HOW CAPITALISM WILL SAVE US

Why Free People and Free Markets are the Best Answer in Today's Economy

Steve Forbes

CENTER OF THE AMERICAN EXPERIMENT

Center of the American Experiment is a nonpartisan, tax-exempt, public policy and educational institution that brings conservative and free market ideas to bear on the hardest problems facing Minnesota and the nation.

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Introduction

Simply put, Steve Forbes is one of the world's most compelling voices for the most successful economic system the world has ever known.

Mr. Forbes is chairman and CEO of Forbes Media and editor-in-chief of *Forbes* magazine. Newer publications launched during his tenure include *Forbes Asia*, and licensee editions in China, India, Russia, Poland, and Israel, among other places.

When it comes to electronic destinations, Forbes websites are visited by nearly 40 million business decision-makers every month.

As you likely know, Mr. Forbes writes a regular editorial for the magazine under the heading "Fact and Comment," and is the only writer ever to have won the prestigious Crystal Owl Award four times, given annually to the financial journalist whose economic forecasts for the following year prove most accurate. His two newest books are his masterful *How Capitalism Will Save Us* and *Power Ambition Glory*.

A graduate of Princeton and a former presidential candidate whose claim and credentials for the job look better all the time, he has served as chairman of the bipartisan Board of International Broadcasting and currently sits on the boards of the Ronald Reagan Presidential Foundation, the Heritage Foundation, and the Foundation for the Defense of Democracies.

On behalf of Center of the American Experiment, please welcome a man whose creations and contributions have been a lighthouse for freedom and prosperity, Steve Forbes.

William H. Spell
President
Spell Capital Partners, LLC
Minneapolis

It is a great pleasure to be here, and I thank all of you for coming out to support Center of the American Experiment.

You here tonight represent something that Alexis de Tocqueville, a French aristocrat who visited this country back in the 1830s marveled at—something he called voluntary associations, people coming together for a shared purpose. He'd never seen anything like this in Europe, with its medieval traditions, where you waited for permission to do something or to be told to do something. He was astonished that in this new country, the United States, people would come together for a shared purpose, whether it was to take advantage of an opportunity or to deal with a problem. People were sharing resources to make positive things happen in an array of activities, whether it was in education, health care, professional activities or sporting activities.

Tocqueville said that participation in so many activities was how people learned to be citizens of a republic and thereby enabled this republic to work. If you think about it, what puzzled our Founders was how to create a republic that worked. After all, the Athenian democracy was really just people meeting in a square. Our Founders wondered if you could have a representative government that was geographically big, and yet here it is, working more than 230 years later.

The State of Capitalism

I've been asked to make some observations about the economy and the state of capitalism. I've just recently published a book with coauthor Elizabeth Ames called *How Capitalism Will Save Us: Why Free People and Free Markets are the Best Answer in Today's Economy*. When you say anything nice about capitalism right now, you meet a great deal of skepticism. After all, it looks like capitalism has ill-served us. It looks like free markets are inherently unstable and full of greed and corruption, with the rich getting richer and crushing the poor, and with CEOs getting outsize pay packages while their companies collapse around them. Government has had to come in and bail out the banks, yet those banks have managed to still pay huge bonuses to their executives. What in the world is going on?

First of all, it is important to understand what free markets, free enterprise and entrepreneurial capitalism are actually about. Contrary to our pop-culture media, capitalism in not based on greed, avarice or trying to figure out how to euchre somebody. It actually has a moral foundation.

Think about it. In a true, free economy you don't succeed unless you meet the needs and wants of other people. You may be greedy; you may be lusting for money; you may have a nasty personality, the kind that makes babies cry or dogs bark when you walk down the street—all the kinds of hideous, villainess things that Hollywood portrays capitalists as being. Yet you won't succeed unless you provide a product or service that people actually want. Thus, capitalism really is, as Adam Smith put it, "a mutual exchange." You may want money, but you're not going to get it unless you provide something in return. Therefore, it is not a zero-sum but a mutually beneficial exchange. It has a moral foundation.

The Founders understood that we are endowed with certain energies and ambitions, and one of the challenges they faced—particularly Alexander Hamilton and Ben Franklin—was how to channel those ambitions in constructive rather than destructive ways. For millennia it was thought that if you wanted to get ahead you had to take something from somebody else. The idea that you could do something to fulfill your ambitions, and in such a way that would benefit others, was an alien idea. Even today commerce is portrayed as something that gives us a higher standard of living yet is a tainted, corrupt bargain. Those in commerce do nasty things, appealing to people's worst instincts and then if they make money, they make up for it by giving it away.

Now, think of these words — and we all use them, and you use them: "giving back." Not giving, but giving *back*. "Giving back" implies that you took something that didn't belong to you and that you make up for this by giving it back—not by creating something and then sharing and giving it, but by giving it back.

Thus commerce is portrayed as the worst of human behavior, philanthropy as noble behavior. Here we get to the seeming paradox of American life: We are the most commercial nation ever brought into being, but we're also the most philanthropic. People devote considerable resources and time to charitable activities. Therefore, commerce and philanthropy, if you think about it, are not polar opposites. They're actually two sides of the same coin—meeting the needs and wants of others. Now, the skill-set to succeed in commerce may be different from the skill-set needed to succeed in philanthropy, but both fields have the same objectives. Consequently, successful entrepreneurs many times turn out also to be very innovative and successful philanthropists. Take one of the great villains in history—he wasn't, but that's how he is portrayed—John D. Rockefeller, a great entrepreneur, and at the same time a quite successful philanthropist.

Remember, as Adam Smith said, "mutual exchange." You want dinner; the restaurant wants your money. They provide the food, and you give them your money. You both get something out of the exchange.

Now, this gets to the sources of wealth. In ancient times, wealth was seen as physical things: a pile of gold, jewelry, lots of land and huge armies, whereas in this information age the real source of wealth is the human mind—imagination, a sense of inventiveness, innovation. The brain counts.

Think about the microchip, the source of today's economy. What is it? What's it based on? Sand—silicon. What you might not think of as a natural resource is at the root of the greatest human innovation to date. Take something that is very much in the headlines these days: oil. Is oil a natural resource? Not really. Think of it. What is oil? In and of itself, it is a glob of gooey stuff. You can't eat it. You can't drink it. You can't even feed it to camels. So what made it into something that we can't live without? Human imagination and innovation turned it into something that is absolutely vital in a modern economy.

The human mind is the true source of wealth. That's why there are many places on earth that are endowed with many natural resources yet still lag behind, while other places that seemingly have no natural resources surge ahead.

Hong Kong is a classic example. Ten years ago, after years of being part of the British economy, Hong Kong reverted to China. Hong Kong is a speck of real estate so lacking in natural resources that it even has to import water! Sixty years ago Hong Kong was a backwater, with low per capita income; today it has one of the highest per capita incomes in the world simply because of sheer human innovation, energy and inventiveness. Its success has nothing to do with natural resources, just human activity.

What about all of the recent economic scandals? Well, human nature does not change; it has its good sides and its undersides. That's been true since humans existed. Corruption isn't confined to capitalism or business. Just because you get a Bernie Madoff or executives who do things they shouldn't doesn't mean that capitalism is bad, any more than abuses in voting means that democracy is bad. Just because some people misuse automobiles doesn't mean you need to get rid of automobiles. You institute sensible rules of the road. Rules of the road? You don't go 80 mph in a school zone. You turn on your blinker to signal when you want to make a turn. Those are sensible rules of the road, but that doesn't mean that the government tells you what to drive, when to drive or where to drive. You make those choices. Even though you have sensible rules of the road, there are limits to the rules.

There's a difference between sensible rules and those that government is attempting to force on the economy today. Technology is always bringing about the need for changes in laws and regulations.

Take the invention 45 or so years ago of the Xerox copier. Its advent brought about entirely new questions: What is fair use? How many pages could you copy from a book without violating the copyright? We see this same thing playing out today in the digitalization of music. The music industry was suing everybody who was downloading music. That didn't get very far. It took an outsider, Steve Jobs, to figure out how to make money with digital music—through a thing called iTunes.

As new things come along, we need new laws and regulations, but that doesn't mean government ought to say what's permissible risk-taking and what isn't. After all, you want people out there striving to do things, to get things done, to take risks and put something new out in the marketplace. Most of the time, if wrongdoing is occurring in the marketplace, it will eventually get flushed out.

How We Got Here

This brings us to where we are today. How in the world did we get into the economic mess we're in today? First of all, we have to put things in perspective. Between the early 1980s and 2007, when the current financial crisis hit, we went through one of the most extraordinary periods in economic history. Never before had so many people in so many parts of the world advanced so quickly as they did in that quarter-century. This happened not only in India and China but also in Central and Eastern Europe. Europe as a whole grew faster than the Asian region as a whole. At least 16 countries in Africa—something that received no publicity—in the last ten years before the crisis hit were growing at good economic growth rates. And several countries in Latin America, including Colombia, were beginning to make real economic advances. The United States also did well during this period. Our share of the world economy actually rose. In the four-and-a-half-year period between the beginning of 2003 and the summer of 2007 the expansion of the U.S. economy—in growth alone—exceeded the entire size of the Chinese economy. Clearly China's growth rates were higher, but China was working off a smaller base.

So what in the world went wrong? Well, when you look back at the big economic blowups of the past century, you find in every single case that the mess was the result of catastrophic government errors. Now, this doesn't excuse non-government mistakes, but if the government had performed properly the disasters would not have been anywhere near the magnitude of what we're experiencing today.

The first and foremost problem is monetary policy. Think of monetary policy as you would an automobile. You can have a magnificent vehicle, but if you don't have sufficient fuel to run it you'll stall. If you have too much fuel, you'll flood the engine. If you have just the right amount—the fuel injector is working just right—you'll have a chance to move ahead. The same is true of monetary policy. An economy can have great strengths, but if you don't feed it enough money it will stall. If you print too much money, you'll get the economic equivalent of flooding the engine and creating huge distortions. With just the right amount of economic fuel, you have the chance to move ahead.

Because it misjudged the state of the U.S. economy several years ago, the Federal Reserve started to print money. It thought the economy needed the extra juice, so it printed a lot of money and kept on printing it, thereby keeping interest rates at an artificially low level. When you do that, bad things happen. This is what happened in the 1970s.

When the Federal Reserve prints too much money, excess liquidity goes into commodities. Why? Because commodities are global cash markets, denominated in dollars. That's where the problem is first seen. Normally, with commodities such as soybeans, gold and corn, some are up and some are down, depending on circumstances. When all the commodities go in one direction, something is fundamentally wrong. Remember what happened in 2004? Oil shot up. Copper went up. Lumber went up. Gold went up. Silver went up. Soybeans went up. Corn went up. Wheat went up. The price of mud went up. Everything went up.

Everyone wondered what in world was going on. India and China must be buying up everything. But to the populists, it had to be those evil oil company executives. In reality, it was a classic commodities bubble.

When there's a flood of money, it doesn't stop in one area. This country went into housing big time. Housing was already booming by 2004. Why? Because a 1998 tax law change virtually removed capital gains tax assessments from your house. If you were a couple and sold your house, the first $500,000 was free of tax. As you know, if the tax on an asset is lowered, the value of the asset goes up. So by 2004, when this flood of money hit the economy, housing was already booming. Then it went berserk. Everyone figured housing was a no-lose proposition. So lending standards were lowered. A new mortgage was invented.

Presidents Bill Clinton and George H.W. Bush were saying, "We need more home ownership, why have a down payment?" You didn't have to make a down payment and didn't have to pay principal. The housing bubble got bigger and bigger, you didn't have to make interest payments: This was called negative amortization. Negative amortization meant the mortgage might get bigger. Normally, you pay down the mortgage each month, but with this it got bigger and bigger because you weren't making any payments. But that didn't matter, because the value of the house was expected to go up faster.

Regarding teaser rates, sometimes a buyer would ask, "What happens when the low teaser rates go up?" "Oh, not to worry," buyers were told. "Just renew the mortgage and get another teaser rate. This can go on forever. This party is never going to end." Well, it did end. The air started to leak out in 2006. The bubble burst in 2007. And then we had a disaster on our hands.

Another huge mistake was made in an utterly boring area: accounting. But sometimes it's the boring things that have the most disastrous consequences. The question for regulators always is how the capital of banks and insurance companies is going to be valued? Banks are supposed to have reserves for such things as loan losses. Insurance companies are supposed to have reserves for future obligations. So the question is, how do you value what is called regulatory capital? Normally, if a bank or an insurance company bought a bond for, say, $1,000, they'd keep it on their books for regulatory purposes at $1,000. That figure would change only when the bond was sold or became impaired.

Then in 2007 we changed this. We decided to look at regulatory capital in the same way we looked at day-trading accounts, as though regulatory capital were a mutual fund. Ride it up; ride it down. What a dumb idea. This became known as mark-to-market accounting. It was banned in 1938 during the Great Depression precisely—*precisely*—because of the devastation it wrought. Think this way about mark-to-market accounting: What would you get if you had to sell your house or car in the next hour? Your cell phone rings and you're told: "Sell your house." What price would you get in an hour? You'd say, "That's *nuts*. That's ridiculous!" Because you wouldn't get anything near your house's worth. Well, using mark-to-market accounting rules during a recession renders you broke. Your house is worthless. You say, "No, it isn't. In a normal market, it would be perfectly valuable. I've got a job and am making payments. What's the problem?" Well, if you had to sell it right away, you wouldn't get very much for it; therefore, if your worth is tied up in your house, you're broke. It's crazy. These rules turned what would have been a flood into a tsunami.

That's why Troubled Assets Relief Program (TARP) money is still with us. A year ago $300 billion was pumped into banks to shore up their balance sheets. Yet, in effect, these funds were put in a black hole because regulators kept telling banks: "Mark down the value of your capital." So the money had to stay in the bank and couldn't be put to work in the economy, which paralyzed the system.

Then add in Fannie Mae and Freddie Mac, which were created by government to help the housing market. With the backing of the government those two entities took over a large part of the mortgage market, running many private companies out of business and growing to gargantuan size because everyone figured the government would back them up financially. Fannie and Freddie could borrow in a way that no private company could. By early 2008 they'd guaranteed $1.5 trillion in junk paper, something that could never have been done in the private sector. So put together the devastation of bank capital, the huge housing bubble and a lot of bad paper and the system became paralyzed.

Thus the disaster that's now on our hands. Now, none of this excuses some of the things Wall Street did. It doesn't excuse some mortgage bankers pushing these dangerous mortgages. But understand, this could not have happened had the government not printed too much money, had Fannie and Freddie not been guaranteeing everything that crossed their desks, and had mark-to-market accounting rules not been applied which devastated the banks and thereby hurt the recovery.

So where are we now? Thankfully, the law governing mark-to-market accounting rules was amended in March 2009. Do you know who finally forced the change in these stupid rules? Not the Federal Reserve. Not the White House. Not the Treasury Department. This will shock you: Congress. Yes, occasionally, Congress does something right.

Congress began to realize something strange and bad was going on and convened a series of hearings in early March 2009 on mark-to-market accounting rules. They brought in the Securities & Exchange Commission, the Financial Accounting Standards Board, what they call FASB, and verbally beat them up. Finally the chairman of the committee said to a guy from the FASB, "You're going to change this rule in two weeks. *Right?*" The guy sort of hedged, "Well, Mr. Chairman, we will consider it. Blah, blah, blah, blah." The congressman said, "No, you're going to change it in two weeks." The guy from the FASB finally realized that if he was going to get out of there alive, he'd better promise to change it. And, he did. A few weeks later, it was amended. That's when the stock market took off. That's when financial stocks started to come back to life.

The system on the credit side is also starting to work again. There are signs of life in the economy. You can tell people want to get the recession behind them and move ahead, but the system isn't fully working yet. Small businesses and consumers still have a hard time getting credit. I was kind of surprised last summer when the head of the Federal Reserve, Ben Bernanke, was patting himself on the back for saving civilization.

Regulators are still telling a lot of banks to shore up their capital and tighten their lending standards. So a lot of perfectly sound businesses and solvent consumers still can't get the credit they need, even when a loan is justifiable. So the system is not quite there yet.

Principles of Economic Growth

There are some basic principles of economic growth. They sound simple, even simplistic, but it's *amazing* how often they're violated.

The rule of law. If you're an entrepreneur, you're challenging an existing power structure, and you need the protection of the law. With property rights, if you buy a piece of property, the government can't just take it from you. Countries that don't have property rights always lag behind those that do.

Contracts should be sacrosanct. If you make a contract, it should be adhered to. If you're what's called a senior lender, you're first in line; you charge a lower interest rate because you figure if something goes wrong, you'll have first call on the assets. Well, if the government comes in and disposes of that understanding, what's going to happen? You're either going to charge more or you're not going to lend the money. This can be seen in the housing market. Yes, housing is starting to show signs of life, but this would be happening much faster if the government hadn't mucked up the mortgage market. Who's going to buy a mortgage now if they don't know what happens if something goes wrong? Normally, if you're a lender and you have a first mortgage and something goes wrong, you're first in line; second mortgage, second in line; equity loan, third in line. That's why the mortgage interest rate is lower than that of the second mortgage, and the second mortgage is lower than that of the equity loan. The more risk, the higher the interest rate. But when things are muddied up and lenders are told, "The equity loan is as good as the mortgage," guess what? People no longer know what the rules are, and the market doesn't work.

Sound money, steady value. The Bush Administration's biggest domestic mistake—and it pains me as a Republican to say it—was its weak-dollar policy. Money should be *stable* in value. If you do an hour's worth of labor for which you're paid, say, $25, that $25 should be worth $25 today, tomorrow and the day after. Politicians shouldn't change the value of what you earn. Period.

Yet because of a crazy economic theory the Bush administration believed a weakened dollar would help our trade balance. A weak dollar would make our exports artificially cheaper, our imports artificially more expensive. Voilà, the trade balance would improve and life would be good. Nice theory, but in the real world this created a bubble, a disaster. The last time we tried this was in the 1970s, and we ended up with an even higher unemployment rate than we have today, along with 18 percent interest rates.

Think of it like this: What if the politicians decided to change the length of the ruler? You know there are 12 inches in a foot. Well, imagine if that was changed to 15. If you were to order a 2,000-square-foot house to be built, by golly, this would generate more economic activity, because you'd be getting a bigger house, which would require more lumber and other materials. Or what if the number of minutes in an hour were changed? There are 60 minutes now. What if that was changed to 70? By golly, you'd be able to watch longer basketball games for the same price. People would work longer for the same price, so you'd get more output.

But we don't manipulate clocks or rulers, and we shouldn't manipulate money. This should not be a partisan issue. John Kennedy said the dollar should be as good as gold. Ronald Reagan killed the great inflation of the 1970s, understanding the importance of a stable dollar—even if some of the people around him didn't. Even Bill Clinton, for crying out loud, understood this even if only for political reasons. He looked at what had happened to Jimmy Carter, the last President who had allowed a weak dollar, and saw the political ramification of this policy. Clinton said it wasn't going to happen on his watch, and it didn't. We had a strong dollar under Bill Clinton. This should not be a partisan stance.

The quicker the Obama administration gets back to a proper dollar policy, the quicker we'll pull out of this slump, the quicker small businesses will get the credit they need to start creating jobs and the new kinds of technologies that make for a better tomorrow. First and foremost: We need a strong and stable dollar.

Taxes. Taxes are a big thing. And they're going to be even bigger next year. The thing about taxes is this: Taxes are not just a means of raising revenue for government; they are also a price and a burden. The tax you pay on income is the price you pay for working; the tax on capital gains is the price you pay for taking risks that work out; the tax on profits is the price you pay for success. The idea is very simple: If you lower the price of good things like productive work or successful risk-taking, you get more of them. If you raise the price of them, you get less of them. That's why raising taxes is just about the dumbest thing to do when the economy is flat on its back. It's dumb to do anytime—*anytime*.

So lower the tax rates. We'll do better. Entrepreneurs will do more. And the government will get its cut. Indeed, the government will end up getting more at the end of the day by lowering taxes than by burdening the economy.

Getting Out of this Mess

How do we get out of the mess we're in? On paper, it looks hopeless. We have huge government deficits—the worst peacetime deficit in our history.

In the last couple of years we've amassed more debt than the previous 200 years put together. It's going to get worse, if you look at what's going to happen regarding Social Security and Medicare. The national debt is now $12 trillion. Social Security's unfunded liability is another $10 trillion. Experts estimate the unfunded liabilities of Medicare and Medicaid to be $40 trillion to $60 trillion, depending on their assumptions. If we institute a new national health care system, add trillions more dollars. We can't raise enough taxes to handle this. If we raise the tax rates, we're going to wreck the economy anyway. So what do we do?

It's all about the balance sheet, assets and liabilities. We're jacking up the liabilities, so we'd better create an environment in which assets can be increased in value. That's key.

So how do you grow the assets? Well, fortunately, we're in a pretty good position, even in today's rotten environment. Even today, if you take what the American people own in financial assets—housing, furniture, cars, etc.—and subtract out all liabilities—credit cards, mortgages and other debts—U.S. households are still worth $53 trillion. The gross assets of American households are almost $70 trillion.

Think of it this way: Even with a semi-benign economic environment the value of assets will go up. We're already starting to see this happening in the stock market. If the nation's assets go up only 10 percent to 15 percent, that comes to $10 trillion. It overwhelms the *stupidity* coming out of Washington.

We've done it before. Remember, the early 1980s looked hopeless, with wild inflation, pensions way underwater and government finances in shambles. Ronald Reagan came in and instituted major reforms. The economy started to grow. Silicon Valley came into its own. You don't only get growth and more revenue when the economy does well, you also get innovation. If people see better prospects, then suddenly the value of assets goes up as well.

During the 1980s the national debt went up $1.7 trillion, almost tripling, because Ronald Reagan spent a lot to win the Cold War. Congress refused to rein in domestic spending. If you looked only at the $1.7 trillion, you'd have said, "Oh, my God, the country is going off a cliff." But if you looked at the balance sheet, the net wealth of the country during that period went up $17 trillion.

So if we create an environment in which growth revives, innovation will follow, wealth will rise, and we'll start to cope with the debts.

Now, let me make quick hits on two biggies. Social Security has a huge unfunded liability. What's the solution? My generation is hopeless, but we have the money to pay for our benefits. Forget the trust fund; it's a fraud. We can "pay as you go," as they call it.

But what about younger people? That's where the system really collapses. We still have time to put a new system in place for younger people, one in which they'd have their own personal retirement accounts, with proper investment rules, regulations, and diversification—mutual funds and the like. In this way their payroll taxes would go into their own accounts, and the money would be invested, which would make for a stronger economy. Workers would have more in their retirement accounts, and we'd have turned a liability into an asset. Can this work? Yes, it can.

In the early part of the 1980s three counties around Galveston, Texas, pulled out of the Social Security system. (They were allowed to do so in those days.) Where did these counties put its workers' money? They put it into guaranteed-interest contracts from insurance companies, bank CDs, and the like. Today, at no risk, those folks are retiring with 50 percent to 200 percent more in benefits than they would have had had they stayed enrolled in Social Security. Somebody who made as little as $17,000 a year under Social Security would receive benefits—as a couple—of $683 a month. Under the Galveston Plan: $1,200 a month. So properly done, this approach works.

Regarding health care, ask yourself, "Why do we have a health care crisis?" Well, people say, "We want more health care. We've living longer." It's a crisis." In any other part of the economy, if people wanted more of something that would be seen as a great opportunity. When people want more software, Silicon Valley and software writers are happy. If people wanted more cars right now, Detroit would be very happy. Yet with health care, we don't have real free enterprise. There is a disconnect between providers and consumers: the third-party system.

With anything else, when you want to buy something you figure out the price. Then, you think about what you're going to get for your money. If you need something, you figure out what the best way is to buy it. But with health care, if you go to a doctor, hospital, or clinic and ask what the cost of a procedure is, the staff thinks that you're crazy or that you don't have insurance. Why else would you want to know what something costs? What's it to you what it costs? Think how bizarre this is. So we don't have a system in which entrepreneurial free enterprise works and where people are always figuring out how to make things cheaper, how to make things more affordable, and how to come up with more and faster innovations.

Now, can we apply this approach to health care? People will say it's too basic. I can tell you what's more basic than health care: food. Yet, do we have a food crisis? The biggest food crisis in this country is that a lot of us eat too much of it. We grow too much food. There's no food shortage in the United States. For those who do have problems, there are programs to help them out, food stamps. So why can't we do the same regarding health care. Can free enterprise work in health care? Yes.

A couple of quick examples: Lasik surgery for the eyes. Millions have had it. Today, the procedure costs less in real terms than it did ten years ago. Why? The patient writes the check; therefore, providers have *every* incentive to make it more affordable and attractive to patients. Cosmetic surgery: In the last 15 years, the cosmetic surgery demand in this country has grown *six*-fold. There have been huge technological advances. Yet, the cost of cosmetic surgery has not been subject to medical inflation. Why? Because, unless the cosmetic surgery is done as the result of disease or accident, the patient is writing the check. Therefore, when a patient wants a procedure, he figures out who can do it, what the cost will be and what he's going to get out of it. This keeps prices lower.

One other example I must mention – medical tourism. In countries such as Singapore, Thailand, and India entrepreneurs are building state-of-the-art medical facilities and hiring the best doctors and nurses in the world to staff them. These facilities do sophisticated open-heart surgery, hip and knee replacements, and all manner of other procedures at one-fourth of the cost in this country. In order to succeed these places must appeal to you. How do they persuade you, other than with costs, to take the risk of traveling to India for open-heart surgery? One of the ways they reassure you is by showing you the infection rates in their facilities: almost none. Workers wash their hands 500 times a day; the floors are scrubbed 300 times. Why? Because they know if there are infections, you won't take the risk in coming.

We can get these results with health care here, too. There are various ways to ensure this. How? Start with insurance. Why can't we buy insurance nationwide?

You live in Minnesota, but if you want to buy a policy in Wisconsin, that's illegal. You can buy a car in Wisconsin, buy a house in Wisconsin, or open a bank account in Wisconsin, but you can't buy insurance. I live in New Jersey, a crazy state when it comes to this kind of thing. A health insurance policy for a family costs me $15,000 to $17,000. But across the border in Pennsylvania a similar policy is $7,000. Why can't I be allowed to buy that policy? There are 1,100 health insurance companies of various sizes in this country. If we wanted real competition, we should allow nationwide shopping. Then we'd see true competition among the insurance companies. Instead of needing to get on our hands and knees to beg for insurance, the companies would be coming to us. We'd have geckos out there saying, "Boy, come to us. We'll show you how to make this work."

If you're a company, you get a tax deduction for offering health insurance to your employees. Well, why can't individuals get one? If your employer offers you a policy and you don't like it, why is it that way or the highway? Why can't an employee, like a company can, go out and get a tax deduction or tax credit when buying insurance?

How about tort reform so there's no more defensive medicine? Or how about making it easier for smaller businesses to combine, if they want to, through a trade association to buy insurance? If we started doing that, we'd change the face of health insurance and turn what appears to be an utter disaster into the greatest growth industry, greatest job creator, and greatest medical innovator the world has even seen. Why would this happen? Because health is personal. "By golly," some people say, "if you don't have government doing it, well, then, people won't get it. In order to have social justice, if there's only a certain amount of health care out there, we will have to ration it." But the whole purpose of entrepreneurial capitalism is that when people want more of something, entrepreneurs will find a way to provide it.

Think of it this way: 110 years ago, a car in this country cost the equivalent of $200,000 in today's money. It was a toy for the rich. Along came Henry Ford. He invented the moving assembly line and turned a toy for the rich into something every working person could afford.

Look at cell phones. Fifteen years ago they were expensive, clunky and as big as shoeboxes. Today they're small, sleek and cheap—and there are 4 billion of them around the world. Now if government 15 years ago had said, "We must have universal access to cell phone service," we'd still have cell phones that were as big as a car and as expensive as a truck.

Apply entrepreneurial free enterprise to health care, and people will figure out ways to do more and provide more health care at less cost. If people want something, others will figure out a way to do it—and in ways we can't even imagine today.

So let's do it, and as we do it we can show the world we truly have a humane society, where those with the least have a chance to get ahead and those who need help get help. We can do it in such a way that we flourish as never before.

After his remarks, Mr. Forbes answered written questions from the audience of 800, relayed by American Experiment Founder and President Mitch Pearlstein.

Pearlstein: Let's start by following up on what you said about individual retirement accounts. Frankly, I was surprised that you raised the issue. Most folks would say it's been a dead issue for a long time, that even when the market was doing well, it wasn't going anyplace, and the market has had a few problems recently. What makes you think that this is still a viable political idea?

Forbes: In terms of personal accounts for younger people instead of Social Security, just the sheer force of events will make the idea viable. In a few years the system is going to start to hemorrhage. Also, I think the mistake that President George W. Bush made, when he raised the issue several years ago, was that he didn't put a specific proposal on the table. Since he was already facing a hostile media, people said, "Well, grandma is going to get shot. They're going to raise the retirement age to 88." All sorts of fears took over. If he'd put a specific proposal on the table, people would have seen exactly what we had in mind.

I also think the problem was addressed in the wrong way. It was made to sound like an actuarial issue. You know: On August 1, 2039, the system is going to go broke. Boy, that's exciting; in 2039 I'm going to have a problem. What the President should have done, I think, is portray the crisis as a *huge* opportunity for young people; that is, they would have their own accounts; they'd be creating their own capital. When you start your first summer job, you'll start accumulating *your* money, not Washington's money. It will be yours. Even if you have minimum-wage jobs for years and years and years, you'll end up with real capital and something really substantial in retirement. Well, once a kid gets a summer job and starts to get a piece of paper showing that he's accumulating money, that'll sound like a pretty good thing, especially compared with his money going to Washington and disappearing into a black hole, never to be seen again. So I think it wasn't put forward in the right way. We're going to have to face this, like it or not. I hope we'll do it right when we do.

Pearlstein: A related question, then, about entitlements: You've spoken about Social Security. Let's focus a moment on Medicare and Medicaid. Those numbers are crazy, as well. What do we do?

Forbes: We remove restrictions and do the equivalent with health savings accounts (HSAs) as I talked about regarding individual retirement accounts. With those already on Medicare, you have to give them a choice. But with younger people, since they're not going to qualify for Medicare for decades, you can create a health savings account system. Instead of paycheck deductions going into Washington's black hole, they'd go into individual HSAs so people would start accumulating real medical capital for when they retire. In terms of those qualifying for Medicare today, why not offer beneficiaries the choice of an equivalent to a health savings account, where the government would put in, say, $10,000 each year, and where people would, in fact, have catastrophic insurance, so if you got a big hit, you'd be covered? Each person would control his $8,000 to $10,000. If he didn't use it, it would grow tax free. Suddenly, you'd have patients figuring out: "Gee, if I can get a generic drug that's as good as a name-brand prescription, that'll be money in my pocket." Or, "If it takes a doctor five visits to find out what he should have found in one, I'm going to change physicians, because it's my money not somebody else's."

In our own company we give people $2,500 cash during the year for medical expenses, before the deductible. So if they're blessed with good health, their money grows tax free. It's their property. But if they want to spend $2,500 to get a gold tooth, they can go right ahead and do so. If they go through the $2,500, then they must meet the deductible before receiving any reimbursements. Beyond the deductible, they have the usual catastrophic coverage. This way if employees save money, it's not for me, for the insurer or for the government. It's for *them*. So our costs have gone up less than our peers'. When people find out that any left over monies are theirs, they suddenly look at things very differently, in terms of what shows up on a piece of paper from the hospital. We should apply this approach to Medicare.

One half-baked version of it—it's very imperfect, but at least it was a lurch in the right direction—is Medicare Advantage. Nine million people are on this, but health care bills currently being considered in Congress would destroy the program. They would take these choices away from the elderly. The elderly aren't yet aware of this because insurers who provide Medicare Advantage have been told to keep their mouths shut or they would be destroyed; they would not be allowed to sell insurance.

Pearlstein: A number of folks have asked about the flat tax. They would like you to speak about the flat tax and, perhaps, for a moment or two about tax reform more broadly.

Forbes: If we really want to get the economy moving, the flat tax is the way to go. Just to put things in perspective: Lincoln's Gettysburg Address defined the character of the American nation in 272 words. There's the ultimate in editing. The Declaration of Independence, largely Thomas Jefferson's creation, 1,300 words. The Constitution, 5,000 words. The Bible, which took centuries to put together, 703,000 words. Now, the Federal Income Tax Code, with all of its attendant rules and regulations, is 9,500,000 *words and rising – and nobody knows what's in it*. The IRS doesn't know. You can call its hotline, and a quarter of the time you're given the wrong answer.

Several years ago *Money* magazine conducted a survey. It took a hypothetical family's finances, gave 46 different tax preparers the family's tax return and asked them to prepare it. Do you know what they got back? Forty-six different returns. Forty-six different estimates. No two preparers agreed on what the family owed—differences in thousands of dollars. And these are people who make their living preparing taxes.

The flat tax would provide a single rate, with generous exemptions for adults and for children. The premise of the flat-rate tax is to take this 9.5 million-word monstrosity and do what a free people should have done long ago: kill the beast, drive a stake through its heart, bury it and hope it never rises again.

With a flat tax, you'd have fairness. For a family of four, the first $46,000 in income would be free of federal income tax. There would be no tax on savings and no death taxes.

Regarding corporate taxes, the United States has some of the worst business taxes in the world. Even the French are cutting their business taxes. But we are raising ours. We should cut the corporate tax rate to 17 percent and get rid of depreciation schedules. If a company makes a capital investment, it should be able to write that investment off in the year in which it was made. If it suffers a loss, the business should be able to carry that loss forward against future profits. If this were done, you'd see the economy really take off. There would be no more chatter about jobless recoveries. There would be a real recovery that people could feel and, in a few years, we'd once again have labor shortages. That would be a real recovery.

Pearlstein: Do you foresee an America that can achieve energy independence, and is it necessary economically? Militarily?

Forbes: Well, one way to achieve energy independence is to bar Americans from having heat and air-conditioning. That would take care of it. But since we don't want to do that, there are various ways to enormously increase the supply of energy. For example, natural gas. Everyone likes natural gas; it's very clean. Why don't we drill for it offshore? How about natural gas found in shale out West? Why aren't we moving on that?

Nuclear energy. Why aren't we moving on that? It's amazing. The Japanese have done it. The French have done it. South Korea is making huge strides in technology. People worry about spent rods. Well, it turns out you can reprocess those; recycle them, almost 90 percent now. The technology is getting better and better.

One of the things we should do in this country—and private enterprise could do this if we just made a few changes—is to modernize our electricity grid. It wastes energy. We have three grids in this country; let's truly unite them. Let's also extend the grid to wind zones, such as those in Texas and North Dakota. We're going to be using electricity for more and more things. You see this happening with cars and in our homes. Electricity is once again a growth industry. We think of it as a stodgy utility, but there's real growth coming.

Pearlstein: As the owner of a print publication, what do you see as the future of print news versus digital news?

Forbes: If you see it as either/or, you're doomed. You have to see digital as just another platform to get information out and gather it in. In the mid-1990s, when everyone else went into electronic publishing and thought they could just take a printed page and throw it up on the screen and violà they were a part of the new age, we at Forbes realized we were in a situation analogous to that of 110 years ago, when Thomas Edison invented movies. At the time some people thought that filming a stage play would give you a feature film. Not so.

When we started our Web site, we knew we were coming from a print mentality. So we put our Web operation in a separate building, with separate staff, so it could grow. It reported to me and my brother, Tim, not to the usual layers. We knew that even with the best of intentions, the traditional ways would twist the new ways to their own particular needs. About a year ago, we started to integrate the two. The Web was by then a big boy. When you work for Forbes, whether it's in advertising or marketing or whatever, you're working across all platforms. When you work in editorial, you're working for Forbes Media, whether your work appears on the Web or in print. You have to think across platforms, not just for one.

You now also have to create social communities. Facebook is a phenomenon. People like communicating. In the old days you printed a story and a few days later you'd receive a letter to the editor. Faxes then made the process a little quicker. The writer would respond in a letter from the editor. This now takes place in a nanoseconds: boom, boom, boom. So when you publish a piece, your task is to make sure you have a proper dialogue—and not just with people who have too much time on their hands.

In terms of gathering information, you can't just do it internally; you have to tap into blogs and everywhere else. There are a lot of people "out there" who can provide insights instantly. Those who marshal these forces will survive in the new age.

Pearlstein: One final question and you can incorporate any final comments you'd like to make. A number of people are interested in what you think of the upcoming presidential race.

Forbes: In terms of 2012, it's going to be even more unusual than in 2008. That was the first election in decades in which neither party had, in effect, a designated frontrunner. There were frontrunners, but not an anointed candidate, such as a vice president. In 2010 Minnesota will have a wide open governor's race, on both sides. Certainly on the Republican side of the presidential race in 2012, it'll be the same thing. A couple of candidates will have name recognition, such as Mitt Romney, if he runs, and former Gov. Mike Huckabee, but they both will have challengers within the party, so they won't be frontrunners. That doesn't mean they won't win, but they're not going to have a huge surge over anyone else. This opens the race up for individuals such as Tim Pawlenty, even though he's not well known nationally.

It will be a very intense campaign, precisely for that reason. All of the above men will be considering running. Your governor is already moving on it. Gov. Mitch Daniels of Indiana will be aggressively looking at the race. Gov. Haley Barbour of Mississippi, Gov. Bobby Jindal of Louisiana, a couple of senators and some members of Congress will also be looking at it. You're going to see other names emerge after the 2010 mid-term elections. Perhaps Sarah Palin may make a run for it. I wish she hadn't resigned as governor, because I think that could get in the way of what she'd like to do. But this is such a crazy environment maybe it won't.

What you're going to see on the Republican side in the congressional elections in 2010 is more of what you saw in Virginia and New Jersey this year, candidates gearing their campaigns specifically to the needs and wants of their voters. In Virginia, for example, the gubernatorial candidate would normally have been seen as a social conservative, but he geared his campaign to Virginia's economy and to such issues as unionization—very controversial in that state—transportation, and the like. The Democrats thought he would be easy to knock off, especially in the suburbs of northern Virginia. Instead, he won by a landslide. In New Jersey, a state that makes Minnesota look like a flaming red state, we elected a Republican governor, Chris Christie, for the same reasons. He campaigned on issues geared to the particular concerns of the state's voters.

I think you're going to see a lot of that in 2010. We're a very heterogeneous country, with people who have various interests, so candidates will reflect that.

On the Democratic side, I don't think anyone will run against President Obama. I just don't think it will happen. Democrats rarely do that. The last one who did was Ted Kennedy, against Jimmy Carter.

I don't think there's a Ted Kennedy-equivalent in the Democratic Party today who would feel that he or she could tackle an incumbent President, even if his popularity is down. I don't think the resources will be there for it. I don't see Hillary Clinton running against Barack Obama in 2012, even if he's unpopular. I think the Republicans will have an advantage, but that's no guarantee we will win. When I think this is going to be a one-term presidency, I remind myself of a saying by Bob Strauss, former chairman of the Democratic Party in the early 1970s. It was in 1972, and Richard Nixon was President. He was not the most charismatic individual; in fact, he was anticharismatic. Strauss liked to say, "We Democrats could beat Nixon in a landslide if we didn't have to run anyone against him."

The key is waging an issues campaign, not a personality campaign, on basic things like health care: Why can't we have a system that increases the supply of health care at more affordable costs? And hammer that thought home.

To conclude: Even with our crazy politics, bad as they may be, if something is not going right, we eventually get it right. Remember the 1970s, a dreadful decade of stagnation, with the United States on the decline around the world and a time when the Soviets looked to be winning the Cold War. Well, it took us ten years to get things straightened out. We elected Ronald Reagan, and huge reforms were made. I think we're entering an era now, especially with the Internet, where instead of depending on one Ronald Reagan we'll have 10,000 mini-Reagans around the country, a true foundation for principled growth. We'll eventually get this country back on track. I'm not sure how long it will take, but I don't think we'll have to wait ten years this time. We'll get there, eventually. As my grandfather used to say and Warren Buffet says, "In the long term, you're not going to get rich going short on America." ■

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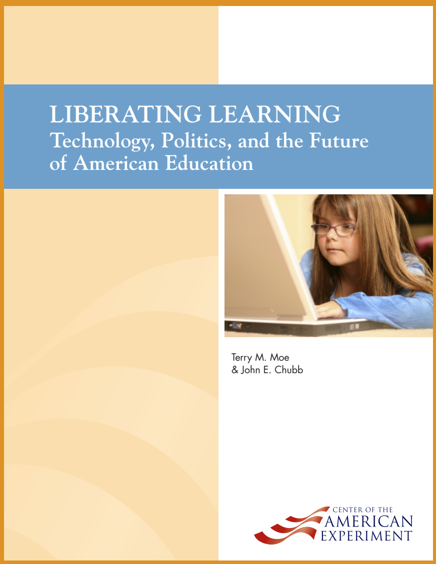

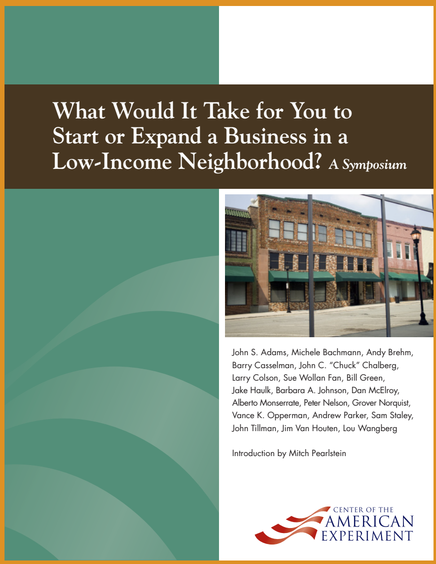

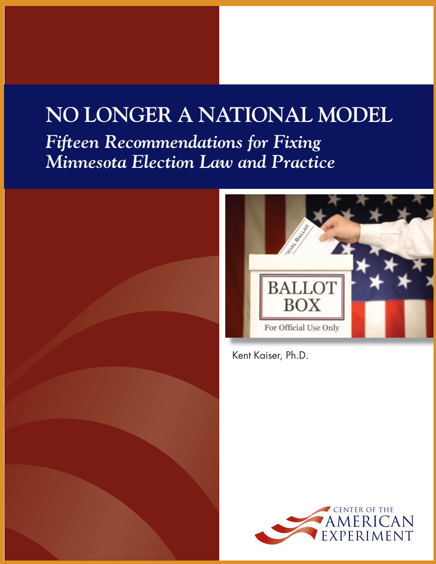

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