Tax Policies for 4% Growth:
Evidence From the States, American History, Markets, and Nations

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Transcript by PremierTranscription.com
Emcee: Ladies and gentlemen, please welcome the President of the George W. Bush Foundation, the Honorable Mark Langdale.

Honorable Mark Langdale: Good morning. Welcome to the New York Historic Society. Three years ago, President Bush and Laura Bush came home to Texas, and they started writing their books. They also started the development of the George W. Bush Presidential Center on the campus of Southern Methodist University. It’s designed by New York’s own Robert A.M. Stern. It’s a beautiful building that will be finished at the end of the year. A year from now, in April, we will dedicate the building at a ceremony in Dallas, and half the building will be given to the federal government to be the permanent home of the George W. Bush Presidential Library and Museum. It’ll be a place where people can come and study and learn about the presidency of George W. Bush and he and Laura’s public service. The other half of the building will become the permanent home of the George W. Bush Institute.

The institute has also been working for three years, started up by President Bush and Laura Bush to be a platform for the continuing service on issues that they’re really interested in. For the last three years we have launched a program to eradicate cervical cancer on the continent of Africa. We’ve worked to empower women in the Middle East to be an agent of change there. We’ve worked to inspire and document the work of dissidents who are trying to bring freedom to their home countries, and today we launch or continue the launch of our economic growth perspective in the 4 percent growth area.

I’d like to especially recognize today a couple of members who have helped bring the institute and the center along: our Chairman of the Board, Donald Evans here, board member Craig Stapleton, Karl Rove and Edward Lazear, who are on the board of our institute, guiding what happens and what we work on with the institute, and Dean Al Niemi, who will be on a panel later today. SMU has been a great partner of ours as we build the center at SMU.

So at the time, I’d like to introduce to you the founding Director of the George W. Bush Institute, a smart and busy man, James K. Glassman.

Honorable James Glassman: Thank you. Thank you, Mark. Good morning, everyone. This conference was conceived and organized by Amity Shlaes, a Senior Fellow of the Bush Institute and Director of our 4% Growth Project. We launched that project a year ago at a major conference in Dallas that included four winners of the Nobel Prize in Economics. The project’s goal is to research, discover and promote ways for the United States to achieve sustainable, real 4 percent growth or about twice the rate that’s now being projected by many economists for the United States. We want to change the conversation in America so that it centers on growth.

You’ll hear from Amity on a panel later today, but in the meantime, let me try to channel her. Amity has been saying now, for the five months that this conference has been in the works, that this is not going to be a boring conference. It is, at its core, about competition. People like competition. It’s fun. That’s why people go to baseball games. Tax competition is a reality, yet the tax debate usually ignores competition, and many analysts just disapprove of it. We don’t. We like it. We think it’s exciting and uplifting, and everybody gains. Competition makes the global pie bigger, but there’s no doubt that bigger national and state incentives make a bigger slice of that pie at home.
People say economics is the dismal science. It is not. It’s actually a happy science, because it is the science of choice, and at its core, choice is all about human freedom. Economics is about the decisions that people make and the incentives that drive those decisions. Public policy plays a key role in determining the incentives, and tax policy is the most powerful of those public policies. The way it’s structured can get people to work more or less, to invest more or less, to start more or fewer new firms and expand more or fewer current ones.

In Europe, people work a full one-third less than we do, and the Nobel Economist Edward Prescott, who presented at our conference in Dallas, has shown that the reason isn’t culture. It isn’t climate. It’s the marginal tax rate. Nations and states that want to work more and invest more and thus have more opportunity and prosperity understand that they are in a global and national tax competition, as we’re going to see today.

In a way, much of what we will be doing today is looking from results to causes. So if strong growth is the desired end, we ask the question who grows. We’ll look at countries, at states, at America at different times in its history. There are places and times where growth has been particularly strong. We want to know whether tax policies are at the root of that success and which tax policies.

The governors who are here with us today understand the incentives that produce growth. Governor Haslam’s state of Tennessee already has no personal state income tax, and that may be the reason that his state has outstripped his neighbor, Missouri, which does have such a tax, in personal income and GDP and in employment. The governors of Kansas, Oklahoma, Maine and New Jersey, who are also here with us today, are all moving to cut their state’s tax rates. They understand the power of incentives and competition.

In the two panels that follow the opening addresses, we will turn the spotlight on state taxes and what they mean to state growth and to national growth. These sessions will be followed by a panel on international tax competition and one on the U.S. government record on taxes throughout history and conclusions we can draw from it. Next, we’ll break for lunch, followed by an address by Representative Paul Ryan, then panels on markets and taxes, on the real life impact of taxes on the people who run businesses, and then we’ll look at what we’ve learned in a star-studded panel called Blitz Solutions, what we should do, in a practical sense, to win the tax competition. Then we’ll close with a reception sponsored by the U.S. Chamber of Commerce.

I’d like to thank the Chamber for its sponsorship of this event, as well as our other sponsors, the Bosarge Family Foundation, Jean and Rex Sinquefield and Tina and Byron Trott and our media partner Forbes.

We are a Dallas-based organization. We like being in the Heartland of America. So what on Earth are we doing here in New York? Not only is this the white-hot center of business and finance in the United States. It’s a city built on global trade, innovation and competition, and what better place for this conference than the New York Historical Society, founded in 1804 with deep roots in the commerce of this city?

And also with deep roots in the commerce of this city is our next speaker, Steve Forbes. Steve’s grandfather, B.C. Forbes, was a journalist who immigrated to New York from Scotland and started a great eponymous business magazine that he presided over for 37 years and passed on to his talented son Malcolm. Today under Steve Forbes, with its international editions, Forbes has a circulation of more than six million. Steve has successfully led the company’s transition to the Internet age with Forbes.com, with 25 million unique monthly visitors and websites in the Real Clear family. Steve served under President George H. W. Bush as Chairman of the Board of International Broadcasting, and in both 1996 and 2000, he sought the Republican nomination for President, running on a principle platform, focused on growth, driven by low marginal tax rates. In 2000, he ran third in the New Hampshire primary and second in the Iowa caucuses, and I can’t for the life of me remember who beat him.
Speaking of happy, which is what we want this conference to be, there is no happier campaigner, no more optimistic campaigner for freedom and growth than Steve Forbes. Steve.

Steve Forbes:

Well, thank you very much, Jim, for those very kind words, and thank everyone with the Bush Institute for making today possible. This meeting couldn’t be more timely, and even though I tried to do something in 2000, obviously it didn’t work, which is why I’m doing the introducing today, but it is a great honor. We should recall President Bush’s two tax cuts, particularly the big one in 2003. Many people today don’t remember that President Bush inherited a faltering economy when he came into office. The economy was falling into recession in the aftermath of the dotcom bubble bursting, but for some reason, he didn’t feel the need to remind us of it for eight years. All right. Got to get on a high level again.

President Bush understood that taxes are a price and a burden and not just a means of raising revenue, and that is a profound insight. When you lower the tax burden on people trying to do good things, like productive work, risk-taking success, you get more of those good things. President Bush also understood that economic numbers represent real people, that the purpose of positive, pro-growth tax reform is to give people the opportunity, as Abraham Lincoln put it, to improve their lot in life. This focus on people is a distinguishing characteristic of President Bush.

We all know presidents must make decisions that can mean harm and death for people, most obviously our men and women in uniform. While President Bush never hesitated to make these necessary but awful decisions, he never let himself forget the casualty numbers involve human beings and their families. Like Lincoln, President Bush spent considerable time visiting the wounded and their families and does so to this day. What the great historian Richard Hofstadter said about Lincoln applies to President Bush. Hofstadter said Lincoln was moved by the wounded and dying men, moved as no one in a place of power can afford to be. For him, it was impossible to drift into the habitual callousness of the sort of officialdom that sees men only as pawns to be shifted here and there and expended at the will of others.

President Bush also shares a fundamental similarity with Harry Truman. Truman’s Cold War policies marked a profound break with American tradition, particularly after the isolationism of the 1930s. Never before had America played such a consistent and active role in the world as it did under Truman. In choosing to respond to the moral threat of Soviet communism and expansionism, Truman had to innovate and navigate with, so to speak, no playbook to go by. He was really operating in the dark, no useful precedents. No wonder that Dean Acheson, who served as Truman’s Secretary of State for four years, entitled his memoirs *Present at the Creation*. So too did President Bush face a situation without precedent, without established principles and rules post 9/11.

Winston Churchill, in 1940, when Britain faced the Nazis alone after the fall of France, expected each day to see Nazi paratroopers descending from the skies as a prelude to invasion. After 9/11, we all expected follow-on attacks of terror. Those paratroopers never did come to Britain. Thankfully, while George W. Bush was in office, a second 9/11 did not happen. Leadership counts. Like Harry Truman, President Bush rose to the occasion.

Both administrations faced their share of mistakes and setbacks and bitter controversy. One example underscores President Bush’s ability to rise to the occasion. By 2006, the War in Iraq was going very badly, and people were counseling, “Get out. Cut your losses.” Against fierce opposition and intense skepticism and criticism, President Bush forced a fundamental shift in strategy. The change worked. The War in Iraq was won when he left office. As was said of Harry Truman in the Cold War, so too it must be said of George W. Bush in the war against terror. He was right on the big ones.

Ladies and gentlemen, the 43rd President of the United States.
George W. Bush: Thank you very much. Thank you very much, Steve, overly generous in your comments. I appreciate it. I appreciate you all coming. I appreciate our sponsors. I want to thank, not only Steve but Forbes Media, as well as the Sinquefields, the Bosarges, the Trotts and the U.S. Chamber. I appreciate our governors being here. It’s a pretty cool job, isn’t it? Yeah. I’m looking forward to hearing you. I want to thank my old friend Henry Kissinger. It’s good to see you, Dr. Kissinger. Thank you for your time. I appreciate those who serve on our board. I appreciate our supporters. I want to thank Mark Langdale and Jim Glassman and Amity for him getting this conference going.

We’re proud to host the conference. It is a part of our mission to enlighten and to achieve results. I toured the facility the other day. These are for the supporters. I went to the facility the other day, and it is an awesome building on a great campus. Robert Stern, who is a world-class architect, has done a fantastic job. The gardens are going to be beautiful. I look forward to the opening in April of 2013.

The Bush Center is comprised of three parts. One is the library and archives. In the library and archives, we will have over four million photos. We’ll have tens of thousands of boxes of materials and hundreds of millions of emails, all stored and sorted, at some point in time so they can be analyzed by historians. Secondly, there will be a museum. Mark mentioned the museum. It’ll be really about presidential decision-making. The museum, frankly, is not going to last if it’s only about me. It’ll be interesting for a brief period of time, but the museum is going to be about principles and how you make decisions, and it’s going to be interesting. For example, we’ve got a piece of the World Trade Center that is going to remind people of that fateful day.

Here’s the lesson, by the way. In life you’re going to be dealt a hand you don’t want to play. It’s going to happen to all of us. It certainly happens when you’re president. The question is not if you’re going to be dealt the hand. The question is how do you play it.

Then there’s the institute. When you get out of office, it’s kind of a daunting feeling. You serve. You’re giving it your all, and all of a sudden, you’ve got some years ahead of you. I have decided to stay out of the limelight. I had plenty of the limelight. I don’t think it’s good, frankly, for our country to undermine our president, and I don’t intend to do so. But I do intend to remain involved in areas that I’m interested in. So the Bush Institute, run by Glassman, is an opportunity to be engaged in public policy in a positive way.

So the building isn’t open, but our institute is, and every day our scholars and fellows and directors come to work to advance this mission: how do we promote freedom, and how do we honor traditional values, timeless values. So our programs are designed — I think you’ll see, or if you study our institute, our programs are designed with clear goals in mind, and we tend to hold people to account. We want people who can contribute to our institute to know that we’re going to achieve concrete results that have an effect on our country and on the world.

In order to have a prosperous and more free America, we’ve got to have an education system that works, and so the Bush Center is a part of a reform movement that insists upon accountability as a key to educational excellence. One of the things we’re doing is that we’re focusing on one of the key components of educational excellence, and that is how to better recruit and train our nation’s principals.

We believe that all human life is precious and know that we have a calling to help save lives in the developing world. I believe we’re better people when we serve the admonition to whom much is given, much is required. So at the Bush Center, we’re going to act out that call. Here’s one way we’re doing it. We’ve started what’s called the Pink Ribbon, Red Ribbon campaign, and that is to diagnose and treat cervical cancer on the continent of Africa. We’ve assembled a group of public and private partners, and we’re getting after it with measurable results.

We believe that all freedom is universal. In other words, we strongly believe in the concept of the universality of freedom, that deep in everybody’s soul is the desire to be free. So I’m not surprised in the Middle East, when given a chance, people demand their God-given right.
We recently announced a one-of-a-kind place, an archive, a freedom archive where dissidents, political prisoners, heroic figures in the march of freedom can — where their stories will be stored and made available over the Internet. People say, “What are you doing that for?” Well, I think it’s important. We think it’s important to record heroic figures like Vaclav Havel or Ellen Johnson Sirleaf or the Dalai Lama as a reminder to our fellow citizens that we cannot become isolationists and hope for a peaceful tomorrow, that it’s in our interests to support those who are willing to take risks for freedom. It also sends a signal to those on the frontline of the freedom movement that the United States hears them. So if you’re interested, you ought to go to our website, which is Freedomcollection.org. I think you’ll find it interesting and a good contribution to the foundation for peace.

We believe women will lead the democracy movement in the Middle East, and so to this end, we have invited Egyptian women to come to the country to see how civil society is developed in our own society, to introduce them to mentors and to send them back home, encouraged and full of confidence that they’ve got support here in the United States to take on the tough tasks of helping democracy advance. One of the goals we’ve established for the women is for them to set up a women’s network across Egypt to provide solace, comfort and strength as they remind the men of Egypt that Egypt needs a society that’s pluralistic, that the minority rights are honored, that the rule of law is important and that democracy yields the peace.

We are advancing freedom by supporting our patriots and veterans. We’ve got what we call the Military Service Initiative, which spotlights effective, non-governmental organizations that are helping our vets. In other words, you’re giving money to these NGOs. You don’t know whether the money is being well-spent or not. Well, we’re going to help you understand whether it is or not.

I’m often asked, “Do you miss the presidency?” Really, I really don’t. I mean, I enjoyed it. It was an unbelievably interesting experience. Yeah, it’s inconvenient to have to stop at some stop signs or stop lights coming over here. I guess I miss that. But I do miss being Commander-in-Chief a lot. I admire our military a lot, and the Bush Institute gives me and Laura an opportunity to repay, as best as we can, our vets. So to this end, for example, I’m taking a bunch of vets mountain bike riding in the Palo Duro Canyon. I love to mountain bike ride. What I don’t like to do is be beaten on a mountain bike ride by a one-legged veteran, but it’s likely to happen. We also sponsor a golf tournament for our vets. It’s a way to say, “We love you, and we honor you, and we thank you.”

Finally, we believe in free enterprise at the Bush Institute. We believe our economy can be more robust and, therefore, provide better opportunities for our citizens. We believe that one of the clearest expressions of freedom is that the aggregate demand of our citizens determines that which is produced. We believe that government is important, but we believe that government ought to trust the people, the collective wisdom of the people. In other words, we trust people when it comes to spending their money, and so should the government.

Much of the political debate, and I guess rightly so, is about our balance sheet. It makes sense. When you look at the debt to GDP, it’s pretty high. When you think about entitlements, the overhang is daunting, but we believe that in order to solve the balance sheet, first and foremost, you’ve got to grow the private sector. Therefore the focus ought to be on private sector growth, and that private sector growth will yield increased revenues. The pie grows. The debt relative to the pie shrinks, and with fiscal discipline, you can better solve your current account deficits and your entitlements.

This July, the Bush Institute is publishing a book. It’s got to be a staggering thing for some of the cynics up here. I publish a book, and now the Bush Institute’s publishing a book. They didn’t think I could read much less write a book. But we’re publishing a book called 4% Solution. Twenty-one experts, including five Nobel laureates, some of whom are here, have provided the content on how to achieve 4 percent growth in the private sector. Now, look, we recognize this is ambitious, but most of the experts believe it’s doable. And so I hope
policymakers take time to read what the experts think. You’re going to read about cutting wasteful spending or entitlement reform or immigration reform, increasing trade, energy policy and, of course, what we’re here to discuss today, which is pro-growth tax policy.

What’s the best tax policy to grow the private sector? Do you notice I’ve been emphasizing private sector growth? The truth of the matter is, if the goal was public sector growth, it would be a short conference, which is raise taxes, but we believe that the best policy is that which creates a robust private sector. So what does that mean? Well, first of all, it means an understanding of how jobs are created or who creates the jobs. Seventy percent of new jobs in America are created by small business owners. Isn’t that an interesting fact? That’s one thing that makes the economy so vital. Most small businesses pay tax at the individual income tax level. Therefore, if you raise taxes on the so-called rich, you’re really raising taxes on the job creators, and if the goal is private sector growth, you’ve got to recognize that the best way to create that growth is to leave capital in the treasuries of the job creators.

Secondly, if you raise taxes — I wish they weren’t called the Bush tax cuts. If they were called some other body’s tax cuts, they’re probably less likely to be raised, but if you raise taxes, you’re taking money out of the pockets of consumers. It’s important for policymakers to recognize that all the doubt about taxes causes capital to stay on the sidelines. Uncertainty means the capital, the fuel for private sector growth simply won’t move. Anyway, that’s what we’re here to discuss. I think you’re going to find it to be a fascinating day. I know I am, and I’m looking forward to the discussions.

I’m looking forward to hearing our first speaker. Chris Christie has caught the attention of a lot of people, including Texans, you’ll be happy to hear, Governor. We see your enormous personality, your robust defense of freedom, your belief in the individual, and we admire the courageous stance you take. We’re looking forward to hearing from you today. Welcome, Governor of New Jersey.

Honorable Chris Christie:

Good morning, everybody. Thank you for having me today. Mr. President, thank you for the invitation to be here today, and I am always — will always be proud, no matter what else I accomplish in my career, to say that I was a proud member of the Bush Administration for seven years as the United States Attorney for the District of New Jersey. I’ve now taken a demotion to be Governor of New Jersey. If you don’t think it’s a demotion, then you go ahead and lose grand jury subpoena power. Anytime you do, it is a demotion. For some of you, that comment is more significant than for others.

I’m happy to be here this morning and talk to you a little bit about our experience in New Jersey, and I agree with the President that the most important thing that you can do, as a governor, for your economy is try to institute pro-growth policies that grow the pie and that are optimistic. However, optimism was a thing that was a little difficult to find in January of 2010 in the state of New Jersey, and here’s why.

In the eight years before I became Governor, our state raised taxes and fees at the state level 115 times. In the decade before I became Governor, New Jersey had a zero private sector job growth decade, a decade where we had net zero job growth in the private sector, yet in that decade before I became Governor, we became the state in America that had the most government workers per square mile in their state. That is an enormous achievement and one that took incredible work by eight years of three Democratic governors and a fully Democratic legislature. So when I came into office, in those last few weeks of January of 2010, you would think to yourself, given that plate coming in, that the news couldn’t get worse.

I was assured by my predecessor, Governor Corzine, that he was leaving me a budget that was, as he said to me in our first meeting post-election, on a glide path for the rest of the fiscal year. Guess he and I have a different definition of the term glide path, because in my second week as Governor, my Chief of Staff and my Treasurer came into my office and said that, if we did not cut $2.2 billion in spending in the next five weeks, that New Jersey would not meet payroll for
the second pay period in March. Now imagine that. Sixty percent of the fiscal year already gone, 60 percent of the money out the door in a $29 billion budget, and we had to find $2.2 million, not in cuts to projected growth, in money that we essentially had to sequester, that had already been appropriated, that was being counted on being spent across the state, in order to meet payroll. Not in order to meet some lofty goal like cutting taxes. In order to meet our payroll in what is the second wealthiest state per capita in America.

If you need any greater example of what happens to an economy when a state government over-taxes, over-spends, over-borrows and over-regulates, come to the New Jersey of January of 2010. Even with the second wealthiest populace in America per capita, we were going to be unable to meet payroll for the second pay period in March. So I had two choices. Now, keep in mind, I still, despite having won the election in November of 2009 — the Democrats maintained healthy majorities in both houses of my legislature. So I was dealing with a Democratic Senate President, a Democratic Assembly Speaker. So we had two choices on the cuts: sit down and negotiate with the legislature or, because of New Jersey’s unique constitutional structure, we could, my Attorney General argued, cut the spending through executive order.

Now, for those of you who have watched me for the last two and a half years, if you believe I made the first choice, then you need to leave now. So we sat in a room over a course of three weeks, and we went over all 2,400 line items of the budget, and we cut $2.2 billion in the budget. Then we asked for a joint session speech in front of the legislature, my first one as Governor. So I went in there, and I’ll take what was a 40-minute speech and break it down to 30 seconds, which some people said I should have done in the first place. But here’s basically what it was. I said, “I came into office. You gave me this problem. You did nothing to fix it. I just went in my office. I cut $2.2 billion in spending. Here are the cuts. I signed an executive order. They’re now in effect. I fixed your problem. Thank you very much. See you later.” And we left.

Now, you can imagine the reaction to this on the floor of the state legislature after I left. Press descended on the floor, and the Democratic leadership had their say. They were calling me all kinds of names: Julius Caesar, Napoleon Bonaparte, all those great leaders of the past I admire so much. The next day I was coming into the State House at the same time as the Senate President. Now, the Senate President in New Jersey is a good guy, a friend. His name is Steve Sweeney. Steve’s from the southern part of our state, and Steve is the President of the Iron Workers Local in New Jersey. So he’s a big guy like me, and we came walking in together. I saw him. I said, “Steve, I read all that stuff you said about me in the newspaper, Julius Caesar, Napoleon Bonaparte.” I said, “You know, you turned me around. I’ll go upstairs right now. I’m going to vacate that executive order, and I’m going to send this problem down the hall. You guys can fix it.” This will tell you all you need to know about politics in New Jersey. He looked at me and said, “Hey, hey, Governor, wait a second now. No reason to overreact.”

So we then, swiftly, within three weeks of that speech, I had to present my fiscal ’11 budget. That had a projected $11 billion deficit on a $29 billion budget, a 37 percent deficit, by percentage, the largest deficit of any state in America. Now my Democratic friends thought that was the time to move in for the kill, and they went back to their favorite thing. The President will be talking about it today. “We’re going to have a millionaire’s surcharge to help to balance the budget.”

Now, I want to make sure you understand, because people mess this up. You think that’s a millionaire’s tax. See, in New Jersey, we already had a millionaire’s tax, and it’s a special millionaire’s tax in New Jersey. See, here’s how it went. In New Jersey, they said the millionaire’s tax applied to everyone who made $400,000 a year or over. Now, that’s called New Jersey math, everybody, and see, I tried to use it as a selling point early in my administration. I said to the people of the country, “Listen, we all aspire to be wealthy. We all aspire for success, and if you are not a millionaire but you’d like to feel like one, come to New Jersey. Even if you’re not a millionaire, we will tax you like one.”
So now, what they’re talking about now is — that millionaire’s tax was 9 percent, 9 percent on everything $400,000 and over. Now what they wanted was 10 and three-quarter percent on everything $400,000 and over. So we had a little discussion, debate about that in the context of my budget, and they decided, before they even consider the budget, they were going to pass that tax. So they did, and with great fanfare, the friend of mine I talked about, Steve Sweeney, he passed the bill in the Senate. He called all the cameras and marched himself from the Senate chamber down towards my office. Now, you know, everybody growing up, if you’re lucky, has a good mother. I had one. She always taught me to be polite. I know your mother did too, Mr. President. I think we have very similar mothers in that respect. So I put my coat on, and I came out to greet the guests who were coming, and he handed me the bill. I forget what it was called, you know, but Democrats always call these tax increases something other than an increase, like the Freedom and Equity for America Act or something like that. So they think that maybe they can slide it by. “Well, Freedom and Equity for America, I’m for that, sure. Where do I sign?”

But he came in with all the TV cameras and handed me the bill. “Mr. Governor, here’s the bill.” I said, “Okay.” I said, “Steve, wait one second. I want you to sit down for a second. I just want you to wait.” I sat down at a little table I had out there, and I took out this pen. I vetoed it right there, and I handed it back to him. I said, “Here, take it back, because this is not where we’re going in New Jersey anymore.” He said, “We’ll be back,” and I said, “We’ll see.”

Then we went ahead and proposed the budget that balanced the budget without any tax increases, that cut spending, not projected growth, based on spending from the year before, by 9 percent. See how one guy started clapping? That was about all the claps I got on that cut initially. I’m glad he’s back. Thanks for coming — because we cut every department in the state government, every one of them. Everything got cut. Everyone shared in the sacrifice. So they said that budget was dead on arrival, but that’s fine. We decided we believe, especially in this Easter season, in resurrected life, and so we resurrected that budget. In fact, the legislature wound up passing it. The Democratic legislature wound up passing it with 99.8 percent of the line items exactly as we went it. For the first time in a decade, New Jerseyans had had a budget passed that did not increase taxes, that did not increase fees, that did not increase the cost of their government to them.

You can’t start pro-growth policies until you get your house in order. You have to first step up to the plate and do the difficult things. So what did we do next? New Jersey has the highest property taxes in America, and in the ten years before I became Governor, property taxes increased 70 percent in 10 years. So as they were passing that budget, at about 2:00 A.M., the day before the constitutional deadline, I faxed them a little surprise. I faxed them letters from me, using my constitutional authority, to call them back into session on July 1st to say we are going to consider a 2 percent cap on property taxes before we leave for summer vacation. So they passed my budget, and then they went back to their offices. They found that letter and had to go back to work.

You know, this places a strain on a family, because they came back to work on July 1st, and they said, “We’re not doing anything on a cap, Governor.” I said, “Okay. Come back on the second.” The second gets a little hairier, because we’re getting closer to the fourth, and it was over a weekend. All of a sudden — they didn’t do anything on the second. The third came. The morning of the third, spouses from all over New Jersey were calling their husbands or wives in the state legislature saying, “Listen, we’re already at the Jersey shore. We are waiting for you. The kids are driving me crazy. Give him whatever the hell he wants and get out of there.” I am still indebted to the husbands and wives of Democratic legislators all over New Jersey, because in the afternoon of July 3rd, we came to an agreement on a permanent 2 percent cap on property taxes in New Jersey and then later in the year totally reformed the interest arbitration system that was driving salaries up 7 to 10 percent for public sector workers. I put the same 2 percent cap on interest arbitration awards so that an unelected arbitrator could no longer drive property taxes up in a way that was unaccountable to the people. Again, done with a Democratic legislature.

We had another big problem to fix thereafter, because in the same way, the Medicare, Medicaid and Social Security are threatening the fiscal health of our country. State pensions and health
benefit costs were threatening the health of our state’s economy. In the fall of 2010, we had a $54 billion deficit in our pension fund and a $67 billion deficit in our health benefit fund, $121 billion combined. That would be four years of a state budget just to bring that to balance if we kept things in the same direction. So I came out in September of 2010 with a pension/health benefit proposal. Now, on health benefits, the public workers in New Jersey, when I became Governor, paid nothing for their health insurance. From the day they were hired until the day they died, nothing for their health insurance, and on pensions, we had to make significant changes, so we proposed increasing the retirement age, eliminating cost-of-living adjustments until the health of the funds were back at 80 percent of the targeted fund or higher, ending early retirement for political appointees and increasing the penalties for retiring early for anybody. Now, as you can imagine, all those things — and by the way, fifth, increased the contributions by public employees to their pensions.

Now, you can imagine, this went over extraordinarily popular, and I went to put this proposal out in its first week to the Firefighters Convention in Wildwood, New Jersey, right on the Boardwalk, 4,000 firefighters at 2:00 on a Friday afternoon. Lunch was not solid that day, I can tell you, and they were fired up and ready to go. I got introduced. It’s a long walk — it seemed longer that day — from the side stage to the front of the stage, and they were booing me like crazy. I got up there, and the guy running things said, “Governor, I’m sorry. The guys are a little upset about your proposal on the pension.” I said, “Don’t worry about it.” My staff had some talking points up on the dais for me, and they were booing, so I said, “I’ve got to do something dramatic.” So I took the talking points out, and I ripped them, and I threw them away so they could see it. Didn’t work. They booed more. Then I said, “Come on. Let it out.” And they did. They booed more. Finally I said, “Come on. You guys can do better than that, and they did.” And so finally they exhausted themselves, literally exhausted themselves.

I said, “Here’s all I have to say to you today. You know about my proposal, and I understand that you are angry, and you feel betrayed and lied to. The reason that you are angry and feel betrayed and lied to is because you have every right to be angry, because you have been betrayed, and you have been lied to, because governors of both parties have come in here for the last 20 years and promised you things they knew they couldn’t pay for. They lied to you to get your vote, and you voted for them. Now you’re angry, and I don’t blame you. Here’s the one thing I don’t get, though. Why are you booing the first guy to come in here and tell you the truth? Because, you know, there is no upside for me coming here to tell you that. See, our pension fund won’t go broke until 2018, and if I have two terms, I’ll be gone in 2017. So there’s no political upside to me coming here and telling you this, but here’s what I will tell you. If these reforms get passed, ten years from now, when you retire and you’re going to be able to collect a pension and get health benefits from the family, you’re going to be on the Internet looking for my home address to send me a thank-you note, because someone finally came in here and told you the truth.”

So we went from there and did 30 town hall meetings across New Jersey, arguing the point that this was not just pro-taxpayer. It was pro-New Jersey economy, and it was pro-union worker. Believe it or not, in June of 2011, with only one-third of the Democrats in the Senate and one-third of the Democrats in the Assembly, along with all the Republicans, we passed that pension and benefit reform package, saving $132 billion over the next 30 years for the taxpayers of our state and securing the future of the pension and health benefit programs for the people whom they’ve been promised to. We did that because my friend I mentioned before, Steve Sweeney, was courageous, and he stood up with a minority of his caucus. He sponsored the bill, and he posted the bill, and he made sure it got the votes. Sheila Oliver, African-American woman from Essex County, our most Democratic county in New Jersey, stood up, voted for the bill, posted the bill with only one-third of her caucus supporting her. That day, they said they did it, “Because we’re partnering with the Governor to do the right thing for the people of our state.” I agree with Steve. Leadership counts. Leadership does count.

So now what do we see in New Jersey? Well, we’re now in a budget situation where we’re not dealing with multi-billion-dollar deficits. Instead, I was able to propose a budget this year that’s proposing the first income tax cut in New Jersey in over 15 years, a 10 percent across the board...
income tax cut. Here’s the amazing thing. You would expect the Democrats would be arguing with me about it, but the majority of the Democrats are now saying, “Yeah, we have to cut taxes.” They’re just arguing with me about how to cut the taxes. Well, for people, like all of you here and for the folks at the Bush Institute, you know what that means. I’ve already won the argument. Now we’re just dickering over the details. What matters — what matters is we’ve changed a place like New Jersey to understand the very principles that the President was talking about when he stood up here a few minutes ago, that if you want to grow jobs in New Jersey, you have to leave more money in the hands of the people who create those jobs. So since I’ve become Governor, we’ve created 75,000 new private sector jobs in New Jersey, and we’ve cut the public sector. There are fewer public employees on the state payroll today than when Christie Whitman left office in January of 2001 to join the Bush Administration as EPA Administrator, less government workers than 11 years ago.

You have to do both. If you want the private sector to grow, you have to take money out of the public sector. We can’t run deficits at the state level. All my fellow governors who are here today know that. So we have the obligation to make those tough choices, and we’re trying to set the example for the rest of the country. See, because if you can do it in New Jersey — I mean, look at, come on, Haslam and Fallin sitting up here, from Tennessee and Oklahoma. I love them both. They’re great governors, but come on. Seriously. I mean, you know, I would trade my right arm to come and deal with Tennessee and Oklahoma rather than deal with New Jersey. LePage knows, in Maine, I have a little more sympathy for him, little more. Not a lot, Paul, but a little more sympathy for him, but if you can do this in New Jersey, you can do it anywhere. Most importantly, you can do it in Washington, D.C.

What we need, again, is some leadership that is not going to take no for an answer, leadership who understands that these things happen in New Jersey not just because our ideas were right — and they are — but because we developed relationships with the other side of the aisle that allowed them to trust us. That doesn’t happen overnight. Day after day after day, you have to sit with your colleagues and convince them of the goodness of your spirit and of the understanding that compromise is not a dirty word.

See, as governors, what we know is that there is always a boulevard between compromising your principles and getting everything you want. Now, in New Jersey, I abandoned the getting everything you want thing a long time ago, but I refuse to compromise my principles. So when they want to build a tunnel to the basement of Macy’s and stick the New Jersey taxpayers with a bill of $3 [billion] to $5 billion over, no matter how much the administration yells and screams, you have to say no. You have to look them right in the eye, and no matter how much they try to vilify you for it, you have to say no. You have to be willing to say no to those things that compromise your principles, but I think governors find all the time that there is a boulevard — sometimes it’s more narrow; sometimes it’s broader — between getting everything you want and compromising your principles. It’s our job, as leaders, to find the way onto that boulevard and to never forget that what we got sent into office to do was to get things done, not to send out press releases, not to just posture and pose, although I love all three of those things, but we can’t just do that.

At the end of that, you have to find a way to make progress, see, because the 4 percent solution, 4 percent growth, is not going to be achieved if we don’t deal with Medicare. Four percent growth is not going to be achieved if we don’t deal with Medicaid. Four percent growth is not going to be achieved if we don’t deal with Social Security. Four percent growth is not going to be achieved unless we can credibly advocate for pro-growth tax policies because we have our fiscal house in order. So for all of us who believe, who know in our heart that the policies the President advocated and that he spoke about today are the right policies for an America that’s optimistic, we know that job one is to be credible with the people of our state and the people of our country that we will be responsible stewards of the money they already send us. I would contend to you that we’re still a distance from making that case.

Governors, like Haslam and Fallin and LePage and others, are making that case on a state-by-state basis, and they’re showing success. But we have a lot more work to do, a lot more work to
do, and in the end, for the people of my state that don’t always agree with everything I do, and they certainly don’t always agree with the way I always say it, but what they know is, I’m telling them the truth as I see it. I’m not looking to be loved. See, I think politicians get themselves in the biggest trouble when they care more about being loved than being respected. That’s why we run up these deficits we run up. That’s why we can’t say no to anything. Because we care too much about being loved. I’m loved enough at home, believe me, on occasion. It’s not what I’m in this for.

My mother told me a long time ago, “Chris, if you have the choice between being loved and being respected, take respected, because if you’re respected, true love may happen, but love without respect is always fleeting.” Now, of course, she was talking about women, but I think it applies equally to politics. If you get people to respect you, that you’re willing to say now but that you’re also willing to listen, that you’re willing to stand hard on principles that you’ve articulated to the public, been elected on and believe in, but willing to compromise when those principles will not be violated, then respect will come. And in New Jersey, I think respect is coming for us because even those who don’t agree with me know that when I look them in the eye and tell them I’m going to do something, I do it, regardless of the political costs, and when I tell them I’m not going to do something, I won’t, regardless of the political expediency.

On the door of my Senior Staff’s offices, the inside of their door, they have reprinted a headline from a New York Magazine profile they did on me. You always worry when anything New York does a profile on you and you’re Republican, but the headline on the story was, “The answer is no.” They blew that up to about this size, and they taped it on the back of their door so when the lobbyists come in and interest groups come in and they close the door to have the meeting and they start asking for something, they say, “Turn around.” They look at it, and they go, “That’s from the boss.” We start off with the answer being no until we get ourselves in the right fiscal condition, and then we can say yes to the right things, to cutting taxes, to lowering regulation, to empowering the people of our state and our country, to be optimistic again.

I’ve never seen a less optimistic time in my lifetime in this country, and people wonder why. I think it’s really simple. It’s because government’s now telling them, “Stop dreaming. Stop striving. We’ll take care of you.” We’re turning into a paternalistic, entitlement society. That will not just bankrupt us financially. It will bankrupt us morally, because when the American people no longer believe that this is a place where only their willingness to work hard and to act with honor and integrity and ingenuity determines their success in life, then we’ll have a bunch of people sitting on a couch waiting for their next government check. New Jersey moved in that direction. We are moving away from that direction, and then we can say yes to the right things, to cutting taxes, to lowering regulation, to empowering the people of our state and our country, to be optimistic again.

We’re trying to do that every day in New Jersey. We know we’ll be judged. We’re comfortable with being judged, and we’ll be judged on the basis of the decisions we’ve made and the record we’ve created. And I hope that we’re going to be one of the flagship’s in the Bush Institute’s 4 percent growth plan, because if we are — if we’ve done it in New Jersey, that means they’ll be growing at like 8, 9 percent in Tennessee with Haslam, so he’ll be really happy and the most popular politician in America. But more importantly, it’ll mean there will be more money, more hope, more aspirations in the hearts of our children and grandchildren than there are today. That’s what will make the 21st century the second American century. That, more than anything else, will allow the United States to export hope and liberty and freedom around the world, not by just saying it but by living it every day, in the way we conduct ourselves and in the way we govern ourselves.

Mr. President, thank you for setting that example. Thank you for inspiring a whole new generation of conservative Republican leaders whom you helped to create. So many of us who sit in the state houses today are products of your leadership, your willingness to give us a chance to make a difference in our country, in your Administration and now to make a difference in our states and in our country and in the world because of the opportunity you gave us. Thank you all very much.
Thank you, Governor Christie, for that message of realism and optimism, and what a great way to get this conference started, with President Bush and Steve Forbes and Chris Christie. I’d like the first panel to come up. Governor Christi alluded to strong leaders in every state in America, and we’re beginning this conference with the states, with what’s going on in the states. We have a panel on State Governments and Taxes. Dean Niemi is coming up and Michael Cox. I’m not going to name them all. They’ll be here in a second.

I do want to introduce Dean Al Niemi, who is the Dean of the Edwin L. Cox School of Business at Southern Methodist University, and as I said, we will have the governors on after this panel. We wanted to do a panel where we’ve got experts taking a look at what is happening in the states, and I can’t think of a better person to moderate that panel than Al Niemi, who has devoted his academic career to looking at exactly this question, about which states succeed and why. We’re also very proud, at the Bush Institute, to have as our partner in so many things Southern Methodist University. Dean Niemi.

Thank you, Jim, and I liked our position as being the first panel, but I didn’t know we had to follow Governor Christie. So panelists, we have got a tough, tough act to follow. It’s the first time — I’ve seen Governor Christie on Television. It’s the first time I’ve been in the second row with him, but he’s awfully impressive. What he had to say about the growth of government — I teach a course in the fall on the Evolution of American Capitalism, and government collectively, at the federal, state and local level, was 10 percent or less until the Great Depression. In the Great Depression, it got up around 20 percent with all the New Deal programs, not only at the federal level but at state and local, and we never got back there. Now we’ve crept over 40 percent. People say how big should government be. Well, it’s 42 percent now. A few years ago it was 10 percent, and we just don’t seem to find a way to ratchet down with government.

In the interest of true disclosure, I grew up in Boston, Massachusetts. So I’m a refugee from a high-tax — I left Massachusetts when the state income tax was 12 percent. My PhD dissertation was a macroeconomic history, looking at the 25 years after World War II and all the economic forces that were driving companies to move their business to the Carolinas, to Georgia, to Tennessee, to what became known as the Sun Belt. When I finished my dissertation, at age 25, thank God I was offered an opportunity to go to the Sun Belt. I took a faculty position at the University of Georgia, and I’ve spent the last 40 years in two great growth states, Georgia and Texas.

Our panel is going to look at state taxes and how some economies grow and why some are more successful. I’m going to start with Steve Moore, who is a member of the editorial board of The Wall Street Journal and a Senior Economics Writer. He’s the author of five books, including Bullish on Bush, How the Ownership Society is Making America Richer and Rich States, Poor States, which is a terrific read. So Steve, let’s start with you and talk about why are some states rich, why are some states poor, and what do their tax rates have to do with it.

Thank you. It’s a pleasure to be here, and it’s a thrill to be in the President’s presence. I remember in January of 2003, I and about five or six or seven other economists, Steve Forbes, Larry Kudlow, many others, went to visit President Bush in the White House. At that time, the President wanted a stimulus to the economy. He was seeking advice. President, you may remember, we came in, and we recommended — one of the recommendations was to eliminate the dividend tax. We made the case that the dividend tax is just a double tax on corporate income, and we should have a corporate income tax or a dividend tax, but we shouldn’t have both. The President embraced that idea. He came out with a proposal to eliminate the dividend tax. We didn’t get down to zero on the dividend tax, but we did get down to 15 percent, and we cut the capital gains rate to 15 percent. I think that was one of the great accomplishments of the Bush Administration, and if you want to see how tax policy affects behavior, look at what happened in the aftermath of that tax cut. 2003, ‘04, ‘05, ‘06 and ‘07 were four of the strongest economic growth years we’ve had in this country’s history.
The reason I mention it is that there’s all this talk now — Governor Christie mentioned the whole issue of the Buffett tax, which President Obama’s going to be talking about today. The left simply doesn’t believe that tax rates matter. They simply don’t think that taxes affect behavior. They also don’t think that taxes affect revenues, and one of the things I’d like to point you all to, and I wish the President and Tim Geithner and some of the other Obama economists were here, because on this tax issue, they just don’t have their tray tables in the upright and locked position. The point I would make to them is look at what happened in the aftermath of that tax cut. If you read The Wall Street Journal today, we have a piece on capital gains. The capital gains revenues doubled in the four years after we cut the tax rate from 20 to 15 percent. So a lower tax rate actually led to a doubling of the revenues. The same thing happened with dividends. So tax rates do matter.

To get to your question about states, look, if people don’t think that tax rates matter, then please, someone explain to me California. Somebody please explain California. California has every advantage a state could possibly have. It has the most beautiful mountains. It has Silicon Valley. It has beautiful beaches, beautiful women, anything that anyone could possibly want, and yet if you look at the performance of the California economy over the last ten years or so, it has been a catastrophe, a total catastrophe. I think things are going to get worse and worse for California. In fact, one of the reasons I’m not quite so bullish about the economy going forward is California, that traditionally has been a sale for the U.S. economy — every recession we’ve had for the last 30 years, it’s been California that’s led us out of the recession. Now California has become an anchor, and that’s, I believe, because of the very high tax and high regulation policies of that state.

By the way, California now in November will have a ballot initiative to raise the top tax rate to, I believe, 14 to 15 percent, so California will be the highest tax rate in the country, even higher than New York City. I think they hold that up as a badge of honor in California, but that’s going to ruin that state. I do this study every year with Art Laffer for ALEC where we grade the states on their economic policies. We’ve been doing this for about ten years, and we see very clearly than when states do the wrong things, like California is doing, you see the effect on economic output. You see the effect on migration. In fact, migration is just an amazing story, what’s happened in California. California is losing its wealth producers year after year after year. They’re going to states like Nevada. They’re going to states like Idaho. They’re going to states like Texas.

Then you have to ask how do you explain Texas. Texas is a state that, over the last 10 or 12 years, when President Bush was Governor and Governor Perry, Texas has had about 40 percent of all the net new jobs in the United States, an amazing performance. Forty percent of all new jobs over the last decade have been in one state, Texas. Why? Texas is a no income tax state. It’s a light-regulation state, and it is absolutely booming.

Now, you have other states — one of the last points I’ll make and then turn it over to the next speaker, is one of the things that I’m seeing, in looking at what’s happening in state tax activity right now, is that the blue states are getting bluer, and the red states are getting redder. Now, I’m from the state of Illinois. We have such a terrible Governor in Illinois that people want Blagojevich back. That’s how bad things are in my state of Illinois. We raised our income taxes by 67 percent in Illinois this year. We raised our corporate tax by over 50 percent. The corporate tax rate, the business tax rate in Illinois is now the highest in the Midwest and the third highest in the country. Mitch Daniels said it very well when he said that being a neighboring state to Illinois is like living next to the Simpsons. It’s true. Illinois’ economy is in an incredible rut.

So yes. Do taxes affect behavior? They certainly do. The exciting thing that I wanted to report, last point, is these red states — Bill Haslam’s here. I don’t see him in the audience, but here’s an example of a Governor who’s come in. He’s one of the nine states that has no income tax at all, but Tennessee is going to even grow faster over the next decade. Why? Because in the state of Tennessee, they’re eliminating their death and estate tax and gift tax. That will mean now
Tennessee won’t just be a good place to live and work, but it’ll also be a good place to die in as well. So that’s going to keep wealth in the state of Tennessee.

One exciting development: you’ve got three or four states right now that are looking at becoming the tenth no income tax state, and the race is on, so to speak. You’ve got Missouri. You’ve got Oklahoma. I don’t know if Governor Fallin is here, but she’s got a proposal to eliminate the state income tax there. You’ve got Kansas under Governor Brownback, who is moving a proposal to eliminate the state income tax there, and then my favorite state, North Dakota — I mean, North Dakota, which is booming now because of the oil and gas revolution, they have so much revenue in North Dakota. They could easily eliminate their income tax the way Alaska did.

So this is an exciting development. I think a lot of the Republican governors are getting it right. Some of the Democratic governors are getting it right too, but then you have these states like California, Illinois, New York, Oregon and so on that are raising their tax rates. I think that’s a development we ought to be paying really close attention to, because I think what you’re going to see, over the ensuing years, is, because of this dichotomy, the American people will be able to see, through these laboratories of the states, which states work and which don’t.

I see John Engler there. John, you turned around Michigan with your tax policies back in the 1990s. I think you had one of the fastest growths of employment of any state. So taxes do matter, and I wish the people in Washington understood that.

Dean Albert Niemi: You mentioned California and all of its advantages. Do you think, could it turn around? Could it come back? Could they change direction? They’re trying it in Ohio. Indiana made some changes recently. For the last ten years, at least one of my two children have lived in California. I love the place. I’ve had the occasion to go there a lot, and then you say, “They just keep fumbling the ball.” Is it, as Thomas Jefferson called it, the tyranny of the majority, and are the crazies in charge, and is California just dead in the water?

Stephen Moore: Oh, you can turn things around really quickly. California is getting close to a tipping point, where they have more takers than makers, so to speak, and that’s a big problem for California. But you put in a pro-growth Governor, and things can turn around so quickly. That’s why what’s happening in New Jersey under Chris Christie is so exciting. I mean, it doesn’t take a long time for these policies to turn things around. John, you’re the expert at that. When you took over as Governor in Michigan, Michigan was a basket case. That grew like crazy. Then they went back to the bad policies, and there was a regression. But yeah, I think states like California can boom. As you said, California has every possible advantage: Silicon Valley, the most educated workforce in the country and so on. It’s just a tragedy to see how that great state is being ruined by high taxes. By the way, California also passed a cap and trade bill that is also leading businesses to leave the state as well.

Dean Albert Niemi: Next I’m going to turn to my colleague on the right, Michael Cox. I’m changing my order a little bit, but Michael has done significant research on the comparison between why Texas is doing so well and why California is suffering. He runs the O’Neil Center for Global Markets and Freedom at the Cox School of Business, but prior to that, for years he was the Chief Economist at the Dallas Fed and Senior Vice-President at the Dallas Fed, and he joined my faculty fall of 2008. I’m glad he did. So Michael, tell us a little bit about California versus Texas.

Michael Cox: So the question is why are people leaving California and going to Texas. That’s the number one state of migration that’s occurring in America, that direction. We’re fortunate to have data from the IRS going back to the 1970s that documents all of the migration that’s been going on between states and coming into America from abroad as well. The states are a microcosm, of course, for what people want generally, not just as their state government but in their federal government.
So if you look at all the migration that’s going on, for the last five years, as a matter of record, from 2004 to 2009, it’s been the period of the largest single migration within our borders that we’ve ever had, as a matter of record. People are moving. They’re looking for the new, new world. They’re looking for a place they can go and have something that they’re not experiencing in the state that they left. So we decided to do a formal study on why people are moving, what’s causing this migration, and we took 15, 20 variables that people say are causing people to move, such as the court system, the unemployment rate of a state, the average income, the crime rate, whatever it is. We looked at it, said, “What is it? We’ll try it.”

It turned out that, of all these 15 to 20 variables that people tout as being important in state migration, there are six that explain two-thirds of the migration that’s going on amongst the states. Those six are the personal income tax rate, the highest personal income tax rate that that state has; the size of the government, how fast the government is growing. The first of those is a negative. The size of government growth is a negative. Also how unionized is the state, what percentage of the labor force in the private sector is unionized; quality of the public schools. Those are four policy variables. Two more matter as well, which are the average house price in the state and also the climate, which we can’t do anything about that. I won’t talk about that, but the main variable that’s the most quantitative significance is the individual income tax rate. It’s significant at the 99 percent level.

They way you do this, you do normal statistical tests, which economists have developed, called econometrics, hypothesis testing. You take all the 50 states that we have, their income tax rates, and you can take the District of Columbia as well. You take the migration data. You take the data on everything, and you say, “Okay, let’s look and see what the computer says in terms of what’s really driving migration.” As I said, what we find is that what’s driving migration is how high the income taxes are and how big the state budget is, but let’s just focus on income taxes here.

Texas is one of seven states that has no income taxes. California has a 10.6 percent highest marginal income tax rate at the time we did this study. Massachusetts had 12 percent; Hawaii 11 and so on. So you can easily look at this and say what states are people moving from and to on the basis of that. That’s exactly what you find. People are moving to the low income tax states from the high income tax states. They’re voting with their feet, so to speak. They’re telling politicians what they value and what they don’t value. They’re basically telling politicians, “For all your income taxes you charge us, we don’t see that we’re getting enough state benefits from that. It’s not something we value, what you’re doing with the state income tax.” And they say, “We’re leaving.”

I think many Americans would like to follow Ayn Rand’s path out the door in her book Atlas Shrugged, but they’re finding, of course, it’s expensive to leave the country. It’s not expensive to leave one state and move to another. So they’re telling us what they want and what they don’t want. So I invite you to take a look at our study, Looking for the New New World. It’s online under that title. We’ll send you a copy, and this is a car driving from west to east, from California to Texas. As Al was saying, we’ve added more jobs in Texas. From January 2000 to December 2011, Texas added more jobs than the entire rest of the nation combined.

**Dean Albert Niemi:** Michael, given that significant growth in Texas, and I think the number is about 52 percent of all the jobs created in the United States since January of 2000 are in Texas, so what’s the Achilles’ heel for Texas? What could go wrong in Texas? Can they keep it up?

**Michael Cox:** The Achilles’ heel, of course, would therefore be for the state to look around and find they need more tax revenue and to impose a personal income tax rate. That has become the signature of our state, not to have any personal tax rate. I personally think the thing we could do the most to — any state could do the most to add more residents to their state is to reform their public schools, and it wouldn’t even cost more. If you privatize the public schools, you make them responsible to — if you think about what makes America great, it’s not our public sector. It’s competition. Take your cell phone. In 1984, that cell phone was $4,200. It was the size of a brick, and the battery lasted a couple of hours, wouldn’t fit in your pocket, didn’t have any
texting capabilities or any camera on it. Today for $50, you can get a 3G phone that’s an iPhone with all those things and much more. What’s the difference between what has happened at the same time that that phone has gone from $4,200 to $50? The public school systems have gotten worse. What’s the difference between those two things? One is produced in the crucible of competition, and every day the people who work in that sector have to get up and make their phone better or else they lose their customers, lose their jobs. It’s not pretty, but you have to compete and get more productive in the dog-eat-dog jungle out there. That’s one.

The other one, in states like — New Jersey, Governor Christie was talking about it. There are classes in New Jersey where the state spending on the classroom is $450 per classroom in public schools. They’re just not effective, and they’re not producing a student that’s competitive at the worldwide level. We know our schools are broken. What’s the difference between what has happened at the same time that that phone has gone from $4,200 to $50? The public school systems have gotten worse. What’s the difference between those two things? One is produced in the crucible of competition, and every day the people who work in that sector have to get up and make their phone better or else they lose their customers, lose their jobs. It’s not pretty, but you have to compete and get more productive in the dog-eat-dog jungle out there. That’s one.

The other one, in states like — New Jersey, Governor Christie was talking about it. There are classes in New Jersey where the state spending on the classroom is $450 per classroom in public schools. They’re just not effective, and they’re not producing a student that’s competitive at the worldwide level. We know our schools are broken. What’s the difference between those two things? One is produced in the crucible of competition, and every day the people who work in that sector have to get up and make their phone better or else they lose their customers, lose their jobs. It’s not pretty, but you have to compete and get more productive in the dog-eat-dog jungle out there. That’s one.

Dean Albert Niemi: Travis, I’m coming to you. Travis Brown is a leading advocate for tax reform, serves as Chairman of the Missouri-based ballot initiative known as Let Voters Decide, a constitutional amendment to repeal the Show Me State’s income tax. His work is focused extensively on studying the great American migration of workers who are seeking jobs. So I’ll start off, Travis — Missouri has a fairly high state income tax. It’s neighbor Tennessee only taxes interest in dividend income. What’s the competition? What’s the field look like, Missouri and Tennessee?

Travis Brown: Well, it’s a pleasure to be here today, and it’s great to have this conversation, not only at leadership levels across government but also in the private sector, with a number of you in the business community. But we can really put definition around what Michael and Steve have already said about migration. Missouri is no different. We’re in the middle of the country, part of what The Wall Street Journal has affectionately referred to as the Heartland tax rebellion, because I think it’s time for voters to really wake up and shake loose their economy and understand what has worked and what has not.

Missouri provides a great comparison to the state of Tennessee. Fifty years ago, Tennessee inherited a no personal income tax position due to the state Supreme Court decision. As a result, back then they were economically inferior, fewer people, fewer people moving there and had a smaller state budget. Today the reverse is true. They have a larger state budget. They provide more services. To Michael’s point, they pay their teachers more. They start out making more. They stay in the system longer. They have more generous social service programs. So we know that, to Steve’s point earlier, that they’re not shortchanging revenue to pursue a smarter tax policy.

I think our founding fathers understood this concept very well, what made America great among the states and competition there. Ben Franklin, in 1765, in reference to the Stamp Act, said, “Idleness and pride tax with a heavier hand than kings and parliament, and if we can get rid of the former, we may easily bear the latter.” Missouri, in the middle of the country, is like many of those Heartland states. We are not idle people. We enjoy producing good product, working wherever we can work and be productive. What we have is a tax structure that has 11 tax brackets under $9,000 in wages. So I just learned today, if you’re taxed like a millionaire in New Jersey if it’s over $4,000 [sic], in Missouri, you’re taxed at the same rate as millionaires above $9,000 in wages. The result of that policy in the last ten years has been that we rank 48th in relative nominal GDP growth, and so we can and must do better. Our people’s culture is better than that, and you see this migration show up much the way that your medical imaging of your physician might show you with more clarity exactly what is happening to your body.

We can look at net adjusted gross income shifts of all these cases, not just California to Texas, Missouri and Tennessee. States that have the right tax policy, like Florida, for example, have seen $76 billion move to their state since 1994. States like California that have had the policies previously described have lost more than $30 billion. States like Missouri, in the middle, are neither ahead nor behind, but we’re struggling to move to the top of that tier status so that we want to be part of the 4 percent solution this conference is so focused on.
In order to do that, we must wake up our government, our government leadership and our people directly, and we see strong evidence in recent times in states, not just in the Midwest. Washington State under initiative 1098 had an opportunity to choose the California path. The poll on that ballot issue went from 28 points ahead to failing by 28 points once the business community and the citizens woke up.

Closer to home, we’d like to thank Governor Quinn in Illinois for keeping Missouri in the economic race, because as a border state, we have seen migration and the pressure, not just move to our state but to Wisconsin, to Indiana. Incidentally, since that one major policy move was made last January — it was really the only substantial decision made by the state budget — there’s been 18 jobs per hour move out of Illinois, when personal and corporate taxes were raised as the only solution to the state budget.

These consequences matter greatly. The numbers are astounding when you look at migration, and we must do better, and we know the solutions and what worked. It’s a pleasure to see Governor Haslam and others here talking about what has worked for their state, because we don’t have to wonder, and we cannot be, as Ben Franklin said, too proud not to recognize that there’s a better way to do business.

Dean Albert Niemi: What are the prospects for reform in Missouri? Is that going to be on the battle in the fall?

Travis Brown: We’re working at doing everything we can. We’ve got the same opponents that you would expect in every state. I know the governors in places like Kansas and Oklahoma are working hard as well in their state legislative arenas. Whether it’s now, today, tomorrow is a question, but we are going to do everything we can to put us in the race to zero, and we encourage and hope that all the leadership here can inspire your community, your state.

It’s not an accidental thing that Governor Christie spoke so eloquently about getting his financial house in order. I’ll leave you one statistic about New Jersey: 3.4 million taxpayers prior to Governor Christie’s arrival left New Jersey for one state, Florida. So these numbers are much larger than what many people are accustomed to hearing, because most people have just not spent the time studying it and looking at it.

Dean Albert Niemi: Thank you, Travis. Ike, I’m moving your way. Ike Brannon is Director of Economic Policy for the American Action Forum. He’s also a Director of the Prosperity Caucus, a monthly gathering of policy intellectuals in Washington, D.C. Much of your work is focused on how state capital gains taxes affect growth and job creation in particular, so let’s talk about the linkage between those, capital gains taxes and job growth.

Ike Brannon: Sure. One thing I’d just like to point out, that like Steve, I’m from the state of Illinois, and the one break that Illinois has on its tax code is that, in the state constitution, it says it has to be a proportional tax. I think if it weren’t for that provision, the top marginal tax rate on upper income earners and small businesses would be not 5 percent but 10, 12, 15 percent. So my seventh grade social studies teacher told me, “One day you’ll be thankful for that,” and I finally understand what he was talking about.

I did a study with Will Melick, who is at Kenyon College, and Eric Anderson, at University of Chicago, looking at what happens when states change their capital gains rates. What brought this up was that Governor Kasich, in Ohio, was talking about reducing the state’s capital gains taxes. He asked us to do some kind of study and see if we could figure out what this would do to jobs. The results are that it does impact jobs, but I have a stylized story that I think fits what’s going on and what the cost is of states that have heavy capital gains taxes.

So you think about who represents an angel investor in a state like Illinois, Indiana, Wisconsin, Ohio, places like that. They’re never going to get anybody who’s wealthy and made their money in California going from California to Ohio, another high tax state, or Indiana. Most of the people who are going to invest in Ohio are Ohioans. So take, for instance, somebody who retires
at 58, sells off a successful business for $30 or $40 million. What’s that person going to do? Well, the very first thing he’s going to be told to do, and he’s going to be willing to do without much protest, is get a house in Florida and live there 183 days a year and become a Florida resident.

So the real question is what do you do to get that person to remain in Ohio, both as a taxpayer but also as an investor. One thing we suggest is that if you reduce or eliminate the capital gains taxes in these states, these people are going to be much more likely to stay in the state. What we’ve seen, just by interviewing people in Ohio and Indiana, with these people, the angel investors, this 58- to 60-year-old, they want to invest in something they can get their hands on. They don’t want to move to California. They don’t want to move anywhere else. What they want to do is they want to stay in their state, and if you give them a tax reason to do so, they will stay in their state, and they will invest in their state.

I think in the ‘80s and ‘90s, a lot of states — I lived in Wisconsin in the 1990s, and one of the mistakes a lot of states made is, instead of trying to attract individuals, people who are likely to create jobs or invest jobs, they targeted money towards businesses. I think one of the mindsets we have to change, and I think Governor Kasich is doing a good job doing that, is attract people who are more likely to invest.

The results of our study, which is published on the American Action Forum website, is basically that Ohio, which went through — did a variant of this — basically if you’re an Ohio resident and you invest in an Ohio business that has a marketing capital of less than $4 billion — Procter & Gamble is the one that’s not included — basically you don’t have to pay capital gains taxes. That’s a long-term investment.

What Will Melick and I did is we got data from the National Bureau of Economic Research, and we looked at, over the last 40 years, what’s happened to various states that have not only eliminated a capital gains tax but have increased or decreased their capital gains tax. It turns out, in that 40 years, just looking at the 40 states that still have an income tax and capital gains tax, there’s been quite a bit of variation. The results are really indisputable that capital gains taxes have a very strong impact on job creation.

Dean Albert Niemi: Our friends at *Forbes* magazine do these annual rankings of business friendly states. In your analysis of tax structure at the state level, if you had to name your top five business-friendly states and maybe your bottom five — put me in that set. Not in rank order, but who gets it, and who doesn’t?

Ike Brannon: Obviously Texas gets it, I think. They’re pretty much open for business. I think everybody recognizes that. I think the other state that stands out is Indiana. I think Mitch Daniels has been very aggressive about doing precisely that, not necessarily targeting businesses but creating an environment that’s amenable to economic growth, and that’s very difficult, I think, to do politically, because it’s much more difficult to explain this to people, that that’s what you’re doing.

In Wisconsin, in the ’90s and the early 2000s, it was very easy for the Governor to say, “Look, I want to create jobs. I’m going to give $10 million to Harley-Davidson to keep these jobs in the state.” In fact, if you look at the industrial policy of Wisconsin in that 15-year period, that’s basically what it did. It involved giving tax breaks and direct grants to the biggest employers of the state. We all know the history of economics is the big employers of the state usually don’t remain the big employers, right? We’re not good at identifying the small businesses, and then the third state I’d just like to point out is — I think Governor Kasich has done a fantastic job trying to make the state more friendly to businesses and investors. I think he’s got the foresight to recognize that this is a long-term proposition, and he’s willing to take some short-term unpopularity to get the right answer.

Stephen Moore: By the way, as you know, in our state of Illinois, because the tax rates are so high right now, what Governor Quinn is doing is giving tax giveaways to Sears, to Motorola, to the Chicago
Mercantile Exchange. Every big industry is now getting relief from the tax increase, so the only companies that are paying it are the small- and medium-sized businesses.

Ike Brannon: Well, Steve, Sears is the big, growing business.

Stephen Moore: Exactly.

Dean Albert Niemi: In my course this past fall, I worked closely with the Dallas Chamber trying to recruit industry from all of your states to Texas, and there are two states that our Chamber has targeted: California and Illinois. I did one lecture on state competition, because I’ve been studying this for more than 40 years, and I’ve never seen such a small group of winners. There are about 11 or 12 states that are really doing well, and there are 36, 37, 38 states that are really suffering. And the winners and losers, that gap is widening and widening rapidly. So I shared with my students these one-page comparative sheets: Texas, the advantages versus Illinois; Texas and California. This is a death struggle. They’re going for the jugular against California and Illinois and trying to migrate and targeting.

I get calls all the time. “Do you know the CEO of such-and-such company in California [or Illinois]? We’d like an introduction.” Then they go call him, and they are targeting companies they think would prosper in Texas.

Diana, coming your way. Diana Furchtgott-Roth is a Senior Fellow at the Manhattan Institute. She’s a Contributing Editor of RealClearMarkets.com and a Monthly Columnist for Tax Notes. She’s published numerous articles, but what I found intriguing, you have two books coming out this year: *Women’s Figures: An Illustrated Guide to the Economics of Women in America* and *Regulating to Disaster: How Green Job Policies Are Poisoning America’s Economy.* You’ve recently completed a study on revenues collected through the capital gains tax, on the impact on municipal budgets. Could you share some of the findings in your research?

Diana Furchtgott-Roth: Yes, yes. I’d first like to say how refreshing it was to hear President Bush, again, talk about the advantages of low tax rates, and I was very honored to be Chief of Staff of the Council of Economic Advisors in the White House during the 2001 efforts to lower taxes, which we succeeded in doing by great persuasion. Senator Jeffords was persuaded not to change parties until he had voted for the tax cut, and I’m glad that they are called the Bush tax cuts.

So I was looking at capital gains revenues in different cities. In fact, I was asked to look at it in different municipalities, and one of the things that struck me was the big increase in capital gains tax rates and in tax rates on capital that’s going to occur on January 1 at the federal level. It’s goodbye to the Bush tax cuts. Taxes on long-term capital gains for upper-income individuals will go up from 15 to 25 percent, not just because of the expiring of the Bush tax cuts but also because of the new Medicare tax. Taxes on dividends are going to go from 15 percent to the upper level of around 45 percent.

So all of you might say, “Well, what does this have to do with states?” Here, this is a panel on states, but we find that when taxes go up at the federal level on capital, people realize fewer amounts of capital gains. They wait. They hold off. Companies don’t issue dividends as much. So states that are actually getting money from capital gains, and cities that are doing so, find that they have less revenue in their coffers. So to make up for it, they have to raise taxes in other ways.

Now, it’s interesting that we’re here in New York City. I looked at three cities: New York City, Indianapolis and Baltimore. They all raise some revenues from capital gains taxes, and the last year available, 2010, New York had about $1 billion from taxes on capital gains. This funded the Head Start program and daycare, or a billion funded pupil transportation in the schools. It funded charter and contract schools and foster care, and raising capital gains taxes, I can assure you, in New York City people are not going to realize capital gains in the same amount. Everybody is going to see other forms of taxes go up.
Now, this isn’t just in New York City. If we look at Indianapolis, for example, Indianapolis had about $16 million from capital gains taxes, taxes on capital in 2009, and that funded the Department of Metropolitan Police and operating lease payments and administration. You can go through these city budgets, and of course, capital gains taxes didn’t fund directly, because all funds are, we can say, fungible, but this is the approximate amount in these different budget line items.

Now, Baltimore had about $28 million from taxes on capital last year. This $28 million line item was about the equivalent of the Department of Health. It was also the equivalent of the Department of Recreation and Parks, and it was also equivalent to the Department of Housing and Urban Development.

So what we are seeing with these tax hikes coming up — and many of us in the economics world call it a fiscal cliff, because we’re going to go over it on January 1st, and Congress is not even devoting any time, A, to talking about it, and B, to talking about its effects, and C, talking about how to offset it. One would think that with a responsible Congress they would see this is coming. We’ve got to do something about it. It’s not just affecting us. It’s affecting states all over the country because of the interaction between the federal and state tax code, but no, we have no discussion about it at all. I think it’s up to all of us who write articles and who gives speeches to talk about this and say to our congressmen, “Hey, what are you doing? You’re not just going to affect all of us here. We’re going to be affecting different state budgets.” Many states are not fortunate to have governors such as Governor Fallin and Governor Haslam, and they are going to have governors who are not going to take a hard line on raising taxes. Those taxes are going to go up at the state level, and it’s going to be a great detriment.

Dean Albert Niemi: Thank you. E. J., I’m coming to you. E. J. McMahon is a Senior Fellow at the Manhattan Institute. His articles have been in The Wall Street Journey, New York Times, Barrons, The Public Interest and many others. Much of your work, E. J., is focused on the state of New York. We’re all New Yorkers. We all love New York City. It’s where many people embark on their start in America, the immigrants, most pass through New York. Those who aren’t lucky enough to ever come to the United States probably view us under the microscope of New York. So tell us about your research on New York, kind of the good and the bad. What have you found, and what are the prospects for the future?

E. J. McMahon: Well, what people love about New York or what you find appealing about the city when you visit New York, if you live elsewhere, is a legacy of the tremendous wealth generated in New York and of New York’s status as a financial capitol, as a culture capitol, as a media capitol. As Mr. Glassman said in his introduction, we’re the white-hot center of business and commerce, a center of innovation, of competition, of global trade. All these things are what make New York great, what make it appealing to the people who give it its dynamism, that is the immigrants from overseas and migrants from elsewhere in the country who come here to get their starts here.

New York, also, the story of New York and tax policy and the economy of New York actually teaches some very interesting lessons and even a few contradictions about the impact of tax competition and how it is felt and the nature of the impacts of tax competition.

Let’s go into a little history. In the late 1950s, a lot of this begins, as everything in New York does, we begin at year one all over again with the election of Nelson Rockefeller as Governor. 1959, New York State had a 7 percent income tax rate, no sales tax, a corporate tax, a bank tax and some other stuff. The City of New York, at that point and through the early ’60s, was funding itself off of a combination of property, utilities taxes, gross receipts taxes and a mess of nuisance taxes and a Depression Era sales tax, in other words, like a lot of other big cities.

Go through the 1960s and arrive in the early ‘70s. What happened in that period was the nation’s biggest experiment in seeing just how far you could go with an anti-growth tax policy. There’s never been anything like it, before or since. It really is remarkable if you look at it. By the early 1960s, New York State’s income tax rate was over 15 percent. New York City had a tax rate of over 4 percent, and the combined income tax rate in New York State and New York
City approached 20 percent. The city had its own corporate income tax, not just a gross receipts tax. The city had a bigger sales tax. The city had invented an unincorporated business tax, affecting all business partnerships and partnership income in the city.

What happened in New York City between 1969 and 1975 was the city lost 600,000 private sector jobs, 600,000 private sector jobs in five years. During the decade of the ’70s, the city lost 800,000 residents, and the city had a near-death experience. What happened was, there was a collective understanding of what had produced that, and there was a bipartisan agreement that changes had to be made. What happened was the city and the state began to embark on an era of pro-growth tax policy, which, as luck would have it, and also some political design, coincided exactly with the pro-growth tax policies of the Reagan era on the federal level. And so no city benefitted more from pro-growth tax policies, starting in the early ‘80s, than New York City, no state did than New York State.

I should point out, by the way, that during the era when New York City and New York State were increasing their income taxes — I think your neighbors and the proximity of your competition is important, which is relevant to the Illinois example now. New Jersey and Connecticut, at that time, had no income tax. So New York State was doing all of that at a time when its immediate neighbors, right nearby, had no income taxes and much lower taxes.

So in the 1980s, late ’70s, actually, under a Democratic Governor, Hugh Carey, working with a Republican State Senate majority, the state embarked on what ended up being a 17-year, almost unbroken, with one exception, series of tax cuts. The state’s tax rate was cut in half. The city’s taxes began to stabilize and then be reduced most significantly under Mayor Giuliani in the 1990s, who was the first mayor of New York in New York’s modern history and so far, actually, the only one to make an absolute policy priority out of reducing taxes. In the late ‘90s under Mayor Giuliani, the city cut taxes by about $3 billion. The city gained over 300,000 jobs, and a tax model we developed indicated that around 80,000 of those jobs could be attributed directly to tax cuts.

So let’s bring ourselves to the present. We go through the end of the ‘90s, and the tax cutting progress stops on September 11, 2001, which created an immediate fiscal problem for the city. The lasting economic impact of that event was less than had been fear, but that was pretty much the end of concerted efforts to reduce taxes on the city and state level. We benefitted one more time from what the President urged us not to keep calling the Bush tax cut in the early 2000s and especially in 2003 with its acceleration. The city and state did very significant temporary income tax increases, which took effect the same day as the acceleration of the Bush tax cuts, and whose negative impact were overwhelmed by the positive impacts of that tax cut. So we’ve benefitted from pro-growth tax policies.

Where are we now? We’re the most heavily taxed big city in the country. The state has just extended an extra-high tax on its own version of a millionaire tax, which this time it does indeed apply only to million-dollar income, starting this year. The city and the state have begun to turn back in the other direction, and so I think we’re at great risk from federal policy.

To close and mention an aspect of what Diana talked about, our tax base is shared with the federal government. Like most states with an income tax, our definition of income is what the federal government taxes, and we’re subject to changes in how much income is reported when people respond to the impact of federal tax changes. If all of the Bush tax cuts expired and some of the other changes the President has proposed are made, we’ve estimated that the state will lose over $400 million in revenue, due to the impact on the state’s tax base. The city could lose almost a quarter as much. Those are rough estimates we made four years ago. I think that, given changes since then, we probably ended up pretty much back in the same place.

So we are very much susceptible to the impact of federal tax changes, and one other aspect that, perhaps, we can discuss is the impact of changes to the way the federal government taxes or treats state and local taxes. The federal government has subsidized high state and local taxes by making them deductible. When we had a combined income tax rate in New York City of over
19 percent in the late ’70s, over 15 percent at the state level, it was deductible under federal income tax at 70 percent. That meant the net tax price of New York for somebody at the margin, compared to say Florida, was 4½ percent, roughly. Roughly 30 years later, before we did our latest round of tax increases, our permanent tax rate’s net cost to somebody, under the current tax code on the federal level, is, once again, about 4½ percent.

If we curtail deductibility in the way the President has proposed or if, for instance, under a pro-growth tax regime such as the one proposed by Congressman Ryan, it’s decided that base broadening should include the elimination of the federal and state deduction, that’s going to be a challenge to high-tax venues like New York, because you’re suddenly going to not have the federal government subsidizing, to an extent, your anti-competitive tax policies.

Dean Albert Niemi: E. J., could you talk a little bit about the rest of the great state of New York? Several years ago, I chaired the team that reaccredited the Business School at Syracuse University. I was there for three days. It’s not a pretty sight what’s happened to Syracuse. I have a dear friend, who is doing my job at the University of Rochester Simon School of Business. It’s not a pretty sight what’s happening in Rochester. I haven’t been in Buffalo recently, but I think the same thing is true there. What’s going on Upstate? I was in Boston last week, and Boston’s still doing fine, but they’re shutting down the rest of Massachusetts. So what’s going on with these second-tier cities?

E. J. McMahon: Well, Upstate New York used to be, actually, a place that was richer than average, that on its own would have been among the most prosperous states in the Union. I think people will tell you now that one of the things Upstate New York suffers from is being more a curse than blessing, in terms of policy, of being in the same state with New York City, because the politics of New York State and thus the policies of New York State are dominating, more than ever, by Downstate elected officials.

Upstate has suffered from a number of factors that might be called sort of, what they say secular, in the sense that Kodak is not going bankrupt because of New York State’s tax policies. The problem is, though, that because the Upstate cities, that have lost their old manufacturing businesses, are stuck with the tax policies of New York State and the regulatory policies of New York State. They are more vulnerable to the damage done by anti-growth tax policies.

New York City is so enormous and so wealthy that it’s possible for a large number of people to spend years of denial about it, not noticing the impact the policies have, about the growth that’s not occurring as a result of tax policy. Upstate New York is more vulnerable to the damaging effects of state tax policies and high marginal tax rates. Right now, the story of Upstate is one of stagnation. Upstate did not have a high unemployment rate before or after the recession for the simple reason that there were not a lot of people hanging around Upstate New York looking for jobs. Upstate didn’t have a real estate bubble, because there were not a lot of people clamoring to buy houses in Upstate New York.

Upstate New York has a lot of natural advantages. There’s a lot of good things about the cities in Upstate New York, Syracuse, Rochester, Buffalo, that people who are familiar with them can tell you about. They have their own legacies of the era when they were richer and more dominant economically, but right now they suffer from a deep-seated stagnation that’s made worse by state policies.

I’ll give you, in closing, just one example. The wealthiest and most successful entrepreneur produced by Upstate New York since George Eastman was a guy some people in the audience may know, named Tom Golisano. Tom Golisano is a billionaire who started the company called Paychex. He did it by basically tripling out his own credit cards and borrowing money from relatives in the late 1960s. So he’s a billionaire. He built this massive, successful, wonderful company, growing out of Rochester. He’s a huge philanthropist. He dabbles in owning sports teams, et cetera. He also dabbled in politics unsuccessfully. He announced, after the last state tax increase in 2009 — he did something that almost no one has ever done in New York, among those who are pushed out by taxes. Generally people don’t leave a note. They just leave, or they
do the bad date thing, and they say, “It’s not you; it’s me. I’m going.” Tom Golisano held a press conference and said, “That’s it. This is the final straw. This will cost me $30,000 a day,” or some huge amount. “I’m going. I’m moving to Florida.”

Now, you might think that might have some impact on the New York debate. I spent an inordinate amount of time on TV and on the radio and in public sessions with people, debating New York’s tax policy. Perhaps you will or won’t be surprised that when one mentions that the wealthiest, most successful billionaire produced by Upstate New York in the last half century is leaving because of high taxes, they say, “Well, he doesn’t count.” But he is an indication of the problem.

Diana Furchtgott-Roth: If I could just say, the Upstate New York problem is soluble. If you just look across the border at Pennsylvania, if you look at the Marcellus Shale, all New York has to do is decide that they’re going to allow hydrofracturing. They could be having the boom that Pennsylvania is having right now. They have the same shale under Upstate New York as Pennsylvania has. They could be copying the development and the employment that’s going on over the border.

Dean Albert Niemi: Unfortunately, that doesn’t seem to be happening.

Diana Furchtgott-Roth: About a year and a half ago, we, in the Cox School, in conjunction with the Bush Institute, did a day-long conference called America: Natural Gas Nation, and we had Governor Ed Rendell, who was in the waning days of his governorship in Pennsylvania, on one panel with the Assistant Attorney General from the great state of New York. Two different worlds. Governor Rendell was reveling in the fact that they had leased over 450 drilling rights, and I think it was up to 12 in New York — and to hear the attitude toward fracking and taking advantage of these opportunities. Then we had several of the drilling companies on this panel come up next and talk about why they chose to locate in Pennsylvania and then use these horizontal drills and suck that gas out of New York.

It was pretty interesting when you saw the taxes working and the incentives working. These are pretty smart folks, and it hasn’t happened yet. It could. We see what’s happening in North Dakota. Would any one of the panel, before I go to Q and A, want to comment on anything else that any one of the other speakers has said?

Stephen Moore: I just wanted to mention one thing. I don’t think, Michael, you’ve touched on it. You may have. We also, Laffer and I, have done studies, as you have, on this issue of what causes migration from one state to another, and our findings are very similar to yours. The one thing we found was the most powerful actor by far was right-to-work. Right-to-work states significantly outperform non-right-to-work states. That’s important, because Indiana is the first state in a long time, under Mitch Daniels, that just became a right-to-work state.

The states like New York that refuse to be right-to-work simply take themselves off the map. That is to say, even if they got all the other policies right, CEOs of companies, the people who determine where they’re going to place a plant or a facility, they won’t even consider a state that isn’t right-to-work. So I would just add that as a really important component to why some states are working and why others are failing.

Dean Albert Niemi: Steve, if I could add a footnote to that, in the last — if you go back to 1982, so the last 30 years, you look at auto assembly plants, either closed down or newly built, there are 22 new auto assembly plants. Twenty-one out of the 22 were built in right-to-work states. There have been 17 auto plants closed by American auto producers, and 16 out of the 17 were in highly unionized states. I worked that into my course in the story of labor unions and how they create jobs and kill jobs. If you look at the American automobile industry — people see Detroit crumbling. They think we’re losing the automobile industry. Ask the folks in Alabama and South Carolina and Tennessee if the auto industry is alive and well, because the auto industry has moved to the
Sun Belt. It’s run by BMW and Mercedes Benz and Honda and Nissan and other providers of automobiles, but it was the unions that did that. Anybody else?

Michael Cox: I just want to make one comment. We need to go to Q and A, but what we’re talking about here is income taxes. Really what a tax is is something in general that enables one group to consume without producing, to live at the expense of others. Unions are a form of that. They’re definitely a tax on working, but Al, as you’ve pointed out to me many a time, the biggest single tax increase ever foisted upon American employers is Obamacare. It costs American companies more to hire workers today. The increase in the cost of an employee today is far greater than any tax that’s ever been imposed on America.

Dean Albert Niemi: Don’t get me started on that.

Diane Furchtgott-Roth: If you’re calling it a tax, which it really is, it plays into the administration’s hand, because now they’re trying to argue it’s a tax so they’re allowed to do it. Before they argued it was a penalty and it wasn’t a tax.

Dean Albert Niemi: There’s a little company based in Santa Barbara, California called CKE. I’ve gotten to know those folks pretty well, because the CEO’s son is a junior in the Cox School of Business. They had great plans to expand. You don’t know CKE, but it’s a parent of six concept restaurants. The most visible one is Carl’s Jr. Well, the big expansion plans in 2012 to 2014 were going to be to build hundreds of Carl’s Jr. restaurants in Texas, create thousands of new jobs. The cost of Obamacare — because they only provided health insurance to full-time employees, the annual cost of healthcare for CKE was $10 million. Under Obamacare, that rose to $28 million. It almost tripled. They scuttled the plans for those hundreds of new restaurants, and we lost thousands of new jobs that never got off the drawing board. That’s just a small company, but my friends at AT&T in Dallas said the annual cost of their healthcare went up over a billion dollars a year. Those are job killers.

Let’s throw it open to the audience. It’s hard. The lights are on us, but I see a question back here.

Richard Vedder: Richard Vedder from Ohio University.

Dean Albert Niemi: A voice from the past.

Richard Vedder: Oh, yeah. Al and I are both economic historians who went on to make a real living. I want to agree with both Steve and Michael with regards to the right-to-work/individual income tax point. It’s roughly true, and Steve may differ slightly, give slightly different numbers. Roughly 5 million people, between 2000 and 2010 moved from the non-right-to-work states to the right-to-work states. It’s also true, though, that 5 million people moved from the non-income tax states to the income tax states. So I think in the statistical analyses that you do on this, and I do my share as well — I was doing them before Steve was born. I think you will find that both factors are approximately equal in importance.

Michael Cox: That is, in fact, what we found out. If you look at the statistical significance of these two variables and their quantitative significance, the income tax rate and the percentage of the state’s private sector labor force that’s unionized, they’re almost identical in those terms. America is doing some things today that are very un-American historically, and certainly states that aren’t right-to-work states are doing very un-American things. But the income tax thing is a very un-American one too. The idea that people have the right to live at the expense of others is a very un-American idea. That wasn’t the way this nation was formed, and it will be our destruction. We’re not that far behind Greece on the road to serfdom.

Steve Moore: By the way, Rich, I was thinking about you the other day, because you’ve done all the seminal work on this, migration patterns. I was in North Dakota a couple of weeks ago. You want to see migration patterns? Even the strippers from California are moving to North Dakota because they can make more money in North Dakota now than California.
Dean Albert Niemi: Maybe we should do the next conference in North Dakota.

Male: How do you know that?

Mark Skousen: Mark Skousen, editor of Forecasts and Strategies. I’d like some of you to address the issue that Amity Shlaes raised in her editorial today in The Wall Street Journal, and that is there are exceptions. There are some states that have raised taxes, and she uses the example of Massachusetts — I think of Utah. There’s a number of states that have raised taxes but are booming anyway. Clinton raised taxes in ’93, and the economy boomed. This is the major argument that they make for this. How do you respond to this criticism?

Steve Moore: Well, let me just say one — it’s an important question. I don’t want to dominate this, but it’s an important question, because, Mark, this is exactly the point that the Obama Administration is making about tax rates federally. They’re basically saying, “Look, we can go to —” There was a study out by this Nobel Prize winning economist Diamond who says, “We could have a 75 percent individual income tax rate. It wouldn’t hurt the economy,” which is utter nonsense. What they’re doing is saying, “Well, look, in the ‘50s and ‘60s, we had higher tax rates, and the economy did fine.”

I think the way the world is so much different now than it was 50 years ago is with the click on your computer you can move billions of dollars out of the United State to France or Germany or somewhere else. I think you can learn a lot of the wrong lessons from some of these studies that are coming out right now that say you can have a 60 or 70 or 80 percent tax rate and it’s not going to affect behavior.

I think the major effect isn’t even — we’ve been talking about people moving, but I think on the federal level, the real impact of taxes is capital. Capital is just going to move from one place to another, just like it moved to Ireland when Ireland cut their corporate tax rate. So if we have the highest — by the way, think about this. If we do the Buffett tax, we will have not only the highest corporate tax rate in the world, which, as you all know, on April 1st, we became the highest corporate tax rate country in the world, we’ll have the third highest capital gains tax in the country. How in the world are we going to compete with a system like that?

Dean Albert Niemi: Michael?

Michael Cox: And also, there is a bit of a lag from the time that you raise the tax rate till you start losing your people. People don’t quit their job overnight, Mark. You know that. They will migrate, plus Texas, we’ll just put that on our list of states to go after.

Dean Albert Niemi: One comment I’d like to make is Germany’s a great example of how changes in taxes can really rejuvenate an economy. We talked about if California could come back. They had a 57 percent corporate tax rate, the highest in the world. Mercedes Benz and BMW were losing market share terrifically, because their cars were overpriced, because of the corporate tax structure. BMW has now replaced Lexus as the bestselling luxury automobile in the United States market. They reduced their corporate tax rate down to 30 percent, and it really helped save the German auto industry. It’s a great example. I use it with my students. Taxes do matter. Michael’s right. It doesn’t happen the first year. It doesn’t happen the second year. It might take five to seven years, but over time, there’s no argument that high taxes are job killers. Anybody else on the panel?

Diana Furchtgott-Roth: We also don’t know what economic growth would have been in the absence of the increased taxes during the Clinton Administration. It could have been a lot higher than it was.

Dean Albert Niemi: Right. That’s a good point, Diane.

Male: Someone comment on Bloomberg, because he doubled the real estate taxes in New York City, and the economy boomed anyway.
E. J. McMahon: Well, he increased them. He didn’t double them. He implemented the biggest tax increase in about 35 years. It was a 20 percent tax increase early on. New York City has a very strange tax system. In isolation it’s a state tax. It’s basically a state tax system with an enormous property tax on top of it, not counting the New York State taxes. New York City has the largest concentration of wealth in the United States. It’s almost all concentrated below 96th Street in Manhattan, and the city basically strip mines that. It does it through corporate taxes. It does it through corporate and personal income taxes. That’s what it does. It basically puts the pipe in the ground, and stuff gushes out. It strips mines through income taxes, corporate and personal.

The property tax in New York is incredibly Byzantine and arcane. It’s got four classes, and it’s designed, basically, to extract wealth from commercial property in Manhattan. Now, it’s unfortunate if you’re not in Manhattan and have a commercial property in Queens. You too get hit by a very high tax rate. Single-family homes in New York City, the homes, say, in Staten Island or single-family homes in Queens, they are the lowest taxed single-family homes in the northeastern United States, because the city has skewed its tax code that way.

So Bloomberg had one big increase in the property tax. He has not had other significant tax increases except for a very significant temporary income tax increase, between ’03 and ’05, which hit, as I said, precisely the same time as the income tax cut on the federal level. But the mayor has basically been in operation of maintaining the status quo and not having it get worse, with that notable exception of that property tax, having followed Giuliani, who was, again, the lone mayor to really make a primary policy objective of reducing the cities taxes.

What will follow now, I fear, will be a return to the old days, which will be, notwithstanding the headline of Amity’s piece in The Wall Street Journal the other day — the focus of tax policy in the city will return to fairness, as defined in various politically convenient ways, as opposed to competition, because it’s too easy for politicians in New York to look around and decide and declare that we’ve won the competition; nobody can compete with us. That’s a delusion, but it’s an understandable one to an extent, and it feeds the problem.

Dean Albert Niemi: I’d like to ask the last question of my distinguished panel. Do you really think the Bush tax cuts will expire at the end of this year? I serve as one of 36 economists on the Associated Press Board of Economists. We recently polled ourselves, and I’ll give you the result at the end, but do you think the Bush tax cuts are going to expire? Each of you has about 20 seconds, and then we’ll finish right on time. So Steve, what do you —

Stephen Moore: That’s what this election’s going to be all about. This is going to be the number one issue, about whether Americans want those tax rates to go up, and so I don’t know the answer to that. We’ll know on November 4th.

Ike Brannon: I think if President Obama wins, he’s going to be in the catbird seat. He can demand whatever he wants, and I think he’d be just fine if everything expired.

Dean Albert Niemi: Travis.

Travis Brown: Ideas and elections have consequences, and they’re exactly right. This is going to be an important moment in our country’s history. I sure hope that they don’t.

Dean Albert Niemi: Michael, I know your answer.

Michael Cox: No, because I believe that the House and the Senate will both be in the hands of the Republicans.

Stephen Moore: Yeah, but you know what? Taxes go up. Obama won’t need a vote in the Congress, right? These will go up automatically.

Michael Cox: They’ll deal with it.
Stephen Moore: You think they will?

Michael Cox: Yes, I think so.

Diana Furchtgott-Roth: I think it will probably be decided in a lame duck session in December, just as it was a year and a half ago. These congressmen do not want to run on a platform of letting these taxes go up, and besides President Obama doesn’t want them to go up for lower-income individuals. So they’ll come to some agreement before.

Dean Albert Niemi: E. J.?

E. J. McMahon: I don’t think they will either, that they’ll be totally repealed either or even repealed in part, but I think that, more likely, there will be, either through compromise or through Republican control of all arms of government, structural changes to the tax code and to the budget that will pose a really significant challenge to states like New York. That will heighten the importance of tax competition amongst states and localities.

Dean Albert Niemi: Well, I’ll apologize to President Bush, but the consensus of the Associated Press Board of Economists, and I have to use the name, President, that the Bush tax cuts will not expire at the end of this year. That was our consensus. Thank you for being such a great audience. Thank you, panel.

Honorable James Glassman: Thank you. It was a great panel. Thank you, panel. I do want to note that Michael Cox talked about education and the importance of education spending. It’s one of the things that we’re doing at the Bush Institute with our School Productivity Project, trying to find ways to provide higher student achievement at lower costs.

Our next panel is the panel of governors, and if they would please come up. Governors and one deputy mayor. I don’t know, Mr. Deputy Mayor, whether you heard the question about New York City but —

Honorable Robert Steel: Sure did.

Honorable James Glassman: You did. Good. I want to introduce my very good friend, for more than 30 years, Larry Kudlow. Larry is the host of The Kudlow Report on CNBC and, in a distinguished career, has also served as a budget official under President Reagan. I once did a column about Larry, where I called him the most optimistic man in America, which I think he proves every night on CNBC. Larry Kudlow, you have the governor’s panel.

Larry Kudlow: Thank you very much, Jim Glassman. I appreciate it. Are we all hooked in? We all doing good? All right. Sound on. I’m Larry Kudlow from CNBC. It’s a great pleasure to be here. So we’re going to talk about tax reform, tax competition and economic growth among the distinguished governors and the Deputy Mayor. We’ve heard already, I think, from the prior panel and from Governor Christie that low-tax states grow faster than high-tax states. I would regard that as so bloody obvious, but I guess in this day and age you have to spell it out with a lot of PhDs. God bless them all. And leading Republican governors are showing us the way, and we heard a brilliant speech from Governor Christie. So now we’re going to fill in the blanks.

I have Governor Paul LePage of Maine, Governor Mary Fallin of Oklahoma, Governor Bill Haslam of Tennessee and my old friend Robert Steel, who’s the Deputy Mayor of New York City, who’s going to tell us what that’s like also.

What I’d like to do, if you would, is just a little bit of show and tell, because you’re all doing some great things. You’re all doing some very important leadership things. I guess I’ll just start
in the corner. Governor LePage, if you would begin, describe briefly for the group, and for me, your tax reform in the great state of Maine.

Honorable Paul LePage: Our tax reform bill was basically about a $400 million tax cut last year. We took the lowest tax rate for the poor, which is basically the 2 percent rate, and we reduced the 8-½ rate down to 7.9 to show, somewhat symbolic, but it was really telling Maine people that we were going to lower taxes. Then we went in and lowered taxes on our businesses. We initiated new tax credits, made some major reforms on the spending side to pay for it. In our pension reform, we reformed our pension. We had a $4.5 billion shortfall, and we cut that down about 45 percent. We did a new healthcare package so that we can go to free-market healthcare that could compete against Obamacare.

Honorable Bill Haslam: Free-market healthcare? You mean letting consumers choose?

Honorable Paul LePage: Letting consumers choose. Can you believe it?

Honorable Bill Haslam: Does President Obama know that? Has he weighed in on that?

Honorable Paul LePage: Not yet.

Larry Kudlow: I hope he’s nicer to you than he is to my friend Paul Ryan, who is going to be a speaker here later on.

Honorable Paul LePage: Basically we took some taxes off certain types of aircraft maintenance parts and repairs, off fuel. We took taxes off fuel for the fishing industry, and this year we’re trying to get the forest industry into the — we’ve consolidated conservation and agriculture, and now we’re trying to give them the same tax breaks that the agricultural industry has.

Honorable Mary Fallin: Absolutely. Coming off the national recession we just had, started in 2008, Oklahoma, like many other states, faced budget shortfalls. A couple of years, we had a billion-dollar shortfall, and our budget’s annually about $6.7 billion, so a billion dollars, quite a bit of a shortfall. When I took office, we had a $500 million gap in our budget, and of course I wanted to talk about reducing taxes so we could create jobs, create a more competitive business environment in our state. Everybody said, “Well, you can’t do that. You’ve got a $500 million budget shortfall in your state. You’ve had several billion dollars of shortfalls previous years.” But we did that. We prioritized our spending in the state of Oklahoma, focusing on education, public safety, corrections, transportation, health and human services. We balanced our budget. We cut a $500 million budget gap, and we reduced our spending anywhere from 1 to 9 percent. We actually cut spending in the state of Oklahoma.

Larry Kudlow: Baseline, right out of the baseline.

Honorable Mary Fallin: Absolutely, and we did decrease our income tax by a quarter percent. So this year I came back, and I said, “Okay, it’s my second year in office. We’re going to do major restructuring of our tax system in our state.” What we propose to do is let people keep more of their hard-earned money. New concept, but we believe in that in our state. So this year I proposed taking our 5.25 percent income tax top rate down to 0 for those couples that make $0 to $30,000. They pay no
income tax at all, helping the working poor, helping the poor in our state, and from the level of $30,000 to $70,000, a 2.25 percent, down from 5.25, and then $70,000 and above, a 3.5 percent. We’re going to pay for that by eliminating our carve-outs, our loopholes, almost a billion dollars, taking away exemptions, special interest deals that people have got over the years at the state capitol and basically almost cutting our income tax in half, from 5.25 down to 3.5.

Of course people said, “Well, you’re going to hurt the poor. You’re going to have to kick all the seniors out of the nursing homes. You can’t fund schools. You aren’t going to be able to fund public safety,” all those various things that they’ve said. Actually they’ve said that in all the states that are trying to cut their income tax. Amazing.

Larry Kudlow: Actually they say it every time somebody tries to lower marginal tax rates.

Honorable Mary Fallin: Isn’t that the truth?

Larry Kudlow: The opponents always say that.

Honorable Mary Fallin: In every single state.

Larry Kudlow: Doom and gloom. It’s remarkable, and they say it at the federal government also. It’s being said right now regarding Paul Ryan’s tax reform, that everything is going to get shutdown, including the Washington Monument. Why is that? What’s behind that? If you’re cutting spending and you’re cutting spending while you’re lowering the income tax rate, obviously you’re preserving the essential services of state government. Why is it that the liberal opponents always take this line of reasoning?

Honorable Mary Fallin: Well, here’s what I come back to them on. Back many years ago, when Governor Keating was in office, Governor Frank Keating, we cut our income tax significantly, and we had a growth trigger in there that, if our economy grew to a certain level, we’d cut our income tax a quarter percent. So we actually started out, over a decade ago, at 7 percent income tax. Now when I took office, we were down to 5.5 percent. I cut another quarter percent. Now I’m hoping to reduce it on down to 3.5 percent, but guess what happened over the last decade, since we cut our income tax from 7 percent to the 5.25 that we’re at right now? The sky didn’t fall. Chicken Little didn’t happen.

In fact, we’ve still been experiencing, in Oklahoma, double-digit revenue growth. We have the third best job-creation state in the nation. We’re number one in manufacturing in job growth in Oklahoma, and if you look at all the economic indicator factors, we’re in the top ten. In fact, our personal income growth this past measurable year was 6.2 percent. Talk about the 4 percent growth factor, Mr. President, we’ve proven that by cutting taxes, by reducing spending in state government and by creating a more competitive business environment, you can grow an economy.

Larry Kudlow: Well done. Thank you for that. Governor Haslam, you already have a zero income tax. I know my friend Art Laffer moved there from California in order to take advantage of it, but you are, as I did a little bit of homework, you are involved in an estate tax debate. Maybe you could tell us about that, and are there any other tax issues on the table?

Honorable Bill Haslam: Sure. We’re like Mary. We think the 4 percent growth model is too timid. We’re averaging about 8 percent growth the last year, and I think one of the reasons is no income tax. I think that’s actually the biggest reason. We had Volkswagon set up their first plant, North America plant ever, and we asked them why. Lots of reasons, but one of the reasons, they said, was no income tax. We see that a lot, but our story’s a lot like Oklahoma’s. We lead the Southeast in
personal income growth, in revenue growth. Unemployment’s falling faster than the national average, because, I think, capital is going to go where it gets the best return.

One of the things we want to address is Tennessee is one of the 20-something states that does have an estate tax still in place. Again, we think that chases capital away. People have said to my face, “Hey, it’s cheaper to die in Florida. I’m going to move as I get older.” We want that capital to stay in the state of Tennessee, so we’re on a three-year plan to eliminate the estate tax.

Larry Kudlow: To eliminate it.

Honorable Bill Haslam: To eliminate the estate tax, and then we’re also cutting — the one tax that everybody in the state pays is sales tax on groceries. We’re cutting that as well. Here’s the key challenge for states. We all cut our budgets when the recession happened. Then the stimulus plan carried states for a while. It didn’t just go to bridges. It went to states to pay for things like Medicaid and covered up a lot of budgets, and then when Mary and Paul and our class came in, the stimulus plan money was gone, and we had to make those real cuts. So we all cut anywhere from 2 to 5 percent of our budgets. Our was about 3½. Now, as revenue comes back, we have a once in a lifetime opportunity, because we’ve made the cuts. Real growth is happening. We cannot put that money back where it used to be spent, or as Mitch Daniels said, the typical reaction of, “Don’t just stand there; spend something,” but to say, where can we really invest this to be the state that we want, and how can we cut taxes to keep creating more of that.

Larry Kudlow: Where can you?

Honorable Bill Haslam: I think several things. I think for us, like a lot of Southeastern states, education, making sure we particularly focus on what are the jobs that we need to be training for, and that can be everything from trades type jobs to PhD oriented subjects, but we haven’t historically done a good job of that. So you’re going to see some of our focus be in cutting taxes, shrinking the size of government but then redeploying assets so that we can be even more competitive in attracting jobs.

Larry Kudlow: Thank you for that. I’m going to follow through, obviously, but let me go to my friend Robert Steel, who is the Deputy Mayor for Economic Development in the City of New York. Bob, you don’t have the luxury of all the lower income tax rates, but let me ask you, first of all, from the standpoint of business and investment, how tough is it for New York City, just your own view, and what have you and Mayor Bloomberg done to promote economic growth measures?

Honorable Robert Steel: Thanks, Larry, and thanks for letting me be here and join the esteemed group of governors. It’s a pleasure to be here on behalf of the city, and we have some similar issues. We have a big economy, a big budget. The budget’s about $65, $70 billion dollars. $20 billion comes from the state and the federal government. $50 billion we fund ourselves, mostly by the property tax. That’s by a factor of two the most important thing. Then my job is to think about economic development and how to keep the city competitive, and E. J. Dionne [sic], in the previous panel, laid out some of the issues, and that’s really the way we think about it.

Let me make two points, and then we can come back to talk about other things. Point one is there are two kinds of taxes. There’s the tax that you see, and it’s called a tax. Then there’s the indirect tax of basically the government not working well for its people, and I think in a funny way, we think that’s a way or a place that we can attack. Mayor Bloomberg has been very forceful at pushing me and my colleagues every day to say, “How can we make it so the government works for you?”

I’ve got ten examples. I’ll give you an easy one. Four hundred permits, licenses and certificates issued by the City of New York, all kinds of different things — you can get 10 percent of them online. Ninety percent, you show up between 10:00 and 4:00 but not between 12:00 and 1:00.
You bring a blue ballpoint pen, and you wait in line at a place that’s convenient for the city, not that’s convenient for you. Now, you try to factor what that costs the city in terms of business, job creation, things like that, and I could give you ten more examples of what I think of as indirect taxes on the economy.

Larry Kudlow: On that point — it’s an important point — can you see palpable business improvement after making those reforms?

Honorable Robert Steel: Absolutely. There’s no question that we’ve tried to take certain industries. This is a bit more detail than I’d planned, but New York is constantly opening new restaurants. We’ve tried to shorten the time it takes you to open a restaurant. You have to have 24 permits and licenses. It’s up to you to organize them in order in the right forms. We’re trying to organize that for you, and we’ve been successful at shortening the time into business by several months. You’re a new business, short on capital. Every day you’re not serving meals and collecting revenues is hurtful to you, so how soon can we get you in business? So there are lots of examples like that.

I think the second thing, though, Larry, that we talk about a lot and Mayor Bloomberg pushes is that it’s also about expenses. We’ve got to watch our expenses, because that’s the equivalent of a tax also. The one we’ve talked about the most and where we’re pleased we’ve made some progress is really on pensions. Mayor Bloomberg showed up, and our pension bill was a billion and a half dollars a year. This year it will be a little bit more than $9 billion. Basically that’s an 18.8 percent compound rate of increase in pension expense. There’s no expense in the world that can increase at that rate and that you can have a business that works. Impossible. So basically trying to attack that, to bring that down, and we have to do it with the leadership of the Governor, but it’s things like that that we think about: make government work and watch our expenses. That’s the equivalent, in my mind, of what the governors are preaching in terms of their discipline.

Larry Kudlow: I neglected to say, by the way, Robert Steel was an Undersecretary to the Treasury during President Bush’s Administration, so he knows whereof he speaks. Let me go back to some of these specific issues now. We’ve got a lot of tax reform and regulatory reform on the table. Governor Fallin, let me ask you this. Governor Christie made a very emphatic point in his excellent speech. He said, “Look, you want pro-growth policies. You want to go for the Bush 4 percent growth target, but you have to get your books in order. You have to get your budget balanced before the lower tax rates kick in.” I know that’s his path in New Jersey, and it is what it is, because that’s the best thing he can do. Was that the case in Oklahoma, or were you able to work spending reductions — you were talking about stuff you took out of the baseline — and tax reductions at the same time?

Honorable Mary Fallin: We did it at the same time. As I mentioned, we had a $500 million shortfall, and when I took office, we had two dollars in a rainy day savings account. In other words, we have balanced our budget over the years with the shortfalls by the stimulus money that you mentioned, Governor Haslam, whether it was the education budget, public safety or whatever it might have been, and then we took money from our savings account to balance our budget. Granted, we went through some very tough times. All states did in 2008 and on, but we decided we were going to not only prioritize our spending, those core governmental services, weren’t going to starve government, but we were going to right-size government. We were going to really look at what do we need to be spending money on, what’s our priorities in the state. So we did that, and as I mentioned, we cut our income tax a quarter percent.

Now, after our recession got over — and by the way, we passed four major lawsuit reform bills, putting a hard cap on non-economic damages, passed major workers compensation reform to lower the cost of doing business, passed major education reform in our state, and yes, we passed pension reform too. We had a $16 billion unfunded liability in our pension systems, and we took that from $16 billion down to $10 billion in just six months in the state of Oklahoma. Now I have $500 million, a little under $500 million in my rainy day savings account, and I cut our
income tax. Now I’m proposing to really cut our income tax in the state, and we’ve had that double-digit revenue growth. So I do think you can do it all. You have to be careful and measured. You have to go out and talk to the people of your state, why it’s important to them, what it’s going to make, what type of difference it’s going to make, and of course, my whole goal was to create the very best, competitive business environment possible, while also helping our businesses with their bottom line.

You mentioned in New York about how many permits and licenses. Every day that someone has to wait to get a permit and license is money, and when you’re a small business person, you don’t have time to go to all these different places and wait all these lengths of time to get those permits. So one of the things we did is we passed what’s called a one-stop-shop licensing and permitting, to where you could go on the Internet, fill out your information — what we found in Oklahoma, we were operating government in what I would call an eight-track bureaucracy in an iPod world. It just wasn’t working.

In fact, one of the other things I found was that, in the whole state of Oklahoma, we had 76 financial software accounting programs to operate government. Can you imagine owning a business, and you had 76 different financial software programs, and you couldn’t match apples to oranges when you’re trying to figure your budget or your expenses? So we changed that too.

Larry Kudlow: Did you get rid of stuff? I was on the air last night suggesting that we ought to get rid of the Government Services Administration, the GSA, this thing that’s ripping off taxpayers. It’s this puny little administration, puny little thing, but you know, puny little things add up. You can get a bunch of private real estate operators to do what they do, which is run the government buildings and so on. Now, I don’t want to be longwinded on it. I’m saying, in your experience, did you get rid of stuff?

Honorable Mary Fallin: Absolutely.

Larry Kudlow: Did you get rid of programs? Did you get rid of agencies? This is like a lost art or a lost thought in government. Get rid of it.

Honorable Mary Fallin: Isn’t it, though? We actually did what we called shared services. We found that we had small agencies that had their own different divisions of personnel, timekeeping, payroll, financial accounting systems. We brought all of that under the Office of State Finance. We actually consolidated all of our Chief Information Officers in our state under one person. One of the things that we found is that each agency wanted to have their own Information Technology Specialist, wanted to purchase things on their own with computers and software. That gets very expensive, so we brought all them under one person, who is under my purview, consolidated state agencies, consolidated personnel, payroll, timekeeping, all those different things. It is estimated that over the next five years, we’re going to save $170 million just in the personnel and timekeeping, payroll systems in our state, which, by the way, that money now can go towards infrastructure, roads and bridges, education and whatever it is that’s important to our state.

Larry Kudlow: Governor LePage, let me come back to you. Governor Christie was feeling your pain about being in, dare I say, a blue state. New Jersey’s a blue state. I feel your pain. I lived in New York for the better part of my life, when I wasn’t in Washington, D.C. So my question to you is: you’re embarking on this tax reform. You want to be competitive. You want to grow. What do you do? How do you say — how do you react to the critics who say you’re going to end public education and you’re going to tear down poverty programs? How do you do it?

Honorable Paul LePage: Well, in our case, and it is a challenge in a blue state, but in the state of Maine, 83, 82 percent of all state revenue is going to two programs, welfare and education. So we are making a major effort right now in reforming welfare and Medicaid. My point is I simply want to go — because
Obamacare is coming in, I just want to bring the state from where we are today to the national standards. We are way above. I mean, we are 200 percent of poverty, in some programs, 350 percent of poverty. So we are just way too generous. Education is just a matter of getting more efficient in the classroom, and my point, and this is what I say to all Maine people: it’s all about the kids. Every program, every public policy you deal with, if it’s not about the kids, it doesn’t work for the state of Maine.

We’ve added $60 million to our education in our first biennium. We’ve built a rainy day fund. Talk about — we had zero. Back on January 5, 2011, we had no money in the rainy day fund and had not had any for eight years, and now we’re about — oh, we just paid back the federal government $29 million, so now we’re about $60 million, and we’ve lowered our taxes. We lowered our taxes $400 million in addition to having a billion dollar shortfall on January 5, 2011.

Larry Kudlow: So just to understand this, you are essentially in the camp that you have to lower spending and the tax at the same time.

Honorable Paul LePage: Same time.

Larry Kudlow: You don’t have the luxury because you’re deeper in the hole. Is that fair?

Honorable Paul LePage: That is correct.

Larry Kudlow: Did you have a sequence where you went for the spending first, and then the tax rate came second, or was the tax reform in the same legislative session or in the same timeframe?

Honorable Paul LePage: They’re both ongoing. For instance, I’m cutting state spending on state employees. We are one of the highest per capita number of employees to population, and so I’ve just put a 6 percent cut in education, I mean, state employees, and we’re doing it through attrition. So we were at 5 percent last year. We’re up to about 6 percent now, and we’re going to maintain it all the way through so that when people leave, we consolidate, see what we can do to make it more efficient. We are doing a lot of work in systems. In fact, we were very fortunate to get the CIO from Unum Insurance to come and join the state. He’s a brilliant man, and he’s bringing us into the cloud in all kinds of different systems that are available that we spent $100 million every year just chugging along and not making much improvement. So we’re moving ahead. We believe the more money in the private sector, the more opportunity for job creators to create jobs, pay more taxes, and voila, our revenues are up.

Larry Kudlow: Yeah. It’s really a supply-side model. Extraordinary. Governor Haslam, let me come back to you. You haven’t had an income tax, so I did a little homework also. We talked about the estate tax. I don’t know if I have this right, but you have ended collective bargaining or curtailed collective bargaining. I think you were quoted someplace. You’ve had a lot of great governors, Scott Walker and John Kasich and others, but you said you were doing it quietly. I wondered if you cared to talk about that, describe that, and what motivated that and where you are right now with this.

Honorable Bill Haslam: What we really did is we took on the whole civil service system of government employees, and I loved your comment about unseen taxes. If you look, actually we have 22 different departments in the state. I asked every one of them, after a year, I said, “What’s the biggest thing you could do to give better service at a lower price?” Every one of them said, “It’s the way we hire.” Right now you get rewarded for breathing the longest. That’s how we decide who we’re going to hire, who we’re going to promote, who we’re going to give raises to and who’s going to get
laid off when we do that. So we addressed that. It’s not finally passed. I hope I’m not jinxing myself, but it’s pretty certain we’ll get it done this year, to basically do away with our civil service system that used time served instead of merit to determine how we do things. If you don’t think that makes a difference, ask if any business in the country would ever say, “We’re going to base every decision based on length of service rather than merit.” No one — it’s like a football team that decides who’s going to play by who’s been on the team the longest. Nobody does that. It really is addressing those unseen costs of government.

Larry Kudlow: How much flak did you take?

Honorable Bill Haslam: We’re fortunate. Governor Christie made a joke about things being a little easier in Tennessee and Oklahoma than they are in New Jersey, and that’s true. We have a little different culture and environment. Unions aren’t nearly as big of a deal, but it is. It’s interesting. The question you were asking both the other governors about which comes first, the spending cuts or the tax cuts, I think they have to go hand-in-hand for this reason. A lot of people in our party, a lot of Republicans love the tax cuts, but they don’t want to cut the programs. I had a lot of folks who are strong conservatives, who were all for us in cutting the estate tax and cutting the grocery tax, but when we came and said, “We’re going to change the civil service system,” “Whoa, whoa. I don’t know if I want to do that. I have a lot of people in my district who work for the state.” I think you have to, if you’re going to show the reward, you have to help people understand the cost at the same time.

Larry Kudlow: I just want to follow through on that. This is a great debate in Washington, and the issue is lowering tax rates but also lowering spending at the same time. Do you think, from your experience as Governor and your observations of Washington, that there ought to be dollar for dollar reductions in taxes and spending, if you’re going to do it, that’s the best way to do it?

Honorable Bill Haslam: I really do, because I think without that, you’re kidding yourself long term of how you’re going to pay for that. I think our experience also shows that cutting taxes brings in more revenue, but I think you can show the increased revenue and then make those cuts that allow the tax cuts to happen at the same time. I think you’ll have an accelerated model doing it that way.

Larry Kudlow: Do you think the Congress — I’m just going to call it the Congress. I don’t want to do partisanship right now. I just want to ask, do you think the Congress has any sense of the urgency to do both, tax reform and spending reduction? I’m listening to Governor Fallin. You’re taking stuff out of the baseline, which is really that’s it. I was a former Deputy OMB Assistant in the Reagan Administration. That’s the bone. That’s great. That’s what you have to do. I don’t see anybody talking in those terms. The game in Washington, as you know, is to cut the rate of increase off the baseline. So instead of going up at 10 percent, if you want it to go up at 8 percent, you’re considered a killjoy. You’re going to throw grannies off the cliff. That’s the way of the game. That’s the way the game works. It’s like, if you go to the car dealership and you’re going to buy a $100,000 Mercedes but instead you decide to buy a $50,000 Chevy, you’ve spent $50,000. In Washington they call that a $50,000 budget cut, right? Which, I don’t know. I’m an old guy, but that’s really not right.

Honorable Bill Haslam: I think you see that with Congressman Ryan’s budget. He came out and said, “Here’s how we’ll do this.” That just opens him up to shots from everybody. “Oh, look what he’s going to cut.” Right. When you’re spending more than you’re bringing in, you’re going to have to cut something, and I think until we have more people of courage who are willing to say, “Here’s how I would do that,” and put themselves on the line, we’re going to stay in trouble.

Larry Kudlow: Bob Steel, and I ask this with the greatest respect —

Honorable Bill Haslam: That’s a setup.
Larry Kudlow: New York’s got high tax rates. You didn’t start it. You haven’t made it any worse. I’m just saying New York’s got high tax rates at the city and state level. I did not hear E. J. McMahon in the prior panel, but I’m sure he had something to say about that. My question is: are you worried about tax competition? Connecticut is actually edging up its taxes. You don’t have to worry so much about that. New Jersey, you heard Governor Christie, is going to have a 10 percent reduction. You’ve got these low-tax states now throughout the South and the Sun Belt and so forth. What do you think? How difficult is it going to be for New York to be hospitable to business growth and jobs with much higher tax rates?

Honorable Robert Steel: Well, you’re basic premise is correct. New York is an expensive place period, and we see it present itself in all kinds of ways. Some of the things we can try to control, and others are part of these invisible taxes, which I alluded to earlier. I think that it’s unlikely — certain businesses, I don’t believe, will find New York the most logical place for them to build their businesses, and so really, I think, the strategy is to do everything we can to keep costs as low as we can. If you look at construction costs, it’s basically embedded in the work rules and things like that, which we’re trying to fight and push back on, but the reality is that we also have to be cognizant of how to attract new and different types of businesses as we reshape our economy.

The reality is I don’t think that — there are certain types of manufacturing. I think they’ve left for good, and that’s not something that’s positive to say. So instead, the real role of the Mayor has been to encourage an economy that’s diversified, and it’s not just away from industrial activity. It’s also an understanding that we’ll benefit from diversifying away from financial services. If you look at the Mayor’s focus on technology, tourism, transportation and the fact that Google is here with a huge building and that Facebook is here, and Jet Blue is here, and we have 50 million tourists. That’s the way he thinks about it, and so this is a different pattern of how we’re trying to reshape the economy to accept the reality.

The way I think about it is we had 3,000 years of an agrarian economy, 300 years of an industrial economy, and now we’re 30 years into an information-driven economy. We’re trying to get on the front foot as we go ahead and think about things that way. That’s what our policies are. We haven’t really gotten into the business of bidding for business. That’s been the Mayor’s mantra. We’re not going to fight by making us cheaper with government money, but instead, we think we’ll make it a place that wins if we win on quality of life. We have regulation that works, and we continue to invest.

I think one of the things that I would want to just put a marker down, is that not all government spending is bad. I think, for what we see sometimes, is that — my experience is that when legislatures or elected bodies allocate capital, they tend to allocate towards consumption as opposed to investment. I think that the executive branch, Mayor, Governor has to be the parent and say, “We don’t need to just do consumption. We need to do investment.” Sometimes it’s not just spending less. It’s how you spend it, and I think what Mayor Bloomberg has talked about all the time is trying to invest in our economy and do things that we think will have high returns and not to pick winners so much but try to affect the playing field so that it’s an attractive one.

Larry Kudlow: That’s a really important point, city, state and federal. Governor LePage, let me ask you about that. How do you handle the business tax question, corporate tax question? Some states will pony up subsidies and tax credits, will target businesses who orchestrate beautiful campaigns and make a lot of promises about jobs. Many of those promises never pan out. That’s taxpayer money. The mom and pop shop doesn’t get a tax subsidy, but the big Fortune 500 international globalization, whatever, do, or would it be better to just lower the corporate tax rate for everybody?

Honorable Paul LePage: I believe the corporate tax rate has to come down. You lower the tax rate —
Larry Kudlow: Kind of a loaded question. I’m sorry.

Honorable Paul LePage: If you go from the largest tax rate in the world, and if you lowered it — and I believe Canada is a good example of what’s happened in the last two decades in their bringing down their business tax. I frankly am not a big fan of subsidies, because you’ve got local, state, federal. I shy away from the federal as much as I can. I try not to take any of their money, because every time I take their money, they have all kinds of little hooks on them, and they hurt. So I shy away from them. What we try and do with business, and we just got Carbonite in Maine. They closed an office in India and brought it back to the U.S. It was basically on the premises, when they inquired, we jumped all over it. We said, “You want to be here? You’re here. We’ll just make it work.”

Larry Kudlow: You showed up. Did you give them subsidies? Did you bribe them?

Honorable Paul LePage: No subsidies. No subsidies. What we did, was we drove them through the permit process, licensing process, and before they could finish their spiel, we were ready.

Larry Kudlow: That’s the Bob Steel model essentially.

Honorable Paul LePage: Yeah. I believe what we’ve done in our economic development is we’ve hired five executives. We get an inquiry, they get them through the process.

Larry Kudlow: What’s the corporate tax rate in Maine?

Honorable Paul LePage: Right now, 7.95 is our top rate, which we just lowered a little bit, and hopefully, by the end of my first term, I’d like to see it at 4.

Larry Kudlow: That’s a good number. What’s the corporate tax rate in Oklahoma?

Honorable Mary Fallin: It’s 6 percent. One of the things you guys talked about earlier, and I think maybe Governor Christie or President Bush talked about this, is how small businesses can file as individuals and how we believe, by reducing our individual income tax rate — if I could reduce my top rate down to 3.5 percent, that affects our small businesses that file that way. So that’s a huge tax cut for businesses, especially small businesses which are the majority of jobs in Oklahoma. Of course, all we have to do is look at America and their high, high corporate tax rate and how that discourages job projection in the United States and ships jobs overseas, and we can show, in our individual states, that when we lower those tax rates down, we can create strong growth, more than 4 percent growth, in our local economies.

Larry Kudlow: I don't know where Minister Flaherty is, but he’s got it down. The combined rate is 25 percent. Our combined rate is over 40 percent. We can’t win that. We’re going to lose that to Canada. Didn’t you give the Republican radio address rebuttal?

Honorable Mary Fallin: I did, on energy. Our combined rate is over 40 percent. We can’t win that. We’re going to lose that to Canada. Didn’t you give the Republican radio address rebuttal?

Honorable Mary Fallin: I did, on energy.

Larry Kudlow: I was going to say — I was thinking I just went from corporate tax rates to the Canadian corporate tax rates. This is how my mind works. Then I went from Canada to the Keystone Pipeline.
Honorable Mary Fallin: We’re all connected. Canada is a great ally.

Larry Kudlow: So Oklahoma has got this surplus of oil shale related — at the Cushing terminal, and we can’t get it down to the Gulf refineries. That’s one reason why the gasoline price is so darn high. What did you say in that radio address?

Honorable Mary Fallin: Well, of course, we support the Keystone Pipeline, going from Canada on down to the Gulf Coast. In the President’s State of the Union speech, he mentioned about the Cushing pipeline, which is a hub, which has a glut of oil on the marketplace, which is not helping our market, frankly, in Oklahoma, in the pricing of that. He mentioned maybe completing the Keystone portion from Cushing down to the Gulf Coast. So I had the opportunity to be in the White House about four weeks ago when the governors were there, and I asked the President — I said, “I know that you’re not for the Keystone Pipeline, which I am for, because it would create American jobs, revenue back into our states, reduces our dependency, certainly on foreign oil,” and I said, “I hope that, since you mentioned the portion of Cushing down to the Gulf, that you will go ahead and complete that.” Then three weeks later, he shows up in Oklahoma and says, “I’m all for it,” which is good, but the problem is, it could of happened without him. It’s within the United States. We didn’t have to have his approval on that, but he came down to take credit in the state of Oklahoma for that portion of the Keystone Pipeline and for the tremendous job.

I told the President, “We’ve got one of the lowest unemployment rates in the nation. We have double-digit revenue growth. We’re doing very, very good in the state, and we’re cutting our taxes in Oklahoma.” So of course, he wanted to come down and make the point that he supports that portion of the pipeline, but he needs to approve the whole thing. I mean, if we really want to jumpstart America’s economy, the quickest way to do that is producing American-made energy, American-made jobs.

Larry Kudlow: All right. Well done. Well said. Do you want to open it up to questions and answers? I didn’t even know we had a Q and A, but I’m relieved to hear that. I’m sorry. I may not be able to recognize everybody with these old eyes, but yes, go right ahead, sir.

David Fenstermaker: Hi, I’m David Fenstermaker, and I’m with Raymond James out of Washington, D.C. I have clients who live in Tennessee, and we run into something called the Hall tax. I think it’s fair that the people in the room here should understand how that works because — do you have plans for that?

Honorable Bill Haslam: We do. Like I said, we don’t have an income tax in Tennessee. We do have a tax on income, on interest and dividends, which obviously chases some folks away as well. We made the first step in cutting that, particularly to folks over the age of 60, last year, and we’re going to continue to — we’ll probably try to chew or bite away at that rather than try to do away with all of it at one time, but it’s something, again, that’s discouraging capital from being in our state, particularly people over the age of 60, is what our surveys show.

Larry Kudlow: How soon?

Honorable Bill Haslam: I can’t give you a firm answer on that. We took a bit out of it last year. We’ll take another bite next year. I don't know how fast I can get all that done.

Larry Kudlow: What do you think about the President today? He’s out on the campaign trail pushing the Buffett tax. What do you think of that?
Honorable Bill Haslam: Well, I heard President Bush say earlier, “I would hate to have a tax increase named after me permanently.” He said, “The only thing worse would be a maximum security prison.” So hope you don’t mind me borrowing your quote, but I think that’s —

Larry Kudlow: Can I just say something quickly? I don’t mean to be rude. When President Bush lowered the top marginal tax rate and the capital gains tax rate and the dividend tax rate on a permanent basis, which occurred roughly in the spring and early summer of 2003, the U.S. economy almost to the nanosecond began an ambitious recovery, an ambitious recovery, not some weak-kneed, little nothing-heimer 2 percent recovery, but the economy started jumping up fast, and if my memory serves me, in the next four years, created about eight or nine million new jobs right after he lowered marginal tax rates. Now, the reason I’m saying it — you know that, and God bless him, he knows that — I don’t understand. You just had a lousy jobs number. The whole recovery is in doubt. We’ll probably muddle through because private enterprise will do it, but why would we go out taxing successful earners? I just don’t get the logic of that. You’re a successful Governor. Maybe you can help me.

Honorable Bill Haslam: I think there’s two fallacies. Number one, the idea that you take money out of the private sector and put it in the government sector, and it will do better. I’ll give you — this is a little easy example of why government doesn’t work. When you’re spending other people’s money, you don’t do as good a job of it. We have an issue in the country with methamphetamine, the illegal production of that. The federal government used to come in and clean that up. It cost them $2,000 to clean up every time there was an illegal lab. We took it over in the state. We now do that for $300. That’s just a little example. Obviously, the $1,700 saved isn’t a big deal, but it shows you the difference. So the idea that we can take money out of the private sector and the federal government’s going to spend it more efficiently is just crazy. That’s number one.

Number two, the big lie of all of it is that somehow, with the new Buffett rule, the money we’re going to bring in there is going to solve the deficit problem. It doesn’t. It doesn’t even come close, and somehow they’ve communicated this fallacy that, if the rich people just pay their fair share of taxes, we’ll solve the problem. Even without the lost revenue growth that you have from the money coming out of the market, it doesn’t come close.

Larry Kudlow: Combined tax, remember capital gains — this is mostly about capital gains, I guess. Combined tax, you’ve got to pass through the corporate tax, right? So the integrated capital gains tax rate right now is slightly higher than 50 percent, and in view of rolling back the Bush tax cuts on capital gains and dividends, if all this goes through in 2013, that integrated tax, whether it’s dividends and cap gains, will be over 65 percent. 65 percent. Okay, let’s take some more questions.

Mark Skousen: Mark Skousen, Editor of Forecasting Strategies. It seems like everybody here is talking about tinkering with the system. Yeah, you’re lowering rates a little bit here and there. How many of you know when Hong Kong last changed its tax code?

Larry Kudlow: About 1950. I don’t know.

Mark Skousen: You’re right. 1956 was the last time it changed its tax code. Now, they’re not a democracy, right? They’re not a democracy, and we are, but nobody is talking about long-term, real, fundamental reform of the tax system that Steve Forbes tried to get into the presidential debate. Even during the Bush Administration, we tinkered again. When are we going to see long-term, real tax reform, flat tax or whatever it is, to really simplify the tax system?

Honorable Paul LePage: I will just say one thing relative to reforming the tax code. In the state of Maine, that’s exactly what we’re trying to do, is go down to a 4 percent flat tax, no exemptions for anyone. The problem I see is this. Until we as Americans decide whether we want to continue down the path
of welfare, entitlement country or we want to revive the American dream, we are not going to get there. It’s about an attitude.

Larry Kudlow: You’re pretty close to a flat tax in Oklahoma, aren’t you?

Honorable Mary Fallin: And I want to address it too. I think you do see governors that are trying to make a difference, that are innovators, trying to lead the charge, even though Congress and the President won’t make the dramatic changes that they need to make in our tax code so we can be more competitive as a nation. In my state, we have seven different tax brackets. Not only am I trying to reduce our income tax, but I have also proposed taking it down from seven different tax brackets down to three so it’s simpler, so it’s easier to use, especially for our small business people that don’t have time to mess with a complicated tax code. So there are states that are trying to do that. There are governors that are trying to do that, and my hope is that maybe someone in Washington, D.C. will catch fire off some of our efforts and start following our leads.

Honorable Paul LePage: We’ve gone from four rates to two rates, and in the state of Maine — you had a question earlier about the opposition always saying any tax increase, any tax break is for the rich. In the state of Maine, you pay the maximum rate at $18,000 a year. That’s not wealthy.

Larry Kudlow: That’s even better than New Jersey. Governor Christie was saying, “If you want to feel rich, move to New Jersey.” If you want to be a millionaire, they’ll tax you at $400,000. You’re down at $18,000. That’s some hell of a state you’ve got there.

Honorable Paul LePage: We try to capture tourists in the summer and not let them get out.

Larry Kudlow: Other questions out there? Yes, sir. Who’s that? Is that Kevin? Kevin Hassett.

Kevin Hassett: The U.S. is one of the last countries on the Earth to increase its corporate rate. It did it back under President Clinton. Since that date, being a data guy, I went back and counted. Just to the OECD, there have been 133 corporate rate reductions, tax bills that cut the corporate rate, 133 since we increased it. If you look around the world, places like France and Sweden, where you think, “That’s kind of a left-wing country,” it’s often the leftist who are cutting the rates now. In Canada, which has a federal rate of 15, it was really started by the Liberal Party that gave us socialized medicine and everything. They were the ones who cut the corporate rate, and so my question for the panel is: why is it that the left in America is so far to the left compared to the left everywhere else? What can we do to get the left in America to be as reasonable and rational as the liberals in Canada?

Larry Kudlow: You’re saying what we need in America is some supply-side Socialists.

Kevin Hassett: I think it’s a legitimate puzzle. I think it’s a legitimate puzzle. Why is it that the left — the French left gets it? The Canadian left gets it, but our left doesn’t, and so we’re stuck in this really bad place. I wonder why it is. What is the force that led the left so far astray here in the U.S.?

Larry Kudlow: Do you want to take a whack at that, either of you, both distinguished —

Honorable Bill Haslam: I asked the Canadian Minister this morning that question. What made you all, what made Canada have the courage to make those decisions? They went into a recession in ’94, ’95, and he said that’s what forced them. I think some of the European countries you mentioned are
obviously seeing the same thing now. The model doesn’t work. We’re probably the wrong panel to ask that question to.

Larry Kudlow: I think you’re the right panel.

Honorable Mary Fallin: We get it.

Larry Kudlow: Yeah, that’s right, but I mean, this goes back to what I call the Washington Monument syndrome. Every time you cut taxes, critics — there’s two things they say, as Governor LePage said. Number one, you’re just cutting taxes — it’s not fair. You’re only helping rich people at $19,000 in Maine, whatever it was, and number two, you’re pushing grannies off the cliff instead of helping them. You’re cutting all their healthcare services and education services. So you’re destroying them because you stop their government subsidies, and you’re helping rich people. That has been for a long time, too, I think, the two key objections to tax reform.

Honorable Mary Fallin: But we destroyed that argument in Oklahoma with our tax reform and reduction plan, in that in our state we actually taxed — if you made $1 to $1,000, our bottom income tax level kicked in at a half percent. We tax those who are poor. So what I’m proposing, and I’m a Republican, is I’m proposing that, on couples that make $0 to $30,000, they pay no income tax.

Honorable Paul LePage: That’s what we’re doing.

Larry Kudlow: Same thing?

Honorable Paul LePage: Yeah, yeah. We’re moving it up to $30,000.

Larry Kudlow: Before James gives us the hook, what’s the benefit of that? You see that as a fairness issue.

Honorable Mary Fallin: We’re trying to help the middle class. We’re trying to help those that are the working poor in our state, and by the way, for anybody like Warren Buffett, that thinks they don’t pay enough in taxes, come to Oklahoma. We can actually give you a better deal. Just put your money there. We’ve got a lower income tax rate. We’ll give you a good rate of return on your investment, and my last experience shows that businesses and investors will go where they get the best rate of return on their investment.

Larry Kudlow: Yes. That’s great. I just want to say it’s been a great pleasure. We’ve got four stars here, and it’s been wonderful stuff. I don’t know about supply-side socialism. Me, I’m for free enterprise and free-market capitalism. It is still the best path to prosperity. President Bush, thank you very much for having us. Thank you.

Honorable James Glassman: Thank you, Larry. Thank you, Governors. Thank you, Deputy Mayor. I just want to pick up on what Kevin Hassett said about countries that we may consider to be socialist moving to cut their corporate rates. The 4 Percent Growth Project seeks ways for the United States to grow on a nonpartisan basis. We are looking for ideas, not just from Republicans, but from Democrats, and I think that growth is something the entire country can get behind.

We’re going to take a break, but before we take a break, let me just tell you what happens after we take a break. You have signed up for one of two sessions, which will be going on simultaneously. In this room — let me see if I got it right. I think it’s in this room, and correct me if I’m wrong. Karl Rove will be moderating. Is that in this room? Yes, okay. Karl Rove will be moderating Federal Government’s Record on Taxes. So this is historical, as I was saying earlier, 1920s, 1950s, ’60s, ’70s and ’80s with Al Hubbard, Larry Lindsey, John Prestbo, Amity
Shlaes, and Joseph Thorndike. Then on the second floor, in the beautiful library, and we’ll direct you to the second floor, Maria Bartiromo, Larry’s colleague at CNBC, will be moderating a panel on Nations and Taxes, international taxes, with Chris Bergin, Shikha Dalmia, Minister James Flaherty from Canada, who was just mentioned, Scott Hodge, from The Tax Foundation, Roberto Salinas Leon, from Mexico, and David Malpass.

So we’re going to take a break and then go to your breakout session. Thank you.

[Break]

Honorable Karl Rove: — different presentations on those nine decades. I’m going to leave the extensive biographies to be found in your notebook to suffice for most of these people. You know them. I’ll give a brief introduction, and they’ve each been asked to describe their decade or decades in a word or phrase. Why don’t we launch into it so we hopefully will get through each of the decades with enough time, then, for each of them to go at each other in mortal, academic, economical combat? There will be blood all over the floor, Lindsey versus all takers.

Let’s start with the 1920s with Amity. Amity is, as you know, the Director of the 4 Percent Growth Project. If you haven’t read Forgotten Man, please read it. She’s also working on a terrific biography of Calvin Coolidge that’s coming out, Silent Cal. She’s going to talk first about the 1920s, which she describes as roaring. What do you mean?

Amity Shlaes: Roaring. Good afternoon. Thank you for coming. They didn’t start with a roar. We always look for comparisons in history, and I’m looking at it now from the point of Coolidge when he was coming to Washington. We think we have hard times. They always hard times. They had very hard times. The federal debt went up from $1 billion to $26 billion. It was out of control. Taxes were in the 70s. They had nationalized the railroad, killed it and then denationalized it, a carcass. There was no area into which the government wouldn’t go. Meantime, they had inflation they wouldn’t call inflation, because that was embarrassing, and workers were way underpaid and going on strike like in Russia, which had just had a revolution.

So we think oh, we have hard times. We don’t know what we’re doing. We have too much debt. There was greater uncertainty then, and what’s interesting. You look at that recession. What was the policy response to the aftermath of World War I? There was a morning after World War I, the hangover recession. What was the policy response when you have a bad recession and angry workers who are occupying Wall Street and even bombing it? As you’ll recall, there was a bombing of Wall Street after World War I. What do you do? You raise interest rates 300 basis points and cut the budget in half. That was the policy response of the Harding Administration, with some help from the Wilson Administration, outgoing, to unemployment and inflation and general upheaval and misery. Cut the government in half, which they did, part of it easy because of the war, part of it not so easy because of the many angry, disabled veterans, and raise interest rates like crazy to prove to the world you’re serious about inflation.

What was good about what they did? They set the direction of taxes, and that direction was down. They said, “Well, we’ll do a tax cut now, and later we’ll do more.” So there was less uncertainty about taxes. This is just our down payment in terms of tax cuts. We’re going to go all the way. As certainty built that the government meant it, first through Harding and then through Coolidge, the economy came back and back again, not only through the auto industry but through many other industries. So you have a decade that was not a lie roar but a true roar, where you had serious productivity gains, great happiness among the population, general bounty, and miracle of miracles, even distributionally, you found that lower earners paid less of the taxes as the rates come down. When they finally achieved it, Karl, their top rate that they got to in their climb down was 25 percent. That remains the gold standard tax rate for us now, top rate of 25 percent. Should I stop there?
Karl Rove: Great. Thank you, Amity. One minor historical note: the first Director of the Bureau of the Budget was Charles G. Dawes. The Harding era saw the first Bureau of the Budget. He later became Vice-President of the United States under your man Coolidge.

Amity Shlaes: That’s right, and in Coolidge, I talk about how they got the departments to spend less with this terrific law, which we repealed, unfortunately, in the ‘70s, and they did it by hauling them into a room just like this, dear department heads, and yelling at them as if they were kindergartners. “You must cut your budget by 1 percent, and you will get a sticker,” like that, and the departments, lo and behold, behaved and did what the President said through General Dawes.

Honorable Karl Rove: For a slightly different view of the ‘20s, I believe, is John Prestbo, Executive Director and Editor of the Dow Jones Indexes, whose view is slightly longer and maybe a little bit more downbeat at the end. It’s from Bust to Boom and maybe back again.

John Prestbo: Yeah, it was a time of big change. In World War I, the capital gains tax rate was in the 70s, as high as 78 percent, and then in the early 20s, it was cut to 12½ percent. That helped the big stock market rally that happened in — well, we’re familiar with it in the latter part of that decade, when the shoe shine boys and taxi drivers were buying stock on margin, borrowing as much as 95 percent to put into this stock market that would never, never go down, except that it did in 1929. Over two or three days it lost 20-some percent, and it continued down into the Depression.

The interesting thing about the Dow Jones Industrial Average in the period from 1922, when the capital gains rate was cut to 12½ percent, through 1933, which some people think is the depth of the Great Depression, the Dow actually gained 1.75 percent over that period of time. That’s because it was starting out pretty low after World War I. The crash, of course, wiped out a lot of that, but there were some, what they call, dead cat bounces in the early ‘30s. So it was a period of great exuberance, great inventions. My favorite was the invention of the automatic bread slicer, happened in that decade. The first talking pictures, the first movies in color, all of that was a great innovative time in American history. Of course the Depression was a downer for everybody.

Honorable Karl Rove: John, thank you. You left out the one innovation of the 1920s, which has doomed Western civilization, and that is Philo Farnsworth discovery of the television set.

John Prestbo: That’s right. The first demonstration —

Honorable Karl Rove: Don’t ask me why, but these dueling economic brains up here have slightly different views on the ‘30s, so we’re going to start with Amity, with her view of the ‘30s, which is entitled Wrong Direction, and then we’re going to have Joseph Thorndike, who’s the Director of the Tax History Project at Tax Analysts, with his view of the ‘30s, which is Fair Share. Amity, briefly, on the ‘30s?

Amity Shlaes: Well, the ‘30s, there was less concern for business, for growth in terms of companies and less interest in the private sector. We’ve talked about the private sector today. So you see the tax rate — this is a tax conference — go up under Herbert Hoover. That was the great sorrow of the Republicans, that they betrayed themselves by raising taxes at the very end, going from 25 into the 60s. There were a lot of ugly taxes that came in in that period, including a tax for checks, for example, at a time when you want people to transact, the Great Depression. At the beginning of the Depression, they were trying to raise money, because they were short, because the Depression had started.

Then you go into the ‘30s, and you see the government scrambling for revenue and raising rates. What happened? The revenues were disappointing. Surprise, the economy was slow. The story of the Great Depression, especially the first part, is not entirely a tax story, but we’re looking at
the tax factor today. After the monetary and credit events and all the trouble, there wasn’t enough money to go around. There was deflation, and the government was scrambling with taxes. Often it found it didn’t have enough money, and then the government grew a little bit angry, a little pouty with the economy, because it was not yielding up its bounty. So you’ll see, especially in the later ’30s, there is some very weird and vindictive taxes, which are hard to explain, such as the Undistributed Profits Tax. Why did we levy an Undistributed Profits Tax? Because those bad, old businesses are on capital strike. They’re not spending. They could be paying it out in wages. They could be paying dividends. They’re hogging their money.

So you see that dynamic where the government is cross with the economy, which is a bizarre dynamic that we’ve seen repeat itself more recently, and towards the end, you see the government get together with business, again, because of the war. So all of a sudden, the person we were prosecuting is our partner in Washington. We’re meeting together and planning the war. We’re spending for the war. Business was relieved not to be under attack, and that’s one component to the end of the Depression that we tend to neglect when we always look at the spending in the war. There was also the relief of the companies that they were no longer targets and instead were partners.

Honorable Karl Rove: Joe’s going to do three decades, starting with the ’30s, which is Fair Share. He’s going to do the ’40s, which is Class to Mass.

Joseph Thorndike: Class to Mass Tax.

Honorable Karl Rove: And then the ’50s, which is Apparent Paradox. So Joe, 30 years, and you’ve got about ten minutes to do it.

Joseph Thorndike: I think I can do that, actually. I don't know that Amity and I really disagree very much about the ’30s. I think one of the unsung stories — and the notion of Fair Share is in quotes for me too. This is a phrase that gets used all the times in the ’30s, mostly by the Democrats and people in the Roosevelt Administration. What’s unknown to many people about the ’30s is that the government is still raising a vast chunk of its revenue with very regressive taxes throughout the ’30s. They’re raising it with excise taxes on alcohol and tobacco in particular, and these are providing a very large chunk, more than the income tax, of federal revenue for a long time.

The Roosevelt Administration does exactly nothing to get rid of those excise taxes, because believe it or not, there was a genuine strain of fiscal conservatism in the Roosevelt Administration. I imagine that might be — some people might challenge that, but it was true. They were unwilling to give up the money from these very productive old taxes. So what they would try to do was to balance these regressive taxes by ratcheting up the rates on a variety of other more progressive taxes, particularly the income tax, both corporate and individual, and the estate tax. This is the era of the Wealth Tax Act of 1935, for instance, which dramatically raises rates on estates and incomes. It doesn’t do all that much to change the distribution of the federal tax burden, which still remains largely intact, but it does raise effective rates on the richest Americans significantly.

This goes on through most of the ’30s. There is dissent within the Roosevelt Administration about doing this. A bunch of economists, especially in the Treasury Department, are saying, “Hey, you know —” This was by the late ’30s in particular. “This is all well and good. We’re all in favor of progressive tax reform, but we might consider actually lowering rates on the richest Americans and reducing or eliminating some of the more burdensome business taxes,” because they were worried that the Roosevelt tax policy was actually inhibiting recovery to some degree.

The New Dealers had a response to that. It was essentially that by taxing — there were elements of Keynesianism in this, but their argument was about the propensity to save and spend. They felt that by taking this money away from rich people and corporations, you would get all these
sterile accumulations of capital, grab them away from the rich people, give them to the poor people, and they would spend them, and that would encourage the economy to recover. That argument is not driving tax policy in the ‘30s exactly, but it’s an important part of it.

By the end of the ‘30s, you do see them sort of reconsidering all of this, partly because the Roosevelt Administration was losing a lot of political battles, and some of their marquee progressive tax reforms, like the Undistributed Profits Tax, get gutted almost immediately by Congress. Within just a couple of years it’s gone, essentially, off the books, and then the war, I’ll segue into the war, our mass tax. The war does really change the discussion entirely. Among other things, the federal government is faced with much larger revenue needs, and their first response is one that the Treasury Department had been suggesting for some time now, which is, “We’re going to have to tax the middle class with an income tax.” Until then, only rich people paid the income tax, but they had said, “This is our most efficient tax. It’s our most fair tax. It’s going to raise the most money. We should turn this class tax into a mass tax,” and they do that. In the course of about five to six years, the number of income tax payers goes up by seven or eight times. It really does become a middle class reality in a way that federal taxes never had before, with the exception of the Social Security tax, which comes in in the mid ‘30s.

The driving force behind all this is a resurgent fear of inflation. They are extremely worried about runaway inflation during the war. They try to deal with that with price controls to some extent, but they also use progressive taxes, extremely heavy taxes to try to drain purchasing power out of the economy. By most accounts, it does a fairly good job. The economy, of course, recovers from the Depression very effectively. Sometimes World War II is called the GDP war, in the sense that the U.S. won on the basis of its economic — its capacity to produce, and there was a lot of interest in the federal government in maintaining that. So there are even some tax incentives that they create for investment during the war, even as they’re taxing away business profits in huge percentages with excess profits taxes taking almost all profits away above a certain point. They are very concerned that business not be afraid to invest.

At the end of the war, moving on to the ‘50s, you see a natural sort of pullback in taxes. There is after almost every war a moment when tax rates come down, tax burdens come down. That happens a little bit in the ‘40s, especially because the Republicans win an election, but Harry Truman, pretty effectively, pushes back against that. He’s embraced New Deal definitions of what constitutes fairness in taxation, and he is not excited about the idea of cutting rates very far. He describes most Republican-sponsored tax bills as giveaways to the rich. You find the rhetoric has really not changed at all over the decades, but Truman is able to push back against it.

Then Korea comes along, the war in Korea, and that pushes rates back up. The real point here, though, the real question becomes what happens in the ‘50s after 1952 when you have a Republican President in the White House. The odd thing, the apparent paradox here is you have a Republican President. You have a peacetime economy after the Korean War ends, and yet tax rates stay extraordinarily high. They got to over 90 percent during World War II, and although they dropped down for a minute or two, they stay over 90 percent throughout the ‘50s. The Eisenhower Administration doesn’t do anything to challenge that, and that’s sort of perplexing.

At the same time, and you see this a lot in contemporary debate about tax policies, people hold basically the correlation of, “Well, you find under high tax rates we’ve had high growth,” the implication being high taxes must be good for growth. The reality is that the ‘50s were anomalous, and this is where the historians get really irritating, because they tell you, like I’m about to, that you shouldn’t go fishing around for policy lessons in history, because there’s just no good point of comparison. But the ‘50s are a particularly bad point of comparison, because it’s a unique period in U.S. history.

We are economically dominant on the global stage in a way that we never had been and never would be again, and so those high rates could be maintained with relatively minimal economic damage for a while. What’s driving the Eisenhower Administration to keep these rates is, again,
a deep and abiding fear of inflation. Eisenhower is extremely worried that the economy is going
to overheat. He’s extremely worried about deficits. He’s all about fiscal responsibility, and he
makes a deal with Democrats, essentially, to protect the rates as they existed in the war in
exchange for some restraint on spending, to try to get back to a balanced budget. That is the
only factor that really matters in 1950s tax policy, is Eisenhower’s commitment to not cutting
taxes and to trying to restrain spending.

So the paradox is not as great as it appears. Growth is not as good in the 1950s as we now sort
of think it is. The average is just under 3 percent through Eisenhower’s term, and tax rates,
which are over 90 percent, are not nearly as high as we sometimes think they are, because the
effective tax rates start to decline. Those high marginal rates create all sorts of incentives to
create loopholes. Congress is very good at selling those loopholes to interested constituents, and
effective tax rates start to drop. They’re at like 60 percent during the war. They drop down to
around 40 percent right after the war, and they get down to about 30 percent in the 1930s. This
is the effective tax rate on the top 1 percent. So even those targeted by those super high rates are
finding ways around them, and that is a story that will continue into the ‘60s and the ‘70s and the
other decades, these very high rates that are more fictional. They are aspirational if you’re a
liberal, but they’re simply avoidable for many people. I think that leads us into the ‘60s and
when we actually do see some rate reduction.

Honorable Karl Rove: Thank you, Joe. We now have another three-decade hitter, Lawrence Lindsey, at the time of his
appointment, the youngest Federal Reserve Board Governor in history, I believe, and more
importantly, my colleague in the Bush Administration on the second floor as the Head of the
National Economic Council. Dr. Lindsey is going to cover the ‘60s, the ‘70s and the ‘80s, two
good decades sandwiching a very bad decade in between. Victory, Disaster and the Pivot Point,
the ‘40s, those are the three decades Larry’s going to hit.

Honorable Lawrence Lindsey: Thank you, Karl. The ‘60s are interesting because it’s the time when economists actually got
dangerous, and what gave us our ability to be dangerous actually was the computer. We began
to figure out that, gee, all these theories that Keynes had espoused, we could now actually
calibrate. It wasn’t just sort of a theory. You could actually compute the numbers, and so what
we’re going to see in the ‘60s, ‘70s and ‘80s was the economics profession began to experiment
in ways it really had never done before. And to pick up on your point, if you go back and look at
the income tax data from 1960, as a place to start, the top rate was 91 percent. There were eight
— eight Americans who paid the 91 percent tax rate.

Male: There was a bracket in the ‘30s that had one.

Honorable Lawrence Lindsey: Yes, they were avoidable. You’ve got to sort of scratch your head and wonder about the gene
pool that produced those eight, I think, but there it was. Still, how were they avoidable? They
were avoidable by doing something that was essentially non-economic. If you’re tax rate is 91
percent and you have an economically viable project that produces a 10 percent return and one
that’s somehow tax exempt that produce a 2 percent return, with a 91 percent tax rate, you go for
the 2 percent project. So there was a lot of that that went on.

The other thing that helped with the ‘90s [sic] was we actually had a President who knew what it
was like to be rich, and that was John Kennedy. Kennedy was very well aware — maybe he
learned it from his dad; maybe he learned it from himself — about the effective tax rates on
people’s decision making. A lot of his rhetoric would actually be thought of as supply side. He
was very anxious to cut the top rate of tax. The problem was he had a legacy. On his left he had
the New Deal legacy, and a lot of his own party was reluctant to cut rates. On the right, he had
the Eisenhower legacy of balanced budgets, and Republicans were really not pushing getting tax
cuts through.
The President was also worried that he had a Keynesian legacy, and his economists were saying, “We hit a recession in ’58. We had a short recession in ’60. Things aren’t looking so good in ’62. Gosh, you’re up in ’64.” So he was very aggressive in pushing tax cuts for both supply side reasons, what we would today call supply-side reasons, but also demand-side reasons. Of course he was assassinated in ’63, and Lyndon Johnson, who was not exactly incapable of doing political calculations — wasn’t so good at others, but political calculations he knew how to do — decided to pick up the legacy and, since he was up in ’64, decided to seal it and used Kennedy’s death to pass the Kennedy tax cuts.

They cut the top rate from 91 to 70. Now, we still think of 70 as a very high rate of tax, but think of what you’ve just done. At 91, you keep 9 cents on the dollar. At 70, you keep 30 cents on the dollar. You have now more than tripled the after-tax return to people. This is a huge supply-side effect, and you saw it. You had very rapid growth in ’64, ’65 and ’66, and the tax cuts were among the most successful we’ve ever had. The income tax collections from people at the top actually rose during this period. Again, you don’t need — remember, you’re collecting 70 cents still, and you just tripled the incentive for people to do something. This is a real win/win situation. The Kennedy tax cuts were actually the first real proof that there is a revenue-maximizing rate, and it is certainly below 91, and it is actually, as we learn later, below 70. That was a very positive experiment that economists ran.

Then things turned down a bit. Nixon came in, and we had a reversion to the Eisenhower mindset. We had a 10 percent income tax surcharge, which took the top rate back up to 77, and then in the recessions of the early ’70s, we had experimentation with one-time, lump sum tax cuts, a child credit of, I think it was $35, which actually was real money back then, things like that. The thought — again, we had sort of a return of the ’30s thinking, and that is high rates for “fairness” to collect revenue but then Keynesian kind of fiscal experimentation in order to overcome the recessions of that time.

Most of you are probably too young to remember the ’70s, looking around this room, but take my word for it, it was not a successful experiment. It was a disaster, and it was capped with a view of the Carter Administration that actually, since we have inflation, we all remember bracket creep was a good thing. You can find rhetoric from senior administration officials testifying to this, because with bracket creep, people get pushed into higher tax brackets, and therefore they have less money to spend. That’s a way of cooling inflation. So again, this rhetoric that we’ve heard all along was playing out.

So we ended the ’80s with a 70 percent top tax bracket that kicked in at $200,000, and $200,000 was a lot of money in 1950. It was less money in 1980. Ronald Reagan proposed, as we know, an across the board cut in tax rates. When the legislation actually got through, it included a lot of other things as well, some of which were not traditional supply side, but I will cut to the bottom line. You cut the rate from 70 to 50. Instead of keeping 30 cents on the dollar, you keep 50 cents on the dollar. That’s a two-thirds increase in what you’re able to keep. Suddenly people began a lot more economically rational use of their money. The disincentives to work, save and invest were dissipated, and the research on the ’80s suggests that the cut in the rate from 70 to 50 actually was a net revenue gainer.

However, the overall cut across the board was a small revenue loser, and this is sometimes where we get complicated in the debate. When you cut a rate from, say, 20 to 14, how much of a supply-side effect is there? Well, the guy used to keep 80 cents, and now he keeps 86 cents. That’s a tiny increase. There’s not going to be a lot of supply-side feedback. It’s not like the same proportional cut, say, from 70 to 50. So the Reagan tax cuts, because they were across the board, overall lost revenue, not necessarily a bad thing, but the top rates on net were a net producer of revenue. If you look carefully at the data, and I did this as a graduate student, the top rate for maximizing government revenue is probably somewhere in the high 40s.

Now, here’s something we all should keep in mind. Who on Earth would actually want to maximize government revenue? We kind of thought of sort of the high point of the Laffer curve as being a great thing to shoot for. What are we saying when the government is maximizing
revenue? It means we’re getting all the blood from the stone we possibly can. Well, have a little pity on the stone. It’s sort of a preference function between here’s the government and here’s society, and I don’t care how society does as long as the government is extracting all it can. That’s the kind of preference function maybe a Stalin would have or a Mao would have. What you really want to have is the rate well below the revenue maximizing point. At that high point of the Laffer curve, the government is doing great; the rest of us aren’t. So we, who believe in lower taxes, need to start emphasizing that you don’t want to shoot for the revenue-maximizing rate. The rate should be well below.

I won’t go through the math, but I’ll tell you this. When you start crossing 40, generally you start making the government about a dollar better off, and you make the private sector about $2.25 worse off. Now, you do have to collect revenue, so basically you take a buck from the private sector, give it to the government, but the economic burden of moving that dollar really costs another $1.25. As you move up into the 40s, that number rises and rises and rises. So I really think that we need to stand firm here, that once you cross 40, the math of higher rates really doesn’t make a lot of sense. We have a decade of experimentation in the ‘80s to prove that. We have experimentation in the ‘60s and ‘70s about what works and doesn’t work, and I would think that that’s the bottom-line conclusion.

Honorable Karl Rove: Thank you. Our final presenter is Al Hubbard, CEO of E&A Industries, a notorious bottom fisher located in Indianapolis. He attended both Harvard Law and Harvard Business on the struggling southern scholars program for rural Appalachian youth. He was Deputy Chief of Staff to Vice-President Dan Quayle and was my White House colleague as Director of the National Economic Council, where, on August 29, 2007, he became the only member of the Bush staff to be arrested on the White House campus by two uniformed division officers of the Secret Service. Al. He’s going to cover the ‘90s and the 2000s.

Honorable Allan Hubbard: Well, you can see how much you can trust me and trust Karl Rove. Karl Rove had stolen my car numerous times, and that’s what led to this —

Honorable Karl Rove: Does this have anything to do with tax rates?

Honorable Allan Hubbard: All I can say is Larry Lindsey, you can see why he was a very popular professor at Harvard. He makes economics actually sound like it’s fun. So the ‘90s, all of y’all remember the ‘90s. We began with, you’ll remember, the budget deal done by President Bush 41, that included what I would call a modest tax increase. I think it went from 28 to 31-point-something. Is that right, Larry?

Honorable Lawrence Lindsey: Yes.

Honorable Allan Hubbard: Then there was a relatively shallow recession, and then President Clinton comes in and has a very large tax increase. It raises the top rate to 39.6, but if you’ll recall, the ‘90s — you didn’t use my phrase, I don’t think.

Honorable Karl Rove: Cover Up.

Honorable Allan Hubbard: Cover Up, which I think is important. I don’t think the historical — I hope the historical will get it straight. Certainly the media will never get it straight, that the ‘90s were not the great period that the Clinton Administration likes to remind us of. There’s no question the economy boomed because of the tech boom, which, if y’all will recall, the tech boom, we all sat around thinking,
how in the world can these stocks keep going up, up, up and these companies have no earnings? There was a byproduct of that. It was covering up the negative impact that the tax increases had had on the economy, the narrowing of the tax base that 39.6 and other high rates had had on the economy.

The other thing it did, which I think is extremely important to recognize, is that it increased dramatically the tax collections of the Treasury. Over time, since World War II, taxes as a percent of GDP has averaged about 18.4 percent. Well, in the late ‘90s, when we started running the surplus, which the Clinton Administration loves to brag about, tax collections got up to around 21 percent of GDP, because everyone had stock options and capital gains from these inflated stock prices. Then you combine that with the fact that the Clinton Administration dramatically cut defense spending, all about the Defense Department, as some people like to say, and you end up with a surplus. But it obviously was not sustainable, and it was covered up. This tech boom covered up fundamental problems that existed in the economy.

Now, I feel a little uncomfortable, as I move into the 2000s, to talk about what President Bush did, since President Bush happens to be sitting right here, and I’m sure he remembers much better than I. He happened to be President with all decision making, and I was just on the periphery, but if I remember correctly, President Bush, when you were Governor in 1999, you and your advisors, many of whom are sitting here today, started talking about despite this big boom going on in the economy, there was a very real chance that the next President of the United States was going to have a recession.

There was also recognition that the dramatic increase of taxes under Clinton was having an adverse impact on the economy. As a result, towards the end of ‘99, Governor Bush proposed a very ambitious tax cut proposal that was a centerpiece of his campaign, and then once elected, he was successful in ‘01, with the assistance of a lot of these people here, getting that passed, the majority of which he got passed. To give you a sense of what happened — y’all probably all know this — the top rate dropped from 39.6 to 35, 36 to 33, and then the 15 percent rate actually, for some people, dropped to 0 and, for other people dropped, to 10.

Then in ’03, as the economy was still not as strong as it should have been, and recognizing that there were other tax burdens on the economy, President Bush proposed, and this was very, very ambitious — was the initial proposal to take dividends and cap gains to zero? There was certainly a discussion of that.

[Inaudible response]

Honorable Allan Hubbard: No. Was the proposal 15?

Male: 15.

Honorable Allan Hubbard: The proposal — it’s nice having the resources here to answer these questions. So the proposal they were able to get accomplished, cutting the dividend tax from 35 percent to 15 and capital gains from 20 to 15. Now, it’s interesting. There have been a lot of studies about what the impact of these dramatic tax cuts were on the economy and on tax collections. I think the studies on the impact on the economy have concluded that it enlarged the economy over the long run by 0.7 percent. Let me translate that into real dollars. We have a $14 trillion economy right now, so 0.7 percent is $100 billion, which is $300, basically, per person in the U.S. That’s every year. That’s how much larger this economy is as a result of these tax cuts.

Several other things happened. The empirical evidence — they studied what happened to tax collections, and the reduction in tax collections was 40 percent less than would have been expected under a static model, assuming that there was no change in behavior. But because of the lower taxes, there was change in behavior. You had more people working. You had them working longer hours. You had entrepreneurs taking bigger risks. You had people moving their
investments from tax-exempt investments to taxable investments. There was less tax avoidance, and so the tax base was larger, and as a result, the cost to the Treasury was 40 percent less than what had been anticipated under a static model.

In the dividend and capital gains area, it obviously cut the cost of capital. There was additional investment, higher productivity, higher wages and more hiring. Then in the entrepreneurial sector of the economy, which is generally in flow-through companies, the Sub S’s, the LLCs, the LLPs, et cetera, the ones that pay — their personal income tax is the way they pay business tax, and that’s 80 percent of — I think Steve Forbes pointed this out earlier. That’s 80 percent of companies.

Interestingly enough, 55 percent of private workers work for flow-through companies, and almost 50 percent of business taxes come from flow-through companies. The result of the dramatic cuts under the Bush Administration: you had significantly more investment, higher productivity. We had incredible productivity during the Bush Administration and, therefore, higher wages. Now, I call this the Rollercoaster Decade, because we had great growth beginning in ’03 through the end of ’07, and then we had the collapse caused by the — credit expansion finally reached the breaking point. It had started after World War II, dramatically increased during the 2000s, and it finally reached a point that it was not sustainable. We all know what happened. It resulted in the great recession that we’re still recovering from.

So we’re now faced — I don't know whether — maybe I should quit. We’re faced with a choice. We have the Obama Administration saying the way to get the economy going is to start taxing rich people, and we have studies that show the tax reforms and cuts of the ‘80s had a positive impact on economic growth, the tax increases of the ‘90s had a negative on economic growth, and the tax cuts of the 2000s had a very positive impact on economic growth.

Honorable Karl Rove: Thank you, Al. Before we jump to questions from the audience, let’s go to each of the panel members and see if they have a comment on something that they’ve heard from one of their fellow panelists. I will say, it’s interesting. We’ve talked about, in 40 minutes, 90 years of tax policy, and we’re talking about enormous volatility, down in the ’20s, up in the ’30s, turned into a mass tax in the ’40s, equilibrium. It was just sort of stand pat in the ’50s, down in the ’60s, terrible in the ’70s, down in the ’80s, up in the ’90s, down in 2000s. That is a pretty wild pattern for the fundamental tax policy of the United States over a period of time.

Larry, why don’t we start with you? Any comments to add to what Al said or questions or observations about other panelists’ comments?

Honorable Lawrence Lindsey: I think the point of experimentation is a good one, and I think we’re going to experiment going forward. There are some basic rules, though, that I think the entire economics profession, even our friends on the other side, who actually do the studies, would say you want a rate that is as low as possible and a base that is as broad as possible. That is all there is to it, and we can negotiate whether the top rate should be 39.6 or 25, but that is a lot narrower range than — no one that I know of, who is serious about the economy thinks we should ever go back to the really bad old days.

Honorable Karl Rove: Amity?

Amity Shlaes: Just want to say, why are we here? Because there is a record. We just tried to lay it out for you. You could add to it. You could alter it. There’s a tremendous record, and it’s wonderful to consider it. We know the answer, just what Larry said. So why is that important? Because usually these conversations happen as if there’s no record, as if the world is starting anew, but there it is, the history of the 20th century, better somewhat lower than higher. Let us consider it at this crucial point.
Honorable Karl Rove: Joe.

Joseph Thorndike: I think that this question of volatility in tax policy is important. I do think that sort of the take-home message for me, from this most of the century that we just looked at, it’s a brief for sort of traditional tax reform and a kind of boring, expert-dominated, traditional tax reform, as you’ve said, a broader base and lower rates. Almost everyone can agree that that’s a good combination, liberal, conservative, whatever. No one serious wants high rates just for the sake of high rates, not to say that that argument isn’t out there, because it’s out there everywhere right now, but we would all be better off with the broader base and the lower rates.

I think, if you need an example of that, and I think history does provide this, it’s that the really extremely high rates that some on the left do look at sort of longingly at this point, they created an enormous amount of avoidance and some amount of evasion as well, illegal evasion. What it really did was it corrupted the policy process around tax. It made tax loopholes extremely valuable to taxpayers. They were willing to pay lawyers and accountants tons of money to go lobby Congress to do it. That undermines the whole legitimacy of the tax system.

I said this a little earlier on another panel. I think if you’re a liberal and you love taxes, then you should not like these high rates. If you love the income tax, you should want low rates, because what high rates do is they destroy the tax itself. They create the loopholes. They create the avoidance. Faith in the fairness of the system starts to decline, and that’s when people really start to turn around and say, “Hey, I don’t want to put my money into this. I don’t buy the value proposition here anymore.” So I think, for a liberal, if you like big government and lots of tax revenue, high rates are not the answer. For a conservative, high rates are clearly not the answer.

So it seems to me that there’s plenty of room to come together on, again, this sort of boring, not exactly rile the base sort of program, but a very traditional, sort of 1986 style tax reform. It’s impossible to pull off. It was impossible in 1986 too, and it happened. I think that’s the sort of hopeful note to end on, that every once in a while, it does happen.

Honorable Karl Rove: John.

John Prestbo: In my work, I look mainly at the capital gains rate rather than the overall income tax rate, but I think you’ll find something interesting here. In the 99 years, through last year, that we’ve had the 16th Amendment in effect, there were 63 years in which the capital gains tax rate was 25 percent or less, and there were 36 years in which it was over 25 percent. During those 63 years of the 25 percent or less, the Dow Jones Industrial Average had an annualized rate of return of 6.05 percent, but in the years that the capital gains rate was above 25 percent, the rate of return was 3.49 percent. So there is a dramatic difference — that’s 256 basis points — showing that the capital gains tax rate did seem to have an effect on behavior in the stock market. I think that’s an interesting point of view.

Honorable Karl Rove: Thanks, John. Al.

Honorable Allan Hubbard: I would like to pose a question to Professor Lindsey, please. I left out of my little presentation, that I meant to mention, and I would like Larry to comment on this, that when you analyze the Bush tax cuts, that the economic growth came from the cuts at the higher end, I think they say, and among — and the impact they had on the highest income people. We also, the Bush Administration, not only were there the tax cuts I described, we also reduced the penalty for marriage. We also raised the tax credit for children, et cetera, and studies show that those kinds of things, although certainly important for fairness, don’t have a positive impact on economic growth the way cuts in especially the higher rates do and especially for the highest income people. Professor?
Honorable Karl Rove: Can you knock this one out of the park, Larry?

Honorable Lawrence Lindsey: Yes.

Honorable Karl Rove: Softball about the size of the moon coming towards you?

Honorable Lawrence Lindsey: I’ll do my best, and what I’m going to point out is that President Bush was even more clever than you just gave him credit for. What happened was we had two problems in 2001. We had a short-term recession that was made worse by 9/11, and we had a long-term growth problem, where we needed to improve the cash flow of the small-business sector in particular, which had been badly hurt by the stock market collapse. Remember, when President Bush came to office, the NASDAQ had already collapsed by 80 percent. The economy shrank in the third quarter of 2000, before he came to office, and things were not going so well. 9/11 made them worse.

So I think of the 2001 and 2003 tax cuts as sort of two sides of a barbell. The first was the need to really change psychology and get the economy moving again with the doubling of the child credit, the cutting of the bottom rate from 15 to 10. In 2001, we actually mailed checks. They went out in August to give people a rebate from 2001, which turned out to be vital, because 9/11, if people remember it, this economy came to a standstill. If we had daily GDP for the third and fourth week of September, it was darn close to zero. We didn’t even have planes flying. It’s pretty hard to conduct commerce without planes flying. The stock market was closed for five days. Auto production had been shut down, et cetera.

The quarter after those checks got in people’s accounts was the fastest rate of inventory draw down we’ve ever had in post-war period. Why is that important? Well, if people aren’t shopping, the goods pile up on the shelves, and if goods pile up on the shelves, the factories are going to shut down because we don’t need more goods. The fourth quarter, in spite of 9/11, the fourth quarter of 2001 pulled those goods off the shelves because that money went out in people’s pockets, and we were actually able to get the economy growing, again, in 2002, in spite of 9/11, in spite of everything else.

I would call that the demand-side part of the Bush tax cuts, but you then had, as the top rates came down, starting in 2003, was you started to see small-business cash flow revive, employment revive, and we had very rapid growth in ’03, ’04, ’05, ’06. So I think actually the great thing about the President’s tax cuts was, after all this experimentation up and down, we finally got both the supply side and the demand side right, and we got it right in a way that really helped the economy out.

One more small point, if I may, Governor Rove.

Honorable Karl Rove: General Rove.

Honorable Lawrence Lindsey: General Rove, Lord and Master Rove, whatever.

Honorable Allan Hubbard: King Karl.

Honorable Lawrence Lindsey: King Karl. Yeah. You don’t know all the names we called you on the second floor.
Karl Rove: Yes, I did, Larry.

Honorable Lawrence Lindsey: Uh-oh. You had us bugged probably. The difference between the 6 — you mentioned the 6 percent and the 3-½ percent. Gee, 6 percent, 3-½ percent. It doesn’t sound like a lot, but let me just — we talked about this over the course of a century. Over the course of a century, the difference between 6 percent and 3-½ percent means the stock market would be eight times higher, eight times higher, 16,000 instead of 2,000. That’s the difference over a century of 6 percent versus 3-½ percent. It’s real money that we’re talking about here.

Honorable Karl Rove: Thank you. We have time for maybe a couple of questions. Before we do, though, I do want to apologize to Al. I want to frankly admit here today, for the first time publically, I didn’t steal his car. I was merely repositioning his car on West Executive Drive to get it out of the sun, and it was a service I was happy to provide. He retaliated by wrapping my car in industrial cellophane and subjecting me to abuse on national television. So it was only in self-defense that I asked two pals on the uniformed division of the Secret Service to handcuff him, and I have the photographic evidence that it actually took place. We have time for a couple of questions. Yes, sir.

Male: I’m hoping someone can quantify — my name’s John [inaudible] from Nevada. I’m wondering if someone would quantify all the new changes that have occurred in transactions that avoid tax. In other words, [00:53:01 inaudible], real estate, [inaudible] ordinary income and capital gains. There are all sorts of transactions like that that have come and gone through the years. [Inaudible] what are the implications of those changes?

Honorable Karl Rove: Anyone want to tackle that? Joe?

Joseph Thorndike: You’re going to ask a historian that question? I’m the wrong guy.

Honorable Lawrence Lindsey: Here’s a simple way of quantifying it. Back, as I mentioned, in 1960, we had eight people in the top bracket. Last year we had roughly 400,000 taxpayers making over a million dollars. People are willing, with moderate taxes, to actually report income and do business that results in reporting income. I can’t think of any more dramatic explosion than that statistic.

Honorable Karl Rove: Governor Engler. On behalf, incidentally, of the institute, we apologize for putting a picture of a bearded man in your place with your biography in the notebook today.

Honorable John Engler: It might have been an upgrade on the photo, though, over the one I sent them. Mr. Hubbard talked about the parts of the tax strategy in the ’01 and the ’03, those 21st century Bush tax cuts, that we did these parts for fairness, and then we did other parts for growth. That seems to be the fundamental debate today. It’s all about fairness. Growth seems to have dropped out. The growth discussion versus fairness, is that the strategy, Larry or others — how do you sell growth over fairness? Isn’t growth the fairest of all?

Honorable Karl Rove: One way of looking at it, though, is fairness defined as what kind of an action. Fairness in the ’01 and ’03 tax cuts was defined as what kind of tax cuts would benefit people who would not otherwise derive a significant advantage from the other kinds of pro-growth cuts. This administration’s concern, and the current dialogue about fairness, is how can we sock it to somebody who’s not paying enough in our view. Fundamentally different. I mean, there was some discussion, and Larry was very good at the time of making clear things like the child tax credit really didn’t have implications for growth, but they did have implications for the ability of families with large numbers of children to get by. It wasn’t going to create significantly more
economic growth. The feedback wasn’t significant, but it was a way to help people get by in a tougher economy.

Amity Shlaes: Can I say one thing?

Honorable Karl Rove: Yes, Amity.

Amity Shlaes: Jobs. Jobs. If unemployment is high, it’s not fair.

Honorable Karl Rove: Did I see a question over here? Yes.

Brian Wesbury: I’m Brian Wesbury from Chicago. Right now government spending is about 24 percent of GDP. Given this 90 years of tax history, is there any way that the tax code, even remotely like we’ve seen over the last 90 years, could actually raise 24 percent of GDP? I mean, we know historically it’s averaged 18 percent. Is there any way the tax code on income, getting rid of deductions or any other way, could actually raise 24 percent?

Honorable Karl Rove: Let’s have a quick show of hands. Who thinks it could? Who thinks it could not?

Joseph Thorndike: We got within shouting distance to that during the war, but I mean, the top tax rate was 94 percent. Effective tax rates were 60 percent on the top 1 percent. So it’s possible but hard.

Honorable Lawrence Lindsey: And much higher on the middle class.

Joseph Thorndike: Much higher.

Honorable Lawrence Lindsey: Much higher.

Honorable Karl Rove: We have a number of economists in the audience. Those of you who are economists who believe it could raise that much of GDP, raise your hands.

Amity Shlaes: For one year or forever?

Male: Yeah, you could do it.

Honorable Karl Rove: On an ongoing basis, could the tax system generate 24 percent of GDP? Brian, is that fair to say, on an ongoing basis?

Male: [Inaudible]

Honorable Karl Rove: How many do not think it could? All right. Well, on the one hand, yes, and on the other hand, no. With that, thank you for coming.

Honorable James Glassman: Thank you, Karl. Thanks for a great panel. We’re going to break for lunch, but before we do, I just want to remind everyone — I’m not sure whether you’ve noticed it when you’re out there, but there is a terrific exhibit. You heard Travis Brown earlier, on the first panel, from Yourtaxcode.com, there’s an interactive map, and you can see where people have moved from, let’s say, Pennsylvania to Florida. You can see the flow of population and the flow of cash. Just punch it with your finger. We have books for sale. A lot of the people right up here have
written books that are out there for sale. We also have some terrific pictures of what the Bush Center is going to look like. So I urge you all, during your networking lunch, to take a look at that.

We’ll come back after lunch a little bit before 2:00 to hear from Congressman Paul Ryan. Then after that, there will be two breakout sessions, and that will be followed by our Blitz Solutions Panel, a star-studded cast that includes Larry Lindsey making a comeback. So have a great lunch.

[Break]

Honorable James Glassman: Before I introduce our next speaker, I just wanted to remind everyone — I know you were just out there, so don’t rush back, but during the rest of the day, please make sure you see the books that are for sale by people like Karl Rove, a lot of people who’ve been on the panel. Karl Rove, he needs to sell a few more books, John Taylor, Amity Shlaes, even me, as well as there’s a cover, because we don’t have a book, and we won’t have one until July of *The 4% Solution*, which is the book that President Bush alluded to earlier today that the Bush Institute is publishing with Crown Publishers that has 21 chapters and a forward by President Bush, five Nobel Prize winners. It’s really all about what we’re talking about today, as well as this terrific interactive map that Travis Brown and his folks have put together, where you can see where everyone is going when they leave California to go to low-tax states.

It is my pleasure to introduce our next speaker, Paul Gigot, who came to *The Wall Street Journal* in 1980 and has now emerged as probably the most powerful man in America, as the editor of *The Wall Street Journal* editorial page. In 2010, he won the prestigious Bradley Award, which goes to someone who has made major contributions to the promotion of liberal democracy. Paul Gigot, take it away.

Paul Gigot: Thank you very much, Jim, and thank you, ladies and gentlemen. It’s really great to be here with so many friends and people I admire and contributors to the journal and, I might add, especially sources. We are especially grateful for our sources. It’s really a pleasure to be here at this really important and timely conference and especially to introduce our next speaker, Congressman Paul Ryan.

I should first offer a confession, that the Congressman and I share a frustrated career ambition. Had things worked out a little differently, had the Almighty been a little more generous in his genetic endowment, both of us would have rather have played for the Green Bay Packers. This is what happens when you grow up in Wisconsin, and with all due respect to President Bush, the Dallas Cowboys are not America’s team.

If you ever visit Congressman Ryan’s private office on Capitol Hill, you will not find the usual photographs of him with various world dignitaries. What you’ll find are a couple of items of personal memorabilia, two in particular. One is a napkin autographed by, of course Arthur Laffer. The other is a photograph signed by Paul Hornung, the famous running back of the Green Bay Packers, from the glory days with Vince Lombardi. This is a man who has the right role models.

You also may have heard that Paul Ryan is a dangerous man, a very dangerous man. Now, this must be true, because the current President of the United States keeps saying so. When I turn on MSNBC, and of course I’m there every night, and hear Paul Ryan discussed, I’m not sure if I’m listening to a news channel or *America’s Most Wanted*. You may have read that one of America’s supposedly leading newspapers, in its typically current understated style, calls him a cult leader. A TV ad you may have seen had a Paul Ryan lookalike throwing a grandmother in a wheelchair off a cliff.

Now, I’ve known Paul Ryan since he was an intern 20 years ago, and I have rarely seen him criticize anyone, much less throw anyone off a cliff. But I do agree with the critics on one point,
albeit not for the same reason. Paul Ryan is dangerous. He is dangerous to the political status quo in Washington. He’s dangerous because he understands that the United States cannot continue on its current path of a slow-growing economy but a fast-growing government and still remain the prosperous country that it has been for 225 years. He’s dangerous because he’s willing to say this out loud and in public, not once, not twice but again and again, and he’s willing to propose concrete and controversial solutions that will help the country change direction and to suffer the political consequences for doing so.

Now, this is not a partisan point. Before he died, I was lucky enough to get to know, on a personal basis, the late Democratic Senator from New York, Daniel Patrick Moynihan, and every so often, the great liberal intellectual that he was would call me up on the phone and offer some ideas. Now, as an aside, I should say that this is the secret to being the editorial page editor of The Wall Street Journal, get very smart people to call you up with ideas. One of Moynihan’s ideas late in his life was that the big institutions of government, which of course his own party had been so influential in creating, they had to be reformed. He was talking about the tax code. He was talking about the education system, but he had a particular interest in the great middle class entitlements of Medicare and Social Security. He said they were designed for another era. They were becoming unaffordable as America’s demographics changed, and they were crowding out other good, liberal purposes for government spending: education, transportation, a safety net for the poor.

Moynihan told me one other thing. He said that the Democratic Party should reform these programs because they had authored them. They had created them, and they had an obligation to fix them so they could continue on and be as useful and contribute to American society as much in the 21st century as they had in the 20th, but, he said, if Democrats weren’t willing to do it, well, then Republicans were going to have to lead.

So here comes Paul Ryan, who becomes ranking member of the House Budget Committee in 2007, and he decides to break congressional type and actually do something with the job. He writes what he calls The Road Map to America’s Future. That includes entitlement reform, tax reform among other revolutionary ideas. I remember he visited us at the journal with this plan the first time, and I remember thinking to myself, “All this sounds really promising, but is he nuts? How long does he want to stay in Congress? He must want a short career in politics.” Truth be told, the first year he introduced the road map, in 2008, he had eight co-sponsors, eight. Around the journal, we call that the vast right-wing conspiracy. In 2010 he tried again. This time he had 14. Then came the election of 2010, the new House majority, and in 2011 he introduced a modified version of the plan, called The Path to Prosperity. This time it passed the House with 235 votes. Even more amazing, it won the support of 40 Republican Senators. Think about that. Senators voting for a House budget. The sea is parting, cats and dogs living together.

So as recently as 2010, House Republicans were advised by their leaders not to vote for the Ryan budget. Today the reform proposals are at the center, as all of you know, of the presidential campaign. The various Republican candidates have endorsed all, or at least substantial parts, of the Ryan proposals on Medicare reform, on tax reform, and no less than President Obama, I think it’s fair to say, clearly views Mr. Ryan himself and his ideas as a central challenge to his alternative vision of the American economy, as he puts it, built to last in this century and of a larger entitlement state. My point is this is where dangerous ideas can lead you if you believe in them.

Now, some Republicans are saying they’d like to see Paul Ryan debate Vice-President Joe Biden as part of the Republican ticket. I’m not sure that’s a fair fight. Think about it. I think I’d like to see closer to a level playing field, maybe Paul Ryan versus President Obama, assuming that the President would be willing to take the challenge. If you need a moderator, I would be happy to volunteer.

So yes, Paul Ryan is dangerous, in my view, refreshingly so, usefully so, at this moment in our history, necessarily so. Congressman Paul Ryan.
Honorable Paul Ryan: Thanks a lot, Paul. We do share the same aspiration, which is to play for the Green Bay Packers, albeit, we would not be on the team at the same time. Let it sink in there. Yeah.

Mr. President, thank you. Thank you for your leadership. Thank you for doing this. Thank you for pointing out the obvious, which is we have to come up with a growth strategy, 4 percent solution. I was looking at your website. “Free market capitalism is the engine of social mobility, the highway to the American dream.” Well, that pretty much says it right there. Couldn’t have said it better myself. That’s what we’ve got to focus on. What do we do to get back on prosperity, to get our train on the right tracks and get away from austerity? Prosperity is what the American dream is all about, limitless opportunities. You can make the most of your lives. Your rights come from God and nature, not from government, and then you can do what you want with your life to be happy, however you define happiness for yourself. That, in a nutshell, is the idea.

My own family history is pretty unremarkable. It’s just like everybody else’s. The potatoes stopped growing in Ireland. My family was in a class-based society. They came over with the shirts on their backs. They came to Boston, worked the railroads until they had enough money scraped together to buy a farm. That ended up being in Footville, Wisconsin, right outside my town of Jamesville. They were there in the summer, and they thought it looked just like Ireland, so they bought the farm. Then came winter, and they said, “Oh, crap.” They had to make a go of it ever since then, and we’ve been there in this town ever since then.

The idea, though, that you could leave all these class-based societies and come to this country because of the idea of this country — we’re the country that is formed, not based on geography but based on an idea, and we always have to re-realize that idea. Now more than ever that idea is being compromised. That idea is on the line, so we kind of have a choice in front of us. Do we want to get back toward growth and prosperity like the 4 percent solution you’re talking about, Mr. President, or are we going to throw in with the rest of the world and go down this austerity path, which is what Europe is going toward?

Austerity means current cuts to benefits for current retirees. It means cranking up your taxes to try and please the bond market vigilantes, which slows down your economy, makes it harder for young people to get out and have careers and build a life for themselves. It means overburdening regulations, where the central government is picking winners and losers in the marketplace. It means slow growth. It means pain and austerity. That’s what Europe is suffering. Guess who gets hurt the first and the worst when you go down the debt crisis path, when you start imposing austerity. It’s the people who need government the most. It’s the poor. It’s the elderly. It’s the sick. Those are the ones who get hurt the first and the worst when you have a debt crisis, when you’re imposing European-like bitter austerity on your society because you kept kicking the can down the road.

So what we’re experiencing right now is basically decades of politicians from both political parties making promises to voters that they simply couldn’t keep. In Europe, those promises are up now, and now they’re in the austerity mode. Here, for lots of reasons, being the world reserve currency and other reasons, we still have time. We still have a chance to get this under control, to get back to prosperity, to prevent a debt crisis, to prevent austerity, but our time is not that much greater. Our window is starting to close. The next President and the next Congress will make this decision. The reason I say it in such a stark way is because I think we’re reaching basically two tipping points in this country, which arguably Europe has already crossed. These tipping points, if we reach these, will be difficult to come back from.

The first one is sort of a mathematical one: debt, a tipping point of debt, after which, if the bonds market turn on us, then we’re in the austerity mode. Then we’re in the cutting benefits for current beneficiaries, changing the social contract for people who’ve already retired, who organized their lives around these programs, cranking up taxes, slowing down your economy. Then we’re in managed decline mode. Then our budget is whatever the bond markets tell us it has to be. Austerity after austerity. That’s the fiscal tipping point.
The tougher tipping point is the moral tipping point, the one where we become more of a taker society versus a maker society, the kind of tipping point where the vast majority of able-bodied Americans do not see themselves as the provider for themselves but the government, where we have taken our safety net and, instead of working it and reforming it to get people off of welfare and onto work, turned it into a hammock that lulls able-bodied people into lives of dependency and complacency.

Now, the numbers on this front are pretty startling. The debt tipping point, I don’t need to go into all of that. Read Steve Forbes’ magazine. Read The Wall Street Journal. Listen to Jim Glassman. They’ll give you good projections on all of that. The other tipping point, we’re also getting close to that. The Tax Foundation tells us 70 percent of Americans get more benefit from the federal government in dollar value than they pay back in taxes. So you could already argue we’re past that point, but I don’t think we are. Most Americans believe in the American dream. Most Americans believe in the idea of an opportunity society, of a society of growth and of upward mobility, so we still have that window.

What that basically means is we are now at that sort of proverbial fork in the road. We have a choice of two futures in front of us, and the way we see it, as the only majority of the Republican minority in America, the House of Representatives, we owe you, our fellow countrymen, at least the honor of making the choice. So that’s what this fall is going to be about. On the one path, we’ve got the President’s path, a government-centered society, a society on the path to debt and decline, the path we’re on today. On the other path is what we’re proposing, a path to prosperity, a path to actually getting us back on the growth, fixing these problems and preempting a debt crisis. This November, what we’re asking for is the affirmation of the country to give us the permission and the obligation to put these things into place to fix this before it gets out of our control.

The choice couldn’t be clearer. You have an opportunity society, which is reclaiming the American idea, or you have this government-centered society. I would argue that President Bush — excuse me, Freudian slip. President Obama — he’s right there, so come on. He’s in front of my mind. I would argue that President Obama is bringing us toward this government-centered society. He is putting his trust in government, and this is a trust that puts us down the path of debt and decline.

Now, I’ve got a lot of problems with the President’s budget. After all, he did follow the budget law. He submitted a budget each of the four budget seasons, unlike the Senate, which chose to ignore the budget law by not offering a budget in 2010, 2011, and now they say they won’t do it in 2012. Go figure. You’re elected to represent the people of your district or your state. We have a debt crisis on the horizon, meaning you need to pass a budget to fix that, and they’ve decided for over 1,000 days not to do anything about it. Where I come from, that’s a firing offense.

But let me talk about the President’s budget. There’s a lot of problems I have with it, but let’s focus on what the purpose of this conference is, growth. It makes our growth situation worse. There are a number of reasons why. I’ll just quote Tim Geithner, the Secretary of the Treasury who came to the Budget Committee about a month ago. He said to us, “We’re not suggesting that we have a solution to the long-term fiscal problem. We don’t. We just don’t like yours.” I couldn’t have said it better myself. This is, in essence, what the President is doing. Rather than seeing this very clear and present danger to our country, to our economic future, to our way of life, rather than putting a solution out there, wait for the Republicans to offer theirs. Then attack it. Whatever you call that, it’s not called leadership.

Second, certainty: if you put a budget plan in place that deals of the drivers of our debt, to quote John Taylor, who I know is one of your panelists here, or to quote Chairman Bernanke, that will give us an immediate boost to growth today. Confidence trajectory, the future, the bond markets, businesses, they’re looking to see if leadership is being placed in the federal government in Washington to get this situation under control so that they can take risks, so that
they know that they have a certain future that is one to be optimistic about. Until you have a plan like this in place, you will not reap that kind of a growth dividend.

Another reason why I think the President’s budget is bad for growth: cronyism. Now, both parties have been subject to what I call crony capitalism or industrial party. For us, we got confused. We thought being pro-business was being pro-market, when in fact it was being pro-incumbent business. It ended up erecting barriers to entry against would-be competitors. So it’s easier for us to go back to our roots, our core principles, which is be pro-market. It’s a little harder for the left to do this, I think, because the President, in my opinion, subscribes to the notion that they just know better in Washington, that Congress can go pass a lot of these vague laws, and then we have a permanent class of technocrats and bureaucrats who can better micromanage society and our economy, who can do a better job of subsidizing and picking winners and losers. Whether it’s through regulations, whether it’s creating too-big-to-fail banks, through Dodd-Frank, whether it’s the tax code or Solyndra or the regulatory state, they believe in a process, which ends up putting entrepreneurial, small business, risk-taking and capitalism and putting it aside and replacing it with connected capitalism, with crony capitalism, with big-government capitalism. That replaces the rule of law with the rule of bureaucrats, with the rule of the connected. That’s probably one of my biggest criticisms of his budget.

Finally, let me get to the nut of the matter: taxes, tax reform. This is where I think the President’s budget is the most anti-growth, for in January, he is proposing that the top effective marginal income tax rate goes up to 44.8 percent. Where Paul and I come from, overseas, which we mean Lake Superior, the Canadians just dropped their business tax to 15 percent. Nine out of ten businesses in Wisconsin file their taxes as individuals. Eight out of ten businesses in all of America aren’t corporations. They’re businesses that file their taxes as individuals, like Sub Chapter S corporations or partnerships and LLCs.

So what we’re basically saying to them is, if you get successful, if you buy four acres out of the industrial park in Elkhorn, Wisconsin, and you start with five employees, and then you get to 25 employees, and then you get to 250 employees, we used to call that the American dream. Now you’re part of the evil rich. Now you’re going to be hit with effectively about a 45 percent tax rate. Throw our state income tax rate on top of that, and you’re over 50 percent. How on Earth are they going to be able to compete with the likes of the Canadians who are taxing themselves at 15 percent or the Irish at 12-½ percent or the Japanese who are lower than us now or the Chinese? We’ve got to remember we’re in a global economy, and if we tax our job creators, if we tax these businesses, where 65 percent of the net new jobs come from, where more than half of Americans work today, if we tax them at such higher rates than our foreign competitors are taxing their companies, we lose. They win.

So to me, this is a system that is wrecked for austerity. Higher tax rates, more complexity, more loopholes is what the President’s budget is proposing. Now, the bottom line is we’ve tried this approach. We have tried chasing higher spending with higher taxes and more debt. It hasn’t worked. We tried the stimulus spending. We tried all the demand-side Keynesian stimulus. All it got was a debt hangover and a cloud of more uncertainty hanging over our economy, and so it’s put us on slow growth.

Look at the social pathologies that have failed. Our poverty rates are the highest they are in a generation. One out of six Americans are in poverty now. The woman unemployment rate is the highest it’s been since we’ve measured it. So these policies aren’t working. The good news is there’s a better way, and the other good news is some of us are actually putting ideas on the table to show that there’s a better way. That’s what our path to prosperity budget does.

Now, to Paul’s point, a lot of the political pundits told us that we were crazy. When we first started putting these budget ideas out there, the pollsters and the pundits and the political class said, “Whatever you do, don’t do that. You’re going to give up your seat. You’re going to risk political death.” I’ve got to tell you, if you want to be good at these jobs, you have to be willing to lose these jobs. If all you do is worry about getting re-elected and doing what the pundits and the pollsters tell you is the right thing for the moment, based upon the phone calls that took place
last night, you’re going to go nowhere. You’re going to be chasing your tail and running in circles.

We know what works. Freedom works. Limited government works. Free enterprise works. So if you take a look at our budget, it is a huge contrast. To be really quick, the contrast is this: we actually deal with the problem. We actually see the debt crisis coming. We see the drivers of the debt, and we deal with it. We have to have those fundamental and structural entitlement reforms so that we can preempt austerity, and the sooner we act, the better off we all are. We actually have proposals that Medicare doesn’t change the benefits for anybody who is in or near retirement. You wait much longer, you have a debt crisis, all bets are off. You won’t be able to do that.

So what we’re saying is let’s preempt austerity by getting us on the right path so that those people who retired — my mom’s been on Medicare for 11 years. We have this rule in Wisconsin. When you turn 65, you’ve got to go to Florida for the winter. She’s been doing that since she’s been on Medicare. We don’t need to pull the rug out from under these people who’ve already organized their lives around this promise. The promise is it’s a promise with a $37 trillion hole. So if we reform these programs now for the younger generation, we can cash flow the commitment to the current generation and keep the guarantee going, but you must do it soon.

We cut $5.3 trillion in spending from the President’s budget. We save and strengthen these critical entitlement programs. We get our debt under control. We put our budget on a path to balance and to get the debt completely paid off. The second difference we do is we actually propose to end the cronyism. Get rid of all the corporate welfare. Get rid of the notion that we should be subsidizing this company and not that company. Get rid of the idea that regulators should be picking favorites among those who are connected. Get back to the system of free markets and fair play and transparency, and equal rules apply to everybody. Equality under the law, before the law, not equality after the law.

Now, the other big difference, and I’ll finish with this, is tax reform. We propose to do fundamental tax reform. Of all the things you can do in this country to help get people back to work, back on the path to prosperity, you have to acknowledge the fact that basically the income tax system blows up in January.

I was on the Ways and Means Committee when President Bush signed those two tax bills into law in 2001 and 2003. All tax laws must originate in the House and in the House Ways and Means Committee and then go to the Senate. When that bill left the House, it was permanent. It was never intended to be a temporary tax rate reduction. Then came — you guys ever Tom Daschle? So then came this thing called the Byrd Rule in the Senate and the filibuster, which is where the Daschle name comes in. In order to get that tax rate reduction in place, which the 2003 law was to speed it up so we could get out of the slow growth, mild recession we had at the time, which we did, because these policies worked, he had no choice but to accept the time limit on it, because the Senate refused to go along with making these things permanent.

So now we are where we are. We have a cliff coming at the end of the year, and what we’re saying is it actually provides a great opportunity. The code is effectively blowing up, so let’s reform it. Let’s take a page out of Steve Forbes’ playbook and go back with a very common, simple, better system. Lower the rates; broaden the base.

Guess what. There are a lot of Democrats who agree with us. I served on the Fiscal Commission with Erskine Bowles and Alan Simpson. I have tremendous respect for these gentlemen. There are a lot of Democrats who agree with this idea. Take away the tax shelters. Limit the loopholes. Lower everybody’s tax rates for all so that we can be entrepreneurial, so that we can help those small businesses succeed and compete in the global economy. We’ve proposed specifically a 10 percent bracket and a 25 percent bracket for individuals, and bring that corporate rate back down to 25 percent. And get rid of this clumsy, outdated, anti-internationally competitive worldwide tax system and go to a territorial system.
I won't go through a tree on what a territorial system means, but it simply is a system that makes sure that we don't keep pushing capital away from America, and we make America the place where you want to keep your capital. We make America where you want your headquarters to be located. Look, 95 percent of the world’s population, they’re not in this country. They’re in other countries, and if we want to be successful, if we want to have high living standards, entrepreneurial, we have to make and export more things, and we need to have tax laws that jive with that. Now because Japan lowered their corporate tax rate in April, we now are the distinguishing honorees of having the highest in the world. So we think we should lower rates, let people keep more of their own money and improve the incentives to save, work and invest. Lowering marginal tax rates does that.

You also remove distortions out of the tax code. You allow capital to be deployed where it can do the most good, where it can create the most value, where it can create the most wealth, not where some bureaucrat thinks it ought to go but where free individuals, in a free-enterprise system, chasing opportunity, acting in their own interests and helping people in their community decide the money ought to go.

The other thing I would simply say is you've got to keep an eye on competitiveness. If we don’t mind the fact that this is a whole new story — the 21st century is not one where the United States is the undisputed economic super power of the world. We have to be lean. We have to be mean. We have to be competitive. If we keep going down this path, where we divide each other and try and come up with this idea that we can tax ourselves at double the rates our competitors are taxing theirs, we will have a welfare state on our hands. We will be slow growth. It will be economic stagnation.

Now, the other benefit of all this is it actually helps our budget quite a bit. The CBO acknowledges, if these tax increases hit in January, we’ll go down to a 1 percent growth. It could be even lower than that, and what we're showing with an alternative growth scenario we created in the Budget Committee is, if you actually get the kind of plan that President Bush is talking about, if you actually get a growth dividend, you'll balance the budget so much faster. So the secret to success is economic growth, along with spending discipline and entitlement reforms, and if we do those three things, we can quickly get America back on the path to prosperity.

The idea at the end of the day here is this: then we revive the system of upper mobility. So here’s what it all comes down to at the end of the day. We don’t like the direction the President’s taking the country. We think he is putting the country on a very dangerous path, on a path that is a government-centered society, on a path to debt and decline, and we believe that, if we follow this path, it will not end well for anybody, because then you have a debt crisis. In a debt crisis, the people who need government the most, at a very vulnerable time in their life, are the ones who get hurt first. We believe in prosperity. We believe in upper mobility. We believe in a quality of opportunity, not a quality of outcome, which means we want to put these kinds of pro-growth policies in place.

In order to do that, we have to ask the country for permission, and so our commitment is this: we can’t simply win an election by default, by running against the guy and then hopefully winning a negative war. We have to have an affirming election. That’s why we’re putting these ideas out there. What we’re telling people is we don’t look at individuals in society as if they’re stuck in some station in life, fixed in some class and that the government is here to help them cope with it.

When I was working the Quarter-Pounder grill at McDonald’s in Jamesville, when I was detasseling corn and waiting tables to pay back my student loan, I never thought of myself as fixed in some class. It never occurred to me that there was some limit and that the government had to help me cope with it. I always saw myself as just on my own journey in life on my ladder of opportunity to make my life whatever I want it to be. That’s what we do in this country.
So this is the choice of two futures we have. Do we want to get back to prosperity? Do we want to be honest with people about the challenges we have and then have an affirming election where the country gives us the permission and the moral authority and obligation to actually fix this problem before it gets out of our control, where we can keep the commitment to people have already retired and get back to growth? Or are we going to succumb to the tactics that are designed to speak to us in divisive ways, to distort the truth about what’s happening in this country in order to divide and therefore distract Americans and then put us on a path to decline? These are the choices. I hate to be so stark, but it just is that simple.

I want to thank the people who are here, who have done so much to put us on the right path only to see the inertia of math and economics and the status quo come at us. We can do this. We can turn this around, and if we do this, I have no doubt in my mind that we will get this country back on track, just like our parents did for us. That’s the entire legacy of America. You make the country better off for your kids. That legacy is at risk for being severed, and if we get this right and we turn it around, I have no doubt that, for the next generation, they’ll look back at this moment as this is the time America regained its greatness. Thank you very much. Appreciate it.

Honorable James Glassman: Thank you, Congressman Ryan, for that very affirmative uplifting and growth-oriented viewpoint. You talk about leadership; this is leadership. We’re going to move to breakout sessions. We have one here on Markets and Taxes, capital markets and taxes, one of Congressman Ryan’s themes. Then we have one up on the second floor in the beautiful library, Let’s Get Real, where business leaders will talk about how they confront decisions and why taxes are so important to that. Then when we finish that, we’ll come back here for the last panel of the day, the star-studded Blitz Solutions panel, which I have the honor of moderating. That includes Governor Brownback, Steve Forbes, Kevin Hassett, Eddie Lazear, Larry Lindsey, Alan Schwartz, John Stossel and John Taylor. So please — you’ve already made your choice. You can change it a little bit if you want, but we’ll have some people here and some people up on the second floor. Thank you so much. Thank you, Congressman.

[Break]

Honorable James Glassman: — remarkable what that magazine has done. Rich is a publisher of Forbes. He is also the author of the book, Life 2.0, and he writes the Innovation Rules column in Forbes, and I’m not kidding when I say transforms. I think it was really quite remarkable what Rich has done in the time he has been at Forbes. He will lead this distinguished panel on Markets and Taxes, and we mean markets in the broadest sense, capital gains. You take it away, and you’ll learn all about it. Rich.

Rich Karlgaard: Thank you, Jim, for your kind introduction. It so happens that we have a panel that’s pretty neatly aligned here. We have a couple of experts on energy taxes and a couple on transaction taxes. Now, if you think about the taxes that are kind of hardest to defend out there among the people, I don’t think broadly the American people want their income taxes to go up or even capital gains taxes, but there probably is a populist outcry somewhere for taxing transactions on Wall Street and taxing energy companies. So we’re going to hear why that would be an unwise thing to do if we are going to get back to 4 percent growth. We have a great generalist and one of my good friends, Brian Wesbury, who is going to pile in and give his opinion on all of these. He’s always very refreshing.

Don Evans, I’ll start with you. Don Evans, the 34th U.S. Secretary of Commerce under the President. President Obama and his side of the argument get a lot of mileage saying that the energy industry gets a lot of tax breaks. Tell us why that isn’t so and what is a proper tax scheme for the energy industry if we want to have the maximum amount of energy.

Honorable Donald Evans: Well, let me try and bring the thinking of the oil and gas operator from West Texas or the state of Texas or my good friend Bill Armstrong of the Rocky Mountains into this room for just a
minute and tell you how he thinks. First of all, the oil and gas industry, the energy industry is a very high-risk industry, and those that participate in that industry think long and hard about how they’re going to deploy their capital and what kind of risks they’re going to take and the very simple principle of the lower the taxes are, the more of the risk that you’re able to take. So when you think about the oil and gas operator in West Texas and you think about — let me give you an example. I think this is probably the best way to explain how it works and how it’s working today in this country in an incredibly remarkable way.

The independent oil and gas operator in West Texas, back in the early part of the last decade, was continuing to take risks and trying to continue to develop technology that would increase the supply of oil and gas in America. Independent operators started pursuing technologies that were risky. Believe me, as I said, the oil and gas industry has a lot of risks. I certainly drilled my share of dry holes along the way, and others have too. So when you think about that independent oil and gas operator, he begins to explore new ideas because taxes are friendly to him, as they were in this last year, in large part because of the tax cuts of 2001 and 2003. He felt like he was able to take those risks, and what that has led to is probably one of the most remarkable transformations of the oil and gas industry in its history.

In the last ten years, the independent oil operator in America has developed technology that has unlocked natural gas reserves in the United States, in North America and has been a total, complete game changer.

Rich Karlgaard: It’s horizontal drilling you’re talking about.

Honorable Donald Evans: Yeah. It’s been a game changer in terms of, all of a sudden, the United States of America, instead of having some 10 percent of the gas reserves in the world, by some estimates, we’ve got 25 percent of the natural gas reserves in the world. In 2008, natural gas prices were hovering around $14 or $15. Today they are $2. The rest of the world is $15, $16, $14. You go to Asia; you go to Europe. They’re paying $15 for natural gas. This has already been said earlier today. It’s a game changer in terms of the development of industry here in America. The petrochemical industry is going to absolutely have a resurgence.

The interesting thing is that this came about because of independent operators who were comfortable with the friendly tax environment they were in at the time to take the risks, to try new ideas that absolutely lit up the entrepreneurial spirit and the innovators, and it changed the game in natural gas in North America, and I think it will in the world. That led to oil. Next thing you know, these same independent operators, who felt like they were in a friendly tax environment and could afford to take the risks — a lot of people said, “Well, we can do it in natural gas, but we can’t do it in oil.” in terms of the new technology and the horizontal drilling and extracting natural gas from these very tight reservoirs. Well, guess what. It’s now working in oil, and guess what. We’re going to reverse the decline in oil production in the United States for the first time in 40 years. And guess what. For the first time in certainly my lifetime, it’s not unrealistic to talk about energy independence here in America, and it’s certainly very easy to talk about because of this entrepreneurial spirit of the independent oil operator that tried some new ideas in an environment where taxes were low and he was willing to take the risk.

It’s not at all unreasonable to talk about greater energy security, greater economic security and greater national security for America. A lot of that happened because that oil independent operator, wherever he might be, in West Texas, in North Texas, in Colorado, was willing to take the risk to try something new, and it has turned into something that is a total game changer for this country and, I think, eventually the world.

So if you start to take that away, just think about taking it away in the sense of higher taxes. All of a sudden they can’t take the risk and keep trying the new ideas and developing new technology. With the lower taxes and the entrepreneurial spirit, what you do is you just create this incredible opportunity for research and development. That’s in the private sector, and that’s, as I said, I think it’s a game changer.
In West Texas, the oil and gas industry, they love competition. Competition’s been talked a lot about during the day. It is the key. My good friend Glenn Hubbard — when I first came up there, the President always used to say, which was absolutely right, government what it does is it creates the environment for the private sector to do what it does so well, and the private sector does what it does so well when you create that competitive environment. Glenn Hubbard always used to say, “Look, if it makes it easier to compete, it’s probably a pretty good idea. If it makes it harder to compete, it’s probably not a very good idea.” Lower taxes mean it’s easier to compete. Higher taxes mean it’s harder to compete.

Rich Karlgaard: Well, that’s a great point, I think, that’s lost in this discussion, that the Marcellus national gas boom, the Bakken Reserve in North Dakota, that the groundwork was really laid by these independent drillers who are responding to a tax environment that let them take risks. Bud, do you want to jump in on this energy —

Bernard Weinstein: Yeah. I wanted to make an important observation. We shouldn’t give the impression that the oil and gas industry is particularly favored when it comes to taxes. In fact, last year the oil and gas industry paid $40 billion in taxes, income taxes, royalties, lease payments and the like, to the federal government. Their tax preferences were a mere $2.8 billion. So the balance sheet is very much in favor of the federal Treasury. Now, when President Obama runs around, as he’s been doing, saying that these obscene profits are too high, that the oil and gas industry aren’t paying their fair share, he’s just completely off-base. They’re paying lots of taxes, and they’re paying more than their fair share if you look at their other tax burdens as a percent of their profits.

I also don’t see the logic of talking about increasing the taxes on the fastest growing industry in the United States. As Don pointed out, for the last three years, we have seen an increase in domestic oil production. We hadn’t seen that since the 1970s. Last year we saw record output of natural gas in the U.S. So at this point, to be talking about taxing or increasing the tax burden on the most successful industry that’s helping to spur our modest economic recovery — in percentage terms, it’s shown more job growth than any other industry — I think would be very bad public policy.

Rich Karlgaard: Another thing people don’t realize is that the oil companies, even large ones, may have huge revenue numbers, but their profits, their margins aren’t that great. There’s a reason Apple, with one-fifth the revenue of Exxon, has a greater market value than Exxon.

Bernard Weinstein: The effective tax rate on the oil and gas industry is about 41 percent, and if you look at all industries, it’s about 26 percent.

Rich Karlgaard: Brian, I’m going to get to you later on with your larger view, but do you have any comments on the energy sector before we move to transaction trading?

Brian Wesbury: Yeah. I think Bud hit on this, and that is the one thing that I, as an investor, keep going, “Are they really getting those kind of tax breaks that the politicians keep telling us that oil companies do?” I’ve looked into this, and the major oil companies, like Exxon, they get foreign tax credits, so they can pay taxes in lower tax jurisdictions. By the way, Paul Ryan will help fix that with a territorial tax system, but the second thing is being allowed to depreciate 100 percent of the investment on a new well immediately. I personally believe every company should be allowed to do this. We should have instant depreciation or no depreciation, instant expensing on all investments. Energy companies do get that. That’s not really a tax break. It just changes the timing of when you get to take that expense. That’s all. I just get to take it on the first day rather than spreading it out over the three, five, ten years that a normal expense would have to be depreciated. I’m really glad that you said that, Bud, because this is a misnomer, that oil companies get special treatment.

Bernard Weinstein: And a final comment, I think the President is being disingenuous when he keeps referring to this tax preferences as subsidies, because they’re not subsidies.
Honorable
Donald Evans: Can I make one final point on energy?

Rich Karlgaard: Yeah.

Honorable
Donald Evans: When you look at — this conference is about 4 percent growth. That’s what we’re trying to drive toward and reducing taxes, and tax policy is a big part of that. You cannot get to 4 percent growth without available, affordable, clean-burning energy. So it seems like to me, you want to put the policies in place to encourage that. You also cannot attack the number one problem in the world, which is poverty, without affordable, available, clean-burning energy. So as a country, we ought to be thinking about what are the kind of policies we can put in place to encourage the supply of energy in the world, affordable, available, clean-burning energy.

Brian Wesbury: I just will add on to that. You just made me think of this, Don. North Dakota and Oklahoma have the lowest unemployment rates in the country. There are just stories of redemption for people who have lost jobs in California or Florida or anywhere else where the real estate boom has collapsed, and they’ve gone to North Dakota and literally found work within 24 hours. It’s such a booming area that housing is impossible to find, and so clearly, when you find a technology — and it’s not just in energy. It’s in the cloud. It’s in, Rich, your area of focus, which is technology. This is how you create growth, is you find that cutting edge. We should be doing everything we can to help that cutting-edge industry, because that’s where real wealth and standards of living are created.

Rich Karlgaard: Well, I’m fascinated by Don’s point of the horizontal drilling. Where I live, in the Silicon Valley, if you ask people what’s the most impactful invention of the last 20 years, you would get search engines or something like that, but probably, as it impacts the entire world, it’s been horizontal drilling. I bet I’m the only one in this room who was born and raised in North Dakota. There’s a town called Williston in the northwestern part of the state where a McDonald’s franchise is paying $20 an hour for counter help, to compete with unskilled labor in the oil fields, which is earning $80,000 a year.

Well, let’s move to the area of transaction taxes. I daresay that, if you took a poll of Americans, the one place where you’d probably see a consensus, a large consensus of people saying, “Yes, raise the taxes,” would be on Wall Street in general and on transactions. There’s a feeling out there that high-volume transactions are creating instability in the world, flash crashes and all of that. I want you to, starting with you, Cameron, President of Quantlab Financial, a high-frequency trading firm, to say why that’s a bad idea.

Cameron Smith: I think actually the story that Don just told about the energy industry is pretty instructive. We talked about an industry where there’s lots of innovation from independent firms coming in and innovating new ways to drill for natural gas, and in a lot of ways, that’s what’s happened in the trading industry, in the markets, in the capital markets. There was a quiet revolution that took place from 2000 up and through today, where we had this major move to automated markets and automated trading, and despite what a lot of the articles you might have seen recently say, it’s been an incredible success and a boon for American investors. They’ve never had lower trading costs.

There’s ways that economists — maybe Bob can speak to this — measure markets and market quality. Just like when you go to the doctor, you measure your cholesterol and whatever, and there are some standard measures. By every measure, the markets, our markets have never been healthier. So when you want to do a trade, you can do it for as little as possible. Yet, in this environment, where we are at this pinnacle of health, kind of like we’re talking about in the energy industry, there are now some rumblings of a transaction tax.

If you could decipher what the Occupy Movement was about, at the end there, they said, “Oh, yeah. We want a Robin Hood tax.” Over in Europe, the French have actually — and the Germans want to do a transaction tax. The French kind of unilaterally decided. No one else
wanted to do it unless everyone did it, but the French, being French, I guess, went ahead and passed a transaction tax. It goes into effect August 2nd, so we’re going to see what happens with that, but we already kind of know what happens with that. Actually, the EU commissioned some studies to find out, and that’s why actually — the results of these studies are why there is no transaction tax EU-wide yet.

What they found is just a logic chain of events that aren’t good for investors. It starts with, obviously when you tax something, people are now paying more money for that something. So that’s an obvious, direct impact, but what they also found is that asset prices go down, so instantly now your 401(k) goes down. The value of your pension plan goes down. You find that the cost of capital then goes up. Cost of capital goes up; GDP goes down. GDP goes down; employment goes down, or unemployment goes up, however you want to look at it. This is not me saying it. This is the EU Commission in their November report. Nevertheless, the French went ahead.

I think those reports actually underestimate the impact, because there’s another aspect of the market that people don’t think about, and since that’s what our business is, of course, I’m sensitive to it. That is you need professional traders in the market, and that’s part of what this automation and all the talk is about. When they talk, they use this term high-frequency trading. What we’re really talking about is professional traders. For some reason, when it comes to markets, people have a discomfort with that, but if you think about the rest of your life, when you go to the grocery store, that’s a person who bought those groceries for a short term. Whole Foods doesn’t buy their groceries to take them home and cook. They’re buying them to resell them. You go to the gas station. They’re not trying to fill their tank up with the gas. They’re going to try to resell that gas. They’re going to try to resell that gas. They’re short-term intermediaries.

In financial markets, you need financial intermediaries too for them to work. What we do is we bridge that gap between supply and demand. If Vanguard wants to buy 500,000 shares, what are the odds that Fidelity wants to sell 500,000 shares of the same stock the same day? Pretty small. You need professional traders in there to lower the trading cost. It makes the markets better.

Rich Karlgaard: People fear instability in the global capital markets. Number one, the markets fell 21 percent in one day in 1987, and we haven’t had anything like that since, but there’s this perception that they’re more unstable. Are they more unstable or volatile, and are there other means, other than transaction taxes, that could be done, reinstalling the short uptake rule, not permitting as much leverage? Are there other means to making the markets more stable, or do you just reject the idea of government-engineered stability in the first place?

Cameron Smith: Well, I think they are more stable now than they’ve ever been, in terms of the volatility. We have a unique environment now where the macroeconomic factors are driving some of the volatility. There’s been some studies where the open-to-close volatility is pretty stable, but then you get close to the next open, the volatility, overnight volatility when nobody’s trading, so clearly that’s not trading volatility. That’s just a macro environment.

What we should be doing and what we are doing is we’re putting in circuit breakers and other things to prevent the markets from moving so quickly. The one risk of automated markets is that they can move before anyone can react. In the old days, the specialists could effectively call a timeout, have a trading halt and then reopen the stock, try to solicit some buyers if they think it’s moving too quickly. You can replicate that same thing without the inefficiency of a specialist if you have electronic circuit breakers, and the FTC has put those in place in the U.S. They’re widespread. They’re already in all the other markets. That’s why the flash crash was a completely isolated incident. So I think a lot of these things are overwrought. We need to appreciate how good the markets really are right now.

Rich Karlgaard: Yeah, it’s scary times, and the facts, the percentage drops in the market aren’t what people really think they are. Bob Litan, you’re an expert on the transaction tax. What’s your take on it?
Robert Litan: Well, there are two arguments that have been advanced for the transaction tax. One is that it would raise a lot of money. There was a bill by DeFazio and Harken that was introduced a couple of years ago that claimed it would raise about $150 billion. Just a tiny, several basis point tax would raise all this money. Then the second argument is that it would reduce speculation and so reduce, somehow, this volatility.

Let’s just take both of these arguments. First, on the money thing: the whole theme of this morning’s panel about the states was that, if states raise taxes, people will just move and go someplace else, or companies will move. Well, that logic applies probably times 10 or times 100 in the capital markets, because money moves instantaneously. His firm moves it like that, and if you put on a very, very small tax in a market where roughly 50 percent of the volume is high-frequency trading, you will basically wipe out 50 percent of the market right there.

In addition, just do the math, you’re talking, instead of $150 billion, you’re down to $75 [billion], but it actually gets worse. Sweden tried a transactions tax in early 1990 and found that, essentially, its trading just went to other countries in Europe. My prediction is, if the French go ahead with this tax in August, you’re just going to watch trading go to Frankfurt and to London and probably to New York, and the French aren’t going to raise anywhere near the kind of money they’re talking about. So at the end of the day, it’s really just an illusion that you’re going to raise all this money. You’re probably going to raise just a fraction of the $150 [billion].

Secondly, there is no evidence that I know of, at least from the academic literature, that a transactions tax will reduce speculation. In fact, firms like his, that will be penalized, they basically don’t speculate. They arbitrage, and you’re basically going to throw all the arbitragers out of the market. What will happen is that you’ll have much less liquidity in the market, much harder to trade —

Rich Karlgaard: Which is a real source of volatility.

Robert Litan: Exactly, and do you’ll end up with more volatility, and to the extent you have more volatility, you’re more susceptible to the kind of events that people have criticized. Also you probably, may even augment speculation, because in a market with wider spreads, it may pay people to speculate. So I think there is absolutely no evidence that you will reduce speculation. So both of these arguments for transactions tax, seems to me, fall on their face.

Cameron Smith: There’s a third argument that we’ll get Wall Street to pay for the bailout, but again, as I talked about, that change that took place, what people didn’t realize was that Wall Street, back when you thought it was Goldman Sachs, Morgan Stanley and everyone trading equities, those days are over. The equity markets and futures markets and most exchange traded markets now are dominated by small firms, located all around the country and around the world actually, that you’ve never heard of. So if you think you’re going to pass the transaction tax and hit these professional trading firms and you think you’re going to get Morgan Stanley writing the check or Goldman, they don’t trade equity markets. The margins are way too low. They don’t make $100 million a day on certain trading days trading U.S. equities, I can assure you. They make nothing there. Most of the money’s made in all the over-the-counter markets.

Rich Karlgaard: Bob?

Robert Litan: I have one additional point. Let’s put this in larger context. Go back to the 4 percent growth objective, which is the focus of this conference. Something we did, we ran a hypothetical experiment at Kauffman about a couple of years ago, and it’s reflected in the volume that Jim Glassman talked about is in the 4 percent growth book, where basically we asked the question, if the country wanted to increase the growth rate permanently by 1 percent a year, how many additional high-growth firms would it take to get there. I call high-growth firms homerun firms, using President Bush’s favorite sport. Quickly, to do the math, it comes out you need roughly 30 to 60 new firms, homerun firms if you want to get all the growth from those additional homeruns. You don’t need as many if you’re willing to accept singles, doubles and triples, but the idea is that, if you really want to move the needle on growth, we’re going to have to have a
lot of these new growth firms, regardless of whether they’re singles, doubles or triples. The only way we’re going to get those high-growth firms is if a good bunch of them go public.

Now, it turns out, fortunately, a couple of weeks ago, or actually last week, President Obama signed a Jobs Act, which is probably the only bipartisan piece of legislation that’s going to pass this year in Congress, that’s actually going to reduce the cost of raising money, and it’s going to make it easier both for firms to start and also grow their firms. So that’s actually score points for both Congress and the President for doing that, but if you then ask the question — we’ve now just passed an act to make it easier to go public, make the markets work better. We have forces in the opposite direction. We have the Volcker Rule, for example, which is going to diminish liquidity in the market, and we have a lot of people worried about that impact, all the way from Chairman Bernanke all the way down. If you then add a transactions tax on top of the Volcker Rule, you’re going to also further diminish liquidity. Therefore, you’re going to end up offsetting, to a significant extent, the act we just passed, which was to make it easier for companies to go public, because you need liquid markets in order to be able to sell stock. You’re not going to have new companies form and grow at the rapid rate that they want unless people know, especially the venture capitalists and the angel investors, unless they know they can get out and sell their stocks in liquid markets.

Rich Karlgaard: That’s a profound point. I want to get Brian’s thoughts on that and then more broadly. I just want to add that I thought the work that you and Carl Schramm did, showing that that extra 1 percent growth, and the difference between 3 percent and 4 percent growth compounded over generations, is huge. So start with that, but it really is dependent upon the number of firms that can get to a billion dollars in revenue over a 20-year period. So it’s not Facebook type growth. It’s companies that steadily grow, because they do something else. They don’t just add incremental jobs, but they challenge the incumbent industries to get fitter and better. That’s the only way that we know that they will get fitter and better. Otherwise, they run to Washington and ask for protection.

Brian Wesbury: Sure. I want to broaden this out. The way I think of this is a little broader. I mean, the transaction tax, you’re both exactly right. It would just chase it immediately overseas. We’ve done that with the IPO market, going back to Sarbanes-Oxley, and that’s even before Dodd-Frank. So what’s happened is that we have harmed the financial industry in a dramatic way. I want to make a broad point about this. One of the reasons that we go after the financial industry so quickly is that it’s always at the center of an economic crisis, because it’s at the center of the economy.

For example, I love it when I listen to people talk about Europe, saying actually these banks have bought all these risky assets. Well, these risky assets are government bonds. It’s the governments that went bankrupt, and they’re going to blame the financial system for the problem. I find it fascinating. So we have Dodd-Frank. We have Sarbanes-Oxley. They’re talking about transaction taxes and the Volcker Rule, and the Buffett Rule, in a way, also gets to private equity and private capital. So it would harm the economy, because the financial system’s at the center of the economy.

I want to talk, just real briefly, as a participant in the financial markets. First Trust is a money manager. We have about $55 billion under management in little Wheaton, Illinois. So we follow, obviously, where tax rates are going, what might happen in the future very closely, and I’m going to back up just a second, because what really matters, when we look into the future, is the level of spending that the federal government is doing today. It’s at 24 percent of GDP. We have never balanced the budget in the last 60 years when spending was over 19-½ percent of GDP. Not once have we been able to balance the budget, and that’s because when spending goes over that kind of level, it harms growth, reduces tax receipts, then the calls for higher tax rates come in, and it’s a vicious downward spiral. We get virtuous, upward spirals when we cut spending, and that’s what reduces pressure on higher tax rates.
So what’s interesting is these calls for higher tax rates on energy, the calls for transaction tax, they’re just more ways the government is trying to find to fund the spending that they’ve done. I believe to solve — yes, taxes — that’s what we’re talking about mostly today — are absolutely essential, and how they’re put together and what kind of tax matters a great deal, but we will still be talking about this forever and ever and ever if we don’t find a way to pull spending back so that we can actually afford, with any tax system, the government that we have.

Rich Karlgaard: Let me ask a follow-up question. Then I’ll get you in, Bud, and we’ll go to audience questions in about 15 minutes. I saw a couple of hands moving up. As the Chief Economist at First Trust Advisors, you put your hide out on the line all the time with forecasts, GDP growth rates, bond rates and unemployment rates and all those things. You’ve been very, very accurate, in the 95th percentile or better over your career. How much can you predict? Can you look at a country’s tax scheme and monetary policy and predict what that country will do in the near term and predict what its markets will do?

Brian Wesbury: I think, in general, you can make very broad, and I think, mostly accurate forecasts by using supply-side principles, where high tax rates tend to reduce growth, large spending tends to reduce growth, and vice versa. That doesn’t mean you’re always going to get everything right. I missed — thank you very much for that comment. I missed 2008. It was much worse than I thought it was. By the way, I think it was a panic. We hadn’t seen one of those in over 100 years. Steve Forbes and I agree almost completely on the causes, what happened in ’08 and the mistakes that were made, and I still believe mark-to-market accounting was one of the biggest mistakes that we made. We should have changed it, never put it in, changed it very early or gotten rid of it sooner. So anyway, yes, I believe you can make some general, very accurate, directional calls on the economy. For example, today I am long — Canada and Australia, and one of the reasons I like Canada and Australia is that they’re two of the lowest tax, freest market countries in the world.

Rich Karlgaard: But they’re also commodity producers.

Brian Wesbury: Well, they are. That’s helped, but it’s more than just commodities too. If you really get into their growth and what’s happening, they’re starting to produce some of these 30 — I know RIM is on the bad sad of the news cycle these days, but that was one of the most successful smartphone companies of the last move, and that came out of Canada. So we’re seeing more and more of those kinds of things happening in free countries.

Rich Karlgaard: Just a last question, and then we’ll open it up to the panel for other comments, but Art Laffer famously said that there are two rates of taxation to guarantee that you’re going to get no government income, zero and 100. So sliding it along between zero and 100, where do you think you can pluck the most from the goose, for the goose squawking the least?

Brian Wesbury: Larry Lindsey had some great comments on this today. My view is that we’re right about there, in the low 30s. If we get much higher than that, we’re starting to harm the goose. Larry kind of put a dividing line at about 40 percent. I would put it a little bit lower. A lot depends on how many deductions there are, but the bottom line is, if it was a completely flat tax, I think somewhere around 20 percent is where it should be. If we have some deductions that exist today, I think in the low 30s is about where that peak of the Laffer curve is.

Rich Karlgaard: I know Bud wanted to get in. I just couldn’t resist making the point I sometimes make when people say 20. In the Book of Leviticus, there’s a referral of a double tithe, so maybe the ancients knew quite a bit about the proper level of taxation. Bud?

Bernard Weinstein: I was just going to make a general observation. Maybe this could be my last comment. We’ve been talking about capital markets, and we’ve been talking about energy. Today those two industries are seen as somehow villainous, and I think that’s one of the reasons, when you talk about where can we gain additional revenue, well, let’s hit the energy industry, particularly oil and gas, let’s see what we can squeeze from the capital markets. These are bad guys. They’re
not loved. I think that’s fair to say. The oil and gas industry is not well-loved, and financial institutions are not well-loved, and that’s because neither is properly understood.

So this conference is about 4 percent growth. How do we get to 4 percent growth? It just seems to me, in order to get there, we’ve got to have robust capital markets, and we have to have a robust domestic energy sector. We need public policies, including tax policies, that encourage activity in those sectors, not penalize them.

Rich Karlgaard: I’d like to ask everyone of the panel — you already know I was born and raised in North Dakota, but I lived my adult life in Silicon Valley and so seen the mother of all wealth creation purely from matter that exists between people’s ears. Silicon Valley, in the 1980s, used to be very libertarian. Ed Shaw represented it. I think you had a near 100 percent rating from the Cato Institute, but it’s not that way anymore. Why is it that so many successful entrepreneurs, maybe particularly in technology — why do so many successful entrepreneurs advocate the policies that would be disastrous for the American economy, in which they created their billions? Anyone can jump in, and how do we change them?

Honorable Donald Evans: The entrepreneurs in West Texas aren’t advocating those policies, I assure you.

Robert Litan: I think we should have them up here and ask them that.

Rich Karlgaard: Well, we should. We should have Mark Zuckerberg and Eric Schmidt of Google, but it is funny that Steve Jobs, in his dying days, lectured Obama about his tax and regulatory policies, and Jobs was about as liberal as you got. Nobody wants to jump in on that one.

Robert Litan: I’d like to jump in on a previous question, though, which is what’s the gold [00:37:10 unintelligible]. I would phrase it differently and go back to something that was said this morning and go back to some history. That is I think that there is broad-based consensus in this country that people would vote for essentially lower rates and get rid of basically a lot of loopholes. Both conservatives and liberals would agree to this, and I can tell you — I used to be a research assistant for Joe Peckman at the Brookings Institution, who spent his entire life — he was a diehard Democrat — spent his entire life — he was one of the leading tax experts, before he died, in the United States, arguing exactly this. He lived long enough to see Bill Bradley make a deal with Ronald Reagan in 1986, and we have since gone backward since 1986 and junked up the tax code with all these loopholes.

I don’t know where the optimum rate is, but I can tell you the optimal design. The optimal design is the Reagan 1986 tax cut. I don't know what the right number is, whether the right number is 28 or high 30. I actually personally think the right number on the top rate may have to be a little higher than we were in ’86, because we have an aging Baby Boom generation, and we have huge entitlement obligations. We have rising healthcare costs that I don’t think are going to be easily constrained, and so I’d be willing to take a little higher rate, but the basic principle ought to be ensconced. I think it’s something that’s doable. The kind of guts that Paul Ryan showed, I think, need to be infected with the rest of Congress and hopefully whoever wins the presidency in the election.

Rich Karlgaard: I think you’re exactly right with that, another profound point. You’re winning with points on this panel, Bob.

Robert Litan: By accident.

Rich Karlgaard: Against heavy competition, but I think the fact that this unevenly applied tax rate, how demoralizing it is to small business people — I mean the large globally facing, publicly trading American companies are doing well right now. It’s reflected in stock market values, and they pay effective tax rates that is much lower than the nominal rate, getting down to General Electric, which paid less taxes than Jeff Immelt’s personal taxes — when was that, 2010 or ’11 — and Google, which paid 4 percent. The small business owner that Paul Ryan referred to looks
at this and feels completely piled on and demoralized. I think the demoralized small business sector is easily robbing America right now of 1 and maybe 2 percent GDP growth per year. Thoughts on that, Brian?

Brian Wesbury: Yeah, well, I’ll come back to that in a second, but just to go where Bob said. I remember designing — well, everybody that worked on the Hill for the last 30 years, probably at some point designed or worked around a flat tax, but for Connie Mack, we worked on a flat tax. The question was were we going to keep the mortgage interest deduction in there. I swear, we had had a secret meeting, and somehow the next day, all of the lobbyists for housing showed up. I don't know how they heard about it, but it took them less than 24 hours, and they were there. With mortgage rates so low today, I believe it’s a perfect opportunity to get rid of this thing, and I even think that we’re starting to hear some noise behind the scenes that even the realtors and homebuilders are willing to talk about it today. We’ve never had a better opportunity. If rates go up, we might lose that opportunity.

The second thing is the growth. Growth is being undermined today. Lots of people talk about uncertainty, and I have no doubt that uncertainty about future taxes, the cliff that’s coming next January matter a great deal. But I think bad policy is harming growth even more than the uncertainty about bad policy in the future. Spending is too high. Regulations are too high. Taxes are in good shape or reasonably good shape today, but it’s the spending that’s killing us. The bigger the government is, the smaller the private sector is. The smaller the private sector is, the less dynamic the economy is, the higher unemployment will be. Europe shows us that over the last 30 years. We’re living through that today. So we have a double whammy hurting our growth: one, bad policy; two, the impact that that bad policy has on creating uncertainty about future tax rates, et cetera.

Rich Karlgaard: Well, I’d like to open up for audience questions, particularly if you disagree with any of the panelists on oil or energy taxes or transaction taxes. We’ll start here. If you could, say who you are.

Ashley Ai: My name is Ashley Ai. I live in New York City. I’m a Turkish-American. I just wanted to react to your question about why all those very smart and accomplished Silicon Valley entrepreneurs seem to advocate the type of policies that are actually wrong for the country. I’m not an expert on this, but I can think of three reasons why. One, they’re not dealing with unions in Silicon Valley. There are none, so they don’t understand, I think, the type of decisions that Boeing is trying to make. That’s number one I can think of. Number two is those guys become billionaires or millionaires or whatever, but they’re really making their wealth paying capital gains taxes. They’re not paying 35 or 40 percent in income taxes. So that’s another reason why I can think of. That’s a reason. The third thing is, I think, the technology sector, in particular the Internet relative — I’ve spent nine years doing investment banking. Relative to the financial services sector, my God, it’s a paradise of deregulation. So they live in a different world. They don’t live in the world that we live in doing banking in New York City, paying 35 percent of taxes, and you know the drill. So I just wanted to react to that. Thank you.

Rich Karlgaard: Very good, and literally, Silicon Valley, it’s creating wealth, but it’s not adding net jobs, because all the manufacturing jobs have left a long time ago.

Robert Litan: But they are paying high state California taxes.

Brian Wesbury: That’s another proof of how fast growth works, right? They’re growing so fast they don’t even have time to think about what policies really work.

Rich Karlgaard: Okay.

Scott Hodge: I’m Scott Hodge with the Tax Foundation. I’ll ask you the question that’s been burning up my Blackberry for the last hour. The Buffett Rule, how might the Buffett Rule, should it be implemented, affect capital markets, affect capital gains, realizations, economics, et cetera?
Rich Karlgaard: Brian?

Brian Wesbury: If I understand this correctly, what we’re really talking about, there’s two parts I’ve always heard, a minimum tax kind of thing and also a carried interest issue. It would affect all private equity, all venture capital, and I think it would undermine growth dramatically. In addition, it doesn’t raise as much revenue as people think because of exactly the reasons we talked about with — not that I talked about but that Bob and Cameron talked about — with the transaction tax. Scott, did you do a study on how much it might raise? I think it was you.

Scott Hodge: I think we were somewhere around $40 billion, which is about what the Joint Committee came in on.

Brian Wesbury: Yeah, so it’s way —

Scott Hodge: It’s not a whole lot of money for a lot of pain.

Brian Wesbury: It’s a lot of pain. Here’s the deal. We all know this. It’s all based on misinformation, because it’s not true that Warren Buffett’s assets and person, if you think of him and all his assets as a person, pay less in taxes than his secretary. It’s just not true. Those corporations pay a 35 percent tax rate on all money that they earn in the United States, and if he’s not paying it in the United States, then that’s a reason to go to a territorial tax system rather than the one that we have. So it’s just based on a fallacy, and any kind of law, I think, based on a fallacy — two wrongs don’t make a right if you will. I know what the — anyway. Bob probably has comments.

Scott Hodge: One of the interesting aspects of the Joint Committee on Taxation Analysis, however, was the admission on their part that it would have tremendous behavioral effects. I guess that’s what I wanted to get into from people who are in the market and who really understand it a lot better than we do from Washington.

Robert Littan: I have two points. First is it’s not just a tax on carried interest. As people talked about before, it’s a tax on capital gains by a significant number of market participants who are going to have to pay higher capital gains. If you think higher capital gains rates are bad, then ipso facto, you’re going to have a negative impact, but I have another point, a larger point that I don’t understand. I know the answer too. I know why Democrats, being a Democrat, I understand why Democrats are making a fairness argument: huge rise in inequality. We know that there’s a lot. If you look at public opinion polls, there are a lot of people that are very upset about it. So you know why, at least ostensibly, President Obama is arguing for a higher rate, but if they went to a Reagan-style clean tax, lower tax rate, down to 28 or 30 percent, with a lot fewer deductions — and by the way, I don’t think we can get rid of all deductions politically. I like the Simpson-Bowles compromise, which put a percentage of income cap on all deductions. I think that’s a politically saleable thing to do. If you went to that kind of tax system as a practical matter, the rich would pay more.

So I don’t understand why Democrats, who are so intent on trying to sock it to the rich — why don’t they go with something like Simpson-Bowles, which on that, it will correct our fair share problem, but at the same time, it has much better incentive effects. It has much lower rates. It screws up small business less and so forth, so it gets what we want. It gets what Republicans want, and I don’t understand why they don’t go for that.

Rich Karlgaard: Now, do you tax-cutting Democrats, you and Erskine, hold your meetings in a phone booth?

Robert Litan: I’ve never talked to Erskine about this, but I don’t understand why more Democrats don’t figure this out.

Chris Shays: I have an answer for you.

Rich Karlgaard: Could you introduce yourself?
Chris Shays: My name is Chris Shays. I was in Congress for 21 years. Democrats actually don’t want to tax the wealthy more. They just want their constituency to think they’re taxing the wealthy more.

Robert Litan: Right. No, I understand that. It’s easier with a higher rate than to go [inaudible].

Chris Shays: So if there are write-offs that the rich don’t pay, they don’t care. My question, I’m having a bit of a struggle, because I find this an incredibly exciting day. You had the governors set it off with saying, “We had to get our financial house in order, and then we looked at pro-growth.” Candidly, anyone who’s in public life would understand that. How do you ask for a tax cut when you’re starting to cut programs? So the second thing I wrestle with — I don’t want to use the word wrestle. The second thing that I have a challenge with is suddenly austerity has a bad word to it. I found myself contemptuous of the Greeks not wanting to suck it in. Hello, get real. I think you’ve got to tell the American people the truth. I think they empower you to do the right thing. Why are we making austerity seem like a terrible thing? It seems to me, if you’re at 24 freaking percent of GDP in spending, you need a little austerity.

Rich Karlgaard: Anybody want to jump in on that?

Brian Wesbury: Spending cuts are pro-growth, especially when you’re talking about 24 percent of GDP. There’s no doubt. Spending cuts would actually bring in more revenue, because the economy would do better. The Keynesians have won the day with the mainstream media and many members of Congress. That’s unfortunate. So I would agree with that 100 percent.

Cameron Smith: In terms of the Buffett Rule, one of the things — not from an economic standpoint, because I’m not an economist, that’s for sure, but just from what we’re seeing trading globally and loss of asset classes, I think it just adds to the uncertainty out there. We’re seeing trading volumes are down, whether it’s U.S. equities, European equities, Asia, treasuries, everything. We’re just assuming people — there’s this uncertainty out there, and no one’s doing anything. It doesn’t matter what the asset class is or what the geography, and I think just the hostility to the rich and the socking it to them thing, I think, just adds to that environment as well. It’s not going to do anything for growth.

Brian Wesbury: And Cameron, one of the other things is that, if you think about a capital gains tax — and Bob, you’re right to say it’s just that, because it’s on all income, but it’s a wall between the old and the new. So the higher the cost of it for me to get out of my original investment to put it into a new investment, the higher that cost is, the less I’m willing to do that. Warren Buffett hardly ever sells anything, so maybe he doesn’t even care about that, but for somebody who’s helping to invent Microsoft, then taking that money and moving it into Facebook, it matters a great deal, and it limits the amount of resources that can actually be moved from the old to the new.

Rich Karlgaard: Starting with you, Bud, I’d like to go down the line and each give your optimal tax program for 4 percent growth. Give us the top income tax rate, the number of brackets and then the capital gains rate. Let’s get it all out on the record here.

Bernard Weinstein: That’s not really what I do but —

Brian Wesbury: The optimal tax rate for bringing oil out of the ground.

Bernard Weinstein: Let me put it this way. I think in addition to the debate on uncertainty on taxes and budgets and politics and regulation, we’ve got so much uncertainty out there. We have uncertainty about uncertainty, and I think that has been a tremendous retardant to a robust economic recovery. I think, rather than signaling out a particular rate, I think what we need in tax policy is some degree of certainty and predictability. It’s like, if the average tax rate is 30 percent, businesses will adjust. If it’s 50 percent, businesses and people will adjust. I think first we’ve got to have some consensus, and we have to have some certainty.
The final point I’d make — I was just thinking, as we were sitting here, my mentor at Columbia University 40 years ago, CeeLo Harris [phonetic], he used to say, “Remember, businesses don’t pay taxes. Only people pay taxes.” And we need to keep that in mind, whether we’re talking about the individual tax rate or capital gains or death taxes or corporate taxes.

Rich Karlgaard: Your point about uncertainty is a very good one. Brian, where would you peg these numbers?

Brian Wesbury: Yeah. It all depends on where you start the tax, et cetera. I’ve always been an advocate of a flat tax, but let me take this opportunity just to talk about a nationwide sales tax or a value-added tax. If I were going to design a country from the ground up, if you gave me an island and said, “You’re going to start a country,” I would put a sales tax in, because it’s about — you only pay it when you spend. If you’re a bus boy at a restaurant, you can live in a box in the alley and eat all your meals at the restaurant and never pay a dime in tax until you save enough to open your own restaurant. You can do that. It’s your God-given right to live exactly like that. With an income tax, you don’t have the choice. So what I’m saying is that, if I were going to do that — the problem is we’ve started with an income tax in 1913, so if I were to take away the income tax today and put in a sales tax, all these people that have saved after tax to spend in their retirement will actually be taxed twice. They’ll be taxed as they saved it, and then they’ll be taxed as they spend it. That makes it unfair to switch in midstream. The perfect tax can only be instituted if I were to start a country up brand new. So that leads me to — I believe in a flat income tax.

Rich Karlgaard: You two are just both wonderfully evasive here.

Brian Wesbury: I would do a flat income tax of about 20 percent with no deductions whatsoever for anything, and I would pay that tax on income, not on capital gains, not on dividends, not on interest.

Chris Shays: Would that be for every individual?

Brian Wesbury: It depends on where you kicked it in, Chris? If I started at $10,000 per family, yes. I could pretty much guarantee it. If I made it to $30,000, I’d probably have to go to 22 or something or 23.

Rich Karlgaard: Do you think it could be politically palatable — I would love to hear the Congressman’s thoughts on this too — if you said 20 percent but including capital gains and dividends, and so everybody’s in on it? We just stick it at 20. It’s going to be 20 anyway. We’re going to get 20 anyway.

Brian Wesbury: We’d have to reduce the corporate tax rate to the same rate.

Rich Karlgaard: Twenty across the board would be the most politically saleable thing.

Brian Wesbury: Probably.

Rich Karlgaard: Bob?

Robert Litan: I have a variation of that. I could go with 20, but I’m still in favor of a second bracket, a lower bracket, so for lower income, and I have one additional qualification. I haven’t run the numbers, so I don’t know how much money that raises, but let’s say that raises about as much money as we have now. It’s not going to be enough to still deal with the aging baby boomers, so I have been attracted to the notion, which has been advanced by John Shoven of Stanford, Victor Fuchs of Stanford. I’m reading a book now by Bruce Bartlett. There are a lot of other people who’ve talked about this, and that’s tying Medicare financing to a sales tax. It would automatically discipline — they would at least have some discipline on Medicare spending, and it would be a way to finance Medicare spending. I don’t know where that would end up as a percentage of GDP, but at least I would know — I would sleep safer at night that we’re going to finally attack this budget deficit and, at the same time, accommodate aging population.
Rich Karlgaard: The upside surprise in the U.S. economy, I predict, as God is my witness, is going to be a revolution in healthcare that’s going to give us better health at half the cost in a remarkably short period of time. Today you can get your DNA sequence for less than $500. If you’re so brave, you can put that up on a social network and have really smart people run algorithms against it and give you a prediction of where you’re most likely to encounter fatal disease somewhere down the road. The amount of money in Silicon Valley — once Facebook goes public, money is just going to shift. It’s going to be bored with social networks. The big event will have happened. What I’m seeing at the angel level and seed level right now is health informatics, and it’s going to have a dramatic effect. That’s a parenthetical thought, but I thought I would throw that out.

Robert Littan: Kauffman’s coming out with a report on exactly that issue next week, so watch out for it. It’s big data comes to health.

Rich Karlgaard: Cameron and Bob, if you were the czar?

Cameron Smith: Since this is a Forbes conference, I have to — Steve Forbes isn’t here now, but I’d have to go with the flat tax and 20 percent like Brian, because that makes the most sense. It’s simple and get it done.

Rich Karlgaard: Would you apply it to capital gains?

Cameron Smith: Yeah. I’d do it across the board.

Rich Karlgaard: Probably the most productive thing to be capital gains is zero, but in terms of getting it passed, you’d probably have to go across the board.

Cameron Smith: Yeah.

Rich Karlgaard: Don?

Honorable Donald Evans: I’m not an expert, certainly, on tax policy. I am an expert knowing that if you keep spending more than you’re making, you eventually go broke. I would be one that would say, “Look, we’re going to cap the spending. We’re going to move toward capping the spending of government at 20 percent of GDP.” The idea that we’re at 24, going to 25, 26, 27, I mean, that leads toward bankruptcy. So I would put the cap on spending at 20 percent. You’d have to have a glide path to get there, and then whatever kind of tax policy that would generate the 18 or 19 percent in the most productive way is what I would be in favor of. You hear lower the tax and broaden the tax base. Lower taxes, broader base makes sense to me, but let’s get the spending under control. The idea that we’re going to kind of move toward 26, 27, 28 GDP is just disastrous for the country.

Rich Karlgaard: Well, you’re quick with math. If we had 20 percent flat tax, starting with a base of a $14 trillion economy and assuming 4 percent growth with 20 percent taxes across the board, to the Congressman’s question, what do you think that would do to government receipts?

Brian Wesbury: Oh, they would explode upward. I mean, 4 percent growth compared with 2 percent growth, do the math. The revenue potential — it would be like the ‘80s where, yes, I would agree with Larry Lindsey that the Reagan tax cut in a hole cost revenues relative to the path that we would have been on initially, but it grew the economy so much that, by the late 1980s, early 1990s, we had more revenue and more GDP than we would have had under the other tax code.

Rich Karlgaard: Well, thank you, panelists. I would just conclude by saying there’s not a problem the United States faces that gets better with 2 percent growth, and 4 percent growth, you can begin to solve even some of these deeper social problems. So thank you very much, panelists.

[Break]
Honorable James Glassman: I’m going to introduce everyone just standing up here, but before I do, I just want to remind everyone that after this, our final panel, is finished, we will have a reception outside with more of those delicious cookies and other things, sponsored by the U.S. Chamber of Commerce. So one, two, three, four, five, six, seven, eight, and including me, it’s nine. So this is like the Supreme Court, right? Can we decide anything here? There’s still some very important decisions to be made. I’m going to stand here and introduce everybody. Then I’m going to go sit down. Let’s see, who’s at the end?

John Stossel, host of STOSSEL on Fox Business Network, and John has a new book called, No, They Can’t, published today. The publication date is today, and we’re very lucky that he’s here. Next to him is my dear friend and former colleague Kevin Hassett, the Director of Economic Policy Studies and Senior Fellow at the American Enterprise Institute. Hold your applause. Let’s see. Next to him, is that Alan? Yes, Alan Schwartz, Executive Chairman of Guggenheim Partners, LLC, and next to him is John Taylor, the George P. Shultz Senior Fellow at the Hoover Institution and Raymond Professor of Economics at Stanford University. He also has a new book, relatively new book, Five Principles. Then Steve Forbes, whom you heard from earlier today, the Chairman and Editor-in-Chief of Forbes Media. Eddie Lazear, the Jack Steele Parker Professor of Human Resources Management and Economics, and he’s also the Morris Arnold Cox Senior Fellow at the Hoover Institution. He is a member of the George W. Bush Institute Advisory Board. Next to him is Governor Sam Brownback of the great state of Kansas, and next to him is Larry Lindsey, whom you’ve also heard from today, who’s President and Chief Executive Officer of the Lindsey Group. Now I’m going to move down here.

So this session has been called by Amity, who is our — actually I sort of figure this is Amity’s world. We all just live in it. That’s basically the way it works. So we call it Blitz Solutions, right, Amity? So I’ve been asked to start this off by going around or down and asking everyone what is the one quick, and I mean quick, like 20 or 30 seconds — don’t worry; we’ll have plenty of time to talk about things — that they would offer as a tax policy solution to help us get to 4 percent sustainable, real growth. So I’m not going to start with John Stossel. I’m going to start with Larry Lindsey. Larry?

Honorable Lawrence Lindsey: Twenty seconds. Abandon income-based taxation, move to business cash flow taxation with border adjustability. There’s a lot of fancy words. It’s called a VAT. You’re not allowed to say that word.

Honorable James Glassman: We’re going to have to go back to that, because that’s very interesting subject matter. Governor Brownback.

Honorable Sam Brownback: A flat tax with a small business accelerator, where you take the tax totally off of your Sub S’s or LLCs so you really get your acceleration. This is like shooting adrenaline into the heart of growing the economy by taking that tax off of small business where most of your job creation is.

Honorable James Glassman: So you’d have no tax for small business?

Honorable Sam Brownback: Yeah, and a flat tax otherwise.

Honorable James Glassman: Do you mind giving us also a state tax solution?

Honorable Sam Brownback: That’s what I’m proposing.
Honorable James Glassman: So you’re saying not at federal level but state or both?

Honorable Sam Brownback: I’d say both, but this is what we’re doing in our state. Flat tax, step one, small business accelerator inside it, take the tax completely off of Sub S’s and LLCs, because that’s your main growth engine, and then I want to use in our state the growth to ride the income tax rate down to zero, so you create a real growth atmosphere in our state. That’s the plan we’ve put forward. We’re getting to the end of the legislative session. I’m hopeful we can get it through. We’ve gotten a variant of it through both houses, and we’ve got to see it on through to the end, but on the economic modeling of it for our state, it looks really nice on growth. Particularly the growth piece is taking that tax off of small business and really targeting that piece of the growth instrument.

Honorable James Glassman: Eddie, I introduced you and neglected to say that you were the former Chairman of the Council of Economic Advisors. So Eddie?

Honorable Edward Lazear: Well, I would start with a couple of principles. First, we want taxes to be low. We want them to be efficient, and we want them to be neutral, which means they don’t favor any particular sector. They don’t favor any particular financing, and they don’t favor any particular program, like healthcare through employers. So what that points to is a consumption tax of some form, and in particular, what it means is zero taxation of investment. Zero taxation of investment is the key here. There are a number of ways to get there. The way I like best, the easiest way to get there would be to allow full and immediate expensing of all investment and no taxation of dividends, no taxation of capital gains, zero. The flat tax is pretty close to that. That’s a property of the flat tax. It’s also a property of something else called the X tax, which is a more progressive version of the flat tax.

Honorable James Glassman: So that doesn’t sound to me like the Buffett tax at all, except that in real life, I don’t think Warren Buffett does pay any capital gains taxes. Anyway, we’re going to get back to that. Steve Forbes.

Steve Forbes: Well, that sounds like a flat tax, single rate, generous exemptions for adults and for children. Everything else is out of the code. On the business side, you have a low 17 percent rate, instant appreciation, i.e. instant write-off, no tax on investments, whether it’s interest, dividends, capital gains, and no death taxes. You should be allowed to leave the world unmolested by the IRS, or as our founders would say, no taxation without respiration.

Honorable James Glassman: This sounds like your plan for 1996 and 2000 and, I think, even before that, right?

Steve Forbes: Hey, keep at it.

Honorable James Glassman: John Taylor.

John Taylor: Well, to be a little different, I’m very concerned with this unpredictability of the tax code. I think the first thing we could do is just get something, put it in place more permanently so we don’t have a hundred provisions of the tax code expire each year. Obviously it causes unpredictability, uncertainty, and when you do this broadening of the base and lowering of the rates, which we need to do, I would emphasize don’t broaden the base too much. Don’t try to have a stealth tax increase in this tax reform. It should be revenue neutral, and economic growth will generate more revenue, so be careful with this tax reform. It’s not a stealth increase.
Honorable James Glassman: When you say don’t broaden the base too much, and we’ll get to this, but are you saying that you should leave the kinds of exemptions, preferences and deductions that currently exist, like the mortgage deduction?

John Taylor: There’s going to be a battle about broadening the base and lowering the rates, because some people would like to just broaden the base without even changing rates. That’s not tax reform. Tax reform is where you lower the rates enough to stimulate economic activity, but you don’t broaden the base so much that you’re trying to have a stealth tax increase. I will put it that way. When you do that, that’s not good for growth. What you want to do, in fact the ideal thing here, is the tax reform, which lowers these rates, these marginal rates, increases economic growth, and that’s what brings additional revenue, not a tax increase.

Honorable James Glassman: Alan.

Alan Schwartz: I would like to echo one thing. I think that something that looks sustainable, which partially means we’d better move quickly — something that looks sustainable is more important in a lot of ways than exactly what’s in there, because if people in a planning horizon don’t know what the changes are going to be, because the current system doesn’t look sustainable, that actually retards growth. The one thing, I guess, I will say, that I think I have changed my mind on, and so I’m just going to put out, versus where I’ve been my whole career, is that I’ve always been in favor of lower taxes on capital gains and dividends. I believe that as capital has gone global, politics stay local, so we have to compete globally, but we’ve got to be able to sell this. I believe that we’re going to have to bring rates down. I do believe we should bring rates down in a way where we harmonize the rate for earnings and capital gains and dividends. I think there’s a lot about demographics that says we should do that anyway, so I’ve changed my view on that. That’s different from the orthodoxy I’ve had, and the last thing I would like to see is I would like to see Warren Buffett take a new pledge, on top of the one he had, as a way to avoid estate taxes. I would like to see a new pledge that he will pay 100 percent of his income in taxes, and then it will be more than his secretary, and we don’t have to hear about her anymore.

Honorable James Glassman: Just to clarify, so you’re saying that ordinary income rates and capital gains rates would be the same.

Alan Schwartz: Yes. Dividends, capital gains, ordinary rates should be the same. I believe we need to bring down the rates, the marginal rates on corporations, and we need a territorial system. Bring down the marginal top rate, and the combined rate of dividends and capital gains will be close to where we are anyway, even though we’re taxing it twice.

Honorable James Glassman: Close to where we are now, not where we’re about to go, like 15.

Alan Schwartz: Right, correct.

Honorable James Glassman: Kevin?

Kevin Hassett: Yeah. Obviously I agree with just about everything that’s been said, and so therefore, rather than just say let’s have a value-added tax, I was going to raise another issue, which, I guess, you come to New York, and you get surrounded by left-wingers, like I am here on the stage, but everyone here is kind of rejecting the design of the founders. I just want to point to the fact that I think the reason why the U.S. code is so terrible and so indefensible is that we abandoned the view of the founders. The U.S. is such a big economy and so separate from the rest of the world that we’ve not really been engaged in competition, in tax competition while everybody else has. So I’d like to go back to the original idea of what the federal tax needs to be if it’s going to be...
constitutional, and that is that the federal government figures out how much money it needs on a per capita basis and mails a bill to the states and lets the states raise the revenue. Then the states compete amongst themselves with the tax code. If you want to be a New Yorker who redistributes like crazy, then you could raise your federal tax that way, and if you want to do it some other way in some other state, you can raise it the way you like. I think imposing this sort of central planning —

Honorable James Glassman: Do we get to set how much we want to send?

Kevin Hassett: No. The federal government mails a bill to the states, according to the original design. It has to be the same per capita for each state, and then the states can compete for the optimal tax code. If we could do that, then it would be much better than any design that anyone here on the stage could come up with here today, because then the competition would produce the optimal code.

Honorable James Glassman: Wow. I love that idea. So what do you think of that, Governor? Do you think it should be on a per capita basis or an income —

Honorable Sam Brownback: I’d like for us to be able to say how much we want to send.

Honorable James Glassman: Actually that’s a good question. So what would happen, Kevin, if Kansas decided not to send anything? Send the troops?

Honorable Sam Brownback: Yeah, in fact there is historical precedent for that. Whiskey Rebellion.

Male: The whiskey, that’s right.

Honorable James Glassman: John Stossel.

John Stossel: I like Kevin’s idea. I hadn’t heard that before, but I would just say simplify the damn thing. Whether it’s a flat tax or a consumption tax, get rid of all deductions, and that will create growth.

Honorable James Glassman: Lots of great ideas we’re going to explore. Alan Schwartz raised this notion of something that is sustainable. We’ve heard this time and time again today, that there’s a lack of certainty, but how do you get certainty into a tax code without a constitutional amendment. Or maybe it does require a constitutional amendment. Steve?

Steve Forbes: You get it through a consensus. I think Paul Ryan made a point earlier today in one of his interviews, that if you’re going to make a substantial change, whether it’s in entitlements or the tax code, you first have to take it before the voters, the way Ronald Reagan did in 1980 with a 30 percent across the board tax cut. You get the mandate for it. Therefore it has legitimacy. That’s the only way you can do it, but if you want permanency, Franklin was right — taxes and death. Other than that, you’ve got to be eternally vigilant when you get something good in to preserve it. There is no automatic mechanism to do it. Constitutions can be changed, as we saw with Prohibition.

Honorable James Glassman: Anyone else have an idea for sustainability?

Alan Schwartz: I just want to say I think the word certainty is overused, because I don’t think there is any such thing in anything, except death and taxes, I guess. But I think that what you really want is something that people can look at and say, “At least it looks like a sustainable path. Therefore I
can make decisions on my assessment that that path will stay in place.” I think what you have is a spending path and a revenue path that absolutely are impossible to sustain, and therefore, if you’re a business person now, it’s not that you want certainty. It’s that you have absolutely no idea what the rules might be as to what consensus will develop, how to deal with that cliff when we fall off.

Steve Forbes: One of the things that undermines the code is precisely that it is perceived as corrupt, that it’s just filled with special interests. Therefore people can’t understand it. They have no faith in it, and therefore you don’t get the kind of self-policing that you’d have if they felt it was legitimately arrived at, they can understand it, therefore they’ll go along with it.

Honorable James Glassman: John Taylor, you’re right on so many things, I have to say, but I think you have been really pushing this whole certainty angle. It’s in your book. What do you think about certainty or sustainability?

John Taylor: Well, I think the unpredictability of the tax code — that’s my point. The more sustainable tax reforms will alleviate some of that. It doesn’t eliminate it, but one thing you can do is get it — what I think should be a consensus already is these temporary — like a temporary cut in the payroll tax for two months. Who could possibly think that’s good for the economy? It goes exactly against the idea of sustainability and permanence. 1986 tax reform did last quite a while. That was the kind of thing that was more permanent. So you need to have a consensus as best you can. It’s not going to be uniform, but the idea that some of these things just don’t work, these temporary things in particular, seem to me destructive. People can see that.

Honorable James Glassman: It’s so great to have all these smart people on the panel. I’d like to drill down on some of the things that have been brought up. The first one is Larry Lindsey’s VAT, which is kind of a simplified way to talk about value-added tax, consumption tax. One of the arguments against it, Larry, is that, when you look at what happened in Europe, is they got a VAT tax. Yeah, that was fine, and then they brought a personal income tax in on top of that.

Honorable Lawrence Lindsey: Well, they had the personal income tax, and they added the VAT. What this would do, what I would do is get rid of the personal tax, the corporate tax and the Social Security tax, all of which are income-based taxes, and switch to a single business — it’s basically a gross receipts tax minus what you paid other businesses. I think there’s three advantages to it. The first is with regards to sustainability. One thing we learned during the recent crisis is cash is a fact, income is an opinion, and when it comes to income-based taxation, that is exactly the opinion that changes all the time. When you no longer have to define income — so is it a section 3C sub 2 income, or is it a this kind of income? That’s what they play with all the time. I just finished my taxes. We have to move away from this multi-definition of income, and I think the only way to do it is, again, to move to a cash tax.

Second, for simplicity reasons, right now we raise about a trillion in individual tax, about $400 billion in the corporate tax. The compliance costs, not the economic distortions, the compliance costs on that are about $300 billion. So we’re paying 22 cents in compliance for every dollar we collect in revenue. If you’re looking for low-hanging fruit, what you want to do is you want to minimize the number of taxpayers out there. You want to have a simple definition of income, and again, I think you get rid of these three separate kinds of taxes, all of which define income differently, and you move to a single-tax basis.

The third big piece of low-hanging fruit has to do with border adjustability, which you can’t do with any income-based tax. I forgot who said the word territoriality. I’m going to be wonky but simply. The candidates out there are all talking about a territorial tax. What territorial means is within your territory. If you do it here, you tax it. Well, what a dumb thing to do. We have a very high tax. Why would you only want to tax things done in America, especially if you want things to be done in America? What you really want is border adjustability. You want it not to
matter whether it is done in China or done in America, and what you do with border adjustability is, as soon as it hits the border, you impose a tax on the value as it comes in the border. That way you don’t discourage production in America.

So three big advantages: first, you define. You get rid of opinion about income. Secondly, you cut compliance costs dramatically by reducing the number of taxpayers, and third, you stop this discrimination we have about producing in America. Your question was how do you get 4 percent growth, and I think that’s where the low-hanging fruit is.

Honorable James Glassman: Anyone have a reaction to that or to the VAT in general?

Honorable Edward Lazear: I certainly agree with Larry’s point. I think most economists like the VAT, because conceptually it’s probably the best tax. It’s the easiest to implement. It also has the nice feature that, in order to raise my taxes, you have to raise your own. It’s very difficult to raise it for one individual without raising it for another. The problem is the practical implementation of it, and I think this is where we actually have to worry about it, because when you implement it practically, what you tend to do with VATs and with retail sales taxes, is you tend to exempt certain things from it. That’s the big problem, and if you look at the size of the base, these things tend to shrink. So the question would be whether you could apply it universally across the board. If you couldn’t exempt certain things, then you’re almost asking for progressivity in the form of some kind of income tax. We’d like to assume that away. The problem is, I don’t think, as a reality, as a practical matter, you can assume it away. I’ve never seen a country that’s done that. We would be unique if we were able to do it.

Honorable James Glassman: I’m going to get to Larry, but I want Kevin to respond.

Kevin Hassett: The first thing I want to add is that Herman Cain’s 9-9-9 plan was essentially VAT. It was so close to a VAT that, for economists’ sake, you could say it was kind of a VAT. During the debate over the 9-9-9 plan, the distributional, industrial complex came out attacking the 9-9-9 plan and made a sort of glaring error that is a point that’s not really well understood, that I thought I should raise right now, because one argument against Larry’s VAT, that people might make, is that, “Oh, it’s so unfair,” because sales tax is going to be paid by poor people, and they consume all their income and so on. But when you make that observation, you forget the fact that, right now, if Warren Buffett takes a dollar out of the bank and buys an airplane, I guess a lot of dollars, then he won’t pay tax, but if you have a value-added tax, then he would. So all economists would tell you that, if you produce a value-added tax today, it’s, in part, a tax on old capital. So it’s a tax on wealth, because your wealth is only useful to you if you can go buy something. So the wealthy folks who go buy things will suddenly pay a tax that they weren’t going to pay before. So I think the point I just wanted to make was that there’s an economic efficiency argument that Larry raises, and the distributional arguments against the VAT ignore the tax on wealth, which is a really, really big component of it. So I think, if you look at a VAT, even if you’re a fairness guy, then you should be willing to embrace a VAT if it’s designed correctly.

Honorable James Glassman: Larry, then Al.

Honorable Lawrence Lindsey: Yeah. I think exempting anything is a bad idea, and that includes, by the way, defining things as interest or dividends or whatever. I know it’s tempting to want to avoid it, but if I get to define what interest is, and by the way, if you just did your tax return, you know you go through that, or I get to define what a dividend is, you don’t do it. That’s why you want to tax the cash.

One other way of doing the progressivity piece would be — I call it a two-stage VAT, where you have a basic VAT. Then you subtract, say, $10,000 a month in income from all your
workers and then put a second-stage VAT on top of it. So you’ve got a two-stage VAT. I don’t like it as well, but if you have to compromise, that might be a way of going.

Honorable James Glassman: Okay. I’m going to go to Alan, and then we’re going to talk about solutions that may be a little bit more practical than a VAT, as much as a lot of people like the VAT or the consumption tax. Yes, Alan?

Alan Schwartz: I just want to raise one thing I’ve thought about a lot on whether it’s a consumption tax or a VAT as part of a total tax plan. It’s that, I think, we have to address what was very different from let’s go back to the Reagan time when the baby boomers were entering the workforce and the things you were doing, and we had much less total debt. So looking at taxing income had one effect. Baby boomers are leaving the workforce in record numbers every day. The main way we collect taxes now is through social taxes or payroll taxes and income taxes, and more and more people are going to be living off of their capital. Those same people are going to be driving up the expenditure side of the equation, and so while there is a sense of not taxing wealth again, if you don’t find a way to have my generation paying their fair share of taxes while they’re absorbing so much spending, you’re setting up a real battle.

Honorable James Glassman: So almost everyone on this panel agrees to some sort of consumption tax. Steve, can I say that about you? You’re talking about a flat income tax.

Steve Forbes: Flat income tax, which is a variation of a consumption tax but, I think, much more palatable. The idea that you can have a single sales tax, like the so-called fair tax — once they got into the political realities, the thing fell apart, because they had to make exemptions for food. They had to do what they call prebates, which is another word for rebates in advance, and as soon as you go out on the campaign trail and say, “I’m proposing a 30 percent sales tax,” or an X percent VAT, you can talk all you want about embedded taxes and all that kind of thing. It is a killer. Just ask some of the candidates in 2010, in Colorado and elsewhere, who got tagged with that fair tax. They went down to defeat. It is toxic, and in the real world, if you have a consumption tax, I guarantee, as you see in most states in this country and most countries around the world, you end up with both, and you get crushed by both.

Honorable James Glassman: So one way to turn an income tax into a consumption tax is by allowing deductions for anything that you invest.

Male: Full expensing.

Honorable James Glassman: Full expensing of investment.

Steve Forbes: Yeah. The flat tax is the easiest way to get simplicity without putting on a brand new tax, i.e. a VAT or a sales tax.

Honorable Sam Brownback: Can I jump in this?

Honorable James Glassman: Yes.

Honorable Sam Brownback: I worked on this in the Congress. I bet we did it a decade, going at it different times and in different ways, just from the political reality of how you can go at it. Steve’s right. When we first went after it, we said, “Okay, we’re going to abolish the income tax, and we’re going to go to a flat tax, just a whole system.” Well, then everybody that had something stuck in the income
tax code came out of the woodwork and said, “Okay, except for this deduction for this group,” for General Motors, for the farmers, for oil and gas. You just got eaten alive by everybody that had the code, for their little area, just the way they wanted it. So we had to kill it.

The next route we went, which actually had some political salability to it, is you just create he optional atmosphere, say, “Okay, leave the current code the way it is. If you want to use it, God bless you. It’s yours, but anybody else, here’s a flat tax. You pick which one you want to go to and use this.” That’s one you can actually sell in the political marketplace, and people will migrate. My estimation, and I’m almost certain this would happen, most people would migrate to it, and your compliance costs, they don’t go down near to what they would under what you’re proposing, Larry, but they down some substantially.

Honorable James Glassman: That sounds like something John Stossel would like.

Steve Forbes: Hong Kong has a variation of that. You can do a single rate, or you can do their progressive system. They’ve had that for 60 years.

Honorable James Glassman: What do you think of that, John? You get to choose. You choose your tax code, maybe even more than two choices.

John Stossel: I’m not qualified to add to the esteemed panel on that.

Male: Sounds like a politician. My God.

Honorable James Glassman: What I would like to actually focus on — I’m glad the Governor brought that up — is what is realistic. We have theorists here on the panel. The majority of this panel has served in government, probably has a pretty good sense of the politics. We’ve got the Bush tax cuts expiring at the end of the year if nothing is done. Pretty serious situation. What can we actually get done in either a lame duck Congress or right after the election? Anyone have any ideas?

John Taylor: Paul Ryan talked about a proposal of 25/10, broadening the base and described exactly what that would be. It’s not exactly a flat tax, but it’s moving in that direction. There’s a proposal to reduce rates 20 percent across the board, which is out there. Those seem to be getting pretty close to practical. You have the Simpson-Bowles talking about reducing rates. That’s out there, so I think from a point of view of developing a policy, that’s the most effective way to go.

Honorable James Glassman: But all those rate reductions are accompanied by a base broadening. I know you said you don’t want the base to be broadened too much, but certainly the base broadening would include things like ending deductibility of state income taxes or the mortgage deduction or maybe even the deductibility or the exclusion on medical insurance expenses.

John Taylor: Whatever it happens to be, it should be enough that it matches the rate reduction. What I think is, if people think about it, a 25 percent rate or a 10 percent rate, they’ll be saying, “Well, I’ll be willing to give up some of that stuff.” Who knows exactly what it will be, but that’s the debate we should be having. It may not be 25. It may be this 20 percent reduction of the existing rates, but it seems to me that’s where the momentum is going. That’s where the discussion is going, and the biggest criticism we’re having right now is, “Tell me where the base broadening is going to be going.” That seems to me something we can have as a broader discussion.

Steve Forbes: And one point, in terms of simplification, in 1986, when the top rate was cut from 50 to 28, even though they kept deductibility of local taxes in, state income taxes, it forced states to reduce their rates, because suddenly you didn’t get as big a deduction. So New York, under Mario Cuomo, a liberal, cut their rate from about 10 percent, I think, to 7-½ percent, because the top rate on the
federal level went from 50 to 28. So if virtue begins at the federal level, it forces virtue on the state level.

Honorable Ed Lazear: I’m worried that we’re taking our eye off the ball a bit, because this is an opportunity right now. We’re in a very low-growth period. This is a time when we can focus on trying to increase growth. Why do we need to do that? Because wages are connected to productivity, and productivity is connected to investment. That we know. So the key thing is using this opportunity to try to get investment going, and I would argue, again, for this is the time to propose, not taxing investment. This is exactly the time that we should be focusing on cutting dividends, cutting capital gains taxes and allowing full depreciation right away with infinite carry forwards, because this is probably the best opportunity to do it.

Honorable James Glassman: Let me ask the panel whether they agree. Let’s just say, hypothetically, that it was just about impossible to make any cuts in personal income tax rates, but you could either eliminate entirely capital gains rates, dividends, that sort of thing that Eddie’s talking about. Is that something you would go for?

Alan Schwartz: As I said in the beginning, the thing I’ve changed my mind on, after being fully on the side of encouraging investment, I think — I joked about Buffett, but I think he has stolen the issue with the electorate. I think that the notion of people understanding that it’s rich people who have capital gains and dividends, and they’re going to pay no income tax, and I’m going to pay a much higher rate, I think it’s politically stillborn. I think that it keeps us from getting to an answer. I will say, on the other hand, the interesting thing for me is, I would say, being involved with business a lot, corporations, more than I’ve ever seen in my career, are embracing the idea of losing their deductions and getting a lower marginal rate. When you try and poke through why, I believe it’s — and by the way, from a bunch of companies that say, “If the rate comes down to —” Let’s say they pick between 20 and 25 percent. “If it comes down to there, my effective tax rate the last five years has been below that, so my taxes will go up.” But I think the reason they say that is their compliance costs, the costs you don’t see, all of the hours spent in tax planning — I was in a meeting today with a major corporation where one of the things we were talking about was, “It would save so much money to locate your plants here.” They say, “Yeah, but it will kill me in taxes. I justify my profits, having these plants in these low-tax places.” So there’s so much in the way that I think you are getting a consensus that corporate taxes, lowering the rate and broadening the base, I think all sides of the equation agree with that.

Honorable James Glassman: We actually haven’t heard much about corporate taxes here. Kevin Hassett, I think, has been kind of the most tireless campaigner. We’ve heard it from a few. How important is it to bring down the corporate tax rate?

Edward Lazear: Well, remember, the flat tax, the X tax, all of these plans bring it down essentially to zero, so that’s the whole point. Once you allow for full depreciation of investment right at the outset, you’re really not taxing capital. You’re not taxing investment. That’s the whole point of it, so I think, if you go that way, that’s essentially the plan. When we say, “Well, let’s bring it down to 25 percent,” the idea is, if we look at our competition around the world, other countries have rates at that level. That may be true, and capital will move overseas, but I would be much more radical on this. Again, I would at least push for going in the direction of what we think is the efficient tax. We may end up with something that’s not that, but I would at least start with that point.

Kevin Hassett: First, there’s been a little bit of misleading conversation today, in the sense that people are saying the U.S. is the highest corporate tax on Earth. We’re actually not. We’re the third highest, but we’re the highest in the OECD. The other two countries that are higher are the Democratic Republic of the Congo and Ghana.
Male: Our main competitors.

Kevin Hassett: Yes, that’s right.

Male: How about Iran?

Kevin Hassett: The status as high-corporate tax place is clearly the most damaging policy error that we're making right now. I had a recent academic paper, that they wrote up in The Wall Street Journal, but there was also a Brookings paper recently that showed that there’s a clear Laffer curve in the corporate tax base. That Laffer curve is supported by a big empirical literature that shows that, to use economist-ese, the elasticity of taxable income, with respect to the corporate rate, is about three, which means what he was saying, that the money goes to the low-taxed place really, really quickly. What that means is, being 35 percent in the U.S., we’re chasing the revenue away. We’re on the wrong side of the Laffer curve, and in fact, President Obama says he wants a revenue-neutral corporate reform, although he proposed one that was revenue-increasing, according to static scoring. But if you want a revenue-neutral reform right now, given the Laffer curve that we’ve estimated in the data, then you have to cut the rate all the way to 17 percent. If you cut the rate to 25 percent, you get showered with revenue, because we’re so far on the Laffer curve, but to be that far on the wrong side of the Laffer curve, I think that’s really indicative of how terrible this policy is and how harmful.

What we should do is we should just go home and cut the corporate rates. Fine, say the Democrats don’t believe the Brookings paper on this. They still should be willing to let us cut the rate 2 percent this year and then see what happens. What would happen would be we’d get a lot more revenue. Then say, “Okay, let’s cut another 2 percent.” We’d get a lot more revenue. We’ve got to start this process sooner or later, because we’re going to keep having 8 percent unemployment if all the factories are being introduced overseas.

Honorable James Glassman: I’m going to shift gears. Go ahead, John. Then I’m going to shift gears.

John Taylor: One thing on the cap gains and dividends. The Bush tax cut that took those to 15 percent was an incredibly important victory for lowering tax on capital, and to the extent that we can just preserve that, because there’s momentum going in the other direction, I think it would be an important way to get consensus. That was tremendous, good for the economy, good for revenue. So I say leave them at 15. That’s good, and try to prevent them from rising.

Steve Forbes: That underscores something very important about those who would do a preemptive surrender. If you’d said 10 or 12 years ago, “Could you have a President and a Congress seriously pass something that looks so favorite to capital,” they would have said, “Impossible.” But by asking for the complete elimination of the tax on personal dividends so you don’t get double taxation, they got about 60 percent of it. John’s right. The revenue came in. Companies started to pay dividends, again, which was good for management. Instead of companies wasting capital they really didn’t know what to do with, they sent it out to shareholders and let them decide where the capital should efficiently go.

Honorable James Glassman: I want to talk about state taxes for a second. Governor Brownback, earlier today, Governor Christie spoke and talked about how, in New Jersey, he cut spending before he approached the question of cutting taxes, and on a panel of other governors, there was some disagreement on that question, whether you do them at the same time, whether you cut spending first, whether you cut taxes first. What’s your view on that?

Honorable Sam Brownback: Well, my view is what I practice. Basically, we made minor tax cuts last year, but we really fixed the sinking ship. We had a $500 million budget hole when I came into office. It’s in a $14
billion budget, so it’s a substantial piece of it. So we fixed the hole first by cutting spending. Then, when you get your growth that taxes place, and it has been taking place — we’ve got now a $400 million surplus, and we’re cutting taxes in a major way, cutting our rates down, taking the tax completely off of small business, the proposal I just put in front of you. I’m trying to compete. I’m tired of getting beat by the Texans, and Mary Fallin is here from Oklahoma. She’s in the same ballpark. We’re going to get these rates down and attract the capital in, but I felt like we had to convince the citizenry, “Look, we’re going to be responsible. We’re not doing this in a vacuum, and we’re going to be able to pay for essential services.” So we cut a bunch of spending, but we kept our essential services, didn’t cut anybody off Medicaid. We didn’t cut any payments on Medicaid. We made sure our schools were funded, but now, we did eliminate a bunch of other funding areas and had a big discussion about what’s the government’s role for funding of the arts and other things, which I got all sorts of criticism about. But our point was, if you can’t pay your mortgage, would you be buying a piece of art, if you can’t pay your mortgage. They all say, “Well, yeah, I’d probably pay my mortgage.” “Well, what about your government then?” So what we did was we got our spending under control, and now we’re making major changes in the tax code to move forward on growth.

Honorable James Glassman: You said that, when you got your spending under control, growth began to rise.

Honorable Sam Brownback: It did. You show the business community, “Look, we know how to manage this. We’re getting our costs under control.” That starts attracting more capital into the place. One of the things we’ve got to do in the public sector is get on top of the pension systems, and that’s something that people haven’t — they’re talking about more, but we’re talking about a cash balance system where you guarantee a 5 percent rate of return. Anything over that we pay back into it or going to a defined contribution system, allowing the employee the option of getting into it or not. I’d rather just go to the defined contribution system overall. I’m having trouble selling that, and the price tag’s pretty high on just moving whole stock into that, but the public sector’s got to do a lot more discussion on that.

The final point — I’m talking too much on this, but now is actually the time to propose bold public solutions. Most of the political space is occupied by incremental time where you can only propose an incremental solution to something. The public is scared now. They’re scared for the future of their country. You could go across the state of Kansas, get a crowd of any 100 people and ask, “How many of you are scared for the future of your country?” You’ll get 90 percent of the hands shoot up. They’ll be people like my parents. They’ve been salt-of-the-earth farmers all their life. They’re scared. They don’t think the smart people are willing to dig in and handle it, or they can’t figure it out, or nobody’s got a plan about what are we going to do. They are smart people, but they’re just saying. “Where’s the plan,” and, “I’m scared that people are not thinking, and they’re not willing to do the tough things.” Well, now is the time the public is ready to engage tough discussion and real, major solutions. Now’s the time to be bold and aggressive with good, thoughtful plans.

Honorable James Glassman: One question for John Stossel, and then we’re going to take questions from the audience. The title of your book is No, They Can’t. How does that relate to taxes?

John Stossel: No They Can’t was the take-off on the Obama slogan of yes, we can. The subtitle is Government Fails But Individuals Succeed. The Governor talks about cutting spending first. I would agree with that. I think you lose people in much of this discussion as soon as you even say depreciation or carry forward or even defined benefit. Most of the public stops listening. Maybe in Kansas they’re scared. I think in the Upper West Side, outside this building, they don’t think there’s a problem, and they’re just happy to go forward spending as much as possible. A simple budget proposal that says, “Government can’t do these things. Go back to basic principles. We need a Department of Defense, even an EPA, a census, a Justice Department to enforce the rules
and that’s about it. We’ll start over.” But I don’t think the public’s ready. Maybe after Greece riots again and Japan blows up, maybe then they’d be ready.

Honorable James Glassman: Thank you. Questions from the floor? Yes. Just wait for the microphone, and then identify yourself. There’s a question over here. Yes.

Diana Furchtgott-Roth: Yes, I’m Diana Furchtgott-Roth, with the Manhattan Institute. Some people say that we already have, in essence, a consumption tax, because people can shelter the income that they do not spend, through IRAs and college savings accounts and 401(k) accounts, and most people are not up to the maximum in those accounts. So according to your recommendations, all we would have to do is move to full expensing of investment for businesses, and we would practically already have the system that you propose. What does the panel think about that? That would be actually simpler than putting in a value-added tax or some of these other methods.

Honorable Edward Lazear: Yeah, I agree with you, Diana. That’s essentially the proposal that the Bush tax panel came up with. That was the idea. We scored that, by the way, and compared that to the effect of that on the economy, of cutting the corporate income tax rate. Hank and I ran a conference together on this, and Treasury scored it. The bang for the buck is about 4 to 1 in terms of expensing versus cutting corporate tax rates, and the reason is simple. When you cut corporate tax rates, what you’re doing is your grandfathering in old capital. When you’re giving full expensing, you’re only affecting new capital. So for any dollar that you’re spending on reducing taxes, you’re only affecting new capital when you do the full expensing, and that’s the main reason for it. I think that’s the primary argument that most economists would use in favor of going in that direction. I think you’re quite right. We’re almost there. It would be really a pretty simple step to move in that direction. It wouldn’t do everything, but it would probably get us 80 percent of the way in terms of encouraging economic growth.

Honorable James Glassman: Larry, you want to —

Honorable Lawrence Lindsey: I think, though — I hate to enter wonkdom here, but you’d have to get rid of deductibility of interest. We could do that. That would be the flipside of it.


Bernard Weinstein: I’m Bud Weinstein with SMU. I’m also a Bush Growth Fellow. I have a question for the panel. In the past, whenever that VAT trial balloon has gone up, it’s been shot down by the governors associations and the Mayors associations, who say, “Consumption taxes, that’s our sandbox. The feds should stay out.” So has the perspective of the governors and mayors changed? And if not, what can be done to change that perspective?

Honorable Lawrence Lindsey: First of all, I think we have to get rid of the phrase consumption tax and say value-added tax. Consumption tax is related to income and things like that. Value-added tax is a business cash flow tax. It’s border adjustable.

Honorable James Glassman: Maybe you should just unpack that so everybody understands what a value-added tax is.

Honorable Lawrence Lindsey: Here’s the deal. I make cars. I sell my cars. I get $5 billion for selling my cars. From that I subtract the billion I paid the steel company, the glass company, duh, duh, duh, duh, duh, duh. Of $4 billion, I send 25 percent of that to the government. I’m done. That’s it. That’s the whole thing. So the cash comes in. The cash goes out. The cash is only deductible if I send it to
somebody who is going to pay tax on it, the steel company or the glass company. It’s a very simple to administer tax. There’s no definitions of income to worry about, and how about Toyota? When Toyota of America gets a car, it comes off the docket in San Francisco or Long Beach, well, it’s coming over at $30,000. It’s then subject to 25 percent VAT right there. By the way, if Toyota of America has a markup on it, the whole car is subject to that tax. You have a level playing field between a domestically-produced car and a foreign car, and the depreciation doesn’t take care of that problem.

Think about our needs. We need simplification. We need a level playing field competitively, and we have to get rid of this multiple definition of income. I think, by the way — matter of fact, I was on a panel before the Senate Budget Committee, and there were four of us. We hadn’t compared notes. We were across the political spectrum, and the Senate Budget Committee was asking us what would we do. All four of us separately, in answer to the question, said, “The country is going to end up with a VAT.” We were then lectured by the senators on how the Senate had voted 93 to 3 to never, ever consider a VAT ever in its history, which talks about the political problem. We are going to be boxed in that corner. We have a fiscal cliff we’re going to go over. We have a huge debt overhang. We have to solve our budget problem, et cetera. We are no longer going to be able, at some point, to afford all of this, and then we are going to turn to solutions that are the most efficient way of paying for government. I’m sorry to say it. I know it’s politically unpopular, but if you want efficiency and you want growth, it’s the only way to go.

Steve Forbes: Would you have an amendment to the constitution, which allows the income tax?

Honorable Lawrence Lindsey: You can try and move it. I don’t think it’s necessary. I think once you abolish the corporate tax, abolish the personal income tax and abolish the Social Security tax — if I’m a politician and said, “Oh, yeah, now that we have a VAT, I want to bring back the income tax,” I don’t think it’s going to get any votes. So yes. I don’t think we need the constitutional amendment. It’d be a nice thing to have. I’d just move forward with it, abolish the current taxes, put in one simple tax to replace it.

Honorable James Glassman: So in answer to Bud’s question, I just wanted to turn to Governor Brownback. Would you be kind of jealous if the federal government instituted a VAT or even a more transparent consumption tax? Would you say, “That’s my sandbox. Stay out of it”?

Honorable Sam Brownback: Well, as I stated earlier, I think the field is more open to bold solutions now than it has been any time during my political lifetime, because people are looking, and we’re getting boxed into a big hole, like Larry’s saying. I’m sorry to hear what he thinks is the answer. I love you, but I’m just — so I think there would be less of a response, what you’re saying. I just think it’s a Steve Forbes political problem. I don’t think your problem is going to be mayors and governors. I think it’s going to be people standing for election and saying, “I’m for 20 percent value-added tax,” and somebody puts up the ad, “Here’s your price of milk now. Here’s your price of milk if Bud is elected.”

Honorable James Glassman: But you don’t pay any personal income taxes.

Steve Forbes: It would be higher than 20 percent.

Honorable Sam Brownback: Well, that it’ll get lost in the discussion, about you aren’t paying any income tax. People won’t believe they’re not going to pay any income tax.

Steve Forbes: Half the people aren’t anyway.
Honorable James Glassman: By the way, that could be another problem. This side of the Supreme Court hasn’t said anything recently. How big a problem is it that half the people aren’t paying any taxes anyway, as Steve Forbes says? Kevin.

Kevin Hassett: Yeah, I had a piece in the Washington Post a couple of years back on tax day about that.

Honorable James Glassman: We don’t read the Washington Post.

Kevin Hassett: I know, I know, but I have another one in The New York Times, the same issue. The idea is, in fact, you can’t fund a big government without taxing everybody. As we see, the Buffett Rule will raise $30 [billion] to $40 billion over ten years by the joint taxes estimates, and so all this hubbub over the Buffett Rule is really a tiny little pittance of revenue. So you have to tax everybody, and what politicians have done, maybe in both parties, probably in both parties, is they’ve reached an equilibrium, where they tax rich people with taxes that are highly visible, and they tax poor people with taxes that are difficult to attribute. But if you look at the taxes relative to income, across the income distribution, and this is what I did in the article you didn’t read, it’s pretty much always about 30 percent. So poor people pay about 30 percent of their income in taxes, because they pay a lot less income tax. Some of them pay no tax at all, but they pay sales tax, income tax, cigarette tax. I included in the analysis the lottery, because people at the bottom play the lottery a lot, and the lottery’s a really unfair way to gamble. You should go to Atlantic City. You get much better odds. The taxes right now are approximately flat. It’s just this really ornate, ugly, inefficient system that does it in a way that’s kind of satisfying for politicians.


John Taylor: I was going to say, on the issue of people not paying income tax, remember, it used to be that we were excited about tax reform proposals that would take five million off the tax rolls or ten million off the tax rolls. That was like a positive thing to say. I would say we should stop thinking of that as a positive thing to do when you think about your tax reform and the other ways we’ve been talking about it. That’s maybe just got to hold at this point where we are.

Honorable James Glassman: Question.

Female: There was a lot of discussion recently, maybe six months ago, in The Wall Street Journal, about flat tax, tiered flat taxes and whether or not the deductibility of home mortgage loans would be included in that. I just haven’t heard any of that, which seemed to me to be much more politically feasible. I’m a television producer, so that’s something I think about. Your comments on that.

Honorable James Glassman: Anybody have —

Honorable Edward Lazear: Yeah, again, that’s what the X tax is. The X tax is the Forbes flat tax, but it’s a bit more progressive. One of the things, again, when President Bush put me in this uncomfortable position of being on the tax panel and having to say things that were definitely unpopular, one of the things that we talked about was the deductibility of mortgage interest. The other thing was the non-taxability of healthcare benefits that are provided by the employer, and in fact, we were able to cut rates at the margin even for the highest tax bracket, but it was only by eliminating those deductions. That’s how we paid for it, and that created the firestorm. So again, he doesn’t allow me to talk about politics, so I won’t. That’s for others to do, but it certainly is not something that is easily accomplished.
Steve Forbes: That’s why, again, you give people a choice. You have a simple flat tax, pure, and then say, “If you want to stay with the old, you like to punish yourself, you have low self-esteem and want to go through that, go ahead.”

Kevin Hassett: There’s just one other thing to add in defense of the Lindsey plan, which is that most value-added taxes tax new things, but they don’t tax old things. So you wouldn’t tax a used car sale, but you would tax the purchase of a new automobile. This has an unusual and unappreciated effect on real estate markets, which is that the value-added tax would apply to the purchase of a new house under most designs but not to the purchase of an old house. So if you have an old house today, it’s really good for you, because suddenly you have a tax advantage vehicle. So the prices of old houses can actually, surprisingly, respond to the introduction of a value-added tax.

Male: Home builders are going to love that one.

Kevin Hassett: That’s right.

Honorable James Glassman: Isn’t that part of 9-9-9, as I recall? Well, we’ve come to the end of our day of discussing growth and taxes. I think it may be appropriate to end, in fact, with something that Governor Brownback said now, actually twice, that now is the time to propose bold public solutions. I think we’ve heard a range of solutions. A lot of the decisions about which solution to choose has to do with how we gauge politics, but maybe this is the time in our history to propose and ultimately enact bold policy solutions.

I want to thank President Bush first of all. There would be no Bush Institute without President Bush, and his participation today has just been stunning. I really, really appreciate you being here, sir.

Everyone just merely assumes that a conference like this runs just incredibly smoothly all by itself, but it doesn’t. I wanted to thank Andrea Wile and Kristen King and all the people on our events team for making this work. I also want to thank Stacy Cinatl, who makes the entire institute work. So thank you all.

I should finally — this is the part after the opera is over and the curtain comes down. Somebody comes out with roses for the diva, and as we all know, the diva is Amity Shlaes. We have no roses, but we do thank Amity for everything that she’s done.

And thank you all for being such a wonderful and tremendously engaged audience. One of the things that we do at the Bush Institute is we do this little survey after the conference is over, because we’re big on metrics and goals and that sort of thing, and one of the things we’ve learned, as we’ve done conferences before, is that people really like the times when they can mingle with the other people who are at the conference. So we have reserved plenty of time to do that at this conference. There’s a little reception outside, sponsored by the U.S. Chamber of Commerce, so please have lots of fun, and thank you all for coming.

[End of conference]