

The Muhlenkamp Memorandum

Essay (Continued)

In simple terms, the budget deficit is the difference between government receipts and expenditures. In a static world, an increase in receipts would be just as effective as a decrease in expenditures. But in a human world, a change in the rules results in changed behavior. What the government calls receipts, the people call taxes. When taxes become too heavy, the people will change their behavior to lessen the burden. Since 1945, we have had the top income tax rate as high as 70% and as low as 28%. Throughout that time, the ratio of taxes to GNP remained stable at 19-20%. So raising tax rates will not raise tax revenues beyond the growth rate in the economy. What raising tax rates will do is slow the economy. If you raise taxes on individuals, they will have less money to spend. If you raise taxes on businesses, they will hire fewer people (who will then have less money to spend).

Much of our political rhetoric focuses on the creation of jobs. But the people who talk most about creating jobs don't know where jobs come from. Creating jobs is not difficult. Just allow one person to profit from hiring another. Similarly, getting a job is easy. Just be willing to receive 5% less than you produce. If you allow your potential employer to keep that 5% he will hire you. It's as simple as that. But then government enters the picture. Today, government takes a 35% bite. So, in order to be hired, you have to produce \$1.40 in order to take home \$1.00 and let your employer keep the nickel. If government takes away the nickel, either through increased taxes or through increased regulation and paperwork or through compulsory healthcare, you must either produce \$1.45 or lose your job. To those who think we need to create more jobs, go hire someone. You will soon find that the greater difficulty is in finding someone willing to work. Specifically, the difficulty is in finding someone willing to produce \$1.40 in order to take home \$1.00.

When tax rates were 50%, I asked a couple doctor clients how much time they spent curing people and how much time they spent avoiding taxes. They replied that they spent about one day/week avoiding taxes. The returns to them personally were greater by spending one day per week avoiding taxes instead of curing people. What a waste of human talent! At the other end of the spectrum, when I had my office at home and my daughters were in high school, I would hire them to do various keypunching jobs for the office. I paid them something over minimum wage (which was 2 1/2 times what they could earn babysitting). After watching them spend the money on movies and fad clothing and other things that I considered frivolous, I decided that, as a father, I needed to teach them to save some of their earnings, for their own good of course! So I told them that, henceforth, they should save 1/2 of what they earned from working in the office. This would still allow them to spend more than they earned per hour babysitting. It seemed fair to me! But the next time I asked them to keypunch, they were both busy. And the next time, and the next...until I had a problem! Fatherly guidance versus getting the work done. I decided that I needed the work done and removed the savings restriction. The girls were available once again. What was most interesting was that, some six to eight months later, I noticed that they were each socking away a fair amount of their pay. When I asked them why, they each replied that they had concluded they worked too hard for the money to spend it all on movies and clothing. So, as an employer who allowed his employees to make their own decisions, I was able to accomplish what I failed to do as a paternalistic father.

Some years earlier, probably around 1979-80, I spent an afternoon with my old college roommate, Mike, and his wife, Cindy. Cindy and I got into an argument which Mike finally summed up (and thankfully ended) with, "Ron, you believe that the average person, dumb as he may be, is better at making his or her own decisions and spending his or her own money than a highly educated, well meaning person in Washington, D.C. can do it for him." I said, "Absolutely!" He continued, "Cindy, you believe that an intelligent, highly educated, well meaning person in Washington, D.C. can spend the average person's money better than that person can do it for himself." She said, "That's right!" I can't summarize the argument any better than Mike did.

In 1980, we elected Ronald Reagan President. The core of his belief was close to Mike's summary of my belief. In 1992, we elected Bill Clinton, President. The core of his belief and the beliefs of many of the people around him are close to Mike's summary of Cindy's belief. Ronald Reagan was a different kind of Republican. He lowered marginal tax rates and the economy prospered, creating 19 million new jobs and raising government tax revenues by \$240 billion per year (over and above inflation). He slowed the growth in government spending but failed to cap it, which was his great failure. Government spending continued to grow faster than the GNP, which is why we have the deficit today.

In 1982, Reagan and Congress struck a deal to raise taxes \$100 billion immediately and cut spending by \$300 billion later. Taxes were raised but spending wasn't cut; the deficit went up. In 1990, Bush and Congress struck a deal to raise taxes \$140 billion immediately and cut spending later. Taxes were raised but spending still wasn't cut; the deficit continued to grow. Clinton and Congress are now negotiating to raise taxes immediately with a promise to cut spending later. (Many of the promised spending cuts are the same cuts promised in the Bush deal.) These cuts will only be made if the public insists upon them. Our politicians will do whatever we tell them to do. So for, they're only raising taxes which will slow the economy but have little effect on the deficit.

Ron Muhlenkamp

Maybe, the best summary is the following wisdom often credited to Abe Lincoln, although historians credit Rev. William J. H. Broecker:

- ① You cannot bring about prosperity by discouraging thrift.
- ① You cannot strengthen the weak by weakening the strong.
- ① You cannot help the wage earner by pulling down the wage payer.
- ① You cannot further the brotherhood of man by encouraging class hatred.
- ① You cannot help the poor by discouraging the rich.
- ① You cannot establish sound security by spending more than you earn.
- ① You cannot build character and courage by taking away man's initiative and independence.
- ① You cannot help men permanently by doing for them what they could and should do for themselves.