization but there's no market here. It's more like contractors. The least efficient parts of our imaginary national budget, particularly private medicine and higher education, fall into "the subsidy sector." Actual direct bureaucratic government, that everyone is taught to think of as terribly inefficient, has very low administrative costs; is very clean and efficient.

In 2005, before the present crisis, the US spent 16% of its GDP on health care. The OECD average among similar industrial democracies was 8.5%, about half as much. In spite of the greater resources poured into the US health care sector, both access and outcomes are worse. Drugs in the US cost 50% to 70% more than in comparable countries; hospital costs per day are 2.6 times more; and health insurance and administrative costs are six times as much as the average of Western Europe and Northeast Asia. The annual growth of the US health care sector's costs in excess of inflation is by far the highest in the world.

...[G]iven the fact that there are enormous variations in wealth among the states, even a regressive flat tax at the federal level can have a progressive effect if it's replacing equally regressive flat taxes at state level.

Higher education suffers from this same kind of cost disease, arguably for some of the same reasons. It's this kind of a hidden welfare state where you have public subsidies without any public cost controls. America's spending on higher education is far greater than that of other OECD countries at 2.9%, compared to an OECD average of 1.4%. While America's flagship universities are the best in the world, the US has fewer college graduates as a percentage of the population. College is more expensive than in most comparable countries, so there's a parallel here with what we see in the health care sector.

How much money could be freed up for other economic uses if the subsidized sectors in the US were as cost-efficient as those in other countries? If the US spent the OECD average of 8.5% of GDP on health care, and 1.4% of GDP on higher education, the result would be savings of about $1.4 trillion a year.

On the revenue side, the US is going to have to raise taxes. Currently, the US government spends about 25% of GDP. In order to have a balanced budget we need a matching 25% of GDP in revenues. Revenues currently hover around 19%. Defense spending is about 6%. If you cut 3% out of defense spending, you're a long way towards 25% revenues. At the same time, you have to raise a couple of percentage points of GDP through other new revenues.

I think that a national consumption tax is going to be in America's future in order to raise this much revenue. Other very progressive democracies in the world rely on a mixture of three basic taxes at the national level: value-added tax, payroll tax, and income tax. There are concerns about the regressivity of value-added taxes, like all consumption taxes. However, given the fact that there are enormous variations in wealth among the states, even a regressive flat tax at the federal level can have a progressive effect if it's replacing equally regressive flat taxes at state level.

A federal value-added tax shared with the states, replacing part or all of local sales taxes, could move in a progressive direction. With this plan I envision about 40% of US GDP going to government – federal, state, and local – permanently.

None of this is possible between now and the presidential election; it may not be possible in this decade. The Right began in the 1970s with completely unthinkable radical ideas that even conservative Republicans rolled their eyes at; by the 1980s, these were moderate conservative ideas; then they became moderate liberal ideas by the 2000s. To move back the other way is likewise a long-range program. Establish your maximal program and stake out that position before you begin to compromise. I tell people I'm a short-run pessimist and a long-run optimist because I agree with Winston Churchill, who famously said, "The American people can be counted upon to do the right thing when they've exhausted the alternatives."

In Other News – from our monthly e-newsletter, NewsNotes

World Not Prepared For Climate Conflicts
By Laurie Goering, April 28, 2011 for AlertNet

"Accelerating climate change and competition for limited supplies of water, food and energy are poised to ignite long-simmering conflicts in fragile states, monopolising the world's military resources and hampering development efforts, security experts say.

"Defusing these new 21st Century conflicts – or at least preparing governments and citizens to cope with them – will require a broad range of innovative interventions, a gathering at Britain's Department for International Development (DFID) heard earlier this month.

"Mitigation measures include borrowing business risk-management strategies, getting military officials to talk publicly about the constraints they face, building capable institutions in unstable countries, and ensuring billions in climate aid go to the right places and aren't lost to corruption, experts said."

Read the full article at
http://www.trust.org/alertnet/news/world-not-prepared-for-climate-conflicts-security-experts.

A National Security Strategy That Doesn't Focus On Threats
By Jim Dwyer, May 3, 2011 for The New York Times

"Here's a proposition: The death of Osama bin Laden brings a moment to talk about something other than threats – not because they don't exist, but because for the country to see and speak of nothing else is mortally dangerous.

"So listen for a moment to two military strategists, working at the highest level of government, as they turn to the subject of leaky air-conditioners in government buildings in New York. 'Poorly fitted air-conditioners cost New York City $130–$180 million a year in extra energy consumption,' one of the strategists, Captain Wayne Porter of the Navy, said Tuesday. 'They generate 370,525 extra tons of carbon dioxide'."

Read the full article at
http://www.nytimes.com/2011/05/04/nyregion/a-strategy-for-national-security-focused-on-sustainability.html?_r=1&emc=eta1.

Reassessing The Cost Of The Post-9/11 Era, Post Bin Laden
By Dan Froomkin, May 11, 2011 for The Huffington Post

"Osama bin Laden's death doesn't end the post-9/11 era, but it does provide an occasion to look back at everything that's happened since the attacks nearly 10 years ago and reassess the costs.

"It's been a long, grueling and enormously expensive time for this country, a time of endless war and massive fortification, of borrowed money and of missed opportunities.

"There's the human toll. More than twice as many Americans –- over 6,000 – have now died in the two wars that followed 9/11 than did in the original attacks, along with more than 100,000 Iraqis and Afghans. Over three million Iraqis and 400,000 Afghans remain displaced. Several hundred thousand US soldiers suffer from long-term war-related injuries and health problems, with more than 200,000 diagnosed with traumatic brain injury alone."

Read the full article at
http://www.huffingtonpost.com/2011/05/11/reassessing-the-cost-of-9-11-bin-laden_n_860186.html.

UPCOMING EVENTS

June 10 - 11, 2011. The 4th International Summit on Conflict Resolution Education will be held in Cleveland, Ohio. The 4th International Conference on CRE is an opportunity to engage in interdisciplinary collaboration and research on issues related to the development of infrastructure in CRE. Presentations will focus on innovations in the fields that are making broad impacts in local, state, national, and international communities.
Details are available at
http://www.creducation.org/cre/global_cre/about_global_network/4th_intl_cre_summit_2011/.

June 16 - 17, 2011. Fifteenth Annual Conference on Economics and Security will be held in Bristol, UK, hosted by Economists for Peace and Security (UK), University of West England (Bristol), and University of Bristol.
More information is available at http://carecon.org.uk/Conferences/Conf2011.

June 24 - 25, 2011. Department of International Economics 2011Conference on Development Economics and Policy, hosted by the KfW Development Bank and DIW Berlin - German Institute for Economic Research. The keynote speeches will be delivered by Alan Winters (Sussex University and Chief Economist at DFID) and Eliana La Ferrara (Bocconi University, Italy).
For full details, please refer to www2.vwl.wiso.uni-goettingen.de/ael/index.htm.

June 27 - 29, 2011. 11th Annual Jan Tinbergen Peace Science Conference, organized by the Network of European Peace Scientists, will be held at University of Amsterdam, The Netherlands.
For more details, visit http://www.europeanpeacescientists.org/jtinbergen.html.

June 29 - July 1, 2011. 8th International Conference Developments in Economic Theory and Policy.
The Department of Applied Economics V of the University of the Basque Country and the Cambridge Centre for Economic and Public Policy, Department of Land Economy, of the University of Cambridge, are organizing the 8th International Conference Developments in Economic Theory and Policy. The Conference will be held in Bilbao (Spain).
For more information, see http://www.conferencedevelopments.com/.

June 29 - July 3, 2011. The 86th Annual Conference of The Western Economics Association International will be held in San Diego, California.
Details are available at http://www.weainternational.org/.

September 6 - 7, 2011. Conflict Research Society Annual Conference will be held at the Richardson Institute for Conflict and Peace Research, Lancaster University, UK. The theme for this year's conference is *Has War Gone Bust? Peace, Conflict and the Global Financial Crisis*.
For more information, go to http://www.crs2011.org/index.php.

November 11 - 13, 2011. ICAPE's 3rd international research conference, *Re-thinking economics in a time of economic distress*, will be held at the University of Massachusetts-Amherst, Amherst, MA.
The 2007-08 financial crisis and subsequent economic downturn have raised many questions about how well prevailing economic approaches identify and explain pressing economic problems and suggest sound ways to solve them. Exploring what needs to change in economics and identifying productive paths forward are the central themes of The International Confederation of Associations for Pluralism in Economics 3rd international research conference.
Full details about the conference are available at http://www.icape.org/conferences.html.

EPS Quarterly
EPS c/o the Levy Institute
Box 5000
Annandale-on-Hudson, NY 12504
USA
Tel: +1 845.758.0917
Fax: +1 845.758.1149
Email: info@epsusa.org
www.epsusa.org

Nonprofit Organization
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For those who desire monthly updates, we send our electronic newsletter, NewsNotes. Four times yearly, look for our print newsletter, the EPS Quarterly, featuring in-depth articles on the economics of peace, war and security. With these publications you'll always have your finger on the pulse of EPS's work and see how essential your support is to our success. Members also receive invitations to EPS events.

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ABOUT THIS ISSUE OF EPS QUARTERLY

On April 12, 2011, EPS hosted a half-day Bernard Schwartz symposium in Washington DC entitled "Crisis in the States and Cities: What Should Be Done?" The event was co-sponsored by the New America Foundation. This issue of EPS Quarterly is dedicated as a summary of that symposium. To read the complete transcripts or to view video from the event, visit http://epsusa.org/events/411conf/statecrisisprogram.htm.