MANHATTAN INSTITUTE

PRESIDENT'S UPDATE 2013

SUMMER

Lawrence J. Mone

DEAR FRIENDS AND SUPPORTERS,

Over the past several months, the Manhattan Institute, as is our mission, has been focusing public attention on the persistent threats to our economic freedom and advancing reforms that can restore prosperity. Reform, ideally, will begin with our nation's punitive, inefficient, federal tax code. Those who champion more and higher taxes often justify their position by pointing nostalgically to the 1950s. During this decade, it is claimed, high taxes and booming prosperity coexisted. Who, exactly, was paying the top rate of 91 percent? Turns out, almost no one.

As an April Manhattan Institute issue brief written by Arpit Gupta showed, because of the high income threshold, deductions, and loopholes, few Americans paid anything close to the top rate. Moreover, it is not even clear that the tax regime of the 1950s was, taken as a whole, effectively more progressive than the present one—a point that I underscored in a *Wall Street Journal* op-ed based on Gupta's findings, "There's No Going Back to the 1950s Tax System."

Stock owners now include many non-rich investors. Higher taxes and lower returns on capital would hit them as well. —MI president Lawrence Mone, *The Wall Street Journal*, 4/16/13

THE WALL STREET JOURNAL. OPINION Tuesday, April 16, 2013

There's No Going Back to the 1950s Tax System

By Lawrence Mone

The federal budget proposed by President Obama last week differs in details from the budget approved by Senate Democrats in March. But they both assume significantly higher effective tax rates on the wealthiest Americans.

The Senate envisioned fully $975 billion in new tax revenues to be raised over the next 10 years; the White House budget, $600 billion. That Democrats are comfortable targeting top earners can be understood, in part, as a product of a new piece of liberal conventional wisdom: The 1950s were a sort of golden age of economic growth and greater income equality—peacefully coexisting with high taxes.

Marquee liberals—including the American Prospect's Robert Kuttner ("let's restore the income tax schedule of the 1940s and 1950s, when the economy was booming and the rich paid their fair share of taxes") and the Center for American Progress's Michael Linden ("In fact, growth was actually fastest in years with relatively high top marginal tax rates")—champion that era's high corporate taxes and top marginal tax bracket of 91%. In doing so, they are popularizing research by University of California economists Thomas Piketty and Emmanuel Saez.

Nevertheless, a new study by Columbia University's Arpit Gupta, "Revisiting the High Tax Rates of the 1950s," written for the Manhattan Institute, calls into serious question the notion that affluent Americans bore a higher tax burden than they do today.

True enough, the top marginal income-tax bracket after World War II and until the across-the-board cuts of 1964, was 91%. Yet very few people earned enough to pay that rate, which kicked in (for married couples) at $400,000, more than $3 million in current dollars. Moreover, the 25% capital gains tax as well as a variety of deductions and loopholes made the amount of income actually taxed at the highest rate vanishingly small.

What progressives admire about the Eisenhower economy is either wrong or irrelevant today.

These statements are hardly controversial. Indeed, in a 2007 paper, Messrs. Piketty and Saez note that the more progressive tax regime of the 1950s was "not mainly due to the individual income tax." Instead, it reflects the "corporate income tax and the estate tax."

Messrs Piketty and Saez did not reach their conclusion about the burden of corporate income taxes from a direct examination of tax returns. Instead, it stemmed from an estimate, drawn from a complex set of calculations and assumptions, about the corporate tax—which they said took 6.5% of total personal income in 1960 but much less, about 2.1% of total income, today.

Ultimately, Messrs. Piketty and Saez, concluded that the highest income groups paid an effective tax rate of 70%, a figure touted by New York Times columnist Paul Krugman and others. To reach their conclusion, however, they look beyond the income tax to corporate taxes and assume, crucially, that the entire burden of such taxes fell on stockholders, then predominantly wealthy, in the form of lower returns.

One problem with this calculation, as Mr. Gupta notes in his study, is that the burden of corporate taxation is also borne by employees in the form of lower wages. Mr. Gupta also points out that the corporate tax could not serve as a cash cow for a more "progressive" tax regime today. In the first place, thanks to globalization, domestic capital and corporate earnings are no longer a "captive" source of revenue that one nation can easily tax away.

In addition, stock owners now include many non-rich investors, not to mention the pension funds that hold capital in trust for millions upon millions of individuals and families of modest means. Higher taxes and lower returns on capital would hit them as well.

Mr. Gupta points out a third problem facing those who pine for a return to an imagined golden era of the high-tax-rate 1950s. It is not even clear that the tax regime of the 1950s was, taken as a whole, effectively more progressive than the present one.

Mr. Gupta notes that in 1970, Messrs. Saez and Piketty's own data demonstrate that the bottom 90% of Americans took home 67.6% of pretax income, but received 76.5% of income after taxes. In other words, the net impact of taxation on the distribution of income was to raise the income share of anyone not in the top-earning 10% of the population by 4.3%. Fast forward to 2004—after the Bush tax cuts. Now the "bottom" 90% took home 53.75% of income but received 57.28% after taxes. Their post-tax income share actually rose by 6.6%.

Advocates of higher tax rates often cite European nations as models of fairness. Yet to fund their welfare states, these countries typically have turned to broad-based taxes on consumption, such as the value-added tax. The VAT hits all consumers, not just the affluent.

Liberals don't need to be told this. Then-House Speaker Nancy Pelosi in 2009 said that a value-added tax should be "on the table." Without long-term spending reductions, it may have to be, to raise the sums Mr. Obama and Senate Democrats want.

Mr. Mone is president of the Manhattan Institute for Policy Research.

DEBATING IMMIGRATION

Shortages in the labor market, like inefficiencies in the tax code, impede the economy's ability to expand. Despite higher than normal unemployment rates, many firms still struggle to find both the low- and the high-skilled workers they need. Improving the nation's immigration policy can play a key role in helping to ameliorate this problem. As Congress debates how to reform the federal immigration system, Institute scholars are articulating specific changes that can benefit the U.S. economy. In her February issue brief, "The Economic Benefits of Immigration," MI senior fellow Diana Furchtgott-Roth explained how issuing more visas to legal immigrants at both the high and low ends of the skills curve would better enable American businesses to find the talent they need to innovate, compete, and expand.

Bill O'Reilly interviews Diana Furchtgott-Roth

While Institute scholars are focused primarily on publicizing the economic rationale for immigration reform, we have been mindful of related issues—involving national security, the rule of law, citizenship, and culture—that comprehensive legislation should address. In March, we welcomed former Florida governor Jeb Bush to share his ideas concerning these questions. In a public forum moderated by *Wall Street Journal* deputy editorial page director Daniel Henninger, Governor Bush and Clint Bolick of the Goldwater Institute spoke about their new book, *Immigration Wars: Forging an American Solution*. Bush and Bolick emphasized the need for the United States to adopt a market-driven immigration policy and discussed, among other subjects, ways to better secure the border, possible ways to deal with illegals currently in America, and the importance of civil society in assimilating newcomers.

> America's goal should be an immigration policy that fosters economic growth.—Diana Furchtgott-Roth, "The Economic Benefits of Immigration"


Former Florida governor Jeb Bush

On that last front, this spring the Manhattan Institute published new research analyzing postrecession immigrants and the rate at which they assimilate socially, economically, and culturally. In the fourth edition of his *Index of Immigrant Assimilation*, MI adjunct fellow and Duke University economist Jacob Vigdor found that the immigrant population has shifted dramatically since the start of the Great Recession in 2007, with migration rates from Mexico in sharp decline. Newer immigrants are coming from Asia and more likely to be higher-skilled and English-speaking. According to the study, differences between native-born Americans and newcomers are now less noticeable than they have been in a generation. Even should Congress pass a bill this summer, the immigration debate will continue. The Manhattan Institute will work to keep the public conversation centered on facts.

THE ENERGY BOOM

Just as Congress must pass immigration laws that respond to the needs of the U.S. economy, so, too, must lawmakers revise outdated statutes and regulations that are holding back some of America's most promising sectors. For example, laws prohibiting exports of crude oil and limiting exports of natural gas have been on the books for decades. These policies may have made sense in the 1970s, when these resources were thought scarce—but not today, when technological innovation has opened up vast quantities of previously inaccessible hydrocarbons.

Through the Manhattan Institute's Power and Growth Initiative, begun last summer, senior fellow Mark Mills has educated policymakers and the general public about reforms that would allow the United States to harness the benefits—for our economy and for our influence in the world—of our great supply of natural resources.

> Exporting oil and natural gas could lead to a fundamental repositioning of America in world trade and geopolitics.
> —MI Senior Fellow Mark Mills

In a paper published this May, *The Case for Exports*, Mills urged Congress to repeal antiquated laws preventing exports and allow our economy to benefit from this newfound abundance. Mills's paper comes at a critical time, as opponents of exporting more natural gas have heightened efforts to convince the public that increasing exports would hurt America's economy. But as Mills demonstrates, unleashing American energy exports could eliminate the U.S's massive $750 billion trade deficit, boost productivity, and lead to more job creation.

Mark Mills

> The fact-based analysis and market-oriented solutions offered by the Manhattan Institute are needed today more than ever. —Tom Donohue

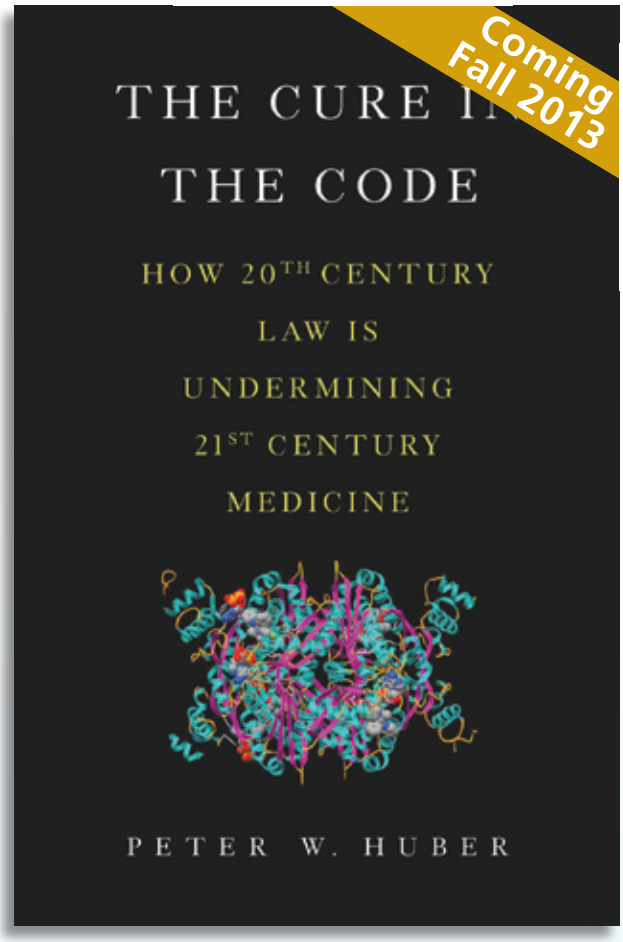
U.S. Chamber of Commerce CEO Tom Donohue spoke to the Institute about deficit reduction, entitlement reform, and the importance of the private sector in promoting economic growth.

THE FDA'S DIGITAL FUTURE

America's health-care sector must also become more market-driven to accelerate the progress of precision medicine. Treatments tailored to an individual's unique biochemistry are the key to making headway against illnesses such as cancer and heart disease. While Institute scholars are steadfastly opposing efforts under the Affordable Care Act to make health care more centralized, bureaucratized, and inefficient, we are working to ensure that the promise of precision medicine is unimpeded.

The MI Center for Medical Progress is currently leading the debate on how to modernize the outdated legal and regulatory framework governing pharmacology—in particular, the antiquated clinical trial protocols in place at the U.S. Food and Drug Administration. These protocols have not kept pace with advances in modern science, a failure that has slowed the development of new lifesaving treatments for patients.

The Manhattan Institute's Project FDA—chaired by former FDA commissioner Dr. Andrew C. von Eschenbach—is committed to promoting reform of the drug review processes so that promising therapies can reach the market safely and efficiently. To this end, in May the Institute held a conference, *The Digital Future of Molecular Medicine: Rethinking FDA Regulation*, based on a pathbreaking new paper by MI senior fellow Peter Huber, who served as the event's keynote speaker. Our conference brought together a wide range of experts in drug development to respond to Huber's proposals for FDA reform. Also represented were the vital perspectives of patient advocates (John Crowley of Amicus Therapeutics), diagnostic innovators (Linda Avey of 23andMe), and venture capitalists (Mark Levin of Third Rock Ventures). Huber will expand on the recommendations from his paper in a forthcoming book, *The Cure in the Code: How 20th Century Law Is Undermining 21st Century Medicine*, scheduled for release



Scott Gottlieb and Peter Huber

The inability of the Food and Drug Administration to keep pace with changes in medical science threatens both economic prosperity and public health.
—Project FDA director Dr. Andrew C. von Eschenbach, Bloomberg View, 2/28/13

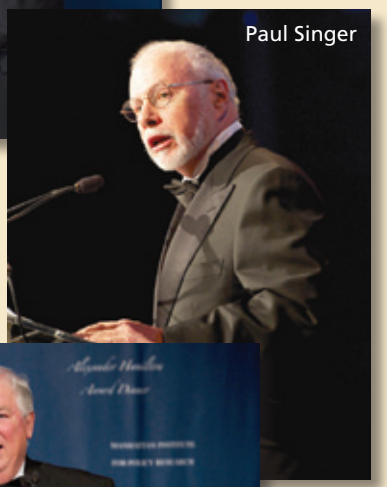
this autumn. In this book, he will articulate how we are at the beginning of a revolutionary period in medicine, when innovations will bring dramatic improvement to the length and quality of our lives—but only if we abandon today's regulatory framework, which is a relic of a different era.

The work of Huber, von Eschenbach, and Paul Howard, the director of the Institute's Center for Medical Progress, synthesizes many of the themes that have long animated our work: the encouragement of a healthier citizenry; economic growth through human ingenuity; and the modernization of government. We already have reason to believe that the message will be popular and powerful. Just one week prior to our conference, Huber was part of a debate team in the popular *intelligence²* series broadcast on National Public Radio—defending the proposition that the FDA's caution is hazardous to our health. Along with Scott Gottlieb of the American Enterprise Institute, Huber converted a skeptical audience and won the debate. Through events like this and forthcoming research, the Institute aims to promote policies that will better incorporate new technologies into the drug development process, accelerating biomedical innovation and improving patient outcomes.

ALEXANDER HAMILTON AWARDS

Our annual Alexander Hamilton Awards honor individuals who have made exceptional contributions to the nation's civic and intellectual life. This year's awards went to Louisiana governor Bobby Jindal and philanthropist Kenneth Langone, founder of The Home Depot—both of whom have gone to great lengths to enhance educational opportunities for disadvantaged children.


Kenneth Langone and Geoffrey Canada


Paul Singer

Since taking office, Governor Jindal has been in the vanguard of education reform, adopting the nation's most meaningful teacher-quality legislation and promoting a robust school-choice program. Thanks to Langone's philanthropy, thousands of low-income New York children have been able to receive high-quality education at Promise Academy Charter Schools in the Harlem Children's Zone. We thank our introducers Joel Klein and Geoffrey Canada for their participation in the Hamilton Awards ceremony, as well as our special guest Haley Barbour, who stressed the importance not just of college-preparatory education but of vocational education as well.


Former Mississippi governor Haley Barbour

GOVERNMENT CROWDED OUT

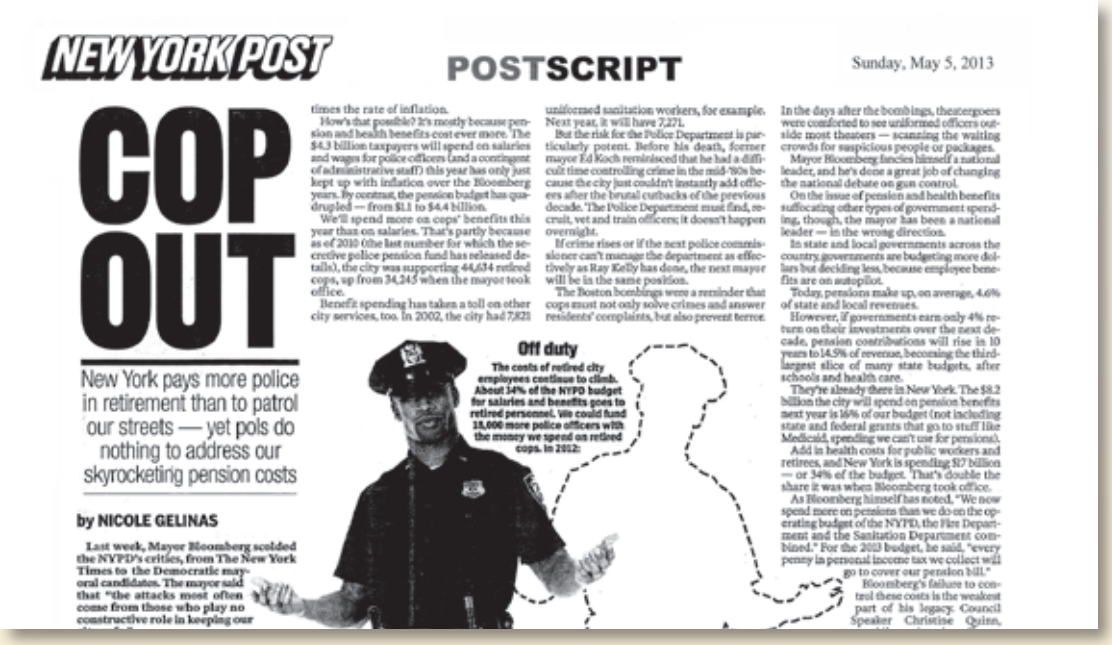
Historically, Institute scholars have focused on how state and local governments can create strong business climates and reduce the rapidly escalating cost of public-employee pensions and health-care benefits. This focus is especially important in light of our current fiscal situation. Not only must locales find ways to rein in these retirement benefits; they must also find innovative ways to deliver core services more effectively.

As senior fellow Daniel DiSalvo made clear in his latest report, *Government Crowded Out: How Employee Compensation Costs Are Reshaping State and Local Government*, post-employment benefits are leading to higher taxes, higher debt, and, crucially, the crowding out of spending on vital government functions from infrastructure and education to public safety and assistance for the poor.

This "crowd-out" problem is most visible wherever the "blue-state model" of governance is dominant. High taxes, high spending, and high concentrations of public-union power discourage entrepreneurs from locating in cities such as Detroit and states such as New York. In New York City, for example, the government will spend $23.3 billion—fully 43 percent of the money received in taxes and fees—on just three things: pensions and health benefits for city workers and retirees, plus payments on city debt. This is up from 24 percent 11 years ago.

Until this phenomenon is effectively addressed, Americans will increasingly live in a paradoxical world of government that spends more and more to do less and less. If we are to keep our schools, libraries, bridges, and parks—to say nothing of our national faith in democratic self-government—this paradox cannot continue.

The Manhattan Institute will continue to help citizens across America understand that a lack of political will on the part of leaders will only make this problem worse, depriving critical public services of the resources necessary for our cities and states to thrive.



NEW YORK POST

POSTSCRIPT

Sunday, May 5, 2013

COP OUT

New York pays more police in retirement than to patrol our streets — yet pols do nothing to address our skyrocketing pension costs

by NICOLE GELINAS

Last week, Mayor Bloomberg scolded the NYPD's critics, from The New York Times to the Democratic mayoral candidates. The mayor said that "the attacks most often come from those who play no constructive role in keeping our

times the rate of inflation.

How's that possible? It's mostly because pension and health benefits cost ever more. The $4.3 billion taxpayers will spend on salaries and wages for police officers (and a contingent of administrative staff) this year has only just kept up with inflation over the Bloomberg years. By contrast, the pension budget has quadrupled — from $1.1 to $4.4 billion.

We'll spend more on cops' benefits this year than on salaries. That's partly because as of 2010 (the last number for which the secretive police pension fund has released details), the city was supporting 44,634 retired cops, up from 34,245 when the mayor took office.

Benefit spending has taken a toll on other city services, too. In 2002, the city had 7,821 uniformed sanitation workers, for example. Next year, it will have 7,271.

But the risk for the Police Department is particularly potent. Before his death, former mayor Ed Koch reminisced that he had a difficult time controlling crime in the mid-'80s because the city just couldn't instantly add officers after the brutal cutbacks of the previous decade. The Police Department must find, recruit, vet and train officers; it doesn't happen overnight.

If crime rises or if the next police commissioner can't manage the department as effectively as Ray Kelly has done, the next mayor will be in the same position.

The Boston bombings were a reminder that cops must not only solve crimes and answer residents' complaints, but also prevent terror. In the days after the bombings, theatergoers were comforted to see uniformed officers outside most theaters — scanning the waiting crowds for suspicious people or packages.

Mayor Bloomberg fancies himself a national leader, and he's done a great job of changing the national debate on gun control.

On the issue of pension and health benefits suffocating other types of government spending, though, the mayor has been a national leader — in the wrong direction.

In state and local governments across the country, governments are budgeting more dollars but deciding less, because employee benefits are on autopilot.

Today, pensions make up, on average, 4.6% of state and local revenues.

However, if governments earn only 4% return on their investments over the next decade, pension contributions will rise in 10 years to 14.5% of revenue, becoming the third-largest slice of many state budgets, after schools and health care.

They're already there in New York. The $8.2 billion the city will spend on pension benefits next year is 16% of our budget (not including state and federal grants that go to stuff like Medicaid, spending we can't use for pensions).

Add in health costs for public workers and retirees, and New York is spending $17 billion — or 34% of the budget. That's double the share it was when Bloomberg took office.

As Bloomberg himself has noted, "We now spend more on pensions than we do on the operating budget of the NYPD, the Fire Department and the Sanitation Department combined." For the 2013 budget, he said, "every penny in personal income tax we collect will go to cover our pension bill."

Bloomberg's failure to control these costs is the weakest part of his legacy. Council Speaker Christine Quinn,

Off duty

The costs of retired city employees continue to climb. About 34% of the NYPD budget for salaries and benefits goes to retired personnel. We could fund 18,000 more police officers with the money we spend on retired cops. In 2012:

A return to true growth and real prosperity is possible. Educating policymakers and the public as to where great possibilities for expansion and innovation lie has always been at the core of our mission. The scholars and staff of the Manhattan Institute are as committed as ever to the ideals that have animated our work for over 30 years—an unshakeable belief in economic freedom, individual liberty, effective government, and personal responsibility.

I thank you for your continued support, without which this vitally important work would not be possible.

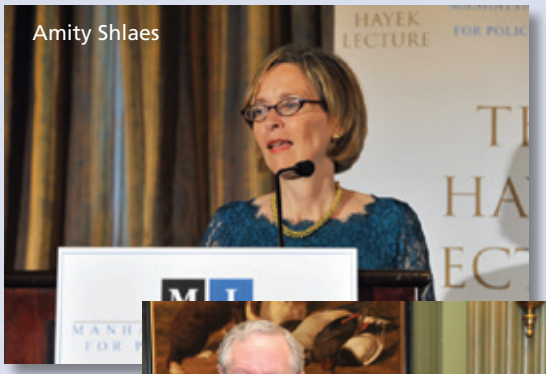
Sincerely,

Lawrence J. Mone
President

2013 HAYEK PRIZE AND LECTURE

The Manhattan Institute's annual Hayek Prize was awarded to Chinese historian Yang Jisheng for his book *Tombstone: The Great Chinese Famine, 1958-1962*. As a journalist with privileged access to official and unofficial sources, Yang spent 20 years piecing together the events that led to mass nationwide starvation that was the result of Mao's Great Leap Forward. Stunning in scale and arresting in its detailed account of the human cost of this tragedy, *Tombstone* is written both as a memorial to the lives lost—an enduring tombstone in memory of the dead—and in hopeful anticipation of the final demise of the totalitarian system.


Author Yang Jisheng


Amity Shlaes


Steve Forbes, Rose Tang, and Yang Jisheng

The Hayek Prize honors the book published within the past two years that best reflects Friedrich Hayek's vision of economic and individual liberty. Hayek, the author of groundbreaking works such as *The Road to Serfdom* and *The Constitution of Liberty*, was the key figure in the twentieth-century revival of classical liberalism and a formative influence on the Manhattan Institute. The winner of the Hayek Prize is chosen by a selection committee of distinguished economists and journalists.

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