How to Fix the Tax Bias That Ships Jobs Overseas

…in a way that generates robust economic growth, expanding opportunity, booming job creation, rising incomes, and lasting prosperity.

By Put Growth First©

If we can find common ground, we can demand that Washington do the same. By focusing on what unites us, we will make ourselves impervious to the forces that benefit by dividing us. The tax code can, and should, be reformed, but how? The tax code's most egregious flaw, and the strong populist appeal for fixing it, should lead the way.

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Executive Summary and Conclusion

It is well known that our tax code is anti-competitive in a global economy. Perhaps the most galling example is our corporate tax rate, the highest of all industrialized nations. To make matters worse, a less visible but more pernicious distortion to the tax code is that, in essence, it double-taxes our own exports and gives a tax advantage to imports over domestic goods. We are the only industrialized country that tilts both playing fields against its own interests. To level the playing field, U.S. companies are forced to invest, locate, produce, and employ elsewhere rather than do so here and export. We then double-tax their foreign earnings — but only if they try to bring them back to invest in America. This creates further incentive to invest elsewhere. Meanwhile, to preserve their tax advantage, foreign companies have an incentive to stay put and continue to import rather than invest, locate, produce, and employ in the U.S.

Jobs follow capital investment. Thus, our tax code contains a bias that "ships jobs overseas." It is immaterial whether this tax bias is deliberate or just another of the many unintended consequences of a tax code run-amok. Either way, it needs fixing. To ignore the problem is anti-growth, anti-job, and anti-American.

The solution is to replace the antiquated tax code with a modern, globally competitive one that exempts our exports and taxes imports at the same rate it taxes domestic goods. This way, exports would compete on a level playing field regardless of the country of destination. Likewise, imports would compete on a level playing field with domestic goods regardless of their country of origin. In both cases, the incentive will be to invest, locate, and produce here, creating U.S. jobs.

Sounds like good common sense. Support for fixing the tax bias that ships jobs overseas spans the full political spectrum, reaches from the factory floor to the boardroom, and spreads from major urban areas to small farming towns. It is doubtful there exists a single issue with such broad support. Just because political divisiveness and polarization have hit all-time highs[1] doesn't mean such division applies to every single issue. It only means we can't expect those on opposite sides of the bargaining table on the more contentious issues to lead on this one. The more they engage in a political chess match locked into a stalemate, the more they worry that the opposing team will take more credit if something productive gets accomplished. Under the old paradigm, presidential leadership is necessary to break through this gridlock. The new paradigm says if we can unite behind fixing the tax bias that ships jobs overseas, we can force congress to act on it.

Perhaps there is much less standing in our way than conventional thinking suggests. To fix the tax bias that ships jobs overseas, we need only the determination to seek common ground, the willingness to reach out and talk with one another beyond the confines of the social media echo chambers, and the conviction that there is no limit to what we can accomplish by working together and sharing credit for the victory.

In short, if we can find common ground on this issue, we can demand that Washington do the same. Let's lead by example. Giving the opposite political party some credit for being part of the solution is a very small price to pay for such a big benefit to American prosperity.

[1] http://www.upi.com/Top_News/US/2012/06/10/Politics-2012-Political-identity-deeply-divisive/UPI-12271339318920/

Support Is Everywhere. It's Time to Act.

"The global economy is more integrated than ever ...
If we're going to grow, it's going to be because of exports."
— President Barack Obama,
APEC CEO Summit, 2011

In his 2010 State of the Union address, President Barack Obama announced the National Export Initiative (NEI), stating that, "We will double our exports over the next five years." According to the NEI website, "the Obama Administration has made it a top priority to improve the conditions that directly affect the private sector's ability to export." On this, we should all be able to find common ground.

Exports serve as a vital component of economic growth and prosperity. America can compete and win against anyone in the world, as long as the playing field is level. Unfortunately, there exists an egregious bias within our tax code that tilts the playing field against American interests. As a consequence, instead of locating here, investing here, employing American workers, and reaching world markets through exports, many U.S. companies go elsewhere.

The solution to this problem, as this paper will illustrate, is straight forward and simple: Fix the tax code so that U.S. exports compete on a level playing field in world markets, and imports compete on a level playing field in domestic markets. Doing so will enable us to make one other essential change, overhauling our tax code to transform it into a magnet that attracts business investment rather than repels it. After all, economic growth and job creation spring from business investment.

Support for leveling the playing field spans the political spectrum, reaches from the factory floor to the boardroom, spreads from our largest metropolitan areas to small farming communities, and is shared by small business, large corporations, and labor unions. With such diverse support, it would be hard to find the constituency that opposes leveling the playing field. However, in every parasite-host relationship, there is one party who prefers the status quo.

Fortunately, support is everywhere. In its *Making U.S. Exports Work for Job Creation — 3 Steps We Must Take,*[2] the liberal **Center for American Progress** (CAP) claims exports should play a larger role in the national debate over how to create jobs. They acknowledge that the President's National Export Initiative is a step in the right direction, and highlight three complementary steps to leverage exports for job creation "for years to come."

The three steps CAP advocates are 1) improve U.S. competitiveness, especially in manufacturing, 2) find out how other countries promote their exports, and find creative ways to promote U.S. exports, and 3) cultivate more demand abroad. CAP should find considerable common ground in this report and plenty of room to stand with Put Growth First.

[2] http://www.americanprogress.org/issues/economy/news/2012/01/11/10959/making-u-s-exports-work-for-job-creation/

The **National Association of Manufacturers** (NAM), in its *Growth Agenda — Four Goals for a Manufacturing Resurgence in America,*[3] stresses, among other things, improving the global competitiveness of the tax code, encouraging investment, opening new markets for trade and boosting exports. NAM should also find considerable common ground and plenty of room to stand with Put Growth First.

The **Business Roundtable** (BR), which represents large multinational corporations, in its recent release, *A Growing Cause: Tax Reform for Growth, Jobs*,[4] supports the **Alliance for Competitive Taxation** (ACT). ACT seeks to "push for a modernized tax system that can restore the U.S. to robust economic growth." It favors a "modern international tax system" like those that other countries use successfully. In addition to calling for lower corporate tax rates to improve competitiveness, ACT advocates for a "territorial" tax system. A territorial system may do well treating symptoms, but our proposal is a superior solution. Nonetheless, the Business Roundtable and the Alliance for Competitive Taxation should find plenty of common ground to stand with Put Growth First.

What about small business? According to the International Trade Administration, more than 300,000 companies exported goods in 2011 and nearly 98% of them were small or medium sized companies (SMEs) with fewer than 500 employees.[5]

The **AFL-CIO** labor union says, "We must fundamentally change the global trading system so that it works for working people in the United States and around the globe by promoting robust job growth."[6] The Jobs and Economy section of the union's website states, "The AFL-CIO is ready to work with anyone — business, government, investors — who wants to create good jobs and help restore America's middle class and challenge policies that stand in the way of giving America the chance to go back to work."[7] Perhaps they'll work with Put Growth First.

The **Metropolitan Policy Program at Brookings** publishes a series called *Export Nation: How U.S. Metropolitan Areas Are Driving National Growth.* By estimating exports according to the location of production rather than the location of the port from which they were shipped, they show that the country's 100 largest metropolitan areas produced almost 65% of U.S. export sales.[8] Furthermore, export sales from Midwestern metro areas generated the fastest growth in direct export-production jobs. One way to help revive our big cities, especially in the Midwest, is for their civic, business, and political leaders to recognize the common ground and mutual benefit — and stand with Put Growth First.

To see how your city or state can benefit by leveling the trade playing field, you can refer to Brookings' website, http://www.brookings.edu/research/interactives/export-nation, which provides an interactive map showing export intensity by geography and industry.

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[3] http://www.nam.org/Communications/Articles/2013/02/NAM-Launches-Growth-Agenda-for-Manufacturing-Resurgence.aspx
[4] http://businessroundtable.org/blog/a-growing-cause-for-u.s.-growth-tax-reform/
[5] http://www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_004048.pdf
[6] http://www.aflcio.org/About/Exec-Council/EC-Statements/Waiting-for-Trade-Policies-That-Build-the-Middle-Class-and-Protect-Workers-Rights-Fighting-More-NAFTAs
[7] http://www.aflcio.org/Issues/Jobs-and-Economy
[8] http://www.brookings.edu/research/interactives/export-nation

Outside of our large metro areas, America's rural landscape is dotted with 2.2 million farms, about 97% of which are operated by families. According to the **American Farm Bureau,**[9] in 2010, $115 billion worth of American agricultural products were exported around the world. One in three U.S. farm acres is planted for export. Thirty-one percent of U.S. gross farm income comes directly from exports. About 23% of raw U.S. farm products are exported each year.

One would be hard pressed to find an issue with such broad appeal. The constituents consist of companies and workers who produce an exportable product or compete with imported products, or both. That's just about as wide of a net as can be cast. Fixing the tax code so that 1) exports compete on a level playing field in world markets, and 2) imports compete on a level playing field in our domestic market will enable us to design a new tax code conducive to strong economic growth and job creation — rather than what we have now, which is an impediment to both.

You know where these varied organizations stand. What matters most is where you stand.

[9] http://www.fb.org/index.php?action=newsroom.fastfacts

Do We Give Tax Breaks to Companies for Shipping Jobs Overseas?

Have you heard that before? Politicians have been riding this line like a rented mule for years. If you had a nickel for each time you heard, "My opponent likes to give tax breaks to companies that ship jobs overseas," you could probably afford to buy a whole fleet of mules. The "tax breaks to companies for shipping jobs overseas" assertion is intriguing. If true, why don't we fix it? If false, it's time to call the bluff on the opportunists. If we had a way to measure a ratio of political rhetoric to political action, this would be off the charts: all talk and no action.

This paper looks at the real issues and finds that the tax code does indeed create an uneven playing field for imports and exports, both of which are tilted against U.S. interests. This bias drives more investment, and therefore employment, overseas versus what would occur on a level playing field.

What Are the Real Issues?

Taxes are a cost of doing business just like any other expenditure. Employees work for after-tax wages, just as shareholders invest for after-tax returns. Taxes matter. Whenever a cost differential (because of a tax, for example) persists between two similar products, advantages accrue for the lower-cost good for as long as the cost advantage persists. In competitive markets, higher costs can't be easily forced on: suppliers in the form of lower prices, workers in the form of lower wages, shareholders in the form of lower returns, or consumers in the form of higher prices. The one with a cost disadvantage is faced with a dilemma: Reduce costs or lose market share.

The cost of our tax code gets embedded at every stage of production into the cost structure of every product made in America (See Box: Business Taxes Are Embedded Sales Taxes). The higher the tax rate, the higher the embedded cost. Exports leave our shores bearing our high-cost tax code and must also pay tax to the countries of destination, most of which assess a retail sales tax or value added tax (VAT). In essence, exports are double-taxed and face a competitive disadvantage relative to goods in world markets. To get on a level playing field, companies may locate overseas.

Meanwhile, imports to the U.S. arrive without the tax system of the

Business Taxes Are Embedded Sales Taxes:

The farmer passes all costs, including taxes, to the processor, who in turn passes those plus all of his costs, including taxes, to the distributor, who passes his costs, plus theirs, to the retailer, who passes all four layers of costs, including taxes, to the consumer. Thus business taxes are the same as hidden sales taxes. Looked at in the opposite direction, you pay $1 to the retailer, who keeps 25 cents and pays 75 cents to the distributor, who keeps 25 cents and pays 50 cents to the processor, who keeps 25 cents and pays 25 cents to the farmer. Each party at each stage of production ends up with 25 cents with which to cover all costs, including paying taxes. Who paid those taxes? The consumer.

exporting country embedded in the cost structure. Why? Because most countries exempt exports from their tax system. The goods reach our shores as tax-free imports, unlike domestic goods, which bear the full brunt of our tax system. Imports enjoy a cost advantage over domestic goods that will persist as long as our current misbegotten tax code exists.

As long as the tax savings for foreign companies exceed costs to ship the product here, there is a disincentive for them to locate, produce, invest, and employ here. In research published by MIT and NBER economists,[10] the authors conclude that import competition explains some of the current unemployment problem in the U.S.

Both playing fields are tilted against our own interests. Exports are overtaxed and imports go untaxed. Consider the following simple example using the cost of a widget to illustrate the concept. In both cases, the price to the consumer will be forced down to the market level or else the sale will not take place. This eats up the profit of the U.S. company.

Export vs. World Good

Holding all other things constant (i.e., labor costs, labor productivity, material costs, profit margins, etc.) and assuming a simplified tax system to illustrate the tax differences, U.S. exports are at a disadvantage in nearly every country — thanks to our tax code. To cover our costs and have the same profit, we must price our export at $100, but then it also faces a tax in the country of destination.

	U.S. Export	Competing World Good
List Price	$100	$90
minus labor	$ 50	$50
minus cost of goods	$ 25	$25
Pretax Profit	$ 25	$15
minus U.S. tax	$ 10	$ 0
After-Tax Profit	**$ 15**	**$15**
15% Sales or VAT tax	$ 15	$14
Price to Consumer	**$115**	**$104**

Domestic Good vs. Import

Holding other things constant (i.e., labor costs, labor productivity, material costs, profit margins, etc.) and assuming a simplified tax system to illustrate the tax differences, an import exempt from tax in the country of origin has a cost advantage over a domestic good — thanks to our tax code.

	Domestic Good	Import
List Price	**$100**	**$90**
minus labor	$ 50	$50
minus cost of goods	$ 25	$25
Pretax Profit	$ 25	$15
minus U.S. tax	$ 10	$ 0
After-Tax Profit	**$ 15**	**$15**

Once a company locates overseas to get on a level playing field, it experiences another insidious bias of the tax code. First, profits earned by its foreign subsidiary are taxed in that country. That's fine and logical. Unfortunately, our tax code is one of the few that operates on a basis of "worldwide" income, meaning we tax income regardless of where a business earns it. This creates another form of double taxation, which a business can avoid only by leaving the profits overseas. Some have called this a "tax break." Don't be fooled: Avoiding double taxation is not a tax break.

Ultimately, these profits get invested overseas, thereby supporting employment overseas. Our tax code seems determined to put American companies at a disadvantage no matter where they locate in the world.

[10] http://conference.nber.org/confer/2013/LMs13m/Acemoglu_Autor_Dorn_Hanson_Price.pdf

The Tax Code Isn't Compatible with a Global Economy

The ability of workers to succeed in the global economy hinges on the ability of companies to compete globally.

The tax code instituted in 1913 is incompatible with the global economy of 2013. The more the world integrates, the more our antiquated tax code impedes our global competitiveness.

Exports have doubled as a share of our GDP in the last 45 years, but the share of U.S. corporate worldwide profits attributable to foreign earnings has increased five-fold — from barely 7% of total profits in 1965 to 35% in 2010.

This has been fueled by cross border investment, which has increased 6 times faster than worldwide GDP — from barely 6% of world output in 1980 to almost 35% of world GDP by 2010.[11]

As the world integrates, both American and foreign-based companies have adopted global manufacturing, global supply chains, global financing, and global marketing strategies. We need a tax code that reflects our competitive, global economy.

There are plenty of legitimate reasons for investing, locating, and employing overseas. But avoiding bad U.S. policy shouldn't be one of them.

Companies locate overseas to reach customers, tap vast growth opportunities, protect market share, maintain a local presence, access important raw materials and natural resources, earn more attractive returns, and maintain competitive costs.

Ninety-five percent of the world's population resides outside the U.S. Seventy-five percent of the world's purchasing power lies outside the U.S. The growth and prosperity of emerging market economies represents significant potential for U.S. companies and their workers.

"The U.S. corporate tax is the most punitive in the developed world."
— William McBride, Chief Economist, Tax Foundation

"The need for action is acute, and emerging trends in global commerce demonstrate the need for tax policies that align with those trends."
—Wall Street Journal Op-Ed, July 18, 2013, Mieko Nakabayashi & James Carter
Ms. Nakabayashi was a member of the Japanese Diet.
Mr. Carter was Deputy Assistant Secretary for Policy Coordination in the U.S. Department of Treasury's Office of Economic Policy

The notion that a company has to "be there to sell there" makes sense in many cases to reduce costs, avoid trade barriers, and meet local market requirements. Companies want a local presence to protect market share since their competitors — foreign multinationals — operate globally, too, and have 750,000 of their own cross-border affiliates.

[11] Taxation of American Companies in the Global Marketplace-A Primer. Business Roundtable

Many services can't be easily exported. Services make up 61 percent of U.S. foreign affiliates and must be supplied locally. Not every company makes an exportable product. McDonald's can't export hamburgers, so it opens stores in the markets it serves. Worldwide, the company operates 34,000 stores in 118 countries. The more it expands internationally, the more jobs are required at headquarters across all departments. To maintain product and store consistency, McDonald's purchases many of the same supplies from U.S. companies, which count as exports of those products. Due to cost and volume limitations, Sherwin-Williams can't easily export paint and still offer it at a competitive price. It makes sense for it to locate close to its foreign customers rather than forfeit the business altogether.

Contrary to the conventional narrative, most foreign investment is not in low-wage countries. According to the U.S. Department of Commerce, Bureau of Economic Analysis, 89% of the assets and 80% of the sales of the majority-owned foreign affiliates are located in countries with relatively high wages, such as Canada, Japan, Australia, Hong Kong, New Zealand, and Singapore as well as many European nations.

American companies with operations both here and abroad are responsible for more than 60 million U.S. jobs, directly employing more than 20 million, and as many as an additional 40 million jobs through their direct and extended supply chains. A typical American company with international operations buys $3 billion in goods and services from more than 6,000 U.S. small businesses. Cumulatively, they purchase $1.52 trillion in supplies and services from small businesses[12].

According to researchers at the Peterson Institute for International Economics, 10% greater foreign investment by multinationals triggers 2.2% additional domestic investment[13].

There is nothing wrong with companies investing and locating overseas. The U.S. benefits by it. There is plenty wrong, however, when the tax code drives businesses away from America when they would otherwise prefer to invest, locate, produce, and employ here. A level playing field is all they ask for.

Avoiding Bad Policy Is Not a Good Reason to Locate Overseas

In testimony before the Senate Budget Committee, Rutgers University economist Rosanne Altshuler said, "Arranging affairs to avoid taxation of foreign earnings is costly…The result is a system that distorts business decisions, treats different multinationals differently, and encourages wasteful tax planning."[14]

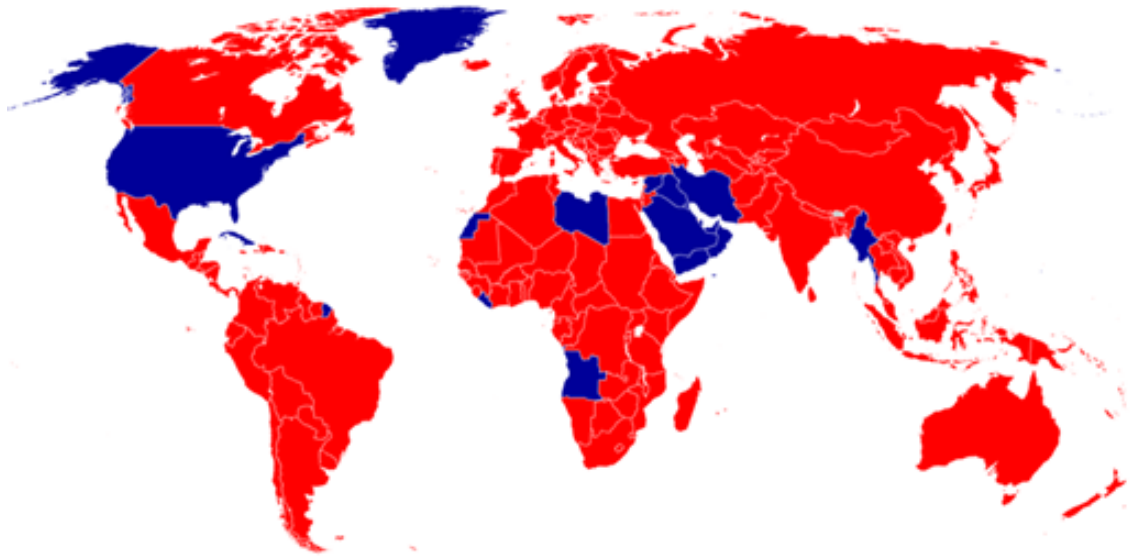
Locating overseas because of bad policies is unacceptable. Making it the only way to get on a level playing field is intolerable and must be fixed.

Our Tax Code Has a Third World Peer Group

When it comes to the treatment of global trade, our tax code has a peer group of Angola, Liberia, Greenland, Myanmar, Western Sahara, Libya, French Guiana, Yemen, Oman, United Arab Emirates, Saudi Arabia, Iran, Iraq, and Syria. Like ours, the tax systems of these countries are incompatible with

[12] Business Roundtable: Taxation of American Companies in the Global Marketplace: A Primer
[13] Do Multinationals That Expand Abroad Invest Less at Home? Theodore H. Moran and Lindsay Oldenski, 10/31/13
[14] http://www.budget.senate.gov/republican/public/index.cfm/files/serve?File_id=a4330db5-ec0e-4669-bb12-4392321a5c62

modern world trade. The countries in blue on the following map[15] have a competitive disadvantage compared to the red countries.



Notice that of the blue countries, Saudi Arabia is the only other member of G20. The rest don't even qualify as industrialized nations. Yes, in relation to its tax code, the world's industrial superpower has Third World countries in its peer group.

This tax code flaw is likely to have a more pronounced negative impact in instances where a product can be exported *and* the location of that production can be changed.

Looking at some of the examples above, countries in the Middle East that export oil can't change the location of that production to a country whose tax system is more compatible with international trade. In the case of Greenland, the largest export is fish. Greenland can't easily change the location of this production to escape the flaws in its tax system. Our "peer group" of tax-flawed countries consists largely of natural-resource-based economies that can't change the location of production — yet they still enjoy a comparative advantage despite their tax flaws.

On the other hand, the U.S. boasts the most diverse economy in the world: We compete across nearly all products, in nearly all sectors, and in nearly every country. The list of exportable products that can be produced anywhere, where competition will drive production to a level playing field, is too long for this report. This flaw hurts us more than it hurts our abovementioned peer group of blue countries.

Meanwhile, imports from roughly 150 trading partners (any of the red countries) arrive free of tax from the country of origin and do not bear the same tax burden as domestic goods.

Government policy can stay irrational longer than a company can stay solvent.

Other Side Effects: The Tax Bias Hurts Free Trade and the Dollar

[15] Map courtesy of Coalition for a Prosperous America

Voluntary trade, by definition, makes both parties better off. If one party considered itself worse off for engaging in trade, it would decline to do so. Involuntary trade, by definition, makes one party worse off (government is the only economic actor that can force involuntary trade — and for this reason alone its actions should be limited). The benefits of voluntary trade hold true whether trade takes place across the street, across town, across the country, or across the world. GDP measures the volume of such trade, thus quantitatively determining what we gain by virtue of engaging in trade. Thus the overarching goal of all economic policy should be to expand or maximize output (i.e., maximize production or GDP).

Given that 95% of the world's consumers live outside of the U.S., it makes sense to execute free trade deals that open markets and reduce barriers to voluntary exchange. If another country can make something that offers better value, we should trade with it, obviously. If the product is the same price but better quality, is there a rational argument to purchase less quality for your money? If you believe that, by all means do so with your own money — but don't force others to practice value destruction. If the product is the same quality but costs less, the consumer saves a dollar and nothing bad can happen to the economy. That dollar is either spent, representing income to another merchant, or it is saved. If saved in a bank account, the dollar supplies deposits, which increase loans, which provides debt capital to finance business expansion. If invested, the dollar provides equity capital to finance business expansion.

Some controversy exists regarding the impact on workers. While free trade undoubtedly benefits consumers and the economy as a whole, there are costs that don't get evenly distributed throughout the country. Even though the benefits exceed the costs (or the trade wouldn't happen), the benefits are typically diffused and less visible while the costs are usually isolated and visible.

When we execute free trade deals to open markets with red countries on the previous map, we expose the uneven playing field imposed by our tax code. This tax bias gives trading partners a cost advantage. Whatever the benefit of that trade arrangement may be, we will experience less than the full amount due to the tax disadvantage we impose upon ourselves. This is the part that is unfair to U.S. workers.

Eliminating this tax bias may help refocus our attention on the reality that differences in wages between countries are explained by differences in productivity. It is when differences in cost extend beyond differences explained by productivity that investment and employment flow to the country with the cost advantage.

The tax bias contributes to weakness in the dollar. First, it drives investment away from the U.S. Next, it contributes to a larger trade deficit, which acts as a drag on the dollar. Some believe that whatever the anti-competitive factor the tax code creates, it can be remedied by a dose of dollar debasement, as if one offsets the other. In reality, this is a double whammy since a weak dollar makes us poorer relative to the rest of the world. We can't devalue our way to prosperity. No country ever has.

In a paper called *Fiscal Devaluations,*[16] published by National Bureau of Economic Research (NBER), the authors show that a uniform increase in import tariffs and export subsidies can improve competitiveness and is an alternative to dollar devaluation. However, the World Trade Organization (WTO) does not permit export subsidies, and tariffs prompt retaliation by trading partners.

[16] http://www.nber.org/papers/w17662

Turning Obstacles into Opportunity

The World Trade Organization (WTO)

The United States has made several attempts over the years to remedy this tax bias. Ultimately, the World Trade Organization (WTO) and its predecessors have ruled repeatedly that our actions amount to an export subsidy, which is illegal under WTO rules.

The WTO and its predecessors have consistently ruled that ultimately it is impossible to exempt exports from our tax system as long as our tax base is net *income*. When taxing income, special treatment can't be given to income derived from exports. If we move to a different tax base, such as *domestic consumption*, it becomes possible. Taxing domestic consumption automatically excludes exports from the tax base since they don't fit the definition of that tax base. That eliminates special treatment or export subsidy problems. In addition, that tax base automatically includes imports, and a tax on them is not a tariff, but the application of equal treatment of the tax base and, as such, passes muster with the WTO.

Who Will Provide the Leadership?

During his tenure (1996 to 2001) as chairman of the House Ways and Means Committee, former congressman Bill Archer suggested we could solve the tax bias dilemma by adopting relatively broad tax reforms rather than making small adjustments in the design. One suggestion at the time was the United States could adopt a form of consumption tax, thus forgoing taxation of business profits altogether.

Who is the next Bill Archer? As fate would have it, Congressman Kevin Brady serves the same Texas district. Through his work as Chairman of the Joint Economic Committee, he is solidifying his role as de facto leader of the *growth wing* of congress. As the second most senior member of the tax-writing Ways and Means Committee, Brady is soliciting input on major tax reform. In an email dated Aug. 21 2013, Brady stated five principles that will guide him on tax reform, including the need to "stop forcing companies to shift jobs overseas."

Brady is a protégé of Archer and, barring an upset, has the inside track to become the next chairman of the Ways and Means Committee — where all tax-reform measures start and finish.

It's one thing for policy advocates to coalesce around an issue. But if that issue doesn't align with the priorities of the appropriate committee chairman, their effort won't translate into legislative traction. In this particular case, however, there is a special confluence of forces. Fixing the tax bias has a very broad constituency and strong populist appeal. If that appeal is shared with ordinary voters across the country, it can be channeled to key congressional leaders like Brady where it *does* align with his stated priorities. This is an exceptional opportunity to solve a very important problem.

The so-called bad news from the WTO, that we can't fix the problem if we keep our current tax code, is actually the good news. Isn't this what we all want: a reason to replace the entire old, corrupt, anti-growth, anti-job, anti-American tax code with a modern, competitive, fair, neutral, pro-growth, pro-job, pro-American tax code? Let's take advantage of the opportunity. The pieces are there to be put into place.

To Make the Tax Code Pro-Growth, Know What Drives Growth

Production Drives the Economy, NOT Consumption

There is a tired but longstanding debate in economics that is comparable to the flat earth debate of centuries past. It would be nice if we could just brush this off as a silly academic debate, except it is so harmful to economic growth and prosperity that we must settle it once and forever.

Production drives the economy, not consumption. Period. No "chicken and egg" problem. No "you need both" cop-out. No "supply and demand are joined at the hip, and you can't separate them" compromise.

You must produce (or serve or supply or work) first. Only then can you get paid, second. Then, and only then, may you consume, third. The economy suffers not from a lack of spending but rather from a breakdown in people's roles as producers. Their lower spending is a *consequence*, not a cause.

The superstition that consumption drives the economy persists because it helps sell redistribution. The so-called Keynesians always talk about the "multiplier effect" that their spending is supposed to have but, for expedience, they never mention that this is always completely cancelled by the offsetting "negative multiplier." To illustrate, if I take money from you and spend it, my spending does indeed create income for the shopkeeper, who in turn spends, creating income for other merchants, and so on and so forth. The "multiplier" measures all these positive effects (by adding them up).

However, the money injected into the economy through redistribution is also taken out of the same economy. That it is taken from different people or at a different time is immaterial. It's akin to taking a bucket of water from the deep end of the pool and pouring it into the shallow end, where one can only *hope* that the water level will *change*. The money taken from you doesn't get spent by you, which means less income to your local store, which results in less spending by that shopkeeper, and so on and so forth. This negative multiplier always completely cancels the positive multiplier.

It would be nice if the two merely cancel each other out and net to zero, but they actually net to a negative. Indeed, while the two multipliers cancel each other out completely, a negative incentive effect remains in place. Taxes affect behavior and people will adjust their behavior in response to them. People who pay taxes and have money redistributed from them will now direct at least some resources toward avoiding or reducing the incidence of taxation. Any resources spent doing this will detract from resources that could otherwise be used to expand output. Further, those receiving government benefits now have less incentive to work and produce, so the result is less work and production.

The superstition that consumption drives the economy is responsible for unsustainable spending, large deficits, and heavy debt loads, both here and in Europe, and is perhaps the single largest impediment to solid, common-sense, pro-growth policies. The ugly underbelly of this failed theory goes on full display after every natural disaster. The Keynesian proponents view rebuilding productive assets as "economic stimulus" and are not always careful to hedge their enthusiasm for such against the obvious tragic loss of life and property. No such conflict exists for those of us who know production drives the economy.

We see disasters for what they are, disasters. Besides, very early in elementary school, we learn that one minus one, plus one, still equals one. However, the ones who cling to the superstition always claim it adds up to more than one.

Take the 'Put Growth First Challenge'

If you believe that consumption drives the economy, would you be willing to prove it in the first-ever empirical study? We will drop you off on an uninhabited Alaskan island. You will demonstrate how you can consume without first producing. Can you really consume fish, for example, without first catching one?

When you figure out that you must produce before you consume, you will become an asset for society (and, according to the contract, you must reimburse our expenses). If you never learn, at least you will be isolated so you no longer contribute to our country's economic stagnation.

One political party advances the superstition because it helps sell redistribution. In other words, if you won't spend your money, the government is justified in taking it and spending it or giving it to someone who will, all in the name of "stimulus." To equip the redistributors, economists have conjured up an official-sounding name, the "marginal propensity to consume." This says we should give money to those most likely to spend it rather than save it. As we'll see in the next section, this is as backward as it gets. If anything, our marginal propensity to *produce* drives growth.

Not to be outdone, the other political party helps perpetuate this superstition out of sheer cluelessness. It was equally backward for a former president to grab a megaphone at Ground Zero to tell the country to go to the shopping mall to help the economy, or when he issued rebate checks that "put money in people's pockets." Taking a dollar out of one's pocket and then putting it back in the other pocket sounds more like the Hokey Pokey than real pro-growth policy.

For those undecided, we've set up the Put Growth First Challenge (see box, left). The purpose of the challenge is to set up the world's first-ever empirical study to determine what *really* drives the economy. At www.putgrowthfirst.com you can find a complete set of rules, agreement of terms and conditions, and required liability waiver.

The Most Dangerous Equation in the World

A major culprit in perpetuating the myth that consumption drives the economy is the standard textbook equation for measuring GDP. This equation only *measures* what was produced and is inadequate for *understanding* how GDP gets produced.

The standard textbook equation goes like this:

$$GDP = C + I + G + (X-M)$$

where C=Consumption, I=Investment, G=Government Spending, and (X-M)=Exports less imports.

Counting GDP differs from *making* GDP; just as counting money differs from making money. Or just as a pay stub only accounts for where a paycheck ends up, it is useless for determining how to actually earn a paycheck in the first place.

To extend this analogy further, imagine a comparable equation that measured your personal income. It would say your income (I) = direct deposit (D) + savings (S) + benefits (B) + taxes (T) or I=D+S+B+T. This is essentially your pay stub. It would say nothing about how you earned the income, and offers zero insight into how to increase your earnings. Imagine if the "intellectuals" who claim that increasing government spending increases GDP looked at your pay stub and told you that increasing "T" (taxes) would increase "I" (your personal income). Would you believe them? It's an optical illusion that increasing government (G) is one way to increase GDP. Government doesn't produce output, so increasing government can only mean that more of the existing output is redistributed. It is a necessary part of the equation because, to properly count production, we must account for production taken by government that would have otherwise fallen into another category.

Another optical illusion is that increasing consumption will increase GDP. This is the equivalent of someone looking at your pay stub and saying to maximize your income all you have to do is just increase "D" (the amount of your direct deposit).

Finally, it creates the optical illusion that imports (I) are inherently negative since they subtract from GDP. They are subtracted from GDP only because they are already included in consumption so the subtraction prevents double-counting. We should welcome imported goods as long as they compete on a level playing field with domestic goods.

Because the most dangerous equation in the world is standard issue in every basic economics textbook it's no wonder the country has spending and debt problems, a non-recovering economic recovery, stagnant wages, and joblessness. What it costs to "learn" this stuff in college pales in comparison to the cost to society when it is misapplied.

Fortunately, there is a much better way to look at the economy if the goal is to maximize GDP. Enter the Woodhill Equation.

Introducing the Woodhill Equation

The Woodhill Equation properly respects the fact that production drives the economy, offers insight into the conditions under which GDP is produced, and identifies a clear-cut path for maximizing GDP. It is named after entrepreneur, economic growth guru, Forbes columnist, and former economic adviser to the Herman Cain presidential campaign, Louis Woodhill. Had it been standard issue in every textbook over the last 40 years, GDP would total at least $25 trillion today instead of $16 trillion and median income would be around $78,000.[17]

Rather than looking at who *consumes* GDP, the Woodhill Equation looks at what *produces* it and how. More precisely, it looks at the stuff that produces the stuff that makes up GDP. It looks at the economy as a whole the way an investor might look at a single company using a *return on assets* calculation. Only in this case, the numerator is not profit or revenues but rather GDP. The denominator is still total assets, but they represent the nations' asset base rather than an individual company's.

To arrive at the numbers, you separate GDP and assets into residential and non-residential components. Next, divide the residential component of GDP by residential assets to calculate the "GDP return on residential assets." Then divide the rest of GDP by non-residential assets to calculate the "GDP return on

[17] Assumes continuing growth of 3.9% over the last 40 years rather than 2.8%

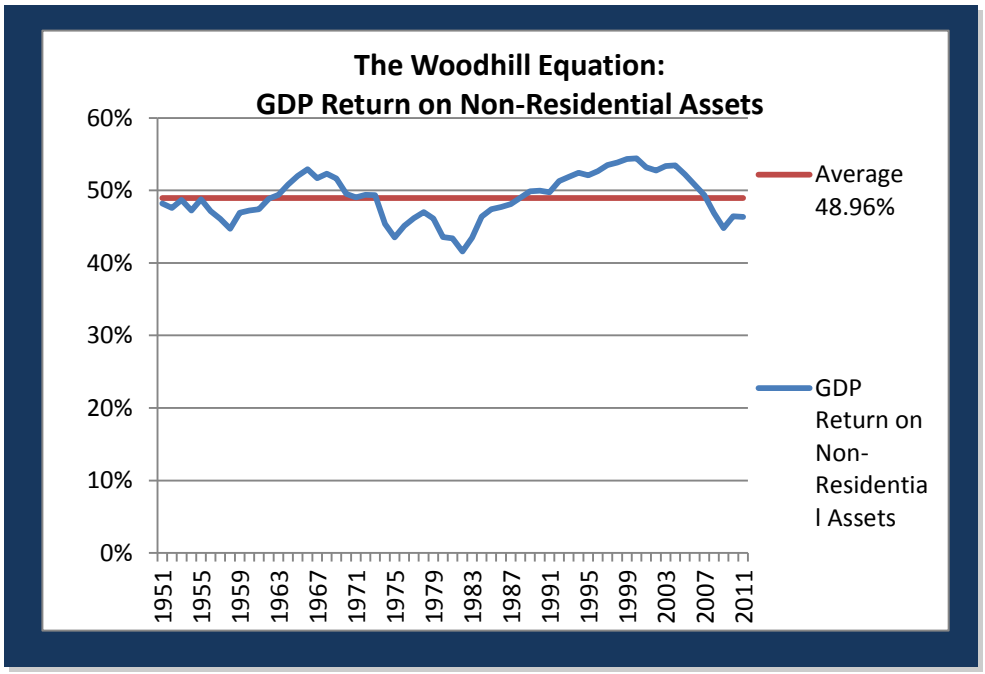
non-residential assets." The Bureau of Economic Analysis reports separate figures for residential assets[18] and non-residential assets (e.g., commercial buildings, machines, equipment, computers, structures, etc.)[19] Residential GDP is reported in table 7.4.5[20] as Gross Housing Value Added. The rest of GDP is deemed to be non-residential. At this point, simple division allows us to calculate the GDP return on residential assets and the GDP return on non-residential assets.

The Woodhill Equation states that GDP is a function of the "GDP return" on residential assets plus the "GDP return" on non-residential assets. Over the last 60 years, the return on residential assets has averaged 7.6% and the return on non-residential assets has averaged a whopping 48.96%. Thus, after rounding downward, we can express the Woodhill Equation this way:

GDP = (48% x non-residential assets) + (7% x residential assets).

Now we're in a position to understand how to maximize GDP, which should be the goal of every economic policy. The first thing that leaps off the page is the 48% "GDP return" on non-residential assets. The next thing that becomes apparent is the low yield on residential assets by comparison. (Does this shed new light on the financial crisis, which was about government-directed "investment" in the residential sector that caused a misallocation of resources away from higher-yielding non-residential assets?)

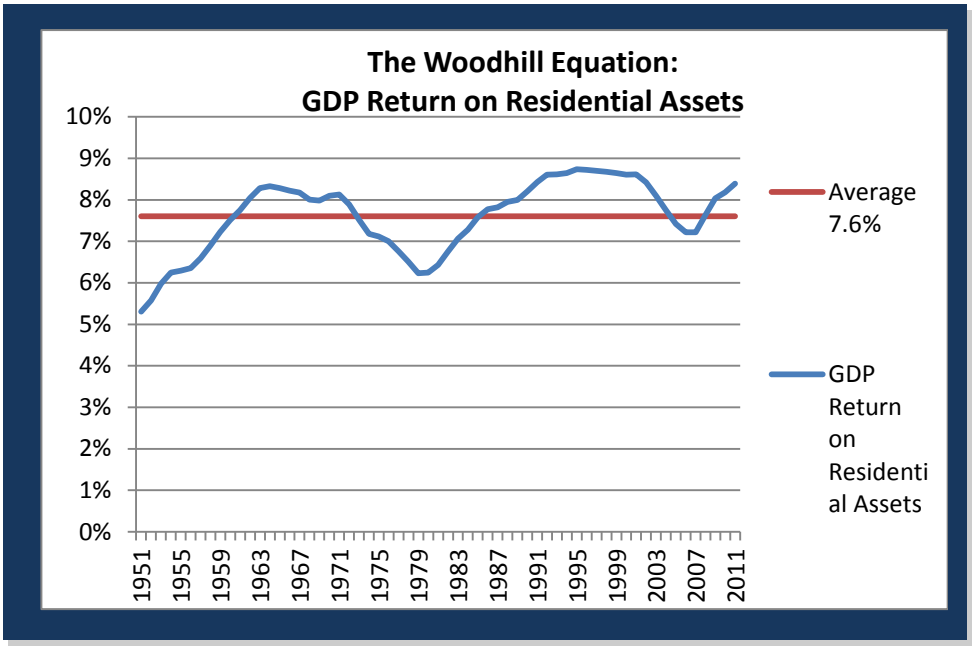
The Woodhill Equation proves there's only one definitive way to expand GDP: Increase the stock of non-residential assets. This is best accomplished via business investment.



Non-residential assets not only define the productive capacity of the economy and its growth potential but also support employment. For every $210,000 of non-residential assets,

[18] http://www.bea.gov/national/FA2004/details/index.html Bureau of Economic Analysis, Detailed Data for Fixed Assets and Consumer Durable Goods, Section 1: Residential Detailed Estimates.
[19] Bureau of Economic Analysis, National Income and Product Accounts, Table 5.9. Changes in Net Stock of Produced Assets.
[20] National Income and Product Account Tables, Housing Sector Output, Gross Housing Value Added http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1#reqid=9&step=3&isuri=1&903=280

one average job is supported. Higher-paying jobs are supported by more assets, and lower-paying jobs require fewer assets.



At this point, we can work backward to solve both our growth and employment problems. To increase GDP ($16 trillion) by 1% requires $160 billion more GDP. Since every dollar of business investment generates 48 cents of GDP, $333 billion of business investment ($160/.48) will increase GDP by 1%. Want to increase GDP by 2%? Business investment of $667 billion will do that. That much business investment will also create 3.2 million new average jobs. To create the 15 million jobs necessary to reach full employment would require roughly $3.1 trillion of new business investment over time. That amount equals roughly what has been squandered on failed stimulus programs that put precious fuel in the caboose rather than the engine.

By now, it should be intuitive. If we want to expand GDP, we start by expanding the productive capacity of the economy, the equipment and machines that produce GDP. This is entirely consistent with the way that households and businesses grow and prosper, by converting after-tax income not spent into capital, which is then used to acquire productive assets. The economy is merely the sum total of those entities and neither a business nor household can spend or tax its way to prosperity.

Litmus Test for Policymakers Who Want to Grow the Economy:

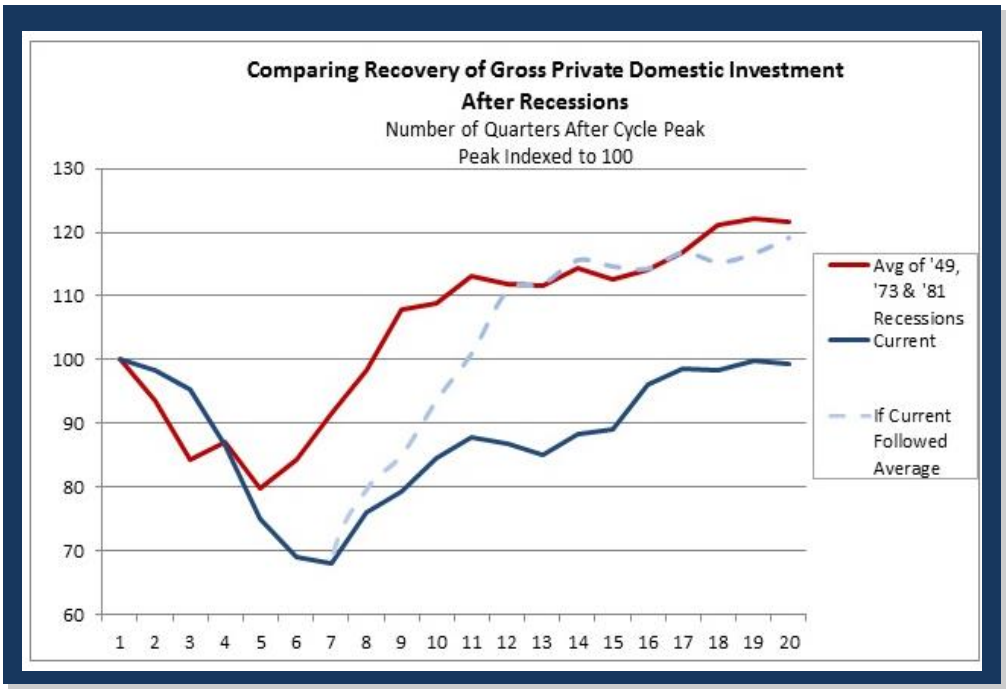
1) What drives the economy, production or consumption? (Note: if you still don't get it, see the box on p. 15 and take the Put Growth First Challenge.)

2) Which is greater, 48% or 7%?

Although the official recession ended in June 2009, this recovery is the weakest in terms of employment and GDP growth as measured against other sharp recessions in the post-WWII era.[21] Although many excuses have been given, and much blame dished out, there is really only one

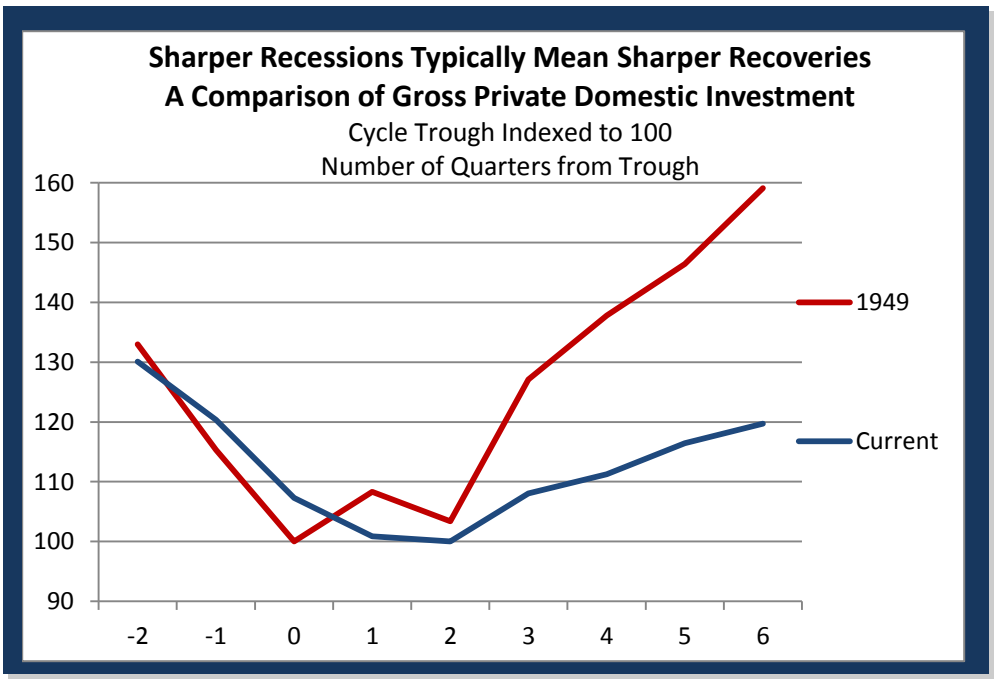
[21] Comparing the sharp recessions of 1949, 1953, 1957, 1973, 1981 and 2007 using tools provided by http://www.minneapolisfed.org/publications_papers/studies/recession_perspective/index.cfm

culprit that makes this the worst recovery. As you may have guessed by now, this is also the worst recovery in terms of business investment, which drives both GDP and jobs. The graph below compares the decline and rebound in investment for the current recovery to a composite of the other sharp recessions in 1949, 1973, and 1981.



The dotted line shows what the current recovery *would* look like if typical of the other recoveries. This suggests business investment *should* be about $3.125 trillion today, instead of the present level of $2.525 trillion. Applying the Woodhill Equation, we see this difference of roughly $600 billion would mean 1.8% more GDP growth and about 2.86 million more average jobs per year.

The fact that the current recession was sharper is no excuse for the lagging recovery. Typically, the sharper the decline, the sharper the recovery, as illustrated in the chart below comparing the 1949 decline and rebound in investment to the current cycle.



Notice the declines are similar, making the lack of recovery in this cycle more damning, not less. Had we matched the recovery, investment would be one-third higher today, roughly $840 billion more, equating to 2.5% more GDP growth and 4 million more average jobs per year.

Unfortunately, among other problems, the U.S. stacks its tax code

against investment. Our wrong-headed tax code punishes most harshly the very thing that drives economic growth.

"Tear Down This Wall"

As in all of nature, growth occurs when a fertilizer comes in contact with a seed. In the economy, the fertilizer is capital and the seeds are the ideas, innovations, and solutions created in the minds of our entrepreneurs. Unfortunately, government policy creates a wall separating those with ideas from those with capital. It makes no sense to wall off those with ideas — they are the source of innovation, new business formation, job creation, and wealth generation. The wall is composed of a tax system that retards new capital formation and double-taxes whatever capital does form. The wall is fortified by a monetary system that scares capital away from productive investment into hedges that shelter it from the chaos caused by an unstable unit of measure (i.e., a floating paper dollar). The wall is guarded by regulators who treat the union of capital and ideas as though it is an anti-social act. Finally, the wall is sealed by a veneer of political correctness that says the wall represents progress.

All of this takes place without regard to the patent unfairness of the way it damages the economy and the employment prospects of those needing help the most. If we want economic growth, if we seek full employment, we must, to borrow a phrase from Ronald Reagan: "Tear down this wall."

Ideal Characteristics of a Tax Code

Simple, Transparent, Efficient, Fair & Neutral

A ***simple*** tax code reduces complexity and makes it easier to comply with the tax code. A ***transparent*** tax code is one in which taxes are visible to the taxpayer. Taxes printed on a sales receipt or itemized on a pay stub are visible. Business taxes are typically not transparent to us, although they are indeed passed along to us (Refer to box on page 7). The more visible the tax system, the more taxpayers know about the true cost of government. An ***efficient*** tax system is one that raises the requisite revenues but requires the fewest resources to administer, comply, collect, and enforce. This generally means taxing the largest possible tax base at the lowest possible rates. Two classic examples of inefficient taxes are the corporate income tax and the death tax. When 30 major corporations earned a collective $163 billion of profit, paid $475 million to lobbyists, yet paid zero income tax,[22] we have the model definition of an inefficient tax system. Likewise, each year taxpayers spend more avoiding the death tax through legal strategies and structures than the government collects in estate tax revenue. A ***fair*** tax code is *proportional* to income. If you earn an income 10 times larger than mine, you pay 10 times the taxes. Somehow, we've allowed Washington to hijack the definition to mean "whatever is politically expedient." Fairness also dictates that we end the artificial division between payroll-tax payers on one side of the rope pulling against income-tax payers on the other side. A tax is a tax, and it is unfair to pit one group against another. A ***neutral*** tax code levels playing fields, doesn't pick winners and losers, and isn't used to dole out special treatment.

Pro-Growth

[22] http://www.ctj.org/corporatetaxdodgers/CorporateTaxDodgersReport.pdf

Every penny of every government program at every level of government is paid for by private sector production. To the extent that the government does important things, why would we want to harm that which pays for all government? The ideal tax code will raise the requisite revenues while doing the least damage to private sector production — the very engine of economic growth.
Production pulls along consumption, just as the engine pulls the caboose. But just because they are traveling at the same speed, don't think for one second that the caboose is pushing the train. Sadly, our tax code is structured as though it is. No wonder the economy is stalled. Think of all the stimulus dollars poured into the caboose and wasted.

Growth solves the deficit problem, the spending problem, and the debt problem. Growth restores solvency to the Social Security and Medicare programs without breaking promises. Growth improves living standards and our quality of life. Growth extends the ladder of economic opportunity right on to the safety net and gives a chance to those wanting to help themselves. Growth creates jobs and drives incomes higher.

In short, growth does the most to solve the most problems at the lowest cost and does so in a way that unites the country.

Proposal: The Right Way to Fix the Tax Bias That Ships Jobs Overseas

This proposal replaces five types of taxes: all corporate income taxes, all personal income taxes, all payroll taxes (both employer and employee sides), the capital gains tax, and the death tax. This plan is revenue neutral, meaning that on a static basis, the two tax bases below will raise the same revenue as the five sources above. Said another way, the tax rate of the new plan was determined by dividing the revenues from the five taxes named above by the sum of the two new tax bases described below.

The Business Flat Tax

- **Gross Sales**
  - **Less → Purchases** from other businesses, but only domestic purchases. This is equivalent to a "cost of goods sold" deduction. However, in the case of imports, the first buyer from the port does not deduct it as a purchase. This adds the import to the tax base and places the item on a level playing field with domestic goods.
  - **Less → All business capital investment** . This eliminates double taxation. The money businesses reinvest back into the business to purchase equipment, machines, structures, etc. has already been taxed once. It doesn't make sense to tax it again, especially since we learned in a previous section that this is the *real* engine of economic growth and job creation.
  - **Less → Exports.** This puts exports on a level playing field in the country of destination.
- **Equals the Tax Base → Times 14%**
- **Notes:** This does not tax "income." This may take a little getting used to. It taxes goods and services that are produced for domestic consumption; it levies this tax only once, and does so proportionally to capital and labor used in the production process. This doesn't change how net income is calculated. It just changes one line item on the income statement: tax liability. Once net income is determined, it flows through to shareholders on the personal return. This in effect extends "**partnership treatment**" to corporations and achieves "***full integration***" of the business tax with the personal tax and ties all shareholders and workers together.

The Personal Flat Tax

- **Wages, business flow-through earnings, dividends, and interest.** This can be thought of as a "factor income" tax since both capital income and labor income are taxed the same way.
  - **Less → charitable contributions**
  - **Less → a refundable family exemption**. This is equal to **2x** the poverty level based on family size. This replaces the standard deduction and personal exemption.
- **Equals Taxable Income → Times 14%**
- **Notes:** This does not tax income either; it taxes income used for consumption or "consumed income," which is taxed only once. It is possible, and some might argue desirable, to split the amount set aside for the family exemption and provide half to the employer and half to the individual taxpayer. This would mean the taxpayer deducts 1x the poverty level rather than 2x. The employer would deduct a flat amount for each employee. This may be more a matter of politics than economics, though.

The Tax Base & Tax Rate Calculations[23]

Business Tax Base	$ Billions
GDP	14,369
Plus Net Exports	+710
Equals Gross Domestic Purchases	15,079
Less Imputations & Adjustments[26]	–1,403
Adjusted Gross Domestic Purchases	13,676
Less Gross Private Domestic Investment	–1,576
Gross Business Tax Base	12,001
Underreporting Adjustment[27]	–529
Adjusted Business Tax Base	11,472

Personal Tax Base	$ Billions
Wages & Salaries	6,559
Business Flow Through Income, Dividends & Interest	3,687
Factor Income Tax Base	10,246
Underreporting Adjustment[24]	–551
Tax Base Before Deductions	9,695
Family Exemptions	–3,985
Charitable Deductions[25]	–314
Adjusted Personal Tax Base	5,396

Tax Rate Calculations	$ Billions
Total Taxes to Be Replaced (SEE NOTE BELOW)	2,308
New Combined Tax Bases	16,823
Tax Rate	13.7%
NOTE: This is *not* designed to replace *all* federal revenues, just tax revenues from named sources: corporate and personal income taxes, payroll taxes, the capital gains tax, and the death tax. It retains duties, excise taxes, etc.	

Advantages:

Levels the Playing Field, Unites All Taxpayers, and Aligns Incentives

The biggest obstacle to true reform is the country's division between payroll-tax payers on one hand, pulling against income-tax payers on the other. A cut in marginal income tax rates may help growth, but is less likely to be enacted when half the country doesn't pay income taxes. Those paying only payroll taxes would prefer a cut in payroll taxes, but that has a miniscule impact on growth. A tax is a tax is a tax. Instead, end the counterproductive tug-of-war, and get everybody on the same side of the rope pulling together for lower rates.

[23] Source: BEA.gov. Uses 2008 as the base year. Subsequent years have been distorted by the recession. If figures are updated for 2011, the calculations do not change much.
[24] Estimated by Gary Robbins of Fiscal Associates
[25] www.charitynavigator.org
[26] Adjustments have been made to the tax bases to remove items that can't be taxed or that don't belong in the tax base. These include subtracting nonbusiness capital income, farm products consumed on farms, margins on owner-built housing, consumption of general government fixed capital, current adjusted surplus of government enterprises, and corporate tax paid by the Fed.
[27] Estimated by Gary Robbins of Fiscal Associates

We all benefit by economic growth; continuing the tug-of-war simply feeds a false premise. Under this proposal, which features a fully integrated tax system, all businesses are taxed the same, capital and labor are taxed equally in the production process, businesses and individuals are taxed the same, workers and shareholders are taxed the same, and employees and independent contractors are taxed the same.

Completely Lifts the Tax Burden off the Lowest Income Brackets

Consolidating the income tax and payroll tax under a single system allows us to completely lift the burden off of the bottom of the income scale. Presently, the *income tax* does not fall on the bottom, but the *payroll tax* hits the hardest there. Not only must employees pay a 7.65% flat tax from the first dollar with no deductions, but also employers are hit with an equal tax. Although politicians refer to this as a "matching contribution," the tax they pay is a direct reduction of the employee's wages.

The following graph shows the difference between effective taxes under the current system (income tax plus employee-only share of payroll taxes) and the proposed system across various incomes.

Under the current system, can you see where the middle class is getting squeezed? Can you see how the proposed plan would be fair?

Retains Progressivity, But in a Way That Doesn't Harm the Economy

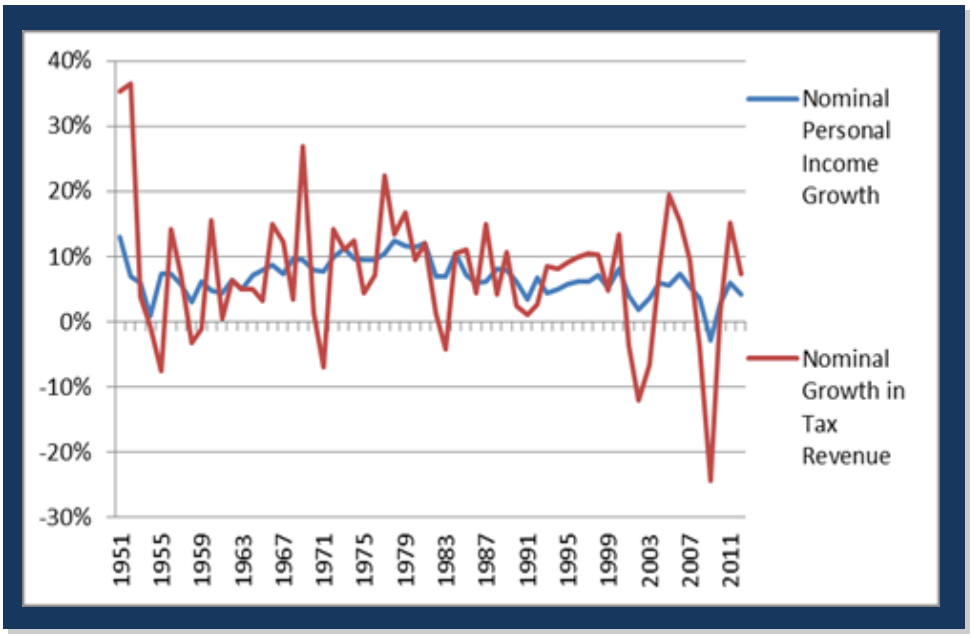
Progressive marginal tax rates may sound good in theory to some. To them, paying a higher marginal rate based on income meets their definition of fairness. Although high marginal rates create an appearance of reducing income inequality, there is no substance to that argument, according to a comprehensive study by economic historian Brian Domitrovic, Ph.D.[28] He finds that the higher the tax rate, the greater the incentive to legally shelter income, which means less reported taxable income. This creates an appearance that income for the top groups has declined, when in reality the difference is being sheltered.

Rather than doing anything constructive, progressive rates cause harm to the economy if the goal is economic growth. First, progressive marginal rates guarantee mathematically that in an economic expansion, revenues to the U.S. Treasury grow faster than personal income. This surge in revenues is typically spent, regardless of which political party is in power. This increased spending locks in place a permanently higher baseline for spending in all future years. Conversely, in an economic slowdown, progressive marginal rates mathematically guarantee that revenues to the Treasury fall faster than personal income, causing a revenue shortfall. The following graph measures growth in tax revenue relative to growth in personal income.

Notice how much more volatile the tax revenue line is compared to the income growth.

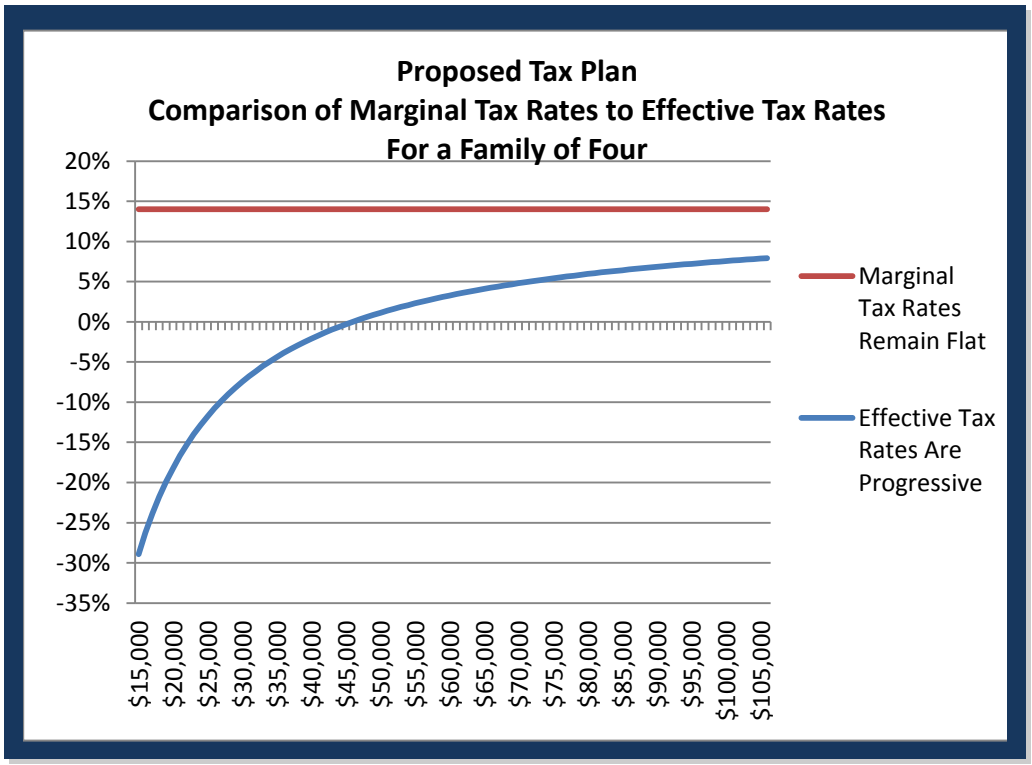
[28] Brian Domitrovic, Ph.D. "The Left's Dubious History of Income Inequality" The Laffer Center. http://www.laffercenter.com/wp-content/uploads/2012/07/2012-07-TheLeftsDubiousHistoryofIncomeInequality-Domitrovic-LafferCenter.pdf

The boom bust cyclicality is entirely man-made. After all, if the government does anything important, why fund it with an artificially volatile revenue stream?



Progressive marginal tax rates facilitate ever-higher spending; in down years, they give cover to the narrative that "we have a revenue problem" and must raise taxes. (As a rule of thumb, whenever you hear someone say, "We have a revenue problem," the chances are we really have only a growth problem.)

If we must have progressive rates, it is best to have progressive *effective* rates rather than progressive *marginal* rates. Because this plan features a refundable family exemption equal to 2x the poverty level based on family size, the effective tax rates for all taxpayers will vary based on income. This way, marginal rates stay low and flat for everyone, which translates into marginal incentives[29] that stay high and steady for everyone. For example, the poverty level for a family of four is about $23,000, so the



[29] The marginal incentive is one minus the tax rate.

family deduction of 2x the poverty level would be about $46,000. For all income levels below that, the family will have a negative *effective* tax rate. A family that earns $46,000 will have a zero *effective* rate while a family earning twice that income, $92,000, will have an effective rate of only 7% ($92,000-$46,000*14%=$6,440. $6,440/$92,000=7%). A family earning $250,000 will have an effective tax rate of 11%, and the highest income earners will have an effective rate of 14%. Crucially, all will have a marginal rate of 14% and a marginal incentive of 86%. This makes for a much more productive way to achieve progressive rates.

Ends the Tax Bias That Ships Jobs Overseas

Exports are deducted from gross sales. They will pay tax only in the country of destination, putting them on a level playing field in all markets in which they compete. Meanwhile, the first purchaser from the port does not deduct an imported good as a "purchase." This brings it into the tax base and places it on a level playing field with domestic goods. The result is more business investment here and, as we know, business investment drives economic growth and job creation.

This will eliminate the need to locate elsewhere for tax reasons. Instead, the incentive is to locate, invest, produce, and employ here in the U.S. Companies will still make investments overseas, locate overseas, and employ people there. However, with this tax bias fixed, and with a new pro-growth tax code, it will be for the legitimate reasons discussed earlier and not because our bad tax policy makes it the only way they can get on a level playing field.

This proposal addresses the problem more comprehensively than under a **"territorial"** tax system, which only alleviates symptoms. A territorial tax system eliminates the double taxation on repatriated profits, so it has merit. But a territorial system keeps in place a tax on income and production and a double tax on investment. Politically, a territorial system feeds the narrative that the tax code will give an even greater incentive to locate *more* production overseas. Finally, a territorial system does not address the implicit advantage our tax code gives to imported goods. A territorial system would be the best choice if the only other alternative was to keep the current tax code and its definition of worldwide income.

Also, by fixing the tax bias, we shore up a chronic source of weakness in the **dollar** and put ourselves in a position to enjoy more of the benefits of **free trade**.

Introduces a Good "Buffett Rule," Not a Harmful One

This proposal offers one of the few tax plans to "integrate" the business tax with the personal tax. This is not a new concept. It originated from a 1977 Treasury Department report titled "Blueprints for Basic Tax Reform."[30] This, in effect, extends partnership treatment to corporations. This way, business net income flows through to the personal return of individual owners for all business entities.

The proposed business tax changes just one line item on the company's income statement: the tax liability. The tax is levied on the value of goods and services produced for domestic consumption, and is assessed only once, proportionately to capital and labor used in the production process. This one line

[30] http://www.treasury.gov/resource-center/tax-policy/Documents/full.pdf

item, tax liability, carries over to the income statement where net income is determined the way it is now.

Once net income is determined, it flows through to shareholders to be picked up on their return. Corporations will remit the tax so the individual taxpayer records it as a non-cash item. Corporations may employ a form similar to the 1099, which is used to report dividends and interest.

If you owned 100 shares of a company that earned $1 per share, you would receive a form instructing you to report $100 of undistributed business income on your personal return and showing that $14 in taxes has already been withheld and remitted on your behalf.

This ends the double taxation of dividends and makes it completely neutral whether companies retain earnings or pay dividends, or whether they finance with debt or equity.

More important, it institutes a good "Buffett Rule." You may have heard by now of the bad Buffett Rule floating around. It is another scheme to raise taxes, based on the faulty notion that Warren Buffett pays less in tax than his secretary. Under this proposed tax system, Mr. Buffett would receive a 1099 form instructing him to report his share of Berkshire Hathaway's earnings on his personal return. Using rough numbers, Mr. Buffett would record $2.2 billion of undistributed business income on his personal return and report that $308 million in taxes were remitted for him by Berkshire. After subtracting his family deduction, his effective tax rate will be 14% and his marginal rate will be 14%.

While we don't know the actual facts of his secretary's income, let's use a hypothetical example: Assume income is $100,000, the family deduction is $46,000 for a family of four, and there is no other income. The effective tax rate is 7.56% ($100k – $46k x 14% divided by $100k), about half Mr. Buffett's rate.

This makes for a much more productive Buffett Rule. The bad Buffett Rule, on the other hand, is simply a tax increase that would hurt the economy. This good Buffett Rule does NOT increase the tax burden; it only increases transparency, equality, and neutrality. Mr. Buffett may be displeased by the demise of his special tax shelter, but I'm sure he'll want what is fair and good for the country

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Generates Strong Growth, and Growth Solves Problems and Unites the Country

Economic growth does the most to solve the most problems, and does so in a way that unites the country. Many of our problems are really symptoms of our one and only *real* problem: a lack of robust economic growth. Joblessness and stagnant incomes are a symptom of our lack of strong growth. The spending, deficit, and debt problems are symptoms as well. The solvency of entitlement programs is, above all else, a direct function of the rate of economic growth. The underfunded pension plans at the state and local government levels are a function of stagnation, too.

Growth is the answer. We must *put growth first*.

When John F. Kennedy ran on a platform of tax cuts, a sound dollar and free trade, in other words economic growth, Democrats enjoyed a clean sweep of power. They not only held the White House and had a majority in both the House and Senate, but also a majority of state governors were Democrat, a majority of state legislatures were Democrat, and a majority of Supreme Court justices and Federal

Reserve governors were Democrat appointees. You can't hold any more power than that. A clean sweep of all seven levels of power is the ultimate sign of trust by the electorate and a just reward for pursuing growth. As JFK's successors drifted too far to the left, Ronald Reagan made those pro-growth issues — of low taxes, sound money, and free trade — centerpieces of the conservative platform. Before long, Republicans were able to achieve a clean sweep of all seven levels of power as a reward for pursuing growth, but lost power as quickly as they lost the mantle of growth.

The moral of the story is that the electorate never changed; the political parties did. The electorate wants today what it always wanted and always will want: economic growth. That voters are willing to give full power to the party with the most credible growth agenda should be encouragement enough for both parties. When growth isn't credible (i.e., not centered on low taxes, sound money, and free trade) divided government is necessary.

When genuine growth is not even an option, the electorate will generally choose redistribution over austerity. Austerity has a value proposition that says, "We'll charge you the same but give you less." It's a losing proposition in any business. In terms of substance, increasing the rate of economic growth by just .1% reduces the projected 10-year deficit by $314 billion. This relationship was brought to light by Forbes columnist Chuck Kadlec, who pieced it together after combing through footnotes to a Congressional Budget Office (CBO) report[31]. By integrating this so-called "Kadlec Curve" with the Woodhill Equation, Put Growth First has created a web calculator[32] (screen print below) to make it easy

[31] Congressional Budget Office, Budget and Economic Outlook: Fiscal Years 2012-2021. Appendix B "Rule of Thumb"
[32] www.putgrowthfirst.com/deficit_reduction_calculator

for policymakers to see how much business investment is needed to achieve their deficit-reduction and job-creation goals. As the example below shows, as an alternative to cutting $4.6 trillion from the 10-year deficit as proffered by House Budget Committee Chairman Paul Ryan, we could increase our rate of real economic growth by only 1.46%.

That's right. Economic growth of 3.66% will reduce the deficit by $4.6 trillion and create an average of 2.7 million jobs per year over 10 years. Even that figure is understated since it is a *static* calculation made by the CBO.

In a dynamic sense, increasing growth by .1% has 27 times the benefit (in present value terms) of reducing spending as a share of GDP by the same .1%. Another litmus test for policymakers: Should you do that which has 27 times the benefit, or that which has 1/27th? Besides failing on the substance, austerity too easily frames the narrative as redistribution from the poor (i.e., benefit cuts) to the rich (i.e., to keep tax rates low).

Reduces the $430 Billion Dead Weight Compliance/Complexity Burden

According to a comprehensive study by the Laffer Center,[33] it costs taxpayers 30 cents on every dollar just to pay the IRS one dollar. Across the economy as a whole, compliance costs amount to more than $430 billion. Applying the Woodhill Equation, if the cost savings were channeled to business investment, it would increase GDP $206 billion, or another 1.2%. Further, $430 of business investment is enough to support 2 million new average jobs.

The tax returns could fit on a postcard, and many taxpayers might not have to even file at all. If your income consisted of only wages, there would be little reason to file a return. Withholding would begin on the first dollar and be a flat 14% on everything. Your employer already records your family size, which determines the amount of refundable family exemption that gets deposited directly into your Universal Savings Account (a newly proposed type of savings vehicle — it's explained on the next page). If you wanted to claim a charitable deduction, you would have to file to get a refund. Business flow-through earnings will already have taxes withheld and remitted on your behalf, so it wouldn't be necessary to file just to report that type of income.

Represents the Largest Transfer of Power and Clean-Up of Corruption

The tax code has turned into a source of power and corrupting influence for politicians. The best way to reduce this influence is to strip politicians of the power to grant special favors and pick winners and losers through the tax code.

Downsizes the IRS: Hostile IRS Agents Replaced by a Few Friendly Bank Tellers

The complexity of the tax code makes it impossible to comprehend, which is a violation of constitutional due process rights. The "guilty until proved innocent" perversion of justice currently being perpetrated in the name of enforcing the income tax must end.

[33] Laffer Center. http://www.laffercenter.com/wp-content/uploads/2011/06/2011-Laffer-TaxCodeComplexity.pdf

This invites selective enforcement and can lead to abuse of power. Confirming the worst fears of a free people, the IRS has become politicized and new evidence continues to mount that it is being used for partisan purposes. Whether one is liberal or conservative, we all can agree this is intolerable.

The IRS can't be reformed any more than the tax code can be reformed. The tax code must be replaced and the IRS needs to be replaced, or our freedom will be displaced. Under the proposed plan, the IRS could consist of not much more than clerks, who will collect and deposit money, then sweep it over to the Treasury.

Correctly Treats Capital Gains

The economically correct tax rate for capital gains is zero. Otherwise, it's a form of triple taxation: Initially, you earn money and pay tax on it, the first tax. Then, you place after-tax income at risk and invest it. A capital gain arises when a capital asset increases in value. Capital assets increase in value when the discounted present value of future *after-tax* cash flows increase, a second tax. Then, if the asset is sold, a capital gain tax is levied, a third tax.

This plan excludes capital gains from the tax base. All business income, whether distributed as dividends or retained, plus wages and interest, will be taxed once and only once. Any unspent after-tax income forms new capital and any capital put at risk — thereby fertilizing the seeds of new growth— shall not be taxed. As we already know, capital investment drives economic growth and job creation. There will be plenty of business income and wages for the government to tax as a result of the investment. When a goose lays golden eggs, the first step toward improving its fertility is to refrain from beating it. It's common sense.

New Possibilities:

Introduces Universal Savings Accounts (USA)

The refundable credit will be deposited to a Universal Savings Account (USA). All amounts in such accounts will grow without facing capital gains taxes. Any dividends, interest, or undistributed business income (i.e., income from extending partnership treatment to all businesses) will still be taxed.

Taxpayers can withdraw funds tax free for any purpose they deem appropriate. With a U.S. population of 314 million, we are diverse, our needs are diverse, and one-size-fits-all solutions do not work. The money inside the account has already been taxed once. The Universal Savings Account provides a safe harbor from double taxation. It will prohibit the government from consuming the seed corn of economic growth. This, in turn, promotes maximum new capital formation. As we learned in an earlier section, business investment drives economic growth, and the rate of such growth depends on new-capital formation. New capital arises when after-tax income is not spent, but rather invested. Conversions from traditional IRAs can take place at the new tax rate.

As we will see in the next couple of sections, the Universal Savings Account is versatile enough to foster new possibilities.

Introduces a Self-Help Safety Net with Dignity

To have a warm heart, one must have clear eyes. The various existing poverty programs are not working. Poverty is at record highs despite (or perhaps *because* of) record spending on poverty programs. These programs may work to create large budgets and bloated staffs of highly paid bureaucrats, or they may work to create dependency and reliable voting blocks, but they don't help people who want to help themselves. In many cases, they remove incentives to reach for the ladder of opportunity.

Every taxpayer will receive a refundable credit equal to the tax rate of 14% multiplied by an exemption equal to twice the poverty level based on family size. The poverty level varies with age and family size, so it's necessary to lay out a table of the various possibilities. For sake of example, the poverty level for an individual is about $15,000 and for a family of four is about $23,000. This means the refundable credit for an individual is $4,200 per year ($15k x 2 x 14%) and for a family of four is $6,440 per year ($23k x 2 x 14%). This refunds or alleviates the burden of taxes on the bottom of the income scale and helps retain progressivity for the overall system. This proposal contemplates that these amounts will be deposited directly in a Universal Savings Account (USA) for each tax payer.

The refundable exemption can collateralize into a self-help line of credit. The government can lend someone money and pay itself back by deducting the repayment from the refundable exemption. Someone who wants to relocate to where the jobs are, Texas or North Dakota, for example, could take out a line of credit from Uncle Sam. If that same individual wants to start a business or acquire new skills, he or she can get no-hassle financing. There would be absolutely zero credit risk for the federal government since all repayments derive from debiting the refundable credit.

This could be the first layer of safety net. It gives people the opportunity to help themselves and avoid the poverty trap[34] caused by other safety net programs. Assuming a 10-year Treasury rate of 2.5%, a single person could borrow as much as $36,000 and have it fully repaid over 10 years using future refundable credits as payment. The family of four could have a credit line of $56,000 if paid over 10 years.

Compatible with Optional Social Security Accounts

This plan does not in any way touch Social Security benefits or benefit calculations. It only changes how we send taxes in. Today, we send in two taxes: income and payroll. Although they initially land in separate buckets, congress has rigged it so one completely siphons the contents of the other. Let's end the charade, and send in one tax to land in one bucket.

Strong growth makes Social Security and all other entitlement programs solvent. Younger workers would elect to voluntarily reduce their future Social Security benefit in return for being able to direct a portion of current taxes into a personal retirement account. By making such an election, a worker receives an additional deposit (i.e., family exemption plus Social Security provision) into a Universal Savings Account. Guidelines could be easily worked out to ensure these funds were invested securely for the worker's retirement. In many places, teachers have been exempt from putting money into Social Security, do not receive the benefits from the system, and have managed nicely to fund their own retirements. We should give everyone the "teacher option."

Makes It Possible to Create a Real Alternative to Obamacare

[34] "Return to Prosperity" Arthur Laffer, Ph.D., and Stephen Moore.

The ultimate source of the uncontrollable costs for health insurance traces back to the tax code.[35] Specifically, a provision inserted during the post-WWII era of wage and price controls established that employers could deduct health insurance provided to employees — but the benefit would not be taxed to the individual as non-cash compensation. This has caused market distortions to compound for 50 years. It drove all coverage to employer-provided plans and introduced a third-party payer, effectively killing individually owned coverage. The third party drives a wedge between buyer and seller and bludgeons normal supply and demand price signals, then engages in price fixing and rationing in an attempt to control costs.

The wedge and its distortions don't exist for other forms of insurance because they don't follow the employer-provided/third-party model. Perhaps it's easier to illustrate what other insurance markets might look like if faced with this same wedge — rather than to illustrate how health insurance might look without it. If auto insurance was structured like health insurance, a co-pay of $20 would cover your gas, oil changes, tire rotations, other preventative maintenance, and perhaps even a few convenience-store items. Further, we would all be dependent on our employers for auto insurance and would have to drop such coverage every time we changed employers or became unemployed. Under this third-party payer model, would anyone care what happened to gas prices? Certainly not. Would uninsured motorists increase? Of course. The result would be exploding costs for auto insurance and no more lizards and cavemen on T.V. telling us how much we can save. To combat this, the third party steps in and engages in rationing and price fixing. Those actions increase demand but limit supply, causing more upward pressure on prices. The solution would be not a bigger third party engaging in more price fixing and more rationing (such as through a government monopoly) but rather a removal of the wedge. A single payer is the mother of all third parties.

The first step to allow market forces to begin working is to remove the special tax preference for employer-provided plans and move to individually owned plans similar to those for homeowners, auto, and life insurance. Employers could make contributions to the Universal Savings Account or just increase compensation. If congress wanted to give special favor to individually owned health insurance without inserting new tax deductions into a flat tax, it could raise the previously mentioned family exemption to a "family plus health care exemption." The entire amount would be deposited into the Universal Savings Account, where it can be used for a wide range of things, including routine out-of-pocket medical expenses and premiums for catastrophic insurance.

The next, and most important, step to controlling health care costs is to find cures to Alzheimer's, cancer, and heart disease. Curing these diseases will only happen through intensive research and capital investment. This proposed tax plan offers the most attractive environment for investment.

Creates Infrastructure to Return Power to the People

The Universal Savings Account could also be used to directly give power back to the states and the people. For example, if given a choice of having problems solved from far away via a one-size-fits-all mandate forced on everyone or having the resources deployed closer to the local community and under more control by those involved most directly, what would people choose? To our knowledge, it's never been proposed this way — and this gives us a chance to try it.

[35] "999 An Army of Davids". Herman Cain and Rich Lowrie.

Centralized, bureaucratic help is as outdated as the floppy-disk and the Betamax. Perhaps there was a time a century ago when the federal government had a hard copy encyclopedia with all the answers while the rest of the country didn't. But now information is so plentiful, robust, and diffused and the world so closely connected that just about anyone, anywhere, has access to all the best information. Maybe there was also a time when large size could have been justified on the basis of scale and efficiency. However, since 1990, the General Accounting Office has issued its "high risk" report at the start of each congressional session, identifying agencies, programs, and initiatives most vulnerable to waste, fraud, abuse, and mismanagement. Six of the 30 programs on the 2013 risk list[36] have remained there since the list's original publication more than two decades ago. Why not try a different approach?

If the federal government is not the best at doing something, it shouldn't do it at all. Transfer the function to the states to give them a try. If the federal government *is* good at providing something, government closer to the people would be *better* at providing it. If the federal government pushes some services back to the states, government is still providing those services. If you had the same employees performing the exact same functions, using the exact same resources, except now they draw their paychecks on a state bank account rather than a federal bank account, is there any rational argument for opposing this change? On Day 1, the only thing that changes is the logo on the pay stub. On Day 2, however, we have empowered 50 governors and 50 state legislatures to tackle this function more effectively. Some will succeed and others may stumble. But at least every state will have an incentive to adopt the better practices and discard the ineffective ones. Hard evidence and good data on what works and what doesn't will abound. A considerable body of evidence about differences in tax and other economic policy among the states[37] already exists and is readily available to guide all policymakers. Why not extend the experimentation to a range of government programs?

We can identify the list of possible candidates to devolve not just from the GAO reports but also via dusting off the 10th Amendment.

Let's say, for example, the Department of Education had all funding redirected to the local communities. The entire amount otherwise spent could be divided by the number of school-aged children and deposited directly into each family's Universal Savings Account based on the number of children. This eliminates a false premise that the choice is somehow about whether government should help people or not or whether kids should be educated or not. This properly frames the discussion in the correct context: "What is the *best way* to help people?"

Of course some refinements may need ironing out, but this approach will give families concrete choices. Would they rather have a few hundred extra dollars in their Universal Savings Accounts each year to cover books, supplies, extra-curricular activities, lab supplies, or tutoring, or simply to cushion the impact of a local levy they supported, or anything else *they* deem appropriate — or do they get more value sending that money to Washington? Would educators be more effective with resources deployed as close to their classrooms as possible, or far away where one-size-fits-all edicts are promulgated? If a majority of citizens in any state held an unshakable belief that a distant monopoly always works best, they could opt to operate that monopoly out of their state capital rather than Washington.

[36] http://www.gao.gov/products/GAO-13-283
[37] http://www.alec.org/publications/rich-states-poor-states/

This kind of decentralization respects the diversity of the country in that every family's needs are different, every municipality has its own challenges, and every state and region of the country is different from all others. Why not try it?

This approach to returning power to the states and people retains a redistributive property, which has its own pros and cons, but which may be necessary politically. If Warren Buffett had school-aged kids, he would pay a much larger share of his $308 million in taxes into the system relative to the standard amount he receives back as a deposit in his Universal Savings Account.

With power back in the hands of the states, residents who find their own states ineffective or corrupt can always cast the ultimate vote, with their feet, by moving to a better-performing state. When the federal government proves itself ineffective or corrupt, there is nowhere else to go.

Disadvantages:

It Is Revenue Neutral (But Tremendously Present Value Positive)

Economically, it never makes sense to impose revenue neutrality on the right kind of tax code changes. The right tax code changes are, of course, ones that incentivize business investment and production. As stated earlier, every dollar of business investment has a *GDP yield* of 48%. So a tax code change that results in one more dollar of business investment will produce an additional 48 cents of GDP every year, and the government will collect its share of that new GDP.

Yet, revenue neutrality assumes that changing tax rates yields zero economic impact. No one actually believes this, but these are the self-imposed rules agreed to on a bipartisan basis that form the straightjacket that typically prevents pro-growth policy from gaining traction.

We should instead insist on *present value* scoring, not static scoring. A positive present value indicates that the market would finance whatever short-term deficit necessary to enact the good policy. There would be no "crowding out" of private investment, which occurs only when a deficit finances negative return projects and the government wants to proceed anyway. But the austerity wing of congress has backed us into a corner, making any and all deficits bad no matter what, and ditto for the debt. What if the government could borrow a dollar to finance a deficit so that we could get a dollar of business investment producing 48 cents of GDP and where the government would take 16% of that in taxes? Is that not a win-win? To the root-canal austerity wing, this would never satisfy. The austerity faction prefers that the beatings continue until morale improves.

Simply raising our average annual real GDP growth rate from the Congressional Budget Office's insufficient 2.2%, to 4% (which was roughly what the U.S. averaged for its first 183 years, under the gold standard), would double the present value of GDP over the next 75 years. This means that, with 4% growth, the "present-value neutral" tax rate of this plan could be closer to a 6% business tax and 6% personal tax than the "static revenue-neutral" tax rate of 14%.

The strong growth will create a tax-revenue gusher. We should commit to using any excess revenues to continue reducing the tax rates, which will create a self-reinforcing virtuous cycle of growth, lower taxes, more growth, etc. With all taxpayers integrated into a single system, both the personal and business tax

rates would be reduced in lockstep to maintain the full integration and neutrality. At some point, when we achieve single-digit rates, we can transition to a completely transparent system such as the Fair Tax.

Revenue neutrality is an "inside the beltway" political beast, not a sound, common-sense economic principle. To reduce political resistance among the green eye-shade types and bean counters of the Budget Committee, this plan is revenue neutral. What we've done is change the tax *base*. The tax base defines what we tax and how we tax it. To get the rate, we simply take the sum of the current revenues from the five taxes we're eliminating (i.e., the numerator) and divide by the new tax base (i.e., the denominator).

Revenue neutrality means that taxpayers generally break even on Day 1 on a static basis. They lose deductions, and are thus taxed on more income — but they're taxed at a lower rate, making it basically a wash. The real benefits and the real economic impact come on Day 2, when America becomes the most attractive place on earth for businesses to locate, invest, produce, and employ.

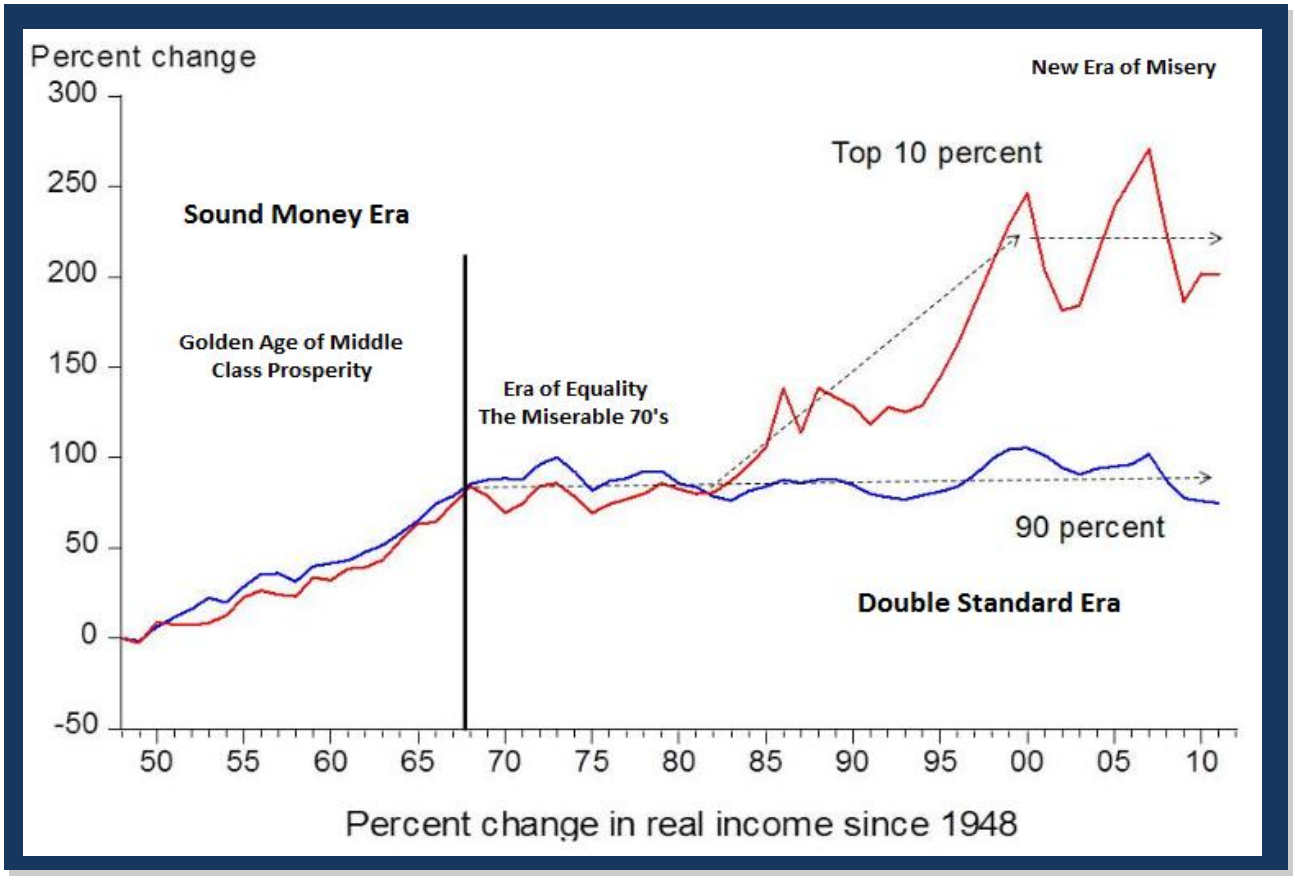
Doesn't Fix the Monetary System

For as much confidence as we have in the positive growth effects of this plan, we are concerned that, absent reform, the Fed will stamp out the prosperity as soon as strong wage growth begins to reach every corner of society. Why? Because in theory the Fed has a "dual mandate" to balance price stability with full employment. In reality, however, this has evolved into a practice of raising interest rates to combat rising wages. Memo to the Fed: Rising wages are *prosperity,* not inflation.

This is best captured in the chart on the following page, which plots real income growth for the top 10% versus the bottom 90% over time.[38] When the Fed had a single mandate to stabilize the dollar (the Sound Money Era), it saw income growth as prosperity and, as such, everybody participated in it. This was the Golden Age of Middle Class Prosperity. Political elites then began dismantling the monetary system in 1968 and completely demolished it 1971. This ushered in the Fed's "dual mandate," now known as the Double Standard Era.

What makes it a double standard is that early in an economic cycle, the Fed lowers rates. This pushes the stock market higher in anticipation of higher corporate profits. This pushes executive compensation higher because it is a function of both. But just when the growth reaches wage earners, the Fed combats it with higher interest rates to cool off growth. The practice of "stamping out" rising wages as though it's "inflation," rather than treating it as a welcomed sign of prosperity, is a double standard. During the Double Standard Era, real income has doubled for the top 10% but remained flat for the bottom 90% — for 40 years!

[38] Louis Woodhill, The Mystery of Income Inequality Broken Down to One Simple Chart. Forbes. Original chart credited to John Taylor's Economics One blog. We have added our notations to the original chart.



If this tax plan is coupled with monetary reform that changes the Fed's mandate in a way that prevents it from treating rising wages as inflation, there is no reason we couldn't have very robust growth that lasts for a generation. Without Fed reform, growth could last only a few years before the Fed stamps it out.

While monetary reform is not the subject of this paper, economic growth is. Recall the calculator displayed on p. 28, which showed the deficit-reduction and job-creation impact of 3.66% growth (i.e., the amount necessary to reduce the deficit by the same $4.6 trillion as the Ryan budget). Below is a screen print of an important message that pops up on the calculator. It says such growth has never been sustained for a full 10 years under the floating paper dollar of the Double Standard Era, but notice that it was routine and expected under a gold-anchored dollar of the Sound Money Era.

IMPORTANT

A decade of **3.66%** growth is unlikely under our floating paper dollar but was common under a gold anchored dollar. (Click here to change the growth rate)

Scoreboard says:

	Number of 10 year periods with growth	Total number of periods	Percent of time growth achieved
Gold Anchored Dollar	94	170	55%
Floating Paper Dollar	0	37	0%

A solid pro-growth tax proposal makes up only half of the picture. To *sustain* the growth, we must engage two gears of the policy mix: low tax rates *and* sound money (a third gear, such as depicted in our logo, represents stable and reasonable regulatory policy.) Because monetary policy is so important, but also so technical and esoteric, the best solution is the Centennial Monetary Commission (HR1176). Think of this as a fair trial in which a bipartisan jury overseen by an accomplished and respected judge will hear all admissible evidence. Giving the historical data due process and its own representation increases the likelihood of a verdict favoring some form of sound money.

Shifts Some of the Incidence of Taxation to Businesses

Because the family exemption is quite large (2x the poverty level based on family size) and it is all applied against the personal tax instead of apportioned to each tax base, the tax base for the business tax is larger than that of the personal tax. Under this plan, we will raise more taxes from businesses than from individuals. This doesn't increase the *burden* of taxation, but shifts some of the *incidence* of it. A revenue-neutral design means the burden stays the *same.*

Less Than Ideal Transparency

Integrating the business tax with the personal tax improves the transparency in some areas. For example, it will become much more transparent that Warren Buffett really does pay a lot in taxes. However, overall transparency is less than ideal. This relates to the above issue, that the business tax base outsizes the personal tax base and business taxes are invisible sales taxes [See box on p. 7].

By contrast, the Fair Tax (a national retail sales tax) exemplifies complete transparency:[39] Every sales receipt would clearly show the amount of sales tax paid — a reminder of how much government really costs. Contrary to much misinformation, it will not raise prices. A bottle of water costing $1 today with no sales tax would likely cost 77 cents plus a 23-cent sales tax. The tax base for this proposal is domestic consumption, so it taxes nearly the same tax base as the Fair Tax (and the 999 Plan) but does so with less visibility.

FAQ:

1. How does the flat tax compare to a Value Added Tax (VAT)?
Considerable controversy arises with any mention of the Value Added Tax (VAT). Generally speaking, a flat tax such as the one Put Growth First proposes is similar to a Subtraction Method VAT , a type of VAT different from the so-called Credit Invoice VAT used in Europe.

A primary advantage of a VAT is its effectiveness in exempting exports and including imports in its tax base. Many of the red countries on the earlier map achieve a level playing field for international trade with a VAT. Further, VATs generally collect revenue efficiently. This is what causes the controversy. To us, as mentioned in a previous section, attaining an efficient system is a tax policy goal; it means collecting the requisite revenues with the lowest possible rate. Low rates promote stronger capital formation. Coupled with a design that eliminates the double taxation of investment, a well-structured efficient tax system will foster robust growth.

[39] www.fairtax.org

However, those wanting to look for any opportunity to increase any tax as much as possible advocate keeping the heavy burden of our existing anti-growth tax system in place and adding a VAT on top of it. Under those circumstances, a VAT would become a dead weight, like an anchor thrown to a drowning man.

For example, the Tax Policy Center, a joint venture between Brookings Institution and The Urban Institute, advocates a VAT, citing several of the same benefits of this plan. The Hamilton Project advocates a VAT[40] because it is efficient, has international trade advantages, and can promote savings and investment. Unfortunately, both call for an add-on VAT to sit on top of the current dysfunctional system. Anchors away! This proposal delivers the benefits they seek, but does so by eliminating five taxes and replacing them with just two taxes. We'll see if their true intentions are to achieve said benefits, or raise your taxes.

2. Aren't low tax rates easier to increase than high rates, so won't this plan end up with 20% rates? First of all, that argument is built on a false premise. We have not had a tax rate increase as a result of a clean vote to hike them since 1993. The tax increase that took place this year was the product of a decade-old budget gimmick containing a sunset provision that expired. Thanks to groups like Americans for Tax Reform holding politicians accountable, it hasn't been easy to raise tax rates. This is particularly impressive given that half of the country, which pays only payroll taxes but no *income* taxes, can vote to increase income taxes on the other half.

This will mark the first time the tax code is fully integrated so Washington can't play divide and conquer. Every voter in every district will pay the same tax. Although it wouldn't surprise us, it would be unlikely for a politician to campaign by saying, "Vote for me, I will raise taxes on all my constituents." People never knowingly vote themselves a tax increase.

Further, with a broad-based flat tax we dampen the unnecessary boom-bust cyclicality caused by progressive marginal rates. This removes the enabler feeding the drum beat for higher taxes.

Finally, the tax base for both the personal tax and business tax is essentially domestic consumption. Anyone arguing to raise either tax would be making a de facto argument to raise taxes on consumption. This would likely face a backlash since considerable research exists demonstrating quickly face a counter argument that raising taxes on consumption is regressive, meaning it would disproportionately impact lower income brackets.

3. Won't a highly efficient tax system allow the government to grow much larger? That is another false premise. It presumes that the counter-productive tax code we have now is somehow constraining the size of government and that moving to a low-rate, efficient tax system will somehow *unbind* its size. However, on a dynamic basis, the boom in prosperity will mean more tax revenue than the static calculation. This means that tax rates can be continually reduced. Because all businesses, all workers, and all shareholders make up a part of an integrated system, all will have the same incentive to keep rates low and push them lower.

[40] http://www.brookings.edu/~/media/Research/Files/Papers/2013/02/thp%20budget%20papers/THP_15WaysRethinkFedDeficit_F2.pdf

4. Won't leveling the trade playing field with imports and exports cause massive disruption in global supply chains? The current uneven playing field is disruptive. It causes decisions to be influenced less by the economic and competitive merits and more by taxes. Leveling the playing field may cause some initial disruption, but only to the extent that decisions made previously due to the tax bias get reversed once the tax bias is fixed.

Products that were offshored may be brought back on shore. Products that require multiple stages of production, whereby each occurs in a different country, may see some consolidation because it will be more attractive to complete the higher value stages here and export.

5. Won't exempting investment benefit the rich? Strong economic growth helps everyone, particularly those at the bottom trying to climb up and those without jobs. This tax plan merely ends double taxation of investment and puts fuel in the engine rather than the caboose. If coupled with monetary reform that stabilizes the dollar, the middle class can return to a golden age of prosperity.

6. Won't the loss of the mortgage interest deduction hurt the middle class? No. When mortgage interest was first given preferential treatment in 1986, the median home price multiplied by the average mortgage interest rate amounted to twice the standard deduction. Over the years, it has lost considerable value to the typical family. Today, the average mortgage rate multiplied by the median home price is only about half of the standard deduction. Chances are, those owning a median-priced home derive little, if any, benefit from this deduction. Meanwhile, the strong vested interests such as the real estate and mortgage loan industries are probably smart enough to figure out that strong growth, more jobs, and rising incomes are better for them in the long run than clinging to deductions that have become skewed toward fewer taxpayers in the upper half of the income brackets over the years.

Comparing the Plans – How Do We Stack Up?

Plan	Fixes Tax Bias That Ships Jobs Overseas?	Editorial Commentary
Simpson-Bowles	No	None needed
2005 Presidents Tax Reform[41]	**Yes**	High marginal rates of 33%, unequal treatment of small, medium, and large businesses. Leaves in place a separate payroll tax, estate taxes
Domenici-Rivlin Debt Reduction Task Force[42]	No	None needed
President's Econ Recovery Advisory Board 2010	No	None needed
Economic Policy Institute[43]	No	None needed
Center for American Progress	No	None needed
Roosevelt Institute Campus Network's "Budget for a Millennial America"[44]	No	None needed
Bipartisan 2011 Tax Fairness & Simplification[45]	No	None needed
Tax Reduction and Reform Act of 2007[46]	No	None needed
Heritage Foundation[47]	**Maybe**	Comes close to achieving the benefits of this proposal. However, the plan does not "integrate" the business and personal tax. Moreover, it is not clear if it will satisfy the WTO since it exempts exports based on cash flows rather than gross sales.
American Enterprise Institute	No	None needed
The Fair Tax[48]	**Yes**	Also taxes domestic consumption but with superior transparency. The challenge is how we transition to this from what we now have.
The 999 Plan[49]	**Yes**	The proposal in this paper essentially taxes the same tax base as the 999 Plan, but leaves out the direct sales tax.
Free Congress Foundation – Growth Code	**No**	Doesn't exempt exports and tax imports, but has good pro-growth merit. Also leaves the payroll tax in place.
Paul Ryan's Roadmap for the Future	**Yes**	Business tax base is similar to our business tax base, so offers some of the same benefits. Maintains a separate payroll tax, which will result in a higher total business rate. Personal tax is optional, which preserves all of the special tax breaks that lobbyists have worked so hard for. Optional systems suffer from "adverse selection," meaning people will self-select to keep the very distortions that the rest of the country is better off eliminating. Compliance costs don't decrease, because taxpayers have two systems to comply with, much like the Alternative Minimum Tax (AMT). Finally, the marginal rate for individuals is nearly 3x larger than the marginal business rate, which will cause distortion and gaming. Dual income tax and payroll tax maintains the tug of war, results in much higher marginal rates, and keeps a heavy burden on the poor.

[41] President's Advisory Panel on Tax Reform 2005, Chairman Mack (R), Vice Chairman Breaux (D)
[42] Debt Reduction Task force, the Bipartisan Policy Center, chaired by Sen. Pete Domenici and Dr. Alice Rivlin, 2010
[43] A joint project of Demos and the Century Foundation, "Investing in America's Economy: A Budget Blueprint for Economic Recovery and Fiscal Responsibility"
[44] Submitted to the Peter G. Peterson Foundation's Solutions Initiative
[45] Introduced by Senators Wyden, Coats, and Begich
[46] Introduced by Congressman Charlie Rangel
[47] Submitted to the Peterson Foundation's Solutions Initiative. Similar to the Inflow-Outflow Tax designed by Norman Ture and Steve Entin of the Institute for Research on the Economics of Taxation (IRET) www.iret.org
[48] The Fair Tax Act of 2013 introduced by Congressman Woodall, et. al.
[49] Full disclosure: Rich Lowrie is a co-founder of Put Growth First, served as adviser and co-author for this white paper, and is also the co-author of Herman Cain's 999 Plan.

Next Steps:

If you would like to help fix the tax bias that ships jobs overseas and become part of a solution that generates robust economic growth, booming job creation, and rising incomes, you may voice your support directly, make your voice heard to your representatives, and help spread the word to your family and friends.

By visiting our website, www.putgrowthfirst.com, you may sign a petition to "Fix the Tax Bias That Ships Jobs Overseas." We have tools that allow you to quickly and easily contact your congressman or congresswoman to make your voice heard. Finally, we have developed convenient tools that enable you to poll your network and contacts to gauge common ground. After conducting your own mini-poll, you may contribute the results to national results broken down by congressional district.

The next step for us is to conduct a comprehensive econometric study of the impact this tax reform proposal will have on the economy and prosperity. With a grant from sponsors, we have commissioned world-renowned economist Dr. John Rutledge to conduct the project.

The Rutledge Project – Using the "Asset Shift" Framework to Capture the Full Economic Benefits

With trillions of dollars having flowed into hedges and shelters, sitting in tangible assets, moved to the sidelines, parked overseas, or piling up on balance sheets, there is tremendous potential to ignite a genuine economic boom if we implement the right policies.

Given the huge impact business capital investment has on GDP, jobs, and incomes, imagine if we can make the U.S. the "capital of capital" and the most attractive place on earth for businesses to invest.

Want to know how big the benefit will be? Stay tuned for the Rutledge Project.

— Rich Lowrie
Put Growth First

The tax plan proposed herein is the major input to the study, along with these assumptions: a) the dollar will be stable throughout the forecast horizon (i.e., the Centennial Monetary Commission leads to reform), b) there is reasonable regulatory restraint so that the burden will not increase further (it is already a larger burden than the corporate income tax and personal tax combined) and c) there is reasonable spending restraint so that growth is less than GDP.

The Project Scope: Analyze the state of the "flow" economy including: GDP, consumption, savings, household employment, business investment, government spending, tax receipts, budget deficit, exports, imports, trade deficit, investment spending, corporate profits, capital accumulation, productivity growth, and economic growth. It will further analyze the state of the economy's balance sheet including: tangible assets, financial assets, liabilities, and implied flows of funds. And it will assess the impact on asset values, including: stock prices, bond prices, home prices, unfunded pensions, and under-water mortgages. Last, the cost of capital and equity values for each major stock market sector will be determined.

Dr. John Rutledge developed the **"Asset Shift Framework"** to

overcome the limits of traditional econometric models. Rather than looking solely at the impact on GDP and its related accounts, the Asset Shift Framework developed by Rutledge explores how policy changes drive changes to conditions in the economy's massive balance sheets. The value of total assets held in the U.S. is roughly $240 trillion, about 15 times the current level of GDP ($16 trillion). Modest shifts in the desired composition of people's assets can have an enormous impact on asset prices and net worth as well as on the flow measures of economic activity (output, employment) recorded in the GDP accounts.

While traditional econometric models are mathematically elegant — making them fun to teach for academics — most cannot capture the worldwide assets flows that will materialize when America becomes the "capital of capital."

This Asset Shift approach applies the widely accepted principles of finance (arbitrage, portfolio balance) as well as more recent developments in non-equilibrium thermodynamics. For more on Rutledge and his Asset Shift Framework, please see www.putgrowthfirst.com.

Additional Information:

For additional information, visit www.putgrowthfirst.com or contact info@putgrowthfirst.com.

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Visit www.putgrowthfirst.com for profiles on our Advisory Board members.

About the Author

Rich Lowrie is co-founder of, and senior advisor to, Put Growth First. He also is Managing Director of a Cleveland-based wealth management practice.

He served as senior economic advisor to Herman Cain and was chairman of the campaign's Economic Policy Advisory Committee. He is the co-architect of the 999 Plan, and co-author of the book "999 An Army of Davids."

He has appeared on Fox, CNN, CNBC, ABC, NBC, and C-SPAN and has been interviewed by the Wall Street Journal, New York Times, and various local news outlets.

He began his investment career in 1988 with McDonald & Company as an analyst, and later led the firm's Portfolio Strategies Group and chaired its Investment Policy Committee.

Over the years, he has served on several advisory boards relating to economic growth and inner-city education.

Rich is an honors graduate of Case Western Reserve University with a degree in Accounting.