Taxes Are Key to Telecom Reform

by Steve Stanek

The telecom industry needs tax relief, according to participants in The Heartland Institute’s Telecom Reform Conference held December 17 and 18 in Chicago. “We want to be treated like any other business,” Deborah Bierbaum, director of external tax policy at AT&T, told conference participants, many of whom were state and municipal lawmakers from across the country.

In three states, telecom consumers

Colorado Governor Wants to Loosen Tax Limits

by Steve Stanek

Colorado Governor Bill Owens (R) has proposed changing his state’s Taxpayer Bill of Rights (TABOR) to allow lawmakers to keep another $500 million of taxes and immediately return spending to pre-recession levels after an economic slowdown.

In return, Owens proposes a slight cut in the personal income tax rate and cashing in the state’s future tobacco lawsuit settlement money.

The proposals are part of a five-point economic plan Owens announced December 20, three weeks before the

Spending On Lotteries in U.S. Tops Spending On Books and Movies

by William Ahern

The average American spent more on lottery tickets in 2002 than on reading materials or movies, according to “Lotteries and State Fiscal Policy,” a study by Tax Foundation policy analyst Alicia Hansen released on December 15.

More than half of Americans play state lotteries in any given year, according to Hansen, making state lotteries the most popular form of gambling in the United States. She contends state lotteries are contrary to sound state tax policy. While

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Budget & Tax News

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Medicaid spending is on pace to crowd out everything else in state budgets within a generation, according to “The Long-Term Care Dilemma, What States Are Doing Right and Wrong,” a new study jointly produced by the American Legislative Exchange Council and Council for Affordable Health Insurance.

Author Steve Moses of the Center for Long Term Care Financing describes fatal flaws in the current financing system for Medicaid long-term care that allow abuse by middle- and upper-income patients. If Medicaid resources are intended exclusively for the truly poor, Moses concludes, policymakers will have to address those flaws.

The study examines the Medicaid policies of 10 states—California, Connecticut, Georgia, Michigan, Minnesota, Nebraska, New Mexico, New York, Oregon, and Texas—and ranks them in order of effectiveness. Even the best state has a long way to go, according to Moses.

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Better Economy Boosts Indiana’s Revenue Projections

by Steve Stanek

Budget officials for the state of Indiana are projecting revenue increases over the next two years, the result of an improving state economy. This is the first projected increase in revenue since 2000.

The state expects to collect nearly $1.8 billion in additional taxes over the next two years, mostly because of increases in individual and corporate income tax receipts, according to Bob Lain, a member of the State Budget Agency, which presented its estimates to the State Budget Committee on December 14.

The report shows Indiana taking in $11.7 billion in fiscal year 2006 and $12.3 billion in fiscal year 2007.

Money Already Likely Spent

But projected increases in the cost of Medicaid and other programs are expected to consume most of the additional money.

“Medicaid is the 500-pound gorilla of Indiana state expenditures, as it is for many other states,” noted economist Barry Keating, Jesse H. Jones Professor in the Mendoza College of Business at the University of Notre Dame. This “is the single most important area for meaningful reform—that is, spending reductions.”

Keating explained, “Any program like Medicaid that splits funding between Indiana taxpayers and the federal government breeds expansion beyond what the cost would be if the total bill were paid by Indiana taxpayers. Governor Daniels would do well to concentrate on Medicaid reform as a source of help in balancing the state budget.”

“What impresses me about the December 14 revenue forecast,” said Cecil Bohanon, professor of economics in the Miller College at Ball State University in Muncie, Indiana, “is that its forecast revenue for 2005 is about $300 million more than in the previous forecast for 2005. That pares the expected budget deficit for 2005 down from $900 million to around $600 million—good news, but the State is still $600 million in the hole. Indiana must either increase revenue, reduce spending, or engage in some combination of the two to restore long-term fiscal balance,” Bohanon noted. “Since over half of the state’s spending is for K-12 and higher education, any spending restraint must include these ‘sacred cows.’”

The higher projected revenues mean “we can pay for a good deal of the automatic growth factors built into law, but nothing new,” said Rep. Jeff Eschiph (R-Uniondale), chairman of the state House Ways and Means Committee, to reporter Niki Kelly of The Journal Gazette newspaper (December 15). “This allows us to pay the bills we know we have.”

“Unfortunately, this revenue forecast raises everybody’s expectations,” said State Rep. Eric Turner (R-Marion) to reporters at the Indianapolis Star (December 15). Turner is a member of the state House Ways and Means Committee, which writes the state budget.

“Medicaid is the 500-pound gorilla of Indiana state expenditures, as it is for many other states. This is the single most important area for meaningful reform—that is, spending reductions.”

BARRY KEATING, JESSE H. JONES PROFESSOR
MENDOZA COLLEGE OF BUSINESS
UNIVERSITY OF NOTRE DAME
High Spending Growth Projected

According to the National Association of State Budget Officers, Medicaid expenditures represented 21.9 percent of total state expenditures in fiscal year 2004. States are projecting a 12.1 percent increase in state funds devoted to Medicaid in 2005.

The Congressional Budget Office projects Medicaid spending increases in the neighborhood of 8 percent annually for the next 10 years. Such growth will create severe pressure on state budgets and the elected officials who oversee them.

Ironically, the study notes, there is a negative correlation between the number of dollars spent on Medicaid and access to care for patients. From 1999 to 2002, the number of physician practices open to “all new Medicaid patients” declined by 23 percent. Over the same three years, total Medicaid spending climbed 36 percent.

Medicaid covers 56 million low-income people. Approximately three-quarters of those receiving Medicaid are children and non-disabled adults. However, that group represents only one-quarter of Medicaid outlays.

The overwhelming majority of Medicaid’s resources go to the one-quarter of enrollees who are elderly or disabled. Care in nursing homes is the primary cost driver.

Medicaid Eligibility Too Easy

Two financial “tests” must be passed in order to achieve eligibility for Medicaid long-term care benefits. One is based on income, the other on assets. Passing both is all too easy, according to the study.

Income test. States administer the income test in one of two ways. Thirty-four states determine whether a person is “medically needy”: If his or her medical costs exceed income, Medicaid will make up the difference.

“According to the National Association of State Budget Officers, Medicaid expenditures represented 21.9 percent of total state expenditures in fiscal year 2004. States are projecting a 12.1 percent increase in state funds devoted to Medicaid in 2005.”

The remaining states have an “income cap” test of $1,692 per month. Residents in these states cannot spend more than their income so as to qualify for Medicaid.

Only 10 to 15 percent of U.S. seniors have incomes high enough that qualifying for Medicaid might pose a serious problem.

Asset test. The asset test is intended to protect seniors’ homes, cars, and businesses from seizure. Most states allow people to keep $2,000 in non- exempt liquid assets. The problem, however, is that the loopholes are so big seniors can quite literally drive two cars through them.

The home and all contiguous property, regardless of value, are exempt. A business, including the capital and cash flow of unlimited value, is exempt. A car of unlimited value is also exempt. Because a car is exempt, giving it away does not qualify as a transfer of assets. Thus, savvy seniors can deplete their cash by buying a car and giving it away, buying and giving away another, and so on—effectively hiding their cash in cars until reaching the $2,000 cash threshold.

Cynics call this the “two Mercedes rule.” Too much of the average senior’s wealth is off limits, the study says.

Assets of Elderly Protected

Seniors hold nearly $2 trillion worth of home equity. Eighty-one percent of U.S. seniors own their homes, and 73 percent of those own their homes free and clear. The key to paying for long-term care under Medicaid, the study contends, is to tap into that pool of wealth. Under current law it is all but off-limits.

The study notes that Medicaid was designed to help finance health care for poor Americans, not to act as “inheritance insurance” for people in the middle- and upper-income brackets. Seniors on the whole, while their monthly incomes may be more modest, are far more asset-rich than, say, couples in their thirties with two children.

One means of tapping into seniors’ asset wealth, the study notes, is home equity conversions, which can be accomplished through reverse mortgages. Seniors could take a lump sum or monthly payments to help defray nursing home costs. Recently, both the Centers for Medicare and Medicaid Services (CMS) and the National Council on Aging have encouraged the use of home equity to cover the cost of long-term care.

The Omnibus Budget Reconciliation Act of 1993 mandated estate recoveries—use of a person’s assets to recoup Medicaid costs—but states do not do so with any significant degree of effectiveness. Oregon led the country in estate recoveries with $13.7 million in 2002. That represented just 6.9 percent of the state’s Medicaid spending on nursing homes that year.

The study suggests Congress require that senior homeowners utilize their home equity in the form of a reverse mortgage before becoming eligible for Medicaid. States also could become more assertive in estate recoveries, seeking a waiver from CMS to extend the “look back” period for transfers of assets. Under current law, states can’t go back more than three years to determine if assets should have gone to the state to reimburse for Medicaid expenses.

Such policy actions, combined with public outreach to educate all citizens on the importance of preparing for future long-term care needs, would lead to greater use of long-term care insurance and other forms of planning and investing.

From 1999 to 2002, the number of physician practices open to “all new Medicaid patients” declined by 23 percent. Over the same three years, total Medicaid spending climbed 36 percent.”

James Frogue (jfrogue@alec.org) is director of the Health and Human Services Task Force at the American Legislative Exchange Council in Washington, DC.

INTERNET INFO

Congress Bails Out Universal Service Fund—For Now

by Tad DeHaven

As one its last acts of 2004, the U.S. Senate on December 8 passed legislation that keeps alive a long-distance telephone fee subsidizing telecommunications service for low-income residents and rural areas. The National Taxpayers Union reluctantly endorsed the measure because failure to pass it could have driven the cost of telephone service far higher.

The Senate’s approval of the National Telecommunications and Information Organization Act, HR 5419, followed approval by the House two weeks earlier. Contained in the legislation are three separate acts addressing the structure of nationwide 911 telecommunications, the Universal Service Fund (USF), and the Universal Service Anti-Deficiency Temporary Suspension Act” proved to be the most politically fraught. The USF is a federal program that collects a 9.8 percent fee from long-distance telecommunications companies to subsidize telecommunications services for low-income and rural customers. It also subsidizes discounts on Internet access for eligible schools, libraries, and rural health care providers.

Shortfall Triggered Action
In September, the Federal Communications Commission (FCC) decided to apply the federal Anti-Deficiency Act (ADA) to the Universal Service Fund. The ADA—passed in the nineteenth century to keep agencies from spending their appropriations all at once and reorganized in 1982—prohibits federal agencies from incurring financial obligations in excess of money on hand. However, because the USF already had overextended itself at the time of the FCC’s ruling, $2.5 billion in money earmarked for schools and libraries was temporarily frozen.

An immediate hike in contributions from subsidizing telecom companies would have been necessary to cover the shortfall and unfreeze the funds. Because telecom companies recoup these USF fees from their customers, the FCC’s decision would have meant a huge increase in consumer landline and wireless telephone bills.

The National Taxpayers Union (NTU) ultimately but reluctantly decided to lend its support to the legislation, for the sole reason of preventing the immediate tax increase that the FCC’s decision would have created. The group’s reluctance stemmed from its longstanding position that the USF itself should be eliminated. However, NTU officials argued consumers shouldn’t be further punished because of an accounting change, regardless of its merit, to a broken federal program.

“By enacting HR 5419, Congress may have saved taxpayers from the immediate threat of a USF-triggered tax hike. But the long-term prospects for the modern, free-market telecommunications system Americans want will be greatly diminished unless elected officials stop looking backward and start moving forward.”

PETE SEPP, VICE PRESIDENT FOR COMMUNICATIONS
NATIONAL TAXPayers UNION

The Universal Service Fund (USF) collects a fee from long-distance telecommunications companies to subsidize services for low-income and rural customers. It also subsidizes discounts on Internet access for eligible schools, libraries, and rural health care providers.

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NATIONAL TAXPayers UNION

The system is broken,” John Stanton, CEO of Western Wireless, told Davidson. He said the subsidies are “an incentive for abuse.”

Tad DeHaven (tdehaven@ntu.org) is an economic policy analyst with the $30,000-member National Taxpayers Union.
Tax Threats Surface in California

Governor opposes increases, but Democrat legislators insist they are necessary

by Ron Roach

Despite emphatic anti-tax election results in 2004, tax-hike proposals are surfacing for the 2005-06 session of the California legislature. In several referenda across the state in the past year, voters rejected proposals to raise taxes or remove legislative constraints on tax hikes.

Nonetheless, new tax-hike proposals are being pushed despite repeated vows from Governor Arnold Schwarzenegger (R) that he will not allow taxes to be increased to address the state’s budget woes. California has a projected $8 billion budget deficit, which is as a result of unbridled spending, not a lack of taxing capacity. Total state spending is about $105 billion.

In spite of Schwarzenegger’s resolve, the Legislative Analyst’s Office (LAO) for the Democrat-controlled state legislature has suggested raising taxes along with some spending reductions. Democrat leaders, being heavily lobbied by public employee unions, insist more taxes be on the table for discussion, and they have rebuffed talk of spending restraint.

Several Tax Hikes Pending

Among the tax-hike proposals already introduced for the session that got underway in earnest on January 3 are these:

“Proposition 56, which would have changed the California constitution to allow the legislature to pass the state budget and budget-related tax and appropriation bills with a 55 percent vote, lost by a 66 to 34 percent margin last March.”

- Limiting tax credits. SB 27 (sponsored by Escutia) would limit aggregate amounts of all tax credits with carry-forward provisions to 50 percent of the net tax.
- A number of tax-hike bills that failed last session are likely to crop up again this session, according to their sponsors. Those measures include:
- Reducing research and development credits. Last session’s SB 1501 (Escutia) sought to reduce the R&D tax credit from 15 percent to 10 percent, and the basic research tax credit from 24 percent to 20 percent. That would have represented a tax increase of $150 million.
- Splitting the roll. Assemblywoman Loni Hancock (D-Berkeley) wrote the proposed Assembly Constitutional Amendment 16, instituting a split-roll property tax by assessing most non-residential property each year at fair market value—constituting a tax increase of up to $3.3 billion. Non-residential property is now reassessed only when it is sold.
- Increasing the vehicle license fee, a property tax-like levy on cars and trucks that Schwarzenegger rolled back soon after winning office in the Fall 2003 special election.
- Granting local authority to impose income taxes.
- New taxes on oil refineries, toxic chemicals, and railroad operations, and a recycling tax on fluorescent lamps.

More New Taxes Proposed

The LAO has suggested taxing owners of rural land to pay for state-provided fire protection. Such a tax, defined as a fee by legislative counsel, was enacted in 2003 but scrapped before the courts could decide a lawsuit contending it was an unconstitutional non-voter-approved parcel tax.

The LAO also has suggested higher taxes on gasoline.

At a December news conference, Assembly Speaker Fabian Nuñez (D-Los Angeles) responded to a reporter who noted the governor’s continued opposition to higher taxes by saying, “Everything ought to be on the table, and that includes new revenues. It is irresponsible to draw a line in the sand.”

The Senate’s new president pro tempore, Don Perata (D-Oakland), also has been an outspoken advocate of boosting taxes on commercial property.

Assembly Republican Leader Kevin McCarthy of Bakersfield believes tax-hike advocates are passionate in their embrace of higher taxes. Many of them can afford a pro-tax stance because they are in politically safe districts, the result of gerrymandering of district boundaries, he said.

Schwarzenegger has been mulling a special election in the fall that could include reapportionment reform.

Hoping to Break Governor’s Will

“(Tax-hike supporters) will continue to push for higher taxes and fees and see if the governor will break,” McCarthy said. “The governor won’t break. Then they will try to pass bills. We [tax-hike opponents] won’t vote for them. Tax increases are losers with voters, and Democrats need to get over it.”

Democrats control the legislature, but not by the two-thirds majority needed to pass tax increases. Democrats outnumber Republicans 25-15 in the Senate and 48-32 in the Assembly; it takes 27 Senate votes and 54 Assembly votes for two-thirds majorities to approve the state budget or raise taxes. So some Republicans would need to vote with the Democrats for higher taxes.

Income Taxes Criticized

McCarthy specifically criticized Chan’s income tax proposal, saying proponents of the tax don’t realize how easily people can avoid it by moving out of state. He cited Nevada, which has become a haven for well-off residents from California because Nevada has no state income tax. He also cited Tiger Woods, who moved from California to Florida after becoming a professional golfer. Florida has no state income tax.

By continuing to raise income taxes, McCarthy said, California drives out high-wage earners, costing the state all of the income tax money that could have been collected from them at lower rates.

McCarthy also noted California voters last year rejected several proposals that would have hiked taxes or made tax increases easier to achieve. For instance, Proposition 56, which would have changed the California constitution to allow the legislature to pass the state budget and budget-related tax and appropriation bills with a 55 percent vote, lost by a 66 to 34 percent margin last March. In November, local tax hikes in Democrat strongholds of San Francisco and Berkeley were defeated, as were county sales tax hikes proposed in Santa Cruz and Los Angeles counties.

The governor’s finance director, Tom Campbell, told the Sacramento Bee on December 18 that state revenues are expected to be 7 percent higher in 2005-06 than in the previous fiscal year. He said the governor’s no-new-taxes budget proposal would reinforce an overriding need to rein in spending growth. The state’s $8 billion gap between revenues and business-as-usual spending is due to auto-pilot spending formulas that must be reformed, said Campbell, a former state legislator and member of Congress.

McCarthy said, “You can [balance the budget and erase the deficit] without raising taxes. Government growth was 46 percent in four full years of a Democratic governor [Gray Davis] and a Democratic legislature. Are the roads 46 percent better? Are the Department of Motor Vehicle lines 46 percent shorter? The answers are ‘No.’”

KEVIN MCCARTHY CALIFORNIA ASSEMBLY LEADER R-BAKERSFIELD

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Ron Roach (ron@caltax.org) is director of communications for the California Taxpayers’ Association (http://www.caltax.org).
Proposed Law Would Put California’s Public Pensions on Private-Sector Footing

by Steve Stanek

A California assemblyman has proposed scrapping the state’s public employee pension system for new employees, instead putting them under the same type of 401(k) pension system offered to most private-sector employees. Current employees and retirees would see no change in their retirement plans.

“Every week we read more stories about state, local, and school budgets being decimated by defined benefit pension costs,” said Assemblyman Keith Richman (R-Northridge), in introducing Assembly Constitutional Amendment 5 (ACA 5) on December 6.

“The City of San Diego, Orange and Contra Costa Counties all have [current total] pension deficits of more than $1 billion,” Richman said. “CalPERS [California Public Employees Retirement System] owes more than $1.9 billion than it has on hand, and just last week state teacher pension fund officials said they may cut benefits for future retirees by $500 a month to eliminate their $23 billion deficit.”

Richman said ACA 5 “will stop state government and local public agencies from making expensive promises they can’t keep and will restore accountability to public pensions.”

Voters would have to approve the proposal in a ballot initiative, and state legislators would have to design the 401(k) plan before it could be implemented.

Union Reps Object

Public employee unions voiced opposition to the proposal even before it was formally introduced, after Richman began publicly floating the idea last fall.

Terry Brennand, a lobbyist for the Service Employees International Union, which represents about 300,000 government workers in California, told reporter Peter Felsenfeld of the Contra Costa Times that 401(k)-type plans could force employees to retire into poverty.

“I don’t think anyone has an interest in putting a bunch of aging former public employees back on the public dole,” he told Felsenfeld for an October 19 article.

Ron Cottingham, president of the Police Officers Research Association of California, also objected that a few years of investment losses could wipe out a 401(k) retirement account.

He told Felsenfeld that ACA 5 “puts California at great risk of losing more officers” because 401(k)-type plans offer no guarantees, “and people need to know they’re going to get something definite when they put their lives on the line.”

Move Emulates Private Sector

Richman, however, noted that during the past 20 years most private-sector companies have dropped guaranteed pension plans like those offered to California’s public employees. Guaranteed pension plans provide retirement benefits based upon a formula of years employed and salary at retirement.

Instead, most private-sector employers have begun offering 401(k) plans, which allow employees to decide how much of their income to contribute to their individual account and how to invest the money: Contributions are tax-deferred and in most cases matched by the employer.

A number of states, including Colorado, Florida, Michigan, Montana, and South Carolina, have adopted some form of 401(k)-type plan for public employees in recent years, according to Richman.

Pension Costs Soaring

“Retirement costs for [California] state employees alone have grown from $200 million in 2000 to $2.6 billion this year [2004], heading to $3.5 billion in 2009,” Richman said. “ACA 5 will begin to stabilize and reduce these retirement costs as the legislature and Governor Schwarzenegger struggle to eliminate California’s $10 billion structural budget deficit.”

Anthony P. Archie, a policy fellow in business and economic studies at the Pacific Research Institute (PRI) in San Francisco, said in an article on the PRI Web site, “With a looming budget deficit of $7.3 billion, California needs to adopt more cost-saving measures. Changing the state’s pension system would be an excellent place to start.”

Archie said a state employee with 30 years on the job and earning $80,000 a year can retire at age 55 and receive an annual pension of $30,000, 60 percent of his or her previous salary. The guaranteed pension for public safety employees is more generous: They can retire at age 50 with 90 percent of their income.

“While these benefits are very attractive to state employees, the taxpayers are left with the bill,” Archie said.

Investments Under-Performing

Employees make contributions to CalPERS, as does the state. Those funds are then invested by a 13-member board. Archie notes their investments have performed poorly in recent years.

“From 2001 to 2003, the investments under-performed, and CalPERS suffered severe shortfalls, forcing taxpayers to pick up the tab,” he said. “In 2004, CalPERS ran a deficit of $1.9 billion. The governor and the legislature are attempting to defer a portion of this by selling $800 million in bonds, a move that the Pacific Legal Foundation claims is unconstitutional.

“The pension problem is even worse for some of California’s counties and cities. “The city of San Diego’s pension system has only enough funds to cover 68 percent of its obligations,” Archie said. “Contra Costa County allocates 11 percent of its budget to pensions, while the city of Bakersfield is at 14 percent. There are literally dozens of localities that face bankruptcy if something isn’t done.”

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.
California Provides Lessons for Private Transportation

by Steve Stanek

Private toll roads are in much wider use in some parts of Europe and Asia than in the United States, but private funding to help solve traffic congestion may soon become more common here, according to University of California, Irvine professors Marlon G. Boarnet and Joseph P. DiMento.

Boarnet and DiMento made the prediction in the Fall 2004 issue of Access magazine, in an article titled “The Private Sector’s Role in Highway Finance: Lessons from SR 91.”

Boarnet is professor of planning, policy, and design and economics and chairman of the Department of Planning, Policy, and Design in the School of Social Ecology at the University of California, Irvine. DiMento is professor of planning, policy, and design, criminology, law and society, and management in that department.

Funding Gaps Will Widen

Boarnet and DiMento argue the gap between the need for highway construction and maintenance and available resources will widen in the years ahead, because the major source of highway funding is motor fuel taxes. As gas-stingy hybrid automobiles, which run on electricity and gasoline, become more popular, and as alternative fuel sources are developed, that revenue source will decline, they say.

They believe the private sector can help plug the funding gap, and they point to SR 91 as an example for future private-public arrangements.

State Route 91 is a 10-mile stretch of toll lanes in California’s Orange County. A limited partnership composed of subsidiaries of several corporations involved in highway construction was formed to build the road, and California granted a 35-year franchise to the partnership in 1990. The highway opened in December 1995.

County Bought Private Highway

“The SR 91 toll lanes were innovative in several respects,” Boarnet and DiMento note. “They were the first U.S. implementation of peak/off-peak road pricing (often called congestion pricing). The lanes have no toll booths; all tolls are collected electronically. While detailed financial information on the privately held CPTC [California Private Transportation Company] has not been released to the public, experts generally agree that toll revenues likely met the private firm’s expectations.”

Boarnet and DiMento say the highway was viewed as a public benefit in its early years of operation, but that perception had shifted, mainly because a Strong Public Partner Essential

Boarnet and DiMento summarized the lessons from the SR 91 experience as follows:

1. Private-sector funding may work, but only as part of a public-private highway financing partnership.
2. Balancing public and private interests will be fundamental. They argue that non-compete clauses are “too inflexible to balance public and private interests over a span of decades.”
3. The public sector must be institutionally strong. They say the SR 91 experience shows that the “complicated nature of public-private highway partnerships requires a well-trained, well-staffed, institutionally strong public-sector partner.”
4. “High-occupancy vehicle lanes (carpool lanes) provide an early opportunity to pioneer some public-private highway partnerships.” The authors add that “carpool lanes, typically adjacent to unpriced highway lanes, provide an opportunity to involve the private sector. Public cost sharing will often be needed to lower private investment to levels that allow profitability.”

Agreeing in large part with Boarnet and DiMento is Robert Poole, director of transportation studies at Reason Foundation, who worked on the creation of SR 91.

“By and large, I agree with Boarnet’s and DiMento’s assessment,” Poole said. “The 91 express lanes have been a huge success in economic and transportation terms, but encountered political problems due to special circumstances. And for several reasons, opportunities to do private toll roads like this one seem to be few and far between.”

Fully Private Projects Unlikely

Poole noted that the limited partnership was able to lease land for the lanes from the OCTA for one dollar a year. Environmental approval for carpool lanes also had been obtained before the franchise discussions began, giving the investors far lower start-up costs than private firms likely could obtain anywhere else.

Poole cited high development and construction costs in urban areas, uncertainty about eventual approval, and “tax-code discrimination that lets the public sector but not the private sector finance such projects at tax-exempt bond rates” as factors working against a totally privately funded project of similar magnitude.

“So for the short- to medium-term, I have concluded that the best way forward is the kinds of public-private partnerships the authors recommend,” Poole said. “This assessment applies to cases of developing brand new capacity, whether an entirely new toll road or specialized toll lanes are added to an existing freeway.”

He cited the Chicago Skyway, an eight-mile toll road recently leased from Chicago by an overseas consortium of investors, as an example of an appropriate public-private arrangement for an existing toll system. The city received $1.8 billion for the 99-year lease. “For existing tolled facilities like the Chicago Skyway, full-fledged private ownership and operation—a 99-year lease is the functional equivalent of ownership—seems quite feasible,” Poole said.

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.
Ten Years of GOP Tax Policy: Good News and Bad

by Chris Edwards
Managing Editor's note: This article is excerpted with permission from a chapter in The Republican Revolution 10 Years Later: Smaller Government or Business as Usual? to be published by the Cato Institute in March 2005.

In part 1 of this two-part excerpt, author Chris Edwards considers the good aspects of GOP tax policy. Next month's excerpt will analyze the bad.

As a result of the 1990s economic boom and the tax rate increases of 1990 and 1993, federal tax revenues soared from 18.1 percent of U.S. gross domestic product (GDP) in fiscal 1994 to 20.9 percent by fiscal 2000, which ties the record high share of GDP set in 1944. The 2001 recession and Bush tax cuts reduced revenues to 15.8 percent of GDP by fiscal 2004. Nonetheless, even if President George W. Bush's 2001 and 2003 tax cuts are made permanent, revenues are expected to rise to more than 18 percent of GDP later this decade.

That rise is expected to occur partly because of a growing economy and partly because of a rapid increase in alternative minimum tax (AMT) payments. Because the AMT is not indexed for inflation, it will hit an increasing number of taxpayers in future years. If made permanent, the Congressional Budget Office (CBO) estimates that the 2001 and 2003 tax cuts would reduce federal revenues by about 1.7 percent of GDP annually by 2014.

The highlights of the GOP's tax cuts include a modest cut in personal income tax rates, a cut in the top capital gains rate from 28 to 15 percent, and a cut in the top dividend tax rate from 39.6 percent to 15 percent. Also, Republicans have substantially cut taxes on savings. IRAs and pension vehicles have been liberalized, health savings accounts were created in 2003, and partial capital expensing was (temporarily) enacted.

The crucial question is whether future Congresses will act to retain those pro-growth tax cuts.

Focusing on Supply Side
Republican leaders in Congress worked hard during the decade to make sure the GOP gained a brand name as the tax-cutting party. Leading tax cutters included Dick Armey (House Majority Leader, 1995-2002), Bill Archer (Ways and Means Committee Chair, 1995-2002), Thomas (Ways and Means Committee Chair, 2001-present), William Roth (Senate Finance Committee Chair, 1995-2000), and John Kasich (House Budget Committee Chair, 1995-2000). Those important party leaders kept Congress focused on pro-growth cuts. In addition, some of those leaders and other members, including Sen. Richard Shelby (R-AL) and Reps. Billy Tauzin (R-LA), Phil English (R-PA), John Linder (R-GA), and Phil Crane (R-IN), championed fundamental tax reform.

Before Bush came to office in 2001, most GOP tax-cutting efforts were focused on social-policy-oriented breaks, particularly child tax credits and marriage penalty relief. Bush changed that course and followed the supply-side tax advice of his two main economists, National Economic Council Chair Larry Lindsey and Council of Economic Advisers Chair Glenn Hubbard.

Although some of Bush's tax proposals have been narrow tax credit provisions, the bulk of his tax cuts have been pro-growth, pro-savings, and pro-investment.

Tax Hikes Averted
Before the 1997 tax law, the six previous major tax laws either imposed tax increases (1982, 1984, 1987, 1990, and 1993) or were roughly revenue-neutral (the Tax Reform Act of 1986). (See Figure 1.) In addition, the 1983 Social Security amendments increased taxes. Without the change in policy direction that resulted from the 1994 election, Congress might have continued along the path of tax increases that had dominated recent budget policies.

Indeed, there were several efforts in the 1990s led by Democrats and liberal Republicans to increase cigarette taxes, gasoline taxes, and corporate taxes. Those were mainly averted. For example, President Clinton's fiscal 2000 budget sought a 55-cents-per-pack cigarette tax increase and proposed dozens of corporate tax increase provisions.

Dynamic Scoring Needed
During the past two decades, tax debates in Congress have put an excessive emphasis on the revenue effects of legislation. That has unfortunately shifted the policy focus away from the effects that legislation might have on economic growth and tax complexity. To compound the problem, official revenue estimates, which are presented as if carved in stone, have often been inaccurate because they ignored the effects of tax changes on the macroeconomy.

To address that problem, the Congressional Budget Office and Joint Committee on Taxation have begun to modernize their tax estimating apparatus by bringing macroeconomic modeling into the process. One result should be to make revenue estimates more accurate.

Also, the greater focus on the economic effects of legislation should help sensitize Congress to the fact that tax changes are not just about gaining and losing money for the government budget; tax changes have serious consequences for economic growth and prosperity.

Chris Edwards (cedwards@cato.org) is director of tax policy at the Cato Institute, Washington, DC.
D.C. Councilwoman Stands against Taxpayer-Funded Stadium—For A While

by John W. Skorburg

Major League Baseball (MLB) was thrown a curveball on December 15 as District of Columbia Councilwoman Linda Cropp (D) tried to help local taxpayers by changing the financing rules for a proposed new stadium.

Instead of approving a new baseball stadium to be wholly taxpayer-funded, Cropp persuaded the council to pass an amendment requiring a partnership between taxpayers and private enterprise. Cropp’s amendment called for at least 50 percent private funding. The amendment passed by a 10-3 vote.

But the uprising came to an end just a week later, on December 21, when the DC City Council voted 7-6 to approve the move of the Montreal Expos to the city for the 2005 season, without the requirement for 50 percent private funding for the stadium. Cropp voted with the majority, even though the private funding requirement she championed was deleted. The team will become the Washington Nationals.

“I wouldn’t know Linda Cropp if I bumped into her in the street, but I sure would like to vote for her.”

RON RAPOPORT, SPORTS WRITER

CHICAGO SUN-TIMES

Opposed a “Lopsided Deal”

Until Cropp’s amendment was approved, it had looked like a lead-pipe cinch that the Expos would move. The last MLB team to play in the nation’s capital—the Washington Senators—moved out after the 1972 season.

In presenting her amendment, Cropp said she would rather lose the new baseball club than “allow the city to be victimized by a lopsided deal,” according to a December 16 article in the Baltimore Sun by reporter Jeff Barker. Cropp said she hoped for the return of Major League Baseball, “but not at any cost.”

“We are not giving up the whole quest for private financing. Linda Cropp is still sticking to her guns that we find at least 50 percent private financing, if not more.”

MARK F. JOHNSON, SPOKESPERSON

Amendment Favored Outside DC

The city had been promising to fully fund the cost of building the 41,000-seat stadium. Some estimates put the price tag in excess of $550 million, including $25 million to pay for renovations to the existing RFK Stadium. The team would play there while the new stadium is built.

MLB responded to Cropp’s proposal by threatening to scuttle the Expo’s move to DC. The new team was ordered to cease its business and promotional activities immediately.

MLB President and Chief Operating Officer Bob DuPuy issued a statement a few hours after the DC council’s vote, denying the private funding requirement as “wholly unacceptable” and stating the amendment was inconsistent with the original agreement.

DC Mayor Perseveres

Washington, DC Mayor Anthony Williams (D), who negotiated the original agreement, told reporters he would keep working for a solution.

“We’ve got 15-16 days to try to keep this alive,” Williams told reporters.

Michael Wilbon, a columnist for the Washington Post, wrote on December 16, “It’s a great idea that private money finance at least 50 percent of the cost of a new stadium, but he blasted the timing of Cropp’s move.

“It’s not like there are negotiations for a new stadium caught Cropp or anybody else by surprise,” Wilbon wrote, pointing out the city had long lobbied for another Major League Baseball franchise.

[VA]

Ron Rapoport, a sports writer for the Chicago Sun-Times, praised Cropp for proposing DC-taxpayer financing.

“I wouldn’t know Linda Cropp if I bumped into her in the street, but I’m sure she would like to vote for her,” Rapoport said in a December 16 column.

In a December 16 editorial in The Roanoke (VA) Times, Cropp also was applauded. “Cropp proposed and the council accepted a requirement that private financing provide at least half the cost of a new stadium. How radical—demanding that private enterprise invest some of its own money itself.”

Temple Stark, owner and operator of Political State Report (http://www.pol-state.com), also praised the amendment. “The D.C. Council is protecting its taxpayers and doing its duty to run a tight budget,” he wrote. “Other municipalities should do the same, shouldn’t they?”

Not Giving Up … Entirely

The City Council and Cropp pledged to continue to solicit private funds for the new stadium. Cropp has said private money could conceivably cover $280 million of the cost.

“We are not giving up the whole quest for private financing,” said Cropp spokesperson Mark F. Johnson to the Washington Times in a story dated December 23. “Linda Cropp is still sticking to her guns that we find at least 50 percent private financing, if not more.”

MLB agreed to share the cost of premiums for insurance that would be purchased to cover potential stadium cost overruns. The league also reduced, from $19 million to $5.3 million, the penalty that would be assessed against the District if the ballpark is not ready for play by March 1, 2008.

Even after compromising her position, Cropp attracted praise from some corners. “I think that her digging in her heels at the point at which she did enriched the debate,” Sister Mary Ann Luby of the Washington Legal Clinic for the Homeless told Washington Times reporter S.A. Miller on December 23.

The clinic was a member of No D.C. Taxes for Baseball, a coalition of groups opposed to tax funding of the stadium.

“It just didn’t have the outcome I wanted,” Luby said.

“I think that her digging in her heels at the point at which she did enriched the debate. It just didn’t have the outcome I wanted.”

SISTER MARY ANN LUBY

WASHINGTON LEGAL CLINIC FOR THE HOMELESS

Williams officially signed the agreement between the District and MLB on December 29, 2004. “This is one of my proudest days as mayor,” he said at the signing.

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.

A Decade of Research on Sports Stadiums

compiled by John W. Skorburg

“Caught Stealing: Debunking the Economic Case for D.C. Baseball”

Dennis Coates and Brad R. Humphreys

October 27, 2004

Cato Institute

http://www.cato.org/pub_display.php?pub_id=2479

This study’s conclusion, and that of nearly all academic economists studying this issue, is that professional sports generally have little, if any, positive effect on a city’s economy. The net economic impact of professional sports in Washington, DC and the 36 other cities that hosted professional sports teams over nearly 30 years, was a reduction in real per capita income over the entire metropolitan area.

“Experts Agree: Public Support for Stadiums Is Madness”

Charles L. Klotsner

March 1, 2002

St. Louis Journalism Review

http://www.heartland.org/Article.cfm?artId=8798

Although research proves sports stadiums drain public resources or are of minimal or no economic benefit, and enrich primarily the owners of sport teams, St. Louis and Missouri might succumb and dole out many millions for decades to come.

“Home Run for Corporate Welfare: Taxpayer Subsidies for Sports Stadiums”

Policy Forum

April 2, 2001

Cato Institute

http://www.cato.org/cgi-bin/scripts/printtech.cgi/events/010402pf.html

During the twentieth century, more than $14 billion in government subsidies went to the four major professional sports—Major League Baseball, the National Football League, the National Basketball Association, and the National Hockey League. While cities build fields of dreams for teams, hoping they will come, it isn’t clear there are economic gains. Three experts on the economics of tax-funded stadiums examined the need for subsidies of sports teams and the economic impact of sports on local economies.

“Sports Stadiums: No Pot of Gold for Cities”

Sam Staley and David Swindell

The Buckeye Institute for Public Policy Solutions

http://www.heartland.org/Article.cfm?artId=8087

Sports stadiums may have psychological and even political benefits, but they are falsely sold as an economic development tool. Cities and boosters ought to rely on private capital for funding these structures.

“Sports Stadium Madness: Why It Started, How to Stop It”

Joseph L. Bast

February 1, 1998

The Heartland Institute

http://www.heartland.org/Article.cfm?artId=9474

Taxpayer subsidies to professional sports teams amount to
Chicago Stadiums Fail to Deliver Promised Benefit

by Steve Stanek

Chicago has two taxpayer-subsidized sports stadiums, neither of which appears to be living up to the promises made by supporters of taxpayer funding.

Removal of Soldier Field, home of the National Football League’s Chicago Bears, was completed in 2003 at a cost of $660 million, with $432 million of the cost covered by bonds issued by the Illinois Sports Facilities Authority (ISFA). After one year of operation, the renovated stadium has netted less revenue than projected for the Chicago Park District, which owns the stadium, according to critics of the deal.

“Chicago Park District officials projected a renovated Soldier Field would generate $10 million annually for park district programs. However, after one full year of operation, the park district actually netted less than $7 million...”

A few miles south of Soldier Field sits U.S. Cellular Field, home of Major League Baseball’s Chicago White Sox. That stadium is supposed to pay rent to the state after attendance hits a certain figure, but in recent years attendance has been below the target, effectively giving the White Sox a rent-free stadium.

The bond payments for both stadiums are funded by a 2 percent hotel tax in Chicago, which generates about $23 million a year. That tax was first levied in 1988, after the Illinois General Assembly created the ISFA to issue bonds for a new stadium for the White Sox.

Hotel Tax Subsidizes Park District

Chicago Park District officials projected some $500 million a year. The decision to subsidize a team is driven by competition among cities for a limited number of franchises and teams with a similar capacity and teams with a similar won/loss record.

“It’s unfair to say the park district is fudging. In most of the years when the Sox have paid rent, they have barely passed the rent threshold.”

New Contract, Old Debt Affect Revenue

Sanderson said the apparent drop in revenue probably stems from a new contract the Bears negotiated with the park district. He also pointed out the renovation reduced the number of stadium seats, from 67,000 to 61,500, making Soldier Field the NFL’s smallest stadium.

Tranter told Dardick the park district is also neglecting to include debt payments in Soldier Field’s net revenue calculations.

White Sox Go Years Rent-Free

At U.S. Cellular Field, the White Sox lease expires in 2011. According to Christopher Lackner, spokesman for the ISFA, which owns and operates the stadium, the White Sox have paid rent nine times since 1991, but only once since 2001, when the annual attendance target was raised from 1.2 million to 1.5 million. Total rent paid depends on total attendance.

“For all practical purposes, the Sox don’t pay rent,” said Sanderson, because in most of the years when the Sox have paid rent, they have barely passed the rent threshold.”

U.S. Cellular Field originally cost $125 million to build, but enhancements have been made since the original construction, putting the total subsidy at more than $200 million, not including interest on the debt.”

“U.S. Cellular Field originally cost $125 million to build, but enhancements have been made since the original construction, putting the total subsidy at more than $200 million, not including interest on the debt.”

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.
“Least Wanted” Poster Warns Pro-Tax Republicans in Virginia

by Steve Stanek

The taxpayer advocacy organization Americans for Tax Reform (ATR) has launched a “Least Wanted” campaign intended to warn every Republican state legislator in the nation against raising taxes.

ATR’s Least Wanted poster features the names and faces of 34 Republican state legislators in Virginia, who last year joined Democrats to pass the largest tax increase in the state’s history. ATR has sent copies of the poster to Republican lawmakers in every state, making clear they could be similarly targeted.

In total, 60,000 copies of the poster have been e-mailed to legislators, taxpayer advocacy groups, and individuals, according to ATR President Grover Norquist.

“We had several audiences for Least Wanted,” said Norquist. “First were the Virginia legislators, letting them know the world knew how they voted. Another audience is the taxpayers of Virginia. The third audience is Republican state legislators across the country. Our goal is to dissuade weak-kneed Republican legislators from caving to those who want to raise taxes, to let them know there are costs, that this will be noticed and remembered.”

“Our goal is to dissuade weak-kneed Republican legislators from caving to those who want to raise taxes, to let them know there are costs, that this will be noticed and remembered.”

GROVER NORQUIST, PRESIDENT
AMERICANS FOR TAX REFORM

Taxers Fighting Back

Republicans pictured on the poster have fought back through the news media.

“What you have there [at ATR] are a group of reactionaries masquerading as conservatives who are out to destroy the Republican Party. Virginia’s House Appropriations Chairman Vincent F. Callahan Jr. (R-Fairfax) told Washington Post reporter Michael Shear, as reported in the paper’s September 15 edition. ATR launched the campaign in September but only recently took it national.

State Senate Majority Leader Walter A. Stosch (R-Henrico) told Shear that Norquist “thrive[s] on divisiveness and fear.” He added, “shriek divisiveness is not constructive.”

Virginia’s estimated $1.38 billion tax increase, approved in 2004 for the current budget year, was proposed by Governor Mark Warner (D) and supported by virtually all Democrat members of the Virginia Assembly and the 34 Republicans, including 19 delegates and 15 senators.

The increase features hikes in state sales, cigarette, and real-estate taxes. ATR and the Virginia Club for Growth argue the tax increase package was unnecessary. Virginia’s official budget Web site shows a state spending increase of 13.3 percent this year. Without the new revenues from the tax increase, state spending would still have increased 10.6 percent.

“Warner argued a tax hike was necessary for the state to maintain its AAA bond rating. Norquist said taxes were hiked simply to fund the surge of spending.

“With the newly adopted budget, state spending during Warner’s term will increase by 26 percent [FY2002 to FY2006],” said Norquist. “From 1998 to 2006, state spending will have increased by a runaway 70 percent.” Warner took office in January 2002; his predecessor, James Gilmore (R), was governor from 1998 until 2002.

Governor Still Popular

Despite the tax and spending increases, Warner apparently remains popular with Virginia voters. A poll taken after the tax hike was approved showed 58 percent of Virginians giving Warner a “good” or “excellent” job rating. The poll is a quarterly public opinion survey of Virginia residents conducted by the Center for Public Policy at Virginia Commonwealth University.

Some news organizations also have defended the tax hike. In response to Norquist’s complaints, the News Leader in Virginia’s Shenandoah Valley wrote on September 23, “Most people are intelligent enough to know the government, whether they’re federal, state, or local, run on money, not magic beans, not promises of growth, not surpluses. They are aware that this money comes from taxes paid by citizens that are necessary in order to fund the infrastructure and services people have come to expect as part of a decent quality of life. Good schools, efficient, well-equipped police forces, responsive fire and rescue teams, and a host of other things—some vital, others less so—aren’t free.”

Other commentators have been less supportive. In a December 15 column for the Roanoke Times, Ed Lynch, associate professor of political science at Hollins University in Roanoke, used the terms “trumped up” and “fraudulent” to describe Warner’s arguments for the tax hikes.

Still, Lynch argued in his column that Norquist and the Virginia Club for Growth would do better to concentrate on defeating Democrats, who voted in lockstep with Warner, than on defeating Republicans who sided with him.

In a followup interview with Budget & Tax News, Lynch said he believes the Least Wanted campaign, at least in the Roanoke area, has had minimal effect on voter attitudes.

“They may be going for Northern Virginia, where there is more national media, and they can get more mileage for the campaign,” he said. “No matter where they go, though, it’s going to be tough. In Virginia, incumbents get to challenge the method of their renomination. If you think you might have an intra-party challenge, you go for a primary. Any of those target ed delegates would go for a primary. If a challenger has not already started hitting the hustings, he’s way behind.”

Some Mending Fences

Virginia also does not have party registration, “so Republicans can unabashedly appeal for Democrat votes and base a primary victory on them,” Lynch said.

Even with these advantages, many of the targeted Republicans have been trying to mend fences, according to Lynch.

“There’s an effort to emphasize that the tax increase was part of a larger agreement, which has an increase in the personal exemption and other good things,” he said. “They are certainly conscious of the fact that a lot of their Republican friends were upset with their vote.”

Steve Stanek (stanek@heartland.org) is managing editor of Budget and Tax News.
Hansen does not offer recommendations for change, the Tax Foundation generally recommends that flat, broadly based taxes with few exemptions should be used to raise whatever funds the state must collect.

Lotteries Spreading
The virtues and defects of lotteries have become more important as states have increased their reliance on lottery revenue.

Oklahoma voters approved a lottery referendum on November 2, making their state the 41st state to sell lottery tickets.

Many existing state lotteries are expanding into new forms of gambling, such as video gaming devices. In fiscal year 2002, South Dakota raised more than 7 percent of its own-source revenue selling paper and video lottery tickets. The nationwide average in states with a lottery was 2.2 percent revenue (a figure that excludes money from the federal government).

In fiscal year 2003, total spending on lotteries was almost $45 billion, or $155 for every man, woman, and child in the United States. Roughly 31 percent of this, or almost $14 billion, went into state coffers. Winnings, advertising, and administration account for the remaining funds.

Hansen finds the increasing popularity of state-run lotteries and other forms of gambling as government revenue sources disturbing. State legislators looking to boost tax revenue would do well to consider other sources more consistent with principles of sound tax policy, she argues.

“State-run lotteries make state tax systems more regressive, less transparent, and less economically neutral,” said Hansen. “For all these reasons, the lottery is an example of poor tax policy.”

Not a “Voluntary” Tax
The study addresses what it describes as a common fallacy used to promote lotteries: the idea that lottery revenue is not actually tax revenue because playing the lottery is voluntary.

“A mandatory tax on a voluntarily purchased lottery ticket is still a tax,” said Hansen, “just as any sales tax or excise tax is a mandatory tax on voluntarily purchased goods and services.”

The U.S. Census Bureau assigns lottery revenue the innocuous designation “miscellaneous revenue” in its reports on state taxation. As a result, state lawmakers establish and expand lotteries without admitting they are raising taxes, Hansen notes.

Government or Private Enterprise?
States call their lottery revenue neither taxes nor miscellaneous revenue, but “profits.” This term from the business world reflects a common perception among lottery officials that lotteries are more like a business than a government agency.

“Lotteries are unique among government agencies in that they actively encourage participation in an activity that they prohibited only 40 years ago,” Hansen points out. “This raises the question of whether profit-maximization is compatible with the goals of responsible government.”

Lottery taxes are not economically neutral, Hansen points out. A neutral tax system is one that doesn’t encourage the consumption of one good over another, thereby distorting consumer spending. According to Hansen, lottery tickets are singled out for a higher tax rate. This causes economic distortion, according to the study, and lowers the payout rate—the amount gamblers win as a percentage of the money they bet.

A third problem with lotteries is that they’re regressive, meaning the poor bear a disproportionately heavy share of the tax burden.

Numerous studies have shown the lottery to be a regressive form of taxation,” said Hansen. In a study of 1997 lottery participation, the National Gambling Impact Study Commission found that, although people of all incomes played the lottery, players with incomes under $10,000 spent almost three times as much as those with incomes over $50,000.

Violating Sound Tax Principles
Hansen argues that lotteries, like other forms of taxation, should adhere to basic principles of sound tax policy, such as transparency and neutrality. According to the study, lotteries violate those principles.

“Taxes should be transparent, that is, clear to taxpayers,” said Hansen. “Taxpayers should understand what is being taxed and at what rate.”

Because state governments refuse to identify lottery “profits” as taxes and advertise the lotteries as recreation, not tax collection, the tax is implicit and transparency is impossible, she said.

Hansen calculates the 2003 lottery tax rate for each state. She explained, “Imagine a state converted from private sales of liquor to a state-controlled system. What used to be tax revenue would suddenly be called ‘profit,’ and ‘taxes’ would go down.

“The successful pressure not to raise taxes,” she continued, “has resulted in a boom in ‘non-tax revenue,’ such as lotteries.”

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Lessons for Capitalists from an Unexpected Source

by Emily Brennan

For Christians, the parable of talents is a clear command to develop the gifts and opportunities given to us. Yet in it also lies a perhaps surprising implication, reaching beyond the moral imperatives that mold and define a Christian.

In the parable of talents, Jesus Christ describes a master who gave a number of coins to his servants, then went away. Upon his return, the master richly rewarded the servants who invested and doubled his money, and he rebuked the one who did nothing with it. In the parable, the good servants were innovative in finding the best way to produce more talents, and they were rewarded accordingly.

The story reveals a dynamic in the master-servant relationship that is also found in the formula explaining economies, where the consumer is the master, the company is the servant, and the economy itself is the realm in which talents are measured and rewards conferred.

Consumer Is Master

An economy is rewarded with prosperity when its actors realize and embrace this relationship, giving companies the freedom to multiply their talents. Moreover, doing so requires both macroeconomic stability and fair, intense competition across all markets.

This idea is an old one, but it is given renewed impetus by a compelling new book, The Power of Productivity: Wealth, Poverty, and the Threat to Global Stability, by William Lewis (University of Chicago Press, 2004).

The simple logic reflected in the parable of talents flies in the face of many current ideas about what drives economic growth and more particularly about how best to help impoverished nations. These mistaken ideas give rise to policies such as protection of domestic markets, government intervention to prevent layoffs and business failures, high minimum wages, and the artificial direction of capital flows to poor countries—all measures designed to coax an economy into growth.

In fact, none of these policies recognizes the “consumer is master” concept; thus, none of them results in the growth for which they were designed. Hence, most of them oblige the country’s top economic priority.

Innovation Is Key

Lewis’s conclusions, drawn from a 12-year study of macro- and microeconomic data from 13 different countries, point the way toward better policies. Using information from 118 individual microeconomic industry studies reported by the McKinsey Global Institute, where he was founding director, Lewis observes a concrete connection between productivity and prosperity in all types of economies, from rich to poor.

The formula is straightforward: “Productivity is simply the ratio of the value of goods and services provided consumers to the amount of time worked and capital used to produce the goods and services,” Lewis says.

But there’s more. Lewis reminds us of the higher truth that “the goods produced have value only because consumers want them.” Consumer behavior as a response to intelligent productivity is the essential ingredient to the success of an economy (or a business), regardless of whether that economy’s participants or its overprotective government know this. Thus, nations must focus on creating the conditions in which creative innovation flourishes and consumer demands are met.

Lewis points to the experience of the United States in the 1990s to show why these conditions are essential in the quest for prosperity. In the second half of the 1990s, only six of the 60 sectors making up the U.S. economy accounted for about 75 percent of the total gross productivity growth acceleration,” he writes.

Each sector’s growth, Lewis notes, depended on changes associated with innovation. One sector, security brokerage, improved by catering to Internet-savvy consumers; it developed online securities trading. In retailing, Wal-Mart captured “a sufficiently large market share by 1995 that its competitors faced a choice of either getting as good as Wal-Mart or going out of business.”

Government Steps Aside

Like the servants mentioned in the biblical parable, companies should be free to discover the most innovative business plan. Governments must stay just close enough to their countries’ economies to ensure macroeconomic stability, providing a firm foundation for steady growth, yet they must be do-or-die incentive for companies to become more efficient.

“Governments must stay just close enough to their economies to ensure macroeconomic stability, providing a firm foundation for steady growth, yet they must step far enough away to allow fair and tough competition, providing a literally do-or-die incentive for companies to become more efficient.”

When governments don’t do this, the result looks like the milk market in the Japanese food-processing industry where, Lewis reports, “productivity is only at 39 percent of that of the United States.” Since Japan’s Large-Scale Retail Location Law discriminates against stores that occupy more than 1,000 square meters, retailers along the lines of a Sam’s Club or a Costco remain scarce. Smaller stores naturally do not buy large quantities, resulting in local producers choosing to deliver three times a day because they have no incentive to invest in chemicals that would allow milk to be safely delivered over longer distances.

While Japanese customers would almost certainly prefer cheaper milk, they do not have the choice. Meanwhile, the Japanese economy continues to reflect this poor productivity.

What happens when governments and economic actors do the right thing? Here, too, the Bible has a useful insight: “For to every one who has, more will be given, and he will have abundance; but from him who has not, even what he has will be taken away” (Matthew 25:29). Under the right conditions, businesses that don’t serve customers well by providing valued products at competitive prices will not survive.

The rest of the economy, by contrast, will reap many rewards: efficiency, productivity, prosperity (especially in poverty-stricken nations), and most importantly, development of that divinely endowed, precious gift to humanity: creative ingenuity.

Acton Institute intern Emily Brennan attends the College of the Holy Cross in Worcester, Massachusetts. An earlier version of this essay was first published as an Acton Commentary on July 21, 2004. It is available on the Acton Institute Web site at http://www.acton.org/ppolicy/comment/article.php?id=298.
President George W. Bush has said he opposes raising payroll taxes to reform Social Security, but he may entertain a proposal by U.S. Senator Lindsey Graham (R-SC) that would sharply increase the payroll tax on upper-income earners.

During a November 17 speech at The Heritage Foundation, Graham proposed raising the limit—he did not specify to what level—on the amount subject to Social Security tax. On January 1 the taxable-income limit rose from $87,900 to $90,000.

**White House Avoids Clarity**

At a daily press briefing December 9, White House Press Secretary Scott McClellan was asked about Graham’s proposal. He declined to say whether Bush would consider raising the amount of income subject to Social Security tax to be a payroll tax increase, if the tax rate remained the same.

Ten days later, on separate Sunday talk shows, White House Chief of Staff Andrew Card and Treasury Secretary John Snow also declined to rule out the possibility of lifting the limit on the amount of income subject to the payroll tax. Instead, they focused on the rate at which income is taxed.

On ABC’s *This Week* show, Card said, “The rate that you and I pay, contribute, to our Social Security, the president does not want to see that rate increased.” He declined to elaborate.

On Fox News Sunday, Snow made a similar comment.

**Tax Hike Tradeoff Considered**

Graham said he believes a tax increase on high-income earners is needed for the president’s proposal for personal Social Security accounts to pass Congress. The president has proposed allowing younger workers to set up personal accounts into which they may invest a portion of their Social Security taxes. The president and his advisors on this issue believe private accounts controlled by individuals are likely to generate greater returns over time than the current system, which pools all tax receipts and doles them out to current retirees.

Some economists expect privatization of a portion of Social Security taxes to generate “transition costs” of between $1 trillion and $2 trillion. Lindsey believes substantially lifting the amount of income subject to the Social Security tax could pay off any transition costs in 10 years. He also believes the strategy could bring some Democrats in Congress to accept private accounts. Without Democrat support, such reform is likely to die, he said.

“Those of us committed to reforming Social Security must honestly deal with the transition costs that come about when personal accounts are established,” Graham said on December 9. “Under my plan, which has been evaluated by the Social Security Administration, we are able to achieve permanent solvency, but the transition costs are over $1 trillion.

Other economists say transition costs would be much less than Lindsey projects, or even non-existent.

In an essay published January 11, 1999, in *The New York Times*, Nobel Prize-winning economist Milton Friedman wrote, “given a proper understanding of Social Security’s current unfunded liabilities—variously estimated at from $4 trillion to $11 trillion—there are no real transition costs to privatizing Social Security, merely the explicit recognition of current implicit debt.”

In a December 12, 2004, article for the *Philadelphia Inquirer*, Jagadeesh Gokhale, senior fellow at the Cato Institute, made much the same point, but with updated estimates:

“The so-called ‘costs’ of reform are already there,” Gokhale wrote. “They’re part of the current system and will continue to grow unless reforms take them fully into account. The full, official measure of the government’s commitment to pay future retirement benefits in excess of future payroll taxes amounts to $12 trillion (in present value terms) under the current system. And, just like debt, this cost grows with interest as time passes.”

Gokhale continued: “Under the current system of budget accounting, all of this cost remains hidden. Indeed, because the Social Security trust fund currently holds government IOUs, many believe that Social Security is well funded and not in trouble; and this partly explains the eye-widening reaction when someone suggests that the ‘transition cost’ of a reform plan is $2 trillion.

“Few people appreciate that the amount of these IOUs is insufficient to pay more than three years’ benefits to current retirees,” Gokhale wrote. “The remaining years’ benefits must come out of current payroll taxes paid by workers—which implies those funds won’t be invested for their own future retirements.”

**Minority Leader Remains Skeptical**

Graham said four things are necessary to save Social Security: “presidential leadership, bipartisan support, the rejection of rigid ideology preventing workable solutions, and shared sacrifice by the American people.”

At a December 9 press conference, House Minority Leader Nancy Pelosi (D-CA) roundly criticized reform concepts. She told reporters reforms such as allowing younger workers to put tax money into private accounts “undermine Social Security by pitting ages against each other, convincing young people it’s not going to be there for them. That’s the beginning of the end for Social Security, the end of the concept of one generation helping another generation. So I’m in a ‘show me’ situation. Show me how you can take money out of a situation where you’re concerned about having enough money to make ends meet and have those ends meet.”

Steve Stanek (stanek@heartland.org) is managing editor of *Budget & Tax News.*
Lower Taxes, Faster Economic Growth

A prominent economist makes the case for lower taxes, private retirement accounts, and Health Savings Accounts

by Robert Genetski

Tax policy is not rocket science, and it’s not nanotechnology. It’s straightforward. When you tax something, you get less of it. When you tax the creation of wealth and income, you get less wealth and income. When you lower the taxes on the creation of wealth and income, you end up getting more. That’s about as straightforward as you can get.

In all the research I’ve done on taxes, I have never come across an example of a country, anywhere, any time, that has significantly reduced tax rates without realizing a significant improvement in economic performance. Nor have I come across an example of a country that has raised tax rates significantly without later experiencing disappointing economic performance.

“In all the research I’ve done on taxes, I have never come across an example of a country, anywhere, any time, that has significantly reduced tax rates without realizing a significant improvement in economic performance.”

Here in the United States we had a major cut in key tax rates a year ago, and over the past year we’ve seen impressive economic performance. Of the top 15 major developed countries in the world, the United States is number one in the past year in terms of economic growth, and it is number one in the past year in terms of reducing the unemployment rate.

**Tax Pressure Mounting**

In spite of the logic and evidence in this area, there are huge forces at work that will bring pressure to raise tax rates during the balance of this decade. The first is the expense necessary to fight the war on terror. Huge increases in resources are needed to fight that battle, and there is pressure, of course, to pay for them by raising taxes. Second is the growth in entitlements, both Social Security and Medicare/Medicaid, as a result not just of new benefits but also demographics: More people are becoming eligible.

In addition, because of a compromise reached with respect to last year’s tax cuts, there will be an automatic reversal of those cuts at the end of the decade if nothing is done. Additional pressure is coming from the progressivity of our tax system. As a result of the recent cuts in taxes across the board, 44 million households—roughly half of all households—no longer pay income taxes. Recent data show that the top 3 percent of income earners now pay roughly 40 percent of the income taxes.

It’s going to become a little less politically attractive to argue for cutting taxes when roughly half the households in the country don’t pay taxes. It’s also going to be more tempting to argue that “someone else” who’s very well off should pay an even larger share of taxes. Economic growth, however, can neutralize these pressures to raise tax rates, because tax revenues increase as incomes rise. The public is fairly well aware that increasing tax rates suppresses economic growth. In addition, the very size of government and its rapid growth over recent decades means there are many reform opportunities at hand.

Two examples come quickly to mind: Social Security and health care.

Social Security Returns Poor

Social Security is one of the oldest and, in some dynamic, the most wasteful of all government programs. Had individuals been allowed to invest their money privately, instead of sending it to the government, they would have been able to get three to five times the monthly income at retirement than the government promises them: three times the monthly income if they had invested only in safe and secure bonds, five times if they had invested in the riskier stock market.

I have no argument with the government requiring people to put aside some of their income for retirement. My objection is to what the government does with that money. Instead of allowing people to put it into individual accounts, the government spends it on other things. This prevents the money from being invested in productive enterprises.

The movement to allow people to put a portion of their Social Security taxes into individual retirement accounts is a dynamic way to alleviate some of this potential waste.

“Had individuals been allowed to invest their money privately, instead of sending it to the government, they would have been able to get three to five times the monthly income at retirement than the government promises them.”

**HSAs Promise Savings**

With respect to health care, we have the same dynamic. With health savings accounts (HSAs), the amount of money you or your employer pay for health insurance, which now tends to be around $8,000 to $10,000 a year, is broken up into two portions. The first portion is given to the individual to use to pay directly for routine medical expenses. The balance is used to buy catastrophic health insurance that kicks in after your medical expenses pass a certain relatively high amount in a year.

The early research on this approach, from the early 1980s when pilot medical savings account programs were put into effect, showed a 50 percent savings on routine medical expenses when people spent their own money as opposed to using third-party resources to fund them. As HSAs become more widespread and popular, they create the potential to save enormous amounts of money.

Right now Americans spend a trillion-and-a-half dollars a year on health care expenses. The potential savings are as much as $750 billion per year.

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Robert Genetski is president of Genetski Financial Advisors.
Sued for Collecting Taxes

“Now we are in a hard place as an industry in dealing with these taxes,” Bierbaum said. “AT&T and a couple of other phone companies now have class-action lawsuits against us for address jurisdictions.”

She explained that in AT&T’s case, a new house was built in an unincorporated area of Oklahoma. The ZIP code indicated the house was in a county with a local telecommunications tax, and AT&T collected the tax. However, the house was actually over the county line.

“The class action names every state that has local taxes on telecommunications,” Bierbaum said, “and an Oklahoma judge is deciding whether we have to refund sales and gross receipts tax for all the other states in the country.”

She said the plaintiffs argue that if AT&T did not know which county the Oklahoma house was in, it must refund sales and gross receipts tax for all the other states in the country.

“Then the court admits AT&T doesn’t have the money, and we refunded it to the customer, and any [revenue] we had was given to government,” Bierbaum said. “It went to the U.S. Supreme Court; they won’t hear the case, so now it’s back in Oklahoma to decide whether we have to refund sales and gross receipts tax for all the other states in the country.”

Hi, wait a minute, my legislators said Internet access was not taxable. Why are you taxing us? Again, we’re put in the middle.

New Entities Treated Differently

New voice providers, such as those using voice over Internet Protocol, which provides telephone service over the Internet, have big tax advantages over traditional firms, because they often have no tangible property or employees in states where they do business, according to Bierbaum. They cannot be compelled to collect taxes in states where they have no physical presence.

“One such provider, in New Jersey, collects sales tax only on New Jersey customers. Customers in the rest of the country are not taxed.”

“So you’re going to buy service from AT&T or Verizon and pay, in Richmond, Virginia, 28 percent,” Bierbaum said. “Or you can go to this new company and pay zero in tax. You’re going to distort behavior in consumers.”

Tax Laws Obsolete

“The technologies are exploding, and the laws are not keeping up with those changes,” said Scott Mackey, an economist at Kimbell Sherman Ellis who specializes in the telecommunications industry. “This is creating a lot of problems,” he said, including discrimination against certain providers of communications services.

“Clearly, the way the economy is going, you have got to have this infrastructure in your states,” Mackey said. “How are the companies that have these billions of dollars in network investments under the regulatory scheme going to survive if we persist in having this discriminatory tax system ... ?

“The gap between the unregulated or favorably taxed provider and the provider that is saddled with all these discriminatory taxes is only going to grow as market forces drive down the price of the service but not the tax.”

Scott Mackey, Economist
Kimbell Sherman Ellis

High Taxes Slow Investment

Mackey also argued that high levels of taxation on communications infrastructure are raising the cost of business and reducing the return on investment. They will depress investment and send capital to other sectors of the economy that are not as important to long-term economic growth, he said.

“Wall Street is not just saying, ‘Take our money and spend it how you want,”’ Mackey said. “Companies are now having to spend their own, internally generated dollars, on this investment. Taxes do matter, funneling back how much money companies have to invest in these networks.”

Mackey also argued it’s not enough to level the playing field within the telecommunications industry, because high tax burdens will drive capital to other sectors of the economy even if all providers in the industry are treated equally.

“It’s amazing to me what an incredible disconnect there is between tax policy and economic development,” Mackey said. “All the states are going around creating new programs to subsidize broadband in rural areas, there are all these bills in Congress, and then you turn around and impose a 25 percent tax on the companies that are trying to generate the cash to make those same investments without subsidies. Something is not right when one hand is doing this and the other hand is doing that.”

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.
state legislature’s scheduled return to business. The plan comes in response to budget problems lawmakers say will force about $260 million in spending cuts and the return of more than $460 million to Colorado taxpayers.

Legislative leaders said they like Owens’ proposal, but Jon Caldara, president of the Golden, Colorado-based Independence Institute, a free-market think tank, said, “It’s a letdown that the governor has capitulated to the new Democratic majority for a tax increase.”

Democrats control both chambers of the legislature for the first time since 1960.

“The framers of TABOR didn’t anticipate a time when state revenues would suffer a two-year, double-digit drop. When such a revenue drop occurs, it causes TABOR limits to ratchet down, and the state budget can’t catch up.”

GOVERNOR BILL OWENS
R-COLORADO

Education, Medicaid Drive Spending

Owens said TABOR changes are needed partly because of Constitutional Amendment 23, which requires annual spending increases for K-12 education, and because of federally mandated increases for Medicaid. Education and Medicaid costs are rising sharply, absorbing more than $260 million in spending cuts and the return of more than $460 million for Medicaid. Education and Medicaid costs for K-12 schools and Medicaid services are rising sharply, absorbing more than $260 million in spending cuts and the return of more than $460 million for Medicaid.

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Education, Medicaid Drive Spending

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“Available revenue under TABOR will not keep pace with those demands and allow us to make the needed investments in transportation, higher education, public safety, and other essential services,” he said in announcing his plan.

The TABOR, also a part of the Colorado constitution, limits spending to the previous year’s level plus increases for population growth and inflation. It requires the state to return surplus funds to taxpayers.

Recession Forced Spending Cuts

State revenues dropped during the recession of 2001, forcing the state government to cut spending in response. The spending increase restrictions in TABOR prevent the state from rapidly expanding the budget when the economy is growing rapidly, which forces the state to make tax refunds even though state spending may not have returned to pre-recession levels.

“The framers of TABOR didn’t anticipate a time when state revenues would suffer a two-year, double-digit drop. When such a revenue drop occurs, it causes TABOR limits to ratchet down, and the state budget can’t catch up. We must ask voters to eliminate this unintended consequence,” Owens said.

Proposes Five Step Plan

The Owens plan includes the following steps:

- Ask voters for permission to retain $500 million in TABOR surplus.
- Reduce the state’s income tax to 4.5 percent (from 4.63 percent).
- Invest $100 million annually in transportation, allowing the state to issue bonds for up to $1.7 billion in projects statewide.
- Amend TABOR to eliminate the “ratchet effect” during and following recessions.
- Secure the state’s future tobacco settlement funds—about $850 million—to address short-term budget needs.

“This plan uses the specific provisions of TABOR to address Colorado’s investment needs going forward. It respects the fact that every dollar in the budget belongs to taxpayers and asks them to keep additional funds,” Owens said.

Searching for Middle Ground

Owens said the TABOR surplus over the next two years will be about $450 million. By retaining $500 million, the state can fund key programs and leave TABOR’s key provisions intact, he said. “I think he’s trying to find a middle ground, and it really is better than nothing. … It’s a very big table, and there’s room for lots of proposals,” House Speaker Andrew Romanoff (D-Denver) told Rocky Mountain News reporter Jim Tankersley for a December 21 story after Owens presented his plan.


TABOR Backers Upset

Caldara views the proposal differently. He said that although asking taxpayers whether the TABOR surplus should remain with the state government “is perfectly within the realm of the Taxpayer Bill of Rights, the governor has gone one step farther and said we should remove the ratchet mechanism, which I think is one of the most interesting and important aspects of TABOR.”

“The shortfall is caused by a spending mandate, called Amendment 23, which was approved in 2000 and says K-12 spending will go up above the rate of inflation, despite recessions,” Caldara said. “Amendment 23 is the cause of our shortfall. The governor’s plan asks for more money than is needed to fill the shortfall, and it takes away the ratchet and changes the state constitution. We don’t need to change that to keep the surplus.”

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

High Jet Fuel Tax Causes Airlines to Avoid Re-Fueling in Chicago, Los Angeles

by John W. Skorburg

According to sources in the airline industry, high jet fuel taxes have commercial airlines going out of their way to avoid fueling up planes in Chicago and Los Angeles.

“We bypass the high-priced locations,” Southwest Airlines spokeswoman Whitney Eichinger told the Chicago Tribune, as reported in a December 13 article (“Airlines fly but don’t fill up here”). Both of Chicago’s major airports—O’Hare International and Midway—are being avoided because of Chicago’s high jet fuel taxes.

Even United Airlines, headquartered in suburban Chicago, avoids the Chicago tax as much as possible. “We lift 20 to 30 percent less fuel in Chicago than we otherwise would because the price is not competitive due to the taxes,” United spokesperson Jeff Green told the Tribune. “Any flight coming to Chicago is taking on as much fuel as it possibly can before it gets here.”

William Warlick, an airlines analyst at Fitch Ratings in Chicago, told the Tribune, “Even if the savings are small, in some ways they’re the only option the airlines have to cut costs.”

Some of the highest jet fuel taxes in the country are currently in Chicago and Los Angeles, where taxes are levied by percentage of price instead of per gallon. Basing the tax on price means that as fuel prices go up, so does the amount of tax paid, even if the amount of fuel purchased remains unchanged.

John Heinrich, chief economist for the Air Transport Association, labeled the percentage-based jet fuel taxes “particularly offensive, because if the price of jet fuel doubles, we pay the states twice as much in taxes even though we are not relying on them to provide more services.”

According to the Tribune, a one-cent increase in the jet fuel tax costs the airline industry an additional $180 million annually. The mid-December 2004 price for jet fuel, including tax, is $1.76 per gallon in Los Angeles and $1.60 in Chicago. That compares to $1.39 in Denver and $1.42 at Dulles International Airport outside Washington, DC.

Excluding taxes, the average jet fuel price for major U.S. airports was $1.25 per gallon in September 2004. That is up from 82 cents in September 2003. Jet fuel, like home heating oil, is a crude oil byproduct, and their prices rise as the price of a barrel of oil rises.

John 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

For more information on Colorado’s Taxpayer Bill of Rights, see: “On the Frontier: Colorado’s Taxpayers’ Bill of Rights,” part 2 in a three-part Budget & Tax News series by Lew Uhler and Barry Poulsen. The article ran in the February 2004 issue of Budget & Tax News and is available online at http://www.heartland.org/Article.cfm?artId=14338, parts 1 and 3 ran in January and March 2004, respectively.
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