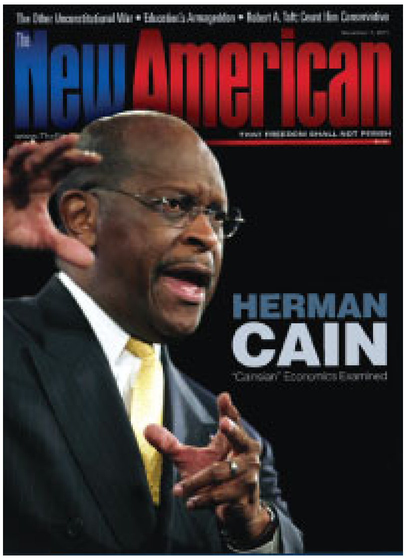
Herman Cain: “Cainsian” Economics Examined



The question from the voter came after Cain explained the nine-percent corporate tax portion of his 9-9-9 plan this way:

> On the first nine, relative to corporate profits, you are allowed to deduct — this was in the calculation — you are allowed to deduct purchases and capital investments. 100 percent. No depreciation schedules. Capital expenses and purchases, if those purchases were made here in the United States of America. If you purchased components from a country outside of the United States, you can’t deduct them. What does that do, folks? It makes U.S. goods more competitive with the rest of the world. It levels the playing field. This is how we deal with China.

Cain’s response of “I have no idea” was noted with an ample helping of snark by liberals such as MSNBC’s Lawrence O’Donnell and concern from serious business analysts such as the *Wall Street Journal*. Indeed, if Cain — the author of the proposal — doesn’t know the details of how it would work, then it raises serious questions about the proposal.

But the part of the proposal where a business couldn’t deduct a foreign-made product it purchases as an expense is no small detail. The proposal — if it ever made it into law — would amount to a giant tariff on foreign imports and overturn just about every trade law that Congress has adopted since the Smoot-Hawley Act of 1930. Yet Cain’s public discussion of 9-9-9 has been bereft of talk about higher tariffs.

Does Cain really have “no idea”? Actually, Cain’s 9-9-9 proposal seems to lack an understanding of how governments have acted in recent history when they have adopted the kind of sales taxes that Cain’s plan would inaugurate.

9-9-9 Plan Basics

The Cain 9-9-9 plan would repeal the current income and Social Security/Medicare payroll taxes and institute a nine-percent flat income tax with no deductions other than for charity and undefined “empowerment zones.” The second “nine” in the 9-9-9 plan would be a flat nine-percent business income tax on profit, and finally Cain would add a new nine-percent sales tax on all goods. Cain’s sales tax contains no exemption for food, as most state sales taxes have, but it does exempt used goods such as used cars and existing homes. The 9-9-9 plan would also repeal the capital gains and death taxes.

“The 9-9-9 plan gets Washington D.C. out of the business of picking winners and losers, using the tax code to dole out favors, and dividing the country with class warfare,” Cain’s presidential campaign website boasts. But it’s unclear what kind of favors those “empowerment zones” in his proposal would dole out. Cain's website also claims, "Empowerment Zones will offer deductions for the payroll of those employed in the zone." Yet Cain's website doesn't define where these "empowerment zones" are. Nor does it define whether payroll for businesses — often the largest business expense — would be a standard expensable deduction for his nine percent corporate income tax, or if it would only be a deduction in the "empowerment zones."

Cain's 9-9-9 plan is actually only a two-year transitional proposal for eventually eliminating the income tax and replacing it with a higher national sales tax that Cain and supporters of the end proposal call the "fair tax." Cain's website says the fair tax would "end the IRS as we know it and repeals the 16th Amendment," and a national sales tax would indeed be less intrusive to the privacy of American taxpayers than the income tax. But many conservative critics of Cain's 9-9-9 plan point out that states and nations that have tried to transition from an income tax to a sales tax end up with both. Grover Norquist, president of the conservative Americans for Tax Reform, explained on MSNBC's *Morning Joe* that once a tax is created, it's tough to kill it off completely. "What if the Democrats win the House, the Senate or the presidency during the transition period and say 'let's keep all three'? All three would grow over time. New Jersey, back in the 70s, said our property taxes are too high. They had no income tax. Let's have an income tax to get the property tax down. Now they have high income and high property tax."

Morning Joe host Joe Scarborough also cited the example of Connecticut: "Look at Lowell Weicker [and] … Connecticut back in the early 1990s, it was the most competitive state for bringing industry in. So Lowell Weicker gets up there, he decides that he's going to add an income tax, thinking that that's going to be a more fair tax…. And guess what? Now Connecticut has one of the highest tax burdens in America, and all of those jobs that kept streaming in to Connecticut, they are leaving — they have been leaving. You can look at Connecticut and it's not as competitive as it was 10-15 years ago."

European nations which have added sales taxes have also failed to eliminate income taxes. Moreover, once a retail sales tax is enacted, the tax has often been expanded into a multi-level "value added tax" (VAT) that levies the tax at every stage of production. A VAT levies the tax at each wholesale exchange at which value is added to a product, such as the sale of brake parts for a car by a subcontractor to an auto manufacturer, which are then again taxed when the manufacturer sells the vehicle to the dealer, and then taxed again at the final sale of the vehicle to the consumer. Denmark first imposed a nine-percent VAT in 1962, but gradually raised the tax over the years to its current 25-percent rate, in addition to having "progressive" income taxes that top out at 60 percent of income. The story has repeated throughout Europe, where the VAT is typically over 25 percent.

Leftist Critics of 9-9-9 ?Make Contradictory Claims

Leftist critics label Cain's proposal "regressive," a derogatory term meaning that the richest Americans would pay the same tax rates as the poorest. But many of the same leftists also make the contradictory claim that the rich hardly pay any taxes at all under the current system, so the 9-9-9 plan should actually look pretty good to them.

Leftist Warren Buffett — one of the richest men in the world — famously complained that he already pays a lower tax rate than his secretary. "In our office," he told Tom Brokaw, "15 people cooperated in a survey out of 18 — I didn't make anybody do it. And my total taxes — payroll taxes plus income tax — mine came to 17.7 percent. The average for the office was 32.9 percent. There wasn't anybody in the office — from the receptionist on — that paid as low a tax rate. And I have no tax planning. I don't have an accountant. I don't have tax shelters. I just follow what the U.S. Congress tells me to do." Of course, Buffett's Berkshire-Hathaway stock pays no dividends, meaning there's no earnings to tax, and when Berkshire-Hathaway stock increases in value, its increased value is not taxed as income. Peter J. Reilly of *Forbes* magazine noted on August 15, 2011 of Buffett's claim, "An investment with a holding period of forever incurs a capital gains tax of 0%, while all along the holder can be getting wealthy from appreciation." In other words, Buffett is counting as "income" what the federal government doesn't count as income. Likewise, appreciation in the value of most people's home during the first half of the last decade was not counted as income unless the property was sold.

Even the hard-Left Economic Policy Institute proved that millionaires actually paid a much higher tax rate on average than either the poor or the beleaguered middle-class families earning $75,000-200,000 per year under the current tax code. The rich would continue to pay more taxes than the poor under Cain's plan, of course, but as a percentage of income it would become virtually identical.

The fact that the current FICA payroll tax is 15.3 percent and far more "regressive" than Cain's 9-9-9 plan should also pacify some leftist critics. FICA taxes toward Social Security do not tax income above $106,800 at all, as Social Security was not designed to operate as a *full-blown* welfare program that transfers the wealth from the rich to the poor. That tax rate means that the poor currently pay a much higher percentage of their income toward the Social Security program than do millionaires.

Of course, these calculations assume Cain's proposals become law, and that Cain can accurately foresee what Washington will do during the transition period. The question is, can Cain accurately predict what Washington will do over the next few years and see to it that it is done? Based upon his past record of predictions and economic analysis, voters shouldn't be reassured.

Cain Said Economy's Fine

As late as September 1, 2008, Cain wrote that the economy appeared to be on solid ground: "The supposed failure of Bush's economic policies has been a constant theme of the Democrats since the 2006 elections, when the Democrats regained control of the House and Senate by convincing enough of the voters that the economic sky was falling, and that the war in Iraq could not be won. Based on all of their convention speeches, they plan to continue those themes right through Election Day on November 4." Only a "supposed failure"? Wall Street giant Lehman Brothers filed for bankruptcy just two weeks after Cain's column was published, and President Bush subsequently began pushing for the $700 billion TARP bailout bill to bail out banks and avert what he and his aides described as another great depression.

The Georgia native recently admitted he had no clue that the economy wasn't on sound footing throughout the housing bubble. But he at least partially diagnosed the housing bubble after the bubble blew up. "What I missed in 2005 was just how bad Fannie Mae and Freddie Mac had distorted the housing market," Cain told MSNBC's Chuck Todd on October 12, 2011. "I honestly did not realize just how bad it was, just how bad the whole bundling and derivatives thing was, and that we were on the brink of a total financial meltdown. So I learned later on by looking into it deeper that the situation was a lot worse than I thought in 2005." Of course, Cain's great strength is supposed to be his business experience and tenure in banking as chairman of the Kansas City Branch of the Federal Reserve Bank during the 1990s.

Cain had also written on August 17, 2005 that media "coverage of the Bush economy reads like a collection of Democratic Party press releases, calling a strong economy everything from struggling to volatile or dicey.… That kind of ignorance makes homeowners fear that their most expensive possession could turn worthless overnight. That won't happen." The housing market collapsed two years later.

Federal Reserve

Cain's use of the term "ignorant" in that 2005 column may have been the genesis of Representative Ron Paul's statement during the October 11 Bloomberg/*Washington Post* New Hampshire presidential debate. "Mr. Cain," Paul said, "in the past you have been rather critical of any of us who would want to audit the Fed. You have said — you've used pretty strong terms, that we were ignorant and that we didn't know what we are doing, and therefore, there was no need for an audit anyway, because if you had one, you're not going to find out anything, because everybody knows everything about the Fed." Paul and his economic advisor Peter Schiff had been predicting that the housing bubble would go bust for several years by 2005. Cain replied, "You have misquoted me. I did not call you or any of your people ignorant. I don't know where that came from. All right, now, you've got to be careful of the stuff you get off the Internet." In reality, Cain had called Paul's supporters "stupid" on page 154 of his new book *This Is Herman Cain*.

But the record demonstrates that Cain was ignorant — and not supporters of Ron Paul. Cain was an opponent of a U.S. Government Accountability Office (GAO) audit of the Fed until 2011, telling Neil Boortz's radio audience on December 29, 2010: "Some people say that we ought to audit the Federal Reserve. Here's what I do know. The Federal Reserve already has so many internal audits it's ridiculous. I don't know why people think we're going to learn this great amount of information by auditing the Federal Reserve.... There's no hidden secrets going on in the Federal Reserve to my knowledge. And I tell people, we've got 12 Federal Reserve Banks. Find out which district you are in, call them up and go from there. We don't need to waste money with another commission or an audit. It's not necessary." Yet even as he was saying those words, Americans were finding out in their newspapers that the Federal Reserve had secretly lent at least $16 trillion in taxpayer-guaranteed money funneled through various Federal Reserve emergency facilities from 2008 through 2010, a sum more than the entire size of the U.S. economy, and 22 times the size of the controversial TARP bailout. Moreover, the bulk of these funds had been lent to favored banks and corporations. And the Federal Reserve Bank steadfastly refused to release the bailout information even to the GAO until Bloomberg won a Freedom of Information Act lawsuit in December 2010.

After Bloomberg News won partial access to the bailout information, the GAO was able to come up with the $16 trillion figure as the bailout total. What came out of the GAO partial audit was that the Federal Reserve highly favored elite Wall Street banks with the following funds: $2.5 trillion for Citigroup, $2.0 trillion for Morgan Stanley, $1.9 trillion for Merrill Lynch, and $1.3 trillion for Bank of America.

TARP Bailout Fan

Cain pronounced TARP a "win-win for the taxpayer" in an October 20, 2008 column: "Unprecedented problems require unprecedented solutions. The actions by the Treasury are a win-win for the taxpayer." After Congress passed the TARP bailout, Cain complained about how the money was doled out, but not about the principle of crony capitalism where profits are privatized and losses are socialized. Cain said in the October 11 Bloomberg/*Washington Post* debate, "They were discretionary in which institutions they were going to save, rather than apply it equitably, which is what most of us thought was going to be done. The implementation of it is where they got off-track." Cain has never made it clear who he believes should have gotten a bailout that didn't, or even if he believed that every failing institution should have been bailed out by taxpayers, but it's clear from that statement that he believed that the taxpayer bailouts didn't go far enough. Perhaps even more importantly, he apparently was unable to predict how government would implement the TARP program any more accurately than he can explain implementation of his own 9-9-9 proposal.

Cain's Economic Advisor ?a Bailout Recipient

But Cain has explained that it's not essential for a President to become an economic Nostradamus, as his presidential rival Ron Paul (who accurately predicted the housing and financial crisis years before the crash) is. "Well, it's real simple, Chuck," Cain replied to a question about why Americans should trust his economic agenda after failing to see the biggest bubble of his lifetime. "I have economic advisors working with me now who spend time studying these various analyses."

And Cain's explanation would seem reasonable: A President who has solid economic advisors, and who defers to them, can indeed often compensate for lack of economic knowledge without the public suffering unnecessary economic crashes. But Cain has only publicly named one economic advisor, Rich Lowrie of the metro Cleveland, Ohio, area. Lowrie is a managing director of a Wells Fargo branch. Wells Fargo is a giant bank which received among the largest bailout funds through the TARP program — $25 billion — in addition to another $169 billion in secret loans from the Federal Reserve Bank during the economic crisis. Liberals have sneered that Lowrie doesn't have "credentials," i.e., a degree in economics, but most of the accredited economists missed the housing bubble/bust anyway. Nevertheless, it's unclear what Lowrie's ability to diagnose the economy is from his scant published record.

In the October 11 Bloomberg/*Washington Pos*t debate, Cain gave some indication of the kind of advisor he might hire when he was asked who was the best Federal Reserve chairman over the past 40 years. Cain amazingly named Alan Greenspan — the Fed Chairman from 1987-2006 who blew up the housing bubble by suppressing interest rates to then-record lows — as the man he thought did the best job.

Thus, Cain's acumen in selecting advisors who would avoid inflationary bubbles is as suspect as his personal economic acumen. But by picking one of the favorite central bankers of the Wall Street elite, Cain may have tapped a golden vein of campaign contributions. Indeed, although his $4.7 million in donations through the third quarter fell well below that of Mitt Romney (whose top source of donations was employees of Goldman Sachs), Cain's second largest source of donations was employees of another bank — Wells Fargo ($8,300). Of course, that completes the financial circle. Wells Fargo is the employer of Cain's main economic advisor, and was a major recipient of Federal Reserve bailout funds. Employees of Wells Fargo have also given generous political donations to Cain.

Cain may or may not be a "tool of big banks," but as a defender of big bank bailouts, he sure makes it look that way.

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