

Tax cuts: All for one and one for all

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The President is correct when he says that extending the tax cuts for the top 2% of income earners will do nothing (in the short term) to stimulate the economy. He correctly says that these people will likely not spend any of the tax cuts. So why does it benefit all of us?

While almost all of us spend more than 95% of our disposable income, the wealthy 2% spend a much much smaller percent, sometimes as low as 10%. Which means, that instead of spending their disposable income, they save or invest a very large portion. In fact the majority of investment capital comes from this source. So, if the tax cuts expire for the wealthy, the amount of investment capital available for business to expand is reduced, especially in an environment where the federal government is siphoning trillions from capital markets because of the large deficits. That leads to a capital shortage as business is "crowded out" of capital markets.

The result hurts all of us. With President Obama stimulating demand by extending the tax cuts for middle America, business should see increased activity. When more customers seek to buy more products, business has a choice to make. Their first choice is to expand output to meet the increased demand. This is what everyone wants. But in order to expand output they need to hire more workers and they need to raise more capital. Because of the high unemployment, there is plenty of labor available. However, if they are crowded out and there is no capital available, they cannot expand. That is what happens when you have a capital shortage. The result is that business cannot expand and the economy does not grow.

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