The Maryland Public Policy Institute

Maryland Policy Report

No 2015-01 January 30, 2015

FOUR WAYS THE HOGAN ADMINISTRATION COULD SAVE MARYLAND BILLIONS

BY JOHN J. WALTERS

WHEN LARRY HOGAN AND BOYD RUTHERFORD took the helm in Annapolis on January 21st, they inherited an approximate $1.2 billion shortfall in revenues. Cutting spending in order to balance next year's budget will be the name of the game in the short-run, but what about actually solving the state's real fiscal problems and restoring long-term solvency to the state?

Over the years, the Maryland Public Policy Institute (MPPI) has published reports that could save the state more than enough money to save this sinking ship—and prove to this blue state that a Republican governor is capable of much more than just "painful cuts" to public services.

The four ideas below are by no means the full scope of the MPPI's recommendations, but represent four of the most potent opportunities for change available to the Hogan administration. They are not one-time cuts that might bridge a single year's budget gap. They are real opportunities to "Change Maryland" for the better, saving taxpayers billions in the process.

Published by the Maryland Public Policy Institute
One Research Court | Suite 450 | Rockville, Maryland 20850 | Telephone 240.686.3510 | mdpolicy.org

1) INDEX STATE RETIREMENT FUNDS.

Every year, the state pays Wall Street money managers to look after the massive public employee retirement fund. In 2012 for example, money management fees on the $40 billion fund came to nearly $250 million.[1] In return for all these hundreds of millions in expenses, the fund has consistently underperformed market medians. Last year alone, these sub-par returns caused the state to earn $1.16 billion less than it should have.[2]

Jeffrey C. Hooke is a former investment banker and author of the 2013 MPPI report *Wall Street Fees, Investment Returns, Maryland and 49 Other State Pension Funds*.[3] He has testified before the state legislature three times that indexing state retirement funds would save approximately $250 million in management fees per year and ensure median market performance.

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When dealing with such large funds, achieving median market performance instead of a few percentage points below it makes a substantial difference. Thanks to the efforts of these expensive money managers, Maryland has missed out on $3.22 billion in lost income over the past 10 years. That hole will have to be filled by taxpayer money in order for the state to keep its promises to retirees.

From the 2013 report: "The Maryland Public Policy Institute recognizes that 'being first in indexing' in the state pension fund business is not easy. And, conveying indexing's benefits to legislators is a tough education process. The goal of saving billions of dollars makes such undertakings worthwhile."

2) REFORM TRANSPORTATION SPENDING.

The state will spend about $4.3 billion over the next five years on transportation projects. Right now, the budget splits these funds evenly between roads/highways and public transportation. However, public transit accounted for just 3 percent of all travel in Maryland in 2008 and under 10 percent of commuting, according to a 2012 MPPI report by Wendell Cox, *Transportation Policy in Maryland*.[4] Although there are some spillover benefits from spending on public transit (reduced pollution and congestion, for example), this 50-50 split likely fails a careful benefit-cost test, and the state needs a better metric.

In his report, Cox cites a 2007 report from the Baltimore Regional Transportation Board[5] that recommends spending only 25 percent on public transit (still nearly 10 times its proportional share of use). Even with this spending plan, every new transit commuter would cost the state 2,000 times as much as every new driver. As Cox points out, "this represents a less than optimal policy trade-off."

Ronald D. Utt, who teamed with Cox in 2013 to write *A New Transportation Plan for Maryland*[6] for the MPPI, has a four-step plan entitled *How States Can Improve Their Transportation Systems and Relieve Traffic Congestion*.[7] Some of Utt's suggestions have been implemented in Virginia, and are showing benefits. According to Utt, "the first thing they did was to hire four independent auditors to review [the state transportation agency], and the consequence was the discovery of a billion dollars of forgotten unspent funds tucked away here and there in various accounts. The billion was added to the next year's transportation budget."

3) GROW THE TAX BASE IN BALTIMORE CITY.

Aid to local governments accounts for $7 billion—over 20 percent—of Maryland's budget for fiscal year 2015. Of that $7 billion, according to Figure A-3.5 in *The 90 Day Report*,[8] Baltimore City gets $1.26 billion. A healthy, thriving Baltimore City would not need such heavy subsidies from the state, but instead would increase state revenues as the tax base blooms.

Stephen J.K. Walters and Louis Miserendino, authors of *How to Make Baltimore a Superstar City*,[9] have a plan to reverse the 60-year trend of declining population that has plagued Baltimore. In a nutshell, their "Cash on Delivery" plan would lock in a competitive property tax rate in the city to take effect in four years (allowing for one full reassessment cycle). In the meantime, enhanced revenue from higher property values, increased transfer taxes, and added "piggy-back" income tax receipts as the city's population grows as a result of friendlier property tax would be placed in an escrow fund that would allow the city to cover any budget gap arising from the rate cut's effect on property tax receipts. Such a plan could even be taken state-wide. Walters comments:

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> *One idea to consider is to have the governor advocate a statewide property tax cap at around 1.1% (Baltimore County's current level), to kick in after 4 years. That wouldn't cost the counties any property tax revenue in the short run, would create a much more favorable investment environment in the city, and also re-assure investors elsewhere that their property is not subject to "expropriation" (in the form of reduced property values) from future tax hikes.*

This plan would stimulate investment in a city that desperately needs it, bringing jobs and tax-paying residents along with it. Over time, the necessary state aid to Baltimore City will be reduced and state revenues will swell without any increase in taxation. When San Francisco's property tax rate was slashed by two-thirds in the late 1970s, via a similar statewide tax cap, overall tax revenues recovered quickly—indeed, they increased over 60 percent in inflation-adjusted terms within four years, and three decades of population loss reversed immediately and continue to the present day. Boston similarly repopulated and recapitalized starting in the early '80s, after passing a cap on property taxes.

4) ACTUALLY SAVE THE BAY.

Maryland is poised to spend upwards of $14 billion over the next 10 years to "Save the Bay" by meeting the federal Environmental Protection Agency's pollution goals for 2025. But research conducted by James Simpson for his report *A Better Way to Restore the Chesapeake Bay*[10] shows that the current plan will actually do little to reduce pollution levels overall—a paltry 3.4 percent reduction in nitrogen levels. Further improvement will require additional multi-billion-dollar expenditures that Marylanders will likely be even more hard-pressed to afford.

Much like with transportation spending, the state needs to fund programs that achieve greater gains per dollar. And, as with transportation, the MPPI has already provided a well-researched plan to do just that.

The biggest recent contributor to Chesapeake Bay pollution is the Conowingo Dam, an 86-year-old installation responsible for 39 percent of all sediment released into the Bay from the Susquehanna between 2002 and 2011. Dredging the Dam of 86 years worth of sediment build-up wouldn't be cheap—over $4 billion to do it all at once—but it would be hundreds of times more effective than the current plan and still be significantly cheaper in the long run. From the report:

[T]he state needs to fund programs that achieve greater gains per dollar.

> *Even at twice the cost, dredging the Conowingo would be a bargain in nutrient and sediment removal, given the $14.4 billion the state intends to spend to remove only 3.4 percent of the Bay's nitrogen. Also, the Maryland Port Administration spends about $43 million per year dredging the Bay—partially as a result of Conowingo silt—to keep commercial shipping lanes open. Dredging the Conowingo could significantly reduce that need.*

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1. http://mdpolicy.org/docLib/20130710_PensionFeesAllDataAllStates.xlsx
2. http://mdpolicy.org/docLib/20140922_MarylandPolicyReport201402.pdf
3. http://mdpolicy.org/docLib/20130710_MarylandPolicyReport201302.pdf
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