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Do CEOs From Financially Sound Firms Exhibit Opportunistic Behavior Prior to a Voluntary Non-routine Departure?

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INTRODUCTION
Accounting accruals can either be used to provide information efficiently to stakeholders (Pourciau 1993) or to manipulate earnings opportunistically, with the intention of misleading some of the firm’s stakeholders about the actual financial condition of the firm (Healy and Wahlen 1999). Pourciau (1993) and Perry and Williams (1994) postulate that a change in CEOs creates opportunities for earnings management. Dechow and Sloan (1991) support this assertion, showing that retiring CEOs do in fact manipulate earnings, using research and development. In contrast, Murphy and Zimmerman (1993) found little evidence of earnings management by outgoing CEOs, concluding it was poor performance that led to the CEOs’ demise. Results like these serve to illustrate the conclusion of Dechow and Skinner (2000) that prior scholarship on earnings management has yielded inconsistent findings. They state that, “understanding management’s incentives is key to understanding the desire to engage in earnings management,” (Dechow and Skinner 2000, 248).

This study examines evidence of earnings manipulation by chief executive officers (CEOs) departing from financially sound firms to evaluate whether there is a difference between those whose departure is anticipated (control group) and
those whose departure is unanticipated (study group). It addresses the issue of how CEOs make accounting choices after they know they soon will be leaving the firm, so their interests are no longer aligned with those of the shareholders.

The research question addressed here is different from prior research in several ways. The scope of this study is limited to the CEOs from financially sound firms who make a non-routine departure. We posit that this group is less stringently monitored than CEOs who are expected to leave the firm either due to age or poor performance. In earlier studies, Murphy and Zimmerman (1993) analyzed all CEOs that were terminated, both those that reached a mandatory retirement age and those that were terminated prior to retirement age, while Pourciau (1993) studies only non-routine terminations. Dechow and Sloan (1991) examined CEOs that faced mandatory retirement (departure was anticipated) and compared those that continued working for the firm either as a board member or in a consulting capacity with those that severed all contact with the firm. In contrast, this study focuses on CEOs that take a voluntary, non-routine departure and have no further contact with the firm. A voluntary, non-routine departure is defined as one in which the departing CEO is less than 64 years old and did not give notice of departure until the quarter in which he or she was leaving the firm.

This study examines whether the information asymmetry created by the CEO’s unanticipated departure creates an opportunity to manipulate earnings (Healy and Wahlen 1999). The information asymmetry results from the fact that the CEO knows that he/she is leaving the firm but the board of directors does not. Once a CEO decides to terminate his or her association with a firm, he/she may no longer care about the *future* earnings of the firm since there will be no performance-related benefits accruing to him/her after departure. The departing CEO continues to have an interest, though, in maximizing earnings in the period of his/her departure. For example, earnings concurrent with the departure may be used in calculating a performance bonus.

This study contributes to the earnings management literature by investigating the propensity of CEOs to manage earnings prior to departing a firm. It also contributes to the moral hazard literature by investigating whether the CEO’s short notice of plans to depart creates an information asymmetry that the CEO then takes advantage of to manipulate accruals upward, before their departure.

Our expectation was that CEOs from financially sound firms taking unanticipated departures (study group) would be less stringently monitored than those
CEOs whose departure was anticipated. As a consequence of this relaxed monitoring, it was our further expectation that study-group CEOs would use positive accounting accruals to manipulate earnings upward. Contrary to our expectation of opportunistic accrual manipulation by the study group, results of this study are that CEOs from financially sound firms taking voluntary, non-routine departures had significantly lower total accruals in the last fiscal year prior to their departure. Possible explanations of the results are discussed in the conclusion section of the paper.

LITERATURE REVIEW

Smith (1993) points to the general consensus that CEOs manipulate earnings opportunistically. Cook and Campbell (1979) further postulate that as CEOs reach retirement they will make one last effort to manage earnings opportunistically. Prior research has yielded mixed results, however, in studying the earning management phenomenon among retiring CEOs. For example, Dechow and Sloan (1991) examined CEOs facing a routine, expected retirement, and found that these CEOs tended to reduce research and development (R&D) spending. They attributed this action to opportunistic behavior (i.e., manipulating earnings to increase the retiring CEO’s bonus). Dechow and Sloan infer from their results that CEOs who expect to leave the firm in the near future reduce R&D expenditures because they have no interest in future earnings (generated by current R&D), but have an incentive to boost short-term earnings by reducing R&D expense. They characterize this lack of alignment as a “horizon problem”, which occurs when a CEO expects to leave a firm and have no further business dealings with the company. Dechow and Sloan also report that stock ownership, along with the CEO’s continued involvement in the firm, mitigates the opportunistic reduction in R&D, overcoming the moral hazard.

In contrast to the Dechow and Sloan study of CEOs who had reached routine retirement age and whose retirements are expected, Murphy and Zimmerman (1993) compared CEOs taking a routine (age 64 and above) departure to those taking a non-routine departure (age less than 64). Murphy and Zimmerman (1993) also considered whether the CEOs were from financially sound or poorly performing firms, though they intentionally excluded the financially strong firms whose CEOs took a non-routine departure from the firm, arguing that they were least likely to manage earnings; this is contrary to the Pourciau (1993) argument about information asymmetry. Unlike Dechow and Sloan, they found no evidence of income-increasing accounting choices by strongly performing firms,
during an anticipated routine retirement of the CEO. They also found little support indicating that departing CEOs were managing earnings at all. Their study found a decline in sales, assets, and stock prices precedes the CEO’s departure.

Pourciau (1993), however, argued that CEOs from strongly performing firms do have incentives to manage earnings prior to voluntary departure for several reasons: to increase reputation, increase annual bonus, and to make the replacement look bad. She hypothesized that an unanticipated change in CEO misaligns the shareholders’ and the CEO’s goals, creating an opportunity for earnings management. In her study of non-routine executive change, however, she did not differentiate between the “strong” and “poor” performing firms. Contrary to her expectations, Pourciau (1993) found evidence of income-decreasing earnings management—a result she attributes to data limitations and model misspecification. Consistent with the Pourciau results, Wells’ (2002) study of Australian CEO turnover failed to find that departing CEOs had high net income in the year prior to their departure. He could not explain the negative income of the last full year associated with the departing CEO.

In summary, Pourciau (1993) suggested that the CEO’s private knowledge of his/her unanticipated departure leaves opportunities for earnings management. While Dechow and Sloan (1991) did find earnings management by departing CEOs, they did not distinguish between the actions of CEOs from financially sound firms making unanticipated departures and those CEOs making anticipated departures. Dechow and Skinner (2000) found that the results of prior earnings management studies have been inconsistent, perhaps because regulators, practitioners and academics look at earnings management differently. Therefore, the circumstances most likely to lead to earnings management merit further study. Healy and Wahlen (1999) suggest that the difficulty with determining whether earning management occurs lies in identifying an opportunity when earnings management would be expected. It is our position that the information asymmetry created by unanticipated CEO departures, coupled with weak monitoring due to strong performance, creates just such an opportunity.

Where earnings management by departing CEOs is present, it must be acknowledged that the CEO’s departure, even when anticipated by the board, may not have been sufficiently anticipated by the CEO to afford the opportunity to manage earnings; thus, any earnings manipulation may not be a consequence of his/her departure. Pourciau (1993) argues however, that because of information asymmetry, the CEO is aware of changes in the financial condition of the firm and can anticipate any dissatisfaction that the board has with his/her actions that
could result in mandatory separation from the firm. Thus it can be argued that even the sudden firing of the CEO does not always come as a surprise.

RESEARCH HYPOTHESES
Opportunistic behavior occurs when the CEO makes accounting choices and structures transactions in such a way as to mask the actual financial condition of the firm or to influence contractual outcomes (Healy and Wahlen 1999). Pourciau (1993) theorized that CEOs even from “strong performing” firms have reasons to manipulate earnings, such as increasing their yearly bonus, increasing positive reputation, and making their replacement look bad. She did not, however, test this hypothesis. This study posits that the best place to detect earnings management in strong performing firms is with CEOs that are planning an unannounced, voluntary, non-traditional departure. The study group’s CEOs have both the motive and the opportunity to manipulate earnings, whereas CEOs whose retirement is anticipated due to age may be more closely monitored (Pourciau 1993). This leads to the first hypothesis:

H1: Financially sound firms whose CEOs take a non-routine departure will have larger operating accruals in the year prior to their departure than CEOs whose departure is anticipated.

Dechow, Sloan, and Sweeney (1995) suggest that regulators look at the difference between earnings and cash flow—accruals—to detect earnings manipulation. Beneish (2001) asks whether accounting accruals are opportunistic or a signal to investors of future performance-related expectations. Intuitively, if the CEO is signaling a real increase in performance by inflating accruals, one would expect a direct correlation between these inflated accruals and future cash flows. If the CEO is acting opportunistically, however, a weak correlation would be expected between these accruals and future cash flows (Dechow 1994).

Thus, if the intent is signaling one would expect that future cash flows would be better aligned with present accruals. If, however, the intent is opportunistic, one would expect that the present accruals would not be reflected in the future cash flows. CEOs that expect to leave the firm in the near future have no interest in future cash flows, but do have an incentive to boost short-term earnings (Dechow and Sloan 1991). This leads to the second hypothesis:

H2: Financially sound firms whose CEOs take a non-routine departure will have operating accruals less aligned with future cash flows than CEOs whose departure is anticipated.
DATA AND METHODOLOGY
Earnings management is difficult to detect because the motivation for account-
ing choices is not observable. Accruals due to signaling are difficult to separate
from accruals due to opportunism (Cahan 1992; Dechow and Skinner 2000).
Total operating accruals are made up of two parts: nondiscretionary accrue-
als that the CEO cannot manipulate easily, and discretionary accruals that are
entirely the choice of management. When determining discretionary accruals, an
important methodological issue arises because they cannot be directly mea-
sured. Instead, the discretionary portion of the accruals must be estimated using
a proxy (Cahan 1992), which is itself affected by earnings management (Kang
and Sivaramakrishnan 1995). Kang and Sivaramakrishnan indicate that “…
error in measurement [of discretionary accruals] can result in a spurious conclu-
sion” (Kang and Sivaramakrishnan 1995, 364), and suggest that the issue can be
addressed by using aggregated total current accruals, thus negating the problem
of disaggregating discretionary accruals from the nondiscretionary accruals. In
order to avoid these problems, this study uses total operating accruals calculated
using balance sheet numbers and depreciation taken from the income statement.

The study group consists of financially sound firms whose CEOs take an unan-
ticipated non-routine departure. Peltier-Rivest and Swirsky (2000) considered a
firm financially sound if the firm did not report a negative income in the preced-
ing three-year period. An unanticipated departure is defined as the CEO publicly
announcing his or her intention to leave the firm during their last quarter with
the firm. The announcement date will be considered public when reported in a
business newspaper in a Lexis-Nexis search. A routine retirement is anticipated
when a CEO reaches the age of 64 or gives the firm more than a quarter’s warn-
ing of the intended departure. It is this expectation of retirement that motivates
the board of directors to monitor the CEO’s actions (Pourciau 1993) during the
final year, thus making it more difficult for the CEO to manipulate earnings.
Inversely, a non-routine departure is when a CEO departs a firm prior to his or
her 64 birthday.

Pourciau (1993) posited that a CEO making a non-routine change would manage
write-offs and accruals to increase earnings. When she used the final year of
the CEO’s tenure as the year of their termination, the results did not support her
hypothesis. However, when she used the last year that the CEO has control of
the financial statements as the last year of tenure, contrary to her expectations,
she found that the change in accruals resulted in a decrease in income. Conse-
sequently, our study will use the balance sheet and income statement from the last year that the CEO has control over the financial statements.

We have included several variables to control for extraneous effects on the results. Dechow, Sloan, and Sweeney (1995) demonstrated that firm ownership mitigated earnings management by the retiring CEOs. In this study, ownership of one percent or more of the firm’s stock will be used as a dichotomous control variable. Additional control variables will also be used to control for the significant correlation that revenues, expenses and property, plant and equipment have on accruals (Jeter and Shivakumar 1999). Finally, there is a debt/equity variable to control for an alternative hypothesis, the debt/equity hypothesis, that earnings are managed to meet debt covenants (Fields, Lys, and Vincent 2001; Duke and Hunt 1990). Ceteris paribus, the larger a firm’s debt/equity ratio, the more likely the firm’s manager is to select accounting procedures that shift reported earnings from future periods to the current period (Watts and Zimmerman, 1986, 216).

The data sample used in testing the hypotheses will use total accruals rather than discretionary accruals, because discretionary accruals estimated using time-series data are contaminated by part of the prior years’ discretionary accrual being impounded in the current discretionary accruals. Cross-sectional data will be used to mitigate extraneous forces that can affect a firm’s earnings. Two years of firm-specific data will be used in generating instrumental variables¹ to increase the sensitivity of detecting earnings management (Kang and Sivaramakrishnan 1995).

This study tests the hypotheses by comparing two groups of CEOs from financially sound firms, with the difference being whether their departure was anticipated. Data were gathered on CEOs that departed from their firms from 1996 through 2000, as determined from a word search of Lexis-Nexis (Words: retir* and resign* [* wild card]). Specifically, the study group consists of CEOs from profitable firms who are less than 64 years old, gave less than three months’ notice of intention to depart from the firm, and have no continuing association with the firm (e.g., as an officer or board member). Interim CEOs are not included in this study. The CEOs must have worked for a firm that is listed on a major stock exchange, have data available on Compustat, and have electronically filed SEC proxy statements. Both the power industry (SIC 4900–4999) and financial institutions (SIC 6000–6999) will be excluded due to regulatory oversight on financial reporting. One year of financial data prior to the departure will also be used in testing both hypotheses.
The information about the CEOs, gleaned from the firm’s proxy statement, consists of the date of departure and whether there is any continued contact between the departing CEO and the firm. Lastly, the CEO’s announcement of the departure date is garnered from Lexis-Nexis news reports.

Total operating accruals are calculated using Thomas and Zhang’s (2000) adaptation of the Kang and Sivaramakrishnan (1995) model. They are estimated as the difference between current assets minus cash and current liabilities, with the depreciation removed. The depreciation is a non-cash accrual that reduces the long-term assets (contra account); this would not be revealed in the current accruals, so depreciation is subtracted from the total accrual. The current assets are reduced by both cash and any tax refunds that the firm expects. This removes the effects of taxes, which would not necessarily be the same between firms. The current liabilities are treated in much the same way. Taxes payable are removed for the same reason that taxes receivable were removed.

Model (1), used to estimate the total accruals, is specified as follows:

\[
TA_{i,t} = [(ACT_{i,t} - CHE_{i,t} - TXR_{i,t} - (LCT_{i,t} - TXP_{i,t}) - DP_{i,t})] \tag{1}
\]

\(TA_{i,t}\) = total operating accruals, by firm and year,

\(ACT_{i,t}\) = current assets, (#A4)

\(CHE_{i,t}\) = cash and equivalents, (#A1)

\(TXR_{i,t}\) = income tax refund, (#A161)

\(LCT_{i,t}\) = current liabilities, (#A5)

\(TXP_{i,t}\) = income taxes payable, (#A71)

\(DP_{i,t}\) = depreciation and amortization. (#A14)

Model (1a) is used to estimate the change in total accruals using a modified Thomas and Zhang (2000) model, and is specified as follows:

\[
TA_{a_{i,t}} = \left(\left(\left((ACT_{i,t} - CHE_{i,t} - TXR_{i,t}) - (ACT_{i,t-1} - CHE_{i,t-1} - TXR_{i,t-1})\right)\right) - \left(\left((LCT_{i,t} - TXP_{i,t}) - (LCT_{i,t-1} - TXP_{i,t-1})\right) - (DP_{i,t} - DP_{i,t-1})\right)\right) \tag{1a}
\]

\(TA_{a_{i,t}}\) = change in total operating accruals,
\[ \text{ACT}_{i,t} = \text{current assets}, \quad (#A4) \]
\[ \text{ACT}_{i,t-1} = \text{current assets lagged one year}, \quad (#A4) \]
\[ \text{CHE}_{i,t} = \text{cash and equivalents}, \quad (#A1) \]
\[ \text{CHE}_{i,t-1} = \text{cash and equivalents lagged one year}, \quad (#A1) \]
\[ \text{TXR}_{i,t} = \text{income tax refund}, \quad (#A161) \]
\[ \text{TXR}_{i,t-1} = \text{income tax refund lagged one year}, \quad (#A161) \]
\[ \text{LCT}_{i,t} = \text{current liabilities}, \quad (#A5) \]
\[ \text{LCT}_{i,t-1} = \text{current liabilities lagged one year}, \quad (#A5) \]
\[ \text{TXP}_{i,t} = \text{income taxes payable}, \quad (#A71) \]
\[ \text{TXP}_{i,t-1} = \text{income taxes payable lagged one year}, \quad (#A71) \]
\[ \text{DP}_{i,t} = \text{depreciation and amortization}, \quad (#A14) \]
\[ \text{DP}_{i,t-1} = \text{depreciation and amortization lagged one year}, \quad (#A14) \]

Kang and Sivaramakrishnan (1995) found that the use of instrumental variables gave their model significantly more sensitivity than either the Jones model or the “naive expectations” models in the prediction of earnings management. Hypothesis one (financially sound firms whose CEOs take a non-routine departure will have larger positive accruals than will routinely retiring CEOs) will be tested using Kang and Sivaramakrishnan (1995) instrumental variable model, as modified by Thomas and Zhang in their 2000 study.

The Kang and Sivaramakrishnan (1995) model used instrumental variables with the instruments consisting of last year’s components that are related to the study year’s components. The revenue component \((a_1)\) uses this year’s sales scaled by last year’s total assets, multiplied by an instrument made up of last year’s accounts receivable minus last year’s taxes receivable; this is divided by last year’s sales. Last year’s accounts receivable are not directly related to sales, but they make a good instrument because there is an association between sales and accounts receivable. The expense component is more complex. Expenses are not listed in Compustat and therefore are difficult to estimate. The expense component \((a_2)\) estimates the expenses by using this year’s sales minus operating
income before depreciation, scaled by last year’s total assets multiplied by an instrument made up of the same variable as the original total accrual estimate, except that they are lagged one year. The expense instrument component is as follows: last year’s current assets minus last year’s accounts receivables without any of last year’s tax receivable, minus last year’s cash and last year’s taxes receivable, minus last year’s current liabilities without last year’s taxes payable component, all divided by last year’s sales minus last year’s operating income. The third component \((a_3)\) represents property, plant, and equipment, scaled by last year’s net assets. The instrument consists of last year’s depreciation divided by last year’s property, plant, and equipment. The fourth component \((a_4)\) represents the log value of the firm’s long-term debt, scaled by net assets. The first four components are scaled by each firm’s last year’s total assets. The fifth component \((a_5)\) is a dichotomous variable representing the CEO’s ownership in the firm. To control for the “history” component, \(a_{(6-10)}\) is a dichotomous variable that represents the last year that the CEO had control of the financial statements. The study group’s component \((a_{11})\) is last. This is a dichotomous variable that is coded 1 if the CEO is part of the study group and 0 otherwise.

Model (2) is stated as follows:

\[
\frac{TA_{i,t}}{AT_{i,t-1}} = a_0 + a_1 \left( \frac{SALE_{i,t}}{AT_{i,t-1}} \right) \times \left( \frac{RECT_{i,t-1} - TXR_{i,t-1}}{SALE_{i,t-1}} \right) + a_2 \left( \frac{SALE_{i,t} - OIBDP_{i,t}}{AT_{i,t-1}} \right) \times \left( \frac{ACT_{i,t-1} - (RECT_{i,t-1} - TXR_{i,t-1}) - CHE_{i,t-1} - TXR_{i,t-1} - (LCT_{i,t-1} - TXP_{i,t-1})}{SALE_{i,t-1} - OIBDP_{i,t-1}} \right) + a_3 \left( \frac{PPEGT_{i,t}}{AT_{i,t-1}} \right) \times \left( \frac{DP_{i,t-1}}{PPEGT_{i,t-1}} \right) + a_4 \ln \left( \frac{DLTT_{i,t}}{AT_{i,t-1}} \right) + a_5 \text{Own1}_{i,t} + a_{(6-10)} \text{Year} + a_{11} \text{Study Group}_{i,t} + e_{i,t} \quad \text{(2)}
\]

\(TA_{i,t}\) = Accruals estimated in model (1),
\(AT_{i,t-1}\) = total assets lagged one year \(#A6\),
\(SALE_{i,t}\) = revenues \(#A12\),
\(SALE_{i,t-1}\) = revenue lagged one year \(#A12\),
\(RECT_{i,t-1}\) = accounts receivable lagged one year \(#A2\),
\(TXR_{i,t-1}\) = taxes receivable lagged one year \(#A161\),
OIBDP_{i,t} = operating income (#A13),
OIBDP_{i,t-1} = operating income lagged one year (#A13),
ACT_{i,t-1} = current assets lagged one year (#A4),
CHE_{i,t-1} = cash equivalents lagged one year (#A1),
LCT_{i,t-1} = current liabilities lagged one year (#A5),
TXP_{i,t-1} = taxes payable lagged one year (#A71),
PPEGT_{i,t} = gross property, plant, and equipment (#A7),
PPEGT_{i,t-1} = gross property, plant, and equipment lagged one year (#A7),
DP_{i,t-1} = depreciation and amortization lagged one year (#A14),
DLTT_{i,t} = long-term debt (no #),

Own1pc_{i,t} = indicator variable, one if the CEO owns one percent or more of the firm at the end of the fiscal year prior to departure and zero otherwise,

Year_{i,t} = year variable, indicator variable for the year, one if the year of the total accruals, zero otherwise,

Study Group_{i,t} = one if CEO has left the firm prior to his or her 64 birthday and with less than one quarter notification of intent and zero otherwise.

It is expected that the control variable coefficients $a_1$ and $a_2$, the revenue and expense component (recorded as a positive number), will be positive and significantly correlated with the accruals (Jeter and Shivakumar 1999). The $a_3$, the property, plant, and equipment component is predicted to be negative as the biggest operating accrual related to property, plant, and equipment is depreciation, which reduces total accruals. Coefficient $a_4$, a control variable, is predicted to be positive and significant according to the debt/equity hypothesis (Watts and Zimmerman 1986) that the CEO was motivated to manipulate earnings by debt covenants. For the control variable coefficient $a_5$, Dechow, Sloan, and Sweeney (1995) would expect an inverse relationship between accruals and ownership. Therefore, $a_5$ is predicted to be negative and significant, supporting the Dechow, Sloan, and Sweeney (1995) finding that ownership mitigates earnings manipulation. The $a_{(6–10)}$ year component has no predicted sign. The year variables are
included to control for extraneous effects that occurred during the last year that the CEO controlled the financial statements. Last, $a_{11}$ is predicted to be significantly positive, supporting hypothesis one that the CEOs in the study group do opportunistically manipulate earnings upward prior to departure.

Present accruals should translate into future cash flows (Dechow and Skinner 2000). Healy and Wahlen (1999) state that present earnings predict future cash flows. If the accruals are an accurate reflection of the present earnings, the relationship between accruals and cash flow should be consistent. On the other hand, a reduction in the correlation between accruals and cash flows would result if the accruals are inflated in order to increase earnings. Hypothesis two investigates whether the control group’s cash flows as a whole will be more closely aligned with their accruals than the study group’s accruals.

This model uses the Chow test to measure the difference in the relationship between the accruals and operating cash flows for the control group and the study group. The group with the highest $R^2$ will be considered to have the most closely aligned accruals with future cash flows.

Model (3) is stated as follows:

$$\frac{CFL_{i,t+1}}{TA_{i,t-1}} = a_0 + a_1 \frac{TA_{i,t}}{TA_{i,t-1}} + e_{i,t} \quad (3)$$

$TA_{i,t}$ = value of accruals from model (1),

$AT_{i,t-1}$ = asset total from the beginning of the year (#A6),

$CFL_{i,t+1}$ = value of cash from operating activities for the next year (No #).

Model (3) and the Chow test will be used to determine whether there is a significant difference between the alignment of accruals with future cash flows between the study group and the older retiring CEOs. It is predicted that the Chow test will result in an $F_{(1,40)}$ value greater than 2.84 at alpha = 0.10. While the Chow test is expected to show that the two groups are different, it does not explain which group’s accruals are more closely aligned to their future cash flows. This will be done by comparing the $R^2$ value to determine which group has the most explanatory power. It is predicted that the study group (SSE1, Chow designation) will have the lowest $R^2$.

In addition, a second test of hypothesis two, measuring the relationship between the change in accruals and change in cash flows during the past year, will be conducted using a modified Leuz, Nanda, and Wysocki (2003) model (4).
The same criterion is used for this test, after the Chow test confirms there is a
difference between the groups. The group with the highest $R^2$ will be considered
to have the most closely aligned accruals with future cash flows. Again a Pear-
son correlation coefficient will be used to confirm the results of the Chow test.
Model (4) is stated as follows:

$$\frac{\Delta \text{Cash flows}_{i,t+1}}{\text{Assets}_{i,t-1}} = a_0 + a_1 \frac{\Delta \text{accruals}_{i,t}}{\text{Assets}_{i,t}} + e_{i,t}$$  

(4)

$\Delta \text{Cash flows}_{i,t} = \text{change in operating cash flows during the year, scaled by}
\text{beginning assets}$

(Mnemonic CFL, no #),

$\text{Assets}_{i,t-1} = \text{prior year’s ending assets (#A6)},$

$\Delta \text{accruals}_{i,t} = \text{Change during the year in estimated accruals (model (1)) per}
\text{firm and year}.$

Model (4) tests hypothesis two by running a Chow test on Lenz’s modified
model. It is predicted that the Chow test will result in a $F_{(1,40)}$ value greater than
2.84 at alpha = .10 and the study group is predicted to have the lowest $R^2$.

DATA AND DESCRIPTIVE STATISTICS
The Lexis-Nexis search found 6,064 retirement announcements for CEO and re-
 retir* or resign* between 1996 and 2000, as shown in Table 1. From this number,
 firms were eliminated for: (1) duplicates and non-CEO retirements (4,158), (2)
lack of Compustat data (1,248), (3) lack of three years of positive net income
(339), (4) did not have electronic proxies available (116, including banks and
utilities), (5) duplicate CEO-firm data (five firms) and (6) missing data for the
control variables (21 firms). The remaining data included 177 CEO departures.

The sample of 177 firms was then divided into study and control groups. The
study group of 69 firms had CEOs who were both less than 64 years old and
who left their firm with less than one period (quarter) notification of their intent
to depart. The control group consisted of the remaining CEOs and is made up of
those CEOs who were 64 years old and older and/or CEOs who gave more than
one period notice of intent to leave the firm. The data (Table 1) spans the years
1995–2000. CEOs are considered to have left their firms if one of the following
occurs: they resign from both their position and the board, or they resign their
position but remain on the board until the end of their term.
The groups were compared to determine any statistical differences between them, using a means test (results not tabulated)\textsuperscript{iii}. The means test found that there was no statistical difference between sales, operating income, net income, operating cash-flows, debt, and amount of assets of the two groups. Therefore, it can be assumed that any differences found in the regression models will not be due to differences between the firms.

\begin{table}
\centering
\caption{CEO Data Set}
\begin{tabular}{|c|c|c|c|c|c|}
\hline
\hline
Retirement announcements & 855 & 1,116 & 1,296 & 1,198 & 1,599 & 6,064 \\
Duplicates and non-CEO retirements & -592 & -802 & -885 & -815 & -1,064 & -4,158 \\
Retiring CEOs & 263 & 314 & 411 & 383 & 535 & 1,906 \\
No Compustat data & -184 & -218 & -276 & -204 & -366 & -1,248 \\
Firms with Compustat data & 79 & 96 & 135 & 179 & 169 & 658 \\
Did not have + NI for past 3 years & -47 & -59 & -80 & -110 & -43 & -339 \\
Had Positive Net Income past 3 years & 32 & 37 & 55 & 69 & 126 & 319 \\
Missing proxies, not CEO, regulated* & -13 & -11 & -9 & -21 & -62 & -116 \\
Number in the test group & 19 & 26 & 46 & 48 & 64 & 203 \\
Duplicates firms from different years & -5 & & & & & 198 \\
Missing data for last year in control of financial statements & -21 & & & & & 177 \\
\hline
\end{tabular}
\end{table}

\* Regulated banks and utilities (SIC 4900 & 6000)
Total accruals, scaled by total assets, for each firm are estimated independently using model (1). A means test compared the total accruals of the control group (108 firms) with the total accruals of the study group (69 firms) and a statistical (Z-Score = 2.66) difference is found between the two groups. The results of the means tests revealed that the control group (mean = 0.0933809) consists of firms with statistically higher total accruals than the study group (mean = 0.0284954), while the standard deviation (variance) for both groups is very close. The study group’s lower total accruals seem contrary to expectations as this study hypothesizes that the study group will have the highest total accruals as these CEOs leaving are expected to manipulate accruals upward.

The first test of hypothesis one, that the study group of CEOs leaving the firm will have higher total accruals, uses model (2) to estimate the association between total accruals and the independent variables. The estimated coefficients in model (2) are expected to have the following signs, as one-tail tests: $a_1$ (revenues) and $a_2$ (expenses) will be positive, while $a_3$ (PPE) will be negative (Jeter and Shivakumar 1999). The debt/equity theory variable $a_4$ is expected to be positive (Watts and Zimmerman 1986). The ownership variable $a_5$ is expected to be negative (Dechow, Sloan, and Sweeney 1995). The year variables $a_{(6-10)}$ do not have an expected sign. The study group variable $a_{11}$ is expected to be significantly positive, supporting hypothesis one, that the CEOs in the study group opportunistically manipulate earnings upward prior to departure.

The regression results of model (2) are shown in Table 2. Revenues (REV), expenses (EXP), and property, plant, and equipment (PPE) are all significant and have the predicted sign. Neither the DEBT or the Own1pc are significant and thus fail to support the debt/equity theory or the theory that ownership mitigates earnings management. The 1995 year coefficient was significantly negative with the only inference being that the overall level of accruals in 1995 was less that the overall level of accruals in 2000 for these firms.

In looking at the study group, the negative 1.32 t-value of the coefficient is contradictory to the expected sign. As a one-tail test with the theory anticipating a positive relationship, the negative results are not significant. The study group’s coefficient would have been slightly significant as a one-tail test if the sign had been positive, but with a negative sign the results of this test fail to support hypothesis one.

As a sensitivity check, a second test utilizing a modified Jones model was used, which supported the first test’s results.
## Table 2

### Model (2) Results

\[
TA = a_0 + a_1 \text{REV}_{t} + a_2 \text{EXP}_{t} + a_3 \text{PP&E}_{t} + a_4 \text{Debt}_{t} + a_5 \text{Ownership}_{t} + \sum_{i=6}^{10} a_i \text{Year Variables}_{t} + a_{11} \text{Study Group}_{t} + \text{error}_{t}
\]

| Variable     | Expected Sign | Parameter Estimate | Standard Error | t Value | Pr>|t| |
|--------------|---------------|--------------------|----------------|---------|-------|
| Intercept    |               | 0.01051            | 0.02333        | 0.45    | 0.6529|
| REV          | +             | 0.94761            | 0.05067        | 18.70** | <.0001'|
| EXP          | +             | 0.89088            | 0.03931        | 22.67** | <.0001'|
| PPE          | -             | -0.89812           | 0.18720        | -4.80** | <.0001'|
| DEBT         | +             | 0.00968            | 0.02927        | 0.33    | 0.3707'|
| Own1pc       | -             | 0.00931            | 0.01998        | 0.85    | 0.8012'|
| Y95          |               | -0.04008           | 0.02327        | -1.72*  | 0.0868|
| Y96          |               | -0.01976           | 0.02192        | -0.90   | 0.3689|
| Y97          |               | 0.01882            | 0.01904        | -0.99   | 0.3244|
| Y98          |               | -0.02524           | 0.01854        | -1.36   | 0.1752|
| Y99          |               | -0.02706           | 0.01866        | -1.45   | 0.1489|
| Study Group  | +             | -0.01429           | 0.01078        | -1.32   | 0.9065'|

* ** significant to 0.10 and 0.0001 respectively

> one-tail test

F-value = 74.29

Adj R² = 0.8208

Variables (Compustat mnemonics used when possible):

\[
\text{REV} = \frac{(\text{SALE}_{t}/\text{AT}_{t-1})((\text{RECT}_{t-1}-\text{TXR}_{t-1})/\text{SALE}_{t-1})}{(\text{RECT}_{t-1})/\text{SALE}_{t-1}}
\]

\[
\text{EXP} = \frac{(\text{SALE}_{t}-\text{OIBDP}_{t})/\text{AT}_{t-1})((\text{ACT}_{t-1}-(\text{RECT}_{t-1}-\text{TXR}_{t-1}) - \text{CHE}_{t-1}-\text{TXR}_{t-1}-(\text{LCT}_{t-1}-\text{TXP}_{t-1}))}{(\text{SALE}_{t-1}-\text{OIBDP}_{t-1})}\]

\[
\text{PP&E} = \frac{(\text{PPEGT}_{t}/\text{AT}_{t-1})((\text{DEP}_{t-1})/\text{PPEGT}_{t-1})}{(\text{AT}_{t-1})/\text{PPEGT}_{t-1}}
\]

\[
\text{DEBT} = \frac{(\text{DLTT}_{t}/\text{AT}_{t-1})}{(\text{AT}_{t-1})/\text{PPEGT}_{t-1}}
\]

\[
\text{TA}_{t} = \text{Accruals estimated in model (1)}
\]

\[
\text{AT}_{t-1} = \text{total assets lagged one year} (\#A6)
\]

\[
\text{SALE}_{t} = \text{revenues} (\#A12)
\]

\[
\text{SALE}_{t-1} = \text{revenue lagged one year} (\#A12)
\]

\[
\text{RECT}_{t-1} = \text{accounts receivable lagged one year} (\#A2)
\]

\[
\text{TXR}_{t-1} = \text{taxes receivable lagged one year} (\#A161)
\]

\[
\text{OIBDP}_{t} = \text{operating income} (\#A13)
\]

\[
\text{OIBDP}_{t-1} = \text{operating income lagged one year} (\#A13)
\]

Northwest Missouri State University
Hypothesis two, operating accruals for financially sound firms whose CEOs are taking a non-routine departure will be less aligned with future cash flows than those for CEOs who are taking a routine retirement, is tested using model (3) and model (4). In addition the Pearson correlation coefficient is used to determine the amount of correlation between the total accruals and future cash flows for both the control group and the study group.

The Chow test results from model (3), shown in Table 3, found that there is a significant difference between the control group and the study group. Contrary to expectations, the study group’s higher R² implies that their accruals are more closely aligned to their cash-flows.

The Pearson Correlation Coefficients similarly find that 32.7% of the study group’s accruals are accounted for by the future cash-flows with a lower probability of error (0.0061) than the 25.6% of the control group with a higher probability of error (0.0074). Thus the Pearson Correlation Coefficient supports the results of the Chow test. Neither result supports hypothesis two.

The second test of hypothesis two uses model (4), which compares the change in total accruals during the year with the change in next year’s cash flows. Table 4 shows the results of the Chow test of model (4) and finds that the probability of error is greater than the 10% arbitrary limit set in this study, so there is not a significant difference between the two groups. The Pearson Correlation Coefficient supports the findings of the Chow test. Again the probability of error is greater than the 10% limit. Therefore, due to the insignificance of the two tests,
### Table 3
Results of Model (3)
\[
\frac{\text{CFL}_{i,t+1}}{\text{AT}_{i,t-1}} = a_0 + a_1 \frac{\text{TA}_{i,t}}{\text{AT}_{i,t-1}} + e_{i,t}
\]

<table>
<thead>
<tr>
<th>Chow Test</th>
<th>N</th>
<th>MSE</th>
<th>R-Sq</th>
<th>F-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full Sample</td>
<td>176</td>
<td>2.10343</td>
<td>0.0550</td>
<td>11.25*</td>
</tr>
<tr>
<td>Control Group</td>
<td>107</td>
<td>1.03938</td>
<td>-0.0089</td>
<td>0.05</td>
</tr>
<tr>
<td>Study Group</td>
<td>68</td>
<td>0.95687</td>
<td>0.0936</td>
<td>8.03*</td>
</tr>
</tbody>
</table>

F-score = 9.29  
Probability = 0.0026679  
* Significant to the 10% error level

Pearson Correlation Coefficient  
Control Group Accruals  
Cash-Flow \(+1\) = -0.25642  
Probability = 0.007

Study Group Accruals  
Cash-Flow \(+1\) = -0.32708  
Probability = 0.0061

### Table 4
Results of Model (4)
\[
\text{Change Cash flows}_{i,t+1} = a_0 + a_i \text{Change accruals}_{i,t} + e_{i,t+1}
\]

\[
\text{Assets}_{i,t-1} \rightarrow \text{Assets}_{i,t}
\]

<table>
<thead>
<tr>
<th>Chow Test</th>
<th>N</th>
<th>MSE</th>
<th>R-Sq</th>
<th>F-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full Sample</td>
<td>176</td>
<td>2.21409</td>
<td>0.0074</td>
<td>2.31</td>
</tr>
<tr>
<td>Control Group</td>
<td>107</td>
<td>1.21366</td>
<td>-0.0089</td>
<td>0.05</td>
</tr>
<tr>
<td>Study Group</td>
<td>68</td>
<td>0.9638</td>
<td>0.0227</td>
<td>2.58</td>
</tr>
</tbody>
</table>

F-score = 2.91  
Probability = 0.08981  
None of the F-Values is significant at the 10% error level

Pearson Correlation Coefficient  
Control Group Accruals  
Cash-Flow \(+1\) = 0.02231  
Probability = 0.8187 (greater than 10%)

Study Group Accruals  
Cash-Flow \(+1\) = 0.19261  
Probability = 0.1128 (greater than 10%)
model (4) does not support or fail to support hypothesis two. Model (4) appears to be misspecified.

Because model (2) failed to be significant with the expected sign, further analysis was performed to examine the robustness of the results. A normality plot of residuals supported the normality of errors assumption. The VIF test did not indicate any severe multicollinearity (all VIF less than 3.00).

Robustness tests were conducted on all models using student residuals as the measure for outliers and filtering out any student residuals that exceeded 1.96 standard deviations (Hair et al. 1998), thus eliminating the top and bottom 5% of the residuals. The robustness test of Hypothesis One supported the unanticipated result, while the robustness test of Hypothesis Two indicate that model (4) is misspecified.

**SUMMARY AND CONCLUSION**

This study examines whether CEO from financially sound firms taking an unanticipated, non-routine departure from the firm (study group) manipulate accruals upward in the last year that they have control of the financial statements. In addition, we examine whether accruals for the study group are less aligned with future cash flows than for CEOs taking a routine retirement. The study postulates that Pourciau’s (1993) and Wells’ (2002) findings were driven by the poor performing firms that were included in their studies. Murphy and Zimmerman (1993) indicate that it was poor performance, not CEO turnover, that led to the decrease in accruals. Therefore this study eliminates the poor performing firms and focuses on strong performing firms. This study predicts that the control group, which consists of departing CEOs whose departure is anticipated, would have lower accruals than CEOs in the study group, due to the likelihood that their expected departure would result in being more closely monitored by the firm. As a result of this monitoring, the accruals of the control group would be more closely aligned with future cash flows than those of the study group.

Contrary to expectations, this study found that in the last year that the study group’s CEOs had control of the financial statements there was an unanticipated significant reduction in their total accruals, resulting in a significant decrease in income. In addition, rather than the control group’s accruals being more closely correlated with future cash flows, the study group’s future cash flows were more closely aligned with their current accruals. These results seem counterintuitive.
We offer two alternative hypotheses for future studies, which might account for our unexpected results. First, lower levels of accruals during the last year of the CEO’s tenure could be due to the reversal of earlier earnings management accruals. Second, the unexpected decline in earnings could be the result of a lack of income-increasing accounting choices. The number of accounting choices for increasing earnings is not inexhaustible (Murphy and Zimmerman 1993); there may not have been any more “arrows in the quiver” to maintain positive earnings.

This study has several limitations. First, data restrictions were increased by the limited number of electronically filed SEC proxy reports, in addition to the number of firms that lacked sufficient Compustat information. Second, some of the CEOs in the control group may not have decided to retire until their actual year of departure. And third, some of the study group’s CEOs may not have decided to terminate their association with the firm until their actual departure.

This study contributes to accounting literature in several ways. This is the first study that the authors are aware of that focuses on a group of CEOs from financially strong firms who chose to make an unanticipated, non-routine departure from their firm and provides additional insight into why prior studies may have failed to find their anticipated results. Analysis of departing CEOs from only strong performing firms did not change the unexpected results. This study expands the principal agency theory by including the moral hazard of non-routine departures of CEOs from financially strong firms and also expands the literature on the likelihood of earnings management by this narrowly defined group of CEOs.

**Endnotes**

1. This is not an instrumental variable in the traditional econometric definition. Traditionally an instrumental variable requires time-series data to estimate the instrument. This study uses Thomas and Zhang (2000) model, which defines the instrument as last year’s related accounts. For example, the instrument for the REV (revenue variable) is last year’s accounts receivable minus taxes receivable, all divided by last year’s sales.

2. The variables from Compustat used in the models are the mnemonics from Compustat; the # is the Compustat number. Some mnemonics do not have a number and these are noted. When using Insight to pull data, the use of mnemonics is more convenient than having to look up the Compustat number and translate it to the mnemonic.
3 If the F-statistic is greater than the critical value, this is evidence that the subsample differs from the total group.

4 Model (2) variables are scaled by total assets. Note the substitution of the generality of the independent variables for the separate independent variables. This is done for clarity.
REFERENCES


Leadership Flexibility and Its Relationship to News Media Trauma

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Rebecca Hendrix
Doug Russell
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INTRODUCTION

According to the current ideals in organizational behavior, the next generation of leaders will need “the charm of a debutante, the flexibility of a gymnast, and the quick agility of a cheetah” (Ivancevich, Konopaske, and Matteson 2008, 4). Throughout the world, political and economic climates are changing at a rapid pace, requiring the problem-solving capabilities of “exemplary” business and government leaders (Bennis 2007) who are able to be flexible, making objective decisions based on complex social and situational variables. At the same time, we are seeing rapid changes and innovations in the nature of news transmission (Christian 2006), including the evolution of news networks devoted solely to news coverage and “on demand” news video streaming via the Internet. This next generation of leaders has a wealth of information at their fingertips. The impact of news coverage on leadership behaviors is, however, not without concern, given a strongly established link between media violence, negative emotions, cognitive inflexibility, and problematic personality variables (Bosco and Harvey 2003; Browne and Hamilton-Giachritsis 2005; Danish and Donohue 1996; Heath, Bresolin, and Rinaldi 1998; Kirsh 2006; Spitzer 2005; Villani 2001).

A generation of young adults, dependent upon information from multiple sources, is beginning to assume leadership positions in the larger society. It has been
hypothesized that the individual styles of these emerging leaders develop early in adult life and are influenced by multiple factors, many beyond the control of institutions of higher education (Hartman and Harris 1992). It is important to explore how these changes in the presentation of news affect the personality and leadership style of future leaders (Macbeth 1996; Perez-Lugo 2004). Twenty years ago, McCormack (as cited in Kane-Urrabazo 2006) suggested that flexibility is a highly desirable, and even necessary, trait in leaders who hope to manage businesses effectively. Researchers continue to make the same suggestion in contemporary work (e.g., Zacarro & Klimoski, 2001; Zacarro, 2007). The present study explores the development of individual flexibility of leadership style within the context of the innovations in news transmission.

As long ago as the early 80s, the famous communications expert Weimann (1983) called the news media a “theater of terror” that would facilitate personality change in our society. Psychological theories such as Frommian Automaton Conformity Theory (FACT) (Fromm 1941) and Terror Management Theory (TMT) (Pyszczynski, Greenberg, and Solomon 1999) provide a theoretical foundation for studying these changes in personality and mindset, in relation to perceived social threat. The Frommian theory, articulated in response to World Wars I and II, suggested that individuals would respond to news of threat by seeking “automaton conformity”—an unquestioning conformance to a set of underlying beliefs hallmarked by cognitive inflexibility—in order to feel secure in a threatening world. Similarly, TMT posits that we pursue cognitive constancy and inflexible attitudes when we are reminded of our mortality, and that we are likely to increase our penchant for already established and secure patterns of personal behavior (Jonas, Greenberg, and Frey 2003).

Television media reports of war and terrorism have been found to invoke a tendency toward more rigid nationalistic belief styles referred to as the “rally round the flag” or “blind trust” effect (Baker and Oneal 2001; Roos 2005). Reminders of mortality (e.g., repeated reports of natural disaster or crime) result in the need to align personal beliefs with firmly established social norms learned from past experience (Liebert 1975; Pyszczynski, Greenberg, and Solomon 1999). Correspondingly, decreased openness to new experiences and ideas has been linked to perceptions of threat and imminent death (Routledge 2006). Together, these theoretical positions, with supporting research, suggest that constant consumption of traumatic news may lead to anxiety that provides a strong foundation for inflexible cognitive styles.
The unquestioning conformity, inflexible attitudes, and anxiety suggested by FACT, TMT, and associated research, have a number of implications for leadership and business management. Inflexibility in leadership or management style is viewed as a problem in a number of contexts, while flexibility is perceived as a strength by many mainstream authors and researchers (Bass 1997; Bennis, Spreitzer, and Cummings 2001; Friedman 2006). Zaccaro’s (2007) review of the theoretical literature related to leadership traits concludes that flexibility in leadership is a consistent trait of strong leaders. Other current perspectives of leadership development focus on the context of the leader/follower interaction, emphasizing the need for flexibility of style (Avolio 2007). In analyzing these and other approaches to leadership research and theory, however, Zaccaro and Klimoski (2001) note that “they typically ignore the cognitive, interpersonal, and social richness of this phenomenon, in that they fail to come to grips with processes that would explain or account for outcomes” (Zaccaro and Klimoski 2001, 15), such as flexibility of leadership style.

In order to expand knowledge related to the development of individual leadership style, the current study seeks to explore the possibility of a relationship between news viewing, traumatic responses to news, and flexibility of leadership style. Consistent with FACT and TMT, we predicted that lower levels of flexibility in leadership style, regardless of preferred style, would be demonstrated by individuals who viewed more hours of televised news and reported higher levels of trauma related to that viewing.

METHOD

Participants
A sample of 134 (74 male, 60 female) business majors from a moderate-sized, rural Midwestern university were surveyed. The majority of students were Caucasian ($n = 115, 85.8\%$) with international students ($n = 14, 10.4\%$) and minority students ($n = 5, 3.7\%$) underrepresented, though the sample reflected the population at the university where the data were collected. The sample was made up of 1.5\% freshmen ($n = 2$), 31.3\% sophomores ($n = 42$), 40.3\% juniors ($n = 54$), 23.9\% seniors ($n = 32$), and 2.2\% graduate students ($n = 4$). Participants were raised in small rural areas with few resources and lacking a regular newspaper (28.8\%, $n = 38$), larger rural areas with resources and daily newspapers (22.7\%, $n = 30$), small cities with industry and resources (9.8\%, $n = 13$), medium-sized cities with several centers of industry and sufficient resources (15.2\%, $n = 20$), and large metropolitan cities (23.1\%, $n = 31$). Two participants failed to report geographic area where they were reared.
**Measures**

**Demographic survey.** A demographic survey collected the following information: age, gender, ethnicity, rural or urban background, and year in school.

**Media Survey.** A simple survey developed by Kim (2003) was used as a descriptive measure of amount and type of media used by participants. This survey assessed time spent viewing televised newscasts, asking participants to quantify average days per week and minutes per day that they watched televised news media.

**Trauma Symptoms Inventory.** The Trauma Symptoms Inventory (TSI) (Briere 1995) was used to measure specific indicators of trauma related to media experiences. TSI questions not only assessed the specific indicators of traumatic stress and acute stress, but also those intra- and interpersonal difficulties that have been clinically related to more chronic psychological trauma. Based on frequency of experiences in the last six months, individuals rated each question on a four-point rating scale from 0 (never) to 3 (often).

For purposes of the current study, the TSI was altered with a resultant form containing 90 questions. Questions on the TSI were reworded to more specifically address trauma related to media news reports that could create anxiety or trauma. (e.g., “nightmares and bad dreams” was changed to “nightmares and bad dreams about traumatic news stories, such as terrorism, violent crime, or natural disaster, I have viewed or read”). Self-harm and sexual questions were omitted to deflate the intrusiveness of the scale. An overall trauma score was calculated as a mean of total responses. In its original form, the measure exhibits reasonable convergent, predictive, and incremental validity (Briere 1995). The present study utilized a modified version of the measure and this reformulated version was found to be internally consistent, with an alpha coefficient of 0.84.

**Leader Behavior Analysis II.** The 20-item Leader Behavior Analysis II (LBAII) was administered. The LBAII is a corporate measure of both perceived leadership style from the perspective of the leader and the flexibility of that perceived leadership style. Each item contained a short vignette of a situation requiring the selection of one of four behavioral responses. Participants’ responses categorized their preferred managerial style between two types of managerial behavior—directive and supportive. A directive style involves a top-down approach, where leaders give guidance and direction; whereas a supportive style is a more collegial and bottom-up style, where leaders facilitate the work of
others. These types were dichotomized (high and low) to produce four LBAII styles: a) High Directive/Low Supportive, b) High Directive/High Supportive, c) Low Directive/High Supportive, and d) Low Directive/Low Supportive. After the preferred style was calculated, a subsequent flexibility scale was computed based on the degree of preference for one of the four types across vignettes. Zigarmi, Edeburn, and Blanchard (1997) reported reliability co-efficients from six research studies that ranged from 0.54 to 0.86, with a median value of 0.74.

Procedure
Participants were recruited from a pool of college students who were enrolled in management, accounting, finance, economics, and management information systems courses. Students were given surveys administered by a graduate student research assistant during a scheduled class period, which only volunteers attended, and no compensation was offered for participation. The Media Survey, the TSI Questionnaire, and the LBAII vignettes were presented in alternating order, to control for demand characteristics and possible order effect.

RESULTS
News viewing scores were calculated from data on the Kim (2003) survey, by determining a product score for reported average days of viewing television news multiplied by reported average hours viewed per day. The average student in this sample watched news stories 3.19 (SD = 1.86) days per week and at an average rate of 1.36 (SD = 1.2) hours per day. Trauma scores were calculated by summing individual responses and creating an overall trauma score for each participant. The mean trauma score calculated for the sample was 169.2 (SD = 47.69).

In this sample, news viewing hours increased as trauma increased ($r_{[132]} = 0.59, p < .01$). Also, as news viewing hours and trauma increased, flexibility of leadership decreased at a significant rate ($r_{[132]} = -0.58, p < .01$ and $r_{[132]} = -0.64, p < .01$, respectively).

Demographics for style of preferred leadership indicated slight sample preference for Low Directive/High Supportive style. Table 1 displays the number of participants within each leadership style. The more pronounced a score is on one style of leadership, in comparison to scores on other styles of leadership, the lower a participant scores on flexibility (Blanchard and Buckley 1999). The average leadership flexibility score for this sample was 18.23 (SD = 3.99). The norm for flexibility scores as reported by Blanchard and Buckley (1999) is 14 to
Regression analysis exploring the contributions of three predictors (hometown size, amount of news viewed, and experienced trauma) related to the criterion leadership flexibility was statistically significant \((F[3, 128] = 39.9, p < .001)\). As predicted, an inverse relationship was found between the criterion variables:

<table>
<thead>
<tr>
<th>Variable</th>
<th>n</th>
<th>B</th>
<th>SE B</th>
<th>b</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hours Viewing News</td>
<td></td>
<td>-0.168</td>
<td>0.043</td>
<td>-0.308**</td>
</tr>
<tr>
<td>Trauma</td>
<td></td>
<td>-3.81</td>
<td>0.674</td>
<td>-0.459**</td>
</tr>
<tr>
<td>Hometown Size</td>
<td></td>
<td>-0.027</td>
<td>0.169</td>
<td>-0.009</td>
</tr>
<tr>
<td>Leadership Style</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Directive/Low Supportive</td>
<td>35</td>
<td>-0.767</td>
<td>0.312</td>
<td>-0.207*</td>
</tr>
<tr>
<td>High Directive/High Supportive</td>
<td>43</td>
<td>-0.408</td>
<td>0.442</td>
<td>-0.125</td>
</tr>
<tr>
<td>Low Directive/High Supportive</td>
<td>46</td>
<td>-0.122</td>
<td>0.251</td>
<td>-0.041</td>
</tr>
<tr>
<td>Low Directive/Low Supportive</td>
<td>10</td>
<td>-0.404</td>
<td>0.397</td>
<td>0.312</td>
</tr>
</tbody>
</table>

*p < .05, **p < .01

a) hours of news viewed, b) resulting trauma, and c) the predictor variable: leadership flexibility \((R = 0.69)\). The predictor variables accounted for a high amount of the variance in flexibility of leadership style (48%). Amount of news viewed \((t = -3.86, \beta = -0.308, p < .01)\) and experienced trauma related to news \((t = -5.65, \beta = -0.459 p < .01)\) emerged as significant predictors of an inverse relationship with leadership flexibility. Hometown size, entered as a potential confound to the results, failed to contribute to variance in leadership flexibility \((t = -0.161, \beta = -0.009 p > .05)\). Regression results are reported in Table 1 while simple correlations for these variables are reported in Table 2.

These findings seemed to warrant that we explore simple correlations between preferred leadership style and amount of television viewed and trauma experienced. Interestingly, High Directive/Low Supportive preference was related to higher levels of trauma, \(r(132) = 0.21, p < .05\), and less flexibility, \(r(132) = -0.18, p < .05\); but not to hours watching news. High Directive/High Supportive style was correlated inversely with leadership flexibility, \(r(132) = -0.23, p < \)
.01, as was Low Directive/Low Supportive, $r(132) = -0.22, p < .05$. Finally, Low Directive/High Supportive preference for leadership style was not predictive of flexibility or trauma. However, leaders high on this preferred style were watching less television news, $r(132) = -0.26, p < .001$. (See Table 2 for correlations).

A second regression analysis explored the contribution of each of the four leadership styles to variance in leadership flexibility ($R = 0.31, R^2 = 0.099, p < .01$). Only the preference for High Directive/Low Supportive leadership style appeared to contribute to leadership flexibility predictably, accounting for just 10% of the variance in leadership flexibility ($t = -2.45, \beta = -0.207, p < .05$). All other leadership style predictors failed to contribute to variance in leadership flexibility (refer to Table 1).

**DISCUSSION**

The current results support existing literature by exhibiting a strong positive relationship between amounts of time spent viewing news stories and level of experienced trauma related to traumatic news stories (e.g., terrorism, violent crime, natural disaster). In support of our leadership hypothesis, flexibility of leadership style was inversely related to both hours of news media viewed and resulting trauma. In other words, watching more hours of televised news depicting terrorism, violent crime or natural disaster was related to higher levels of experienced trauma symptoms and lower flexibility in leadership style.

The association between viewing world news reports repeatedly over time and trauma is well established (Browne and Hamilton-Giachritsis 2005; Spitzer

<table>
<thead>
<tr>
<th></th>
<th>Hours Viewing News</th>
<th>Trauma Score</th>
<th>Leadership Flexibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hours Viewing News</td>
<td>–</td>
<td>.598**</td>
<td>-.584**</td>
</tr>
<tr>
<td>Trauma Score</td>
<td>.598**</td>
<td>–</td>
<td>-.646**</td>
</tr>
<tr>
<td>High Directive/Low Supportive</td>
<td>.089</td>
<td>.208*</td>
<td>-.184*</td>
</tr>
<tr>
<td>High Directive/High Supportive</td>
<td>-.084</td>
<td>-.042</td>
<td>-.229**</td>
</tr>
<tr>
<td>Low Directive/High Supportive</td>
<td>-.265**</td>
<td>-.152</td>
<td>-.053</td>
</tr>
<tr>
<td>Low Directive/Low Supportive</td>
<td>-.091</td>
<td>-.024</td>
<td>-.218*</td>
</tr>
</tbody>
</table>

*p < .05, **p < .01, N = 134
However, our investigation suggests that the repetitive nature of traumatic news broadcasts on television and subsequent anxiety may be linked to a less flexible approach to problem solving and supervising others. Though the correlational nature of the current study prohibits directional or causal statements, leadership theories are based on the premise that the nature of leader behaviors, such as flexibility, is contingent upon the social context (Vroom and Jago 2007). The mass media sensationalizes information in a repetitive manner that may provide a context for the development of less flexible leadership styles and more rigid decision-making strategies in future leaders. The current results provide a strong foundation for future study of the effects of information transmission on young adults.

Principles of TMT and FACT indicate that when we are reminded of mortality, we cling to previously established, secure and more rigid and inflexible patterns of thought and behavior. This pattern of anxiety in response to threat has been referred to as “mortality salience” and it moves individuals to seek dissonance reduction by adhering to an inflexible belief system or problem-solving pattern (Friedman and Arndt 2005) and cognitive comfort through conformance with authority and/or becoming an authority figure who demands conformance to norms. The current findings do, indeed, suggest that the anxiety and fear inculcated by hours of televised news may create a need to seek security through conformation to established and secure patterns of behavior (Pyszczynski et al., 1999).

For example, individuals with a High Directive/Low Supportive leadership style are already strong in instructive goals setting, indicating work roles, and giving express guidance to subordinates (Zigarmi, Edeburn, and Blanchard 1997). The participants in our study who had longer hours of news media viewing and greater news media trauma, reported decision-making styles that were less likely to engage employees in interactive communication or to support subordinate decision making. Lavine, Lodge, and Freitas (2005) have suggested that such a directive and authoritarian leadership style is more likely to surface and become pronounced under threat and mortality salience. It is important to note that across all leadership styles, number of hours viewing television and subsequent trauma accounted for a high amount of variance in flexibility, but the effect is especially pronounced in the directive and authoritarian leadership style.

Another interesting finding was that the Low Directive/High Supportive leadership style is actually less likely to predict inflexibility in leadership style and is related to fewer hours spent watching news media. These leaders may be
otherwise engaged as they are more likely to spend time listening to subordinates, soliciting input, and providing nurturance and support to others (Zigarmi, Edeburn, and Blanchard 1997). These leaders place low emphasis on approaches to evaluation and scrutinizing the workplace in terms of established guidelines.

Because of the third variable problem inherent in all exploratory and correlational research, the current study lacks clarity in its ability to identify the causal pathway. It is possible that anxious and inflexible individuals simply watch more televised news and that news viewing is symptomatic of this personality style. Also, the lack of real-life experience in leadership, inherent in a college student sample, may be important to understanding the current findings. Young college students, in the life process of individuation, may react more rigidly to personal threat than more experienced older individuals in established leadership roles. Some research has indicated that more experienced leaders may rely on successful personal experience that predisposes them to flexibility in spite of perceived threat (Smieja, Kalaska, and Adamczyk 2006). It is also possible that the visual media we explored in this study are more likely to result in the difficulties found in the current sample, as has been the case in other studies (DeRoma 2003; Keinan, Sadeh, and Rosen 2003; Knudsen 2003). In addition, a new generation of students may be more likely to receive news from other sources (e.g., Internet). There is little evidence, however, that this venue has replaced television use (Diddi and LaRose 2006). Students seemed to have increased intake of news media overall, adding to concerns about the effects of media consumption.

The current work provides a springboard for further research seeking to understand the complex relationships between personality variables and the media. Researchers are beginning to look at the effects of media trauma on many aspects of real-life human activities (Landau et. al. 2006). The current results are a small step toward understanding the dynamics of leadership development, as it relates to the influx of media influence in our culture.
REFERENCES


INTRODUCTION
The U.S. and global economies are completing the transition between two energy eras: that of the 20th century, characterized by abundant and ever-cheaper supplies of electricity, and that of the 21st century, a period when rapid increases in global demand will result in dramatically higher and more volatile electricity prices, as world markets struggle to deliver the fuel and plants required to expand production (Haines 2004). As the price of fossil fuels rises, availability declines and, for environmental or other reasons, their use is constrained, so there will be a greater need to rely upon alternative sources of electricity. In this article we discuss the economics of alternative electricity sources and provide additional perspectives on issues that must inform an effective 21st century energy policy.

We compare the alternatives most often considered in the debate over how to transition away from carbon-based power in terms of capital costs and “busbar” costs, or the total cost of electricity when it leaves the power plant. (The power plant bus, or busbar, is the point in the plant switchyard beyond the generator but before to the voltage transformation point. Busbar costs measure the cost per kilowatt hour of producing electricity, including the cost of capital, debt service, operation and maintenance, and fuel.) The options we consider include hydroelectric, geothermal, wind, nuclear, and solar power. We include nuclear...
because it is an alternative to fossil fuel, even though it is often overlooked as an alternative electricity option. The existing interconnected transmission grid, built to accommodate conventional power plants and monopoly markets, is not in all cases well suited to accommodate substantial growth in alternative and competitive sources of power. Accordingly, we briefly discuss the implications of those sources for the interconnected grid.

We also consider additional issues that are vital to a successful 21st century energy policy, including reduction of CO2 emissions, disposal of high-level radioactive waste, and the importance of conservation and efficiency programs that include market-determined incentives for consumers and producers of electricity. We conclude that a greater reliance on nuclear power will be an essential component of the transition away from fossil fuels. Along the way, conservation and efficiency initiatives will also contribute to reduced reliance on fossil fuels, with initiatives that pay for themselves having the greatest chance of succeeding.

To provide context for our analysis we first discuss the relation between the demand for electricity and the system of power plants needed to supply that demand.

**OVERVIEW OF ELECTRICITY SUPPLY AND DEMAND**

Reliability is often an underappreciated quality of a power plant system. Anything short of 100% availability of electric power equals failure. Few industries set such high standards, because few other commodities are as crucial to our way of life. Indirectly—and often directly—food, water and shelter depend upon electricity being continuously available. Because there is no practical way to store electricity on a large scale, it must be generated virtually at the moment it is consumed. A utility must proceed with caution, therefore, when considering unproven technology (Haines 2006).

Ideally, a utility’s mix of power plants closely matches the pattern of how its customers’ demand for electricity changes from one hour, day or season to the next. Figure 1 shows the typical summer and winter daily demand for Westar Energy, a Kansas utility. (Westar’s load profiles are typical for Midwestern electric utilities.) The portion of demand that is constant for months at a time is served most efficiently with base-load plants, which operate continuously. The portion of demand that occurs for only a few hours a day is served with intermediate and peak load plants, which are engineered to be started and stopped on short notice. Base plants are typically fueled with coal or uranium. These plants
cost more to build than peak plants, but their operating costs are significantly lower. Peak plants are typically fueled with natural gas or oil (Haines 2006). Combined-cycle natural gas power plants operate at high levels of efficiency and can also be operated as base-load plants, when the cost of natural gas is low enough to be competitive with coal.

Three points are key to our analysis. First, because electricity cannot be stored, a combination of base and peak load plants is required so the supply of electricity remains uninterrupted when demand is peaking. Second, because base-load plants operate on a continuous basis, the economics of these plants is driven by the cost of fuel. The ability to spread their higher capital costs over billions of kilowatt hours (kWh) substantially reduces the per unit capital cost of a coal or nuclear plant. The combination of low per-unit capital costs and low fuel costs results in low-priced electricity. Conversely, because peak plants operate for relatively few hours during the year, it is more important for them to have low capital costs than low fuel costs. Third, the interconnected transmission grid enables utilities to 1) build base-load plants jointly and thereby take full advantage of economies of scale, and 2) enter into sharing agreements to meet peak demand—especially between systems that typically peak at different times. The grid is not always configured to accommodate a substantial expansion of alternative sources of electricity, however, nor to support the competitive wholesale market such sources will require.

**CAPITAL REQUIREMENTS AND BUSBAR COSTS**

We next compare the cost of conventional fossil fuel plants to alternative sources of electricity. Because we are considering options for new investment, we consider capital costs (the investment necessary to design and build a power plant and prepare it for commercial operation) and busbar costs (again, the cost of power at the point it leaves the plant and enters the interconnected grid). Note that although some types of alternative electricity sources (e.g., wind generation) may require substantial additions to the interconnected grid, these costs are not considered in the following analysis.

Combined-cycle natural gas plants have the lowest capital costs of all the options considered. (In such a plant, a gas turbine generates electricity and the waste heat from this cycle is used to make steam to generate additional electricity by a steam turbine in a second cycle, thus increasing efficiency and reducing the cost of electricity, as compared with a single-cycle natural gas plant.) Therefore, when natural gas prices are relatively low, the high efficiency of combined-
cycle plants makes them attractive as base-load plants. For example, with gas costs of 6.7¢/kWh, a base-load plant operating at 90% of capacity would have busbar costs of less than 9¢/kWh—competitive with most alternative technologies. The problem, however, is the volatility of natural gas prices. Between 1994 and 2006, natural gas prices ranged from less than $2/MMBtu to more than $18 in some markets (Mastrangelo 2008). For just the month of October 2008, prices ranged between $7 and $13 (Williams 2008). (Of course, over a short period, such volatility is usually hedged; but over longer periods the price of the hedge is usually prohibitive.) Combined-cycle plants are attractive because they are at least as reliable as and emit less than half the CO2 of conventional coal plants. (Clean coal technology emits 4–10 times less CO2 than combined-cycle natural gas and conventional coal plants, respectively, but the technology is not yet commercially viable. Its prospects were set back in early 2008 when the U.S. Department of Energy, due to projected cost increases, pulled out of the FutureGen Alliance, in which it and coal producers and users aimed to build the world’s first fossil-fueled zero-emissions power plant to begin operation in 2012. The earliest date now considered possible for such technology is 2020.) The remaining alternative options considered below have zero carbon emissions (Western Governors’ Association 2002; Energy and Environmental Economics 2008).

At first consideration, wind turbines might appear to be the best alternative electricity choice. They have the second-lowest capital costs and, because the wind is free, they have the lowest busbar costs. Wind farms can be placed in almost any location where the average wind speed is 10–50 mph. Wind farms also offer an efficient use of land; for example, a wind farm that occupied 12,000
acres would directly use only six acres, thus leaving most of the land available for grazing or other agricultural uses. The major problem with wind as a power source is that wind is unreliable; even in the best locations the wind does not blow all the time. For example, the British Wind Energy Association (BWEA) reports that “An average windfarm with an installed capacity of say 5 MW will produce an output of 13,140 MW hours/year, i.e. 30% of what it would produce if it were operating continually at maximum output” (British Wind Energy Association 2007). Wind turbines, like all power plants, are designed to operate continuously at full capacity, so this does not mean that the average wind farm will operate continuously at 30% of capacity; it means that up to 70% of the time it will not operate at all, simply because the wind is not blowing. The disadvantage of wind’s low rate of production is compounded because there can be no assurance that the wind will blow when the demand for electric power is peaking. In contrast, it is common for a nuclear power plant, during the 18 months between refueling cycles, to operate well over 90% of the time at 100% of its capacity. (In the example immediately above, that would mean an output of at least 39,420 MWH.)

**Hydropower also has relatively low** capital costs, and enjoys a benefit similar to wind—rivers flow as freely as the wind blows. Accordingly, hydropower has low busbar costs. Hydroplants can also be controlled and scheduled to meet peak demand. Hydropower, however, relies on rivers and reservoirs. Most of the attractive sites for it have already been developed, and those that have not remain

![Figure 2: Capital Costs for Various Energy Sources in Dollars Per Kilowatt Per Year](Image)
under the watchful eye of vigorous environmental advocates. Hydropower will not, therefore, play a significant role in reducing the use of fossil fuel to generate electricity (Power-Technology.com 2008; Energy and Environmental Economics, Inc. 2008; Wisconsin Valley Improvement Company 2008).

Solar thermal collection—absorption and concentration of heat from sunlight through an array of specialized collectors, currently the most efficient form of solar power generation, is not unattractive from a capital cost standpoint. Its busbar cost, however, is the third highest of the alternatives explored, less than only nuclear and natural gas. This high busbar cost is mainly due to the limited hours that a solar field can operate. Solar thermal collection depends upon sunshine and, therefore, cannot be reliably scheduled on a power grid, although periods when solar is most likely to generate its peak output often coincide with periods of peak demand for electricity. Solar power also requires a lot of land—it takes 400 acres of collectors to generate 75 MW of capacity (Coker 2007; Energy and Environmental Economics, Inc. 2008). Of course, rooftop deployment of this technology is appealing from an egalitarian point of view, but the loss of scale and the difficulty of dispersed maintenance requirements adds costs.

The capital costs for geothermal sources of electricity are exceeded only by nuclear and clean coal. Geothermal, however, has the second lowest busbar cost
of the alternative electricity options. As with wind, solar and hydropower, geothermal power requires no fuel, but, unlike wind and solar, geothermal is reliable in that it can be scheduled to meet peak demand. Geothermal would be an ideal option, if it were not for two major issues. First, it is only feasible in locations that have pockets of geothermal heat that can be tapped. Second, the geothermal sources that present technology can access are not sufficient to provide more than a fraction of the electric power needs of the U.S. (U.S. Department of Energy 2008, Geothermal Energy Association 2008; Energy and Environmental Economics, Inc. 2008; Shuster 2008).

From both economic and reliability standpoints, nuclear reactors are the most feasible alternative to fossil-fuel plants. Nuclear plants have the highest capital costs of the alternatives considered, other than clean coal. Nuclear power’s busbar costs are also high, but not nearly as high as gas or clean coal. The attributes that make nuclear power the most viable alternative to fossil fuels are its low fuel costs and its ability to generate large volumes of power consistently over a reactor’s lifetime (World Nuclear Association 2008a; World Nuclear Association 2008b; SeekingAlpha.com 2008; Energy and Environmental Economics, Inc. 2008).

Integrated Gasification Combined Cycle (IGCC) coal plants with Carbon Capture and Storage (CCS), otherwise known as “clean coal,” are not economically viable, at least currently. IGCC coal plants have the highest capital costs and second highest busbar costs of all the options considered. Additionally,
IGCC/CCS technology is unproven on a commercial scale. With technological improvements, however, IGCC plants would emit approximately one-tenth the CO2 produced by conventional coal plants (Energy and Environmental Economics, Inc. 2008). If a national energy policy imposes some form of carbon penalty (e.g., through a direct tax or a cap and trade system) on carbon emissions, the costs of conventional coal-fueled power would increase, perhaps to the point that IGCC technology would become attractive—assuming it can be perfected.

BEYOND ECONOMICS: THE POLICY DILEMMA

Alternative sources of electricity will not eliminate the need for new coal or nuclear plants, and any energy policy that does not include such plants will fail. Approximately 50 percent of the current electricity supply in the U.S. comes from coal, and about 20 percent from nuclear plants (Haines 2007). Although many of these plants are wearing out, few new large coal plants have been built, and no new nuclear plant has come on line since the late 1980s. Based on economics and existing technology, state-of-the-art coal and nuclear plants must play a major role in meeting increases in the demand for electricity and in replacing the capacity expected to be lost as existing plants wear out or are shut down for environmental reasons.

To picture the challenge confronting energy policymakers as they attempt to reduce dependence on fossil fuel power plants, consider the following charts from the U.S. Energy Information Administration (Energy Information Administration 2008).1 In the EIA’s reference case (Figure 4), total electricity sales will increase by 29% between 2006 and 2030 (annual growth of 1.1%). In the high growth case, sales increase by 39%. Both these growth rates reflect assumed efficiency gains in electricity-based equipment and appliances.

As Figure 5 shows, the EIA forecasts that coal plants will continue to be the dominant source of electricity generation through 2030. Although natural gas

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1 “EIA’s Annual Energy Outlook (AEO) is a well-known reference that presents projections of energy supply, demand, and prices for the energy sector (not just electricity) over a 25-year horizon. The projections are based on results from the National Energy Modeling System (NEMS) and assume no changes in energy policy, such as enactment of a federal policy that limits carbon emissions. The AEO is a reliable starting point for analyzing the need for new generation capacity because of its high visibility and credibility among policy makers.” “Transforming America’s Power Industry: The Investment Challenge 2010-2030,” Marc W. Chupka, Robert Earle, Peter Fox-Penner, Ryan Hledik, The Edison Foundation, November 2008, p. 1. Reprinted with the permission of the The Edison Foundation. Nonetheless, any analysis at a point in time (including the analysis herein) is vulnerable to the ephemeral nature of prices and markets and forecasts of such.
plants with lower capital costs make up most of the capacity additions early in the period, more coal plants are built in later years as natural gas costs increase. The natural gas share of electricity generation falls from 20% in 2006 to 14% in 2030, while coal’s share increases from 49% to 54%.

As noted above, fuel costs are an important determinant of the cost of electricity. Figure 6 is telling in that it shows no significant increase in the cost of coal- or nuclear-fueled electricity through 2030, while costs of gas- and oil-fueled electricity are expected to rise substantially over the same period.

The evidence presented above underscores the U.S.’s energy-policy dilemma: how to reduce fossil-fuel use and still maintain a reliable supply of reasonably-priced electricity. Our analysis suggests that, based on cost and reliability, nuclear power must play a larger role in future energy policy if the U.S. is to be successful in reducing fossil fuel use. The EIA projections are sobering because they predict an opposite trend—increased dependence on coal plants and reduced dependence on nuclear plants.

**ADDITIONAL FACTORS CRUCIAL TO A SUCCESSFUL ENERGY POLICY**

**Reliability**
The need for electricity is pervasive and continuous. There are virtually no aspects of a first-world 21st century economy and lifestyle that do not depend upon
electricity. It follows, then, that any energy policy that would degrade electricity’s reliability or supply will fail. This explains why some alternative electricity options, such as solar and wind power, can provide only a relatively small piece of our electricity supply, at least with current commercially-viable technology. Many policymakers stress the importance of energy independence. Currently, the U.S. consumes about four times more oil than it produces. If energy independence is to be achieved without compromising the reliability of the electricity supply, the U.S. must make greater use of its domestic supplies of coal and uranium. At the present rate of use, these supplies will last for centuries (Haines 2004).

Global Warming
Whether caused by human activity or natural cycles, rapid climate change is a reality. To ignore that fact would be foolish, and to take the chance that human activity is not a contributor—if not the principal cause—would also be foolish. We have only one planet Earth to inhabit. Any energy policy that does not meaningfully reduce CO2 emissions will fail. Electricity generation is not the only source of CO2 emissions, however. Fossil fuel power plants account for about 41% of CO2 releases in the U.S., while vehicles account for about 33%. Furthermore, CO2 is not the only greenhouse gas. The second most abundant greenhouse gas, methane, has 21 times more heat-trapping capacity than CO2 (Haines 2006). For any emissions-reduction policy to be successful, it will have
to address all the major sources of greenhouse gas emissions, not just fossil-fueled power plants.

Radioactive Waste Disposal
While nuclear power plants emit no greenhouse gases, they do produce high-level radioactive waste, which must be properly disposed of for very long periods of time. Despite its attractiveness from an economic perspective, no renaissance of nuclear power is likely until the political riddle of high-level radioactive waste disposal is resolved. Although the technology exists to safely dispose of radioactive waste, political resistance to development of disposal facilities has significantly slowed the growth of nuclear power. For example, construction of a high-level disposal facility at Yucca Mountain in Nevada has been stalled for years—despite the fact that federal law required the Department of Energy to have a facility in operation by 1998 and more than $28 billion has been collected from consumers of nuclear-generated power to develop such a facility.

Reprocessing (recycling) spent nuclear fuel to harvest its unused energy would greatly reduce the volume of waste needing to be permanently stored, and would significantly increase the supply of nuclear fuel to make electricity. Other countries, including France and Japan, reprocess nuclear fuel. The U.S. stopped reprocessing nuclear fuel in the late 1970s. Opposition to reprocessing is generally based on that fact that one of its by-products is plutonium, which can not only be used to make reactor fuel, but nuclear weapons as well (Haines 2006).

Conservation and Efficiency
When we think of conservation and efficiency, we typically envision the use of energy by end users. In fact, with respect to electric energy, the greatest potential for efficiency gains is in power plants themselves. It is estimated that an increase of only 2% in the efficiency (in terms of Btu’s per kWh) of coal plants would exceed all additional renewable power generation through 2030 (Haines 2006). Policymakers should therefore emphasize programs that increase the efficiency of existing resources, like relicensing nuclear plants to extend their operating lives, repowering coal plants to increase their efficiency, upgrading transmission lines to increase the flow of power and reduce line losses, etc. Policymakers should especially favor market-based programs that enable profit-maximizing individuals and firms to increase the efficient use of energy, as these policies create winners and winners. An industrial user that figures out how to produce

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anything with fewer energy inputs is immediately more competitive, just as a homeowner who figures out how to be comfortable with the house at 64 degrees in the winter and 76 degrees in the summer has more to spend on other things.

Nonetheless, while they are good and proper energy practices to promote, conservation and efficiency are not sources of energy. At the end of the day (literally and figuratively), we need a source of power to turn on the lights—conservation and efficiency can only reduce the amount of electricity required to power the lights. There will always be a need for sources of electricity.

**Jevons Paradox**

Electricity is the cleanest, most efficient and most versatile form of energy known to exist. Increasingly, it is the energy form of choice. Our lives are better because we have substituted electricity use for so many relatively inefficient, dirty and inflexible forms of energy. Improvements in the efficiency with which we 1) extract energy from sources such as coal, oil and gas and uranium, 2) convert this energy to electricity, and 3) use electricity, have led to an overall increase—not a decrease—in the use of electricity. This is known as “Jevons paradox” (also known as the rebound effect)—greater energy efficiency produces energy savings in the short-run, but often results in higher energy use in the long run. First noted by the British economist W. Stanley Jevons in his book *The Coal Question* (1865), Jevons argued that “It is a confusion of ideas to suppose that the economical use of fuel is equivalent to diminished consumption. The very contrary is the truth” (Cleveland 2008).

**Consumers Decide**

Ultimately, the potential for renewable sources of electricity, efficiency improvements and conservation initiatives to reduce the need for new coal plants depends upon the choices of those who use electricity, not the wishes of politicians and regulators or the producers that supply it. To draw a parallel example, even though Americans have access to the most ubiquitous supply of publicly available potable water in the world, they choose to consume large quantities of bottled water, a consumer good with a significant carbon footprint. Effective implementation of alternative electricity sources must be accompanied by consumers’ desire to purchase electricity from alternative sources in the same way that decreasing our reliance on plastic packaging must be accompanied by consumers’ willingness to drink water from the tap.
CAVEATS FOR POLICY MAKERS

The False Hope of New Technology

In considering sources of electricity generation, policymakers must be wary of technology that is still in the research and development and demonstration stage. There is typically a learning curve associated with any new technology, meaning that it almost always costs more and takes longer to implement commercially than its advocates estimate. Additionally, after implementation, new technology almost always takes longer than expected to reach its profitable “sweet spot.” Clean coal technology, discussed earlier, is an example of unproven technology that has created high hopes in some quarters.

Free Riders

Policy makers should be wary of programs that can be gamed by free riders. The release of CO2 and other greenhouse gases as a by-product of industrial, agricultural and other activities is a global phenomenon. Any program that meaningfully reduces greenhouse gas emissions will have the effect, at least over the next five to ten years, of increasing the cost of electricity and vehicle fuel. So, for example, if one area (nation, region, state, or locality) assumes a disproportionate responsibility to reduce CO2 emissions, that area will also see its cost of energy increase disproportionately, perhaps to the extent of rendering its economy uncompetitive—at least for energy-intensive uses. Likewise, those areas that shirk responsibility will not only get whatever benefit accrues from the CO2 reduction, but also will enjoy lower energy prices. Of course, this does not mean that the Midwest should do nothing until global action is underway. It simply means that Midwestern states must be careful not to burden their economies with costs that render them uncompetitive. This consideration should create a bias in favor of programs that have the potential to pay for themselves, similar to the way changing from incandescent bulbs to compact fluorescent bulbs justifies the latter’s higher cost.

Carrots and Sticks

The market is ultimately the most efficient regulator. If government-mandated programs must be relied upon, however, they will almost certainly fail if they do not include incentives to participate. Even then, history shows they often fail. For example, the Public Utility Regulatory Policies Act of 1978 (PURPA) was widely hailed as a new and positive direction in energy policy, but its most salient provisions that required electric utilities to purchase electricity from “non-utility generators” were subject to extreme abuse. They were not repealed.
until the Energy Policy Act of 2005. Joseph T. Kelliher, the Chairman of the Federal Energy Regulatory Commission said this about new FERC rules that gave full effect to the repeal: “These rules should limit the potential for abuse under PURPA, curtail sham transactions, and prevent new PURPA ‘machines’ …. Congress wanted to guard against certification of qualifying facilities whose thermal output was for contrived purposes…” (Federal Energy Regulatory Commission 2006).

**Economies of Scale**

Electric power generation is a capital-intensive industry. In the economics of power plants, size matters. Policymakers should be skeptical of programs that fail to take advantage of economies of scale. Many forms of distributed power generation, including many alternative sources of electricity (other than nuclear) are vulnerable to this concern. In most cases, one large generating station has lower overall costs and less environmental impact than several smaller ones. Furthermore, maintaining high quality maintenance programs, which keep efficiency and reliability at peak levels, is much easier and less costly at a large central station than at several smaller, dispersed stations with the same total capacity. It is also easier and less costly to monitor the performance of large generating stations. The so-called “PURPA machines” that proliferated after 1978 provide an illustrative example. These plants drove up costs, diminished reliability and performed poorly, which underscores another important point regarding conservation and efficiency: the greatest efficiency gains in electricity consumption often occur at the point of production, not at the point of end use. In other words, the most efficient dollars spent are often the ones that improve the productivity of the conversion of resource BTUs into electricity, as opposed to spending on things such as insulation, double-pane windows, etc. (Of course, any efficiency that pays for itself should be pursued.)

**Market-Based Pricing**

Many states have mandated that a certain percentage of the supply of electricity should come from alternative sources of generation by a certain date. For example, a state might require that 10% of electricity come from alternative sources by 2010 and 20% by 2020. (In such laws, nuclear power is not considered an alternative energy source.) Some states have also mandated conservation and efficiency standards. The need to mandate such sources and standards suggests that they might not be economically viable in many cases. We propose that implementing such sources and standards in a long-term sustainable manner
must include a system where the prices of the various solutions are determined by market forces. When programs require a departure from market-based pricing, winners and losers are arbitrarily created. In most human endeavors, the best and longest-lasting alliances are forged as a result of participants’ market incentives. Furthermore, it is unrealistic to expect markets to deliver products or services that no one finds profitable to supply.

**Always Favor Electricity**

Electricity is the cleanest, most efficient source of energy. One of the keys to reducing the growth rate of energy consumption is to increase the substitution of electricity for other forms of energy. Hybrid vehicles are a good example of this, although at their present cost hybrids violate the market pricing guideline discussed above.

**SUMMARY AND CONCLUSIONS**

The U.S. and global economies are completing the transition from the 20th-century era of cheap and abundant energy to the 21st-century era of higher and more volatile energy prices. For the use of fossil fuels to decline, there will have to be greater reliance upon alternative sources of electricity. A comparison of the capital and busbar costs of the major alternative sources of electricity suggests that reducing fossil fuels as a source of electricity in the most economical fashion will require a greater reliance on nuclear power than present U.S. energy forecasts contemplate. Moreover, despite the need to reduce CO2 emissions, no electricity policy that prohibits new coal plants will succeed, because of the increasing importance placed on energy independence and the fact that coal plants provide approximately 50 percent of the current electricity supply in the U.S. To the extent that new nuclear plants are not built to meet increased base-load requirements and to replace aging coal plants, new coal plants will be the only alternative capable of maintaining an adequate supply of electricity at a reasonable price. As alternative technologies to both coal and nuclear plants are proven, it will be possible to reduce reliance on both. Government forecasts currently assume an increase in reliance upon coal plants between now and 2030.

Beyond purely economic issues, a successful 21st-century energy policy must address CO2 emissions and the issue of high-level radioactive waste disposal. Moreover, regulations and conservation programs that do not include market-determined incentives will almost certainly fail. Consumers and producers are
most likely to conserve and adopt alternative electricity sources when their behavior is governed by economic incentives. An energy policy that emphasizes regulatory structures that increase competitiveness, conservation and efficiency initiatives that pay for themselves has the greatest chance of succeeding.
REFERENCES


INTRODUCTION

Despite the mega-wealth of Major League Baseball (MLB) club owners, the historical relationship and communal nature between professional teams and their host cities have enabled many club owners to seek and obtain taxpayer support for the construction of and improvements to sport facilities. As a result, teams supported as the beneficiaries of significant public subsidies would obtain a theoretical advantage over other teams via this cost savings. Research, however, leads us to argue that teams that play in publicly owned ballparks perform no better than teams that play in privately financed stadiums. This study attempts to address the call for additional research on the relationship between sports and other stakeholders, including taxpayers (Senge 2007; Thibault and Harvey 1997), and builds on the work of O’Roark (2001), which found that public financing of baseball stadiums is inimical to producing a winning team. This paper argues that the greater the public subsidy and public ownership stake in the stadium, the poorer the team’s performance.

The higher the public ownership stake in the stadium, the greater the potential license for interference (Von Nordenflycht 2007), because it is only natural for someone with a vested interest in an enterprise to want to exercise ownership prerogatives. For example, clubs that play in public facilities have a tenant/land-
lord relationship with a public authority or control board and must contend with issues arising out of this association. In contrast, clubs that play in their own facilities benefit from the expediency of being their own masters. Tenant/landlord issues arising over the public ownership of the ballpark can detract from maintaining a proper focus on the franchise’s core competencies. Indeed, this is one of the arguments for corporate privatization; that is, privately held companies are less susceptible to government regulation and political interference.

From the beginning, cities adopted an “if you build it, they will come” mindset (Riess 1998), and sport teams came to be associated—and even synonymous—with the cities in which they played, enhancing the cities’ visibility and stature as “major league” cities. As cities with professional sport clubs basked in the limelight of their namesake teams’ fame and celebrity, other cities felt compelled to subsidize, if not completely finance and build, bigger and better stadiums to lure or retain professional sport teams (Sneider 1997). For many municipalities desirous of being regarded as first-tier American cities, laying claim to a professional sport team is an important jewel in their crown (Wisniewski 2000).

Cities have vied to attract and retain Major League Baseball teams since the 1920s (Riess 1998). Notwithstanding robust debates questioning the lasting economic benefits of MLB ballparks to cities, some local and state public officials have fought to obtain taxpayer funds to build and improve sport facilities in the name of economic development and civic pride (Sneider 1997). In the face of growing evidence that questions the economic return on investment, however, public expenditures for such stadiums have slowed (Powell 2006). For example, in Major League Baseball’s history, fewer than ten ballparks have been wholly privately financed, and in the past 45 years only AT&T Park—home of the San Francisco Giants—has enjoyed this distinction (Ingram’s 2005; Hannah 2004; Williamson 1997).

Given that modern ballparks cost hundreds of millions of dollars to build (Diaz 2006), it is exceedingly rare that a club’s ownership would undertake that venture without co-opting local and state taxing authorities (Hull 2005); and, in fact, the vast majority of MLB ballparks are the products of public/private partnerships (Mark, Belkin, and Cortell 1998). While public financing of ballparks is not new, exorbitant price tags have made this form of financing even more controversial (Sneider 1997). Even ballparks that are wholly financed with private funds inevitably require the expenditure of tax dollars for public works infrastructure, site preparation and municipal services, and sometimes the
acquisition of land via the government’s power of condemnation and eminent domain. Another key concession includes tax abatements on revenue generated by facility operations.

Furthermore, many franchises seek taxpayer funding for expensive renovations to existing ballparks and, in some instances, for enhancements to the surrounding neighborhoods as well. For example, as part of its decision to remain in Fenway Park, the Boston Red Sox publicly expressed its desire to see improvements made to the streets and sidewalks around the stadium, as well as parking garages and a new train station nearby (Bailey and Talcott 2005).

While a public policy discussion over the merits of public subsidization of stadium construction and renovation is beyond the scope of this paper, it is helpful to note that municipalities and states, and even the federal government, via infrastructure and transportation grants, have contributed to the development of these great temples for sport veneration for more than a century (Riess 1998). As early as 1869, local politicians organized baseball teams as marketing tools to promote their cities, with the Cincinnati Red Stockings and Chicago White Stockings leading the way. In the early 1920s—the so-called Golden Age of sports—large open-air sport facilities were built in San Diego, Pasadena, Los Angeles, Baltimore, and Chicago to promote tourism (Riess 1998).

Taxpayer subsidies of sport facilities have recently come under increasing scrutiny, and although 100% public funding of professional sport stadiums is rare (Powell 2006), winning final approval of even partial subsidies has become a long, drawn-out process that can span many years (Goodman 2006). In the case of the Minnesota Twins, the campaign to build a new $522 million open-air stadium that will debut in 2010 lasted a decade (Shields 2006).

The popular model for professional-sport-stadium ownership in the United States is a public/private partnership, with construction costs split between public coffers and club ownership (Burke 1997). The nearly dozen new MLB stadiums built since 1998 averaged 60% public financing (Feldmann 2004).

While public subsidization of professional-sport stadiums has been decried as corporate welfare (Kampeas 2001), this economic phenomenon has become virtually institutionalized because of the “love affair” that residents and politicians have with their professional sport teams (Maher 2001). Professional sport teams leverage their scarcity in the marketplace to pry public monies for new stadium construction (Mark, Belkin, and Cortell 1998), because the demand by metro
areas across the country continues to exceed the supply (Rappaport and Wilkerson 2001). Indeed, public subsidization has trended higher, with private ownership on the decline. According to Riess (1998), 30.4 percent of MLB stadiums in 1971 were privately owned, and by 1988, privately controlled baseball parks declined to 20.8 percent. “Today, only five of the 30 MLB ballparks (16.6%) were wholly financed with private funds” (Sports Facility Reports 2008).

While most MLB teams play in facilities that are partly or entirely owned by the public, five ballparks—Fenway Park in Boston, Wrigley Field in Chicago, Dolphin Stadium in Miami, Dodger Stadium in Los Angeles, and AT&T Park in San Francisco—are privately owned. Given the enormous expenditure of public funds on construction of ballparks for professional baseball—for example, the New York Mets’ new stadium, Citi Field, to open in 2009, will cost close to $800 million (Lennon and Lam 2006)—especially in the context of cash-strapped municipal budgets, this paper examines the effect of public/private ownership of MLB stadiums on organizational performance.

Whether it makes economic sense for a city to spend tax dollars on professional-sport facilities has been the subject of lengthy discussions (Rebeggiani 2006; Johnson and Whitehead 2000; Zimmerman 1997) and is beyond the scope of this paper. This paper merely examines the relationship between public financing and organizational performance. This study defines organizational performance by analysis of a team’s winning percentage, market value, and spectator attendance. We examine data on the financing of the 30 MLB clubs’ facilities, and compare the degree of public financing against team performance. Consistent with another study of the effect of private ownership on team performance (O’Roark 2001), this study found that public financing has a significant effect on team performance, albeit negatively. In other words, higher percentages of public financing of clubs’ ballparks are related to lower levels of team performance.

THEORETICAL DEVELOPMENT

While the literature is replete with studies analyzing the relationship between public/private ownership of corporations and performance (Pryke 1982) and efficiencies of the corporate versus partnership form of business (Greenwood and Empson 2003), more recent research has focused on the effect of public ownership on professional service firms. Traditionally, professional service firms have been privately held, being owned and managed exclusively by the professionals within the firm (Von Nordenflycht 2007), although examples of these enterprises emerging as public corporations abound (Greenwood and Empson 2003).
In his study of firms in the advertising industry, Von Nordenflycht (2007) found that public ownership was not necessarily associated with inferior performance, although such public ownership was better suited to larger firms, with smaller public agencies experiencing lower growth rates than comparably sized private agencies. The results of Von Nordenflycht’s study challenged existing theories about the ownership of professional service firms, in which the model of privately held firms was assumed to be optimal, because of the equity incentive available to the professionals who comprise the source of value for the firm and who are the firm’s sole ownership stakeholders (Greenwood et. al. 2005; Dow and Putterman 2000; Roberts and Van den Steen 2000).

Lorsch and Tierney (2002) observed that an ownership stake was a powerful factor in a firm’s ability to retain and motivate its professional service providers, although the key to sustained growth and success was a proper alignment of organizational goals and strategies. On the other hand, the principal argument for “going public” was the potential access to greater avenues of capital (Dow and Putterman 2000; Pagano, Panetta, and Zingales 1998; Ritter and Welch 2002; Gorman and Brannon 2002).

Given these findings, this study was designed to learn whether public ownership in other contexts has a similar effect on organizational performance. The interest in organizational theory as applied to sport led to this study of public/private ownership and organizational performance of MLB clubs. Since every one of the 30 MLB franchises is privately held in either corporate, partnership, or sole ownership business forms, this study looked to the ownership of the ballparks where the clubs play.

Other studies have analyzed the economic return on investment of professional sport facilities (Parlow 2002), but this study sought to determine the effect of public financing of an MLB facility on that team’s organizational performance. O’Roark (2001) studied the relationship between baseball stadiums’ capital structure and professional baseball teams’ success manifested via winning percentage from 1887 to 1997 and found that publicly owned stadiums are an impediment to team performance. This paper affirms the earlier finding and extends the inquiry to an analysis of a franchise’s internal strengths relative to team performance. Table 1 lists the MLB clubs, their respective home baseball stadiums, and the percentage of public financing of the stadiums.

This study theorizes that stadium ownership affects club performance, but not
### Table 1
**Teams, Fields, Funding and Winning Percentage**

<table>
<thead>
<tr>
<th>TEAM</th>
<th>FIELD</th>
<th>% PUBLIC FINANCING</th>
<th>FRANCHISE WINNING %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arizone Diamondbacks</td>
<td>Chase Field (1998)</td>
<td>75</td>
<td>.499</td>
</tr>
<tr>
<td>Atlanta Braves</td>
<td>Turner Field (1996)</td>
<td>100</td>
<td>.499</td>
</tr>
<tr>
<td>Baltimore Orioles</td>
<td>Camden Yards (1992)</td>
<td>96</td>
<td>.477</td>
</tr>
<tr>
<td>Boston Red Sox</td>
<td>Fenway Park (1912)</td>
<td>0</td>
<td>.515</td>
</tr>
<tr>
<td>Chicago Cubs</td>
<td>Wrigley Field (1914)</td>
<td>0</td>
<td>.513</td>
</tr>
<tr>
<td>Cincinnati Reds</td>
<td>Great American Ballpark (2003)</td>
<td>90</td>
<td>.506</td>
</tr>
<tr>
<td>Cincinnati White Sox</td>
<td>U.S. Cellular Field (1991)</td>
<td>100</td>
<td>.506</td>
</tr>
<tr>
<td>Cleveland Indians</td>
<td>Jacobs Field (1994)</td>
<td>82</td>
<td>.511</td>
</tr>
<tr>
<td>Colorado Rockies</td>
<td>Coors Field (1995)</td>
<td>75</td>
<td>.465</td>
</tr>
<tr>
<td>Detroit Tigers</td>
<td>Comerica Park (2000)</td>
<td>45</td>
<td>.506</td>
</tr>
<tr>
<td>Florida Marlins</td>
<td>Dolphins Stadium (1987)</td>
<td>0</td>
<td>.473</td>
</tr>
<tr>
<td>Houston Astros</td>
<td>Minute Maid Park (2000)</td>
<td>68</td>
<td>.500</td>
</tr>
<tr>
<td>Kansas City Royals</td>
<td>Kauffman Stadium (1973)</td>
<td>100</td>
<td>.488</td>
</tr>
<tr>
<td>Los Angeles Angels of Anaheim</td>
<td>Angel Stadium (1966)</td>
<td>100</td>
<td>.491</td>
</tr>
<tr>
<td>Los Angeles Dodgers</td>
<td>Dodger Stadium (1962)</td>
<td>100</td>
<td>.524</td>
</tr>
<tr>
<td>Milwaukee Brewers</td>
<td>Miller Park (2001)</td>
<td>71</td>
<td>.471</td>
</tr>
<tr>
<td>Minnesota Twins</td>
<td>Humphrey Metrodome (1982)</td>
<td>91</td>
<td>.481</td>
</tr>
<tr>
<td>New York Mets</td>
<td>Shea Stadium (1964)</td>
<td>100</td>
<td>.477</td>
</tr>
<tr>
<td>New York Yankees</td>
<td>Yankee Stadium (1923)</td>
<td>21</td>
<td>.567</td>
</tr>
<tr>
<td>Oakland Athletics</td>
<td>McAfee Coliseum (1968)</td>
<td>100</td>
<td>.486</td>
</tr>
<tr>
<td>Pittsburgh Pirates</td>
<td>PNC Park (2001)</td>
<td>85</td>
<td>.507</td>
</tr>
<tr>
<td>St. Louis Cardinals</td>
<td>Busch Stadium (2006)</td>
<td>45</td>
<td>.517</td>
</tr>
<tr>
<td>San Francisco Giants</td>
<td>SBC Park (2000)</td>
<td>0</td>
<td>.539</td>
</tr>
<tr>
<td>Seattle Mariners</td>
<td>Safeco Field (1999)</td>
<td>76</td>
<td>.470</td>
</tr>
<tr>
<td>Tampa Bay Rays</td>
<td>Tropicana Field (1990)</td>
<td>100</td>
<td>.398</td>
</tr>
<tr>
<td>Texas Rangers</td>
<td>Ameriquest Field (1994)</td>
<td>71</td>
<td>.468</td>
</tr>
<tr>
<td>Toronto Blue Jays</td>
<td>Rogers Centre (1989)</td>
<td>n/a</td>
<td>.495</td>
</tr>
<tr>
<td>Washington Nationals</td>
<td>RFK Stadium (1961)</td>
<td>100</td>
<td>.483</td>
</tr>
</tbody>
</table>
because public financing of ballpark construction is tantamount to a subsidy that enables the beneficiary club to marshal its financial assets for incremental performance enhancement. Indeed, public financing represents a considerable cost savings to the franchise ownership. This windfall may relate positively to performance only, however, if team ownership/management is able to exploit this economic condition on a net-gain basis, which is a similar exercise that corporations with realized market gains face in deciding to reinvest profits in the core business versus distributing them as shareholder dividends.

In the case of the MLB, teams that opt to pocket the cost savings attributable to the public subsidy will not fare as well as teams that apply this sum to enhancing performance. Thus, while any windfall resulting from public financing has the capability to be additive, the potential can be realized only if a team is willing and able to invest the amount of the cost savings in performance factors.

One might assume that most sport teams seek to obtain competitive advantages via investment in performance-enhancement factors such as talent acquisition, sport medicine, science and technology, performance incentives, performance analysis, equipment, facilities and logistics, and creation of an environment and culture conducive to achieving optimal performance. Thus, franchises that view their public subsidies as being synergistic to their own capital (that but for the subsidies would have necessitated an outlay of significant club assets), and then apply that cost savings to performance enhancement, are more insulated from the negative effects of public ownership.

That public ownership of ballparks does not relate positively with organizational performance suggests that many MLB franchises do not apply their cost-savings windfall to factors that contribute to performance enhancement or, if they do, they do so in a way that does not maximize the utility of the windfall. In other words, it is important that franchise ownership and management take a strategic approach in performance reinvestment by critically determining those factors that will produce the greatest marginal return on that reinvestment. In the competitive professional sport environment, this is often a complex formula.

For example, while it may seem obvious for a ball club that desires to improve its winning percentage simply to acquire more talented personnel, often there are economic and regulatory restrictions on doing so. Also, given the vagaries of so-called team chemistry, improving team performance cannot be assured by merely obtaining the services of the statistically validated best players and coaches. Rather, club management must carefully evaluate the panoply of performance
factors (e.g., from talent identification and acquisition of best available on- and off-field personnel to social, psychological, economic, and environmental conditions, including an organizational culture that instills and inspires confidence), and craft the right mix for a given team’s situation.

As Ritter and Welch (2002, 1798) noted, “absent cash considerations, most entrepreneurs would rather just run their firms than concern themselves with the complex public market process.” This leads to the first hypothesis:

H1: Levels of public financing are negatively related to team performance. That is, teams with more public financing do not perform as well as teams with less public financing.

A number of factors will affect the degree to which public ownership is related to poorer performance. Arguably the fastest growing universal school of strategy—the resource-based view of the firm—considers internal strengths and resources as the fundamental predictor of performance (Clemens 2006; Clemens and Douglas 2006; Gerrard 2005). As envisioned by Wernerfelt (1984) and developed by Barney (1986, 1991, 2001), the resource-based view argues that firms need key internal resources to attain sustained competitive advantages. Therefore, this paper investigates the effect of internal strengths on the relationship between public financing and performance. This investigation follows the trail blazed by Stinson and Howard (2007), who investigated the moderating effect of academic reputation (an internal strength) on the relationship between institutional giving (public support) and athletic success (performance). This paper argues that better endowed franchises will benefit less than poorly endowed franchises from public financing.

This study theorizes that an MLB club’s internal strengths and resources (such as a winning tradition, high-performance personnel, culture of success, strong profit margins, etc.) intensify the negative relationship between public financing and team performance, because clubs with high organizational effectiveness tend to have strong-willed owners and front-office managers who need to exercise absolute power and control. These compulsions only increase the potential for friction in dealings with external parties, especially over fundamental matters such as tenant/landlord issues (Hynes and Roever 2005). In other words, stronger teams are more negatively affected by public ownership of their ballparks than teams with heightened internal weaknesses.

Receiving public support, then, is a performance impediment to a strong and
well-endowed club’s otherwise high operational efficiencies, because of the significant influence wielded by this outside stakeholder. Politicians who approve the public funding and taxpayers who foot the bill for professional-sport stadiums feel entitled to influence decisions affecting their home team, regardless of whether it concerns facility-only issues. For the same reason that some organizations abhor government intervention as unwelcome scrutiny and hence are wary of accepting public funding, the stronger MLB clubs are loathe to tolerate what they view as meddling on the part of stadium authorities or control boards in internal organizational affairs, even as they accept hundreds of millions of dollars in public subsidies.

Clubs with deep ownership wealth and strong revenue streams are financially more capable of building their own stadiums and thus are less dependent on public coffers. If, indeed, higher percentages of public financing of MLB stadiums relates to lower team performance, this paper theorizes that greater dependency on public funding is detrimental to franchise performance because it opens the door to myriad distractions and interventions from a non-franchise stakeholder (Clemens and Douglas 2006). Less-endowed clubs may need the public support, but it can hurt a strong franchise.

As noted earlier, this paper theorizes that public financing of stadiums does not have a salutary effect on team performance, as measured by winning percentage, market value, and spectator attendance, because public investment implies the existence of public actors who create at least the potential for interference in organizational matters. Franchise market value and a club’s winning percentage are leading indicators of organizational performance, but this study also included fan attendance as a third measure, because a franchise’s ability to market its product by increasing ticket sales and generating higher game attendance is a legitimate gauge of organizational performance. It remains to be seen if our theory holds true in the case of the New York Yankees; a private ownership group is largely financing the $1.3 billion cost—albeit not without significant public subsidies—of the new Yankee Stadium that is scheduled to open in April 2009.

Stronger franchises can be more affected by such interference for at least two additional reasons. First, stronger franchises would be able to exist more easily without the external support. Second, stronger franchises already have rare and effective strategies and need flexibility to continue to thrive (Barney 1986; Clemens 2006). Adding a public partner can render the strategy less rare and more imitable by other clubs.
In summary, this paper offers that internal strengths will positively moderate the negative relationship between public ownership and performance. Franchises with a healthy balance sheet, deep talent pool, unyielding ownership commitment, strong management, staunch fan base, and other internal strengths may be more affected by public ownership. This leads to the second hypothesis:
H2: Internal strengths will negatively moderate the relationship between public financing and team performance. That is, the negative relationship between public financing and performance will be stronger (more negative) for better-endowed franchises.

Figure 1 provides a summary of the theoretical constructs. Figure 2 portrays the second hypothesis.

METHODS

Variables and Measures

Performance. The Sport Management field has long been interested in attendance and has used it as a measure for long-term viability of sports franchises (Yokum, Gonzalez, and Badgett 2006). Researchers have also studied the relationship between attendance and winning percentages (DeSchriver and Jensen 2002). Researchers have used the value of a franchise as an important determinant of performance (Gladden, Irwin, and Sutton 2001). This study measured performance as the mean of attendance (Cebula et al. 1997; Nourayi 2006; Society of Baseball Research 2007), team value (Forbes 2007), and winning percentage (Nourayi 2006). The Cronbach’s alpha was .86.

Internal Strengths. This study measured internal strengths as the mean of franchise age (McEvoy et. al. 2005) and payroll (Frick, Prinz, and Winkelmann 2003). We included franchise age because previous research has shown that there is a statistically significant relationship between the age of MLB parks and spectator attendance (McEvoy et. al. 2005). The Cronbach’s alpha was .86.

Public Financing. We measured this as the percentage of public financing for the teams’ stadiums (Society of Baseball Research 2007).

Controls. Bradbury (2007) documented the importance of the size of the market to MLB clubs. Thus, this study controlled for the population within the local standard metropolitan statistical area (SMSA).

Results

Table 2 provides the descriptive statistics and the correlation matrix for all variables. Table 3 shows the results of the hierarchical regressions.

The data were normally distributed and multicollinearity was not a problem. Table 2 supports Hypothesis #1 by showing that public financing was negatively
Table 2
Descriptive Statistics and Correlations¹
(Cronbach’s alphas in parentheses)

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>Cronbach’s Alpha</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Performance</td>
<td>10*10³</td>
<td>3.2*10³</td>
<td>(.86)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. SMSA Population</td>
<td>5.7*10⁶</td>
<td>4.7*10⁶</td>
<td>.71*</td>
<td>N/A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Public Financing</td>
<td>2.4*10⁹</td>
<td>2.0*10⁹</td>
<td>-.52*</td>
<td>-.18</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>4. Internal Strength</td>
<td>39*10⁶</td>
<td>17*10⁶</td>
<td>.74*</td>
<td>.71*</td>
<td>-.17 (.86)</td>
<td></td>
</tr>
</tbody>
</table>

**Correlation is significant at the 0.01 level (2-tailed)
*pCorrelation is significant at the 0.05 level (2-tailed).
N = 30

¹Pearson’s correlation coefficients

Table 3
Results of the Hierarchical Regressions—Centered Variables²

<table>
<thead>
<tr>
<th></th>
<th>Standardized beta coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Model 1</td>
</tr>
<tr>
<td>Control</td>
<td></td>
</tr>
<tr>
<td>SMSA Population</td>
<td>.32*</td>
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<tr>
<td>Direct Effects:</td>
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<td>Public Financing</td>
<td>-.38***</td>
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<td>Internal Strength</td>
<td>.45**</td>
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<td>Indirect Effects:</td>
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<td>Public Financing * Internal Strength</td>
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<tr>
<td>Change in R²</td>
<td>.03+</td>
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<tr>
<td>Adjusted R²</td>
<td>.76***</td>
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Dependent Variable: Franchise performance—one-tailed tests N=30
+p < .10, *p < .05, **p < .01, ***p < .001

²(Aiken and West 1991)

related to team performance (p=.001). The negative sign in the standardized regression coefficient (Beta = –.38) indicates a negative relationship, as hypothesized. That is, higher levels of public financing are related to lower levels of performance. Table 2 also supports Hypothesis #2; that is, measures of internal organizational strength weaken the relationship between public financing and
performance (Beta = -.54; p=.06). The change in the R-squared is also significant (p=.06).

**Limitations**

**Generalizability.** The context of this study is novel, which lends interest, but it is also a bit restrictive. The potential for generalizability depends to a large extent upon how one views idiosyncrasies associated with this particular context of public financing, performance, and internal strengths. The results are consistent with the findings for advertising agencies, especially in larger firms (Von Nordenflycht 2007); thus, they do not seem to be completely idiosyncratic.

Nourayi (2006) identified generalizability concerns regarding his study of the National Basketball Association franchises. The author cautioned about extrapolating results from one professional sport to another. Major League Baseball enjoys a unique antitrust exemption (Bradbury 2007). As such, the league exhibits some similarities to an oligopoly. Arguably, researchers should exercise caution in attempting to generalize the results of this study.

One way to enhance external validity is deliberate sampling for heterogeneity (Cook and Campbell 1979). This study investigated two disparate groups of Major League clubs—those from the National and American leagues. The control variable that identified this difference was not significant (p=.25).

**Causality.** This study did not address causality. Even though the conclusions indicate a negative relationship between public ownership and performance, one cannot conclude that the public ownership causes decreased performance. One can legitimately argue that the slack generated in good performance will provide the ability to invest in the club. Further, success can also facilitate fundraising. Humphreys and Mondello (2007) found that postseason success in intercollegiate basketball tournaments was associated with increases in contributions to private institutions. Additional longitudinal studies—always a rich field for further research—and studies to control for other potential factors could help address this limitation.

**Mono-method Bias.** Empirical studies run the risk of mono-method bias. One test of mono-method bias is the Harman one-factor test (Podsakoff and Organ 1986). In the Harman test, all of the items describing each variable are entered into a factor analysis. Subsequently, the researcher examines the unrotated factor solution. If a substantial amount of mono-method variance is present, either a
single factor will emerge or one general factor will account for the majority of the covariance between the independent and dependent variables. In this sample, the Harman test generated eight factors explaining 99 percent of the variance. The first factor explained 50 percent of the variance. Thus, the results of the Harman one-factor test assuage some concerns of mono-method bias.

**Measurement of Financial and Team Performance for Private Firms.**
Jacobson (1987) identified the difficulties in measuring performance for large, publicly traded firms due to the multidimensional nature of performance. Typical measures for financial performance include market-based measures (including market return, price/earning ratios, and market value/book value), accounting-based measures (including return on assets, return on equity, and earnings per share), measures of risk (including current ratio, quick ratio, debt/equity ratio, interest coverage, Altman’s Z-score, and market beta), and other firm-specific characteristics (including capital investment intensity, size, number of business lines, and dividend payout ratios). Measures related to stock are not available for private firms and not appropriate for the sole-proprietorships typical in Major League Baseball. Accounting-based measures are confidential for private firms.

Arguably, difficulties in measuring team performance dwarf the attempts to measure financial performance. Team performance is even more multidimensional than financial performance as it encompasses fan support, stakeholder issues, and the team’s effect on the local economy. This study attempted to measure team performance comprehensively, including estimates of fan attendance, team value, and winning percentage. Further studies measuring team performance could help determine construct validity.

**CONCLUSIONS**
Given the exorbitant cost of stadium construction, renovation, and maintenance, it is hardly surprising that the vast majority of MLB ballparks are either wholly or partly owned by public authorities. While it seems logical that MLB clubs that play in publicly subsidized baseball stadiums realize an economic benefit not available to clubs that play in privately owned facilities, this cost savings does not translate into any kind of competitive advantage in terms of team performance. In fact, this study found that the greater the public subsidy, the poorer a team’s performance. This paper theorizes that clubs that play in public facilities have not been successful in capitalizing on the full potential of the economic benefit conferred by the public subsidy, while teams that play in private
ballparks are not subject to interference into organization management and other distractions to team performance as a result of having a public landlord or lessor.

This paper’s findings validate a previous study’s conclusion that MLB teams that play in publicly funded stadiums do not have a competitive advantage over clubs that play in those that are privately owned (O’Roark 2001), which should give pause to franchises that seek to have municipal or state authorities build or renovate ballparks for their tenancy.

This paper also found that MLB teams with greater internal strengths will benefit less from a publicly financed facility than would a poorly endowed franchise. This is because well-run organizations with strong-willed leadership have a greater propensity to become embroiled in a multitude of issues affecting the franchise’s tenancy, which is further compounded by the public authority’s inclination to scrutinize the expenditure of taxpayer monies closely, ostensibly for the private purposes of the resident ball club. That is, successful and well-run franchises should look beyond public financing of stadiums and consider creative alternatives.

Future researchers may wish to extend this paper’s findings by attempting to draw a causal link between public financing and performance, including a study of changes in financial terms attributable to franchise migration to new stadiums or renovation of existing ballparks.
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INTRODUCTION
The Hudson Institute predicted in its landmark study in 1987 that the U.S. workforce would become more and more diverse (Johnston 1987). This trend was confirmed in a report released by the U.S. Department of Labor in 1999:

“By 2050, the U.S. population is expected to increase by 50% and minority groups will make up nearly half of the population. Immigration will account for almost two-thirds of the nation’s population growth. The population of older Americans is expected to more than double. One quarter of all Americans will be of Hispanic origin. Almost one in 10 Americans will be of Asian or Pacific Islander descent. And more women and people with disabilities will be on the job” (1999, 2).

In response, businesses began examining their roles in managing these new human resources. Diversity training became the latest “buzz phrase,” thousands of articles with advice on handling this new workforce were published, and diversity consulting developed into a lucrative industry (Robinson, Reithel, and Franklin 2001). Currently, businesses spend over $200 million a year on diversity training (Vedantam 2008). At the same time, grievances and lawsuits based on employment discrimination have also increased and “in some cases, diversity training appears to heighten differences and tensions among groups” (Roberson, Kulik, and Pepper 2003).
Traditional training approaches have concentrated on the legal issues of diversity by using “sensitivity training” as a way to reduce discrimination against protected group members as identified by equal employment opportunity (EEO) laws. The Supreme Court has held that companies can avoid punitive damages in employment discrimination lawsuits if they have made “good faith efforts,” such as disseminating antidiscrimination policies and providing training programs on diversity (Kolstad v. American Dental Association 1999).

The mere presence of policies and training programs, however, may not be enough, because they don’t get to the reasons why we find diversity problematic and how we should address these core concerns. Failure to change long-time attitudes and processes while espousing acceptance of diversity has been noted, even by the courts. For example, in Lowery v. Circuit City Stores, Inc. (2000), the court doubted the company’s sincerity about nondiscrimination, because the actions of the managers in the company did not reflect the policies and training in place.

In fact, diversity initiatives can actually backfire. A recent study that reviewed 31 years of data from U.S. workplaces found that much of the diversity training being conducted is “ineffective and even counterproductive” (Vedantam 2008, A03). Research also shows that diversity training has “little to no effect on the racial and gender mix of a company’s top ranks” (Cullen 2007, 1). In some cases, the training itself has led to lawsuits based on how employees were treated during the training sessions.

There is a need, therefore, to consider diversity carefully, as a complex concern, rather than as a simple problem that can be addressed and solved with a few hours of “training.” The challenges and promises of diversity include learning how to deal with uncertainty and its accompanying uncomfortable feelings, as well as how to find common ground with those perceived as different. Diversity involves more than counting members of protected classes in order to comply with EEO and affirmative-action regulations. According to Roosevelt Thomas, the reason “to move beyond affirmative action to managing diversity is because affirmative action fails to deal with the root causes of prejudices and inequality and does little to develop the full potential of every man and woman in the company” (1990, 117).

The authors of this paper propose a theoretical approach to help managers and employees understand that anxiety in dealing with others who appear different originates in shortcomings found in language itself. By training managers and
employees on how our language has led to misunderstandings about diversity and by using storytelling as a tool to help us understand both the differences and similarities we all have, we can take the first step to working effectively with a wide range of employees and customers.

AFFECTIVE RESPONSES AND DIVERSITY TRAINING
As mentioned earlier, while the desired end result of diversity training programs may be to build common understanding and acceptance among organizational members, these may actually end up have the opposite effect. Focusing only on differences can reinforce isolation and alienation between groups. On the other hand, proclaiming that “we are all really the same” ignores and demeans legitimate differences and perceptions. Recognizing the affective (or emotional) responses people have when encountering others perceived as different is crucial to good interpersonal relations (Stangor, Sullivan, and Ford 1991). Understanding the source of such discomfort when interacting with others of a different culture, race, religion, sexual orientation or who may have physical or mental disabilities is crucial to effective diversity training. Typical affective responses to diversity have included fear, anxiety, frustration, and the desire to be accepted by others (Jackson, Stone, and Alvarez 1992).

According to Monteith and Winters, fear of others who seem strange to us “comes out when we are under stress. That fear, known as xenophobia, seems almost hardwired into the human psyche” (2002, 44). They go on to say that we have a “drive to completely and quickly divide the world into ‘us’ and ‘them’” (46), in other words, into categories. These categories, or stereotypes, allow us

“to manage complex realities…, store new information, quickly identify things, handle multisensory experiences, and make sense of things…[the problem is] we sometimes attach strong emotions to these stereotypes, even when they’re false, and we often use stereotypes to justify our dislike of someone” (Carr-Ruffino 2006, 88).

This then sets up “the framework for prejudice toward an entire group of people” (89), which can cause destructive conflict “and often denigrates into personal attacks and animosity that may never go away” leading to “negative effects on team satisfaction and commitment” (Carson, Mosley, and Boyar 2004, 123).

The uncertainty and affective responses generated by taking people out of their comfort zones during diversity training can “upset many people, who then
actively resist change” (Vedantam 2008, A03). “When you try to persuade someone about something, the other person’s natural reaction is to raise barriers against being persuaded” (Barnett 2007, 121). In fact, it is a “cruel irony for some employers that have provided harassment or discrimination prevention training [in order to protect themselves from litigation] that the training itself, or the conduct of participants during the training, has sometimes been used as evidence against the employer in a subsequent lawsuit” (Johnson 2004, 128). For example, in one lawsuit a company ended up paying $107 million, because of a sensitivity-training program that encouraged their managers to voice their own and society’s prejudices and stereotypes. The comments made by the managers were then determined to be proof of discriminatory intent when employees in the training sessions complained (Stender v. Lucky Stores, Inc. 1992). In another case, a female employee claimed her boss harassed her based on her gender and sexual orientation by making inappropriate comments and jokes during a harassment training session (Caggiano v. Fontoura 2002). In Hartman v. Pena, the Federal Aviation Administration was sued after it was determined that their three-day diversity-training program scapegoated white males (Bader 2007). A judge for the Tenth Circuit Court of Appeals noted in yet another lawsuit alleging inappropriate behavior during diversity training, that “diversity training sessions generate conflict and emotion” and that “diversity training is perhaps a tyranny of virtue” (Bader 2007).

Thus, diversity training needs to go beyond the traditional approach of sensitizing us to others with different external physical characteristics, to considering why we are uncomfortable with others different from ourselves. Diversity management requires understanding the emotional effects of misunderstandings, based on different assumptions about others and ourselves, which often lead to conflict (Smircich and Morgan 1982). The next section briefly explores how language has the potential to provide understanding but many times leads to misunderstanding and divisiveness.

**LANGUAGE, CATEGORIES, AND DIVERSITY**

In many ways, “the reality within an organization may be shaped by its language” (Morgan, Frost, and Pondy 1983, 10). We interpret each other’s words and actions in order to gauge how to proceed. Language is not neutral, however; it needs to be held in common with the people we are talking with or it can’t work—it won’t be meaningful. Similarly, words get meaning through their relationships with other words, such as their placement in a sentence. Words, and
those things we try to represent with words, get their value through the ways that they differ from other words or things. “What characterizes each most exactly is being whatever the others are not” (Saussure 1966, 117). All value, therefore, needs differences as well as similarities. For example, to determine what a dollar is worth, you need to know what it can buy (how it is equal to something different) and its relative value in the currency system (how it is different from similar bills, the ten-dollar bill or the five-euro bill, for instance). Meaning results from signification (the connection to other members of the system) and value (the differences from them).

Based on Saussure’s insights into language, Claude Lévi-Strauss (1963) pointed out that not only language, but also culture is built on binary oppositions. We know what something is by contrasting it to what it is not: black is “not white,” for instance. As noted below, language categories allow for either black or white but not both black and white.

Having clear categories of mutually exclusive items is the basis for modern bureaucracies, with their emphasis on formal divisions of departments, duties, and personnel, and the forms that depend on and support such differences. In a diversity context, one example is the Equal Employment Opportunity Commission’s (EEOC) applicant flow data form, on which the job applicants indicate race and gender by checking one box for each category. Problems have arisen, however, when an applicant does not clearly fit into just one box. Which should an applicant check if she has an Asian father and a Hispanic mother? Which box should a transgendered applicant check if currently undergoing hormone treatment and surgery to change from male to female?

**Sample EEO form**

- [ ] White
- [ ] Hispanic
- [ ] American Indian/Alaskan Native
- [ ] Black/African-American
- [ ] Asian
- [ ] Native Hawaiian/Pacific Islander
- [ ] Male
- [ ] Female

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In other words, the applicants might occupy a gray area between the clear categories. Because differences are needed for meaning and value, the gray areas can feel threatening. During times of change or transformation in ourselves or in organizations, we go through the gray area of being neither here nor there. We don’t have the old ways of being and doing and the new ways are not yet established (Lewin 1947). Categories provide a sense of meaning, and the safety that comes from knowing what something is. Changing the meaning of something, including our jobs or identities, is threatening because it threatens our categories.

Another way in which our categories may fail us, and thus lead to feelings of uncertainty and insecurity, is when we face an anomaly. An anomaly is something that doesn’t clearly fit in a ready-made category. When things are in place, we know what they are and we can name them, so we feel safe. When they don’t, the anomaly can lead to the unpleasant experience of uncertainty. Anthropologist Mary Douglas noted, “Dirt is matter out of place” (2002, 35) to illustrate how something changes in our perspective depending on whether it is inside or outside our categories, or what we expect. Outside, the soil is good; once it enters our home, it is a threat to our health and expectations of what belongs.

Diversity has the potential to threaten our categories, so it is experienced as threatening to our well-being in three ways. First, diversity is often described as a symptom or an outcome of radical changes in society and the workplace. Because change undermines security, resistance to it has led to an emphasis on “training” or “diversity management” in the past two decades. Second, cultural diversity means that the distinctions that are important to us are often not even apparent to those from different backgrounds, and vice versa. This kind of diversity comes from the differences in perceptions between those with different training and experiences, such as differences between labor and management, or between marketers and engineers, and among different nationalities and religions. When the categories that are important to us are not shared, words may fail and we are uncomfortable. Third, when individuals from other demographic groups enter places that had traditionally been “off limits,” they may be experienced as out-of-place. This is what happens in many occupational sexism cases. Women are discriminated against when they take jobs in occupations that have traditionally been held by men, thus being seen as working “out of their category.” For example, in the Supreme Court case, Pollard v. E.I. du Pont de Nemours, a male co-worker of Pollard left a Bible on her desk open to the section that said, “I do not permit a woman to teach or have authority over man.
She must be silent.” Other male colleagues referred to her using gendered slurs, sabotaged her work projects, and criticized her in an email for participating in “Take Your Daughter to Work Day” (Grossman 2001).

The next section looks at how diversity thinking itself can provide clues to effective diversity training and management.

SIGNIFICATION AND DIVERSITY
An important contribution to loosening our categories and inviting contradictions is that the traditional either/or thinking of categories does not align well with the open-systems interactions that characterize modern organizations. Argyris and Schon (1996) describe the interplay and differences among organizational systems as a ladder of aggregation that proceeds from individuals to small groups, to departments made up of many small groups, to divisions that are clusters of departments, to the organization as a whole, to the larger field in which the organization interacts with other organizations. These organizational layers exist not only as abstractions but as living entities, each of which may be described as having interests, intentions, values, and theories-in-use of their own.

Similarly, Katz and Kahn (1978) identified both differentiation and integration as characteristics of systems. Therefore, the ability to see things as both separate and unified in a greater whole is crucial. Either/or thinking, in which the primary identity of anything is its distinction and separation from something else, focuses on divisions rather than collaborations (Ford and Ford 1994). Both/and thinking admits both differences and similarities. A focus on differences through identification and elaboration of categories is important for organizational functioning.

What would it take, therefore, to have systems that are able to balance this central challenge of identity, being both/and—having sufficient boundary-coding rules for integrity of the system (Katz and Kahn 1978) while remaining sufficiently open to others? In systems thinking, this is a question of being able to be both an integral system and a functional, contributing subsystem within the larger systems on which identity, even life, depends. Put another way, how can the unique meanings (rules, values, norms, roles, goals, boundaries) of different individuals and groups interact across the boundaries, to create the shared meaning that allows for coordinated action?
Saussure’s (1966) description of language is based on the relationships and inter-relationships between sameness and difference. As noted above, in the system of language, any word or concept gets its meaning in relationships—in similarities with items and concepts that are different, and in differences between similar items and concepts. Relationships require diversity, and diversity gives value to relationships. What is needed is a way to use language that captures the paradox that meaning comes from similarities and differences. Duck (1994) recommended that we imagine alternatives to the assumption that differences threaten social systems, and instead look for ways to think about how differences support meaning and meaningful relationships.

So where does this leave us? We have two imperatives, or things we need to do, that contradict: We need BOTH to understand and preserve the distinctions AND to cross the line to foster change, creativity, and relationships. This isn’t an impossible task, but it requires the willingness to be creative by looking for value in anomalies, redefining them as opportunities for a competitive advantage through their value, rareness, inimitability, and social/relational complexity “like reputation, trust, friendship, teamwork, and culture” (Barney 1999, 134). Flexibility with language is key to relationships and to novel products, both of which support business success (Nootebom 1992).

**HOW DOES THIS FIT INTO DIVERSITY TRAINING?**

The relationship of language and categories to diversity has important implications for diversity management. First, diversity-training tactics that emphasize the need to adapt to change may end up reinforcing and even accelerating people’s natural resistance to change. Second, training that focuses only on our similarities, that says that “we are all the same essentially,” ignores the very real differences in perception, training, culture, and values among individuals and groups that underlie inevitable misunderstandings. Also, when we say “we are all the same,” we tend to mean that “we are all the same as I am” and so our comment is likely to be received with doubt, if not outright cynicism. Third, emphasizing differences risks hardening the categories that created the divisions to start with and so heightening preferences for one’s own kind (Tajfel and Turner 1979). If language and categories are necessary for communication and meaning, but if at the same time they create diversity, how can organizations begin to imagine a way to support diversity—given that language is all we have?

The ideal diversity training program requires an intentional process in which the participants can see the limitations of their current values, paradigms, and mind
sets. This takes place when we disengage ourselves and examine our processes of interpreting the assumptions we have of others. This kind of learning provides new tools or possibilities and these tools “can facilitate changes in points of view and habits of mind. The importance of language, and especially new concepts, has increasingly been understood to be critical to inspiring transformative change” (Sims 2006, 28). Growing in self-awareness occurs in social and organizational contexts when we identify ourselves with, and distinguish ourselves from, one another. A way to accomplish both can be done by sharing our own stories and listening deeply as others share theirs.

THE CASE FOR STORYTELLING AS A DIVERSITY-TRAINING TOOL

Isaacs (1999) presents the difference between discussion and dialogue: in discussion, the speaker tries to convince others to change their mind to the point of view of the speaker while with dialogue, the speaker both asserts his or her point of view and tries to hear, and learn from, the other’s perspective. What is needed is a way to use language to express one’s point of view while noting its limitation as only one view out of many. Storytelling works here as it is taken for granted that one’s story is uniquely one’s own limited perspective. Therefore, it is easier for the listener to enter into or identify with the narrative. “Stories, then, are especially viable instruments for social negotiation . . . it is easier to live with alternative versions of a story than of a ‘factual’ account because we are prepared to accept differences in versions as ‘only human’” (Bruner 1990, 54). As we listen to more and more stories, we gain a better understanding of our differences and similarities. Different views and cross-sections contribute to our understanding of many aspects of objects, people, and situations (Bohm 1957, 31).

On the affective level, stories help reduce the anxiety that comes from experiencing the unexpected or the anomalous. We create stories to make sense of the difference between what was intended and what actually happened (Bruner 1990). Stories create a virtual shared reality, in which we identify how we are different and how we are the same. We remember stories that inform us about ways to be safe and circumstances in which the storyteller experienced difficulties. Stories assume change and thus provide an opportunity to learn by mentally replaying the event and one’s place in it, including the consequences of one’s actions (Tappan and Brown 1991). The anxiety that comes from experiencing the seemingly senseless can be mitigated through stories, as they weave a thread of
connectedness, causality, and community through what had previously seemed random (Huberman 1995).

Stories have value and significance through their both/and qualities. Telling the story of one’s experiences both illustrates uniqueness and creates belongingness (Myrsiades 1987). Stories present events in a way that listeners can more easily remember (Bolman and Deal 1991; Bruner 1990; Martin and Powers 1983); thus, they remake personal memories into social ones (Bruner 1990). Listening to another’s story requires one to suspend disbelief (Wisely and Lynn 1994) and in turn, the listeners are allowed their own interpretations (Narayan 1991). The story and its teller allow people to make connections with their experiences, individually and collectively, and with one another. Contributing one’s story is an important form of participation, one that can change a person from being an “outsider” to an insider (Barley 1991). The teller of a story gains authority and legitimacy from the listeners (Mumby 1988). Personal accounts of human frailty or failure are especially successful as a means of encouraging a sense of connection or common humanity (Wisely and Lynn 1994). Thus, reflecting on our personal experiences, having the courage to tell stories about the gaps between our intentions and the actual results, and having our stories listened to by organizational leaders helps organizations function optimally by creating a sense of shared values and goals (Mumby 1988). As noted earlier, because stories are accepted as one or more person’s “take” on the event, multiple, diverse interpretations are welcome:

“Each comment offers a picture from a different vantage point in an effort to tell the whole story. The whole picture in soft focus brings better understanding than detailed pictures of fragmented parts. Each person adds to the common pool of ideas; [the organization is] challenged to find a coherent interpretation of their multiple perspectives” (Bennett and Brown 1995, 177).

Stories are useful “if the purpose is to learn, to grow past our present limitations, to expand our vision to include more and more of the whole” (Cory and Underwood 1995, 131).

Another benefit of stories is that they help to expand problem-solving abilities by providing a relatively safe “practice field” for imagining different and novel meanings, including the implicated action of the various meanings. By allowing multiple points of view and imagination, stories thus lead to creativity and new ways of looking at things (Hausman 1984).
TIPS TO BUILDING AN EFFECTIVE DIVERSE WORKFORCE

As discussed earlier, there are a number of reasons why traditional diversity training programs have not been effective. Complex affective, cognitive, and language processes accompany the experience of differences. Psychological and cognitive elements are intertwined with demographic characteristics (Carson, Mosley, and Boyar 2004; Knight et. al. 1999). Therefore, rather than focusing narrowly on rules for adaptation, we suggest a broader goal for diversity training.

Table 1 lists ways we could improve relationships within our organizations, to build a more effective diverse workforce. Essentially, we are focusing on a set of action-steps, which require us to look for sameness when we perceive differences; to look for differences so we can take advantage of each other’s strengths; to assume anything we say will be “misinterpreted” by others and thus use this to expand our own ideas; and to make sure that we put courtesy first, in developing good working relationships with others.

By setting goals for diversity training around good corporate citizenship, customer service, and shareholder confidence, each organization can ask what kind of interpersonal behaviors serve to create a unit whose members share a sense of responsibility, commitment, and expectations among a variety of levels, functions, and tasks. Further, given the inevitability of organizational change at all levels—environmental, strategic, technological, personnel, and customers—it is important to practice the skill of co-creating shared meaning amidst conditions of risk, uncertainty, and ambiguity, and the feelings of vulnerability and dismay that accompany such conditions. Some approaches to doing this are given below. These are only suggested ground rules, however; the point is to get away from the “one-size-fits-all or cookie-cutter approach to designing this type of instruction” (Sample 2007, 23) that seems to be prevalent in many organizations.

Approach Diversity Training Proactively Rather Than Reactively

For the most part, companies have concentrated on protecting their organizations from discrimination lawsuits rather than doing what is right for their employees and customers. This had led to a narrow definition of diversity that focuses primarily on race and gender rather than expanding to include cultures, values, behaviors, personality differences, work styles, etc. Forcing employees to attend these limited workshops can backfire and cause resentment by co-workers who don’t understand the need for diversity training or who feel uncomfortable with the training itself.
Table 1
How to Build an Effective Diverse Workforce

Focus on ...
- Getting away from one-sided emphasis on either “we are all the same” or “we should embrace our differences”
- Changing our emphasis from not being sued to that of inclusion
- Eliminating mandatory training and instead making diversity awareness an integral part of performance appraisal systems
- Recognizing that effective diversity management is a 24/7 perspective, not a one-day workshop

A set of action steps ...
- Recognizing the limitations of language and categories and helping others to understand these limitations so we can speak the same language
- Telling our own stories and encouraging others to tell theirs
- Moving away from defining diversity as limited to race and gender to recognizing diverse cultures, personalities, work styles, values, etc.
- Designating a diversity point person at the top of the organization to ensure accountability
- Establishing formal mentoring programs for anyone interested, not just women or minorities

Which requires each of us to ...
- Look for sameness when we perceive others as different
- Look for differences so that we can take advantage of one another’s strengths and skills
- Assume that anything we say will be “misinterpreted” by others, and avoid getting frustrated. Instead, see how their new interpretation can expand our own ideas.
- Put courtesy first. Respectful relationships go a long way toward developing tolerance of our differences—no matter what kind.

Address Affective Responses and Language Shortcomings
Making it clear that emotional responses to difference and change are normal can help employees move past initial reactions and toward making better choices. Explaining that language itself is the root cause of stereotypes and why
we have (and need) categories can help organizational members understand the strengths and limitations of words. After assumptions about a tight link between words and signification are relaxed, decisions can be made about what kind of communication will best serve organizational goals, and what communication limits potential.

**Encourage Sharing of Stories**
Training approaches have tended to be one-sided, emphasizing either similarities (“we are all the same”) OR that we are all different and should value these differences. Both approaches are relevant and should be incorporated into diversity-training programs. A way to explore both is through the use of personal and organizational stories. To signal the value of understanding, however, we recommend that management provide a safe context for stories, and that they approach diversity training as an opportunity to learn from, more than to teach, employees about what it means to be unique and what it means to be included—or what it means to be standardized or excluded—at work.

Interpersonal communication training should emphasize listening to different points of view, especially at times when the routine procedures break down. Workplace stories about mistakes could be encouraged and rewarded, not to promote unsafe or ineffective practices, but rather to vividly illustrate the kinds of contexts that are more likely to result in problems. Also, swapping stories builds the camaraderie and willingness to help each other that creates the checks and balances necessary for effective organizations.

One caution, though, on using stories during diversity training sessions. It’s important that ground rules be set that note there is not a right or wrong story. Additionally, issues around discrepancies in power can interfere with effective sharing. For example, in the case of *Stender v. Lucky Stores Inc.*, participants felt threatened by the admissions of prejudice and stereotypes. It might be safer at first to limit stories to task-based concerns, building up gradually to more personal perspectives as relationships increase in trust. In addition, Sample (2007) recommends separating managers and employees during training workshops, when the topic at hand is the presence of actual harassment in the organization.

**Incorporate Diversity Into the Company Culture**
Focus on establishing a culture where everyone’s skills are valued. Building an effective diverse workforce means going beyond diversity training to looking at your selection process, training and career planning programs, and performance
appraisals, to make sure you are recognizing and rewarding the behaviors you want. A multipronged approach, involving formal mentoring and accountability from the top down, would help. Focus should be on establishing a culture where everyone’s skills are valued. As noted by Roosevelt Thomas, founder of the American Institute for Managing Diversity, “In a foxhole, I want someone who can shoot…I don’t care where they’re from” (Cullen 2007, 2).

Storytelling can be a useful tool to incorporate diversity into the organization. In the selection process, managers can conduct behavioral description interviews, asking applicants to give specific examples of problems they have faced in the past, including how they dealt with change and differences. Mentors could be assigned to provide opportunities for sharing stories about current and past experiences, to help employees make good task and career choices. In addition, companies should recognize that their “dialogue with their customers [both internal and external] is a dialogue of equals” (Prahalad and Ramaswamy 2000, 82) in order “to understand the purpose, meaning, and quality of the dialogue from the customer’s perspective” (82). Inviting and listening to workplace stories of co-workers aids in understanding what it takes to builds high quality interactions with each other and with customers.

CONCLUSION
Conflict and misunderstanding often occur when we interact with others perceived as different from ourselves. We may become anxious when we come into contact with others who aren’t where we think they belong, or do not fit into neat categories, whether based on race, sexual orientation, religion, nationality, class, job title, etc. Thus, having a dialogue about the usefulness and shortcomings of binary oppositions or categories can set the stage for discussing much more complex issues involved in diversity management.

Part of the problem we have with diversity in the workplace occurs because of the limitations of our language and our uncertainty as to how to approach others viewed as different. Issues of political correctness, uncertainty, and embarrassment at not knowing the best terminology come into play. Many of us struggle when referring to someone of a different race, sexual orientation, disability, etc. Is the preferred term “black” or “African-American”? Should we say “gay” or “homosexual”? Why is it that a derogatory term can be used as a term of endearment by those perceived to be in one’s in-group, but it is an insult when used by others? Our discomfort with words sometimes leads us to avoid interacting with others perceived as different from ourselves and who don’t fit in the categories
we are used to. By acknowledging our limitations, including disclosing times when we are at a loss for words, and through telling our own stories and actively listening to those of others, we show that we are still interested in continuing a dialogue in order to learn.

We suggest that diversity management requires attention to boundaries, and a willingness to suspend them, in order to understand ourselves and one another better. The hope is that when faced with uncertainty, violation, and contradictions, managers and employees will try to see both sides of a two-valued orientation. During times of anxiety, when lines are being crossed, it is potentially fruitful to exchange points of view in the interplay of sameness/difference. Thus, where you see difference, look for sameness: likes, education, family, goals, etc. And where you see sameness, look for differences. Find out what is it about your employees or co-workers that make them unique and capitalize on their strengths. Storytelling is valuable as a tool to do both, as employees are able to look at problems and issues from multiple viewpoints. Stories can be used to illustrate what has happened in the past, to stimulate a discussion on issues and problems, and to then envision what the future could be (Damon 2008).

As noted by Gloria Woods, vice president of diversity for CNA Insurance, storytelling can be a compelling way to help others understand the problems with stereotypes and categories.

“I always think of diversity work as engaging heads and hearts. You’ve got to do the intellectual stuff, but you also have to reach listeners’ hearts with human stories. It’s one thing to talk about racial profiling. It’s another to hear [a co-worker’s] personal story of how, when he flies first class with a white colleague, the flight attendant checks only his ticket” (Bennett 2003).

What is the story you want your employees to tell? The point is to move beyond an “us versus them” mentality to one where all employees are united to help the organization remain competitive in today’s volatile economy.
REFERENCES


Eminent Domain Controversy:
Property Rights versus Economic Development

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INTRODUCTION
Should municipalities or their surrogates be permitted to exercise eminent domain to condemn private property to foster economic redevelopment? Who should determine what constitutes public use or public purpose and whether such use is wise public policy? Should government participate in the funding of such redevelopment projects? Should private property rights of existing homeowners and small businesses prevail over needs of the broader community for an increased tax base or revitalization of a blighted area? Is the nonconsensual taking of property for economic redevelopment constitutionally permissible or statutorily sanctioned?

In the 2005 case of *Kelo v. City of New London*,¹ the U.S. Supreme Court decided that it was constitutionally permissible under the Fifth Amendment of the U.S. Constitution for a city to use eminent domain to acquire the unblighted property of unwilling citizens so that property could become part of an economic redevelopment project. The Court left to the states the ultimate decision of what restrictions should be placed on this practice. As a consequence, this 5–4 decision sparked considerable debate and prompted state legislatures to enact legislation clarifying and modifying the government sanctioned “taking power.” Missouri’s legislature responded by declaring that economic development could not be the “sole” basis for exercising eminent domain,² but left plenty of avenues though which property could be “taken” for “public use” in light of case law equating the concept of “public use” with “public purpose.” After exploring
the facts and ruling of the landmark Kelo Supreme Court case, this paper will explore Missouri’s legislative changes and recent court interpretations related to eminent domain issues associated with economic development.

**KELO v. CITY OF NEW LONDON**

**Facts and Procedural Background**

Facing decades of economic downturn and growing unemployment after the closure of the U.S. Naval Undersea Warfare Center, the City of New London, Connecticut decided to delegate authority to the New London Development Corporation (a private not-for-profit entity) to develop a revitalization plan for the Fort Trumbull area. Several plans were reviewed, augmented by Pfizer, Inc.’s announcement that it would build a research facility adjacent to the area. The 32 acres were to be divided into tracks for the establishment of a Coast Guard museum, marina and river walk, as well as an urban village conference area with a hotel, restaurants, shopping district, office space and high-rise residences. However, the area was already comprised of 115 privately owned properties, primarily middle-class housing—not a “blighted” neighborhood. Many of these residences were located in the area designated to become a parking lot and state park and would have to be torn down to facilitate the plan. Susette Kelo (who had recently made extensive renovations to her bay-view house) and Wilhelmina Dery (who was born in her house in 1918) were among the 15 landowners who refused to sell and objected to the use of eminent domain to force them to relinquish their property rights.³

These homeowners argued that the use of eminent domain condemnation violated the Takings Clause of the Fifth Amendment of the U.S. Constitution. After the trial court upheld part of the takings and rejected others, both sides appealed. The Connecticut Supreme Court upheld all of the condemnations, considering the revitalization plan as tantamount to “public use.” It recognized that the takings were authorized under Connecticut’s municipal development statute.⁴ The U.S. Supreme Court granted the writ of certiorari to decide “whether the City’s decision to take property for the purpose of economic development satisfies the ‘public use’ requirement of the Fifth Amendment.”⁵

The Fifth Amendment to the United States Constitution provides that “nor shall private property be taken for public use, without just compensation.” This clause has been applied to the state governments through the Fourteenth Amendment. Fundamentally at issue was whether the “Takings Clause” should be narrowly
construed as a limitation on the ability of government to terminate private property rights or whether it should be more broadly interpreted as a means to facilitate public purposes such as economic development.6

**Majority Opinion**

In his U.S. Supreme Court majority opinion, Justice Stevens embraced the broader view, adopting what he deemed to be “the more natural interpretation of public use as ‘public purpose.’”7 In so doing, he concluded that the literal requirement that the condemned property had to be “put into use for the general public . . . proved to be impractical given the diverse and always evolving needs of society.”8 He recognized an evolution of cases since the late 1800s with a broadening view of what constituted public use. Traditional uses, such as arteries of transportation, had long been recognized. Prior case law legitimized the taking of intellectual property rights (trade secrets) for the purpose of enhancing competition in the pesticide industry by eliminating significant research barriers to entry.9 Justice Stevens saw the taking of private land for economic revitalization to build hotels and theatres (available to the public for a fee) as no less of a public purpose.10

Pivotal to the Court’s decision were two prior U.S. Supreme Court cases: **Berman v. Parker**11 and **Hawaii Housing Authority v. Midkiff**.12 Both of these cases took a broad view of the Fifth Amendment’s “public use” requirement. Unlike the **Kelo** case, Berman involved a very “blighted” area of Washington, D.C, including dilapidated housing with sanitation issues. Like the **Kelo** case, economic redevelopment was the goal. In **Berman**, Justice Douglas equated “public welfare” with the Fifth Amendment’s public use component (although “public welfare” is the chosen phrase in the Preamble and it was not the phrase used in the Fifth Amendment). In rejecting an appeal from a department store owner whose property was not itself blighted, Justice Douglas maintained that viewing taking decisions on a lot-by-lot basis would undermine accomplishment of community redevelopment.13 As a result, both blighted and nonblighted property could be taken under a valid plan. Justice Stevens then adopted that “totality of the plan” approach to the taking of Suzette Kelo’s house.

In Hawaii, land ownership had been highly concentrated since tribal days. A state statute authorized the taking of title from some of the landed lessors and the selling of the land to the tenants. This was more controversial, because it involved a more direct one-to-one transfer of private property from one set of owners to another set of private property owners—arguably a violation of the
Fifth Amendment. Because the public purpose was the elimination of “social and economic evils of land oligopoly,” the Court upheld the takings in Midkiff, however, maintaining that “it is only the taking’s purpose, and not its mechanics” that determine public use. In his concurring opinion in Kelo, however, Justice Kennedy stated that he would reject benefits “with only incidental or pretextual public benefits” and require the taking to be “rationally related to a conceivable public purpose” to satisfy the “public use” requirement.

Broad deference to legislative bodies’ decisions as to what constitutes public purpose was at the cornerstone of Justice Stevens’ majority decision. He was less inclined than Justice Kennedy to “second guess” legislative determinations, stating that the courts “wisely eschewed rigid formulas and intrusive scrutiny in favor of affording legislatures broad latitude in determining what public needs justify the use of the taking power.” Consequently, he rejected petitioners’ pleas for a “bright-line rule” that would prohibit economic development from qualifying as “public use.”

Petitioners also argued that the takings were unconstitutional because the city failed to prove by “clear and convincing evidence” that the economic benefits would in fact accrue. The majority opinion rejected a “reasonable certainty” test, holding instead that if “the legislature’s purpose is legitimate and its means are not irrational…debates over the wisdom of the taking . . . are not to be carried out in the federal courts.” Furthermore, the Court reasoned that “[o]rdery implementation of a comprehensive redevelopment plan obviously requires that the legal rights of all interested parties be established before new construction can be commenced.” After these landowners lost in the U.S. Supreme Court, their houses were demolished, pursuant to that plan. Ironically, the exercise of eminent domain was so controversial that no businesses have been willing to build in the now deserted tumbleweed field. The goal of economic revitalization remained unaccomplished in New London, despite the uprooting of the homeowners.

Justices Souter, Ginsburg, Breyer and Kennedy concurred with Stevens’ majority opinion. Justice Kennedy’s concurring opinion would require the public benefit to be more than merely “incidental,” but he offered no clear test for measuring the degree of benefit. Justice Thomas and O’Connor wrote dissenting opinions; the latter was joined by Chief Justice Rehnquist, Justice Scalia and Justice Thomas. The dissenters took a narrower view of the “Takings Clause” and “public use” as a check on government power and chided the majority for
“jeopardizing the security of all private property ownership”\textsuperscript{20} since “nearly any lawful use of real private property can be said to generate some incidental benefit to the public.”\textsuperscript{21}

\textbf{Dissenting Opinions}

Using a strict constructionist approach, Justice Thomas implored that the “Takings Clause” is “a prohibition, not a grant of power.”\textsuperscript{22} There were two components to the clause: first, that government cannot take the property at all unless it is for “public use” and second, that “just compensation” be paid for property that is taken. In the Preamble to the Constitution, the framers used the broader concept of “general welfare,” but the Fifth Amendment contains the more limited term “public use.” From Blackstone to Locke\textsuperscript{23} to Alexander Hamilton (first U.S. Secretary of Treasury), framers understood “that property is a natural, fundamental right”\textsuperscript{24} and that protecting “the security of property” was one of the primary reasons governments were instituted.\textsuperscript{25} From an “originist’s” perspective, this amendment was designed to protect property rights, not abrogate them. Any other conclusion, in Justice Thomas’ view, rendered the “public use” clause as “surplusage” in the Fifth Amendment.

Furthermore, Justice Thomas maintained that the majority opinion’s unrequited “deference” to legislative determination of what constitutes a public purpose is misplaced. It is the role of the Court to interpret the Constitution. The court “owes no deference to a legislature’s judgment concerning the quintessentially legal question [emphasis added] of whether the government owns, or the public has a legal right to use, the taken property.”\textsuperscript{26} While the courts have been more willing to second guess the reasonableness of a search of a home, the majority opinion fosters unchecked deference to the legislature on the “infinitely more intrusive step of tearing down petitioners’ homes. Something has gone seriously awry with this Court’s interpretation of the Constitution. Though citizens are safe from the government in their homes, the homes themselves are not.”\textsuperscript{27}

Likewise, Justice O’Connor decried economic development takings, lamenting that “no homeowner’s, merchant’s or manufacturer’s property, however productive or valuable to its owner, is immune from condemnation for the benefit of other private interests that will put it to a ‘higher’ use.”\textsuperscript{28} To her, “public use” meant either (a) traditional public use or (b) “public benefit” aimed at elimination of a social evil. Traditional public uses included land taken to build roads, railroads, canals and public parks. The takings in \textit{Berman} and \textit{Midkiff} were
justified because they were designed to cure the social evils of blight and land oligopoly. To O’Connor, “the public purpose was realized when the harmful use was eliminated” and the subsequent private use did not matter. The public benefit, however, had to be substantial and not merely a secondary benefit. In New London, middle class homes were being taken and no social evil was being remedied, so to Justice O’Connor the takings were unjustified.

One must differentiate Justice O’Connor’s “social justice” or “social benefit” policy from the means used to accomplish it. The majority opinion and the dissenting opinions all recognized that private property cannot be taken from citizen A and be directly given to citizen B for private use. They differed, however, in the follow-up analysis of when and why the property taken may eventually be transferred from government to private entities. While Justice O’Connor condemned the taking of middle-class property in *Kelo* to transfer it to developers, she condoned the transfer of private property to other private citizens in *Midkiff* (where the property was being taken from the rich to sell it to the poor and middle class). Justice O’Connor’s philosophical passion for equating the “public use” clause with the “public purpose” of eliminating social harms was consistent in both decisions, though her legal philosophy for implementing that goal was not. It was O’Connor’s majority decision in *Midkiff* that established the precedent of very broad deference to legislative intent—deference that she wanted the Supreme Court to circumvent in *Kelo*. In *Midkiff* she insisted that the Court “will not substitute its judgment for the legislature’s judgment as to what constitutes a public use ‘unless the use be palpably without reasonable foundation,’” thus providing the foundation upon which the majority decision rested in *Kelo*.

Examples across the nation in the aftermath of the *Kelo* decision demonstrate that some developers are eager to abuse this power. In Burien, Washington, an upscale “Town Square” developer forced out a popular local restaurant by redesigning the road to make sure it went through the restaurant (when the initial survey skirted the restaurant). With deference to the local authority, the Washington Court of Appeals affirmed the decision. Similarly, in Port Chester, New York, a developer exercised its political clout to contemn property slated to become a CVS pharmacy after blackmailing the landowner failed. The homes of Susette Kelo and Wilhelmina Dery were demolished in New London, Connecticut—even though the promises of economic redevelopment have not been fulfilled.
The *Kelo* decision simply concluded that exercise of “taking power” for economic development purposes did not violate the “Public Use” requirement of the Fifth Amendment to the U.S. Constitution. The majority opinion in *Kelo* made it clear, however, that states were free to place limits on the exercise of eminent domain. Consequently, many states, including Missouri, convened task forces to study eminent domain issues and offer legislative reform.

**PUBLIC USE v. PUBLIC PURPOSE**

Arguably “public use” is a narrower concept than “public purpose.” Traditional public use would include land owned by the government to provide public services (water works for drinking and for generation of power, utilities, schools, public hospitals) and the buildings housing such services. Universities have exercised eminent domain authority to acquire space for buildings and parking lots. Arteries of transportation are deemed to be public use where they are available to and actually “employed” by members of the public (interstate highway systems, railroads in the era of passenger train service, and airports). Public parks (owned by government) accessible for hiking and biking, as well as public conservation of natural resources fall within the parameters of public use.

Arguably, public purpose is a broader concept, of which public use is subcomponent, but not equivalent. In contrast, public purpose implies public benefit, public interest or general welfare—but not necessarily direct access or public use of the resources. The benefit of the public purpose can be more indirect than public use. Economic redevelopment is a public purpose or public policy decision that may indirectly benefit the public at large through increased tax revenue, fostering businesses that generate jobs and sometimes increasing availability of housing or recreational resources that are privately owned.

Case law in Missouri (as well as at the federal level), however, seems to equate public purpose and public use, while affording broad deference to legislative determinations of what constitutes a public purpose. According to the Missouri Constitution, article I, section 26, “[p]rivate property shall not be taken or damaged for public use without just compensation.” Furthermore, the Missouri Constitution, article I, section 28, generally provides that “private property shall not be taken for private use” and mandates that “the question of whether the contemplated use be public shall be judicially determined without regard to any legislative declaration that the use is public.” Nevertheless, Missouri courts have traditionally given great deference to legislative determinations of what is a pub-
lic use, and what constitutes “blight” in the absence of “arbitrary, capricious [decision] . . . fraud, collusion or bad faith.”

As early as 1923, the Missouri Supreme Court adopted the “public advantage” or “public benefits” theory, rather than the narrower view of public use. The fact that a private entity may benefit from a public improvement does not negate the public character. Even the operation of private entities may sufficiently advantage or benefit the public as to constitute public use. The fact that some groups will be more advantaged and others disadvantaged does not negate the public character of a project. Arteries of transportation are traditional public uses. A buffer zone that has the effect of devaluing private residences does not negate the public nature of the street improvement project. Where the Kansas City airport sought property beyond that needed for runways and terminals, the Court of Appeals deferred to the trial court’s determination that controlled commercial and industrial development around the airport was needed “to avoid future incompatible developments.” Industrial development has been deemed to be a proper public purpose. Ultimately, public policy issues and the public benefits derived from projects vary with the facts and circumstances, but this “elastic” view of public use generally has been permitted by Missouri courts.

**LAND ACQUISITION AND FUNDING OF ECONOMIC DEVELOPMENT PROJECTS**

While the state of Missouri has inherent sovereign power to exercise eminent domain for proper purposes, municipalities must derive any eminent domain authority from the state Constitution or laws enacted by the state legislature. Missouri Constitution article VI, section 21 provides that

> “laws may be enacted, **and** any city or county operating under a constitutional charter may enact ordinances, providing for the clearance, re-planning, reconstruction, redevelopment and rehabilitation of blighted, substandard or unsanitary areas and for recreational and other facilities incidental or appurtenant thereto, and for the taking or permitting the taking, by eminent domain, of property for such purposes . . .” (emphasis added)

The Missouri Supreme Court construed this provision of the Constitution as laying the foundation for both charter and noncharter cities to exercise eminent domain. The thirty-six charter cities have greater authority to govern themselves under article VI, section 19(a) of the Missouri Constitution, including the power to pass eminent domain ordinances per article VI, section 21. The City of Arnold
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(a noncharter, third-class city) approved a redevelopment plan, and adopted an ordinance to blight the area to acquire property from unwilling sellers by eminent domain. The owners of a dental office objected, unsuccessfully arguing that Missouri’s Real Property Tax Increment Allocation Redevelopment Act (“TIF Act”) did not apply to noncharter cities. The TIF Act authorizes “municipalities” to exercise eminent domain to acquire private property necessary for urban renewal and permits tax abatements to facilitate financing of the project. In 2008, the Missouri Supreme Court concluded that the first four words of the above-quoted article VI, section 21 authorize the legislature to pass laws (such as the TIF Act) to grant eminent domain authority to noncharter cities to eliminate blighted areas.43

The primary authority for using eminent domain to take of private property for economic redevelopment purposes is derived from four statutory sources in Missouri:

- Real Property Tax Increment Allocation Redevelopment Act (TIF law) (1982, 1997);44
- Urban Redevelopment Corporation Law,45 authorizing a private entity to carry out a redevelopment plan;
- Planned Industrial Expansion Law (1967, 1986),46 creating a public body corporate that is answerable to the city and charged with developing a plan;
- Municipal Housing Land Clearance for Redevelopment Law (1951, 1972),47 granting eminent domain authority primarily to municipalities and counties with at least 75,000 inhabitants to act through a Land Clearance for Redevelopment Authority.

In conjunction with these statutes, three additional controversies stand out in the debate over use of eminent domain to foster economic development projects in Missouri:

- the use of public resources as funding mechanisms to benefit privately owned economic development projects,
- the scope of the application of the “blight” requirement, and
- the transferal of eminent domain authority to a private entity.
The means by which economic development projects are often funded is controversial. Tax increment financing (TIFs) uses tax forgiveness, loan guarantees, earmarked funds or the sale of public bonds to finance or reimburse developers in economic development projects. If the assessed valuation of the developed property has increased, higher taxes generally will not be imposed on that property during the lengthy grace period in most deals contracted with developers. Instead PILOTs (payments in lieu of taxes) by developers are placed in a “special allocation fund” that is in turn used to retire the debt on bonds or notes issued by the government entity or governmentally sanctioned redevelopment authority. Since these funds are designated for that limited purpose and the developer pays into that fund rather than paying taxes that go into the general revenue, the general tax base is actually decreased for a substantial number of years. Those “in lieu of taxes” funds are not available to support the public schools, repair local roads or to provide revenue for public safety officers or ice-storm clean up. Concerns over the public/private partnership have generated constitutional challenges, arguing unsuccessfully that the Real Property Tax Increment Allocation Redevelopment Act created an impermissible indebtedness for the political subdivision, violated the equal protection clause, and increased a tax levy without voter approval. In addition, more recent statutory changes requiring a 12-member county TIF commission in three counties in the St. Louis/St. Charles area face constitutional challenges that have caused law firms to withhold “clean legal opinions” needed to facilitate the sale of bonds.

Where TIFs are structured in accord with a financially sound plan (with revenues preceding expenditures) and where they foster cooperation of local businesses, TIFs may advantage the community. In Springfield, Missouri, the Commercial Street businesses are considering a “blight” designation so they can create a TIF district aimed at revitalizing the area to the benefit of existing small businesses, with promises from city leaders that eminent domain will not be used. Better lighting, more parking, and outdoor stages are being considered. Project restraints promise cautious spending of funds to improve infrastructures only after the funds are generated. In the Branson area, the Herschend Family Entertainment Company (owners of Silver Dollar City) will guarantee the purchase of bonds to fund a widening of Indian Point Road to help local residents circumvent the traffic near the theme park.

Many TIF promoters, however, cannot deliver on their promises—negating the advantages of redevelopment, while further depressing the targeted area. This is particularly problematic where anticipated future increases in revenue streams...
are spent or borrowed against before they materialize. Fresh in the minds of legislators considering reform in Missouri was the controversial 2005 Sunset Hills project in the St. Louis area. Within weeks of the *Kelo* decision, the Sunset Hills aldermen approved a shopping center project, granting a developer eminent domain rights to acquire the necessary land for this economic redevelopment project. To facilitate the use of tax incentive financing (TIF), the condemned property must be classified as “blighted.” The first firm hired by the city did not believe that the working class neighborhood was “blighted.” Eventually a second firm gave the city the classification it wanted. Under the TIF Act a “blighted area” is:

> “an area which, by reason of the predominance of defective or inadequate street layout, unsanitary or unsafe conditions, deterioration of site improvements, improper subdivision or obsolete platting, or the existence of conditions which endanger life or property by fire and other causes, or any combination of such factors, retards the provision of housing accommodations or constitutes an economic or social liability or a menace to the public health, safety, morals, or welfare in its present condition and use.”

The developer, however, was unable to secure the necessary financing, leaving homeowners without the “just compensation” promised to them (and which they needed to purchase alternate housing). Despite a recall election of the aldermen and a repeal of the TIF authorization, the hardship to the affected citizens remained. The stigma of “blight” had made their properties practically unmarketable.

University of Missouri Law School Professor Dale Whitman (a legislative consultant for developers) remarked that there was “near universal agreement that the legislature had to do, or be seen to do, something that would prevent another similar disaster.” Nevertheless, no legislative reformulation of the definition of “blight” occurred and no check on the method of its determination was forthcoming. Although the new statute prohibits using “economic development” as the “sole” basis for eminent domain taking the concept of “blight” was exempted from definition of “economic development.” Therefore, “blight” can still be used as a reason for exercising eminent domain power. Furthermore, prior cases recognized that incidental taking of non-blighted property within a redevelopment area is allowed. Since urban land is scarce, blighting of continuous blocks is permitted (even if some of the property within the block is not in blighted condition).
Each of the four statutes facilitating economic development requires that the condemned land satisfy the definition of “blight,” near-blight (“conservation area”), or be unsanitary (“insanitary”). Under three of the statutes, including the TIF Act, the site must also pose either an economic or social liability to constitute “blight” because of unsafe or unsanitary conditions that are a menace to public health, safety, morals or welfare or contain obsolete or inadequate layout of the streets or subdivision. Note that the language is in the disjunctive for these three statutes, providing many paths to the determination that there is either an economic or social liability sufficient for the “blight” declaration.

Where the city delegates eminent domain authority to a private development corporation under the Urban Redevelopment Corporation Law, however, a finding of both economic and social liabilities is required.

“[The] portion of the city within which the legislative authority of such city determines that by reason of age, obsolescence, inadequate or outmoded design or physical deterioration have become economic and social liabilities, and that such conditions are conductive to ill health, transmission of disease, crime or inability to pay reasonable taxes.”

In the 2007 decision of Centene Plaza Redevelopment Corp. v. Mint Properties, the Missouri Supreme Court required “substantial evidence” of both economic and social liabilities as a prerequisite to a “blight” designation—rather than merely deferring to the determination of the Urban Redevelopment Corporation. In so ruling, the majority opinion equated public health, safety, morals and welfare with the concept of “social liability” in the absence of a clear statutory definition. The Court found insufficient evidence of social blight in Clayton, Missouri, at the site where the shopping center wanted to acquire adjacent property to facilitate its remodeling and expansion. Furthermore, it held that the “prospective benefits of redevelopment” cannot substitute for evidence of social liability of the current state of the properties. In essence, it recognized that economic redevelopment could not be the sole reason justifying the use of eminent domain.

Before the 2006 reforms, deference to legislative determinations of what constituted “blight” was strong and could be overcome only with a showing that the decision was “arbitrary or capricious or induced by fraud, collusion or bad faith.” Both the Court in Centene and the 2006 legislative reform now add “failure to demonstrate substantial evidence of blight” as a basis for challenging
decisions of boards empowered with eminent domain authority.\textsuperscript{63} It is too early to tell whether these recent pronouncements will actually result in less deference to legislative determinations.\textsuperscript{64}

**Missouri’s Legislative Reply**

In light of public opposition to the *Kelo* decision from homeowners, farm owners and small businesses, Governor Matt Blunt appointed the Missouri Eminent Domain Task Force to consider state eminent domain issues and make recommendations to the legislature. The group was asked to balance individual property rights with the need of state and local governments to exercise eminent domain to accomplish clear public purposes.\textsuperscript{65} Consequently, a better definition of “public use” was needed, and clearer criteria for governments to use in eminent domain scenarios. Many of the Task Force’s final report provisions were adopted related to a “Landowners”’ Bill of Rights—strengthening procedures, notice, and penalties for abusing the process, while enhancing “just compensation.” Both the task force and the legislature side-stepped revising the definition of “blight”—the elephant in the door. The legislature failed to adopt the task force’s recommendation that “public use” be more narrowly defined. Had the task force’s Recommendation 13 been adopted:

- **Public use** would “only mean the possession, occupation, and enjoyment of the land by the general public, or by public agencies; or the use of land for the creation or functioning of public utilities or common carriers; or the acquisition of abandoned or blighted property.”

- **Economic development’s public benefits** of “an increase in tax base, tax revenues, employment, or general economic health, standing alone, [would] not constitute a public use.”

- **Transfer of eminent domain authority** to private entities would be prohibited (with few exceptions, such as public utilities or common carriers).

Missouri’s 2006 eminent domain reform statute\textsuperscript{66} prohibits acquisition of “private property through the process of eminent domain for solely economic development purposes.”\textsuperscript{67} Under the new statute, “economic development” means property used to increase the tax base, tax revenues, general economic health or employment in the political subdivision.\textsuperscript{68} By getting the legislators to exclude “blight” from the definition of “economic development,” private developers were able to preserve “blight” as a separate reason to justify eminent
domain condemnations. A strong farm lobby, however, was able to prohibit farmland from being blighted. A strong farm lobby, however, was able to prohibit farmland from being blighted.69

Many private developers still retain eminent domain power (contrary to the task force’s recommendations). Government entities, utility companies, rural electric cooperatives, pipelines, railroads and common carriers also retain this power.70 In addition, private developers (as Urban Redevelopment Corporations) can exercise eminent domain authority. Greater oversight by government entities is required, however, including requiring (a) a local ordinance authorizing eminent domain and (b) board members of redevelopment corporations and other non-governmental authorities to be appointed by elected official(s).71 Universities, utility companies and private developers all need to be sensitive to the concerns of private property owners and to the public relations consequences of exercising eminent domain power rather than blindly focusing only on the benefits of their newest project.

Determining what constitutes “just compensation” has been as controversial as the condemnation itself. Even when the public use clause of the U.S. Constitution and state constitution is satisfied, the owner of the condemned property must be paid “just compensation.” Where a satisfactory price cannot be negotiated, the landowner is entitled to a jury determination of the amount. Recently, juries awarded much more than was initially offered by the condemning authority. In Northeast Missouri, the Missouri Highways and Transportation Commission offered $180,250 for condemned farmland. The farmer maintained that the 23.3 acres taken for a drainage easement and right-of-way made the balance of the 190-acre parcel hard to farm. In a case tried in adjacent Schuyler County in 2007, the jury awarded the farmer $265,000. The Missouri Court of Appeals recently affirmed an $810,000 (plus interest) St. Louis County verdict on property taken to facilitate the Metrolink light rail extension (that the Bi-State Development Agency had valued at $277,000).72

Probably the most significant 2006 statutory change is the manner by which “just compensation” is calculated. “Fair market value” is broadened to mean “the value of the property taken after considering the comparable sales in the area, capitalization of income, and replacement costs less depreciation, singularly or in combination with . . . its highest and best use, using generally accepted appraisal practices.” More importantly, “heritage value” and “homestead value” enhancers are added. Where one’s primary residence is taken, the “homestead taking” provision allows the displaced homeowner to receive 125% of fair
market value. If a family has owned a house or small business for at least 50 years, the “heritage value” requires payment of 150% of fair market value. In addition, moving and relocation expenses are enhanced. This determination is not uncontroversial. The Eminent Domain Committee of the Missouri Bar discussed concerns over a proposed new MAI Instruction for determining fair value. The Missouri Supreme Court recently determined that (according to statutory interpretation), the circuit judge is required to order the commissioners to make the factual determination of whether the property had been in the family for fifty years or more (with the burden of proof on the family claiming “heritage value”). Once the determination is made, the judge shall increase the commissioners’ award to provide the additional “heritage value” compensation. This statutory duty exists even if one of the parties files “exceptions” to the commissioners’ report. In the event that a jury later awards a different amount of damages, the “heritage value” applied to that award would require recalculation by the judge. The court left unsettled the question of whether the initial “heritage value” amount must be paid to the circuit clerk’s office pending a trial on the “exceptions.” According to the new statutes, displaced individuals and business also are entitled to actual moving expenses or $1,000 for individuals and $3,000 for businesses (plus up to $10,000 in reestablishment costs for businesses to adapt replacement property).

Other aspects of the “Landowners’ Bill of Rights” include improvements to notice, process, and penalties. A sixty-days’ notice must be accompanied with an explanation of landowner rights (along with identifying the property and purpose for the proposed condemnation). Landowner rights include rights to contest the condemnation, negotiate (with or without an attorney), counteroffer, get a separate appraisal, and receive just compensation. In addition, the condemning authority is required to inform the landowner of add-ons to fair market value, moving expenses and relocation assistance. Written offers to purchase the property must precede filing a condemnation petition by thirty days. To help citizens better understand the condemnation process, an Ombudsman was added to the Department of Economic Development.

“Good faith” negotiations are a prerequisite to filing a condemnation petition. The decision that an area is “blighted, substandard or unsanitary” must be supported by “substantial evidence,” with expedited hearings to review allegations of fraud, collusion or bad faith in the determination. If the “preponderance” of the redevelopment area is considered “blighted,” condemnation proceedings can be used against any parcel in the area, despite other provisions requiring a
parcel-by-parcel assessment. Where partial takings are involved, the landowner has 30 days to propose alternative locations on his property. The determination of “just compensation” shall be made by the commissioners, or alternately by a jury where the amount is challenged. If the principal place of residence is the subject of condemnation, homeowners will have 100 days to move (rather than the traditional ten days) from notice that just compensation has been paid to the Circuit Court. If redevelopment plans are abandoned after the condemnation proceedings, landowners are entitled to attorney’s fees, costs, expert expenses and actual damages or damages guaranteed under the redevelopment plan. The statute does not address situations where condemnation procedure and blight designations have been initiated, followed by undue delay rather than abandonment. Recently, the Missouri Supreme Court recognized a cause of action for pre-condemnation damage using an inverse condemnation theory.

CONCLUSION

Priorities as to what is in the “public interest” need to be reevaluated, especially where eminent domain condemnation is being considered. Bigger and newer is not always better. Economic redevelopment does not have to mean taking small businesses to create large swaths of land for the next big-box store or upscale condominiums. The latter does not tend to foster local community relationships or “social justice” principles. Area small businesses and homeowners need more seats at the table to counterweigh the dominance of moneyed economic interests on redevelopment boards.

Better funding mechanisms are needed for neighborhoods and current landowners to retain and improve their existing facilities without necessitating a declaration of “blight.” The “blight stigma” is counterproductive. Instead of encouraging existing small businesses and homeowners to make improvements, it is often used as leverage to force them out. It devalues property, making it more attractive to land speculators and large developers, or further depresses the neighborhood if redevelopment projects and funding are not forthcoming. This conundrum is currently being faced by the Commercial Street area in Springfield, Missouri, which wants to use TIF money to revive the existing neighborhood without forcing out current small business owners.

“Blight” needs to be more narrowly defined. If economic redevelopment cannot be the sole reason for the exercise of eminent domain, then all “blight” statutes need to require both “social” and “economic” variables (rather than just one of the factors). Obsolescence, age, and inadequate/outmoded design of facili-
ties need to be removed as statutory excuses for blight declarations. Substantial health and safety concerns should be at the core of “blight” designations and need to be more clearly delineated in blight statutes.

Eminent domain should be used sparingly. It should be reserved primarily for traditional public uses, not merely for broader public purposes. Where easement rights are needed for sewage and water lines or land is needed for road expansion in highly contested areas, condemnation may be necessary if cooperation of landowners cannot be secured with sufficiently attractive financial compensation. While economic development or redevelopment may indirectly benefit the community at large, the use of eminent domain by developers to displace viable existing businesses and middle-class homeowners should rarely be considered, and restraints on its exercise need to be tightened through local oversight, statutory revisions, and meaningful judicial review.

**Endnotes**

2 § 523.271.1, RSMo 2006 (emphasis added): “[n]o condemning authority shall acquire private property through the process of eminent domain for solely economic development purposes.”
3 545 U.S. at 473-476.
5 Id. at 477.
7 545 U.S. at 480.
8 Id. at 479-480.
13 Berman at 33.
14 Midkiff at 241-242.
15 Id. at 244.
16 Kelo at 490. Justice Kennedy is the swing vote in this 5-4 decision, suggesting that he may not give total deference to legislative determinations where there is only incidental public benefit.
17 Id. at 482-3.
18 Id. at 484.
19 Id. at 488-89.
20 Id. at 505 (O’Connor, J., dissenting).
21 Id. at 501 (O’Connor, J., dissenting).
22 Id. at 511.
24 See 545 U.S. at 509-10, citing *Calder v. Bull*, 3 Dall. 386, 1 L.Ed. 648 (1798).
26 545 U.S. at 517.
27 *Id.* at 518.
29 545 U.S. at 500.
30 See *Midkiff*, 467 U.S. at 244.
31 *Id.* at 241.
33 545 U.S. at 489.
34 *Bd. of Regents for NE Mo. State Teachers College v. Palmer*, 204 S.W.2d 291 (Mo. 1947); Southwest Missouri State University in taking a house housing a restaurant to facilitate construction of a parking garage adjacent to a new performing arts center circa 1990.
36 *Dalton v. Land Clearance for Redevelopment Authority of Kansas City*, 270 S.W.2d 44 (Mo. 1954).
37 § 523.262, RSMo 2006.
38 *In re: Kansas City Ordinance No. 39946*, 252 S.W. 404 (Mo. 1923).
39 *Arata v. Monsanto Chemical Co.*, 351 S.W.2d 717 (Mo. 1961). *See Phillips Pipeline Co. v. Bransteller*, 263 S.W.2d 880 (Mo. App. 1954), where condemnation of a right of way for an underground pipeline is such an example, where the private company as a common carrier is willing to include products of other companies.
40 *City of Kansas City v. Kindle*, 446 S.W.2d 807 (Mo. 1969).
41 *City of Kansas City v. Hon*, 972 S.W.2d 407, 411 (Mo. App. 1998).
42 *Tierney v. Planned Industrial Expansion Authority*, 742 S.W.2d 146 (Mo. 1987).
44 § 99.805(1), RSMo 2006.
45 § 353.020, RSMo 2006.
46 § 100.310, RSMo 2006.
47 § 99.320, RSMo 2006.
49 *See Tax Increment Financing Commission of Kansas City, Mo. v. J.E. Dunn Construction Co., Inc*, 781 S.W.2d 70 (Mo. 1989).
52 *See Martin Van Der Werf, If at First You Can’t Blight Sunset Manor, Try, and Try Again*, St. Louis Post-Dispatch, Sept. 29, 2005, at C1.


§ 523.271.1, RSMo 2006.

§ 523.271.2, RSMo 2006.

*Tierney v. Planned Industrial Expansion Authority*, 742 S.W.2d 146 (Mo. 1987).

These three statutes contain identical language, except that the most recent of the three (the TIF law) changes “insanitary” to “unsanitary.”

§ 353.020, RSMo 2006 (emphasis added).

225 S.W.3d 431 (Mo. 2007).

*Id.* at 434.

*Id.* at 433, n. 2.

*Id.* at 436, 437 (Stith, J, concurring) asserting the “substantial evidence” requirement was merely the codification of existing case law, making no discernable change in the standard of review and rebuking the Court for creating a definition of “social liability” in the absence of a legislative definition. (The new law was not addressed by the Court in *Centene*.)

Missouri Governor’s Exec. Order No. 05-15, June 28, 2005.


§ 523.271.1, RSMo [emphasis added].

§ 523.271.2, RSMo.

§ 523.286, RSMo 2006 and see Missouri Farm Bureau Fighting for Your Rights, [http://www.mofb.org/emenentdomainform/](http://www.mofb.org/emenentdomainform/).

§ 523.262.2, RSMo 2006.

*See* §§ 523.262.1, 238.247.1,99.460, and 99.120, RSMo 2006.


§523.001(3), RSMo.: A "homestead taking" included the primary residence or property within 300 feet :that prevents the owner from utilizing he property in substantially the same manner as it is currently being utilized.”

§§ 523.001(2) and 523.039(3), RSMo 2006 (classify family ownership as ownership by children, grandchildren, siblings or nephews or nieces of the family member owning the property fifty years prior to taking, with at least 50% ownership within the family line).

The business must employ less than 100 employees to qualify.

§§ 523.039(3) and 523.001(3), RSMo.

Missouri Bar Eminent Domain Committee discussion, May 9, 2008.


*Roldan* at case note 6.

§ 523.205.5(3), RSMo 2006.

§ 523.205.7, RSMo 2006.

§ 523.250.1, RSMo 2006.

§ 523.205.5(3), RSMo 2006.
§§ 523.250.2 and 523.040.2, RSMo 2006.
§ 523.277, RSMo 2006.
§ 523.256, RSMo 2006.
§ 523.261, RSMo 2006.
§ 523.256, RSMo 2006, with the court have authority to dismiss the condemnation petition and assess court costs and attorney’s fees to the condemning authority.
§ 523.274.1, RSMo 2006.
§ 523.265, RSMo 2006.
§ 523.040, RSMo 2006.
§ 523.060.2, RSMo 2006.
§ 523.055, RSMo 2006.
§ 523.259.1, RSMo 2006. Landowners whose property values are harmed by the abandoned threat of condemnation or announcement of proposed redevelopment plans, however, are not expressly afforded a remedy. If easements acquired through condemnation are abandoned for more than ten years, they can be vacated by a court order. § 527.188, RSMo 2006.
Clay Cty. Realty Co. et al. v. City of Gladstone, 2008 Mo. LEXIS 51 (Mo. 2008). Where governmental regulations so restrict the use of property that the property cannot be economically viable, some individually have successfully sued the government to force the government to purchase the land or pay damages using an “inverse condemnation” theory. The premise is that the government action had the effect of condemning the land without compensation. This theory has also been used where a government entity did exercise eminent domain on a portion of a landowner’s property, thereby significantly compromising the viability of the section of land not taken. For example, if the government used eminent domain to take part of a farmer’s land to create a new road that dissects the property, it may no longer be practicable to farm the remaining property. The farmer uses the inverse condemnation theory to compel the government to condemn (and pay for) the whole tract instead just the smaller segment or to compensate the farmer for the diminished value.
Currently only the Urban Redevelopment Corporation Law requires both economic and social liabilities, while other blight statutes require either economic or social liabilities.
Economic Growth and Political Instability in Ethiopia

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INTRODUCTION
Ethiopia is a country in the Horn of Africa with a population of 76.5 million and a per capita income in 2006 of roughly $1,000 (based on purchasing power parity estimate, World Bank ADI 2006). Recently, the country’s economy has been growing impressively—between eight and ten percent. Ethiopia celebrated her second millennium in September 2007. The contemporary history of Ethiopia can be subdivided into three periods: the Emperor Haile Selassie era, the Mengistu (military junta) era, and the current Meles period of multiparty elections.

The Selassie era started in 1930 and ended in 1974, when the military junta known as the Derg took control of the government and established a socialist state until May 28, 1991—this was a turbulent period for the country. During this period, Ethiopia faced coup attempts and uprisings, droughts, and extensive refugee problems. The current period, which had its genesis in August 1995 under Prime Minister Meles Zenawi, has been characterized by multiparty elections (and conflicts with Eritrea and Somalia) and rapid economic growth on the order of eight to ten percent. Patterson (1998), who focused his research on Ethiopia, has emphasized the necessity of economic growth in Ethiopia. He explains that low income in Ethiopia is a manifestation of low productivity, which in turn is due to low wages. The argument is clearly circular; nonetheless, the potential
benefits from growth cannot be overemphasized. The poverty line is defined as
the minimum average calorie consumption of 2100 calories per person per day.
This requires an expenditure of Birr 244 per month to meet the calorie intake for
a household (World Bank 1993). This is equivalent to $25 U.S. dollars. Recently,
the percentage of the population below the poverty line has fallen to 38.7 per-
cent (2005/2006 figures, CIA 2008). Productivity growth and higher income will
mean more education, better health and higher living standards. The need for
economic growth in Ethiopia is emphasized by basic descriptive statistics—life
expectancy is 49.23 years and the literacy rate is 42.7 percent (CIA 2008).

Most economic literature posits the view that political instability indirectly im-
pacts economic growth through its negative effect on investment. For instance,
Barro (1991) made this connection specifically by looking at investments in
human capital via education. His cross-section study of Pacific Rim countries
and sub-Saharan countries (including Ethiopia) effectively showed that politi-
cal instability negatively affects investments in human capital, which slows
economic growth. In addition, Patterson (1999) has made a similar argument.
The source of political instability can be traced to, among other things, eth-
nic diversity (perhaps also to corruption). One facet of interest is Ethiopia’s
ethno-linguistic diversity. There are seven major groups: Oromo 32.1%, Amara
30.1%, Tigraway 6.2%, Somalie 5.9%, Guragie 4.3%, Sidama 3.5%, Welaita
2.4%, other 15.4% (Ethiopia Central Statistical Authority, 1998). There are also
seven major ethnic languages spoken in Ethiopia. These are Amarigna 32.7%,
Oromigna 31.6%, Tigrigna 6.1%, Somaligna 6%, Guaragigna 3.5%, Sidamigna
3.5%, Hadiyigna 1.7%, other 14.8%, English (the major foreign language taught
in schools) (Ethiopia Central Statistical Authority, 1998). Ethnic diversity can
cause political instability especially when public control of resources is viewed
as a source of income. Thus other ethnicities perceive the controlling ethnicity
becoming wealthy from public resources. It (ethnic differentiation) might also
explain differences in performance between the junta years and the multiparty
years—though this seems unlikely because the ethnic composition of the coun-
try remained the same during the two periods. This fact legitimizes the focus on
the effects of the junta years on growth, compared with the effects of the multi-
party election years of a more responsible and accountable regime.

The purpose of this paper is to analyze the effect of political instability on eco-
nomic growth in Ethiopia. The rest of the paper is developed as follows: Section
II provides a definition and discussion of economic growth and development;
Section III uses a graph to examine the performance of the Ethiopian economy.
between the junta years and the multiparty election years (1980–91 and 1991–
2002); Sections IV, V, and VI refer briefly to the literature on political instabil-
ity, the types of conflicts, and the effects of conflicts on economic performance,
respectively. Section VII develops a model for investigating the effects of the
junta on economic growth in Ethiopia, and Section VIII presents some conclud-
ing remarks.

DEFINITION OF GROWTH AND DEVELOPMENT

There is a difference between economic development and economic growth.
Economic growth means an increase in GDP or per capita GDP (Perkins et. al.
2001) GDP is defined as the total value of final goods and services produced in
a country during a specified period of time. Per capita GDP is GDP divided by
population. Economic development refers to a transformation of the country
such that, as Barry W. Poulson puts it, “Economic development may be defined
as an increase in social welfare,” (Poulson 2001, 9). Growth occurs when more
of the same is produced—for example more typewriters; but development oc-
curs with technological progress such as computers and computer software.
Or to put forward another example, more horses pulling buggies as a means of
transportation is growth, but the advent of the automobile is development.

Suppose real GDP in Ethiopia is $73.79 billion in 2006 and in 2007 about
$81.17 billion. Thus the calculated the growth in real GDP is (81.17-
73.79)/73.79 = 0.10 or 10 percent. Now, suppose the population of Ethiopia is
growing at 2.27 percent a year. Therefore, using the above growth in real GDP,
between 2006 and 2007 per capita GDP in Ethiopia grew at 7.73 percent.

ETHIOPIAN GROWTH PERFORMANCE

Recently, Ethiopia has been growing at about 10 percent. At this rate, how long
would it take for real GDP in Ethiopia to double? The answer is easy to calcu-
late. By the Rule of 70 it would take Ethiopia 70/10 = 7 years to double GDP. A
more interesting calculation is to find how long it would take for Ethiopia’s GDP
to match the per capita GDP of the United States. Assume the U.S.’s long-term
growth rate is 3 percent and Ethiopia continues to impress with 10 percent. U.S.
per capita income is about $40,000 and Ethiopia’s $1,000. The answer is 52.7
years.

Figure 1 shows real GDP growth in Ethiopia from 1981 to 2002, which during
the junta and the Meles years, has followed an upward trend. It was relatively
constant from 1981 to 1991; it fell during the transitional government years
from 1991 to 1994 and started to rise with multiparty elections. The transitional years were also a period of time when Ethiopia and Eritrea region fought over Eritrea’s wishes to separate from Ethiopia. This is not to be confused with a later territorial war between Ethiopia and the independent Eritrea, from 1998–2000. The chart displayed in Figure 1 was constructed using data from World Development Indicators 2006 (World Bank 2006).

All GDP and capital growth (investment) data came from the World Development Indicators. Since the paper focuses on the connection between political stability, as evidenced by investment, and growth in Ethiopia, it was appropriate to uncover any statistical relationship between investment and economic growth in the country over the period under study. First, the percentage change in GDP for each year was calculated. Using Excel to evaluate the correlation between GDP growth and investment in capital yielded a correlation coefficient between economic growth and investment/GDP was 68.9 percent and positive. This appears to conform to the predictions of the Harrod-Domar model and the Solow growth model (Perkins et al. 2001) Without assuming causality, it appears that these two variables moved together. Would performance have been better absent a socialist period? What was the impact of the presence of the junta on economic growth in Ethiopia from 1980 to 1990 (data for earlier years are not available)?

**POLITICAL INSTABILITY**

One can argue that the absence of political stability reduces economic growth
because of its negative effect on investment (Barro 1991; Barro and Lee 1994). Barro, and Barro and Lee provide empirical support for this argument, which has intuitive appeal and is part of the conventional wisdom in economics. The disincentive effect of the absence of political stability might be the inefficient allocation of resources from civilian use (in the case of wars). Or political instability might be the catalyst for capital flight in the face of adverse economic conditions that undermine the profitability of investment.

**TYPE OF CONFLICTS**

For a long time, internal and regional conflicts have been important topics of international discourse. These conflicts include civil wars, secessionist conflicts, and political disharmony that have led to Africa’s poor performance. We identify four forms for conflicts in Africa. First, one type of conflict was the anti-colonial wars, which were armed struggles for independence. Second, civil wars are internal conflicts, such as in Somalia and Angola, that are driven by ideological differences, and may be based on a struggle for power. Third, there have been secessionist movements in Africa. These are attempts to withdraw from a state (country) and establish a separate state or country. “The Katanga rebellion in Congo, as well as the Biafra attempted secession in Nigeria,” (Ruiz 1997) are strong examples of this type of conflict. Also, included in this type was the separation of Eritrea from Ethiopia in 1991. The last type of conflict is regional in nature. Emmanuel Ruiz (1997) writes:

“Last but not least, ‘regional conflict’ has been classified as being ‘irredentist’ in character. An irredentist conflict arises when one country has some territorial ambitions over another country. For example, the Somali claim on the Ogaden region of Ethiopia, and Libya’s effort to annex part of northern Chad. Similarly, the Tanzania / Uganda interstate war can be depicted as a projection of forces by one country over another. In that unique case, President Julius Nerreri of Tanzania had the ambition to outst the leader of Uganda, Idi Amin. Another similar form of regional conflict has been examined during the recent overthrow of Mobutu Sese Seko in Zaire, Congo. It can be interpreted as a binding of forces by several states determined to turn around the regional balance of power status. It makes no doubt that Uganda and Rwanda governments provided military training, weapons and logistics to help Laurent Kabila’s rebels in eastern Zaire.”
The ethnic source of conflicts is examined by Gyimah-Brempong (2003), Nafziger (2003), Collier (2003), and Patterson (2003). In each case, the focus was on how political instability negatively affects economic growth through its negative effect on investment, according to Barro (1991), although Collier (2003) registers objections to this view.

**EFFECTS OF CONFLICTS**

According to the United Nations,

“`major wars’ are military conflicts involving 1,000 battlefield deaths a year. In 1965, there were 10 major wars under way, but by mid-2005, there were eight major wars under way [down from 15 at the end of 2003], with about two dozen lesser ongoing conflicts in recent years. Many of these conflicts have racial, ethnic, or religious undertones, and the victims are mainly civilians who represent about 75 percent or more killed or wounded non-combatants in wars. Africa has more wars, about 20 major civil wars since 1960 in such states Rwanda, Somalia, Angola, Sudan, Liberia, and Burundi” (GlobalSecurity.org 2007).

Conflict has resulted in economic and social losses in Africa by making food production impossible in conflict areas, sometimes creating famine. It has led to refugee problems for Africa and homelessness for children whose families are displaced or killed.

“Conflict prevention, mediation, humanitarian intervention and demobilization are among the tools needed to underwrite the success of development assistance programs. Nutrition and education programs, for example, cannot succeed in a nation at war. Billions of dollars of development assistance have been virtually wasted in war-ravaged countries such as Liberia, Somalia, and Sudan” (GlobalSecurity.org 1993).

**POLITICAL INSTABILITY—INVESTMENT/INCOME NEXUS**

For some time now, economists have linked investment and economic growth. For example, according to the Harrod (1939)/Domar (1946) model, and the Solow (1956), there is a connection between investment and economic growth. Easterly and Levine (1997) dispute the robustness of this connection. Furthermore, investment is not the sole source of growth. Some researchers, including Michaeli (1977) and Feder (1983) find a positive correlation between exports and economic performance. Nevertheless, Patterson (2003) and Barro (1991)
argue that growth is restrained by impaired investment due to political instability often linked to, among other things, socio-linguistic ethnic diversity.

The first part of this link is the relationship between output and investment to real GDP. Thus, the change in real GDP can be thought of as equal to the product of the inverse of the capital/output ratio and the investment, which is assumed to be constant. Thus,

\[ dY_t = \frac{1}{v}I_t \]  

where \( dY \) is the first difference of output, \( I \) is investment, and \( v \) is the capital/output ratio.

To come up with the growth rate in equation (1) suffice it to divide through by \( Y \). The result can be written as

\[ \frac{dY}{Y} = \Phi \left( \frac{I}{Y} \right) \]  

where \( \Phi \) denotes the reciprocal of the incremental capital/output ratio \( (1/v) \). The null hypothesis \( \Phi \) is different from zero.

The effect of political instability enters the model through dummy variables for the period of the military junta, on the assumption that the coups and uprisings during this period had deleterious consequences for investment and, thereby, economic growth. If political instability negatively influences investment, the coefficient of the investment variable should decline when political instability is introduced to the model.

Data for income and investment are taken from the World Development Indicators 2004, and cover the period from 1980–1990 (junta); and 1991–2002 (multiparty elections).

The form of equation (3) to be estimated, including both investment and dummy variables for political instability broadly defined, is

\[ g_y = a_0 + a_1IY + a_2DJ \]  

The results of the regression of growth in Ethiopia on capital formation and political instability are shown below.
In (1) the results indicate that the investment/income ratio had a small (the coefficient is 0.46) but positive and statistically significant (at the one percent level of significance) influence on growth (the dependent variable \( g_y \)). Thus, an increase in the investment (capital formation) to income ratio caused economic growth to increase as well. Note that the correlation coefficient is only .46, suggesting that this equation accounts for less than 50 percent of the variation in growth. In (2) the correlation coefficient is .70. The coefficient of the investment/income ratio is significant (and positive) at the one percent level. Moreover, the dummy variable representing the junta years is negative and statistically significant at the same level. It suggests that political instability during the junta period had a negative effect on economic growth in Ethiopia. Finally, number (3) is a mirror image of (2). The correlation coefficient is .70 and the dummy variable coefficient (0.20) for the multiparty period (including the transitional government) is positive, despite the war with Eritrea. The implication is that multiparty elections, coupled with the some degree of responsibility and accountability to the voters (the people), provide greater incentives for economic growth. The constant term in the three equations is large and statistically significant at the one percent level of significance. It suggests that factors other than investment and political instability influence economic growth. A more extensive growth model would include not only investment, but also exports and labor input. However, since the objective of the paper is to analyze the connection between growth, investment, and political instability, the results support the notion that political instability has reduced economic growth in Ethiopia.

**CONCLUSION**

In recent years, Ethiopia’s economy has grown between eight and ten percent per year. The period from 1980 to 1990 was characterized by a socialist military junta ruling Ethiopia. During that period, GDP growth was relatively constant and the correlation coefficient between growth and investment/GDP was nearly 70 percent (implicit connect in the Harrod-Domar model and the Solow growth model). The advent of a more open and accountable multiparty regime brought with it growth in GDP, even in the face of continuing conflicts between Ethiopia
and Eritrea; and between Ethiopia and Somalia. It is possible that some degree of poor economic performance was due to ethnic diversity—but this variable was constant during and after the junta period. Regardless of sources, conflicts have economic and social consequences, and wars challenge a country’s ability to increase the growth rate of its GDP, and to invest in human and physical capital. Therefore, conflicts discourage foreign direct investment because the investments (and aid dollars) will be misdirected and wasted.

This study has demonstrated that investment has a positive effect on economic performance in all the periods. It also shows that other factors influence economic growth—the constant in the equation is significant, positive, and large. But the purpose of the paper was to follow the connection between growth, investment, and political instability. The results of the empirical test indicate that economic performance was inferior during the junta years but recovered during the years following the junta’s collapse and going forward. Currently, economic growth in Ethiopia continues at an impressive 10 percent, despite the political and economic (and social) traumas of actual fighting with Somalia, tensions with Eritrea, and violent challenges to results of recent elections. Yet, this growth rate is still in its nascent stages, making it difficult to determine its impact on the Ethiopian people.
REFERENCES


INTRODUCTION
In the decade from 1993 to 2003, U.S. national health-care expenditures grew more than 70 percent, compared to only 38 percent growth in average weekly earnings over the same period and a 28 percent increase in economy-wide prices (Bureau of Labor Statistics 1994, 2004, 2005; Heffler et al. 2005). As health-care costs continue to climb, employers offering health benefits have reacted by shifting a larger share of the costs to employees, scaling back the generosity of health benefits, or ceasing to offer any health benefits at all (Kaiser Family Foundation 2004; Porter 2004; Regopoulos and Trude 2004).

These increases are likely to have an important effect on household finances. Direct medical costs are a nontrivial component of household expenditures,
comprising approximately 20 percent of the median household income in Iowa (Bureau of Labor Statistics 2004; Kaiser Family Foundation 2005). How do consumers change their economic behavior when nearly one-fifth of their family budget is rising at a rate more than twice as fast as other components of household expenditures? Firms faced with the same rate of increase in health-care expenses report that they offset health-care costs by passing more costs to employees, investing less in the company, and accepting lower profits (Porter 2004; Schneider, Selzer, and Kinzel 2004). Do households make analogous decisions? If so, how do those decisions aggregate to the regional economy?

The economic effects of rising health-insurance premiums on individual behavior and regional economies are very complex. The scope of this paper is to (1) briefly outline the economic problem, (2) identify the key pathways through which rising health insurance costs are likely to affect consumers and regional economies, and (3) draw on some of the findings of a Iowa Department of Public Health consumer survey to generate preliminary estimates of the magnitude of the economic effects of rising health-insurance expenditures on consumers.

CONCEPTUAL FRAMEWORK

The economic effects of price inflation on consumers are relatively complex. In general, too much price inflation is believed to be bad for consumers, which is an important reason why U.S. monetary policy is focused on controlling economy-wide price inflation. Inflation is thought to be costly to the economy because it can cause higher long-term interest rates, which discourage borrowing and investment and may also cause short-run volatility in financial markets. For example,

“virtually all economists agree that high inflation rates are disruptive. Economies experiencing double-digit inflation rates tend to have lower growth rates than economies experiencing lower rates of inflation. This is due, in large part, to the increased uncertainty about future income and prices that accompanies higher inflation rates. Thus, most economists agree that inflation rates should be relatively low. There is much less consensus about whether an inflation rate of 0% is better or worse than an inflation rate of 3%” (Economic Debates Online 2005).

There is disagreement among economists, however, over whether price inflation is unambiguously detrimental. Inflation that reflects increases in aggregate
demand or in quality are likely to have positive effects on consumers and the economy.

The effects of inflation in health-care expenses can be demonstrated with a simple model of household budgets. To make the problem more tractable, let us assume our typical household consumes only two things, H and X. Let H refer to all products and services related to health care. Let X refer to all products and services other than medical care. In other words, consider things like food, housing, utilities, education and entertainment to be captured in the X group. Furthermore, let us assume that our typical household saves an amount S every year. Depending on the method used to track savings rates, the typical saving rate in the U.S. in recent years has been 1–5 percent of income. Thus, the household’s “budget constraint” can be expressed as \( Y = p_h H + p_x X + S \). In other words, the household spends all of its annual income (Y) on H and X, the costs of which are equal to the amounts consumed multiplied by the prices of each. Whatever is not spent on H and X is saved (S). We make the final assumption that income (Y) is fixed in the short run; in other words, a household cannot significantly change the level of Y in a short period of time, except through debt financing (e.g., loans and credit cards).

Now consider what happens when overall health expenditures \( p_h H \) rise. Given the assumptions of the model, there are five possible adaptive responses: decrease non-health consumption, decrease health consumption, decrease savings, accept a larger share of income in the form of health benefits rather than wages, or increase annual income through debt financing. The first and second options—decreasing either non-health or health consumption (or some amount of both)—have two components: reducing the amount (or volume) consumed, or substituting a lower-priced mix of products and services. For example, in the case of non-health-care products and services, a household can choose to lower \( p_x \) by consuming a less expensive mix of groceries (i.e., substituting lower cost brands or substituting home-cooked meals for meals out) or by consuming less food. These options require an additional assumption regarding the relationship between price and quality. In reasonably competitive markets quality differences are reflected in prices, and consumers typically use a mix of price and non-price information to evaluate the quality of the goods and services that they consume. Thus, in this model we assume that the substitution of lower-priced goods and services for higher-priced ones generally reflects consumption of a mix of goods and services of lower quality relative to those consumed prior to the adaptive response. Note that “lower quality” does not necessarily imply “low quality” in
an absolute sense, although in some cases it may. (That is, we assume that there is some range of prices associated with high, medium, and low quality, and one may still obtain a “high quality” product or service at a price significantly lower than the highest price good or service in the “high quality” range. An example of this is Consumer Reports’ identification of products and services as “Best Buy,” which identifies comparatively low-priced products within the “high quality” grouping.) It is also possible that, depending on the magnitude, reductions in volume of non-health-care or health-care goods and services can have quality implications. For example, reduction in the amount of health care the household consumes might be achieved by going to the doctor less frequently or putting off non-emergency medical-care procedures.

Another possible adaptive response to rising health-benefit costs is the reduction of wages. Pauly (1997) and other economists have made the argument that health benefits are a form of employee compensation akin to wages, and that benefits and wages should be treated as alternate and substitutable forms of worker compensation. According to Pauly, “The economic viewpoint is that [increases in health benefit costs] will be offset by lower real wages, which will make workers worse off if the higher costs are not offset by benefits of higher quality or greater value” (1997, 25).

As prices rise, to what extent can consumers respond by increasing their income? The answer is dependent on several factors. In the short run, most consumers have the ability to undertake some degree of debt financing, either through personal loans, home equity loans, or by carrying over credit-card balances. Debt financing has the short-run effect of raising income, but will obviously reduce the amount of income in the long run, due to the payment of fees and interest payments that typically exceed returns on other investments. Another option is for a non-wage member of the household to begin working. For example, in single-income two-person households, depending on labor market conditions, it may be possible to increase short-run income by having one person return to work. Adding a person to the workforce generally has a positive effect on regional economies. The net effects, however, are highly dependent on the services the new worker was providing prior to entry into the workforce (e.g., child care), the type of work the new worker secures, and the marginal productivity of the worker in their new job. A final option is to work more hours. Again, the ability to do so is dependent on the type of job and household management constraints. In our model, we feature debt as a feasible short-run adaptive response, but we assume that in the short run the typical household
does not have the ability to increase wages by either working more hours\(^1\) or adding a wage-earner.

**METHODS**

Most of the findings in this paper are based on an Iowa Department of Public Health (IDPH) and Selzer and Company Inc. survey of 1,202 Iowans, ages 18–64. The survey was conducted during the second week of July, 2005. The interview lasted approximately 15 minutes. Random-digit telephone numbers, provided by Survey Sampling Inc., were used as the sampling frame. The numbers were drawn in such a way that each household in the state with a landline telephone had an equal chance of participating in the survey. The response rate was 17 percent. To qualify for the survey, respondents had to be between the ages of 18 and 64, and be the person in the household who knows the most about health insurance. This latter qualification has a demographic effect, lowering the proportion of respondents in the age 18–24 group, for example, and resulting in slightly more females than is normal for the population at large. Because of this screen, we have no benchmark against which to compare the remaining demographics, but they appear to be consistent with census reports for the population generally; thus, it is likely that this particular sample is representative of the universe of Iowa households. The margin of error was ±2.8 percentage points. In addition to the survey results, we draw on published literature on the economic burden of health-care costs. We also conduct a simple analysis of the regional impact of health insurance increases using economic data from the Bureau of Economic Analysis (BEA).

Common means of measuring consumer financial burden include calculating ratios of out-of-pocket expenses to family income (e.g., see Hong and Kim 2000; Stum, Bauer, and Delaney 1998). The IDPH survey adopts a different approach, looking instead at self-reported “experience” measures of financial burden associated with health-care expenses. Such measures are common in health-care opinion surveys. The disadvantages of experience measures are that they are likely to reflect feelings of satisfaction or dissatisfaction irrespective of actual

\(^1\) An interesting and potentially important aspect of this assumption is that, because health benefits can be considered a fixed cost (varying only by the number of employees) firms face an incentive to hire fewer workers and encourage (or require) existing workers to work more hours. Indeed, Cutler and Madrian (1998) found that over a relatively long period of time (1980–1993) rising health insurance costs increased hours worked by those with employer-based health insurance by up to 3%. It is important to note that these increases do not necessarily reflect employees opting to work more to offset the rising health insurance premiums.
financial burden (e.g., one may consider the inability to afford a subscription to premium cable television a severe financial burden). On the other hand, the advantages of experience measures are that they may be a more accurate reflection of household resource management. Calculated ratios imply the existence of uniform “burden” thresholds, but financial burden may mean operationally different things to different consumers.

RESULTS

Overall Economic Burden
To assess the extent of general economic impact of health cost increases on consumers, after asking respondents about their own experiences with health cost increases, the IDPH survey asked the following question: “How much effect does this increasing cost have on your household budget—are you making major sacrifices because of having to pay more for health insurance, minor sacrifices, or are you not really sacrificing because of rising health insurance costs?” More than half of the respondents reported making either minor or major sacrifices (Table 1). Surprisingly, 14 percent reported making major sacrifices in response to rising health-care costs.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Respondents Reporting Difficulties Attributable to Health-Care Costs</th>
</tr>
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<tbody>
<tr>
<td>Q: “How much effect does this increasing cost have on your household budget—are you making major sacrifices because of having to pay more for health insurance, minor sacrifices, or not really sacrificing because of rising health insurance costs?”</td>
<td>Percent</td>
</tr>
<tr>
<td>Major sacrifices</td>
<td>14</td>
</tr>
<tr>
<td>Minor sacrifices</td>
<td>45</td>
</tr>
<tr>
<td>Not really sacrificing</td>
<td>40</td>
</tr>
<tr>
<td>Not sure</td>
<td>1</td>
</tr>
</tbody>
</table>

Notes: (1) based only on those whose premium is increasing (n = 690). Source: 2005 IDPH Health Insurance Survey of Iowa Households.

Non-Health Consumption
The IDPH survey found that consumers are very likely to reduce the consumption of non-health-care products and services in response to rising health-care costs (Table 2). More than three-quarters of the survey respondents indicated that they would cut back on spending for entertainment, vacations, or leisure
activities, and a surprising 44 percent indicated that they would cut back on essentials like food and utilities.

The net economic effects of reductions in non-health-care consumption are complicated to model at the regional level. One approach is to assume that the additional resources going into the health sector of the economy will at least compensate for the drain of resources from the non-health sector (Pauly 1995; Pauly 2003). But this assumption depends on two necessary conditions: (1) the total economic value of a dollar spent in the health sector is at least equivalent to the value of a dollar spent in the non-health sector, and (2) the geographic reach of the two markets are approximately equal; that is, the additional economic activity generated by each sector is primarily regional.

The reasonableness of these assumptions is largely dependent on the value of regional economic “multipliers” for the health-care industry relative to other industries in the economy. Multipliers are derived from “input/output models” of a country or region and measure the total dollar effect on an economy that

### Table 2

<table>
<thead>
<tr>
<th>Changes in Consumer Economic Behavior Attributed to Health-Care Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q: “I'm going to mention some ways your household budget might be affected by having to pay more for health insurance. For each, please tell me if this affects your household budget or not. Just answer yes or no.”</td>
</tr>
<tr>
<td>Percent</td>
</tr>
<tr>
<td>Cut back on how much you can save</td>
</tr>
<tr>
<td>Cut back on spending for entertainment, vacations or leisure activities</td>
</tr>
<tr>
<td>Cut back on normal household expenses such as food, utilities, and so on.</td>
</tr>
<tr>
<td>Downgrade what your policy covers so you do not have to pay so much (includes changing to a different policy)</td>
</tr>
<tr>
<td>Reduce or eliminate other kinds of insurance coverage, such as life, disability, auto, and homeowners insurance</td>
</tr>
<tr>
<td>Take on more debt, such as credit card debt or other loans</td>
</tr>
</tbody>
</table>

Notes: (1) Based only on those who are making sacrifices because of having to pay more for health insurance: n = 407) Source: 2005 IDPH Health Insurance Survey of Iowa Households
results from a change in production, earnings, or employment levels in a given industrial sector. The existence and construction of multipliers is predicated on the assumption that industrial sectors within a given economy are interrelated through forward (i.e., end user demand) and backward (i.e., supply) linkages. Input/output (IO) models have been in existence for a number of years and there is a rich history of their application to the economic effect of different government policies.

A short discussion of the basic IO framework follows, but readers can refer to the literature (e.g., Chiang 1984; Hoover and Giarratani 1984; Hewings 1985) for further details. Basically, an IO model envisions an economy described by \( m \) industrial sectors. Gross output in a given sector is defined as output from an industrial sector that sold within that sector, to other industrial sectors who use the output for further production processing (referred to as “intermediate demand”), and to final consumers (referred to as “final demand”). For instance, some portion of timber harvests can be sold with minimal processing to a consumer for the purposes of burning in his own fireplace or home furnace. Alternatively, timber can be sold to paper manufactures for the purpose of manufacturing paper and paper products. The former would count as “final demand” where that later would count as “intermediate demand.”

Defining \( g \) to be an \( m \times 1 \) vector describing gross output in each of the \( m \) sectors, the IO model can be mathematically described as:

\[
g = Ag + f,
\]

where \( A \) is an \( m \times m \) matrix containing “technological coefficients” and \( f \) represents final demand.\(^2\) Solving for \( g \), the following expression is obtained:

\[
g = (I - A)^{-1} f,
\]

where \( I \) is an \( m \times m \) identity matrix. The matrix \((I - A)^{-1}\) is often referred to as the “Leontief inverse” matrix, the elements of which, in effect, comprise multiplier values for any given sector in relation to another. If one were to select a column of values from the Leontief inverse matrix, (i.e. select a particular indus-

\(^2\) A technological coefficient measures the proportional amount of gross output from industry \( i \) that comes from (purchased from) industry \( j \). For example, the technological coefficient for transportation's (industry \( j \)'s) contribution to manufacturing (industry \( i \)) is 0.03. This indicates that three percent of manufacturing's gross output is attributable to input purchases from the transportation sector of the economy.
trial sector $i$) and add those values together, one would obtain the total multiplier for sector $i$. For instance, if the sum of column $i$ in the Leontief inverse matrix were 2.05, one would conclude that if a $1.00 immediate increase in industrial sector $i$, or final demand, etc., (often referred to as the “direct effect” impact) would ultimately result in $2.05 increase in total gross output in the economy ($1.00 worth of direct effect and $1.05 worth of indirect effect). The reason for this indirect effect is that the initial increase in sector $i$ will be purchased by other sectors to increase output in those other sectors, which will in turn be purchased by other sectors to stimulate output, and so on. While model is silent as to the dynamic path by which initial (direct) effects filter through an economy or how long it takes before all indirect effects are ultimately realized (it has other conceptual limitations as well), it nonetheless remains a widely used means of generating quantitative estimates of how a change in one sector in an economy will ultimately affect the overall economy.

Once one has the Leontief inverse matrix, one can construct other multiplier measure, such as an employment multiplier measuring the total employment effect that results from a $1.00 increase in industrial sector $i$’s activity. There are different types of regional economic multipliers generated by the Regional Economic Analysis Division of the Bureau of Economic Analysis (BEA). Several key multipliers for the state of Iowa relevant to this analysis are shown in Table 3.

To illustrate the interpretation of multipliers, consider column one of Table 3, which represents the total dollar change in output that occurs in all Iowa industries for each additional dollar of output delivered to final demand by three different industry groupings: all industries, household goods and services sector (excluding health care) and health sector. A simplified interpretation of the data is that for every $1 spent in the service sector of the Iowa economy, $1.82 worth of economic activity is generated. The Iowa health-care sector generates slightly more: every $1 spent in health care generates $1.96 worth of economic activity. While these results are illuminating, given the characteristics of the theoretical model developed earlier, it is more appropriate to compare the health sector

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3 “Final demand” refers to output from a given sector demanded by the “final consumer” of that output, as apposed to “intermediate consumers” who use the output for further production processing. For instance, some portion of timber harvests can be sold with minimal processing to a consumer for the purposes of burning in one’s own fireplace or home furnace. Alternatively, timber can be sold to paper manufactures for the purposes of manufacturing paper and paper products. The former would count as “final demand” where that later would count as “intermediate demand.”
multiplier to the average of all other (non-health) household goods and services industries, mainly because it is more likely that a dollar not spent on health care will instead be spent on some other consumer good. This is more likely to include, for instance, automobiles and automotive parts, electric housewares and other retail goods. The all-industry average, on the other hand, includes many industrial intermediate products, such as rolled steel and asphalt and other road surface products, the consumption of which, at the regional level, is less likely to be affected by changes in health insurance expenditures.

Column two shows the total dollar change in earnings of households employed by all industries for each additional dollar of output delivered to final demand by the non-health-care versus health-care industries in Iowa. Again, health care appears to have a stronger effect than non-health industries. For each additional dollar of output produced by the health-care sector, earnings of all households increase by $0.74, compared with a $0.56 increase attributable to the service sector. Column three shows the analogous effect on employment. Each additional $1 million of output delivered to final demand in the health-care industry generates approximately 26.2 jobs, whereas the same amount of final demand across all other service industries generates 25.3 jobs.

Table 3
Regional Multipliers for Iowa, 2001

<table>
<thead>
<tr>
<th></th>
<th>Final-demand Output (dollars)</th>
<th>Final-demand Earnings (dollars)</th>
<th>Final-demand Employment (number of jobs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All industries</td>
<td>$1.86</td>
<td>$0.44</td>
<td>16.65</td>
</tr>
<tr>
<td>Household goods and services sector</td>
<td>$1.82</td>
<td>$0.56</td>
<td>25.32</td>
</tr>
<tr>
<td>Health sector</td>
<td>$1.96</td>
<td>$0.74</td>
<td>26.22</td>
</tr>
</tbody>
</table>

Notes: (1) Multipliers are based on the 1997 Benchmark Input-Output Table for the Nation and 2001 regional data; (2) total dollar change in output that occurs in all industries for each additional dollar of output delivered to final demand by the industry; (3) total dollar change in earnings of households employed by all industries for each additional dollar of output delivered to final demand by the industry; (4) total change in number of jobs that occurs in all industries for each additional $1 million of output delivered to final demand by the industry (because the employment multipliers are based on 2001 data, the output delivered to final demand should be in 2001 dollars); (5) average of all household goods and services sector industries in Iowa (includes codes beginning with 4–8, excluding health care; also includes construction and retail trade); (6) Average based on five health-care sectors: offices of physicians, dentists, and other health-care providers; other ambulatory health-care services; hospitals; and home health-care services. Source: Authors’ analysis of data from the Regional Input-Output Modeling System (RIMS II) from the Regional Economic Analysis Division of the Bureau of Economic Analysis, U.S. Department of Commerce.
In sum, this multiplier analysis demonstrates that the health sector of the economy generates economic growth. The Iowa health sector’s effect on total output is about 8% higher than that of the household goods and services (excluding health) sector. In addition, perhaps because of the comparatively higher skill levels and wages in health care, the health sector adds about 32 percent more to earnings than the non-health-care goods and services sector. Aggregate effects on employment are similar. These data suggest that moving dollars from one sector to the other would have an effect on the regional economy, a conclusion consistent with similar analyses conducted by Pauly (1995; 2003). These multipliers provide some quantitative measures of the health sector’s effect, but to obtain more precise measures of the employment and earnings effects on the Iowa economy would require a more structured analysis of an initial change in health sector demand. Therefore, since more detailed analysis would be required, some caution should be exercised when interpreting the results presented here.

**Health Consumption**

The discussion of the previous adaptive response assumed that the level of health care consumption remained constant; that is, consumers choose to change other things and leave health-care consumption alone. We know, however, that consumers are likely to also reduce health-care consumption as health costs escalate, often such that reductions result in negative health effects (Hadley and Reschovsky 2002; Schoen et al. 2005). Due to high health-care costs, respondents to the survey indicated (Table 4) that they would: change to a policy with less coverage (35 percent), avoid visiting a physician (33 percent), stop taking or take lower (non-prescribed) doses of prescription medications (17–23 percent), not schedule recommended tests (23 percent), and wait longer while sick before seeing a health-care provider (55 percent). These findings are remarkably consistent with similar surveys and analyses of the uninsured and underinsured (Schoen et al. 2005).

There are two important economic effects of decreasing health consumption.

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4 The definition of underinsured is based on cost-exposure to family income. Underinsured were defined as those with at least one of three indicators: (1) out-of-pocket medical expenses ≥ 10 percent of income; (2) out-of-pocket medical expenses ≥ 5 percent of income if income < 200 percent of the federal poverty level; and (3) health plan deductibles ≥ 5 percent of income.

5 Simulations of these effects on the Iowa economy are difficult because poor health can be due to many factors beyond access problems stemming from financial barriers. For example, how many work-loss days can be attributed to financially based access problems versus health behaviors (e.g., smoking), obesity, alcoholism, age, genetic factors, etc.?
First, the previous discussion of multipliers showed that the health-care sector has a positive effect on economic growth. But it appears as though at the regional level the health-care sector is only slightly more of an engine of economic growth than other Iowa industries (Table 3). Thus, it is unlikely that a shift in expenditures away from health and into other sectors of the Iowa economy will by itself have an appreciable net effect on the Iowa economy.

That leaves the second possible effect, which is based on the health effects of reduced health-care consumption. Reduced health-care consumption may be the result of consumers changing to a less generous policy (as more than a third of

<table>
<thead>
<tr>
<th>Q: I have some questions about ways you might be trying to save on health-care expenses. Thinking just about the past two or three years . . .</th>
</tr>
</thead>
<tbody>
<tr>
<td>Have you decided not to go to the doctor when you felt you needed to because of cost?</td>
</tr>
<tr>
<td>Have you stopped taking medication to avoid the cost of prescription drugs?</td>
</tr>
<tr>
<td>Have you cut back the dose of prescription drugs to help make the drugs last longer?</td>
</tr>
<tr>
<td>Have you decided not to fill prescriptions given to you by your doctor because of cost?</td>
</tr>
<tr>
<td>Have you not scheduled tests your doctor has suggested in order to save on cost?</td>
</tr>
<tr>
<td>Do you wait longer to see a doctor when you are sick with hopes you will get better on your own?</td>
</tr>
<tr>
<td>Do you try to minimize how often you use your health insurance in order to keep the overall cost of premiums for everyone in your group from rising?²</td>
</tr>
<tr>
<td>Have you switched doctors or hospitals in order to save money?²</td>
</tr>
<tr>
<td>Have you switched health insurance to a plan with higher deductibles and co-payments in order to save money?²</td>
</tr>
<tr>
<td>Have you switched health insurance to a plan with more restrictions on access to save money?²</td>
</tr>
<tr>
<td>Have you switched health insurance to a plan with fewer benefits to save money?²</td>
</tr>
</tbody>
</table>

Notes: (1) Most of these questions are asked of the full sample (n = 1,202); (2) Based only on those who report that they currently have some form of health insurance (n = 1,060). Source: 2005 IDPH Health Insurance Survey of Iowa Households
the survey respondents indicated) or by changing consumption behavior such that consumption converges toward that which is normally attributed to the underinsured or the uninsured. According to Schoen et al. (2005), the underinsured experience health access problems remarkably similar to those of the uninsured, including failure to fill prescriptions, forgoing tests and treatment, and forgoing visits to regular doctors and specialists. We also know that rising health insurance premiums can result in a larger number of uninsured, as people drop coverage altogether (Kronick and Gilmer 1999).

In one of the most extensive literature reviews on the uninsured to date, Hadley (2002) found that the uninsured receive less preventive care, are diagnosed at more advanced disease stages, and once diagnosed, tend to receive less therapeutic care. Hadley also finds substantial evidence that access-related health problems have a nontrivial effect on labor force participation, productivity, full- or part-time status, wage rates, and annual income. The research generally finds that poor health reduces annual earnings of U.S. workers by roughly 15–30 percent. The economic implications of these findings are unclear because it is very difficult to identify the point at which decreases in health consumption result in negative health effects.6

Savings
Health insurance premiums have been rising faster than wages in recent years. This puts added pressure on households to finance the increases by reallocating household expenses. Among the first to be cut appears to be savings. According to the survey, 86 percent of respondents indicating that their family budgets have been affected by health insurance costs report that they would reduce the amount of household income that is saved for future use (Table 2).

Savings has two economic benefits. First, it protects households from financial uncertainty and allows them to maintain desired levels of consumption in the event of price instability. Second, in the aggregate, household and business savings creates a pool of funds necessary to invest in new plant and equipment, thereby supporting ongoing economic growth (Marquis and Long 2001; Ferguson 2004).

6 The main reason for the difficulty is the lagged relationship between consumption of primary health care and future health expenditures. Preventive care tends to have more elastic demand than acute care (Kenkel 1994, 2000). Thus, it is likely that cost increases in period t will result in decreases in preventive care in period t, the health effects of which may not be observable until t+5 or more, depending on the type of preventive care and the condition in question.
It is difficult to simulate the regional effects of decreases in personal savings rates, but it is likely that the effects are small. First, as personal savings rates have declined precipitously in the past decade, the ratio of household financial wealth to disposable personal income has increased from three in 1980 to four in 2001, a 33 percent increase (Marquis and Long 2001). Putting aside differences in liquidity, it is likely that the increase in household financial wealth is serving the same role as savings in terms of protection from financial instability. Second, in terms of macro effects, personal savings rates are a relatively small component of the total amount of capital available for investment. Capital markets—including the supply, demand, and cost of capital—tend to be national or international in scope, which suggests that regional economies may be less sensitive to fluctuations in savings rates. Moreover, the volume of capital supplied by businesses and governments far outweighs that supplied through personal savings (Marquis and Long 2001). In sum, it is not likely that regional economies are significantly affected by a decline in the personal savings rate.

Wages
Economists have long argued that health benefits should be treated as an alternate form of compensation, a variable that employers can adjust depending on prevailing labor-market conditions and employees can use in making employment decisions (Pauly 1997; Cutler and Madrian 1998; Gruber and McKnight 2002; Olson 2002; Baicker and Chandra 2005). The amount of compensation taken in the form of health benefits has been shown to vary by firm size, degree of unionization, regulated versus unregulated industries, local labor market conditions, employee age, employee education, and whether employees have working spouses (Marquis and Long 2001). To illustrate the wage/benefit tradeoff, a recent Wall Street Journal/Harris poll found that close to 60 percent of respondents would prefer to forgo a pay increase in order to maintain current health insurance benefits (Wall Street Journal 2003).

7 The economic theory of wages and compensation to date has not been the prevailing theory in the trade press and popular media, where health insurance costs often are viewed exclusively as an input in the production of goods and services, one that is likely to affect the profits and incentives of businesses more than wages (e.g., Porter 2004). But the trend is shifting somewhat, as reports emerge that explicitly discuss health insurance cost increases in terms of wage reductions (Wall Street Journal 2003; Regopoulos and Trude 2004; Wall Street Journal 2005). In addition, we argued in an earlier report that, based on extensive evidence from surveys, firms actually do treat health insurance premiums as an input in the production process, but that the effects thereof need to be modeled simultaneously with the wage/benefits tradeoffs (Schneider, Selzer, and Kinzel 2004).
There is ample empirical evidence to support compensating wage theory with respect to health benefits. Using data from the Current Population Survey, Olson (2002) found that in some cases workers will accept jobs with as much as 20 percent lower wages in order to obtain health benefits. Baicker and Chandra (2005) estimated that, for workers with employee-based health insurance, a 10 percent increase in health insurance premiums results in an offsetting 2.3 percent decrease in wages.

This offsetting wage decrease is perhaps the most important regional effect of rising health insurance premiums. Taxable income of Iowa residents was $51.2 billion in 2003 (Iowa Department of Revenue 2004). Based on the findings of Baicker and Chandra (2005), a 2.3 percent reduction in wages (attributable to a 10 percent rise in health insurance premiums) will result in a reduction in taxable income in Iowa of approximately $1.2 billion. Assuming a four percent average marginal tax rate (Iowa Department of Revenue 2004), the net result is a reduction in state tax revenue of about $48 million. The reduction in wages is also likely to have a regional effect on gross state product, as workers experiencing the reduction in wages spend less. Recalling the multipliers from Table 3, a $1.2 billion reduction in earnings is likely to result in a $528 million reduction in final demand. (This estimate ignores the secondary effects the reduced spending would have on state sales tax revenue. Assuming a five-percent sales-tax rate, state revenues may decline by an additional $26.4 million due to attenuation in spending.) Based on a gross state product of about $102.4 billion, this represents a 0.05 percent decline. The 10 percent increase in health insurance costs, however, is associated with a 1.96 multiplier. Thus, the offsetting health-sector effect will add another $1.4 billion, resulting in a net gain to the regional economy attributable to increased health-related expenditures.

The effects of wage offsets, however, are somewhat deceiving because they may not reflect the added value of health insurance benefits associated with the higher premiums. For example, it is conceivable that a 10 percent annual increase in health insurance premiums—an amount roughly equal to $850 in Iowa—reflects an additional $850 worth of value in terms of the medical care received. Thus, estimates of the economic impact of health insurance costs should, to the extent possible, account for changes in quality (Cutler, McClellan, and Newhouse 1999). Such estimates have been empirically generated, and have consistently shown that, in the aggregate, a large proportion of inflation in medical care cost increases over the past decade does indeed reflect improvements in quality, the
benefits of which exceed the costs (Cutler, McClellan, and Newhouse 1999; Cutler and McClellan 2001; Lichtenberg 2001).

One important caveat is that the purchasers of health insurance have little, if any, flexibility in choosing quality levels. Hence, even if cost increases reflect quality improvements, there still may be nontrivial economic burdens associated with the disconnection between levels of quality and willingness to pay. Put another way, forcing everyone to buy a luxury car might be a neutral proposition for those that were already planning on buying one, but will be an economic burden to those whose budgets are more in line with an economy car.

**Increases in Debt**

The final adaptive response to consider is the possibility of increasing income by taking on more debt. More than a third (38 percent) of the respondents to the survey indicated that they would “take on more debt, such as credit card debt or other loans” to offset increases in health insurance premiums (Table 2). Debt is an important part of the economy, the effects of which depend on the nature of the debt. Using debt financing to buy appreciating assets, such as housing, is generally considered desirable debt, as long as the magnitude of the debt is not disproportionate to the income necessary to service it. Other kinds of debt, such as credit card debt, can also benefit the economy by decoupling temporal differences in consumption and income. But in many cases levels of debt grow too fast or exceed the levels at which the economy benefits. Too much debt increases the probability that households will experience financial distress in the event of uncertainty (e.g., job loss or unanticipated out-of-pocket medical expenses). Increases in the probability of financial distress have the effect of dampening consumer spending, which in turn has a negative effect on the regional and national economy, though there is little direct evidence that higher debt levels have led to economic slowdowns (Carlson 1993; Garner 1996).

Consumer debt has been rising over the past 30 years. It comprised about 16 percent of disposable income in 1960 compared with more than 20 percent in 1996 (Garner 1996), a large part of which was credit card debt (Guimaraes, Yoon, and Clevenson 1997). Consistent with our conceptual framework, there is ample evidence that consumers rely on debt financing specifically to fund the consumption of medical care. According to a recent Commonwealth Fund survey, 37 percent of adults have difficulty paying medical bills, have accrued medical debt, or both (Doty, Edwards, and Holmgren 2005). Although the survey used different questions to get at the same problem, the results from our survey are remarkably
similar to their findings. In addition, according to the Center for Studying Health System Change, there is a direct relationship between medical bill problems and out-of-pocket costs. Families with more than $2,000 of annual out-of-pocket medical costs were more than five times more likely to experience problems paying medical bills, compared to those with annual out-of-pocket costs less than $250 (May and Cunningham 2004).

Not surprisingly, there is an association between medical-bill problems and access to health care that is very similar to that observed in the uninsured population. Compared to all families, persons in families with medical-bill problems are two to three times more likely to report unmet medical need, delayed care, or inability to obtain prescription drugs in the past year (May and Cunningham 2004). Other studies have reached similar conclusions (e.g., Tu 2004).

Other Effects
The IDPH survey revealed several other potentially important economic effects of rising health insurance costs, including the association between health insurance, employment mobility, and entrepreneurial activity. Survey results indicate that 24 percent of insured Iowans “stayed in a job they didn’t like in order to keep health insurance,” 24 percent indicated that heath insurance costs have affected their ability to retire, and 19 percent of insured Iowans indicated that they were working full time only to quality for employer health benefits (Table 5). The size of these proportions suggest that job mobility is a serious concern among insured working Iowans, despite national evidence that the prevalence and severity of job lock is likely to be quite small (Kapur 1998).

Employment mobility has two components: the disutility of remaining in a relatively undesirable employment situation, and the inefficiencies associated with underemployment. In order to quantify the disutility of remaining in a relatively undesirable employment situation, individuals would have to be asked a series of questions that address their willingness to pay for employment changes. One would also want to consider additional costs associated with stress, a risk factor that has been found to increase health expenditures by as much as 46 percent (Goetzel et al. 1998). The IDPH survey identified several important stress-related effects (Table 5), including job lock (24 percent) and various family-related problems (6–18 percent). Similarly, in order to assess the impact of underemployment, one would have to measure the difference between an employee’s highest attainable wage (i.e., their maximum marginal product) and current wage.
Table 5
Changes in Other Factors Attributed to Health-Care Costs

Q. Sometimes people make major decisions based on what might happen with health insurance. For each of the following, please tell me if this describes your situation. Just answer yes or no.

<table>
<thead>
<tr>
<th>Decision</th>
<th>You or someone in your household faced in the past three or four years (Percent)</th>
<th>... based on what might happen [in the future] to your health insurance (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stayed in a job you didn’t like in order to keep health insurance</td>
<td>24</td>
<td>35</td>
</tr>
<tr>
<td>Stayed with the same insurance policy to avoid problems with “pre-existing conditions”</td>
<td>25</td>
<td>39</td>
</tr>
<tr>
<td>Decided whether or when to have a baby, based on health insurance coverage</td>
<td>8</td>
<td>13</td>
</tr>
<tr>
<td>Decided whether or when to retire, based on health insurance coverage</td>
<td>24</td>
<td>44</td>
</tr>
<tr>
<td>Decided to start working in order to get health insurance coverage</td>
<td>13</td>
<td>21</td>
</tr>
<tr>
<td>Decided not to start a business on your own because of losing health insurance coverage</td>
<td>14</td>
<td>23</td>
</tr>
<tr>
<td>Decided to get married or stay married to get or keep health insurance</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>Decided to continue working instead of staying home to care for children or other family members in order to keep health insurance</td>
<td>18</td>
<td>30</td>
</tr>
<tr>
<td>Switched to a job that was less desirable in order to get health insurance coverage or get better coverage</td>
<td>7</td>
<td>19</td>
</tr>
<tr>
<td>Decided to forgo making an investment in the future, such as starting a college fund for a child or putting money into a retirement savings account</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td>Worked full-time so you would qualify for the company health insurance plan when you would have preferred part-time, so you could to go to school, for example, or spend time with family</td>
<td>19</td>
<td>34</td>
</tr>
</tbody>
</table>

Notes: (1) Most of these questions are asked of the full sample (n = 1,202); (2) Based only on those who report that they currently have some form of health insurance (n = 1,060). Source: 2005 IDPH Health Insurance Survey of Iowa Households
In addition to problems associated with employment mobility, 14 percent of survey respondents indicated they decided not to start a business on their own because of losing health insurance coverage (Table 5). Again, it is difficult to quantify these effects; for example, Holtz-Eakin, Penrod, and Rosen (1996) failed to find strong evidence of reduced entrepreneurial activity attributable to health insurance costs. Nevertheless, even if the effects are small it is likely that the effect would be larger in a state with a disproportionately high proportion of small firms, like Iowa and other rural states.

Discussion

Based on a simple economic model, the range of reactions that individuals might have in response to inflation in health-care costs includes reductions in non-health-care consumption, reductions in health-care consumption, reductions in savings, reductions in wages, and increases in debt burden. In addition to the economic model, a working hypothesis is that price inflation, particularly affecting disproportionately large components of household expenditures (like health care), is a cause of anxiety and stress within the household.

The results of the IDPH survey suggest that all of these effects are to varying degrees observed among the Iowa population. In this paper we have put forth a discussion of how these effects might impact consumers and the regional economy. We conclude that: (1) individuals view inflation in health costs as a serious problem that broadly affects their lives, (2) high rates of inflation in health costs are likely to have an effect on the regional economy, although the expected negative effects of price inflation and net wage reductions are most likely offset by gains to the regional economy from growth in the health sector, (3) the demand for health care is downward sloping, which implies that higher prices lead to less consumption, and beyond some threshold less consumption is likely to have negative effects on health, and (4) the secondary effects of inflation in health-care costs are less employment mobility, dampening of entrepreneurial incentives, and stress.

Based on simulations and estimates, we conclude that the net effect of these adaptive responses on the regional economy is likely to be small, mainly due to the offset associated with increased economic activity in the health-care sector. That said, we caution against inferring that the net effect will be small under all circumstances and over time. For example, the net economic effects of migration of economic activity from the non-health sector to the health sector of the economy may be offsetting in the short run but not in the long run, as small
sub-regional economies (such as rural areas) experience net losses in economic activity. Firms operating in small local economies, such as hardware stores or accounting agencies, face a double-edged sword: they could potentially experience a decrease in demand for their (non-health-care) services while at the same time having to pay more for employee benefits. There is little question that small firms face difficulties as health-benefit costs increase two to three times faster than inflation (Kapur 2004; Morrisey, Jensen, and Morlock 1994; William M. Mercer Inc. 1999; Kronick and Gilmer 1999). Some of these firms may eventually fail, which could potentially have a dramatic one-time effect on a local economy. Similarly, the effects of reductions in health-care consumption are likely to be greater for sicker, low-income populations, where the marginal health effects of small reductions in health-care consumption may be large. Thus, there would be great value in further study of these effects, observing changes in a diverse cross-section of markets over time.
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———. ———. History of CPI-U.S.: All items indexes and annual percentage changes from 1913 to present. 2005. Washington, DC.


Revitalizing the Value-Added Statement to Enhance Sustainability Reporting

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Western Washington University

INTRODUCTION
The value-added statement (VAS) gained some acceptance during the 1970s as a supplement to the more traditional income-statement approach to reporting corporate earnings. The VAS grew from an enterprise theory of the firm that emphasizes the distribution of the total value added among various contributors. Subsequently, the VAS declined in popularity during the 1980s, as both financial statement preparers and users focused on other aspects of reporting income. Early in the 21st century, however, supporters of comprehensive sustainability reporting have advocated the disclosure of a firm’s “economic footprint” including, once again, its economic effects on major groups of contributors.

Currently, no uniform format exists for reporting this comprehensive economic effect, and, as a result, both completeness and comparability suffer. This analysis describes the historical development and decline of the VAS, discusses a specific current need of sustainability reporting, and links this current need with a revitalized, contemporary VAS. The discussion concludes with examples from two firms’ award-winning sustainability reports that could be improved by the presentation of an enhanced VAS.

THE VALUE-ADDED STATEMENT
During the mid-20th century, support grew for an enterprise theory of the firm as a modification to the earlier proprietary and entity theories. This observation led to proposals for and limited implementation of supplementary income disclosures generally described as value-added statements (VAS).
Theoretical Perspectives
While the proprietary and entity theories, respectively, emphasize the role of entrepreneurs and shareholders in the success of a firm, the enterprise theory focuses on a much larger group of participants who contribute to a firm’s performance and prosperity. This enterprise perspective also concludes that these various participant groups are, in turn, affected by the organization, because “decisions made in the enterprise affect, in one way or another, the stockholders, the employees, the creditors, the customers, various governmental...agencies, and that most ephemeral of groups known as the public” (Suojanen 1954, 392). With the recognition of both contributions by and effects on these various participant groups, advocates of this broader enterprise perspective proposed the value-added concept of income or “the measurement of the flow [of income] and its division among the participants in the organization” (Suojanen 1954, 395).

Based on this enterprise concept of income, supporters encouraged firms to issue a value-added statement as a supplementary report to the traditional income statement. Described during the 1970s as a “new direction in accounting theory and practice,” the VAS emphasizes the wealth attributed to all the various groups of participants (Morley 1979, 618). Like a traditional income statement, the VAS focuses on a firm’s operating activities, but the two statements disclose information very differently. Exhibit 1 compares the format of a traditional single-step income statement and a composite view of the early VAS model.

Supporting the proprietary and entity theories, the traditional income statement format focuses on income as a reward for the efforts and risk-taking of the entrepreneurs or shareholders. This format organizes all payments to other participants as expenses. Alternatively, reflecting the enterprise theory, the VAS format highlights payments to all major groups of participants.

All the variations of these early VAS models begin with the determination of value added—the difference between sales revenue and the cost of purchased materials and outside services. In the lower portion of the report, this value added is then distributed among the key participant groups—employees, creditors, the government, and shareholders. The separate identification of dividend represents an important difference in the content of the two reports. An income statement does not separate income into dividends and retained earnings. In contrast, the VAS separates dividends (value-added applied to shareholders) from retained earnings (value-added retained by the firm).
Since most of the information reported on a VAS is already captured during the process of preparing a traditional income statement, proponents of this new disclosure maintained that this supplementary income information would not increase reporting costs significantly. With relatively low cost, therefore, the supplementary statement would achieve a key benefit—the clear presentation of the share of value-added flowing to all participants.

Historical Development and Decline
With this theoretical rationale for its utility, along with the encouragement of several professional accounting groups, the VAS gained some moderate acceptance—especially in Great Britain. Described as a simple and direct way to put profit into perspective, VAS reports were issued by 60 of the top 250 British firms in the late 1970s (Pong and Mitchell 2005).

Exhibit 1: A Comparison of Traditional Income Statement and Value-added Statement Formats
(monetary amounts presented only as examples)

<table>
<thead>
<tr>
<th>Category</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part A: A Traditional Single-Step Income Statement Format</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>$100</td>
</tr>
<tr>
<td>Less: Expenses</td>
<td></td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>$65</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>25</td>
</tr>
<tr>
<td>Income</td>
<td>$10</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Category</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part B: A Composite View of an Early Value-added Statement</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>$100</td>
</tr>
<tr>
<td>Less: Purchased Materials and Services</td>
<td>40</td>
</tr>
<tr>
<td>Value-added Available for Application</td>
<td>$60</td>
</tr>
<tr>
<td>Value-added Applied to:</td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>$35</td>
</tr>
<tr>
<td>Creditors</td>
<td>5</td>
</tr>
<tr>
<td>Government</td>
<td>10</td>
</tr>
<tr>
<td>Shareholders</td>
<td>4</td>
</tr>
<tr>
<td>Profit Retained</td>
<td>6</td>
</tr>
<tr>
<td>Value-added Applied</td>
<td>$60</td>
</tr>
</tbody>
</table>
Issuing firms and public supporters praised the VAS reports for their ability to foster positive team attitudes, emphasize the interdependence of participants, condition participant expectations, disclose the importance of a firm to the community, and provide a format for common size comparisons (Morley 1979; Meek and Gray 1988). The emphasis on the participant teams and the conditioning of expectations were considered especially important attributes in the pro-labor economic climate of mid-to-late 1970s Great Britain.

As the VAS gained popularity, debate grew concerning several theoretical aspects of value added. Although a detailed analysis of these theoretical issues is beyond the scope of this presentation, a brief reference adds to the overall conceptual background. The major debate focused on the relative merits of gross versus net value added as the key measure (Meek and Gray 1988). The central issue was whether depreciation should be included in a value-added calculation. Additional discussions highlighted issues with inventory costs, taxes, and the definitions of participants.

After a promising start, however, the popularity of the VAS waned. European and North American interest in the report had significantly declined by the mid-1980s (Pong and Mitchell 2005). Reasons cited for the decline include dwindling interest in the information in the VAS and the presentation of the statement. Since Great Britain was the site of significant early VAS activity, overall interest declined when the British economic climate changed to a more conservative perspective in the early 1980s (Pong and Mitchell 2005). In addition, the lack of standardization of the VAS reports limited the promised benefit of comparability.

**A GROWING INTEREST IN SUSTAINABILITY REPORTING**

After several decades of decline in VAS popularity, the interest of corporate report users once again shifted toward the firm’s effects on various participant groups. During the 1990s and 2000s, a growing number of NGOs, governments, and other interested groups have called for greater company disclosures of economic, environmental, and social effects—now called sustainability reporting. This renewed emphasis on the breadth of reporting has led to an increased scope of traditional corporate disclosure and encouraged new standards of this more comprehensive approach.

**An Increased Scope of Reporting**

Although the impetus for sustainability reporting emerged around the turn of the
most recent century, its seeds were visible during the 1940s. In their landmark monograph, Paton and Littleton commented:

“From a convenient mechanical device privately applied to the measurement of the status and results of a business enterprise, [accounting] has become an important medium for the public expression of important facts about our vast and complex commercial and industrial society. Where the accountant once was concerned merely with assisting the owners of a business to evaluate its operations in money terms, he [or she] now must recognize a broad social responsibility” (Paton and Littleton 1940, v).

This sentiment was developed more specifically a half century later, when authors such as John Elkington called for the systematic reporting of a firm’s “triple bottom line”—its impact on economic prosperity, environmental quality, and social justice (Elkington 1998).

Broadly speaking, the modern sustainability report allows a company to disclose the influences it has on both internal and external stakeholders. According to the Corporate Register clearinghouse, by mid-2008 over 4,400 organizations had issued over 17,500 sustainability reports (Corporate Register 2008). While the goal is to present comparable, comprehensive, and credible information on economic, environmental, and social effects of an organization, these supplementary reports often have varying structures and levels of disclosure, involving quantitative information, narrative text, graphics, and pictures. This lack of uniformity is predictable and understandable as organizations experiment with various alternatives. Progress toward standardization and uniformity, however, is evident in organizations’ attempts to prepare and issue reports consistent with the framework of the Global Reporting Initiative (2008).

The Global Reporting Initiative (2008)
The Global Reporting Initiative (GRI) currently represents the “leading benchmark for measuring, monitoring, and reporting sustainability information” (Savitz and Weber 2006, 211–2). The most recent GRI framework—the G3—establishes underlying principles, organizes disclosure categories, and presents specific performance-indicator requirements for contemporary sustainability reporting. In this sense, the G3 represents efforts similar to national and international generally accepted accounting practices, in that each seeks to codify and unify reporting.
The following summary provides some important highlights of G3 reporting principles and standards. The framework presents three specific elements for interested firms to consider.

- **Reporting Principles:** Defining underlying concepts such as materiality, completeness, balance, comparability, accuracy, timeliness, clarity, reliability, and assurance.

- **Strategy and Profile:** Describing disclosures of an organization’s general profile, strategy, governance structure, and overall management approach.

- **Specific Performance Indicators:** Discussing the nine specific economic performance indicators (labeled EC1–EC9), 30 environmental performance indicators (labeled EN1–EN30), and 40 social performance indicators (labeled SO1–SO8, LA1–LA14, HR1–HR9, and PR1–PR9) that constitute comprehensive sustainability disclosure. Exhibit 2 presents examples of these specific performance indicators.

While the strategy and profile section is generally narrative, the indicators require a combination of quantitative and qualitative disclosures. Since both issuing a sustainability report and conforming to the G3 standards represent voluntary management actions, the G3 provides several levels of participation.

### Exhibit 2
**Examples of Specific G3 Performance Indicators**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Required Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>EC 1</td>
<td>The direct economic value generated and distributed including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments (G3, 26).</td>
</tr>
<tr>
<td>EC 4</td>
<td>Significant financial assistance received from government (G3, 26).</td>
</tr>
<tr>
<td>EN 1</td>
<td>Materials used by weight or volume (G3, 28).</td>
</tr>
<tr>
<td>EN 6</td>
<td>Initiatives to provide energy-efficient or renewable-energy-based products and services and reduction of energy requirements as a result of these initiatives (G3, 28).</td>
</tr>
<tr>
<td>SO1</td>
<td>Nature, scope, and effectiveness of any programs and practices that assess and manage the effects of operations on communities including entering, operating, and exiting (G3, 34)</td>
</tr>
<tr>
<td>SO5</td>
<td>Public policy positions and participation in public policy development and lobbying (G3, 34)</td>
</tr>
</tbody>
</table>
for beginning, intermediate, and advanced reporters. In addition, the G3 allows
significant latitude regarding the format and approach a firm selects. Many firms
elect to “tell their own story” by weaving together their disclosures, while focusing
on specific themes that appeal to specific stakeholder groups. The reporting
firm then provides an index indicating where a reader could locate information
on specific G3 indicators. A detailed analysis of the G3 Reporting Framework
and numerous examples of contemporary sustainability reports conforming
to the G3 are available on the GRI and Corporate Register websites—

LINKING THE VAS AND THE
CONTEMPORARY SUSTAINABILITY REPORT
Although sustainability reporting has increased in popularity and the GRI
guidelines have improved the quality and content of reports, opportunities for
significant improvement still exist. The flexible nature of the G3 can lead to a re-
duction in report quality. A revitalized, contemporary VAS can assist the clarity,
completeness, and comparability of several specific aspects of G3 reporting.

A Current Sustainability Reporting Need
The ability of a firm to conform to the G3 standards at multiple levels of compli-
ance and to address the various specific indicators, while telling its own story
its own way, provide some important benefits. Since sustainability reporting is
primarily voluntary at this time, the flexibility of the G3 approach encourages
organizations to make an initial attempt, improve with successive reports, and
develop a report style that fits the organization. Conversely, this flexibility can
affect clarity, completeness, and comparability both between firms and in suc-
cessive yearly reports of the same firm. To evaluate this effect more thoroughly,
Exhibit 3 describes the G3 definitions of these three important underlying
principles.

Given the current approach that many firms take to G3 reporting, a reader often
must search multiple report locations to identify the data and discussion relevant
to just one performance indicator. Although the G3 principles emphasize clarity,
completeness, and comparability, current practice may permit too much flexibil-
ity to support quality reporting.

The Quality Reporting Movement
Since the financial reporting scandals of the early 2000s, numerous account-
ing professionals in practice and the academy have emphasized the benefits of
quality financial reporting (QFR) in both primary and supplementary information. Beginning with the observation that quality reporting is a key value-adding policy tool, proponents make an effective business case for improving reporting clarity (Miller and Bahnson 2002). This case relies on the following logic. Better quality information for internal and external stakeholders leads to lower uncertainty about an organization. A lower level of uncertainty leads to a lower risk profile for the organization, and, therefore, a lower cost of capital and higher equity price (Miller and Bahnson 2002). Citing obfuscation and minimal reporting as key challenges, advocates of QFR assert that managers who ignore the needs of the information user increase the capital costs of their organizations. QFR supporters further encourage managers to adopt the attitude and initiative to communicate openly and completely rather than merely seek a level of reporting that is barely “good enough.”

QFR advocates cite two additional benefits of sustainability reporting. First, the cost of reporting is not merely the cost of report preparation by the issuing firm, but also includes costs incurred by analysts engaged in the “hunting and gathering process,” as they attempt to sort information disclosed through a minimalist or obfuscating approach (Miller and Bahnson 2002, 236). Second, those who report on a minimal and confusing basis drive analysts to other sources of information. The problem with this approach rests with the inconsistent nature of the information pieced together from a variety of secondary and tertiary sources. Thus, this hunting process might not present a reliable composite view (Miller and Bahnson 2002).

<table>
<thead>
<tr>
<th>Exhibit 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>G3 Statements on Clarity, Completeness, and Comparability</strong></td>
</tr>
<tr>
<td><strong>Clarity</strong></td>
</tr>
<tr>
<td>Information should be made available in a manner that is understandable and accessible to stakeholders using the report (G3, 16).</td>
</tr>
<tr>
<td><strong>Completeness</strong></td>
</tr>
<tr>
<td>Coverage of the material topics and indicators and definition of the report boundary should be sufficient to reflect significant economic, environmental, and social impacts and enable stakeholders to assess the reporting organization’s performance in the reporting period (G3, 12).</td>
</tr>
<tr>
<td><strong>Comparability</strong></td>
</tr>
<tr>
<td>Stakeholders using this report should be able to compare information reported on economic, environmental, and social performance against the organization’s past performance, its objectives, and, to the degree possible, the performance of other organizations (G3, 14)</td>
</tr>
</tbody>
</table>
A Revitalized, Contemporary VAS

Including a revitalized, contemporary VAS in a firm’s sustainability report can reduce the “hunting and gathering” and improve clarity, completeness, and comparability. Specifically, an updated and adapted VAS will enhance the reporting of two important G3 core indicators of economic effect.

Within the G3 indicators presented in Exhibit 2, EC1 (the first core measure of economic performance) requires disclosure of direct economic value generated and distributed to various stakeholder groups. Further, EC4, a subsequent core economic indicator, requires the disclosure of significant financial assistance received from governments. The current G3 approach permits firms to present information to satisfy these two reporting requirements in a variety of locations and formats. As the examples in the next section demonstrate, this current lack of uniformity creates high search costs and questionable information reliability, as readers look in perhaps a half-dozen report locations and then piece together the information.

In order to improve reporting in these two important economic-effect areas, the proposed VAS in Exhibit 4 presents a standardizing framework.

While the proposed VAS retains the general approach of its predecessor, it also includes several formatting features that assist in reporting the direct economic effect information required in EC1 and EC4.

This updated VAS maintains the basic format of calculating the value added at the beginning of the statement, and then presenting the distribution of this same amount of value added among various groups. Like its predecessor, this proposed VAS presents the reader with an underlying equality—the value added available equals the value added applied among the various stakeholder groups. The format relies on a stakeholder classification model based on five important stakeholder groups: the 5C’s—customers, chain-of-value participants, colleagues, the community, and capital providers. While this information is similar to the initial VAS prototype, the revised statement highlights the total distributions to various stakeholder groups. Revenue from customers minus the cost of materials and outside services provided by chain-of-value participants determines the amount of value added by an organization. This added value is then distributed to three additional stakeholder groups—colleagues, the community, and capital providers. The community and capital provider groups include several types of payments. Community payments include taxes paid to various levels of government, charitable donations, and grants received (as a subtraction).
Payments to capital providers include interest, dividends, and retained earnings. This approach includes retained earnings as a distribution attributable to capital providers, because the earnings retained increase the shareholders’ investment in the firm. Alternatively, the retained earnings can be displayed separately. Although this VAS model shows only a single category of payments to colleagues, this total could be divided into several subcategories, if desired. Subcategories in this area might include wages and salaries, benefits, and payments to retirees.

Along with the organization of the lower portion of the VAS, this proposed model includes not only monetary amounts but also common size percentages. This increases comparability in a manner similar to the importance of common size calculations when comparing primary financial statement information. Readers may compare year-to-year changes in percentages for a given firm and make firm-to-firm comparisons within a given year.

**OBSERVATIONS FROM TWO EXAMPLES**

To further examine the current need and potential VAS contribution to the sustainability reporting of economic effects, this updated VAS model was applied to the EC1 and EC4 disclosures of Ford Motor Company (2007, 2007–8) and

<table>
<thead>
<tr>
<th>Stakeholders</th>
<th>Category</th>
<th>$</th>
<th>%</th>
<th>$</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers</td>
<td>Sales</td>
<td>$1,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chain of Value</td>
<td>Purchased Materials &amp; Services</td>
<td>600</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Value-added Available</td>
<td>$400</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Colleagues</td>
<td>Wages, Salaries and Benefits</td>
<td>$260</td>
<td>65%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Taxes</td>
<td>$40</td>
<td>10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Community</td>
<td>Grants Received</td>
<td>(4)</td>
<td>(1%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Charitable Donations</td>
<td>20</td>
<td>5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Subtotal</td>
<td>56</td>
<td>14%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest</td>
<td>36</td>
<td>9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dividends</td>
<td>16</td>
<td>4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Providers</td>
<td>Retained Earnings</td>
<td>32</td>
<td>8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Subtotal</td>
<td>84</td>
<td>21%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Value-added Applied</td>
<td>$400</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Daimler (2007, 2008) in their 2007–8 sustainability reports. (Unlike traditional financial reports, sustainability reports do not necessarily align with a specific fiscal period. Time periods for sustainability reports may overlap portions of two fiscal years.)

These firms’ reports provide good comparative examples for several reasons. First, the firms operate in the same global industry, and each emphasizes the importance of sustainability considerations in its management decisions. Second, both firms have issued award-winning sustainability reports based on the G3 reporting framework. Both evaluate their reports at the “A” level within the GRI hierarchy. The “A” level—the highest level possible without external assurance—asserts that a firm has reported on each G3 core indicator with due regard for materiality and disclosure requirements. In addition to high scores on the GRI evaluation hierarchy, both firms have earned competitive awards for quality sustainability reporting. Ford’s report was selected by CERES as a winner of the Best Sustainability Report Award in January 2008 (CERES 2007). In November 2007, Daimler received a top-10 ranking from AccountAbility (Daimler 2007). Parenthetically, Daimler, the European firm, reports its financial results in euros based on International Financial Reporting Standards (IFRS) while Ford, the U.S. firm, reports financial results in dollars based on U.S. Generally Accepted Accounting Principles (U.S. GAAP). This reporting difference, however, does not affect the quality and coverage of the firm’s sustainability reports.

Exhibits 5 and 6 present the results of the application of the contemporary VAS model to the 2007/8 Ford and Daimler sustainability disclosures. As the analysis following the exhibits indicates, these results raise some important questions about the clarity, completeness, and comparability of these firms’ EC1 and EC4 disclosures.

These exhibits present a slightly different VAS picture, in format and content, from the model in Exhibit 4. Specifically, Exhibits 5 and 6 include several changes for illustrative purposes. In an actual report setting, these modifications are not necessary. They do, however, highlight some important shortcomings of current reporting practice.

Exhibits 5 and 6 omit any common size information, contain a column for the measurement basis, and also include an explanation of the various sources of information, as portions of EC1 and EC4 performance indicators are reported throughout these firms’ financial and sustainability reports. Common size calculations cannot be made for either firm, because value added cannot be
## Exhibit 5
Ford 2007/8 Enhanced Value-added Statement
(assembled from disclosed information)

<table>
<thead>
<tr>
<th>Stakeholders</th>
<th>Category</th>
<th>$ Millions</th>
<th>Basis</th>
<th>Information Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers</td>
<td>Sales</td>
<td>$172,455</td>
<td>Accrual</td>
<td>Consolidated Income Statement in Annual Report</td>
</tr>
</tbody>
</table>

Chain of Value

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>and Services</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value-added Available</td>
<td></td>
<td>&lt; $82,455</td>
<td>?</td>
<td>Sales–Purchased Materials and Services</td>
</tr>
</tbody>
</table>

Colleagues

| Value-Added Applied: | Wages, Salaries and Benefits | $? | ? |

Community

| Grants Received      | ? | ? | Interactive Sustainability Report Society Data |
| Charitable Donations | 54 | Cash | Sum of Category |

Capital Providers

| Interest             | 10,927 | Accrual | Consolidated Income Statement in Annual Report |
| Dividends            | 0      | ?       | Interactive Sustainability Report Selected Financial Data |

| Retained Earnings    | (1,468) | Accrual | Comparison of Consolidated Balance Sheets in Annual Report |

| Subtotal             | 9,459   |         | Sum of Category |

Value-added Applied | ? | ? |

---

determined. Although the current G3 disclosures do not require the presentation of the total value added, the sum of the distribution to the stakeholder categories listed in EC1 and EC4 should equal the value added. Both firms report a mixture of cash-basis data, accrual-basis data, and some data without a reference to ba-
### Exhibit 6
**Daimler 2007/8 Enhanced Value-Added Statement**
(assembled from disclosed information)

<table>
<thead>
<tr>
<th>Stakeholders</th>
<th>Category</th>
<th>€ Millions</th>
<th>Basis</th>
<th>Information Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customers</strong></td>
<td>Sales</td>
<td>99,399</td>
<td>Accrual</td>
<td>Sustainability report economic indicators</td>
</tr>
<tr>
<td><strong>Chain of Value</strong></td>
<td>Less: Purchase of Materials and Services</td>
<td>?</td>
<td>?</td>
<td>Sales–purchased materials and services</td>
</tr>
<tr>
<td><strong>Colleagues</strong></td>
<td>Value-added Applied: Wages, Salaries and Benefits</td>
<td>20,256</td>
<td>Accrual</td>
<td>Interactive and printed sustainability reports</td>
</tr>
<tr>
<td></td>
<td>Taxes</td>
<td>4,326</td>
<td>Accrual</td>
<td>Interactive and printed sustainability reports</td>
</tr>
<tr>
<td>/ Community</td>
<td>Grants Received</td>
<td>?</td>
<td>?</td>
<td>Sustainability report (detailed listing in differing currencies)</td>
</tr>
<tr>
<td></td>
<td>Charitable Donations</td>
<td>&gt; 3</td>
<td>?</td>
<td></td>
</tr>
<tr>
<td>Subtotal</td>
<td></td>
<td>?</td>
<td>?</td>
<td>Sum of category</td>
</tr>
<tr>
<td><strong>Capital Providers</strong></td>
<td>Interest</td>
<td>471</td>
<td>Accrual</td>
<td>Consolidated income statement in annual report (net interest revenue)</td>
</tr>
<tr>
<td></td>
<td>Dividends</td>
<td>1.579</td>
<td>Cash</td>
<td>Consolidated statement of cash flows</td>
</tr>
<tr>
<td></td>
<td>Retained Earnings</td>
<td>(1,046)</td>
<td>Accrual</td>
<td>Comparison of Consolidated Balance Sheets in Annual Report</td>
</tr>
<tr>
<td>Subtotal</td>
<td></td>
<td>?</td>
<td>?</td>
<td>Sum of Category</td>
</tr>
<tr>
<td>Value-added Applied</td>
<td></td>
<td>?</td>
<td>?</td>
<td></td>
</tr>
</tbody>
</table>

In each case, the information for the VAS has been assembled from throughout the firm’s disclosures using the “hunting and gathering” approach applied to several hundred pages of data, text, and graphics.

Overall, the results of applying the revitalized VAS model to these two award-winning sustainability reports appear quite mixed. Both firms have reported in a variety of locations, have included some aspects of EC1 and EC4 indicators but not others, and appear to have taken a “good enough” approach to quality reporting. The firms’ disclosures also differ in content. Ford provides data by which
to estimate value added along with payments to capital providers. The firm, however, does not readily disclose total payments to employees or the value of government grants received. By contrast, Daimler reports payments to employees and capital providers, but does not disclose enough additional information to calculate the total value added. The firms have reported in several different measurement bases that inhibit aggregation. A reader must devote considerable time to reviewing the financial and sustainability disclosures by each firm to piece together a composite picture that is still incomplete. One must ask whether these disclosures meet the intent of the framers of the G3 guidelines.

To be fair, both firms acknowledge some of these shortcomings. Ford (2007) signals only partial compliance with EC1 and no compliance with EC4. Daimler (2007) states that grants received are proprietary information and, therefore, the firm discloses no EC4 information.

Both firms voluntarily report within the current bounds and recommendations of the G3, so their sustainability disclosures are commendable. When considered in terms of the revised VAS approach—an approach consistent with the performance indicator disclosures of both EC1 and EC4—however, these disclosures fall short of the expectation of full and fair quality sustainability reporting.

CONCLUSION
All managers who report sustainability information, especially those who put forth the extra effort to address the G3 criteria, should receive a measure of support. They have exercised the initiative to report their firms’ effect on a wide range of stakeholders. Yet, a firm’s failure to address the underlying G3 principles of clarity, completeness, and comparability often dilutes a good-faith effort. Quality reporting begins with the right management attitude and relies on managers’ desire to move beyond the all-too-familiar approaches of obfuscation and minimization. Preparers of contemporary sustainability reports must strike a more effective balance between flexibility and uniformity. Either through voluntary management action or the revision of the G3 framework, firms could improve this balance with a contemporary VAS. The VAS has always been described as a supplementary disclosure, but given the current emphasis on stakeholder inclusiveness, a revitalized VAS may provide just the right framework for reporting a firm’s economic effects. Over the last decade and with the assistance of the GRI, organizations have issued increasingly more comprehensive and organized sustainability reports. The clear presentation of a complete and comparable VAS will be another big step forward.
REFERENCES


INTRODUCTION
In an October 2008 report, the Pew Hispanic Center, a project of the respected Pew Research Center, estimated that there were 11.9 million unauthorized immigrants living in the United States as of March 2008. Although the Pew Report indicates that the number of unauthorized immigrants in 2008 was approximately 0.5 million fewer than in 2007, the 2008 figure reflects an increase of 3.5 million from the 8.4 million reported in 2000. This increase has prompted the federal government to explore new methods of tougher enforcement, such as adding 670 more miles to the border fence between the United States and Mexico. Congress has been unable to pass legislation to address the root problem, however, which is the need for immigration reform. Political and philosophical differences have led to a stalemate in resolving the complex issues associated with dramatic increases in the numbers of illegal aliens. The states, which have borne most of the costs associated with illegal immigration, have become frustrated with federal inaction and have begun to take matters into their own hands.

In response to the increasing number of undocumented immigrants and the seeming inability of the federal government to enforce federal immigration laws, a majority of the states have undertaken the task of regulating immigration by adopting laws that address numerous issues related to employment, public benefits, health, education, and other areas of concern. While it is clear that state law enforcement agents have authority to enforce federal laws, some earlier
attempts by states to control immigration through state laws have been struck down on the basis of the Supremacy Clause and the Equal Protection Clause.5 This paper will discuss federal laws that address immigration, some effects of illegal immigration, its effect on local communities, and states’ attempts to control employment of undocumented workers. Finally, it will advocate for Congress to take responsibility to legislate in this area of national concern and to preempt state laws dealing with immigration.

FEDERAL LAWS

The Immigration and Nationality Act (INA)
The Immigration and Nationality Act of 1952 (INA) is the primary federal law that regulates immigration status.6 The INA has been amended numerous times since its original enactment, but still remains the primary source of immigration law.7 One INA amendment, known as the Antiterrorism and Effective Death Penalty Act of 1996 (AEDPA), specifically authorizes state and local law enforcement officials to arrest and detain a person who “(1) is an alien illegally present in the United States; and (2) has previously been convicted of a felony in the United States and deported or left the United States after such conviction…”8 The amendment limits this authority, however, by requiring state or local law enforcement officials to “obtain appropriate confirmation from the Immigration and Naturalization Service of the status of such individual and only for such period of time as may be required for the Service to take the individual into federal custody for purposes of deporting or removing the alien from the United States.”9 Since the Immigration and Naturalization Service (INS) was dismantled and its functions merged into the Department of Homeland Security (DHS), the status of a detained person must now be confirmed through DHS.

Immigration Reform and Control Act of 1986 (IRCA)
The Immigration Reform and Control Act of 198610 made it unlawful for an employer to hire an undocumented worker and established a process for verifying the work eligibility of all employees. Any person “hiring, recruiting, or referring an individual for employment in the United States” must examine that individual’s documentation, which establishes “both employment authorization and identity” and which “reasonably appears on its face to be genuine.”11 One of the goals of the IRCA was to reduce the number of illegal aliens in the U.S. workforce, but it proved ineffective. According to one scholar, the main drawback of the IRCA “was that it did not include a secure worker identity or work authori-
zation system, without which all other control measures were less effective and often counterproductive.”

One proposed solution was the introduction of the Basic Pilot Program, a voluntary internet-based employment verification system operated by U.S. Citizenship and Immigration Services (USCIS) in partnership with the Social Security Administration. At this point, participation in the Basic Pilot Program, now known as E-Verify, remains voluntary for most employers. A new rule implementing President George W. Bush’s Executive Order 12989 will require federal contractors to use E-Verify beginning May 21, 2009. Federal contractors, however, may not use E-Verify for current employees until the rule becomes effective. Currently, ten states require at least some employers to use the system, one state encourages its use, and one state prohibits employers from enrolling in any verification systems.

Immigration Act of 1990 (IMMECT 90)
The Immigration Act of 1990 amended the INA to establish immigration priorities based on certain preference. “IMMECT 90 primarily reformed the rules pertaining to the legal entry of foreign nationals [and] augmented the regulations enacted by IRCA.” The act defines three categories of preference for the allocation of immigrant visas, with specified numerical limitations in each. The preference allocations are for family-sponsored immigrants, for employment-based immigrants, and a new category for diversity immigrants. The most noticeable change of IMMECT 90 was the increase by approximately 35% in the numerical limitation system, or overall immigration allowed.

The 1990 act also established the U.S. Commission on Immigration Reform, later known as the Jordan Commission after its chair Barbara Jordan, to “assess how immigration affects our society, how immigration laws function, and how to assess the demographics of the immigrant population.” In its report, the commission stated the belief that the key to limiting illegal immigration lies in establishing a better employment eligibility system than was provided in IRCA. As a part of its findings, the commission recommended the

“development and implementation of a simpler, more fraud-resistant system for verifying work authorization. The current system is doubly flawed: it is too susceptible to fraud, particularly through the counterfeiting of documents; and it can lead to increased discrimination against foreign-looking or foreign-
sounding authorized workers. In examining the options for improving verification, the Commission believes that the most promising option for secure, non-discriminatory verification is a computerized registry using data provided by the Social Security Administration [SSA] and the INS.”

THE FAILURE OF IMMIGRATION REFORM 2007

The Comprehensive Immigration Reform Act of 2007 called for the legalization of all illegal immigrants currently in the country, a guest-worker program with special provisions provided to farm workers, tighter border enforcement, and a new verification system for all U.S. employers and workers. After extensive debate, it failed to pass, as had numerous earlier reform attempts. Jeff Sessions, senator from Alabama, said that those supporting the bill were simply “trying to work a compromise to pass something” and urged members to instead pass legislation that “will work” in their next attempt. President Bush expressed disappointment that Congress was not able to address the American people’s concern over ineffective immigration laws when he stated “A lot of us worked hard to see if we couldn’t find a common ground—it didn’t work.”

Congress was unable to agree on what provisions would make the Comprehensive Immigration Reform Act of 2007 an appropriate law. Many illegal immigrants die in their efforts to cross the border, which makes enforcement a humanitarian and economic concern. According to Senator David Vitter of Louisiana, the American people are asking for enforcement results, not promises. Thus, one of the conflicts that must be resolved is the drafting of a law that is both humane and enforceable.

One reason for the bill’s failure was the influence Nativists and other right-wing groups exerted on the congressional leaders. Approximately 300 anti-immigration groups have surfaced since 2005, with the Ku Klux Klan being one of the most notorious. Another group, called the Federation for American Immigration Reform (FAIR), provided more than 30 testimonials to Congress since 2000. These groups used a variety of resources to emphasize the threat of terror and risk, potentially influencing the decisions of those voting.

On April 17, 2007, representatives from 20 major organizations were present on Capitol Hill to support the Strive Act, which was a component of the Comprehensive Immigration Reform Act. One of these groups, the Coalition for Comprehensive Immigration Reform, acts as a national umbrella for 333 groups. It supported the bill because of the potential benefits it would bring, even though
it disagreed with the guest-worker provisions.\textsuperscript{35} Labor unions opposed the measure, because they believed that immigration reform would cut wages and opportunities for Americans.\textsuperscript{36} The National Urban League, a civil rights organization, opposed the act, stating that any new temporary worker visa should be coupled with a requirement that black, white, Hispanic, Asian, or Native American workers have the highest priority to be selected for employment.\textsuperscript{37}

The political climate played a key role in the failure of the Comprehensive Immigration Reform Act of 2007. President Bush lost support from members of the Republican Party and Democrats no longer were willing to negotiate with them.\textsuperscript{38} While President Bush chastised members of his own party for failure to support immigration reform, conservative senators proposed a series of amendments that led to key parts of the bill being toughened. Republican Senator Lindsey Graham of South Carolina stated “[t]he American people have a low opinion of us because we can’t seem to do the things that we need to do because we’re too worried about us and not them.”\textsuperscript{39}

Perhaps the biggest reason for the bill’s failure was an amnesty provision, which called for the legalization of immigrants who entered illegally and are currently living in the United States. Dianne Feinstein, a Democratic Senator from California, spoke in favor of this provision when she stated, “[w]hat we have in America is in effect an amnesty. We certainly can’t pick up 12 million people, and we certainly can’t deport 12 million people.”\textsuperscript{40} This attitude focuses on the difficulty of enforcement. Other proponents of amnesty emphasize that “undocumented workers make economic contributions to our society through the taxes they pay and because they require housing, food and services, just like any person in this country with documentation requires.”\textsuperscript{41}

Arguments against an amnesty provision generally fell into one of two categories. The first concerns fairness. In other words, there are people outside the United States who have spent years waiting for entry visas under the current immigration quota system. Would it be unfair to these persons who have followed the rules to allow those who have entered illegally to become citizens?\textsuperscript{42} A former General Counsel of the Immigration and Naturalization Service phrased it another way, “[S]uch a notion flies against a strong popular headwind derived from a widely held (and publicly valuable) aversion to lawbreaking.”\textsuperscript{43}

A second argument against amnesty is that a majority of the undocumented workers are likely to be working in lower-paying jobs. The granting of citizen-
ship would allow them to move into higher-paying jobs, “creating a vacuum at the lower end of the economy which would draw in many more illegal workers.”

Eventually, a majority of the Senate would not agree to vote on the bill, ensuring its failure.

RECENT EVENTS
A review of recent events illustrates the widespread nature of states’ efforts to regulate immigration. In 2006, Colorado’s Supreme Court struck down a law calling for a voter initiative to approve a measure that would prevent “non-emergency” social services to illegal immigrants, because the measure mixed the issues of benefits and taxation. In a special session following this decision, the Colorado legislature approved a new bill to prohibit illegal immigrants from receiving non-emergency state services, and a separate bill that would force employers to confirm that their employees are authorized to work in the U.S. Under this bill, employers who intentionally employ illegal workers would be denied tax benefits.

In a similar move, Georgia lawmakers passed the Georgia Security & Immigration Compliance Act on April 17, 2006, which requires any person over the age of 18 to provide evidence of legal status if they are seeking state or local benefits. It also requires employers and companies with state contracts to examine the legality of their employees’ immigration status, or risk having their state-income-tax deductions for employee wages denied.

Many other states have enacted legislation dealing with a variety of such issues, according to the Immigrant Policy Project of the National Conference of State Legislatures. For example, Arizona and Illinois require U.S. citizenship or legal-immigrant classification to receive health benefits, Wyoming will not provide state scholarships to non-citizens, and a bill that would have created a College Assistance Migrant Program at New Mexico State University was vetoed by the governor. Tennessee prohibits companies from state contracts for a year if they hired non-citizens. Louisiana allows state agencies to review hiring policies of contractors suspected of hiring illegal immigrants, permits the reviewing agency to terminate the employment of undocumented workers, and to fine employers not willing to cooperate. Pennsylvania bans employers who hire illegal aliens from receiving grants or loans on a state-assisted project.
Not all state and local immigration laws are as detrimental to immigrants. For example, California passed Proposition 187, which would prevent social services for immigrants, in 1994, but it was ruled unconstitutional in 1997.59 Recently California approved legislation to extend benefits to immigrant workers, including housing and income benefits.60 Evanston, Illinois, became one of the municipalities to consider what have come to be known as “sanctuary laws.” A draft resolution approved by the City Council on January 4, 2008, would prohibit city employees and police from inquiring into a person’s immigration status, “unless it is required by a law or deemed integral to a police investigation.”61

A more detailed discussion of local immigration initiatives is found in a subsequent section of this paper.

**ECONOMIC IMPACT OF IMMIGRATION**

One reason illegal immigration became a topic of nationwide debate is the growth in the Hispanic segment of the population in recent years. According to the Pew Hispanic Center, the Hispanic segment of the population grew by 9,094,495, between 2000 and 2006, a 25.8% increase.62 Hispanics who were foreign-born comprised an estimated 39.1% of this growth, while native-born Hispanics made up the remaining 60.9%.63

Hispanics comprised a significant portion of the workforce in several job categories in 2006. An analysis of the occupations of Hispanics in the United States shows that 60.4% of those who are foreign-born worked in one of the following occupation groups: construction trades (16.3%), production (13.0%), building-and-grounds cleaning and maintenance (12.5%), food preparation and serving (9.5%), and transportation and material moving (9.1%). By comparison, only 35.4% of native-born Hispanics hold jobs in these five categories.64 Agriculture, an industry that has historically relied on migrant workers for labor supply, employed a lower percentage of the total number of Hispanic workers; however, 41.8% of persons working in farming, fishing, and forestry in 2006 were Hispanic.65

By 2050, “[t]he Latino population, already the nation’s largest minority group, will … account for most of the nation’s population growth from 2005 to 2050. Hispanics will make up 29% of the U.S. population in 2050, compared with 14% in 2005.”66
Undocumented immigrants play an important role in the national, state, and local economies in the United States. Illegal workers pay taxes in the form of sales, property and payroll taxes, including Social Security, Medicare, and unemployment withholding.\textsuperscript{67} A recent study shows that immigrants have contributed about $30 billion a year to the U.S. economy.\textsuperscript{68} Depending on the state, they may also have a positive effect on state and local economies. In the state of Oregon in 2007, for example, $134–$187 million was paid by undocumented workers in the form of income and property tax. Additionally, the employers of these undocumented workers paid $97–$136 million in taxes.\textsuperscript{69} During the same year, undocumented workers in Iowa paid $40–$62 million in state taxes and $50–$77.8 million into Social Security and Medicare.\textsuperscript{70} Interestingly, a 2007 survey conducted by Pew Hispanic Center found that 75% of Hispanics feel that illegal immigration helps the U.S. economy.\textsuperscript{71}

A 2007 report issued by the American Immigration Law Foundation stated that immigrants increase the U.S. GDP by about $37 billion each year due to providing employment opportunities.\textsuperscript{72} Illegal immigrants fill positions that are less desired, most commonly because of other workers finding better-paying jobs,\textsuperscript{73} with some industries being more dependent on their availability than others. For example, some sources estimate that 70% of the agricultural workers in the country are undocumented workers; their hard work is essential to the functioning of this industry.\textsuperscript{74} Some employers intentionally hire illegal immigrants with the intention of avoiding higher wages, benefits, and taxes, which can decrease the costs associated with their products or services.\textsuperscript{75}

Illegal immigration has numerous negative effects at the state and local levels. Among these are the financial costs illegal immigrants may impose on state and local governments for education, health care, and law enforcement. Not all state or local economies can offset these costs with the tax revenue they receive, because undocumented workers generally have lower incomes and therefore pay fewer taxes.\textsuperscript{76} For example, recent estimates show that “annual costs for unauthorized immigrants in Colorado were between $217 million and $225 for education, Medicaid, and corrections.”\textsuperscript{77} For the same time period, estimated state and local taxes paid by unauthorized immigrants was estimated to be between $159 and $194 million.\textsuperscript{78}

The federal government requires health providers that receive federal funding to provide a certain level of health services to all residents, regardless of immigration status or ability to pay. Because immigrants, “both authorized and
Unauthorized, are less likely than their native-born counterparts to have health insurance," this can create an economic drain, which can lead to a state and local emergency. “[I]n 2000, county governments that share a border with Mexico incurred almost $190 million in cost for providing uncompensated care to unauthorized immigrants [which] represented about one-quarter of all uncompensated health costs” during that year.

According to a recent report from the Congressional Budget Office, “[e]ducation is the largest single expenditure in state and local budgets.” The National Association of State Budget Officers reports that, on average, elementary and secondary education comprised 34.5% of state general fund expenditures for fiscal year 2007. “Because state and local governments bear the primary fiscal and administrative responsibility of providing schooling from kindergarten through grade 12, they incur substantial costs to educate children who are unauthorized immigrants.” The United State Supreme Court ruled in the 1982 case of Plyler v. Doe that children may not be excluded from public education due to immigration status. The requirement that public schools educate children of unauthorized immigrants imposes a significant expense on states; current studies estimate that approximately two million children are unauthorized immigrants and an additional three million children of unauthorized immigrants who are U.S. citizens, because they were born in the U.S.

According to census data released in 2006, approximately four percent of the overall school-age population are unauthorized immigrants. These numbers increase the demand on public-school budgets. For example, during the 2003–2004 school year, Minnesota spent an estimated $79–$118 million educating 9,400–14,000 unauthorized immigrant children; New Mexico spent an estimated $67 million educating 9,200 unauthorized immigrant children during the same time period.

Steven A. Camarota, research director at the Center for Immigration Studies, estimates that educating illegal aliens costs about $15 billion a year. That figure would double if the children then become involved in other school activities. Still, there are costs associated with not educating the children of illegals. A 1996 study in California, based on the assumption that “most of the state’s immigrants will remain in the United States long-term,” found that “an immigrant educated in California receives an average of $62,600 in education costs, but pays an average of $89,437 in state income and sales taxes to education alone” over a presumed forty year employment. In the majority opinion in Plyler v.
Doe, Justice Brennan wrote of the state of Texas’ attempt to avoid educating children of unauthorized aliens,

> It is difficult to understand precisely what the State hopes to achieve by promoting the creation and perpetuation of a subclass of illiterates within our boundaries, surely adding to the problems and costs of unemployment, welfare, and crime. It is thus clear that whatever savings might be achieved by denying these children an education, they are wholly insubstantial in the light of the costs involved to these children, the State, and the Nation.88

The increased cost of law enforcement also imposes a large cost on state and local governments, as they apprehend and detain illegal aliens until they are taken into custody by federal authorities or deported. In 1999, California, Arizona, New Mexico, and Texas spent a combined $108 million on law enforcement activities involving illegal immigrants.89

The increased number of illegal aliens and the effect this has had on state and local expenditures to provide social services, education, and jobs make the issue of immigration reform a topic of heated public debate. There are numerous laws, from federal to state to local, that attempt to regulate immigration. Some state laws seem to be appropriate exercises of concurrent jurisdiction, while others appear to either exceed constitutional authority or to conflict with laws of other jurisdictions.

**CONSTITUTIONAL AUTHORITY FOR LOCAL CONTROL OF IMMIGRATION**

**Authority of States to Enforce Federal Law**

“The foundation for state and local enforcement authority in the realm of immigration law is derived from a state’s inherent power, subject to federal preemption, to make arrests for violations of federal law.”90 As a general rule, courts have found that there is no intent to preempt state enforcement authority unless the federal statute’s regulatory scheme is so pervasive that it implies exclusive federal authority. With regard to federal immigration laws, only the Ninth Circuit has held that such a regulatory scheme is evidenced in the Immigration and Naturalization Act. In *Gonzales v. Peoria*,91 the Ninth Circuit distinguished states’ authority to enforce civil provisions of the INA from their authority to enforce criminal provisions. That court found that INA, with respect to such civil issues as “authorized entry, length of stay, residence, status, and deportation,
constitute[d] such a pervasive regulatory scheme, as would be consistent with the exclusive federal power over immigration." In contrast, the court found that statutes relating to criminal activity by aliens are relatively simple in their terms, and “therefore [it] cannot be inferred that the federal government has occupied the field of criminal immigration enforcement.” Following this reasoning, the Ninth Circuit held that state and local police authority to enforce immigration law is “limited to criminal violations.”

In a Tenth Circuit case, a plaintiff challenged his arrest by a local police officer, Pratt, which was based upon the officer’s suspicion that the plaintiff was an illegal alien and not because he was committing a crime. The plaintiff Alvarez moved to suppress evidence acquired after the arrest, alleging that the policeman had exceeded his authority under 8 U.S.C 1252c. The arrest did not meet the three conditions required by the statute, in that Pratt did not know that Alvarez had previously been convicted of a felony and deported. The court, however, stated that “in the absence of express preemptive language, federal courts should be ‘reluctant to infer pre-emption.’”

Until recently, the U.S. Department of Justice (DOJ) agreed with the Ninth Circuit’s interpretation, issuing an opinion in 1996 that the INA precluded state police from arresting aliens “on the basis of civil deportability,” but reversed itself in a memorandum dated April 3, 2002, concluding that states have authority to arrest aliens, subject to compliance with the Fourth Amendment. The memorandum explains that the states’ authority in this realm is not based on delegated federal power but in the arrest authority under the states’ “status as sovereign entities.”

**Authority of States to Regulate Immigration**

The Supreme Court has consistently held that the “[p]ower to regulate immigration is unquestionably a federal power.” As early as 1849, the Supreme Court was called upon to determine the extent to which a state may control or tax aliens entering into the United States. In two cases, *Smith v. Turner* and *Norris v. Boston*, known together as “The Passenger Cases,” the states of Massachusetts and New York imposed per-passenger taxes on ships carrying immigrants, effectively giving the states the power to decide which persons could enter the U.S. and which would be turned away. The court based its decision on the Commerce Clause, reasoning that if states have the power to tax passengers and other contents of ships, the constitution will have failed in one of its central purposes—to regulate commerce.
“These provisions impose restrictions on the exercise of the commercial power, which was exclusively vested in Congress; and it is as binding on the States as any other exclusive power with which it is classed in the Constitution. … Except to guard its citizens against diseases and paupers, the municipal power of a State cannot prohibit the introduction of foreigners brought to this country under the authority of Congress … If this power to tax passengers from a foreign country belongs to a State, a tax, on the same principle, may be imposed on all persons coming into or passing through it from any other State of the Union.”

Twenty-five years after the Passenger Cases decision, the state of California enacted a statute giving its Commissioner of Immigration the authority to determine whether an arriving passenger should be allowed to land. The constitutionality of this statute was challenged by a Chinese immigrant who was held as a prisoner after the captain of the ship on which she had arrived refused to pay the commissioner a bond for her. The U.S. Supreme Court based its decision on the federal government’s exclusive authority to deal with foreign nations rather than on the Commerce Clause, holding that the

“passage of laws which concern the admission of citizens and subjects of foreign nations to our shores belongs to Congress, and not to the States. It has the power to regulate commerce with foreign nations: the responsibility for the character of those regulations, and for the manner of their execution, belongs solely to the national government. If it be not otherwise, a single State can … embroil us in disastrous quarrels with other nations.”

Using Unrelated State Statutes to Regulate Immigration

Police in some states have begun to enforce non-immigration-related state laws in creative ways to regulate immigration. In 2005, police chiefs in two New Hampshire cities arrested illegal immigrants for trespassing and mischief, reasoning that if illegal aliens are on any property they are guilty of violating state trespass laws, since these persons don’t have the legal right to be there or anywhere else in the U.S.

Garrett Chamberlain, a police chief in New Ipswich, N.H. who believes that this exercise of local police power is legitimate, states “[e]ver since I took a stand, [illegal immigrants] avoid my town like the plague. If every illegal avoids my town, then I think we’ve won part of the battle.” Ultimately, this novel
interpretation of trespass was not successful. In the New Hampshire criminal trespass statute,\textsuperscript{105} the term “place” had been interpreted as “a specific parcel or structure of privately-owned real property, rather than any public or private place within the respective town.”\textsuperscript{106} While the court acknowledged the right of states to enforce federal immigration laws,\textsuperscript{107} it determined that the application of a state trespass statute as a means of controlling illegal immigration violated the Supremacy Clause, because such an interpretation would “impose additional penalties beyond those the defendants would face under federal immigration law.”\textsuperscript{108}

The charges were thrown out by state court Judge L. Phillips Runyon III, who wrote “The criminal trespass charges against the defendants are unconstitutional attempts to regulate in the area of enforcement of immigration violations, an area where Congress must be deemed to have regulated with such civil sanctions and criminal penalties as it feels are sufficient.”\textsuperscript{109}

**State and Local Immigration Legislation in the Twenty-First Century**

“In the continued absence of a comprehensive federal reform of the United States’ challenged immigration system, states have displayed an unprecedented level of activity [in 2007]—and have developed a variety of their own approaches and solutions.”\textsuperscript{110} In 2007, a combined total of 1,562 bills were introduced in the legislatures of all 50 states. “Of these bills, 244 became law in 46 states.”\textsuperscript{111}

These new laws cover a wide range of issues, from education to voting. Twenty states adopted 31 laws regulating employment of aliens, 19 states passed 32 laws related to public benefits, and 31 states enacted laws covering identification, drivers’ licenses, or other types of licenses.\textsuperscript{112} Challenges to state immigration regulation have relied on various constitutional theories, including preemption\textsuperscript{113}, Equal Protection\textsuperscript{114}, and the Commerce Clause.

**CHALLENGING STATES’ AUTHORITY TO REGULATE IMMIGRATION**

**Preemption**

The Supreme Court recognizes that not every state statute “which in any way deals with aliens is a regulation of immigration and thus per se preempted…”\textsuperscript{115} and “the fact that aliens are the subject of a state statute does not render it a regulation of immigration, which is essentially a determination of who should or should not be admitted into the country.”\textsuperscript{116} For that reason, state laws related to employment have been interpreted as an exercise of their “police powers to
regulate the employment relationship to protect workers within the State,”117 and therefore not a violation of the Supremacy Clause.

Two recent cases in Arizona challenged the constitutionality of Arizona’s new Legal Arizona Workers Act.118 The act119 requires Arizona employers to use E-Verify, which is voluntary under federal law, and gives the Superior Court the power to suspend or revoke business licenses of employers who intentionally or knowingly employ unauthorized aliens.120

Plaintiffs asserted that the act was preempted by the IRCA, which imposes sanctions on employers of unauthorized aliens. The District Court discussed the principle of preemption and the circumstances in which a state law would conflict with federal law.

“Where Congress has enacted a federal law on a given subject, but evinces no express or implied intention to preempt the field, states retain the power to regulate in the area concurrently with the federal government…A state law conflicts with federal law “where compliance with both federal and state regulations is a physical impossibility, or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress…”121

The court referred to the language of IRCA in determining whether the Arizona act would be preempted by the IRCA. The language of 8 U.S.C. § 1324a(h)(2) reads “The provisions of this section preempt any State or local law imposing civil or criminal sanctions (other than through licensing and similar laws) upon those who employ, or recruit or refer for a fee for employment, unauthorized aliens.” The District Court held that the act was a licensing law, “because it sets out criteria and a process to suspend or revoke a permission to business in the state,”122 because the statute fell within the meaning of IRCA’s savings clause, and is therefore not preempted. A petition for an injunction to prevent the enforcement of the Legal Arizona Workers Act pending appeal was denied.123

**Equal Protection and Due Process**

Using an Equal Protection analysis to challenge state regulation of the employment of undocumented aliens has also met with little success. As one author noted, “[u]ndocumented alien adults do not enjoy the same constitutional protections as legal aliens,”124 because illegal entry into the United States is a criminal violation punishable by deportation. For this reason, “classifications that
discriminate against undocumented aliens are subject to rational basis review”125 rather than the more onerous strict scrutiny analysis afforded classification based on membership in a suspect class.

That is not to say that persons who are in the U.S. illegally have no rights under the Fifth and Fourteenth Amendments. “Whatever his status under the immigration laws, an alien is surely a ‘person’ in any ordinary sense of that term. Aliens, even aliens whose presence in this country is unlawful, have long been recognized as ‘persons’ guaranteed due process of law by the Fifth and Fourteenth Amendments.”126 Additionally, an alien is “within the jurisdiction” of a state and therefore also entitled to equal protection under that state’s laws “until he leaves the jurisdiction—either voluntarily, or involuntarily…”127 With respect to minor children of undocumented aliens, because they are not responsible for their status in the United States, the court has applied an intermediate scrutiny test to laws that would discriminate against their access to public schools.128

**Commerce Clause**

The Commerce Clause presents a more compelling argument for the federal government asserting control over immigration. Due to the nature of legislative processes, state legislatures have adopted immigration laws that have varying requirements and different consequences for noncompliance. One such conflict between the laws of Arizona and Illinois illustrates the difficulty that multi-state employers will face if they are required to comply with state immigration laws in all the jurisdictions in which they conduct business. Arizona requires that employers use the E-Verify Program (formerly known as the Basic Pilot Program) under A.R.S. 23–214.129

Illinois, recognizing that the program has been shown to be inaccurate in many cases, passed a statute to prohibit employers from “enrolling in any Employment Eligibility Verification System, including the E-Verify program…until the… databases are able to make a determination on 99% of the tentative non-confirmation notices issued to employers within 3 days, unless otherwise required by federal law.”130 Few recent cases challenging immigration state laws have been based on the Commerce Clause, although several nineteenth-century decisions were based on the premise that Congress has sole authority to regulate the imposition of taxes on arriving immigrants, based on this clause.131 Although states continue to have authority under their police powers to regulate commerce within their borders, their authority is limited in that a state’s laws may not place an “undue burden” on interstate commerce.132 With the increasing numbers of
state regulations dealing with the employment of aliens, it will soon become an undue burden for multi-state employers to keep abreast of the changes and to comply with different and sometimes conflicting reporting and verification requirements for work eligibility.

NEW EMPLOYEE VERIFICATION ACT OF 2008 (H.R. 5515)
The proposed New Employee Verification Act of 2008\textsuperscript{133} is one of the most recent immigration bills before Congress. It was introduced in February, 2008, and referred to committee in April. This bill would amend the Immigration and Nationality Act and the Social Security Act to implement newer employment eligibility systems. The new systems, called Employment Eligibility Verification System (EEVS) and Secure Employment Eligibility Verification System (SEEVS), would use information from both the Department of Homeland Security and the Social Security Administration. In general, most employers would be required to participate in either EEVS or SEEVS, and those not required to participate would be allowed to do so voluntarily. The act specifically preempts “any provision of any law of any State or political subdivision” dealing with employment eligibility verification, employer sanctions, and other immigration status systems except those required by federal law.

The act would provide safeguards for employees whose documentation is initially disapproved, and establish a process for appealing the initial determination. It contains antidiscrimination provisions to make it an unfair immigration-related employment practice “to terminate or undertake any adverse employment action due to an initial disapproval” or “to use the verification system for screening of an applicant prior to an offer of employment.”\textsuperscript{134}

Susan Meisinger, President and CEO of Society for Human Resource Management (SHRM), says that “[i]t is time to go beyond E-Verify and to provide employers the option of enrolling in a more secure system. That is why we have endorsed the New Employee Verification Act (NEVA) as it offers a far superior alternative.”\textsuperscript{135}

Critics are concerned, though, that if this act passes it could have the effect of driving undocumented workers underground, and “could cost the government an estimated $770 million a year in lost tax revenues.”\textsuperscript{136} It could also give unscrupulous employers leverage to keep undocumented workers from complaining about wages and working conditions, and make them more vulnerable to exploitation.\textsuperscript{137} The strongest criticism of NEVA, however, relates to the databases
themselves. The current electronic verification system has an error rate of around 4%, which could lead to millions of citizens being flagged as ineligible to work. If NEVA is implemented without first correcting the database problems that have resulted in such a high error rate, the outcome of verification could be expected to be as flawed as the current system.

CONCLUSION
The federal government has the power to regulate immigration, and that power should be interpreted as exclusively federal. The federal government determines whether persons are citizens under the Immigration and Nationality Act and whether workers are authorized under the Immigration Reform and Control Act to be employed in the United States. States have the authority to enforce federal laws and to arrest those within their jurisdiction who are found to be in the country illegally. In fact, because federal law enforcement agencies are too understaffed to stop the entrance of illegal immigrants effectively, state and local law enforcement personnel are critical components in this effort.

If states are allowed to regulate immigration, even indirectly, by enacting laws that impose additional penalties on employers beyond those outlined by the IRCA, by requiring landlords to verify residency status of tenants, and by limiting benefits that dependents may receive, the scheme of federal regulation may be undermined. If multi-state employers must comply with various and sometimes conflicting state-employee verification requirements, it would potentially impose an undue burden on interstate commerce in terms of the amount of time and expense incurred.

Congress needs to address immigration reform specifically to pre-empt any state or local attempts at immigration control. The new legislation should include additional funding for enforcement, a more accurate method of work eligibility verification, and penalties for employers who disregard work status of their employees. Additionally, it should include support for state law enforcement agencies that assist in enforcing federal immigration requirements. Such a law would properly assert exclusive federal authority over all immigration issues and would resolve conflicts among state laws by preempting them. It is time to recognize illegal immigration as a national concern, not merely one that involves only our border states.
Endnotes


2 Id.


4 8 U.S.C. 1252c.


6 8 U.S.C. §1101 et seq.

7 U.S. Citizenship and Immigration Services website, available at http://www.uscis.gov/portal/site/uscis/menuitem.eb1d4c2a3e5b9ae89243c6a7543f6d1a/?vgnextoid=f3829c7755ce9010VgnVCM10000045f3d6a1RCRD&vgnextchannel=f3829c7755ce9010VgnVCM10000045f3d6a1RCRD


9 Id.


11 8 U.S.C. §1324a(b).

12 Ray Marshall, Getting Immigration Reform Right, CHOICES (July–August, 2007).


19 DAVID WEISSBRODT & LAURA DANIELSON, IMMIGRATION LAW AND PROCEDURE IN A NUTSHELL, § 1–7.


21 8 U.S.C. §1153(b).

22 8 U.S.C. §1153(c).

23 WEISSBRODT & DANIELSON, supra note 19, at § 1–7.1.

24 Id., at § 1–7.6.


26 S. 1348, available at http://thomas.loc.gov/cgi-bin/query/z?c110:S.1348:


30 It’s No Time to Dawdle on Immigration Reform Talk, NEW YORK DAILY NEWS, Suburban, March 1, 2007, 3.


*Supra*, note 31.


*Id.*, at 283.


*Supra* note 41, at 291

http://thomas.loc.gov/cgi-bin/bdquery/z?d110:SN01348:@@@L&summ2=m&#major%20actions


V. Richardson, *Colorado OKs denying services to illegals*, *The Washington Times*, July 12, 2006, A06.


GA. CODE ANN. § 50-36-1 (a).

GA. CODE ANN. § 48-7-21, “On or after January 1, 2008, no wages or remuneration for labor services to an individual of $600.00 or more per annum may be claimed and allowed as a deductible business expense for state income tax purposes by a taxpayer unless such individual is an authorized employee. The provisions of this subsection shall apply whether or not an Internal Revenue Service Form 1099 is issued in conjunction with the wages or remuneration.”


Id.

Id.

Id.

Id.

Id.

Id

43 P.S. § 166.5.


W. Roche Jr., *Number of state-level immigration laws is growing*, *Los Angeles Times*, Main News; August 6, 2007, A15.

65 Id.
68 Johan Goldberg, You can’t say that, USA TODAY, July 3, 2007, 9A.
70 Id.
72 Supra note 52.
73 Albor Ruiz, SOC SEC Crackdowns Off Fast Track, For Now, SUBURBAN, Sept. 6, 2007, 56.
74 Id.
75 Fein, supra Note 67.
78 Id.
79 Id., 8.
81 C.B.O. Paper, supra note 77, at 7
83 C.B.O. Paper, supra note 79.
84 457 U.S. 202 (1982).
85 Id., at 8.
86 Id.
87 Dinan, supra note 72.
89 Id., at 9.
722 F.2d 468 (9th Cir. 1983).
92 Id. at 475.
93 Id.
94 Id. at 476.
97 Memorandum of Understanding, available at http://www.aclu.org/FilesPDFs/ACF27DA.pdf
100 48 U.S. 283 (1849).
101 Id. at 406.
102 Chy Lung v. Freeman, 92 U.S. 275 (1876).
104 Id.
105 N.H. REV. STAT. ANN. §635:2.
111 Id.
112 Id., p. 2.
113 Chy Lung v. Freeman
116 Id.
117 Id. at 356.
121 Id., citing Hines v. Davidowitz, 312 U.S. 52, 67 (1941), at 1045.
122 Id., at 1046.
125 Id. At 1049.
The text of the statute reads, “After December 31, 2007, every employer, after hiring an employee, shall verify the employment eligibility of the employee through the basic pilot program.”

820 I.L.C.S. 55/12.

Smith v. Turner; Norris v. City of Boston (The Passenger Cases), 48 U.S. 283 (1849); Chy Lung v. Freeman, 92 U.S. 275 (1876); Henderson v. Mayor of New York, 92 U.S. 259 (1876).


H.B. 5515, Sec. 103.(a)(3)(A).


Id.

INTRODUCTION
In ancient Athens about 2500 years ago, Sophocles examined the relationship between moral or divine law and human law in his classic play, *Antigone* (Sophocles 2005). Antigone was ordered by Creon, King of Thebes, to leave the body of her brother unburied and outside the city walls to be eaten by vultures, as punishment for his treachery. Antigone, ordinarily a loyal citizen, followed her conscience and answered in the name of her religion and her gods and buried her brother, thereby defying the order of the king, who subsequently sentenced her to death.

Fast forward several millennia and the words of founding father James Madison resound: “The Religion then of every man must be left to the convictions and conscience of every man, and it is the right of every man to exercise it as these may dictate” (Madison 1999, 29). Madison’s opinion regarding the sanctity of individual conscience has become a well-established value in the U.S. that continues to this day. Nevertheless, the sanctity of conscience has become an increasingly contentious issue in contemporary America. For example, conscience may drive a woman to conclude that an abortion is her best option to prevent an unplanned child, but conscience may also drive her physician to decline to perform it. Conscience compels a school teacher to talk about intelligent design during science class, but also compels the parents of his student to insist that he be prohibited from doing so. Conscience requires a federally funded drug rehabilitation program leader to integrate biblical teachings into group discussions, but also requires a program participant to object to such proselytizing (Vischer 2006).
Nowhere is this controversy more pronounced than in the well-publicized battle over the extent to which pharmacists may allow their religiously shaped moral judgments to narrow the range of services they offer consumers, particularly women. Both sides ask government to enshrine collectively a particular vision of the individual’s prerogative (Stein 2005). On one side, conscience is invoked to justify legislation that would enable individual pharmacists to refuse to fill prescriptions on moral grounds. On the other side, conscience is invoked to support laws that would enable individual consumers to compel pharmacies to fill any legally obtained prescriptions without delay or inconvenience.

This article examines the historical importance of conscience in various world and U.S. laws and regulations and the implications for employers in the modern American workplace.

CONSCIENCE AND RELIGION
While there are many definitions of conscience, the one included in the Illinois Health Care Right of Conscience Act is cited, because it was the first of its kind and has been named as model legislation in the conscience area: “Conscience means a sincerely held set of moral convictions arising from belief in and relation to God, or which, though not so derived, arises from a place in the life of its possessor parallel to that filled by God among adherents to religious faiths” (Health Care Right of Conscience Act n.d.). It is not to be construed as one’s mere ideas and opinions, or whatever vagrant and morally vacuous thoughts race through one’s mind.

Most definitions of conscience in the U.S. legal context are broadly defined as including moral, ethical, and religious principles. Indeed, some authors believe that the definitions of religion and conscience involves a “distinction without a difference” (Smith 2005, 911) while others have suggested that “the framers viewed ‘free exercise of religion’ and ‘freedom of conscience’ as virtually interchangeable concepts” (Smith 2005, 912). Similarly, the Supreme Court has construed religion broadly to include convictions that are deeply-held, but not religious in any conventional sense of the term (United States v. Seeger 1965; Welsh v. United States 1970).

FREEDOM OF CONSCIENCE IN THE INTERNATIONAL ARENA
The right to freedom of conscience is represented in all international conventions concerning human rights. For example, Article 18 of the Universal Decla-
ration of Human Rights adopted by the General Assembly of the United Nations (UN) on December 10, 1948 states:

Everyone has the right to freedom of thought, conscience and religion; this right includes freedom to change his religion or belief, and freedom, either alone or in community with others and in public or private, to manifest his religion or belief in teaching, practice, worship and observance (United Nations 1948).

A similar formulation appears in Article 18.1 of the International Covenant on Civil and Political Rights, which was adopted and opened for signature, ratification and accession by UN’s General Assembly Resolution 2200 on December 16, 1966 and entered into force in March 1976 (Office of the High Commissioner for Human Rights 1976). The recognition of the right to freedom of conscience, as it appears in the UN Declaration of 1948, is quoted also in Articles 12.1 and 12.2 of the American Convention on Human Rights, signed in 1969, which has been in legal force since 1978, and prohibits any oppression of persons as a result of their faith (Human & Constitutional Rights Document 1969a). Interestingly, Articles 27.1 and 27.2 of the American convention address the state’s privilege to limit some human and civil rights in case of a war or national emergency, ensuring, however, the right to freedom of conscience even in these extreme circumstances (Human & Constitutional Rights Document 1969b).

Thus, many countries, including the U.S., have made great efforts to advance freedom of conscience in their cultures. Indeed, Jesuit scholar Richard J. Regan noted “no culture without some idea of moral conscience has yet been discovered” (Regan 1972, 207). There is no question, then, that an individual’s “sovereignty of conscience” (Little 2001, 607) is something that is accorded a significant level of respect in culture and law and that across numerous societies freedom of thought, conscience, belief, and religion is one of the most basic of all human rights, and assigned special rights and protection.

**CONSCIENCE-PROTECTION IN THE UNITED STATES OUTSIDE THE EMPLOYMENT CONTEXT**

Legislatures and courts in the U.S. have protected the right of conscience in areas outside the employment framework in two key areas: the First Amendment and conscientious objection to war.
The First Amendment Protection against Coerced Expression

The Supreme Court has held that the First Amendment prevents the government from forcing individuals to voice or promote viewpoints with which they disagree. The model cases are *West Virginia Board of Education v. Barnette* (1943) and *Wooley v. Maynard* (1977). In *Barnette* and *Maynard*, respectively, the court struck down a statute requiring a compulsory flag salute and a law requiring compulsory display of the state motto (“Live Free or Die”) on license plates. These cases sought to protect “the sphere of intellect and spirit” (*West Virginia Board of Education v. Barnette* 1943, 642) and “individual freedom of mind” (*Wooley v. Maynard* 1977, 714). Moreover, Chief Justice Rehnquist characterized these cases as protecting “the broader constitutional interest of natural persons in freedom of conscience” (*Pacific Gas & Electric Company v. Public Utilities Commission of California* 1986, 32).

Conscientious Objection to War

Another area where American society has shown sensitivity to the right of conscience is in exempting from military service those who conscientiously object. Indeed, conscientious objectors have been included in every federal statutory scheme authorizing compulsory military service in the U.S. since the Civil War (Davis 1991). The statute defined religious faith as belief “in relation to a Supreme Being” and “does not include essentially political, sociological, or philosophical views or a merely personal code” (Davis 1991, 192). In cases that arose during the Vietnam War, however, the Supreme Court fundamentally broadened the statute to encompass nonreligious conscientious objection (*United States v. Seeger*, 1965; *Welsh v. United States* 1970). Seeking to avoid Establishment Clause problems, the court reversed the convictions of conscientious objectors who explicitly disavowed belief in a Supreme Being.

CONSCIENCE-PROTECTION IN THE UNITED STATES RELATED TO THE WORKPLACE

**Federal Level**

The issue of conscience became more prominent in the 1970s, when health-care providers and facilities were permitted to decline to provide services to which they were morally or ethically opposed (National Conference of State Legislatures 2008). It began with the Supreme Court’s decision to legalize abortion in *Roe v. Wade* (1973). Literally within weeks, in response to *Roe*, Congress passed the so-called “Church Amendment”—named after former Sen. Frank Church.
(R-ID)—as part of the Health Programs Extension Act (1973). The amendment states that public officials may not require individuals or organizations who receive certain public funds to perform abortion or sterilization procedures or to make facilities or personnel available for the performance of such procedures if such performance “would be contrary to [the individual or entity’s] religious beliefs or moral convictions” (Health Programs Extension Act 1973, at § 300a–7(b)).

This amendment, which remains in force today, provides that the receipt of federal funds in various health programs will not require hospitals or individuals to participate in abortions, if they object based on moral or religious convictions. It also forbids hospitals in these programs to make willingness or unwillingness to perform these procedures a condition of employment. The Church Amendment is considered by many, albeit primarily in the abortion context, to be the first freedom-of-conscience clause in an employment context (Briggs 2005).

Protection-of-conscience laws are generally designed to reconcile “the conflict between religious health care providers who provide care in accordance with their religious beliefs and the patients who want access to medical care that these religious providers find objectionable” (White 1999, 1703). These activities may include abortion, capital punishment, contraception, sterilization, artificial reproduction, euthanasia, assisted suicide, human experimentation, torture, etc. Conscience laws protect conscientious objectors from coercive hiring or employment practices, discrimination and other forms of punishment or pressure. They generally also include protection from civil liability. Conscience clauses, on the other hand, are usually less comprehensive than protection-of-conscience laws and afford varying degrees of protection for conscientious objectors. They may appear in statutes or in the policies of organizations or institutions (The Protection of Conscience Project 2008). Those individuals who believe that people should not be forced to facilitate practices or procedures to which they object for moral reasons often refer to “conscience clauses,” while reproductive rights groups and patients’-rights advocates call such wording “refusal clauses.” This is not a semantic difference, but a significantly different worldview.

Enacted in 1996, section 245 of the Public Health Service Act (PHS Act) (1996) prohibits the federal government and any state or local government receiving federal financial assistance from discriminating against any health care entity on the basis that the entity: (1) refuses to receive
training in the performance of abortions, to require or provide such training, to
perform such abortions, or to provide referrals for such training or such abor-
tions, (2) refuses to make arrangements for such activities, or (3) attends or at-
tended a post-graduate physician training program or any other training program
in the health professions that does not (or did not) perform abortions or require,
provide, or refer for training in the performance of abortions or make arrange-
ments for the provision of such training. In addition, PHS Act Section 245
requires that, in determining whether to grant legal status to a health-care entity
(including a state’s determination of whether to issue a license or certificate,
such as a medical license), the federal government and any state or local govern-
ment receiving federal financial assistance deem accredited any post-graduate
physician-training program that otherwise would be accredited but for the reli-
ance on an accrediting standard that requires an entity: (1) to perform induced
abortions, or (2) to require, provide, or refer for training in the performance of
induced abortions, or make arrangements for such training.

A conscience-clause provision, also known as the Weldon Amendment (enacted
as part of the Consolidated Appropriations Act 2008)—named after Congress-
man Dave Weldon (R-FL)—provides that

“[n]one of the funds made available under this Act may be
made available to a federal agency or program, or to a State
or local government, if such agency, program, or government
subjects any institutional or individual health care entity to
discrimination on the basis that the health care entity does not
provide, pay for, provide coverage of, or refer for abortions”
(Consolidated Appropriations Act 2008, at § 508 (d)(1)).

The act also defines “health care entity” to include “an individual physician or
other health care professional, a hospital, a provider-sponsored organization,
(a health maintenance organization, a health insurance plan, or any other kind
of health care facility, organization, or plan” (Consolidated Appropriations Act
2008, at § 508 (d)(2)).

The primary federal law that arguably concerns conscience, albeit of the
religious variety, is Title VII (1964). Title VII covers most private and public
employers with fifteen or more workers, and, along with a host of other bases
(e.g., race, gender, ethnicity), prohibits employment discrimination because of
religion. Title VII defines religion to include
“all aspects of religious observance and practice, as well as belief, unless an employer demonstrates that he is unable to reasonably accommodate to an employee’s or prospective employee’s religious observance or practice without undue hardship on the conduct of the employer’s business” (Title VII 1964, at § 2000e-2(a)).

The Equal Employment Opportunity Commission (EEOC), Title VII’s chief enforcement agency, declared that it “will define religious practice to include moral or ethical beliefs as to what is right and wrong which are sincerely held with the strength of traditional religious views” (Guidelines on Discrimination Because of Religion, n.d., at § 1605.1). Although these merely provide “guidance,” and do “not carry the force of regulation,” (Wolf, Friedman, and Sutherland 1998, 16), the courts have consistently followed the EEOC’s lead” (Wolf, Friedman, and Sutherland 1998, 28). It is more likely that many “beliefs” fit this definition of religion, including freedom of conscience.

Physicians, nurses, and prison employees also have a right to refuse, based on conscientious objection, to participate in any way in executions (Refusal to Participate in Executions or in Prosecution of a Capital Crime n.d.). This statute also ensures that employees in the U.S. Department of Justice, the Federal Bureau of Prisons, or the U.S. Marshals Service who object to capital punishment for reasons of conscience cannot be forced to participate in an execution or even in a prosecution for a capital offence.

Additionally, federal statutes and cases protecting whistleblowers (those who believe that the public interest overrides the organization they serve, and report incidences of corrupt, unlawful, fraudulent, or harmful activity) have been construed as protecting individuals’ right to conscience. For example, in Mgmt. Info. Techs. v. Alyeska Pipeline Serv. Co., whistleblowers were described as “employees who speak out as a matter of conscience” (Mgmt. Info. Techs v. Alyeska Pipeline Serv. Co. 1993, 481).

Most recently, the Bush administration, shortly before leaving office, implemented a controversial regulation designed to protect doctors, nurses, and other health care workers who object to abortion from being forced to deliver services that violate their personal beliefs (Department of Health and Human Services 2008). The rule empowers federal health authorities to deny funding to more than 584,000 hospitals, clinics, health plans, doctor’s offices, and other entities, if they do not accommodate employees who refuse to participate in care they find objectionable on personal, moral, or religious grounds (Stein 2008). “People
should not be forced to say or do things they believe are morally wrong. Health care workers should not be forced to provide services that violate their own conscience” said Health and Human Services Secretary Mike Leavitt (Stein 2008).

State Level
The states have truly been the trendsetters for the recent expansion of conscience protection in the workplace. This has been most evident in the battle over the extent to which pharmacists may allow their religiously shaped moral judgments to narrow the range of services they offer consumers (Stein 2005). Journalists and others have reported cases of individual pharmacists refusing to fill prescriptions for emergency contraceptives. Because emergency contraception can act to block implantation of a fertilized egg, individuals who believe in protection of human life after conception find them morally objectionable and support the right of refusal (Dresser 2005). The American Pharmacists Association appears to support this position and indicated that it “recognizes the individual pharmacist’s right to exercise conscientious refusal and supports the establishment of systems to ensure patients’ access to legally prescribed therapy without compromising the pharmacist’s right of refusal” (Winckler and Gans, 2006, p. 13).

Generally, state officials have responded in two ways to the refusal issue. Some have endorsed legal requirements that protect women’s access to the drugs; others have sought to protect pharmacists’ conscientious-objection rights. In this and other contexts, there is disagreement over when to protect the professional’s freedom to reject on moral grounds a practice that is ordinarily required of the professional. The dispute over pharmacist refusals and workplace demands offers an opportunity to examine this issue in more detail.

By 1978—five years after the decision in Roe v. Wade—virtually all of the states had enacted conscience clause legislation in one form or another (Rambaud 2006). Similarly, most states offer protection for religion discrimination (similar to Title VII) and procedure-specific protection in the areas of abortion, sterilization, and artificial contraception (similar to the Church Amendment). Additionally, an increased number of states have expanded into general conscience protection, albeit still primarily limited to health care, without any procedural restrictions (Nelson 2005). Following the Church Amendment, forty-seven states have conscience clauses addressing the refusal to perform abortions and, of these, forty offer direct protection from related employment discrimination and/or recrimination (Sonne 2006–7).
Moreover, a growing trend in state legislation involves more general “health care” clauses (Illinois, Mississippi, and Washington). For example, the Illinois statute indicates:

“It shall be unlawful for any person, public or private institution, or public official to discriminate against any person in any manner, including but not limited to, licensing, hiring, promotion, transfer, staff appointment, hospital, managed care entity, or any other privileges, because of such person’s conscientious refusal to receive, obtain, accept, perform, assist, counsel, suggest, recommend, refer or participate in any way in any particular form of health care services contrary to his or her conscience” (Health Care Right of Conscience Act n.d., §70/5).

The Mississippi statute shields health-care providers from being held “civilly, criminally, or administratively liable for declining to participate in a health care service that violates his or her conscience” (Mississippi Code Annotated 2004, at § 41-107-3), and forbids any employment discrimination based on such exercises of conscience (Mississippi Code Annotated 2004). In covering all health-care services, the statutes in Illinois, Mississippi, and Washington go well beyond the procedure-specific laws (National Conference of State Legislatures 2008). Other states having broad refusal clauses for health-care providers include Colorado, Florida, Maine, Tennessee, Georgia, Arkansas, and South Dakota. Furthermore, refusing to include an “undue hardship” or other accommodation limit of any significance, they go further than their counterparts in Title VII or analogous state provisions on religious practice accommodation.

Although the trend supports increased freedom of conscience for health-care professionals, there are states that view the situation differently. For example, New Jersey’s 2007 law prohibits pharmacists from refusing to fill prescriptions on solely moral, religious or ethical grounds (Emergency Contraception for Sexual Assault Victims 2007) and California pharmacists have a duty to dispense prescriptions and can only refuse to dispense a prescription, including contraceptives, when their employer approves the refusal and the woman can still access her prescription in a timely manner (California Labor Code 2005). More recently, the California Supreme Court unanimously ruled that doctors may not refuse non-emergency medical treatment to gay men or lesbians for religious reasons (North Coast Women’s Care Medical Care Group, Inc. et. al. v. San Diego County Superior Court [Guadalupe T. Benitez] 2008). The court ruled that physicians’ constitutional right to the free exercise of religion does not
exempt businesses that serve the public from following state laws that prohibit discrimination on the basis of sexual orientation “even if compliance poses an incidental conflict with the defendants’ religious beliefs” (Surdin 2008). The lawsuit was filed by Guadalupe Benítez, who said her doctors and their employer, a San Diego-based fertility clinic, refused her a standard fertility treatment because of her sexual orientation. The doctors, who are Christian, said that they denied the treatment because Benítez was unmarried, and that they were allowed to do so under the First Amendment’s guarantee of freedom of religion. Benítez sought the treatment in 1999 after two years of trying to conceive using an at-home insemination kit. When she informed her doctor, Christine Brody, of her sexual orientation, Brody replied that she could not perform intrauterine insemination, should it later be required. Benítez asserted that Brody said it was her sexual orientation; Brody said it was Benítez’s marital status.

In Missouri, House Bill 1625 offers protection for pharmacies in the state that refuse to dispense drugs or devices that are abortifacients, and identifies not only RU486 (Mifepristone), but the morning after pill (Plan B) as abortifacient. The bill appears to be a response to House Bill 1720, which would suppress freedom of conscience by requiring pharmacies to dispense drugs like Plan B without delay. Both bills are still under consideration by the Missouri legislature at the time of this publication.

CONSCIENCE IN THE GENERAL WORKPLACE

Although the significance of conscience in American culture has existed since the country’s founding, its protection in the private workplace is a new and rising phenomenon. While such conscience protection statutes at both the federal and state level have been primarily limited to the health-care arena today, there is little question of their future expansion into the larger workplace (Sonne 2006–7). There is a growing trend in employment law that employees should be protected in the exercise of their consciences (notwithstanding the California Supreme Court’s recent ruling)—even if such exercise is contrary to their employers’ wishes or the demands of their jobs (Nader and Hirsch 2004). This rapidly expanding and intensifying conflict centers on the role that religious faith should play in the provision of goods in American society (Vischer 2006).

While the conscientious-objection controversy continues in the health-care field (see Table 1), it has expanded to other workers (see Table 2) seeking exemptions from requirements to perform actions that violate their moral integrity. Indeed, the conflict about conscience clauses may represent “the latest struggle
Table 1
Cases Involving Health-care Workers Who Object to Work That Is in Opposition to Their Conscience

- A health care professional refuses to fill prescriptions from medical products and treatments resulting from stem cell research when they are introduced into the market (Greenberger and Vogelstein, 2005).
- A physician refuses to discuss, provide information, or refer patients for medical interventions to which they have moral objections (Curlin et. al. 2007).
- A pharmacist refuses to fill a prescription for antibiotics because it came from a facility that provides abortion medications (Davidow 2006).
- A gynecologist declines to prescribe birth control pills (Weidner 2008).
- A pharmacist refuses to fill prescriptions for “morning-after” pills, saying that dispensing the medications violates his or her personal moral or religious beliefs (Stein 2005).
- A physician refuses requests for Viagra from unmarried men (Weidner 2008).
- A health-related professional declines to participate in physician-assisted suicide (The Oregon Death with Dignity Act 1997).
- An ambulance driver refuses to transport a patient for an abortion (Stein 2006).
- A pharmacist job applicant indicates that he will refuse to sell condoms due to his religious beliefs and is not hired (Hellinger v. Eckerd Corp. 1999).

with regard to religion in America” (Charo 2005, 2471) and is rapidly becoming one of the more controversial issues confronting employers (Kelly 2008). The objection to the work may be based on religious beliefs founded on the tenets or beliefs of a church, sect, denomination, or other religious group, or on ethical, philosophical, or moral grounds and requires employers to accommodate the religious needs of their workers as mandated by Title VII the Civil Rights Act of 1964 (Title VII § 2000e(j)).

CONCLUSION
Freedom of conscience is a particularly contentious issue in America, because the U.S. is a highly individualistic society that emphasizes personal freedom and choice (Fijneman, Willemsen, and Poortinga 1996), leading to claims of absolute rights across a myriad of issues including reproduction, religious, and work-related matters. One effect of such intense individualism is that restrictions on individual freedom be limited. Persons should be entitled to exercise their freedom of conscience just so long as those individual decisions do not impinge on the freedom of others. Balance is necessary but difficult to achieve.
America is filled with claims for the rights of airline passengers, smokers, nonsmokers, obese persons, AIDS victims, and immigrants (Carroll and Buchholtz 2006), just to name a few, and when those rights conflict with others’ rights difficulties surface.

The wave of state and federal laws and bills supporting conscience protection for medical personnel is increasingly covering all health care services—not only abortion—and this has created challenges to the idea that health-related professionals may deny legally and medically permitted therapeutic interventions, particularly if their objections are personal and religious. This controversy has become particularly acute with one researcher arguing that “a doctor’s conscience has little place in the delivery of modern medical care” (Savulescu 2006, 294) and that “if people are not prepared to offer legally permitted, efficient, and beneficial care to a patient because it conflicts with their values, [then] they should not be doctors,” (Savulescu 2006, 294) and that they “can escape

Table 2
Cases Involving Employees in the General Workplace Who Have Objected to Work That Is in Opposition to Their Conscience

- A Baptist law enforcement official refuses to work at casinos (Ben Endres v. Indiana State Police 2004).
- An organization prohibited a consultant from working on their premises who wore a kirpan, a small, curved, ornamental sword, which is one of five articles of faith that initiated Sikh males are required to carry on their person at all times (Sikh Coalition 2007).
- A Muslim police officer refuses to remove her khimar, a headpiece which covers the hair, forehead, sides of the head, neck, shoulders, and chest (Webb v. City of Philadelphia 2007).
- A photographer refuses to take pictures of a civil-commitment ceremony planned by a lesbian couple (Vanessa Willock v. Elane Photography 2008).
- Prison employees are unwilling to participate in executions (Gawande 2006).
- An Orthodox Jewish police detective refuses to cut his beard (Associated Press 2008).
this burden by merely taking another job” (Nader and Hirsch 2004, 327). The question is not whether the compulsory activity can be escaped. The question is whether Americans deem it proper to put a person in the position of leaving their job or violating their conscience. Because conscience is defined in a virtually boundless fashion to include religion, moral, or ethical principles and convictions (Sonne 2006–7), it may bring the freedom of conscious debate clearly within the purview of Title VII and its prohibition of religious discrimination, which has gained much recent attention, compelling the EEOC to issue “Section 12: Religious Discrimination” to its Compliance Manual on July 22, 2008 (Equal Employment Opportunity Commission 2008).

Like religion in the workplace, the “conscience trend” presents an extraordinary challenge to employers. In light of the blanket nature of the relevant exemptions and the broad definitions of conscience that are offered both in existing law and in pending legislation, there is no question that employers will face an increasingly serious challenge regarding how they choose to conduct their business. Indeed, as one commentator noted, “this issue is the San Andreas Fault of our culture” (Stein 2006).

Yet this need not be. While American courts and legislatures have historically shown themselves solicitous of the conscience of employees, the protection is minimal when compared with that provided in Germany. The German Constitution contains a provision providing for freedom of conscience (Schäfer and Dannemann 1998). This provision has been construed to permit all employees to decline to perform a task they deem incompatible with their conscience (Gerhart 1995). The determination is left to the employee, who may not be discharged because of its exercise (Gerhart 1995).

While this broad right of conscience in the German Constitution can pose difficulties of implementation, with judges wrestling with a “reasonable” conscience justifying a refusal to do certain work and an “unreasonable” conscience deemed irrelevant (Weiss and Geck 1995), it has hardly wreaked havoc on Germany’s economy or society. Indeed, Germany has not suffered because all employees have a right of conscience, just as America has not suffered because of respect for the conscience of citizens in assorted situations. Our society has shown sensitivity to the call of individual conscience. Americans respect the conscience of draftees who oppose war, physicians who oppose abortion, employees who oppose their superiors’ misconduct, and citizens who oppose government dogma (e.g., on license plates and in the classroom).
While thorny issues remain, organizations should not overreact. Employers are becoming more adept at accommodating and balancing the rights of workers and this should provide a measure of closure and aid practitioners who might be hoping to develop acceptable policies. Having said this, however, one factor alone may change or negate everything. This involves a contentious debate anticipated early in President Obama’s term concerning the controversial “Freedom of Choice Act” (FOCA) (n.d.). In the days after the U.S. Supreme Court’s historic decision in *Gonzales v. Carhart* (2007), upholding the federal ban on partial-birth abortion, Senator Barack Obama, along with Senator Hillary Clinton and others, introduced the federal FOCA, a key provision of which indicates that physicians, hospitals, and hospital staff members would no longer have the protection of state or federal laws to refuse to provide abortions based on moral or ethical beliefs. In the 2008 presidential campaign Mr. Obama promised to sign FOCA if he was elected, and if he keeps this pledge then the conscience at work issue will be front and center and uncertainty will prevail for the foreseeable future.
REFERENCES


Ben Endres v. Indiana State Police. 2004. 50S05-0406-CV-245.


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Book Reviews
High Performance with High Integrity

By Ben W. Heineman Jr.

Reviewed by Chi Lo Lim

High Performance with High Integrity is written by Heineman, who was the senior vice president and general counsel and senior vice president for law and public affairs at General Electric from 1987 to 2005. He retired in 2005 to join Harvard Law School as a distinguished senior fellow at Harvard’s Kennedy School of Government. Heineman shares a wealth of knowledge that he accumulated throughout his years of service at GE.

Heineman discusses the proper role of business in society. He states that business has an obligation to serve the needs of its shareholders and stakeholders, but proposes that this can be achieved without having to compromise integrity. Heineman believes that integrity is critically important to businesses, as the pressure to be financially viable is constant and all too often temptations of corruption can become appealing. This is especially true when an organization is doing business in different countries, with cultures that hold integrity in different light.

Heineman presents the readers with compelling reasons to avoid integrity risks. He informs us that high integrity must start with the leaders in the organization, who must be committed to infuse integrity in the organization and create an atmosphere that continuously fosters a strong stance to sustain integrity. High performance with high integrity cannot exist in any organizations if the leaders in the organizations do not hold people accountable or when they do not apply the same standard across the board.

The three most important foundations to infusing high performance with high integrity are: organizations must create a system and process, develop a cul-
ture of integrity, and have real consequences in place. Heineman also provides the reader with eight core principles that can help organizations achieve high performance with high integrity. He discusses each of the principles clearly, and shares real cases about how decisions to perform with high integrity do not come easy and do have real financial consequences. Heineman offers many examples of how GE applied each of the eight principles as it undertook ethical challenges around the world and in some cases, GE’s strong integrity stance cost the organization millions of dollars in revenue.

Heineman’s book is timely and a “must read” for all business students and corporate leaders. This short yet powerful book is evidence that if we, as a society, hold integrity in high regard, uphold the policies we put in place, and hold people accountable for their actions, we just might had been able to avoid unnecessary failures in industries.

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“Practice makes perfect” is a good description of the philosophy espoused in Outliers by Malcolm Gladwell, which is the latest of his #1 bestsellers. The author of The Tipping Point and Blink reviews the lives of truly extraordinary people, both well known and of lesser notoriety, by reviewing their past experiences as building blocks of their current achievements. While many believe that success is due to natural talent, Gladwell refutes that claim to explain how nurture, or the individual’s environment, is the critical component of accomplishment.

Gladwell sets out to explain success in a way that is different from previous measures. In his elucidation of achievement, he explains that people are not individually responsible for their accomplishments; rather, “they are invariably the beneficiaries of hidden advantages and extraordinary opportunities and cultural legacies that allow them to work hard and make sense of the world in ways others cannot. It makes a difference where and when we grew up” (p. 19).

Outliers examines a variety of interesting phenomena, including the review of adolescent sports teams, namely Canadian hockey, and the birth month of the individual players. When looking at two 10-year-old boys, one with a January and the second with an October birthday of the same year, which one do you think is more likely to be picked for a recess game of dodgeball? Given the normal maturity of males, there may be quite a difference in ability of the two boys. Following this reasoning to the extreme, the book examines that relationship between birth month and success in Canadian hockey. The deadline for age-class hockey in Canada is January 1st. Therefore, members of a team that have been the designated age for 11½ months are playing alongside those who just turned
the qualifying age days before the deadline. When coaches look for members of a traveling “rep” program, they typically identify strength, size, and coordination as important components of a skilled player. Consequently, those on a traveling team, with additional practices, skill development, and experienced coaches, are more likely the older members of each age group. As this practice progresses, the boys that were older in the age group spend more time developing and progressing as hockey savants, while those who were not born at the right time of the year are excluded from these opportunities.

Sports teams, Bill Gates, math abilities of Asian students, the Beatles, students at the South Bronx KIPP Academy, and others all have one thing in common: the magic number 10,000. According to Gladwell, those who have mastered an activity have generally spent at least 10,000 hours practicing. Students in the KIPP Academy are in classes from 7:25 a.m. until 5:00 p.m. daily, with additional instruction on Saturdays from 9:00 a.m. until 1:00 p.m. Each student has enough homework at night to last until 10:00 p.m., only to awaken the next day and do it again. Additionally, when the Beatles first started as a high-school band and were invited to perform in Hamburg, Germany, the particular location of their shows had a schedule of an eight-hour session and that progressed to a seven-day week, for eight hours each. They performed live 270 times in Hamburg and approximately 1200 times in their career. Also, would Bill Gates be a computer guru if he didn’t live within walking distance of the University of Washington when growing up? The final story is of a Jamaican girl and her educational passage to England; Gladwell’s description of this individual is by far the most gripping and emotional.

Although his qualitative methodology of story-telling seems simplistic, it is compelling at the same time. By the end of each segment he has convinced the reader that this path to success was only available at this time, for those individuals, while still giving the reader hope that their actions are “good enough” for at least a moderate level of success.