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Veritas

A Publication of the Texas Public Policy Foundation

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Texas Public Policy Foundation

Veritas

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PRESIDENT'S MESSAGE

Dear Friend of Liberty,

The recent election results remind me of one of the late satirist H.L. Mencken's observations that "democracy is the theory that the common people know what they want, and deserve to get it good and hard."

But what exactly did the people want? After all, while the President was reelected and the U.S. Senate remained in liberal control, the U.S. House also saw no change. Further, Republicans now have unified control of the governor's mansion and both legislative houses in 24 states, up three from the 2010 election and the most since 1952. So the federal government remains in divided hands, with neither taxes nor spending likely to go down any time soon.

By contrast, one of the two major parties is in full control in 37 states, the greatest number of states with unified control in 60 years. This offers the perfect opportunity to observe the laboratory of federalism work its magic. Does anyone doubt that California, doubling down on tax increases and red tape, will see a further hemorrhage of job creators to states such as Texas which take the opposite approach? To add urgency to California's challenge, now that liberals control two-thirds of both legislative houses there, the U.S. Census Bureau just came out with a new measure of poverty that shows that the Golden State has America's highest poverty rate: 23.5 percent versus 16.5 percent in Texas.

And why wouldn't poverty be high in California? The official unemployment rate there is pegged at 10.2 percent versus 6.8 percent in Texas. Further, California, with one-eighth of the nation's population, has one-third of America's welfare caseload. Add to this the fact that state and local government in California consumes 10.6 percent of personal income versus Texas' 7.9 percent levy—a tax burden that's effectively 34 percent greater in the Golden State.

All of which brings us to this issue of *Veritas,* where we discuss eliminating the Texas margin tax as well as the danger to state sovereignty inherent in the intermingling of the state and federal budgets. What can be more Texan than these two topics while, at the same time, serving as examples for other states to follow?

Texas' tax on business, the margin tax (a/k/a the business franchise tax), was revamped in 2006 as part of an effort to reduce Texas' high property taxes. Since then, most small businesses have seen an exponential increase in their tax burden while the tax itself only accounts for 6.4 percent of the state's revenue from taxes, fees, and lottery sales. The Tax Foundation cites Texas' margin tax as a one-of-a-kind tax that is overly complex and difficult to administer. Professional tax preparers and CPAs frequently note that the compliance costs for the tax often end up costing more than the tax itself for many small businesses.

Our Center for Tenth Amendment Studies takes on the issue of how the practice of federalism has taken a back seat to federal power ever since the Tenth Amendment was drafted. While the federal government has a hard time compelling state governments, it can bend them to do its bidding with the lure of federal funds, which now account for about 40 percent of the average state budget. This "free" federal money comes from some 600 separate federal funding sources, each with their own specific conditions that serve to commandeer state power in the service of federal goals. To break this control, Texas needs to provide leadership to states in forging a consensus that federal "assistance" to the states is most often simply federal overreach.

Thank you for your commitment to helping us tackle these and other important issues. I hope the new year brings continued blessings to your families, the Lone Star State, and our nation.

Yours in liberty,

Brooke Rollins
President and CEO

The Texas Margin Tax: Surveying its Impact and Finding a "Fix"

by The Honorable Talmadge Heflin, The Honorable Chuck DeVore & James Quintero

The margin tax is the epitome of bad tax policy. It is costly, complicated, and distorts business and investment decisions. Fortunately, there is a relatively straightforward fix—abolish the margin tax and watch the economy soar as the Lone Star State becomes the first in the nation to be without an income tax or a business tax.

In 2006, the Texas Legislature—under pressure from a Texas Supreme Court ruling declaring the state's school finance system unconstitutional*—overhauled the state's Tax Code with the twin goals of generating more money for state government and enabling the state to provide meaningful local property tax relief to homeowners and businesses. To achieve those ends, a handful of changes were made, but the most profound was the creation of the revised franchise tax, or "margin tax," a hybrid tax combining elements of a modified gross receipts tax and a corporate income tax.

Under the redesigned business tax scheme, Texas' old corporate franchise tax—based on the greater of a 4.5 percent tax on earned surplus (net income) or a 0.25 percent tax on taxable capital (net worth)—was replaced with a broad-based, low rate tax on an entity's "taxable margin," a concept similar to taxable income.

Initially, hopes were high that the margin tax would be a boon for government coffers while also allowing the state to buy down a portion of the local property tax. But in the few short years since the tax went into effect, it has been plagued with problems, including an inability to meet revenue projections and diminution of the state's competitive edge.

* See *Neeley v. W. Orange-Cove Consol. Indep. Sch. Dist.*, 176 S.W.3d 746, (Tex. 2005).

The Texas margin tax, enacted by the Legislature in 2006, is the state's primary tax on business. Its structure resembles a hybrid of a modified gross receipts tax and a corporate income tax.

A History of Underperformance

Margin tax collections came in lower than projections from the start. In fact, collections have only met or exceeded expectations once: fiscal 2012. According to recently released data from the Texas Comptroller, tax collections for fiscal 2012 were estimated at $4.3 billion, above initial estimates of $4 billion as detailed in the state's *2012-13 Certification Revenue Estimate*.[1] In every other year since its inception, collections have underperformed.

The high point for collections with this tax occurred in its first year of enactment, in 2008, when it generated $4.45 billion, up from $3.1 billion in 2007, the last year of collections before the tax was broadened. However, the official revenue estimate for 2008 was $5.9 billion, so revenue was still $1.4 billion below estimates in the tax's first year of operation.[2]

By fiscal 2010, the tax was $2.5 billion shy of initial estimates, of which $1 billion was attributed to the recession.[3] In fiscal 2011, the franchise tax produced $3.93 billion, up from $3.86 billion the year before but still $500 million below initial projections.[4]

The Texas Comptroller figures that "…the effects of the recession played a significant part in the poor performance of the tax and likely accounted for virtually all of the decline in tax collections from fiscal 2008 to fiscal 2010," estimating that, had the tax not been broadened, it would have produced $2.6 billion in 2010, some $1.3 billion less than actually collected.[5]

The Texas Margin Tax in a Nutshell

The Texas margin tax, enacted by the Legislature in 2006, is the state's primary tax on business. Its structure resembles a hybrid of a modified gross receipts tax and a corporate income tax.

In many respects, the tax is experimental in nature as no other state in the nation currently levies this kind of tax on its business sector.

The tax is levied according to an entity's "taxable margin," defined as the lowest of three possible options:

- Total revenue minus cost of goods sold;
- Total revenue minus compensation; or
- Total revenue times 70 percent.

Once the taxable base has been determined for a particular taxpayer, most entities are taxed at a rate of one percent. However, the rate differs somewhat for retailers and wholesalers. For these two types of entities, the tax rate is 0.5 percent, a difference intended to mitigate some of the cascading effects usually associated with a gross receipts tax.

In determining an entity's tax liability other factors are also taken into consideration, such as the $1 million small business tax exemption, the removal of any tax liability for businesses owing less than $1,000, and the requirement that businesses pay regardless of profitability. This, in a nutshell, is the Texas margin tax.

The Texas Business Climate: Losing Its Luster

Higher and more complex business taxes have taken their toll on the state's business-friendly image, ultimately leaving the state in a less competitive position nationally, according to the rankings of some well-respected groups like the Tax Foundation.

continued >>

Every year the Tax Foundation, a non-profit educational organization, evaluates and ranks the competitiveness of each state's tax system in its report, *State Business Tax Climate Index* (SBTCI). The high-profile ranking surveys each state's tax system and critiques them based on certain state-specific considerations such as the types of taxes levied, tax bases and rates, and more.

Generally speaking, the SBTCI finds that "the most competitive tax systems are typically found in states that raise sufficient tax revenue with economically neutral and simple tax systems. The least competitive are typically found in states with complex, multi-rate corporate and individual tax codes; above-average sales tax rates that exempt few business-to-business transactions; high state tax collections; and few institutional restraints on the level of taxation or spending."[6] In simpler terms, competitive states typically have simple, broad-based tax systems, whereas uncompetitive states commonly feature complicated, high tax systems.

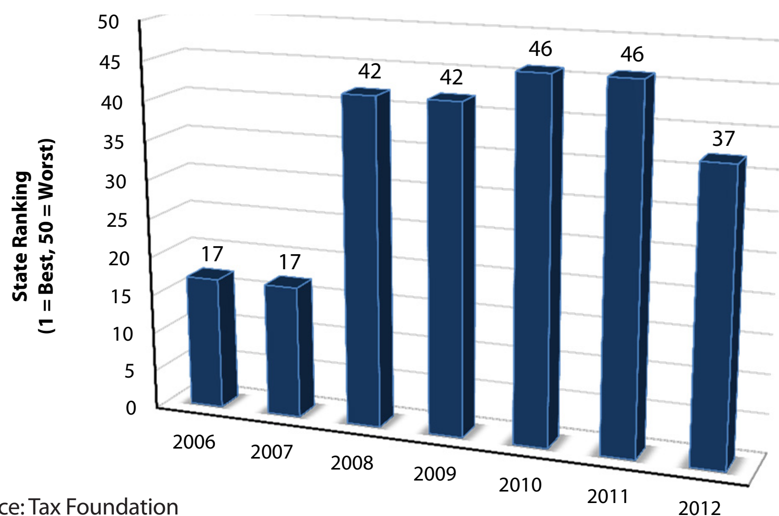
Texas, with its business-friendly, pro-growth environment, usually fares quite well in the Tax Foundation's business climate rankings. But, in recent years, the state's rankings have begun to noticeably falter.

The detrimental impact of the margin tax is most apparent in the SBTCI's *Corporate Tax Rate Sub-Index*, a metric "designed to gauge how a state's corporate income tax top rate, bracket structure, and gross receipts affect its competitiveness compared to other states."[7] The measure comprises 19.35 percent of a state's overall SBTCI ranking.

In 2006 and 2007, Texas' corporate tax ranking among the states placed it 17th in the nation. However, in 2008, the first effective year of the margin tax, the state's competitive corporate-ranking fell 25 positions to a 42nd place standing (*see Figure 1*). In the years following 2008, the state's competitive ranking has fluctuated somewhat, reaching a low point of 46th place and improving slightly to its current 37th place position; but it has yet to regain anything close to its pre-margin tax ranking.

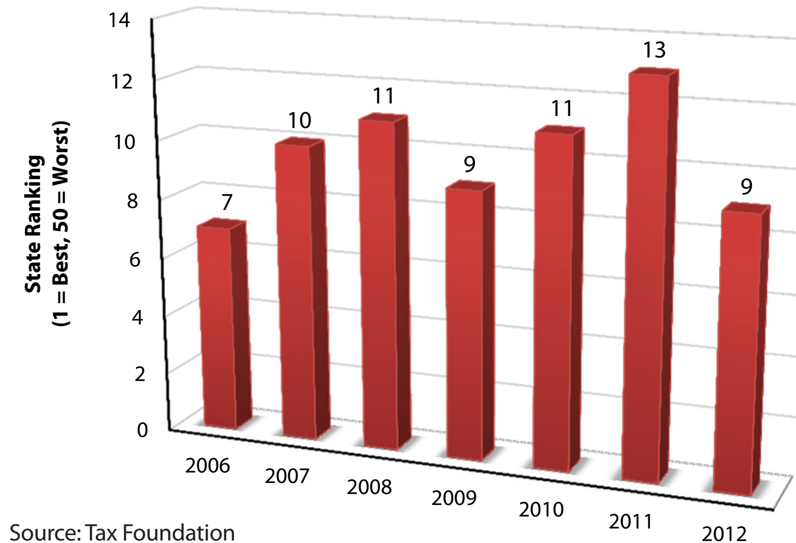
The negative contribution of the margin tax to the overall business climate can be seen in the

Figure 1: Texas' Corporate Tax Ranking in the State Business Tax Climate Index has declined since 2006 (lower is better)



Source: Tax Foundation

Figure 2: Texas' Overall Ranking in the State Business Tax Climate Index was better in 2006 before the Margin Tax changes (lower is better)



Source: Tax Foundation

decline of Texas ranking from 7th in 2006 to 11th in 2008. In 2011, the state's ranking fell to a near-term low of 13th place. In the most recent ranking, Texas' tax climate moved back into the top 10, ranking as the 9th best nationally, but the ranking is still below its pre-margin tax standing at 7th place[8] (*see Figure 2*).

The marginal improvement in Texas' 2012 ranking is likely the result of a comparative decrease in the competitiveness of some of the top states. Delaware, for example, fell out of the top 10 in 2012 for the first in the SBTCI's short history. Its drop to 12th place is partly attributable to marginal increases in its property tax rates.[9]

The Tax Foundation makes it clear that the state's declining competitiveness, as seen in both measures above, is linked to "a complicated gross receipts 'margin tax.'"[10] Explaining further, the Tax Foundation argues that the margin tax is problematic because it combines "all the problems of minimum income taxation in general—excess compliance and administrative cost, penalization of the unsuccessful business, undesirable incentive impacts, doubtful equity basis—with those of taxation according to gross receipts."[11] Texas' current top 10 ranking in the Foundation's overall rankings is clearly a result of its many other business-friendly policies and achieved despite the margin tax.

Finding a "Fix"

Given the problems associated with the margin tax, some have begun calling for the Legislature to "fix" the tax in the upcoming legislative session, presumably by raising the rate, adjusting how the tax is calculated, or some combination of both. But these are only temporary fixes to a problem that ultimately deserves a more permanent solution, like abolishing it entirely.

Texas missed a golden opportunity in 2006. The old franchise tax was a relatively minor portion of the state's overall revenue. With the state in the mood for tax reform, that would have been the time to make Texas the only major U.S. state to not have a dedicated business tax.

continued >>

THE TEXAS MARGIN TAX

Texas Public Policy Foundation Policy Primer: "Problems with the Margin Tax: Real or Imagined?"

In November 2012, the Texas Public Policy Foundation hosted a margin tax discussion featuring some of the state's leading authorities, including: State Representative Charles Perry, a returning lawmaker and CPA; Dale Craymer, President of the Texas Taxpayers and Research Association, a leading research and trade association; Jimmy Martens, attorney and former lead counsel in a recent case questioning the constitutionality of the margin tax; and Peter Nolan, attorney and former lead counsel in the most recent constitutional challenge to the margin tax.

Though no firm consensus was reached on exactly how the margin tax should be reformed, the general sentiment was that, for the sake of the Texas economy, incoming state lawmakers should reform the tax during the next legislative session.

ABOVE: Rep. Charles Perry (R-Lubbock) speaks about the many problems with the margin tax and the need for meaningful tax reform.

Yet there is still opportunity. The margin tax accounts for only 6.4 percent of the state's revenue from taxes, fees and lottery sales. **Given its size, it is entirely reasonable to begin phasing out the tax completely by extending and increasing the amount of total revenue below which a taxable entity would owe no tax up to $10 million in 2013 and $50 million in 2015, and then eliminating it entirely after 2017.** Lost revenues could be made up through a combination of spending reductions, existing revenue growth, and the expected increase in revenues by making Texas the only state in the nation without a business or income tax.

Already, the idea is gaining traction in the statehouse among lawmakers looking for ways to create jobs, deliver tax relief, and prime the state's economy for more growth.

Alternatives to the Phase-Out Plan

The best way to fix the margin tax is to get rid of it. In the event that that particular reform is not able to make it through the legislative process though, lawmakers should consider these five fixes:

FIX #1: Permanently extend the small business tax exemption and increase the amount of total revenue below which a taxable entity would owe no tax to $10 million.

FIX #2: Allow unprofitable businesses to deduct a portion of their margin tax liability.*

FIX #3: Require any increase in the margin tax rate to be approved by two-thirds of all members of each house of the Legislature.

FIX #4: Allow deductions for cost of employment for all contract labor used by Texas firms.

FIX #5: Simplify the tax by reducing the number of moving parts.

The combination of these fixes would do much to make the tax more palatable to Texas businesses, though it is still an inferior solution when compared to an outright repeal.

Conclusion

Almost any way you cut it, the margin tax has been bad for Texas.

The tax has underperformed from a fiscal standpoint; been a drag on Texas' economic competitiveness, tarnishing the state's otherwise business-friendly image; and served only to unite policy wonks on its deficiencies.

Incoming lawmakers would do right by businesses and taxpayers by doing away with the margin tax forever, and letting the natural growth in the economy and budget cuts make up for anything lost. ✭

* The Texas Comptroller estimates that this reform might reduce tax revenue by $1 billion. This amount might be mitigated by ensuring losses aren't used as a means of tax planning or tax avoidance.

Making Headway in the Fight to Get Rid of the Texas Margin Tax

The 83rd legislative session is right around the corner and already there has been some encouraging movement on the tax reform front.

Namely, State Senator Craig Estes (R-Wichita Falls) has already pre-filed legislation that would repeal the tax completely.

Responding to its pre-filing, the Tax Foundation has said that if the bill—Senate Bill 113—were to go into effect, Texas' business climate could expect to improve significantly.

Right now, Texas is ranked by the Tax Foundation as the 9th best state for business overall and has the 38th best business tax structure. If the repeal were to happen, the Tax Foundation estimates that Texas' overall ranking would improve to 5th overall and have the nation's best business tax system.

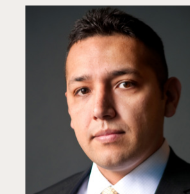
See more: "What's a Surefire Way to Jolt the Texas Economy?"

[1] Texas Comptroller of Public Accounts, "The 2012-13 Certification Revenue Estimate" (Dec. 2011) 33.
[2] Ibid., 4.
[3] Ibid., 14.
[4] Online query from "Where the Money Comes From" (accessed 17 Apr. 2012).
[5] "The Business Tax Advisory Committee, Report to the 82nd Legislature," Susan Combs, Texas Comptroller of Public Accounts (Dec. 2010) 14.
[6] Tax Foundation, "State Business Tax Climate Index Homepage" (5 Mar. 2012).
[7] Tax Foundation, "2012 State Business Tax Climate Index" (Jan. 2012).
[8] Tax Foundation, "State Business Tax Climate Index Rankings, 2006–2011" (26 Oct. 2010).
[9] State of Delaware, "Property Tax Information and Rates" (Sept. 2010).
[10] Tax Foundation, "2012 State Business Tax Climate Index" (Jan. 2012).
[11] Tax Foundation, "Fiscal Fact No. 279: Texas Margin Tax Experiment Failing Due to Collection Shortfalls, Perceived Unfairness for Taxing Unprofitable and Small Businesses, and Confusing Rules" (17 Aug. 2011).

Chuck DeVore is Vice President of Communications and Senior Fellow for Fiscal Policy at the Texas Public Policy Foundation. From 2004 to 2010, DeVore represented almost 500,000 people in the California State Assembly in the coastal Orange County region that includes the cities of Irvine, Newport Beach, Laguna Beach, and others. He was the Vice Chairman of the Assembly Committee on Revenue and Taxation and served on the Budget Committee as well.

DeVore served as a Reagan White House appointee in the Pentagon from 1986 to 1988. As Special Assistant for Foreign Affairs his duties included working with Congress to advance the President's foreign and military policy. He later served on staff for a U.S. Congressman.

Talmadge Heflin is the Director of the Texas Public Policy Foundation's Center for Fiscal Policy. For 11 terms, he served the people of Harris County as a state representative. In the 78th Session, Talmadge served as chairman of the House Committee on Appropriations.



James Quintero is the Center's senior fiscal policy analyst. His work includes restricting the growth of taxation, appropriations reform, increasing governmental transparency, and instituting expenditure limits.

5th Annual Texas Public Policy Foundation Visionaries Meeting

January 9-11, 2013 ∞ Austin, Texas

For individual supporters of the Texas Public Policy Foundation

By now, you have probably heard many discussions on the presidential election outcome, and how Texas will be affected. Although these views may differ, one thing remains steadfast: the Texas Public Policy Foundation must continue to defend Texas, defy Washington overreach, and reignite the American Dream. We stand strong. We will continue to be bold, assertive, innovative—and lead the way for workable policy solutions both here and nationally. In fact, it is our time to shine because Texas is where freedom proves its case!

And to help make that case, we are finalizing plans now for our most important event of the year: our 11th Annual Policy Orientation for the Texas Legislature and Visionaries Meeting on Wednesday, January 9 through Friday, January 11, 2013.

Many of you have already attended one of our premier policy conferences, and we thank you. Because not only do we fashion the conference to educate legislators on the most important issues to be voted on in the 83rd legislative session, we bring together our most important supporters from across the state to share ideas, recommendations, and personally connect with our board members and policy leaders. It's so important that you be here with us.

Only those individuals committed to being a Texas Public Policy Foundation Visionary* are invited to this special gathering. Nearly 92 percent of the Texas Public Policy Foundation's funding comes from Visionaries, or those who contribute a minimum of $1,000 per year. You are crucial to our cause!

As a Visionary, you and your guest will be our guests for special programming, apart from the larger Policy Orientation audience, such as:

- A private meeting with keynote speaker The Honorable Newt Gingrich, Republican presidential candidate (2012 election) and Speaker of the U.S. House of Representatives (1995-1999) and *The Wall Street Journal* editorial board member Steve Moore;
- An exclusive dinner at the remarkable Bullock Texas State History Museum with Comptroller Susan Combs and syndicated columnist Jonah Goldberg;
- A VIP reception and private tour with Governor and Mrs. Rick Perry at the Governor's Mansion with special guest speaker Dr. Bill Bennett of the syndicated radio program "Morning in America;" and
- A special reception with U.S. Senator John Cornyn.

If you are not yet a Visionary but would like to become one by making your first contribution or increasing your current contribution to reach the $1,000 annual contribution, please let us hear from you today.

It is your vision, your love of freedom, and your confidence in our work that brings us hope for the future.

Those individuals contributing $1,000 or more per year to the Texas Public Policy Foundation.

To register for Policy Orientation and Visionaries Meeting, please contact Shari Hanrahan at 512.472.2700 (office), 512.627.9831 (cell), or shanrahan@texaspolicy.com.

Special events at the Bullock Texas State History Museum and the newly refurbished Governor's Mansion are a few of the exclusive opportunities for Visionaries Meeting attendees.

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BEWARE FEDS BEARING GIFTS

Beware Feds Bearing Gifts

What Washington's really offering is a choice between your money and your liberty

by Mario Loyola

The federal government can't require the state governments to do anything—the Supreme Court has been very clear about that. The only problem is this: The federal government has many ways of requiring states to do things without saying so. Its favorite is money. Federal assistance now accounts for 40 percent of the typical state's budget, including more than 600 separate federal funding sources—each of them with its own strings attached.

The cumulative effect of those strings is to ensnare state governments in a web of federal control. As Texas legislators seek to find solutions for Texas-sized problems, they find that everywhere they turn there is some condition they can't violate, or they risk losing millions or billions in federal funds. Federal grants for the states accounted for well under one percent of GDP in 1952, just before the start of massive investments in the federal highway system. Today, federal grants account for over 4 percent of GDP, sustaining each of the 50 states most important programs in health and human services, education, and transportation.

Federal funding for state governments is among the most insidious of Congress' tactics. It allows Members of Congress to hide their power in the institutions of state government, escaping accountability for their policies by making them seem like state policies, freely chosen by the states' residents, through their representatives in the state legislatures. But nothing could be further from the truth.

The vast intermingling of federal and state budgets has left states both dependent on the federal government and subordinate to its preferences on a range of core state responsibilities. Far from helping states, federal largesse leaves them far more vulnerable to economic downturns: When states need to trim the fat, they find that the conditions attached to federal funds (which they can generally not afford to lose) restrict their flexibility.

> Until the Court fixes this flaw in its federalism doctrine, the Congress will continue to take advantage of a loophole big enough to drive a Trojan horse through.

State are supposedly completely free to accept or reject these funds. But the consequences of not accepting are prohibitively onerous: States lose all of the money their residents have contributed to the federal program in question, and the money instead goes to other states. As Chief Justice Roberts said of the penalties in ObamaCare, the penalties for not complying with the conditions attached to federal funds are often "a gun to the head."

When accountable, representative government is diminished our democracy inevitably suffers. That is why federalism matters. As the Supreme Court has said, the separation of federal and state governments "protects the liberty of the individual from arbitrary power."

As I argue in the new issue of *The American Interest* magazine ("The Federal-State Crack-Up", Jan/Feb 2013) it is vital to keep federal and state government functions separate. Federal courts must begin to enforce a strict separation of powers both between the federal and state governments. Congress will also have to help undo the consequences of its self-indulgence. But state legislators have perhaps the greatest incentive to insist on the separation of state and federal government functions.

The essential thing is to recognize that conditional federal funds for the states violates the constitutional principle of federalism. Such "assistance" allows uncompetitive states for "political cartels" in Congress that strangle innovation and regulatory competition at the state level, and impose uncompetitive policies on everybody. The result in both cases is fiscal dysfunction, overregulation, and the loss of accountability and self-government at all levels.

In recent decades, the Supreme Court has ruled that the federal government cannot directly compel states to do anything. But it has ruled that pressure indirectly applied in the form of "encouragement" (such as conditional grants) does not run afoul of the Constitution. This is a distinction without a difference, because pressure indirectly applied is no less compelling than the direct forms of pressure the Court has prohibited. Until the Court fixes this flaw in its federalism doctrine, the Congress will continue to take advantage of a loophole big enough to drive a Trojan horse through.

In *New York v. United States* (1992) the Court struck down part of a federal law because it required states either to take title to low-level radioactive waste generated within their borders, or regulate its disposal according to Congress's instruction. "In this provision," reasoned the majority, "Congress has crossed the line distinguishing encouragement from coercion." Congress could not force states to choose between two alternatives neither of which Congress had the power to impose "as a free standing requirement." The Court said, "While Congress has substantial powers to govern the Nation directly, including in areas of intimate concern to the States, the Constitution has never been understood to confer upon Congress the ability to require the States to govern according to Congress' instructions."

continued >>

Texas Attorney General Greg Abbott discusses federal overreach and how the Lone Star State is working to preserve states sovereignty with the Foundation's Mario Loyola, Director of the Center for Tenth Amendment Studies; and Chuck DeVore, Vice President of Communications.

In *Printz v. United States* (1997) the Court further strengthened its emerging doctrine of federalism. It struck down a part of the Brady Act that required states to conduct background checks on prospective gun purchasers. The Court insisted that federal and state governments occupy separate spheres in a "structural framework of dual sovereignty" and that the States must remain "independent and autonomous within their proper sphere of authority." Writing for the majority, Justice Antonin Scalia write that a federal law that offends "the structural framework of dual sovereignty" is categorically impermissible. Hence, Congress simply cannot command a state official to do anything.

New York and *Printz* constituted significant victories for the Constitution. But both decisions maintained that both conditional federal grants and cooperative regulation are forms of "encouragement" not rising to the level of "coercion." Where the federal government merely "encourages state regulation rather than compelling it, state governments remain responsive to the local electorate's preferences; state officials remain accountable to the people."

As many state legislators know from personal experience, this distinction between compulsion and encouragement is utterly fictitious, because there is always a penalty. If states don't accept "voluntary" federal grants (and comply with the attached conditions) the tax revenue their citizens have already contributed to the program will get transferred to other states and they will lose all of it. With very few exceptions, these penalties have proven almost completely effective in securing universal state compliance with federal preferences.

If we reverse the logic of O'Connor's distinction between encouragement and coercion, and start by asking whether a federal law leaves elected state officials free to regulate "in accordance with the views of the local electorate," it becomes obvious that virtually all instances of cooperative federalism boil down to federal commandeering of state agencies. That commandeering is no less effective or compelling just because it operates "indirectly" through the leverage of penalty.

South Dakota v. Dole (1987) upheld a federal law that threatened states with the loss of five percent of federal highways funds if they did not raise their drinking age to 21. *Dole* noted

that the penalties attaching to such programs could not be so onerous as to "pass the point at which pressure turns into compulsion." *Dole* insists that state prerogative must be preserved, both in theory and in fact, but would have us believe that the state's freedom to refuse the funding and its conditions constitutes freedom of choice.

But the fact is that states must either obey the federal will or accept a penalty which is almost always more than the states can bear, namely the loss of their state's share of funding for the program in question. *Dole* imagines a spectrum of penalties from mild to onerous, and some imaginary point in between that Congress cannot cross. This rule is so indeterminate that it proved impossible for courts to apply in the decades after *Dole* was handed down. No federal court applying Dole ever struck down a federal penalty as coercive, no matter how coercive it was—that is, until this year's ObamaCare ruling.

ObamaCare requires that states expand their Medicaid programs from arrangements to help specific categories of poor people (pregnant women, the disabled, needy families, children) into a vast wealth-redistribution scheme for the entire non-elderly population up to 133 percent of the Federal Poverty Level. It threatened states with the loss of all federal Medicaid funds if they don't comply with the new mandates. That draconian penalty was too much for the Roberts Court, which ruled that the federal government could refuse the subsidies that Obama Care provides for the expansion itself, but could not cut off existing Medicaid funds for states that refused to comply.

Compared with the modest penalty in *Dole*, the threat of losing all federal Medicaid funding (more than 20 percent of the typical state's budget) was "much more than relatively mild encouragement," wrote Roberts: "It is a gun to the head." Wherever the point is between encouragement and compulsion, the penalty for not complying with the Medicaid expansion was well beyond it.

States must either obey the federal will or accept a penalty which is almost always more than the states can bear, namely the loss of their state's share of funding for the program in question.

But where is that all-important point? Alas, as with the Court's other indeterminate, sliding-scale rules, the differentiating point exists wherever the Court may fancy. The Court still has not recognized that all conditional federal grants are coercive. In each case, the federal government taxes money away from the residents of a state and offers to give it back only on condition that the state comply with federal preferences. Even under the Court's ObamaCare ruling, states that refuse to expand their Medicaid programs will still be massively subsidizing the expansions in other states. That is coercion, pure and simple.

The essential problem in conditional federal funds for the states arises from the lack of restraints on the purposes for which Congress may use its taxing and spending power. Under the Constitution, Congress has the power to levy taxes only in order "to provide for the common Defense and general Welfare of the United States." But nothing prevents it from using that power wholly in order to provide for the welfare of special interest groups.

Until the early 20th century there were significant limits on Congress's ability to extend its control over society through the taxing power. But after the 17th Amendment gave Congress the

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Both Congress and the Courts have a responsibility to restore the Constitution's protections for accountable and responsive government. But it is state legislators who have the greatest incentive to address the problem.

power to levy income taxes without apportionment among the states, Congress was able to seize and redistribute vast sums of taxpayer money.

It was then in a position to offer state officials a Faustian bargain: give up your autonomy in exchange for federal funds, and you will be able to expand the range of goodies you can offer your constituents while avoiding accountability for increased taxation. The blurred accountability has allowed officials at the federal and state levels to claim credit for much more spending than if they had to account for it entirely by raising taxes on their own.

This is the problem with federal assistance: States give up self-government in exchange for it, and the federal government goes further in debt in order to expand its control of state governments. In the short term, the arrangement is convenient for both federal and state legislators. But it is not convenient for the people. In the long term it is deeply damaging to democracy in the largest sense.

In recent decades, Congress's self-indulgence and the Supreme Court's mistakes have combined to produce a moment of national crisis. Both Congress and the Courts have a responsibility to restore the Constitution's protections for accountable and responsive government. But it is state legislators who have the greatest incentive to address the problem.

They must work together. The coming session of the Texas Legislature provides an opportunity to start coordinating a common approach to federal overreach disguised as "assistance." Working through institutions such as the American Legislative Exchange Council, the National Conference of State Legislators, and the various Governors' Associations, in addition to ad hoc working groups, state legislators can begin to develop effective strategies and solutions.

The first crucial step is for the legislators of each state—starting with Texas—to develop a consensus on the dangers of federal assistance. Patriotic Americans need to be far more wary of feds bearing gifts. ★

Mario Loyola is director of the Center for Tenth Amendment Studies. He previously served in the Pentagon as a special assistant to the Under Secretary of Defense for Policy, and on Capitol Hill as counsel for foreign and defense affairs to the U.S. Senate Republican Policy Committee. Mario has written extensively for national and international publications, including features for *National Review* and *The Weekly Standard*, and op-eds in *The Wall Street Journal*. He has appeared on The Glenn Beck Show, CNN International, BBC Television, Radio America, and more. Mario received a B.A. in European history from the University of Wisconsin-Madison and a J.D. from Washington University School of Law.

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TPPF In the News

by The Honorable Chuck DeVore

631 PRINT CLIPS

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87 Social NETWORKING SITES

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TPPF IN THE NEWS

- Rollins on *Bill Bennett's Morning In America* syndicated radio program
- Loyola on *Glenn Beck TV*
- Treviño on the *Guardian* (UK) panel
- Rollins hosts Mike Gallagher radio show
- More than 60 Op-Eds placed in media outlets across the state and nation!

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Communications is a vital element in accomplishing the Foundation's mission. Effective communication to the right persons at the right time can make the difference between a Foundation study or recommendation being acted upon or largely ignored.

To that end, we track all several communications metrics to gauge our success. For instance, so far this year, the Foundation has been mentioned in various media outlets 4,404 times totaling 268.5 million impressions. Comparing previous years over a similar period, in 2012 we were mentioned more times than in 2008, 2009 and 2010 combined.

Our redesigned TexasPolicy.com website hosts an average of 8,482 unique visitors per month. The number of visits to our sites is up 9.4 percent, while total page views are up 30.4 percent from the last year.

Driving this effort is a great communications team benefiting from intelligent insights and excellent prose from our policy staff.

It may be interesting to *Veritas* readers to read about three paths we take to the news.

Once the Foundation's Policy leadership develops their goals for the year, these goals are then supported with research and reports. As these come close to completion, Communications works closely with Policy to determine how best to promote the work. A news release might be written, social media engaged (Facebook and Twitter), calls to the press placed to spark interest in an interview with a policy expert and the like. Frequently a shorter commentary piece will be written to promote the report in the broader popular media.

A second common way we get into the news is to exploit the news cycle with a commentary piece playing off of a current story. This can

The Foundation's Chuck DeVore, Vice President of Communications, discusses the strong Texas economic environment on *Fox and Friends* morning show.

happen when either Communications or Policy staff sees an opportunity to place an article in a newspaper or national publication. Timeliness and relevance are crucial to success here and, as a bonus, such efforts can lead to broadcast media opportunities that can spread the Foundation's message and name nationwide.

Our periodic policy primers provide another, common way of making news. Last July we hosted a primer entitled, "The ObamaCare Ruling: What's Next?" This resulted in record media attendance for a primer event with six media outlets including: *Reuters, Austin American-Statesman, Bloomberg, Texas Tribune*, the *Amarillo Globe-News/Lubbock Avalanche-Journal* and KEYE TV. The *San Antonio Express-News/Houston Chronicle, Dallas Morning News* and FOX 7 News Austin also logged on to the livestream of the event.

In September we hosted "Addressing the College Affordability Crisis: The Rise of the $10,000 Degree." *The Wall Street Journal's* Nathan Koppel attended this primer, later quoting our Center for Higher Education Director Dr. Thomas Lindsay in an article about Governor Perry's renewed challenge for institutions to create more affordable $10,000 bachelor's degree options. ✩

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