Focus on Fiscal Policy

April 2009 A Publication of the American Legislative Exchange Council

Rich States, Poor States:

The 2009 ALEC-Laffer Economic Competitiveness Index

Performance-Based Budgeting:

How to address budget shortfalls in the states

Stimulus Bill Wrong Prescription for Economy

By Governor Mark Sanford

It's All About Jobs:

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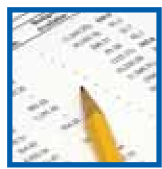
11  **Performance-Based Budgeting**
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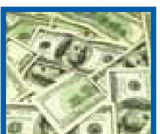
13  **Rich States, Poor States**
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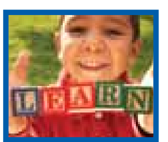
15 

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ALEC Calendar

May 1-2, 2009	Spring Task Force Summit	Memphis, TN
July 15-18, 2009	ALEC Annual Meeting ***Deadline to submit Model Legislation is June 1st***	Atlanta, GA
December 2-4, 2009	States & Nation Policy Summit	Washington, D.C.

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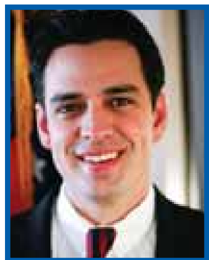
State Spotlight: Model Legislators

Georgia's Real Economic Stimulus

By Rep. Tom Graves



Does economic recovery come as a result of increased government spending or the reduction in government spending and lower taxes? President Ronald Reagan answered this question in 1981 when he signed into law the immensely successful Economic Recovery Act. It was the largest tax cut in American history and as a result the U.S. economy turned around in 1983 and boomed for many years. Shortly afterward he said, "We in government should learn to look at our country with the eyes of the entrepreneur, seeing possibilities where others see only problems."

In the spirit of Reagan's remarkable presidential leadership, we introduced legislation titled the "JOBS Act," a series of tax credits, cuts, and incentives to create, expand, and attract new jobs for Georgians. We recognize that the greatest stimulus for a robust economy comes from an economic environment that encourages opportunity, productivity, and innovation. It's the hard-working people of Georgia—not big government—that are the key to our economic prosperity.

The JOBS Act of 2009, HB 481 and HB 482, includes:

- A quarterly credit towards the Unemployment Insurance Tax of up to $500 per year for each eligible employee hired who is currently receiving unemployment benefits.
- A $2,400 income tax credit for each eligible employee hired. This credit will be available to those who hire an employee that has been unemployed and remains employed for at least 24 consecutive months at a rate above the average weekly rate of unemployment benefits as determined by the Department of Labor.
- A "New Business Tax Holiday." This component would create a 1 year "holiday" or moratorium on filing fees for new LLC's, Limited Partnerships, and For Profit Companies.
- The elimination of the Sales Tax Deposit. This is a deposit charged to all Georgia businesses which have $5,000 or more in sales tax collections each month. This component will restore more than $180 million of working capital to Georgia businesses.
- The elimination of the State Inventory Tax on all Georgia businesses through a statewide referendum. Lifting this tax will lead to a great incentive for businesses to purchase products, stock inventory, and locate distribution centers throughout Georgia.
- A phase-out of the Corporate Income Tax. This would take a responsible, long term approach to the phase-out of the tax over a 12 year period at reduction of .5 percent each year.

Many of these ideas are based on ALEC Model Legislation. We are very optimistic about Georgia's future and confident that economic recovery will occur, but we have three options before us: we can wait with fear, prolong it with regulation, or speed it up through economic creativity. These measures, coupled with the entrepreneurial spirit and industrial grit of everyday Georgians, make our decision clear.

Georgia is going to speed up recovery by being proactive, thus making our state the epicenter of economic recovery for the nation and a beacon of hope for all.

State Representative Tom Graves is a Republican from Ranger, Georgia and is the primary author of HB 481 and HB 482. As a legislator and small business owner, Rep. Graves has been at the forefront of efforts to stem the tide of expansive government and reduce the tax burden on Georgians. Rep. Graves is serving in his 7th year and is married with 3 children.

Stimulus Bill Wrong for Economy

By Governor Mark Sanford

The so-called stimulus package is now a reality, as is the trillion or so dollar tab it carries with it. To some this means the debate on the merits of this particular package is over and that those of us who opposed the bill lost and should just move on. I respectfully disagree.

Over the last year or so we have seen ad-hoc bailout after ad-hoc bailout, stimulus after stimulus, and there is no reason to suspect that this trend will not continue. The American people need to fully understand the consequences of what the federal government has done and is likely to do.

First, while throwing enough money at any problem will ultimately have some effect, in the end it may not be the effect we were looking for. Yes, the trillion dollars of taxpayer money the feds are currently injecting into our economy may very well create jobs in the short-term, but a cost-benefit analysis of the stimulus package that only looks at the next two years is dangerously short-sighted.

The real question should be how do we balance the short-term with the long-term? The longer the perspective with which one makes a decision, the better that decision will end up being. Decisions based on what's good in the next ten minutes are generally inferior to those made in the context of what will this mean over the next ten years.

Passing the stimulus package was, in my belief, a decision based on those next ten minutes. To wit: according to the Congressional Budget Office (CBO), Congress' non-partisan analytical agency, the stimulus package will inevitably lead to a lower rate of growth than would have otherwise been the case.

Second, it is not just predictions about how the economy will react going forward that tell us this stimulus package was a bad idea—history shows us the same.

Simply throwing government money at a struggling economy in the past has not translated into economic growth. It certainly didn't in Japan during the 1990s when the Japanese government initiated no fewer than ten stimulus packages over an eight-year period. Instead of fortifying the Japanese economy, the government's intervention led to what is often referred to as 'the lost decade,' a decade in which Japan's unemployment rate more than doubled.

Governor Sanford calls on General Assembly to pass a budget that checks government growth.

Supporters of the current plan like to point to the New Deal as a model, declaring that FDR's massive government expenditures dragged this country out of the Great Depression. But the historical record just doesn't back that up. In fact, Henry Morganthau, President Roosevelt's own Treasury Secretary, said the following: "We have tried spending money. We are spending more than we have ever spent before and it does not work….I say after eight years of this Administration we have just as much unemployment as when we started…And an enormous debt to boot!"

Third, there is an old idea that seems to have gone out of style in Washington, that being grandmother's notion of

leaving things better than you found them. I say that it has gone out of style because that trillion dollar price tag is most likely not going to be our responsibility. Instead, it will fall to our children and our children's children to deal with the economic ramifications of our generation accruing an unprecedented level of debt.

Those ramifications are terrific in scope. We are moving dangerously close to the tipping point of devaluing every American dollar and, as a consequence, rendering any short-term economic stimulation moot. Why is that so? Because if you print enough of anything, you devalue it, and the Federal Reserve has been increasing its liabilities at an alarming rate.

Already in January the core-producer-price index—one measure of inflation—rose four times faster than what economists had expected. If we continue down this road, we may find ourselves in the position Argentina found itself in the 1920s when they had a near-complete devaluation of their currency, or of Germany between World War I and World War II when its citizens had to in effect carry a wheelbarrow of currency to get so much as a loaf of bread.

Finally, the bailout approach undermines what has historically been the ultimate source of economic stimulus—the American worker and entrepreneur. For entrepreneurs to take risks in the marketplace, they need to know the rules, yet how can they when those rules are ever-changing? A business owner may wake up today and wonder, "Will I get a bailout from the government? Will my competitor? Will my supplier?" In this environment, those questions are perfectly applicable—and that makes it an environment not at all conducive to economic growth.

In the end, the rush to do something for the sake of doing something means this package is already law, a mistake with which we will have to live. But I believe it is a mistake we can't afford to compound by acquiescing to further bailouts and further spending bills cloaked as stimulus. I implore each of you to show leadership in not only raising the concerns a number of us share with the bailout approach, but in looking for ways within your specific state to push back against it.

Mark Sanford was elected as South Carolina's 115th governor in 2002 and re-elected in 2006, becoming only the third two-term governor in modern state history.

Taxpayer Funded Political Campaigns:
Government Takeover at the Taxpayer's Expense

By Kristi Meade

Quite often, the phrase "clean elections" is used by advocates of legislation in support of taxpayer financing for political campaigns. They tout a variety of claims to the public, arguing that by eliminating big money from politics, you will get rid of "special interest" influence, make campaigns more competitive, reduce campaign spending, allow more women and others from "non-traditional" backgrounds to get elected, and improve public opinion of state government.

However, so-called "clean elections" legislation is simply a clever name for a bad idea. Taxpayer funded elections bills transfer significant sums from the state's general funds to a "Public Election Fund" and add a complex bureaucratic administrative oversight structure. Most also contain a "matching funds" provision—meaning that if a candidate participating in the public financing program is opposed by a non-participating candidate, the state will give the participating candidate additional funds when or if the non-participating candidate receives contributions exceeding the taxpayer funded amount.

Last year in *Davis v. Federal Election Commission*, the Supreme Court ruled that a similar mechanism aiming to "equalize races" on the federal level was unconstitutional. In the first post-Davis case, a federal judge ruled that such so-called "rescue funds" in Arizona's law are unconstitutional and violate the First Amendment, though the judge has not issued a final judgment. In fact, the Supreme Court has always held that "the concept that government may restrict the speech of some elements of our society in order to enhance the relative voice of others is wholly foreign to the First Amendment."

Government funded political campaigns are so directly contrary to the Jeffersonian principles of individual liberty, limited government, and free markets that the American Legislative Exchange Council recently passed its *Resolution Opposing Taxpayer Funded Campaigns.*

Still, states and some lawmakers continue to champion taxpayer funding for campaigns on the mistaken notion that these programs actually save taxpayer money—because legislators will no longer feel obligated to earmark funds or approve contracts in order to reward campaign contributors. However, this argument has not been borne out by the research.

The Center for Competitive Politics recently analyzed spending patterns and tax burdens in Maine and Arizona for the periods before and after they adopted their taxpayer financing programs. The research showed that the total tax burden on residents in both states has actually increased since implementation of taxpayer funded political campaigns.

Expenditure growth also increased after the enactment of taxpayer funded political campaigns, and actually exceeded that of the rest of the nation. Between 2001 and 2006, Arizona's expenditures increased by 46.25 percent. In Maine, spending grew 34.75 percent over the same period. Nationally, the rate of growth in state spending was 30.81 percent.

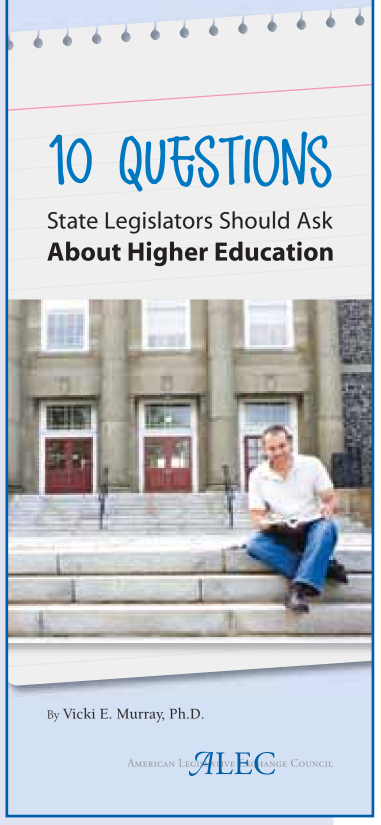
Some proponents of taxpayer financed campaigns have acknowledged that the claims made in an effort to sell these programs are often exaggerated. Bob Bauer, President Obama's campaign attorney and legal counsel for the Democratic National Committee, as well as the Democratic Senatorial and Congressional campaign committees, and himself a supporter of taxpayer funded political campaigns, noted recently that the benefits of such programs are modest at best. He also contended that advocates of so-called "clean elections" unrealistically claim that they can "deliver transformative changes in government" in order to sell a program that is often rightfully met with legislative and public resistance.

The solutions to curbing corruption cannot be legislated, and the best ones are simply common sense: enforcing bribery laws, providing transparency and merit-bidding in government contracting, making it easier, not harder, to unseat corrupt incumbents, and encouraging a vigilant press and an engaged citizenry that does not tolerate corruption.

Kristi Meade is the Director of Government and Coalition Relations at the Center for Competitive Politics.

ELECTIONS & ETHICS UPDATE:
As a reminder, the Criminal Justice & Homeland Security Task Force has been changed to the Public Safety & Elections Task Force. The Elections & Ethics subcommittee within this task force passed its first resolution at the States & Nation Summit in December 2008 and remains active on this and other important related issues. The subcommittee and task force will be working on these issues at the upcoming Spring Task Force Summit in Memphis, TN. For more information, contact Jonathan Moody, Policy Coordinator and Elections & Ethics Subcommittee Manager, 202-742-8516 or jmoody@alec.org.

10 Questions State Legislators Should Ask About Higher Education



State legislators now have access to a new resource for information on higher education in their states. ALEC's new report *10 Questions State Legislators Should Ask About Higher Education* addresses the ten most common and most important issues that legislators must deal with in this area. This especially affects state legislators serving on higher education committees, which must now operate with the pressure of shrinking budgets and growing demand for immediate solutions.

This report also includes a comprehensive listing of both private and public resources for additional higher education information.
To read the full report please log onto ALEC's website at www.alec.org.

Taxing the Limits:
States Increasingly Seek Taxes from Out-of-State Businesses

By Seth Cooper

There is a growing trend among states to impose tax obligations on out-of-state businesses. Traditionally, states have taxed businesses that have a physical presence or employees within their respective jurisdictions. However, cash-strapped states have sought to expand their taxing powers to businesses with no presence or employees within their respective territories.

The Federal Constitution Limits Extraterritorial State Taxation

Existing Supreme Court precedent under the Commerce Clause provides that extraterritorial state taxation will be sustained only if the tax is: (1) applied to an activity with a substantial nexus with the taxing state; (2) fairly apportioned; (3) not discriminatory against interstate commerce; and (4) fairly related to services provided by the State. This four-part test prohibits taxes that pass an unfair share of the burden on interstate commerce.

In the context of sales and use taxes, the Supreme Court has also set a bright-line rule that forbids state taxation of businesses whose only connection to customers in the taxing state is through common carrier or the U.S. mail. This safe harbor has also been held to prohibit taxation of out-of-state businesses who only license software to customers in the taxing state. The rule establishes a clear boundary to reduce litigation and foster investment by businesses and individuals.

States Expanding the Scope of Their Taxing Powers

States view extraterritorial taxation as a way to increase revenues without having to tax their own citizens. Since the Supreme Court and Congress have been silent on the issue of state taxation of interstate commerce in recent years, a number of states have seized the initiative and are chipping away at nexus limits.

New York's "Amazon Tax" Targets Online Ad Referrals
Last spring, New York State asserted taxing authority over online retailers who pay for online ad referrals from New York-based websites. The tax department indicated that out-of-state retailers who refuse to register could face auditing and years of back taxes for any sales made through online ads from websites based in that state. Both Amazon.com and Overstock.com challenged the law in state court, arguing that the law places unconstitutional burdens on interstate commerce. However, in January, a state trial judge upheld the controversial tax, which is now being appealed. Other states, such as California, Connecticut, Minnesota, North Carolina, and Tennessee and have had similar bills introduced in their respective legislatures.

Massachusetts' Extraterritorial Tax Assessments
In January, the Supreme Judicial Court also upheld the Massachusetts' tax department's imposition of tax assessments on Capital One because of the thousands of credit card transactions it made with businesses and residents in the state. This came despite the lack of a physical presence or employees in Massachusetts. This ruling was similar to a 2005 decision by the West Virginia Supreme Court which upheld the state's income tax on earnings of an out-of-state credit card company that had no property or employees in the jurisdiction.

Moreover, the Supreme Judicial Court of Massachusetts will soon rule on whether the Massachusetts tax department can impose use tax collection duties on a Connecticut-based business that sells tires to

Massachusetts residents from stores located in New Hampshire. The business has no physical presence or employees in Massachusetts, but many residents of that state purchase tires from the New Hampshire stores. For its part, the New Hampshire legislature is contemplating legislation that will block the imposition of foreign-state use tax collection duties on in-state businesses.

Maryland Tax Collection Duties Plan
The Maryland Comptroller of the Treasury sought to impose tax collection duties on AT&T Communications of Maryland because it provided 900 telecommunications services to an out-of-state information provider. Three different courts upheld the tax collection obligations, holding that the long-distance provider was either a vendor or an agent of the vendor of the out-of-state business that purchased 900 telecom services. A 900 area code reflects that information or services (sports scores, weather, computer tech support, "date lines," psychics, etc.) are transferred over the carrier's lines. When the end-consumer dials a 900 number, the consumer is charged a fee that is typically included on the monthly phone bill. However, last spring, the Maryland Court of Appeals unanimously struck down the imposing of tax collecting obligations. The Court concluded that there was no nexus to legitimize tax collection burdens because the long-distance company only acted as a common carrier.

New Mexico Taxes Mail-Order Computer Sales
New Mexico's tax department subjected a subsidiary of Dell, Inc. to a gross receipts (sales) tax on mail-order sales of computers that are shipped into New Mexico for use. The Department also imposed a consumption tax on the value of catalogs it distributes in New Mexico. Although Dell has no stores or employees in the state, the New Mexico Court of Appeals recently ruled that Dell's contracting with an in-state company for optional computer service repairs for customers created a substantial nexus that justified the taxation. This result mirrored a 2003 ruling by the Superior Court of Connecticut that upheld similar taxes on Dell mail-orders.

ALEC Policies Support Nexus Rules for State Taxation

ALEC model legislation calls for states to exercise their respective taxing authority consistent with nexus requirements. ALEC's *Business Activities Tax Simplification Act* recognizes that direct state and local taxes on business can impose significant burdens on businesses engaged in interstate commerce. The *Act* provides that state and local taxes on business such as income, franchise, net worth, business license, business and occupation, single business, capital stock, and like taxes shall only be imposed on businesses with a physical presence in the state.

In the sales and use tax context, ALEC policies also affirm nexus limits. ALEC's *21st Century Commercial Nexus Act* provides that businesses shall not be liable to collect and remit sales and use taxes to the taxing state unless those respective businesses have nexus in that state. The *Act* exempts from nexus calculations certain categories of economic activities directed by businesses to the taxing state, such as licensing software, attending trade shows, or securing advertising. On the flip side is ALEC's *Sales Use Collection & Protection Act*. This model bill provides in-state businesses a special declaratory judgment action to determine whether they have the required nexus with foreign-states that are demanding tax collection and remittance.

Seth Cooper is the Director of ALEC's Telecommunications and Information Technology Task Force.

Washington Supreme Court Upholds Separation of Powers, Preserves Supermajority Rule for Tax Increases

In March, the Washington Supreme Court issued a unanimous 9-0 ruling in *Brown v. Owen* that rejected a legal challenge to that state senate's supermajority rule for tax increases. ALEC filed a "friend of the court" brief in defense of a Washington State Senate parliamentary rule requiring a supermajority vote for all tax increases. The brief stressed that separation of powers principles prohibit a court from interfering with the legislative branch's ability to interpret and apply its own rules in discretionary matters. ALEC's brief observed that the Washington Senate could have overturned its own supermajority rule with a simple majority vote, but that it declined to do so. The Washington Supreme Court's ruling makes it clear that the exercise of legislative power requires that each house should be able to govern its own proceedings. ALEC's position was based on official policy contained in our *Super-Majority Act*.

It's All About Jobs:
Congress and the Estate Tax

By Dr. Douglas Holtz-Eakin

Policy makers have largely viewed the estate tax through the lens of social policy and issues of fairness. However, it has very real, very strong negative effects on capital accumulation, bequests, family businesses and entrepreneurs, labor supply, and overall economic efficiency.

Currently the estate tax faces an uncertain future, and in the absence of Congressional legislation, it will be repealed in 2010, only to reappear in 2011. Since neither full repeal, nor statutory rates reaching 55 percent appear to be politically palatable, Congress will act. My recent paper, *Changing Views of the Estate Tax: Implications for Legislative Options* (co-authored with Cameron Smith), examines the possible policy actions that Congress might take on the estate tax and estimates their likely impact on the overall U.S. economy, small and family businesses, and entrepreneurial decisions.

> ***"Eliminating the estate tax would raise the probability of hiring by 8.6 percent, increase payrolls by 2.6 percent and expand investment by 3 percent."***

In 2004, individuals reported a total of $10.2 trillion in wealth on estate tax returns. Our study estimates that eliminating the estate tax would raise the wealth reported on estates by over $1.6 trillion. In contrast, allowing the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) to sunset would raise the estate tax and lower estate wealth accumulation by nearly $540 billion.

To estimate the impact of estate taxation on the cost of capital, we reason that taxing capital via the marginal statutory estate tax is comparable to confiscatory annual taxes on the rate of return to capital. For example, expecting to pay a marginal estate tax rate of 45 percent (current 2009 law) is equivalent to an annual tax of over 150 percent over a 5-year horizon. Over longer periods, the equivalent tax declines–for example, over a 30-year horizon is 26.6 percent–but it remains quite substantial. Eliminating the estate tax, accordingly, has a fairly dramatic impact on the incentives to accumulate capital. Similarly, allowing current law to permit the top effective marginal estate tax rate (as would happen if EGTRRA sunsets) to reach 60 percent would be tantamount to an increase in the annual rate of marginal capital taxation of between 14 percent (over 30 years) to 74 percent (over 5 years). Tax incentives of this magnitude are important policy considerations.

Our study suggests that the federal estate tax has a substantial impact on family businesses. Eliminating the estate tax would raise the probability of hiring by 8.6 percent, increase payrolls by 2.6 percent, and expand investment by 3 percent. A symmetric result is expected for permitting the estate tax to rise with the sunset of EGTRRA–lower payrolls and capital outlays.

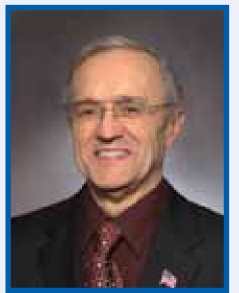
To get a sense of the magnitude of these estimates, recall that roughly 50 million workers are employed in small business. If small business payrolls were to rise by as much as 2.6 percent strictly through additional hiring, this translates to roughly 1.5 million additional small business jobs. Alternatively, a higher estate tax that lowers payrolls by 0.9 percent would translate into a reduction of over 500,000 jobs. Our study suggests that simply eliminating the estate tax could bring the President nearly half way to his goal of creating four million jobs.

Decisions by entrepreneurs and family businesses are strongly influenced by tax policy in general and by the rate of taxation on the return to capital in particular. Eliminating the estate tax would increase investment outlays, hiring propensities, and the size of family business payrolls. When deciding the fate of the estate tax this spring, policy makers will be wise to consider that killing it is a positive step towards instilling life back into the ailing U.S. economy.

Dr. Douglas Holtz-Eakin is a former Director of the Congressional Budget Office, a Fellow on the Council on Foreign Relations, and a Fellow at the Peterson Institute for International Economics. Copies of the full study can be obtained from the American Family Business Foundation at www.nodeathtax.org.

Performance-Based (Priority-Based) Budgeting: How to address budget shortfalls in the states

By Bob Williams



At least 42 states have major budget shortfalls. How can legislators advance Jeffersonian principles of free markets, limited government, federalism, and individual liberty when there is a budget crisis?

The temptation will be to try to take the usual approach—across the board cuts, raid accounts from non-general fund accounts, delay funding of some legislation, avoid full funding of pensions, and use the federal stimulus funds to postpone meaningful budget reforms. Those actions may give states a temporary "patch" in their budget shortfall, but when the federal funds run out in a year or two, the states that did not take action to permanently solve their budgetary shortfalls will face an even greater one.

When budgets are built in this traditional manner, without deliberate efforts to develop core governing principles first, legislators become "enablers" for agencies and programs that likely have fundamental design flaws or that may be providing services in direct conflict with lawmakers' policy views. Building budgets the conventional way virtually assures overspending since there is little, if any, focus on efficiency or effectiveness.

Debating, writing, and approving a state budget are the primary task legislators must accomplish because the budget drives all policy.

Governors and state agencies cannot spend even one dollar without legislative approval. Conventional thinking in most states has legislators adjusting the current budget for inflation, adding caseload increase, splicing in a few new

initiatives, and calling this the baseline budget. This type of approach is almost entirely focused on inputs (more money). Legislators then often find that the baseline budget is higher than the estimated revenue forecast. They then focus on cutting programs, raising taxes, or a combination of both until the total of the general fund matches the forecasted revenue. However, today most state economies are too weak to withstand a tax hike. An increase in tax rates at this time may very well produce less revenue (after the tax rates are raised) due to the negative economic impact.

The conventional budgeting approach ignores the efficiency and effectiveness of existing state programs. Rarely is the question asked about how existing programs can be improved or how can we maximize the return on the tax dollars that are collected.

Solution—a new budget system

The Evergreen Freedom Foundation (EFF) recommends that states take action this year to address the serious financial crises in the various states by changing their budgetary system from the normal input system to a budget system using performance-based budgeting focused on outcomes. This approach asks, "What quantifiable results are taxpayers getting for their investments?" In 2003, Washington State actually implemented performance-based budgeting to close a $2.8 billion deficit without raising taxes, dumping the expensive traditional cost-plus budgeting model.

Performance-based budgeting

Governors and legislators need to answer the following questions:

1. What is the forecasted revenue for the next budget cycle?
2. What are the essential services the state must deliver to citizens?
3. How will the state measure its progress in accomplishing those goals?
4. What is the most effective way to accomplish the state's goals with the money available?

Question #1. What is the forecasted revenue for the next budget cycle?

States should not spend more than the revenue forecast for the budget period. EFF suggests states set up a non-partisan revenue forecast council and then put 2 percent of the estimated forecast into a reserve fund.

Question #2. What are the essential services the state must deliver to citizens?

In other words, "What should state government do, and in what priority?" States should develop a meaningful set of core government principles (EFF suggests no more than ten). All existing programs should fit within one of the core functions or they should be abolished. For each core function measurable outcomes should be identified and agency activities prioritized.

Washington State's core functions currently are:

1. Improve student achievement in elementary, middle, and high schools.
2. Improve the value of post-secondary learning.
3. Improve the health of Washingtonians.
4. Improve the security of Washington's vulnerable children and adults.
5. Improve economic vitality of businesses and individuals.
6. Improve statewide mobility of people, goods, and services.
7. Improve the safety of people and property.
8. Improve the quality of Washington's natural resources.
9. Improve the cultural and recreational opportunities throughout the state.
10. Strengthen government's ability to achieve results efficiently and effectively.

More details on these core functions can be found at www.ofm.wa.gov/budget/pog/default.asp.

Once core functions are identified, legislators must prioritize activities within these functions to deliver the expected outcomes. Otherwise, state budgets resemble an iceberg, with decades worth of spending unseen and unexamined under the water, while the debate rages year after year over the small part that sticks out of the water. The longer state lawmakers continue to use the cost-plus model, the more "hardwired" their deficit problems will become.

As a result of following this performance-based budgeting, Washington state salvaged a budget that had a $2.8 billion shortfall—without making lazy and often irresponsible across-the-board cuts. The reductions in spending were not haphazard or routine. They came from prioritizing what the state determined were the most important things to buy to deliver the designated service. Agencies were directed by the Governor to provide more details

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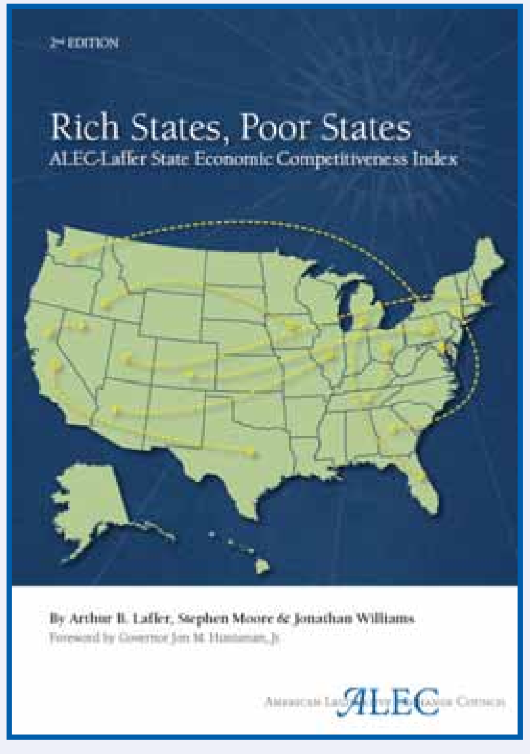
Rich States, Poor States:
The 2009 ALEC-Laffer Economic Competitiveness Index
How Does Your State Rank?

By Jonathan Williams

This second edition of *Rich States, Poor States* by the American Legislative Exchange Council is yet another invaluable resource ALEC has provided for state lawmakers and citizens to evaluate their state's fiscal and economic policies, as well as the results and ramifications of those policies. This year's book focuses on some of the most critical issues facing lawmakers today, with more than 40 states struggling with budget deficits. In the midst of economic turmoil and budget shortfalls in the states, this publication analyzes why millions of Americans are moving from high-tax states to low-tax states.



Arthur Laffer ("The Father of Supply-Side Economics") and Stephen Moore (senior economics writer at *The Wall Street Journal*) have teamed up with ALEC once again to provide you with this in-depth analysis of economic competitiveness in the states. As our elected officials think about the annual task of budget writing, we remind lawmakers that levying tax increases is not a sustainable answer for budget problems.

Especially during an economic downturn, states need to be doing everything they can to become more competitive, not less. Chapter one presents our most recent state economic competitiveness rankings with a number of brief commentaries. We compare the economic performances of the top 10 states—according to our 2009 Economic Outlook Rankings—with the bottom 10 states. The results are shocking. (see page 14)

This year's book on state competitiveness focuses on California. The Golden State is not only our nation's largest state in most every economic metric, it also has a highly volatile political climate. California can move from Karl Marx to Adam Smith and back again in what seems to be the blink of a political eye. California's experiences from its radical shifts in policy are the very essence of what we mean when we write "policy matters." Chapter two compares California's recent experiences with those of another populous state, Texas. The results may surprise you.

Chapter three compares California's present with the "Ghosts of California's Past." The history of California—centered on the tax revolt crystallized in Proposition 13—shows a laboratory experiment in which the state went from fiscal malaise to fiscal health and then back to malaise again. By showing the current class of legislators the ghosts of California's past, we hope they can begin picturing the ghosts of California's future—identified by much lower taxes and much higher economic growth.

The final section of this book is a state-by-state detailed description of the key economic variables. The 2009 *ALEC-Laffer State Economic Competitiveness Index* offers two rankings. The first, the Economic Performance Rank, is a historical measure based on a state's performance on three important variables: Personal Income Per Capita, Absolute Domestic Migration, and Non-farm Payroll Employment—all of which are highly influenced by state policy. This ranking

Continued on next page

Relationship Between Policies and Performance:

ALEC-Laffer State Economic Outlook Rank vs. 10-Year Economic Performance: 1997-2007

State	Rank	Gross State Product Growth	Personal Income Growth	Personal Income Per Capita Growth	Population Growth	Net Domestic in-Migration as % of Population	Non-Farm Payroll Employment Growth	2007 Unemployment Rate
Utah	1	86.7%	82.3%	45.6%	26.3%	0.3%	25.9%	2.7%
Colorado	2	77.8%	84.9%	52.1%	20.0%	4.6%	17.7%	3.8%
Arizona	3	93.9%	101.4%	47.9%	33.1%	12.2%	34.4%	3.8%
Virginia	4	80.7%	78.4%	56.4%	12.6%	2.2%	16.4%	3.0%
South Dakota	5	71.3%	73.8%	63.9%	7.8%	0.2%	15.2%	3.0%
Wyoming	6	111.4%	114.6%	103.4%	8.5%	2.1%	28.3%	3.0%
Nevada	7	112.3%	114.6%	48.4%	40.3%	17.2%	45.0%	4.8%
Georgia	8	67.0%	74.4%	38.5%	23.2%	6.7%	14.7%	4.4%
Tennessee	9	59.0%	64.8%	46.5%	11.6%	4.4%	8.3%	4.7%
Texas	10	90.5%	89.8%	55.8%	20.7%	3.4%	20.3%	4.3%
10 Highest Ranked States*	-	**85.1%**	**87.9%**	**55.9%**	**20.4%**	**5.3%**	**22.6%**	**3.8%**
Florida	11	87.6%	87.9%	55.0%	18.3%	7.8%	25.5%	4.0%
Arkansas	12	61.1%	67.5%	55.8%	8.7%	2.6%	9.0%	5.4%
North Dakota	13	69.9%	71.1%	75.3%	-0.9%	-5.4%	13.9%	3.2%
Idaho	14	79.4%	87.4%	53.5%	21.7%	8.5%	29.7%	2.7%
Oklahoma	15	78.6%	81.1%	69.3%	7.0%	0.4%	11.9%	4.3%
Alabama	16	61.9%	64.0%	54.6%	5.8%	1.6%	7.5%	3.5%
Indiana	17	46.6%	51.6%	40.9%	6.3%	-0.4%	4.6%	4.5%
Louisiana	18	90.8%	68.0%	74.4%	-0.7%	-7.4%	3.9%	3.8%
Mississippi	19	52.8%	61.6%	52.8%	4.8%	-0.9%	4.0%	6.3%
South Carolina	20	56.9%	68.9%	47.3%	14.3%	6.9%	13.5%	5.9%
North Carolina	21	74.5%	69.3%	41.8%	18.1%	7.0%	13.7%	4.7%
Washington	22	74.5%	76.9%	55.8%	13.5%	3.5%	16.6%	4.5%
Missouri	23	45.0%	53.7%	43.1%	7.1%	0.8%	6.0%	5.0%
Kansas	24	62.8%	59.9%	51.5%	5.3%	-2.7%	8.6%	4.1%
New Mexico	25	60.6%	72.4%	55.8%	10.6%	0.6%	19.0%	3.5%
Massachusetts	26	58.5%	66.9%	61.4%	3.6%	-5.6%	5.3%	4.5%
Wisconsin	27	53.3%	57.3%	46.5%	6.2%	0.1%	8.5%	4.9%
Maryland	28	74.3%	77.3%	61.1%	8.2%	-1.5%	15.0%	3.6%
Nebraska	29	58.5%	58.3%	51.6%	5.2%	-2.6%	12.4%	3.0%
Montana	30	78.9%	79.5%	66.1%	8.4%	3.9%	21.2%	3.1%
Delaware	31	69.4%	74.1%	48.8%	14.4%	5.7%	12.7%	3.4%
Connecticut	32	57.1%	67.3%	58.2%	4.0%	-3.0%	5.6%	4.6%
West Virginia	33	48.8%	51.6%	52.4%	-0.1%	0.5%	7.0%	4.6%
Michigan	34	27.7%	39.0%	33.8%	1.6%	-4.8%	-4.0%	7.2%
Iowa	35	57.5%	52.2%	47.5%	3.4%	-1.7%	7.8%	3.8%
Kentucky	36	45.8%	58.4%	46.8%	7.1%	2.0%	9.2%	5.5%
New Hampshire	37	56.8%	68.2%	50.1%	9.1%	4.0%	13.8%	3.6%
Alaska	38	77.9%	66.4%	49.5%	10.7%	-2.3%	18.1%	6.2%
Oregon	39	63.8%	62.3%	42.9%	13.1%	4.8%	12.7%	5.2%
Minnesota	40	63.5%	65.9%	50.7%	8.5%	-0.3%	10.9%	4.6%
Hawaii	41	63.9%	61.7%	54.4%	6.0%	-4.0%	17.3%	2.6%
Pennsylvania	42	54.7%	54.6%	50.9%	1.7%	-0.9%	7.2%	4.4%
California	43	77.9%	76.6%	56.0%	11.4%	-4.0%	15.5%	5.4%
Illinois	44	50.9%	55.6%	47.1%	5.1%	-5.4%	3.6%	5.0%
Ohio	45	40.4%	42.3%	38.4%	1.5%	-3.5%	0.6%	5.6%
New Jersey	46	54.7%	62.4%	52.5%	4.8%	-5.3%	9.4%	4.2%
Maine	47	55.8%	60.7%	52.1%	4.6%	3.1%	11.5%	4.7%
Rhode Island	48	64.5%	61.7%	55.4%	1.9%	-3.7%	9.6%	5.0%
Vermont	49	61.8%	69.3%	61.2%	3.5%	0.1%	10.2%	3.9%
New York	50	68.5%	61.7%	55.3%	3.9%	-9.5%	8.3%	4.5%
10 Lowest Ranked States*	-	**59.3%**	**60.7%**	**52.3%**	**4.4%**	**-3.3%**	**9.3%**	**4.5%**
U.S. Average*	-	**66.8%**	**69.5%**	**53.6%**	**9.9%**	**0.9%**	**13.3%**	**4.3%**

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Demography Defeated:
The Radical Success of Florida's K-12 Reforms

By Matthew Ladner and Dan Lips

Some experts say states with growing Hispanic populations are doomed to fail, weighed down with ineffective school systems and abysmal test scores. One demographer at an academic conference went so far as to predict that the Southwest will become the "Appalachia of the 21st Century."

His logic was simple: Hispanic populations are growing rapidly; Hispanic students under-perform academically, drop out of school in high numbers, and attend colleges and universities in low numbers. Hispanic students finish college in still smaller numbers.

Does demography dictate destiny in K-12 education? Should states with large or growing Hispanic populations accept that they will never succeed and ask for exceptions to federal accountability standards? To the contrary, statistics show that with systemic education reform, states can raise the academic performance of Hispanic children. That's what Florida did in 1999, and it worked.

Improving Academic Achievement in Florida

Florida began the 1990s with low fourth-grade reading scores on the National Assessment of Educational Progress (NAEP), and they declined between 1992 and 1998. However, between 1998 and 2007 the percentage of Florida students scoring "basic" or above increased by more than three times compared with those in Arizona, a state with similar student demographics and per-student funding.

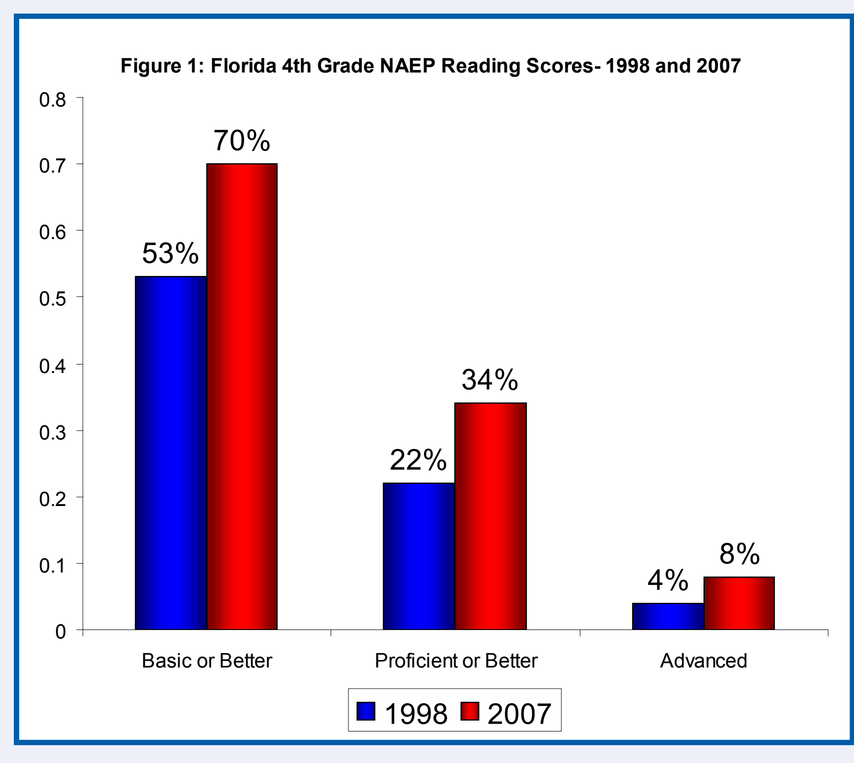

Figure 1 shows the improvement in Florida's fourth-grade NAEP reading scores from 1998 to 2007 in three different categories: those scoring "basic" or above, those scoring "proficient" or better, and those scoring "advanced." Nine years later, 32 percent more students scored "basic" or better, while 54 percent more students scored at the "proficient" level or better. The percentage of Florida students scoring "advanced" doubled, from 4 to 8 percent.

Improvement in test scores among minority students has likewise been extremely impressive. In 2007, the average NAEP reading score—a test conducted in English—for Hispanic fourth-graders in Florida was higher than the overall average NAEP reading scores of *all students* in Alabama, Alaska, Arizona, Arkansas,

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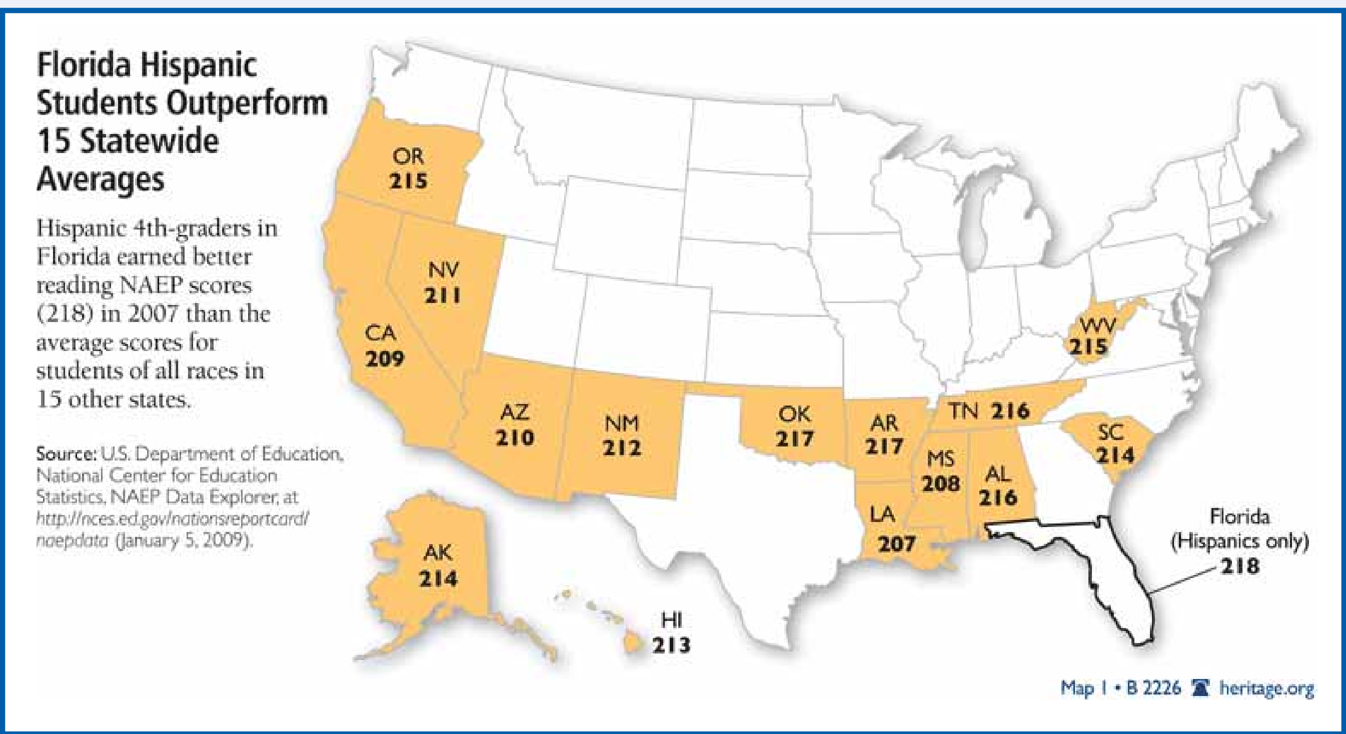

California, Hawaii, Louisiana, Mississippi, Nevada, New Mexico, Oklahoma, Oregon, South Carolina, Tennessee, and West Virginia.

Education Reform in Florida—How the State Improved Achievement

It is reasonable to conclude that Florida's education reforms are in part responsible for higher student achievement. Given the impressive progress in students' academic achievement, policymakers in other states should study those reforms.

In his first state-of-the-state speech in 1999, Gov. Jeb Bush outlined broad categories for reform. First, Florida would implement annual testing in grades 3 through 10 and rank schools based on achievement. Second, they would end social promotion—the practice of promoting students to higher grades even if they had not completed the academic requirements of the previous grade. Third, some funding would be tied to performance—rewarding successful schools with additional funding and autonomy. Fourth, the state would provide additional funding for struggling schools while allowing parents the option of transferring their child to a better school.

Academic Testing and Accountability

In 1999, Florida enacted the "A+ Accountability Plan," which became the foundation of school reform efforts in the state. The A+ Plan required that students in grades 3 through 10 be tested annually in reading and math on the state FCAT assessment system.

The state also created a new accountability system for schools based on the FCAT assessment. Schools that earned high marks received funding bonuses and greater autonomy. The state required schools receiving an "F" grade twice over a four-year period to implement state-sanctioned reforms.

Students were also held accountable for their performance. The A+ Plan ended social promotion. Students were required to meet a level of academic achievement before proceeding to the next grade.

Curriculum and Academic Standards

A major focus in Florida's curriculum reforms over the past decade has been to improve reading instruction. In 2002, the state implemented the initiative "Just Read, Florida!" to help reach that goal. Among other programs, the initiative created new academies to train teachers in reading instruction and provided for the hiring of 2,000 reading coaches in public schools across the states.

American Legislative Exchange Council

ALEC

2009 Spring Task Force Summit

Memphis, TN
May 1-2

There is still time to register!

It's not too late to register for ALEC's 2009 Spring Task Force Summit, to be held May 1-2 at the Memphis Cook Convention Center and the adjoining hotel, Memphis Marriott Downtown.

Register today to join the expected 400 state legislators, business leaders, and policy experts who will work on cutting-edge Model Legislation for the states. ALEC Task Force members have already developed over 1,000 pieces of Model Legislation to date, addressing everything from taxes and health care reform to education and public safety. ALEC's policy solutions focus on proven and innovative ideas for state legislators. Don't be left out of the debate!

State legislators will also share their knowledge and experiences with one another and hear from national leaders and renowned policy experts. Speakers include: U.S. Rep. Marsha Blackburn (R-TN); Governor Haley Barbour (MS); Kimball Rasmussen, CEO of Deseret Power; and Phelim McAleer and Ann McElhinney, producers of the film "Not Evil, Just Wrong."

Visit us online at www.alec.org for a complete conference agenda, registration and travel information, and a list of area attractions.

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Improving Teacher Quality
Teacher quality is a leading factor affecting how students perform in the classroom. All public school systems face the challenge of attracting and retaining high-quality teachers. Florida's challenge was exacerbated by a 2002 ballot initiative that created a state constitutional amendment establishing maximum class sizes in the state's public schools.

Traditionally, most public school systems have tried to ensure teacher quality by establishing certification requirements and licensing regimes. But this strategy has had questionable results. Studies have found little relationship between certification and student test score gains and suggest that selectively retaining teachers demonstrating gains in early years of teaching would be a far more effective method for increasing teacher quality than mere certification.

Over the past decade, Florida enacted new policies for attracting and rewarding high-quality teachers. First, Florida established policies to allow for alternative paths to teacher certification. The purpose of these policies was to attract high-quality teachers to the classroom who otherwise would not consider teaching as a profession given the barrier created by the traditional teacher certification requirements.

For example, qualified professionals who wish to become teachers in Florida can attend "Educator Preparation Institutes," which facilitate these career transitions. Districts are also required to offer their own forms of alternative certification. Today, about half of all new teachers in Florida are coming through alternative certification programs.

Florida also offers performance pay for teachers. Traditionally, most public school systems have compensated public school teachers based on the tenure of their service. Florida, however, implemented reforms to provide bonuses to highly effective teachers.

In 2007, Florida's performance pay system offered a total of $147 million annually in state aid to school districts to pay performance bonuses to teachers. Bonuses can reach up to 10 percent of a teacher's pay. Through this program, schools are awarded funds to provide bonuses to personnel who contribute to measurable improvement in students' academic achievement.

Parental Choice Options
The A+ Accountability Plan also established new school choice options for families. Students attending any school receiving two "F" grades in any four-year period became eligible for a voucher they could use to attend another public or private school. This policy helped hundreds of children attend a school of their parents' choice.

In addition to the A+ Plan, Florida policymakers offered families a range of public and private school choice options, including:

- *The McKay Scholarship Program for Students with Disabilities*. Since 2000-2001, Florida has offered private school tuition scholarships to children with disabilities through the McKay Scholarship Program.
- *Step Up for Students Corporate Tax Credits for Private School Scholarships*. Since 2001, Florida has also offered corporations a dollar-for-dollar tax credit for contributions to fund private school scholarships for disadvantaged children.
- *Charter Schools*. Florida has one of the strongest charter school laws in the country.
- *Virtual Education*. Florida offers students the ability to learn online through virtual education.

Florida's Increased Minority College Preparation
Florida's education reforms did not stop at improving childhood literacy. They have also prepared more minority children for college. Former Gov. Jeb Bush pushed the "One Florida Initiative," which replaced race-based affirmative action at colleges and universities with more effective classroom instruction at the high school level. The theory was better preparation for college admission rather than lower standards.

Working in partnership with the College Board, the One Florida plan sought to increase the academic achievement of Florida's students, particularly of demographic groups that are under-represented in universities. The comprehensive plan included professional development for teachers and counselors and free PSAT exams for students. Florida officials created AP Potential, a Web-based tool to identify promising students for advanced-placement coursework.

Continued on next page

The program relied heavily on incentives, creating an AP Teacher Bonus of $50 for every student who passed the test, up to $2,000. The program also created an incentive for the school, an additional $650 per student who passed an AP exam. Florida officials carefully wrote this bonus into the funding formula so that it went to the school, not to the school district.

Furthermore, using Florida's A+ designations, which assign letter grades to schools based upon overall student performance, One Florida provides an additional school bonus of $500 per student passing an AP exam for schools rated "D" or "F."

The results have been extremely impressive: The number of Hispanic and African American students passing AP exams has more than tripled since 1998. Florida now has a ratio of Hispanic students passing AP exams almost eight times higher than Arizona.

Florida's Reforms Are a Beginning, Not an End

The comprehensive education reforms Florida policymakers have implemented over the past decade appear to be having a positive impact. Specifically, initial evidence suggests that ending social promotion, increasing school accountability, and expanding parental choice in education are contributing to improved academic achievement and public school performance. Florida students are improving academically at a higher rate than are students across the country with comparatively less funding. Importantly, children from minority populations are making the greatest improvements—proof that Florida is making progress in reducing the achievement gap.

In Florida, schools and teachers make more money the old-fashioned way: They earn it. The days of "provide money first, hope for results later" must end, in Washington and our state capitals.

Florida's success should inspire replication in other states, but its reforms should be viewed as a starting point, not a finish line. States should follow Florida's lead in combining incentive- and instruction-based reforms. In fact, they should take them even further. America's disadvantaged children await these tragically overdue reforms.

Matthew Ladner is vice president of research for the Goldwater Institute and a member of the ALEC Education Task Force. Dan Lips is a senior fellow at the Goldwater Institute.

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***Rich States, Poor States* from page 14**

details states' individual performances over the past 10 years based on this economic data.

The second measure, the Economic Outlook Rank, is a forecast based on a state's current standing in 15 state-policy variables. Each of these factors is influenced directly by state lawmakers through the legislative process. Generally speaking, states that spend less—especially on income-transfer programs—and states that tax less—particularly on productive activities such as working or investing—experience higher growth rates than states which tax and spend more.

Top performing states in the *ALEC-Laffer State Economic Competitiveness Index* are highly correlated to economic growth, while many of the losers suffer economic malaise. The top performing states keep taxes, spending, and regulatory burdens low. The biggest losers in the Index tend to share similar policies of high tax rates, unsustainable spending, and regulation.

Continued on next page

What others are saying about *Rich States, Poor States*

"*Rich States, Poor States* adds to the mountain of evidence demonstrating that high taxes, big government, and poor labor policy are toxic to economic growth in the states. The authors and ALEC have created a wonderful resource for anyone looking to make their state more competitive, and I wholeheartedly encourage you to take their message to heart. This book is a must read for state lawmakers who are serious about free market tax and budget reform."

Larry Kudlow, CNBC's *The Kudlow Report*

"The second edition of *Rich States, Poor States* is a valuable resource to those charged with understanding fiscal policy and enacting change. In times of change, it is essential to understand the perspectives from which other states are making decisions, especially as policy-makers determine the best path forward for their respective states."

Utah Governor Jon M. Huntsman, Jr.

"During today's difficult economic times, many lawmakers are facing pressure to increase taxes. However, *Rich States, Poor States* gives my fellow lawmakers clear evidence that taxes are not the answer to budget shortfalls. In fact, taxes, along with profligate spending policies, caused many of today's problems. *Rich States, Poor States* is another great example of how ALEC is taking the lead to protect taxpayers by promoting sound policy to state legislators."

William J. Howell, Speaker of the Virginia House of Delegates
ALEC's 2009 National Chairman

"Taxes destroy income, wealth, jobs and innovation. Laffer, Moore and Williams demonstrate this in a multiplicity of ways. The ALEC *Rich States, Poor States* project is a welcome tonic to all the erroneous talk promoting government spending and taxation as a way to prosperity."

Dr. Richard Vedder, Professor of Economics, Ohio University

"*Rich States, Poor States* documents well and clearly the fact that citizens of market-friendly states enjoy more prosperity than do citizens of states less friendly to markets. In particular, the evidence on the destructiveness of high taxes has never been more vital."

Dr. Donald J. Boudreaux, Professor of Economics
George Mason University

The 15 policy factors included in the 2009 ALEC-Laffer State Economic Outlook Index:

- Highest Marginal Personal Income Tax Rate
- Highest Marginal Corporate Income Tax Rate
- Personal Income Tax Progressivity
- Property Tax Burden
- Sales Tax Burden
- Tax Burden From All Remaining Taxes
- Estate Tax/Inheritance Tax (Yes or No)
- Recently Legislated Tax Policy Changes
- Debt Service as a Share of Tax Revenue
- Public Employees Per 1,000 Residents
- Quality of State Legal System
- State Minimum Wage
- Workers' Compensation Costs
- Right-to-Work State (Yes or No)
- Tax or Expenditure Limits

While the states are certainly suffering from the current economic downturn, this new publication clearly demonstrates that we cannot tax or spend our way into prosperity. *Rich States, Poor States* exposes the economic burden that high taxes and other big government policies place on our states. Already being touted in the mainstream media, including *The Wall Street Journal*, CNBC's The Kudlow Report and Your World with Neil Cavuto, *Rich States, Poor States* is making a real impact on the national debate.

It is our hope that you will take advantage of this treasure trove of information to demonstrate the benefits of pro-growth tax and economic policies in your state. This book is not about Republican versus Democrat, or left versus right. It simply highlights how state policy choices can mean the difference between economic vitality and economic malaise.

Jonathan Williams is the Director of ALEC's Tax and Fiscal Policy Task Force and a co-author of the book, Rich States, Poor States.

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"Performance-Based Budgeting" from page 12

on the specific services they delivered, who benefited, how much the services cost, and what results the agencies expected to achieve. Agencies were required to prioritize all their activities as high, medium, or low priority, with at least one third of the agency's expenditures in the low priority category. By focusing on specific activities—not programs or agencies—the Governor's budget staff created prioritized lists across the entire government for each of the core functions and proposed to fund those activities that contributed the most to each core function.

The results borne from this process surprised nearly everyone, especially those who initially believed it was just another public relations program. Its success scared agency directors, unions, many lobbyists, and lots of lazy legislators who suddenly realized they had to pay attention and say "no" to special interests that couldn't prove high value for a dollar spent.

Taxpayers understand this is the best way of doing business, but it must be explained in simple, compelling terms. This type of system protects the programs deemed most important from budget cuts. It holds agency directors responsible for spending taxpayers' dollars in the best way possible to deliver the best services possible. It protects vulnerable programs from election-year rhetoric—and the list goes on. The bad guys are those people who want more taxpayer dollars when they don't deliver the goods. It's just that simple and we should say so, over and over again!

Our Stewardship Program (www.effwa.org/projects/stewardship_series.php) is structured to help lawmakers seize on this budget opportunity by developing state budgets around core governing principles. We believe this is the best way to make fundamental budget, tax, and governing reforms.

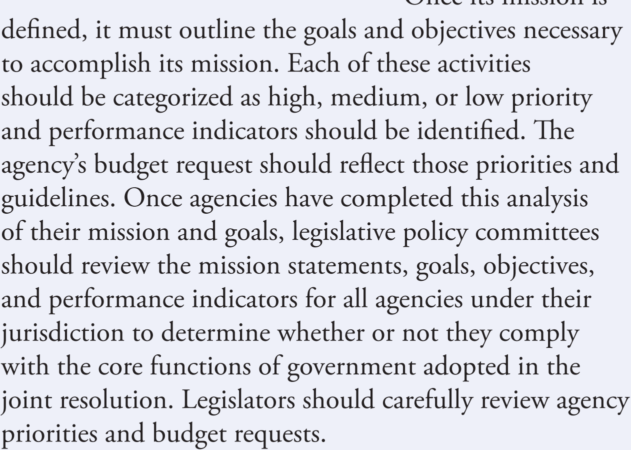
Question #3. How will the state measure its progress in accomplishing those goals?

After identifying the state's core functions, the next step is for legislators to ensure measureable outcomes are developed for each of the identified core functions. Agency programs should then be prioritized based on how effectively and efficiently each will help meet the goals. I can't stress enough the importance of a careful review of both the core functions of government and the indicators of success. The indicators **must** be measurable.

Question #4. What is the most effective way to accomplish the state's goals with the funds available?

The first three questions in performance-based budgeting are about developing meaningful measurable goals. This question is about using market forces and competition to deliver those goals effectively and efficiently without compromising cost and quality.

To make this process functional, each state agency should develop what it believes to be its mission as established by law. Once its mission is defined, it must outline the goals and objectives necessary to accomplish its mission. Each of these activities should be categorized as high, medium, or low priority and performance indicators should be identified. The agency's budget request should reflect those priorities and guidelines. Once agencies have completed this analysis of their mission and goals, legislative policy committees should review the mission statements, goals, objectives, and performance indicators for all agencies under their jurisdiction to determine whether or not they comply with the core functions of government adopted in the joint resolution. Legislators should carefully review agency priorities and budget requests.



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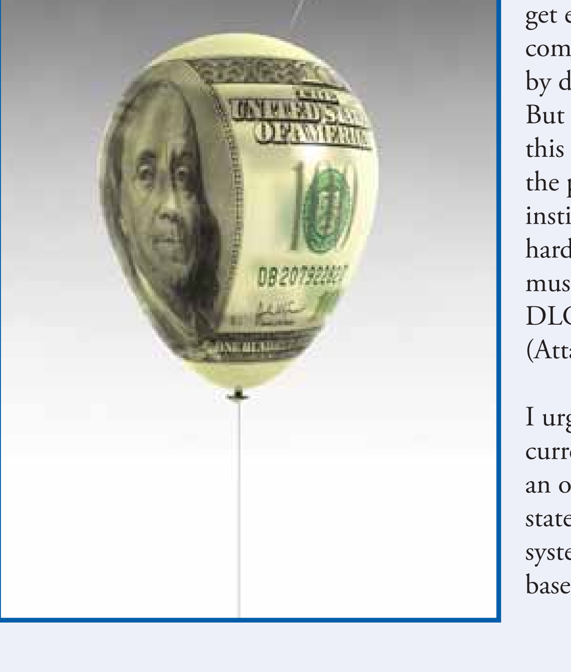
This is when legislators should debate the "make or buy" issue. As lawmakers review agency goals they should consider whether they must actually deliver the various services necessary to accomplish those goals, or whether government's duty is to simply ensure that the goals are accomplished.

By following this budget process, a government "buy list" is created, directing the discussion away from "cuts" to instead what outcomes are being purchased. Performance-based budgeting provides a logical process for measuring the activities of government against desired performance outcomes and prioritizing decisions accordingly. This budget process also greatly increases spending efficiency and economy.

Once the budget is developed, EFF recommends that legislators implement the ALEC model legislation calling for the budget to be posted online for 72 hours before legislators vote on it. After the budget is signed we urge legislators to insist the state have a state budget transparency website.



The move to performance-based budgeting is not a partisan issue. For example, for years the Democrat Leadership Council has been actively lobbying its members to embrace outcome-based budgeting.

"That citizens want value for their money is no mystery. We all want as much value as we can get from each dollar we spend—including what we spend on government. The price and value of government are up against the price and value of housing, food, clothing, health care, and countless other goods and services that meet people's needs. The price of government is limited, therefore, by the value that citizens want—and get—from government, compared with the value they want and get elsewhere. Government can compete—and stay relevant—only by delivering more value per dollar. But the only way to accomplish this is to reinvent the way we do the public's business. Our public institutions must learn to work harder, but more important, they must learn to work smarter." DLC May 7 Blue Print Magazine (Attachment 3)

I urge legislators to use this current budget shortfall crisis as an opportunity to reform their state budget process from an input system to an outcome performance-based budgeting system.

Bob Williams serves as Private Sector Chairman of ALEC's Tax and Fiscal Policy Task Force, and is the Founder of the Evergreen Freedom Foundation in Olympia, WA.

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Opportunities for Taxpayer Protection in 2009

By Dr. Michael J. New

Recent developments in Colorado and Maine are making 2009 a very interesting year for supporters of fiscal limits modeled after the Taxpayers' Bill of Rights (TABOR). As many readers know, TABOR is America's best known and most effective fiscal limit. Enacted by Colorado voters in 1992, TABOR established a tight limit for revenue growth and mandated that all surpluses be rebated to taxpayers. Between 1997 and 2002, Colorado taxpayers received $3.2 billion in tax refunds from the state government. Colorado easily led the nation in both tax relief and economic growth during this time.

However, ever since it was enacted, TABOR has been under constant assault from the legislature, the media, and unions. In every year from 1993 to 1999, a proposal on the Colorado ballot sought either to raise taxes or to increase spending in excess of the TABOR limit. In 2005, TABOR opponents finally succeeded in suspending TABOR's revenue limit until 2010. However, the attacks on TABOR have continued. In 2008, TABOR opponents placed Amendment 59 on the ballot. Amendment 59 would have effectively nullified TABOR's revenue limit by mandating that surplus revenues not be refunded to taxpayers, but be deposited in an account for schools. However, Amendment 59 was resoundingly defeated at the polls.

This year, the assault on TABOR has continued. Some Colorado state legislators have expressed an interest in trying to nullify another of TABOR's provisions. When TABOR was passed in 1992, its language effectively placed an earlier statutory spending limit into the state constitution. That limit, known as the Arveschoug-Bird limit, states that general fund appropriations can grow by only 6 percent each year. Money over that 6 percent limit can only be spent on transportation and capital construction. State Senator John Morse, (D-Colorado Springs) has sponsored legislation which would repeal this 6 percent limit. Morse has argued that the state needs more flexibility in its budget process.

It should also be noted that, regardless of what happens to Senator Morse's proposal, there remains a very strong possibility that there will be another ballot measure to weaken or nullify TABOR's revenue limit in either 2009 or 2010. In fiscal 2010, TABOR's revenue limit is scheduled to come back into effect. The subsequent tax rebates, triggered by the revenue limit, will once again increase TABOR's visibility and popularity. That explains why TABOR opponents have been so aggressive in recent years.

Meanwhile, good news comes in from Maine, where on February 23, the Maine Secretary of State announced that a TABOR-style spending limit received enough signatures to appear on the November ballot. The sponsors of the 2009 initiative include a Portland attorney, David Crocker, and Maine Leads, a fiscally conservative citizen action group. This is good news. Even though TABOR has captured the imagination of conservative and libertarian activists across the country, no state has really succeeded in enacting a TABOR-style fiscal limit since Colorado did so in 1992. However, Maine has probably come the closest.

Indeed, in 2006, a TABOR-style spending limit on the Maine ballot won over 46 percent of the vote in a blue state during a tough election for conservatives nationwide. Interestingly, this ballot measure performed much better than similar ballot measures in Nebraska and Oregon. The strong showing in Maine was due to a few factors. First, the campaign was spearheaded by a local activist, Mary Adams, who had been working on enacting TABOR for over two years. Furthermore, TABOR activists won endorsements from a number of candidates and editorial boards, including Maine's largest daily newspaper, *The Portland Press Herald*. This strong local support made many Maine voters more comfortable with the idea of a fiscal limit and less susceptible to the scare tactics used by

Continued on next page

TABOR opponents. Hopefully, the political climate this fall will be more amenable to fiscal conservatism and the sponsors of the current TABOR measure will learn from the previous campaign.

However, regardless of what happens in Maine this fall, history shows that fiscal conservatives would do well to be persistent. In Colorado, Douglas Bruce tried and failed to enact fiscal limits similar to TABOR through the initiative process in both 1988 and 1990. It was not until 1992 that TABOR received majority support. Perhaps an even better example comes from California. During the late 1960s and early 1970s, Howard Jarvis was able to win some victories for taxpayers in southern California. However, prior to the passage of Proposition 13, most of his statewide efforts were unsuccessful. In 1976, he even failed to collect enough signatures to get a proposal for property tax relief on the California ballot. It was not until he joined forces with Paul Gann of People's Advocate in 1978 that he received enough signatures to put Proposition 13 on the ballot. The rest, of course, is history.

Furthermore, even though TABOR proponents have not enjoyed much political success in recent years, it is important to note that fiscal conservatives have already achieved a larger and more important victory in that we have finally found a strategy that is actually effective at limiting the growth of government. There is plenty of evidence from the state and federal level that statutory budget caps do very little to halt government growth. When voters successfully use the initiative process to lower taxes, state and local governments often respond by raising other taxes. However, TABOR's combination of a low, constitutional limit on revenue growth and immediate rebates of surpluses, gave TABOR enough visibility and popularity to enjoy long term success in Colorado. This model can still be successful in Maine and elsewhere—if fiscal conservatives do not give up the fight.

Dr. Michael New is a Visiting Fellow at the Witherspoon Institute, an Assistant Professor of Political Science at The University of Alabama, and an Adjunct Scholar at the Cato Institute.

Shining a Light on the Taxes We Pay

By Jason Mercier

A government transparency movement is sweeping across the nation, as citizens demand state and local officials make it easier for taxpayers to find information on public spending. Thanks to the ongoing partnership between ALEC and policy organizations at the state and national levels, there have been many successes to date, as states create searchable budget websites based on the ALEC model language developed in the Tax and Fiscal Policy Task Force. As we continue this battle for spending transparency, we shouldn't lose sight of the need to improve voters' understanding of the taxes they pay.

Why focus on tax transparency? Consider the following details from Washington State. There are 1,790 taxing districts in the state whose officials impose various taxes on Washingtonians. Unfortunately for taxpayers, there is no single comprehensive resource available to help individuals and businesses learn which taxing districts and rates they are subject to, and how much officials in each taxing district add to their total tax burden. A typical home, for example, can be located in as many as ten different taxing districts. Unfortunately, this scenario is likely true in your state as well.

To improve the transparency of state and local taxation, the Seattle-based Washington Policy Center (WPC) sponsored model language at ALEC's 2008 States and Nation Policy Summit. The model bill provides for the same level of transparency for state and local tax rates as for spending. That language was unanimously adopted as ALEC Model Legislation and is now available for use in your states.

Moving forward with this type of tax transparency reform has the potential to help remove the mystery surrounding taxation. It could also help facilitate meaningful tax competition among taxing districts and states as taxpayers could compare potential tax liabilities based on where they decide to live or locate their businesses.

The proposed tax web site has already received favorable reviews in Washington State. "The Department of Revenue considers the web to be a great way to communicate with taxpayers and the public, and it supports the concept of a searchable database of state and local taxes by location. In fact, it already has been moving toward that goal as resources permit," said Mike Gowrylow, spokesperson for Washington's Department of Revenue.

State newspapers have also commented favorably on the recommendation for more tax transparency. Here are some examples.

Seattle Post-Intelligencer (8/17/08): "The Legislature and the governor recently moved the state into a new era of budget transparency with a law creating a searchable Web site detailing state spending. The state should advance its impressive digital empowerment of the public by giving everyone access to the same type of information about his or her state and local taxes. The Washington Policy Center last week unveiled a proposal to create 'a tax

Continued on next page

transparency Web site' allowing individuals and businesses to figure out just how much they are paying in all local and state taxes. The site would have information not just about state and city tax rates, for example, but also the entire range of rates from other taxing districts, such as school, county, library, fire, transit and other entities. There also would be a calculator allowing individuals to figure their own total state and local tax burdens…Like the spending idea, this plan ought to have bipartisan appeal. Whether one tends to think we have too few services or too many taxes, there is broad common ground on the value of accurate information for making good decisions."

Olympian (10/2/08): "State lawmakers are fond of talking about openness and transparency in government, but generally come up short when it comes to taking positive legislative action. This year was an exception when the House and Senate passed Senate Bill 6818, which requires the state to make available to the public detailed information about state spending. State officials have until Jan. 1, 2009, to assemble line-by-line state spending data and make it available to the public via a Web site. It's a great step forward to a more open and transparent government. Now it's time for lawmakers to shift their focus to the revenue side and give the public the same kind of detailed information about the taxes they pay to support government programs."

Bills based on the ALEC model tax transparency language have already been introduced in Iowa and Washington.

Here are details from Washington's SB 6105 - Concerning transparency in state and local taxation (in-part):

(1) By January 1, 2010, the department [of revenue] must make publicly available an online searchable database of all taxes and tax rates in the state for each taxing district. The information must be aggregated by type of tax and accessible by entering a physical address for each residency or business. In addition to searching by physical address for each residence or business, searches must be accommodated by navigating through a map of the state as a whole and down to the level of each taxing district.

(2) The department must also provide tax rate calculators on the searchable database to allow taxpayers to calculate their potential taxes. Calculators must be provided at a minimum for property, sales and use, business and occupation, vehicle, and other business taxes and must be specific to the rate for the taxing district in which the taxpayer resides. The calculator may only be used for educational purposes and does not have a legal effect on taxes due.

(3) To facilitate the department's efforts in creating and maintaining the searchable database of each tax rate for all taxing districts in the state, each taxing district must report its tax rates to the department by September 30, 2009. In addition, every taxing district must report any changes to its tax rates within thirty days of an enactment of a different rate.

The Washington bill would also require the new tax transparency website to be linked with the state's new searchable budget web site (www.fiscal.wa.gov), which is also based on ALEC model language and went live last December.

Whether your state has already enacted a searchable budget web site or is still considering this commonsense reform, there is no reason not to extend this vital level of transparency to the tax side of the ledger. Taxpayers should not have to hire a lawyer to understand what taxes they are subject to and who is collecting and spending their money.

ALEC and organizations like Washington Policy Center stand ready to assist you in your efforts to help make details about state and local spending and tax information a click of the mouse away for your constituents.

Jason Mercier is Director of the Center for Government Reform at Washington Policy Center, a non-partisan independent policy research organization in Seattle and Olympia. He is a voting member on the American Legislative Exchange Council's Tax and Fiscal Policy Task Force and is a contributing editor of the Heartland Institute's Budget & Tax News. Jason also serves as Treasurer on the board of the Washington Coalition for Open Government and was an advisor to the 2002 Washington State Tax Structure Committee.

Proposition K:

A Better Property Tax System for Kansas

By Rep. Steve Brunk

Property taxes are essentially a tax on wealth, taxing assets instead of income. These taxes don't take into consideration a person's ability to pay and they can create a burden for the taxpayer when appraised values increase. Too often the increase in the appraised value of property is far greater than inflation and is often significantly greater than any increase in income. This is certainly the case in Kansas. During the last ten years, taxes for property overall have increased by 83 percent, while the tax on residential property increased 119 percent.

Ever accelerating assessed valuations on property allow government officials to proclaim that they are holding the line on tax rates, while enjoying the stealth nature of increasing revenues. In addition, the mass appraisal system is unpredictable for the taxpayer and is often inaccurate. We need a better method, and Proposition K is a fair, easy to understand, easy to implement system, which modernizes the old way of taxing properties.

Prop K has four primary policy goals

1. **Stop appraisal driven tax increases for home owners and businesses.**

   Surprise changes in valuations, incorrect and inconsistent valuations, and valuations that place new burdens on taxpayers (that may not have the ability to pay), are just a few of the problems associated with a mass appraisal system. Individuals on fixed incomes or lower income families are particularly burdened by sudden and often substantive increases in their property tax.

2. **Make the property tax rate the only moving part.**

   The current Kansas property tax has two moving parts: the appraised value and the tax rate. By eliminating the appraised value, the tax rate will be the only part of the equation that is subject to change. Those rates must be openly set by elected officials to support a budget proposal. Additional revenue will not just automatically come in. Elected officials will have to make their case to the public for raising or lowering their taxes to support a proposed budget. This will bring a great deal of transparency to the system, and with transparency comes accountability.

3. **Improved predictability for both taxpayers and government budgeters.**

   Replacing the old system that continually re-appraises property with a system that has a stable tax base and relies on a standard formula, will bring much needed predictability to all parties involved. A standard, unchanging formula will give residential and commercial taxpayers the predictability they need to plan for the future. They will no longer be subject to unexpected or run-away valuation changes in their property tax. Likewise, government planners can accurately implement the necessary rate to meet their budget proposals. A stable base and a stable system will bring a great deal of desired predictability to the process for all parties involved.

Continued on next page

4. **Maintain local government autonomy.**

   While Prop K seeks stability, predictability and transparency, it does not attempt to put limitations or caps on the amount of revenue that government can collect from the property tax. It is left to elected officials to determine the appropriate mix of taxes to effectively meet the demands of providing necessary services to the public. However, in the Prop K system it is necessary for officials to publicly raise the property tax rate to gain more revenue. This new level of transparency will empower voters and make it easier for taxpayers to know and analyze the spending patterns of their elected officials.

How Prop K works

A baseline for all current properties must be established. The existing appraised value of the land and the improvements will be adopted as the new baseline values for property tax purposes. Land and the improvements to the land will continue to be tracked separately. Taxpayers will continue to have access to the appeals process if their baseline falls below actual market value. This makes the transition seamless and is revenue neutral, protecting both the taxpayer and government.

The appraisal system will be eliminated. Once the new baseline is established, it will grow at a fixed rate of 2 percent per year and will never revalue. New owners of an existing property will inherit the annually adjusted baseline value of the property.

This gives the taxpayer the stability and predictability that is missing from the current system. Government will have the same stability and predictability and any new construction that comes on line coupled with the 2 percent increase, should provide them with an acceptable hedge against inflation. If government has too much or too little revenue, the tax rate can be adjusted as necessary and will be implemented under the watchful eye of the taxpayer.

Assuming the original baseline value is reasonably accurate and fair, then the taxes will continue to be fair because the distribution is frozen. This is an equal and uniform approach to taxing property.

New construction and re-classified land will be adopted based on a square foot formula. New construction will come on line at the same "per square foot" value of nearby like value properties, making it consistent with like properties in an existing area. The details are numerous, but the concept is simple. The "per square foot" method eliminates the need for tax related property appraisals and establishes an objective standard for establishing a baseline value for new properties that is consistent with the surrounding properties.

A recent statewide poll indicated that 77 percent of Kansans believe that we need a better system of taxing property. Prop K brings transparency, stability, and predictability to the taxing system.

Representative Steve Brunk has served in the Kansas State House since 2003. He is currently the Chairman of the House Commerce and Labor Committee. For a great explanation of Prop K go to www.propositionk.org. The author wishes to thank Dr. Arthur P. Hall Ph.D., Executive Director, Center for Applied Economics, University of Kansas School of Business and Dave Trabert, President of the Flint Hills Center for Public Policy,

Primary benefits of Prop K

- Prop K stops appraisal driven tax increases by creating a simple and predictable formula to set values.
- Prop K maintains local government autonomy by placing no limits on property tax revenue or rates.
- Prop K improves transparency and accountability of local government budgeting process.
- Prop K creates a more stable business climate to improve the economic development potential of the state.

ALEC's First Predatory Tax Academy:
Lessons for State Lawmakers

By Don Sheff

Steve Moore of The Wall Street Journal speaking at the lunch reception during the 2008 Predatory Tax Academy.

On the eve of ALEC's 2008 States and Nation Policy Summit, ALEC's Tax and Fiscal Policy Task Force held its first Predatory Tax Academy. This day-long intensive policy program featured a wide range of national experts presenting on some of the most pertinent topics in the tax policy debate. The academy was designed to provide legislators the expertise, information, and tools to battle tax policies that limit economic growth. Each speaker discussed how state tax policies affect everything from internet sales to the states' global competitiveness.

The first panel on priority-based budgeting addressed how states can develop and execute budgets by measuring how well a program supports the mission and/or business plan of the particular state governmental agency that is being evaluated. Moderated by former Task Force Chairman, Rep. Jamie Van Fossen of Iowa, the panel of experts included Dr. Bill Beech, Director of the Heritage Foundation's Center for Data Analysis, Dr. Barry Poulson, University of Colorado Professor of Economics, and Bob Williams, President of the Evergreen Freedom Foundation and a member of ALEC's Board of Scholars.

Following the first panel, task force member, Illinois Sen. Chris Lauzen, led an important discussion on the often complicated issue of corporate combined reporting. State legislators were given information on this growing trend to extract more revenue from the business community through these hidden tax increases. The remainder of the morning panels discussed the importance of maintaining tax competition among the states and how travel taxes, particularly rental car taxes, are damaging local economies around the country.

The academy's lunch address was given by Stephen Moore, senior economics writer at *The Wall Street Journal*, who highlighted the current economic crisis and how it is impacting the states. He encouraged legislators to find innovative ways to lower the burden of government on individuals and businesses.

State legislators also heard from Grover Norquist, President of Americans for Tax Reform, who spoke on the topic of budget transparency. ALEC's Tax and Fiscal Policy Task Force has been a leader on this issue, promoting several pieces of model legislation—including the widely popular *Taxpayer Transparency Act*. This ALEC model bill requires states to post grants, contracts, and government spending on an easily accessible and searchable database.

Chris Edwards of the Cato Institute and Dr. Robert Carroll of the Tax Foundation, appeared on a panel moderated by our new Tax and Fiscal Policy Task Force Chair, Indiana Sen. Jim Buck, and agreed that the United States corporate income tax rate, currently the second highest in the world, is severely damaging our country's global competitiveness. In order for the United States to increase prosperity, these experts explained, the country needs to work towards lowering and simplifying the corporate tax rates in America.

The next panel discussed internet taxes and the other aspects of the multi-state taxation. Rep. Jamie Van Fossen moderated the panel that included Mr. Jonathan Johnson III, President of Overstock.com and Marie Lee from AeA (formerly the American Electronics Association). Some states today are trying to force businesses to pay taxes to states where they do not have a physical presence. The physical presence criteria for state taxation has been the

Tennessee Rep. Susan Lynn, North Carolina Rep. Fred Steen, California Sen. Bob Huff, and Illinois Sen. Chris Lauzen enjoy lunch at ALEC's Academy.

legal precedent for decades and is now being threatened by overzealous state revenue officials and legislators.

The multi-state taxation discussion continued as the main topic of the following panel moderated by Jay Jennings of Sanofi-aventis U.S. Panelists included Art Rosen, partner in the law firm of McDermott Will & Emery LLP and Branden Ritchie from the office of Congressman Bob Goodlatte. The panel highlighted the federal effort attempting to protect the physical presence standard for business activity taxes. Mr. Ritchie explained that if the physical presence standard is further eroded, it would be devastating to the business community and may have unintended negative consequences for the states.

Later in the afternoon Dick Patten, President of the American Family Business Institute, spoke about the looming federal estate tax, commonly referred to as the "Death Tax." According to the American Family Business Institute, "The Internal Revenue Service defines the Death Tax…as 'a tax on your right to transfer property at your death.' The tax is applied to the transfer of a person's life-savings which exceed a particular amount." The Death Tax is currently scheduled to rise to a confiscatory tax rate of 55 percent in 2011. If the federal government doesn't act soon, the death tax could spell economic demise for states and communities that heavily rely on family businesses and farms.

Before dinner, Dr. Richard Vedder, a professor of economics at Ohio University and a member of ALEC's Board of Scholars, gave the concluding remarks for the afternoon session. Dr. Vedder summarized his 12 Commandments of sound tax and fiscal policy in the states. His overall theme was to avoid tax increases in the current economic downturn and to oppose the federal bailout of the states.

The dinner program was hosted at the historic City Tavern Club of Washington. The City Tavern Club building has been host to private functions for John Adams, Thomas Jefferson, and Ronald Reagan. The academy participants dined in the Great Room as Bob McTeer, former President of the Federal Reserve Bank of Dallas and current Distinguished Fellow at the National Center for Policy Analysis, gave the keynote address on the current economic crisis facing the country. Dr. McTeer gave an in-depth analysis of how the country slipped into the credit crisis and what policy tools are being used today to encourage economic recovery.

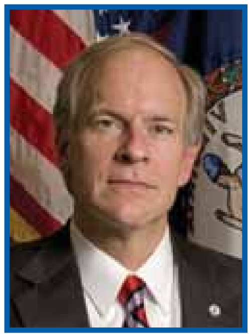
If lawmakers are to effectively address the budget deficits in their states, they need ammunition. ALEC's inaugural Predatory Tax Academy played a key role in addressing this need by providing state policymakers the resources necessary to fight the predatory taxes they will almost certainly confront in 2009.

Don Sheff is the legislative assistant to ALEC's Tax and Fiscal Policy Task Force.

Former Tax and Fiscal Policy Task Force Chairman Rep. Jamie Van Fossen of Iowa talking about the important information contained in Rich States, Poor States.

Member News

ALEC Alumni Named as Virginia Attorney General



ALEC alumni William C. Mims, a former Republican legislator from Loudoun County, Virginia, was unanimously confirmed by the Virginia General Assembly as the state's new Attorney General to complete the term of Robert F. McDonnell, also a former ALEC member. "I am honored to serve as Attorney General following Bob McDonnell. He was an exceptional Attorney General, and I plan to continue his legacy by providing the very best legal services for Virginia's citizens," said Mims, who previously served three terms in the House and two state terms in the Senate.

ALEC Membership Event in South Carolina

ALEC held a special membership event in Columbia, SC on February 25. We would like to thank Rep. Liston Barfield, Rep. Harry Cato, Sen. Ray Cleary, Frank Rogers of GlaxoSmithKline, and Tom Mullikin of Moore & Van Allen for their hospitality in hosting an amazing membership event. This was one of several recent ALEC membership events held around the country. A complete list of these events is available online at www.alec.org. For more information please contact Rick Gowdy, Deputy Director of Membership and Development at rgowdy@alec.org or at 202-742-8512.

Rep. Alan Clemmons, and Rep. Joe Daning

Public State Chairs Rep. Barfield, Rep. Cato, add Missing Sen. Cleary, Private Sector State Chairs Tom Mullikin of Moore & Van Allen and Frank Rogers of GlaxoSmithKline

Rep. Robert Williams, Rep. Wendell Gilliard, and Rep. Chip Limehouse

Rep. Jeff Duncan, Shelvie Belzer of Blue Cross Blue Shield, and Rep. George Hearn

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Register for ALEC's
Spring Task Force Summit
at **www.alec.org**

Upcoming ALEC Meetings

Spring Task Force Summit
May 1-2, 2009
Memphis, TN

36th Annual Meeting
July 15-18, 2009
Atlanta, GA

States & Nation Policy Summit
December 2-4, 2009
Washington, D.C.