

## Chapter 1

### What Is Capitalism?

Naturally, if we are going to have an intelligent discussion as to why capitalism is the best system, we need to have a working definition of exactly what capitalism is. Well, the way I like to think of it, is, “it is an economic system where two consenting adults can enter into any exchange of goods or services so long as it is within the bounds of the law”. I am sure that there are countless economic textbooks that will give you a more technical definition, but I am just trying to give a definition that better fits into the situations we run into in everyday life.

Of course, within this definition, what exactly does “legal” mean? This is not intended to be a facetious question, but something that is critical to what I will be discussing in this book. While it may be tempting to say that what is legal is whatever the government says it is, I will repeatedly come back to the idea that the government is either overreaching or unclear when saying what is legal. So, I say that what is legal is whatever falls within the bounds of the Constitution.

I know, I know, the Constitution was written by a bunch of slave-owning, rich white guys from a bygone era to establish a set of rules that no longer apply to our “modern, evolved, sophisticated society”. While you may not agree with what the Constitution says, I ask, “what should the rules that we live by be?” See, the Constitution is intended to be a set of objective rules that we as citizens of the United States agree we will live by. A contract between the governed, if you will.

It is kind of like people getting together to play football and agreeing that a touchdown will be worth 6 points, a field goal will be worth 3 points, etc. Before you start the game, you can set these values at whatever you wish, but once the game starts, everyone that is playing is expected to abide by this set of rules. If they do not like the rules, they can always stop playing. In this case, that would mean moving to another country.

The real genius of the Constitution is that the founding fathers realized that they were not omniscient and also that times and circumstances change. Therefore, they provided a process for amending the Constitution if there is enough of a change in the beliefs of the people to ratify an amendment. While I feel this was a critical aspect of the Constitution, I think this also plays into the constant debates as to whether it is a “living document”.

My take on it is that it IS a “living document” in the sense that it can be changed/amended by following a specifically laid out process. It is NOT a “living

document” in the sense that it can be interpreted based on whatever the judge feels on any given day. If it DID mean the judge could “interpret” it any way they want, why even write it out at all? Why not just say that judges can decide whatever the law is based on their personal whims?

Going on a bit of a tangent here, it drives me crazy when some people argue that “nowhere does it say capitalism in the Constitution”. That is true, but nowhere does it say socialism either! Plus, if you examine what the Constitution was attempting to do, which is to put strict limits on the power of the federal government, does that go more with a capitalist economic system or a socialist economic system?

Regardless of whether the Constitution is a “living document”, some will argue that they were not alive when the Constitution was written and that they never had a say in it. While that is true, the Constitution is easily accessible and you can feel free to read through it and see if you believe in this set of rules. Again, if the rules are not to your liking, you can feel free to go somewhere where the rules are more to your liking.

It is always strange to me how a lot of people immigrate to America from other countries and then promptly try to change the rules/laws of America towards what the laws of their former country were. If you liked those laws so much, why did you come to America in the first place?

Now before you accuse me of being a racist old white guy who wants to go back to the days of slavery and prevent all immigration, let me give you a bit of my own backstory. I actually was not born in America and moved here from Taiwan when I was 4. Never when I was growing up was there talk of, “well those were not the rules in Taiwan so we just won’t follow them.”

Again, my parents voluntarily chose to come here. This comes with an implicit acknowledgment that there is something that is better about America to justify moving halfway across the world and leaving your entire family behind. Not to mention that English is not even your first language and you have to try to pick it up in your 30’s.

As a certain prominent political figure likes to say, “let me be clear”. I am NOT saying that immigrants have to abandon all of their beliefs and traditions just because they moved to America. However, if your beliefs are in direct conflict with the Constitution, then the Constitution has to win. This is actually kind of a roundabout definition of the “American Dream”. That is, you can accomplish anything and believe anything you want so long as you are willing to work hard and do not affect anybody else (maybe it is better to say “have as little effect on other people as possible” after all, merely by existing, we take up space/consume food/goods that other people could use, so there is no way to be totally isolated).

This is why I feel capitalism is so intertwined with the American Dream. It is because capitalism is based on VOLUNTARY transactions between two consenting adults. I am guessing some will argue that not all transactions are voluntary because you have no say in how much people charge for certain goods and services.

Well, that is true, but you do have a choice as to whether you want to buy that good or service from that particular person. The next argument will likely be that there are such things that you have no choice whether to buy or not, such as food, water, health care, etc. This is where I feel a fundamental misunderstanding of capitalism has taken root.

A key principle of capitalism is that prices are set by supply and demand. Yet somehow people seem to think that goods that everyone needs should be cheaper. Let me clarify a little. In the case of food, EVERYONE needs food. This essentially means demand is infinite, which directly translates to higher prices.

Of course, this may go against what some may feel is “morally justifiable”. So let’s delve a little deeper into this analysis. Is it unfortunate/tragic that some people cannot afford food? Of course, but what is the solution? Do you think that our ancestors had a lower standard of living/had to struggle to feed themselves by choice?

The reason that we can afford so many of the conveniences of modern life is because of the productivity gains due to technology and human ingenuity. This has allowed more food to be produced, meaning that there is enough supply to meet the demand to make food as cheap as it is. That is, people used to have to spend a much larger portion of their income on the basic necessities and had much less discretionary income.

Now, because of the aforementioned productivity gains, food has become (relatively) cheap so people have enough discretionary income to buy plasma TV’s, iPods, etc. So, if your income falls, you are supposed to cut back on your discretionary spending so you can still afford to pay for the basic necessities. Instead, popular culture has corrupted this concept and people now seem to think that it is up to the government to make sure their basic needs are met so they can continue to afford plasma TV’s, iPods, etc.

Also, if you are going to argue that it is immoral to charge someone for food, isn’t it immoral to charge someone to watch a sporting event? To watch a movie? To go to a concert?

Some may argue that any form of entertainment requires the labor of the performers and they deserve to be compensated. Fair enough, but food represents the labor of farmers and everyone else along the chain to make it available to you at your local

grocery store. So why do the labors of farmers not deserve to be compensated? This leads into another concept that drives me absolutely crazy.

The notion that working for a paycheck is something to be ashamed of is something I feel is the worst corruption of the principles of capitalism. Something you will probably notice throughout the course of this book is that I have a beef with how Hollywood and the entertainment industry have fostered a hatred of capitalism.

This is ironic because, if it was not for capitalism, all these “stars” would not have the wealth or the platform to make these statements. I think this notion of “selling out” is something that has largely been created by the entertainment industry and it is just a horrible example of hypocrisy.

So, “selling out” means that actors or musicians have given up their artistic credibility because they only take certain roles or perform certain songs because they know that they will be commercially successful. The reason they chose to join the entertainment industry is because they wanted to perfect their “craft” and it has nothing to do with the money, right? Okay, if that is true, then why don’t they perform for free?

Nothing prevents any of these “stars” from taking a vow of poverty and not taking any material gains from their jobs. Or, if they feel that the government is better at managing money than the private sector, then why don’t they take their multimillion dollar salaries and then hand them over to the government?

Another sad, comical aspect of the grandstanding by the entertainment industry is how often they say the rich “need to pay their fair share” and they want the government to tax them more. Then, they turn around and give so much of their money to private charities.

The more cynical may say they give to charities because it gives them a tax write-off (another contradiction). Let’s give them the benefit of the doubt though and say that they are donating to charity because they truly want to help the less fortunate. Well, wouldn’t the government be a better steward of that money than a private charity?

There is a question I have wondered since I recently took an income tax course and plan to prepare taxes in 2012. As an aside, I’m sure some readers might feel this makes me hypocritical as I want lower taxes and yet am getting paid to prepare tax returns. In this case, I am playing the hand I have been dealt in that there is a tax system and people need help navigating it. If they were to abolish the IRS entirely, that would be fine with me. If that is not satisfactory reasoning, again, I can handle the criticism. Anyways, do you remember when the Vietnam War was at its least popular and there were gatherings where people would burn their draft cards as a way to protest the government? Are there equivalent gatherings in Hollywood when W-2’s come out

where millionaires get together and burn their W-2's because the federal government did not withhold enough of their money in taxes for that year?

Also, why is there not a box on the 1040 (regular, A, or EZ to be specific) that says, "check this box if you want all of your tax refund donated to the federal government? The point is, the vast majority, if not the entire population, only worry about reducing their tax liability and they do not EVER try to find a way to pay MORE taxes. So, when I see these people who actually ask the government to raise their taxes, SPARE ME!

To elaborate on this point, you may have heard in the news recently how Warren Buffet feels that taxes on millionaires should be increased. That he is paying at a lower tax rate than his secretary and he wants his taxes raised.

There are several reasons why this is disingenuous at best (assuming he doesn't understand the tax code, which doesn't make much sense considering he is hailed as a business genius), and outright lying at worst. First, there are no laws preventing people from voluntarily paying MORE taxes than they owe.

You can always choose to not claim all your deductions/credits and increase your liability on your tax return. The IRS does not perform audits on people who pay MORE than they are required to. If you want to get really adventurous/compassionate, you can also cut a check to the IRS for more money than you owe on your tax return.

So, I think it is already clear that Warren Buffet is grandstanding when he says he wants his taxes raised. Here is the REAL coup de grace to his argument though. Check out this website: <http://www.gatesfoundation.org/about/Pages/implementing-warren-buffetts-gift.aspx>

I apologize that it is such a long URL and there is no way for you to copy and paste it. I do think it is worth your time to check it out and verify what I am saying though. Once you have reached the website, scroll down to the section "The future of the gift" and read the second bullet point as it is absolutely priceless.

If you do not have a computer/internet access handy, I will summarize what this says. First, Warren Buffet has donated over \$1 billion to the Bill & Melinda Gates Foundation (a PRIVATE CHARITY) upon his death. This alone is already hypocritical. Say that he wants to pay less in taxes when he is alive, wouldn't the government benefit more from that money once he is dead and taxes no longer affect him? The real gem is that in the aforementioned second bullet point, his donation to the foundation is contingent upon the fact that it is considered a "charitable donation" and therefore, drumroll please ..... EXEMPT FROM TAXES!!

Truth really is stranger than fiction. Here is someone who lectures “the wealthy” on not paying enough taxes and then ties strings to a donation that has to be kept tax exempt or else he will withdraw the donation. On top of all that, he is cited by Obama as a compassionate humanitarian who wants to “pay his fair share” and others should step up and follow suit. It would be funny if it wasn’t so infuriating.

Now let’s go back to the “selling out” concept. There is also this glamorized, romanticized story of the actor/entertainer who “paid their dues” by working as a waiter or some other “dead end job” while waiting for their big break. Just because they did this, they deserve all the wealth they get when they hit it big.

First, what is so degrading about working as a waiter? After all, championing the “average Joe” is something entertainers love to do, so why is it “paying dues” to work as a waiter? More importantly, is it somehow less noble for a person to work a part time job to put themselves through medical school? What if that same person has to take out a huge amount of student loans to become a doctor? Do they not deserve their salaries when they finally become doctors? Did they not “pay their dues”?

Going beyond just Hollywood to any other people who think that working for a paycheck is beneath them, I have a simple question. Let’s say tomorrow you showed up at work and your boss told you, “You know what, this ‘work’ thing is overrated. From now on, I’ll pay you your salary regardless of whether you come to work or not.” Would you still go to work every day? Or on the flipside, your boss says “Money is inherently evil, so you still have to come to work every day but I will no longer pay you.” Would you still go to work then?

From my personal experience, I have run into plenty of people who complain about how bad their job is when they ARE getting paid. I can’t begin to imagine what these people would be like if they were told they had to work just for “the good of the collective”.

Another insidious side effect of this whole “selling out” concept is that it has become ingrained in several generations now that “job satisfaction” is most important. Don’t get me wrong, there is nothing wrong with working hard and preparing yourself to try to get a job in a field you really enjoy and do not necessarily see as “work”. The problem arises when people start feeling that a satisfying job is owed to them.

I don’t want to cite any particular occupation for fear of seeming to single any one out, but do you think that most “blue collar workers” go to work for the intellectual challenge/stimulation of it? No, they go because they want to be able to feed themselves/their families. To me, it is MORE noble that a person will go to a job every day that they do not particularly like because they feel it is their responsibility to EARN a living.

Also, I'm sure some people try to make the best of the situation. That is, they would rather be at home with their families, but because they have to work, they try to approach it with a positive attitude. There is a BIG difference between trying to make the best of it and saying that people should go to work solely for the fun of it.

Let me switch gears a little bit now. Not to be too topical, but the Occupy Wall Street movement has been in the news quite a bit lately. People love to point to Wall Street as an example of capitalism run amok and how intrinsically evil it is. It is a little ironic that they feel that government needs more power to police Wall Street. Then the government has the police come dressed in riot gear and use pepper spray to break up the crowds. I thought the government was totally benevolent and "looking after the 99%".

Still, I do identify with the Occupy Wall Street crowd in a few ways. Mainly, Wall Street is not really a capitalist system anymore. The initial concept of Wall Street was that the "average person" did not have the time nor the knowhow to study the balance sheets and business models of public companies. Despite this, the "average person" may have capital they wanted to invest.

To buy shares in the sound companies to get a greater return on them than just putting their money in the bank, they needed someone more experienced with the stock market. This would in turn lead to a "virtuous cycle" where the best companies would get additional capital to expand their businesses. In the end, this would make everyone a winner because society would get more goods and services from a quality company.

Was this done out of altruism? No, the incentive for the stock broker to only suggest quality companies was their own reputation as a stock broker. If they consistently recommended bad companies, their clients would tell their friends and family how much money the broker lost them and they would not keep getting new clients. Is this a perfect system? No, because to separate the quality advice from the bad advice, some people have to lose. However, as my dad used to tell me in my more naïve days, it is not a question of whether capitalism is perfect, but whether there is something better.

This is where the notion of the SEC and government regulation came in. That is, if we rely on reputation to separate the wheat from the chaff, this is not an instantaneous process. Not being instantaneous, unfortunately, some people have to lose. So, can't the government come in and guarantee a certain level of quality for ALL brokers, so no one gets REALLY bad advice? On the surface, this sounds great, and if this truly worked, I would be all for it. The problem arises when the government tries to determine what a "quality broker" means.

This is another concept I will be coming back to over and over again. The government is not omniscient! So, the only way they can try to determine a "quality broker" is by

administering some sort of test. Okay, so what do you put on the test? Is there some divine set of questions you can ask to determine how good a broker is? You can certainly test if they have a grasp of certain concepts critical to the financial industry, but does that mean they can apply those concepts and give good advice?

Also, from my personal experience, when a person knows that there is a certain test they have to pass to be certified for something, they do put a lot of effort into preparing for the test. However, once they have passed the test, they think they can just erase all of that from their mind. (Being a lawyer five years removed from the bar exam, I can GUARANTEE you that lawyers could not tell you everything that is tested on the bar 2-3 years after they take it, if even that long). After all, they have now been stamped “quality broker” by the government, so all their learning is done, right?

This is the beauty of the reputation test. It is constantly adapting to changing conditions in the world. So, even if you had a great grasp of the best stocks 5 years ago, maybe the market has changed and you have not kept up with the changing times. Rather, you have not kept up enough with changing trends relative to your peers. There is no way for a certifying test to keep up with these changes!

This government test standard also has the perverse incentive of discouraging people from trying to keep up on changing trends and giving the most cutting edge advice. I think of it as turning what should be an A-F grading scale to a pass-fail system. That is, if you do constantly study the market AFTER you have passed the test, you cannot get any credit for this. This is because if you are giving advice radically different from other people that have passed the test, you can be accused of taking crazy risks. By their very nature, the cutting edge of trends and ideas goes against the grain of traditional thinking.

In contrast, if you use the A-F system, taking a chance and recommending what you think is a cutting edge idea/business, if you are right, this gets you rewarded with an “A reputation”. You foresaw the trends before everyone else and word could get around that you led people the right way/made them a lot of money. If your foresight is wrong, then you get an F. So brokers have every incentive to do their due diligence and only advise a long shot investment if they really do believe in it. With the government standard, they can give the long shot advice because if it pans out, they did a great job. If it does not pan out, well, the government said that they are a “qualified broker” so just because they were wrong this time has no bearing on whether they will be wrong next time, right?

Let me digress a little bit on this point. After the financial collapse of 2008, it was trotted out constantly that “there was no way to foresee the collapse” and that it was not the fault of any of the brokers who failed to advise their clients they should stay away from



the housing bubble. Wait a minute. I thought the reason you pay a stockbroker is because you are paying for their knowledge of the markets and it is precisely their job to try to foresee these collapses. Are they always right? No, but that is what separates the quality brokers from the bad ones. If it is truly impossible to foresee bubbles, then why pay a stockbroker at all? If the stock market is just based on a series of random events, then why not just throw darts to make your stock picks?

I have heard bandied about a bit of a conspiracy theory that Wall Street was colluding with the government to create the housing bubble so they could rob Main Street. From my own experiences in just trying to coordinate a small group of people to focus on a single goal, I have a hard time believing that. It is just hard for me to imagine so many different companies with their own agendas getting together to come up with this plan.

HOWEVER, I do feel that once the calamity of the financial crisis of 2008 occurred, Wall Street DID “close ranks”. That is, they figured that if they ALL said that this was unforeseeable, then it justified the fact that they did not warn their clients and so none of them were at fault. Sort of the, “we all did it and you can’t punish everybody” logic. On top of this, they also had the fallback of saying that they were certified by the government so they had to be giving good advice.

So, at this point, I am sure some readers will accuse me of being too idealistic in thinking that the market can regulate itself solely based on the brokers trying to protect their reputation. But is this really that crazy? Think of your everyday life. Do you decide who you are going to associate with as friends or who you are going to marry based on the government telling you who is “good enough” to associate with? No, you base these decisions on your experiences and knowledge and your own opinion as to their character. Again, this is not a foolproof system and I know that personally I have been wrong on these judgments several times. The mistake is thinking that the government is quick and efficient enough to “weed out” these people before you do.

Also, I want to briefly discuss a theory I have that may explain why the “reputation test” does not work as well as one would hope. The theory is that there are essentially two types of people in the world. Type 1 is the kind of person, who, as a result of being burned or swindled or the victim of some tragedy they want to do their best to prevent others from having to go through that same pain. Type 2 is the kind of person who feels that, “I got swindled, so I will only be happy if as many people as possible have to go through the same pain I did”.

Capitalism works best when most people are type 1 people who will spread the word if they get a bad deal. It is also critical that they spread the word if they thought they were treated exceptionally well. The same filter mechanism does not work if most people are

type 2 people who keep quiet about being tricked. I personally still choose to believe that most people are type 1's. If I am wrong about that, I think society will have a lot of problems to worry about beyond just the economy.

Another reason that the "reputation test" is not perfect is because of, what I feel at least, a growing sentiment where "nothing is ever good enough". That is, if someone does a bad job/gives you poor service, people have no problem telling everyone how bad that person/establishment is. If you do a good job/provide excellent service sometimes people take that for granted and do not mention it to anyone else. Worse yet, even if someone does a GREAT job, some people will just say, "meh, they could have been better".

Again, capitalism works best when people act like reasonable adults and are willing to give credit where credit is due. Not just blame when blame is due (or even not due in many cases).

Maybe the best example of how the "reputation test" has been corrupted to some extent is the attitude that "any publicity is good publicity". Again, in a perfect world, if you got publicity for doing something stupid/horrible, you SHOULD be ostracized and no one should frequent your business or buy anything associated with you. Unfortunately, there will be a certain percentage of people who will actually support you. Why?

Some people may feel sorry for that person, feel the media is being unfair, any number of factors. The problem is, if 100-200 million are seeing this news, and just 1 or 2% support that person, that can still be a substantial amount of money. In fact, it pretty much becomes a good business strategy for someone to do something just to get them in the news.

Maybe part of this is using the "sticking up for a friend even when they are wrong" philosophy. Personally, I think this philosophy makes no sense and let me clarify. It is one thing if, say, a friend you have known for a long time is accused of a heinous crime. You believe they are innocent because that does not jibe with their character that you have seen. HOWEVER, this is a "benefit of the doubt" situation because you do not KNOW if they committed the crime.

If they come out and ADMIT to doing the crime, should you still stick by them? Remember, the reason you initially stuck by them was because what they were accused of does not square with the person you know. If they actually did commit the crime, maybe you didn't know the person as well as you thought.

Does this mean that you are a poor judge of character? I would say, absolutely not. After all, is it even possible to know 100% about someone? I've often thought that if I could travel back in time and meet myself 15 years ago, and I told my younger self "in

15 years you will believe x, y and z” my younger self would have thought I was crazy. So, if I cannot even know MYSELF 100%, as I have changed much over the years, how can you POSSIBLY know someone else 100%?

I would say that a similar dynamic to the “any publicity is good publicity” logic is also at play in the stock market and the big brokers. The big investment houses/brokers now have a big enough client list that they can pretty much rely on this principle. What I mean is, if they give a certain stock recommendation, they can pretty much count on at least 10-15% of their client list buying the stock SOLELY because it was recommended. If there are a relatively few number of shares of that stock, this percentage of people alone could cause the price to rise. Then, the investment house/broker can claim that it was their genius stock picking when in reality they are causing the rise in price.

Let me clarify, I am NOT saying that the government should get involved and regulate/prevent this. My point is that we as a society need to reevaluate our relationship/reliance on someone else to “protect us”. Again, “the price of liberty is eternal vigilance” (sorry to use that quote twice if you read the introduction).

We need to realize that the really big banks/brokers know/are counting on the fact that a certain percentage of their clientele will take their advice without following up on it and so they do not value their reputation as much as they should. If people think that “it is just too much work” to research and keep the banks on their toes, then we have no one to blame but ourselves when the banks/brokers take advantage of this dynamic.

Back to the idea of government regulating the quality of brokers. Okay, okay, maybe the government cannot separate out quality individual brokers for you, but surely they can provide a set of rules that ALL brokers have to play by, right? Yes and no. Remember back when I said that capitalism is a voluntary exchange of goods and services by two consenting adults? Well, implicit in that system is that the exchange that occurs is the one that is agreed upon.

That is why fraud is illegal and is also where the government does have a role to enforce contracts as is. (I have heard of the “anarcho-capitalist” view where the government should not even be involved in policing fraud. Instead of the government, we can have competing private entities that we agree to contracts under and who will enforce the contracts. In theory I think that sounds good, but I am not totally convinced that it would work in practice.)

So, if you have a Picasso painting and you want to sell it to me for \$100,000, then you have a responsibility to give me an ACTUAL Picasso painting and I have a responsibility to give you a genuine \$100,000 because that is the transaction that was agreed upon. If you give me a fake Picasso, you have violated the agreement and the contract can no longer be enforced. What if you thought it was a genuine Picasso but it was whoever

you bought it from that misled you? Well, it is up to you to take it up with them. It is not my fault that you were tricked.

Now, what if I agree to this transaction and you give me an actual Picasso, but I suddenly change my mind and think that it is not worth \$100,000. That is my own fault and it is not the government's job to bail me out from my bad decision. This is why the government bailout of Wall Street was so immoral and such a bad precedent.

Essentially what happened is that most, if not all, of the major banks valued their Picasso (the housing market) as being worth \$100,000. When they realized that it was only worth \$10,000 or \$1,000, they wanted the government to make up the difference. However, had they suddenly determined that the Picasso was actually worth \$200,000, they would have been all too happy to have the government enforce the contract at the \$100,000 price. Heads I win, tails you lose at its worst.

So, the government does have a role in policing Wall Street as a whole in terms of forcing them to live up to their agreements. If someone does not live up to their agreement, they have to somehow compensate the other party for defrauding them. The problem arises when government tries to get involved in determining whether the transaction itself is "fair". In fact, I am going to now make a statement that may seem outrageous on its face, but should (hopefully) make perfect sense after I am through discussing it.

**THERE IS NO SUCH THING AS A "FAIR PRICE" IN A FREE MARKET ECONOMY!**

Does sound kind of shocking, doesn't it? Surely it is not "fair" if I were to charge a million dollars for a stick of gum, right? I will come back and discuss how the million dollars (along with all prices) is really a relative value in the next chapter about money. Still, wouldn't it be unfair to charge several years' worth of someone's labor for something as minor as a stick of gum? Upon further examination, what something is "worth" is a largely subjective determination.

Let's look at an everyday example. Say that you are a big New York Yankees fan and you are willing to pay \$1,000 for a ticket to a Yankees game. However, someone offers you a ticket to a New York Mets game for \$1,000. You might think that this is a ridiculous price. Why? They are both baseball teams. They both wear caps with an NY on them. They both play in New York. What is the big difference?

Of course, it is due to your SUBJECTIVE feeling that the Yankees are worth watching while the Mets are not. By the same token, maybe someone who does not like baseball at all may think that \$1,000 for ANY ticket is a ridiculous waste of money. Is one person "right" and one person "wrong" here? Is \$1,000 "fair" or "unfair"?

This is where we come back to the voluntary transaction idea. If I think a ticket is worth \$1,000, and someone is willing to sell it to me for that price, why is it anyone else's business that we want to make this exchange? But, going back to the Picasso example, let's say that I pay you \$1,000 for a Yankees ticket but you give me a Mets ticket. Well, now I do have a right to get an objective third party involved to make you make good on the agreement we made. If you cannot make good, you have to refund my money or make some kind of reparation.

But baseball tickets and paintings are luxury items or hobby items, right? Surely in the case of something critical like health care, SOMEONE has to police the prices and make sure that people are being "fair", right? I definitely understand how on an emotional level this argument is very appealing. As a matter of fact, I use to think that way myself. But when you really dig beneath the surface, you see that this is really just the same as the baseball example. It is just that the stakes are higher and so emotions begin to play a much bigger role.

The first question you need to ask when examining this, is, WHO will decide what the "fair" price is? The price of medical care is based on the amount of costs the hospital or clinic incurs to be able to provide the care. The hospital or clinic also has to factor in the cost of labor for the doctor and nurses themselves. It is tempting to say that doctors charge too much for their labor. Before alleging this, remember how much training and investment they had to put in to get enough expertise to be able to treat you.

The idea of competition also plays a big role here. Doctor A might charge \$5,000 for some service but doctor B only charges \$2,500 for that same service. Word of mouth will eventually get this information out and more and more customers will go to doctor B to get treated. So, doctor A will either have to lower their fee to get new customers or doctor A will go out of business altogether.

Again, this is not an instantaneous process and it will take time for word of mouth to get this information out. During this lag time, some people will pay \$5,000 for a service they could have paid \$2,500 for. Going back to the emotional aspect, it is easy to get outraged at this and feel that someone should have forced doctor A to charge less to begin with.

Take a step back though. You actually already run into this situation pretty much every day. Due to my writing this in between Thanksgiving and Christmas, a great example is black Friday and all the sales that go along with it. A sale is this exact same situation, just in a different field of business. Of course both retailer A and retailer B would like to get the highest price possible for their merchandise.

However, retailer A knows that if they try to charge too much, then everyone will go to retailer B. Maybe both retailer A and retailer B start off charging the same price, but

then retailer B decides that they are willing to make a little less on each sale. That is, while they make less on each individual sale, they feel they will compensate for this by generating more total sales volume by selling for 10% less than retailer A.

Well, how is that bad for the consumer? I'm sure there will be the gut reaction that maybe someone should force both retailer A and B to just charge the 10% lower fee and everyone wins. The problem with this is that you are assuming the government, or some other third party, knows what the "right" price of the product is to begin with.

Maybe B can charge less than A because they have a more efficient supply chain. It is also possible that B has more initial capital to buy in bigger quantities and therefore at a lower per unit cost. There are a lot of variables involved that both retailers have to determine in their own business models to try to sell at a competitive price, yet still make a profit.

If you think the government, or a third party, can take these variables and calculate the "right" price, then essentially you are saying that the government should set all prices (I suppose those who are for a single payer health care system are cheering this). After all, if the government can figure out the proper price for something as sophisticated as health care, surely they can calculate how much a DVD or a stick of gum SHOULD cost, right?

Also, once you allow the government to get involved in policing prices, there is really no end to the arguments they can make as to how you should change your price. I heard this saying once that describes this perfectly: "If you charge more than your competitor you are price gouging and the government should stop it. If you charge less than your competitor, then you are engaging in unfair business practices to put your competitor out of business and the government should stop it. If you charge the same as your competitor, you are colluding with your competitors to rip off your customers and the government should stop it." Well, unless there is another option that escapes me, I guess this means that everything in the world is communal property and we can just take whatever we want!

I will talk more about healthcare and WHY some of the competitive/capitalist principles have been corrupted in chapter 6. For now, just try to view what I just mentioned about healthcare and competition and try to take the emotion out of it. You may find that the solutions that have been proposed need to be examined more closely.

The last subject I want to cover in this chapter is a term you may hear when discussing capitalism, which is "counterparty risk". I want to clarify exactly what this means and how it is critical to the concept of a voluntary exchange.

First, let's discuss the concept of "counterparty risk". Again, I am not going to use a technical definition, but a more familiar concept. When you go into a casino, if you decide to place a bet, you are ASSUMING that the casino is able to pay you back if you win. You would not place a bet where, if you lose, the casino keeps your money, but if you win, they have no money to pay you.

Quick side note, there is that saying that you should never "assume anything because you will make an ..." you can finish the quote. While this saying may be well-intentioned in that it means you should think through/confirm anything before you do it, I think it is overused. Mainly, I think it has become a cliché for teachers/parents to not explain to students/kids why their solution/idea is wrong.

I say this because there are ALL KINDS of assumptions that we make every day. First, I'm guessing that 95-99% of the population have not had a DNA test to make sure that their parents are really their parents. You could say they are ASSUMING that their parents are genuinely their parents.

This assumption makes sense based on the context of the evidence, as why would someone put so much effort into feeding/taking care of you if they weren't truly your parents? (yes, there are occasional examples of people who kidnap kids and raise them as their own, I would imagine that is 0.000001% of the population and they could say they made a bad assumption) So, I would say a "blind assumption" where you have no information and just take everything on its face is bad, but an "educated assumption" can make sense.

Going back to the casino/counterparty risk, this concept played a HUGE ROLE in the financial crisis of 2008 and showed how critical this concept is to a properly functioning free market economy. Remember the big bailout of AIG? Why did the government CLAIM (propaganda in my opinion) that this was so important? AIG is primarily an insurance company and they offered a lot of insurance policies to cover people if mortgages weren't repaid.

So, the big banks (JP Morgan, Goldman Sachs, etc.) were buying packages of mortgages from the smaller more regional banks. They then took these mortgages and came up with all kinds of stock market products to trade. I won't get into the detail of that, the point is that the big banks were buying a HUGE amount of mortgages (sub-prime, prime, you name it). The big banks were essentially relying on the smaller banks doing the vetting of borrowers (they also had unreliable computer models and implied guarantees feeding into this) because of the sheer number of mortgages being taken out.

Relying on other's vetting meant that they really had no idea what the likelihood was the borrowers could repay their mortgages. Even if the banks had originated the mortgages

themselves, they are not foolproof and some of the loans would have gone bad. So, the big banks were taking out insurance policies and paying AIG premiums in case of loan defaults.

The problem is that AIG had NOWHERE near enough capital/assets to pay all the insurance claims on the defaulting mortgages. SHOULD the big banks have known that AIG couldn't pay the claims? I would argue that they should have realized there were risks when they got into the sums of money being discussed. If capitalism were truly at work here, the banks would have been more careful buying up these mortgages/taking out so much insurance with AIG. The reason they were careless/reckless was because they figured the government would bail them out if the mortgages/insurance was not paid.

This (unfortunately) turned out to be a smart bet as the end result was that AIG got bailed out so that they could pay the insurance claims when the mortgages went bad. I don't know if the government did it this way so that it would look less like they were directly bailing out the banks. It may have just worked out that way, but this should make clear why this was not a fault of capitalism.

As I move towards wrapping up this chapter, I want to share a lighthearted and (hopefully) humorous story, yet a great example of capitalism and redistribution of wealth.

Let's look at the three little pigs. I have no idea what the original moral of this story was, although I suspect it has more to do with the idea that sometimes quality takes time. I use it here because I think it also describes the American Dream and capitalism perfectly.

I do have to add a few assumptions to the original story. First, all three pigs are essentially clones so they have the same physical and mental capabilities. Second, all three pigs start the story in the same economic situation. That is, none of them had any "unfairly" inherited wealth. Also, we will assume that the pigs can asexually reproduce so I can keep the number of characters manageable.

Okay, so the first pig thinks that taking the time to build a house made of bricks is just too much work and would rather build a house of straw. He can do this very quickly and can get back to his easy life of relaxing and rolling in a big pile of ... uh, well you can fill in the blank. Remember, the first pig is of equal strength as the other pigs. He is also equally adept at coming up with an architectural design for a brick house, he just decides that he does not want to.

The second pig thinks the first pig is lazy and thinks that a house of wood would be much more sturdy and can withstand the elements better. At the same time, he thinks



the third pig is an overachiever and is wasting his time by building a house of brick because it is overkill and a wood house is just fine.

The third pig has to watch the first and second pig finish their houses first and get back to relaxing. He even has to listen to their mocking catcalls that he is such a loser for wasting all that time building a brick house. Still, he grits his teeth and trudges on because he feels that the extra work will pay off in the future. Maybe even in the long run he will have more time to relax because he won't have to make repairs or rebuild it due to damage or total destruction.

Well, now the big bad wolf comes along and destroys the first two houses. The third pig is enjoying a nice relaxing bath when he hears a commotion at the front door. The first two pigs are yelling that it is unfair that he gets to be safe in the brick house and he should "spread the wealth". So, the third pig comes to the door and tells them both that he will be willing to let them in the house on one condition. They will do all the chores and upkeep of the house for the next year as a form of payment for "using" the house. So, in a panic, they both agree and are let into the house.

The next day, the big bad wolf has moved on to greener pastures, and the two pigs are doing some chores. All the while muttering that it is unfair that they have to work while the third pig is relaxing. Then they hear a knock at the door. It turns out to be the mayor of the town (who has already shown that the government is not all knowing by not preventing the wolf from coming in and destroying the first two houses in the first place). He states that it is against the law for the third pig to force the first two pigs to work in exchange for shelter because that is heartless and immoral.

Now free of their obligations, the first two pigs go back to enjoying their leisure time and decide to not even rebuild their houses. After all, they now know that they always have the option of just using the third pig's house. So the third pig is resigned to his fate that he put in all this extra work but everyone else gets to benefit from it.

A couple of years pass and all three pigs have offspring. The third pig shares his tale of woe with his son. He tells him that while he built the house they live in, it is perfectly okay for the first two pigs and their children to come and go as they please. The third pig's son takes this story as a cautionary tale and realizes there is no benefit in going the extra mile.

Now the second generation pigs decide to move to a new town. They get to the town and are deciding what they are going to do for lodging. The third pig's son remembers his father's story and decides he will only do as much work as the other two pigs. Why do any more work than the others when they equally benefit from the extra work? Meanwhile, the first two pigs have also heard their parents' tales of the overachieving third pig who built the house that they all get to use. So these two pigs decide to not do

any work at all because they figure the third pig's son will build a house for them to live in as well.

This time when the big bad wolf comes around, nothing has been built. All three pigs were figuring they could just wait for one of the others to start building. What happens next?

The mayor of this new town shows up the next day and cannot find the three pigs to collect his taxes. He sees the wolf taking a nap with a big pile of bones next to him and realizes what must have happened.

"Now whose wealth am I going to redistribute?!"

This little revision of the Three Little Pigs hopefully reinforces some of the concepts I have discussed in an entertaining way. When I was first going through this "reimagining" of the three little pigs, I thought the 2nd/middle pig was an extraneous character. Couldn't the same "moral of the story" be reached with just two pigs? Upon further review, I realized that the second pig was critical in illustrating the concept that "hard work" is relative.

What I mean by this is that the second pig could argue that the first pig is a slacker/lazy and that he is "working harder" than the first pig. However, the third pig can just as easily feel that the second pig is a slacker/lazy because he is "working harder" than the second pig.

Who is "right" when it comes to this analysis? It is really in the eye of the beholder. Imagine if the wolf had never come along, but a really strong gust of wind blew away the first house made of straw. The second house withstood the gust of wind and served as a perfectly sufficient house for all the purposes the second pig wanted it for.

In a sense, you could argue that the third pig was an "overachiever" as the extra time spent to build the house of bricks wasn't necessary. I mean "wasn't necessary" in that the third pig could have lived a perfectly safe and satisfactory existence in a similar house made of wood. The problem is, we as humans DO NOT KNOW in advance exactly which house is necessary for a safe existence.

The key is that people have to bear the consequences of their actions. In the case of the third pig, it could be argued that the extra time spent building the brick house was "wasted time" and he has to live with the consequences. He could have spent that time doing something else, but his initial calculation was that it was worth the extra effort to build a "safer house". Similarly, the second pig has to live with the consequences if the wood house turns out not to be enough for a secure house, as the time he spent relaxing could have been spent building a safer house.

I can already imagine some of the negative feedback/hate mail about how it is unrealistic. After all, in the real world, people don't have the same physical and mental capabilities and some people do have inherited wealth. While I acknowledge that this is true, what can we really do about that?

It is also important to realize what inherited wealth really results from. Bear with me if this seems too elementary. I just think that it is easy to get caught up in the emotion of thinking that the person who inherits the wealth "did nothing to deserve it". Realize that it is not a matter of whether the person doing the inheriting "earned it". It is actually a matter of the person who leaves the wealth to decide who they want to leave it to.

The person who wants to leave the wealth to their family DID "earn it". As a result, it is ultimately up to them to decide who gets their possessions once they have died. It is not that different than that person giving their family presents/gifts when they are alive. Would you argue that there should be an additional tax on the presents you give their kids/family at Christmas?

Yes you have to pay sales taxes/income taxes on the money you spent to buy these gifts. However, the person who is leaving their wealth behind had to pay taxes on their income once as well. Also, whoever inherits the money will have to pay sales taxes just like everyone else when they spend that money. This all may still strike you as "unfair".

If so, I would ask what you suggest we do about it? Unless there is some machine or potion we can take to make it so everyone starts off from the exact same point in life, the fact is that life is not fair. Even if everyone started at the same place, how would you guarantee that everyone has the same quality parents, teachers, coaches, etc.?

To take this concept a little further, let's examine an example that has already touched a lot of lives. Think of how many people have already died of cancer. Now, if someone were to come up with a cure for all cancers today, should they even be allowed to tell people about it? After all, isn't it "unfair" that some people's relatives have already died from cancer but now some people's relatives can be saved because of the cure? Why should some people be punished because they happened to be born before the cure was discovered? Of course, this same logic could be employed with regards to all diseases and treatments.

Another example I personally love is Mozart. Here was a kid/man who was already composing by the age of 5. I think that it is pretty safe to say that he had more musical ability than most of the billboard top 10 combined. Yet the famous musicians of today have a much higher standard of living compared to "the average person" than the famous musicians of the past. Is that "fair"? Also, can you imagine what kind of music Mozart (or hundreds of other composers for that matter) could make if they had a modern day recording studio with a mixing board? Is that "fair"?

Hopefully you get the point that life is intrinsically unfair and we just try to do the best we can with the circumstances we are dealt. If you think the government can remedy this, you have a right to your opinion. I would just ask that you at least examine the bloody history of communism and government attempts to control and plan everything before putting all your faith into this. Of course, as a lot of us have been told for a lot of our lives that “the government is here to help” it becomes difficult to overcome this hurdle.

When it comes to changing one’s mind, I think there is a built in resistance to changing your opinion. I think people feel that if they have defended a view for a long time they can’t suddenly change their mind. If they do, this somehow means their previous beliefs were a lie. Let me give two explanations why this is not true. First, I’ll go with the nerdier, scientific take on it.

The scientific method states that you have a hypothesis as to why a certain phenomenon works the way it does. After you form this hypothesis, you test it by controlling all other variables and testing to see if the phenomenon produces the same results you predicted. If the experiment does not work the way you predicted, you are free to change your hypothesis. You now have new information and so you have to try to find a new explanation for why things work the way they do. Essentially, it is just a nonstop trial and error process to find the truth of why the universe works the way it does.

Similarly, if you used to believe that, say, the government can solve all problems, you can test this hypothesis with your experiences. If you have evidence and personal experiences that contradict this belief, then it does not make you a hypocrite if you change your mind. You are just basing your opinion on the new information/observations you have come across since you formed the hypothesis. The second example I’ll use is a more lighthearted way to think of this.

Did you believe in Santa Claus when you were a kid? Do you still believe in him now? Obviously it was easy (or at least easier) to believe in him when you were a kid. Your life experiences and education had not yet taught you that he could not really exist. Are you a hypocrite for not believing in him anymore? No, you just have new evidence that disproves that possibility.

Of course, the previous examples are more black and white situations. When it comes to the economy and governmental policy, you really can’t control all the variables except for the one you are testing. For instance, let’s look back at the Wall Street bailout in 2008. Some people will say that that saved the financial system and so it justifies all government intrusion.

The problem with this is that there is no way for us to “control for this one variable”. That is, we don’t know what would have happened had we not passed the TARP. Yes, we can make educated guesses, but nothing can be proved conclusively either way.

I actually believe that this is an active part of the government’s strategy as they know there are a lot of variables they can blame something “not working” on. That is why it is so important to really bring up/discuss all possible foreseeable outcomes of a government action.

Going beyond that, it is impossible to foresee ALL possible results of an action. That is why it is also important to revisit a program once it has been started and some of these unforeseen consequences start appearing. Before moving on to the next chapter, the take home message of this chapter is the idea that capitalism is based on voluntary decisions. This is critical to keep in mind when it comes to money and whether that money is part of the voluntary exchange.