Senate Vote Suggests End of the Line for High-Speed Rail

With its September 21 vote, the U.S. Senate Appropriations Committee ended rail boosters’ hopes of getting a meaningful appropriation for high-speed rail in Fiscal Year 2012. It probably also dealt a decisive blow to President Barack Obama’s goal of “giving 80 percent of Americans access to high-speed rail.”

By including only a token $100 million for high-speed rail as a “placeholder” in their FY 2012 budget, rail cost growth is likely to gain steam, making it nearly impossible to catch.

Rail Cost Growth Gaining Steam

If the proposed bullet train in California could move as fast as cost increases for the project come rolling in, nothing could catch it.

Cook County Debt Load Exposed

Households in suburban Cook County, Illinois owe nearly $33,000 on average for local government debt, with households in the City of Chicago owing more than $63,000 on average, according to Cook County Treasurer Maria Pappas.

On City Payroll, Union Job

Collective bargaining agreements with seven labor organizations require Phoenix, Arizona to pay union officers and provide members with thousands of additional hours to conduct union business instead of doing their government jobs.

Ala. County ‘Teetering’ After Sewer Deals

Alabama’s Jefferson County is “teetering on the edge of bankruptcy,” says Jefferson County Commissioner Jimmie Stephens. The county is $3.14 billion in debt as a result of sewer construction and financing deals tainted by corruption.

In September, county commissioners voted 4–1 to approve a repayment agreement that includes $1.1 billion in concessions from creditors. But the agreement, Stephens said, “requires cooperation from our state delegation and the state legislature, working in conjunction with the governor’s office.”

If that fails, Jefferson County will undergo the largest municipal bankruptcy case in Alabama history.

By Mike Reid

By C. Kenneth Orski

The Monthly Newspaper for Elected Officials and Taxpayers

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The Bottom Line

Illinois Still in Budget Trouble

Illinois imposed huge increases in the personal and corporate income tax rates this year, yet a recent report says the state’s budget could still end up $8 billion in the red.

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By Mike Reid

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The financial crisis continues to shake America. It’s getting a lot worse for towns and communities. Where can you turn for help and information?

www.smarttowns.org

Although the cumulative spending in most states by towns and counties actually exceeds what the state legislatures spend, the growing economic crisis of municipal governments has been largely ignored by policymakers.

Squeezed from the top by the states cutting back on subsidies to schools and local government, while simultaneously squeezed from the bottom by homeowners unable to afford high property taxes on homes with falling values, officials are desperate for cost-effective ways to meet their obligations.

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Higher Taxes, Worsening Budget in Ill.

By Steve Stanek

Despite record tax increases in 2011, Illinois state government remains in budget trouble.

Pension obligations for government workers and a huge backlog of unpaid bills are largely responsible for the state government’s continued problems, according to a report by the Institute for Illinois’ Fiscal Sustainability at the Civic Federation of Chicago.

The fiscal watchdog group estimates the state could end this budget year more than $8 billion in the red—despite $7 billion in tax increases. The tax increases are being eaten up by higher pension costs and the costs of paying back money that has been borrowed to fund the state’s bad spending habits, according to the report.

Illinois has long underfunded its pension plans, using monies that should have gone to pensions to pay for spending in other areas of the budget. Ten years ago Illinois’ debt totaled $9.4 billion. This year it tops $30 billion, with more than $16 billion of the increase due to pension obligation bonds.

Rising Pension Costs

Fully 17.4 percent of the General Funds budget of $33.6 billion in Fiscal Year 2012 will go to pension-related payments. The state will pay $4.2 billion in pension contributions and $1.6 billion for pension bonds debt service. The total $5.8 billion in pensions-related spending would be $464 million more than a year earlier. Pension costs are expected to top $6.3 billion in the 2013 budget year.

“In spite of a tax increase, Illinois is actually losing ground under this budget,” said Civic Federation President Laurence Msall.

On the last day of this year’s lame-duck session, shortly before new lawmakers would have been sworn in to stop the moves, lawmakers approved a 67 percent increase in the state’s personal income tax and a 46 percent increase in the corporate income tax. Gov. Pat Quinn (D) promptly signed the tax increases into law.

The state will end Fiscal Year 2012 with a total General Fund operating deficit of approximately $5 billion, according to the Civic Federation. That deficit comes on top of $1.7 billion the state shorted Medicaid and another $600 million in tax refunds it owes to businesses. Those costs are being pushed into Fiscal Year 2013.

$8 Billion Backlog

“While the budget process was somewhat improved this year, the Civic Federation cannot say the State of Illinois is better off,” said Msall. “By the end of FY2012, the state will have a payment backlog that could require over $8 billion in state money to pay off. The state’s finances have not been fixed” despite the enormous tax increases that were approved at the start of the year.

“This budget plainly demonstrates the need for further pension reform by the State of Illinois,” said Msall. “Neither dramatic increases in revenue nor painful cuts to appropriations were enough to offset the increased costs imposed on the state by its underfunded pensions.”

He said the Civic Federation supports a proposal backed by Republican House Leader Tom Cross of Oswego to create a three-tiered system that would allow employees to stay in the existing system at a higher cost, pay less for a smaller benefit, or join a defined contribution plan.

Quinn and many Democrat lawmakers, who control the General Assembly, have expressed opposition to the plan and have blocked its advance.

Pension Scandal

Meanwhile, the Chicago Tribune in September broke a story about top government union officials walking off with millions of dollars in pension payments by taking advantage of an obscure provision of Illinois law.

One example involved Dennis Gannon, who was credited for 33 years in the Chicago Department of Streets and Sanitation, when half that time was spent working management for a union. Gannon’s city salary never topped $56,000 a year, yet his government pension is worth more than $5 million.

Two dozen Chicago city workers—all of them union bosses—have won similar pensions, according to the Tribune investigation.

Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of two Heartland publications, Budget & Tax News and FIRE Policy News.
Alabama Sewer Deals Could End in Record Bankruptcy

Continued from page 1

Bankruptcy in U.S. history.
Commissioner George Bowman, the 1 in that 4–1 vote, said the new deal is “balancing the books on the backs of the poor” because it requires large sewer rate hikes, potentially for decades.
Sewer rates are now 329 percent of what they were in 1999, and the new deal begins with further increases of 8.2 percent each year for the first three years.
Nearly 70 percent of the sewer ratepayers live in Jefferson’s districts 1 and 2, which are largely low-income.

Criminal Convictions
Twenty-two people have been convicted on corruption charges in the ongoing SEC investigation into the case. Among them are four Jefferson County commissioners, including Larry Langford, who was elected mayor of Birmingham in 2007. Langford is serving a 15-year federal prison sentence for accepting $236,000 in bribes in connection with refinancing the sewer debt in 2002.
George Singleton, a sewer ratepayer and ex-New York banker, has been following the case closely. He said financial services firm J. P. Morgan, which was both a broker and creditor bank in the corrupt deal, has settled the SEC civil case by paying $75 million in penalties and writing down more than $647 million in the county’s debt.
The state judge in the civil suit between banks and the county has appointed John Young, who has prepared reports for the federal and state courts in this case, as receiver of the Jefferson County sewer system. This gives him authority over rate increases.
Jefferson County has retained Kenneth Klee, who served as an advisor in Orange County, California’s 1994 municipal bankruptcy filing, currently the largest ever.
“Ken is very much involved in everything we’re doing right now, because we still have to do the General Fund fix,” Stephens said. The county’s General Fund is almost $40 million in the red.

Division Over Agreement
Gov. Robert Bentley (R) supports the negotiated settlement for the sake of “economic development in Jefferson County and to avoid a negative reflection on the rest of the state,” said his press secretary, Jennifer Ardis.
She said the governor’s office could not say whether bankruptcy would increase borrowing costs for other Alabama municipalities.
“We do not actually know exactly what bankruptcy would mean for the rest of the state. The governor wants to avoid it altogether,” Ardis said.
State Rep. John W. Rogers, Jr. (D), whose district includes Jefferson County, said he is “totally opposed” to the rate increases in the settlement, saying it would be “cruelest, inhumane, and insane” to force those costs on the ratepayers.
Commissioner George Bowman, the 1 in that 4–1 vote, said the new deal is “balancing the books on the backs of the poor” because it requires large sewer rate hikes, potentially for decades.

“Bankruptcy is the only option. Perhaps a case can be made that those in Jefferson County government who inked this deal should pay, but not innocent citizens who must rely on government for sewer service.”
DOUG FRENCH, PRESIDENT, LUDWIG VON MISES INSTITUTE

This isn’t the first time Young’s impartiality has been questioned. In 2009, Commissioner Jim Carns said a court report written by Young was invalid because “his company seeks to purchase or manage the county’s sewer system.”
Young said the allegation is “absurd.” He added, “American Water has no interest in doing that.”

More Municipal Bankruptcies
Doug French, president of the Alabama-based Ludwig von Mises Institute, said “bankruptcy is the only option” for Jefferson County.
“Perhaps a case can be made that those in Jefferson County government who inked this deal should pay, but not innocent citizens who must rely on government for sewer service. Morgan and their investors should take their licking and move on.”
French also said, “Municipal bankruptcies will be numerous in the coming years as tax revenues will never be able to pay the pension obligations of the municipalities.”

Mike Reid (mikereid@mises.com) writes from Manitoba, Canada.
Unlikely Allies Show ‘Super Committee’ Where to Cut

By Steve Stanek

One of the nation’s leading taxpayer watchdog organizations and a liberal public interest organization have identified more than $1 trillion in cuts to federal government spending they believe have appeal across the political spectrum.

Though the National Taxpayers Union and the U.S. Public Interest Research Group have widely divergent views on many tax and fiscal policy issues, the organizations have identified 54 specific cuts to federal programs they say Republican and Democratic lawmakers should agree are wasteful and inefficient uses of taxpayer dollars.

Recommended cuts in “Toward Common Ground: Bridging the Political Divide with Deficit Reduction Recommendations for the Super Committee” include:

• $214.9 billion in savings from eliminating wasteful subsidies to agribusiness and other corporations;
• $428.8 billion in savings from ending low-priority or unnecessary military programs;
• $232.3 billion in savings from improvements to program execution and government operations; and
• $132.1 in savings from reforms to major entitlement programs.

“Though it gets drowned out by the din of Washington’s partisan rancor, there is actually a large amount of agreement between watchdog groups both right and left about where the waste is in the budget,” said report co-author Andrew Moylan, vice president of government affairs for the National Taxpayers Union. “We hope this report can aid the super committee in the difficult task of repairing the federal balance sheet by giving them suggestions with widespread support.”

The so-called “super committee” is made up of 12 members of the U.S. House of Representatives and the U.S. Senate, chosen by the Republican and Democrat leaders. The committee is supposed to recommend $1.5 trillion in spending cuts over the next 10 years. The committee was called together in the deal President Barack Obama signed into law last month to raise the national debt ceiling another $2.4 trillion. The committee has a November 23 deadline to present its recommendations.

The organizations plan to send their findings to the super committee for consideration.

“In an effort to address the deficit, we too often forget to differentiate between the good and the bad; between public priorities and special-interest handouts,” said co-author Dan Smith, U.S. PIRG tax and budget associate. “These recommendations correct years of insider lobbying that has benefited narrow interests, allowing room either for investment in valued programs or deficit reduction.”

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

IN OTHER WORDS . . .

“Faced with the stark failure of their policies to create jobs or to produce a ‘more just’ society, progressives are replacing ‘spread the wealth’ with ‘spreading the misery’ as their polar star. Thus, President Barack Obama champions a so-called ‘jobs bill’ calling for the very same policy mix that produced today’s high misery index. Targeted and temporary tax cuts and another massive increase in government spending are to be funded by permanent increases in tax rates on so-called millionaires and billionaires—those who make more than $200,000 a year.”

— Charles Kadlec writing in Forbes, October 10, 2011

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Senate Vote Suggests End of Line for High-Speed Rail

Continued from page 1

get recommendations (a sum likely to be further cut in the House-Senate negotiations on FY 2012 appropriations), Senate appropriators have done more than declare a temporary slowdown in the high-speed rail program. They effectively have given a vote of “no confidence” to the president’s signature infrastructure initiative.

Along with their House counterparts, who had denied the program any new money, the Senate lawmakers have sent a bipartisan signal that Congress has no appetite for pouring more money into a venture that many lawmakers have come to view as a poster child for wasteful government spending.

Little Accomplished

Their posture is understandable. After committing $8 billion in stimulus money and an additional $2.5 billion in regular appropriations, Obama has little to show for it. Aside from an ongoing project to upgrade track between Chicago and St. Louis (a $1.1 billion venture that promises to offer a mere 48-minute reduction in travel time between those two cities), no significant construction has begun on any of the authorized rail projects.

In the meantime, the U.S. Department of Transportation (DOT) has rushed to distribute the balance of the authorized high-speed rail dollars, in case Congress decides to rescind funds that remain unobligated.

Continuing its practice of scattering money far and wide rather than focusing it on one or two worthwhile projects, the Federal Railroad Administration approved in September more than $480 million worth of planning, engineering, and construction grants “to improve high-speed and intercity passenger rail service” in 11 states. The beneficiaries are Connecticut, Maine, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Texas, Vermont, Virginia, and Washington State.

Backing Off

None of the grants will help to bring true “high-speed” rail service to the United States. At best they will permit modest incremental improvements in speed and frequency of existing Amtrak services by helping to upgrade tracks of Class One railroads on which Amtrak runs its trains.

DOT has dropped its earlier rhetoric that high-speed rail “is just around the corner” (Secretary LaHood’s words) and “80 percent of Americans will have access to high-speed rail” (repeated assertions by LaHood and DOT press releases).

At the policy level, the project has been subjected to several recent analyses. First came a critical report by California’s nonpartisan Legislative Analyst’s Office. It questioned the Rail Authority’s cost estimates and its decision to build the first segment in a sparsely populated region where travel demand is not expected to be sufficient to cover operating expenses.

Concern about escalating costs and overly optimistic ridership forecasts were echoed by an independent Peer Review Group and numerous newspaper editorials. Even some of the project’s former state-level legislative supporters have begun to express reservations and are urging the authority to rethink its plan.

Funding Doubts

A more recent challenge to the project’s financial credibility came from a team of respected independent experts, Alain Enthoven, William Grindley, and William Warren, who cooperate with a citizen watchdog group, the Community Coalition on High Speed Rail. The team has concluded that without further federal aid (which almost certainly can no longer be counted upon) the project stands no chance of meeting its legislative requirements and the conditions of the enabling bond initiative (Proposition 1A).

Nor is reliance on private financial participation a credible option. In the authors’ judgment, private risk capital won’t come without revenue guarantees (meaning a public subsidy).

Politically, the most damaging blow to the project has come from a recent opinion survey. According to this poll, nearly two-thirds of California’s likely voters (62.4 percent) would stop the bullet train project from proceeding further.

Virtually the same number said they are unlikely ever to travel on the train between Los Angeles and San Francisco, casting doubt on the Authority’s optimistic ridership forecasts.

In addition, the project came in dead last (at 11 percent) in a list of voters’ spending priorities, according to the Irvine-based Probolsky Research polling outfit.

Given the possibility of the California bullet train’s demise, the attention and hopes of high-speed train advocates probably will (and should) turn to the Northeast Corridor—the nation’s most likely travel corridor where high-speed rail can eventually succeed and prosper.

C. Kenneth Orski (korski@verizon.net) is editor and publisher of Innovation NewsBriefs, where a version of this article first appeared. Used with permission.
California’s high-speed rail project is setting speed records—not on tracks, but in cost escalation.

The California High Speed Rail Authority (CHSRA) recently announced the Bakersfield to Merced section, part of which will comprise the first leg of the system to be built, will cost between $10 billion and $13.9 billion. That is an increase of approximately 40 percent to 100 percent over the previous estimate of $7.1 billion—an estimate that is less than two years old.

This “flatter than Kansas” section of the proposed high-speed rail project should be the least expensive part of the system. It can only be imagined how much costs might rise where construction is more challenging, such as tunneling through the Tehachapi Mountains and for the route across the environmentally sensitive Pacheco Pass that leads to the Silicon Valley.

CHSRA officials admit the $43 billion cost estimate to complete the Los Angeles (Anaheim) to San Francisco first phase will rise substantially. This estimate is also less than two years old.

Only the most ardent supporters still believe that initial estimate. Early in the year, Californians Advocating Responsible Rail Design (CARRD) looked closely at CHSRA documentation and estimated Phase I would cost $65 billion. In May, the California Legislative Analyst’s Office indicated the cost of Phase I could reach $67 billion.

**Triple 2000 Projection**

Alain Enthoven of Stanford University, William Grindle, formerly of the World Bank, and William Warren, a former Silicon Valley CEO, project a $66 billion price tag. They estimate costs for the full project, with extensions to San Diego and Sacramento, could be up to $116 billion. This is triple the 2000 CHSRA projection, after adjusting for inflation.

Megan McArdle of The Atlantic magazine characterized the obsolete $43 billion estimate as “giddily optimistic,” while Reihan Salam of National Review Online called the cost escalation “a national embarrassment.” In fact, even the $43 billion represented substantial cost escalation. Over the previous decade the project cost had escalated more than 50 percent after adjustment for inflation.

Any one of the new cost projections would put the California High Speed Rail project on track for a world speed record in cost escalation. Available data indicate no transportation infrastructure project in history has experienced such a large cost increase in so little time.

In 2008, Joseph Vranich and I wrote “The California High Speed Rail Proposal: A Due Diligence Report” for Reason Foundation. Based on the cost escalation we predicted in that report, our cost escalation estimate for Phase I would have been between $49 billion and $61 billion. Little did we expect our maximum cost escalation figure would turn out to be too conservative and be exceeded before the first shovel had been turned.

There already has been a ripple effect from California’s record cost escalation. My Reason Foundation report on the Florida high-speed rail project (“The Tampa to Orlando High Speed Rail Project: A Florida Taxpayer Assessment”) used a comparison to the first segment of the California system to produce a maximum cost overrun estimate of $3 billion for the Florida system. Had the new cost estimates been available at the time, we would have projected higher cost overruns. Gov. Rick Scott (R) this year canceled that project to shield state taxpayers from obligations not only for cost overruns but also for operating subsidies.

**Citizen Opposition**

Meanwhile, the California project has encountered other difficulties. Strong community opposition has developed along the route through the generally Democratic-voting peninsula cities between San Jose and San Francisco. CHSRA had intended to expand the existing commuter rail and freight rail right-of-way from two to four tracks either elevated or in a trench. Residents fear an elevated system would be a virtual “Berlin Wall” dividing their communities, and a trench would be little better.

Vigorous opposition also has developed in the San Joaquin Valley, one of the world’s leading agricultural areas. There is also a dispute on routing, as CHSRA considers crossing the “Grapevine” parallel to Interstate 5 between Los Angeles and Bakersfield, instead of the adopted, longer route through the Antelope Valley (the Lancaster-Palmdale urban area, which is likely to have 500,000 people by 2020 when the train is supposed to begin operating).

**Funding Problems**

Perhaps the final blow will come from financial reality. At this point, the project has received less than $4 billion in federal grants, and a matching $4 billion in state bonds has been authorized by taxpayers. Given the Republican control of the House of Representatives and the tight federal budget, the prospect for additional federal funding seems dim.

High-speed rail was deleted from the federal budget in the agreement between Congress and the president in April. The 2012 budget passed by the House of Representatives does not include money for high-speed rail.

CHSRA is optimistic about receiving private investment to fund a major part of the construction. Yet although there is no shortage of companies looking to be paid to do work on the [California] high-speed rail project, the room empties out when firms are asked to risk billions of their own capital on it.”

By Wendell Cox

California High-Speed Rail Sets Record—for Cost Growth
Local Debt Level Stuns Cook County Treasurer

By Steve Stanek

Households in suburban Cook County, Illinois owe nearly $33,000 on average for local government debt, with households in the City of Chicago owing more than $63,000 on average, according to Cook County Treasurer Maria Pappas.

Pappas has undertaken perhaps the nation’s first comprehensive study to determine all local government debt owed in a major metropolitan county.

“The numbers are staggering,” Pappas said. And she acknowledges her estimates are low because 53 local governments declined to report their debts despite a county ordinance that requires them to do so.

Even so, Pappas was able to total up more than $108.3 billion in debts from 498 Cook County governments, including the county government itself, city, village, and township governments, and school, park, library, fire protection, and other local taxing districts.

“Local governments reported total pension liabilities of more than $50 billion, and the pensions are only half-funded. Unfunded pension liabilities total $25 billion. That’s nearly one-quarter of the total countywide debt.”

INTERVIEW

MARIA PAPPAS

“Local governments reported total pension liabilities of more than $50 billion, and the pensions are only half-funded. Unfunded pension liabilities total $25 billion. That’s nearly one-quarter of the total countywide debt.”

“I was stunned by how big the [debt] problems are for local governments. Even little townships and fire districts and park districts have big problems, and their taxpayers are on the hook.”

Since she started the study, Pappas has been getting phone calls from elected officials and residents asking why taxes are going up.

“I get emails and phone calls from elected officials and residents asking why taxes are going up,” she said. “People don’t understand what the expenses are. They need to understand when they vote for a local bond deal what the financial burden will be for their children. Most entities present budgets once a year. Nobody shows up [for budget hearings]. Local leaders say nobody shows up, so they do what they want. Then the tax bills arrive and everyone gets upset.

BTN: What finding of the study is most troubling to you?

Pappas: Local governments reported total pension liabilities of more than $50 billion, and the pensions are only half-funded. Unfunded pension liabilities total $25 billion. That’s nearly one-quarter of the total countywide debt.

Experts say pension plans should be at federal levels. That’s gotten lots of news coverage. I was stunned by how big the problems are for local governments. Even little townships and fire districts and park districts have big problems, and their taxpayers are on the hook.

BTN: What did you find?

Pappas: Everyone’s heard about debt and pension problems at the state and federal levels. That’s gotten lots of news coverage. I was stunned by how big the problems are for local governments. Even little townships and fire districts and park districts have big problems, and their taxpayers are on the hook.

We review the information and see the debt is overwhelming, but I don’t say much about it. So I go back to the board [in January 2011] to amend the ordinance to get information on pension liabilities and underfunding. That information comes back, we slice and dice, and get a figure of $108 billion. I see something still wrong. So I go back to the board for an amended ordinance to have the local governments report OPEB liabilities—other post-employment benefits. That’s health insurance for retirees. We know roughly one-third did not report that. We also want them to disclose actuarial cost methods.

We want to know rate of return, annual rate of salary increases, participant morbidity rates, and health care cost trends. We will slice and dice and do the numbers again. When we add OPEB, those numbers are going to fly up.

In my 20 years of government service, this is probably the smartest thing I’ve done. I’m getting to the bottom of the dirt and grime. When you tell people they owe $30,000 or $40,000 for local government debt, that gets their attention.

BTN: What made you decide to try to find out how much local government debt there is in Cook County?

Pappas: From where I sit, as the banker for the county, I kind of hear everything. Property taxes are payable to the treasurer’s office, and I get emails and phone calls from elected officials and residents asking why taxes are going up.

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People don’t understand what the expenses are. They need to understand when they vote for a local bond deal what the financial burden will be for their children. Most entities present budgets once a year. Nobody shows up [for budget hearings]. Local leaders say nobody shows up, so they do what they want. Then the tax bills arrive and everyone gets upset. 

BTN: How long did it take you to compile all this information?

Pappas: We started in 2009 when I proposed a debt disclosure ordinance, which the county board approved, requiring all local governments to report their yearly budget and their debt.

We review the information and see the debt is overwhelming, but I don’t say much about it. So I go back to the board [in January 2011] to amend the ordinance to get information on pension liabilities and underfunding. That information comes back, we slice and dice, and get a figure of $108 billion. I see something still wrong. So I go back to the board for an amended ordinance to have the local governments report OPEB liabilities—other post-employment benefits. That’s health insurance for retirees. We know roughly one-third did not report that. We also want them to disclose actuarial cost methods.

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Three Milwaukee taxi drivers have filed a federal lawsuit alleging the city has outlawed competition in the taxi market, causing permits to rise in price from $85 to a staggering $150,000.

Milwaukee County Supervisor Joe Sanfelippo’s brother Michael controls 162 of the city’s 321 taxi permits and runs American United Taxi Cab Co., a taxi dispatch service.

The Institute for Justice, a national public interest law firm, filed the lawsuit on behalf of taxi drivers Ghaleb Ibrahim, Jatinder Cheema, and Amitpal Singh.

“In the classic story of entrepreneurship, someone starts a taxi business in order to save up enough money to buy a house,” said Anthony Sanders, staff attorney for the Institute for Justice and lead counsel in the lawsuit. “In Milwaukee, you need to save up enough money to buy a house just to start a taxi business.”

Market Limited Since 1991

In 1991, the city of Milwaukee prohibited any new entrepreneurs from entering the taxi market. The city council imposed a hard cap of 321 taxis for the entire city; thereafter, the only way to get a taxi permit was to purchase one from an existing permit holder. As a result, today the city has just one taxi for every 1,850 residents (compared to 1 in 90 for Washington, DC and 1 in 480 for Denver) and taxi permits have risen in price from $85 to $150,000—more than the average cost of a house in Milwaukee, according to the Institute for Justice.

“It isn’t the government’s role to play favorites, protecting a special few from competition,” said Sanders. “If the government tried to artificially limit any other industry, saying only 30 restaurants or three hardware stores could operate in town, everyone would agree it’s completely arbitrary and wrong.”

Benefits Entrenched Businesses

Sanders said the city’s taxi law does nothing but funnel money to a small group of entrenched businesses at the expense of entrepreneurs, who lose out on opportunities, and at the expense of consumers, who face poor service and long wait times.

Michael Sanfelippo told the Milwaukee Journal-Sentinel the quality of cabs and service suffered before the city imposed a limit on the number allowed to operate in the city.

“This is not a cab town,” he said.

He also disputed the claim that taxi permits can sell for as much as $150,000 each. “I think the last couple I bought were maybe $80,000,” he told the Journal-Sentinel.

Ibrahim said he started driving a taxi in Milwaukee in 1983, when a license cost $85. He insists the cost for a permit now can hit $150,000.

“It isn’t the place of the government to say what the right size of the market is,” Sanders said. “That should be left up to cab owners and their customers.”

Steve Stanek (sstanek@heartland.org) is managing editor of Budget & Tax News.
Editor’s Note: This is Part 1 of a two-part series on how mistaken assumptions by top U.S. policymakers have worsened the financial crisis.

By Robert Genetski

It has been three years since the worst financial collapse in modern history. While much has been written about events surrounding the crisis, there is a deep sense of unease over what happened and why.

Key policymakers dealt with the crisis through the application of the economic theory of John Maynard Keynes, from the early decades of the twentieth century. Understanding why the theory failed is crucial to avoiding repeating the mistakes that produced such painful consequences.

Former U.S. Treasury Secretary Hank Paulson’s book On the Brink (Business Plus, Grand Central Publishing, 2010) provides a firsthand account of how and why policymakers responded as they did at each stage of the developing crisis.

Paulson’s conclusion is shared by many. He believes his decisions, along with those of Fed Chairman Ben Bernanke and Tim Geithner (then president of the New York Federal Reserve), saved the economy and the financial system from another Great Depression.

Series of Policy Mistakes

An alternative interpretation is the financial crisis resulted from a series of policy mistakes by each of these policymakers. A close look at the events and policy decisions during this period reinforces the alternative explanation. As the financial situation deteriorated in response to each policy mistake, the key players appeared oblivious to why things kept getting worse.

For example, Paulson’s book notes on October 9, 2008, after successive policy moves failed to contain the damage, White House Chief of Staff Joshua Bolten raised an important question: “I just wonder, Hank, why after all the steps we’ve taken to stabilize the market, are the markets not responding?”

Paulson’s response: “Josh, I wonder exactly the same thing” (Paulson, p. 346).

Alternative Perspective Ignored

The reason financial markets failed to respond as these policymakers expected is their decisions were based on a flawed economic theory.

Each of the key U.S. players—Paulson, Bernanke, Geithner, and President George W. Bush—views the economy from a Keynesian economic perspective. All were educated at Ivy League schools (mainly Harvard). All were instructed in Keynesian economic theory. None of these key policymakers appears to have been aware of an alternative, classical economic perspective, which provides a different interpretation of economic events and how to deal with them.

Keynesian theory assumes when government increases its spending or provides credit to various entities, it adds to the total amount of spending or credit. The alternative classical economic theory assumes government spending and loans come at the expense of private spending and credit. From the classical perspective, a government move to boost spending or credit to one area of the economy weakens another area.

A second distinction between the two competing theories concerns monetary policy. The Keynesian view emphasizes the importance of interest rates as a guide to the amount of money and liquidity in the economy. The classical view downplays interest rates and focuses instead on the amount of money and liquidity in the banking system.

A final distinction between the two theories relates to the role of confidence. The Keynesian view assumes confidence plays a leading role in determining the economy’s performance. Classical economic theory, by contrast, views confidence as a consequence of economic conditions. Constructive policies improve those conditions and boost confidence; destructive policies make conditions worse and undermine confidence.

Policymakers consistently relied on a Keynesian perspective to formulate economic policies to deal with the financial crisis. In so doing, they contributed to the financial crisis.

Gathering Economic Storm

Some background on events leading up to 2008 is important to understand key policy decisions surrounding the crisis.

In 2001–05 the Federal Reserve had adopted a highly expansive monetary policy. One key measure of money is bank reserves, which represent the raw ingredients of the money supply. (All references to bank reserves in this article refer to the St. Louis Federal Reserve series on adjusted bank reserves less excess reserves.)

Bank reserves are the first step in the Fed’s money-creating process. They are the one measure of money completely under the control of the Federal Reserve. When the Fed creates bank reserves, the banking system transmits the newly created reserves into more spending. When banking institutions are increasing their leverage, the pace of spending tends to increase at a faster rate than the increase in reserves. When leverage in the banking system is contracting, spending tends to increase at a slower pace than the increase in reserves.

In 2001–05 the Fed increased bank reserves at a 5 percent annual rate. Typical
Contributed to the Financial Crisis

In the summer of 2008, bank reserves remained 3 percent lower than the level that existed three-and-one-half years earlier. This lower level of bank reserves was consistent with a further slowdown, perhaps even a decline in current dollar spending. By the spring of 2009, year-over-year current dollar spending had fallen by 3 percent. A highly unusual multiyear decline in bank reserves was followed by the first year-over-year decline in current dollar spending in more than half a century.

Critical Policy Decisions
Paulson’s discussion of the deterioration in the U.S. economy in 2007 and 2008 is instructive. Throughout he shows policymakers never considered the slowdown in spending and developing lack of liquidity might be related to Fed policy.

In a speech he delivered in April 2007, Paulson told audiences the subprime mortgage problems were “largely contained” (Paulson, p. 66). Bernanke made similar comments in July 2007. Paulson admits he and Bernanke were wrong. He says their problem was “We missed the dreadful quality of the most recent mortgages…” (Paulson, p. 66).

However, Paulson also notes, “We were in the midst of a general credit bubble. Banks and investment banks were financing record-size leveraged buyouts on increasingly more lenient terms” (Paulson, p. 69). Paulson clearly recognized the real problem extended far beyond the housing market.

Confusion over the role of monetary policy continued throughout this period. Paulson relates how in mid-November 2007 the Fed pumped $47 billion in temporary reserves into the banking system, “its biggest injection since 9/11” (Paulson, p. 83). The next month the Fed lowered its target interest rate to 4¼ percent, a full percentage point below where it had been only three months earlier.

In spite of what was widely thought to be an expansive monetary policy, data on bank reserves reveal a different outcome. In November 2007, reserves increased by only $2 billion. In December they declined by $4 billion. This pattern occurs throughout Bernanke’s tenure. The Fed announces major changes in monetary policy involving tens or even hundreds of billions of dollars in purchases or loans. Fed data then show changes in bank reserves that are often unrelated to the Fed’s announced policy.

Meanwhile, Paulson and Bernanke dealt with the developing crisis by addressing specific individual problems. As the Fed was removing reserves from the economy in December 2007, it announced a new program—Term Auction Facility (TAF)—designed to lend funds to depository institutions (Paulson, p. 84). This was a prelude to numerous attempts by both the Bush and Obama administrations and the Fed to solve problems related to a specific company or industry. While policymakers were focusing on solving these specific problems, the Fed was removing reserves and contributing to a shortage of liquidity in the overall economy.

Wrong Call on Confidence
By January 2008 it became evident the economy was getting worse. Instead of looking for the reason liquidity was drying up, Paulson and Bernanke perceived the problem as a lack of confidence. In an attempt to boost consumer confidence, Paulson recommended a $150 billion “stimulus” program including one-time tax rebates and tax breaks to encourage business investment. The idea was to put money in people’s hands so they would spend it.

Keynesian economic theory assumes when government provides people with more money, it raises their confidence and has a multiple effect that boosts spending throughout the economy. Classical economic theory, by contrast, assumes government spending creates no increase in demand. Instead, government borrowing to fund the spending reduces the amount of credit available to others. The reduction in available credit reduces spending in other areas. This offsets the increase in demand created by government spending.

During the spring of 2008, as consumers received and spent their tax rebates, there was a brief increase in demand. Current dollar GDP, a measure of overall demand, increased by 1 percent in the spring quarter. This compares to no increase in both the preceding and subsequent quarters and is generally consistent with normal quarterly fluctuations. If it did anything, then, the tax rebate merely shifted demand from one quarter into another.

From a classical perspective, demand is primarily dictated by Fed policy. Any temporary boost created by government spending will be offset by the reduction in credit caused by the increase in government borrowing. The overall impact of such fiscal manipulation is positive only if the benefits of the government’s spending outweigh the costs to those who are denied credit due to the government’s borrowing.

Since the market tends to allocate credit to its most efficient uses, policymakers’ decisions to reallocate it to other areas will tend to weaken the economy, not strengthen it. The weakness in the economy throughout the spring and summer of 2008 is consistent with this classical view.

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‘Green Scissors’ Would Cut Harmful Spending by $380B

By Steve Stanek

The federal government could cut $380 billion of spending over five years to save taxpayers money and protect the environment, say a group of environmental and fiscal watchdog organizations that call themselves the Green Scissors coalition.

“These are common-sense cuts. Outside of the Beltway, these [projects] are things people agree don’t make sense,” said Ryan Alexander, president of coalition member Taxpayers for Common Sense. Other members include Friends of the Earth, consumer watchdog Public Citizen, and free-market think tank The Heartland Institute, which publishes Budget & Tax News.

“Lawmakers across the political spectrum should be scrambling to eliminate these examples of wasteful spending and unnecessary tax breaks that are squandering our precious tax dollars while the nation is staring into a chasm of debt,” said Alexander.

On the chopping block would be subsidies for ethanol and many other forms of alternative energy, as well as oil and gas industry and nuclear energy subsidies. The coalition also recommends cuts to poorly conceived road projects, U.S. Army Corps of Engineers water projects, and government support for crop insurance and flood insurance.

Heartland Institute Vice President Eli Lehrer, whose area of expertise is insurance, says crop insurance encourages the tilling of marginal lands that would be better left in their natural state. The National Flood Insurance Program is $18 billion in debt and encourages development in areas at high risk of flooding, resulting in worse damage when flooding occurs, he says. Many high-risk flood areas also are environmentally sensitive, another reason government should not subsidize development in those areas.

The Green Scissors coalition announced its recommendations at a press conference August 24 in Chicago. On hand to lend support was Rep. Earl Blumenauer (D-OR), who said, “The 2011 Green Scissors Report is a reminder that it’s time for Congress to have a serious, rational discussion about cutting the budget.”

On the other side of the political aisle is Rep. Tom Petri (R-WI), who said, “The Green Scissors report is full of recommendations that will help us be good stewards of the environment while also being good stewards of taxpayer dollars. While we won’t all agree on every proposed cut, the report’s recommendations are a good place to start as we look for ways to put our nation on a more sustainable fiscal path.”

“We can go a long way toward solving our nation’s budget problems by cutting spending that harms the environment, and this report provides the Super Committee with a road map,” said Friends of the Earth climate and energy tax analyst Ben Schreiber. The Super Committee is made up of 12 members of Congress who in November are supposed to recommend $1.2 trillion of spending cuts over 10 years.

“At a time of great polarization, Super Committee members can and should find common ground by ending wasteful polluter giveaways,” Schreiber said.

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GOP Presidential Candidates Agree: Kill the ‘Death Tax’

By Sean Parnell

A s candidates for the 2012 Republican nomination spar over differences on health care policy, job growth, and the war on terror, a consensus has emerged on at least one issue: repeal of the federal estate tax, commonly referred to as the “death tax.”

All of the major Republican candidates except former Utah governor Jon Huntsman and former Louisiana governor Charles ‘Buddy’ Roemer have signed a pledge committing themselves to repeal the estate tax.

“Several bills to repeal the [estate] tax are in Congress, including one each by Republican presidential contenders Michele Bachmann and Ron Paul,” according to AFBI President Dick Patten.

Likely Campaign Issue

The unanimous agreement among Republicans that the estate tax should be repealed stands in contrast to President Barack Obama, who favors keeping it. This makes it likely the estate tax will be an issue in the 2012 contest between Obama and whoever emerges as his Republican opponent.

“With jobs being a major focus of the 2012 election campaign, and three separate studies showing the job-growth benefits of eliminating the death tax, you have to figure this is going to be part of the campaign,” said Patten. He cited estimates from the studies showing between 1.5 million and 2 million jobs could be created if the estate tax were permanently repealed.

The first estate tax was imposed to help pay for the Civil War. It was repealed in 1870, revived during the Spanish-American War, and repealed in 1902 after the end of that conflict. The modern estate tax was established in 1916 alongside the income tax and quickly raised in 1917 to help pay for World War I.

The Civil War and Spanish-American War estate tax rates ranged between 1.5 million and 2 million jobs being lost, and even a modest rate of 15 percent would lead to up to 350,000 jobs being lost.

A 2006 report by the Joint Economic Committee of Congress—“Costs and Consequences of the Federal Estate Tax”—further documented the negative impact of the estate tax on the economy. “Survey data suggest that the estate tax continues to be a primary reason why small businesses fail to survive beyond one generation,” according to the report. “Close to two-thirds (64 percent) of respondents in one survey of family businesses reported that the estate tax makes survival of the business more difficult.”

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The Civil War and Spanish-American War estate tax rates ranged between .75 percent and 15 percent, much lower than today’s rates. By 2001, the highest rate was 60 percent. Rates were lowered under the Economic Growth and Tax Relief Reconciliation Act signed by President George W. Bush in 2001, gradually falling to 45 percent in 2007 before being eliminated in 2010. An increase in the amount that could be exempted also was included in the 2001 legislation.

Due to congressional budgeting rules, the complete repeal was for only 2010, and the tax was scheduled to return to 55 percent in 2011. As part of a compromise with Republicans, in December 2010 Obama signed legislation setting the estate tax rate at 35 percent, while also increasing the amount that could be exempted from the tax. The lower rates are temporary, however, and in 2013 the estate tax is scheduled to rise to 55 percent and the exemption to drop to $1 million.

Benefit for Jobs, Economy

Several studies have shown that elimination of the inheritance tax could benefit job creation. “Growth Consequences of Estate Tax Reform: Impacts on Small and Family Businesses,” a September 2010 report by former Congressional Budget Office Director Douglas Holtz-Eakin, found that allowing the estate tax to rise to 60 percent would result in up to 1.5 million jobs being lost, and even a modest rate of 15 percent would lead to up to 350,000 jobs being lost.

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Supporters of the estate tax largely focus on revenue to the government at a time of budget deficits, as well as the fact that relatively few estates wind up having to pay the tax.

In May 2011, Gillian Brunet of the Center for Budget & Policy Priorities wrote the tax-cut compromise enacted the prior December would cost the federal government “about $23 billion more than reinstating the 2009 rules … yet will benefit only the largest one-quarter of 1 percent of estates” because they are the only ones that would owe any estate tax.

Estate Planning Costs

Brunet’s analysis ignores the expense of estate planning and the job-killing effects of the tax, say advocates of repeal. According to AFBI, the inheritance tax imposes a burden well beyond one-quarter of 1 percent of estates because it forces “business owners to use complex tax planning strategies to reduce their estate tax liability… but the resulting compliance costs (such as paying for an accountant or attorney, purchasing life insurance, and otherwise misallocating capital) impose a heavy financial burden.”

Several bills to repeal the tax are in Congress, including one each by Republican presidential contenders Michele Bachmann and Ron Paul.

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Baltimore: East Coast’s Shrinking City

By Cheryl K. Chumley

Poor Baltimore.

For decades, the Maryland city has been plagued by high crime, low student test scores and graduation rates, rising taxes, and a falling population.

Even when it tries to do something right—when its political leaders take what they believe are pro-business steps—results often disappoint.

Consider the inaugural Grand Prix auto race in September, a “game changer” for Baltimore’s way of doing business, according to Mayor Stephanie Rawlings-Blake (D), who characterized the race as a surefire means of raising city revenues and boosting employment.

Maryland Public Policy Institute Senior Fellow Marta Mossburg says it changed virtually nothing.

“Despite predictions by race organizers and the mayor’s office, most jobs related to the Grand Prix are temporary,” Mossburg wrote in a Baltimore Sun column. “And while the event may bump tax receipts for the weekend it runs, visitors will likely not make return visits for non-racing events.”

Baltimore’s Bungles

Baltimore has a long list of political bungles, scandals, and policy failures. The result: The city is the only one of its size on the East Coast to lose population since 2000, according to recent Census Bureau figures. Between 1990 and 2010 Baltimore’s population dropped more than 84,000, to 620,961.

What ails?

“The trajectory in Baltimore has been downward since 1950,” said Steve H. Hanke, professor of applied economics at Johns Hopkins University in Baltimore. He paints a picture of declining commerce and job opportunities and rising taxes and crime rates. “The property taxes in particular are very high. They’re the highest in the state. They’re double those of the surrounding counties.”

In January of this year, soft-drink company Pepsi moved production out of Baltimore, taking it tax revenues and approximately 75 jobs. Six months earlier the city had passed a two cents per bottle “sugary drink” tax that could go as high as four cents when it comes before the city council for possible renewal in three years. Pepsi had warned in the lead-up discussions to the tax’s approval it could not and would not pay the tax.

“The main thing that has to be done is to replace the current business model with something different and something that’s more congenial to business,” Hanke said.

Pay-to-Play Politics

The city’s current “regulatory approach,” as Steve Walters, economics professor at Loyola University Maryland, describes it, is not only unsustainable but rife with corruption and political shenanigans.

“Baltimore sets itself up as the middleman on virtually any deal,” Walters said. “They know they’ve got a problem [with the tax burden]. So if they’re going to attract any business, they’ve got to give breaks, discounts. ... You have to pay to play. The political in-crowd has extraordinary power.”

The most recent past mayor plea-bargained her way out of prison, Walters notes, for improper dealings with a real estate developer. Another in-crowd politician on the city council gave up a committee leadership role over ethics questions, he added.

“I’m sure there are [other cities] where similar deals are brokered,” Walters said. “But in Baltimore, the difference is there’s no option. The high property tax makes it so there’s no choice but pay to play.”

Billion-Dollar Boondoggle

Christopher B. Summers, president of the Maryland Public Policy Institute, has been tracking what he describes as a real estate development scandal. The city’s State Center, a $1.6 billion downtown redevelopment project aimed at drawing high-paying tenants and boosting tax revenues, is little more than a heavily subsidized “fiscal boondoggle” that has wasted taxpayer dollars, he said.

“The State Center has corruption in Maryland government that has gone up to its highest levels,” Summers said. “The state owns the building, and the idea was to replace [it]. They billed it as a public-private partnership. But there were some procurement laws broken.”

If the project does get built—numerous businesses and property owners in downtown Baltimore are suing to block it—the result could be high vacancy rates, Summers said. Office space rents in the city average between $22 and $23 a square foot. The state government guarantees State Center space will lease for $36 a square foot, with taxpayer subsidies to bridge the difference, Summers said.

Crime Fears

High crime rates are also driving people and businesses out. Earlier this year the FBI reported Baltimore is the fifth-deadliest city in the nation and the seventh most dangerous in terms of overall violent crime.

“The city could improve on the perception of the crime issue and decrease the crime statistics,” said Carl Herber, branch vice president of Coldwell Banker in Green Spring, Maryland, who has been in real estate investment in the city for 10 years. “The school system is also not generally regarded as a great service. I find fewer people willing to compromise to take advantage of a great older neighborhood in the city. Fewer people are willing to pay the price on that.”

Herber added, “If you buy a house in the city at $500,000, your taxes will be about $12,000 a year. Move out of Baltimore boundaries, and that same house will only cost $5,000 a year in taxes. Many folks look at that and say no [to Baltimore].”

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Local Income Taxes on the Wane

By Joseph Henchman

Nearly 5,000 U.S. cities and counties in 17 states, encompassing more than 23 million Americans, impose a local income tax.

The local income taxes in these 4,943 jurisdictions provide a longstanding and significant source of revenue to many cities in “Rust Belt” states in the northeastern United States. All counties in Indiana and Maryland impose a local income tax. In Ohio, 593 municipalities and 181 school districts have such a tax. In Pennsylvania, 2,469 municipalities and 469 school districts impose local income or wage taxes. Many cities and school districts in Iowa and Michigan also have these taxes.

Over the past few decades, the number of local income taxes has declined, and although there are exceptions, the rates at which these taxes are imposed have dropped as well.

For example, Philadelphia’s wage tax in 1995 was 4.96 percent for residents and 4.31 percent for nonresidents. It has gradually dropped to the current 3.928 percent for residents and 3.498 for nonresidents, and further cuts are expected in the medium to long term.

In New York, the state senate voted in June 2011 to exempt small businesses from the citywide 0.34 percent Metropolitan Transportation Authority (MTA) payroll tax and phase it out completely by 2014.

Remnants of Great Depression

Local income taxes arose during the Great Depression: Declining property tax revenues caused by rising foreclosures forced local governments to look for other ways to raise revenue. The first local income taxes emerged in Philadelphia in 1939 as the city sought to avoid bankruptcy. They spread gradually to select cities in Ohio (1946), Kentucky (1947), Missouri (1948), and Michigan (1962). New York City and Baltimore adopted municipal income taxes in 1966.

Income and wage taxes are generally applied to those who live or work in the affected jurisdiction. They can complement or replace other local revenue sources such as property, business, sales, or tourist taxes. Unlike property taxes, local income taxes also can be applied to nonresidents. If abused, however, local income taxes could enable a jurisdiction to export its tax burden to nonresidents who are not the primary beneficiary of city- and county-provided services such as schooling, policing, parks, and social services.

In most cases, city officials understand this need to avoid taxation in excess of benefits provided, and they impose a lower rate on nonresidents than residents. In Maryland, for example, county and city income taxes range from 1.25 percent to 3.20 percent, but nonresidents pay a uniform rate statewide, set at the lowest county rate (1.25 percent). Cities in Michigan and Pennsylvania generally impose income and wage taxes on nonresidents at a lower rate than residents, although Ohio communities generally impose the same rates on both groups.

Variety of Local Income Taxes

Local income taxes appear under a variety of designations: wage taxes, income taxes, payroll taxes, local services taxes, and occupational privilege taxes. They are generally paid by the employee but withheld by the employer, although in some cases (as in San Francisco, California and Portland, Oregon), they are paid directly by the employer.

Some of these taxes are imposed as a percentage of salaries or wages, others are stated as a percentage of federal or state tax, and still others are flat amounts charged to all workers.

Two West Virginia cities, for example, impose a flat charge of $2 or $3 per week on all those employed in the city. Appanoose County, Iowa—alone among Iowa counties—imposes a 1 percent emergency services surtax. Residents of Yonkers, New York pay 15 percent of their state tax as a “piggyback” local tax.

Like federal and state income taxes, some local wage taxes have provisions for exemption, such as excluding military income or low-income individuals. In Maryland and New York City, residents pay their local income tax when they file their state income tax. However, there are examples of extreme compliance burdens associated with local income taxes collected by local authorities. For example, taxpayers in Albion, Michigan must fill out a city income tax form of 16 pages, with instructions, separate from state and federal income tax forms.

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Available now at Amazon and Barnes & Noble for $19.99
Md. Finds O’Malley Drink Tax Hike Hard to Swallow

By Ben Jenkins

At a time when most policymakers around the country fought to protect citizens from paying higher taxes, anti-alcohol activists in Maryland fought hard and won a tax hike through the legislature.

The tax increase leaves advocates for the developmentally disabled and many people in Maryland’s small business community and hospitality industry with a terrible taste in their mouths.

The measure raises the sales tax on liquor, beer, and wine from 6 percent to 9 percent. That’s a whopping 50 percent increase in the tax rate signed by a governor who ran for election pledging not to raise taxes.

“The advocates wanted this bill, and they wanted it for the disabled and the mentally ill,” Delegate Susan Krebs (R-Carroll County) said on the House floor. “In my opinion, this money is going to buy votes instead of going to where it was meant to be.”

Broken No-Tax Pledge

Gov. Martin O’Malley (D) signed the bill despite a campaign pledge not to raise taxes. When the measure was proposed it was sold as a way to provide money to help the disabled statewide. Instead, most of the money will be spent in heavily Democratic Party-dominated Prince George’s County and Baltimore City, and almost none of it will go to the disabled.

“This alcohol tax hike was promoted as a way of helping people with disabilities because its backers knew this was popular,” said Marc Kilmer, senior fellow at the Maryland Public Policy Institute.

“Tying it to people with disabilities was key,” Kilmer continued. “At the end of the day, those people got almost nothing from this. They got crumbs. It was a complete sham. If the supporters of this tax increase had said they are going to raise the sales tax on alcohol all across the state to fund school construction in Prince George’s County and Baltimore City, I don’t think there’s any way it would have passed.”

50% of Price Is Taxes

The new tax, which took effect in July, is the latest in a trend of hospitality taxes across Maryland that have hurt consumers and forced some businesses to shutter or leave town. More than half the purchase price for a bottle of alcohol in Maryland goes to taxes of some kind.

When Maryland lawmakers took to the floor at the beginning of this year’s legislative session, anti-alcohol advocates already had floated the idea of raising the alcohol tax to funnel money into programs to help the developmentally disabled. Many legislators lined up to support that cause.

In the end, less than 20 percent of the estimated $90 million annually from the new alcohol tax was dedicated to helping the disabled. Most of the tax, collected statewide, was earmarked for school improvement funds in the heavily Democratic Baltimore and Prince George’s Counties.

Unnecessary Increase

One thing that has made the tax hike especially hard to swallow for some is that it was unnecessary, according to Maryland Comptroller Peter Franchot, who will distribute the new revenue to the General Fund. Franchot told the Salisbury Daily Times the sales tax increase was “gratuitous” because the budget was already balanced.

O’Malley took heat from news organizations that called him out for so brazenly violating his campaign pledge.

The Annapolis Capital, the state capital newspaper, editorialized: “It was extremely disingenuous for Gov. Martin O’Malley to say that he balanced the budget without new taxes. During last year’s campaign, O’Malley mocked his opponent for making a distinction between higher fees and higher taxes. And while the increase in the alcohol tax may not have been in O’Malley’s budget, and may have been engineered by General Assembly Democrats while the governor was humming loudly and studying passing clouds, he’s not vetoing it. It’s his.”

Other media came out against the tax after discovering the true destination of the new tax revenues.

The Frederick News Post wrote: “This is another example of ‘good of’ boy, back-door, smoke-filled-room politics’ aimed at garnering enough votes to ram a piece of legislation through to help prop up counties that can’t control their spending.”

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IN OTHER WORDS . . .

“The income tax hike that Gov. Pat Quinn and Democratic legislators engineered in January is taking an extra $7 billion or so per year from Illinois’ private sector—employers, employees and their families. Individuals this year are sending the state an additional 2 percent of their pay. Given that the typical Illinoisan earns 2 percent of his or her annual income each week, think of it this way: Beyond the other federal, state and local government taxes you have to pay this year, you’re working this week solely to cover your new Quinncome Tax.

“And where goeth nearly every penny of that take-home pay for this week? Virtually everyone who has a job in Illinois is working this week just to pay state government’s pension obligations. That’s right—in fiscal 2012, which started July 1, Illinois will spend $5.8 billion in required contributions to its pension funds, and in debt service on money borrowed to make the pension contributions in prior years. ...

“The officials who run this state have gone to elaborate lengths to avoid confronting leaders of public employee unions with the obvious: Illinois cannot continue to let the pension system be the tail that wags the rest of state government. Lawmakers need to create lower, more realistic and more affordable pension benefits for current employees.”

— Chicago Tribune editorial, October 4, 2011
Liquored Up: Why Michigan Should Exit Its Liquor Wholesale Business

By Michael D. LaFaiwe and Todd Nesbit

Michigan is one of 18 states in which the state government is the statewide wholesaler for all hard liquor (or “spirits”) sold to consumers by retailers, bars, and restaurants.

Anecdotal and empirical evidence indicates this arrangement unnecessarily drives up costs while providing no public safety advantages.

As wholesaler, the state is in a unique position to drive up the cost of liquor. The Michigan Liquor Control Commission tacks on a 65 percent markup on every bottle sold, plus four separate taxes earmarked for various purposes. On top of this the state imposes a 6 percent retail sales tax. Michigan then artificially restricts competition between retailers by imposing a price control floor, below which stores may not sell.

The Mackinac Center has examined how all this impacts the retail price of Scotch whisky. We collected data on prices of J&B Scotch Whisky for all 50 states between 1995 and 2004 from the ACCRA Cost of Living Index and constructed a statistical model that controlled for such things as prices for alternative products; the proportion of the population who are moderate or heavy drinkers; demographics including age, gender, and race; employment in manufacturing; employment in the leisure and hospitality industry; the unemployment rate; and the extent to which each state controls the distribution of liquor.

More Control, Higher Prices

The results show that a fifth of a gallon of J&B is, on average, $1.59 more expensive in liquor-control states compared to non-control (or so-called “license” states), or 6.3 percent higher. We further categorized “control” as either light, moderate, or heavy. The price of Scotch in light-control states, which includes Michigan because the state does not have a retail monopoly, is $0.94 higher than in non-control states. Consumers in moderate-control states pay $1.72 more. Buyers pay $2.26 more in heavy-control states.

Anecdotally, we found similar evidence. On August 10, we looked at liquor prices in Meijer stores in South Bend, Indiana and Kalamazoo, Michigan. Most products were less expensive south of the Michigan border, some by a large margin. Of the 11 liquors in 750 ml bottles we examined, eight were less expensive in the Hoosier state. Of 10 types in half-gallon containers, eight were cheaper in Indiana.

For example, a fifth of Johnny Walker Black cost almost 37 percent less in Indiana. Of the few products that cost less in Michigan, the largest price saving was 12 percent.

No Safer with Control

Supposedly, the regulatory regime responsible for these higher prices makes Michigan safer. But empirical evidence suggests this is a myth.

A 2010 study titled “Impaired Judgment: The Failure of Control States to Reduce Alcohol-Related Problems,” by economists Don Boudreaux and Julia Williams, found no statistically significant difference between control and license states in binge drinking, alcohol-related traffic fatalities, or alcohol-related deaths overall.

The control-state concept was born in 1933 after the end of Prohibition, due in part to teetotalers’ fears that bootleggers would smuggle in illegal or adulterated products. Yet ironically, Michigan still has a smuggling problem—in part because of state-mandated price differentials with other states.

Costly Liquor Smuggling

The Liquor Control Commission itself estimated alcohol smuggling costs Michigan approximately $14 million annually in lost markup and tax revenues. It also reports distributors’ trucks have been hijacked and at least one driver shot in the process.

Previous Mackinac Center reports show the same consequences from artificially driving up cigarette prices with high excise taxes.

While the focus of our research has been on liquor, provisions of Michigan’s law also drive up beer and wine costs, both for producers and consumers. Notoriously, the state grants exclusive sales territories to beer and wine wholesalers and encourages anti-consumer collusion between them through bureaucratic “post-and-hold” restrictions on price changes.

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Phoenix Taxpayers Foot Huge Bill for Union Activities

By Mark Flatten

Phoenix taxpayers spend millions of dollars to pay full salary and benefits for city employees to work exclusively for labor unions, a Goldwater Institute investigation has found.

Collective bargaining agreements with seven labor organizations require the city to pay union officers and provide union members with thousands of additional hours to conduct union business instead of doing their government jobs.

The total cost to Phoenix taxpayers is about $3.7 million per year, based on payroll records supplied by the city. In all, more than 73,000 hours of annual release time for city workers to conduct union business at taxpayers’ expense are permitted in the agreements.

City Jobs but No City Work

The top officials in all the unions have regular jobs with the city, and buried in the labor agreements are provisions for those employees to be released from their regular duties to perform union work.

For top officers, the typical amount of annual release time is 2,080 hours, a full year of work based on 52 weeks at 40 hours each. They continue to draw full pay and benefits, just as if they were showing up for their regular jobs. But they are released from their regular duties to conduct undefined union business.

Union officials say the time is a good investment that leads to a more productive workforce. Critics say it amounts to an illegal gift of taxpayer money.

“It’s shocking,” said Phoenix City Councilman Sal DiCiccio, who has battled with unions that represent city workers over employee pay and his efforts to trim spending. “Taxpayers should not be funding union activities. It should all come out of union dues.”

DiCiccio voted for the union contracts in March 2010, as did every other council member present. The provisions for release time have long been a part of city contracts with labor organizations, but DiCiccio said he was unaware of them until recently.

Cops Get Cushiest Contract

The most generous contract both in terms of both money and time is between the city and the Phoenix Law Enforcement Association (PLEA), which represents frontline police officers.

All six of the top officials at PLEA draw their full pay and benefits from the city, even though they are assigned full-time to the union. Each is also entitled to 160 hours of overtime annually.

All the other unions have the salaries and benefits of their top officials paid by the taxpayers.

Each of the unions also receives banks of additional release time ranging from a few hundred hours to 5,500 hours annually, which members can use to conduct union business on city time.

Additional Payouts

One union leader says it was city officials who insisted on providing additional release hours, which had become a standard provision in contracts with other labor organizations.

PLEA and the Phoenix Fire Fighters Association Local 493 each get 500 hours of annual city-paid time for a lobbyist. The firefighters’ union also gets a taxpayer-funded secretary.

Two other unions each receive payments of $14,000 from the city to pay for membership training and conferences, and a third gets a $2,000 parking allowance.

Other sections of the labor agreements allowing city-paid release time are difficult to quantify because they do not specify the number of hours allowed for certain tasks. They instead state time spent on such things as instructing union stewards on the terms of new two-year contracts does not count against the other hours specifically allotted.

City Money on Top of Dues

The money coming from taxpayers is in addition to union dues that each of the labor organizations receives from its members, dues collected by the city through payroll deductions.

Some top union officials also draw salaries or stipends from their labor organization in addition to their city checks while working exclusively on union business.

Other metro-Phoenix cities have similar contracts, but they tend to be less generous and involve fewer labor organizations. The federal government also allows for union business to be done on taxpayer time, but it prohibits release hours for internal union activities.

Ed Zuercher, Phoenix’s assistant city manager, said if union officials trade release hours for lower overall wage and benefits packages for their members, it does not end up costing the city anything extra. Release time allows unions to provide services such as training on city ordinances and job requirements, which leads to better relations between management and employees, and ultimately better service to residents, Zuercher said.

State Constitutional Prohibition?

James Tierney, president of the AFSCME local that represents skilled laborers such as electricians and mechanics in the city, said the work done by unions improves worker productivity and morale. Representing rank-and-file workers at grievance and disciplinary hearings shields them from bad decisions made by the city’s bloated management, Tierney said.

But using taxpayer dollars for the salaries and benefits of union officials likely violates the state constitution’s prohibition against using public funds to benefit private organizations, said Clint Bolick, director of the Goldwater Institute’s Scharf-Norton Center for Constitutional Litigation.

“This looks like a naked constitutional violation,” Bolick said. “This is a direct subsidy to the union for union activities that are directed and specified by the union itself. So there is no assurance of any benefit to the city, much less a proportionate benefit.”

Mark Flatten (mflatten@goldwaterinstitute.org) is an investigative reporter with the Arizona-based Goldwater Institute, which first reported this story. Used with permission.
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