

[The Bill Walton Show](#)

Everything You Need to Know About Economics (in only 45 minutes)

Speaker 1:

Okay this is Common Ground Bill Walter on July 20. Art Laffer.

Art Laffer:

So ready, set, go?

Speaker 1:

Oh no, I'll let you know.

Art Laffer:

Okay.

Speaker 1:

All right, the cameras here, camera one if you could just let camera eight just a smidgen. Okay good. Everything looks good. Okay Bill when you're ready looking at your camera. Art, you'll be on from the very beginning as well.

Art Laffer:

Okay.

Speaker 1:

All right guys have a great show, and when you're ready.

Bill Walter:

Everything in today's America seems to become political, economics, education, art, music, and in recent years, even the weather. ESPN now has made sports political and I believe this is toxic. When things get cast in political terms life becomes a zero sum game with political class dividing up what they see as a fixed pie trying to mandate results and outcomes rather than creating incentives for innovation and growth. But things are framed by politics and this program inevitably strays into politics. The aim though is to get into issues that touch on them without also getting toxic. For example, economics, the classical term for economics is political economy. One of America's greatest economists tells us that good political economics is neither left wing nor right wing, is not liberal, yet it's not conservative, and goodness knows it's not Republican or Democrat, it's just plain straightforward economics. Good economics always turns out to be, ultimately, good politics.

Bill Walter:

With me today is the author of those words Doctor Arthur Laffer. Doctor Laffer who earned his PhD in economics from Stanford University was the founder and chairman of Laffer Associates an economic resurge and consulting firm. He served on President Reagan's economic policy advisory board for both Reagan's terms as president and Doctor Laffer also was an advisor to Donald Trump's successful 2016 campaign for the presidency of the United States. Doctor Laffer created what is probably the best

visualization of effective income tax policy, the Laffer Curve. His economic acumen and influence triggered a world wide tax cutting movement in the 1980s that has earned him the distinction and the father of supply side economics. Among his many publications he is the co-author of the end of prosperity and the return to prosperity, and among other things, we'll be talking today about his fourth coming book "A Template for Understanding the Economy". Art welcome.

Art Laffer:

Thank you very much Bill, I could go on listening to you all day, I love it [inaudible 00:02:59]. Thank you.

Bill Walter:

That was a pretty brief summary of everything you've done.

Art Laffer:

Very nice though, thank you very much.

Bill Walter:

So economics it's not political?

Art Laffer:

No it shouldn't be, it shouldn't be. Incentives are what economics is all about and people like doing things they find attractive, and they just like doing things they find unattractive, and government policies can affect the attractiveness of an activity. For example, if you attack something you make it less attractive and people will do less of it. If you subsidize an activity, you make it more attractive, and people will do more of it and that's why it's very dangerous when you tax people who work and you pay people who don't work. If you have two locations, A and B, and you raise taxes in B and lower them in A, producers and manufacturers, and people are going to move from B to A.

Bill Walter:

Now we're seeing that working out in the states, you've done a lot of work on states and the difference in policies in one state to the next, and we're seeing people actually moving, people leaving California...

Art Laffer:

They really do and I did.

Bill Walter:

You did move, you moved from California...

Art Laffer:

Oh I moved from Rancho Santa Fe, California to Nashville, Tennessee for one reason, there's no income tax in Tennessee. I paid for my house in Nashville with my first year's tax savings, no mortgage. It's a no-brainer as Larry Galin says, "It ain't rocket surgery Art," and everyone else is doing the same thing. People like making money and keeping it.

Bill Walter:

So your book though, the one that I'm looking forward to seeing, the "Template for Understanding the Economy" you've got a section in there on states, describe what's in that.

Art Laffer:

The first page of it, of the states thing is there are nine states in the U.S. that do not have an earned income tax. Now two of those states had an unearned tax in New Hampshire and Tennessee but we in Tennessee just got rid of our unearned income tax.

Bill Walter:

Now for those not economists, an earned income tax is just regular income tax, wages...

Art Laffer:

Yeah you're right, no income tax on wages, salaries.

Bill Walter:

And non-earned income tax is capital gains...

Art Laffer:

Dividends, capital gains, other torrid royalties, that type of stuff. If you look at the nine states with no income tax and compare it with the 9 states that have the highest income tax rates, if you look at those 2 groups, the highest and the lowest group, the 9 states without an income tax beat the living bajabbers out of the 9 highest income tax states if you take a 10 year period in every single metric, population growth, growth state, product growth, and even tax revenues they do better than. It's just amazing. I took these numbers back 50 years, every single year using the 10 year moving average every single year the 0 income tax rate states have beaten the equivalent number of the highest income tax rate states in every single metric you can measure. It's just amazing how that works. I then did one which you might find fun too, I looked at those 11 states that have introduced the income tax since 1960, it started off with West Virginia and then the last one is Connecticut, and then you have states like Maine, and Connecticut of course I mentioned that, Rhode Island, you have Pennsylvania, you have Ohio, you have Michigan, you have Indiana, you have Nebraska, Illinois, all these states that have introduced an income tax. What I did very simply is I looked at those states and the year they introduced the income tax and what their performance had been...

Bill Walter:

Performance is measured by...

Art Laffer:

Measured by economic growth, population all of these...

Bill Walter:

Are favored jobs?

Art Laffer:

Our jobs, I look at a labor force, jobs, total output, all of these, and I also include tax revenues. I look at each of these states compared to the rest of the nation, of those 11 states that introduced the income tax in the last what 57 years?

Bill Walter:

Mm-hmm (affirmative).

Art Laffer:

Every single one of those states has declined relative to the rest of the nation. Every single one of them in every single one of those metrics. Some of those states have declined by a lot. Romney was the one who put the income tax in Michigan, you can't believe it in Detroit in 1950 was a city the size of 1.85 million people, today it's 650 thousand.

Bill Walter:

This may be a good point to talk about the Laffer Curve. The Laffer Curve I think is one of the best ways to understand how tax revenue can go up to a certain point, and then beyond that point it goes down.

Art Laffer:

Yes.

Bill Walter:

Can you elaborate on that?

Art Laffer:

Sure. There are two effects tax rates have on revenues. One is if you raise tax rates you do collect more money per dollar of tax base, that's true. So that's the arithmetic effect. But then there's also the economic effect which if you raise tax rates on an activity you make that activity less attractive and people do less of it. These two effects always work in the opposite direction from each other. Sometimes when you raise tax rates the arithmetic effect wins and you collect more revenues, but sometimes when you raise tax rates the economic effect wins and you lower the base by a larger percentage than you increase the rate, and you lose revenues, and everyone understands you can over price your product and make no money.

Bill Walter:

Well is there a rate, we talk about a curve, the rate goes up to a certain point and then it becomes counterproductive, and you get lower revenues, is there a number, is there a percentage...

Art Laffer:

I...

Bill Walter:

Is it 18%, is it 22%...

Art Laffer:

[crosstalk 00:08:18] pedagogy device for my students just to get them to understand the two affects. So I made a little Laffer which sort of looks like my profile...

Bill Walter:

Oh it looks like a little curve, a little...

Art Laffer:

It looks like a little belly curve, yes thank you.

Bill Walter:

Well I don't think you quite look like that.

Art Laffer:

But I did that, and just for illustrating the principal, but yeah, you can see a lot of tax for capital gains is obviously way in the prohibitive range.

Bill Walter:

Yeah, for those who want a better visualization it's like an egg on its side cut in half.

Art Laffer:

Yeah, that's right. That's exactly right. That's just pedagogy, but I would guess those tax rates...

Bill Walter:

I'm trying to move off your tummy, just so you know.

Art Laffer:

Thank you, I'm trying to move off it [inaudible 00:08:52]. How do you stay so slim and trim, I have all this ... Well never mind. But the curve is a good pedagogy device to explain to congressmen, to explain to senators, explain to just students that there ain't no such thing as a free lunch as my colleague Milton Freeman always would say.

Bill Walter:

So there's an example though that there's a state that seems to have gotten it wrong and that state is Kansas. We talked about this a little bit before the show. Sam Brownback lowered taxes but there's a lot of other things that work in Kansas that offset that, could you describe the Kansas situation?

Art Laffer:

Sure, in the first place it was a huge political...

Bill Walter:

Except that it's home to Wyatt Erp...

Art Laffer:

It's home to Wyatt Erp, and Dorothy...

Bill Walter:
From Oz yeah.

Art Laffer:

For his first proposal I think was a \$90 million tax cut that he had proposed. Kansas is all Republicans, there are a couple of Democrats there but not many and never have been. A lot of the Republicans were against Sam Brownback for personal reasons, it wasn't that they were rhinos or anything, there were just these personality clashes that happened and they wouldn't pass his bill. So...

Bill Walter:
So this is Republican versus Republican?

Art Laffer:

It's Republicans versus ... And not even ideological. When I would go down there and talk with the senators there they would say they had a better bill than Sam's, they may be right, it may be ... But you should never let the best be the enemy of the good. What happened was in the Republican primary they through out a bunch of these Republican senators and they swept them out, so Sam had total control. Before the change occurred they based a bill in the senate which increased the tax cut to \$250 million, so they way increased it. He had kept he higher sales tax rate, they dropped it back down, they did all this stuff begging him to veto it. Well he didn't veto it, he signed it. Then of course you had all sorts of problem aris in Kansas, you had the Supreme Court requiring a lot more funding for schools, you had a big forecast error in 2012 on capital gains on unearned income which caused a huge shortfall in ... By the way, 40 other states did the same thing and then you had all sorts of problems with their pension fund which he had to fund to bring it up, it was the 49th in the nation.

Bill Walter:
Well as I...

Art Laffer:

Agricultural price and oil prices dropped which just killed the Kansas economy. But the bottom line is when you look at the tax cut that he did it was fine, it was a little tax cut in a backwater state, a very small state economically.

Bill Walter:
Well the underside of the Laffer Curve is that if you drop rates too much you too lose revenue...

Art Laffer:
Oh yeah, yes.

Bill Walter:
And that's what happened. So there is an optimal point...

Art Laffer:
I don't know that that was...

Bill Walter:

You don't know?

Art Laffer:

The tax rates on this one, he dropped it just a ... It wasn't a big tax cut, it wasn't like Prop 13 in California, it wasn't like Kennedy's others. When I look at Kansas and the lessons coming from Kansas it's a minor lesson compared to Illinois, compared to Connecticut, compared to Kentucky, compared to West Virginia, compared to Michigan, compared to California, these are huge tax driven states. Kansas was not a huge tax driven state. Frankly, I don't think there was much of a lesson in there except for political lesson.

Bill Walter:

One of the things I don't think a lot of us understand is how the federal tax codes subsidizes these high income tax states.

Art Laffer:

Oh they do.

Bill Walter:

Would you explain that?

Art Laffer:

Sure, but you get to deduct your state taxes on your federal tax returns.

Bill Walter:

So if I'm paying 15% in New York I can deduct all that from my federal?

Art Laffer:

Not totally, but yes you can.

Bill Walter:

Generally.

Art Laffer:

You can deduct that but then you have the alternative minimum tax where state taxes are not a preferred item so therefore you have to factor that back in. But bottom line...

Bill Walter:

Okay, but that's a detail, in general.

Art Laffer:

It's a big detail, but yes it is. But the federal government subsidizes states with high income tax rates, California, New York, Illinois, these states they subsidize those with your tax dollars from other states. Oh by the way, you're in a pretty high one too. This is the IQ test, I ask people where do they live.

Bill Walter:

So why I am not living in Tennessee, okay.

Art Laffer:

That's my question, that's the first IQ test.

Bill Walter:

I have a lot of friends in Tennessee it's a great state.

Art Laffer:

It's good. Making money is a lot more fun at lower taxes.

Bill Walter:

I'm for that.

Art Laffer:

Me too.

Bill Walter:

That's what I mean about economics not being political, right?

Art Laffer:

We have the fastest growth in Tennessee, we have the best improvement of public services in the nation, we have fully funded pension funds, we ran a surplus this last year, \$2 billion, and we have the lowest tax rates of any state, but we're just doing fine.

Bill Walter:

So the tax revenue comes from property taxes?

Art Laffer:

No property tax is one of the lowest in the nation as well.

Bill Walter:

Okay.

Art Laffer:

We have a sales tax.

Bill Walter:

All right.

Art Laffer:

With almost no exemptions, a broad-based flat tax that really works, that's our work house, then we have one of the lowest numbers of public employees per 10 thousand population. We have one of the five or seven lowest pay of those employed. We still have long lines and our education system, our highways, we went from 37th in the nation to 7th in the nation in highways.

Bill Walter:

Well let me try this. People talk about getting rid of the income tax nationally and going to a vat tax and it seems like Tennessee is experimented with something like that.

Art Laffer:

It's exactly what we do. It works, as long as you make your vat tax comprehensive.

Bill Walter:

That means value added tax [crosstalk 00:14:10]...

Art Laffer:

Yes, well I use sales tax, very same thing.

Bill Walter:

Sales tax, same thing. Yes, okay. You started out in life as a Democrat and for all I know you may still be a Democrat, I'm not sure...

Art Laffer:

I don't know that I started ... There was a moment in there...

Bill Walter:

There was a moment, okay.

Art Laffer:

Democrats a lot. I've been basically economic's driven, I loved Kennedy, I loved Clinton, and I loved Reagan. They all were tax cutters.

Bill Walter:

And I also heard you thought Clinton did a pretty good job economically as president.

Art Laffer:

He did, I voted for him twice, and God knows I didn't vote and that party's primary, and I would not have allowed my daughter to intern in that White House let me tell you. [inaudible 00:14:46]. But he was a damn good president. He really was. He cut taxes a lot, he got rid of the retirement dust on Social Security, he cut the capital gains tax to 15%, he got rid of the capital gains tax on owner occupied homes completely. That's pretty amazing. He did the welfare reform where you actually have to look for a job to get welfare, how does that? Clinton did. He was an amazingly good president in economics.

Bill Walter:

You got a great chapter in your book on, maybe a couple chapters, on Reagan/Kennedy versus Obama. Would you give me a compare and contrast there.

Art Laffer:

Sure. When we took office...

Bill Walter:

We meaning?

Art Laffer:

Reagan.

Bill Walter:

Reagan when you were working for ... Yeah [crosstalk 00:15:31].

Art Laffer:

He dropped the tax rate and I'm talking about the [inaudible 00:15:34] but we dropped the highest tax rate from 70% down to 20%. We did all the tax reforms there and I can just take you through all of them there. Obama did just the reverse. Obama raised taxes, increased regulations, and increased government spending dramatically. If you look at the results, the growth rate from the MBER trough in Reagan to the NBER trough on Obama, the difference in growth rates is 4.7% Reagan, 2.1% Obama. If you look at it from January 1st, 1983, just think of this, from January 1st, 1983 until June 30, 1984, that's 18 months, a year and a half, U.S. real GDP under Reagan grew by 12%. It grew at an average annual rate of smidgen below 8% ... Those are Chinese growth rates. Do you know what that does to your economy, to your budget, to your employment, to your world? It is just an amazing elixir, and by the time we got to 1984 election Reagan won 49 out of 50 states, then we got the greatest tax reform bill ever which was the '86 Tax Act which I like to think of as sort of my baby, that was the complete flat ... The same one I did for Jerry Brown when he ran for president in 1992.

Bill Walter:

Yeah Jerry Brown most people don't know ran on a flat tax...

Art Laffer:

Totally.

Bill Walter:

1992 with a 13%...

Art Laffer:

13%...

Bill Walter:

Personal loss, 14% corporate.

Art Laffer:

[crosstalk 00:17:06] no inclusions, no deductions, no exclusions, just to pay your tax across the board flat tax. If you make 10 times as much money as much as I do you pay 10 times as much in taxes.

Bill Walter:

Well I think there may be some people in California that wish he would bring you back as a consultant.

Art Laffer:

I'd like that.

Bill Walter:

At least the people leaving because they're paying so much in taxes.

Art Laffer:

I don't think he's responsible for all this. The governor of California is not as powerful as the governor's in other states.

Bill Walter:

That's true. New normal, new normal is 1% growth, I think we all know that, right?

Art Laffer:

That's what they say, Larry Summers here we go again.

Bill Walter:

Yeah, so talk about the new normal versus the 4% that we think we get.

Art Laffer:

Well the new normal is not the new normal, it's the same as we had under Jimmy Carter, and we had ... I like to refer to them as the four stooges, Johnson, Nixon, Ford, and Carter. The largest assemblage of bi-partisan ignorance probably ever [crosstalk 00:17:58]

Bill Walter:

So that's pretty bi-partisan, you got two D's and two R's.

Art Laffer:

Two D's and two R's, but four bads. No party has a monopoly in good or bad, and if you look at that we had this horrible period I think it was from let's say from 1966, February, I think the stock market peaked at 1000 if you take the Dow, and by August of 1982, just before Reagan's tax cuts took effect the Dow was at 777.

Bill Walter:

Yeah six something.

Art Laffer:

770...

Bill Walter:

It was a low number.

Art Laffer:

For 16 and a half years you had the stock market decline by 23%. If you adjusted it for inflation the stock market declined at an average annual rate in real terms of 7% per annum compounded for 16 and a half year, that's a bare market.

Bill Walter:

So you think it's policy folly that causes low [crosstalk 00:18:47]?

Art Laffer:

Totally.

Bill Walter:

What about the people that are talking about demographics, lower rate of innovation, no new big things like the...

Art Laffer:

Well but...

Bill Walter:

Jet plane, that kind of thing...

Art Laffer:

Well big things...

Bill Walter:

I don't know necessarily believe that, but that's the narrative. There's a lot of other things besides just taxes and economics. There are brilliant geniuses sitting out there that do things on their own that are extra economic, they're not ready not. But economics matters, but you break it down, the four policy areas you've got fiscal, you've got monetary, you've got trade, and we've got what you call income is policy...

Art Laffer:

Income is policy.

Bill Walter:

Which is regulatory...

Art Laffer:

Yes it is.

Bill Walter:

And you got to get all those right.

Art Laffer:

Well the more you get right the better off you're going to be.

Bill Walter:

Okay, well...

Art Laffer:

You need a low rate, broad based flat tax.

Bill Walter:

All right that's taxes.

Art Laffer:

All taxes are bad but some are worse than others, and a flat tax is the most efficient way of collecting the money.

Bill Walter:

And what do you do with the tax code?

Art Laffer:

Well what you do with the tax code is you have two flat tax rates, one I did was on business net sales, or value added, and one on personal unadjusted gross income, and then get rid of all the other taxes. Bingo, and the little details we kept sin taxes because frankly they're not so much to raise money as they are to change behavior, alcohol, tobacco, fire arms.

Bill Walter:

That's probably your theme of the incentives since...

Art Laffer:

Yes, it's all...

Bill Walter:

Incentives are just incentives, you want to incent people not to smoke.

Art Laffer:

Then you want spending restraint. Government spending as Milton always said is, "Taxation," government spending is. So you want to collect your taxes with the damage done by the last dollar of taxes collected is a little bit less than the benefit done by the last dollar spent then just stop already.

Bill Walter:

Can you explain a little bit...

Art Laffer:

The sound of money.

Bill Walter:

Can you amplify that, government spending is taxation, could you unpack that?

Art Laffer:

As Milton says, "There ain't no such thing as a free lunch," and the way I like to explain it to an audience is if it's good economics it's scalable. It should work for a big economy, a little economy, it should work for a two person economy. It's important because you can understand a two person economy, it's hard to understand an example in the U.S. economy. Let's imagine we have a two person economy, Farmer A and Farmer B, that's it, nothing else, just those two farmers. If Farmer B gets unemployment benefits who do you think pays for them? Am I going way over your head on this?

Bill Walter:

I think I got this.

Art Laffer:

Government standing is taxation, it's called the Slutsky Equation, you got the income effects of government programs are two-fold, the guy who receives the money gets a positive income effect, the guy who loses the money gets a negative income effect. The income effects' always washed to zero and the substitution effects or the incentive effects always cumulate by paying someone not to work you reduce their incentives to work. By taxing someone if they do work you reduce their incentives to work. It's not that you don't do redistribution, you do, but you got to be clear-eyed about it and understand what the consequences are when you do it. We as a civilized society are going to take care of people who can't take care of themselves, but how far you go depends upon the consequences.

Bill Walter:

Yeah I like to say you have to be companionate, but you got to be smart compassionate.

Art Laffer:

Yeah, well clear-eyed, I just say clear-eyed. You got to have that little green eye shade as well as a big heart, both matter.

Bill Walter:

Well when I get into discussions like this people start saying, "Well you don't want any government," that's not the case.

Art Laffer:

That's not true, that's not true.

Bill Walter:

What kind of government do we need? When you talk about what is it and what does it do?

Art Laffer:

We need government that is compassionate and yet does not go beyond the balance of good sense. When you create the very problems with a program that you're intending to cure the joke was that Lyndon Johnson waged the war on poverty and poverty won because he made it so attractive that he created the very unemployment that he was trying to get rid of and alleviate the pain through. You've got to be very delicate how far you go on paying people who don't work to make sure that you don't create the incentives so they don't want to work. It's not easy, and it's not simple, there's not a clear answer that's right, that's wrong, but this is where you want good governance to really be able to draw those, but be very careful about going beyond the bounds with which you're redoing good instead of creating more harm.

Bill Walter:

Now we've compared states, good states, bad states in terms of economic policy, we've talked about the different presidents and the kind of policies that they've brought about under their administration. You've also got a chapter in the book on countries and an interesting chapter on China, what a...

Art Laffer:

China's cool, China's so cool. It really is. I was on the first trip to China with the Nixon White House...

Bill Walter:

Right.

Art Laffer:

I went there in 1970 and in October 1970 we did the pre-Kissinger trip to China and I was there with Air Force, I went with John Schultz and John Ehrlichmann, and I was sort of in charge of the economics of China then. I just fell in love with China, I just thought they were the most entrepreneurial wonderful ... I went there with my arms crossed, I didn't know I was going to ... In 1970, I think it was, 90% of all production in China went through state-run enterprises. Today it's less than 10%, that's a tax cut. For in China they went from another currency [inaudible 00:23:59] they have no value whatsoever, they then outsourced monetary policy to Alan Greenspan and stabilized the value of their currency through renminbi and that's some money. Then what they did is they opened up their borders to trade. So they had free trade, sound money, and tax cuts, and look at the growth this country has had. They have reduced, now let me just ... They have reduced poverty more in China in the last 40 years than the earth has ever done all countries combined from the beginning of humanity to the present.

Bill Walter:

Well what do you say about the people that say China's really richest running in mercantilist economy there they've got the government directing things, or they're building cities that have nobody living there, that they've got a big investment boon that's basically not supported by demand, and our President Trump just talked about China being a currency manipulating and then cheating on trade. So what do we...

Art Laffer:

China's far from perfect but it's done a great job, and all of this stuff may be right on the little bitty ... But when you look at China over the past 50 years it's just spectacular Bill, and what it has done for the Chinese people is just unbelievably wonderful. It is at least on a par with our own economic [crosstalk 00:25:18]...

Bill Walter:

So you don't see China on the verge of an infrastructure in building...

Art Laffer:

No not a big one, not going back to where they were now, not at all. They may have a downturn, but there's nothing like they're going back to being the China of the past, not at all. It was one of the poorest nations on Earth on a per capita GNP. When I went to Hong Kong in 1970 and I stepped into the new territories there off into China if you looked at the hovels on the hillsides average income of China was a little less than \$50 a person. It was just tragic. Look at them now, look at Hong Kong. Hong Kong will match any city on the Earth. What they have done with prosperity is spectacular. Now are they a communist government? Yeah, supply set economics work with democracy, it works with state run government, it works.

Bill Walter:

The tax cuts, sound money, and free trade.

Art Laffer:

Yes, and that's amazing. If you look at Turkey's probe recently, under Erodgan they even now like Erdogan for all sorts of other reasons and they may be very ... But that man has created a machine of economic ... Do you realize that...

Bill Walter:

Well Singapore's like that.

Art Laffer:

Singapore's like that too, Lee Kuan Yew especially...

Bill Walter:

Sure, yeah.

Art Laffer:

Who's very dictatorial, and it just it really ... And it worked very much in Germany and the end of the World War II under Ludwig Arhard, and the tax cuts there were just amazing, now it's stopped. Japan, the same thing has happened, stopped.

Bill Walter:

Well this steers us toward trade.

Art Laffer:

Yes.

Bill Walter:

We've got a president now who says that we're getting hurt on trade, we've got to come up with what's he call it? He says he's for free trade but he wants fair trade, so could you break this down for as to what's a good idea and what's a bad idea?

Art Laffer:

Let me not ... Renegotiating the deals with these other countries is fine. What you've got to understand is that free trade really is a huge plus for everyone. We make some things better than foreigners and foreigners make some things better than we do. We and they would be foolish in the extreme if we didn't sell them those things we made better than we do in exchange for those things they make better than we do, it's a win-win situation. When you look at trade a reason a country exports is to earn the wherewithal to buy imports. If you prohibit imports, or put tariffs on imports, it is exactly the same thing as putting a tax or a tariff on exports. What you find happening in this trade is country's exports are there to earn the imports. Trying to be protectionist on the import side will hurt your export sides. We had that happen with the Smoot-Hawley Tariff bill, now this is 1929, '30, '31...

Bill Walter:

Yeah, yeah.

Art Laffer:

We had the largest increases in taxes on trades products in the history of the United States, enormous. The volume of trade fell by 80%, the stock market collapsed to 10% of what it was, the unemployment rate went through the ceiling, and the trade balance didn't change at all, our exports declined right with our imports because if we don't import no one needs to export. And that's exactly what happened.

Bill Walter:

You've got an interesting example in the book, you call it autarchy, a world without trade, could you explain what that is so we can look about...

Art Laffer:

Yep, I did...

Bill Walter:

What the world would look like without grade?

Art Laffer:

Yeah, what I did was I used five different countries, the U.S., I forget what we produce, I looked into Costa Rica which includes coffee and bananas...

Bill Walter:

You got coffee in Costa Rica, applies in Ohio...

Art Laffer:

Applies.

Bill Walter:

Kiwis in New Zealand...

Art Laffer:

And...

Bill Walter:

Bananas in Africa, and silk in China.

Art Laffer:

Yes. Autoarchy is when you have to consume what you produce, just a home farm. You grow your own meat, you grow everything, there's no trade. What you then find is when you trade every one of these trading partners is better off. We think we get a great deal getting coffee from Costa Rica, and they think they're great in getting apples from Ohio. So that is where you get the trade. The benefits from trade come from consumption, and they come from production. We have the consumption gains from trade and the production gains from trade. Both those are winners, winners, winners for everyone. Protectionism hurts everybody.

Bill Walter:

And the production side is what creates jobs so...

Art Laffer:

The consumption side does too.

Bill Walter:

When we're building industries ... Okay, well explain.

Art Laffer:

Why do you work?

Bill Walter:

The broker class is so focused on jobs, trade's supposed to protect industries...

Art Laffer:

Let's focus on jobs. Let's focus on jobs.

Bill Walter:

Okay, all right.

Art Laffer:

Why do you work? To buy perfume from France. If you're not allowed to buy perfume from France it's a tax on you.

Bill Walter:

You've been talking to Sarah.

Art Laffer:

I have been talking to Sarah, that's true I have. And you get production from the sale of goods to foreigners, but you also get domestic production because we get to buy cheaper, better foreign products and that raises our wage rate and we want to work more. It's a win-win-win for everyone in this process, it works with jobs and it works with consumption. But no one on Earth wants production without income. I'll let you work all you want but I'm not going to pay you a penny, how much you going to work? None.

Bill Walter:

Let's talk.

Art Laffer:

Yeah, there you go. But there is no advantage to exporting if you don't use the proceeds to import, that's your wage, that's the income you make for exporting, and you make the income from producing in the U.S. by producing goods that other people consume and they produce goods that you consume. It's the same process.

Bill Walter:

So what about this border adjustment tax that people are talking about?

Art Laffer:

It makes no sense.

Bill Walter:

First what is it?

Art Laffer:

Well that's very complicated because I read Ryan and Brady's and in my paper on it I quote them all over the place and I don't think they know what it is. But what they are trying to make it to be is a corporate tax on revenues, or a corporate subsidy. All...

Bill Walter:

This is what Germany does.

Art Laffer:

Well no, this is not a value add, this is even worse.

Bill Walter:

Okay yeah.

Art Laffer:

What it is the value about it...

Bill Walter:

I don't want to get too deep into the weeds about it but okay.

Art Laffer:

Everything you export is non-taxable.

Bill Walter:

Right.

Art Laffer:

No corporate tax on exports. And everything you import you can't deduct for expenses. That's what is.

Bill Walter:

Okay, that's straightforward.

Art Laffer:

Which means that you'll hit your limit on deductions with the first \$10 you import, you can't deduct it, and then all the rest is just a tariff on imports. Then you have on exports you have the same as subsidy there and it will lead to a huge net tariff on trade and profits, that's what it will do, and it will prohibit all capital inflows into the U.S.

Bill Walter:

So in your perfect world, what kind of taxes or tariffs would we have on trade, zero?

Art Laffer:

No not necessarily, but what you want to do is have the lowest possible rate on the broadest possible base. So you provide people with the least incentives to evade, avoid, or otherwise not report taxable income, and you provide them with the least place that they could stick their income without paying tax on it. So you have it just so there's no incentive to try to be a tax shelterer or do all this other stuff, just a broad-based flat tax just like I did for Jerry Brown. If you do that you can have a border tax adjustment if you'd like, but what you've got to do is if you're going to have a border tax adjustment you subsidize the exports and you tax the imports to make it an expenditure tax. If you don't use a border tax adjustment it then becomes a production tax, the two combined are about the exact same thing, it's a sales tax versus a production tax, they're very, very similar. But you can do it either way you want, the way the Europeans do it is they do a border tax adjustment but not the way Brady and Ryan talk about it. Brady and Ryan talk about it as being a broad-based income tax and deductions which is nonsense.

Bill Walter:

So I think you've been asked to talk with the administration about corporate income taxes, that's much on people's mind now, what should we do about corporate taxes?

Art Laffer:

Well right now what I would love to see us do is not tax profits, but tax total production so you don't provide an incentive to lose money. If you tax products and subsidize losers you're going to get bad/worse corporations, but let's not talk about that for the second. The rate, we have the 35...

Bill Walter:

I think you've said ... One of the things I've read you said I think is very interesting, you said let's find the most successful companies we can to make the best products the most productive...

Art Laffer:

Thank you.

Bill Walter:

And just amazing creators of wealth, they use the resources incredibly efficiently, so let's tax them.

Art Laffer:

That's what we did.

Bill Walter:

Let's tax the most successful ones, and I don't think most people understand, most corporations don't pay taxes.

Art Laffer:

No they don't.

Bill Walter:

The reason, they don't make any money.

Art Laffer:

Right, but [crosstalk 00:34:10]...

Bill Walter:

So we're taxing the most successful, so talk about reverse incentives.

Art Laffer:

Oh God, you get this company that makes a wonderful product, everyone wants the product, they make it really efficiently at low cost, and they make lots of them, they eschew the use of lawyers and accounts in favor grabbers and lobbyists, they don't do any of that stuff and we tax the living bajabbers out of them. Then you get Cylendra out there or [inaudible 00:34:31] that makes a lousy product no one wants, makes it really inefficiently, they hire all these guys to go lobby the government and they get subsidies for that. It makes not sense. What you want to do is tax the use of natural resources, resources, labor and capital, and resources, and tax at a low, flat rate and then let the companies be able to may their money if they want it.

Bill Walter:

One of the things I always try to get at with these policy discussions is what's the affect on ordinary people and I don't think that most people understand that corporate taxes are taxed on them as a consumer and if you work for one it's a tax on you as an employee, and it's a tax on capital, these are all not good things and we all get hurt.

Art Laffer:

We know we have to pay taxes, and you're right on this, but what you want to do is collect your taxes in the least damaging fashion. When you have impressive taxes so that people hire lawyers and accountants instead of producing goods and services, and paying their taxes fair and square, the real reason I want to low rate, broad-based flat tax is they won't use tax shelters anymore Bill, they won't cheat on their taxes, they won't try to maximize their tax forms, they won't try to shift income out of the ... They'll pay their damn takes fair and square and then go on to make business. That's what you really want, you want it to be neutral with respect, and then you collect the requisite sums you need to provide government services, then you stop.

Bill Walter:

Well you got seven items on your book that are tax items that people "they can escape the lease, tax the things you like the least, sin taxes, you take the things least where collection costs are the highest, broad-based tax rates provide people with the least incentive to evade, avoid, or otherwise not report taxable income, you tax people fairly, make sure that taxation is not arbitrary or not easily subject to changes, and you collect only as much as you need."

Art Laffer:

That's what you do, what more than do you want than that?

Bill Walter:

Okay well...

Art Laffer:

The thing about taxes is taxes are all bad but some is worse than others and what you want to do is just do it in the least damaging fashion to collect the requisite revenues, and you don't want politicians, especially politicians, to use taxes as weapons against their enemies. You don't want that. You don't want class warfare in the taxes. Now if you want to help poor people, God bless you, I want to very much. First place I take the Kennedy phrase, the best form of welfare is still a good high paying job, okay that's the number one, growth and ... But there will be some people who don't make it, you write him a check, you do it in a transparent, clear, straightforward, warm way and that way you know exactly what you're doing.

Bill Walter:

I think one of the things that's underappreciated is how much the tax cut is used as a revenue raising device for politicians when they're running for office, the tax cut and regulatory structure basically provide enormous incentives for people to come lobby and write checks.

Art Laffer:

Don't tax you, don't tax me, tax the men behind the tree.

Bill Walter:
Use the Huey Law.

Art Laffer:
Remember that one? It was great. Yes of course they do that, and then they go out and solicit funds from the industries and all that. If you have a low rate flat tax there wouldn't be any of this solicitation. The politician ... Now, the last one, the politicians will hate you for a flat tax unless you ready for this one?

Bill Walter:
I'm ready.

Art Laffer:
The problem with politician's is they spend other people's money and they don't not bare the consequences of their inactions. So my solution to politicians, put them on commission. If you have GDP growth at 3% the politicians get their pay, if GDP growth is 4%, double pay, 5% of growth, triple pay, I don't mind them making money as long as I do. But if it's 2% growth they get no pay at all, if it's 1% growth they owe the people their pay.

Bill Walter:
Well you...

Art Laffer:
And if you made them to bare the consequences of their own actions they would all of a sudden behave very differently than they do right now, just the way companies do, just the way everything else ... Politicians need to be on a merit pay basis, period. That is the one thing that would really work.

Bill Walter:
You mentioned Jackie Mason in here, he says, "If we want politicians to be successful put them on a commission and don't pay them until they show a profit."

Art Laffer:
Yes. I love Jackie Mason, and he gets roars and laughter from the crowds when he says that. I don't but ... Well anyway.

Bill Walter:
So tax cut on the rich, the theme of this show is obviously taxes because you probably know more about taxation than anybody else on the planet, tax cuts and the rich, why do they work, and isn't that just trickle down, and isn't trickle down a bad thing?

Art Laffer:
A names, if you can call them names, but sticks and stones will break my bones but names ... Well you can use any name you want to. I had one by Galbraith when I had that debate with him at Harvard and he referred to my tax theory as, "If you feed the horse enough oats the sparrow will survive on the

highway." That's his version of trickle down. We've had three major periods of huge tax cuts on the rich, the 1920s we cut the highest tax rate in the top 1% of income earnings from 77% to 25%, pretty big cut. When that happened we have detailed data on the income from the top 1% of income earners, what you find happening in the 1920s is when you cut tax rates on the rich, revenues from the rich, the top 1% went way up, they went from about 30% of total taxes to over 60% of total taxes, and their rate was less than a third of what it had been before, and the revenues went way...

Art Laffer:

Another good example, John F. Kennedy cut the highest rate from 91% to 70%, cut the lowest rate from 20% to 14%. The top 1% of income earners, the 90%-70% people revenues went through the ceiling during that period. Lastly, we had the Reagan period where we cut revenues from the top 1% of income earners, tax revenues only, not all the secondary effects which are huge too, tax revenues from the 1% went from 1.5% of GDP in 1981 to 3.2% of GDP in 2004. It more than doubled, every other category went down because of tax rate reductions. But the rich are really sensitive to tax rates and every time we've cut the highest rate, every time, revenues have gone up not down.

Bill Walter:

So something else is going on though besides revenue increases or decreases and we talked about tax rates. We started out talking about politics and economics, I think there's a certain amount of class warfare, there's a certain amount of just we're not going to do this because you're rich and we're not. How do you cut through that with our politics?

Art Laffer:

I don't know. Every now and then the stars are aligned and good economics wins. Then when people get rich they feel guilty and then bad economics starts winning again, but then we always come back to winning. We won with the Harding and Coolidge after a long period of Wilson and Taft, and it was really a bad period there. Then all of a sudden we got Harding and Coolidge and a really great eight year period there of the '20s. Then you've got the Roosevelt bad period all the way through until Jack Kennedy, then you got a very short window, the go-go '60s which was really spectacular, then you got the four stooges, which I call the four stooges, that 16 year period, Johnson, Nixon, Ford, and Carter. Then you got the Reagan prosper ... Reagan threw Clinton by the way, Clinton was a great president. Then we went to the dark ages once again with W and Obama, I don't see really much difference between Obama and W, they were twins to me in economics.

Bill Walter:

Well and they both gave us the bailout packages and stimulus in 2008.

Art Laffer:

Terrible.

Bill Walter:

The story I like is we had a sharp economic turndown in 1920 and I love the dramatic policy action that President Harding took.

Art Laffer:

Yes.

Bill Walter:

Nothing.

Art Laffer:

Yes, that's correct. It's beautiful.

Bill Walter:

And everything came roaring back without a single...

Art Laffer:

Now let me take you through the Harding ... Because the Harding one is fascinating.

Bill Walter:

Okay.

Art Laffer:

Harding and Coolidge won the election by the largest ever. They ran on a slogan of we'll return to normalcy which means cutting tax rates way back to where they were before World War I. Now if you know they're going to cut tax rates way down next year what do you do this year? The recession of 1920, '21, '22 was caused by the tax cuts in the future, and then we've got the Roaring '20s, the huge boom that occurred with [inaudible 00:43:24]. Same thing happened with Kennedy and the same thing happened with Reagan. When we came in everyone knew we were going to cut tax rates way down so we got this deferral effect until the tax rates did come down. Our tax cuts began on January 1st, 1983. Guess when the boom started? January 1st, 1983. It is amazing how tax cuts don't work until the take effect, and then they work like ... And it's the same problem you always have is because the anticipation of a tax cut is depressing to an economy. So you have that initial downturn but then you get the boom that goes crazy.

Bill Walter:

With everything going on in the world you are also a money manager, where are you allocating your capital?

Art Laffer:

Well we do global one, we do a global thing which is we look at a number of ETF's in different countries, and we look at the policies of all these different countries...

Bill Walter:

So you have a policy-based economy...

Art Laffer:

Oh totally.

Bill Walter:

Okay.

Art Laffer:

And we look at the four pillars of prosperity, just what you went through, monetary policy, trade policy, incomes policies, and fiscal policies/taxes, and we look at countries that are changing their policies. For example, we've gone very heavily into France because we think Macron is much better than Hollande. So this is how we judge all of these and keep very close track of all of these countries and then we select them. We are allowed to have only two emerging market countries because frankly there's a little while when they're crazy...

Bill Walter:

They're volatile, yeah.

Art Laffer:

So we have that and we've been doing that for years, and years, and years, and it's worked out pretty nicely. We also have a macro one which is, again, policies and which industries do well under tax cuts, under spending [inaudible 00:44:58], we call it high CATS, low CATS, tradable, non-tradables.

Bill Walter:

What's a high CAT?

Art Laffer:

Oh capital tax sensitivity, call its CATS.

Bill Walter:

All right.

Art Laffer:

But if you look at what happened when Kennedy did the tax cuts you found a very strong pattern of industry's performances. The same pattern occurred with Reagan. The same pattern we believe is going to incur in the future here because we're back to a growth agenda. So when you look at it, prosperity is not evenly distributed amongst all industries and all companies, it's not. For example, gold generally doesn't do really well during a prosperity, nor do tax shelters [inaudible 00:45:36] and other industries do really well. So what we try to do is find that pattern and overlay that pattern with what we think the policies are going on in the U.S. and then we select those industries, and then we select those states, we look at the states and where the companies are located, both where their capital is located, where their labor is located, where their sales are located, and we try to be in states ... Now I am on a board of a company called NXRT and I'm obviously invested heavily in it, but they look at states for development of real estate trust, our rate, and we're doing really, really well because we are very careful in where we buy the real estate as well as how well we buy. But you don't want to be in states like California or other places where they have tax and you're going to get low growth, you just don't want to be there.

Bill Walter:

All right.

Art Laffer:
Make sense?

Bill Walter:
It makes a ton of sense. I'm going to call my broker...

Art Laffer:
Uh oh. Some of these are really ... I love being involved.

Bill Walter:
I think this is ... How are the returns compared to the benchmarks, are you able to disclose that?

Art Laffer:
For sure I think we're doing real well.

Bill Walter:
You're doing pretty well.

Art Laffer:
You can look it up, it's a New York stock exchange company, NXRT, and I'm on probably 10 or 12 company boards, I love applying the economics on a personal level, as well as on a U.S. level, as well as on a global level, as you know I did with Thatcher. I worked with her, I was the only American really involved in the policy stuff with her. It's really fun and it works Bill, it really work if...

Bill Walter:
So...

Art Laffer:
You want prosperity.

Bill Walter:
Last topic, it's now summer of 2017, we have a new administration, how much of what we're talking about that you want to bring about do you think we can bring about with current political...

Art Laffer:
We can bring about a lot of it. One of the areas which I try to stay out of is politics, let me drift a little bit because politics is where the rubber hits the road.

Bill Walter:
Yes.

Art Laffer:

That's where economics is applied. We did a good job with Reagan in the '81 Tax Act, fine and all that, but the real winner was '86 Tax Act, we brought the rates down to 28%, pretty amazing, corporate rate we dropped a lot too. To get a bipartisan consensus you need a resounding political victory. Now, we had a terrible time in '82, we lost a lot of house seats, we lost one senate seat because your tax cuts hadn't started. But as I remember I talked to you about the growth rate from January 1st through that '83-'84, if you look at '84 we won 49 states out of 50, we swept the world, everyone wanted to be a Reaganite, and then we were able to get bipartisan consensus. The '86 Tax Act, which is the best bill ever, the vote in the senate was 97-3.

Art Laffer:

Once you have a big victory and then everyone works together you then get really constructive bipartisan, we need that victory first. It may or may not come, it's dependent upon lots of other stuff but I would wait for the massive, big one until later on in this administration. Now I just dropped that corporate from 35% to 15%, that will be a direct adrenaline shock right to the heart of the economy, and boom, get us going. But if it did that, and don't worry about all the reforms and all the other stuff now. Once we get the political process rolling, once the growth starts Bill it doesn't stop. Everyone then wants to get on board.

Bill Walter:

Well now, just to review, at 35% we've got the highest corporate tax rate in the world.

Art Laffer:

Yes.

Bill Walter:

And we are seeing companies fleeing the United States, we have inversions, we have all sorts of [crosstalk 00:49:16], and taking it from 35 to 15 would be a one-time shot in the arm that would make us an investment haven...

Art Laffer:

Yes.

Bill Walter:

Rather than a...

Art Laffer:

Only Ireland would be lower than we are.

Bill Walter:

Ireland, we'll let Ireland [crosstalk 00:49:30].

Art Laffer:

I love Ireland.

Bill Walter:

We have a little Irish...

Art Laffer:

Do you know why everyone's investing Ireland Bill, do you know that?

Bill Walter:

I don't know.

Art Laffer:

Because the capital is always Dublin. Thank you, thank you, thank you.

Bill Walter:

Art thank you.

Art Laffer:

My pleasure.

Bill Walter:

Please come back, and lot's to learn, and hope you're effective here in Washington on your travels this time.

Art Laffer:

Thank you very much sir.

Bill Walter:

Okay, thank you.

Art Laffer:

It's great fun.

Bill Walter:

Yeah.

Speaker 1:

Super.

Art Laffer:

Was that all right.

Speaker 1:

Fantastic. Good show, yeah.

Bill Walter:

We got a lot into that one.

Art Laffer:

I dropped my coaster, did you see that?

Bill Walter:

Yeah, yeah. I was going to warn you about that.

Speaker 1:

[crosstalk 00:50:05] Laffer looked like me upstairs with my [inaudible 00:50:08].

Bill Walter:

We need to rethink coasters too.

Speaker 1:

Yeah that's happened.

Bill Walter:

It happens every time, yeah.

Speaker 4:

We need cloth.

Bill Walter:

We need cloth.

Art Laffer:

Huh?

Bill Walter:

We need cloth.

Speaker 1:

Cloth coasters.

Art Laffer:

Well yeah that and...

Speaker 1:

Condensation...

Art Laffer:

Or just a mat.

