Elgin Groseclose

REAGANOMICS AND THE INTEREST SYNDROME

THE Administration's efforts to balance the budget and reactivate the economy recall the county fair contests of an earlier generation known as climbing the greased pole. Just as it appears that inflation is being brought under control, interest rates start rising again, bringing the seed of inflation, erosion of savings, reduced capital investment, slower business and continued deficits.

How to control interest rates? Should the Federal Reserve lower its lending rate, push more reserves into the banking system, or use some other mechanisms? Professor Milton Friedman, an advocate of steady increase in what is called money supply, has complained that the FED did not use the right tools, and added that there was no historical precedent for the constant interest rate fluctuations of the past few years.

For decades the Federal Reserve has assumed responsibility for determining how much money/debt/credit the country needs, and in 1978 was required by law to set and announce "targets" for money supply. An Open Market Committee—a group of twelve—meets periodically and with the assistance of batteries of computers and reams of charts decides the amount of "money" needed by the economy to maintain steady growth at reasonable interest rates. Its main device is to buy or sell in

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Dr. Groseclose, a financial consultant in Washington, D.C., is the author of *Money and Man* (1934, 4th edition 1976) and *America's Money Machine* (1966, 1980). He serves as executive director of the Institute for Monetary Research.

the market its own debt instruments (notes or deposit credits) which thereafter become money equivalents and reserves in the banks. This system permits the banks to extend their own debt commitments through deposit liabilities and thereby increase the "money supply."

Whipping a Dead Horse

"Money supply," taken to represent the current purchasing power in the economy, is generally defined as the note liabilities of the Federal Reserve Banks plus the demand liabilities of banking and like institutions; it is called M_1 (or M_{1b}). A simpler definition is the amount of demand debt in the economy.

The futility in trying to control "money supply," and thereby interest rates, was illustrated by a speech by Anthony M. Solomon, president of the Federal Reserve Bank of New York before the American Economic and American Finance Associations on December 28, 1981. Mr. Solomon pointed out that during the first eleven months of 1981, the money supply figure used by the Federal Reserve (M_1) rose at a modest 2.5 percentage rate; the figure, however, was deceptive; other money equivalents in the form of Eurodollars, money market funds and the like, called M_2 and M_3, rose at 10.1 per cent and 11.1 per cent respectively.

In short, as Mr. Solomon conceded, "A fundamental re-evaluation of our use of monetary targets may be necessary."

Vestigial Marxism

This observation is one that should have been apparent years ago to monetary historians and students of monetary phenomena. That money supply through debt formation can be controlled by a select group of experts sitting in a marble mausoleum on Washington's Constitution Avenue is a vestigial relic of Marxist economics—the theory that the state is the repository of all economic wisdom and hence the ultimate authority for economic planning.

The reason debt and money supply and interest rates can not be controlled, but will continue to increase, lies in the nature of what passes for money. The currency in circulation, apart from debased token coinage, consists mainly of Federal Reserve notes. Until 1934 these notes were payable on demand in gold coin. Since 1934, the notes have been redeemable only in other notes—a perpetual rollover of debt without maturity, with the interest payable only in more debt. Debt multiplies upon itself without limit, with each increment lowering the purchasing power of the total.

Here is the basic explanation of the upward pressure on interest rates, the effects of which filter through into the general price structure. Until 1946 these effects were hidden by reason of the great influx of gold during the preceding decade, an influx that anesthetized the inflationary effects of Federal Reserve policy. The awakening came after the close of World War II, when the flow of gold seeking security here ceased, and a reverse movement began.

As prices rose, investors grew increasingly reluctant to put funds out at long term except at the higher rates of interest required to offset the loss of purchasing power of the dollars received at maturity. This is reflected statistically in the amount of government debt that increasingly had to be incurred at short term. In 1946, the mean interest rate on government bonds was 2.19 per cent, and 23 per cent of the public debt was at long term. In 1981, the mean interest rate was 12.87 per cent, and only 6 per cent of government debt was long term.

How Much Debt?

The Federal Reserve System sits over the economy, breeding debt like a queen bee of a hive spending its existence in laying eggs. Can a stable price level and stable interest rates be achieved while this debt creation continues? Total dollar debt that ten years ago was calculated at around \$1.8 trillion is today around \$5.5 trillion, the largest increase occurring during the past 5 years.

During 1981, M_3, the broadest measure of "money supply," increased by \$222 billion. Federal debt in the hands of the public increased by \$93 billion. Who were the other borrowers? Billions were lent to finance mergers and acquisitions, like those by du Pont and U.S. Steel. One bank alone (First Boston Corporation) boasted that it had underwritten or participated in mergers and acquisitions involving over \$30 billion. Other amounts were sunk in loans to indigent foreigners, like Poland and Turkey.

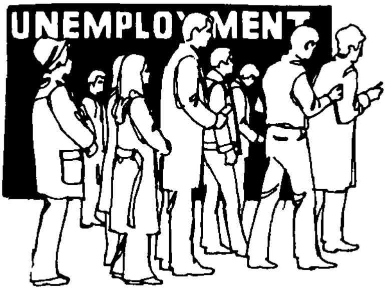
Reduction of interest rates, the price level, and the debt burden, demand what neither the Administration, nor the Federal Reserve, nor the monetarist school yet accept, namely, a restoration of a money of substance. The country can not prosper on a system of perpetual debt, or a system in which the only means of debt payment is another I.O.U.

Francis Adams Truslow

IDEAS ON LIBERTY

THE CITIZEN who calls on government to supply him with security from the cradle to the grave, thereby encouraging government spending, is a danger to himself and his fellow citizens. If his pleas are successful, he can lose his freedom and gain no security in exchange.

Roland W. Holmes



The Cure for Unemployment

THE cure under discussion here does not refer to the elimination of all unemployment. Some unemployment is voluntary and some is caused temporarily by unavoidable natural catastrophes such as earthquakes and floods, or by human error and misfortune. Rather, we are concerned about those arbitrary, deliberately applied forces in the marketplace—attempts to raise wages above free-market levels. Such forces, to the extent that they accomplish their objectives, cause totally unnecessary and permanent unemployment. Bitter frustration and misery for countless thousands of would-be workers is the inevitable result.

During the Great Depression of the thirties, the fear of unemployment panicked Americans into letting down the bars to the so-called liberals; and for about five decades, these liberals have addressed almost every conceivable human problem by being liberal with other people's money—collected, or printed, by the government. For a time it seemed that no great harm was being done. But now it has become apparent to more and more citizens that this kind of cure-all results in intolerable degrees of taxation and inflation, accompanied by a growing amount of unemployment.

Current political philosophy, to a great extent, recognizes the crucial importance of reducing inflation. Consumers are disgruntled over constantly and rapidly rising prices. But suppose prices are forced to level off by restricting the increase in the money supply, while wages continue to be forced upward. Marginal employees will lose their jobs. Unemployment will increase. If this should

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Mr. Holmes is a retired aeronautical engineer in Bellevue, Washington. He has written, lectured, and organized study groups to help understand and preserve freedom.