Oklahoma Income Tax
A cut in the Oklahoma state income tax has taken a step toward reality. Page 9

Bogus Blight
If the government deprives you of your rights, wouldn’t you like to know why that’s being done? That’s the crux of a petition recently filed with the California Supreme Court. Page 7

Soda Tax
Illinois Democrats are seeking a penny-per-ounce tax on soda along with a handful of other sugary drinks. Page 12

Maryland Pension Flap
Maryland State Treasurer Nancy Kopp has said she opposes Gov. Martin O’Malley’s proposed $100 million cut in the state’s pension contribution, saying it would undermine trust by the state’s bond rating agencies. Page 15

Traffic Camera Backlash
New state regulations regarding traffic cameras may threaten the income stream Sioux City, Iowa has been using to cover gaps in its operating budget. Page 17

Chicago Aldermen Barely Discuss Adding $1.9 Bil. of Debt
By Steve Stanek
Neither triple downgrades in Chicago’s credit rating nor data showing Chicago in worse debt shape than bankrupt Detroit could stop the Chicago City Council from doing what it’s done for decades: borrow huge sums of money with little discussion.

Two days after Mayor Rahm Emanuel announced a plan to borrow another $1.9 billion, and with virtually no discussion, the City Council voted 43–4 to approve the plan. Emanuel gave little information about how the money would be used other than to say about $1 billion would go for Midway Airport, with much of the rest refinancing old debt and covering huge legal settlements the city must pay for police misconduct and other lawsuits.

By Phil Britt
U.S. House Ways and Means Committee Chairman Dave Camp (R-MI) has proposed legislation he says will fix the nation’s broken tax code by lowering tax rates while making the code simpler and fairer for families and job creators. House and Senate leaders have given it a tepid response.

Camp’s Tax Reform Act of 2014 would reduce the number of tax “loopholes” while making it easier for individuals to complete their own tax returns confidently and accurately, Camp says.

“It is no secret that Americans are struggling,” Camp said in announcing his plan. “Far too many families haven’t seen a pay raise in years. Many

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TAX, p. 6

House Ways and Means Committee Chairman Dave Camp holds a news conference to introduce tax reform legislation in February.
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“In a country whose political dialogue has been clouded with the lack of transparency created by conventional political thinking Heartland throws open the door to fresh and creative thought and discussion.”

HON. JEFF ESSMAN
STATE SENATOR
MONTANA
States Need to Prepare for Likely Cuts in Federal Funding

By Jonathan Williams

Endless gridlock and an exploding national debt have become the new normal in Washington, DC. Despite this volatile policy environment, states continue to rely heavily on federal funds for their budgets and, according to the nonpartisan fiscal watchdog group State Budget Solutions, this dependence is increasing every year.

A new State Budget Solutions report reveals that on the whole, states received 31.6 percent of their total revenue from the federal government in 2012. Reliance on federal money in state budgets ranges from nearly 20 percent of spending in Alaska to more than 45 percent in Mississippi. Unfortunately, the costly strings attached to the federal funds, like burdensome “maintenance of effort” requirements, will last far longer than the federal support and will make it increasingly difficult for state governments to balance their budgets in a financially responsible way.

“We all know that federal spending is not sustainable and federal funding to the states will be cut. The major question for states is whether they will plan ahead for this inevitability,” said Bob Williams, president of State Budget Solutions.

Utah Leads Way

Policymakers in Utah provide a great example for how states can prepare for the fiscal challenges that lie ahead. “States are far too dependent on federal dollars. It would be financial malpractice for states not to create fiscal emergency plans to prepare for the inevitable time when those federal funds dwindle or disappear,” said Utah state Sen. Deidre Henderson (R-Spanish Fork).

Nearly 32 percent of Utah’s state spending relied on federal money in 2012, according to State Budget Solutions.

Financial Ready Utah is an initiative that prepares the state for future financial stress handed down by the federal government. This includes assessing the risk of a significant reduction in federal funds, developing a contingency plan in the event the federal government reduces funding to the state, and requiring the reporting of federal receipts received by state agencies.

Utah’s fiscal management record has earned the state strong bond ratings from the Fitch, Standard & Poor’s, and Moody’s Investors Service rating agencies.

ALEC Adopts Funding Policies

Looking to help other states weather future economic challenges, Henderson and state Rep. Ken Ivory (R-West Jordan) proposed three policies that were adopted by the American Legislative Exchange Council’s Task Force on Tax and Fiscal Policy during the States and Nation Policy Summit in December. The task force approved the Federal Funds Commission Act, a Resolution to Reduce the State’s Dependence on Federal Funds, and a Statement of Principles on States’ Dependence on Federal Funds.

More information about these ideas is publicly available at www.alec.org.

“For most states, the single largest line item of their revenue is federally sourced funds,” said Ivory. “With the bipartisan fiscal recklessness at the federal level on frequent display, this largest source of revenue to the states is in jeopardy—in fact, it is already being cut back.

“Developing a financial earthquake plan in the states is not just good policy, it’s an imperative going forward,” he continued. “While Washington, DC may struggle with fiscal uncertainties, states like Utah are pursuing innovative and pro-growth solutions to their financial challenges.”

The difficult work of crafting responsible fiscal policy is best accomplished before it is absolutely necessary. As any knowledgeable financial planner will tell you, complicated financial problems rarely improve on their own. However, prudent lawmakers can follow Utah’s example and prepare for the day when Uncle Sam calls with bad news from Washington.

Jonathan Williams (jwilliams@alec.org) serves as director of the Center for State Fiscal Reform at the American Legislative Exchange Council and is an author of Rich States, Poor States, an annual economic outlook ranking of the nation’s states, whose co-authors are economists Arthur Laffer and Stephen Moore.
Most States Reveal Jobs Subsidies ... And Do It Poorly

All but three states now post at least partial information online showing which companies are receiving economic development subsidies. But the quality and depth of that disclosure varies widely, both among and within states.

Three-fourths of major state development programs fail to disclose actual jobs created or workers trained, and only one in 11 discloses wages actually paid. The best disclosure practices are found in Illinois and Michigan, but even their scores would be near-failing as report card grades.

These are the key findings of “Show Us the Subsidized Jobs,” a report issued by Good Jobs First, a non-profit, non-partisan research center based in Washington, DC.

Aside from a handful of holdouts, state governments now accept the idea that the public has a right to online data about which companies are receiving taxpayer-funded job subsidies,” said Good Jobs First Executive Director Greg LeRoy. “But with unemployment still high, Americans need to know how many jobs and what kind of wages and benefits their taxpayer investments are generating.”

Double the Number Posting Data

“Show Us the Subsidized Jobs” is the third in a series of reports Good Jobs First has produced on subsidy transparency since 2007. In that period the number of states with at least some online disclosure has doubled from 23 to 47. The District of Columbia also has embraced transparency.

Since the 2007 report was issued, Good Jobs First has raised the bar in its rating criteria, reflecting rising public expectations about government transparency and improving Web technology.

“Transparency by itself is no guarantee that a subsidy program is accountable or effective,” said Good Jobs First Research Director Philip Mattera, principal author of the report. “But it is the foundation for any meaningful assessment.”

“Show Us the Subsidized Jobs” rates the reporting practices of 246 key state economic development subsidy programs on how well they disclose online information such as company-specific award amounts, job-creation and wage-rate figures, the geographic location of subsidized facilities, and details on the recipient company and the project.

Programs are also evaluated in terms of how easy it is to find and use the online data. Each program is rated on a scale of 0 to 100, and the program scores for each state are then averaged to derive a state score.

“With most programs still failing to disclose actual jobs created or wages paid, taxpayers cannot even begin to weigh costs versus benefits,” LeRoy concluded. “Taxpayers have the right to know exactly what they are getting in return for their economic development investments.”

INTERNET INFO


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KEY FINDINGS

Forty-six states and the District of Columbia provide online recipient disclosure for at least one key subsidy program. This is up from 37 in late 2010 and 23 in 2007.

The states with the best average program scores are: Illinois (65), Michigan (58), North Carolina (48), Wisconsin (46), Vermont (43), Maryland (42), and Texas (40). The most-improved state is Oregon, which had no disclosure in 2010 and is now in the top ten with an average of 38.

The four states still lacking online disclosure are: Arkansas, Delaware, Idaho, and Kansas.

Of the 246 programs examined, 135 of them, or 55 percent, have online recipient disclosure (up from 42 percent in 2010). The average score for the programs with disclosure is 39. Only seven programs score 75 or better.

Of the 135 programs with disclosure, 101 require some degree of job reporting, but only 59 report actual jobs created or workers trained. Only 47 provide any form of wage or payroll data, and only 21 provide wage data on jobs actually created or workers trained.

Only six states practice consistency by providing online recipient reporting for all of the key programs we examined: Maryland, Michigan, North Carolina, Vermont, Washington and Wisconsin.

States with disclosure often have major discrepancies in the quality of reporting from one program to another. In Minnesota and Virginia, for example, there is a spread of more than 50 points between their highest and lowest program scores. Consistent with our previous state accountability report cards, the existence and quality of subsidy transparency follow no partisan pattern. There are “red” and “blue” states among both disclosure leaders and laggards.
Cigarette Smuggling Still Widespread Despite Slight Decline

By Michael D. LaFaive and Todd Nesbit

As state and local units of government continue to hike cigarette excise taxes to raise revenues, smoke grills apparently continue to profit from their illicit trafficking.

Nationwide, our research and other academic papers suggest cigarette smuggling is not abating dramatically. There is both empirical and recent anecdotal evidence to suggest the problem is increasing in some areas along with big excise tax hikes.

We have just published our fourth set of smuggling estimates for 47 of the 48 contiguous states, expanding our research to include data through 2012. Previous editions were released last year as well as in 2008 and 2010.

The 2008 and 2010 reports contain detailed explanations of the statistical modeling effort we use. In short, the model matches up legal paid sales vs. predicted smoking rates. The difference between the two is our total smuggling rate for 2012.

The model matches up legal paid sales vs. predicted smoking rates. The difference between the two is our total smuggling rate for 2012.

The average estimated magnitude of the smuggling rate for 2012 has declined 2.03 percentage points relative to our 2011 estimates, or by 8.2 percent. While that is good news there are still significant smuggling flows in total with the average smuggling rate of the top 10 in-bound smuggling states totaling 39.1 percent of consumption. The average smuggling rate for the top 10 out-bound smuggling states totals 12.8 percent of consumption. So, while the estimates as a share of consumption are down, they remain at significant levels.

New York Tops List

The top five in-bound smuggling states were New York (56.9 percent), Arizona (51.5 percent), New Mexico (48.1 percent), Washington state (47.8 percent), and Wisconsin (35.0 percent). This is a first appearance for Wisconsin among the top five smuggling states. It was ranked as low as 18th in the nation through 2006.

The top five out-bound smuggling states are New Hampshire (25.0 percent), Wyoming (22.3 percent), Idaho (21.3 percent), Virginia (21.1 percent), and Delaware (20.9 percent). Only Idaho is a new addition to the list of top five exports, displacing West Virginia.

We estimate that for 2012, 27.6 percent of all cigarettes consumed in Michigan were smuggled into the state.

Michigan Near Top of List

Michigan’s smuggling rate for 2012 is down slightly from the previous year but it still ranks 10th-highest in the nation. Michigan’s smuggling rate is split almost evenly between commercial and casual categories and contains an export component, too. According to our study, for every 100 cigarettes consumed in Michigan another 3.3 were smuggled into Canada.

We would be remiss if we did not also remind our readers that smuggling is not the only activity that increases as excise taxes go up. We have chronicled instances of a terror group being funded by Michigan-related trafficking; adulterated and dangerous products; brazen thefts from wholesalers and retailers; and violence toward police and other people. Just last September police in metro Detroit shot at cigarette thieves in fear for their lives.

Unless tobacco excise tax rates start coming down we will likely see a lot more stories like these.

Michael D. LaFaive (lafaive@mackinac.org) is director of the Morey Fiscal Policy Institute at the Mackinac Center for Public Policy in Midland, Michigan. Todd Nesbit (nesbit.19@osu.edu) is senior lecturer in economics at Ohio State University and a member of the Mackinac Center’s Board of Scholars.

Smuggling in Boston, Chicago

A 2013 study published in the journal Tobacco Control and titled “Cigarette Trafficking in Five Northeastern U.S. Cities” found almost 40 percent of discarded cigarette packages in Boston had tax stamps from other jurisdictions. That is, they were brought in from elsewhere. A tax stamp is used as evidence that cigarette excise taxes have been paid in a particular jurisdiction.

This is the most recent but not the only discarded cigarette pack-type study completed by scholars for peer-reviewed journals. A 2012 report also published in Tobacco Control examined illicit cigarettes in “socioeconomically deprived” neighborhoods (South Bronx, New York) and reported 57.9 percent of the cigarettes packs collected were untaxed. Other studies using this technique have been in done in Chicago and Ontario, Canada, and also have reported significant smuggling.

Cross-border smuggling activities can be broken into two major categories: casual and commercial. Casual smuggling occurs when individuals cross a border and buy cigarettes for personal consumption. Commercial smuggling involves larger, long-haul shipments done in an organized fashion.

INTERNET INFO

State Cigarette Smuggling as a Percentage of Total Cigarette Consumption: http://www.mackinac.org/media/images/2014/2014_LaFaive_Smuggling_Chart.jpg


“The top five in-bound smuggling states were New York (56.9 percent), Arizona (51.5 percent), New Mexico (48.1 percent), Washington state (47.8 percent), and Wisconsin (35.0 percent).”
Congressman Wants Tax Reform; Leaders Want to Wait

Continued from page 1

have lost hope and stopped looking for a job. And too many kids coming out of college are buried under a mountain of debt and have few prospects for a good-paying career. We’ve already lost a decade, and before we lose a generation, Washington needs to wake up to this reality and start offering concrete solutions and debating real policies that strengthen the economy and help hardworking taxpayers. Tax reform is one way we can do that.”

In a February op-ed in The Wall Street Journal, Camp pointed out the United States hasn’t enacted major tax reform since 1986, while many other nations, including Canada and Mexico, have made major changes in their tax laws to make their nations more competitive economically.

The U.S. tax laws are so complex that Nina Olson, the IRS National Taxpayer Advocate, estimates Americans spend more than six billion hours and $168 billion annually to file their returns.

‘Deserves a Lot of Praise’
“Chairman Camp has undertaken a monumental task in a thoughtful, forthright manner, for which he deserves a lot of praise,” said Pete Sepp, executive vice president of the National Taxpayers Union. “Wherever they stand on the particulars, taxpayers should welcome the beginning of the serious, methodical debate that this proposal ought to engender.”

“It’s too soon to condemn or to jump on board all of the tradeoffs made in this plan, and of course any tax reform plan is going to have details that are deal-killers for specific groups, but Mr. Camp’s focus on tax reform as a major initiative to drive greater economic growth and job creation is refreshing and admirable,” said Tom Giovanetti, president of the Institute for Policy Innovation.

Leaders Noncommittal
House Speaker John Boehner (R-OH) declined to endorse Camp’s plan. In a press conference, he laughed at the notion of the bill coming up for a vote this year and called it a “discussion draft” that will start a “conversation” about the federal tax system. House Budget Committee Chairman Paul Ryan (R-WI) also would not commit to action on the plan, though he told reporters “the status quo is indefensible.”

Senate Minority Leader Mitch McConnell (R-KY) told reporters “I have no hope” about the Camp plan being approved this year. Senate Majority Leader Harry Reid (D-NV) also said he doubts the bill will go anywhere.

“Even though most observers believe it will not receive a vote this year, this draft is a marker that can jumpstart the debate instead of continuing abstract discussions about individual tax breaks or the preferred top rate,” said Ryan Alexander, president of Taxpayers for Common Sense, in a statement.

“Many of the proposals set forth in the discussion drafts begin to remove unnecessary favoritism for certain corporate taxpayers, reduce the number of distortions in the tax code overall, and create more certainty with regard to international taxation,” he said. “Like most everyone, we won’t support every policy prescription in the draft, but we support moving forward with the debate.”

‘About More Than Reform’
Some business organizations have given the proposal a cautious thumbs-up.

“This plan would give our nation the simpler, fairer tax system that we desperately need, but it’s about far more than just tax reform,” said Matthew Shay, president and CEO of the National Retail Federation, in a statement. “This is the foundation for job creation, increased take-home pay, and business growth that would restore the prosperity that has slipped away for far too many American families.”

“At first glance, our reaction is that some provisions are encouraging, while others are troubling,” said Thomas J. Bisacquino, president and CEO of NAIOP, the Commercial Real Estate Development Association, in a statement. “We view this as the beginning of an important discussion for our country and for our economy, and we stand ready to provide our guidance so America’s commercial real estate sector can continue to grow and create jobs.”

Fewer Brackets, Simpler Code
Camp’s proposal is designed to simplify the tax code by:

• Flattening taxes by reducing rates and collapsing today’s seven tax brackets into two brackets of 10 and 25 percent for virtually all taxable income, ensuring more than 99 percent of all taxpayers face maximum rates of 25 percent or less. The plan also reduces the corporate rate to 25 percent.

• Simplifying taxation of investment income. The plan would tax long-term capital gains and dividends as ordinary income but exempt 40 percent of such income from taxation—resulting in a three percentage point decrease from the maximum rates individuals pay today on such income while achieving the lowest level of double taxation on investment income in modern history.

• Eliminating the Alternative Minimum Tax. The plan repeals the Alternative Minimum Tax (AMT) for individuals, pass-through businesses, and corporations.

• Simplifying the tax code. The plan repeals more than 220 sections of the income tax code, reducing it by 25 percent.

• Demanding better IRS accountability. The proposal includes provisions prohibiting implementation of the Obama administration’s recently proposed rules affecting 501(c)(4) organizations and provides victims of IRS targeting with information regarding the status of investigations into violations of their taxpayer rights.

Phil Britt (spenterprises@wowway.com) writes from South Holland, Illinois.
Court Asked to Stop ‘Blighted’ Seizures in California

By John Kramer

“[A]ny home, any small business, farm or church could be taken without the government having to properly justify its actions.”

DANA BERLINER, LITIGATION DIRECTOR
INSTITUTE FOR JUSTICE

The government deprives you of your rights, wouldn’t you like to know why that’s being done?

That’s the crux of a petition recently filed with the California Supreme Court on behalf of an inner-city boxing gym and mentoring center for at-risk kids in National City, California.

The Community Youth Athletic Center (CYAC) has asked the California Supreme Court to review a Court of Appeal decision holding that the Due Process Clause of the U.S. Constitution did not apply to National City’s most recent “blight” declaration.

In July 2007, National City declared nearly 700 properties blighted, including the CYAC’s, to make it possible to use eminent domain to transfer private property to private developers. The CYAC repeatedly asked National City to make public its supposed evidence that justified blighting the well-maintained property, but the city refused.

All Property at Risk

If not reversed, governments across California will be able to use this decision to deprive people of their rights without having to provide evidence justifying the deprivation.

“In that case, any home, any small business, farm or church could be taken without the government having to properly justify its actions,” said Institute for Justice Litigation Director Dana Berliner. The institute is the nation’s leading defender of property rights. As with all of its clients, IJ is representing the CYAC for free.

At trial, the CYAC argued that National City violated the Due Process Clause of the U.S. Constitution in failing to release its evidence of blight prior to a key public hearing that was the CYAC’s only opportunity to place evidence into the record. The trial court agreed and also found National City violated various California redevelop-ment statutes and the California Public Records Act.

Appeal Court Reversal

The Court of Appeal reversed the Due Process Clause ruling, holding that the Due Process Clause did not apply to public hearings because they are part of a “legislative” process. Berliner explained, “The government can’t take away a constitutional right without providing due process, and people have a right to keep their property unless the government needs it for ‘public use.’ The blight hearing may have been a ‘legislative’ hearing, but it was also a final decision that taking the gym’s property would be for a ‘public use.’ The blight hearing was a final determination of the CYAC’s individual, constitutional ‘public use’ right, and that’s why the CYAC should have gotten due process.”

‘Perfect Case for Court’

“This is a perfect case for the California Supreme Court because there is a lot of confusion in the lower courts about when due process applies and the high court hasn’t addressed this issue in nearly 30 years,” said IJ Senior Attorney Jeff Rowes. “Courts over the years have wrestled with this issue in the context of property rights, school desegregation, and government employment contracts.”

The California Supreme Court is expected to rule on the petition for review soon.

The Institute for Justice has been assisted in this case by local counsel Richard Segal, Brian Martin, and Nathaniel Smith in the San Diego office of Pillsbury, Winthrop, Shaw, Pittman.

John Kramer is vice president for communications at the Institute for Justice.

IN OTHER WORDS . . .

“On Wednesday, Chairman Dave Camp, a Michigan Republican, unveiled a serious plan to overhaul the broken federal tax code. Instead of stimulating a fruitful debate on how to fix one of this nation’s most pressing problems, Camp’s proposal fell flat.

“Lawmakers from both parties barely took time to dismiss the Camp plan. Even House Speaker John Boehner wouldn’t give credence to a sincere effort at reform from a leader of his own party. It takes some nerve for Boehner to issue a press release, as he did Thursday, with the headline, ‘While Dems sit on the sidelines, we’ll continue to lead.’

“Camp is one of the most influential policymakers in the House. He has headed Ways and Means for three years.

“People used to automatically put the adjective ‘powerful’ before the proper noun ‘Ways and Means.’

“But here’s what’s powerful now. It’s not Ways and Means, it’s Fear and Opportunism.”

— Chicago Tribune editorial, March 3, 2014

HELPING KIDS SUCCEED

Learning is easier and faster when properly designed incentive systems are used. But teachers are trained not to use them—almost entirely for ideological reasons.

Rewards: How to use rewards to help children learn – and why teachers don’t use them well marshals the psychological and economic evidence to refute the arguments against incentives. This important new book explains how rewarding students, teachers, and schools for their progress can work—and makes a powerful case for more school choice.

Coming this year from The Heartland Institute. For pre-order information, visit heartlandstore.org
Chicago Aldermen Barely Discuss Issuing New Debt

Continued from page 1

Shortly after the City Council vote, Moody’s Investors Service downgraded Chicago’s debt to Baa1, just three ticks above “junk” status.

“The city has been spending more than it takes in for years and borrowing to make up the difference. And if you compare Detroit to Chicago on this score, Chicago actually looks much worse, not better, than Detroit,” said Bill Bergman, director of research for StateDataLab.org, a project of the Illinois-based Institute for Truth in Accounting.

In a report released last year with The Heartland Institute, which publishes Budget & Tax News, Truth in Accounting analyzed assets versus liabilities for Chicago, Cook County (which includes Chicago), and the State of Illinois and determined the total “taxpayer burden” for Chicago households is roughly $67,000 ($18,000 for Chicago, $10,000 for Chicago-related Cook County taxing districts, and $39,000 for the state). This compares with a total state-local taxpayer burden of roughly $61,000 for Detroit households.

‘A Derelict City Council’
The Chicago Tribune also sees dangerous parallels between the two cities. In a February 5 editorial headlined “Chicago is on the road to Detroit,” the editors wrote:

“By the most recent numbers, Mayor Rahm Emanuel’s government owes $13.9 billion in general obligation bond debt, plus $19.5 billion in unfunded pension obligations. Add in Chicago Public Schools and City Hall’s other ‘sister agencies’ and you’re talking billions more in debts that Chicago taxpayers owe. Yet here we are on a Wednesday when the mayor probably will get approval from a derelict City Council to issue another up-to-$900 million in bonds backed by property taxes—and to double, to $1 billion, the amount of short-term bank money his administration can borrow to raise cash.

“Tuesday’s Tribune reported that, despite a lack of particulars on the costs or types of projects the bond proceeds would fund, this huge new borrowing package on Monday flew through the council’s Finance Committee. Most of the questions from aldermen centered on whether the financial firms executing the deals are employing enough minorities. ‘These transactions are the largest opportunities for people to make money off the government, and we want to make sure everybody is included;’ said Ald. Walter Burnett, 27th. ‘It’s a lot of money. It’s enough for everybody.’”

“We’ve been voting on a lot of these bond issues not knowing specifically what we’re voting on. … They’ve given us some specific numbers, but not specific tasks, projects, or equipment that they’re spending it on.”

SCOTT WAGUESPACK
32ND WARD ALDERMAN
CHICAGO, ILLINOIS

False Balanced-Budget Claims
Bergman said Chicago city leaders “regularly claim to ‘balance the budget’ according to state law, even though they spend more than they take in every year. We think the city should overhaul its budgeting and financial reporting practices with ‘F.A.C.T-based budgeting’ [Full Accrual Calculations and Techniques], a model for a solution.”

At the Illinois Policy Institute, which has an office in Chicago, Senior Budget and Tax Policy Analyst Ben VanMetre said, “The skyrocketing property taxes used to prop up this debt are quickly forcing people out of the city.”

Just two weeks before the City Council approved the extra $1.9 billion of borrowing, Crain’s Chicago Business reported, “Next year, Chicago must come up with a state-mandated $590 million increase in its contribution to police and fire pension funds. A Crain’s analysis of the city’s tax and budget options shows that payment could lead to the highest commercial property tax rate in the nation and still leave the city needing to make millions of dollars in spending cuts that could decimate many services.”

Much of this new round of borrowing appears aimed at dealing with that short-term problem, but money borrowed now must be paid back later with interest.

“Government officials in Chicago are looking to bury the city even further in debt with an additional $1.9 billion in new borrowing, Taxpayers should be worried,” Van Metre said.

Last July Moody’s Investors Service hit Chicago with an unprecedented triple-level drop in the city’s credit rating. The credit rating agency cited Chicago’s “very large and growing” pension liabilities, “significant” debt service payments, and “unrelenting public-safety demands” to explain the move. Then last November Fitch Ratings also gave the city a triple downgrade.

Unanswered Questions
Chicago Chief Financial Officer Lois Scott this week told Finance Committee members she did not know how much more the city will have to pay in higher interest costs, as this would be the city’s first debt issuance since the downgrades. But last fall she told aldermen the city could pay another $1 million a year for every $100 million borrowed.

“We’ve been voting on a lot of these bond issues not knowing specifically what we’re voting on, and that’s what we’re trying to get today,” 32nd Ward Ald. Scott Waguespack told reporters after the Finance Committee voted to recommend approval. “Tell us exactly what we’re spending this money on. They’ve given us some specific numbers, but not specific tasks, projects, or equipment that they’re spending it on.”

Waguespack was one of the four aldermen who voted to oppose the borrowing.

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

INTERNET INFO
Income Tax Cut Advances in Oklahoma Legislature

By Steve Stanek

A cut in the Oklahoma state income tax took a step toward reality in February when a state House subcommittee passed House Bill 3291, which would lower the personal income tax rate to 4 percent by 2018.

The approval of the tax-cut measure by the House Appropriations and Budget Subcommittee on Revenue and Taxation came approximately one month after the state’s Office of Management and Enterprise Services reported tax collections have never been higher in Oklahoma. The state collected $7.86 billion in total taxes in Fiscal Year 2013, 37 percent more than the $5.73 billion collected 10 years earlier. Much of the gain came from greater sales tax revenues.

“This vote is a step toward empowering Oklahoma’s wage-earners. In Oklahoma we penalize many working men and women simply for having a job. This proposal would reduce our state’s penalty on work, increasing economic freedom for mothers and fathers, small business owners, and job-creators across our state,” said Dave Bond, CEO of OCPA Impact, Inc., an organization that partners with the Oklahoma Council of Public Affairs and other organizations that promote pro-growth economic policies in the state.

Lower Tax, Higher Growth

“Over the past decade, Oklahoma has reduced its penalty on work by 25 percent. Yet tax collections and state government spending have been at record highs. Clearly, tax cuts have not depleted state revenues,” Bond said. “The evidence is strong, particularly when you also consider dynamics around the country, that low tax rates result in increased private-sector economic growth.”

Oklahoma’s top personal income tax rate was 7 percent in 2004 and has been cut gradually since then. It currently stands at 5.25 percent, approximately 25 percent lower than 10 years ago. The state also has raised the standard exemption and added a child tax credit.

Border State Competition

Tax competition appears to be the motivation. Oklahoma’s neighbor to the north, Kansas, would have a 3.9 percent income tax rate in 2018. Oklahoma’s neighbor to the south, Texas, has no state income tax.

“As long as Oklahoma penalizes work by charging an income tax, and other states don’t, we will be at a disadvantage for bringing jobs and opportunity to our state,” said state Rep. Leslie Osborn (R-Mustang), author of HB 3291, to The Daily Ardmoreite newspaper in Ardmore, Oklahoma.

“With the dynamic changes Kansas is making, reducing taxes on families and small businesses, Oklahoma is in an income-tax sandwich between our neighbors to the north and south.”

LESLIE OSBORN
STATE REPRESENTATIVE
MUSTANG, OKLAHOMA

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

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Illinois Governor Paints a Rosy Picture of State’s Ugly Finances

By Dennis Byrne

Illinois, perhaps the most financially challenged state in the Union, is either inching back to health or accelerating its plunge into insolvency—depending on who’s doing the talking.

Gov. Pat Quinn, a Democrat who faces reelection this fall, pronounced in his January 28 State of the State address, “Illinois is making a comeback” after suffering through the “perfect storm” of a “triple crisis of government corruption, economic collapse, and financial instability.”

Of the last three Illinois governors, Quinn is the only one who hasn’t ended up in a federal prison cell. He can claim progress on that front, but he also provoked critics from both major political parties by asserting he had “accomplished comprehensive pension reform.” He quoted Moody’s Investors Service as saying Illinois had possibly the “largest reform package implemented” by any state.

His office also points to a study by CareerBuilder and Economic Modeling Specialists International that shows Illinois ranked third-highest nationally in the creation of net new business establishments, totaling 18,000 from 2009 to 2012. Quinn does not mention the state lost almost 34,000 payroll jobs over that period and has the nation’s third-worst unemployment rate.

Dubious Pension Reform Benefits

Quinn’s critics—of whom there are many in both major political parties—beg to differ.

They note the pension reform mostly affects new government workers and leaves overly generous benefits in place for existing employees and retirees. And even the minimal gains might never be realized because public employee unions have filed suit, alleging the reforms violate a state constitutional provision against diminishment of negotiated benefits.

Even with the reforms, Illinois’ pension debt burden remains the highest among the states and puts the state’s solvency at risk. And the back-loaded reforms will do little, if anything, to bring the state up to date on a backlog of more than $6 billion of unpaid bills.

Also, three years ago, straining under the pressure of huge budget deficits, unpaid bills, and growing unfunded pension liability, the governor and legislature raised the state’s personal income tax rate by 67 percent, to 5 percent from 3 percent. They also raised the corporate income tax rate by 46 percent, to 7 percent from 4.8 percent. Combined with an existing 2.5 percent “personal property replacement tax,” corporations in the state now pay an effective income tax of 9.5 percent.

As part of the deal, the increases are to sunset on January 1, 2015—the 5 percent individual rate would drop to 3.75 percent and the corporate rate to 5.25 percent. The individual rate would go to 3.25 percent on January 1, 2025.

Complicated Tax Issues

But many doubt the rollbacks will happen. Already there are calls from some legislators and others to make the “temporary” increases permanent. Quinn has dodged the question and isn’t expected to make his position clear until he delivers his budget message for the fiscal year beginning on July 1. When that will be is, as of this writing, unclear.

The question has been complicated by a startling proposal sprung by fellow Democrat and House Majority Leader Michael Madigan, who engineered the tax increases: Cut corporate taxes in half.

His legislation (HB 4479) would reduce the 7 percent corporate rate to 3.5 percent (but retain the 2.5 percent replacement tax, making for an effective corporate rate of 6 percent). The reduction in the individual rate would remain as scheduled.

The corporate tax cut would not apply to the 75 percent of Illinois businesses that file as individual taxpayers—the businesses that account for most job creation.

The tax situation is further complicated by legislation that has been introduced to convert the state’s flat income tax into a graduated tax to charge higher rates on higher incomes.

Businesses vs. Individuals?

Government and tax watchdogs have been cautious in their analyses, especially of the unexpected Madigan proposal. Benjamin VanMetre, senior budget and tax policy analyst at the Illinois Policy Institute, a free-market think tank, suggested Madigan is angling to make the graduated tax more palatable to the business community.

Others suggest the proposal might be a tradeoff for an increase in the state’s minimum wage, now at $8.25. Others speculate Madigan is trying to divert attention from the state’s dismal jobs and economic development climate, which Republicans are increasingly using as an election issue against the Speaker’s Democratic legislative allies.

As appealing as a tax cut might be to the business community, VanMetre and Laurence Msall, president of the nonpartisan Civic Federation, say much more is needed to right the state’s fiscal ship. Further pension system reforms are among the necessary additions, they say.

Madigan’s tax cut would leave the state with a $1.5 billion annual hole and the $6 billion in unpaid bills. This could be where a graduated income tax would come into play, making the “rich pay a fuller share” as part of a package of tax reforms.

For now, Madigan argues the corporate tax cut would generate the additional extra revenue to fill the hole, making Illinois’ most powerful Democratic Party lawmaker sound more Republican than some Republicans. With four men contending for the Republican Party’s nomination to run for governor, the political implications are somewhat cloudy. And that means more increasing fog for the state’s financial condition.

Dennis Byrne (dennis@dennisbyrne.net) is a Chicago freelance writer and a Chicago Tribune contributing op-ed columnist.
By Kenneth Orski

It may come as a surprise to you, but there is a quiet revolution in transportation funding underway these days. Faced with a depleted Highway Trust Fund and uncertain prospects for more money from a deficit-conscious Congress, many states are taking matters into their own hands and aggressively pursuing more fiscal independence.

A survey we have recently conducted documents significant funding initiatives in 18 states. Some states—Maryland, Wyoming, Massachusetts, and Vermont—have raised their gasoline taxes. Others, including Pennsylvania, have shifted to a tax on fuel at the wholesale level. Still others, including Alaska and Virginia, have enacted dedicated sales taxes for transportation or floated toll revenue bonds, as Ohio did.

Further evidence of local initiatives came on election day last November when voters approved more than 70 percent of ballot measures to increase or extend funding for local transportation.

“Pragmatic Response to Realities”

A senior state transportation official commenting on our survey of funding initiatives told us, “What you are seeing is the governors’ and state legislatures’ realistic assessment and pragmatic response to the fiscal realities in Washington.” He added, “We all realize the era of free-flowing federal dollars is over … It’s up to us to find a new way.”

So it would seem the federal budgetary realities are helping to achieve de facto some of the federalist reform objectives that have been on the congressional agenda ever since they were first put forward back in the late 1990s by former Congressman (now Ohio Governor) John Kasich, later embraced by former Sen. Jim DeMint, and just recently revived through the Transportation Empowerment Act by Rep. Tom Graves and Sen. Mike Lee.

Admittedly, what we are seeing today is not “devolution,” properly speaking, as envisioned in the Empowerment Act. But it’s a significant step in the direction of shifting more transportation decision-making to the state and local levels.

More Long-Term Financing

What is helping states to become fiscally more independent is their growing embrace of long-term financing and easier access to private capital through public-private partnerships.

Costly multi-year infrastructure projects no longer have to rely on uncertain annual appropriations or to compete for scarce Trust Fund dollars. Instead, they are being financed with a variety of tools, such as private activity bonds, TIFIA loans, toll revenue concessions, availability payments, and private risk capital.

In turning away from “pay-as-you-go” funding and toward project financing, states are emulating a long-established practice in the private sector. All of the nation’s privately owned infrastructure has been, and still is, financed by borrowing front-end capital and repaying it over time rather than by relying on current cash flow. Now, states are adopting the same approach toward public infrastructure, convinced they no longer can count on a reliable, stable and generous flow of federal transportation dollars.

Partnerships Worth $20 Billion

Our survey has identified 20 jurisdictions undertaking major reconstruction projects with the help of long-term debt. In addition, states have entered into more than 30 public-private partnerships worth about $20 billion. This is on top of some $35 billion worth of municipal bonds that are annually sold to finance local transportation.

And this may be only the beginning. As states acquire more sophistication and familiarity with credit transactions, and as federal budgetary restraints continue, long-term financing of large-scale capital-intensive projects through public-private partnerships (P3) and availability payments is bound to become the states’ primary method of expanding and modernizing aging infrastructure.

Nor will future P3 transactions be confined to roads and bridges any more. Maryland Gov. Martin O’Malley recently announced that the Purple Line, a $2.2 billion, 16-mile light rail line connecting two suburban counties in the Washington metro area, will be built, financed, and operated through a public-private partnership. It is the second project of its kind—a system of commuter lines in Denver, the Eagle P3 Project, was the first—but almost certainly not the last.

Likely Consequences

There are several potential consequenc- es flowing from these developments.

With states becoming more fiscally independent, Congress might conclude there is less of a justification to increase the transportation reauthorization spending levels or to approve a long-term bill. A one- or two-year measure funded at current spending levels ($54 billion a year) now appears as a distinct possibility according to congressional sources in the House as well as in the Senate.

Even at those levels of expenditure, an extra $15 billion to $16 billion a year in new revenue would be required to close the gap in funding, according to the Congressional Budget Office. No one—neither in Congress, nor in the administration, nor among the stakeholders—has come up with an answer as to where this money is to come from, nor to speak of the $90 billion required to fund a six-year bill many transportation stakeholders advocate.

Secondly, assuming costly multi-year projects will henceforth be financed with long-term debt, there will be fewer demands placed on the resources of the Highway Trust Fund—and thus less of a threat the fund will go broke. However, it’s doubtful that capital demands on the fund will lessen sufficiently to stabilize it at its CBO-estimated revenue inflow level of $34 billion a year. So a funding shortfall will remain, posing a serious challenge for the congressional fiscal authorizers.

Kenneth Orski (korski@verizon.net) is editor and publisher of the Innovation Briefs newsletter.
Illinois Legislators Consider $600 Mil. Tax on Sugary Drinks

By Benjamin Yount

In Illinois it’s called everything from pop to soda to sody, but the state’s Democrats are now calling soda pop a money maker.

State Sen. Mattie Hunter (D-Chicago) in February laid out a plan to add a penny-per-ounce tax to soda along with a handful of other sugary drinks.

Why? Kids (and adults) are getting chubby, and it costs a lot to treat people who get sick from weighing too much, according to Hunter.

“This is one of the most progressive initiatives I have ever had the opportunity to sponsor,” Hunter said.

“People will pay a little more, but that is just to offset the burden those beverages [cause] in terms of health and health care costs here in Illinois.”

$600 Million Tax Hike

Hunter and other state lawmakers know that a penny-per-ounce tax on soda, which comes to $3 a case or 67 cents for a two-liter bottle, could raise a lot of money. That cash would supplement the $13 billion Illinois now spends on Medicaid.

“This legislation is projected to produce over $600 million each year for prevention, wellness, and Medicaid services in this state,” state Rep. Robyn Gabel (D-Evanston) said.

Illinois’ vast bureaucracy of public health groups and advocates are jumping at the chance to get some new money.

“The monies and the revenue coming to local health departments for health education is greatly needed,” said Tom Hughes, executive director of the Illinois Public Health Association.

‘Failed Strategy for Reducing Obesity’

Not everyone is on board. Illinois’ business groups are chief among them.

“Illinois taxpayers are tired of politicians raising taxes,” said Mark Dzler, vice president and chief operating officer of the Illinois Manufacturers’ Association. “More importantly, [the soda tax] is a failed strategy for reducing obesity.”

State Sen. Dave Syverson (R-Rockford) said no one who looks at this tax can believe it’s about making people healthy or fighting obesity.

“It’s clearly just another way to tax Illinois residents. It’s not going to have any impact on health outcomes. If they want to change health outcomes, they should deal with all of the foods and drinks.”

DAVE SYVERSSEN, STATE SENATOR ROCKFORD, ILLINOIS

“Illinois has added 168,000 people to Medicaid since January 1 due in large part to Obamacare. Syverson and other Republicans worry the state’s Medicaid rolls will swell from last year’s 2.7 million to 3 million by the end of the year.

The soda tax plan has yet to get a hearing in the statehouse.

Benjamin Yount writes for Illinois Watchdog.
Appeals Court Rejects Licensing of Tax Preparers

By John Kramer

The District of Columbia Circuit Court of Appeals in February ruled the Internal Revenue Service has no legal authority to impose a nationwide licensing scheme on tax-return preparers.

The decision affirms a January 2013 ruling by U.S. District Court Judge James E. Boasberg, who struck down the IRS’s new regulations as unlawful. Both courts rejected the agency’s claim tax-preparer licensure was authorized by an obscure 1884 statute governing the representatives of Civil War soldiers seeking compensation for dead horses.

“This is a major victory for tax preparers—and taxpayers—nationwide,” said Dan Alban of the Institute for Justice, the lead attorney for the three independent tax preparers who filed the suit. “The court found that Congress never gave the IRS the power to license tax preparers, and the IRS cannot give itself that authority.”

The court held, “If we were to accept the IRS’s interpretation of [the statute], the IRS would be empowered for the first time to regulate hundreds of thousands of individuals in the multi-billion-dollar tax-preparation industry. Yet nothing in the statute’s text or the legislative record contemplates that vast expansion of the IRS’s authority.”

IRS Targeted Hundreds of Thousands

More than 350,000 tax-return preparers would have been hampered by the regulations. The burden would have fallen most heavily on independent tax preparers and consumers, putting tens of thousands of mom-and-pop preparers out of business and increasing the cost of tax-return preparation for millions of taxpayers.

“My customers—not the IRS—should be the ones who get to choose who prepares their taxes,” said Sabina Loving, an independent tax preparer from Chicago and the lead plaintiff in the case. “I have a right to earn an honest living without getting permission from the IRS.”

The court ruled “[t]he IRS may not unilaterally expand its authority through such an expansive, atextual, and ahistorical reading of [the statute].”

‘Regs Were Economic Protectionism’

“These regulations were classic economic protectionism,” said Institute for Justice Senior Attorney Scott Bullock. “Licensing tax preparers would have benefitted powerful industry insiders at the expense of entrepreneurs and consumers.”

The Economist magazine explained the new IRS regulations “threaten to crush ... small, local” tax preparers and were “likely to push mom and pop into another line of work.”

The Wall Street Journal agreed, noting, “Big-foot tax preparers like H&R Block and Jackson Hewitt lobbied for the regulation and have been explicit in hoping it will squeeze lower-priced competition.”

The drafting of the regulations was overseen by former H&R Block CEO Mark Ernst, and several financial analysts concluded they would benefit the company.

“Administrative agency overreach threatens the economic liberty rights of entrepreneurs,” said William Melior, president and general council for the Institute for Justice. “This precedent ensures that agencies must follow the law and cannot exceed the power given to them by Congress. As the court noted, ‘fox-in-the-henhouse syndrome is to be avoided ... by taking seriously, and applying rigorously, in all cases, statutory limits on agencies’ authority.’”

John Kramer is vice president for communications at the Institute for Justice.

Most Consumers Want Lower Taxes on Wireless Services, Survey Says

By Josh Peterson

A majority of American consumers say wireless communication taxes are too high and should be significantly lower than they are now, according to a recent survey.

The survey, conducted online by McLaughlin & Associates and Penn Schoen Berland, found 84 percent of U.S. consumers say their combined state and local tax rate on wireless services is too much.

Taxed Twice as Much

Fifty-four percent of consumers, according to the survey, say the tax rate on their monthly cell phone bill should be lower than 7 percent. This would put it in the range of taxes on most other goods and services. Nationally, the average tax rate on wireless services is more than double the rate on other goods and services. In some states, the tax rate on wireless services tops 20 percent.

The survey of 1,000 adult participants who said they are likely voters was conducted on December 2-6. The survey has a margin of error of plus or minus 3.1 percent.

Seen as Essential

In addition, 81 percent of respondents said they considered wireless services an essential part of daily life. Sixty-five percent said they used a wireless tablet or mobile phone for purposes related to work, school, and personal management.

Rob Schrum, director of political advocacy at MyWireless.org, said although the results of the survey represented an overall consumer satisfaction with wireless services, consumers were highly dissatisfied with how they were being taxed to use them.

“That’s why it’s time for Congress to act and pass the ‘Wireless Tax Fairness Act,’ to provide relief and stability to consumers when they need it the most,” Schrum wrote in a blog post.

Tax Moratorium Introduced


Nearly two-thirds of survey respondents, 61 percent, said they favored Congress passing such a moratorium.

Josh Peterson (jpeterson@watchdog.org) reports for Watchdog.org, where this article first appeared.
Repeal Foreign Account Tax Compliance Act, RNC Says

By Steve Stanek

The Republican National Committee has adopted a repeal of the Foreign Account Tax Compliance Act as part of its official platform.

FATCA became federal law in 2010 and began going into effect in 2013. Its stated aim is to reduce tax evasion, but the Congressional Joint Committee on Taxation estimates the federal government would take in only about $800 million a year as a result of the law. Opponents say the costs far outweigh the projected gains.

FATCA requires financial institutions around the world to comply with U.S. government demands to report to the Internal Revenue Service about the accounts and assets of U.S. citizens. The information includes the names and addresses of U.S. clients, their account balances, and the total debits and credits from each U.S. account.

Non-compliant institutions face severe penalties, including a 30 percent withholding tax on all financial transactions. These transactions include interest and dividend payments and proceeds from the sale of U.S. stocks or bonds.

Compliance also raises operating costs of the financial institutions and often means they must violate the banking practices and laws of their home countries.

Americans Turned Away

Many foreign institutions have responded to the imposition of U.S. law on their operations by turning away American customers.

“The costs of FATCA’s misguided fiscal imperialism are mounting. It is past time for elected officials to wake up to the unmitigated disaster that they have unleashed upon the world,” said Andrew Quinlan, president of the Center for Freedom and Prosperity, in a statement. CF&P has led the Coalition for Tax Competition in opposing FATCA. The coalition includes 21 large and influential free-market, taxpayer-protection, and grassroots organizations.

Quinlan noted Sen. Rand Paul (R-KY) has responded by introducing Senate Bill 887 to repeal FATCA and restore basic privacy rights.

Relations Strained, Investment Harmessed

Last year the coalition sent a letter to senators requesting FATCA repeal.

The letter argued FATCA will fail to significantly reduce tax evasion, is straining foreign relations because of the burdens placed on foreign financial institutions, and is reducing investment in the United States.

The letter also noted, “During FATCA’s implementation process, the Treasury Department has made a bad law worse. Without specific authorization from Congress, Treasury has sought to circumvent problems posed by foreign privacy laws through the negotiation of intergovernmental agreements (IGAs) that would obligate foreign governments to collect information from their institutions in order to pass it on to the IRS. The funneling of comprehensive financial information of U.S. citizens through foreign governments is a serious breach of privacy that potentially exposes Americans to identity theft, harassment, and other crimes.”

Organizations whose representatives signed the letter include the Center for Freedom and Prosperity, Americans for Tax Reform, National Taxpayers Union, American Commitment, 60 Plus Association, Institute for Policy Innovation, and Family Business Coalition.

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

Detroit Rescue Plan Leans (Lightly) on Privatizing Some City Services

By Michael D. LaFaive

The city of Detroit has published its plan of adjustment detailing how it intends to solve the city’s fiscal and other problems. It includes important references to privatization of certain services, though it doesn’t go far enough. A bolder vision might spare city retirees and creditors from deeper cuts.

Page 116 of the Disclosure document makes it clear Emergency Manager Kevyn Orr is prepared to contract out for some if not all the operations now provided by the Detroit Department of Transportation. This was a recommendation made by the Mackinac Center for Public Policy in late 2000. At the time, we estimated the city could save $60 million a year by doing so. If they had saved just half of that since 2000, Detroit would have accrued $360 million in savings by now.

The report also alludes to the possibility of outsourcing city airport work and redeveloping city parking assets.

On balance the reforms laid out by Orr “give short shrift to outsourcing and asset sales,” according to Leonard Gilroy of the Reason Foundation, a national expert on privatization, although the city has just recently signed a contract for refuse collection.

“Lots of Low-Hanging Fruit”

“While it’s encouraging to see proposals for sensible privatization initiatives in transit operations, parking, payroll administration, and airport operations, these are drops in the city’s fiscal bucket,” Gilroy said. “There’s still a lot of low-hanging fruit left untouched in terms of cost-savings opportunities through privatization, particularly in areas like public works, fleet operations, and various administrative support functions.”

LEONARD GILROY
REASON FOUNDATION

“There’s still a lot of low-hanging fruit left untouched in terms of cost-savings opportunities through privatization, particularly in areas like public works, fleet operations, and various administrative support functions.”

LEONARD GILROY
REASON FOUNDATION

Cutting 43.5 percent out of Detroit’s General Fund would mean a nearly $480 million decline in spending, which would go a long way toward reducing the cuts that may be imposed on the city’s retirees and creditors.

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Md. Treasurer Opposes Guv’s $100M Cut in Pension Funding

By Len Lazarick

Maryland State Treasurer Nancy Kopp has told lawmakers she opposes Gov. Martin O’Malley’s proposed $100 million cut in the state’s pension contribution for government workers, saying it would undermine trust by the state’s bond rating agencies.

“I think this is a very difficult thing to defend with the rating agencies,” Kopp told the House Appropriations Subcommittee on Public Safety and Administration.

Kopp, a Democrat, was testifying as chair of the State Retirement and Pension System Board of Trustees. As state treasurer, she is also the top state official handling Maryland’s bond issues and deals with the three New York firms that rate them.

In 2011, the legislature and governor made major reforms, including employee higher contributions and lower benefits, in pensions for state employees and teachers. At that time, the state promised in law to set aside $300 million from those savings to beef up Maryland’s chronically underfunded pension fund.

O’Malley, a Democrat, has proposed permanently reducing that annual contribution to $200 million, but the legislature must agree to the change before it can be implemented.

“We set out a plan, and we were going to stick with that plan,” said Kopp, who served on the special commission that recommended the changes. Unions for state employees and public school teachers are actively opposing O’Malley’s proposal.

“A Question of Trust’

“It’s a question of trust, in all candor. ... We trusted $300 million, and now we’re told to trust $200 million,” Kopp said.

“Making such reforms and remaining faithful to them is of great importance to the rating agencies,” Dean Kenderdine, executive director of the retirement agency, told the committee in written testimony supporting Kopp’s position. “It is fair to expect that any further reneging on the state’s reform plan will be dimly viewed.”

Maryland has been able to maintain its triple-A bond rating for five decades, but the rating agencies persistently point out its pension system is currently covered for only 65 percent of promised benefits, a lower figure than the handful of other states with triple-A ratings.

One rating agency uses a different expected rate of investment return to calculate liabilities and says Maryland has even higher pension liabilities than reported.

The State Retirement Agency assures retirees there’s plenty of money to cover current pension payments to 138,000 retirees, who were paid almost $3 billion in fiscal 2013.

Unfunded liabilities are the amount of money the state would owe all the plan participants—an additional 192,000 active participants—if the state went bankrupt.

Pension Fund Underperformance

An essential component of the pension fund is the return on its $40 billion investment portfolio, which contributes more money than either the state or its employees to the pension fund.

At the same hearing on the budget for the retirement agency, legislative analyst Michael Rubinstein asked the agency to defend its poor performance compared to other states.

“The system’s investments returned 10.6 percent in fiscal 2013, which exceeded both the actuarial funding target and its own plan benchmark,” said Rubinstein’s report. “However, the fund performed poorly in comparison to other large public pension plans.”

“The fund’s movement away from public equity at a time when it is performing well continues to place it at a disadvantage relative to the performance of its peers, whose allocations to public equity tend to be greater,” Rubinstein said.

Diversity to Reduce Volatility

SRA Chief Investment Officer Melissa Moye defended the plan’s diversification, saying it was designed to reduce volatility—the up-and-down swings in the stock market. The Maryland fund has a lower percentage of its investments in stocks than some other pension systems, and stocks have been performing well recently.

“During periods of very strong stock returns, the system’s performance will likely lag more aggressive funds,” Kenderdine said in his testimony. “Conversely, the system would likely outperform those funds during time periods when public equity does not perform well.”

Investment banker Jeff Hooke, a persistent critic of the system’s investment strategy, told the legislators Maryland’s underperformance by 1.8 percentage points compared to funds comparable in size cost the system $720 million in earnings last year, and $3.5 billion over the last 10 years.

As he has in the past, Hooke again recommended the system stop paying Wall Street managers $275 million in fees for active management, hedge funds, and private equity, by using stock index funds.

“Pension fund trustees and staff are no doubt trying to beat the averages, but their tactics aren’t working,” Hooke said.

“We do index a lot in the portfolio,” Moye responded, with 65 percent of U.S. stock holdings matching a broad portfolio of stocks. “Indexing is not a panacea. We’re actually big believers in indexing, but we don’t believe it is the only thing that should be done.”

Len Lazarick (len@marylandreporter.com) is the editor and publisher of MarylandReporter.com, where this article first appeared.
FACT-Based Budgeting: Medicine for What Ails Government Finances

By Donna Rook

Some surprises, such as Valentine’s Day candy, are nice. Others, like government spending crises and bankruptcies, are hard to swallow. Instead of trying to treat the heartburn after the pain becomes intense, a careful look at causes and prevention might help.

Governments, which are expected to balance their budgets, can avoid these painful financial surprises. It all depends on the meaning of “balanced budgets.” Budgets primarily focus on yearly income and spending, but politicians like to provide more “goodies” without raising taxes. So they hide from public view some expenses that should be paid each year, much like credit card balances when the borrower makes only the minimum monthly payments.

Struggles to match spending to revenue are not new. In the early 1800s, several states declared bankruptcy after large “internal improvement” projects such as road- and canal-building exceeded funding. To prevent this problem, governments adopted “fund accounting,” setting up separate checking accounts for special projects so they could not tap general revenues. Since then, however, government missions have become more extensive and complicated, with human-services costs becoming hard to predict, often increasing when economic conditions worsen and government revenues decrease.

‘Political Math’

To avoid unpopular tax increases, spending cuts, or both, government officials have created a new game we call political math to deal with these spending challenges. This game includes moves such as:

• Creating revenue by moving money into an overdrawn fund from a solvent fund.
• Treating loan proceeds, meant for a specific project, as “funds available” to pay bills for other services.
• Delaying payment for this year’s bills until next year.
• Shifting a significant portion of current employee compensation costs onto future taxpayers. Pension and other retirement benefits, like salaries, are a form of compensation cost. A government may choose to “charge” these earned benefits on a “credit card” for pension and other retirement plans. This choice does not change the fact the retirement benefits portion of the compensation cost should be included in the balanced budget calculation.

“To avoid unpopular tax increases, spending cuts, or both, government officials have created a new game we call political math, to deal with these spending challenges.”

More recent solutions to today’s financial challenges. FACT-based budgeting requires each year’s budget “to be approved” by government employees. Elected officials should adopt Full Accrual and Calculation Techniques in their budget processes. FACT-based budgeting requires each year’s budget to be calculated and reported in a way that allows everyone to see the impact on the government’s current and future financial position. Debt cannot be hidden in financial footnotes and appendices. Debt has to be truthfully and transparently shown, on a timely basis, before budgets are passed.

“A FACT-Based Budget

To prevent painful financial surprises, elected officials should adopt Full Accrual and Calculation Techniques in their budget processes. FACT-based budgeting requires each year’s budget to be calculated and reported in a way that allows everyone to see the impact on the government’s current and future financial position. Debt cannot be hidden in financial footnotes and appendices. Debt has to be truthfully and transparently shown, on a timely basis, before budgets are passed.

Under such a system, each year citizens could clearly see whether the budget causes debt to increase or be paid up. No longer could government create “credit card” debt for today’s services to accumulate for future taxpayers to pay.

Government distribution of goodies can be a false sign of affection, especially if it leads to debt and spending heartburn. Effective prevention requires knowledge of the true cause.

Truthful, timely, transparent government reporting would enable all involved—citizens, elected officials, and government employees—to assess proposed solutions to today’s financial challenges. FACT-based budgeting would also prevent debt from increasing and being hidden from taxpayers.

Elected officials should improve both reporting and budgeting, and not kick the can down the road for future citizens to handle.

Donna Rook (drook@statedatalab.org) is president of StateDataLab.org, a project of the Institute for Truth in Accounting.

IN OTHER WORDS . . .

“Americans still awaiting the full truth about the Obama administration’s IRS targeting tea party groups for excessive scrutiny during the 2012 election cycle should applaud House Republicans’ efforts to compel testimony from a woman at the center of that scandal.

“Lois Lerner retired in September after heading an IRS division that determines groups’ tax-exempt status. Last May, during a House Oversight and Government Reform Committee hearing, she invoked her Fifth Amendment right against self-incrimination. But she also proclaimed her innocence—and the committee ruled that by doing so, she waived that Fifth Amendment right and left herself open to being compelled to testify. ...

“With the Obama administration still defending the indefensible, recalling Lerner to testify shows that Mr. Issa and his committee aren’t backing down in their efforts to document the full extent of politically motivated IRS abuses—which the American people have every right to know.”

— Pittsburgh Tribune-Review editorial, March 2, 2014

INTERNET INFO

Sioux City May Sue State Over Traffic Camera Rules

By Paul Brennan

Exactly what Sioux City, Iowa’s automated traffic cameras have done to improve public safety is debatable, but the more than $1 million they’ve raised to fatten police and firefighter pensions isn’t.

Now new regulations from the Iowa Department of Transportation curbing use of the cameras on state highways and interstates threaten a revenue stream the city has been using to cover gaps in its operating budget. IDOT regulations say cameras should be used as a last resort to address safety issues, and not as a way to bring in money.

Sioux City is considering suing IDOT in hopes the courts might invalidate the new regulations.

Seven of Sioux City’s 11 red-light cameras are located on state highways. The city also has two mobile speed cameras on Interstate 29.

In fiscal year 2013, the city earned $536,000 from its red-light cameras. The I-29 speed camera generated $4.5 million for Sioux City during the same period.

$1 Million Spent on Pensions

According to Sioux City Councilman Keith Radig, at least $1 million of the city’s traffic camera money has gone to the Municipal Fire and Police Retirement System of Iowa (MFPRSI).

Radig has been the only Sioux City official willing to publicly criticize the city’s dependence on traffic camera money.

“I always thought it should have been considered one-time money, because the state could eventually take it away,” Radig told Iowa Watchdog. “It should have been used for capital expenses—preferably for safety projects—since the cameras are supposed to be used to improve safety.”

He’s equally critical of the pension burdens the state has placed on the city.

State Maintains Control

Although MFPRSI, which covers the police and firefighters of Iowa’s 49 largest cities, is funded by those cities, the state legislature controls it. Only that body can change the way the retirement system is run, the benefits it pays, and the mandates it imposes on cities.

Because of the way laws regarding state pensions are written, changes to MFPRSI and the larger Iowa Public Employees Retirement System can be made only in the second year of a legislative session.

That means any change will have to be voted on during an election year, providing a powerful incentive for lawmakers not to do more than modestly tinker with the retirement systems.

Although there is a broad consensus the state’s retirement systems are in need of reform—MFPRSI had an unfunded liability of $657 million at the end of the last fiscal year, according to the most generous interpretation of its finances—there’s no serious movement for reform this year.

Prospects for overturning the new IDOT regulations are slightly better. A House bill that would restore control over traffic cameras on highways to local officials has been endorsed by the House Transportation Committee.

Governor Sides with IDOT

The bill’s ultimate fate is less certain, especially since Gov. Terry Branstad (R) is in favor of IDOT’s regulations.

If all else fails, there’s talk of moving the traffic cameras to city streets not under IDOT jurisdiction.

“The cameras, after all, are mobile, but the city’s MFPRSI obligations aren’t going away. “They’re only going to increase,” Radig said.

Paul Brennan (pbrennan@watchdog.org) reports for IowaWatchdog.org, where a version of this article first appeared. Used with permission.

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IN OTHER WORDS . . .

“Two developments in the past week underscore why Big Labor has to rely on political power: It can no longer win arguments on the merits.

“The first occurred in San Diego, where Republican mayoral candidate Kevin Faulconer triumphed last week over Democrat David Alvarez, who had received more than $4 million in labor support. Faulconer’s campaign relied heavily on criticizing Alvarez’s union ties. Given a December Field Poll that showed more Californians think that unions are a force for harm rather than good, that was a savvy strategy.

“The other result came out of Chattanooga, Tenn., where employees of a Volkswagen plant voted against joining the United Auto Workers despite the fact that the union and the company had been actively collaborating to make it happen.

“What are we to make of these results? That the public has lost faith in organized labor.”

— Orange County Register editorial, February 19, 2014
Mom at Center of Union Case Misses High Court Hearing to Care for Disabled Son

By Scott Reeder

Pam Harris is an unlikely activist. She is just a Lake County, Illinois mom looking after her disabled adult son.

Rather than place her son, Josh, in an institution, she entered a program where she receives state assistance to care for him at home.

But one Sunday morning, an organizer for Service Employees International Union knocked on her door and asked her to vote to join a union.

It threw her for a loop. You see, if a majority of home-care workers voted to join a union, she would have to give money to the union—whether she wanted to belong or not.

And she didn’t think she should have to give money to some union boss in order to care for her son.

Union Rejected But Doesn’t Care

So she led a push among caregivers to reject union representation—and won.

But the story doesn’t end there. SEIU can keep calling for votes.

Faced with this prospect, Harris and seven other home-care workers went to court. On January 21, their case was heard by the U.S. Supreme Court.

I found the case intriguing, so I traveled to Washington to hear it argued. It’s important to remember Harris doesn’t consider herself anyone’s employee, let alone someone ripe for union organizing.

Governor Made the Change

It turns out Illinois Gov. Pat Quinn (D) had issued an executive order classifying home-care workers like Harris as state employees for the purposes of “collective bargaining.”

Just why would an “employer” try to assist “employees” in joining a union?

During my more than 30 years in the private-sector workforce, I’ve never had a boss come up to me and say, “Hey, guys, let me help you start a union.”

But I guess Quinn is a different sort of boss. For that matter, so was his predecessor and current federal prison inmate, Rod Blagojevich, who also issued orders of this type.

Justice Notes Political Corruption

Supreme Court Justice Samuel Alito expressed skepticism of the past governor’s motivations to help unions.

“I thought the situation was that Gov. Blagojevich got a huge campaign contribution from the union, and virtually as soon as he got into office he took out his pen and signed an executive order that had the effect of putting, what was it, $3.6 million into the union coffers.”

SAMUEL ALITO, SUPREME COURT JUSTICE

Not surprisingly, the unions have pulled out all the stops in fighting the suit.

They even brought out people in wheelchairs—in the middle of a snowstorm—to tell reporters on the steps of the U.S. Supreme Court they hope their home-care workers will be pushed into unionization.

Some home-care workers who want to belong to a union told reporters at the gathering why they thought organized labor was just swell.

Harris Stays Home with Son

But glancing around at all the TV cameras and microphones, one couldn’t help but wonder: Where is Pam Harris?

After all, it’s not every day one has a case argued before the highest court in the land.

But Harris was nowhere to be found. She didn’t see the justices in their robes enter the marble courtroom or hear the clerk call out, Oyez! Oyez! Oyez!

She certainly didn’t see the TV cameras and reporters on the front steps of the high court. Pam Harris was home in Illinois looking after her son.

After all, she isn’t an activist—just a mom doing what’s best for her son.

“Robert Reich writes:

“The nation could create millions of jobs tomorrow if we eliminated the minimum wage altogether and allowed employers to pay workers $1 an hour or less. But do we really want to do that?’

“That’s quite an admission. Most lefties (that I read, at least) won’t admit that abolishing the minimum wage would unleash an environment where a wave of job creation could take place. ...

“Could someone be paid $1/hr? I don’t know, and neither does Reich. Is it possible that some will be employed for $1/hr? Of course it’s possible, but the two parties to the contract obviously don’t have an issue with it, and no one is ever forced to make a contract.”

— Chris Rossini writing at EconomicePolicyJournal.com, March 1, 2014

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Happy Birthday, Heartland.

In 1984, The Heartland Institute changed the definition of a think tank.

We were the first think tank created to apply free-market ideas to the problems of a specific state, Illinois.

We quickly expanded our reach throughout the Midwest, and in 1993 we became a national organization.

Today we communicate with all 7,300 of the nation’s state elected officials, helping them solve social and economic problems with public policy ideas that empower people.

Many people helped us get to where we are today. We thank you all.

And we look forward to our next 30 years of fighting for your freedom.