High Spending Has San Francisco in Dire Budget Crunch

By Thomas Cheplick

With San Francisco spending more than $8,000 a year per resident—more than in Denver, New York, and Philadelphia—and more than the entire Idaho state government spends ($6.5 billion annually), the city’s fiscal problems keep getting worse.

The city is grappling with a $522 million budget deficit. Middle-income earners have all but abandoned the city. Service routes on the municipal transportation system are being shuttered and fares

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High Spending Catches San Francisco in Budget Crunch

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are rising. The city’s public employee pay and pension costs are exploding. Commercial and apartment rents are dropping dramatically. The homelessness problem is getting worse. Businesses are leaving town. Unemployment is rising.

The situation has become so desperate that San Francisco is going after the Catholic Church and Office Depot for money.

Church Contests Transfer Taxes
In December the city declared it had determined the Roman Catholic Archdiocese of San Francisco owes $14.4 million in taxes on 2008 property "transfers." The Archdiocese disagrees. City officials also announced they had determined Office Depot overcharged the city by close to $6 million for paper clips, staples, and other office supplies. Office Depot denied the charge.

Supervisor John Avalos, chairman of the city’s Board of Supervisors’ budget committee, stated San Francisco is looking at piling more tax increases on its property owners and raising business taxes and utility taxes, creating a new citywide parcel tax, and hiking the vehicle license fee and the city’s sales tax.

Michael Antonini, a member of the San Francisco Republican Central Committee, noted Avalos’s proposals would be added to already burdensome policies. "San Francisco has an extraordinary tax—its own payroll tax. No other Bay Area city has a payroll tax," he said. And he noted San Francisco also has "a very high, business-crippiling minimum wage" and forces businesses, regardless of their size, to pay for sick leave.

"Raising more taxes is only going to drive more businesses out of San Francisco," Antonini said. "It is not good public policy. It is unfortunate because we have a great downtown area here, the most concentrated area outside of Manhattan where everything is in one place—civic institutions, entertainment, sports, all these things. Companies should be climbing over themselves to get here, but we drive them away with our politics."

’Worst-Run City’
To dampen San Franciscans’ spirits even more, a recent article in San Francisco Weekly magazine lambasted the City by the Bay as "The Worst Run Big City in the U.S." The widely circulated piece pointed to signs San Francisco is being crushed by expensive city employee retirement packages and left-wing nonprofit organizations that secure hundreds of millions of dollars of city homeless maintenance grants without accountability or performance requirements.

Richard Rodriguez, a San Francisco resident, Harper’s magazine contributing editor, and essayist for NewsHour with Jim Lehrer, says San Francisco is dying.

"The city’s last major newspaper is dying because San Francisco is dying, and the city is without a sense of itself," Rodriguez said. "That idea rhymes with the troubles outlined in the San Francisco Weekly piece but from a totally different direction."

Defender: Worries ‘Overblown’
Gabriel Metcalf, executive director of the San Francisco Planning and Urban Research Association, which is closely allied with San Francisco Mayor Gavin Newsom (D), believes reports of the tax and budget problems facing the city are overblown.

"San Francisco has a lot of problems, and the city government could be much more efficient than it is, but it is the same with every big city in America," Metcalf said. "The answer to the $500 million deficit in San Francisco is we will become more efficient, we will raise more money in new taxes and fees, and we will offer reduced public services in one form or another. This is a little bit of a normal thing, that when there is an economic downturn, there is less money, and everybody cuts back."

"The whole thing is overblown," Metcalf added. "Yes, there is a projected budget deficit, and yes, we will make cuts till [the budget] is balanced, and life will go on."

Metcalf believes the city’s leaders understand the problems and are working to solve them.

"Everybody understands we need a healthy economy and that we are competing with other regions. That’s basic economics 101," Metcalf said. "New taxes might have people freaking out. I am just saying we should have a sense of perspective: that basically this is still a community that has the ability to generate wealth, there is a tax base, there is an employment base, that is intact."

Hoping for Condo Conversions
Antonini thinks more condo conversions—and the resulting transfer tax fees—will help balance the city’s budget and lay the foundation for a more responsible and moderate voting public.

"In the 1960s, 1970s, and 1980s we lost a lot of our middle-income, particularly blue-collar union workers, who voted moderately," Antonini said. "And in the void, leftist activists took over. ... But encouraging condo conversions will help. The left does not want condos; condo voters are the wrong sort of voters, who are financially invested in the city’s welfare."

Thomas Cheplick (thomascheplick@yahoo.com) writes from Cambridge, Massachusetts.

IN OTHER WORDS

"In San Francisco, the intermittent talk of charging drivers to enter the city’s downtown core assumes the deployment of electronic toll collection. How much further can this go? Is it only a matter of time until coin-operated parking meters are replaced with 'smart readers' that detect your transponders and assess a fee based on the hour of the day? Will these transponders eventually report how many miles we’ve driven and assess a carbon tax for exceeding a state-sanctioned ration?"

John Diaz
Editorial Page Editor
San Francisco Chronicle
January 17, 2010
COMMENTARY

Taxpayer-Funded Political Campaigns
No Substitute for Common Sense

By Sean Parnell

Advocates of legislation to transform campaign funding from a system of private donations to a government-controlled scheme dub their plan “clean elections.” They tout a variety of sanitizing benefits, arguing the minimization of money in politics will get rid of “special interest” influence, make campaigns more competitive, reduce campaign spending, allow more women and others from “nontraditional” backgrounds to reach elected office, and improve public opinion of government.

But “clean elections” bills simply put a sheen on a dingy idea. Taxpayer-funded campaign programs transfer significant sums from the states’ general funds to government bureaucracies, which then layer a complex, bureaucratic, administrative oversight structure on gubernatorial and legislative campaigns.

Most such proposals also contain a “rescue funds” provision, meaning if a candidate participating in the public financing program is opposed by a nonparticipating candidate, the state will give the participating candidate additional funds when or if the nonparticipating candidate receives contributions exceeding the taxpayer-funded amount.

Constitutionality Questions

In Arizona and Connecticut, federal judges have struck down such provisions as unconstitutional in recent months, based on U.S. Supreme Court precedent. The Court, in Davis v. Federal Election Commission (2008), ruled a mechanism aiming to “equalize races” was unconstitutional. Since the Court’s seminal campaign finance decision in Buckley v. Valeo (1976), it has always held “the concept that government may restrict the speech of some elements of our society in order to enhance the relative voice of others is wholly foreign to the First Amendment.”

Although such proposals go against the nation’s fundamental principles of individual liberty, limited government, and free markets, some lawmakers champion taxpayer funding for campaigns in the mistaken belief these programs save taxpayer dollars because legislators will no longer feel obligated to earmark funds or approve contracts in order to reward campaign contributors. This argument, however, is unsupported by research examining the link—or lack thereof—between state budgets and public financing.

Higher Taxes, More Spending

In 2008, the Center for Competitive Politics analyzed spending patterns and tax burdens in Maine and Arizona for the periods before and after those states adopted their taxpayer financing programs. The total tax burden on residents in both states increased after implementation of taxpayer funding of political campaigns.

Public spending growth also increased after the enactment of the taxpayer funding of political campaigns, exceeding the national average rate of growth. Between 2001 and 2006, Arizona’s expenditures increased by 46.25 percent. In Maine, spending grew 34.75 percent over the same period. Nationally the rate of growth in state spending was 30.81 percent.

Some proponents of taxpayer-financed campaigns acknowledge the claims made to sell these programs are often exaggerated. For instance, Bob Bauer, White House counsel and former campaign attorney for President Barack Obama, supports taxpayer-funded political campaigns but noted the benefits of such programs are modest at best, in a February 24, 2009 article on his More Soft Money Hard Law blog (“Public Financing Reform and its Evaluators”).

Bauer also admitted advocates of so-called “clean elections” make unrealistic claims, such as that they can “deliver transformative changes in government,” to sell a program often rightly met with legislative and public resistance.

There is no simple legislative solution to political corruption; the best preventive measures are simply common sense …”

Sean Parnell (sparnell@campaignfreedom.org) is president of the Center for Competitive Politics in Alexandria, Virginia.
I
n addition to police officers and sher-
iff's deputies, more than 200 New
Orleans employees enjoy the taxpayer-
financed perk of driving a city-owned
vehicle, according to the latest city
report and other public documents.
That number would be much higher
had the city not revoked the privilege
from nearly 100 employees between
April and October, the report shows.
The list of people still driving on the
taxpayers' dime includes City Council
staffers, the mayor's top budget officers,
many department heads, judges, and a
host of other employees who may or may
not meet the city's criteria for having
such a vehicle.

Gas, Insurance, Maintenance Covered
The perk also includes gas, insurance,
and maintenance, all of which can be
an increasingly expensive proposition
for vehicles driven by employees who
live outside the city. The latest report
shows city taxpayers are covering the
commuting costs of a handful of employ-
ees living more than 30 miles from their
workplace.
The list covers only departments
under the supervision of the city's chief
administrative officer. That doesn't
include the city courts, the Sewerage &
Water Board, the Aviation Board, or
such related entities—many of which
issue cars to employees.
In general, the employees pay $1,200
per year for the car and related services.
As an unofficial bonus, drivers of vehi-
cles marked as city property aren't likely
to get parking tickets, as evidenced by
the daily glut of city vehicles parking for
free in metered spots around City Hall.

Limit Ignored, then Removed
Until recently the city had a legal limit
of 50 take-home cars, which was flatly
ignored. Partly in response to a Decem-
ber 2008 Inspector General's report find-
ing 274 such vehicles, the City Council
removed the cap over the summer.
The Inspector General's report said
the city spent about $9.2 million on
maintenance and fuel in 2007, although
that includes all city vehicles, not just
take-home cars.

Ruling Bars Cars
A 1990 attorney general's opinion, cited
by the Inspector General, makes it clear
government can't offer a vehicle as a
fringe benefit.
“No public entity may donate an auto-
mobile to an official or employee for
unrestricted personal use,” the opinion
reads. “All public vehicles must be used
for a public purpose subject to the fidu-
ciary duty of the operator. Personal use
is permissible only when it is minimal,
reasonably necessary and incidental to
the authorized public use.”

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tive reporter for the Pelican Institute for Pub-
lie Policy in New Orleans, Louisiana.
By Christian R. Cámara

The most expensive rail deal in U.S. history has become law in Florida. Critics charge the price was vastly inflated.

After failing twice before, a plan that will link several central Florida communities and clear the way for new commuter and high-speed rail systems in the state won approval during a six-day special session of the Florida legislature.

Gov. Charlie Crist (R) signed the bill into law soon after its passage in December. It allows the state to purchase 61.5 miles of track from the freight railroad CSX for $432 million. CSX will then lease the track from the state.

High Cost, Big Risk
Critics have said the deal is 10 times more expensive than the track is worth. In addition, the bill shifts liability for any accidents caused by a CSX freight train from the company to the taxpayers, requiring the state to purchase a $200 million insurance policy to cover any major accidents by freight or passenger trains.

State Sen. Paula Dockery (R-Lakeland), a candidate for governor and opponent of the sale, was particularly harsh in her criticism.

“Nowhere does it appear that [the Florida] Department of Transportation tried to renegotiate the price of this deal,” Dockery said. “Why should taxpayers pay to improve CSX’s freight tracks across the state? CSX is a Fortune 500 company. Repairing its infrastructure should be the company’s own responsibility.”

Federal Money, Rising Unemployment
Although similar legislation had been defeated, the prospect of federal stimulus money this year and the state’s deepening unemployment crisis led previous opponents to rethink the idea. Lawmakers and proponents of the bill cited $2.6 billion in federal stimulus money for a high-speed rail system between the Orlando area and Tampa Bay, which must be linked to a commuter rail system in order to qualify for the federal funding.

As part of an agreement with legislators from South Florida, the bill also increases the state’s subsidy for the existing Tri-Rail commuter rail line in South Florida by $13 to $15 million a year.

More Agency Bureaucracies
The bill creates two new agencies: the Statewide Passenger Rail Commission to serve in an advisory capacity to the Department of Transportation (DOT) and the legislature concerning passenger rail issues in Florida; and the Florida Rail Enterprise within the DOT to oversee the development and administration of the state-owned passenger rail systems.

Supporters saw the bill as a major step forward for Florida’s infrastructure.

“This bill is a framework to build a future infrastructure for the state of Florida,” State Sen. Jeremy Ring, (D-Margate) told the Jacksonville Times-Union.

Christian R. Cámara (ccamara@heartland.org) is director of the Florida Insurance Project at The Heartland Institute.

"Why should taxpayers pay to improve CSX’s freight tracks across the state? CSX is a Fortune 500 company. Repairing its infrastructure should be the company’s own responsibility."

PAULA DOCKERY
STATE SENATOR
LAKELAND, FLORIDA
JOIN YAL

www.yaliberty.org

"The importance of YAL to the future of Liberty cannot be overstated." - Ron Paul
By Arin Greenwood

The House Financial Services Committee is considering bills that would pave the way for legalized online gambling in the United States.

The chief bill under consideration at a December committee hearing was the Internet Gambling Regulation, Consumer Protection, and Enforcement Act (HR 2267), written by Rep. Barney Frank (D-MA), a longtime opponent of Internet gambling bans.

The bill—which Frank announced would be considered this year—would create a federal framework for the licensing and regulation of Internet gambling, effectively legalizing it.

“I continue to believe it is a great mistake for the Congress of the United States to tell adults what to do with their own money on a voluntary basis,” Frank said during the hearing. “It is not the business of the federal government to prevent them legally from doing it.”

Safety Concerns

Hearing testimony focused on how HR 2267 could help bolster the safety of online gambling and online gamblers in the United States.

“If the United States decides to legalize and regulate online gambling sites, we would expect that most U.S. resident gamblers would be diverted eventually from overseas sites to reputable and trusted domestic operators,” said Prof. Malcolm K. Sparrow of the John F. Kennedy School of Government at Harvard University in his testimony. “In the long run, reputable gambling operations under American control should come to dominate online gambling opportunities selected by U.S. residents. And if that happens, all categories of risk would be better controlled than they are at present, and I believe that U.S. consumers would be better protected.”

Regulatory Uncertainties

Samuel A. Vallandingham, testifying for the Independent Community Bankers of America, described regulatory uncertainty created by previous Internet gambling laws HR 2267 would supplant. These laws include the Unlawful Internet Gambling Enforcement Act of 2006, known as UIGEA, which prohibits U.S. banks and other financial institutions from moving funds associated with “unlawful Internet gambling.”

Vallandingham said, “the law fails to define ‘unlawful Internet gambling,’ which is vitally necessary if banks are to comply with the law. Obviously, this is not workable.”

Just days before December 1, 2009, when the UIGEA prohibitions were to go into effect, the Department of the Treasury and the Federal Reserve delayed the start date. The prohibitions are now scheduled to go into effect June 1.

“This will give us a chance to act in an unhurried manner on my legislation to undo this regulatory excess by the Bush administration and to undo this ill-advised law,” said Frank in response to the delay.

“We remain baffled by the right wing’s insistence that the personal freedoms of American adults to do what they want with their own money be curtailed,” said Steven W. Adamske, communications director for the House Committee on Financial Services. “We hope to be able to give Americans the freedom online that they have in many other parts of the country very soon.”

Arin Greenwood (aringreenwood@hotmail.com) is a writer and lawyer in Alexandria, Virginia.
ANALYSIS

Congress Won’t Act on Transportation Reform

By C. Kenneth Orski

Shortly before the scheduled December 18 expiration of the third temporary extension of the federal government’s surface transportation program, the House and the Senate passed another short-term extension, this time through the end of February 2010.

Further legislation is pending, and the congressional action underscored once again the continued inability of Congress to agree on a plan addressing the long-term transportation needs of the nation.

Before adjourning for the holidays, the House also passed, by a vote of 217 to 212, a second job stimulus bill (HR 2847), which included transportation money.

The $154 billion measure, endorsed by Rep. James Oberstar (D-MN), chairman of the House Transportation and Infrastructure Committee, allocates $36.7 billion in additional funds for highways, transit, and Amtrak; extends the surface transportation authorization through September 30, 2010; credits the Highway Trust Fund with $19.5 billion in foregone interest payments; and allows the trust fund to accrue interest in the future.

Criticized as Short-Term Fix

Environmental advocacy groups, while supportive of the measure, expressed disappointment the House failed to focus on long-term transportation reform or include a National Infrastructure Bank. Even Rep. John Mica (R-FL), ranking member of the House Transportation & Infrastructure Committee, who generally supports Oberstar, was moved to criticize the House measure.

The “Son of Stimulus,” Mica wrote in Roll Call, will be no more successful in creating permanent new jobs in the transportation sector than was the first stimulus bill, because the dollars are being spent on short-term transportation enhancement and road repaving projects that provide jobs for only a few weeks or months.

In short, the transportation community sees the latest House action as another example of Congressional equivocation, extemporization, and inability to come to grips with the nation’s long-range transportation needs in a substantive way.

“Is Anyone Listening?”

At the Transportation Policy & Finance Summit held by the International Bridge, Tunnel, and Turnpike Association (IBTTA) on December 14-15, the sense of frustration with the legislative inertia was palpable.

“Is anyone listening out there?” asked Steve Heminger, executive director of the Bay Area Metropolitan Transportation Commission and moderator of a panel session on the future of distance-based charging. His fellow panelists—Jack Schenendorf, Kathy Ruffalo, and Emil Frankel, all of whom, like Heminger, served on commissions that recommended significant program reforms—agreed there is no appetite in Congress to tackle long-term transportation reform.

There is no political will in either party to raise taxes for transportation infrastructure, and the alternative—distance-based charging of road users—raises a host of contentious issues that will need to be answered before Congress considers VMT (vehicle miles traveled) fees as a serious financing option.

Regarding how to overcome the inertia, panelists’ answers had a familiar ring: “The program has to be given a real sense of purpose.” “Congress must come up with a bold vision.” “There must be stronger leadership on Capitol Hill.” “People must be convinced that the money is wisely spent.” “We must inform and educate the public that doing nothing is not an option.”

Public Unconvinced

The dilemma facing transportation advocates is that these warnings fall on deaf ears among the general public and many elected officials. People do not sense an impending crisis, nor are they alarmed about the deteriorating state of infrastructure. Toll road operators attending the IBTTA meeting informally told us their customer surveys show a high degree of satisfaction with the quality of service and the physical condition of their facilities.

Collapsing bridges are happily few and far between, and the focused attention state and local highway agencies devote to repair and maintenance of their assets keeps signs of aging infrastructure largely hidden from view.

Another transportation problem—traffic congestion—is highly visible, however, and public dissatisfaction with it is well-documented. But the driving public has grown skeptical toward the idea more money or program reform will bring effective congestion relief.

Regarding how to overcome the inertia, panelists’ answers had a familiar ring: “The program has to be given a real sense of purpose.” “Congress must come up with a bold vision.” “There must be stronger leadership on Capitol Hill.” “People must be convinced that the money is wisely spent.” “We must inform and educate the public that doing nothing is not an option.”

In addition, traffic congestion leaves vast stretches of rural and small-town America (and their elected representatives in Congress) unaffected. Although it is a source of great concern in many urban communities, it does not seem to be perceived nationally as a crisis warranting congressional intervention.

IN OTHER WORDS

“A new report from the Treasury Department’s Inspector General for Tax Administration counts 56 tax provisions in the [American Recovery and Reinvestment Act, aka ‘the stimulus’] bill having a potential cost of $325 billion. Of those, 20 are tax breaks for individuals and 36 are for businesses.

“The problem, the Inspector General says, is the IRS can’t verify taxpayer eligibility ‘for the majority of Recovery Act tax benefits and credits.’ For individual taxpayers, 13 of the 20 benefits and credits can’t be verified; for businesses, it’s 26 of 36.”

House Editorial
Investor’s Business Daily
December 23, 2009

C. Kenneth Orski (korski@verizon.net) is editor/publisher of the transportation newsletter Innovation NewsBriefs, where an earlier version of this article appeared. Used with permission.
Forgotten Highways Can Give Boost to Small Towns

By Steve Stanek

John Gann has driven hundreds of thousands of miles during his many years as a community and economic development consultant, and he has become convinced thousands of small towns are failing to take advantage of an asset many of them view as a liability: their off-the-beaten-path highways.

“We’re told all the time that we need to spend billions of federal and state dollars to fix up the interstate highways to carry more traffic with safety,” said Gann, president of Gann Associates, in Glen Ellyn, Illinois. “But outside of the Interstates we have a great highway system that we’ve already paid for. The best of these are what I call the UNterstate highways. They’re still good, many of them, for long trips, but because of the Interstates they are not used as much as they could be. They’re underused and forgotten highways.”

He has produced “Marketing UNterstate Highways: Bringing Out-Of-Town Dollars to Non-Destination Small Towns,” a 78-page manual offering local community and business leaders ways to draw more traffic to their roads in the interest of economic development.

Success also could have the side benefit of more evenly distributing traffic over the existing highway network.

‘Better Travel Experience’

“The manual is intended for bypassed rural communities that aren’t and can’t be tourist destinations, that maybe don’t have what it takes to attract industry,” Gann said.

“This is what I call economic development for the rest of us. It’s about getting business and traffic by being en route to someplace else.”

Gann’s manual suggests ways to induce travelers headed elsewhere to use non-Interstate highways that go through these small towns and rural areas. The increased traffic would result in more customer traffic for local businesses.

“We must show travelers through marketing that it’s in their interest to try these older highways, that they offer a better travel experience even if they might be a little bit slower than an Interstate,” Gann said. “There’s much less tractor-trailer traffic, less road construction, and more to see because you’re close to farms and towns. It’s easier to stop anywhere. You have more choices in where to buy gas or eat. If you’re in an emergency situation, you’ll probably be closer to help, not 15 miles from the nearest interchange.”

Faster than Flying

Gann notes a National Aeronautics and Space Administration study determined for trips up to 500 miles, flying is no faster portal to portal than driving, even when the plane is on time.

“When you consider the time people spend driving to the airport, then getting through security, waiting to board the plane, time in the air, time getting through the destination airport, and from there to the final destination, driving is as fast or faster,” Gann said. “Flying is a nightmare. We’ve got TSA security, whole-body scanners, delayed flights, passengers held hostage in grounded planes, and fewer and more crowded flights.”

Gann stresses UNterstates are not scenic or historic byways. Scenic or historic features of these highways are incidental to their utility. He is talking about highways that were mainstays of car and truck transportation before the building of the Interstates.

“They are the best of the older U.S., state, or sometimes even county roads that by themselves or in combination can provide good transportation for long distances between cities or other major destinations,” Gann said. “They’re selected as good transportation to get from point A to point B. I’ve driven many of them on long trips and have often felt like I am on my own private highway because there is so little traffic.”

Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of Budget & Tax News.

Non-Interstates Shine ‘Beyond the Suburbs’

John Gann says marketing UNterstate highways “does not work in urban/suburban areas. In those areas people do better on the Interstates, but once they are beyond the suburbs, that’s where these non-Interstates shine.”

Here are some examples highlighted in “Marketing UNterstate Highways”:

Chicago to Wisconsin

“People from Madison, Wisconsin heading for Chicagoland—or Chicagoans bound for The Dells or other central Wisconsin vacation spots—can pay tolls to drive the heavily traveled I-90.

“Or they can have their choice of good UNterstate candidates such as U.S. 20, U.S. 12, and U.S. 14. All are slow going once they reach Chicago’s spread-out suburbs but a pleasure to drive in the countryside.”

Across the Northeast

“From Boston west to Cleveland or Chicago or for just getting across Upstate New York, it’s hard to find a better UNterstate candidate than U.S. 20.

“The Interstate competitor, I-90, is pretty much a string of tollways from the Bay State to the Prairie State, so out-of-pocket savings can be substantial. …

“In Illinois it’s in the south Chicago suburbs, where it’s best avoided, as it should also be around Cleveland.”

Keystone College Towns

“Parents of high school seniors making campus tours have an alternative for getting between State College, home of Pennsylvania State University, and the campus of Clarion University in the town of the same name.

“It’s U.S. 322, also good for travelers wishing to avoid the heavy trucks barreling to and from New York City on the Keystone Shortway, Interstate 80.”

— Steve Stanek

INTERNET INFO

Marketing UNterstate Highways is available for $77.95 plus $5 shipping and handling from Carpe Horam, 866/614-6726. Information available from the author at citykid@ualumni.com.
Increasing Federal Role Sought

These and other events have focused attention on the administration’s intent to increase the federal role in shaping local development patterns and influencing travel behavior. “Smart growth” planning and shifting more automobile travel to public transportation have been longstanding goals of progressive planners and asserted anti-sprawl activists, but these goals may become a matter of federal policy under Obama’s “livability” initiative.

That initiative—called the HUD-DOT-EPA Interagency Partnership for Sustainable Communities—is designed, in the words of the official announcement, “to help improve access to affordable housing, provide more transportation options, and lower transportation costs while protecting the environment in communities nationwide.” The interagency partnership will coordinate federal housing, transportation, and other infrastructure investments through “livability principles” and interagency agreements.

‘Government Must Lead’

Opinion has split along familiar lines. Planners, environmentalists, champions of New Urbanism, and smart growth advocates have welcomed the initiative as a sign of willingness to tackle sprawl, promote a wider range of transportation and housing choices, and encourage people to curb automobile use. “The federal government must use the tools it has, coordinate its efforts and lead by example,” wrote National Journal transportation blogger, Rep. Earl Blumenauer (D-OR).

Critics have focused on the social engineering and central planning nature of the “livability” initiative and its intrusiveness into individual choices. Leading that charge have been columnist George Will, author and urban scholar Joel Kotkin, and Heritage Foundation Senior Research Fellow Ron Utt.

In an April 14, 2009 Newsweek column, Will mocked Transportation Secretary Ray LaHood as “Secretary of Behavior Modification.” For many generations,” Will wrote, “Americans by the scores of millions have been happily trading distance for space, living farther from their jobs in order to enjoy ample backyards and other aspects of low-density living. … Today’s far-seeing and fastidious government, not content with designing the cars Americans drive and the light bulbs they use in their homes, … wants to say where their homes can be.”

‘Lifestyles Under Siege’

Kotkin echoed those sentiments in a September 2009 editorial in Politico: “Traditions governing land use that have existed since the beginning of the republic would be overturned,” he warned, referring to the livability initiative’s emphasis on denser housing patterns. “The preferred lifestyles of most Americans would come under siege.”

Ron Utt is equally suspicious of the administration’s motives. “Recognizing that their efforts to demonize suburban living have failed to deter the millions of American families that still flock to the suburbs, Smart Growth advocates have now enlisted the federal government in their war against the suburbs, and the HUD-DOT-EPA partnership is the beginning of that effort,” he wrote in an April 14, 2009 Heritage Foundation commentary.

Many aspects of the livability initiative are commendable, such as safe biking access to local schools, suburban communities to be more accessible on foot, and is safe biking access to local schools. Promoting equitable, affordable housing in suburban communities is a worthy goal that has been widely accepted throughout the country.

Expanding paratransit services in local communities for elderly residents is likewise a commendable, noncontroversial objective. Reducing traffic congestion that prolongs commutes and chokes even smaller communities is an imperative everybody can agree on.

‘Everything We Do Is Intrusion’

But the debate has been needlessly polarized by LaHood. At a May 21, 2009 event at the National Press Club, LaHood was asked whether the administration’s livability initiative could be construed as an effort to “coerce” people out of their cars. He agreed with that interpretation, adding, “about everything we do around here is government intrusion in people’s lives.”

“I think we can change people’s behavior” LaHood argued in the same forum. Those are not exactly words that would soothe the already aroused sensitivities of those who believe that government already intrudes too much into people’s lives.

To most people, “livable community” conjures up an image of a leafy neighborhood, good schools, low crime rates, a private back yard, and the comfort and flexibility of personal transportation. It has little to do with “affordable housing,” “infill development,” or “densification.” That’s what’s behind the increasingly intense debate behind the Obama initiative.

C. Kenneth Orski (korski@verizon.net) is editor and publisher of the transportation newsletter Innovation NewsBriefs, where an earlier version of this article was published. Used with permission.
Finance, Insurance & Real Estate News
A MONTHLY INSERT IN BUDGET & TAX NEWS

Federal Role in Insurance Could Increase

By Eli Lehrer

Insurance remains the largest area of economic activity regulated entirely at the state level, but that may change dramatically this year.

The massive financial services overhaul that passed the House of Representatives in December has set the stage for a mixed bag of new federal regulations of insurance firms. Some insurers, consumer advocates, and research organizations are proposing various measures intended to create a federal regulator for insurance.

The proposed creation of a new Federal Office of Insurance and federal “systemic regulator” in the new bill stops far short of what most federal regulation proponents envisioned, but it represents a significant change in the way the federal government interacts with the insurance industry.

Under the bill the Federal Office of Insurance would serve as a repository of expert insurance knowledge in the federal government and play a major role in negotiating international agreements involving insurance. The systemic regulator would provide an additional level of oversight of very large firms that officials consider key to the health of the overall economy.

Leigh Ann Pusey, president of the American Insurance Association, which mostly represents the interests of larger insurers, had a mixed view of the legislation.

“Although she pronounced herself ‘encouraged that the legislation establishes a federal office of insurance,’ she expressed concern about a proposed ‘dissolution fund’ that would impose special taxes on all large financial firms to provide for bailouts of any firms that failed.

‘To the extent property and casualty insurers are considered in these reforms, the nature of our business and regulatory standards, our existing resolution and guaranty processes, and the general risk our industry poses to the broader financial system has to be recognized,’ Pusey said.

Insurers largely deal with their own ills through state-level guarantee funds that, except in New York State, rely on taxing insurers after a major collapse. The new system would require large insurers to remain at risk of these special taxes while also paying new taxes into a special fund backstopping all large financial firms including those outside the insurance industry.

Mixed Reaction

Leigh Ann Pusey, president of the American Insurance Association, which mostly represents the interests of larger insurers, had a mixed view of the legislation.

“While I have a concern about the bill overall, the presence of a strong National Insurance Office is a positive step for consumers and a move in the right direction.”

Steve Pociask, President
American Consumer Institute

State Lawmakers Skeptical

Concern over the proposed new federal capacity is widespread among state-level regulators of the insurance industry.

The National Council of Insurance Legislators (NCOIL), which represents state legislators who serve on insurance committees, opposed all the insurance-related provisions in the House bill.

“Insurance consumers are currently protected from fraud and abuse by a comprehensive set of state laws and regulations,” said NCOIL President Robert Damron, a Kentucky state legislator.

“Enhanced communication and information sharing between state and federal regulators regarding financial market risk is a must.”

Robert Damron, President
National Council of Insurance Legislators

Consumer Groups Supportive

Consumer advocates, by contrast, tend to favor the insurance office.

“While I have a concern about the bill overall, the presence of a strong National Insurance Office is a positive step for consumers and a move in the right direction,” said Steve Pociask, president of the American Consumer Institute.

The Senate probably will take up similar financial overhaul legislation—including insurance provisions—this year.

Eli Lehrer (elehrer@heartland.org) is a senior fellow of The Heartland Institute and director of its Center on Risk, Regulation, and Markets.
Property insurers have been struggling to make money providing insurance coverage for wind damage in high-risk areas, where chances of profit are low and political scrutiny is high. As a result, most wind coverage in hurricane-prone areas has shifted to state-run insurers of last resort.

While many of the larger insurers have given up on coastal markets, State Farm Insurance Companies has chosen to remain. That decision has led to numerous challenges exemplifying the difficulties the industry and regulators face in reconciling their respective concerns.

In Florida, State Farm—the second-largest homeowner insurer in Florida with more than 700,000 policies in force—has engaged in a years-long struggle with Gov. Charlie Crist (R) and the Florida legislature over the rates the company can charge its policyholders.

**Struggle Over Requested Increase**
The battles in Florida came to a head after state regulators rebuffed State Farm’s request for a 47 percent rate increase. State Farm, headquartered in Bloomington, Illinois, then declared it would pull out of the Florida homeowners insurance market.

Recent efforts by Florida regulators have convinced the firm to remain in the state. In November 2009, Florida Insurance Commissioner Kevin McCarty approved a 14.8 percent rate increase for State Farm. He also allowed the insurer to drop approximately 15 percent of its residential policies.

The compromise agreement, forged after a year of conflict, had both sides declaring victory.

‘Product of Arduous Process’

“This agreement is the product of a long and arduous negotiation process. The final result is beneficial to the people of the State of Florida, and beneficial to the Florida insurance marketplace,” McCarty told Reuters.

Jim Thompson, president of State Farm Florida, said, “This is an important step. It helps stem State Farm Florida’s deteriorating financial condition. It reduces the company’s risk exposure. It moves us closer to rate adequacy. And for most of our customers it means that State Farm Florida continues to be there for them.”

“I want to acknowledge the cooperation of the Office of Insurance Regulation in working through all of this. This was not easy for any of us. We were losing $20 million a month, and we both were trying to work through some tough issues,” Thompson added.

Thompson said the order helps move the company toward its goal of stabilizing its financial condition, but he cautioned it is a long-term process with many continuing challenges.

“As State Farm Florida tries to rebuild its financial strength, it still faces significant issues in order to meet its obligations to policyholders,” Thompson said. “Equally important is a stable regulatory environment that supports a viable and sustainable private property insurance market in Florida.”

In Mississippi, State Farm in December 2009 received approval from State Insurance Commissioner Mike Chaney for a 19.5 percent rate hike for its coastal policies. The rate increase took effect in February. State Farm’s initial request was for a 45 percent rate hike in the three coastal counties.

**Statewide Rates Required**
After approving State Farm’s increase, however, Chaney announced the state would require the firm and other large insurers to file rates that apply to the state as a whole. They would then be allowed to come back with rate modifications depending on the rating territory.

Chaney said while the company adjusted rates up for hurricane risk in the coastal counties, it did not adjust down for reduced risks for certain other losses, including hail and tornado damage. Those risks are much greater in the inland areas.

“We are taking an aggressive stance to protect insurance consumers, make sure we have a viable insurance industry, and ensure claims can be paid,” Chaney said.

Matthew Glans (mnglans@heartland.org) is a legislative specialist in insurance and finance at The Heartland Institute.
Obama Drafts Federal Floodplain Management Update

By Dennis Kelly

The Obama administration has drafted an executive order updating the federal government’s floodplain management efforts.

A broad spectrum of supporters, from environmental groups to insurance interests, say the move may reduce government subsidies and save tax dollars by making development in high-risk areas more expensive, thus reducing development and flood damage exposure.

They applaud the renewed interest in floodplain management and are urging the administration to call on state lawmakers and the public to demand better flood risk measures.

David Conrad, a senior water resources specialist with the National Wildlife Federation, supports the Obama administration’s plan to revise the 1978 executive order that established the nation’s current floodplain policy.

“Given all the lessons we have learned or should have learned from floods, and even hurricanes and storm surges, it is long overdue to update the nation’s executive order on floodplain management,” David Conrad, senior water resources specialist with the National Wildlife Federation, said.

Management Would Expand

The management policy established in the 1978 order requires the federal government to, among other things, “minimize the impact of floods on human safety, health and welfare, and to restore and preserve the natural and beneficial values served by floodplains and avoid direct or indirect support of floodplain development wherever there is a practicable alternative.”

The Obama administration’s proposed executive order retains these requirements and charges federal agencies with a variety of additional tasks, including efforts to promote and implement cost-effective and environmentally sound floodplain management; consider the effect climate change and anticipated future conditions might have on the extent and frequency of flooding; and avoid the short- and long-term adverse effects of occupying and modifying floodplains, according to Eli Lehrer, senior fellow and director of the Center on Risk, Regulation, and Markets at The Heartland Institute.

Some new restrictions on federal agencies are also included in the draft, Lehrer said.

“Agency regulations and procedures must also, at a minimum, require that the construction of federal facilities and federally assisted structures comply with the standards issued under the National Flood Insurance Program and the requirements of this order,” the draft states.

Floodplains Are Changing

Conrad urged the administration to take the executive order revision further by recognizing floodplains are more dynamic now than ever.

“The number of factors that are creating flood risks are certainly not decreasing, but often increasing, around most bodies of water,” Conrad said. “Given that reality, there are a whole lot of actions the federal government should be taking to help the public manage and reduce flood risks.”

Updating FEMA’s floodplain maps is one critically important action, Conrad said. A major effort to update the floodplain maps has been ongoing since 2002.

“But it is a daunting task that will continue to be a major task well into the next decade. And then if we’re basing a lot of public policy on those maps, they have to continue to be kept up to date,” Conrad said.

The states also should become more involved in regulating floodplains, Conrad said.

“Land use policy is needed in the floodplains because they will flood. Flooding is the most common natural disaster, and among the most expensive,” Conrad said. “This really needs more attention at the state level. We need to get states more engaged and get the public to demand better risk measures.”

Big Floods Keep Happening

Conrad noted that so-called 100-year floods are occurring with alarming frequency.

“We have had two 100-year floods along the Mississippi and its tributaries within 15 years of each other. The public believes if it is outside the 100-year floodplain, it has no risk. That couldn’t be further from the truth,” Conrad said.

Smartersafer.org called for expanding the scope of the draft. For example, the “critical” list should be broadened, it says, by specifically identifying key transportation arteries and telecommunications infrastructure.

“Likewise, the risks of flooding key national and homeland security facilities seem just as great—if not greater—than the risks of flooding in public safety facilities,” Smartersafer writes.

Dennis Kelly (dk550@aol.com) is a freelance writer living in Columbia, Maryland.
Payday Loan Services Attract Legislator’s Attention

By Matthew Glans

Several states this year will launch new regulations on the payday loan industry, some even taking a direct role in providing the loans themselves.

Restrictions in Washington

In Washington State, a bill signed into law last year by Gov. Chris Gregoire (D) places several restrictions on the payday loan industry. The law limits the size of a payday loan to 30 percent of a person’s monthly income, or $700, whichever is less. It also prohibits a borrower from having multiple loans from different lenders, allows a maximum of eight loans in 12 months, and establishes a database to track the number of loans people take out.

“What they don’t like is the eight-loan limit. A lot of companies make loans because people take out another loan, and another loan; that’s where the revenue stream comes from,” said Deborah Bortner, director of consumer services at Washington’s Department of Financial Institutions, in a press statement.

“The Legislature clearly wanted to stop the cycle of debt for some of these people who went from lender to lender borrowing from one to pay the next one.”

Important Purpose

Payday borrowers typically have no credit history, a bad credit history, or other reasons for being denied access to conventional lenders. Because of the high risk of lending money to such people, the money is loaned at interest rates or fees higher than those charged by traditional institutions lending to traditional-risk consumers.

Payday lending industry leaders argue the loans serve an important purpose by providing consumers with short-term emergency loans when other sources of financing are unavailable. This enables people to avoid bounced checks and late fees on debts, both of which further damage a blemished credit history.

Payday lending bans often come with unexpected side effects. In a study by the Federal Reserve Bank of New York, researchers found when Georgia and North Carolina banned payday lending, people in those states “bounced more checks, complained more to the Federal Trade Commission about lenders and debt collectors, and filed for Chapter 7 bankruptcy protection at a higher rate.”

Joe Brown, general counsel for the Check Masters chain of payday lenders, told the Seattle Post-Intelligencer, “There’s still high demand for our product but we won’t be able to feed it,” adding the new law “will push people to other forms of short-term credit” such as online lenders that operate off shore.

Government Loans

The Virginia State Employee Assistance Fund partnered with the Virginia Credit Union in 2009 to create the Virginia State Employee Loan Program. The program offers small loans ranging from $100 to $500 to state employees. The loans are offered at an annual percentage rate of 24.99 percent.

State employees who access the program repay their loans through direct withdrawals from their paychecks over a six-month period. About 3,000 employees used the program last year.

Gov. Tim Kaine (D) is promoting Virginia’s program as a model for other states.

Controversial Real Estate Appraiser Code Could End

By Arin Greenwood

Pending federal legislation could end the Home Valuation Code of Conduct, instituted less than one year ago to protect consumers against inflated home appraisals.

The code aims to prevent falsely inflated appraisals by increasing appraisers’ independence, eliminating the relationships between mortgage brokers or real estate agents and appraisers.

But HVCC has caused a maelstrom in the real estate appraisal industry, where critics—even those who support the code’s overall goal of preventing fraudulently inflated appraisals—claim the code is harming the appraisal industry as a whole.

Under HVCC, mortgage lenders—not mortgage brokers or real estate agents—must select and hire appraisers for home loans that will go to Fannie Mae or Freddie Mac, the government-sponsored entities that have become the nation’s largest mortgage finance companies. As of May 1, 2009, Fannie and Freddie no longer purchase loans that do not comply with HVCC.

**Lawsuit Brings New Code**

The code was negotiated as an agreement among New York Attorney General Andrew Cuomo (D), Fannie Mae, Freddie Mac, and the Federal Housing Finance Agency, which regulates Fannie and Freddie.

The agreement came in response to a lawsuit Cuomo filed against the appraisal management company eAppraiseIT. The suit charged eAppraiseIT had succumbed to pressure from one of its clients to inflate appraisals—a not-uncommon practice that helped contribute to the housing bubble and, later, the housing collapse, says T.J. McCarthy, a Chicago-area appraiser and member and former chairman of the Illinois Real Estate Appraisal Licensing Board.

“Anyone in a position to benefit financially from the outcome of an appraisal should not be involved in selecting the appraiser or having direct communication with the appraiser,” said McCarthy—say the rest of HVCC is many steps in the wrong direction. Criticism of the code has been rampant. Among other things, critics argue HVCC has led to lower house prices, that it is not being enforced, and that the code is harming the appraisal industry.

“Eighteen months ago 60 percent of appraisals came from brokers,” said Bill Garber, director of government and external relations for the Appraisal Institute, a Chicago-based association for professional real estate appraisers. “Appraisers are frustrated.”

Exemplifying appraiser anger with the new rule, the industry newsletter AppraisalPress titled an article “HVCC: The Cure Is Worse Than The Disease.”

At the end of December, one New York appraiser was arrested for threatening to kill Attorney General Cuomo, so strong were his objections to the code.

In July 2009, the Federal Housing Finance Agency issued a report on HVCC in which many of the appraisers’ complaints were addressed. The report stated HVCC is “serving the intended purpose” and is not—contrary to reported “misinformation,” as the agency report called it—resulting in low appraisals, appraisals being performed by unqualified appraisers, and increased closing costs.

“The poor practices of the past are being corrected and lessons learned are being addressed,” the FHFA report stated.

**Bill Imposes Regulations**

Those lessons may be addressed on a national scale. The Wall Street Reform and Consumer Protection Act of 2009, which passed the House in December 2009 and is pending in the Senate Committee on Banking, Housing, and Urban Affairs, would end HVCC and call for national regulations ensuring appraisers’ independence.

McCarthy says serious damage will already have been caused to the appraisal industry by the time any such bill goes into effect. He says appraisers are already among the most regulated licensed professionals, and bad appraisers will still thumb their noses at regulators.

Even so, McCarthy says he would support the bill and believes other appraisers would, too.

“Would the House bill be a step in the right direction? I absolutely think it would be. Still, enforcement is the key,” said McCarthy.

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**INTERNET INFO**


"Anyone in a position to benefit financially from the outcome of an appraisal should not be involved in selecting the appraiser or having direct communication with the appraiser.”

T.J. McCarthy, Appraiser Member and Former Chairman Illinois Real Estate Appraisal Licensing Board
New Bill Aims to Help Fla. Insurers, Customers

By Christian R. Cámara

Florida state Rep. Bill Proctor (R-St. Augustine) and state Sen. Bill Bennett (R-Bradenton) recently revived their efforts to deregulate property insurance rates in the Sunshine State.

Last year the two legislators’ Consumer Choice Bill received overwhelming approval from Florida legislators (85 percent favored it), but it was vetoed by Gov. Charlie Crist (R).

While last year’s bill would have deregulated rates for larger, well-capitalized companies, the bill recently filed by Proctor and Bennett aims to deregulate rates for any private insurer—large or small—that chooses to participate.

The bill retains all the consumer protections and disclosure requirements of its predecessor, including mandates that companies educate consumers about their ability to choose between policies and companies whose rates are regulated versus those that are not.

Private Market Eroding

“What we have done in past years is put the state in the possibility of bankruptcy” by involving the state in backing property insurance, said Proctor. “This [bill] is to revitalize the private insurance market in Florida, which we know is eroding.”

“What we really wanted to do is trust the consumers, “added Bennett. “Anybody should be able to shop with any company they want.”

The state’s Office of Insurance Regulation would maintain nearly all its existing regulatory oversight, except its ability to deny a rate filing for excessive-ness. This would allow rates for the new types of deregulated policies created by the bill to be based on the market and consumer buying habits, rather than government bureaucrats.

The state would retain its ability to regulate for solvency to ensure premiums are sufficient so insurers are financially sound enough to pay claims.

Reorientation Process

Though the measure was vetoed, last year’s legislative passage of the Consumer Choice Bill, as well as another sweeping, market-freeing insurance reform package that was signed into law, signaled a major property insurance policy reorientation.

In 2007 Crist passed a series of reforms through the Republican-controlled legislature that dramatically expanded the government’s intrusion into Florida’s property insurance market. The state-run insurer of “last resort”—Citizens Property Insurance Corporation—was unleashed to compete with private carriers; price controls were established; rates were artificially reduced and frozen; and massive amounts of reinsurance risk were transferred from private companies to taxpayers.

Those changes had noticeable effects on the market. Most large insurers have either cut back on writing insurance policies or left the state altogether; the state-run insurer is now Florida’s largest property insurance provider; and half of the state’s remaining private insurance companies are losing money—without a hurricane having hit the state.

“This [bill] is to revitalize the private insurance market in Florida, which we know is eroding.”

BILL PROCTOR
STATE REPRESENTATIVE
ST. AUGUSTINE, FLORIDA

BOOK REVIEW

For Crying Out Loud: From Open Outcry to the Electronic Screen
By Leo Melamed
Wiley, 2009, 343 pages, $39.95

Innovation Drives Markets and the Maker of Financial Futures

By Matthew Glans

Leo Melamed created the financial futures market nearly 40 years ago. In For Crying Out Loud, he tells how the Chicago Mercantile Exchange became one of the world’s largest futures exchanges and a leader in providing risk management services.

In a word: innovation. The book describes “the Merc’s” singular drive to be the industry leader in both the products it offers and the efficiency of its services. It’s a testament to the strength of the Merc’s leadership and refusal to stand still.

The Chicago Mercantile Exchange was the first exchange to offer futures contracts for financial instruments, launching the International Monetary Market in 1971. Two decades later, CME Group launched Globex, the first global electronic trading platform, becoming the first futures exchange to move away from the open outcry system of trading to a new digital platform.

These two landmark innovations were the brainchildren of Melamed, now chairman emeritus of CME Group. They did not come about without opposition. In For Crying Out Loud, Melamed discusses the transition of the Merc from its traditional open-outcry roots to the current electronic system of trading. He describes from firsthand experience the clashes of power and personality that defined the decade-long transition.

Innovation, Growth

Guided by his belief that “The Firsteth with the Mosteth, Winneth” and his confidence in the future of electronic trading, Melamed fought against what the late Nobel Prize-winning economist Milton Friedman called “the tyranny of the status quo,” embodied in the Merc’s reliance on the open outcry system, an anachronism that Melamed believed left the CME dangerously vulnerable to competitors.

Through a combination of shrewd planning, strong teamwork, and great timing, Melamed and his colleagues were able to guide the Merc into a new, electronic era, staving off competitors and elevating the Merc to a new level of prominence.

Melamed’s other achievements recounted in the book include the Chicago Mercantile Exchange becoming the first publicly traded U.S. exchange, a historic merger with the Chicago Board of Trade, and, in 2008, the Merc’s acquisition of the New York Mercantile Exchange.

For Crying Out Loud is not merely a blow-by-blow account of Melamed’s fight for change. It provides an inside look at the relationships and battles that formed the new CME ...

“For Crying Out Loud is not merely a blow-by-blow account of Melamed’s fight for change. It provides an inside look at the relationships and battles that formed the new CME ...”

Matthew Glans (mglans@heartland.org) is a legislative specialist in financial services for The Heartland Institute.
Louisiana May Revamp Insurer; Regulators Argue for Caution

By Eli Lehrer

Public policy advocates and state regulators say Louisiana's legislature should take a deliberate, skeptical look at a commission's recommendation that the state restructure its property insurer of last resort.

The state's Commission on Streamlining Government has suggested the state phase out the Louisiana Citizens Property Insurance Corporation and revert to the joint underwriting association structure that existed in the state before 2003.

Louisiana Citizens, an agency of state government, writes property insurance for those unable to find it in the private market. A joint underwriting association also would write insurance for people unable to find it elsewhere, but it is structured as a private entity that all property insurers in the state must join and help support.

As a government agency, Citizens is exempt from some taxes a JUA would have to pay. And by virtue of being part of state government, it has greater explicit and implicit access to the state's line of credit. In the wake of Hurricane Katrina, the state issued more than $1 billion in bonds to cover Citizens' deficits. Surcharges on insurance policies around the state serve to pay down the bonds.

‘Big Hornswoggle’

State auditors have announced Citizens will almost certainly receive a negative audit. State Treasurer James Kennedy, the chief proponent of eliminating Citizens, was blunt in his assessment of the agency.

“I think the passage of Citizens ... constitutes one of the biggest hornswoggles of the taxpayers of Louisiana in my lifetime,” he told the New Orleans Times-Picayune.

“The Streamlining Commission’s goal of reducing the cost of state government can be furthered by effective insurance reform. Phasing out Citizens makes sense, though it needs to be done carefully.”

KEVIN KANE, PRESIDENT
PELICAN INSTITUTE

Top insurance overseers, including Commissioner of Insurance James Donelon and Citizens CEO John Wortman, spoke out in the agency’s defense.

“In the long run [abolishing Citizens] would add to the state’s exposure,” Wortman told the newspaper.

A report from the Louisiana-based Pelican Institute and The Heartland Institute recommended the state carefully consider its options before acting to revise Citizens’ structure. The report says Donelon has done a good job overseeing Citizens and any revised structure should take into account the agency’s successes as well as its problems.

Equal Treatment

Among other things, the report suggests Louisiana subject any new entity to many of the same open government and ethics rules that apply to Citizens; realize that simply changing the entity’s structure probably will not solve any problems; and require any replacement for Citizens to purchase a significant amount of private reinsurance.

“The Streamlining Commission’s goal of reducing the cost of state government can be furthered by effective insurance reform. Replacing Citizens makes sense, though it needs to be done carefully,” said Pelican Institute President Kevin Kane.

“The new insurer of last resort should not compete with private companies or put taxpayers on the hook for future bailouts,” Kane said. “And its finances should be completely transparent.”

Eli Lehrer (ehrler@heartland.org) is a senior fellow of The Heartland Institute and director of its Center on Risk, Regulation, and Markets.

Michigan House Passes Auto Insurance Regulations

By Dennis Kelly

Michigan’s House of Representatives has approved a package of bills that proponents claim will lower auto insurance rates and opponents assert will do the opposite.

Next step for the legislative package is the state Senate. If approved there and signed by Gov. Jennifer Granholm (D), the bills would make it illegal for insurance companies to use factors such as a driver’s occupation, education level, or credit history to set rates or deny coverage. The bills also would prohibit insurance companies from selling consumers’ personal information without their consent and would bar insurance commissioners from going to work for an insurance company within two years of leaving office.

About half the bills in the 12-bill legislative package, dubbed Fair, Affordable Insurance Rates (FAIR), passed in the Democratic-controlled Michigan House. Republicans in the House objected to the bills, citing them as a catalyst for driving auto insurers to take their business to other states.

The Michigan Senate, where Republicans have the majority, adjourned before Christmas without taking action on the legislative package.

“We understand Senate Republicans have little or no interest in moving any of these pieces of legislation, other than the one prohibiting the insurance commissioner from working for [the] insurance industry within two years of leaving office,” said Tom Shields, a spokesman for the Michigan Insurance Coalition.

Insurers acknowledge a problem with Michigan’s auto insurance system but do not see the FAIR legislative initiative as the answer. Insurers say one of the biggest culprits is Michigan’s “no-fault” system, which gives state residents no choice but to buy what’s described as “a Cadillac” auto insurance policy.

“If the problem is high rates, and for some that is absolutely a problem, insurers believe giving rate payers more options in the kind of insurance they want to buy would allow them to control their costs,” Shields said. “Our no-fault system is unique. It provides unlimited medical coverage, which adds significant costs for everyone and makes [the cost of] that coverage the highest in the country.”

“Michigan should follow the lead of states such as South Carolina, Massachusetts, and even New Jersey, which once also had unacceptable automobile insurance systems but turned them around by allowing insurers to better compete with one another on rates and types of coverage,” said John Birkenbine, assistant vice president for the American Insurance Association, in a statement. “Such competition ultimately benefits all consumers with more choices for products and prices.”

Dennis Kelly (dk550@aol.com) is a freelance writer living in Columbia, Maryland.
Market Institutions Can Protect Against Fed’s Manipulations

By Cathy Fasano and Jim Johnston

The nation is in the midst of a financial crisis, according to most analysts, but arguments rage among them over what to do about it.

At the heart of government policy is the Federal Reserve, which some people blame for many of the economic woes. The Fed manipulates the nation’s money supply and interest rates and has expanded its purview to cover investment banks and federal regulation of credit default swaps that were created to insure against the collapse of housing securities.

Those securities were the product of a widespread program urged by the government to extend home ownership to those who did not qualify under normal credit criteria.

Many Fed critics, including Rep. Ron Paul (R-TX), say the Fed should be abolished. Paul makes a strong case for this in his new book, End the Fed. Paul also has introduced a bill to audit the Fed’s actions.

However, Paul and other critics could strengthen their case by emphasizing there are already viable and functioning alternative market institutions that offer better hedging opportunities than are provided by the Fed and other government agencies.

Merc Transparency, Fed Murkiness

One such institution is the Chicago Mercantile Exchange Group, called the

Merc. The Merc trades liquid contracts in foreign exchange, gold, interest rate derivatives, energy derivatives, and Standard & Poor’s indexes (which correlate with the general level of economic activity). Many of the contracts extend to a decade or more.

Businesses, individual investors, and hedge funds use these contracts and those on other exchanges to hedge their risk exposure from the changing value of the dollar and other currencies, interest rate movements, expected changes in overall economic activity, and fluctuations in energy prices.

There are some important fundamental differences between the Fed and the Merc.

The minutes of the Fed’s Open Market Committee, which sets Fed policies, are not made public until six months after the committee meets. Fed policies also are not guaranteed. They can change on a whim.

The contract prices at the Merc and other exchanges, by contrast, are instantaneously known and guaranteed. Moreover, there are clearing institutions that protect the honoring of trades.

Outstanding open interest is settled twice a day at the Merc, to reduce the temptation of traders to default. When traders try to default, their positions are covered by the Merc, which acts as counterparty and guarantees the success of the trades. No trade has failed in the Merc’s 110-year history, former Merc Chairman Leo Melamed reports in his 2009 book, For Crying Out Loud.

IN OTHER WORDS

“There is growing recognition that our financial system is running a doomsday cycle. Whenever it fails, we rely on lax money and fiscal policies to bail it out. This response teaches the financial sector a simple lesson: take large gambles to get paid handsomely, and don’t worry about the costs—they will be paid by taxpayers (through fiscal bail-outs), savers (through interest rates cut to zero), and many workers (through lost jobs). Our financial system is thus resurrected to gamble again—and to fail again. Such cycles have been manifest at least since the 1970s and they are getting larger. This danger has even been recognized at the Bank of England, where Andrew Haldane, responsible for financial stability, recently published an eloquent critique of what he calls our ‘doom loop.’

“Not surprisingly, Ben Bernanke, chairman of the Federal Reserve, does not agree that blame rests squarely with our monetary authorities. In a speech in Atlanta, he (incredibly) argued that extremely low interest rates on his watch—and decades of similar bail-outs of the financial sector—did not play a role in the recent collapse. Like an old-time Soviet bureaucrat, he put the blame on bad regulators and argued that more complex rules are needed to make regulation ‘better and smarter.’"

Peter Boone and Simon Johnson
The Financial Times
January 18, 2010

Ben Bernanke is chairman of the Federal Reserve.

Protecting Traders vs. Trades

The Fed and other government agencies behave far differently from the Merc and other exchanges. The government protects the traders, especially the big ones. The Merc, on the other hand, protects the trades.

The government creates a moral hazard and promotes bad behavior by bailing out large institutions, whereas the Merc and other exchanges promote good behavior and the honoring of contractual obligations.

In August 1971 the Nixon administration, at the suggestion of the late Nobel Prize-winning economist Milton Friedman and colleague George Shultz, eliminated the fixed exchange rates and convertibility of the dollar into gold. Melamed recognized an opportunity to fill the gap by trading foreign exchange futures and options. Friedman endorsed the idea, and trading began in May 1972.

Since then the hedging of foreign exchange risk has been a combination of exchange-traded and over-the-counter contracts such as those at the Merc.

Worries Over Regulation

Of course, overregulation or the institution of a proposed tax on financial transactions could spoil the hedging. Too few people appreciate that traders provide crucial liquidity and, more importantly, do targeted arbitrage. Without these actors the markets would be substantially less efficient.

Markets are available at the Merc and other exchanges to substitute for a flawed Federal Reserve, as long as the government does not destroy their effectiveness by overregulation.

Cathy Fasano (cfasano@maplecity.com) is a longtime consultant to trading institutions. Jim Johnston (jamesjohnston@cs.com) is an economic advisor to The Heartland Institute.
Unlimited Backing for Fannie, Freddie Draws Fire

By Steve Stanek

Annual reports for Fannie Mae and Freddie Mac used to declare, “Neither company has received any taxpayer dollars. In addition, no taxpayer funds are needed for their safety and soundness.”

Now, however, the federal government has pledged unlimited taxpayer backing for the failing mortgage giants—and economists and Washington politicians are criticizing the move.

The announcement came after major financial markets had closed on Christmas Eve, when most news organizations would be running a skeleton crew. It also came just days before Treasury Department officials would have had to go to Congress for permission to ignore a $400 billion limit of support the lawmakers had imposed.

“Giving unlimited funding to Fannie and Freddie is like giving liquor and car keys to two irresponsible teenagers,” said Mark Thornton, an economist at the Mises Institute in Auburn, Alabama. “It puts the taxpayers at great risk and only worsens the financial outlook for the nation and economy.

‘Running Out of Bullets’

“Long-term interest rates are inching up, and the outlook for foreclosures in 2010 is very bad, while our government is backing nearly 90 percent of new home mortgages. The government is running out of bullets in its war to restore confidence,” Thornton said.

Fannie Mae and Freddie Mac purchase home loans from lenders and sell them to investors. Together they own or guarantee almost 31 million home loans, about half of all mortgages in the nation, worth about $5.5 trillion.

The companies were created by the federal government decades ago to expand home ownership but were ostensibly private operations called government-sponsored entities.

Critics have long said the GSEs had implicit government backing. The backing became explicit in September 2008 when then-Treasury Secretary Henry Paulson announced the creation of a new body—the Federal Housing Finance Agency—would put Fannie and Freddie under government conservatorship. This action followed staggering financial losses and the collapse of the housing market.

To date taxpayers have spent more than $110 billion to prop up Fannie and Freddie.

“More than a year after the financial meltdown caused by the Fed’s easy-money policies and years of subsidies to home owners, federal policymakers appear to have learned nothing from their mistakes,” said Chris Edwards, director of tax policy at the Cato Institute. “Fannie Mae and Freddie Mac’s cheap mortgage policies were central to the housing boom and bust, so to prevent a repeat disaster we should withdraw subsidies from housing markets and allow them to find a sustainable equilibrium.

“Fannie and Freddie ought to be fully privatized and completely cut off from Washington’s money spigot,” Edwards added.

Members of Congress from both sides of the political aisle have expressed varying degrees of consternation over the Treasury Department’s surprise move.

House Energy and Commerce Committee Chairman Henry Waxman (D-CA) criticized what he described as the “blank check” for Fannie and Freddie.

Fellow California Congressman Darrell Issa, a Republican, told reporters the move is “a continuation of the bailout policies that have mortgaged away the future solvency of our country.”

Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of Budget & Tax News.

Financial Transaction Tax Proposal Gets Mixed Response in Congress

By Matthew Glans

After a year of multibillion-dollar bailouts of large Wall Street firms through programs such as the Troubled Asset Relief Program (TARP), many federal lawmakers are looking for payback from the financial industry. One idea is for a financial transaction tax.

Rep. Peter DeFazio (D-OR) and 25 other members of the House of Representatives have introduced the Let Wall Street Pay for the Restoration of Main Street Act (HR 4191), which would impose a tax on nearly all financial transactions, including stocks, bonds, futures contracts, credit default swaps, and option transactions.

Sen. Tom Harkin (D-IA) said he plans to introduce a similar bill in the Senate.

Did During Depression

“Until 1966, the United States taxed all stock transactions and transfers,” Harkin said in a news conference call. “Indeed, Congress doubled the transaction tax rate during the Great Depression in order to finance economic recovery initiatives.”

The reaction in Washington has been mixed. Reciprocity with other nations seems to be a sticking point for many politicians. House Speaker Nancy Pelosi (D-CA) said in early December the idea has “a great deal of merit” as long as other major nations also do it.

Two Sides of Wall Street

Wall Street’s response to the transaction tax is mixed as well. In an interview with The Hill, John Bogle, founder of the Vanguard Group investment management company, favored the tax.

But other investment companies opposed it. In a press statement, online broker TradeKing voiced a concern of many trading companies.

“Our fear is that any tax on securities transactions will only serve to once again penalize everyday investors who are struggling right now to drive return on their shrinking investments to pay for a child’s college tuition, care for aging parents or save for a retirement that is looking further off in the distance every day. These are precisely the people our country is counting on to help pull us out of our current economic recession, but by burdening the investment system with an added transaction cost, we will only make that process longer and harder.”

Matthew Glans (mglans@heartland.org) is a legislative specialist in insurance and finance at The Heartland Institute.
Residential’s Bad, but Commercial Real Estate’s Worse in NYC

“Yikes! What a year.” That’s how Stuart Elliott (right), editor in chief of The Real Deal, a New York City-based monthly real estate news magazine and daily Web site, opened his first Editor’s Note of 2010, reviewing NYC’s 2009 real estate market. Things could have been worse, however, Elliott noted.

For more perspective, we spoke with Elliott about the real estate situation in New York City.

By Brien Farley

Heartland: What’s worse in New York City, the residential or the commercial market?

Elliott: The commercial market. There’s a stat out there that says building sales have dropped 92 percent from the previous year. That’s about three or four sales for every 100 you had last year. And as far as prices, there have been so few transactions that it’s hard to tell how far prices have fallen in the commercial market. But generally prices have fallen somewhere in the range of 70 percent.

With office leasing, there’s a lot more vacancies than there were before, and also the rent for office space has dropped something like 30 percent in the last year.

Heartland: With prices so low, isn’t this a good time to buy?

Elliott: It is a good time to buy, but when it’s a down market there’s a lot of fear. People think if prices go down they may just go down even more. Another huge thing right now is the credit market. The ability to borrow money has just really limited. Banks froze up back in mid-2007, and since then there hasn’t been that much availability of money out there to borrow.

Heartland: In March 2009, Fannie Mae began requiring commercial properties be 70 percent sold before Fannie would help with financing. What has this requirement done?

Elliott: It’s definitely destructive to sales, but you could make the counter-argument that it might be dangerous to finance those sales anyway. It definitely leaves developers in the lurch.

Here in New York you have condo towers that are having real trouble selling, that are mostly vacant. But it’s definitely worse in other cities such as Miami, Las Vegas, and Detroit.

Heartland: Why has New York City not suffered as badly as those cities?

Elliott: In Miami and Las Vegas you’re seeing a lot more investors buying. In New York there are a lot more people who buy as an end user; they buy the apartment to actually use it, to live in it. I think the more investors you have, the more volatile and unstable a market you have.

If you look at Detroit, the economic base there is terrible with the [problems with the] car companies. Wall Street is the economic driver of New York City. While it’s been hit, it hasn’t been hit as hard as the economic driver in Detroit.

Also, New York doesn’t have the same sort of sprawl as other cities. You look at places like Phoenix that just keep building out and out; you have a massive oversupply of housing. In New York there’s excess housing but not quite at that level.

Elliott: During the Great Depression, government didn’t step in and try to fix things very quickly. This time the federal government has stepped in considerably. You could say that it’s possibly been successful. It’s staved off things for now.

But I think the thing people are worried about is seeing how the federal government is issuing so much money that long term you could have serious problems for the United States. Come 2018, 2019 this could really come back to bite us.

A specific example of harmful government intervention is the Home Valuation Code of Conduct (HVCC). They tried to fix an appraisal law that sort of contributed to the subprime bust, by reforming that whole industry. They actually made things worse.

An example of successful government intervention has been the first-time homebuyers tax credit. That’s helped a lot of first-time buyers come out and make purchases.

Heartland: What fundamentals have to be addressed for the situation to improve?

Elliott: I think unemployment is a fundamental. That would need to get better for the market to improve. It’s hovering around 10 percent in New York. That’s pretty high.

Foreclosures are another big issue. Those are expected to get higher before they get lower.

Companies need to be expanding and leasing more. As the economy gets stronger, companies will get stronger. That’s another fundamental.

Banks loaning money more readily, that’s another fundamental thing. I think the credit markets have to unfreeze for there to be more economic activity and home-buying.

Heartland: What will it take to unfreeze the credit markets?

Elliott: Banks with problem loans where the borrowers are not able to pay have not really been confronting the problem. They call this “extending and pretending,” “delay and pray,” and “kicking the can down the road.”

I think once banks start dealing with these bad loans on their books and sell them off, get a balance sheet that makes sense without all these hidden problems in it, then I think there will be a more solid basis on which to move forward and people will feel more comfortable lending money.

Brien Farley (brien.farley@gmail.com) writes from Genesee, Wisconsin.
Sarbanes-Oxley Might Be Coming to an End

By John Berlau

Prospects for substantial relief from or repeal of one of the most burden-some corporate regulations in recent history have suddenly grown in Congress and in a constitutional challenge before the U.S. Supreme Court.

The regulation is known as the Sarbanes-Oxley Act of 2002, or SarbOx.

Rushed through Congress and signed by President George W. Bush in the wake of the Enron and WorldCom scandals in 2002, the law has quadrupled the costs of the audit process for public companies and achieved little in preventing fraud.

Rep. John Adler (D-NJ) recently sponsored a successful amendment to the financial regulation bill being pushed by the Obama administration that would exempt smaller public companies—those with market valuations of $75 million and below—from the particularly onerous “internal control” audits mandated by Section 404 (b) of SarbOx.

Despite the opposition of powerful House Financial Services Committee Chairman Barney Frank (D-MA), 101 Democrats joined all but one Republican in voting to retain the relief from SarbOx in the final financial bill that passed the House in December.

And on December 7 the U.S. Supreme Court heard a case on Sarbanes-Oxley that could lead to a gutting of a substantial part of the law and a major positive impact on U.S. capital markets.

Prominent attorneys, including Pepperdine Law School Dean Ken Starr, argue the structure of Sarbanes-Oxley’s Public Company Accounting Oversight Board lacks constitutional accountability because it bypasses presidential appointment, Senate confirmation, and the executive branch’s power to remove.

Because of the high-paying work it creates for auditors in helping firms comply with the law, SarbOx has cost the economy $1.4 trillion in direct and indirect costs. And new research from economist Kenneth Lehn of the University of Pittsburgh shows such costs reduce firms’ research and development spending and business investment, two important precursors for job growth.

SarbOx compliance processes can significantly delay going public even for a company as large as Google Inc. Tech journalist John Battelle reports in his book The Search that because Google “made its money literally pennies at a time, from millions upon millions of microtransactions,” it “had to significantly restructure its advertising reporting system from the ground up” to meet SarbOx internal control reporting requirements.

While SarbOx imposes this type of burden on a company like Google, which had a market valuation of more than $1 billion before it went public, the burden for smaller companies trying to raise capital can be much greater. That helps explain why in the post-SarbOx years initial public offerings slowed dramatically in the United States, with fewer IPOs in the booms year of 2006 than in 1991, when the economy was in recession.

A repealing or scaling back of Sarbanes-Oxley could boost prosperity as entrepreneurial energies are unleashed and more investment is allowed to flow to promising new companies.

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Health Care Tax Increases Shred President’s Pledges

By John Kartch

President Barack Obama is on a collision course with his central campaign promise, a “firm pledge” not to raise “any form” of taxes on families making less than $250,000 per year.

The Senate health care bill is loaded with 18 tax increases, seven of which break the president’s pledge. He heartily endorses the bill nonetheless.

Obama reiterated his campaign promise in his nationally televised speech to a joint session of Congress in February 2009: “If your family earns less than $250,000 a year, you will not see your taxes increased a single dime. I repeat: not one single dime.”

No Caveats

Asked afterward if the promise applied to health care reform, White House spokesman Robert Gibbs replied, “The statement didn’t come with caveats.”

As House Speaker Nancy Pelosi (D-CA) cloistered with Senate Majority Leader Harry Reid (D-NV) to work out the differences between the House and Senate versions of the health care bills, the White House has largely escaped national media scrutiny of the tax implications about to befall Americans if the legislation becomes law.

Let’s take a look at the seven pledge-breaking tax hikes:

• Individual Mandate Excise Tax: For the first time in American history, the federal government would compel you, as a condition of merely existing, to enter into a private contract. Starting in 2014, anyone not purchasing “qualified” health insurance—as defined by the government—would pay an excise tax of $495 to $1,485 a year.

• Employer Mandate Tax: Under this provision of the bill, if an employer does not offer health coverage and at least one employee qualifies for a health care tax credit, the employer must pay an additional nondeductible tax of $750 for all full-time employees. This would apply to all employers with 50 or more employees. If the employer requires a waiting period to enroll in coverage of 30 to 60 days, there is a $400 tax per employee ($800 if the period is 60 days or longer).

• FSA Cap: Thirty million American families use flexible spending accounts. The Senate health care bill would impose a cap of $2,500 on these accounts, which are currently unlimited under federal law. Most people use their FSA for expenses such as insurance deductibles, copayments, and eyeglasses, but families with special-needs children would be especially hard hit by the new cap. These families often rely on FSA dollars for special-needs education, which can cost thousands of dollars per year.

• “Haircut” for Medical Itemized Deductions: Under current law, if you want to deduct medical expenses on your tax form you must reduce their total by 7.5 percent of your income. The Senate bill raises this “haircut” from 7.5 percent to 10 percent of your income.

• Tax on Indoor Tanning Services: After being rightly mocked on late night television for the “Bo-Tax” in the previous version of their bill, Senate Democrats have replaced it with a “Tanning Tax.” Those using indoor tanning salons will have to pony up a 10 percent excise tax on the price of their bronzing.

Middle Income Not Exempt

None of the above tax hikes includes an exemption for Americans making less than $250,000 per year.

When challenged on his tax promise in a face-to-face interview last September with George Stephanopoulos, then the host of ABC-TV’s This Week, Obama denied the individual mandate excise tax was really a tax. Stephanopoulos then read aloud the dictionary definition of “tax” to Obama. The president laughed it off and accused the host of “stretching a little bit.”

Then on January 14 came word the administration and top Democrat leaders had agreed “Cadillac” health insurance plans—those costing more than $23,000 for family coverage or $8,500 for single coverage—would not be taxed until 2018 if the policyholder belongs to a union. Such plans for persons not in unions would be taxed beginning in 2013.

Eroding Support

With numerous polls showing most citizens oppose the health care overhaul and opposition continues to grow, the president broke still another promise, this one to have health care negotiations in public and for all to see on C-SPAN.

White House and legislative leaders walked away from the usual conference committee procedure used to reconcile differing versions of House and Senate bills. Instead of a conference televised and covered by reporters, a handful of lawmakers have met in secret to reconcile the two bills.

“Those using indoor tanning salons will have to pony up a 10 percent excise tax on the price of their bronzing.”

John Kartch (jkartch@atr.org) is director of communications at Americans for Tax Reform in Washington, DC.
By Thomas Cheplick

The federal debt ceiling is set to rise to close to $14 trillion just before Valentine’s Day, which will move America one step closer to default, according to one renowned economist.

“[America] is going to default on its debt,” said David Henderson, editor of The Concise Encyclopedia of Economics and an economics professor at the Naval Postgraduate School in Monterey, California. He is a protégé of Nobel Prize-winning economist Paul Samuelson of MIT, who recently died at age 94.

“At some point, with the raising of the federal debt ceiling level, payments on Medicare, Medicaid, foreign adventures, ... it just won’t be sustainable,” Henderson said.

“Already they are set to be paying, by 2019, $700 billion on interest alone on the debt. The government will not be able to raise funds without paying substantially higher [interest] rates, too, so instead they may say, ‘Hey, maybe let’s not pay and save a chunk,’” Henderson added.

Stopping Payments

The government could do this in several ways, including paying no interest and only some principal, paying some interest and no principal, or paying nothing on interest or principal, Henderson added.

“If it happened, it would happen very quickly,” Henderson said.

Syndicated columnist and longtime political analyst Cal Thomas thinks Congress’s decision to raise the debt ceiling shows the lawmakers do not understand basic laws of economics.

“[Raising the national debt ceiling] is part of a larger problem, and, that is, we continue to spend beyond our means,” Thomas said in an interview for this story. “The world, predominantly China in this case, cannot continue to buy U.S. debt. We should be concerned. No nation can live constantly spending money it does not have.

“There are laws of economics, laws of nature, and if you violate economic laws, you splat economically,” Thomas added. “People and nations cannot live like this.”

Expects Problem to Persist

Henderson says the national debt and federal budget deficits will be perennial issues. Unless many social insurance programs are reformed and more economic deregulation is implemented, there’s little chance America will avoid default, he says.

“We would need a ‘Ross Perot-squared’ politician, in a sense, to fix this,” Henderson said, referring to the billionaire businessman from Texas who ran for president in 1992 as a third-party candidate and received 19 percent of the popular vote, the highest percentage for a third-party candidate since Teddy Roosevelt in 1912. Perot’s major themes were attacks on soaring government spending, entitlement program costs, and indebtedness.

Henderson said he tells his college students “the federal debt and deficit are going to be the major public policy issue for the rest of their lives.” He warns unless the government raises the ages for Medicare and Social Security eligibility and takes other steps to control entitlement program costs, “avoiding the problem cannot be done. Things would have to be aligned just right; otherwise it is more likely for some kind of default.”

Deficits Increasing Under Obama

Thomas notes Democrats who protested President George W. Bush’s budget deficits have remained nearly silent in the face of President Barack Obama’s much larger budget gaps. The federal government ended the last fiscal year with a $1.4 trillion budget deficit, and Obama projects $1 trillion annual budget deficits for the foreseeable future.

“I find it interesting that Democrats expressed much alarm when the budget deficit under President Bush was around $450 billion but now are not raising a peep when it is in the trillions,” Thomas said. “I think there ought to be a referendum or a public vote on whether we want the Congress to continue to mortgage our financial future, because the main problem is the politicians just do not care.”

Bipartisan Vote Buying

Thomas says both parties are guilty.

“They want to buy votes and do not care [about the deficit]. Democrats want to expand entitlement programs because giving more people a government check wins them votes in the next election. Republicans have done the same,” Thomas said.

“Politicians want all the perks of office and are willing to do this to keep their job. That is what it is all about. They need to be able to dole out favors to keep their perks. The Founding Fathers understood this, which is why they were in favor of limited government,” Thomas added.

Henderson agrees politicians lack incentives to combat the budget deficit and national debt. As a result, he says, they are not acting in the nation’s long-term interests.

“There is just no incentive for any individual within the government to care about this,” Henderson said. “Look at how cavalier President Bush was and now also how President Obama is. ... Then just look at Congress. This is the reason we will get into a default—because we are not acting in the long-term interest of the nation.

Thomas also blames the belief many policymakers have in Keynesianism, the economic approach promoted by British thinker John Maynard Keynes in the 1930s. He advocated government spending and deficits to stimulate economic growth.

Thomas calls it “a cultlike philosophy that encourages debts and says there is only one economic pie and it is all about what share of the pie people take.”

Thomas Cheplick (thomascheplick@yahoo.com) writes from Cambridge, Massachusetts.

“At some point, with the raising of the federal debt ceiling level, payments on Medicare, Medicaid, foreign adventures, ... it just won’t be sustainable.”

David Henderson

Editor, The Concise Encyclopedia of Economics
Economics Professor, Naval Postgraduate School
Unshackle Upstate New York, Citizens’ Group Argues

By Nick Baker

With its high taxes and overregulation, New York State has consistently ranked as one of the worst places in the nation to do business. Particularly hard hit over the years has been upstate New York, which has seen many employers flee during the past few decades.

One group hoping to change that trend is Unshackle Upstate, a bipartisan collection of more than 75 businesses and trade organizations formed in 2006 to achieve legislative reforms and make Upstate a better place to do business.

Unshackle Upstate has grown recently as taxpayers and business operators have become more upset at the policies of the state legislature.

Many Upstate residents complain the state legislature is dominated by New York City politicians who ignore their concerns.

“Taxpayers are the single-largest interest group in New York, and they are listened to the least,” said Unshackle Upstate Executive Director Brian Sampson.

Sampson said New Yorkers have tolerated higher-than-average taxes and burdensome regulations for so long because Upstate is “a phenomenal place to live and raise a family,” with excellent universities and opportunities for outdoor activities.

Tax Base, Job Pool Shrink

In the past several years, however, residents have been feeling the burdens of heavy taxes and regulations more than ever. Large employers such as General Motors and Bausch & Lomb have pulled up stakes, leaving behind a shrinking tax base and thousands of unemployed.

The state has been experiencing an exodus of young people, according to a 2006 U.S. Census report. Between 1990 and 2004 the number of 25- to 34-year-old residents in the 52 counties north of Rockland and Putnam counties declined by 25 percent. Those figures stand in stark contrast to those of the New York City region, which saw a 1.5 percent increase of residents in that age range since 1990.

“You don’t just magically make it up with new births. These are people who are starting careers, starting families, buying homes,” said David Schaffer, president of the Public Policy Institute of New York.

Sampson said New Yorkers reached a breaking point during the 2009 legislative session when lawmakers added 9 percent, or $11 billion, in new spending to the state budget. Six Assembly Democrats, all from Upstate, joined their Republican colleagues in opposing the budget.

During the 2009 local and county elections, New Yorkers took their frustration out on incumbents. Among the upsets were Democrat county executives in Westchester and Nassau counties who lost reelection to their Republican opponents despite having an advantage in party registration. New York City Mayor Michael Bloomberg (R) won reelection by just four points despite being the incumbent and spending $100 million on his campaign.

In addition to calling for the government to hold the line on state spending, Unshackle Upstate has focused attention on tax relief and reducing the cost of energy, among other priorities.

“New York State has become the Imelda Marcos of state programs, and it’s simply not affordable anymore,” Sampson said, referring to the widow of the former president of the Philippines, whose lavish spending on hundreds of gowns and thousands of shoes made her a focal point of derision for her husband’s opponents.

Sampson said out-of-control property taxes are the number one issue facing the state, and reforming the property tax system is necessary to reduce the cost of doing business.

In addition, Unshackle Upstate believes New York must institute a sound energy policy. The average price of electricity is 13 cents per kilowatt hour, second-highest in the United States. Unshackle Upstate supports the renewal of Article X, the power plant siting law, which Sampson said would jumpstart construction of new power plants, increase energy supply, and lower costs.

Sampson also said the state needs to use natural gas reserves found in Marcellus shale in Upstate, but efforts to do so have been blocked by state legislators in New York City who oppose it on environmental grounds.

“Energy is a large part of why New York isn’t competitive,” Sampson said.

Demanding Accountability

Unshackle Upstate has been using new media, such as Facebook, YouTube, and Twitter, to spread its message and keep supporters informed. Its Facebook page provides updates of the latest goings-on in the legislature and affords a platform for fans to vent their anger at Albany’s policies.

The 2008 presidential elections proved social media works, Sampson says, and helps organizations such as Unshackle Upstate get out their message. He said Unshackle Upstate’s social media campaign has helped fill a void by providing young New Yorkers with information and ways to become engaged in the cause, such as the forming of Unshackle groups on campuses across the state.

Sampson said Unshackle Upstate is gearing up for the 2010 elections, when the governor and all members of the State Senate and Assembly will be on the ballot. The group plans to develop report cards on lawmakers, mobilize voters, and encourage citizens to run for office and work to defeat those who do not listen to the taxpayers.

“Incumbents are seeing the power of the grassroots. Taxpayers are demanding more accountability, more for their tax dollar,” Sampson said.

Nick Baker (nhbaker2006@gmail.com) writes from Washington, DC.
Washington State Agencies Ignore Money-Saving Law

Agencies could save big with existing competitive contracting authority

By Jason Mercier

Washington lawmakers again face a multibillion-dollar budget deficit. One tool available for improving service delivery while addressing the budget deficit is Washington’s competitive contracting law, passed as part of civil service reform and signed by Gov. Gary Locke (D) in 2002.

In practice, state managers rarely exercise their statutory authority to contract out, meaning an important provision of the 2002 civil service law remains largely unused, according to a recent study by the Washington Policy Center.

Last summer, staff for the Washington Policy Center asked the state Office of Financial Management’s contract division how many private-sector personal service contracts had been requested or approved by agencies under the Civil Service Competition provision of the 2002 law. The answer was zero.

The 2002 law authorized state agencies to open up to competitive bids from the open market public services traditionally provided through an in-house government monopoly. Public employees are encouraged to participate in the bidding process, because the intent of the law is not to benefit private companies but to secure the best service for the public no matter who does the work.

**Ultimate Sacred Cow**

“The ultimate sacred cow continues to graze because the third leg of civil service reform has never been realized or embraced,” said state Rep. Gary Alexander (R-Olympia), ranking member on the state’s House Ways and Means Committee. “Contracting for state services or privatizing services and programs altogether has never been seriously considered, despite continued studies that suggest significant cost savings are possible.”

In 2002 the legislature passed the Personnel System Reform Act. Under the law, beginning in July 2005 agency managers could seek competitive bids to lower the cost of delivering services to the public.

In the years since, however, little competitive contracting has occurred.

**Unions’ In-House Monopoly**

After last summer’s survey revealed no private-sector personal service contracts had been requested or approved by state agencies under the 2002 law, Washington Policy Center analysts directly surveyed 20 state agencies to determine whether and to what extent managers were using their competitive bidding authority.

Of all the agencies surveyed, only one reported it had used competitive contracting under the 2002 law.

According to the Washington Policy Center’s report, “How Competitive Contracting Can Help Balance the Budget without Raising Taxes,” the primary reason is an agency’s contracting-out authority is subject to mandatory collective bargaining.

Not surprisingly, union leaders seeking to maintain an in-house monopoly usually make bargaining away their agency’s contracting-out authority a top negotiating priority. On the whole they have succeeded at preventing state agencies from contracting out.

The primary flaw in the 2002 civil service law was making an agency’s contracting-out authority subject to collective bargaining, the report concludes. Public-sector unions have a strong financial incentive to induce agency managers to surrender their ability to seek lower prices, because the agency’s work is then reserved for union members, regardless of cost to taxpayers.

**Savings Ignored**

Before 2002, state law barred agencies from competitively bidding any public services that traditionally had been provided by state employees, the report notes. The ban stemmed from a 1978 court ruling blocking administrators at Spokane Community College from hiring a private company to clean newly built school buildings and using the savings to augment the college’s education programs.

The ruling backed public-sector union leaders who had filed a lawsuit to prevent college administrators from loosening the in-house monopoly on janitorial work.

Union leaders sought to have the legislature make the ruling binding on all state agencies, colleges, and universities. The legislature soon codified the Spokane decision, establishing a statewide rule that any work historically performed by state workers always had to be performed by them.

College presidents and agency managers were not allowed to consider bids from private companies, even if the same amount and quality of work could be achieved at lower cost to taxpayers.


**IN OTHER WORDS**

“Forceful, eloquent, ambitious—for Democrats, those are words that aptly describe Gov. Chris Gregoire’s State of the State address she delivered Tuesday to a joint session of the Legislature.

“Worrisome, evasive, costly—for Republicans, those accurately portray what they heard from the governor.

“What words will be uttered at the end of this short 60-day session depend on how well the two parties cooperate in bringing into balance a budget that’s $2.6 billion out of kilter. It won’t be easy, and from the rumblings we hear following the governor’s speech, it won’t be pretty either.

“Lawmakers have already discussed legislation that would give universities full authority to boost tuition rates without approval from the Legislature. We’ll be interested to see how far that goes. The University of Washington is a prime mover behind this measure.

“Republicans correctly question why the governor did not address the issue of salaries for state workers. Why search for more tax revenues at a time when state employees are in line to receive scheduled increases in their salaries? Shouldn’t those be frozen in order to bring the expense side of the budget back into alignment?”

*House Editorial*

Yakima Herald-Republic

January 14, 2010
States Target Health Providers, Hospitals for Medicaid Match

By Natasha Altamirano

A new Tax Foundation analysis shows several states are taking advantage of a provision of the 2009 economic stimulus bill—increased federal matching rates for Medicaid—at the expense of health care providers in their own states and taxpayers in others.

Twenty-two states have significant health provider or hospital taxes, six of which were enacted or expanded in the past year. Another four enactments or expansions are pending.

“Taxes on health care providers are popular targets for states as they struggle to close budget gaps and meet increased Medicaid demands because the revenue raised from those taxes can be used to obtain a larger amount of federal matching funds,” said Tax Foundation analyst Justin Higginbottom, author of Tax Foundation Fiscal Fact No. 203, “State Hospital and Medical Provider Taxes: Not What the Doctor Should Order.”

Shifting Revenues, Costs

“States are turning the federal match into a budget gimmick by shifting Medicaid revenues into their general funds and shifting Medicaid costs to the federal government,” Higginbottom said. “As states get more federal funds for Medicaid, the federal government must tax or borrow to pay for this spending increase.”

Medicaid is financed at both the federal and state levels, and the federal match varies based on the state’s poverty level and unemployment rate. The American Recovery and Reinvestment Act of 2009 increased Medicaid matching rates by an average of 8.7 percent from October 1, 2008 through December 31, 2010, totaling an additional $87 billion in federal funding, giving states an added incentive to tax hospitals and health care providers.

California, Colorado, Missouri, Ohio, Oregon, and Wisconsin enacted or expanded their health provider taxes within the past year. New or expanded health provider or hospital taxes are pending in Arkansas, Michigan, Vermont, and Washington.

In Wisconsin’s case, the 20 percent increase in health provider taxes would increase federal matching funds from $635 million to $796 million, more than a third of which ($292 million) is expected to be used for non-Medicaid purposes.

But health care providers also can be hurt by these taxes. Generally, when hospital taxes are reimbursed by greater state Medicaid support, the benefits depend on the quantity of Medicaid-covered services a doctor or hospital provides. Those that provide little in Medicaid services must pay the tax without much additional reimbursement.

Ohio Hospitals’ Opposition

The Ohio Hospital Association opposes the state’s 2009 hospital tax because its hospitals will not be fully reimbursed for the $718 million assessment that enables the state to draw $1.8 billion in matching federal funds, according to association spokeswoman Tiffany Himmelreich.

“Hospitals are already facing increased charity care and bad debt expenses coupled with reduced government reimbursement for Medicaid and Medicare,” Himmelreich said. “Taxing hospitals during dire economic times is forcing them to make tough choices to lay off employees, reduce or eliminate services, and delay necessary facility modernizations.”

IN OTHER WORDS

“The current economic downturn provides us an important opportunity to reassess state government’s approach to budgeting. The present method employed in Minnesota and many other states is volatile and uncertain: spending with little discretion when economic conditions are robust, while imposing large tax increases and sudden budget cuts when the economy falters.

“Minnesota can and should follow the lead of more than two dozen other states and impose a reasonable cap on state expenditures. The Spending Accountability Amendment will hold general fund expenditures to the amount of revenue actually collected during the previous budget biennium, bringing the same fiscal sanity to government that is already common sense to millions of Minnesota households.”

Testimony of Joshua Culling, state government affairs manager, National Taxpayers Union, before the Minnesota Senate Tax Committee regarding Governor Tim Pawlenty’s “Spending Accountability Amendment,” December 7, 2009.

“Health provider taxes are a short-term fix that can harm health care providers and perpetuate the dysfunctional Medicaid fund-matching system.”

JUSTIN HIGGINBOTTOM, POLICY ANALYST
TAX FOUNDATION
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"Budget & Tax News carries articles which are useful to cities at various times. If one issue does not cover a situation, then another issue will. I personally think that it is worthwhile to have and to read for any Mayor who wished to stay informed on the laws and regulations which could affect their city’s budget."

HON. CHUCK MCLARAN
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City of Albany

"Budget & Tax News is a great tool for state legislators. In Iowa we rely on it for timely research on critical tax and spending issues. It is regularly cited by legislators looking for innovative ways to save taxpayer dollars. Heartland’s fourth public policy newspaper demonstrates again why Heartland is considered one of the leading sources of information for state legislators across the country."

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