The Wealth Effect on Individuals suggests that the more wealth people know or feel they have, the more likely they are to spend their money. Which in turn is good for the economy.

I'm no economist. Thankfully. I try to pay attention to what is happening with the economy and create observations based on experience and common sense. Based on that, I think the Fed is making a big mistake in how they are implementing their Quantitative Easing 2 policy.

Here is why: Companies are not spending money. Corporate cash balances at public companies are at an all time high.

When People feel like they are getting richer, that wealth doesn't convey power to the vast majority of the population. They reward themselves for all their hard work and success with increasing their standard of living.

In today's world, when companies accumulate cash they feel the exact opposite. A growing cash balance conveys a feeling of power to CEOs. The more cash in the bank, the more power with in their industry that CEOs feel that they have. It is not an accident that CEOs refer to their cash balances as a "war chest". The more cash a company has , the bigger the industry sledgehammer they have with which to make acquisitions, buy back stock and most importantly increase their own personal wealth through a rising stock price.

Not only does a big cash balance convey power to the CEO, but it also acts as a foundation for a stock price. Analysts are quick to justify Apple's stock price by pointing to the fact that 17pct of Apple's market cap is in cash. Steve Jobs has been quick to point out that there is no reason to spend their "war chest" because of the opportunity value the cash presents for acquisitions in a very competitive industry.

Jobs doesn't chase stock price increases. Most CEOs do. The same personal wealth greed that pushed companies to over leverage (only to be deleveraged) is now pushing companies to aggregate as much cash as possible. With cash you can buy back stock at any time, increasing the company's stock price and your personal wealth.

With cash in the bank, you don't have to pay to repatriate cash from overseas . You already have the cash you need.

With cash you can lay off people to increase earnings per share, knowing that if you make a mistake, you have the cash to fix it.

With cash you can borrow all the money you need at barely breathing interest rates.

Companies are not holding on to cash because of fear of political and tax uncertainty. Companies are holding on to cash because of the power it offers and the opportunity to increase personal wealth.

All that cash is sitting in the bank earning NOTHING. Economists would tell you that if you can earn more from deploying cash than by hoarding it, you should deploy it. **Not true. In this age of CEOs, power trumps return on cash every time.**

If the Fed thinks that creating money to make it easier for companies to borrow money is going to stimulate the economy, they are wrong.

They are simply making it easier for companies to hoard cash.

What should the Fed do ? I'm not sure the fed can provide the solution. I don't think they have the authority to encourage or penalize companies into using their cash. The way to get companies to spend their cash is to make it hard for them to spend their "warchests" in manners that only serve to increase their personal wealth. As i wrote several years ago:

How to Tax Wealth = Earned vs Found Money

Aug 26th 2008 4:41PM

When you go to work, whether you get paid by the hour, or on commission, tips or by salary, you earn every penny of it. The operative word being earned.

When you invest your own sweat equity and/or money to create a company, the operative word being create, you earn every penny of it.

I think Obama is about to make a HUGE misake, if elected, by increasing taxes on EARNED income of 250k or more. 250k does not make you rich, particularly if you live in a city, say New York City, with a huge cost of living. 250k does not make you rich if you are 60 years old, hoping not to get laid off and holding on to your salary long enough to have enough in the bank to retire. 250k does not make you rich if you have 3 kids near or at college age.

The disparity in wealth in this country does not come on the backs of people making 250k, or even 500k or 1mm per year FROM THEIR JOBS. The ever increasing delta between the rich and everyone else does not come from EARNED INCOME at all. It comes from found money.

Found money is when an internet bubble hits and the options you got for 1 dollar are sold for 250. It comes from buying a stock for $1 and seeing it turn into a "10 bagger". It comes from hitting the lottery. It doesn't matter whether you were smart or lucky, it is money you FOUND based on good fortune.

When I sold broadcast.com does anyone seriously think I would have cared if the tax on my FOUND money was 10pct or 20pct more ? Hell no. Would I have made any decisions differently, HELL NO.

I dont have access to financial data, or maybe Im just too lazy to find it, to know how much income in this country is found money. Capital gains earned from limited risk capital. Things like stock options awards sold. I dont know what the number is, but its found money and could be taxed higher. If Steve Jobs gives himeself 1mm Apple options at a buck or two apiece, and he sells them for $175 dollars each, would anything about his actions change if that FOUND income were taxed at 20pct higher rate ? Sure Steve Jobs busts his ass to increase the output of Apple Computer. But his ass busting does really change the multiple or base price assigned to the stock. Thats a function of the market and market trends.

Im not the economist, fortunately, but if we can arbitrarily assign taxation to given income levels, we can arbitrarily define what constitutes FOUND MONEY.

I would do the following:

if an individual, in any given year, has short term capital gains of more than 1mm dollars, AND that gain is 200pct or more (remember, for your taxes, you list cost and sales price, so gain percentage would not be difficult to calculate) you pay the existing cap gains tax, plus you get hit with a “You got lucky tax of 30pct”

For long term capital gains, it would be more difficult, but I would tax it at a gain greater than $1mm or a basis equal to the compounded CPI for every year held, against a 300pct increase and reduce the GOT LUCKY percentage to 20pct.. So in the Steve Jobs example, if he had held his stock for 5 years, then sold it at 175mm a share, he would pay tax on 175mm in gains at the current rate, then a GOT LUCKY tax at 20pct of $175mm or $35mm dollars.

Will it piss off rich people like me.. Yep. But it wont affect our behavior at all. At some point you know the difference between FOUND MONEY and EARNED INCOME. That stock that went crazy, the options or warrants you got that vested just at the right time, thats where people get in to the Fuck You money territory, and most if not all recognize that paying taxes at that level is a great problem to have.

The transactions this GET LUCKY tax is most likely to impact

So what does the blogosphere think about all of this ?

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