

## Who Guards the Guardians? How the United States Government Caused a Worldwide Economic Crisis By Jeffrey Borrowdale

In a fiercely partisan speech which led to the narrow failure of the first bailout bill, House Speaker Nancy Pelosi blamed our current financial crisis on Republican support for unfettered capitalism

They claim to be free-market advocates, when it's really an anything goes mentality. No regulation, no supervision, no discipline...in this unbridled form, as encouraged and supported by the Republicans — some Republicans, not all — it has created not jobs, not capital, it has created chaos.<sup>1</sup>

Was this a *market failure*, caused by *Republican deregulation*, or the result of *government intervention*, and *market distortions* caused by programs and policies of primarily *Democratic* politicians?

Fannie Mae was created in 1938 as a New Deal program to help lower income Americans buy homes. It did so by creating a national mortgage market, so that borrowers weren't restricted by the credit policies of their regional banks. President Johnson made Fannie Mae into a Government Sponsored Enterprise (GSE), allowing it to function as a market entity but with the backing and oversight of the Federal Government. Following this were a series of Democrat-backed anti-discrimination measures all aimed at pressuring banks to make loans to poor and minority borrowers with questionable credit worthiness.<sup>2</sup> Despite these measures, and the fact that the government had even created another GSE, Freddie Mac, to "compete" with Fannie, Democrats argued that borrowers were still held hostage to local demographics and that racial and ethnic prejudices were keeping otherwise qualified borrowers from getting loans. So, President Carter and a Democrat majority Congress passed the Community Reinvestment Act of 1977 (CRA) requiring federal regulators "to assess an institution's record of helping to meet the credit needs of the local communities in which the institution is chartered, consistent with the safe and sound operation of the institution."<sup>3</sup> In practice, this meant banks receiving FDIC insurance in areas near poor, minority populations were strong-armed into loans to high-risk borrowers or faced restrictions on mergers and acquisitions. Then, in 1989 the Home Mortgage Public Disclosure Act was amended to force banks to collect and publish racial data,<sup>4</sup> allowing political pressure groups like ACORN to sue banks for not making enough CRA mandated loans.<sup>5 6 7 8</sup>

The paradoxically named Federal Housing Enterprises Financial Safety and Soundness Act of 1992 "imposed housing goals for financing of affordable housing and housing in central cities and other rural and underserved areas" on Fannie Mae and Freddie Mac.<sup>9</sup> That same year the Federal Reserve Bank of Boston published a manual to help banks to comply with these regulations. "Closing the Gap: A Guide to Equal Opportunities Lending" advised against adherence to "outdated" traditional criteria such as a mortgage payment as a proportion of income, down payment amount or credit history. It suggested participation in a credit counseling program might be an adequate proof of credit worthiness and reminded banks that unemployment, welfare and disability benefits are accepted as income by Fannie and Freddie.<sup>10</sup> In 1995, the Clinton Administration amended the CRA to authorize subprime loans to risky borrowers, while at the same time rewriting the CRA compliance rules, making it so difficult for banks to comply that with new "diversity" requirements that they were forced to make unwise loans based solely on race.<sup>11</sup> In his last year in office, Clinton, through the Department of Housing and Urban Development, mandated that Fannie Mae dedicate 50% of its business to "low and moderate income families."<sup>12</sup> Throughout the 90s the Federal Reserve System, another GSE which works closely with the Treasury Department to set monetary policy, kept interest rates absurdly low, further inflating the housing bubble.

Enter the market. In 1997 First Union Capital and Bear Sterns began a public offering of Mortgage Backed Securities (MBS) derived from these government mandated risky loans.<sup>13</sup> Because Fannie and Freddie had the implicit backing of the Federal Government, these securities had a AAA rating as well as a high rate of return and were thus bought *en masse* by big fund managers of retirement accounts, investment banks and insurance firms, as well as many foreign investors. Just as important, this flooded the housing market with a virtually unlimited amount of capital. All banks had to do was find the borrowers, process the paperwork and resell the loans to Fannie and Freddie, making a handsome profit in origination fees. No credit? No income? No down payment? No problem! Uncle Sam wants *you* to have a home loan! Banks like Countrywide and IndyMac started making "ninja" (No Income, No Assets) loans and low/no document loans to anyone, including illegal aliens;<sup>14</sup> Fannie and Freddie bought them all. With people who previously could never afford homes or qualify for loans began buying homes, the housing boom began in earnest. Because of Federal Reserve had set interest rates so low, borrowing was cheap. Increased demand drove prices up, encouraging people to buy investment properties and flip houses for quick profits, especially in attractive areas like Southern California and the Florida coast. Lenders also began applying the lax standards of their low-income loans to middle and upper-class house-flippers and investors. Many of these risky loans had adjustable rates, were interest-only or

had introductory teaser rates. When unsustainably low rates rose, teasers expired and gas prices skyrocketed, defaults began. Housing prices began declining in over-valued markets, and borrowers found themselves owing more on houses than they were worth. Those who had put nothing down, simply walked away from the loans. Foreclosures further fueled price drops, sending cascading effects into the MBS and derivatives markets, with the shockwaves reverberating to overseas investors and global financial markets.

The chief catalyst of this government-created crisis wasn't *deregulation of markets championed by Republicans*,<sup>15</sup> but rather *resistance of government oversight of GSEs by Democrats*.<sup>16</sup> Bush and Congressional Republicans lobbied for additional oversight from 2002 to 2007, with Senator McCain co-sponsoring a key reform bill.<sup>17</sup> All efforts were rebuffed by Democrats with party-line votes.<sup>18</sup> It's no coincidence that Democrats, who started these programs, defended them, and that those who chaired banking and finance committees and obstructed were the chief recipients of lobbyist money from Fannie and Freddie.<sup>19</sup> And it's not surprising that calls for oversight by Republicans met with charges of racism.<sup>20</sup>

While the details of this market crisis are complex, the fundamentals are simple. This financial wildfire was sparked by the Federal Government keeping interest rates artificially low, coercing and enticing banks into making "affirmative action" loans, then buying and reselling them to investors. Resulting lower credit standards and capital flood created an artificial housing bubble, which, when it burst, sent cascading effects into financial markets. As GSEs, Fannie and Freddie took risks no private institution would take, and because of their GSE status investors saw them as a low risk. Democrats resisted oversight because they created and believed in these institutions, because these loans went to their key constituencies and because of lobbyist contributions. The Bush Administration's only role in the crisis is in not replacing long-time Federal Reserve Chairman Alan Greenspan, and allowing him to flood the housing market with cheap money, fueling the speculative housing bubble.

The market has built-in corrective mechanisms of risk-aversion, loss-aversion and failure. But, if instead of trusting markets, we trust politicians to guard economy, it begs the question, "Who guards the guardians?"<sup>21</sup>

#### ENDNOTES

1 Nancy Pelosi, C-SPAN, September 29, 2008, 12:21pm ET <http://www.youtube.com/watch?v=ey3ZlsmIkz42> The Fair Housing Act (1968), The Equal Credit Opportunity Act (1974) and the Home Mortgage Disclosure Act (1975)

<http://www.federalreserve.gov/newsevents/testimony/braunstein20080213a.htm>

3 Title 12: Banks and Banking, Part 345—Community Reinvestment <http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=44059fe1dfc00c61e5a82d909ebafac0&rgn=div8&view=text&node=12:4.0.1.2.33.1.3.1&idno=12>

4 Federal Deposit Insurance Corporation Press Release, March 31, 2005: Frequently Asked Questions About the New HDMA Data - 1. What is the Home Mortgage Disclosure Act (HDMA)?

<http://www.fdic.gov/news/news/press/2005/pr3005a.html>

5 Thomas J. DiLorenzo, "The Government-Created Subprime Mortgage Meltdown"

<http://www.lewrockwell.com/dilorenzo/dilorenzo125.html>

6 Stan Leibowitz, "The Real Scandal: How Feds Invited The Mortgage MESS", *New York Post*

[http://www.nypost.com/seven/02052008/postopinion/opedcolumnists/the\\_real\\_scandal\\_243911.htm?page=0](http://www.nypost.com/seven/02052008/postopinion/opedcolumnists/the_real_scandal_243911.htm?page=0)

7 Stanley Kurtz, "O's Dangerous Pals: Barack's 'Organizer' Buds Pushed For Bad Mortgages" September 29, 2008, Posted: 3:53 AM ET.

[http://www.nypost.com/seven/09292008/postopinion/opedcolumnists/os\\_dangerous\\_pals\\_131216.htm?page=0](http://www.nypost.com/seven/09292008/postopinion/opedcolumnists/os_dangerous_pals_131216.htm?page=0)

8 In 1994, a young Barack Obama sued Citibank for failing to give loans to minority applicants. Citibank settled out of court in 1998 for an undisclosed amount. <http://www.mediacircus.com/2008/10/obama-sued-citibank-under-cra-to-force-it-to-make-bad-loans/>

9 About Fannie Mae: Our Charter – The Federal Housing Enterprises Financial Safety and Soundness Act of 1992. Last Revised: March 6, 2008. <http://www.fanniemae.com/aboutfm/charter.jhtml>

10 The Federal Reserve Bank of Boston, *Closing the Gap: A Guide to Equal Opportunities Lending*, Last Updated 4/92. <http://www.bos.frb.org/commdev/commaff/closingt.pdf>

11 Terry Jones, "How A Clinton-Era Rule Rewrite Made Subprime Crisis Inevitable"

*Investor's Business Daily*, Posted Wednesday, September 24, 2008 4:30 PM PT

<http://www.ibdeditorials.com/IBDArticles.aspx?id=307149667289804>

12 "Fannie Mae Increases CRA Options," *ABA Banking Journal*, November 2000.

[http://findarticles.com/p/articles/mi\\_hb6632/is\\_200011/ai\\_n26424963?tag=rel.res1](http://findarticles.com/p/articles/mi_hb6632/is_200011/ai_n26424963?tag=rel.res1)

13 Wachovia Press Release, October 20, 1997, "Unique Transaction To Benefit Underserved Housing Market"

[http://www.wachovia.com/inside/page/textonly/0,,134\\_307%5E306.00.html](http://www.wachovia.com/inside/page/textonly/0,,134_307%5E306.00.html)

14 Chris Isidore , "'Liar Loans': Mortgage Woes Beyond Subprime: Loans where borrowers gave little proof of income could be the next threat to the troubled real estate market - and the economy," CNN Money, March 19 2007: 5:01 PM EDT

[http://money.cnn.com/2007/03/19/news/economy/next\\_subprime/index.htm](http://money.cnn.com/2007/03/19/news/economy/next_subprime/index.htm)

15 The Graham-Leach-Bliley Act of 1999, rather than being a cause of the meltdown, helped markets cope with it. The act, supported by Larry Summers, Robert Rubin, John Sweeney and Harry Reid, among others, repeal parts of the Glass-Steagall Act of 1933, which separated commercial and investment banking. This allowed investment firms Bear Stearns and Merrill Lynch to be absorbed into more soundly capitalized J.P. Morgan/Chase and Bank of America respectively. See "Dispelling The 'Deregulation' Myth," *Investor's Business Daily*, Posted Friday, September 19, 2008 4:20 PM PT

[http://www.liveleak.com/view?i=966\\_1222076584](http://www.liveleak.com/view?i=966_1222076584)

16 In 2002, the housing boom was the one bright spot in an otherwise dark economy, still reeling from the dot-com bust and the 9/11 attacks, so Democrats were reluctant to acknowledge the danger. *Wall Street Journal* editor Paul Gigot, who reports being savaged by Fannie and Freddie allies, quips about his paper's February editorial of that year, "Fannie Mae Enron?" that his only regret was the question mark.

[http://online.wsj.com/public/article\\_print/SB121677050160675397.html](http://online.wsj.com/public/article_print/SB121677050160675397.html)

Observe the important distinction between *regulation of markets by government, and oversight of government-chartered entities*. I am against the former but strongly in favor of the latter. *If we are to have such organizations, they must be watched very closely*. It should be noted that *Ron Paul* warned of just such a GSE-based economic meltdown in 2003 and introduced the Free Housing Market Enhancement Act, which would have completely averted the crisis by repealing the authority given to the Federal Reserve to purchase GSE debt. <http://www.lewrockwell.com/paul/paul128.html>

17 "Mr. President, this week Fannie Mae's regulator reported that the company's quarterly reports of profit growth over the past few years were 'illusions deliberately and systematically created' by the company's senior management, which resulted in a \$10.6 billion accounting scandal. The Office of Federal Housing Enterprise Oversight's report goes on to say that Fannie Mae employees deliberately and intentionally manipulated financial reports to hit earnings targets in order to trigger bonuses for senior executives. In the case of Franklin Raines, Fannie Mae's former chief executive officer, OFHEO's report shows that over half of Mr. Raines' compensation for the 6 years through 2003 was directly tied to meeting earnings targets. The report of financial misconduct at Fannie Mae echoes the deeply troubling \$5 billion profit restatement at Freddie Mac.

The OFHEO report also states that Fannie Mae used its political power to lobby Congress in an effort to interfere with the regulator's examination of the company's accounting problems. This report comes some weeks after Freddie Mac paid a record \$3.8 million fine in a settlement with the Federal Election Commission and restated lobbying disclosure reports from 2004 to 2005. These are entities that have demonstrated over and over again that they are deeply in need of reform. For years I have been concerned about the regulatory structure that governs Fannie Mae and Freddie Mac--known as Government-sponsored entities [sic] or GSEs--and the sheer magnitude of these companies and the role they play in the housing market. OFHEO's report this week does nothing to ease these concerns. In fact, the report does quite the contrary. OFHEO's report solidifies my view that the GSEs need to be reformed without delay.

I join as a cosponsor of the Federal Housing Enterprise Regulatory Reform Act of 2005, S. 190, to underscore my support for quick passage of GSE regulatory reform legislation. *If Congress does not act, American taxpayers will continue to be exposed to the enormous risk that Fannie Mae and Freddie Mac pose to the housing market, the overall financial system, and the economy as a whole.*

I urge my colleagues to support swift action on this GSE reform legislation." – Sen. John McCain, United States Senate, May 25, 2006, Section 16. <http://www.govtrack.us/congress/record.xpd?id=109-s20060525-16&bill=s109-190>

During the Vice Presidential Debate, Joe Biden deliberately mislead the audience, claiming that McCain was surprised by the mortgage crisis while Barack Obama sent a letter of warning to Treasury Secretary Paulson and Fed Chairman Bernake in 2007. However, scrutiny of Obama's letter shows that while it warns of immanent foreclosures, it focuses on "predatory lending," calling for a summit aimed at preserving the status quo, keeping people in their homes, and providing more credit counseling for wayward borrowers; it contains no warning of a catastrophic impending financial crisis based on massive foreclosures, as did Senator McCain's speech. [http://obama.senate.gov/press/070322-obama\\_urges\\_ber/](http://obama.senate.gov/press/070322-obama_urges_ber/)

18 Al Hubbard and Noam Neusner, "Where Was Sen. Dodd? Playing the Blame Game On Fannie and Freddie," Friday, September 12, 2008; Page A15. <http://www.washingtonpost.com/wp-dyn/content/article/2008/09/11/AR2008091102841.html>

19 <http://www.opensecrets.org/news/2008/09/update-fannie-mae-and-freddie.html>

20 In late 2004 an Office of Federal Housing Enterprise Oversight (OFEO) report showed the serious trouble Fannie and Freddie were in, and Democrats, especially black Democrats Maxine Waters, Gregory Meeks, and Artur Davis vociferously defended the Fannie, its minority loans and its African-American chairman, Franklin Raines, resisting new

regulation. Rep. Lacy Clay referred to the criticism of Chairman Raines a "political lynching."

[http://www.youtube.com/watch?v=MGT\\_cSi7Rs](http://www.youtube.com/watch?v=MGT_cSi7Rs)

21 This quote, often misattributed to Plato, is from Juvenal's *Satire* and concerns a husband's dilemma about his unfaithful wife, but has an obvious political analog: "I know the plan that my friends always advise me to adopt: "Lock her up, imprison her!" But who will guard the guardians? They keep quiet about the girl's secrets and get *her* as their payment; everyone hushes it up." --Juvenal, *Oxoniensis* 29-33, E.O. Winstedt 1899, "A Bodleian MS of *Juvenal*", *Classical Review* 13: 201–205

## THE GREAT ECONOMIC DEBATE OF THE TWENTIETH CENTURY

Steve Forbes

The great economic debate of the twentieth century was between collectivists and free-marketers. In one sense, the free-marketers won: When the Berlin Wall fell in 1989, it was widely acknowledged that Soviet socialism had been a catastrophic, not to say murderous, failure. But in another sense, the debate continues. Democratic capitalism still has not vanquished the idea of collectivism. Far from it.

At the beginning of the last century, free markets seemed to be on the ascendancy everywhere. But two events gave collectivism its lease on life. The first was World War I. In addition to the slaughter - and to breeding the ideologies of communism, state fascism, Nazism, and even the Islamic fascism we are battling today - World War I served as an intoxicating drug to those in the West who believed that a handful of people in government could manage affairs better than the messy way in which free peoples tend to do so. Massive increases in government powers, coupled with massive increases in taxation, gave many the idea that you can achieve massive increases in production by commandeering the financial resources of society.

The second event that served as a boon to collectivism was the Great Depression, which was widely seen as a free-market failure. This view was false. Misguided government policies were at fault – the Smoot-Hawley Tariff, for instance, which dried up the flow of capital in and out of the country. If you track the stock market crash of 1929, it parallels the course of this tariff bill through Congress. When Smoot-Hawley arose in the fall of 1929, the markets fell; when it looked like the tariff bill was sidetracked in late 1929, the markets revived (the Dow Jones went up 50 percent from its lows in November); in the spring of 1930 it was signed into law, and the rest is history. There were other factors at work in the Great Depression, of course, such as President Hoover's gigantic tax increases of 1931. But despite the fact that these also involved bad policies, the lesson taken away by many was that economies will implode unless the government manages them. **John Maynard Keynes, the intellectual guiding light behind New Deal economics, believed that an economy was like a machine: If you put doses of money into it or pull money out at the right times, he thought, you can achieve an equilibrium.** This idea that government can drive an economy has had baleful consequences.

Other leading economists at the time, such as **Joseph Schumpeter, recognized that an economy is an aggregate of disparate activities – thus that the idea of achieving equilibrium, while it makes for a neat theory, is nonsense in the real world.** A vibrant economy is full of constant *disequilibria*: New enterprises rise up, old ones decline, etc. Snapshots of such economies mean very little. In the real world, therefore, free markets operate rationally and efficiently in a way that government regulators simply can't. Here in America we came to this realization at the end of the 1970s. Following World War II, we largely bought into the idea that government must play an active role to prevent the economy from going off the cliff. But in the late 1970s, the devastation of inflation and high taxes brought about a reassessment. **With the election of Ronald Reagan, the U.S. took a step back from Keynesian economics.** Since then, as Western Europe has stagnated-creating, for instance, only a fraction of the private sector jobs that the U.S. has created-our country has undergone an economic revival.

Nonetheless, democratic capitalism often still seems on the defensive. Why?

### IS DEMOCRATIC CAPITALISM GOOD?

One of the great vulnerabilities of capitalism is the perception that it is somehow less than moral, if not positively amoral. A common view of business was depicted in the movie *Wall Street*, in which Michael Douglas's character made famous the phrase, "Greed is good." Capitalism is widely seen as promoting selfishness. We tolerate it because it gives us jobs and prosperity, but many look on this as a Faustian bargain. Charity and capitalism are seen as polar opposites. Thus there's a phrase that's often used today - I myself use it from time to time without thinking - which is "giving back." If you've succeeded in business, it's counted a good thing if you "give back" to the community. And charity is, of course, a good thing. The problem with this phrase is its implication that by succeeding, we have taken something that wasn't ours. The same idea is summed up in the cynical saying. "Behind every great fortune lies a great crime." This way of

thinking about democratic capitalism is wrong.

In fact, philanthropy and capitalism are two sides of the same coin. To succeed in business in a free-market economy, one must meet the needs and wants of others. Even someone who makes babies cry is not going to succeed unless he or she provides a product or service that people want. This system weaves intricate webs of cooperation that we don't even think about. Take a restaurant: Someone who opens a restaurant assumes that farmers will provide the food and that someone else will process and package it and that someone else will deliver it, having been supplied the fuel to do so by yet someone else, etc. These marvelous webs of cooperation happen every day throughout a free economy. No one is commanding it. It occurs spontaneously in a way that economists like Schumpeter understood.

Free markets also force people to look to the future and take risks. Misers do not found companies like Microsoft. Nor should we look on it as immoral for people to work for the betterment of themselves and their families. We are all born with God-given talents, and it is right to develop them to the fullest. The great virtue of democratic capitalism is that it guarantees that as we develop our talents, we're contributing to the public good. Statistics show that the U.S. is both the most commercial nation and the most philanthropic nation in human history. And this is no paradox. The two go hand-in-hand.

Another vulnerability of democratic capitalism is that although it leads to progress and to an increase in our societal standard of living, progress is usually disruptive. This allows collectivists to play on people's natural fear of change. We saw this with the rise of industrialism in the 19<sup>th</sup> century. We had paintings and writings depicting a pastoral agricultural past. Then railroads came along to disrupt the canals, and cars came along to disrupt the railroads. Buggy-whip makers and blacksmiths were done for. One can imagine what *60 Minutes* would have been investigating 100 years ago: the poor blacksmiths being put out of work by Henry Ford. Likewise, when TV came along in the late 1940s and early 1950s, most movie theaters in the country went broke. Now the internet is disrupting newspapers and Craig's List is disrupting classified advertising. Disruptions are inevitable in a free-market system. The political challenge is to allow these disruptions to take place - they are ultimately constructive, after all - rather than reacting in a way that stymies progress.

In recent decades, collectivists have also hijacked the cause of environmentalism to promote their agenda. I'm not talking about the desire to have clean water; we're all in favor of that. Or clean air; one of the great things we've done in the last century is getting lead out of the air. Saving tigers and elephants is also a good thing. I'm talking about those who use the mantra of environmentalism to try to control the economy the way the old-time socialists wanted to, breathing hellfire and damnation on those who don't subscribe to their new, post-Christian religion. The fact is, if our goal is to improve the environment, increasing government regulation and destroying manufacturing is counterproductive. Affluence is the friend, not the enemy, of the environment. As people become better off, they want a higher quality of life, including environmental improvements. And new technology drives such improvements. Consider the east coast of the U.S. Even though its population has more than doubled - in some areas, it's tripled - and even though there are more developments, malls, and urban sprawl, there are more trees today than there were 80 years ago. Why? Because of technology that allows us to grow more food on less land. Technology is a friend of the environment.

#### ADDITIONAL COLLECTIVIST MYTHS

Let me mention three additional myths that are used to promote collectivism. One is the idea that demand is the key to economic growth. **Economists often talk about means to increase "aggregate demand," as if that would ensure that the economy will grow. Following Keynes, they assume that the economy is like a machine.** But again, the economy is an aggregate of tens of millions of people, millions of businesses, millions of technologies. We don't know how it interacts on a day-to-day basis. We don't know what's going to work or not work. Who could have conceived of eBay ten to twelve years ago? But today, 400,000 people make their livings on eBay. When Google was launched, there were ten other search engines. Who would have thought another one was needed? Isn't that how you get so-called "bubbles"? But Google found a way to do it better and ended up on top. Innovation is the key. Whether it's railroads, cars, computers, the Internet, or iPods, risk-taking is messy. It is often irrational, and seemingly wasteful. But it's the only way to determine what works best and what doesn't.

Another collectivist myth concerns trade. If I were dictator of the world - even though I believe in the First Amendment - I would ban trade numbers, especially merchandise trade numbers. They just lead to mischief. We are given the impression that a trade surplus is like a profit and a trade deficit is like a loss. But trade is not a transaction between countries. It takes place between parties. For example, *Forbes* magazine buys paper. For all of the 88 years that we've been in existence, we've run a trade deficit with our paper suppliers. If you look just at the trade deficit, you might think we are doing poorly. But if you look at the two parties involved, that turns out to be an illusion. The paper supplier thinks he is going to make money selling his paper. We think we're going to make money by taking the paper and putting print on it, with value added. So it's a mutually profitable transaction, even if it looks like a trade deficit. Or consider a

book printed in Taiwan. Looking at the trade number alone, it appears there is a two dollar trade deficit with Taiwan. Yet the book comes back here and retails for \$24.95. The value added is in the U.S. The author gets a cut, the publisher gets a cut, booksellers get a cut, distributors get a cut, and remainder stores get a cut. Something similar happened with iPods: A lot of its parts are made overseas, but where is most of its value added? Here in the United States. North America has had a merchandise trade deficit for 350 out of the last 400 years, and we have done very well, thank you.

The final myth I'll mention concerns budget deficits. **Milton Friedman said several years ago that if he had a choice between a federal budget of \$1 trillion that was in the red and a federal budget of \$2 trillion that was balanced, he would take the former.** Deficits, in and of themselves, are not evil. Deficits must be put into context, because Washington's inability to curb spending is often used as an excuse to raise taxes.

## PRINCIPLES OF PROSPERITY

Now let me turn to five basic principles of economic growth. First and foremost is the rule of law: Without individual equality before the law, entrepreneurs cannot challenge already existing businesses. Alliances between the latter and government regulators who place barriers before entrepreneurs must be guarded against.

The second essential principle is property rights. We take it for granted in this country that if you buy a piece of property, everyone acknowledges that you own it. Most countries don't have that kind of uniform property system. A few years ago, Hernando DeSoto, a great economist from Peru, saw that in countries like his, although there is entrepreneurial activity, there isn't the corresponding prosperity found in the U.S. And he wondered why. In his recent book – *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* - one of the key factors he cites is the absence in so many other countries of a legal foundation for property rights. In Brazil's shanty towns, an individual may know that he owns the house in which he lives, and his neighbors may know it, but the fact is not recognized elsewhere.

Mr. Desoto was asked by the Egyptian government a few years ago to determine who owns the businesses and residences in Egypt. His finding was that 88 percent of businesses in Egypt are illegal. Why is that? Here in the U.S., it is possible to set up a business legally in a matter of days. In Egypt, it takes a couple of years. It requires going through numerous bureaucracies, doling out numerous bribes, etc. So it makes sense to proceed "informally." On the other hand, running a business outside the law limits its growth. Most "informal" enterprises never grow beyond the level of family enterprises, because if they get too big, they might attract the attention of the tax collector. DeSoto's group also reported that 92 percent of Egyptian housing is illegal. People living in residences may have deeds; but only a few miles away, those deeds are not recognized. In Egypt, as in so many other places, there is no uniform system of establishing and protecting property rights. As a result, four billion people around the world own \$9 trillion of assets that amount to dead capital.

What do I mean by "dead capital"? Remember that here in the U.S., the most important source of capital for new ventures is not Wall Street, the local banker or the venture capitalist. It is the mortgage market. People either increase their mortgage or take out a second mortgage in order to start businesses. That is not possible in countries like Egypt. Understanding this was the key to Japan's post-World War II economic boom. General MacArthur reformed a feudalistic property system, in which the peasants had only an informal system of property exchange, into a system with formalized property rights. Immediately, the Japanese economy took off. The importance of property rights is not sufficiently recognized by those of us who take them for granted.

The third principle of economic prosperity is low taxes. Taxes are not just a means of raising revenue for the government. They are also a price. Income taxes are a price paid for working; taxes on profits are the price paid for being successful in business; taxes on capital gains are the price paid for taking risks. In light of this, the importance of low taxes is easy to see: When you lower the price of good things - things like work, success and risk-taking - you tend to get more of them. Raise the price of these good things and you get less. In 2003, we lowered tax rates in the U.S. and the economy started to grow again. As we've seen time and again, tax cuts do not mean a loss of tax revenue. By increasing incentives, the government comes out ahead. Washington's revenues in the last fiscal year were up 15 percent - \$100 billion above expectations. Washington's problem is not revenue, but spending.

The fourth principle I would mention is making it simpler to launch legal businesses. Getting bureaucracy out of the way will inject a new vibrancy into the economy. The fifth and final principle is free trade. Expanding markets and creating greater opportunity for trade benefits us all.

In closing, I will remind you of a point I made earlier: The reason that the great economic debate continues into the 21<sup>st</sup> century, despite the proven superiority of free markets in terms of delivering prosperity, is because of the misperceptions that keep democratic capitalism from capturing the moral high ground. Dispelling these misperceptions should be our priority as we carry on that debate in the years ahead.

Excerpted from a speech delivered at Hillsdale College on January 29, 2006

Steve Forbes is president and CEO of Forbes, Inc., and editor-in-chief of *Forbes* magazine. In 1985, President Reagan named him chairman of the Board for International Broadcasting, where he oversaw the operation of Radio Free Europe and Radio Liberty. He was reappointed to this post by President George H. W. Bush and served until 1993. Mr. Forbes graduated in 1966 from Brooks School in North Andover, Massachusetts, and received a B.A. in history from Princeton University in 1970. He serves on the boards of the Ronald Reagan Presidential Foundation, the Heritage Foundation and the Foundation for the Defense of Democracies. His most recent book is *Flat Tax revolution: Using a Postcard to Abolish the IRS*.

## A TAXING PARABLE

Adapted by Bill Burrows

Let's put tax cuts in terms everyone can understand. Suppose that every day, ten people go out for dinner. The bill for all ten comes to \$100. If they paid their bill the way we pay our taxes, it would go something like this:

- \* The first four people (the poorest) would pay nothing.
- \* The fifth would pay \$1.
- \* The sixth would pay \$3.
- \* The seventh \$7.
- \* The eighth \$12.
- \* The ninth \$18.
- \* The tenth person (the richest) would pay \$59.

So, that's what they decided to do. The ten people at dinner in the restaurant every day and seemed quite happy with the arrangement, until one day, the owner threw them a curve.

"Since you are all such good customers," he said, "I'm going to reduce the cost of your daily meal by \$20."

So, now dinner for the ten only cost \$80. The group still wanted to pay their bill the way we pay our taxes.

So, the first four people were unaffected. They would still eat for free. But what about the other six, the paying customers? How could they divvy up the \$20 windfall so that everyone would get a 'fair share'?

The six people realized that \$20 divided by six is \$3.33. But if they subtracted that from everybody's share, then the fifth person and the sixth person would each end up being 'PAID' to eat their meal.

And so:

- \* The fifth person, like the first four, now paid nothing (100% savings).
- \* The sixth now paid \$2 instead of \$3 (33% savings).
- \* The seventh now paid \$5 instead of \$7 (28% savings).
- \* The eighth now paid \$9 instead of \$12 (25% savings).
- \* The ninth now paid \$14 instead of \$18 (22% savings).
- \* The tenth now paid \$49 instead of \$59 (16% savings).

Each of the six was better off than before. And the first four continued to eat for free. But once outside the restaurant, the people began to compare their savings.

"I only got a dollar out of the \$20," declared the sixth person. He pointed to the tenth person "but he got \$10!"

"Yeah, that's right," exclaimed the fifth person. "I only saved a dollar, too. It's unfair that he got ten times more than me!"

"That's true!!" shouted the seventh person. "Why should he get \$10 back when I got only \$2? The wealthy get all the breaks!"

"Wait a minute," yelled the first four people in unison. "We didn't get anything at all. The system exploits the poor!"

The nine people surrounded the tenth and beat him up. The next night the tenth person didn't show up for dinner, so the nine sat down and ate without him. But when it came time to pay the bill, they discovered something important. They didn't have enough money between all of them for even half of the bill! And that, boys and girls, journalists and college professors, is how our highly progressive tax system works. The people who pay the highest taxes get a larger benefit from a tax reduction. Tax them too much, attack them for being wealthy, and as many may not show up at the table anymore. There are lots of good restaurants in Europe and the Caribbean.

### **Reading from The Philosophy of Success (Borrowdale):**

#### **The Origins of Money**

Human beings evolved as hunter gatherer societies and originally traded with other clans and tribes who produced things they didn't know how to produce or produced more efficiently. For example, a coastal tribe would trade dried fish with an inland tribe which had fur pelts from the animals it hunted. A fishing culture, which made nets might also make excellent hammocks or be adept at weaving baskets, whereas the inland culture might have rawhide bows and arrows or wine skins to trade. Remember the old saying, "Jack of all trades, master of none"? Cultures would specialize in particular things, based on the material conditions of their society, be able to produce things in larger quantities and better quality than another tribe, and could then benefit from the skills other tribes through trading.

As we moved from hunting and gathering to agriculture, the surpluses became larger, and a reliable food supply allowed for the rise of an artisan class, which could specialize in making just shoes, pottery, etc. With the advent of large sailing ships and animal-drawn wagons, large amounts of goods could be moved long distances and traded in local marketplaces. When dealing with a variety and large amount of goods, barter becomes cumbersome. Suppose you have fish to sell and want to buy some tomatoes, but the tomato merchant doesn't like fish or bought from someone else. You're stuck. How many tomatoes do you get for a how many fish anyway?

Enter a common medium of exchange: money. Rare substances which were thus highly valued were used, like gold and silver, eventually minted into coins of a standard weights. Instead of trying to compare apples with oranges all the time, you can compare everything with gold or silver. You receive money for your fish and then can buy anything you want with it, instead of having to have something to trade which the seller wants. Since large quantities of coins are difficult to carry around, banks would store these in a safe place and issue paper notes based on the value of the deposit, which could be redeemed for gold and silver. Paper notes have given way to data stored in computers. But the money itself is generated through productive activity, which produces something of perceived value to others.

**What's It Worth?** How do you know what something is worth? It's worth whatever someone else is willing to pay for it. How do you know that? Look at what people are paying for it now. When a business offers a product or service, it is worth whatever its perceived value is, as determined by supply and demand. If there is a large demand and short supply, the price rises. If there is a large supply and small demand, the price does down. What happens when more than one person are selling the same kind of good or service? People will buy from the seller who offers the highest quality at the lowest price. When dealing with goods, "quality" also includes "customer service." For example, I may patronize a business with a helpful and friendly staff with a clean and well-stocked store over another business with lower prices, but a rude staff who are often out of the product I want.

**Competition Keeps Prices Low and Quality High** Businesses are motivated by profit, which is the price of their goods or services minus the cost to produce them. Why can't they charge whatever they want? One reason is that they can probably sell more items at a lower price. Even if they make less in each individual item, they make more on quantity. If you sell a million downloads of a song for a dollar each, that's a million dollars. If you jacked up the price to \$10, you might only get 50,000 downloads, in which case you've only made \$500,000. By increasing your price ten times, you've cut your sales in half. With other items, where there is no exclusive right (as there is in the case of a copyrighted song), a competitor will just offer the same or similar product for less, or the competitor might offer a product for the same price with much better quality.

**The Invisible Hand of the Marketplace** In *The Wealth of Nations*, Adam Smith writes about "the invisible hand of the marketplace" which directs wealth naturally into to the most productive hands when people are free to buy and sell freely. The market is the result of the myriad of choices people all over the world make every day, following self-interest. Customers want the best deal and businesses want to outsell their competitors by giving it to them. It's win-win. Market distortions emerge when governments control interest rates or give special subsidies or pass regulations which favor some companies or industries over others, protect domestic companies from foreign competition or require other things not essential for the operation of the business. The result of the thousands of pages of regulations written every year and of taxes (government skimming from productive businesses through threat of violence), is depressed economic output, higher prices and higher unemployment.

In a free market, businesses have no power over you except to assault you with low prices, torture you with wide selection and kill you with high quality. Why would they do that? Because if they don't, a competitor who is doing those things will put them out of business. Unlike the government, they can't force you to buy their products and services. However, if some politician can be bribed with a campaign contribution to pass a favorable law, a business or industry will do so. It may even be doing this for self-defense purposes, since, if they don't have their "boys in Washington," other companies that do will get laws passed which harm *them*. Moreover, if other industries are getting subsidies and they aren't, they will be at a competitive disadvantage. Since they are in business to make money, they ignore the ability to "complete" through political bribes at their peril.

The sad truth is that most bills are written by lawyers, advised by lobbyists in difficult to understand legalese. The politicians who vote on them don't even read them and in many cases couldn't because the bills are so long, complex and in such technical jargon. They only have the vaguest idea of what is in them from legislative summaries, but they make sure their legislative staff creates and inserts tax loopholes, subsidies and regulations which benefit their corporate contributors.

Rather than protecting you from corporations, politicians *are in bed with the corporations* to stick it to their competitors. When corporations can get around having to compete by passing laws, consumers lose out. Instead of benefiting from low priced imports, an import tariff allows them to keep prices high. Are milk or sugar prices down? Agriculture subsidies bring them back up. Local beauty school not getting enough students? Pass a regulation requiring a "beautician's license" to cut hair and give manicures. Big businesses can deal with all these laws and regulations, though it make them less productive, but they create a high barrier to entry for the small businessman or entrepreneur without a legal department or army of accountants.

The solution to this is not more laws but *limited government*. The less power the government has to regulate commercial activity, the fewer anti-competitive laws and corporate welfare subsidies there will be. Since the Constitution restricts the Federal Government to the 17 enumerated powers listed in its pages, a fact made explicit by what ought to be a superfluous Tenth Amendment, most of the laws passed by Congress are Unconstitutional anyway. A large Federal government regulating businesses is not only disastrous, it violates the legal charter which created and supposedly governs this union of states.

**Why Understanding Economics Is Important** If you see businessmen as exploitative, wealth as an accident and poverty as a metaphysical condition created by "unfortunate circumstances," instead of the result of individual choices and behavior, your chances of becoming wealthy are less, both in terms of the economic conditions you create through voting or other political action and the way such an attitude affects your own behavior and they way employers see you

Democrat House Majority Leader Dick Gephardt used to refer to the wealthy as "the winners of life's lottery" and argue that as such, they had an obligation to help the "less fortunate." Of course, he was not referring to voluntary charity, but to politicians forcibly taking money from productive businesses and workers and doling it out to those who have not earned it. Do they do this out of pure altruism? Of course not, it's intended to buy their votes in the next election. Who is more "greedy": the businessman who wants to get the best price and the greatest profit when he produces something of value in the marketplace, or the person who votes themselves benefits they haven't earned by checking a box on a ballot?

This sort of idea, that wealth is a matter of luck, is not only largely false, it creates disincentives to success, because it makes you a victim of circumstance. You have no control over your lot in life. However, successful people have found the

following is curious phenomena: the harder you work, the luckier you get. Coupled with a proper understanding of the market and a realistic plan, hard work is what makes the difference between success and failure. The very wealthy may have gotten into the right business at the right time or possess a tremendous talent and been the one in the million who skyrocketed to the pop charts, etc., but even these people typically failed over and over again at various things before finding something that worked. The key was persisting through failure instead of giving up. Do some people just get lucky? Of course they do. Some people smoke, drink, never exercise, eat a poor diet and live to be 100. But what happens to most people who do these things? Cancer, heart disease, diabetes and an early grave. You can't count on luck, but you can count on yourself.

Contrast this approach with that of President Obama campaign speech in Roanoke, Virginia:

"There are a lot of wealthy, successful Americans who agree with me — because they want to give something back. They know they didn't — look, if you've been successful, you didn't get there on your own. You didn't get there on your own. I'm always struck by people who think, well, it must be because I was just so smart. There are a lot of smart people out there. It must be because I worked harder than everybody else. Let me tell you something — there are a whole bunch of hardworking people out there.

If you were successful, somebody along the line gave you some help. There was a great teacher somewhere in your life. Somebody helped to create this unbelievable American system that we have that allowed you to thrive. Somebody invested in roads and bridges. If you've got a business — you didn't build that. Somebody else made that happen. The Internet didn't get invented on its own. Government research created the Internet so that all the companies could make money off the Internet.

The point is, is that when we succeed, we succeed because of our individual initiative, but also because we do things together."

There's that throw-away line about "individual initiative" but the tone and emphasis is that lots of people work hard, and if you succeed, there's nothing special about you. Rather than taking pride in your accomplishment, you should thank the government for all the roads and bridges. I guess Steve Jobs should thank his fifth grade teacher and roads and bridges were what made John Mackey, CEO of Whole Foods so successful. Jeff Bezos should thank the government for inventing the internet.

But wait a minute. Who paid for these teachers, roads and bridges? The very people Obama is trying to knock down a notch. The "rich" who pay the most taxes. And everyone had access to the same schools, bridges and roads, so why do some people end up poor, barely getting by, while others end up solidly middle class or better? Could it have to do with that last line about individual initiative?

Another questionable assumption is that without government, and particularly without the Federal government, there would be no education, no roads and bridges. But is that true? Don't parents want to educate their children? Don't businesses want educated employees? Don't businesses need roads to transport goods and allow customers to get to them? If left to the market, there things would still exist and in all likelihood be of a higher quality and lower cost.

Consider a similar quote from Senator Elizabeth Warren (D- Massachusetts) from September 14, 2011:

"I hear all this, you know, 'Well, this is class warfare, this is whatever. No. There is nobody in this country who got rich on his own. Nobody.

"You built a factory out there? Good for you. But I want to be clear: you moved your goods to market on the roads the rest of us paid for; you hired workers the rest of us paid to educate; you were safe in your factory because of police forces and fire forces that the rest of us paid for. You didn't have to worry that marauding bands would come and seize everything at your factory, and hire someone to protect against this, because of the work the rest of us did.

"Now look, you built a factory and it turned into something terrific, or a great idea? God bless. Keep a big hunk of it. But part of the underlying social contract is you take a hunk of that and pay forward for the next kid who comes along."

How Generous of Miss Warren to allow the owner to "keep a big hunk" of her business. She speaks as if the owner didn't pay for the schools, roads, fire department and police like everyone else did. And if government only covered these basic services and did them well and efficiently, few would complain. Note that none of these things are the job of the Federal Government or mentioned in the Constitution as one of its powers, and taxing the affluent at 50% makes them a slave on Uncle Sam's plantation half the year. She also neglects to mention the cost to the business owner of not only taxes, but burdensome licensing requirements and regulations, along with government policies which drive down the economy or subsidize politically connected competitors, making running an honest business difficult.

**Avoid Class Envy and Negative Attitudes Towards Money** Financial success is not a crap shoot. It is true that unforeseeable tragedy can put someone in temporary poverty, but poverty is typically a result of an individual's choices and behavior. In *Life at the Bottom: The Worldview that Makes the Underclass*, Theodore Dalrymple shows that the poor have two things in common: they blame others for their problems and they adopt a passive, fatalistic point of view. Take responsibility for your own choices and rather than envying the rich, start trying to figure out what they did to get where they are. Bitterness and resentment are not only misplaced, but they alienate you from the object of your desire and the very type of people who are in the best position to lift you out of poverty.

Do you see money as "the root of all evil" or "profit" as a dirty word? Do you find yourself ranting about how "people these days only care about money?" Examine these negative attitudes you may have about money. Where did they come from? Are they really about money itself, or is this a negative attitude you picked up from a perpetually poor parent, someone of means who treated you on a shoddy fashion, or of society in general?

Who is the favorite villain of Hollywood movies? The greedy, unscrupulous businessman. Who is demonized in college classrooms? The rich, the productive class whose property confiscations by the majority through force is referred to as "social justice." If you carry all these negative attitudes about wealth and the wealthy around in your head, every time you think about becoming wealthy, you're going to suffer cognitive dissonance. One part of your brain links the pleasure of financial security, the trappings of wealth and comfort and freedom that comes from not having to worry about money. But the other part of your brain is going to say that money is evil and that pursuing it is bad and wrong. It links pain and guilt with pursuing money. The result is going to be a half-hearted attempt to pursue wealth, or even self-sabotage, where you take a bold risk and your subconscious mind pulls the rug out from underneath you.

As we discussed in the section on achievement, goals are achieved through a burning desire, which leads to a driving, fanatical pursuit of them. This overwhelming motivation is what makes successful people keep trying, even after suffering humiliating defeats. Persistence is the key to financial success, as it is with other forms of success, and it can't be maintained if you are of two minds when it comes to money.

**Beware of College Professors** Most college professors lack real world experience in economics. They work in government institutions or institutions which are heavily subsidized by the government. Hence, they are typically in favor of State control of private industry. Academia, like journalism, tends to attract idealists who believe in "social justice" and "wealth redistribution," concepts explained adroitly [in this Penn and Teller sketch](#). You are likely to get an unrealistic and biased view of the workings of capital from your studies, especially in the Social Sciences, Sociology, Anthropology and Political Science in particular...

There are several recent studies on the ideological and political leanings of college faculty, all showing similar results. In November 2004 Klein & Stern released a nation-wide study of college professors, finding that in the Social Sciences and Humanities Democrats outnumbered Republicans by a ratio of at least 7 to 1, with disparities as high as 28 to 1 and 30 to 1 in the fields of Sociology and Anthropology, respectively. A paper based on their research "How Politically Diverse Are the Social Sciences and Humanities? Survey Evidence from Six Fields" is forthcoming in *Academic Questions*. In a separate survey based on voter registration, a public and objective indicator of ideological leaning, Klein & Western ascertained that across 23 major academic departments, including mathematics, business and the hard sciences, which tend to lean less to the left, Democrats outnumbered Republicans at Stanford by a ratio of 7 to 1 and at Berkeley by a ratio of 10 to 1.

Ask yourself this: Is the college professor who rails against the free enterprise system wealthy? Has he ever tried to start a business or has he ever had to meet a payroll? Are his arguments that the system is rigged sound? Does he understand how markets work or is he just offering up anecdotal stories and emotional rhetoric? Or just repeating what he learned

from *his* professors, who have also never operated productive businesses. Might you even characterize what he does as making money stirring up people against the evils or "excesses" of capitalism? As a unionized government employee, might he have some vested interest in getting you to adopt his views?

**Property Rights and the Rule of Law** All of the founding fathers believed that property rights were the heart of liberty. John Adams said, "The moment the idea is admitted into society that property is not as sacred as the laws of God, and that there is not a force of law and public justice to protect it, anarchy and tyranny commence. If 'Thou shalt not covet' and 'Thou shalt not steal' were not commandments of Heaven, they must be made inviolable precepts in every society before it can be civilized or made free." Samuel Adams echoed these sentiments when he said, "Among the natural rights of the Colonists are these: First, a right to life; Secondly, to liberty; Thirdly, to property; together with the right to support and defend them in the best manner they can." Note that these were considered "natural rights" inherent in a person, not granted by government, but preexisting rights one has the right to protect. Economist Bastiat makes this point, when he says, "Life, liberty, and property do not exist because men have made laws. On the contrary, it was the fact that life, liberty, and property existed beforehand that caused men to make laws in the first place." Governments exist to keep people from using force on one another to harm their person or deprive them of their property or freedom. As Thomas Jefferson wrote, "The true foundation of republican government is the equal right of every citizen in his person and property, and in their management." To paraphrase Jefferson, *you* are the one who controls what you do and what you have, not the government.

When government goes beyond this role and actually begins seizing property from some to give it others who did not earn it for the supposed "common good" "anarchy and tyranny commence." We can see an example of this in the collapse of the Soviet Union, the poverty in formerly prosperous nations, such as Cuba and Argentina, and now in Greece, Portugal and Spain, whose welfare state economies are near economic collapse. The same thing is happening in California, Nevada and New Jersey, and if we're not careful, could happen to our nation as a whole. Our national debt, now closing in at 13 trillion dollars (approaching the total annual economic output) is a ticking time bomb. And that doesn't even consider the 108 trillion dollars in unfunded social security and Medicare obligations.

**The End of Prosperity?** In *The End of Prosperity: How Higher Taxes Will Doom the Economy--If We Let It Happen*, economists Stephen Moore, Arthur Laffer and Peter Tanous describe how high taxes, government regulation and reckless deficit spending threaten collapse and another Great Depression in this country. Each time you vote for a bigger government or constraints on business, you're containing not only your opportunities, but those of everyone around you. Even if you just want a job working for someone else, you're relying on the profit-motivated businessman to hire you. The wage he's able to pay you or whether he will be able to afford to hire you at all, is going to depend on general market conditions. Those conditions become worse as government grows larger takes more out of the private economy and cause more distortions. More government means less freedom and fewer economic opportunities. As Thomas Jefferson said, "The government which governs best, governs least."

**The High Cost of Big Government** Government is by its very nature inefficient. It has no competition to keep its cost low or quality high because its customers are forced to buy whatever it's selling. Because of the nature of the two-party system and entrenched political constituencies, incumbent politicians have over a 90% reelection rate. Elections aren't competition. Barack Obama recently argued that having the government health care option would inject competition into the market place. How can you compete with someone who writes all the rules and can borrow, steal or print its own money? That's not competition either. And that's one of the reasons why health care is so expensive: government rules on what insurance has to cover and the inability to buy across state lines. Unfortunately, all of those State mandates which were keeping prices high have been replaced by new Federal mandates and regulations on what companies can charge and who they must accept. This same thing was tried in Massachusetts and has resulted in massive increases in premium costs and long waits to see doctors.

What about the latest economic downturn? Wasn't that caused by "greed on Wall Street"? No, it was caused by government policies. The government central bank (the Federal Reserve) kept interest rates artificially low, creating a housing bubble. The bubble was further fueled by the government coercing banks into giving mortgages to people with bad credit and low incomes and then guaranteeing the bad loans. They bought up some while others were repackaged and sold as an investment. Who would buy a bunch of bad loans as an investment? Lots of people if they were backed by a government guarantee in case of default. It was government policy which caused people to take risks no rational person would take, leading to the bubble and eventual bursting of that bubble. When people act in self-interest, greed for profit is

tempered by fear of loss. The market is self-correcting when not distorted by artificial government coercion or incentives. See Thomas Sowell's *The Housing Boom and Bust* and Thomas Woods' *Meltdown* for more details.

In every area where you see major government involvement, you see market distortions and pay higher prices for lower quality. Want low cost, high quality health care, education and housing? Allow the market to work its magic. The market has produced smart phones, net books and tablet devices (Kindle, iPad) which only cost a few hundred dollars. Electronics are cheap and get better every year because of relatively little regulation and international trade. One way of being prosperous and creating a prosperous nation is to advocate for the free enterprise system and say no to all but basic government programs which protect life and property. For a very readable explanation of basic economics and common fallacies, especially related to government controls, see the online version Henry Hazlitt's *Economics in One Lesson* or buy the inexpensive paperback or check the library. Also recommended is Gene Callahan's *Economics for Real People*. For a more scholarly treatment of the subject, see Bastiat's *The Law* (.pdf) or F.A. Hayek's classic *The Road to Serfdom*.

**Keeping What You Earn** How much wealth you can obtain is depends on how much you get to keep. Since self-employment is the primary vehicle to wealth, the 15% self-employment tax and State income tax are going to take a quarter of your wealth off the top, even if you're not paying any Federal income tax. As you earn more, that's going to move more towards 50%. Not only is that less money for you, that's less money you have to give to causes and charities you believe in, as opposed to those things the government would spend it on, which you might regard as wasteful or immoral. Put pressure on government on all levels to do more with less, and when politicians tell you they can't afford books for schools when they're buying laps for first graders and spending \$11,000 per pupil, don't believe them. If you are concerned about the poor or think the arts need funding, donate your own money to charities and causes you believe in; don't take money out of your neighbor's pocket at the ballot box.

On a more direct level, you have a choice as to where you will live. Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming have no personal income tax. New Hampshire and Tennessee only tax stock dividends and interest income. Alaska, Delaware, Montana, New Hampshire and Oregon have no sales tax. If you want to live in California, you'll have to pay 8.75% sales tax, and 9.3% income tax if you make over \$47,000. If you're looking at total tax burden, Alaska is number one, but that is offset by its high cost of living and cold climate. But Nevada is very close at 6.6% and has no corporate tax, in case you want to start a business there. Wyoming, Florida, New Hampshire and South Dakota are all in the 7% range. You can find more information from this Tax Foundation report.

**America: Love It or Leave It?** Another way to not only avoid taxes but to take advantage of an extreme difference in cost of living is to relocate in a country like Belize, Ecuador, Costa Rica or Panama. In these countries if you are directing an internet business or receiving a pension, you pay no income taxes. You can also afford a very nice house or condo on the beach with a warm climate for what you'd pay for a beat up tract home many places in the U.S. Nice restaurant meals can be had for \$5 and maids and gardeners are very affordable. Even if you become a legal resident, you can still retain your American citizenship, live like royalty on very little and won't owe any U.S. tax as long as you make less than \$75,000. Unlike most other countries, the U.S. Government will continue to tax you no matter where you live or whether you're using any of its services. In order to stop paying altogether, you'll have to renounce your citizenship. But is this a legitimate moral argument? If America has an oppressive and burdensome tax system but it's worse most other places and difficult to get permission from the good places to move, this argument presents a misleading choice. It also ignores the involuntary nature of the restrictions imposed. Do you really give implicit agreement to all laws simply by not moving to another country when you turn 18? Isn't love it or leave it a false dilemma? How about resistance or trying to change it?

**Take Advantage of the Free Enterprise System** Although America has lost its place as the most economically free nation to nations like Hong Kong, Singapore, Australia and New Zealand, it's still a comparatively great place to launch a professional career or start a business. Take advantage of the market, such as it is. Even in its restricted form, with all the taxes and regulations, understanding it is the surest way to wealth.

**Why Do Britney and Shaq Make So Much?** Often you will hear people decry the "disparity between rich and poor." The disparity between rich and poor is what makes America great, because *inequality is the natural consequence of freedom*. The rich are richer because of the vast opportunities which exist to make money in the U.S. And not only are the rich getting richer, but the poor are getting richer, too, or have the opportunity to do so. Britney Spears makes money because people want to download her songs and watch her concerts. Maybe a latex-clad blond who sounds like one of the munchkins from the Wizard of Oz in a bed of highly produced techno isn't your cup of tea. Maybe you think a school

teacher is "more valuable to society." Obviously people disagree with you, because they are paying millions more to Britney while many private school teachers make less than their less effective government school counterparts (though this is in part because of the market distortions caused by government schools). Why do star athletes like Shaquille O'Neal make so much? Because millions of people love to watch sports and no one can play like Shaq. Both Britney and Shaq have *rare, high-demand skills*. Part of Britney's and Magic's success is the multiplication effect of *media*. They can perform in front of thousands of fans and millions on television. Britney can sell CD's and DVDs and music downloads, while Magic can do lucrative product endorsements. If we broke the government monopoly on schooling, maybe there would be a teaching superstar who educated your kids via live broadcast or DVD.

**What Unique Talent or Ability Do You Have?** Becoming wealthy means taking your natural talents and abilities and creating something of value to other people. You can do this through a talent like acting, singing, composing, playing an instrument, writing or film making and multiply your individual labors through the multiplication effect of media. The artist behind Owl City's Adam Young started in his parents' basement with keyboard, computer and a MySpace page. Do you have any skills that would impress people and could be multiplied through the power of mass media? If you have an idea for new product or invention, patent it and create a business plan to market and sell it and do some test-marketing at a flea market or sell it on Ebay. Take a class on business or e-commerce and start small, learning from your failures and building on your successes. Then harness the power of mass-marketing. If you want to sell an existing category of products, decide how you will be different. Plan how you will beat your competition on price, quality, personal service, design or sheer marketing and salesmanship. If you manage to start a productive local business, like a restaurant, you can even license your successful business model and sell franchises, multiplying your success in that way. If you have saved up some cash or can get a small business loan with your good credit, buying an existing franchise may be the way to go. You have a little less control, but you benefit from the lesser risk of operating a business which has proved successful and the training which comes along with it. In some cases operating a franchise can be a paint-by-numbers, prefab, plug-and-play setup, where you just do what others have done in thousands of other locations using the same business model. Find a mentor through an internship or apprenticeship or business group like SCORE.

Learn to market and perform a service and, if successful, you can expand by training others to work for you. Or you can do what most people do, which is to trade your labor to an employer for a steady paycheck and save at least 10% and put it away in savings and investment. If you have it automatically deducted from your paycheck, you'll hardly miss it. Pick something you love, find a field that pays well with good employment prospects, keep your expenses in check, and you will become wealthy. Take this information and craft the financial part of your success plan. Include any career and business goals, along with the requisite degrees or experience you'd need, and list short and long-term income goals and how you plan on achieving them. There's nothing magical about attaining wealth. Study the wealthy. Find someone who has attained what you would like to attain. Just do what they did and you will have what they have.

FROM THE COMMUNIST MANIFESTO  
by Karl Marx and Frederick Engels

## II -- PROLETARIANS AND COMMUNISTS

In what relation do the Communists stand to the proletarians as a whole? The Communists do not form a separate party opposed to the other working-class parties. They have no interests separate and apart from those of the proletariat as a whole. They do not set up any sectarian principles of their own, by which to shape and mold the proletarian movement. The Communists are distinguished from the other working-class parties by this only: (1) In the national struggles of the proletarians of the different countries, they point out and bring to the front the common interests of the entire proletariat, independently of all nationality. (2) In the various stages of development which the struggle of the working class against the bourgeoisie has to pass through, they always and everywhere represent the interests of the movement as a whole.

The Communists, therefore, are on the one hand practically, the most advanced and resolute section of the working-class parties of every country, that section which pushes forward all others; on the other hand, theoretically, they have over the great mass of the proletariat the advantage of clearly understanding the lines of march, the conditions, and the ultimate general results of the proletarian movement. The immediate aim of the Communists is the same as that of all other proletarian parties: Formation of the proletariat into a class, overthrow of the bourgeois supremacy, conquest of political power by the proletariat. The theoretical conclusions of the Communists are in no way based on ideas or principles that have been invented, or discovered, by this or that would-be universal reformer. They merely express, in general terms, actual relations springing from an existing class struggle, from a historical movement going on under our very eyes. The

abolition of existing property relations is not at all a distinctive feature of communism. All property relations in the past have continually been subject to historical change consequent upon the change in historical conditions. The French Revolution, for example, abolished feudal property in favor of bourgeois property. The distinguishing feature of communism is not the abolition of property generally, but the abolition of bourgeois property. But modern bourgeois private property is the final and most complete expression of the system of producing and appropriating products that is based on class antagonisms, on the exploitation of the many by the few.

In this sense, the theory of the Communists may be summed up in the single sentence: Abolition of private property. We Communists have been reproached with the desire of abolishing the right of personally acquiring property as the fruit of a man's own labor, which property is alleged to be the groundwork of all personal freedom, activity and independence. Hard-won, self-acquired, self-earned property! Do you mean the property of petty artisan and of the small peasant, a form of property that preceded the bourgeois form? There is no need to abolish that; the development of industry has to a great extent already destroyed it, and is still destroying it daily. Or do you mean the modern bourgeois private property?

But does wage labor create any property for the laborer? Not a bit. It creates capital, i.e., that kind of property which exploits wage labor, and which cannot increase except upon conditions of begetting a new supply of wage labor for fresh exploitation. Property, in its present form, is based on the antagonism of capital and wage labor. Let us examine both sides of this antagonism. To be a capitalist, is to have not only a purely personal, but a social STATUS in production. Capital is a collective product, and only by the united action of many members, nay, in the last resort, only by the united action of all members of society, can it be set in motion. Capital is therefore not only personal; it is a social power. When, therefore, capital is converted into common property, into the property of all members of society, personal property is not thereby transformed into social property. It is only the social character of the property that is changed. It loses its class character.

Let us now take wage labor. The average price of wage labor is the minimum wage, i.e., that quantum of the means of subsistence which is absolutely requisite to keep the laborer in bare existence as a laborer. What, therefore, the wage laborer appropriates by means of his labor merely suffices to prolong and reproduce a bare existence. We by no means intend to abolish this personal appropriation of the products of labor, an appropriation that is made for the maintenance and reproduction of human life, and that leaves no surplus wherewith to command the labor of others. All that we want to do away with is the miserable character of this appropriation, under which the laborer lives merely to increase capital, and is allowed to live only in so far as the interest of the ruling class requires it. In bourgeois society, living labor is but a means to increase accumulated labor. In communist society, accumulated labor is but a means to widen, to enrich, to promote the existence of the laborer. In bourgeois society, therefore, the past dominates the present; in communist society, the present dominates the past. In bourgeois society, capital is independent and has individuality, while the living person is dependent and has no individuality.

And the abolition of this state of things is called by the bourgeois, abolition of individuality and freedom! And rightly so. The abolition of bourgeois individuality, bourgeois independence, and bourgeois freedom is undoubtedly aimed at. By freedom is meant, under the present bourgeois conditions of production, free trade, free selling and buying. But if selling and buying disappears, free selling and buying disappears also. This talk about free selling and buying, and all the other "brave words" of our bourgeois about freedom in general, have a meaning, if any, only in contrast with restricted selling and buying, with the fettered traders of the Middle Ages, but have no meaning when opposed to the communist abolition of buying and selling, or the bourgeois conditions of production, and of the bourgeoisie itself.

You are horrified at our intending to do away with private property. But in your existing society, private property is already done away with for nine-tenths of the population; its existence for the few is solely due to its non-existence in the hands of those nine-tenths. You reproach us, therefore, with intending to do away with a form of property, the necessary condition for whose existence is the non-existence of any property for the immense majority of society. In one word, you reproach us with intending to do away with your property. Precisely so; that is just what we intend. From the moment when labor can no longer be converted into capital, money, or rent, into a social power capable of being monopolized, i.e., from the moment when individual property can no longer be transformed into bourgeois property, into capital, from that moment, you say, individuality vanishes. You must, therefore, confess that by "individual" you mean no other person than the bourgeois, than the middle-class owner of property. This person must, indeed, be swept out of the way, and made impossible.

Communism deprives no man of the power to appropriate the products of society; all that it does is to deprive him of the

power to subjugate the labor of others by means of such appropriations. It has been objected that upon the abolition of private property, all work will cease, and universal laziness will overtake us. According to this, bourgeois society ought long ago to have gone to the dogs through sheer idleness; for those who acquire anything, do not work. The whole of this objection is but another expression of the tautology: There can no longer be any wage labor when there is no longer any capital. All objections urged against the communistic mode of producing and appropriating material products, have, in the same way, been urged against the communistic mode of producing and appropriating intellectual products. Just as to the bourgeois, the disappearance of class property is the disappearance of production itself, so the disappearance of class culture is to him identical with the disappearance of all culture.

That culture, the loss of which he laments, is, for the enormous majority, a mere training to act as a machine. But don't wrangle with us so long as you apply, to our intended abolition of bourgeois property, the standard of your bourgeois notions of freedom, culture, law, etc. Your very ideas are but the outgrowth of the conditions of your bourgeois production and bourgeois property, just as your jurisprudence is but the will of your class made into a law for all, a will whose essential character and direction are determined by the economical conditions of existence of your class. The selfish misconception that induces you to transform into eternal laws of nature and of reason the social forms stringing from your present mode of production and form of property -- historical relations that rise and disappear in the progress of production -- this misconception you share with every ruling class that has preceded you. What you see clearly in the case of ancient property, what you admit in the case of feudal property, you are of course forbidden to admit in the case of your own bourgeois form of property. Abolition of the family! Even the most radical flare up at this infamous proposal of the Communists. On what foundation is the present family, the bourgeois family, based? On capital, on private gain. In its completely developed form, this family exists only among the bourgeoisie. But this state of things finds its complement in the practical absence of the family among proletarians, and in public prostitution. The bourgeois family will vanish as a matter of course when its complement vanishes, and both will vanish with the vanishing of capital.

Do you charge us with wanting to stop the exploitation of children by their parents? To this crime we plead guilty. But, you say, we destroy the most hallowed of relations, when we replace home education by social. And your education! Is not that also social, and determined by the social conditions under which you educate, by the intervention direct or indirect, of society, by means of schools, etc.? The Communists have not intended the intervention of society in education; they do but seek to alter the character of that intervention, and to rescue education from the influence of the ruling class. The bourgeois claptrap about the family and education, about the hallowed correlation of parents and child, becomes all the more disgusting, the more, by the action of Modern Industry, all the family ties among the proletarians are torn asunder, and their children transformed into simple articles of commerce and instruments of labor.

But you Communists would introduce community of women, screams the bourgeoisie in chorus. The bourgeois sees his wife a mere instrument of production. He hears that the instruments of production are to be exploited in common, and, naturally, can come to no other conclusion that the lot of being common to all will likewise fall to the women. He has not even a suspicion that the real point aimed at is to do away with the status of women as mere instruments of production. For the rest, nothing is more ridiculous than the virtuous indignation of our bourgeois at the community of women which, they pretend, is to be openly and officially established by the Communists. The Communists have no need to introduce free love; it has existed almost from time immemorial. Our bourgeois, not content with having wives and daughters of their proletarians at their disposal, not to speak of common prostitutes, take the greatest pleasure in seducing each other's wives. (Ah, those were the days!)

Bourgeois marriage is, in reality, a system of wives in common and thus, at the most, what the Communists might possibly be reproached with is that they desire to introduce, in substitution for a hypocritically concealed, an openly legalized system of free love. For the rest, it is self-evident that the abolition of the present system of production must bring with it the abolition of free love springing from that system, i.e., of prostitution both public and private.

The Communists are further reproached with desiring to abolish countries and nationality. The workers have no country. We cannot take from them what they have not got. Since the proletariat must first of all acquire political supremacy, must rise to be the leading class of the nation, must constitute itself the nation, it is, so far, itself national, though not in the bourgeois sense of the word. National differences and antagonism between peoples are daily more and more vanishing, owing to the development of the bourgeoisie, to freedom of commerce, to the world market, to uniformity in the mode of production and in the conditions of life corresponding thereto. The supremacy of the proletariat will cause them to vanish still faster. United action of the leading civilized countries at least is one of the first conditions for the emancipation of the

proletariat.

In proportion as the exploitation of one individual by another will also be put an end to, the exploitation of one nation by another will also be put an end to. In proportion as the antagonism between classes within the nation vanishes, the hostility of one nation to another will come to an end. The charges against communism made from a religious, a philosophical and, generally, from an ideological standpoint, are not deserving of serious examination. Does it require deep intuition to comprehend that man's ideas, views, and conception, in one word, man's consciousness, changes with every change in the conditions of his material existence, in his social relations and in his social life?

What else does the history of ideas prove, than that intellectual production changes its character in proportion as material production is changed? The ruling ideas of each age have ever been the ideas of its ruling class. When people speak of the ideas that revolutionize society, they do but express that fact that within the old society the elements of a new one have been created, and that the dissolution of the old ideas keeps even pace with the dissolution of the old conditions of existence. When the ancient world was in its last throes, the ancient religions were overcome by Christianity. When Christian ideas succumbed in the eighteenth century to rationalist ideas, feudal society fought its death battle with the then revolutionary bourgeoisie. The ideas of religious liberty and freedom of conscience merely gave expression to the sway of free competition within the domain of knowledge. "Undoubtedly," it will be said, "religious, moral, philosophical, and juridical ideas have been modified in the course of historical development. But religion, morality, philosophy, political science, and law, constantly survived this change." "There are, besides, eternal truths, such as Freedom, Justice, etc., that are common to all states of society. But communism abolishes eternal truths, it abolishes all religion, and all morality, instead of constituting them on a new basis; it therefore acts in contradiction to all past historical experience."

What does this accusation reduce itself to? The history of all past society has consisted in the development of class antagonisms, antagonisms that assumed different forms at different epochs. But whatever form they may have taken, one fact is common to all past ages, viz., the exploitation of one part of society by the other. No wonder, then, that the social consciousness of past ages, despite all the multiplicity and variety it displays, moves within certain common forms, or general ideas, which cannot completely vanish except with the total disappearance of class antagonisms. The communist revolution is the most radical rupture with traditional relations; no wonder that its development involved the most radical rupture with traditional ideas. But let us have done with the bourgeois objections to communism.

We have seen above that the first step in the revolution by the working class is to raise the proletariat to the position of ruling class to win the battle of democracy. The proletariat will use its political supremacy to wrest, by degree, all capital from the bourgeoisie, to centralize all instruments of production in the hands of the state, i.e., of the proletariat organized as the ruling class; and to increase the total productive forces as rapidly as possible. Of course, in the beginning, this cannot be effected except by means of despotic inroads on the rights of property, and on the conditions of bourgeois production; by means of measures, therefore, which appear economically insufficient and untenable, but which, in the course of the movement, outstrip themselves, necessitate further inroads upon the old social order, and are unavoidable as a means of entirely revolutionizing the mode of production.

These measures will, of course, be different in different countries. Nevertheless, in most advanced countries, the following will be pretty generally applicable.

1. Abolition of property in land and application of all rents of land to public purposes.
2. A heavy progressive or graduated income tax.
3. Abolition of all rights of inheritance.
4. Confiscation of the property of all emigrants and rebels.
5. Centralization of credit in the banks of the state, by means of a national bank with state capital and an exclusive monopoly.
6. Centralization of the means of communication and transport in the hands of the state.
7. Extension of factories and instruments of production owned by the state; the bringing into cultivation of waste lands, and the improvement of the soil generally in accordance with a common plan.
8. Equal obligation of all to work. Establishment of industrial armies, especially for agriculture.
9. Combination of agriculture with manufacturing industries; gradual abolition of all the distinction between town and country by a more equable distribution of the populace over the country.
10. Free education for all children in public schools. Abolition of children's factory labor in its present form. Combination

of education with industrial production, etc.

When, in the course of development, class distinctions have disappeared, and all production has been concentrated in the hands of a vast association of the whole nation, the public power will lose its political character. Political power, properly so called, is merely the organized power of one class for oppressing another. If the proletariat during its contest with the bourgeoisie is compelled, by the force of circumstances, to organize itself as a class; if, by means of a revolution, it makes itself the ruling class, and, as such, sweeps away by force the old conditions of production, then it will, along with these conditions, have swept away the conditions for the existence of class antagonisms and of classes generally, and will thereby have abolished its own supremacy as a class.

In place of the old bourgeois society, with its classes and class antagonisms, we shall have an association in which the free development of each is the condition for the free development of all.