

Competitiveness: Through Productivity or Dependency?

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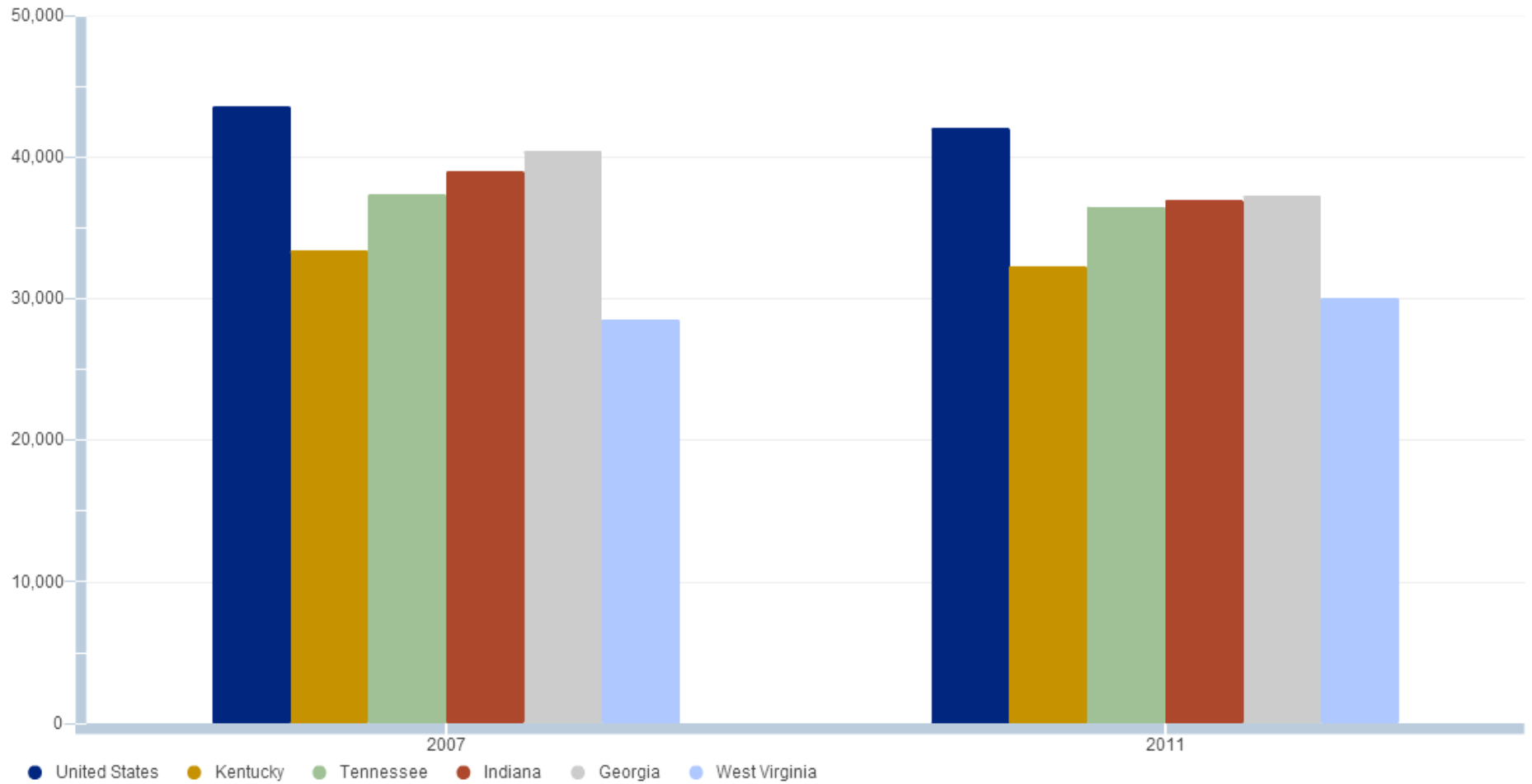
Outline of the Talk

1. Some information on Kentucky's situation: low income, low productivity, high dependency.
2. The dependency trap.
3. How to compete via productivity? What is government's role?
4. How is Kentucky doing in this regard: taxes and spending.

GDP Per Capita

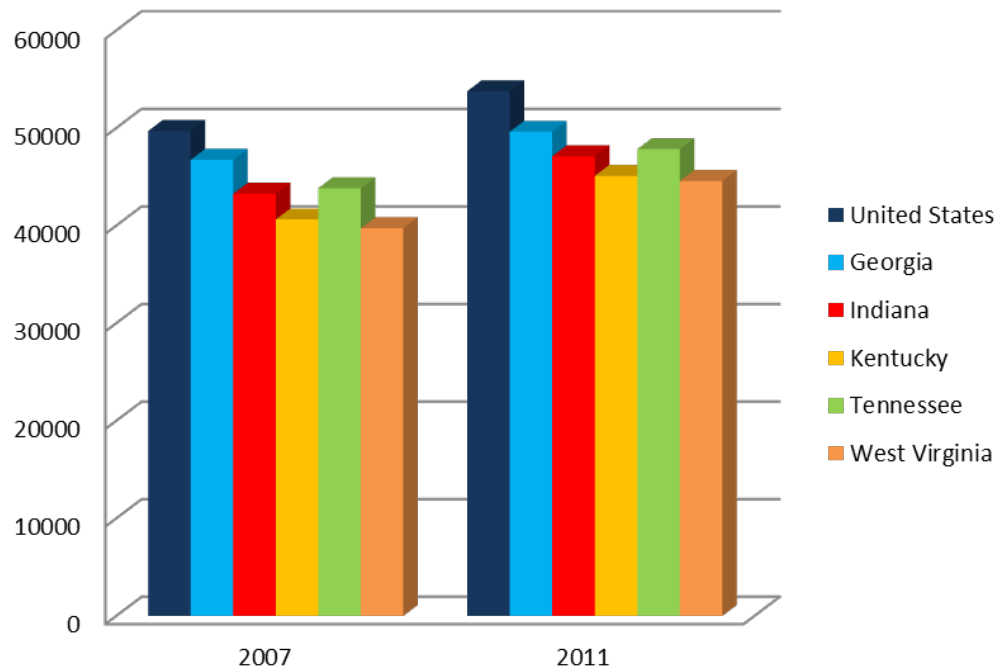
<ITT ID="2392">Per capita real GDP by state (chained 2005 dollars)</ITT>

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Source: U.S. Bureau of Economic Analysis

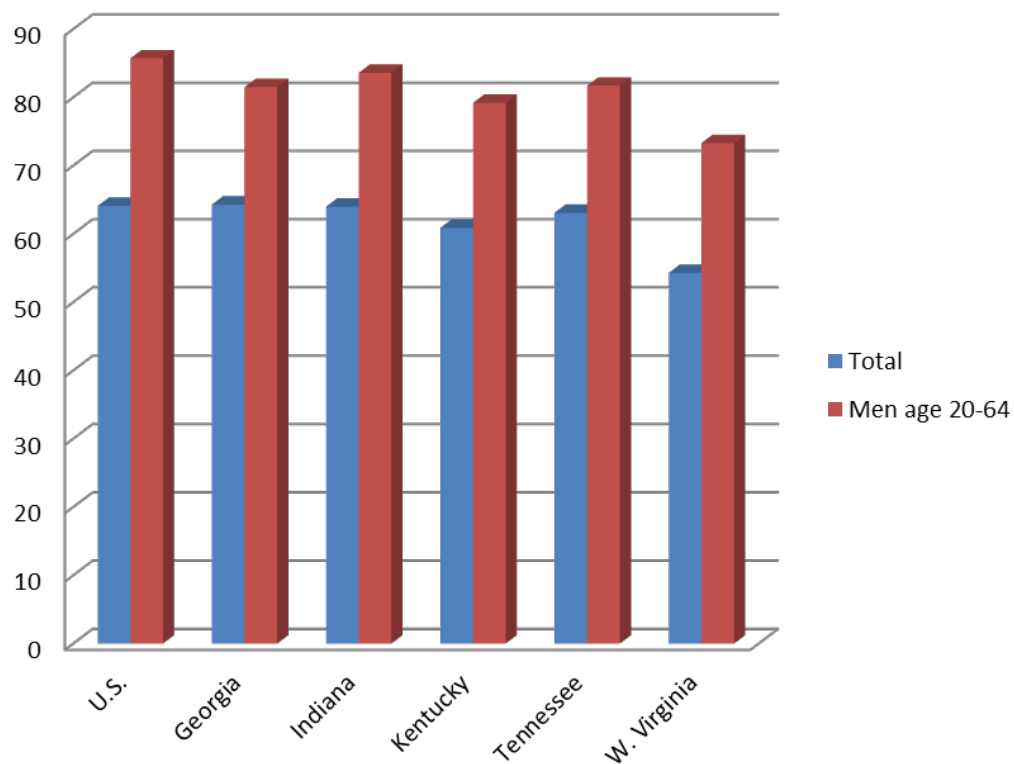
Earnings Per Job



Source: Bureau of Economic Analysis, <http://www.bea.gov/iTable/iTable.cfm?reqid=70&step=1&isuri=1&acrdn=4#reqid=70&step=1&isuri=1>.

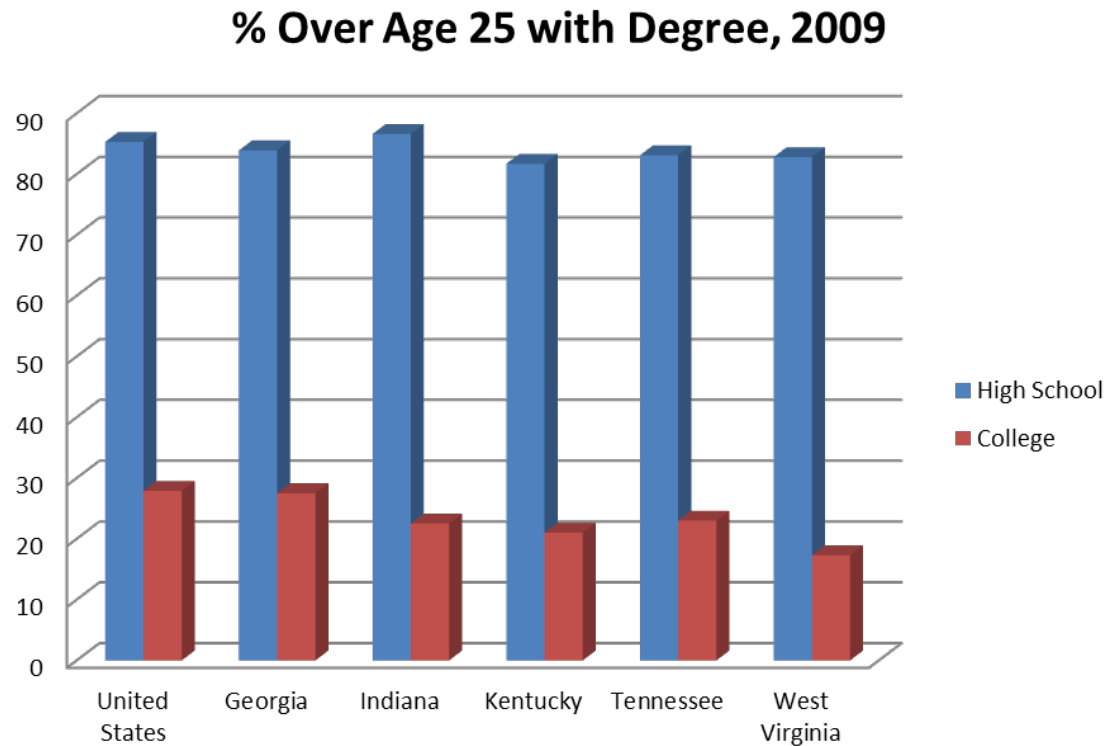
Work Effort: Labor Force Participation, 2007

Labor Force Participation Rate



Source: Bureau of Labor Statistics, <http://www.bls.gov/lau/#ex14> .

Job Skills: Education



Source: Bureau of Labor Statistics, <http://www.bls.gov/sae/>.

Kentucky's Rank on Health Indicators

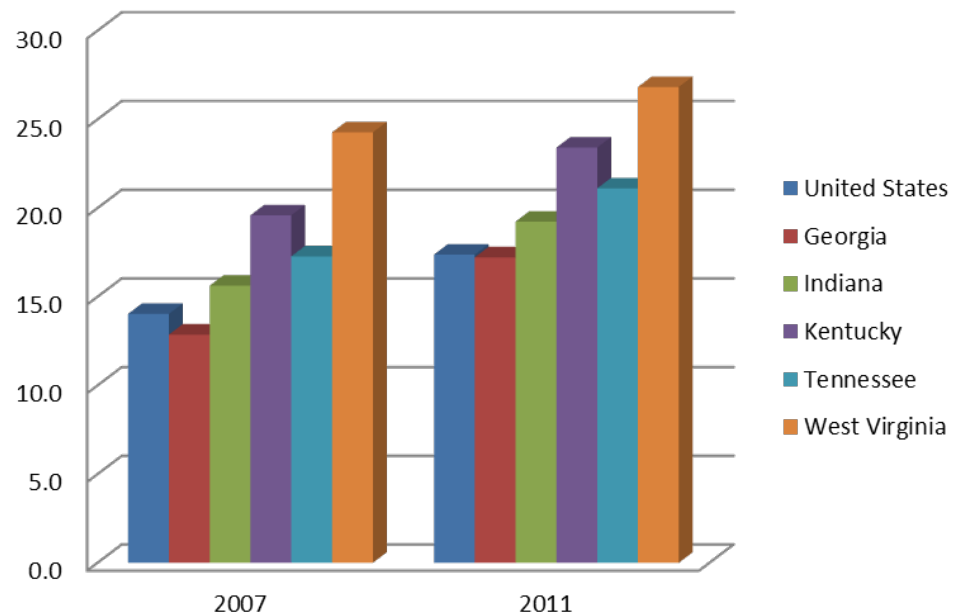
2'

	State Rank
Heart disease	48
Coronary heart disease	39
Total cancer	54
Stroke	43
Chronic obstructive pulmonary diseases (age 45 & over)	51
Diagnosed high blood pressure (2007-2009)	49
Obesity (2008-2010) (age 20 & over)	49
Smoking currently (2008-2010)	53

Source: U.S. Department of Health and Human Services, http://www.healthstatus2020.com/disparities/ChartBookData_list.asp .

Personal Dependency: Transfer Income Relative to Total Income

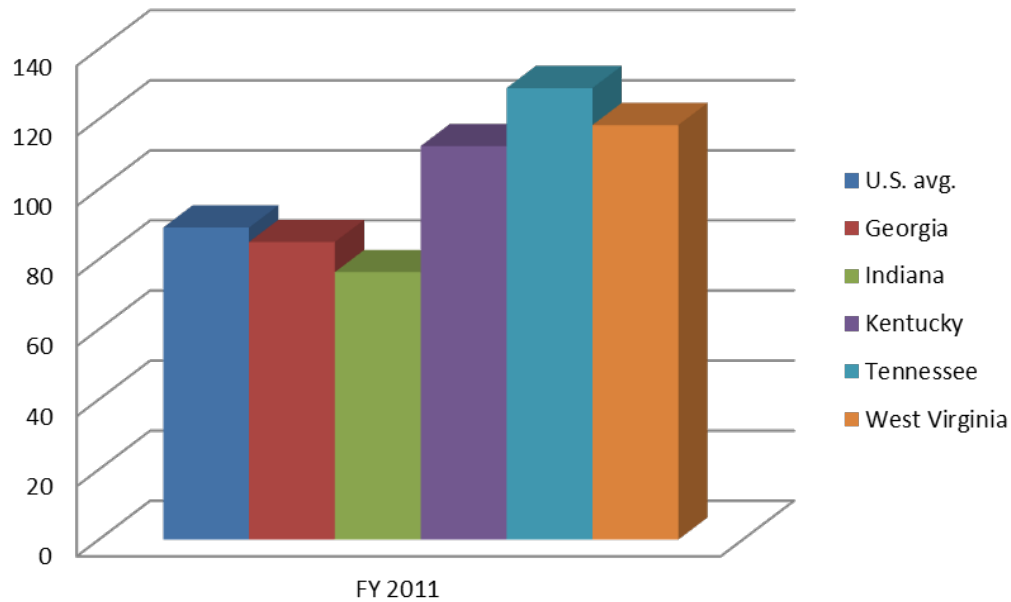
Transfer Payments As a Share of Personal Income



Source: Bureau of Economic Analysis, <http://www.bea.gov>.

State-Level Dependency

Federal Aid to States As a Share of General Fund Spending



Source: NASBO, http://www.nasbo.org/sites/default/files/State%20Expenditure%20Report_1.pdf.

How To Move Ahead

More Dependency or More
Productivity?

The Dependency Trap

- Federal inducements:
 - Explicit federal matching like Medicaid: Ky. pays \$.25, feds pay \$.75.
 - Projects w/o an explicit match rate: Ky. receives federal dollars, but pays 1/50th (or less) of the federal taxes to pay for it.
- The cost of a federal dollar is less than a dollar.
- Incentive to expand programs, lobby for projects.

An Illustrative Example

- Lobby or not for a \$100 million project. Value to each state is \$30 million. Each state pays 1/50th of the taxes to support.
- My state lobbies and gets a project:
 - State Benefit: \$30 million
 - State Cost: \$ 2 million
 - Cost to Other States: \$98 million
- Every state lobbies and gets a project. Total cost is 50 x \$100 million.
 - Each State Benefits: \$30 million
 - Cost Per State: \$100 million
- These ideas apply to the Medicaid expansion; state health insurance exchanges.

Competing Via Productivity

- More productivity: a positive sum “game.”
- What goods and services do people want?
How to produce – and trade – those goods?
- How to encourage individuals and businesses to invest in these productive activities . . . rather than adopting unhelpful investments, lower work effort, unhealthy lifestyles?

Fundamentals of Social Organization

- Friedrich Hayek:

The economic problem “ . . . is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only those individuals know.”

“The Use of Knowledge in Society,” *American Economic Review*, 1945.

- Decision making and rewards must be decentralized. Individuals decide; no central planner.

- Milton Friedman:

“What can I and my compatriots do through government’ . . . to achieve our several goals and purposes . . . ?”

Capitalism and Freedom, 1962.

- Limit government to functions that enable individuals to peacefully pursue their interests.

The Functions of Government . . . and the “Secret” to Success

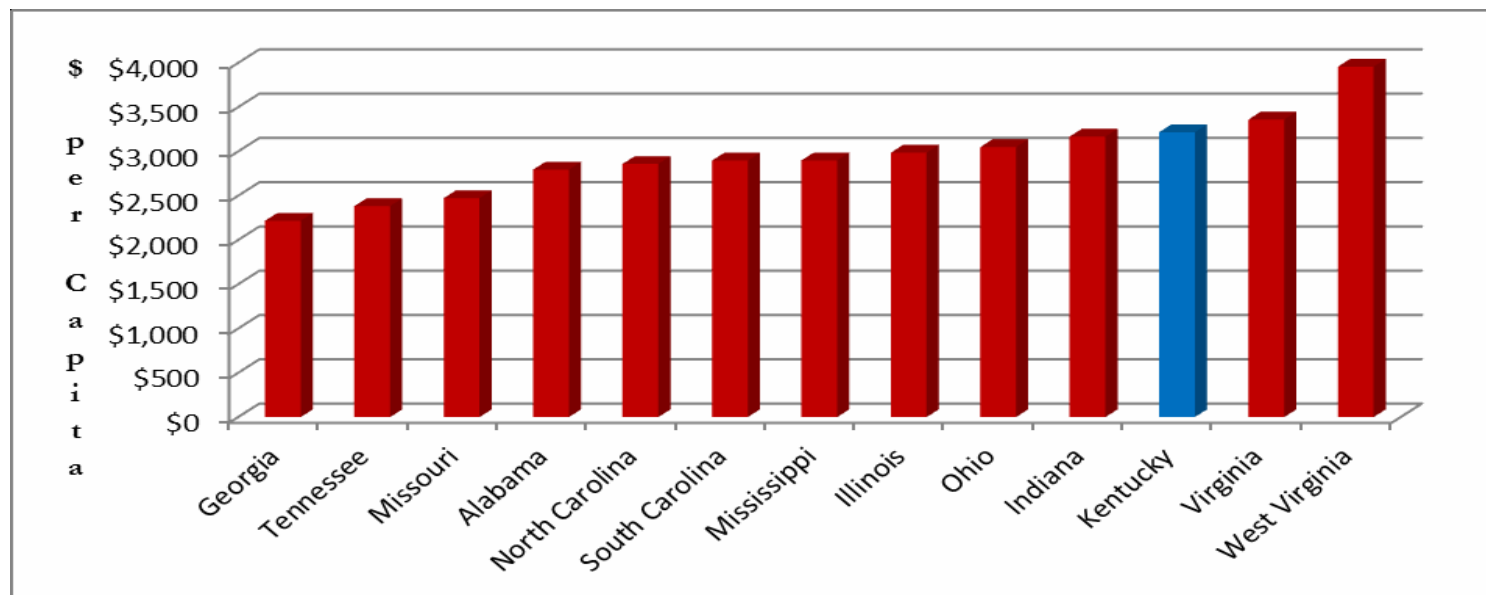
- Providing a legal infrastructure: protection of lives and property; establishing effective criminal, contract, property, tort law.
- Providing certain physical infrastructure: roads, sewer systems.
- Dealing with externalities, e.g., pollution.
- Promoting competition; preventing monopoly.
- A social safety net.
- Pay for it via the least distorting (disruptive) way.

How is Kentucky Doing on These Criteria?

- Taxation:
 - state and local tax payments are not especially low
 - state government dominates local regarding tax and spending
 - taxation is skewed toward income taxes, away from property taxes, and has numerous loopholes
- Each of these is problematic

State Taxes Per Capita

Figure 2.1A: Total State Revenue per Capita (2009)

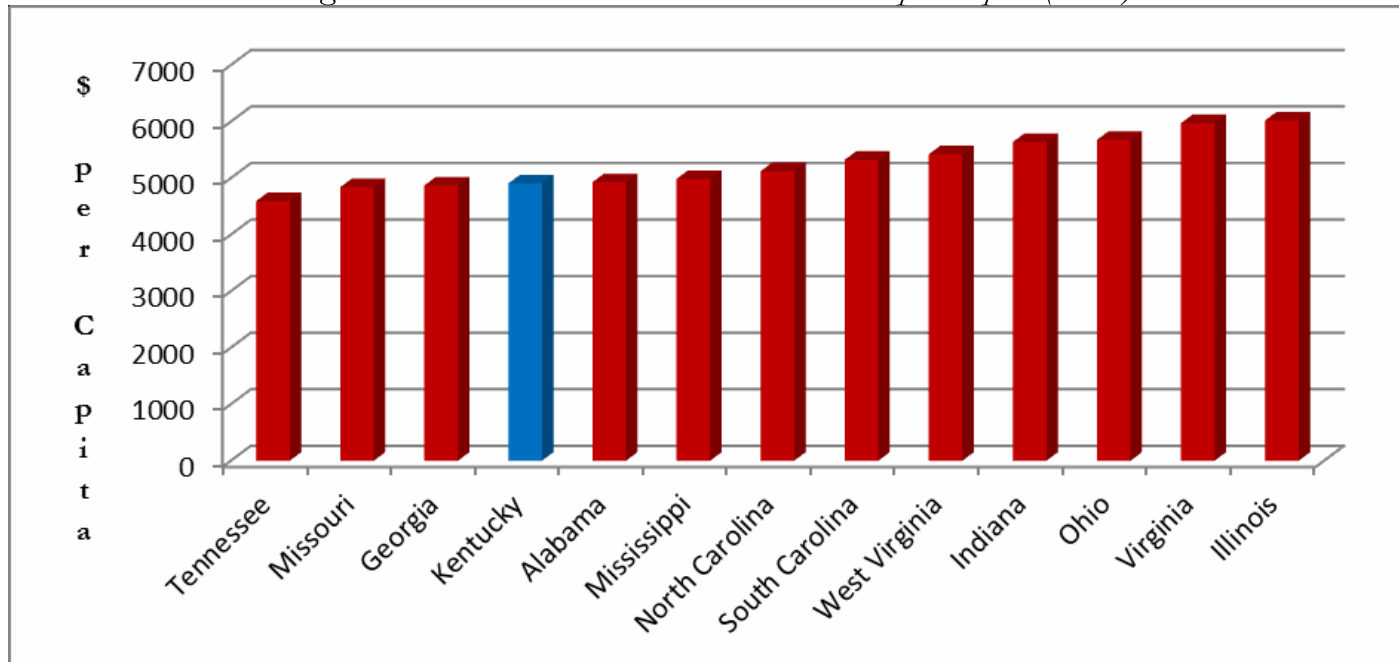


Source: Authors' calculations from 2009 State and Local Government Finance Summary Report, United States Census Bureau, U.S. Department of Census, <http://www.census.gov/govs/estimate/>.

W. Hoyt, W. Fox, M. Childress, J. Saunoris, Report to Governor's Blue Ribbon Commission on Tax Reform by Economic Consultants, Univ. of Kentucky, Gatton College CBER, Sept. 2012 http://ltgovernor.ky.gov/taxreform/Documents/20120919/20120920_ConsultantReport.pdf.

State Plus Local Taxes Per Capita

Figure 2.4: State & Local Own Source Revenue per Capita (2009)

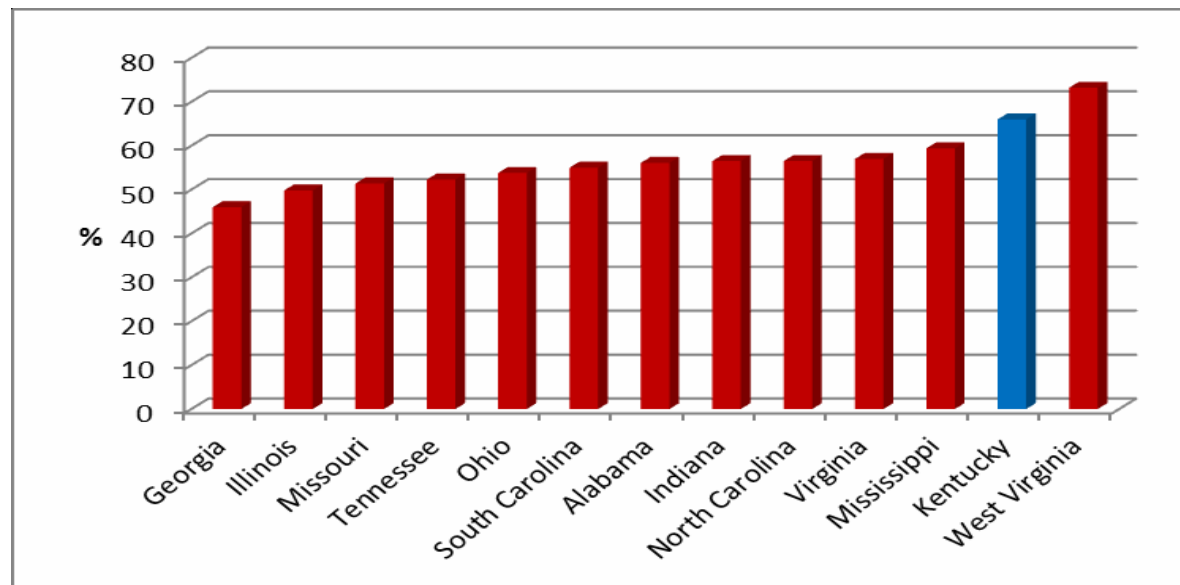


Source: Authors' calculations from 2009 State and Local Government Finance Summary Report, United States Census Bureau, U.S. Department of Census, <http://www.census.gov/govs/estimate/>.

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State Share of State and Local Tax Revenue

Figure 2.5: State Share of State and Local Revenue, Kentucky and Competitor States (2009)

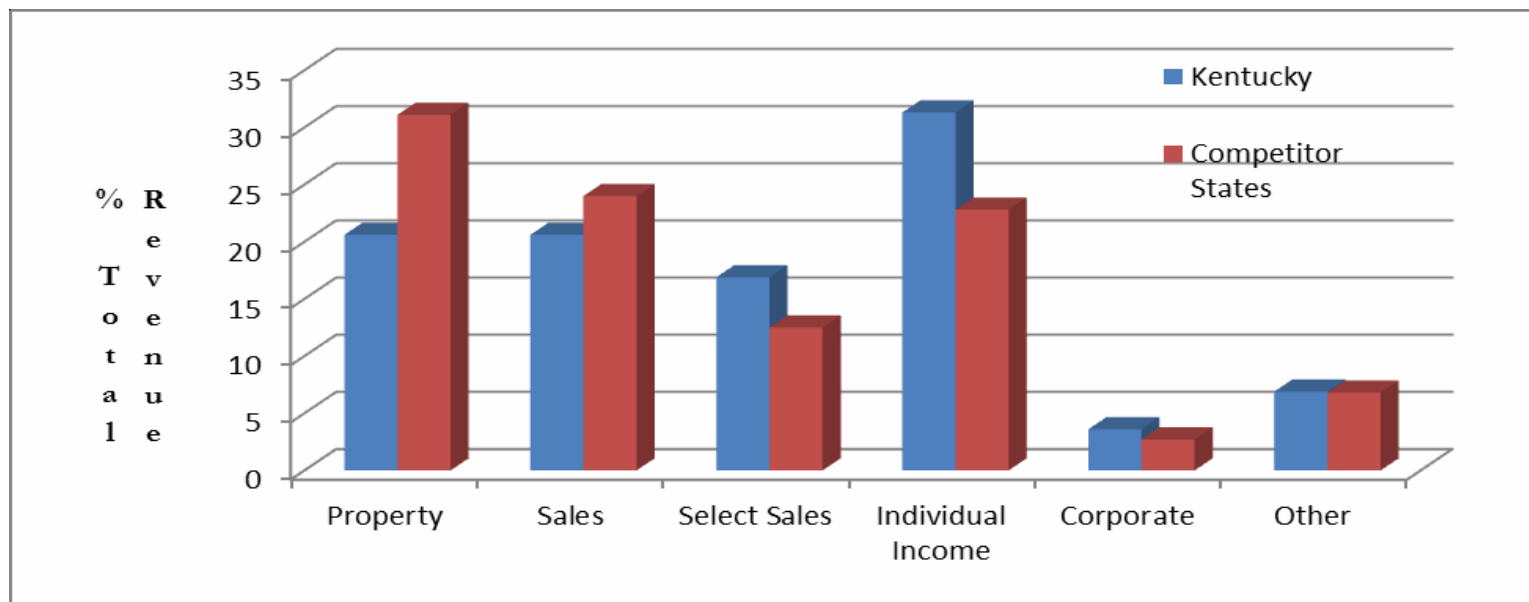


Source: Authors' calculations from 2009 State and Local Government Finance Summary Report, United States Census Bureau, U.S. Department of Census, <http://www.census.gov/govs/estimate/>.

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Tax Revenue Sources

Figure 2.6: State and Local Tax Revenues by Source (2009)



Source: Authors' calculations from 2009 State and Local Government Finance Summary Report, United States Census Bureau, U.S. Department of Census, <http://www.census.gov/govs/estimate/>.

W. Hoyt, W. Fox, M. Childress, J. Saunoris, Report to Governor's Blue Ribbon Commission on Tax Reform by Economic Consultants, Univ. of Kentucky, Gatton College CBER, Sept. 2012 http://tfgovernor.ky.gov/taxreform/Documents/20120919/20120920_ConsultantReport.pdf.

State Government Budget

Source of funds (2013 budget)

Total General Fund	9,624 million
Total Tobacco Fund	111 million
Total Restricted Funds	7,398 million
Total Road Fund	1,535 million
Total Federal Funds	10,078 million
TOTAL SOURCE OF FUNDS	28,747 million

<http://www.osbd.ky.gov/NR/rdonlyres/F3A4AF4D-BD42-4890-B28F-243F12EF0AB8/0/1214BOCVolumel.pdf>

General Categories of Spending (million \$)

General Government	1,042
Economic Development	29
Department of Education	4,620
Education and Workforce Development	2,594
Energy and Environment	252
Finance and Administration	759
Health and Family Services	7,950
Justice and Public Safety	893
Labor	217
Personnel	67
Postsecondary Education	6,650
Public Protection	112
Tourism, Arts and Heritage	211
Transportation	2,375
TOTAL EXPENDITURES	28,747

What Functions of Government Are Funded?

- Protection of lives and property; infrastructure; externalities.
\$893 million: justice and public safety (local govt. adds to this)
\$252 million: environment-related spending
\$2,375 million: roads and transportation

This is 12.2% of the \$28,747 million total.

- Spending on income redistribution and education dominates:

Department of Education	\$4,620 million
Postsecondary Education	\$6,650 million
Education and Workforce Development	\$2,594 million
Health and Family Services	\$7,950 million

These account for 75.9% of the total.

A Closer Look at Selected Items

- Post Secondary Education: 67.9% is funded by current receipts of the institutions (e.g., tuition).
- Education and Workforce Development: This is predominantly unemployment insurance.

Health and Family Services: Mostly Medicaid

	All	Medicaid	TANF, Food Stamps, other
Total	\$7,950 million	\$5,900 million	\$929 million
General Fund	\$1,887 million	\$1,336 million	\$329 million
Restricted Funds	\$ 968 million	\$ 451 million	\$139 million
Federal Funds	\$4,962 million	\$4,111 million	\$452 million

- Medicaid matching: inducements to spend more on an inefficient program.

Department of Education

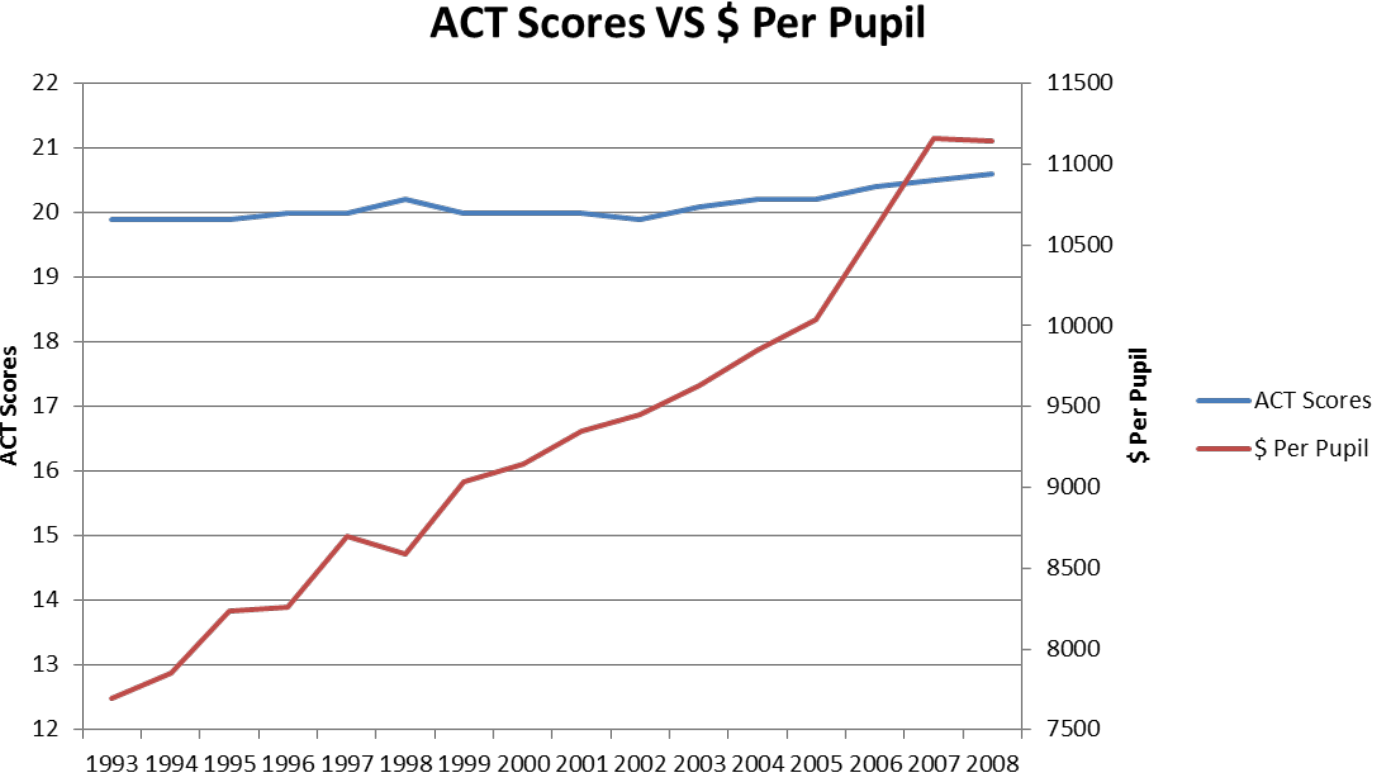
Total Expenditure \$4,620 million

General Fund \$3,826 million

Federal \$ 781 million

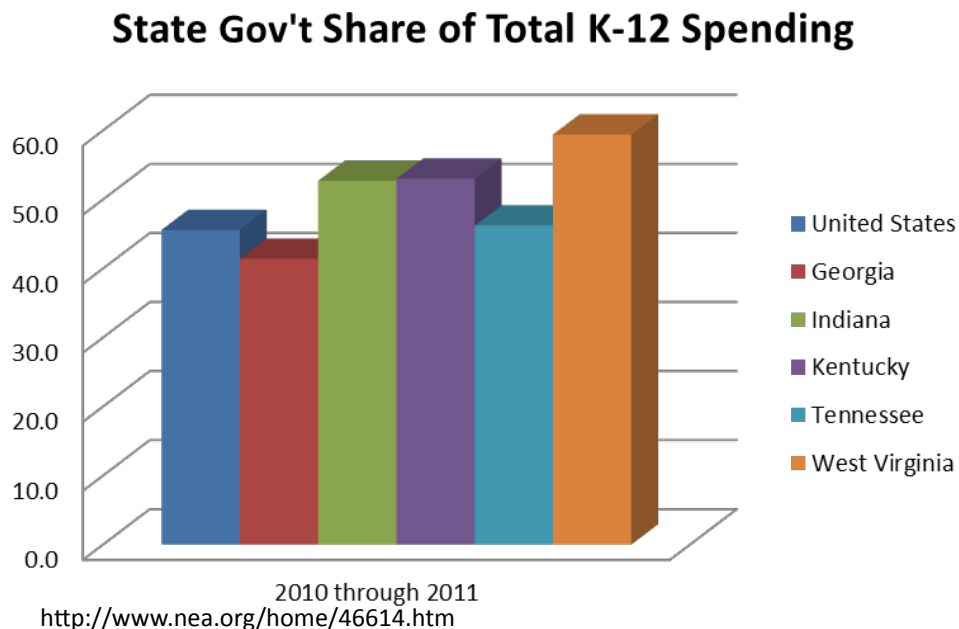
- Basic Funding to local schools (SEEK): \$2,899 million (local government supplements).
- The remaining ~ \$1,700 million is mostly spent on disabled children programs and remedial programs for disadvantaged children, funds for local district health insurance, development of curriculum and special programs and support services for local districts.
- 17% of total is from the federal government

More On K-12: Spending and Results



Sources: <http://www.nea.org/home/46614.htm> and : http://www.freedomkentucky.org/index.php?title=ACT_Scores_in_Kentucky_by_Year

Centrally Directed Spending: State K-12 Funding as a Percent of the Total



- And we have no charter schools.

Conclusion

- “Competing” effectively requires improved productivity.
- This entails embracing a decentralized, market-based economy where individuals and business have incentives for sound investment and productive behavior.
- Kentucky state government’s role in supporting this has much need for improvement.
- The tax system has many loopholes, generates many distortions, and the level of taxation is not especially low.
- Educational expenditures are very centralized with a lack of choice. Little is geared toward enabling parents to find what’s best for their children.
- Safety net expenditures are, unfortunately, tied heavily to ineffectual federal programs, e.g., Medicaid.