A Growth Agenda for the New Congress

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For now: Extend the Bush tax cuts, repeal ObamaCare, support free trade. After 2012: Enact a flat tax, stabilize prices, balance the budget, give politicians incentive pay.

By ARTHUR LAFFER

Since its cyclical zenith in December 2007, U.S. economic production has been on its worst trajectory since the Great Depression. Massive stimulus spending and unprecedented monetary easing haven't helped, and yet the Obama administration and the Federal Reserve still cling to the book of Keynes. It's an approach ill-suited to solving the growth problem that the United States has today.

The solution can be found in the price theory section of any economics textbook. It's basic supply and demand. Employment is low because the incentives for workers to work are too small, and the incentives not to work too high. Workers' net wages are down, so the supply of labor is limited. Meanwhile, demand for labor is also down since employers consider the costs of employing new workers—wages, health care and more—to be greater today than the benefits.

Firms choose whether to hire based on the total cost of employing workers, including all federal, state and local income taxes; all payroll, sales and property taxes; regulatory costs; record-keeping costs; the costs of maintaining health and safety standards; and the costs of insurance for health care, class action lawsuits, and workers compensation. In addition, gross wages are often inflated by the power of unions and legislative restrictions such as "buy American" provisions and the minimum wage. Gross wages also include all future benefits to workers in the form of retirement plans.

For a worker to be attractive, that worker must be productive enough to cover all those costs plus leave room for some profit and the costs of running an enterprise. Being in business isn't easy, and today not enough workers qualify to be hired.

But workers don't focus on how much it costs a firm to employ them. Workers care about how much they receive and can spend after taxes. For them, the question is how the wages they'd receive for working compare to what they'd receive (from the government) if they didn't work, plus the value of their leisure from not working.

.The problem is that the government has driven a massive wedge between the wages paid by firms and the wages received by workers. To make work and employment attractive again, this government wedge has to shrink. This can happen over the next two years, even with a Democratic majority in the Senate and President Obama in the White House, through the following measures:

1) The full extension of the Bush tax cuts. The Republican-controlled House of Representatives can write legislation extending all the tax cuts in perpetuity. Of particular importance for employment is keeping the highest personal income tax rate at 35%, the capital gains tax rate at 15% and the dividend tax rate at 15%, while eliminating the estate tax permanently. If the Senate blocks this legislation or Mr. Obama refuses to sign it, House Republicans should hold firm and let voters decide in 2012. (My guess is that he'll sign it or have his veto overridden.)

2) The full repeal of ObamaCare, which allows individuals to pay only five cents for each dollar of health care. Who do you think pays the other 95 cents? As former Sen. Phil Gramm notes, if he had to pay only five cents for each dollar of groceries he bought, he would eat really well—and so would his dog. No single bill is more antithetical to growth than ObamaCare.

Repeal could take the form of Michele Bachmann's Legislative Repeal Act, and if it is blocked in the Senate or by a veto Republicans should continue bringing it up every six months. Come 2012 the public will have a clear view of what congressional candidates stand for. The end game for U.S. prosperity is the election in 2012.

3) The cancellation of all spending that punishes those who produce and rewards those who don't. This is really the distinction between demand-side economics and supply-side economics. Stimulus spending and quantitative easing don't make it more rewarding to work an extra hour. If the government pays people not to work and taxes people who do work, is it really so difficult to see why employment is so low?

So the government should sell its stakes in public companies acquired via TARP, sell government-run enterprises that lose money (e.g., Amtrak and the Postal Service), end farm subsidies that pay people not to farm, cancel the rest of the stimulus and return all spending programs to their pre-stimulus levels. Congress should also continually examine spending in Afghanistan and Iraq. And it should return the duration of unemployment benefits to the standard 26 weeks, from the current 99 weeks.

4) The enactment of stalled free trade agreements with South Korea, Colombia and Panama.

These changes would spur recovery, but they are just the start. Elected officials should offer longer-term measures that voters can judge in 2012, when 33 senators—including 21 Democrats, two independents who caucus with the Democrats, and 10 Republicans—as well as the entire House and President Obama are up for re-election.

Beyond 2012, the ideal growth agenda would include:

1) A true flat tax, a la Jerry Brown's proposal in 1992. Congress should replace all federal taxes (except sin taxes) with two flat-rate taxes, one on personal income and one on net business sales. The personal income tax would be on all forms of income: wage income, dividends, inheritance (as proposed by Democratic Rep. Jared Polis), and all capital gains. This tax code would remove loopholes and almost all deductions, and the static revenue rate would be around 11.5%.

2) Price stability. Congress should revise the Federal Reserve's mandate, making it serve only the goal of price stability (and not also full employment). In addition, the Fed should follow a monetary rule, targeting either the quantity of money or the price level. There can be no prosperity without price stability.

3) Passage of a balanced budget amendment, without raising taxes. This would prevent government from being able to balance its budget by unbalancing the budgets of its citizens. And it would force politicians to make difficult decisions about what spending is worthwhile, just like the rest of us.

4) Finally, saving the best for last, the mother of all supply-side reforms is incentive pay for politicians (which the comedian Jackie Mason called "putting the politicians on commission"). Politicians must be held personally responsible for their actions. In business, firms align the incentives of decision makers with the incentives of shareholders to ensure that they take the best course of action. Washington must begin doing the same by creating an incentive structure that pays elected officials according to factors such as stock market performance and economic growth.

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