

48%
of legislators read
Budget & Tax News

**EXPECT MORE
CORPORATE
'INVERSIONS' 2**

**STATE 'COMPACTS' FOR
NATIONAL BALANCED
BUDGET 5**



**SUBSIDIZED FLIGHTS
BURY UNSUBSIDIZED
BUSES 15**

Budget & Tax News

©2014 THE HEARTLAND INSTITUTE

www.budgetandtax-news.org

Vol. 12 No. 8 ~ SEPTEMBER 2014

The Bottom Line

Rising Pension Investment Risks

Pew Research has documented a systematic shift of public pension plans away from fixed-income investments toward equities and alternative investments—sharply increasing the risks and volatility of their portfolios. **Page 3**

Forced Unionization Halted

Barring state governments from forcing home caregivers to join a union, the U.S. Supreme Court also swiped at a prior ruling that allows states to force full-time state workers to join unions. **Page 9**

Detroit Pension Solution

Detroit's employees and retirees approved a plan in late July to cut benefits to their pension as part of the bankruptcy proceedings, but some taxpayer advocates and a pension expert say the city missed a chance to provide a better solution. **Page 10**

OPEB Bigger than Pensions

Can anything be in worse condition than unfunded government pensions? Unfortunately, yes, and it's something few people have heard of: Other Post-Employment Benefits, mostly government retiree health care commitments. **Page 12**



Blame Govt. Policies, Not Companies, for Reincorporations Abroad

By Steve Stanek

Recent corporate mergers and acquisitions—and talk of more in the works—have some Americans, including federal legislators, accusing the companies of being “unpatriotic,” “freeloaders,” and “avoiding their fair share” of taxes.

Senate Majority Whip Dick Durbin (D-IL) has led a group of other Democratic senators

in introducing the Patriot Employer Tax Credit Act, which he said in a statement “will reward businesses that exemplify American values and treat workers fairly—not companies who ship jobs overseas.”

Defenders of the companies say they are merely responding to terrible U.S. tax policies. There would be no need for tax-credit programs

BLAME, p. 4

Highway Trust Fund Nearly Out of Money

By Tom Gantert

The U.S. Department of Transportation has created a “ticker” that estimates when the fund earmarked to pay for highways across the nation will run out of money. It estimates the Highway Account of the Highway Trust Fund will be in shortfall by the end of August.

That has triggered a flurry of debate over how to deal with the Highway

Trust Fund, the \$50 billion fund that receives revenue from the federal gas tax.

The federal gas tax was last raised to 18.4 cents a gallon in 1993, up from 4 cents in 1982. Twenty years without a tax increase has caused some of the funding shortfall, but overspending also has been a problem.

HIGHWAY, p. 7

NON PROFIT
ORGANIZATION
US POSTAGE PAID
BEAVER DAM, WI
PERMIT NO. 412

The Heartland Institute
One South Wacker Drive #2740
Chicago, IL 60606

Federal Regulatory Costs Soar More than Last Year

By Heather Kays

With the national debt climbing to more than \$17 trillion, spending more than \$200 billion a year to comply with government regulations might not come as a shock.

It should, according to Sam Batkins, director of regulatory policy at the American Action Forum and author of a recent report on regulatory spending.

Batkins points out in his report that the federal government published more than \$100 billion in new regulatory costs in just the first six months of 2014. By comparison, \$100 billion in new costs had not been published last year until the end of December. At the current pace, additional regulatory costs will top \$200 billion by the end of 2014.

Earlier this year, the Competitive Enterprise Institute's annual *Ten Thousand Commandments* report estimated federal regulations imposed a total of \$1.8 trillion of costs on the economy in 2013.

Batkins examined every proposed and finalized regulation in the *Federal Register* for the first half of 2014 and extracted data regarding costs and hours to be spent on paperwork.

Energy, Environmental Regs Dominate Among Batkins' findings: The Department of Energy has imposed more in new regulatory costs than any other federal agency. The DOE and Environmental Protection Agency combined accounted for almost all the increased

"Energy regulations might directly affect utilities, but consumers are ultimately responsible for paying the bill."

SAM BATKINS
DIRECTOR OF REGULATORY POLICY
AMERICAN ACTION FORUM



regulatory costs during the first half of the year.

The increase in regulatory spending has occurred, at least in part, because of President Barack Obama's "Year of Action," said Batkins.

The "Year of Action" constitutes 40 specific White House initiatives ranging from promoting economic development to raising the minimum wage to increasing fuel efficiency of motor vehicles. Batkins said each of these proposed programs comes at a cost.

Meanwhile, the White House has released a 42-page report proudly announcing "an update on what President Obama has done this year to help

ensure opportunity for all Americans."

Batkins contends Obama and his staff believe they can defend the "Year of Action" programs despite their financial impacts on businesses and individuals.

Obama Unconcerned About Costs

"The president is confident in the legality and soundness of his actions from a policy perspective," said Batkins. "The administration understands that these measures will have costs, but it is more than happy to defend the benefits of these measures. They were aware a 'Year of Action' would have burdens and might be unconcerned with the

political ramifications."

The additional regulatory costs will affect Americans in several ways, according to Batkins.

"If all the regulations are finalized, the average American will see higher health care premiums, higher gasoline prices, higher energy prices, and more expensive vehicles," said Batkins. "Energy regulations might directly affect utilities, but consumers are ultimately responsible for paying the bill."

Heather Kays (heather.a.kays@gmail.com) writes from River Edge, New Jersey.

Expect More Companies to Quit U.S., International Advisor Warns

By George Prior

Living standards, jobs, and long-term economic growth are at risk because an increasing number of U.S. firms are likely to relocate overseas in response to America's current "uncompetitive and anti-business" corporation tax rate, warns the boss of one of the world's largest independent financial advisory organizations.

The prediction from Nigel Green, founder and chief executive of deVere Group, which operates in 100 countries worldwide, came after the chairman of the Senate Finance Committee, Ron Wyden (D-OR), once again spoke out against inversions, or mergers, in which U.S. companies move their headquarters to relatively lower tax

jurisdictions, such as the United Kingdom and Luxembourg.

'Uncompetitive, Anti-Business' Taxes

"Unless the current corporation tax is slashed, it is highly likely that an increasing number of America's multinationals will relocate to overseas jurisdictions with lower tax rates," said Green. "The current U.S. rates are widely perceived in the corporate world as uncompetitive and therefore comparatively anti-business. This is evidenced by the fact that a growing number of American firms are considering such a move out of the U.S."

He added, "The vast majority of American companies do want to remain headquartered in America, but with the tax code as it stands, and with obligations to shareholders, there is mounting pressure to consider overseas, lower-tax destinations."

If America's tax regime remains as it is, capital flight out of the United

States "will soar" and cause investment to stall, which would hit productivity and harm wages, jobs, living standards, and long-term economic growth, Green said.

'Corporations Don't Pay, People Do'

"To the opponents of reducing corporation tax who cite that higher corporation tax is preferable to higher personal taxation, I say this: Corporations don't pay corporation tax, people do. The burden of comparatively high corporation tax is carried by investors through lower returns, workers through reduced wages, and/or consumers through higher prices," Green said.

He said significantly lowering the corporation tax rate would expand the tax base and increase government revenue.

"A reduction would instantly make the U.S. a more desirable location for businesses and investors. Essentially, it would powerfully tell the world that

"Unless the current corporation tax is slashed, it is highly likely that an increasing number of America's multinationals will relocate to overseas jurisdictions with lower tax rates."

NIGEL GREEN
FOUNDER AND CHIEF EXECUTIVE
DEVERE GROUP

the United States is open for and supportive of business," he said.

George Prior (george@priorconsultancy.co.uk) is principal and founder of Prior Consultancy, an international communications agency in the United Kingdom and Spain. Used with permission of Prior Consultancy.



Ron Wyden
U.S. Senator - OR

Budget & Tax News



THE HEARTLAND INSTITUTE

One South Wacker Drive #2740
Chicago, Illinois 60606
312/377-4000 voice • 312/377-5000 fax
e-mail think@heartland.org

Budget & Tax News is available on the Internet. Point your web browser to <http://www.heartland.org> www.budgetandtax-news.org

PUBLISHER

Joseph L. Bast

ASSOCIATE PUBLISHER

Nikki Comerford

EXECUTIVE EDITOR

Diane Carol Bast

SENIOR EDITOR

S.T. Karnick

MANAGING EDITOR

Steve Stanek
staneke@heartland.org

ASSOCIATE EDITOR

John Skorburg

DESIGN AND PRODUCTION

Chris Whitehead

CIRCULATION MANAGER

Tonya Houston

CONTRIBUTING EDITORS

Tonya Barr, Ryan Bedford
David Denholm, Sandra Fabry
Robert Genetski, Matthew Glans
Amber Gunn, Jason Mercier
Dan Mitchell, Jonathan Williams

BOARD OF DIRECTORS

William Armistead, Joseph Bast, Robert Buford
Jeré Fabick, Dan Hales, James L. Johnston
Jeff Judson, Chuck Lang, Jeffrey Madden,
Jeffrey V. McKinley, Brian D. Singer
Herbert J. Walberg

ADVERTISING:

Budget & Tax News accepts display advertising and advertising inserts. For an advertising kit with rate card and editorial calendar, contact Associate Publisher Nikki Comerford at 312/377-4000, e-mail ncomerford@heartland.org.

Budget & Tax News is published 10 times per year by The Heartland Institute. Heartland is a nonprofit and nonpartisan public policy research organization serving the nation's federal and state elected officials, journalists, Heartland donors, and other opinion leaders. Its activities are tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

© 2014 The Heartland Institute. Nothing in this issue of *Budget & Tax News* should be construed as reflecting the views of The Heartland Institute, an endorsement of or opposition to any candidate for public office, or an attempt to aid or hinder the passage of any legislation.

ANALYSIS

Public Pension Investments Are A Risky Chase for High Returns

By **Truong Bui**

A recent Pew Research report shows a systematic shift of public pension plans away from fixed-income investments toward equities and alternative investments in the past 30 years.

Using investment data on public pensions from 1952 to 2012, Pew found public plans “significantly increased their reliance on stocks” during the 1980s and 1990s.

The data reveal fixed-income investments and cash constituted nearly 96 percent of public pension assets in 1952. The proportion decreased to 47 percent by 1992 and had dropped to 27 percent by 2012. During the past decade, public pension funds have allocated an increasing share of their assets to alternative investments, including private equity, hedge funds, real estate, and commodities. From 2006 to 2012, the share of pension assets in these alternatives more than doubled, from 11 percent to 23 percent.

Unrealistically high assumed rates of return are behind the shift.

Aggressive Response

From 1992 to 2012, while the average annual yield on 30-year Treasury bonds declined by 4.75 percentage points, from 7.67 percent to 2.92 percent, the median pension fund's assumed rate of return decreased by only 0.25 percentage points, from 8 percent to 7.75 percent. That means pension funds have to be much more aggressive than in the past to earn their assumed rates of return, hence the shift to equities and alternative investments.

Although moving away from fixed-income securities allows pension funds to keep up with the high assumed rates of return, it also entails substantial risk. Higher risk means higher volatility, which implies higher chances of incurring losses.

Pension expert Andrew Biggs made the same point not long ago. Biggs estimated a portfolio in 1975 could earn an annual expected return of 8 percent with a standard deviation of 3.7 percent, losing money on average only once every 65 years. By contrast, a portfolio today must have a standard deviation of 14 percent to get the same expected return, suffering losses about once every four years.

In finance, standard deviation is a

“[M]oving away from fixed-income securities allows pension funds to keep up with the high assumed rates of return, [but] it also entails substantial risk. Higher risk means higher volatility, which implies higher chances of incurring losses.”



measure of how much an investment's returns can vary from its average return; in other words, how “spread out” those returns are. It is, therefore, a measure of volatility. The higher the standard deviation, the greater the volatility, and thus the riskier the investment.

Huge Deviations

Larger pensions and riskier investments therefore create a substantial threat to state and local budgets. In 1975, the standard deviation of public pension investments amounted to only 1.8 percent of state and local budgets, whereas it has increased tenfold to 19.8 percent today.

Higher risk is not only about higher volatility. It also involves higher responsiveness to market movements (in financial terms, it means a higher “Beta”). The implication is that riskier investments such as equities and alternative investments tend to move more in tandem with the market, and their change in values is more magnified by market change. In other words, when the market performs well, these investments can earn large returns, but when the market falls, the investments dive even deeper than the market, risking large unfunded liabilities.

Vicious Cycle

Unfortunately, state and local governments' revenues typically plunge during market downturns, meaning pension systems' unfunded gaps balloon when government budgets are most constrained and thus least able to make up for the shortfalls. This potentially creates a vicious cycle: pension plans that suffer substantial losses during recessions lack money to reduce funding gaps, thereby have an incentive to invest more in risky assets with a hope of earning larger returns to reduce the debts, and thus expose government budgets to even more risk.

The use of unrealistic rates of return stems from a flawed approach to liability valuation. Instead of using a near-risk-free rate to value pension liabilities, public pensions rely on the expected rates of return of pension assets, which can be easily manipulated to artificially reduce the required contributions and conceal the real funding gap.

Truong Bui (truong.bui@reason.org) is a policy analyst at Reason Foundation. Used with permission of Reason's “Out of Control Policy Blog,” <http://reason.org/blog/show/public-pension-investments-risky-ch>.

Don't Blame Companies for Reincorporations Abroad

Continued from page 1

to induce companies to remain headquartered in the United States if the federal government were to adopt a corporate tax system similar to those in most other industrialized countries, including our largest trading partner, Canada, said Chris Edwards, director of tax policy at the Cato Institute.

'Properly Trying to Escape'

"It's so irresponsible, Durbin's position," said Edwards. "We have a horrible corporate tax code, with the highest tax rate in the industrialized world, and he complains when corporations properly try to escape it."

Durbin and other critics are objecting to corporate "inversions," in which companies reincorporate in foreign countries with lower corporate income taxes and a territorial tax system instead of the worldwide tax system imposed by the United States. Their aim is to reduce taxes on income earned abroad. Mergers and acquisitions make inversions possible.

The United States is nearly the only nation that claims the power to tax income earned anywhere in the world. Most other governments tax only income earned in their countries. They levy no tax on income earned abroad. Edwards said this makes U.S. tax policies "more hostile" than those of governments in Canada, Europe, and most of industrialized Asia.

'European Left More Sensible'

"Mainly left-wing governments in Europe are more sensible than the left is here in America," Edwards said. "We don't find companies trying to invert out of Canada or Ireland these days, because they have reasonable corporate tax policies."

Edwards noted, "They have a 15 percent tax rate in Canada, which compares to our federal rate of 35 percent. [Most states impose a corporate tax on top of that.] The Canadians are not radical tax-cutters. They're centrists who want their companies and their economy to do well. They asked, 'What do we need to do to achieve this?' They cut taxes.



"It's not America's companies who have given up on this nation, it's America's tax system that's given up on companies, workers, shareholders, and consumers."

PETE SEPP, EXECUTIVE VICE PRESIDENT, NATIONAL TAXPAYERS UNION

"Left wingers like Durbin and [U.S. Sen. Carl] Levin talk about how government is losing money because of these inversions. The government is losing because their policies are inducing companies to move offshore," Edwards said.

Lower Tax Rate, Equal Revenue

Edwards noted Canada, with a corporate tax rate less than half the U.S. rate, receives as much corporate tax revenue as a percentage of its gross domestic product as the United States receives.

The Tax Foundation earlier this year also noted the average corporate tax rate of the 33 other nations in the Organisation for Economic Cooperation and Development (OECD) is 10 points lower than the U.S. federal tax rate and 14.1 points lower when state corporate taxes are included. Even Sweden, long known for high taxes, has a corporate tax rate 13 points lower than the U.S.

federal rate.

Sen. Elizabeth Warren (D-MA), who introduced the bill with Durbin, said in a statement, "Big corporations have rigged the tax code so badly that they're actually rewarded when they move American jobs overseas. We should stitch up those loopholes and invest in those companies that invest in America—not those companies that invest in the most lobbyists."

'We're [Number] 61!'

Lobbyists have nothing to do with it, said Pete Sepp, executive vice president of the National Taxpayers Union.

"It's not America's companies who have given up on this nation, it's America's tax system that's given up on companies, workers, shareholders, and consumers," Sepp said. "The statistics about other countries' more attractive tax rates tell a compelling story of why many firms can feel pushed to choose

inversions, but so do the statistics on tax compliance burdens.

"PricewaterhouseCoopers' annual 'Paying Taxes' study shows that for a hypothetical medium-sized firm, the time and cost spent just on tax paperwork puts the U.S. 61st out of 189 countries. Somehow the chant of 'We're 61!' doesn't seem to have much appeal to a beleaguered business."

Number 61 might be optimistic. Sepp added, "Tellingly, the U.S. did even worse when ranked by total tax rate [corporate, payroll, and other taxes] alone—132nd-best out of 189. Five years ago, the U.S.'s ranking was 92nd out of 181, a stark indication that our country is falling behind in global tax competition."

Big Pharmacy Inversion

Currently making headlines over its proposed, and then abandoned, inversion is Walgreen Co., the nation's largest pharmacy chain. Walgreen plans to buy Swiss-based Alliance Boots GmbH, a giant European pharmacy company. Walgreen CEO Greg Wasson told analysts the company is "looking at everything," including its tax structure with Alliance Boots, to improve the company's finances.

"It is deeply disturbing that Walgreens would even consider this unpatriotic move to avoid paying its fair share of taxes. What will its customers say? The company profits from billions in taxpayer dollars every year, but appears to be putting the interests of Wall Street hedge funds ahead of the American people," said Frank Clemente, executive director of Americans for Tax Fairness, in a statement.

Cato's Edwards said this perspective fails to understand the global nature of economies.

"I broadly see, with the U.S. Congress and policymakers, people who are incredibly parochial. They don't get what globalization is and what it means," Edwards said. "It means they can't willy-nilly adopt anti-competitive policies. They don't get this."

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

Author Offers Plan for Balanced Budget Amendment

By Steve Stanek

In the 225 years since the Constitution of the United States of America became the guiding law of the land, it has been amended 27 times (including the first 10 amendments that make up the Bill of Rights).

Now there is a proposal to bring states together in a way to speed the arduous process of amending the Constitution to force Congress to balance the federal budget. The proposal calls for “compacts,” or agreements, among the states to use their power under the Constitution to demand a Constitutional convention limited to a single amendment.

It has never been done, even though the power has always been there. With the federal government nearing \$18 trillion of national debt, and facing hundreds of trillions of dollars of unfunded liabilities such as for Medicare not counted in the national debt, the timing could be right, says Nick Dranias, an attorney and director of policy development and constitutional government studies at the Goldwater Institute in Arizona.

Dranias is the originator of the idea, which has been refined by other lawyers, a judge, and public policy experts. He is author of a policy study released by The Heartland Institute, which publishes *Budget & Tax News*, that describes and outlines the idea.

‘Two Overarching Acts’

“The compact approach consolidates the entire amendment process that the states originate into just two overarching legislative acts,” Dranias said.

He explained, “First, you have the compact, which is the agreement among the states. All you need to do is have 38 states pass this compact. In the compact are all of the moving parts, legislatively, that they would otherwise control and have to separately enact in various stages.” These include the application for the convention, designation of the contemplated amendment, identification of and instructions to all delegates, rules for the convention, and who would attend the convention.

On the Congressional side, Dranias

“It’s not hard to defeat most of the fiscal gaming we see in states. The way you do it is you just define the balanced budget requirement in terms of strict cash flow.”

NICK DRANIAS
ATTORNEY AND AUTHOR
THE COMPACT FOR A BALANCED BUDGET

said, legislators would need to pass one resolution with simple majorities in each House calling a convention in accordance with the compact and pre-selecting ratification if the amendment that’s contemplated in the compact is approved.

In total, 39 legislative acts would be needed: 38 state resolutions calling for the convention, and one resolution in Congress. This compares to “at least 100 legislative enactments, six independent legislative stages, and five or more years of legislative sessions to generate a constitutional amendment” without a compact, Dranias notes.

Learning from States

Forty-nine of the 50 states have balanced budget requirements, either in their constitutions or statutory, yet many have budget deficits and large debts. Dranias says a federal balanced budget amendment could be structured to avoid the “gaming” that many state governments engage in to get around their balanced budget requirements.

He notes few states come anywhere close to being as badly in debt as the federal government relative to their economies.

“Regardless of how effective or not state-based balanced budget amendments and debt limits have been, they do create a political atmosphere of scarcity in the use of debt, and at least of embarrassment, which tends to minimize the use of debt relative to what we see in Washington,” Dranias said.

In addition, he noted, “The benefit of observing what does not work in the states is that we can design and develop

a better amendment for the federal government, and that’s what we’ve done.

“It’s not hard to defeat most of the fiscal gaming we see in states. The way you do it is you just define the balanced budget requirement in terms of strict cash flow,” he explained. “Limit spending to the available cash flow from taxes and from authorized borrowing. Define the amount of authorized borrowing to be a specific line of credit of a specific amount, and you don’t give control of the amount of the line of credit to the addicted debtor.

“You don’t give Congress unilateral

authority to increase its own debt limit, because it’s obviously absurd. Instead you have to have some sort of outside intervention, some sort of referendum process to allow Congress to engage in any borrowing. If you do that, you can defeat nearly any possible way of gaming the system, short of outright fraud in accounting,” he said.

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



Putting a Face on America's Tax Returns

A CHART BOOK

Second Edition

Your guide to understanding America's tax code and what it means for you.



Order your copy today!
store.taxfoundation.org



Fundamental tax reform can achieve our goals. It can restore the nation's competitiveness and put us on a path to growth for the future. That is a win for every American.

Scott A. Hodge
President, Tax Foundation

PODCAST INFO

Nick Dranias: State Compacts Could Force Federal Budget Amendment:
<http://news.heartland.org/podcasts/2014/07/21/nick-dranias-state-compacts-could-force-federal-budget-amendment>

INTERNET INFO

“Introducing ‘Article V 2.0’: The Compact for a Balanced Budget,” Nick Dranias: <http://heartland.org/policy-documents/introducing-article-v-20-compact-balanced-budget>

House Passes Permanent Ban on Internet Taxation



“The tax ban ... is fully consistent with the principles of federalism. The Internet, by its nature, is an interstate network. The effects of Internet tax policy in one state are borne not just by that state’s citizens, but by citizens of other states.”

JAMES GATTUSO, SENIOR FELLOW, THE HERITAGE FOUNDATION

By Josh Peterson

A debate over states’ rights ensued in the U.S. House in July as it sought to permanently ban state and local governments from taxing Internet access.

The House passed the ban via voice vote, placing pressure on the Senate to pass its version of the Permanent Internet Tax Freedom Act before November 1, when the current moratorium on Internet access taxes expires.

The Senate version, called the Internet Tax Freedom Forever Act, is awaiting consideration from the Senate Finance Committee.

Under the original Internet Tax Freedom Act, passed in 1998, 10 states—Hawaii, New Hampshire, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Washington, and Wisconsin—were “grandfathered” under the moratorium and allowed to tax Internet access. They will not be exempted under PITFA.

‘Important for Digital Economy’

PITFA’s main sponsor, House Judiciary Committee Chairman Bob Goodlatte, a Virginia Republican, praised the vote in a tweet, saying the ban was “important for our growing digital economy.”

Advocates for a permanent ban worry taxation of Internet access would slow broadband subscriber growth.

HIS Global Insight, an industry research company, reported in December that, by the end of the first half of 2013, more than 70 percent of U.S. households were broadband Internet subscribers. The company expected that figure to rise to more than 74 percent of U.S. households by 2017.

A Federal Communications Commission fact sheet from September 2011 reported broadband subscriber growth, according to research from McKinsey and Deloitte, was helping to generate new jobs.

“A 7 (percent) increase in broadband penetration could create an additional 2.4 million new jobs,” said the report.

The strongest opposition to the ban came from Democratic Reps. John Conyers of Michigan and Sheila Jackson Lee of Texas, who expressed their concern about federal interference in

state and local taxation authorities.

Economists such as James Gattuso, a senior fellow at The Heritage Foundation, have argued the very structure of the Internet justifies a ban.

“Some have argued that despite the economic dangers, a federal ban on state Internet taxation would violate state prerogatives,” wrote Gattuso in a policy brief released June 30. “The tax ban, however, is fully consistent with the principles of federalism.”

He explained, “The Internet, by its nature, is an interstate network. The effects of Internet tax policy in one state are borne not just by that state’s citizens, but by citizens of other states.”

Jackson Lee and Conyers advocated for a continuation of a temporary ban.

Jackson Lee’s district includes the inner city of Houston; Conyers represents a portion of the Detroit area. Both cities are among many across the country that have fallen gravely short of meeting public pension obligations.

Opposition from Government Unions

Unions whose members’ pensions depend on cash-strapped city and state governments to collect taxes oppose the permanent Internet access tax ban.

Detroit city workers and retirees finished voting July 11 on whether to accept pension cuts as part of a plan to reduce the city’s estimated \$18 billion debt. The city declared bankruptcy July 18, 2013 because it was unable to pay its bills, which included its public pension obligations.

Houston is considering suing the firm that advised the city to make changes to its firefighters’ pensions in 2011, according to the *Houston Chronicle*. The city says the advice made the firefighters’ pensions unaffordable.

Concerns over Goodlatte’s permanent ban on Internet access taxes did not fall solely along partisan lines.

Texas Republican Rep. Joe Barton, whose district includes Arlington, also raised concerns that the bill would negatively affect the cities he represents.

Josh Peterson (jpeterson@watchdog.org) reports for Watchdog.org, where a version of this article first appeared.

NOW AVAILABLE FROM THE CATO INSTITUTE

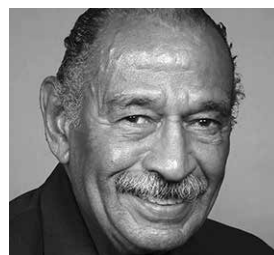
Research Briefs

IN ECONOMIC POLICY

Issued every two weeks—and available at Cato.org for immediate access and downloading—*Research Briefs in Economic Policy* are written by noted economists on key economic policy matters. Concise, succinct, and sharply focused, the goal of each brief is to inform, clarify, and enhance economic analyses and discussions. The topics covered will include immigration, government employee benefits, the Affordable Care Act, education, and more.



CATO INSTITUTE | WWW.CATO.ORG



John Conyers
U.S. Representative - MI



Sheila Jackson Lee
U.S. Representative - TX



Joe Barton
U.S. Representative - TX



Highway Trust Fund Almost Out of Money

Continued from page 1

In 2015, highway spending could exceed revenues by nearly \$15 billion, according to the Committee for a Responsible Federal Budget.

Bipartisan Tax Increase Proposal

U.S. Sens. Bob Corker (R-TN) and Chris Murphy (D-CT) put together a bipartisan proposal for the Highway Trust Fund. The Corker-Murphy proposal would increase federal gasoline and diesel taxes by six cents in each of the next two years for a total of 12 cents. The plan also would index the gas tax to inflation.

“For too long, Congress has shied away from taking serious action to update our country’s aging infrastructure,” Murphy said in a press statement. “We’re currently facing a transportation crisis that will only get worse if we don’t take bold action to fund the Highway Trust Fund. By modestly raising the federal gas tax, we can address a crippling economic liability for this country—the inability to finance long-term improvements to our crumbling national infrastructure.”

William McBride, chief economist at the Tax Foundation, said Congress wants to raise revenue for the Highway Trust Fund and he thinks the Corker-Murphy proposal is the best option he’s seen. Another option included ending U.S. Postal Service delivery on Saturday and sending the savings to the highway fund.

Randal O’Toole, a senior fellow at the Cato Institute who works on transpor-

“There is no reason to raise the federal gas tax. You send the money to Washington, a lot of it gets lost in paperwork and bureaucracy and pork-barrel politics.”

**CHRIS EDWARDS
DIRECTOR OF TAX POLICY STUDIES
CATO INSTITUTE**

tation issues, called the post office idea “absurd.”

“The money saved from 10 years of Postal Service cuts would barely fund one year of transportation deficits,” O’Toole said.

No Inflation Adjustments

McBride said the main problem is the Highway Trust Fund is not an effective revenue system because motor fuel taxes are not indexed for inflation.

“The voters don’t want to pay more gas tax,” McBride said. “They are enjoying the annual gas tax cut that results from no inflation [indexing]. If you are going to let that tax go down, you have to let the spending go down, too.”

Supporters of motor fuel taxes like them because highway users pay the tax.

“The essential principle is the user pays the cost of it,” McBride said.

Jonathan Williams, director of the Tax and Fiscal Policy Task Force of the

American Legislative Exchange Council, studied the Highway Trust Fund in 2007 and found gas taxes have been spent on far more than just crumbling highways. That raises concerns over how Highway Trust Fund money would be spent if taxes are increased.

Big Gas Tax Diversions

Williams found Highway Trust Fund dollars have been spent on such things as public education, museums, parking garages, and graffiti removal. He said it is premature to increase gas taxes until Americans can be assured the money would be spent on legitimate road construction projects.

“There’s just so much diversion of funds,” Williams said.

Nothing has changed since Williams’s study. Chris Edwards, director of tax policy studies at the Cato Institute, raised similar concerns in testimony in May to the Senate Finance Committee.

“There is no reason to raise the federal gas tax,” Edwards said. “You send the money to Washington, a lot of it gets lost in paperwork and bureaucracy and pork-barrel politics.”

25 Percent for ‘Non-Highway Purposes’

Since the 1970s, Edwards noted in his testimony, “fuel taxes have been siphoned off for non-highway purposes, particularly with the creation of the transit program in 1982. About one-quarter of HTF spending today is for non-highway purposes.”

O’Toole said in the past decade Congress has diverted \$55 billion of gas tax

revenues to public transit.

“Congress has until the end of August to do something about the dwindling Trust Fund and until October 1 to reauthorize the gas tax,” O’Toole said. “Unless fiscal conservatives apply intense pressure, Congress is most likely to throw more General Funds at the Trust Fund and extend the current bad system another two years.”

More State Responsibility

Some policy analysts believe the states should take the lead when it comes to highway funding.

“Instead of having this discussion in Washington, we should be having it at 50 state capitols,” Williams said.

That is happening in Michigan, where legislators have debated how to pay to repair crumbling roads due in part to the harsh winter of 2013–14.

“As I’ve said for some time, we need a sustainable, long-term approach toward improving our crumbling roads and bridges,” Michigan Gov. Rick Snyder (R) said recently in a press statement. “Our challenge moving forward is to arrive—together—on a plan that will serve Michigan long into the future.”

The federal government accounts for more than 25 percent of total highway funding. States and local governments primarily pay for the rest of it, according to the Committee for a Responsible Federal Budget.

Tom Gantert is senior capitol correspondent for Michigan Capitol Confidential, a daily news site of the Mackinac Center for Public Policy.

Unfunded Liabilities Leave Hawaii 'Drowning in Debt,' Watchdog Says

By Malia Zimmerman

Hawaii Gov. Neil Abercrombie's administration is touting fiscal prudence, announcing the state deposited \$100 million to the Hawaii Employer-Union Health Benefits Trust Fund in late June.

That was to "prefund" the cost of the state's unfunded liabilities, including health insurance premiums and life insurance for state retirees.

Sheila Weinberg, founder and CEO of the Chicago-based fiscal watchdog Truth in Accounting, said Hawaii can't claim it's being fiscally prudent because that trust fund is "drowning in debt."

"Flaunting this relatively little deposit is like expecting people to think you're a hero because you threw a one-foot rope into the water to save someone drowning in water 110 feet deep," Weinberg said.

Huge Retiree Health Costs

Weinberg points out retirees' health care costs are \$11 billion, more than \$24,000 per Hawaii household and almost three times state employees' annual pay.

In the past, Abercrombie said, the state opted to pay only the required minimum annual premiums, but it is now working to pay down the \$11 billion debt ahead of schedule.

"After decades of this issue being

ignored, today we are taking action by beginning to pre-fund—and pay down—our [retiree] liability," Abercrombie said. "This is the first step in many that are required to address this longstanding liability. We are demonstrating our resolve to meet and address our financial health and take our obligations seriously."

Kalbert Young, director of the state Department of Budget & Finance, dismissed Weinberg's criticism outright.



Kalbert Young

"While it is true that the total liability is still in excess of \$10 billion to \$11 billion, what Truth in Accounting has never appreciated or been truthful about is that there is no realistic or rational way to eliminate, pay, or reduce that liability over a year or any short period of time," Young said.

No household can pay off its mortgage in any one year, nor would it be rationally expected to do so, Young said, comparing that situation to the state's long-term liabilities.

"The significance is that the state is beginning that long road this year," Young said. "One hundred million may be small in comparison to \$11-plus billion, but it's \$100 million more than



"Flaunting this relatively little deposit [into the pension fund] is like expecting people to think you're a hero because you threw a one-foot rope into the water to save someone drowning in water 110 feet deep."

SHEILA WEINBERG, FOUNDER AND CEO, TRUTH IN ACCOUNTING

was there 12 months ago, three years ago, 10 years ago."

'\$4 Billion Trick'

Weinberg also expressed skepticism toward the state's reason for "pre-funding" the \$100 million, saying it resulted in the administration "performing a \$4 billion magic trick."

"The administration took advantage of an obscure accounting loophole. This dodge of reality allows states to significantly reduce the amount of their unfunded liability by 'pre-funding' relatively minuscule amounts of their retiree health care benefits," Weinberg said.

She said that in 2011, the trust fund's unfunded liabilities were \$16.3 billion, but after Abercrombie's administration discounted future benefits from 7 percent to 4 percent, the value dropped to \$11.2 billion in 2013.

Young said that analysis by Truth in Accounting is "not really realistic or truthful."

The reason the Unfunded Actuarial Accrued Liability went down from \$16 billion to \$11.8 billion isn't an "accounting loophole," Young said, but rather because that liability is calculated as an actuarial formula the Government Accounting Standards Board sets.

When the state wasn't prefunding the discount rate, the liability was 4 percent, but when prefunded, the UAAL would be calculated at a 7 percent discount rate since it would have a basis from which to earn investment returns for a longer period of time, Young said.

Required Funding Increases

Hawaii enacted Act 268 in 2013, mandating state and county governments

pay at least 20 percent of the annual amount needed to fund promised benefits to current and retired workers by fiscal 2015. That percentage bumps up 20 percent annually until 2019, when the funding mandate reaches 100 percent and continues at that level for at least 30 years.

The state will begin prefunding one year earlier than the 2013 Act 268 requirement.

Despite those steps, Weinberg criticized Hawaii for "ignoring related employee compensation cost." In 2013, she said, the administration claimed it met the state's constitutional balanced budget requirement, while putting off more than \$600 million of compensation costs related to retiree benefits.

Actuaries who reviewed Hawaii's finances said the state should pay \$868 million in 2013, but the state paid only 27 percent of that, Weinberg said.

Young said a portion of the \$868 million cited by Weinberg—roughly \$400-plus million—is already being paid by the state.

"For all the criticism from Truth In Accounting, I challenge them to find another state or municipality in the country that has made such a significant turnaround in approach, or headway in dealing with (other post-employment benefits), or with a better proposed funding trajectory for OPEB in the country," Young said. "I would argue that Hawaii stands alone in its approach to positively address its OPEB liability."

Malia Zimmerman is president and editor of Hawaii Reporter. Used with permission of HawaiiReporter.com.

IN OTHER WORDS . . .

"Projections in this year's trustees' report show that the current shortfall results from an excess of scheduled benefits over tax contributions for individuals who have already entered the Social Security system. This shortfall equals 4.4 percent of projected future wages. In other words, if current formulae remain unchanged for those now in the system, future workers will be subjected to a net income loss through Social Security equal to 4.4 percent of earnings."

— Testimony of Charles Blahous, Public Trustee for Social Security, before the U.S. House Subcommittee on Social Security, July 29, 2014

High Court Ruling Threatens Public Employee Unions

By Steve Stanek

In barring state governments from forcing home caregivers to join a labor union, the U.S. Supreme Court also took big swipes at a prior ruling that allows states to force full-time state workers to join unions.

“They destroyed *Abood* in every conceivable way,” said Prof. Josh Blackman of South Texas College of Law, referring to the Court’s 5–4 ruling in *Harris v. Quinn*. The *Harris* ruling also addresses *Abood v. Detroit Board of Education*, a 1977 Supreme Court case that allowed states to force full-time government employees to join unions.

The *Harris* decision, written by Justice Samuel Alito, declares Illinois violated the First Amendment rights of Pamela Harris and seven other home health care workers who joined her in the lawsuit. Harris cares for a severely disabled son in her home. Several years ago Illinois forced her and 20,000 other independent home health care providers to pay fees to the Service Employees International Union. Most of those workers, like Harris, are caring for family members who receive state Medicaid payments.

No Benefits from Membership

Blackman said these caregivers received no grievance protections, insurance, or other benefits from the SEIU.

“[The SEIU] represented them in name only” and demanded fees from them, which Illinois’ governor at the time, Rod Blagojevich, was happy to provide, knowing some of that money would find its way back into his campaign coffers. Blagojevich is currently serving a 14-year sentence in federal prison after having been convicted on corruption charges that included trying to “sell” the Senate seat formerly held by Barack Obama after he became president.

“Everyone knew this was government inserting itself between family members. This looks like government trying to interfere with a welfare payment and siphon off some of it for the union,” said Walter Olson of the Cato Institute, who added Alito “was doing all but say ‘I dare you to bring us a sympathetic case’” to also challenge the *Abood* ruling.

Blackman and Olson made their comments during a Tax Foundation conference call to discuss the *Harris* case.

The Alito ruling distinguishes between “quasi” government workers like Harris and other independent home health care workers and “full-fledged” government employees such

“[T]he Supreme Court made two facts crystal clear: Home health care workers work for their disabled or elderly patients—not the state—and private homes are not union shops.”

**CAROL PLATT LIEBAU
PRESIDENT
YANKEE INSTITUTE**



as teachers or police who receive collectively bargained pay, health insurance, vacation pay, sick pay, and other benefits, and who are under direct supervision of other government employees.

Alito wrote the Court did not gut forced unionization for all government employees because the Illinois law applied only to home workers for unionization purposes, and not other state benefits or protections.

Worries of Union Officials

Even though the Court left the ruling in *Abood* in place, labor union officials apparently fear the implications for *Abood* in the *Harris* ruling.

“The Supreme Court, today, struck down the collective bargaining rights of public employees and virtually told all workers that their American Dream might actually become an American Nightmare,” said Larry Hanley, president of the Amalgamated Transit Union, in a statement.

He added, “Make no mistake—this decision is not the end of this story. It is part of an ongoing effort by the obscenely wealthy ultra-rich to render unions totally ineffective, if not eliminate them altogether. And that will ultimately accelerate the current erosion of the middle class and hasten the economic polarization of society that threatens the very foundations of our republic.”

Paul Kersey, director of labor at the Illinois Policy Institute, declared in a blog post, “For more than a decade, government unions have been forcing people who are not state workers—moms and dads caring for children with developmental disabilities, home day-care providers for low-income children and others—to pay dues to a union as a condition of receiving help from their state governments. Both Gov. Pat Quinn and now-disgraced former Gov. Rod Blagojevich issued executive orders allowing the unionization of people who were not state workers.

This resulted in Illinois government unions making \$20 million a year from these workers, many of whom never wanted to join or pay dues to a union in the first place.

“Fortunately, today the U.S. Supreme Court has affirmed that plaintiff Pam Harris won’t have to jeopardize and limit her son’s care by being forced to join a union she does not want, agree with or support,” Kersey wrote.

Carol Platt Liebau, president of the Yankee Institute in Connecticut, said the ruling defends the right of freedom

of association for workers around the country. “Vindicating the First Amendment guarantee of freedom of association, the Supreme Court made two facts crystal clear: Home health care workers work for their disabled or elderly patients—not the state—and private homes are not union shops,” she said in a statement.

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

Shop Heartland's online store

The Heartland Institute Store (heartlandstore.org) has a selection of unique gift ideas that are perfect for Lovers of Liberty.

Choose from our famous deck of “Freedom Cards” – featuring portraits of the most important figures in this history of freedom, from John Locke to Ayn Rand.

Heartland’s selection of books is great for the intellectually curious. Pick from hot-sellers such as: *The Patriot’s Tool Box*, *The Obamacare Disaster*, and many more. Plus coffee mugs, t-shirts, tote bags, posters, and more!

Give gifts that say something about your beliefs and dedication to advancing the cause of liberty. Visit the Heartland Store today! heartlandstore.org



THE HEARTLAND INSTITUTE  IDEAS THAT EMPOWER PEOPLE

ANALYSIS

Two Tales of a City: How Detroit Transcended Ideology to Reform Broken Pension System

By Ed Ring

Traveling through suburban Detroit, a sprawling city of 143 square miles whose population has dropped from nearly two million to less than 700,000, you can often imagine you are in rural Tennessee.

Rutted, narrow roads bend past groves of cottonwood, oak, and silver maple. Deer and rabbits forage in tall grass. Until you pass a burned-out ruin of a home, not yet removed and now obscured by greenery, it is difficult to imagine these neighborhoods once were filled with homes set 35 feet apart and carpeting the land for mile after mile.

City retirees have voted overwhelmingly to accept pension cuts as part of a bankruptcy deal.

For many, Detroit's demise is attributable to the unchecked power of labor unions. Private-sector unions were inflexible in the face of foreign competition, driving Detroit's auto industry into irreversible decline. Public-sector unions gobbled up every dime of taxpayer revenue they could bully and intimidate politicians into granting, further straining the finances of an already imploding city. Financially unsustainable pension benefits ultimately drove the city into bankruptcy.

A different tale emerges from the left side of the ideological spectrum. Taken from a guest column written for MSNBC.com, here's a quote from Jordan Marks, executive director of the National Public Pension Coalition, a group largely funded by public-sector unions:

"While public coffers were running dry, Wall Street banks were out to make millions. Mayor Kwame Kilpatrick, who now sits in jail, worked with Wall Street banks that designed an illegal borrowing scheme that evaded state debt limits and piled on unwise interest rate swaps. When interest rates plummeted, Wall Street demanded more than \$300 million from Detroit to terminate these swap deals—making a bad situation even worse. These same Wall Street firms stand to make millions if other cities move to privatize their pension plans."

Some Truth in Both

These two tales of Detroit's struggles both have elements of truth. Yes, the city's unions were unwilling to adjust their pensions and benefits until it was too late, but even if they had, the city's finances would have failed anyway because Detroit lost nearly two-thirds of its tax base.

And although the automotive industry's

unions were unwilling to adjust their pensions and benefits until it was too late, that industry would have shrunk anyway, because very capable foreign competitors gained strength starting back in the 1960s. It is unrealistic to expect, under any circumstances, that Detroit's auto industry could have maintained the overwhelming global market share it had up to and through the 1950s. Without economic diversification, Detroit was destined to fall hard.

The tale that comes from the left, however, strains credulity even further. First of all, public-sector unions don't represent the "left." They represent the state. When Jordan Marks writes about banks colluding with corrupt politicians, he is referring to politicians elected and controlled by public-sector unions.

Wall Street, Governments Willing Partners

His assertion that "Wall Street banks" exploited Detroit does not reflect reality. Bankers issue bonds—debt—to cities that willingly borrow the funds because their union agenda forces them to spend more than they collect in taxes and fees. Government pension fund managers pour billions of dollars into Wall Street investment firms every year. Bankers and city governments—controlled by government unions—work together to exploit taxpayers and private businesses.

They use the state power of imprisonment to enforce punitive levels of taxation, to pay down debt and unfunded liabilities incurred so they could live beyond their means. Wall Street bankers and municipal government unions work together to build a financial house of cards, and when it collapses they deserve equal blame.

Detroit's solution for its pension crisis will not please the ideologues. For the libertarian right, the failure to throw everyone into 401(k) plans must rattle. For the left, the new plan's built-in "triggers" that adjust benefits when necessary to compensate for possible future shortfalls in investment returns violates their goal of an immutable defined benefit. But it works. And the libertarians' enthusiasm for individual 401(k)s contradicts their entirely valid criticism of overly optimistic investment return projections on the part of pension funds (Detroit's was 7.9 percent a year).

Ideologically Impure but Workable

When the market tanks, as it periodically does, only a pooled plan with multigenera-



"For many, Detroit's demise is attributable to the unchecked power of labor unions. ... A different tale emerges from the left side of the ideological spectrum."

"Wall Street bankers and municipal government unions work together to build a financial house of cards, and when it collapses they deserve equal blame."

tional, active payees, plus retired participants with adjustable benefits, can maintain solvency through a balance of contributions from active workers and returns from invested assets.

A pooled 401(k) plan is nothing more than an ideologically impure version of individual 401(k) plans. An adjustable defined benefit plan is nothing more than an ideologically impure version of a fixed defined benefit plan. They can be functionally identical, two tales of the same thing, and they are both practical compromises.

Detroit's failures, and the city's response, are easy to describe using hyperbole and polemics. But ultimately there is one destiny,



one tale in reality, that will define Detroit's future.

Cutting through the rhetoric, cities around the nation may look to Detroit for answers, especially regarding the city's new pension plan, because Detroit has passed through a clarifying crucible of pain and self-evaluation that cities with better weather and more diversified economies have deferred. One big market correction will erase those advantages. The tale of Detroit makes for compelling analysis, from New York to LA.

Ed Ring (ed@calpolicycenter.org) is executive director of the California Policy Center. Used with permission of UnionWatch.org.

Detroit Backs Pension Cuts

But some are calling for a new retirement system

By Tom Gantert

When the City of Detroit's employees and retirees approved a plan in late July to cut benefits to their pension as part of the bankruptcy proceedings, Emergency Manager Kevyn Orr lauded the deal as something that allowed the city to offer a "sustainable retirement plan" that is "fiscally sound."

But some taxpayer advocates and a pension expert say the city missed a chance to provide a better solution to the long-standing problem with city pensions.

Detroit's pension liabilities were a big reason the city ended up in bankruptcy, according to James Hohman, assistant director of fiscal policy at the Michigan-based Mackinac Center for Public Policy.

Orr estimates the city's unfunded pension liability is \$3.5 billion. The problems that led to the multi-billion-dollar liability can be repeated in the future, because the city is keeping its defined-benefit pension plans, which means the city pays out an annual pension every year for the lifetime of the employee.

Hohman said Detroit doesn't have the money to pay its debts, which created "a bad situation."

"So it had to create this whole process to figure out who is going to take cuts," Hohman said. "The better policy is to not get into this situation to begin with. They shouldn't have to take cuts in the first place. They should convert to a defined-contribution plan where employees know the city will keep its promises. The city can't underfund these benefits."

Paying for Past Promises

Leon Drolet, chairman of the Michigan Taxpayers Alliance, said it is not surprising the defined-benefit pension plans were not ended in favor of a defined-contribution 401(k)-type plan.

"Politicians have it both ways," Drolet said. "They give labor unions benefits without raising taxes by making people pay for it in the future. Cities today are paying for the promises made by politicians decades ago."

Drolet said politicians know public employee unions are very aggressive in local elections and pay close attention to what politicians do.

"It is usually in a politician's best interests to collaborate with unions rather than negotiate," Drolet said. "The moral of the story: Require any benefit promises

to be paid up front today and 'pay as you go.'"

Retirees and active employees who are in the city's two public pension plans approved the deal that will clear the way for \$816 in private and public funds to be used to "shore up" pensions and put the collection of the Detroit Institute of Arts in a protective trust, according to the city.

Overwhelming Backing for Deal

According to the city, 82 percent of the retirees and active employees in the Police and Fire Retirement System and 73 percent of retirees and active employees in the General Retiree System voted in favor of the plan that will reduce their monthly pensions by 4.5 percent and also eliminate cost-of-living increases.

"The voting shows strong support for the city's plan to adjust its debts and for the investment necessary to provide essential services and put Detroit on secure financial footing," Orr said in a press release.

Detroit moved its employees to a new, hybrid pension plan July 1. In a deal negotiated with the unions, current city employees who are part of the General Retirement System will contribute 4 percent of their salary. City employees who are part of the Police and Fire Retirement System will pay 6 percent. Police and Fire Retirement System members hired after June 30, 2014 contribute 8 percent.

"The city and its labor partners have come up with what we think is the best option to strengthen employee pensions so we can continue to meet future obligations in a financially responsible and sustainable manner," Orr said in a press statement. "This new pension plan is the result of months of intense negotiation between the city, its unions and its retirees. The city's intention all along was to create a sustainable retirement plan for its employees that is fiscally sound and continues to meet their needs."

The city's pensions were underfunded because investment returns were lower than projected, Hohman said. The pension funds also gave retirees and active workers "13th checks," or bonus payments each year. The *Detroit Free Press* reported the city's General Retirement System board said in an affidavit during the bankruptcy proceedings that it gave out \$756.2 million in excess earnings to active employees from 1985 to 2007. Retirees received another \$195 million.

Tom Gantert is senior capitol correspondent for Michigan Capitol Confidential, a daily news site of the Mackinac Center for Public Policy.

"[Government employees] shouldn't have to take cuts in the first place. They should convert to a defined-contribution plan where employees know the city will keep its promises. The city can't underfund these benefits."

**JAMES HOHMAN
ASSISTANT DIRECTOR
OF FISCAL POLICY
MACKINAC CENTER
FOR PUBLIC POLICY**

"Politicians have it both ways. They give labor unions benefits without raising taxes by making people pay for it in the future. Cities today are paying for the promises made by politicians decades ago."

**LEON DROLET
CHAIRMAN
MICHIGAN TAXPAYERS
ALLIANCE**

www.LimitedGovernment.org

Public Interest Institute at Iowa Wesleyan College



600 North Jackson Street,
Mount Pleasant, Iowa 52641-1328
Public.Interest.Institute@LimitedGovernment.org

Members of
Public Interest Institute receive:

3 Monthly **INSTITUTE BRIEFS**

**IOWA TRANSPARENCY
NEWSLETTER**

One quarterly publication each month:
LIMITS, FACTS & OPINIONS, or
IOWA ECONOMIC SCORECARD

If you wish to support our efforts,
please donate by sending a check to us
at the above address

If you wish to donate by credit card,
please go to our website:
www.LimitedGovernment.org

PII is a 501 (c)(3) non-profit organization
and all contributions are tax deductible

www.LimitedGovernment.org

COMMENTARY

“Beginning in Fiscal Year 2015, governments will be required to disclose all their retiree pension debt to the public. But the hidden retiree health care ‘grenade’ will continue to rattle around the floor, pin loose and ready to fall out.”



Retiree Health Care Tops Unfunded Pensions as Fiscal Threat to States

By **Donna Rook**

Can anything be in worse condition than unfunded government pensions? Unfortunately, yes—and it’s something few people have heard of: other post-employment benefits (OPEB), essentially government retiree health care commitments.

The average state has \$11.46 billion of unfunded retiree health care debt, compared to \$10.85 billion of pension debt as of fiscal year-end 2012.

OPEB and pension benefits are part of employee compensation. Just like salaries, these retirement benefits are costs incurred each year the employees work, and they should be included in the state’s budget and paid each year. Today’s taxpayers should pay all compensation costs for services they receive.

Unfortunately, state governments do not include all these compensation costs in the budget as employees earn them. Instead, states typically handle OPEB benefits on a “pay-as-you-go” basis. Because no money is set aside each year to cover these expenses, future taxpayers must cover retirees’ health care checks when they are written. Current employment costs are paid by future taxpayers who did not receive services from the retired employees.

Accounting Tricks

Some states use an accounting trick to make their OPEB debt appear lower. By dropping a few dollars into an OPEB fund, states can assume higher rates of return, decreasing the estimated size of their unfunded promises.

Hawaii recently “prefunded” \$100 million of its \$11.2 billion in retiree health promises. (See “Unfunded Liabilities Leave Hawaii ‘Drowning in Debt,’ Watchdog Says,” this issue.) An accounting loophole then allowed the state to assume a rate of return on investments of 7 percent instead of 4 percent. Hawaii’s unfunded OPEB debt fell from \$11.2 billion to

\$7.7 billion—a \$3.5 billion reduction by the stroke of a pen.

Across the Fortune 1000 companies, combined debt for retiree medical benefits totals \$285 billion, according to a recent *Wall Street Journal* article. State government retiree medical benefit debt totals more than twice that amount, \$573 billion. The public is not as well informed about government retiree health care funding as business investors are about corporate debt. Governments still hide their retiree health care debt from public view.

Hidden Health Care Debt

Beginning in Fiscal Year 2015, governments will be required to disclose all their retiree pension debt to the public. But the hidden retiree health care “grenade” will continue to rattle around the floor, pin loose and ready to fall out. If current revenues are not enough to cover increasing health expenses for retired employees, other spending priorities may suffer.

Instead of including current-year checkbook receipts and only checks written, states should calculate all bills and expenses incurred regardless of when they will be paid. Budget documents should clearly estimate year-end debt (the balance sheet, including pension and retiree health care debt).

We call this FACT-based budgeting (Full Accrual and Calculation Techniques). FACT-based budgets fully inform citizens of the results of their state’s spending plans, enabling them to hold elected officials responsible.

To see how your state’s retirement pension and health care debt has grown since 2009, and compare it to other states, use the “Create Your Own Chart” option at <http://www.statedatalab.org/>.

Donna Rook (drook@statedatalab.org) is president of StateDataLab.org, a project of Truth in Accounting.

Vermont City's Telecom Drains Taxpayers of Millions

By Bruce Parker

A city-owned telecommunications provider in Burlington, Vermont sounded like a good idea a decade ago. But as Burlington Telecom seeks to settle a \$33 million debt with Citibank, local taxpayers are wondering where the city's money went. Some are wondering whether they'll ever get service.

"Our biggest concern is the city's decision to sell Burlington Telecom. By selling, the city has no chance to recoup the money that is owed the taxpayer," Lauren-Glenn Davitian, executive director of CCTV Center for Media & Democracy, told *Vermont Watchdog*.

Davitian, who oversees Channel 17 Town Meeting Television, a public access cable channel serving 25,000 households in Chittenden County, urged the Vermont Public Service Board to reject the sale of the municipal telecom to a private investor.

Default Forcing Sale

Launched in 2002 as a fiber-optics money-making venture for the city, Burlington Telecom experienced financial trouble before defaulting on interest payments to Citibank in 2010. After a lengthy legal battle, Citibank in February agreed to settle its \$33 million lawsuit for \$10.5 million plus an ownership stake in a new, privately held company.

Under a plan backed by Mayor Miro Weinberger, Burlington would repay Citibank using a \$6 million interim lease obtained through a local lender. The city also wants to renege on its obligation to expand cable and Internet service to all residents as mandated.

Burlington Telecom has long been mired in controversy.

Secretly Diverted Millions Missing

In 2008, former Burlington Chief Administrative Officer Jonathan Leopold secretly diverted \$16.9 million from the city's general fund to prop up the cable and Internet provider. A citizens' lawsuit filed against Leopold in 2009 has failed to retrieve any of that money.

Norman Williams, lead counsel in the suit to recover the \$16.9 million, said much of that cash is still unaccounted for.

"There's at least \$5 million that we don't know where it went," Williams told *Vermont Watchdog*.

He continued, "Some of the \$16.9 million was used to pay back the city's cash pool at the beginning, and some of it was used to cover operating deficits. After that, they had about \$10.2 million that they used for capital expenditures. The question is, what capital expenditures?"



"Our biggest concern is the city's decision to sell Burlington Telecom. By selling, the city has no chance to recoup the money that is owed the taxpayer."

**LAUREN-GLENN DAVITIAN
EXECUTIVE DIRECTOR
CCTV CENTER FOR MEDIA &
DEMOCRACY**

Capital Expenditures Shortfall

According to Williams, Leopold's claim that \$10.2 million was used for capital expenditures—namely, customer hookups and stringing cable lines—doesn't add up. Roughly \$4 million is accounted for by the telecom's reported 2,500 customer hookups at the time, estimated to cost \$1,600 each. Another \$1 million was spent running 10 miles of cable lines, Williams said.

He explained, "Basically that's your \$5 million. So, it wasn't all used for hookups and line stringing. ... [The other] \$5 million was used for something else. We don't know what that was. There's never been an audit. ...

It's just not explained what happened to that money."

Williams said as much as \$15 million in taxpayer money could be recovered through insurance, since Leopold was bonded and may have breached his duty of faithful performance as chief administrative officer for the city.

City Wants to Back Out

A newer controversy relates to Burlington's request to be released from providing cable, phone, and Internet access to Burlington residents—a slight to taxpayers who subsidize Burlington Telecom.

As discussed in a recent open hearing with the Public Service Board, the city has asked to bail on the citywide build-out of infrastructure mandated in the Certificate of Public Good.

"There's about one-fifth of the city that Burlington Telecom cable doesn't even go past their house. So they cannot even sign up if they wanted to. That seems the height of unfairness to me, that you're forced to subsidize a business that you can't even participate in if you wanted to," Williams said.

The city's request is tied to the financials of the settlement.

"The taxpayers don't retrieve much if it's sold to a private entity," Williams said. "The reason they want to take out

this provision is because Burlington Telecom is worth just about nothing if you have to build out the whole city. That's the problem. But if you don't build out the city you've just forced taxpayers to pay for something that they can't even use."

Public Left Out of Process

Davitian said public access television will survive regardless of whether Burlington Telecom becomes a private company, but she argues the public should have been part of the decision-making process.

"The decision to sell Burlington Telecom was not made with significant public process. ... If this is going to be sold, then we need to follow the process that we do with pretty much every other public asset we've ever had in the city of Burlington in the last 30 years."

For Williams, the city's plan completely ignores the legal rights of taxpayers.

"The legislature made clear that the taxpayers were not supposed to be taking any risk at all with Burlington Telecom. Lo and behold, they have taken a hit."

Bruce Parker (bparker@watchdog.org) reports for VermontWatchdog.org, where an earlier version of this article appeared. Used with permission.

Milwaukee Council Repeals Cap on Number of Taxis

By Nico Perrino

Last year Judge Jane Carroll of the Milwaukee County Circuit Court declared unconstitutional the city of Milwaukee's law imposing a cap on the number of taxicabs in the city.

Now the city is finally complying with that order. The Common Council voted unanimously in July to completely lift the cap on how many taxicabs may operate in the city. In lifting its cap, Milwaukee becomes one of the freest cities in the nation for drivers looking to enter the taxicab market.

The new law requires taxis to comply with basic health and safety requirements such as inspections and minimum insurance coverage.

Longtime cab drivers such as Ghaleb Ibrahim and Jatinder Cheema have been waiting for this day for years. In 2011, Ibrahim and Cheema joined a coalition of other cab drivers and the Institute for Justice, a public-interest law firm, in filing the lawsuit that culminated in the Common Council vote.

'Long Struggle'

"This is the culmination of a long struggle against an oppressive and unconsti-

"The unconstitutional cap is no more. Now, after driving in the city for more than a decade, I finally have the right to open my own cab company without having to buy permission from someone else."

**JATINDER CHEEMA, TAXICAB DRIVER
MILWAUKEE, WISCONSIN**

tutional system," said Institute for Justice attorney Anthony Sanders. "It used to be that because of the government-imposed cap, a Milwaukee taxicab cost more than a house. Taxi entrepreneurs can now afford to keep their house and open a business, too."

The law also offers a path for services such as Uber and Lyft to be recognized and licensed, increasing transportation options in Milwaukee.

The former cap, implemented by the city in 1991, caused the price of a taxi permit to rise from \$85 to more than \$150,000 on the secondary market. Under the law, the number of cab permits was fixed at about 320.

In response to the cabbies' court victory, the city voted last November to raise that cap by 100. With the latest vote the city has lifted the cap altogether.

'Don't Need Permission'

"The unconstitutional cap is no more," said Cheema. "Now, after driving in the city for more than a decade, I finally have the right to open my own cab company without having to buy permission from someone else."

Despite the victory for aspiring cab operators, the struggle for taxi freedom in Milwaukee is not over.

The existing taxi company owners,

who have enjoyed the protectionism offered by the city's cap for more than 20 years, are not quitting without a fight. They have vowed to sue to prevent the cap from being repealed. The Institute for Justice and its clients stand ready to intervene and seek dismissal of any lawsuit that seeks to prevent the city from lifting the cap.

The Institute for Justice has helped open taxi markets in Cincinnati, Denver, Indianapolis, and Minneapolis. For more than 20 years it has been the nation's leading legal advocate for the rights of entrepreneurs.

Nico Perrino (nperrino@ij.org) is communications coordinator at the Institute for Justice.

INTERNET INFO

"Ghaleb Ibrahim v. City of Milwaukee: Challenging Milwaukee's Unconstitutional Taxicab Law," Institute for Justice: www.ij.org/milwaukee-taxis

INVEST IN FREEDOM

INCLUDE THE HEARTLAND INSTITUTE IN YOUR ESTATE PLAN

One way to ensure free-market ideas are effectively promoted in the future is to name The Heartland Institute a beneficiary of your estate. You may designate a dollar amount or a percentage of your estate, or name Heartland a beneficiary of your insurance policy, retirement plan, IRA, bank or brokerage account, real estate, or other financial assets.

Many legacy gifts are easy to make and do not require legal assistance. For those that do, Heartland has legal advisors willing to help.

For sample bequest language or for further information please contact Gwendalyn Carver, Development Director, at 312/377-4000 or by email at gcarver@heartland.org.



THE HEARTLAND INSTITUTE 
HEARTLAND.ORG

The Heartland Institute
One South Wacker Drive #2740
Chicago, IL 60606

The Heartland Institute is tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Its federal tax identification number is 36-3309812.

Government-Subsidized Air Service Stymies Private Bus Service

By Heather Kays

It seemed simple enough: Just expand. That was the vision Jake Winkler had for his family's business, Illinois-based Peoria Charter Coach Company.

But the story gets complicated because of competition from a federally subsidized air service program that this year is costing U.S. taxpayers approximately \$250 million.

Peoria Charter's luxurious coach buses hold five times as many passengers as the subsidized planes that make the short flight to and from Chicago, create less air pollution than the planes, and receive no taxpayer dollars to operate.

Peoria Charter already provides daily bus service for the Peoria, Normal, and Champaign areas to O'Hare International and Midway airports in Chicago. Recently, 23-year-old Jake Winkler and his parents, who run the company, which has been in the Winkler family since 1941, decided they would offer shuttle bus service from Decatur to Chicago each day. The distance one way is

approximately 180 miles.

When they crunched the numbers, it became painfully clear this new plan for the business would never succeed, because the Decatur-Chicago route is one of more than 200 routes where the federal Essential Air Service subsidizes flights and travel services every day.

Tiny Airline, Big Subsidies

More than \$2.6 million of annual taxpayer subsidies go to Air Choice One, which flies nine-seat Cessna Caravans to Chicago and St. Louis from Decatur Airport. Thanks to the subsidies, Air Choice One can charge passengers less and offer more departures and arrivals than would be possible for Peoria Coach to offer, according to Winkler.

The Essential Air Service program, which began in 1978, was intended to give smaller communities time to adjust to deregulation of the airlines, which, until then, were required to provide service to small airports. Each day there are at least two flights out of each of the EAS-subsidized airports.

The program was supposed to be



temporary. Instead, it has grown, now costing taxpayers about \$250 million a year, up from \$22 million in 1998, according to officials.

Winkler says this is a waste of taxpayer dollars and against the free-market aspects of the way the American economy is supposed to work.

'Impossible to Compete'

"The incredible price, time, and frequency that the Essential Air Service provides, makes it impossible for a private company to compete against," said Winkler. "If the government gave us half the amount that the airliner receives in Decatur, we would be able to constantly [offer] 10 full-size shuttle buses a day for free."

Winkler isn't the only one who has taken issue with the subsidized program over the years.

Chris Edwards, director of tax policy at the Cato Institute and editor of *DownsizingGovernment.org*, said the extension of the EAS program should not have occurred, because it was intended as a temporary transition for airports with few passengers to adjust to deregulation.

"Here we are, three decades later," Edwards said. "If the airports were essential, they would have survived in the marketplace" without subsidies.

'Total Waste of Money'

"It's corporate welfare," Edwards said. "It benefits these few businesses, but that's not fair to the rest of us who don't get these subsidies. Congress gave [the program] a name that is the reverse of what it actually is," suggesting there is nothing essential about the EAS. "It's a total waste of taxpayer money."

The Cato Institute has repeatedly called for elimination of the EAS program in its "Corporate Welfare" report, released every few years. Other organizations calling for EAS repeal include

Citizens Against Government Waste and Taxpayers for Common Sense.

A spokesman for the U.S. Department of Transportation, who asked not to be named, said the program was initially slated to last 10 years. Thereafter, it was repeatedly renewed by Congress until the expiration or "sunset date" was removed entirely in 1996.

Small airlines such as Air Choice One, Sky West, Silver Airways, and Cape Air have been using the program to provide flights in areas where there is too little market demand for them to remain in business without subsidies. This has allowed smaller communities to have air service to major hubs in large cities, according to the DOT spokesman.

"Deregulation would never have passed without some sort of protections for smaller communities," the DOT official said. "No senators in small states would have voted for it."

Three Airports Nearby

But in the Decatur, Illinois case, three airports provide unsubsidized air service less than a one-hour drive away.

Winkler said he sees no choice but to focus on the places where the family's company can turn a profit, such as Peoria, Normal, and Champaign. In those cities, where there are no Essential Air Service subsidies being handed to competitors, Winkler's company successfully competes against commercial planes and trains. The free market works there, he said.

"The overkill of transportation this airline provides Decatur will keep any other transportation company away," said Winkler. "When was the last time a small company competed against the government and won?"

Heather Kays (heather.a.kays@gmail.com) writes from River Edge, New Jersey.



"The overkill of transportation this airline provides Decatur will keep any other transportation company away. When was the last time a small company competed against the government and won?"

JAKE WINKLER
PEORIA CHARTER COACH COMPANY

Business Lobbying Boosts Executive Pay, Not Company Profitability

By Kyle Precourt

Many people believe a modern business's success or failure depends partly on its ability to lobby or secure favor through political connections.

That belief has only grown since the federal government responded to the financial crisis by increasing the subsidies, grants, and contracts given directly to specific businesses. Some businesses have benefited; others have failed in spite of these taxpayer-funded favors.

So is "rent-seeking," as the process is known, actually profitable for businesses? Is it worth the investment of time and money that could be put to other uses?

In a new study from the Mercatus Center at George Mason University, economists Russell Sobel and Rachel Graefe-Anderson find political activity has no significant effect on the performance of most firms and industries. However, individual company execu-

tives do appear to profit from having close ties to the political process.

Using data that include recent stimulus funding, the authors find:

- Total expenditures on lobbying the federal government rose by almost 25 percent from 2007 to 2010, to more than \$3.5 billion. There are more than 12,000 federal lobbyists pushing their interests in Washington. There is little evidence companies' lobbying expenditures or political contributions lead to greater profits.
- Company executives appear to be the main beneficiaries of strong political connections between firms and the federal government, capturing dollars that do not flow to the rest of the firm or its shareholders.
- There is one notable exception: the banking and finance industries. Influenced by the \$450 billion TARP program, these sectors show a link

"There is a clear incentive for executives to direct resources to seek government funds even when it may not strengthen the company."

between lobbying efforts and both corporate executive compensation and firm profitability.

• Companies that accepted TARP funds did so with limitations on executive compensation; that the program's designers saw fit to insert this provision may be more understandable considering the paper's findings.

• Despite its high level of media attention, crony capitalism does not seem to have a widespread resource-allocation impact on the economy. Still, the authors' findings are consistent with highly publicized examples of politically favored firms such as Solyndra, which go bankrupt despite receiving government assistance. There is a clear incentive for executives to direct resources to seek government funds even when it may not strengthen the company.

In short, government-granted privilege does not increase prosperity for the vast majority of American workers and investors. Additionally, another recent Mercatus study details how these policies fail state and city governments

that offer benefits in hopes of attracting jobs and economic activity.

Kyle Precourt (kprecourt@mercatus.gmu.edu) is state and local media coordinator for the Mercatus Center at George Mason University.

INTERNET INFO

"The Relationship Between Political Connections and the Financial Performance of Industries and Firms," Russell S. Sobel and Rachel L. Graefe-Anderson, Mercatus Center: <http://heartland.org/policy-documents/relationship-between-political-connections-and-financial-performance-industries-and>

"The Political Economy of State-Provided Targeted Benefits," Christopher J. Coyne and Lotta Moberg, Mercatus Center: <http://heartland.org/policy-documents/political-economy-state-provided-targeted-benefits>

A BETTER WAY TO TEACH POLITICS

Make Your Social Studies, Political Science, or Government Class More Dynamic and Fun!

Make your next class come alive with the World's Smallest Political Quiz – a fast, fun way to measure political beliefs.

The Quiz asks 10 questions about political issues. Based on the answers, the students learn where they fit on the political map – and they learn about other viewpoints as well. The Quiz has been used in hundreds of high school and college classrooms across America – including Harvard University's

Kennedy School of Government.

Created by the non-profit, non-partisan Advocates for Self-Government, the Quiz is a break-



no wrong answers! And you'll enjoy the discussion and learning that follows.

Get the Quiz for FREE

Best of all, it's FREE! We'll send you as many copies of the handy, card-sized Quiz as you need – no charge.

Call toll free: 1-800-932-1776. Or email: Quiz@theAdvocates.org. (Include name, mailing address, school name, name of class(es), and the number of Quizzes you need.)



through educational tool – which is one of the reasons the *Washington Post* says: "The Quiz has gained respect as a valid measure of a person's political leanings."

Your students will love taking a Quiz they don't have to study for – one with

Get your Quizzes for FREE!

Michigan Voters Approve Pro-Growth Tax Cut Plan

By Ted O'Neil

Michigan voters in August overwhelmingly approved Proposal 1, a measure to cut personal property taxes—taxes levied on businesses for equipment and machinery—by about \$500 million a year.

In addition, the 69 percent to 31 percent vote ensures local units of government are reimbursed for the entirety of revenue lost due to the cuts, according to a policy brief released by the Mackinac Center for Public Policy.

Voters were asked “to certify a \$500 million reduction in an economically inefficient tax,” said James Hohman, assistant director of fiscal policy and author of the policy brief. “Taxing equipment and machinery discourages expansion and growth.”

He added, “Proposal 1 was very unique because it had no formal opposition. And it was a remarkably clean initiative: It cut personal property taxes in strategic ways to improve the economy. Local governments that normally would have been on the losing end came out even with reimbursement from the state. And unlike Illinois and Ohio, Michigan is reducing its business tax burden without replacement.”

Proposal 1 puts in place legislation, already approved by the legislature, that creates three new exemptions for certain businesses that currently pay personal property taxes. Those exemptions free businesses with less than \$80,000 of personal property from all PPT liability; phase in relief for manufacturing personal property that has

been subjected to the tax for at least 10 years; and exempt all new manufacturing personal property.

\$500M Net Tax Cut

Those exemptions will result in a tax cut of more than \$600 million annually but will be offset by a new, smaller tax on personal property that qualifies for either of the latter two exemptions. That is estimated to raise about \$117.5 million annually. State and local governments receive about \$1.3 billion in PPT revenue currently.

The bills that will become law with the passage of Proposal 1 will cause the state to set aside a portion of the use tax revenue to reimburse local municipalities and school districts that experience a decrease in PPT revenue. The state would accomplish this through a new authority that would levy a use tax and redistribute the money back to local governments.

This “local” use tax will be accompanied by a decrease in the state use tax, leaving taxpayers unaffected. Although the package of bills had been approved, Michigan’s Headlee Amendment required the matter be put to a vote because it creates a new “local” tax.

“The state is going to absorb the revenue lost from these exemptions while cutting the personal property tax,” Hohman said. “It’s a hefty tax cut that should encourage job growth.”

Ted O'Neil (oneil@mackinac.org) is media relations director for the Mackinac Center for Public Policy.

IN OTHER WORDS . . .

“[Association of Local Government Auditors] recommended that local governments not only establish an independent audit committee, but also make certain that the committee includes financial experts who are not members of the governing body. The guidance goes on to say that properly resourced audit committees should have access to outside experts who can help make sense of complex or unforeseen financial issues. ...

“ALGA’s message is subtle, but clear: As public finance becomes ever more complex, even small local governments need a competent, vigilant, independent and expansive voice to make sure the public’s money is managed prudently.”

— Justin Marlowe writing in *Governing* magazine, August 2, 2014



‘Rolling Thunder’ Nets Big Bucks, Few Arrests for South Carolina Cops

By Nick Sibilla

Scouring I-85 and I-26 for motorists, almost 90 officers from 21 law enforcement agencies conducted their annual “Operation Rolling Thunder” last October in Spartanburg County, South Carolina.

Every year, police stop well over 1,000 cars as a way to combat drug trafficking and get tough on crime.

But the vast majority of drivers caught in the operation’s dragnet weren’t felons, according to a recent investigation by WSPA-TV, the local CBS affiliate. Last October, officers searched 171 cars, wrote more than 300 speeding tickets, and issued 1,300 traffic citations in just four days.

Out of more than 1,000 vehicles stopped, only 34 people were charged with a crime. Last year’s Operation Rolling Thunder netted only a single felony conviction and seven felony arrests; two of those cases have been dismissed.

Boosting Police Budgets

In addition to fighting crime, supplementing police budgets seems to be behind this operation.

In 2013, police seized almost \$100,000, using a tactic known as civil forfeiture. Under civil forfeiture, an individual need not be convicted or charged with a crime to permanently lose his property. The cash seized during Rolling Thunder funds future operations. The amount of

cash taken from these operations has varied wildly, ranging from \$25,000 in 2012 to more than \$3 million in 2007, the operation’s first year.

According to a report by the Institute for Justice, “Policing for Profit,” South Carolina merited a D+ for its abysmal civil forfeiture laws. In South Carolina, the government need only show probable cause to believe the property is related to a crime to subject it to civil forfeiture. More than 40 other states require more evidence for civil forfeiture cases.

Probable cause is the same standard used for a search warrant and is far lower than the “beyond a reasonable doubt” evidentiary standard used in criminal convictions. In addition, law enforcement in South Carolina can keep up to 95 percent of the proceeds from forfeited property, leading to a perverse incentive to “police for profit,” instead of the fair administration of justice.

Nick Sibilla (nsibilla@ij.org) is communications associate at the Institute for Justice.

INTERNET INFO

“Policing for Profit: The Abuse of Civil Asset Forfeiture,” Institute for Justice: <http://heartland.org/policy-documents/policing-profit-abuse-civil-asset-forfeiture>

FDA Targets Cigar Makers; 119-Year-Old Firm at Risk

By William Patrick

J.C. Newman Cigar Co. is one of a kind, literally.

Founded in 1895 by Julius Caesar Newman, a Hungarian immigrant, the Tampa-based family business is the last of what was once 150 “Cigar City” factories.

The business has outlasted 19 U.S. presidents, two world wars, a Cuban economic embargo that crushed many of its competitors, and, most recently, the Great Recession.

Now, the company is fighting for its life.

New FDA Crackdown

A new executive branch regulation aimed at curbing youth access to tobacco by stomping out affordable cigars effectively would extinguish the Newman family legacy and its 130 jobs.

“It’s totally unfair the way the U.S. Food and Drug Administration is approaching us,” Eric Newman, the cigar company’s president, told Watchdog.org.

“Cigars are to Tampa what wine is to Napa Valley and what automobiles are to Michigan,” he said.

“If you know anyone whose family has been in Tampa for three or four generations, chances are someone was working in the cigar industry because they were the only jobs around,” he said.

The company’s success is in no small part due to its market niche.

J.C. Newman’s, known locally by its signature clock tower, El Reloj, uses 1930s vintage equipment to roll cigars



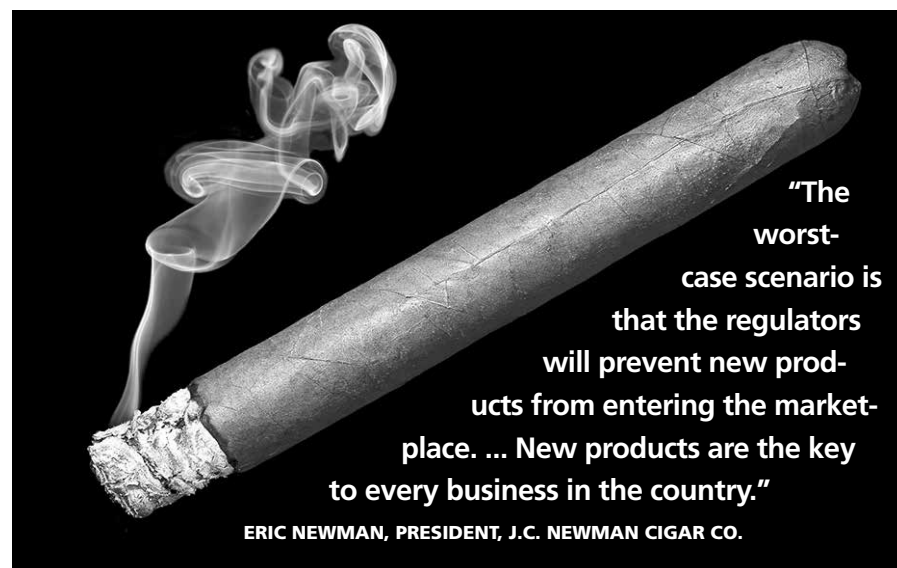
that sell for \$10 or less. They’re an affordable luxury that does not qualify for a “premium cigar” regulatory exemption.

Despite the quality of tobacco and the factory’s traditional methods, the company’s cigars are simply too inexpensive for government approval, and its machines don’t meet the technical definition of producing a handmade product.

“Not everyone has \$10 or more to spend on a cigar,” Newman said. “It takes us four months to teach a cigar maker how to use our hand-operated machines. We’re making cigars the same way my grandfather made them in the 1930s.”

Spreading Regulatory Power

In 2009, a Democratic-controlled Con-



“The worst-case scenario is that the regulators will prevent new products from entering the marketplace. ... New products are the key to every business in the country.”

ERIC NEWMAN, PRESIDENT, J.C. NEWMAN CIGAR CO.

gress gave FDA the power to regulate the tobacco industry. After first cracking down on cigarettes and smokeless tobacco, federal regulators now are moving on e-cigarettes, pipe and hookah tobacco, and cigars.

The problem, Newman said, is that treating cigars as if they’re cigarettes is a one-size-fits-all approach that doesn’t make much sense.

“I don’t blame them,” said Newman. “Their job is to regulate youth access to tobacco, and it’s our job to explain to them how totally unfair it would be to regulate our industry the same way they regulate cigarettes. It’s apples and oranges.”

In April, a 67-page proposed rule was published in the *Federal Register*. If finalized, it will require J.C. Newman Cigar Co. to:

- Obtain federal approval before offering any new cigar product.
- Submit every type of cigar sold to “rigorous scientific review.”
- Comply with new manufacturing practices.

New Fees, Reporting Burdens

The company also would be required to pay a user fee in the hundreds of thousands of dollars, effectively paying FDA to regulate it.

“This is an important moment for consumer protection—when the proposed regulation is finalized, FDA will be able to apply powerful regulatory tools, such as age restrictions and rigorous scientific review of new tobacco products and claims, to help reduce tobacco-related disease and death,” Mitch Zeller, J.D., director of FDA’s Center for Tobacco Products, said in a statement.

“Ultimately, FDA will play a vital gatekeeping role in protecting the pub-

lic by reviewing all new products and health-related claims for tobacco products in today’s rapidly evolving marketplace,” Zeller added.

The gatekeeping role includes requiring cigar manufacturers to spend thousands of hours, according to an FDA analysis, to test new products before submitting an application to sell a single new brand or size of cigar. New packaging on an existing cigar also would require FDA approval, and the tightened manufacturing practices could prohibit J.C. Newman’s vintage equipment.

“The worst-case scenario is that the regulators will prevent new products from entering the marketplace,” said Newman. “Eighty percent of what we sell today we didn’t 10 years ago. New products are the key to every business in the country.”

Last Survivor

Many of J.C. Newman’s employees come from one-time competitors that are no longer in business. If the El Reloj facility goes under, there is no other factory in Tampa where cigar makers will be able to apply their skills.

Newman told Watchdog.org he’ll continue to advocate for a premium exemption. FDA also received public comment about its proposed rule through August 8. As of late July, 37,943 comments had been submitted.

Newman said he recently met with FDA officials and showed them two cigars: one produced at his Tampa factory and a potentially exempted hand-rolled premium cigar. The regulators couldn’t tell the difference, he said.

William Patrick writes for Florida Watchdog.org. Used with permission of Watchdog.org.

IN OTHER WORDS . . .

“Since the early 1980s, the federal government has transferred about 15 percent of its budget to the states, which is almost as much as the federal deficit in an average year. Why does the federal government borrow so much money, only to transfer it to the states? Do the states really need that much help?”

“They don’t. States have their own taxing authority. The real reason for federal ‘assistance’ lies in the conditions that come attached to it, which allow the feds to dictate state policies and even what the states do with large chunks of their own money.”

— Richard A. Epstein and Mario Loyola writing in *The Atlantic*, July 31, 2014

With 18 titles so far, The Heartland Institute's ebook offerings range from *The Obamacare Disaster* and *The Patriot's Toolbox* to *Booker T. Washington: A Re-Examination*. In the convenient, easily downloaded Kindle format, you can read these and other Heartland books on one handy device.

Visit Amazon's Kindle store, search for The Heartland Institute, and discover our offerings for yourself.

We're just a click away!



You Can Take Our Experts Anywhere

Whatever your policy interests, Heartland's daily podcasts connect you with key players



BUDGET AND TAX

Steve Stanek and other budget and tax policy experts relate news and views from the local, state, and federal arenas.
heartland.org/issues/budgets-and-taxes

FINANCE, INSURANCE, AND REAL ESTATE

Stanek also interviews some of the nation's leading experts on FIRE policy issues.
heartland.org/issues/finance-insurance-and-real-estate



ENVIRONMENT

James M. Taylor conducts interviews and breaks news on climate change and other environment issues.
heartland.org/issues/environment



HEALTH CARE

Benjamin Domenech interviews leading health care policy analysts and relates news and views from the health policy arena.
heartland.org/issues/health-care



INFOTECH & TELECOM

Jim Lakely brings news and views on information technology and telecom issues.
heartland.org/issues/telecom



EDUCATION

Joy Pullmann and the staff of the Center for Transforming Education share news and views on topics from distance learning to vouchers.
heartland.org/issues/education

Subscribe to Heartland's daily podcasts on iTunes or listen from the audio pages at heartland.org