Great Expectations: States Still Using Unrealistic Pension Assumptions

Burlington Boondoggle
After spending nearly $50 million on a little-used telecommunications system, Burlington, Vermont is asking its taxpayers for $10.5 million more. Page 7

No Illinois Progressive Tax
Democrat leaders in Illinois have for now given up their attempts to impose an income tax surcharge on high-income earners and create a “progressive” income tax to replace the current flat-rate tax. Page 14

Start-Ups Tax Break
An obscure tax break meant for start-up companies has allowed major corporations to receive millions of dollars in tax refunds from the State of Iowa. Page 13

Rich States, Poor States
For the seventh consecutive year, Utah has been ranked as the state with the best economic outlook by the authors of Rich States, Poor States. Page 8

United States of Envy
President Barack Obama has openly encouraged envy of the top 1 percent of income earners. Pages 10–11

Lawmakers Seek End to Solar Tax Breaks
By Tori Richards
A pair of bills in the U.S. House of Representatives would end tax credits responsible for creating and propping up the American solar energy industry. House Ways and Means Committee Chairman Dave Camp, a Michigan Republican, proposes to end the federal giveaways. Fellow GOP Con gressman Mike Pompeo of Kansas has introduced a similar bill. “For years we had worked on building consensus among our caucus against tax credits for energy companies—oil, gas, wind, solar—because profitable corporations shouldn’t rely on taxpayer support. They should rely on customers,” Pompeo said in a written statement.

By Eric Boehm
Two years ago, when Rhode Island passed bipartisan legislation to reform a state pension system that threatened to bankrupt the state, it was hailed as an example for other states to follow.

Now, Rhode Island is once again an example for other states struggling with their own pension issues. But this time around, it’s an example of what not to do.

A recent audit of the state’s pension system by Cheiron, an actuarial firm based in McLean, Virginia, concluded the state was unlikely to achieve its expected 7.5 percent return. PENSION, p. 4
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Lawmakers Seek End to Solar Industry Tax Breaks; Industry Fears Collapse

Continued from page 1

California-based SolarCity, one of the nation’s largest solar system contractors, has admitted in Securities and Exchange Commission filings that any curtailment of tax dollars would spell doom for the company. Nearly a third of the cost of its equipment has been paid for by taxpayers.

The company, which has received more than $422 million in taxpayer funding, is $166 million in the red and has never turned a profit, according to its latest financial report.

The $30.2 billion given away by the government for green energy had its start in September 2008 in the midst of the subprime mortgage bank bailout mess. Solar Investment Tax Credits had bipartisan support that included such GOP stalwarts as U.S. Sens. Chuck Grassley of Iowa and Mitch McConnell of Kentucky.

The law allowed a solar utility firm purchasing $1 million in solar energy-related equipment to claim a $300,000 tax credit deducted directly from taxes owed. The massive tax rebate made it possible for some solar businesses to operate tax-free.

Free Lunch Through ‘Front Loading’

A year later, the U.S. Treasury Department made it even easier for solar businesses issuing checks to companies that didn’t want to use the tax credit. Dan Kish, senior vice president of policy at the Institute for Energy Research, said front-loading cash grants rather than back-loaded credits allowed unprofitable companies to get a free lunch.

“The tax credit took new life in ’09 with the economic stimulus,” Kish said. “Initially, it was a 30 percent credit, but what happened is people said that in order to have a credit that’s worth something you have to make a profit, and we’re not making a profit. So what about a grant program instead. And that’s what they ultimately went forward with.”

Despite intense lobbying by the solar industry, the incentives expired in 2012 when Congress didn’t vote to renew them.

“The [cash grant] money is gone now, because that provision is expired from the law,” said Kish. “But what happened is people said, ‘oh my gosh, that’s what we really wanted’ so Congress passed the solar energy industry tax break called the ‘Investment Tax Credit’ and it was worth $23,000 for the first year of construction, $20,000 for the second year of construction, $17,000 for the third year of construction, and $15,000 for the fourth year of construction.”

Pompeo’s measure also ends future tax credits, but it is a stand-alone bill.

Precedent Set in 1962

The recent solar subsidies like SolarCity’s trace their origins back to the Investment Tax Credit the U.S. government began providing to targeted industries in 1962. These federal tax credits, which offer businesses a direct dollar-for-dollar reduction in income taxes owed to the government, provide a powerful incentive for business investment.

Over the years, investment tax credits have been used for everything from low-income housing to employer-provided child care. Congress first extended ITCs to solar initiatives by way of the Energy Tax Act of 1978.

The Energy Tax Incentives Act of 2005, a Bush-era initiative, first delivered a 30 percent tax credit for individuals who purchased solar installations. The subsidy, though generous, was capped at $2,000 and wasn’t available to utility companies.

Dollars Flow from 2008 Crisis

It was the Emergency Economic Stabilization Act of 2008 that opened the floodgates by removing the $2,000 cap and tying the 30 percent tax rebate to purchase and installation costs. The new Solar Investment Tax Credit was a dollar-for-dollar reduction in taxes owed, not a mere reduction in taxable income.

Some solar companies have found ways to make good on the solar investment tax credit by partnering with investors—primarily top U.S. banks—that have large tax liabilities. The solar tax credit gets passed on to the investors by way of the “tax equity market.”

However, this source of funding for the solar industry could collapse if Congress fails to renew the solar ITC in 2016. Without it, the future of the U.S. solar energy industry is in grave doubt.
States Still Using Unreasonable Pension Assumptions

Continued from page 1

annual rate of return in its pension system. The audit said the state should consider lowering its expectations because there is only a 40 percent chance of hitting that goal.

Coming up short of the expected rate of return means higher contributions will be necessary from the state’s taxpayers.

Similar Problem Nationally
The report has national implications.

“If Rhode Island is going to have a hard time earning returns of 7.5 percent, there isn’t any reason to think other states are substantially better or worse at investing their pension dollars,” said Rick Dreyfuss, a retired actuary and pension expert for the Manhattan Institute think tank.

A recent study by the Society of Actuaries, a national industry group, noted states and municipalities shouldn’t use rates of return that are unlikely to be achieved.

“Plans should be using rates of return that they believe can be achieved over the next 20- to 30-year period with a 50 percent probability,” the group concluded.

Rhode Island knows it’s unlikely to hit the targeted rate of 7.5 percent, but that expected return is actually slightly lower than the national average of 7.77 percent, according to the most recent survey from the National Association of State Retirement Administrators, another industry group.

Some states have begun to adjust their expectations downward in recent years, but even so, most states still expect much greater returns than they are likely to get in the long run. That’s a problem.

Employers, Taxpayers on Hook
In theory, a fiscally sound pension system rests on a “three-legged stool” made up of investment returns, contributions from employees, and contributions from employers. In the case of a public pension system, employer contributions come from taxpayers via the federal, state, or local government.

Though the exact math varies from state to state and system to system, the basic model is the same, whether you’re looking at Rhode Island or California or anywhere in between.

If the investment returns come up short of expectations, the shortfall has to be made up with higher contributions from the other two “legs” of the stool.

Employee contributions are usually fixed as part of a collectively bargained contract. That means the employer is usually the one who has to make up the difference.

In the private sector, these kinds of pension plans are nearly extinct, long since replaced by 401(k)-style plans that let individual workers assume the risks and rewards for investing in their retirements.

The few private-sector pension plans that are left must operate under much stricter rules. Federal law requires rate of return assumptions in line with high-level corporate bonds, considered one of the safer, more conservative investment options, which rarely climb above 5 percent.

Returns ‘Unrealistic’
Though no one can predict investment returns, an 8 percent rate seems “unrealistic,” and pension funds should use more conservative expectations, said Robert Pozen, a professor at Harvard Business School and senior fellow for the Brookings Institution, a nonpartisan think tank.

“These things should be done conservatively so the retirees know what they will have,” Pozen said. “You don’t want to create an incentive for politicians to underfund the plans.”

There are major political reasons why states don’t lower their expected rates of return.

For one, it adds potentially billions of dollars to states’ already deeply indebted pension funds.

Rhode Island reduced its expected rate of return from 8.25 percent to the current level of 7.5 percent in 2011, but the small adjustment added $125 million to the state’s pension liability.

And that’s a small state with a relatively small pension system. In a big state such as Illinois—already dealing with a $146 billion unfunded liability by its official accounting—using a more reasonable expected rate of return means the state is on the hook for more than $272 billion in unfunded pension debt.

Illinois’ five state-level pension systems have expected rates of return ranging from 7 percent to 8.5 percent, but none of them has earned better than 6 percent over the past decade.

Bigger Debts than Acknowledged
According to the Pew Center on the States, a think tank, pension obligations of state governments totaled $1.26 trillion in 2011. But that’s using the states’ own assumptions about how well their investments will fare over the coming decades.

Using a different, lower, rate—the rate required for corporate pension plans—would cause the overall liability to hit $1.8 trillion, Pew estimated.

“If investment returns are disappointing and do not meet expectations, states are still required to pay retirees the benefits they have earned,” the authors of the Pew report wrote.

Politicians who have limited budgetary dollars to spend have an incentive to keep rosy projections on the books to keep the current pension crisis from appearing worse than it really is. A higher expected rate of return means lower mandatory contributions from the state budget.

“The reason why people use these higher rates of return is to avoid having to put in higher contributions year after year,” said Pozen.

But if the expected higher rates of return don’t materialize, the bill still has to be paid.

Eric Boehm writes for the Pennsylvania Independent, where this column first appeared.
Kansas lawmakers sent the governor a bill that would provide up to $8,000 for private-school tuition from scholarship funds established with donations from businesses.

Gov. Sam Brownback (R) signed the bill in late April, making it the state’s first private school choice program.

Students with disabilities or from families earning up to 185 percent of the federal poverty level could qualify to receive the scholarships. That’s an annual income of $44,000 for a family of four.

“This is a corporate credit scholarship bill that will help low-income and special-needs students,” said James Franko, vice president and policy director of the Kansas Policy Institute. “It’s an opportunity for kids who need it the most who aren’t getting what they need from public schools.”

Senate Bill 22 grants businesses a 70 percent tax credit on the amount they donate to nonprofit organizations that award K–12 scholarships, up to an annual statewide cap of $10 million. That would allow for 2,000 scholarships averaging $5,000. Kansans currently pay an average of $9,700 per student in public schools, according to the National Center for Education Statistics, and the state supreme court recently ordered the legislature to spend more.

SB 22 is a “great idea” and “a great start,” said Michael Chartier, a state programs and government relations director at the Friedman Foundation for Educational Choice. “I’d like to see the Kansas legislature broaden it a bit to open up eligibility for who receives the scholarships. Hopefully, this will gain some traction so more children can qualify.”

What’s More Important?
Tax-credit scholarships are the most prevalent school choice option. There are currently 17 tax-credit scholarship programs operating in 13 states. Because the scholarships are funded entirely by private money that never enters state coffers, they are the least burdened by government mandates. State supreme courts typically agree these programs use private, rather than tax, money.

“Americans need to decide what’s more important: funding a child’s education and spurring educational innovation or funding a governmental system because that’s the way we’ve been doing it for decades,” said Kyle Olson, CEO of the Michigan-based Education Action Group. “If parents—who know their children best—decide an alternative is best for their children, why not let the dollars follow the child, even in an indirect way as is being proposed in Kansas?”

Franko concurs. “I’d like to see this program expanded to cover more children,” he said. “Ultimately, what we’d like to see is education dollars following all Kansas children to the schools their parents select for them.”

Bruce Edward Walker writes from Michigan.
Judiciary Committee Hears Testimony on Internet Sales Tax

By Steve Stanek

Many “bricks-and-mortar” retail stores, as well as the nation’s largest online retailer, Amazon.com, have come together to lobby for the collection of sales tax on all online and catalog sales.

Currently, online and catalog retailers are not required to collect sales tax unless a buyer is in a state where the retailer has a physical presence, such as a store, warehouse, or distribution center. Traditional retailers collect sales tax from every buyer but must comply only with the sales tax rules where a sale is made.

Amazon used to oppose an Internet sales tax, but now that it has a physical presence in states where the bulk of its sales are made and therefore must collect sales tax anyway, the company has reversed its position. However, eBay and smaller online retailers oppose forcing all online sales to be taxed because of the difficult logistics of complying with the nation’s thousands of state and local sales tax jurisdictions.

To help sort out the issues and look for a possible alternative to the Marketplace Fairness Act, which would allow sales tax collections regardless of whether a remote or catalog retailer has a physical presence in a state, House Judiciary Committee Chairman Bob Goodlatte (R-VA) called a hearing in March that featured six witnesses whose opinions ranged from support to opposition to allowing states to ban interstate commerce that does not comply with state tax laws.

Joe Crosby, a principal with Multi-State Associates and advisor to the retail industry, Crosby has worked on this issue for decades, and his testimony discussed the possibility of requiring a simplified structure only for online retailers, leaving bricks-and-mortar retailers with existing state sales taxes.

Stephanie Kranz, a partner with McDermott Will & Emery, who has worked extensively as the business representative on the Streamlined Sales Tax Project. His testimony emphasized the danger of continued congressional action as states strike out on their own.

William Moschella of the shopping center industry. He represented retailers and his testimony urged adoption of the Marketplace Fairness Act. Alternatively, he suggested giving states the authority to ban interstate commerce that does not comply with state tax laws.

Andrew Moylan of the R Street Institute. His testimony favored origin-sourcing, the concept of taxing sales based on where the seller is located rather than where the customer is located. Origin-sourcing reconfigures the sales tax from a consumption tax to a business activity tax, which is revolutionary. The most common critique of origin-sourcing is that it would lead to online sellers clustering in states with no sales tax, a questionable concern.

James Sutton, a lawyer and CPA from Florida. His testimony discussed specific examples of sales tax complexity and errors by state administrators. Sutton also proposed something akin to a 1099 reporting regime, whereby retailers would collect information about their customers and provide it to tax authorities.

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

The measure passed the Senate last year but has not advanced in the House of Representatives.

‘Fresh Alternatives Needed’

“Congress is no stranger to the remote sales tax collection issue. Over the past 10 years, more than 30 congressional hearings have been held on the topic. While this is not a new conversation, the process that the Committee takes today is unprecedented,” said Goodlatte in a statement before the March hearing.

Last fall Goodlatte released seven principles for an online sales tax: tax relief, neutrality, representation, simplicity, tax competition, states’ rights, and privacy.

The hearing drew praise from Marketplace Fairness Act opponents and supporters alike.

“We thank Chairman Goodlatte for taking up the important issue of the E-fairness, returning the rightful power to the states to determine sales tax policy. It is sound from a federalism perspective and from an overall policy standpoint,” said Nathan Mehrens, president of Americans for Limited Government, in a statement.

“The unintended consequence of current law is to dictate winners and losers between local and online sales, when it is Congress’s duty to facilitate commerce and remove artificial advantages,” Mehrens said.

“Their hearing made clear that a majority of the committee believes we need to end government policy that picks winners and losers in the retail marketplace,” said Melissa Palmer, owner of Chocolatepaper in Roanoke, Virginia, in a statement. She is a member of Stand With Main Street and a constituent of Goodlatte’s.

“This hearing brings to light the unfair advantage against our locally owned retailers,” said Louisiana state Sen. Sharon Weston Broome in a statement. “E-fairness is simply about jobs and placing every retailer on the same set of rules. In 2012, my state of Louisiana was estimated to have lost more than $808 million to out of state sales.”

Range of Witnesses

Tax Foundation Vice President Joseph Henchman attended the hearing and reported the witnesses were:

• Former Rep. Chris Cox, now an advisor to NetChoice (online sellers). His testimony emphasized the importance of the existing constitutional standard, insisted on meaningful simplification, and criticized the Marketplace Fairness Act and the Streamlined Sales Tax Project.

• Joe Crosby, a principal with Multi-State Associates and advisor to the retail industry. Crosby has worked on this issue for decades, and his testimony discussed the possibility of requiring a simplified structure only for online retailers, leaving bricks-and-mortar retailers with existing state sales taxes.

• Stephen Kranz, a partner with McDermott Will & Emery, who has worked extensively as the business representative on the Streamlined Sales Tax Project. His testimony emphasized the danger of continued congressional action as states strike out on their own.

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Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of Budget & Tax News.
City’s Telecom Boondoggle Still Costing Taxpayers

By Jon Street

After spending nearly $50 million on a telecommunications system less than 10 percent of the population uses, Burlington, Vermont is asking its taxpayers for $10.5 million more.

The city has an unpleasant choice: Dump the debt directly onto the tax rolls or defray some of it with an unlikely $6 million loan at interest rates inflated by a municipal credit rating downgraded three times because of all the borrowing for Burlington Telecom.

Although Burlington taxpayers will be living with and paying for the mistakes of its municipal government for years, highlighted by a notorious misappropriation of $16.9 million from the general fund, it could have been worse.

Bank Offers Settlement Deal

CitiBank, which made the initial $33 million loan on which the city defaulted, is asking Burlington to repay just $10.5 million.

The settlement must be approved by the city council, a majority of whose members support the agreement, and the Vermont Public Service Board. Burlington Mayor Miro Weinberger has also voiced his support for the settlement.

Based on the settlement and the city’s past credit history, Moody’s Investors Service may reduce Burlington’s credit rating for a fourth time in the Burlington Telecom era, a downgrade that cost taxpayers $55,000 in added interest during the first year of new borrowing in 2013.

As early as August 2013, Moody’s warned, “Moody’s expects that any obligation borne by the General Fund could adversely affect the city’s credit profile.”

‘The Evidence Speaks for Itself’

“I think the evidence speaks for itself,” Andrew Moylan, a senior fellow at the Washington, DC-based R Street Institute, told Vermont Watchdog. “Funneling millions of dollars in funds into a failing business in violation of the city charter, repeatedly failing to meet its targets in terms of build out, and potentially imposing large costs on taxpayers when these systems are pitched as something that aren’t going to be a burden on taxpayers.”

This municipal foray began in 2007 when Burlington’s elected officials decided to finance public telecommunication where no system existed before. By 2009, the city had exhausted a $33 million loan from CitiBank.

Taxpayers were unaware until 2009 that the city also was burning through $16.9 million transferred without public knowledge or approval by Jonathan Leopold, the city’s chief administrative officer.

Leopold had violated Condition 60, a state law requiring approval from the Public Service Board before money could be withdrawn from general funds for such a telecom project.

General Fund Treated Like Loan Fund

At the time, Leopold argued the use of general funds was a kind of loan to be repaid when the city borrowed enough to replace it. The city council, however, refused to authorize the piling on of any new debt for Burlington Telecom.

Leopold resigned, but he wasn’t charged with committing any crime. Because he didn’t take money from the general fund for himself, the Vermont Superior Court found he had “invested” the mismanaged funds in the city’s existing infrastructure and wasn’t responsible for repaying any of it.

“Mr. Leopold acted at all times as an officer of the City. He authorized the expenditures from the pooled cash account in order to pay the expenses of BT. There was no ‘transaction’ between himself and the City which could support a claim of fraud,” the court concluded.

What were Burlington taxpayers buying with all this investment? As recently as February 4, the Burlington Free Press reported Burlington Telecom had only 4,000 subscribers, about 9.5 percent of the city’s total population. According to the National Broadband Map, the telecom company has the capacity to reach 38,500 residents, or about 90 percent of the city’s population.

Can’t Market System, Repay Loan

Expanding the subscriber base has so far proven unsuccessful, as the Burlington Free Press reported, because the city hasn’t the money to spend marketing the service.

Burlington also doesn’t have the money to repay its initial loan, hence CitiBank’s lawsuit and the subsequent settlement. City officials have spoken of a $6 million loan to pay off part of it, but they have refused to say who the lender is and describe the terms of the loan.

Those same officials have floated the idea of selling Burlington Telecom, but the costs of broadband and subscriber improvements required by law make a purchase prohibitively expensive.

‘None of This Was Necessary’

Current city officials see the settlement as a starting point to correct years of mistakes.

“I am pleased to announce to the people of Burlington that with this agreement, there is now for the first time a clear path to resolution of our BT challenges,” Weinberger said in a news release. “The agreement—once completed in the months ahead—will accomplish all the goals the City has pursued over the past two years.”

Moylan agrees the settlement likely forecloses an even worse disaster, but he notes local taxpayers are suffering from a string of very poor decisions by city leaders.

“The sad reality is that it could have been substantially worse for the city,” said Moylan, the former vice president of government affairs at the National Taxpayers Union. “That’s small consolation when none of this was necessary in the first place and all of it stems from what was a major mistake to get into a very expensive and difficult-to-manage project.”

Jon Street (jstreet@watchdog.org) reports for Vermont Watchdog, where a version of this article first appeared.

LEARN MORE


Utah Has Nation’s Best Economic Outlook, New York Its Worst

By Steve Stanek

For the seventh consecutive year, Utah has been ranked as the state with the best economic outlook by the authors of Rich States, Poor States, published by the American Legislative Exchange Council.

New York was ranked 50th, with the nation’s worst economic outlook.

Rounding out the top 10 for best economic outlook are South Dakota (2), Indiana (3), North Dakota (4), Idaho (5), North Carolina (6), Arizona (7), Nevada (8), Georgia (9), and Wyoming (10).

Rounding out the bottom 10 for worst economic outlook are Vermont (49), Illinois (48), California (47), Minnesota (46), New Jersey (45), Connecticut (44), Montana (43), Oregon (42), and Rhode Island (41).

This is the seventh year ALEC has published the report, which evaluates states based on 15 variables including taxes, labor policies, and regulations.

“We’ve wanted to be focusing on areas legislators could influence and change in a relatively short time,” said ALEC economist and report coauthor Jonathan Williams. The evaluation criteria have remained the same throughout the seven editions cowritten by Williams, economist Stephen Moore of The Heritage Foundation, and economist Arthur Laffer of Laffer Associates.

‘Historic Reforms’ in North Carolina
Quick changes for the better or worse can be seen in this year’s rankings. Williams noted North Carolina moved up from 22nd place for economic outlook in the 2013 edition to 6th place this year.

He cited “historic tax reform to cut rates across the board” as a big reason. The state “is much more competitive.”

Among other things, North Carolina moved from a “progressive” income tax with multiple tax rates that rose as incomes rose to a flat tax, meaning everyone pays the same tax rate. Furthermore, the flat tax rate is lower than any of the rates under the progressive income tax, “meaning everyone saw a tax cut,” Williams said. The state also eliminated its estate tax and reduced corporate taxes.

Indiana climbed from 14th to 3rd place, the result of tax and other reforms that were started under Gov. Mitch Daniels continuing under Gov. Mike Pence, Williams said.

Importance of Right-to-Work Law
He noted his home state of Michigan climbed from 20th to 12th place, “mostly because of a right-to-work law that was enacted one year ago.” Under right-to-work, employees cannot be forced to join a labor union as a condition of employment. Approval of right-to-work in Michigan is all the more remarkable considering the state is home to the United Auto Workers, he said.

On the other hand, Florida dropped seven spots from 9th to 16th place in economic outlook, followed by Colorado, New Jersey, Virginia, and Wyoming, each of which dropped six spots. Most of the drops were because of tax increases or spending problems, such as pension underfunding, or increases in the state minimum wage, which increases the cost of labor.

Moore said several factors stand out to him when assessing states’ economic outlooks.

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Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of Budget & Tax News.
Tennessee Moves to End Tax on Dividend Income

By Steve Stanek

Tennessee legislators are considering a bill to phase out the state’s 6 percent tax on dividend and other investment income. Tennessee already has no tax on wages or salaries.

The state’s tax on dividend and other income is known as the “Hall Income Tax” after state Sen. Frank Hall, who led the fight for it in 1929.

Gov. Bill Haslam has publicly opposed the tax cut but more than half the state’s legislators from both sides of the political aisle have signed a pledge to do away with the tax. Retirees who depend on dividend and other investment income to pay their bills have long complained the tax is unfair because people who receive wages pay no state tax.

“Repeal of the Hall Income Tax is now supported by a majority of members in the 108th General Assembly including Lt. Governor Ramsey and Speaker Harwell. Any [attempt] to derail our incremental reductions defies the will of the majority of members and hurts seniors, those who certainly deserve tax relief,” said Andrew Ogles, Tennessee director of Americans for Prosperity, in a statement.

Phased Out Over 6 Years

The Tennessee chapter of Americans for Prosperity, Americans for Tax Reform, and the Beacon Center of Tennessee have been leading the charge against the tax by endorsing HB 1367, introduced by State Rep. Charles Sargent (R-Franklin), chairman of the Tennessee House Finance, Ways and Means Committee. If the measure becomes law, it would reduce the tax rate one percentage point a year beginning January 1, 2015. The tax would be totally phased out over six years. The bill has a provision that would stop the yearly reduction in years when state revenue targets are not met.

In a letter to the state’s Finance, Ways and Means Committee, Americans for Tax Reform President Grover Norquist wrote, “As it stands, the Hall Tax represents a relatively small portion of Tennessee’s annual revenue, amounting to only 0.09% of state and local revenue in Tennessee. This small reduction in revenue, which would be gradually phased in, should also be compared to the growth of Tennessee’s budget in recent decades.

“From 1999 to 2009, Tennessee’s spending ballooned by more than 20% in excess of the rate of inflation and population growth. From 1989 to 2009, spending grew by 36% in excess. Phasing out the Hall Tax during a minimum of six years would provide ample time for state and local governments to prepare.”

Business Climate Boost

A recent Tax Foundation analysis concluded elimination of the tax would move Tennessee up from 15th to 11th in the foundation’s business tax climate rankings.

The left-leaning Institute on Taxation and Economic Policy recently issued a report that concluded, “Because the vast majority of investment income subject to the Hall Tax is collected by high-income taxpayers with large amounts of accumulated wealth, most Tennesseans would see little if any direct benefit from repealing the tax.”

The ITEP report estimates 63 percent of the benefit would go to the wealthiest 5 percent of Tennesseans. Because state residents may deduct Hall Income Tax payments from their federal taxes, eliminating the tax would offset some of the savings by boosting the amount of income subject to federal tax, according to the study.

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

In advance of the 2014 election, the Obama administration has drawn the political discussion away from its unpopular and flawed health care plan, usually called Obamacare, to bring public attention and support for increased income redistribution.

President Barack Obama has openly encouraged envy of the top 1 percent of income earners. Reducing the share received by the highest earners to provide revenue for larger transfers to the lowest earners has long been a main objective of his administration. We can all expect this theme to be trumpeted loudly by the mainstream press as the midterm election approaches: Some of us can have more, the argument goes, if we force others to have less.

Support for the alleged social benefits of setting much higher marginal tax rates on the highest incomes has now been offered by the International Monetary Fund, based heavily on research by two French economists named Thomas Piketty and Emanuel Saez. The two worked together on the faculty at MIT, where the current research director of the IMF, Olivier Blanchard, was a professor. Like Piketty and Saez, he too is French. France has, for many years, implemented destructive policies of income redistribution.

Professor Piketty collected data on income distribution from approximately 20 countries over periods of different length. He concluded that raising the tax rate to 60 percent on the highest incomes has now been offered by the International Monetary Fund, based in the New York Times, Capital in the 21st Century, one of the great achievements of modern economics. It put it in a class with Karl Marx’s Das Kapital and John Maynard Keynes’s General Theory.

Wrong Conclusion on Causality

This lavish praise seems both wrong and extreme. I agree that in the past there was a notable positive association between economic growth and the spread between the shares of income going to the top 1, 5, or 10 percent of the earners and the share going to the remainder.

The mistake is to conclude that narrowing the distribution contributes to growth. The far more plausible explanation is that investment and the IMF have the causality running the wrong way. Taxing the rich to redistribute did not produce growth. On the contrary, growth reduced the share earned by the highest earners.

In my 2012 book Why Capitalism? I used some data on the share of income received by the top 1 percent that two Swedish economists gathered. Piketty uses some of the same data. The seven countries in the Swedish dataset are the United States, the United Kingdom, Sweden, Australia, France, Canada, and the Netherlands. Of course, data on income distribution are never precise, but broad trends can be informative.

The data show a remarkable degree of uniformity. The share of income received by the top 1 percent declined persistently from about 1910 to 1980. The share fell from an initial 20 to 25 percent of total income to about 5 to 8 percent. Then the share rose in several of the countries, notably the United States, the UK, Canada, and Sweden. By the end of the sample data, about 2005, the share in several of these countries was back to about 10 percent. The share of the top 1 percent in the United States reached 15 percent, more than halfway back to where it was early in the twentieth century.

At the start of the series, private capital received a relatively high return because it is rather scarce. As investment and the capital stock rose during the twentieth century, the share of total income going to capital declined. The total income from capital increased but more slowly than total income. Since the highest-income earners receive a disproportionate share of their income as earnings on capital, their share fell.

That alone does not explain the steep decline in the share received by the top 1 percent. During the early twentieth century, the United States absorbed millions of immigrants, many unskilled. Many began employment at low-wage jobs. Minimum wage laws were not passed until the 1930s. By working, the immigrants learned new skills; their productivity increased and with it their wages. That narrowed the gap between the incomes of the top and the bottom earners. But many did something else. They sent their children to colleges and uni-
versities where they learned professional skills that earned middle-class incomes.

This process continued in recent decades for immigrants from Korea, China, Mexico, and Latin America. That history sends an important message. The growth of the middle class and the narrowing of the income distribution was in large part a result of working to acquire new skills and higher productivity.

President Obama’s program works against this process. It doesn’t reward work. It gives the unemployed and underemployed food stamps, health care, housing allowances, and income. Instead of working, many learn to live on the government benefits, supplementing them occasionally by working in the underground economy. Instead of acquiring productive skills, they learn how to live without working at regular jobs. That’s one way the welfare state worked to increase the share of the highest paid 1 percent after 1980. The welfare state contributes also by weakening and even destroying family structure. Single-family women are often on the bottom rung of the income distribution.

Importance of Human Capital

A different process is at work now. The capital that is most highly rewarded is now human capital—the education and skill that produces innovations such as the Internet, social media, popular apps, fracking, and three-dimensional manufacturing. The top 1 percent of the earners in any year include people like Steve Jobs and Bill Gates who made the Internet into a commercially successful, widely used means of communicating. But the top 1 percent also includes leading sports stars with unique skills and rock musicians with enormous popular appeal.

And what does Bill Gates do with his wealth? He spends much of it on improving health care in Africa and improving education in the United States. An example is the effort to provide bed nets to protect Africans from malaria, an outcome the public bureaucrats failed to achieve after decades of foreign aid.

The noisy political clamor about the rise in the share going to the top 1 percent gives no attention to the importance of education, skill, and an environment that encourages innovation. It is not an accident that most new products and much new music originate in the United States. Countries like Canada, Sweden, and the UK contribute also, welcoming foreign innovation and willing to reward those who bring new ideas to market successfully. And for reasons that the critics should explain, they do not include in-kind transfers and corporate payments for health care and pensions as part of the income of the employed.

What has worked in the United States for several centuries has worked well for many other countries in the past 50 years. Once China adopted capitalist methods, it moved millions out of low-productivity agriculture, taught them new skills, and raised their wages. Korea sends its young to learn new skills in the United States. That enabled it to move successfully from a low-wage provider of unskilled labor to a technically advanced country with a skilled labor force. And it increased freedom along with wealth. Other examples are Hong Kong, Singapore, and Taiwan—free, capitalist democracies. Add Chile, Peru, and Mexico among others.

The Fleeing French

France is at the opposite pole. Mired in its hatred of capitalism and demands for redistribution, it has maintained its low share of income going to the top 1 percent. But the cost is high. The young and innovative leave France for the UK and other shores. The French get massive redistribution and unemployment for many who remain behind.

Voters who will hear the Obama call for envy and redistribution should ask themselves and others: Would you prefer to live in an America where the market is dynamic and opportunity abounds, or in France, where unemployment is high and tax rates are crushing? Don’t you prefer opportunity to envy?

Allan H. Meltzer (am05@andrew.cmu.edu) is a distinguished visiting fellow at the Hoover Institution and the Allan H. Meltzer University Professor of Political Economy at the Tepper School of Business at Carnegie Mellon University. Professor Meltzer has served as a consultant on economic policy for the U.S. Congress, U.S. Treasury, the Federal Reserve, the World Bank, and the U.S. and foreign governments and was chair of the International Financial Institution Advisory Commission. Used with permission of Defining Ideas, a Hoover Institution journal: http://www.hoover.org/publications/defining-ideas/
Kansas Lawmakers Made ‘Unreasonable Disparities’ in School Funding, State’s Supreme Court Rules

By Travis Perry

In a long-awaited decision, the Kansas Supreme Court ruled state lawmakers created “unconstitutional” and “unreasonable wealth-based disparities” by withholding certain state aid payments to public schools.

Although the legal battle leading up to the decision in *Luke Gannon et al. v. State of Kansas* has been a four-year slog since the lawsuit’s initial filing in 2010, much of the March ruling boiled down to the court’s interpretation of what is considered equitable and adequate education funding.

Although the state supreme court unanimously upheld a lower court decision regarding the state’s failure to equitably disburse capital outlay and supplemental general payments to Sunflower State schools, it stopped short of issuing a decree for specific funding to meet the legislature’s constitutional requirement to provide an “adequate” education.

“Under the facts of this case, the district court panel did not apply the correct test to determine whether the State met its duty to provide adequacy in K–12 public education as required under Article 6 of the Kansas Constitution,” the court decision stated, explaining any decision about total funding levels would be bounced back to Shawnee County District Court for further consideration.

The justices stated in the opinion that addressing concerns relating to equal state aid payments also could affect its assessment of overall education funding.

Dave Trabert, president of the Kansas Policy Institute, a pro-market think tank, said the partial reversal of the ruling, plaintiffs told the Topeka Capital-Journal the state would need to appropriate between $80 million and $150 million to comply with the judicial decision.

No Way to Force Compliance

“With no police force and no ability to sanction or punish lawmakers, the court would have no way to make the legislature comply,” said Chapman Rackaway, political science professor at Fort Hays State University. “If the legislature wants to ignore the court’s decision, they are perfectly within their rights to do it. It would only be with a massive revolt by voters ousting lawmakers who participated in ignoring the decision that there would be any consequences to defying the court.”

Travis Perry writes for Watchdog.org, where this article first appeared. Used with permission.

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Tax Breaks for Iowa Start-Ups Go Mainly to Big Corporations

By Paul Brennan

According to reports from the Iowa Department of Revenue, an obscure tax break—the Research Activities Credit—has allowed major corporations to receive millions of dollars in tax refunds from the state without paying a dime in state corporate income tax.

Exactly how much Iowa has paid to companies such as Deere and Company and Monsanto since the RAC was created in 1985 is impossible to determine. The IDR wasn’t required to issue reports on the tax credit until 2009, and 2010 was the first full year covered by annual reports.

The RAC allows a company to claim a tax credit equal to 6.5 percent of its Iowa-apportioned research activities. Although most states offer research-and-development tax credits, Iowa is one of only seven states in which that credit is refundable. This means the companies receive money from other taxpayers if their RAC tax credit is more than what they owe in taxes.

Lion’s Share to 12 Companies

In 2013, 185 companies claimed $53.5 million under the RAC and a supplemental RAC, but almost 87 percent of it went to just 12 big companies.

Deere and Company, which reported profits of more than $3.5 billion in 2013, was last year’s biggest RAC claimant, receiving $13.8 million.

This is almost the exact opposite of how it was proposed the RAC would work when it was sold to the legislature and public in 1985. It was supposed to help start-up companies in Iowa, not fatten the bottom line of big corporations headquartered out of state.

Even though almost all benefits of the RAC go to already-profitable larger companies, the Iowa Economic Development Authority still claims it is important for job growth in Iowa.

“It’s an important element in our toolbox,” Tina Hoffman, IEDA’s marketing and communications director, told IowaWatchdog.

“Research is tied to manufacturing and leads to new production lines,” Hoffman explained. “It creates the sort of high-skill, high-wage jobs we want in Iowa.”

But Hoffman’s confidence in the RAC isn’t supported by economists who have studied it.

‘Not Possible to Measure’

A study of the RAC published in 2011 by the IDR concluded “it is not possible to measure the extent to which the credit drives the amount of research conducted in Iowa.”

And to whatever extent the RAC is driving research, the results are not impressive.

According to a 2010 study of research activities in Iowa, conducted by two Iowa State University economists, “there is no clear evidence that the state’s competitive position in terms of overall R&D activity or total productivity growth as measured by GDP have improved during the two decades of the RAC program’s existence.”

Evidence is also lacking for the high-wage part of the “high-skill, high-wage jobs” the IEDA claims the RAC creates.

The 2011 IDR study states “an analysis of wages paid by companies with credit claims did not show those companies pay higher average wages to employees compared to companies in the same industry with no credit claims.”

Barely Used by Start-Ups

As for helping Iowa start-ups, the IDR study concludes, “the credit is not heavily utilized by start-up companies.”

Between 2006 and 2009 “just over one percent” of new companies filed an RAC claim.

According to the IDR study, the most remarkable thing about the RAC is the unusually large amount it pays in refunds to “large, multi-state research companies” that pay no state corporate income tax.

Iowa pays approximately 63 percent more to such companies than other states the study examined, the report stated.

‘Outside the Budgeting Process’

Thinking about the RAC only as a tax break for big companies obscures its real impact on the state, says Mike Owen, executive director of the non-partisan Iowa Policy Project and a long-time critic of the RAC.

“This is a budget decision that’s being made outside the budgeting process,” Owen said. “The money for the refund checks being sent to those companies comes out of the state’s general fund. It could be used for other purposes, like funding schools.”

But because the RAC is a permanent part of the tax code and doesn’t need to be renewed, the question of how it affects the state budget is seldom considered.

“It’s been a long time since the legislature has taken a serious look at it,” Owen said.

Still, he says he’s hopeful the information provided in annual reports on the RAC will eventually lead lawmakers to reconsider it.

“Iowa taxpayers should be allowed to decide whether they want to be sending those checks to those already very profitable companies,” Owen said. “Whether the money is going to be sent to the shareholders of Deere and Company or spent on needs in the state isn’t a decision that should be made on autopilot, like it is now.”

Paul Brennan (pbrennan@watchdog.org) reports for IowaWatchdog.org, where this article first appeared. Reprinted with permission.
Ill. Dems Drop Plans for Surcharge, Progressive Tax

By Steve Stanek

Democratic leaders in Illinois have given up their attempts—for now—to impose an income tax surcharge on high-income earners and create a “progressive” income tax to replace the current flat-rate tax.

State Senate President Pro Tempore Don Harmon (D-Oak Park) acknowledged in late April he could not muster enough votes before the end of the spring session to OK a statewide referendum for an income tax that would charge higher rates on higher incomes.

Earlier in the month, House Speaker Michael Madigan (D-Chicago) dropped plans for a 3 percentage-point tax surcharge on persons with incomes of $1 million or more. He needed every Democrat legislator to support the measure but was stymied by two holdouts—state Reps. Scott Drury (D-Highwood) and Jack Franks (D-Marengo).

Harmon called his measure the “Fair Tax” because he said it’s fair that people who earn higher incomes pay higher tax rates.

“The Fair Tax has gained significant momentum in the last year, and I’m committed to continuing to work to get this passed in the fall veto session later this year,” Harmon said in a statement.

‘Massive Tax on Middle Class’

“The progressive tax was sold as a ‘fair tax’ that would ‘make the rich pay their fair share.’ However, the more information taxpayers received about the progressive tax, the more they realized it would have equated to a massive tax increase on middle-class Illinoisans that would only serve to feed Springfield’s insatiable appetite for overspending,” said John Tillman, CEO of the Illinois Policy Institute.

He continued, “Illinois government doesn’t need more money. Instead, legislators need to focus on truly reforming Illinois’ budget and bringing jobs back to our great state.”

Three years ago the Democrat-dominated Illinois General Assembly—with no Republican votes—raised the state’s personal income tax rate from 3 percent to 5 percent, a 67 percent increase in the tax rate. That increase, coupled with a 46 percent increase in the state’s corporate tax, has taken an additional $31 billion from Illinois residents and businesses. The tax increases are scheduled to roll back partially in January 2015.

More Money, Worse Problems

Gov. Pat Quinn (D) and other Democrat leaders want to make the temporary tax increases permanent. Despite billions of dollars of additional revenue, Illinois’ fiscal situation has worsened, with the state having the nation’s worst pension funding, lowest credit rating among the 50 states, and second-highest unemployment rate.

Quinn and legislative Democrats say the state government cannot afford to lose the revenue. When they passed the tax increases, they promised the extra revenue would be used to fix the state’s fiscal problems.

David From, Illinois state director of Americans for Prosperity, said the Madigan and progressive income tax proposals would further hurt job prospects in the state:

“With the second-highest unemployment rate in the nation, one would think the Democrat leaders of Illinois would want to grow jobs for our families. Unfortunately, yet again they choose to pursue policies that will push more jobs out of the Land of Lincoln by punishing job creators,” he said in a statement.

Steve Stanek (sstantek@heartland.org) is a research fellow at The Heartland Institute and managing editor of Budget & Tax News.
N.D. Expects to Gain from Minn. Minimum Wage Hike

By Rob Port

Minnesota lawmakers have agreed to a minimum wage increase that would require pay hikes for an estimated 350,000 residents. How will the policy affect bordering states?

The Greater North Dakota Chamber of Commerce, which recently upset some Minnesota officials with cheeky “North Dakota Is Open For Business” billboards aimed at luring Minnesota businesses west across the border, says the state is poised to take advantage.

“This move by Minnesota again proves that the leadership in Minnesota looks at business as something to tax and regulate, whereas in North Dakota we see business as something that is encouraged in our state, and is the lifeblood to our economy and our citizens’ prosperity,” said Jon Godfread, the group’s vice president for governmental affairs.

“I think in terms of businesses it shows another reason to relocate to North Dakota,” he said.

Godfread sees a trend in Minnesota businesses moving to North Dakota or expanding their operations there, and he expects that to continue because of the new wage policy.

“There are many companies located in [Minnesota] that are expanding into North Dakota,” he said. “I see that trend continuing especially if the leadership in Minnesota wants to make the contrast between North Dakota and Minnesota so great.”

Godfread said some North Dakota border communities may lose a few employees to Minnesota’s higher minimum wage, but he noted wages have grown rapidly in North Dakota, thanks to a booming economy.

“I doubt we see much change in North Dakota, other than more businesses moving from Minnesota to North Dakota,” he said. “In terms of employees we are paying in many cases above the proposed minimum wage already, that is the market at work. A $15 [per hour] job at a McDonald’s in Bismarck is [a] prime example of the free market at work.”

North Dakota Leads in Income Growth

According to the federal Bureau of Labor Statistics, North Dakota has led the nation in personal income growth in six of the past seven years, with incomes in the state nearly doubling in the past decade. The state is now third in the nation for personal incomes, behind Connecticut and Washington, DC.

Here are the minimum wage changes Minnesota lawmakers have agreed to:

• The minimum wage for businesses with gross sales of more than $500,000 would rise to $8 in 2014, $8.50 in 2015, and $9.50 in 2016.
• The minimum wage for businesses with gross sales less than $500,000 would rise to $6.50 in 2014, $7.25 in 2015, and $7.75 by 2016.
• In 2018 the minimum wage will begin increasing with inflation, with a cap at no more than 2.5 percent per year. The governor would have the option to halt the yearly increase.

North Dakota has no state minimum wage. The federal minimum wage is $7.25 per hour.

Rob Port (rport@watchdog.org) reports for Watchdog.org, where this article first appeared.

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Scott A. Hodge
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Louisiana has the nation’s highest rate of incarceration. There are a number of reasons for the dramatic growth of the state’s prison population over the past two decades, but one important factor is the rise of determinate sentencing laws.

This has caused a growing number of non-violent offenders to serve long prison terms without an opportunity to be considered for parole. In many cases, these offenders serve time in prisons where the lack of training and educational options increases the likelihood that they will be released without any of the skills needed to play a productive role in society.

This costs the state hundreds of millions of dollars in increased corrections expenditures, to say nothing of the incalculable social costs. The fact that so many young men and women are behind bars also worsens the state’s growing labor shortage.

‘Conservative’ States Scaling Back

As many other states also experienced increased incarceration rates over this time, legislators around the country have been taking steps to reduce prison populations without compromising public safety.

Notably, conservative states such as Texas and Georgia have begun to steer nonviolent offenders away from prison, emphasize rehabilitation over jail time, and reduce penalties for many drug and property crimes. The Right on Crime project has worked to advance sensible reforms throughout the states and is supported by leaders across the center-right spectrum.

These reforms are receiving broad support. Businesses are playing an increasingly important role in this trend, and a statewide consortium of business, religious, and civic organizations is now committed to developing a more just and sustainable criminal justice system in Louisiana.

The Smart on Crime campaign would apply relevant lessons from other states to Louisiana. Below are bills that have been filed in the state legislature to advance these goals and therefore improve public safety in Louisiana:

- Opening Doors to Workforce Provisional Occupational Licenses: HB911 (Leger) allows certain ex-offenders to obtain a provisional, or probationary, occupational license if they are otherwise qualified. This bill would make it easier for qualified ex-offenders to rejoin the workforce.
- Civil Liability Protection: SB339 (Donahue)/HB505 (Dixon) would immunize employers who hire ex-offenders without a violent or sex offense from being sued on that basis alone. This would increase the likelihood that employers will consider hiring qualified ex-offenders.

Expanding Alternatives to Incarceration

- Veteran’s Courts Program: SB332 (E. Guillory) authorizes courts to create specialized Veteran’s Treatment Court Programs throughout Louisiana to assist veterans overcoming drug and substance abuse issues and any mental health issues contributing to involvement with the criminal justice system. The court programs would operate like current drug court programs throughout the state but function in a manner tailored for veterans. These specialized courts could use federal resources and help veterans access federal veteran programs and services offered for reintegration and rehabilitation.
- Community-Based Corrections: HB914 (Leger) creates the Community Corrections Performance Incentive Act and applies cost savings from reduced incarceration costs to building up community-based corrections. This bill provides for an annual calculation of savings from reduced recidivism and applies a portion of the savings to implementing practices demonstrated to further reduce recidivism.

Sensible Guidelines for Parole Eligibility

- Cleansing Period: SB383 (LaFleur/Mills) says an offense will not be counted as a second or subsequent offense if more than 10 years have lapsed since expiration of maximum sentence for prior conviction. This would apply only to non-violent and non-sex offenses and would result in more non-violent offenders being eligible for parole consideration.
- Parole Eligibility for Older, Non-Violent Inmates: HB329 (Lopinto) makes parole eligibility available to non-violent offenders serving life sentences pursuant to habitual offender law, who are at least 50 years of age, if they have met a list of specified conditions. These include, but are not limited to, having served at least 13 years of imprisonment in actual custody, no disciplinary offenses in past 12 months, and completing relevant treatment/counseling.
- Medical Parole: HB210 (Jefferson) would amend current law to expand eligibility for medical parole. The proposed reforms would enable the Department of Corrections to more efficiently and preemptively utilize the Medical Parole Procedure, further tap into existing cost-effective treatment alternatives to offset the medical cost of these infirm inmates, and curb DOC’s increasing need to dedicate additional wings at correctional institutes specifically to infirm inmates.

Smarter Sentencing for Non-Violent Offenders

- Marijuana Possession: SB323 (Morrell/Adley) provides that simple possession of marijuana would be a misdemeanor upon second and subsequent conviction, rather than enhanced to a felony grade offense with increasing penalties. The state would save millions of dollars in supervision and incarceration costs by making this change. This would not affect possession with intent to distribute, cultivation, or distribution.
- Safety Valve: HB745 (Moreno) would give the judge discretion in certain non-violent/non-sex cases to depart from mandatory minimum sentences. This would generally affect sentences for drug offenses. This legislation is based upon a statute passed and successfully implemented in Georgia.

Republicans have benefited politically from being the tough-on-crime party. The success of leaders like Rudy Giuliani, who helped improve public safety in New York City by supporting strong and effective law enforcement, is something to be embraced.

While lawbreakers should be punished, the evidence from states like Texas demonstrates there is a path that is fair to victims, offenders, and taxpayers.

Kevin Kane (kkane@pelicaninstitute.org) is president of the Pelican Institute for Public Policy in New Orleans, Louisiana.
**Portland-Area Revolt Against Light Rail Project Continues**

**By Wendell Cox**

In a hard-fought election campaign, voters in the city of Tigard, Oregon narrowly enacted another barrier to light rail expansion in suburban Portland.

The Washington County Elections Division reported that with 100 percent of precincts counted, Charter Amendment 34-210 had obtained 51 percent of the vote, compared to 49 percent opposed, in the March election.

The Charter Amendment establishes as city policy no transit high-capacity corridor can be developed within the city without first having been approved by a vote of the people. High-capacity transit in Portland has virtually always meant light rail.

**Anti-Rail Candidates Win**

In a previous ballot issue, Tigard voters had enacted an ordinance requiring voter approval of any city funding for light rail. Similar measures were enacted in Clackamas County and in King City in Washington County. Across the Columbia River in Clark County (county seat: Vancouver), voters rejected funding for connecting to the Portland light rail system.

After the Clackamas County Commission rushed through a $20 million loan for light rail, just days before the vote against light rail, two county commissioners were defeated by candidates opposed to light rail, with a commission majority now in opposition.

The Columbia River Crossing, which would have included light rail to Vancouver, was cancelled after the Washington legislature declined to fund it. In a surreal aftermath, interests in Oregon seriously proposed virtually forcing the bridge on Washington, fully funding the project itself. A just-adjourned session of the Oregon legislature failed to act on the proposal, which now appears to be dead.

**Transit Faces Money, Ridership Woes**

Portland’s transit agency faces financial difficulty and has been seriously criticized in a report by the secretary of state. The agency has more than $1 billion in unfunded liabilities and carries a smaller share of commuters than it did before the first of its six light rail and commuter rail lines was opened.

The latest American Community Survey indicates 3,000 more people work at home than ride transit (including light rail and commuter rail) to work in the Portland metropolitan area. Before light rail (1980), transit commuters numbered 35,000 more than people working at home. Since then, transit’s market share has dropped by one-quarter.

Wendell Cox is a senior fellow of The Heartland Institute. Used with permission of NewGeography.com.
Pennsylvania Auditor General Warns of Pension Woe

By Eric Boehm

Pennsylvania’s public pension nightmares are worse than they seem, and local governments face the prospect of tax increases or even bankruptcies caused by mounting levels of pension debt.

While Pennsylvania lawmakers try to find a foothold on the $47 billion unfunded liability in two state-level pension plans for public school employees and state workers, another potential pension crisis is unfolding in small towns, mid-sized boroughs, and large cities across the Keystone State.

“One pension plans are so under-funded that promised retirement commitments are at risk. If they fail, the cost will be passed on to the taxpayers. This liability can truly become every taxpayer’s nightmare,” said Eugene DePasquale, Pennsylvania’s auditor general.

All told, 573 of the 1,218 municipalities in the state have under-funded pension plans—totaling more than $6 billion in the red.

DePasquale has called for action from state and local officials.

‘Pension Tax’ a Possibility

Municipalities with underfunded pension plans will have to increase property taxes, and some may have to create a direct “pension tax” on residents’ earned income to pay the bills, DePasquale warned.

He rattled off a list of 13 recommendations that would help, saying no single change would be enough to address the problem.

Much of the problem rests in Philadelphia and Pittsburgh. The two cities account for more than $5 billion of the total unfunded liability for municipal pension plans in the state. But that doesn’t mean other places don’t have troubles, too.

‘More Imminent at Local Level’

“The crisis is really more imminent at the local level than it is at the state level,” said Jim McAneny, executive director of the state’s Public Employee Retirement Commission, which advises the General Assembly on pension issues.

Though the state has an eye-popping $47 billion unfunded pension liability, it has more means to raise revenue and more options when it comes to dealing with those costs, he said.

Municipalities have fewer options to deal with pension costs because of state laws concerning collective bargaining rights for public employees. That means places such as Allentown ($138 million in unfunded pension debt as of 2011), Scranton ($113 million), York ($54 million), and the 12 other cities with more than $10 million in debt have few options when it comes to reducing long-term debts.

Raising revenue is really the only option, but that comes with a steep price for taxpayers.

DePasquale warned municipalities may be forced to follow Detroit into bankruptcy to relieve some of the pension burden.

That raises the risk of slashing public employees’ expected retirement payments, which comes with its own set of problems.

‘System Is Not Sustainable’

“The current system is not sustainable and municipal employees, including police officers and firefighters, deserve to know that the pension they are counting on will be there when they retire,” DePasquale said.

For now, the General Assembly does not seem too interested in the municipal pension issue.

But DePasquale, a Democrat from York County, received some support from state Rep. Seth Grove (R-York).

Last year Grove touted a plan to overhaul municipal pension plans by moving all future hires into a different pension system that would reduce benefit costs. It never moved out of committee, though the bill is still alive.

“I strongly support the auditor general’s findings,” Grove said. “My legislation would reduce the financial burden on local governments while ensuring sustainable municipal worker pensions.”

Consolidation Recommended

Most of DePasquale’s recommendations have to do with restructuring Pennsylvania municipal pensions into a more consolidated form. He suggested establishing consistent member contribution levels, a uniform expected rate of return, and a new pension system for new hires.

He’s not the first person to look at Pennsylvania’s 2,500 separate municipal pension plans and conclude consolidation should be a major part of any reforms. The state has roughly a quarter of all municipal pension plans in the country, and no other state has more than 500 such plans.

“It’s a longstanding recommendation from anyone who has ever looked at pensions in Pennsylvania,” said McAneny. “We’re all looking for ways to save money, so eliminating duplicative processes would be a good place to start.”

No Guarantee of Improvement

But consolidation of plans does not guarantee any serious financial reform, said Rick Dreyfuss, a pension expert with the Manhattan Institute, a conservative think tank.

“After all, they consolidated the 500 school districts into one pension plan,” said Dreyfuss, referring to the Public School Employees Retirement System, or PSERS, which has an unfunded liability of more than $30 billion.

DePasquale might have one more motivation for suggesting consolidation. The state auditor general is charged with auditing each municipal pension plan each year—so fewer plans would make his own job a little easier.

Eric Boehm writes for the Pennsylvania Independent, where this column first appeared. Used with permission.
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