

## Joe Six-pack and Billy Bordeaux; Who Wins?

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Joe Six-pack and Billy Bordeaux both worked in identical jobs for the same company and produced the identical output. They were identical twins (one changed his name...) and were hired to work on the same date after finishing high school, so they accumulated identical academic records, and identical work experience. Joe and Billy were boringly identical except...

Joe rented his home for \$1000/mo., and Billy purchased an identical home right next door. With “nothing down” Billy’s house payment on an attractive 30-year fixed loan was \$1200/mo (Principle, Interest, Taxes, and Insurance; PITI). The home market values were identical.

Billy was able to benefit from the mortgage interest and real estate tax deductions, which reduced his total tax bill by \$200 per month. Therefore, Billy’s **net** monthly payment was \$1000, the same as Joe’s.

In the mean time Billy and Joe’s Federal Government promised its constituency “a rose garden”, and spent more than it collected in tax revenue, thus developed a chronic fiscal deficit. Of course, their Federal government embarked upon the “tried and true” path of least resistance to address this deficit, and monetized the debt, thus debasing the currency (i.e. monetary inflation).

After five years of increasing inflation Joe was paying \$1300/mo in rent. Billy was paying \$1050 **net** for his mortgage payment (PITI) because his taxes and insurance went up slightly due to inflation. As a result Billy could enjoy a glass of fine wine every night for dinner, while Joe was financially restricted to a can of Bud each night.

After thirty years and one month Joe was paying \$3000/mo. in rent, and Billy was paying \$500 per month for taxes and insurance after paying off his mortgage completely. Joe was still restricted to a can of Bud per day; Billy could drink a glass of wine while cruising in the Caribbean’s.

The only way (with a noted exception <sup>(1)</sup>) Billy can enjoy more goods and services **is FROM THE INDIRECT COERCION of Joe**. Joe and Billy contributed precisely the same job output into the “aggregate pool of wealth”, only Billy was able to keep a much larger portion of the wealth he produced after the **tax** and **inflation** effects were included.

Is that fair? Is it right? NO and NO...!

Of course, we are modeling a fictitious story. There are many “technical” holes to be poked, if inclined. HOWEVER, there are two clear drivers that will generally always favor Mr. Bordeaux and the EXPENSE of Mr. Six-pack. First is the mortgage interest deduction, which is a government tax code regulation. Second is the currency debasement (inflation) enabled solely by the Federal government. They are both GOVERNMENT drivers that favor Billy over Joe.

Isn’t home ownership on par with “motherhood and apple pie”? Similar to many government initiatives, it should be *limited* to *verbal* encouragement only for the *right reasons*. In a truly “free” Republic, we would not coerce Joe Six-pack’s hard earned wealth and transfer it to Billy Bordeaux indirectly through tax advantages and inflation just because we all want to encourage home ownership. The *reasons for home ownership must stand on their own*. There are many including identity, pride, gradual mortgage pay-down <sup>(1)</sup>, tradition, fewer barriers to modify or improve the property, etc.

**Conclusion:**

1. Any mortgage interest and real estate tax deductions should be removed from our Federal and State tax codes to prevent the unfair transfer of wealth from renters to homeowners.
2. A Balanced Budget Amendment (BBA) should be passed to prevent the irresistible urge of government to debase our currency.
3. Freddie Bordeaux (yes, the older brother of Joe and Billy) was Joe's landlord and enjoyed some of the benefits along with Billy of the two "drivers" referenced above, again, at Joe's expense. Additionally, Freddie also input work into the rental process as well as risked his capital, and received a return for those factors as well.

- (1) There is a third factor, which involves the imputed rent Billy is paying via the monthly PITI payments. In time Billy will gain full ownership of his house, but for this gain he risks the loss of its value through decay or a depreciating neighborhood. He also owns a very illiquid asset with high exchange costs, if a move becomes necessary. Therefore, assuming Billy's home is in a valuation-stable neighborhood, and he never moved he would enjoy the reduced PITI to only paying "TI" (taxes and insurance) along with major maintenance expenses. This third "driver" will enable Billy to enjoy more goods and services at the expense of Joe, but NOT because of a government intervention.

By Russell Randall; 12-13-2005