Maryland May Shift Pension Burdens to Local Government

By Gabriel J. Michael

A key piece of Maryland Gov. Martin O’Malley’s (D) legislative agenda this year involves shifting some government employee pension costs away from the state and requiring county governments to make up the difference.

In Maryland, as in the rest of the nation, the growing cost of public pensions remains a primary fiscal and political concern. Last year the state enacted a significant reform of its pension plan, decreasing benefits, raising contribution rates, and lengthening vesting periods in an attempt to rein in spending.

Maryland, p. 6

Kansas Republicans Seek Tax Reforms

By Gene Meyer

Kansas House Republican leaders have unveiled the broad outlines of a major tax overhaul proposal that focuses on curbing state spending to reduce state income taxes, eliminating many taxes that small businesses pay, and accelerating the reduction of Kansas’s 3.5 percent and 6.25 percent state income tax brackets for low- and moderate-income taxpayers.

The new proposal will join a plan, presented in January by Gov. Sam Brownback (R), that cuts Kansas’s top state income tax rates to below 5 percent while abolishing many tax credits and deductions taxpayers now claim, as well as a plan that has yet to emerge from a

Kansas, p. 4

Georgia Prisoner Snafu

Georgia penitentiaries continue to feed, clothe, and pay medical expenses for hundreds of inmates who were approved for parole but cannot be released because they have nowhere to live.

Free Loans in Portland

Over the past decade Portland, Oregon’s redevelopment agency has loaned developers, private companies, and organizations $125 million, more than half at interest rates below the annual inflation rate.

Michigan Pays Studio’s Loan

Just 10 months after the Raleigh Michigan Studios opened in Pontiac, Michigan, the movie studio missed a $630,000 bond payment. But the bondholders received their money courtesy of the Michigan Employees’ Retirement System.

Federal Debt Danger

Cut the federal debt or the United States will cease to exist as a superpower—that was the message Erskine Bowles and Alan Simpson had for a packed house at Duke University’s Page Auditorium.
With the financial stakes so high, it’s no time for policy gambles.

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Indiana Enacts Right-to-Work Law

By Nick Baker

A battle in Indiana that lasted more than a year and two legislative sessions ended February 1 when Gov. Mitch Daniels (R) signed into law a right-to-work bill, making Indiana the 23rd right-to-work state—and the first in the Rust Belt.

The bill had passed the State Senate 28–22 and the House 55–44.

Supporters hailed it as a major victory that will retain employers and attract new ones. Right-to-work states do not allow people to be forced to join labor unions or pay union dues as a condition of employment.

“This law won’t be a magic answer, but we’ll be far better off with it,” Daniels said in a statement. “I respect those who have objected, but they have alarmed themselves unnecessarily: No one’s wages will go down, no one’s benefits will be reduced, and the right to organize and bargain is untouched and intact.”

Experience Changed Stance

Although while first running for governor in 2004 Daniels said he would not push right-to-work, he said seven years as the state’s chief executive have demonstrated to him such a law is necessary to attract jobs. He noted one reason Volkswagen opened a new auto manufacturing plant in Tennessee last year was because Tennessee is a right-to-work state and Indiana was not.

State Senate President Pro Tempore David Long (R-Pt. Wayne) said he received word from officials at one Indiana company that they will remain in the state rather than relocate to Alabama, another right-to-work state. He also said a company from Michigan is considering moving to Indiana.

“When they saw what was happening here, [they] invited the state to bid. We are now in consideration for those jobs,” he said.

Labor Union Backlash

During the legislative session, busloads of union members descended on the statehouse in Indianapolis and heckled lawmakers from the galleries in an attempt to disrupt proceedings. On several occasions in January, Democrat House members walked out, preventing a quorum and bringing all legislative business to a standstill.

However, unlike last year’s drama that saw the Democrats flee for several weeks to an Illinois hotel, House Minority Leader Patrick Bauer (D-South Bend) ordered his caucus to return to the statehouse after an amendment was defeated that would have put right-to-work on the ballot this year.

After the bill’s signing, Indiana AFL-CIO President Nancy Guyott shouted to union members from the statehouse steps, “We’ll take our state back, one citizen at a time! You ain’t seen nothin’ yet!”

Falling Union Membership

With union membership declining, however, it remains to be seen whether unions can mount a campaign to defeat Hoosier lawmakers who supported the bill. According to the U.S. Bureau of Labor Statistics, union membership stood at just over 10 percent in Indiana in 2010, down from 15 percent in 2000. Nationally, only 6.9 percent of the private-sector workforce is in unions.

This isn’t Indiana’s first experience with right-to-work. It was adopted in 1957 but was repealed in 1965 after union members managed to elect a Democrat governor and legislature the year before.

‘Marketplace Sets Wages’

John Sampson, president of the Northeast Indiana Regional Partnership, an economic development group, said he viewed passage of the bill as historic.

“I think this sends a clear message to the country that Indiana is going to lead in preparing a place for us to grow our economy and make a place for workers to be successful in the future,” Sampson said.

As for claims the bill would drive down wages and benefits, Sampson said, “the marketplace sets wages, not unions.”

Nick Baker (nickmaker1776@gmail.com) writes from Washington, DC.

“In other Words...”

“The path to right to work finally seems clear in the Indiana General Assembly. That is good news for working people and good news for the unemployed. It’s not so good for union bosses and Democrat politicians but, as President Obama might say, everyone needs to make sacrifices in order to create a better, fairer world.

“Right to work combined with the healthy fiscal situation in Indiana will, we think, give our state a significant advantage in competition with other Midwestern states looking for manufacturing employment.”

— Editorial, Indiana Economic Digest, February 13, 2012
Kansas Republicans Propose Major Reforms to State’s Business, Income Taxes

Continued from page 1

state Senate tax study committee.

The Kansas legislative session lasts 90 days. Whatever is proposed must be heard in committees and debated on the floors of both the Senate and the House before being voted on. So there’s not much time, noted state Sen. Les Donovan (R-Wichita). Donovan chairs both the study committee and the Senate Assessment and Taxation Committee, the Senate’s primary tax policy panel.

Details to Come

Few details of any of the three plans are known.

Still, Kansans will see a significant change in the state’s income tax plan before legislators adjourn this spring, said House Speaker Mike O’Neal (R-Hutchinson).

“We see these plans as three different roads to the same destination,” he said.

But Larry Halloran, a tax reform advocate from Mulvane, said all the plans discussed so far fall short of the bigger changes that Kansas needs.

“They offer half-measures when we need to take major steps,” Halloran said.

Halloran favors scrapping all Kansas income taxes and imposing consumption taxes on goods and services.

“For one thing, if we don’t like what government does, a consumption tax gives us a means to shut the money—just stop consuming,” he said.

May Keep More Profit

But Ken Daniel, who owns a Topeka building materials distribution company, said prospects for Kansas tax reform look promising. “I started my business 41 years ago, with $300,” Daniel said. “It’s worth $15 million today. We financed that growth with retained profits, which is what you do. And the governor’s plan lets me retain more of those profits.”

The plan House leaders outlined in late January includes some of the governor’s proposed changes, including a requirement that any growth in general fund tax revenue exceeding 2 percent annually be used to reduce state income tax rates for filers in the two bottom brackets, which generally is those with household income of $30,000 or less.

Business Income Taxes Would Go

The House plan, like Brownback’s, also calls for the elimination—as early as next year—of all state income taxes on business and rental income, royalties, and similar income received by individual business owners, partners, limited liability company participants, and similar income received by individual business owners, partners, limited liability company participants, and small subchapter S corporation shareholders.

The changes would refocus Kansas tax codes “on growing private-sector businesses without adding to the burden of lower-income taxpayers,” said state Rep. Richard Carlson (R-St. Mary’s), who chairs the House Taxation Committee.

But unlike Brownback’s plan, the House proposal won’t abolish state income tax deductions for home mortgage interest or tax credits that return sales tax money that low-income Kansans pay for food and housing. The House proposal would allow a temporary sales tax increase to expire on schedule next year; Brownback proposed to make the increase permanent.

Medicaid Match

Like the governor’s plan, the House proposal would eliminate the state’s earned income tax credit that low-income wage earners can claim to help offset payroll taxes. Both plans call for investing the tax credit money, about $60 million, in Medicaid, so matching federal funds would raise the total increase in Kansas’ revenues to $130 million.

Both the Medicaid enhancement and lower sales taxes would help low-income residents, said state Rep. Marvin Kleeb (R-Overland Park), the tax committee’s vice chairman.

But the change will come as a jolt to low-income Kansans for whom the money is a tax-time boon, said Sister Therese Bangert, social justice coordinator of the Sisters of Charity of Leavenworth and a tax-time volunteer in Kansas City’s inner city.

Gene Meyer (gene.meyer@kansascityreporter.org) is state capitol reporter for KansasReporter.org, where a version of this article first appeared. Used with permission.
State Sales Tax Burdens Fell Slightly in 2011

By Cheryl K. Chumley

The average level of state sales taxes fell in 2011 to 5.49 percent, according to an annual report from Vertex, Inc., a provider of corporate tax software and services.

“Looking ahead, we expect the number of rate changes and combined average rate to remain level in the coming year,” said John Minassian, chief sales and use tax officer for Vertex, in a written statement.

Vertex reports Indiana, Mississippi, New Jersey, Rhode Island, and Tennessee had the highest state sales tax rates in 2011, at 7 percent.

Within states, total sales tax rates can vary widely, because of city, county, and other sales taxes that may be added to state sales taxes.

13.725 Percent in Tuba City

The nation’s highest city sales tax rate in 2011—7 percent—was in Wrangell, Alaska. The highest combined sales tax rate—state, county, local, and special-purpose sales taxes—was in Tuba City, Arizona, at 13.725 percent.

The average combined sales tax rate for the nation was 9.6 percent in 2011 and 9.64 percent in 2010, according to Vertex.

“Wow, a combined sales tax rate of 13.725 percent. That’s significant,” said Rachelle Bernstein, vice president, tax counsel for the National Retail Foundation. “I see that and I think, boy, does that exacerbate the competitive advantage that a remote Internet seller might have over a brick-and-mortar store.”

Fewer Rate Changes

The number of rate changes nationally seems to be leveling off. The number at all levels of government declined in 2011 to 459. In 2010 Vertex tracked 555 sales tax rate changes. In 2009 there were 707 changes. In 2008 there were 797.

“The record levels of changes in 2008 and 2009 can be attributed, at least partially, to the financial crisis and recession,” said Minassian, in an email response to questions. “As governments, particularly state and local ones, faced budget shortfalls and declining revenues, they sought new sources of tax revenue to fund various public programs.”

In 2011, 232 of the 459 sales tax changes were increases. Another 175 were new taxes. Only 52 were decreases, Vertex found.

Since 2003, governments have imposed 2,109 new sales and use taxes, an average of 234 per year. There have been 3,757 changes to existing sales and use taxes, an average of 417 changes each year.

Better for Consumers

Consumers fared much better in 2011 than in 2008 and 2009, Minassian said.

“The leveling and decline in tax rate changes may signal that there has been some improvement in the overall economy,” he wrote. “However, it is important to note that it may indicate that governments have exhausted the number of new and increased sales tax rates that can logically be levied at this time.

For consumers, it means some relief from new and increased sales taxes, though many of the increases and additions made over the past four years or so remain in place.”

For businesses, Minassian added, the figures indicate complexities in rates will continue to prove a challenge, especially for interstate commerce. But the flip side of the challenge is this: Opportunity exists for businesses to exploit a competitive edge in areas with relatively low sales taxes. In the end, consumers could prove the big winners.

State Competition

“These numbers could spark a competitive spirit in some of these state legisla-

Cheryl K. Chumley (ckchumley@aol.com) writes from northern Virginia.
Md. May Shift Pension Burden to Local Government

Continued from page 1

Despite the reforms, a structural budget deficit is forcing the state to look for additional savings again this year. Over the past decade the annual cost of funding Maryland's public school teacher pensions has more than doubled, increasing from $403 million in 2001 to $900 million in 2011.

100% on State's Shoulders
The proposed cost-shift stems from Maryland's unusual method of financing teacher pensions. Although county governments employ public school teachers, the state pays the full cost of employer pension contributions. The same is true of local library and community college employees.

While the state has been paying the costs associated with these retirement programs since 1927, this practice is rare. Kansas and Texas are the only other states to pay the full cost of teacher pension contributions. Part of Maryland's outlier status stems from the fact the state's local school boards also lack independent taxing authority, making them financially dependent on annual appropriations from county governments.

Aside from Maryland, only eight other states do not grant local school boards independent taxing authority.

$239 Million Burden on Counties
Unsurprisingly, Maryland's county governments show little enthusiasm for the proposed cost-shift. In fiscal year 2013, the state's counties face the prospect of being responsible for an additional $239 million in costs, at a time of lean local budgets and falling state aid. Although O'Malley's plan includes some features designed to mitigate the burden in the coming year, future costs will increase significantly. The result is likely to be local tax increases.

While perhaps not a popular result, forging a more direct link in the public's mind between local tax levels and local employee pension costs could engender more public interest in school board elections and union contract negotiations.

The proposed cost-shift was one of several reforms suggested by the Blue Ribbon Commission responsible for identifying ways to ensure the state's pension system remains sustainable. O'Malley opted not to phase in the cost-shift or include an explicit wealth-equalization component. Doing so might have made the proposal more palatable to the counties, but it would have significantly reduced the savings to the state budget.

Skeptical Response
Attempts to justify the cost-shift as more than purely a budgetary necessity have met with only partial success.

Supporters of the cost-shift argue counties have been able to increase teacher salaries excessively because the full cost of the pensions associated with those salaries is not paid by the counties.

Opponents point out the counties are not the ones that negotiate salary levels with teachers—that responsibility falls to local school boards, over whose actions the county governments have little influence. Indeed, although some of the blame for the pension system's current shortfall does rest on increasing salary levels, a large portion is also due to unreasonable benefits adopted at the state level, inadequate funding in prior years, and poor investment returns throughout the recent financial downturn.

Teacher Union Opposition
The Maryland State Education Association (MSEA, the state's teacher union) staunchly opposes cost-shifting, and last year it compiled figures claiming a shift could result in more than 2,800 lost jobs. That estimate assumes counties would make up for the cost-shift solely by laying off teachers.

Instead, news reports from around the state have quoted various local school board officials warning a cost-shift would affect their ability to offer salary increases at the bargaining table. This is precisely the intended effect. Nevertheless, the cost-shift does raise important questions about recruiting and retaining teachers given the fiscal constraints that Maryland—and the rest of the country—will be facing in the coming years.

Part of the answer may come from reforms related to Race to the Top, a federal competitive grant program created in 2009. Maryland, along with several other states, is in the midst of adopting teacher evaluation processes to identify and reward high-quality teachers and allow the state to dismiss ineffective teachers when necessary. Public pensions are expensive, and there is little sense in continually offering generous benefits in cases of ineffective performance.

Bucks Must Stop
The inescapable conclusion of Maryland's proposed cost-shift of teacher pension contributions is that the buck must stop somewhere. If counties find their residents unwilling to shoulder higher tax burdens, and the state is unwilling to continue assuming the burden the pensions pose, it may be time for Maryland and other states in similar positions to consider more than incremental reforms.

Hybrid retirement plans that combine a smaller state-financed portion along with individual employee accounts have the potential to offer cost savings, not merely cost-shifting.

Whether legislators have the political will to seriously consider such an alternative will depend on how Maryland's citizens react to the increased costs associated with funding public pensions.

Gabriel J. Michael (gmichael@mdpolicy.org) is a senior fellow at the Maryland Public Policy Institute.
Hundreds Kept Imprisoned in Georgia Despite Serving Their Sentences

By Mike Klein

Georgia penitentiaries continue to feed, clothe, and pay medical expenses for hundreds of inmates who were approved for parole but cannot be released because they have nowhere to live.

About two-thirds of those remaining in prison are convicted sex offenders. About one-third require mental illness treatment but are otherwise not considered a threat to public safety.

“We have got to do something about the housing situation, about the need for these individuals to have stable housing in order to be able to assimilate back into communities,” state Rep. Jay Neal (R-Lafayette) said during a recent hearing in which testimony was heard from officials at the State Board of Pardons and Paroles, State Department of Community Affairs, the Clayton County Sheriff’s Office, and Support Housing Atlanta.

Having nowhere to go means inmates approved for parole have no family able or willing to take them and no publicly supported housing facility willing to accept them. One of the challenges of Georgia corrections reform is where released inmates are to go when they leave prisons.

The 2011 state Special Council on Criminal Justice Reform delivered its report before Thanksgiving. It emphasized establishing alternatives to incarceration to reduce budget-devouring prison system costs. The new legislature has been in session since January. The committee that will turn the special council recommendations into a bill is currently drafting the legislation.

More Millions for Prison Beds

Gov. Nathan Deal (R) outlined his criminal justice reform priorities in his State of the State address and his proposed FY 2013 budget: $35.2 million for additional prison beds, $10 million for accountability courts expansion, $5.7 million to convert three pre-release centers to residential substance abuse treatment centers, and $1.4 million to fund additional parole officers.

Moving away from a strategy that emphasized incarceration to one focused on alternative treatment for nonviolent persons who do not pose any public safety threat means the state criminal justice system must change the tools it uses. Beds would be reserved for dangerous individuals. People who need treatment more than incarceration would be placed in community settings.

A House committee met for 90 minutes during the week of January 30 to discuss the lack of available housing statewide for paroled inmates. State Parole Director Michael Nail told the committee Georgia currently has 367 former sex offenders and 147 people with treatable mental illness needs who are still locked up even though they served all required time and were approved for release from the prison system.

‘Two Years Beyond Parole Date’

How long might they stay locked up? Most inmates are freed within 30 to 45 days after the parole board grants release. That is not the case for hard-to-release inmates.

Nail said, “We’ve had inmates that have been there two years beyond their parole date simply because they have nowhere to go.”

Patients who require mental health treatment are a special challenge. Georgia and the federal government entered into an October 2010 consent decree requiring the state to transfer mental illness patients out of hospitals and into community settings. The state must be equipped to deal with 9,000 persons released from hospitals on a strict timetable concluding no later than July 1, 2015.

Twenty Percent Immediately Homeless

Paul Bolster, director of Support Housing Atlanta, which conducted a survey of mental health patients being held in several metropolitan-area county jails, said inmates were asked where they would live if they were released. Twenty percent said they would be immediately homeless, and 12 percent more said they did not know.

“Thirty-five hundred people with serious mental illness will be discharged from metro jails within a year’s time to probably, homelessness,” Bolster told the House committee. “This explains why you have recidivism.”

The survey was conducted in Cobb, Gwinnett, and DeKalb County jails, and statistics were incorporated from Fulton County.

Millions for Medicine

Clayton is Georgia’s third-smallest county by land mass, but it has the state’s fifth-largest population. Last year the county processed 26,000 prisoners. Those inmates consume between $7 million and $8 million annually in medicine and other health care expenses. About 900 of the jail’s 1,700-capacity prisoners require mental health services, and between 300 and 400 require intensive mental health treatment.

Sheriff Kemuel Kimbrough said those services could be provided at less expense outside a jail setting.

Kimbrough’s varied assignments have included work on the implementation of mental health community service boards, and he holds an Emory University law degree.

“We’re spending god-awful amounts of money to keep them behind bars when the reality is we could probably spend less to support them in treatment, support them in housing, get them back out into the community and maybe even rehabilitate them into quality citizens,” said Kimbrough.

“We could have up to 300 folks that would meet drug court parameters but for one component, one very key factor: that they have stable residential housing outside the jail,” Kimbrough said. “That is the number one thing that gets them knocked out. If they don’t have a place to stay that is stable, then they are not eligible for the drug court program.”

Mike Klein (mikeklein@georgia policy.org) is editor of the Forum Blog of the Georgia Public Policy Foundation, where a version of this article first appeared. Used with permission.
Illinois Needs Urgent Reforms to Avoid Financial Disaster

By Steve Stanek

The Illinois state government could see its backlog of unpaid bills balloon from $9.2 billion to nearly $35 billion over the next five years unless major reforms are implemented soon, says an Illinois-based research institute.

“The governor and General Assembly must act now,” said Laurence Msall, president of the Civic Federation, whose report analyzes the state’s current fiscal position, reviews Gov. Pat Quinn’s (D) three-year budget plan, presents a rough five-year budget projection for FY2013 to FY2017, and provides recommendations to improve the state’s financial condition.

“Failure to address unsustainable trends in the state’s pension and Medicaid systems will only result in financial disaster for the State of Illinois,” Msall said.

Illinois will end the current fiscal year with approximately $9.2 billion in unpaid bills. Without budget reforms, these will total $34.8 billion at the end of FY2017, the report says.

And that’s after the state in 2011 raised the corporate tax 46 percent and the personal income tax 67 percent. Those tax rates are supposed to be cut in 2015, though some political observers expect the cuts not to happen.

Ballooning Medicaid Burdens

Soaring costs in Medicaid, government employee pensions, and health insurance are the biggest budget problems the state faces, Msall said.

The report cites an analysis by the Illinois Department of Healthcare and Family Services that concludes current trends of rising Medicaid costs and insufficient state Medicaid appropriations could cause the backlog of unpaid Medicaid bills to reach a staggering $21.0 billion by the end of FY2017.

The Civic Federation urges aggressive implementation of Medicaid reform legislation, passed in January 2011, which addressed two of the program’s major shortcomings: inadequate use of managed care and overuse of institutional care for the elderly and disabled.

The group also recommends the state continue working to control prescription drug costs and eliminate programs that do not qualify for federal reimbursement, such as Illinois Cares Rx.

Nation’s Worst Pension Funding

Illinois also has the nation’s largest unfunded pension liability. The Civic Federation writes the funding problems have worsened because of investment losses in FY2008 and FY2009 but are mainly due to a history of insufficient state funding.

As of June 30, 2011, the five State of Illinois retirement systems had total unfunded liabilities of $83.1 billion and a combined funded ratio of 43.3 percent.

“Illinois can no longer afford to grant automatic pension benefit increases that are not tied to cost of living increases,” said Msall.

The Civic Federation is recommending that for the first time current Illinois retirees and employees hired before January 1, 2011 receive the same annual benefit increases as new workers: 3 percent a year or one-half of the increase in the consumer price index, whichever is less, increased by a simple interest rate.

Huge Rise in Operating Deficit

In addition to an unprecedented level of unpaid bills, the state’s operating deficit is expected to increase dramatically to $3.2 billion in FY2017 from $508 million in FY2012.

“The State of Illinois’ continued practice of spending more than it takes in and pushing operating expenses into future fiscal years is a growing threat to our most vulnerable social service providers, local governments, and anyone doing business with the State of Illinois,” said Msall.

Legislators Call for Reform

Legislators also are calling for reform.

The Senate President and House Speaker both have expressed support for making local school districts assume more of the costs of funding teacher pensions, a move backers expect would make local school boards more sensitive to the impact of their hiring and compensation decisions.

At least one state representative, Kent Gaffney (R-Lake Barrington), has announced he will not participate in the General Assembly Retirement System and will turn down his legislative pension.

“I support comprehensive pension reform that will reduce Illinois’ unfunded pension liability and ensure the solvency of our retirement systems,” Gaffney said. “I urge the governor and General Assembly to work together to pass a sustainable public-employee pension plan.

“House Republican Leader Tom Cross has proposed a three-tiered pension plan [Senate Bill 512], which would reduce pension benefits not yet earned and offer state workers three options for earning future benefits,” Gaffney noted.

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.
Illinois Had Nation’s Worst Jobs Record in 2011

By Mark Cavers

Over the past year, Illinois has been dogged by numerous news stories about the state’s poor jobs climate and negative economic outlook.

The latest employment numbers indicate the trend won’t end anytime soon.

In 2011, Illinois experienced the largest increase in unemployment rate of any state in the nation, according to a new report by the Illinois Policy Institute.

Illinois’ unemployment rate increased to 9.8 percent in December 2011, up from 9 percent in January 2011. This bucks a national trend of slow but evident economic recovery. Over the same period, 46 states saw a decline in their unemployment rates. Illinois was one of only four states that experienced increases in the unemployment rate.

Poor Policy Decisions

Illinois’ weak economic performance was made worse by poor public policy decisions, including a 67 percent personal income tax hike and 46 percent corporate tax hike that were enacted in January 2011, according to the institute.

“Any progress Illinois made in putting people back to work was wiped out by the tax hikes,” said Kristina Rasmussen, executive vice president of the Illinois Policy Institute. “Rather than pursuing job-friendly policies like our neighboring states did, the Democrat-led legislature made it harder for families to pay their bills and for businesses to hire more employees.”

The average family sent an extra $1,400 to state government in 2011 because of higher taxes. But the tax hike that generated $7 billion statewide hasn’t improved the state’s finances.

Illinois has more than $8 billion in unpaid bills and more than $100 billion in unfunded pension liabilities, problems that will have to be dealt with in coming years.

Lawmakers failed to make progress on either of those major issues in 2011, creating an environment of uncertainty for businesses.

‘Fundamental Distrust’

“There is so much bad news coming down the pike that the threat of another tax hike is always hanging over the head of businesses,” said state Rep. Tom Morrison (R-Palatine). “There is a fundamental distrust in the leadership coming out of Springfield. Business owners I talk to are worried about when the next shoe will drop.”

Illinois’ governing approach stands in contrast to the ones pursued by many of its neighbors. Governors Scott Walker (R) in Wisconsin and Mitch Daniels (R) in Indiana have pursued policies to limit government spending and improve their business climates by lowering tax and regulatory burdens.

Mark Cavers (mcavers@illinoispolicy.org) is a policy analyst at the Illinois Policy Institute.

“There is a fundamental distrust in the leadership coming out of Springfield. Business owners I talk to are worried about when the next shoe will drop.”

TOM MORRISON
STATE REPRESENTATIVE
PALATINE, ILLINOIS

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Portland Development Agency Effectively Pays Borrowers to Take Money

By Jacob Szeto

Over the past decade Portland’s redevelopment agency has lent developers, private companies, and organizations $125 million, more than half of which was at interest rates below the annual inflation rate.

You won’t find many similar deals from banks or credit unions, and for good reason. Lending below the inflation rate is essentially paying someone to borrow your money, something Portland Development Commission (PDC) spokesman Shawn Uhlman calls a “mischaracterization.”

Of course, banks and credit unions are in the business of seeking financial returns on their investments, whereas the PDC has other criteria for measuring success.

The Portland Development Commission’s stated mission is to “bring together resources to achieve Portland’s vision of a diverse, sustainable community with healthy neighborhoods, a vibrant central city, a strong regional economy, and quality jobs and housing for all.”

Last-Resort Lender

To achieve its mission, the PDC promotes, finances, and arranges housing projects, economic development, and urban renewal. That includes loans to private parties.

The PDC conducts what it calls “gap financing,” a sort of lender of last resort to fill any missing pieces for projects and businesses. Filling in the “gaps” requires flexible loan terms to ensure the best chance of success for borrowers, the PDC claims.

Between November 2001 and October 2011, the PDC completed 422 loans worth $125 million. The average loan amount was just above $70,000, and loans ranged from as little as $20 to as much as $8.6 million.

Of the 422 loans, 148 had interest rates below the annual inflation rate of the origination year. Those 148 loans totaled $78.3 million, or 63 percent of the total money loaned over the past decade.

Zero Interest Rates

More than a quarter of those loans had a zero interest rate. In other words, nearly one of every five dollars the PDC has lent over the past 10 years does not cost the borrower anything in interest, and financially speaking it is not just free money, they are paid to borrow it.

The weighted average interest rate for the entire loan portfolio was 2.66 percent, only 16 basis points above the average inflation rate of 2.5 percent, and less than half of the average 30-year fixed mortgage rate of 5.88 percent for the same period.

The long-term Treasury composite rate was 4.55 percent, almost two percentage points above the PDC average. Long-term Treasury bills are considered to be the safest investment in the world. Theoretically, if entities were to borrow money below the Treasury rate, they could exploit the arbitrage and get an almost-guaranteed return.

Similar deals were given to banks by the Federal Reserve during the bailouts. Uhlman says lending practices and policies are taken from the banking industry, but they “have the flexibility to work with business owners.”

Such flexibility includes setting interest rates and payment structures.

Market Rates Too Pricey

When asked why the PDC does not charge market interest rates, Executive Director Patrick Quinton said that would risk making projects too expensive.

“If you make it so expensive that the project can’t go forward, we are really not serving our mission,” he said.

Quinton acknowledges interest rates influence risk behavior but says he does not believe it has a direct correlation to how people choose to spend the loan.

“Sure, there are some incentives out there that we create by having lower-cost money,” he said, “but I think we are far more attuned to that than we have been in the past.”

Millions in Losses

Interest rates are not the only aspect of loans where the PDC diverges from traditional lenders. Approximately 4 percent of the $125 million has been written off as losses so far, resulting in $5.1 million in losses.

When asked how the PDC loan rate losses compared to those of traditional lenders, Quinton said, “Our losses are higher than what you would find at a bank. A bank wouldn’t be able to have these kinds of losses.”

Uhlman says the PDC generally takes on riskier projects and at times makes loans to businesses that are “struggling to get their last piece of financing and are operating in areas that traditional banks may not be willing to.”

Quinton says the risk is part of their goal. They make loans to businesses to which banks would not lend.

No Repayments

The largest single write-off was for $688,500 to Caplan Landlord, LLC, which filed for bankruptcy in August 2010. Caplan, owned by developer Bruce Wood, renovated a seven-story office building downtown at 500 SW Fifth Avenue.

The loan was for 19 months at a 3 percent interest rate and was originated in March 2008. More than two years later, the loan was written off by the PDC for the same amount, without a single dollar paid down on the balance by Caplan.

Many of the loans written off by the PDC experienced similar payment progressions. Of the total 46 loans written off to date, 19 loans never had their balance reduced. If balance reductions of less than $50 are excluded, the total rises to 27. In other words, 27 of the total 422 loans made over the past decade, or 6.4 percent, received essentially zero payments on principal.

Jacob Szeto (jacob@oregoncapitolnews.com) is an investigative reporter for Oregon Capitol News, a project of the Cascade Policy Institute in Portland, Oregon. Used with permission.
Mich. Pensions Cover Missed Bond Payment for Studio

By Steve Stanek

The $80 million Raleigh Michigan Studios in Pontiac, Mich. missed a $630,000 bond payment that came due February 1, forcing the Michigan Employees’ Retirement System to make the payment.

The pension system for state government workers had to make the payment because the MERS had guaranteed $18 million in bonds issued for the studio. The missed payment came just 10 months after the studio opened.

“First, every sitting politician who championed this program should be on the hook for its failure. To be clear, they should write a check from their personal resources to cover the losses,” said Michael D. LaFaive, director of the Morey Fiscal Policy Initiative for the Mackinac Center for Public Policy in Midland, Michigan.

“It’s easy to issue press releases and make grandiose claims about new jobs when your money is not on the line, but it is quite another to deliver the goods when it is,” he said. “In the end Michigan’s political class delivered more job announcements than real jobs.”

LaFaive has long criticized Michigan state government’s economic development programs and handouts to select businesses and industries, including the film and television production industry.

History of Failure

“Second, Michigan pols ignored a mountain of evidence—anecdotal and otherwise—that showed government economic development programs rarely deliver as promised. This was just the film version of AutoWorld [an $80 million theme park partly funded with taxpayer dollars that opened in Flint, Michigan in 1984 to attract tourists and their money. It closed a few months later and was demolished in the 1990s].”

Third, said LaFaive, Michigan citizens should be angry, and not just at the film subsidy “follies.”

“Robbing Peter to pay Paul is unlikely to create any jobs on net balance,” he said. “Yet year after year the pols seem to line up to do the bidding for our state’s corporate welfare-industrial complex.”

Former Governor’s Pet Project

MERS ended up backing the $18 million in bonds after then-governor Jennifer Granholm (D) in 2009 pushed to make the state employee pension funds the guarantor. This came on top of another $15 million in tax incentives the state promised the studio.

Raleigh Studios has three facilities in California and one each in Georgia, Louisiana, and Budapest, Hungary.

The Raleigh Web site bills its Pontiac, Michigan facility as “the first full-service, built-for-production studio in the State of Michigan.”

It has seven sound stages in a 170,000-square-foot building and another 350,000 square feet of office and support space, some of which is available for rent to nonproduction companies.

The big-budget movie “Oz: The Great and Powerful,” was filmed there last year, though Raleigh is geared toward smaller, independent productions.

Henchman noted Michigan had been extending some of the most generous film tax credits in the nation, “offering to cover 40 percent of qualified expenses, an outlay that cost Wolverine State taxpayers nearly $100 million a year.”

Much Less State Support

That changed last year when new Gov. Rick Snyder (R) persuaded legislators to dismantle the film tax credit program and replace it with a $25 million grant program.

Michigan’s new film program, which Snyder signed into law last December, gives productions shooting at a qualified facility such as Raleigh Michigan Studios a 30 percent incentive for direct production expenditures. Michigan residents will be eligible for 35 percent.

Senate Majority Leader Randy Richardville (R-Monroe), who sponsored the bill, said in a statement, “With the passage of this five-year program, we will now be able to focus on creating sustainable jobs for Michiganders and supporting and developing the infrastructure to support this exciting industry in Michigan.”

Henchman has his doubts.

“While supporters talked about how they were building a permanent new Hollywood, in reality the whole thing depended entirely on ongoing state subsidies,” he said. “Their reduction kicked the legs out from under the lie that it was ever going to be self-sustainable.”

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 . . .

“The president is expected to release his budget today that projects a $1.3 trillion deficit for the ongoing fiscal year—that would be the fourth year in a row of $1 trillion or more deficit spending, according to the nonpartisan Congressional Budget Office. And surprise, surprise, the Obama budget will also include yet another pitch to raise taxes on top income earners from 35 percent to 39.6 percent as part of some $1.6 trillion in tax hikes proposed over the next decade.

“It is, in fact, an election year budget in the very worst sense of that phrase. It proposes $476 billion in spending over six years on roads and surface transportation. And it does precious little to address the long-term solvency of the big ticket items of government spending—Medicare, Medicaid and Social Security.

“In 2011 those three programs accounted for $1.56 trillion or about 43 percent of all federal spending. The CBO projects that a decade from now as even more Baby Boomers join the ranks of those collecting benefits, the Big Three will cost $3 trillion a year or 54 percent of all spending if nothing is done about any of them.”

— Editorial, Boston Herald, February 13, 2012
By Phil Britt

Maryland Gov. Martin O’Malley (D) is seeking to raise revenue by applying the state’s 6 percent sales tax to motor fuel purchases.

O’Malley and other proponents of the tax expansion say it would provide funding to help with road repairs and other transportation needs.

However, history shows large amounts of any additional monies “designated” for transportation use tend to go elsewhere, notes Christopher Summers, president of the Maryland Public Policy Institute in Rockland, Maryland.

“We’re adamantly opposed to it,” Summers said. “For years they’ve transferred a lot of money out of the transportation trust fund to the general fund in order to balance the budget. Maryland motorists have already paid for this.”

The diversions have been done to satisfy the state’s requirement for a balanced budget.

More than $1 Billion Shifted

According to Summers, state officials took $370 million from the transportation fund to cover other spending needs in Fiscal Year 2010. This was not a one-time move but a continuation of a multiyear trend that has resulted in some $1.1 billion being “borrowed” from the transportation trust fund, with no signs the money will be returned.

In a Maryland Public Policy Institute study, Rethinking Maryland’s Proposed Gas Tax Increase, released February 1, transportation policy experts Wendell Cox and Ronald D. Utt conclude Maryland would have to raise its gas tax by at least 10 cents for two years to offset those recent diversions of transportation tax revenues.

“They’re using this as a cookie jar to cover other budget gaps,” Summers said. “This is a regressive tax; it will hit the poor and the middle class the hardest.”

‘Wrong Answer’

Rethinking Maryland’s Proposed Gas Tax Increase estimates those in the lowest income brackets would pay a share of their incomes seven times greater than would be paid by wealthier households.

Summers adds much of the state’s transportation money goes to projects that benefit relatively few citizens. For example, public transportation projects tend to receive priority on many funding requests, even though those projects tend to benefit the fewest taxpayers.

Proponents say the additional tax would create jobs, but Summers says any additional jobs would come at the expense of Maryland motorists, who will not have the estimated $491 million that would be raised from the tax to purchase other goods and services, purchases that also would support jobs.

“I don’t dispute that there are some transportation maintenance and building projects that need to be completed,” Summers said. “We don’t need a gas tax hike to fix those problems, however. Simply reprioritizing current funding would free up significant revenue. Raising the gas tax is the wrong answer to an overhyped problem. This proposal is nothing more than another attempt by the state to balance its wasteful budget on the back of its citizens.”

Phil Britt (spenterprises@wowway.com) writes from South Holland, Illinois.
Cut federal debt or the United States will cease to exist as a superpower—that was the message Erskine Bowles and Alan Simpson had for a packed house at Duke University’s Page Auditorium.

Bowles and Simpson, co-chairs of a congressional committee created through a 2010 executive order of President Barack Obama to address the nation’s fiscal hurdles, spread the blame evenly between the major political parties for the country’s $15 trillion debt during their Page Auditorium appearance in January.

“I believe that if Congress and the administration don’t wake up, that we face both the most predictable and also the most avoidable economic crisis in history,” said Bowles, a two-time Democratic U.S. Senate candidate in North Carolina, chief of staff to President Bill Clinton, and recent past president of the University of North Carolina system.

“The deficits are like a cancer. They are truly going to destroy this country from within.”

Spending Cuts, Tax Hikes

Simpson, a former Republican U.S. Senator from Wyoming with a flair for colorful phrasing, argued for a combination of budget cuts and tax increases. He decried the notion that taxing the wealthy will bring the United States out of its fiscal woes.

“You can’t get there with taxes,” Simpson said.

The National Commission on Fiscal Responsibility and Reform, better known as the Simpson-Bowles commission, released a report in late 2010 recommending $4 trillion in debt reduction. The report suggested a 3:1 ratio of budget cuts to tax increases to manage the debt and called for holding federal spending to 21 percent of Gross Domestic Product.

The recommendations irked both Republicans and Democrats by reaching deeply into entitlements and defense spending, although Republicans generally have been more receptive.

Entitlement, Military Reforms

The plan would shore up Social Security by gradually raising the retirement age to 69 by 2075 and altering the formula by raising the retirement age by 2 percent, 14 percent, and 23 percent and raising the federal gas tax by 15 cents per gallon.

Members of the commission voted to approve the plan December 3, 2010, in a 11–7 vote, three votes short of the supermajority needed to endorse it officially.

Blame All Around

At their Duke University lecture, Bowles and Simpson drew applause for ripping organizations on all sides of the political arena—from Grover Norquist and Americans for Tax Reform to the American Association of Retired Persons.

“No long-term plan

Bowles and Simpson expressed frustration with the Obama administration and Congress for passing a stimulus package without first creating a long-term financial plan.

“The Congress turned around and passed the stimulus package,” Bowles said. “You can argue the pluses and minuses of a stimulus, but you can’t argue the point that if you’re going to have the stimulus, you should have had it in the context of long-term fiscal reform.”

$1 Trillion Interest Payments

“If we don’t do something about [the deficit], by the year 2020 we’ll be spending over $1 trillion a year in interest costs alone,” Bowles said.

“Not only is it a trillion dollars that we can’t spend in this country to educate our kids and to build our infrastructure and to perform the research that will create the next new thing here,” he said, “it’s a trillion dollars that’s principally going to be spent in Asia educating their kids and building their infrastructure and creating the next new thing over there.”

Former Senator Alan K. Simpson (left) listens to Erskine Bowles, co-chair of the National Commission on Fiscal Responsibility and Reform.
L
etting the nation’s roads and bridges deteriorate may worsen traffic congestion and add to our commuting woes, but when water and sewer systems begin to fail our very civilization is at risk.

That is the message of a recent Washington Post story drawing attention to the alarming state of the nation’s water and sewer infrastructure. The story looks at the Washington, DC system as a poster child for neglected and dilapidated municipal utilities.

The average age of the DC water pipes is 77 years, and a great many were laid in the nineteenth century, notes the article. Emergency crews rush from site to site to tackle an average of 450 breaks a year.

Antiquated municipal water and sewer systems are indeed a ticking bomb, all the more so since their deterioration— unlike that of highways and bridges—remains invisible until a break occurs.

But maintaining water and sewer infrastructure in a state of good repair is a fairly straightforward challenge. Water supply and sewers are a public utility, and as such they can cover their maintenance and replacement costs through user fees. So can many other public services such as electricity, natural gas, broadband, and telecommunications.

The ability to charge for service (and to raise rates as necessary) ensures public utilities a steady and reliable stream of revenue with which to maintain, preserve, and grow their assets.

Roads, Bridges More Difficult
Finding the resources to keep transportation infrastructure in good order is a more difficult challenge. Unlike traditional utilities, roads and bridges have no ratepayers to fall back on. Politicians and the public seem to attach a low priority to fixing aging transportation infrastructure, and this translates into a lack of support for raising fuel taxes or imposing tolls.

Investment in infrastructure did not even make the top 10 list of public priorities in the latest Pew Research Center survey of domestic concerns. Calls by two congressionally mandated commissions to vastly increase transportation infrastructure spending have gone ignored. So have repeated pleas by advocacy groups such as Building America’s Future, the U.S. Chamber of Commerce, and the University of Virginia’s Miller Center.

Nor has the need to increase federal spending on infrastructure come up in the numerous policy debates held by the Republican presidential candidates. Even President Barack Obama seems to have lost his former fervor for this issue. In his most recent State of the Union message he made only a perfunctory reference to “rebuilding roads and bridges.”

High-speed rail and an infrastructure bank, two of the president’s past favorites, were not even mentioned.

Skeptical Public
There are various theories why appeals to increase infrastructure spending do not resonate with the public. One widely held view is that people do not trust the federal government to spend their tax dollars wisely. Evidence is cited that a great majority of state and local transportation ballot measures do get passed, because voters know where their tax money will be going.

No doubt there is much truth to that. Thanks to local funding initiatives and the use of tolling, state transportation agencies are becoming increasingly more self-reliant and less dependent on federal funding.

Another explanation, and one that I find highly plausible, was offered by Charles Lane, editorial writer for the Washington Post, in an October 31, 2011 column. “How come my family and I traveled thousands of miles on both the east and west coast last summer without actually seeing any crumbling roads or airports? On the whole, the highways and byways were clean, safe and did not remind me of the Third World countries. … Should I believe the pundits or my own eyes?” asked Lane.

Like Lane, I think the American public is skeptical about alarmist claims of “crumbling infrastructure” because they see no evidence of it around them. State DOTs and transit authorities take great pride in maintaining their systems in good condition and, by and large, they succeed in doing a good job of it. Potholes are rare, transit buses and trains seldom break down, and collapsing bridges, happily, are few and far between.

Lobbyists’ Interests
The oft-cited “D” the American Society of Civil Engineers has given the nation’s infrastructure (along with an estimate of $2.2 trillion needed to fix it) is taken with a grain of salt, says Lane, because the engineers’ lobby has a vested interest in increasing infrastructure spending to make more work for engineers. So do the legions of road and transit builders, rail and road equipment manufacturers, construction firms, planners, and consultants.

This does not mean the nation does not need to invest more resources in preserving and expanding its highways and transit systems. The “infrastructure deficit” is real. It’s just that in making a case for higher spending, the transportation community must do a much better job of explaining why, how, and where they propose to spend those funds. Unsupported claims that the nation’s infrastructure is “falling apart” will not be taken seriously.

People want to know where their tax dollars are going and exactly what they’re getting for their money.

C. Kenneth Orski (korski@verizon.net) is editor and publisher of Innovation Briefs. Used with permission from Public Works Financing, where a version of this article first appeared.
By John Skorburg

“One taxpayer moved out of Illinois every 10 minutes between 1995 and 2009,” according to the Illinois Policy Institute, and it appears taxes and tax policies are to blame for many of the losses.

Researchers at the institute examined IRS and other data and found over the past 15 years, more people have moved out of Illinois than moved in. Approximately 806,000 people on a net basis left Illinois for other states, taking with them a net of more than $26 billion in taxable income.

In 2009 alone, Illinois lost a net of 40,000 people to 43 other states. The U.S. Census Bureau places the 2010 Illinois population at 12.8 million.

‘Public Policies Matter’

“This study shows that public policies matter. Illinois has a record of poor governance, fiscal mismanagement, and higher taxes, leaving people with no choice but to vote with their feet” by leaving the state, said Ted Dabrowski, the institute’s vice president of policy.

“While conventional wisdom might suggest people move away in pursuit of warmer weather,” states the report, “more than 270,000 people have fled Illinois for other states in the Midwest.” Notably, Illinois has lost population to all its border states.

Researchers found “people preferred states where tax burdens were lighter and housing costs were lower” when climate was not a major factor. People also left Illinois for states with lower estate taxes, labor union membership rates, and population densities.

‘Leaving for Higher Standard of Living’

“Public policies drastically influence quality of life. On average, Illinois residents are leaving for states where they can have a higher standard of living,” said J. Scott Moody, a senior fellow for budget and tax policy with the institute and primary contributor to the report.

“State-to-state migration is the ultimate expression of voting with your feet. After tallying the vote, Illinois is losing.”

Moline, Illinois Mayor Don Welvaert said he’s not surprised by the findings because “Illinois hasn’t been able to get its act together in a number of years.”

Moline is one of the “Quad Cities” on the Illinois-Iowa border and has experienced net out-migration in recent years.

Welvaert said Illinois has a bad reputation among many people because of its notorious political and fiscal climates. Four of Illinois’ last nine governors have been convicted of federal crimes. One is in federal prison, and another—Rod Blagojevich—is scheduled to go to prison in March after being sentenced to a 14-year term last December. He was convicted on 18 corruption charges.

“Illinois Can Regain Its Mantle”

“It doesn’t have to be this way,” said Kristina Rasmussen, Illinois Policy Institute executive vice president. “Illinois can regain its mantle of being a place where people want to live if we implement public policy solutions that create a dynamic and growing environment, creating a state where families want to grow and businesses want to expand.”

Moody said Illinois needs to lower taxes so it can compete with its neighbors and states around the country.

The state’s lawmakers instead have gone in the opposite direction. In 2011, legislators raised the state corporate tax 46 percent and personal income tax 67 percent. A family of four in Illinois is having another $1,500 a year, on average, taken from it as a result of the higher income tax, the report notes.

‘Must End Spending, Borrowing’

“In addition,” said Moody, “the state must end its culture of spending and borrowing, which ultimately drives up taxes and chases away residents. Only through fiscal discipline can the state avoid a crisis and set the tone for a wave of in-migration.”

“An influx of residents to Illinois could bring increased taxable income to a state in fiscal crisis, increased entrepreneurial activity to a state experiencing an employment crisis, and increased purchasing power to a state in economic crisis,” the report states.

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“State-to-state migration is the ultimate expression of voting with your feet. After tallying the vote, Illinois is losing.”

J. SCOTT MOODY, SENIOR FELLOW
BUDGET AND TAX POLICY
ILLINOIS POLICY INSTITUTE
Wyoming Best, New Jersey Worst for Business Tax Climate

By Steve Stanek

Wyoming, South Dakota, and Florida have the best business tax climates in the nation, and New Jersey, New York, and California have the worst, according to the Tax Foundation’s 2012 State Business Tax Climate Index.

The index accounts for dozens of state tax provisions, creating a single easy-to-use score that measures each state’s tax climate in comparison with the others. Each state’s ranking is relative to the actual tax policies in place around the country, not a measurement against a theoretical “perfect” system.

“Even in our global economy, a state’s stiffest and most direct competition often comes from other states,” said Tax Foundation economist Mark Robyn, the lead author of the report. “State lawmakers need to be aware of how their states’ business climates match up to their immediate neighbors and to other states in their region.”

Top 10 States
The 10 best states in this year’s index are, in order, Wyoming (#1), South Dakota, Nevada, Alaska, Florida, New Hampshire, Washington, Montana, Texas, and Utah (#10).

Robyn noted nine of the top 10 states do without at least one of the three major taxes: corporate tax, personal income tax, sales tax.

Three of the states—Wyoming, Nevada, and South Dakota—do without two of the three major taxes. They have no corporate or individual income tax. Alaska has no individual income or state-level sales tax. Florida has no individual income tax. New Hampshire and Montana have no sales tax.

Doing without one or more of the major taxes reduces the complexity and distortions they cause, making the states easier for business, Robyn said.

Wrong Approach
Many state governments use targeted tax incentives, credits, and other breaks in the mistaken belief they make the state more competitive.

“Things like film credits, enterprise zones, company-specific sweetheart deals, ... people think that’s competition. It is, but it’s poor competition,” Robyn said. “You’re playing tug of war over a fixed number of businesses, and ultimately nobody wins. If you can reduce tax preferences and reduce rates at the same time, that will benefit the state as a whole.”

He cited Illinois as an example. Legislators last year enacted big increases in the corporate and personal income tax rates. Major businesses soon threatened to leave the state. State government responded by pledging hundreds of millions of dollars of tax revenue to a handful of large corporations, forcing other businesses and individuals to shoulder the full tax burden.

Illinois dropped 12 places, to 28th place, in the index rankings, more than any other state. Robyn said Illinois’ 5 percent flat personal income tax is still good compared to many other states, and its sales tax rate is in the middle. These kept the state from falling farther in the rankings, but Robyn warned Illinois’ unemployment insurance, corporate, and local property taxes could drag it down in future.

Other states seeing a big move in their ranking include Vermont, which fell four places, while Massachusetts and North Dakota both advanced four places up the chart.

“In other words...”

“Oklahoma Governor Mary Fallin is starting to feel surrounded. On her state’s southern border, Texas has no income tax. Now two of its other neighbors, Missouri and Kansas, are considering plans to cut and eventually abolish their income taxes. ‘Oklahoma doesn’t want to end up an income-tax sandwich,’ she quips.

“On Monday she announced her new tax plan, which calls for lowering the state income-tax rate to 3.5% next year from 5.25%, and an ambition to phase out the income tax over 10 years. ‘We’re going to have the most pro-growth tax system in the region,’ she says. ..." The tax competition in America’s heartland is an encouraging sign that at least some U.S. politicians understand that they can’t take prosperity for granted. It must be nurtured with good policy, as they compete for jobs and investment with other states and the rest of the world.

“Our goal is for our economy to look more like Texas, and a lot less like California,” says Mr. Brownback, the Kansas Governor. It’s the right goal.”

— Editorial, Wall Street Journal, February 8, 2012
By Steve Stanek

CBO Says Federal Workers Get Higher Compensation

Considering that four of the five wealthiest counties in the United States are in suburban Washington, DC, it’s probably no surprise that the Congressional Budget Office has determined federal government workers receive substantially more in total compensation than their counterparts in the private sector.

The CBO in January announced federal government workers average 16 percent more in compensation—wages and benefits combined—than private-sector workers doing similar jobs. The major difference is in fringe benefits. Federal workers typically enjoy far more non-wage benefits than private-sector workers.

Federal workers average more than $20 per hour in non-wage benefits—48 percent more than the average pro-rated hourly benefits of $13.60 in the private sector. Federal workers on average enjoy wages that are approximately 2 percent higher than similar private-sector workers.

$52 vs. $45

“For workers at all education levels, the cost of total compensation averaged about $52 per hour worked for federal employees, compared with about $45 per hour worked for employees in the private sector with certain similar observable characteristics,” the CBO wrote.

The CBO noted, “The most important factor contributing to differences between the two sectors in the costs of benefits is the defined-benefit pension plan that is available to most federal employees. Such plans are becoming less common in the private sector.”

Unlike in state and local governments, where government worker unions may negotiate for wages and benefits, federal employee unions don’t negotiate for pay and perks. How then to explain such high total compensation for federal workers?

‘Generally Sympathetic Relationship’

“There is a natural, generally sympathetic relationship between elected public officials and public employees. Public administrators, the ones who recommend compensation levels to elected officials, benefit by making generous recommendations,” said David Denholm, president of the Public Service Research Foundation, a nonprofit research organization that studies the effects of government workers and labor unions on government policies.

“For example, if I were to propose that a 5 percent pay increase for public employees was in order, it would stand to reason that I ought to get at least as much of an increase myself,” Denholm explained. “In addition, consider that most public officials consider what they do to be of importance and a ‘public good,’ so it is reasonable that they believe the public employees who actually carry out those functions are doing something important and a ‘public good.’”

And, Denholm added, there is the ability of government workers “to make an elected official look bad if they had a mind to. If I were an elected official I would most likely want public employees to think well of me.”

John Gage, president of the American Federation of Federal Employees, downplayed the CBO report. In comments to the Washington Times, he said the report is flawed because it looked at factors such as education level of workers in certain positions instead of at specific jobs. On that score, he said, federal workers likely are paid less than private-sector workers.

“Salaries and wages should be a function of the job, not the job-holder—and that’s the case in the federal government,” Gage said.

Less Education, More Compensation

The CBO report noted federal workers with lower education levels tended to have substantially higher wages and benefits than similarly educated workers in the private sector. The differences diminish higher up the education ladder. At the doctoral level of education, private-sector workers receive higher total compensation than federal workers.

Chris Edwards, director of tax policy studies at the Cato Institute, noted the CBO’s observation that federal workers have much more job security than private-sector workers.

“High job security is an important federal benefit that should be considered when deciding on federal pay levels,” he wrote on the Cato@Liberty blog. “Federal workers get laid off and fired at much lower rates than private-sector workers. That benefit has value, and thus federal pay rates should be set somewhat lower than for otherwise comparable jobs in the private sector.”

Democrats and Republicans in Congress agreed to suspend cost-of-living adjustments for federal workers in 2011 and 2012. Congress is considering extending that suspension of cost-of-living increases in 2013. The freeze does not affect merit pay or pay increases for promotions.

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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
Md. Governor Calls for Sweeping New Internet Taxes

By Bruce Edward Walker

Maryland Gov. Martin O’Malley’s (D) 2012 budget would impose taxes on digitally delivered goods and services and tax purchases made from out-of-state online retailers that rely on referrals from affiliates.

The proposed budget is in bills introduced in the Maryland Senate and House in January. Under the governor’s proposal, digitally delivered goods and services would be subject to the state’s general 6 percent sales tax. The proposal also would tax digitally delivered goods and services such as music downloads on iTunes, ringtones, smartphone applications, and blogs that charge for their services.

“The sales tax language contained in the governor’s proposed budget is sweeping,” said Seth Cooper, research fellow at the Free State Foundation, a non-profit, nonpartisan think tank in Rockville, Maryland. “It appears to tax retail sales of digital goods and services by consumers as well as digitally delivered services in business-to-business transactions. But Maryland doesn’t tax most services. So the governor’s proposal would create special tax burdens for digitally delivered services.”

Earlier Effort Repealed

The new proposals reintroduce portions of the Maryland Computer Services Tax, which was unpopular and repealed before it could take effect in 2008. The Maryland legislature adopted the computer services tax in a late-2007 special session, without public debate. The outcry prompted legislators to repeal it a few months later.

O’Malley’s budget proposals also would impose an affiliate nexus tax. Maryland would impose sales tax collection obligations on out-of-state online retailers that have online ad affiliate agreements with Maryland residents.

“Digital technologies can create efficiencies and reduce costs for businesses,” said Cooper. “However, Gov. O’Malley’s proposal for taxing digitally delivered services could actually drive up costs for businesses. And businesses will likely pass those extra costs on to consumers in the form of higher prices.”

O’Malley’s budget proposal ignores the warning contained in the Maryland Comptroller’s report that ad affiliate nexus taxes likely would result in a reduction or complete end of tax revenue from in-state affiliates of online retailers such as Amazon, Cooper added.

“The Comptroller noted that online retailers cancelled their ad affiliate agreements with residents in other states that adopted ad affiliate nexus taxes,” he said.

‘Likely Unconstitutional’

“Maryland businesses and consumers recognized that computer services are an economic force multiplier and that specially taxing them would be a drag on productivity, drive up costs, and put the state of Maryland at further risk of losing business opportunities to neighboring states,” said Cooper.

He noted the idea of a Maryland ad affiliate nexus tax has been floated for a few years.

“Bills for expanding Maryland’s sales and use tax to include retail sales made through online ad referrals were introduced in 2009 and 2010, for instance,” he said. “In November 2011, Maryland Comptroller Peter Franchot issued a report analyzing ad affiliate nexus taxes.”

It’s unclear whether states that impose these taxes actually increase revenue collection. With major online retailers typically eliminating ad affiliates in states that adopt such taxes, those states lose the “nexus” that triggers the sales tax, and hence the revenue, while in-state residents lose their commissions for sales resulting from Web site ad referrals.

That, said Cooper, is why ad affiliate nexus taxes are controversial. “More to the point,” he said, “they are counterproductive and likely unconstitutional.”

‘Concoction of Bad Tax Policies’

Cooper says Maryland has overspent itself and “has some big bills to show for it.”

He called O’Malley’s budget “a concoction of bad tax policies toward e-commerce.” He said the governor and some Maryland legislators “seem to think the state can tax its way back to fiscal responsibility by raising taxes or imposing new taxes.”

Digital technologies create efficiencies and grow economies and shouldn’t be targeted for excessive taxation, explained Cooper. “It’s misguided to saddle digital goods and services that enable the state’s economy with new tax burdens. It will only slow down the state’s economic productivity and further decrease its competitiveness with pro-growth neighboring states like Virginia and Delaware. Fiscal responsibility starts with restraints on state spending.”

‘Next Cash Cow’

John Stephenson, director of the Telecommunications and Information Technology Task Force at the American Legislative Exchange Council, said the proposed taxes are a convenient way for Maryland legislators to exploit “the Internet as the next cash cow.”

Stephenson said, “What concerns me is that at a time of economic crisis, a new tax comes along to stifle innovation and investment. When you tax something, you get less of it. Consumers scale back on their purchases, and so do companies.”

Stephenson noted the Tax Foundation’s 2012 State Business Tax Climate study ranked Maryland as having one of the nation’s worst business tax systems.

“The Tax Foundation has ranked Maryland 42nd in the nation,” he said. “Maryland should be doing everything it can to keep these innovations and investments in-state rather than further complicating the tax code.”

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INTERNET INFO

Maryland Senate Bill 152, January 2012: http://mlis.state.md.us/2012rs/billfile/sb0152.htm

Maryland House Bill 87, January 2012: http://mlis.state.md.us/2012rs/billfile/hb0087.htm

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