



# FACTS & OPINIONS

*On Public Interest Issues*

## Quotes

Freedom is the sure possession of those alone who have the courage to defend it.

—Pericles

Politicians say they are beefing up the economy. Most don't know beef from pork.

—Harold Lowman

We laugh at honor and are shocked to find traitors in our midst.

—C.S. Lewis

The strongest reason for the people to retain the right to keep and bear arms is, as a last resort, to protect themselves from tyranny in government.

—Thomas Jefferson

## President Bush's Tax Package: Pro-Growth Reform

Daniel J. Mitchell

The Bush Administration has announced a supply-side tax package that will significantly improve the economy and make America more competitive. Its crown jewel is a proposal to eliminate the double taxation of dividend income. This dramatic initiative, which is an important part of fundamental tax reform, will increase investment, improve corporate governance, and attract capital to the U.S. economy.

The White House also has proposed to immediately implement the personal income tax rate reductions that were approved in 2001 but were not scheduled to be fully effective until 2006 — fixing a bizarre policy that encourages taxpayers to delay economic activity. In addition, the President is seeking a three-fold increase in the amount of small-business, investment that can be immediately deducted (“expensed”), thus reducing a perverse bias in the tax code and taking a further step on

the road to fundamental tax reform.

**The Problem of Double Taxation.** The Internal Revenue Code imposes two layers of tax on corporate income. Companies must pay a 35 percent tax on profits. If the remaining after-tax income is then distributed to shareholders, it is subject to another layer of tax, since individuals must include dividends in their taxable income.

Depending on an individual's tax rate, the effective tax rate on corporate income can exceed 60 percent. Moreover, companies generally have to overstate their profits thanks to depreciation, foreign tax rules, and the alternative minimum tax. This income can also be hit by capital gains taxes and the death tax, further exacerbating the tax code's bias against investment.

**The President's Solution.** The Administration proposes to end the double taxation of

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## FACTS & OPINIONS

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**President**  
Dr. Don Racheter

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## Focus on Iowa Wesleyan College

Amy K. Frantz

The Inauguration of Iowa Wesleyan College's 27<sup>th</sup> President, Dr. William N. Johnston, took place on April 11, 2003. The Inauguration ceremony was the highlight of the events scheduled over several days to mark the occasion.

Earlier in the week, IWC music professor Dr. Joel Brown was featured in a piano concert and art exhibition in the Chapel auditorium. Other venues around campus featured exhibits and presentations, including a look at the family legacy of Abraham Lincoln at the Harlan-Lincoln House, and the Underground Railroad in Southeast Iowa, at the Chadwick Library.

The Howe Student Activity Center hosted a community reception and portrait unveiling honoring Public Interest Institute Board member Stanley Howe and Helen Howe. The Howe

Student Activity Center features basketball and volleyball courts, conference rooms, a "smart" classroom, athletic training room, a walking and jogging track and fitness-wellness center. Stanley and Helen Howe's generous contribution toward the construction of a student activity center enabled this project to become a reality, which has benefited IWC students, faculty, staff, and members of the community.

The festivities closed with an event featuring astronaut Dr. Peggy Whitson, an Iowa native and IWC alumna, who spent six months on the International Space Station last year.

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## President Bush's Tax Package

Daniel J. Mitchell

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dividends by allowing individuals to “exclude” dividends from their tax return, while preserving the current 35 percent corporate tax that is imposed on this income. The President’s plan recognizes that dividends are after-tax payments and puts an end to the discriminatory and unfair practice of making individuals pay a second layer of tax on this income.

Alternatively, the double tax could be eliminated by keeping the tax on individuals and instead allowing companies to deduct dividends—similar to the tax treatment of interest payments to corporate bondholders. While both approaches help to ensure that the income is taxed only one time, the President’s approach is simpler to administer and promotes privacy, since individuals presumably would no longer have to report their dividends to the IRS.

### **Multiple Benefits.**

Eliminating the double tax on dividend income will increase growth by dramatically lowering the effective tax rate on business equity investment. Tax rates currently can exceed 60 percent, making many investments that could be profitable not worth undertaking. The President’s

bold proposal will result in more jobs for American workers and more capital for American businesses.

The President’s plan will have additional benefits. Currently, subjecting dividend income to an extra layer of tax creates a bias for corporate debt and equity on a level playing field, encouraging companies to restructure their finances and improve their balance sheets, reducing bankruptcies.

*The President’s plan recognizes that dividends are after-tax payments and puts an end to the discriminatory and unfair practice of making individuals pay a second layer of tax on this income.*

Another benefit is the plan’s impact on investors’ attitudes. Current tax law imposes a heavier tax on dividends (distributed earnings) than on capital gains (retained earnings). President Bush’s proposal will eliminate this anti-dividend bias, and companies will be more likely to attract investors by offering periodic payments instead of promising capital gains. This will improve corporate governance, since firms no longer will feel as much pressure to boost share prices by making unwarranted claims about future revenue. Investors then will be more likely to judge companies by the dividends paid to shareholders.

**International Competitiveness.** According to a Cato Institute survey, only three of the world’s 30 developed nations—America, Switzerland, and Ireland—double tax corporation income. Given that Switzerland and Ireland have lower corporate tax rates, America has the most punitive and antigrowth treatment of dividends in the industrialized world. This is an embarrassment, and it clearly puts America in a disadvantageous position. Nearly one-fourth of our competitors do not impose any double taxation on dividends, while almost all the rest have policies that provide at least partial protection from double taxation. Eliminating the double taxation of dividends can bring America from last place to first place in this critical measure of the global competitiveness. This means more jobs for American workers and more capital for American companies.

**Making Tax Rate Reductions Effective Immediately.** The President also is proposing to immediately implement the rate reductions that are scheduled for 2004 and 2006. This is particularly important for short-term growth since workers, savers, and investors now face a perverse incentive to defer economic activity to take advantage of future rate reductions. Making the tax rate reductions immediately effective will encourage people to earn more income and therefore simultaneously boost consumption and saving. The plan also will be a boon for small business, since a substantial share of “upper-  
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## President Bush's Tax Package

Daniel J. Mitchell

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income" taxpayers are not-incorporated companies. Equally Important, lower tax rates will make America more competitive in the global economy.

### **Small Business Expensing.**

The final supply-side component of the President's growth package is a reduction in the tax penalty on new investment. Under a neutral tax system, companies should only have to pay tax on their net income—the difference between total revenue and total costs. Under current law, however, business can deduct only a reduction of new investment expense in the first year and must wait years to deduct the full cost of a new investment. President Bush's tax reform initiative will help reduce this anti-investment bias by increasing the amount of investment that can be immediately deducted ("Section 179 expensing") from \$25,000 per year to \$75,000 per year. (Ultimately, lawmakers should allow all investment costs to be immediately expensed, a policy that is part of the flat tax)

Good tax policy will lead to faster economic growth and more

prosperity. President Bush's Tax plan meets this test and is an important step on the road to tax reform. Like the flat tax, it is based on key principles of reform, including low tax rates, taxing income only one time, and taxing companies on profit instead of cost. The President's growth package will create a stronger economy today and a better tax code tomorrow.

*Daniel J. Mitchell is McKenna Senior Fellow in Political Economy at Heritage Foundation. Reprinted with permission from Heritage Foundation. For more information, contact Heritage Foundation at 214 Massachusetts Ave. NE, Washington DC 20002-4999, call (202) 546-4400, or visit its website at [www.heritage.org](http://www.heritage.org).*

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## American Unilateralism - Part I

Charles Krauthammer

American unilateralism has to do with the motives and the methods of American behavior in the world, but any discussion of it has to begin with a discussion of the structure of the international system. The reason that we talk about unilateralism today is that we live in a totally new world. We live in a unipolar world of a sort that has not existed in at least 1500 years.

At the end of the Cold War, the conventional wisdom was that with the demise of the Soviet Empire, the bipolarity of the second half of the 20<sup>th</sup> century would yield to a multi-polar world. You might recall the school of thought led by historian Paul Kennedy, who said that America was already in decline, suffering from imperial overstretch. There was also the Asian enthusiasm, popularized by James Fallows and others, whose thinking was best captured by the late-1980s witticism: "The United States and Russia decided to hold a Cold War. Who won? Japan."

Well, they were wrong, and ironically no one has put it better than Paul Kennedy himself, in a classic recantation emphasizing

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America's power: "Nothing has ever existed like the disparity of power, nothing. Charlemagne's empire was merely Western European in its reach. The Roman Empire stretched farther afield, but there was another great empire in Persia and a larger one in China. There is, therefore, no comparison."

We tend not to see or understand the historical uniqueness of this situation. Even at its height, Britain could always be seriously challenged by the next greatest powers. It had a smaller army than the land powers of Europe, and its navy was equaled by the next two navies combined. Today, the American military exceeds in spending the next *twenty* countries combined. Its Navy, Air Force and space power are unrivaled. Its dominance extends as well to every other aspect of international life — not only military, but economic, technological, diplomatic, cultural, even linguistic, with a myriad of countries trying to fend off the inexorable march of MTV English.

Ironically, September 11 accentuated and accelerated this unipolarity. It did so in three ways. The first and most obvious was the demonstration it brought forth of American power. In Kosovo, we had seen the first war ever fought and won exclusively from the air, which gave the world a hint of the recent quantum leap in American military

power. But it took September 11 for the U.S. to unleash, with concentrated fury, a fuller display of its power in Afghanistan. Being a relatively pacific commercial republic, the U.S. does not go around looking for demonstration wars. This one being thrust upon it, it demonstrated that at a range of 7000 miles, with but a handful of losses and a sum total of 426 men on the ground, it could destroy within weeks, a hardened fanatical regime favored by geography and climate in a land-locked country that was already well known as the graveyard of empires. Without September 11, the giant would surely have slept longer. The world would have been aware of America's size and potential, but not its ferocity and full capacities.

*The question is,  
how do we act in  
this new world?*

Secondly, September 11 demonstrated a new kind of American strength. The center of our economy was struck, aviation was shut down, the government was sent underground and the country was rendered paralyzed and fearful. Yet within days, the markets reopened, the economy began its recovery, the president mobilized the nation and a unified Congress immediately underwrote a huge worldwide war on terror. The Pentagon, with its demolished western façade still smoldering,

began planning the war. The illusion of America's invulnerability was shattered, but with the demonstration of its recuperative powers, that sense of invulnerability assumed a new character. It was transmuted from impermeability to resilience—the product of unrivaled human, technological and political reserves.

The third effect of September 11 was the realignment it caused among the great powers. In 1990, our principal ally was NATO. A decade later, the alliance had expanded to include some of the former Warsaw Pact countries. But several major powers remained uncommitted: Russia and China flirted with the idea of an anti-hegemonic alliance, as they called it. Some Russian leaders made ostentatious visits to little outposts of the ex-Soviet Empire like North Korea and Cuba, India and Pakistan sat on the sidelines.

Then came September 11, and the bystanders lined up. Pakistan immediately made a strategic decision to join the American camp. India enlisted with equal alacrity. Russia's Putin, seeing a coincidence of interests with the U.S. in the war on terror and an opportunity to develop a close relation with the one remaining superpower, fell into line. Even China, while remaining more distant, saw a coincidence of interest with the U.S. in fighting Islamic radicalism, and so page 6

## American Unilateralism - Part I

Charles Krauthammer

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cooperated in the war on terror and has not pressed competition with the U.S. in the Pacific.

The realignment accentuated a remarkable historical anomaly. All of our historical experience with hegemony suggests that it creates a countervailing coalition of weaker power. Think of Napoleonic France, or of Germany in the 20<sup>th</sup> century. Nature abhors a vacuum and history abhors hegemony. But in the first decade of post-Cold War unipolarity, not a single great power, let alone a coalition of great power arose to challenge America. On the contrary, they all aligned with the U.S. after September 11.

So we bestride the world like a colossus. The question is, how do we act in this new world? What do we do with our position?

Secretary of Defense Rumsfeld gave the classic formulation of unilateralism when he said, regarding Afghanistan — but it applies equally to the war on terror and to other conflicts — that “*the mission determines the coalition.*” This means take our friends where we find them, but only in order to help us accomplish our mission. The mission comes first and we define the mission.

## *Facts & Opinions* Question of the Quarter:

### Should the United States pull out of the United Nations?

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We will publish some of your ideas in the next issue  
of *Facts & Opinions* in August 2003 and on our  
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This is in contrast with what I believe is a classic case study in multilateralism: the American decision eleven years ago to conclude the Gulf War. As the Iraqi Army was fleeing, the first Bush Administration had to decide whether its goal in the war was the liberation of Kuwait or the liberation of Iraq. National Security Advisor Brent Scowcroft, who was instrumental in making the decision to stop with Kuwait, has explained that going further would have fractured the coalition, gone against our promise to our allies, and violated the U.N. resolutions under which we had gone to war. “Had we added occupation of Iraq and removal of Saddam Hussein to those objectives,” he wrote, “our Arab Allies, refusing to countenance an invasion of an Arab colleague, would have deserted us.” Therefore we did not act. The coalition defined the mission.

*Charles Krauthammer is a Washington Post columnist and FoxNews contributor.*

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## Increasing Productivity in Florida's Schools

J. Stanley Marshall

The public discussion about the recently adopted class-size amendment to the Florida Constitution has centered on the dollar cost of implementation. Adding new classrooms and hiring additional teachers would impose heavy burdens on school districts and the state. Precise cost calculations have yet to be made but the cost, by most estimates, is likely to require either new taxes or reduced services to Florida citizens, or both.

Consideration should be given to other means of meeting the terms of the amendment. One of those may be to increase the productivity of our public schools by increasing the productive efforts of teachers and making more productive use of facilities. The application of this concept can be illustrated by considering a hypothetical secondary school class — Miss Smith's tenth-grade English class.

Miss Smith teaches five periods a day, each class containing 30 students. That's 150 student-contact hours with five more students in each class than the new law permits. If Miss Smith would agree to teach six periods with twenty-five students in each class, she would have carried the same student load as

before; she would have satisfied the new law and, in doing so, she would have taught an extra period each day.

To do this, the school day would have to be lengthened by one period and other adjustments in the use of school facilities might be acquired. Miss Smith and the other teachers might expect a salary increase as compensation for the longer work day.

Introducing an adjustment of this kind in the management of our schools would, of course, require special efforts of the part of teachers, school administration and other personnel. However, on close examination, such a plan would have the following advantages:

- No additional teachers would need to be hired.
- No additional classrooms would have to be built
- The longer work day for teachers might justify an increase in salary. If so, the increase in the school district's expense budget would very likely be less — almost certainly much less — than employing new teachers in numbers required to meet the terms of the new law, even assuming the availability of qualified teachers.

Let's consider the matter of productivity. There is little doubt that the management of the schools in most of our school districts leaves room for some degree of increased productivity. In addition, there are

opportunities in many districts for non-teaching personnel who are certified and qualified to teach to return to the classroom. While many school administrators might be less than enthusiastic about adjustments of this kind, they may find doing so to be less costly and less disruptive than other methods to meet the new requirements.

The plan described above would cause some perturbation in our public school personnel; no one should question that. But the essential question is whether or not the hiring of qualified teachers, the construction of new buildings (or, as an alternative, the increased use of portables), the increased teacher payrolls represent a greater burden on the state and on local school districts than other, more innovative approaches.

Reduced to its simplest terms, the discussion should focus on alternatives to the widely accepted notion that the amendment leaves no choice but to hire more teachers and build more classrooms. Increased productivity in the state's schools, as they now exist, may be a better way.

*J. Stanley Marshall is the Founding Chairman of the James Madison Institute.*

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