California Agency Misplaced Hundreds of Millions of Dollars

Agency faced intense scrutiny while Gray Davis was governor

by Andy Furillo

Hundreds of millions of dollars flowing through California’s now-disbanded Office of Criminal Justice Planning (OCJP) were never properly documented, in what officials are describing as one of the worst accounting nightmares in recent state history. “In my 30 years of experience, this is the worst thing I have ever seen,” said Samuel E. Hull, chief of the California Department of Finance’s Office of State Audits and Evaluations, on February 2.

The assessment of five years’ worth of grant handling by the OCJP, released on February 2, was so grim that Department of Finance officials declined even to call it an audit. Instead, they characterized their efforts to make sense of the agency’s accounting as a “reconstruction” of financial events.

When they were finished, the 46-person audit team, which spent 16,000 hours on the project, called into question $425 million in federal grants that were administered through the OCJP over the five-year period ending in the fiscal year 2003-04.

Report Sent to AG

Finance officials stopped short of characterizing the accounting shortcomings at the OCJP as criminal. But they called for an audit of the agency’s operations.

Finance officials stopped short of characterizing the accounting shortcomings at the OCJP as criminal. But they called for an audit of the agency’s operations.

Pataki administration appeals, promises more court action

by David S. Shaffer

State Supreme Court Justice Leland DeGrasse of Manhattan has ordered New York state to ensure that within four years the New York City school system has another $7.4 billion a year to spend on top of the $12.9 billion a year the system already consumes.

Officials in the administration of Gov. George Pataki (R) immediately said the state will appeal the decision. That sets the stage for months or even a year of appeals, the state’s brief said.

Oregon to Test Plan that Taxes Motorists by Miles Driven

by Craig Westover

Several states are considering shifting from per-gallon fuel taxes to mile-based tax systems, none more seriously than Oregon. The Oregon Department of Transportation (ODOT) is preparing to test a global positioning system capable of tracking a vehicle’s location, recording in-state miles driven, and calculating a tax based on miles driven.

Bush Threatens to Veto Controls on Medicare Drug Spending

by Steve Stanek

Two days after Bush administration officials released new cost estimates for the Medicare prescription drug program, President George W. Bush threatened to make the first veto of his presidency against efforts to control the program’s costs.

“Any attempt to limit the choices of our seniors and to take away their prescription drug coverage under Medicare...
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* Source: Bureau of the Public Debt, U.S. Department of the Treasury

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Wisconsin to Collect Internet Tax Despite Federal Ban

by Steve Stanek

The State of Wisconsin plans to keep collecting its Internet access tax, despite a federal law designed to require the state to drop the tax in 2006.

On January 25 officials with the Wisconsin Department of Revenue announced the state would continue to collect the 5 percent tax, which was implemented in 1991 and brings in about $30 million a year. A provision that apparently requires Wisconsin to drop the tax was included in the Internet Tax Nondiscrimination Act, which President George W. Bush signed in December 2004. Wisconsin Governor James Doyle (D) opposed the act.

“Governor Doyle is looking for a loophole to continue taxing Wisconsinites who log onto the Internet,” said Rep. James Sensenbrenner (R-WI), who insisted his home state be forced to drop its Internet tax.

“Governor Doyle is looking for a loophole to continue taxing Wisconsinites who log onto the Internet. This is a slap in the face to Congress, as the intent of this law is crystal clear.”

REp. JAMES SENSENBRENNER
R-WISCONSIN

“He claims that this new law does not apply to Wisconsin.” Sensenbrenner said. “This is a slap in the face to Congress, as the intent of this law is crystal clear. This also goes to show that Governor Doyle has a hard time keeping his nose out of the tax trough, and his hands out of the wallets of people from Wisconsin.”

The Internet Tax Nondiscrimination Act extended by three years a ban on state Internet taxes. It blocks state and local governments from taxing Internet connections, including dial-up and DSL. Nondiscrimination blocks multiple state and local taxes from being levied on online purchases and prohibits the creating of taxes unique to the Internet.

Wisconsin was one of several states that began taxing Internet access before the original Internet tax ban in 1991. Wisconsin Department of Revenue officials said they believe Wisconsin may continue to impose the sales tax on Internet access services. The letter said the department intends to continue taxing such services.

The provision in question says any state that enacted an Internet access tax on or after October 1, 1991 must end the tax on November 1, 2006.

The state Department of Revenue argues Wisconsin “enacted” the law in August 1991 and that it merely took effect on October 1, 1991. Therefore, the department says, the provision does not apply to Wisconsin.

“We’re implementing the law as written in the statute,” said Audra Brennan, the Department of Revenue’s division administrator for research and policy.

“We don’t meet the criteria. There’s no room for interpretation.”

She said Wisconsin expects to collect about $37 million in Internet access taxes during fiscal 2005.

“Revenues are increasing a lot because Internet sales are increasing every year,” Brennan said.

Congressman Shocked by Decision

Rep. Mark Green (R-WI), who joined Sensenbrenner in pushing for the phase-out provision in the act, said he was “shocked” to learn of plans by Doyle’s administration to continue taxing Internet service charges.

“While Chairman Sensenbrenner and I have been fighting to lower the tax burden on Wisconsinites, Governor Doyle has continued looking for every opportunity to collect more of their hard-earned income,” Green said. “The intent of this federal law they plan to ignore couldn’t be more apparent: No more taxing Internet access services in Wisconsin.”

Sensenbrenner hinted at a lawsuit in a January 28 press statement.

State Government Unworried

“It’s possible that Governor Doyle will use more taxpayer dollars to defend his position,” Sensenbrenner said. “This would be a poor use of our state’s finances, and Governor Doyle’s time and efforts would be better spent in more clearly reading the legislation Congress passed in November.”

Brennan said the Department of Revenue is not worried about a possible lawsuit if the state continues to collect Internet access taxes.

“The law is clear,” Brennan said. “If a taxpayer refused to pay, we would follow our typical audit routes. We’re reading the language and following it.”

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

Steve Moore, Dan Pilla, Geoffrey Segal

Herbert J. Walberg, Thomas Walton

James L. Johnston, Roy E. Marden

David H. Padden, Frank Resnik

Dan Hales, William Higginson

Emily Sedgwick, Bob Williams

Aid or hinder the passage of any legislation.
did forward their 46-page report to the state attorney general’s office for review.

“This kind of accounting, or lack there-
of, does not happen on the natural.”

Department of Finance spokesman H.D. Palmer said.

State Department of Justice spokesman Nathan Barankin declined to comment on the referral except to say, “We have received the report and other information from the Department of Finance, and we are evaluating it.”

 Millions of Dollars Frozen

As a result of the accounting problems, federal officials last year froze millions of dollars in funding that had already been approved for a variety of criminal justice programs to vendors operating in good faith all over state.

Although the state’s OCJP cleanup efforts prompted the federal government to provide interim funding last year for the programs, tens of millions of dollars in additional grants are still in danger of being disallowed as a result of the agency’s accounting problems, according to the state Department of Finance.

Auditors found extensive evidence of commingled funds, with federal funding earmarked for one program winding up in the coffers of another.

“They violated all the basic principles [by] not using money as it was authorized, both at the federal and state level,” said Jim Tilton, the Department of Finance’s program budget manager.

In its 30-year history, the OCJP has acted as a state clearinghouse within the Governor’s Office to disburse federal crime-fighting grants to hundreds of California agencies, directing the money to a plethora of projects targeting domestic violence, street gangs, and sex crimes, and providing assistance to victims groups and other organizations.

“The OCJP had long been a target for political critics who disagreed with any sitting governor’s criminal justice agenda, but the agency came in for some of its most intense scrutiny during Gov. Gray Davis’ tenure.”

Under the Democratic former governor, one OCJP chief was blasted for withdrawing funding for battered women’s shelters, while another came under fire and was forced to resign when he was implicated in a federal investigation into political corruption in San Joaquin County.

“The latter appointee, N. Allen Sawyer, has since pleaded guilty to mail fraud and is awaiting sentencing. He could not be reached for comment.”

State Sen. Sheila Kuehl (D-Santa Monica) said she had many run-ins with the OCJP during the years before her election, when she worked to obtain funding for battered women’s shelters.

“We always found them to be inept and inadequately supervised,” Kuehl said in an interview. “I’d say the line people always tried their best, but the leadership was always really lame.”

Slew of Problems Identified

The OCJP met its demise through the state budget approved in 2003, which turned its grant-administering functions over to the state Office of Emergency Services. It was then scheduled for a closure audit in December 2003, which at a cost of more than $1.1 million ultimately resulted in the “reconstruction” document.

The reconstruction of the OCJP’s accounting found numerous instances of “incomplete” and “inaccurate” accounting records. Finance auditors said in their report they discovered “significant differences” between the OCJP’s records and those of other state and federal agencies, as well as massive disorganization and the “apparent intentional manipulation” of additional records by the OCJP’s former staff.

“Most expensive problem the reconstruction effort found was $322 million in grants and awards administered through the OCJP’s Public Safety and Victims Services programs. Officials in the Office of Emergency Services who inherited the programs administration were “unable to certify the accuracy of the financial data...because of the recordkeeping weaknesses of OCJP,” the report stated.

Andy Furillo (afurillo@sacbee.com) is a staff reporter for the Sacramento Bee.

This article originally appeared in the newspaper’s February 3, 2005 edition. Reprinted by permission.

Privatization Brings Big Savings to Michigan’s State Universities

by Laura J. Davis

Budget pressure in recent years has forced Michigan’s public institutions of higher education toward cost savings and contracting out of services, according to news reports and a recent survey by the Mackinac Center for Public Policy.

In fiscal 2005, for which the state government approved an effective “no change” in funding for Michigan’s 15 public universities, those institutions have been working overtime to balance their budgets. This has led them to increase contracting out to the private sector for services.

In May 2004, for example, Western Michigan University (WMU) signed a contract with Consolidated Vendors Corporation (CVC) to handle custodial needs in its 22 residence halls.

The contract is projected to save the university $1.5 million annually.

$1.1 Million Below Union

Before choosing Commercial Sanitation, WMU received bids from five private firms and from the union that represented the 60 custodial workers WMU had employed prior to its decision to privatize.

Commercial Sanitation submitted the lowest bid—approximately $1.1 million less than the union’s.

Need for Firms’ Expertise

Almost all of the university officials interviewed for the Mackinac Center study said expertise was their main reason for outsourcing.

“Most commonly outsourced services among the responding universities were garbage and sanitation services (80 percent of the schools outsourced these services), bookstore operations (80 percent), vending operations (70 percent), and legal services (70 percent).”

By outsourcing these services, they hope to save money and increase efficiency.

“Cost savings and efficiency also rated high among universities’ reasons for privatizing. Ferris State University’s (FSU) vice president for administration and finance, Dr. Richard P. Duffett, reported going from losses of $85,000 per year to profits of $85,000 per year on the school’s vending services once the university partnered with Consolidated Vendors Corporation of Norton Shores, Michigan in August 2003.”

Some school administrators also cited...
University
Continued from left

equipment needs and capabilities as dri-
ving their schools to outsource. FSU con-
tracted with Automated Apartment
Laundries to purchase and replace the
school’s old laundry equipment when it
hired the company to provide laundry
services beginning in August 2003. Duf-
fett said of outsourcing, “I think we,[uni-
versities] have taken advantage where-
ever we can...to serve both students,
faculty, and staff. [There’s] been a lot of
good, hard work done.”

Advantages of Consortium
Officials of the universities have adopted
a creative solution to their budget prob-
lems through creation of the “Higher Edu-
cation Purchasing Consortium,” which
the schools formed with the state of Michi-
gan in August 2003 to gain leverage when
negotiating contracts with private firms.

Michael Boulus, executive director of
the Presidents’ Council, State Universi-
ties of Michigan, said of the consortium,
“The overarching goal is for universities
to work creatively to keep costs down.”

All 15 public universities in Michigan
are part of the consortium. Each univer-
sity participates only in the contracts it
chooses.

One example of the consortium’s work was
a recent contract for electrical power.
In February 2004, the State Department
of Management and Budget, Michigan
State University, Western Michigan Uni-
versity, and the University of Michigan-
Flint signed a contract with Consumers
Energy through the consortium. The
agreement is expected to save each sign-
er 7 percent on electricity, or approxi-
mately $730,000 for the three universi-
ties combined.

The universities also have used the
strength-in-numbers approach to man-
ge their rising costs of health care and
insurance, forming the Michigan Univer-
sities Coalition on Health (MUCH) and
Michigan Universities Self-Insurance
Corporation (MUSIC).

Room for Improvement
Despite the progress made so far in
response to the state’s current budget cri-

sis, there is still room for improvement in
state university spending, said Michael
LaFaive, director of fiscal policy at the
Mackinac Center.

“Institutions that contract out for
important services should remember a
few basic items to optimize results,”
LaFaive said. “Maintain an open bidding
process; include multiple vendors; give
appropriately detailed specifications for
the desired service; and engage in period-
ic, competitive rebidding. If schools don’t
get these minimal aspects right they may
risk giving privatization a bad name.”

LaFaive said contracting that saves
money and focuses the schools on educa-
tion will be good for Michigan citizens and
state university budgets.

Laura J. Davis (ljdav@umich.edu) is a
University of Michigan student who served
as a fiscal policy intern for the Mackinac
Center for Public Policy in 2004.

Illinois Governor Rejects Income
Tax Hike for Education
Rift between state’s top Democrats grows over tax shift for school funding

by John W. Skorburb

Illinois Gov. Rod Blagojevich (D) used his annual State of the State address on February 16 to reject a bill that would sharply increase the state income tax and reduce reliance on local property taxes to fund public education.

“Any proposal that swaps income
taxes and property taxes still wouldn’t
mean more total funding for schools unless taxes go up more than they go down,” Blagojevich said of the
tax plan sponsored by Emil Jones, leader of the Illinois Senate and a fell
Chicago Democrat.

Jones told reporters afterward, “I don’t appreciate him taking a shot at reforming education. I don’t appreci-
ate that. I’ve got a mean streak.”

Jones backs House Bill 750, which
would increase the state income tax
from 3 to 5 percent and raise other
taxes in exchange for a cut in proper-
ty taxes. He has introduced an iden-
tical bill in the State Senate.

Critics say the proposed legislation
is not revenue-neutral and instead is
a tax increase that would send more
money to public schools and state
budget coffers and slow the state’s
economy.

Bill “Hostile to Business”

“Passage of [H.B. 750] would make
Illinois more hostile to business
investment, less competitive in
attracting new jobs, and would harm
the state’s ability to keep current

“This bill would single-

handedly lower Illinois’
ranking in the [Tax
Foundation State
Business Tax Climate]
Index from 23rd to 38th.
The economic damage
inflicted by the tax
increases in H.B. 750
would far outweigh any
contemplated benefits.”
CHRIS ATKINS, STAFF ATTORNEY
TAX FOUNDATION

ed by the tax increases in H.B. 750
would far outweigh any contemplat-
ed benefits.”

The Tax Foundation’s State Busi-
ness Tax Climate Index rewards
states whose tax policies create a
“level playing field” for economic
activity, have moderate tax rates, and
do not impose burdensome compli-
ance rules.

Opposition Determined
Illinois State Sen. Chris Lauzen (R-
Aurora), a member of the state’s rev-

enue and appropriations committees,
had pledged to make sure the Sen-
ate’s version of H.B. 750 does not pass.

“Since the day I first was elected to the
General Assembly, I have made
fiscal responsibility in state govern-
ment my highest priority, next to con-
stituent service,” Lauzen said in a
statement issued February 8.

“I hope to use the analysis and dis-
cussion in the Revenue Committee to
help my constituents and other citi-
zens in Illinois to protect property tax
caps, support Governor Blagojevich’s
pledge to not raise sales and income
taxes, and explore comprehensive ‘impact fee’ legislation to reduce the
need for frequent referendums,”
Lauzen said.

Illinois Gov. Rod Blagojevich and
Senate Majority Leader Emil Jones
(inset) disagree on the wisdom of a
tax hike for education.

Political Rift Widening
On February 17, Blagojevich met
with the editorial board of the Chica-
go Tribune and confirmed his intent
to veto a tax swap bill. According to a
February 18 Tribune report, the “rift
between Gov. Rod Blagojevich and
Senate President Emil Jones grew
wider as the Governor vowed to veto
[any] school funding reforms being
pushed by Jones if they included any
increase in income taxes.”

The Tribune also reported Blagojev-
ich said the state could “reap more
money to spend on schools if law-
makers would go along with his pro-
posal to reduce retirement perks for
new state workers—a move that
would free up cash that would [oth-
erwise] have to be paid to government
employee pension funds.”

“I’m not convinced that the only
answer to school funding and the
inequities to the school-funding for-
mulas necessarily mean you have to
raise the income tax or the sales tax,”
Blagojevich said.

John W. Skorburb (skorburb@heartland.org) is a visiting lecturer in economics at the University of Illi-

ois-Chicago and associate editor of
Budget & Tax News.
Unexpected Tax Hike Drills Alaska Oil Producers

by Steve Stanek

A laska Gov. Frank Murkowski (R) surprised oil and gas industry officials in his State of the State speech on January 12 by announcing a $150 million tax increase on an industry that already pays more than 80 percent of the state’s general fund budget.

“We were totally taken by surprise,” said Judy Brady, executive director of the Alaska Oil and Gas Association. “This is a governor who campaigned on no increase in taxes. The concern on oil companies’ part is a change in policy from how oil fields were treated. It’s caused a lot of concern. At the same time, the governor has suggested hearings on changing the production tax.”

Brady said 87 percent of Alaska’s general fund budget revenues come from the oil and gas industry.

Satellite Fields Now Taxed

Murkowski increased taxes by ordering smaller oil fields to be consolidated with larger fields for tax purposes.

Under the state’s Economic Limit Factor (ELF), which charges a tax based on the amount of oil drawn from fields and the number of wells in operation, fields or wells that fall below the ELF pay no tax. By ordering the consolidation of multiple fields for tax purposes, owners of wells that had been below the ELF began paying taxes on them.

“There were six fields operating with an anchor field. The Department of Revenue can aggregate fields or separate them. These fields were really part of the anchor field,” said Dan Dickinson, director of the tax division of the Alaska Department of Revenue. “Alaska law gives the department authority to decide on its own whether oil and gas fields should be treated separately or aggregated, Dickinson said.

Changes Were Discussed

In an official statement, Murkowski said, “If my decision to aggregate six fields with Prudhoe Bay was based on faulty data, I have given them [oil and gas industry officials] the opportunity to come in and present their facts and figures to the Department of Revenue. In this way all pertinent data will be on the table so that at the end of the day both the oil producers and the people of Alaska will be treated fairly.

“If production is what you’re after, increasing taxes is not the way to do that.” JUDY BRADY, EXECUTIVE DIRECTOR ALASKA OIL AND GAS ASSOCIATION

“I ran for governor to get Alaska’s economy back on track. Tough decisions require a significant resolve of conviction, and I am convinced that it was fair to aggregate the six fields with Prudhoe Bay for severance tax purposes. My decision reflects the producers’ decision to consolidate the individual satellite fields into the Prudhoe Bay Unit.”

Murkowski said he twice met with industry representatives to discuss tax changes and was told they would not support the changes.

Preferred No Change

Brady confirmed this. “We said our best advice is do not change the taxes, do not increase them. If production is what you’re after, increasing taxes is not the way to do that. We’re making about $3.5 billion from oil revenues, about the same as 1981 and 1982 when production was higher.

“Our tax system protects the state on low prices, gives them a big chunk at medium prices, and at high prices the state still does well. If it’s working, you’re taking terrible risks by changing things.”

Brady said Alaska is the highest-cost place in the world for oil producers. Production has fallen from 2.1 million barrels a day in 1989 to 1 million a day now because the larger fields are being drained of oil, and smaller fields are expensive to bring on line.

“If you’re going to have the kind of investment you need to keep it at one million barrels a day, we’re going to need to double investment from $30 billion [over 10 years; companies are spending more than $3 billion a year on these fields] to $60 billion over 10 years [because production in these fields is falling]. If you start messing with taxes, we have other places to go. We’re in worldwide competition for money. The state doesn’t see it like that.”

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

Lawmakers Move to Reform Union Political Finance Practices

Utah union sees huge drop in political action funds after payments become strictly voluntary

by Ron Nehring

P ublic employee unions’ political practices are drawing increased scrutiny from Utah lawmakers this legislative session as some of whom are moving forward with reforms aimed at protecting the rights of individual union members.

The moves come in response to the practice of organized labor in recent years steering a substantial portion of its resources away from collective bargaining activities and toward political action. Public sector unions typically support policies that would expand government spending and payrolls.

One of the first states to respond was Utah, which enacted the Voluntary Contributions Bill (House Bill 223) in 2000. The law placed legislative restraints on the way public sector labor organizations could use their political action committee (PAC) funds. Utah was not the only state to implement legislation, as several other states passed similar bills during this legislative session.

Utah lawmakers sought to combat the political influence of public sector unions by placing a ban on using PAC funds to finance political activities, such as public sector lobbying, political campaigns, and elections. The law also required public sector unions to obtain an annual election certificate from the state’s auditor in order to continue receiving the PAC designation.

Idaho enacted similar legislation in 2003.

Unions Fought Vigorously

Labor leaders in Utah fought the law vigorously, but the courts ultimately upheld it. The law went into effect in 2004, and the results have been dramatic.

The Utah Education Association (UEA), arguably the strongest political interest group in the state, saw its political action committee income plummet by 35 percent. The union was denied the ability to transfer dues directly to political action and was concurrently denied access to public worker paychecks through PAC payroll deductions.

National Movement Brewing

Several major national organizations are using the case for further labor reform.

The National Legal and Policy Center has established an Organized Labor Accountability Project to document and publicize internal union corruption, while the new Alliance for Worker Freedom advocates policy reforms aimed at empowering individual workers rather than union officials. The American Legislative Exchange Council (ALEC) has developed several model bills aimed at promoting financial transparency and reform in state public sector unions.

Public Employees Crucial

The recent spike in union political activity parallels labor’s increased reliance on the public sector for members. The 2005 Union Membership Survey report from the U.S. Bureau of Labor Statistics, released January 27, reports only 7.9 percent of the total U.S. private sector workforce chooses to join a labor union, whereas 36 percent of public sector workers are in unions.

In the 1990s, Democrat governors supported by organized labor provided generous rewards to public sector unions. Some organized state workers by executive order (as in Indiana, Kentucky, and Missouri), while others required workers who refused to join a union labor to pay agency fees to the union if they are covered by a union collective bargaining agreement (as in California).

The use of political power to promote unionization in the private sector continues to be a labor objective, and the drive to impose “project labor agreements” that essentially eliminate non-union firms from bidding on public works projects provides a prime example. (See “Illinois Contractors Fight Union-Friendly Order,” Budget & Tax News, March 2003.)

Perhaps the clearest example of recent union political action came in the 2004 presidential election, when hundreds of millions of dollars in labor money was allocated to the defeat of President George W. Bush. Many union officials justified the campaign as merely “representing” the will of union members, but post-election surveys found nearly 50 percent of union households supported Bush. The vast majority of union resources were used to support Democrat John Kerry.

CONTINUED at right
Workers Fighting Back

While union officials often pretend dis-union members do not exist, the Internet is giving such workers the opportunity to express their opinions ... and their dissatisfaction with union abuses of power.

One firefighter who supported Bush in 2004 put it this way in a message posted on firefightersforbush.com on March 11: “I am a union firefighter. I support my local on local and national issues. However, I don’t support Kerry for President. I am offended that my dues are constantly used to support candidates that I oppose.

“I hope that the general public under-stands that when they see all those yellow & black banners that say, ‘Firefighters for Kerry’ that those signs don’t actually speak for all firefighters.

“Those posters should say, ‘Firefighter’s LABOR UNION for Kerry.’”

Law Supports Workers

Union members do not have to watch their dues be used to support candi-dates they oppose. The U.S. Supreme Court, in its Beck (1988) and Hudson (1986) decisions, found that the portion of a union member’s dues used for polit-ical advocacy is protected under the member’s First Amendment rights. A union cannot use an objecting member’s dues for politics.

“While that sounds simple and straightforward, state lawmakers are discovering Beck and Hudson rights are not self-enforcing, and union officials have little incentive to inform members of how they can avoid financially sup-porting union political action.

In response, state lawmakers are increasingly taking action to require unions to pay for their political action solely through voluntary funds estab-lished for that purpose, and requiring the union funds to file disclosure reports as any other state political com-mittee would.

In Georgia, for example, Rep. Ron Forster (R-Ringgold) is promoting legis-lation similar to Utah’s Voluntary Contributions Act.

“My bill will provide a choice for tax-payer union members employed by the State of Georgia on whether their dues can be diverted to state and local polit-ical candidates,” said Forster. “This is an issue of fairness and sunshine fol-lowing a common sense approach for campaign finance reform. Public sup-port seems overwhelming—when I am out I ask people whether they believe a union should get a member’s approval before dues can be spent on politics, and every time the answer has been ‘Yes!’”

Ron Nehring (rnehring@atr-dc.org) is senior consultant at Americans for Tax Reform.

Union

Continued from left

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“While that sounds simple and straightforward, state lawmakers are discovering Beck and Hudson rights are not self-enforcing, and union officials have little incentive to inform members of how they can avoid financially sup-porting union political action.

In response, state lawmakers are increasingly taking action to require unions to pay for their political action solely through voluntary funds estab-lished for that purpose, and requiring the union funds to file disclosure reports as any other state political com-mittee would.

In Georgia, for example, Rep. Ron Forster (R-Ringgold) is promoting legis-lation similar to Utah’s Voluntary Contributions Act.

“My bill will provide a choice for tax-payer union members employed by the State of Georgia on whether their dues can be diverted to state and local polit-ical candidates,” said Forster. “This is an issue of fairness and sunshine fol-lowing a common sense approach for campaign finance reform. Public sup-port seems overwhelming—when I am out I ask people whether they believe a union should get a member’s approval before dues can be spent on politics, and every time the answer has been ‘Yes!’”

Ron Nehring (rnehring@atr-dc.org) is senior consultant at Americans for Tax Reform.
Eminent Domain Takes Center Stage in Redevelopment Debates

Investment discouraged when governments can seize homes and businesses

by Samuel R. Staley

The U.S. Supreme Court on February 22 heard oral arguments in a case that could have far-reaching implications for cities and for private citizens’ property rights.

In _Kelo v. New London_, a small band of property owners is challenging the city of New London, Connecticut’s authority to seize their homes and businesses for the sole purpose of redeveloping the land to generate higher tax revenues. If the Supreme Court sides with the city, private property rights may effectively become non-issues for local governments, as cities plow under neighborhoods in the name of redevelopment to boost the tax base.

Eminent domain is the government power to forcibly confiscate, or “take,” private property for a “public use.” Property owners are supposed to receive “just compensation.” Traditionally, public use has meant services and programs for the use of the public at large with equal access. The power was reserved for government use, under specific circumstances, and was not intended as a tool for wielding by private individuals and businesses to compel others to sell their land.

A February 2005 analysis of takings cases for redevelopment purposes, conducted by this author for the Reason Foundation, suggests this distinction is fuzzy at best.

**Michigan Case Created Precedent**

The New London case is a direct outcome of the judiciary’s tendency, going back several decades, toward a “hands-off” approach to eminent domain. Case law, including the groundbreaking 1984 decision by the Michigan Supreme Court in _Poletown v. the City of Detroit_, broadened the power of local governments and gave them license to effectively void individual property rights as long as they say it is for a public benefit. The _Poletown_ case, in particular, was important because the _City_ of New London, for which the Supreme Court allowed a city to raze an entire neighborhood to accommodate a new General Motors plant to meet an explicit economic development goal. Although _Poletown_ was a state court decision, it had nationwide impact.

Building on federal law that granted increasingly broad authority to state and local governments, cities and states across the nation have used eminent domain to seize property from some private owners and hand it over to others, with economic development as a justification.

The Michigan Supreme Court overturned _Poletown_ in July 2004, however, when it ruled against use of eminent domain for a private business and office park in the _County of Wayne v. Edward Hutchins_. The effects of this reversal are unclear because eminent domain has become so pervasive in urban redevelopment. The U.S. Supreme Court’s decision in _Kelo v. New London_ thus carries even more significance.

**Governments Avoid Fair Compensation**

The _Kelo_ case hinges on a decision by New London officials to target the 90-acre Fort Trumbull site for redevelopment. They condemned 115 properties in the neighborhood to clear the way for new offices and luxury apartments to complement a research facility developed by Pfizer, Inc.

The Institute for Justice, a Washington, D.C.-based public interest law firm, is defending Fort Trumbull property owners and others in eminent domain cases. The Institute estimates eminent domain was used to threaten or “take” more than 10,200 properties nationwide between 1998 and 2002 for the primary benefit of another private property owner.

“Eminent domain destabilizes the investment climate ... [I]nvestors cannot be certain their investments and property are safe. If the neighborhood or commercial area continues to decline, or if it fails to achieve the investment objectives established by the redevelopment plan, their property rights will be at risk as well.”

“The [Institute for Justice] estimates eminent domain was used to threaten or “take” more than 10,200 properties nationwide between 1998 and 2002 for the primary benefit of another private property owner.”

**Character Redefined as Blight**

The consultants’ report, however, does not provide evidence that most structures in the West End neighborhood meet the criteria for blight. The report’s conclusions rest on inferences from small samples of buildings and a fundamental belief that older buildings are inherently inferior to new, comprehensively developed.

The consultants presented virtually no evidence regarding ill health, transmission of disease, infant mortality, juvenile delinquency, or moral hazard in the West End. Almost all the evidence presented highlighted features of buildings and sites typical of neighborhoods 80 years old outside the primary growth path of a region.

While significant differences appear to exist in different areas of the West End, these differences would be expected when some areas are characterized by very high densities and others by lower densities.

Moreover, this kind of diversity is part of the natural evolution of neighborhoods. It should be expected in a neighborhood more than 80 years old. In short, homes and buildings built in the early twentieth century did not conform to the current definition of a blight

**Neighborhood Was Quite Healthy**

The Reason Foundation analysis showed contrary trends, including:

- Property values in some parts of the West End were increasing faster than for the city as a whole, suggesting a strong real estate market.
- Residential vacancy rates were falling faster in the West End neighborhood than for the city as a whole.
- Homeownership rates had increased in the West End neighborhood between 1990 and 2000; and
- The West End neighborhood was healthy, growing, and stable using standard criteria of neighborhood development.

“[T]he very vast majority of businesses come from local small businesses starting up, expanding, and diversifying over time. These are the businesses the government’s redline plans ...”

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Eminent
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rants, luxury apartments, and movie theaters.

Potential Taxes Attracted Attention
Significantly expanding the commercial mix of the land and replacing the existing affordable homes with upscale housing would increase the total value of real estate in the West End neighborhood from $31.3 million to between $79.8 million and $131.1 million. Real estate taxes would triple, and income taxes would double. Redevelopment could boost city tax revenues from the West End from $638,694 to as much as $1,657,733.

In the end, the West End was saved at the ballot box. Grassroots opposition to the project arose, and in November 2003 voters rejected the redevelopment plan, despite heavy lobbying for it by local politicians and financial support from the business establishment.

But a political solution can be overturned in the next election cycle, and no judicial precedent was set by the West End matter.

“Government should ... avoid the trap of believing the biggest or wealthiest citizen has more rights or more to offer than the hundreds of homeowners and businessmen that make up the city’s foundation.”

Redevelopment Alternatives Exist
Eminent domain destabilizes the investment climate for everyone except those negotiating directly with the city for a piece of the development project. And even in those cases, investors cannot be certain their investments and property are safe. If the neighborhood or commercial area continues to decline, or if it fails to achieve the investment objectives established by the redevelopment plan, their property rights will be at risk as well.

Few people will invest in homes or small businesses with such uncertainty hanging over them. Yet this is the climate created by the broad use of eminent domain for redevelopment purposes.

Cities increasingly think of redevelopment as large-scale, comprehensive projects. An incremental approach to redevelopment is discouraged—even when a project’s timetable for completion may be 10 or 15 years.

An alternate approach is to look for more incremental and property-rights-friendly approaches to redevelopment. Dozens of alternatives exist, including:

- reforming zoning codes to allow faster and streamlined project approval;
- employment of incentive zoning to encourage private-sector development of specific types of projects;
- landscaping and streetscaping;
- offering loans, grants, and direct subsidies to developers and builders; and/or
- voluntarily purchasing land.

Fresh Look Required
Citizens and local policymakers must take a fresh look at how the economy repositions itself in an information-driven, globally competitive world market and what, if anything, public policy can do to influence those shifts. The following key observations and principles may help redefine how public officials approach redevelopment in urban areas.

1. Focus on the achievable. Vision is not enough. A practical key to successful economic development policy is the ability of local leaders to be realistic in their expectations and in the programs they create to achieve them.

2. Provide core services efficiently for long-term success. Government investment does not create long-term job growth. Certain types of investments, such as road and sewer infrastructure, help lay a broad-based foundation for private investment.

3. Create sustainable economies through private investment. The vast majority of jobs come from local small businesses starting up, expanding, and diversifying over time. These are the businesses hurt most by eminent domain proceedings and large-scale redevelopment plans catering to large developers.

4. Lead with focus, drive, and simplicity. A more effective strategy has been for local leaders to identify two or three key areas and goals, and then develop a timed, phased action plan to achieve them. The results are easier to measure, and implementation is more likely to succeed.

5. Respect the rights of all citizens. Government should focus on providing core services that serve the broad-based citizenry and avoid the trap of believing the biggest or wealthiest citizen has more rights or more to offer than the hundreds of homeowners and businessmen that make up the city’s foundation.

6. Encourage voluntary investment and redevelopment. Cities should work with developers to accommodate property rights protections to create a business climate more supportive of property rights, greater investment certainty, and a more cohesive community. Most redevelopment projects are implemented in phases, and few projects depend on all properties being acquired in order for them to be successful.

7. Evaluate the process rigorously. A more rigorous definition of “blight” or “deteriorating” would provide guidance regarding which neighborhoods do in fact degrade community welfare. Public officials should be required to consider the feasibility of accomplishing the project’s goals by less-aggressive means.

Samuel R. Staley, Ph.D. (sam.staley@reason.org) is director of urban and land use policy at Reason Foundation and co-author with John P. Blair, Ph.D. of “Eminent Domain, Private Property, and Redevelopment: An Economic Development Analysis.”

INTERNET INFO
Movement for Supermajorities to Raise Taxes Growing Fast

by Scott LaGanga and Sandra Fabry

Illinois Republican House Minority Leader Tom Cross is proposing legislation that would require a “supermajority” vote in both houses before the General Assembly could raise income or sales taxes, raising the threshold for these taxes from a simple majority to a more restrictive three-fifths majority.

Says Cross, “I think we’ve been too quick, in the past, to try to solve our budget problems by automatically looking at tax increases; I think it’s time we said enough is enough to that line of reasoning.”

This most recent attempt to force “government to live within its means,” as Cross put it, fits the pattern of a growing counter-movement to the tax-and-spend sprees many states have embarked on.

For more than a decade, fiscally conservative legislators, governors, and activists have sought to minimize the ability of elected officials to raise taxes without a legislative super plurality or direct approval of voters. Known as tax limitation amendments (TLAs) or “supermajority” requirements, the measures require majorities of two-thirds, three-fifths, or three-fourths votes of each legislative chamber before a tax can be increased.

Growing Trend

As many as 16 states have a supermajority requirement for tax increases, either statutory or constitutional in nature. Most of these states—Arizona, California, Colorado, Louisiana, Nevada, South Dakota, and Washington—have opted for two-thirds requirements. Others—Delaware, Florida (for corporate income tax increases only), Kentucky, Mississippi, and Oregon—require a three-fifths majority.

The most restrictive requirements exist in Arkansas and Oklahoma, where any tax increase must be approved by a three-quarters majority of members of each chamber.

The supermajority requirements implemented in Michigan and Missouri do not appear on all listings compiled by scholars researching the issue. Michigan requires approval by three-quarters of the legislature on any adjustment to the state property tax assessment. Missouri’s constitution mandates that all tax increases exceeding the revenue limit first achieve a declaration of emergency by two-thirds of each of the legislature’s two houses.

Statutory Versus Constitutional

Many of the first supermajority measures were enacted by statute instead of by amendment to the state constitution. Critics argue this has created a measure without teeth strong enough to constrain tax hikes. Supermajority statutes can be voided, temporarily or permanently, by legislators passing another statute.

Jason Mercier of the Evergreen Freedom Foundation contends supermajority statutes are abused by legislators who simply override the statute for their own interests. “As Washington state legislators have demonstrated,” Mercier said, “taxpayers don’t really have the protection of a supermajority requirement for tax increases unless that tax restriction is found in the state constitution.”

“When Washington State has a statutory 2/3 vote requirement for tax increases,” Mercier notes, “legislators have ‘suspended’ that taxpayer protection with just a simple majority vote. This makes statutory supermajority requirements paper tigers in their actual ability to restrain the spending and taxing appetite of legislators. A meaningful supermajority requirement must be part of a state’s constitution.”

 Constitutional or statutory, to taxpayers advocates any supermajority requirement is better than a blank check to raise taxes with a simple majority.

Said Grover Norquist, president of Americans for Tax Reform, “Raising taxes should never be easy, and any obstacle legislators must overcome to reach into taxpayers’ wallets is a good one. Of course, one would favor constitutional requirements, but Rome wasn’t built in a day, and if these requirements create an atmosphere that is favorable to [Taxpayer Bill of Rights]-like tax-and-expenditure limitations, then this is definitely a step in the right direction.”

Permanent Temporary Taxes

Proponents of supermajority requirements frequently note the permanent nature of most “temporary” tax hikes. When government outlays exceed revenue, they say, some legislators look for short-term solutions like accounting gimmicks and temporary tax increases, none of which actually solves the problem. A case in point is Ohio, where in...
2003 a one-cent sales tax increase was passed as a short-term remedy for the state’s budget crisis. State history shows every temporary tax increase has become permanent.

“When taxes go up, they rarely ever go back down, even when they are sold as ‘temporary,’” said State Sen. John Campbell of California (R-Irvine), who speaks from experience in his own state, which has a two-thirds supermajority requirement in place. Campbell points out that supermajority-type checks in the system force greater unanimity among legislators of both parties. “The supermajority vote to raise taxes in California protects taxpayers by requiring that there is overwhelming support from both parties before taxes go up.” Campbell said. “Otherwise, a temporary change in legislative power or control could result in permanent tax increases.”

Large Observable Effect

Scott Michael New, assistant professor at the University of Alabama. “During the budgetary shortfalls [in numerous states] in 2001 and 2002, supermajority tax limits demonstrated their ability to prevent tax increases, protect taxpayers, and steer states toward sound fiscal policies.”

New compares supermajority states and those without a limitation, evaluating their state fiscal behavior (determined by budget cuts versus tax increases) during the budgetary deficits of FY2002. Among states that had comprehensive supermajority requirements (determined by no political party), the ratio of budget cuts to tax increases (in dollar terms) was 37.52 to 1, compared with 1.18 to 1 among all other states.

New argues this shows supermajority rules can force legislators to “live within their means.”

Under Fire

While pro-taxpayer groups stress the importance of supermajority requirements as a means to protect taxpayers, the measures currently in place have come under fire many times.

In a highly contested decision in 2003, the Nevada Supreme Court threw out the two-thirds requirement that had been added by citizen initiative a decade earlier. This followed a lawsuit filed by the governor against the legislature, in which he contended a constitutional mandate to “adequately fund education” trumped the supermajority requirement for passing new taxes.

“[S]tatutory supermajority requirements [are] paper tigers in their actual ability to restrain the spending and taxing appetite of legislators. A meaningful supermajority requirement must be part of a state’s constitution.”

JASON MERCIER
EVERGREEN FREEDOM FOUNDATION

School Finance Drives Texas Budget, Tax Talks

Judge rules state system unconstitutional, search on for $3 billion in cuts

by Peggy Venable

Two years ago, Texas legislators sweated through a legislative session with a $10 billion budget shortfall. They found ways to cut spending and cover the shortfall, passing a $117 billion biennial budget. Taxpayers gave Gov. Rick Perry (R) high marks for getting a budget passed without raising taxes.

During the current session, even with a $400 million surplus, legislators once again face tough decisions as they consider a 2007–2008 budget that may reach $136 billion. The surplus will not be nearly enough to bridge the gap between funds currently available and the funds that may be needed as legislators seek to address a school finance dilemma that hovers like a storm cloud over the Texas capitol.

Perry is leath to raise taxes, and both he and any revenue bill sent to him by the state legislature must be revenue-neutral. Perry and other state government leaders—including Lt. Gov. David Dewhurst and House Speaker Tom Craddick—are looking for a way to expand an existing tax or implement a new tax for school funding while maintaining a favorable business climate and achieving revenue-neutrality.

Property Tax Unconstitutional

Texas has a local property tax system that currently provides almost 60 percent of the state’s public education funds. Local property taxes have escalated in recent years due to rate increases and rising property valuations.

Some 300 school districts, including Dallas and Austin, have sued the state, charging the Texas public school finance system violates rules set forth in the state constitution governing local property taxes. They contend local districts have lost meaningful control over their tax rates.

In November 2004, Judge John Dietz, presiding judge for the 250th Judicial District in Travis County, issued a Final Judgment, supported by Findings of Fact and Conclusions of Law, finding the Texas public school finance system unconstitutional because it violated mandates for “efficiency, suitability and adequacy” of school funding. The state has appealed to the Texas Supreme Court.

The legislature eventually struck a deal and passed the tax increase on July 21, 2001 with the two-thirds supermajority required.

In California in 2004, activists and interest groups took aim at revoking the limitations set by the passage of the Gann Limit in the late 1970s, which mandated passage of a two-thirds threshold for all tax increases.

Proposition 56, on the ballot in March 2004, would have lowered the required two-thirds constraint to 55 percent. With $60 billion in tax increase proposals pending in the legislature that session, passage of Prop 56 would have been essential to support the pro-economic growth policies envisioned by Gov. Arnold Schwarzenegger (R).

Taxpayers defeated the measure, dubbed by opponents as a “blank check for tax increases,” by a vote of 63.5 percent to 34.5 percent.

Ron Nehring, vice chair of the California Republican Party, said, “Californians have a real opportunity to maintain a favorable business climate and achieve revenue-neutrality.”

Further Plans

The list of states looking to incorporate supermajority requirements to raise taxes is growing and includes Illinois, Indiana, Maine, Ohio, and Pennsylvania, among others. Taxpayer advocate groups in Florida are seeking to strengthen the existing requirement that addresses corporate tax increases only.

Many taxpayer advocates see supermajority requirements as steps not only toward tax restraint, but toward reductions in state spending as well. One activist stated, “You can’t burn down the house if you don’t have the matches.”

School Finance Drives Texas Budget, Tax Talks

Billions in Cuts Sought

Pending the state’s appeal, legislators are working to address Dietz’s ruling. They hope to identify $3 billion in budget cuts and raise $8 million in additional revenues, which would allow state funds to replace one-third of the school funding currently raised by local school property taxes.

Rep. Carl Isett (R-Lubbock) has been charged with scrubbing the state budget to find $3 billion to cut. He also has introduced the Texas Taxpayer Bill of Rights (TABOR) legislation, which he has championed the past several sessions to give teeth to the state’s tax and expenditure limitations.

As of early March, the Texas House was considering a revenue bill that would cut local property tax rates for schools by one-third from a maximum of $1.50 per $100 valuation to $1. The measure would reduce property tax revenues by about $5.5 billion, which would be offset by other taxes raising about the same amount.

Suggested replacement taxes include an increase in the state sales tax from 6.25 percent to 7.2 percent; an extension of the sales tax to include, but not be limited to, billboard advertising, car repairs, and car washes, along with an increase in the motor vehicles sales tax from 6.25 to 7.35 percent; and an additional $1 tax on cigarettes.

The Texas constitution prohibits personal and corporate income taxes, and few legislators favor amending the constitution to allow for such taxes.

The Texas Senate, led by Dewhurst, has floated a plan for a statewide property tax. Dewhurst has said he believes businessmen will agree to a low-rate tax that everyone pays.

Legislators have until the end of the regular legislative session in May to adopt the biennial budget.

Peggy Venable (pvenable@afptx.org) is director of Americans for Prosperity in Texas.

INTERNET INFO

The Final Judgment and Findings of Fact and Conclusions of Law issued by District Judge John Dietz in November 2004 are available through PolicyBot™, the Heartland Institute’s free online research database. Point your Web browser to http://www.heartland.org, click on the PolicyBot™ button, and search for documents 16633 (Final Judgment, 8 pages) and 16632 (Findings of Fact and Conclusions of Law, 126 pages).
“Transition Costs” for Social Security Reform an Illusion
It’s money we’ll have to pay anyway, and reform would make it easier

by Lawrence A. Hunter

Contrary to conventional thinking, allowing workers to invest a portion of their Social Security taxes through personal retirement accounts will incur no net cost to the federal government.

The misconception that there will be new costs—i.e., “transition costs”—arises from a failure to remember that Social Security is already, in effect, debt-financed.

Consequently, (1) any debt sold to the public in the short term during the so-called “transition period” to pay all promised Social Security benefits will refinance an existing liability; and (2) refinancing Social Security’s debt through personal accounts makes possible a reduction, and eventually an elimination, of Social Security’s unfunded liability, which otherwise is scheduled to grow without bound.

Mountain of Debt Looms

In Social Security, the current generation of workers pre-funds its retirement benefits by making contributions to the program in the form of a tax taken out of every paycheck. In exchange for this tax, the government promises to pay the taxpayer, when he or she retires, precisely defined benefits, which are specified in law by formula.

The amount of money paid in payroll taxes would be more than adequate to pre-fund workers’ retirement benefits were it properly invested, but it is not. Instead, the federal government borrows the payroll tax payments of current workers to pay retirement benefits to current retirees.

But unlike ordinary government debt, the debt obligation owed to workers through Social Security is not quantified and memorialized by the issuance of a bond, note, or bill certificates to workers. Nor is it formally recorded as debt on the balance sheet of the federal government.

It is real debt nonetheless. Hence, what pundits have labeled the “transition cost” is really the short-term cash-flow crunch that will happen when workers are allowed to invest a part of their Social Security taxes in personal retirement accounts rather than loan that money to the government to pay the benefits of current retirees.

Government Would Borrow Less

This cash-flow problem, however, does not arise because personal accounts create new (“transition”) costs.

On the contrary, the cash-flow problem arises because the government would be borrowing less. Every dollar of a worker’s Social Security payroll tax contribution invested in a personal retirement account is a dollar less debt the government owes to the worker and would otherwise have to pay back in the form of future Social Security benefits.

Congress can choose from several options for managing this temporary cash-flow shortage.

- It can refinance the old (undocumented) debt obligation to Social Security beneficiaries through some new formal debt instrument, a form of federal bonds.
- It can forgo refinancing this debt and actually reduce the country’s current indebtedness by cutting future federal spending and use the freed-up revenue to repay the debt to former workers in the form of Social Security benefits.
- It can increase taxes to raise the required cash.

Bonds Could Cover Transition

Economically, the most rational solution would be to require Social Security personal retirement account holders to lend the federal government whatever funds are needed to pay current Social Security benefits that otherwise would have been covered by the account holders’ payroll taxes.

In exchange, the federal government would deposit into the taxpayer’s personal retirement account Treasury Inflation-Protected Securities (TIPS), interest-bearing long-term federal bonds backed by the full faith and credit of the United States with no restrictions on the right of the account holder to resell the bonds in secondary markets.

Refinancing the Social Security liability in this way would not cause a short-term shock to the bond market, nor would it create immediate upward pressure on interest rates, because the government would not be entering credit markets to raise new cash. It would simply issue new bonds.

Nor does this approach pose a long-term threat to financial markets since the bond market is already fully aware of the unfunded Social Security liability. The future financial obligation represented by the Social Security liability is already reflected in the current price of federal bonds.

Since new bonds issued to personal retirement accounts would simply refinance an already existing liability, no net increase in federal indebtedness results. There are no “transition costs” involved.

Accounts Pay for Themselves

Not only would refinancing the Social Security liability through personal retirement accounts not entail new debt, it would make it possible to pay off that debt and leave Social Security financially sound in perpetuity. The accompanying chart illustrates this fact.

The amount of money paid in payroll taxes would be more than adequate to pre-fund workers’ retirement benefits were it properly invested, but it is not. Instead, the federal government borrows the payroll tax payments of current workers to pay retirement benefits to current retirees.”

“The amount of money paid in payroll taxes would be more than adequate to pre-fund workers’ retirement benefits were it properly invested, but it is not. Instead, the federal government borrows the payroll tax payments of current workers to pay retirement benefits to current retirees.”

The red line represents the total new debt, as a share of Gross Domestic Product (GDP), that would be incurred under current law if there are no benefit cuts or refinancing-control mechanism proposed in the legislation introduced by Rep. Paul Ryan (R-WI) and Sen. John Sununu (R-NH), which is designed to reduce the growth rate of federal spending one percentage point a year below CBO’s baseline for eight years—i.e., 3.6 percent a year vs. 4.6 percent projected on average.

This would lower total federal spending as a share of GDP in the coming decade from CBO’s projected 20 percent to about 18.4 percent—the historic average for federal revenues during the past 40 years and exactly what CBO projects federal revenues would be in the future if all of the Bush tax cuts were made permanent and the alternative minimum tax (AMT) were reformed.

The chart conservatively and unrealistically also assumes no positive dynamic income revenue feedback effect from creating the personal retirement accounts.

The area between the two lines to the left of their intersection—usually mistakenly characterized as “transition costs”—is significantly smaller than the “do-nothing costs” represented by the

CONTINUED at right
Social Security’s Looming Problems Need Fixing Now

by Terry Savage

I f you’re between the ages of 21 and 55, you’ve made a terrible investment and you continue to do so with every paycheck. I’m talking about Social Security, of course.

Under the current system, you simply can’t get the promised benefits at the promised time. Or if you do get the dollars, they’ll be worth far less because of inflation. When you realize you’re caught in this losing deal, we’ll face Generation Warfare.

 Wouldn’t it be nice if we faced up to this inevitability now, and restructured the system to be fairer to younger workers while still giving current retirees and those near the retirement benefits they’ve been promised?

Here are the possibilities, an assessment of the costs and consequences of various plans to either raise taxes, cut benefits, or add private accounts.

But first, let me acknowledge that there’s a slight chance that Social Security won’t need fixing. If we have very strong economic growth over the next 20 or 30 years, we might not face a problem in 2042 when the Social Security system is projected to run out of money in its “trust fund.” But do you want to bet your or your children’s retirement on it?

**Tax Hikes, Benefit Cuts**

Let’s agree that current and near-retiree benefits should not be affected. Then there are some limited choices.

- **Raise the retirement age.** We’re already doing that. Those born after 1959 will get full retirement benefits at age 67 plus.
- **Raise current FICA taxes.** Currently workers and employers pay a combined 12.4 percent. Actuaries estimate that if we raised the rate to 13.9 percent, the system would be solvent for 75 years.

**Problem:** Higher tax rates could slow the economy so much that unemployment climbs, payroll taxes dip, and the problem gets worse, not better.

- **Expand the wage base.** Currently the FICA tax stops at $90,000 of income. That captures 83 percent of all wages. Extending FICA collections to $140,000 of wages would capture 90 percent of wages and, say experts, fill about 40 percent of the projected deficit.

- **Reduce the growth of future initial benefits.** That’s part of the president’s proposal: Linking initial payments for future retirees to a more conservative index of consumer prices, instead of the current wage index.

- **Deny benefits to wealthy retirees.** Social Security could become a “means-tested” benefits program, even though wealthy retirees paid into the system over their lifetime.

**Private Accounts**

A combination of some of these elements could put Social Security in a more solvent position for younger baby boomers’ retirement. But as noted previously, each of these elements has its own potential economic consequences—not to mention the political implications.

The president has proposed that current workers be allowed to voluntarily set aside up to 4 percent of their FICA contributions to invested in private accounts in conservative mutual funds, in return for accepting lower Social Security benefits at retirement.

The idea of private investments has generated great debate. What if people don’t make smart investment decisions? What if you retire when the markets are down? Plus, there’s the issue of what happens if young workers stop paying into Social Security and divert their money to private accounts. Without that money, how will current benefits be paid? The gap could be $1 trillion or more.

**Looming Medicare Disaster**

On the other hand, at least workers would have the potential of a better return than the guaranteed bad deal Social Security currently gives them. And they would have assets to leave to their family. Plus, they’d have an ownership stake in the American economy. One thing is certain. Even the most ardent supporters of diverting Social Security taxes into private accounts concede doing so won’t solve the overall problem of paying future benefits to today’s workers. The system itself must be adjusted in one of the ways mentioned above.

Then we can go to work on Medicare, another looming financial disaster. Hoping and wishing these problems simply will disappear is irresponsible. It’s time to face the issues. And that’s The Savage Truth.

Chicago Sun-Times columnist Terry Savage (savage@suntimes.com), a registered investment adviser, is on the board of the Chicago Mercantile Exchange. This article was first published by the Chicago Sun-Times on February 17, 2005. Reprinted by permission.

**How to Explain the Social Security System to Your Grandchildren**

It’s kinda like having a safety deposit box in a big bank... here’s where you have a portion of your income for when you retire.

**Comments**

By Terry Savage

- **Transition**

Continued from left

area to the right of the intersection, which increases without bound beyond 2057. Thus, the debt incurred to refinance the Social Security liability (which reaches a maximum of 29 percent of GDP in 2032) and alleviate the cash crunch when workers are allowed to invest their Social Security payroll tax contributions—so-called “transition costs”—not only isn’t new debt, it is more than offset in later years when personal accounts reduce and eventually eliminate the Social Security liability altogether.

**Spending Restraints Required**

President George W. Bush and Congress have a golden opportunity to modernize Social Security and make it solvent in perpetuity through personal retirement accounts. Then, rather than panic over fictitious “transition costs,” they should alleviate as much of the cash crunch as possible by restraining the growth of federal spending and enacting tax reforms to spur faster economic growth and generate as large a dynamic revenue feedback effect as possible.

After that, there is no need to worry about the rest. Congress should simply borrow money from workers’ personal accounts to pay all promised Social Security benefits (going outside the accounts to credit markets only if necessary) and in exchange for the funds borrowed, issue the accounts new, long-term, inflation-protected bonds (TIPS) with no restrictions that would require the Federal Reserve to resell in the secondary bond market.

To paraphrase Alexander Hamilton, that debt would be to us a “national blessing.”

Lawrence A. Hunter (hunter@empower.org) is an author with the Institute for Policy Innovation and is affiliated with the Free Enterprise Fund. This article originally appeared January 7 in Human Events. Reprinted by permission.
Despite Rhetoric, Bush Budget Cuts Little, Spends a Lot

by Peter J. Sepp

Taxpayers will find many items to praise and more than a few to pan in President George W. Bush’s Fiscal Year 2006 budget, according to an analysis released by the National Taxpayers Union (NTU).

“Despite the budget’s stated goal to ‘accomplish more with less,’” said NTU Senior Policy Analyst Demian Brady, who conducted the research. “Among Brady’s findings:

- Federal receipts are projected to grow by 50 percent from Fiscal Year 2004 ($1.88 trillion) to FY 2010 ($2.82 trillion). Meanwhile, outlays will rise by nearly one-third between 2004 ($2.29 trillion) and 2010 ($3.03 trillion). Adjusting for inflation, outlays would still jump by 14.2 percent.

- Revenues are projected to consume a larger share of the nation’s economic output (GDP), from 16.3 percent in 2004 to 17.7 percent in 2010. Over that period, outlays would eventually fall as a share of GDP from 19.8 percent to 19.0 percent (after peaking in 2005 at 20.3 percent).

- Of the 15 cabinet-level departments, six would receive increases in their discretionary budgets totaling $25.1 billion for 2006, while nine would receive reductions totaling $9.6 billion for the year.

- While discretionary agriculture spending would take a significant cut of $2 billion in the president’s budget, expenditures in this area would still be twice as high as they were in the year immediately following enactment of the 1996 Freedom to Farm Act ($8.89 billion in 1997 vs. $19.4 billion for 2006).

Would Kill Amtrak Subsidy

The budget proposes to terminate subsidies for Amtrak, although $350 million in other taxpayer funds would still have to be set aside to meet the railroad’s obligations. Since Amtrak’s creation in 1971, Congress has provided it with roughly $29 billion in direct subsidies. Although the administration has said it plans to reduce expenditures on Cold War weapons systems, the budget tables provide confusing presentations on a forthcoming “supplemental” request, mainly for Iraq War funds (estimated at $81 billion). Some tables list an allowance for this request, while others do not.

New Taxes Proposed

While extending many of the 2001 and 2003 income tax reductions, the budget proposes increases in other types of taxes, such as new inspection and security fees on air travel. The average tax burden on a $200 round-trip airline ticket will be 26 percent, a higher effective rate than many middle-class travelers pay on their 1040 income tax forms.

Brady conducted a line-by-line cost analysis of Bush’s State of the Union address for NTU’s research affiliate and found the president had proposed a total of $12.8 billion in additional yearly federal spending—the smallest increase among the six most recent State of the Union addresses.

“The Fiscal Year 2006 budget looks leaner than those the Bush administration proposed in previous years, but Washington’s waistline will still grow noticeably due to numerous spending programs with an unhealthy appetite for tax dollars.”

DEMIAN BRADY, SENIOR POLICY ANALYST
NATIONAL TAXPAYERS UNION

Spending, Not Tax Cuts, Has Sent Federal Deficit Spirling

by Stephen Moore

You know that fiscal sanity has flown south for the winter when Nancy Pelosi and Ted Kennedy are throwing eggs at the Republicans for their budgetary recklessness. Kennedy has been on a tirade about how George Bush took a $1.35 trillion budget surplus and converted it into a $400 billion deficit.

President Bush released his 2006 budget of the United States government on February 7. Bush requested just over $2.6 trillion in spending. That’s $2,600,000,000,000. If a Democrat proposed a budget this size, Republican fiscal hawks would squawk to the rafters of the Capitol Dome in protest.

This is more money than the federal government spent in its first 120 years combined!

Spending Spree to Continue?

For fiscal conservatives, the biggest question about President Bush’s second term is whether the reckless spending spree this president launched four years ago will continue over the next four years. If the expenditure patterns continue, Bush will go down in American history as one of the biggest debt-and-spend presidents ever.

There are positive features to the budget that suggest a change of course. Bush would eliminate more than 100 useless agencies, and he would hold all domestic social spending below the rate of inflation.

“There are positive features to the budget that suggest a change of course...”

Democrats continue to argue that the budget deficit explosion is a result of the Bush tax cuts. However, that’s inconsistent with the facts. The 2003 reduction in the capital gains and dividend taxes, for example, has led to an increase in revenues, because it has led to an increase in economic growth and stock values.

“The problem is spending increases.”

The latest ratings by the National Taxpayers Union tell us that during the 2003-04 session, only 13 members of Congress—a record low—voted to reduce the overall outlays of the federal government.

Over the past 30 years, there have been only two periods when the federal budget actually shrank.

The first instance was in 1981-82, when Ronald Reagan set a new course for the budget and his first two budgets actually reduced overall domestic spending after adjusting for inflation. The second time this happened was in 1995-96, the Contract with America period. In those two years, federal spending in real terms fell by almost 4 percent.

But because of the high cost of the war in Iraq, the overall budget still rises well above the inflation rate.

Tax Cuts Increase Revenue

Democrats continue to argue that the budget deficit explosion is a result of the Bush tax cuts. However, that’s inconsistent with the facts. The 2003 reduction in the capital gains and dividend taxes, for example, has led to an increase in revenues, because it has led to an increase in economic growth and stock values.

“The problem is spending increases...”

The goal of the new GOP Congress, with the largest majorities in my lifetime, should be to reduce government spending over the next two years in real terms. This is an achievable goal, especially given that federal agency budgets have grown so massively in recent years.

If Bush and the Republican Congress would make spending reduction the goal, even with the initiative to make the tax cuts permanent, the deficit, which now stands just north of $400 billion, would be easily cut in half four years from now, which is what Bush promised during the campaign.

Ronald Reagan once quipped that getting the budget under control is like protecting your virginity: You just have to say no. Republicans haven’t been saying no to the Washington spending establishment in recent years, and that is why we face an ocean of debt.

It would be a bitter irony if in 2006 Republicans lost the majorities in Congress they have spent two generations achieving, because voters decided that Pelosi and Kennedy Democrats would do a better job as fiscal stewards.

As one freshman Republican, Louie Gohmert of Texas, told me, “I came to Washington to replace the big-spending party, not to become a member of it.” That’s a lesson Republicans forget at their own peril.

Stephen Moore (smoore@clubforgrowth.org) is president of the Free Enterprise Fund and a senior fellow at the Cato Institute.
**Medicare**

Continued from page 1

will meet my veto," Bush said during a February 11 swearing-in ceremony for Mike O. Leavitt as the new secretary of the U.S. Department of Health and Human Services (HHS).

The remark clearly was aimed at fed-
eral lawmakers who have said some-
thing needs to be done to control Medicare drug costs.

**Estimated Costs Soar**

Bush championed the prescription drug benefit—originally estimated to cost $395 billion over 10 years—and signed into law in December 2003. The pro-
posal squeaked to victory after the vote was delayed several hours while White House officials lobbied hold-out Senators and promised reluctant Republicans the $395 billion estimate was solid.

Seven weeks later, HHS announced a new estimate, $534 billion. Then on Febru-
ary 9 of this year, the White House announced the expected cost would be $724 billion.

“We did not think we were creating an open-ended program that would grow completely out of control.”

**SEN. JEFF SESSIONS**

R-ALABAMA

Administration officials explained that earlier estimates included 2004 and 2005, before the prescription drug program fully took effect. The new estimate projects 10 years from 2006, when the full prescription drug benefit goes into effect.

“When it’s fully phased in, of course it’s going to cost more,” White House spokesman Scott McClellan told reporters.

**Lawmakers Challenge Explanation**

Some Republican lawmakers do not accept that answer. Democrats are call-
ing for an investigation.

“we did not think we were creating an open-ended program that would grow completely out of control,” Sen. Jeff Sessions (R-AL) told White House Budget Director Joshua Bolten during a Febru-
ary 9 Senate Budget Committee hear-
ing.

Sessions told Bolten he felt misled, saying he may draft legislation that would hold the drug benefit’s cost to $400 billion over a decade, close to the amount the Bush administration promised hold-out members of Congress to win their support.

Democrats also jumped on the higher estimates. Sen. Dianne Feinstein (D-
CA) told reporters, “I believe the Senate Finance Committee should investigate the process used to estimate the cost of this bill.”

Sen. John F. Kerry (D-MA) said, “If the numbers don’t add up for Medicare, how can we be sure they will add up for Social Security?” Kerry’s comment came in reference to Bush’s proposal to allow younger workers to put some of their Social Security payroll taxes into pri-
vate accounts.

**Unfunded Liability Evident**

Some of the problem apparently stems from the sources of the estimates. The original $395 million estimate came from the Congressional Budget Office (CBO). The later estimates have come from HHS. The two agencies used dif-
ferent scoring methods to arrive at their estimates.

The Medicare law requires those who sign up for drug coverage to pay a pre-
mium now estimated at about $35 a month, an annual deductible of $250, and other fees. Benefits are available to all Medicare recipients, regardless of their income or assets. Different assumptions about utilization of the new benefit have produced significantly varying cost estimates.

Agreement is widespread, however, that the program will be expensive in a period when Medicare costs are sched-
uled to rise anyway. On February 9, Bush told White House reporters Amer-
ica’s aging population will strain Medicare as well as Social Security.

“There’s no question that there’s an unfunded liability inherent in Medicare that Congress and the administration are going to have to deal with over time,” Bush said.

**“Growth Is Unsustainable”**

Recent comments by CBO Director Dou-
glas Holtz-Eakin painted an even bleak-
er picture.

He estimated 20 percent of Medicare spending 10 years from now will go toward new prescription drug pay-
ments. Entitlement spending cannot continue to grow at such a pace, he said.

“The growth of these programs is sim-
ply unsustainable. Big changes are com-
ing regardless of what you might think at the moment,” Holtz-Eakin said Feb-
ruary 1 to the 1,500 health industry execu-
tives who attended the 2nd Annu-
al World Health Care Congress in Wash-
ington, DC.

Holtz-Eakin forecast that Medicare and Medicaid will cost taxpayers more than Social Security within 10 years. Together, those three programs will con-
sume more than half of all federal spend-
ing, he told World Health Care Congress attendees.

**“Ratchet Effect” May Lead to More Federal Spending Profligacy**

New Bush budget calls for continued spending growth

by Stephen Slivinski

**T**here are a few things for taxpayers to cheer about in President George W. Bush’s new budget pro-
posal, but it also includes plenty of evi-
dence that the death of budget proli-
gacy in Washington has been greatly exaggerated.

The new Bush budget proposes an overall 3.6 percent increase in feder-
al spending for 2006.

The president proposes to end the recent growth in discretionary spend-
ing, which is composed of spending other than entitlement programs such as Medicare and Social Security. The proposed budget makes cuts of just under 1 percent in this category.

Under his watch, that portion of the budget has grown by 48.5 per-
cent. During his first term, Bush sub-
mitted guns and butter budgets that did not reprioritize federal spending: Large increases in defense budgets to fight the wars in Afghanistan and Iraq and to fund homeland security programs were accompanied by large increases in the non-defense budget.

**Paltry Cuts**

The proposed cuts, however, are some-
what paltry. They do target some high-
profile programs, such as a proposed elimination of Amtrak subsidies, cuts to housing programs, and the termi-
nation of some corporate welfare such

Continued on page 2

**COMMENTARY**

Once Congress gets its hands on the budget, all proposed cuts typically go out the window, and the president’s proposals are usually seen as spend-
ing floors, not ceilings. Congress usu-
ally starts ratcheting up the spend-
ing almost from the minute the presi-
dent’s budget reaches Capitol Hill.

Over the past four years, for exam-
ple, Congress appropriated $187 bil-
lion more than Bush proposed in defense and domestic spending. By refusing to veto a single bill in his first term, Bush did nothing to stop this budget ratchet.

**Higher Hill to Climb**

After failing to battle the budget ratchet in his first term, the presi-
dent is going to have to push even harder to keep his spending cuts intact now. The only way this will work is if he threatens to veto any budget bill more expensive than what he proposed.

Bush’s threat to veto the federal highway bill last year if the price tag were larger than his proposal led to substantial handicapping among Repub-
licans in the House and Senate over what spending level would trigger a Bush veto. This killed the prospects of passing that bill by the end of the year. Similar wielding of the veto threat could help scale back the ratchet effect the president encour-
gaged during his first term.

Republicans have a stronger level of control over both houses of Con-
gress than in Bush’s first term, and they have a re-elected and confident presi-
dent. That means they have run out of excuses as to why they haven’t controlled spending.

Stephen Slivinski (sслиvinski@cato.org) is director of budget stud-
ies at the Cato Institute. A version of this article appeared in the Washing-
ton Times on February 9, 2005. Reprinted by permission.
Proposed Tax Hike on Air Travelers Meets Stiff Opposition

Bush administration proposal would more than double airport security tax

by Ryan Ellis

The Bush administration’s proposed fiscal 2006 budget includes a massive tax increase on every American who uses air travel.

The tax, estimated to raise $1.5 billion annually, would go to the Homeland Security Department’s Transportation Security Administration (TSA) to offset airport security costs.

According to the Air Transport Association of America, in 2005 the federal government will collect $3.2 billion in homeland security taxes on flights. The total tax burden represents 26 percent of a typical $200 ticket.

Security Tax Doubles

The TSA proposal would hike total taxes on airplane tickets by 47 percent, to $4.7 billion in 2006. For the average traveler, the security tax portion of a ticket for one-way flights would go up by 120 percent and on round-trip flights by 60 percent. The federal security tax would rise to $5.50 per flight from $2.50 each way and would cap multiple-leg flights at $8 each way instead of the current $5.

“It was a dangerous idea to give a government agency carte blanche to raise taxes whenever it wanted to. TSA, despite having a needed role in safeguarding our nation’s security, is feathering its nest like any other government bureaucracy.”

GROVER NORQUIST, PRESIDENT
AMERICANS FOR TAX REFORM

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“This is a lethal tax. It will kill jobs and further rob U.S. airlines of the vital revenue needed to restore their financial health and stability,” said the Air Transport Association on February 15 in an official statement to the Senate Committee on Commerce, Science, and Transportation.

The organization’s statement also said, “We face a situation today where efforts to improve our national security are undermining our economic security. Bluntly put, current government policies imposing excessive taxes on the airline industry are crippling a vital segment of our economy.”

Bush administration officials defend the proposal by calling the tax a user fee and saying it will improve airport security.

TSA Labor Costs Soar

The TSA was created in the wake of the 9/11 terrorist attacks to centralize and improve airport security. TSA has experienced one of the fastest-growing costs of labor of any government agency. In its first two years of existence, airport screener labor costs have grown by an average of 10 percent a year.

The airline industry is irritated by the degree to which TSA continues to look to that industry, rather than the general population of Americans who benefit from enhanced security, to fund its bureaucracy. Air Transport Association President James May said at a February 10 news conference on the tax increase, “[It is] said that aviation security is a shared responsibility. If that’s so, our share is over $3 billion per year. We’re doing more than our part.

Of the total TSA budget request for 2006, 74 percent is expected to be paid for by taxes on airlines and air travelers.

TSA Policies Criticized

In February in a joint statement with 14 other organizations opposed to the tax hike, Grover Norquist of Americans for Tax Reform said, “it was a dangerous idea to give a government agency carte blanche to raise taxes whenever it wanted to. TSA, despite having a needed role in safeguarding our nation’s security, is feathering its nest like any other government bureaucracy.”

TSA is exempt from competitive sourcing rules that apply to other federal government departments. Prior to 9/11, most airports had hired private screeners to inspect luggage and passengers.

On February 10 Fred L. Smith, president of the Competitive Enterprise Institute, raised this issue at a news conference hosted by the Air Transport Association.

“The Transportation Security Administration lacks incentive to ask whether an additional ‘safety’ factor does or does not make a meaningful contribution to air safety,” Smith said. “Like all ‘precautionary’ agencies, their bias is to ensure against risks for which they, the bureaucrats, are responsible.

“To put ‘risk’ in perspective,” Smith said, “there’s no such thing as risk-free travel; there can only be safer travel. Airlines, data consistently show, offer a safer mode of travel compared to most alternatives, even taking into account any terrorist threat.”

FRED L. SMITH, PRESIDENT
COMPETITIVE ENTERPRISE INSTITUTE

Moreover, lawmakers who want to improve homeland security should re-examine whether the current balkanization of our nation’s air travel network is a good system,” Smith said.

“Wouldn’t it be better to allow airport managers and airline owners to work together to coordinate operational decisions, including better security?”

“It’s time to bring together an appropriate mix of both private sector and government measures that ensure a proper balance of safety, convenience, and affordability,” Smith said.

Ryan Ellis (rellis@atr.org) is federal affairs manager at Americans for Tax Reform.
miles per gallon. The six-year project, launched in 2001, is being funded with a $2.1 million grant from the Federal Highway Administration and $771,000 in state funds. Highway testing could begin this fall. A vehicle miles traveled (VMT) tax could be implemented in 2007, according to ODOT officials.

The ODOT is currently recruiting drivers and service stations to participate in the test. State fuel taxes calculated on a per-gallon basis are currently the primary source of funding for state road maintenance and construction. On average, fuel taxes cover 65 to 85 percent of road use costs, according to the ODOT.

Included at the pump in the price per gallon, fuel taxes are easy to collect and virtually fraud-free. The more one drives, the more gasoline one uses, the more tax one pays.

However, as increasingly fuel-efficient vehicles and gas-electric hybrids hit the highways, more miles per gallon means less revenue for state governments.

Gas Tax Revenues Flattening

Although more drivers are on the road than ever before and more miles are being driven, increased fuel efficiency of vehicles has virtually flattened fuel tax revenues. As more alternative-fuel vehicles are added to the current mix of better fuel efficiency of standard vehicles and market penetration by hybrid vehicles, Oregon officials predict fuel tax revenues will begin declining by 2014.

Oregon’s current tax, 24 cents per gallon, funds about 70 percent of its road maintenance and construction costs. The tax rate hasn’t changed since 1991. As in other states, Oregon lawmakers are reluctant to incur the wrath of taxpayers by raising the gas tax, especially given the recent run-up in prices at the pump. Less revenue and reluctance to raise the fuel tax change the fuel-tax equation further. More miles driven means more wear and tear on the roads, which leaves states looking at more costs and less revenue, even without taking into account inflationary pressures.

The Oregon Road User Fee Task Force, created by legislation in 2001, looked at some two dozen proposals for increasing revenue before deciding a VMT system would provide sufficient additional revenue and was technologically feasible. “The VMT fee is a replacement tax,” said Jack Svadlenak, transportation economist with the ODOT. “If a VMT fee is implemented, drivers paying the fee would not pay the per-gallon tax.”

Fuel Efficiency Avoids Taxes

Before high-mileage imports made a significant and lasting impact on the domestic auto market, average fuel efficiency was approximately 12 miles per gallon. Today, the average mileage is almost 20 miles per gallon.

Not all vehicles get “average” mileage. At the suggested tax rate of 1.25 cents per mile, a vehicle averaging 20 miles per gallon would pay roughly the same amount in tax in a mileage-based system as under the current fuel tax system at 24 cents per gallon.

A Toyota Prius, which combines electric and gasoline power for maximum fuel efficiency, has an EPA mileage rating of 55 miles per gallon, whereas a Chevy Suburban gets in at about 12 miles per gallon. Under the current tax-per-gallon system, a 1,000-mile trip in the Suburban produces about $20 in tax revenue, compared to roughly $4.36 for [a Toyota] Prius.

In a VMT fee system, both drivers would pay a tax of $12.50, reflecting equal use of the roads.

Implementation Will Be Costly

Eventually, of course, all cars would have to be equipped with GPS devices and gas pumps with the ability to read mileage data and transmit the information to a central database, where the tax would be recorded and calculated.

Oregon officials estimate providing the onboard devices could cost as much as $225 per vehicle. In addition, oil companies are not thrilled about using their gas station computer systems to collect state taxes. Custom equipment for the Oregon test costs about $300 per vehicle. Impolt noted, though, that implementation of a VMT fee would not occur before 2007 and “there’s no telling how technology will develop by then.”

Retrofitting all vehicles is likely to be impractical, and the system also will have to allow for out-of-state cars. A dual tax system will be required unless and until some multistate or national standardization is achieved.

The current timetable calls for a 400-vehicle/six service station technology test to be conducted in Eugene beginning this fall.

Invasive Potential Worrisome

Sobel cites some possible concerns.

Once the technology is in place, he noted, law enforcement officers will want to use it. “There are some real privacy issues when government has the ability to track where people go,” Sobel said.

Sobel cautions that however the system plays out, the individual should always be in control of his or her data. For example, in a pay-at-the-pump model, if the individual accepts the tax calculation as correct, he or she should have the option of purging the record from the system.

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additional court action as the case works its way back up to the Court of Appeals, the state’s highest.

2003 Decision Upheld
The Court of Appeals ruled in July 2003 that the state must ensure the city’s schools get more money, but the court did not put a dollar figure on its ruling. DeGrasse’s ruling, issued after 18 months of political gridlock on the issue, represents the first judicial attempt to tie a specific amount of money to the case. DeGrasse rejected New York City Mayor Michael Bloomberg’s (R) attempt to get him to rule that the state itself must pay the entire extra amount. The judge noted the Court of Appeals had already explicitly stated it was for the legislature to decide how much of the new money for the schools must come from the state, and how much from the city.

Pataki has suggested the state might pay 40 percent of any new aid to the city’s schools. Assembly Democrats have said the figure should be closer to 75 percent. Either way, if upheld, the ruling would probably mean a minimum of another $3 billion a year more by 2009.

Judge Raises Ante
Reviewing proposals from various parties to the case, DeGrasse picked the highest dollar amount on the table—slightly higher even than the plaintiffs, the Campaign for Fiscal Equity (CFE), had recommended.

DeGrasse also stood with a three-judge panel that had reviewed the case for him and rejected any new accountability measures, even a proposal from CFE itself that the city have a detailed plan for how it will spend the money.

Like the Court of Appeals ruling before it, DeGrasse’s ruling applies only to New York City schools. CFE and various allies, including the New York State School Boards Association, want the legislature to extend the principles used to calculate the extra New York City spending to schools statewide, at an additional cost of about $3.2 billion a year.

The judge said the state should ensure the city’s schools get $5.6 billion a year in additional operating spending, phased in over the next four school years. That would raise per-pupil spending in the city’s schools to $16,800 a year. That is double the national average and works out to $336,000 for each hypothetical 20-student classroom.

In addition, the schools need $9.2 billion over the next five years, or $1.84 billion a year, in capital spending to add new classrooms and otherwise upgrade facilities, DeGrasse ruled.

Under the Court of Appeals ruling, the legislature could decide the state will pay the entire extra amount itself. Or it could require that the city contribute some of it. One way or the other, however, the high court said it is the state’s responsibility to ensure the new money arrives.

Fairness Not the Issue
Although supporters of the increase, among others, and CFE conduct- ing a sound basic education in New York City schools.

The court held the city is a creation of the state, and the state is thus ultimately responsible for the condition of the city’s schools.

If the city has underfunded its schools, the court said, then the state should not have allowed that to happen.

Objective Analysis Ordered
In its July 2003 ruling, the Court of Appeals ordered the state to determine objectively just what is the cost of providing a sound basic education in New York City. It gave the state until July of last year to come up with a plan for putting the money in place. Pataki appointed a special commission to work on the cost-determination issue, among others, and CFE conducted its own “costing out” study.

But when the legislature gridlocked over the issue and the deadline passed without action, CFE went back to DeGrasse seeking a new order demanding a specific amount of money and a specific timetable. Unless the state and CFE reach an out-of-court settlement in the meantime, that order will now go back up the chain of appeals.

David S. Shaffer (david.shaffer@bcnys.org) is president of the Public Policy Institute of New York State and served on the Zarb Commission, which was appointed by New York Gov. George Pataki to recommend funding options for New York City schools.
Politics, Not Need, Drive New York’s Tax-and-Spend Policies

Federal Reserve study shows big disconnect between state's fiscal needs and fiscal practices

by Robert Ward

A new study by the Federal Reserve Bank of Boston confirms New York state’s taxes are by far the highest in the country and finds social needs don’t explain the heavy tax burden.

The study provides research on every state with a rich source of information on spending and taxes compared to those elsewhere. Analysis of the Federal Reserve Bank’s findings relative to New York, conducted by the Public Policy Institute of New York State, was covered in the New York Post and other media outlets.

“The ‘tax effort’ required of New York’s workers and businesses is 43 percent higher than the national average ... The state with the second-highest tax effort, Connecticut, was only 19 percent above average.”

“Tax Effort” Exorbitant

The “tax effort” required of New York’s workers and businesses is 43 percent higher than the national average, according to the Federal Reserve Bank’s study. That level is far above that of any other state. The state with the second-highest tax effort, Connecticut, was only 19 percent above average.

Tax effort measures how much state and local governments in each state collect in taxes, compared with the revenue-generating capacity of the state’s economy.

The study found New York’s tax effort is especially high in these areas:

- personal income taxes, where New York is number 1 among the states, 71 percent above average;
- corporate income taxes, 83 percent above average; and
- property taxes, 48 percent above average.

High Spending Not Necessary

Federal Reserve economists Robert Tannenwald and Nicholas Turner also calculated “fiscal need” in each state. That index includes measures such as the poverty rate, the proportion of residents who are school-aged, and the number of vehicle-miles traveled.

New York State’s fiscal need was only 1 percent above the national average, Tannenwald and Turner found. After adjusting for need, state and local government spending in New York was at least 39 percent above average in such major areas as education, public welfare, health/hospitals, highways, and police/corrections, the Federal Reserve study concluded.

“New York State’s high tax effort reflects in part its policy preferences, not just its fiscal need,” Tannenwald said. He added that it’s possible the study underestimates fiscal need in New York State because of special circumstances in New York City, but he said he doubts the difference would be enough to materially affect the outcome of the study.

Politics Drive Decisions

Most of the differences in taxes and spending among states appear to be based on political and policy decisions, rather than differences in wealth and ability to generate revenue, Tannenwald and Turner concluded.

“States with low levels of public expenditures tend to spend less because they want to, not because they are constrained by a lack of revenue,” they wrote. “States have unique preferences for public services.”

Tannenwald said the report does not show major changes in long-term trends in relative spending and relative tax effort among the states. For example, he noted, between 1994 and 1999 there was little change in the difference between the tax effort of the states at the top and the bottom of the tax-effort list.

Robert Ward (bob.ward@bcnys.org) is director of research for the Public Policy Institute of New York State, the research affiliate of The Business Council of New York State. A version of this article was published on the council’s Web site, http://www.bcnys.org.
Your state’s legal system may hurt you more than you know. Companies are hesitant to do business in a state with a reputation for unfair court systems. Lost business means lost jobs. Fewer workers bear a higher tax burden to pay for schools, roads and public services. Lawsuits cost every American $845$ a year. It’s enough to make you scream.

A recent Harris poll ranked the fairness of all fifty states. If your state didn’t make the top of the list, you are probably paying for it.

### America needs legal reform now.
Demand that your elected officials fix the flaws in the justice system. Require fairness from your judges. For a copy of the survey and to learn how you can help, visit www.instituteforlegalreform.org.

### Lawsuit abuse hurts your state... and it hurts you.

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1. A January 2005 Tillinghast Towsen Perrin study estimated the cost of the U.S. tort system to be $245 billion in 2003, or $845 per person.
2. Mississippi has recently made reforms to its legal system that, when fully implemented, may change its future ranking.

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