

Re: how to compare living standards

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- *From:* William F Hummel <wfhummel@xxxxxxxxxxx>
 - *Date:* Mon, 03 Apr 2006 10:08:04 -0700
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On Mon, 3 Apr 2006 10:58:07 -0500, "Jim Blair" <jeb@xxxxxxxx> wrote:

"William F Hummel" <wfhummel@xxxxxxxxxxx> wrote in message
news:5r9r225n3dbmrt3eme0p9g4unv7e9hv5u3@xxxxxxxx

On Fri, 31 Mar 2006 15:30:50 -0600, "Jim Blair" <jeb@xxxxxxxx> wrote:

"William F Hummel" <wfhummel@xxxxxxxxxxx> wrote in
message
news:u11r221splsdkkmbocqpal8ov8sntd9503@xxxxxxxx

On Fri, 31 Mar 2006 12:13:03 -0600, "Jim
Blair" <jeb@xxxxxxxx> wrote:

Do you think poor and low
income people save and
invest more than rich

and high income people?

Irrelevant. The issue is whether reducing
taxes primarily on the
wealthy will increase capital formation for
real investment. Don't
confuse financial investment with real
investment. If you increase
after-tax income for the wealthy, most of it
will end up spent on
financial assets and drive up asset prices.

Or do asset prices increase because the assets become more
valuable?

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Strange question. Obviously when the market bids up asset prices, their _monetary_ value increases.

But when a company improves/expands/modernizes/markets new products/etc. the value of the company increases. And thus the value of a share of the company (it stock) also increases in value, doesn't it? And the market price of a share of stock is supposed to reflect the value of the stock and thus of the company.

On balance, the share price increases with increasing real value of a company. However the monetary value of the shares may or may not increase, depending on the competition and investor psychology. But don't ignore the fact that the market has a life of its own. During recessions, share prices typically fall and during bubbles share prices rise independent of the real value.

If the money chasing a given number of shares increases, share prices will increase — until that liquidity dries up — and then you have just witnessed a bubble.

Which I read to mean that sometimes those buying stocks overestimate the "real value" of a company. But not every increase in stock price is an overestimate of the company's value.

Goes without saying.

....All of which has nothing whatsoever to do with the real value of the assets behind those shares.

But it is a measure of what those buying and selling THINK the value of the assets is. Sure they are sometimes wrong, but they are the "experts": they study the market, the companies, and they have a financial incentive to make accurate judgements. (and by "they" here I mean the mostly mutual fund and pension fund managers—the general investing public mostly bases their purchases on the history and reputation of the particular fund, not the individual companies in the fund)

The large middle class savings in pension funds, mutual funds, life insurance companies, etc. is far more

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important in supporting real investment.

jeb:

Your statement above must stem from the idea that money in the stock market, mutual funds, bonds, T-bills and bank CD's does not correspond to money "invested", because you surely don't

think

that

people with low incomes have more money in these than people with high incomes.

There is no shortage of funds available for investment. But there is a chronic shortage of funds available among the broad middle and lower middle class. That shows up on the demand side and is what explains the business cycle and the occasional shrinkage in the economy, otherwise known as a recession or depression.

The notion that reducing taxes on the wealthy leads to greater output is simply false.

jeb:

Interesting theory. But how does it explain the fact that recessions in

the

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US have become less frequent and less severe since Reagan pushed through his supply side tax cuts?

Recessions have been moderate since 1982 for two reasons: (1) the Fed learned from past mistakes regarding monetary policy, (2) the enormous Reagan/Bush budget deficits primed the pump quite effectively. Borrowing at a record pace for SDI, a 600 ship navy, and all the other goodies did a lot for aggregate demand.

So it took from the creation of the Federal Reserve until Reagan for them to learn how to properly manage fiscal policy?

Who is "them"? Fiscal policy under Reagan was to shrink government spending in order to shrink the size of the government. He did just the opposite, borrowed and spent like a drunken sailor. Fiscal policy today is non-existent, so don't talk about properly managing fiscal policy. Bush calls for huge spending on his Iraq war while also cutting taxes. He refuses to pass the pain on to the home front, and his Republican-led Congress obliges.

If "them" refers to the Fed, credit Paul Volcker and Alan Greenspan with cleaning up the mess left by the monetary policy mistakes of the 1970s, especially those of Arthur Burns.

And the US had a large deficit (relative to GDP) from 1945 to the 1960's but we also had more and deeper recessions

The deficits from 1945 to the 1960s were small, and there were no deep recessions in that period. There were a couple of mild recessions under Eisenhower, but they were nothing compared to the 1974-1975 recession under Ford and the 1981-1982 recession under Reagan.

....Reagan is the most Keynesian of all our presidents, although he apparently never understood why.

I agree, except perhaps with the "never understood" part. I think Reagan (pre-Alzheimer) was smarter than he wanted his enemies to think. The better to out fox them ;-)

Reagan was not a reader of economics, or much of anything else. I doubt that he even heard of the Keynesian multiplier effect due to fiscal deficits. Reagan had a strong visual memory and his aides

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often used videos to get their messages to him.

<http://www.kc.frb.org/publicat/econrev/PDF/4q98haim.pdf>

What data supports your claim?

Another bad link.

Twice you used the term "bad link". Explain.

I get an error message "the page cannot be found" when I try to access the link.

As I see it, you and other "demand siders" claim that a more even distribution of incomes would mean a better economy because of "more demand" from the bottom of the income distribution. Supply siders say it is the rich who invest and provide the capital for a better economy, so cuts in tax RATES can supply more capital, expand the GDP and thus in the long run increase tax REVENUE for both the feds and the states.

Supply siders don't understand that financial capital comes from a wide variety of sources. The notion that it is only the wealthy who finance investment is simply wrong. As I've tried to explain, cuts in tax rates for the high income group do little beyond increasing the price of financial assets in the secondary market. The wealthy like to accumulate them.

Financial capital has seldom been in short supply. Can you point to an example where the lack of such capital has caused a recession? Recessions ultimately result from a shortage of purchasing power within the broad middle class sector, not among the wealthy.

Since the tax rate reductions of Reagan, the US economy has been more stable than before, and has grown faster than either Europe or Japan. Isn't that fact contrary to the "demand side" predictions?

In a word, "no".

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