

MuhlenkampMethods

For the Intelligent Investor

Answers to questions you may not even know you have.

Open Letter to My Congressman

This essay was originally published in Muhlenkamp Memorandum Issue 16, October 1990. At that time, much discussion in Washington, D.C., revolved around the federal budget deficit, taxes, government spending, and entitlement programs. The letter offers fresh ways of looking at all of the above and their effects on the economy and the American people.

Dear Doug:

I am disturbed by the current state of affairs in Washington, D.C. You and your colleagues in Congress are addressing issues important to the future of our nation and our economy. Here are my thoughts on these issues:

Congress and the executive branch maintain that our biggest problem today is the budget deficit. The deficit has two parts—taxes and spending. Many would like to shrink the deficit by raising taxes, but we've tried that and it doesn't work. During the 1970s, we allowed inflation to raise effective tax rates to the highest level in our nation's history. People quit working, and the result was 10% unemployment and 10% inflation.

I'd like to make several points about taxes:

First, the focus seems to be on taxing the wealthy by raising income tax rates. Income is not wealth; wealth is assets. When you tax income, you tax those who are trying to become wealthy, not necessarily those who already are.

Second, a simple definition of wealth vs. poverty is that the wealthy have more options. There would be no point in trying to become wealthy, through concentrated time and effort, if it did not increase your options.

Third, in the final analysis the payment of taxes is voluntary. You can tax my income, but you cannot force me to earn it. Much of the political and economic dialogue of the past decade concerned the maximum tax rate at which people are encouraged to earn the most and, not incidentally, to pay the most taxes. Two of my offspring received their first real paychecks this year, and judging by their reactions to the amount withheld for taxes, we're pushing the limit. I know you're pushing my limit! If you raise my



tax rates, I'll do less work. Even a mule will quit if you load him too heavily, and most people are smarter than mules.

If income taxes are too high, the wealthy will simply buy municipal bonds, or they'll buy farmland and get paid not to grow food. Doctors will defer income or play golf. Businesses will be managed to minimize taxes rather than to grow and to create new products and new jobs. This isn't hypothetical; we saw all of the above in the 1970s. They gave us 10% inflation and 10% unemployment. Do we really wish to return to those circumstances?

Among all income taxes, the most voluntary is capital gains. The truly wealthy, having the most options, can live off their dividends and interest. They have no need to sell appreciated assets.

Ronald Reagan knew that people work harder and produce more if you lighten the tax load. (Maybe it was his experience with horses.) So he lowered tax rates and people went to work, creating over 20 million new jobs. (Politicians don't seem to understand how jobs are created. Jobs are created when one person can benefit or profit from hiring another. If you tax away the profit, you tax away the job.) They also paid more in taxes. By 1990, federal tax receipts exceeded 1980 receipts by more than \$240 billion *per year*, adjusted for inflation. In your wildest dreams, you've never imagined a "peace dividend" of \$240 billion per year. Yet we have a "growth dividend" of \$240 billion per year in tax receipts! Surely that's enough. But no, federal spending has grown even more.

Congress makes noises about cutting spending, but I see no real effort to do so. In the current year, each appropriations bill which went through the House was loaded with pet projects and pork barreling. Not one bill was held to the overall budget limits!

In your recent newsletter, you said you voted to limit spending on a number of provisions in these bills, but you never mentioned whether any actually passed. One was a provision to limit subsidy payments to farmers earning over \$100,000 per year, hardly a draconian cut. The provision failed in the House by a 2-to-1 margin. This says to me that Congress is not interested in cutting subsidies, even to the wealthy. You said at a recent town meeting that the effect of special interests in Congress is limited because you must get 218 representatives on the same side to pass anything. Yet experience shows that when a congressman adds pork to a bill, it stays in. No congressman has an incentive to delete another's line items, and the president isn't allowed to. The result is an inherent bias toward spending, which I've encouraged you to remedy by supporting a line-item veto.

I've noticed that your town meetings are well attended by people who receive checks from the federal government. Invariably they want more, and certainly not less. My wife characterized the theme of a recent meeting as "gimme." After attending a number of these meetings, I can understand why members



of Congress believe they are elected to spend more money. Nevertheless, at election time the taxpayers have sent clear signals for over a decade that they're carrying as big a load as they're willing to carry.

So you're faced with a dilemma: How to keep your promises to the recipients of federal programs without raising taxes? The answer is: you can't! You've promised money you don't have, and you've promised money the taxpayer is unwilling to pay. For a decade we've made up the difference by borrowing, but we've exhausted our credit.

One of the great dangers of the current circumstance is that the dichotomy between taxpayers and recipients has become intergenerational. While taxes are paid by working people, 60% of federal outlays go to senior citizens and retirees. And the percentage is still climbing! In a recent debate, a spokesman for a senior group said that "Other than cost of living (adjustments), Social Security benefits to a retired individual haven't been raised since 1972." I don't know why these raises should exceed the cost of living in the first place, but as an individual worker my Social Security taxes have *tripled* in real terms since 1972. I'm 46, and I've already paid more in Social Security taxes than someone who retired five years ago. At the same time, anyone, rich or poor, who has been retired for five years has already received more from Social Security than they ever paid in, again adjusted for inflation. Enough already!

Entitlement programs such as Medicare, farm subsidies, and Social Security are always justified based on the financial need of the poorest participants. But the benefits paid out are not determined by need. As a consequence, the benefits go disproportionately to those who are not needy. The bulk of farm subsidies go to wealthy farmers. Wealthy retirees pay only 25% of the cost of their Medicare benefits. Five hundred thousand millionaires will receive Social Security benefits that exceed five times what they paid in. Taxpayers pay the rest—how is this equitable?

Congress is trying to cope with the intergenerational problem, in its own way. At the insistence of a group of senior citizens, Congress passed the Medicare Catastrophic Coverage Act of 1988, and provided that it be paid for by Medicare participants. Once they saw the cost, a larger group of senior citizens immediately got the bill repealed.

Several years ago, Tip O'Neill proposed taxing 85% of Social Security benefits. At the time, I wondered how he came to the 85% number. He used a study that concluded that the average Social Security recipient would receive benefits roughly seven times what he paid in. Or put another way, of the benefits received, only 15% represented personal contributions. Tip proposed taxing the other 85%. The proposal went nowhere, but the idea was again floated at the recent budget summit. Taxes would have been progressive, affecting only those retirees earning more than \$25,000 per year. But at the first whisper of "tax Social Security," a great hue and cry shot the idea down. So the summiteers turned to Medicare.



I'm embarrassed at how long I thought Medicare was for poor people. Then I learned that Medicaid is for poor people. Medicare is simply for people over 65, rich or poor. Today, these people directly pay 25% of the cost of their Medicare. The budget summit proposed raising this to 30% through higher deductibles and copayments. Again the great hue and cry! I can sympathize with the complainers. I don't like paying the cost of medical insurance either, but I don't expect you to tax them to subsidize me.

I don't object to subsidizing the needy. But, as currently run, "entitlement" programs tax me and my children to subsidize people who are better off than we are simply because they've reached a certain age. A senior citizen told me he counted on Social Security and Medicare to provide a cushion to prevent his being a burden to his children. Someone should tell our seniors that the biggest financial burden their children have is paying for Social Security and Medicare!

Sincerely,
Ron Muhlenkamp

Editor's Note

There is no free lunch. Government spending is a response to constituents' demands for more. However, anything the government spends must ultimately come from taxes. And the taxpayers are also America's workers. If we overtax our workers, we risk economic stagnation (as in the 1970s).

