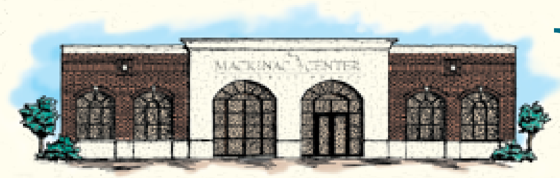

VIEWPOINT
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Taxpayers Never Get Early Retirement

By James M. Hohman

Summary

Policymakers don't seem to have a problem with across-the-board tax increases that impact nearly all Michiganders, but they don't apply the same fervor to keeping their spending in line.

Main Text Word Count: 709

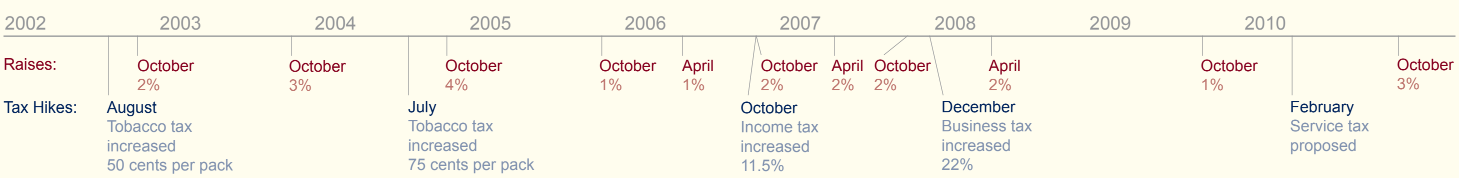
State legislators squirm under the latest news that tax revenues are down while their spending is up. The state's been in this situation before, and if past budgets can teach Michigan residents anything, it's that taxpayers never get early retirement.

Michigan legislators have created budget overspending crises every year since 2002. Since tax rates rarely went down and since most spending is directly under their control, these deficits are largely a matter of the legislators wanting to spend more than they did the previous year.

Legislators have made the same decisions year after year in addressing the gap between spending and revenues. They found ways to avoid tough decisions, mostly by using accounting gimmicks, borrowing from the future and spending down fund reserves. When it comes to cutting costs, early retirement and pay freezes are occasionally used, but never sweeping reforms to lower expenses. And when they were out of gimmicks and there was still a gap, the politicians raised taxes.

Taxes are never raised in a mutually beneficial "let's try to create a win-win situation" manner — they are blunt increases. In 2002, tobacco taxes were increased by 50 cents per pack and another 75 cents per pack in 2004. In 2007, income taxes were increased by 11.5 percent and business taxes by 22 percent.

Tax hikes and state employee overall raises*
2002-2010



Source: Civil Service Salary and Benefit Comparisons, Michigan House Fiscal Agency, November 2008.
**The overall raises are above the automatic annual raises for continuing employees already built into the state's compensation plan.*

Recently, Gov. Jennifer Granholm proposed taxing nearly every service provided in Michigan. If the policy is enacted, Michigan would be the only state to increase income, sales and business taxes since 2000. This would be a strong signal to private industry to do business elsewhere.

If state politicians would take this same blunt approach with public employment costs, then state government's spending problems would be solved. Just bringing public-sector benefits in line with private-sector averages would save an estimated $5.7 billion.

But instead of finding straightforward ways to lower spending, legislators are actually making government more expensive. At a time

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when more tax hikes are being proposed, the state has approved raises for its employee groups in addition to the automatic raises already built into most government employment contracts.

And school districts' income from federal, state and local revenue (which largely goes to pay the salaries and benefits of school employees) increased from $13.7 billion in 2000 to $19.0 billion in 2008. If spending had simply increased commensurately with inflation and student headcount, Michigan's school spending would be $2.5 billion less than it is now. That difference is more than enough, for example, to run the state's expensive prisons.

Michigan legislators look for apparent savings, but do nothing to restructure costs.

Across-the-board cuts in school employee compensation have worked in other states. For instance, Alabama resolved its school funding crisis simply by requiring teachers to contribute a greater percentage of their income to their retirement system and by freezing the state's health insurance premium contributions for school employees.

Unlike Alabama, Michigan legislators look for apparent savings, but do nothing to restructure costs. For instance, an early-retirement incentive for public school employees and for state bureaucrats does not lower educational expenses; it shifts them. That is because the governor's proposal includes plans to fill most positions left by retirees. The natural employment turnover ensures that automatic increases cancel each other out and only overall pay hikes and benefit increases affect the costs of compensation. By offering early retirement, not only would the state be on the hook for a large payment right now, but after an initial drop, employment costs would again be subject to both automatic and overall pay increases.

In addition, early retirement would be costly to the state's employee retirement systems, especially since they cover health care expenses for all their members until Medicare kicks in. It cost the state $396 million to provide this benefit for state bureaucrats in fiscal 2008 — 25 percent more than it spent on community colleges — and the state already has an unfunded liability of $13.5 billion to pay these benefits without adding the cost of early retirements.

An across-the-board cut is not the most efficient way of making public schools less costly (and would likely run afoul of current district-union agreements), but across-the-board hikes are exactly how Michigan residents are treated when taxes are raised. Legislators lose the velvet gloves when it comes to tax hikes. They should start using the same approach when it comes to spending.

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