The Bottom Line

PA Property Tax Reform
Although a grassroots effort to shift Pennsylvania’s heavy property tax into a broader and fairer tax structure was stalled by legislative leaders and activists, lawmakers remain optimistic about their chances in 2015. Page 3

Year-End Spending Sprees
Confirming many people’s suspicions about federal agency spending, a new study finds government departments actually do go on spending sprees at the end of the year, and the fiscal rules under which agencies operate may be a primary culprit. Page 6

Philly Ridesharing Crackdown
Granted police powers by the state legislature, the city of Philadelphia’s parking authority began seizing private cars, under the guise of enforcing health safety—and they say they’re proud of their hard work. Page 7

Green Appliance Subsidy
The federal government’s attempts to convince homeowners to trade in old home appliances and buy new, more energy-efficient ones was largely a bust, according to new economic research. Page 9

Congress OKs $1.1 Trillion ‘Cromnibus’ Spending Bill

By Jesse Hathaway
In mid-December 2014, the outgoing 113th Congress agreed on a $1.1 trillion government spending bill, keeping the federal government operational until the end of the next fiscal year in September 2015.

Funding for all government agencies except the Department of Homeland Security (DHS) was included in the “cromnibus bill,” a combination of “continuing resolution” and “omnibus bill.”

The budget for DHS was separated from the larger spending bill early in the bill’s genesis as part of congressional Republicans’ plan to use DHS funding as leverage against President Barack Obama’s November 2014 executive action to shield illegal immigrants from deportation. DHS’s budget is expected to begin running dry in February 2015, by which time the new Congress elected in November 2014 will have taken office. CROMNIBUS, p. 8

CPSC Offers Bad Tidings of Yule Season Rules

By Hannah Yang

Federal consumer safety regulators made the holiday season less festive for homeowners this year as a wave of new product safety rules took effect in December.

The Consumer Product Safety Commission (CPSC) issued rules banning the sale of some types of decorative holiday lights, stating the action would reduce deaths.

The new regulations classify “seasonal and decorative lighting products” with wire gauges smaller than 0.8 millimeters as “substantial product hazards,” citing as justification a fatality rate of just over one death per year associated with holiday lighting.

To compare, actuarial risk estimates suggest near-Earth-objects (NEOs) col U.S. House Speaker John Boehner answers questions on the “cromnibus” bill prior to its passage in mid-December 2014.
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Property Tax Reform Gains Support in Pennsylvania Statehouse

By Dotty Young

A lthough a bill aimed at relieving tax burdens for homeowners was halted without receiving a full hearing during the 2014 legislative session, support for property tax reform in Pennsylvania has grown since the November elections.

Several new incoming state representatives campaigned on supporting comprehensive reforms of the state’s tax structure, nicknamed the Property Tax Independence Act (PTIA), suggesting a future attempt at the bill may be more successful.

PTIA was approved by the respective originating Pennsylvania House and Senate committees, but it stalled while under consideration by other committees. The bill will have to be reintroduced next year, as the state’s legislative session has ended.

“There are other areas around the state that have a big property tax problem,” the bill’s primary sponsor, state Rep. James Cox (R-Berks), said. “As I talk to other members in the House, they’re saying the same things that we see in Berks County.”

‘Ancient Formula’

“Where [the property tax problem] comes from” is an ancient formula—and I say ancient, it’s from the 1990s—that funds our schools, and there’s this little provision in there, a ‘hold-harmless’ provision,” Cox said. “If you had 1,000 students in 1991—when the formula was put into place—you got a set amount of money for those students. Let’s say they’d be getting $100,000 under our state budget for those 1,000 kids.

As the state’s population shifted from west to east, however, the formula remained unchanged. Overcrowded eastern schools were forced to make do with inadequate state funding, while western schools continued to receive the same amount of money.

“We in the eastern part of the state are educating more students but not getting the proportional share of funding that we should get from the state, because those counties with dwindling populations simply don’t need the money, but they get it, because of that hold-harmless provision,” said Cox.

“We aren’t getting what we need from the state, so we had to raise it in local property taxes.”

Cox, who initially drafted PTIA in 2003 as a legislative staffer, said, “It generates the same amount of money in sales and income tax that the local property tax generates, statewide,” he said. “When you’re looking at replacing $10 billion in property tax, you find that the only place you can get that are very broad taxes like the sales and income taxes.”

If passed by both chambers of the legislature and signed into law next year, the act would gradually decrease property taxes and shift the burden to sales and income taxes. Estimates by supporters of the act say the sales tax would increase by one percent and the personal income tax would increase by 1.27 percent.

Better Luck Next Year

“The bill would raise state taxes on personal income and sales to eliminate property taxes levied by the state’s 500 school districts,” said Eric Montart, a senior policy analyst at the Allegheny Institute for Public Policy. “The proposal would apply to school property taxes only—it would not affect municipal or county property taxes—and would apply to all types of property ... residential, commercial, industrial, and so on.”

Optimistic about the bill’s chances next year, Cox noted his proposal progressed farther than in past attempts. “We’ve reached the highest number of cosponsors, we got a high level of traction on it, but we just could not get our caucus leaders to get behind it,” he said.

“This is the opportunity for people to finally have home ownership—the opportunity for people to control their level of involvement in how much taxes they pay,” Cox said. “People can finally own their homes; they don’t have to worry about paying rent to a school district—to the tune of five, six, eight, ten thousand dollars a year. That kind of money in people’s pockets would be huge.”

Dotty Young (dottyjyoung@yahoo.com) writes from Ashland, Ohio.
dangerous or defective parts, as “voluntary conformance” with industry standards is nearly universal.

Walter Olson, a senior fellow at the Cato Institute’s Center for Constitutional Studies, criticized the new rules against cheery Christmas lights, explaining, “the CPSC—like other agencies—has an interest in justifying its own existence.”

“Part of the politics of the CPSC is that, after decades, rulemaking kind of became an embarrassment for advocates at the agency,” Olson added. “Critics were saying, ‘look at you, you don’t have any rulemaking, you’re not an independent agency. We should throw you back into the Department of Commerce.’ You see, back then they could have recalls but no rulemaking.

“They’ve become somewhat truculent from all the criticism,” Olson said, noting CPSC actions and regulations often seem to be intended to send a message: “See how much you laugh when we send our lawyers after you.”

“It’s interesting that the great majority of lights sold would be compliant with the rule they’re proposing—which raises a number of questions,” Olson said. “As we know from other CPSC regulations, it can be quite expensive to comply with a CPSC rule, even if your product is not in violation.”

WALTER OLSON, SENIOR FELLOW, CATO INSTITUTE

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INTERNET INFO
San Francisco Voters Sour on Soft Drink Sin Tax

By Paula Bolyard

San Francisco voters in November rejected a proposal to add a new tax on sugary beverages sold within the city—a “sin tax” with the stated goal of reducing consumption of the products.

If enacted, the ballot proposition would have added roughly 24 cents in excise taxes on every can of soft drinks sold in retail stores, increasing government revenue by an estimated $31 million per year.

Nudging Consumers

Sin taxes levied on soft drinks are “intended to discourage consumption of sugar-sweetened beverages by making them more expensive,” said Jacob Sullum, an award-winning journalist and senior editor at Reason magazine.

“The hope is that less soda drinking will translate into fewer total calories consumed,” he said, “which will reduce obesity and the health problems associated with it.”

In 2009, Lisa Powell, a University of Illinois-Chicago professor of health policy and administration, found no causal links between sin taxes and improved health outcomes.

In her review of research literature, Powell wrote, “no studies to date have linked tax data to individual-level data to derive BMI [body mass index] or obesity tax elasticity estimates.”

In her study, Powell explains the statistically noisy nature of collected data—numerous social and economic factors interfere with the link between applied sin taxes and food and beverage choices.

‘Weak Evidence’

In 2012, Dr. Oliver Mytton, an Oxford University academic clinical fellow, and Wellington University economics teacher Dushy Clarke published a study in the British Medical Journal, also reviewing empirical evidence regarding the efficacy of taxes on allegedly unhealthy foods and drink.

“Even if consumers respond to the tax by consuming less of the targeted beverages—as opposed to buying them in other municipalities, buying cheaper brands, or reducing spending on other items—they may not consume fewer total calories. That depends on whether they increase consumption of other foods as they cut back on sugar-sweetened soft drinks.”

JACOB SULLUM
SENIOR EDITOR
REASON

Unforeseen Consequences

Citing a 2011 study by United States Department of Agriculture (USDA) Senior Economist Biing Hwan-Lin and University of Florida-Gainesville Department of Food and Resource economics professor Jong-Ying Lee, Mytton and Clarke noted taxes are an inefficient method of encouraging good nutrition, as a 20 percent tax on sugar would “reduce the prevalence of obesity by only 3.5 percent.”

“Even if consumers respond to the tax by consuming less of the targeted beverages—as opposed to buying them in other municipalities, buying cheaper brands, or reducing spending on other items—they may not consume fewer total calories,” Sullum said. “That depends on whether they increase consumption of other foods as they cut back on sugar-sweetened soft drinks.”

Evidence of substitution by “vice” consumers was collected by University of Maryland economics professor William Evans in a 1998 study of national health data. Using anonymized data from tobacco users interviewed by the National Center for Health Statistics, Evans concluded, “taxes do not alter average daily nicotine intake among tobacco users, another consumer demographic targeted by policymakers for taxation over past decades.

In fact, Evans’ study observed tobacco users switching to “higher-yield cigarettes,” a pattern that “mitigates many of the health benefits of tax-induced smoking cessation.”

Noting the general failure of sin taxes to mold human behavior, Sullum suggests a simple solution for reducing obesity.

“A free-market solution already exists,” Sullum said. “It’s called diet soda, which I consider a perfectly adequate substitute.

“I gather that not everyone agrees,” he added.

Paula Bolyard (paula.bolyard@gmail.com) writes from Doylestown, Ohio.
Budget Rules May Encourage Agencies’ Year-End Shopping Spree

By Alexander Anton

Scholars from the Mercatus Center at George Mason University searched numerous public spending databases for evidence of wasteful “use it or lose it” spending by government agencies.

As described in Missouri State Auditor Thomas Schweich’s 2012 examination of state spending practices, government officials often have “a concern that expiring funds would result in future agency budget cuts,” as budget rules at both the state and federal level often prevent most agencies’ unused balances from being carried over into the next fiscal year.

In late September, Mercatus Center Senior Research Fellow Jason Fichtner and Frédéric Bastiat Fellow Robert Greene examined the scholarly research on year-end spending surges, as well as public data on state and federal government spending.

Fichtner and Greene could not establish solid evidence of causality between the budget rule and spending patterns, but Fichtner says he believes the study did help provide a better understanding of the correlation between the rule and agencies’ spending habits.

“The aggregate spending patterns tell an interesting story that we feel requires further research and congressional oversight,” Fichtner said.

‘Not Optimal’

Fichtner says the study suggests “the current budget rule of use-it-or-lose-it is not optimal and may be encouraging wasteful spending of taxpayer dollars.”

Last year, Harvard University professor Jeffrey B. Liebman and University of Chicago professor Neale Mahoney submitted a study on this topic to the National Bureau of Economic Research. Using data from the Federal Procurement Data System and the White House’s IT Dashboard, Liebman and Mahoney created mathematical simulations of congressional appropriations and agency spending, modifying the simulations to predict the effects of reform ideas.

According to Liebman and Mahoney, “the prospect of expiring funds” scares agencies into spending the rest of their allotted money, “even if the marginal value is below the social costs of funds.”

Explaining the results, Liebman and Mahoney said their study provided “some evidence on the causes of lower performance at the end of the year,” as “contracting officers face substantial time pressure at the end of the year, obtaining fewer bids for each contract and choosing to use less time-intensive contract vehicles when they have sufficient discretion.

“We assume that agencies—and their employees—do not have self-control problems,” Liebman and Mahoney said, noting alternative hypotheses exist, such as “agencies may save lower priority projects for the end of the year” and may start those low-priority projects only when funds permit.

Fichtner and Greene’s work is based more on a broader review of government spending than is the NBER study. The Mercatus Center study examined records from numerous sources, including the Federal Procurement Data System, Federal Assistance Award Data System PLUS, SmartPay, Federal Assistance Award Data System, Catalog of Federal Domestic Assistance, Federal Funding Accountability and Transparency Act Subaward Reporting System, and Catalog of Federal Domestic Assistance.

By summing monthly expenditures for each executive department and creating weighted averages for agencies’ monthly spending, Fichtner and Greene were able to determine how the calendar month may be affecting an agency’s spending. All but two federal departments—the Department of Energy and the Department of Veterans Affairs—spent more money during the last month of the fiscal year, September, than in the first month of the year, October.

More Oversight Needed, More Often

“Our findings were shocking,” Fichtner said. “If an agency were to spread its contract spending evenly over a 12-month period, roughly 33 percent of spending would occur in each month. However, in September 2013 the Department of State spent 38.8 percent of its contracting expenditures, and the Department of Health and Human Services spent 28.7 percent.”

Fichtner does not characterize their study as definitive, instead saying these budget rule effects merit further study.

“Anecdotal stories about the State Department spending $1 million on a sculpture for the embassy in London or $400,000 for a statue of a camel for the embassy in Pakistan are numerous and have been widely covered in the news,” Fichtner said. He suggests more frequent congressional oversight reviews and budget rule reforms as possible solutions.

“The question remains,” he concluded, “if such spending is indeed wasteful, what can be done to reduce it?”

One suggestion Fichtner and Greene’s study proposes is allowing “agencies limited rollover—also known as carry-over—authority for funds not spent by the end of the fiscal year. In order to improve accountability, we’d also suggest that Congress conduct more oversight, throughout the year, of where agencies spend their money and when.”

Fichtner’s proposals echo suggestions made in Liebman and Neale’s narrower study.

“A natural way to increase efficiency would be to allow organizations to roll over budget authority across years,” Liebman and Neale wrote in their study. “Under such a system, budgeting would still occur on an annual basis, but rather than expiring at year’s end, unused funds would be added to the newly granted budget authority in the next year.”

Alexander Anton (alexanderanton.heartland@gmail.com) writes from Robert Palatine, Illinois.

INTERNET INFO

Philadelphia Vows to Seize Residents’ Property in Ridesharing Crackdown

By Tom Blumer

Uber, the smartphone-driven ride-sharing company, launched its UberX service in Philadelphia in late October 2014, prompting a regulatory crackdown by the city’s transportation enforcement agency.

Uber Black, Uber’s luxury-level ridesharing program, was barred from the city until Uber agreed to comply with Philadelphia’s licensing and supply restrictions. Unlike Uber Black, a popular option for already-licensed cabbies, UberX drivers use their personal vehicles.

The Philadelphia Parking Authority (PPA), tasked with regulating all cabs and limousines in the city, enforced city regulations against “unauthorized service providers,” classifying UberX as an illegal taxi operation.

Artificial Scarcity

In 1982, the Pennsylvania legislature passed the Philadelphia Streets Department and the Revenue Department to enhance PPA’s parking and street regulation efforts. Other law enforcement powers gifted to the agency include the authority to impound vehicles and issue tickets.

State lawmakers expanded the agency’s authority again in 2004, authorizing it to regulate all taxicabs and limousines operating in Philadelphia.

Undercover Stings

Contradicting the agency’s stated mission of providing “an efficient, well-organized transportation system that serves the needs of the public and encourages economic development,” PPA began conducting undercover sting operations against UberX drivers on October 26, responding to the company’s announcement of UberX services within the city.

As reported by Victor Fiorillo, senior reporter for Philadelphia Magazine, PPA officials promised to seize vehicles as a response to UberX’s expansion into the area, vowing to “take the vehicle off the streets” and “impound the vehicle” being used.

During a 2013 wave of sting operations against Uber competitor SideCar, PPA officials told Fiorillo such companies “have absolutely no authority to operate here. They have nothing.”

Adam C. Smith, an assistant professor at Johnson and Wales University, criticized Philadelphia’s sting operations as “obvious rent-seeking, pure and simple.”

“You see that places like Philadelphia, where [the taxi industry has] a lot of power, they’re going to exercise that power in very explicit ways,” Smith said. “Other places, like DC and Chicago, you’re seeing the opposite. You’re seeing consumers and the new firms winning out in the debates.”

Regulatory Capture

In testimony submitted to the Pennsylvania Public Utility Commission (PAPUC), PPA regulator James Ney claimed he was carrying out the wishes of the business community, citing local companies as having “requested and embraced” government control of the market.

Ney’s testimony touted the city’s effectiveness at placing the market under government control. “Unlike many other U.S. cities, Philadelphia has been successful at keeping the so-called ‘Ride-share App’ companies such as SideCar and Lyft out of operation,” he told the commission.

Responding to criticism of his agency’s “hardnosed” market planning, Ney characterized PPA’s centralized distribution and planning of cab routes as consumer-friendly mandates.

Studies Deny Alleged Benefits

Transportation policy research, however, does not support claims of positive market effects from regulation.

In 2013, Turkish economics professors Tamer Çetin and Kadir Yasin Eryigi studied New York City’s heavily regulated taxicab industry, investigating the economic effects of government regulations on consumer fares. Çetin and Eryigi found “unique empirical support” for economic claims of adverse market effects caused by government regulation, describing a relationship where “regulation causes an increase in medallion prices, and this increase in medallion prices drives up taxi fares when the number of taxis is restricted by government regulation.”

Speaking of Çetin and Eryigi’s empirical confirmation of economic theory, Smith said the Turkish researchers’ study was “absolutely” correct.

“Medallion prices have outperformed the Standard & Poor’s 500 index,” he noted. “Forget gold, buy medallions!”

“When you have all the money in an industry locked up in making supply scarce, then clearly the money’s going to go to vendors, at the expense of consumers,” said Smith. “Once supply is allowed to increase, the price has to fall, just based on a standard supply-and-demand analysis.

“In the long run, the voters and consumers are going to win,” Smith said. “It is unfortunate to see some of these practices, in the interim.”

Tom Blumer (tblumer@monetary matters.com) writes from Mason, Ohio.

FIXING PUBLIC PENSIONS


by Kim Crockett

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Tom Blumer (tblumer@monetary matters.com) writes from Mason, Ohio.
Any bill that requires bipartisan support to pass probably contains a mix of good and bad. The bill helps to prevent a taxpayer bailout of Obamacare insurance companies, but more is needed to make that fully waterproof.

ROMINA BOCCIA
FEDERAL BUDGET EXPERT
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THE HERITAGE FOUNDATION

By Matt Kelly

Advocates of the growing micro-housing movement are trying to promote smaller housing alternatives for people pursuing simpler lifestyles. “Micro-apartments” and “tiny houses” are typically less than 300 square feet in area, a fraction of the average American home’s 2,600 square feet.

Often weighed down by credit cards and student loan debt, millennials in particular find these minimalist dwellings—many selling for $23,000 or less—an attractive path to homeownership, allowing them to avoid 30-year mortgages.

Local-government zoning laws and homeowners associations’ regulations, however, are suppressing this innovation.

In a dismal job market, parents are taking out student loans in their own names in order to send their kids back to school. In a rush to move out of mom and dad’s place, twenty-somethings are finding micro-housing an affordable alternative. With the additional long-term trend of shrinking family sizes, the emergence of micro-housing as an affordable housing solution is quite understandable.

Regulators have been slow to accommodate this phenomenon. Local zoning laws often require living areas to exceed 500 square feet, serving to make micro-housing illegal in most places.

Hacking Around Regulations

To get around these limitations, micro-housing enthusiasts have established unique strategies. Seattle micro-apartment developers have exploited a loophole in which kitchens, not sleeping units, are counted for the purpose of regulating development. To bypass the rules, developers attach multiple micro-apartment units to one communal kitchen.

Because recreational vehicles do not require a building permit, tiny houses are often built on wheeled trailers and classified as mobile homes. Regulatory problem solved—for now.

Though ingenious in their legal maneuvering, builders and residents remain stuck in a legal grey area. Cities have withheld utility services, condemned properties, and even bulldozed homes in communities where the micro-housing movement is considered an unwelcome intrusion.

Some municipalities, however, have altered their zoning laws to attract micro-housing. In August, Spur, Texas became the first self-proclaimed “tiny house friendly town” by removing square-footage regulations.

Seattle, already home to several burgeoning micro-apartment complexes, lowered its minimum area allowed for individual apartments to 220 square feet in October 2014.

No SmallFeat

Micro-housing is gaining media attention, but it still represents only a small portion of the overall housing market. Only one percent of U.S. buyers acquire homes of less than 1,000 square feet.

The micro-housing movement will probably not dominate the U.S. landscape anytime soon, but the entrepreneurs who have spearheaded this cottage industry have enabled a previously underserved population to avoid accumulating large amounts of additional debt while owning their own homes.

That’s no “tiny” accomplishment.

Congress OKs $1.1 Trillion ‘Cromnibus’ Spending Bill

Continued from page 1

Despite the increase in the amount of funding over last year’s omnibus bill, Senate Democrats essentially threatened during floor arguments to push for a government shutdown, objecting to provisions in the cromnibus weakening some parts of the Dodd-Frank Wall Street Reform and Consumer Protection Act, a set of financial regulations enacted in response to the 2008 recession.

The year-end spending bill removes the Dodd-Frank “swap push-out rule” requiring banks to segregate from their primary actions certain classes of derivatives trades. The push-out rule prevented banks from holding derivatives trades in banking units insured by the Federal Deposit Insurance Corporation.

Efforts to chip away at the sweeping power of Dodd-Frank had begun earlier in 2014 over Democrats’ vigorous objections. In testimony before the U.S. House Appropriations Committee in June 2014, Rep. Kevin Yoder (R-KS) explained an early, standalone version of the provision as being “about the farmer in your district who wants to get a loan.”

Sen. Elizabeth Warren (D-MA), leading a small contingent of dissenters in the U.S. House and Senate, called the rider “risky for our economy” and had urged her counterparts in the House of Representatives to remove the provision.

Bitter Pills

House Democrats, including outgoing Rep. Carl Levin (D-MI), voiced displeasure about the changes to Dodd-Frank, but they accepted the deregulatory move as the price of passing the larger bill.

At a breakfast meeting sponsored by the Christian Science Monitor, Levin told reporters he would “be voting to keep the government open,” even if that included small measures of deregulation as a concession.

“Now, what do people like me do who want to keep the government going? I end up voting for the bill,” he said.

Other concessions Republicans extracted include a $345 million reduction in the Internal Revenue Service budget and a ban on taxpayer bailouts of insurance companies through the Affordable Care Act. The cromnibus bill also extended for one year the Internet Tax Freedom Act, a moratorium on local and state taxation of Internet access.

“Any bill that requires bipartisan support to pass probably contains a mix of good and bad,” explained Romina Boccia, a federal budget expert with The Heritage Foundation’s Roe Institute for Economic Policy Studies. “The bill helps to prevent a taxpayer bailout of Obamacare insurance companies, but more is needed to make that fully waterproof.”

Jesse Hathaway (jhathaway@heartland.org) is managing editor of Budget & Tax News.
Govt. Green Appliance Subsidy Called Half-Baked

By Jesse Hathaway

Academic research examining the outcomes of a green subsidy program in the American Recovery and Reinvestment Act of 2009 has found the program largely failed to achieve its stated goals.

The State Energy-Efficient Appliance Rebate Program—commonly referred to as Cash for Appliances (C4A)—was a green subsidy program inserted into the American Recovery and Reinvestment Act of 2009, the federal government’s effort to revitalize the American economy after the 2008 financial collapse.

Intended to encourage consumers to trade inefficient home appliances for ones with lower energy demands, C4A was part of national politicians’ larger plan to accelerate the economic recovery by using increased government spending and manipulation of consumers’ economic behavior.

Announcing the new subsidy program in July 2009, U.S. Department of Energy Secretary Steven Chu promised C4A would “help families make savings every month,” said Chu.

**Stimulus, Response**

Like a similar government rebate program enacted in 2009, the Car Allowance Rebate System—commonly known as Cash for Clunkers—C4A’s goal was removing inefficient products from use and replacing them with efficient models, tying environmentalist policy goals to economic rewards for consumers.

Spending $300 million of taxpayer money, C4A gifted funds to state governments, who in turn rewarded consumers who purchased qualifying appliances.

In a study released by the National Bureau of Economic Research in October 2014, Sébastien Houde, assistant professor of economics at the University of Maryland, and Joseph Aldy, assistant professor of public policy at the Kennedy School of Government at Harvard University, examined individual transaction-level data on appliance sales from each state’s individual implementation of the C4A program. Contrary to the high hopes expressed by Chu’s press release, empirical data collected by Aldyis and Houde show C4A “did not have a meaningful impact on” energy consumption.

**Economic Laws Remain**

C4A’s failure to achieve its stated goals was predictable, says Veronique de Rugy, a senior research fellow at the Mercatus Center at George Mason University.

“It’s assumed that, when someone switches appliances and reduces his energy bill, the laws of economics are suspended. They aren’t,” she said.

“When the price of energy goes down, people tend to increase their consumption, hence [there is] no or little energy savings.”

C4A, de Rugy explained, attempted “to convince people to buy something they had no intention of buying,” so it turns out “the people who are using the program would have changed their consumption anyway.”

Noting the rebate program’s failure to achieve its goals, de Rugy offered an alternative for policymakers seeking to use market forces to reduce energy consumption.

“The only free-market policy is to get rid of all subsidies and let the market allocate resources to their best uses,” said de Rugy.

-Jesse Hathaway (jhathaway@heartland.org) is managing editor of Budget & Tax News.
By Robert Poole

In November 2014, the company that had won a 75-year concession contract to operate, maintain, and improve the 157-mile Indiana Toll Road (ITR) filed to begin Chapter 11 bankruptcy proceedings.

Critics of the original 2005 Indiana Toll Road transaction are cheering, hoping this event will derail the growing trend of private investors moving into the U.S. highway sector. That, fortunately, is not likely to happen.

In the original deal, Indiana Gov. Mitch Daniels (R) persuaded the state legislature to outsource the management and operation of the state’s most important highway, Interstates 80 and 90, to a competitively selected consortium for 75 years.

The winning bidder was required to offer 75 years of lease payments in an up-front lump sum. The highest bid was submitted by a joint venture of Spanish toll-road company Cintra and Australian investment bank Macquarie, bidding a whopping $3.8 billion—far more than anyone expected.

Post-Mortem

What went wrong?

Two factors were responsible. First, the company based its financing model on an overly optimistic projection of traffic and toll revenue. Second, it used a very aggressive financing structure, requiring large debt service payments toward the end of the first decade of the 75-year agreement. The 2008 recession torpedoed both assumptions, making it impossible to meet the upcoming debt service payments.

The Indiana Toll Road Concession Company (ITRCC), 50 percent of which is owned by Cintra and the remainder owned by two Macquarie funds, reached an agreement with its principal creditors on a “pre-packaged” Chapter 11 process. They will seek a new operator to take over the remainder of the 75-year concession agreement, subject to approval by the Indiana Finance Authority.

If that effort fails, ITRCC will complete a financial reorganization to recapitalize itself with a reduced debt structure. Typically in such reorganizations, the company loses all or nearly all of its equity investment and the creditors accept a haircut on debt obligations.

For customers of the Indiana Toll Road, things will proceed as usual. There will be no interruption of service, no increases in toll rates, and no changes in the performance requirements embodied in the 75-year concession agreement. Taxpayers will likely experience no impact at all, and there will not be a taxpayer-funded bailout.

Taxpayers Unaffected

Despite ITRCC’s current troubles, Indiana comes out of this deal in great shape. The $3.8 billion worth of up-front lease payments was used to pay for a 10-year highway capital improvement program that proved very popular.

Contrary to early critics’ predictions that Daniels would pay a high political price for “selling the family silver,” he was reelected by a wide margin to a second and final term.

Indiana Toll Road customers today have a much better highway than before. Since taking over in 2006, ITRCC has invested $458 million into the toll road, adding new lanes, rehabilitating bridges and pavement, and implementing a new electronic tolling system, the 15-state E-ZPass system, to replace the former cash tolls.

A 2012 opinion survey found 76 percent of the road’s customers have a favorable impression of the highway, and it has high ratings on bridge sufficiency and pavement condition, consistent with requirements of the concession agreement.

Doom and Gloom Predictions

Mother Jones magazine featured the lease in a major story that was critical of long-term concessions, called “The Highwaymen.” The authors quoted several critics saying Indiana had let the tollway go at a “fire sale price,” implying ITRCC would make an enormous return on its investment thanks to ever-higher toll rates.

This prediction ignores the large expenses involved in operations and maintenance, improvements over 75 years, and likely reconstruction and replacement of all the pavement, let alone debt service costs.

Rep. Peter DeFazio (D-OR) called the deal “a license to print money.” He and the late Rep. James Oberstar (D-MN) even called for congressional legislation to outlaw the leasing of existing highways—which, fortunately, went nowhere.

So what can we learn from this latest chapter in the ITR saga?

Most importantly, this event demonstrates that long-term toll concessions protect taxpayers. The risk of construction cost overruns and of inadequate traffic and revenue are shifted from taxpayers to sophisticated investors.

Even though ITR was an existing highway, it has been measurably improved during its first decade under private management and operation and has not experienced a dip in maintenance or development quality as a result of ongoing financial problems.

Teachable Moment

Infrastructure investment funds are not fleeing from long-term highway concessions. The impending bankruptcy filing of ITRCC has been rumored for the past year, yet the Florida Department of Transportation had no problem getting financing in the summer of 2014 for its $2.3 billion concession for the Orlando I-4 reconstruction and modernization project, which plans to add four express toll lanes.

Although Indiana used its $3.8 billion up-front payment to fully fund a 10-year highway improvement program, state departments of transportation should not optimize bidding competitions to seek up-front windfalls. Such rigging may well lead the winning bidder to take on excessive debt, jeopardizing its ability to run the project as a business.

Even more importantly, a long-term concession is intended to be a true public-private partnership over many decades. Having the concession company make monthly or annual lease payments provides both parties with ongoing incentives to work together to make their partnership succeed. It also avoids the unfairness of charging higher tolls to toll road users to pay for highways elsewhere in the state, which should be paid for by their own users.

Robert Poole (bob.poole@reason.org) is a Searl Freedom Trust transportation fellow and director of transportation policy for the Reason Foundation. An earlier version of this story appeared at Reason’s Out of Control Policy Blog at http://www.reason.org/blog. Reprinted with permission.
Study Says States Skimping on Pension Funding

By Jesse Hathaway

Despite requirements to fully account for and balance spending and revenue, state governments are carrying a massive amount of unfunded liabilities on their accounting sheets, endangering the finances of future taxpayers and retiring public-sector employees alike.

New research conducted by State Budget Solutions (SBS)—a nonpartisan public policy organization focusing on local and state budget issues—estimates the total of states’ unfunded public pension liabilities to be $4.7 trillion, an increase of more than 14 percent since 2013.

SBS determined state public pension plans are able to pay only 36 percent of their combined obligations to retiring U.S. public-sector workers. If the value of the remaining unfunded liability were split among all American citizens, each person would have to pay more than $15,000 to fulfill pension promises made by state and local governments.

“Our research shows that despite the rosy investment numbers that you might hear this year, state pension plans have a serious, structural issue that needs to be solved sooner rather than later,” said Joe Luppino-Esposito, general counsel for SBS.

Smoke and Mirrors

By using accounting tricks and gimmicks, public-sector pension fund managers have worked to conceal the funds’ inability to keep promises of lavish benefits and pensions. By assuming that future years will bring better investment returns, state pension funds are able to give the appearance of better financial health than may actually be the case.

After assessing the real health of states’ programs by calculating the difference between projected investment return rates and realistic rates of investment returns, SBS crowned California with the dubious honor of being the largest carrier of unfunded liabilities.

According to the report, California’s public pension system carries $754,049,342 in unfunded pension liabilities—sticking every resident with the equivalent of a bill for $19,671.

Wisconsin’s public pension system is in the best shape, relatively speaking. Using the amount of money the system might realistically expect to receive in the future, the Badger State is able to pay about 67 percent of its total obligations.

This success, the report notes, is primarily due to relatively realistic assumptions for future returns—Wisconsin pension projections plan for receiving 5.5 percent annually on pension investments. Most states assume future returns in the neighborhood of 8 percent. By contrast, private-sector investment firms generally assume returns of about 2.5 percent.

“States use higher discount rates in order to put as little money into the system as possible today, assuming great gains in the future,” Luppino-Esposito said. “What makes this worse, is when politicians ‘borrow’ from the pension plan’s required contributions in order to ‘balance’ the regular budget.”

The report singles out New Jersey as especially prone to skipping out on its pension obligations, noting the Garden State has reduced its annual pension funding by $2.4 billion in order to increase spending elsewhere. The ratio of the state’s unfunded pension liabilities—$200,150,052—to the value of the state’s total economic output is 37 percent, larger than 41 other states.

“The liability also takes up large percentages of the gross state product of every state, making it clear that we can’t just tax our way out of the problem,” said Luppino-Esposito.

Stuck with the Bill

The SBS report calculates each pension fund’s unfunded liabilities on a per-capita basis, a useful figure. By simulating the equal division of a state’s unfunded liability among all residents, differences between states can be held equal, as the data are instead presented in terms of how it would affect any single resident.

Although the report described state government pensions as generally “gloomy,” Luppino-Esposito says it is not impossible to avoid the “bleak” predictions detailed within the report.

“State residents should be on the lookout for reforms when they arise in their states. Those who support these pension plans’ risky accounting are quick to demonize reformers for trying to ‘steal’ pensions from teachers and firefighters. Don’t believe them,” he said.

“Pension reform ensures that the money is still there for government employees, and also ensures that the government has enough money to pay the teachers and firefighters currently on the job,” Luppino-Esposito said.

Jesse Hathaway (@jthathaway@heartland.org) is managing editor of Budget & Tax News.

IN OTHER WORDS . . .

“A recent report from Moody’s Investor Services explains that even though the 25 largest state pension plans have been very close to meeting ... lofty investment return goals in the last 10 years, their unfunded liabilities are nearly $2 trillion.

“Second, state governments are often guilty of exacerbating the high discount rate problem by not making the necessary annual contributions to the pension funds. State Budget Solutions found that in recent years several states have reduced the annual required contribution to the pension funds, or just skipped the payment altogether. New Jersey is the latest state to pull off this budget gimmick, reducing this year’s payment by a whopping $2.4 billion as a way of ‘balancing’ the state’s budget.

“Though public pension plans have been vocal in their opposition to our analysis, their annual filings tell a different story. Even by the states’ own generous assumptions, the combined public pension plans stand at only 72.5% funded and just over $1 trillion in unfunded liabilities.”

—Joe Luppino-Esposito, writing for State Budget Solutions, November 12, 2014

INTERNET INFO

Fed Morphs from Central Bank to Central Planner

By Jeffery Rogers Hummel

A common concern among critics of recent Federal Reserve policy is that it does not have an adequate exit strategy to shrink its balance sheet.

Since the financial crisis of 2007 and 2008, the value of its assets has risen nearly fivefold, from less than $900 billion to nearly $4.5 trillion.

This ongoing quantitative easing appears to create a looming monetary overhang that could unleash significant inflationary forces once the economy reaches full recovery.

Measurements of the most liquid parts of the overall money supply—physical cash, checking accounts, and other easily liquidated assets—show banks’ overall reserve accounts exceed 100 percent. As interest rates begin to rise, some banks might give more loans to create more assets, in turn causing the broader measures of the money stock to “explode.”

Tools of the Trade

The Federal Reserve (the Fed) has created or expanded its tools in an effort to prevent any sudden expansion of broader monetary measures.

“Quantitative easing has converted the Fed into a financial central planner, in which the Fed, rather than the market, determines the allocation of large amounts of credit.”

During the crisis, the Treasury created a special deposit account at the Fed, in which it lodged more than half a trillion dollars “borrowed” from the public. However, this borrowing was not for financing government expenditures.

Instead, the Treasury simply lent the money to the Fed, which in turn lent the money to acquire assets that appeared on its balance sheet without an impact on Fed-created money. The Treasury simply withdrew this money from circulation, while the Fed injected it back into the economy.

The Fed has also engaged in direct borrowing, through what are called reverse repurchase agreements, or “reverse repos.” In a reverse repo, the Fed uses its securities as collateral for short-term loans.

Nudging Banks

However, the most important way the Fed borrows is through an indirect transaction, paying interest to banks on their reserves.

Ben Bernanke, the former chairman of the Federal Reserve, received authorization to do this with the Troubled Asset Relief Program in 2008. Effectively, the Fed created money through quantitative easing and then borrowed it back from the banks by paying them interest.

On April 30, 2010, the Fed announced the creation of the Term Deposit Facility (TDF). This is a mechanism through which banks can convert their reserve deposits at the Fed into deposits of fixed maturity at higher interest rates set by auction—making them just like Fed-provided certificates of deposit for banks.

By using these four tools, the Fed doesn’t actually have to sell off a single asset if interest rates start to rise. If interest rates climb, the Fed can simply raise interest rates on reserves and other forms of borrowing. By draining reserves or locking them up in the banks, the Fed will perpetuate its enormous impact on the allocation of savings, while preventing any significant change in the money supply.

Quantitative easing has converted the Fed into a financial central planner, in which the Fed, rather than the market, determines the allocation of large amounts of credit.

Jeffery Rogers Hummel, Ph.D. (jeffrey.hummel@sjsu.edu) is a professor of economics at San Jose State University.

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State Retirement Funds Play Accounting Tricks on Retirees, Taxpayers

By Dannie Mahoney

Awareness of underfunded public pensions is increasing among the public, as states seek to balance their budgets without reneging on prior agreements with workers, but a less publicized liability problem is also becoming a concern.

In too many cases, states’ retirement health benefits programs are overpromising and underfunded.

State governments, in the aggregate, have set aside only four cents for each dollar of promised health care benefits. In addition, some states have started using an accounting trick to hide this debt; they keep it off their balance sheets, effectively sweeping the debt “under the rug” and out of sight.

Papiering over the Problem

As a result, some of the reported improvements in health care programs’ finances are false. Alaska, Hawaii, and Michigan, for example, employ gimmicks that give the appearance of fiscal improvements in their entitlement programs.

Most states maintain a zero balance in their retirement health fund to cover expenses. As there is no money in the fund, the state can “lowball” its expected rate of return on debt owed, assuming a pessimistic 4 percent rate of investment return.

When money is eventually placed into the health fund, the use of a higher estimated rate of return allows state governments to claim the fund has been “prefunded”—making the fund appear much healthier than it may be in reality.

By triggering overly optimistic funding scenarios through the manipulation of fund balances, states engineer perceptions that their retirement health care fund reserves are filling up faster than they are.

Generally speaking, state pension funds assume 8 percent returns on pension investments—a wildly optimistic assumption. Studies by Pew Charitable Trusts found state entitlement funds’ investments had experienced only a 5.9 percent average annual return over the past decade.

The average state has a total pension and retirement health care debt of more than $22 billion, but more than 80 percent of that debt, almost $19 billion, is hidden from citizens and state legislators by accounting gimmicks.

Fixing the Structure

These accounting tricks enable governments to understate their unfunded liabilities by billions of dollars. However, not all states are deceiving their taxpayers in this way.

In Kentucky, the actual value of health care and pension claims was lower than earlier estimates made by the fund, allowing the state to revise its expectations and lower its debt load.

Other states have enacted structural reforms to their systems, improving the fiscal outlook. In Ohio, increasing the age of retirement for employees has decreased the estimated amount of money required to fund retirees’ health care.

Taxpayers will ultimately be responsible for the real value of the debt, regardless of how accurate the estimated rate of return turns out to be. Unless other states follow the lead of Kentucky and Ohio, by making real reforms to pension structures, future taxpayers will be forced to make up the difference if the fund does not have enough money to pay benefits owed to retirees.

Dannie Mahoney (dmahoney@truthinaaccounting.org) is media relations manager for Truth in Accounting.

FDA Regulatory Expansion Jeopardizes Public Health

By Michael L. Marlow

The U.S. Food and Drug Administration (FDA) has proposed expanding its regulatory authority over tobacco products to include cigars, pipe tobacco, hookah tobacco, electronic cigarettes (e-cigarettes), and dissolvable products and gels.

Currently, cigars are the most popular item in this group, but e-cigarette use is rapidly expanding.

New regulations would require product registration, standardized listings of ingredients, government preapproval of new products, labeling, and prohibitions against providing free samples to consumers.

First, Do No Regulatory Harm

By dismissing harm reduction policy, FDA is jeopardizing its own public health goals. “Harm reduction” is a policy concept suggesting that minimizing the damage incurred from risky behaviors more effectively promotes public health than seeking the outright elimination of the behavior.

Up to 98 percent of tobacco-related deaths are attributable to cigarettes, pipes, and cigars, but FDA downplays the possibility e-cigarettes are less dangerous than combustible tobacco products.

The American Medical Association published a “Patient Page” fact sheet in January 2014 stating e-cigarettes’ lack of tobacco is the reason why e-cigarettes “vapor is much less toxic than secondhand tobacco smoke.”

Instead of using new technology as an opportunity to improve the public’s health, FDA errs by assuming e-cigarettes pose more of a health risk than traditional tobacco products.

The available evidence indicates e-cigarettes help some smokers reduce or quit smoking. Reported success rates indicate between 7 and 20 percent of smokers who attempt to quit smoking by using e-cigarettes achieve that goal.

Rules Would Weaken Competition

FDA’s proposed rule would slow development of the e-cigarette market by prohibiting manufacturers from marketing e-cigarettes as safer than cigarettes. Federal health regulators already prohibit manufacturers from informing consumers that such products do not contain tobacco.

The proposed rule removes much of the profit from developing safer and more effective harm-reduction products, redirecting resources toward attributes—such as color, taste, and packaging—unrelated to improved public health.

The regulations may help traditional tobacco companies, as the proposed rule weakens the creative destruction otherwise exerted upon the tobacco industry by the competing e-cigarette industry.

Prohibiting sales to youths and requiring a clear description of product ingredients may be appropriate, but prohibiting any information regarding potential efficacy in harm reduction is hard to justify given the substantial benefits reported in scientific studies.

FDA should fully consider the potential benefits of e-cigarettes, as well as the many unintended adverse effects on public health caused by regulatory discouragement of market innovations.

Michael L. Marlow (mmarlow@calpoly.edu) is a professor of economics at California Polytechnic State University.

INTERNET INFO

CFTC Rulemaking Process Needs Greater Scrutiny

By Hester Peirce

Regulators, confident in their own virtue and ability, often see little need to have anyone check their work. As a result, regulatory requirements are flowing out of agencies such as the Commodity Futures Trading Commission without required public, judicial, and legislative oversight.

As government has expanded, Congress increasingly has regulated by delegation, leaving major policy decisions to regulatory agencies charged with implementing broad statutory mandates.

Force of Law

The 800-page Dodd–Frank Wall Street Reform and Consumer Protection Act is a prime example. The law charges financial regulators with bringing the statute to life through its hundreds of attendant rules. These rules, many of which span hundreds of pages, carry the force of law. Requirements they impose are just as mandatory as those resulting from the force of law themselves are not credible regulators. By making rules hidden from the public eye and statutory accountability mechanisms, CFTC and other regulators are overstepping legal boundaries.

Iron Fist in Velvet Glove

Aiding agencies in this effort is a natural inclination by regulated companies to follow agency directives, regardless of the form they take. A company that anticipates being under a regulator’s watch for decades to come will heed that regulator’s commands, even if they are informal.

Regulators can make life miserable for a company bucking such informal diktats. Agencies can punish non-compliant companies by withholding approval for new products or mergers and by dragging out compliance audits.

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Study Details Tax Reforms for Conn.

By Suzanne Bates

As other states are starting to initiate significant tax reform, Connecticut still has not done anything to make its tax climate more business-friendly, despite its recent placement at the bottom of several national rankings and its slow economic growth.

Although state officials like to claim Connecticut has a friendly business tax environment because of its 7.5 percent corporate income tax rate, the state’s very high property taxes and relatively high taxes in a variety of other areas account for Connecticut’s failure to fully recover from the 2008 economic crash.

Connecticut has the second-highest per-capita property taxes in the nation, and the state levies sales taxes on many business-to-business transactions. Connecticut’s capital stock tax rate, a tax on business wealth, is the worst in the nation, and the state’s gift tax significantly affects small businesses. Connecticut’s alternative minimum tax for personal income taxes is also detrimental to small businesses because many are taxed using personal income tax rates.

Some state officials claim Connecticut has made significant efforts to improve its business climate through endeavors like Gov. Dannel Malloy’s (D) First Five “job creation initiative,” a program that grants tax credits and other incentives to businesses that create a specified number of new, full-time jobs between 2011 and 2015.

A study by the Tax Foundation released in October 2014, however, says business incentive programs do less to help states attract and retain businesses than a business-friendly tax environment does. In other words, it is better to have an enduring business-friendly tax structure than to have short-term programs like Connecticut’s First Five program.

Until Connecticut’s state officials make real efforts to transform the Constitution State’s suffocating and destructive business climate, businesses and entrepreneurs will continue to move on to greener, more lucrative pastures in other states.

Suzanne Bates (suzanne@yankeeinstitute.org) serves as policy director for the Yankee Institute for Public Policy, based in East Hartford, Connecticut. An earlier version of this story appeared at the Yankee Institute’s website at http://www.yankeeinstitute.org/2014/10/bottom-10-yet-again/. Reprinted with permission.

Free-Market Reforms Benefit Taxi Customers, Economy

By Stewart Dompe

For decades, urban dwellers and tourists have been forced to rely on taxis to navigate their cities. These days, however, hailing a stranger in a cab or calling a dispatcher is an unnecessary hassle.

New technology allows customers to download a smartphone app that—with the push of a button—will dispatch a vehicle and driver to an exact location.

GPS technology ensures drivers know exactly where to go and customers can see them coming and know exactly when to meet them. Who could object to such a convenient invention? The answer, unsurprisingly, is traditional taxicab and limousine services.

The taxi industry is heavily regulated, with steep barriers to entry. In many cities, a special license, called a “medallion,” is required to operate a cab. One may purchase a medallion from an existing owner, usually for an exorbitant price. In New York City, the price for a single medallion is often in excess of a million dollars.

Whining, Not Winning

So-called “rideshare” companies such as Uber, Lyft, and Sidecar are attracting customers away from traditional cabs by offering lower fares and greater convenience. Instead of competing with new firms in the marketplace, the “old guard” is running to city hall, demanding local regulators shut down the new competitors, claiming phony concerns about public safety.

Despite claims from critics, the market already incentivizes quality and safety, and it is reflected in how these businesses operate. Lyft, for example, requires all vehicles to be 2000 model year or later and pass a 19-point inspection. Drivers must carry excess liability coverage of one million dollars and an uninsured- and underinsured-motorist policy of one million dollars.

The strongest incentive for quality comes from letting customers rate drivers, an advantage the taxi industry does not provide. Bad taxi drivers hurtling down the road at breakneck speeds while weaving through traffic are the butt of many jokes. Even when the driver’s name and license number are displayed, calling a cab company and lodging a formal complaint is a hassle for most customers that appears to have had little effect on customer satisfaction or product quality.

By allowing customers to rate drivers instantly, however, rideshare companies make the complaint process easy. Drivers with bad ratings are automatically excluded from the system, placing a great deal of power in consumers’ hands.

Erasing the ‘Red Line’

Finally, it is an all-too-common problem that members of some low-income or minority communities experience difficulty hailing a cab. Existing regulations make this problem worse.

When customer demand exceeds an artificially constrained taxi supply, drivers can arbitrarily decline minority customers because they are certain they can quickly find another paying customer. With Uber and Lyft expanding the number of their vehicles in operation based on growing demand, it is much more costly for a driver to turn down a fare. By increasing competition, taxi deregulation forces expansion into underserved communities.

Taxicab regulation benefits license owners at the expense of consumers, whereas allowing free-market forces to work within the industry results in cheaper fares and happier customers.

Stewart Dompe (stewart.dompe@jwu.edu) is an instructor of economics at Johnson & Wales University.

INTERNET INFO


INTERNET INFO

Private Toll Roads Better for Drivers, State Budgets

By Tom Gantert

As some states increasingly see toll roads as a good way to pay for neglected highways, one transportation expert is warning about using toll roads as “cash cows.”

Other states, he notes, are privatizing their toll roads and reaping the benefits.

Robert Poole, director of transportation policy for the Reason Foundation, says privatization of toll roads is a good way to prevent government from tapping tolls and unsuspecting motorists for the costs of other road projects.

“Why is the government in this business?” Poole said. “My view is highways should be like the investor-owned utilities, like cable TV. Motorists should pay user fees that pay for the capital and operating costs of the roads they use. They should not be taxed through additional tolls to pay for other people’s projects. That’s a very bad tendency and is a growing trend.”

Revenue Grabs

Over the past year, some local and state governments have worked to import that “very bad tendency” into their own communities.

Atlantic City’s City Council proposed a resolution earlier this year asking the South Jersey Transportation Authority to double toll rates in order to increase the city’s revenue.

In Pennsylvania, state law requires the Pennsylvania Turnpike to make payments to that state’s Department of Transportation (PennDOT) to be used by the state government. The Pennsylvania Turnpike Commission says it has to raise tolls every year in order to cover that payment to PennDOT, in addition to making cuts to its own long-term projects and capital expenses.

In Texas, state legislators are discussing expansion of the state’s toll system. Texas has invested billions in toll road projects across the state, and Joe Weber, executive director of the state transportation department, said in September toll roads were a vital part of the Texas Department of Transportation’s public transportation planning.

Taxing Questions

Lobbyist groups are campaigning against the addition of more private toll roads, claiming they unfairly impact toll customers. Instead, such groups push for a higher tax on gasoline to help pay for state transportation costs.

In May 2014, the Owner-Operator Independent Drivers Association (OOIDA), a trade association representing truckers, sent a letter to Michigan state Rep. Wayne Schmidt (R- Traverse City) opposing a bill that would expand the state’s ability to enter into agreements with private entities involving public transportation.

“Tolls are financially crippling to truckers,” Mike Matousek, OOIDA’s director of legislative affairs said in the letter to Schmidt. Matousek suggests raising revenue for infrastructure by increasing the gasoline tax.

In a July 2014 letter to Virginia Gov. Terry McAuliffe (D), OOIDA stated the organization opposes the addition of toll roads through public-private partnerships, fearing private companies may hike toll-use fees.

Unsupported Fears

Such fears are not supported by the evidence provided by the history of Indiana’s toll-road company, the Indiana Toll Road Concession Company (ITRCC).

In 2006, former Gov. Mitch Daniels (R) approved leasing some of the state’s roads to a group of private companies operating as a collective entity, ITRCC.

The state received a payment of $3.8 billion up front for the rights to run the 157-mile roadway. ITRCC applied for bankruptcy proceedings in September 2014, but drivers and taxpayers will remain unaffected.

“The ones criticizing the Indiana toll road are people who don’t understand the difference between private losses and public losses,” said Wendell Cox, a national transportation consultant and senior fellow for The Heartland Institute, which publishes Budget & Tax News. “If private investors want to invest their money stupidly, what do we care? If a government makes a bad deal, it’s not an indictment of privatization. It’s an indictment of government.”

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

Internet Sales Tax Falls Victim to Lame-Duck Session

By Jesse Hathaway

Despite protests from trade groups and some state governors, U.S. House of Representatives Speaker John Boehner (R-OH) has remained resolute in his refusal to allow the Marketplace Fairness Act (MFA) to receive a hearing on the House floor.

Currently, online retailers are not required to collect sales taxes on purchases made from states in which they are not physically located. MFA would require retailers to remit tax revenue to states and other tax jurisdictions regardless of the location of the physical centers of operation.

Boehner has resisted pressure from outgoing Senate Majority Leader Harry Reid (D-NV) and other supporters of the tax measure. In November, Boehner spokesman Kevin Smith told reporters, “The speaker has made clear in the past he has significant concerns about the bill, and it won’t move forward this year.”

Although proponents, such as the U.S. Conference of Mayors, want the millions of dollars of potential tax revenue that currently escapes them, the rise of e-commerce and the current tax freedom it allows benefits the economy, says Veronique de Rugy, senior research fellow at the Mercatus Center at George Mason University.

Calling MFA “problematic,” de Rugy cheered its demise.

“The ones criticizing the Indiana toll road are people who don’t understand the difference between private losses and public losses,” said Wendell Cox, a national transportation consultant and senior fellow for The Heartland Institute, which publishes Budget & Tax News. “If private investors want to invest their money stupidly, what do we care? If a government makes a bad deal, it’s not an indictment of privatization. It’s an indictment of government.”

Jesse Hathaway (jhathaway@heartland.org) is managing editor of Budget & Tax News.
Capital Gains Tax Reform Could Benefit N. Carolina

By Roy Cordato

In 2013, North Carolina instituted sweeping tax reforms, making its tax system more efficient by imposing a single-rate system and bringing both the top rate of 7.75 percent and the bottom rate of 6 percent down to a flat rate of 5.75 percent.

Lawmakers broadened the base of the tax, eliminating many special privileges in the code, and they reduced the corporate income tax. They also used the tax reform process to reduce the overall tax burden on North Carolinians, allowing taxpayers from all income groups to keep more of their earned income.

Bias Against Entrepreneurship

All these reforms will benefit North Carolina’s economy. In addition to transferring more money from inefficient bureaucrat into the hands of the more-efficient private sector, the rate changes reduce the tax system’s bias against saving, investment, and entrepreneurship.

Unfortunately, one important area of the state’s tax code was left unformed: the treatment of capital gains. Reforming this area of the tax code would be a logical next step in North Carolina’s movement toward a truly efficient tax system, one without special penalties for investment and entrepreneurship, such as those in the current code.

Capital gains taxes, like all taxes on investment returns, impose a second layer of taxation on investment, and therefore entrepreneurship.

Capital gains are the increase in value of an equity investment. This kind of investment includes anything from stocks and bonds to a plot of land or one’s home or business. For example, if a person invests in stock costing $5,000 and 10 years later he sells that stock for $10,000, his capital gain would be $5,000.

Currently in North Carolina, the $5,000 gain is taxed at the same rate as regular income. At the federal level and in other states, however, capital gains are taxed at a lower rate than regular income, or not at all.

That’s because when capital gains and other investment returns are hit with the same tax rate as ordinary income, the returns on those investments are actually double-taxed: first when the income is earned as ordinary income and then again by the capital gains tax.

Let’s assume that, in our example, the $5,000 used to invest in stocks began as $5,555 in pre-tax income and $555 in taxes. Without the tax, the investor could have made a $5,555 investment. After the tax, however, the investment was reduced to $5,000. The value of the stock the individual could purchase was reduced by roughly 10 percent. Everything else being equal, the return generated from that investment also was reduced by 10 percent.

To tax the gain is to reduce the investment return a second time. Taxing capital gains is a form of double taxation: once when the initial investment is taxed and again when the gain on that investment is taxed.

The most straightforward way to eliminate this double taxation is to completely eliminate the tax on capital gains. Although there are no U.S. states that do this, a number of other places do, including Belgium, New Zealand, and, not surprisingly, the leading world financial hub of Hong Kong.

Baby Steps, If Not Leaps

If eliminating double taxation entirely is too politically difficult or poses hard-to-overcome fiscal concerns, lawmakers can at least work to reduce the size of the problem by following the national government’s approach and taxing capital gains less than ordinary income.

The national government taxes capital gains at about half the rate applied to regular income. Using this as a model, North Carolina could have a capital gains tax of about 2.9 percent.

An alternative approach used by a number of states is to exempt a certain amount of capital gains from taxation. For example, South Carolina allows taxpayers to exempt 44 percent of their capital gains from taxation; Wisconsin excludes 30 percent.

Whatever the North Carolina legislature does in this regard, it must do something. The current approach is a relic from the state’s old tax system and is inconsistent with North Carolina’s new and more economically sensible approach to tax policy.

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INTERNET INFO


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By William Todd

The Supreme Court of the United States (SCOTUS) has begun hearing arguments in a case setting federal regulators against a North Carolina trade organization empowered with state authority.

The case, North Carolina Board of Dental Examiners v. Federal Trade Commission, would decide whether state regulatory boards are exempt from federal anti-monopoly regulations.

In the U.S. Court of Appeals for the Fourth Circuit, the state-sponsored regulatory board initially challenged a 2010 administrative order from the Federal Trade Commission (FTC) claiming that preventing unlicensed entrepreneurs from performing teeth-whitening services was a proper use of its power.

**Years-Long Dispute**

Beginning in 2003, the North Carolina Board of Dental Examiners began cracking down on the perceived threat of unlicensed individuals performing teeth-whitening services. In 2011, the board was instructed to cease its hunt for unlicensed hygienists, but it has been appealing that order for years.

Federal regulators argued the state regulatory board’s actions were tantamount to “colluding to exclude non-dentists from competing with dentists in the provision of teeth whitening services,” actions that served only to “prevent and deter non-dentists from providing or expanding teeth whitening services, increase prices and reduce consumer choice without any legitimate justification or defense.”

The North Carolina Board of Dental Examiners (NCBDE) unsuccessfully argued preventing prospective entrants from competing against their colleagues was an appropriate use of state power. NCBDE appealed the decision, claiming FTC was unfairly “questioning the defendants actual motives versus their potential motives” by suggesting a board of dentists might wish to enact regulations that benefit their colleagues.

NCBDE also argued, “It does not matter that a state agency’s officials are market participants” benefitting from their regulatory power. “It also does not matter that those officials are elected to office by other market participants who would likewise benefit from keeping entrepreneurs from competing against them.”

**Economic Self-Interest**

Before the case made its way to the Supreme Court, NCBDE claimed state law actually requires the dentists’ board to issue cease-and-desist orders against their upstart competitors.

Federal regulators, however, say a “body dominated by market participants can be expected to foster anti-competitive practices for the benefit of its members,” as such a board “consists chiefly of active market participants who are economically affected by competitive threats from new entrants into the markets they serve.”

State regulatory boards such as NCBDE, FTC argued in its brief, are more akin to private trade associations than “to a municipality or traditional state regulatory agency,” as members are not appointed by the government but elected by fellow members of the trade.

NCBDE’s “members are economically self-interested private actors—dentists competing in the same market they regulate,” the federal government’s brief said. “And, like the board members of a private trade association that may govern its members conduct to some extent, petitioner’s members are largely accountable to their fellow market participants rather than to the State.”

“To me, that’s of some significance, because it indicates that—clearly—they have the economic interest of the dentists at heart,” Heritage Foundation Senior Legal Fellow Alden Abbott said. “There are lots of health and safety regulations that they have every reason to promulgate, but—to my knowledge of this case—there was absolutely no evidence and no complaints of any consumer harm from these sorts of storefront dental whitening clinics.”

**GUILD LAW**

In oral arguments before the Supreme Court, Deputy Solicitor General Malcolm Stewart said, “The board members, the majority of them at least, are required to be practicing dentists, they have an evident self-interest in the manner in which the dental profession is regulated and in regulations that might keep other people from competing with dentists.”

“That natural self-interest is reinforced by the method of selection,” Stewart said during his October 14 testimony. “North Carolina law provides that the members of this dental board will be selected not by the governor or by the public, but by the community of dentists.”

In February 2014, University of Minnesota public policy professor Morris M. Kleiner analyzed the economic consequences of occupational licensing laws, such as those in North Carolina.

Noting such “capturing” of regulatory power “could reduce access to health services among some segments of the population,” Kleiner’s study found “more restrictive state licensing practices increase the costs of medical care, change wages and employment patterns, and do not appear to influence health care quality.”

According to Walter Olson, senior fellow at the Cato Institute’s Center for Constitutional Studies, “the not-so-hidden secret about occupational licensure laws is that they enable incumbent providers to protect their own incomes by locking newcomers and competitors out of markets by artificial government force.”

Abbott agreed with Kleiner’s and Olson’s analyses, noting licensing requirements like those in North Carolina tend to hurt “poor consumers, who have to pay higher prices,” as well as small businesses.

“There’s a lot of evidence that these regulations have been enacted at the behest of existing firms, to prevent new competitors from entering. This hurts small businesses; it prevents them—for no good reason—from getting started.”

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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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