Panel Sees ‘Immense Risk’ in California High-Speed Rail Plans

By Steve Stanek

Transportation experts and taxpayer advocates are hailing an independent review panel’s recommendation against borrowing to build a high-speed rail line in California, but the state’s rail authority indicates it plans to keep rolling with its plans.

The California High-Speed Rail Peer Review Group created by the state legislature to analyze the feasibility of the proposed high-speed rail system concluded it “represents immense financial risk” because there is no identifiable source of reliable funding. The recommendation is non-binding.

The state government is mulling borrowing $2.7 billion to start construction of the first leg of the project. Cost estimates for the full project have tripled to $66 billion in current dollars since 2000, with the rail authority itself estimating...
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Illinois College Tuition Program May Need $1.6 Billion Rescue

By Phil Britt

The College Illinois! prepaid college tuition program needs a bailout in order to stay solvent, according to an analysis completed for the Illinois Student Assistance Commission.

According to financial consultant Gabriel Roeder Smith & Company, the program has a deficit of nearly $560 million and needs $1.6 billion to stay solvent for the next 25 years. Program underfunding, failure to account for quickly rising college costs, exaggerated return on investment expectations, and poor investment performance are the main problems.

The program has suspended sales of new contracts. If no new contracts are sold, the shortfall will develop between 2022 and 2036 to pay for past contracts coming due, the report adds. The contracts are supposed to allow parents to pay in advance and lock in lower tuition rates for their children to attend state colleges and universities.

‘Questionable Investment Decisions’

“With the recent announcement that College Illinois! has suspended the sale of new contracts, many concerned families have contacted my office,” said state Rep. Jim Durkin (R-Western Springs), whose family has bought College Illinois! contracts. “I believe that Chairman Kym Hubbard’s decision is not leading College Illinois! down the path of closure. I believe this is a chance for the Illinois Student Assistance Commission to take a step back and evaluate the fund.”

Durkin said he would “like to see timelier reporting standards on the investments and liabilities in the fund” and added, “advertising, administrative costs, salaries, and operational costs are all draining the investment fund, and this must stop immediately.”

Durkin has introduced legislation to require College Illinois! to make investment decisions in open meetings. Those decisions currently are exempt from public review.

“[I]t is not a great shock that this type of ‘college pension plan’ is running into difficulty. ... Keeping pace with college tuition is like trying to catch a moving train.”

JOE ORSOLINI, PRESIDENT COLLEGE AID PLANNERS, INC.

‘Concerns About Mismanagement’

“Prepaid college tuition plans, such as College Illinois!, are designed to act like a ‘pension’ for college tuition in that you know what goes in and what should come out,” said Joe Orsolini, president of College Aid Planners, Inc., of Glen Ellyn, Illinois. “Given the performance of pensions in this country it is not a great shock that this type of ‘college pension plan’ is running into difficulty, especially when college tuition and fees increase 5.6 percent nationally per year over the past decade. Keeping pace with college tuition is like trying to catch a moving train.”

“[I]t comes down to mismanagement,” said Andrew Schrage, co-owner of Money Crashers, a Boston, Massachusetts-based personal finance site geared to young adults and teens. “College Illinois! made some bad investment decisions. They weren’t factoring in the underfunding of the account. They weren’t having people make the payments they needed to in order to match the withdrawals.”

Another problem, according to Schrage, was the failure to recognize the quickly rising cost of college, which has faroustripped inflation for many years, putting more pressure on fund managers to attempt to garner higher returns with the risky investments.

Schrage says the program made too many bad investments in risky financial instruments in order to increase returns rather than staying with safer investments. “Managing something like this isn’t like running a hedge fund. They should have recognized the problem a lot sooner. Only in the last quarter did they realize that there was a problem.”

Worst in Nation

Though there are other states with similar prepaid tuition programs, and some of the other ones have underfunding problems as well, College Illinois! is in the worst shape of any of them, Schrage says.

If the state does bail out the program, Schrage recommended administrators lower their promises and expectations for future returns for any new participants. However, Schrage says, the negative publicity College Illinois! has received may make it difficult for the program to attract future participants.

Phil Britt (spenterprises@wowway.com) writes from South Holland, Illinois.
‘Immense Risk’ Seen in Calif. High-Speed Rail Plans

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$98 billion to $118 billion when adjusted for inflation over the expected buildout, which could take 30 years.

‘Starts and Ends Nowhere’
The first segment is proposed to run from just north of Bakersfield to just south of Fresno in California’s Central Valley.

“It starts and ends in the middle of nowhere. That segment alone would eat up the entire bond issue,” said David Wolfe, legislative director of the Howard Jarvis Taxpayers Association, which opposes the project. “The private money isn’t there. The federal money isn’t there. It’s not an operational segment. It has to be able to exist and have a chance at turning a profit, and that is not possible.”

The California High-Speed Rail Authority rejected the Peer Review Group report, calling it “deeply flawed,” “in some areas misleading,” and “unfounded” in its conclusions.

“It is unfortunate that the Peer Review Committee has delivered a report to the Legislature that is deeply flawed in its understanding of the Authority’s program and the experience around the world in successfully developing high-speed rail,” said Roelof van Ark, CEO of the High-Speed Rail Authority, in a statement. “As someone involved in many of the successful high-speed rail programs internationally, I can say that the recommendations of this Committee simply do not reflect a real world view of what it takes to bring such projects to fruition.”

Soaring Costs
State Sen. Doug LaMalfa (R-Richvale) said he is about to introduce SB 22, a bill that would allow citizens across the state to vote on whether the project should be funded. In 2008, 53 percent of voters approved borrowing $10 billion for high-speed rail, but in less than four years official cost estimates have doubled, as have estimated ticket prices, from $55 a ride to $105 a ride. LaMalfa said polls show overwhelming opposition to the project today.

“Even that $105-a-ride estimate is low-balled,” LaMalfa said. “And ticket revenues will do nothing to retire the debt. The entire debt load would be repaid by California taxpayers or the federal government. Californians don’t want high-speed rail, the state can’t afford it, and the costs far exceed any benefit to our state’s transportation infrastructure. All credibility is shot with this rail bunch.”

LaMalfa said opponents still have a tough slog to kill the project, as the state legislature is dominated by Democrats, and many of the state’s Democratic Party leaders, including Gov. Jerry Brown, support the project. No Democrats have pledged to sponsor his bill to throw the high-speed rail issue back to voters.

Supporters say the project could create one million jobs—a figure LaMalfa scoffs at—and also argue more than $3 billion in federal funding would be lost if the state does not borrow the $2.7 billion to start construction.

Any Amount Too Much?
“One wonders, is there any amount of money that would cause California to pull the plug on this project? It started out as a $20 billion project, then became a $40 billion project, and they’re now talking $66 billion,” said transportation expert Wendell Cox, principal of Wendell Cox Consultancy.

“Beyond that,” Cox said, “when you look at the $98 billion figure people are mentioning, which accounts for the passage of time to finish construction, if you read the rail Authority’s business plan, they say $98 billion to $118 billion. I seriously wonder what it would take before the powers that be decide this is too much.”

Tom Schatz, president of Citizens Against Government Waste, said his organization, along with the California-based Reason Foundation and Howard Jarvis Taxpayers Association, issued a report in 2007 predicting the spiraling costs and funding problems.

“At that time, we pointed out the cost estimates were very low,” Schatz said. “We thought the cost would be at least $80 billion, and now they’re saying $98 billion, which I’m sure is still low. Perhaps, with this peer group recommendation, fiscal reality is hitting people square in the face.

“Even in California, where legislators are ready to spend money on anything, maybe they’ll see this as something where they say maybe we can’t afford to do anything more. It’s not surprising there are doubts. Anything that triples in price should cause doubts. The state certainly has other problems they should be addressing.”

IN OTHER WORDS . . .

“Despite a huge state budget deficit, Gov. Jerry Brown said last week that he not only intends to increase spending, he also plans to move ahead with California’s questionable high-speed rail project, even though multiple critiques conclude it is a waste of tax money.

“The governor’s refusal to delay or kill the implausible train project should make taxpayers wary of a bill introduced last week by Assemblyman Mike Feuer, D-West Hollywood, to allow ‘public rail transit projects’ to avoid rigorous environmental review.

“The Legislature should kill this bill, which threatens special treatment for the overpriced, little-needed and under-funded bullet train.”

— Orange County Register editorial, January 12, 2012

“Californians don’t want high-speed rail, the state can’t afford it, and the costs far exceed any benefit to our state’s transportation infrastructure. All credibility is shot with this rail bunch.”

DOUG LAMALFA
STATE SENATOR
RICHVALE, CALIFORNIA

Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of two Heartland publications, Budget & Tax News and FIRE Policy News.
By Kenneth Orski

Like many other observers, we have found the California High-Speed Rail Peer Review Group to have made a convincing case for a fresh look at the feasibility of the California high-speed rail project.

The Group’s report was issued as 11 House Democrats—eight from California—joined an earlier request from 12 Republican House members for an independent Government Accountability Office investigation of the embattled project.

That is why we find Governor Jerry Brown’s reaction—that the peer reviewers’ report “does not appear to add any arguments that are new or compelling enough to suggest a change of course”—incomprehensible. Either the governor issued the statement without the benefit of having read the report, or else he is so ideologically committed to the project that he refuses to look the facts in the face.

Powerful Conclusions

Precisely which conclusions of the report are not compelling enough, the governor’s spokesman has not made clear. Is it the statement that “the Funding Plan fails to identify any long term funding commitments” and therefore “the project as it is currently planned is not financially feasible”? Is it the reviewers’ assertion that “[travel] forecasts have not been subject to external and public review” and, absent such an open examination, “they are simply unverifiable from our point of view”?

Could it be their statement that “the ICS [Initial Construction Section] has no independent utility other than as a possible temporary re-routing of the Amtrak-operated San Joaquin service ... before an IOS [Initial Operating Segment] is opened”? Or, is it the panel’s conclusion that “… moving ahead on the HSR project without credible sources of funding, without a definitive business model, without a strategy to maximize the independent utility and value to the State, and without the appropriate management resources, represents an immense financial risk on the part of the State of California”?

To us, the findings seem at least deserving of a respectful consideration.

Dismissive Response

But the California High-Speed Rail Authority (CHSRA) is not ready to concede anything. Here is the opening paragraph of its response: “While some of the recommendations in the Peer Review Group report merit consideration, by and large this report is deeply flawed, in some areas misleading and its conclusions are unfounded. ... Although some high-speed rail experience exists among Peer Review Panel members, this report suffers from a lack of appreciation of how high-speed rail systems have been constructed throughout the world, makes unrealistic and unsubstantiated assumptions about private sector involvement in such systems and ignores or misconstrues the legal requirements that govern construction of the high speed rail program in California.”

It is not our intention to delve in detail into the Authority’s response and judge the soundness of its arguments. No doubt, the CHSRA response will come under a detailed examination by the Authority’s critics in the days ahead.

No Funding Source

Suffice it to say that, having carefully and with an open mind examined the Authority’s rambling nine-page response, we find that it did not satisfactorily rebut the Peer Review Group’s central point: that it is not prudent, nor “financially feasible,” to proceed with the $6 billion rail project in the Central Valley (including $2.7 billion in Proposition 1A bonds) in the absence of any identifiable source of funding with which to complete even the Initial Operating Segment.

To do so would be to expose the state to the risk of being stuck, perhaps for many years, with a rail segment unconnected to major urban areas and unable to generate sufficient ridership to operate without a significant state subsidy.

The Authority’s lashing out at the Peer Review Group and the dismissive tone of its response suggest that it has already made up its mind to stay the course and circle the wagons. That is not a wise posture to assume in the face of an already skeptical state legislature. C. Kenneth Orski (korski@verizon.net) is editor and publisher of the transportation newsletter Innovation NewsBriefs, where a version of this article was published. Used with permission.
Boeing Betrays Kansas, Despite Promises and Contract

Continued from page 1

The jobs will go to other Boeing facilities in Oklahoma, Texas, and Washington.

Angry Response
The imminent loss of Boeing has upset and angered many local, state, and federal officials in Kansas.

Boeing’s decision “is a confession that it will not honor its commitment to Kansas,” said Rep. Mike Pompeo (R-KS), in a statement. “Boeing’s statement confirms that it will indeed break years and years of promises.”

Pompeo added, “As I have said repeatedly—both publicly and to Boeing—Boeing, like every company, has the right to change its business plans and operate in the best interests of its stakeholders. What neither Boeing, nor any other company, has the right to do is make false statements, violate long-held commitments to communities or to receive federal contracts based on representations that it knows are not accurate.”

Mike Pompeo
U.S. REPRESENTATIVE - KS

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Pompeo added, “As I have said repeatedly—both publicly and to Boeing—Boeing, like every company, has the right to change its business plans and operate in the best interests of its stakeholders. What neither Boeing, nor any other company, has the right to do is make false statements, violate long-held commitments to communities or to receive federal contracts based on representations that it knows are not accurate.”

Poster Child for Incentives
“Boeing is the poster child for corporate tax incentives,” said state Rep. Jim Ward (D-Wichita), in a statement. “This company has benefited from property tax incentives, sales tax exemptions, infrastructure investments, and other tax breaks at every level of government. “These incentives were provided in an effort to retain and create thousands of Kansas jobs. We will be less trusting in the future of corporate promises,” Ward said.

Sedgwick County Commissioner Karl Peterjohn said, “Wichita and Kansas elected officials rallied to support Boeing during the tanker contract battle. The entire Kansas congressional delegation fiercely fought this extended multi-year fight. That support turned out to be a one-way street as Boeing’s political bait and switch blindsided Wichita and the half-million Kansans in the rest of Sedgwick County by eliminating over 2,000 jobs instead of providing the 7,500 additional aviation positions that had been promised.”

Peterjohn noted Boeing has long been the largest private employer in Kansas, building aircraft from World War II-era B-29s to Cold War-era B-47s and B-52s. Most recently Boeing in Wichita has fitted out the Boeing 747s that serve the president’s air travel needs as Air Force One.

“The Wichita area was used by Boeing like an oil rag that was a vital tool during the tanker contract battle but as disposable as a dirty rag once the contract was won,” Peterjohn said.

“A Severe Blow”
Wichita Mayor Carl Brewer said at a news conference, “The loss of 2,100 jobs will deal a severe blow to our local economy, and I offer my deepest condolences to the families who will be directly affected by this development.”

He added, “Wichita is still the Air Capital of the World, and the home to the highest qualified cadre of aviation workers. Boeing’s decision was Boeing’s to make, but we still hold the keys to our own future.”


Bitterly Fought Contract
Boeing won the tanker plane contract only after a long and bitter fight with the help of Kansas government officials. European Aeronautic Defence and Space Co., which builds the Airbus passenger aircraft, competed for the contract but lost to Boeing despite a scandal that saw two Boeing executives sent to federal prison in 2004 and 2005 for corruption in trying to win the contract. EADS would have built the tanker planes in Alabama.

The scandal forced the government to reopen the bidding, and in 2008 the Air Force awarded the tanker plane contract to a Northrop/EADS consortium. Boeing then succeeded in getting the government to change the selection criteria and again reopen competition.

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Transportation Bill, California Rail Funding in Doubt

By Kenneth Orski

Putting aside the major imponderable—the outcome of the presidential and congressional elections that inevitably will impact the federal transportation program—what can the transportation community expect in 2012?

Will Congress muster the will to enact a multiyear surface transportation reauthorization? Or will the legislation fall victim to election year paralysis? What other significant transportation-related developments lie ahead in the new year? Here are our speculations as we gaze into our somewhat clouded crystal ball.

A Multiyear Bill?

In 2011, the Senate Environment and Public Works (EPW) Committee passed a bipartisan, two-year surface transportation bill (MAP-21), and the Senate Commerce Committee approved the measure’s safety, freight, and research components. But at the end of the year, the bill’s titles dealing with public transportation, intercity passenger rail, and financing were still tied up in their respective committees (Banking, Commerce, and Finance). What’s more, the Senate bill ended up $12 billion short of meeting the $109 billion mark set by the EPW Committee as necessary to maintain the current level of funding plus inflation.

Finance Committee Chairman Max Baucus (D-MT) has yet to identify publicly the offsets needed to cover the final $12 billion of the bill’s cost. Repeated assurances by EPW Committee Chairman Sen. Barbara Boxer (D-CA) that the necessary “pay fors” have been found have met with widespread skepticism. It’s not entirely clear the bill, as approved on the Senate floor, will contain the full $109 billion in funding.

Cloudy Prospects for House Bill

On the House side, the fate of a multiyear bill remains equally clouded. In November, Speaker John Boehner (R-OH) announced he would unveil a combined transportation and energy bill, the American Energy & Infrastructure Jobs Act (HR 7). The bill would authorize expanded offshore gas and oil exploration and dedicate royalties from such exploration to “infrastructure repair and improvement” focused on roads and bridges.

However, questions have been raised about this approach. Numerous critics, including Boxer and Sen. James Inhofe (R-OK), the EPW Committee’s ranking member, allege the royalties the House is counting upon would fall billions of dollars short of filling the gap in needed revenue. The gap is estimated at approximately $75 billion to $80 billion over five years.

What’s more, using oil royalties to pay for transportation would essentially destroy the principle of a trust fund supported by highway user fees. In sum, the House bill, if unveiled in its currently proposed form, will meet with a highly skeptical reception in the Senate.

Assuming some form of both reauthorization bills will gain approval in February, will the two legislative bodies be able to reconcile their widely different versions by March 31, when the current program extension is set to expire? Or will the negotiations bog down in an impasse reminiscent of the current payroll tax stalemate?

Given the importance both sides attach to enacting transportation legislation, and given the desire of both sides to avoid the blame of causing an impasse, we think the odds are in favor of them reaching an accommodation—probably more along the lines of the Senate’s two-year bill than the still vague and unfunded House five-year version.

California Train Derailment?

In 2011 Congress effectively put an end to the Obama administration’s high-speed rail initiative by denying any funds to the program for a second year in a row. Does the same fate await the embattled $98 billion California high-speed rail project at the hands of California’s governor and state legislature in 2012?

At a December 15 congressional oversight hearing, witnesses cited a litany of reasons the projects is a “disaster,” in Rep. John Mica’s (R-FL) words. Among them: unrealistic assumptions concerning future funding; quixotic choice of location for the initial line section (“in a cow patch,” as several lawmakers remarked); lack of evidence of any private investor interest in the project; eroding public support (nearly two-thirds of Californians would now oppose the project if given the chance, according to a recent poll); “devastating” impact of the proposed line on local communities and farmland; unrealistic and outdated ridership forecasts; and lack of proper management oversight.

More recently, the project came under additional criticism. The job estimates claimed by the project’s advocates (“over one million good-paying jobs,” according to House Minority Leader Nancy Pelosi) have been challenged—and acknowledged by project officials—as grossly inflated. Four local governments in the Central Valley, including the City of Bakersfield, formally voted to oppose the project, fearing harmful effects on their communities. And agricultural interests are gearing up for a major legal battle, according to the Los Angeles Times.

Most unsettling for the project’s future is the inability of its sponsors to come up with the needed funding. To complete the Initial Operating Segment to San Jose (or the San Fernando Valley) would require an additional $24.7 billion. To finance this construction, the California Rail Authority’s business plan calls for $4.9 billion in Proposition 1A bonds and assumes $19.8 billion in federal contributions—$7.4 billion in federal grants and $12.4 billion in so-called Qualified Tax Credit Bonds (QTCB).

But the latter assumptions came in for sharp congressional criticism as so much wishful thinking, given the bipartisan congressional refusal to appropriate funds for high-speed rail two years in a row.

C. Kenneth Orski (korski@verizon.net) is editor and publisher of Innovation Briefs, where a version of this article first appeared. Used with permission.
Traffic Cameras in Chicago—For Safety or Money?

By Ian Mason

The Illinois General Assembly has sent to Gov. Pat Quinn (D) a bill that, among other things, would authorize speed-enforcement cameras on roads within one-eighth of a mile of Chicago’s schools and parks.

As 2012 opened, Quinn said he would decide by the end of January whether to sign or veto the bill many critics say appears designed more to boost city fine revenues than to improve safety.

A Chicago Tribune analysis determined approximately 47 percent of the city could be covered by the speed-enforcement cameras. Drivers caught going more than six miles per hour over the speed limit would receive $100 citations.

Chicago Mayor Rahm Emanuel asked for the bill, citing improved pedestrian safety near schools and parks if cameras are installed. The history of similar initiatives, both in Illinois and abroad, indicates money may be the main consideration.

The experience of red-light enforcement cameras lends credence to the idea that Illinois municipalities are motivated by traffic cameras’ revenue rather than safety. The cameras are manufactured and installed by private companies such as RedSpeed Illinois, based in the Chicago suburb of Lombard, and the international safety camera conglomerate Redflex Group. In a typical arrangement, the camera company monitors the cameras and mails tickets to those caught in an intersection on red, taking up to half the ticket revenue in the process.

More Cameras, More Crashes

The companies point to studies showing drops in intersection crash rates after camera installation, but independent studies, such as one conducted in 2008 by the University of South Florida, have found the cameras increase traffic accidents due to drivers slamming on the brakes to avoid tickets.

Brian Costin of the Illinois Policy Institute was instrumental in the recent abandonment of red-light cameras by his hometown of Schaumburg, Illinois.

When Schaumburg installed its first cameras at a busy intersection in 2009, more than 98 percent of tickets went to drivers turning right on red without a complete stop, something a 2001 National Highway Transportation Safety Administration study found virtually never caused crashes.

In a few months, that one intersection had generated nearly $1 million in ticket revenue.

Camera Backlash

After a public outcry, Schaumburg village officials asked the camera company, RedSpeed, to stop issuing tickets for right-on-red violations. Rather than sort between different types of violations, RedSpeed opted out of its enforcement contract. Presumably, without the cash flow from right-on-red tickets, and with the added burden of differentiating between violation types, the arrangement was no longer profitable for RedSpeed, Costin said.

Schaumburg eventually removed the cameras that, only months earlier, had cost hundreds of thousands of dollars to install.

Costin said if local officials really want to reduce the number of car crashes at intersections, a better alternative is to lengthen yellow lights. Several studies have shown extension of yellow lights decreases the number of motorists who run red lights and reduces accidents by 40 to 80 percent.

Chicago, with 186 red-light cameras, the most in the nation, sets its yellow light duration to three seconds, the bare federal minimum and significantly shorter than in its own suburbs. This increases the number of drivers in intersections during red lights.

Dubious Results

Speed cameras have a similarly dubious history elsewhere. In the United Kingdom, they are ubiquitous. As their political proponents and manufacturers are quick to point out, road accidents in the U.K. have fallen steadily since speed cameras were first approved in the early 1990s. Here too, some evidence disputes the role speed cameras play in improving road safety.

Accident rates continued to fall even as speed camera use decreased after 2010. According to the U.K. Department of Transportation, some sites saw an increase in accidents after cameras were installed, despite the nationwide decrease.

The cameras’ link to revenue generation is even more suspicious than their dubious safety record. Since 1993, British local government councils and central planning agencies installed more of the cameras on every type of road in the U.K. After Conservatives won control of the British parliament in 2010, their austerity measures forced a rever-

Sal. Local councils were forced to stop installing new cameras and cease operating some existing ones.

Suspicious Enforcement

Which cameras they left on is telling. A single camera in Dorset, placed immediately after a road switches from a 50 mph to a 30 mph speed limit, annually issued more than 22,000 tickets for more than £1.3 million ($2 million) in revenue. The area in question has seen only one serious car crash injury since 1999. Even as the cuts forced local councils and “safety camera partnerships” to turn off nearly half of Britain’s 6,000-odd speed cameras, this one remains in operation.

Chicago’s speed camera supporters, including Emanuel, insist safety is their only interest. In October 2011, a Freedom of Information Act request by the Chicago Tribune sought internal documents and emails pertaining to the camera project. The request was denied. Despite identifying 1,300 relevant emails, City Hall cited the “deliberative materials” exemption to FOIA in preventing the information’s release.

In evaluating the motives behind the speed-enforcement camera flash that may soon follow drivers traveling 26 mph in a 20 mph zone, Chicagoans can rely only on the history of their city government and of other traffic camera implementations.

“If the existing track record of the City of Chicago is any indicator,” said Costin, “this is an attempt to balance the city’s budget on the backs of motorists.”

Ian Mason (ninthoption@gmail.com) writes from Chicago.
By Elizabeth Henderson

In a recent statement to the Idaho Reporter, state Rep. Dennis Lake (R-Blackfoot) labeled himself a legislative “errand boy” for the American Cancer Society, pledging to work for higher cigarette taxes at the group’s behest.

Lake offered legislation for a higher cigarette tax last year but failed to win support from the Revenue and Taxation Committee, which he chairs. He says he plans to try again.

The proposal, touted as a “win, win, win solution” by the ACS coalition in terms of public health, revenue, and politics, would increase the Idaho cigarette tax by $1.25 per pack.

“The ACS and its supporters have an agenda. They’re trying to convince an otherwise anti-tax legislature to raise taxes,” said John Nothdurft, director of government relations at The Heartland Institute, which publishes Budget & Tax News. “Following a 2007 cigarette tax increase, New Jersey lost nearly $24 million in revenue as residents looked across state lines, online, and even to black markets for their cigarette purchases. In Idaho, tribal lands offer yet another loophole.”

More Tax Increases

Discrepancies between projected and actual revenue from cigarette tax increases often encourage government overspending as states receive less money than projected. According to the National Taxpayers Union, 41 of 59 state tobacco tax increases from 2001 to 2006 were followed within two years by tax hikes on the general public.

Cigarette taxes and other excise taxes attempt to tap resources from a base that is, by nature of the tax itself, both narrow and shrinking, as higher taxes discourage use of the taxed products or cause movement to black markets to avoid the higher taxes.

The taxes also can harm a state’s economic competitiveness. Idaho’s current tax rate of 57 cents per pack is eighth-lowest in the nation, and the suggested increase would render it 15th-highest.

“Having been a smoker, I know people will pay the price. You just won’t buy a quart of milk or something else to pay for it.”

LENORE HARDY BARRETT
STATE REPRESENTATIVE
CHALLIS, IDAHO

Excise taxes rarely deter existing smokers, something one outspoken opponent of Lake’s proposal—Idaho state Rep. Lenore Hardy Barrett (R-Challis)—said she knows firsthand.

“Having been a smoker, I know people will pay the price. You just won’t buy a quart of milk or something else to pay for it,” she told IdahoReporter.com in January.

Elizabeth Henderson (elizabeth henderson2012@u.northwestern.edu) writes from Chicago.

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Sinkholes seem to appear without notice. The earth beneath may be eroding for years, but the surface usually stays intact until the land collapses suddenly.

That describes the dire fiscal situations of most of the states in 2012. For years the financial conditions of 45 states have been eroding to the point that the Institute for Truth in Accounting (IFTA) has labeled them “financial sinkholes.”

A pervasive lack of truthful accounting and transparency in government budget processes has made it so most citizens have little warning of the impending fiscal collapse. On the contrary, they have been made to believe balanced budget requirements are preventing their states from spending more than their resources allow.

More than $1 Trillion Debt
According to the IFTA’s recent “Financial State of the States” study, that’s not the case. The IFTA has determined states have accumulated more than $1 trillion in debt.

In all but four states, a “taxpayer’s burden” now exists, representing the amount each taxpayer would have to send to their state treasury to fill its financial hole.

Put simply, responsibility for government spending in years past—including for government employees’ retirement benefits—has been shifted to future taxpayers.

If state budgets truly had been balanced, no taxpayer burden would have accumulated.

Connecticut’s Big Burden
The top five “Sinkhole” states each carries a per-taxpayer burden exceeding $23,000. Connecticut’s taxpayer’s burden is $41,200; New Jersey’s is $34,600; Illinois’ is $26,800; Hawaii’s is $25,000; and Kentucky’s is $23,800.

By contrast, the IFTA also identified five “Sunshine” states. Four of them—Nebraska, North Dakota, Utah, and Wyoming—each have a per-taxpayer surplus because they have available assets more than adequate to pay their obligations. Although taxpayers in South Dakota are burdened by past spending for which they will have to pay, South Dakota is included as a “Sunshine State” because it has the smallest deficit among the other states.

Due to the delay in states publishing their annual financial reports, data for the IFTA study are derived from states’ 2009 financial reports and related retirement plans’ actuarial reports. Now that all states have issued their 2010 financial reports, the IFTA is currently working to recalculate each state’s financial condition and taxpayers’ burdens.

These taxpayers’ burdens exist despite balanced budget requirements due to the deficient accounting policies used to calculate state budgets.

Flawed Budgeting Procedure
States today use cash basis budgeting, which allows them to overestimate revenues and underestimate expenses in the following ways:

- Loan proceeds are considered revenue.
- Revenue is created by moving money from one fund to another.
- Long-term assets are sold to fill short-term budget holes.
- A current budget year cost is not included if the related check isn’t written.
- Current compensation costs are pushed into the future.

The largest annual cost incurred by states is employees’ compensation, which includes benefits, such as health care, life insurance, and pensions, as well as other post-employment benefits (OPEB). These benefits are earned each day an employee works, meaning the cost accumulates every day. As these benefits are promised and earned, a liability is created that must be paid in the future.

Prudent management demands the value of this liability be estimated—and assets set aside—to make sure the payments can be made when they come due.

Because of the historical use of cash basis accounting and its focus on checks written today, the retirement benefit portion of current compensation costs have been ignored in budget calculations.

The IFTA also found most states’ unfunded pension liabilities are calculated assuming pension investments will earn 7 percent to 8.5 percent each year. These rates would be optimistic even in good economic times.

Missing Full Costs
The primary focus now, however, should be to get states to include in their budget calculations their full employee compensation costs, including the retirement benefits earned.

Current convoluted rules enable and encourage dishonesty in the budget process. It is practically impossible for legislators independently to determine whether the budget they are voting on is truly balanced.

A balanced budget is not just something to make citizens and politicians feel better. Every state but Vermont has a balanced budget requirement to help avert future financial difficulties and increase accountability. Because state governments can neither print money nor tax excessively, their ability to spend is finite, making truthful accounting crucial.

Truthful accounting also protects intergenerational equity, preventing the current generation of citizens from shifting the burden of paying for current-year services to future-year taxpayers—namely, our children and grandchildren.

IFTA’s “Financial State of the States” report proves these good intentions have been circumvented.

Pleasure But No Pain
Former U.S. Treasury economist Francis X. Cavanaugh once said, “Politicians should not have the pleasure of spending (getting votes) without the pain of taxing (losing votes).”

Yet that is precisely what has happened.

Future taxpayers will be burdened with paying prior years’ costs without receiving any services for those tax dollars.

Put simply, balanced budget requirements without truthful accounting do not work.

In the article on the opposite page I outline a budgeting system called “Full Accrual Calculations and Techniques” or F.A.C.T., which would give taxpayers a realistic idea of the burdens being placed on them.

Sheila Weinberg (sweinberg@truthinaccounting.org) is founder and CEO of the Institute for Truth in Accounting.
By Sheila Weinberg

To bring truth and greater transparency to state budget processes, the Institute for Truth in Accounting has developed a budgeting system called “Full Accrual Calculations and Techniques,” or F.A.C.T., which would require governors and legislatures to recognize expenses when incurred regardless of when they’re paid.

F.A.C.T.-Based Budgeting

F.A.C.T.-based budgeting is necessary because government has increasingly grown its role from funding and building infrastructure and operating the rather limited machinery of the state’s internal operations to being concerned with the health, welfare, and lifestyles of citizens and government employees. This expanded role involves committing new programs for citizens and employees not just for the current period but also for years to come.

F.A.C.T.-based budgeting would allow governments’ accounting and budgeting systems to evolve to provide a comprehensive indication of total activity and the long-term effects of current policies. It would record revenue in the budget year the activity revenue was generated. Expenses would be included in the budget year when the resources were consumed and the liability was incurred, regardless of when associated cash is actually received or paid.

By recording accounts payable and receivable, and thus the change in the value of assets and liabilities, F.A.C.T.-based accounting would keep a running tally of what a government owns and owes in economic terms. If a government promises pension benefits in the current year and must pay retirement claims in future years, the liability and expense is recorded when the event occurs. When the cash is actually paid, the liability is removed.

More Transparency

To increase transparency before a budget would come up for a vote, its financial effects would be summarized in easy-to-read, pro forma balance sheets, income statements, and cash flow statements. After the budget year, these statements could easily be compared to the state’s audited financial statements.

The calculation of the retirement liabilities on the pro forma balance sheet and the related costs included in the income statement would be based on the unfunded retirement liabilities determined by the states’ actuaries.

Particularly important for intergenerational equity, F.A.C.T.-based budgeting will limit elected officials’ ability to expand programs and services by deferring the payment of current costs.

The IFTA believes that if F.A.C.T.-based budgeting had been used by state governments over the past 50 years, they would not be in the situations of high financial risk they are in today.

Oversea Examples

Australia, Canada, and New Zealand have adopted successfully systems similar to F.A.C.T. These countries have experienced benefits in linking their budgeting and accounting systems.

The IFTA would like to educate legislators and other state officials on the Truth in Accounting Act, which would require the implementation of F.A.C.T.-based budgeting. Model legislation can be found at the end of the “Financial State of the States” report, available at www.truthinaccounting.org.

The IFTA staff is available to hold legislators’ workshops on budgeting processes and best practices for state government budgeting. The staff has testified at budget hearings throughout the country and can be scheduled in legislators’ states.

The American people have made it clear that putting our nation’s finances in order is a top priority. Effectively addressing this will require an accurate picture of our public finances and electing policymakers who are willing to make hard decisions.

To avoid what Europe now is facing, Congress, the White House, and state and local governments must act soon, before their budget sinkhole collapses.

Sheila Weinberg (sweinberg@truthinaccounting.org) is founder and CEO of the Institute for Truth in Accounting.
By Steve Stanek

Federal regulations in 2011 added more than $231 billion in regulatory costs to private businesses and state and local governments and required 133 million hours of paperwork, according to a report by the Washington, DC-based American Action Forum.

The organization pored over the Federal Register and determined 66,730 employees would be needed just to file federal paperwork, based on a 2,000-hour work year. The financial costs and paperwork totals were derived by adding up the government's own estimates for the regulations, which totaled 78,464 pages in 2011.

"Price Paid by Job Creators"

"With partisan gridlock on Capitol Hill, the Obama administration used regulations as the path of least resistance in advancing its agenda, and this report details the price paid by job creators," said Sam Batkins, the Forum's director of regulatory policy.

"Any serious strategy to promote economic growth will include a reduction of the onerous regulations imposed last year." Expensive, Burdensome

The most expensive and burdensome regulations in 2011 include:

- CAFE (Corporate Average Fuel Economy) standards for light-duty vehicles: $141.4 billion.
- The utility MACT (Maximum Achievable Control Technology) rule requiring power plants to reduce emissions of mercury and other pollutants: $10.9 billion.
- Greenhouse gas standards for long-haul and heavy-duty trucks: $8.1 billion.
- Conservation standards for lamp ballasts: $6.9 billion.
- Federal school lunch standards: $6.8 billion.

Regulations requiring the greatest expenditures of time on paperwork include:

- Employee rights notification: 12 million hours.
- Medicaid eligibility changes under the Affordable Care Act (aka Obamacare): 11.07 million hours.
- Railroad conductor certification: 10.99 million hours.
- Investment advice changes: 8.8 million hours.
- CHIP (Children’s Health Insurance Program) annual transparency reporting: 7.99 million hours.

Down from 82,840 Pages

Batkins noted 2011 in some ways may have been an improvement from 2010, when the Obama administration published 82,480 pages of regulations, including the Affordable Care Act and the Dodd-Frank financial regulatory bill, each of which totaled more than 2,000 pages in length.

Obama took heat for these and other behemoth bills and responded with Executive Order 13563, which called for an analysis of “outdated, ineffective, insufficient, or excessively burdensome” regulations. In 2011, agencies finalized $187 million in deregulatory actions and proposed more than $1.1 billion in regulatory rollbacks.

Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of two Heartland publications, Budget & Tax News and FIRE Policy News.
Indiana, Amazon.com Reach Agreement on Sales Tax

By Nick Baker

Indiana government officials and the nation’s largest online retailer have reached an agreement to begin collecting Indiana sales tax on Internet purchases.

Indiana will become the fourth state to reach such an agreement with Amazon.com, but Gov. Mitch Daniels (R) said he wants federal legislation to address the online sales tax issue.

“The only complete answer to this problem is a federal solution that treats all retailers and all states the same,” said Daniels in a statement.

According to the agreement between Amazon and the Indiana Department of Revenue, the company will begin to collect and remit the 7 percent Indiana sales tax beginning January 1, 2014 or 90 days after enactment of federal legislation, whichever occurs earlier. The state will not assess the company for sales tax for other periods.

Potential $75 Million Annually

State officials estimate Indiana residents who shop online would have approximately $75 million annually taken from them if all online sales were taxed. The State Budget Agency and Department of Revenue estimate Amazon.com purchases will pull in $20 million to $25 million per year in sales tax revenue.

The Alliance for Main Street Fairness, which represents traditional retail stores, has been lobbying hard for taxation of Internet sales, arguing the ability of online shoppers to avoid paying sales taxes gives online retailers an unfair advantage. However, the organization isn’t satisfied with the deal between Indiana and Amazon.

“We are disappointed that Indiana’s elected leaders understand the need for a level playing field, this specific agreement allows Amazon.com to enjoy special treatment for two more years despite an obvious physical presence in the state. It is deeply unfortunate that the lifeblood of Indiana’s economy—its brick-and-mortar businesses—will need to survive two more holiday shopping seasons at a competitive disadvantage,” said AMSF spokesperson Danny Diaz.

Push for Federal Law

Diaz said the agreement “underscores the importance of Congress acting and dealing with this issue once and for all. We appreciate Gov. Daniels’ support for a national solution and hope he will urge the Indiana Congressional delegation to support federal legislation in 2012.”

Meanwhile, Amazon.com, which once fought hard against taxing online shopping, has come out for a federal approach to online sales taxes.

Senators Dick Durbin (D-IL), Mike Enzi (R-WY), and Lamar Alexander (R-TN) in November 2011 introduced a bill that would grant national authorization for states to collect online sales taxes.

“Amazon strongly supports enactment of the Enzi-Durbin-Alexander bill and will work with Congress, retailers, and the states to get this bipartisan legislation passed,” said Paul Misener, Amazon’s vice president of global public policy, in a statement when the legislation was introduced.

Many smaller online retailers remain opposed.

“Small online retailers are right to fear the costs and compliance burdens of this proposal,” said Steve DelBianco, executive director of NetChoice, an online retailer advocacy group.

Nick Baker (nhbaker2006@gmail.com) writes from Washington, DC.

Exactly What the Tea Party Needs Right Now!

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

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THE HEARTLAND INSTITUTE
San Francisco's High Minimum Wage: More Harm than Good

By Doug and Polly White

On January 1, the minimum wage in San Francisco increased to $10.24 per hour—about $3.00 above the federal minimum wage.

San Francisco is a very expensive place to live. According to Kiplinger’s, it ranks third on the list of most expensive places to live in the U.S., behind only the New York metropolitan area and Honolulu, Hawaii. Giving those at the bottom end of the income scale a bit of a boost may seem only fair. Unfortunately, when government bureaucrats rather than the free market determine wages, there are negative, if unintended, consequences.

First Order Effects
Jobs will leave the city and unemployment will rise. Think about it. You’re a widget manufacturer in San Francisco. You need lots of low-skilled labor to build your widgets. In most of the U.S., you could hire this labor for $7.25 per hour. In San Francisco, the law forces you to pay a 41 percent premium over what your competitors, who manufacture widgets elsewhere, pay. You won’t be able to compete. You’re left with two choices: move your production facilities outside of San Francisco, or shut your doors.

Small businesses will be hurt disproportionately. Larger companies can more easily shift jobs to other geographic locations where they already have operations. Small businesses are more likely to remain local, become uncompetitive due to higher labor costs, and ultimately close their doors. Workers who might have held these jobs will be unemployed. The cost of government entitlements—welfare, food stamps, unemployment compensation, and Medicaid—will increase. Ultimately, these higher costs will be borne by taxpayers.

Second Order Effects
Fewer new jobs will come to the city, even those that would pay well above $10.24 per hour. Here’s why: As explained above, jobs at the lower end of the wage scale that are mobile will leave the city. However, many jobs are not mobile. Fast-food restaurant workers, those who clean hotel rooms, and retail store clerks are examples of employees at the lower end of the wage scale whose jobs aren’t mobile. These people will see an increase in their take-home pay.

Some workers currently making more than the new minimum wage will also see increases in their compensation. When employees at the bottom end of the wage scale are bumped up, some of those above them in the economic pecking order also will be paid more so their relative position will be maintained.

Unfortunately, the story doesn’t end there. Shareholders, such as those with 401(k) plans, who legitimately want to see a return on their investment, will not allow employers to accept lower profits. Therefore, the cost increases will be passed on to consumers. The cost of living and working in San Francisco will be pushed even higher.

Companies thinking about relocating their executive offices to the city will reconsider because the city will be so expensive. Associations deciding where to hold their national meetings will conclude the cost in San Francisco is prohibitive. Developers will put plans for building new hotels and office buildings on hold—engineers, architects, and contractors will suffer.

We could go on and on, but you get the picture. Second order effects will mean fewer jobs in San Francisco at every point on the income scale.

Third Order Effects
In the long run, even those who seemingly benefit from the new higher minimum wage won’t see the improved lifestyle that might be expected. As described above, increasing the minimum wage will drive up the cost of living and working in San Francisco. The purchasing power of low-wage workers will be reduced—$10.24 per hour won’t buy what it used to. Eventually, people at the low end of the wage scale, now defined as $10.24 per hour, will have no more purchasing power than they did to start with.

Cries will again go out to increase the minimum wage for those at the bottom end of the scale and the job-destroying cycle will begin anew. While the government may be able to legislate a higher minimum wage, it can’t legislate a better lifestyle.

For those who still think a government-mandated minimum wage is a good idea, we have a question. If $10.24 per hour is good, wouldn’t $15, $20 or even $30 per hour be even better? Of course, it wouldn’t! All of the things outlined above would happen—just at an accelerated rate. This would make the inherent flaws in a government-mandated minimum wage patently obvious.

Free Wage Setting
There is an alternative. Let the free market set wages. Employers will pay what they need to pay to fill their jobs with people who have the skills they need. For years, the federal minimum wage was $5.15 per hour. However, by 2000, even McDonald’s restaurants paid significantly more than this for entry-level jobs, not because they wanted to, but because they had to in order to fill their positions.

A government-mandated minimum wage may seem like a good idea and it may be politically expedient. Unfortunately, the economic reality is that it does more harm than good.

Doug and Polly White (info@whitestonepartnersinc.com) are principals at Whitestone Partners, a management consulting firm that helps small businesses, and are also coauthors of the new book, Let Go to GROW: Why some businesses thrive and others fail to reach their potential (Palari Publishing 2011).
Tax Debate Takes Center Stage in Washington State

By Jason Mercier

One way or another, Washington voters may be asked to raise taxes in 2012 to bail the state out of a nearly $2 billion budget deficit.

Special-interest groups long have been rumored to be targeting the 2012 ballot with citizen initiatives to raise taxes, and Gov. Chris Gregoire (D) wants the legislature to go directly to the people as well, with a referendum to “temporarily” raise the state’s sales tax.

“After three years of cutting, now is the time to invest in a better future for all Washingtonians—for all of us to take responsibility, and, yes, spend a half-penny more,” Gregoire said in announcing her support for raising the sales tax.

She continued, “I believe Washingtonians will stand with me. I believe they will pass the sales tax.

Hundreds of Millions More

According to the Washington Department of Revenue, increasing the state sales tax rate from 6.5 percent to 7.0 percent, as proposed by the governor, would generate an additional $494 million in Fiscal Year 2013, $522 million in FY 2014, and $567 million in FY 2015.

Gregoire also is asking lawmakers to consider other tax increases worth an additional $341 million, though her focus is on the sales tax increase as being the most politically viable.

Republicans, Democrats Oppose

Opposition to the proposal has been bipartisan.

“Creating jobs is a far better approach than the Democrat plan to raise taxes on people and employers when they can least afford it,” said House Minority Leader Richard DeBolt (R-Chehalis).

“House Republicans believe we should establish priorities of government to fund education, protect the most vulnerable, and keep our communities safe. Instead Democrats have tied these essential services to a tax increase. Clearly we don’t share the same priorities.”

Members of the self-proclaimed fiscally conservative Democrat “Roadkill Caucus” are also saying more reforms are needed before tax increases can be considered.

“If we’re going to have sustainability over what many of us see as maybe a six- to ten-year rocky period, then we simply can’t say ‘okay we just need to raise revenue and then we’re done,’” state Rep. Deb Eddy (D-Kirkland) told KUOW (NPR) news radio.

“We’re going to ask them to vote for more taxes, whether they be more sales tax or other taxes,” state Sen. Jim Kastama (D-Puyallup) also told KUOW.

More Income, Higher Taxes?

Some tax hike proponents have argued state revenue hasn’t kept pace with the growth of personal income in the state, meaning there is room for a higher tax burden. That belief has drawn sharp criticism from public policy experts such as Paul Guppy, vice president of research for the Washington Policy Center.

“The rise in personal incomes is irrelevant to what state revenue should be. If people are doing better in their lives, why should the state automatically get a cut [of the increase in personal income]? That view sees government as a business—it grows in relation to people’s perceived ability to pay, not based on real public need,” said Guppy.

“Raising the financial burden of government based on average income is pretty tough on people living with billionnaire neighbors like Bill Gates and Paul Allen. An unemployed person’s income might drop to zero, but the state-wide average increased,” Guppy said.

The next step in the tax debate began unfolding when lawmakers convened for the 2012 legislative session in January.


Heritage Foundation President Edwin J. Feulner attributes much of the decline to growing government regulatory burdens and economic “stimulus” spending that seems to benefit only the politically well-connected.

The Index shows:

• Canada, the United States, Mexico, and 31 of the 43 countries in Europe have been losing economic freedom.
• The United States’ economic freedom score dropped to 76.3 in 2012 from 81.2 in 2007 (on a scale 0–100). The United States ranked Number 10 on the scale. Neighboring Canada ranked Number 6.
• Total U.S. government expenditures have grown to a level equivalent to more than 40 percent of gross domestic product, and total government debt exceeds the size of the economy.

The report did note some good news—for some countries other than the United States:

• Economic freedom is growing in much of Asia and Africa.
• Four Asia-Pacific economies—Hong Kong, Singapore, Australia, and New Zealand—top the Index of Economic Freedom this year.
• Eleven of the 46 economies in sub-Saharan Africa gained at least a full point on the index’s economic freedom scale. Mauritius ranked in eighth place, the highest ranking ever achieved by an African country and two spots ahead of the United States.

— Steve Stanek

Economic Freedom Takes Step Back
Entertaining Lessons in Finance from this Tour of Battered Economies

Review by Jay Lehr

I promise you will easily learn more about international finance between the covers of this book than you ever thought possible.

Michael Lewis is perhaps best known for his books that have become movies, namely The Blind Side and Moneyball. It is his penchant for telling great non-fiction stories that has enabled him to relate this amazing tale, which got its start while he was researching the U.S. financial debacle that began in 2008. Lewis learned a special few persons named for his books that have become movies, for those he bet against. He became a billionaire.

No insurance company can legally sell you fire protection on another person’s house, but the financial markets can and will sell you insurance on another person’s investments. They are called credit default swaps. One prescient young man in Texas bought such insurance for $1,100 per unit, which paid him $700,000 per unit when things went bad for those he bet against. He became a billionaire.

There to Here

Research for Lewis’s earlier book, The Big Short, was done primarily by talking to lots of people both smart and not so smart. This led his editor to ask him to jaunt around the world and find out what was going on abroad. His itinerary of Iceland, Greece, Ireland, Germany, and then our own headed-to-economic-Third-World-status state—California—makes for the most exciting and informative travelogue you are likely ever to read.

His itinerary began in Iceland, whose recent economic story you may have read about in publications including the Wall Street Journal. Iceland is a comfortable country of 300,000 persons, where cod fishermen and others realized they could borrow money in Japanese yen and Swiss francs at 3 percent and lend them in Icelandic krónur at 15.5 percent. They made fortunes in krónur and bought everything in sight in Iceland—until the house of cards collapsed.

Riches to Rags

The krónur became worthless, and Icelanders stuck with them had no way to pay interest on their Japanese and Swiss loans. It is a story not of rags to riches, but riches to rags. Every successful fisherman became a banker and now a much poorer fisherman.

Part of Iceland’s problem stemmed from an amazing naïveté among its politicians and educators. Iceland is one of the most fascinating countries on the planet, rich in cod and geothermal energy and not much else. It was a center of the 2008 economic bubble, and Lewis tells Iceland’s story with such warmth that you will think you are seeing it on TV.

Beyond Bailout

He lands in Greece, quickly to be overwhelmed by disbelief at a government that pays its workers three times what the private sector pays, a railroad that costs €700 million a year to run against revenues of €100 million and pays average annual salaries of €65,000, an education system considered the worst in Europe, a private sector that totally avoids paying taxes (there is a cottage industry of folks helping others avoid taxes), and early retirement pensions for persons in cushy jobs such as hairdressers, radio announcers, waiters, and musicians.

The story is astounding and quickly makes the reader understand the hopeless bankruptcy of that nation and the lack of any sound reason to bail it out. It is obvious why the Greeks salivated over the opportunity to trade their worthless drachmas for valuable euros.

Their real debt was long hidden by those benefitting from it, including Goldman Sachs, which in 2001 engineered a loan of $1 billion, from which Goldman Sachs carved out a fee of $300 million.

It was not until an ancient monastery of astute monks gamed the Greek financial system for billions of dollars that the system unraveled in plain view because at last the public became incensed. You will read no better spy novel than this. Lewis leaves Greece with a sober assessment of its chances.

Boom and Bust

Then it’s on to Ireland, where Lewis discovered the remnants of a condensed boom and bust cycle that went so fast from rags to riches and back that it never went through a period of normalcy. The 1990s found land prices dirt cheap, a government offering low corporate taxes and free public education, and an influx of 250,000 Polish workers, which to Ireland was the equivalent of 17.5 million
immigrants to the United States.

The banks loaned so much money for housing that eventually Ireland had the highest homeownership rate in the world, 87 percent. This dwarfed the low-income housing boom in the United States.

In 2006 the unemployment rate in Ireland was 6 percent. When Lewis touched down there, it was 14 percent. Banks had loaned 40 percent of development costs. It was simply a national Ponzi scheme that worked when people thought it was sustainable and collapsed when they realized it was not.

Readers will find the path through the Irish banking debacle convoluted, but it becomes obvious that greed plus stupidity equals bankruptcy. Lewis weaves a childlike story of naive Irishmen building little communities in the middle of nowhere until the flow of money from the banks dries up, leaving communities of unfinished, never-lived-in homes.

Ireland’s banking laws, however, do not allow borrowers to abandon their upside-down mortgages. someday they are taking it with a stiff upper lip. The Poles have gone home, some Irish again are moving to the exit, but they will survive.

German Burden
Finally the author gets to Germany. If the European Union is to survive, Germans will have to pay the bill. His fascination with Germany is perhaps my only criticism of the book, because he tells the reader more than most will want to know. Lest you fail to buy this book, here is the story in a nutshell.

The Germans can afford to bail out all of Europe. Their population is fiscally conservative and never tempted by economic bubbles. The European Union was never a good deal for them because the deutsche mark was always worth more than the euro. Everyone benefitted but the Germans. And they have 3,400 tons of gold.

But will the Germans actually do it? A condition of entering the European Union was for a nation to maintain a wide variety of fiscal restraint in measurable ways, but the facts show most governments cooked their books and gained admittance without changing their profligate ways. Are Germans responsible for their fellow Europeans or not? It is political suicide in Germany now to believe the former, which leaves Chancellor Angela Merkel on the hot seat.

Lewis writes, “For better or worse, the Germans now control the financial fate of Europe. If the rest of Europe was to continue to enjoy the benefits of what is essentially a German currency they’d need to become more German.” This is not likely.

An amusing part of the German story is that although the citizens maintain a conservative financial lifestyle, their bankers got caught in every get-rich scheme across the world with the possible exception of the Bernie Madoff scam.

California Like Greece
It is fitting that Lewis ends his sojourn through the New Third World in California, where a frenetic bicycle-riding interview through Santa Monica with former Gov. Arnold Schwarzenegger unearthed the state's major problems and how Schwarzenegger was swallowed by a system not unlike what Lewis found in Greece.

Lewis conveys the hopelessness of the current economic path by highlighting one of California’s richest cities, San Jose, and one of its poorest, Vallejo. In both cities government employee pension costs outweigh their potential tax and fee income.

If you are interested in economics on a large scale, enjoy a good read, and would look forward to showing your friends how much you know about international finance and the problems of the day, this book is a must. It will take you just eight hours to read its 212 pages, and every minute will be worth it.

Joy Lehr, Ph.D. (jlehr@heartland.org) is science director of The Heartland Institute.
Small Businesses Pessimistic About Obamacare Tax Credit

By Loren Heal

The tax credit included in President Barack Obama’s health care law may be too small and too temporary to encourage small business owners to insure their employees, according to industry representatives.

The complex rules for the credit create a barrier to small businesses using it, and some conclude the cost of preparing the return would be larger than the credit they’d receive, says Robert F. Graboyes, senior health care advisor at the National Federation of Independent Business (NFIB).

“We said early on that we had no principled opposition to some kind of credit, but they were creating a highly complex one that was going to do very little good for a relatively few firms. I stress that we always tell very small businesses with low wages, ‘Check into it. If it’s good for you, take it,’” Graboyes said.

Broken Promises

Graboyes said the Obama administration failed to live up to what it told small business representatives during the legislative battle.

“We were told incessantly,” Graboyes said, “that this was the greatest thing, and this was going to spur businesses to offer insurance; that it was great, that it would really make the whole law a wonderful thing for small businesses. And we always said ‘Look, we’re not opposed to credits, but we think this one is rather insignificant. It’s short-lived. It’s only going to help a relatively small number of firms.’ And we got criticized for our criticism.”

Backers of Obama’s law promised up to 4.4 million businesses would benefit from the small-business tax credit, Graboyes said.

“[Even] our most pessimistic view of it turns out to have been an overestimate,” Graboyes said. “We looked at the numbers and said, ‘There is no way on Earth it could be more than 2 million, and probably not more than 1 million.’ It turns out that 308,000 got it, and it seems they got a fairly trivial amount.”

Excessive Complexity, Stinginess

Dean Clancy, vice president for health care policy at FreedomWorks, echoes Graboyes’ views.

“When Obamacare was pending, we mocked the small-business tax credit for excessive complexity and stinginess. And the low take-up and high error rate on the applications suggest we were right,” Clancy said.

Jeffrey Anderson, a senior fellow in health care studies at the Pacific Research Institute, put the Small Business Tax Credit in context of the wider deleterious effects of the health insurance law.

“From an employment perspective, the incentives in Obamacare are perverse,” Anderson said. “Obamacare offers significant financial incentives for employers to avoid passing certain thresholds of employment and to avoid raising employees’ wages. Under Obamacare, the fewer employees you have, and the lower their wages, the more tax breaks you’ll get and the fewer mandates you’ll face.

“For example, to get the full tax credit under Obamacare, you can’t have more than ten workers or pay them more than $25,000 in average annual wages. To get any tax credit at all, you can’t have more than 25 workers,” Anderson added.

Few Stand to Benefit

Anderson says he is hard-pressed to find a way small businesses will benefit under Obama’s law. He points out if the law were a good thing by simple mathematics for small businesses, “the U.S. Chamber of Commerce and the NFIB wouldn’t both publicly support its repeal.

“The basic effect of Obamacare, I think, will be to cause most smaller employers, up to 100 or even up to 500 employees, to get out of the business of offering health benefits. Those workers will end up in the exchanges or on Medicaid or uninsured. I am skeptical this particular credit will have much effect either way, because of the low take-up,” he added.

There is a small silver lining, Graboyes notes.

“At least the federal deficit won’t be quite as bad, since they’re not spending as much as the CBO thought they were going to spend on the tax credit,” Graboyes said. “But that’s not much of a silver lining for American small businesses facing rising health care costs.”

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