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Supply-Side Investment Research
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10-yr T-Note: 2.38% DJIA: 21,012.28 NASDAQ: 6,102.66 S&P 500: 2,399.38 S&P 500 Undervalued: 105.4%

THE PRESIDENT'S TAX PLAN

By Arthur B. Laffer, Ph.D.

Simply, the President's tax plan is as follows:

i.) The highest federal corporate tax rate is to be cut to 15% from 35%. Although I don't quite know how this will be structured, the Administration has said that the rate will also apply to pass-through corporations.

ii.) Federal taxes on foreign operations will be taxed on a territorial basis rather than on a global basis which means that profits earned abroad will no longer be subject to U.S. federal taxes. There will be, however, a special tax provision for the repatriation of past profits (estimated to be some $2 to $3 trillion) that U.S. companies have held abroad to avoid U.S. taxes.

iii.) The inheritance/estate tax will be eliminated in its entirety.

iv.) The personal income tax code will be reduced to include three tax brackets with tax rates of 15%, 25%, and 35%.

v.) The individual deduction will be doubled. All other deductions, save charitable contributions, mortgage interest and some retirement savings contributions,[1] will be eliminated—most specifically this means that the deduction for state and local income taxes will be terminated. And finally,

vi.) The alternative minimum tax (AMT) will be terminated completely. The elimination of the federal tax deduction for state and local taxes paid basically emasculates the AMT anyway, so the actual termination of the AMT is the second wooden stake in the black heart of Nosferatu.

A. <u>The Corporate Tax Proposal</u>

I really don't wish to enumerate all of the static tax effects of the President's tax plan because the whole purpose of the President's proposal is to spur growth, reduce tax sheltering and encourage capital flows into the U.S. But for many wannabe accountants who have nothing else better to do, there is always the challenge of figuring out what the static accounting impact of these proposals will have on the federal deficit. And with my own *droit de seigneur* I choose to carefully go through the various dynamic economic effects the President's plan will have on the economy and on the federal deficit. I also want to add the President's proposal's economic and budgetary impacts on state and local deficits and output.

i.) <u>Corporate Tax Rate Cut and the Sheltering of Corporate Taxable Income</u>

As a matter of basic static accounting, whenever corporate tax rates are cut there will be less tax revenue collected per dollar of corporate taxable income reported. This effect is what economists call the "arithmetic effect" of a tax rate change. Therefore, if everything is as it was, i.e. there were no supply-side or behavioral responses of any type, tax revenues would be down if tax rates are cut.

If all corporate tax that had been collected at the 35% tax bracket would now be taxed at 15%, then the tax revenue decline would be a smidgeon less than 60%. But, of course, there are domestic and international supply-side and reporting responses that do and will occur. These responses are called the "economic effects" of a tax rate change, and, over time, these economic effects will do nothing but grow larger and larger while the arithmetic effect stays the same. Let's go through a few of these economic effects in order to be able to range their impact on the budget and tax revenues.

ii.) <u>Sheltering of Income Reported for Tax Purposes</u>

One consideration in assessing the effects of a corporate tax rate change on tax revenues that is especially overlooked by most analysts is the sheltering of income from taxation. These analysts just assume that people pay the tax rates that Congress legislates. Yet when those analysts see sheltering in a specific company, they harshly criticize the company in question for the practice. GE is often held up as the classic example of tax sheltering. Even when tax sheltering is not complete, many companies at the very least report the income they do report in preferred (i.e. lower tax rate) categories such as employee/owner compensation and other expensable benefits, pass-through entities such as partnerships, LLCs and Chapter S corporations, capital gains, dividends, future expense deductions (especially for insurance companies) and other such items. This sheltering aspect is by no means small. For example, if GE doesn't pay any corporate taxes at 35%,

[1] While not mentioned in the outline of the Trump tax reform plan, the White House clarified that contributions to 401(k) plans and some other forms of retirement savings plans will retain their tax advantages. For more, see: Richard Rubin and Eli Stokols, "Trump Tax Plan Keeps Tax Breaks for 401(k)s," *The Wall Street Journal*, April 27, 2017. https://www.wsj.com/articles/trump-tax-plan-keeps-tax-breaks-for-401-k-s-1493324552

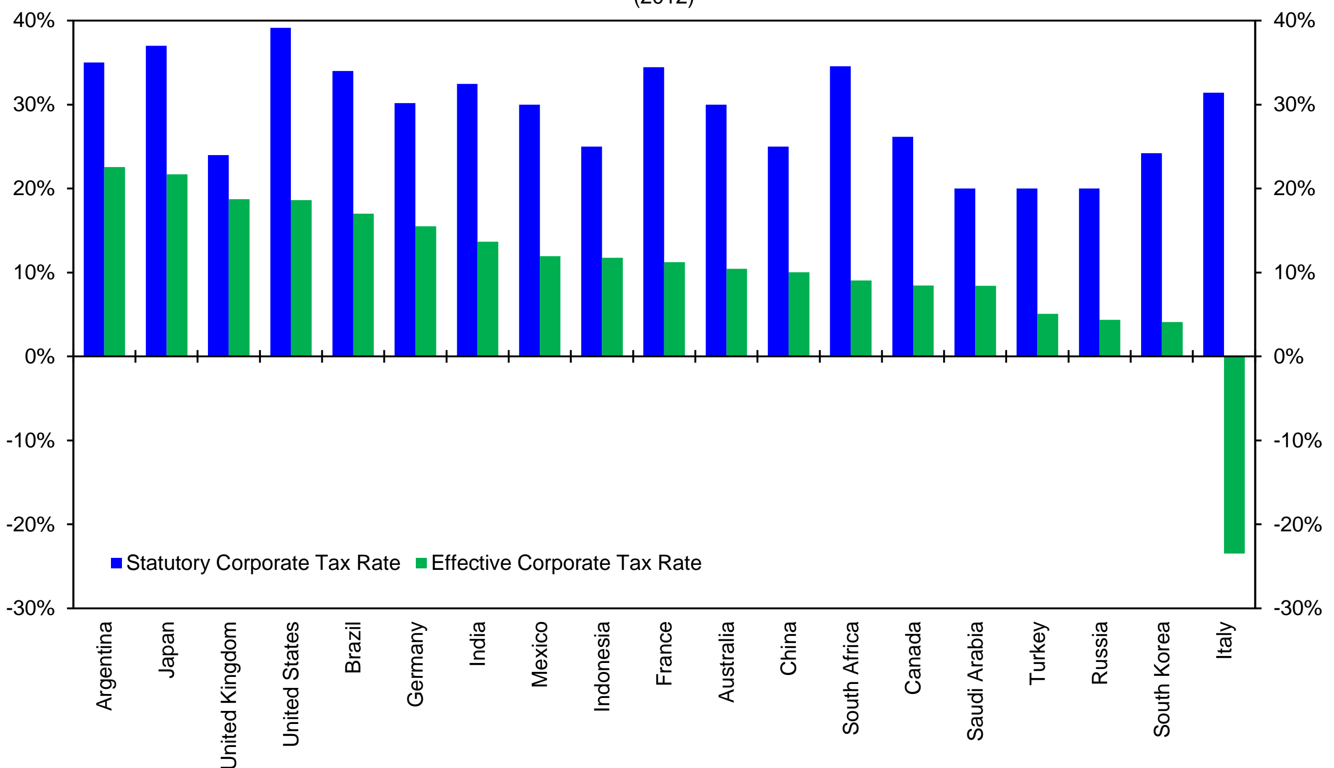
surely they won't pay any less taxes at 15%. They can't pay less. And some of those lawyers, accountants, and lobbyist that GE employed because they needed to shelter income at a 35% rate will no longer be worth the cost at a 15% rate and therefore they will be let go in exchange for paying some tax.

According to the Tax Foundation Special Report *The U.S. Corporate Effective Tax Rate: Myth and Fact*, "It seems reasonable to suggest that the high statutory corporate income tax rate encouraged corporations to shift profits to other jurisdictions, including Canada. It also reflects the actions of discouraged U.S. entrepreneurs from incorporating their business activities by choosing instead limited liability partnerships and other organizational forms that avoid double taxation at the corporate and personal level; such actions have been dubbed "distorporation" in a recent issue of *The Economist*".[2]

The point here is simply that business owners have lots of options open to them to reduce their tax burden, and they choose those options often in part for tax reasons.

Recognizing that sheltering, over-expensing and rebalancing taxable income categories occurs, we can see a small part of its effect. The top statutory U.S. corporate tax rate[3] in 2012 was 39.1% and yet the CBO measured the actual effective tax rate at 18.6% on corporate profits, which is far, far lower than 39.1%. In fact, according to the CBO "the effective corporate tax rate in the United States was 13.3%--more than 5 percentage points lower than it would be had the credit" (tax credit for research and development) "not existed."[4] In Figure 1 below, I've listed the highest corporate tax rate for a number of countries and total corporate taxes collected as a share of National Income and Product Accounts (NIPA) profits (these are <u>not</u> GAAP profits, but in fact represent far better, more accurate and no-nonsense profit figures that should be the object of corporate taxation). As you can see, tax collections are way below the corporate tax rate because of sheltering. And, these data do <u>not</u> include the effect of the R&D tax credit or many, many, many other tax shelters.

Figure 1
Effective Corporate Tax Rates and Top Statutory Corporate Income Tax Rates in G20 Countries, Inclusive of All Types of Assets and Financing Sources
(2012)



Source: Congressional Budget Office

[2] Jack Mintz and Duanjie Chen, "Special Report: The U.S. Corporate Effective Tax Rate: Myth and Fact", Tax Foundation, February 2014. https://files.taxfoundation.org/legacy/docs/SR214.pdf
[3] The top statutory *federal* corporate tax rate has been 35% since 1993. The additional 4.1 percentage points added to 35% to get a top statutory corporate tax rate of 39.1% are derived from the average value of *state* corporate tax rates faced by corporations in the U.S.
[4] "International Comparisons of Corporate Income Tax Rates", Congressional Budget Office, March 2017. https://www.cbo.gov/sites/default/files/115th-congress-2017-2018/reports/52419-internationaltaxratecomp.pdf

Let me just write that if the tax rates were lower, the incentives to shelter income would also be lower, and effective taxes would fall by much, much less than the fall in the highest tax rates. It is altogether possible and even reasonable to expect a very large offset to the negative arithmetic effect of lower tax collections if not even a revenue reversal (i.e. *higher* tax revenues) at 15% than at 35% (Figure 1).

iii.) Corporate Tax Rate Cut and the Volume of Corporate Profits

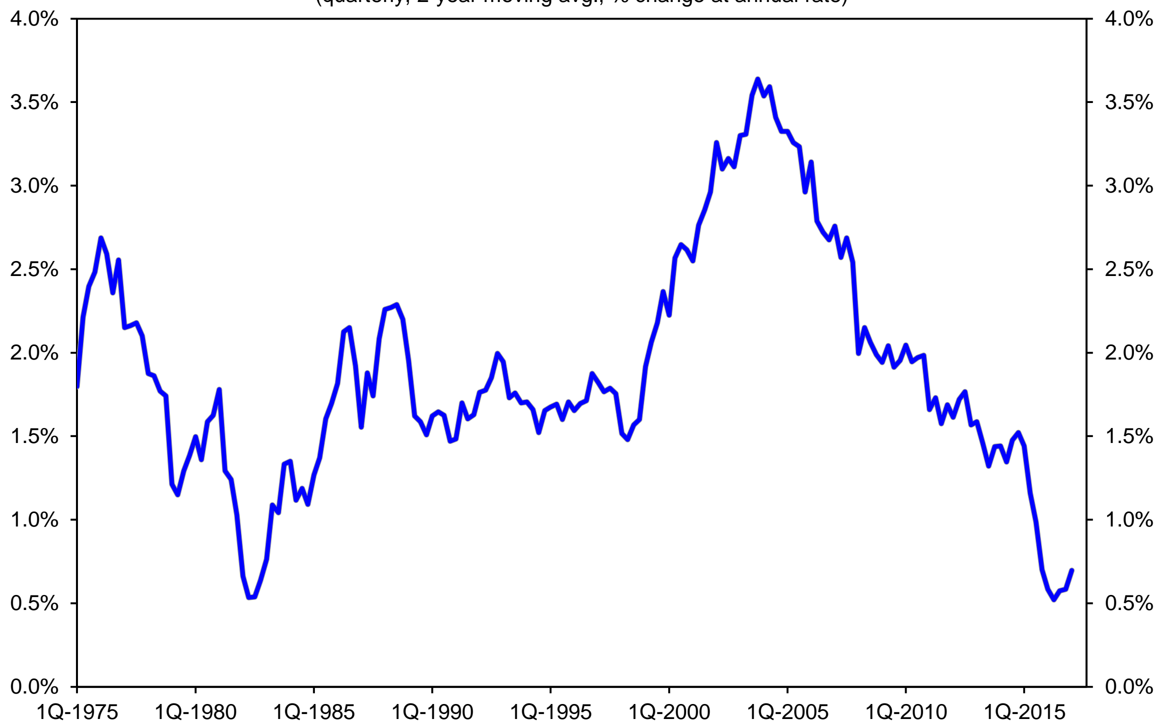
Existing companies will find profits more attractive at a 15% tax rate than they do at a 35% tax rate and thus those companies that could now be facing a lower corporate tax rate, if President Trump's plan is put into law, will do more profitable business (in part as an offset to spending less resources on tax avoidance) or they will make their existing business more profitable. Incentives do matter after all.

Each and every one of us knows that if our incentives increase we'll work harder, longer and smarter. If you don't believe me just look at the performance of people on the payrolls of government enterprises such as Post Office "workers" and Department of Motor Vehicles employees versus those entrepreneurs in businesses where pay corresponds to actual production (incentive based compensation) such as Google, Microsoft, Amazon, Apple and Tesla. Work is a lot more fun with lower tax rates.

Figure 2

Productivity as Measured by Real Output Per Hour of All Persons

(quarterly, 2-year moving avg., % change at annual rate)



U.S. Bureau of Labor Statistics

A basic measure of the incentive effects on work, output and employment of government tax and other policies is the pace of increases in overall productivity. Again, in Figure 2 below, I've plotted U.S. productivity growth from 1975 to the present. Larry Summers and others call this most recent period of extremely low productivity gains "the new normal." It's not a new normal at all! Low productivity gains are exactly what happens when economic incentives are muted and dimmed. I believe that the President's tax proposal plus what else he has also done will increase annual productivity growth by something like 1 to 2 percentage points per year over the coming decade. This productivity growth will generate more tax revenues in addition to more jobs, output and employment. With productivity increases in the 1.7 to 2.7 percentage point range, 3% GDP growth over the coming decade should be a "slam dunk." And with this type of GDP growth, tax revenues won't be a problem.

iv.) Corporate Tax Rate Cut and the Location Selection for Companies and People

One of the most basic principles of economics is that taxes don't redistribute income; they redistribute people and businesses. Among the 50 states of the United States, net in-migration *into the low tax states* way exceeds net in-migration *into the high tax states* (which in fact have really a larger out-migration). See Table 1 below.

Table 1

Tax Burden and Tax Migration among the States

2010 Tax Burden Rank (1=lowest burden)*	State	18-Yr. Cumulative Avg. AGI-Adjusted Net In-Migrant AGI ($000s)	Total AGI of 09/10 In-State Filers (In-State Filers means nonmigrants + those filing this year who didn't file last year) ($000s)	18-Yr. Cumulative Avg. AGI-Adjusted Net In-Migrant AGI as a Share of Total AGI of 09/10 In-State Filers
1	South Dakota	$783,020	$16,446,613	4.8%
2	Tennessee	$10,759,648	$109,911,657	9.8%
3	Wyoming	$1,807,690	$12,632,694	14.3%
4	Texas	$25,837,426	$446,452,021	5.8%
5	New Hampshire	$3,772,345	$33,504,596	11.3%
6	Alabama	$2,685,885	$81,059,302	3.3%
7	Nevada	$18,552,716	$51,533,333	36.0%
8	South Carolina	$14,894,551	$77,276,163	19.3%
9	Arizona	$29,755,900	$107,748,740	27.6%
	Sum ▲	$108,849,182	$936,565,119	11.6%
	Sum ▼	-$186,533,444	$2,056,241,745	-9.1%
42	Maine	$1,649,840	$25,768,148	6.4%
43	Massachusetts	-$13,529,722	$179,162,979	-7.6%
44	Minnesota	-$4,335,735	$127,833,471	-3.4%
45	Rhode Island	-$2,091,967	$23,473,916	-8.9%
46	Wisconsin	-$2,204,133	$124,870,434	-1.8%
47	California	-$55,251,641	$773,289,989	-7.1%
48	Connecticut	-$8,577,137	$103,738,552	-8.3%
49	New Jersey	-$24,070,129	$249,694,312	-9.6%
50	New York	-$78,122,819	$448,409,944	-17.4%

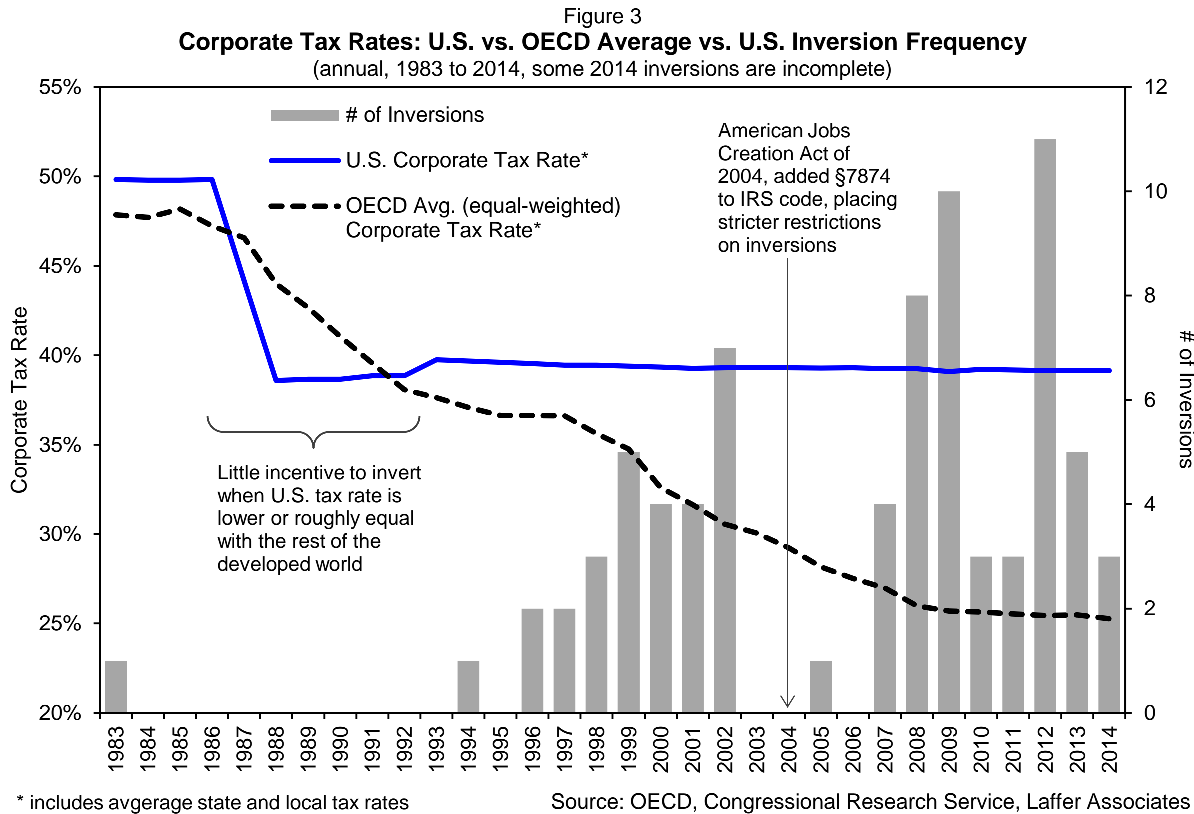
* Alaska and Louisiana (#1 and #4 lowest tax burden states) were removed from this list because of the very large share of output derived from hydrocarbon production, which skews these numbers.

Source: Internal Revenue Service, Tax Foundation, Laffer Associates

The above table, Table 1, makes it patently clear that low-tax states excel in attracting businesses and people.

For companies on a global scale, the effects are even more pronounced. Just look at the inversions of U.S. companies in Figure 3, which enumerates companies leaving the U.S. tax jurisdiction versus the highest U.S. corporate tax rate and the average of the highest OECD corporate tax rates. It's amazing and it looks like an ever-increasing stampede out of the U.S.

Figure 3
Corporate Tax Rates: U.S. vs. OECD Average vs. U.S. Inversion Frequency
(annual, 1983 to 2014, some 2014 inversions are incomplete)



* includes avgerage state and local tax rates Source: OECD, Congressional Research Service, Laffer Associates

If the U.S. were to cut its corporate tax rate *à la* President Trump's plan to 15% from 35%, inversions from the U.S. into foreign tax jurisdictions would not only disappear as they did after the 1986 tax cut (see Figure 3 above), bringing back gobs and gobs of U.S. companies' profits and jobs, but we would also attract lots and lots of foreign companies to seek U.S. domicile for tax purposes (reverse inversions), thereby adding hugely to our corporate tax base.

At present there are estimates of $2 to $3 trillion of funds (10% to 15% of U.S. GDP) held abroad and poised to return if only tax conditions were favorable.

If these U.S. profits domiciled abroad were repatriated, not only would there be a large foreign inflow of reported profits for tax purposes, but the income, output, employment and production effects of such massive capital inflows could well be highly material. For example, the return flows of capital, jobs and income would flip some people and companies who currently receive government assistance payments into becoming income-tax-paying people and companies. Transfer payments to "needs-," "income-," "means-" and "employment-" tested people would fall, as would corporate welfare payments. Just think how much money could be saved—especially over longer periods of time.

The unemployed would get jobs. And over time they would become more and more employable.[5] They would acquire skills and self-confidence. And, as time passes, these once-upon-a-time-unemployed people would actually earn good livable wages and become productive contributing members of society. Hell, even if the corporate tax cut didn't reduce the deficit, creating more jobs and eliminating some poverty would make America a far better place to live. It reminds me of Bobby Kennedy's quote "I see what is happening and I ask why? And then I imagine what could happen and I ask why not?"

These corporate and profit location effects will, in short order, be very large and quickly aggregate over time. In my opinion, after a year or two at most, this "inversion" capital location effect would, in and of itself, way more than offset any revenue losses.

[5] Dr. Arthur B. Laffer, "The Minimum Wage is Holding Our Country Back," Laffer Associates, July 21, 2016.

v.) Corporate Tax Rate Cuts and Other Tax Revenues

A final direct point I need to make here is that corporate tax revenues are not the only tax revenues to be impacted by a cut in the corporate tax rate. In fact, with robust economic growth, you would soon see higher employment, higher wages, more sales, more homes built, and, as a consequence, you would also see higher payroll taxes, higher personal income taxes, higher sales taxes and higher property taxes, all as a consequence of the drop in the highest corporate tax rate.

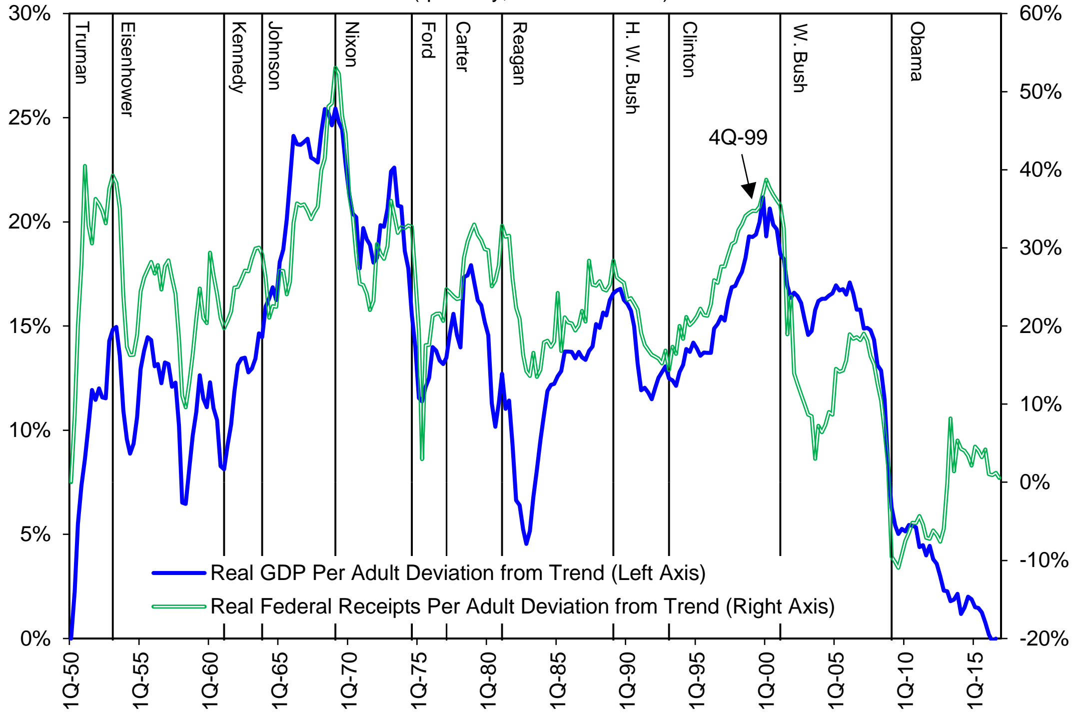
Higher output employment and production would also increase corporate profits and stock prices and thus investments. The unfunded liabilities of pension funds would drop for state, local and the federal government and private businesses. Individual savings would appreciate in value and so would the returns to investors in either "fixed" income or equity assets. Government spending items such as welfare and supplemental income would fall, tax revenues would rise. What's wrong with that?

These secondary, tertiary and quaternary tax revenue increases as well as higher earnings will be very large in relation to the tax cuts.

To show my point, I have plotted two versions of detrended real GDP per adult and detrended real federal tax receipts per adult from the 1st quarter of 1950 to the present in the figures on the next page: The reason for two identical charts save for the scale of each series is to show i.) just how closely the series are correlated (Figure 4) and ii.) the hypersensitivity of tax revenues to economic growth—the magnification effect of growth on tax revenues (Figure 5). The bottom line is that economic growth is the key driver of magnified tax revenues, and low tax rates, deregulation, sound money and freer trade are the key drivers of growth. High and rising tax rates smother economic growth and drive tax revenues down. Now what's so hard to understand about that?

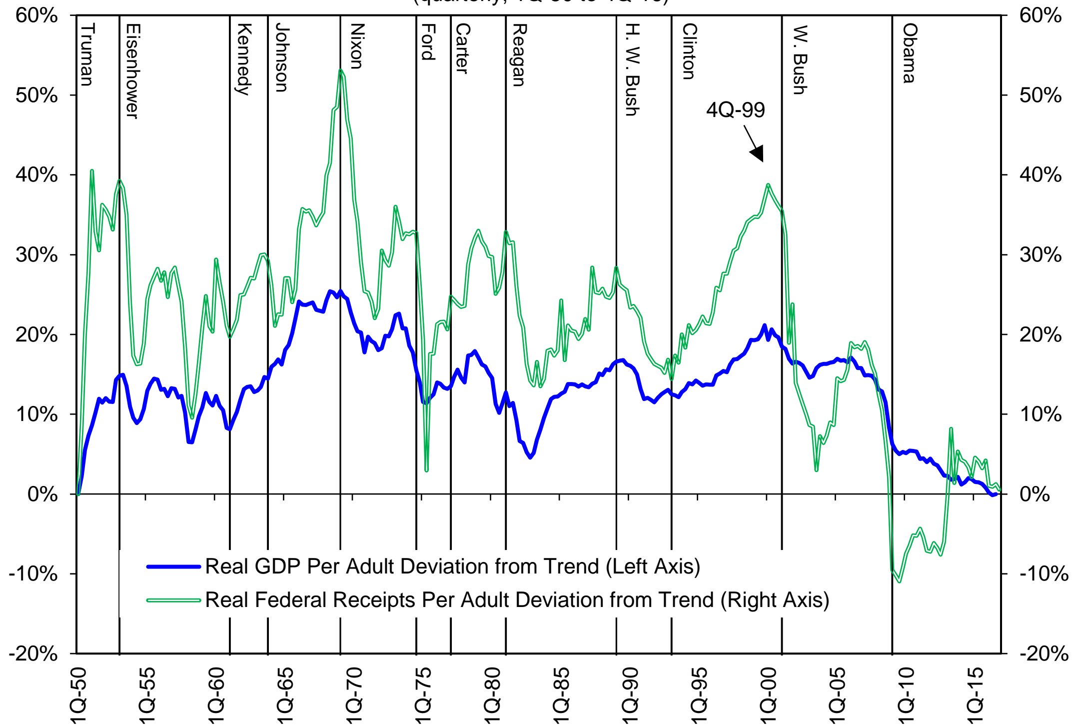
Same Tax Revenue and Economic Growth Data, Displayed Two Different Ways…

Figure 4
Version #1: The Correlation Effect between Tax Revenues and Economic Growth
(quarterly, 1Q-50 to 4Q-16)



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Laffer Associates

Figure 5
Version #2: The Magnification Effect of Growth on Tax Revenues
(quarterly, 1Q-50 to 4Q-16)



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Laffer Associates

As you can see, the primary driver of tax revenues is economic growth. Of course, we all know that if tax rates were zero there would be no tax revenues irrespective of growth. Likewise, if all tax rates were over 100%, there would be no output and thus no tax revenues either. What we're focusing on here is what the economic and budget responses are within the range of existing experience. Yes, tax rates do have an effect on tax revenue but not the effect the "thirty second sound bite" hacks and political spinners would have you believe. In the range of taxation of the U.S. for the past 70 or so years, increases in marginal tax rates affect growth in GDP in a negative fashion and that falling GDP growth in turn affects tax receipts also in a negative direction. The bigger the tax cut in marginal tax rates within reason, the faster the U.S. economy grows, and the greater the increase in magnified tax receipts will be (the less entitlement spending will be) and the better off our country will be. Even as long ago as 1979, Irving Kristol, in a *Wall Street Journal* editorial quoting Senate Finance Committee testimony by Reg Jones, the CEO of General Electric, understood:

> *...that we have had 11 tax cuts since World War II and that, in 10 out of those 11 cases, government revenues increased within a year. In the eleventh case—1948—it took two years for that to occur.*[6]

From 2010 through 2015, the U.S. top corporate tax rate was the highest in the OECD (35 countries), at 39%, and the U.S. had the 9th lowest average corporate tax revenues as a share of GDP (see Table 2). While every OECD country has a lower average top corporate tax rate than the U.S. has, those countries that have lower revenues are the likes of Hungary, Latvia, Slovenia, Estonia, Greece, Turkey, Poland and not surprisingly, Germany. Also, not surprisingly, Germany's average top corporate tax rate is the 6th highest in the OECD and only a few years ago Germany's highest marginal corporate tax rate had been the highest in the OECD. The Germans have the Laffer Curve to end all Laffer Curves.

Table 2
OECD Member Countries: Corporate Income Tax Rates and Tax Revenues as a Share of GDP[7]

Country	Corporate Income Tax Rate (%, 2014)	Country	Corporate Income Tax Revenues % GDP (2013)
United States	39.08	Norway	8.8
Japan	36.99	Australia	4.9
France	34.43	Luxembourg	4.8
Belgium	33.99	New Zealand	4.4
Germany	30.18	Japan	4.0
Australia	30.00	Czech Republic	3.4
Spain	30.00	Korea	3.4
Luxembourg	29.22	Israel	3.2
New Zealand	28.00	Italy	3.2
Italy	27.50	Belgium	3.1
Norway	27.00	Canada	3.0
Israel	26.50	Switzerland	2.8
Canada	26.20	Denmark	2.7
Greece	26.00	Sweden	2.6
Austria	25.00	France	2.5
Netherlands	25.00	Finland	2.4
Denmark	24.50	Ireland	2.4
Korea	24.20	United Kingdom	2.4
Sweden	22.00	Austria	2.2
Switzerland	21.15	Iceland	2.2
Estonia	21.00	Spain	2.0
United Kingdom	21.00	Netherlands	1.9
Finland	20.00	Turkey	1.9
Iceland	20.00	United States	1.9
Turkey	20.00	Germany	1.8
Czech Republic	19.00	Greece	1.3
Slovenia	17.00	Slovenia	1.2
Ireland	12.50	Estonia	0.3

[6] Irving Kristol, "Populist Remedy for Populist Abuses," in *The Economics of the Tax Revolt*, ed. Arthur B. Laffer & Jan P. Seymour, p. 52, 1979.
[7] The table shows the U.S. vs. International: Highest Statutory Combined Corporate Income Tax Rate (Federal, State and Local) and Corporate Income Tax Revenue (again Federal, State and Local) as a Share of GDP. Note: We chose to examine countries that are members of the OECD. We were not able to display results for OECD member countries Chile, Hungary, Mexico, Poland, Portugal and the Slovak Republic due to the OECD missing Corporate Income Tax Revenue data for these countries.

Who in their right mind honestly believes that if we made our highest corporate tax rate more in line with other OECD countries or even more competitive than most OECD countries, that our corporate tax revenues would actually go down and become even further below the mainstream of other countries? If the U.S. lowered its corporate tax rate, based upon the rankings of the OECD, the U.S. would get higher corporate tax revenues as a share of U.S. GDP. It's math, not fantasy or factless ideology. To quote John Maynard Keynes:

> *Nor should the argument seem strange that taxation may be so high as to defeat its object, and that, given sufficient time to gather the fruits, a reduction of taxation will run a better chance than an increase of balancing the budget. For to take the opposite view today is to resemble a manufacturer who, running at a loss, decides to raise his price, and when his declining sales increase the loss, wrapping himself in the rectitude of plain arithmetic, decides that prudence requires him to raise the price still more—and who, when at last his account is balanced with nought on both sides, is still found righteously declaring that it would have been the act of a gambler to reduce the price when you were already making a loss.*[8]

Over the period 2003 through 2012, quite a few countries in the G20 (a subset of the OECD) actually made material changes in their highest corporate tax rate. For example, Canada cut its highest corporate tax rate from 36% (2003) to 25% (2012) and Canada's tax revenues as a share of GDP rose from 3.15% to 3.29% respectively. Canada then reversed their corporate tax rate policy and raised the highest corporate tax rate in 2015 and tax revenues fell. Ouch!

Japan cut its highest corporate tax rate from 40.9% in 2003 (its rate in 2003 was tied for the highest in the OECD) to 32.1% in 2015, and corporate tax revenues as a share of Japan's GDP rose from 3.3% to 4.26%. How's that strike you, Mr. Static Green Eyeshade Accountant?

Portugal raised its highest corporate tax rate from 26.5% in 2010 to 31.5% in 2012 with no noticeable effect on corporate tax revenues as a share of GDP, but then reversed direction and cut their highest corporate tax rate back down to 29.5% in 2015 and tax revenues rose from 2.75% to 3.16% of GDP. Still, over the whole period 2010 to 2015, Portugal raised its tax rate and tax revenues did go up. Sweden was yet another country to cut its highest marginal corporate tax rate from 26.3% in 2012 to 22.0% in 2015 and revenues rose from 2.57% of GDP to 2.99%.

All in all, looking exclusively at corporate tax revenues and the highest corporate tax rate, the evidence of corporate tax rates in the OECD or its subset the G20 relative to the tax revenue share of GDP by country is not strong, but it most definitely does not support the notion that a cut in corporate tax rates leads to a decline in tax revenue. In fact, if there is an effect, it's most likely that a drop in tax rates increases tax revenues and a rise in rates lowers tax revenues.

vi.) A Federal Corporate Tax Rate Cut and State and Local Tax Revenues

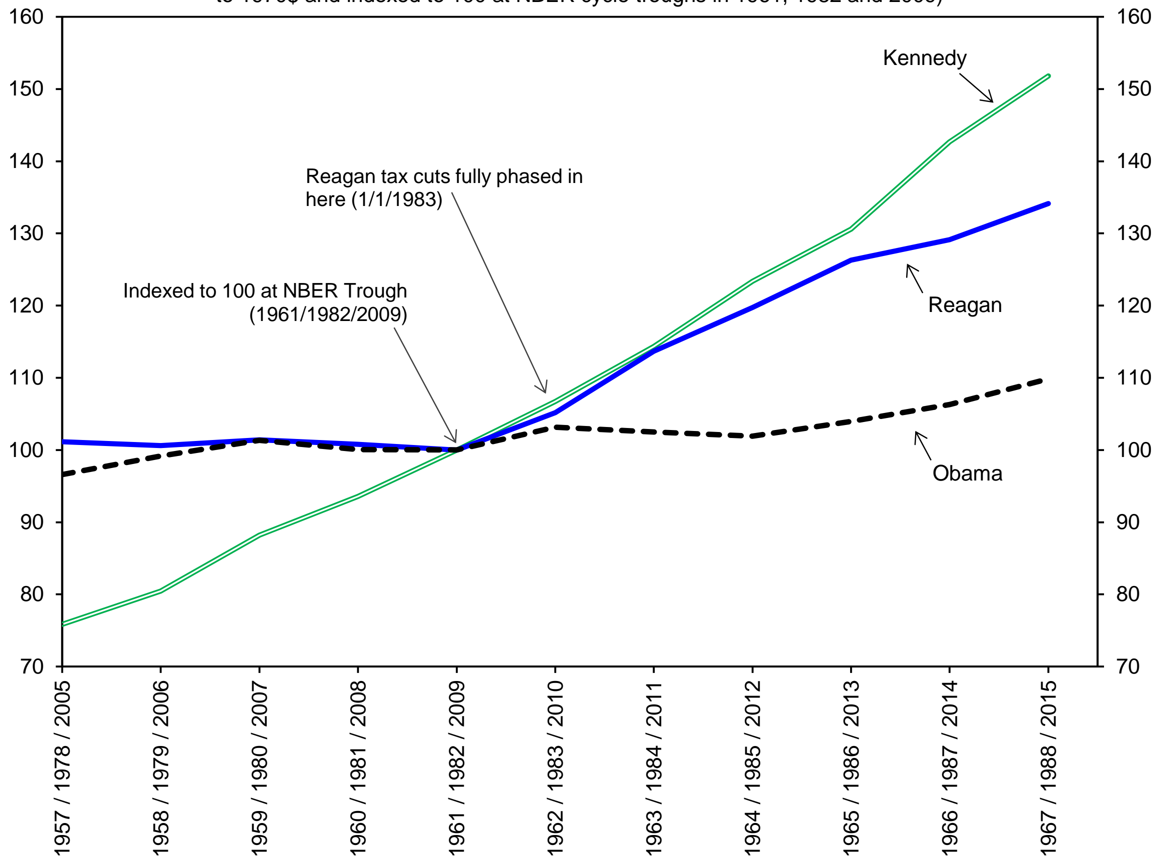
Another point that needs to be made is the affect a cut in the Federal highest corporate tax rate would have on state and local tax revenues. In Figure 6, I've plotted state and local tax revenues for the Kennedy, Reagan and Obama periods. Presidents Kennedy and Reagan enacted some of the most aggressive pro-growth tax rate cuts in U.S. history while President Obama was a buzz-killing tax-rate-increasing President. Just look at this state and local tax revenue chart carefully and imagine what could be (Figure 6).

[8] John Maynard Keynes, "Keynes and the Laffer Curve," Adam Smith Institute, January 4, 2011. http://www.adamsmith.org/blog/tax-spending/keynes-and-the-laffer-curve

Figure 6

Real Total State & Local Government Receipts under Kennedy, Reagan and Obama

(annual, Kennedy: 1957-1967, Reagan: 1978-1988, Obama: 2005-2015, deflated with GDP price index to 1970$ and indexed to 100 at NBER cycle troughs in 1961, 1982 and 2009)



Source: U.S. Bureau of Economic Analysis, NBER

If state and local government receipts had grown under President Obama at the rate they grew under President Reagan, 2016 state and local receipts would be $2,906 billion instead of $2,325 billion, or $581 billion (25%) greater.

B. <u>Other Features of the Total Trump Package Summarized</u>

All told, in addition to the changes in the tax treatment of U.S. corporations, the rest of President Trump's economic growth package makes lots of sense as well. Literally every aspect of Trump's plan on a conceptual basis should enhance growth, increase employment and augment wealth.

i.) <u>The Estate Tax</u>

I'm especially taken by the elimination of the estate tax. I know of no tax more immoral and contrary to the principles of sound economics than the estate/inheritance or what they call the "death tax." Anytime you have a high tax rate on a small tax base you know bad things will happen, which describes the death tax to a "T." Rich people shelter their estates in all sorts of ways to avoid paying death duties that only benefit estate lawyers. For the government there's no money in the estate tax, and the only benefit appears to be some pandering to green-eyed jealous people.

As it stands today, a person can take his or her after-tax income and go to Vegas and gamble, drink, smoke and carouse, and as far as my government is concerned, God bless that person; it's their money to do with as they please. But Heaven forbid if that same person takes that money and gives it to his grandchildren—then the government taxes those funds up to 35%. The death tax is morally repugnant and economically counterproductive.

ii.) <u>The Obamacare Add-On Unearned Income Tax</u>

With all of these tax reforms—especially the elimination of the 3.8% add-on unearned income tax embedded in the Obamacare legislation—there should be a sharp increase in asset values even in a static world. Think of it—a dividend earner paid from a company stock now has to pay an additional 3.8% tax on those dividends. Adding the highest marginal income tax rate of 39.6% to the add-on tax of 3.8% means that the total tax is 43.4% (forget payroll taxes including the additional Medicare add-on payroll tax and state and local taxes, which would only make matters worse).

Now, as we all know, people don't invest to go broke or to pay taxes; they invest to receive an after-tax return on their investments. Therefore, the value of an asset is the discounted present value of those expected after-tax returns. Thus, for the investor, the after-tax return today is 1 minus 0.434 (the total tax rate) which equals 0.566 of the investment's gross returns (I'm not even considering corporate or other taxes). And it is that 0.566 that determines the asset's value.

When Trump's plan passes, that 0.566 rises to 0.65, which means that asset values—by the President's proposed tax cut alone—should rise by some 15% *per se*. On a Down Jones Industrial Average of some 21,000 that would be an increase of over 3,000 points. Not too shabby! Add on to this the corporate tax rate cut and the other features of the President's plan and you'll have a mini stock market boom.

iii.) <u>The U.S. National Debt</u>

And this leads to another serious point: U.S. federal debt is at all-time highs which could well inhibit overall economic growth. Budget deficits are projected to continue for as far as the eye can see. Today's national debt is around $17½ trillion and rising by some $700 billion each year. That's a lot of money but <u>not</u> an insurmountable amount of money. The question so many people ask is: how on earth can President Trump propose all these tax cuts when debt is so high and rising so rapidly? And the simple answer, of course, is that you can't balance the budget on the backs of the unemployed, the underemployed or the out-of-work. Without much higher economic growth there is no debt solution.

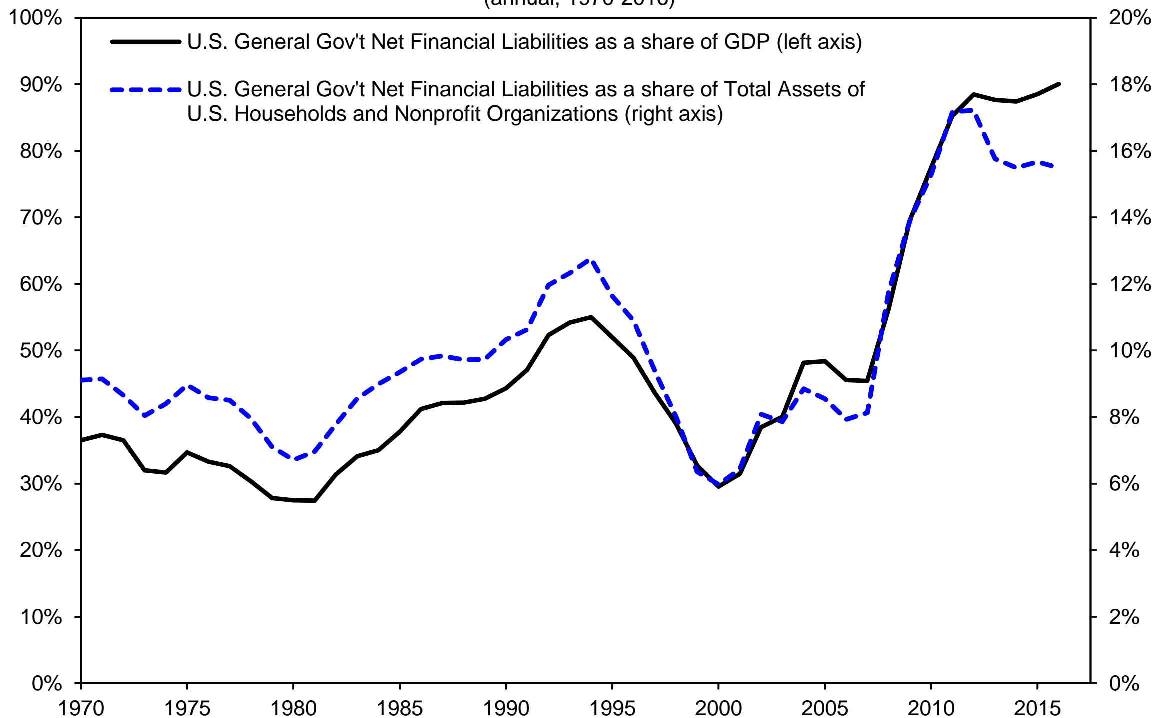
Let's first look at the premise that our national debt is too high and requires immediate higher tax rates to redress. Relative to annual GDP, the federal net debt is inching up on the 100% mark. This is a recent 70 year high. But federal debt as a share of GDP is not the sole proper measure of debt. In fact, conceptually, debt should more appropriately be compared to wealth, and debt service should be compared to income: i.e. flows should be compared to flows and stocks to stocks.

The correct measure to evaluate the potential harm of federal debt should for sure include our nation's net wealth. A person who makes $100 thousand per year and has a debt of $250 thousand is in terrible shape unless he also has assets of $400k or more—like a home. Debt and debt service should be viewed in terms of both income and wealth. And, as such the U.S. can, should and must handle its debt in the proper perspective. Since President Trump took office, for example, the national debt has risen some $200 billion even before any of his priorities have been enacted or taken effect. U.S. wealth, however, has risen by well over $3 trillion, and that's a trade-off I'll take every day of the week and twice on Sunday. Just look at Figure 7 below and compare net government debt to GDP and U.S. net wealth.

Figure 7

U.S. General Government Net Financial Liabilities: As a Share of U.S. GDP vs. As a Share of Total U.S. Assets of Households and Nonprofit Organizations

(annual, 1970-2016)



Source: U.S. Bureau of Economic Analysis, OECD, U.S. Federal Reserve, Laffer Associates

We have time to bring our debt burden under control. But we must do it with economic growth.

iv.) A Note of Caution and Hope

There are two last points I'd like to leave with you. First, life is a marathon, not a sprint. Take a deep breath and calm down. Trump's plan is great for the time path of a prosperous America, so don't get you knickers in a twist. The sooner the Trump plan is passed and signed into law and the longer the Trump plan is in place, the greater its impact on output employment, prosperity and yes, even budget solvency.

The second point I wish to make is specifically about me. I am great at forecasting the past and reporting those results with great confidence. The future, however, is a great deal more difficult for me to forecast, and, as such, I have a lot less confidence in forecasting the future than I do the past. But, all things considered, I have never felt better about the future of the U.S. economy and the budget than I do today. Thank you and good night.

-Arthur B. Laffer

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