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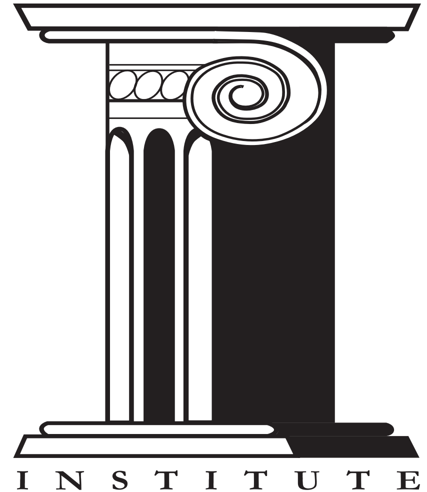

On Power and the Use of Coercion

The Tax-Cutting Boon Sweeping the States

by Stephen Moore

While the prospects for tax reform in Washington are dim, as many as 20 Republican Governors are moving forward with their own pro-growth tax-relief initiatives. This is on top of the 14 states, including Florida, Michigan, Ohio and Wisconsin, whose 2014 tax cuts will take effect this year.

Arizona's new Gov. Doug Ducey says his goal is to eventually eliminate the state income tax — joining the nine states that already don't tax their residents' wages and salaries. Mr. Ducey has promised income-tax cuts "every year I'm in office." He announced his first cuts, indexing tax brackets for inflation and expensing for business capital spending, this month. To offset phasing out the income tax, he wants to close some of the state's hundreds of sales-tax exemptions.

In Arkansas, Republicans now control both houses of the state legislature and the governorship for the first time in more than 100 years. This will allow Asa Hutchinson, the state's new Governor, to push what he calls a "very ambitious" tax-reform agenda. Last week the state senate in Little Rock passed a one-percentage-point cut in the income-tax rate applying to middle-income earners ($21,000-$75,000).

In Illinois, Maryland, and Massachusetts — three blue states that elected Republican Governors in November — tax rates are likely to fall to provide juice and jobs for local economies. In Illinois, Gov. Bruce Rauner vowed in his inaugural address to erase the income-tax-rate hikes of his Democratic predecessor, Pat Quinn. In Maryland, Larry Hogan won the governor's race by pledging to overturn "as many as possible" of the 19 taxes and fees that were raised by his predecessor, Democrat Martin O'Malley. And in Massachusetts, Charlie Baker plans to eliminate the state tax on business inventory and cut the corporate income tax.

The story is the same in many other states. Gov. Nikki Haley of South Carolina proposed a gas-tax hike on Jan. 21 to offset reducing the top state income-tax rate to 5 percent from 7 percent. Ohio's Gov. John Kasich lowered the highest personal income tax to 5.39 percent, and he has proposed trading higher oil-and-gas-production taxes for lower income-tax rates, though the collapse in oil prices over the

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The Tax–Cutting Boon Sweeping the States by Stephen Moore (continued from page 1)

past six months may require a new strategy.

In Maine, Gov. Paul LePage also wants to end the income tax in order to "compete with big states." His new budget proposes cutting the top income-tax rate to 5.75 percent from 7.95 percent and eliminating the estate tax while broadening the sales tax.

In Tennessee, which imposes no income tax on wages and salaries, Republican state Sen. Bill Ketron, who runs the revenue committee, will push a bill to eliminate the state's tax on investment income — the 1929 "Hall tax," named after the original senate sponsor, Frank Hall. In Nebraska, newly elected Gov. Pete Ricketts has proposed a sweeping statewide property-tax cut, while the state senate is moving forward with a plan to cut the top income-tax rate to 5 percent from 6.84 percent.

There are a few Republican Governors bucking the trend. Terry Branstad in Iowa and Rick Snyder in Michigan are pushing for major gas-tax hikes with no offsetting tax cuts. Brian Sandoval in Nevada wants to raise business taxes to pay for a 12 percent hike in state spending. The state's Republican-controlled legislature is not likely to go along.

These tax-hike proposals are the exceptions. Most of the 31 Republican Governors recognize that the states with lower taxes on working, investing, and business activity are winning the competition for jobs and businesses. There are more than 50 peer-reviewed academic studies that have found that higher state tax rates on income and businesses lead to fewer jobs and growth inside the state. American Governors increasingly get that.

"It's all about making our state competitive," says Mr. Ducey about his tax agenda. "We want those jobs and companies that have been headed to no-income-tax states like Florida and Texas to start coming here at a faster pace."

Indiana Gov. Mike Pence, whose state is experiencing a manufacturing revival, makes a similar argument. "Taxes aren't everything, but we see the evidence every day from the superior economic performance of low-tax states, so we want to duplicate the success of places like Texas and Tennessee," Mr. Pence says. "You can just follow the direction of the U-Haul vans to find out where the growth is happening in America."

Texas is the model for many Republican Governors. According to the Bureau of Labor Statistics, from December 2007, the official beginning of the Great Recession, through October 2014 Texas created more jobs than the other 49 states combined. But Texas, which has no income tax, is not done. The new Governor,

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The Unsustainability of Federal Spending

by Edwin J. Feulner, Ph.D

With so many high-profile, headline-grabbing issues facing the incoming Congress, lawmakers might be tempted to ignore one of the most persistent problems in Washington: overspending.

How bad is it? In 2014, federal spending reached $3.5 trillion, and the one-year deficit was $486 billion. These huge numbers represent "a small and temporary improvement in the nation's fiscal situation," a recent report by the Heritage Foundation notes.

But as the authors point out, that doesn't mean we're on the right track. Far from it. A serious effort to cut spending — not just trim a bit here and there — is needed.

"Without further spending reforms, rising debt threatens to impede growth, harm Americans' economic opportunities, and even threaten the nation's security," the authors warn.

If that sounds a bit hyperbolic, consider these facts from the report:

Washington spent nearly $3.5 trillion in 2014 (that's $3,500,000,000,000) while collecting nearly $3 trillion in revenues, resulting in a deficit of slightly less than half a trillion. In other words, 14 cents of every dollar that Washington spent in 2014 was borrowed.

Over the past 20 years, federal spending grew 63 percent faster than inflation.

Mandatory spending, including Social Security and means-tested entitlements, doubled after adjusting for inflation.

Discretionary spending grew by 47 percent in real terms.

Despite publicly held debt surging to three-fourths the size of the economy (as measured by gross domestic product, or GDP), net interest costs have fallen as interest rates have dropped to historic lows.

Three major budget categories — major health care programs, Social Security, and interest on the debt — will account for 85 percent of nominal spending growth over the next decade. Entitlement reform is a must to curb the growth in spending.

Even though mandatory spending on entitlement programs is by far the largest slice of the budgetary pie, that doesn't mean there aren't other cuts that can be made. Wasteful spending abounds — unless you think the National Institutes of Health spending $387,000 of your money to study the effects of Swedish massage on rabbits is essential.

Sure, $387,000 isn't much by Washington standards, but the budget is filled with such examples, and every little bit helps. It's easy to shrug off one or two, but getting rid of enough of them can make a real difference.

There's also far too much redundancy in the budget. According to a report from the Government Accountability Office, duplication of federal programs and services could cost taxpayers $45 billion annually. Elimination of wasteful and duplicative spending is definitely a worthwhile task for the new Congress.

Another huge driver of future overspending is Obamacare. New spending for the absurdly misnamed Affordable Care Act will cost more than $1.8 trillion over the next decade, and why? Because of its massive expansion of Medicaid and subsidies for those who buy health insurance in the new exchanges.

Some may suggest cutting defense spending, but as a percentage of the budget, it's already been falling for quite some time. In 1965, defense spending was 7.2 percent of GDP. In 2014, it was 3.5 percent of GDP — less than half of what it was in 1965.

Meanwhile, entitlement spending has been booming. Social Security, Medicare, and Medicaid make up 77 percent, or more than three-fourths, of mandatory program spending in 2014 — and have no budget limits.

To put the problem of overspending in perspective, consider what is perhaps the most striking chart in the Heritage report. It's titled "What if a typical family spent money

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The Unsustainability of Federal Spending by Edwin J. Feulner, Ph.D. (continued from page 3)

like the federal government?"

It notes that the median family income is $52,000: "If they spent money like the federal government, they'd spend $60,400 a year, which would mean they'd put $8,400 on the credit card each year, despite already being $308,800 in debt.

This is unsustainable. Does the new Congress realize this? More importantly, do they care?

Ed Feulner is founder of The Heritage Foundation and Chairman of the Asian Studies Center and Chung Ju-yung Fellow.

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The Sad State of the Union

by Richard A. Epstein

In his State of the Union address, President Barack Obama painted a rosy picture of his administration's work both in foreign and domestic policy. Reviewing the speech, it becomes clear that his failures both at home and abroad stem from his fundamental misconception of his own role.

In working with matters overseas, the President must lead. The most that one can expect of Congress is to authorize or ratify the actions that the President must implement. Presidential leadership, announced in a single and decisive voice, is essential, for no one can expect a deliberative body to take the lead in foreign statecraft. On domestic affairs, the opposite stance is appropriate. It is wise in general to look to the Congress to take some leadership in setting basic social and economic policies. But the President gets this division of labor exactly backwards. He is far too passive on foreign affairs and far too meddlesome on domestic ones, which is why his policies in both domains have failed.

Starting on the foreign policy side, Obama's policies are driven by the flawed proposition that "smarter" leadership lies in building coalitions that "combine military power with strong diplomacy." This position, he said in his State of the Union, pays concrete dividends: "In Iraq and Syria, American leadership—including our military power—is stopping ISIL's advance. Instead of getting dragged into another ground war in the Middle East, we are leading a broad coalition, including Arab nations, to degrade and ultimately destroy this terrorist group."

It is all wishful thinking. Militarily, it is never enough to stop an advance if it allows the enemy to use the breathing space to entrench itself further in the places that are under occupation. Obama's word choice of "ultimately" allows for endless equivocation and delay. The odds of putting together an effective coalition without demonstrable leadership are slim to none, for the President's only firm commitment — not to use ground troops ever against ISIL — signals to our allies that they too can discharge their obligations by flying the occasional sortie against ISIL positions.

The President may think that it has been an accomplishment to reduce over the past six years the number of American troops in Iraq and Afghanistan from close to 180,000 to under 15,000. But to everyone else,

rt of individuals like you who believe in individual liberty and free-market
e-paid envelope to make your tax-deductible contribution to this effort today.

the civil disorder attributable to American disengagement signals that America is not an ally to be trusted.

The President therefore grossly miscalculates when he concludes that "The shadow of crisis has passed, and the State of the Union is strong." Unfortunately, the facts on the ground show the opposite. Right now the President is bogged down in negotiations with the Iranians over their deployment of nuclear weapons. Little visible progress has been made to date.

Originally, the President supported at most a six-month moratorium on sanctions in order to lead the Iranians to the bargaining table. Yet when faced with their stalling tactics, he has pleaded for additional time, thus backing away from his explicit promise to keep a firm deadline for making a deal and vowing to veto any legislation that tries to firm up the initial position. Congress may well intervene to keep him to his original word. Generally, this kind of interference is most unwise, but the bipartisan unhappiness on the Iran problem reveals a complete and bipartisan breakdown in trust between Congress and the President.

Another sign of foreign policy disarray was the Congressional invitation to Israeli Prime Minister Benjamin Netanyahu to address the United States Congress in the middle of his own election campaign in Israel. When the President goes off track, the Congress tries the risky tactic of compensating for his errors, making it easy for everyone to second-guess its decisions.

It is also no surprise that the Russians under Putin have extended their offensive activities in the Ukraine, with a new attack on the key port of Mariupol in Eastern Ukraine. Why not, when the United States will not supply Ukraine any military weapons for self-defense? But to the President, his policy has succeeded "by opposing Russian aggression, supporting Ukraine's democracy, and reassuring our NATO allies." With support like ours, what are friends worth? "Speak softly, and carry a big stick" may not be the prescription for sound foreign policy, but it is equally dangerous to lurch to the opposite extreme: "Speak loudly, but carry a tiny twig."

The President, through his foreign policy, has lost the confidence of his allies across the globe and has emboldened the aggressive behavior of our enemies. Lacking confidence in the United States, our allies will have to fend for themselves, which helps explain the hopeless impasse in the Israeli-Palestinian negotiations, and the recent coup in Yemen, to which a few drone attacks are no response. There is also the strong likelihood that Afghanistan will lapse into further violence. It boggles the mind that the President can gloss over such massive failures with empty platitudes.

The situation on the domestic front is different. On these issues, the President knows that none of his short-term proposals are likely to get through a Republican Congress that is set against further tax increases and government transfer payments. But he nonetheless charges forward in an effort to build a populist political base that will perhaps in time enact most of his program.

But politics aside, the President wholly fails to understand the importance of economic growth in his relentless attack on economic inequality. The difference between these two programs is striking. A growth-program seeks to expand the size of the overall pie, trusting that the able and hardworking people whom the President lauds will be able to garner their share of the pie. The key point here is that gains from growth are sustainable because no firm has any incentive to back away from employment contracts that work to its own advantage. The hands-off policy thus improves economic incentives and reduces administrative overhead at the same time.

None of this makes the slightest impression on the President, who has concluded that his own brand of "middle-class economics works." At one level, he is surely correct to insist that everyone "gets their fair shot, everyone does their fair share, and everyone plays by the same set of rules." But it

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hardly follows that the way to make "working class families feel more secure" is to ply them with a set of educational, housing, and health-care subsidies, all of which have to be paid for by someone else, whose life is made less secure by the constant threat of ad hoc government intervention.

Indeed, it takes a remarkable amount of intellectual ingenuity to think that the President's policies can achieve a fraction of their lofty ambitions. Start with the situation in the employment markets. A sensible policy is to reduce the barriers to exchange that are imposed by taxes and regulations. But the President is buoyed to move in the opposite direction by putting his support behind labor unions that inject massive inefficiency into labor markets.

He speaks about the 11 million jobs created since the depths of the last recession. But his claim is full of holes. Right now, the total number of employed individuals in the United States is about what it was six years ago, notwithstanding a population gain of over 15 million people. Worse still, virtually all the gain in employment has come from part-time employment, which is encouraged in part by the Obamacare mandate that stipulates that employers must provide health-care insurance for those who work 30 hours a week or more—a topic on which the President was mysteriously silent in his State of the Union address.

Unfortunately, the President has already proposed an increase in the capital gains tax to 28 percent for people who earn more than $500,000 in order to fund a variety of educational programs, chiefly by offering a free ride to students who attend community colleges and maintain a 2.5 average, which he hopes would hone skills needed for middle class jobs, but which is more likely to lead to grade inflation. But the argument is wrong on both sides. Proprietary schools are more likely to train people for jobs than community colleges, because they face market responses when they don't perform. The President's program thus increases government subsidies without any promise or expectation of improved performance.

Yet the increase in the capital gains tax creates a double whammy. The first point is that the reduction in capital investment that this tax promises will make it more difficult for wages to rise. The simple proposition here is that capital and labor are complementary goods, so that higher wages depend on the better facilities and equipment that makes labor more productive. The second point is that the increase in capital gains rates is likely to translate into a reduction of taxable income. Unlike income from earnings, the capital gains tax is only triggered by a sale or other disposition of property. The high tax results in a reduction of the number of sales. That in turn not only decreases tax revenues, but also the efficiency of the capital markets, because it is more costly for people to switch their investments from inefficient to efficient firms.

Ideally, we should have a consumption tax that is not keyed to how income is acquired but to how it is consumed. On that view, all capital gains, if reinvested, will escape taxation, thereby increasing the level of productive capital. But the President always misconceives of taxation as a zero-sum game, thereby paving the path for increased transfer payments away from the top 1 percent to everyone else. But it is a mug's game, for unintended consequences matter, as the slow but persistent eight-percent decline in median income levels over the last six years reveals.

So there it is: An upside down world in which the President abdicates leadership on foreign affairs, and wants to overregulate on the domestic side. It will be a long two years.

Richard A. Epstein is the Peter and Kirsten Bedford Senior Fellow at the Hoover Institution. This article originally appeared on January 26, 2015, in Defining Ideas: A Hoover Institution Journal *and is reprinted with permission.*

Governors Love Federal Funding

by Nicole Kaeding

Obamacare gives states the option to expand Medicaid to cover all individuals below 138 percent of the federal poverty level, which is approximately $33,500 a year for a family of four. To encourage states to expand, the federal government agreed to fund 100 percent of expenditures for the newly-eligible participants until 2016, and then slowly decrease the match to 90 percent in 2020 and into the future.

Democratic and Republican Governors alike are showing their penchant for "free" federal dollars by supporting expanded Medicaid roles in their state. Republican Governors — who often say they dislike Obamacare — are in many cases pushing their legislatures to expand Medicaid to take advantage of this windfall.

GOP Governor Bill Haslam in Tennessee announced that he would support Medicaid expansion. His administration promoted the plan by saying, "Insure Tennessee will leverage the enhanced federal funding which will pay for between 90 and 100 percent of the cost and in doing so will bring federal tax dollars Tennesseans are already paying back to the state."

To help minimize the state's contribution and maximize federal funding, Haslam decided to expand the state's health provider tax. Under a provider tax, a state agrees to increase Medicaid reimbursements to the providers paying the tax, such as hospitals. The higher reimbursement level draws a higher federal contribution. So state politicians and hospitals win, but federal taxpayers lose.

In this case, luckily, Tennessee's legislature denied Haslam's expansion attempts.

Governor Mike Pence in Indiana is pushing for Medicaid expansion, dubbing the program "Healthy IN Plan 2.0." Governor Pence received an "A" in our Fiscal Policy Report Card on America's Governors last year for his tax-and-spending restraint. But his decision to expand Medicaid to include working-aged, able-bodied, childless adults sends a very different signal.

Governors Pence and Haslam aren't the only two Republicans wanting to expand Medicaid. Wyoming Governor Matt Mead said that by rejecting Medicaid expansion the legislature is "rejecting $120 million dollars meant for Wyoming." Governor Gary Herbert of Utah has said that Medicaid expansion allows "Utah [to bring] taxpayer dollars back to our state." More than 10 Republican Governors support Medicaid expansion, many using this same sort of rhetoric.

These Governors justify their actions by claiming that it will return tax dollars to their states. But Medicaid spending is not a fixed pie. The more that each state expands its program, the more that the nation's taxpayers will be hit. Federal expenditures are funded based on the matching percentage. It's not true to say that if Tennessee doesn't expand, that the money goes to California. Instead, if Tennessee doesn't expand, then the money isn't spent and taxpayers keep more of their earnings.

As I've discussed before, expanding Medicaid is also a risky proposition for state budgets, which some Republican Governors do not seem to understand. They boast of their fiscal conservatism, but their recent actions on Medicaid expansion come at the expense of a larger burden on the nation's taxpayers.

Nicole Kaeding is a Budget Analyst for the Cato Institute. This article originally appeared on February 11, 2015, on Downsizing the Federal Government *website, http://www.downsizinggovernment.org/, and is reprinted with permission from the Cato Institute.*

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The Tax–Cutting Boon Sweeping the States
by Stephen Moore
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Greg Abbott, says that "we can still make things better here by cutting business and property taxes — which is what I intend to do."

Labor unions and liberal groups had hoped to discredit tax cuts on the state level by spending millions of dollars to defeat incumbent Governors Sam Brownback of Kansas, Rick Scott of Florida, and Scott Walker of Wisconsin. But these tax-cutters were re-elected while voters told tax hikers such as Illinois Gov. Quinn to take a hike. "One message from the last election was that voters want lower taxes and more cost-conscious government," says Mr. Walker.

Many Governors have come to understand that states aren't just competing against each other for businesses and jobs. As Mr. Kasich puts it, "In Ohio we're in a contest against Europe, Asia, and the rest of the world, so we have to keep our taxes low."

That has become the dominant view in statehouses this year, and it explains why the big tax-cutting activity in 2015 won't be in Washington but in state capitals.

Stephen Moore is Chief Economist at The Heritage Foundation. Reprinted from The Wall Street Journal © *January 29, 2015 Dow Jones & Company. All rights reserved.*

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