



La Follette Policy Report

ROBERT M. LA FOLLETTE SCHOOL OF PUBLIC AFFAIRS

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DIRECTOR'S PERSPECTIVE

Spring 2002 graduation ceremonies in the Wisconsin state capitol marked the completion of degree requirements for our first class of candidates for the Master of International Public Affairs degree. Students organize and arrange for their own ceremony each year, choosing student, faculty, and guest speakers. This year, Amy Forster-Rothbart represented the students receiving the international degree, and Heather Priess spoke for the students in the domestic program. Professor Melanie Manion was chosen by the students to speak for the faculty, and Senator Russ Feingold inspired students and visitors alike with his words urging attention to public life.

Lucas Szylow received the Penniman Prize for best student paper of the year, and Rachel Walker the Directors' Book

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Tokyo Confronts Terrorism

by David Leheny

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In the aftermath of the September 11 terror attacks on the United States, observers of Japanese politics were astonished to see the decisiveness with which Prime Minister Junichiro Koizumi acted to lend Japanese support to the U.S. war on terrorism. Using remarkably tough language, Koizumi called the attacks—in which 24 Japanese perished—“unforgivable” and followed with a seven-point emergency plan committing the Japanese military to support U.S. activities in Afghanistan. Most notably, he pushed forcefully for the dispatch of members of Japan's Self-Defense Forces, largely aboard high-tech Aegis cruisers, to the Indian Ocean to provide intelligence support. These actions stood in stark contrast to decades of Japanese pacifism and public ambivalence about the nation's military stance, and Koizumi certainly expected to meet serious resistance from dovish members of the Japanese government. Perhaps for this reason, the popular, self-styled maverick Koizumi seemed especially eager to push through the debate quickly so that Japan would avoid the kind of harsh international criticism that had attended the nation's tardiness in accepting any role in the Persian Gulf War. Although Japan ultimately made the largest financial contribution of any nation to

that conflict, critics both at home and abroad referred derisively to the nation's “checkbook diplomacy” and its unwillingness to risk lives even to support collective security arrangements. Although some argued that Japan would never be a “normal” country, Koizumi's determination and the Japanese Diet's relatively speedy passage of his legislation together indicated that Japan had done the seemingly impossible.

But if the war on terrorism really is a new kind of war, experts on Japan may need to rethink what this apparent shift really means. Something is and has been happening in Japanese debates over international security, and we may yet witness a sea change in the nation's policies toward the security of the Asia-Pacific region. What these recent moves will not do, however, is guarantee a change in Japanese thinking about terrorism and how to confront it. This, more than any specific Japanese failure to support American actions in Afghanistan, may genuinely endanger the alliance in ways that no one in Washington or Tokyo has addressed. If the U.S. war on terrorism expands to the Pacific Rim—as most analysts now believe it will—the United States will need and will expect support that Japan will find difficult to provide. The nation

is not prepared to engage in a genuine counterterrorist campaign, and its eagerness to support the United States may begin to backfire when it becomes clear what a war on terrorism means.

The Security Treaty

The story of the U.S.-Japan Security Treaty is familiar if peculiar. In the aftermath of World War II, the U.S. Occupation forces in Japan dedicated themselves to two initial tasks: the country's democratization and its pacification. Working with representatives of the Japanese government, Supreme Commander of Allied Forces in the Pacific Douglas MacArthur and his team crafted a new constitution reflecting both goals. Although this constitution, officially adopted in 1947, maintained some of the institutional features of the prewar Japanese government—especially its parliamentary system and a role for the emperor—it emphasized democratic rights and liberties and included a new legal commitment to pacifism. In Article IX of the constitution, Japan “forever renounces

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the threat or use of force as a means of settling international disputes” and further stipulates that “land, sea, and air forces . . . will never be maintained.” In explicit language, the section concludes, “the right of belligerency of the state will not be recognized.” This, it seemed, would satisfy the American desire to avoid a future war with Japan.

Within a few short years, however, U.S. authorities—who occupied Japan until 1952—added two more goals for the nation, both tied to the developing Cold War with the Soviet Union. On a general level, the U.S. government

sought Japanese economic development to demonstrate to other Pacific nations that growth and wealth would accompany the democratic path rather than the communist path. Japan would thus serve an important propaganda role. With concerns over Soviet expansionism, however, American military authorities began to push for Japanese rearmament in order to provide the United States with an important ally in its Asian containment strategy. Some even hoped to enlist active Japanese military participation in the Korean War.

Ironically, the first important defenders of Japan's pacifism were its conservatives, especially its formidable postwar prime minister, Shigeru Yoshida. Fearing that a rapid move toward military re-engagement would undermine the country's fragile prospects for economic growth, Yoshida held firm against American demands for active Japanese participation in containment. Japan's leftist parties, especially the powerful Socialists and less powerful Communists, also endorsed pacifism, though for very different reasons. For them, Article IX served as both a repudiation of the country's rightist military platform in the 1930s and a limit on their country's willingness to support America's anti-communism in the Pacific. By the late 1950s, however, this area of left-right agreement had been replaced by a growing rift over how Japan could best ensure its own defense. Yoshida's successors in the newly formed Liberal Democratic Party (LDP) sensed that unless Japan solidified its security relationship with the United States, it would be vulnerable to potential enemies in the region, particularly China and the Soviet Union. They sought to extend a formal agreement that would allow America to continue to hold bases in Japan while Japan would remain under an American security umbrella. When Prime Minister Nobusuke Kishi staked his reputation on the quick ratification of the U.S.-Japan Security Treaty in 1960, he faced fierce opposition from the parties on the left, who saw it as an effort to implicate Japan in U.S. military adventures in Asia. Kishi succeeded, but only by arresting the Socialist Diet members who had physically blocked access to the legislative chambers in a last-ditch effort to prevent a vote. The protests in Tokyo surrounding this controversy were so severe that Kishi resigned his position.

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This would in many ways prove to be the defining issue in Japan's postwar politics, producing sharper party divisions than would welfare, labor, or other domestic policies. For nearly 40 years, the ruling LDP's hawks—not always a unified bloc—aimed for a larger military role for the nation but could not overcome the opposition of the parties of the left to constitutional revision. When Japan began to build genuine armed forces capable of playing at least some role in the defense of the Japanese islands, it had to name them the “Self-Defense Forces” (SDF) in order to ensure that they were fully consistent with the constitution's rejection of belligerency and the right of war. At best, more aggressive LDP members had to settle for “reinterpretation” of the constitution, which was used incrementally to allow a growing, though still highly constrained, military role for the nation. The Japanese commitment to pacifism has been more complex than a simple left-right issue, with many believing that Japan's security is best served through political and economic rather than military engagement. Even after the recent collapse of the traditional opposition, like the Socialists, the LDP has needed to maintain coalitions with parties less inclined to support an enhanced role for the Japanese military. Moreover, Japan's Asian neighbors have generally been quick to criticize any LDP effort to expand the size or mission of the Self-Defense Forces, producing vitriol that has been a potent tool for the domestic opponents of rearmament.

American requests for increased Japanese military commitments under the U.S.-Japan Security Treaty have not fallen on deaf ears, but they have sometimes seemed to reverberate off political issues linked only tangentially to questions of national defense. Although Japan's commitment of \$13 billion to the allied effort in the Persian Gulf War dwarfed that of most other nations, its perceived dithering over constitutional issues left many convinced it was unprepared to accept a genuine political role in the post-Cold War world. A 1995 rape of a 12-year-old girl by three American servicemen in Okinawa inflamed Japanese public opinion against the U.S. forces, provoking anger in Okinawa, Tokyo, and Washington over the role of the United States in the region. When the Japanese and American governments renegotiated the guidelines surrounding the treaty in 1997, issues like these played a heavy role in extracting American guarantees of cooperation in the event of criminal behavior by its troops, and also Japanese promises of an expanded SDF role in the event of a crisis near Japan. These changes have thus far remained largely untested. Until September 11, 2001, however, American and Japanese concerns over the alliance remained focused on potential hot spots in the Taiwan Straits and the Korean peninsula. The Japanese response

to the attacks needs to be seen in the context of a more durable debate over Japan's partnership with America in the Pacific and may be a poor guide to the part Japan will play in a long-term counterterrorist coalition.

The Counterterrorism Bill

It might seem natural for a conservative Japanese politician to seize upon the September 11 attacks as an opportunity to expand Japan's security role. After all, here was Japan's closest ally—and in the minds of many Japanese, a trusted friend—badly wounded and calling immediately for help. Additionally, because Japanese national security was not directly threatened by the attack, policymakers on all sides could calmly debate the long-term implications of Japan's response. If Japanese hawks were to have a chance to make Japan more “normal” by giving its armed forces the opportunity to participate in internationally sanctioned activities, this would likely be it.

Even so, it is hard to imagine any recent Japanese politician having been as bold as Koizumi. Armed with remarkable popularity and a reputation as a free-thinking maverick, perhaps only he could have immediately made the bold, seven-point proposal his cabinet sent to the Diet for a vote. Koizumi's apparent willingness to

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stake his reputation on Japanese military participation has been, by Japanese standards, amazingly bold, even given the envy that many conservatives feel of Britain's immediate willingness to commit itself wholly to the U.S.-led war. The measures may be largely symbolic—after all, the lack of joint training makes it difficult

to see how Japan's flagships, the Aegis cruisers, will contribute much to American intelligence-gathering efforts after they are dispatched to the Indian Ocean—but they undoubtedly reflect a genuine desire to make Japan a more reliable alliance partner, one that is willing to share risks with the Americans.

Although even the loosest interpretations of the Japanese constitution prohibit a direct combat role for Japanese soldiers in an offensive against the Taliban, Koizumi's cabinet moved as close to that position as it reasonably could. In discussions of its Bill to Support Counterterrorism, the cabinet stipulated that Japanese medical personnel should be allowed to set up field hospitals in Pakistan to respond to casualties should land attacks ensue. Nothing bottles up the Japanese Diet like defense debates, and even some Liberal Democratic Party members expressed concerns about the extent of the proposed reforms. Undaunted, however, Prime Minister Koizumi even remarked on October 10 that he did not see Diet approval as necessary for the dispatch of the Self-Defense Forces on his command. Aware that this

would most likely provoke a constitutional crisis that his career might not survive, Koizumi will likely steer clear of this option. But with the memory of national embarrassment in the Persian Gulf War hanging over the Diet, politicians have struggled to ensure that Japan is not once again left outside the club of allies.

The frustrating pace of debate has resulted not from cowardice or weakness but from genuine questions over what the Japanese constitution permits. It should thus be compared not to the speed of American or British deployment but rather to the careful and lengthy deliberation of the U.S. Congress over antiterrorism legislation. The Japanese Diet pored over the constitutional issues in the Koizumi counterterrorism bill just as the U.S. Congress repeatedly sent Attorney General John Ashcroft back to the drawing board to ensure that his own counterterrorism bill would be consistent with congressional concerns about individual rights and liberties.

The difference, therefore, is not in the Japanese caution regarding a law that would dramatically alter the nation's constitutional orientation. It lies instead in the nature of the law. Whatever one thinks of the Ashcroft bill, it is legitimately a counterterrorism proposal, one that seeks to create a systematic government approach to dealing with this discrete phenomenon. The Japanese version is not real counterterrorism legislation, but rather an initiative to help U.S. action in this specific instance. This may not matter for Japan's participation in the military campaign in Afghanistan, but it spells trouble in the event of a lengthy, U.S.-led war on terrorism, especially one that spreads—as it probably will—to the Pacific basin. There, the United States will want and expect assistance that even Prime Minister Koizumi will be unable to extend.

Two Rocks and a Hard Place

Japan will likely not be able to provide significant assistance to the United States in a long war on terrorism because, unlike the United States, Japan has no real counterterrorism policy. No basic counterterrorism philosophy exists in Japan, and it has never been a real topic of conversation between the government and the governed. Even Japan's most renowned and articulate hawks have tended to bracket terrorism not as a security issue but rather as a "crisis management" problem. To the extent that the Japanese debate international security, they have focused largely on the constitutional issues involved in the U.S.-Japan alliance.

To be sure, these concerns bear on Japan's ability to create a counterterrorism strategy. Facing constitutional restrictions on the use of military force as well as ad-

mirable—even by American standards—guarantees of civil liberties, the Japanese National Defense Agency and National Police Agency have both encountered distinct problems in confronting terrorism. Although the

police have Special Assault Teams that ostensibly resemble SWAT teams in the United States, their use has been highly circumscribed; the SDF have virtually no special forces capabilities to speak of, and therefore cannot prosecute any kind of offensive operations against terrorist groups. The National Police

Agency used to have a counterterrorism division, which focused largely on the threat from the Japanese Red Army, but it was reduced to a smaller office in an organizational shift in the 1990s.

In the absence of an ability to "fight" terrorism meaningfully, Japan has in the past negotiated with terrorist organizations. In 1977, for example, the Japanese Red Army hijacked a Japan Air Lines jet and landed it in Dacca, Bangladesh; the Japanese government paid a ransom of \$6 million to secure the release of the hostages. Now facing international conventions and agreements that forbid negotiating with terrorists (on the logical though empirically unproven grounds that concessions to terrorists will produce more terrorism), Japan has adopted a "no concessions" principle. Japan's Diplomatic Blue Book from 1996, however, leaves little doubt that the principle owes at least as much to "international responsibilities" as it does to a deeply held conviction that negotiations are improper. In fact, Japanese newspapers reported that, in spite of government denials, Japan paid a ransom of between \$2 million and \$5 million to the Islamic Movement of Uzbekistan (linked closely with the Taliban and with al Qaeda) to win the release of four Japanese geologists taken hostage in Kyrgyzstan in 1999.

Even constrained by limits on the use of force and by international prohibitions on concessions, however, Japan might have adopted a policy of simply doing nothing. That is, the government could have concluded that terrorism represents at best a minor security threat and therefore should not force any change in other political priorities, security guarantees, or basic international principles. But this too is off the table because of a widespread belief that the government should do anything possible—including the payment of ransoms—to ensure the safety of Japanese hostages in terrorist crises. Newspaper polls show that the majority of Japanese believe that the government should make concessions to terrorists to win the release of hostages, though the percentage dropped from 67 percent during the Dacca crisis to a more recent 55 percent during a similar event at

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Wisconsin's Structural Deficit: Our Fiscal Future at the Crossroads

by **Andrew Reschovsky**

Andrew Reschovsky is professor of public affairs and applied economics at the La Follette School of Public Affairs and in the Department of Agricultural and Applied Economics at the University of Wisconsin–Madison. He teaches and has published numerous studies on state and local government finance—in Wisconsin, other states, and other countries as well.

The Wisconsin legislature is currently attempting to close a \$1.1 billion deficit in the state's 2001–03 biennial budget. The causes of the deficit most frequently cited have been the recession and the tragic events of September 11. If the slow economy were in fact the major cause of the deficit, then as soon as the economy recovers, we should expect that the state's deficit problems should also disappear. The sad fact is that the cause of Wisconsin's state government budgetary woes are more deep-seated and will still be with us for a long time after the economy recovers.

In the simplest terms, budgets are in deficit when the amount of money the state spends exceeds the revenues it takes in. The state spends money in order to provide services to state residents. These services include everything from maintaining state parks, imprisoning criminals, and subsidizing health care for poor families to helping to provide a university education for our children. In addition, a substantial portion of state spending is in the form of grants to local school districts and to county and municipal governments. These grants both subsidize public education and municipal and county government services and help reduce the property tax burdens on Wisconsin residents.

To predict what the state's budget will look like in future years, we need to start by figuring out how much the state will have to spend each year in order to continue providing the same services that it provides state residents today. I call this the state's current services budget. Spending, at least for some types of services, will rise over time because the state population rises. Thus, if the number of students educated by the University of Wisconsin System rises, the current services budget for higher education will need to increase. Rising costs for goods and services purchased by the state will also result in increases in current service budgets. For example, steep increases in energy prices or in medical insurance for state employees will increase the amount of money needed by the state to maintain current services. Wisconsin faces a structural deficit whenever the amount of money needed to maintain current services exceeds the revenue generated by the state's current tax system. In this article, I show that even under very conservative assumptions about budget growth and reasonably optimistic assumptions about revenue growth, the state will face a very large structural deficit during the next biennium. If no efforts are made to reduce the struc-

tural deficit during the next biennium, annual structural deficits will continue through fiscal year 2009–10.

As I explain in more detail below, the state has faced a structural deficit at least since the mid-1990s. A series of fortunate circumstances—in particular, stronger than expected economic growth—have allowed us to put off the hard choices necessary to eliminate the structural deficit. Although no final decisions have been reached, it now appears that the legislature and the governor will “solve” the state's current fiscal problems primarily by using a one-time source of funds (the tobacco settlement). Using non-recurring sources of revenue and budget gimmicks does nothing to reduce the underlying structural deficit.

The state's economy should rebound strongly over the next couple of years. Even under the most optimistic economic assumptions, however, economic growth will not generate enough extra tax revenue to eliminate the structural deficit. We have certainly run out of short-term budgetary fixes and one-time pots of money. The day of reckoning will come in 2003. We will no longer be able to put off the hard choices that will be necessary to eliminate our structural deficit.

Calculating the State's Structural Imbalance

The starting point for these calculations is the amount of state spending through the General Fund in the most recently completed fiscal year—fiscal year 2000–01, which ran from July 1, 2000 through June 30, 2001. For each of the state's major spending programs, we determine the minimum amount of money that will be needed each year to maintain the level of public services provided in the base year (2000–01). The sum of these amounts is referred to as the current services budget. Next, we calculate how much General Fund revenue will be collected in each year if no changes are made in the tax system used in 2000–01. This means that the 2000–01 tax rates, exemptions, and other features of the tax code remain in force. In any year in which the current services budget exceeds the available revenues under current laws, a structural deficit will occur. A structural surplus will occur in any year when available revenues exceed current services expenditures.

The following paragraphs explain the assumptions that I made in order to project a current service budget

and available revenues for each fiscal year from 2001–02 through 2010–11.

Estimating a Current Services Budget

In calculating the state's current service budget for the next 10 years, I have made a number of quite conservative assumptions about the growth of costs of providing public services. The specific assumptions are outlined below. Projecting future costs for every state government program between now and 2011 would be a Herculean task. The approach I follow here is to make separate estimates for each of the five largest General Fund programs. I then make the simple assumption that the real (inflation-adjusted) costs of maintaining all other state government programs funded through the General Fund remains constant between now and 2011 with the exception of a proportional adjustment for projected annual growth in state population over that period.

For fiscal year 2000–01, the five largest General Fund programs in order of size were: (1) state aid for elementary and secondary (K–12) public education, (2) Medical Assistance (health care for the needy), (3) the University of Wisconsin System, (4) shared revenue (state aid to municipal and county governments) and (5) corrections. Together these five programs accounted for 74 percent of General Fund expenditures. The assumptions underlying the real growth in the costs of current services for each of these programs are listed below:

K–12 Public Education. In 1996, in addition to its commitment to fund two-thirds of the cost of K–12 education, the legislature enacted a permanent revenue cap, limiting the annual amount by which school districts can increase school revenues and hence expenditures. The data show that the revenue cap has been successful in restraining the growth of school spending. During the first half of the 1990s, the annual rate of growth of General Fund expenditures on K–12 education averaged 3.1 percentage points above the rate of inflation. Between 1995 and 2000, average annual expenditures grew at a rate of 2.5 percentage points above the rate of inflation. A heated debate is raging over whether the revenue caps are preventing school districts from maintaining the quality of public education. For the purposes of this exercise, I make the conservative assumption that over the next decade, school districts will be able to maintain the current quality of education with an annual real increase in state school aids of 1.25 percent—a rate that is one-half of the rate of real expenditure growth during the second half of the 1990s. Official demographic projections indicate that over the next decade, the number of school-aged children in Wisconsin will be declining by a modest amount. The current service budget projections for K–12 education also assume that expenditures on state education aid will decline proportionately to the projected fall in enrollments.

Medical Assistance. Predicting the costs of Medical Assistance expenditures is particularly difficult. It is

necessary not only to predict changes in the number of persons eligible for Medical Assistance, but also to predict changes in the annual costs of health care. After a period of relatively modest growth in the late 1990s, the rise in health care costs appears to be accelerating rapidly. Nevertheless, in developing a current services budget for Medical Assistance, I have assumed that the real annual growth in General Fund expenditures on Medical Assistance will grow at a rate proportionate to the projected growth in the population of the state and the average percentage amount by which the medical care price index exceeded the consumer price index during the 1991–2001 period. These calculations result in a real increase in Medical Assistance expenditures of around 2 percent per year.

University of Wisconsin System. As a means of maintaining the quality of education, the Regents of the UW System have placed caps on the annual growth of enrollment through 2006. For the years between 2007 and 2011, I have assumed an annual enrollment cap increase of 0.17 percent, a figure that is the average of the annual growth in the enrollment cap for the years 2002–06. In each year, the caps are considerably lower than projected growth in state population. In calculating the current services budget for the UW System, I have assumed that real spending will increase by the annual increases in enrollment allowable under the caps and by the average amount by which the government's higher education price index exceeded the Consumer Price Index during the 1990s.

Shared Revenue. General Fund allocations to the shared revenue program provide all county and municipal governments in Wisconsin with grants. In general, larger per capita grants go to local governments with the smallest property tax bases. The Kettl Commission and others have suggested that there are good reasons to reform the formulas used to allocate shared revenue among local governments. Despite these criticisms, there is little question that reductions in the real value of shared revenue allocations lead to either cuts in local government public services or to increases in local government property taxes and fees. A reasonable argument can be made that, on average, the real costs of providing municipal and county services grow proportionately with the growth of population. Thus, in calculating a current services budget for shared revenues for the 2002–11 period, I assume that real per capita shared revenue spending will remain constant—that is, real spending on shared revenue will grow at the same rate as the state's population.

Corrections. Starting in the late 1980s, the legislature took a number of steps designed to increase the prison sentences of convicted criminals and to reduce their access to parole. As a result of these “get tough on crime” policies, between 1987 and 2001, the number of inmates in state prisons grew at an average annual rate of 9.36 percent. This rapid growth in prison population was reflected in a steady increase in state spending on correc-

tions. In projecting a current services budget for corrections for the 2002–11 period, I make the conservative assumption that the real growth in corrections spending can be kept to the projected growth rate of population over this period—a rate that averages less than 0.5 percent per year.

All Other Programs. I assume that the real cost of all other programs financed through the General Fund will grow at the projected rate of state population growth. This is equivalent to assuming constant real per capita spending between 2002 and 2011. Again this is a quite optimistic assumption. Between 1996 and 2000, real per capita spending financed by the General Fund grew at an average annual rate of 1.27 percent. Thus, the assumption that current services can be maintained with no growth in real per capita spending requires that the state increase the efficiency in the delivery of services by enough to offset any growth in state employee wages and benefits or in the costs of other inputs, such as fuel, that exceed the growth in the Consumer Price Index.

The assumptions outlined above result in a current services budget that is projected to grow at an annual average rate of only 0.83 percent above the rate of inflation. The data show that the average annual rate of real growth of General Fund spending between fiscal years 1989 and 2001 was equal to 2.9 percent per year. This pattern of spending growth suggests that continuing to provide current levels of public services over the next decade while constraining the real rate of spending growth to under 1 percent per year will require substantial gains in the efficiency with which public services are delivered. To the extent that these efficiency gains cannot be achieved, the current services budget will grow at a faster rate than assumed here, and the structural deficits reported below will be underestimated. For example, if the real current services budget were to grow at an annual rate of 2 percent over the next decade (instead of 0.83 percent), the structural deficit for the next biennium would be 25 percent greater than the deficit projection in this report.

Estimating Future Revenues

The best way to predict the amount of revenue our tax system will generate is to look at the historical relationship between tax revenue and personal income growth. Largely because of Wisconsin's relatively heavy reliance on the individual income tax, tax revenue tends to grow at a faster rate than personal income. Although precise calculations are difficult, a careful analysis of data on personal income growth and tax revenue growth over the past decade led me to assume a revenue elasticity of 1.115. This means that each 1 percent increase in real personal income will lead to a 1.115 percent increase in General Fund tax revenue.

The basis of the revenue projections used in this report are the latest long-run projections of real growth in personal income released by the Wisconsin Department of Revenue. Those projections (dated February 28,

2002) indicate that the Wisconsin economy is apt to improve dramatically over the next couple years. Projected growth in real personal income is for an increase from 1.1 percent in 2002 to 2.2 percent in 2003 and 2.6 percent in 2004. If the economy grows at a faster than projected rate, the structural deficits reported below will be reduced. If, however, the economic recovery is slower than anticipated, the structural deficits during the next biennium will be larger than indicated. The detailed spending and revenue projections through fiscal year 2011 are displayed in Table 1 (see page 21).

The Results

In any given year, a structural deficit exists if the sum of the current services budget for that year plus the required 1.2 percent reserve exceeds estimated general fund revenues. As shown in Table 2 (see page 22), the structural deficit averages about \$950 million per year over the current biennium. In fiscal year 2003–04, the first year of the next biennium, the state will face a structural deficit of nearly \$990 million (measured in 2002 dollars). If nothing is done to close this structural deficit, the state is expected to face a structural deficit of about \$770 million in fiscal year 2004–05. Over the course of the biennium, the structural deficit will be \$1.75 billion. This amount equals 7.8 percent of the total General Fund revenue that would be raised during the biennium assuming no changes to current tax law.

The calculations summarized in Table 2 also reveal that without remedial action, annual structural deficits would occur in every fiscal year through 2009–10. Because I have assumed that General Fund revenues will grow at a faster rate than the state's current services budget, the projected structural deficits will become smaller with each passing year.

As this report is being written, a conference committee of the legislature is trying to reconcile the differences between the Assembly and Senate versions of 2001–03 budget adjustment bill (formally, the Budget Reform Bill.) Because the final bill that is passed by the legislature and signed by the governor will presumably include elements of both the Senate and Assembly budget bills, the general outline of the revised 2001–03 budget is quite clear. Most of the money needed to close the current budget deficit will come from one-time sources of revenue. By far the largest source of these one-time funds is the state's share of the tobacco settlement. The multi-state settlement with the major tobacco companies resulted in an agreement that the states would receive a stream of annual payments from 2000 through 2032. Wisconsin has decided to convert this stream of promised payments into a one-time, up-front payment (referred to as "securitizing" the tobacco settlement). It accomplishes this by, in effect, issuing bonds whose debt payments are met by the flow of tobacco settlement payments. Most of the proceeds of the bond sale

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Using the Full Toolbox: Environmental Policy in Britain

by **Graham Wilson**

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Throughout the 1980s, the British were regarded as laggards in the prevention and control of pollution in Europe. Emissions from the smokestacks of their power plants carried by the prevailing westerly winds were a major cause of acid rain in the rest of Europe, killing much loved forests in countries such as Germany. Discharge from the nuclear fuel reprocessing plant into the Irish Sea from the city of Cumbria in northwest England caused considerable concern in both Britain and the Irish Republic. A large number of Britain's beaches failed to meet the standards of cleanliness set by the European Union (EU). Perhaps in part in response to criticisms that it was slow to protect the environment, Britain adopted comprehensive new environmental legislation in 1990, the Environmental Protection Act. Many believe that the act has made a major contribution to improving Britain's environmental standards. Unintended consequences of unrelated policy changes have also helped. Britain is no longer a major cause of acid rain in Europe, for example, not because of changes in its environmental policy, but because of the decline of the use of coal in power plants.

The Blair government has decided, however, that the 1990 law is inadequate. They feel the need to innovate for several reasons. First, the approach adopted by the 1990 act was a classic "command and control" form of regulation. To discharge pollutants, businesses are required to submit fairly lengthy applications (500 pages or so) demonstrating that they have minimized the pollution they discharge in all media (e.g., water, air, solid waste) using best available technology. Once the applications are approved, inspectors from the Environment Agency (the enforcement arm of the Department of the Environment, Food and Rural Affairs, or DEFRA) visit plants to ensure that permit conditions are being met.

While this process is much less adversarial than in the United States, and relations between inspectors and businesses are generally cordial, it still suffers from some of the well-known problems of "command and control" regulation. Businesses have little incentive to innovate and push for higher standards of pollution control beyond current best available technology standards.

In addition, few inducements exist for companies to reduce their negative environmental impacts in ways that are unrelated to the permits themselves, for example, by reducing packaging, planning for environmentally friendly disposal of the product when it reaches the end of its life, or reducing pollution from vehicles delivering their products.

Finally, the permitting system is geared to controlling the impact of fixed-point sources of pollution such as smokestacks or pipes discharging waste into waterways, whereas internationally the concern is switching to non-point sources of pollution such as runoff from fertilizers, herbicides, and insecticides. In brief, the 1990 act is seen as a classic policy approach that has reached the limits of its ability to improve the environment.

The second reason to innovate is that the Blair government has been anxious to be seen as "business friendly." The Labour Party came to power in 1997 and triumphantly won reelection in 2001 by defining itself as "New Labour," a party that had repudiated the anti-business policies and attitudes associated

with "Old Labour" in the past. The main employers' organization, the Confederation of British Industries, has nonetheless been vocal in demanding a reduction in the regulatory burdens imposed on its members. The Blair government has responded by creating deregulation task forces and units within major government departments coordinated centrally by a unit in the Cabinet Office. In brief, the Blair government has not been about to compromise the image of "New Labour" by launching a wave of stringent traditional regulations even in pursuit of a popular and important goal such as a cleaner environment.

Third, Britain has placed a high priority on being an attractive location for direct foreign investment, attracting a disproportionately large share of foreign investment in the European Union. While there may be many reasons for this—including the fact that Britain shares a language and a legal tradition with the largest source of foreign investment, the United States—successive British governments have believed that providing a "business friendly" environment is crucial. Britain offers overseas investors a setting within the European Union

Few inducements exist for companies to reduce their negative environmental impacts in ways that are unrelated to the permits themselves.

with unrestricted access to its vast market without the numerous regulations that complicate basic business decision-making in countries such as France. British governments have emphasized the “flexibility” of its market economy compared with those of its EU partners. The Blair government has had no wish to compromise this reputation by adopting stringent environmental regulations.

How then can the Blair government square the circle of being pro-environment while avoiding onerous and irritating (to business) regulations? In its attempts to answer this question, the Blair government has made Britain a leading innovator in environmental policy using a variety of techniques that have attracted favorable attention from other governments and environmental activists.

Perhaps the most innovative policies have relied on mobilizing private sector forces to promote enhanced environmental performance. Much of this activity has relied on persuasion. The government has been active, for example, in trying to ensure that all major companies compile and publish reports on the environmental impact of their activities. This effort was spearheaded by a middle-ranking minister, Michael Meacher, and Blair himself committed the government to the goal of having the top 350 companies in Britain involved in compiling and publishing these reports. The ideal level of environmental reporting would be integrated into one of the externally monitored self-regulatory schemes such as ISO 14001 of the International Organization for Standards or EMAS (Environmental Management and Auditing Systems) promoted by the EU. Though these schemes differ somewhat, both emphasize the identification of environmental impacts, steps to reduce them, and the development of future goals.

The government also turned for assistance to the chairman of the London Stock Exchange, who issued a letter saying that such reports were expected of the major listings on the London Stock Exchange. Insurance companies, most notably CGNU, which has massive holdings on the London Stock Exchange, have also been mobilized. CGNU has announced that its investment arm, Morley Finance, will vote against the adoption of the annual report of any company in which it holds stock if the company’s report does not contain the environmental risks that result from its activities, and the steps it is taking to manage them. The Institute of Chartered Accountants has also encouraged such reporting, basing its arguments on the belief that the true value of a corporation can be assessed only if the extent of the risks they generate—including environmental risks—and the steps to manage them are known.

So far, the only statutory aspect of this reporting policy has been to require the managers of pension funds to

announce each year whether or not they take social factors, such as a corporation’s environmental record, into account in making investments. Pension fund managers are fully entitled to announce each year that they do not take social factors into account in making their decisions, but in practice this requirement has had a major impact in encouraging socially (including environmentally) conscious investment. In this regard, there is evidence that British policy has had a spillover effect, encouraging similar developments in other EU countries. Socially responsible investing has been growing rapidly, and Britain now has 60 socially responsible funds worth

There is evidence that British policy has had a spillover effect, encouraging similar developments in other EU countries.

about \$5.6 billion. Moves are also under way to spread the requirement to other EU countries. In the meantime, the possibilities for further growth in socially responsible investment in Britain are significant. The Association of

British Insurers has decided that its members also must comply with the policy of announcing whether they take social factors into account in investment decisions even if they are not required to do so by law. Because members of that association control about a quarter of the stock in UK companies, this could make a major difference.

Another approach to innovation is a blend of voluntary and compelled action which uses taxes that can be ameliorated through negotiations. The British Treasury has levied significant taxes on the use of carbon fuels, aggregates, and landfills. Industrial sectors, however, can negotiate reductions in the tax in return for commitments to improving environmental performance. So far, more than 40 agreements, generally negotiated between trade associations and the government, have been made in return for tax reductions. Civil servants involved in the negotiations feel strongly that although voluntary agreements have considerable advantage over traditional forms of regulations, the threat of paying a significant tax on environmentally damaging activity is an effective, powerful tool in concentrating an industry’s thinking on its environmental impact.

But Will It Last?

One reading of the developments in British environmental policy is that they collectively constitute an exciting new alternative to regulation. Yet there are factors at play that might limit or even undermine new initiatives.

The first is that the new approaches are being grafted onto an existing system of permitting and inspection. The permitting process can be regarded as the baseline from which alternative approaches can raise environmental performance to new heights. Unfortunately, the permitting system may also impede the ability of alternative approaches to achieve superior results. If inspectors push businesses to focus all their executive and

monetary resources on meeting conditions of their permits, companies will be less likely to think more holistically about their environmental performance. In terms of the environment as a whole, for example, it may be more important to have automobile manufacturers think about how to dismantle and recycle automobiles than about how to reduce the emissions of their factories by a small amount. Inspectors from the Environment Agency are generally regarded as flexible and sensible in their approach. These inspectors, however, may also wonder what their own career and legal prospects would be if they failed to enforce environmental laws rigorously and a disaster ensued. Could they be held liable individually if their behavior could be described as negligent? This classic problem of regulation—that inspectors are under pressures to “go by the book” to protect their own interests—has long been recognized in the United States. Such a phenomenon could serve as a serious barrier to alternative forms of regulation in Britain.

The second problem involves how receptive business will be to pleas for cooperation. Most of the government's efforts have been placed on persuading firms to adopt environmental reporting, yet accounts disagree regarding how successful these efforts have been. The government argues that over 85 percent of the largest 350 firms have adopted environmental reporting. A recent study skeptical of these results was published in the periodical *ENDS Reports*, arguing that the figure was far lower than 85 percent and scarcely higher than before the government program began. The government, in turn, contests the figures in the *ENDS* survey. Environmental reporting, officials maintain, has increased considerably in quality as well as quantity since the government's campaign began.

A third problem concerns the policy of negotiating reductions in taxes on environmentally damaging activities, processes, or materials. Agreements to reduce taxes

on carbon fuels, aggregates, or landfills are made sector by sector. Yet not all sectors are well equipped to make agreements. Some sectors are composed of a few large and powerful companies that can negotiate deals themselves. Others have strong trade associations to help them to negotiate. Still other sectors are composed of numerous smaller firms with limited capacity to negotiate with the government and for which no strong trade association works to support them. It is unclear how the government can make deals with the sectors that have limited negotiation power. It would be economically and possibly politically unsustainable, however, for tax reductions to be offered only to sectors with strong trade associations or high degrees of concentration. In the twentieth century, British attempts to institute neocorporatist arrangements and indicative planning—a voluntary planning structure wherein government works in partnership with business—were handicapped by the poor organization of employers in some industrial sectors. Innovation in environmental policy may be similarly handicapped. At the very least, this type of bargaining is easier to achieve in countries such as the Netherlands with more organization by employers.

Conclusion

It is not clear, therefore, that all the innovations the British are attempting in environmental policy will last. It would be unduly pessimistic to conclude, however, that they will not. Considerable enthusiasm exists for these innovations in the financial sector and very large companies such as Shell and BP. That enthusiasm may well help to institutionalize these new approaches. No one expects traditional permitting-based regulation to disappear, but the new approaches could enable the British to use the full toolbox to approach environmental problems. ■

Students Present Spring Policy Workshop Analyses

Issues ranging from juvenile delinquency in Britain to housing policies in Milwaukee were among the eight projects studied this spring in domestic and international classes of the La Follette School Workshop in Program and Policy Analysis. Under the direction of Professor Andrew Reschovsky, students worked with the city of Milwaukee's Budget and Management Division and with the Wisconsin Joint Legislative Council. Associate Professor Melanie Manion directed the international issues class.

Improving the Effectiveness of Wisconsin's Comprehensive Planning Legislation. This report for the Legislative Council investigates the experiences of local government with a new comprehensive land-use planning law passed by the legislature in 1999 (Leslie Albrecht Huber, Jeremy Levin and Margaret E. Mooney).

Special Education Funding in Wisconsin: An Analysis of Distribution Mechanisms. In this study for the Legislative Council, students examine Wisconsin's special education funding dilemma by exploring funding and distribution trends, as well as identification rates (Chad Cotti, Heidi Frechette, Sam Harshner and Jeff Kostelic).

Using Community Development Block Grants Funds Effectively: A Search for Innovative Housing Programs. Students conclude in this study that three small innovative programs may have promise for housing programs in Milwaukee funded by CDBG (David Fosdick, Hilary Murrish, Rob Suls and Craig Wieber).

Worker's Compensation in Milwaukee: Analyzing Spending Increases. The authors explore why city spending on Worker's Comp has grown so rapidly and

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The Economic Well-Being of Women Leaving Welfare

by **Maria Cancian, Robert Haveman, Daniel Meyer, and Barbara Wolfe**

Maria Cancian is an associate professor of public affairs and social work, Robert Haveman is a John Bascom Professor of economics and public affairs, Daniel Meyer is a professor and director of the School of Social Work, and Barbara Wolfe is a professor of economics, public affairs, and preventive medicine at the University of Wisconsin–Madison. This article was originally published as a discussion paper entitled “Before and After TANF: The Economic Well Being of Women Leaving Welfare,” by the University of Wisconsin–Madison Institute for Research on Poverty. The full text of this article can be viewed at <http://www.ssc.wisc.edu/irp/pubs/dp124402.pdf>.

Since the passage of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), welfare caseloads have fallen dramatically, raising questions about who has left welfare, at what level they are employed, their earnings, the government benefits for those who have left, and broader measures of their economic well-being after welfare. These questions are particularly timely because federal funding for the main cash welfare program, Temporary Assistance for Needy Families (TANF), expires in 2002, and one of the issues to be considered is the extent to which welfare reform has “worked.”

It will be difficult to know whether reform has worked because no state that we are aware of has commissioned an explicit evaluation of the effects of its current TANF policies. Instead, several studies have been conducted at the state level of later outcomes among women who left welfare. These studies do not provide convincing evidence for the effectiveness of welfare reform because there is no explicit counterfactual. It is difficult to know, for example, whether a given level of employment, earnings, or income is a “success” or a “problem” unless there is a point of comparison.

We begin by describing those who have recently left welfare in Wisconsin. We compare the postexit earnings, employment, and income of recent leavers with those who left welfare two years earlier. We also compare a measure of postexit income (earnings plus in-work supports and any benefits) to each woman’s measured income in the quarter before leaving welfare. Although these comparisons cannot fully answer questions about the effects of welfare reform, they do provide valuable information on outcomes for welfare recipients, and they provide important context for considering other evidence regarding the effects of the reform.

A national study of the effects of welfare reform is difficult because programs in each state are quite different and thus the characteristics of the key features of welfare reform in each state are hard to identify. Moreover, available data do not generally have sufficient samples in individual states. An alternative is to select a particular state that may provide particularly useful information. We believe the experience of Wisconsin is of special interest because it has the TANF program that focuses most heavily on work. Since 1997, no cash assistance has been available to families unless they participate in work or work-like activities through the Wisconsin Works (W-2) program or unless they have a child less

than 13 weeks old. Cash benefits are available only after a period of program participation to mirror the world of work. Wisconsin began work-based welfare reforms in the late 1980s, and it was one of the first states to establish a radically different approach to assisting low-income families—an approach focused on work. Because other states may consider Wisconsin’s example, an examination of Wisconsin’s leavers may offer insight into the results of a work-based welfare system. Moreover, a comparison of those who left welfare under the early Wisconsin reforms (which had a work emphasis, but were not totally work-based) with those who left under the later, more stringent work-based regime may offer insight into the relationship between these different policy models and levels of employment and economic well-being.

We study the time patterns of employment, earnings, and incomes of members of two groups—women who left welfare in late 1995 (under early welfare reform) and women who left welfare two years later, after the initial implementation of W-2, the state’s post-PRWORA program. We provide information on the socioeconomic characteristics of leavers and on the work, earnings, and income patterns of these two cohorts in the year after they left welfare (1996 and 1998). We also examine individual leavers to see whether their own earnings and in-work supports a year after leaving add up to more or less than the welfare income they had received. Although these comparisons help us consider the level of well-being of welfare leavers, findings provide descriptive information on outcomes rather than estimates that isolate the effects of welfare reform.

Prior Literature

The literature on the economic well-being of women who have left welfare is growing. Most studies find that about two-thirds of leavers work in the first years after exiting, and that they earn \$6.50 to \$7.50 per hour. Poverty rates are quite high—more than 50 percent in the early years after leaving.

Little scholarship exists, however, that explicitly compares the economic well-being of those who left welfare at different times. One might expect that those who left AFDC/TANF in 1997 would be doing worse than those who left in 1995, because the most work-ready participants are likely to be the first to leave. Some evidence shows that the composition of the caseload has been

shifting over time toward a higher percentage of those with more barriers to employment. Other studies find surprisingly few differences in the characteristics of recipients. Indeed, leavers in the later cohort exited after stricter time limits and work requirements were implemented, and this change in regime might encourage or demand increased earnings. Pamela Loprest of the Urban Institute conducted a study providing information on leavers at two different periods. She compares those leaving welfare in 1995–97 with those leaving in 1997–99, using the National Survey of America’s Families (NSAF), and finds that recent leavers and earlier leavers have similar rates of employment, hourly wages, family monthly earnings, and post-tax family incomes. Recent leavers have slightly lower poverty rates but slightly higher rates of economic hardship (housing problems or worries about food). These findings of very small differences could be the result of increases in employment and earnings in some states (perhaps states with a very work-focused policy) being offset by decreases in others (states with a less work-focused policy). By using data from a state with a very work-focused program, our research can inform our understanding of the national efforts. In addition, we provide an additional point of comparison: an individual’s postwelfare outcomes with her outcomes in a quarter when she received welfare.

Research Methods

For our analysis we merged data available in Wisconsin from (1) the Client Assistance for Re-employment and Economic Support (CARES) system, which includes information collected in administering AFDC, W-2, and related means-tested programs; (2) the Computer Reporting Network (CRN) system, the precursor of CARES, providing earlier AFDC administrative data useful for constructing an AFDC history for each case; and (3) the Unemployment Insurance (UI) system, which includes information on quarterly earnings and employers.

Sample

Our samples begin with women receiving assistance under AFDC-Regular or W-2 (Wisconsin’s TANF program) in September 1995 and 1997 who are listed as the “case head” and who do not have the other parent of any of the children also listed on the case. We define a woman as having left welfare if she does not receive cash assistance within three months of our initial observation and remains off the welfare caseload for at least two consecutive months. The sample included 49,605 AFDC recipients in September 1995, 8,042 women who left AFDC during the last quarter of 1995, 20,608 recipients

in September 1997, and 8,162 who left AFDC or W-2 during the last quarter of 1997. The rate of exit is much higher in the second period: 16 percent of women participating in AFDC in September 1995 left the program in the next three months, whereas in 1997, 40 percent of those receiving cash assistance in September 1997 left within three months.

Although the characteristics of the two groups of leavers are fairly similar, Wisconsin’s 1997 recipients appear to have more barriers to work. For example, women who left welfare in the last quarter of 1997 were more likely to have low levels of education (46 percent with less than a high school diploma versus 34 percent in 1995), more children, very young children, and children with a disability (receiving SSI). Leavers in the later year were also less likely to have recent work experience and were much more likely to be African American and to live in Milwaukee County.

Women who left welfare in the last quarter of 1997 were more likely to have low levels of education, more children, very young children, and children with a disability.

Empirical Measures and Their Attributes

Our main outcomes of interest are a leaver’s employment, earnings, and personal income. Employment and earnings data are taken from the Wisconsin UI earnings records. Because these data are provided by employers, we believe they are more accurate than survey reports in measuring formal employment and earnings. However, because these data do not contain information on individuals who move out of state, are self-employed, or are in jobs not covered by the UI system (covered workers include about 91 percent of official Wisconsin workers), we are unable to distinguish between women who truly have no earnings and those who have unrecorded earnings.

We also examine a leaver’s “personal” or “own” income, a measure of the income under her own control. This includes her own earnings and the cash and Food Stamp benefits she receives for the family. We also add in the amount of the Earned Income Tax Credit (EITC) she would receive based on her earnings and subtract the amount of payroll and income taxes we estimate she would pay. Because our interest is in the income that is under her own control, we do not include the income of a spouse or partner or the amount of child support she receives. We calculate poverty status based on the measure of personal income, using the official poverty line.

Finally, we examine a measure of family income. Family income will differ from our measure of own income primarily to the extent that a welfare leaver has a spouse or partner with income. Although the women in our sample did not have a recorded spouse or partner when they received AFDC/TANF, they may have had one later. The administrative records do contain some information on household composition after leaving cash assistance. We have included the earnings of any new

spouses or potential partners, along with the EITC and taxes associated with these earnings, in our measure of family income. Because the measurement of the leaver's own income is more accurate than that of family income, we focus most of our attention on the leaver's own income.

Although our measure of income is not a complete estimate of economic well-being, it does allow an assessment of self-sufficiency based on own earnings, a focus of welfare reform. Moreover, the extent to which earnings and in-work supports (Food Stamps and the EITC) observed after leaving cash assistance replace (or fail to replace) welfare income is seen as critical by many policymakers.

Approach

Any differences in outcomes we observe between the two cohorts of leavers may merely be the result of differences in observable characteristics. A simple approach to exploring whether recent leavers are doing better or worse than the previous cohort is to conduct a multivariate analysis on the pooled sample, differentiating between cohorts with an indicator variable; the coefficient on the indicator variable provides an indication of whether recent leavers are doing better or worse, controlling for observable characteristics. It is possible, however, that there are different relationships between the outcomes and the characteristics in the two periods. We also run a fully interacted model (equivalent to separate models in each period) and conduct a test to see if the fully interacted model fits the data better than the pooled model. Because this model does not provide a straightforward answer to the question of whether recent leavers are doing better or worse, we use the results to calculate estimated outcomes for women with a given set of characteristics, then compare these simulated results across cohorts.

Results

First we review the characteristics of leavers, using the results of a descriptive multivariate analysis with probit estimates of the probability of leaving welfare in each period. We see that relative to those with less than a high school diploma, high school graduates were significantly more likely to leave welfare in both cohorts, with no statistically significant difference in the effect of high school graduation between the two cohorts. Having more than a high school diploma also had a significant positive impact on the probability of leaving welfare, but in this case the magnitude of the effect is significantly larger in the second period.

In both periods we find some evidence that women were more likely to leave if they had fewer barriers to employment. Factors that increased the probability of exit included greater education, more adults in the household, and more prior work experience. Women were also more likely to leave welfare if they were Hispanic or white than if they were African American or other, if they lived outside of Milwaukee, if they lived in an area with lower levels of female headship, and if they had fewer months of prior welfare receipt.

Women were also more likely to leave welfare if they were Hispanic or white than if they were African American or other, if they lived outside of Milwaukee, if they lived in an area with lower levels of female headship, and if they had fewer months of prior welfare receipt.

Overall, although the magnitude of effects varies between the two cohorts, the direction of most statistically significant relationships remains the same. There is one important exception to this otherwise

consistent pattern. Women with more children were less likely to leave welfare in the first period than those with fewer children, but they were actually more likely to leave in the second. This change is consistent with the changes in grant amounts over this period. In both periods we expect that, all else being equal, women with larger families generally face more substantial barriers to employment. In 1995, women with larger families were also eligible for more generous cash assistance, so their lower likelihood of leaving is not surprising. For the later cohort, however, W-2 payments do not vary with family size. Larger families experienced substantial declines in the level of benefits, but smaller families—especially those with only one or two children—experienced potential gains. Thus, it may be that in the later period women with only one child were less likely to leave welfare than those with larger families because their potential benefits actually rose over these two years. One other noteworthy difference between the two cohorts is that whereas women in Milwaukee were less likely to exit in both periods, the coefficient in the later period is much larger, showing increasing differences between exit patterns in Milwaukee and the rest of the state.

Employment and Earnings after Welfare

Comparing the earnings and work experience of the two cohorts in the year after exiting, we find that employment rates do not differ markedly between the two periods, with about 70 percent of leavers in both years having some earnings in each quarter. A slightly higher percentage of leavers in the second cohort have earnings at some point during the year, 84 percent versus 81 percent in the first cohort. However, earnings (in 1998 dollars) are lower in the second cohort, with mean annual earnings totaling \$1,400 less than in the earlier cohort (\$7,700 versus \$9,100) and median earnings totaling

nearly \$2,000 less. These differences are consistent with the hypothesis that the new “work first” strategy emphasizes entry into the labor market, perhaps pushing people with fewer employment skills to accept lower-paying jobs. They are also consistent with the hypothesis that the new strategy pushes people with more barriers (e.g., child care difficulties) into the labor market, where they work fewer hours.

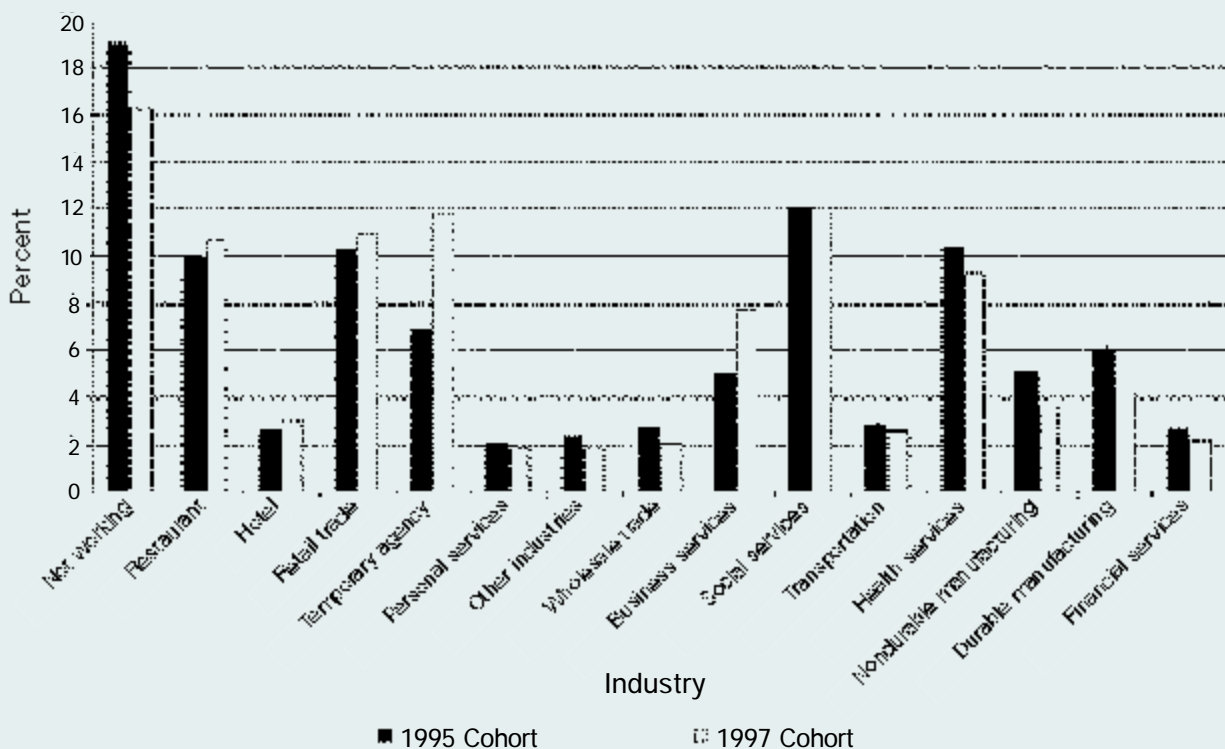
Figure 1 shows the industry of the main job in the first year after welfare for the 1995 and 1997 leavers. We first assign each woman’s main employer to one of 14 industries. We then rank the 14 industry groups by the first-year earnings of the women in our sample who begin in a particular industry. Under this ranking, the industry with the lowest earnings for the 1995 cohort is restaurants, while the highest-earning industry is financial services. This ranking of industries enables us to examine the extent to which individuals begin in a “good” industry (from the perspective of earnings only). The figure displays the percentage of each cohort not working and the percentage working in various industries, with the lowest-earning industry, restaurants, shown in the second bars and the highest-earning industry (financial services) in the final bars. The figure shows that although leavers in the second cohort are more likely to be working, they are less likely to be in the highest-earning sectors (financial services, durable manufacturing, and non-durable manufacturing). They are somewhat more likely to be working in the three lowest-earning sectors (restaurants, hotels, and retail trade), and substantially more

likely to be working in temporary agencies.

Overall, the results comparing earnings and work experience of the two cohorts and the information in Figure 1 document substantial postexit employment and suggest the potential importance of earnings to postwelfare economic status. At the same time, the results show substantial diversity in labor market experience. As an initial step toward understanding postexit employment patterns, we turn to an examination of characteristics associated with labor market success, using multivariate descriptive models. We examine two measures of labor market success—whether a woman has recorded employment and the level of earnings in the first year (among those with earnings). In both cases we measure the impact of individual characteristics at exit on employment and earnings in the first year after exit. In addition to the characteristics included in our previous analysis of the probability of leaving welfare, we include an indicator variable denoting whether the individual had earnings in the quarter of exit (the last quarter of 1995 or 1997) to differentiate recent earnings experience. We also include variables for the industry of the primary employer in the quarter of exit (last quarter of 1995 or 1997) and an indicator variable for having more than one employer in that quarter.

The results indicate that in both cohorts employment is less likely for women of color, and more likely for those with more prior work experience, those employed in the quarter of exit, and, among those employed, those with more than one employer. Contrary to expectations,

FIGURE 1
Industry of Longest Job in Year after Exit



employment is significantly more likely among those who had more months of welfare receipt in the 24 months prior to the sample being drawn. Finally, employment in a temporary agency in the quarter of exit is associated with being less likely to be employed in the following year than being employed in many other industries. There are relatively few differences between the two cohorts in the relationships of initial characteristics and employment.

We estimate the level of earnings in the first year after leaving welfare among women with any earnings in both cohorts. Among workers in the first cohort, earnings are significantly higher for those with more education and more work experience, those working in the quarter of exit, those living in areas with fewer female-headed households, and those living in areas with lower unemployment rates. Among those working at exit, those with multiple employers had higher later earnings. Earnings also varied significantly with industry of primary employer in the quarter of exit. For example, women working in temporary agencies in that quarter earned more in the following year than those initially employed in restaurants, but significantly less than those in business, financial, health or social services, transportation, wholesale trade, or manufacturing. Somewhat surprisingly, among workers, those with more children and younger children actually had higher earnings, though the differences are small. This may reflect that women with greater family responsibilities or higher child care costs need more substantial earnings in order to leave welfare or to be employed given that they have left welfare. Those in Milwaukee and other urban counties have higher earnings than those in rural counties.

Benefits, Income, and Poverty after Welfare

To calculate income and poverty, we first add cash assistance and Food Stamps to earnings. Over the first year, 29 percent of women leaving welfare in 1995 returned to AFDC. Women leaving in 1997 were somewhat less likely to return—25 percent received benefits in the first year. Among those who returned, the amount received was about \$1,000 per year higher in the second cohort (about \$3,000, versus \$2,000). A potential reason is that W-2 benefits (received by the second cohort) are higher than are AFDC maximum benefits (received by the first cohort) for families with one or two children. The relatively lower rate of returning to welfare in the second period is notable, given that a high proportion of cases leaving welfare in the second period included individuals with more substantial barriers to employment. On the other hand, differences in Food Stamp amounts are consistent with the view that individuals leaving in the second period include more who continue to need as-

sistance: 81 percent of the 1997 leavers received Food Stamps during the next year, compared with only 57 percent of 1995 leavers. Moreover, recipients in the second cohort received an average of \$1,934 in Food Stamps, compared with \$1,343 in the first cohort.

Our measure of a woman's own postexit income includes her earnings reported to the UI system, estimated federal income taxes, payroll taxes, EITC, cash assistance, and Food Stamps. We also have a measure of "family income" that includes the earnings of other adults listed as being part of the household in the AFDC/W-2, Food Stamp, or Medicaid files. Figure 2 compares mean income in the third quarter of 1995 (and

Nearly half of the leavers are worse off than they were before leaving welfare, according to all the income-based measures.

1997) with mean income in the third quarter of 1996 (and 1998), in each case multiplying quarterly data by four to get annualized data. The first bar shows annualized income for the first cohort in the quarter immediately prior to leaving

AFDC (July to September 1995) and indicates that these leavers had significant earnings even before exit, averaging about \$4,700. Estimated "net taxes" (EITC benefits less payroll and any income taxes on these earnings) add about \$1,000 in income, AFDC about \$4,400, and Food Stamps about \$2,100. Thus total "own income" is about \$12,200 and can be seen in the figure as all parts of the bar except the top portion. We then add in the net earnings of others in the household; this adds only a small amount. A year later, earnings for this cohort of leavers have increased substantially, to \$7,200; increases in EITC are largely offset by increased taxes; and AFDC and Food Stamps are much lower. Thus total measured own income is substantially lower, despite the large earnings increase. The earnings of others adds about \$800, not enough to offset the other losses in our measure of family income. The later cohort tells a similar story—lower total measured own and family income as large increases in own earnings (and small increases in others' earnings) are outweighed by large declines in TANF and Food Stamps.

As we discussed above, postexit family income differs from own income because it includes income of a spouse or partner or other family members. In the first cohort, 7 percent have earnings from a spouse or partner, and another 4 percent have a spouse or partner without earnings. These numbers increase to 9 percent and 6 percent in the second cohort. In addition, some leavers have earnings from other family members (teens or adult children with their own earnings). Adding the earnings of spouses, partners, and others increases the incomes of only 13 and 11 percent of the families, but these earnings are not trivial for those who have them—over \$3,000 in the year after exit. These estimates of the percentage of welfare mothers who have a spouse or partner, and the amounts of earnings provided are lower than those of

survey estimates. Thus we tend to place more weight on the estimates of own income.

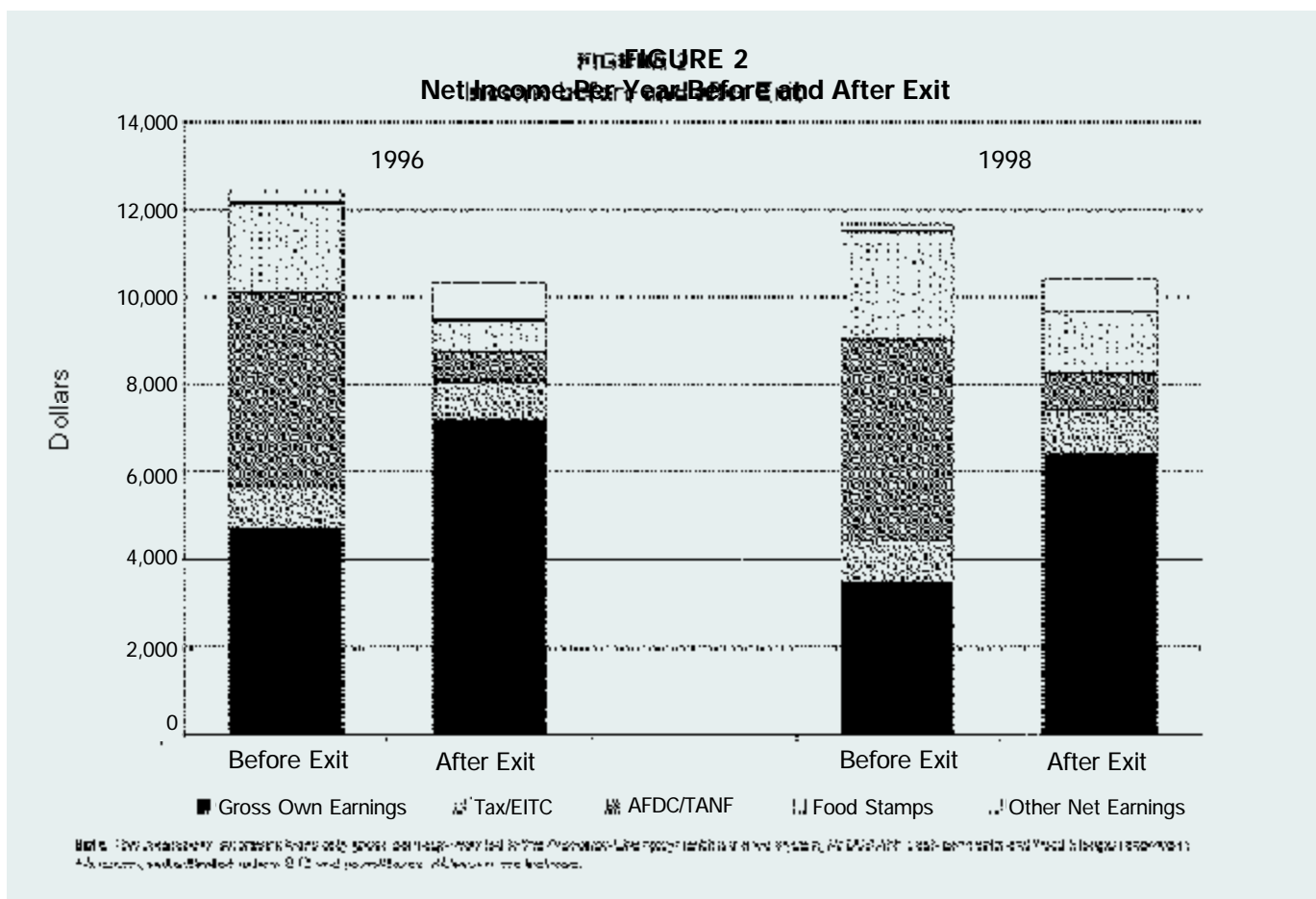
The average income figures mask substantial diversity in outcomes. We divide individuals in the postexit period into three categories: those who are “worse off” (earnings or income has declined by \$1,000 or more), “about the same” (earnings or income within \$1,000 of previous amounts), and “better off” (earnings or income has increased by \$1,000 or more). We compare preexit income (four times the amount in the third quarter of 1995 or 1997) with postexit income (four times the amount in the third quarter of 1996 or 1998). We use three measures of income: own earnings (without EITC or taxes), own income (earnings, EITC, taxes, AFDC/W-2, and Food Stamps), and family income (adding in the net earnings of other household members).

Own earnings increased for nearly half the leavers. In the first cohort, 47 percent of leavers have more earnings than they did before exit, 31 percent have similar earnings (many of these are without earnings in either period), and the remaining 22 percent have lower earnings. The second cohort’s figures are nearly identical, with corresponding percentages of 48, 31, and 21, respectively. In contrast to the improved earnings, most of the sample has lower own income. In the first cohort, 61 percent have lower income and only 29 percent have higher income. There is a slight improvement in the second cohort, with 58 percent having lower income and 32

percent having higher. Adding in the earnings of others in the household improves the picture slightly for the first cohort and more substantially for the second—in 1998, 42 percent of leavers were better off using our measure of family income compared with only 32 percent using our measure of own income. However, nearly half of leavers are worse off than they were before leaving welfare, according to all the income-based measures.

We now turn to an absolute measure of economic well-being and compare three measures of annual income (after-tax earnings plus the EITC, our own income measure, and our family income measure) to the poverty line and 150 percent of the poverty line. Seventy percent of the first cohort have after-tax earnings below poverty, 25 percent are near poor (between 100 and 150 percent of poverty), and only 5 percent have earnings of at least 150 percent of the poverty line. Adding in other sources of own income decreases the poverty rate somewhat, to 63 percent, and adding the income of other household members decreases it even more, to 59 percent. The second cohort has even higher poverty rates—80 percent based on after-tax earnings, 72 percent based on own income, and 69 percent based on family income.

We examine the probability that own after-tax income is above the poverty line in the first year after exit, using a multivariate probit analysis. Overall, the results are generally similar for the two cohorts. Not surprisingly, the characteristics associated with having own in-



come above the poverty line generally parallel those for total earnings. In particular, poverty rates are lower for those with more education, more work experience, and smaller families, those working in the quarter of exit, those living in areas with fewer female-headed households, and those living in areas with lower unemployment rates. Poverty rates also vary significantly with industry of primary employer in the quarter of exit, following the same pattern as for earnings. There is no consistent relationship between poverty and the age of the youngest child. Although African Americans had less employment, they were actually less likely to be poor than were whites, all else being equal. One exception to the similarity of results between the cohorts is that those in the later cohort with two children are more likely to have incomes above poverty than are one-child families. An analysis of having estimated family income above the poverty level shows quite similar results.

Summary and Conclusions

We find higher rates of employment for women who have left welfare under recent reforms than have been reported in many other studies. In both cohorts, over four-fifths of leavers were employed at some point in the first year after exit. Prior studies conducted by the U.S. Department of Health and Human Services, the U.S. General Accounting Office, and researchers Gregory Acs and Pamela Loprest, and Maria Cancian, Robert Haveman, Thomas Kaplan, Daniel Meyer, and Barbara Wolfe find that estimates from other states are generally closer to two-thirds. The estimates from the National Survey of America's Families (NSAF) data analyzed by Pamela Loprest of the Urban Institute are 61 percent to 64 percent, but this is employment during a particular week rather than over the whole year.

Our finding is consistent with other studies showing that single mothers in Wisconsin have relatively high levels of labor force participation. Given that individuals are working, our earnings estimates of \$8,000–\$9,000 per year are generally similar to other states. Loprest does not present NSAF estimates of a leaver's own earnings but does present median monthly family earnings of \$1,246 and \$1,360 for working families, an estimate much higher than the Wisconsin data on family earnings. Also similar to outcomes in other states, we find that about 20 percent of leavers return to cash benefits within the first several months, and that Food Stamp reciprocity is fairly common in the first year. Finally, consistent with results of other studies of leavers, we find poverty rates, based only on own income, to be quite high (63 percent and 72 percent). NSAF estimates of poverty based on family income (including the EITC and Food Stamps) are similarly quite high (though lower than our findings), 41 percent to 48 percent.

We summarize our results of the explicit comparisons of leavers in the two different periods and we also compare our results to the bivariate comparisons of

those who left early and late in the NSAF. We find much higher probabilities of leaving in the recent (1997) cohort using all three methods. These recent leavers have slightly higher employment rates, but the differences are not large. The NSAF finds no significant difference. The NSAF report compares only family earnings (not own earnings) and finds no significant difference between the cohorts. We find that recent leavers are more likely to be poor, based on either own or family income. In contrast, the NSAF shows that more recent leavers are less likely to be poor, based on family income.

In addition, we compare a leaver's earnings and income in the quarter before leaving welfare to her situation a year later. Our calculations tend to show that a leaver's earnings are substantially higher one year later, but declines in benefits outweigh the increases in earnings, resulting in lower own income and generally lower family income (using the best available measure of family income). Although we find that this decline in income occurs in both cohorts, the figures for the more recent leavers are not quite as negative.

Interpreting these differences is complicated because of changes in the background characteristics of welfare recipients, changes in the economy, and likely changes in unobserved characteristics of leavers in the two periods. None of our methods can convincingly account for unobserved differences, and thus we view these results as suggestive rather than documenting an explicit result of policy.

The encouraging news from this study is that most women are working. The first challenge of welfare reform—to move recipients into the labor market quickly—seems to have been met successfully for many participants in Wisconsin. In both cohorts we see that over half of leavers have substantially higher earnings in the first year after welfare than they had in the quarter before leaving. We would argue, however, that this is only part of the story. Another policy goal should be to increase economic well-being, and the early results suggest that this is a much stiffer challenge. Fewer than half of the leavers had higher measured net income a year after leaving. We have noted that our measure of net income neglects some potentially important sources; research that can include these other sources is clearly needed. More broadly, ongoing monitoring of more inclusive measures of economic well-being (not just income, but other measures of economic hardship as well) is needed in order to know whether policy reforms have met this second challenge.

Finally, we note that the Earned Income Tax Credit has a significant effect on poverty rates, even when it is considered simultaneously with payroll taxes. For example, poverty rates based only on a leaver's gross earnings are 78 percent in the first year; subtracting payroll taxes and adding the EITC decreases the poverty rate to 70 percent. In a regime in which single mothers are expected to rely primarily on their own earnings, earnings supports within the tax system are especially important. ■

Leheny continued from page 4

the residence of the Japanese ambassador to Peru in 1996–97. Understandably, Japanese policymakers believe that their primary responsibility is to protect Japanese overseas rather than to engage in a sustained campaign against terrorism. In fact, the bureau that calls itself in English the “Anti-Terrorism Bureau” in the Ministry of Foreign Affairs is, in Japanese, the “Hôjin tokubetsu taisakushitsu,” or “Office of Special Measures for Our Citizens Overseas.”

Japanese and foreign critics of the nation’s admitted “case-by-case” approach to terrorism argue that its stance makes it particularly unable to deal with individual terrorist crises. During the 1996–97 siege in Peru by militants from the Tupac Amaru movement, the Japanese government’s cautious voice seemed to add little to the quality of Peruvian and international efforts to end the standoff. Moreover, the sarin gas attack on the Tokyo subways almost certainly had a more pronounced effect on U.S. counterterrorism policy than it did on Japan’s.

Instead of creating new institutions to cope with the possibility of terrorism using weapons of mass destruction, the National Police Agency, after years of careful deliberation, pushed through a law giving the government more powers to investigate and regulate “those organizations that have committed indiscriminate mass murder.”

Rather than adopt a strong stance against terrorism, the government gave itself more power to prosecute Aum Shinrikyo and other groups, provided that those groups have already carried out large-scale slaughter. Nothing in the debate over Koizumi’s law to support America’s war on terrorism suggests that there has been a radical rethinking of Japan’s appropriate response to terrorist crises.

After Afghanistan, What?

The impulse to support the United States in its war on terrorism thus arises from the criticism of Japan’s tardiness in the Gulf War and from an eagerness of Japanese hawks to demonstrate the nation’s support for its alliance partner. It does not, however, represent Japanese resolve against terrorism as a phenomenon that can be meaningfully confronted as part of an overall strategy. Although Japan might well provide symbolic and important practical support to the United States, advocates of Japanese commitments on both sides of the Pacific almost certainly see this as a harbinger of a more fruitful U.S.-Japan alliance. In doing so, they have missed the likely limits on Japanese cooperation in a bona fide U.S.-led war on terrorism and therefore will likely not recognize the political tensions that might serve to undermine the alliance.

The Japanese have no illusions about the risks to SDF members in the Afghani theater, particularly if they run field hospitals for American troops in Pakistan, as has been suggested. In fact, much of the Diet debate before the October 30 passage of the Koizumi bill focused on the conditions under which SDF members can fire their weapons to defend themselves or those under their care. But there has been little discussion in Japan of the possibility that Japanese civilians themselves will become targets if they are seen to be part of a broader counterterrorism effort. Should the conflict spread to Southeast Asia, Japan will find itself in a terrible dilemma.

Why would it spread to that region? U.S. policymakers have identified clear links between al Qaeda and Islamic movements in the region, including the Abu Sayyaf Group in the Philippines and the Islamic Defenders Front and Laskar Jihad in Indonesia. In the Philippines, of course, Islamic militants operate in a nation that is largely Roman Catholic, and their efforts are

largely secessionist in nature. The relationship between Islam and the Indonesian government is more complex because the nation is predominantly Muslim and Islamic parties have been important players in Indonesian politics for decades. With the recent ouster of long-time dictator President Suharto, they are more relevant than ever, and President Megawati

Sukarnoputri has to be concerned about taking steps that will rile conservative Muslim communities.

Terrorists thrive in communities that are broadly sympathetic to their goals, as well as in areas where state power is highly limited. Failed states like Afghanistan provide an exceptionally good environment for terrorist training, financing, and planning. If the United States successfully pushes militants out of Afghanistan as a result of its attacks, remaining al Qaeda operatives will likely gravitate toward established groups with whom they have had some links, especially in areas where state authorities have weak law enforcement and intelligence capabilities. American analysts have determined that the southern Philippines and Indonesia would be likely arenas for the planning and organization of further anti-American attacks. For this reason, security policymakers in Washington are considering options for counterterrorist operations in Southeast Asia.

This will mean that the United States will expect active Japanese participation; this participation will endanger the lives of Japanese throughout the region and perhaps at home as well. SDF troops in Pakistan would be close enough to the front line to take fire, but as everyone in the American counterterrorism community recognizes, there really are no borders in terrorism. To be sure, the United States will be the prime target, but

Terrorists thrive in communities that are broadly sympathetic to their goals, as well as in areas where state power is highly limited.

no one who has traveled extensively in Southeast Asia can fail to be impressed by anti-Japanese sentiment born both of economic resentment and of anger over Japan's wartime behavior. Should Japan be clearly and publicly allied with the American effort, Japanese civilians in these nations will face a new and threatening environment. Especially given the predilection of some groups toward attacking "soft targets," lightly guarded Japanese diplomatic installations and private firms would likely become tempting targets of opportunity.

Nothing in Japan's counterterrorism policies or the government's dialogue with citizens has prepared Japanese for this possibility. Right now, the only risks under serious discussion are the nation's constitutional virtues, its relations with skeptical Asian neighbors, its links to the United States, and the possible danger to Japanese troops. It is possible that terrorist attacks on Japanese people would increase the enthusiasm for a war on terrorism, but history suggests otherwise. In the aftermath of the Lima crisis, the Japanese government tightened security on some installations but otherwise showed little increased interest in terrorism. And after the Kyrgyzstan attack, the Japanese government continued its aid programs to the Ferghana Valley—but hired foreign workers to replace the Japanese on the ground. In fact, the clear role of the Japanese government has been to protect Japanese, usually by trying to keep them out of harm's way, which in this case, might mean "out of the war on terrorism."

Even if Japanese are not made immediate targets, the spread of U.S. operations to Southeast Asia would imperil Japan's own diplomatic initiatives in these countries, especially Indonesia.

Even if Japanese are not made immediate targets, the spread of U.S. operations to Southeast Asia would imperil Japan's own diplomatic initiatives in these countries, especially Indonesia. Japan has thrived on its economic relations with other states, especially those in East and Southeast Asia; it will understandably be reluctant to jeopardize these to adhere to the U.S. line on terrorism in the region. Without a guiding set of principles or policies, Japan's few counterterrorism specialists are no match for the entrenched corps of regional affairs, economic policy, and diplomatic bureaucrats who guide most of the nation's foreign policies. How many "economic cooperation" initiatives would be sacrificed in Indonesia if the Japanese government were to provide support to the United States there? If the Indonesian government were to reject U.S. military operations, would the Japanese government remain silent on covert operations launched from American bases in Okinawa? How far would the SDF go in supporting U.S. troops in Southeast Asia?

No one yet knows the answers to these questions. Alarming, no one seems to have asked. Instead, remembering Japan's late and limited role in the Persian Gulf War, most American analysts of Japanese security

politics seem heartened by the alacrity with which Koizumi made his seven-point proposal. To be sure, a precedent set now would make more likely Japanese support of America's overall security profile in the Pacific rim. But it might be less important if the Bush administration proves to be truly committed to a global war on terrorism. If Japan seems not to cooperate in, and even to hinder, America's progress in the war on terrorism, American public support for U.S. commitments to the defense of Japan will face its most serious challenge since the occupation.

A Difficult New Choice

Japan's foreign policy and security leaders thus face a difficult choice, and not the conventional one of pacifism vs. military engagement. The American war on terrorism involves great dangers and genuinely unforeseeable conclusions. Most of the terrorist organizations that interest U.S. policymakers have shown little interest in Japan, though this will likely change if Japan becomes

more deeply involved. Clearly, Japan's interests would be served by maintaining a strong alliance with the United States, but it takes a leap of faith to conclude that Japan will be safer even in the long term from terrorism if it joins the American-led campaign in earnest.

If Japanese leaders want to make their nation a more comprehensive partner of the United States in the war on terrorism, they will need to take different, more nuanced steps than they have thus far. Rather than expending all political capital on open-ended support for a large-scale American offensive in southwestern Asia, the prime minister should move to re-establish a terrorism division in the National Police Agency and should also substantially beef up the size and profile of the Special Measures office in the Ministry of Foreign Affairs, where it is institutionally powerless against regional bureaus. They should also enlarge the intelligence capabilities of the Defense Agency, giving it a mandate broader than its current focus primarily on China and North Korea.

Even more important, Japanese leaders will need to discuss terrorism to ensure that citizens understand why it is a threat and why the government will adhere to fixed, transparent standards regarding its handling. If the Japanese public is behind—it clearly is not now—a genuine war on terrorism that will likely involve dangers to civilians, police, and members of the armed forces alike, Japan can provide more important guarantees to the United States regarding long-term support. In the absence of any public debate on what terrorism is and why it presents a threat, Japanese cooperation in the war on terrorism will remain doubtful.

These recommendations presuppose that Japan's interests are and should be firmly aligned with those of the United States. But Japanese policymakers may want to bear in mind that for all the expertise, talent, and institutional support involved in America's counterterrorism efforts, the U.S. government does not fundamentally know how to stop terrorism. To be sure, the U.S. government has successfully isolated the Taliban, has won the extradition of terrorist suspects for trial in the United States, and may have destroyed individual terrorist groups. These accomplishments, however, are hardly the same as ensuring that Americans are safe. It seems logical, of course, that a stern approach to terrorism that emphasizes military and law enforcement capabilities might be more useful than concessions or other, more conciliatory, approaches. But the evidence is mixed, as we simply do not know precisely the best method for reducing the overall threat of terrorism. It is possible, after all, that Japanese will be safer if the government tries to fly under the radar of terrorist groups, dealing with inci-

dents on its familiar "case-by-case" basis, than if it cooperates with the United States. The risks to the alliance would, however, be profound.

This is not to argue that Japan should necessarily continue its ambivalent approach to international terrorism. Perhaps a genuine war, built at least in part on military engagement, is necessary, and the Bush administration's program might be effective. Moreover, maintaining American faith in the U.S.-Japan alliance—so crucial to Japan's security—is almost certainly worth some risks. But risks there are, and the Japanese government will need to consider what real cooperation with the United States in this conflict will look like. For decades, Japanese politicians have debated what it means for the Japanese constitution to have Japanese troops on or near the front lines. Now they will have to consider how their nation will enter a war without fronts, in which all civilians are themselves part of the campaign. ■

DIRECTOR'S PERSPECTIVE *continued from page 1*

Award for highest student achievement in her two years in the program.

Graduation is such a joyful occasion, and we are all proud of our thirty-five new policy analysts and public managers, who will make many positive contributions in the world of policy-making. Twenty-four students received the Master of Public Affairs degree, and eleven received the Master of International Public Affairs degree.

This issue of the *La Follette Policy Report* illustrates the most recent work of our faculty, while it also notes a number of student projects that took place during this spring semester, projects that resulted in publications prepared for local, state, and international agencies.

Among our many outreach efforts during this past academic year was a breakfast series for policymakers on international issues. One speaker in that series was David Leheny, a specialist in Japan studies whose academic home is in the university's Department of Political Science. His lead article in this issue offers a comparative perspective on the issue of terrorism as he discusses the way in which Japan as a nation responds to terrorist threats.

Graham Wilson, who continues as our associate director, is heavily involved in the politics of environmental issues both here and abroad. His article represents some of his most recent work in this area, in this case discussing British innovations in environmental regulation. Again, he provides a comparative perspective that is most insightful. His newest book, *Business and Politics*, will soon be published by Palgrave.

Maria Cancian, on leave this year at the Russell Sage Foundation in New York, continues her work on welfare. The article she co-authored with Robert Haveman, Daniel Meyer, and Barbara Wolfe explains several of the issues that continue to be discussed among policymakers regarding women who leave

welfare. We look forward to Maria's return to La Follette and the University of Wisconsin-Madison in the fall semester.

Andrew Reschovsky, an economist who studies and teaches courses in government finance, has completed a study this spring on the severe budget issues facing Wisconsin—not just in the current budget year but into the next decade. He writes clearly and engagingly, enabling readers to understand the issues related to "structural" deficits that our state and many others are and will be facing.

Don Kettl's brief article, stimulating as always, offers his apt insights on the issue of federalism as it applies to efforts to thwart terrorism.

This semester wraps up my last term as La Follette's director. I have begun a study on charter schools in Wisconsin and throughout the United States, funded by the U.S. Department of Education as well as our own College of Letters and Science.

We have a rotating directorship at La Follette, and while I have greatly enjoyed my tenure as director, I am pleased to announce my successor: Professor Donald Nichols. Don is an economist who is extremely highly regarded for, among other things, his accurate economic forecasting. He has a great deal of administrative experience as well, and La Follette is lucky to have him as its next director.

We're pleased that our *Policy Report*—and indeed, all aspects of our endeavors at La Follette—represent important work being done both here in Wisconsin and throughout the world. Our faculty, staff, and students are stimulated daily by the discussions of events ranging from local government issues in the cities of Madison and Milwaukee to those in countries across the globe.

John F. Witte

Reschovsky continued from page 7

are then used to finance the current budgetary shortfall.

Because the use of one-time funding does nothing to increase future revenue flows or reduce the current services budget, it will have no impact on the size of the structural deficit. The 2001–03 budget compromise will almost certainly include some modest reductions in the permanent funding level for existing state programs. Although these spending cuts will reduce my estimate of the structural deficits for the 2003–05 biennium, it is unlikely that they will reduce the estimates by more than \$200 million—leaving a structural deficit in 2003–04 of over \$700 million and a structural deficit for the whole biennium of well over \$1 billion.

Can Economic Growth Solve Our Problems?

The structural deficit projections made in this report are based on the assumption that the state’s economy will begin recovering this year, with the economic recovery continuing over the next couple years. By 2004, real personal income is projected to grow at a rate of 2.6 percent. During the second half of the 1990s, the state’s economy grew at an extremely fast rate, with the

rate of real economic growth peaking in 1998 at 4.2 percent. During the three-year period, 1997 through 1999, personal income grew at an average annual rate of 3.6 percent.

Although economists think it is highly unlikely that the Wisconsin economy will be able to grow at anywhere near that rate, what if such a rate of growth was in fact sustainable in both 2003 and 2004? If the economy grew at an annual rate of 3.6 percent (in real terms), would this rapid economic growth solve our structural deficit problems? The answer is decidedly no. The structural deficit would decline by about \$150 million in 2003–04 and by about \$275 million in 2004–05, but the total structural deficit over the course of the biennium would still add up to \$1.3 billion.

Why Does Wisconsin Have a Structural Deficit?

It is not difficult to identify the major elements that have contributed to the current fiscal situation. In 1994, in response to a growing public frustration with rising school property taxes, the legislature committed the state to paying two-thirds of the cost of primary and secondary public education beginning in the 1996–97 school year. To fulfill this promise, the state had to

TABLE 1
Wisconsin’s General Fund Structural Imbalance, 2001–02 to 2010–11
(millions of dollars)

	In current dollars		In 2002 dollars							
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
REVENUE										
Opening Balance	207.5	138.1	137.2	131.1	134.9	137.9	140.7	143.5	146.4	149.4
Estimated Revenue	10,610.1	10,951.7	11,058.9	11,379.6	11,633.4	11,867.0	12,105.2	12,348.2	12,596.1	12,849.0
Available Revenue	10,817.6	11,089.8	11,196.1	11,510.7	11,768.4	12,004.9	12,245.9	12,491.7	12,742.5	12,998.3
APPROPRIATIONS										
K-12 Public Education	4,594.7	4,763.6	4,799.7	4,836.1	4,885.9	4,936.2	4,987.1	5,038.4	5,090.3	5,142.7
Medical Assistance	1,106.7	1,024.3	1,046.7	1,069.6	1,091.0	1,112.8	1,135.0	1,157.7	1,180.9	1,204.5
UW System	1,058.3	1,115.6	1,124.7	1,135.0	1,145.4	1,155.1	1,165.3	1,175.5	1,185.9	1,196.3
Shared Revenue	1,047.8	1,062.4	1,068.5	1,074.5	1,078.7	1,082.8	1,087.0	1,091.1	1,095.3	1,099.5
Corrections	770.9	786.1	790.6	795.0	798.1	801.2	804.2	807.3	810.4	813.5
All Other Programs	3,010.4	3,069.9	3,087.4	3,104.9	3,116.8	3,128.8	3,140.8	3,152.9	3,165.0	3,177.1
Total Current Appropriations	11,588.8	11,821.9	11,917.5	12,015.2	12,115.9	12,216.9	12,319.4	12,423.0	12,527.8	12,633.7
Annual Real Growth in Appropriations			0.81%	0.82%	0.84%	0.83%	0.84%	0.84%	0.84%	0.85%
BALANCES										
Revenue-Appropriations	-771.2	-732.1	-721.4	-504.4	-347.5	-212.0	-73.5	68.7	214.7	364.6
Required Reserves (1.2%)	138.1	137.2	131.1	134.9	137.9	140.7	143.5	146.4	149.4	152.4
Net Balance	-909.3	-869.3	-852.5	-639.4	-485.5	-352.7	-217.0	-77.7	65.4	212.2
Annual Structural Deficit (estimated revenues- current services- reserves)	-909.3	-1007.4	-989.7	-770.5	-620.4	-490.7	-357.7	-221.2	-81.1	62.9
Structural deficit/estimated revenue	8.6%	9.2%	8.9%	6.8%	5.3%	4.1%	3.0%	1.8%	0.6%	-0.5%

TABLE 2
Wisconsin's General Fund Structural Imbalances
(millions of 2002 dollars)

Fiscal Year	Estimated Revenue	Current Services Budget*	Structural Imbalance
2001-02	10,817.6	11,726.9	-909.3
2002-03	10,951.7	11,959.1	-1007.4
2003-04	11,058.9	12,048.6	-989.7
2004-05	11,379.6	12,150.1	-770.5
2005-06	11,633.4	12,253.8	-620.4
2006-07	11,867.0	12,357.6	-490.7
2007-08	12,105.2	12,462.9	-357.7
2008-09	12,348.2	12,569.5	-221.2
2009-10	12,596.1	12,677.2	-81.1
2010-11	12,849.0	12,786.1	62.9

*Includes 1.2 percent required reserve.

increase grants to school districts by a total of \$1.2 billion in fiscal year 1997. During the early and mid-1990s, the legislature was also “getting tough on crime” by instituting longer sentences on convicted criminals and restricting access to parole. Largely as a consequence of these stiffened sentencing rules, the state’s prison population grew from nearly 6,000 in 1987 to nearly 21,000 by the end of 2001.

While both of these policies committed the state to substantial increases in spending, the legislature failed to reduce spending on other state programs or to make changes in our tax system designed to fund these new commitments. During the latter half of the 1990s, the legislature was able to avoid making these difficult choices because the booming economy was producing unanticipated additional tax revenue with which to balance each biennial budget.

During the late 1990s, most states were using at least a portion of their unexpected tax revenue to invest in so-called “rainy day” funds. Wisconsin, however, was one of only five states that chose to put nothing away for a time when the economy stopped growing. Although legislation authorizing the establishment of a stabilization fund has been on the books for a number of years, no money has been deposited in the fund. In fact, during the late 1990s, the legislature enacted a multi-year individual income tax reduction, exempted some additional goods and services from the sales tax, authorized a sales tax rebate, and instituted a number of business tax breaks. Regardless of the merits of these tax policy

changes, their net effect was to increase the size of the state’s structural deficit.

Conclusion

Over the past few biennial budgets, the legislature has been able to put off making the difficult choices that are required to eliminate the structural deficit. First, the extraordinary economic growth during the late 1990s and then the ability to use up the tobacco settlement have allowed the state to balance the past few biennial budgets. It is hard to imagine, however, any source of revenue suddenly materializing to bail out the state once again. Come 2003, the legislature and the governor will have no choice but to address the state’s structural deficit.

State government in Wisconsin has a well-deserved reputation for innovation over a wide range of policy areas. It is widely recognized as a leader in a number of areas such as welfare reform, environmental protection, mental health, social services, and higher education. The citizens of the state are used to receiving high quality public services. Arguably, both individuals and businesses are attracted to the state because of the level and quality of services provided by its state and local governments. The existence of a structural deficit means that as a state we must choose whether we want to reduce the existing level of public services or whether we are willing to collectively pay more money in taxes and fees in order to continue receiving the public services to which we have become accustomed. ■

Devolve and Protect: Implications of September 11

By Donald F. Kettl

Donald Kettl is a professor of public affairs and political science. He has served on commissions and as a consultant to agencies at all levels of government. He is a nonresident senior fellow in governmental studies at the Brookings Institution and a fellow of the National Academy of Public Administration. This article was first published in the December 2001 edition of Governing Magazine. Reprinted with permission.

Behind the united public front on the war against terrorism, there are fears in Washington and in the hinterland that devolution will be added to the list of casualties of September 11. It's easy to see why.

In the country's foreign and domestic response lies a potential strengthening of the federal role not seen since the Great Depression and World War II. The White House immediately set up its Office of Homeland Security for the purpose of organizing and coordinating strategy. Barely two months after the terrorist attacks, emergency spending had helped send the federal budget sliding toward deficit for first time since the mid-1990s.

So far, these actions appear to have strong public support. Opinion polls have shown more confidence in government to do what is right than anytime in the past 30 years. There are at least as many nervous citizens calling on the feds as there are second-guessers urging caution.

Is there any chance that such a dramatic reassertion of federal prerogatives could take place without disrupting the transfer of power from Washington to state and local governments, which has been picking up steam over the past two decades? Actually, yes. Devolution will continue. It just may not look quite like the version we've been experiencing in recent years.

Throughout American history, of course, national calamities have produced great periods of centralization. Before the Civil War, authors wrote of "the United States" in the plural. That war made "United States" a singular noun with power far more concentrated at the federal level than ever before.

The great battles of the first half of the twentieth century—namely, the New Deal's approach to economic collapse and World War II's answer to a two-front conflict—had exactly the same effect. They tilted the axis of government toward Washington. Despite complaints about states' rights, both of these crises fortified national power at the expense of the states. Lyndon B. Johnson further strengthened that with his Great Society of the 1960s.

Then, however, with the Reagan administration in the early 1980s and continuing through the Clinton era—from the Contract with America to welfare reform—the United States has seen a genuine devolution revolution. It has gone too far now to be reversed. The real question to ask at this point is how September 2001's events will alter the nature of the process.

Unlike the earlier crises that centralized federalism, this one all but requires some form of devolution. Government's reaction to the terrorist attacks isn't something that can be managed entirely from Washington.

Even if federal officials wanted to concentrate more power in Washington, the mundane realities of homeland defense would frustrate them. Federal officials may argue the need for increased airport security, but local governments operate most of the nation's airports, and they will continue to do so. The cold, wet noses of bomb-sniffing dogs will belong to local police forces.

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When the FBI puts the nation on a high terrorist alert, it's local police officers who guard the bridges and water systems and nuclear power plants and football stadiums. It's state governments that deploy the National Guard. In order for the new security effort to work, there has to be a grassroots, public-private partnership in pursuit of coherent national policy. That may not be devolution as Ronald Reagan envisioned it, but it's still devolution.

What we are likely to emerge with is a new federal-state-local relationship even more interconnected than in the past. The federal government will play the role of orchestra conductor, writing the tunes and coordinating the parts. State and local governments will play most of the instruments.

For the states and localities, this means accelerating changes they've been making in recent years, only doing it in a more coordinated fashion. The challenge for the federal government is to move away from its instinct to micromanage the front lines, and to shift toward honing its ability to set broader strategy and, most important, to improve its ability to coordinate action. The feds have for too long thought of themselves as both conductor and player. In their eagerness to play every part, they've often not gotten the conductor's role right.

But there's a bit of reassurance in this: The conductor's job is one that the federal government simply had to start doing better in any event if it wanted to make serious progress towards solving the most difficult problems of the twenty-first century. Devolution based on partnership was becoming a necessity even before the terrorists struck. It's just more urgent now.

So asking about a return to centralism in the wake of September 11 amounts to asking the wrong question. The right question is how Washington can become a far more adept conductor of a new kind of collaborative federalism. ■

identify several likely causes and make several policy recommendations (Amber Hyman, Andrew Snyder and Angie Sweeney).

Intergovernmental Collaboration in the Milwaukee Metropolitan Area. This report develops a strategic framework for identifying potentially fruitful collaborations for the City Assessor's Office (Alicia Sidman, Joshua Todd, Tanya Wagner, and Rachel Walker).

Transfers in Mexican Fiscal Federalism. This report, prepared for the Organization for Economic Cooperation and Development, examines the equity and efficiency of federal fiscal transfers for subnational governments in Mexico (Sylvia Diaz, Robin Lisowki, Kirstin Nelson, and Joel O'Connell).

Juvenile Delinquency Prevention: What Works in the United States and Is Promising for Great Britain.

In this study for the British Embassy, in Washington, D.C., students examine 12 state programs for juvenile delinquency and their transferability to Britain (Yoshiko Araki, Scott Braunschweig, Alex Conant, and Russ Dabel).

Effective Strategies for Preventing HIV/AIDS in Developing Countries: Lessons from Brazil, Senegal, Thailand, and Uganda.

By examining countries with successful HIV/AIDS prevention, students make policy recommendations to the International Institute for Educational Planning at UNESCO (Amy Forster-Rothbart, Shigeaki Kamo, Sang-Moon Lee, and Laura Miner-Nordstrom). ■



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