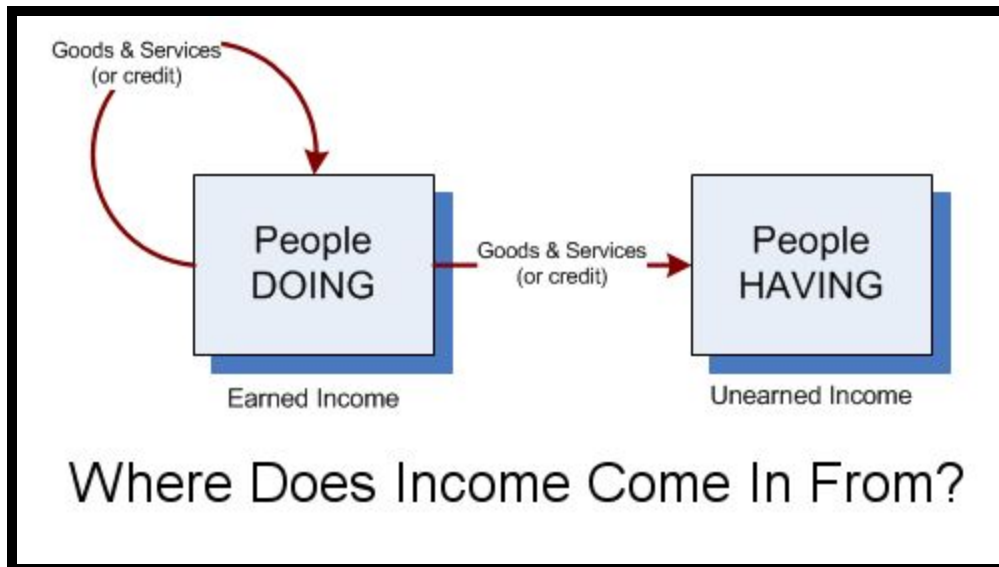


What's the Problem With Unearned Income?

by William Spademan, Executive Director
Society to Benefit Everyone, December, 2006

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Making a fortune and living off the interest is central to the American Dream. We aspire to luxury and leisure. But investment income is a bad dream. Here's why.

There are two kinds of income:

1. income from *doing* (earned income) and
2. income from *having* (unearned income).

If I live off my investments, doing no useful work, where do the goods and services I consume come from? They don't just pop into existence. The government doesn't create them by printing more money. Someone has to do the actual work. Someone has to slave for me.

Our present economic system is unfair and unsustainable.

Economic justice boils down to one question: **Am I producing more goods and services than I am consuming?** Our cultural training makes it very hard to see the system's unfairness, so I begin with two parables in which the unfairness is obvious.



Extortion (Gouging) -- demanding more pay than is fair

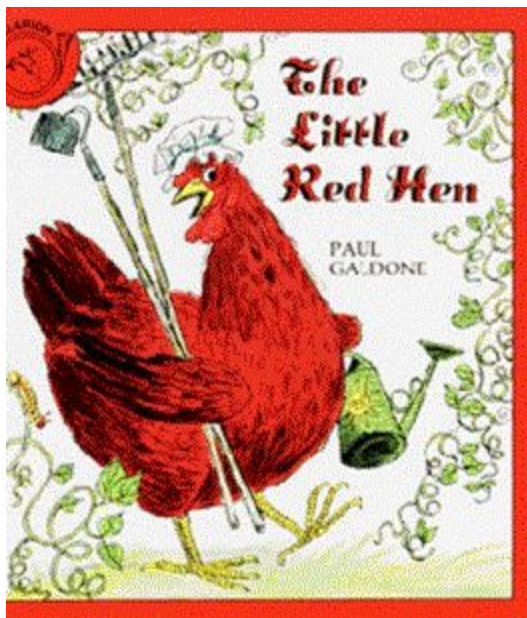
When the girl was alone the little man came again for the third time, and said, "What will you give me if I spin the straw for you this time also?"

"I have nothing left that I could give," answered the girl.

"Then promise me, if you should become Queen, your first child."

"Who knows whether that will ever happen?" thought the miller's daughter; and, not knowing how else to help herself in this strait, she promised the little man what he wanted, and for that he once more spun the straw into gold.¹

Rumpelstiltskin exploits the girl's desperate circumstances, demanding much more than fair payment for his help. This is clearly evil.



Freeloading -- accepting payment for no work at all

One fine morning the little red hen said: "Who'll get up and light the fire?"

"I won't," said the cat.

"And I won't," said the rat.

"I'll do it myself," said the little red hen. So she got up and lit the fire. Then she said: "Who'll get up and sweep out the room?"

"I won't," & c.

Then she said: "Who'll get up and get the breakfast?"

"I won't," & c. Then she said: "Who'll get up and eat the breakfast?"

"I will!" said the cat.

"And I will!" said the rat.

"No, I'll do it myself," said the little red hen.²

This was written as a "nursery tale"; that is, a learning story for children. We recognize freeloading as shameful behavior. The Duck, Cat and Dog refuse to work, yet they are willing to receive the benefits of the Little Red Hen's labors. They are clearly in the wrong and the Little Red Hen is entirely justified in telling them: no work, no food.

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Investment Income -- accepting payment for no work at all

We all agree that extortion and freeloading are unfair. How then are we to view what the IRS calls "unearned income" -- that is, investment income: rent, interest, dividends, capital gains, and other passive profits? Isn't this also "accepting payment for no work at all" or at least "more pay than is fair" for the amount of work done? At first glance it looks as though this unearned income is harmless enough; it seems to benefit the investor without causing any harm to anyone.

But it does cause harm, as humankind has known for hundreds of years³. Consider the typical tale of poor farmers oppressed by the wealthy landowner:



Once upon a time, there was a small farming community where everyone lived in peace and prosperity. A kind old woman owned the land and generously allowed all the local farmers to cultivate it at no charge. On Tuesdays and Thursdays, she taught philosophy at the community's grammar school.

Meanwhile, the woman's lazy son spent his days in idle amusement. When the old woman died, the son, as the new landowner, quickly put his inheritance to work. He informed the local farmers that they must give him one third of their harvest each year, in exchange for the right to cultivate his land. This payment being more than he required for his own sustenance, he traded the surplus for every conceivable luxury, and stored the remainder for future use.

Some of the farmers, wary of this extra burden, accepted more lucrative positions as soldiers, protecting the landowner's estate from theft. Others took jobs cleaning his house, caring for his riding horses, crafting fine furniture for his use, or managing his estate. Before long, the efforts of fully half of the community were dedicated to serving the landowner. The remaining farmers struggled in vain to do the work that had once been shared by the whole community. Food became scarce. Most of the people survived on boiled oatmeal and figs, saving the costlier foods for the landowner and his few friends.

The landowner gladly lent his surplus food to the poor, to be repaid with interest at the next harvest. He looked on the poor with pity, secure in the knowledge that he, at least, would not starve, for he had managed his inheritance wisely and could afford a life of luxury indefinitely. What a shame, he thought, that the poor were too ignorant and lazy to succeed as he had done.

The landowner in the story enjoys his idle luxury at everyone else's expense. That's not fair and everyone knows it. Having does not imply a moral right to have more.

Yet in our larger society, complicated by money standing in for goods and services, most of us remain blind to this injustice. Extravagant consumption is clearly wrong. Unearned income is unjust income, by the very dint of its being unearned. **Unearned equals undeserved.**



If I consume more than I produce, then I am unfairly exploiting my fellow people. When I take an honest look at all that I consume, it is perfectly obvious that someone else is toiling hard on my behalf.

One complication is when ownership requires some labor. For example, if I own a second house and rent it out, part of the rent pays me for the labor and expenses of managing the property (advertising, interviewing tenants, doing or arranging for maintenance, paying the bills, reporting to the government, etc.). That part of the rent is fair; it is compensation for useful labor. Any rent demanded beyond fair compensation for that labor is not fair; it is extortion.

On the other hand, the effort I spend managing my speculative investments (choosing which stocks to buy) produces no useful value and serves only to enrich myself. The value of those riches has to come from somewhere; and since I'm not creating it, it's coming from someone else. Like the landowner in the story, I am living in luxury at other people's expense -- freeloading.

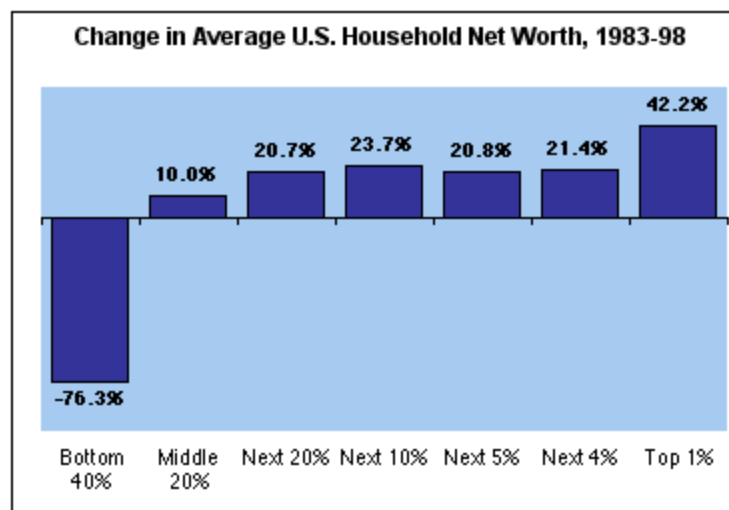
Unearned income pumps credit from those who do productive work to those who don't. In any society a certain finite amount of value is produced. A just and sensible society would distribute this value in a way that rewards labor, not idle ownership and wealth.

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Investment income is a problem

Summarizing the arguments above:

- Money has value because you can get something of value for it.
- That value has to come from somewhere (Money is a zero-sum system).
- Only nature and people create value. Invested money gets you more money, but cannot do real work; it cannot actually create anything.
- When I receive investment income (for example interest), I am being given credit for value created by someone else; that is, I am being paid for their work.
- Therefore, investment income is unjust.



The Rich Get Richer and The Poor Get Poorer⁴

I find this truth very disturbing -- that investment income is unjust. I work hard to earn what little money I manage to save. So it seems only fair that I sit back and let my saved money "work" for me. But there is no justice in getting paid twice for my work, when it dictates that someone else gets paid that much less. Unfortunately, renouncing investment income (when you can get it) is very hard. I haven't succeeded yet and I know very few people who have. Ultimately we hope to make that sacrifice easier by creating a new economic system that rewards productive work, not wealth. The [common good bank™ project](#) is a big step in that direction.

In our current economic system, the more money you have, the more money your investments bring you. The rich get richer and the poor get poorer. Poorer and poorer until they starve to death. This is probably not what we want for our country and our world. The pervasiveness of the problem is much broader than it appears at first glance. A large part of the cost of everything we buy, both goods and labor, ends up as investment income for someone somewhere. According to German economist Margrit Kennedy, this unearned income part averages between 30% and 50%.⁵

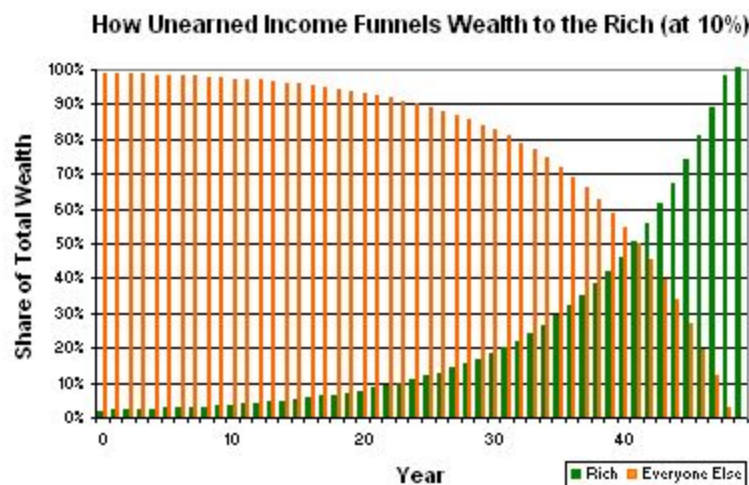
Overall, 852 million people are hungry⁶ - about 1 in 8. Even here in the United States 10.7 million are hungry⁷. And it's getting worse. From 1983 to 1998, household net worth of our poorest 40% fell by 76% (see diagram above). To see how bad our wealth disparity is currently, take a look at the **L curve** (be sure to zoom out).

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Compounding the Problem

Unearned income *inevitably* funnels wealth to the rich -- slowly at first, then faster and faster. Here's how it works:

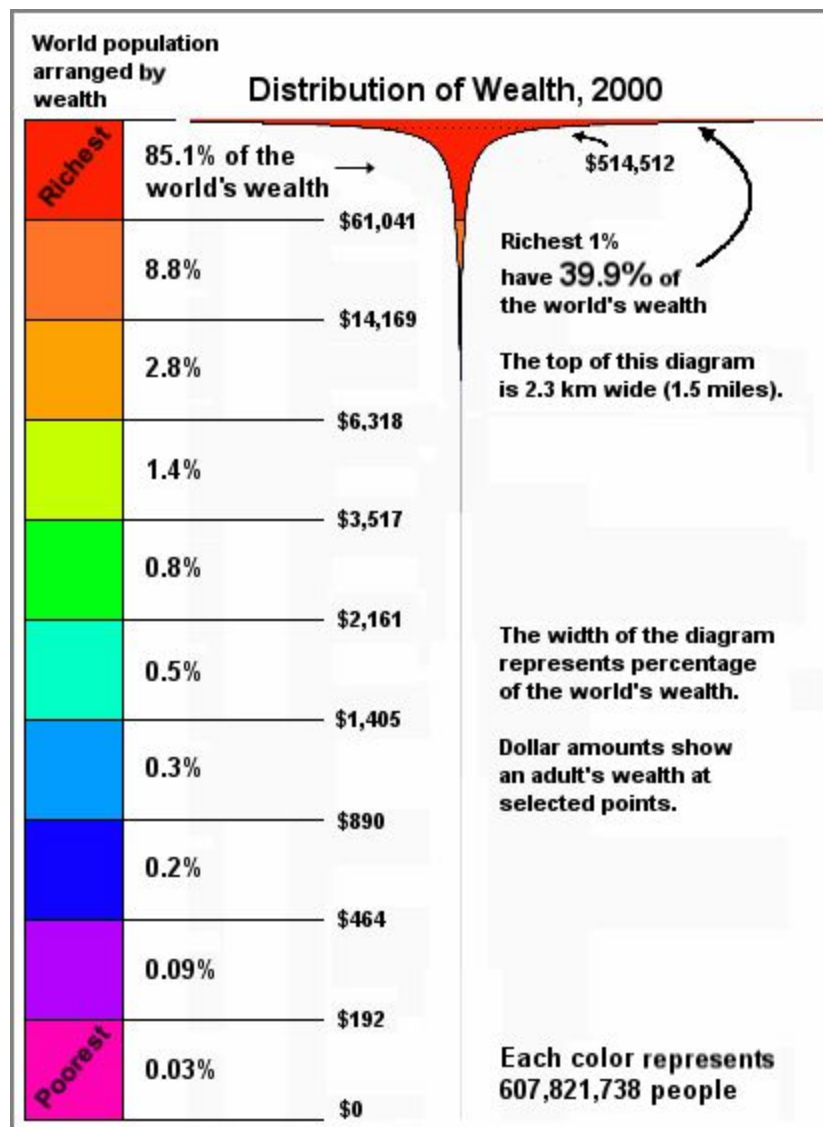
Once upon a time, 101 young peasants lived in peace and harmony, with a cash economy, on an otherwise uninhabited planet. By a remarkable coincidence, one year at harvest time, each peasant had precisely \$1,000 -- exactly the amount necessary to survive until the next harvest.



As it happened, one of the peasants, a mathematician named Rich, lost his sister that week in a mysterious accident, leaving him an extra \$1,000. At the funeral, Rich announced that he had no need for the whole extra thousand and would happily distribute it among the rest of the community, \$10 to each person, in memory of his sister, keeping just \$10 for himself and allowing everyone to live a bit more comfortably that year. In exchange all he asked was that they return the money with 10% interest at the next harvest. Everyone agreed that this was a great gift and accepted gladly.

The next year, however, after paying Rich back, some of the peasants found that they had too little money to make it through the year. Following the precedent of the previous year, they borrowed as much as possible from Rich or from anyone else who had a bit extra, again at 10% interest. And so it went, until one year, exactly 49 years later, the peasants found after the harvest that Rich had all the money -- \$101,000 -- and everyone else owed him \$66.62, more or less.

Unfortunately, this is no fairy tale. It is a mathematical truth. As a group, the poor have less money each year, so each year they must borrow more, in order to survive. This example story assumes only that the richest person starts with (and lends out) a surplus equal to the average wealth of everyone else. Once the interest rate is set, it determines the length of time to the end. At 10%, 49 years; at 5%, 95 years; at 20%, 26 years. The shape of the graph does not change -- only the number of years.



Compiled from UNU-WIDER Report Dec 2006 by s2be.org

Return on investment is an exponential function in a finite environment, pumping credit faster and faster from the poor to the rich. If it continues, it WILL reach the limit; the rich will have it all and the poor will live forevermore in debt.

The story roughly parallels our world situation, several years ago. Each peasant in this story represents one percent of the world population. In the year 2000, the richest 1% already held 40% of the world's wealth⁸ (year #38 in the diagram above, "How Unearned Income Funnels Money to the Rich").

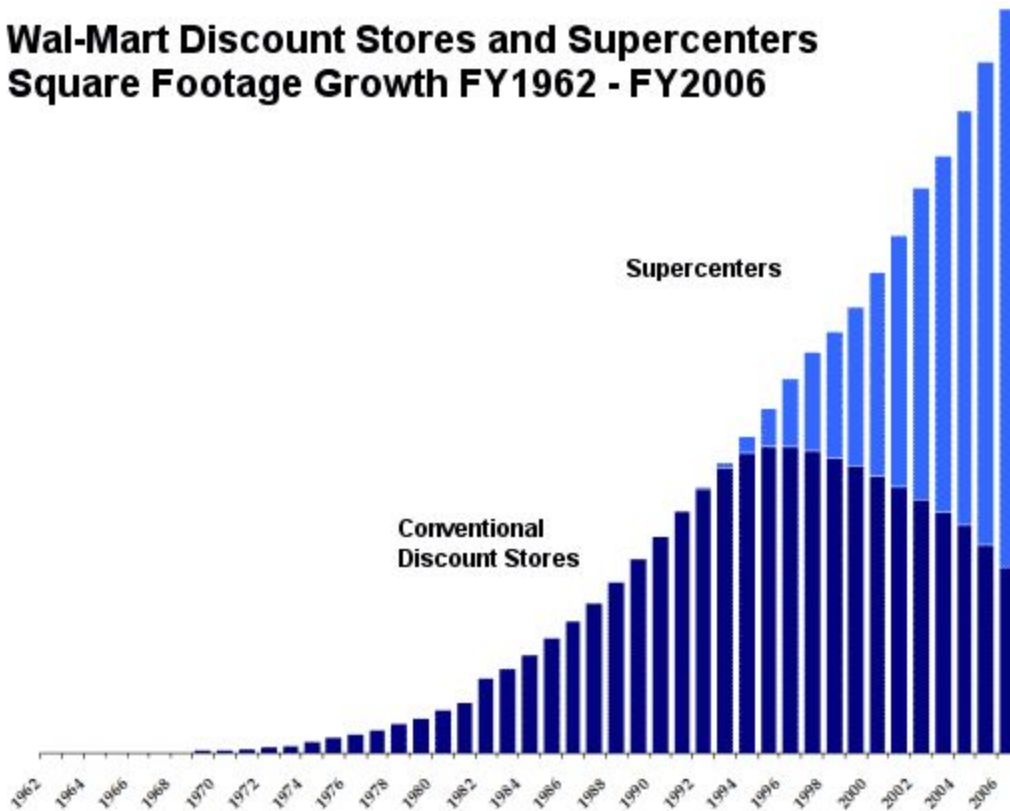
Most of you who are reading this are near the bottom of that 1%. The top percent itself is similarly stratified, with the wealth of the top 1% of 1% dwarfing the rest. At the pinnacle are the 946 billionaires (the top one-seventh of 1% of 1% of 1%), collectively holding 2.5% of the world's wealth -- about 170,000 times their share and about twice the total wealth of the 3,800,000,000 people in the poorest half of the world.⁹

The "Distribution of Wealth" diagram to the right groups people by wealth. Each color represents 10% of the world population, with the poorest 10% at the bottom. The width of the funnel represents graphically the amount of wealth held by people at each level (0.03% for the poorest 10%, and so forth). The wealth held by the top 1% is so large in relation to the rest, that it mostly could not be shown here. You must imagine it as a thinner and thinner line, 2.3 kilometers wide at the top of the figure.

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Unearned Income Requires Ruthless Corporations

Wal-Mart Discount Stores and Supercenters Square Footage Growth FY1962 - FY2006



Source: Coriolis Research and Wal-Mart annual reports

The predominate vehicle for delivering a high return on investment is the for-profit corporation. We have created corporations as a structure whose primary mission -- overriding all other concerns -- is to maximize percentage return to investors. In order to maintain even a constant percentage increase in value from year to year, a corporation must grow exponentially (faster and faster), on a finite planet with finite resources, forcing it to become increasingly ruthless at the expense of the environment and the well-being of society. For example, Wal-Mart, the world's largest corporation, has over 6,500 stores. It has grown at an average rate of 20% per year since its beginning in 1962¹⁰. To maintain even its current 9.5% annual rate of return, it must build more stores each year than the year before, and give as little as possible to its employees, suppliers, and communities. Indeed, Wal-Mart is notorious for destroying communities, strong-arming its suppliers, and abusing its employees.¹¹

Unearned income requires ruthless exploitation of people and destruction of the environment.

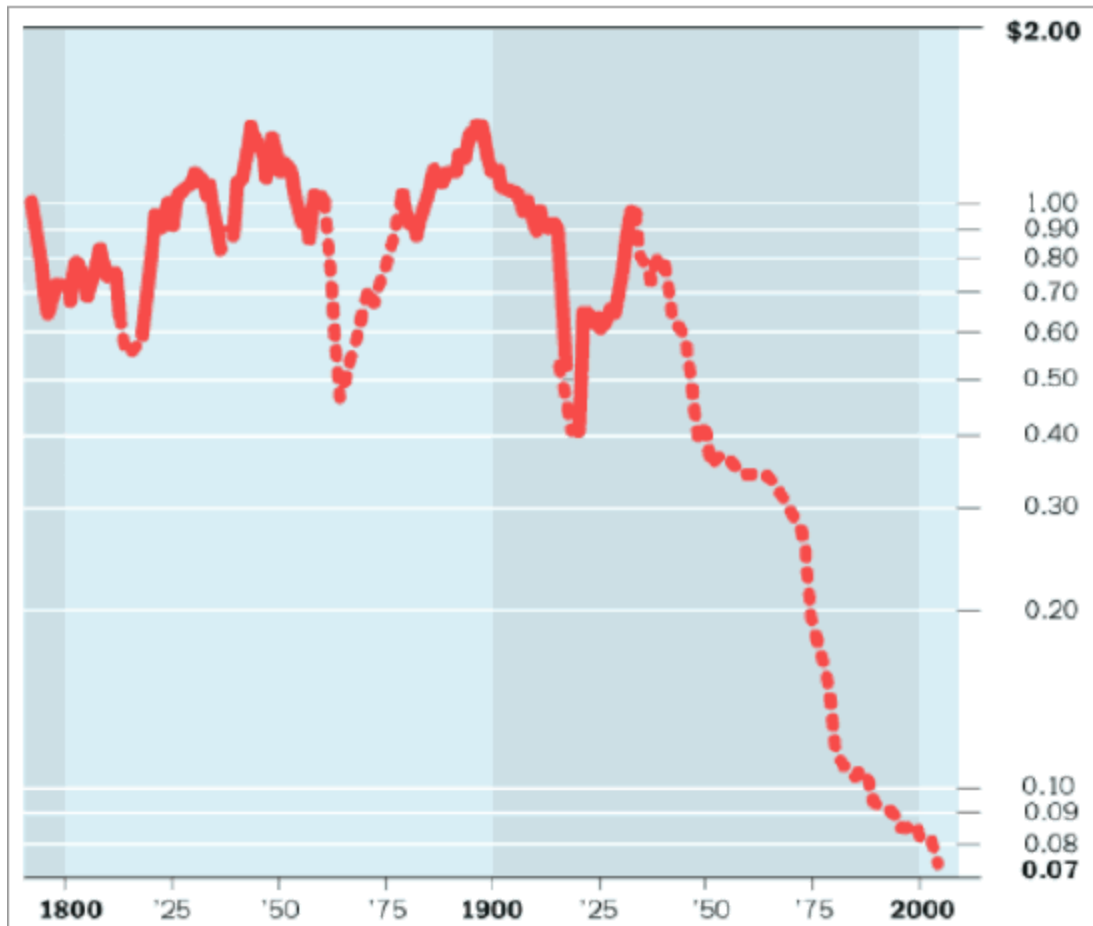
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Unearned Income Causes Inflation

The largest factor contributing to inflation is the growing volume of unproductive, self-serving and counterproductive activity. For example, if I stop doing productive work and live off my investments, then the cost of living goes up for everyone. Activities that serve only to increase someone's wealth or to provide luxuries add to inflation: theft, speculative investment, diamond-cutting, and many, many other activities. Of course our federal government also contributes to inflation, as governments nearly always do. Pressured by corporations to spend public money on expensive boondoggles that will further enrich investors (especially preparation for war, waging war, and reconstruction after war), government must find inconspicuous ways of financing its wild spending. Our government gets money primarily in two ways:

1. by taxation and
2. by creating it out of thin air (or, more accurately, by authorizing the big banks to create it).

Purchasing Power of U.S. Dollar, 1800 - 2005¹²



Taxes are very unpopular with the public. However, when the government creates money faster than it "earns" it back as taxes, the effect is like writing a really big bad check. Lots more money, with no increase in goods or services to spend it on, makes each dollar worth less, so the cost of living appears to go up.

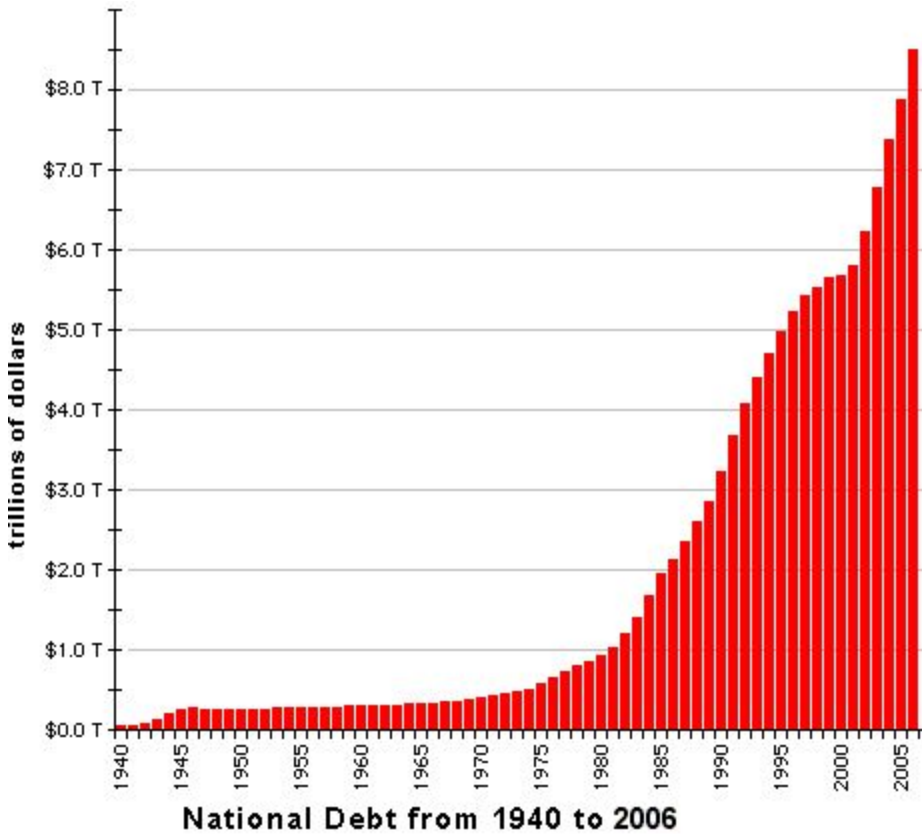
Inflation is a sort of hidden tax that affects everyone equally – unless of course you have your money invested at a rate of return that more than compensates for the devaluation of the dollar. That is, inflation is a hidden tax that affects only people who are struggling financially. It is a kind of theft. At first glance, it seems that inflation justifies investment income. For example, let's say I make 10% on my investments (on average). Six of those percents just compensate for inflation (which is much higher than what the government reports¹³). So I'm really only making 4%, which is close to a wash, right? Unfortunately, no. The full 10% is earnings that rightfully belong to someone else. Then inflation snatches

6% from both me and that someone else. The poor get hit twice: once by investors and once by inflation.
The end result is that I gain 4% and someone somewhere loses 16%.

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Hopeless Debt -- the ultimate unearned income

Debt can be even more insidious than inflation because it maintains a pretense that the money will be paid back at some point.



National Debt from 1940 to 2006

Small debts are not a problem, if they get repaid. But outrageously colossal debts that can't possibly be repaid -- those are a problem.

Ultimately there are only two ways to handle a debt:

1. pay it off or
2. default on it.

Defaulting on a debt (borrowing and never paying back) is equivalent to theft. If you borrow more than you can pay back in your lifetime, it is a theft from future generations. Continuously "borrowing from Peter to pay Paul" is a kind of default, too.

As a nation we are currently over \$8.6 trillion in debt¹⁴ (\$50 trillion, counting "off balance sheet" debt¹⁵), increasing by \$2.13 billion a day or about \$1.5 million a minute¹⁶. That means each one of us (including babies) owes about \$29,000, plus another \$2,600 every year. If we start paying it off now, say by doubling our income taxes, we'll have it paid off in ... well, never. Doubling the taxes wouldn't be enough, unless we also cut federal discretionary spending by about \$1 billion a day (a 43% cut). And that still leaves the much larger \$41 trillion problem of off-balance-sheet debt.

(These calculations are based on the following FY 2006 figures: 300 million people in the U.S.¹⁷, \$990 billion income tax revenue¹⁸, \$840 billion discretionary spending¹⁹, and \$406 billion in interest spending²⁰ – about 4.7% annual interest).

Of course, there are many other obvious ways to pay off the national debt, besides personal income tax. Most of them involve taking some money back from those who have the most. This is unlikely to happen under our current system. Wealth controls government; and government, in turn, protects wealth.

Conclusion

Our current economic system is crazy. Unearned income leads to increasing poverty, unrestrained corporate plunder, devastation of the environment, human rights abuses, war, deceit, and misery for almost everyone. Please join me in fixing the system. Meditate on what is right. Support the **common good bank™ project**. Divest or do something fair with your investment income. **Work for economic justice.**
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