Cliff Looms; It’s Anyone’s Guess How Bad the Fall Could Be

By Steve Stanek

Big cliff, sidewalk crack, or something in between? Americans may soon find out.

On January 1 the so-called “fiscal cliff” will be reached unless Congress and the president agree to avert it. The effect of its big tax hikes and smaller spending cuts on the economy remain a matter of much speculation.

On November 9, President Barack Obama, fresh off his victory over Repub-
Cook County OKs New Taxes, Reduces Sales Tax

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Preckwinkle floated the tax increases to help cover a deficit projected at $267.5 million in the county’s $2.95 billion budget for 2013. Even with that deficit, Cook County’s budget is $100 million smaller than the budget Preckwinkle was handed two years ago as she took office.

Under the tax increases and new taxes, a pack of cigarettes would cost a dollar more. In Chicago, the overall tax on a pack of cigarettes will be $6.67. Only New York City has a higher cigarette tax burden.

Each firearm sold in Cook County would carry a tax of $25, regardless of the price of the firearm. Slot and video poker machines would be taxed $800 per machine. And annual purchases of goods that total more than $3,500 would be charged a 1.25 percent “use” tax if the items are bought outside the county for use inside the county.

Altogether, the taxes would raise an estimated $43.4 million, with the cigarette and use taxes accounting for $25.6 million and $15 million, respectively.

Preckwinkle argues the tax increases would benefit businesses and residents.

Business Angle
“We want to encourage businesses to buy within Cook County,” Preckwinkle said in an October 29 news conference where she announced a modification to the proposed “Buy Local Tax”—raising to $3,500 the exemption on out-of-county purchases from her initial offer of $2,500. “County government is making it easier for local business to thrive in our communities, expand their operations, and hire new workers,” she said.

Retailers are not so sure.

“With the exemption, it effectively means businesses—job creators—are the ones who will end up paying the tax,” said David F. Vite, president of the Illinois Retail Merchants Association (IRMA).

Vite said rather than support local business, the use tax would extinguish marginal savings companies gain by buying outside the county.

“It’s a nice spin [to say] that it levels the playing field, but the fact is, county businesses would pay more money,” Vite said.

Public Benefit Argument
Preckwinkle says the taxes are intended to fight the two largest drains on the county’s budget: its public health and criminal justice systems.

Preckwinkle says she’ll use the taxes to curb behaviors blamed for bad health, social problems, and crime—meaning smoking, gambling, and violence. She said the targeted taxes would allow further reductions of taxes on other items.

“The higher we increase our cigarette prices, the more we discourage particularly young people from smoking and save [ourselves] the cost of treating people who are addicted to tobacco and nicotine,” Preckwinkle told the Chicago Tribune editorial board.

Some county board members expressed reservations, particularly regarding the cigarette tax increase. Cook County last raised the cigarette tax by $1 per pack in 2006. After an initial spike in cigarette tax revenue, tax collections plunged. By 2009, the county collected $20.4 million less than it had in 2005, according to county budget records. There are many anecdotal stories of cigarette buyers crossing into neighboring counties or Indiana, where cigarette taxes are much lower, to make their purchases.

Scrimping for Smokes
A September 2011 study for the New York State Department of Health points to evidence that as tobacco taxes nationally have risen, low-income smokers have not significantly cut back. Instead they have been spending more of their household income on cigarettes, going from an average of 12 percent to 23.6 percent since 2004.

Similarly, the executive director of the Illinois State Rifle Association said the proposed taxes on firearms and ammunition would have no impact on crime.

Richard Pearson called the proposals a “punishment on the wrong people” and said residents who collect firearms or shoot for recreation would make more gun and ammo purchases outside the county to avoid the taxes.

“The people who buy firearms and bullets in Cook County are not the gang bangers, they’re law-abiding citizens,” Pearson said.

Whitney Stewart (whitney.stewart04@gmail.com) writes from Minnesota.

IN OTHER WORDS . . .

“Michigan has long been thought of as a stronghold of big labor. But crushing defeats for two labor-backed constitutional amendments and the survival of two GOP incumbents on the state Supreme Court in the face of a well-funded campaign may signal waning power for organized labor in this state.

“The labor defeats in the Supreme Court race and proposed constitutional changes came on the same night in which Michigan voters gave President Barack Obama the state’s electoral votes and returned an incumbent Democratic U.S. senator to office. ...

“This does not mean that labor voices should not be heard in the councils of government. ...

“But this week’s defeats on specific labor issues in the face of other Democratic election victories indicate that labor’s influence is being tempered.”

— Detroit News editorial, November 8, 2012

“Cook County last raised the cigarette tax by $1 per pack in 2006. ... By 2009, the county collected $20.4 million less than it had in 2005, according to county budget records.”
Fiscal Cliff Looms: How Bad Can It Be?

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of his own in which he proposed delaying the arrival of the fiscal cliff for another year. In the meantime, Congress and the president could seek a mutually agreeable long-term alternative.

According to a November 9, 2012 article by Andrew Taylor, a reporter for The Associated Press who covered the press conference, “Boehner indicated that increasing the nation’s borrowing authority, which was a divisive issue in August 2011 talks, should be part of any talks in the coming weeks on avoiding the fiscal cliff. The government has said the nation won’t reach the debt limit until the spring.”

“It’s an issue that’s going to have to be addressed, sooner rather than later,” Taylor quoted Boehner as saying.

Boehner also has told reporters he may be more open to raising some taxes to help shrink the government’s budget deficits and growing national debt burden.

‘Looking for Solutions’

Meanwhile, Senate Majority Leader Harry Reid (D-NV), in a November 7 press statement, said, “Now that the election is over, it’s time to put politics aside, and work together to find solutions. The strategy of obstruction, gridlock, and delay was soundly rejected by the American people. Now, they are looking to us for solutions. We have big challenges facing us in the months ahead. Democrats and Republicans must come together, and show that we are up to the challenge.”

If the fiscal cliff goes into effect as scheduled, personal income tax bracket rates will climb from 10 to 15 percent, 25 to 28 percent, 28 to 31 percent, 33 to 36 percent, and 35 to 39.6 percent. Capital gains taxes would go from two brackets, one with a rate of 5 percent and the other of 15 percent, to three brackets with rates of 8, 10, and 20 percent, according to the nonpartisan Congressional Budget Office.

The current lower tax rates were designed to expire when Congress passed and Republican President George W. Bush signed temporary tax cuts into law. The tax rates would be reverting to what they were immediately before Bush took office on January 20, 2001.

Social Security Tax Hike

Social Security tax rates also would rise, from 4.2 to 6.2 percent for individuals and from 10.4 to 12.4 percent for persons who are self-employed, according to the CBO. The Social Security tax cut was not enacted as part of the Bush-era cuts. It was done in 2010 under Obama.

Estate taxes also are set to rise, from the current 35 percent rate with a $5 million exclusion, to the old 55 percent rate and $1 million exclusion. The alternative minimum tax “patch,” which has kept millions of persons from paying higher taxes, has already expired and would not be renewed.

In addition, a variety of tax increases as part of the Obamacare health insurance legislation are coming online.

Spending cuts—the “sequester”—are the other part of the fiscal cliff. The sequester calls for automatic across-the-board cuts that would lop $1.2 trillion from federal spending over 10 years.

‘Sequestration Is Bad’

Though many taxpayer advocacy groups favor spending cuts, some of them oppose the sequester. Ryan Alexander, president of Taxpayers for Common Sense, an advocacy group in Washington, DC, said in an October 1 statement, “Sequestration is bad. It is irresponsible. It would cut the best and the worst the government has to offer without distinction. And no amount of finger pointing can change the fact that both Congress and the President are responsible for this threat.”

The statement coincided with the release of the Taxpayers for Common Sense report, “Sliding Past Sequestration: Two trillion in common sense cuts to avoid the cliff,” which recommends spending cuts that could be achieved without hurting individuals or vital government services.

“[T]axes are the most worrisome part of the immediate picture. Families and businesses of all kinds will be hit with bigger bills—and, as a result, declining incomes, investments, and job opportunities...”

Pete Sepp
Executive Vice President
National Taxpayers Union

Pete Sepp, executive vice president of the National Taxpayers Union, a tax watchdog group based in Alexandria, Virginia, said, “All told, expiring tax provisions of various kinds, plus new taxes taking effect in 2013, amount to nearly five times more than the sequester, which will shave $109 billion from a federal budget of about $3.5 trillion [in the first year].

“With this perspective, it’s easier to see why, even from a Keynesian standpoint, taxes are the most worrisome part of the immediate picture,” he said. “Families and businesses of all kinds will be hit with bigger bills—and, as a result, declining incomes, investments, and job opportunities—from the tax hikes. Indeed, Congress should allow the sequester spending cuts to take effect, and reduce the negative impact that federal borrowing can exert on the economy.”

Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of two Heartland publications, Budget & Tax News and FIRE Policy News.
Georgia Voters Approve Charter Schools Measure

By Christine Ries

Georgia voters have approved an amendment to the state constitution that allows the general assembly to authorize charter schools even if they have been denied by local school districts.

Constitutional Amendment One won 58 percent to 41 percent in the November 6 election.

Groups including the Georgia School Boards Association and Georgia School Superintendents Association created an advocacy group that lined up funding, speakers, debates, and media contributions to oppose the measure. They argued school choice and new charter schools would drain resources from regular school district systems and hurt children “left behind” as programs including band and athletics are cut or eliminated.

Most voters rejected the argument and were right to do so, based on evidence that shows when charter public schools are created, the regular public schools do better, not worse. Their student achievement scores increase and they often manage to work more effectively on smaller budgets.

The economic reality is that building a vibrant charter school environment in Georgia means the traditional public schools’ band teachers will be able to purchase more clarinets and their football coaches will be able to buy more equipment.

Better Outcomes, Lower Costs

Developing a vibrant public charter school sector is also good for taxpayers, according to the findings in “Do Charter Schools Hurt Students in Traditional District-Run Schools?” published by the Georgia Institute of Technology. In Georgia, the public charter schools that were authorized by a previous state commission deliver significantly higher educational outcomes at 15 to 40 percent below the costs of regular public schools.

The report was written to explore the assumption that Amendment One meant robbing Peter to pay Paul. The study estimates the loss of revenue for each of Georgia’s 180 public school districts if a single child left the school (but remained living in the district) to attend a charter public school. It used the state education superintendent’s annual financial accounting to calculate the share of the school district’s costs that are “variable.” Those are the costs that would disappear when a child transferred out of the school.

The study compares the loss of revenue for each transferring child to the potential reduction in system costs to determine which districts would realize a financial loss or gain when one student left the district school system to enroll in a public charter school.

More for 129 of 180 Districts

Of Georgia’s 180 public school districts, 129 would gain financially for each child transferring to a public charter school, according to the report. For those districts, the possible reduction in costs for each withdrawal is greater than the reduction in state revenues. Gaining districts can potentially add an average of $1,218 to their school district budget for each child lost to charters. In the highest case, the Atlanta Public School District can potentially gain $6,507 for each child transferring to a public charter school.

The 129 districts that could realize financial gains enroll nearly 1.4 million, or 89 percent, of Georgia’s public school students. Those districts that can gain financially educate an average of 11,448 students. That is, these are primarily the largest districts and, therefore, the most likely environment for a financially viable charter school to emerge.

As expected, the remaining 51 school districts are primarily the smallest in terms of enrollment and number of schools. They enroll just over 164,000 students, or 3,221 students per district, and usually have five or fewer schools. Because economic viability requires that charter schools attract 800 to 1,000 students, they are unlikely to develop in districts with small school-aged populations. Therefore, it is highly unlikely these smaller districts would experience that net loss of resources.

Charter schools would not, on net, drain resources from the regular public schools. Instead, losing more costs than revenues means most public school officials should support rather than oppose the authorization of charter schools.

Christine Ries (christine.ries@gmail.com) is professor of economics at the Georgia Institute of Technology and author of “Do Charter Schools Hurt Students in Traditional District-Run Schools?”

“Our of Georgia’s 180 public school districts, 129 would gain financially for each child transferring to a public charter school ...”
Obamacare Tax Credit Could Head to the Courts

By Kathryn Watson

A new legal challenge could be brought against President Barack Obama’s law over questions about the federal government’s ability and legal authority to set up the health insurance exchanges critical to the law’s implementation.

At issue are a few missing critical words in the health care law. Obama’s law allows state-run exchanges to offer the tax credits and assess the penalties integral to Obamacare, but there’s no language authorizing federal exchanges to perform the same function.

Michael Cannon, director of health care policy studies at the Cato Institute, said the missing language explains a last-minute Internal Revenue Service rule change—a revision he maintains is illegal, designed to collect cash for federal exchanges that are otherwise unfunded.

“It’s called taxation without representation,” said Cannon. “It’s called taxation without congressional authorization.”

Flawed Funding Mechanism

Under Obama’s law, a health insurance exchange operates as a virtual marketplace in which people can purchase coverage from government-vetted insurers. The exchanges will cost money to run, but the text of the law authorizes only state-run exchanges to collect the cash and disburse the tax credits that are essential to the functioning of Obama’s law.

As many as 30 states have refused to set up state exchanges or have made no progress toward creating them. That would leave the federal government to establish the exchanges—without the revenue to operate them.

“There is no funding in Obamacare for a federal exchange—none,” Cannon said.

Cannon and his colleague Jonathan Adler, a professor at Case Western Reserve University School of Law in Cleveland, wrote in an extensive analytical paper that the IRS tried to correct the shortcoming in the law with its announcement after 6 p.m. on a Friday night in May that tax credits and revenue can be funneled through federal exchanges, too. Cannon and Adler argue that circumstances congressional authority, and it will soon be challenged in the courts.

Taxpayers on the Hook

Even with the cash collected by the IRS in the form of penalties assessed on non-compliant individuals and companies, the federal government will be forced into massive deficit spending to operate the exchanges, Cannon and Adler say.

The Congressional Budget Office estimated that in the unlikely scenario in which no states create exchanges, the operation of federal exchanges could cost the government $1 trillion or more over the next decade, offset by roughly only $172 billion collected from penalties. States that create their own exchanges will likely have to rely on deficit spending, too, as the federal government provides only start-up money, not operating funds, said Adler.

“On balance, this rule is a large net tax increase,” Adler and Cannon testified in August before the U.S. House Committee on Oversight and Reform. “For every $2 of unauthorized tax reduction, it imposes $1 of unauthorized taxes on employers and commits taxpayers to pay for $8 of unauthorized subsidies to private insurance companies.”

What Did Congress Intend?

Timothy Jost, a law professor at Washington and Lee University in Virginia, says federal exchanges were always meant to manage tax credits and revenues, and that the May IRS rule change is merely a clarification.

“I think they ignore the history of the bill, they ignore the structure of the bill, and they pick on a couple of particular phrases of the legislation and say that’s the only language in the legislation that matters,” Jost said.

Jost said it “never occurred to anybody” that federal exchanges wouldn’t be able to issue tax credits. He predicted the courts would defer to the IRS.

“They’ve come up with an interesting legal argument here,” said Jost. “They’ve convinced a few tea party legislators that there’s something there. But if it ever gets to court, the courts aren’t going to have too much trouble with this.”

Jost and others claim no business or individual could file a lawsuit earlier than 2014, once the penalties are in place, because of the Tax Anti-Injunction Act, which bars suits to restrain taxes before they’re levied. But Adler said he thinks the act won’t apply here, in the same way the Supreme Court justices in Spring oral arguments over the health care case decided they could move forward with the case even though the penalties hadn’t come into play.

Could Void Entire Law

Adler and Cannon say the law is clear.

And if the IRS rule is eliminated through the courts, Congress, or another IRS administrative rule change, states could opt out of the health care law with no penalties—making Obama’s law essentially void.

“Either it’s intentional—in which case, it’s the law—or it’s a mistake, in which case, it’s still the law,” Cannon said.

But whatever happens, Adler said this hiccup in the law illustrates a greater point.

“This is a massive piece of legislation [for which] people did not spend the time to understand how the pieces fit together,” Adler said. “My own view is, that’s not a responsible way to legislate. And this is but one example of many things I think will be found in the law as people try to implement it.”

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“"There is no funding in Obamacare for a federal exchange—none."”

MICHAEL CANNON, DIRECTOR OF HEALTH CARE POLICY STUDIES, CATO INSTITUTE

INTERNET INFO

By Steve Stanek

California voters have approved measures to raise taxes by billions of dollars and rejected a measure to stop labor unions from forcing members to pay dues for union-backed political activities.

Proposition 30, successfully championed by Gov. Jerry Brown (D), will raise California’s sales tax a quarter-cent on the dollar for four years and the income tax on annual earnings over $250,000 for seven years. The top tax rate on those earning more than $1 million a year will rise to 13.3 percent, up from 10.3 percent.

The measure is estimated to cost taxpayers another $6 billion a year.

“Last night, Californians made the courageous decision to protect our schools and colleges and strengthen the California dream,” said Brown in a statement. “We joined together as Californians first in a resounding victory for education and fiscal integrity. The people of California have put their trust in a bold path for our state because we will have more initiatives like these, more ways for government to grab our money. And there will be new things for us to pay for.”

The November 6 election results were a “total disaster” for California, said John Seiler, managing editor of CalWatchdog.com, a news Web site devoted to covering California governmental issues.

“Government unions are dominating everything here,” he said. “It’s a disaster for California because we will have more initiatives like these, more ways for government to grab our money. And the Legislature will be two-thirds Democrat, which means they’ll be able to do whatever they want to do. They need a two-thirds majority to pass tax increases, and now they’ll have it.”

Hedge Funds Benefiting

He added Proposition 39 was designed to steer money to hedge funds with energy investments.

“If you read it, you can see it’s to help hedge funds with alternative energy investments. Thomas Steyer will benefit,” he said.

Steyer is a billionaire hedge fund manager and environmentalist who poured $30 million of his own money into the Prop 39 campaign.

If there is any consolation for California taxpayer advocates, it’s that Proposition 38 was defeated. This measure was a rival to Proposition 30 that had the strong backing of Molly Munger, daughter of multi-billionaire Charlie Munger, vice chairman of Berkshire Hathaway Corporation, the multinational holding company run by fellow multi-billionaire Warren Buffett. Proposition 38 would have raised taxes $10 billion a year.

“We have the highest-paid public employees in the United States, according to the Census Bureau. Their ability to use paychecks for political activity makes them by far the most powerful political force in California. When they feel threatened, the amount of money they’re willing to spend to mislead voters is almost unlimited,” said Kris Vosburgh, executive director of the Howard Jarvis Taxpayers Association.

‘Rogue Corporate Interests’

Like Seiler, Vosburgh also slammed corporate cronyism in California politics.

“We have rogue corporate interests, too, like PG&E [Pacific Gas and Electric Company],” which provides natural gas and electricity to approximately two-thirds of California, he said. PG&E and other major corporations, including Kaiser Permanente, AT&T, and Bank of America, supported one or both of the tax increase measures.

“It’s hard to imagine with all the money in these elections, and companies like PG&E giving it out, it doesn’t have a powerful influence,” Vosburgh said.

Even the California Chamber of Commerce, which has many small businesses as members, took a neutral position. Vosburgh said many owners of small businesses will be hit with higher taxes.

“Jerry Brown tried to portray it as a millionaires’ tax even though it hits at $250,000, which hits a lot of small business owners.”

Kris Vosburgh, Executive Director Howard Jarvis Taxpayers Association

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Four A’s and Five F’s in Cato’s Governors’ Report Card

By Chris Edwards

The recovery from the recent recession has been very sluggish, and the nation’s governors have struggled with the resulting budget deficits, unemployment, and other economic problems in their states.

Many reform-minded governors elected in 2010 have championed tax reforms and spending restraint to get their states back on track. Other governors have expanded government with old-fashioned tax-and-spend policies.

That’s the backdrop to the Cato Institute’s 11th biennial fiscal report card on the governors, which examines state budget actions since 2010. It uses statistical data to grade the governors on their taxing and spending records—governors who have cut taxes and spending the most receive the highest grades, and those who have increased taxes and spending the most receive the lowest grades.


Partisan Divide

The report is nonpartisan and data-driven, yet all the governors who received A grades are Republicans and all who earned F grades are Democrats.

Rising debt and growing health and pension costs portend tax increases in many states. However, intense global economic competition makes it imperative that states improve their investment climates.

To that end, some governors are pursuing broad-based tax reforms, such as cutting income tax rates and reducing property taxes on businesses. The bad news is that many governors are expanding narrow “tax incentives,” which clutter the tax code in an attempt to micromanage the economy.

The Good

Here’s what the top-graded governors in Cato’s “Fiscal Policy Report Card on America’s Governors: 2012” did to receive their high marks:

• In Kansas, Brownback led lawmakers to cut the top individual income tax rate to 4.9 percent from 6.45 percent, increased the standard deduction, and lowered taxes on small business income.

• Corbett worked with legislators to cut Pennsylvania’s Capital Stock and Franchise Tax with the goal of ending it by 2014. That tax imposes an $800 million annual burden on businesses. Ending it would keep that money in the hands of businesses and the state’s economy.

• In Illinois, Quinn is a prime example.}

“In Kansas, [Gov. Sam] Brownback led lawmakers to cut the top individual income tax rate to 4.9 percent from 6.45 percent, increased the standard deduction, and lowered taxes on small business income.”

Cato Says These Four Governors Get an A …

Sam Brownback Kansas

Rick Scott Florida

Paul LePage Maine

Tom Corbett Pennsylvania

… While These Five Get an F

Pat Quinn Illinois

Dan Malloy Connecticut

Mark Dayton Minnesota

Neil Abercrombie Hawaii

Chris Gregoire Washington

Sears Holdings Corp., CME Group Inc. (which operates the Chicago Mercantile Exchange), and other large Illinois employers have been promised hundreds of millions of dollars of taxpayer handouts to stay in the state. The handouts came shortly after the state raised annual tax collections an astonishing $7 billion in 2011 by jacking up the personal income tax and corporate income tax 67 percent and 46 percent, respectively.

Increasing burdens on all businesses and individuals only to reduce them on a handful of businesses with political pull is no way to boost an economy.

Chris Edwards (cedwards@cato.org) is director of tax policy studies at the Cato Institute and author of the “Fiscal Policy Report Card on America’s Governors: 2012.”

Internet Info

Pressure Grows to Push State Pension Funding to Local Government Level

By Mary Petrides Tillotson

Economist Jonathan Williams says one way to solve state pension funding problems is to give local governments more control over and responsibility for their employees’ pensions.

Many states that are responsible for contributing to local employee pensions haven’t done so, spawning a national government pension crisis, said Williams, director of tax and fiscal policy for the American Legislative Exchange Council.

Because municipalities and school districts have less fiscal leeway, they are more likely to be financially responsible, he said.

“At the state level, you can just ignore the annual employee contribution. Many states have done it for a decade or two,” he said. “If you don’t make changes in pensions at the local level, it tends to eat up a big part of the local budget.”

Part of the problem, Williams said, is inherent in the political system.

“Let’s say we make a long-term promise. I might be out of office by the time the bills come due. It’s easy to make a promise and pass the bills down to future legislatures and future taxpayers. The bigger the promise, the bigger the liability problems,” he said.

State Law for Texas Cities

In Texas’s seven major cities, local pensions are funded by the local municipality but codified in state law, leaving city councils unable to reform their pensions.

“We’re advocating for returning that authority back to the local legislative body. They have to pay the bills,” said Talmadge Heflin, director of the Center for Fiscal Policy at the Texas Public Policy Foundation.

Currently, reducing retirement benefits, even for a cash-strapped city, would mean first changing state law.

Expansive Benefits

Many municipalities are finding they cannot afford their employees’ generous retirement benefits.

“It becomes a costly proposition to the pension system when you have a lot of people retiring at a younger age with rich benefits and living much longer, as they do today. That exacerbates the unfunded liability,” Heflin said.

A defined contribution system like the 401(k) accounts many private-sector workers have would give municipalities more control over future pension liabilities, Heflin and Williams said.

Illinois Tour

In Illinois, pension liability is “basically crushing the state,” said Kristina Rasmussen, executive vice president at the Illinois Policy Institute. The institute recently held a “Local Pension Accountability Tour,” a series of debates at eight locations across the state.

“At each event ... we really focus on making sure that people debating the issues aren’t singing from the same hymnal. It’s important to get different perspectives,” she said.

The tour served to educate voters and policymakers, giving them “more informed opinions.”

“It’s been great to hear people express their concerns, how it would affect them locally, what it means for teachers, parents, taxpayers, students,” she said.

School Pension Reform

The institute backs legislation to reform how teacher pensions are funded, among other changes in school finance regulations. In particular, it contends local districts, not the state, should make the employer contribution to the pensions.

Most citizens don’t need to worry about local taxes increasing if school districts begin covering it, Rasmussen said.

“A little-known secret is that many districts over time have decided to pick up and pay for the teacher portion” of the pension contribution, she said. “If you move the employer cost back to the district and the employee cost to the teacher, it could be a wash for many districts.”

Also, some districts “spike” teachers’ salaries during the last few years of employment to increase their pension benefits, Rasmussen said. School district responsibility for funding those spiked pensions likely would deter that practice, she said.

In addition, she said, the state should let up on some operational regulations and allow the districts more freedom in spending their own money.

“If they’re going to relocate the costs, you should give the entity that’s absorbing the costs some flexibility so they can better absorb the cost,” she said.

Fudging Numbers

The unfunded pension liability problem may be bigger than policymakers realize—or are willing to admit, Williams said.

“Sixth-grade math tells you that when you lose 30 percent and gain 30 percent [of the remainder] back, you aren’t where you started. That’s the problem. The pension problems have taken such a big hit from the 2008 crash that it’s going to take them a long time to get back.”

Previously, investors could count on an 8 percent annual return, but now 5 or 6 percent is the norm, Williams said. Yet policymakers are still relying on the old 8 percent figure to make budget predictions.

“The problems are much bigger than people see on paper every day,” he said. “When you change that expectation down to 6 or 5 percent, as actuaries have said we need to do, that absolutely explodes the unfunded liability. It’s just not sustainable to say we’re going to earn 8 percent. Now, for a decade, we’ve not been earning 8 percent.”

Williams said “it could be quite some time” before the economy fully recovers from the financial crisis of 2008.

“That means, absent reform, there’s going to be a serious cash-flow problem to cover pension liabilities, he said.

Mary Petrides Tillotson (mary.c.tillotson@gmail.com), a former Michigan reporter, now writes from Front Royal, Virginia.
**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.

**You Can Help!** By working together, we can rein in the Environmental Protection Agency! We can protect the environment without sacrificing jobs or our essential freedoms.

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**Competitive Bidding Saves Money for Municipal Water Systems**

**By Jeff Edgens**

Water infrastructure across the country is deteriorating and will cost municipalities $1 trillion over the next 25 years, according to the American Water Works Association.

A recent study prepared by Bonner Cohen of the Competitive Enterprise Institute suggests ways to bring down those costs. “Fixing America’s Crumbling Underground Water Infrastructure” instructs city governments to replace “outdated and prohibitive local procurement policies ... that discriminate against the use of innovative, more cost-effective material” with policies that encourage competition and innovation.

The report notes some municipalities are embracing changes to procurement systems and saving money. Unfunded mandates, shrinking tax bases, and increasing federal and state regulations all contribute to the fiscal woes local governments are confronting. This makes it more important than ever for political leaders to change the way they do business, Cohen says.

**Indy’s Mayor on Board**

Mayor Greg Ballard of Indianapolis, writing in the Mayors Water Council newsletter, explained the city has saved money by rethinking its materials procurement system “because the repair and replacement of collection systems was driven by aging pipes that were corroding and leaking water.”

As municipal governments move to an open and fair competitive bidding process, it drives down costs and encourages the use of newer and better practices and materials for water projects.

Ballard added in his article, “a lifecycle analysis found that PVC has both a longer useful life than traditional pipe materials, and has a lower cost to both install and maintain.” PVC now comprises 28 percent of Indianapolis’s total water distribution system with a 2.5 times lower failure rate than traditional iron pipes.

Indianapolis is a model for other cities such as Dalton, Georgia, the carpet capital of the world—nearly 90 percent of all carpet in the United States is made within a 25-mile radius of Dalton. This makes the carpet industry a significant user of the municipal water system.

**Dalton, Georgia Saves Big**
Dalton Utilities officials visited Indianapolis and saw the difference competitive bidding can bring to water infrastructure projects.

“Dalton has installed 750,000 feet of [polyethylene pipe] in the first phase of our project and went from a leaking, corroded system to a completely fused, homogenous system that won’t corrode,” said Steve Bratton of Dalton Utilities.

Dalton awarded its system improvements work to a local contractor who bid $5 million below the estimated $25 million price tag and completed the project in one year, three years sooner than utility officials expected. Finishing the project early has enabled Dalton to collect water revenue earlier than anticipated.

Other local governments in Georgia, including Cobb and Henry counties and the cities of Conyers, Sandersville, and Garden City, also have adopted the use of PVC in their water systems.

**INTERNET INFO**


“Dalton [Georgia] has installed 750,000 feet of [polyethylene pipe] in the first phase of our project and went from a leaking, corroded system to a completely fused, homogenous system that won’t corrode.”

Steve Bratton, Dalton Utilities

**Jef Edgens (jedgens@cei.edu) is an assistant professor of political science at East Georgia State College and an adjunct scholar with the Competitive Enterprise Institute in Washington, DC.**

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‘Tax Expenditures’ Nearly Match Federal Income Tax Collections

By Jeremy Horpedahl

The loopholes known as ‘tax expenditures’ reduce individual and corporate tax obligations by more than $1 trillion each year. But while these tax deductions are hugely popular and fiercely protected, are they really a good deal for most Americans?

“A Trillion Little Subsidies: The Economic Impact of Tax Expenditures in the Federal Income Tax Code” is a new Mercatus Center study that looks at the 10 largest tax expenditures for individuals and corporations and weighs the economic impact of each. The study also reviews the intended-vs.-actual beneficiaries and outcomes of particular tax expenditures and considers the economic and political implications of eliminating all expenditures in a single swipe.

According to the federal Office of Management and Budget, FY 2011 federal tax expenditures were more than $1 trillion—with 80 percent, or $891 billion, going to individuals, and 20 percent, or $181 billion, to corporations.

Breaks Equal Discretionary Spending
To put this in perspective: FY 2011 tax expenditures were nearly equal to all federal income tax collected in that year, or to the entire FY 2011 discretionary budget. They were greater than the annual federal spending on Medicare or Social Security.

Although applied through the tax code, their effect is similar to spending provisions, hence the name tax expenditures: They encourage certain kinds of government-supported behavior by subsidizing it. Because they are part of the tax code, however—reducing revenue from what it otherwise would be, rather than overtly increasing spending—they mask the true size and scope of government.

The paper argues tax expenditures hinder economic growth by distorting individuals’ and corporations’ behavior toward qualifying for tax loopholes rather than making the best economic decisions.

Big Economic Distortions
By distorting behavior, tax expenditures distort the entire economic system by altering spending on goods and services; distorting capital allocation; changing the distribution of income; and encouraging lobbying and rent-seeking to maintain and expand these provisions.

For example, corporations must divert significant resources away from pro-growth activities to the non-productive—but critical to compete with other U.S. corporations—activity of fighting and the distribution of income; and encouraging lobbying and rent-seeking to maintain and expand these provisions. Of the largest tax expenditures studied, the stated legislative intent was seldom realized.

Misdirected Benefits
The intended economic benefits seldom materialized, and the intended beneficiaries were seldom the greatest beneficiaries. Most tax-expenditure benefits accrue disproportionately to higher-income earners and encourage “gaming” the system by those in a position to take advantage, often resulting in cronyism and the capture of the tax code for private gain.

For example, while the encouragement of home ownership has become the common justification for the home mortgage interest deduction, it does not effectively achieve this goal. Of the 33 percent of taxpayers who itemize deductions, only 20 percent claim the home mortgage deduction. Of those, two-thirds make more than $100,000 a year.

Consequently, individuals and families on the margin who could be motivated to become homeowners by incentives—that is, lower-income individuals and families—are unlikely to use this deduction.

End and Cut
The paper concludes that economically optimal tax reform must include two key pieces: Eliminate all tax expenditures and lower marginal tax rates across the board enough to keep from raising taxes.

Eliminating expenditures without simultaneously lowering tax rates amounts to a tax increase on the economy as a whole. This would result in slower economic growth and, thus, lower future tax collections.

The report suggests a one-shot elimination of tax expenditures would be more probable than a piecemeal elimination. This is because the former would give all taxpayers an immediately recognizable benefit (such as an increase in individuals’ paychecks or a significant reduction in lobbying and accounting expenses for businesses) to offset later.

The benefits of eliminating tax expenditures include less distortion, a simpler tax code, and less money spent on lobbying and rent-seeking. All of these changes would benefit the economy at large, and the nation, the study concludes.

Jeremy Horpedahl (horpedahl@bv.edu) is an assistant professor of economics in the H.W. Siebens School of Business at Buena Vista University in Storm Lake, Iowa and author, with George Mason University graduate student Brandon Pizzola, of “A Trillion Little Subsidies.”

IN OTHER WORDS . . .

“‘Next to language, money is the most important medium through which modern societies communicate,’ writes Bernd Widdig in his masterful analysis of Germany’s inflation crisis ‘Culture and Inflation in Weimar Germany.’ His may be an abstract observation, but it has the commendable merit of being true: all economic activity requires the cooperation of strangers and therefore, a degree of trust between cooperating strangers. Since money is the agent of such mutual trust, debasing money implies debasing the trust upon which social cohesion rests.

‘So I keep wondering to myself, do our money-printing central banks and their cheerleaders understand the full consequences of the monetary debasement they continue to engineer? Inflation of the CPI might be a consequence seen, though not measurable. But what about the consequences that are unseen but unmeasurable—and are all the more destructive for it? I feel queasy about the enthusiasm with which our wise economists play games with something about which we have such a poor understanding.”

— Dylan Grice, Societe Generale research analyst, “Popular Delusions” column, October 2, 2012

INTERNET INFO

**Ending Mortgage Interest Deduction Being Floated Again**

By Daniel J. Pilla

As the federal government grows increasingly desperate for money, Congress looks for more creative ways to grab more of our cash. One sure way to raise taxes without necessarily raising tax rates is to do away with deductions.

The current budget battles have brought the mortgage interest deduction under attack yet again.

The idea of killing the mortgage interest deduction was floated in the early 1990s by the Clinton administration as a way of getting its arms around annual deficits, which at the time were about $400 billion. Today’s annual deficits are more than three times that amount, which is why politicians on both sides of the aisle believe they need to grab more cash.

The attack on the mortgage interest deduction in the 1990s resulted in limits to the amounts that may be deducted. For example, no deduction may be claimed for interest on a primary mortgage to the extent the loan exceeds $100,000. And no interest can be claimed on a home equity line of credit to the extent it exceeds $100,000.

**Two Possibilities**

The ideas currently being batted around include two possibilities. The first would be to eliminate the deduction for mortgage interest on a second home. Under the current law, you can deduct mortgage interest on a second residence if you use it as a personal residence at least 14 days out of the year.

The second idea is to kill the deduction for mortgage interest on a home equity line of credit. As mentioned, there is already a severe and strict limitation on the ability to deduct mortgage interest on an equity line of credit. Most people (and too many tax pros) are not familiar with this limitation and they end up stuck with tax bills when the IRS audits their returns.

But if the current idea morphs into law, there will be no allowable deduction for interest on a home equity line of credit. As such, the tax debt of the typical home-owner family will likely rise because many have used their equity lines to buy big-ticket items they otherwise would have had to finance independently, and for which the interest would be non-deductible. Examples include cars, boats, and vacations.

The idea of killing the interest deduction on second homes is fueled by the same class-warfare, greed, and envy-mongering that fuels much of the tax debate today.

The other reality that’s overlooked in this debate is that while the mega-rich often own multiple homes in exotic locations, those homes are largely paid for and carry no mortgages. Thus, the elimination of the deduction for interest on a second home will have little or no impact on that group of citizens.

Another important consideration is that to the extent middle-income Americans own second residences in vacation regions of the country, most of those properties function as commercial rental properties. In that regard, they are income-producing assets, not merely extravagant indulgences of a rich fat cat.

And to the extent that income-producing assets incur interest charges, that interest is fully deductible, regardless of the current or proposed future limits on the mortgage interest deduction for a person’s primary residence. The reason is that the tax code fully recognizes expenses necessary to earn income are deductible from the gross receipts earned by the activity, whether it’s a rental activity or otherwise. Nothing in the proposed limitations would change that.

**Money in the Middle**

Consequently, the only people who would pay more taxes as a result of this are in the middle-income group. Proponents of these changes know that. The middle is where the money is. There are not enough rich people who claim mortgage interest deductions on second homes to make a difference.

In fact, there’s not much to be gained at all by eliminating the deduction. The Treasury Department estimates disallowing the deduction would raise tax revenue $7 billion to $8 billion annually—hardly close to filling the budget hole Congress has dug. Even that figure could be high because those estimates are based upon the assumption that the top tax bracket will return to the 36.5 percent level that was in effect before the Bush tax cuts of 2001 and 2003.

What they really want to do is kill the deduction altogether. Such a move would net closer to $130 billion per year in increased taxes to the federal government. Congress does not have the political nerve to propose an outright elimination of the deduction outside the context of major tax reform.

The changes that would be brought about by these proposals would make middle-income Americans poorer without solving any of America’s debt problems.

Our tax code is a deplorable mess and must be bulldozed. We have to start over, with an entirely new system that spreads the burden of taxation across all economic lines in a rational, constitutional manner.

Dan Pilla (pillatax@aol.com) is a tax litigation consultant and author of 11 books on IRS defense strategies. He runs the TaxHelpOnline.com Web site and publishes the Pilla Talks Taxes newsletter, where a version of this article first appeared.

**INTERNET INFO**

“Ten Principles of Federal Tax Policy,”

Dan Pilla: [http://www.heartland.org/budgetandtax-news.org/article/28542](http://www.heartland.org/budgetandtax-news.org/article/28542)
Michigan Voters Nix Tax Measure

By Michael D. LaFai

Michigan voters in the November 6 election rejected a statewide ballot initiative for a constitutional amendment to make it more difficult to raise state taxes.

Proposal 5 called for a two-thirds supermajority vote of both the Michigan House and Senate, or a simple majority vote of the people in a November election, to impose new state taxes or raise existing state taxes that currently need only a majority vote of the legislature.

The measure failed by a vote of 69 to 31 percent.

Initiatives Swept to Defeat

“It looks like Proposal 5 got swept up in the enthusiasm to reject each of the six proposals on the ballot this year,” said James Hohman, assistant director of fiscal policy for the Mackinac Center for Public Policy. “This is unfortunate since it would have improved Michigan’s fiscal landscape.”

Proposal 5 stated the amendment “shall in no way be construed to limit or modify tax limitations otherwise created in this constitution.” This language means Proposal 5 would have left unaffected the state constitution’s 1978 Headlee Amendment, which contains a variety of tax and revenue limitations on state and local government. The proposal also would not have changed the state’s constitutional requirement of a three-quarters supermajority vote of both the state House and Senate for any increase in the state education property tax.

Opponents Joined Forces

Prominent Michigan politicians and government unions led the fight against Prop 5. Those publicly opposing the measure included Republican Gov. Rick Snyder, Democratic Mayor Virg Bernero of Lansing, Chief Randall Talifarro of the Lansing/East Lansing Fire Department, the Michigan Manufacturers Association, and numerous Michigan labor unions.

In a video ad against the measure, Snyder said it would establish “minority rule” on tax policy.

Among the supporters were the Michigan branch of the National Federation of Independent Business and Michigan Alliance for Prosperity.

Sixteen states have a legislative supermajority tax vote requirement, and 30 have a tax or expenditure limit like the Headlee Amendment. Michigan would have had both types of limitations under Proposal 5—and to some extent already does, given the state’s supermajority tax vote requirement for raising state education property taxes.

Michigan’s recent history does not suggest a supermajority tax vote requirement would have made raising taxes impossible. When the legislature passed a $1.4 billion increase in personal and business taxes in 2007, the state House and Senate did not meet the two-thirds threshold that Proposal 5 would have required. Nevertheless, most of the Republicans who voted against the tax hike ended up voting for much of the spending associated with the new tax revenue. Had they been faced with the possibility of not having this money due to a two-thirds tax vote requirement, many of them might have provided votes for the tax hike after all.

Michael D. LaFai (lafaive@mackinac.org) is director of the Morey Fiscal Policy Initiative at the Mackinac Center in Midland, Michigan.
Michigan Voters Slap Down Union-Backed Job Proposal

By Mary Petrides Tillotson

Michigan voters defeated the union-backed Proposal 2, with 58 percent voting no and 42 percent voting yes. “I had full confidence in Michigan voters that they’d see the union power grab for what it was,” said Vincent Vernuccio shortly after the November 6 election results were known. Vernuccio is director of labor policy at the Michigan-based Mackinac Center for Public Policy.

Proposal 2, or the Protect Our Jobs Amendment, would have added union collective bargaining rights to the state’s constitution. That would have turned every collective bargaining session into a “mini constitutional convention” and made labor union leaders more powerful than legislators, Vernuccio said.

‘Tired of Forced Unionism’

Greg Mourad, vice president of the National Right to Work Committee, said he expected the proposal to be defeated but was surprised at how soundly it lost.

“The people of Michigan are even more tired of forced unionism than we thought they were,” he said.

Vernuccio noted that even though Proposal 2 was handily defeated, President Barack Obama carried Michigan in his successful bid for re-election.

“This shows that even Obama Democrats would not vote for the union special-interest power grab, and that represents a change in the country. Traditional Democrats are no longer rubber-stamping union demands,” he said.

Vernuccio said the proposal’s defeat was good news for Michigan.

“It means that Michigan families have just avoided subsidizing special interests. Michigan workers, Michigan families, Michigan employees, and Michigan taxpayers have avoided losing the $1.6 billion projected savings Proposal 2 would have overruled,” he said.

Savings Were At Risk

A recently passed 80/20 law, which requires government employees to pay 20 percent of the cost of their own health insurance, easily could have been overturned under the Protect Our Jobs Amendment, if a union had challenged it. Taxpayers then could have been responsible for 100 percent of a government employee’s health insurance.

Under the amendment, a teachers union also could have overruled a law requiring that school officials consider several factors, not just seniority, when deciding which teachers to fire or lay off.

Individuals Still Protected

The amendment would have empowered unions instead of individual workers and prevented any reforms on existing bargaining systems—and prevented the state from passing a right-to-work law, Mourad said.

Under right-to-work laws, union membership cannot be a condition of employment, he said. When workers are permitted to leave unions, and not pay dues, union leaders become more responsive to union workers’ needs. This makes for better unions, he said.

States with right-to-work laws are attractive to companies, and that brings jobs to the state, he said.

“I think this is a pretty clear sign that Michigan is ready for a right-to-work law. That would be great news,” he said. “If they can pass one, it’ll be more jobs, more economic opportunity, and more interest in Michigan.”

Mary Petrides Tillotson (mary.c.tillotson@gmail.com), a former Michigan reporter, now writes from Front Royal, Virginia.

“I think this is a pretty clear sign that Michigan is ready for a right-to-work law. ... If they can pass one, it’ll be more jobs, more economic opportunity, and more interest in Michigan. ...”

GREG MOURAD
VICE PRESIDENT
NATIONAL RIGHT TO WORK COMMITTEE

Missouri Stubs Out Cigarette Tax Hike

By Steve Stanek

The third time was not the charm for supporters of a higher cigarette tax in Missouri, as voters rejected for the third time in 11 years a ballot measure to raise the state’s cigarette tax.

“While 21 percent of Missouri adults smoke, 51 percent of voters rejected another attempt to raise the state’s cigarette tax at the ballot box. This is evidence that nonsmokers understand that targeted tax increases on cigarettes and other products prop up more government spending and do nothing to prevent future tax increases,” said John Nothdurft, director of government relations at The Heartland Institute, which publishes Budget & Tax News.

Missouri has the lowest state cigarette tax in the nation, at 17 cents a pack, according to the Tax Foundation. Proposition B, which appeared on the November 6 ballot, would have raised it to 90 cents, still below the national average of $1.49 per pack.

Shopping Lure

The low cigarette tax lures shoppers from neighboring states to Missouri to buy cigarettes and, often, other things as well, said Ronald Leone, executive director of the Missouri Petroleum Marketers & Convenience Store Association. The organization led the opposition to the tax increase.

“If we can give common-sense Missourians the facts, we’re confident they’ll make the right choice,” Leone said.

He said many voters were turned off by such a large tax increase. They also doubted the promises of politicians on how the money would be spent.

Voters also understood the low tax draws shoppers from other states and realized some of that business would be lost if the cigarette tax were to take a big jump, he said.

Education, Smoking Cessation

The Missouri state auditor’s office estimated the state government could have collected as much as another $423 million annually if voters had approved the tax increase. Proposition B had the support of the American Cancer Society and public school officials, among others. Legislators had said they would spend the additional money on education and smoking cessation programs.

In a November 7 article in the Kansas City Star newspaper, reporter Bill Draper of The Associated Press quoted state Rep. Chris Kelly (D-Columbia), who sponsored the measure, as saying, “It was the most important thing on the ballot, more important than any statewide candidate, for the well-being of both the kids in Missouri and our economic development.”

Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of two Heartland publications, Budget & Tax News and FIRE Policy News.
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Chicago Mayor Warns of Huge Pension Shortfall

By Phil Britt

The City of Chicago needs $1.5 billion a year beginning in 2016 to shore up its pensions for municipal workers across police, fire, water, and other municipal departments as well asfor elected officials, Mayor Rahm Emanuel has warned the city’s aldermen.

Like many pension fund managers, city officials had hoped above-market returns on investments would help cover funding shortfalls. However, investment performance has not met the optimistic return projections, making the shortfall from the city’s contributions worse.

Bringing the issue to a head in the next few years is a state mandate that municipalities start paying enough in 2015 to ensure fire and police pension funds are at least 90 percent funded within 30 years.

Reform, Cut, or Tax

In presenting his annual budget to the city council in October, Emanuel cautioned without state pension reform it will be difficult to avoid a major property tax increase or dramatic cuts to services in future budgets.

“If we can realize all of the goals set forth in this budget, we can make Chicago the best city in the country to start a business, find a job, and raise a family,” Emanuel said in his budget address.

He continued, “It has been a long road to get to where we are today. We have all worked hard to get the city to a point where we can balance our budget, invest in our children, improve our neighborhood services, make fundamental reforms to our government, strengthen our commitment to public safety, all while holding the line on taxes. But if we do not come to terms with our past and fix the crisis surrounding our pension payments, our work will be for naught,” he said. “The residents of Chicago elected us to tell the hard truths so that we can make the tough decisions. We need to be honest with everyone about the challenges we face and the difficult choices we must make to solve them.”

$22.8 Billion Liability Increase

The city’s current pension woes are due in part due to a large increase in underfunding.

According to “Status of Local Pension Funding,” a report released in 2012 by the Chicago-based Civic Federation government research organization, between fiscal years 2001 and 2010 the aggregate unfunded actuarial accrued liabilities for the city’s 10 pension funds increased $22.8 billion, from $4.6 billion to $27.4 billion.

Unfunded liabilities per capita in Chicago for the 10 local funds rose from $1,189 in fiscal year 2000 to $8,993 in fiscal year 2010.

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

Educa on Funds Are Wasted on Master’s Degrees

By Ashley Bateman

Although master’s degrees in education do not link to better instruction, states spent nearly $15 billion in the 2007–08 school year on this wasteful “master’s degree bump,” according to a summer report.

“The Sheepskin Effect and Student Achievement” quantifies a long-studied difficulty: Though some research has shown math and science teachers improve instruction by earning a master’s degree, 90 percent of teachers who hold master’s degrees are no more effective than those without them.

The economic research demonstrating this waste has been clear for a long time, says Jason Richwine, a Heritage Foundation senior policy analyst.

“The real contribution [the report] adds is it quantifies how much money is actually being spent on the master’s ‘bump’,” Richwine said. “We’ve known for a while that the master’s degree is not a useful thing for the teachers to get. It’s making education reform a bipartisan issue.”

The pay bump artificially increases the number of master’s degrees, the authors found, and soaks up funds school districts could use on measures that actually increase student performance. Districts also often pay extra to reimburse teachers for graduate tuition, but the authors found most teachers left the classroom before the financial gain of earning a master’s outweighed related costs.

“The U.S. has too much debt. This is no longer a controversial statement. Some may believe other problems are more urgent, or that we need to grow our way out rather than slash spending. But even the most spendthrift pundits acknowledge that the debt-to-GDP ratio of the U.S. must decrease if we are to have a stable, prosperous economy.

“The private sector has reacted to this overindebted reality as you would expect: by deleveraging. Since 2008, households and businesses have extinguished 67% of their debt when measured against GDP. Some paid debt down purposefully, and others defaulted. For our purposes, it doesn’t matter how the debt went away. Only that it did.

“Meanwhile, the government has done the exact opposite. It has upped its own borrowing by 52% of GDP since 2008.

“As a result of these countervailing forces, the aggregate debt-to-GDP ratio has declined only slightly since 2008. Had the government not stepped in, the US economy would be well on its way to a sustainable debt path. Instead, it has shed [debt worth] a paltry 15% of GDP. In other words, government borrowing largely offset private deleveraging.”

Social Security Old Age and Disability Benefit Payments Hit Record High

By Cheryl K. Chumley

The federal government hit a new high in Social Security and disability benefit payments a full month before the end of the fiscal year on September 30.

By the end of August—and with a month to go in the fiscal year—the government had paid out just under $595 billion in benefits from the Old Age and Survivors Insurance Trust Fund. In all of fiscal 2011, by comparison, OASITF payments were about $591 billion.

Payments for federal disability insurance benefits also set an annual record in just the first 11 months of fiscal 2012.

In fiscal 2010 the government spent $120.126 billion on disability benefits; in fiscal 2011, it was $129.094 billion in benefits from the federal disability insurance trust fund. Through all of fiscal 2011, the government paid $128.094 billion in disability benefits.

In fiscal 2010 the government spent $123.038 on disability benefits; in fiscal 2009, it was $115.086 billion; in fiscal 2008, $104.328 billion; and in fiscal 2007, $97.061 billion.

The data are taken from the Monthly Treasury Statement for September 2012.

Expected Baby Boom Bounce

As dramatic as the numbers seem, at least one expert advises calm. Lawrence Summers, president of the Social Security Institute, a nonprofit group dedicated to reforming the system, says 2012 is a difficult year to compare with past years of benefit payouts because it includes expected bounces from the Baby Boomer effect.

“First, 2012 is an ‘odd’ year in that there is an unusual bulge in the growth in Social Security recipients, and hence benefits paid this year, 2012,” Summers said. “This was not a surprise, and it is a result of the beginning retirement of the ‘pig in the python,’ the Baby Boomers. In other words, this increase is not due to something wacky or unexpected or unusual going on.”

However, he added, the numbers do point out the crucial need to overhaul Social Security.

“This is not to say the program is not out of actuarial balance over the long run,” he said. “Congress’s appalling handling of Social Security makes Hoffa’s misuse of Teamster pension fund monies pale by comparison. Just because it’s Congress, however, doesn’t make it any less criminal than what Hoffa or company did.”

‘Going to Get Worse’

Jason Fichtner likewise wasn’t surprised at the growing Social Security payout. “But what might be surprising to people is to know that it’s just going to continue to get worse,” he warned.

Fichtner is a senior research fellow at the Mercatus Center at George Mason University and formerly held several positions at the Social Security Administration, including acting deputy commissioner, chief economist, and associate commissioner for retirement policy.

“The increase in Social Security payments is a result of the Baby Boomer generation retiring and more people turning to the disability program due to the recent slow economic growth,” he said. “Additionally, the slow economy has kept job creation low and, hence, payroll tax revenue is low as well.”

The solution, Summers said, consists of two steps. Step one, he said, is for Congress to honor the payout promises that were made at the program’s inception.

“It offers them an enormous lever to cut the rest of government. It puts seniors on their side, and it requires the country to prioritize spending with Social Security at the top,” he said. “Then, once everyone is guaranteed they won’t do any worse than they’ve been promised, give everyone the option either to stay in the old program or voluntarily get out” and invest in private retirement plans.

Cheryl K. Chumley (ckchumley@gmail.com) writes from Northern Virginia.

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How to Limit Social Security’s Drag on Economic Growth

By Charles Blahous and Jason Fichtner

Despite the lack of action, most policymakers understand the urgency of the federal entitlement crisis and, specifically, the need to reform the largest entitlements—Medicare, Social Security, and Medicaid—to constrain cost growth.

Less frequently discussed, however, is the importance of reforming these programs in a way that ensures their future operation doesn’t unnecessarily constrain broader economic growth, labor participation, and savings.

A new study from the Mercatus Center at George Mason University finds pro-economic growth entitlement reform must not only rein in unsustainable cost growth. It also must remove the barriers to labor force participation and disincentives to personal savings currently embedded in the largest entitlement programs generally, and the Social Security program in particular.

“Limiting Social Security’s Drag on Economic Growth: Program Reforms to Facilitate Labor and Savings Formation” stresses several key points, including:

Entitlement reform must constrain costs and correct economic disincentives. The primary driver of unsustainable federal spending growth is federal entitlement spending. Without effective reform, the largest entitlement programs cannot continue to function effectively. Their unchecked growth will require an insupportable burden of federal taxation and indebtedness that limits the nation’s potential for economic growth.

Economically sustainable entitlement reform must focus on:
1) reining in unsustainable program costs; and
2) correcting economic disincentives currently embedded in the programs—Social Security being a key case in point.

There can be no ‘fix’ to the entitlement crisis without meaningful spending reform. Attempting to fund currently projected entitlement spending growth through increased borrowing or increased taxes would be an ineffective and economically crippling approach.

Economically sustainable Social Security reform promotes work and savings. Several design features of Social Security undercut our national economic growth potential. These include disincentives for work, savings, investment, and caring for dependent children.

To ensure Social Security is economically sustainable in the future, these flaws must be corrected as a part of comprehensive reform to control costs.

Various reforms to encourage work—such as adequately compensating those in early- and middle-age who extend their working years—would benefit both Social Security’s specific financing and general economic growth.

Studies of other nations show increased levels of personal savings and investment (including private accounts) have led to increased economic growth. In recognition of the extent to which both Social Security finances and general economic growth depend on future growth of the working population, the report explores a fertility-neutral payroll tax system to finance Social Security as an alternative to the current system of compensating parents through the income tax code.

Charles Blahous (info@economics21.org) is a public trustee for Social Security and Medicare, a senior research fellow with the Mercatus Center at George Mason University, and author of Social Security: The Unfinished Work. Jason Fichtner (jfichtner@gmu.edu) is a senior research fellow at the Mercatus Center. Previously, he served in several positions at the Social Security Administration, including as deputy commissioner of social security (acting), chief economist, and associate commissioner for retirement policy.
**Perils of Money Manipulation Explained**

By Edmund Contoski

American Liberty Publishers, Minneapolis, MN, 2012

206 pages, $19.95. ISBN: 978-0-9655007-0-8

**Review by Jay Lehr**

Edmund Contoski’s *The Impending Monetary Revolution, the Dollar and Gold* is as an important addition to the discussion and understanding of monetary policy and its effects on economies, societies, and individuals.

The book will improve your understanding of what money is, why the European Union is doomed to failure, why inflation ultimately creates recessions, and why it is impossible for a country to inflate its way out of a recession.

The book would be even better if it had less political partisanship and the author made greater efforts to prove some of the causal relationships he identifies. It also would have benefited from more varied citations supporting the author’s assertions. However, Contoski gets the big things right and has an intensely interesting story to tell.

Probably few readers have a real grasp of the complex financial instrument called the credit default swap. These insurance-like contracts pay buyers when bonds default. CDS prices rise when bonds’ creditworthiness deteriorates. Contoski explains how incredible volumes of these contracts are temporarily propping up bankrupt members of the European Union, and how they became bankrupt.

**See Long Ago**

The author notes problems of this nature were recognized by Thomas Jefferson and George Washington, who said, “Paper money has had the effect in your state that it will ever have, to ruin commerce, oppress the honest and open the door to every species of fraud and injustice.”

Washington was speaking of “fiat” money, which is now used in major countries around the world. It’s called fiat because it is created by government order, or fiat. It is paper money that has nothing of real value supporting it, such as gold or silver. The U.S. dollar is a fiat currency.

Contoski explains how bank notes and checks simply grew out of receipts given by goldsmiths who were the keepers of the valuable resource in an earlier day. The U.S. Constitution never gave the federal government the power to print paper money, he says, but the government eventually assumed that power.

Few people today realize that President Franklin Delano Roosevelt, feeling his administration threatened by the value of gold in the face of the government’s paper money, made it illegal to own gold. Everyone was forced to turn in their gold or risk going to prison.

Contoski also tells wonderful contemporary stories of intrigue, such as how a woman working at Goldman Sachs was able to disguise Greece’s debt for several years while collecting $300 million for the effort. JP Morgan worked similar magic for Italy.

**Fannie’s, Freddie’s Failures**

Contoski makes the failures of government mortgage behemoths Fannie Mae and Freddie Mac easy to understand, and he names politicians who created the housing bubble, starting with the Community Reinvestment Act in 1977 and its subsequent amendments, and continuing through the Dodd-Frank Act of 2010.

President Richard M. Nixon ended all pretense the dollar was backed by gold in 1971 by unilaterally ending the Bretton Woods Agreement of 1944 that linked the dollar to gold. Nixon did this because some other nations’ governments were stockpiling gold instead of dollars in recognition of the eventual worthlessness of most paper money.

Contoski also dismantles the economic theory of Depression-era economist John Maynard Keynes, who argued governments can stimulate economies by spending lots of money. It never works over the long haul. Contoski states Keynes’ doctrine grew out of his desire to subordinate liberty and individual rights to a plan of coerced social “improvement.”

Contoski also explains the history of property rights and their importance to a free society, noting the Founding Fathers feared what the French economist and philosopher Frederic Bastiat later wrote about more than 160 years ago: “When plunder becomes a way of life for a group of men living together in a society, they create for themselves in the course of time a legal system that authorizes it and a moral code that glorifies it.”

Redistributionist government policies and handouts of social welfare and corporate welfare are the plunder the Founders feared and Bastiat described.

**Constitutional Corrections**

A most refreshing part of this book is Contoski’s recognition that it is unlikely any politician can cure the nation’s economic problems, considering their never-ending desire to win votes by pleasing their constituents. He concludes only a Constitutional convention to change the rules for running government can work, and state legislators should be willing to call one in order to get their government back.

Contoski recognizes the difficulty of reforming the federal government, but he convinced me that a few Constitutional amendments, in the states’ favor, could right a century of wrongs and bring the federal government back under the states, which created the federal government. States have allowed themselves to become subservient to the Feds, which was never intended by the nation’s Founders.

Contoski describes a relatively simple set of amendments that could easily pass in a convention and put us back on track. I will not divulge them here—you must get the book for that.

I promise you that every fifth page of this book you will be thinking, “If only my economics teacher had been able to explain things this well years ago, I would not have had to be silent on so many issues in which the government undermined our free society.”

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