IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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JACK KEMP, 1935 - 2009

Jack Kemp, the nation's leading advocate of pro-growth tax reform, passed away on May 3 at the age of 73. We will not see his like any time soon.

Jack came from a middle class background. His father was in the trucking business. Jack was a football star in high school and college, and he became a pro quarterback after graduation. He persevered through stints with several pro teams, and eventually found a home with the Buffalo Bills, which he led to league championships.

Jack had many fans as a great quarterback for the Bills. In turn, Jack was a great fan of the people. He had a profound faith that, given a chance, they would use their talents and energy to build a good life for themselves and their families. He won a seat in Congress on that platform in the election of 1970, and served nine terms.

Taking on the establishment

Jack entered Congress in 1971, at the beginning of the Nixon-Ford-Carter inflation and tax spirals. At the time, most economists believed in easy money, which supposedly would depress interest rates and thereby increase investment and employment. If inflation threatened, they preferred to reduce "demand" by raising taxes or trimming federal spending rather than risk a tighter monetary policy.

Most politicians went along with these ideas. They favored easy money, and relied either on price controls and regulation (Nixon) or "jawboning" or rising tax rates (Ford and Carter) to fight inflation by mopping up "excess demand." The traditional Republican response was to advocate cutting government spending to balance the budget and trim demand, in the hope that a lower deficit would also reduce interest rates to spur investment. In reality, Congress drove spending up, let taxes rise, and ran budget deficits. Congress relied on the Federal Reserve to accommodated the deficits by buying the added federal debt, in a vain attempt to hold down interest rates by increasing the money supply.

As Milton Friedman and other monetarist economists predicted, the easy money held interest rates down only briefly before spurring inflation. The inflation raised tax rates on individuals (via bracket creep) and on businesses (by eroding the value of depreciation write-offs, overstating real profit). Growth faltered, and the deficit remained intractable. The deficit hawks were left wringing their hands and accepting the higher tax rates.

The escalating tax rates did far more damage to investment and employment than the deficits ever did by making incremental work, saving, and investment unattractive, which contracted the supply of labor and capital. Investment failed to keep up with the work force, productivity slumped, and wages, especially after-tax wages, failed to keep pace with inflation. The economy was stuck ever deeper in stagflation. Contrary to the Keynesian economic "wisdom" of the time, inflation proved to be a disaster for job creation. The Keynesian model had collapsed. It had completely failed to anticipate the adverse effects of inflation and tax rates on the supply of labor and capital, and the supply of goods and services.

As early as the mid-1960s, Friedman and others were questioning the Keynesian idea that tax and spending changes affected the economy by raising or lowering total demand. Any rise in spending or reduction in taxes had to be paid for by offsetting tax or spending changes, or by borrowing the difference from the public. There would be no real change in disposable (after-tax) income to spur consumption and "demand". If the Federal Reserve bought the added debt, it would pump up the money supply, which is a change in monetary policy. That would raise demand, but would also drive up prices and inflation, which would hurt, not help real growth.

It was time to bring the economics of supply back into the calculation. Tax cuts can work to expand output and employment if they are of the type that make it more rewarding to work the extra hour, save the extra dollar, buy the extra machine, or erect the additional building. (Some examples are: cuts in marginal tax rates, faster depreciation, lower corporate tax rates, expanded tax deferral of saving.) By raising after-tax rewards to effort, supply-side tax cuts make labor more attractive compared to leisure, and make saving and investment more attractive compared to consumption, than they were before the tax change. This emphasis on the incentive or relative price effects of tax changes is what came to be called "supply-side economics." Expanding supply by lowering the cost of production and encouraging output is inherently non-inflationary. It leads to more goods chasing the same money – the opposite of an easy money policy that involves more money chasing the same goods.

Kemp became an early and eager student of the supply-side concepts. He hated the harm that stagflation policies did to the public and the country. He read widely to become familiar with the prevailing economic thinking, and with possible alternatives. He surrounded himself with advisors who challenged the old economic order, in the hope of finding a new set of policies to fight inflation and unemployment at the same time. These advisors included IRET's founder, Dr. Norman Ture, a tax consultant who had been on the staff of the Joint Economic Committee and was an advisor to Chairman Wilbur Mills at Ways and Means; Dr. Paul Craig Roberts, who was on the Kemp staff and later worked on the House and Senate Budget Committees; Dr. Richard Rahn, chief economist of the U.S. Chamber of Commerce; Professor Arthur Laffer of the University of Chicago Business School; Professor Robert Mundell of the University of Chicago Economics Department, who later won the Nobel memorial prize in economics; and others on the Congressional staff who opposed demand-side pump-priming. I was drawn into this circle soon after I came to Washington in 1975 to fill a slot on the Joint Economic Committee, first for Senator Bob Taft, Jr. (R-OH) and later with Congressman Bud Brown (R-OH). They were both key supporters of tax indexing to fight the effects of inflation on tax rates.

When I say "surrounded," I mean that literally. Jack would have half a dozen people in the room at the same time to hash out economic issues and theories, and to develop ways of communicating the ideas with the press, the public, and his colleagues in Congress. It was a sort of seminar with six professors agreeing on the general approach (sound money, lower tax rates, smaller government) while arguing fiercely over details, and one student (Jack) who was the one who had to keep order. After these sessions, we would have a good idea of how to present the arguments and rebut the inevitable counter-attacks by defenders of the status quo. Jack, an excellent public speaker, was our earliest "great communicator" on tax issues, pre-Reagan. When Jack presented these ideas to Congress, he was not just reading from talking points. He knew the issues and theories inside and out.

Right policy mix

In a nutshell, Jack Kemp rejected the easy money, high tax policies of the day. Kemp favored the opposite approach. He wanted sound money to fight inflation and rein in nominal "demand," even flirting with the gold standard or some other price rule to limit the Federal Reserve's inflationary bias.

He favored lower tax rates on work, saving, and investment to boost incentives to raise real output. He also favored reduced regulation and lower barriers to trade.

Kemp offered several tax reductions designed to encourage business investment in 1974-1976. They received a cold reception in Congress. His next effort, more populist and more popular, was a proposal for a 30 percent across the board reduction in individual income tax rates, which he developed and introduced in partnership with Senator Bill Roth (R-DE). The Kemp-Roth bill focused on the individual side of the tax code, to promote hiring, work effort, and saving. It was also key to promoting non-corporate business and entre-preneurship.

Kemp's policies gave a positive message. We could have strong economic growth without inflation. Instead of root-canal economics, we could have a new round of prosperity. These ideas were a ray of hope in a dismal economic decade. Many old-guard economists sneered that the new economic ideas had come out of Washington instead of academia, but that was their fault, not ours. In fact, there was always more support for some or all of the new notions at various schools than the opponents realized or let on. The deficit hawks were equally upset, unwilling to risk a tax reduction of any sort, and not willing to count on the reflow of tax revenue that would follow a rise in output and income.

Kemp persevered. He was instrumental in getting these ideas across to the press (strongly supported by Robert Bartley, editor, and Jude Wanniski, editorial writer, at the Wall Street Journal), and to his colleagues. The Kemp-Roth bill became a rallying point for Republicans in both Houses. Amendments to allow room for across-the-board tax rate reductions were presented at every Budget Resolution debate in the House in the late 1970s, with the help of Representatives John Rousselot (R-CA) and Marjorie Holt (R-MD), and in the Senate Finance and Budget Committees by Senators Bill Roth and Orrin Hatch (R-UT).

Kemp-Roth was offered as a substitute for the Ways and Means Committee's tax bill in 1978, and a scaled down version tied to spending restraint that was offered by Senator Nunn (D-GA) actually passed the Senate with bipartisan support. It was rejected by the House Members in conference at the insistence of President Carter, even though the House itself voted on a bipartisan basis to instruct the conferees to accept the provision.

These ideas attracted the attention of Senator Russell Long (D-LA), chairman of the Senate Finance Committee. He became persuaded that the major commercial computer models of the economy that Congress consulted for budget estimates made tax cuts look more expensive than they really were by understating their benefits for economic growth. This gave the Finance Committee less room to make tax changes under the Budget Resolutions. Long supported research into alternative modeling. Jack Kemp was asked to testify at before Finance on the benefits of rate cuts.

Senate Budget Committee Chairman Ed Muskie (D-ME) rejected a request by Senator Hatch to hold a hearing on the lack of supply-side elements in the economic models. Hatch turned to the Joint Economic Committee, which held hearings that confirmed the models' omission of price effects of taxes. The Joint Economic Committee Minority had described supply-side economics in several JEC reports between 1976 and 1978. Later, the JEC Majority under Senator Lloyd Bentsen (D-TX) even joined in, producing two unanimous reports in 1979 and 1980, covering some supply side business issues. (Bentsen proposed to accelerate depreciation with 10, 5, and 3-year write-off periods for equipment and structures). The 1980 JEC Annual Report was even entitled "Plugging in the Supply Side."

Jack was instrumental in bringing these new tax and monetary policy ideas to the attention of Ronald Reagan, who embraced them and made them the centerpiece of his economic platform in 1980. After Reagan's election, Kemp-Roth (along with Bentsen's "10-5-3" plan) became the template for Reagan's

1981 Economic Recovery Tax Act. That three-year, 23 percent reduction in marginal tax rates, combined with a less expansive monetary policy conducted by Paul Volcker at the Federal Reserve, broke the back of inflation and restored economic growth to the country. It led to the creation of over 18 million jobs during the Administration's time in office.

After retiring from Congress in 1988, Jack served as Secretary of Housing and Urban Development in the Administration of President George H. W. Bush. Jack sincerely believed that everyone, of all races and backgrounds, could and would benefit from lower tax rates and more economic opportunity. He wanted to make test cases out of the inner cities and most depressed rural areas, and pushed through the "enterprise zone" initiative that brought added tax incentives for regional renewal.

After leaving government, Jack continued to support an overhaul of the tax system to make it simpler, fairer, and more conducive to growth. To that end, he chaired the 1995-1996 National Commission on Economic Growth and Tax Reform, helping to keep pro-growth tax ideas alive. I helped staff that effort, and it was a privilege to work with Jack on tax ideas again.

In 1996, Jack ran as Bob Dole's vice-presidential running mate on the Republican ticket. His message of lower taxes and sound money was as compelling as ever. Ironically, the low inflation environment and relatively strong economy that Jack's policies had made possible favored the reelection of the popular moderate incumbent, Bill Clinton.

The policy mix that Kemp helped to develop and promote in the 1970s and 1980s – sound money and lower tax rates at the margin for individuals and businesses – was the right mix for that time, and it is still the right policy mix today. Had it been followed more closely in the early 2000's (more tax cuts at the margin effective without delay in 2001, fewer credits for social purposes, and much less reliance on excessively easy money to end the previous recession), we would not be in the current policy mess.

Jack continued to work on tax, housing, and social issues until his last illness. He was a friend to all men of good will in either party. He was a personal friend and inspiration to me, and he served several years on IRET's board of directors. We shall miss him greatly.

Stephen J. Entin
President and Executive Director
