America As A Desert Island

One often hears the argument, "The economy was good while Bill Clinton was in the White House, and income taxes were higher then, so if we raise income taxes to the Clinton levels then the economy will be good again!" The argument is absurd. It erroneously links higher tax rates with increased investment and productivity, falsely assuming a direct cause and effect relationship. But there are millions of factors that influence an economy. One cannot simply look at one of them and say, "X existed when the economy was better, therefore if we reinstate X the economy will be better again!" X may *not* be what caused the prosperous economy.

One could just as easily argue, "The economy boomed in the 1950s and housing starts went through the roof, and a Republican named Eisenhower was president. Therefore, if we elect a Republican named Eisenhower the economy will boom again and housing starts will increase dramatically." It is not quite that simple. It may rain every time you wear a red jacket, but that does not mean red jackets cause rain. (That is an example of "Al Gore logic.")

An economy may grow *despite* high taxes, but it certainly does not grow *because o*f high taxes. That is common sense—which nowadays seems to be in remarkably short supply. High taxes remove money from the private economy, leaving less available for investment and economic expansion. That is an inescapable fact. In reality, much of the economic growth in the 1990s occurred after the capital gains tax was lowered—a change Clinton opposed but which the Republican Congress enacted and persuaded him to accept. Lowering the capital gains tax impacts the economy far more than a minor change in income tax rates, because a low capital gains tax encourages investment in the private sector. (A reduction in personal income taxes may increase demand for goods and services, but that does not stimulate the economy as much as a capital gains tax cut because it does not provide sufficient immediate capital for expansion. A demand for goods means little if the company that sells those goods cannot find someone willing to invest in the expansion of the factory to allow it to produce more goods.)

Investment is needed to start and expand businesses and to create jobs. When the capital gains tax is lowered, there is more investment and jobs are created. When the capital gains tax is raised, there is less investment and jobs are not created. Raising the capital gains tax can actually result in *reduced* tax revenue, because individuals simply hold onto their assets. No asset sale means no profit and no profit means no gain—and a tax on a zero gain yields zero tax revenue. (In a 2008 primary campaign debate, Obama told ABC's Charlie Gibson, "I would look at raising the capital-gains tax for purposes of fairness." To his credit, Gibson correctly pointed out that a higher capital gains tax would result in less tax revenue for the federal government, but Obama, showing his true Marxist colors, said he would raise it anyway. Obama is at least consistent. In 1998 he told an audience at Loyola University, "The trick is figuring out how do we structure government systems that pool resources and hence facilitate some [wealth] redistribution—because I actually believe in redistribution, at least at a certain level to make sure that everybody's got a shot.")

Obama has made it clear that he wants to raise taxes on the wealthy, and the election results showed that a majority of voters were persuaded by his class warfare strategy. But why would anyone believe that people will respond to higher taxes simply by paying them and not doing anything else differently? Unlike the federal government and the Federal Reserve, individual Americans cannot print money or create it out of thin air. If a wealthy person's taxes go up by $50,000 he may respond by not buying a new Cadillac. His response harms the middle class auto worker who makes Cadillacs, the salesman who sells them, and the people—many of them retirees—who own stock in General Motors. Or, the wealthy person may cancel plans for a room addition in order to get the $50,000 for the higher taxes. That causes a contractor to lose business and carpenters to lose work.

If Obama raises taxes by $100 billion, that means $100 billion will be sucked out of the private economy every year. It is simply impossible to take that money out of the economy without causing job losses somewhere. Granted, the job losses won't necessarily all be at the Cadillac factory. No one knows where the job losses will be. But there *will* be job losses. Because those job losses are distributed throughout the economy, no reporter can interview a particular newly-unemployed worker and claim for certain that the tax increase caused his specific job loss. But that does not mean it did not happen.

The problem is the seen versus the unseen. One can "see"—and easily report—that Obama got $100 billion more in tax revenue, some of which he will perhaps use for a bailout of California's state budget. "Oh, how wonderful!" the media sycophants will exclaim. But not so wonderful is the fact that people in other states will lose their jobs because the $100 billion that was employing them was instead taken by force to be given to Governor Moonbeam in Sacramento. (Aside from John Stossel, no reporter will cover the story properly.)

What many people fail to see is that raising taxes on the wealthy hurts the middle class workers. Years ago, when Congress imposed a yacht tax to raise revenue, the result was not the increased tax revenue they expected. Why? Because the wealthy either stopped buying yachts, or they bought them from other countries. What was the result of the yacht tax? Thousands of boat builders in the United States lost their jobs. What happened was entirely predictable, and if Ron Paul was then in Congress one can assume he argued against the tax.

Why can people not understand that individuals act in their own rational self-interest and in economic self-defense? It is not that complicated. "You must provide health insurance if you have at least 50 full-time workers," demands the ObamaCare legislation. How difficult is it to understand that companies with employee counts just slightly over 50 will fire enough workers to get to 49 or fewer? How difficult is it to understand that many businesses will reduce workers' hours to get them classified as part-time? Somehow, many people wrongly believe that higher taxes are good for the economy, yet they cannot see the obvious: individuals and businesses act in economic self-defense to avoid the taxes and the regulatory burdens imposed by government.

Why are businesses and individuals fleeing California, Illinois, and New York? To escape the tax and regulatory burdens. How can people not see that? How can anyone believe that higher federal taxes will help the economy, while failing to notice that businesses and individuals are leaving California to escape higher state taxes? Does anyone think federal taxes are "good taxes" that have *no* negative economic impact while state taxes are " bad taxes" that *do* have a negative economic impact? Taxes are taxes! They always impact an economy negatively, regardless of whether they are imposed by the federal, state, or local government. In all cases, taxes take money out of the private economy, robbing it of wealth that would otherwise be invested or consumed.

Anyone who believes the coming Obama taxes will not harm the economy is mistaken. Anyone who believes the wealthy will simply sit back and take the abuse without acting in their own rational self-interest is mistaken. Anyone who believes actions do not have consequences is mistaken. One can pretend not to see reality, but that does not make reality go away.

Yes, many people may respond, "Well, just change ObamaCare so that all businesses have to provide health insurance, *regardless* of worker counts or part-time status!" Do they not understand the consequences of such an action? It would put thousands of companies out of business, causing hundreds of thousands of workers to lose their jobs. Those companies that do not fail will be forced to raise their prices to cover the cost of insuring the teen-aged hamburger fryer. How much is someone willing to pay for a fast-food hamburger so that the kid behind the counter has "free" health insurance? Businesses would react to those additional demands by getting rid of even more employees, while having the remaining employees work more hours. (Why? It may be cheaper to pay fewer insured workers overtime than to have more workers and be forced to provide them all with insurance.)

The point is that businesses and individuals act in their own self-interest. That is *not* selfishness. It is *rational self-interest*. A person stranded on a desert island must act to preserve his life. It is *not* selfishness to seek food, climb trees to get coconuts, or spear fish to obtain dinner. If three people are stranded, they may divide their labor because it is more efficient. One may be the fisherman, one may be the tree-climber, and another may gather firewood and fresh water from a creek. But they are not acting selfishly. They are acting in their own rational self-interest.

But problems arise when a government interferes with those voluntary exchanges of labor. A bureaucrat may assign the fishing task to someone who is a lousy fisherman, and the tree-climbing task to someone who is afraid of heights. Worse yet, the bureaucrat may allow one favored person to sit in the shade and do nothing, forcing the others to do his firewood gathering and water collecting. That favored person is essentially on welfare. The "progressives" then complain that the fisherman and the tree climber are not doing their "fair share!" because the person resting under the tree is hungry and thirsty.

Take that desert island and make it larger. Give it a population of 315 million, of which only 115 million fish, collect coconuts, and gather firewood and water. Allow 200 million to rest in the shade under the trees. Have several million bureaucrats order those 115 workers around, telling them how to fish, collect, and gather. Just to make it more inefficient, have the bureaucrats restrict the use of firewood because of fears of "global warming" and the possibility of another typhoon like the one that recently struck the island. As conditions on the island worsen and the workers have trouble keeping up with the demands of the non-workers, hold a referendum to decide whether at least some of the non-workers should perhaps also engage in fishing, collecting, and gathering. During the weeks leading up to the vote, relentlessly excoriate the workers for being selfish and greedy. (Also allow some time for one of the bureaucrats to express concern that the island will "tip over" because too many people live on one side.) The referendum is then soundly defeated, by a vote of 200 million to 115 million.

Some of the fishermen give up fishing, opting to rest with the others under the trees. They are soon joined by some of the coconut collectors and firewood gatherers. The island residents grow increasingly hungry, thirsty, and cold. They respond by beating the remaining workers, demanding more fish, coconuts, firewood, and water. As time passes, the islanders notice that increasing numbers of fishermen and gatherers have disappeared. The fishermen and gatherers have been secretly building boats and sailing away in the middle of the night. Some do not make it and are killed in storms. But others find refuge on another island, where they happily fish, collect, and gather—after first cutting down the shade trees…

Conservatives readily understand this parable. To those who do not, conservatives ask that they expand their minds and expose themselves to the concept of rational self-interest. It will help them better under basic economics. Once they understand basic economics, they will begin to see why raising taxes while continuing wasteful spending is destructive. By raising taxes and not cutting spending, we are telling the fisherman and the coconut gatherer to work harder, while signaling to the guy under the tree that he can continue to rest without a care in the world.

Yes, it *is* that simple. No one should be afraid to accept that the solution to a problem is often simple. The solution may not always be *easy*, but it is often *simple*. Slash spending and don't raise taxes. Yes, it's easier said than done. But if it is not done, the nation will collapse—because everyone cannot sit under the trees.

Don Fredrick
November 21, 2012

Note: In 2010 Great Britain raised its top tax rate from 40 to 50 percent as part of a "deficit-reduction" package. The tax increase not only did not result in the revenue that was expected, it brought in even less than what was collected under the 40 percent rate.