Wis. Voters Slap Government Unions

By Brian Farley

The intense political brawl that was the Wisconsin gubernatorial recall election came to a quick and decisive end the evening of June 5 with sitting Gov. Scott Walker (R) retaining his seat by a margin of seven points.

It turned out to be an excellent night for fiscal conservatives, a dismal night for government unions, and a thorough repudiation of a recall effort many political analysts viewed as a referendum on Walker and his reform agenda.

Also surviving recall efforts by comfortable margins were Lt. Gov. Rebecca Kleefisch (R), state Senate Majority Leader Scott Fitzgerald (R-Juneau), and state Sen. Terry Moulton (R-Chippewa Falls).

Jerry Petrowski (R-Marathon) defeated Democrat Donna Seidel for Republican Pam Galloway's vacated seat in the 29th senate district. The race between state Sen. Van Wanggard (R-Racine) and former Democrat senator John Lehman was too close to call. A recount appears likely.

Recall Without a Cause

Over the 16-month recall process, proponents repeatedly changed their ratio-

Reforms Urged as Calif. Deficit Soars

By Whitney Stewart

California is facing a budget predicament worse than previously thought, and while the governor touts additional short-term fixes of tax hikes and spending cuts, others are calling for systemic reform.

In January, the state was staring down a $9.2 billion deficit. By mid-May, the projection had ballooned to $15.7 billion. Gov. Jerry Brown (D) told reporters the soaring deficit has been caused by lower tax receipts in the aftermath of the “worst recession since the 1930s.”

A few days later, the state’s nonpartisan Legislative Analyst’s Office said the budget hole might bottom out at $17 billion.

Wisconsin, p. 6

California, p. 4
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Appeal Promised on Challenge to Seattle Light Rail Plan Along Highway

By Jeff Rhodes

Opponents of a plan to allow Sound Transit to use the center two lanes on the Interstate 90 bridge in order to extend light rail from Seattle to Bellevue promise to take their case back to Washington state’s highest court.

Representatives from the Eastside Transportation Association (ETA), including former state senator Jim Horn and Bellevue real estate developer Kemper Freeman, have announced they will appeal a Kittitas County Superior Court ruling that dismissed the group’s lawsuit, which named Gov. Christine Gregoire (D), Department of Transportation Secretary Paula Hammond, and Sound Transit as defendants.

Sound Transit is the popular name for Washington state’s Central Puget Sound Regional Transit Authority. The case dates back to 2009 and was originally heard by the state supreme court in September 2010, but the justices ruled in April 2011 the plaintiffs could not prevent the Washington State Department of Transportation from transferring the lanes before the fact.

Carpool Lanes for Rail

Sound Transit plans to connect Seattle’s Central Link with Bellevue and the Eastside’s future East Link by building a light rail line along Interstate 90 where the carpool lanes currently are.

Sound Transit hopes to start construction of East Link in 2015 or 2016 and launch passenger service in 2023.

“Ask any driver who suffers the daily misery across the bridge if they see any ‘unneeded’ highway,” said Horn. “Mercer Islanders need to be advised that they will be losing their special access to Seattle, if and when these lanes are surrendered to Sound Transit.”

Horn and ETA supporters argue the state constitution’s 18th amendment disallows gas taxes paid by road users to be used for anything other than the construction and maintenance of roads—defined as “highway purposes” in the amendment. Previous Washington Supreme Court rulings have upheld this view and determined rail programs are not a highway purpose.

Diversion of Road Money

In its effort to thwart the project, ETA argued “any transfer of the lanes” from an original plan for the I-90 bridge, one that did not include light rail at the time as it predated Sound Transit 2, “would essentially be an unlawful diversion of motor vehicle fund money.” They add the state is prohibited “from entering into ‘any agreement’ with Sound Transit for use of the two center lanes of I-90 for high-capacity light rail.”

The state supreme court rejected the first argument but left open the possibility of a future lawsuit. ETA responded by filing a similar action last fall, only to see it thrown out by Kittitas County Judge Michael Cooper, who declared the East Link light rail project, approved by voters in 2008, conforms to plans and agreements that have been in place since before the bridge was built.

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California Deficit Soars, Calls for Spending Reform Grow

Continued from page 1

This November, Californians will vote on a measure that would increase the personal income tax rate on the state’s wealthiest taxpayers for seven years, to 13.3 percent (the highest state income tax rate in the nation) and raise the sales tax one-quarter percent for four years. The initiative is estimated to generate $8.5 billion annually. If rejected by voters, $61 billion in automatic cuts to school and public safety funding would commence January 2013.

The voter referendum allows Brown and the legislature to dodge responsibility for making lasting change, said Brian Calle, a senior research fellow at the San Francisco-based Pacific Research Institute.

“The average person isn’t meant to dissect a complicated tax code,” Calle said. “Our ballot box legislating in California has really, really hurt the state.”

‘Scotch Tape and Gimmicks’

Amid the intense debate, Democrats and Republicans blame each other for “phony” or “gimmicky” measures they say led to the red ink in this and previous years.

“Budget after budget was patched together with Scotch tape and gimmicks,” Brown said of the budgets before he took office last year. “I worked with the legislature to enact billions in painful spending cuts from welfare and Medi-Cal to prisons. When the legislature passed another gimmicky budget … I vetoed it.”

California’s problems run deeper than the annual budgeting nightmare, however. The state was struggling with its budget long before the recession hit, Calle notes.

“It’s budgeting 101,” Calle said, “but the state budget office estimated expenses low and revenue high. You’re always going to end up in the red when you do that.”

The state’s budget plans have long relied on trimming spending around the edges but mostly reallocating money from one pot to another. This year’s projected revenues include $1 billion from cap-and-trade regulations as AB 32, California’s Global Warming Solutions Act of 2006, goes into effect. The Legislative Analyst’s Office warns it is an unstable calculation.

Huge Unfunded Liabilities

That’s compounded by the state’s collapsing economy and large number of unfunded projects and programs. These include unfunded obligations of more than $100 billion for government pensions and $62.1 billion for health insurance for retired government employees. There’s also a $69 billion high-speed rail line. Transportation analysts say that rail line, the largest public works project in state history, could end up costing more than $100 billion—mostly unfunded.

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Brown’s revised budget outlines an approximate 50-50 split between state spending reductions and tax increases. His proposal includes reductions to public assistance, hospitals, and the state’s Medi-Cal program. He is also negotiating with Service Employees International Union Local 1000, which represents the largest number of state employees, on a 5 percent pay cut.

In spite of the cuts, the budget includes $4.9 billion in additional spending, and general fund spending is expected to grow 29 percent above 2011-12 levels by 2015-16, according to California Fact Check, a Web site run by the California Assembly Republican Caucus.

‘De Facto Default’

“We are in a state of de facto default because Wall Street is about to cut off our credit,” said Jon Coupal, president of the Howard Jarvis Taxpayers Association, based in Los Angeles. “When you can’t even get money at a Tony Soprano interest rate, you’ve got a problem.”

With the nation’s CEOs recently voting California as the worst state in which to do business for the eighth year in a row in CEO Magazine’s annual business climate survey, and Silicon Valley industries migrating to more business-friendly states, Republican lawmakers say the way for California to climb out of the budget hole starts with becoming business-friendly again.

“Californians can’t afford another budget based on phony revenue projections and spending reductions that never materialize,” said state Sen. Bill Emmerson (R-Hemet), vice-chairman of the Standing Committee on Budget and Fiscal Review. “State spending has increased by $20 billion since the recession began. Despite this fact, the majority party continues to ask Californians to raise their taxes even though they are unwilling to enact crucial government reforms and improve our state’s tough business climate.”

‘Time to Clean House’

Emmerson and others say the legislature needs to take systemic steps toward paying down the debt and creating jobs.

Coupal said the legislature is paralyzed by an institutional resistance to needed reforms.

“In California, if this budget were in Barnes & Noble, it would be in the fiction section—everything about it is fake,” he said. “Brown says we’ve stopped the gimmicks. Nobody in this town believes that. Californians are not anti-government, but they’re paying a lot of money and getting really lousy services. At this point they’re saying, we give you this money, it’s time to clean house.”

Whitney Stewart writes from Minnesota.
The results of a June 5 ballot measure that would raise California’s cigarette tax from 87 cents to $1.87 a pack remain too close to call at press time.

After 100 percent of precincts reported 50.4 percent opposed versus 49.6 percent in favor, the final tally won’t be released until hundreds of thousands of mailed-in, dropped-off, and provisional ballots are counted.

The ballot measure, known as Proposition 29 and more formally as the California Cancer Research Act, would raise excise taxes on all tobacco products. State officials project the tax increase would raise approximately $735 million a year. Three-quarters of that money is supposed to go toward cancer research, but opponents of the measure argue there is no guarantee that is how the additional money eventually would be used.

‘Sensing a Ceiling’

“Although the Secretary of State says the race remains too close to call, the measure right now is losing by about a percentage point. So even if the tax increase happens, it will be by the barest of margins,” said Joseph Henchman, an attorney and policy analyst at the Tax Foundation.

“While 14 states raised their tax in 2009, only six states did so in 2010 and just three states in 2011,” he added. “Voters perhaps are sensing that a ceiling has been reached on how high cigarette tax rates should go.”

Tobacco taxes are widely recognized as regressive, meaning they disproportionately affect low-income persons, who are more likely to be smokers than persons at high income levels.

Californians for a Cure, which backs Prop 29, wrote on the organization’s “Yes on 29” Web site, “Prop 29 is and has always been about saving lives and fighting tobacco-related diseases. With less than 1 percent separating defeat from victory, we remain vigilant and ever hopeful, no matter how long the odds.”

Dubious Priorities

Prop 29 supporters cite the extra dollars that could flow to cancer research if the measure passes. Opponents argue the measure does not address pressing state priorities, pointing to California’s budget deficit of more than $16 billion, unfunded retirement liabilities for government employees, and other fiscal problems. They also point to the temptation legislators would have to divert the money to other purposes.

National Democratic political commentator Bob Beckel told reporters, “If anybody believes this stuff is going to pay … [for] cancer research, they are kidding themselves.”

“Voters recognized that with California’s 11 percent unemployment and a budget deficit of $16 billion, it makes no sense at all to raise taxes, even for a good cause, that will do nothing to fix these problems,” said Jessica Headley of Americans for Prosperity in California.

The outcome may not be known until early July.

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Wisconsin Voters Give Government Unions a Drubbing

Continued from page 1

nale for the recall.

Originally they said it was a response to Act 10, Walker’s hallmark legislation that forced state government workers to contribute more to their pensions and health insurance, limited collective bargaining privileges, and ended automatic withdrawals of union dues from government workers’ paychecks. Then it was about Wisconsin losing jobs under Walker. Next was Walker’s “war on women.” Near the end it was about a John Doe investigation into potential wrongdoing among Walker’s previous staff.

None of these narratives bore the scrutiny of a highly engaged and well-informed electorate. Voter turnout was large for a Wisconsin mid-term election: 57 percent of voting-age adults, the highest voter turnout in at least 60 years.

“The recall process has been a farce from the beginning,” said Brett Healy, president of the John K. MacIver Institute for Public Policy in the Wisconsin state capital of Madison. “It’s the result of one very powerful special-interest group having their spigot turned off.”

Dues Drying Up

That spigot was automatic dues payments from state government workers to government unions. Act 10 made dues payments voluntary. Thousands of government workers have stopped sending dues.

“The biggest part of the problem was removing the conduit of taxpayer money the teachers union and other public-sector unions were stealing to fund all of their political activities,” said Steve Welcenbach, owner and editor of Reality News, a Wisconsin conservative grassroots periodical. “Act 10 did this.”

Walker’s June 5 victory—as well as victories in previous surrogate Walker referenda in the form of a state supreme court election and state senate recall elections in 2011—served to validate voter endorsement of Act 10 reforms.

“The symbolic importance of this is really important,” said John McAdams, associate professor of political science at Marquette University and a policy advisor to The Heartland Institute, which publishes Budget & Tax News. “It shows that a chief executive can take on the unions and win. Public service employee unions can be beaten.”

McAdams said that dynamic would not necessarily apply to other states or at the presidential level. “But clearly the nation would be a lot better off if other governors could do this.”

In less than a year, Act 10 reforms have, among other things, eliminated Wisconsin’s $3.6 billion deficit without raising taxes. The state has gained more than 23,000 jobs since the enactment of Act 10. Wisconsin’s unemployment rate has dropped to 6.8 percent, well below the national average of 8.2 percent. The state and local governments have realized more than $1 billion in savings for taxpayers. Layoffs of thousands of state workers have been prevented.

Alternative Media Messaging

Making sure voters were aware of these benefits in a less-than-friendly mainstream media environment was Wisconsin’s increasingly formidable conservative alternative news media.

“I think that conservative media has been terribly important for investigative journalism [Media Trackers], policy analysis [MacIver Institute], and especially encouraging conservative voters and activists [talk radio],” said McAdams.

“Factual issue knowledge is the enemy of the Left,” added Welcenbach. “Ultimately, for the Right to win long-term, this alternative media infrastructure must continue to develop and become the dominant means by which the population becomes informed on issues.”

Recall Over Policies

Recalls of state officials are governed by the Wisconsin constitution, which allows recalls upon the submission of signatures from 25 percent of the number of persons who voted in the last election for the office in question. No reason need be provided for such recalls, said attorney Maureen Martin, a Wisconsin resident and senior fellow for legal affairs at The Heartland Institute.

“Walker was being recalled due to disagreement with his policies, not any misconduct,” Martin said. “The constitution ought to be amended to require official misconduct before a recall can take place.”

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Maureen Martin, a Wisconsin resident

Historian Chris Kliesmet disagreed. He is executive administrator of Citizens for Responsible Government Network, a Wisconsin fiscal conservatism advocacy group that has overseen numerous recall efforts.

“The people have the right to hire and fire at will for any reason they see fit,” said Kliesmet. “And just who gets to decide what egregious conduct is? A judge? Perhaps some other partisan? No thanks! The process is fine as is.”

High Price for Do-Over

The cost of that process to taxpayers, however, is of concern to Healy.

“Election officials lacked the capacity and/or the will to properly vet the recall petitioning process,” Healy said. “It cost taxpayers in excess of $16 million to hold this election, which ultimately was nothing more than a do-over of the 2010 election.”

“The Walker recall election was the greatest gift the Left has ever given the conservative movement,” said Welcenbach. “After Tuesday’s Walker victory, nothing will be left; the latest union numbers showing massive membership reduction foreshadow this inevitability. Once voter ID is upheld, the Left has no chance in Wisconsin for the foreseeable future.”

Brien Farley (brien.farley@gmail.com) writes from Genesee, Wisconsin.
Big Votes for Pension Reform in San Diego, San Jose

By Steve Stanek

Wisconsin wasn’t the only place government unions took an election-day drubbing in June.

Voters in two major California cities overwhelmingly approved cuts in future retirement perks for local government workers.

Most of the national headlines on the June 5 election results focused on Wisconsin Gov. Scott Walker (R), who beat down a recall challenge that had been led by government employee unions.

The unions were angered at legislation Walker backed and signed into law to restrict collective bargaining and end the forced collection of union dues. Thousands of Wisconsin government workers have stopped paying union dues. Membership in the state’s chapter of the American Federation of State, County and Municipal Employees (AFSCME) has dropped 45 percent.

More than Two-Thirds Support

Also on June 5 more than two-thirds of voters in San Diego and San Jose backed separate measures to reduce future pension benefits for their local government employees.

Labor unions in both cities already have gone to court to stop the reforms. They argue the reforms are illegal because court rulings say government employers may increase but never decrease retirement benefits for current workers. One lawsuit also claims San Diego’s mayor should have negotiated with the union over the initiative.

In San Diego a ballot initiative to give new hires 401(k)-style plans similar to those common in the private sector had the support not only of two-thirds of the city’s voters but of the mayor and other local government leaders. The measure also would freeze for five years the portion of current workers’ salaries that is used to calculate future pensions.

San Diego Councilman Kevin Faulconer, who backed the measure, said government employee pension reform “cuts across partisan lines, cuts across demographic lines.”

He said the city’s pension costs already approach nearly one-quarter billion dollars annually and will soon top $300 million. Pension costs are under-cutting the city’s ability to fund basic services. City residents who see government workers retiring earlier and with better benefits than most people in the private sector have come to realize the harmful impact of these government pensions, he said.

Want No Better, No Worse

“The voters are tired of their taxpayer dollars going to expensive pensions while services are being cut and, in some instances, tax increases are being proposed,” said Lani Lutar, president and CEO of the San Diego County Taxpayers Association, which helped draft the initiative.

“Pension reform is supported across party lines. Most people are familiar with a 401(k)-style retirement plan and want to see public employees getting the same type of benefits, no better and no worse,” Lutar said. “There is a very clear understanding by the public that the current defined benefit pension plans are unsustainable.”

She said she was not surprised by the overwhelming support for pension reform because numerous surveys had shown pension costs are “the number one concern of voters.”

“The initiative was the only way to ensure comprehensive, real reform which would become permanent law,” Lutar said. “The greatest challenge in the process was overcoming the labor union tactics to try to block signature-gathering efforts. The labor unions knew that once the measure qualified, it would pass, so they targeted the signature-gathering efforts in every way imaginable.”

‘Desperate for a Solution’

In San Jose, where 70 percent of voters cast ballots in favor of pension reform, Councilman Sam Liccardo said “residents were desperate for a solution.” He noted most city officials who supported reform are registered Democrats who ordinarily back government unions. He agreed with Faulconer that pension costs have become so burdensome most people no longer care about political party labels. They care more about stopping the pension costs spiral.

“I want to thank the voters of San Jose for their commitment to fiscal reform and to creating a more sustainable future for our children and grandchildren,” Mayor Chuck Reed told reporters as election returns showed overwhelming support for the pension measure.

The San Jose pension reform allows current workers to keep benefits they already have accrued but requires them to pay more for future pension benefits or choose lower benefit levels if they do not pay more. Other reforms include requiring future hires to pay half the cost of a pension.

“... These extraordinarily complex micro-relationships are what we are really referring to when we speak of ‘the economy.’ It is definitely not a single, simple process for producing a uniform, aggregate gloop. Moreover, when we speak of ‘economic action,’ we are referring to the choices that millions of diverse participants make in selecting one course of action and setting aside a possible alternative. Without choice, constrained by scarcity, no true economic action takes place. Thus, vulgar Keynesianism, which purports to be an economic model or at least a coherent framework of economic analysis, actually excludes the very possibility of genuine economic action, substituting for it a simple, mechanical conception, the intellectual equivalent of a baby toy.”

**Minn. to Send Nearly $500 Mil. to Billionaire Team Owners**

By Sean Parnell

Nearly $500 million in taxpayer subsidies will go to a new stadium for the Minnesota Vikings of the National Football League.

Gov. Mark Dayton (DFL) signed the bill authorizing the taxpayer giveaway in May. Many Vikings fans greeted the bill-signing with jubilation. Taxpayer advocates and economists who study the impact of sports stadiums warned the promised benefits are unlikely to materialize.

The team’s principal owner is billionaire real estate magnate Zygmunt Wilf.

Several days after the governor’s signing ceremony, the Minneapolis City Council passed a measure ratifying the city’s share of the stadium subsidies, $150 million in construction costs. The city will provide another $159 million in operating expenses over the life of the lease.

Proponents say the new stadium will keep the Vikings in Minneapolis for another 30 years.

**Number of Jobs Disputed**

Dayton defended the taxpayer subsidies during an appearance on Minnesota Public Television, arguing they will create jobs.

“I believe it’s the best deal available under the circumstances,” Dayton said. “The bottom line was, do we want to create three or four thousand jobs by building this new facility?”

State Sen. John Marty (DFL-Roseville) gave an opposing view. In an end-of-session report to his constituents he stated the Vikings’ lobbying push was “successful in convincing politicians that it was a good way to create construction jobs, twisting the numbers in a manner that convinced some public officials that it would create far more than the equivalent of 700 full-time jobs over the 3 years of construction.”

He added, “Minnesota has an urgent need to create more building trades jobs, and we would create far more jobs using public dollars to fix our public infrastructure,” instead of providing subsidies to a stadium for a privately owned sports team.

**Subsidy Gravy Train**

The Vikings had been seeking a new stadium for more than a decade but were repeatedly stymied by opposition to pouring yet more taxpayer dollars into sports arenas. In recent years the Minnesota Twins (Target Field, $392 million subsidy), Minnesota Wild (Xcel Energy Center, $130 million in “loans” from state and city, much of which has “forgiven”), and Minnesota Timberwolves (Target Center, $80 million from Minneapolis to purchase arena) have been on the receiving end of significant taxpayer subsidies.

Legislation to provide taxpayer funds for a Vikings stadium had appeared doomed for 2012. But Dayton, frequently referred to as the “biggest cheerleader” for a new stadium, successfully worked with key allies to put together a deal.

**Backroom Dealing Saved Subsidies**

Some observers criticize the deal not just as a handout to billionaire owners—brothers and team co-owners Zygi and Mark Wilf reportedly have at least $2 billion of net worth—but as an example of corrupt backroom politics that kept the public in the dark throughout the process.

In a blog post titled “State of Corruption: How the Vikings Stadium Deal Went Down and Took Honest & Open Government With It,” former Minneapolis Star-Tribune reporter Mark Coleman reported on how the governor and legislative leaders allegedly skirted important open-meetings and transparency laws to get the deal done.

In the conference room where the deal was being hammered out, Coleman reports, “two or three members of the Legislative Conference Committee were meeting—but never more than that number. The six-member conference committee only needed four legislators for a quorum, and a quorum would trigger the state’s Open Meeting law, requiring that the doors to the deliberations be opened to the press and public.”

As a result, “The public had no input into the process,” Coleman told *Budget & Tax News.*

**General Revenue Committed**

Minnesota state Rep. Mary Kiffmeyer (R-Big Lake) expressed concern the deal commits revenue from the state’s general fund instead of relying on user fees. Although some revenue is scheduled to come from gambling, if that projected revenue doesn’t materialize the state’s general fund revenues will be used for construction and bond payments.

“The taxpayer lost out on this and is at great risk,” Kiffmeyer said. “Making other people pay for what a few want—especially sports, which is not an essential function of government—is bad public policy.”

She suggested a more appropriate way to fund the stadium would have been through user fees such as surcharges on tickets and luxury boxes, or the proceeds from special license plates.

“It’s a choice that way,” Kiffmeyer said. “That way the people who use it pay for it.”

**Wilfs to Pay Little or Nothing**

While politicians and media reporting the deal typically state the Vikings will be putting in $477 million toward construction costs of the new stadium, this likely overstates the figure significantly.

An estimated $210 million of the Wilfs’ portion of the costs is to come from the sale of stadium naming rights, even though the state will own the stadium, and the NFL is kicking in $200 million in loans to be paid back through funding that otherwise would be shared with other teams.

“The Wilfs will never pay a nickel,” Coleman said. “We got snookered, and this deal will go down as a bad deal for taxpayers.”

Sean Parnell (sean@impactpolicy.com) is president of Impact Policy Management (IPM), a Washington, DC-area full-service public policy firm that provides fund-raising consulting services, and manages political advocacy projects for free-market and limited government causes.
The St. Louis Convention and Visitors Commission (CVC) has rejected a proposal for an estimated $700 million in renovations to the Edward Jones Dome, home field of the Rams of the National Football League.

The CVC’s decision to reject the Rams’ proposal, announced in early June, follows the team’s rejection of a proposal by the CVC for $124 million in renovations. The matter could go to arbitration. The CVC has the authority to accept or reject any plan the arbitrators select or create.

Whatever the outcome of the negotiations or arbitration, some local leaders are already mobilizing against further taxpayer subsidies for the Rams.

"Economic analysis of the more than five dozen publicly funded professional ballparks and stadiums nationally does not make the case for this being a good investment for taxpayers," said state Rep. Jeanette Mott Oxford (D-St. Louis). "I believe the taxpayers of St. Louis City and County should have the right to a public hearing and a public vote on any appropriation of public dollars for professional sports projects."

The CVC’s original proposal for $124 million in renovations would have split the costs almost equally between taxpayers and the team, with the public providing $60 million and the team providing the remaining $64 million. The proposal submitted by the Rams did not indicate how much the public would be expected to fund and how much, if any, the team would pay. The $700 million figure is an estimate provided by an independent consultant hired by the CVC, as the Rams proposal did not include a price tag.

The competing proposals were spurred by an “escape clause” in the Rams lease with the CVC, which allows them to break the lease after 2015 if the stadium is not considered “top tier” compared to other NFL stadiums. “Top tier” refers to stadium features including luxury suites, pricey club seats, scoreboard, and other features.

The Edward Jones Dome was built entirely at taxpayer expense, with the costs split between the state (50 percent), county (25 percent), and city (25 percent). The original debt of $320 million, scheduled to be paid off in 2022, is expected to have cost a total of $720 million over the 30-year term of the bonds. The City of St. Louis reports it still owes $38 million on the original debt and will pay approximately $50 million between now and 2022 when the debt is finally paid off.

In view of the almost daily media stories about local and state government being unable to fund legitimate taxpayer responsibilities, it would be absurd for the taxpayers to pile new debt on top of old debt,” said Fred Lindecke, spokesman for a local group, Coalition Against Public Funding for Stadiums. “Particularly to help a multi-billionaire pay for a new playground for his toy, the Rams.”

Sean Parnell is president of Impact Policy Management (IPM), a Washington, DC-area full-service public policy firm that lobbies, conducts original research and analysis, provides fundraising consulting services, and manages political advocacy projects for free market and limited government causes.
Public Pension ‘Stimulus’ Claims Are Easily Debunked

By Andrew G. Biggs

Breaking windows will stimulate the economy, according to a leading public pension advocacy group.

Skeptical? The National Institute on Retirement Security (NIRS) has not literally endorsed breaking windows, but a report recently published by the organization relies on the same economic fallacy.

According to NIRS—whose membership consists principally of public employee unions, the pension plans in which they participate, and the actuarial and investment firms that serve them—the best economic stimulus is not tax cuts or unemployment checks, but increased pension benefits to public-sector retirees.

Each dollar of pension benefits produces $2.37 in economic output, NIRS says, creating millions of new jobs and billions in additional labor income.

Put simply, this is nonsense.

Famous Fallacy

Many people have heard of the “broken windows” fallacy in economics. The argument is that breaking a window is actually good for the economy because the window owner has to pay a glazier, who uses the money to pay a butcher, who uses the money to pay a cobbler, and so on. One doesn’t need to be an economist to see the problem: Had the window not been broken, the owner could have spent or invested the money elsewhere and thus increased total economic output.

NIRS gives its own version of the broken windows story: “A retired firefighter uses his pension money to buy a new lawnmower. As a result of that purchase, the owner of the hardware store, a lawnmower salesman, and each of the companies involved in the production of the lawnmower all see an increase in income, and spend that additional income. These companies hire additional employees as a result of this increased business, and those new employees spend their paychecks in the local economy.”

According to NIRS, each dollar of pension payments results in an additional $1.37 of income flowing to non-retirees. By this logic, states could spend themselves to prosperity by borrowing money to increase public-sector pension benefits. And, some states appear to be giving this approach a try.

Missing Half the Equation

Of course, this reasoning is wrong because it ignores the cost of the economy of providing public pension benefits. Each taxpayer dollar flowing into public pensions is a dollar that cannot be saved or spent on something else. To the degree it is not spent, today’s economy is smaller as a result. To the degree it is not saved, tomorrow’s economy is smaller, since saving helps boost productivity. If the stimulus provided by pension benefits has a multiplier effect, the cost of funding pensions presumably has a divisor effect—and this effect is entirely unaccounted for by the NIRS study.

Indeed, NIRS acknowledges its study measures only the “gross economic impact” of pension payments, not the net effect once taxpayer and employee contributions are accounted for. But leaving out half of the equation makes the entire exercise meaningless. Unless we assume that public pensions have a magic ability to create money, the net economic impact of pension benefits is at best roughly zero.

It’s even possible that defined-benefit pensions reduce economic output. After all, it is well-known that employees with DB pensions leave the workforce earlier than workers with defined contribution 401(k) plans. Researchers at the Center for Retirement Research at Boston College found workers “covered by a defined benefit plan will retire about one year earlier than those covered by a defined contribution plan.” If we assume the average person works 35 years over his or her career, we find DB pensions lower labor supply and economic output by roughly 3 percent.

Just a Money Transfer

Public-sector pensions are not economic stimulus. They are simply a transfer of money from taxpayers to public employees. To the degree that pensions are fair compensation for public service, these transfers are perfectly appropriate. But as my work with Jason Richwine of The Heritage Foundation has shown, public-sector pensions are often several times more generous than the 401(k) plans enjoyed by private-sector workers.

In fact, research on “fiscal consolidations”—attempts to balance government budgets and reduce public debt—shows that the most successful efforts toward cutting deficits and boosting growth include reductions in public-sector compensation, of which retirement benefits are by far the most generous component.

Pension Politicization

The faulty NIRS study illustrates a larger problem: the willingness of those who run public pensions to jump into the political fray. Across the nation, pension administrators are publishing their own, localized versions of the NIRS fallacy, touting the supposed economic benefits of generous pension payments. Administrators also regularly exaggerate the transition costs of moving to a 401(k)-style system, and they insist to critics that even the most generous benefits are really quite modest.

Pension administrators should be apolitical public servants. Instead, too many fight tooth and nail to preserve the existing pension systems,advancing dubious arguments along the way.

Since the managers of public retirement plans justify generous benefits with economic claims easily dismissed—not just by trained economists, but by the average person using common sense—the only reasonable conclusion is that administrators have taken sides in the pension debate. And it’s not the taxpayers’ side.

Andrew G. Biggs (andrew.biggs@aei.org) is a resident scholar at the American Enterprise Institute. He previously served as principal deputy commissioner of the Social Security Administration. Used with permission from RealClearMarkets.com.
Md. Imposes ‘Millionaires Tax’ on $100,000 Incomes

By Len Lazarick

A s Republican delegates railed against a state income tax hike shortly before legislators approved it in mid-May, a lone freshman Democrat from one of the most liberal and affluent districts inside the Capitol Beltway got up to explain why she too could not vote for the taxes.

“I believe this discriminates against two-income families with children at home,” said Del. Ariana Kelly, a Bethesda mom with two young children at home.

The State and Local Revenue and Financing Act raises state income tax rates by 0.25 percentage points for single filers reporting more than $100,000 and joint filers reporting more than $150,000 taxable income. For people in the $300,000 to $500,000 range, taxes go up 0.50 percentage points, an almost $150,000 taxable income. For people in joint filers reporting more than $100,000 and single colleagues in the exact same household expenses, including childcare, earning $150,000 (for example, a husband and wife who each earn $75,000). This makes absolutely no sense to me,” Kelly said.

Increasing Marriage Penalty

On her personal Web site, Kelly explained her opposition further.

“In current tax law, married Marylanders pay a higher tax rate than their single colleagues in the exact same jobs starting at a household income of $200,000. This is known as a ‘marriage penalty,’” Kelly said.

“By changing the tax brackets, this legislation expands the higher marriage penalty tax rates to affect couples earning $150,000 (for example, a husband and wife who each earn $75,000). This makes absolutely no sense to me, because when both parents are working, household expenses, including childcare, are higher, not lower.”

In addition, the highest marginal tax rate of 8.95 percent—including the county piggyback—will now be applied to married working parents who together earn more than $300,000, but not to a single person living on $250,000.

Exemptions Pile on Inequities

The change in the personal exemption had a similar impact, Kelly said.

For families with a combined income of more than $150,000, “this amounts to a flat fee per child between $53 and $107. A family of four with a combined income of $150,000 will pay $394 in new Maryland taxes due to this exemption phase-out. However, a single man making $150,000 will pay only $104. A single millionaire will pay only $53 extra. Even if that millionaire had a wife and two kids, they would pay only $212 in new taxes from this exemption phase-out.

“This part of the tax plan brings in $82 million, almost entirely from middle-class families with two working parents and dependent children,” Kelly said. Based on data from the comptroller’s office, she said, “I believe that 78 percent of the estimated 300,000 tax filers affected will have incomes under $250,000; 85 percent will have two working spouses; and 70 percent will have dependents at home.”

Derided as ‘Not Progressive’

Along with Kelly, Del. Kirill Reznik, another Montgomery County lawmaker who describes himself as a progressive, joined four other Montgomery Democrats in voting against both the tax hikes and the budget act, which shifted teacher pension costs to the counties.

“I saw these bills as an unacceptable burden to our lower- and middle-class working families in Maryland,” Reznik wrote on his blog.

He continued, “As a vocal critic of the teacher pension cost shifts, I believe that this shift will force counties, particularly Montgomery County, to either increase property taxes, cut services to the community, or both. The pension shift, coupled with the tax increases passed, put too heavy a burden on middle-class families, especially those with children. This was not a plan that increased taxes on the top 1 percent. Rather, more than 40 percent of Montgomery County residents will see a tax increase of one form or another from this plan, and I refused to vote for a plan that was not progressive.”

Impacts Disputed

The impact of the tax hikes was widely disputed. Another Montgomery County Democrat, House Majority Leader Kumar Barve, said the tax hikes amounted to $6.25 a week ($325 per year) for a married couple making $250,000. Barve said he and his wife would be paying an additional $4.88 per week and “I am willing to pay that price” to maintain state programs.

Citizens for Tax Justice approved the tax hike and said Maryland lawmakers were “bucking a national trend” of cutting taxes, particularly on the wealthy. “Only 11 percent of Maryland taxpayers would face an income tax increase in 2012 as a result of SB 1302,” the group said, though legislators were quoting a figure of 14 percent.

The group said 54 percent of the new income tax revenue would come from the wealthiest 1 percent of state taxpayers, a group with an average income of nearly $1.6 million per year. Eighty-seven percent of the revenue would come from the top 5 percent of taxpayers, the group said.

Tax Foundation Disagrees

A report by Scott Drenkard of the Tax Foundation calculated a dual-earner, two-child family with $250,000 in federal adjusted income living in Maryland would pay $989 more in state income taxes this year, a total of $17,775, compared to $16,612 in the District of Columbia and $11,651 in Virginia.

Len Lazarick (len@marylandreporter.com) is editor and publisher of MarylandReporter.com, where a version of this article first appeared. Used with permission.
Highway Toll Issue Prompts Hearing by U.S. Senate

By Phil Britt

Highway toll revenues are increasingly being diverted to pay for projects and other expenses unrelated to roads, bridges, and tunnels used by motorists who pay the tolls, the nation’s largest auto club says.

The diversion of tolls for unrelated projects undermines the “user pays” principle behind transportation tolls and weakens public support for them, said Chris Plaushin, director of federal relations for AAA, during testimony at a hearing of the federal Highway Subcommittee of the Senate Commerce, Science, and Transportation Committee.

A bill introduced by Subcommittee Chairman Sen. Frank Lautenberg (D-NJ) would give the U.S. Secretary of Transportation the power to reject toll increases on highways and bridges that receive federal aid if they are judged to be excessive.

Plaushin and a trucking official said they support the bill, but an official representing state departments of transportation expressed concern it would hinder the ability of states to pay for transportation needs.

‘Accountability is Needed’

“We’re not anti-tolling but we think some accountability in the process is needed,” Plaushin testified.

The hearing came as a result of toll hikes approved last year by the Port Authority of New York and New Jersey. It now costs as much as $12 for motorists paying cash rather than using an automated toll system to cross between New York and New Jersey.

By 2015, a trip from Baltimore to New York will cost a five-axle truck more than $209 in tolls, testified Steve Grambel, chief financial officer of the New Jersey trucking firm NFI, who testified on behalf of the trucking industry.

Seton Motley, president of Less Government, which advocates smaller, less centralized government, said roads should be handled on a state-by-state basis, because that’s where the users live. Most Kansas residents, for example, won’t be using roads on the coasts. So there shouldn’t be federal taxes to pay for local roads, says Motley.

‘Playing With Money’

Federal, state, and local taxes, as well as tolls, often get siphoned off for parks, public transportation, and other projects, Motley said.

“They are playing with other people’s money,” Motley said. “That’s one reason there needs to be smaller government, so that we can keep an eye on government spending. The larger the government, the more bureaucrats there are and the harder it is to dig down and see where funds are being spent.”

Taxes can be used for other projects if the uses are clearly spelled out and voters approve the taxes, Motley added. So voters in some municipal areas might approve higher taxes to pay for public transportation projects, for example.

But there needs to be true transparency for the actual use of the tax and toll funds, Motley said, echoing some of the AAA testimony.

Phil Britt (spenterprises@wowway.com) writes from South Holland, Illinois.
Medicaid: Ticking Time Bomb for Texas, Other States

By Loren Heal

Texas Gov. Rick Perry (R) recently described the state’s Medicaid costs as a “ticking time bomb” that will threaten the state’s finances even more unless President Barack Obama’s health care law is struck down by the U.S. Supreme Court or repealed by Congress.

According to calculations by The Heritage Foundation based on data from the Centers for Medicare and Medicaid Services (CMS), Texas’s Medicaid population will increase by 56.7 percent in 2014 under Obama’s law. That means millions of additional Medicaid recipients in a program that, according to Stephanie Goodman, communication director for the Texas Health and Human Services Commission, is already dramatically increasing in size.


Increased Eligibility, Enrollment

Spencer Harris, a health care policy analyst at the Texas Public Policy Foundation, said the state faces significant cost increases for Medicaid due not just to the expanded coverage under Obama’s law but also to expected increases in enrollment among currently eligible Texans.

“As we all know, Obamacare expands eligibility up to about 138 percent of the poverty level. Mainly it brings in an entirely new eligibility class: childless adults. These are people who were not eligible previously...” Harris said.

“The cost comes not in the newly eligible people, because they’re covered by the law 100 percent [by the federal government]. The cost comes because people who are currently covered, but not enrolled, are going to enroll under an individual mandate and [because of] churning between insurance exchanges,” Harris said. “Those people will be covered under the current match rate, which is about 60:40 in Texas.”

Medicaid Taking Over Budget

Harris says Medicaid will soon become Texas’s biggest budgetary line-item, as it has in other states.

“As a proportion of the state budget, Medicaid spending has grown faster than any other during the last 20 years,” said Harris. “It has grown faster than public education, but it is still a smaller proportion of the budget. But we think that if it continues as it is, and education continues on the trend line that it is, it’s not going to be long before [Medicaid] surpasses [education] as the biggest item in the budget.”

Medicaid is already the largest budget item if all revenue is included.

“There are two ways to look at it,” said Harris. “We have a ‘General Revenue’ budget, and we have an ‘All Funds’ budget which incorporates the federal money and the state money. Medicaid is a little over 20 percent of our state budget if you just include the state funds, but if you look at the federal money it is closer to 30 percent.”

Rising Dual Eligibility Problem

Harris also notes the costs of dual eligibles—elderly Americans eligible for both Medicare and Medicaid—will become a larger problem nationally as the population ages and people see the financial advantages of accessing both programs.

“There’s also another part of this that has nothing to do with Obamacare, and that’s our aging population. That’s the other big factor in what makes Medicaid a ‘ticking time bomb’,” Harris said. “As this population starts to enter the program, the costs are going to escalate rapidly.”

Harris notes the first round of baby boomers is already entering retirement.

“We think we’re hitting that moment right now. We think the 2014–15 biennium is going to be the first biennium when we see costs ramp up,” Harris said.

States Seek More Flexibility

Edmund Haislmaier, senior health care policy analyst at The Heritage Foundation in Washington, DC, says many states are facing the same problem as Texas but on a smaller scale.

“Is Medicaid a problem? Yes,” said Haislmaier. “Right now it’s particularly acute because states are under even more restraint than normal as to what they can do with their program because of the maintenance-of-effort requirement in Obama’s law, which says that they can’t change stuff or cut back benefits, and on top of that they’re coming out of a recession.”

Haislmaier says if the Supreme Court strikes down Obama’s law, action on Medicaid will be a top priority in Congress and state legislatures.

“If they want to fix this program, if they want to reduce the costs and control the growth, what they need to do is block-grant the program to the states and let us take care of our citizens the way we know is best.”

SPEAKER HARRIS

HEALTH CARE POLICY ANALYST

TEXAS PUBLIC POLICY FOUNDATION

Push for Block Grants

Harris expects a strong push for more flexibility following any Court decision.

“It is our position that the state is in a better position to run this program than is the federal government,” Harris said. “If they want to fix this program, if they want to reduce the costs and control the growth, what they need to do is block-grant the program to the states and let us take care of our citizens the way we know is best.”

That would require Congressional approval.

“Ultimately, the whole thing has to be completely revamped,” Haislmaier said. “That’s what we’ve been arguing, and that’s going to require federal action. Ten years ago we had some flexibility. We really don’t have that now.”

Loren Heal (loren.heal@gmail.com) is a research programmer at University of Illinois at Urbana-Champaign and a reporter for The Heartland Institute.
Illinois Auditor Slams State’s College Tuition Program

By Phil Britt

The College Illinois! savings program has been plagued by weak financial controls and conflicts of interest between top administrators and companies hired to invest millions of dollars from the prepaid tuition fund, according to the state auditor general.

The auditor general’s report covers 2006 to 2011, when the commission that oversees the program approved a series of what many considered risky investments—including $12.8 million that went to ShoreBank two years before the bank collapsed.

The fund also suffered from fast-rising administrative costs, investment returns that fell well short of projections, and college costs that were rising much faster than the cost of inflation, according to Auditor General William G. Holland.

May Not Meet Obligations

College Illinois! is so poorly underfunded the program has stopped enrolling new participants and may not be able to meet its existing obligations. Financial consultant Gabriel Roeder Smith & Company late last year said the program could go insolvent without a $1.6 billion bailout. With no new College Illinois! contracts, the program’s shortfall will develop between 2022 and 2036 to pay for past contracts coming due.

College Illinois!, like similar programs in other states, was designed to be a “worry-free way to pay for college.” It enabled an estimated 33,000 families to lock in tuition payments for 55,000 future students. But the program was put on hold after audits showed massive shortfalls tied in part to declining sales and large tuition increases.

“One of the problems with these prepaid plans is that it is very difficult to catch up if you fall behind,” said Joe Orsolini, president of College Aid Planners, Inc., in Glen Ellyn, Illinois. “After the earlier market downturn, they made riskier investments to try to make up the deficit.”

Illinois Tops Average Costs

But the financial market downturn is not solely to blame. College costs nationally have been rising nearly 6 percent a year for the past four years, while returns on the Dow Jones Industrial Average have been a full percentage point behind, Orsolini said. So even prudent investing would have left fund shortfalls.

And costs at Illinois colleges and universities have climbed faster than the national averages. The University of Illinois-Champaign is now one of the five most expensive state universities in the nation, and University of Illinois-Chicago is the ninth most expensive, according to Orsolini.

Part of the reason for the big cost increases at University of Illinois campuses was a decision by university trustees several years ago to give four-year tuition guarantees to students who enter as freshmen. Trustees have accelerated tuition increases to cover the guarantees, according to Orsolini.

But underfunding of the program by the state government, failure to adjust to quickly rising college costs, exaggerated expected returns on investments, and poor investment decisions have all contributed to the program’s financial shortfall, according to financial planning experts.

“College savings programs are big business in this country, with more than $130 billion invested as of 2010. The details behind the College Illinois! program are startling to say the least,” said Andrew Schrage, co-owner of Money Crashers, a Chicago-based personal finance site geared to young adults and teens.

Phil Britt (spenterprises@wowway.com) writes from South Holland, Illinois.

The Patriot’s Toolbox

On February 19, 2009, CNBC commentator Rick Santelli stood on the trading floor of the Chicago Board of Trade and called for a “new tea party” to protest out-of-control spending by politicians in Washington. Little did he know that his words would become the rallying call for millions of Americans, many of them getting involved in politics for the very first time.

The Patriot’s Toolbox gives the new patriots of the Tea Party movement the intellectual ammunition they need to take their country back! The book consists of 10 chapters, each devoted to presenting ten principles for free-market reform in clear and precise English.

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Kansas Tax Reforms Favor Pass-Through Businesses Over C Corporations

By Richard Morrison

AFTER being shut down in the Kansas state Senate, resurrected, and debated for several months, major tax reform legislation has been signed into law by Gov. Sam Brownback (R).

While much of the bill Brownback signed in May promotes sound tax policy—specifically broadening the bases and lowering the rates of individual income taxes—a new study by the Tax Foundation says other portions of the bill might be misguided.

Prior to passage of the tax reform legislation, Kansas had three income tax rates: 3.5 percent, 6.25 percent, and 6.45 percent. Under the new law, the top rate and bracket are eliminated, the 6.25 percent rate is reduced to 4.9 percent, and the 3.5 percent rate is reduced to 3 percent. In addition, the law also eliminates several individual income tax credits and stipulates that renters no longer qualify for a low-income property tax credit.

Favorable Treatment

Changes also have been made to the way owners of small “pass-through” businesses are taxed. Pass-throughs are businesses in which the owner declares profits from the business as income under the personal tax code, rather than filing as a corporation.

“A pass-through business owner typically pays himself or herself a salary, which is taxed as wage income on their income tax return,” said Tax Foundation economist Mark Robyn.

He continued, “Additional profit above and beyond the business’s cost of doing business is reported as one of several forms of business income on the business owner’s tax return and also taxed under the personal income tax. The new Kansas law would make this non-wage income exempt from taxation.”

The legislation also allows a previously planned sales tax reduction from 6.3 percent to 5.7 percent to take effect as scheduled. The sales tax was increased from 5.3 percent to 6.3 percent in 2010.

Questionable Assumptions

Although supporters predict the changes will promote economic growth and job creation, the new study questions some of the assumptions behind the legislation.

“The small business exemption creates an incentive for businesses to structure themselves as pass-through entities for tax reasons, even though it might otherwise be unwise for them to do so,” said Robyn.

“Furthermore, promoting pass-through entities will not necessarily create net new jobs. Favoring those businesses over traditional C-corporations may lead to an increase in people employed by pass-through entities, but many of these ‘new’ pass-through entity jobs may simply be reclassified C-corporation jobs,” he said.

Younger vs. Smaller

Robyn notes in his report: “Small businesses are often touted as the primary job creators and engines of the economy, but the evidence supporting this conclusion is mixed. Many ‘small businesses,’ for example, are individuals who work a salaried job as their major source of income but earn a small amount doing work on the side (e.g., babysitting or freelance writing) and are unlikely to expand or hire additional workers.

“One key study found that there is no connection between firm size and growth.” Robyn continued. “At the same time, the study found that younger firms, not smaller firms, do grow faster (though they are also more likely to fail), suggesting that firm age may be important for job creation. However, policymakers should be careful to note that a young firm is not the same thing as a small firm, nor will a young firm necessarily be organized as a pass-through.”

The report also notes: “… a pass-through business is distinct from a small business. In fact, it is primarily large businesses that account for a large fraction of the assets, revenues, and profits of pass-through entities, as pointed out by Donald Marron of the Tax Policy Center. He notes that firms with over $50 million in revenues make up just 0.1% of all pass-through businesses but account for 40% of pass-through revenues. Firms with over $10 million in revenues account for 0.4% of pass-through businesses and 60% of pass-through revenues. Tax policy that targets pass-through entities is thus not necessarily effective at targeting ‘small business.’”

Richard Morrison (morrison@taxfoundation.org) is manager of communications at the Tax Foundation.
**Earned Income Tax Credit Better for Working Poor than Minimum Wage**

By Ian Mason

New York Assembly Speaker Sheldon Silver (D-Manhattan) is leading a push to raise the state’s minimum wage from the federally mandated $7.25 an hour to $8.50 an hour, with future annual increases tied to the Consumer Price Index.

“[The Earned Income Tax Credit] doesn’t lead to job loss, it doesn’t deter hiring, and ... it already raises the effective minimum wage for a mom with two kids from $7.25 to $10.44 an hour.”

From Chicago.

BTN: In your brief you note the EITC often is not factored into official measures of poverty. Would you care to elaborate?

Sykes: In addition to the federal EITC, 26 states have their own EITC programs, pegged mostly to the federal rate. New York has by far the largest. It puts about $1 billion back into workers’ pockets. The official Census measures of poverty don’t look at either EITC as a form of income, and, I think, therefore greatly over-count the number of people in poverty.

BTN: What would you say to an argument that minimum wage increases have businesses foot the bill for poverty rather than the taxpayer?

Sykes: The public expenditure for the EITC exists, [and] it’s substantial, but it’s been a bipartisan agreement for decades. It’s a recognition of the fact that there will always be low-wage earners with limited skills and workforce history, but we still want them to be working and productive.

If you raise the minimum wage in New York as is being discussed, you’re adding $2,600 a year to the cost of each worker. There’s a strong research basis that workers are less likely to be hired if you price them out of their skill set.

BTN: Given that the EITC is demonstrably better at supplementing low-wage earners’ pay than a minimum wage increase, what do you think explains the political support for the minimum wage?

Sykes: I think you used the key word— I think it’s politics. I think a lot of the people who advance minimum wages tend to ignore the costs on businesses and the possible negative employment effects because it resonates well with a lot of their constituents, particularly union labor.

BTN: If you could make a general argument about the EITC to state or municipal officials considering adopting a higher minimum wage, what would it be?

Sykes: It comes down to the targeting issue. If we’re talking about increasing the minimum wage as a way to mitigate poverty, it doesn’t do that; the EITC does. The EITC has a very high penetration rate, unlike a lot of other programs like food stamps and so forth. There are no caseworkers, no interviews, you file by filing a tax return.

In 2007, Sen. [Charles] Grassley asked the Government Accountability Office to compare the benefits of hypothetical minimum wage increases and EITC expansions. The GAO report showed that only about 60 percent of the EITC benefit would have gone to poor families, whereas only about 16 percent of minimum wage benefits would have.

Our general point is, putting aside whether you’re going to increase either the minimum wage or the EITC, at least be realistic about what the reality is for low-income working families with children who earn at or near the minimum wage.

The fact of the matter is that the nominal $7.25 that everyone talks about is not the case. To be transparent in the debate about whether you should or should not raise wages, you should throw all the factors into the mix and discuss what [incomes] really are with the EITC rather than acting as if people are actually living on $15,000 a year. With the EITC that mom with two kids is actually getting $21,700-plus a year.
Study: No Safety Benefit to ‘Alcohol Control’ Regulations

By Michael D. LaFaive

Eighteen states are considered “control” states for the way they regulate alcohol distribution. This means the state monopolizes some portion of the sales of alcoholic products such as hard liquor.

A new study by the Mackinac Center for Public Policy in Michigan shows, despite the pleadings of special interests that benefit from the control states’ price-raising regulations, those regulations do not necessarily lead to greater public health and safety as measured by alcohol-attributable deaths.

“Alcohol Control Reform and Public Health and Safety” is particularly timely for Michigan, because Gov. Rick Snyder (R) and the state legislature may soon take up some modest reforms of the state’s alcohol control regime. Already, beneficiaries of the status quo are pushing their claims that deregulation may harm public health and safety.

Dubious Safety Benefits

The study examined the reform opponents’ health and safety claims in detail. It divides “control” states into three levels of control: heavy, moderate, and light.

In heavy control states, the state itself sells at least two of the three major types of alcohol (beer, wine, liquor) at retail; moderate control states sell only one type at retail and at least one at wholesale; and light control states sell one or more types but only at the wholesale level.

In addition to the 18 “control” states there are 32 “license” states, where manufacturers, wholesalers, and retailers are required only to obtain a license to do business. License states were also examined, and the alcohol-attributable death rates per 100,000 people were compared. Alcohol-attributable death is probably the broadest measure of alcohol-related harm categories.

Little Difference

The study found little difference in alcohol-attributable death rates regardless of the level of regulatory control. The average alcohol-attributable fatality rate was lower in license states (28.46 vs. 29.95 per 100,000 people) than in light-control states such as Michigan.

The result is the same when teasing out just the fatality rate for individuals under age 21. Of the 10 states with the lowest fatality rates, eight were license states, according to the study.

The study also reviewed recent scholarly literature to assess the idea that greater retail density (more liquor stores) causes more alcohol-related problems. A 2010 study from a University of Michigan doctoral candidate found, among other things, “for both men and women, higher density of alcohol establishments was related to lower alcohol consumption (quantity/frequency), binge drinking, and drink/driving.” Hers is not the only study to come to that conclusion.

More Regulation, Higher Prices

The new study is not the Mackinac Center’s first state control-related analysis. Last year the center looked at alcohol code length and state control-related analysis. The research strongly suggests that people in control states are paying a premium and in return receiving no real advantages in public health and safety.

The research strongly suggests that people in [alcohol] control states are paying a premium and in return receiving no real advancements in public health and safety.

“The research strongly suggests that people in [alcohol] control states are paying a premium and in return receiving no real advancements in public health and safety.”

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No Benefits, More Burdens in Ending Carried Interest

By Jeff McKinley

The practice of hedge fund managers being compensated through a carried interest in investment partnerships has received a lot of attention from some in Congress and President Barack Obama.

Multiple bills have been submitted to change the tax character of carried interests for hedge fund managers to ordinary income. These include the Carried Interest Fairness Act of 2012, introduced by House Ways and Means Committee Ranking Member Sander Levin (D-MI).

The primary reason mentioned for the change is based on the claim that compensation to a hedge fund manager shouldn’t be taxed any differently than income earned from other occupations.

To properly analyze the carried interest issue, we need to focus on two important tax concepts. One is the ability for a partner to provide services to a partnership in exchange for a carried interest. The other is the differential between the tax rates on ordinary income and long-term capital gains. These two concepts often have been conflated in discussions related to this issue and need to be examined separately to bring clarity.

A carried interest—or, as it is referred to in the tax code, a profits interest—is a business arrangement where a partner receives an allocation of partnership income, retaining the underlying tax character, in exchange for providing services to the partnership. The underlying tax character can be capital gains, which are long-term or short-term depending on holding period, or ordinary income. The current top rates for each are 15 percent, 35 percent, and 35 percent, respectively. The partner receiving the carried interest is not required to contribute capital for this share of the profits.

Carried Interests for Others

Granting a profits interest is not a special carve-out for hedge fund managers but is instead a well-established provision of the tax code. The attractiveness of a profits interest is that it brings together those who have the ideas and are willing to manage the business with outside investors who will supply the capital. Carried interests are even used in some accounting and law firms as a tool to retain talented employees. Although many businesses avoid themselves of carried interest structures, it is primarily the hedge fund community that is being targeted with the proposed legislation.

Legislators claim the services performed by hedge fund managers are indistinguishable from those performed by teachers or others who have their income taxed at ordinary rates. They may or may not have a point. However, under current tax law, the profits interest arrangement is allowable. If access to this provision is blocked for hedge fund managers, then it begs the question, why would others such as lawyers who receive carried interests be allowed to continue using a carried interest structure?

Capital Gains vs. Ordinary Income

It appears those who want to eliminate carried interests for hedge fund managers do not have an issue with the concept of carried interests in general. If they did, they would want to ban it in totality. With the only distinguishing factor related to hedge fund managers being that they can generate long-term capital gains, it appears the substantive issue is the larger debate over the gap between the tax rates on ordinary income and long-term capital gains.

Capital gains are taxed at lower rates for various reasons, including encouraging people to take risks, and recognition that people use after-tax money to make investments. The lower capital gains rate helps soften the impact of double taxation of invested funds.

If legislators disagree with the gap in rates, then it would be more productive to debate whether long-term capital gains should be taxed at a different rate as opposed to introducing legislation that targets an industry’s allocation of their legitimate taxable income.

The legislation bans the manager from receiving compensation in any form besides ordinary income and forces the partnership to allocate individual taxable items, including long-term capital gains, amongst the other investors.

Because there is no reduction in income taxed at 15 percent, as it is only reallocated, and given that the tax effect from the ordinary fee income claimed by the manager will come close to being offset by the tax write-off by the investors, the net effect of the proposed legislation would be minimal. This is evident as the average annual tax revenue is estimated to be $1.3 billion, or 0.03 percent of the proposed 2013 federal budget—not even a rounding error.

‘Significant Complexities Added’

Implementation of the legislation would be burdensome to the many businesses that would be affected, including real estate ventures and possibly proprietary trading firms. The American Bar Association’s Section of Taxation has stated, “... we believe Proposed Section 710 [addressing carried interests] would add significant and burdensome complexities to the Code and alter fundamental principles of partnership taxation.”

To give an idea of the added complexity, the proposed new code section is 3,060 words long. This compares to an 88-word count for another critical and important existing code section relating to partnership taxation.

In addition, the proposals do not contain what are referred to as “grandfather clauses” that allow existing agreements to stay unchanged. The effect of this is that every agreement that is currently in place would need to be renegotiated and rewritten. That would be a massively expensive and time-consuming undertaking.

It’s clear the proposed legislation regarding carried interests is a misguided and burdensome exercise that would produce little or no benefit to the government while unnecessarily adding to the complexity and expense of running a business.

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