Bush Tax Reform Agenda Begins to Take Shape

President George W. Bush has pledged to work in his second term for tax reform that may include a flat tax or national retail sales tax.

U.S. Lags Behind Rest of World in Corporate Tax Reform

As global economic competition has heated up, many other nations have cut their corporate tax rates, but the United States has lagged on reforms. Congress passed a corporate tax bill in 2004, but it did not cut taxes nor reform the tax code substantially. Today the U.S. has the second-highest corporate tax rate in the 30-nation Organization for Economic Cooperation and Development (OECD). The U.S. corporate rate is 40 percent, including the 35 percent

Illinois Study Questions SSTP

Supporters of a plan to require out-of-state retailers to collect sales tax from Illinois customers to send back to Illinois say the state and local governments could gain $500 million of revenue, but a report by a Chicago-based government research group says the state stands to lose $295 million.

On October 18, The Civic Federation, a nonpartisan organization that focuses its activities on the Chicago region, issued “The Potential Impact of the SSTP p. 13

Utah Voters Reject Tax Hike for Open Space

Despite being outspent by a 40-1 margin, opponents of Utah’s Initiative 1 carried the day November 2, as voters rejected tax and debt increases for the “open space” proposal.

Initiative 1 lost by a 55 to 45 percent vote. If it had passed, the state sales tax would have been increased by 1/20th of a cent to fund a $150 million bond that would have paid for open space preservation and other activities, including construction of convention centers and other buildings.

The initiative, sponsored by Utahns

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Montana Senators Named Porkers of the Month for Drought-Relief Votes

by Tom Finnigan

The taxpayer group Citizens Against Government Waste (CAGW) named U.S. Senators Max Baucus (D-MT) and Conrad Burns (R-MT) its October Porkers of the Month for tripping up the fiscal 2005 homeland security bill by adding $3 billion for spending unrelated to terrorism or national defense. The farm-state senators added a $3 billion drought-relief package to the Senate version of the homeland security appropriations bill (S. 2437), accounting for nearly 10 percent of the bill’s total cost. Because there previously were few differences between the two chambers’ versions, the last-minute insertion of drought relief prolonged congressional negotiations and delayed essential funding for homeland security.

Political Considerations Reigned

The drought-relief package was aimed at Midwestern and Great Plains states with hotly contested congressional races. Despite the fiscal 2004 record deficit and the 2004 election, the farm-state senators added a $3 billion drought-relief package to the Senate version of the homeland security appropriations bill (S. 2437), accounting for nearly 10 percent of the bill’s total cost. Because there previously were few differences between the two chambers’ versions, the last-minute insertion of drought relief prolonged congressional negotiations and delayed essential funding for homeland security.


Farming Highly Subsidized

Farming is already one of the most subsidized professions in America, according to Schatz. The $180 billion farm bill passed in 2002 was the most generous in history and included money for drought-relief programs. Most farm aid goes to large farms and agribusinesses. The top 10 percent of recipients received 65 percent of all farm subsidies in 2002, Schatz said. They have the financial ability to prepare for and adjust to revenue shortfalls just like any other business, without begging for government handouts every time the weather changes, he said.

Even more outrageous, said Schatz, is that the drought “emergency” relief covers losses incurred in 2003, casting doubt on statements that the problem is as urgent as hurricane recovery. In addition, Schatz argued, drought relief has nothing to do with homeland security, whereas hurricane damage does indeed pose some security risks, and should not get wrapped up in the essential task of defending the homeland from terrorists.

For elevating home-state politics above homeland security and ignoring the deficit, Citizens Against Government Waste designated Baucus and Burns as Porkers of the Month for October 2004.
Three NY Legislators Ace New “Vote for Jobs Index”

by Matthew Maguire

Only three of New York’s 210 state legislators received a grade of A on a new “Vote for Jobs Index” developed by The Business Council of New York State.

Sixty-three legislators earned a B; 132 received a C; and 12 earned a D. No legislator received a grade of F.

“Only three of New York’s 210 state legislators received a grade of A [on the index] ... Sixty-three legislators earned a B; 132 received a C; and 12 earned a D. No legislator received a grade of F.”

New York State Senators (from left to right) James Wright, Joseph Bruno, and Raymond Meier received A grades on a new pro-jobs vote index.

The Vote for Jobs Index is based on bills in five priority areas: taxes, energy, environment, economic development, and employee benefits. Legislators’ scores ranged from a high of +19 to a low of -8 on a scale from a high of +21 (which could be earned with a favorable vote on all bills) and a low of -21. That range was divided into fifths, each of which was the basis for a letter grade:

- A (for scores of +21 to +13)
- B (scores of +12 to +4)
- C (scores of +3 to -5)
- D (scores of -6 to -14)
- F (scores of -15 to -21)

Legislators earned points for votes consistent with, and lost points for votes at odds with, the council’s position. Additional points could be awarded to (or taken away from) legislators who sponsored and championed bills of interest to the council. A legislator who had no record on a priority issue received a 0 on that issue. The 0 rating was meant to address the fact that many priority issues are never considered because relevant bills are not allowed to the floor for a vote.

The three grades of A went to Sen. James Wright (R-Watertown), Senate Majority Leader Joseph Bruno (R-Rensselaer County), and Sen. Raymond Meier (R-Utica). Assembly scores tended to be lower than Senate members’ scores because many priority bills never made it to the floor of the Assembly, and the members therefore could not earn (or lose) points by voting on them. In addition, more bills the council judged anti-business were taken up by the Assembly.

The council’s board of directors recently voted to produce and publish information on legislators’ achievements or failures on measures to improve New York’s business climate. The initiative, the first of its kind by the council, was developed in response to the council’s 2003 survey of members.

Matthew Maguire (matthew.maguire@bcnys.org) is director of communications for The Business Council of New York State, Inc.

New York Teacher Union Punishes Lawmakers Who Backed Budget Cuts

by Steve Stanek

Twenty-six Republican state lawmakers backed New York Governor George Pataki’s (R) veto of $1 billion of education spending last year, and this year they paid for their support by losing the backing of New York State United Teachers (NYSUT), the state’s largest teacher union.

The union had endorsed all 26 of the lawmakers in 2002 but withdrew its endorsement this year. Only two of the lawmakers, however, lost their reelection bid on November 2.

Pataki had vetoed 119 budget items in 2003, and every one of the vetoes was overridden. Government employees were strong supporters of the overrides, said Edward Scharfenberger, chairman of the Warwick Taxpayers Association, a taxpayer rights advocacy group in Warwick, New York.

“Government workers have a lot of clout here,” he said, “the teachers especially. There are 721 school districts in New York. They were out to knock all these people out of the Assembly.”

“The union represents more than 500,000 of the state’s public school teachers. In August, union officials announced they would drop their endorsement of the lawmakers who supported Pataki’s veto.

“NYSUT supports candidates who support the issues our members care about,” NYSUT President Thomas Y. Hobart, Jr., said in a statement on August 5. “In NYSUT’s history, there has perhaps been no bigger vote than last year’s override of the governor’s veto of increased funding for public education. These Assembly Republicans made a choice to put their own political interests ahead of New York’s children. They chose to cut education and raise local property taxes. They have not earned our endorsement.”

“Government workers have a lot of clout here, the teachers especially. There are 721 school districts in New York. They were out to knock all these people out of the Assembly.”

EDWARD SCHArFENBERGER, CHAIRMAN WARRICK TAXPAYERS ASSOCIATION

Lauded As Courageous

Scharfenberger views the actions of the 26 Republicans much differently. He said they “courageously” put the interests of New York’s taxpayers ahead of their own political interests.

“It took no small amount of courage for the 26 Republican members of the Assembly to vote against the override of the governor’s veto of drastic increases in spending for public education,” Scharfenberger said.

In an October 13 letter to Assembly Minority Leader Charles Nesbitt (R-Albion), who was among those who supported Pataki’s veto and lost the teacher union endorsement, Scharfenberger said, “it should come as no surprise” that the teacher union called for the defeat of every Assembly member who supported the veto.

“After all, the public education system, as we now know it, is nothing less than an adjunct of the Democrat Party, and a cash cow for the teacher unionists who run the schools and exploit the children for their own benefit,” Scharfenberger said.

Despite the union’s opposition, Nesbitt won reelection.

Battle Brewing Over Vouchers

Scharfenberger sees another battle brewing between public school teachers and fed-up taxpayers in New York. In October, the state’s seven Roman Catholic bishops announced they were no longer backing a proposal for a voucher program to help parents pay for tuition at private and parochial schools. Instead, the bishops threw their support to the Freedom of Education Act, versions of which are pending in state Senate and Assembly committees.

The Freedom of Education Act would provide tax credits to parents who send their children to private or parochial schools. Scharfenberger said the Warwick Taxpayers Association prefers tax credits over vouchers because a tax credit means a person simply deducts the cost of tuition from his tax bill. A voucher is a tuition reimbursement that comes from the government, funded by taxes that already have been collected.

“In the case of vouchers, payments come from a government entity, reinforcing the idea of collective responsibility,” Scharfenberger said. “In the case of tax credits, the taxpayer keeps the money in the first place, reinforcing the idea of personal responsibility, which I favor.”

Scharfenberger said the teacher union opposes both vouchers and tax credits, because such programs weaken the power of unions and the public school establishment.

“By increasing the number of tuition-supported students, we decrease the number of students in government schools and reduce the need for public school teachers and union dues,” Scharfenberger said. “When you reduce dues and the number of teachers, you lessen the power of teacher unions.”

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.
New York Has Nation's Second-Highest Public Employee Payroll, Study Finds

by Matthew Maguire

New York's state and local governments pay public employees more than any state except California, and the number of government workers compared to population is among the highest in the country, according to an analysis of U.S. Census Bureau numbers released by The Public Policy Institute of New York State.

The analysis, released in October, found the average annual pay for government workers in New York was $51,445 in 2003, the second-highest in the nation (behind only California, with its average annual pay in 2003, the second-highest $51,445 in 2003, the second-highest). "Our analysis shows that New York State agencies employed an average of 49 workers per 1,000 residents in 2003. That figure was 23 percent above the national average, according to the report.

State government employment was 13 per 1,000 residents, while the national average was 14.5 per 1,000 residents. In August 2004, a Public Policy Institute of New York State report showed upstate New York taxpayers paid as much as $6 billion more in state and local taxes than they would in an average state, partly because of the state's far above-average local government payrolls.

The report, How High is the Upstate Tax Burden and Why? found upstate New York has some 93,500 more employees than other states, which might merely match the national average ratio of local government workers to population. "This excess of more than 25 percent alone costs upstate taxpayers more than $4 billion extra a year," the report noted.

Matthew Maguire (matthew.maguire@bcnys.org) is director of communications at The Public Policy Institute of New York State.
Investment Firm “Windfall” from Social Security Privatization Won’t Happen

by David C. John

Sometimes an academic study offers much less information than it claims. And sometimes what appears to be an academic study is not a study at all.

Professor Austan Goolsbee of the University of Chicago, who has done respected work on other financial issues, has written a study that claims to prove the system of Social Security personal retirement accounts proposed by Plan II of the President’s Commission to Strengthen Social Security would result in an unprecedented “windfall” for financial services firms. Goolsbee’s study, “The Fees of Private Accounts and the Impact of Social Security Privatization on Financial Managers,” was issued by the university in September 2004.

A closer examination of the study shows it is riddled with errors, unjustified assumptions, and sensational but meaningless numbers.

Fee Level Estimate Far Too High
Goolsbee rejects the 0.3 percent annual administrative fee that the Social Security Administration (SSA) and other reputable experts use to estimate the costs of the personal retirement accounts that would be established under the Commission’s Plan II. Instead, Goolsbee claims a 0.8 percent annual fee is more appropriate. His assumption is simply wrong. Although that fee level would be appropriate for a system of individually managed accounts with a high level of personal services, this is not what the President’s Commission to Strengthen Social Security would create. Instead, the plan modeled after the Thrift Saving Plan that is offered as part of the retirement program for federal employees.

Goolsbee argues a 0.3 percent fee would cover only “individual accounts where there is little or no customer service and where individuals are not allowed to make choices about their investment mix.” But that is basically what the commission plan would create, not the sort of accounts Goolsbee envisions in his estimate. Moreover, the SSA and Congressional Budget Office have concluded that even limited accounts could in fact offer their holders some investment choices at the 0.3 percent fee level.

A 1999 study by professional fund managers at State Street Corporation, led by Bill Shipman, estimated a plan similar to the one proposed by the commission would have administrative fees around 0.3 percent. The State Street study is especially important because it estimated the costs of answering phone calls from account holders, developing the necessary computer equipment and programs, providing annual statements, and shifting between investment options.

In short, Goolsbee’s administrative cost estimates might be appropriate for one type of personal account structure, but that structure is vastly different from the one he claims to be studying.

Phantom Requirement Assumed
Goolsbee claims the commission’s Plan II requires account holders to convert their accounts from a low-cost centralized system to high-cost private management when they reach $5,000 in assets. He uses this to justify his assumption of higher fees.

But Plan II requires no such thing. Instead, it would create a low-cost, centralized system in which workers could remain throughout their careers. And while the plan recommends examining the possibility of moving to private managers, that discussion is put off for the future. And even then, a system based on Plan II would allow such a move if it proved feasible, but it would not require workers to convert their accounts.

Even if a plan allowed workers to move their personal retirement accounts to a private manager at a higher cost, only a few workers would take that opportunity. Only a few of the potential fund managers could offer higher returns, after subtracting the greater administrative fees, than the centralized system could provide. Workers who saw their earnings fall would promptly return to the centralized system.

Moreover, when retirement account holders are faced with choices and are uncertain about what to do, they usually end up doing nothing. Because workers would have to decide affirmatively to use a private funds manager and would not be moved to one automatically, most would do nothing and would therefore remain in the less expensive centralized system.

Ignored Benefits and Improved Security
Goolsbee’s calculations also ignore the benefits that would accrue from a system of personal retirement accounts. The first question that should be asked when someone talks about fees is, “What do I get for that money?”

For a younger worker, today’s Social Security offers minimal or even negative returns. A 20-year-old male can expect an ultimate annual return on his lifetime of Social Security retirement taxes of 0.85 percent, while a 20-year-old female can expect a return of 1.91 percent.

A 20-year-old male can expect an ultimate annual return on his lifetime of Social Security retirement taxes of 0.85 percent, while a 20-year-old female can expect a return of 1.91 percent.

“A 20-year-old male can expect an ultimate annual return on his lifetime of Social Security retirement taxes of 0.85 percent, while a 20-year-old female can expect a return of 1.91 percent.”

funds in part on assets they own, rather than depending solely on government promises.

In short, the better return is clearly worth even the exaggerated administrative fee Goolsbee falsely assumes. This is not a case where the funds managers will get fees for doing nothing; their activities will increase individual worker’s retirement assets.

Estimates Revenues, Not Profits
Even if Goolsbee’s $940 billion estimate of fees paid to financial firms were correct, which it is not, it is still not an estimate of profit. Instead, Goolsbee estimates gross revenues to financial managers. From that number must be subtracted the costs of keeping records on 140 million or more accounts, answering questions from account owners, providing regular statements, processing individual workers’ investment changes, doing research into investment options, making trades, etc.

Altogether, this is not a cheap proposition, and significantly, the federal government, not the financial industry, would undertake many of these administrative functions. Only a small portion of the total fees would be left for the financial industry to profit from.

The 1999 study by State Street Trust assumed that, nationally, a personal retirement account system would generate 175 million to 350 million calls a year from account owners—including 26 mil-
The Reason Foundation shows 2004 has been a banner year for privatization at the state level. A slowing economy and fewer new revenues opened the doors to more privatization as governors and legislatures across the country either expanded current initiatives or created new ones.

The Council of State Governments (CSG) conducted a national survey of state government officials to identify recent privatization trends. That survey showed a continued increase in and reliance on privatization. In addition, nearly half of the respondents noted privatization is expected to continue to increase over the next five years. The major factors behind that projected increase in privatization activity include cost savings, a lack of expertise and personnel within government agencies, improved quality, and increased flexibility and speed of delivery.

In California, privatization, and competition were centerpieces of Governor Arnold Schwarzenegger’s (R) California Performance Review (CPR), conducted over five months by 275 volunteers and released in July 2004. Beyond efforts to expand the use of privatization in local public schools (which failed and did not make it into the final budget), hundreds of recommendations were made in the CPR to subject services to competition and expand the use of private-public partnerships.

In addition, the review report also calls for the creation of a California Competitive Government Panel to assist state agencies in identifying opportunities to use competition and strategies for overcoming barriers to its application. In Florida, Governor Jeb Bush (R) signed an executive order directing the state’s Department of Management Services to create a Center for Efficient Government to imply this money is going to Florida’s privatization efforts. The new center also was directed “identify opportunities for additional outsourcing initiatives, and oversee execution of future outsourcing projects.” Among its many duties and activities, the center has developed a centralized “gate process” to evaluate the best sources to use in delivering services. That process consists of a robust set of standards, templates, and guidelines and a transparent method of managing each stage of any outsourcing initiative.

Additional Initiatives on the Way
South Carolina Gov. Mark Sanford (R) also stepped into the privatization fray, promoting five projects in the last budget cycle. Although none of the five is guaranteed to be enacted, Sanford has put them in motion. In addition, the governor is reportedly considering a number of other such projects for the upcoming budget cycle and has entertained the concept of initiating a process similar to Florida’s. It was the General Assembly that got into the privatization act in Virginia. This year’s legislative session saw many privatization-related bills passed, spearheaded by Delegate Chris Saxman (R-Staunton), who chairs the bipartisan cost-cutting caucus.

Perhaps the most noteworthy of the Virginia bills was HB 1043, the Competitive Government Act, which requires every state agency to analyze its workforce and identify competition opportunities.

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Chicago Lands $1.8 Billion in Tollway Lease Deal

by John W. Skorburg

Chicago Mayor Richard M. Daley recently signed a $1.82 billion deal with a consortium of foreign investors to privatize the Chicago Skyway, a nearly eight-mile tollway system that links the City of Chicago with northwest Indiana.

The Chicago City Council voted 43-0 in favor of the 99-year lease on October 27. Minutes later, Daley signed the deal with the Cintra-Macquarie Consortium, a Spanish/Australian group that operates more than 30 tollroads worldwide.

“I believe it would be fiscally irresponsible to use all of the money at one time. If we use the funds wisely, we can protect our taxpayers and our city's financial situation for both the short term and the long term.”

RICHARD M. DALEY, MAYOR CITY OF CHICAGO

Deal Called Good for City

“Like Rumpelstiltskin, Mayor Daley spun straw into gold by handing off to the Cintra-Macquarie Consortium the 7.8-mile roadway that, not too long ago, was an albatross around the city’s neck,” said Alderman Richard Mell at the signing.

On October 16, Chicago Tribune reporter Gary Washburn broke the story that Daley was considering handing control of the Skyway to private operators. Daley’s father, the late Mayor Richard J. Daley, was running the city when the road was built more than four decades ago.

The deal will return $233 million per mile to the taxpayers of Chicago, or $44,191 a foot—making it “the biggest steal since the Dutch bought Manhattan,” according to Fran Spielman, a reporter at the Chicago Sun-Times.

The Civic Federation, a Chicago-based nonpartisan group that advocates improvements in government efficiency, also approved of the deal. It is recommending the revenue be used to pay down the city's long-term debt and boost its fund balance, according to an October 19 article in The Bond-Buyer’s online service.

99-Year Lease Effective Jan. 2005

The agreement takes effect within 90 days of the city's October 27 approval. Cintra-Macquarie must pay the $1.82 billion by then.

“Cintra-Macquarie was one of five finalists for the lease deal, and it offered the highest price,” city Budget Director John Harris told the Chicago Tribune. Harris added the final price was “within the range of expectation.”

The agreement gives the consortium authority to raise the current $2 one-way toll to $2.50, where it must remain until 2009. A $3 fee is possible by 2011, and a $5 fee could be reached by 2017, with any further increases to be based on future inflation.

New Owners Plans Efficiency Upgrades

According to Jose M. Lopes, a director for the Cintra-Macquarie group, the firm is pleased with the deal and will monitor the toll situation for years to come.

“We are in the business of obtaining better revenues. That doesn’t mean getting the highest tolls, because if you get very high tolls, you lose customers and you get less revenue,” Lopes told the Chicago Tribune shortly after the city council’s approval.

Lopes also said the consortium will make sure traffic travels efficiently. Speaking about a similar toll road in Sydney, Australia, he said, “We’ve moved the toll booths over and had some free-flow electronic lanes. All of this is about better service. Rush-hour in the toll booths is bad for our customers, bad for business.”

Travelers React

One Skyway traveler agreed it is a good idea to trade higher tolls for more efficiency.

“I’d pay five bucks if I didn’t have to stop for all the construction and all the other stuff. I’d gladly do it,” Wisconsin businessman Bill Grider told the Chicago Sun-Times while on a recent trip on the Skyway. “It saves me 30 minutes to two hours depending on traffic. My time is worth more than an additional three bucks (over the next few years).”

Construction worker David Aguayo, however, told the newspaper he was a bit hesitant about the future fares.

“When it gets up to $3 each way, that’s 30 bucks a week. And that’s a lot of money at the end of the year. This won’t be very good.” But Aguayo added, “It’s a short-cut, even when there’s traffic, it’s better than going the other (alternative) way.”

In 2003, the Skyway was used by 17.4 million vehicles, generating almost $40 million in toll revenues. Both figures are about double those of 10 years earlier.

City’s Budget to Benefit

City officials have not yet said what they will do with the infusion of cash.

The Chicago Tribune reported on October 16 that Daley said, “I believe it would be fiscally irresponsible to use all of the money at one time. If we use the funds wisely, we can protect our taxpayers and our city’s financial situation for both the short term and the long term.”

City budget officials are projecting a deficit of $220 million in 2005. The lease payment may help the city avert a property tax hike, according to Jacqueline Leavy, executive director of Chicago’s Neighborhood Capital Budget Group, a local civic organization.

In an October 20 column, Chicago Tri...
for Clean Water, Clean Air, & Quality Growth, would have cost the average Utah family about $14 a year, according to estimates.

**Grassroots Approach Successful**

The defeat of Initiative 1 surprised many observers because the campaign spending was so lopsided in favor of the initiative and similar initiatives had passed in other western states. Initiative supporters spent close to $2 million, a large sum in a small state like Utah, on television advertising and mailers. Opponents had a budget of just $700,000 a year. In response, the Utah Taxpayers Association, which opposed the measure, took a grassroots approach, sending emails to several thousand conservative activists who then forwarded the emails to thousands of other Utahns. The Utah Farm Bureau covered the rural areas through its network of farmers and ranchers.

Supporters of the initiative, including the Virginia-based Nature Conservancy, claimed the Utah legislature did not care about clean air, clean water, and open space and had reduced funding for these efforts to just $700,000 a year. In response, the Utah Taxpayers Association identified more than $5 billion it said had been allocated for these purposes over the past 10 years, an average of $500 million per year.

The Nature Conservancy also tried to portray Initiative 1 as a conservative Republican effort by playing up prominent Republican supporters and downplaying prominent Democrat supporters.

**Governor Led Opposition**

Water quality was a major issue with supporters of the measure. Postcards mailed to women voters had a picture of a young child filling a pitcher with water from the kitchen tap, with the caption, “If our water is dirty, it won’t matter if your glass is clean.”

Supporters also downplayed the tax increase as costing a typical family the equivalent of just two movie tickets per year. The tax increase had the support of many prominent Utahns, including former U.S. Senator Jake Garn, former Brigham Young University football coach LaVell Edwards, author Stephen R. Covey, retired Mormon University football coach LaVell Edwards, prominent Utahns, including former U.S. Representative Jim Hansen and Howard Nielsen, Utah Republican Party Chairman Joe Cannon, and numerous state legislators and local government officials.

One week before the election, The Deseret Morning News, the state’s second-largest newspaper, switched its position from support to opposition.

“The initiative touts open space and other admirable concepts, but do citizens realize that $30 million of the $150 million will be used for such things as convention centers, fair grounds, and local government buildings?” Walker asked in an official statement questioning the proposal. “This initiative commits the state to assume local government funding issues when it already has such pressing needs as education, transportation, and prison growth.”

The initiative also required the state to pay property taxes to local governments.

“I question the wisdom of the state paying property tax on local government facilities,” the governor stated.

**Problems Already Being Addressed**

The Utah Taxpayers Association published a document identifying 13 problems with Initiative 1. A key argument was that the initiative duplicated current efforts at the federal, state, local, and private levels to protect the environment. The association also pointed out that Utah’s air and water quality are the best they have been in many years and are continuing to improve in response to the hundreds of millions of tax dollars that have been spent on water and air quality improvements in recent years.

Opponents of the tax increase also argued open space preservation already was being adequately addressed in Utah. The federal and state governments typically own and protect between 75 and 95 percent of all land in the state’s rural counties, and in urban areas open space preservation is a responsibility of local governments, which have made commendable open space protection efforts, opponents argued.

The Utah Taxpayers Association also argued voters should be insisting on tax cuts instead of small tax hikes, and that a tax increase equivalent to two movie tickets per family was still too much considering the state’s already high state-local tax and fee burden.

**Possible Future Initiatives a Worry**

Lack of accountability was also a concern. Unlike similar efforts in other western states, the initiative did not specifically say how the money would be spent. No specific projects or critical land parcels were identified in the initiative petition.

Walker also expressed concern that approval of Initiative 1 would encourage well-funded groups to make further attempts to raise taxes and spending by initiative, a prospect that alarmed many Utahns who used to live in California.

“This process has not served states like California and Oregon well,” said Walker, whose opposition to the initiative was crucial to its defeat. “It is prudent to determine the budget by looking at all needs and issues facing Utah, rather than addressing them in a piecemeal fashion.”

Initial polls had shown the public supporting the initiative by roughly 70 to 30 percent. On election night, exit polls indicated 54 percent approval. As soon as the polls closed, the state’s largest TV station, which had given the initiative favorable coverage and had received a large amount of advertising from initiative supporters, announced Initiative 1 had passed by a comfortable margin.

By the time all the votes were tallied, however, Initiative 1 had received a majority of votes in only two small counties and had been rejected in the other 27, going down to defeat.

Mike Jerman (mike@utahtaxpayers.org) is vice president of the Utah Taxpayers Association.
South Dakota, Florida
Top Business Climate Study

Index shows lowering the overall tax burden is most effective way to attract business

by William Ahern

Citing U.S. Department of Labor statistics showing job relocation to other states is twice as common as “outsourcing” abroad, a new study by the Tax Foundation examines the role of business tax climates in the shifting of economic activity.

The new study, “State Business Tax Climate Index,” ranks the 50 states on how “business friendly” their tax systems are, providing a roadmap for state lawmakers concerned with keeping their states tax-competitive.

According to the index, the 10 states that began 2004 with the most business-friendly tax systems were Alaska, Colorado, Florida, Nevada, New Hampshire, Oregon, South Dakota, Texas, Washington, and Wyoming.

“Nearly all of the best states raise sufficient revenue without imposing at least one of the three major state taxes: sales taxes, personal income taxes, and corporate income taxes,” said Scott Hodge, president of the Tax Foundation and coauthor of the study. Four of the top 10—Alaska, South Dakota, Washington, and Wyoming—each have only one of the three taxes.

The 10 states with the least hospitable business tax climates are Arkansas, Hawaii, Kentucky, Maine, Minnesota, New York, Rhode Island, Vermont, West Virginia, and Wisconsin. The study authors say the worst state tax codes tend to have the following:

- complex, multi-rate corporate and individual income taxes with above-average tax rates;
- above-average sales tax rates that don’t exempt business-to-business purchases;
- complex, high-rate unemployment tax systems; and
- high overall state tax collections with few tax or expenditure controls.

“The ideal tax system, whether at the state, federal, or international level, should be neutral to business activity,” said Hodge. “In such a system, people would base their economic decisions on the merits of the transactions rather than the tax implications.”

The overall index is composed of five specific indices devoted to major features of a state’s tax system: the corporate income tax, individual income tax, sales or gross receipts tax, unemployment insurance tax, and the state’s fiscal balance. Those five indices are themselves composed of several sub-indices. Overall, the index consists of five specific indices, 10 sub-indices, 33 categories, and 109 variables.

Each state’s laws and tax collections were assessed as of January 1, 2004 and therefore reflect the business tax climate for the current year, but without consideration of 2004 legislative action. While the index is comprehensive, it is not exhaustive. Future research into state taxation will lead to new variables and sub-indices in future editions of the index, Hodge said.

William Ahern (ahern@taxfoundation.org) is director of communications at the Tax Foundation.
### Tax Breaks for Businesses Usually Don’t Work

By William Ahern

Lawmakers seeking to foster economic growth should focus on good tax fundamentals in their states, rather than short-term tax packages and exemptions designed to lure prestigious companies, professional sports teams, and auto plants from other states for a usually temporary relocation.

“The temptation is for state lawmakers to lure high-profile companies with packages of tax breaks,” said Scott Hodge, president of the Tax Foundation and co-author of its recent report, “State Business Tax Climate Index.” “But that strategy can backfire.”

In 2000, for example, officials in Columbus, Ohio lured a moving company with a five-year package of tax incentives. The company not only failed to add 100 jobs as promised, but by 2004 it had actually fired 98 employees. The final year of tax breaks was canceled.

“Ohio’s experience shows preferential tax bonuses don’t guarantee jobs will stay permanently,” said Hodge. “Often they mask deeper flaws in state taxes. The Tax Foundation’s new State Business Tax Climate Index helps draw those to lawmakers’ attention.”

Even states with excellent business tax climates may not be able to outbid tax breaks. In 1996, Florida offered a $4 million tax refund package to lure Capital One, a major credit card company, to open a call center in Tampa. But lawmakers were shocked by the company’s announcement in July of this year that it was closing the Tampa call center and laying off 1,100 workers, despite having received nearly $3 million in tax refunds since 1996.

“More than 3,000 Tampa employees helped build this company from the ground up. They not only gave Capital One their dedication and their hard work, transforming the company into one of the industry’s leaders—but their tax dollars as well, almost $3 million at last count,” said State Senate Minority Leader Les Miller (D) to Dave Wasson, who quoted Miller in the July 21 issue of TaxAnalysts.

“To repay them by outsourcing their jobs, likely to India or other Third World countries, is appalling,” Miller told Wasson.

Capital One has declined to say where the jobs are going, saying only that the company will contract with “U.S.-based companies” to perform the work.

“Florida’s experience shows that the special tax package game is often a futile approach,” said J. Scott Moody, senior economist at the Tax Foundation and another of the study’s authors. “States are better advised to keep taxes low and simple. It’s fair to existing businesses, it prevents boondoggles, and it works.”

William Ahern (ahern@taxfoundation.org) is director of communications at the Tax Foundation.

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**Table 1: 2004 State Business Tax Climate Index and Ranking (U.S. Average Score = 5)**

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No, Virginia, Illinois Is Not a Low-Tax State

by John W. Skorburg

The Springfield-based Illinois Policy Institute (IPI) has released a policy brief which, in its own words, debunks the “myth that Illinois is a low-tax state.”

Among those who have said Illinois is a low-tax state are local political heavyweights such as U.S. Senator-elect Barack Obama (D-IL), who gave the keynote speech at the 2004 Democratic National Convention and easily won the November 2 general election for a seat in the U.S. Senate, and the Illinois Tax Federation.

But the facts, according to the report issued October 14 by IPI, indicate Illinois businesses and individuals are heavily taxed when one includes federal taxes and local property and excise taxes.

“Even as the Fiscal Year 2005 state budget plans to roll back the taxes and fees that have led to Illinois’ decoupling from the national economic recovery, there are still those who would have us believe that Illinois is a low-tax state,” said Mike Van Winkle, a policy analyst at IPI and the study’s author.

“Due to our relatively high tax burden and our overly complex tax code, tax increases are not an option for Illinois as long as it plans to have a nationally competitive economy. Instead, Illinois should simplify the current code to make the state a friendlier climate for business.”

MIKE VAN WINKLE, POLICY ANALYST
ILLINOIS POLICY INSTITUTE

“Taxes in Illinois may not be what they are in [high-tax] Connecticut and California, but in no way is Illinois a low-tax state,” Van Winkle said. “Due to our relatively high tax burden and our overly complex tax code, tax increases are not an option for Illinois as long as it plans to have a nationally competitive economy. Instead, Illinois should simplify the current code to make the state a friendlier climate for business.”

Dueling Conceptions of Tax Burden

According to Van Winkle, the FTA data took into account only specific “state taxes.” Other taxes, such as property taxes and excise taxes, are considered “local taxes” in the FTA analysis and are not included in the state rankings. Illinois ranks 10th highest nationally in per-capita property taxes. At the local level, Illinois is actually a high-tax state.

“Even more troubling is the fact that measuring local tax burdens as a percentage of personal income can itself be problematic,” Van Winkle said. “Results tend to be distorted for states with large populations and high wages.

“Take, for instance, a traditionally thought-of high-tax state like California,” he continued. “Looking at state and local tax burden alone, California appears middle of the road, ranking 26th in the nation. Yet, once federal taxes are accounted for they’re the 10th most heavily taxed state out of 50. Notably, their state and local tax burden is only a 10th of a percentage point higher than Illinois.”

No, Virginia, Illinois Is Not a Low-Tax State

Noted Van Winkle, “Once we factor in federal income taxes, Illinois’ residents have the 14th highest tax burden in the nation.” The 2004 Tax Foundation report has Illinois ranked 13th highest after factoring in the federal tax bite.

Higher Salaries Hit Harder by Taxes

According to the Tax Foundation study, “Generally, high-income states rise [in ranking when federal taxes are added to the state and local total] because, with their high costs of living and commensurately higher salaries, they are hit harder by the progressive federal income tax.” This is consistent with the Illinois data.

“Taxes in Illinois may not be what they are in [high-tax] Connecticut and California, but in no way is Illinois a low-tax state,” Van Winkle said. “Due to our relatively high tax burden and our overly complex tax code, tax increases are not an option for Illinois as long as it plans to have a nationally competitive economy. Instead, Illinois should simplify the current code to make the state a friendlier climate for business.”

“Economic growth and frugality from Springfield are the only long-term solutions to our budget woes,” said Van Winkle. “Budget deficits should be filled with politicians’ pet projects rather than the cash of hardworking citizens.”

John W. Skorburg (skorburg@heartland.org) is associate editor of Budget & Tax News and a visiting lecturer in economics at the University of Illinois-Chicago.

INTERNET INFO


“Among those who have said Illinois is a low-tax state are local political heavyweights such as U.S. Senator-elect Barack Obama (D-IL) ... and the Illinois Tax Federation.”
SSTP
Continued from page 1

Streamlined Sales and Use Tax Agreement on Illinois,” a report criticizing the Streamlined Sales and Use Tax Project (SSTP). The SSTP is a national effort sponsored by retail industry groups and the National Conference of State Legislatures to simplify and make uniform the sales- and use-tax statutes of most states. This is being done, supporters say, to encourage the taxation of Internet, catalog, and other sales by out-of-state retailers.

All states but four collect sales and use taxes, and many of those that do collect the taxes exempt or reduce taxes on certain items, such as food or medicine. Local governments in states with sales taxes also collect their own sales taxes on top of the state taxes. Only states that enact the SSTP agreement would be subject to the out-of-state collections.

Under the proposed changes, sales taxes would be collected based on where a buyer takes possession of an item, instead of where the sale is made. As a result, a Chicago resident who bought an item over the Internet from an out-of-state retailer would be charged the sales tax rate that applies in Chicago. Currently, in most instances that sales tax would not be charged at all.

Questions about Expected Benefits
The Civic Federation report says the expected benefits for Illinois would not materialize because of unrealistically high projections of revenue increases and underestimation of compliance costs, including loss of lease tax revenue in Chicago and outside the city. Many Chicago businesses have set up purchasing corporations outside of the city to purchase goods. Because there is not a corresponding use tax, they end up not paying 2 percent to the city.

Vite acknowledges businesses usually do pay taxes on all transactions, because they are audited. “However,” said Vite, “businesses are pretty sophisticated. There is a 2 percent difference in sales tax rates between Chicago and outside the city. Many Chicago businesses have set up purchasing corporations outside of the city to purchase goods. Because there is not a corresponding use tax, they end up not paying 2 percent to the city.”

Vite also argues the Civic Federation’s analysis of business-to-business transactions is wrong. The group claims such sales account for the bulk of remote transactions and already result in sales tax collections.

There is a 2 percent difference in sales tax rates between Chicago and outside the city. Many Chicago businesses have set up purchasing corporations outside of the city to purchase goods. Because there is not a corresponding use tax, they end up not paying 2 percent to the city. If the streamlined sales tax comes, they will pay that 2 percent, because it’s based on point of delivery instead of point of purchase.”

DAVID VITE, PRESIDENT AND CEO
ILLINOIS RETAIL MERCHANTS ASSOCIATION

Despite growing Internet retail sales, indicating the state is not losing sales tax money, Vite argues that if Illinois and catalog retailers were collecting sales taxes based on where purchased items are delivered, the state’s sales tax receipts would be climbing.

Vite notes, however, that some municipalities probably would “cry and scream” at the idea of point-of-delivery rather than point-of-sale taxation.

“Those municipalities would be ones that have had the benefit of primarily big-ticket item companies, like lumberyards or window manufacturers or things like that,” Vite said. “A truck from that window manufacturer might deliver product to every municipality in Illinois, but the one city gets the benefit of all those purchases. Under SSTP, if windows are delivered to Woodstock or McHenry [suburban Chicago communities], those towns will get the benefit of those sales.”

The SSTP was created in 2000 to develop measures to design, test, and implement a system that simplifies sales and use taxes. Thirty-four states and the District of Columbia approved the Streamlined Sales and Use Tax Agreement that year.

In early 2003, legislation designed to conform state sales and use tax statutes to the agreement began to be introduced in state legislatures. The agreement says it will go into effect when 10 states representing at least 20 percent of the population of the states that currently impose a sales tax come into compliance. It would apply only in states that approve the SSTP agreement.

As of July 1, 2003, 20 states representing 31.7 percent of the U.S. population in states with sales and use tax levies had enacted legislation implementing the SSTP agreement, according to Taxware Resources, a developer of global, transaction-based tax calculation and compliance systems. However, two of those states, Texas and Washington, did not enact legislation implementing destination sourcing, and most observers believe this will prevent them from being in compliance.

Ohio adopted destination sourcing with an effective date of January 1, 2004, but later enacted legislation delaying the effective date to January 1, 2005. As a result, the 20 percent threshold for implementation of the SSTP will not be reached until the early part of 2005, according to Vite.

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.

$295 million more than it gains from making the changes necessary to join the Streamlined Sales and Use Tax Agreement.”

David Vite, president and chief executive of the Illinois Retail Merchants Association, said the Civic Federation report is wrong on several counts.

“The City of Chicago will not lose $100 million, as they say,” Vite said. “I talked to the co-chairman of the SSTP, and the agreement allows for lease tax payments to continue to be collected up front.”

Vite also argues the Civic Federation’s analysis of business-to-business transactions is wrong. The group claims such sales account for the bulk of remote transactions and already result in sales tax collections.

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“If the streamlined sales tax comes, they will pay that 2 percent, because it’s based on point of delivery instead of point of purchase,” Vite said.

Some Municipalities May “Cry and Scream”
The Civic Federation says Illinois sales tax receipts have remained stable, and if Illinois begins taxing the lease payments with the Agreement may require localities probably would “cry and scream” at the idea of point-of-delivery rather than point-of-sale taxation.

“Those municipalities would be ones that have had the benefit of primarily big-ticket item companies, like lumberyards or window manufacturers or things like that,” Vite said. “A truck from that window manufacturer might deliver product to every municipality in Illinois, but the one city gets the benefit of all those purchases. Under SSTP, if windows are delivered to Woodstock or McHenry [suburban Chicago communities], those towns will get the benefit of those sales.”

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Bush
Continued from page 1

ly interested in moving to a national sales tax or some other vehicle for eliminating the income tax, the president would not have mentioned protecting charitable and mortgage deductions. Bartlett also said the comment about fairness suggests Bush may oppose a flat tax.

Bartlett spelled out his thinking in an article posted November 10 on the NCPA Web site (http://www.ncpa.org/edo/ibb/2004/20041110bb.htm):

“Mr. Bush has said that his two highest domestic priorities are tax reform and Social Security reform,” Bartlett wrote. “Unfortunately, he has said very little about what he means in these areas. Consequently, someone is going to have to be assigned to draft a specific proposal—or at least detailed guidelines—before action in Congress can proceed.”

Bartlett also noted, “On both tax reform and Social Security, the budgetary implications of whatever is done will be a central consideration, especially so since the budget deficit is a problem that Mr. Bush has also promised to address.”

Grover Norquist, president of Americans for Tax Reform, said he believes “the Bush administration, on tax reform, is where it was four years ago with Social Security reform. Bush did not ask for a plan, but the right to have a reasonable discussion of the pros and cons of Social Security reforms. That’s the approach with tax reform.”

The president is assembling a tax reform commission to study ideas, a process Norquist expects to take at least 18 months. As those discussions go on, various changes in the tax code are likely to occur, he said.

“While this is going on, we’ll have the ability to abolish the death tax,” Norquist said. “I think we’ll see one tax cut each year for the next four years. Each cut moves us toward reform. I know we can get rid of the death tax and get LSAs [lifetime savings accounts] and RSAs [retirement savings accounts].”

Social Security Reform in View

Norquist said he views Social Security reform as a major part of tax reform, arguing that if Bush pushes for a program that allows people to put half of their Social Security tax money into personal savings accounts, “that is cutting in half the largest tax most people pay. That would probably be the most substantive cut. For people who ask why is the administration doing Social Security reform before tax reform, that kind of Social Security reform is addressing the most expensive tax around and is fundamental tax reform.”

Norquist also said, “For those who like sales taxes, until we move Social Security off the table by turning it into a forced savings program, we’ll never be able to shift onto a retail sales tax.” That is because the sales tax burden would need to be so high to cover Social Security’s costs that “people would work as hard to avoid the sales tax as they do the income tax,” he said.

Bill Gale, codirector of the Tax Policy Center at The Brookings Institution, said he doubts any “fundamental” tax reform will occur in 2005, largely because the work of the tax reform commission will not be completed.

However, Gale said he believes less-ambitious tax reform activity will continue early in Bush’s second term.

“I think we will see three things,” Gale said. “First, a push to make the [previous] tax cuts permanent. Second, and equally important, is they will look for ways to do it so that the cuts don’t have to be paid for. They will try to change the budget rules. That’s an under-the-radar thing to watch out for, because that would be an enormous liability. Third, they’ll push for added incentives for tax-preferred savings.”

Flattening a Possibility

Tim Kane, an economist at The Heritage Foundation, told Chicago Tribune Washington correspondent William Neikirk he believes Bush might strive to make the income tax system “flatter” by closing loopholes and reducing the number of tax brackets from four to two.

“You can get a pseudo-flat tax by reforming and simplifying the income tax,” Kane told Neikirk. “It’s doubtful you can get to a single rate.”

Neikirk also spoke with Robert Reischauer, president of the Urban Institute and a former director of the Congressional Budget Office, who said he doubts any major tax reform will pass Congress.

“Tax reform is terribly difficult to accomplish because it involves not only very important philosophical issues, but also because it involves huge amounts of redistribution of income,” Reischauer told Neikirk. “Without money to offset the losses that some interests will experience, tax reform becomes a virtual impossibility.”

Steve Stanek (stanek@heartland.org) is managing editor of Budget and Tax News.
Chicago Mayor Loads Budget with $87 Million in Tax and Fee Hikes

Rising personnel costs cited as the major culprit causing tax increase

by Steve Stanek

Chicago businesses and residents, who already pay some of the highest local taxes and fees in the nation, will soon see many taxes and fees climb still higher if Mayor Richard M. Daley's proposed 2005 budget passes as presented.

Daley submitted a proposed budget of $5.08 billion on November 9, up from $3 billion when he took office in 1989. He projects an extra $87 million in tax and fee revenue over the previous year's budget if his plan is approved.

Numerous Increases Planned

Taxes and fees would increase on a host of items, including beer, wine, and hard liquor; public parking; tickets to sporting events, theater productions and other entertainment; cigarettes; hotel accommodations; retail sales; vehicle rentals; natural gas; and restaurant meals.

Among the proposed increases are these:

- a one-quarter percent rise in the city portion of the retail sales tax, taking it from 8.75 to 9 percent, making it the highest sales tax rate among major U.S. cities. The sales tax is 8.625 percent in New York City and 8.25 percent in Los Angeles;
- a tax of 10.25 percent on restaurant meals, up from 10 percent;
- a 32-cents-per-pack increase in the city tax on cigarettes;
- a nearly quadruple increase in the tax on natural gas, from $0.14 to 52 cents per therm; and
- a hike in the minimum fee to operate sidewalk cafes, from $600 to $1,000.

Personnel Costs Are Biggest Challenge

In delivering his proposed budget, Daley made little mention of his proposed tax and fee hikes. He said the city’s finances are strained because the city has not rebounded from the recession of 2000-2001; wage and health care costs, which make up more than 80 percent of the city’s budget, continue to rise; and state and federal aid have lagged.

“Revenues are slow,” Daley said. “The cost of personnel continues to increase. And, we’re not getting all the support we need from Springfield [Illinois’ capital] or Washington, DC.”

Daley said he has tried to control costs, and noted that the city’s civilian workforce has dropped by more than 3,800 since he took office in 1989. He also cited efforts to improve management of city functions and mentioned initiatives to outsource certain tasks, such as custodial services at O’Hare International Airport and water management customer service operations.

The city’s biggest challenge is management of personnel costs, according to Laurence Msall, president of The Civic Federation, a Chicago-based, nonpartisan government research organization.

“The number one challenge is that personnel costs are growing much faster than revenues,” Msall said. “Health insurance, pensions, and other personnel costs contribute to the structural deficit of the city.

They have about 36,000 city employees, but an additional 3,000 to 4,000 contractual workers funded through grants. With 39,000 to 40,000 employees, they have to look at controlling those costs as key to balancing the budget.”

“We would hope the city will further pursue privatization and management efficiencies before going to any of the revenue enhancers,” Msall said.

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.
Chicago Mayor Proposes Decriminalization of Marijuana Possession

by John W. Skorburg

Chicago Mayor Richard M. Daley is advocating the decriminalization of marijuana possession, proposing to make the offense similar to an ordinance violation rather than a criminal action, with violators subject to fees and fines instead of jail time.

"If 99 percent of the (marijuana) cases are thrown out (of court), and we have police officers going to court to testify in the cases, why?" the mayor asked reporters October 3 when explaining why he wants marijuana possession to be decriminalized. "It costs a lot of money for police officers to go to court."

Nearly All Cases Are Dismissed

A recent police report appeared to support the mayor’s argument.

According to an October 4 report in TheState.com, a South Carolina online newspaper, "(Chicago Police) Sgt. Thomas Donegan determined that nearly 7,000 local cases involving 2.5 grams of pot or less were filed last year (2003) in Chicago. About 94 percent were dismissed.

"While officers are doing everything to keep the streets safe, the offender gets arrested and is walking the streets in just a few hours," Donegan wrote in his report. "To me, this is a slap in the face to the officers."

Donegan concluded that a system of fines and fees could have collected more than $5 million for Chicago in 2003.

Columnists Respond Positively

The Cato Institute in Washington, DC said in its online Daily Dispatch for October 4, "Mayor Richard Daley, a former prosecutor, runs the nation’s third-largest city with a pragmatic, law-and-order style. So when he starts complaining about the colossal waste of time and money involved in prosecuting small-time marijuana cases, people take notice...." Cato has long been an advocate of decriminalization of certain drugs.

In "Forget the War on Drugs Already," published in January 2004 by Cato, Senior Fellow Doug Bandow wrote, "Why government toasses pot smokers in jail ... has never been obvious. There is good reason for people to abstain ... there is no good reason to imprison them if people do not."

"Last year (2003) 19.5 million Americans used drugs," Bandow noted. "Some 14.6 million people smoked marijuana, despite the law; assorted police stings, operations, and campaigns; hundreds of arrests; and overflowing prisons."

Bandow concluded, "We should treat drug use as a medical, moral, and spiritual issue—not a criminal one."

Rachael Campbell of the Wisconsin-based Journal Times agrees with Daley and Cato. In an October 5 online story, Campbell said of Daley’s proposal, "Personally, I think it’s a great idea, and one the rest of the nation would be wise to adopt. Jail time for pot is clearly an ineffective deterrent."

Dissenting Voices Raised

But Jeff Wilford of the Journal Times took the opposite view in his October 4 story.

"Marijuana is considered by many to be a gateway drug, meaning marijuana use can lead to the use of more dangerous drugs," Wilford wrote. "Some argue that watering down marijuana laws would send the wrong message."

Wilford quoted a letter, published in the Chicago Tribune, written by Kevin J. Hacker, a Republican committeeman in Chicago’s 36th Ward: "The message they are going to receive is that smoking marijuana isn’t a serious offense and is equivalent to rolling through a stop sign."

California, Colorado, Oregon Set Pace

Other municipalities, and even states, have begun to implement the type of approach Daley is advocating for Chicago. Seattle, for example, enforces a citizen-passed initiative requiring law enforcement officials to make personal-use marijuana cases their least priority. In California and Oregon, possession of a small amount of marijuana is a misdemeanor punishable by a fine of $100 to $500. In Colorado, ... it’s a petty offense with a maximum fine of $100."

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No date has been set for further discussion of the issue by the Chicago City Council.

John W. Skorburg (skorburg@heartland.org) is associate editor of Budget & Tax News and a visiting lecturer at the University of Illinois-Chicago.
Chicagoland Chamber Files Legal Challenge to Assessment Cap

New state law unconstitutional, unfairly shifts burden to suburban homeowners and commercial and industrial taxpayers, lawsuit asserts

by Steve Stanek

The Chicagoland Chamber of Commerce and other groups recently filed a lawsuit in Cook County Circuit Court challenging the constitutionality of a state law that allows Illinois counties to impose a 7 percent cap on property tax assessment increases.

Illinois enacted the law in July 2004, after thousands of taxpayers in Chicago and surrounding Cook County protested property tax bills that skyrocketed after their property was reassessed. Cook County is the only county among the 102 in Illinois that has adopted the cap.

Claim Cap Would Shift Burden Unfairly Chamber officials complain the cap shifts hundreds of millions of dollars in tax burden onto commercial and industrial taxpayers and thousands of homeowners throughout Cook County, whose property values do not rapidly escalate.

“We strongly believe the law is not only unfair and unconstitutional, but actually prevents true reform of our property tax system,” the group said in announcing its lawsuit October 13. “Many of you know that Cook County already treats residential taxpayers differently than business taxpayers. This new law intensifies this unequal treatment and asks businesses and many homeowners to pay more so some taxpayers can pay less.”

“Cutting taxes for high-value homes and then asking other homeowners and all Cook County businesses to pay more is not reform. It takes us backwards.”

JERRY ROPER, PRESIDENT AND CEO
CHICAGOLAND CHAMBER OF COMMERCE

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.

The lawsuit asks the Cook County Circuit Court to strike down the new state law authorizing the assessment cap and order an eventual recalculation of the 2003 property tax bills. The lawsuit does not challenge certain other sections of the law, such as narrowly focused additional tax relief for seniors and homeowners beyond the so-called “assessment cap.”

Plaintiffs include several individual homeowners and business owners, the Chicagoland Chamber of Commerce, the Building Owners and Managers Association of Chicago, and the Chicago Development Council. Defendants are the three Cook County officials involved most directly in tax assessment and billing: Assessor James Houlihan, Treasurer Maria Pappas, and Clerk David Orr.

“This law is not tax relief. It’s a tax shift—and for many, that means a tax increase because they’re paying more than they would have paid if this law had never been enacted,” said Roper.

Unfairly Benefits Chicago Homeowners, Chamber Says

The Chamber contends the law:

- benefits Chicago homeowners at the expense of suburban homeowners, especially those in the south Cook County suburbs;
- favors certain Chicago homeowners in the wealthier or gentrifying neighborhoods at the expense of homeowners in neighborhoods where values have not appreciated as much;
- benefits existing homeowners at the expense of young families buying their first home or homeowners entering a new neighborhood;
- pits homeowners against apartment tenants by increasing taxes on apartment buildings, driving up rents; and
- shifts tax burdens to small businesses and other commercial tenants, increasing their costs of doing business throughout Cook County.

The lawsuit alleges a number of legal and constitutional flaws, including the following:

- The Illinois Constitution requires that property taxes be levied uniformly, but the new law does not treat all homeowners alike.
- The measure discriminates against suburban Cook County homeowners by the manner and timeframe in which the tax cap would be implemented in the three Cook County assessment districts.
- By giving counties the ability to opt in or out of the new homestead-exemption scheme, the law unconstitutionally delegates to counties the exclusive authority of the General Assembly to establish Homestead Exemptions.
- The law makes fair administration of the Property Tax Code impossible in situations where taxing bodies derive property tax revenue from more than one county, which is not uncommon in school districts near the borders of Cook County.
- The law violates the equal protection clause of the Illinois Constitution by establishing tax classifications that “have no rational foundation in sound public policy relevant to the purposes ostensibly served by the law,” thus depriving the plaintiffs and other taxpayers of equal protection under the law.
- The retroactive application of the law to 2003 taxes affected thousands of real estate transactions during 2003 and the first six months of 2004, but neither party in any of those transactions could have anticipated the tax shifting caused by the law nor had the opportunity to negotiate the division of responsibility for the unexpected tax increases.

Law Called “Band-Aid,” “Good First Step” Houlihan was instrumental in the bill’s passage. At a July 2004 meeting with the County Board, he conceded the assessment cap shifts tax burdens, but by only about 1.9 percent. Studies conducted by his office have shown the property tax burden has been shifting from businesses to homeowners, because housing prices have been climbing faster than those for commercial or industrial property.

“This will slow down the shift,” Houlihan said.

Cook County assessor James Houlihan (above) was instrumental in the passage of a bill allowing Illinois counties to impose a 7 percent cap on property tax assessment increases. Chicagoland Chamber President and CEO Gerald Roper (inset) claims the bill prevents true reform of the property tax system.

Chicago Sun-Times reporter Abdon Palasch quoted Cook County Board member Larry Suffredin, who lobbied heavily for the 7 percent assessment cap, as saying, “This is a Band-Aid. This is a good first step.”
Fort Mitchell Latest Kentucky Town to OK Sunday Liquor Sales

by Lisa Hawkins

For the first time since Prohibition, people may buy liquor on Sundays in Fort Mitchell, Kentucky.

The Fort Mitchell City Council voted on October 18 to allow sales of packaged distilled spirits, wine, and beer after 11 a.m. on Sundays. The city joins only three other Kentucky communities—Bellevue, Independence, and Crescent Springs—in allowing Sunday liquor sales.

The ordinances allowing Sunday spirits sales have followed a July 30 court ruling overturning the state’s Blue Law barring such sales and thereby allowing local governments in Kentucky to decide the matter individually.

“In today’s busy society, Sunday is the second-busiest shopping day of the week, and it makes good business sense to modernize spirits sales and allow stores to open seven days a week,” said Peter H. Cressy, president of the Distilled Spirits Council, which has successfully pushed for states to allow beverage alcohol sales on Sundays. “... Sunday is the second-busiest shopping day of the week, and it makes good business sense to modernize spirits sales and allow stores to open seven days a week.”

Peter H. Cressy, president
Distilled Spirits Council

The Distilled Spirits Council is working with the Kentucky Wine and Spirits Wholesalers Association and retailers in other Kentucky cities to support Sunday sales measures.

In the past two-and-a-half years, 11 states, including Kentucky and nearby Ohio, have moved to allow Sunday spirits sales, bringing to 32 the total number of states that allow beverage alcohol sales on Sundays.

Fort Mitchell has two package-liquor license holders—Kroger’s grocery and Jim’s Beverage Station—according to City Administrator Bill Goetz.

“It’s more of a convenience issue than anything,” Goetz told Cincinnati Enquirer reporter Cindy Schroeder, who discussed prospects for Fort Mitchell’s Sunday liquor sales ordinance in an October 2 article. “A lot of people entertain on Sundays,” Goetz said. “If they run out of liquor, it would be available in the city (seven days a week).”

The move to allow Sunday liquor sales in Kentucky began two years ago, when the Party Source in Bellevue, a liquor megastore, deliberately sold a bottle of Jim Beam to an Alcoholic Beverage Control agent on a Sunday. That resulted in a court challenge and a state appeals court ruling overturning Kentucky’s ban on Sunday liquor sales. The state chose not to appeal to the state Supreme Court.

Lisa Hawkins is vice president of public affairs and communications at the Distilled Spirits Council of the United States. She can be reached through the organization’s Web feedback form at http://www.discus.org/contact/.

New Estimate of Smoking Costs Misleading

Smokers already pay more in taxes than their habit imposes on others

by Robert A. Levy

More ammunition for the anti-smoking crowd will soon be released in a new book from MIT Press, The Price of Smoking.

According to prepublication reports, the authors—Duke University economist Frank Sloan and four colleagues—estimate the actual costs of smoking at nearly $40 per pack. That includes roughly $33 for reduced life expectancy and tobacco-related disabilities among smokers, $5.44 for the costs of secondhand smoke, and $1.44 for pooled-risk programs like Medicare, Medicaid, group life insurance, and sick leave.

Regrettably, the data will be exploited by zealots to stop the rest of us from making our own decisions about cigarettes. That’s why it’s important to understand what is behind the estimated $40 cost and the public policy implications of Sloan’s work. Assuming the numbers are accurate, their principal utility lies in helping private parties make rational choices, not in promoting yet another anti-tobacco crusade.

Externalized Costs a Valid Concern

For starters, the authors properly distinguish costs incurred by each smoker, which can be averted by not smoking, and about $7 of costs imposed by smokers on others, which economists call externalities. The lesson here is crucial: With respect to the $33 component, decisions about smoking are voluntary, private matters. We do not need government making those decisions for us.

Externalized costs are different. Consider, for example, secondhand smoke.

Some nonsmokers have illnesses—such as asthma or bronchitis—that are exacerbated by secondhand smoke. Still, those nonsmokers have an obviou remedy. Do not hang around places where smokers light up. On private property, this would mean the owner should determine whether to admit smokers, nonsmokers, neither, or both. Persons who objected to the policy of any particular property owner could go elsewhere.

To be sure, however, not all property is private. Government-owned property, for example, belongs to the taxpayers, most of whom are nonsmokers. They should not be required to leave their own property to escape offensive smoke, especially in locations that do not afford ready means of ingress, such as reading rooms in public libraries, waiting rooms in public hospitals, and elevators in government office buildings. But at locations that are not particularly confining, such as public beaches, visitors can steer clear of smoke by taking a step or two away or can avail themselves of smoke-free areas.

Externalized Costs Easily Avoidable

In other words, very little of Sloan’s estimated $5.44 cost of secondhand smoke justifies additional anti-smoking regulations. Almost all of that cost is easily avoidable.

Ditto for Sloan’s other “social” costs, which total $1.44 per pack. Basically, smokers are able to impose social costs upon nonsmokers because the government has decided, first, to insulate the health care costs of low-income and elderly persons, and, second, to fund the insurance in a manner that does not distinguish between high-risk smokers and lower-risk nonsmokers. If insurance premiums fully reflected the health risk implicit in each policyholder’s smoking habits, no costs would be transferred from smokers as a group to nonsmokers as a group.

Hence, the remedy for tobacco-related costs that deplete Medicaid and Medicare coffers is to increase the “premiums” for smokers or reduce the benefits payable for their illnesses. Taxpayers have a right to demand responsible behavior from persons who receive public benefits.

Moreover, there’s another factor in the equation. It may sound ghoulish, but premature deaths from smoking can generate long-term external benefits in the form of lower retirement and nursing-home costs. Those benefits (less any payroll taxes that would otherwise have been paid by deceased or disabled smokers) are an offset to near-term medical outlays.

“If anything,” concludes Sloan, “Medicare should compensate smokers and tobacco companies, not the reverse.”

Rational Discrimination

The other major pooled-risk programs are group life insurance and sick leave. In providing those benefits, health care employers may have decided that discrimination between smokers and nonsmokers isn’t cost-effective, or perhaps employers fear litigation or are constrained by labor contracts. In any event, the externalized costs of pooled insurance and sick leave are not very large, and the remedy, if one is needed, is to remove legal and contractual prohibitions on such discrimination against smokers.

In a nutshell, then, Sloan and his colleagues have identified three types of costs: private internalized costs, which can be eliminated by choosing not to smoke; externalized costs of secondhand smoke, which can be mostly redressed by recognizing private property rights and providing for smoke-free areas on government property; and externalized costs of pooled risk programs, which can be remedied by permitting rational discrimination against smokers who impose those costs.

Yes, there may be some residual costs for which smokers should be held accountable. But don’t forget that state and federal excise taxes already yield revenues of $.76 per pack, and smokers have been socked with a quarter-of-a-trillion-dollar cost payable to state governments under the terms of the November 1998 Master Settlement Agreement.

In short, even the figures cited in The Price of Smoking show smokers more than pay their way.

Robert A. Levy (rlevy@cato.org) is senior fellow in constitutional studies at the Cato Institute (http://www.cato.org) and author of Shakedown: How Corporations, Government, and Trial Lawyers Abuse the Judicial Process (Cato Institute, November 2004).

This article originally appeared in the Chicago Sun-Times.

“Very little of Sloan’s estimated $5.44 cost of secondhand smoke justifies additional anti-smoking regulations. Almost all of that cost is easily avoidable. Ditto for Sloan’s other ‘social’ costs, which total $1.44 per pack.”

Frank Sloan, economist
Duke University

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The Price of Smoking shows smokers more than pay their way.
Corporates

Continued from page 1

the federal rate and the average state rate.

By contrast, Figure 1 shows the average rate in Asia, Europe, and Latin America is 30 percent or less. The figure is based on data for countries listed in Table 1. The average corporate tax rate in the OECD fell from 37.6 percent in 1996 to just 30.0 percent in 2004.

Since the late 1990s, many Eastern European countries have sharply slashed their tax rates to attract investment. For instance:
- Poland cut its tax rate from 40 to 19 percent;
- Slovakia cut its rate from 29 to 19 percent;
- The Czech Republic cut its rate from 39 to 28 percent;
- Hungary cut its rate from 33.3 to 16 percent; and
- Russia cut its rate from 35 to 24 percent.

In August, Greece announced it will cut its corporate rate from 35 to 25 percent, and the Netherlands announced it will cut its rate from 34.5 to 30 percent.

Election Failed to Address Issue Squarely

Before the November 2 general election, Bush promised to consider tax reform if he won re-election, but he did not reveal a plan for the corporate tax. He is allowing to expire a pro-growth tax provision that allows firms to deduct, or "expense," half the cost of qualified capital investments.

Bush's challenger for president, Sen. John Kerry (D-MA), addressed the tax rules on foreign investment during the campaign, noting in speeches and campaign literature that the rules are "almost completely broken" and acknowledging that other nations have corporate taxes that average one-third lower than those of the U.S.

Kerry's solutions, however, probably would have done more harm than good, as a closer look suggests.

Damaging Corporate Tax Plan

The Kerry plan would have cut the U.S. corporate tax rate of 35 percent by 1.75 percentage points. To fund that small cut, however, Kerry proposed to increase taxes on foreign income from U.S. corporations by immediately taxing subsidiaries of U.S. companies. As their global sales declined, many of those firms would downsize their U.S. operations, such as research, marketing, and management personnel. Some U.S. firms would run their headquarters to more tax-friendly countries. Others would be taken over by foreign companies. All of those effects would probably cost U.S. jobs.

Kerry's plan and others like it assume foreign subsidiaries and joint ventures are hurting the U.S. economy. In fact, however, they mainly complement U.S. firms in building their headquarters to more tax-friendly countries. Kerry's plan would impede U.S.-based activities that depend on expanded foreign tax benefits.

Tax Cuts Likely to Shift International Investment

Cuts in corporate tax rates probably will continue overseas, because of the benefits countries gain from attracting foreign investment. As much as $1 trillion of direct investment crosses international borders each year, and research shows those flows are increasingly sensitive to corporate tax rates.

In contrast to this global economic trend, U.S. policy rests on the assumption that America can have high growth and good jobs without a competitive tax climate. But many economists contend our complex and costly corporate tax system will have an increasingly negative effect on U.S. productivity, wages, and growth and will create a breeding ground for further Enron-style tax scandals.

Chris Edwards (cedwards@cato.org) is director of tax policy studies for the Cato Institute.

New Senate More Taxpayer-Friendly

by John Berthoud

The 2004 election brought significant turnover in the United States Senate and good news for taxpayers, as revealed in data compiled by the National Taxpayers Union (of which the author is president).

Because most of the incoming senators have previously served in the U.S. House of Representatives, a comparison can be made of the fiscal records of the outgoing senators and most of the new senators.

This analysis uses the most recent National Taxpayers Union (NTU) Rates Congress grades for outgoing and incoming senators. Grades for 2003 were available for all nine outgoing senators. Grades were available for six of the nine incoming senators. Senators-elect Barack Obama (D-IL), Ken Salazar (D-CO), and Mel Martinez (R-FL) did not have previous service in Congress.

The NTU Rates Congress data present a comprehensive picture of the fiscal records of these senators and senators-elect. Unlike the ratings compiled by other organizations, NTU’s annual rating does not focus on only a handful of equally weighted “key votes.” For this reason, it has received praise from lawmakers on both sides of the aisle.

Table 1 presents an overview of nine states with new senators. Among the highlights of the data are the following:
- The latest NTU Rates Congress grade of four of the nine outgoing senators (44 percent) was “F.”
- The lowest grade earned by any of the six incoming senators with previous House service was “B-.” Only three of the nine outgoing senators (33 percent) achieved an “A” or better in the 2003 NTU Rates Congress.
- In five of the six cases where both outgoing and incoming senators had grades in NTU Rates Congress, the incoming senator has a better mark. In the sixth instance (Ohio), both the outgoing and incoming senators received an “A” in their most recent NTU ranking.
- In other words, in no instance does a new senator have a lower grade than the outgoing senator.

The result is that supporters of limited government and lower taxes got very good news in the 2004 Senate elections. Come January 2005, taxpayers will have new allies in the Senate on critical votes on appropriations bills, budget process reform, pending energy and transportation bills bloated with pork, Social Security reform, and tax relief.

John Berthoud (jberthoud@ntu.org) is president of the National Taxpayers Union.

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Table 1. NTU Grades of Outgoing and Incoming Senators

BUDGET & TAX NEWS DECEMBER 2004 19

Source: KPMG. Includes subnational taxes.
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* Source: Bureau of the Public Debt, U.S. Department of the Treasury

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