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LAFFER CURVE PERFORMANCE

Speaker: ARTHUR B. LAFFER*

o Discussion of performance over the last eight years, emphasizing the effect of recent market volatility on pension plan assets.

MR. GARY CORBETT: Dr. Laffer is a member of the Economic Policy Advisory Board to the President. He is also a member of the policy committee and the board of directors of the American Council for Capital Formation in Washington, D.C. In addition, he is editor of the Marcel Decker series on Economics, Finance and Business and a contributing editor of the *Conservative Digest.* From 1972 to 1977, he was a consultant to the Secretaries of Treasury and Defense. He served as an economist, Office of Management and Budget, from 1970 to 1972. Dr. Laffer has also held teaching positions at Pepperdine University, the University of Southern California and the University of Chicago. He has received numerous awards and honors for his teaching excellence and his work in the financial analysis field. He is the founder and chairman of A.B. Laffer Associates, an economic research and financial consulting firm, headquartered in Lomita, California.

DR. ARTHUR B. LAFFER: One nice thing about being at the University of Chicago, by the way, was whenever you followed Milton Friedman at the podium, you didn't have to lower the microphone that much. I prepared a very special talk for you in great detail. I prepared my GNP forecast for the rest of the decade, in fact, on into the 1990s. I've done it on a quarterly basis, by each of the GNP accounts, all seventy-eight of them, to the sixth decimal place to really show you the conviction of my own analysis. And Gary asked me not to read the computer output to you; in fact he asked me to talk a little bit about politics and economics. Do any of you mind, by the way, if I don't read that computer output? And talk a little bit about politics and economics? Because, you know, if you look at economics from my perspective, it's terrific fun. I mean theoretically it's great sport, and it's lovely and entertaining. But if you want the practical side of the world, really, politics is where the economics is applied. It's sort of literally where the rubber hits the road; it's the practical application of economics.

I don't usually admit this in southern California, but I was not actually born and raised here. In fact, I was born and raised in a place called Cleveland, Ohio. Do any of you know Cleveland? Do you remember the story about the legendary Clevelander? Seriously. This guy was born in Cleveland, he lived there for twenty years and on his 20th birthday, he moved to Pittsburgh. He lived there for twenty years and on his 40th birthday, he moved to Philadelphia. He lived there for twenty years and on his 60th birthday, he moved to Baltimore. He lived in Baltimore for twenty years and on his 80th birthday, he moved to

* Dr. Laffer, not a member of the Society, is President of A.B. Laffer Associates in Lomita, California.

Washington, D.C. Uunfortunately, he lived in Washington, D.C., only ten years because on his 90th birthday, this poor fellow died, and he went straight to hell. But, you know, he didn't notice the difference, the change was so gradual.

Let me, if I can, pull you back a few steps and let you look at what's been happening over the last seven or eight or nine years in this country. If you go back to the late 1970s and the early 1980s, the United States went through an economics revolution of sorts. This revolution transcended all previous economics. The notion underlying the revolution was a very simple notion, that people like doing things they find attractive and they're repelled by things they find unattractive. Incentives were the key. And the basic notion underlying this theory was that the government can, through its policies, affect the attractiveness of activities.

For example, if the government makes an activity more attractive, people will tend to do more of that activity. If they make an activity less attractive, people will tend to do less of that activity. If you think of it in my area of economics, it's very simple and straightforward. In general, in my area, if you attack an activity, you tend to make that activity less attractive and people tend to do less of that activity. If you subsidize an activity, you tend to make that activity more attractive and people do more of that activity. If you look at U.S. economic policies, prior to this revolution, you could see we've been doing basically two things in America. We've been taxing work, output and employment, and we've been subsidizing nonwork, leisure and unemployment. It should come as no shock that we've been getting so little work, output and employment, and so much nonwork, leisure and unemployment.

If you think of the changes here, and you know, I don't like to brag about southern California, but it really started here in southern California with Howard Jarvis and Paul Glenn. Do any of you remember Proposition 13? I mean effectively, what did they do? They allowed people to keep their own homes. I know that's a shocking concept of politicians, but do any of you remember Bill Stiger and Senator Hanson? The Stiger/Hanson amendment cut the capital gains tax rate. It allowed the entrepreneurs, the creators, the developers, to keep part of the profits that they made for the rest of society. Ronald Reagan, in cutting income tax rates across the board, effectively allowed people to keep part of their own income, much to Teddy Kennedy's chagrin, by the way. All of you are aware of Teddy Kennedy's proposal last year on the flat tax. He had a very simplified flat tax; in fact his was truly a flat tax and truly simplified. In fact, his tax return had only two lines. The first line was, how much did you make? The second line was, send it in. As some of you are aware, by the way, they have transition rules in there. He had a very simplified transition as well. It just said, "except for the Kennedys."

But if you look at what's happened here, in this country the highest tax rates on personal income have dropped from 70% to 28%. Corporate income has dropped from 46% to 34%. If you go back to pre-Stiger and Hanson, 49 1/2% on capital gains is down to 28%, with a little interlude there at twenty, and is now back up again. If you look at the effects of inflation, underdepreciation, and inventory evaluation, the tax rates are more affected than even that. If you look at state and local taxes, major changes in rates are there as well. Do any of you remember what the prime interest rate was before Reagan came into office? What was it -- 21 1/2%? Do you remember what inflation was? I mean, before kids got into school they knew log tables just to figure out prices. If you've looked at employment growth in the last five years, we've had 15% growth in employment, averaging 3% per year. My view is, we've had a lot of successes, but there's been a few failures, as well.

In fact, some fairly substantial failures, and I don't want to belabor those to get you in a bad mood or anything, but there was sort of an assessment required of me here, and I'd like to discuss some of the real problems and shortcomings of this administration and what's happened. Are all of you aware of the budget deficit? You've heard of that? You know when you look at it, I apologize for these numbers. And all of you who are actuaries know how to deal with numbers, which is a real advantage on this earth. But there's some real problems worrying about the federal budget numbers -- billions and trillions of dollars. What is the national debt now -- $2.3 trillion? Bill Safire of the *New York Times* refers to these numbers as *MEGO* numbers, which he claims, stands for "My Eyes Glaze Over." And when you look at the size of these numbers, they really are mind-boggling. It's really hard to bring them down to personal terms. But when you look at our national debt, which is really the accumulation of deficits, our national debt today stands at approximately 50% of GNP. Try to put it into personal terms. If you knew someone who had a stable steady income of $100,000 a year and that person had a total debt, including mortgage, of $50,000, would that guy be in deep trouble? I think not.

There's been a huge increase in the national debt during this administration, which is a serious problem. But when you think about the national debt and the deficits, in terms of the overall economy, I don't think it's something that's going to stop the economy cold in its tracks. If you look at it, that ratio has been rising over the last six years; it shouldn't have risen, but it has. But if you go back to the early 1950s -- back then the national debt was about 87% of GNP. It fell very sharply to about 42%, and since then it's been going up. It's way too high, but my view is the national debt, and even the deficit as it now stands, is not the real problem. It is what politicians might do with these types of numbers. And I'm sure you're all not terrified of politicians as I am, but I view these people as a group who invariably prefer complex error over simple truth.

Let me try to put the deficit into perspective for you, at least from the standpoint of how I look at the national deficit. Let me just ask a rhetorical question. Can I ask you seriously what the difference is between taxing the money from you or borrowing it from you with a promise never to repay? I mean honestly, if you think about the deficit, the deficit really isn't the problem. The issue is not how they take the money from you -- the issue literally is whether they take the money from you. To me, the problem of the Macro economy is not the deficit, but it is total government spending. What has happened during this administration is that while the tax rates have been cut dramatically, total federal, state and local tax receipts, as a share of GNP, have actually risen from 1983 on. In fact today, tax receipts as a share of GNP are higher than they've ever been, using the national income and product accounts basis. There's been no shortfall in revenue. GNP growth has been extraordinarily large. Tax revenues have gone up. The problem has not been the tax receipt side of the equation; the problem, literally, has been government spending. During this boom time period, government spending as a share of GNP has increased dramatically.

My view and my fear is that you're going to let some of these intellectuals in. By the way, being a PhD and having taught at the University of Chicago and elsewhere, I adhere to Irving Crystal's line when he said, "It takes a PhD in Economics not to be able to understand the obvious." Do you know David Stockman? Do you know the Peterson model? They say these deficits are so far out of line that we just have to raise taxes. And the notion is that that will solve the deficit.

Well, think of the problem as I do, it being government spending and not the deficit. Let's go the full Stockman-Peterson route and really raise taxes. And let's raise them $100-$150 billion a year. How many of you honestly believe that if we raise taxes by $100 billion per year, the federal budget deficit would decline by $100 billion per year? If you give spendthrifts more money, they don't spend less, they spend more. My view is that if you're worried about spending, just don't give them the money. The real problem, as far as I can tell on the budget deficit side, is not the deficit, again it's government spending.

The real problem we face is looking at a political solution to a false problem. I don't think you're going to see that happening. I think what's happened is that the ghost of Howard Jarvis and the ghost of Ronald Reagan exist in the political halls. When I looked at the election results of this primary campaign, I watched Bob Dole go down in New Hampshire by the hint, the smell of raising taxes. I watched the press handling Babbitt. They said, "Here is a guy who calls it the way it is. He's honest, honorable and he tells it the way it really is." Now there's no question he's honest and honorable. And there's no question at all that he tells it the way he sees it. But then the press goes on to say that the electorate of America won't elect an honest politician; that's their conclusion. Well, when you really think of Babbitt, his solution invariably is to raise taxes, which is always the wrong answer. I'd much rather have some shady character, who with luck, might get the right answer, than I would someone who is always guaranteed to be wrong.

I think the electorate was perfectly correct about John Glenn. I don't mean to keep picking on Ohio, but it is my home state. John Glenn (he's a former astronaut, a marine, and he's tough as nails) stood up there when he was running for president and he said, "Ladies and gentlemen, I'm going to tell you the way it is. I'm going to tell you what I'm going to do. This deficit is out of hand and I'm going to raise your taxes, and I'm going to raise them a lot." That was the last day he got a vote. You know, the only person he convinced was Walter Mondale.

Politically, I don't think you can have that. In fact, I guess it's very clear to all of you that I'm an unabashed Ronald Reagan fan. You don't have to like everything about him, but jobs are nice, there is low inflation, and low interest rates. You may not think of Ronald Reagan as I do -- as a genius. Some of you may think that he's just lucky. But whatever it is, you have to admit that his one unique characteristic is his uncanny ability to select his four predecessors. Anyone following on the heels of Johnson, Nixon, Ford and Carter can't look bad.

Let me just talk about the other big problems. You refer to them as twins. They aren't literally twins, but they're closely related. You're all aware of this budget deficit. In fact, have you ever heard anyone describe the budget deficit in good terms? Back east you hear it in very ethnic terms. They don't show a nice French face when they talk about the trade deficit. They don't show a nice German or English face; it's always an oriental face. You know the group I'm talking about -- these people who work hard. They never take a vacation; they never have any leisure, and they save all of their income. These horrible people are just going to outproduce us everywhere. They start factories in Ohio -- at least our movies tell us -- they don't even allow a beer break.

You're all aware of this trade deficit problem. It's just incomprehensible. Have you ever heard anyone say anything nice about the trade deficit? I'm not going to start you off with saying something nice. My view is the trade deficit is not nearly large enough. I'd love to see it really large. All of you work in the real world, and I've been in fuzzy academics all my life. But let me try giving you a real world example. When you look at a growth company, does a growth company lend money or borrow money? A growth company borrows money, doesn't it? Well extend the analogy one step further. Does a growth country lend money or borrow money? Think of it in terms of the basics of supplies and economics. There are two locations -- Location A and Location B. You cut tax rates in B, and you don't cut them in A. Producers and manufacturers will try to move from A to B.

Think about what happened in the last administration, what's happened the last six or seven years. Did Ronald Reagan cut tax rates dramatically? We had property tax cuts, inflation came way down, interest rates fell sharply, and there was a huge increase in the aftertax rate of return on U.S. located assets. Foreigners, seeing an enormous increase in the huge aftertax rate of return on U.S. assets, tried to get their share of the investments here in the United States. How can foreigners get the dollars to buy U.S. located assets? There are only two ways they can do it. They have to sell more goods to us and they have to buy less goods from us. Our trade deficit is nothing more and nothing less than our capital surplus. Now you tell me -- would you prefer to have investors lined up on our borders, trying to get into your country or trying to get out of your country? What we have done is create such an investment environment, that our trade deficit, which is our capital surplus, has been the attraction of foreigners from the rest of the world into this country. Far from being a problem, what they've done is provide us with the real resources to increase our output, employment, and productivity.

There's no problem with the trade deficit at all. In fact, if you look historically, just what were the two countries that had the largest trade deficits in the period 1946 to 1960? Japan and West Germany. What were the two countries that cut their tax systems most? What were the two countries that grew the fastest? What were the two countries that you'd have loved to have invested in back then and still own those assets to this day? Countries run trade deficits because they attract capital from the rest of the world. Our trade deficit is nothing more than our capital surplus. If you look at it from this standpoint, again the problem falls down to politics. We are trying to put real solutions on nonproblems. Consider these Dick Gephardts and all these other wonders of our political system.

Let me ask you, just intuitively again, if you find a store that sells you high quality products at low cost, is your first thought not how to boycott that store? It's the silliest thing in the world. If the Japanese sell us high quality products at low cost, the most wonderful thing in the world is to buy them. I almost get the sense that if Japan agreed to give us all of their cars free of charge, our Congress would want to nuke them for that. Take their logic a step further. This amazes me. They say they don't trade fairly. And they're right on that; Congress made a correct statement, Japan doesn't trade fairly.

In fact if there's one country on earth that is even sillier than our country, it's probably Japan. In fact they are probably the only country on earth whose government really thinks our government is right. But, you know, just because they don't trade fairly, just because they have quotas and tariffs, doesn't mean that we should match their ignorance; it makes no sense.

Let me use the example this way. Let's imagine that the United States discovers a cure for polio. And let's imagine Japan discovers a cure for cancer. And let's imagine, true to form, that Japan prohibits us from marketing that cure for polio in Japan. Should we get even -- and not allow them to market that cure for cancer in the U.S.? You know, trade barriers, in my view, are the real problem. And here you find the political solutions as being the problem, not the trade deficit. The trade deficit is far from being a problem; it is a wonderful solution for what's going on. Foreigners own so much of our country, it's terrifying. My solution to that is that we should allow all foreigners who own net wealth in this country to immigrate here, and then we'll owe it to ourselves again. Just pay them a little bounty and they'll come here really quickly.

Again, to me the budget deficit and the trade deficit are not the real problems. To me the real problems are the market's anticipation of the political responses, the fear of raising taxes, the fear of raising tariffs and quotas in the overall system. If you look at this political system again, it's the political responses that we really fear, not the situation. Why should I care, as an American, whether a fellow American borrows from a Nesae or Fensae in Stockton, California or an ethnic Japanese from Colby? Should I give someone a quarter to call someone who cares? What contingent liability do I have if that loan goes bad? None. I don't have a government guarantee on it. We're not dealing with Mexico, Brazil and Argentina, where all the government guarantees for the taxpayers are ultimately held liable. These are private transactions in private capital markets. It makes no sense to me why there should be a public concern over private transactions, just because one of those participants happens to be an ethnic foreigner. It just makes no sense at all to me. We have no contingent liability in the sense of taxes, if in fact those loans do well or do badly. It's not our personal problem; it's the lender's and the borrower's problem. And as long as they're mature adults, I don't see why we should care at all about their passport.

But again, it boils down to politics. Do any of you get enjoyment out of politics, too? You can't take it seriously or else you might commit suicide. Did any of you get the full irony and fun out of the board hearings? Here we have Teddy Kennedy and Joe Biden defending the morals of America. I find it classic. Or Colonel North, and I'm no fan of Colonel North. But I did find the hearings terribly entertaining. Here we have politicals, Congressmen and Senators, accusing someone else of having self-serving motives, especially in three categories. One is sexual shenanigans; remember the lingerie in the shop there? A turtle unescorted is not safe in Washington. It's the misuse of public funds. Again, talk about experts on the subject. Or it's the misuse of private fund-raising techniques; that's another one. I love the Ginsberg one as well -- Judge Ginsberg that Reagan was going to appoint to the Supreme Court. Conjure up this image in your own mind's eye. Here is Nancy, "just say no", Reagan's husband appointing a rogue smoking professor from Harvard. It just boggles the mind, doesn't it? Or the Gary Hart affair, did any of you watch that? Do you remember when he dropped out of the race and then came back in the race? Well we in the academic community call that campaignus interruptus.

I think this administration has really changed America, and changed it dramatically in the right direction. I am terribly pro what's happened in this administration. But if you look at the one dangerous legacy, my view, in real serious economic terms, is the devaluation of the U.S. dollar over the last three years. I have never seen a strong economy with a weak currency. The logic underlying this, of course, is to solve a nonproblem, the trade deficit. They figure if you devalue the currency, what happens? Our goods become cheaper, don't they? Foreign goods become more expensive, so therefore foreigners will buy more of our goods and our exports will go up. You know the logic there, don't you? Their goods are more expensive so therefore we buy less of their goods and our imports come down. See how that trade balance turns around by the logic. If we devalue, we make our goods cheaper; they buy more of ours, we buy less of theirs and our trade balance comes around. Are you all with me on the logic? I expressed it fairly correctly, didn't I? If devaluation helped trade balances, Mexico would have the biggest surplus on earth and West Germany and Japan would long ago have been deeply in the red. The theory is totally wrong. Devaluations do not help trade balances, period. What they do is lead precisely to offsetting inflation, period.

Take for a moment the world economy as being the single marketplace. Imagine a ton of steel being sold in that marketplace. That ton of steel will sell for the same dollar price, whether it's made in Italy, Germany, Britain, France, the U.S. or Japan. That's the notion of the one world price or the one market price. A foreign ton of steel of the same quality sells for the same dollar price as a U.S. ton of steel. If the dollar devalues against Germany, the mark price of steel times the dollar price of the mark must equal the dollar price of a ton of steel, period. That's the arbitrage. If the dollar devalues against the mark, the dollar price of a mark goes up, which means one of two things must occur to keep that arbitrage condition holding. Either the German mark price of the ton of steel falls or the dollar price of a ton of steel rises. If the dollar devalues by 11.16% against the mark, U.S. prices will, in due course, rise by 11.16% against mark prices, period. Devaluation results in precisely offsetting inflation, period. No ifs, ands or buts. Now obviously with an internationally traded product that arbitrage occurs instantaneously. And if you want to see what it's like, take a look at the world price for oil. If you think oil prices have come down here in the United States recently, you can't believe what happened in yen. For example, while the dollar price of oil has gone from $20 a barrel to maybe $15, Japanese prices, yen prices, have gone from $20 to about $7. Take a look at the mark price of gold, for example; it's tumbled. That arbitrage occurs.

Now the only question is how long does it take for that arbitrage to work its way fully through the economy? That arbitrage takes a long time to happen, but once you divide your currency, your prices will rise relevant to the currencies against which you've devalued, by the full amount of that devaluation. My view is that what we are in for, with the devaluation of the dollar, is that it will, in the next six, twelve, or eighteen months cause much higher measured inflation in the United States and it will raise interest rates substantially in this country, relative to the rest of the world. You're going to see U.S. prices having that lid removed and you're going to see inflation coming back. Now I'm not talking about the inflation of the late 1970s or the prime interest rate, but interest rates going up 250 to 350 basis points. My view is that inflation will be running at the end of this year, around 8, 9, or 10% annualized rates on a monthly basis. You're talking about a major increase in that area.

I mentioned that the national debt is $2.3 trillion. If interest rates go up by one percentage point, what happens to interest expense on that national debt? Every 1% increase in interest rates on the national debt increases government spending by about $23 billion annually, once that debt rolls over. If you have interest rates going up by 300 basis points, you're talking about a pro forma increase in the budget deficit of about a $70 billion annualized rate. If those interest rates go up, my view is that you're going to see a slowdown in the economy. The slowdown in the economy means there will be more people unemployed, less people employed, less taxes collected, more government spending. The rule of thumb is, of every 1% change in employment, there's about a $45 billion change in the deficit. You could easily have an $80 billion pro forma increase in the deficit due to a slowdown in employment growth in this country, with rising interest rates and rising inflation.

What I think you're going to have happening is a substantially increased projected deficit in the U.S., which sets the classic liberal trend. And the reason I call it a classic liberal trend is it's very reminiscent of the 1920s when we had the supply-side policies in place. All of a sudden there were all of these people whose politics attracted them like moths to a flame to Washington, D.C. At the time that Ronald Reagan leaves office, you will see these interest rates coming up and the budget deficit projections increasing. You'll have an entirely new group coming into Washington at exactly the moment that the avalanche occurs. There will be a major change in the scenario. My view is that the Congress at that time, and the administration, whichever administration it will be -- Republican or Democrat -- will have no choice on taxes; they will not be able to raise taxes. There's no way they can even increase taxes or reduce benefits on social security, as far as I can tell, because the program itself is running huge surpluses right now.

By the way, as they calculate surpluses, not one of them is an actuary. In fact, as you know, they define "actuary" by law. Have any of you read the law, the actuarial laws with regard to social security? Doesn't it make you quiver? It's incredible.

But they will be running these current budget surpluses of about $37 billion, which means they can't raise taxes, they can't raise them federally. All those lobbyists and special interest groups that were not eliminated in the Tax Reform Act of 1986, those people who have political clout, won't be able to reduce deductions or exemptions or exclusion. They won't be able to go on raising. In my view, the next administration will be forced, under all circumstances, to really face the spending problem and bring spending under control. You know, I think this is one of the most bullish signs where finally, in the United States you're going to see the spending issue handled correctly. What that means with regard to the economy in the next year or so is what they call August in Minnesota, a period of roughsledding. Once you get the spending cuts, you're really going to be back on a long-term growth path in the United States. But I've been wrong before, a lot of times. (I don't usually admit that either.) In fact, if any of you have a large grain of salt on this, please take it.

And also with regard to product liability, I guess if you really listen to the forecast and what's happening, it's sort of reminiscent of the 97-year-old man, married to the 21-year-old young lady. Just before his wedding day, he had his annual physical check-up and informed his doctor of his impending wedding. His doctor was aghast and said, "That could be fatal." And the man sort of shrugged his shoulders and said, "Well, if she dies, she dies."

FROM THE FLOOR: I believe we did not devalue the dollar, and wouldn't the devaluation of the dollar really affect the free market forces?

DR. LAFFER: I would argue that, at least from 1980 through 1985, the appreciation of the dollar was really dramatic because of tax cuts and because of all this demand for U.S. assets. If you require someone to switch products (from buying an American car to buying a foreign car) in the very short term, you've got to have a huge price differential. And so therefore the dollar appreciates dramatically. Once we hit the peak in February 1985, the dollar fell quite appropriately. I would say that the U.S. created an environment of expecting the dollar to fall and really pushed it further, because of the silly notion that depreciated currencies have trade surplus. I think that was literally what happened. Once you get a run on the dollar, it's very hard to stop it.

I'll give you an even bet: one dollar on the Mexican peso versus the Swiss franc over the next twelve months. Why do you giggle? The reason you giggle is because everyone knows that the Swiss franc is going to appreciate against the Mexican peso. And you ask, why is that true? Once you get a currency in decline, people shift out of that currency. Once you get people to have expectations of depreciation, it's very hard to reverse those expectations. I think that's what this government did in 1987. They really set into place those expectations. They never defended the dollar or stabilized the value. And that, to me, is the most serious policy legacy we have coming with us in this country. The rest of the problems are really Washington-oriented.

FROM THE FLOOR: With the tax rate reductions the tax advantages of a pension are much less than they have heretofore been, because the income on the pension is not taxable.

DR. LAFFER: I think that's wonderful. My view is that you should have aftertax relative prices closely corresponding to pretax relative prices to make efficient allocations. I think using tax-exemption status to encourage an activity makes no sense. Now to use tax rate reduction on an activity to encourage it makes all the sense in the world. My view is that what we should have is a purposely flat tax.

Let me just go back to tax theory. A tax theory is like all behavior. People respond to positive things and they dislike negative things. For example, if you beat a dog, you know where that dog won't be, but you have no idea where the dog will be. If, on the other hand, you feed a dog, you know exactly where the dog will be. You know, taxes are like beating; you know exactly what people will not do. They will not report taxable income; but you have no idea how they won't report that taxable income. They use evasion, avoidance, or they go into pension funds -- all those activities. What you want to do is have the lowest possible rate on the broadest possible base. Have the minimum number of exemptions and deductions. Basically provide them with the lowest rate and there will be the least incentive to evade, avoid or otherwise not report taxable income. And with the broadest base, you provide them the least places to which they can escape. That's the real theory of supply economics -- the lowest possible rate on the broadest possible base.

With regard to pension funds, I see no reason why in any economic sense, putting a dollar into a pension should be any different than paying a person a dollar in income and having that person then contribute to a private savings plan. That is my view. If you think the people should be encouraged to save, I think you should make that a private decision, not a public decision. If my family and I like to go to Las Vegas instead of save, my family will suffer, not your family. And I think trying to encourage public savings through these tax gimmicks makes no sense. Personally, I really like individual choice in that. Now I know I've made real friends here.

But, I also think it's true that if we really want to get rid of these tax exemptions, we must lower rates simultaneously. I would hate to see those rates stay the same and eliminate the pension fund. As long as you're going to have a pension fund being tax-exempt, I would never limit it. The whole key to saving is to make it marginal. And if you limit it, like the IRAs, the Keoghs, the 401-(k)s, and the pension funds, it's clearly not marginal in many cases. And they still have the marginal effect because they're limited to that. If you really want to do it to encourage something, make sure you don't limit it, because then you lose all the marginal benefits. I would much rather see us cut spending in this system and get a purer, truly flat rate tax.

Do you know how low the rate could be, by the way? If you had a flat rate tax and business value added and a flat rate tax on personal unadjusted gross income, and you had them both at the same rate, do you know how low you could get that rate -- without losing a penny of revenue? Static revenue, static income assumption. It's about 11 1/4% on each. With any type of growth effect in there, you could clearly get it below 10%. To me, that's the dream of tax policy. It is not to let Teddy Kennedy, Howard Metzenbaum, Joe Biden, and Paul Simon determine where the resource of America goes. You really should let the private market do that determination, not because of tax advantages, but because of economics. You guys are more qualified and more skilled and your rates of return on your pension fund management are so much higher than what these people could do themselves. They would clearly put their money with you anyway.

I don't think the market looks really strong for the rest of this year because of rising interest rates. And I think that's been, to a large extent, set in stone. It's not a Jesse Jackson problem; it's not a Mike Dukakis problem; it's not a George Bush problem. My view is, it's pretty much because of the devaluation, which I really think is a serious problem. And it's not played very much anywhere. My view on politics is that I think there's a real problem, no matter who gets into office. I'm obviously a Bush supporter from the beginning of time. I posed Bush in 1980 because I was working for the President back then and I thought Ronald Reagan was great in 1980; I think George Bush is great now. I liken it to the Apple computer. Ronald Reagan is the creative entrepreneur. He knows his own limitations; he's not a manager; he's an entrepreneur; he's a creator; he's a developer; he's a peaceful revolutionary. But as all of you know, and I'm not telling any secrets, this man does not take budget documents home at night to study them. But he did change the direction of America. And like Wosniak and Jobs, this guy had a creative insight and literally changed the direction. But once Apple computer got to a certain size, managers needed to come in and recontrol. And that's where, I think, Skully made a lot of sense coming in. The same thing is true now. The direction has been changed and now what is really needed is good competent management to control.