Economics Brief

SEEL-Systems Engineering Economics Lab

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Income Disparity

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The flawed Irving Fisher version of the Quantity Theory of Money (QTM) identity obscures the fact that assets absorb a large proportion of funds. This leaves a reduced residual accessible to investment, inputs and wages for the production of goods and services. This was particularly evident between 2008 and 2022 during quantitative easing (QE).

The QTM obscures this reality because it contains no variables for assets, overseas flows and savings. As a result, the QTM is far too simplistic and of no utility because it is not a determinant function.

$$M.V = P.Y \quad \ldots \quad (i)$$

Where:

M is the volume of money;
V is the velocity of money circulation;
P is the average price of goods & services;
Y is the quantity of goods & services or, real income.

I therefore, elaborated a Real Money Theory (RMT) to replace the QTM, which includes all of the asset classes as follows:

$$(M - (l + r + p + m + a + h + f + c + o + s)).V = P.Y \ldots (ii)$$

The missing asset variables are:

l as land;
r as real estate houses & buildings;
p as precious metals;
m as commodities;
a as rare & art objects;
h as shares;
f as financial instruments;
c as crypto currencies;

In 1975 Denis Healey, the Labour government Chancellor, altered macreconomic policy to one placing more emphasis on monetary policy instruments.

Since then investment and productivity in industry and manufacturing declined and the balance of payments for goods collapsed.

The other troubling trend has been a rise in income disparity which has a line of demarcation between wage-earners in general making up some 95% of the constituency of the United Kingdom and asset holders and traders making up the other 5%.

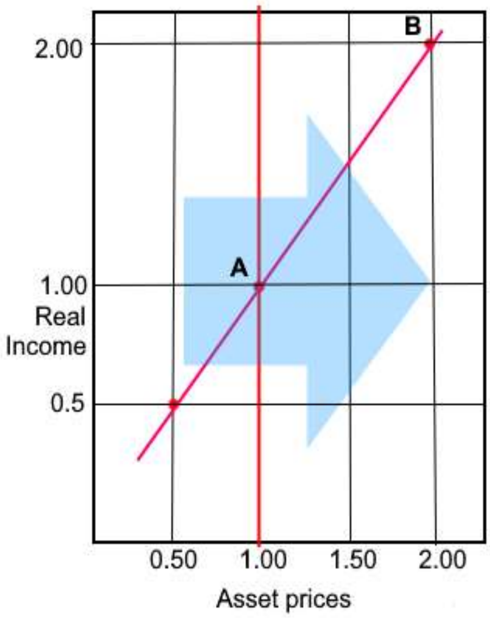
Asset holders and traders' wealth constantly rises ad real wages constantly decline as a direct function of monetary policy decisions and fiscal policies also.

Two other significant withdrawals from national transactable money volumes include:

o as overseas money flows;
s as savings.

The fact that considerable proportion of funds flow into assets, overseas and into savings and, under QE, this flow was greater, has a significant impact on income disparity.

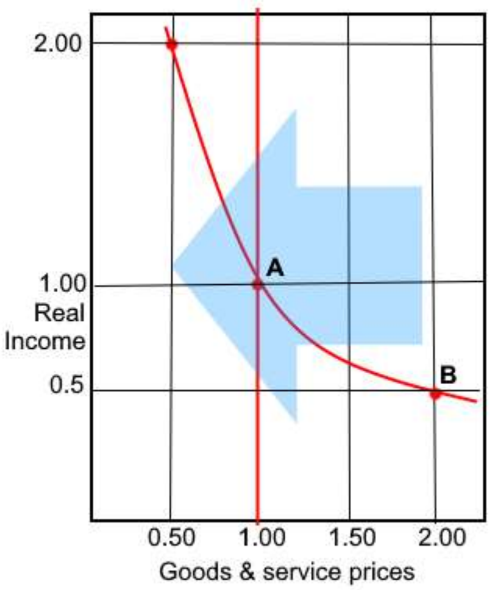
Figure 1
Asset prices
& Real Income



Asset holders & traders

The income levels of income of assets holders and traders benefit from rapidly rising asset prices. The volume of transactions and volume of money drives asset prices higher. Because of this effect as money volumes rise so do sales margins and income of traders. In the meantime, the held assets accumulate value, raising wealth.
Therefore, the real incomes of asset holders and traders rise with rising asset prices as shown in Figure 1.. A price rise from 1.00 to 2.00 doubles real incomes by moving from position A to point B. The blue arrow indicates the price movement preference of asset holders.

Figure 2
Good & Services prices
& Real Income



Wage-earners

In the case of wage-earners, nominal wages do not rise significantly from year to year. As shown in Figure 2, a doubling of goods and service prices will halve real incomes by moving the state of real income from A to B as a function of rising prices.

Therefore, the blue arrow indicates the price movement preference of wage-earners.

As can be appreciated asset holders and traders price movement preferences are diametrically opposed to wage-earner preferences.

The fact that in one case we refer to assets and in the second case goods and services is not a matter of comparing apples and pears.

This is because the determinant of the real incomes of asset holders and traders are the very products they trade in or hold. Therefore, their real recompense varies with movements in asset prices but as prices are rising so are their real incomes.

Similarly, the determinant of the real incomes of wage-earners are goods and services purchased for consumption but which are not resold. Therefore, their real recompense varies with movements in the prices of goods and services but as prices rise real incomes decline.

Because of the prices of the assets of land. real estate (houses, offices, commercial and industrial units) are rising there is a knock-on effect in housing markets and industrial and logistics units causing a rise in rentals and prices. This raises business costs and the cost of living for families paying rent or attempting to purchase a home. This results in family and business costs rising and a corresponding rise in the prices of goods and services production.

Once the inflation rate of goods and services begin to rise the real demand begins to decline because the purchasing power of wages declines. This means that there will be difficulties faced by businesses and households to pay rent so that the return on rental properties will falter and the resales market will weaken resulting in hedge funds coming onto the scene and purchasing from middle income owners, usually at a discount.

When the United Kingdom modified the macroeconomic approach to place more emphasis on monetary policy in 1975, the average house price was £10,388 and the weekly wage around £48, by 2023 the average price of a house was £258,115 and the weekly wags around £600. Over that time period wages increased by a factor of around 12.5 whereas house prices increased by a factor of around 25. Therefore, house prices and rents as a component of the cost of living of average wages contributed to a halving of the purchasing power of wages for that component. At the same time buying and selling houses and renting them remained profitable.

The Bank of England while referring to "price stability" and also relying in the logic of a defunct QTM gives the impression that the price stability it refers to is goods and services. However, the actions reflect their objective it to maintain the value of assets because these remain as collateral for banks. This is understandable. However, the way in which monetary policy has been managed has contributed to a marked rise in income disparity and poverty amongst wage-earners, and the majority of those in the lower income segments.

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