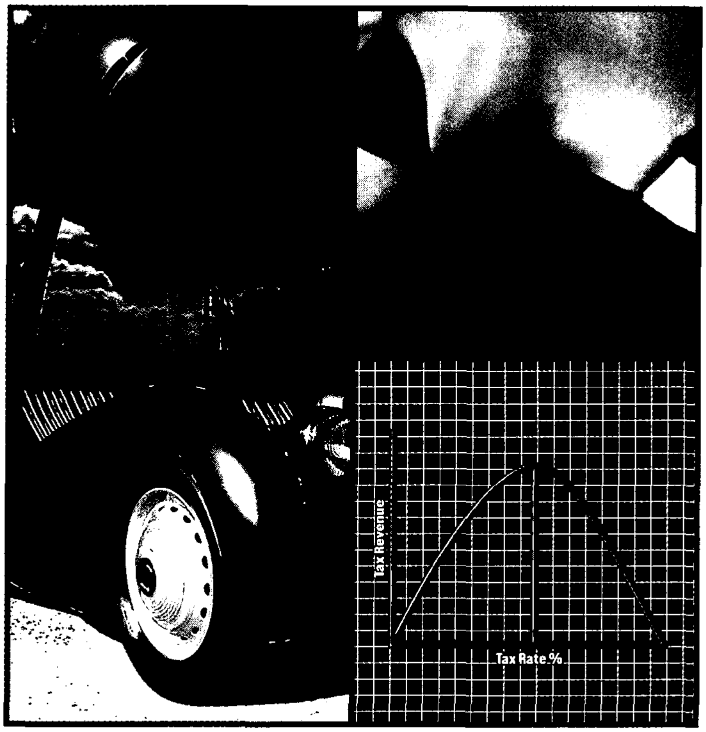
AHEAD OF THE CURVE

ART LAFFER SPEAKS

BY BRET SWANSON

It is the Friday before Christmas in California, and Arthur Laffer is hurtling down the freeway in a silver Lexus ES 400. He's treating his youngest son, Justin, 18, and eldest grandson, Kai, 13, to a semi-pro hockey game between the hometown San Diego Gulls and the Bakersfield Condors. They jump off at the exit for Kai's house, searching for the right quiet street. "That was it!" Justin yells. Laffer whips the Lexus around and surges, then rolls into his daughter's driveway. His self-imposed 80 mile-per-hour speed limit, I'd learned, applies not just on thoroughfares but on twisty mountain roads and side streets as well. He had a minor fender-bender that very day but says there have been no major accidents in decades.



Art Laffer has been hurtling along the usually sedate byways of the dismal science for three decades, ever since he hit Washington during the Nixon administration, as the first chief economist of the Office of Management and Budget. On leave from a teaching job at the citadel of American free-market economics, the University of Chicago, he quickly impressed his OMB boss, the future Secretary of State George Shultz, with what turned out to be an uncanny prediction of the gross domestic product in 1971.

Then, on a cool autumn evening in Washington in 1974, Laffer, 35, had one of those moments that end up defining someone for the rest of his life. Gerald Ford's chief of staff, Don Rumsfeld, and his deputy, Dick Cheney—things were different then—were sitting atop the Hotel Washington in the Two Continents lounge near the White House. Watergate and stagflation gripped the country. Ford wanted to WIN—Whip Inflation Now!—with a five-percent tax surcharge, which was supposed to re-ignite the American economy by taking big bites out of it. Today raising tax rates in a recession seems silly to almost everyone except Tom Daschle and the junior senator from New York. In the fall of 1974, Rumsfeld and Cheney were looking for alternatives. Happy to oblige was Laffer, who pointed to a mandala sketched on a cocktail napkin—two perpendicular lines and an arc—as the answer to the complex problems plaguing the nation. The Laffer Curve, one of the icons of supply-side economics, was born.

But when Jimmy Carter arrived, Laffer turned his back on the Washington power game, and headed off to California. Keeping in touch with is old friends, he was part of Reagan's informal team of economic advisers, but he never again took a full-time job in Washington. He taught for several more years and then started his own California-based economics consulting firm. And reveled in America's Eden, raising kids, cultivating palm trees, rearing giant turtles and helping turn Jerry Brown from whatever he was into a temporary flat-taxer for his quixotic 1992 Democratic presidential run. (What if...)

And that is where he seemed inclined to stay, the happy Hobbit of Rancho Santa Fe. But somewhere along the road that brought Republicans—and a lot of his old friends—back into the White House, something happened. Art Laffer, now 62, is once again plugged in—and making waves. The last time he did that, back in his napkin-sketching days, liberals and traditional Republicans were the ones expressing horror. This time, however, it is Laffer's supply-side friends and protégés who think he's crazy. *A lefty sales-tax holiday? A one-year capital-gains gimmick? No signs of deflation? None?*

The central insight embodied in Laffer's curve is that lower tax rates—by encouraging people to work, invest, create (and report their income)—can expand the economy, the tax base and tax revenues. Though rooted in thousands of years of human experience, academic economists and politicians of all stripes laughed. Laffer and his mentor, Robert Mundell, a future Nobel prizewinner, were pariahs.

It would take six more dismal years and two presidential campaigns by Ronald Reagan to fulfill Laffer's inspired doodling. After Reagan's tax rate reductions were put in place, inflation plummeted and real tax revenues surged 39 percent in six years. We also got an 18-year boom.

And now, at the end of that boom, Laffer's old crew is back for a last hurrah. Cheney, Rumsfeld, and two of their good friends from the Ford administration, Paul O'Neill and Alan Greenspan, form a Washington power pyramid. And once again, Laffer is making trouble.

The rumblings began last spring when he wrote in the *Wall Street Journal* (and The American Spectator) that easy money from the Fed in response to Y2K computer fears—not tight money signified by interest rate hikes and a rising dollar—had caused the stock market crash and economic slowdown.

Most free-market economists believed that after the Fed removed its Y2K cash reserves, there could be no long-term inflationary impact. Commodity prices were at 15-year lows, and debtors the world over were going bankrupt at record levels, classic signs of *deflation*. Laffer was suggesting that inflation (too much money), rather than deflation (too little money), was the problem, and that economic growth of 6 percent around the turn of the millennium was unsustainable. We were borrowing growth from the future and would now have to pay it back.

In November of 2001, Laffer endorsed an ill-fated tax proposal offered by two liberal senators, Democrat Patty Murray of Washington and Republican Olympia Snowe of Maine. The idea was to give the post-terror economy a quick boost with a ten-day nationwide sales tax holiday. It seemed a typical effort to pump up consumer demand, not a worthwhile goal to supply-siders who focus on producers as the source of growth. Laffer explained how a temporary cut in sales taxes can actually have supply-side effects (if you know items will be less expensive during a certain period, you will work harder for funds to buy them). But no one was buying Laffer's line.

In mid-December, Laffer offered another temporary tax cut idea, this time directly to his old friend, the vice president. Laffer suggested eliminating the capital gains tax for all assets bought in 2002 and held for three years or more. Within hours, White House aides began floating the idea among conservative economists, Cheney's interest was apparent, and e-mails critiquing the proposal began to fly. "No gimmicks, please." "A demand-side plan."

Many conservatives, who don't like "holding periods" and who tend to favor permanent tax changes that simplify the code, think the proposal resembles an incentive twisting Democratic attempt to "fine-tune" the economy. To many of Laffer's fans and followers the capital gains "gimmick" seemed the third strike on him in one year.

Laffer is aware of the sniping. He still wants big things—an 11 percent flat tax and privatized Social Security—but says you've got to figure out ways to win politically. "We have a very, very weak economy," Laffer says. "We've had an enormous asset value reduction in the country. And I would like to see a zero capital gains tax for a year. I'd rather see it for two years. I'd rather see it for five years. I'd rather see it for 500 years. But I'd rather see it for a year than for nothing."

The measure could boost asset values by 5 to 15 percent, Laffer believes. The economy would do well and people would wonder why we ever had a capital gains tax. "Just try putting the rate back up to 20 percent."

Laffer also believes President Bush needs something big to ensure at least a mild economic rebound before the November elections. Otherwise, the House of Representatives could go Democratic, and politicians could make what is a mild recession much worse. Hillary and Dick Gephardt, meet Larry Lindsey. Not a pretty thought.

Attempts by the supply-side crowd to hold Laffer to some sort of religious economic orthodoxy amuse him. "It's not a movement, it's economics," he insists. Too many "pundits" and "op-ed writers" masquerade as economists. "Ask them where they got their Ph.D.s.," he laughs.

Laffer's six children all live in California. Two work with him at Laffer Associates, which advises big Wall Street firms as well as European and Asian clients. Art, Jr., 36, runs the company.

Traci, Laffer's wife of twenty years, "rescued" Laffer and his first four children after Laffer's first wife abandoned them in the late nineteen-seventies. Laffer gained custody and was struggling as a forty-two year old single father when the twenty-two year old "angel" saved them. Today there are eight grandchildren.

Trees from around the world dot the Laffer family's sixteen hilltop acres. Visit the barn and you will meet Mahatma, a 450-pound Aldabra tortoise from the Indian Ocean—the endangered *geochelone gigantica*, if you are wondering. There are peacocks, pigs, and a herd of rare African deer. Alligators lurk in the greenhouse. Inside the house (as in his office) is a clutter of art, crystal, china, antique tables, cabinets, desks, chairs, and shelves, vases, pedestals, books, plants, maps, artifacts and fossils. A pedestal in the living room is cloaked with an American flag and topped with a bust of Ronald Reagan.

Would he trade it all for a seat on the Fed, as some suspect his recent string of trial balloons might be signaling? Maybe not. Laffer's West Coast perch seems to instill an optimism, a good cheer, not found among those closer to Washington and its insider battles. So what if he tries to help a few liberal senators cut taxes in an unorthodox manner? So what if a former gold-standard adherent is playing good cop with a Fed chairman who has marginalized most supply-siders. "I'm not here to scream," Laffer says. "I'm just thinking about ways to make the world better."

The American Spectator: What's the simplest explanation of the Laffer Curve?

Arthur Laffer: There are two effects tax rates have on revenues. One is the arithmetic effect: If you raise tax rates, you collect more money per dollar of tax base. Then there's the economic or incentive effect: If you raise tax rates on something, you reduce the incentives for doing that activity and end up with a smaller tax base.

Not obvious at the time you said it?

In the mid-1970s, the marginal cost of collecting taxes was huge. The five percent tax surcharge put on by Gerry Ford was just a major mistake. What I tried to do was to show that while you may get more revenues, you won't get 5 percent more. You may get 4, 3, 2 percent. You might even lose revenues. But you won't get 5 percent, which made it a budget discussion. If you believed that, 150 percent tax rates would yield tax receipts greater than GDP.

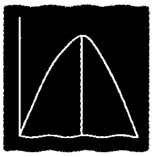
Why hadn't anyone else pointed that out?

Tons of people had. The best one I've seen is the fourteenth century *Muqaddimah,* by Ibn Khaldun. You can find the idea everywhere—Adam Smith, David Ricardo, they all have it. Keynes has it explicitly. What had happened in fiscal policy was that everyone had forgotten it for thirty or forty years. Tax rates and revenues became assumed as one. I just brought it back to a public realization.

The result was the Reagan tax cuts. But we never did get the ultimate extension of the Laffer Curve, fundamental tax reform.

That's why I wrote Jerry Brown's flat tax proposal. We came pretty close—at the 1992 convention, he had the second most delegates after Clinton. I think he would have won if he hadn't named Jesse Jackson as his running mate.

What does your perfect tax code look like?



Number one, it should start out on the first dollar you earn. Then take all federal taxes, (except the sin taxes, which are there to discourage behavior not collect revenue)—I'm talking payroll taxes, income taxes, corporate profits taxes, all federal excise taxes, tariffs, telecom taxes—get rid of them all. And have two taxes. One on business value added. And one on personal unadjusted gross income.

Why do you like a value added tax?

Because it's got a huge base. And it's all value added. You want to tax the value added to the GDP because that's what you're getting the resource base out of. You want to tax both unadjusted gross income and business value added because that way you get the whole GDP twice, so you can have half the rate.

What's the rationale for that?

If you beat a dog, it's gonna run, but you don't know in which direction. If you feed a dog, you know where it will be. Taxes are like that. People will do all they can to avoid paying taxes. Evasion, avoidance, underground economy, tax shelters, etc. Going out of work. So the theory behind the flat tax is you want the lowest possible rate on the broadest possible base. By having the lowest rate, you provide the fewest incentives to evade, avoid or otherwise not report taxable income.

Isn't there double taxation involved?

Oh, there is. But it's double taxation of everything the same. There are no distortions. You can tax GDP at, what is it today, 22 percent of GDP. Or you can tax it 11 percent at the individual level and 11 percent at the production level. I think it makes a lot of sense to tax 11 percent of each because you make the base that much bigger and the rate that much smaller.

Eleven percent sounds pretty good.

Well, it came out to 10.87 percent when I did it for Jerry Brown. He wanted to reduce the deficit in '92, and he also wanted some new programs, so he made it 13 percent. We would have run huge surpluses. It was perfect. You saw who liked it. The Robbinses.

Gary and Aldona, the super-supply-sider former Reagan Treasury officials?

Yeah, they wrote a great piece on Jerry's flat tax. And I couldn't raise my head because, of course, if I became the point man on a Democratic issue, well…

What about mortgage interest deductions?

You have to have them. Here's why: If I borrow $100,000 at 10 percent interest and I lend $100,000 at 10 percent interest, have I done anything of any economic consequence that would require me to pay a tax? No, I've just been a conduit for a loan. I've just been a pass-through. But if I borrow $100,000 at 10 percent, and I lend $100,000 at 20 percent, should I be liable for a tax? Yes, because I've increased value. I've been a financial intermediary—a bank, a savings and loan, an insurance company. All interest income should be taxable, and all interest expense should be deductible.

You're very cheerful…

Intellectually, we've won. No one today is proposing legislation for a 93 percent marginal tax rate, which is what it was when Harry Truman cut it. Those people were our ancestors, though it's hard to imagine them even being the same species. Barry Goldwater opposed the Kennedy tax cut. Bob Dole opposed it. Marginal tax rates have come down substantially, and the base has expanded. We've got a lot of things left to do, but they're not nearly as imperative as back in the 70s. That was serious trouble, and we needed a quick fix.

Why did it take so long?

I thought it was pretty amazing we turned it around as fast as we did. Just to win even in your lifetime is amazing. The California tax revolt, Howard Jarvis and Prop. 13. Puerto Rico, the tax reform for Carlos Romero-Barcelo. The rate, I think, was 87.1 percent. We cut it down to 50. That's the one we used to really show Reagan what tax cuts can do. We've been winning and winning, and we lose a little, but generally we've won.

So we now live in a supply-side world.

We've always lived in a supply-side world. Now we live in a world where everyone realizes it's a supply-side world. By the way, that's just on taxes. On monetary policy, Alan Greenspan's been wonderful. Paul Volcker was terrific. We've been able to get a stable value of money without some hokey hookup, a return to the gold standard.

What did Volcker and Greenspan use that allowed them to do better than gold?

They use a price rule. I can remember a conversation I had with Volcker in 1983 where he used spot commodity prices, an upper band and a lower band, and when commodity prices rise above a certain level, he sells bonds in the market and takes base out of the system. They've been using, effectively, a price rule through policy. They've just done a crackerjack job. See, the one problem with gold, if you don't fix the price right, you got a huge hit coming. If we had fixed the price of gold at say $800 an ounce…

We would have kept on inflating…

…Oh, like you wouldn't believe. And you know, the problem with getting it right, and this is what Britain did with the wrong exchange rate after World War I…

Or after our Greenback era of the Civil War…

…precisely. Exactly. When we set the Greenbacks to gold, we had a real problem with deflation. Gold is a great anchor, and it's a great way of controlling miscreants, like we had in the 70s. But it can also force you into policies that are really terrible if you set the price wrong. Imagine we have a gold standard, at today's $275 per ounce, and we discover a new gold mine that can produce unlimited quantities of gold at $5 an ounce.

But that's a special case that doesn't happen.

I'm giving you a hypothetical. You'd have to have a huge amount of inflation to get $275 to be the right price. All I'm saying is that when we have disturbances in the gold market, it causes problems in the money market.

Isn't the reason we use gold, however, as an indicator if not a standard, because there are so many fewer disturbances in the gold market than just about anything else in the economy?

No, no, I don't think so. Throughout the

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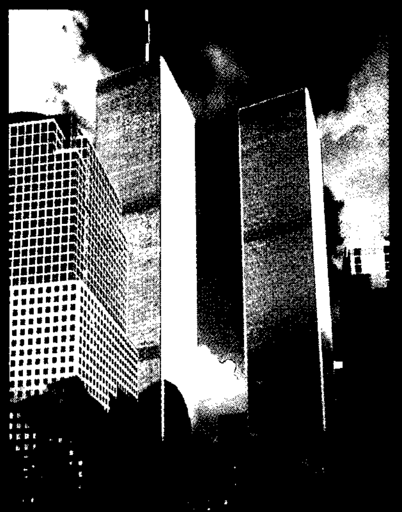

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period of convertibility there were always periods of "judicious suspension of convertibility." You had the Spanish inflation with the discovery of gold in the New World. It's not been unheard of. By the way, I'm not against gold. I think gold would have been great when you had a bad Fed. The point is a good Fed is always better than some arbitrary rule.

You commend Volcker and Greenspan for following a price rule. But you have a pretty significant move down from $385 in 1996 to $275 today. It doesn't seem that Greenspan continued with that price rule.

He sure did.

How do you reconcile the fall in gold with a continuation of the price rule?

The price rule follows a bundle of commodities. The one Volcker described to me was a spot commodity price index, which includes gold.

But everything followed gold down. Coffee, steel, grains, oil...

Oh no. They went up and down. Yes, spot commodity prices today are low. And that's the only one that's off the mark. But two-and-a-half, three years ago, they were pretty high.

You've written that commodity prices could be low because of the bad economy, but the fall in commodity prices preceded the bad economy by four years.

They were falling before the bad economy. But you had a sharp turn up in inflation during the Y2K period, which you know I wrote in the Spectator.

The monetary base increased when the Fed put temporary reserves in bank vaults in case of Y2K bank runs. When Y2K problems didn't materialize, the Fed removed the reserves, and all the indicators that had looked a bit inflationary—gold spiked a bit, commodities spiked a bit—resumed their fall toward lower prices, an indication of *deflation*.

No, not a little spike. Gold went up to $325 an ounce.

On a five-year path, that spike is a blip.

That may be a blip on the five-year path, but the economy's a blip, probably, on a five-year path. I thought there was a very serious problem of the Y2K expansion of the monetary base. My view at the time was that there was no real Y2K problem and this was a very dangerous precedent, sort of a 1970s-redux, and what would happen was, sooner or later, banks would have the constraints and reserve requirements taken off, and they would make loans to marginal companies, they would make loans for marginal projects at good companies, and the consequences of the whole 1999, early 2000, model would occur. When the Fed realized the mistake, it did exactly as it should have and removed the base. If I were a member of the Fed, would I have gone along with the monetary base expansion? I might well have.

They took the base out, but continued for five months after that increasing interest rates.

They didn't increase interest rates.

Well, the Fed Funds rate.

No, no, no, no. The Fed Funds rate follows the market. It doesn't lead it. The Fed is not proactive on interest rates. It's reactive on interest rates. The discount rate follows the T-bill. It doesn't lead the T-bill. You can predict the discount rate changes by looking at what's happening at the 91-day T-bill.

So why was the T-bill rising during those six months?

Prior to the Fed removing the base, we were building an inflationary model. It was 1970s redux. The world was coming back to that type of model.

But after they withdrew the monetary base, rates kept on rising for those six months.

Yeah, when you first take the base out, you do have a problem. There's a scramble for funds. All those guys who had loans not only didn't get new ones, they had the old ones recalled.

Almost two years later, aren't companies still desperately looking for financing?

No. The liquidity problem's over. When the inverted yield curve flipped, the liquidity crisis was over.

Liquidity's one thing. But doesn't the dollar's 30 percent revaluation over the last five years have a drastic effect on companies that borrowed money at one level and have to pay it back at a much higher price?

Yes. If a company has a problem with different currencies, they should cover.

But today they can't cover because the dollar is the global standard. The important leveraged companies of the 80s—MCI, TCI, McCaw Cellular—all almost failed several times, but they kept rolling over their debt.

Okay, you're talking about exchange rates. You're not talking about high-risk investments...

Doesn't a revalued dollar affect the ability of borrowers to roll-over their debt?

Let's talk about your debt, let's not just talk about high risk for a company, which gives you high yields. McCaw Cellular and these others. They needed it badly, and Milken came along and was able to satisfy a lot of that. This bag [points to canvas bag on table that he carries with him]is from the '89 Drexel conference. Now let's talk about currencies. You're a company and you've got a currency exposure. You can take care of that currency exposure if you'd like. Now, you don't have to. And if you don't do it, you take the risk of being caught one way or the other.

Currency exposure implies you're operating a business overseas, and there are difficult foreign exchange issues. But when the dollar—effectively the world's currency with 70 percent circulating overseas—has a significant revaluation...

Against what? You gotta tell me. Revalues against what? Revalues against goods and services? I don't think so. The price level has not shown a huge drop in prices. In fact, far from it.

Do you believe in the CPI?

It's okay. It's not great. I think the CPI overstates inflation...by maybe a percent a year.

I've been trying to get at deflation, which I think you've called a bunch of "hooey."

That was in a nice mood.

Well, has Japan deflated over the last decade? And how do *you* define deflation?

Deflation is falling prices. You want to use the CPI or the Producers Price Index (PPI). And Japan has had some deflation. Now let's talk about Japan. Has Japan's deflation been primarily because of monetary policy? Let me tell you, no.

Japan's problems are political and cultural?

I wouldn't go that far...There might be all of those...But I would say taxes. They have so raised taxes in Japan that everyone in their right mind wants out. The overhang in the unfunded liabilities of social security, in unfunded liabilities for corporations. The top marginal tax rate before Obuchi dropped it was 65 percent. Sixty-five. They had a 1 percent transactions tax. A 1 percent per annum pension fund tax. They had all of these horrible taxes.

They've got a huge demographic problem.

No. When you have defined benefit programs that are then matched with demographics, you have a problem. If they had a defined contribution problem, there would be no demographic problem at all. An asset has a negative rate of return in Japan—and a positive return in the U.S. You pick that machine up, load it onto a ship in Japan, ship it to the U.S., offload it in the U.S., that machine goes from a negative rate of return to a positive rate of return. That would be called a Japanese export, a Japanese trade surplus, and a U.S. import and a U.S. trade deficit. The reason why you've got huge trade surpluses in Japan and huge trade deficits in the U.S is...

...everyone sends their capital here...

Yeah, that's exactly what's going on. It's the transportation costs that prevent a hundred percent shift in one day.

Taxes can be exacerbated by inflation, but they can also spur inflation, as they did here in the 1970s. Why haven't Japan's high tax problems been inflationary, rather than deflationary?

Because they've had a wonderful monetary policy until recently, until weirdos have gotten in there now, and told them that they have a deflation problem. And now they've caused the Bank of Japan to start printing money ridiculously. And what you're seeing now is the yen fall...

Isn't that a good thing?

No, it's ridiculous. They don't have a monetary problem. They have a tax problem, an overhang, a defined benefit problem. The one thing they've done well is have a stable currency. And now all these guys have gone in there and told them, you've got to inflate. How dumb can they be?

How do you define Japan's stable currency? They went from some 60,000 yen per ounce of gold to some 30,000 yen per ounce of gold in the last decade...

See, you define it in terms of gold, I don't.

So why do you say the yen's been stable?

I just look at the value of the yen in terms of the dollar during this period. And I look at the value of goods and services in Japan. I look at the price index. They've had very low interest rates and very low inflation. Now, the problem with Japan, the reason interest rates are so close to zero, is they have no real return on capital. I'd love to see interest rates much higher in Japan. Not because they inflate, but because the marginal return on capital goes up and you get the real yield on capital rises. The way it's much higher in the U.S.

Is social security privatization Japan's answer?

All the stuff we do on Social Security is really silly as well. We need IRAs, Keoughs, 401(k)s, all the defined contribution plans. Then you're never overfunded or underfunded. You can't get rid of market risk. All you can do is allocate the burden of it to someone. Social Security puts it all on the economy.

Isn't a zero percent capital gains tax rate really the ultimate IRA or 401(k)?

You need a zero capital gains tax rate because economically it's the right thing to do. A capital gain is the appreciation in the value of an existing asset. You buy something at 10. You sell it at 13. You've got a capital gain of 3. The value of an asset is the discounted present value of that asset's after-tax cash flow. Therefore, capital gains is the discounted present value of the *increase* in after-tax cash flow. As you can see, by having the discounted present value of the increase in after-tax cash flow, capital gains—*untaxed* capital gains—already include the effects of all taxes on future increases in earnings. Therefore, any additional tax on capital gains is double taxation. And I think you'll find every economist agreeing with that. Some just find the social gains of redistribution, or whatever, overcome the economics.

What's the outlook?

If you held the current political position, I'd be fine with the economy. As I sit here with you, nothing tells me there's a real problem. I don't see any major tariff increases, do you? Quotas, no. I don't see any major tax increases coming. The Fed's done a great job. I don't see any wage and price controls. If you believe that the political process is not going to change drastically.

How fast do you think we grow in 2002?

I think we can get nice, solid growth in 2002. But politically, I'm very worried about state and local governments raising tax rates. And if you get a huge political reversal in November, I think it bodes very ill for the future of the economy. It's not that I'd just like to see W. win. I really see a group in the Senate as being very harmful. It's Schumer, it's Hillary, Corzine, it's Feinstein, it's Boxer, it's Wellstone. If they get control of the Senate, and the Democrats win the House, and Bush is still president, they can do unconscionable acts, and Bush will get blamed.

Your answer is the zero capital gains tax rate for all assets bought in 2002.

You don't have time to do a 20-year plan for 2002. You need something that hits, now. And you need something you can get passed with the Democrats. The Democrats, most of them, would like to do something that would help the country.

You've praised Treasury Secretary Paul O'Neill for his intelligence but criticized him for the lack of a coherent worldview. Who has that worldview?

My favorite is a guy named Gerry Parsky of Aurora Capital, from San Diego. Gerry Parsky was an undersecretary of the treasury under Simon and is just really good. He ran the Bush campaign here in California. A very elegant man. He has all the experience. And he has the humility of someone who has lived in the marketplace. I mean lived in the marketplace by buying and selling assets. Not by being the head of a major corporation. Paul O'Neill coming from Alcoa does not serve him well. Don Regan coming from Merrill *does*. We've all bought bad assets. It's true of all of us. It gives you humility.

How about our president and vice president?

I think W. has been an excellent president. Much better than I thought he'd be. You know I'm not fan of his father's. In fact I voted for Clinton twice. I did vote for W. I didn't expect nearly as good a *person* as I've seen. Although I wasn't expecting a bad person. Don't get me wrong. I think he's been failed by some of the people he selected. O'Neill's just a catastrophe waiting to happen. I think Larry Lindsey has not done the proper job, and Larry has all the capacity to do a great job. The one solid rock, the finest person in my mind, is Dick Cheney. Dick Cheney is a young George Shultz. He and Don Rumsfeld are just super, wonderful public servants. And it's all a credit to W.

Will the bad economy block him from achieving some of the other big, important goals?

It would be wonderful if he could do the zero capital gains tax and get Gerry Parsky as secretary of the treasury. Then you could do today, on a global scale, as big a revolution as Reagan did. Economics is not really our problem as it was in the 70s. Our problem is really terrorism and related issues. The global role of the U.S. as a moral leader, as a military leader. You know, the Europeans are not our guys. We have to show the way, not look for coalitions. We have to step up front. That's where I think Rumsfeld and Cheney have done such a wonderful job. But you especially need the domestic support...When Reagan was reelected in the 1984 landslide, it was there. W. needs that type of base to be able to push his agenda forward in the international arena. His big thing was to give rebates to people who never paid taxes. Which is not only bad economics but is also linguistically flawed. A rebate requires that you've already paid. It's bad English. It's bad economics.

As you've said, "rebates" don't increase demand. By transferring resources from the productive to the less productive, they decrease both supply and demand, and shrink the economy.

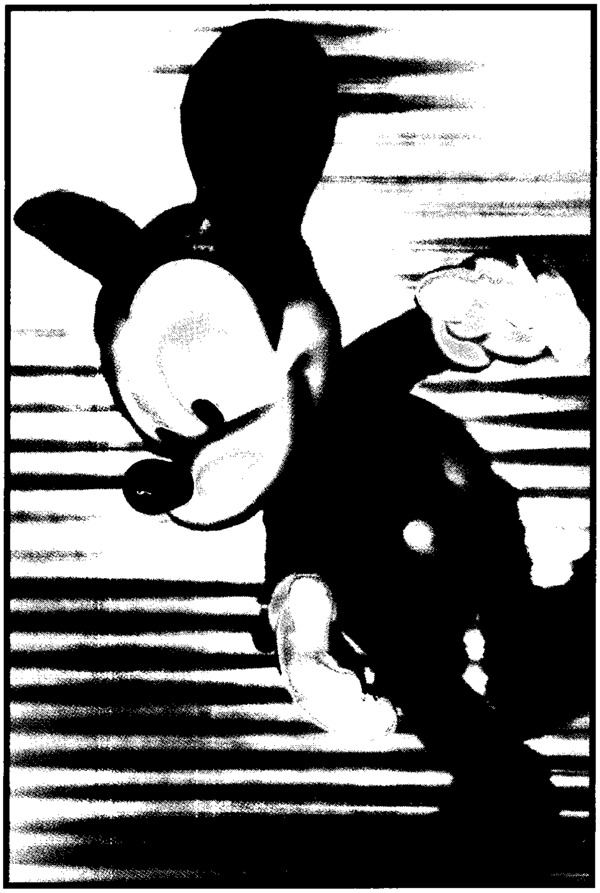
You can never increase demand without increasing supply. Let me tell you, the two equal. Hello!

CONTROL & CREATIVITY

The future of ideas is in the balance

BY LAWRENCE LESSIG

The Internet puts two futures in front of us, the one we seem to be taking and the one we could. The one we seem to be taking is easy to describe. Take the Net, mix it with the fanciest TV, add a simple way to buy things, and that's pretty much it.



Though I don't (yet) believe this view of America Online, it is the most cynical image of Time Warner's marriage to AOL: the forging of an estate of large-scale networks with power over users to an estate dedicated to almost perfect control over content, through intellectual property and other government-granted exclusive rights. The promise of many-to-many communication that defined the early Internet will be replaced by a reality of many, many ways to buy things and many, many ways to select among what is offered. What gets offered will be just what fits within the current model of the concentrated systems of distribution. Cable television on speed, addicting a much more manageable, malleable and sellable public.

The future that we could have is much harder to describe. It is harder because the very premise of the Internet is that no one can predict how it will develop. The architects who crafted the first protocols of the Net had no sense of a world where grandparents would use computers to keep in touch with their grandkids. They had no idea of a technology where every song imaginable is available within thirty seconds' reach. The World Wide Web was the fantasy of a few MIT computer scientists. The perpetual tracking of preferences that allows a computer in Washington state to suggest an artist I might like because of a book I just purchased was an idea that no one had made famous before the Internet made it real.

Yet there are elements of this future that we can fairly imagine. They are the consequences of falling costs, and hence falling barriers to creativity. The most dramatic are the changes in the costs of distribution; but just as important are the changes in the costs of production. Both are the consequence of going digital: Digital technologies create and replicate reality much more efficiently than non-digital technology does. This will mean a world of change.

Skip ahead to just a few years from now and think about the new potential for creativity. The cost of filmmaking is a fraction of what it was just a decade ago. The same is true for the production of music or any digital art. Digital tools dramatically extend the horizon of opportunity for those who could create something new.

And not just for those who would create something "totally new," if such an idea were even possible. Think about the ads from Apple Computer urging that "consumers" do more than simply consume:

Rip, mix, burn.
After all, it's your music.

Apple, of course, wants to sell computers. Yet their ad touches an ideal that runs very deep in our history. For the technology that they (and of course others) sell could enable this generation to do with our culture what generations have done from the very beginning of human society: to take what is our culture; to "rip" it—meaning to copy it; to "mix" it—meaning to re-form it

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