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WHAT'S WRONG WITH MAINSTREAM MACROECONOMICS?

John H. Hotson*

I shall argue there are at least four things wrong with the mainstream macroeconomic policies currently practiced in the United States and other "advanced" countries. First, mainstream macroeconomics is immoral. Second, mainstream macroeconomics is illegal. Third, mainstream macroeconomics is irrational. Fourth, mainstream macro-economics has resulted in a crisis where our only choices appear to be between a world wide debt repudiation crisis and strato, or even, hyper-inflation. However, I shall also argue that every crisis is also an opportunity and that by adopting better policies we can set the world economy up for another run of good years.

By "mainstream macroeconomics" I mean not only the "monetarist" policy of deliberately causing the current world depression by "tight" money and high interest rates but also those corrupted versions of "Keynesianism" which seek to "trade-off" prosperity for price stability. Whether the means are "monetary" or "fiscal" or some combination, all such attempts inflict on innocent bystanders enormous damage while at the same time wholly failing to come to grips with the root causes of higher prices. Indeed these policies contribute to inflation secularly, whatever their short term, or cyclical effects.

Mainstream Macroeconomics Is Immoral

At present some 40 million persons are unemployed in the 24 O.E.C.D. nations alone. Furthermore, some 300 million persons are unemployed in the less developed nations of the "south." In the 1973-83 period the world economy has lost several trillion dollars worth of real output which would have been achieved had the growth rates of the 1950-1972 period been maintained. Meanwhile a billion human beings remain seriously undernourished, and some 20 million die annually of hunger in a world which produces more than enough food for all. However, instead of recognizing the hunger, disease, and poverty of the poorest nations as the greatest economic problem on the planet; and that this problem represents an opportunity to solve the unemployment problems of the rich and poor, world leaders have since the "oil shock" of 1973 distracted themselves with a never ending, no win "war" on inflation. Even if they _had_ succeeded in "licking" inflation by "tight money" and depression the benefits could never have come close to equaling the costs-the trillions of dollars of lost output and the millions of lost human lives those dollars represented.

As James P. Grant, Executive Director of UNICEF, has pointed out, 40,000 children die every day from malnutrition and infection. If the goal of the U.N.'s International Development Strategy (IDS) of a 7 per cent a year rise in the real GDP of the developing nations is achieved, child deaths can be cut in half by 1990 and by the year 2000 the infant mortality rate in all low income countries can be reduced to 50 per 1,000 or less, average life expectancy can be raised to 60 years and every child can have at least the four years of primary education necessary to acquire literacy. Achievement of these goals would, as Grant shows, slow down, rather than speed up the 'population explosion."[1]

*Professor of Economics, University of Waterloo, Waterloo, Ontario.

[1]James P. Grant, _The State of the World's Children 1982-1983_, Unicef, New York, December 17, 1982, pp. 6-7.

However, as Grant also writes:

> "Between the end of World War II and the beginning of the 1970s,..., child death rates in the low income countries were reduced by half. Yet in recent years, that progress has not been maintained...Overall, present trends predict that the proportion of the world's children who live without adequate food, water, health-care, and education - a proportion which has been steadily declining for more than a generation - will now remain approximately the same at the end of the century as it is today. Meanwhile, the absolute numbers of children living and growing in malnutrition and ill health is set to increase."[2]

Recession in the "north" deals a multiple blow to the "south." First, a fall in output in the advanced countries reduces their imports from the developing world. Secondly, much of the decrease in the inflation rate is achieved by the fall of the south's raw material prices relative to those of the north's manufactured goods - thus the terms of trade turn against them. Thirdly, recession leads to increased protectionism with especial discrimination against the south's "low wage" manufactures. Fourth, immigration barriers are raised and "guest workers" from the south are shipped home. Fifth, the high interest policy means that more of the south's export earnings are used up to pay interest rather than being available to finance needed imports. Finally, recession leads to cut backs in foreign aid flows from north to south.

Certainly, President Reagan and Federal Reserve Chairman Paul Volcker, their counterparts in other advanced countries and the economists who advise them, did not set out deliberately to condemn millions of babies to death.

But this is exactly what they have done, by insisting that "licking inflation" is more important than world economic development. It is immoral to add to the woes of the "wretched of the earth" to alleviate the problems of the rich countries _even if it worked_. But it has not--indeed it cannot.

Mainstream Macroeconomics Is Illegal

At the end of the Second World War the governments of the United Kingdom, the United States, Canada, and others assumed governmental responsibility to maintain full employment and rapid growth of real output. In the United States the operative legislation was The Employment Act of 1946 which requires all organs of the U.S. Government--which certainly includes the Federal Reserve System -- "to use all practicable means...to promote maximum employment, production, and purchasing power." This act does not direct the government or the "Fed" to stabilize the price level, or to sacrifice "maximum" employment in the pursuit of stable prices and, to my knowledge, Congress has not so directed in other legislation. Therefore, the "Fed's" long "tight money crusade" is an illegal, vigilante attack upon the livelihoods of the great bulk of the population to promote the interests of a small group of money lenders.

[2]Grant, p. 1.

Officialdom has been aided and abetted in this illegal "class warfare" policy, and indeed egged on, by many professional economists. Therefore, Sidney Weintraub is too mild when he urges that, "Those who advocate unemployment as a cure for inflation should themselves be the first to be disemployed." In addition to being fired, such economists should be deprived of their right to practice economics, like lawyers disbarred for participating in illegal activities, doctors stripped of their title for malpractice, or priests defrocked for doing the devil's work.

Mainstream Macroeconomics is Irrational

Now morality and legality are not the special province of economists, but it is indeed strange that men who claim special expertise regarding "rationality" and "efficiency" would ever have advocated depression via high interest rates and high taxes as a cure for inflation. It is irrational to seek to lower prices by policies which raise costs. It is inefficient to use "blunt instruments" such as quantitative controls over "money" when selective credit controls are so much more cost effective.

In order to see the irrationality - indeed insanity - of the mainstream economist's ideas on inflation cures try the following thought experiment. If what we economists and our textbooks teach is true, it should be possible not only to "lick" inflation, but also to choose any price level we want by the following policy "menu:" Let us raise interest rates very high - say to 100%; this will reduce demand so prices will start to fall. Then let us collect a heavy "excess interest income" tax from interest recipients, further reducing demand and prices. Finally, let us use the proceeds of this tax to subsidize producers to lower their prices. Prices would be lowered by a triple count! By maintaining this policy for "x" months we ought to be able to drive prices back to their 1978 level, while 1972 would only take a little longer, some "x + y" months! Nonsense? But of course, and so is most of what economists teach about inflation control.[3]

Just as it is possible to get from Chicago to New York by travelling west, north, or south instead of east, since the earth is a ball, it is possible to reduce inflation with tight money. It's just extraordinarily inefficient and expensive. We see around us in a wrecked economy with temporarily lower inflation rates the proof of the proposition that if "tight money" is maintained long enough the direct inflationary impact of the policy will be, at least temporarily, more than offset by wage and profit deflation because of the unemployment and bankruptcy such policies cause. I stress "temporarily" because the reduction of inflation tight money achieves is only "cyclical" while the long term debt contracts entered into at high rates lock a higher underlying, or "secular" rate of inflation into the system. Each time we attempt to "restart" the economy after a "successful" bout of monetarist blood letting we do so at a higher level of interest costs, a lower rate of profit, an older capital stock, a higher "natural" rate of unemployment, and a higher rate of inflation.

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[3]I am indebted to William Krehm for much of the above paragraph, and for much else including his "tax-bond" proposal - a partial solution to both high interest rates and high taxes. See his Babel's Tower: The Dynamics of Economic Breakdown, (Thornwood, Toronto, 1977,) p. iv.

Mainstream Macroeconomics has Resulted in a Debt Repudiation or Hyper-Inflation Crisis

As anyone who reads newspapers or watches television knows only too well, the world economy is in an economic and financial crisis which daily threatens to return us to scenes of financial panic not seen since the 1931-33 period, when the world's leaders fiddled and fumbled their way into the Great Depression. As TIME (Jan. 16, 1983) informs its readers in its cover story, "The Debt Bomb: The Worldwide Peril of Go-Go Lending," the poor nations of the "south" and "east" owe the rich nations of the "north" and "west" over $700 billion and are unable to pay even the interest due, much less make agreed upon reductions in principal. The Wall Street Journal (Dec. 10, 1982) carried a front page story, "World Banking Bust" describing in vivid detail a scenario by which the world banking system might self destruct in a few days.

Perhaps the professors of economics' greatest "contribution" to this threatened debacle was a sin of omission. They gave the world's present policy makers and statesmen, many of whom received a "good" university education in economic theory, no warning whatsoever of such perils as debt "bombs", and the choice they seem to pose between world financial collapse now or hyperinflation now and an even greater collapse later. Now "debt repudiation crises" have recurred many times in the past, and economics and international finance texts devote many pages to such topics as "interest rates", "borrowing", "return flows", and "growth". However, the rate of change of total debt and the rate of change of total interest burden relative to the rate of increase in total income is never discussed. An economics text which purports to tell, "Everything You Always Wanted to Know About Debt--But Were Afraid To Ask," and that omits to mention that a tendency for debt and interest to rise relative to income must eventually cause breakdown, is as incomplete and irresponsible as a sex manual that regales with description of 101 ways to "do it" and never mentions once that sex relations cause babies, nor even mentions herpies. No textbook that I have even seen--and I have seen at least a hundred--has ever stated such basic propositions as: total debt cannot grow faster than total income for very long; total interest income increasing relatively to total income is "stagflationary"; therefore total debt and interest income must grow no more rapidly than does real income if stable prices are to be obtained and maintained.

While economists were failing to understand the costs of high interest such costs were growing explosively over the past few decades. Table 1 and Figure 1 provide comparisons between indices of income categories in the U.S. from 1950 to 1982. Whereas real, or constant dollar, GNP increased by a multiple of only 1 to 2.8 from 1950 to 1982, nominal, or current dollar, GNP grew 10.7 times as the price level almost quadrupled. All categories of gross income which increased to an index of more than 2.8 from 1950 to 1982 "participated" in inflation. However, categories which increased to less than 10.7 decreased as a share of GNP. Several things are striking about Table 1 and Figure 1. Over the three plus decades, small business did very badly, particularly farm proprietors, whose real income fell greatly. Corporate profits fell as a proportion of GNP, while their Capital Consumption Allowances rose, perhaps sheltering some of their profits. Compensation of employees rose faster than nominal GNP, lending weight to the "wage push" inflation thesis, and Net Interest rose to a phenomenal 88.4! Who would argue that we should attempt to stop inflation by raising wages, or profits nearly 90 fold when real output has increased less than 2 fold? Yet so confused is present day economic theory that otherwise clear thinking economists advocate interest hikes as inflation cure alls.

Net interest was only 22 per cent of Farm proprietors income in 1950, while it was 1,426 per cent of farm income in 1982. (As a further comparison, Personal interest

income, which includes public debt interest, was $9.7 billion in 1950 and $381.8 billion in 1982; thus 71 per cent of farm income in 1950 and 2,053 per cent of farm income in 1982!) By adding together Net Corporate Profits and Farm and Non-farm proprietors income to obtain "Total Enterprise Income" and dividing this into Net interest, we obtain

TABLE 1: GNP and Sub-Categories

	1950	1982	1982/1950
	(billions of dollars)		
GNP at Constant (1972) Prices	$534.8	$1,475.5	2.76
GNP at Current Prices	286.5	3,057.5	10.67
Capital Consumption Allowances	23.5	356.8	15.18
Indirect Business Taxes	23.4	258.8	11.06
Compensation of Employees	154.8	1,855.9	11.99
Farm Proprietors Net Income	13.7	18.6	1.36
Non-Farm Proprietors Net Income	25.0	101.4	4.06
Net Rental Income of Persons	7.1	34.1	4.80
Net Corporate Profits	33.9	161.1	4.75
Net Interest	3.0	265.3	88.43

Source: Economic Report of The President: February 1983

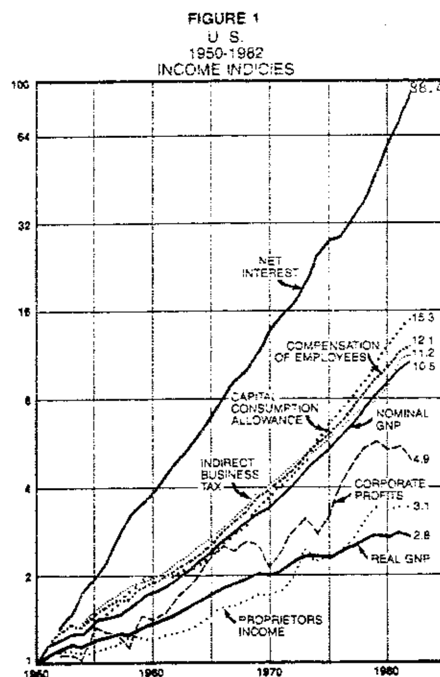

FIGURE 1
U S.
1950-1982
INCOME INDICIES

a further comparison. Net interest, or, "rentier" income received from the private sector, was only 4.1 per cent of Total Enterprise Income in 1950, but 94.4 per cent in 1982!

In Figure 1, Farm and Non-farm proprietors income is combined to produce the line labeled "Proprietors Income," and the imputed income category, Net rental income of persons is omitted. The Figure is visually dominated by the explosive growth of Net interest. And as the semi-log format of Figure 1 makes evident, the rate of increase of Net interest has been high, and all but constant, since 1950. Defenders of the "conventional wisdom" are quick to point out that Net interest was only 1 per cent of GNP in 1950, virtually an all time low, and that it is today only 8.7 per cent of GNP, or still not too significant. However, the rise in the share of the small "rentier" category of income has squeezed down the "gross profit residual" more than the slow rise of the massive wage share. Thus in 1950 Employee compensation was 54 per cent of GNP and in 1982 it was 60.7 per cent. Thus the wage share gained 6.7 per cent of GNP between these years, and the rentier share gained 7.7 per cent. Inflation is routinely blamed on wage gains in excess of labour productivity gains, but who would argue that the productivity of borrowed money has increased explosively over the post World War II era? Interest rates are 4 times higher now than in 1950; is the "marginal productivity" of a dollar 4 times higher?

The faster growth of net interest than of nominal GNP is the product of the fact that Total Debt has grown faster than has GNP and the fact that interest rates have increased. As I show in "Can Capitalism Survive Its Economists?"[4], Total Net Debt increased 11.9 times (from $472.9 billion in 1950 to $5,617 billion in 1981) while GNP increased only 10.2 times. The fact that Net interest increased more rapidly than Personal interest income (which increased "only" 38.4 fold) also reflects the fact that it has been the private sector, rather than the public sector which has been increasing its debts at a rapid rate. As William F. Hixson ably shows in the paper, "Some Aspects of Interest and Reaganomics,"[5] the private sector since WWII has been increasing its indebtness twice as fast as it increases its nominal income (and thus roughly eight times as fast as it has increased its real income) and it has increased its interest payments six times as rapidly as its nominal income (thus twenty four times as fast as it increased its real income).

Monetary Interest Paid on a total indebtedness of $5,617 billion in the U.S. in 1981 reached the staggering sum of $873 billion--or about the size of GNP in 1968. Thus the average rate of interest was 15.5%. In contrast, Americans owed each other only $534.8 billion in 1950 and paid each other interest of $16.6 billion, or an average rate of 3.5%. Only some 40% of Monetary Interest Paid (MIP) becomes Personal Interest Income, the remaining 60% is absorbed by the banking and financial structure, entering GNP as wages and profits of financial & non-financial corporations, or, in the case of interest on public debt, is excluded from the calculation of GNP.

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[4]John H. Hotson, "Can Capitalism Survive Its Economists?", The Future of Monetary Policy, Hearings before the Joint Economic Committee, Congress of the United States, June 2-15, 1982, GPO Washington, 1982, p. 254.

[5]William F. Hixson, "Some Aspects of Interest and Reaganomics," The Future of Monetary Policy, pp. 321-367, esp. p. 329.

It cannot be too strongly stressed that the disproportionate growth of interest that we have seen for the past three decades is not sustainable; for if it were sustained we would in a very few years find Monetary Interest Paid greater than GNP -- an impossible situation. MIP is so large, and growing so rapidly, (51.6 times as large as in 1950) that in 1981, for the first time, the increase in MIP exceeded the increase in the wage bill (MIP = $205.5 billion, W = $175.1 billion, and in 1982 MIP exceeded $1 trillion.) Furthermore, should both MIP and wages increase in the future as they have in the recent past, by 1988 MIP will exceed Employee Compensation! I do not believe it is possible for MIP, which provides the income of our financial sector and a small group of wealthy "rentiers", to become equal to Employee Compensation--which provides the income of some 80% of the population. Either the pace of the growth of MIP must be reined in, and soon, or the pace of growth of employee compensation will rise to match it, i.e. we shall have a "hyper" wage inflation to match the "hyper" interest inflation which is afflicting us.

It matters greatly, however, how the growth of MIP is reined in. If the Reagan Administration and Congress succeeded with plans to cut government borrowing just as the private sector is exhausting its credit, we would "succeed" in reining in MIP, but at the cost of a debt repudiation crisis on the scale of 1931-33 and deep depression.

Hixson's Helix--The True Inflation Spiral

As William F. Hixson fully documents in "Some Aspects of Interest and Reaganomics,"[6] the U.S. economy only prospers in years in which Private Deficit Spending (PDS) exceeds Private Debt Interest (PDI) by some 40 to 60 per cent. In years in which PDI exceeded PDS a recession occurred. He also demonstrates that the private sector has found it increasingly difficult to increase its debts faster than its interest burden increases, "despite herculean efforts of the federal government to facilitate the process by loan-guarantees, interest rate subsidies, tax cuts, panic orders for poorly planned military hardware, import-export subsidies, and expansion of the money supply at such a rate as to permit private debt to increase more than 1973 to 1980 than from 1789 to 1973."[7]

In a growing economy total indebtedness will increase. If debt increases no more rapidly than income, and the rate of interest is constant at the growth rate of per capita income, the "rentier" share will remain constant and the situation will be one of long run sustainability. Further, if nominal income grows no more rapidly than real income, the situation will be one of over all price level stability as well.

No such sustainable rate has been achieved in the case of U.S. private debt and debt interest payments. Both PDS and PDI have increased more rapidly than GNP secularly, while over the business cycle PDS has grown faster than PDI in all but recession years.

Figure 2, Hixson's Helix, traces the explosive girations of Total Deficit Spending (TDS, thus the annual increase in net public and private debt) and Total Debt Interest (TDI, roughly the same as MIP) as percentages of GNP from 1967 through 1982. The 45^0 line represents all possible points at which TDS is just equal to TAI. Of the years surveyed, only 1970, 1980, 1981 and 1982 were "below the line" and thus years in which new borrowing was less than interest payments. These were also, and not coincidentally, years of recession and much economic "discomfort."

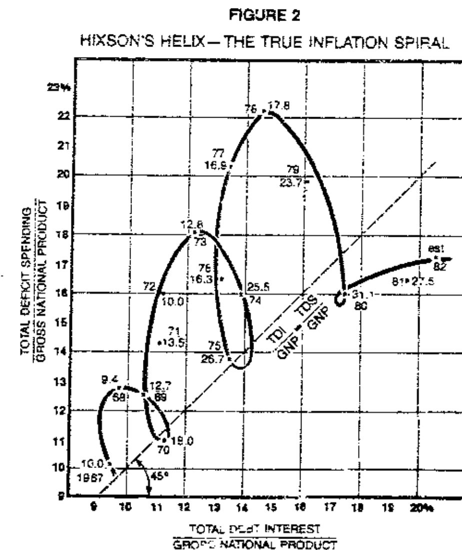

FIGURE 2
HIXSON'S HELIX—THE TRUE INFLATION SPIRAL

The over all visual impression of Figure 2 is of increasingly violent financial fluctuations, with each "peak" year of the business cycle--1968, 1973 and 1978-increasing Total Deficit Spending greatly as a percentage of GNP to an all time--so far at least - high in 1978 when some 22.2% of GNP was deficit financed. However, these vertical departures from the 45^0 line do not return to the same point with downturns for Total Debt Interest is likewise increasing secularly as a percentage of GNP. Thus the upward spiral. No one can say just where the upper limit is to the percentage of GNP which can be borrowed and spent, or how much of our incomes we can devote to repayment of interest. But such a limit must exist somewhere. It is hard to believe that the economy could operate with, say, half of total spending being deficit financed, or with debtors paying half of GNP to creditors as interest. Yet as Hixson shows, if Post WW II trends continue we shall reach such a state of affairs by 1990.

Figure 2 also indicates that something unusual happened in 1982 in that, following the 1980 recession the economy did not resume a high deficit spending recovery path, but instead appears deflected on a depression path with the TDI/GNP ratio increasing greatly both from the rapid growth of the numerator and slowed growth of the denominator.

The economy has, until now, succeeded in expanding real, as well as, merely nominal income despite a tight money policy, by "layering" ever more rapidly expanding debts on a slowly expanding "official money supply." The private sector has been overwhelmingly the deficit financier, engaging in roughly 80% of debt creation. However, the private sector has increasingly "run out of steam" over the 1967-82 period as Figure 2 makes evident. The number associated with each year in Figure 2 represents Government Deficit Spending (GDS) as a percentage of Total Deficit Spending (TDS). The pattern is clearly counter-cyclical, with government (i.e. Federal + State and Local)

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[6] Hixson, The Future of Monetary Policy, pp. 325-7, 331.

[7] Hixson, pp. 326-9.

borrowing "filling in the troughs" during recession years when private borrowing falters, then shrinking relatively and absolutely in more prosperous years. There is also a clear pattern of secular increase in the GDS/TDS ratio to be seen not so much in the peak years (1968, 1973, and 1978) as in the trough years (1970, 1975, 1980, 1981, 1982).

The most significant years surveyed in Figure 2 are: 1975, when GDS more than doubled from its 1974 level of $48.4 billion to $111.0 billion and set the economy up for an upswing, by supplying almost half of the economy's deficit finance; and 1982. In 1982 the government did almost 58% of total deficit spending and yet the economy did not recover. GDS grew from $165.5 billion in 1981 to $282.7 billion in 1982 and interest rates fell considerably after mid 1982 as the tight money policy was relaxed. GDS was 2.5 times larger in 1982 than in 1975, yet GNP was only 2 times larger. Why did not the economy recover more strongly in 1982? Much of the answer lies in the high real interest rates and higher interest burden (TDI) in 1982 than in 1975. Then the real rate of interest was - 1.1% (the avg. rate of interest was 0.8 and the rate of inflation was 9.1) while in 1982 the average rate of interest was 11.18 and the rate of inflation 06.1 for a real rate of 05.7, the highest since the 1929-33 period. Furthermore, the increased government debt load ($1,800 billion in 1982 vs. $776 billion in 1975) coupled with higher interest rates, meant that about 70% of GDS in 1982 went to pay interest, while less than 50% of government borrowing in 1975 went right back to "rentiers", rather than being available for current government spending.

Much nonsense is now being written about the need to get President Reagan's "run away deficits" under control. Those who insist that now is the time to at least make gestures toward "balancing the budget" could not be more wrong. Have we forgot everything Keynes taught us? Are we determined to relive the 1930s and wait for some latter day Hitler to give us an excuse to raise GDS sufficiently to restore full employment? However, we must do more than set the economy up for just one more, yet wilder ride on "Hixson's Helix." We cannot continue indefinitely, or indeed for more than a very few years, increasing deficit spending and interest repayment as a percentage of GNP. We must find policies which will keep TDS some constant percentage, and TDI some constant, and lower percentage of GNP. In terms of Figure 2, we must cease to move "east," for that way lies a debt repudiation depression. However, we cannot continue to move "north-north east" either, for that way lies accelerating stagflation. We must move almost due "west" into some small stable orbit above the 45° line. Furthermore, if we are to accomplish a non-inflationary expansion of the world economy we must find policies to bring down the growth rate of nominal GNP, including especially interest, to that of sustainable real GNP. The remainder of this paper is given over to sketching just such policy directions.

The Income Policy Context for Interest and Credit Control

All sensible discussions of income policies must start with the recognition that we already have income policies which work, and work to give us stagflation. What we need to design are incomes policies which will give us the outcomes we desire -- full employment and stable prices. Income policies are the net result, whether intended or unintended, of all government policies upon the rate of growth and distribution of income. Thus labor relations laws, anti-trust laws, agricultural support prices, marketing boards, and tariff laws, and much more make up our present incomes policies -- and give us stagflation.

Tight money is itself a potent incomes policy. It is also a very indirect, inefficient, and unjust way to slow incomes inflation. It decreases the pace of investment--upon which the pace of real income growth largely depends, decreases the incomes of farmers

and other small businessmen and their employees, especially those in construction, shrinks the profits of corporations which have financed their growth by borrowing, while conferring windfalls on those which are equity financed to such an extent that they are deterred from their major function to become money lenders. All this is done in the hope that if there is enough "slack" in the economy the next round of wage and price increases will be smaller. Surely we can do better than this.

A good incomes policy is easy to specify, if harder to achieve. A good incomes policy works to cause money incomes to grow only as rapidly as the full employment of human and nonhuman resources allows our real output to grow, and for this output to be equitably distributed. Thus, if real output can grow only 5% per year, then money incomes, total debt, and total debt interest, must also grow by 5%; not 14%, 16%, and 27% respectively, as they have in the recent past.

Pasinetti's "Natural" and "Market" Rate of Interest[8]

The only "natural" rate of interest, the only rate that society can pay over the long run, is one equal to the growth of "total factor productivity," i.e., real output per head. When the "market" rate exceeds this natural rate it causes an unsustainable growth in the "rentier" share of income at the expense of wages of profit. The attempts by wage and profit recipients to hold onto "their" shares sets off an inflationary spiral--financed by layering more and more debt claims per dollar of prime money, and pressing more and more debt claims into service as "money." Ultimately such a "fragile" financial system, to use Minsky's useful word,[9] must become top heavy and crash. Thus the boom and bust cycle of capitalism. The above is the essence of Pasinetti's theory. It accords well with Keynes' emphasis on the need to hold the long term rate of interest down as low as possible with usury laws and with the ancient wisdom of our society. I refer to the prohibition of interest taking in all the books of ancient wisdom of our society -- The Bible, the Greek philosophers, The Koran, and the fathers of the Catholic Church. All held that there was no quicker road to social or individual hell than allowing "usurous," or indeed, any interests rate. For in a world of zero productivity gains such as theirs, the "natural" rate is clearly also zero and the result of allowing any positive market rate is inevitable -- a society of a few wealthy, money lending landlords with everyone else their tenants, servants and slaves.

Wilmeth and Krehm's Contributions

Productivity gains in even highly advanced societies seldom exceed 4%, and in recent years they have been much less than that. How are market rates of interest as low as this to be achieved? First of all, it is a remarkable fact that the real (inflation

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[8] Luigi Pasinetti, "The Rate of Interest and the Distribution of Income in a Pure Labor Economy," Journal of Post Keynesian Economics, Winter 1980-81, III-2, 170-82. Further see his, Structural Change and Economic Growth, Cambridge University Press, Cambridge, 1981. Note that Pasinetti's use of these terms is very different than Wicksell's earlier usage where the "natural" rate was defined as that rate which equates saving and investment at full employment.

[9] Hyman Minsky, "The Financial Instability Hypothesis: An Interpretation of Keynes and an Alternative to 'Standard' Theory," Nebraska Journal of Economics and Business reprinted in Challenge, March-April 1977, 20-7.

adjusted) rate of interest infrequently exceeds 3% (1982 being highly unusual in this respect) and is quite frequently negative (as in 1974, 1975, 1979 and 1980). Stable prices require, as well as help bring about, low interest rates.

In testimony before the Joint Economic Committee of Congress,[10] Harvey D. Wilmeth demonstrated that the rise in the market rate of interest from 1953 to its highly "unnatural" heights in 1982 is to be explained by a rise in the "Monetary Policy Index," the ratio of new borrowing to the prime money supply, thus TDS/M_1. In the early 1950s there was only 25 cents of TDS for every dollar of M_1 (interest free currency and demand deposits) and the average rate of interest was about 3%. By 1981 there was over $1.10 of TDS for every dollar of M_1 and rates averaged 11.5%. He also showed that in the U.K. and Australia (and he could have added, Canada), where the ratio of M_1 to GNP has fallen similarly to the U.S., interest rates have similarly increased, while Switzerland, Germany and Japan, which have maintained near constant M_1/GNP ratios, have enjoyed lower and near constant interest rates. Indeed, Switzerland, which has by far the highest ratio of "narrow" money to GNP has by far the lowest interest rates, and, he might have added, by far the lowest rates of inflation.

Thus, while the "Fed" and other central banks have attempted to make credit tight by restricting the growth of M_1 a new version of "Gresham's Law"--that bad money drives out (replaces) good -- was at work. Borrowers and lenders have invented "bad" i.e. high interest rate monies, to take the place of the "good", non-interest bearing prime money, M_1. Wilmeth's proposed solution is greatly to step up the creation of M_1 by the central bank <u>after</u> controls are put on the rate at which the commercial banking system creates bad money, M_2 (M_1 + time deposits), M_3,...,M_x etcs. International treaties must be negotiated, however, to bring the "xenocurrency" market under control.

William Krehm's "tax-bond" proposal is a halfway house between an involuntary tax receipt and a purely voluntary subscription to a bond.[11] The lower the rate of interest on the tax-bond and the more remote the redemption date, the more the tax element of the tax-bond, and the greater must be the other inducements to get them placed. The prime inducement to buy tax-bonds is to avoid taxation. Thus those wishing to commute w dollars of taxation would be allowed to subscribe to w +x dollars of tax-bonds paying y rate of interest and maturing in year z. By varying x, y and z the government could make the tax-bonds sufficiently attractive to sell any desired amount at interest rates far below the current "unnatural" market rate.

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[10]Harvey D. Wilmeth, "A Program for the Permanent Reduction of Interest Rates," <u>The Future of Monetary Policy</u>, pp. 196-215. See also his, "Is Inflation Curable Without High Unemployment?" <u>Creative Living</u>, Summer 1981. The fullest statement of Wilmeth's views and research is in two papers given at the Eastern Economic Association meetings in March 1983, "A New Framework for Macroeconomic Analysis: Or the Framework is the Theory," and "The Interrelationships of Money, Debt & Interest Rates, A New Framework for New Explanations."

[11]William Krehm, "Tax-Bonding: An Economic Systems Approach," <u>The Future of Monetary Policy</u>, pp. 266-289; <u>Price is a Mixed Economy: Our Record of Disaster</u> (Thornwood, Toronto, 1975); <u>Babel's Tower-The Dynamics of Economic Breakdown</u> (Thornwood, Toronto, 1977); <u>How to Make Money in a Mismanaged Economy</u> (Thornwood, Toronto, 1980).

There is merit in combining Wilmeth and Krehm's proposals as follows: Let the Treasury announced that it will from now on finance its deficits, and refinance its existing debt, only at the Federal Reserve and with financial, and non-financial institutions, and households only via tax-bonds. The "Fed" is the most efficient money producer on earth, it can finance the government at 1% interest and still show a profit, as it did in World War II, while households could be offered the more generous 2.5% bonds like those which paid for the war.[12] The Fed should also lower its discount rate to 1 or 2 percent while keeping a tight rein on the growth of money substitutes. We should abolish interest on NOW accounts and reduce interest on savings accounts to 2 to 3 per cent. People who want a higher return than that should take their chances on the stock market, instead of being offered an assured return on a riskless investment. Additionally, many changes are possible to the tax laws to induce corporations to finance more of their expansion via equity and less via debt.

It would be best to achieve these dramatically lower interest rates by close international coordination -- to prevent hot money flows and exchange rate instabilities. However, in the absence of such agreement the U.S. should go it alone as others will quickly copy it, just as they copied the disasterous high interest policy.

<u>The Crisis Is The Opportunity: Saving the World Economy by Saving the World's Children</u>

Economically, as well as militarily, the fate of all mankind -- both children starving in Africa and the directors of Citbank -- are interdependent. Henry Kissinger has recently pointed out that growth, not austerity, offers the third world and the west their one hope of settling now crushing debts. He argued that only a new Marshal Plan, led by the U.S., can stave off economic disaster.[13] At Cancun in October 1981, President Reagan joined with 21 other heads of state in endorsing the goals of the U.N. International Development Strategy, specifically the goal of the end of the persistence of hunger by the year 2000. To date, however, he has done little or nothing to validate this pledge, and indeed has led us in the opposite direction -- into recession and increased military spending. James Grant writes of the children health revolution new technologies have lately made possible and concludes:

> "With the commitment to that revolution which it..deserves, ...the most effective attack ever made on child malnutrition could now be mounted...Without that commitment, the present slowdown of progress will continue and the target of halving the infant and child death rate in the year 2000...will be quietly abandoned. If such a target, accepted by the international community only two years ago, is indeed laid by, then it means that the number of children who die unnecessarily each year from now on will be the equivalent of the entire under-five population of the United States."[14]

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[12]See John W. Wright, "A Proposal to the Secretary of the Treasury et al.," <u>The Future of Monetary Policy</u>, pp. 483-538 for such a proposal (p. 493-4)."

[13]Henry A. Kissinger, "Saving the World Economy," <u>Newsweek</u>, Jan. 24, 1983, 46-9.

[14]Grant, 12.