



# FACTS & OPINIONS

*On Public Interest Issues*

## Quotes

There is no art which one government sooner learns of another than that of draining money from the pockets of other people.

—Adam Smith

I absolutely believe that the most bloated, obscene, blubber-infested bureaucratic institution that has ever existed is indeed the Internal Revenue Service.

—Ted Nugent

This is the way liberals always avoid taking action against other liberals. They furrow their brows and dutifully register some vague consternation, for which they expect great admiration. With their impeccable consciences duly placed on the record, they believe no further action should be required of them.

—Ann Coulter  
Syndicated Columnist

## The Legitimate Role of Government in a Free Society — Part I

Walter E. Williams

What did the founders of the United States see as the legitimate role of government? To answer that question we should turn to the rule book they gave us: the United States Constitution. Most of what they considered legitimate functions of the federal government are found in Article 1, Section 8 of our Constitution, which says, in part: “The Congress shall have the Power To lay and collect Taxes, Duties, Imposts and Excises, to pay Debts and provide for the common Defense and general Welfare of the United States...To borrow Money on the credit of the United States...To regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes...To coin money...To establish Post Offices and post Roads...To raise and support Armies.” The framers granted Congress taxing and spending powers for a few other activities, but nowhere in the

Constitution do we find authority for up to three-quarters of what Congress taxes and spends for today. There is no constitutional authorization for farm subsidies, bank bailouts, or food stamps — not to mention midnight basketball. We have made a significant departure from the constitutional principles of individual freedom and limited government that made us a rich nation in the first place. These principles of freedom were embodied in our nation through the combined institutions of private ownership of property and free enterprise, both of which have suffered devastating attacks and are mere skeletons of what they were in the past.

Private property performs at least two important social functions: it encourages people to do voluntarily what is in the social interest, and it minimizes the coercive power that one man or the state can have over another. And it performs these functions

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## FACTS & OPINIONS

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Dr. Don Racheter

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## What's New at Public Interest Institute?

**David Hogberg**

In November 2000, Public Interest Institute Research Analyst Arlan M. DeBlicek delivered a speech at the Iowa Good Roads Association Conference. His speech emphasized the virtues of the free-market and the disadvantages of a centrally managed energy policy. He placed the speech in a historical context by reviewing the failed 1970s centrally managed energy policies of the Nixon and Carter Administrations.

Many of the speeches preceding Arlan's were followed with negative comments about road funds being held hostage if Iowa did not pass a ".08 Blood-Alcohol" law. Upon hearing these remarks, Arlan decided to include some remarks on federalism in his speech. He explained that the U.S. Constitution limited the powers of the federal government, and that states' powers were numerous and unlimited. He further explained that federalism was also competition between governments, particularly "state vs. state," and "state vs. the federal government."

His speech was well received by the audience and drew lots of questions. It even drew a few new memberships for PII.

*David Hogberg is a Research Analyst at Public Interest Institute.*

## Focus on Iowa Wesleyan College

**Shelley Doak**

Two recent initiatives undertaken by Iowa Wesleyan College are now producing results. The first is the Title III Grant: *Improvement of Retention by Strengthening Academic Programs through Technology* which disburses more than \$1 million over five years to make technological improvements on campus. Due to the grant, both residence halls now have phone service and computer drops in students' individual rooms. Other recent beneficiaries include 45 faculty offices that have been upgraded with new computers, and various computer labs around the campus that have been upgraded with top-of-the-line Dell computers. Future improvements include upgrading the main web server to offer on-line courses and 24 hour Internet access for students and faculty.

The second initiative involves efforts with the United Methodist Church and the Ada S. McKinley Center of Chicago to recruit more Latino and African-American students. These efforts have resulted in more minority students attending IWC than ever before. This initiative has improved minority enrollment of full-time students from 14 percent to 21 percent.

*Shelley Doak is Public Relations Director at Iowa Wesleyan College.*

## The Legitimate Role of Government — Part I

Walter E. Williams

*In a free society, most relationships should be voluntary, and involuntary exchange should be minimized. Widespread private control and ownership of property is consistent with this objective.*

*Walter E. Williams is the John M. Olin Distinguished Professor of Economics at George Mason University, author of a syndicated newspaper column, and a radio talk show guest host.*

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without appeal to beneficence.

I do not care much about future generations. After all, what has a child born in 2050 A.D. ever done for me? My actions, however, do not reflect this personal sentiment. Several years ago I planted young trees on my property and made other improvements. I will be dead by the time the trees mature. A child born in 2050 A.D. will enjoy the fruits of my sacrifices. I could just as easily have spent the money for steaks and fine Bordeaux wine, which I would have fully enjoyed all to myself.

Why did I make these improvements to my property? At least part of the reason is that I will get a higher price when I sell the property if its quality is higher and it can be expected to provide housing services for a longer period of time. By pursuing my own interest, I made it possible for future generations to have a nice house. Would I have had the same strong incentive if the government owned my house? Obviously not.

Look around the world: you will see that what receives the least care tends to be commonly owned; that which receives the best care tends to be privately owned. In free markets one's personal wealth is held hostage to socially responsible behavior.

To take another example, the citizens of New York derive their daily meals not from the benevolence of the Missouri farmer (who may in fact hate New Yorkers), but because it is in his own private self-interest to supply them. Most

things get done because of self interest and private property rights.

In a free society, most relationships should be voluntary, and involuntary exchange should be minimized. Widespread private control and ownership of property is consistent with this objective. Despite the size and alleged power of industrial giants like IBM, AT&T, and General Motors, in a free market they cannot get a dollar from me unless I volunteer to give it to them. Widespread government ownership and/or control of property is the antithesis of voluntary exchange. Government is the major source of forced exchanges, the most prominent of which is taxation.

Anything that weakens the institution of private property interferes with the attainment of the socially desirable outcomes just described. Taxes represent government claims on private property. As taxes rise, you own less and less of what you earn. If the tax rate were ever to reach 100 percent, the government would have destroyed private property, and you would own none of what you had earned.

Keep in mind that a working definition of slavery is that you work, but do not have any rights to the fruit of your labor. Taxation and regulation constitute the confiscation of some or all of the freedom to own and use property. This confiscation has reached unprecedented proportions.

In 1902 expenditures at all levels of government totaled \$1.7

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# The Legitimate Role of

G o v e r n m e n t — P a r t I

Walter E. Williams

*Free enterprise...is  
threatened today not  
because of its failure, but  
somewhat ironically,  
because of its success.*

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billion, and the average taxpayer paid only \$60 a year in taxes. In fact, from 1787 to 1920, federal expenditures never exceeded 4 percent of the Gross National Product (GNP), except in war-time. Today federal expenditures alone are \$1.8 trillion — almost 30 percent of GNP — and state and local governments spend over a trillion more. The average taxpayer now pays more than \$8,000 a year, working from January 1 to May 8 to pay federal, state, and local taxes.

In addition to the out-of-pocket cost, Americans spend 5.4 billion hours each year complying with the federal tax code — roughly the equivalent of 3 million people working full time. If it were employed in productive activity, the labor now devoted to tax compliance would be worth \$232 billion annually. The federal cost of hiring 93,000 IRS employees is \$6 billion. If these Americans weren't fooling around with the tax code, they could produce the entire annual output of the aircraft, trucking, auto, and food-processing industries combined.

*The second half of  
Walter E. William's speech  
"The Legitimate Role of  
Government in a  
Free Society,"  
will appear in the  
May 2001 issue of  
Facts & Opinions.*

*For other works by  
Walter E. Williams  
published by  
Public Interest Institute, see  
"How Regulation and  
Taxation Stifle  
Entrepreneurship,"  
in the August 2000 issue of  
Facts & Opinion.*

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## The Power of Compounding and Social Security

Matt Moore

*Increasing numbers of Americans understand the importance of investing and the value of compounding — more than 48 percent of Americans own stock.*

*Matt Moore is a Policy Analyst at National Center for Policy Analysis.*

Albert Einstein called it the greatest mathematical discovery of all time. Benjamin Franklin supposedly said it was the eighth wonder of the world. Master-Card, Visa, and American Express use it — with devastating effects for unwary cardholders. The tool is compounding, and if harnessed correctly, it can save Social Security while ensuring a safe, comfortable, and secure retirement for even the lowest-income Americans.

Investing money in an asset on which the gain or interest is compounded, such as a mutual fund or a savings account, is more beneficial than hiding the money under a mattress — that much is common sense. Consider the example of the ant and the grasshopper from Aesop's fable.

\* The ant, recognizing the importance of saving, starts at age 25 and invests \$1,000 for 10 years in a portfolio that earns 5.5 percent a year. At that point, she stops contributing. But her investment continues to grow; and when she reaches 67, it is worth \$75,352.

\* The grasshopper, who spends his money in early years, doesn't start investing until age 45. In order for him to make the same amount as the ant who started investing 20 years earlier, he will have to invest almost \$1,750 a year for 22 years to catch up.

This example demonstrates the value of compound interest. The investor not only earns money on his initial investment,

but in subsequent years earns money on previous years' earnings as well. Increasing numbers of Americans understand the importance of investing and the value of compounding — more than 48 percent of Americans own stock.

Compounding can best be demonstrated with a long-term investment such as retirement savings. If you tuck away a percentage of your paycheck every month — and leave the money alone — compounding can work its magic.

\* A worker invests \$800 in his retirement account each year beginning at age 24, and it earns an average return of 8 percent a year. His total contributions by the time he retires at age 67 are only \$34,400. But his whole investment will have grown to \$284,760. If his employer matches his contribution, the worker will have \$569,520 at retirement.

\* Another worker invests only \$500 a year beginning at age 21 in a conservative portfolio that earns 8 percent interest a year. Her actual contributions by age 67 total only \$23,000, but her whole account will have grown to \$225,950 by the time she retires.

These examples are simple. They do not reflect wage increases over the workers' lives, nor do they take offsets like taxes or inflation into account. But they do demonstrate that, coupled with a prudent long-term investment strategy, compounding dramatically increases the amount of money an individual can earn over time, even on small investments.

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## The Power of Compounding and Social Security

Matt Moore

*[I]f younger workers were given the opportunity to invest a portion of their payroll taxes in personal retirement accounts, which incorporate the power of compounding, we could avert the need to substantially raise taxes or cut benefits in the future.*

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Under the current system, surplus Social Security taxes are either spent as they are collected or used to reduce the federal government's debt. If we continue on the current path we will be forced to reduce benefits by nearly a third or raise taxes by as much as one-half. However, if younger workers were given the opportunity to invest a portion of their payroll taxes in personal retirement accounts, which incorporate the power of compounding, we could avert the need to substantially raise taxes or cut benefits in the future.

Each dollar in an individual's private account would represent a reduced claim on the government for Social Security benefits at retirement. (The offset depends on the particular plan adopted — some would reduce the Social Security benefit, for example, by 75 cents for each dollar in the individual's account.) Once all retirees are drawing benefits from individual accounts, Social Security's spiraling costs will be contained, and the program's multi-trillion dollar unfunded liability will be reduced. Granted, there will be some short-term adjustments between now and the time the first accounts mature.

By taking advantage of compounding, workers can retire on a greater benefit than Social Security can provide. And unlike Social Security, the personal retirement account will become part of a worker's estate.

The following examples were calculated using the NCPA's Social Security Calculator at

<http://www.mysocialsecurity.org>.

These examples show how much better off workers would be if Social Security had been restructured to take advantage of compounding and workers had been allowed to invest the retirement portion of their Social Security taxes (10.6 percent of the 12.4 percent tax) in a personal retirement account.

\* A 23-year-old elementary school teacher making \$22,000 can expect to receive a \$1,590 monthly Social Security benefit — if Social Security is able to pay her full benefits when she retires. If she had invested the same tax money in a personal retirement account, she could have a \$3,726 monthly payment from a retirement account worth \$459,257.

\* A 30-year-old welder earning \$35,000 can expect a \$1,528 monthly Social Security benefit. If he had had the opportunity to invest in a private account, he could have a \$6,614 monthly payment from an account worth \$690,022 at retirement.

\* A 28-year-old receptionist making \$18,000 can expect a \$1,002 monthly Social Security benefit. If he could invest the same tax money in a personal account, he could instead receive a \$3,234 monthly payment from an account worth \$338,258 at retirement.

In all three cases, the workers would fare better under a system that takes advantage of compounding. Such a system would provide a larger retirement benefit for workers, and the benefit would be their property to keep, spend, or pass on to heirs.

## When the Going Gets Tough...

Matthew Mitchell

*Arizona and New Mexico have in common a past political affiliation, a shared birth-year, similar climates, geographic size, natural resources, and comparable demographics. Nevertheless, the states are on very different economic paths of growth.*

*Matthew Mitchell is a Research Assistant at Goldwater Institute. Reprinted with permission from Goldwater Institute.*

In 1913, the United States finally mustered enough misguided gumption to pass the 16<sup>th</sup> Amendment to the Constitution, legalizing a federal income tax. As Jude Wanniski noted, the timing “does not seem entirely coincidental.” It was just a year earlier that New Mexico and Arizona entered the union, closing the frontier, and with it, any escape from onerous federal taxation. Nearly a century later the old frontier is still a haven for tax relief. Well, most of it anyway.

If we narrow our focus on what was once the New Mexico Territory, we find an interesting story. Arizona and New Mexico have in common a past political affiliation, a shared birth-year, similar climates, geographic size, natural resources, and comparable demographics. Nevertheless, the states are on very different economic paths of growth. The sun that bathes the Arizona desert had brought with it 114.5 percent growth in personal income per capita during the 1990s. This bests the national average of 113.7 percent growth as well as New Mexico’s 113.5 percent rate. New Mexico ranks 48<sup>th</sup> in the Union for per capita earnings. Arizona’s rank of 35<sup>th</sup>, on the other hand, is nothing to brag about. It lies somewhere between New Mexico’s dismal performance and the remarkable prosperity of the region as a whole (most of the others in the Southwest are in the top 20, and a 120 percent growth in per capita income is not uncommon).

So, what is it that makes New Mexico, a beautiful and diverse state — similar in so many ways to Arizona — lag behind the country and, particularly, the region? What is it that allows Arizona to perform better than New Mexico yet keeps her from achieving the success of her neighbors? One explanation is taxes.

New Mexicans endure the most oppressive income tax rates in the region, with the average resident forking over 12 percent of his or her earning to the state and local tax collectors. This is higher than the national average for state and local taxation of 11 percent and well above the regional average of 10.7 percent. What is particularly interesting about these statistics is the way that they are calculated. We would expect states like New Mexico to have lower “average” tax burdens than the others since their residents do not, on average, earn as much money as citizens of other states, and are therefore not shoved into higher tax brackets. So when we see that a relatively poor state like New Mexico has the 7<sup>th</sup> highest “average” state and local tax rate in the country, we should be particularly alarmed.

How does Arizona stand in the tax comparison? After a decade of tax cutting, the rate on the average taxpayer is 10.8 percent. This makes the state the 33<sup>rd</sup> highest taxed in the country. Like her average earnings, the rate lies somewhere between New Mexico’s procrustean rates and the region’s low 10.68 percent average — a number brought

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## **When the Going Gets Tough...**

**Matthew Mitchell**  
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down by states like Nevada and Colorado whose average citizen pays less than 10 percent.

Perhaps we have yet one more not entirely coincidental statistic: people have poured into Arizona — as they have nearly everywhere in the Southwest. You can chalk it up to the dry heat and ubiquitous sun, but New Mexico, with its high mountains and lush forests, offers this and more. Nevertheless, there seems to be some reluctance to relocate

to the Land of Enchantment. Throughout the last decade, Arizona has seen nearly 600,000 people move in from other states. During the same period, New Mexico had just 40,000 trickle in. Arizona saw more than that just last year, a year when New Mexico actually lost residents to other states.

The Southwest as a whole is on the frontier of tax cutting and the people seem to be voting with their feet, stampeding to the tax havens. When the dust settles, policy makers in New Mexico might do well to pay attention to the “election” results.

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