It’s Either Bankruptcy or State Takeover in Pennsylvania’s Capital City

With the Harrisburg, Pennsylvania City Council recently voting to have the city file for bankruptcy, Harrisburg’s mayor saying the filing is illegal, and the Pennsylvania governor approving a state takeover of the city’s finances, one thing is clear: No matter how things shake out in Pennsylvania’s state capital, city officials have made some bad decisions.

Pennsylvania, p. 2

North Carolina Zoo Says Privatization Could Free It from Fiscal Captivity

“Basically, what we’re looking at is a public-private partnership, which 75 percent of the accredited zoos and aquariums in the country now have.”

Mary Joan Pugh, Chief of Staff, North Carolina Zoo

Pensions Backlash in Illinois
Government pension abuses have prompted some Illinois lawmakers to offer legislation to stop labor leaders from cashing in on taxpay-ers. Page 4

Incomes Down, Tax Rates Up
The income earned by the top 1 percent of Americans has declined for the second year in a row while their average tax rate has increased. Page 14

Kans. May Borrow for Pensions
Legislators in Kansas are considering a $5 billion loan to cover unfunded liabilities in the state workers’ pension system. Page 5

Which Tax Plan Is Fair?
Multibillionaire Warren Buffett has made news calling for higher taxes on the “mega-wealthy.” Others say a “flat tax” would be fairer—or a consumption tax. Heartland Institute experts discuss. Page 16

Failure of Keynesianism
An emphasis on confidence as a cause of economic activity instead of a consequence of economic conditions seems to have prevented policymakers from identifying the role of Fed actions. Page 10

The Bottom Line
Bankruptcy or State Takeover Facing Pa. State Capital

Continued from page 1

As if owing hundreds of millions of dollars on a trash incinerator that does not come close to paying for itself is not enough, there’s this: millions of dollars spent over a decade by this small mid-Atlantic city to buy artifacts for a Wild West museum that will never be built.

But this is small potatoes compared to the incinerator fiasco that has driven the city to bankruptcy, or state takeover, depending on how things end up.

Lousy Contracts, Poor Management
“I was thoroughly surprised at the lack of well-written contracts and inability to monitor contracts or use performance bonds,” said Beverly Cigler, professor of public policy and administration at Penn State-Harrisburg. “I was disappointed, but not surprised, at the failure to have appropriate checks on the former mayor’s visionary economic development projects but sloppy use of loans, borrowing, etc.”

Her reference was to Mayor Stephen Reed, who held office from 1981 to 2010.

The city council’s 4–3 vote to file for bankruptcy was an attempt to head off an agreement worked out by state Rep. Glen Grell (R-Cumberland) and state Sen. Jeffrey Piccola (R-Dauphin/York) that allows the state to impose an immediate recovery plan on the city. Gov. Tom Corbett (R) signed that measure into law October 20.

The deal allows Corbett to declare a state of fiscal emergency in Harrisburg and to direct the secretary of the Department of Community and Economic Development to develop an emergency plan to provide for vital and necessary services, including police and emergency, water and sewer, trash pickup, and other services.

“Sen. Piccola and I have the same goal in mind, to break the political stalemate and get the City of Harrisburg on the road to financial recovery. ... Harrisburg’s fiscal condition impacts us all.”

GLEN GRELL
STATE REPRESENTATIVE
CUMBERLAND, PENNSYLVANIA

Problems Beyond Incinerator
“There’s been a long history of bad decisions and management related to the incinerator and other things,” said Nate Benefield, director of policy analysis for the Harrisburg-based Commonwealth Foundation for Public Policy Alternatives. “The incinerator was supposed be hugely profitable. The city owes $300 million on it. If it’s sold, they would get just a fraction of that.”

The city also has had several tourism-related economic development failures, Benefield said.

“The city spent millions of dollars to create a Wild West museum that was never done. They’re auctioning off those Wild West artifacts and are going to lose money on that. They’ve also spent money on a Civil War museum, but Harrisburg is an hour from Gettysburg, where Civil War buffs want to go.”

Pennsylvania has a fiscal distress law, known as Act 47, that requires a state-appointed consultant to work with local officials on a fiscal plan. State officials have tried to use it for Harrisburg.

Rescue Plan Rejected
Last summer city and state officials tried to hammer out an Act 47 plan that would have had the city sell some assets and cut spending. The state also amended Act 47 to block “third-class” cities such as Harrisburg from filing for bankruptcy before July 2012.

The city council rejected the plan and moved to impose a 2 percent income tax on people who work in the city and live outside its boundaries. Income taxes also would have increased on city residents. The state rejected that idea.

Such tax increases “would be the worst possible solution to the city’s mess,” said Benefield. “This is a small city. It’s easy to move an office a few blocks and be out of the city.”

Cigler said neither bankruptcy nor a state takeover as proposed by the Grell-Piccola legislation is warranted until all other options are exhausted.

“I think the courts must resolve whether the council can declare for bankruptcy without Act 47, whether the council’s recent filing on bankruptcy without mayoral action is proper procedure, and whether the state’s recent change to the fiscal code for third-class cities is constitutional in denying the bankruptcy option before July 2012,” she said. “There are questions regarding constitutionality with a state takeover. If the state can enforce the Act 47 process and positive changes don’t occur, then filing for bankruptcy would be justified. Act 47, however, provides state guidance but not a takeover.”

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.
Could Privatization Rescue N.C. Zoo?

Continued from page 1

Under a private operator, the state “would cap the amount of money they are giving to the zoo, and the zoo would be freed up to generate the money for its entire operating budget,” Pugh said. “It seems to work in other situations, and what they’ve found is donors are more willing to give to a privately operated nonprofit institution rather than a government-run institution.”

‘Huge Uptick in Partnerships’
Rick Biddle, vice president of Schultz and Williams, the Philadelphia-based consulting firm conducting the feasibility study, said a report is due for completion by year-end 2011.

“There’s been a huge uptick” nationally, dating back 15 years but especially in the past five years, for accredited zoos and aquariums to enter into public-private partnerships, Biddle said.

“I think cities, counties, states that have partnered, those leaders look at it as a positive change for their respective institutions,” Biddle said. “Visitation are up, revenues are up, the number of household members are up.”

When the Houston Zoo created a public-private entity 10 years ago, visitation was about 1.2 million to 1.3 million people annually, but “this year will get very close to 3 million visitors,” Biddle said.

‘Tremendous Growth’ for Institution
“That’s a tremendous growth for a cultural institution,” Biddle said. “We haven’t had an institution that was publicly managed, moved into a private sector [operation], and then come back to the public sector,” Biddle said. “I take that as a good indication that these are good models for institutions to look at.”

“Governments just are not very good at running businesses. Government should not be in the business of running public-sector businesses, she said. “We have to go through all the hoops required by state rules and regulations.

Streamlined Process
For example, adding a new exhibit requires multiple steps, from study phase to design, purchase, and construction, each individually dependent on an act of the legislature, Pugh said. That process would be streamlined under private operation.

Currently, the zoo must come up with roughly $6 million towards its $17 million annual operating budget. If the zoo raises more revenue than anticipated, the state may reduce appropriations accordingly. “That’s what’s happening now,” Pugh said.

In a privately run zoo, there would be no rigid funding formulas. “That gives us an incentive to raise money,” Pugh said.

Dan Way (dway@carolinajournal.com) is a contributor to Carolina Journal. Used with permission from Carolina Journal.
‘Obscene’ Pension Abuses Spark Illinois Reform Push

By Steve Stanek

Government pension abuses in Illinois have prompted some lawmakers to try to advance legislation to stop labor leaders from cashing in on taxpayers’ pockets to take more than they have earned.

TOM CROSS
HOUSE REPUBLICAN LEADER
OSWEGO, ILLINOIS

“With this legislation, we are attempting to make our state laws stronger to prevent government employees from dipping into taxpayers’ pockets to take more than they have earned.”

The moves come in response to a series of articles by the Chicago Tribune detailing the ways union officials have been able to count their work for their unions toward local and state government pensions worth millions of dollars.

The most egregious abuse arguably involves two Illinois Federation of Teachers lobbyists with no teaching experience who were allowed to substitute-teach one day in 2007 and count their years working for the union as credit in the state Teachers’ Retirement System.

One Day’s Work, $108K Pension

For Steven Preckwinkle, the IFT’s political director, that one day of substitute teaching will qualify him for a government-funded pension starting at $108,000 annually when he retires next year at age 60, according to the Tribune’s analysis. Teacher pension benefits increase 3 percent annually.

Many lawmakers say they did not know of a provision in state law that allowed the lobbyists to do one day of classroom work and receive years of credit toward a government pension.

‘Closing Obscene Loophole’

State Rep. Jack D. Franks (D-Woodstock) has introduced legislation to rescind the two lobbyists’ ability to participate in the Illinois Teachers’ Retirement System (TRS).

“With this legislation, we are closing an obscene loophole that harms Illinois’ hardworking teachers,” said Franks.

“This type of all-too-familiar insider gamesmanship has contributed to the widespread demonization of our public-sector employees and has put Illinois’ retirement systems further into debt.”

Franks called upon Preckwinkle and fellow IFT lobbyist David Piccioli to resign their positions with the IFT.

“These individuals have a fiduciary obligation to protect their members’ retirement benefits, but instead did just the opposite,” Franks said. “They self-dealt for their own interests and harmed their members. Springfield bears its share of the blame for creating openings like this, but when the only two people to take advantage of the situation are IFT lobbyists deeply involved with crafting the legislation, this is inexcusable.”

In a statement on its Web site, the IFT defended the lobbyists’ action by saying it was legal and added, “The Tribune story specifically mentions IFT staff and the pensions they are legally eligible to receive in the Teachers Retirement System (TRS). That isolated opportunity for union staff to purchase past pension credit isn’t legal anymore and it should never be allowed again. The IFT would oppose any provision to revive that practice. The law should also be changed to prevent any future union employees from receiving pension credit from TRS without substantial time teaching in the classroom.”

Chicago Double-Dipping

Meanwhile, House Republican Leader Tom Cross of Oswego hopes to advance legislation that calls for workers employed by labor organizations in Chicago to have retirement contributions based on their regular salary, not the salary received from the union.

Cross is the chief sponsor of House Bill 2813, which would repeal a portion of state law passed in 1991 that allowed Chicago city employees to retire with a city pension that was based on a much higher union salary. This would affect the Chicago Municipal Employees’ Pension Fund, Chicago Laborers’ Pension Fund, and Chicago Teachers’ Pension Fund. The change would allow future union officials to accept a city pension based on their city salary when they left service.

As amended, HB 3813 also would ensure union officials cannot collect two pensions, one through the City of Chicago and one through a labor organization, by earning pension credit in both pension funds for the same period of service. This would affect the Chicago Municipal Employees’ Pension Fund and Chicago Laborers’ Pension Fund.

‘Outrageous Stories’

“This summer, Chicago media outlets uncovered some outrageous stories about Chicago city employees taking huge pension bumps, dipping into multiple pension funds for the same service, and engaging in fraud,” said Cross.

“We are attempting to make our state laws stronger to prevent government employees from dipping into taxpayers’ pockets to take more than they have earned,” he added.

The bill was sent to the full House for consideration at the end of October.

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The Next Steps for Congress

With a mandate for change from the American voters, Congress now must get to work. This booklet aims to bridge the gap between campaign promises and actual governance. In a series of essays, it offers some incremental but bold proposals that would improve public policy and increase individual freedom. Here are practical, positive, forward-looking ideas to protect the environment, improve health care, enhance education, and more.

“Good public policy comes from good ideas. This guide, we believe, provides a group of them.”

– Eli Lehrer
Editor

Available for free online at www.heartland.org.
Kansas Mulls Record Loan to Shore Up Govt. Pensions

By Gene Meyer

Kansas lawmakers may have to take out the largest loan in state history—$5 billion—to help plug a growing hole in the state’s pension system.

The loan, for almost more money than Kansas spent to run the entire government two years ago, would be financed through the sale of state bonds.

The Kansas Public Employees Retirement System (KPERS) Study Commission is expected to decide soon whether to recommend the loan to legislators for a vote in January as part of a KPERS overhaul plan.

“I don’t like debt,” said state Rep. Mitch Holmes (R-St. John), one of the commission’s co-chairmen. “But we’ve got to realize that unfunded liabilities are a debt too.”

Unrealistic Projected Returns

The unfunded liabilities to which Holmes referred are an officially projected $8.3 billion gap between pension benefits that KPERS has promised to about 158,000 teachers and state and local government workers by 2033 and the money KPERS is projected to have by then to make those payments.

Pension fund critics who say the official projections are based on unrealistically high investment returns generally estimate the Kansas gap is $20 billion or larger.

Either way, Kansas taxpayers would have to pay far more taxes to meet those obligations.

Alternative Possibilities

Gov. Sam Brownback, a Republican, and several legislators have been advocating curbing some of that future exposure by offering new KPERS members some version of a 401(k)-style retirement savings plan instead of traditional benefits.

Savings plans would prevent employer contributions from potentially skyrocketing, but they would not guarantee retirees lifelong incomes as the current pensions do.

Switching from traditional pensions, known as defined benefit plans, to retirement savings plans, known as defined contribution plans, presents additional challenges, said Ilana Boivie, an economist and director of programs at the National Institute on Retirement Security, a Washington, DC nonprofit research group specializing in retirement issues.

Savers in individual retirement plans might spend twice as much in investment fees to achieve the same earnings that traditional pension plans can earn by pooling large sums of money under professional management, Boivie said.

“Far greater contributions are required from both employers and employees [in defined contribution plans] to maintain the same level of benefit,” she said. “Plus maintaining two plans is more costly than operating just one.”

Lawmakers last spring ordered a 13-member panel of legislators, finance specialists, and KPERS member representatives, co-chaired by Holmes and state Sen. Jeff King (R-Independence), to consider alternatives—such as defined contribution plans, changes to the current traditional pensions, or combinations of the two—and present specific proposals for closing the gaps and returning KPERS to long-term health.

Bonds for Stability

The so-called pension obligation bonds the panel will consider would help solve problems such as the need to run two plans at once, King said.

The bonds also would help stabilize future funding, he said. Future legislators would find it harder to cut back retirement plan funding if the system were required to meet specific contractual obligations to lenders.

Even the seemingly eye-popping $5 billion price tag is relatively affordable, “though I certainly would advise against trying to issue the whole $5 billion at once,” said Rebecca Floyd, executive vice president and general counsel of the Kansas Development Finance Authority, the agency in charge of the state’s long-term capital and other borrowing.

“Rating agencies such as Moody’s are indicating they already are counting pension fund obligations along with other state obligations,” Floyd said.

Prior Bond Debts

Kansas is paying off $500 million in similar pension obligation bonds sold to raise KPERS money in 2004 plus more than $460 million in bonds for highway construction and renovation of the state capitol building, all with a relatively thrifty 1.98 percent of the state’s general fund revenue, she said.

Kansas’s credit is rated AA+ by Standard & Poor’s and Aa2 by Moody’s, the second-highest ratings either firm assigns to government’s long-term debt. Kansas doesn’t qualify for the absolute highest ratings because the state requires legislators to vote to repay debts each year instead of automatically making the payments a tax-paid obligation, Floyd said.

Issuing state bonds to help pay Kansas’s unfunded obligations “might be an OK way to go, but I’m not sure it’s a great idea,” said state Rep. Ed Trimmer (D-Winfield), who also serves on the study commission.

The same KPERS reform legislation that created the study commission “already puts us in the black by 2033,” Trimmer said. The new law calls for increased contributions from employers and state workers.

Unanswered Questions

“With bonds, there are a whole lot of unanswered questions,” Trimmer said, such as, “What rate will we sell the bonds for?”

Longtime government spending watchdog Bob Williams of State Budget Solutions, a Seattle-area nonprofit that promotes transparency in government spending, says states usually aren’t very trustworthy in these cases.

“States generally have a pretty bad history of handling pension obligation bonds the way they promise to,” Williams said. “They face a lot of temptation. But if they use the money as they promise, and don’t add additional benefits or do anything else to raise costs to constituents, it’s acceptable.”

Gene Meyer (gene.meyer@kansasreporter.org) is state capital reporter for KansasReporter.org.

“States generally have a pretty bad history of handling pension obligation bonds the way they promise to. They face a lot of temptation.”

BOB WILLIAMS, STATE BUDGET SOLUTIONS

“I don’t like debt. But we’ve got to realize that unfunded liabilities are a debt too.”

MITCH HOLMES

STATE REPRESENTATIVE ST. JOHN, KANSAS
Ohioans Vote to Overturn Collective Bargaining Limits

By Mike Reid

Ohioans in November voted 61 percent to 39 percent to repeal Senate Bill 5, a law that would have limited the collective-bargaining ability of public employee unions. Support for the repeal had majorities in 82 of Ohio’s 88 counties.

AFL-CIO spokeswoman Amaya Tune said after the vote this is “not just a victory for unions but a huge victory for working families in Ohio.”

AFL-CIO President Richard Trumka released a triumphant statement, saying, “Ohio’s working people successfully fought back against lies pushed by shadowy multi-national corporations and their anonymous front groups that attempted to scapegoat public service employees and everyone they serve by assaulting collective bargaining rights.”

Matt Mayer, president of the Buckeye Institute for Public Policy Solutions in Columbus, Ohio, said Trumka “needs to get some more sleep. The working class in Ohio are not government workers; they are people out of jobs.”

“I’m projecting that what we’re going to see is mass layoffs, because voters have shown that when they’re given the choice, they don’t have a tolerance for tax increases, because they can’t afford them.”

REBECCA HEIMLICH
OHIO STATE DIRECTOR
AMERICANS FOR PROSPERITY

Foregone Cost Controls

Mayer used Ohio school districts’ own numbers to calculate that by 2015 the schools will have a deficit of $7.6 billion, with 96 percent of education tax dollars spent on employee compensation.

Mayer projected SB 5 would have enabled local governments to save taxpayers about $1.3 billion next year alone. It became law last spring but was not implemented.

Republican Gov. John Kasich had been a staunch defender of SB 5 since signing it into law on March 31. He defended it in numerous TV commercials and at campaign rallies during the repeal campaign.

The now-repealed law would have limited public-sector union powers in several ways, such as preventing them from going on strike and stopping them from charging union fees to nonmembers covered by their contracts.

Possible Layoffs

Rebecca Heimlich, Ohio’s state director of Americans for Prosperity, noted Ohioans also consistently have rejected tax increases in the past few months. Increasing taxes is one of only three ways to resolve a local fiscal crisis, she observed. The others are to reduce expensive benefits for government workers (which the defeated SB 5 might have led to), or to cut pay and personnel.

Heimlich said, “I’m projecting that what we’re going to see is mass layoffs, because voters have shown that when they’re given the choice, they don’t have a tolerance for tax increases, because they can’t afford them.”

Mayer said Kasich and Republican lawmakers would be wise to step back from the issue now.

Pause in Fight

“The smart next step for the Republicans is to essentially say, ‘Okay, you won on this issue. So we’re going to allow you to propose bills on the reforms you think need to happen,’” Mayer said.

Kasich may be taking this advice. On election night he told backers, “It’s time to pause. The people have spoken clearly. You don’t ignore the public.”

The Ohio ballot fight is being compared to measures limiting collective-bargaining rights in Wisconsin that took effect nearly one year ago. Those limits survived vocal union opposition and legal challenges. One difference is that the Wisconsin law excluded firefighters and policemen. Kasich’s bill would have limited the collective-bargaining rights of all public-sector workers.

Ballot Bellwether for 2012?

Democrats and union leaders see the successful repeal in Ohio as a positive sign for them in the 2012 elections, partly because the repeal effort organized and energized the unions. In a victory speech Tuesday night, Stephen Loomis, president of Cleveland’s police union, said, “Thank you, John Kasich, for uniting the labor movement like it’s never been before.”

But Ohioans’ treatment of an important health care measure also on Tuesday’s ballot complicates the picture. More than 65 percent of voters, with majorities in all 88 counties, voted in favor of an amendment to the state’s constitution to exempt Ohio from President Barack Obama’s national health care mandate.

Meghan Snyder, spokeswoman for Ohioans for Healthcare Freedom, called it “a resounding victory” with “plenty of national significance.” She pointed out in particular that U.S. Sen. Sherrod Brown, a Democrat who has been a prominent supporter of Obama’s health care reform, must face the voters again in 2012.

Mike Reid (mikereid@mises.com) writes from Manitoba, Canada.

Cracking the Conspiracy

What can one man do when he finds himself up against the most dangerous men in America? His only weapons are intellectual: a keen analytical mind and rational morality. His opponents have vast resources of money and power—and no moral limitations on their use. The Trojan Project is a technological fantasy set amid today’s political realities.

“Listen up, America! This book contains relevant and necessary information for every individual in this country today. It’s that powerful.”

— LORI CREVER, host of TV show “30 Minutes with the Author.”
With the United States imposing one of the highest corporate tax rates of any nation, U.S. companies with overseas subsidiaries face an important decision: They can pay U.S. taxes when they bring back to the United States cash earned in a foreign subsidiary, or they can avoid that tax by permanently reinvesting their earnings abroad.

Many companies, according to MIT Sloan School of Management Professor Michelle Hanlon, choose not to repatriate the money, investing a substantial amount of money overseas.

"This is a big policy issue because the current system encourages companies not only to go overseas but to permanently keep their money there," Hanlon said. "Generally, countries want to attract assets and investments within their borders, but our tax policy does the exact opposite."

"Worldwide" Tax System
Hanlon explains that in the current system in the United States—known as the worldwide tax system—U.S. companies’ earnings are taxed in the United States even if earned overseas. The system does, however, allow companies to defer paying U.S. taxes on the operating income of foreign subsidiaries until they bring cash home to the U.S. parent company.

The taxation of those earnings, she says, also affects financial accounting numbers reported to shareholders. For financial accounting purposes, companies expense taxes paid and accrued. However, companies are not required to record the U.S. tax expense related to overseas operating earnings if the company thinks the earnings will not be repatriated back to the United States. Both of those effects—the saving of cash taxes and the ability to report a lower income tax expense to shareholders—provide incentives for companies to operate overseas and leave cash there.

Factor in Location Decisions
Hanlon surveyed approximately 600 tax executives and found reducing both U.S. cash taxes and U.S. income tax expense are important factors when corporations decide where to locate and whether to repatriate foreign earnings.

Nearly one-third of the respondents rated the reduction of U.S. income tax expense as important in their choice about whether to locate operations outside of the United States. More than 40 percent reported it as important in their decision to reinvest funds outside of the United States. Those percentages were even higher for publicly traded companies that have foreign assets and high levels of research and development, as nearly two-thirds rated the lower expense reported in financial accounting as an important factor in their decision.

"The implications of our evidence are that both the tax and the financial accounting effects lead to greater foreign direct investment by U.S. companies and lower repatriations," said Hanlon, noting the research is particularly timely in light of recent talks of corporate tax reform and another repatriation act.

"Generally, countries want to attract assets and investments within their borders, but our tax policy does the exact opposite."

MICHIELE HANLON, PROFESSOR, MIT SLOAN SCHOOL OF MANAGEMENT

‘United States Has to Reform’
“‘It’s a complicated issue that companies are spending a lot of time on right now,’ Hanlon said.

She continued, “The United States has to reform the corporate tax system in a manner that provides greater incentives to stay in the United States and provides fewer distortions in companies’ decisions to move cash internally. The hope is that this would lead to more companies staying in the United States with greater production and more jobs here as well as decisions based on business reasons rather than tax and accounting benefits.”

As tax reform is debated, it’s clear the current system creates “terrible” incentives for U.S. companies, she says.

“With such a high tax rate that is triggered any time companies bring foreign earned money back to the United States, they are motivated to continue expanding overseas and indeed to hold cash overseas. We really need to think about how to tax multinationals while balancing the need for U.S. companies to stay competitive,” Hanlon said.

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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?

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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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By Robert Genetski


As each new problem emerges, the book reveals Paulson and Federal Reserve Chairman Ben Bernanke focused on the need to boost consumer confidence. This emphasis on confidence as a cause of economic activity instead of a consequence of economic conditions seems to have prevented them from identifying the role Fed policy was playing in restraining money and liquidity.

In Bernanke’s account, he, Paulson, and Tim Geithner (then president of the New York Federal Reserve) address each new problem as it develops—from the failure of investment bank Bear Sterns to the deterioration of Lehman Bros. and on to the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. They attempt to devise a specific solution for each new emerging crisis. As the economy continues to deteriorate, each specific problem becomes worse, and new problems emerge.

Fannie, Freddie Bailouts
Fannie Mae and Freddie Mac were among the more seriously troubled financial institutions. They had hundreds of billions of dollars in debt and were losing billions of dollars each quarter. These agencies were created, sponsored, and regulated by the U.S. government, but were privately owned. Common stock was owned by the public, but the preferred stock was owned mostly by banks. Bank regulators had encouraged banks to buy preferred stock in these enterprises. In response, banks reportedly owned $30 billion to $36 billion of preferred stock in Fannie and Freddie.

In July 2008, amid massive losses at the GSEs, Paulson sought and received Congressional approval for Treasury to bail out the GSEs. “The legislation gave us broad discretion to provide financial support to the GSEs as we saw fit. ... The legislation did not impose any limitations on the amount of that support, except that it would not be exempt from the debt ceiling ... It was perhaps the most expansive power to commit funds ever given to a Treasury secretary” (Paulson, p. 155).

Astute financial experts knew the U.S. Treasury had a difficult problem resolving the GSEs’ preferred stock problem. In late August, one analyst described the problem: “Now that Fannie and Freddie are in trouble, the government is in a bind. After encouraging banks to buy FNMA/FRE preferred by loosening regulations, they cannot easily make the banking sector take $36 billion of writedowns on securities that banks only invested in because of strong government incentives. ...

We are curious to see how the government will get out of that quagmire. Taking too steep a haircut on the preferred is out of the question due to the risk of further credit contraction. $36 billion of writedowns decreases banks’ lending capacity by at least $450 billion” (Lawrence Kirchner, “Seeking Alpha,” August 28, 2008).

With Treasury’s unlimited authority to deal with this problem, Paulson (with help from Bernanke, Geithner, and others) did what Kirchner and others believed was out of the question.

Financial Panic’s Trigger
On September 5, Treasury announced its solution to the “quagmire.” Treasury would guarantee all the GSEs’ hundreds of billions of dollars in debt. However, it would place Treasury in a senior position above preferred stockholders. This meant if any money were ever recovered from the GSEs it would go first to the U.S. Treasury. Given the huge cost of bailing out the GSEs’ debt, this meant the preferred stock would be essentially worthless. In effect, Treasury had overnight eliminated well over $20 billion in bank equity, which supported well over $200 billion in loans and investments.

Those following the Fannie-Freddie fiasco were stunned. They could not imagine a move that would trigger a major shortfall in liquidity in the midst of a financial crisis. In spite of highly detailed descriptions surrounding many of his decisions, Paulson says nothing about this fateful one.

The decision produces an immediate collapse in financial markets. Within a week, a struggling Lehman declares bankruptcy, AIG follows, and problems quickly spread not only to the entire banking system but also to money market funds.

Shocked by Consequences
Less than two weeks after this decision, Paulson was apparently shocked to discover that “… all hell broke loose” (Paulson, p. 228) and “Liquidity was evaporating all over the place” (Paulson, p. 231).

With the financial system imploding, Paulson opted for a second bailout. Treasury had committed most of what at the time was an $800 billion source of funds to bail out the GSEs. Since the situation was now worse, Paulson told President George W. Bush he would need another $700 billion to shore up the financial system.

When the president and vice president pressed the Fed for alternatives, Bernanke insisted that, legally, there was nothing more the Fed could do. The central bank had already strained its resources and pushed the limits of its powers. The situation called for fiscal policy, and Congress had to make that judgment. Bush pushed him, but Bernanke held firm.

“We are past the point of what the Fed and Treasury can do on their own,” Bernanke said (Paulson, p. 257).

Keynesian Trap
That was untrue. The Fed has unlimited authority to create bank reserves and restore liquidity to the banking system. That, in fact, was the reason the Fed was created. There
More Problems, More Failed Solutions

occurs when the Federal Reserve uses its tools to add or subtract money and liquidity. Unfortunately, instead of restoring liquidity, the Fed inadvertently reduced it in the midst of the financial meltdown.

**Liquidity Reduction**

The reduction came in October 2008, when the Fed began paying banks to keep their reserves with the Fed. Although the Fed offered to pay only 4 percent for the funds, the rate was attractive given existing financial conditions. So long as banks choose to keep reserves with the Fed instead of using them for loans and investments, the reserves cannot increase liquidity. It is similar to the Fed raising reserve requirements. The only distinction is that raising reserve requirements makes it mandatory to keep reserves out of the economy. Paying banks interest to keep reserves out of the economy makes the decision voluntary.

In October 2008 the amount of bank reserves used for loans and investments dropped to $79 billion from $99 billion in September. Under the assumption of a ten-to-one leverage ratio, this $20 billion bank reserve reduction was equivalent to removing $200 billion in liquidity from the banking system.

Instead of flooding the system with liquidity, the Fed’s policy removed 20 percent of the banking system’s reserves in the face of the worst financial crisis since the 1930s. The following month the Fed began restoring bank reserves. Within two months the worst of the crisis had passed.

**Sees Importance of Reserves**

Paulson hints he may have, or at least should have, recognized the impact of destroying bank capital. Here’s what he says about his thinking in early October 2008, a month after the fateful decision regarding the GSEs’ preferred stock:

“From the start of the credit crisis, I had been focused on bank capital, encouraging CEOs to raise equity to strengthen their balance sheets. … Initially, when we sought legislative flexibility to inject capital, I thought we might need it to save a systemically important failing institution. … Now I realized two crucial things: the market was deteriorating so quickly that the asset-buying program could not get under way fast enough to help. … We knew the money would stretch much further if it were injected as capital that the banks could leverage. To oversimplify: assuming banks had a ten-to-one leverage ratio, injecting $70 billion in equity would give us as much impact as buying $700 billion in assets” (Paulson, pp. 336–337).

**Misdiagnosing Crisis**

Paulson provides several hints certain foreign officials had a better grasp of events than U.S. officials. For example, Chinese officials (who are familiar with the classical economic framework) are seen to be consistently more accurate in their assessment of U.S. financial problems than our own officials. There is also a telling conversation in October 2008 between President Bush and France’s President Sarkozy, who wants to discuss detailed financial reforms.

“That’s not for us,” President Bush said. “We’re going to have our experts do that.”

The French leader came right back at him. “These experts are the ones that got us in trouble in the first place” (Paulson, p.375).

**Lessons Yet to Be Learned?**

Looking back at the challenges and decisions surrounding the financial meltdown of 2008, several things are readily apparent:

- Key policymakers all used the Keynesian economic perspective to assess what was wrong and formulate policies intended to promote financial stability.
- Policymakers were continually surprised to find that after implementing their proposed solutions, the financial situation became worse instead of better.
- By relying on interest rates instead of assessing bank reserves and the existence of financial leverage, the Fed often ended up with a monetary policy opposite to what it intended.

The recent financial crisis provides important lessons of how the Keynesian economic perspective produced a series of policy mistakes that created the worst financial collapse in modern times. As long as policymakers continue to use the Keynesian framework in developing economic policies, the potential for another financial crisis is uncomfortably high.

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President Barack Obama's dream of a high-speed rail future for California is dead. The only question now is whether the state government will kill it in time to save taxpayers billions of dollars.

On November 1, the California High-Speed Rail Authority issued a new report conceding what critics have been saying for years—that the ambitious plan to build a bullet train linking San Francisco and Los Angeles would “take longer and cost more than previously estimated.”

In 2008, when California voters approved the project in a ballot measure, the system was projected to cost $33 billion to build. Now, the revised projection is that the system would cost a whopping $98 billion, accounting for inflation over the life of the project. The date of completion was pushed back 13 years, to 2033.

Little Private Funding
Making matters worse, the new business plan predicts only 20 percent of the funding will come from private sources. Even optimistically, then, planners will have to come up with $80 billion during times when federal, state, and local governments are already strapped for cash.

California enjoyed a one-time bonanza when Obama and the Democratic Congress came to Washington in 2009 with a crisis they didn’t want to waste and allocated billions of dollars to high-speed rail projects. But since Republicans have taken over the House of Representatives, they’ve turned off the spigots.

Though logic would suggest it would make sense to kill the project altogether, if the state were to do that, it would have to forgo $3.5 billion in stimulus money that’s already been directed to it.

‘Corruption at Whole New Level!’
“The project is dead, period, because they have no money,” Rep. Devin Nunes (R-CA) said. “But the problem is everyone’s hand is now in the cookie jar ... and they’re buying off every lobbyist and consultant that they can in California, so the corruption has reached a whole new level.”

He added, “I don’t think you could dream up a bigger boondoggle than this, even if you tried.”

The initial 130-mile stretch of the system is supposed to be built in the less-inhabited Central Valley at a cost of $8.8 billion, partially funded with stimulus money.

But that would pay for only the tracks themselves, which won’t even be running high-speed trains until more of the system is built. According to the San Jose Mercury News, taxpayers would be paying to “provide a 45-minute shortcut for the 3,000 riders on Amtrak’s San Joaquin line.”

Opponents of the project have criticized the rail authority for seemingly pulling numbers out of a hat. State Sen. Doug LaMalfa (R-Richvale) noted when the project was put before voters on the 2008 ballot, average ticket prices between San Francisco and Los Angeles were said to be $55.

Then the estimate shot up to $105. In a hearing this July, the head of the rail authority told LaMalfa the actual cost would be $120. Yet in its November report, the price went back down to $81.

Possible Ballot Issue
When the state Senate goes back in session in January, LaMalfa will propose putting the high-speed rail proposal back on the ballot. The measure passed by a relatively narrow 53 percent to 47 percent vote in 2008, but a September survey by Republican pollster Probolsky Research found 62 percent of Californians want to stop the project.

At a time when Californians are being asked to endure cuts to health care and schools because of the budget crunch, there’s less appetite for an expensive high-speed rail venture. “People are insulted by this,” LaMalfa said.

The only reasonable response at this point would be to send back the federal money and cancel it, as several other states already have done with high-speed rail projects. Then again, we’re talking about California.

Philip Klein (pklein@washingtonexaminer.com) is senior editorial writer for The Washington Examiner, where this article first appeared. Used with permission.
San Antonio Council OKs Streetcar Rail Project

By Cheryl K. Chumley

The San Antonio City Council has approved a multi-million-dollar battery-powered streetcar service that critics say could put the city on “a dangerous fiscal path.”

The council gave its approval in mid-October with a 9–1 vote, with one member absent. The project by VIA Metropolitan Transit is expected to become operational sometime after 2013.

With $40 million of San Antonio funding, the city will begin immediately to design and build a transit station on the west side of the city and a second on the east side, as well as a park and ride center on U.S. 281, according to Thomas Marks, spokesman for Councilwoman Elisa Chan, who voted in favor of the project.

Federal Funding Needed

VIA also will need to obtain additional federal revenues to complete the project, which includes at least $65 million for related construction on the non-streetcar portion of the transit system.

“As the city continues to grow, it is important that we address our city’s transportation needs proactively,” said Councilwoman Chan (District 9), in a statement. “Many people have asked me, ‘what would happen if VIA fails to secure the federal funding for the proposed streetcar routes?’ ‘Would the city give out more money?’ What I would say is that it would be another decision for another day with another vote.”

And that, in a nutshell, is one glaring problem with streetcar transit plans, said Jeff Judson, a senior fellow with The Heartland Institute.

“Rail transit is predicated on the availability of federal funds, which are not likely to be available,” Judson said. “Rail transit is also predicated on the success of rail spurring economic development, but objective research shows that little or no development will occur without significant additional taxpayer subsidies to entice developers to invest in the area. Rail alone does not induce development.”

Randal O’Toole, a senior fellow with the Cato Institute who specializes in urban growth, public land, and transportation issues, finds that historically true.

“Portland built a parking garage next to the streetcar line and persuaded Whole Foods to move into a retail space next to the garage,” O’Toole said, in an email. “Then Portland claims that Whole Foods moved there because of the streetcar line. In fact, Whole Foods only moved there because of the parking garage.”

Streetcars, O’Toole continued, “are just a scam.”

Not everyone in San Antonio favors the plan, either.

“There was a contingency of folks who were at the [council] meeting and after the vote was taken, they said they were going to try and start a drive to vote out of office the council members who passed the plan, Marks said.

Better Options Will Suffer

Meanwhile, other modes of transportation—like bus systems, which are several times more cost-effective in terms of attracting customers and providing reasonably priced transport, when compared to streetcars—will suffer, Judson said.

“Local funds available for buses ... will be cannibalized to pay for the voraciously expensive rail system,” Judson said. “As bus fares increase and bus service is reduced, transit ridership will drop. This is the experience in other light-rail metropolitan areas.”

In Portland, O’Toole said, 9.8 percent of Portland commuters rode public transit before rail existed, according to 1980 Census Bureau figures. By 2000, when two rail lines were in operation, public commuting dropped to 7.7 percent. A year later, Portland opened its streetcar line and a third light-rail line. And in 2004, the city opened a fourth light-rail line. But by 2007, only 6.5 percent of commuters took transit to work.

Then in 2009, public transit participation in Portland saw a slight rise to 7.6 percent—but that was due largely to high gas prices, O’Toole found.

San Antonio is not Portland, but O’Toole said it doesn’t matter, adding politics and personal greed are the fueling forces in streetcar development nationwide.

“The modern streetcar craze started in Portland and was initiated by a member of the city council,” O’Toole said. “After Portland built the first streetcar, he quit the council and took a job with a consulting firm named HDR. In this job, he travels around the country telling cities what a great success the Portland streetcar is and why they should build streetcars of their own. Of course, HDR expects to make huge profits helping to plan and engineer the streetcar lines.”

Cheryl K. Chumley (ckchumley@gmail.com) writes from Northern Virginia.
The income earned by the top 1 percent of Americans has declined for the second year in a row while their average tax rate has increased, according to a new Tax Foundation study.

The average federal tax rate for those reporting at least $343,927 in income increased from 22.5 percent in 2007 to 24.0 percent in 2009, while the average income for the top 1 percent declined from $1.4 million to $1 million over the same period.

The Tax Foundation’s analysis is based on new data from the Internal Revenue Service on individual income taxes, reporting on calendar year 2009. The total amount of individual income tax paid declined by $166 billion, twice the decline from 2007 to 2008.

Nationally, average effective income tax rates were the lowest since the IRS began tracking them in 1986. The average tax rate for returns with a positive liability went from 12.2 percent in 2008 to 11.1 percent in 2009.

**Fluctuating Tax Liabilities**

“During a time of economic downturn, we expect to see significant changes in both total income reported and the share of taxes paid by those with the highest incomes,” said study author and Tax Foundation economist David S. Logan.

“Unlike middle-income wage-earners, whose incomes and tax liabilities are fairly steady, high-income people tend to realize significant capital gains that fluctuate wildly with the economy, causing their income tax liabilities to fluctuate as well,” Logan added.

In 2009, the top 1 percent of tax returns earned 16.9 percent of adjusted gross income reported and paid 36.7 percent of all federal individual income taxes. In 2008 those figures were 20.0 percent and 38.0 percent, respectively. Each year from 2005 to 2007, the top 1 percent’s continually growing share of income earned and taxes paid set a record. The 2008 reversal of this trend continued in 2009.

**Decline Among Very Highest**

The study also looks at the very highest earners, the top 0.1 percent of tax returns, which the IRS began singling out only in recent years. In 2009, those 138,000 tax returns accounted for nearly 7.8 percent of adjusted gross income earned (down from almost 10 percent in 2008), and they paid approximately 17 percent of the nation’s federal individual income taxes (down from 18.5 percent in 2008).

“The very highest income group—the top one-tenth of one percent—actually has a lower average effective income tax rate than the rest of the top 1 percent of returns because these extremely high-income returns are more likely to have income from capital gains and dividends, which are typically taxed at lower rates,” said Logan.

“It’s worth pointing out that in the case of capital gains and dividends, however, income derived from these sources has already been taxed once by the corporate income tax, which is not included in the current study, meaning the average effective tax rate numbers can be somewhat misleading,” Logan added.

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Transportation Bill Math Shows Neither Party Has the Money

By C. Kenneth Orski

An October 26 letter from Sen. Barbara Boxer (D-CA) to Rep. John Mica (R-FL) has brought to the surface the confusion over funding of the multiyear surface transportation authorization. Boxer is chairman of the Senate Environment and Public Works Committee. She asked Mica, chairman of the House Transportation and Infrastructure Committee, to clarify “whether the proposal you support fully funds surface transportation programs at $339 billion over six years, or if news reports stating that you support funding levels of $286 billion are correct.”

She added the Senate proposal for $109 billion would fund the programs “at current funding levels indexed for inflation” over two years. The committee, Boxer added, is seeking offsets of $12 billion—the estimated revenue shortfall of the Highway Trust Fund (HTF) over two years.

**Boxer’s Funding Caveats**

“I am willing to consider a six-year transportation bill at current funding levels plus inflation if it is fully paid for in a way that had bipartisan support and does not cut jobs elsewhere in the economy,” Boxer wrote.

In its latest (August 30) report, the Congressional Budget Office (CBO) estimated over the next six years (FY 2012–2017), dedicated taxes will generate approximately $234 billion in revenue and interest ($204 billion in the Highway Account and $30 billion in the Transit Account). This comes to annualized revenue of $39 billion.

CBO also estimated the HTF ended FY 2011 with approximately $14 billion in the Highway Account and $7 billion in the Transit Account. These unspent balances have made it possible for Boxer to come up with a two-year $109 billion budget even though HTF revenue over that period is expected to amount only to $78 billion. The remaining $31 billion is proposed to be covered with $19 billion in unspent Trust Fund balances and $12 billion in (as yet undetermined) offsets.

**Billions in Offsets**

According to Boxer, a six-year program “at current funding levels plus inflation” would require $339 billion and offsets of approximately $75 billion. CBO projects the six-year outlays at a somewhat lower level of $329.4 billion ($267.4 from the Highway Account, $56 billion from the Transit Account). At this level of expenditures, CBO estimates the six-year revenue shortfall requiring offsets would total $68 billion ($55 billion in the Highway Account, $13 billion in the Transit Account).

Although Mica has not been specific about the dollar amounts he is seeking for his six-year bill, he has been quoted as saying the House bill would be funded at the level of the “current bill.” Although the discussion of funding at a level close to the “current bill level” or at “current funding level” may appear to be semantic, it represents real dollars. Neither political party seems to have found the necessary extra money to achieve its funding goal.

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Can any tax be fair?

Multi-billionaire Warren Buffett has been decrying what he says are unfair tax policies that let the “mega-wealthy,” including himself, off easy.

His premise comes into question, however, when reviewing tax data. For 2011, households earning more than $1 million will pay, on average, 29.1 percent of their income in federal taxes. A household making between $50,000 and $75,000 will pay 15 percent of its income in federal taxes, including income taxes and Social Security and Medicare payroll taxes, according to the nonpartisan Tax Policy Center.

Nonetheless, President Barack Obama has picked up on Buffett’s lament to call for a “Buffett rule”—a minimum tax on persons earning more than $1 million a year. Yet Buffett himself has said millionaires are not mega-wealthy. A person with $1 billion, after all, has a thousand times as much money as someone with $1 million.

Is Flat the New Fair?

Stephen Moore of the Wall Street Journal recently took up the issue of tax fairness with a column headlined, “Flat Is the New Fair.” A flat tax would impose one rather than multiple tax rates based on income level, and it would get rid of most or all tax deductions, exemptions, and credits.

Republican presidential contenders are also addressing tax fairness. The proposal with the most press recently has been Herman Cain’s “9-9-9” plan: personal income, corporate, and national sales taxes of 9 percent each.

Budget & Tax News asked Heartland Institute policy advisors who’ve done a good deal of thinking about taxes and the economy for their views on the tax fairness issue. Here’s what they wrote.

Living in an imaginary world where substantial tax reform is possible, both a flat tax and a Fair Tax have appeal. [Editor’s note: The “Fair Tax” would replace the federal tax system with a national consumption tax of 23 percent, similar to a sales tax, but with “prebates” to help taxpayers offset some of the tax burden.]

Fair Tax proponents make several major claims, most of which I find unconvincing, including that it will keep the government from “picking winners and losers” and that it will allow us to “eliminate the IRS.” Neither of those claims is true.

Beyond that, the Fair Tax would turn millions of small businesses, including online businesses in particular, into tax collectors for the federal government. If the nation decides to continue down a path of considering a national sales tax, such as Herman Cain proposes in his 9-9-9 plan, it is absolutely critical that the implementation of that tax—unlike in the 9-9-9 formulation—be done simultaneously with repealing the 16th Amendment (which allows the federal government to impose an income tax).

Hauser’s Law (which posits that no matter what income tax rates the federal government sets, the Treasury will not collect more than about 19.5 percent of national income) is only true in the United States because we do not have both a national sales tax and an income tax.

Manipulation, Black Markets

I strongly prefer a flat tax. It is much less burdensome to administer than a sales tax on every retail transaction. This burden should not be overestimated. And, despite pleas of the national sales tax crowd, it is likely to end up less subject to political manipulation than the Fair Tax would be.

In each case there will be questions of how to protect the poor. With a flat tax, some first number of dollars of income will not be taxable. With a Fair Tax, there will be a “prebate” with the government guessing how much money people spend on taxable items.

The flat tax does not have the black market-causing effects that a large national sales tax would have. Fair Tax proponents argue there won’t be a black market because final prices after the sales tax would be close to current retail prices due to companies being able to lower their base prices once the corporate income tax is eliminated.

However, the desirability of a black market is based only on the relative prices of that black market versus the regular market. And when you’re talking about a 23 percent difference in price, it is foolish to think there won’t be an enormous black market created. It’s also worth noting that this will drive consumers to buy things from other countries in situations where the transportation cost of items is less than 23 percent of the item’s cost.

Look at all the eBay sellers from Hong Kong. They’ll suddenly have a huge price advantage, given that they are already competitive even including the cost of postage. This, combined with the paperwork burden of collecting tax on every sale, means the Fair Tax would put many online businesses out of business. There is none of this problem with a flat tax.

The word “fair” is used a lot by the Left, though with them it is usually used in a way that a rational person would think means “unfair.”

Meaning of ‘Fair’

What is fair is to treat each American the same way, with the same opportunity (or lack thereof) for exclusions, exemptions, deductions, and so on. The flat tax, assuming we prevent another tax code metastasis around it, is more likely to be fair in that way. The Fair Tax’s “prebate” is just a recipe for expanding the welfare state and making the tax code even more progressive.

It is not “fair” for nearly half the nation’s earners to contribute zero toward the cost of government, even while I stipulate that more than half of what the government
Heartland Institute Experts Discuss

spends is unconstitutional. Does someone who earns $25,000 a year really have so little stake in, for example, national defense, that he or she should be able to pay zero income tax?

Whether either tax reform would address the issue of free riders is an open question, especially given that nearly half of American income earners have no incentive to support anything that would no longer let them free-load off those who do pay tax.

**Government Snooping**

Fair Tax proponents also argue their plan is better because it keeps the federal government from knowing what we make and how we make it. I have sympathy for that argument. On the other hand, those who sell things at retail for a living would be in the same position; it’s just the rest of us who wouldn’t have to tell Big Brother about every penny we earn.

That disclosure to the federal government is, however, a price I would be willing to pay if it meant a system that is easier to comply with and more difficult for politicians to manipulate.

The main practical benefit of the flat tax is that it can be implemented without amending the Constitution. Passing an amendment to repeal the federal government’s authority to impose an income tax, which is to say repealing the 16th Amendment, would be the Mount Everest of political challenges, and that probably understates the difficulty.

**Government Uncertainties**

I think investors who could fund new capital with the $2 trillion in cash and short-term securities are also very much in doubt about what will be done before the election in 2012 and its long-term economic effects. That is why, among other government uncertainties (financial and environmental regulation and monetary policy), businesses and individual investors are holding back.

Broadening the tax base is a tax increase. Not enough is known about what will be done before the election in 2012 and its long-term economic effects. That is why, among other government uncertainties (financial and environmental regulation and monetary policy), businesses and individual investors are holding back.

**Prices for Services**

The other model sees taxes as prices for government services. The corporate and individual income tax systems are unevenly applied because the government services are also consumed unevenly. Social Security, for example, is mostly a benefit for low-income individuals and is largely levied on low-income taxpayers.

The pioneering work on the tax price theory was done by Earl Thompson. It was published in the *Journal of Political Economy* in 1974. His theory recognized that national defense was the federal government’s largest budget item. He then observed that not all assets are vulnerable to appropriation by a hostile aggressor. Looking at the tax and budget systems at the time, he found that assets not vulnerable to appropriation were taxed at a low rate.

An interesting twist on this observation is that energy and mineral deposits are attractive to a hostile aggressor. But as they are recovered and consumed, the need to protect them is reduced. Thus, there is a rationale for expensing intangible drilling costs and depletion allowances.

I do not know of any significant additional work on the tax price model since Thompson’s in the early 1970s. Therefore we lack guidance on which “tax loopholes” to remove. Putting this in the hands of an elite committee and the Congress with a very short time limit, suggests to me that substantial harm cannot be avoided.

The federal tax system is complicated. Having said that, I would quickly add that assuming there is no good reason for the complexity is not convincing, at least to me. Before one sets out to change the world, one ought to understand why the world is the way it is.

There are at least two tax models vying for verification. One is that politicians have a free hand to give tax breaks in any amount and to any group without limit in order to improve the chances for reelection. A corollary is that politicians can and will punish unpopular entities with high taxes.

An implication is the government has the potential for being unlimited in size. While I have sympathy for trying to limit government, I do not see it being infinitely large. Moreover, I do not know what to cut and what to increase. And nobody else knows either. With all due respect to the academic work on the mortgage interest deduction, for example, I do not believe that homeowners with mortgages are under-taxed.

**In Part Two**

I will explore the potential for goods to carry prices that are not taxes. I see a potential for goods to carry prices that are not taxes.
Statewide smoking bans have “little or no measurable immediate effect” on the number of persons who die from heart attacks, according to a new report by medical researchers at two universities.

In “Acute Myocardial Infarction Mortality Before and After State-wide Smoking Bans,” researchers Brad Rodu and Nicholas Peiper of the University of Louisville and Phillip Cole of the University of Alabama write, “Our results are consistent with a recent analysis finding that smoking bans were not associated with short-term declines in mortality or hospital admissions for myocardial infarction or other diseases.” They add, “This study’s results are consistent with the fact that even the decline in active smoking has played only a minor role in reducing heart disease.” According to another recent study, titled “Explaining the decrease in US deaths from coronary disease, 1980–2000,” published in the New England Journal of Medicine, the decline in smoking accounted for only about 12 percent of the total decline in heart disease mortality.

Rodu, Peiper, and Cole conducted the study after noting several published reports have claimed smoking bans result in almost immediate reductions in heart attack mortality rates. To test the observations, they compared the acute myocardial infarction mortality rate among persons 45 years old or older (deaths per 100,000 persons, age-standardized to the 2000 U.S. population) in the three years before adoption of the smoke-free ordinance (the expected rate) with the rate observed in the first full year after the ban (the target year) in six U.S. states.

Target-year declines also were compared to those in states without smoking bans. Target-year declines in California, Delaware, and Utah were not statistically different from expected declines based on the prior three years. In South Dakota, heart attack mortality increased 8.9 percent in the target year. Florida and New York saw bigger declines than expected but not statistically different from the 9.8 percent decline in the 44 states without a statewide smoking ban.

They conclude, “Smoke-free ordinances may serve public health objectives by providing non-smokers with indoor environments that are free from irritating and potentially harmful pollutants. However, this study does not provide evidence that these ordinances result in a measurable immediate reduction in AMI mortality of the magnitude claimed by reports based on very small incident numbers.”

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. This article first appeared in the December 2011 issue of Health Care News and is used with permission.
With the financial stakes so high, it’s no time for policy gambles.

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