Budget Discipline Collapses in Washington State

Democrats hike taxes $500 million, raise spending limit despite voter initiative

by Jason Mercier

Exercising complete political control for the first time in years, Washington state Democrats pushed through a record $26 billion budget for the state’s 2005-07 budget cycle on April 24. The legislature relied on nearly half-a-billion dollars in tax increases and one-time revenue sources and left $200 million in reserve, less than 1 percent of the total budget.

The vote on the budget in the state Senate was 25-22. All 25 votes in favor were by Democrats, with only one Democrat voting no. All 21 votes cast by Republicans opposed the budget. In the House, 55 Democrats and 1 Republican voted yes, and 42 Republicans voted no, for a 56-42 majority for passage.

Creative Accounting Used

To reach $26 billion in spending, legislators resorted to creative accounting to artificially increase the spending limit formula approved by voters in a 1993 initiative. For example, they transferred $250 million from a dedicated fund—the health services account—to the general fund, then appropriated $250 million from the general fund to the violence reduction and drug enforcement account. Then they transferred $200 million in reserve, less than 1 percent of the total budget.

by Dennis Byrne

Trying to balance the Illinois state budget by shifting highway funds into other government programs is creating a statewide “road crisis,” an unusual coalition of business and organized labor groups is warning.

The Transportation for Illinois Coalition

Gas Tax Diversions Cause Road Crisis in Illinois

New Bush Plan for Social Security Gets Mixed Response

by Steve Stanek

Reaction to President George W. Bush’s suggestion for a sliding scale of benefits for Social Security recipients has been mixed, with critics accusing the president of changing Social Security into a poverty program and supporters arguing the proposed changes will keep the system solvent while continuing to provide benefits to all retirees.

Bush raised the idea of different formulas to measure retirement benefits, during a rare nationally televised press conference.

Economists Back ‘Fair Tax’
Ill. Auditor Slams State Agency
CAFTA-DR Approval Urged
Phone Tax Targeted
Social Security Deficits Near
’Sin’ Taxes Draw Opposition

TABOR’s Future in Voters’ Hands

by Jon Caldara

Colorado’s state House and Senate have sent a major tax increase to the voters for a decision by passing House Bill 1194, which will place an override of the state’s Taxpayers’ Bill of Rights (TABOR) on ballots statewide this fall.

Sponsored by Speaker of the House Andrew Romanoff (D-Denver), the bill asks voters to allow state government to keep all excess tax revenue that otherwise would be rebated to taxpayers over the next five years. It is estimated this TABOR override will cost taxpayers $3.1 billion. Because there is no cap on the tax increase, however, the actual amount could be higher.

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Isn’t it time you joined a think tank?
Federal Income Tax Hike Looms for Millions of Middle-Income Americans

Ranks of payers of alternative minimum tax about to swell

by Steve Stanek

The Alternative Minimum Tax, signed into law in 1978, is about to hit tens of millions of middle-income households with a tax originally meant to touch only a handful of wealthy Americans. A temporary exemption from the AMT enacted by Congress for the years 2004 and 2005 is about to expire, which will throw several million taxpayers into the AMT system.

The AMT tax rate is 26 percent on the first $175,000 for couples, and 28 percent on anything over that.

The tax wipes out personal and dependent exemptions, state and local tax exemptions, home equity loan interest deductions, some medical and dental deductions, and other common deductions. This makes it resemble a flat tax, “but with rates that are much too high,” said Leonard Burman, co-director of the Urban-Brookings Tax Policy Center in Washington, DC and U.S. Treasury deputy assistant secretary for tax analysis during the Clinton administration.

“Every year your alternative minimum tax increases relative to your regular tax,” Burman said.

“By 2010, 94 percent of households with two or more kids and incomes between $75,000 and $100,000 will be on the AMT. There are horrible marriage penalties built into the AMT.”

LEONARD BURMAN, CO-DIRECTOR URBAN-BROOKINGS TAX POLICY CENTER

Increasing Numbers Affected

About 3.8 million taxpayers will be hit by the AMT this year, 18 million next year, and more than 30 million by 2010, according to Internal Revenue Service estimates.

“By 2010, 94 percent of households with two or more kids and incomes between $75,000 and $100,000 will be on the AMT. There are horrible marriage penalties built into the AMT,” Burman said.

“It’s a tax on families, on people who live in high-tax states, on middle-income people,” said Burman, who worked on proposals to reform the AMT during the Clinton administration. He said the proposals went nowhere because of political stalemates between Democrats and Republicans in Congress.

“Blue” States Hit Hardest

The 10 states with the most taxpayers nailed by the AMT voted for John Kerry for president in 2004: California, Connecticut, Massachusetts, New York, and other states with high property taxes, high state and local income taxes, high property values, and generally high costs of living.

“[Tax Foundation President] Scott Hodge has been quoted as saying that since most of the AMT returns are being filed in so-called blue states, maybe the rush to fix the AMT isn’t as urgent from a Republican perspective as some people think it should be,” said William Ahern, the Tax Foundation’s director of communications.

“The fact is that what triggers the AMT is a high deduction for state and local taxes,” Ahern said, “so high-tax states naturally are pushing more of their residents into the AMT.”

“Failure to index for inflation. Reg-ular tax brackets and personal exemp-tions are indexed for inflation each year to prevent automatically shifting people into higher tax brackets because of cost-of-living adjustments in wages. Because the AMT exemption amounts have not been indexed for inflation, people are being pushed into the AMT even though their wages may not be changed in any real terms.”

Expiration of temporary AMT breaks Congress enacted for 2004 and 2005. Millions more taxpayers would already be paying the AMT if not for those temporary breaks.

Tax Called Outmoded, Ineffective

“The genesis of the alternative minimum tax shows how the country has changed over the last 30 years,” said Burman. “The Treasury Secretary in 1969 testified there were 155 people with incomes over $200,000 who paid no federal income tax. There were more letters to Congress about that in 1969 than about the Vietnam War.”

Congress responded with a variety of measures to get high-income households to pay federal income tax, but each year some managed to avoid taxes. So in 1978 Congress created the AMT, a confusing “parallel” income tax system that effectively wipes out most exemptions and deductions in the regular tax system. Even with the AMT, some high-income earners still manage to avoid paying fed-eral income tax.

Steve Stanek (stanek@heartland.org) is managing editor of Budget and Tax News.
Economists Back ‘Fair Tax’ Proposal

by Merrill Bender

Scores of economists across the country have come out in support of the “Fair Tax” concept, giving a boost to supporters who are working to have at least 100 Congressmen and Senators signed on as sponsors of Fair Tax bills during the current 109th Congress.

“Our tax code is a mess for a reason. Special interests pay for special favors,” said Fair Tax supporter Laurence Kotlikoff, economics department chairman at Boston University and coauthor of The Coming Generational Storm. “And with thousands of pages and counting, there are plenty of places for our politicians to hide the kickbacks.”

On April 12 Kotlikoff joined more than 75 economists nationwide who endorsed the Fair Tax in a letter delivered to the U.S. House, Senate, Treasury, president’s tax reform panel, and President George W. Bush.

The Fair Tax would replace federal personal, gift, estate, capital gains, alternative minimum, earned income, Social Security/Medicare, self-employment, and corporate taxes with a national sales tax. It would include a rebate system to make the Fair Tax a progressive tax system, where the net effective rate for low- and middle-income persons is less than the effective tax rate for the wealthy.

Georgia Lawmakers Take Lead

The Fair Tax bills currently under consideration in Congress—House Bill 25 and Senate Bill 25—are sponsored by Rep. John Linder (R-GA) and Senator Saxby Chambliss (R-GA).

HR 25 was originally introduced in the 106th Congress by Linder and Rep. Collin Peterson (D-MN). In the 108th Congress, there were 56 cosponsors in the House and Senate.

In an indication of leadership support for the Fair Tax, Linder recently moved from the Rules Committee to the Ways and Means Committee, House Speaker Dennis Hastert (R-IL) expressed support for a national sales tax in his recent book, Speaker: Lessons from Forty Years in Coaching and Politics. House Majority Leader Tom DeLay (R-TX) is a cosponsor of HR 25.

On March 3, Federal Reserve Chairman Alan Greenspan told a presidential tax reform panel that a consumption tax “could certainly meet the fundamental criteria of being simple, fair, and pro-growth.”

Grassroots Support Rises

The legislation is based on work done by Americans for Fair Taxation (http://www.fairtax.org), a grassroots organization that has spent more than $22 million on marketing and academic research and in the past five years has grown to more than 560,000 supporters. The organization has 280 congressional district directors across the country trying to organize local support for the legislation.

“Just like taking down the Berlin Wall, we will end the worst, most invasive tax ever devised and replace it with a simple, transparent, progressive, national retail sales tax,” said Tom Wright, executive director of Americans for Fair Taxation.

“I think all Americans are dismayed, outraged, and disgusted that our federal tax code contains millions of eye-glazing words spread across more than 60,000 pages. We all know it’s a disgrace, and we all know it must be changed.”

Hidden Tax Costs Eliminated

Calculations conducted by several nationally known economists conclude the Fair Tax package would eliminate tax costs currently hidden in retail prices, taxes that represent 22 to 25 percent of the cost of retail goods.

Adding in the Fair Tax progressive retail sales tax of 30 percent, according to Wright, consumers would pay a little more than they pay now for products and services but would take home paychecks free from federal income and payroll tax deductions.

Wright said this is a key fact often missed by many people, who make the mistake of thinking the tax would be solely an add-on to current prices. A key component of the Fair Tax package is a rebate to all resident Americans with a legal Social Security number. Purchases up to a certain amount would effectively be tax-free, because taxpayers would receive monthly rebate checks, the amount of which would be determined by a formula tied to the federal poverty level.

“Our federal income tax system is inefficient, far too costly, and simply not the best way to pay for government.”

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Auditor Slams Illinois’ Guardian Against Waste

by Steve Stanek

A n Illinois agency that claims to have saved taxpayers $600 million by reducing waste and fraud has itself wasted money, granted multimillion-dollar contracts to politically connected firms, and failed to show it has saved money, according to a blistering audit by Illinois Auditor General William Holland.

Holland issued his report on Central Management Services (CMS) April 26. He held a news conference—his first in 12 years as auditor general—to announce the findings and defend himself against attacks by members of Democrat Gov. Rod Blagojevich’s administration.

“This is worse than just sloppy,” Holland said to reporters in describing the operations of CMS. Blagojevich revamped the department in 2003 to consolidate the awarding and maintenance of most state contracts, with the stated aim of making the state’s government more efficient.

Attorney General Reviewing Findings

Holland said he has sent a copy of the audit to Illinois Auditor General Lisa Madigan (D) for legal review. He said he did so because there are serious questions surrounding the awarding and management of state contracts to political insiders, including major donors to the governor’s political fund.

In addition to questioning contracts awarded and managed by CMS, Holland questioned more than $546,000 in expense reimbursements the agency has paid contractors. Those expenses include parking at Chicago Bulls basketball games, dinners and drinks for state officials, rentals of seven sport utility vehicles for a contractor’s staff to drive, and a party thrown by a contractor to celebrate having won a $24.9 million state contract.

Officials Say Audit “Misleads”

CMS officials defended their practices and criticized Holland’s report, issuing a statement saying it “contains inaccurate and misleading findings.”

They say they have saved Illinois taxpayers $600 million since Blagojevich overhauled CMS. Holland’s audit, however, says there are almost no financial records showing the department has actually saved money.

“The whole system has become a joke. This was a routine annual audit. This was not an extraordinary audit, but the findings were.”

STATE REP. JACK FRANKS
D-WOODSTOCK

Paul Campbell, assistant director of CMS, told Chicago Sun-Times reporters Dave McKinney and Chris Fusco for an April 27 story, “The organization we’ve built is, in many ways, best in class and will sustain those savings.”

Campbell has been nominated by Blagojevich to replace Michael Rumman, who unexpectedly resigned as director of CMS several weeks before the audit was released.

Acts of Intimidation Alleged

CMS also came under fire from some lawmakers for engaging in what State Rep. Jack Franks (D-Glen Ellyn) called “acts of intimidation” before the report’s release. CMS officials asked for Holland’s own office contracting records and expenditures, apparently to try to discredit his report.

“I have never seen such a rotten, arrogant response, where they attack the messenger,” Franks said. “The governor’s cavalier response takes away from the severity of the issue.”

Franks is chairman of the State Government Administration Committee. He told reporters he plans to use Holland’s audit as the basis for committee hearings into the operations of CMS.

According to Holland’s audit, several contractors were allowed to draw up bid specifications and then bid on the contracts, giving them an advantage over competitors. Holland also documented an instance in which a contractor that originally lost a bid was allowed to submit a new bid to win the contract. Competitors were not allowed to submit new bids.

“The whole system has become a joke,” Franks said. “This was a routine annual audit. This was not an extraordinary audit, but the findings were.”

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

Schwarzenegger Backs Public Pension Reform

by Steve Stanek

California Gov. Arnold Schwarzenegger (R) continues to promise public employee pension reform but has hacked away from a proposal to move public employees out of traditional pensions and into a “defined contribution” plan.

On April 7 Schwarzenegger announced that a ballot initiative, proposed by Assemblyman Keith Richman (R-Glendale) to move California’s public employees into a defined contribution system, was flawed. The governor made the decision after Attorney General Bill Lockyer (D) determined the wording also would have stripped employees of death benefits.

Police, firefighters, and other public employees adamantly opposed the proposal and bombarded the governor’s office with complaints.

Schwarzenegger said he remains committed to bringing California’s public pension system in line with private-sector practices but does not want to strip away death and disability benefits.

“Schwarzenegger has been a vocal supporter of pension reform in California,” Richman said. “The problem of unfunded liabilities is so widespread it requires a statewide approach,” Richman said. “The important point is the need to keep pressure on for pension reform. The governor has made clear that he plans on having an initiative on the June 2006 ballot no matter what. Whether it goes through the legislative process or is placed on the ballot directly through signatures on petitions from voters, the governor has made clear he wants to address the pension crisis.”

“Whether it goes through the legislative process or is placed on the ballot directly through signatures on petitions from voters, the governor has made clear he wants to address the pension crisis.”

ASSEMBLYMAN KEITH RICHMAN
R-GRANADA HILLS

Private Employers Flee Pensions

Private employers have moved away from traditional defined benefit pensions, which pay a guaranteed retirement benefit based on factors such as years of service and wage history, because the costs and complexity of such plans have soared.

According to the federal Pension Benefit Guaranty Corporation, which insures pension plans, the number of traditional single-employer pension plans dropped from 112,208 in 1985 to 29,651 in 2004. Most of those plans were replaced by 401(k) defined contribution plans.

Steve Stanek (stanek@heartland.org) is managing editor of Budget & Tax News.
Opposition to Expanded Gaming Grows in Minnesota

by Randy Wanke

Faced with a $446 million budget shortfall, the lure of “revenues” is leading many political leaders in Minnesota, including Republican Gov. Tim Pawlenty, to advocate the expansion of gambling to help fill the state’s coffers.

Pawlenty proposed in March to have the state enter into a partnership with Northern Minnesota Indian tribes to open a state-run casino in the Twin Cities. Pawlenty’s plan would require tribes to take on $375 million in debt to build the casino and to pay a one-time state licensing fee of $200 million.

The state and tribes would then share the profits. The governor would use the $200 million licensing fee to help plug a projected $446 million budget shortfall in the upcoming biennium.

Other Minnesota political leaders from both political parties also have offered legislation to expand gambling.

State Senate Minority Leader Dick Day (R-Owatonna) has proposed a “racino,” which would allow the Canterbury Park horse race track to add an area for video slot machines, provided the state receives a portion of the revenues. Democrat state Rep. Tom Rukavina (DFL-Virginia) is sponsoring legislation that would allow establishments that sell beer or liquor to have video slot machines to be played by persons 21 or older.

Attorney General Dissents

Minnesota Attorney General Mike Hatch (D) has issued a legal opinion stating Pawlenty’s proposal would violate the Minnesota State Constitution. The governor’s office disputes that opinion.

The attorney general ruled that the 1988 constitutional amendment allowing a state lottery does not permit state involvement in a casino. He said the issue would need to be brought before voters.

In addition, some organizations are urging the governor and other state leaders to consider the social and economic costs of gambling before pushing for its expansion.

“Minnesota political leaders can’t talk about expanding gambling and at the same time ignore the true costs associated with gambling,” said Annette Meeks, chief executive officer of Center of the American Experiment, a Minnesota think tank. “Expanded gambling is not a harmless way for the state to collect more revenue.”

One legislator who is bucking the gambling expansion craze is state Sen. David Hann (R-Rid-Rid-Prairie), who has introduced legislation to do away with the Minnesota State Lottery.

Critics Cite Gambling’s Costs

While Minnesota’s gambling expansion proponents have heralded it as a boon for the state, critics say they have done little to address the social costs of expanded gambling. To help bring that issue to the attention of state political leaders, Center of the American Experiment in April hosted a forum with nationally known gambling expert Earl Grinols, an economics professor at Baylor University who has extensively studied gambling.

Grinols told forum participants, including Pawlenty’s chief of staff, Dan McElroy, that gambling expansion in Minnesota is “coming from the wrong place, it’s coming from the wrong people, and it’s coming at the wrong price.”

Citing a study by the Ontario Problem Gambling Research Center, Grinols reported 48 percent of casino revenues typically come from problem and pathological gamblers.

Economic Costs Outlined

Nationwide, Grinols said, “the social costs of problem and pathological gambling are between $32.4 billion and $53.8 billion” annually.

One of the costs associated with gambling is increased crime. Based on raw data, Grinols said, 12.6 percent of the crime observed in casino counties would not be present if casinos were absent.

Grinols has pushed lawmakers and Pawlenty to conduct comprehensive studies of the likely impact of gambling in Minnesota before proceeding with its expansion, and state Rep. Frank Hornstein (DFL-Minneapolis) has introduced legislation to require such a study.”

Critics Being Heard

Efforts to bring the social costs of gambling to the attention of Minnesota political leaders appear to be paying off. Shortly after Grinols’ presentation, a state Senate committee voted overwhelmingly against the creation of a state-run casino and a racino proposal. The state House of Representatives passed two separate budget bills—one that includes revenue from a state-run casino and one that does not—indicating lawmakers are giving serious consideration to going forward without gambling revenues.

Despite those setbacks for the governor’s plan, Pawlenty’s chief of staff has hinted expansion of gambling may be worked out in last-minute, closed-door budget negotiations later this spring.

Meeks said regardless of what happens to the proposals currently being debated before the legislature, gambling expansion will continue to be an issue facing Minnesota in the near future.

“Legislators and other state leaders have gotten into their heads that expanded gambling is a panacea for the financial problems facing state government,” said Meeks. “As long as they continue to operate on that false assumption, Center of the American Experiment will continue to educate them about the fact that expanded gambling also comes with social costs that are just too high for the people of Minnesota to pay.”

Capitol Awash in Gambling Proposals

Since Gov. Luther Youngdahl rid Minnesota of slot machines and gambling devices in the 1940s, gambling has inched its way back into Minnesota—evolving from legalized charitable bingo in the 1970s to a multifaceted and multibillion-dollar industry today.

Gambling boomed in Minnesota in the 1980s after Congress gave Indian tribes more authority to expand gambling, and Minnesota officials negotiated compacts with several tribes that allowed for video gambling devices and blackjack.

Gambling has been a less-lucrative enterprise for the Northern Minnesota tribes than they had hoped, because of their remote locations.

During a March news conference announcing a proposed partnership with the northern tribes, Gov. Tim Pawlenty (R) said, “It is time that Minnesota and the tribal governments who are represented as part of this partnership get a better deal, get a more fair deal.”

Randy Wanke (randy.wanke@americanexperiment.org) is director of communications for Center of the American Experiment.
Wisconsin’s “Balanced” Budget Running $1.9 Billion Deficit

by George Lightbourn

Contrary to announcements from Wisconsin Gov. Jim Doyle (D) and the state’s legislature that they had “fixed” the budget deficit in the summer of 2003, the state’s official fiscal report reveals a balance sheet awash in red ink.

The state government actually keeps two sets of books, in the hands of the state controller. A cash-based report, which is given to the public and used to satisfy state statute, shows the state’s finances as being in balance. The more accurate accrual report, which is given to bonding agencies, shows Wisconsin finances to be $1.9 billion in the red. The deficit exceeds revenues by 18 percent, a higher percentage than in any other state.

Wisconsin’s bond rating is among the lowest in the nation.

Dual Books Mask Deficit

The differences between the two reports are substantial. The most recent Comprehensive Annual Fiscal Report, issued by the state controller, said the state’s cash report understated its spending obligations and overstated its revenues, accounting for the $1.9 billion deficit in 2004.

Private industry and most government agencies long ago converted to accrual accounting. Under accrual accounting, items are brought to account and included in the financial statements as they are earned or incurred, rather than as they are received or paid. Accrual accounting more accurately reflects an organization’s true financial condition.

Wisconsin’s use of cash accounting for budgeting purposes allows the creation of financial loopholes that make the state’s budget appear to be in balance when it isn’t.

Accounting Standards Bypassed

To reconcile the differences in financial reporting among states and among the thousands of local jurisdictions, the Government Accounting Standards Board (GASB) in 1984 developed a standard protocol of accounting for public revenues and spending.

The GASB standards were developed to provide an external report done in a uniform way by every state and local government. Wisconsin state law, however, was never changed to reflect the new standards.

The state government continues to maintain its internal report in a way that principally tracks cash.

Each year the Wisconsin controller, in compliance with state statutes, issues the same type of cash-based report that has been prepared since the Wisconsin Constitution was written in 1848. Wisconsin is one of only a handful of states that uses its original constitution. It is the oldest state constitution outside of New England.

The state’s cash-based report is exactly the type of report the GASB standards were intended to replace.

Problems Likely to Persist

Sixteen states prepare their budgets according to generally accepted account-

ing principles (GAAP). A GAAP report is needed to satisfy bonding agencies concerned about the state’s finances.

Wisconsin has a long way to go before it can join them. A number of factors will make it difficult for the state to do so:

- The size of the deficit, representing 18 percent of revenues, is daunting. Even the most determined policymakers find eliminating the deficit to be almost overwhelming.
- Reducing and eventually eliminating the deficit will require support from state policymakers. Yet the track record since the deficit was first documented in 1990 suggests little interest in reducing it.
- Elected officials are being asked to solve a problem that is not of their making. The current $1.9 billion deficit is the result of budget decisions made over decades.

“Wisconsin’s use of cash accounting for budgeting purposes allows the creation of financial loopholes that make the state’s budget appear to be in balance when it isn’t.”

George Lightbourn (lightgk@tds.net) is senior fellow at the Wisconsin Policy Research Institute and former secretary of the Wisconsin Department of Administration, which supports other state agencies with purchasing and financial management and helps the governor develop and implement the state budget.

Kentucky Kills Plan to Tax Retail Liquor Sales

Bourbon maker moves forward with expansion plans

by Steve Stanek

A famous maker of Kentucky bourbon says a multimillion-dollar expansion of its distillery might proceed now that state lawmakers voted on March 9 to kill plans for a 6 percent retail sales tax on alcoholic beverages.

Maker’s Mark had planned a $35 million expansion of its distillery in Loretto, Kentucky. On February 16, the firm’s president, Bill Samuels Jr., told state lawmakers executives at the parent company were considering killing the expansion because of the retail sales tax proposal. Liquor is now untaxed at the retail level in Kentucky.

Lawmakers on March 9 instead voted to increase from 9 to 11 percent the wholesale tax on beer, wine, and distilled spirits. The effect will be to increase the price “just a couple of cents a bottle,” according to Chris Swonger, vice president of government affairs at Allied Domecq Spirits, USA, which owns Maker’s Mark.

“We were much happier with the wholesale tax than we would have been with a 6 percent retail tax,” Swonger said. “Kentucky is the home of bourbon. We found it hard to swallow a punitive tax like that.”

Corporate, Personal Taxes Cut

The increase in the wholesale liquor tax was one of several tax changes Kentucky lawmakers made. They also:

- raised the cigarette tax from 3 cents to 30 cents a pack;
- lowered corporate taxes from 8.25 percent to 7 percent in 2006 and 6 percent in 2007;
- cut the personal income tax by 2/10ths of 1 percent; and
- eliminated the income tax for those living below the federal poverty level.

Full Effect Unknown

Gov. Ernie Fletcher (R) said the mix of tax increases and cuts will be revenue-neutral, but tax watchdog groups are analyzing the package to determine the full impact.

Aaron Morris, fiscal policy analyst at the Bluegrass Institute, said it’s difficult to say who is correct.

“People on the right are saying it will be revenue positive. People on the left say it will be revenue negative,” Morris said. “It will probably be positive in that the state will bring in more money next year, but in my opinion we will get more growth, more jobs, and more employers. As long as the growth of tax revenue doesn’t exceed the growth of income, that’s okay. You don’t want the government to take up a larger share of the economy.”

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

Free Trade Agreement Gains Support from Agriculture and Manufacturing

Bob Stallman
American Farm Bureau Federation

A new push for Congressional approval of the Central America-Dominican Republic Free Trade Agreement (CAFTA-DR) has officially begun. During April, separate agricultural and manufacturing coalitions released studies proclaiming the benefits of expanding free trade.

Farmers rallied for CAFTA-DR on April 11. More than 50 organizations, coming together as the Agriculture Coalition for CAFTA-DR, were joined by Mike Johanns, secretary of the U.S. Department of Agriculture, and other public and private officials at a media event in the nation’s capital. The groups are urging Congress to “pass the already negotiated agreement.”

$1.5 Billion Boost Cited

According to the coalition, the trade deal would yield nearly $1.5 billion in U.S. agricultural exports to the CAFTA-DR region, providing significant opportunities for U.S. farmers and ranchers. The nations of CAFTA-DR represent the second largest market in Latin America for U.S. products.

“When you look at the aggregate, CAFTA-DR is a net positive for [U.S.] agriculture,” said American Farm Bureau Federation (AFBF) President Bob Stallman. “The agreement will generate millions of dollars annually by eliminating tariffs on U.S. agricultural goods.”

In a NAM media statement, Engler said, “People who claim that CAFTA-DR will have a detrimental impact on the U.S. economy are seriously mistaken. Together these seven countries have an economy the size of Sacramento, California. To say they pose a major threat to us is ludicrous.”

“When you look at the aggregate, CAFTA-DR is a net positive for [U.S.] agriculture. The agreement will generate millions of dollars annually by eliminating tariffs on U.S. agricultural goods.”

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CAFTA and Agriculture

The Bush administration has proposed an ambitious trade agenda by moving forward with several countries on Free Trade Agreements. Currently under negotiation are the Free Trade Agreement of the Americas, the Southern African Customs Union, and Andean, Panama, and Thailand Free Trade Agreements.

The administration recently concluded negotiations for the Central American and Dominican Republic Free Trade Agreement (CAFTA-DR), and with Bahrain. Below is a brief synopsis of current trade information on CAFTA.

Countries included: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic

Negotiations began: January 27, 2003

Negotiations status: Negotiations completed

New manufacturing exports to CAFTA nations after passage: $1 billion

Additional U.S. manufacturing jobs: 12,000 related jobs

Value of U.S. agricultural exports to CAFTA nations in 2002: $1.251 billion

Top U.S. agriculture exports to CAFTA nations in 2002:
Corn - $195 million
Wheat - $163 million
Soybean meal - $98 million
Soybean oil - $82 million

Value of U.S. agricultural imports from CAFTA nations in 2002: $1.960 billion

Top U.S. agricultural imports from CAFTA nations in 2002:
Bananas - $655 million
Coffee - $387 million
Pineapples - $173 million
Melons - $162 million

Projected U.S. agricultural gains after full implementation of CAFTA-DR in 2024: $1.44 billion

INTERNET INFO

The study conducted by Ross Korves for the Agriculture Coalition for CAFTA-DR is available online at http://www.nppc.org/hot_topics/40districts.html and, with other CAFTA-DR information, at http://www.uscafta.org.

The National Association of Manufacturers analysis can be found on the group’s Web site at http://www.nam.org/caftadrstudy.

— compiled by John W. Skorburg

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Tax Group Targets Spanish-American War Tax

by John W. Skorburg and Tom Readmond

Americans for Tax Reform (ATR) announced on March 10 that it would make repeal of a 107-year-old federal excise tax on telephone service a major priority in the current session of Congress. Since then, support for the proposal has been increasing.

The tax—a flat 3 percent on every telephone bill—was enacted in 1898 to fund the Spanish-American War.

“More than a century ago, the federal government sold the American people a bill of goods by telling them this was a ‘temporary’ tax to fund the Spanish-American War,” said Damon Ansell, chief of staff for ATR. “Since Virgil Goode signed our form, several other prominent members of Congress have also done so, including Republican Jim Sensenbrenner of Wisconsin and Republican Chris Cannon of Utah.”

Congressman Promises Repeal Bill

Rep. Gary Miller (R-CA) has promised to introduce legislation to repeal the tax.

“The Spanish-American War ‘luxury’ tax on telephone services has long outlived its purpose, and I am committed to its repeal,” Miller said.

Rep. Virgil Goode (R-VA) on March 14 became the first member of the 109th Congress to sign and return to ATR a form stating his intention to end the tax. By March 23 seven members had made the promise.

“Representative Goode showed real leadership by being the first to voice his support for repealing this ridiculous tax on telephones,” said Damon Ansell, chief of staff for ATR. “Since Virgil Goode signed our form, several other prominent members of Congress have also done so.”

DAMON ANSELL, CHIEF OF STAFF
AMERICANS FOR TAX REFORM

Each of these Congressmen has said “Yes” to the following question: “If legislation to repeal the 3 percent Spanish-American War tax on telephones came to the floor, would you vote in favor of repeal?”

Rep. Jim Ramstad (R-MN) said, “The telephone excise tax is an absurd relic that should have been repealed a century ago.”

Repeal Vetoed in 2000

The House and Senate passed joint appropriations legislation in 2000 that included the Spanish-American War tax repeal, but then-President Bill Clinton vetoed it.

“Once in a while a bill of the President’s gets vetoed and the veto is soundly defeated,” Grover Norquist, president of Americans for Tax Reform, said in a statement. “The Spanish-American War tax is one such bill. It is finally defeated.

The Spanish-American War tax prices up to 140,000 low-income Americans out of Internet access. The Progress and Freedom Foundation is a market-oriented think tank that studies the digital revolution and its implications for public policy.

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“The Spanish-American War tax costs phone and Internet users about $6 billion per year.”

There is no arguing that the heavy load of taxes on phone bills discourages phone and Internet use for people at lower income levels. The Spanish-American War tax costs phone and Internet users about $6 billion per year.

In 2000, both the House and Senate voted overwhelmingly to get rid of the tax. In the House of Representatives, 420 of 435 members voted to end it. Ninety-seven of 100 Senators agreed it was time for the tax to go.

President Bill Clinton promptly vetoed the measure in retaliation against Republicans who opposed another bill he supported.

Five years after Congress overwhelmingly voted to end the Spanish-American War tax on telephones, support is growing for another vote to end the tax. Perhaps this will be the year this pesky and obsolete tax is finally defeated.

Tom Readmond (treadmond@atr.org) is a federal affairs manager with Americans for Tax Reform.
**Tax Incentives to Texas Competitor Frustrate North Carolina Firm**

 State gives $10 million to out-of-state firm that competes with long-time local business

by Johnny Kerr

The owners of Pate Dawson Company, a Goldsboro, North Carolina food distributor that has been doing business in the state for 120 years, are wondering how the state can justify giving the company’s main competitor, Houston, Texas-based Sysco Inc., $10 million in tax incentives to build a distribution center in Johnston County. A deal is in place to do just that.

“I’ve been hearing rumors for a long time that Sysco has been thinking of building a new distribution center either in the eastern part of the state or Virginia, but only last August did I learn they may be trying to get money from the state,” said Mac Sullivan, president and COO of Pate Dawson.

“Sysco is a very large company that has gotten that way, in part, by gobbling up smaller competitors,” said Sullivan. He said Sysco would just be moving jobs already at Sysco locations in North Carolina to Selma.

“Sysco already has a facility in Charlotte, which is where the jobs would be moved from, according to Sullivan.

“Our industry is growing 4 to 5 percent a year and all the current customers are being served by distributors already doing business in North Carolina,” Sullivan said. “For Sysco to come to this part of the state they’ve got to take jobs from somewhere. In fact, they are already trying to hire some of our employees away.”

Houston, Texas-based Sysco Inc. is getting a $10 million tax incentive from North Carolina to build a distribution center that will compete with locally owned Pate Dawson Company, which has served the region for 120 years.

**Grant Helps Biggest Player**

The same press release says Sysco is North America’s largest food-service marketer and distributor and does almost $30 billion in sales through 155 distribution centers like the one the company wants to build in Selma with the help of North Carolina taxpayers.

Gov. Mike Easley (D) said he wants North Carolina’s taxpayers to be business partners with Sysco via the state’s Job Development Investment Grant (JDIG) initiative, a partnership Sullivan thinks is not fair to companies like his and others that have been in the state and paying taxes for a long time.

“They chose North Carolina because of our excellent workforce, our strong and continuing support of education, and our business-friendly climate,” Easley said in the January 26 news release that included an announcement that Sysco is expanding because of a JDIG grant. Sysco officials say the Johnston County distribution center will be 395,000 square feet and is expected to create 600 jobs by 2010, the same job prediction Easley uses.

**Job Predictions Called Fictional**

But Sullivan considers the job predictions fictional at best.

“Even if Sysco does have that many employees in Selma, a lot of those jobs will be filled by people Sysco already has on the ground in North Carolina,” he said. “Sysco is a very large company that has gotten that way, in part, by gobbling up smaller competitors,” said Sullivan.

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“Our industry is growing 4 to 5 percent a year and all the current customers are being served by distributors already doing business in North Carolina,” Sullivan said. “For Sysco to come to this part of the state they’ve got to take jobs from somewhere. In fact, they are already trying to hire some of our employees away.”

“Truck drivers are already in short supply, especially short-haul drivers like the ones food distributors employ,” Sullivan said. “Where will the new drivers Sysco will need come from?”

**Economic Benefits Doubted**

In asking that question, Sullivan said he wants to challenge the economic benefits the JDIG programs supposedly provide to the state. If economic incentives create jobs where a shortage of qualified workers exists, as in the case of the state’s short-haul truck drivers, then what is the economic benefit?

Sullivan understands the dynamics of job creation. Pate Dawson Co. employs 290 people and recently added 82. The new jobs, he said, have come from newly acquired accounts that were taken from competitors. That implies the jobs themselves came from some other company and are not “new” jobs, he said.

Sullivan’s concerns mirror those recently expressed by some Charlotte business leaders. The Charlotte City Council approved a $218,866 incentive grant for Sysco to expand its Charlotte warehouse, according to the Associated Press. A Sysco official said that 80 of those new jobs would have come without the incentives, according to the article.

“I want to be clear that I harbor no ill will toward Sysco; they are a well-run company trying to make a profit. It’s state government I have a complaint with.”

MAC SULLIVAN, PRESIDENT AND COO
PATE DAWSON COMPANY

Sullivan says he is well aware of Sysco’s “fold out” strategy, in which the firm first develops business in a region and then folds out a new distribution center to serve it.

“The fold-out concept of building new facilities in an area with an established sales base that has been served by a distant Sysco company has been integral to the success of Sysco’s internal growth strategies and enabled us to provide more localized service to customers in those areas,” Sysco Chairman and CEO Richard Schnieders said in a January 26 news release announcing the new facility, which is expected to be operational early in 2006.

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Johnny Kerr (jkerr19@nc.rr.com) is a contributing editor of Carolina Journal.

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Ohio Groups Push for Limitation on State Taxes and Spending

Ohio Secretary of State J. Kenneth Blackwell

A determined group of Ohio citizens, led by Ohio’s Secretary of State, is moving forward with an effort to take a tax and expenditure limitation (TEL) measure directly to the voters. The push for such a measure in Ohio began in 2002, when the Columbus-based Buckeye Institute released an article suggesting Ohio policymakers should consider following the successful model of Colorado, which has a Taxpayers’ Bill of Rights that limits taxes and spending.

Three years later, many Ohio legislators remain opposed to the idea, but members of Citizens for Tax Reform (CFTR), an organization directed by Ohio Secretary of State J. Kenneth Blackwell (R), have unveiled plans for a tax and expenditure limitation ballot proposal.

Constitutional Limits Proposed

“We must put in place enforceable spending and tax restraints to restore fiscal discipline in our state,” said Blackwell in an August 17, 2004 article published by Gongwer News Service. “CFTR will lead a constitutional amendment effort to establish fiscal restraints on government.”

CFTR hopes to place the measure on the November ballot. In January of this year, the Buckeye Institute and The Independence Institute in Colorado jointly released a report titled “Should Ohio Limit Government Spending and Taxes?” The report argues a TEL is needed if Ohio is to get back on sound economic footing.

Tax Burden Soars

Ohio has struggled to maintain control of its spending. In its “Companion of State and Local Tax Burdens Across the Nation, 1970-2005” report, the nonpartisan Tax Foundation in Washington, DC reports Ohio has gone from nearly the lowest state and local tax burden per capita—47th in the nation in 1970—to seventh highest this year.

“This is a fundamental conflict of vision. I envision a growing economy that produces more tax dollars. They believe that you can tax and spend your way into a growing economy.”

J. KENNETH BLACKWELL
OHIO SECRETARY OF STATE

Without a binding budget constraint at the constitutional level that will force policymakers to make tough choices, the report states, “there is little hope that the recent trends will improve.”

The Ohio House of Representatives issued a document in January 2005 showing that if a TEL had been in place since 1997, $19 billion less would have been spent by state government and dramatic budget cuts would have been made. According to House Chief of Staff Scott Borgemenke, quoted in a January 19, 2005 editorial in the Akron Beacon Journal, little funding would remain beyond mandatory spending on Medicaid and corrections.

“We will become an insurer and an incarcerator,” Borgemenke said.

Rewritten for Flexibility

Faced with that prospect, Gov. Bob Taft (R) and some legislators considered offering alternative tax and expenditure proposals that would allow for more spending flexibility. Ultimately, CFTR agreed to loosen the language in its proposal. The latest version includes measures to address flexibility.

The revised petition retains annual spending limits tied to the growth of inflation and population, but adds a provision allowing for at least 3.5 percent spending growth. That provision is meant to avoid spiraling declines in spending during recessionary periods.

The updated version also replaces a requirement for a three-fifths legislative majority to seek voter approval for exceeding annual spending limits with a less-stringent simple majority. The proposal also now contains language that forces any efforts aimed at repealing the TEL to state clearly to voters that they would be voting on whether to remove a constitutional limit on taxation.

According to CFTR spokesman Gene Pierce, the concessions prove Blackwell is “mollifying a little bit. It shows he can negotiate.”

The revised proposal was recently refiled with Ohio Attorney General Jim Petro (R). Pending Petro’s approval of the wording, CFTR expects to begin collecting petition signatures to include the ballot proposal in the November elections.

House, Senate Have Proposal

Identical proposals also are moving forward in the state House and Senate. Hearings are expected to begin soon on House Joint Resolution 4, sponsored by Rep. Linda Reidelbach (R-Columbus).

Given the progress of those proposals, Ohio may very well become ground zero in the effort to bring fiscal discipline to state budgeting this November. Recognizing that, detractors are stepping up their attempts to discredit the concept.

The Coalition for Ohio’s Future, for instance, invited former Colorado Rep. Brad Young, a Republican who has been outspoken in opposing Colorado’s Taxpayers’ Bill of Rights, to speak against the Ohio proposal.

“[T]he nonpartisan Tax Foundation in Washington, DC reports Ohio has gone from nearly the lowest state and local tax burden per capita—47th in the nation in 1970—to seventh highest this year.”

“It was sold as something that magically creates accountability, eliminates waste, and forces the legislature to set the right priorities,” Young said at an April 29 news conference sponsored by the coalition. “Well, it simply doesn’t do those things.”

In response, the Buckeye Institute scheduled a May 17 legislative orientation briefing in Columbus, Ohio to feature former Colorado Senate President John Andrews, who supports the Taxpayers’ Bill of Rights, offering a contrasting perspective.

“This is a fundamental conflict of vision,” Blackwell told The Plain Dealer. “I envision a growing economy that produces more tax dollars. They believe that you can tax and spend your way into a growing economy.”

Matt Hirsch (hirsch@buckeyeinstitute.org) is a policy analyst at The Buckeye Institute.

INTERNET INFO

Social Security and Medicare Are Unsustainable

by John C. Goodman

In 2011, the first group of baby boomers in the United States will reach the age of 65. When the last of that generation retires in 2032, 77 million of them will have ceased working and paying taxes and will have at least begun receiving taxpayer-funded health care and pension benefits.

A similar trend is occurring throughout the developed world. In Japan, Europe, and North America, the number of retirees will double over the next 25 years while the number of taxpayers will grow by 10 percent. The economic consequences of these changes are dire: higher taxes, slower growth, and lower living standards.

“Without changes in worker payroll tax rates or senior citizen benefits, the shortfall in Social Security and Medicare revenues compared to promised benefits will top more than $2 trillion in 2030, $4 trillion in 2040, and $7 trillion in 2050.”

Cash Flow Deficits Begin

In a pay-as-you-go system such as Social Security, what matters most is cash flow. And the cash flow drain that elderly entitlement programs portend is not a problem of the distant future, as some argue. The problem has already begun.

For several decades, Social Security and Medicare have been paying more in payroll taxes than they have been paying out in benefits. The declining U.S. population growth rate, however, is beginning to take its toll. Last year, the two programs combined spent more than they took in, requiring a general revenue subsidy of about $45 billion. The magnitude of the deficits in these two programs will soar in the years to come.

For those who believe Social Security and Medicare are in sound financial shape for decades to come, Figure 1 presents a sobering picture. In 2010, the federal government will need $127 billion in additional funds to pay promised benefits. Five years later, the size of the annual deficit will double. Five years after that, it will double again. In just 15 years, the federal government will have to raise taxes, reduce other spending, or borrow $761 billion to keep its promises to America’s senior citizens.

As the years pass, the size of the deficits will continue to grow. Without changes in worker payroll tax rates or senior citizen benefits, the shortfall in Social Security and Medicare revenues compared to promised benefits will top more than $2 trillion in 2030, $4 trillion in 2040, and $7 trillion in 2050.

Huge Deficits Projected

These deficit numbers include projected inflation. Yet even in 2004 dollars, the numbers are staggering. Valued in today’s dollars, the annual Social Security deficit will top $50 billion in 2020, $250 billion in 2030, and $400 billion in 2050. Adding Medicare’s deficits, the federal government will need more than $500 billion in 2020, $1 trillion in 2030, and $2 trillion in 2050 to fund elderly entitlement programs alone.

Note that these estimates, which come from the latest Social Security Trustees report, do not include the growing burden of senior health care costs under Medicaid.

The combined budget shortfalls for Social Security and Medicare are so large it is difficult to comprehend what the numbers mean. Figure 2 presents the projected deficits as a percentage of federal income tax revenues. It shows that combined Social Security and Medicare deficits will equal more than 28 percent of federal income taxes by 2020.

Roughly, this means that in just 15 years, if the federal government is to keep its promises to seniors, it will have to stop doing more than one-fourth of everything it does today. Alternatively, it will have to raise income taxes by one-fourth or borrow an equivalent sum of money.

By 2030, about the midpoint of the baby boomer retirement years, federal guarantees to Social Security and Medicare will eat up one in every two income tax dollars. By 2050, they will take three in every four.

IOUs Can’t Pay Benefits

What about the Trust Funds? The Social Security and Medicare Trust Funds serve an accounting function, not an economic one. They work like this: When payroll tax revenues exceed expenses, the U.S. Treasury issues special bonds to keep track of the surplus.

Unlike other Treasury securities, however, these bonds are not sold in the marketplace. They are created on paper and placed in filing cabinets in Parkersburg, West Virginia, while the actual surplus payroll tax dollars are spent on other things. When tax revenues fall short of expenses, the process is reversed: the bonds are taken out of the filing cabinets and retired.

The Social Security Trust Fund currently holds about $1.6 trillion of these non-negotiable bonds. But these bonds cannot pay benefits. Although they are treated as assets of the trust fund, they are also liabilities of the Treasury. Summing over both these agencies of government, assets plus liabilities net out to zero.

If the federal government had purchased assets with the Social Security surpluses, the Trust Funds would today represent real economic value. Instead, the funds were spent in other ways, and the government essentially wrote IOUs to itself.

If a fire were to destroy the filing cabinets in Parkersburg, this would in no way diminish the capacity of the federal government to pay benefits. Alternatively, if a stroke of the president’s pen were to double or triple the number of bonds in those filing cabinets, that would in no way increase our ability to pay benefits. If we could create value by writing IOUs to ourselves, Social Security would have no financial problems. Unfortunately, there is no free lunch.

“In a pay-as-you-go system such as Social Security, what matters most is cash flow. And the cash flow drain that elderly entitlement programs portend is not a problem of the distant future, as some argue. The problem has already begun.”

Social Security, Medicare Linked

Both Social Security and Medicare are pay-as-you-go programs, and costs of both will be drastically increased by the aging of the population. Currently, Social Security surpluses are covering deficits in Medicare. After 2018, however, both programs will be running deficits. Any change that helps one program will automatically help the other.

The federal deficit this year is projected to be the largest in U.S. history, and President George W. Bush has pledged to cut it by half. Even if he is successful, the United States will face large (and rising) deficits in coming years due to our elderly entitlement programs.

John C. Goodman (jcg@ncpa.org) is president of the National Center for Policy Analysis. Reprinted by permission from NCPA Brief Analysis No. 502.
Social Security
Continued from page 1

conference April 28.

Under the proposed formula, low-
income retirees would continue to have
their benefits tied to the rate of growth
in wages over their working career, as
is now done for all retirees. Wealthy Americans would have their benefits
determined by the growth in prices,
which is generally lower than the
growth in wages. Middle-income work-
ers would have their benefits deter-
mined by a blend of the two approaches,
resulting in lower rates than what they
would receive under the current system,
but not as big a cut as wealthy retirees
would receive.

The news conference was only the
fourth of Bush’s presidency, and it was
announced just one day earlier. The
major television networks all carried the
event, but only after some last-minute
negotiation with the White House, which
agreed to start it 30 minutes earlier than
planned to accommodate the networks’
programming schedules.

Poorer Workers Receive More

“I propose a Social Security system in
the future where benefits for low-income
workers will grow faster than benefits
for people who are better off,” Bush said.
The president reiterated his support for
allowing younger workers to put some
of their Social Security taxes into pri-

tive retirement accounts.

Sean Tuffnell, project manager for
Social Security outreach at the Nation-
al Center for Policy Analysis, said his
organization “was encouraged” by the
president’s comments.

“The idea of progressive indexing of
benefits is a reasonable alternative,”
Tuffnell said. “We would prefer to see a
system where that is not necessary, but
understanding the political alterna-
tives, it is probably needed to get reform

passed.

“The key here is that it’s a two-part
proposal,” Tuffnell continued. “One, it’s
a reduction in the growth of govern-
ment-provided benefits. Two, it’s per-
sonal accounts to help people who are
affected by the first part.”

Democrat lawmakers in Congress,
who have nearly universally rejected the
president’s reform proposals, main-
tained their opposition.

Middle-Income “Cuts” Derided

“All the president did tonight was
confirm that he will pay for his risky pri-
vatization scheme by cutting the bene-

fits of middle-class seniors,” said Sen-
ate Minority Leader Harry Reid (D-NV)
and House Minority Leader Nancy
Pelosi (D-CA) in a joint statement.

“President Bush cannot escape the fact
that privatization will weaken Social
Security at a time when we should be
strengthening it.”

Tuffnell said the Reid-Pelosi state-
ment mischaracterizes Bush’s proposal.

“The indexing change has nothing to do
with private accounts,” he said. “It has to
do with an $11 trillion unfunded liability
that we face.”

Federal Spending Controls Disappearing

Proposed cuts in farm subsidies,
Medicaid dropped

by Steve Stanek

In introducing his proposed bud-
get for the 2006 fiscal year, Pres-
ident George W. Bush spoke of his
commitment to spending controls,
even though the budget calls for an
overall spending increase of 3.6
percent.

Since Bush released his budget
proposal on February 7, some of the
key spending controls he cited have
disappeared. By a 214 to 211 vote,
the House on April 28 approved a
$2.6 trillion budget that includes a
$10 billion cut in Medicaid spend-
ing over the next five years—the
House’s original proposal was for
$20 billion in cuts—and a prior vote
by the Senate has no Medicaid
spending cuts, setting the stage for
a possible budget stalemate.

Farm Spending Cuts Gone

On April 12, Agriculture Secretary
Mike Johanns told members of the
Senate Appropriations Committee
panel on farm spending the admin-
istration would drop its plan to cut
farm subsidies by $8 billion over
10 years.

Johanns’ announcement came
less than one month after some
Senate Republicans joined Demo-
rats to delete $14 billion in pro-
posed Medicaid reductions over the
next five years.

“We acknowledge that many of
these policy proposals, such as the
reduction in the payment limit, are
quite sensitive,” Johanns told com-
mittee members. “We recognize
Congress may have other propos-
als to achieve these savings, and
we are willing to work with the
Congress on other cost-saving mea-

sures.”

The cuts in farm subsidies would
have been accomplished by limit-
ating payments to farmers to
$250,000 a year, down from
$360,000. Loopholes some farmers
use to collect amounts far above
the limits also would have been
closed.

The subsidies go to farmers who
produce certain agricultural crops
or products, including corn, cotton,
soybeans, and milk.

Farm groups immediately
announced their opposition to the
planned cuts, and farm-state law-
makers from both major political
parties lobbied hard against the
proposals.

Some Republican committee
chairmen have suggested reducing
spending in other parts of the Agri-
culture Department, including
land conservation and nutrition
programs.

Senate Rejects Medicaid Controls

On March 17 Senate Republicans
and Democrats joined forces to
remove proposed cuts in Medicaid
spending from the Republican-con-
trolled Senate Budget Committee
recommendations. Seven Senate
Republicans joined Democrats and
the Senate’s lone independent in
voting 52-48 to defeat the cuts.

Medicaid provides health care
services to low-income persons and
is jointly funded by states and the
federal government. Many states
are grappling with soaringMedic-
aid costs and opposed any cuts in
federal funding.

“I applaud this vote and am
pleased that the Senate listened to
the bipartisan voices of many gov-

erors who warned against trying
to reduce the federal deficit by cut-

ting health care for our most vul-

nerable citizens,” said Louisiana
Gov. Kathleen Babineaux Blanco
(D) in an official statement.

Not everyone was pleased with
the Senate’s action.

In a March 18 Washington Times
article by reporter Stephen Dinan,
Senate Budget Committee Chair-
man Judd Gregg (R-NH) said the
Senate’s vote to restore the Medic-
aid spending will “gut the only
thing in this budget which actual-

ly will generate fiscal discipline.
And it’s being done by Republicans.
You know, you just have to ask
yourself how they get up in the
morning and look in the mirror.”

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

Broad Benefit Increases Claimed

On the May 1 edition of Fox News Sun-
day, White House Chief of Staff Andrew
Card said middle-income and high-

income earners “would get an increase
in benefits as compared to what they
would get if nothing were to happen.

This is because the system by 2041 is
expected to be able to pay only three-
fourths the promised benefits if no
changes are made.

“I propose a Social Security
system in the future where
benefits for low-income
workers will grow faster
than benefits for people
who are better off.”

PRESIDENT GEORGE W. BUSH

The news conference came shortly after
Bush wrapped up a 60-day tour of the coun-
try to drum up support for Social Security
reform, including allowing younger work-

ers to divert some of their Social Security
taxes into private accounts.

Both Sides Losing Support

The increase in support the president
hoped for apparently did not material-
ize. Many polls indicate citizens are
skeptical, with the president’s approval
ratings sliding to the mid-40 percent
range. The strongest support for his
plan comes from young workers, the
strongest opposition from older work-

ers and retirees.

Social Security appears not to be a
winning issue for either side. Democrats
in Congress, who have been virtually
unanimous in opposing the president’s
plans and in refusing to negotiate,
recommendations. Seven Senate

after learning from focus groups that
they were being viewed as obstruction-
ists, according to an April 17 Associated
Press article by Glen Johnson.

“People feel like it doesn’t show a good-
faith effort,” a Democrat aide told John-
son on condition of anonymity.

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is managing editor of Budget & Tax
News.
Washington
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money from there back to the health ser-
services account.

When money is transferred into the gen-

eral fund and appropriated, the spending
limit is raised. In this case, money was sim-
ply moved among accounts, raising the
spending limit even though no more money
was available.

Legislators also deferred paying $325 million
in pension obligations for state en-
employees.

TABOR Ignored

Besides artificially increasing the spend-
ing limit approved by voters in I-601, a
statutory Taxpayers’ Bill of Rights enacted in
1993, Democrats also approved a bill that
redefined the remaining taxpayer pro-
tections. Approved on a strictly party-line
vote, SB 6078 removed the two-thirds vote
requirement for the legislature to raise
taxes during the 2005-07 biennium.

The budget also redefined the spending
limit growth factor to allow state spending
to grow at a faster pace than previously
authorized. This allowed Democrats to
implement nearly half-a-billion dollars in
tax increases with a simple majority vote
and without any Republican support.

Budget Maneuvers Create Furor

“Welcome to Democrat control of the legis-
lature, folks. Here we go again,” said Sen.
Don Benton (R-Vancouver). “If you are a
business considering moving to Washing-

ton, stay away. If you want to buy ciga-
rettes or extended warranties, cross the
state border.”

Gov. Christine Gregoire (D) countered
the Republicans’ description of the budget,
saying, “If you’re not a millionaire, not a
smoker, and you don’t drink hard alcohol,
there’s no impact on the citizens of the state
of Washington at all.”

Rep. Eileen Cody (D) told a House-
appropriations hearing on March 24 that the
spending limit adjustments were “neces-
sary in order to live within the very narrow
constraints of our state expenditure limit.”
Cody said the spending limit maneuvers
were legal and should be utilized “until the
state has a more meaningful expenditure
limit that might be able to accommodate
the growth of vital state programs.”

School Funding Drove Increases

Supporters of the increase in the voter-
approved spending limit said the move
was necessary to meet the funding require-
ments of another voter-approved initia-
tive to reduce class sizes in the public
schools. Known as I-728, the class size
reduction measure was approved by vot-
ers in 2000 based on the promises made by
former Gov. Gary Locke (D) that the ini-
tiative would not raise taxes.

The state’s billion-dollar surplus disap-
peared in 2001. With I-728 causing a drain of more than $800 million from the state’s budget, Democrats voted to dedicate portions of
an increased cigarette tax and new estate
tax to cover part of the cost.

According to Bob Williams, president of
the Evergreen Freedom Foundation, over-
riding the voter-approved spending limit
to fund I-728 was unnecessary.

“Democrats were not prevented from rais-
ing taxes and spending at any level they
want, but under the law, voters were
to be given the opportunity to approve
expenditures in excess of the spending
limit,” Williams said. “By playing budget
games, the Democrats simply denied the
people their right to reaffirm that the bud-
get actually reflects their priorities.

“Rather than resort to budget gimmicks
to thwart the will of the people, the Democ-
rats should have referred the full costs of
the ‘free’ education initiative to a vote
of the people with a corresponding revenue
source,” he said.

Tax Increase Initiative Failed

“Last year’s failure of Initiative 884, which
would have increased the state’s sales tax
by a billion dollars a year to fund the pro-
visions of I-728 along with other educa-
tion-related initiatives, helps explain why
Democrats did not want a vote of the peo-
ple,” said Jamie Daniels of Freedom
Works.

“A tax here, a tax there, everywhere a
tax tax,” Rep. Barbara Bailey (R-Oak Har-
bor), told the Everett Herald. “We’ve taken
everything we can take. The taxpayers
have no more to give.”

Criticism of the Democrats’ $26 billion
tax-and-spend budget was fierce and swift
in coming.

“It is outrageous the legislature raised
taxes by nearly $500 million in adopting its
unsustainable budget. We do not have a
revenue problem, we have a spending
problem,” said Daniels. “There is no need
for higher taxes; there is a need to curtail
spending, prioritize, and invest in target-
ed programs that work. The voters over-
whelmingly rejected new taxes with the
defeat of I-884 on the November ballot
and nothing has been done since then to
restore their confidence in state spend-
ing accountability.”

Dunn Mead Smith, president of the
Washington Policy Center, agreed. “Sim-
ply taking more tax money from citizens
won’t help, but thorough budget reform,
like spending limits, competitive bidding
for government services, and legal safe-
guards against tax increases, would final-
ly ease the chronic sense of crisis in state
finances.”

Washington’s business community also
voiced disapproval of the Democrats’ bud-
get.

“Democrats in Washington State are
completely out of touch with the rest of
America. While the U.S. Congress is
eliminating the estate tax, Washington is
embracing it,” said Erin Shannon of
the Building Industry Association of
Washington. “This will have a devastat-
ing effect on family farms and small busi-
nesses. Knowing they’ll have to pay this
tax gives other family-owned businesses
one more reason to stay out of Washing-
ton State.”

— Jason Mercier (jmercier@effwa.org) is a
budget research analyst for the Evergreen
Freedom Foundation.

The Entrepreneurial City:
A How-To Handbook
for Urban Innovators

Introduction by Mayor Stephen
Goldsmith
Chairman, Center for Civic
Innovation

The Entrepreneurial City includes over
20 case studies of successful programs
from other cities, names and phone
numbers of hundreds of firms help-
ing cities nationwide, and lists of
suggested reading on each topic. The
Entrepreneurial City is a comprehen-
sive guide to successful urban policy,
including urban policy.

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Urban Innovators
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State Nominated for Innovation Award

Just days before the Washington state legislature adopted the 2005-07 budget,
Gov. Christine Gregoire (D) issued a news release highlighting Washington’s nomi-
nation for Harvard University’s “Innovation in Government Award.” The state was
nominated because of its use of the priorities of government (POG) budget model
in crafting a no-new-taxes budget in 2003.

Gregoire’s release read in part, “Washington’s pioneering budgeting method,
which follows a process to prioritize state services within available resources,
is among 18 government initiatives from across the nation to emerge as finalists out
of an initial field of more than 1,000 applicants.”

Gregoire went on to say she “used the POG process to prepare the budget [she]
proposed”—a budget that exceeded available revenue.

— Jason Mercier

Budget to Affect Campaigns

Washington state’s record $26 billion budget and tax increases are already being
used to posture for the next election. Republicans hope the Democrats’ budget
will be seen as an attack on taxpayers, while Democrats plan to make the case their
governing reflected the priorities of the people.

“The taxpayers of the state of Washington have been the losers in this session,”
we’ll be back here some time later to deal with it.”

“It is a great sense of relief and pride because we lived up to the promises we
made when we got here,” state Sen. Margarita Prentice (D-Seattle) told the
Everett Herald. “We didn’t go on a spending spree.”

The question to be answered at the next election is which of these budget posi-
tions reflects the sentiment of a majority of voters—voters who as a result of the
2005 legislative session will be entering the polls with less in their wallets than a
year ago.

— Jason Mercier
Reliance on “Sin” Taxes Draws Opposition

Taxes on tobacco, alcohol are just stealth tax hikes, critics say

by Sandra Fabry

As lawmakers look for ways to continue growing state budgets, they are increasingly turning to excise taxes, often known as “sin” taxes. In the past, general tax hikes were often the answer. But voters across the nation have been rejecting broad tax increases by wide margins, either directly through voter referenda or by ousting tax-hiking legislators and replacing them with pro-taxpayer candidates in primary elections.

Even though taxpayers have been rejecting higher taxes, general fund spending in all 50 states increased from $274.7 billion in 1990 to $518 billion in 2003, an increase of 88.7 percent, according to Chris Edwards, Stephen Moore, and Phil Kerpen in their 2003 study, “States Face Fiscal Crunch after 1990s Spending Surge.”

“Morally Ambiguous” Products Targeted

Rather than reining in spending, many lawmakers have succeeded in finding other ways to fund additional spending increases.

A common expedient has been to levy excise taxes on “morally ambiguous” products such as alcoholic beverages and cigarettes and other tobacco products.

The list of states eyeing tax increases on cigarettes and other tobacco products, beer, wine, distilled spirits, or combinations thereof has grown long.

Numerous Cigarette Tax Hikes Proposed

Virginia enacted a two-step cigarette tax increase of 30 cents per pack last year. This year, legislators in more than 30 states have introduced more than 95 bills that include cigarette tax increases.

Illinois raised its cigarette tax 40 cents a pack in 2002, and earlier this year Gov. Rod Blagojevich (D) proposed another 75 cents per pack tax hike. If Blagojevich’s proposed tax hike goes through, the Illinois cigarette tax would be $1.73 a pack. In Chicago, where there are additional city and county cigarette taxes, the total tax would be $3.21 a pack.

Iowa, Wisconsin, and several other states are also still considering cigarette tax increases. In North Carolina and some other states, both tobacco and alcohol taxes are on the table. More than 40 different proposals for tax increases on beverage alcohol have been introduced or are pending introduction in the states.

After the Indiana House of Representatives passed a no-new-taxes budget, the Senate decided not to pass proposals to raise alcohol taxes, but included a 19-cent cigarette tax increase. The House and Senate bills now go to conference committees to iron out differences.

“There will never be enough revenue to satisfy the spending demands of special interests. Targeting one class of citizens to pay for the programs of another is not only shortsighted budget policy, it’s morally wrong.”

JASON MERCIER, BUDGET ANALYST
EVERGREEN FREEDOM FOUNDATION

Derided as Tax Increases

In Mississippi, the House of Representatives on February 1 passed one of eight proposed cigarette tax hikes—a 50 cents per pack increase, from 18 to 68 cents—and a number of other tax increases, despite a veto promise by Gov. Haley Barbour (R). Barbour rejects tax increases as a matter of principle and sees the state’s budget problems as being on the spending side.

“Raising taxes is the enemy of controlling spending,” Barbour said. “Over the last 10 years, Mississippi revenue has increased 34 percent, but spending has increased 50 percent.”

The cigarette tax increase went nowhere in the state Senate, because Sen. Alan Nunnelee (R-Tupelo), chairman of the Senate Public Health Committee, decided not to bring it for a vote.

“Taxes-and-spenders’ have seized the cigarette tax, because the damage caused by cigarettes is so great,” Nunnelee said. “I’m not opposed to seeing the tax on cigarettes increase as long as it is offset by a tax cut elsewhere. So far, the proponents will not even consider a revenue-neutral cigarette tax bill, which I feel reveals their true motives. They want government to take in more money so they can spend it to buy constituencies.”

Targeted Tax Hikes

Paul Gessing, director of government affairs at the National Taxpayers Union, explained another reason for the current popularity of excise tax increases. “Such narrowly targeted taxes have become increasingly popular in recent years because legislators can raise significant revenue without raising taxes on a majority of their constituents, most of whom do not smoke or rarely drink,” Gessing said.

“There is no question that states plan to continue raising taxes on alcohol and tobacco products,” he noted, “but as tax levels reach a tipping point and revenue growth is reduced, states will look for new ways to levy excise taxes on smaller groups.”

Gessing points to real estate transfer taxes as an area that has received attention recently. Property values have risen dramatically in recent years, and policymakers sense an opportunity to grab more tax money. Another example of targeted excise tax increases is the recent attempt to apply existing hotel taxes to the fees charged by online travel services.

Questionable Motives

Acton Institute President Rev. Robert A. Sirico questions the motives behind such “sin taxes.”

“Interestingly, the state has a vested interest in applying this supposedly sinful behavior,” Sirico wrote in an April 28 commentary on the organization’s Web site. “Under a sin tax, the state finds itself in the peculiar and contradictory position to discourage certain behaviors while relying on their continuance as a source of revenue.”

Grover Norquist, president of Americans for Tax Reform, also questioned the motivation behind “sin tax” increases.

“It really is absurd,” Norquist said. “With the help of health activists fighting addictions, big government tax-and-spenders can expand their ever-increasing anti-consumer, anti-sustainability’s Web site. “Under a sin tax, people pay to support the very organizations that want to discourage the very behaviors people pay to support.”

“Interestingly, the state has a vested interest in people continuing this supposedly sinful behavior. Under a sin tax, the state finds itself in the peculiar and contradictory position to discourage certain behaviors while relying on their continuance as a source of revenue.”

REV. ROBERT A. SIRICO, PRESIDENT
ACTON INSTITUTE

Jason Mercier, budget analyst at the Evergreen Freedom Foundation in Washington, advised, “Legislators need to get out of the social engineering business and instead enact a uniform tax policy that treats all citizens equally. Cherry picking ‘sin’ taxes and other revenue raising schemes deemed to be politically safe ignores the most important equation in budget sustainability: spending restraint and prioritization.”

“There will never be enough revenue to satisfy the spending demands of special interests,” Mercier said. “Targeting one class of citizens to pay for the programs of another is not only shortsighted budget policy, it’s morally wrong.”

Sandra Fabry (sfabry@atr.org) is state government affairs manager for Americans for Tax Reform.
Delaware County Keeps $208 Million Surplus, Despite Ruling

by Peter J. Sepp and Steve Stanek

Despite having a $208 million surplus and a court ruling that the funds were accumulated illegally, members of the New Castle County (Delaware) Council voted unanimously March 22 to keep the money by creating separate reserve accounts for property tax and sewer funds.

“By voting to hoard millions of hard-earned tax dollars that were accumulated illegitimately in the first place, New Castle County leaders have created a government slush fund, not genuine savings accounts,” said Paul Gessing, director of government affairs for the National Taxpayers Union.

“County officials claim that this money is necessary to ‘bridge the budget gap,’ but what it really adds up to is a scheme to overtax county residents in order to pay for future government spending excesses,” Gessing said.

No legal action has been taken by interested parties since the vote.

Accounts, Budget Declared Illegal
The council’s action followed a February 10 Chancery Court ruling on a lawsuit brought against New Castle County by attorney Ronald Poliquin on behalf of taxpayers Richard Korn and Andrew Hal Nagore, who charged illegal stockpiling of tax dollars. In his ruling, Chancellor William Chandler declared the $208 million in off-budget accounts were illegal, as was the county’s 2005 fiscal year operating budget.

“The county code said there could be only a 20 percent surplus. Reserves in the sewer fund were more than 200 percent. It was a remarkable illegality.”

RONALD POLIQUIN ATTORNEY FOR PLAINTIFFS

Accounts Were Kept Secret
Poliquin said few people knew about the off-budget accounts or how much money was in them.

“We asked, ‘Where is this money? What’s it for?’ It’s just cash collecting interest,” Poliquin said. “We had to get the chancellor to force them to answer some pretty basic questions. The county code said there could be only a 20 percent surplus. Reserves in the sewer fund were more than 200 percent. It was a remarkable illegality.”

“The Government Financial Officer’s Association recommends 5 to 10 percent reserves. Here we had reserves in excess of 100 percent of the total operating budget. Government isn’t there to accumulate cash. It’s so sad it’s almost funny,” Poliquin said.

County officials could not be reached for comment.

Colorado

Continued from page 1

The bill passed the state House on April 19 with all 35 Democrat state representatives voting in favor. Six Republicans joined them, while 22 Republican representatives voted against the bill. In the state Senate, all 18 Democrats voted in favor, joined by eight Republicans, with nine GOP senators opposed.

On March 17, the Democrats had picked up an endorsement from Republican Gov. Bill Owens, who by law may not veto or sign the bill because it is a legislative referral to the ballot.

Cost For Exceeds Shortfall
The bill’s $3.1 billion cost is nearly four times higher than the estimated $800 million shortfall in the general fund over five years predicted by state budget experts.

Colorado voters passed the Taxpayers’ Bill of Rights in a citizens’ ballot initiative in 1992. TABOR limits the growth of government spending for all levels of government to the state’s rate of population growth plus inflation. Because of TABOR’s success in warding off large budget deficits, it was labeled the “Gold Standard” of tax and expenditure limitation laws by the the $208 million from “off-budget” accounts into the new “reserve” accounts, county officials hope they will satisfy Chandler’s objections and be allowed to keep the money.

Chandler’s ruling, however, gave no indication the county could legally keep the money through the reserve account mechanism or any other means.

Chandler’s ruling handed Poliquin, a 27-year-old attorney in his first year of practice, what is believed to be the largest taxpayer lawsuit victory in the history of the State of Delaware.

Amendment 23 Major Culprit
Most notably, HB 1194 makes no adjustment to Amendment 23, which has squeezed Colorado’s general fund budget. Amendment 23, passed by voters in 2000, is an unfunded mandate requiring the general fund expenditure for K-12 education to increase by more than the rate of inflation each year for a decade. After that, K-12 education spending must rise annually by at least the rate of inflation.

The spending increases required by Amendment 23 must occur regardless of the condition of the state’s economy or budget. During the recent economic downturn, the unfunded mandate was a major factor in squeezing other line items in the general fund, including corrections, health care, and higher education.

Owens Reneged on Tax Pledge
Owens signed “no tax” pledges with Americans for Tax Reform and the Colorado Union of Taxpayers, and both organizations say his endorsement of HB 1194 means he has broken his pledge.

While legislators have focused on the general fund, taxpayer advocates have noted the ballooning size of Colorado’s overall budget. The general fund represents less than half of the state’s total budget. Even during the past several years of recession, Colorado’s total budget continued to climb.

The state’s most recent budget, more than $15 billion, is at an all-time high. It has increases in every line item, including health care, roads, and corrections, and a 25 percent increase for higher education.

“Missing from HB 1194 are any measures to promote efficiencies in state government ...”

State Saved from Big Cuts
TABOR defenders note that in the late 1990s, while the national economy was surging, most states enjoyed a bonanza of revenue and used it for massive outlays of spending. That did not happen in Colorado, where TABOR required those excess tax revenues to be refunded to taxpayers. About $3.2 billion was returned over a five-year period, the equivalent of $800 for every man, woman, and child in the state.

After the recession struck in 2001, Colorado took a relatively small hit to its budget because TABOR had helped keep state spending in check during the boom years. Many other states, including California, found themselves with huge shortfalls, forcing them to make much larger budget cuts than Colorado had to make.

Jon Caldara (jon@i2i.org) is president of the Independence Institute, based in Golden, Colorado.
Gas

Continued from page 1

In a January 2005 white paper, “Rough Roads Ahead,” the group called for an end to the use of state highway user fees for non-highway programs, the enactment of a federal highway bill with “significant funding increases,” and the beginning of a statewide “dialogue” to examine the need for “additional resources.”

The coalition has used the report as the basis for subsequent lobbying efforts aimed at securing increased highway funding.

Road, Bridge Repairs Delayed
The road crisis means the state won’t be able to start new construction to relieve congestion or serve growing communities, TFIC said. It will also prevent the state from keeping the existing system in shape by delaying repairs beyond what should be standard, thus plunging neglected highways into a downward spiral of further deterioration.

For example, at the projected rate of spending in the state’s 2005-2011 highway outlook, Illinois roads will have to be repaired on a 50-year cycle, even though their life expectancy is only 20 years. Bridges, which are expected to last 50 years, will have to be repaired on a 92-year cycle, the coalition said.

The stern warning was issued by TCIF Co-Chairs Doug Whitley, president of the Illinois Chamber of Commerce, and Margaret Blackshere, president of the AFL-CIO of Illinois. The 56 signatory members of TCIF are weighted heavily in favor of contractors and related highway interests but also include chambers of commerce and the Metropolitan Planning Council of Chicago.

Hundreds of Millions Diverted
TFIC blamed much of the highway funding crisis on the long-time practice of diverting highway user fees, such as the motor fuel tax and license plate fees, to a variety of non-highway purposes. From FY2002 to FY2004, the diversions more than doubled—to $783 million, from $368 million. Although the projected FY 2005 budget shows a decline in diversions, they remain far higher than usual, at $606 million.

The FY2004 diversion of $783 million amounted to nearly 30 percent of state user-fee revenues. In effect, that accounts for 15 cents of the 19-cent state gasoline tax, the report noted. Even with the decline in diversions in the FY2005 budget, they would represent 10 of every 19 cents.

None of the 6.25 percent state sales tax that motorists also pay at the pump goes to the highway fund, thus depriving the road system of any revenue increases that flow from record-high gasoline prices.

Normally, the diversions go to departments that can arguably claim they should be compensated for highway-related costs, such as the State Police for patrolling highways, Central Management Services for administering the road fund, and the Secretary of State for license replacement. But just how much of the diversions ultimately are used for highway-related purposes has been a long-running debate in Illinois. For its part, TFIC did not contest the legitimacy of any particular diversion, focusing instead on the impact of the total amount diverted.

More recently, the practice of diverting highway funds has become such an accepted practice that $50 million was placed in the state’s General Revenue Fund without any pretense that the money was meant for highway-related projects. No such “one-time” grab is planned for the FY2005 budget.

Bad Roads Backlog to Triple
Illinois, with the third-largest interstate highway network in the nation, expects—as does every state—significant help (some $900 million annually) from Washington, but a new multiyear transportation bill has been held up by political and budgetary considerations.

The backlog of bad roads in the state at the end of FY2011 is expected to reach 4,450 miles, triple the current backlog of 1,470 miles. The TFIC report concludes that the state has sufficient road capacity to meet long-term needs up to 2014, or 20 years, and that the backlog in 1996 was $1.5 billion, expected to rise to $2.5 billion in 2008, $3.7 billion in 2009, and $4.5 billion in 2010.

A study by the Illinois Transportation Federation (ITF) said the diversions, when coupled with the current rate of road deterioration, will cause more than a quarter of the state’s highways to fall into “bad repair” within seven years.

Waste, Delays, and Danger

The “Rough Roads Ahead” report issued by the Transportation for Illinois Coalition said the effects of bad roads ripple through the economy. For example, bad roads:

• increase congestion, which in 2002 cost the Chicago area $4.2 billion, or $520 a person, while wasting 365 million gallons of gasoline;

• cause almost one-third of all crashes. Every dollar in highway improvements saves $2 in health care costs, insurance, lost wages, and productivity;

• endanger the state’s competitive edge. Illinois ranked fourth among states in the tonnage of materials moved by truck, up 17 percent in just five years. On Illinois’ interstates, truck travel has almost tripled in the past 20 years. The state’s transportation and transportation-related industries employ more than 373,000 people. That doesn’t include highway construction, which creates or sustains 47,500 direct or indirect jobs for every $1 billion of highway construction.

The coalition argues bad roads raise the cost of doing business in the state, discourage economic development, and contribute to job losses.

Illinois Comptroller Warns Against Diversions

Diversions of state highway funds toward other purposes have become such a problem that Illinois Comptroller Dan Hynes warned against them in his 2004 quarterly report. He noted that because fuel taxes and license fees are flat (not indexed to rising prices), the problem is compounded in the face of inflation. “If one monies are diverted,” Hynes said, “it is almost impossible for the highway program to recoup.”

Missouri voters last year approved by referendum an anti-diversion amendment, but no such calls have been raised in Illinois.

Significantly, more highways suffer from diversions. Almost 25 percent of highway user fees collected by the state go to local governments—many of them cash-strapped—for local roads.

The Transportation for Illinois Coalition attributed the diversions to promises by Gov. Rod Blagojevich (D) to hold the line on taxes, a deficit budget, and hot competition for state-funded services. However, Richard Adorjan, a spokesman for the coalition, argued that by diverting highway funds for other purposes, the state has managed to add another crisis—failing roads—to its present inventory of crises.

— Dennis Byrne

Dennis Byrne (dbyrne1942@earthlink.net) is a Chicago writer and consultant who formerly covered highway and transportation issues for the Chicago Sun-Times and Chicago Daily News.
Welcome New BTN Readers!

by Steve Stanek

If this is your first issue of Budget & Tax News, you are probably one of the 85,000 executives, village presidents, city council members, and village board members who have been added to the complimentary mailing list for Budget & Tax News. Our total circulation now stands at 18,400.

Budget & Tax News covers developments on Capitol Hill, in the states, and in cities and counties related to taxes, spending, and economic activity.

Social Security, Medicare, Medicaid, highway funding, subsidized sports stadiums, public employee pension funding, local utility taxes, state gasoline taxes, cigarette taxes, liquor taxes, tax incentives to major manufacturers or retailers, income taxes, property taxes, outsourcing of government services to private firms ... developments in these and other areas of interest to elected officials and their constituents are regularly covered in the pages of Budget & Tax News.

We strive to make our coverage of these and other public policy issues interesting, educational, and entertaining.

Our goal is to inform readers of what is happening in these vital areas of public interest, with the aim of documenting through news stories how local, state, and federal governments can hold down spending and taxes, grow their economies, and give citizens good value for the taxes they pay.

Many of our articles are written by experts in the tax and budget fields. You will often find quoted in our articles respected economists, lawmakers, and taxpayer advocates who sometimes are overlooked by establishment news organizations.

We also report on research by some of the nation’s leading free-market thinkers and taxpayer advocacy groups. And you will occasionally find superb analysis or opinion pieces by top economists, tax analysts, and financial writers.

So welcome to Budget & Tax News, and thanks for reading. If you have questions or suggestions for stories you’d like to see covered in future issues, please feel free to drop me a line—I’m here for you. Enjoy!

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

Land Value Property Tax Under Consideration in Seven States

Land value taxation has revitalized Penn. capital city

by Joshua Vincent

The unpopularity of the property tax is axiomatic, yet it remains the revenue source of choice for most local governments, including school districts. Sales taxes are regressive, and business and income taxation tend to deflate any local economy in this age of mobile people and capital.

For local governments wondering what to do, one idea making headway is land value taxation (LVT).

Whereas the typical real property tax applies to land and improvements on the land at the same rate, LVT taxes land at a higher rate, while reducing or even eliminating the tax on improvements. Under LVT private land is taxed on the basis of its value rather than how it is used, encouraging cities, especially older ones, to consider LVT as a way to provide a stable revenue source without punishing investment.

Twenty cities in Pennsylvania have used LVT for several decades, and serious efforts are underway to expand its use in the Keystone State and permit cities in other states to use it. Harrisburg, the state capital, uses LVT and has experienced lower taxes for homeowners and employers and a rare revival of a once-moribund downtown. Mayor Stephen Reed credits LVT with playing a major role in Harrisburg’s rejuvenation.

Philadelphia Considering Adoption

Nearly unique among U.S. cities, Philadelphia has suffered from a lethal tax “cocktail” of local income taxes, punitive business taxes, low property taxes, and a reputation for a city government more concerned with dealmaking than sane policy.

That may be changing. Last year, the Philadelphia Tax Reform Commission recommended adoption of LVT. In late 2001 the Philadelphia city controller, Jonathan Saidel, had released a landmark tax reform document that embraced land value taxation. This year, the local assessment authority will reassess the entire city (an important step in preparing for LVT), and Saidel is running for mayor.

Three separate studies indicate nearly 80 percent of the city’s homeowners—and nearly all poor, working, and pension homeowners—would see tax reductions under an LVT plan.

LVT Movement Spreads

The experience of Pennsylvania towns, especially Harrisburg, has led to the introduction of seven LVT bills currently pending in Alabama, Connecticut, Maryland, and Minnesota.

The law with the best chance of passage is in Connecticut. SB 977 will permit cities with a population greater than 100,000 to enact LVT. That includes suburban towns as Hartford and New Haven.

After decades of infusions of taxpayer cash with little result, people in those towns now believe the tax system itself must be changed to encourage capital investment and address the real problem of speculation in vacant land and abandoned buildings.

“The City of Hartford as well as other municipalities across the state lose a great amount of revenue for undeveloped land and vacant lots when such lots are paved over and used as parking facilities,” said Hartford Mayor Eddie Perez at legislative hearings in March. “By correcting this problem with a land tax value, the state will create a more equitable system where all businesses pay their fair share of property tax (not only those in buildings),”

Absentee Owners Would Pay

A study (“Impact of a Two-Rate Tax in Hartford”) conducted in 2004 by the author for the Center for the Study of Economics showed 78 percent of Hartford homeowners would get a tax decrease, and vacant lots owned by (mostly) absentees would receive a tax increase, under an LVT system.

Many urban professionals and officials are coming to believe the nation’s cities can’t be fixed by government subsidies, government intervention, and more taxes. “Taxing the ground rent that otherwise accretes to locations makes real estate more liquid and responsive to market forces,” said political scientist and consultant H. William Batt, who has studied LVT for state and local governments.

“Untaxing wages and interest provides the additional wherewithal for wider and deeper entry into those markets.”

Joshua Vincent (joshuavincent@msn.com) is executive director of the Center for the Study of Economics, based in Philadelphia.

INTERNET INFO

For more information on land value taxation, visit the Web site of the Center for the Study of Economics, http://www.urbantools.net.
ANALYSIS

Did a Federal Court Decision Emasculate the IRS?

Here’s what really happened in the Schulz case

by Daniel J. Pilla

Robert Schulz has been battling the Internal Revenue Service for years. As head of the We the People Foundation for Constitutional Education, Schulz has a long history of sponsoring conferences, symposia, and full-page newspaper ads agitating against the IRS and the income tax.

Schulz’s philosophy is, among other things, that no law requires American citizens to file tax returns. Schulz argues that the filing of tax returns is essentially voluntary. He claims no law requires a worker to subject himself to wage withholding for income taxes. Schulz claims employers are under no legal duty to withhold income taxes from the wages of their employees.

Schulz calls himself a tax researcher. The IRS refers to him as a tax protestor.

IRS Irate

Not surprisingly, Schulz has raised the ire of the IRS. He has come under heavy scrutiny because on a broad scale he’s encouraging others to stop filing tax returns and paying taxes. In June 2003, the IRS issued a series of administrative summonses to Schulz seeking testimony and documents from him in connection with his investigation of his affairs.

The ensuing court battle over those summonses has been the subject of much discussion in tax protestor circles and by Schulz on his Web site. Schulz would have us believe that a January 25, 2005 court decision entered in his case, Schulz v. IRS; Docket No. 04-0196-cv, by the United States Court of Appeals for the Second Circuit, has emasculated the IRS.

He suggests the decision nullified key enforcement provisions of the Internal Revenue Code, stripping the IRS of much of its power to compel compliance with its administrative demands for personal and private property, according to a January 30, 2005 news release by the We the People Foundation.

Decision Misunderstood

Unfortunately, Schulz misunderstands the significance of the Court of Appeals decision in his case.

It’s important to clear the air because the view advanced by Schulz will serve only to further confuse unwitting citizens, potentially leading many to subscribe to the faulty ideas of Schulz and others like him.

To understand what the court did and did not do in the Schulz decision, let me give you some background. An IRS summons is a tool used by the agency during an audit or investigation. It is not a subpoena, which is what the summons advanced by Schulz claims on his Web site, taxresearcherprotestor.com, is. The IRS has no such power to enforce the summons independently. For all practical purposes, the summons is just a request by the IRS to produce records or give testimony, albeit couched in somewhat ominous language. While it appears to be a demand, it is not self-enforcing. The court decision fully supports this reading of the law.

Does this mean, as Schulz suggests, that we are free to ignore any IRS summons and the agency is at a loss to do anything about it? Not at all.

“Schulz misunderstands the significance of the Court of Appeals decision in his case. It’s important to clear the air because the view advanced by Schulz will serve only to further confuse unwitting citizens, potentially leading many to subscribe to the faulty ideas of Schulz and others like him.”

Not a Landmark

What is remarkable about the Schulz decision is that while he refers to it as a “landmark” ruling that will forever change the course of IRS enforcement procedures, there is nothing novel about it. In fact, the decision is a mere restatement of the law that’s been settled since the Supreme Court first addressed the issue in 1964.

At that time, the Court ruled in the case of Reisman v. Caplin, 375 U.S. 440 (1964), that IRS summons do not create independent judicial power to enforce them through the judicial process. That is to say, only a federal judge can enforce an IRS summons. That rule was restated in 1975 by the Supreme Court in the case of United States v. Bisceglia, 420 U.S. 141 (1975).

This means simply that if one refuses to comply with an IRS summons, the agency is free to petition a United States District Court for an order enforcing the summons. A federal judge then reviews the process by which the summons was issued, considers any defenses raised to the summons by the person summoned, and finally determines whether an order should be issued compelling compliance.

Procedure Is Well-Established

This procedure is well known to tax practitioners as a “summons enforcement proceeding.” It is a common procedure that has been around for 40 years. (See United States v. Powell, 379 U.S. 48 (1964).)

The IRS brings hundreds of such cases to court every year. In the vast majority, federal courts order the summoned person to release records or provide testimony to the IRS. If the person refuses to comply with the court’s order, he faces sanction by the court in the form of a contempt order.

More than a few people have been fined or jailed for contempt of court for violating a court’s order to disgorge records or testimony. In such cases, a federal judge administers the recalcitrant citizen that he “holds the keys to the jail door.” In other words, all he need do is comply with the court’s order and he’ll be set free.

Schulz claims on his Web site, http://www.givemeliberty.org, that the court’s decision in his case cut at the heart of IRS collection enforcement tools such as levies, liens, and property seizures, but nothing could be further from the truth. Summons enforcement litigation is a well-established procedure that has nothing whatsoever to do with collection procedures.

In addition, in 1934 the Supreme Court ruled the IRS was under no obligation to seek or obtain a court order before enforcing collection of a tax through liens, levies, or seizures. The procedures allowing the agency to collect without a court order have been held to be constitutional. (See Bull v. United States, 295 U.S. 247 (1934).)

Procedures Allow Review

There are procedures allowing a person to seek and obtain judicial review of IRS collection actions, but the burden is on the citizen to invoke them. (See code sections 6320 and 6330, known as the “collection due process procedures.”) More importantly, in any such proceeding, the burden of proof as to the propriety of the action is largely on the citizen, not the IRS.

Perhaps the most astonishing aspect of this latest episode in the Schulz saga is the fact he’s hailing the court decision as a great win for his cause. The truth is, he lost the case. He commenced a court action seeking an order preventing the IRS from getting his records, and the district court denied his request. He appealed the decision, and the Court of Appeals upheld the district court.

Schulz lost.

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