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By Jesse Hathaway
In late December 2014, the U.S. Treasury Department announced the official end of the 2009 automobile industry bailout, with loans given to two of the three largest automakers having been repaid to the government’s satisfaction.

Final accounting tallies published in 2014 reveal the corporations received nearly $10 billion more than they repaid.

Created in January 2009 as part of the Troubled Asset Relief Program, the Auto Industry Financing Program (AIFP) loaned $79.69 billion to U.S. car manufacturing companies General Motors and Chrysler Motors and to their respective in-house financing companies.

Funds allocated from the bailout program, part of the national government’s response to the subprime lending crisis, were also used to purchase majority shares of the corporations, effectively nationalizing the companies.

TARP, p. 12

Taxpayers Lose Billions as Auto Industry Bailout Ends

By Tom Gantert
Georgia state officials and infrastructure consultants met at an annual industry conference in December in Athens to discuss mounting transportation problems in the Peach State.

Addressing the dual problem of declining gas tax revenue and increasing transportation construction and repair costs has been a priority for the Georgia legislature. In April 2014, the Georgia General Assembly created a Joint Study Committee on Critical Transportation Infrastructure Funding, tasking the committee with producing recommendations for how to pay for necessary road improvements.

At the December conference—sponsored by the state Department of Transportation—Georgia officials discussed the need for new revenue streams and the limitations of the gas tax for maintaining and upgrading the state’s transportation system.

Georgia, p. 10
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Study Shows How Bad Zoning Policies Can Lead to Economic Stagnation

By Dotty Young

A team of New York-based researchers found policies intended to preserve historic neighborhoods resulted in depressed economic activity by discouraging developers from investing in communities.

Examining historical property value and construction data spanning 35 years and hundreds of neighborhoods in New York City, New York University School of Law public policy professor Vicki Been and researchers Ingrid Gould Ellen, Michael Gedal, Edward Glaser, and Brian J. McCabe discovered the city’s land-planning policies may be distorting local economies in unforeseen ways.

Squeezing Renters

The study found annual real construction rates in New York City as a whole are 21 percent lower than expected rates calculated by the researchers, which they attributed to the city’s historic neighborhood policies.

“Historic districts have significantly less new housing construction, while prices for homes within these neighborhoods, and those just outside, receive a boost relative to others. The story of supply restrictions increasing prices seems to be confirmed,” said Matt Kelly, a policy analyst with Florida State University’s College of Social Sciences and Public Policy.

“The historic preservation status definitely squeezes renters and depresses values for buildings whose height is below average,” Kelly explained. “This policy contributes to sprawl, and when contrasted with the rent control policies elsewhere in the city, makes little sense.”

Cutting Profitability

The study identified multiple variables underlying zoning policies’ effects on the housing market, such as restrictions on the height of buildings. In New York City, neighborhood zoning codes often include restrictions on the maximum height of a building for aesthetic reasons. These rules make investing in buildings in non-historic neighborhoods more profitable than in the height-restricted areas, because the former can have greater overall square footage by virtue of their greater height.

The study additionally found the value of property bordering high-demand historic neighborhoods is typically higher than other properties because the bordering areas enjoy the geographic benefits of designation without the accompanying restrictions.

Reducing Buildings’ Value

Kelly says the study’s findings are “novel, but not surprising.”

“As builders are prevented from building upward, the resulting lack of housing supply would intuitively lead to an increase in price. This increase is seen in most areas, but where the [existing] building height is sufficiently low, it does not occur,” Kelly said. “When one realizes that building restrictions are preventing a building from being used in the most profitable way, the decrease in price [relative to buildings free of the restrictions] is less surprising.”

In historic neighborhoods, building owners must seek approval from the city’s Department of Buildings and Landmarks Preservation Commission before starting repairs and building maintenance. In some cases, maintenance requests may be subject to public hearings.

“Since 1965, New York’s Landmarks Preservation Commission has designated 120 historic neighborhoods, and the pace of these designations has spiked since 2000,” Kelly said. “Essentially, this designation prevents developers from building anything new or significantly changing the existing edifices.”

Distorting Market Signals

Kelly said he agrees with the authors’ conclusion that zoning policies are sending “a distorted market signal, preventing entrepreneurs from building where it is most profitable to do so.”

“Historic districts have significantly less new housing construction, while sales prices for homes within these neighborhoods, and those just outside, receive a boost relative to others,” he said. “Entrepreneurs and developers are taking into account the future cash flow of a building, and when the potential profits of a taller building outweigh both the costs of redevelopment and the profits of the current building, such redevelopment is likely to occur.”

Kelly expressed hope New York City policymakers would take the study’s advice when designing future policies.

“By considering the relative height of buildings in an area, the Landmarks Preservation Commission can better prevent the negative effects that the designation can have on new construction,” Kelly said.
**Swiss Bank Exits IRS Tax Compliance Program**

**By Alexander Anton**

Barclays Bank (Suisse) SA, a Swiss private bank owned by Barclays, a large and influential multinational bank, is ending its cooperation with the Internal Revenue Service’s (IRS) efforts to prevent investors from investing money in foreign countries with more favorable tax structures and policies, such as Ireland and Switzerland.

In a November 2014 speech in Zurich, Switzerland, Barclays executive Francesco Grosoli announced the bank had "recently exited the program" after evaluating its legal options.

Grosoli says Barclays' Swiss bank decided to end compliance with U.S. extraterritorial enforcement actions within the past “three or four months,” but he did not explain the reasons behind the decision.

**Dropping Out**

The IRS program, organized under the Foreign Account Tax Compliance Act (FATCA), requires foreign banks to provide confidential information to the IRS. Noncompliance carries heavy penalties, with fines exceeding half the assets kept secret.

Announcing the law’s passage in 2010, President Barack Obama warned the world’s banks if they do not “cooperate with us, we will assume that they are sheltering money in tax havens and act accordingly.”

Since the law’s passage, U.S. authorities have accused 25 international bank employees of helping clients evade taxes. Two of Switzerland’s top banks, UBS and Credit Suisse, have paid fines of more than $3 billion combined, and dozens of other banks are still under investigation.

**‘Deputy Enforcers’ for IRS**

Although Barclays Bank (Suisse) SA is currently the only Swiss bank to have announced its noncompliance with the program, Cato Institute Senior Fellow Dan Mitchell says a foreign bank’s refusal to hand over its customers’ data to the IRS is understandable.

“Banks are subjected to very costly regulations and are put in an unpalatable position of acting as deputy enforcers for the IRS, even though that may violate the human rights laws on privacy in other countries,” Mitchell said.

Lack of cooperation between high- and low-tax jurisdictions is not a new economic development, Mitchell says. Countries such as Switzerland have traditionally respected investors’ privacy.

“Low-tax, privacy-respecting jurisdictions have always existed. They first became ‘havens’ for human rights or political freedom,” Mitchell said. “Successful people in some European nations put their money in places like Geneva to avoid confiscation, expropriation, or discrimination in their home countries.”

Instead of trying to generate additional tax revenue by increasing the difficulty of placing money in other countries, Mitchell says the United States should make its own tax structure more attractive to investors.

“The entire issue is solved with the right kind of tax reform,” Mitchell said. “If we no longer double-taxed saving and investment, and no longer had extraterritorial taxation, then it wouldn’t matter if people had their money in a bank in Georgetown, Cayman Islands or Georgetown, Kentucky.”

**Neighbors Also Benefit**

In addition to providing more investment options for individuals, empirical evidence shows investor-friendly tax rules have significant positive economic benefits for the United States.

In 2004, Harvard University professor Mihir A. Desai examined data from U.S. multinational firms and found “use of tax havens indirectly stimulates the growth of operations in non-haven countries in the same region,” because “careful use of tax haven affiliates permits foreign investors to avoid some of the tax burdens imposed by countries with high tax rates, thereby maintaining foreign investment at levels exceeding those that would persist if tax havens were unavailable.”

**“Banks are subjected to very costly regulations and are put in an unpalatable position of acting as deputy enforcers for the IRS, even though that may violate the human rights laws on privacy in other countries.””**

**IN OTHER WORDS . . .**

“The Internal Revenue Service has introduced an International Data Exchange Service [IDES] that financial institutions and tax authorities in other countries will use to report tax information under the Foreign Account Tax Compliance Act, or FATCA.

“Financial institutions and host country tax authorities will use IDES to securely send their information reports on financial accounts held by U.S. persons to the IRS under FATCA or pursuant to the terms of an intergovernmental agreement, as applicable.

“FATCA was passed as part of the HIRE Act of 2010 and requires foreign financial institutions to report on the holdings of U.S. taxpayers to the IRS or else face steep penalties of up to 30 percent on their U.S. source income. The law has attracted considerable controversy abroad and in response, the U.S. has been signing a series of intergovernmental agreements, or IGAs, with the tax authorities in other countries.”

—Michael Cohn, writing in Accounting Today, January 12, 2015
Govt. Employees Sheltered from Economic Storms

By Jesse Hathaway

A new study by the National Bureau of Economic Research finds public-sector employees enjoy greater job security than private-sector employees, especially during recessions and other economic downturns.

The study’s authors, Jason Kopelman and Princeton University professor Harvey Rosen, examined 22 years of employment data from the U.S. Census Bureau’s Current Population Survey to identify differences in how the public- and private-sector job markets respond to changing economic conditions.

Federal government workers enjoy 6 percent more job security compared to private-sector employees, assuming all other variables are held equal, the study found.

Job Security
In the public sector, the average federal government worker’s baseline risk of job loss between 1990 and 2012 was only 6.9 percent. During recessionary periods, federal workers’ job security increased by 1.5 percentage points and state government workers’ job security increased by 0.7 percentage points. In the private sector, economic slowdowns decreased workers’ job security by about 0.7 percentage points.

During the 2007 economic recession, the average private-sector worker was about 5.3 percentage points more likely to be fired than the average federal employee, the study found. Private-sector workers were also 6.4 percentage points more likely to be fired than the average local government employee, who faced a 7.7 percent chance of job loss.

The analysis by Kopelman and Rosen found state and local government workers weathered the most recent recession better than federal employees, a reversal of trends in prior recessions.

Unusual Job Trends
The collected data “show that during recessions other than the Great Recession, the probability of being displaced fell for federal and state government workers, but increased for local government workers,” Kopelman and Rosen wrote.

The researchers added, “[D]uring the Great Recession, the probability of a job loss increased for workers in the private and federal sectors, but went down for state and local workers, holding worker characteristics constant.”

Asked to explain this surprising result, Rosen was at a loss. “Fair question,” he said. “But I’m afraid that I don’t have a good story to account for the difference.”

Sheltered from the Storm
The authors conclude, “Workers in all levels of government are substantially less likely to be displaced than their counterparts in the private sector even after differences in worker characteristics are taken into account. During non-recession years, employees of the federal government are 4.2 percentage points less likely to lose their jobs than private-sector workers.

“We document that public-sector workers do indeed have an advantage in terms of job security, and the relative advantage increases during recessions,” Rosen said. “We were careful, though, not to draw any policy implications, because our data did not allow us to explore just why the differential exists—is it union power, unobserved worker characteristics, or something else we can’t measure?”

‘They Don’t Get Fired’
James Sherk, a senior policy analyst in labor economics at the Institute for Economic Freedom and Opportunity at The Heritage Foundation, called the results of Kopelman and Rosen’s study “unsurprising.”

“Throughout the recession, government employees have had lower unemployment rates than any other occupational group in the country,” Sherk said. “They’ve had consistently low unemployment, and the statistics at the federal level are very clear—once employees get past the probationary period, they do okay.”

“At the federal level, it is vanishingly rare that employees would get fired. They don’t get fired, because it’s such a hassle for administrators to go through to do it,” he added. “It’s only one out of a few thousand federal employees who get fired every year after they’ve passed the probationary period.”

Rosen says he hopes his research will lead others to study the issue in greater depth.

“Jason [Kopelman] and I hope that our study will stimulate further research along these lines. In the meantime, though, we’ve settled a basic issue,” he said. “Even taking into account all the observable worker characteristics that are available in conventional data sets, public-sector workers do enjoy an advantage as far as job security, both in recessionary and non-recessionary environments.”

Jesse Hathaway (jhathaway@heartland.org) is managing editor of Budget & Tax News.
Virginia Considers Increased Tobacco Regulations

By Matt Hurley

Virginia is considering forcing retailers to get licenses to sell tobacco products in an attempt to increase the difficulty of reselling Virginia-purchased tobacco in other states.

Currently, Virginia law does not restrict to whom wholesalers may sell their products, and excise taxes are applied only during retail transactions. Virginia is one of 14 states without laws requiring cigarette retailers to obtain licenses before selling the products, and it has very low excise taxes on tobacco.

The Virginia State Crime Commission, whose stated goal is determining “the causes of crime” and recommending “ways to reduce and prevent it,” recommended requiring tobacco retail licenses.

Under the Crime Commission’s proposal, wholesalers would be allowed to conduct business only with state-authorized sellers.

High-Tax Neighbors Complain

Neighboring states in the Mid-Atlantic region blame Virginia’s low excise taxes and lack of economic regulations for lost tobacco excise tax revenue in their states. Many individuals choose to purchase tobacco in Virginia and resell it elsewhere, such as in Maryland and Pennsylvania.

According to the commission’s report filed with the state legislature in 2014, high excise taxes in “mid-Atlantic and New England states directly north of Virginia” create an “opportunity for traffickers to make huge profits” by transporting “cigarettes from Virginia to higher tax states.”

The tax differences are significant. For every 10 packs of cigarettes purchased in Virginia, consumers pay $3.00 in taxes. Pennsylvania consumers pay $16.00 in taxes for the same quantity, and Massachusetts consumers pay $35.10 in taxes.

‘Rational Enterprise’

Economic research suggests excise tax avoidance is a rational response to poorly implemented policies.

Nachum Gabler, a former research assistant with the Fraser Institute’s Centre for Canadian-American Relations, says there are better options for states that want to reduce the economic impact of underground sales.

“Buying contraband tobacco is a rational consumer response, given individual budget constraints, tastes, and preferences and weighing the risks and rewards associated with buying tobacco,” Gabler said. “Tobacco smuggling is a rational enterprise to meet that consumer demand and earn a profit, after weighing the risks and rewards associated with selling tobacco.”

In 2010, Gabler and Fraser Institute Director of Risk, Environment, and Energy Policy Diane Katz authored a comprehensive study on the outcomes of Canadian excise tax policies enacted by provinces during the 1990s and 2000s.

“The contraband tobacco market is entirely driven by an economic calculus,” Gabler said.

Excise tax policies create price differentials between states, Gabler says, causing people to decide to purchase cigarettes originating in other states because other states’ prices are closer to their preferred price.

In their 2010 study, Gabler and Katz determined consumers do not perceive a difference between contraband and “lawful” tobacco, causing purchasers to discriminate primarily on price.

“Contraband cigarettes are perceived to be a near-perfect substitute for lawfully purchased cigarettes. As such, contraband tobacco use neutralizes the deterrent effect of higher taxes. Moreover, the tobacco tax revenues sought by politicians shrink when the contraband market enables smokers to evade taxation,” Gabler and Katz wrote. “Combating the contraband trade is particularly difficult given the tax environments of neighboring jurisdictions. A price differential between domestic and smuggled cigarettes increases opportunities for black market profits.”

Finding the Sweet Spot

Gabler says state policymakers in Virginia and elsewhere should examine the results of the Canadian government’s attempts to combat the underground economy during the 1990s and 2000s.

“Governments can fail to appreciate the lessons learned from their own earlier experiences,” he said. “To me, it’s an example of Mark Twain’s observation about ‘history rhyming’—ultimately, at the taxpayer’s expense.

“The current contraband smuggling issue is a repeat of an earlier Canadian episode that transpired between the mid-1980s to 1994. Tobacco smuggling was rampant back then, taxes were too high, and interdiction couldn’t eliminate the criminal activity,” Gabler said. “The government cut taxes, knowing that they’d be taking the wind out of the smugglers’ sails, reducing the profitability of black marketeering and reducing the incentive for smokers to buy contraband tobacco.

“They implemented deep excise tax cuts, and—presto—smuggling almost disappears, figuratively speaking, overnight,” Gabler said.

Solution: Cut Tax Rate

The key to reducing tobacco tax evasion, Gabler says, is lowering the economic incentive to evade the tax by reducing tax rates.

“To eliminate tobacco tax evasion, all jurisdictions in close geographic proximity should harmonize their excise tax rates at a reasonable level, commensurate with the optimal tax rate, which should reflect the average consumer’s preference disposition and disposable income level,” Gabler suggested. “That would be the only way to end cross-jurisdictional smuggling, in my opinion. ... No tax-induced price differential to capitalize on, no incentive to buy tax evaded tobacco, no tobacco smuggling problem.”

Police enforcement and interdiction of transportation are similarly ineffective at keeping excise tax dollars at home, Gabler says.

“Interdiction is not effective at all. It’s hard to say with certainty, but as is the case with the prohibition of other controlled substances, like narcotics or alcohol during the Prohibition Era, the law enforcement approach has been a failure,” Gabler said. “Nonetheless, scarce police resources are being squandered in an unwinnable law enforcement campaign.

“The limited instances of successful interdiction have no discernable impact on supply,” he said. “Illicit producers can make up for any confiscated product, and the offenders are prosecuted and incarcerated for what—selling cigarettes?”

Matt Hurley (wmdtv.matt@yahoo.com) writes from Cincinnati, Ohio.
Ill. Statehouse Drops Plan to Revive Rideshare Curbs

By Paula Bolyard
In late November 2014, the Illinois General Assembly abandoned a plan to override outgoing Gov. Pat Quinn’s (D) veto of heavy restrictions on ridesharing network companies.

Explaining his August veto, Quinn said “a one-size-fits-all approach” to commercial ridesharing companies such as Lyft or Uber was inadvisable and such services were “best regulated at the local level.”

Provisions in the vetoed House Bill 4075 include a requirement that would force individuals who want to work as drivers to undergo etiquette testing by state regulators and a proposed regulation that would have restricted the number of hours per week drivers can work, similar to those imposed on commercial truck drivers.

The legislation also would have prohibited ridesharing drivers from picking up or dropping off passengers in areas designated by airports and queues such as airports, and the bill would have made the purchase of expensive commercial insurance policies and professional licenses a legal requirement.

‘Unnecessary Restraints’

Adam C. Smith, assistant professor of economics and director of the Center for Free Market Studies at Johnson & Wales University, says he was unsurprised the General Assembly gave up its efforts to override Quinn’s veto.

“I think the main thing is that these are very popular services, so when they’re trying to put unnecessary restraints on those services, they’re basically putting themselves in opposition to voters,” Smith said. “I would speculate that politicians are reluctant to put themselves in opposition to voters like that so obviously and so publicly.”

Smith says the General Assembly’s abandonment of the proposed override exemplified pro-consumer policies transcending partisan politics.

“It exposes how unique the issue is and how it can unite both sides of the aisle, mainly because it’s so beneficial to consumers and to voters. If that’s the case, whoever opposes it is going to put themselves in the crossfire,” Smith said. “If you’re going to impose rules— the fewer rules, the better.”

Regulations Spurring Price Hikes
Smith warned placing additional regulations on ridesharing companies would hurt both consumers and local economies.

“So, even if prices are set by a centralized cab company, which has kind of been the status quo, those prices are just moved upwards, in terms of paying for the licenses or medallions or however they’re allocating it,” Smith said.

“The bottom line is you’ve still got the same amount of demand but less supply, … so, higher prices and fewer services available.”

ADAM C. SMITH, JOHNSON & WALES UNIVERSITY

“[E]ven if prices are set by a centralized cab company, which has kind of been the status quo, those prices are just moved upwards, in terms of paying for the licenses or medallions or however they’re allocating it. The bottom line is you’ve still got the same amount of demand but less supply, … so, higher prices and fewer services available.”

Paula Bolyard (paula.bolyard@gmail.com) writes from Doylestown, Ohio.

By Matt Hurley

The Federal Communications Commission (FCC) voted in mid-December to raise fees on consumers’ wireless services to increase subsidies for Internet connectivity for schools and public libraries.

Created in 1996 as part of the Telecommunications Act, the E-rate program receives $2.25 billion annually in U.S. consumers’ money through the Universal Service Fund (USF), a line-item fee included in bills for consumers’ use of wireless devices.

FCC Chairman Tom Wheeler proposed a 62 percent increase in fees, hiking the E-rate program by an estimated $1.5 billion. As a result, all mobile phone users in the United States will have an additional 16 cents added to their monthly phone bills.

The Tax Foundation, a nonpartisan taxpayer advocacy group, states wireless fees and taxes have increased three times more rapidly than any other tax on goods or services between 2003 and 2014. After combining local, state, and federal taxes, U.S. consumers pay an average tax rate of 17.05 percent on their phone bills.

In his October 2014 study of wireless taxation, Tax Foundation State Policy Analyst Joseph Henchman wrote, “Wireless taxes and fees are regressive and have a disproportionate impact on poorer citizens. Excessive taxes and fees may reduce low-income consumers’ access to wireless service at a time when such access is critical to economic success.”

‘Less Skin in the Game’

In a December 2014 interview, FCC Commissioner Ajit Pai publicly disagreed with Wheeler’s proposed rate hike, arguing the program’s goals can be achieved without additional fees.

“Cutting down the red tape would have meant fewer delays, would have been predictable for a lot of these folks who need E-rate funds, and it would have eliminated or at least significantly reduced the need for all these schools and libraries to hire E-rate consultants,” Pai said.

The E-rate program incentivizes public schools to lean on the federal government for discounted Internet access and for funding for technology programs.

“Part of the problem is, as you might imagine, that if your school is getting a 90 percent discount—and you only have to put in one dollar for every nine dollars you get in E-rate funding—you have a much stronger incentive just to ask for additional funding, because you have less skin in the game.”

According to Pai, schools receiving the most taxpayer subsidies are also the biggest spenders of USF money.

“As a result, a large number of schools don’t even get funding from the E-rate program at all, because of this discount system,” Pai said.

Pai proposed shifting to a “per-student model,” explaining “there would be a bump, in terms of the funding equation or funding formula for rural and low-income areas, as well as smaller schools,” as schools highly dependent on E-rate funding would not crowd out less dependent schools.

Matt Hurley (wmdtvmat@yahoo.com) writes from Cincinnati, Ohio.
State Death Tax Changes May Hurt Family Landowners

By Tamara Cushing

In the United States, more than one-third of all forest land is owned by families.

Studies tell us half of these family forests are owned by people over the age of 65. In the not-too-distant future, those lands will go through the estate transfer process and possibly be subject to taxation. In 2010, when the federal estate tax was reduced, landowners rejoiced, and it was hard not to be happy for them.

Additional changes to the federal tax code made in 2013 reduced or eliminated the federal estate tax for more taxpayers. Lurking in the background without much attention from the forestry community, however, are state estate tax laws and state death taxes.

As many taxpayers have become aware of the federal estate tax changes, owners have shifted from planning for tax minimization to planning for succession. In some states, this failure to plan for tax minimization could result in the need to cut timber or sell off portions of an estate.

‘Doing Nothing’

Historically, the federal income tax code included a credit for taxes paid to the state upon a taxpayer’s death. On January 1, 2005, this credit was phased out, replaced with a deduction for state death taxes. If legislators had not come to an agreement in 2013, estate tax laws would have reverted to the mandates passed in 2001, bringing back the credit for state taxes as well.

States responded to the 2013 federal tax changes in different ways.

Twenty-three states did nothing, which effectively killed the state death tax. When the federal credit was eliminated, many states no longer collected estate taxes, because they had tied the state’s tax rate to the federal government’s tax credit, cancelling out one another. Should federal estate tax changes include a credit for state death taxes, these states would start collecting death tax revenue once again.

A second way states responded was through the creation of a standalone estate tax. As of August 2014, 14 states and the District of Columbia have a state death tax separated from the federal government’s estate tax credit. In the states with estate taxes, private forest land constitutes between 34 and 94 percent of the states’ total forested areas.

Tied to Earlier Laws

Some states, such as Minnesota, tied their state death tax exemption to the federal exemption at a specific point in time. Minnesota uses the federal estate tax law as it was on December 31, 2000.

On that date, the federal law included an exemption for estates with less than $675,000 in assets. Minnesota’s exemption was set up to incrementally increase to a $1 million exemption. Because Minnesota’s estate tax is tied to the pre-2001 federal law, an estate in 2001—when the federal law allowed a $5 million exemption—would pay state taxes at a rate of 41 percent on the first $93,000 over the $1 million exemption.

In March 2014, Gov. Mark Dayton (D) signed legislation increasing the exemption to $1.2 million for 2014, with step increases in future years. The exemption will continue to increase until 2018, when it reaches $2 million.

Triggering the Tax

In Minnesota, 44 percent of forest land is owned privately. As land values increase over time, it isn’t hard to see how a modest amount of forest land in an estate can trigger a state estate tax liability.

The resulting tax may exceed the liquid assets in the estate, requiring either a sale of timber before the forest has matured, or a partial property sale. A couple of states have recently made efforts to increase the exemption and in at least one case to expedite the phasing out of the state death tax.

Additionally, there are federal proposals on the table to alter both the death tax rate and exemption levels. Should the federal tax credit for state death taxes return, landowners in 23 states will have to plan for estate taxes in their state.

Many forest landowners have operated under the belief that very few of them will have to worry about the estate tax, but in reality, many states with state death taxes have a lot of private forest land that could be taxed at exceptionally high rates in the coming years.

Although much work has been done on federal estate tax reform, state death taxes still represent a hidden threat to continuing stewardship of inherited family land.

Tamara Cushing (Tamara.Cushing@oregonstate.edu) is the Starker Assistant Professor of Private & Family Forestry at Oregon State University.
Ga. Debates Gas Tax Hike, Transportation Needs

Continued from page 1

Transportation, the state affiliate of the United States Chamber of Commerce, and several private trade groups—private infrastructure consultant Keli Kemp estimated the total cost of rehabilitating the state’s 123,546 miles of public roads would exceed $3.9 billion per year.

Official state estimates are closer to $1.8 billion, according to Reason Foundation Transportation Policy Analyst Baruch Feigenbaum. He says Kemp’s higher estimates are similar to the numbers promoted by the Atlanta Chamber of Commerce.

“There is a general consensus that Georgia needs more revenue for maintenance,” Feigenbaum said. “However, the amount of revenue needed is subject to much debate.”

Feigenbaum says Kemp’s higher estimates submitted by Kemp and the Chamber of Commerce “likely include a lot of wasteful improvements” with lower benefit-cost ratios.

Inefficient Spending Cited

In 2014, Georgia collected 27.49 cents per gallon in state fuel taxes and fees in addition to the 18 cents per gallon collected by the federal government. The state adds 7.49 cents per gallon in excise taxes and an extra 19.99 cents per gallon in “other state taxes and fees,” according to the American Petroleum Institute. Sales taxes applied by counties and the state also add to the price of gasoline.

“A higher gas tax will take money out of folks’ pockets—particularly lower-income folks,” Feigenbaum noted. “This causes them to cut back [spending] on other products and can harm the economy.”

Feigenbaum says insufficiently high taxes on gasoline are not to blame for the state’s current problem; the true issue is the state spends its gas tax revenue inefficiently.

“Georgia’s gas taxes are 23rd highest in the country, but per-capita spending on transportation is ranked 49th. How can this be? About 48 percent of gas taxes in Georgia are spent on non-transportation purposes,” Feigenbaum said. “Georgia has two gas tax components. The first is a flat 7.5 cent gas excise tax. The second is a sales tax on gasoline. The state gasoline sales tax rate is 4 percent, and the counties all add an additional 2 to 4 percent.

“All though all of the flat 7.5 cent tax funds highways, only 3 percent of the sales tax funds transportation. One percent is deposited into the general fund. The rest of the taxes are enacted by counties and [are] used for everything from education to sewer repairs … but seldom transportation,” he said.

“If Georgia dedicated the transportation gas sales tax to highways, it would generate $812 million in additional revenue [for highways] per year, without raising taxes. This would likely be enough new revenue to solve the maintenance issue and build a number of new projects,” he said, disputing Kemp’s figures.

Federal Funding Falling

Feigenbaum says another contributing factor hampering state transportation funding is the increasing unreliability of the U.S. Highway Trust Fund, which is financed by the national gasoline tax established in 1956.

“The other question mark is federal funding. Georgia, like many states, gets more than 50 percent of its transportation revenue from federal gasoline taxes,” Feigenbaum said. “However, the federal gasoline tax—due to improving fuel economy and [the] transfer of funds to non-highway purposes—is in much worse shape than most state gasoline taxes.”

Calling the Highway Trust Fund “a bad way to fund transportation” and “not politically sustainable over the long run,” Feigenbaum said, “many states are worried that the federal government will provide substantially fewer transportation funds in the near future, … perhaps as soon as next year.”

There are ways to increase transportation funding without increasing taxes, says Feigenbaum. “There are several alternatives,” he said. “Mileage-based user fees [MBUFs] are a per-mile fee that varies based on the type of road and level of congestion. Since different prices can be charged by time of day and type of road, they are a more ideal ‘user-pay, user-benefit’ mechanism than the gas tax.”

Feigenbaum suggests toll roads as another solution, calling them “a precursor to MBUFs that would also increase transportation revenue without hiking gasoline taxes.”

Opportunity to Experiment

Feigenbaum suggests Georgia policymakers use the declining gasoline tax revenues as an opportunity to explore alternatives to gasoline tax hikes.

“Not raising the gas tax, so MBUFs can be implemented, would be a good thing, although I would want the gas tax to sunset when MBUFs become operational. Not raising the gas tax so tolling becomes more attractive also has positives,” he said.

“If our goal is to improve the environment or reduce congestion, then declining [gas tax] revenue is a good thing,” Feigenbaum said. “But if our goal is to improve the transportation network, which I argue it is, declining gasoline tax revenue is a bad thing. We can use mileage-based user fees or tolls to manage congestion.”

Tom Gantert (ganert@mackinac.org) is the Mackinac Center for Public Policy’s senior news correspondent.

IN OTHER WORDS . . .

“There are some in Congress that have different ideas, including raising the gas tax. That’s certainly something that we’ll take a look at it [sic], but it’s not something that we have considered from here.”

—White House Press Secretary Josh Earnest, January 5, 2015
How U.S. Tax Mix May Weaken Economic Growth

By Tom Gantert

European nations have become increasingly reliant on value-added taxes (VAT) during the past 50 years, according to a recent study released in December 2014 by the Tax Foundation. This trend has benefited the United States economically, the study found.

The study by Kyle Pomerleau, an economist for the Tax Foundation’s Center for Federal Tax Policy, explores how the respective mix of tax revenues affects nations’ economic growth.

Looking at the 34 countries in the Organisation for Economic Co-operation and Development (OECD), the researchers broke down how each country gets its tax revenues. OECD members include Canada, France, Germany, Greece, Italy, Japan, Spain, the United Kingdom, and the United States.

The United States is the only country in OECD with no VAT. Instead, most state governments use a retail sales tax and an excise tax on goods such as alcohol and tobacco.

VATs are consumption taxes, usually collected when businesses or consumers make a purchase from a business, including sales within a product’s supply chain. A sales tax, by contrast, is charged only to the consumer at the end of the supply chain.

**VAT ‘An Alien Concept’**

Ryan Ellis, tax policy director for the nonpartisan Americans for Tax Reform, says the United States has been wise to avoid adding a VAT to the current tax mix.

“Doing so would almost certainly result in a higher overall tax burden, not a displacement within the existing distribution of taxes collected,” Ellis said. “The U.S. tax system has always been an income tax based one, and probably always will be. The corporate and personal income taxes came out of the Progressive Era, and the payroll tax—which is really just a redundant second income tax just on wages—came out of the New Deal and the Great Society.

“It’s hard to imagine shifting any of these over to a VAT, which is really an alien concept here, culturally,” he said.

**Rising Popularity in OECD**

The study examined data from 1965 to 2011, highlighting the rise in the value-added tax’s popularity among European policymakers.

In 1965, only France had a VAT, and it raised about 4.6 percent of total consumption tax revenue from the VAT, according to the Tax Foundation study. By 2011, VATs accounted for 49.7 percent of total consumption tax revenue in OECD nations.

“Countries started replacing sales taxes, excise taxes, and custom duties with the VAT, which was seen as an improvement due to its export neutrality and exemption of business-to-business transactions,” Pomerleau says in the study. “As countries throughout Europe and the rest of the OECD adopted the VAT, reliance on its revenue steadily grew.”

In Europe, international transactions between businesses registered with tax authorities are exempt from the VAT. Business transactions involving an unregistered business buyer are not exempt.

**Overall Burden Is Key**

Ellis says adding a VAT without correspondingly reducing other taxes is a bad idea.

“The OECD countries rely on consumption taxes; they assess more cash-register-level taxes,” Ellis said. “This is a good thing for the United States, since we’ve avoided adding the VAT to our already large tax burden.”

The mix of taxes applied to an economy has significant implications. “A country may decide to have a lower corporate income tax to attract investment, as many have, which may reduce their reliance on corporate income tax revenue and increase reliance on social insurance taxes or consumption taxes,” Pomerleau explains in the study.

The United States relies heavily on individual income taxes to generate its tax revenue, with 37.1 percent of taxes in the United States coming from individual income taxes. By comparison, 24.1 percent of OECD nations’ revenue comes from taxes on individuals’ earnings.

**VAT Can Benefit Investment**

The largest difference between how the United States and Europe fund government services is European countries levy more taxes directly against consumption. The study found only 18.3 percent of government revenues in the United States are generated by taxes on consumer purchases, whereas 36.7 percent of government revenues in the United States are generated by taxes on business purchases, as opposed to OECD’s 32.9 percent take from consumer goods and services.

“Taxing consumption—and avoiding taxes on savings until savings are consumed—results in the most productive use of capital,” Ellis explained. “It retains money outside the tax system for investment in new technologies and business expansion.”

“A consumption tax can also mean a tax with incidence at a different point—say, when income is earned—but using a consumption tax base,” he said.

**Heavy Reliance on Property Taxes**

The study notes property taxes are a very small source of revenue for all OECD countries.

The United States relies on property taxes for 12.4 percent of total tax revenue—the highest such reliance among OECD nations. In contrast, only 1.2 percent of Austria’s tax revenue comes from individual property taxes.

While cautioning against the formal implementation of a VAT, Ellis suggests the United States could move toward fairer consumption-based taxation.

“It’s imperative that policymakers shift the corporate and personal income taxes over to a consumption base. This can be done by moving toward immediate expensing of all business purchases, ending the double taxation of savings, and ending the double taxation of income earned overseas,” Ellis said. “There’s a number of ways to skin the cat on that, but it’s important that we keep moving in that direction.”

Tom Gantert (gantert@mackinac.org) is senior capital correspondent for Michigan Capitol Confidential, a daily news site of the Mackinac Center for Public Policy.

“Countries started replacing sales taxes, excise taxes, and custom duties with the VAT, which was seen as an improvement due to its export neutrality and exemption of business-to-business transactions. As countries throughout Europe and the rest of the OECD adopted the VAT, reliance on its revenue steadily grew.”

*KYLE POMERLEAU*

*TAX FOUNDATION*

**INTERNET INFO**

After the quasi-nationalization effort, the government later sold Chrysler Motors to foreign manufacturer Fiat. General Motors separated from the General Motors Acceptance Corporation (GMAC) financing company, now called Ally Financial, to allow GMAC to receive bailout funds as a financial corporation.

Repaid in 2010
Eighteen days before leaving office, President George W. Bush’s administration loaned Chrysler Motors $4 billion in taxpayer funds through AIFP. On April 30, 2009, President Barack Obama gave an additional $8.5 billion in taxpayer-backed loans and investments to support Chrysler’s restructurings.

General Motors repaid its loans to the Treasury Department in April 2010 and government control ceased as a result. Chrysler Motors officially repaid its public loans in May 2011, assisted by the 2009 bankruptcy reorganization.

In 2011, the federal government sold its remaining shares of Chrysler, based in Auburn Hills, Michigan, to Italian automobile manufacturer Fiat, for $560 million. Before the sale, Chrysler received $12.5 billion from the national government, an average of about $91.52 from every taxpayer in the United States.

After the Fiat sale, the federal government recovered only $10.6 billion, writing off the remaining $1.9 billion in outstanding loans as unrecoverable. Adding proceeds from the sale, nearly $1.3 billion in taxpayer money loaned to Chrysler remains unrecovered.

Another AIFP beneficiary, Ally Financial, made its final repayment on December 19, 2014, resulting in Ally’s return to private ownership. Providing a total of $17.2 billion in public loans, the Treasury Department once owned nearly three-fourths of the bank holdings company.

Taxpayers Took a Loss
The Treasury Department’s accounting of auto bailout loans reveals taxpayers recovered only $70.42 billion of the $79.69 billion loaned through AIFP, a loss of $9.6 billion, or about $65.75 per taxpayer.

“The sale of the government’s stake in Ally Financial—GM’s financing arm—marks the end of a piece of the Troubled Asset Relief Program, which was originally billed as a bank bailout program,” said Senior Research Fellow Hester Peirce of the Mercatus Center at George Mason University. “Taxpayer money was put at great risk, and the return on investment that Treasury now trumpets is not adequate to compensate taxpayers for the risk they took.

“Government should not be in the business of selecting winners and losers in the marketplace by directing cheap financing to favored sectors of the economy. Taxpayer dollars were invested in a sector of the economy that private money was avoiding for good reason.”

HESTER PEIRCE, SENIOR RESEARCH FELLOW, MERCATUS CENTER

Jesse Hathaway (jhathaway@heartland.org) is managing editor of Budget & Tax News.
By Michael D. LaFaive

As if to prove there is nothing new under the public policy sun, Michigan Gov. Rick Snyder (R) in December 2014 announced a government reorganization that attempts to marry the state’s existing “economic growth and job training efforts under one department.”

They’ve been married before, however, and it didn’t work well. In fact, corporate welfare doesn’t work at all, and no amount of reorganizing will make it so.

Michigan had a similar system during the 1990s, when economic development efforts and job training efforts were both run out of the Michigan Jobs Commission. Then-Gov. John Engler (R) split “job and talent training” from “economic development” in 1999, because he believed the split would improve the state’s economic development efforts.

Same Old, Same Old

Under Engler’s approach, the Michigan Economic Development Corporation (MEDC) was tasked with concentrating on economic development efforts, while the separate Michigan Department of Career Development handled workforce development.

In a 1999 Michigan Information & Research Service report, MEDC President and CEO Doug Rothwell said, “the state’s economy [had] grown to the point where the Michigan Jobs Commission model didn’t fit anymore.”

It’s difficult not to be cynical about moves made within the state’s corporate welfare complex, because so much of it just ends up being the same old musty wine in a new skin.

If It Was Working, Why Fix It?

According to Snyder, “One of my top priorities has been to make Michigan a national leader in talent development by focusing on workforce training for the jobs of today and tomorrow.

That effort will require a comprehensive, unified approach to best help Michiganders while working to retain and attract businesses to create more and better jobs.”

Rearranging Michigan’s Economic Development Agencies Is an Old Idea

The governor responded, “It was working.” As proof, Snyder said the state had “passed the 300,000 private-sector job mark,” creating new jobs by filling job positions.

Reorganizing the agencies again “is a way to accelerate that,” the governor concluded.

Snyder says job creation is an issue gaining more attention nationally, as governments focus on ensuring that citizens are trained with the “requisite skills to be successful in the careers that are going to be the careers of the future.”

Private-Sector Alternative

It doesn’t matter how often a state government moves its seating chart around. Taking money from many businesses and people and giving it to just a few isn’t a recipe for economic growth, and the empirical evidence is pretty clear on that.

Many of the job training goals laid out by government should be reached through the private market, unencumbered by government interference. After all, if companies and people were allowed to keep more of what they earn, they could tailor their own needs and desires and revenue to fit the demands of the marketplace.

Michael D. LaFaive (lafaive@mackinac.org) is director of the Morey Fiscal Policy Initiative at the Mackinac Center for Public Policy. An earlier version of this story appeared at the Mackinac Center for Public Policy’s website at http://www.mackinac.org/20855/. Reprinted with permission.
Has the time come to reconsider the way we pay for transportation?

Should the Highway Trust Fund and its fuel tax revenue continue as the main source of funds for the federal transportation program? If not, what are the alternatives? And more broadly, is the age of heavy reliance on federal funding drawing to a close?

These questions are no longer outside the realm of a serious policy debate. They have been raised by a number of respected think tanks, such as the Brookings Institution, The Heritage Foundation, The Pew Charitable Trusts, the Bipartisan Policy Center, the Building America’s Future Educational Fund, and the Eno Center for Transportation.

In the public sector, U.S. Secretary of Transportation Anthony Foxx acknowledged the need to reconsider traditional approaches to funding the federal transportation program.

“We have to get unstuck from this idea that we’ve got to keep doing transportation [funding] for the next 50 years the way we’ve done it for the first 50 years of the Interstate system,” Foxx said in a November interview at the CityLab 2014 Conference on Urban Solutions for Global Challenges.

**Bigger Isn’t Better**

Meanwhile, statements by congressional leaders have cast doubt on the approval of a six-year reauthorization of a federal transportation spending plan that has an estimated price tag of $100 billion. Annual highway and transit expenditures at current levels exceed annual trust fund revenue by roughly $16 billion per year.

“We will oversee a legislature in which ‘bigger’ isn’t automatically equated with ‘better’ when it comes to writing and passing bills,” wrote House Speaker John Boehner (R-OH) and Senate Majority Leader Mitch McConnell (R-KY) in a joint post-election opinion piece in The Wall Street Journal.

The statement was couched in broad generalities, but its message was clear. There will be no massive splurge in spending in the Republican-controlled Congress in 2015.

President Barack Obama seems to have reached the same conclusion. Responding to a question by FedEx CEO Fred Smith at a December 2014 meeting with members of the Business Roundtable, Obama said, “even if we were able to get something done [during the lame duck session], it would not be the kind of 10-year solution that we need ... The best they could do would be to stagger through another year.”

As for the lack of action on the gas tax, Obama said, “in fairness to members of Congress, votes on gas taxes are really tough. Gas prices are one of those things that really bug people.”

Obama says we should be looking for a “dedicated revenue source for infrastructure funding that is not so politically frightening to members of Congress.”

Obama did not volunteer what that revenue source might be. Significantly, he did not refer to his earlier proposal to pay for a long-term surface transportation bill with “corporate tax reform,” a proposal that was met with widespread congressional skepticism. Obama’s clear-eyed assessment of the congressional mood dimmed the hopes of infrastructure advocates for a boost in transportation revenue or a multi-year transportation reauthorization, even as gas prices have reached a four-year low.

**Challenging the Status Quo**

Challenging the funding status quo is the Eno Center for Transportation, a self-described “neutral, non-partisan transportation think tank.”


“The current approach to funding surface transportation is not working,” declared the report’s authors, citing political opposition to increasing the gas tax, diminishing travel per capita, and improved fuel efficiency that have held down demand for gasoline. The report also says the desire to maintain transportation spending above trust fund receipts necessitates continual infusions from the general fund to keep the transportation fund solvent.

“Maintaining the status quo will continue to produce funding uncertainty and perpetuate current funding problems,” says the report.

The report suggests the entire surface transportation bill should be funded with general funds through the appropriations process. This more straightforward approach “deserves fair consideration as an effective long-term solution to our national transportation funding problem,” said the report.

Commenting on the report, former head of the Louisiana and Rhode Island Departments of Transportation William Ankner said, “[I]t is time to change how we fund transportation. Who benefits from our national transportation system?

“The answer is every person and business. If everyone benefits, then everyone should pay.”

Although Eno Center for Transportation’s proposed approach might be good policy, it is not likely to find widespread support among transportation stakeholders. The transportation industry does not cherish the thought of having its program become part of the annual appropriations process, making it vulnerable to budget-cutting pressures and exposing it to competition for funds from other federal programs.

Kenneth Orski (korski@verizon.net) is a public policy consultant and former principal of the Urban Mobility Corporation. Used with permission of NewsBriefs, www.innobriefs.com.

**IN OTHER WORDS . . .**

“The president has ruled out a gas tax. I don’t think there’s a will in Congress, and the American people don’t want it.”


**INTERNET INFO**

Eminent Domain for Private Uses Lacks Economic Benefits

By Carrie Kerekes and Dean Stansel

In a recent working paper for the Mercatus Center at George Mason University, we examined the relationship between eminent domain activity and state and local revenue, finding no correlation between private takings and tax revenue.

Eminent domain supporters say private takings generate a public benefit by expanding the economy, thereby increasing government revenue. However, we found some evidence of a negative relationship between eminent domain and future revenue growth.

Cutting Standard of Living

In 2005, the U.S. Supreme Court’s decision in Kelo v. City of New London determined governments could take private property for “private benefit” as well as for “public use.” Historically, the Fifth Amendment has been interpreted to support the government’s power to use eminent domain for public use, but the Kelo decision marked the first time the nation’s highest court ruled takings are permissible for private benefit.

Public outrage swiftly followed the court’s ruling. The Kelo decision allowed governments to use eminent domain to transfer property from one private entity to another, determining that more productive use of property by another private party could be considered a public benefit because the public would benefit from increased tax revenues and economic development.

In the wake of the Kelo ruling, many state governments amended their constitutions to better secure property rights. Almost 10 years have passed since this landmark court case. Although the uproar surrounding Kelo has subsided, the issue remains. The use of eminent domain for private benefit is an egregious abuse of private property rights.

Given the importance of property rights for economic growth, the long-term consequences of this decision will likely reduce Americans’ standard of living.

We empirically investigated the consequences of government takings for private benefit by examining the effects on subsequent revenue and growth. We used data from previous studies recording the number of total condemnations, sorted by state, as a proxy for the number of properties taken through eminent domain to benefit private parties. We measured tax revenue as a percentage of personal income. Tax revenue ratios were calculated using local government revenue figures, state government revenue figures, and combined local and state government revenues.

The lack of any statistically significant correlation between eminent domain activity and revenue levels supports the claim there is no relationship between takings and government revenues.

Fundamentals of Success

In an era of increasing government economic intervention and regulations, people have myriad reasons to be concerned about future government growth. After sweeping changes in health care and immigration policies, as well as to public education, policy changes are adding to people’s uncertainty about the health of the U.S. economy.

Any interventions undermining the security of private property rights can adversely affect economic growth and development. In other words, our standard of living goes down as property rights become less secure. Private property rights are the foundation of a successful market economy and the basis upon which all voluntary and mutually beneficial trade occurs.

The land and property of Susette Kelo and her neighbors was taken as part of a redevelopment plan that included research, office, and retail space to accompany a new facility for pharmaceutical company Pfizer. This redevelopment did not come to fruition, and the land was actually used as a temporary dump for storm debris in the aftermath of Hurricane Irene in 2011.

These actions hardly qualify as a public benefit, and it did not increase government revenues or expand the economy.

Voters should be more skeptical when politicians claim using eminent domain for private purposes can benefit the economy, and politicians should pay more attention to the importance of protecting private property rights instead of approving plans to take land from some residents—who are typically poor and lacking political influence—and handing it over to their political supporters.

Carrie Kerekes (ckerekes@fgcu.edu) and Dean Stansel (dstansel@fgcu.edu) are associate professors of economics at Florida Gulf State University.
‘Consumer-Friendly’ Insurance Laws More Bane than Boon to Homeowners

By Kathleen Hunker

Reflectively responding to the 2008 financial crisis, many government regulators moved to reduce the burden of toxic assets in the financial market after widespread speculation instigated a credit crunch and contributed to the economic slowdown.

Despite the consensus these firms’ inability to shed toxic assets instigated their failure, many state governments continue to use “consumer interests” as a justification to force other industries—in this case home insurance companies—to shoulder more toxic assets. Perhaps surprisingly, Texas is one of those states forcing businesses to make bad investments.

Amendments to the Texas Insurance Code passed in 2013 prevent home insurance companies from declining to renew a homeowner’s insurance contract once it expires, unless the policyholder has submitted three or more claims. The ban excludes any claim resulting from natural causes, and it applies even when the policyholder has overused or abused the claims process.

Bane, Not Boon, to Consumers

These narrow parameters make it nearly impossible for insurers to reach the state’s statutory threshold, obliging them to maintain policies that pocket more money than their premiums cover—in other words, a toxic asset.

Although this restriction may seem like a boon to homeowners because it shields them from the loss of their insurance, nonrenewal laws inflate insurance premiums for most consumers by forcing insurers, and therefore their customer base, to bear the costs of certain high-risk policies.

But isn’t that how insurance works, smoothing over high-risk clients by submerging them within a pool of safer policyholders? Not exactly.

Although it’s true insurers rely on “the law of large numbers” to diffuse clients’ risk, the logic behind insurance companies’ management of that risk and calculation of customers’ monthly premiums is carefully devised to gain the most customers, using lower costs, while also protecting against avoidable risk.

Absent government interference, a home insurer pools together customers with similarly situated risks and properties. This not only allows the company to calculate its population-to-risk ratio more accurately but also helps ensure homeowners pay only for the risks they themselves incur, keeping their premiums low.

Market Distortion

Nonrenewal laws disrupt this ideal actuarial practice by preventing insurers from self-correcting their risk pools when a policy proves more expensive than originally anticipated.

The inability to self-correct puts both insurers and their customers in an awkward position. Insurance companies have a legal obligation to stay solvent. At the same time, nonrenewal laws bar them from dropping unsound policies. Since lowering their risk exposure is not an option, the only way left for them to balance their books is to increase their cash flow—through the use of across-the-board premium increases—or lowering their business costs by providing fewer services to customers.

This is where we see parallels to the credit crunch of the 2000s. The over-abundance of toxic assets in a market crowds out the availability of a product or service. Companies become so overexposed that they do not have the resources to invest in new customers, even when there is little likelihood of losing money.

Universal Laws

As we can see in retrospect, the mismanagement of risk spurred on by government interference was a big reason why the collapse of subprime mortgages caused a sudden credit shortage. The mortgages lost so much value that the banks could not afford to broaden loan exposure, regardless of someone’s good credit. Instead, consumers had to accept higher interest rates and stricter terms in order for the banks to extend credit.

Differing in degree but not kind, nonrenewal laws mimic the subprime mortgage problem. The toxic policies crowd out the availability of cheap insurance and clog up what otherwise would be a flexible market.

Insurance companies are not immune to the laws of economics, and overburdening an industry with toxic assets hurts consumers, who ultimately bear the costs of the added vulnerability. The situation Texas insurance companies have been placed in is no different. Mandated regulations directed at how consumers protect their homes, not how they finance it, are putting tremendous pressure on insurers to make a profit without being able to properly manage risk.

Kathleen Hunker

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INTERNET INFO

How Housing Bubble Influenced Consumer Prices

By Matt Kelly

A new study uncovered evidence that the housing bubble of the 2000s affected the U.S. economy in previously unsuspected ways, by causing consumer prices to rise and fall based on the rate of homeownership in any particular area.

In their study “House Prices, Local Demand, and Retail Prices,” New York University professor Johannes Stroebel and University of Chicago professor Joseph Vavra found an unexpected connection between housing prices and consumer retail prices—two seemingly disparate sectors of the economy. Their study is a strong example of the unpredictable effects of government intervention.

Between 2001 and 2006, U.S. home prices skyrocketed during what is now popularly called the “housing bubble.” During that period, retail prices of consumer goods also increased. This occurred at different rates in different neighborhoods, and housing price increases were a key factor.

Feedback Loops
Stroebel and Vavra’s work builds on prior research into how money flows through the economy. Relaxed lending policies are known to cause inflation, which leads to higher asset prices. Higher asset prices increase the wealth of asset holders, such as homeowners. This leads to increased demand for homes, and thus higher home prices.

What is good for homeowners is not always good for renters. Higher home values put economic pressure on renters as rents increase and reduce remaining levels of disposable income. Consequently, in areas where there are more renters, both renters and retailers are squeezed, because as rent prices rise, retail sales decrease.

Areas with higher rates of homeownership, by contrast, experience higher retail prices because homeowners’ demand for retail goods increases with their wealth.

That’s what happened during the housing boom.

Challenging Old Ideas
Stroebel and Vavra challenge the idea of “sticky prices,” which suggests firms are reluctant to change prices, as there is a cost for doing so. Many previous studies have indicated retail prices are slow to adjust to economic conditions and are driven by a firm’s costs.

Stroebel and Vavra’s research suggests sticky prices may play a smaller role in price-setting than previously thought.

Because retail goods are not produced locally, “change in a retailer’s local demand is unlikely to be correlated with its marginal cost, which implies that the increase in retail prices we observe mostly reflects higher markups,” wrote Stroebel and Vavra.

Instead of increasing prices because of higher costs, retailers notice customers are buying more, and they raise the prices in response to the greater demand.

Additional Implications
The connection between home and retail prices also has implications for urban planning and business cycle theories.

The authors found both the location of retail stores and neighborhoods’ economic recovery rates depend on the rates of homeownership in a given community, allowing urban planners to model these different factors with the same tool.

The model also can be used to predict where retail stores may move, seeking neighborhoods with high home ownership rates and high home values.

Blunt Instrument
The authors’ findings are also useful to monetary authorities, who may be able to use the information to enact reforms that minimize some of the negative impacts of expansionary monetary policies.

Monetary policy can be a blunt instrument, and understanding these policies have different effects in different places can help avert future crashes.

Matt Kelly (mlk12b@my.fsu.edu) is a DeVoe L. Moore Center policy analyst with Florida State University’s College of Social Sciences and Public Policy.
A Well-Written Overview of Governments’ Economic Misdeeds

By Jay Lehr, Ph.D.

The first edition of Edmund Contoski’s book The Impending Monetary Revolution, the Dollar and Gold was excellent, and it makes an outstanding textbook for a college economics course. The second edition, released in November 2014, is even better. Contoski has added significant new chapters on issues such as the world’s gold economy, alternative currencies, and the logical inconsistency of Keynesian economics.

In my opinion, this book ranks among those written by Adam Smith, Frederic Bastiat, and Ludwig von Mises. Understanding Contoski’s message will make a reader a more effective participant in the fight to fix our country’s flawed economic policies.

Inflation: Cause of All Recessions

By reading Contoski’s clearly written book—a rare trait among economics books—one gains an understanding of just what money is. By inflating the money supply beyond the amount of resources supporting currency reserves, governments become the root cause of all recessions.

Contoski explains the history and development of bank notes and checks, and he explains fiat money—paper currency unrepresentative of value from physical resources—descended from the receipts given by goldsmiths, the keepers of a valuable physical resource. Contoski also tells entertaining true stories of intrigue, such as how a single individual working at Goldman Sachs was able to keep Greece’s debt crisis from becoming public knowledge for years, collecting $300 million as a reward.

A Presentation that Thrills

This and other parts of the gold story read like a best-selling mystery thriller.

Contoski makes the failure of mortgage-finance companies Fannie Mae and Freddie Mac easy to comprehend, naming the politicians and bureaucrats who created the housing bubble that began with the Community Reinvestment Act and expanded through the Federal Housing Administration and various U.S. Department of Housing and Urban Development mandates—characters such as former U.S. Attorney General Janet Reno and President Barack Obama.

Another compelling true story is Contoski’s retelling of some of President Richard Nixon’s economic measures designed to shift the American monetary system to a fiat system.

Reading the author’s common-sense approach to economics makes one wonder how governments can get monetary policy so wrong. In a free market, he notes, every transaction benefits both sides, according to each’s judgment. If a transaction does not benefit all parties, those involved would not participate in it. Transactions forced by government present a win-lose game, because government seeks to benefit one side by imposing a loss on the other.

“When plunder becomes a way of life for a group of men living together in a society,” French economist and philosopher Frederic Bastiat wrote, “they create for themselves, in the course of time, a legal system that authorizes it and a moral code that glorifies it.”

Throughout his book, Contoski provides evidence we live in such a society. The U.S. Founding Fathers, Contoski notes, feared the evolution of a system in which politicians would enact policies by force, declaring unilateral actions as beneficial to all.

This fear is coming true, Contoski writes, as government actions and regulations become more aggressive.

Calls for Constitutional Convention

The Impending Monetary Revolution, the Dollar and Gold is refreshing because of the author’s pragmatic recognition of the improbability politicians will solve the nation’s economic problems.

Because of politicians’ desire to win votes by favoring their own constituents over the good of the nation, Contoski concludes a constitutional convention to change the rules by which government plays represents the best hope for success.

State legislators, he writes, should be willing to call for a constitutional convention to retake power over the government’s operation. At some point during the nation’s history, the states allowed themselves to become subservient to the federal government, an outcome our Founding Fathers would have found undesirable and dangerous.

Amendments Suggested

Contoski outlines a simple set of amendments he believes would be met with widespread approval during a constitutional convention and could help put our nation back on its intended track.

Examples include reforming the Electoral College and the introduction of a balanced budget amendment that punishes legislators with removal from office should the national government fail to balance its checkbook.

Other suggested reforms include the restoration of the constitutional limitation on congressional authority to the enumerated powers of the Constitution, repealing the Federal Reserve Act, and restoring the earlier, more limited, definition of the term “inter-state commerce.”

My favorite suggestion is the official recognition of the right to pursue happiness, a reform that would eliminate government control over crops Americans plant and which light bulbs or bathroom showerheads we install in our homes.

“Either we return to the principles on which this country was founded which were the basis for its success,” Contoski soberly concludes, “or we face a bleak future.”

This outstanding text is a cautionary tale worth reading by anyone who has a serious interest in U.S. economics.

I rarely rate the books I review, but economics books—often called “the dismal science”—sometimes scare readers away. Giving it “five stars” may encourage people to pick up this enjoyable and informative book.

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The Heartland Institute is a 31-year-old national nonprofit organization based in Chicago. Its mission is to discover, develop, and promote free-market solutions to social and economic problems. For more information, visit our Web site at heartland.org or call 312/377-4000.

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Rein in EPA

EPA Is a Rogue Agency
The Environmental Protection Agency (EPA) is the nation’s leading job killer, implementing and enforcing laws that impose impossible regulatory burdens on American businesses. EPA has perverted the Clean Air Act by declaring carbon dioxide a “pollutant,” despite the plain intent of the law’s authors to exclude such naturally occurring gases, and despite major flaws in the science used to claim carbon dioxide endangers human health.

The Solution
Congress must rein in EPA through deep cuts in the size, power, and cost of the agency. Congress can repeal EPA’s authority to regulate carbon dioxide in the name of “global warming,” and it can demand cost-benefit analysis be applied to all environmental regulations.

The Petition
The Citizen’s Petition to Rein in the Environmental Protection Agency calls out EPA’s unscientific and destructive campaign to frighten people over the threat of man-made global warming and demands “deep cuts in the size, power, and cost of the EPA.” You can sign it online at www.heartland.org, or print out copies and fax signed copies to 312/377-5000, or mail them to us at The Heartland Institute, One South Wacker Drive #2740, Chicago, IL 60606.

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