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Introduction

By Joseph L. Bast[1]

On October 5, 2006, The Heartland Institute hosted its third annual Emerging Issues Forum. The program featured 13 speakers from across the country, addressing emerging public policy issues in four arenas: health care, budget and taxes, environment, and telecommunications. Their focus was on the future: looking ahead at what issues are "emerging." What are we going to be debating next year, and the year after, and the year after? What issues are going to dominate elections or government affairs efforts in the future?

Luncheon keynote speaker Douglas Whitley, president and CEO of the Illinois State Chamber of Commerce, delivered an "inspired" address on "How to Create Prosperity in Illinois."

Whitley used the Emerging Issues Forum to "set forth an economic agenda ... that our state's political, business, and community leaders should embrace if Illinois is to re-emerge in its rightful place as national leader and economic powerhouse that is generating jobs and prosperity for the people of this great state." His 10-point agenda included agriculture, manufacturing, transportation, energy, and health care, among other topics.

More than 100 guests attended the event, held at Chicago's Newberry Library. In addition to Whitley's keynote, the group heard stellar panel presentations. They are all collected in this book.

About The Heartland Institute

The Heartland Institute is a nonprofit organization devoted to discovering and promoting free-market solutions to social and economic problems. While there are hundreds of thousands of nonprofit advocacy groups and think tanks in the United States, few of them are devoted to protecting and expanding individual liberty and freedom.

[1] Joseph L. Bast is president of The Heartland Institute. He was the principal organizer of the 2006 Emerging Issues Forum.

That's an odd thing, because freedom is really the wellspring of all the other benefits and all the other good things most charitable groups are trying to accomplish. Without freedom, we don't have prosperity; without prosperity, we don't have good health care; we're not able to respond to emergencies, like Hurricane Katrina; we don't have better schools. All of these things track back to the peace and prosperity that freedom makes possible.

Freedom does not defend itself very well. It is always being chipped away by special interest groups and little compromises. And yet there is this very small, straggling, little network of nonprofit groups, like The Heartland Institute, that set out every morning to defend the freedom of others.

The Heartland Institute's primary audience is the nation's 7,300 state elected officials. They oversee huge budgets, and they set policy on education and health care and the environment. They are in many ways more influential than the federal government, so we try to provide as much good public policy research from a free-market perspective to these state legislators as we can.

Heartland sends to state elected officials—as well as members of Congress, thousands of municipal officials, and journalists—a publication about once a week: four public policy newspapers and one public policy newsletter. Eighty-four percent of state legislators say they read one of our publications; nearly half of them say one of our publications has changed their mind or affected public policy.

Thanks to Sponsors

The work of The Heartland Institute is made possible by more than 1,400 individual, corporate, and foundation donors. We are grateful to them all, but we especially thank here the five cosponsors of the third Emerging Issues Forum: DCI Group, Inc., CTIA - The Wireless Association, Caterpillar, PepsiCo., and Phoenix Strategies.

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Health Care

The Next Big Thing in Health Care? Real Prices

By Sean Parnell[2]

I'd like to focus my remarks this morning on the development of real prices in health care as we move towards a more market-oriented health care system.

The introduction of health savings accounts and insurance policies with higher deductibles is based on the idea that health care is similar to other services—that patients will become more prudent consumers of health care if they have a better idea of how much health care costs and must bear some of the costs of their care.

Several studies over the years have, in fact, shown this to be the case: Patients responsible for their own health care costs tend to avoid pricey services that don't provide much benefit compared to the cost.

The problem is that accurate prices aren't widely available. Hospitals often inflate charges wildly so they can offer big discounts to insurance companies; patients often have first-dollar coverage or just a $10 co-pay for expensive services; and prices at doctors' offices depend on who your insurer is. Nobody knows what anything really costs. Simply put, there are no real prices, and without real prices, there will not be a real market for health care.

Doctors as Pricing Innovators

Fortunately, innovative providers are emerging to spur the development of real prices. I'd like to describe very briefly a few of these innovators and their impact.

The first "innovation" is simply doctors practicing the way they did decades ago, before third-party payment from insurers became common

[2] Sean Parnell is vice president - external relations for The Heartland Institute.

for inexpensive health care. These doctors, many of them affiliated with an organization called SimpleCare, operate on a very simple premise: They post their prices and typically accept only cash payment in full at the time of service.

The doctors who operate this way do not accept payment from insurers or government programs, only directly from patients. By adopting this type of practice, doctors are discovering they have more time with patients, they have dramatically lower overhead costs because they have no staff to file claims, and they have greater autonomy, because third parties can't interfere with care through denial of benefits or coverage disputes.

It's simple—you see your doctor, he or she gives you a bill with real prices, and you pay it.

Best of all, the prices from doctors operating this way are not only real, but they are typically lower—anywhere from 25 percent to 50 percent lower—than even the pre-negotiated rates of doctors who accept insurance.

Retail Clinics

Another innovative provider model is the growing number of clinics staffed by nurse practitioners and based in retail settings, such as "Minute Clinics." These clinics can be found in CVS pharmacies, Target stores, Wal-Marts, and other locations.

These clinics treat and prescribe medication for a limited number of minor ailments; they refer patients with more serious conditions to doctors. These clinics also offer real prices: For example, at Minute Clinic in the Minneapolis area, treatments for most ailments are $49, including ear infection, pink eye, and minor burns.

Once again, with retail clinics you get real prices, allowing patients to shop for care, and prices that are typically lower than the cost of a visit to a physician.

Medical Tourism

The third and potentially most radical source of real prices comes from overseas hospitals that cater to so-called "medical tourists," patients who travel overseas for surgery or treatment. Several articles have appeared in recent months in major media outlets reporting on this trend.

Hospitals catering to "medical tourists" are popular with patients in countries with government-run health care, where there are often long waits for needed care, as well as Americans who have large out-of-pocket costs.

India is one country that has jumped into the "medical tourist" business, offering high-quality health care for a fraction of the price American hospitals charge. For example, a recent article in the online magazine *Slate* reported that a bone marrow transplant with a price tag of $2.5 million in the U.S. is only $26,000 in India. The *Wall Street Journal* reports that cardiac surgery in India is about $4,000 compared to $30,000 in the U.S.

Once again, these are real prices that allow patients to weigh the costs and benefits of treatment.

Competition Spurs Change

The exciting thing is not only that these new providers are offering real prices, but that in doing so they will force other providers to begin offering real prices. This, in turn, will lead to the development of the price information patients need to begin making prudent decisions on health care. In addition, real prices will lead to real competition, which will lower prices and increase efficiency and innovation in health care.

For elected officials and others interested in health care wondering what the best public policy is, I have a few simple recommendations. The first two involve how to encourage the development of real prices in health care, and the final two offer ideas on how you might be able to take advantage of these developments.

First, allow these new providers to freely offer their services, and look for opportunities to lift regulations and laws that prevent them from offering their services.

Second, consider legislation that would require greater transparency in pricing for hospital services. State and local governments have significant jurisdiction over hospitals, particularly non-profits and county or city hospitals.

Third, think about including in Medicaid and public employee health plans some type of account, such as a health savings account, that would allow plan participants to visit doctors who accept only cash payment, or to visit a clinic staffed by nurse practitioners for relatively minor ailments. Doing so should save taxpayer money.

Finally, and perhaps the most radical suggestion I have today, consider pilot programs and demonstration projects that might, for example, send some Medicaid beneficiaries or public employees to high-quality hospitals overseas for some procedures.

Participants would have to volunteer, of course, and careful investigation of the overseas hospitals and doctors would have to be undertaken to ensure safety and quality. But imagine what kind of savings could be realized, for example, by sending just 10 percent of public employees and retirees needing orthopedic surgery to a quality facility overseas that costs 15 or 20 percent of what it would cost in the local hospital.

I'd probably best stop there, before I start offering *really* radical ideas on health care.

How to Affect State Health Policy

By Tarren Bragdon[3]

Health care has been a perennial issue in every state in recent years. Public policy in this area is typically focused solely on expanding insurance coverage (mostly through Medicaid) to reduce the ranks of the uninsured. From this perspective, it doesn't matter how well or poorly a state is doing; it can always do better.

Politicians often say things like, "If we could guarantee that every child in our state has health coverage ..." Republicans and Democrats alike are collectively repeating the mantra of universal coverage and the goal of reducing the number of uninsured.

Health care is one of the most emotionally charged public policy issues of our time. Legislation is often introduced based on questionable anecdotes, to correct perceived wrongs. A handful of constituent stories somehow add up to compelling facts. Major legislation, regulations, and new social programs are enacted to right these "wrongs." Legislators, like physicians, view themselves as healers.

Expanding State Involvement

In recent years, state health policy discussions have been limited to Medicaid cost containment reforms suggested during times of budget deficits. But today, most states are flush with cash. With many states now more fiscally sound, the emotional desire to enact well-intentioned social programs is met with available taxpayer resources.

Health coverage initiatives create some of the most lasting legacies—good or bad—for elected officials. Governors and legislators, of course, have a strong need to be known for some big accomplishment(s). Health coverage, before or tied with education, ranks as the most feel-good measure.

The key states to watch in the coming year for Medicaid reform are Florida, Kentucky, and West Virginia. For health insurance coverage, the key states are Illinois, Massachusetts, and Vermont.

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[3] Tarren R. Bragdon serves as director of health reform initiatives at the Maine Heritage Policy Center.

Free-Market Principles

Medicaid reform and insurance coverage are, as noted above, emotionally charged issues and present a great temptation for ambitious politicians. As a result, it is important for free-market advocates to know how best to argue the major aspects of state health policy. The following are several important principles to consider.

1. *Understand the problem yourself.*

2. *Know your state.* What is good about your state? What areas demand immediate attention? Health care is complex and personal. Don't take a simple approach to understanding this challenge.

3. *Understand the issue of the uninsured.* Don't just look at the uninsured rate. Examine the rate of those with private health insurance. Analyze by age cohort and/or income level, look at the type of coverage (employer-provided or purchased in the individual market), and compare it to the national average and neighboring states.

4. *Be familiar with your state's insurance market.* Examine premium costs compared to those in other states. Look at the individual and small group markets and employer-sponsored employee-only and family plans.

5. *Understand how employers in your state provide insurance.* Compare businesses, large and small, offering coverage to their employees. Examine participation rates.

6. *Get up to speed on Medicaid.* Look at Medicaid eligibility levels, spending per recipient (children, adults, those with disabilities, and the elderly), and key outcomes (portion in home or community settings for elderly and those with disabilities). Here, too, compare results regionally and to the U.S. average.

7. *Consider the future.* Analyze how projected demographic trends will influence the current situation. Remember: Demographics are destiny.

8. *Celebrate what is working well so that the politicians will be less inclined to mess with it.*

9. *Identify the challenges unique to your state.* The ideal is to do this preemptively, before any legislative proposals are introduced.

10. *Get to know and understand the motivations of elected officials.* Most legislators are completely removed from the real world when it comes to health care. They have the richest benefit package available (outside Medicaid)—the public employees' health plan—and they pay very little for it. For too many politicians, this is simply an intellectual debate, not a personal one.

11. *Get to know and understand the motivations of the interested parties.* The vast majority of health care "interested parties" have little interest in free-market reforms. Despite how bad the current situation may be, the current players have figured out how to play and win. Most have little interest in making the game more competitive.

12. *Set out clear principles to guide any debate.* Concentrate on the following:

    - Maximize private coverage: The ideal is affordable, private health insurance either through the employer or purchased by the individual.

    - Create an affordable, competitive, private health insurance market that can offer numerous innovative and reasonably priced products of interest to numerous differing constituencies.

    - Support private coverage first—including for working Medicaid-eligibles who have access to employer-sponsored insurance.

    - Maintain an affordable, sustainable, public health care safety net (Medicaid).

    - Demand a competitive, accountable health provider market.

13. *Suggest real reforms.* Clearly identify each problem and the best strategic public response to this targeted need.

14. *There is no silver bullet.* Don't pretend there is.

15. *Talk about the issue with compassion* and from the patient's perspective (not just numbers).

16. *Provide compelling anecdotes.* It works. Don't fight this reality, as frustrating as it may be.

17. *Use data to inform and shape your argument.* Too many people rely on PowerPoint solely to outline their talk. Do more: Use slides to present complex health data in visual form (graph or table).

18. *Bring in outsiders* to talk about what they are doing in their own states and the lessons they have learned. Host a conference with four to six speakers from other states. This is a great way to shape and move the political discussion. Most state health policy reform debates happen in a vacuum.

19. *Live by example.* Invest in a health savings account (HSA). My wife and I have had an HSA for more than two years. The premiums for our HSA-eligible insurance plan have averaged $300 a month less than a traditional, low-deductible insurance plan (about $400 a month compared to more than $700 a month). To date, we have saved more than $8,700 in lower premiums in 29 months, deposited $9,500 into our HSA, and used just $2,700 from the HSA to pay out-of-pocket health care expenses incurred during this time. Today, we have $6,800 in our HSA earning 2.5 percent interest each year. We now have more in our HSA than our entire deductible for our health insurance plan.

Resources

Here are some resources I have found to be particularly useful in my own work in Maine.

Basic State, Medicaid, Health Insurance and Health Provider landscape

Kaiser Family Foundation: http://www.statehealthfacts.org
Council for Affordable Health Insurance: http://www.cahi.org
National Association of Health Underwriters: http://www.nahu.org
America's Health Insurance Plans: http://www.ahip.org
FamiliesUSA: http://www.familiesusa.org
Robert Wood Johnson Foundation: http://www.statecoverage.net

Health Affairs Journal: http://www.healthaffairs.org
Government Accountability Office: http://www.gao.gov

Health Coverage

U.S. Census Bureau Current Population Survey table creator, to look in detail at health coverage:
http://www.census.gov/hhes/www/cpstc/cps_table_creator.html

Medicaid Spending

Centers for Medicare and Medicaid Services, Medicaid Statistical Information System (MSIS) data on cost, utilization, and spending for a variety of Medicaid populations and services:
http://www.cms.hhs.gov/medicaiddatasourcesgeninfo/02_msisdata.asp

Health Insurance Premiums, Health Care Spending and Employers Offering Coverage

Agency on Health Care Research and Quality; the Medical Expenditure Panel Survey (MEPS) is a set of large-scale surveys of families and individuals, their medical providers, and employers across the United States: http://www.meps.ahrq.gov/

Free-Market Think Tanks

The Heartland Institute: http://www.heartland.org
State Policy Network: http://www.spn.org
The Heritage Foundation: http://www.heritage.org
Cato Institute: http://www.cato.org
Galen Institute: http://www.galen.org
Consumers for Health Care Choices: http://www.chcchoices.org
Center for Long-Term Care: http://www.centerltc.com

The Fallacy of "Pay for Performance" Medicine Schemes

By Richard Dolinar, M.D.[4]

Those of us who practice medicine and are familiar with the writings of such great Austrian economists as Ludwig von Mises and Friedrich Hayek continue to find health care to be a source of great amusement and even merriment.

Two weeks ago, for example, I wrote a prescription for myself for a medical cream. I went to pick it up at the pharmacy. They handed me the generic and said there would be a $55 co-pay.

I, however, prefer to use brand-name drugs whenever possible. They didn't have the brand-name version available that day but agreed to order it and assured me it would be ready for pickup the next day. But I was very busy the next day and could not get back to the pharmacy. That night—about 2:00 in the morning —I happened to wake up and couldn't fall back to sleep. So rather than waste time tossing and turning in bed I decided to run down to the pharmacy and pick up my cream. The pharmacy is only a block away and is open 24 hours a day.

I was fully expecting to pay a much greater co-pay for the brand name than $55. I braced myself and went in. I was the only customer there. So, I thought I'd just scoot in and scoot out. Boy was I wrong!

The first hurdle I encountered was they didn't know what to charge me. They had to call the 24-hour help line at the insurance company to figure out the price. Now, I ask you, what other businesses, other than those in health care, have to call a third party to ask what price they can charge? Isn't this just an adult version of the childhood game of "Mother may I?"

In a free market is it not the seller who determines the price at which he is going to sell his goods and services? Don't all other businesses set their own prices and then go to the marketplace and compete with other businesses? Could you imagine Ford or GM asking the customer what price they could charge for the car he is about to buy? Yet this happens in health care all of the time, and we consider it to be normal.

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[4] Richard O. Dolinar, M.D., a clinical endocrinologist specializing in diabetes in Phoenix, Arizona, is a senior fellow with The Heartland Institute and a consultant to the pharmaceutical industry.

After many minutes the answer came back from the insurance company. I should be charged $35 for the brand-name cream. The tech then asked me, "Would you prefer the generic?" What, I should pay $55 for the generic when I can get the brand-name drug for $35?

Often in health care one gets the distinct feeling they have gone down the "rabbit hole" with Alice and are now in Wonderland. This was one of those moments. She obviously had not looked up the generic price and was not aware of the conversation I had had with the day-shift tech.

"Well, that's fine," I said, "I'm willing to pay for the brand name." I handed her $35. But that didn't solve the problem. It merely took us to the next obstacle.

For some reason, the store cash register wouldn't accept the price and therefore wouldn't open. She couldn't put my money in. It had a mind of its own. It was computerized.

At this point I've been standing there about 25 minutes. I'm not complaining. I have no screaming children with me. I am in possession of no cane, walker, or other potential projectiles. I have not threatened bodily harm. I am just patiently standing there waiting to receive my medication, when to my surprise the following happened. And maybe it occurred because the onslaught of patients earlier that evening had softened up the defenses, or this was the pharmacist's last day on the job, or maybe his frustration had reached such an unbearable level he just couldn't hold back any longer. But somewhere from in the depths of the shelves I heard him exclaim to the pharmacy tech, "Just give it to him!"

So she gave me not only the cream but also my $35! And off I went. The generic version would have cost me $55, the brand-name $35, but I got it for zero. Who says this isn't a great system? This is a terrific system! Only in America ... and only in America's health care system could something like this happen. It is amusing to watch. You've just got to laugh. You can't let it get to you.

Systemic Problems

But I must admit, it is not so amusing when the shoe is on the other foot. There are huge problems in American health care today that go far beyond the fiasco I participated in at the pharmacy.

Unbeknownst to the general public, including some physicians, doctors in the U.S. have just completed what has been euphemistically called their first "Medicare Payday Holiday." During this "holiday," extending from September 22 to the end of the month, the government did not send out payments to any physician in the United States for treating Medicare patients. Those payments were delayed until after October 1. This "relieved" the physician and his staff of all the time and "hassle" involved in keeping track of such payments. He was thus on "holiday." Unfortunately, his bills weren't.

This was done in order to allow the federal government to pay those nine days of bills in the next fiscal year, which began October 1. It was an accounting maneuver to make last year's budget look better. Of course, this year's budget is going to look worse and might result in an even longer "holiday" at the end of this year.

The federal government has overspent its budget. Medicare's unfunded liabilities are now estimated to be more than $27.7 trillion. Medicare is bankrupting the federal budget. This has led to a movement to restrain the cost of health care via "pay for performance."

Pay for Performance

Usually, in our economic world, party A buys from party B and party A pays. But in health care it's different. Party A buys from party B, and party C pays. The patient buys from the pharmacy, the doctor, or the hospital, and the insurance company or the government pays.

This is a flawed economic model because it sets up inherent tension between A and C: A always wants more—after all, he or she is not paying the whole bill—and C always wants to pay less because it's not getting anything for the payment.

In an attempt to address this inherent tension, party C (the government and various insurance companies) is implementing pay for performance.

How will this work? Pay for performance uses "evidence-based medicine" to establish "best practices." Then, "outcomes" are measured and physicians are paid accordingly—those who perform well receive a bonus.

Appealing Ambiguity

On the surface, this is a very appealing notion. It is difficult to oppose such wonderful-sounding things as "evidence-based medicine," "best practices," "outcome measurements," and "pay for performance." But what do these terms really mean?

When legislation is passed or movements occur, there are often two reasons why they happen: the "good reason" and the "real reason."

In the case of pay for performance, a good reason is offered: It's all about quality.

Others, however, see the *real* reason as control—control over the most expensive instrument a physician uses: not the CT scanner, not the MRI, but the physician's pen. According to this view, pay for performance is an attempt to control the medical decision-making process in order to control the cost of health care.

Just as formularies restrict the choice of drugs doctors can use, pay for performance will restrict the choice of therapies they can use. Allow me to explain.

Consider the term "evidence-based medicine." Note that "evidence" is primarily a legal term, not a medical term. A car goes through a red light and crashes. We have it on videotape—that's evidence.

However, in health care, what we usually have to work with is data rather than evidence. And it is very important to realize that unlike evidence, data is open to individual interpretation, conflicting interpretations, and even changing interpretations as we become more knowledgeable in our understanding of medicine. Evidence, on the other hand, is unchanging. It is what it is. It is black and white. Today, in medicine, what is often being called evidence is really only just data.

Individual Needs

This "evidence" is then used to develop "best practice" guidelines. But a treatment that, on average, might be the best for a group of patients might not necessarily be best for a particular individual patient. So the question arises: Who should decide whether the guidelines apply to this particular patient? Should it be the third-party payer, who is paying the bill, or the treating physician, who actually sees the patient and is legally liable for his/her care? If this best practice guideline is not applicable to this patient, is not the physician obligated by his oath to do something else?

Problems also arise regarding "outcome measurements." We have to make sure what we are really measuring. For example, studies show when physicians write prescriptions to treat patients for high cholesterol levels, 10 percent of those patients don't even get the prescription filled. Another 10 percent get the prescription filled but don't take the drug. At the six-month mark, fully 50 percent of the patients are not taking the drug. Yet physicians are being measured on what share of patients have their cholesterol levels under control. Their bonuses are based on that number. But who are we really measuring, the physician or the patient?

Distorted Incentives

Pay for performance adds an extra layer of complexity to the doctor's medical decision-making process.

Under a pay for performance system, if you walk into a doctor's office and it becomes apparent to him that you will drag down his statistics for whatever reason—whether it be problems with compliance in taking medications, or perhaps just the sheer complexity of your case—he will be best off moving you on to somebody else. And he most likely will do so in such a way that you will not even be aware of the decision he has made.

The physician will say something like the following: "Mrs. Jones, I'm only a primary care doctor. I want the best care for you. You need to see someone with more experience taking care of problems like yours. Therefore I'm going to send you to a specialist."

The specialist, after evaluating you and coming to the same conclusion, will also push you out of his practice. He doesn't want his statistics hurt either. Beware if he says, "Mrs. Jones, I'm only a specialist. You need to see someone with even more experience than I. I want the best care for you. Therefore I am sending you to the University Medical Center." And there you might very well be seen by an intern fresh out of medical school!

In Search of Quality Care

As a result of the distorted incentives created by pay for performance, the patients requiring the most help, the most difficult patients, will be on a constant caravan in search of care.

Words such as "evidence based," "outcome measurements," and "pay for performance" sound very good, but the impact on patient care could be highly destructive. Instead of improving quality, this approach could greatly hinder it.

Physicians and weathermen have a lot in common. Neither one controls the subject of their studies. The physician doesn't control the patient. The weatherman doesn't control the weather.

Could you imagine if we paid weathermen on a pay for performance basis? The weatherman in San Diego would get all of the bonuses, while the weatherman in Buffalo, New York would get none. Now that would be amusing!

And that is exactly what we are doing in health care today ... although it is far from amusing.

Real Problems, Poor Solutions

Elizabeth Whelan, Sc.D., M.P.H.[5]

The current-day approach to real or perceived public health problems in the United States is to attack real problems with poor solutions.

Noting that Americans often solved past public health problems through government intervention, activists are now pressing to use the same approach in solving individual health problems caused by personal behavior or economic forces. This is a very different thing, of course, and the public health community is clearly heading in the wrong direction in confronting and dealing with the real health problems looming before us.

Three areas where political activity is most prevalent today are obesity, tobacco, and pharmaceutical cost and availability.

Attacking Obesity

Obesity is a real health threat in the United States, and it is getting worse instead of better.

In 1960 about 13 percent of U.S. adults were obese. Recent numbers indicate the proportion has risen to 22 percent. Currently, nearly two-thirds of Americans are either overweight or obese.

Obesity is a serious risk factor for diabetes, heart disease, certain forms of cancer, and more. It is a real public health threat in America today.

But what to do about it? The public health community is proposing that we treat obesity as a public health problem instead of a private concern. Noting that "government" was able to intervene successfully in controlling infectious and communicable diseases by mandating chlorinating water, offering vaccinations, etc. activists have created a very substantial movement today to have government "solve" the obesity problem.

[5] Elizabeth Whelan, Sc.D., M.P.H. is president and founder of the American Council on Science and Health, a consumer education consortium concerned with issues related to food, nutrition, chemicals, pharmaceuticals, lifestyle, the environment, and health.

The question, then, is not whether to do it but what means to use. There are a variety of proposals actively being considered. These include:

- banning a range of food advertising;
- banning the sale of certain foods, particularly in schools;
- mandating that restaurants carry calorie information on every menu;
- slapping heavy taxes on certain foods;
- banning fast food restaurants in neighborhoods with high obesity rates;
- advocating lawsuits against food companies;
- making weight reportable on students' report cards; and
- requiring medical personnel to report patients' obesity-related conditions. This is already happening in New York City, where diabetes became a reportable disease in 2006. If you have diabetes, your blood test data, with your name and contact information, are now sent to the Department of Health, and you can expect to hear from them. Will obesity itself soon be a reportable condition?

These interventions clearly pose a concern in a free society. Obesity is a personal health problem—one that involves lifestyle factors and individual choices.

Even if we set aside the matters of privacy and individual rights, there is no evidence that any of these interventions will actually make our country slimmer. The list of proposed activities to confront obesity rarely contains an emphasis on education about the basic equation of calories in (as food) and calories out (as exercise). In addition, there is never any mention of using technology to reduce the calorie content of food and to intensify the search for pharmaceutical solutions.

Real problem, poor solutions.

Stopping Cigarette Smoking

Cigarette smoking is still the leading cause of preventable death in the United States, responsible for more than 400,000 premature deaths annually in the United States. Nearly 25 percent of American adults still smoke and they incur, among other problems, greater risks of lung, pancreatic, oral, bladder, esophageal, cervical, and other cancers; chronic obstructive lung disease; and the biggie in cigarette mortality, heart disease. It's a real problem.

But in recent years, activists have proposed two very unwise solutions. First, there has been a rising tide of hyperbole about the health effects of secondhand smoke (environmental tobacco smoke, or ETS). There is no denying that ongoing exposure to ETS can cause acute health effects such as ear infections, asthma attacks, and upper respiratory symptoms. And it is very possible that long-term, high-dose exposure to ETS—as can be encountered when living with someone who is constantly smoking—could be bad for you. It is also revolting and can make your clothes and hair smell, and so on.

Those are certainly problems—so why do anti-smoking activists feel the need to exaggerate the risks from secondhand smoke? And exaggerate they do. Even the U.S. Surgeon General's office told us recently there is "no safe level" of exposure to ETS.

I personally am in favor of smoke-free environments—but I am also in favor of sticking to sound science.

Second, the anti-smoking community routinely rejects any strategy to encourage smokers to switch to reduced-harm tobacco products, even though it is clear that prior efforts to help people quit smoking entirely have produced dismal results. Statistics show 70 percent of smokers want to quit and 40 percent make a serious effort to do so each year, but fewer than 5 percent succeed.

That brings up the option of "smokeless tobacco." As you may know, nicotine is what keeps smokers hooked. But nicotine by itself does not pose a public health hazard. The products of combustion in cigarettes are what cause the health threat. That is why it is particularly stupid to propose (as some public health advocates have done) that we reduce the level of nicotine in cigarettes. That would cause people to smoke more to get their "fix," and in the process would cause them to take in more and more of the illness-generating products of combustion.

The use of smokeless tobacco in Sweden, by contrast, has caused a rapid decline in the frequency of smoking-related systemic disease. Smokeless tobacco has several advantages over cigarette smoking:

- It does not cause chronic lung disease.
- It does not cause cancer of the lung, bladder, kidney, or pancreas, as cigarette smoking does.
- It has been convincingly associated with only one type of cancer—oral cancer—and the risk of oral cancer associated with smokeless tobacco is significantly less than that associated with smoking.
- Smokeless tobacco produces zero secondhand smoke, of course.

Overall, the use of smokeless tobacco confers only about 2 percent of the health risks of smoking. Cigarette smoking kills about 50 percent of longtime smokers. Smokeless tobacco kills about l percent of those who use it.

Thus, you would think the anti-smoking community would embrace harm reduction and let the word out that smokeless tobacco is less hazardous than cigarette smoking. But that has not happened. The office of the Surgeon General and the anti-smoking community have entirely rejected this option to help smokers reduce their risk.

Cutting Pharmaceutical Costs

Finally, we are all concerned about the high cost of drugs. Many Americans, however, apparently have no idea about how the system works; how drugs are developed, tested, and marketed; and the huge costs involved in creating new pharmaceuticals and bringing them to market. Many simply do not understand the incentive system at work, and why pharmaceutical companies and investors are simply not going to invest large amounts of money if they cannot recover it in sales.

Sometimes when people tell me they are outraged because a certain life-saving drug they are taking is so expensive, I want to ask them, “Would you rather that the drug not be on the market at all?” Those are the two alternatives. A real or at least perceived problem is the failure to accept the advertising slogan, “Today’s investments produce tomorrow’s miracles.”

The proposed solution—drug importation—is worse than the problem. Bringing in “cheaper” drugs from Canada and other countries is a poor solution because it removes the profits that make it possible to develop new drugs in the first place, and hence destroys both the incentive and the ability to create new cures.

In my travels, I have found that 99 percent of people do not understand why drugs are cheaper in other countries. The answer is price controls. In countries such as Canada, U.S. companies are forced to sell drugs at a fraction of the price they would cost in the United States. This is part of an international trade agreement.

By legalizing the importation of drugs—95 percent of which are products of American companies—we are actually importing price controls, which come inside a Trojan horse promised as a gift of lower drug prices.

Countries with price controls do not produce very many new drugs. If we do not reverse course, we are heading toward de facto price controls and the same lack of new cures as in the nations from which we import U.S.-produced drugs.

The other big problem with drug importation is the threat of counterfeit drugs coming our way—and they already are doing so, as documented in a recent American Council on Science and Health report on the threat of counterfeit drugs.

We face many serious public health challenges, which also include the threat of chemical, biological, and radiological terrorism. We should insist that our public health agencies identify real problems and provide some credible evidence that their proposed solutions will actually work.

2
Budget and Taxes

How to Provide a Quality Education in Illinois

By Illinois State Sen. Chris Lauzen[6]

Out of all the discussions that should unite the people of this country and the State of Illinois, the foremost ought to be the importance and best approach to properly educating our children.

As we watch highly paid manufacturing jobs dissolve in the United States and mushroom first in Central America and more recently in China and India; as Northern Illinois University reports an unprecedented shrinkage in the standard of living in the northern portion of our state; and as we watch enormous levels of education spending yield so little result in concrete benefit and academic performance in our elementary and secondary schools, wouldn't you think that we would insist on thoroughly researched recommendations for improvement and substantial productivity gains?

Shouldn't every state in the union construct the most robust marketplaces, where our "best and brightest" innovators and service providers are encouraged to compete for the privilege of preparing future generations to meet the global challenges that we already face? It is a founding principle of our nation's success that, in properly functioning markets, efficient, high-quality competitors thrive and grow while the inefficient or poor-quality competitors either fix their problems or go out of business.

Need for Education Choice

In the time of an ancient world power, "All roads led to Rome." In the education reform and funding debate, so many of the solutions point to education freedom and school choice. In a country or state that values

[6] Chris Lauzen has served in the Illinois State Senate since his election in 1992.

"equal opportunity," it makes no sense for the financially fortunate to be able to choose to take their children out of public schools that do not meet their expectations, while poor families are not allowed the same freedom of school choice.

Instead of freedom, we get more bureaucracy, more protection for special interests, and proposals for growth-stifling tax increases. We are given, for example, Illinois H.B. 750, which falsely promises significant and substantial property tax relief in exchange for a 66 percent increase in personal and business income taxes (a further disincentive for people who work and save), an expansion of sales taxes, $2 billion of additional uncommitted general revenue spending, and—for the first time ever in Illinois—an income tax on senior citizen pension incomes over a certain amount.

Comprehensive Reform

In contrast to the above-mentioned tax-heavy policy, a comprehensive approach to education reform and funding in Illinois would include at least three major components: building schools without property tax increase referenda in rapidly growing areas, operating schools without taxing people out of their homes, and insisting on education reforms that research shows actually increase students' academic performance—those that show a real return on our substantial investment.

First, we must stop the runaway costs of building new schools in growing areas, and we must stop the constant taxpayer barrage of building referenda. In order for new residents and growth to remain welcome, development must accurately and totally pay for itself. Meaningful construction cost standards should be implemented and supervised by an agency that will ensure we are building schools rather than replicas of the Taj Mahal.

Local decision-makers' authority to say "No" to inadequate development fees must be strengthened. Some people object to the words and even concepts of impact and transition fees. Others say, "You'll make new subdivision housing more expensive and less affordable because developers just pass on these costs to homebuyers."

Of course they do. But the large majority of the people whom I serve respond, "If you do not pay the full cost of your new home in terms of schools, roads, and clean water, then I'm sorry but you cannot move here." They continue, "I simply cannot afford to pay my own property taxes, feed my family, stay up with my bills, and pay for your house, too."

Development Fee Reform

The two components of development fees that must be addressed in an accurate calculation presented and discussed in open meetings are the building-capital cost of land, bricks, and mortar; and the working-capital cost of operating the school for the average 18 months between the time a family moves in and the child starts going to school and the actual collection of property tax occurs and is made available to the school district.

The first cost is usually called impact fees, and it needs to be no more and no less than the incremental expense created by the new growth. The formula for this calculation must be consistent across all municipalities and villages, or developers will play one town off another with the local taxpayers eventually holding the referendum bag. Because of the cash flow constraints on developers paying higher up-front development fees (and passing the costs on to homebuyers), it may be necessary to construct a finance instrument for developers to spread the cost over a reasonable period.

It is a practical truth in proper management that the person who has the responsibility to get a job done should be given the authority to make decisions. In an initial proposal, it was suggested that school officials be given "veto" power over local government decisions to approve new growth without adequate development fees. However, school boards have not demonstrated staunch fiscal restraint in the past, and they say they have no permitting process to enforce their decisions. At this point, I sense they wish to help calculate the proper fee but want the final decision to be made and enforced by the local municipality.

Property Tax Reform

Next, the operation of schools must be paid for without taxing homeowners and businesses out of their property. Some have suggested a "shift" from property taxes to income taxes, promising an initial 30 percent decrease in property taxes. This strikes many observers as a false promise similar to government assurances such as, "The lottery money will go to education" and "The tollways will become freeways as soon as we pay off the bonds."

In the case of Illinois law, this promise is invalid on its surface. The amount of promised tax savings in H.B. 750 is $1.5 billion to $2.0 billion in property tax relief. Yet, it is my understanding that statewide property tax revenue in Illinois is $20 billion, which means the promised $2.0 billion in savings is 10 percent of the total, not 30 percent.

In addition, not only is the promise less than what is being advertised, it is not permanent. Most of my informed constituents believe property taxes will begin to be ratcheted back up as soon as the other tax increases have been signed into law.

So, instead of “shifting” property taxes, let’s freeze them, like California property owners did with Proposition 13 more than 26 years ago. In California, which has a thriving real estate market, many people can afford to remain in their current homes solely because of the real taxpayer protection instituted by Proposition 13. This effective policy still enjoys 65 percent voter approval all these years later.

Simplifying the Tax Structure

Freezing taxes, however, is actually the easy side of the equation. When people ask how the state will manage to pay for the natural growth in expenses under such a freeze, I make two suggestions.

First, according to *State Legislatures* magazine, Illinois loses $600 million to $1 billion each year because it does not consistently apply sales/use tax law to all retail purchases, specifically those made over the Internet. It’s basically unfair and inconsistent that a local merchant must charge me sales tax when I buy a shirt at his or her store, and I’m charged sales tax on that shirt if I order it over the phone, but if I use a computer to order it over the Internet I pay no sales tax. A huge amount of our revenue solution is being launched somewhere into cyberspace.

Currently, 40 states are working to simplify their sales tax structures to consistently collect sales/use taxes on retail purchases over the Internet. Some national retailers such as Land’s End are already cooperating with many states to level the playing field.

I favor no increase in what is covered in the base. This is not a “tax on the Internet.” In fact, preliminary legislation that I sponsored last year seeks to demonstrate this point clearly by repealing a tax that some Internet access companies are charging on phone bills.

The second suggestion I make to those who insist we need more funding for schools, especially in Chicago, is not to extend Chicago’s Tax Increment Financing (TIF) districts in developed areas beyond their original 23 years. It is simply amazing to me that Chicago is one of the most powerful, wealthiest cities in the world and yet it pretends not to have an adequate property base with which to support its own schools. According to the *Chicago Tribune*, just one of those TIFs, the Central Loop TIF in the highly developed downtown financial district, will have generated $1 billion over its life to Chicago's City Hall rather than the Chicago Public Schools. The Central Loop TIF was the first and is the largest Chicago TIF. It is due to expire in 2007.

It's also very important to note the Chicago Public Schools' budget is $5.05 billion for approximately 420,000 students. That's nearly $12,000 per child per year. Given that level of spending, it is not only important to ask "how much" money is spent but "how well" it is spent.

Restructuring School Districts

Two other proposals ought to be considered in the operations portion of this school funding debate.

First, Chicago legislators should sponsor, and suburban and downstate legislators should support, the Downtown Chicago Pilot Program for School Choice, to give many of their constituents the same type of educational freedom and "equal opportunity" that wealthier parents already enjoy.

Second, consolidation and proper alignment of elementary school districts with high school districts must be a prerequisite for any additional funding. I am told there is a school district in Illinois with 43 students and six high school districts that have fewer than 100 students each. I've also been told 240 of approximately 850 districts in Illinois would be eliminated if every high school district were limited to only one elementary school district within its borders.

Not only would redundant administrative costs be reduced, but education would improve because curricula between grade schools and high schools could be coordinated more efficiently and effectively.

Also, there is a consistent pattern in unit districts of under-compensating high school teachers and over-compensating elementary school teachers because they are in the same union bargaining pool. I'm working on a statistical study of the 850 districts and the least painful methods of cost-saving, education-improving consolidation.

Real Return on Investment

Finally, we want a real return on our investment for education. The standard cliché is, "This is for the kids," but the lack of progress in improving academic achievement given the enormous amount of additional local, state, and federal spending would indicate kids have not been beneficiaries. I notice the legislators who argue the loudest for more money don't even mention educational improvement as a motivation. The rest of us must insist that real reform is at least as important as money in this debate.

Every education policymaker ought to research the question, "What five factors (independent variables) have the largest effect on student academic achievement (the dependent variable)?" Then, we should focus our effort on aligning the investment we make where it can do the most good. This is much harder and more ambiguous than it appears on the surface. If the experts can't agree on the research, how can politicians properly decide?

Priorities for Improvement

The most important element in student achievement is a family that highly values education and provides the proper stability and support for its children. That said, here are some priorities for the public schools to do their part:

- Safe, clean, properly equipped schools. This is an obvious prerequisite for student achievement, but it is all too often not available, especially to inner-city families.

- Competent, motivated teachers. In very few fields other than education is career advancement tied primarily to seniority and the number of hours spent studying for advanced degrees. Basing teachers' pay and career advancement rigidly on these variables instead of performance ensures that high-performing college students will avoid the teaching profession.

- Adherence to research-based, proven-effective, direct instruction curricula. "Project Follow Through" was the largest, most expensive federally funded experiment in education ever conducted. One billion dollars were spent over nearly 30 years to study thoroughly the question of which teaching method best instills knowledge, cognitive skills, and positive self-concept in students in grades K-3. A total of 700,000 students in 170 socio-economically disadvantaged communities around the country were involved.

  The study concluded that the "direct instruction" method showed the greatest positive impact on all three types of development. This method features small-group instruction (not the same as small classrooms), high rates of participation, immediate correction of errors, and repetition until each student demonstrates mastery. The method had especially positive effects at high-poverty schools. Rather than emphasize “small class size,” our spending should be targeted toward extra instructional time for students who are not meeting standards.

If you’re like me and had not heard of this enormously important study, it’s because the curriculum controversy hit the fan. Education professor Douglas Carnine at the University of Oregon commented, “The education profession has never been particularly interested in results, especially if they run counter to the prejudices of the profession.” As policymakers and taxpayers who funded this research, we do need to be interested.

- Measurement of growth by each individual student rather than against static standards by groups in schools and districts. In looking at student performance, we may be measuring the wrong thing. Currently, we measure and focus time, effort, and money on those students who can “benefit our numbers”—those who are on the bubble or have the potential to meet or exceed the standards.

  Several problems with this approach are that it pulls resources away from gifted or desperately behind students (these don’t improve the statistics); it gives teachers no incentive to advance a child more than one-year’s-progress-for-one-year’s-instruction if the student doesn’t reach the “meet and exceeds” plateau; and merit pay is less practical when success is more a matter of the pool of students you’re assigned than of the quality of a year’s instruction.

- A longer school year. Finally, if all else fails, students should have to “stay after school.” An additional 15 days per year, times 13 years of K-12 education, would yield a whole additional year of schooling, 195 more days, if it’s not squandered on field trips, etc.

  If Illinois were to institute this, we would be the first state in the union to have a 200-day school year. And there would still be approximately two months during the summer for teachers and students to regenerate.

Coming Budget and Tax Issues

By Sandra Fabry[7]

Daniel Clifton and Elizabeth Karasmeighan of Americans for Tax Reform recently released an analysis of 25 years of tax data. They noted the following:

1. Tax increases are getting smaller in size and scope (particularly in recessions).

2. States tend to cut taxes during growth periods more than in the past.

3. Revenue sources have shifted away from income taxes to more targeted tax increases such as tobacco and other forms of double taxation on consumption.

Two major factors have led the way in triggering this change. First is that the electorate has begun ousting proponents of higher taxes in elections and has rejected tax hikes at the ballot box when given a chance. In line with this trend, more and more state legislators are signing the Taxpayer Protection Pledge never to raise taxes.

Second, as the distinguished economist Richard Vedder has pointed out, taxpayers are voting with their feet. In 2004 alone, the nine states with no income tax gained an additional 323,579 domestic residents from the 41 states with an income tax. According to Internal Revenue Service (IRS) data, these migrating residents took with them $10.6 billion of adjusted gross income. So taxes clearly matter.

Tax Competition

As states increasingly realize the role that interstate tax competition plays in economic growth, they are cutting their income tax rates or eliminating income taxes for certain groups of their citizenry. Consider the following:

[7] Sandra Fabry is state government affairs manager for Americans for Tax Reform.

- The Rhode Island legislature passed a budget in 2006 including an "alternative flat income tax rate." This tax cut allows taxpayers earning more than $250,000 a year to choose between paying the current, graduated income tax rate, 9.9 percent at the highest after deductions, or a new flat rate of 8 percent with no deductions, scheduled to drop to 5.5 percent by 2011.

- The Arizona legislature passed and the governor signed a $500 million tax cut package that included a permanent 10 percent income tax cut over two years.

- Iowa voted to phase out the state's income tax on Social Security income over eight years. Additionally, every senior will receive a tax cut under a plan to exempt the first $24,000 for a single filer and $32,000 for joint filers.

- The Hawaii legislature passed a (decidedly modest) income tax cut of $58 million.

- The Utah legislature in 2006 passed an income tax cut following the Rhode Island model. Legislators in the Beehive State voted for a "dual track" income tax system allowing Utahns the choice of either filing their state income tax under the existing bracketed system with deductions, or a new flat rate of 5.35 percent. In addition to the flat tax option, lawmakers also cut the top bracketed rate from 7 percent to 6.98 percent.

Fairly Good Year

Overall, 2006 constituted a fairly good year for taxes at the state level. Most states went into their legislative session fiscally well-cushioned. Since state coffers were flush, more than 20 states cut taxes, and many tax increase proposals never gained momentum or were killed fairly easily.

Of course, there are always exceptions, and—no surprise here—one major exception was New Jersey, which raised taxes by $2 billion.

Clouds on the Horizon

As positive as 2006 may look at first glance, however, there are clouds on the horizon, and the bright revenue picture is only short-lived.

Mounting pressures on state budgets in the form of health care liabilities and the looming mass retirement of the Baby Boomers paired with other demographic pressures warrant actions by state governments.

Health care reform, and probably more specifically Medicaid reform, represents one of the most daunting fiscal challenges state governments now face. Medicaid costs have been growing at 6 percent or more annually, twice the rate of inflation, and represent a major threat to state budgets. These are costs that will have to be shouldered by taxpayers in just the next few years unless the system undergoes serious reform in the very near future.

At the same time, public employee pension plans are a financial time bomb in many states and localities. Public pension systems, which are mostly defined benefit plans, are taking up a greater percentage of the states' budgets. Particularly as the Baby Boomers are reaching the retirement age, the worker-to-retiree ratio is significantly declining. As a result, state and local governments are running huge unfunded liabilities.

Increasing retirement and health care costs with fewer workers is a recipe for economic disaster. The states will have to address the issue now, or tax increases will soon have to be the order of the day. These issues are compounded by demographic changes such as higher life expectancy.

Continuing Health Crusade

An issue that dominated the 2006 agenda will continue to be prevalent: Health care regulation advocates and other special-interest groups will continue their crusade to get government to make health care consumption decisions for their constituents. This is a boon to government big spenders who can easily hijack the activists' cause for their interests.

The number one target continues to be smokers. Tobacco taxes have been one of the most popular revenue raisers among state legislators these days. Our research shows a dramatic shift in state revenue sources, and at this point tobacco seems to be the vehicle of choice.

Several states considered proposals for higher tobacco taxes on the November 2006 ballot. Most notable among these was California, where voters were presented a proposal for a huge cigarette tax increase of $2.60 per pack. The new tobacco tax would have brought the total cigarette tax to $3.47 a pack and would have created a convoluted government bureaucracy. Voters decided against higher taxes and more red tape and let the measure go up in smoke.

Missourians, too, rejected an 80 cents per pack cigarette tax increase, while Arizona and South Dakota voters approved cigarette tax increases in their states.

Cigarette Tax Push

In Iowa, health care regulation advocates and other groups for years have been pushing for an increase in the state cigarette tax with the help of the governor. House Speaker Christopher Rants was able to avert the tax increase two years in a row, but the pressure will continue.

In South Carolina, the legislature rejected several attempts to raise the state's cigarette tax, but one proposal got farther than ever before and will likely be back on the 2007 agenda. Similar versions of this tax increase proposal are also likely to pop up around the country: Cigarette tax increases to fund Medicaid spending programs.

In Indiana, Gov. Mitch Daniels took many by surprise when he proposed a cigarette tax increase in 2005. The idea never got off the ground, but in the fall of 2006 he once again put forth the idea of raising the cigarette tax for health reasons—an idea the big-spending interests are likely to feast on.

Other Bans, Taxes

Other states that are likely to review the issue in one form or another are Connecticut, Illinois, Massachusetts, New Hampshire, New York, Oregon, Rhode Island, Washington state, West Virginia, possibly Maryland, and maybe Florida.

The push for higher tobacco taxes has been accompanied by a push for strict smoking bans in public areas.

The issue of government making consumption decisions for its constituents does not end with smoking. Alcoholism, drunk driving, underage drinking, and obesity are invoked as top concerns, and higher taxes on related products rank high on the agenda.

In 2006, more than 30 states considered imposing higher alcohol taxes, but with state coffers flush and recent research suggesting higher alcohol taxes are not effective in reducing underage drinking or driving while intoxicated, these proposals did not go anywhere. Likewise, more than 10 states were looking at taxes on soda. While no tax increase passed in 2006, the issue is likely to resurface along with "snack taxes," "fat taxes," or—as suggested in an October 2006 *New York Times* op-ed—"drive-through food taxes."

Need for Transportation Funding

Whereas in 2006 property tax reform dominated the agenda in many states, and it will continue to drive the debate in a number of states, one issue that is likely to range even higher on the agenda this coming year is transportation funding.

A recently released study by the National Conference of State Legislatures finds that since the 1990s, vehicle miles traveled have grown more than 35 percent, urban traffic has increased by 45 percent, and rural traffic has increased by 23 percent. Transit authorities and local chambers of commerce are calling for higher taxes to address the need to accommodate this traffic.

The debate is already well underway in a number of states, particularly Virginia. In the commonwealth, a Republican-led yet tax-and-spend happy senate (the leading force behind the 2004 tax increase package) has been joined by Gov. Tim Kaine, a Democrat, the second governor in a row who has been working to raise taxes after making campaign promises that he would seek no tax increases.

During the past year, however, after a series of primary challenges against Republicans who voted for the 2004 tax increase, House Republicans rejected tax increases for transportation funding.

More Trans Taxes

Utah decided to allow a one-quarter percent county optional transit tax to be placed on the November 2006 ballot. The measure, which was approved by voters, was pushed by the local chamber of commerce in Salt Lake City.

The issue of transportation funding is also likely to resurface in Hawaii, where legislators in 2005 voted to allow localities to raise the state's general excise tax to fund a "light rail" system that is in fact a heavy rail system. The revenue generated through the excise tax increase is unlikely to be sufficient, however, and big-spending interests can be expected to come back for more.

Transit authorities in Florida and North Carolina have been voicing their concerns about transportation crises in their respective states—almost resulting in a local rental car tax increase in Florida, which Gov. Jeb Bush vetoed.

Oklahoma taxpayers in 2005 clearly rejected a gas tax increase for transportation by the highest margin in the state's history. Although the legislature increased funding for transportation without imposing a gas tax increase, this may not be enough to satisfy the special interests, as they were very vocal about painting doomsday scenarios during the weeks and months leading up to the ballot vote.

Telecom Tax Reform

Reforming the tax structure for telecommunications and information services will also likely rank high on the states' agenda. Thanks to technological changes, telephone service is now available over the Internet, phone companies are preparing to offer video, and cable companies are selling phone service. Many lawmakers have set their eyes on broadband and wireless services these days.

While some are looking to "level the playing field," citing fairness as their main concern, others see the call for telecom tax reform as a unique opportunity to tap new revenue sources in the face of dwindling conventional revenue sources such as income and sales taxes. As a result, leveling the playing field in this area, as in most others, typically means tax increases.

The challenge here is that the impulse to make the tax structure fair is likely to backfire, as too often in telecom tax reform the tax burden is shifted from declining services to growing sectors, which amounts to long-term tax increases for consumers. Virginia was one of the states addressing the issue in 2006, and a number of others are looking to address this issue in the near future as well.

Court-Mandated Tax Reform

Some lawmakers in several states have lost sleep over another issue that is likely to resurface around the country: court-mandated tax reform. Kansas and most recently Texas have had to pick up the pieces when their state supreme courts declared their school funding mechanisms inadequate.

The issue here goes deeper than just the issues at hand in each particular case, as it involves the issue of whether judges should be allowed to legislate from the bench. An activist court played a major role in Nevada in 2003 when the state supreme court set aside a voter-initiated state constitutional amendment requiring a two-thirds supermajority to raise taxes.

Responding to the court decision in Kansas, fiscal conservatives tried and unfortunately failed to change the constitution to prevent activist judges from legislating from the bench. Texas passed a massive tax shift to meet the court's requirements in 2006.

This question will be back on the table in New Hampshire, where the state supreme court ruled in 2006 that the state alone has the responsibility to provide an adequate education to every child in New Hampshire and fund it entirely with state, not local, money. To meet the court's ruling, the state must increase spending by roughly $1 billion, a level that some have said even the institution of an income tax could not meet. The court set a deadline of July 2007, and if legislators have not found a solution by then, it will impose its own solution. This issue is not likely to go away.

Business Tax Reform

States are also looking at overhauling their business tax structures to be competitive. The most prominent case these days is probably Michigan, where the legislature in 2006 decided to repeal the state's onerous single business tax, which was already scheduled to be eliminated by 2009.

While repealing the tax effective at the end of 2007 rather than in 2009 is a good step in the direction of jumpstarting Michigan's sluggish economy, any attempt to recoup the "lost" revenue would undo the positive effects of the repeal. And if a replacement for the single business tax generates more than what the single business tax would have generated until 2009, it will clearly constitute a tax increase.

What we are currently up against regarding business taxes are attempts to move to gross receipts taxes. In 2005 Kentucky passed an alternative minimum calculation, or AMC, under which businesses are to be taxed on net income, gross receipts, or gross profits—whichever is highest. For any business with thin profit margins—such as grocery stores, restaurants, and car dealerships—gross-receipt taxes are particularly painful, because they apply regardless of whether a business actually turns a profit in any given year.

Tax and Expenditure Limitations

Another key issue area that will continue to rank high on the agenda, and from our point of view a more positive one, is a push to bring spending restraint to the states. In light of recent trends—tax increases becoming smaller in size and scope while spending continues to increase at unsustainable rates and unfunded liabilities are becoming an overbearing problem—it is absolutely crucial that states put an end to runaway spending.

In 2006, nine states were supposed to have tax and expenditure limitation measures on the November 2006 ballot. Most of these measures were removed from the ballot for various reasons, such as legal challenges or state officials declining to certify, and only three made it to a vote. None of the measures passed.

In Maine, where the Taxpayer Bill of Rights had been polling at 70 percent of support in the weeks leading up to the vote, tax and spenders mobilized all resources at their disposal and outspent proponents by a ratio of 5:1. While the outcome is certainly a disappointment—the measure failed by 54 percent to 46 percent—fiscal conservatives in Maine and elsewhere will not be discouraged in their efforts to bring spending restraint to their respective states. After all, it took several years to get the Taxpayer's Bill of Rights passed in Colorado.

Income Tax Restructuring

For taxpayers, the push for tax and expenditure limitations is a positive step. Equally positive is the aforementioned movement toward income tax restructuring. States will continue to look at making their income tax structures more competitive. The most recent examples that point towards more income tax restructuring are Georgia and Massachusetts.

Cutting income taxes was the hottest issue in the Democrat primary for governor in Massachusetts in 2006, as two of three candidates endorsed the idea of getting back on track with a rollback of the state flat-rate income tax to 5 percent, a reform that had been passed by the voters but was then frozen legislatively.

In an effort to make the state more attractive for retirees, many of whom flock to income tax-free Florida, Georgia Gov. Sonny Perdue made the repeal of the retirement income tax for seniors a plank of his 2006 re-election campaign platform. The proposed measure would amount to a tax cut of roughly $142 million a year and is estimated to affect at least 305,000 Georgians.

Taxing 'the Other'

While there are always exceptions to the rule, the general trend away from broad-based income and sales tax increases towards more targeted tax increases will continue.

Taxing "the other" will rank high on the agenda. Tax increases will increasingly single out one segment of the population. So-called "sin taxes" are an easy target, because they are tailored toward certain behaviors that are perceived as "bad" by many, and as such, it is more difficult for these groups to lobby against these tax increases. An additional selling point for these tax increases is the idea of dedicating the revenue toward funding of health-related programs.

What the general public is unaware of, however, is that too often even dedicated revenue will not go where it is intended to go, or only a ridiculously small percentage will. Along with new spending mandates, these tax increases tend to create convoluted bureaucracies with little oversight and accountability.

What is also often forgotten is that it should not be up to the government to make consumption decisions for its constituents, and that small segments of society should not be forced to carry the weight of paying for public health care systems they may never use.

Another example of taxing "the other" is a recent shift toward certain hospitality tax increases. In 2005, for example, Mecklenburg County in North Carolina passed a rental car tax increase to fund an arts center in the city of Charlotte. Taxing tourists, who have no way of voting in the district, seems to be an easy sell. However, tourists can and will eventually vote with their feet and stay away from localities that single them out and raise taxes on them. In the case of rental car taxes, a point that is often overlooked is that more than 50 percent of all car rentals are local rentals—people who have their car in the shop for repairs, for example.

Taxes Disguised as Fees

Legislatures are also increasingly resorting to local option taxes. The idea here is that the legislator supporting the tax is not personally raising it but is only granting localities the authority to do so, or putting a tax increase on the ballot. However, this is merely an example of passing the buck.

Another revenue source that state legislators are likely to tap into more than in the past are taxes disguised as user fees. In their efforts to raise revenue, tax-and-spenders are aided by a lack of a clear, universal definition of what constitutes a legitimate fee and what constitutes a tax.

For the purpose of policing the Taxpayer Protection Pledge, Americans for Tax Reform has made a clear distinction that we have shared with signers of the Taxpayer Protection Pledge. To qualify as a fee, a charge must:

1. fund a specific service, with no excess going into a general fund,

2. be paid only by those who use that specific government service, and

3. give individuals the choice of whether to purchase the service from government (and thus pay the fee) or to purchase it from a private business.

As this definition makes clear, excise taxes, sales taxes, and taxes levied on businesses to pay for government regulation are not user fees. Minnesota Gov. Tim Pawlenty took many by surprise and upset fiscal conservatives when he made tried to sell a cigarette tax as a "health impact fee" in 2005.

Continuing Efforts

Fishing and hunting licenses, park fees, and charges for making photocopies—all these can be counted as legitimate fees, and increases thereof as legitimate fee increases, as long as the increase covers the actual cost of the service and is not excessive. For example, Ohio's increase of the cost of an annual fishing license for out-of-state residents from $24 to $40 over four years smells like a tax increase.

One day before the beginning of a four-day September 2006 special session on transportation in Virginia, two members of the state's house of delegates tried to get a bill out of the tax committee that would have sought regional increases in the tax on annual vehicle registrations, the tax on initial registration of vehicles and driver's licenses, the hotel tax, the rental car tax, and the commercial real property tax. The delegates tried to sell their proposals as "very directed fees." Luckily, the finance committee balked and refused to pass the bill or any other tax increase out of the committee.

However, the current debate in Virginia is a clear indication of lawmakers increasingly resorting to tax increases disguised as fee increases.

Much Progress

Looking at the big picture, we have come a long way over the past 25 years. The message following the 1990 recession has resonated with policymakers across the country: Tax increases are politically unpopular and hamper economic growth in their respective states. As a result, state tax increases have become smaller, fewer, and more targeted and have shifted away from capital, which is the key to economic growth.

The movement toward meaningful spending restraint through a new generation of tax and expenditure limitations is an encouraging trend. Once implemented, these measures will do their part in getting unsustainable budget growth in check.

Health care reform and pension reform are issues that must be addressed today. While a lot rests with the U.S. Congress—such as the option of turning Medicaid into a block grant program for the states—there is much the states can do to curtail costs. For example, they can tighten eligibility, shift to employee-owned health care, and combat fraud. Florida and South Carolina are leading the way in this respect, as outgoing Gov. Jeb Bush and re-elected Gov. Mark Sanford, respectively, are resorting to market-based approaches such as personal health accounts and bringing in private-sector health care provider networks.

In the area of state pension reform, eight of the last 10 changes to state pension systems came in the form of a move from defined benefit plans to defined contribution plans. This move, following the example of the private sector, creates better predictability for state taxpayer contributions and will remove the current unfunded liabilities in the system.

Volatile Revenue Sources to Avoid

Finally, states should rein in their reliance on volatile revenue sources such as non-wage income, including capital gains and dividends. Dan Clifton and Elizabeth Karasmeighan have pointed out that with the 1990s stock market rise, states became flush with temporary capital gains revenue and used it to raise spending levels permanently. When the market declined, states lost up to 80 percent of this revenue source but continued spending. This behavior was a major factor driving the tax increases that followed.

Removing capital gains revenue from the general budget (or eliminating the growth-inhibiting tax on these gains) will bring greater predictability in budgeting and consequently less appetite for tax increases for the states.

Much Room for Improvement

Although a lot of progress has been made, the states have their work cut out for them, and taxpayers do too, if we want to help the states take the appropriate steps to deal with these crises.

It is the job of groups such as Americans for Tax Reform and other members of the center-right movement to educate taxpayers about the dangers of tax increases and to make the general point that any tax increase, regardless of who the target is, drains money out of the private sector and hampers economic growth. Free-market think tanks and institutions such as The Heartland Institute do their part in educating taxpayers and legislators about the options at hand.

Americans for Tax Reform has begun pushing a rather small and symbolic project that nonetheless helps make this point: the so-called "Tax-Me-More" funds. The idea derives from a Massachusetts effort in which a section was added to the state income tax form where a taxpayer can elect to pay a higher tax rate. A tax-me-more fund is a fund into which a taxpayer who feels his tax burden is not high enough can make a payment. Currently, at least six states have accounts available for voluntary contributions.

The fact that these funds remain fairly dry is indicative of the hypocrisy of those pushing higher taxes. The tax-me-more funds thus are a helpful tool in dismantling big-spending rhetoric and exposing the tax-and-spend shell game.

Resources

Daniel Clifton and Elizabeth Karasmeighan, "State Tax Trends Over Twenty-Five Years: Tax Increases Down, Revenue Sources Shifting," Americans for Tax Reform, August 14, 2006.

Elizabeth Karasmeighan, "A Model for Property Tax Reform in 2006: Reducing Property Tax Growth through Local Spending Limits," Americans for Tax Reform, January 25, 2006.

Americans for Tax Reform material on Tax-Me-More Funds, http://www.atr.org/state/projects/taxmemore.html

The Looming Federal Budget Disaster

By John Berthoud[8]

I doubt it will be news to this audience that Washington has established a pretty lousy fiscal track record during the presidency of George W. Bush. In a nutshell, the Bush program has been to try to tax like Ronald Reagan but spend like Howard Dean.

This spending explosion is particularly detrimental in light of the coming crises of Social Security and Medicare, which loom as perhaps the largest domestic policy issues of the coming half-century.

Sensible Tax Policies

Taxes are the one area where we've seen some good trends during the current administration, but I worry we may lose many of the tax cuts that have been enacted. Making the tax cuts permanent will be a big fight in the coming couple of years.

The deficits we're currently experiencing in Washington—about 2 percent of gross domestic product (GDP), according to the Congressional Budget Office's latest estimates—aren't particularly harmful in terms of the economy. But they are harmful politically to the cause of cutting taxes.

Over the next few years, as we fight these fights, even though the current deficits aren't due to a lack of federal revenue, the pro-spending crowd will be sure to use the deficits as an excuse to block extension of the tax cuts ... which is also known as raising taxes.

Disastrous Spending Choices

The news is pretty grim when it comes to spending. The Bush record has been terrible.

We don't know what the final numbers of congressionally passed appropriations bills will be, but even if Congress goes no higher than the president's budget, federal spending for Fiscal Year 2007 (which began

[8] John Berthoud is president of the National Taxpayers Union (NTU) and the National Taxpayers Union Foundation (NTUF) in Alexandria, Virginia.

October 1) will be 49 percent higher than in 2001 (the last Clinton budget).

And of course the worst sin committed by the Bush administration is its Medicare prescription drug bill, adding $8.1 trillion in unfunded liabilities to the federal government's ledger.

Support for Further Increases

That's the bad news about where we've been on spending. What's ahead?

The National Taxpayers Union Foundation (NTUF) has a research product named BillTally, which is a unique tool that lets us get a glimpse of where we're going in terms of spending. BillTally is a computerized tracking system developed by NTUF that reports a cost estimate for every legislative proposal in each Congress. BillTally uses data from the Congressional Budget Office and similar sources. Agenda totals for individual members are developed by cross-indexing each member's sponsorship and co-sponsorship record with cost estimates for all these bills.

The numbers show that as bad as the Republicans have been on spending, we can expect a Democrat-led Congress to be much, much worse. In the study we released in August, we found the typical House Republican proposed legislation resulting in a net increase in federal spending of $11.6 billion per year, while the average Democrat was proposing a net annual increase of $547.4 billion—the highest BillTally has ever recorded for either chamber.

On the Senate side, the partisan gap was smaller but still significant: Republicans are proposing a net increase of $11.4 billion in new spending, while Democrats on average are proposing legislation that would lead to a net increase of $52.1 billion per year.

Huge Domestic Spending Hikes

In the fights over taxes and spending in the next couple of years, there are a couple of key messages that supporters of limited government should keep banging away at.

First, don't let the Bush administration or Republicans get away with claiming all this increased spending is due to the War in Iraq or homeland security. Spending has been increasing across the board.

Consider education, for example. Federal education spending—which NTU continues to believe should be a local matter—is

81 percent higher in the president's budget for 2007 than in 2001. In fact, under Bush's budget, the Department of Education will spend more in 2007 than it did in the entire second term of the Reagan administration.

Huge Increase in Tax Revenue

Second, as we fight over making the tax cuts permanent, don't let the pro-government forces get away with the claim that tax cuts have been the cause of the big federal deficits of recent years. In 2001, the federal government collected less than $2 trillion in receipts. According to the latest estimates of the Congressional Budget Office, the federal government will collect more than $2.5 trillion in 2007.

So much for starving the beast!

If President Bush and Congress had simply held annual spending increases to 5.1 percent, the federal budget in the current fiscal year (2007) would be balanced.

Unfunded Liabilities

While the current federal deficits won't cause adverse economic consequences, we do face a grave economic danger in the form of the long-term unfunded liabilities in Medicare and Social Security.

We have pay-as-you-go systems, which can keep financially balanced as long as the ratio of workers to retirees doesn't change. Unfortunately, change is exactly what's happening.

We are facing the "Floridaization" of America. By 2030, older Americans will represent 19 percent of the U.S. population. That exceeds the percentage of older Americans in Florida today.

The growing number of seniors means that by 2030 we will be spending about 13 percent of GDP on Medicare and Social Security—roughly double what we're spending today.

Overall, the biggest fiscal time bomb is Medicare. In about 20 years, it will exceed the size of Social Security. According to the Social Security and Medicare Trustees, it will consume 11 percent of GDP by 2080.

Combined, we have in today's dollars unfunded liabilities for Social Security and Medicare totaling $84 trillion.

Necessity for Benefit Cuts

In light of these numbers, the key messages that supporters of limited government should keep banging away at are that we need to address these problems as soon as possible, and that solving this problem by tax increases would be a disaster. We have already delayed too long. We are now just two years away from when the first members of the Baby Boom generation can start collecting Social Security benefits.

According to calculations of the Federal Reserve Bank, if we do nothing, federal taxation will have to rise by one-third by 2030—from 18 percent of GDP to 24 percent of GDP.

There are some pro-growth, win-win elements that can help solve the problem (private accounts for Social Security, for example), but we also have to make some real choices. In Medicare and Social Security, in the coming years we are going to have a titanic struggle over whether we'll enact massive tax increases or scale back some of our spending.

Unfortunately, some fiscal conservatives decided to oppose President Bush when he proposed changing from calculating benefits based on a wage index to a price index. If fiscal conservatives fight against proposals to trim back benefits, we will guarantee massive tax increases, because the fiscal help that things like private accounts will provide is not nearly enough to bring Social Security and Medicare into balance.

3
Luncheon Remarks

Stick with Science and Principles

By Joseph L. Bast[9]

Al Gore recently announced he is recruiting 1,000 people to deliver his PowerPoint presentation on global warming to chambers of commerce, Rotary Clubs, and other civic groups. If three or more people gather indoors, there will be a surrogate Al Gore giving his global warming spiel.

This should worry or even alarm those who are committed to open and informed debate over important issues. Fake documentary films, demonization of opponents, and highly orchestrated, political-campaign-style efforts to shape public opinion aren't likely to lead to sound public policies, yet these increasingly are the tactics being used by those in the public policy arena.

Chemophobia

Consider the "war on cancer" that has been going on for more than 30 years now. During the 1960s it morphed into chemophobia, the irrational fear of chemicals. People were told, and still are being told, to fear any trace of chemicals in our food, or in our water, or in the air we breathe. And since we are now able to detect the presence of chemicals in concentrations as small as parts per billion and even parts per trillion, anyone with an agenda can claim the presence of "toxic poisons" to ban anything.

This fear of chemicals is wrong. It is based on the notion that mice are little men, and if enormous amounts of a chemical can cause cancer in laboratory mice, then tiny amounts of the same chemical must explain some tiny percentage of human cancers. This dubious methodology is

[9] Joseph L. Bast is president of The Heartland Institute.

used to justify countless environmental and health regulations that cost the economy billions and billions of dollars every year.

Junk Science-Based Policies

Minimum wage laws are another example of policies dependent on junk science. Economists have known for generations that if you raise the minimum wage you get fewer jobs. In particular, you get fewer jobs for young people and others who don't have a lot of skills or experience. Ex-offenders who are trying to get their lives back on track are particularly vulnerable.

Yet, every three or four years, an assistant adjunct professor at some obscure university does a small study claiming a minimum wage doesn't actually destroy jobs. And that one study is then paraded around by unions and their front groups to justify higher minimum wages.

Another example is the "research" used to justify restrictions or bans on advertising. Public health advocates want to ban advertisements for anything they think might be potentially harmful to us. They started out with tobacco—first cigarettes and now smokeless—and have moved on from there, calling for bans or limits on advertising for alcohol, breakfast cereal with sugar in it, and fast foods.

A couple of months ago an associate professor at the University of Connecticut claimed to have found a correlation between underage drinking and ads for alcohol. The study contradicts virtually all past research, two-thirds of its subjects dropped out before the end of the study period, and it used a measure of underage drinking that other researchers reject. Nonetheless, the anti-alcohol crowd has been citing it relentlessly to make the case for more restrictions on liquor advertising.

Actually, we have a good idea of why kids choose to drink: It's caused by peer pressure and by adults giving them alcohol, not liquor stores selling to kids. Focusing on advertising only distracts us from the truly effective but more challenging ways of protecting kids from alcohol.

Dangers of Compromise

It is tempting, in all these cases, to give up arguing the science. On climate variance, for example, we don't want to be dismissed as "global-warming deniers," as if we are in the same camp as Holocaust deniers and other certifiable nut cases. We don't want to be accused of being pro-cancer, or against paying people a "living wage," or encouraging kids to smoke, drink, or get fat.

Compromise in each of these cases is easy, but compromise would be wrong.

On climate variance the recommended compromise is to cap emissions but allow emissions trading to keep the expense low. But anything short of draconian reductions in emissions will have zero impact on the global climate, according to the alarmists' own models, and an emissions trading regime will create a "carbon cartel" that will lobby to keep caps in place forever.

That's no compromise. That's losing.

On raising the minimum wage, I recently met with a representative of a trade association representing major retailers and he said, "Well, you know, it's really not our issue. We already pay more than the minimum wage, so raising it wouldn't affect us, and might even benefit us by increasing our competitors' costs."

We can't ask Wal-Mart to oppose raising the minimum wage. Someone else has to stand up for young people, minorities, and ex-offenders looking to find their first jobs. That somebody else has to speak out for truth and for principle, not go looking for a compromise.

Fatal Defeatism

If you need proof that sound science and sticking with principle can win over time, just look at the case of the pesticide DDT.

Starting in the 1960s, environmentalists in the United States demonized DDT, making claims about its health and environmental effects that have never been substantiated but are still widely repeated by environmental activists. Thanks to their efforts, DDT was banned in the United States. Restrictions were imposed by the United Nations, effectively banning the use of DDT in Third World countries as well.

But DDT is the safest, most effective, and least expensive means we have to kill mosquitoes that carry malaria. So once we started to discourage and prohibit the use of DDT in Third World countries, malaria exploded.

For years this went on with very little public debate. The environmentalists had so successfully demonized DDT that no self-respecting politician proposed using it, and very few scientists or policy analysts dared to stand up and defend it. The folks at Environmental Defense and other environmental advocacy groups said "the debate is over." They labeled anyone who claimed otherwise as "fronts for the chemical industry." They dominated the public debate, just as global warming alarmists are dominating that debate today.

Millions of people died because nobody stood up to defend DDT. Think about that: Not "hypothetical lives lost," and not "lost income," but real lives lost because people with an agenda dominated the public debate, and a lot of people sat on the sidelines and did nothing.

Ultimate Success

That changed during just the past two or three years. A small group of dedicated scientists and policy analysts had never given up on DDT, and they finally got the attention of the public and then of elected officials. The World Health Organization recently reversed its policy and is starting to allow the use of DDT, and the U.S. has agreed to start allowing some of its foreign aid funds to be used for DDT to kill malarial mosquitoes.

Lives are being saved. One of the greatest miscarriages of justice in recent history—the withholding of a lifesaving chemical from millions of people—has finally ended.

The lesson is: Never give up the scientific debate, and never compromise principles. It may be unpopular to stand opposed to the crowd, to say, "Wait, that claim can't be right. Let's think about this more clearly." But if nobody does this, if we all sit on the sidelines and say, "It isn't my fight," then nobody will step forth, and the human costs will be enormous.

4
Luncheon Keynote Address

Promoting Prosperity for Illinois

By Douglas L. Whitley[10]

The primary focus of my remarks today is that Illinois' economy has lagged behind the nation's economic recovery. In addition, the economic trajectory the state has been on for the past several years is not sustainable. Therefore, steps must be taken to promote job growth, prosperity, and economic opportunity.

This is not to suggest Illinois has failed to experience any population growth or that new jobs aren't being created. During 2006, Illinois twice led the nation in number of jobs created in a given month, and its current unemployment rate is under 5 percent. Construction cranes are visible on the Chicago skyline, and the state's farmers harvested a bumper corn crop in 2006.

However, I contend that such rosy reports are being used by our state's political leaders to veil the real, long-term economic issues that are fundamental to the state's future prosperity. In short, I'm tired of delivering the doom-and-gloom speech that dwells on our state's many problem areas. It is appropriate that I acknowledge and review some of the "horribles," but this speech primarily aims to focus on our strengths and positive points for Illinois' future.

Some Horribles

Since 1999, the median household income in Illinois has dropped by 12 percent, the second steepest decline in the nation over that time period. Adjusted for inflation, the median household income in Illinois today is the same as it was in 1989. This is no doubt in part due to the loss of

[10] Douglas L. Whitley is president and CEO of the Illinois Chamber of Commerce.

more than 250,000 well-paid manufacturing jobs since the turn of the century.

Illinois ranks 45th in the nation in job growth since January 2003. Nationwide, the average state job growth has been 3.8 percent, while Illinois job growth is 0.8 percent. Meanwhile, Illinois has reached an all-time high in the number of people who are provided assistance through the state's Medicaid program. One in every seven Illinoisans is covered by Medicaid. A rising welfare case load is not a national trend.

Increased Obligations, Taxes

In addition, chronic underfunding of public employee pension obligations has resulted in a $43 billion outstanding liability, the largest of any state in the nation. It is an obligation our elected leadership continues to inflate and ignore.

Illinois is one of the few states that is neither giving tax cuts nor padding the "rainy day fund" as a result of the nation's current economic expansion. Our state budgets have been constructed on fiscal gimmicks such as borrowing and deferring obligations. It hasn't been "balanced" in years.

The most recent numbers I found showed Illinois is ranked 48th in net population migration. Is it any wonder we continue to lose a Congressman every 10 years when re-apportionment occurs? We can expect nothing different after the 2010 census, because creative and industrious people go where the jobs are—and increasingly they aren't in Illinois.

Many Economic Strengths

While it is important to acknowledge our shortcomings and challenges, I refuse to dwell on the negatives. Illinois has many economic strengths that could effectively propel our economy well into the twenty-first century. But, in order to capitalize on the opportunity, it requires leadership. And it takes vision, communications, commitment, and a horizon that extends beyond the next press release, media sound bite, or campaign photo-op.

In short, our state is far more concerned about election cycles than economic cycles—and that, I contend, is a fundamental problem. We must get beyond the thought that the future is the two-year election calendar and "gotcha" politics are more important than promoting the general welfare and common interests of the state as a whole. We must recognize that long-term success for the people of Illinois means many initiatives require 10- and 20-year commitments.

I have chosen this occasion to set forth an economic agenda that I offer as capturing the most critical emerging issues that our state's political, business, and community leaders should embrace if Illinois is to re-emerge in its rightful place as national leader and economic powerhouse that is generating jobs and prosperity for the people of this great state.

This is critical because the best option for meeting the state's governmental, social, and civic expectations and obligations is a vibrant economy that both encourages and rewards investment and hard work. If the economy is strong and people are working, many of the state's "horribles" will begin to resolve themselves.

Building Blocks for a Stronger State Economy

1. Agriculture

Illinois has long been known for its highly productive farmland. However, our future depends on more than just harvesting raw product from rows of corn and beans. Twenty-first century agriculture is better characterized by the term "bio." We must look at agriculture as food, pharmaceuticals, renewable energy, bio-tech, bio-research, and genetics.

2. Manufacturing

While some would have us write off manufacturing as a basic American industry, I reject that view. Illinois remains a dominant industrial state and ranks fifth in manufacturing production in the United States. It is true the industry has been in constant change, but American manufacturers have become more efficient, more productive, and more high-tech in our approach to global competition. Despite the loss of both jobs and industrial facilities, many Illinois manufacturers have adapted, remain successful, and are looking to hire qualified technicians.

It should also be noted that many of the industrial job losses we have experienced did not move overseas but instead went to neighboring states and to the South. We need to explore and understand the competitive underpinnings that led to the decisions that industrialists have made to abandon Illinois, and then take steps to remove disincentives where appropriate.

3. Transportation

Warehousing and logistics compose one of only two broad categories where jobs were created in every region of the state over the past decade. In part, this is due to the growth in just-in-time production techniques, but it is also the result of changing patterns of the international marketplace, which depends upon modern and efficient transportation of products.

Illinois' geographic location places us at the crossroads of the nation. Thanks to O'Hare Airport, Illinois is a gateway for world travel, whether for business or pleasure. However, long before O'Hare helped to give us a smaller world, Illinois was handling the nation's rail, water, and highway cargo needs.

This has not changed. Illinois has 13 Interstate highways crossing or feeding our state, more than any other state. Illinois is the only place in the United States where all six Class One railroads converge. Two-thirds of the nation's container cargo traffic crosses Illinois. Illinois shippers have access to the world's water ports.

The state is also a major convergence point for pipelines and fiber-optic networks. Transportation is a cornerstone of the state's economy.

4. Energy

Illinois is one of the few states with the potential to lead the nation towards self-sufficiency in energy. Illinois has the natural resources, the industrial know-how, the research institutions, and a history of embracing cutting-edge technology, all of which are necessary to lead our nation forward with advancements in clean and alternative fuels.

Southern Illinois University is a leading energy research center. The Carbondale campus focuses on coal, while Edwardsville hosts the nation's premier ethanol laboratory. Illinois is the home of the grandfather of ethanol production thanks to ADM's Decatur headquarters. Illinois is also home to the nation's largest producer of nuclear power. The state is home to engine researchers and manufacturing leaders Caterpillar and International.

Illinois has more BTUs underground than does Saudi Arabia, but it is in the form of coal instead of oil. The world's largest coal producer isn't based in Illinois, but St. Louis-based Peabody Energy certainly has huge holdings in and future investment plans for Illinois coal. The future of the coal industry is brighter than it has been for more than 30 years.

The U.S. Department of Energy is pursuing the investment of a billion dollars to help commercially develop the next generation of coal technology and coal-based energy resources. Illinois has two communities identified as finalists in the selection process for where the nation's "FutureGen" facility is going to be located. Whether the facility is located in Illinois or not, the technological advancement that is expected to be achieved from this investment will benefit Illinois coal.

Regarding oil, BP has major holdings in Illinois and recently announced a $3 billion investment to upgrade and expand capacity at its Whiting, Indiana refinery. Illinois is home to four major oil refineries and is the primary receiving point for Canada's shale oil production. With Illinois' history as a refining and industrial state, there is no doubt our political leaders should be actively recruiting the construction of the nation's newest refinery facilities in Illinois.

We, and the industry, should have learned from the destructive experience of Hurricane Katrina that having the preponderance of the nation's refining capacity on the Gulf Coast isn't in our collective best interest. Furthermore, additional refining capacity in the heartland of America might also help Illinois drivers get cheaper prices at the fuel pump.

It has been reported that four refineries need to be built somewhere in the world every year, yet the United States has not constructed a new facility in 30 years. If the capacity is lacking, our government should get out of the way and become an enabler rather than an obstructionist.

5. Health Care

Illinois has a tremendous opportunity to lead in health care. Illinois is home to outstanding health care facilities, not just care-giving facilities but also research and teaching hospitals. For example, the UIC Medical Center is the largest in the world. We are also blessed to be home to some of the world's leading health care companies, such as Abbott, Baxter, Takeda, and others.

The emerging and differentiating health care issues that are going to distinguish the cutting-edge health care leaders in this country are: (1) accountability around the quality of care; (2) accountability around the pricing of care, including full transparency that comes with disclosure of competitive and comparative pricing; (3) self-directed responsibility for personal health; (4) embracing technology to modernize a system that is subject to far too much human error; and (5) availability of care for all.

The financing of health care today is a virtual house of cards that has been constructed on cost-shifting among a variety of payers, subsidies to some providers, and government programs that continue to be both expansive and inadequately funded.

6. Electronic and Financial Markets

The significance of the presence of MERC, CBOT, CBOE, and the Chicago Stock Exchange is too often overlooked and underestimated. Chicago market-makers are recognized world leaders in creative thinking and adoption of new technology. Chicago is the Midwest home for numerous private equity funds. More can and needs to be done, however, to put the state's full financial talent and resources to work.

7. Conventions and Hospitality

This is one of only two industry segments that grew jobs in all regions of the state over the past decade. Illinois is a strong draw for business travel because of our conveniently accessible geographic location in the center of the country; superior convention facilities; hotel availability; high-quality, diverse restaurant choices; and excellent leisure opportunities.

The number of leisure visitors, especially from foreign countries, has also grown, due to Lincoln history, world-class cultural institutions, professional sports, destination shopping, diverse outdoor recreation, and outstanding neighborhoods, communities, and festivals.

The state benefits from a reputation as a clean, safe, beautiful, and friendly destination. Still, Chicago's prominence as a premier convention and meeting city is at constant risk due to competitive options from other cities and states.

8. International Markets

Illinois hosts more foreign consulates than other American cities, exclusive of Washington, D.C. and New York City, where the United Nations' prominence is understood. Illinois is a headquarters location for many international corporations, has a multicultural population, and is a primary urban center destination for immigrant populations. O'Hare is an international gateway.

With so many obvious advantages, it is disappointing that our approach to international trade is fragmented and sorely underwhelming. It is critical that Illinois businesses become more engaged in international markets, and it is important that we prepare our young people and our workers for the fast-paced and increasingly competitive nature of a global economy.

9. Higher Education, National Labs, Corporate R&D

Illinois is home to some of the nation's leading higher education research institutions, three major national laboratories, and substantial private-sector R&D facilities. Human creativity and innovation are the ultimate job generators, and research and development is an economic engine that must be recognized and rewarded. Universities must focus on transferring technology to private entrepreneurs, and private firms must be confident that Illinois is a state that nurtures success and prosperity.

The state's future success requires that we strive to keep creative minds and technological advances working to bring growth to Illinois. The U.S. economy is increasingly being driven by innovation that is quickly mimicked by the rest of the world. It is American creativity, individualism, and free-market capitalism that keeps America a leader and innovator of economic progress.

Consequently, one of the great differentiators of Illinois' place in the world may be our development of a knowledge-based economy that retains the best and brightest people to develop and grow the latest cutting-edge business advances in the state.

10. Small Business Entrepreneurship

Illinois must demonstrate its value as a nurturing environment for small business. It is, after all, all about jobs. Small business has proven consistently to be the most innovative and nimble at job creation. The most successful economies are home to young, high-growth companies with multiyear, double-digit growth trends and aspirations for more. These small businesses on steroids propel a surging economy.

As multinational corporations become less reliable as stable local employers, it has become increasingly apparent that successful economies must attract new business ventures with the spirit, innovation, and drive to grow and prosper in the communities where they are born.

The public sector does not create prosperity. It is incumbent upon the public sector to create an environment where entrepreneurs and investors have confidence that their inspiration and perspiration will be adequately rewarded.

Illinois' political leaders must recognize that the private sector has choices about where to invest in people and place capital to make it work for higher returns. A successful future for our state requires that we assure private-sector job creators that Illinois is such a place.

Several Fundamental Problems

Despite all these positive attributes, Illinois has been held back by several fundamental problems. The state must overcome these if it is to assume the place its natural, human, and cultural resources make possible.

Education and Work Force

We need to demand a new compact between employers and the state's education community. We cannot afford to be complacent about curriculum rigor, educational outcomes, job-readiness skills, or the unacceptable number of young people who fail to graduate from high school.

We must not tolerate a population that is unemployable, under-employed, or disproportionately dependent upon government services such as welfare and corrections facilities. The current situation is unacceptable.

In order to be a highly productive state, we must capitalize on the traditions of a positive Midwestern work ethic, boast productive and efficient workers, and value human capital as a key economic input. Our future success requires a paradigm change.

High Cost of Doing Business

What are the differentiators that will make Illinois and the rest of the Midwest successful? We must initiate a dialogue with the state's business leaders about what makes a successful economic environment and move to change the laws and adopt the necessary changes that are determining factors for investment.

We should observe prosperity policies pursued by others and learn from a "Best Practices" approach, not only those adopted by other states that are growing jobs faster than Illinois, but also looking to foreign locations where prosperity is celebrated, as in Ireland and Singapore.

Anti-business policies—such as tax policies that consistently impose higher obligations on employers than individuals, government-dictated labor costs, discrimination against "big box" retail companies, attempts to freeze energy costs below market prices, and government interference even in restaurant menu selections—hardly project a reputation for a stable and predictable business environment.

Employers and investors notice such things. Consequently, there are economic consequences to such political decisions.

As much as politicians may wish to ignore it, I would contend that government may obstruct market forces and technological advances but cannot control them. Markets and technology are in constant change. The business community understands this, and successful business leaders understand it best. The public sector, however, has trouble dealing with change.

As a final matter regarding state-created business costs, I would observe that Americans have in many ways become too sophisticated and litigious for our own good. Too many Americans seem far more comfortable with confrontation and obstruction than in celebrating growth and progress, and Illinois laws reflect this tendency.

Deteriorating Public Infrastructure

Investment in public infrastructure requires multiyear visioning and continued stewardship of the public's resources, because the private sector cannot, generally speaking, do this for themselves. And it is a proven fact that private-sector investment follows public-sector investments.

Our parents and grandparents celebrated the investment in a nationwide interstate highway system that has yielded tremendous benefits for us all. Yet, today's politicians balk at the expense of maintaining a system that is now 50 years old and in desperate need of reinvestment. These obligations must be shouldered even if the costs are huge and the solutions require sacrifice in the form of higher taxes.

Political Sleaze

Finally, Illinois must confront and overcome its reputation as a political cesspool where investigations, indictments, and political corruption trials not only dominate the daily media but appear unending, regardless of which political party is in power.

The impression that Illinois governments are dominated by heavy-handed politicians who tolerate "pay-to-play contracting," job-buying, political shakedowns, kickbacks, hostage-taking in the form of intimidation and retribution, and regulatory populism at the expense of free markets, suggests that the fifth-largest state in America is as corrupt and expensive to do business in as the proverbial "banana republic."

I conclude that Illinois finds itself at a critical juncture. We have great strengths and tremendous potential for an even brighter future. This is no time to accept mediocrity.

We must fight public complacency and disillusionment by challenging ourselves to set a course that will achieve a better and brighter future, one that celebrates prosperity and opportunity for all the people of Illinois. It is achievable. All we need are vision, leadership, and courage.

5
Environment

Science Is Defeating Environmental Fears

By James M. Taylor[11]

In the environment realm, after long years in the wilderness, science is finally beginning to win out over political propaganda.

Regardless of how often the media bombard us with doom-and-gloom stories about global warming, the truth is that science is vindicating the so-called skeptics, and the alarmists are failing in their efforts to mislead the general public with fear-mongering rhetoric.

Here is what I expect regarding this issue in the upcoming year:

1. Expect real-world temperature measurements to confirm a moderate warming that falls well short of alarmist scare scenarios.

2. Expect the continued absence of the alleged catastrophic side effects of global warming.

3. Expect democracy to be vindicated as the public continues to reject the alarmists' political goals.

Moderate Real-World Warming

Regarding the outlook for real-world temperature measurements, we can expect science to continue to reduce the upper reaches of alarmist temperature projections. In 2001, the Intergovernmental Panel on Climate Change (IPCC) estimated the Earth would warm 1.5 to 5.8 degrees Celsius by the year 2100.

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In reporting on the IPCC estimates, the media focused almost exclusively on the worst-case temperature estimates and what a 5.8 degree warming could do to the planet. Ignored were the relatively benign, and in many ways beneficial, effects a 1.5 to 2.0 degree warming would have on life on Earth.

In the fall of 2006, however, a draft report of the IPCC's next climate assessment was leaked to the media. Very notably, the IPCC has lowered its worst-case scenario to 4.5 degrees of warming by 2100. And, of course, the "worst case" is just that: the most extreme situation, and one that is not a likely scenario.

Even global warming alarmists such as NASA's James Hansen are reluctant to project temperatures anywhere near the IPCC's worst-case scenario. In an article Hansen published in the fall of 2006, he projects warming of 0.2 degrees per decade—less than 2 degrees warming by the year 2100.

Lower Worst-Case Forecasts

We can expect science to continue to reduce the upper realms of projected "worst-case" temperature predictions. Satellite measurements of the Earth's lower atmosphere show a steady moderate warming of merely 0.12 degrees per decade since we emerged from an alarming cooling spell in the late 1970s. Even surface temperature measurements—not corrected for the false warming signal sent by the urban heat island effect—show a steady, moderate warming of only 0.17 degrees per decade.

This means just 1.7 degrees of warming over the next century if we believe the surface readings, and only 1.2 degrees of warming if we believe the satellite readings. Expect temperature measurements to continue to reflect this moderate and unalarming warming.

What is particularly notable regarding even the unjustified 2.0 degree warming estimate by such a prominent global warming alarmist as James Hansen is that even this is not alarming, or even unusual, by historical records.

Long-Term Ice Age

Although temperatures are relatively mild and favorable to planetary life at the moment, we are actually in the middle of a long-term planetary ice age. For the past 400,000 years, the Earth has endured periods of roughly 100,000 years of advancing ice sheets, known as glaciations, followed by roughly 10,000 years of warming, known as interglacials. For the past 10,000 years we have been in an interglacial. By historical standards, we are imminently due for another glaciation.

What is striking about our current interglacial is that temperatures are roughly 3 degrees Celsius below the temperatures that existed in the past three interglacials. For all the planetary scare scenarios presented by the alarmists, all three of our prior interglacials attained temperatures far above what exist on Earth today.

Indeed, the planet would need well over a century of the warming projected by alarmists such as James Hansen merely to reach historically typical temperatures for interglacials. The real emerging issue is not "why is the Earth so warm today," but rather "why is the Earth so unusually cool today?"

False Predictions of Catastrophe

A second emerging issue is the continued debunking of the alleged catastrophic side effects of global warming. A 2 degree rise in temperatures 100 years from now does not tell us much in and of itself. For example, it was supposed to reach 61 degrees in Chicago on the day I wrote this chapter. So what if in the year 2100 the temperature reaches 63 instead?

Alarmists answer this by conjuring up all sorts of natural disasters they allege are only 2 degrees away. Let's examine the most prominent predictions one by one.

First, alarmists claim the polar ice caps will melt. Real-world evidence refutes this. Currently, after 30 years of alleged "dramatic" global warming, the Greenland ice sheet remains in rough balance, and the much larger Antarctic ice cap is actually growing. Even alpine glaciers, such as those in the Himalayas, are growing, counterbalancing the shrinking alpine glaciers to which alarmists love to call our attention.

Moreover, current temperatures are lower than they were 1,000 years ago during the Medieval Optimum, which is so named because the warm temperatures were optimal for plant, animal, and human life. The polar ice caps came nowhere near melting even during the warmer temperatures of 1,000 years ago.

With the continuing advancement of scientific technology, alarmist forecasts of an imminent melting of, for example, the Greenland ice sheet, are now being replaced by alarmist forecasts of a melting a century or two from now. We can expect science to bolster the evidence that there is no imminent threat of mass melting of ice sheets.

Sea Level, Hurricane Scares

Second, alarmists claim sea levels will rise, inundating coastal cities. The recently leaked draft of the IPCC's Fourth Assessment predicts a total sea level rise of 5 to 17 inches (between half-a-foot and a foot-and-a-half) over the next century.

But sea levels have been rising consistently for the past 10,000 years, since the end of the last glaciation. Indeed, sea level is now 370 feet higher than it was 10,000 years ago. That's an average sea level rise of 3.7 feet per century. Yet the alarmists cry "catastrophe" over a projected sea level rise of only 1 foot during the upcoming century. The real question is not 'why is sea level rising so rapidly?' but rather 'why is sea level rising so slowly?'

Alarmist predictions of coastal cities being engulfed by relentlessly rising oceans are being exposed for the unsupported propaganda they have always been. Expect the evidence for minimal sea level changes to solidify during the next year.

Third, and finally, alarmists claim warming temperatures will create unprecedented numbers of super-hurricanes ravaging the Atlantic and Gulf Coasts. In support of this, they point to Hurricane Katrina's devastation of New Orleans. Climatologists and hurricane experts have led a rather remarkable counteroffensive to this baseless propaganda.

Hurricane expert Chris Landsea, a prominent research meteorologist with the hurricane research division of the National Oceanic and Atmospheric Administration, published a paper in the summer of 2006 showing that superior tracking technology allows us to identify and measure the full fury of hurricanes far beyond what was possible in the past. What alarmists have claimed as unprecedented hurricane fury is simply a reflection of unprecedented hurricane tracking technology.

Increasing Consensus

Landsea, it should be noted, is by no means alone among hurricane experts debunking the global warming hurricane myth. Bill Gray, the nation's most prominent hurricane forecaster, who has appeared on the Weather Channel for many years, has prominently rebuffed the notion that a recent upsurge in hurricanes is linked to anything other than long-term hurricane cycles.

The National Oceanic and Atmospheric Administration has linked the 2003 through 2005 Atlantic hurricane seasons to normal hurricane cycles.

Indeed, if the modest planetary warming of the past 30 years was responsible for Hurricane Katrina, experts point out, then why has there been a long-term relative lack of strong hurricanes during the "unprecedented" warming of the 25 years prior to 2003? Moreover, why has the Pacific Ocean not experienced a similar uptick in hurricanes in recent years? And finally, why did we have such a below-average hurricane season in 2006?

In the near future, we can expect hurricane experts and climatologists to continue to debunk global warming hurricane myths.

Alarmists' Campaign Failure

A third emerging trend is that global warming alarmists will increasingly tear out their hair over why the general public fails to demand, or even accept, dramatic action to address the asserted global warming threat.

The media likes to report—accurately, for a change—that a vast majority of U.S. citizens believe global warming is occurring and humans are largely responsible for such warming. But the media conveniently fails to mention that the public is not alarmed about this. Poll after poll shows global warming at or near the bottom of priority issues among the electorate.

For example, the Gallup Poll reported in April 2006, "Americans are more convinced than ever that the Earth is being affected by global warming, but they have still not grown especially concerned about it. Only a third predict global warming will pose a serious threat in their lifetimes."

The reason for this is that the alarmists' predictions of imminent catastrophes—melting ice caps, coastal floods, drought, and unprecedented hurricanes—are repeatedly proven false. The alarmists and their media allies love to grab headlines and temporary spikes of interest with weekly new predictions of imminent catastrophe, but every time they make such a prediction and the asserted catastrophe does not occur, the public grows more skeptical of the alarmists' claims. Expect this trend of increasing public skepticism to continue as more predictions of catastrophe fail to materialize.

Persistent Alarmists

A year ago, at The Heartland Institute's 2005 Emerging Issues Forum, I noted global warming alarmists and their media allies were raising public fears with a high-profile misinformation campaign alleging alpine glaciers in the Himalayan Mountains were melting at unprecedented rates and that this threatened the water supply for tens of millions of people.

As I predicted in 2005, the high-profile media scare has been proven false, and the alarmists and their media allies had to retract their glacial melting scare campaign. True to form, however, they "corrected" their debunked glacier melting scare in typical fashion.

The following quote is from the September 11 National Geographic News, which so prominently featured the Himalayan glacier melt scare in 2005:

> Some glaciers in Pakistan's Upper Indus River Basin appear to be growing, and a new study suggests that global warming is the cause.

BBC News, which also prominently reported the Himalayan glacier melt scare in 2005, published an article on August 24, 2006 titled, "Global warming boost to glaciers." It warned, "the findings are significant, because temperature and rain and snow trends in the area impact on water availability for more than 50 million Pakistanis."

We can expect more of the same spin-doctoring as the warming alarmists' claims consistently prove untrue.

Emerging Issues in Air Quality Regulation: Tough New Federal Standards for Ozone and Fine Particulate Matter

Joel Schwartz[12]

Since 1970 the Unites States has had a centralized, federally controlled system of air quality regulation governed by the Clean Air Act (CAA) and administered by the Environmental Protection Agency (EPA).

Under the CAA, EPA must periodically review and, if it believes necessary, revise its air pollution standards.

EPA's current review of the federal ozone standard is the most important emerging issue in air pollution policy. Federal air pollution regulation already has huge—but for the most part hidden—effects on our prosperity and on our freedom to live our lives in ways we find most fulfilling. Yet in exchange for these burdens we get little in return, because our air is already safe to breathe.

The reason air quality *seems* bad is that as the air has gotten cleaner, EPA has continued to tighten the standards, ensuring that CAA compliance remains out of reach for many metropolitan areas. Furthermore, environmental activists, regulators, and journalists exaggerate air pollution levels and health effects. Unfortunately, the Bush administration is making a bad situation worse.

Tougher Standards

EPA recently finalized a tougher standard for fine particulate matter, which is known as $PM_{2.5}$, airborne particulates under 2.5 micrometers in diameter. About 15 percent of metropolitan areas in 19 states exceed the current standards—an annual standard of 15 micrograms per cubic meter (ug/m^3) and a 24-hour standard of 65 ug/m^3. The annual standard will stay the same, but the 24-hour standard has been reduced to 35 ug/m^3. About 25 percent of areas in 31 states exceed the new standard.

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As big a change as that is, it is relatively minor when compared to what EPA is planning for the ozone standard.

Ozone, like particulate matter, is one of the pollutants EPA regulates under the Clean Air Act, and it is already the pollutant that commands the most regulatory attention and activity. In March 2007 EPA will propose a much tougher ozone standard. Right now about one-third of metropolitan areas in the U.S. are classified as "non-attainment" for ozone under the eight-hour ozone standard of 0.085 parts per million (ppm).

Under even the least stringent new standard EPA is considering—0.075 ppm—the proportion of metro areas in non-attainment would double, to two-thirds. And it could be worse than that, because the most stringent standard EPA is considering would put virtually the entire nation out of attainment for ozone.

Reason for Concern

Local and state governments and their constituents should be worried. EPA's new ozone standard will mean a vast increase in all of the costs, administrative requirements, and restrictions that go along with being a Clean Air Act non-attainment area. What makes the situation even more disturbing is that the new standard will effectively institute a permanent war on air pollution. The new standard is likely to be unattainable in many parts of the country, even if EPA chooses its least stringent alternative.

Certainly, we all agree that we need clean air and that people have a right to be free from unreasonable risks imposed by others. But current standards are already more than stringent enough to protect people's health. The pressure for even tougher standards is cloaked in the language of public health, but it is really about protecting and expanding the powers of federal and state regulators and environmental activists to control people's lives and impose their values of how Americans ought to live, work, and travel.

All the incentives in environmental regulation encourage exaggeration of risks and imposition of stringent and expensive standards and requirements. Regulators and activists depend on public fear of air pollution to maintain their jobs and budgets. Regulators fund much of the research intended to justify tougher air pollution standards. They also fund environmental groups to promote environmental scares and lobby for more stringent regulations.

Rather than being about protecting people from risk, the system has been turned upside down. We're in a situation where regulators and their allies continue to manufacture the appearance of risk in order to maintain and expand their powers and pursue their social agendas.

Air Pollution Trends

Air pollution has been dropping for decades, and will continue to decrease. In the past 25 years, national average levels of fine particulate matter, ozone, carbon monoxide, and everything else we measure have all sharply declined. $PM_{2.5}$ declined 40 percent. Days per year exceeding the old ozone standard—the so-called one-hour standard—declined 95 percent. Days per year exceeding the newer eight-hour ozone standard—that's the current standard EPA adopted in 1997—dropped 75 percent. Peak carbon monoxide levels dropped 70 percent.

These sharp declines in air pollution levels occurred at the same time that Americans vastly increased total driving and energy use. Since 1980, total miles of automobile driving have grown 93 percent. Total miles of diesel truck driving grew 112 percent. The amount of coal burned for electricity increased 61 percent. The long-term trends have been much more driving and energy use, but much less air pollution. These trends are going to continue due to federal and state air regulations that have already been adopted.

Although we've been very successful in reducing air pollution, most Americans believe we haven't reduced air pollution, or that it has even increased.

The reason perception is the opposite of reality is that most public information on air pollution is false. Environmentalists claim air pollution is getting worse, when in fact it's getting better. And journalists pass along these claims without any critical review. Regulators claim we've made progress, but "much work remains to be done."

As a result, most of what Americans "know" about air pollution is false.

Disinformation Campaign

There are dozens of examples of such misleading information every year. My current favorite is how regulators and environmentalists described ozone levels after 2005. The number of days above the eight-hour ozone standard nearly doubled across the United States between 2004 and 2005. After the end of the 2005 "ozone season," the environmental group Clean Air Watch put out a press release claiming, "smog problems nearly double in 2005."

Regulators and journalists followed suit. The Pennsylvania Department of Environmental Protection put out a press release about 2005's higher ozone levels. And the *New York Times* ran a story titled, "A Hot Summer Meant More Smog." All of these groups created the appearance of a worsening ozone problem.

Now here's what actually happened: 2005 was the second-lowest year on record for ozone smog! It just happened that 2004 was the lowest year. So 2005 was better than any other year except 2004.

It is also important to recognize that 2005 was one of the hottest years on record. All else equal, this favors higher ozone levels. Yet ozone remained at historic lows. Environmental fear-mongers turned this success into an apparent failure. As air pollution continues to go down, the amount and stridency of air pollution alarmism continues to rise.

Diminishing Health Effects

The trend regarding human health effects is the same as for air pollution levels: less risk, more alarmism. Asthma is a prime example. The prevalence of asthma has nearly doubled over the past 25 years. Almost any time asthma is mentioned, journalists and activists implicate air pollution as a major, if not the major, cause.

But every air pollutant we measure has been going down. That applies to the six "criteria" air pollutants, such as particulate matter, ozone, and carbon monoxide. And it applies to other air pollutants such as benzene and 1,3-butadiene, for which there are no ambient air quality standards but which have been sharply reduced nonetheless.

How could declining air pollution be causing a rise in asthma? It can't. But asthma is a serious disease. Millions of children suffer from it. And it just seems so plausible that air pollution must be the cause ... especially if you mistakenly believe air pollution has been rising.

Thus, activists, regulators, and journalists have hijacked asthma as a literal poster child for air pollution, even though air pollution doesn't cause asthma.

Scientists Help Spread Misinformation

Scientists help exaggerate these fears as well. For example, the California Air Resources Board (CARB) funded scientists from the University of Southern California (USC) to perform the children's health study (CHS). The CHS followed thousands of California children during the 1990s. These children lived in 12 different communities with pollution ranging from background up to the highest levels in the country.

At a joint press conference in 2002, the USC researchers and CARB managers reported that children who played three or more team sports were more than three times as likely to develop asthma if they lived in a high-ozone community, when compared with similar children in low-ozone communities. They also claimed the study's results applied to cities across the United States.

Ironically, the CHS asthma study actually showed just the opposite. While higher ozone was associated with a greater risk of developing asthma for children who played three or more team sports (8 percent of children in the study), higher ozone was associated with a 30 percent lower risk of developing asthma in the full sample of children in the study. While this fact was discussed in a journal article on the study, it was not mentioned at the press conference.

Irrelevant Findings

The assertion that the study is relevant for other parts of the country was also false. The high-ozone areas in the study averaged 89 days per year exceeding the federal eight-hour ozone standard and 59 days per year exceeding the one-hour standard during 1994-1997, the years used to assess pollution exposure in the study. No area of the United States, outside a few parts of California, has ever had ozone levels this high even for a single year, much less for several years running.

In fact, by the time of its release in February 2002, the study no longer applied even in the southern California areas where it was performed. Eight-hour ozone exceedances had declined 55 percent, and one-hour exceedances had declined 78 percent in the interim. By 2002, communities that were "high-ozone" areas during the study had become "medium-ozone" areas, for which ozone had no association with asthma risk.

False information on the CHS asthma results was not limited just to CARB officials or USC scientists. Health experts from around the country misinterpreted the study's results.

For example, on the day the study was released, a professor at the State University of New York at Stony Brook, who has since become the American Lung Association's medical director, claimed, "This is not just a Southern California problem. There are communities across the nation that have high ozone."

The director of the pediatric asthma program at the University of California at Davis claimed, "Sacramento is a very high ozone area, so this [the CHS asthma study] is going to be very relevant to us."

Not only were these nominal experts wrong about whether the study is relevant to actual ozone levels in the United States, all of them completely missed the fact that ozone and other air pollutants were associated with an overall lower risk of developing asthma.

Pro-Government Bias

Dozens of newspapers ran stories on the CHS asthma study's release. Unfortunately, they reported what ostensible air quality and asthma experts told them, rather than what the study actually found. To this day, the CHS asthma results are cited, even in the scientific literature, to support the claim that ozone causes asthma. This is just one among many examples in which what regulators or scientists say and what they actually find are two different things.

But the promoters of the regulatory state do something that is perhaps even more pernicious than exaggerating air pollution levels and health risks. They also create the false appearance that centralized, detailed, heavy-handed federal environmental regulation was and is necessary for environmental improvement and protection of public health.

That too is false. Though few people are aware of it, air pollution was decreasing for decades before the Clean Air Act was adopted in 1970. Pittsburgh reduced particulate matter levels by 75 percent between the early 1900s and 1965. Many other cities had steadily declining particulate matter levels for decades before passage of the Clean Air Act. Ozone and sulfur dioxide levels were also declining before passage of the Clean Air Act.

Air quality is just one of many examples of improvements in health and safety that occurred without federal regulation. For example, automobile deaths per mile of travel dropped by two-thirds between 1925 and 1966, when the National Highway Safety Act was passed. The rate of improvement in both air quality and automobile safety was about the same before and after the federal government took over policy control.

False Dichotomy

The proponents of the regulatory state create a false dichotomy: It's either centralized, comprehensive, heavy-handed control under the Clean

Air Act, or a free-for-all in which everyone pollutes as much as they want. But the reality is that there are many ways to provide safe air and a healthy environment, and the current Clean Air Act/EPA structure is a poor choice.

Yes, air pollution went down. But it was going down before the Clean Air Act as well. And the Clean Air Act added a great deal of collateral damage.

The Clean Air Act and associated EPA regulations and requirements are mainly about process, not results. A large fraction of the money spent on air pollution control is spent on planning, permitting, and reporting; on creating new administrative requirements and demonstrating compliance with them.

Under the Clean Air Act it is more important to have an approved State Implementation Plan—that's the plan by which states make a paper demonstration that they will attain the standards by some future deadline—than to actually meet the air quality standards. A state can be sanctioned for failing to have an approved plan, but not for failing to attain the actual air quality standards.

Another aspect of the Clean Air Act's process focus is facility permits that specify in minute detail how each piece of equipment at the facility will be operated and must be amended any time a process is changed.

Perverse Incentives

None of this has anything to do with actually cleaning the air. Businesses had to comply with emissions limits before there were permits. And cities could certainly reduce pollution without having a State Implementation Plan. But all of these administrative requirements do support large numbers of jobs at state and federal bureaucracies. The obsessively detailed requirements give regulators and environmental activists tremendous power to micromanage private decisions.

The regulatory system also includes many perverse incentives, and many ineffective or counterproductive programs. One key example is a requirement for industrial plants called New Source Review (NSR).

NSR says that if you have an existing industrial plant you're "grandfathered" in. You can keep operating without installing any new pollution controls, and you can do basic repair and maintenance of your equipment.

But if you want to upgrade or expand or build a new facility, you have to install pollution controls over your entire facility to meet the

Lowest Achievable Emissions Rate (LAER). That's a CAA term of art that means the greatest (and generally the most expensive) pollution reduction achievable without actually shutting down the plant outright.

Unnecessary Added Costs

Let me give you an analogy for the incentives that NSR creates. Imagine you have an old house and your old, rusty, rickety, inefficient water heater breaks down. You could repair it, but most people find it more cost-effective and beneficial to replace it with a new, probably larger, and more energy-efficient water heater.

But imagine if you had to go through the equivalent of New Source Review when your water heater breaks. Under NSR, if you decided to replace your water heater, you'd also have to modernize your entire house. You'd have to replace your single-paned windows with double-paned windows, put insulation in all your walls, add a sprinkler system, change your old galvanized plumbing to copper, ground all your electrical outlets, and so on.

If we applied NSR to houses, nobody would upgrade their houses unless they simply couldn't repair a piece of essential equipment.

We've ended up with a similar result under the Clean Air Act. NSR encouraged industry to put its research and development funds into keeping old plants running well beyond their original useful lives.

For environmentalists and regulators, New Source Review is a sacred cow. But in reality, NSR has slowed progress on air pollution. NSR is the reason so many old, high-polluting power plants are still in service.

NSR also reduces competition and innovation by creating a barrier to entry for new businesses. In fact, existing businesses in some ways like New Source Review, because, while it can be costly, it also protects them from competition. It's kind of a central planning trifecta: higher costs for pollution control, slower progress on air pollution, and harm to consumers by reducing competition and innovation.

Ineffective, Harmful Programs

There are many more examples of ineffective or harmful Clean Air Act programs. Many cities have automobile emissions inspection and maintenance (I/M) programs. We have a lot of evidence they don't work. They're analogous to trying to stop drunk driving by giving people a sobriety test once a year at the Department of Motor Vehicles. They also put most of the money into testing clean cars, because only a few percent of cars account for most of the emissions.

Yet I/M programs have been difficult to kill. They are protected by the state and federal bureaucracies that operate them, by environmentalists who like having an additional way of making people feel guilty about driving, and by businesses who make money testing cars.

Similarly, federal law requires us to use gasoline that contains ethanol. It's done under the guise of improving air quality, but it actually makes air quality worse and it makes gasoline more expensive. The political hook is that the ethanol is made from corn, so ethanol has powerful Midwest agribusinesses and legislators behind it.

All of these counterproductive programs harm ordinary people, but they are supported by special interests who gain money and/or power or who advance their social agendas through them.

Powerful Bureaucracies

Probably the most damaging aspect of the federal regulatory state is that it has created large, powerful federal and state bureaucracies with the power to keep expanding their power. There is no brake built into the system.

EPA and state regulators depend on having a serious and urgent problem to solve. But they are also the ones who decide when their job is finished, because EPA gets to set the pollution standards and specify the means by which the standards will be achieved. Not surprisingly, the air is never declared safe, and EPA keeps tightening the standards.

Imagine a company that got to decide how much of its product people would have to buy. That's the Environmental Protection Agency. EPA also gets to decide for itself how effective and beneficial its regulations are. Imagine a company that gets to audit its own books. That's EPA.

Regulators are also major funders of the health research intended to demonstrate the need for more regulation. They decide what questions are asked, which scientists are funded to answer them, and how the results are portrayed in official reports. Regulators also provide millions of dollars a year to environmental groups, who then use the money to foment public fear and lobby for greater regulatory powers.

Fear-Mongering

Regulators themselves also create fear through their regional air pollution alert systems. These are the “code orange” and “code red” days and the “spare the air” days. This constant stream of air pollution warnings maintains public anxiety that air pollution is causing them great harm.

And as the standards are tightened, the number of warnings actually increases, even as actual air pollution declines. This is one of the ways regulators and activists have created an appearance of increasing air pollution even as actual pollution levels have declined.

The missions and goals of regulatory agencies often conflict with the interests of the people they are supposedly helping. For example, air quality was the justification for placing regional transportation planning under the aegis of the Clean Air Act. Regional transportation plans are drawn up by councils of local governments in each of the nation’s metropolitan areas. Yet these local government councils exist largely to implement national anti-mobility, anti-suburb policies that are at odds with Americans’ actual lifestyle preferences.

The Clean Air Act has thus created regional planning agencies whose mission is to override the private choices and preferences of their constituents. In fact, some regional transportation plans have the explicit goal of increasing road congestion in order to discourage automobile use and encourage the use of public transit.

Diminishing Returns

We have an air quality regulation system that imposes large costs that continue to get larger. At the same time, we’ve already gone well beyond the point of diminishing returns on health benefits. And yet there is no end in sight ... and there will never be an end under our current system, in which the regulators get to decide when their job is done.

What can we do? In the short term, local and state elected officials and economic-liberty activists need to exert pressure on federal officials to prevent EPA from further tightening the eight-hour ozone standard. This won’t be easy. Nevertheless, it is important to act now. Once the standard is proposed—probably sometime in May 2007—it will be nearly impossible to reverse it.

Over the longer term, we need to create a political environment in which air quality regulation can be revamped to focus on ensuring clean-enough air at the least possible cost. Americans need and deserve an air quality system that is narrowly tailored to solve real problems rather than to expand and perpetuate the power of government bureaucracies and special interests.

Energy Sustainability Requires Fuel Diversity

By Alexandra Liddy Bourne[13]

Recently a colleague of mine asked me if there was a single source, book, Web site, or federal agency that listed all of the energy policies of each of the 50 states. The simple answer to the question is, "No."

For those of us who consider ourselves free marketers, that is good news and bad news. The good news is that the state governments have not gotten too engaged in energy policy. The bad news is that the state governments have no idea what they are doing with energy policy.

Think about it. We take our energy for granted. Most candidates for political office at the state and local level have position statements on tax policy, health care, education, transportation, and environment ... but nothing on energy.

Yet energy is the underlying platform of our economy. Without energy to produce goods to generate revenue, we would have no spending capacity to address issues such as health care, education, and the environment.

Much of our energy policy today is occurring by default. When we institute an environmental policy to protect land areas and we prohibit access to domestic natural resources, we are cutting off supply to our own energy markets. When a local government blocks placement of transmission lines through communities because the view will no longer be aesthetically pleasing to members of a civic association, it is interfering with the distribution of electricity to consumers.

Energy Policy Driven by Other Concerns

In a time when the nation's demand for electricity and other energy products is at an all-time high, our state and local energy policies are simply the byproducts of environmental regulations, tax laws, or slow-growth development ordinances.

As a result, several emerging energy problems are currently developing in the states.

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Since 1997, 29 states have established some form of greenhouse gas regulation. In September 2006, Gov. Arnold Schwarzenegger of California imposed the first carbon dioxide emissions cap mandate in the country. Thirty states have or are considering greenhouse gas registries. The city of Chicago has established the Chicago Climate Exchange, and a Wall Street investment firm just purchased 10 percent of the shares. New England has a Regional Greenhouse Gas Initiative that would allow the trading of carbon credits among states in the region.

Phony Market Scheme

Why are the states taking action when the science does not support fears of human-caused global warming and the federal government has rejected a carbon dioxide emission cap program?

The strategy is to develop a new carbon credit trading market that claims to be reducing carbon dioxide emissions through market forces, but in reality is just another government-imposed scheme that would tax the consumer and do nothing to reduce greenhouse gas emissions. The push is coming from Europe, where the carbon credit market is failing, and state governments and companies that stand to gain financially from this new regime.

The fundamental problem is that more than 80 percent of our energy comes from fossil fuel sources such as coal, natural gas, and oil. One of the byproducts of fossil fuel combustion is carbon dioxide. Every business entity, residence, and vehicle emits carbon dioxide.

The only fuel sources that do not emit carbon dioxide are solar, hydropower, wind, and nuclear energy. These sources alone, however, do not provide us with reliable and affordable energy. Except for nuclear power, which has been hamstrung by unwarranted worries about safety, these alternative sources of energy are significantly more expensive than fossil fuels.

Hence, if we raise the cost of fossil fuel power or increase taxes on it, we force people to switch to other sources of power that are not as reliable—and therefore seriously hinder our ability to develop the goods and services that fuel our economy.

Invitation to Corruption

But that is not the worst of it. The development of a carbon market with transferable credits is really the creation of a pseudomarket by government. A carbon credit would become a new common currency, the value of which can be established only by the regulatory regime of the government, not the marketplace.

The trouble with transferable carbon credits is that they force a fuel switch chain from coal, to natural gas, to nuclear, solar, and so on. Each step of the way becomes more expensive for the consumer and limits fuel diversity that responds to pricing signals in the market. Greenhouse gas lobbyists will become a new political power for companies seeking to profit from energy credit schemes.

In addition, it is important to remember that carbon credits will not have any real value unless there is a carbon dioxide cap and rationing is imposed. In other words, government sets the price and picks winners and losers, rather than allowing the market to do it.

It is a coercive system in which for every company that gets a credit, another company must lose one. One can easily see how this can further corrupt the politics of U.S. energy policy. If you think OPEC is bad, just wait until you see the new carbon cartel.

Weak Infrastructure

A second emerging issue is the nation's energy distribution and transmission capacity. Its condition is an important reflection of the state of the nation's critical infrastructure.

Our country is laced with 220,000 miles of high-voltage lines, 70 percent of which are more than 30 years old. We have only one major pipeline for oil in New England—should it fail, the northeastern states will face a real heating and transportation problem.

A recent example of this vulnerability is the pipeline break in Phoenix, Arizona. No gasoline from the surrounding cities could be routed to Phoenix for 10 days, because Phoenix is not allowed to use just any fuel: It is required by the federal government's air quality restrictions to use boutique fuels. Individuals endured long lines at the gas stations, reminiscent of the 1970s, before common sense took hold and the governor requested a waiver from the Environmental Protection Agency (EPA) to get fuel flowing to the city.

In 2005, Hurricanes Katrina and Rita knocked out 30 percent of this country's refining capacity for oil, natural gas, and petroleum products, because those facilities were concentrated in the areas hit hardest by the storm. Clearly, fuel sources and supply lines should be placed in multiple areas around the country and along the coastlines to avoid massive interruptions in the supply chain to key urban areas and other points of interest for economy and security reasons.

Need for Accurate Pricing

Twenty-four states have deregulated their wholesale power generation, but even in these cases the transmission of electricity remains under the control of state regulators or public utility commissions. Transmission rates and electricity prices have been rolled back and capped with the intention of protecting consumers from fluctuating prices.

Over the past decade, however, we have seen a huge surge in the use of personal computers, cell phones, and wireless data transfers. Demand for electricity is at an all-time high, but there has been no real investment in transmission capacity. The rate caps have prevented utilities from recapturing their costs for transmission investments, and some utilities are on the brink of bankruptcy. This glaring problem has been signaled by the New England blackout and California brownouts.

Illinois and Maryland are trying to lead the way toward a market structure that uses demand-response mechanisms to encourage real-time metering and other innovative technologies that will provide transparency in the system and give the consumer choices for appliance utilization in their homes and businesses. A recent study of 2,500 electricity customers using real-time meters in California demonstrated that consumers armed with knowledge about their electricity usage will alter demand peaks and flows and conserve energy.

Mandating Expensive Biofuels

A third emerging energy issue is the use of ethanol in gasoline. There is great interest in expanding the use of biofuels in America's transportation energy supply. Corn ethanol is in use now and makes up about 10 percent of each gallon of gasoline. Cellulosic ethanol is an emerging innovation for biomass that shows great potential for commercial use in the future.

The issue that is creeping up in the states is the use of ethanol mandates, combined with the federal tariff on imports of ethanol. Instead of letting market forces allow the real demand to come out, seven states have imposed ethanol mandates. Perhaps not surprisingly, those states are in the Midwest, where the bulk of our corn is grown.

The ethanol cannot be piped to the coastlines, however, because of the damage it does to the pipelines; it draws off debris and water, which in turn corrodes the system. As a result, the ethanol has to be trucked to the distribution center and then mixed in with the gasoline when it arrives at the retailer. The states are imposing ethanol mandates without the supporting infrastructure.

Price-Increasing Policies

In addition, the federal government has imposed a tariff that increases the cost of imported ethanol that supplies several regions of the country.

This process has added approximately 25 to 30 cents to the cost of a gallon of gasoline. Plus, a gallon of gasoline with ethanol provides only two-thirds of the energy derived from a gallon of gasoline without ethanol. Demand for gasoline has not decreased, and in fact we have to go to the pump to refuel more frequently.

The mandates and tariffs simply benefit the companies that produce and distribute ethanol, certainly not the consumer. If we remove the mandates and tariff, the market may actually move to cellulosic ethanol a little faster and with more efficiency.

States Thwarting Nuclear Power

Another emerging energy issue in the states is nuclear power. Nuclear energy provides approximately 21 percent of the nation's electricity and 8.2 percent of all energy consumed in the United States.

There are only 104 nuclear power plants in the U.S., and no new nuclear generators have been built in three decades. Kentucky and South Carolina have expressed interest in building more nuclear generation to supplement their coal generation.

The cost of building nuclear facilities has fallen to approximately $2 billion per facility, as opposed to $6 billion in the 1980s. So why is there any doubt whether new facilities should be built?

The issues facing the states are the disposal of nuclear waste and the siting of power plants. Environmentalists have won the day with the "Not In My Backyard" or NIMBY argument.

To date, the nuclear power plants have produced 50,000 tons of spent fuel. It can be stored at Yucca Mountain for use by future generations, but many states are hesitant to allow the material to be transported across their borders, by rail or by truck.

The nuclear industry has a "Defense in Depth" design for each plant and storage facility, which provides several different physical and computerized systems to prevent radiation leakage from any vessel in storage or in transit. State legislatures should consider policies that will facilitate nuclear power plant siting and the safe transportation of nuclear waste.

Need for Diverse Sources

If we consider energy policy in the same way we consider our own retirement portfolios, we can ensure energy security. Would any one of us invest only in bonds or in a single stock for our future economic independence? Then why would we want our energy portfolio in each state or nationally to rely solely on fossil fuels or renewable sources of energy? We need all of it!

The Energy Information Administration posts each state's consumption of energy in a pie chart on its Web site. (http://www.eia.doe.gov/emeu/states/_seds.html) If state leaders reviewed their individual state portfolios, they would see they must facilitate investment in a variety of fuel sources based on their state's natural resources and capacity for technology. Then, as prices in the energy market rise and fall, consumers will have more flexibility and choices to ensure stability in the cost of producing and transporting goods.

Four Energy Policy Principles

Rather than bring issues or problems to the table without proposing solutions, I am going to describe a few principles for energy policy that should guide all lawmakers at the local, state, and federal level.

First is the principle of energy diversity. Energy security requires a diversity of fuel supplies or supply routes. All resources—oil, coal, natural gas, hydropower, wind, solar, and alternative fuels—should be developed with market forces, not governments determining the appropriate fuel mix at any point in time.

Second is the need for access to domestic sources of fuels and distribution of fuel supplies. We have closed access to reserves in our interior lands and coasts. We have new technology that has decreased the size of the environmental footprint of resource acquisition. Furthermore, reclamation efforts have made many areas once used for fossil fuel extraction able to support a variety of ecosystems.

Third, maintenance and enhancement of our aging energy infrastructure is paramount in transmission and distribution of fuels and economic development. State government budgets and our national deficit make it clear that government funding for rebuilding the country's energy infrastructure is not sufficient. The private sector should be encouraged to make the appropriate investments and develop innovative technology. The best way to do this is to streamline regulations, which will also serve to improve environmental protection and encourage conservation.

Fourth, energy efficiency is improved with technology development honed by market forces. Government should just get out of the way and allow markets to determine prices and provide transparency to help the consumer make individual choices in appliances, fuels, and energy suppliers.

Looking Toward the Future

The energy policy question for lawmakers is this: How do we balance environmental protection and increase our energy production sufficiently to ensure a robust economic future? A quote attributed to Thomas Jefferson may hold the answer: “We must look ahead seven generations.”

If we provide our great, great grandchildren with the flexibility of individual freedom and the power of the free market, and if we do not allow government regulations to select a fuel source for them at this time, innovation and technology will develop for that generation amazing energy resources, resources we simply cannot envision today.

6
Telecommunications

Why We Over-Tax Communications Services

By Paul Bachman[14]

Communications services today consist of voice, video, and Internet access services delivered over telephone wires (wireline), cables, or wirelessly (via satellite or point-to-point signal transmission).

In the past, each service relied on a different technology, and they tended to be purchased, regulated, and taxed separately. Today, however, all three services can be delivered via all three technological platforms, and they often are offered in packages combining several different services using one or more platforms.

Local, state, and federal governments impose taxes and fees on communications, so the total tax burden on consumers varies from city to city and state to state. Taxes also vary depending on the kind of technology used to deliver the same or similar communication services.

My Beacon Hill Institute colleague, David Tuerck, and I have performed a study on taxes and fees applying to communications services, about to be published by The Heartland Institute. The purpose of the study is to identify the taxes and fees that apply to communication services, calculate the per-subscriber dollar value and effective tax rates for each, and sum the values by service (video, voice, and Internet access) and technological platform (cable, wireline, and wireless). We were able to collect data for 59 cities in 37 states.

Starting with video, we find the prominent taxes and fees are franchise fees, access fees, FCC user fees, initial capital grants, and sales taxes. Franchise fees are paid by the cable companies to local governments in exchange for the use of the public right-of-way for the provision of cable services. Cable franchise agreements often are long

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documents that require companies to provide additional perks and benefits to local governments and nonprofit organizations, such as cash grants, free equipment, and free services. Cable subscribers in our sample paid, on average, taxes and fees totaling 12 percent.

The prominent taxes and fees imposed on voice services include the recently ended federal excise tax, federal and state Universal Service Fund fees, state and local 911 fees, city communications taxes, and sales taxes. Wireline voice subscribers pay, on average, a rate of more than 18 percent, while wireless subscribers pay, on average, a rate of more than 14 percent.

Internet access used to be taxed at various rates depending on whether it was delivered by wireline, cable, or wireless, but the Internet Tax Freedom Act and FCC rulings have pretty much ended all taxes on broadband Internet access in all but eight states, where pre-existing Internet access fees were "grandfathered." Dial-up Internet access (not broadband) is taxed at the same rates as telephone service.

Consumers across our 59-city sample pay an average rate of 12.3 percent for all three (cable video, wireline, and wireless telephone) services—double the 6 percent average tax rate on general business. In fact, consumers in several cities pay tax rates on communications services that are higher than the so-called sin taxes applied to alcohol and tobacco. Therefore, we conclude that the tax burden placed on communications services is high and discriminatory when compared to the rates levied on other industries.

Obsolete Policies

Why are communications services—which some see as being essential to a high quality of life—routinely taxed at several times the rate of general businesses? There are three reasons, the first historical, the second political, and the third bureaucratic.

The heavy taxation of communications services is a legacy of the time when the industry was dominated by government-regulated monopolies. Telephone and cable companies could pass taxes on to customers without concern that a high tax might cause those consumers to search for lower prices offered by a competitor. There simply were no competitors.

Today, by contrast, new technologies and regulatory changes allow cable, wireline, and wireless companies to compete for each other's traditional core businesses. They also allow the entry of new competitors (such as Vonage, a Voice over Internet Protocol (VOIP) telephone service) not subject to the same taxes and fees as telephone and cable companies.

In this newly competitive marketplace, taxing wireline telephone calls at a rate different from wireless calls or calls over cable via VoIP results in people moving from the higher-taxed technology platform to the less-taxed platform. Competition and choice mean service providers can no longer pass through taxes to their customers without losing customers.

Although the technological hurdles that once limited competition in communications services have been overcome, policymakers have not reduced the high tax rates that are a legacy of the monopoly era.

Politics

Telephone and cable companies are easy targets for taxation because nearly everyone is a customer and because the companies bill their customers every month. Many legislators still view phone and cable companies as tax collection machines able to bear any tax without losing market share to less-taxed or untaxed competitors.

Unfortunately, governments at all levels have yielded to the temptation to use income from telecom taxes and fees to fund programs and activities unrelated to communications. Taxes and fees have morphed into sources of revenue for the general fund or to support programs benefiting small but highly leveraged interest groups.

Franchise fees, for example, generated approximately $2.4 billion in 2004, more than $37 per year per household that subscribed to cable. There are some 33,000 communities serviced by cable in the country. One industry estimate places the number of actual franchise agreements at 12,000 to 13,000, as some smaller communities band together to create a franchise agreement for a consolidated area. Much of the opposition to video franchise reform comes from local governments and nonprofit organizations that fear a loss of revenues.

Bureaucracy

Bureaucracy is the third reason for high telecom taxes. An enormous federal and state bureaucracy has built up around programs funded by communications taxes—and like all bureaucracies, these are well organized and opposed to change. One example is the federal Universal Service Fund (USF). Since 1998, the USF tax rate has tripled, and annual dispersals have grown nearly 50 percent, from $5 billion to $7 billion.

While the Federal Communications Commission (FCC) is nominally in charge of managing the USF, it has delegated much of the operation and administration of the fund to the nonprofit Universal Service Administration Company (USAC). USAC's board is made up of public education advocates, telecom industry executives, and state regulators—all direct beneficiaries of the program.

In a recent report titled *Digital Welfare: The Failure of the Universal Service System*, Vince Vasquez described the problems and abuses inherent in the current structure. He summarized his findings as follows:

> ... unaccountable bureaucrats have quietly rubber-stamped a massive increase in program disbursements, allowing special interest groups to raid more than $48 billion in industry profits. A lack of adequate oversight over the universal service system has also generated endless cases of fraud and abuse, as ravenous recipients have exploited the fund for financial profit and personal gain.

Unfair Burden

What are the consequences of this excessively high taxation? Imposing taxes on telecommunications services that are two and three times higher than those imposed on other goods and services:

- forms an unjustifiable burden on low- and middle-income consumers. These taxes add up to hundreds of dollars a year on families that, because of their low incomes, are otherwise exempt from other taxes;

- places a high compliance burden on communications companies, which must file tax returns with tens of thousands of state and local tax jurisdictions, each with different rules and rates;

- distorts consumer choices and investment decisions by causing purchasing and investment decisions to be based on tax consequences rather than true price, quality, and before-tax profitability; and

- hampers economic growth and our global competitiveness, by discouraging the optimal level of consumption of communication services and investment in new communications infrastructure.

Opportunities for Reform

Policymakers at the federal, state, and local levels all have opportunities to introduce or support legislation to reduce taxes on communications services and make them more uniform.

Federal preemption of local and state communications taxes and fees is justified because communications has clearly become a national and even global form of commerce, and state and local taxes and fees have become barriers to interstate commerce. In addition, technological change means a growing number of competitors in the communications marketplace do not maintain a local presence in their customers' communities. Whereas wireline telephone companies usually need a central office switch and cable companies have their "pipes" and sometimes satellite download facilities, a growing number of VoIP and online video services have no physical "nexus" to their customers and consequently cannot be taxed by state or local governments.

The most direct solution to the problem of high and discriminatory communications taxes would be federal legislation prohibiting discriminatory sales, use, or business taxes on communications services. Such a prohibition would extend to federal, state, and local governments.

Also, with proper review, the revenue demands of the federal USF, as well as similar state funds, can be substantially reduced yet accomplish much more. The FCC should take back authority for universal service and reform the pay-in mechanisms to reflect the larger base of communications companies now providing service, and the dispersal mechanisms so they encourage the deployment of economical and innovative alternatives.

Growing Support for Reform

The past year has seen support for franchise reform grow. Bipartisan support is spreading, and legislation is moving through Congress. Franchise reform leads to lower prices and more choices for consumers.

At least six states have passed laws streamlining the process by which new entrants can get authorization to offer video services by applying directly to the state. Although the specifics of the state laws differ, the best of them require that franchise fees apply only to right-of-way costs, allow cable companies to apply for statewide franchising upon entry of a competitor, and limit the definition of "video revenues" subject to the franchise fee formula.

While Texas and Indiana were the first to pass reform, measures also have passed in California and North Carolina.

States also can enact legislation that reduces state-level communications taxation to the level of general business taxes. Florida and Ohio have passed tax reforms that could be models for other states.

Local Reform Needed

Local governments, for their part, can act unilaterally to repeal discriminatory taxes on communications services, consider altering or ending existing franchise agreements with cable companies, and remove regulatory obstacles that block new entrants. Zoning and licensing regulations that keep out small competitors should be repealed. Some of those rules can delay rollout of new services for years.

Ironically, public officials often cite high telecom prices as a reason for having the city provide communication services such as broadband—but these prices are kept higher by the very discriminatory taxes they apply to such services.

Local governments should avoid competing with private companies to provide commercial communications services. Contrary to what some advocates and consultants say, broadband isn't "just like sewers" or other traditional public utilities. Broadband is a fiercely competitive industry with rapidly changing technology.

Building a municipal communications system isn't part of a good economic development plan. Cities hoping to get on the broadband bandwagon should review policies that are discouraging private investment in affordable broadband before gambling their taxpayers' dollars on municipal systems.

The Doubtful Future of Franchise Fees

By Steven Titch[15]

The battle over municipal cable television franchise fees comes down to money. Municipalities fear losing a reliable revenue stream from local cable companies, and they do not wish to lose the leverage to demand the perks that come with local control. As policy analyst Sonia Arrison has noted:

> That local elected officials would take advantage of their power to grant exclusive rights to service a cable area is perhaps not surprising, but it is wrong nevertheless. For instance, one city requested that, in addition to other requirements, Verizon turn over a parking lot for use as free parking for a library. Another city requested free television for every "house of worship" and a 10 percent video discount for select customers. Yet another asked for a new recreation center and pool.[16]

Perhaps local officials rationalized their demands by telling themselves that the local cable system was a monopoly, and that even though these perks raised prices for consumers, TV entertainment was not so essential a service that adding a dollar or two a month in taxes or surcharges could be considered a burden.

Broadband Changes Situation

But franchise reform is about much more than cable TV. The broadband dimension that is coming with network upgrades brings a new level of

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[15] Steven Titch is The Heartland Institute's senior fellow for information technology and telecom policy and managing editor of its monthly publication, *IT&T News*. This essay is excerpted and adapted from "The Momentum for Franchise Fee Reform: The Federal and State Picture," by Steven Titch, to be published by the Reason Foundation.

[16] Sonia Arrison, "Cable Reform Is Almost Here," TechNewsWorld, March 17, 2006, available at http://www.technewsworld.com/story/49410.html.

urgency to policy change. The United States ranks nineteenth in the world in terms of broadband penetration, according to the International Telecommunications Union's January 2006 Bandwidth Report.[17] While that status is due in part to the vast geography of the country, the relatively high cost of terrestrial broadband services is a major factor. And those costs are propped up in part by franchise rules that artificially raise prices and insulate cable systems from competition.

The reason the industry and some enlightened state legislatures are seeking franchise reform is not because the phone companies want to offer video for its own sake. The ultimate goal of both the phone and cable companies is to create rich broadband networks that can integrate various types of data. Today, video service is the avenue of entry—the means, not the end.

Local Regulations Burdensome

Unfortunately, the provisioning of video services today is highly regulated at the local level. While video is the primary application associated with franchising, in the scheme of wireline broadband it is part of a suite of integrated services that can be delivered not only by service providers but also by third parties using those service provider networks.

This integration will lead to a fundamental shift in the way phone and cable companies do business. It is more complex than a matter of each segment invading the other's turf (cable companies offering phone service and phone companies offering cable). Both groups are coming to terms with their emerging, not-yet-fully-defined role in the global supply chain for information services and Web-driven consumer information technology.

In order to complete this evolution—which will unleash the massive consumer and community benefits that all sides of the policy debate envision—local regulation of cable TV, which keeps the industry anchored to the past, must give way.

In fact, local officials may not have much of a say in this. Technology and business opportunities are already changing distribution models for video entertainment. In this scheme, "cable TV" becomes just another choice consumers have for electronic video acquisition.

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[17] "China Will Pass US in Broadband Lines by Late 2006," WebSiteOptimization.com, Jan. 23, 2006, available at http://www.websiteoptimization.com/bw/0601/.

Market Changing Thoroughly

"On demand" video over the Internet, in fact, may be the most significant development in the delivery of home entertainment since the introduction of multichannel cable TV. Until recently, cable TV companies had exclusive control over the distribution of entertainment to the TV. True, customers could purchase or rent videocassettes and DVDs, but it still required an extra step—a visit to a video store or an online order through Netflix. The "impulse" decision that drives video-on-demand purchasing was the exclusive purview of the cable provider until recently.

In January 2006, Starz, the premium pay network available only on cable systems, launched Vongo, a Web site that currently offers 1,500 titles for download. Consumers pay a monthly subscription fee. Other sites, such as Movielink, offer similar services. Apple's iTunes offers downloads of episodes of popular television shows such as Lost and Desperate Housewives.

Major League Baseball and the National Basketball Association stream live video of games. Even the TV networks have gotten into the act, offering Web-only episodes or "uncensored" versions of their broadcast shows.

Distinctions Breaking Down

Viewers, by and large, must watch these videos on a PC, as opposed to a TV. But that is largely a limitation of home electronics, not service provider networks. Operating systems such as Windows XP Media Center, and the far richer Windows Vista due to be released in early 2007, turn home PCs into a hub for distribution of content to TVs, stereos, and other home information appliances. These will further break down the distinction between cable TV and Internet video.

So as phone and cable companies invade each other's turf, regulators should be wary of looking at phone, cable, and the Internet as distinct services like items on a Chinese menu. PC software like Vista is designed to manipulate the interaction of all three. For example, you may be watching Cars on HBO, delivered via cable connection. However, while watching the movie you may be able to go out onto the Internet and order the soundtrack album, conducting the entire transaction with your cable remote.

How does this factor into the franchise fee debate? The ability to create new revenue streams from the combination of Internet applications and video programming while keeping it all transparent to the user is the immediate challenge facing service providers, be they cable or phone.

Regulatory changes that help all service providers deal with this challenge are vital to their growth and their ability to expand the availability, quality, and utility of broadband services to their customer base and provide an ongoing incentive for applications developers to work toward creation of more.

Less-Intrusive System Needed

That is why a minimally intrusive and level regulatory playing field is so important. Of all local officials who have voiced a position on franchise reform, perhaps it is Anaheim Mayor Curt Pringle who best understands this transition:

> City leaders do not believe that government should determine whether residents receive video content through established cable providers, growing competition from satellite television, or new concepts coming online like Internet Protocol television (IPTV), or technologies on the horizon like Wi-Fi delivery of video content. Anaheim is supportive of maintaining open market competition in which any franchise fee is eliminated for consumers and a variety of service providers have an opportunity to earn customer support.
>
> The current franchise system inhibits additional companies who might be subject to it from entering the marketplace and investing in infrastructure when they are challenged by the expense and difficulty of attaining enough market share to recoup costs. At the same time, companies that are clearly exempt from franchising, like satellite providers, flourish.
>
> Franchise fees and many elements within franchise agreements, therefore, are merely an artificial intrusion by government into the consumer marketplace. Attempts to apply franchise fees and agreements to some providers, while exempting others, effectively eschew the market.[18]

[18] Curt Pringle, on behalf of City of Anaheim, "Reply Comments of City of Anaheim," In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992, FCC MB Docket No. 05-311, page 2; available at http://www.anaheim.net/administration/PIO/FCCComments.pdf.

Fees Limit Competition

Further on, Pringle suggests that as alternate technologies flourish, revenues from video services will move beyond the reach of local franchise authorities. One way or another, time might be short for the franchise fee regime:

> But, in fact, cities have created an unfair tax on cable companies and limited competition in a fast-paced, competitive marketplace. Furthermore, many cities have used these fees to fund essential municipal services unrelated to cable, although the fees simply are not a long-term stable source of revenue for cities. As an example, just look at the emergence of satellite services. This, a non-taxed cable competitor, has increasingly taken a significant share of the entertainment market. As cable companies have lost customers to other competing entities, cities have seen a corresponding drop in the revenues that come from cable franchise fees. It is a weak fiscal model that subjects core municipal services such as public safety to a dwindling source of revenue, regulated by sources out of direct control of that municipality.[19]

Pringle's suggestion that cities begin to wean themselves from franchise revenues is sound advice. Cities would do well to remember that local franchise fees are not specifically tied to video revenues, just the revenues that are collected via the cable TV model. Franchise revenues are safe only as long as the service provider uses a local satellite head-end to receive hundreds of programming channels and pipes them down the cable to area homes.

New Sources Not Taxable

Should programming delivery shift to predominantly Web-based sources—say through content aggregation by Google, Yahoo, Netflix, or the studios themselves—it would severely cut into, if not replace, today's downlink-and-transmit cable distribution model.

The way franchise rules work, cities can no more collect a fee on these revenues than they can on iTunes downloads or any other online transaction. Should at some point it become unprofitable for broadband providers to act as "cable companies" in the sense we know now, and

[19] Pringle, page 3.

they reorganize their businesses away from direct distribution to Web-based content aggregation, franchise fee revenues will dry up. This stands to occur a lot sooner than the 10 to 15 years many local franchise agreements still have to run.

The recent news that CBS plans to launch a Web-based TV channel stokes some thinking about the future of video delivery over the Internet, and the issue of cable franchise fees. While ABC, NBC, and Time Warner have been making some of their popular TV programs available for post-broadcast download, CBS's Innertube site is the first to offer original, network-branded entertainment via the Web. Most of the programs are youth-oriented and, in CBS's terms, "edgier" than standard broadcast content.

Beyond that, pending affiliate approval, Innertube will stream network shows once they air in their usual time slot. CBS also plans to make a library of 100,000 hours of earlier programming available on the site, some of it on a pay-per-view basis.

Customers Moving

Multichannel video may never go away, but a large share of customers will elect to download TV entertainment via the Internet. Most franchise laws do not consider Internet purchases as part of "gross video revenue," although a U.S. Senate bill includes language that tries to shoehorn in video revenues from undefined "affiliates." Should major service providers initiate this type of shift, it may take either a court ruling or an FCC decision to reinforce the exclusion of Internet-derived revenues.

Already, regulatory rulings in Connecticut and Oklahoma have classified Internet Protocol video as separate and distinct from multichannel cable TV service. So, in addition to confronting the trend toward franchise reform, cities and towns need to begin thinking about their fiscal sources in an era of diminished cable revenues. Franchise fee systems can exist only as long as consumers find cable video more attractive than broadband video. Change is coming, and it favors currently unregulated models.

For local franchise agencies, the battle against franchise reform stands to be a losing one. Initiatives at the state and federal level have the momentum of constituent and legislator support. Right behind them are companies with video distribution schemes that exist outside current tax and regulatory bounds. For local authorities, the wisest course of action is to make plans now for the day when local TV distribution is no longer a cash cow.

The False Promise of "Net Neutrality"

By Raymond L. Gifford[20]

Net neutrality has made its way, albeit in a limited fashion, into the public mindset and into popular political discourse. It is dismaying to see how crudely it is spoken about in the popular press, but that is to be expected.

What I hope to do here is to provide a degree of economic and legal rigor so that we can evaluate the net neutralists' calls for regulation.

What Is Net Neutrality?

First of all, it is important to define network neutrality and identify the recent history that brought it to the forefront of the current communications public policy debate.

What is network neutrality is very much in the eye of the beholder, but I'll give two extremes of what a network neutrality advocate would say. Network neutrality, on one end, would be to continue the historic regulatory tradition by forcing broadband providers—formerly phone providers—to allow common carriage over their network.

These net neutrality advocates point out that we have a long, old regulatory tradition—which actually goes back to the Middle Ages—under which certain industries are treated as common carriers. Common carriers have to take anything that comes over their pipes and cannot discriminate between different users. It was, and is, a reasonable solution to situational monopoly problems that arise across a variety of industries—communications, transportation, hostelry, and so forth.

This set of net neutrality proponents would say we need to continue this tradition of common carriage regulation in the new broadband world.

In addition to these, there are proponents of net neutrality who say that what we need to do is make sure broadband providers do not have the ability to vertically integrate, that they should not be allowed to

[20] Raymond L. Gifford, past president of the Progress & Freedom Foundation, is currently a senior adjunct fellow and member of its board of directors.

create any difference in the way they treat any information coming over a broadband network. These proponents of net neutrality are even more ardent than the first-named group. They are, for lack of a better label, the net neutrality religionists.

Religious War

Now, to understand communications regulation you either have to become deeply cynical or have a highly developed sense of irony, because what happens throughout its history is this constant fight between two major factions.

First there is the historical reality that we regulate communications networks very heavily and very clearly parse what folks can do over them. On the other side are those who militate for freedom, who advocate treating the communications media as we would other parts of the general economy, where private contracts and property rights are the way we do things.

From about 1997 to 2005 the entire struggle was over unbundling the telephone network. And just as that was completed, when the D.C. Circuit and eventually the Supreme Court said the government could not continue forcibly unbundling and socializing this network, along comes this new issue of net neutrality.

What we have here is both a religious war and a public choice problem.

Stanford University law professor Larry Lessig is probably the greatest proponent of the religious war side of the telecommunications debate. Every two or three years he proclaims that the end of the Internet is near, and if we do not regulate it in some specific fashion it will be ruined by rapacious commercial interests, and monopolies and other evil beings will take over this wonderful, free, and open Internet.

The latest iteration of that approach is net neutrality. The religious net neutralists are led by this academic movement that says openness is the supreme value of the Internet and we need regulation to continue that.

In addition, there is a public choice aspect of this argument—which, not coincidentally, overlaps with the religious element. On one side of the public choice conflict are our broadband providers—the phone companies, cable firms, and wireless broadband providers, who own and are building and are risking capital to build broadband networks. They want freedom to have things like property rights and make commercial deals with whatever providers and on whatever terms they and their customers want.

On the other side of the public choice conflict is a host of tech companies led by Google, Microsoft, and other very cool, new economy companies. They are responding to the very obvious temptation that a government scheme like network neutrality provides: I really like my property rights quite a lot, but if the government is willing to squash another party's property rights to my benefit, that is perfectly all right with me.

Moreover, what is at stake is the division of what economists call "rents" between the various Internet players. With net neutrality regulation, the content and applications providers—the Microsofts, Amazons, and Googles—can essentially regulate the broadband providers'—the Comcasts and AT&Ts—share of producer rents, and have more to divvy up for themselves.

And so what we have here as the net neutrality debate bubbles up into the political side of things is a situation where the Democrats are for it (because they like to regulate things) and Republicans are not necessarily for it but are not really against it either (because there is money on both sides of the debate).

Principles of Net Freedom

There are four principles of Internet freedom that started during Michael Powell's reign as Federal Communications Commission (FCC) chief and that provide the context for the current debate:

- consumers have the right to access the lawful Internet content of their choice;
- consumers have the right to run applications and services of their choice;
- consumers have the right to connect their choice of legal devices that do not harm the network; and
- competition among network providers, applications, service providers, and content providers shall be preserved.

That's kind of a soft version of net neutrality and is the basic context for the present argument.

Unlike the religious net neutralists, I do not tend to look at net neutrality as a normative, "essence-of-the-Internet" question. I tend to see it as an economic question.

If you look at the debate as a question of competition policy, then the natural area of interest is the economic tradeoffs you are making. That means we have to ask what a net neutrality mandate would do to the broadband providers who are, right now, risking capital to build these networks.

The providers are not achieving the same regulated rate of return as they used to. Verizon, for instance, is basically dumping its entire old network and running fiber to homes across its territory at enormous cost. The wireless companies are putting up towers, upgrading to third- and eventually fourth-generation wireless networks, and they are doing so not with a comfortable, regulator-guaranteed rate-of-return behind them, but through the good graces of capital markets that see them as ultimately having the ability to get a return on their investments.

Mandated Mediocrity

What net neutrality would do to these firms would be to mandate a particular business model, one under which the only way they can recover their costs and create business opportunities is by charging the end-use customer. In addition, a hard net neutrality mandate would prohibit price discrimination, even though it is a natural and inevitable thing in markets that have high fixed costs and low marginal costs.

What net neutrality does, then, is to commoditize the broadband pipe and mandate mediocre, crappy Internet service for all.

A net neutrality advocate would demand that all packets be treated equally, with no opportunity for service gradations. This has severe consequences for applications like voice, video, and interactive gaming, which require "low latency" to maintain quality of service. Low latency is an engineering term that basically means there cannot be delay in the packets of data reaching the user before the experience degrades.

For example, to use Voice over Internet Protocol, I need my voice packets to reach the person I am talking to in order, in real time. If I, or more likely my son, is playing Xbox Live with a friend, the packets that "communicate" he moved his jet fighter to the left need to reach his friend instantaneously so his friend can react in real time as well. By contrast, email or a Web page, if I load it and there is a half-second delay, I don't care.

Where net neutrality comes in is that it would prohibit exclusive deal prioritizing to make these experiences possible—or worse, it would require regulatory approval before the broadband providers can offer such deals.

In essence, what you're trading off under net neutrality is all the dynamic economic incentives to invest in and upgrade broadband networks, for static gains in innovation on the current platform. In addition, net neutrality prohibits the emergence of two-sided markets. Two-sided markets are pervasive and beneficial to consumers—lowering costs and increasing availability.

Two-sided markets are very familiar in the broadcast realm, where, for example, free television comes from. When I watch free, over-the-air television, I am a beneficiary of a two-sided market: as a consumer, my effective price is zero, but I have to watch advertising. Advertisers pay the network to put on that content. Similarly, if you go into Wal-Mart, Procter & Gamble has paid Wal-Mart for the prime shelf space for Tide detergent. That's a two-sided market.

Two-sided markets emerge everywhere and are immensely beneficial to consumers, because they allow consumers to reveal their preferences and their willingness to pay. Such markets create situations where beneficial price discrimination can occur. Net neutrality would forbid that.

Worries About Walls

Now there are concerns—and this is where antitrust skeptics become especially upset at the likes of me who haven't quite yet given up on antitrust—that situations could occur in which a monopoly broadband provider would block some services' content, would give preference to their own content, to the detriment of other content out there.

First of all, we don't have any monopoly broadband providers out there. On the contrary, we have vigorous broadband competition. In fact, we used to have those walled, Internet gardens such as CompuServe and America On Line. The market drove them out because consumers didn't want them.

Nonetheless, one can foresee situations in which a specific firm does have an effective monopoly—as in the case of some rural phone companies—and thus could prohibit new, innovative services from cannibalizing their revenue. The most famous such case is a rural North Carolina phone company that was blocking voice over Internet providers that wanted to cannibalize their landline service.

Sensible Alternative

The sensible solution in such cases, however, would be to let the FCC or (preferably) the Federal Trade Commission do an antitrust analysis when there are complaints that a broadband service provider is engaging in an activity that harms consumers, with a response coming if it is specifically proven that such behavior is occurring.

If there is a very clear case that a provider is blocking a port for no technically good reason, that would probably be an antitrust violation and should be regulated. However, we should allow everything else in a new market where we don't know what's going to develop and what sort of deals will be most beneficial to consumers.

Such an approach will allow two-sided markets to evolve, if they are possible in this arena. It would allow price discrimination to emerge and different customers to get different levels of service according to their needs and willingness to pay. Providers will be able to see whether different sorts of broadband service plans attract more consumers, and can give them different options according to their wants and needs.

With a certain sense of cynicism and a highly developed sense of irony, I conclude that net neutrality will be the major regulatory issue we will fight over in the telecom realm for the next five to 10 years, just as we fought over similar open access issues in the 1970s in the FCC's *Computer Inquiries* (where the FCC looked into whether phone companies could get into computing), in the 1980s in the form of the AT&T break-up, and in the 1990s regarding open access to cable service and phone unbundling.

The fight over regulation of private markets is perpetual and repetitive, and net neutrality is but the latest instance.

Speaker Biographies

Paul Bachman is director of research at the Beacon Hill Institute.

He holds a Master of Science degree in international economics from Suffolk University and a Bachelor of Arts (politics) degree from the St. Joseph's University in Philadelphia.

Joseph Bast is president and CEO of The Heartland Institute, a 22-year-old national nonprofit research center located in Chicago, Illinois. According to a recent telephone survey, among state elected officials The Heartland Institute is among the nation's best-known and most highly regarded "think tanks."

Bast is the coauthor of ten books, including *Rebuilding America's Schools* (1990), *Why We Spend Too Much on Health Care* (1992), *Eco-Sanity: A Common-Sense Guide to Environmentalism* (1994), and *Education & Capitalism* (2003). His writing has appeared in *Phi Delta Kappan, Economics of Education Review, Wall Street Journal*, *Investor's Business Daily*, *The Cato Journal, USA Today*, and many of the country's largest-circulation newspapers.

Bast is publisher of five monthly publications with a combined circulation of nearly 200,000 copies. Those publications are titled *School Reform News*, *Environment & Climate News*, *Health Care News, Budget & Tax News,* and *IT&T News*.

John Berthoud, Ph.D. is president of the National Taxpayers Union (NTU) and the National Taxpayers Union Foundation (NTUF) in Alexandria, Virginia.

NTU, founded in 1969, is the nation's largest grassroots taxpayer group, with 350,000 members in all 50 states. NTUF was founded in 1977 and produces research on economics, tax policy, and government spending.

Berthoud serves on numerous boards, including the board of directors of the World Taxpayers Associations. For more than a decade, he has been an adjunct lecturer at George Washington University, teaching graduate-level courses on budgetary policy and politics. He is also a contributing editor to *Human Events*.

Prior to joining NTU and NTUF, Berthoud worked for several different public policy organizations in Washington. He has been a guest on hundreds of radio and television programs, and his work has appeared in a wide variety of publications across the country.

Alexandra (Sandy) Liddy Bourne is vice president for policy and strategy of The Heartland Institute. She acts as Heartland's Washington DC media spokesman and liaison to Heartland's Legislative Advisors (elected officials), donors, and allies. She authors media statements and commissions and edits original research on the major issues of the day, particularly those concerning energy and environmental regulation.

Prior to joining Heartland, Bourne worked for the American Legislative Exchange Council, the nation's largest membership organization for state elected officials. As policy director she provided supervision and guidance to the policy development of nine task forces, federal affairs program, and the international program. Under her leadership, 20 percent of ALEC model bills were enacted by one state or more, up from 11 percent.

Bourne started her career as a nurse, receiving a B.S.N. degree from the College of New Rochelle, New Rochelle, New York, and an M.S.N. from Catholic University of America. From 1986 to 2003 she served in the U.S. Army Reserves, attaining the rank of captain in the Army Nurse Corps. In October 2001, she worked with ALEC leadership to develop a homeland security working group in response to the attacks of September 11, 2001.

TARREN R. BRAGDON serves as director of health reform initiatives at the Maine Heritage Policy Center.

During 2001 and 2002, he served as the special assistant to the president of the Maine Senate, Sen. Richard Bennett. In that capacity, he provided policy research, analysis, and advice on a variety of policy areas, focusing on health care and tax policy. In 2002, he worked extensively on the legislation and eventual enactment of the Maine Consumer Choice Health Plan, a state-administered consumer choice insurance exchange of several private health plans available to Maine individuals and small businesses.

From 1996 through 2000, Bragdon served in the Maine House of Representatives representing District 119, part of Bangor. He is the youngest person ever to be elected to the Maine House, being sworn in when he was just 11 days past the constitutional requirement of 21 years of age. During his tenure in the House, Bragdon served on the Joint Standing Committee on Health and Human Services.

Bragdon worked for three years at a nonprofit child welfare agency overseeing community relations and licensing compliance for the 260 employee, $11 million organization. He has served as adjunct faculty to the Maine Technical College System. He received his bachelors degree in computer science from the University of Maine and his masters degree in business from Husson College.

RICHARD O. DOLINAR, M.D. is a senior fellow with The Heartland Institute and a consultant to the pharmaceutical industry. A clinical endocrinologist specializing in diabetes in Phoenix, Arizona, he earned his medical degree from The State University of New York at Buffalo and did his endocrinology fellowship at Duke University. His direct interaction with patients for more than 30 years as a physician has nurtured an acute understanding of not only his specialty but also the evolution and current state of the American health care system.

Dolinar speaks frequently throughout the United States on the historical, political, and economic aspects of health care. He has testified before the U.S. Senate Subcommittee on Consumer Affairs and has also given Congressional briefings regarding health care issues. He has presented to state legislators, attorneys general, and various industry groups. He is interviewed frequently by local and national media, including CNN, CBS, and PBS.

Dolinar's articles and opinion pieces have appeared in *The Wall Street Journal*, *USA Today*, *New York Times*, *New England Journal of Medicine*, *Journal of the American Medical Association*, *Health Care News*, and *Diabetes Research*. He is co-author of the book *Diabetes 101*, now in its third edition.

He is a member of the board of the American Association of Clinical Endocrinologists (AACE) and serves on its National Legislative and Regulatory Committee. He is also the chair of its Future of Health Care Task Force. Dolinar is a member of numerous other professional and civic organizations. In the past he was president of the Arizona Chapter of the Juvenile Diabetes Association.

Dolinar served as a flight surgeon in the Vietnam War and is a retired U.S. Air Force Colonel.

SANDRA FABRY is state government affairs manager for Americans for Tax Reform.

RAY GIFFORD, past president of the Progress & Freedom Foundation, is currently a senior adjunct fellow and member of its board of directors.

Before joining the foundation in 2003, Gifford served as chairman of the Colorado Public Utilities Commission for four years, following his appointment by Gov. Bill Owens. As a regulator, Gifford aspired to a competitive, consumer-driven telecommunications market; a low-cost, unbundled natural gas utility; a reliable, efficient electric system; and an economically rational regulatory scheme for transportation.

Before joining the commission, Gifford served under then-Colorado Attorney General Gale Norton as first assistant attorney general. From 1993-1996, he worked for two national law firms—Kirkland & Ellis and Baker & Hostetler.

SEN. CHRIS LAUZEN has served in the Illinois State Senate since his election in 1992. His vision for government is based on his abiding faith in the capacity of people to see good beyond the horizon and the discipline to make the journey.

Lauzen brings to the Illinois Senate the leadership experience of owning and managing a successful accounting practice. As an accountant, Lauzen managed the books for more than 200 small businesses, so he understands how businesses are crippled by tax and fee increases. Since entering public service, he has brought his leadership skills to bear on some of the toughest challenges we face. He has been a leader on property tax reform and education funding and has fought to lower gas prices by capping the gas tax.

When Lauzen was elected, he joined what became known as the "Fab Five": a celebrated crop of young conservative senators in Illinois: Peter Fitzgerald, Patrick O'Malley, Steve Rauschenberger, and Dave Syverson. Since the beginning, Lauzen has had two main legislative priorities: to curb wasteful government spending and to create a business climate in Illinois where the private sector can maintain and create jobs paying higher wages. In 2002, the Illinois State Chamber of Commerce honored him with its "Champion of Free Enterprise" award.

SEAN PARNELL is vice president for external affairs with The Heartland Institute. His responsibilities include fundraising, staff liaison with donors and potential supporters, and outreach and networking with other nonprofit organizations, business groups, and trade associations.

Parnell is a frequent contributor to *Health Care News*, *School Reform News*, and *Budget & Tax News*. His writing also has appeared in the *Washington Post*, *Chicago Tribune*, and *Dallas Business Journal*. He is a frequent guest on talk radio.

Prior to joining Heartland, Parnell worked on several political campaigns, most recently serving as finance director for Congressman Greg Ganske's U.S. Senate race in Iowa. Prior to that, he was campaign manager for Ganske's congressional re-election campaign. He also has worked on campaigns for state legislature and U.S. President.

Parnell received an economics degree from Drake University in Des Moines, Iowa.

JOEL SCHWARTZ is a visiting scholar at the American Enterprise Institute (AEI), where he studies air pollution, transportation, climate change, regulatory policy, and chemical risks. He is the author of the AEI study, *No Way Back: Why Air Pollution Will Continue to Decline* and is currently working on the forthcoming AEI book, *Air Quality in America*.

Before coming to AEI, Schwartz directed the Reason Public Policy Institute's Air Quality Project. He also served as executive officer of the California Inspection and Maintenance Review Committee, a government agency charged with evaluating California's vehicle emissions inspection program and making recommendations to the legislature and governor on program improvements. Schwartz also has worked at the RAND Corporation, the South Coast Air Quality Management District, and the Coalition for Clean Air.

Schwartz holds a bachelors degree in chemistry from Cornell University and a masters degree in planetary science from the California Institute of Technology. He was a German Marshall Fund fellow in 1993, when he studied European approaches to transportation and air quality policy. He lives and works in Sacramento, California.

JAMES M. TAYLOR, J.D. is managing editor of *Environment & Climate News* and a senior fellow for The Heartland Institute.

Taylor has appeared on the Fox News Channel and the "Good Morning America" and "Newsmakers" national radio programs. His writing on environmental issues has appeared in the *Los Angeles Times, Houston Chronicle, Detroit News, Boston Globe, Tampa Tribune*, and elsewhere.

Taylor previously served as managing editor of CCH Incorporated's disability law publications, where he became a nationally known expert and frequent speaker on a variety of employment law topics. Prior to that he was a legal analyst for Defenders of Property Rights, a public interest legal foundation.

Taylor received his bachelors degree from Dartmouth College and his law degree from the Syracuse University College of Law, where he was president of the local chapter of the Federalist Society and founder and editor-in-chief of the *Federalist Voice*.

He lives near St. Petersburg, Florida.

STEVEN TITCH is The Heartland Institute's senior fellow for IT and telecom policy and managing editor of *IT&T News*, Heartland's monthly newsletter for state legislators and policymakers on telecommunications and information technology issues.

Titch was director-editorial projects for *Data Communications* magazine, where he directed content development for supplemental publications and special projects prior to the publication's sale to United News & Media and subsequent closure.

Titch is best known as the former editorial director of *Telephony* magazine and its international spin-off, *Global Telephony*. Titch planned and executed *Telephony's* mid-90's turnaround and its 1996 redesign and relaunch. He also was founding editor of *Global Telephony*.

Titch's experience as a telecommunications industry journalist goes back to 1980, when he started his career as associate editor-communications at *Electronic News*. He was founding editor of *Cellular Business* (now *Wireless Review*), which in 1984 was the first business-to-business publication serving the nascent wireless industry, and Midwest Bureau Chief for *Communications Week* (now *Internet Week*).

ELIZABETH WHELAN, SC.D., M.P.H. is president and founder of the American Council on Science and Health, a consumer education consortium concerned with issues related to food, nutrition, chemicals, pharmaceuticals, lifestyle, the environment, and health.

Whelan holds a masters degree in public health from the Yale School of Medicine, a master of science degree from the Harvard School of Public Health, and a doctor of science degree from the Harvard School of Public Health. She is the author or co-author of 23 books on nutrition, smoking, and environmental topics, including *Panic in the Pantry* and *Toxic Terror*.

DOUGLAS L. WHITLEY is president and chief executive officer of the Illinois State Chamber of Commerce. He leads the chamber's charge to aggressively promote the interests of Illinois business. Under Whitley's leadership, the chamber has taken unprecedented actions on behalf of Illinois employers, strengthened its role in shaping state and federal legislation, and re-established itself as the unifying voice for business in Illinois.

Since taking the chamber's helm in September 2001, Whitley has built the chamber to a new level of strength and visibility for the twenty-first century. Whitley and his team have revitalized the chamber's advocacy role on the most important business issues of the day, including: taxation, regulation, litigation, fee and budget policy; jobs creation; tort and medical malpractice insurance reform; workers' compensation; transportation; the environment; and health care costs.

Whitley has a long record of business leadership and expertise in taxation and regulation, which he has earned in a career spanning the public and private sectors. Before joining the Illinois Chamber, Whitley was president of Ameritech Illinois for the six years prior to SBC Corporation's acquisition of Ameritech. There, he successfully directed legislative initiatives in Congress, the Illinois General Assembly, and local Illinois governments, accomplishing the agenda of a highly regulated corporation facing significant change in its industry.

Whitley served two years as director of the Illinois Department of Revenue during the administration of Governor Jim Edgar. He played a central role in helping the governor deliver on his campaign promise to impose property tax caps. Prior to that, Whitley was president of the Taxpayers' Federation of Illinois for 14 years. In earlier years, he was a legislative staff member in the Illinois House of Representatives. Whitley has been a registered Illinois lobbyist for more than 30 years.