President Signs “Budget-Busting” Medicare Reform

by Jay Lehr

A December 1 memorandum from the Social Security Administration (SSA) to a renowned policy analyst marked the first time SSA has officially admitted private retirement plans will work.

“The chief actuary of the Social Security Administration confirmed the feasibility of every worker’s owning a substantial personal retirement account,” said Jack Kemp of Empower America.

Long-Term Solvency

The memo from SSA Chief Actuary Steve Gross to Institute for Policy Innovation (IPI) tax expert Peter Ferrara admits that, “Under the plan specifications described [by Ferrara] the Social Security program would be expected to be solvent and to meet its benefit obligations throughout the long range period 2003 through 2077 and beyond.” That statement confident with SSA figures that place the current Social Security system in bankruptcy within the forecast horizon.

“The SSAs scoring turns traditional Washington-establishment thinking on its head,” says Ferrara. “The scoring reveals that large personal accounts would achieve permanent solvency for Social Security, without benefit cuts or tax increases, with manageable transition financing burdens. Up until now, establishment Washington has assumed that any personal account option for Social Security would involve at most 2 percentage points of the 12.4 percent Social Security tax.

Judge Orders Billion-Dollar Tax Hike in Kansas

by Karl Peterjohn

In a December 2 ruling sure to haunt the governor and lawmakers in the 2004 legislative session, a Topeka judge declared the Kansas school finance system unconstitutional and gave lawmakers until July 1, 2004 to fix it.

The decision by Shawnee County (Topeka) District Court Judge Terry Bullock came in response to a lawsuit brought by mid-size districts in Kansas, alleging schools are underfunded and that small, mostly white districts get more than their fair share of the money.

Bullock announced his decision a week after lawyers for both sides wrapped up their closing arguments in the case, which was originally filed in 1999.

In his order, Bullock said the state was “shortchanging public schools, especially minority and disadvantaged students, by about $1 billion.” According to the Lawrence Journal-World, Bullock also warned it could increase the power of government and bust the federal budget in 30 years or sooner.

As National Taxpayers Union President John Berthoud observed, “the nation is in a deep Medicare hole. Instead of stopping the digging, Congress and President Bush have just dug the hole a lot deeper. That’s why conservative, free market, and wealthy Medicare p. 13

IRS to Audit NEA

by Daniel J. Pilla

According to a November 24 news release from the Landmark Legal Foundation, “the Internal Revenue Service (IRS) has launched an investigation into whether the National Education Association (NEA) has violated federal tax law by spending millions in tax-exempt, members dues on unreported political activities.”

Reg Weaver, president of the National Education Association (NEA), acknowledged the probe in a Fox News Channel special, “Breaking Point: Education in America,” which aired November 23.

“In September the IRS indicated that they were coming in,” Weaver said. “When they come in, we feel confident SSA p. 15

KANSAS p. 17

The Heartland Institute
19 South LaSalle #903
Chicago, IL 60603
Iraq to Receive Flat Tax in 2004

By John Skorburg

The citizens of Iraq will receive a tax reform gift in 2004, compliments of the U.S. government. “That’s because the Iraqis will enjoy something we don’t—a simple and fair tax system,” said Daniel J. Mitchell, the McKenna Fellow in political economy at The Heritage Foundation. “Beginning in January, all Iraqis will pay a flat tax of 15 percent.”

President George W. Bush’s administra
tor in Baghdad, L. Paul Bremer, recently authorized the flat tax measure, which will replace Saddam Hussein’s tax regime, with tax rates as high as 45 percent. The order was signed on September 19 and took effect January 1.

“The highest individual and corporate tax rates for 2004 and subsequent years (in Iraq) shall not exceed 15 percent,” says Bremer’s order. That could mean either a flat 15 percent tax, or a maximum marginal tax rate in Iraq of 15 percent.

“An Iraqi flat tax is good news for the United States on several counts,” said Mitchell. “Perhaps most importantly, it will advance our national security interests by boosting the Iraqi economy. A prospering and growing Iraq will be less susceptible to radical politics—and less fertile territory for terrorist groups seeking new recruits. And the sooner Iraq is stable and free, the sooner our troops can come home,” he noted.

New Life in U.S.?

A November 2 report in the Washington Post said Bremer’s action was sparking a new drive to revive domestic flat tax proposals. Economist Bruce Bartlett, a senior fellow with the National Center for Policy Analysis, points out that Iraq is not the only country welcoming flat tax reforms. “While advocates of the flat tax are ... pleased with the Iraqi initiative,” notes Bartlett, “they are actually much more excited by what is going on in many former Soviet bloc countries.

“Estonia established a flat tax in 1994, Latvia in 1995, and Russia in 2001,” Bartlett continues. “Earlier this year [2003], Ukraine adopted a flat tax beginning in 2004, and on October 28 Slovakia became the latest country to do so. China is said to be interested as well.”

Bartlett believes success in Iraq will put flat tax reform front and center in the upcoming U.S. Presidential elections, even among Democratic candidates. “It is worth remembering that former California Governor Jerry Brown ran on a flat tax in the Democratic Presidential primaries in 1992, giving his campaign a big boost.”

Brown’s support rose steadily as he campaigned on the flat tax, according to Bartlett’s analysis of Gallup Poll data, rising from the low single digits to about 25 percent of the Democratic electorate, second only to Bill Clinton. Brown defeated Clinton in primaries in Colorado, Connecticut, Maine, Nevada, Utah, and Vermont. He was the only candidate able to challenge Clinton all the way to the Democratic convention.

According to Bartlett, “I would suggest that Dick Gephardt is probably best positioned to duplicate Brown’s success. He has already staked out a rightward position on Iraq and was a prime mover of tax reform in the 1980s as coauthor of the Bradley-Gephardt tax plan. I think he would generate a lot of excitement by endorsing a flat tax—something his campaign desperately needs to challenge Howard Dean and give him a better shot at the Democratic Presidential nomination. It has the added virtue of being good policy.”

BRUCE BARTLETT

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“Unfortunately, I don’t see Democrats getting their act together next year to regain either the White House or Congress. As a Republican, I am sorry to see that because my party needs them in order to avoid corrupting itself,” notes Bartlett.

California Governor Arnold Schwarzenegger is said to be looking at some sort of flat tax there, according to an October 30 report in the Los Angeles Times.

Importance of Prosperity

“The Bush administration deserves considerable praise for the Iraq flat tax,” said The Heritage Foundation’s Mitchell. “Officials could have left Saddam’s bad tax system in place or turned the Iraqi economy over to the United Nations, who probably would have increased tax rates even higher! But the President and his team know that peace and stability in the Middle East are impossible without prosperity.”

The next step, said Mitchell, is to “find some country to liberate us and replace our terrible tax code with a 15 percent flat tax. Any takers?”

John Skorburg is managing editor of Budget & Tax News. His email address is skorburg@heartland.org.
Flat Tax Benefits for Iraq

The flat tax measure, predicts Daniel J. Mitchell in a November 10 commentary for The Heritage Foundation, will reap the following significant positive results for the Iraqi people:

- Help restore the Iraqi economy. Decades of heavy-handed government control crippled Iraq's private sector. Saddam and his henchmen treated the country as a personal piggy bank, and the Iraqi people quickly learned to use the underground economy to survive. The flat tax will "legalize" productive behavior and help unleash entrepreneurship and innovation. Businesses will be formed and jobs will be created. To be sure, the flat tax is just part of the solution, but it's an important step on the road to economic recovery.
- Reduce U.S. foreign aid. An Iraqi flat tax also will save American taxpayers money. Nations that experience strong economic growth generally don't feel the need to come to Washington begging for handouts. This is a critical issue since, for better or for worse, we now bear considerable responsibility for Iraq's future. If its economy is weak, we'll be sending billions of dollars to Baghdad every year for the indefinite future. But the flat tax can help wean Iraq from American aid.
- Boost economic reform in the Middle East. Creating a democracy in Iraq should stimulate political reform in other Middle East nations. The same principle applies to economic reform. The Iraqi flat tax will provide an example to other nations in the region that want to modernize their economies. It would be especially helpful if Israel and Egypt learned from Iraq, since both nations consume a lot of U.S. foreign aid—money they wouldn't need if they replaced their punitive tax regimes with a flat tax.
- Educate U.S. politicians. If American officials recognize that a flat tax is good for Iraq, this raises an obvious question: Why isn't it also good for the United States? One of the indirect benefits of the Iraqi flat tax is that it will create another case study showing the benefits of a fair, simple, pro-growth tax system. Not that politicians should need more evidence: Hong Kong's flat tax, after all, is a long-time success story, and the flat taxes in Russia, Lithuania, Estonia, and Latvia are helping their economies grow as well.

Daniel J. Mitchell is the McKenna Fellow in political economy at The Heritage Foundation. The full text of his November 10 commentary is available on the Heritage Foundation Web site at http://www.heritage.org/Press/Commentary/ed111003c.cfm.

The Flat Tax

Current plans for a flat tax are usually based on a plan introduced in 1981 by economists Robert E. Hall and Alvin Rabushka of the Hoover Institution at Stanford University. The discussion below is excerpted from their pioneering book, The Flat Tax (Stanford, California: Hoover Institution Press, second edition 1995).

Under our flat tax, all income would be taxed once and only once, at a uniform low rate of 19 percent. Our plan is fair to ordinary Americans because it would permit a tax-free allowance of $25,500 for a family of four. The family would pay a tax of 19 percent on its earnings above that allowance. Millions of U.S. residents would no longer pay any income taxes. All wage earners would pay less tax under our flat tax than under the current system.

Our flat tax would eliminate the distortions of the present tax treatment of business. It would replace a hodgepodge of depreciation schedules with an effective investment incentive, a first-year write-off. It would reduce the current corporate tax of 35 percent to 19 percent. It would eliminate double taxation of business income by ending taxation of dividends and capital gains.

Our flat tax adheres to the principle of a consumption tax: People are taxed on what they take out of the economy, not on what they put in.

Our flat tax is not an academic abstraction. We have designed tax forms, rewritten the Internal Revenue Code, and worked out all the practical details. The flat tax has withstood the scrutiny of leading experts on taxation and has been endorsed enthusiastically by many of them. Both the New York Times and the Wall Street Journal have endorsed our flat tax. Both Republicans and Democrats have introduced it as bills in previous sessions of Congress.

The Heartland Institute invites you to meet John Stossel, ABC News correspondent and co-anchor of 20/20, and author of Give Me a Break: How I Exposed Hucksters, Cheats, and Scam Artists and Became the Scourge of the Liberal Media.

Wednesday February 4, 2004 11:30 a.m. - 1:30 p.m.
The Ritz Carlton, 160 East Pearson Street, Chicago, Illinois

To order tickets or reserve a table call 312/377-4000, visit www.heartland.org, or send check or money order to The Heartland Institute, 19 South LaSalle Street #903, Chicago, Illinois 60603. To make hotel reservations, call 312/266-1000.
Revenues Rising

The report lands at a time when the national economy is emerging from a nearly flat slump and many states are reaping the benefits. Arkansas, for example, reported that revenues were 8.9 percent, or $26 million, in November 2003 over a year ago. Since July, Arkansas revenues have increased 5 percent over the previous year. The new NGA-NASBO report shows a state fiscal landscape marked by slumping numbers but promising, with revenues growing in a variety of places. Sixteen states laid off employees, 13 used early retirement to pare their workforces, and 13 reorganized programs to cut cost savings, according to the NGA-NASBO report.

Looking ahead, NGAs Scheppach said state revenue growth will remain sluggish until states realign their tax systems, many of which were last overhauled in the 1980s.

“States have done a lot of one-time cuts, they’ve got under-funded pensions, they’ve borrowed money from trust funds, they’ve securitized tobacco (settlements), and they’ve moved pay-roll dates around. There’s going to be some backfilling on that hole.”

RAY SCHEPPACH NATIONAL GOVERNORS ASSOCIATION

Spending Restraint

The overall hole from which states are emerging is a deep one. State general fund spending grew 0.6 percent in fiscal 2003 and 0.2 percent in fiscal 2004, according to the report. This is the smallest nominal general fund increase since 1979. It’s unprecedented to have close to three years of nearly flat spending, but that’s what we’re finding in the survey,” said Scott Pattison, NASBO’s executive director and a former Virginia budget director.

When the erosion of inflation are factored in, state budgets shrank by 1.6 percent in fiscal 2003 and 2 percent in fiscal 2004, the report finds. That has resulted in widespread budget cuts and tax and fee increases in several states.

Eighteen states raised taxes by nearly $6.2 billion for fiscal year 2004, according to a report released in December, The 2003 Tax and Budget Review, by the Rockefeller Institute of Government at the state university of New York, Albany. This is in addition to at least $26 billion in fee increases in the states, more than not more than states have ever before raised fees.

“This shift toward fee increases appears to result from states shying away from more tax increases, while still needing new revenue to close the budget gaps,” said the Rockefeller report.

“By taking his stand on November 25, 2003, Governor Arnold Schwarzenegger of California proved to his governors that they can do to earn ideal ratings from Americans for Tax Reform, continued Norquist. ATR issues continuously updated rankings of governors based on their taxing and spending activities.

“The governor of California has provided a useful example of things a governor can do to use fees to improve their state’s revenue-neutral performance,” said Scott Pattison, NASBO’s executive director.

“The rankings

The rankings

“ATR has long defended taxpayers against lawmakers who would increase their taxes in devious ways,” commented ATR spokesman Rob Stutzman. According to Norquist, penalties for cutting taxes and spending. “We don’t exactly wipe the slate clean on January 1, but we continuously revisit the governors’ rankings. If a governor executes pro-taxpayer policies, we’re likely to revise his or her ranking upwards,” Norquist noted.

ATR’s 2003 Gold Star governors were:

• Frank O’Bannon (Indiana), who died in September 2003
• Mike Foster (R-Louisiana)
• John Baldacci (D-Maine)
• Mitt Romney (R-Massachusetts)
• John Hickenlooper (R-Colorado)
• John Kitzhaber (D-Oregon)
• Jim Doyle (D-Wisconsin)
• Bill Owens (R-Colorado)
• Jeb Bush (R-Florida)
• Linda Lingle (R-Hawaii)
• Tim Pawlenty (R-Minnesota)
• Craig Benson (R-New Hampshire)
• Ron Bond (D-Alabama)
• Tim Breseden (D-Tennessee)
• Rick Perry (R-Texas)
• Rod Blagojevich (D-Illinois)
• Brad Henry (D-Oklahoma)
• Phil Bredesen (D-Tennessee)
• Dave Freudenthal (D-Wyoming)

Several governors are currently ranked #2 by ATR, indicating the group has used a useful example of things a governor can do to earn ideal ratings from Americans for Tax Reform. The group’s #2-ranked governors are:

• Frank Murkowski (R-Alaska)
• Mike Foster (R-Louisiana)
• Bob Ehrlich (R-Maryland)
• Jennifer Granholm (D-Michigan)
• John Hoeven (R-North Dakota)
• Gary Locke (D-Washington)
• Mike Johanns (R-Nebraska)
• Bill Richardson (D-New Mexico)
• John Baldacci (D-Maine)
• John Kitzhaber (D-Oregon)
• Jim Doyle (R-Wisconsin)
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• Jeb Bush (R-Florida)
• Bill Owens (R-Colorado)
Sees Promise in State Governors

posed increase, her rank will fall to #3 until she renews her pledge.

In a joint press release issued through their House Taxpayer Protection Caucus, Michigan Representatives Leon Drolet (R-Clinton Township) and Jacob Hooftveld Jr. (R-Portage), said their caucus and other pro-taxpayer legislators also oppose the delay.

“The government spent its way into this problem and government should cut its way out,” said Drolet. “Michigan families didn’t create this deficit and they should not be paying the bill for it.” Similarly, in the wee hours of the morning in late April when the Kansas legislature passed its plan to delay a scheduled sales tax cut out of 0.1 percent, Democrat Governor Kathleen Sebelius denied the delay was a tax increase, and called the action “a responsible choice.” “The responsible thing to do is to keep your promises and cut taxes when you say you will,” countered Norquist.

In New Mexico, Democrat Governor Bill Richardson signed a 70 cents-per-pack cigarette tax increase and legislation to stop gas taxes from falling by 1 cent per gallon.

“Governor Richardson made some encouraging noises about cutting personal income taxes and capital gains taxes earlier this year, but the cigarette tax increase and the gas tax cut delay effectively downgraded his ranking,” Norquist said.

Passing “user fees” that are really tax increases is another ploy that will earn a governor a lower ranking. Illinois Democrat Governor Rod Blagojevich proposed increasing more than 100 taxes and fees earlier this year. Democrat Governor Bob Wise of West Virginia increased cigarette taxes, calling them a “user fee.” Their rankings were downgraded by ATR.

Other actions that typically result in a lower ATR ranking include simultaneous tax cuts and tax increases, where the tax increase is larger or equal to the tax cut.

“Tax cuts must be greater than or equal to tax increases, and lawmakers must pass both types of legislation simultaneously. Otherwise, it’s a tax increase,” Norquist said.

How Governors Can Improve Ranking

“First and foremost, governors can sign the Taxpayer Protection Pledge, and keep that promise to taxpayers that they will oppose and veto any and all efforts to increase taxes,” said Norquist.

ATR offers the pledge to all candidates for state and federal elective office, including candidates for governor. An incumbent governor may sign the pledge at any time.

Eight governors have signed the pledge, including two governors currently ranked #2 by ATR.

“Vetoing and opposing efforts to increase taxes, opposing plans like Maine Rx to impose price controls on prescription drugs, signing the pledge, and spearheading efforts to repeal existing tax increases all will help improve a governor’s ranking,” commented Norquist.

“I particularly appreciate Ohio’s Secretary of State Kenneth Blackwell working to repeal Governor [Bob] Taft’s $2.9 billion tax increase,” Norquist said. “I wish Blackwell were governor; he would earn a rank of #1 and probably a Gold Star.”

Schwarzenegger Recovery Plan on March Ballot

by John Skorburg

On December 12, Governor Arnold Schwarzenegger signed legislation, passed by the state senate earlier that day, putting his economic recovery plan before the people of California in a March 2004 ballot referendum.

“In my swearing-in speech,” Schwarzenegger explained in a prepared statement, “I called upon the legislators to put aside ‘politics as usual’ and deliver a miracle of Sacramento for the people. I am pleased and grateful they were able to do that and pass my California Recovery Plan. Our plan includes a balanced budget requirement to prevent our state from ever facing such a disastrous situation again. I urge the people to join us in putting California on the road to recovery by voting for our plan on the March ballot.”

Schwarzenegger’s plan must be approved by the state’s voters because it includes an amendment to the state constitution.

“The budget agreement that just passed the Assembly is an important step in the right direction for California,” said Leon E. Panetta, former California Congressman and White House Chief of Staff under President Bill Clinton.

“Make no mistake,” Panetta continued, “there are many tough decisions that remain to be made by both the governor and the legislature to restore fiscal discipline to this state. But the first challenge is for both sides to show that they are willing to work together to govern this state rather than engage in politics as usual. This agreement should give all of us in California greater hope that the difficult challenges that remain ahead can be resolved by leadership instead of crisis.”

The governor’s finance director, Donna Arduin, described the fiscal challenges facing California.

“For the past five years, California government has spent $235 billion more than it has taken in. Over the past five years, while revenues have increased by 25 percent, state expenditures have risen by 43 percent. If government had simply spent at the same rate that California’s economy has grown, the state’s budget would be balanced today.”

Recovery Plan

According to Arduin, the recovery plan includes:

- Constitutional spending limit. For 2004-05, expenditures will not be permitted to exceed revenues. For the 2005-06 fiscal year, spending growth over the preceding year will match inflation and population growth. The measure will also establish a Revenue Stabilization Fund, which will receive any general fund revenue that comes in above the spending limit. This ‘rainy day’ fund could be used— with a two-thirds vote of the legislature—only for repaying deficit bonds, tax rebates, emergencies declared by the governor, and transfers to the general fund when revenues fall below the spending limit in the future.

- General obligation bond issue, which would be used to refinance $15 billion of the $25 billion in debt that has already been incurred.

- Spending reductions. Estimates on the size of the budget shortfall for the current fiscal year range between $2.2 billion and $4.3 billion. The governor is asking the legislature to eliminate nearly $2 billion of the projected shortfall immediately by cutting spending.

Arduin was quoted in early December in the Wall Street Journal saying, “We have a list of proposals to start reducing spending now. It includes 38 specific actions that cover a range of program areas, including transportation, resources, health and human services, and education. Together, these total $1.9 billion in budget savings in the current and next [2004] year.

“We have a realistic assessment of the state’s fiscal picture,” noted Arduin, “and a comprehensive plan to begin to fix fiscal problems that have grown in the past five years. No one is under illusions about how difficult this task will be. But the alternative—failing to take action—is simply not an option.”

John Skorburg is managing editor of Budget & Tax News. His email address is skorburg@heartland.org.
Michigan Poll Finds Support for Smaller Government

By John Skorburg

With their state government facing a potential $1 billion deficit, Michi-
gan taxpayers want lawmakers to bal-
cance the budget with spending cuts rather than tax increases, according to a recent poll.

In the November 2003 survey of 600 registered voters in Michigan, respondents voted overwhelmingly in favor of less government spending, increased employment, and a strengthened economy. Participants were asked how they recommended the state balance its current budget. Sixty-eight percent advocated cutting spending, while just 17 percent advocated raising taxes.

“Clearly, there is no desire to raise taxes in Michigan this term,” said Michigan House Majority Leader Steve Mitchell of Mitchell Research & Communications Inc., which conducted the survey.

Lawrence W. Reed, president of the Mackinac Center for Public Policy, believes the seeds for smaller government in Michigan were planted 25 years ago with the passage of a 1978 amendment that puts “limits on state and local government” by incorporating them into the Michigan Constitution. Today Reed notes, “Without the restraints on government provided for in the 1978 amendment, Michigan workers and families would be struggling today to make do with less. Both the tax burden and the Lansing bureaucracy would be larger, at the cost of an exodus of people and their businesses from Michigan.”

“Jobs and the economy rank as Michigan residents’ top concerns,” according to State Rep. Marc Shulman (R-West Bloomfield), chair of the House Appropriations Committee. “The results of this survey will guide us through the difficult days to come as we work to balance this budget,” Shulman said.

Liz Boyd, spokeswoman for Democratic Gov. Jennifer Granholm, told the Oakland Press that Granholm’s budget goals “are in line with the survey results.”

“The governor favors cuts in spending to balance the budget,” Boyd said, “not a tax increase.”

On December 18, the Michigan House voted 64-46 to approve a bill, similar to an agreement reached by Granholm and the state senate, to cut projected spending by $379.8 million and cut business taxes, but also to delay a planned reduction in the state income tax.

“The most basic responsibility of a state representative is to advocate on behalf of his or her constituents. Similarly, the task of the Appropriations Committee is first and foremost to make suggestions about state spending based on what best serves the residents of Michigan,” said Shulman. “It is my responsibility to know what the public is saying.”

According to the survey, residents believe the most important problem facing the State of Michigan is jobs and the economy (43 percent), followed by budget issues (19 percent), education and schools (10 percent), and health care and prescription drugs (6 percent). Jobs and the economy also rank first when respondents were asked to identify the most important problem facing their local communities.

“Through this poll, the residents of Michigan have spoken,” Shulman said. “We will do our best to listen.”

“Will lawmakers listen to Michigan residents?” asked Mitchell. “I don’t know. But it’s pretty clear there is no support here for a tax hike.”

The poll was conducted November 3-11. Poll results are available at Shulman’s online office at http://www.gophouse.com/shulman.htm.

John Skorburg is managing editor of Budget & Tax News. His email address is skorburg@heartland.org.

Massachusetts Ends Ban on Sunday Liquor Sales

Measure adopted as part of economic stimulus package

by Frank Coleman and Lisa Hawkins

With the stroke of a pen on November 26, Governor Mitt Romney brought the Puritan State into the twenty-first century, striking down the state’s ban on Sunday alcohol sales, one of the last vestiges of the Prohibition era.

“Here in Massachusetts, the Mother of all Blue Laws—the Sunday sales prohibition—is finally history,” said Peter Cressy, president of the Distilled Spirits Council of the United States (DISCUS), the national trade association representing producers and marketers of distilled spirits sold in the United States.

“Consumers and retailers will no longer be bound by Blue Laws of a bygone era, while the state will gain new revenue.” DISCUS lobbied aggressively in support of the change, as did beer wholesalers.

Under the new law, which goes into effect immediately, package [liquor] stores throughout Massachusetts will be permitted to open on Sunday all year round. Since 1990, those stores have been permitted to open on the Sunday after Thanksgiving through New Year’s Day, or year-round if they were located within 10 miles of the New Hampshire and Vermont borders.

“It is clear to me that the extension of Sunday sales will reap untold benefits upon businesses, employees, consumers, and the Commonwealth,” said State Rep. Daniel E. Bosley (D-North Adams), House Chairman of the Joint Committee on Government Regulations. “Enactment of this legislation will help us retain untold millions in tax revenue that we are currently losing to our neighboring states both in the form of alcohol sales on Sunday as well as sales incidental to the purchase of alcohol on Sunday.”

STATE REP. DANIEL E. BOSLEY

have resulted in an immediate boost to state tax revenues. Pennsylvania’s sales are up 10 percent since Sunday sales have gone into effect. Pennsylvania Liquor Control Chairman Jonathan New- man called Sunday sales a “grand slam home run,” reporting that Sunday sales have not detracted from sales on other days. In Oregon, a survey by the State Stores Association found that stores open on Sundays have increased weekly revenues between 9.2 and 19.6 percent.

Frank Coleman is senior vice president, and Lisa Hawkins is vice president for public affairs and communications, with the Distilled Spirits Council of the United States.

“Enactment of this legislation will help us retain untold millions in tax revenue that we are currently losing to our neighboring states both in the form of alcohol sales on Sunday as well as sales incidental to the purchase of alcohol on Sunday.”

Massachusetts Ends Ban on Sunday Liquor Sales

Governor Mitt Romney signed a bill ending the state’s ban on Sunday alcohol sales.
by John Skorburg

Oregon voters have launched an effort to repeal an income tax surcharge imposed a year ago by the Oregon Legislative Assembly in mid-2003, scheduled to take effect this spring. The movement appears to have gained momentum in recent weeks, as taxpayer groups succeeded in getting a repeal referendum certified for the February 2004 ballot.

According to Steve Buckstein, president of the Portland-based Cascade Policy Institute, “the referendum has been certified for the ballot by Oregon’s Secretary of State, so Oregon voters will vote on it February 3, 2004. The vote was demanded by some 147,000 Oregonians signing petitions to refer the tax package to the ballot. In the one hundred year history of Oregon’s initiative and referendum system,” said Buckstein, “no measure ever collected so many signatures.”

In a poll conducted for Portland’s KGW-TV, 56 percent of respondents said they would oppose the surcharge if it made it onto the ballot. The statewide telephone survey of 464 adults was conducted November 10-17 and has a margin of error of plus or minus 4.5 percentage points.

If the tax increase is repealed by voters, the Washington Times reported, “automatic spending cuts in such areas as education and social services will be triggered to keep the 2003-05 budget balanced.”

Jason Merciers, an adjunct scholar to the Cascade Policy Institute, suggested lawmakers begin preparing now for the possibility that voters will reject the tax surcharge. “It would be best to prepare for voters repealing the increase,” said Merciers, “rather than waiting until the dust actually settles. An ounce of budget reform leadership is worth more than a pound of chaos.”

by Karl Peterjohn

In November 2003, a delegation of eight Kansas legislators attended the Streamlined Sales Tax System’s Scottsdale, Arizona meeting seeking help to correct the mess a new “streamlined” sales tax law and its destination sourcing provisions had created in Kansas. Some Kansas legislators are now discussing taking Kansas out of this multi-state compact.

The Kansas delegation was seeking areas of flexibility since the destination sourcing provisions of the streamlined sales tax have created havoc among many Kansas retailers. That havoc is now beginning to affect cities and counties dependent on sales tax revenues.

When Kansas House Speaker Doug Mays (R-Topeka) spoke and sought flexibility on implementing the destination sourcing provision of the streamline law, he received a hostile reception from the sizable audience of state tax agencies. When the Kansas delegation brought up furniture stores that deliver, the opposition was even more hostile. “We became pariahs after we spoke,” Mays said.

Another delegation member, Representative Steve Brunk (R-Wichita), a small businessman, went even further and said this law should be repealed.

Brunk was one of only 31 legislators voting against this bill on the last day of the regular 2003 Kansas legislative session. Brunk wants the place of origin sales tax restored and complained that the streamlined sales tax “could be the straw that breaks the camel’s back” for many retailers.

The 2004 Kansas legislature will be exploring all its options when its session begins in January. There is a tremendous amount of confusion among Kansas retailers that is further hurting a stagnant state economy. Neighboring states like Colorado are beginning to take advantage of Kansas’ mistake. Colorado’s Governor Bill Owens proudly boasts that the streamlined tax nonsense will never occur there.

Repealing this law is likely to be one of the first items considered by the 2004 Kansas legislature, but there are enough Democrats in the Kansas house to defend a gubernatorial veto. If the new law is not repealed, the Kansas legislature and Governor Sebelius will have sent a clear message that Kansas is hostile to small business in general and retailers in particular.

Karl Peterjohn is executive director of the Kansas Taxpayers Network.
Thoughtful leaders in many states are fed up with the fiscal rollercoaster they have experienced during the past decade and want to smooth out the ride. The result in many states is a new interest in constitutional tax and expenditure limitations (TELs) and efforts to impose limits where they currently exist.

Roller Coaster Ride

States are paying a heavy price for allowing rapid tax revenue growth during the 1990s to fuel an unsustainable expansion in spending. Between fiscal years 1990 and 2001, state tax revenue grew 86 percent. Inflation and population growth grew at a combined rate of 55 percent during that same period.

If states had limited spending growth to the rate of increase in inflation and population, according to analysts from the Cato Institute, state budgets would have been $93 billion smaller by FY01 than they actually were. The savings are roughly twice the size of today’s state budget gap.

If revenue growth higher than the benchmark had been given back to taxpayers in permanent tax cuts and annual rebates, the rebates could have been temporarily suspended during FY02 and FY03 to provide a cushion with which to balance state budgets.

Origins in California

In 1972, Governor Ronald Reagan decided California government was too big, and its swings between feast and famine were too wild and unpredictable. He decided to put the size of state and local governments, putting them on a diet that would control government growth and stabilize their fiscal practices.

The backdoor to Reagan’s fiscal initiative was a decade of explosive growth in state government. During the decade of the ’80s, when population and inflation increased just over 60 percent, total state spending increased 160 percent, also dwarfing personal income growth of 115 percent. In other words, California government was consuming an ever-larger share of the state economy, threatening the private sector’s ability to prosper.

Reagan established the Governor's Tax Reduction Task Force to analyze the problem and come up with some original, surefire answers. The task force presented its work to Reagan in December 1972, having concluded that a constitutional amendment, limiting the growth of taxes and spending year over year, was the answer.

Since this TEL was a case of first impression, the drafters interviewed nearly every financial bureaucrat and fiscal expert in the state to get it right. There were 44 drafts before the proposed amendment was submitted to the legislature and ultimately placed on the state ballot as an initiative at a special election called by the governor in November 1973. The “Revenue Control and Tax Reduction Initiative” was designated Proposition 1.

State Budget Problems Lead to Renewed Interest in TELs

by Lew Uhler and Barry Poulson

“If states had limited spending growth to the rate of increase in inflation and population, ... state budgets would have been $93 billion smaller by FY01 than they actually were.”

Key Features of TELs

The key elements of Prop. 1 have become the cornerstones of effective TELs—then and now. They are:

- Limit on government growth. Prop. 1 limited state expenditures to the then-percent of state personal income (about 8.5 percent) and required that percentage to be reduced by .1 percent per year until it reached 7 percent, at which time the legislature (by a two-thirds vote) could halt the annual reduction. Other states followed the personal income percentage formula without the annual reductions, which has been found to be entirely too generous. It is now clear that annual increases in expenditures should be limited to the growth in inflation and population, as in the Colorado TABOR model. That approach avoids another element of the original California design, i.e., the establishment of an economic estimates commission to determine the spending limit for the year based on estimates of personal income growth. By using specifically identified population and inflation indicators, government officials cannot “play” with the formula.

- Defining the tax and spending base. The California limit exempted a variety of spending and revenues, i.e., bond payments, federal funds, gifts to the state, etc. It has been determined since that broadening the base of included expenditure and revenue sources is the best answer.

- Super-majority vote on taxes. Prop. 1 required a two-thirds vote to increase the rate or base of any existing tax or to add a new tax.

- Tax surplus fund. Tax revenues in excess of allowable expenditures were to be transferred to the tax surplus fund and refunded to the people. The measure explicitly required the legislature to minimize surpluses by making periodic refunds and reducing tax rates.

A lot has been learned over the years about the games played with such revenues. It is essential to capture these excess funds and rebate them as soon as possible.

- Emergency fund. A fund equal to .2 percent of state personal income (about 3 percent of the state budget) was set aside for emergencies, which could be determined by the governor alone.

Over the years this provision has morphed to include a declaration by the governor, super-majority vote by the legislature, and explicit limitation on the types of emergencies, i.e., natural disasters, not economic crises, for which the funds may be used. For economic recessions, a Budget Stabilization Fund is now the recommended approach.

- Exceeding the limit. Prop. 1 contained an explicit provision for exceeding the limit based on a vote of the people following a two-thirds vote of the legislature for that purpose. Current models recognize that at any time the people can vote to increase spending/taxes in a measure providing for same and that an existing limit would be adjusted by that amount.

- State mandates. The state was required to reimburse local governments for newly mandated programs or increases in the costs of existing mandated programs. This provision is essential to prevent an expenditure-limited state government from shifting costs to locals to escape the real impact of the state limit.

- Local government tax/expenditure limit. Prop. 1 recognized that state and local governments are part of a total fiscal system. It would not benefit taxpayers to control state expenditures only to have local governments fill in the gap. Prop. 1 set limits on local property tax rates, which could be overridden by a vote of the people. It allowed emergency expenditures over the limit only upon a four-fifths vote of the local governing board. The legislature could adjust property tax levels to meet special circumstances.

- Shifts in program responsibilities. The limits at the state and local levels could be automatically adjusted for shifts of program responsibilities between the state and local units of government and the federal government. This provision has found its way into most current TELs to allow changes in responsibility for welfare, health, and other programs as well as between various governmental units.

A TEL is not a substitute for, but an addition to, every other fiscal restraint device extant in any state: gubernatorial line item veto, impoundment or rescission authority, sunset laws, performance-based budgeting, etc. It will work with a part- or full-time legislature, a biennial or single-year budget, any type of state balanced budget requirement, etc. It will work with any type of tax structure, whether progressive or regressive.

Simply stated, a TEL automatically (constitutionally) says to the governor and legislators, “here’s the total amount you may spend this year; you decide how to allocate it and how to raise it.” That is the essence of a TEL.

Next month: Colorado’s Taxpayers Bill of Rights

Lew Uhler, president of the National Tax Limitation Committee, chaired then-Governor Ronald Reagan’s Tax Reduction Task Force that developed Proposition 1. Uhler has remained active in the TEL movement nationally. Dr. Barry Poulson is a senior fellow in economic policy with the Independence Institute and professor of economics at the University of Colorado.
Five Ways to Spend Less on Higher Education

by Lewis M. Andrews

On October 21, 2003, the College Board once again documented the widespread impression that college costs are spiraling wildly out of control. In the decade from 1990 to 2000, tuition at the average four-year private college nearly doubled, going from $10,348 to $19,312. During that same period, state universities imposed an 85 percent tuition increase on their students.

In the current academic year, according to the Board, while the national economy has experienced almost no inflation, tuition at four-year private colleges is up 6 percent over 2002, while tuition at state schools has jumped an astonishing 14 percent in just one year.

While these trends suggest higher spending on higher education is inevitable, many experts say otherwise. A 1998 report to Congress by the National Commission on the Cost of Higher Education (NCCHE) concludes that a costly and unnecessary degree of specialization has developed in most academic departments, with institutions now supporting disciplines that did not even exist a generation or two ago. Were professors willing to shoulder a bit more of their focus, the number of positions needed for schools to allocate educational costs to supporting disciplines that did not even exist a generation or two ago. Were professors willing to shoulder a bit more of their focus, the number of positions needed for schools to allocate educational costs to supporting disciplines that did not even exist a generation or two ago. Were professors willing to shoulder a bit more of their focus, the number of positions needed for schools to allocate educational costs to supporting disciplines that did not even exist a generation or two ago. Were professors willing to shoulder a bit more of their focus, the number of positions needed for schools to allocate educational costs to supporting disciplines that did not even exist a generation or two ago. Were professors willing to shoulder a bit more of their focus, the number of positions needed for schools to allocate educational costs to supporting disciplines that did not even exist a generation or two ago. Were professors willing to shoulder a bit more of their focus, the number of positions needed for schools to allocate educational costs.

According to Martin Kramer, editor-in-chief of New Directions for Higher Education, even the modest reform of insuring that courses required for a major be offered on cycles that make completing college in four years more feasible—in other words, ranking students’ academic needs above sabbatical convenience—could significantly restrain college costs.

Another reform that promises significant savings is the more efficient use of online resources. Robert Zemesky, director of the Institute for Research on Higher Education at the University of Pennsylvania, has observed that for a one-time collective investment of around $50 million, groups of community colleges, each now spending heavily to provide remedial programs in mathematics, could together save hundreds of millions of dollars “and quality could be continuously improved.”

Alan Guskin, president emeritus of Antioch University and co-director of the Project on the Future of Higher Education, believes a more creative approach to the design of libraries—using them as learning centers to provide online course instruction, not just as places to research the occasional class paper—would yield significant cost savings over the long run.

A third efficiency that could reduce the cost of attending a college or university is for schools to allocate educational costs to multi-layered tuitions. For example, courses using videotapes of the best professors from around the country, with an emphasis on independent study and only occasional classes with live teachers, could be priced at one low economy level, while courses involving expensive laboratory facilities or lengthy seminars with an ongoing instructor could be priced at an appropriate premium.

As colleges unbundled their offerings and prices, students in their turn could elect a base rate for courses with high levels of automation or, alternatively, pay a supplement for as much mentoring and personal attention as they wished.

William Massy, director of the Stanford Institute for Higher Education Research, has a fourth suggestion: Professors should adopt quality control methods used in manufacturing and service industries. Just as cars are designed to accommodate the needs and limitations of the purchaser, so classes could be better designed to accommodate the interests and learning abilities of the students.

Supported by an $8.8 million grant from the Pew Charitable Trust, Carol A. Twigg at Rensselaer Polytechnic Institute tested the viability of Massy’s suggestion by working with professors at 30 institutions of various sizes around the country. She wanted to see if fine-tuning the design of large enrollment courses could simultaneously reduce instructional costs while improving the quality of instruction.

“Our preliminary results show that all 30 [colleges and universities] reduced the costs of course delivery by 40 percent on average, with savings ranging from 20 to 86 percent,” says Twigg. At the same time, the redesigned courses produced “increased course-completion rates, improved retention, better student attitudes toward the subject matter, and increased student satisfaction.”

A final way in which college professors—especially the social scientists—could help reduce the cost of higher education is by using their expertise to identify alternatives to the current wasteful regulation of higher education. In 1998 Stanford University estimated the school incurred approximately $20 million per year (or 7.5 cents for every tuition dollar) in costs related to compliance with a maze of federal and local reporting rules.

Many state universities are further burdened by rigid finance laws, which require comptrollers to “sweep” college and university accounts at the end of each year, returning unspent balances to state treasuries. Such laws encourage schools to do everything but think economically and instead spend all their appropriated money in order to prove, if nothing else, that they are not over-funded.

Dr. Lewis Andrews is executive director of the Yankee Institute, a think tank based in Hartford, Connecticut. His email address is white-light@att.net.
Three farm horror stories paint bleak picture

by John Skorburg

In a November 6 statement to the U.S. Treasury Department, American Farm Bureau Federation (AFBF) tax specialist Pat Wolff testified her organization “remains committed to full repeal of the federal death tax” because of its potential to prevent the transfer of farms from one generation to the next.

Wolff, participating in a Treasury Department roundtable on jobs, growth, and abolition of the death tax, said “death taxes have long been a concern for farm- ers and ranchers, and Farm Bureau members consistently list it as the organization’s top tax priority.”

“While other sectors of the economy have similar concerns, farmers and ranchers are particularly sensitive to the death tax issue for several reasons,” Wolff continued. “Most notably, farm and ranch estates face heavier, potentially more disruptive death tax burdens than other estates.”

Death taxes fall more heavily on farm and ranch estates because they typically own more property (land) than the average homeowner, and that land is valued more highly than other land. The death tax is potentially more disruptive to farm and ranch families because, since the land is both valuable and productive, those families desire to keep the property in the family and prefer not to sell at the time of death. Moreover, the average death tax burden on farm and ranch estates face heavier, potentially more disruptive death tax burdens than other estates.”

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The Koopmans faced the death tax issue for several reasons,” Wolff said, and exactly “the farm estate is being distributed.

Under provisions of the Taxpayer Relief Act of 1997 and the Tax Relief Act of 2001, the Unified Credit has been gradually increasing. The credit will increase from $1 million per taxpayer in 2002 and 2003 to $1.5 million in 2009.

In addition, the top estate tax rate will be falling gradually until 2010. The top marginal rate will decline from 50 percent in 2002 to 45 percent in 2009. In 2010, the rate is zeroed out.

But unless Congress acts to make the credit and rate reforms permanent, between 2011 and 2013 the top estate tax rate will revert to its 2002 level of 50 percent, and the Unified Credit will fall again, to the 2002 level of $1 million.

“The reinstatement of death taxes in 2011 would translate into a wider range of medium and large farm estates owing more taxes in 2011 than in 2001 before the latest round of reforms began,” Wolff said.

A tax burden of that magnitude would be large enough to disrupt farm and ranch operations, Wolff said, and exacerbate for a growing number of families the problem of transferring farms and ranches from one generation to the next.

“Those are the farms and ranches that produce more than 80 percent of all agricultural production in the United States,” Wolff said. “When the death tax disrupts these farms, it disrupts a very critical part of the U.S. economy and our future ability to maintain production of food and fiber.”

John Skorburg is managing editor of Budget & Tax News. His email address is skorburg@heartland.org.

Farm Group Calls for Permanent Repeal of Death Tax

Three farm horror stories paint bleak picture

by John Skorburg

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Unified Credit and Top Estate Tax Rates

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Estate taxes are due to the IRS only nine months from date of death. In many cases, heirs are forced to sell personal property, real property, and other belongings to pay this tax bill.
Why Gates’ Dad Is Wrong on the Death Tax

by Terry Savage

So Bill Gates Sr. has decided that all Americans should pay estate taxes. He’s even written a book, Why America Should Tax Accumulated Fortunes. Hey, Mr. Gates: Speak for yourself!

By 2009, the federal estate tax will take 45 percent of estates worth over $3.5 million. The Gates family is estimated to be worth nearly $53 billion. Using that tax rate of 45 percent, and some simple rounding, I figure that Bill Jr.’s heirs will still have about $25 billion left even after estate taxes take their bite. So excuse me, Mr. Gates Sr., if I question your commitment to equality, charity, and all those sentiments you expressed in Chicago recently. Because the rest of us—all of us together—could live quite nicely on the remaining $25 billion Gates fortune after estate taxes.

Now let’s take a look at the reality of the estate tax.

The Real Estate Tax

If you die in 2003, you can pass along $1 million to your heirs without paying estate taxes. In 2004 the level rises to $1.5 million. Above that amount, your estate will be taxed at 48 percent.

That exclusion is gradually scheduled to rise until in 2009, when you may pass along $3.5 million—while the remainder is taxed at 45 percent.

If you die in 2010, your heirs hit the jackpot: Under current law, there will be no estate tax that year. And that’s why Congress is debating President Bush’s request to make the repeal of the estate tax permanent.

If you think this is just a political attempt to help the President’s rich friends, I have news for you: You may very well be one of those rich friends. By 2009, the federal estate tax will take 45 percent of estates worth over $3.5 million. The Gates family is estimated to be worth nearly $53 billion. Using that tax rate of 45 percent, and some simple rounding, I figure that Bill Jr.’s heirs will still have about $25 billion left even after estate taxes take their bite.

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So what’s the likely outcome? Bill Jr.’s estate will be worth over $3.5 million. The Gates family is estimated to be worth nearly $53 billion.

And then add on the value of your retirement accounts. If you die in 2003, you can pass along $1 million to your heirs without paying estate taxes. In 2004 the level rises to $1.5 million. Above that amount, your estate will be taxed at 48 percent.

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The Lucky Sperm Club

I’d say Gates Senior has benefitted from the “lucky sperm club”—lucky that his sperm created Bill Gates Jr. So that this 77-year-old former attorney doesn’t have to worry about living on Social Security or going to Canada to get cheaper prescription drugs.

The rest of us are going to keep right on working and saving and investing and hoping we have enough money to live comfortably in retirement. And at the end, if we have a bit left over, we’re absolutely sure we’d like it to go to our family—and not to Uncle Sam. And that’s the Savage Truth.

Terry Savage is a registered investment advisor and is on the board of the Chicago Mercantile Exchange and McDonald’s Corp. She appears weekly on Chicago’s WMAQ-Channel 5’s 4:30 p.m. newscast, and can be reached at her Web site, http://www.terrysavage.com. This commentary first appeared in the December 10, 2003 issue of the Chicago Sun-Times and is reprinted here with permission.
House Republicans Make Stand on Medicare

25 supporters of limited government reject reform measure

By Chris Kinnan

When the U.S. House of Representatives passed its version of the Medicare bill on November 22, 25 principle Republicans voted “no.”

Despite overwhelming pressure from their party, the liberal media, and the AARP, a handful of House Republicans refused to swallow this bitter medicine. President George W. Bush wanted it badly. House Speaker Dennis Hastert (R-Illinois) wanted it. Senate Majority Leader Bill Frist (R-Tennessee) wanted it, too. The measure ultimately passed the House by a vote of 220-215.

Congressional leaders even named this bill H.R. 1 to emphasize its priority. Trying to attract the senior citizen vote, Congress determined to create a new drug benefit for Medicare. In November, the Washington establishment lined up to pass a flawed bill that will cost hundreds of billions of dollars and disrupt the existing drug coverage currently enjoyed by most seniors. Scott Garrett (R-New Jersey) voted against the measure, explaining: “My ‘no’ vote was based on a Medicare plan that will create additional fiscal burdens, not less, and is both unnecessary and potentially harmful for most seniors who already have prescription drug coverage. Passing the wrong plan won’t help anyone. Rather, it will just speed us towards bankrupting the system—leaving every senior now and in the future without coverage. The real result of this Medicare plan is a lower standard of living for our grandchildren. They are the ones who will be stuck with the fiscal burden brought on by this socialized Medicare package.”

The Heritage Foundation reports H.R. 1 will cost taxpayers $2 trillion through 2030 alone, with “escalating costs thereafter.” Instead of H.R. 1, House leaders should have numbered the bill H.R. 2030 alone, with “escalating costs thereafter.” The real result of this Medicare bill is misguided and will ultimately do more harm than good. Unfortunately, the end result will be that many seniors will have fewer choices and end up losing their existing drug coverage.

It didn’t have to be this way. In late 2002, Bush floated a real Medicare reform proposal, one that created a prescription drug benefit within a competitive, innovative system that gave seniors real choices. If Bush, who faces an extremely competitive election next year, could back such a plan, then surely the politicians serving on Capitol Hill could fall in line. But lacking both courage and imagination, most Congressional Republicans ran for the woods and into the embrace of the AARP.

The majority in Congress has completely lost its direction on spending and size-of-government issues. Discretionary government spending has increased a staggering 27 percent over the past two years. The Medicare bill will hasten America’s fiscal fiasko and backfire politically on those who supported it. Former House Majority Leader Dick Armey, chairman of Citizens for a Sound Economy, elaborated on that point recently, telling the media, “Bad policy is not good politics. This Medicare bill is misguided and will ultimately do more harm than good. Unfortunately, the end result will be that many seniors will have fewer choices and end up losing their existing drug coverage.”

Still, a few Members of Congress stood firm on their limited government principles and voted against the bill. For them, as they faced party leaders and the special interests, it was a truly “Mr. Smith Goes to Washington” situation. Knight-Ridder described one moment, when Florida freshman Rep. Tom Feeney received a phone call from President Bush, who was lobbying for the bill. Feeney listened, then told the President, “I came to Washington not to ratify and expand Great Society programs, but to get rid of programs that don’t work and reform the ones that do.”

That’s great stuff. Similarly, the men and women listed here all made, in political terms, a heroic vote for the sake of a principle. For the idea of fiscal responsibility and limited, prudent government, these Members voted against their party, their leadership, and the special interests rejoicing in trillions of dollars stolen from future generations.

Chris Kinnan is director of public affairs for Citizens for a Sound Economy. His email address is ckinnan@cse.org. For more information about CSE, visit its Web site at http://www.cse.org.
Medicare
Continued from page 1

taxpayer groups were just about unani-
ously in strongly opposing this legislation.

The Medicare measure provides for a
prescription drug program that will be
implemented beginning in 2006. Before
that, senior citizens will be able to pur-
chase, by mid-2004, a discount card pro-
ponents say will provide 10 to 25 percent
off prescription drugs.

Starting Somewhere
Grace-Marie Turner, president of the Galen
Institute, sees the new Medicare measure as
the beginning of reform. “Changes to major
programs and systems evolve over time. We
must start somewhere. While the compro-
mise agreement falls short of overall mod-
erization, it contains important features to
set consumer-friendly initiatives in motion.
This is a starting place for reform.”

Congressional supporters of the bill, like
Senator Dianne Feinstein (D-California),
said it was “better than no bill at all” and
hailed the vote as a victory for senior citizens.
Advocates say the bill will help lead to bet-
er coverage for seniors. But the measure’s
opponents disagree.

“I was struck by how vacant the gal-
leries were and so few seniors citizens look-
ing down,” said Senator Tom Daschle (D-
South Dakota) after the vote. “What you saw
instead were lobbyists packing the halls.
They will do well. Our seniors will not, and
that is why the fight will go on.”

The reform measure’s opponents say it
wastes taxpayer funds, bloats the federal
budget, and effectively moves more respon-

sibility toward the government and away
from individuals.

Sen. Barbara Mikulski (D-Maryland) said
senators had “squandered the opportunity
to truly change history and to truly change
the lives of senior citizens” by providing them
with “a skimpy benefit.”

Escalating Costs
Other observers agreed with Mikulski’s
opposition to the bill, but hardly considered
the measure “skimpy.”

Noted Brian Riedl and William Beach of
The Heritage Foundation. “The Medicare
debate has focused almost exclusively on
what form of drug benefit to provide to senior
citizens. Loet in the debate is what the huge
new unfunded liability implicit in the drug
legislation would mean to American tax-
payers. There are no free lunches, and future
taxpayers will have to pick up the commit-
ment to senior citizens.”

Based on research they conducted for
Heritage, Riedl and Beach warn, “The 10-
year cost estimates performed by the Con-
gressional Budget Office (CBO) do not
capture the substantial cost that will like-
ly be felt by taxpayers in 15, 20, and 30
years.”

Like the CBO, Riedl and Beach estimate
the Medicare reform measure would cost
approximately $400 billion over the next 10
years. Yet costs accelerate tremendously
beyond the 10-year budgeting window, they
note. In the following 10 years, from 2014
through 2023, the drug benefit is projected
to cost $772 billion. That rapid growth rate
continues through 2030.

“Lawmakers who voted for the Medicare
drug benefit are voting for a $2 trillion tax
increase [over 30 years],” they concluded.
“Responsible lawmakers who oppose such
substantial tax increases should look beyond
the 2004 election and examine the burden
that a Medicare drug benefit will impose on
future generations.”

Shifting Responsibility
Economist Bruce Bartlett of the National
Center for Policy Analysis also objected to
the Medicare reform bill, but for a different
reason: The measure represents yet anoth-
er transfer of responsibility from the indi-
vidual to the government.

“As the government takes over all aspects
of care for the elderly, their children are
relieved of personal responsibility,” explained
Bartlett. “The Medicare drug bill that has
just passed Congress will be a kind of tax cut
for those who would otherwise have had to
pay for their parents’ prescription drugs.
Indeed, the Roosevelt administration origi-
nally sold Social Security to the young exact-
ly this way.”

Today, Social Security and Medicare are
two of the largest programs in the federal
budget.

Two key Senate Democrats—Presidential
candidates John Kerry (D-Massachusetts) and
Joe Lieberman (D-Connecticut)—did not
vote on the reform bill. Lieberman’s press
secretary, Jarro Cabrera, said the senator left
for a campaign stop in Arizona after it became “ultimately clear the bill was head-
ing toward passage.”

In a written statement, Kerry said he fought “tooth and nail against this special
interest giveaway,” but returned to the cam-
paign trail once he decided his vote would
not make a difference.

The U.S. House of Representatives had
passed the bill on November 22, three days
before the Senate vote, by a 220-215 margin.

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What Exactly Is Medicare?
by John Berthoud

Medicare was established in 1965 to
provide health care insurance to
individuals age 65 and over. The pro-
gram was expanded over the years to
include disabled individuals as well.
Today, Medicare covers more than 40
million Americans and is the nation’s
largest health insurance program.

Medicare consists of two parts.
Part A, Hospital Insurance (HI), cov-
ers hospital, some home health care,
services delivered at a skilled nurs-
facility, and hospice care expens-
es. HI is financed primarily by pay-
roll taxes.

Medicare Part B, Supplementary
Medical Insurance (SMI), covers
physician, outpatient hospital, and
other certain home health expenses.
SMI is financed primarily by trans-
fers of money from the general fund of
the U.S. Treasury, and also by the
collection of monthly premiums.

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Congress Shows Little Interest in Budget-Cutting Measures

by John Berthoud

A ccording to the latest BillTally study released in late November by the National Taxpayers Union Foundation (NTUF), just 26 members of the 107th Congress had 2002-2003 legislative agendas that would reduce overall federal spending. By contrast, 32 lawmakers sought to raise the federal budget by more than $1 trillion—the most lopsided margin against budget-cutters in BillTally’s 12-year history.

“Taxpayers hoping to see federal spending restraint will be disappointed to learn that the 107th Congress took a long holiday from this task,” said NTUF senior policy analyst and study author Demian Brady.

“There is indeed a difference between Republicans and Democrats: One party proposes bigger government, while the other party proposes much bigger government.”

DEMIAN BRADY
NATIONAL TAXPAYERS UNION FOUNDATION

Brady. “When special interests knocked on Congress’s door asking for tax-funded treats, most lawmakers were willing to oblige even when it wasn’t Halloween.”

As Stephen Moore of the Club for Growth recounted in an article for the Washington Times, “Where is the fiscal outrage?” Moore blamed “the recent spending trends of fiscal conservatives” in both parties who at one time could be relied on to keep Congress in check. “This year [2003] was one of the worst years for fiscal conservatives in many moons,” wrote Moore. “The federal budget grew by more than $150 billion—more than twice as much as any year that Bill Clinton was in the White House—and deficit spending eclipsed $300 billion, a 10-year high.”

And it all took place with the GOP firmly ensconced at both ends of Pennsylvania Avenue. The White House gets some of the blame for allowing Congress to break the bank. “George Bush doesn’t really have an anti-Big Government bone in his body,” said Moore. “Compassionate conservatism means never having to say no.”

“The results of sponsorship records during the 107th Congress show that there is indeed a difference between Republicans and Democrats: One party proposes bigger government, while the other party proposes much bigger government,” Brady concluded. “For taxpayers who prefer prudence to profligacy, reversing this trend will remain their top concern.”

BillTally is a cost accounting system that computes a net annual agenda for each Member of Congress and has done so since 1991. The results are based on each Member’s individual sponsorship and cosponsorship of pending legislation. The study offers a unique look at the fiscal behavior of lawmakers, free from the influence of committees, party leaders, and rules influencing floor votes.

All cost estimates for bills are obtained from third-party sources or calculated from neutral data. Within the 107th Congress, BillTally identified a record-high number of bills as having a fiscal impact of at least $1 million—1,186 measures in the House and 851 in the Senate. Among Brady’s findings:

- A record-low 26 Representatives sponsored bills that, if enacted all at once, would reduce federal spending; not a single Senator had a net budget-cutting agenda. As recently as the 104th Congress, a comfortable majority in both chambers could claim to sponsor net spending reductions.

- For the first time ever, BillTally found individual Representatives (32 in all) who would raise federal spending by at least $1 trillion (50 percent of current outlays) annually. The House average was $222.9 billion, while the average Senator would boost the budget by $92.9 billion per year.

- In the House, nearly 24 bills to increase federal spending were introduced for every bill to cut spending. In the Senate the ratio was 36:1, while the combined total for both chambers was 28:1.

- House Democrats called for an average of $417.6 billion in new spending, nearly 13 times more than House Republicans ($32.3 billion). Annualized over 10 years, that level of increase ($4.2 trillion) is more than twice the size of the tax cut alone in 2001 and 2003 combined ($1.7 trillion).

- Both political parties in the House proposed agendas that were seven times higher than their average 106th Congress totals. In the Senate, the spending gap was only somewhat narrower ($150.9 billion for Democrats vs. $34.2 billion for Republicans).

NTUF is the research affiliate of the 350,000-member National Taxpayers Union.

John Berthoud is president of the National Taxpayers Union and National Taxpayers Union Foundation. His email address is ntu@ntu.org.

GOP Abandons Conservatives

by Hon. Ron Paul

T he Medicare prescription drug bill passed by Congress in late November may prove to be a watered-down event for political conservatives in America.

This latest expansion of the federal government, potentially the largest in our nation’s history, is firmly in keeping with the failed New Deal and Great Society programs of the far left. This leaves true conservatives, who believe strongly in limited government and identify with the Goldwater-era Republican party, wondering whether they still have a political home in the modern GOP.

The Bush administration, aided by a Republican Congress, has increased spending more in three years than the previous administration did in eight. Federal spending has grown by more than 25 percent since President Bush took office. The federal government now spends roughly $21,000 per household every year, up from $16,000 just four years ago.

Columnists have coined the phrase “Big-Government Republicans” to describe the current crop of lawmakers who support the White House, Senate, and House of Representatives. Many of the President’s closest advisors are Big-Government Republicans, former leftists who have no qualms about spending huge amounts of money both at home and abroad to achieve supposedly conservative ends.

The irony is that conservatives suffered through decades of Democratic control of Congress, always believing that liberals were to blame for the relentless growth of the federal government. When Republicans finally took control of Congress in 1994, many saw an opportunity for a real conservative revolution. But first, conservatives were told, the Democratic administration had to be removed.

In the meantime, spending continued unabated throughout the 1990s. When Republicans won the White House in 2000, another opportunity seemed at hand. The Senate, however, was still in Democratic hands—the last possible GOP scapegoat.

Finally, in 2002 the GOP took control of the Senate and increased its majority in the U.S. House. Surely this was the moment conservatives had been waiting for! Yet the past year has seen more spending than ever, including the disastrous Medicare bill that will cost trillions over coming decades. The latest line is that the GOP needs a filibuster-proof Senate of 60 Republicans, and then, finally, the party can begin to implement a conservative agenda.

When does the conservative base of the GOP, a base that remains firmly committed to the principle of limited government, finally demand new leadership and a return to conservative values? Will conservatives abandon the party when they realize the GOP, at least under its current leadership, is simply not interested in reducing the size and scope of the federal government?

With Republicans controlling the administration and the legislature, and nominally controlling the Supreme Court, the party has run out of other people to blame. Republicans who support bigger entitlement programs and bigger federal budgets have lost all credibility as advocates for limited government.

Ron Paul, M.D., represents the 14th District of Texas in the U.S. House of Representatives. This is a reprint of his December 1, 2003 “Texas Straight Talk” column, edited for length. Paul’s columns are available online at http://www.house.gov/ paul/tst/welcome.htm
Social Security
Continued from page 1

Security payroll tax."

As we just learned with Medicare, however, the devil will be in the details of getting such a program through the Congress," warned Kemp. "The devil in this case is a zero-sum mind set among many members of Congress from both parties who believe to their very core that Social Security reform is fundamentally about cutting future benefits for retirees and raising payroll taxes on workers."

According to the SSA Web site, benefit cuts may be needed to keep the current system solvent. "If benefits were reduced to meet the shortfall in revenue for the (Social Security) program, the reduction would need to be 27 percent starting with the exhaustion of the Trust Fund in 2042 and would rise to 35 percent for 2077." SSA Chief Actuary Gross confirmed those figures.

One alternative to benefit cuts would be a tax hike. According to the SSA Web site, "If additional revenue were provided beginning in 2042, revenue equivalent to a payroll tax rate increase of about 0.9 percent (from 12.4 percent under current law to about 13.3 percent) would be needed for the year. The additional revenue needed for 2043 would be equivalent to a payroll tax rate increase of about 4.6 percent for the year. Therefore, the amount of additional revenue needed would gradually rise, reaching an amount equivalent to an increase in the payroll tax rate of about 6.5 percent for 2077 (or more than 50 percent higher than today’s rate)."

A Better Plan
Ferrara offers a third alternative: neither benefit cuts nor tax hikes, but instead a partial privatization of Social Security.

According to the SSA memo, here’s how the Ferrara plan would work.

■ Starting in 2005, all workers who will reach their 55th birthday on or after January 1, 2005 will have the option to enroll in the personal account plan.
■ Enrollees with earnings in Social Security-covered employment will have a portion of their payroll tax contribution redirected from the Trust Fund to an individual account. The progressive scale for contributions redirected from the Trust Fund is estimated to amount to about 6.4 percentage points of the 12.4 percent payroll tax rate on average.
■ Benefits withdrawn from the accounts would substitute for a portion of benefits otherwise promised by Social Security.
■ The government would provide a safe-net guaranteeing each individual no less than the actual amount of money he or she was taxed from his or her earnings by the SSA. That would parallel the Federal Deposit Insurance program, which insures up to $100,000 of an individual’s savings in an FDIC bank.
■ Disability or survivor benefits guaranteed by the current system would not be changed.

Gross’s staff at SSA concluded that the Ferrara plan, assuming conservative returns on individual accounts, would support all benefit obligations by 2055 and eliminate the deficits of the current program. The Social Security Trust Fund would never fall below $1.38 trillion, enough to fund 145 percent of a single year’s obligations. That is well in excess of the Social Security standard for solvency, which is based on 100 percent of annual obligations.

Everyone who crunched Ferrara’s numbers agreed that by 2055, his plan would allow Social Security payroll taxes to be reduced. If the Ferrara program were launched in 2005, by 2080, the tax rate could fall from 12.4 percent to 9.9 percent.

“Under the plan specifications described [by Ferrara] the Social Security program would be expected to be solvent and to meet its benefit obligations throughout the long range period 2003 through 2077 and beyond.”

STEVE GROSS, CHIEF ACTUARY
SOCIAL SECURITY ADMINISTRATION

Looking for an outstanding speaker?

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Merrill Matthews Jr., Ph.D., is a Heartland Senior Fellow specializing in health care policy and director of the Council for Affordable Health Insurance. Dr. Matthews is past president of the Health Economics Roundtable for the National Association for Business Economics, the largest trade association of business economists, and health policy advisor to the American Legislative Exchange Council, a bipartisan association of state legislators.

Engagements are scheduled on a “first come, first served” basis, so call 312/377-4000 today to schedule Dr. Merrill Matthews to keynote your next event!
Taxpayer Group Blasts Effort to Kill Internet Tax Moratorium

by Jonathan Collegio

The U.S. Senate adjourned for the year without voting on S. 150, the Internet Tax Non-Discrimination Act. Noting Internet taxes impose an “immense burden” on the economy, Americans for Tax Reform (ATR) strongly opposed the efforts of two Senators to kill S. 150 and allow states to tax the Internet.

“Now that Senators Lamar Alexander and George Voinovich have succeeded in killing the moratorium on Internet taxes, clearly the Senators are more concerned about protecting the Internal Revenue Service from being a source of revenue than protecting the taxpayer,” said Grover Norquist, president of ATR. “Their actions are preventing the permanent elimination of taxes on Internet access, double-taxation of a product or service on the Internet, and discriminatory taxes that treat Internet purchases differently from other types of purchases.”

According to the Toledo Blade, “George Voinovich (R-Ohio) told the Congress to pass a compromise that would extend the moratorium on Internet taxes without further devastating the already cash-strapped budgets of states and localities.”

Under the Voinovich proposal, the five-year-old moratorium on Internet taxes, which expired November 1, would be extended for another two years—and not banned permanently. The compromise stalled, as did the original bill.

The compromise was a direct effort to block legislation, recently passed by the U.S. House of Representatives, that would permanently ban states and localities from imposing Internet taxes. Supper.
“Kansas SchoolFinance History

Key Dates in Kansas School Finance History

November 8, 1966
Voters approve a constitutional amendment establishing a 10-member State Board of Education with “general supervision” over public schools, with the legislature required to “make suitable provision for finance of the educational interests of the state.”

September 10, 1990
Officials with 31 school districts file a lawsuit challenging the legality of the state’s school finance formula, saying they receive less than a proportionate share of the funding for elementary and secondary education.

October 14, 1991
Shawnee County District Court Judge Terry Bullock issues a pretrial opinion finding the state’s school finance formula unconstitutional.

May 5, 1992
Legislators approve a new school finance formula, providing money on a per-pupil basis.

December 2, 1994
The Kansas Supreme Court upholds the constitutionality of the school finance formula.

May 21, 1999
Administrators and parents of students in the Salina and Dodge City school districts file state and federal lawsuits, claiming the finance formula is unconstitutional and violates the equal protection rights of minority and poor students.

November 21, 2001
Bullock dismisses the lawsuit.

January 24, 2003
The Kansas Supreme Court reverses Bullock’s decision to dismiss the case, ordering a trial in Shawnee County District Court.

September 22-October 1, 2003
Bullock hears testimony and closing arguments in the school finance lawsuit.

December 2, 2003
Bullock issues preliminary order saying the state’s school finance formula is unconstitutional.

January 12, 2004
Start of 2004 legislative session.

July 1, 2004
Deadline imposed by judge Bullock for fixing the school finance formula, and the start of the state’s 2005 fiscal year.

Source: Dodge City Daily Globe Online

Even before Judge Terry Bullock’s ruling (right), Kansas Governor Kathleen Sebelius (above) had been floating sales tax hike proposals of varying sizes around the capitol informally with legislators.

Kansas

Continued from page 1

said the “unequal disbursement of education funds in Kansas was a blatant violation of state and federal constitutional provisions.”

George Petersen, taxpayer advocate for the Kansas Taxpayers Network, called Bullock’s ruling “judicial nonsense.”

“Bullock basically overruled himself,” Petersen said, “since he dismissed a similar lawsuit in his court in 1992. This decision means Kansas will follow in the footsteps of Nevada, which in 2003 also faced a judge trying to usurp legislative and executive authority.”

Tax Hike on the Horizon

House Speaker Doug Mays, a Topeka Republican, said complying with the judge’s order would mean a tax increase so big it “would be a crushing blow to the economy of this state and would send us into a death spiral.”

Mays told the Journal-World that, despite the judge’s order, there would be no such tax increase, because all legislative seats would be up for election in 2004.

“I know that is distasteful to some, but that’s reality,” Mays said. “The votes are not there for a tax increase.”

In addition, Mays said, the legislature cannot be ram-rodded by a judge on school finance, a subject he described as complex. “We need to take our time and do what’s right for the children of Kansas,” he said.

The state already spends $2.6 billion, about 52 percent of its total annual budget, to educate nearly 445,000 students. Total state, local, and federal funding for the state’s K-12 government schools is now approaching $4 billion.

A $1 billion increase would require a tax increase equivalent to a 3 cents increase in the state sales tax, a 250 percent hike in the statewide property tax, a 50 percent hike in income taxes, or significant budget cuts. For a family of four, the tax hike would reach nearly $1,500.”

Sign of Things to Come

Kerr also said the order wasn’t realistic. “This judge is not the final authority on this or any other issue.”

Because Bullock’s decision was a “preliminary order,” it wasn’t clear whether the state could appeal immediately, or would have to wait until a final order is issued. Governor Kathleen Sebelius said she would propose a school finance measure in January, regardless of the status of Bullock’s ruling.

“The governor is committed to ensuring that all Kansas children have the best possible educational opportunities,” Sebelius spokesman Nicole Corcoran said. Even before Bullock’s ruling, Sebelius had been floating sales tax hike proposals of varying sizes around the capitol informally with legislators.

In late 1991, Bullock issued a similar ruling, and the legislature responded by passing the largest tax hike in state history, raising personal and corporate income taxes as well as the state’s sales tax rate. At that time, Kansas had a Democratic governor, a narrowly Democratic House of Representatives, and a narrowly Republican Senate.

In 1992 there was a major swing of seats from Democratic to Republican in both houses that continued with the 1994 election. In 1994 Kansas elected a GOP governor who campaigned as a fiscal conservative.

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When former Commissioner Charles Rossotti left office a year ago, he advised Congress that in order for the IRS to return to pre-1998 enforcement levels, the agency would require annual budget increases of about 2 percent per year for the next five years.

NEA
Continued from page 1

that they will go out the same way they did in 1999 and that is having the NEA have a clean bill of health.”

Unreported Political Expenditures
According to Landmark, the investigation into the union’s political expenditures was initiated by its filing of complaints with the IRS, starting in 2000, documenting tens of millions of dollars in political expenditures that have not been reported on the union’s tax returns over the last several years.

“I think Mr. Weaver’s confidence in the NEA getting a clean bill of health may be a case of whistling through a graveyard,” explained Landmark President Mark R. Levin. “We provided the IRS with a chapter and verse road map into the union’s political expenditures. It appears that the NEA may finally be called to account for its failure to tell the government—and its members—how much it is spending on politics.”

“We provided the IRS with a chapter and verse road map into the union’s political expenditures. It appears that the NEA may finally be called to account for its failure to tell the government—and its members—how much it is spending on politics.”

MARK R. LEVIN
LANDMARK LEGAL FOUNDATION

more than $75 million each year on political activities, money many experts say should be accounted for.

Krista Kafer, an education analyst at The Heritage Foundation, isn’t surprised by the IRS’s pending investigation. “The NEA has been spending millions and millions of dollars on politics, but claiming that they’re not spending anything out of their general funds for these kinds of things,” she said. Kafer added that NEA money primarily backs liberal candidates and causes. “It is frustrating, particularly to those who are forced to pay union dues in non-right-to-work states, that their money is going to these kinds of activities,” she explained.

The NEA regularly claims it spends nothing from its general revenues on political activities, according to Landmark documents. Yet the NEA spends

money primarily backs liberal candidates and causes. “It is frustrating, particularly to those who are forced to pay union dues in non-right-to-work states, that their money is going to these kinds of activities,” she explained.

Focus on the Family, a Christian ministry based in Colorado, notes the controversy is not over the NEA spending its dues money on politics—that practice is legal. At issue is whether the NEA is getting its request is more than a billion dollars greater than the 2004 request, and most of the new money would go to fund law enforcement projects, including the hiring of 5,000 additional employees.

When former Commissioner Charles Rossotti left office a year ago, he advised Congress that in order for the IRS to return to pre-1998 enforcement levels, the agency would require annual budget increases of about 2 percent per year for the next five years. Under the most recent budget request, the agency’s bankroll would grow by a whopping 12 percent over the 2004 figure.

Assuming Congress authorizes the 2004 budget request, expect unprecedented enforcement in the following five key areas.

- Increased audits of small businesses
- For years, the IRS has been concerned that partnerships and small business corporations (so-called S corporations) may not be reporting all their income. The IRS began a program two years ago to target small businesses for audit to ensure they’re reporting everything. With new enforcement funds, the agency expects to increase the number of small business audits by 110 percent in 2004.
- More attacks on non-filers. The IRS’s known inventory of tax return non-filers is 6.8 million. For obvious reasons, it is unable to target all these people for enforcement action. However, by earmarking $3.6 million to the program and increasing its staff, the IRS expects to contact an additional 1.6 million non-filers in 2004. Through this process, the IRS expects to make $74 million in new tax assessments.
- Increased scrutiny of W-4 Forms. Form W-4, Employees Withholding Allowance Certificate, is the form employees file with their employers to set wage withholding. Many non-filers inflate their allowances in order to stop wage withholding. The IRS intends to increase the use of its Questionable W-4 Program to intercept the bogus forms. Under the program, the IRS sends a letter to those whose W-4s (turned into the IRS by one’s employer) fail outside acceptable parameters. The letter demands the form be corrected or the IRS will impose penalties and instruct the employer to disregard the W-4 and withhold at the highest level. The agency’s goal is to use the Questionable W-4 Program to identify new non-filers and enforce collection against those already in its case inventory.
- Targeting under-reporters. An under-reporter is one who failed to claim all income. The IRS uses several different methods to unearth under-reporters and currently, there are approximately 5 million cases in inventory. By increasing its staff assigned to those cases, the IRS intends to step up the attention given them and thereby create $98 million in additional tax assessments in 2004. In 2002, the agency increased its contact with these people by 36 percent over 2001 levels. This is the area under which the NEA case falls.

**Tax Law Discourages Companies from “Bringing Home” Foreign Income**

by Stephen J. Entin

The United States has the second highest corporate tax rate in the 30-member Organization for Economic Cooperation and Development (OECD). The result is that foreign earnings by U.S. multinational corporations face higher add-on U.S. taxes if the income is "repatriated," or brought home.

Firms are reluctant to bring home profits to the extent that their income is protected by foreign tax credits. Those credits are getting scarcer, because, over time, foreign countries have reduced their corporate tax rates. This is poor economic and tax policy, putting up barriers to the free flow of capital and discouraging investment in the United States.

**Recent Legislation**

On October 1, the Senate Finance Committee reported out a bill (S. 1637) to repeal the Extraterritorial Income deduction (ETI) that was ruled illegal by the World Trade Organization (WTO). On October 15, the House Ways and Means Committee approved its own version (H.R. 2896). Both bills use the revenue from repealing the deduction to reduce business taxes. (ETI replaced the old Foreign Sales Corporation (FSC) export subsidy that also ran afoul of the WTO.)

The Senate ETI bill includes a variant of the "Homeland Investment Act," which would temporarily allow U.S. multinational corporations to repatriate foreign profits at a reduced tax rate of 5.25 percent on dividends paid by a foreign subsidiary to its U.S. parent. The Ways and Means Committee considered a similar provision with a 7 percent tax rate, but dropped it to trim costs.

**Corporate Income Subject to Foreign Taxes**

These special tax rates may seem low compared to the U.S. corporate tax rate of 35 percent, but most foreign-source corporate income is subject to foreign income taxes. The foreign tax credit reduces the residual U.S. tax to low single digits (about 3.7 percent in 1999 according to IRS data).

Some companies, however, have exhausted their foreign tax credits, or cannot access them due to various restrictions on their use, and leave substantial earnings abroad to avoid the full U.S. tax. Luring that income home, even at a reduced tax rate, would raise revenue.

A study by JP Morgan Securities concluded that about $300 billion of "trapped" foreign-source past profits might be repatriated under the Homeland provision, increasing investment spending in the United States and raising GDP by half a percentage point.

That is more than $50 billion a year in added U.S. output and income, on which the federal tax take would run about $10 to $12 billion a year. That tax feedback may seem like a small number, but it annually dwarfs the projected 10-year revenue loss. Altering only, it is more than 25 percent of the projected annual federal subsidy of the prescription drug benefits under the Medicare reform measure signed in December by President George W. Bush.

**Better than the Alternative**

Tax economists may dispute such investment gains, pointing out that “money is fungible” and there are already ways to tap unrepatirated profits without paying U.S. tax.

For example, a firm could deposit the profits in a foreign branch of a multinational bank as proof of creditworthiness and use the bank's working capital of debt. Alternatively, a firm with subsidiaries in both low-tax and high-tax foreign countries could repatriate all proceeds from the high-tax country, and then replenish that subsidiary's working capital with a transfer of unrepatirated earnings from the low-tax country subsidiary.

In the real world, however, such arrangements have costs. The offsetting deposit's higher interest rate for added risk. The high- and low-tax country gambit requires the company to maintain operations in a high-tax jurisdiction that it might prefer to avoid. With net-of-tax real interest on capital on the order of 3 percent, even a fraction of a percent of added cost can cut the value of a potential investment by enough to kill it.

**Government Provisions and Scores**

The repatriation provision would lower the cost of obtaining funds to invest in the United States. Therefore, although the net increase in domestic investment might not match the cost for dollar the amounts projected in the JP Morgan study, the increase in investment would not be negligible.

The Joint Tax Committee scored the Homeland Investment Act (similar to the Senate provision) as costing about $4.4 billion over 10 years, on a static basis. Initially, the bill is shown to raise revenue as the repatriated money is subject to tax. That effect—a modest revenue increase—is quite obvious and straightforward, and is probably the true “static” revenue result of the bill.

However, the analysis goes on to assume that, in later years, the bill would cost more revenue than it first brought in, due entirely to the assumption that it would give firms hope for another amnesty in later years, causing them to delay future taxable repatriations.

That assumption of future losses is pure speculation and highly suspect. Significant future repatriations in excess of amounts protected by the foreign tax credit are highly unlikely to occur, especially if there is a residual U.S. tax, because investment opportunities are rising abroad.

China, with a fifth of the planet’s population and heavily under-capitalized, is growing at about 7 percent a year. Russia, with a flat tax and huge natural resources, has just achieved “investment grade” according to Standard and Poor's. India is liberalizing and is becoming a major high-tech powerhouse.

Much of the rest of Asia and Latin America is also moving toward free-market economies, and will be growing apace.

If this progress continues, these regions could profitably absorb all the future foreign profits of U.S. multinational companies for decades.

**Improving U.S. Tax Policy**

The repatriation proposal improves tax policy in that it moves, if only briefly, in the direction of a territorial tax. Under a territorial income tax, the United States would tax income earned here, and leave foreign-source income to be taxed by the countries in which it is earned.

That is the system generally used by other countries. It would be easier to enforce, requiring no tracking of foreign activity and no foreign tax credit. It would make American companies more competitive abroad and boost exports from U.S. suppliers to U.S. foreign subsidiaries.

But that's for a future reform bill. Meanwhile, the repatriation proposal would probably raise U.S. tax revenue by shifting income to the U.S. and boosting domestic investment and GDP.

Stephen J. Entin is president and executive director of the Washington, DC-based Institute for Research on the Economics of Taxation (IRET). A longer version of this essay was first published by IRET as Congressional Advisory 162 on October 31, 2003 and is available at http://www.iret.org. Entin's email address is sentin@iret.org.
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