"Among the many ironies: The current economic crisis is largely the result of too much investment in housing, which led to a bubble and then a collapse, and too little investment in energy, leading to fuel shortages and skyrocketing prices. Yet the political class is acting, as far as I can see, to increase investment still further in housing and reduce investment in energy." --www.DoctorHousingBubble.com

Tax and Financial Strategies

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Issue #34 Fall 2008

Wealth Creation Strategies

The Wealth of Individuals
Part 2

What is the root of wealth?

In Part 1 (summer 2008 issue of *Wealth Creation Strategies*), we talked about the importance of debt avoidance, stable growth, relative stability in one's personal life and beginning a savings and investing program earlier rather than later. While these strategies increase the likelihood of becoming wealthy, there are plenty of entrepreneurs who have overcome the odds while taking inordinate risks with debt. They have suffered massive instability in both their investments and personal lives, and even started late on their savings program—or lost it all to bankruptcy and started over. Relatively free markets gave them an opportunity to rebuild and recover.

An absence of free markets creates political instability, disincentives and distorted incentives that preclude the creation of wealth for all except those willing to be corrupted, whether through the dictatorial socialism of Hugo Chavez or the crony capitalism of Countrywide's Angelo Mozilo and Fannie Mae's Franklin Raines. With an election looming and many investments crashing, it may be helpful to look at the root of wealth for honest individuals from a big picture—or macroeconomic—point of view. While we had to talk numbers in Part 1, this time we've got to look at theory. Again, I promise you'll gain insight into wealth you won't find anywhere else—and it may even make you think twice while holding your nose as you cast your ballot.

Ludwig von Mises, the Austrian School economist, asserted that the difference between an American truck driver and a Chinese coolie is the truck. Before the days of a version of capitalism in China, coolies carried products without the benefit of a truck. Like the modern-day Zimbabwean, Cuban, or North Korean, he was out-produced by the American truck driver a thousand-fold. In free markets, competitive pressures force employers to compete for good quality workers by paying higher wages. In a society in which capital equipment is all-pervasive and largely allocated based on consumers' preferences through free-market pricing, the trucker's wages are a thousand times greater than the coolie's.

We would think, then, that capital equipment in the broadest sense of the term—which we'll call "trucks"—must be at the root of wealth. Not quite. Think about what you would do if you weren't able to keep the product of your work. That's right, you wouldn't produce anything new and you'd spend what you have, leaving nothing to invest. Without savings, you don't buy trucks. You don't build buildings or create, whether books, music, paintings, inventions, or new drugs—after all, even artists and inventors and researchers need savings to live on while creating, inventing and researching, which takes time if not capital. Without savings and "trucks" to lever our work, our standard of living drops to subsistence levels.

The idea that the protection of property encourages us to save funds used for investment, which in turn are used to pay for the trucks that produce goods and services, suggests that the protection of property is at the root of wealth.

Most advocates of education (of which I am one, albeit privately provided) believe a good education is practically essential to increase one's standard of living. At the risk of seeming politically incorrect, this isn't always true. Aside from learning how to drive an 80,000 pound vehicle, the trucker doesn't necessarily have any greater skills, strength, education or intelligence than the Cuban or North Korean or coolie. The American trucker can have less of all of these attributes and earn vastly more and become far wealthier. The truck, paid for by investors—entrepreneurs—who depend on savings (whether or not their own), which depend on the protection of property, allows the driver to dramatically out-earn those lacking this tool.

Many think that spending is the source of wealth. But we can't spend what we don't have and we can't buy what isn't built or created. Without the savings that produce machines and equipment and corporate organizations (think: Wal-Mart) and drugs and inventions and entertainment for mass consumption (TV, radio, CDs and DVDs), we couldn't spend because there would be nothing to buy.

The quantity of money or extra cash in the hands of consumers doesn't create wealth either. The recent tax rebate was the equivalent of a hit of cocaine or a shot of steroids. Wealth isn't created by politically shifting or printing money.

The great philanthropists are not who you think they are

Please don't misunderstand me. There is nothing wrong with spending, albeit modestly. We need to spend to survive and, beyond that, to enjoy the fruits of the highest standard of living in human history. However, if we are to continue to increase the style of living to which we have become accustomed, we need to learn to save.

Giving to others can help them survive. Many of us donate to Save the Children and other such charities, which provide urgently needed food for little innocents who might otherwise starve. Money currently spent on food in Africa may temporarily save a few lives, but it doesn't alleviate the poverty of the continent. Ask yourself, "Why are these children starving?" It's because the countries in which they live allow rampant violations of property (including one's life), which creates disincentives to save. In fact, people in some countries spend so much of their time protecting what little they have, there is no time to produce enough to create a surplus over basic needs that can be saved and invested.

Donations can be leveraged by giving money to charities* that support the idea of property rights (which are essentially non-existent in the poorest countries). Once people know that what they produce is theirs to keep, not only will they produce more, but also they'll save some of it for the future, where it can be used to buy trucks.

We can also leverage our funds by investing in companies that provide the trucks. Trucks (and other equipment, patents, drugs, know-how and organizational systems) create leverage because far more can be produced with than without them. Money saved and invested in trucks isn't consumed, which as an act of self-denial should be considered one of great charity. The Jewish scholar Maimonides apparently agreed with this sentiment when he wrote in *Foundations of the Torah* that investing is the *highest* form of charity.

So, it should make you feel as good (or even better!) to save and invest as to give. While your act of self-denial may be seen as temporarily reducing the quality of your life, you help to enrich others. In the long run you provide them with a far higher standard of living than they would otherwise have. Savings create capital for equipment and production machines that cost tens of millions of dollars, which few of us could ever individually afford, providing you and others with goods and services for relatively few dollars. For a mere $10 we can purchase entertainment that cost investors and savers tens of millions to create. For $70 a day, we can buy exciting rides that cost a hundred million dollars to build. For a few dollars (or a few hundred if still under patent) we can gain relief from pain in our old age that our forefathers couldn't buy at any price. Savings offer a form of leverage that isn't possible with ordinary charity. It provides the means by which to increase the production of food, other necessities of life, and luxuries. To paraphrase the old adage, give a man food and he'll eat for a day; save and invest in a fishing reel (or plow) that he can purchase and he'll eat for a lifetime. The food you give will rot in days, while in a society in which property is protected, the fishing boat (and farm building, equipment and organizational structure) will not wear out or be rendered obsolete for decades. Moreover, except in rare instances you don't even know the people for whom you provide this remarkable benefit and don't care about their beliefs, creed or skin color. Saving and investing is truly the most all-encompassing, beneficial and highest form of charity.

Amazingly, when we become philanthropists through investing, we not only increase the well-being of others, but also our own. Over the long run earnings from providing that machinery of production for the benefit of others will be, even with temporary setbacks like today, greater than zero. We earn interest by lending saved funds to others to invest and dividends and capital gains by investing the funds ourselves. In the end, by helping ourselves—without benefit of the crony capitalism of the Fannie Mae's of the world—everyone's standard of living increases, just as Adam Smith said it would in his *Wealth of Nations* and Ayn Rand in *Atlas Shrugged*.

Specializing in what we do

We must learn to use the equipment and organizations and know-how that such investing creates. If nothing else, we need to know how to manage our investments or hire the right people to do so. Therefore, education in the broadest sense of the term becomes a crucial part of the investment equation. To the extent this investment in time detracts from time to just "have fun," education is similar to saving. Current pleasure—spending and living for the moment now—is exchanged for future greater pleasure. Assuming this education is used, it benefits others as well.

Specialization of labor among countries (which become particularly good at certain "jobs"—America for technical know-how, the Middle East for its oil and Southeast Asia for its production of practically everything, which facilitates trade between nations) trickles down to individuals. Along the way, different locales evolve to provide that which they are better suited for—the Great Lakes region for its heavy industry (cheaper to transport on water than land), Florida for its tourism and California for its agriculture. So it is with individuals, who generally gravitate towards what they are naturally inclined to do best.

Specialization of labor is increasingly demanded as the capital base (the equipment, organizational structure and the like) grows over time. Specialized training, then, becomes more essential as wealth increases. This is not to say that generalists are not needed. Seemingly disparate fields would never be integrated without those willing to look at the forest; for example, I am a generalist who integrated financial disarray and alcoholism. Most of the time even generalists have a specialization that becomes the centerpiece of their "other" work (mine is tax law, surrounded by the far more general fields of financial planning, addiction and economics).

The munificence of the top .1%

The top .1% becomes supremely specialized and is paid well for it. The baseball player who hits 60 home runs in a season earns many times the player who hits none, unless that player pitches balls that others rarely hit. The businessman who specializes by harnessing the productive power of tens of thousands of employees is paid far greater sums than the one who manages only a few. The director who produces films that attract audiences in the tens of millions commands wages far greater than those who create entertainment for mere thousands. Note that as the number of customers increases so does the recompense to the provider. Providing others—fans, consumers and film goers—with value pays. As the number of those who benefit increases logarithmically, so does the income of those who provide the benefits. Consider the income of sports and celebrity super-stars before equipment for film and TV could showcase them, when their audience might have consisted of hundreds or at most thousands, vs. today with fans numbering in the millions.

Peak performers don't have to be so beneficent to the rest of us. They could rest on their laurels with a small fraction of what they earn, but choose not to. In more primitive societies—those that offer few if any protections for accumulated property—they wouldn't bother (or worse, if their consciences allow, they gravitate towards government positions that offer the potential for unearned gains through corruption, graft and *violating* the property of others). In more advanced societies as tax rates rise, the odds increase that these supreme achievers and providers of things for the rest of us will say "to hell with it." The odds of this occurring are magnified since such wealth often proves to be so fleeting—only a handful of the top 400 individuals or corporations of 30 years ago are still among the top tier today. Joseph Schumpeter's "creative destruction" of free market capitalism suggests that markets undo the wealth of particular individuals through the reallocation of capital to an even greater extent than taxation ever could. But taxation is a more *certain* obstacle.

High taxes not only reduce production, but also savings. Top income earners respond just like any other rational human hit with high rates, which includes reducing the amount of savings subject to such taxes. Before you cast your next vote for a politician "asking" that we share the wealth, consider who is in a better position to save and supply the capital for trucks: the subsistence farmer, the trucker earning $50,000 per year or the executive earning a half million (or fifty million)? If you recall, savings—and it doesn't matter by whom—increase standards of living for *all* of us. While some are pretty good at spending it all (and even with their yachts provide jobs and the potential to save among the skilled craftsmen who build them), most choose to save more if tax rates—the non-violation of their property—are low enough.

(Warning: although the rest of this is tough sledding until immediately after the "yacht" chart, if you're interested in compelling macroeconomic studies and ideas supporting the assertion that low tax rates at the top end are essential to improving the plight of the poor, you'll want to try and plod through.) Statistics provide overwhelming evidence for the assertion that lower tax rates—allowing people to keep more of what they produce—yield increased savings and, hence, greater wealth. In countries where governments slimmed down from 1996 to 2006, where the average highest tax rate on individuals fell from 36% to 30% and 30% to 22% on corporations, investment grew from an annual average rate of 3.8% to 5.9%. Countries in which governments went on a less restricted diet in the same period (rates fell, but by far less) experienced a decrease in investment from 4.1% to .8% yearly. Contrary to what we'd expect, the latter nations ran budget deficits and had four times the overall net debt of the former, which ran surpluses. (In other words, lower tax rates yielded greater government revenue because the pie got bigger.) In a nod to the idea that lower tax rates benefit everyone now, not only in ten years after the increased savings bears fruit, annual employment growth was 1.7% in those countries with governments that more dramatically lowered top tax rates and only .9% in countries with higher rates. Consumption even increased to an annual growth rate of 4.1% from 2.8% in the lower-tax nations, while slowing to 1.3% annual growth from 2.1% in the higher-tax rate countries. (Adapted from Keith Mardsen, *The Wall Street Journal*, June 16, 2008, "New Evidence on Government and Growth.")

Skinny government is better government

	Investment	**Budget**	**Employment**	**Consumption**
Slender govt's	Grew	Surpluses	Grew more	Increased
Fat govt's	Shrank	Deficits	Grew less	Shrank

If savers get to keep less of their earnings, there is less to compound over time. A high income earner with an inkling to buy a new yacht may well do so—knowing that the 50 cents on the dollar he keeps after tax would grow to a far smaller sum than 80 cents under a regime of lower tax rates (the difference in value after just 10 years is almost 100% and close to 200% after 30 years at a growth rate of 6% minus taxes; it's 400% at 10%). Just as they are inclined to smoke less when taxes are higher on cigarettes, people in the aggregate react to disincentives by using or producing less of anything that is taxed. If their labor, or brilliance, or savings is taxed at higher rates they'll produce, give of their genius, or save less.

The would-be yacht owner may be more inclined to save than splurge at lower tax rates because he can buy a bigger yacht later

# of years	Earn a million, pay 50% tax & buy $500k yacht	Earn $1 million, pay 50% tax and invest $500,000 minus tax @ 50%		Earn $1 million, pay 20% tax and invest $800,000 @ 6% minus tax @ 20%		Extra savings @ 20% tax rates	
		6%*	10%*	6%**	10%**	6%	10%
10	Yacht still runs	**$672k**	$814k	**$1,279k**	$1,727k	$607k	$913k
20	Yacht is aging	$903k	$1,327k	$2,043k	$3,729k	$1,140k	$2,402k
30	Yacht dies	$1,214k	**$2,161k**	$3,265k	**$8,050k**	$2,051k	$5,889k
40	Yacht-less	$1,631k	$3,520k	$5,218k	$17,380k	$3,587k	$13,860k

* The after-tax yield of 6% and 10% at 50% tax rates is calculated at 3% and 5% respectively.
** The after-tax yield of 6% and 10% at 20% tax rates is calculated at 4.8% and 8% respectively.

This idea that people are less likely to take risks at higher tax rates is particularly true of long-shot investments. Greater expected returns up the odds that such risks will be taken. Tax rates on capital gains must be factored into the equation. As rates on such capital increase, the propensity to take such risks is reduced. The lower the rates, the greater the odds, for example, that university students will risk their futures by investing their time and ingenuity in an attempt to create the next Google. The more likely are you and I to risk our hard-earned savings on the next Microsoft.

Low tax rates now are crucial for long-term wealth creation. Sound government policy, then, should encourage the low-tax build-up of wealth by providing protection from thugs, foreign and domestic, at the lowest possible price. This should apply to tax rates on the wealthy as well as those on the upwardly mobile, whose goal is to increase their earnings when they see they can keep the fruits of their labor, entrepreneurial spirit, brilliance and savings. The beauty of free markets and low tax rates is that this self-serving behavior inadvertently increases the standard of living for all. For this miracle to keep working, we need to know that the country in which we live is stable and that tax rates will remain low enough to make it all worthwhile. If not, Atlas may shrug.

* Such charities, which can be Googled for further information, include: Foundation for Research on Economics and the Environment, Liberty Foundation, Moving Picture Institute, Institute for Justice, Reason Foundation, Cato Institute, International Society for Individual Liberty, Atlas Economic Research Foundation, The Independent Institute, Foundation for Economic Education, Property and Environment Research Center, Alliance for School Choice, Friedman Foundation, Pacific Research Institute, Competitive Enterprise Institute, Advocates for Self-Government, Pacific Legal Foundation, George Mason University Foundation, Institute for Humane Studies, Lincoln Institute, Manhattan Institute, PrevenTragedy Foundation

The End of Crony Capitalism

The stock market collapse has supposedly laid out the flaws of capitalism for all to see: greed, taken to excess, can bring down the very system that feeds such avarice.

The problem with this interpretation of recent events is that we don't have capitalism, at least not the free market variety. Ours is crony capitalism superimposed on socialism.

The current system began with the Federal Reserve Act of 1913, which created a government-sanctioned central bank serving as a socialized source of money and credit. This was followed by the transformation of a system based on the idea that money should have intrinsic value (backed by a commodity such as gold) to one based on nothing more than faith (a "fiat" money system). Along the way, two government sanctioned enterprises (GSEs), Fannie Mae and Freddie Mac, were created to "encourage" investment in housing (meaning: more housing would be created than in a market free of government regulation). An implicit guarantee that any losses would be covered by the U.S. government compelled these enterprises to take risks that private owners would never have taken without such assurances. Then, changes to the Community Reinvestment Act, or CRA, got the ball rolling in the late 1990s.

A snowball turns into an avalanche

Traditional underwriting standards were gradually thrown out the window because the federal government, using the CRA as its enforcer, coerced banks into making home loans to borrowers regardless of their ability to pay. An accommodating central bank brought inflation-adjusted short-term interest rates to below zero in the mid-2000s. With Fannie and Freddie buying $500,000 mortgages given to low-income earners who couldn't possibly repay once artificially low short-term rates reset to long-term market rates, a bubble was created. The aftermath is what I meant in 2005 when I wrote that bubbles do not end well. I fully expected this, even if I couldn't get the timing quite right.

The foundation for the bubble required a combination of government entities, creations and regulations. Crony capitalists—those adept at forging and using political connections and rules to their advantage—saw opportunity. They could package mortgages originated by bankers coerced by the CRA and sell those packages to other investors. By slicing and dicing, accommodating rating agencies given semi-monopolistic powers by government were able to give junk mortgages triple-A ratings. William Voegeli, a research fellow at the Claremont Institute, explains that an "infinitely malleable regime [such as this] puts entrepreneurs who excel only at making their customers happy and their investors rich at a disadvantage, relative to those adept at forging and using political connections." In other words, the James Taggarts of Ayn Rand's *Atlas Shrugged* had a field day creating and selling garbage loans.

The cronies working at Fannie Mae saw they could artificially inflate earnings by purchasing such toxic mortgages and record income that, ultimately, would never be received. They kept Congress off its back through gargantuan lobbying (more to Democrats than Republicans, even if both have their share of crony enablers), insuring that profits continued to flow to its employees while losses, when they occurred, would accrue to taxpayers. Fannie and Freddie had 46 lobbying firms before their demise and packed their boards with politically well-connected politicians (including former Clinton aide Rahm Emanuel before he became a Democratic Congressman and Rick Davis before he became Republican John McCain's campaign manager). Some might argue that preventing Congress from interfering amounts to a freer market. Wrong. Congress was risking taxpayers' money, which is anything but free-market capitalism. The implicit guarantee of government backing, as *The Wall Street Journal* columnist William McGurn wrote, "Removed the discipline that market competition forces on other private enterprises." It allowed Fannie to borrow at what were essentially taxpayer-subsidized rates and lever up debt to about 100 times equity. No other business has ever been so levered.

Former Louisiana Republican Richard Baker, who spent nearly a decade and some 40 congressional hearings warning anyone who would listen that Fannie and Freddie were ticking time bombs, explained, "The closer an enterprise is to the taxpayer's wallet, the more congressional oversight it requires. The further away you get from that wallet, the more freedom you should give people, because they are risking their own money, not the taxpayers'." When Baker questioned Fannie's triple-A rating and made public the $90 million in total compensation that former Fannie CEO Franklin Raines took, he was dismissed as a "crank" and accused of a "lynching" by a fellow congressman.

The "Republicans caused this mess by deregulating" crowd blames the repeal of part of the Glass-Steagall Act of 1933. This is nonsense. First, while the bill's key sponsors were Republicans, it was supported by the Clinton administration and signed by President Clinton. Second, it repealed only the prohibition of commercial banks from affiliating with firms engaged principally in underwriting or dealing in securities. This allowed several mergers that have worked (so far) to save the system from complete collapse, including J.P. Morgan Chase's acquisition of Bear Stearns and Bank of America's purchase of Merrill Lynch. This repeal had nothing to do with creating the financial mess—none of the investment banks that have failed were even affiliated with commercial banks. As American Enterprise Institute senior fellow Peter J. Wallison pointed out in *The Wall Street Journal*, "The ability of these banks to diversify into nonbanking activities has been a source of their strength."

The direct reason for the mess is that banks, following the lead of Fannie and Freddie, invested in toxic mortgages for which the two GSEs created a market, which in turn resulted from the CRA mandating garbage loans (under the guise of "helping the poor," which as pointed out in previous newsletters helped sellers raise market-clearing prices). It worsened dramatically during six years of Republican rule which, despite the protestations of a few Richard Bakers, decided that home ownership was some sort of an American birthright. Although it may have been too late (the real estate bubble was already at or near its peak), it was worsened when the Senate Banking Committee, which in the summer of 2005 voted along party lines (all Republicans in favor, all Democrats opposed), couldn't get a bill tightening regulations over Fannie and Freddie to a vote in the Senate because Democrats refused to limit debate.

The market is doing it right; the problems stem from government doing it wrong

The government is pulling out all the stops in trying to prevent housing prices from continuing their descent. Ironically, the original mission of the GSEs was to make homes affordable. Now that the *market* is doing just that, the same politicians who did everything they could to insure the opacity of the GSEs are doing all they can to keep prices unaffordable. I'm not sure who is more annoying from a free-market libertarian perspective: Democrats who seek hand-outs for low-income housing, or Republicans who do less to prevent housing from being built but who now alongside Democrats are trying to prevent its downward re-pricing.

Among the few economists and commentators who saw this collapse as inevitable were those who understood that the excess credit creation largely responsible for blowing bubbles, which occurred even in the days of free market money, was greatly exacerbated by government. We have been using "hair of the dog" remedies for decades, like alcoholics drinking the morning after to fend off the hangover—a much-needed one created by excess borrowing and consumption. While a few Republicans understand the necessity of going through withdrawal even though it will be painful, they completely failed in preventing this mess in the first place (in the case of Ron Paul, not for lack of trying).

We should send a message to both parties by voting for those with a far better grasp of the idea that free markets are the solution and not the problem. While the Libertarian Party and its leaders (Bob Barr for President and Wayne Root for Vice-President) are far from perfect, we could send this message by voting for them—particularly in states where the Electoral College outcome of the election is certain. As I've written on a number of occasions, the purpose of a third party is to influence the major parties into adopting some of the third party's goals and platform. The socialists did this from 1900 to 1932, when their candidate proclaimed victory, explaining that the major parties had adopted the Socialist platform. By winning a few percent of the vote, the losing party realized, "We could have won had we gotten that third-party vote—so let's go after it," and by causing the winning party to figure, "We almost lost—we'd better get that vote to insure victory next time." In other words, a third party doesn't need to win an election to win the war. And by the way, the Libertarian Party is the only one that favors dramatically reduced government spending and taxation to the point at which you would no longer need the services of your favorite tax professional, even if we'd miss each other. Unfortunately for the country, I don't think we have to be too concerned about that occurring anytime soon.

Dear Barack

Dear Barack,

Congratulations on your recent win. Now you have a few challenges ahead.

The first is to accept the idea that economics is no more your strong suit than it is John McCain's. Among your numerous proposals that could result in economic pain greatly exacerbating that which we have already suffered, two are particularly troublesome: an increased mandatory minimum wage adjusted for inflation each year, and your tax plan.

Wages have nothing to do with government mandates and everything to do with productivity, which is based largely on capital investment. Higher-than-market prices of anything result in unsold things. If you have an apple stand and your apples aren't selling for a buck each, what do you do? You lower the price and somewhere on the way down buyers magically appear. Minimum wages price those who aren't yet worth the cost, especially the unskilled, out of a job. Consider the fact that only about 2.5% of the American work force is paid minimum wage. In a society with vast pools of savings and investment, 97.5% of workers, many with only a modicum of skills, are worth more than the current minimum. Raise that mandatory minimum price of labor and you'll end up with a greater number of unemployed workers.

Your tax plan won't so much affect Plumber Joe's ability to hire employees once he earns $250,000 a year as much as it will create a disincentive to work hard enough to ever earn that high an income. A number of my clients have the talent and skill to expand their businesses and hire more employees, but simply won't bother at the rates you propose. Increasing the maximum tax rate from 36% to 39% combined with a new 12.4% Social Security tax on earnings over $250,000, alongside a 2.9% Medicare tax and a 9.3% tax rate in California will all but destroy incentives to build businesses and create new jobs. While a few altruists may be willing to work for less than 40 cents on dollars earned over that quarter million, many will simply shrug off the burden. It's challenging enough having to navigate employment rules and regulations without further increasing tax rates that are already too high. And by the way, Barack, it's time to dispense with the demagoguery—we both know that the top 1% of income earners pay 26% of all federal taxes (including income, payroll, corporate and death taxes) and the top 20% pay 67%. The "rich" already pay more than their "fair share."

You seem an open-minded sort of intuitive feeler (NF, in the Myers-Briggs/Keirsey paradigm), an idealist and diplomat, who can bring those with disparate views together. However, a weakness of NFs can be naiveté. If you really want to change Washington you need to be willing to take unpopular positions in areas where you may lose friends. By your own testimony, you knew there was a problem with lending standards, but never pressed your own party for legislation to right such standards. The fact that you were the 2nd biggest recipient of Fannie Mae lobbying contributions *ever* may have something to do with it, but for now I'll give the benefit of the doubt and assume it was a one-way payment. Now, please prove that the benefit of my doubt is earned.

You also seem to have a faith in government—and intuitive feelers are among the most credulous—that has been proven time and again to be misplaced. You said you will listen to all comers—including libertarians. Here's a thought: if you really think government works, then let it compete. Allow choice and competition on equal terms without subsidies among private and government providers. You can start by supporting educational vouchers and open the medical arena to greater rather than less competition (I offered a few thoughts on the subject in my summer-fall 2008 newsletter, which you may find of interest). You'll note that the areas with the most challenging problems today—those we are constantly bickering over, which is anathema to an intuitive feeler—are areas filled with the heavy hand of government such as education, health care and energy.

Also consider another tenet of libertarian thought: government requires coercion, which is less civilized than allowing people—adults, many of whom don't want the nanny state looking over their shoulders—to make up their own minds about how they spend their money. Remember too that we all spend our own money better than someone else does, except when we don't. When that happens, we are given the opportunity to learn and to grow. As an NF you enjoy seeing people become all they can become. So let us be free to make our own goofs and benefit from them. Stop letting government protect us from consequences, Barack. Let us grow.

You may argue that government saved capitalism from itself in the Great Depression. This is a myth. Hoover pushed businesses to keep wages high, without any consideration to the idea that when you can't sell something—whether apples or labor—you simply drop the price (and when the price level of everything else is falling, wages *must* follow). He also pushed to keep investment high in industries that experienced falling demand for their products. That's like telling home builders to keep building new homes in today's market, which would obviously be idiotic. He created—long before FDR—public works programs that employed workers with artificially high wages and signed on to a draconian hike in tariffs that was the equivalent of a declaration of war on the rest of the world. Inasmuch as you have stated your opposition to NAFTA, this is an error in policy to which you could easily succumb. (The loss of jobs from foreign competitors is no different from a loss of employment from domestic competition.) Hoover also began to hike taxes, which accelerated during the Depression, all but completely stifling the very innovation that would have led the country out of it.

The Great Depression was triggered initially by an excess of credit creation leading to mal-investment, which is the cause of the current recession (too much money and credit was invested in real estate). Please don't make the same mistakes that Hoover and then FDR made through continuous meddling, which resulted in a depression lasting over a decade. If you don't believe that a "hands-off" approach is best, have your economic policy advisers tell you about the Depression of 1921. On the other hand, they may not even know about it since it lasted only a year, despite a 25% drop in economic output. The difference between it and the Great Depression was the government did nothing. Accept the fact that people are ingenious when left to their own devices and that, in the long run, they will be better off for it.

You seem a modest sort, despite the jokes about Barack the Messiah. Intuitive feelers are generally humble if they are not alcoholics, which you are not. However, both your father and step-father were alcoholics, which resulted in a lack of control over your early life and a need to right things. You may think you can make up for it by trying to control things as an adult. This is arrogant and beneath you. Your advisers will try to guide you into directing others in a vain attempt to control the economy. If you refrain from following their lead you will be a better leader. In fact, with your oratory skills, you could be a great leader. But a leader, Barack, is not a ruler.

Also, remember the definition of insanity: doing the same thing over and over and expecting a different result. You have intimated that you would support a second "stimulus" payment. The first one gave a temporary boost to spending, no increase in productivity (simply shifting money around does not increase aggregate wealth) and ended in the October surprise. As economist Arthur Laffer suggests, "Ask yourself why not a $40,000 rebate per person…if a $600 rebate is so good." Learn a basic economic truism: rebates reduce output because they reduce incentives to produce output. If you want to see an increase in wealth, focus on policies that increase savings and investment, not transfers. As author Alvaro Vargas Llosa puts it, "People who start and grow businesses don't need a government's help; they need assurances that government will not destroy their efforts through taxation or regulation or—worst and most common of all—by bestowing favors on their competitors." Rise above those in Congress who will implore you to do it again, only to further increase America's debt burden and mislead Americans into thinking they can get something for nothing.

Dear John

Dear John,

Well, you and the Republican Party, formerly the Party of small government, blew it. You helped it grow into a Party of big government under Bush's watch, during which time government grew at a 20% per annum rate. This was far greater than its growth even under Carter's and Clinton's watches, when it grew 17% and 6% per annum respectively. You lost those who believe America is about the freedom to do what we want, for better or worse in our own lives. You caved in to those who tell us that government knows better than we do. And where you may have done some good, you didn't adequately explain why you did it. (I refer to, among other mismanaged policies, the Iraq War, over which I have some disagreement with my libertarian brethren. I view it as the world in 1938 and give you credit for the possibility that, so far, you prevented 1941 from occurring. However, you mismanaged it—but then what war isn't badly mangled?—and didn't do the one thing essential to teaching the world a lesson about free market capitalism, which was to privatize the Iraqi oil fields. But I digress.)

You didn't complain, and in fact by your own testimony supported your President's push of his agenda for an ownership society. Owning rights to Social Security and Health Savings Accounts are one thing; pushing us to all purchase homes is quite another. Yes, home ownership increases the strength of our roots in the community, but suggesting that government knows what is best and that it should subsidize a massive diversion of debt and capital into housing is the height of arrogance. You stood by as the American Dream Downpayment and Zero-Downpayment Initiatives were implemented with the worthy goal of helping low-income families overcome the hurdle of down payments. You didn't think this through, John. You forgot to ask, what sort of unintended consequence might result from making it so buyers have no skin in the game? Hence, my initial comment to Barack: economics is not your strong suit. Misguided government attempts at allocating capital and people no more work in the United States than it did in the former Soviet Union.

Now you support propping up home prices and a $700 billion (probably more like $7 trillion) bailout, which only serves to slow down the market cleansing process. Look, John, the market will eventually find equilibrium. Supporting prices by bailing out mortgagees not only sets a bad example by teaching both borrower and lender that the nanny state will save them from their own follies; it will prolong the pain and make it even worse over the long run by digging the debt hole ever deeper. Such policies—having government take ownership positions in firms and mortgages—increase moral hazard and the misallocation of capital that has gotten us into this mess. This is not what America is about. Let badly managed firms and individuals who stretched beyond their ability to pay go bankrupt. Free people have a way of rising out of such ashes.

Now John, you may actually agree with much of what I'm saying. But you didn't defend it and certainly didn't practice it for much of the last eight years. You have been complicit in hiring the same people who helped create the economic mess to fix it. The folks who only weeks ago said that everything is fine are now heading up a trillion dollar bailout. As I mentioned to Barack, the definition of insanity is doing the same thing repeatedly and expecting a different result. Hopefully in 2012, as a member of the loyal opposition, you'll have learned to try something different.

A Good Year to Create Unnecessary Income

If you have suffered a drop in income, whether through unemployment or a decrease in business income, capital gains, rents, interest or any other income, now may be the time to act. You can convert some IRA funds to a Roth IRA or, if you think you may need funds during next year's economic slowdown and you're already in a low enough tax bracket you could withdraw some money from an IRA or other retirement plan. DO NOT DO THIS WITHOUT TALKING TO YOUR FAVORITE TAX PROFESSIONAL! Please call or write if you think you could be a candidate for this strategy and we'll work through the numbers. Obviously, while this is something to avoid if you can—especially if under 59 ½ due to the likely imposition of the 10% federal penalty in addition to the tax (and 2.5% penalty if a California residence)—we've got to be realistic about your financial situation over the near-term.

At least one client is going back to school while his industry experiences a slowdown. He is taking planned withdrawals from his IRA—some of which qualify for an exclusion of the penalty (funds withdrawn for tuition are exempt). He figures by the time he graduates, economic conditions will have improved—and he'll be worth 30% more in the marketplace than without the advanced degree. Now that's good planning!

You could also consider deferring deductions such as prepayment of property taxes, charitable donations, 4th quarterly state estimated taxes and business expenses. As I've written many times, the idea of "smoothing" income can result in substantially lower overall taxes over multi-year periods. If you are single and taxable income in one year is $17,000 and the next year it's $47,000, your federal tax is roughly $1,500 greater than if your income had been $32,000 in each year. You may not have control over this, but then again you might in unexpected ways. Who knows, you may still have capital gains left in a mutual fund or even individual stock.