ROADMAP FOR THE 21ST CENTURY

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Budget and Tax Reform

Prepared by the Working Group on Tax Reform
December 6, 2016

Introduction: The Economic Growth Crisis

The U.S. economy sustained a real rate of economic growth of 3.3 percent from 1945 to 1973 and again from 1982 to 2007.[1] It was only during the stagflation decade of 1973 to 1982, reflecting the deeply misguided reigning intellectual leadership of the time, when real growth fell to only half the pace of the long-term trend.

During times of good, pro-growth economic policy, real U.S. economic growth has equaled 4 percent or more, as Larry Kudlow explained in *National Review Online* on June 19, 2015[2]:

- "Following the Kennedy tax cuts, the economy averaged 5.2 percent yearly growth between 1963 and 1969."
- "After the Reagan tax rates fully went into effect, alongside Paul Volcker's conquering of inflation, the economy grew at 4.5 percent annually between 1982 and 1989."
- "And between 1994 and 1999, the Bill Clinton/Newt Gingrich economy increased 4.3 percent annually, after welfare reform, NAFTA trade, and cap-gains tax relief."

Kudlow also noted that during the entire *60-year* period from 1947 to 2007, U.S. economic growth averaged 3.4 percent. Economic historians Simon Kuznets and John Kendrick constructed the record of U.S. economic growth dating before 1900 and found long-run real GDP growth averaged 3.5 percent.[3]

At a real annual rate of 4 percent economic growth, real GDP and consequently the standard of living double in 18 years. After another 18 years, it would double again, making it *four times* the level it was 36 years previous. After another 18 years, it would double again, making it *eight times* the level 54 years previously, just over half a century.

During the twentieth century, as noted by Stephen Moore and Julian L. Simon in their underappreciated work, *It's Getting Better All the Time: 100 Greatest Trends of the Last 100 Years*, real per-capita GDP grew by nearly seven times from 1900 to 2000.[4] Adding population growth, total economic growth increased total GDP over the twentieth century by several times more.

As Brian Domitrovic explained in his revealing book *Econoclasts: The Rebels Who Sparked the Supply Side Revolution and Restored American Prosperity*, "The unique ability of the United States to maintain a historic rate of economic growth over the long term is what has rendered this nation the world's lone 'hyperpower.'"[5] That sustained high

[1] Brian Domitrovic, *Econoclasts: The Rebels Who Sparked the Supply Side Revolution and Restored American Prosperity* (Wilmington, DE: Intercollegiate Studies Institute, 2009), p. 6.
[2] Larry Kudlow, "Jeb Is Right About 4 percent Economic Growth," *National Review Online*, June 19, 2015.
[3] Andrew Atkeson, Lee E. Ohanian, and William Simon, Jr., "4 percent Economic Growth? Yes, We Can Achieve That," *Investor's Business Daily*, September 3, 2015.
[4] Stephen Moore and Julian L. Simon, *It's Getting Better All the Time: 100 Greatest Trends of the Last 100 Years* (Washington, DC: Cato Institute), p. 58.
[5] Brian Domitrovic, *supra* note 1.

rate of economic growth, compounding year after year, over decades and centuries, is what made America the nation we see today: the richest, most prosperous economic power, and consequently military power, in world history.

But over the past decade or so, real economic growth has sputtered, returning to the sickly rate last seen in the 1970s, less than 2 percent a year. That is because we went back to the foolish Keynesian economic policies of the 1970s, and they produced the same economic results of those dog days of American history. *This is the economic crisis of our time*: sustained long-term stagnation, returning to a level just half the long-term economic growth that made America great.

Simple mathematical calculation tells us what will result if we don't reverse course and restore the traditional, long-term, booming, world-leading, American economic growth of 3 percent to 4 percent a year. An annual economic growth rate of just 1 percentage point less compounded over 50 years would result in an economy only about 60 percent as large as what would be achieved at the higher growth rate. After 50 years at the 1 percentage point higher economic growth rate, the economy would be 62.7 percent bigger, providing a standard of living nearly two-thirds higher.

By the 50th year, GDP of the economy growing 1 percentage point less each year would be $30 trillion smaller than the economy growing 1 percentage point faster each year. The cumulative loss over those 50 years for the 1 percentage point slower-growing economy would be a staggering $521 trillion. For context, the entire U.S. economy today is about $18 trillion. So a loss of $521 trillion over 50 years would be equivalent to a loss of 29 U.S. economies.

In 1900, the standards of living in the United States and in Argentina were roughly equivalent. The difference in economic growth between the two nations over the next century made one country the most dominant nation in human history and the other, a third-world country. It was the difference of only 2 percentage points of economic growth each year over the course of a century.

In other words, *the economic policies adopted during the Obama years produced a sustained slower rate of economic growth that fundamentally transformed America into a nation on the path to becoming a third world country*.

President Ronald Reagan's economic policies, which restored America's long-term booming economic growth rate from the stagnation of the 1970s, consisted of four components:

1. Cuts in tax *rates* to restore incentives for economic growth, implemented first with a reduction in the top income tax rate of 70 percent down to 50 percent, and then a 25 percent across-the-board reduction in income tax rates for everyone. The 1986 tax reform then reduced tax rates further, leaving just two rates, 28 percent and 15 percent. Despite those sharp dramatic cuts in rates, federal revenues doubled during the 1980s, because the economy boomed, producing booming revenues as a result;

2. Deregulation, which saved consumers an estimated $100 billion per year in lower prices. Reagan's first executive order eliminated price controls on oil and natural gas. Production soared, and the price of oil declined by more than 50 percent;

3. Spending reductions, including a $31 billion cut in spending in 1981, close to 5 percent of the federal budget then, or the equivalent of about $200 billion in spending cuts for the year today. In constant dollars, non-defense discretionary spending declined by 14.4 percent from 1981 to 1982, and by 16.8 percent from 1981 to 1983.[6] In constant dollars, this non-defense discretionary spending never returned to its 1981 level for the rest of Reagan's two terms.[7] By 1988, this spending was still down 14.4 percent from its 1981 level in constant dollars.[8] Even with the Reagan defense buildup, which won the Cold War without firing a shot, total spending by the national government declined from a high of 23.5 percent of GDP in 1983 to 21.3 percent in 1988 and 21.2 percent in 1989.[9] That's a real reduction in the size of government relative to the economy of 10 percent;

[6] Peter Ferrara, "When the Republicans Cut Spending," *American Spectator,* September 2008.
[7] *Ibid.*
[8] *Ibid.*
[9] *Ibid.*

4. Anti-inflation monetary policy restraining money supply growth compared to demand, to maintain a stable value of the dollar. That cut the double-digit inflation of 1979 and 1980 in half by 1982, and in half again to about 3 percent by 1983, never to be heard from again to this day.

The rest of this paper focuses on how tax policy should be changed to restart America's economic engine.

Marginal Tax Rates

The key to understanding the effect of taxes on the economy is to focus on tax rates, particularly marginal tax rates, the tax rate that applies to the next dollar earned.

The tax rate determines how much a producer is allowed to keep out of what he produces. For example, at a 25 percent tax rate, the producer keeps three-fourths of his or her production. If the tax rate is increased to 50 percent, the producer keeps only half of what he produces, reducing his reward for production and output by one-third. Incentives are consequently slashed for productive activity, such as savings, investment, work, business expansion, business creation, job creation, and entrepreneurship. The result is fewer jobs, lower wages, slower economic growth, or even economic downturn.

In contrast, if the tax rate is reduced from 50 percent to 25 percent, what producers are allowed to keep from their production increases from one-half to three-fourths, increasing the reward for production and output by one-half. That sharply increases incentives for all of the above productive activities, resulting in more of them, and more jobs, higher wages, and faster economic growth.

These incentives do not just expand or contract the economy by the amount of any tax cut or tax increase. For example, a tax cut of $100 billion involving reduced tax rates does not affect the economy by only $100 billion. The lower tax rates affect every dollar and every economic decision throughout the economy. That is because every economic decision is based on the new lower tax rates.

In fact, the new lower tax rates affect every dollar, or unit of currency, and every economic decision throughout the whole world regarding whether to invest in America, start or expand businesses here, create jobs here, even work here, because all these decisions will be based on the new lower tax rates. Tax rate increases have just the opposite effect on every dollar and economic decision throughout the economy and the world.

In addition, marginal tax rates affect those to whom the rates may apply in the future. For example, consider a small business owner. If he invests more capital in the business to expand production, or hires more workers to increase output, that may result in higher net taxable income. It is the tax rate at that higher income level, not at his current income level, that will determine whether he undertakes the capital investment or hires more workers.

Flat Rate vs. Progressive Rates

A so-called "progressive" tax rate structure applies progressively higher rates to higher incomes. Those higher rates impose all of the counterproductive incentives of higher marginal tax rates as discussed above. The "progressive" tax rate structure effectively imposes a penalty for producing and earning more. Consequently, it naturally results in less productive activity, reducing economic growth and GDP.

Despite these negative economic effects, the progressive tax rate structure is advanced in the name of fairness, on the grounds that it is supposed to be fair for "the rich" to pay more. But it is the flat rate tax structure that is the most fair, not the progressive rates.

Under a flat tax rate, if Taxpayer A earns 10 times what Taxpayer B does, then Taxpayer A pays 10 times what Taxpayer B does. Under a progressive tax rate structure, if Taxpayer A earns 10 times what Taxpayer B does, then Taxpayer A pays more than 10 times what Taxpayer B does. That is an unfair penalty on production, and it is also economically counterproductive.

For example, consider a pure flat rate tax of 20 percent applied to all. Taxpayer A makes $500,000 a year; Taxpayer B makes $50,000. Under the 20 percent tax rate, Taxpayer A would pay $100,000 in taxes, taxpayer B would pay $10,000 in taxes. Consequently, Taxpayer A makes 10 times what Taxpayer B does, and pays 10 times what Taxpayer B does.

Now consider a pure "progressive" income tax that applies a 20 percent rate to the first $100,000 earned, 25 percent to the next $100,000, 30 percent to the next $100,000, 35 percent to the next $100,000, and 40 percent to all income above that. Taxpayer B who makes $50,000 a year would still pay $10,000 under that tax. But Taxpayer A, who makes 10 times as much at $500,000 per year, would pay $150,000, which is 15 times as much as Taxpayer B.

This penalty on higher incomes is both economically counterproductive and unfair. A flat rate tax with loopholes closed so that a taxpayer who makes 10 times as much pays 10 times as much, but not more, would provide incentives to maximize economic growth, and would be the most fair.

The Multiple Taxation of Capital

These incentive effects are compounded in our tax system through the multiple taxation of capital. Capital income is taxed not once, but several times in federal and state tax codes.

Consider a saver who invests a dollar in a corporate enterprise. Any dollar that corporation earns is subject to national and state corporate income taxes, totaling roughly 40 percent in America on average now. If the remainder of that dollar is paid to the investor in dividends, then it is taxed again through the individual income tax at the dividends tax rate. With President Barack Obama increasing the dividends tax rate from 15 percent to 23.8 percent, applying that 23.8 percent tax rate to the 60 cents remaining after paying the corporate income tax leaves just 45.72 cents for the investor out of the original dollar earned.

A third layer of taxation of capital income is represented by the capital gains tax. Consider an asset such as a share of stock. When the price of that asset increases, that is reflecting an increase in the expected value of the future income stream to that asset. That future income will be taxed by both the corporate income tax and the individual income tax when earned. If that asset is sold now, taxing the increased value by the capital gains tax is effectively taxing that future income stream a third time.

The death tax (the popular name for the estate tax) is still another, fourth layer of taxation of capital income. If the investor in our example above saves the 45.72 cents remaining on that dollar of corporate earnings after paying the corporate and individual income tax, and leaves it to his children at death, applying the death tax to it would take roughly half of what is left, leaving his children just 22.86 cents out of the original dollar earned.

Our tax system further burdens capital income through depreciation rather than immediate expensing. Except for capital investment in plant and equipment, all other business expenses incurred for the production of income are deducted in the year they are incurred, because the income tax is supposed to be on net income after expenses. But deductions for the expenses of acquiring capital equipment must be spread out over many years under arbitrary depreciation schedules.

Capital equipment is what makes American workers the most productive, and hence the most highly paid with the highest standard of living, in the world. With such capital equipment, for example, workers can use mechanized, computerized, modern crane shovels, rather than their bare hands, for digging and building. Or they can use modern computers rather than just computing in their heads. The effective result of extended, arbitrary depreciation schedules instead of immediate deductions or expensing is higher taxes on investment in capital equipment, which means less of such capital equipment, slowing growth in jobs, productivity, and wages.

Kennedy Got It

While President Obama and his administration failed to understand any of this, President John F. Kennedy did. Kennedy proposed legislation to reduce income tax rates across the board by nearly 30 percent. Kennedy explained,

> It is a paradoxical truth that tax rates are too high today, and tax revenues are too low and the soundest way to raise the revenues in the long run is to cut the tax rates. … [A]n economy constrained by high tax rates will never produce enough revenue to balance the budget, just as it will never create enough jobs or enough profits.[10]

Kennedy added,

[10] Arthur B. Laffer, Stephen Moore, and Peter J. Tanous, *The End of Prosperity* (New York, NY: Simon & Schuster, 2008).

> Our true choice is not between tax reduction, on the one hand, and the avoidance of large federal deficits on the other. … It is between two kinds of deficits – a chronic deficit of inertia, as the unwanted result of inadequate revenues and a restricted economy – or a temporary deficit of transition, resulting from a tax cut designed to boost the economy, produce revenues, and achieve a future budget surplus.[11]

Kennedy explained further that the best way to promote economic growth "is to reduce the burden on private income and the deterrents to private initiative which are imposed by our present tax system – and this administration is pledged to an across-the-board reduction in personal and corporate income tax rates."[12]

Kennedy's proposed tax rate cuts were adopted in 1964, cutting the top tax rate from 91 percent to 70 percent and reducing the lower rates as well. The next year, economic growth soared by 50 percent and *income tax revenues* ***increased*** *by 41 percent.*[13] By 1966, unemployment had fallen to its lowest peacetime level in almost 40 years. *U.S. News and World Report* noted, "The unusual budget spectacle of sharply rising revenues following the biggest tax cut in history is beginning to astonish even those who pushed hardest for tax cuts in the first place."[14] Arthur Okun, the administration's chief economic advisor, estimated the tax cuts expanded the economy in just two years by 10 percent above where it would have been.

The Rich and Their "Fair Share"

Even before the election of Barrack Obama, official IRS data showed that in 2007 the top 1 percent of income earners paid 40.4 percent of all federal income taxes, almost twice their share of adjusted gross income.[15] The top 5 percent paid 60.6 percent of all federal income taxes, while earning 37.7 percent of adjusted gross income.[16] The top 10 percent paid 71.2 percent of all income taxes, while earning 48 percent of adjusted gross income.[17]

By contrast, the bottom 95 percent of income earners paid 39.4 percent of all federal income taxes.[18] That means the top 1 percent of income earners paid more federal income taxes than the bottom 95 percent.

Again, this was *before* the across-the-board tax rate increases for nearly every major federal tax central to Obama's economic plan, which he justified by saying they were necessary to ensure that the rich paid their fair share of taxes. But the figures above raise the question, just what would be their "fair share?"

IRS data also show that those on whom Obama increased taxes, earning more than $200,000 a year, constitute just 3 percent of taxpayers. That 3 percent already paid more in income taxes than the bottom 97 percent combined.[19]

Given these facts, increasing taxes on the top 1 percent, or the top 3 percent, in the name of "fairness," would effectively enshrine in the tax code the morality of pirates or of Jesse James, who explained that he robbed banks because "that's where the money is."

Because of the gross imbalance in the tax code that already exists, attempting to raise taxes further on this small sliver of the population is not going to generate any significant additional revenues. More likely, such a tax increase will lose revenue overall, especially if a recession results.

The Middle Class, the Working Poor, and Reagan's Republicans

The facts also demonstrate the falsehood of the claim that Republicans cut taxes for the rich but haven't "given a break to folks who make less."

The share of federal income taxes paid by the top 1 percent was 17.6 percent in 1981, when Reagan brought his supply-side economics to Washington.[20] After a quarter-century of rate cuts, that share had more than doubled by 2007, to 40.4 percent, as noted above. That is because with the lower tax rates,

[11] *Ibid*.
[12] *Ibid*.
[13] *Ibid*.
[14] *Ibid*.
[15] Internal Revenue Service, Statistics of Income.
[16] *Ibid*.
[17] *Ibid*.
[18] *Ibid*.
[19] *Ibid*. "The $31 Billion Fantasy," *The Wall Street Journal*, August 28–29, 2010.
[20] *The Reagan Tax Cuts: Lessons for Tax Reform*, Joint Economic Committee, Congress of the United States, April 1996.

incomes boomed along with the economy, and high-income taxpayers had incentives to pull their money out of tax shelters and invest in the real economy, further fueling the boom while increasing their reported income.

But in 2007, even before Obama was elected, the bottom 40 percent of income earners as a group paid no federal income taxes.[21] Instead, they received net payments from the income tax system equal to 3.8 percent of all federal income taxes.[22] In other words, they paid negative 3.8 percent of federal income taxes. The middle 20 percent of income earners, the actual middle class, paid 4.7 percent of all federal income taxes.[23]

This was the result of Reagan Republican supply-side economics, which began with Reagan and Jack Kemp in the 1970s and 1980s, continued through Newt Gingrich and his Contract with America, and further played out with the Bush tax cuts of 2001 and 2003. Reagan and his Republicans abolished federal income taxes on the poor and what liberals call the working class. Moreover, they almost entirely abolished federal income taxes on the actual middle class (the middle 20 percent).

The origins of the Earned Income Tax Credit (EITC), which has done so much to reduce income tax liabilities for lower-income people, can be found in Ronald Reagan's famous testimony before the Senate Finance Committee in 1972, where he proposed exempting the working poor from all Social Security and income taxes as an alternative to welfare. As president, Reagan cut federal income tax rates across the board for all taxpayers by 25 percent. He also indexed the tax brackets for all taxpayers to prevent inflation from pushing workers into higher tax brackets.

In the Tax Reform Act of 1986, Reagan reduced the federal income tax rate for "folks who make less" all the way down to 15 percent. That act also doubled the personal exemption, shielding more income from taxation for everybody.

Newt Gingrich's Contract with America adopted a child tax credit of $500 per child that reduced the tax liabilities of lower income people by a higher percentage than for higher income people. Bush doubled that credit to $1,000 per child and made it refundable, so that low-income people who do not pay even $1,000 in federal income taxes could still get the full credit. Bush also adopted a new lower tax bracket of 10 percent for the lowest income workers, reducing their federal income tax rate by 33 percent. He cut the top rate for the highest income workers by just 11.6 percent, from 39.6 percent to 35 percent.

Many conservatives do not think it was a good idea to exempt so many from paying any income taxes at all. Nevertheless, the charge that Republicans cut taxes only for the rich is factually groundless. Under Reagan Republican tax policies, the share of income taxes paid by "the rich" has soared to arguably excessive, even abusive, levels, while income taxes were, again, abolished for the poor and working class, and almost abolished for the middle class.

Pro-Growth Tax Reform Alternatives

Free-market conservatives have advanced several tax reform alternatives that would promote booming economic growth. At least five of those alternatives would serve as the foundation of a historic economic boom.

1. Ted Cruz/Rand Paul Flat Tax. This plan was developed for Senators Ted Cruz and Rand Paul by Art Laffer and Steve Moore. Cruz proposed a 10 percent flat tax for individuals and a 16 percent flat tax for business, rates substantially lower than the rates even under Reagan. The business tax at this flat rate would produce so much revenue, as scored by the non-partisan Tax Foundation, that Cruz also would eliminate the nearly 16 percent payroll tax, the corporate income tax, the death tax, the Alternative Minimum Tax, and the Obamacare taxes. Social Security and Medicare would be financed by the general revenues produced by the two flat taxes, ending deficits in both programs.

The 10 percent flat tax would apply that same 10 percent rate to everything: wages, capital gains, dividends, rents, royalties, all forms of non-business taxable income. That would eliminate any claim that billionaires are paying lower tax rates than their secretaries.

The plan includes a $10,000 standard deduction

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[21] Congressional Budget Office; Peter Ferrara, *Federal Income Taxes: Who Pays and How Much, Americans for Tax Reform*, Washington, DC, August 2008.
[22] *Ibid*.
[23] *Ibid*.

for each taxpaying adult and a $4,000 personal exemption. That means the first $36,000 for a family of four would be completely exempt from all major federal taxes. The payroll tax is the largest tax paid by taxpayers in the bottom 60 percent of income earners. The plan expands the EITC by 20 percent, while retaining the Child Tax Credit. These features make Cruz's flat tax quite "progressive" in fact.

The business flat tax would be border adjustable, with all exports getting refunds for taxes paid while all imports would be taxed by 16 percent. That is a big advantage for American manufacturing and also legal under all international trade treaties; many countries include such border adjustability in their tax systems.

The business tax also would be territorial: Business income would be taxable only in the country in which it is earned, not also taxed by the U.S. government as it is today. The $2 trillion that multinational U.S. companies are presently holding overseas to avoid double taxation by the federal government would consequently "come home."

The business flat tax provides for immediate expensing, or deductions, of the costs of plant and equipment. That promotes investment in worker productivity – the foundation of rising wages – and in businesses providing good-paying blue-collar jobs, like heavy industry, mining, energy, farming, ranching, and manufacturing. Workers also would enjoy Universal Savings Accounts, with tax-deferred savings for any purpose up to $25,000 a year, effectively shielding all savings for the middle class.

The Cruz plan is not designed to be revenue-neutral, because Cruz was running for president to make government smaller, not to raise the same amount of tax revenue to pay for the same spending. The Tax Foundation scored the reform dynamically as a tax cut of $768 billion over 10 years. That revenue loss would be offset over the first 10 years by $500 billion in specific cuts in discretionary spending Cruz specifically identified, plus repealing the spending of Obamacare.

The Tax Foundation further scored Cruz's tax reform as increasing capital investment by nearly 50 percent, creating nearly 5 million new jobs, with rising wages increasing the after-tax income of all workers by 21.3 percent on average. Even those in the bottom 20 percent would see income increases of 15.3 percent.

Rand Paul's version of the tax is quite similar, except that the personal, individual flat tax and the business flat tax both have the same rate of 14.5 percent. Paul also would abolish the payroll tax, corporate income tax, death tax, Alternative Minimum Tax, and the Obamacare taxes, and he would repeal Obamacare spending as well. The Tax Foundation estimates the revenue loss for Rand Paul's reform as about $1 trillion over the first 10 years.

Conservative, free-market critics of the Cruz/Paul proposal argue the business flat tax provisions are effectively value-added taxes (VATs), which are very powerful revenue-producers even at much lower rates. Any percentage point future increase in the rate would produce a great deal of revenue as well. VATs in Europe have financed the explosion of big government spending in those countries.

Free-market defenders of the proposal argue the two Senators use the revenues from these business flat taxes to abolish most other federal taxes, so the net effect would be to constrain big government. If the Senators would propose fundamental free-market entitlement reforms along with these flat taxes, the reforms overall would involve sweeping reductions in big government.

2. Steve Forbes Flat Tax. Despite the emergence of the new flat tax proposals of Senators Cruz and Paul, Steve Forbes has reiterated his original version of the flat tax in his latest book, *Reviving America*. That original flat tax would be revenue-neutral with a 17 percent to 19 percent flat rate, applying to both corporate and non-corporate income.

Under the Forbes flat tax, which was first proposed by academics Robert Hall and Alvin Rabushka, the multiple taxation of capital would be eliminated. That means capital income, like labor income, would be taxed only once at the flat rate.

Indeed, Forbes' proposed flat tax would effectively be a tax on consumption instead of a tax on savings and capital investment, which are the foundation of a capitalist economy. That would result first by allowing immediate expensing, meaning an immediate deduction for all business investment in plant and equipment, just like for all other costs of production. That would replace arbitrary depreciation stretching deductions for capital costs over many years, even decades, which is effectively a bias against capital. It also would be the result of allowing a deduction from the personal, individual flat tax for the savings and investment made by all families.

The Social Security and Medicare payroll taxes would remain in place until those programs can be reformed through personal savings, investment, and insurance accounts, enabling the payroll tax to be phased out altogether.

The capital gains tax, dividends tax, death tax, and Alternative Minimum Tax would be abolished under the Forbes/Hall/Rabushka flat tax. All Obamacare taxes would be abolished as well, through the repeal and replacement of Obamacare by free-market medicine.

Many free-market conservatives favor a 15 percent flat tax, making Forbes' proposal a major tax cut, not designed to be revenue-neutral but to be part of a plan to make government smaller, with less taxes and less spending. This flat tax plan would not be a VAT, threatening a possibly explosive future growth of taxes and spending. The Forbes' proposal is very much alive in the current tax reform debate.

3. Abolish the Corporate Income Tax. Boston University economics professor Lawrence Kotlikoff argues the federal corporate income tax raises only marginal revenues, less than 2 percent of GDP, but imposes great compliance, collection, and avoidance costs, disrupting the U.S. economy. Federal and state corporate income taxes in the United States impose a combined top marginal tax rate of nearly 40 percent, highest in the developed world and third highest in the entire world, with only Chad and the United Arab Emirates imposing higher rates.

When the current federal corporate income tax rate was last set in 1986, the average corporate rate of other industrialized nations was 47.2 percent. Today, the average is 24.8 percent, reflecting modern economic research showing that 80 percent of corporate income taxes are effectively borne by workers through reduced wages or lost jobs.

High marginal corporate tax rates encourage U.S. and foreign firms to operate outside the United States and discourage foreign and domestic investment in the United States. Such investment is the foundation for the creation of new jobs and rising wages. We see that in so-called "inversions": U.S. companies merging with foreign companies in low-tax jurisdictions, which is a form of "capital flight" from the overtaxed United States.

Capital can easily locate outside the United States, while workers cannot so easily relocate their homes and families abroad. As a result, the corporate tax burden is borne primarily by the stationary, effectively captive workers, rather than mobile capital. Economic studies show workers end up bearing 70 cents to 92 cents of every corporate tax dollar in terms of reduced wages and lost jobs.

This broadly recognized economic reality is why European and other Western countries have so aggressively cut corporate tax rates over the past 20 years, leaving America behind. Even formerly Communist Russia and China impose marginal corporate rates of 20 percent, with Germany at 18 percent, Britain and Canada 15 percent, and Ireland 12.5 percent. America and its workers cannot compete in the global economy under this tax disparity.

Also, the U.S. corporate income tax is imposed on the global operations of American companies, with the tax assessed when money earned abroad is invested back home. This is why American companies now how hold trillions of dollars offshore, unwilling to return to the United States capital that would help in creating jobs and bidding up wages in the United States. These foolish, outdated policies are now producing capital flight from America. The U.S. Treasury is doing what it can to build a "Berlin Tax Wall" around American businesses to prevent them from fleeing through corporate inversions.

Reagan won the Cold War without firing a shot, as British Prime Minister Margaret Thatcher famously observed. But today, economically illiterate politicians in Washington, DC are losing the peace.

Kotlikoff has built an international economic model that shows eliminating the U.S. corporate income tax would produce the following economic benefits:

- The capital stock would increase by one-fourth to about one-third (23 percent to 37 percent) – with most of the added investment reflecting capital flowing into the United States.
- Real wages would rise 12 to 13 percent.
- Gross domestic product would rise 8 percent to 10 percent.

Further, the tax base would expand over time, producing additional revenues that would make up for about one-third of the revenue loss from repealing the corporate tax.

As Ways and Means Chairman Kevin Brady has observed, the barrier to abolishing the corporate income tax is political, with a massive effort required for the re-education of the American people in a hostile media and academic environment. Kotlikoff notes most of the gains from reducing corporate income tax rates can be achieved with a 9 percent corporate rate, redolent of Herman Cain's 9 9 9 tax reform plan.

4. The Ryan-Brady Plan. Another good model has been developed by House Speaker Paul Ryan's Tax Reform Task Force Report, which was spearheaded by Ways and Means Chairman Kevin Brady.

Ryan/Brady proposes to replace the seven tax brackets of the current income tax code, with effective rates reaching into the mid-40s, with just three rates of 12 percent, 25 percent, and 33 percent, cutting marginal tax rates for everyone. The standard deduction for married couples filing jointly would be increased from $12,600 today to $24,000, doubling income that can be earned tax-free. The refundable $1,000 Child Tax Credit and Earned Income Tax Credit of up to $5,572 for a single mother with two children, $6,269 for three children, would continue. This would assure zero federal income taxes for everyone in the 10 percent bracket today.

Currently, 95 percent of all businesses in America, and 50 percent of all business income, are taxed as sole proprietorships or "pass through" entities, such as partnerships, limited liability corporations (LLCs), and Subchapter S corps, subject to a tax rate as high as 44.6 percent. For many years, most new jobs in America have been created by these businesses. Ryan/Brady would enact a new maximum small business tax rate of 25 percent for such income, sparking explosive small business job expansion.

With U.S. corporate rates so outdated, capital flight from America has soared through corporate inversions (merging with foreign companies). American companies subject to double taxation under federal tax law are also holding more than $2 trillion in capital overseas. Ryan/Brady would end this double taxation penalty by adopting territoriality, following the lead of all other developed nations by ending attempted U.S. taxation of corporate income earned abroad.

Ryan/Brady would adopt a flat 20 percent federal corporate income tax rate, making American companies and their workers internationally competitive again. Ryan/Brady also would abolish the death tax and Alternative Minimum Tax and would offset the income tax code's bias against capital investment by allowing taxpayers to deduct 50 percent of their capital gains, dividends, and interest income, resulting in rates of 6 percent to 16.5 percent on investment income. The plan also would provide for expensing capital investment, just like all other expenses for production of income. The plan also would provide for border adjustability, exempting exports from taxation while taxing imports.

The plan is scored dynamically as revenue-neutral based on reasonable expectations of the economic growth it will generate, compared to the current policy baseline, which incorporates what Congress routinely does to avoid tax increases from current law. The result will likely be higher tax revenues due to booming, long-overdue economic recovery, growth, and soaring jobs, wages, and incomes.

5. The Trump Plan. On August 9, at the Detroit Economic Club, President-elect Donald Trump unveiled his economic growth plan. He discarded his earlier tax reform proposal with its estimated $12 trillion in revenue losses, replacing it instead with a plan quite similar to Ryan/Brady. Instead of Ryan/Brady's 20 percent federal corporate rate, Trump proposed to reduce that rate to 15 percent. And instead of the business pass-through rate of 25 percent, Trump proposed a 15 percent rate for those businesses as well.

Because of its positive economic growth effects, Trump's tax reform plan would be highly beneficial for the poor, the blue-collar "working class," and the middle class. America can enjoy bipartisan, powerfully pro-growth, tax reform involving a compromise between the Ryan/Brady plan and the Trump proposal.

The key challenge faced by Trump, leaders in Congress, and conservative Republican supporters is to persuasively address the liberal/progressive claim that reducing or eliminating the corporate income tax is a Republican concession to Wall Street that will only line the pockets of the rich.

Free-market conservatives must drive home, through an aggressive educational program, how working Americans will benefit from a corporate tax cut. Three major groups would benefit:

- Employees: Up to 90% of each dollar saved will serve to increase wages and available jobs.
- Consumers: *All* consumers will enjoy a reduction in the cost of a corporation's goods or services.
- Owners: Shareholders (retirement funds especially) will receive enhanced returns on their investments in corporate stock.

A corporate tax cut also will bring home the $2 trillion owned by American corporations that remain "off shore" because of the current punitive double tax on profits earned abroad. Capital and jobs will come rushing home.

Conclusion

America suffers under the world's highest marginal tax rates on investment, corporate, and business income. America urgently needs pro-growth tax reform, with much lower, internationally competitive, marginal tax rates.

If Trump and the next Congress move forward on some compromise of Trump's version of the Ryan/Brady tax reform plan, America will see a huge positive effect on economic growth. This powerfully pro-growth tax reform plan would be beneficial for working people, blue-collar workers, the poor, and the middle class.

We stand on the brink of a fiscal/investment/jobs/ economic growth renaissance through major tax reform in the United States. The Keynesian no-nothings cannot be permitted to block progress. Education of the American people is key, but as future papers in this series will explain, we cannot rely on our public schools or colleges/universities to do the job effectively. Our challenge – and opportunity – is to reach the American people through information channels, and *minds,* newly opened by the November election.

About the Authors

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About the National Tax Limitation Committee

The National Tax Limitation Committee (NTLC) was organized in 1975. Its mission is to provide national leadership to achieve the optimal size and functions of government and promote candidates and initiatives that support these goals.

NTLC and its foundation, the National Tax Limitation Foundation (NTLF), have organized numerous conferences and seminars around the nation on critical issues. Uhler speaks regularly at the annual Conservative Political Action Conference (CPAC) in Washington, sponsored by the American Conservative Union (ACU), on whose board he served for many years. NTLC's operating philosophy has always been to partner with other groups and individuals in the accomplishment of mutual goals. NTLC and NTLF are further supported by a distinguished Board of Advisors.

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Heartland has a full-time staff of 38. Joseph Bast is cofounder, president, and CEO. Dr. Herbert Walberg is chairman of the 10-member Board of Directors. Approximately 250 academics participate in the peer review of its publications and more than 200 elected officials pay annual dues to serve on its Legislative Forum.

For more information, visit our website at www.heartland.org, call 312/377-4000, or visit us at 3939 North Wilke Road, Arlington Heights, Illinois.