

Democracy Gone Nuts -- Again

Richard B. McKenzie

The political plot unfolding these days in Washington is as old as demagoguery, following a well-worn script: Declare a national economic disaster all out of proportion with reality that can only be handled by the smart people in power with massive federal deficit dollars distributed at the discretion of political leaders who truly think they can divine with great wisdom what is best for a complex troubled economy. Never mind that the federal allocations will pad the pockets of firms and CEOs whose past decisions were poor at best and criminal at worst.

Then, bash the rich as blood-sucking economic leaches, whose claims to their incomes are dubious at best, all with the goal of making them ultimately pay for the venturesome, squandering ways of political leaders who thirst to be seen as the saviors of “everyman.” So it has been that President Obama has proposed to drain the rich (those with annual incomes of more than \$250,000) of several hundred billion dollars over the next decade.

If the country were really going to reap the exorbitant, widely distributed benefits our political leaders claim will emerge in the not-too-distant future from

the proposed ever-growing bailout and stimulus packages, then why level higher taxes only on the rich? People of lesser means should be eager to help fund the bailout and stimulus packages, and it would be only fair that they carry their part of the funding burden, since they will share in the resulting prosperity. The very fact that the administration has proposed to raise taxes on the few (the top 5 percent of all income earners) should make everyone suspicious of the efficacy and fairness of these bailout and stimulus packages -- and other proposed federal fiscal ventures.

President Obama justifies his greater taxes on the rich with a simplistic argument: The rich have gained disproportionately over recent decades from economic prosperity. No mention is made of an inconvenient truth, that the prosperity of most working rich people (not the slothful heirs to great wealth) came from their having produced goods and services of far greater value than the gains they were able to siphon off.

The soak-the-rich tax proposal reduces to the argument that those Americans who made good (and conservative) economic decisions in the past should now be forced to pad the pockets of CEOs who made unbridled risky business decisions and of other profligate Americans who over the last decade tried to live far beyond their means.

Any proposal to soak the rich is all too often grounded in the presumption that the rich got their gains through graft, corruption, and thievery. Some no doubt did. The now rich and retired CEOs who absconded with tens of millions of ill-gotten bonuses and stock options when they were misrepresenting the risks they had their companies take should be jailed, with all of their ill-gotten gains taxed at not just high rates, but confiscatory rates.

However, many of today's rich people got their high incomes the good old fashioned way -- through hard work, frugality, and judicious and conservative investment policies. Indeed, many rich people today have actually earned over the course of their lives a lower average wage rate than people making far less.

How can that be? Many rich people today put in mountains of unpaid hours developing a product or business over decades, with their efforts finally paying off. Their current incomes may look excessively high, but only because no account is made for all the unpaid hours worked long ago – or for the substantial risks they took.

Embedded in the soak-the-rich fiscal strategy is the presumption that higher taxes on the rich affect only today's rich. Advocates of these tax policies fail to realize that hordes of low-income Americans today are working very hard and are taking substantial risks in the expectation that they, also, will one day be rich. Many of today's lower-income Americans can be expected to interpret proposed

higher tax rates on the rich as a grab of their future incomes. They can be expected to react, “Why bother? Why put in all the unpaid hours or take the risks today?” Therein lies the potential economic damage that can be imposed on future generations from higher taxes on today’s rich. But then, understandably, today’s demagogues would just as soon no one considers such downsides to their arguments to tax today’s rich.

Richard McKenzie is the Walter B. Gerken Professor of Enterprise and Society in the Merage School of Business at the University of California, Irvine. His most recent book is ***Why Popcorn Costs So Much at the Movies, And Other Pricing Puzzles*** (Springer-Copernicus, 2008).