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BIC LLC News Release

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Reich is Wrong

The following is our response to Robert Reich's opinion the Government should incur massive deficits today in order to avoid them in the future. Prof. Reich's and our posted comments appear in today's online Wall Street Journal:

Dear Bob,

You are wrong. Government spending is the problem. Private Investment is the solution for a real recovery. Deficit spending has crowded out Private Consumption and Private Investment; it has left our country overly dependent on foreign sources of capital and has compromised our national security. Can the USA really afford to fight a large scale war today? How about 10 years from now when our debt equals our income?

Private Investment is the only long-term solution for sustainable economic growth. The Government needs to get out of the way; banks need to make loans and the entrepreneurs be allowed to take over. Success should be a rewarded, not a taxed, and failure made final. No more government fixes. Not more government bailouts!

And this is why:

As you know, Gross Domestic Product (GDP) measures our Nation's income (Y) and can be written as a simple identity:

$Y = \text{GDP}$

GDP can also be expressed in terms of its components: Consumption (C), Government Spending (G), Investment (I) and Net Exports (X).

$$Y = C + I + G + X$$

To prove our point we define a couple of other variables: After Tax Income and Savings.

After Tax Income ($Y - T$) equals Income (Y) minus Taxes (T).

$$(Y - T) = Y - T$$

Personal Savings (S) equals After Tax Income ($Y - T$) minus Consumption (C).

$$S = Y - T - C$$

Those who recall their algebra understand that a change to one side of an identity must be matched by an equal change to the other side in order to remain in balance. To quantify this rule we add symbol Δ to connote change. So:

$$\Delta Y = \Delta GDP$$

Using substitution:

$$\Delta Y = \Delta(C + I + G + X)$$

Using distribution:

$$\Delta Y = \Delta C + \Delta I + \Delta G + \Delta X$$

To solve for the change in After Tax Income ($\Delta(Y - T)$) we subtract change in Tax (ΔT) from both sides of the equation.

$$\Delta Y - \Delta T = \Delta C + \Delta I + \Delta G + \Delta X - \Delta T$$

Now, let's use a little algebra to relocate the variables:

$$\Delta Y - \Delta T = \Delta C + \Delta I + \Delta X + (\Delta G - \Delta T)$$

In the parenthesis we have: Government Spending (G) minus Tax (T), which measures the deficit (D) or Surplus (S). In other words $G - T =$ Deficit (D) when $G > T$ or Surplus (S) when $T > G$. The budget is in balance when $G = T$.

Please make special note: We use mathematical identities to make our case for Private Investment over Government Spending to save the economy. No Keynesian economics. No multipliers.

So let's move on and solve for the change in Savings. Savings (S) equals After Tax Income - Consumption (C).

$$S = Y - C$$

The change in Savings equals:

$$\Delta S = \Delta Y - \Delta C$$

We arrive at the change in Savings (ΔS) by subtracting the change in Consumption (ΔC) from both sides of the equation. As you can see ΔC is cancelled from the right side. $\Delta C - \Delta C = 0$.

$$\Delta S = \Delta Y - \Delta C = +\Delta I + \Delta X + (\Delta G - \Delta T)$$

Let's assume there is no change in Net Exports so $\Delta X = 0$.

$$\Delta S = \Delta Y - \Delta C = +\Delta I + (\Delta G - \Delta T)$$

Let's set everything equal to the change in Savings (ΔS).

$$\Delta S = +\Delta I + (\Delta G - \Delta T)$$

Personal Savings (S) have been going up since late 2008. This is because Consumption (C) dropped at a faster rate than After Tax Income ($\Delta Y - \Delta T$). Bob sees the drop in Consumption (C) as a problem to be fixed by Government Spending (G). I see the drop in Consumption as an increase in Savings (S) which will eventually lead to increased Investment (I)...as soon as banks start lending again. Further Private Investment (I) will provide future productivity gains to support our economy's recovery. Government Spending (G) will not. It is no coincidence Investment (I) has been a drag on the economy at a time of record Government Spending. Government Spending is crowding out Private Investment!

If the government were to stop spending had hold taxes constant, Investment (I) would have to go up to keep the Savings equation in balance. If the government were to cut Spending (G) and Taxes (T), Private Investment (I) would have to go higher to match the increase in Savings (S). Is there anyone who doubts Private

Investment is more productive than funding your Congressman's next pet project?

The math is perfectly clear. Respectfully, you have been proven wrong. Government Spending (G) is the problem. Stop it now. Encourage banks to lend and let Investment (I) takeover!

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