

Wealth Creation Under Attack

President Obama wants to use American prosperity to further his public agenda—and is threatening that prosperity as a result.

By Francis Cianfrocca

THAT SOME should be rich shows that others may become rich,” said Abraham Lincoln, “and hence, is just encouragement to industry and enterprise.” Barack Obama has made it quite clear he wants to be seen as Lincoln’s heir. But in this instance, he is an heir in open rebellion. He is promising a range of policy initiatives that will have the effect of closing off new pathways to wealth, to the detriment not only of our economy but of our national life as well.

It’s a matter of some debate among economists whether the private generation of wealth is a necessary precondition for providing the means for a decent prosperity that can be shared by all. Clearly, there are and always have been societies throughout the world in which a small class of wealthy families controls the wealth of their nation or region and does little or

nothing to spread it around. In those cases, usually in economies that maintain aspects of feudalism or that run along mercantilist lines, the rules of the marketplace are rigged in their favor.

But what of economies organized along market principles, like ours? These are a very different matter. Milton Friedman and his intellectual forebears in the Austrian School famously argued that free-market capitalism, in which people engage in largely unregulated commercial activity that places them in active competition with each other, produces maximal prosperity for all levels of society in the aggregate.

This argument has always struck many people as a counterintuitive leap of faith, and yet over the past 30 years it has become the dominant economic view across the globe. After years in which the term “capitalism” was treated almost as a pejorative and the “free market” conjured up images of plutocrats and sweatshops, it became an axiom that “markets work.” China changed its financial course and set loose the fastest-growing economy in the history of the world when its post-Mao leader, Deng Xiaoping, declared, “To be rich is glorious”—a startling declaration for a Communist regime. In the United States in the 1990s, the party that

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had historically stood against the idea that the market should be left to work on its own was led by a President who not only embraced the idea of the free market but evangelized for it.

The financial collapse of 2008 caused Bill Clinton's activist party to awake from its market dream and reconstitute its economic philosophy around the ideas that had governed it through most of the 20th century—that the economy could and should be guided and managed by government for the betterment of all the rest. With the economy in the hands of mandarins, calamities could be averted, shocks absorbed, pain lessened, and a more even and level system brought into being. Balance would be achieved by ensuring that the system's top-heaviness should be rectified and the wealth garnered by those near the apex shifted downward to create a greater equilibrium.

American society had been for some time already organized loosely around this principle. Our tax system is progressive, which means that it takes a greater percentage from the well-to-do and an increasingly small amount from the least wealthy. The top 20 percent of taxpayers were responsible for 67.1 percent of the income-tax receipts to the federal government in 2004, up from 66.7 in 2000. The bottom 40 percent paid . . . nothing, and a substantial number of those in the lowest two quintiles actually received money from the government in the form of tax credits.

What numbers like this suggest is that private wealth generation is indeed a necessary component of social-welfare programs run by the government. It not only produces jobs, it creates a pool of money to provide the capital stock that produces the goods and services that all may consume. And not only that. The government's ability to provide social services is almost entirely dependent on the wealth produced by the private market, since the more there is, the more money will be available to the government for redistributive purposes.

This is far from the only defense of private wealth generation, or free markets. The United States is organized on the principle of the consent of the governed. Power and legitimacy do not flow from the state to the people, but the other way around. In this respect, what individuals do is entirely their own business, just so long as they do not violate the law or the sovereignty of other citizens. Generating wealth is therefore no different from any other private human activity; it is and should remain private, outside the reach of government, until the point at which it impinges on others.

This is a philosophical understanding of American society with which Obama and his policymakers are not in immediate sympathy. They are not opposed

to wealth generation; nothing they say indicates any such thing. But they do not see it as a private activity. Rather, they see it as a human endeavor that can and should be harnessed to aid in producing the social changes they believe are most beneficial for the greatest number of people. In the view of the Obamaites, private wealth is not a bad thing, but neither is it a good thing; it is only good if it can be used in furtherance of large-scale public goals.

But this understanding is deeply flawed, because it fails to take into account the factors that motivate the generation of wealth. Those who work to get rich are not doing so because they are seeking to provide enhanced tax receipts for the government, or to make it easier for government to do what elected officials and unelected bureaucrats think is best. They are, rather, fulfilling basic human desires—to excel, to succeed, to best the other person, to show the old man. Those desires provide the drive. The drive provides the wealth. The wealth provides the ancillary benefit for others. And the act of wealth creation itself creates opportunities for others. Americans pursue business and wealth for their own reasons, and we should be deeply hesitant to throw those out with the proverbial bathwater. The unintended consequences of such action could be catastrophic.

THE EASIEST way to get rich is, and always been, to be born that way. Inherited wealth is a cornerstone of American society, primarily through its highly beneficial effects on cultural organizations, the fine and performing arts, and philanthropy. But the quintessentially American way to wealth is entrepreneurship. The classic picture of a great American fortune starts with an exceptional man who founds a major enterprise, and goes on to invest in younger entrepreneurs and in charitable foundations. This storybook picture inspires many a young American. And it's largely true.

Entrepreneurship is by no means limited to men like Vanderbilt, Rockefeller, Carnegie, Ford, and Gates. Entrepreneurial efforts are not typically dedicated to amassing world-historical fortunes. Today's typical entrepreneur is looking for freedom, self-determination, and a chance to do well for himself or herself in proportion to the effort he makes. Most small, micro-, and nanobusinesses don't become Google. When they succeed, they provide a moderate amount of wealth that is greatly rewarding in itself. And besides that, they generate tax revenues and the wherewithal to participate in charitable and philanthropic activities.

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Successful small-business owners become moderately wealthy over time because they make, and save, a lot of money. A small handful of entrepreneurs become very wealthy through capital gains, by selling stock to the public or to other public companies. Yet another pathway to moderate wealth is through investing, or asset growth. In America today, much of the aggregate growth in economic productivity is ultimately captured in the valuation of the stock markets. (This includes growth accruing to American corporations through activities overseas.) Through investment activities, private individuals can and do participate in the increase of America's prosperity as a whole.

Even more important, successful entrepreneurs become community leaders outside the realm of government. The dispersion of power into what political scientists call "mediating institutions" is one of the hallmarks of American society. The weakening of this sector is perilous because it allows government to arrogate even more authority to itself without having to answer for it.

OBAMA HIMSELF has expressed sympathy for the goal of reducing income inequality on many occasions before becoming President, as in the notorious episode when he came to an Ohio cul de sac and told the man who would forever after be known as "Joe the Plumber" that he was going to raise his taxes in part to "spread the wealth around" because "it's good for everybody."

Tax policy is a key area where policy changes will powerfully impact the creation of private wealth. The administration's intentions are clearly legible in this year's federal budget, which lays out spending plans and revenue changes for the next ten years. Quite forthrightly, the budget intends to fund a vast expansion of government by heavily increasing levies on high-income earners, capital, and business income.

The increased levies will come through a new energy plan called "cap and trade," higher marginal tax rates on individuals and businesses, and adverse

rule changes that will increase the proportion of high incomes subject to taxation.

And it's clear that this is not merely pragmatic, a way of going after needed revenue. The administration sees the generators of private wealth in a new role, as the funders of an ambitious range of new spending plans, from national health care to green energy to mass transportation projects to an unspecified transformation of education.

Another burden on private capital will come from the administration's efforts to rein in the financial sector, to prevent the emergence of unhedged "systemic risk" of the kind that caused the financial collapse. To a large extent, though, such regulation is unnecessary, because global investors have already self-regulated. In the 2008 crisis, more private wealth was palpably destroyed for ultimately mysterious reasons than at any time outside of war in human history. The degree of leverage and the reliance on incomprehensible derivatives will strike future investors as terrifying anomalies from which to flee, not safe havens for easy profit toward which to flock. As a result, we now run a great risk of over-regulating finance and industry, in a classic case of closing the barn door after the horse has fled the stable.

But in the wake of the financial meltdown and the disasters that have flowed from it, the administration and certain members of Congress have seen fit to intervene directly in the affairs of individual corporations in ways that recall some of the worst abuses of power in our history. The recent actions in respect of Chrysler, the stricken automaker, are quite revealing. The administration's management of the Chrysler bankruptcy has led to an astonishingly reckless abrogation of contract law that will introduce a new level of uncertainty into business transactions at all levels, and make wealth generation more difficult going forward.

In a typical case, a bankruptcy judge or trustee will gain the power to force a company's creditors to accept less than full value for their claims, and otherwise manage the situation to produce an outcome that is as fair as possible, complies with the law, and allows the company to continue as a viable concern.

In particular, the position of secured creditors

(those who have lent money at a lower interest rate in return for a direct claim on the company's assets in case of liquidation) is generally held to be senior to that of unsecured creditors and trade claimants. That is, at any rate, what the contracts between the secured creditors and the debtor companies say.

In the case of Chrysler, the President of the United States egregiously went out of his way to take sides in the negotiation. As the holder of a \$4-billion note (soon to be more, as the government infuses more taxpayer money into Chrysler), the President is, in effect, an unsecured creditor. But Obama gave a nationally broadcast speech on April 29 in which he singled out Chrysler's secured creditors (including a group of hedge funds that had purchased Chrysler bonds) as bad actors seeking to profit unduly from a bad situation.

They were no such thing. Those who accepted the President's final offer stood to lose more than 60 cents on the dollar of their investment's par value, when the nature of the contracts they held should have entitled them to better terms. For them to hold out for a better offer was nothing more than looking out for their own interests and those of their clients—with a basis in settled law.

An extraordinary uncertainty has been created when the most powerful man in the world can rewrite contracts and choose winners and losers in private negotiations as he sees fit. Since this is an unquantifiable uncertainty, and not a quantifiable risk, its effect on business and investor confidence will be large and unpredictable. As in the 1930s, a time when government also cavalierly rewrote private contracts, the prudent approach for business will be to invest minimally and wait for another administration. The deleterious effects on wealth creation will be unambiguous.

THE NET EFFECT of Obama's alterations in the financial atmosphere will be to create an extraordinary and needless drag on private wealth creation. The drag will pull on individuals who will find it harder to increase their wealth through investment activities. And it will be felt by the few entrepreneurs in a position to sell their companies. They will find that the value of their "exits" will be lower than in past years. But what about our intrepid small businessman, who asks nothing but a fair shot at success? Here the future actually looks insidious as a result of tax policy changes.

The administration points out often that it wishes only to raise marginal income tax rates to the levels that prevailed during the Clinton years. But the

amount of deficit spending it proposes is breathtakingly large. This year's federal budget is likely to consume almost 25 percent of GDP, a proportion far in excess of any prior peacetime budget. And the spending will have to grow as government is called upon to fund not only its new spending initiatives but also the coming commitments to retiring baby boomers.

Obama will need new revenue sources to pay for some of this. So far, he has disavowed raising taxes on the middle and lower classes. That can only mean very sharp increases in taxes on the highest earners, who in many cases are America's entrepreneurs, ambitious to achieve moderate personal wealth.

Using very rough numbers, the top 5 percent of earners today generally pay approximately 25 percent of their incomes in taxes to all levels of government. If Obama enlarges government on the scale he has announced he will—around five percent of the annual gross domestic product per year—without increasing the deficit beyond where it is this year, then the federal government will need to find another \$700 billion in revenue per year (in today's dollars). That \$700 billion is approximately the total amount of income tax collected today. (Roughly the same amount is garnered in payroll taxes.)

That demand will increase the average overall tax take on high-income individuals to well over 30 percent of their total income, and possibly as high as 40 percent. In other words, Obama may be increasing the tax burden on the upper bracket by 20 percent at a bare minimum and maybe as much as 45 percent. Such a burden will put the goal of private wealth out of reach for many. Even worse, it will make it even more difficult to fund the expansion of small businesses, which generally must be done out of retained earnings. That, in turn, will mean that the overall rate of employment growth in the private sector will slow.

The systematic pursuit of policies that create a series of impediments to private wealth creation is a fast road to disaster, especially given the coming explosion in entitlement costs as the baby boomers begin to access Social Security and Medicare. One way or another, we must find a way to expand total economic production simply to cope with the carrying costs.

More generally, the United States under Barack Obama may be taking a hatchet to a pillar of the American social contract, which is that Americans should be free of encumbrance in their pursuit of private wealth. The pursuit of prosperity made America the most prosperous nation on earth. The excessive pursuit of fairness at the expense of wealth creation will not make America fairer. It will, however, make America poorer—and less free. 