

10.26.00 Misconceptions

This chapter is selective summary by way of repetition. This chapter briefly describes some misconceptions about capitalism and about life in capitalism. These are not full analyses but are statements for reference.

Not Trade-Offs. It is easy to see many of the suggestions throughout this part of the book as trade-offs: welfare recipients get an “easy ride” as long as they do not have children until they are at least 21 years old; we all get national health insurance in exchange for not making corporations pay any taxes; etc. The suggestions are not trade-offs. Each suggestion has its own merit and should be considered on its own. Even if welfare recipients do not get a square deal in other ways, they should not be eligible for welfare if they have a child while a minor. Even if we have to give welfare to minors that have children, we ought to give them as good a deal as we can. Even if we cannot fund national health insurance, we need to equalize taxes between types of business firms by putting a ceiling on taxes for all business firms – and so on. In the real world political process, it is likely that some of these suggestions could not “float” except as trade-offs, but I want the reader to avoid thinking of these suggestions that way.

“There Is No Free Lunch”. Everybody understands what this slogan means when it applies to not giving poor children lunch at school: somebody has to pay for everything. Resources do not come out of thin air just because the state issues the check. Moving resources toward something means moving resources away from other things. When somebody gets, somebody else has to pay for it. The problem is that people do not understand what this slogan means when it applies to business firms, the middle class, or the wealthy. ANY positive gift to ANYBODY moves resources from one place to another. ANY advantage to ANYBODY through not assessing them taxes or other costs moves resources from one place to another. ANY help to ANY group requires taxing some other groups in some way, even if only through the effects of inflation. There is no free lunch for any group. Giving tax breaks to the upper middle class so that they will save means taking resources away from everybody else, including the middle class, the working class, and the poor. Letting the middle class write off the interest payments for their houses means that house renters and poor people pay more in taxes so as to subsidize middle class houses. Giving people tax breaks for health insurance means that people that cannot afford any health insurance subsidize health insurance. Protection raises taxes and raises prices. To solve obvious problems in the economy, sometimes we do have to give some group better treatment even at the cost of hurting other groups, but the case had better be strong. I would give school children a free lunch even though I know I have to pay for it. But I would not give tax shelters or tax breaks to anybody.

We Can Afford It All. We cannot. We cannot afford all the programs and the favors that we do for ourselves. We can afford some things. The Japanese keep their farmers as pets, and, until recently, could afford to do so. I do not know how much we can afford to diminish the economy through tax breaks and programs before we begin to really hurt ourselves. Through the

distortions I see in such markets as real estate and medicine, I believe we have already gone too far.

We Could Afford It All If We Had Bigger Hearts. We could not afford it all even if we had bigger hearts.

Besides the horrendously distorted tax system, and the morass of programs, the big problem with deciding how much we can afford is comparative competition. People need more than just bare subsistence, and they even need more than just what it takes to put their kids through college. People judge themselves by comparison with their neighbors, and it is not possible to change that without changing a core part of what is human. We cannot undermine the tendency of people to compare themselves without also undermining the core motives that drive people to succeed and to make everybody wealthier.

If we took away a bit from everybody, we could afford to help more than we do now. We would need an absolutely fair and stable system of moving wealth, or people will not wish to contribute, and people would begin to undermine the system for their advantage.

It is hard to accept that one of the biggest brakes on our becoming a more fair society is comparative competition but that is just true.

We Can Afford to Help the Poor Enough. I am not sure. We have to help them as much as we can for moral reasons, but I doubt that we can help them enough to raise them out of poverty. I think we can help the poor enough to make sure their children have a decent chance in life.

It is better to decide how much we can help and stick with that, than to pretend to help but avoid really helping by making help hard.

There is A Final Solution to Poverty and Unemployment. Poverty can be solved by growth, by being mean, by education, by job training, by induced inflation, or by some other intervention. This is all false. Poverty is the result of interactive strategies by real people under imperfect competition. We cannot cure it once and for all. We have to learn to live with it in an honorable and humane manner.

Having a Color TV Makes Poverty OK. Most poor people in the United States do live tolerably well compared to poor people in other parts of the world except Europe. But that does not make it OK.

People starve in the United States. People die of diseases induced by poverty and stress. Many homeless people live in very bad conditions. Anybody who thinks that all poor people in the U.S. have color TV sets and air conditioning should drive through the rural South, the Appalachian or Adirondack mountains, or even some of the mountain areas in the supposedly all-affluent state of California.

The poor that have TV sets and air conditioning do so through the help of kin and through present state programs - not because America has so much wealth that it just naturally percolates down to them. The natural operation of the economy creates a hole that is not filled unless people fill it on purpose.

Even if all the poor in America did have TV sets and air conditioning, that still would not get at the main problem: grossly unequal opportunity for their children. We can never make all opportunity for all children equal, but we can do a better job than we do now.

Education Cures All. If only all children got an education, then all of them would find jobs, and there would be no poverty. This is false. The hole in the economy would exist even if everybody had a Ph.D. and everybody deserved his/her Ph.D. An education of absolutely equal quality, so that all children would be equally certified, would go a long way toward equalizing the distribution of jobs, and toward reducing racism and sexism; but it would not eliminate poverty or unemployment. We still need welfare and health insurance.

Sometimes I fear that people who tout education as a simple cure do so as a way to take our minds off the core problem. They offer a poor education to poor children so that they can say, "Aha! See! The poor got what they need and they still can't get a job. So we shouldn't have helped after all."

Even though an education will not eliminate unemployment and poverty, we still have to try to give all children a competent education.

Being Nasty Cures All. The poor are lazy and dishonest. There are enough jobs if we just force people to work. Welfare only allows the lazy and dishonest to get away with it. If we were only mean enough, then everybody would have to go to work on his/her own. We cause problems for ourselves by being too nice. "The road to hell is paved with good intentions".

Some of the poor are lazy and dishonest, but not most of them. Welfare and other programs do allow some people to get away with it, and probably do make otherwise decent people more lazy and dishonest. Sometimes we have to be mean. But there are not enough jobs, and being mean will not make it so.

The road to hell often is paved with good intentions, but that is probably truer of programs that help the middle class, the rich, and business firms than programs that help the poor. The rule should be applied across the board.

Expansion Solves All Problems. There is no point arguing more against this idea. Expansion creates a bigger pie with the same relative pieces. It does not make a better pie. It does not make a pie with more equal slices. It does not make a pie out of which everybody gets a slice.

Induced expansion distorts the economy and does more harm than good.

I think most people who promote growth schemes do so as a way to promote their own interests rather than out of concern for the poor or even for the welfare of the country as a whole.

We still should promote research, and should collect information about products and about the state of the world; and we should still promote the dissemination of technology and information.

A Little Bit Does Not Matter. What are one or two programs? What does it matter if we protect a little bit here, or give a little bit there?

Suppose there are 50 million mortgages in the United States, and each of those mortgages benefits by \$5000 in tax credits every year. That is 250 billion dollars of distortion. People that do not have mortgages pay for the people that do have mortgages. That is too much distortion even from only one project.

We have tens of thousand of such programs. Even if one project did not matter much, it opens a door. When some people see other people benefiting from a project, they naturally want to benefit equally. If they cannot benefit from the same project, they want another project that will benefit them. The end is a horrible morass. Except where we definitely have to correct problems such as poverty, a little bit does matter, both in itself and because it invites snowballing abuse.

What Helps the Middle Class Helps Everybody. Tax credits for house buyers help primarily the middle class, which helps everybody because everybody is in the middle class. Credits for college tuition help the middle class and thus help everybody. Not true. Not everybody is in the middle class. Not everybody has bought a house or is buying a house. Only about 25% of young people finish college in the United States (in Seattle, about 50% of young people have a college degree). Programs that benefit the middle class usually do not hurt the rich. The poor end up paying for programs that help the middle class.

Poverty Programs Are Still Rampant. That depends on what we mean by “rampant”, and this is another statistical question that cannot be addressed here. Entitlement programs still eat several trillion dollars of government budgets every year, but those are not mostly poverty programs. The large entitlement programs are Social Security, Medicare, and Medicaid. Those are funded mostly by taxes paid by recipients or by future recipients. It is very unlikely that most Americans really wish to eliminate these programs.

Welfare does cost a lot, but not as much as Social Security or defense.

Nobody suggests building more housing projects or going back to the programs that failed in the 1970s.

Whatever is left of social programs, Americans wish to keep, either because they think we owe it to the poor (and ourselves) or because they realize that things would be a lot worse if we did not have the programs. We are not going to save much money by looking for more poverty programs to eliminate. We probably will save more by looking for other kinds of programs to eliminate.

Poverty Programs Caused the Growth in Government. They did in the 1970s, but, before then, and since then, most growth came from programs such as recreation, roads, education, defense, Social Security, and Medicare.

Recreation, roads, education, etc. serve the middle class more than the poor. The middle class wants these programs.

Still, the middle class balks at paying for them when some families do not feel that they benefit from these programs as much as other families.

The State Always Does a Bad Job. “The state always runs airports, prisons, schools, hospitals, and disaster relief worse than a private firm would.” This is only partly true. When the state wishes to do a good job, the state can do a very good job. The military often does a good job. When the state starts out, it often does a good job. But the state does not often sustain quality work. The state does often sustain quality work in some projects that only the state really should carry out, such as fire control, police, control of utilities, and the protection of nature.

People say that the state always does a bad job because they wish to promote the free market as much as possible. Not giving credit to the state when the state deserves credit only invites backlash against the free market when people see that the state does do a good job sometimes. Badmouthing the state invites backlash against the free market when people see that the market does a bad job sometimes, as with persistent poverty and pollution.

Everything Would Be OK If the Rich Weren't Wasteful. Once I had an activist friend who delighted in telling me stories about the indulgences of the rich. It is the socialist version of obsessing over what movie stars, including secret envy. It was boring. I could not convince him that it really did not matter. Stories about how much money corporate officers make appear on the Internet all the time. The problems in the economy do not come from the wastefulness of the rich. The problems come from imperfect competition, externalities, and state intrusions. All the wastefulness of the rich does not amount to a small fraction of the distortion caused by tax credits for business expenses. Trying to make the rich live like puritans will not straighten out anything.

Some excesses of the rich are disgusting. Some practices of the rich contribute to graceful living. I will not try to sort it out here because it does not matter.

Nowadays, the large majority of the rich actually are stewards of national wealth. They do not use their wealth in riotous living as did the landlords in the time of Adam Smith but instead invest their wealth in business firms. This does not mean that the rich do not cause problems; but they cause problems through the problems inherent in the economy and in human nature rather than through problems inherent in themselves.

There Are No Social Classes In America. A common version of this is “we are all middle class now”. A lot of people think this, especially people on the border of the middle class, such as the poor working class and the upper middle class. I do not know how to argue against it except to

refer the reader to books on sociology. Social classes exist, they are based on wealth as much as on anything else, and they persist over generations.

Class Differences Are Getting Better. No. The gap between the rich and everybody else is getting wider, especially since Reagan, especially in America. Class differences are not necessarily bad, and even increasing class differences are not necessarily bad; but both are unsettling and somewhat un-American.

I do not know what to do about a large and increasing gap between the upper classes and everybody else. I do not wish to take away wealth from the rich so as to give to the poor (forced redistribution) if we can help it. I do not even want much of an inheritance tax. I would take away the many existing tax breaks that favor the rich now, and then see what happens.

There Is No Class Conflict. It is easy to believe this fantasy in an all-White suburb anywhere in America but it is not true. People in different classes still envy and fear each other, and they act on those emotions. Some ways of acting are overt, such as beating up the homeless; several homeless people had just been beaten to death in Florida a couple of weeks before I wrote this chapter; advocates of the homeless said that this was a regular occurrence and that this case differed only in being more visible to the media. Some ways are subtler, such as pushing laws that hurt the poor (anti-soft-drugs) even while advocates of the laws (working class and middle class) break the laws.

Progressive and Regressive Taxes, and Redistribution. A “flat” tax takes the same percent of income from a person of low income as from a person of high income. A “progressive” tax takes a lower percent of income from a poor person while it takes a higher percent from a rich person. A “regressive” tax takes a higher percent from a poor person than from a rich person. Usually the idea applies to income taxes but we have to apply the idea to all taxes, and we have to think about the total effects of any tax.

For example, a sales tax is usually highly regressive, even if it seems to be a flat tax, because poor people spend a much higher percent of their income and so pay more of their income as sales tax. Suppose a sales tax is 10%. If a person makes \$20,000 per year and spends \$10,000 of it on income, he/she pays \$1000 in sales tax, or 5% of his/her income on sales tax. With the remainder of his/her income, a low income person pays income tax and spends it on items that do not incur a sales tax such as rent and medical bills. If a richer person makes \$200,000 per year and spends \$40,000 per year, he/she pays \$4000 in sales tax, or 2% of his/her income on sales tax. With the remainder of his/her income, the richer person pays some income taxes and invests in items that do not incur any taxes right away such as real estate and stocks.

Tax “breaks” have the same effect. Suppose the income tax rate is an apparent flat rate of 30%. A person who makes \$20,000 per year pays \$6000 in income taxes. A richer person who makes \$200,000 per year pays \$60,000. Now allow the rich person \$20,000 per year in tax breaks, in which case he/she pays only \$40,000 in taxes, or a rate of only 20%.

A progressive income tax is often used deliberately to help the poor and to make the rich pay a greater share of the tax burden. A progressive income tax is used to deliberately redistribute wealth from the rich to the poor. Whether or not we think that is fair depends on how we view human nature, capitalism, the role of human nature in capitalism, and the role of the state.

Different kinds of tax, different rates, and tax breaks, interact in complicated ways that require experts to figure the actual effects on people of different income and on the economy as a whole. State officials often hide behind confusion to help their clients. Therefore simpler is better.

Not just progressive taxes but most taxes redistribute income or wealth in some way, even apparently flat taxes such as a sales tax. In practice, most taxes as they are actually carried out (as opposed to any ideal) are regressive. We have to think about how to minimize redistribution if we do not intend to redistribute. If we do intend to redistribute, then we need taxes that are transparent in their effects on particular income groups and on the economy as whole.

It is best to avoid sales taxes and tax breaks, and to work entirely with income taxes. It is best to minimize rate differences between the rich and poor so as to avoid incentive to cheat. Only if income taxes cause so many problems through cheating do we have to fall back on a sales tax. If we do use a sales tax, then we should understand that it is regressive, and we should simplify the tax system in all other ways by eliminating tax breaks.

We Need Savings from the Rich. In the time of Adam Smith, industrialists had to fund new factories out of their own savings because the financial sector was not what it is now. Now, we are wealthy enough and the economy is diverse enough to provide the capital to anybody who can sell an idea. We do not need to make sure that the rich have a lot of money, so that they can save it, so that we have enough so that business can invest.

On the other hand, if we deplete the rich, then we do hurt the economy. We can tax them, and we should tax them, but we should not tax them at a much higher rate than everybody else.

Giving Breaks to the Rich Pays for Itself Through Growth. Maybe this was true in Adam Smith's time when it meant giving breaks to industrialists while not giving breaks to rich landowners. It is not true now. It is not clear that giving the wealthy more money actually does increase growth much, especially when capitalists have access in the financial markets to considerable funds other than through the savings of the rich. Giving the wealthy more money through tax shelters might stimulate expansion for a short while, but it is distorted expansion that is likely to cause problems. Giving the wealthy more money through tax breaks distorts the economy now by taking away funds from other taxpayers.

This idea is based on a macroeconomic fallacy. Savings does equal investment most of the time. But that does not mean an increase in savings causes an increase in investment. We cannot force investment by forcing savings. And we cannot force savings by giving benefits to the rich.

Taxing the Rich Removes All Incentive. The lack of incentive due to high taxes hurts the economy and hurts everybody in it by inhibiting growth while inhibiting the accumulation of

wealth. This is true to some extent, but it is true only if we tax the rich heavily. Nobody is quite sure how heavily we can tax the rich without destroying incentive. A good rule of thumb is that we should not have a tax structure that takes away more than half of additional dollars made [the marginal tax rate should not exceed 50%]. Suppose Arlene makes \$100,000 and might make an additional \$20,000. Suppose the tax on the additional \$20,000 will be \$15,000. That is too much. The tax on the additional \$20,000 should never be more than \$10,000, and should probably be less than that. It should probably never be more than about 35%. The tax on additional income should never be 50% even on small incomes, probably never more than 35%. Albert makes only \$15,000 and might be able to make an extra \$2000. Albert should never have to pay an additional \$1000 on his additional \$2000 in income.

People like to think they get more out of what they make than they have to give to the state. People like to think they are working primarily for themselves and their families rather than for the state. This attitude makes good intuitive (evolutionary) sense. If we need to tax the rich, or anybody, more than at a rate of 50% on extra income, then we need to seriously think about why our bills for government are so high.

Globalization is No Threat. 100 years from now, when globalization is pretty much finished, then everybody will be better off who did not perish in the transition (ignoring effects from biotechnology and artificial intelligence). In the meantime, globalization will cause real hardship to some American business firms and to some groups of American working people. Owners will lose their firms, and workers will lose their jobs. Many of the workers will not be able to find new jobs at near the same rate of pay as before, or will not be able to find new jobs at all. They will be unhappy and angry. They will exert political force. They will get help from religious demagogues and other champions of false Americanism. I do not know what to do about this. I think some honesty would help but honesty on this topic costs politicians their jobs too.

The Traditional Work Ethic Grounds Capitalism. There is nothing wrong with the traditional work ethic, and there is much right with it. But it is not the foundation of capitalism. If it were the only attitude prevalent in capitalism, capitalism would not work. Capitalism needs a variety of attitudes among various groups so as to work well, of which the traditional work ethic is only one. Please see the next chapter.

The traditional work ethic probably has more to do with agrarian life than with capitalism. Peasants all over the world, in various cultures and societies, had this ethic long before there was capitalism. It did not produce capitalism wherever it prevailed.

I worked for several years with business people. They work very hard. Most successful business people are “workaholics”. They have a work ethic but not the traditional work ethic. They have their own ethic about how to apportion time, labor, and resources. They have an acute sense of when to let go, when they are wasting time, labor, or resources. They have an acute sense of when this thing is more likely to yield than that thing. They like money and power, and know how to use them. Yet they do not compete for money as much as for clear-cut recognition by their peers that they are competent and that they are a bit better than their fellows. They use money and power to gauge recognition and success. Hard work contributes toward their goals but hard

work is not necessarily valuable in itself. They can let go of the hard work when appropriate but they never let go of the mental link to their business and to their measures of success. Business people are more like professional athletes and coaches than like bookworms.

Capitalism needs the traditional work ethic, it needs the business person's ethic, and it needs the ethics of scientists, mechanics, and artists. It probably even needs conniving "Yankee traders".

People that promote the work ethic often do so to underscore how lazy are the people that live off the system, such as undeserving welfare recipients. They use the work ethic to spur their children on to the effort needed in a competitive society. These are good uses of the work ethic. Some people promote the work ethic as part of promoting their religious view of society or of family life. This is a bad use of the work ethic. People that promote the work ethic need to take a serious look at what actually succeeds and what people actually do. They need to accept a wide variety of attitudes and strategies.

Traditional Family Values Ground Capitalism. The same is true of traditional family values. Healthy, happy families are good in themselves, and they can be good for capitalism; but traditional family values are not the only way that people can live nor are they necessary for capitalism.

Some people fear the variety of capitalism. They fear the poor and unemployed. They fear that their children will be seduced by the pleasures of capitalism and so will not successfully reproduce. They fear their own inabilities as parents. They use family values as a way to control their situations. Some of their fears are well founded, but, even so, their fears are not a legitimate excuse to force people to conform to one way of living. They insist on a view of life that is much narrower than is needed even to safeguard their own children. They seem happy to use religious, moral, economic, and political blackmail to get their way without realizing that those tactics contradict decent family values.

A successful capitalist society means a variety of material goods but even more it means a variety in ways of life. Some ways of life can be morally unsound and can seduce young people away from successful families of their own. But that is part of the price we pay, just as the transformation of nature and the presence of pollution are part of the price that we pay. People that insist on family values are often willing to devastate nature while not seeing the contradiction. If all families were the same, such as stereotyped loving hippy families as with the Finkelsteins on "Dharma and Greg", it would kill capitalism, even though that family ideal is lofty and admirable. Forcing everybody into the traditional family values mold would just as surely kill the variety of attitudes and the creativity that we need for successful capitalism.

The trick is to allow variety in ways of life without putting traditional families in too much danger. There are many ways to do this, and I think that we succeed pretty well right now. I will not review the ways. People need to relax and take an objective view of the facts.