Proc. Natl. Acad. Sci. USA
Vol. 95, pp. 1340–1347, February 1998
Economic Sciences

This contribution is a part of the special series of Inaugural Articles by members of the National Academy of Sciences elected April 30, 1996.

Fifteen fatal fallacies of financial fundamentalism: A disquisition on demand-side economics

WILLIAM VICKREY*

Economics Department, Columbia University, New York, NY 10027

Contributed by William Vickrey, September 18, 1996

Much of the conventional economic wisdom prevailing in financial circles, largely subscribed to as a basis for governmental policy, and widely accepted by the media and the public, is based on incomplete analysis, contrafactual assumptions, and false analogy. For instance, encouragement to save is advocated without attention to the fact that for most people encouraging saving is equivalent to discouraging consumption and reducing market demand, and a purchase by a consumer is also income to vendors and suppliers. Equally fallacious are implications that what is possible or desirable for individuals one at a time will be equally possible or desirable for all who might wish to do so or for the economy as a whole.

And often analysis seems to be based on the assumption that future economic output is almost entirely determined by inexorable economic forces independently of government policy so that devoting more resources to one use inevitably detracts from availability for another. This might be justifiable in an economy at chock-full employment, or it might be validated in a sense by postulating that the Federal Reserve Board (FRB) will pursue and succeed in a policy of holding unemployment strictly to a fixed "non-inflation-accelerating" or "natural" rate. But under current conditions such success is neither likely nor desirable.

Some of the fallacies that result from such modes of thought are as follows. Taken together, their acceptance is leading to policies that at best are keeping us in the economic doldrums with overall unemployment rates stuck in the 5–6% range. This is bad enough merely in terms of the loss of 10–15% of our potential production, even if shared equitably, but when it translates into unemployment of 10%, 20%, and 40% among disadvantaged groups, the further damages in terms of poverty, family breakup, school truancy and dropout, illegitimacy, drug use, and crime become serious indeed. And should the implied policies be fully carried out in terms of a "balanced budget," we could well be in for a serious depression.

Fallacy 1. Deficits are considered to represent sinful profligate spending at the expense of future generations, who will be left with a smaller endowment of invested capital. This fallacy seems to stem from a false analogy to borrowing by individuals.

Current reality is almost the exact opposite. Deficits add to the net disposable income of individuals, to the extent that government disbursements that constitute income to recipients exceed that abstracted from disposable income in taxes, fees, and other charges. This added purchasing power, when spent, provides markets for private production, inducing producers to invest in additional plant capacity, which will form part of the real heritage left to the future. This is in addition to whatever public investment takes place in infrastructure, education, research, and the like. Larger deficits, sufficient to recycle savings out of a growing gross domestic product (GDP) in excess of what can be recycled by profit-seeking private investment, are not an economic sin but an economic necessity. Deficits in excess of a gap growing as a result of the maximum feasible growth in real output might indeed cause problems, but we are nowhere near that level.

Even the analogy itself is faulty. If General Motors, AT&T, and individual households had been required to balance their budgets in the manner being applied to the federal government, there would be no corporate bonds, no mortgages, no bank loans, and many fewer automobiles, telephones, and houses.

Fallacy 2. Urging or providing incentives for individuals to try to save more is said to stimulate investment and economic growth. This seems to derive from an assumption of an unchanged aggregate output so that what is not used for consumption will necessarily and automatically be devoted to capital formation.

Again, actually the exact reverse is true. In a money economy, for most individuals a decision to try to save more means a decision to spend less; less spending by a saver means less income and less saving for the vendors and producers, and aggregate saving is not increased, but diminished, as vendors in turn reduce their purchases, national income is reduced and with it national saving. A given individual may indeed succeed in increasing his own saving, but only at the expense of reducing the income and saving of others by even more.

Where the saving consists of reduced spending on nonstorable services, such as a haircut, the effect on the vendor's income and saving is immediate and obvious. Where a storable commodity is involved, there may be an immediate temporary investment in inventory, but this will soon disappear as the vendor cuts back on orders from his suppliers to return the inventory to a normal level, eventually leading to a cutback of production, employment, and income.

Saving does not create "loanable funds" out of thin air. There is no presumption that the additional bank balance of the saver will increase the ability of his bank to extend credit by more than the credit-supplying ability of the vendor's bank will be reduced. If anything, the vendor is more likely to be active in equities markets or to use credit enhanced by the sale to invest in his business than a saver responding to inducements such as individual retirement accounts (IRA)s, exemption or deferral of taxes on pension fund accruals, and the like. so that the net effect of the saving inducement is to reduce the overall extension of bank loans. Attempted saving, with corresponding reduction in spending, does nothing to enhance the willingness of banks and other lenders to finance adequately promising investment projects. With unemployed resources available, saving is neither a prerequisite nor a stimulus to, but a consequence of capital formation, as the income generated by capital formation provides a source of additional savings.

Fallacy 3. Government borrowing is supposed to "crowd out" private investment.

Abbreviations: CBO, Congressional Budget Office; FRB, Federal Reserve Board; GDP, gross domestic product; NIARU, non-inflation-accelerating rate of unemployment; NIARRU, non-inflation-accelerating rate of reduction of unemployment.

*Deceased October 11, 1996.

© 1998 by The National Academy of Sciences 0027-8424/98/951340-8$2.00/0
PNAS is available online at http://www.pnas.org.

Downloaded at Palestinian Territory, occupied on December 29, 2021
المنارة للاستشارات
www.manaraa.com

The current reality is that, on the contrary, the expenditure of the borrowed funds (unlike the expenditure of tax revenues) will generate added disposable income, enhance the demand for the products of private industry, and make private investment more profitable. As long as there are plenty of idle resources lying around, and monetary authorities behave sensibly (instead of trying to counter the supposedly inflationary effect of the deficit), those with a prospect for profitable investment can be enabled to obtain financing. Under these circumstances, each additional dollar of deficit will in the medium-long run induce two or more additional dollars of private investment. The capital created is an increment to someone's wealth and *ipso facto* someone's saving. "Supply creates its own demand" fails as soon as some of the income generated by the supply is saved, but investment does create its own saving, and more. Any crowding out that may occur is the result, not of underlying economic reality, but of inappropriate restrictive reactions on the part of a monetary authority in response to the deficit.

Fallacy 4. Inflation is called the "cruelest tax." The perception seems to be that if only prices would stop rising, one's income would go further, disregarding the consequences for income.

Current reality: The tax element in anticipated inflation in terms of gain to the government and loss to the holders of currency and government securities is limited to the reduction in the value in real terms of non-interest-bearing currency, (equivalent to the increase in the interest rate saving on the no-interest loan, as compared to what it would have been with no inflation), plus the gain from the increment of inflation over what was anticipated at the time the interest rate on the outstanding debt was established. On the other hand, a reduction in the rate of inflation below that previously anticipated would result in a windfall subsidy to holders of long-term government debt and a corresponding increase in the real impact of the debt on the fisc.

In previous regimes where regulations forbade the crediting of interest on demand deposits, the seigniorage profit on these balances, reflecting the loss to depositors in purchasing power, that would be enhanced by inflation would accrue to banks, with competition inducing some pass-through to customers in terms of uncharged-for services. In an economy where most transactions are in terms of credit card and bank accounts with respect to which interest may be charged or credited, the burden will be trivial for most individuals, limited to loss of interest on currency outstanding. Most of the gain to the government will be derived from those using large quantities of currency for tax evasion or the carrying on of illicit activity, plus burdens on those few who keep cash under the mattress or in cookie jars.

The main difficulty with inflation, indeed, is not with the effects of inflation itself, but the unemployment produced by inappropriate attempts to control the inflation. Actually, unanticipated acceleration of inflation can reduce the real deficit relative to the nominal deficit by reducing the real value of the outstanding long-term debt. If a policy of limiting the nominal budget deficit is persisted in, this is likely to result in continued excessive unemployment due to reduction in effective demand. The answer is not to decrease the nominal deficit to check inflation by increased unemployment, but rather to increase the nominal deficit to maintain the real deficit, controlling inflation, if necessary, by direct means that do not involve increased unemployment.

Fallacy 5. "A chronic trend towards inflation is a reflection of living beyond our means" (Alfred Kahn, quoted in *Cornell '93*, summer issue).

Reality: The only time we could be said to have been really living beyond our means was in wartime, when capital was being destroyed and undermaintained. We have not lived even up to our means in peacetime since 1926, when it is now estimated that unemployment according to today's definition went down to around 1.5%. This level has not been approached since, except at the height of World War II.

Inflation occurs when sellers raise prices; they can do this profitably when the forces of competition are weakened by the differentiation of products, real and factitious, misleading advertising, obfuscating sales gimmicks and package deals, mergers and takeovers, and the increasing importance of ancillary services, trade secrets, patents, copyrights, economies of scale, overheads, and start-up costs. Inflation can and does occur in the midst of underutilized resources, and it need not occur even if we were to consume our capital by failure to maintain and replace it, consuming more than we produce.

Fallacy 6. It is thought necessary to keep unemployment at a "non-inflation-accelerating rate of unemployment" (NIARU) level in the range of 4–6% if inflation is to be kept from increasing unacceptably.

Currently the unemployment rate as officially measured has fallen to 5.1%, while the Congressional Budget Office (CBO) has put the NIARU for 1964 at 6.0%, having ranged between 5.5% and 6.3% since 1958. Recent CBO projections were for unemployment to remain steady at 6.0% through the year 2005, with inflation in the urban consumer price index fairly steady at about 3.0% (*Economic and Budget Outlook*, May 1996, pp. xv, xvi, 2, 3).

This may be a fairly optimistic forecast of the results to be expected from current tendencies, but as a goal it is simply intolerable. While even 5% unemployment might be barely acceptable if it meant a compulsory extra two weeks of unpaid furlough annually for everyone, it is totally unacceptable when it means 10%, 20%, and 40% unemployment among disadvantaged groups, with serious consequences for poverty, homelessness, family breakups, drug addiction, and crime. The malaise that pervades our cities may be attributable in no small measure to the fact that for the first time in our history, an entire generation and more has grown up without experiencing reasonably full employment, even briefly. In contrast, while most other industrialized countries are currently experiencing higher rates of unemployment than the U.S., they have nearly all had relatively recent periods of close to full employment. Unemployment insurance and other welfare programs have also been much more generous, so that the sociological impacts have been much less demoralizing.

The underlying assumption that there is an exogenous NIARU imposing an unavoidable constraint on macroeconomic possibilities is open to serious question on both historical and analytical grounds. Historically, the U.S. enjoyed an unemployment rate of 1.8% for 1926 as a whole with the price level falling, if anything. West Germany enjoyed an unemployment rate of around 0.6% over the several years around 1960, and most developed countries have enjoyed episodes of unemployment under 2% without serious inflation. Thus a NIARU, if it exists at all, must be regarded as highly variable over time and place. It is not clear that estimates of the NIARU have not been contaminated by failure to allow for a possible impact of inflation on employment as well as the impact of unemployment on inflation. A Marxist interpretation of the insistence on a NIARU might be as a stalking horse to enlist the fear of inflation to justify the maintenance of a "reserve army of the unemployed," allegedly to keep wages from initiating a "wage–price spiral." One never hears of a "rent–price spiral," or an "interest–price spiral," though these costs are also to be considered in the setting of prices. Indeed, when the FRB raises interest rates in an attempt to ward off inflation, the increase in interest costs to merchants may well trigger a small price increase.

Analytically, it would be more rational to expect that there could be a maximum non-inflation-accelerating *rate of reduction* of unemployment (NIARRU), such that if an attempt were made to proceed more rapidly by a greater recycling of excess savings into purchasing power through government deficits, prices would start to rise more rapidly than had been generally anticipated. This would occur as a result of a failure of supply to keep up with the increased demand, giving rise to shortages and the dissipation of part of the increased demand into more rapidly rising prices. This NIARRU may be determined by limits to the rates at which labor can be hired and put to work to meet anticipated increases in demand, and perhaps lags in the realization that demand will be increased, and even new productive facilities created, installed, and brought up to speed. The ultimate technological constraint to putting unemployed to work more rapidly in the private sector may reside in a limited capacity in the capital goods industries such as construction, cement, and machine tools.

Downloaded at Palestinian Territory, occupied on December 29, 2021

المنارة للاستشارات

www.manaraa.com

In any case, much will depend on the degree of confidence that can be engendered in the proposed increase in demand. It might be wise to start slowly, with a reduction of unemployment by say 0.5% the first year, and increasing to say 1% per year as confidence is gained. Possibly the growth rate should subsequently be reduced somewhat as full employment is approached, allowing for the increasing difficulty of matching workers to vacancies. It is mainly at the later stages of the approach to full employment that training and improving the organization of the labor market may become needed. In the face of a policy of maintaining a fixed NIARU, "workfare" efforts to retrain and assist welfare clients amount to assistance in the playing of a cruel game of musical chairs.

Such a NIARRU is likely to prove somewhat volatile and difficult to predict, and in any case it might prove desirable to push to full employment somewhat faster than would be permitted by an unaltered NIARRU. This would call for the introduction of some new means of inflation control that does not require unemployment for it to be effective. Indeed, if we are to control three major macroeconomic dimensions of the economy, namely the inflation rate, the unemployment rate, and the growth rate, a third control is needed that will be reasonably noncollinear in its effects to those of a fiscal policy operating through disposable income generation on the one hand, and monetary policy operating through interest rates on the other.

What may be needed is a method of directly controlling inflation that does not interfere with free-market adjustments in relative prices or rely on unemployment to keep inflation in check. Without such a control, unanticipated changes in the rate of inflation, either up or down, will continue to plague the economy and make planning for investment difficult. Trying to control an economy in three major macroeconomic dimensions with only two instruments is like trying to fly an airplane with elevator and rudder but no ailerons; in calm weather and with sufficient dihedral one can manage if turns are made very gingerly, but trying to land in a cross-wind is likely to produce a crash.

One possible third control measure would be a system of marketable rights to value added, (or "gross markups") issued to firms enjoying limited liability, proportioned to the prime factors employed, such as labor and capital, with an aggregate face value corresponding to the overall market value of the output at a programmed overall price level. Firms encountering a specially favorable market could realize a higher than normal level of markups only by purchasing rights from firms less favorably situated. The market value of the rights would vary automatically so as to apply the correct downward pressure on markups to produce the desired overall price level. A suitable penalty tax would be levied on any firm found to have had value added in excess of the warrants held.

In any case it is important to keep in mind that divergences in the rate of inflation *either up or down*, from what was previously expected, produce merely an arbitrary redistribution of a given total product, equivalent at worst to legitimized embezzlement, unless indeed these unpredictable variations are so extreme and rapid as to destroy the usefulness of currency as a means of exchange. Unemployment, on the other hand, reduces the total product to be distributed; it is at best equivalent to vandalism, and when it contributes to crime it becomes the equivalent of homicidal arson. In the U.S. the widespread availability of automatic teller machines in supermarkets and elsewhere would make the "shoe-leather cost" of a high but predictable inflation rate quite negligible.

Fallacy 7. Many profess a faith that if only governments would stop meddling, and balance their budgets, free capital markets would in their own good time bring about prosperity, possibly with the aid of "sound" monetary policy. It is assumed that there is a market mechanism by which interest rates adjust promptly and automatically to equate planned saving and investment in a manner analogous to the market by which the price of potatoes balances supply and demand. In reality no such market mechanism exists; if a prosperous equilibrium is to be achieved it will require deliberate intervention on the part of monetary authorities.

In the heyday of the industrial revolution it would probably have been possible for monetary authorities to act to adjust interest rates to equate aggregate planned saving and aggregate planned investment at levels of GDP growing in such a fashion as to produce and maintain full employment. Generally, however, monetary authorities failed to recognize the need for such action and instead pursued such goals as the maintenance of the gold standard, or the value of their currency in terms of foreign exchange, or the value of financial assets in the capital markets. The result was usually that adjustments to shocks took place slowly and painfully via unemployment and the business cycle.

Current reality: The time is long gone, however, when even the lowest interest rates manageable by capital markets can stimulate enough profit-motivated net capital formation to absorb and recycle into income over any extended period the savings that individuals will wish to put aside out of a prosperity level of disposable personal income. Trends in technology, demand patterns, and demographics have created a gap between the amounts for which the private sector can find profitable investment in productive facilities and the increasingly large amounts individuals will attempt to accumulate for retirement and other purposes. This gap has become far too large for monetary or capital market adjustments to close.

On the one hand the prevalence of capital saving innovation, found in extreme form in the telecommunications and electronics industries, high rates of obsolescence and depreciation, causing a sharp decline in the value of old capital that must be made good out of new gross investment before any net increase in the aggregate market value of capital can be registered, together with shifts from heavy to light industry to services, have sharply limited the ability of the private sector to find profitable placement for new capital funds. Over the past 50 years the ratio of the market value of private capital to GDP has remained, in the U.S., fairly constant in the neighborhood of 25 months.

On the other hand, aspirations for asset holdings to finance longer retirements at higher living standards have increased sharply. At the same time the increased concentration of the distribution of income has increased the share of those with a high propensity to save for other purposes, such as the acquisition of chips with which to play high-stakes financial games, the building of industrial empires, the acquisition of managerial or political clout, the establishment of a dynasty, or the endowment of a philanthropy. This has further contributed to a rising trend in the demand of individuals for assets, relative to GDP.

The result has been that the gap between the private supply and the private demand for assets has come to constitute an increasing proportion of GDP. This gap has also been augmented by the foreign trade current account deficit, which corresponds to a diminution of the stock of domestic assets available to domestic investors. For an economy to be balanced at a given level of GDP requires the provision of additional assets in the form either of government debt or net foreign investment to fill this growing gap. The gap is now tentatively and roughly estimated for the U.S. to be equal to about 13 months of GDP. There are indications that for the foreseeable future this ratio will tend to rise rather than fall. This is in addition to whatever role Social Security and Medicare entitlements have played in providing a minimal level of old-age security.

In the absence of change in the flow of net foreign investment, a government recycling of income through current deficits of somewhat more than the desired growth in nominal GDP will be needed to keep the economy in balance. Curtailing deficits will correspondingly stifle growth. A balanced budget, indeed, would tend to stop growth in nominal GDP altogether, and in the presence of inflation it would lead to a downturn in real GDP and a corresponding increase in unemployment.

Depending in part on what may happen at the state and local levels, current programs for gradually reducing the federal deficit to zero over the next 7 years would in effect put a cap on total government debt at about 9 trillion dollars, implying that GDP would, in the absence of changes in net foreign investment, converge on a level of about 8 to 9 trillion dollars, aside from short-run cyclical fluctuations. This compares with a full-employment GDP after 7 years at 3% inflation of about 13 trillion dollars. The balanced budget GDP of about 65% of this would

Downloaded at Palestinian Territory, occupied on December 29, 2021

www.manaraa.com

correspond to a reported level of unemployment of 15% or more, in addition to unreported underemployment. Thereafter, if the strictures of a balanced budget amendment were to be adhered to, unemployment would continue to increase. Before this could happen, however, some concession to reality would probably be accepted, though not until a great deal of needless suffering would have been endured.

Fallacy 8. If deficits continue, the debt service would eventually swamp the fisc.

Real prospect: While viewers with alarm are fond of horror-story projections in which per capita debt would become intolerably burdensome, debt service would absorb the entire income tax revenue, or confidence is lost in the ability or willingness of the government to levy the required taxes so that bonds cannot be marketed on reasonable terms, reasonable scenarios project a negligible or even favorable effect on the fisc. If full employment is maintained so that the nominal GDP continues to grow at say 6%, consisting of about 3% inflation and 3% real growth, the equilibrating debt would have to grow at 6% or perhaps at a slightly higher rate; if the nominal interest rate were 8%, 6% of this would be financed out of the needed growth in the debt, leaving only 2% to be met out of the current budget. Income tax on the increased interest payments would offset much of this, and savings from reduced unemployment insurance benefits and welfare costs would more than cover the remainder, even aside from substantial increases in tax revenues from the more prosperous economy. Though much of these gains would accrue to state and local governments rather than to the federal government, this could be adjusted to through changes in intergovernmental grants. A 15 trillion dollar debt will be far easier to deal with out of a full employment economy with greatly reduced needs for unemployment benefits and welfare payments than a 5 trillion dollar debt from an economy in the doldrums with its equipment in disrepair. There is simply no problem.

Fallacy 9. The negative effect of considering the overhanging burden of the increased debt would, it is claimed, cancel the stimulative effect of the deficit. This sweeping claim depends on a failure to analyze the situation in detail.

Analytical reality: This "Ricardian equivalence" thesis, while referred to by Ricardo, may not in the end have been subscribed to by him. In any case its validity depends crucially on the system of taxation expected to be used to finance the debt service.

At one extreme, in a Georgist economy making exclusive use of a "single tax" on land values, and where land values are expected to evolve proportionally over time, any debt becomes in effect a collective mortgage on the land parcels. Any increase in government debt to offset current tax reduction depresses the market value of land by an equal amount, aggregate wealth of individuals is unaffected, Ricardian equivalence is complete, and pure fiscal policy is impotent. A larger debt may still be desirable in terms of taking advantage of possibly lower interest rates available on government debt than on individual mortgages, and in effectively endowing property with a built-in assumable mortgage that facilitates the financing of transfers. And there may still be a possibility for stimulating the economy by tax-financed expenditures that redistribute income towards those with a higher propensity to spend.

In another scenario, if the main tax is one on all real estate, such as is common in American local finance, the effect is drastically different. In this case any investor erecting a building thereby assumes, for the time being at least, a share in the government debt, subject to some of this burden possibly being eventually taken over by further construction. Not only does this discourage construction, but if the debt overhang gets too great, this expectation of others taking up part of the burden may vanish rather suddenly, and all construction come to a grinding halt. Debt becomes a strong inhibitor of growth. While this result may resemble that claimed by the "crowding out" theory, the mechanism is not one of displacement but of disincentive.

With a sales or value-added tax as the mainstay, a deficit involving a reduction in tax rates today will have no depressing effect on capital values and will have a fully stimulating effect, through the increase in the aggregate supply of assets, possibly reinforced by anticipatory spending motivated by expectations that taxes may have to be higher at a later date to finance the debt service. There will be no Ricardian equivalence effect; if anything, anticipation of higher future taxes will encourage current spending, adding to the stimulus of the increased supply of securities.

The U.S. federal tax system is dominated by the income tax, for which the effect will be somewhat intermediate between taxes on savings and taxes on expenditure. In practice few individuals will have any clear idea of the taxes likely to be imposed in the future as a result of the existence of a larger debt, and it can be safely said that no reasoned Ricardian equivalence phenomenon will occur, though there may be some generalized malaise among the viewers with alarm, involving a kind of partially self-fulfilling prophecy.

Fallacy 10. The value of the national currency in terms of foreign exchange (or gold) is held to be a measure of economic health, and steps to maintain that value are thought to contribute to this health. In some quarters a kind of jingoistic pride is taken in the value of one's currency, or satisfaction may be derived from the greater purchasing power of the domestic currency in terms of foreign travel.

Reality: Freely floating exchange rates are the means whereby adaptations are made to disparate price level trends in different countries and trade imbalances are brought into line with capital flows appropriate to increasing the overall productivity of capital. Fixed exchange rates or rates confined to a narrow band can be maintained only by coordinated fiscal policies among the countries involved, by imposing efficiency-impairing tariffs or other restraints on trade, or by imposing costly disciplines involving needlessly high rates of unemployment, as is implied by the Maastricht agreements. Attempts to restrain foreign exchange rates by financial manipulation in the face of a basic disequilibrium usually break down, eventually, with large losses to the agencies making the attempt and a corresponding gain to agile speculators. Even short of breakdown, much of the volatility of foreign exchange rates can be traced to speculation over possibilities of massive central bank intervention.

Restraints on exchange rates, such as are involved in the Maastricht agreements, would make it virtually impossible for a small open economy, such as that of Denmark, to pursue an effective full-employment policy on its own. Much of the increase in purchasing power generated by a stimulative fiscal policy would be spent on imports, spreading the stimulating effect over the rest of the monetary union so that Denmark's borrowing capacity would be exhausted long before full employment could be achieved. With flexible exchange rates the increased demand for imports would cause a rise in the price of foreign currency, checking the import increase and stimulating exports so that most of the effects of an expansionary policy would be kept at home. The danger of wild speculative gyrations under freely floating conditions would be greatly diminished under a well-established full-employment policy, especially if combined with a third dimension of direct control over the overall domestic price level.

Similarly, the main reason states and localities cannot pursue an independent full employment policy is that they lack an independent currency and are constrained to have a fixed exchange rate with the rest of the country.

Fallacy 11. It is claimed that exemption of capital gains from income tax will promote investment and growth.

Reality: Any attempt to define a special category of income entitled to differential treatment is an invitation to the sorcerer's apprentices in Congress and in the offices of the Internal Revenue Service to start casting spells that are bound to produce surprising consequences. Attempting to draw up administrable rules defining economically meaningful lines between interest credited to accounts but not drawn on, zero-coupon bonds, stock appreciation from undistributed profits, inflationary gains, profits from insider trading, gains from speculation in land, gambles on derivatives, profits or losses on speculative ventures, and so on is a sysyphean task. Taxpayers' techies can then get busy ferreting out shortcuts through the resulting labyrinth to the detriment of the revenue and also of economic efficiency. Ten special provisons of the code can be combined with one another in over a thousand ways to produce

Downloaded at Palestinian Territory, occupied on December 29, 2021
www.manaraa.com

results far beyond the capacity of a congressional committee and its staff to anticipate.

Concessions to gains must entail corresponding limitations on the deductibility of losses, lest there be intolerably large opportunities for arbitrage against the revenue. In an attempt to counter the skills of the taxpayers' "techies," the rules are likely to be more severe on the deductibility of losses than liberal with respect to gains, so as to produce a number of situations where the Treasury is playing "heads I win, tails you lose" with the taxpayer. Even with effectively parallel rules, reduced effective deductibility of losses may well be more of a disincentive to speculative investment than the attractiveness of low taxes on gains in the event of success.

Most economically desirable investments take considerable time for the anticipated results to be reflected in the capital markets, and the promise of a tax concession to be effective in a remote future and subject to possible alteration by future legislatures is likely to be of little weight in the calculation of the investor. In any case the personal income tax on gains is levied at or below the market and has its primary effect on the disposable income of the investor, and relatively little effect on the capital market from which the funds for capital formation are derived.

In practice, many capital gains arise from transactions of negligible or dubious social merit. Gains derived from speculation in land add nothing to the supply of land, and much of the gains from securities trading based on advance information, whether or not characterizable as insider trading, does no more to enhance productivity or investment than winnings from betting on basketball games. Attempts to exclude gains from speculation by limiting concessions to assets held for longer periods not only introduce new complexities in determining the holding period in cases of rollovers, reinvested dividends, and other trades, but aggravate the lock-in effect as realization is deferred to obtain the concession, an effect especially severe in the case of the total exemption from income taxation of gains on property transferred by gift or bequest.

Any increase in disposable income resulting from lower capital gains taxation is likely to accrue to individuals with a high propensity to save. If the proposal is advanced on a revenue-neutral basis, the replacement revenues are likely to have a greater impact on consumption demand, so that the net overall effect of making concessions to capital gains may be to reduce demand, sales, and investment in productive facilities. The main driving force behind the proposals may well be as a pretext for providing windfalls to persons who can contribute to campaign funds as well as added commissions for brokers.

Some have argued for reductions in capital gains rates rather than full exemption, pointing to surges in revenue from the "fire sale" spate of realizations to take advantage of the new and possibly short-lived tax bargains. If this is done on a current-revenue-neutral basis, there may be some one-time stimulus to the economy and to investment, resulting from what would be an increase in the effective deficit as viewed from a longer-term perspective, but this will be small, temporary, and counterproductive in the long run.

A far more effective measure would be to reduce or eliminate the corporate income tax, which is in effect a tax above the market, constituting an additional hurdle that prospective equity-financed investments must face, as contrasted to the below- or after-market impact of capital gain concessions. In addition to this double-whammy impact on the economy whereby the tax both abstracts from disposable income and also discourages investment, the tax has numerous defects in distorting investment allocation, encouraging thin equity financing with consequent increased incidence of bankruptcies, and complicating tax laws. Unfortunately, any such elimination is likely to be opposed not only by those making a living from the complexities but by many who variously believe firmly that its burden falls on someone other than themselves. Actually in most plausible scenarios the chief burden will be on wage earners. If considered as a substitute for other taxes on a revenue-neutral basis, it would increase current unemployment. If current employment is assumed to be maintained by an appropriate fiscal policy, future labor productivity and wages will be depressed by labor having less capital to work with.

One excuse sometimes offered for the imposition of a corporation income tax is that undistributed profits do not bear their fair share of the individual income tax. Rather than retaining a tax on all corporate income, this consideration would call for a countervailing tax of say 2% per year on the accumulated undistributed profits, as a rough equivalent to an interest charge on the resulting deferral of the individual income tax on shareholders. This would be rough at best, since it allows neither for variations in the marginal rates payable by individual shareholders nor for possible realization of the undistributed profits through sale of shares, but it would be far better than the inept and draconic taxes on undistributed profits enacted briefly during the 1930s.

A more thoroughgoing removal of the distorting effect of taxes on real investment could be accomplished by assessing the individual income tax on a cumulative basis, whereby a gross tax on the accumulated income to date (including interest credited with respect to past taxes paid on this income) is calculated by reference to tables that would take the period covered into account. The accumulated value, with interest, of taxes previously paid on this income is then credited against this gross tax. Provided that all income is eventually brought to account, the ultimate tax burden will be independent of the timing of realization of income; about two-thirds of the internal revenue code and regulations would become superfluous. The playing field would be effectively leveled; equitable treatment would be afforded both to those realizing large gains in a single year and to those having to retire after a brief career of high earnings, a group not adequately dealt with under most other averaging schemes. Bias against investments yielding fluctuating or risky returns would be largely eliminated. Decisions as to when to sell assets to realize gains or losses or when to distribute dividends could be made purely on the basis of appraisal of market conditions without having to consider tax consequences. Hordes of tax techies could turn their talents to more productive activities.

Taxpayer compliance would be greatly simplified. The actual computation of the cumulative tax and tax payable requires only six additional entries on the return, three of which are items simply copied from a preceding return. As an introductory measure, cumulative assessment could be limited to those subject to rates above the initial bracket.

Fallacy 12. Debt would, it is held, eventually reach levels that cause lenders to balk with taxpayers threatening rebellion and default.

Relevant reality: This fear arises in part from observing crises in which capital-poor countries have had difficulty in meeting obligations denominated in a foreign currency, incurred in many cases to finance imports and ultimately requiring servicing and repayment in terms of exports, the crisis often arising because of a collapse in the market for the exports. In the case at hand the debt is intended to supply a domestic demand for assets denominated in the domestic currency, and in the absence of a norm such as a gold clause, there can be no question of the ability of the government to make payments when due, albeit possibly in a currency devalued by inflation. Nor can there be any question of balking by domestic lenders as long as the debt is limited to that needed to fill a gap created by an excess of private asset demand over private asset supply.

It is not intended that the domestic government debt should be held in any large quantity by foreigners. But should foreigners wish to liquidate holdings of this debt or any other domestic assets, they can only do so as a whole by generating an export surplus, easing the domestic unemployment problem, releasing assets to supply the domestic demand, and making it possible to get along with smaller deficits and a less rapidly growing government debt. The same thing happens if domestic investors turn to investing in foreign assets, thereby reducing their drain on the domestic asset supply.

In a panicky market it might happen that the market price of assets might fall sufficiently rapidly so that the total market value of the assets available to meet the domestic demand might fall. In such a case a temporary increase in government deficits rather than a decrease would be in order. Arranging this on short notice may be difficult, and the danger of overreacting or poor timing is

Downloaded at Palestinian Territory, occupied on December 29, 2021
www.manaraa.com

real. Something more than mere pious declarations that the economy is fundamentally sound, however, is called for. Nevertheless, one cannot entirely rule out the possibility of this becoming a panic-generating self-fulfilling prophecy derived from concentrating attention on the financial symbols rather than the underlying human reality. In Roosevelt's terms, the main thing to fear is fear itself.

Fallacy 13. Authorizing income-generating budget deficits results in larger and possibly more extravagant, wasteful, and oppressive government expenditures.

Reality: The two issues are quite independent, in spite of the fact that many anarcholibertarians appear to have been using the ideology of budget-balancing as a way to put a straitjacket on government activity. A government could run a deficit with no activity at all other than borrowing money by issuing bonds, paying out the proceeds in old-age pensions, and levying taxes sufficient to cover any net debt service. The issue of what activities are worth while for the government to carry on is a totally different issue from what the government contribution to the flow of disposable income needs to be to balance the economy at full employment.

Fallacy 14. Government debt is thought of as a burden handed on from one generation to its children and grandchildren.

Reality: Quite the contrary, in generational terms (as distinct from time slices), the debt is the means whereby the present working cohorts are enabled to earn more by fuller employment and invest in the increased supply of assets, of which the debt is a part, so as to provide for their own old age. In this way the children and grandchildren are relieved of the burden of providing for the retirement of the preceding generations, whether on a personal basis or through government programs.

This fallacy is another example of zero-sum thinking that ignores the possibility of increased employment and expanded output. While it is still true that the goods consumed by retirees will have to be produced by the contemporary working population, the increased government debt will enable more of these goods to be to be exchanged for assets rather than transferred through the tax-benefit mechanism.

In some ways the result of such deficit financing is analogous to the extension of a social security retirement scheme to provide added benefits to middle and upper incomes beyond the existing caps to the wages and earnings subject to social security contributions and the corresponding benefits. There are important differences, however. The Social Security System is indeed often criticized as being in effect a kind of Ponzi scheme in which benefits to earlier cohorts are financed by taxes on later cohorts. The scheme is kept from collapsing by virtue of its being compulsory so that there will always be succeeding cohorts to foot the bill, though possibly by higher or lower tax rates, unlike private schemes, which tend to collapse when it is discovered that the emperor has no clothes and new contributors shy away.

This Ponzi element was, however, necessary to get the program off the ground during the depression. Retirees were given pension payments far beyond what would have been financed by their contributions and only a relatively small reserve fund was accumulated to allow for adventitious differences between receipts and outlays. Even so, the relatively brief lag between the onset of social security contributions out of payrolls and the beginning of substantial payments to retirees constituted a withdrawal from purchasing power, aggravated by the exclusion of the revenue in computing the formal deficit, adding to pressure to reduce government's net addition to purchasing power, and to overall pessimism stemming from the preception of deficits as symptoms of economic ill-health. These impacts substantially aggravated the drop in industrial production in the fall of 1937, by far the sharpest ever recorded.

Currently the amount by which the present value of expected future payments to current participants exceeds that of expected future contributions by them is a real liability of the government that is probably at least as inescapable as that represented by the formal debt. While the schedules of payments are subject to alteration by act of Congress, whether by changing the age of retirement, subjecting more of the payments to income tax, or otherwise, political pressures are likely to require at least some degree of indexation for inflation, so that on balance the real burden is likely to prove as unavoidable a real "entitlement" obligation as that of the formal debt, which is to a much greater extent subject to possible erosion through accelerated inflation. The amounts are not small; one estimate has put the capital value of governments entitlements, including military and civil service pensions, at over 3 years of GDP, though such estimates are necessarily subject to a wide range of uncertainty.

The situation could be formally regularized by a bookkeeping entry that would add to the assets of the Social Security System and to the explicit liabilities of the government. However, this would be a purely formal move that should in principle be of negligible practical significance, though a Congress obsessed with reducing the formal deficit might seize upon this recognition of a liability as an excuse for further inappropriate budgetary stringency. In any case the macroeconomic impact is measured not by the magnitude of the government liability, however calculated, but by the value placed on these entitlements by the potential beneficiaries in making decisions as to saving and consumption.

Many have even complained that the investment of the small actual social security reserves in special government securities amounts to the diversion of social security contributions to government expenditure. But the situation would be no different if the Social Security Administration were to invest in private securities instead, with the private insurance industry switching its reserve funds from private to government securities. The only real impact of moving the social security system "off budget" would lie in the reaction of Congress to the enlargement of the nominal deficit by the disregarding of the growth in the social security reserve. Should the Congress react to offset this increase by budget tightening, the result would be an increase in unemployment produced as a result of a notional rescuing of the social security reserve from being "squandered" in government expenditure.

Setting aside, as irremediable bygones, the subsidizing of the earlier cohorts, for those currently paying payroll taxes the relevant reality (as distinct from arbitrary accounting conventions) is that the relation between the taxes paid by or on behalf of any individual and the present expected value of future benefits is extremely loose. Overall, if one were to apply the rules currently on the books to a steady demographic state of a constant population with a constant expectation of life, with the relatively small social security reserve fund kept at a constant level, present value of benefits payable to a given cohort would fall short of the net present value of the taxes paid during its working life by the difference between the interest that would have been earned by a full actuarial reserve and the smaller amount of interest paid on the recorded reserve. From this viewpoint, looking only at the future, there would thus be a net contribution from the social security system to the general-purpose fisc, much larger, actually, than the amount involved in the charge that the addition to the small nominal reserve is being improperly appropriated to current government expenditures.

In terms of actual demographic changes, a growing population and a lengthening expectation of life both mean that if the reserve fund were held constant, current cohorts still gain at the expense of later cohorts. In practice this is somewhat modified by differentials between total current tax revenues and total current benefit payments, reflected in fluctuations in the reserve fund.

Within each cohort, the often arbitrary and even capricious operation of the complex formulas by which benefits are determined mean that the relation between taxes paid at any given time by a given individual and the consequent increase in expected eventual benefits varies widely and often capriciously. At one extreme, many of those who accumulate less than 40 quarters of covered employment over their working life will not become eligible for any benefits; their contributions are effectively a tax on their wages, whether nominally paid by themselves or their employer. Examples are women who start work at 18 but marry and leave the labor force at 25, or "empty nesters" who enter the labor force for the first time at age 54 or later; for such persons squeezing in a fortieth quarter of coverage could be extremely lucrative.

Even for most of those who do become eligible, there is an arbitrary exclusion from the formula of the 5 years of lowest

Downloaded at Palestinian Territory, occupied on December 29, 2021

المنارة للاستشارات www.manaraa.com

indexed annual covered earnings, so that for these years the contributions are again a pure tax. This is particularly unfortunate in that these lowest years are in most cases the earliest years of employment, at ages for which unemployment rates are highest, and the effects of the tax most unfortunate.

Benefits are not paid on the basis of taxes paid but on the basis of covered wages, which means that those employed during years in which tax rates were low obtain benefits as though they had paid taxes at the later higher rates. On the other hand, in computing benefits wages are indexed, not by a price index or by a compound interest factor, but by a nationwide average wage, which has tended to grow at a rate significantly below an appropriate rate of interest. The result is that over a period of constant tax rates, taxes on earlier wages purchase fewer benefits in terms of present value than those on later wages.

Benefits are determined on a fairly steeply progressive basis, being roughly 90% of the first $5,000 of the individual's average indexed annual wages, 32% of wages between $5,000 and $30,000, 15% between $30,000 and $60,000, and 0% above $60,000. The result is a fairly substantial transfer from high-wage earners to low-wage earners. Low-wage earners may actually receive, as a group, benefits exceeding in present value that of the payroll taxes paid on their earnings, while a relatively large part of the payroll taxes paid on higher wages would be effectively a tax rather than a premium.

Because of this low return in terms of benefits on taxes on wages in the $30,000–$60,000 bracket, the fact that no payroll taxes are levied on wages above this $60,000 cap produces a highly anomalous dip in the combined marginal effective tax rate on earnings as earnings rise above this cap. Not only is this inversion of progression inefficient in terms of incentives, it even opens the door to an arrangement whereby an employer would agree with his employee to pay $20,000 and $100,000 in alternate years, instead of a constant $60,000. This would reduce the payroll taxes payable while producing only a relatively minor reduction in expected benefits. This might be partially offset by consequent increases in the individual's income tax unless some countervailing shifting of other income can be devised.

The impact of the Social Security System on the balance between the demand for and supply of assets and on employment is thus fairly complex. However, it does not depend so much on the intricate realities of the system as on the way it is perceived, both by its participants and by Congress. Many in Congress seem bemused by wildly irrelevant rhetoric concerning the supposed "diversion" of surplus social security revenues to government expenditure, and contentions over whether the system should be considered "off budget" or on. Most payroll taxpayers are only dimly aware of the relation of their "contributions" to eventual benefits. Most younger wage earners probably pay little attention to the prospect of benefits several decades in the future, and tend to treat their contribution as entirely a tax, though perhaps persisting under the delusion that the "employer's" share of the tax is actually borne by the employer.

Older low-wage workers are perhaps more likely to take future benefits into consideration in determining their attitude towards payroll taxes, expectations of benefits, and decisions on the level of expenditure. High-wage earners, on the other hand, may be more likely to regard payroll contributions as a tax, encouraged, in many cases, by propaganda showing how their contributions, if invested instead on an individual basis in private pensions or annuities, could yield substantially greater benefits, so that Social Security appears to be a bad bargain for them.

Another way of looking at it is to inquire what the equivalent is, in terms of individual wealth, of the interest of clients in the system. On the one hand the level of future benefits is not guaranteed, but is subject to modification by Congress, such as by subjecting benefits to individual income tax, increasing the normal age of retirement in terms of which benefits are calculated, increasing the cap on taxable wages, or even changing the benefit formulas themselves. While there is no guaranteed minimum below which benefits cannot be reduced, the political reality seems to be that taxpayers can rely on a fairly substantial wealth-equivalence. There is even a fairly well-established practice of indexing benefits by the consumer price index, so that social security wealth is likely to be less impaired by inflation than investment in long-term government securities.

Also, social security wealth is much less heavily concentrated among middle and upper classes than wealth in general, and thus tends to have a greater favorable influence on the level of consumption expenditure.

Fallacy 15. Unemployment is not due to lack of effective demand, reducible by demand-increasing deficits, but is "structural," resulting from a mismatch between the skills of the unemployed and the requirements of jobs, or is "regulatory," resulting from minimum wage laws, restrictions on the employment of classes of individuals in certain occupations, requirements for medical coverage, or burdensome dismissal constraints, or is "voluntary," in part the result of excessively generous and poorly designed social insurance and relief provisions.

Current situation: To anyone acquainted with labor market conditions, it is abundantly apparent that a large proportion of those currently officially registered as unemployed, as well as large numbers who are not, are ready and able to take most, if not all, of the kinds of jobs that would be opened up by an increase in market demand. In the absence of such an increase, at current levels of unemployment, attempts to move selected unemployed individuals or groups into jobs by training, instruction in job search techniques, threats of benefit withdrawal or denial, and the like, merely move the selected individuals to the head of the queue without reducing the length of the queue. Merely because any one traveler can secure a seat on a flight by getting to the airport sufficiently early does not mean that if everyone gets to the airport sufficiently early 200 passengers can get on a flight with seats for 150.

Even if jobs are specifically created for selected clients, as by facilitating the opening of a new shop or business, while there may be a temporary stimulus to the economy from whatever capital investment is involved, ultimately in many cases this will merely draw purchasing power from other establishments, resulting in reduced sales, reduced capital value, and eventually reduced employment elsewhere. Only if some element of novelty tempts consumers to spend additional amounts, impinging on their planned savings, or if "workfare" involves producing a free public good or service enhancement that does not compete for purchasing power or replace other public employment, will there be any net reduction in unemployment. But while such public works programs can indeed convert unemployed labor into improved public amenities and facilities of various types, as long as they are financed on the basis of an unchanged deficit, any further impact on the economy as a whole will be limited to the difference between the spending rate of those deriving income from the program and the spending rate of those paying the taxes to finance it.

Aside from such a public works program, the result of attempts to push people into jobs is simply a vast game of musical chairs in which local agencies instruct their clients in the art of rapid sitting, with "workfare" curmudgeons threatening to confiscate the crutches of the unsuccessful, while Washington is busy removing the chairs by deficit slashing.

As for "voluntary" unemployment, much of this would disappear as demand and activity increases, and overqualified workers move up out of low-skill jobs into the expanding demand for higher skills, leaving more openings for low-skilled unemployed to fill, and removing the depressing effect of high unemployment levels on low-skill wages. Wages for low-skill but necessary jobs would tend to increase, raising them sufficiently above the safety-net level to mitigate the adverse incentives of the welfare state. Higher wages would raise the prices of low-skill products, increasing the measured "productivity" of such jobs and diminishing the stigma attached to them as "low-productivity" or "dead-end" jobs. Prices of high-skill products may fall to offset this, possibly as a result of technological advance or economies of scale, but if not there may be a small one-shot increase in the cost of living. This would still be a small price to pay for the benefits of full employment. It should not be assumed that this is the beginning of an inflationary spiral.

Downloaded at Palestinian Territory, occupied on December 29, 2021

المنارة للاستشارات

www.manaraa.com

To be sure, there are horror stories of individuals who quite rationally decline employment because of the combined impact of the resulting reductions in various means-tested welfare benefits, increases in taxes and social security contributions, and travel, child care, and other costs associated with employment. To a considerable extent this is the result of designing a variety of welfare and income-dependent programs independently of each other without regard to interactions and combined effects. As each means-tested program is set up separately, the benefits tend to be phased out or capped in ways designed to keep the direct costs attributed to the particular program or measure down. These phase-outs and caps may seem quite reasonable when considered separately, but when several of them happen to overlap the combined results create absurdly high effective marginal "tax" rates. Slower phase-outs are called for, even if this increases the budgeted cost of the programs.

In many cases there is no overall justification for any phase-out. In the case of the earned income credit, for example, eliminating the phase-out and recouping the revenue by increases in marginal rates on upper income brackets would result in a smoother pattern of effective marginal rates with smaller overall disincentive effects and a considerable simplification of tax forms and reduction in compliance costs. The existing law seems to have arisen because the earned income credit was enacted as a patch on the preexisting law, subject to a taboo against raising nominal marginal rates, while the raising of effective marginal rates by the phase-out could get by. Political posturing and the arcane mechanics of the legislative process prevented a rational examination of the tax structure as a whole.

Ready availability of jobs at respectable wages would make it easier to deny benefits to those unduly finicky about the type of employment they will accept, and reduce the need for severance pay and other forms of featherbedding. Real full employment would also reduce the pressure for protectionism, resistance to the abandonment of redundant military installations and other obsolete activities, and make job security generally less of an issue. Real full employment would also encourage employers to compete in arranging work schedules and workplace arrangements to accommodate those with family obligations or other constraints, and otherwise pay more attention to improvement of working conditions. There will be less need for minimum-wage laws and other government regulation of working conditions, and less difficulty in the enforcement of those that there are.

Conclusions. These fallacious notions, which seem to be widely held in various forms by those close to the seats of economic power, are leading to policies that are not only cruel but unnecessary and even self-defeating in terms of their professed objectives. In some quarters there seems even to be a move on towards "declaring prosperity" and taking steps to "prevent the economy from overheating" or bringing on a higher inflation rate. The CBO, indeed, echoing the prevailing mood in Washington, appears satisfied with projections that involve unemployment rates continuing at close to 6% indefinitely. To those with even a minimal concern with the plight of the unemployed and the homeless, such an attitude appears callous in the extreme.

We will not get out of the economic doldrums as long as we continue to be governed by fallacious notions that are based on false analogies, one-sided analysis, and an implicit underlying counterfactual assumption of an inevitable level of unemployment. Worse, we may well be in a situation comparable to 1926, when, according to the orthodoxy of the day, the debt accumulated during World War I was something to be retired as rapidly as possible. Accordingly, purchasing power was taken from the income stream by taxes and used to retire the debt. The amounts paid out to retire bonds were not considered by the recipients as income to be spent, so that consumer demand grew insufficiently to maintain the level of employment, and unemployment increased considerably from 1926 to 1928 and 1929. Instead the proceeds were used to bid up asset prices. For a time this slowing of growth was moderated by the euphoria created by the corresponding accrual of capital gains and the resulting enhanced rate of spending. But even the easier financing afforded by the higher price/earnings ratios of stocks could not induce much capacity expansion beyond the ability of demand to provide profitable sales, and when it was realized that further increases in asset prices could not be justified by the slower increase in the demand for products, capital gains ceased to accrue and the system collapsed into the depression of the 1930s.

The parallel of today is that although we are not actually retiring debt, in relation to current conditions deficit cutting is a comparable reduction in the net contribution of the government to disposable income. In its projections the CBO appears to discount almost entirely the effect of a diminution of this recycling on the level of activity. On the contrary, the CBO assumes that if this recycling is further reduced by a budget-balancing program the result will be a slight increase in the growth rate of GDP by 0.1% per year, rather than a decrease (*Economic and Budget Outlook*, May, 1996, pp. 1–3).

Apparently it was assumed that the reduction in the deficit will induce the FRB to lower interest rates, and that this will lead to an increase in investment activity. But it seems unlikely that there is anything the FRB would or could do that would overcome over any extended period the discouragement to investment inherent in the reduction of market demand resulting from the reduction in government recycling of income. There is, indeed, a tendency to overstate the long-run effect of interest rate changes on rates of investment as a result of observing the short-to-medium-run responses of investment flows to changes in interest rates. Once installed stocks of capital have reached a level corresponding to the lower interest rate, further investment will fall to near its former rate. This is much as while the flow in the mill-race can be increased for a time by lowering the top of the weir, the flow will fall back to its former level as soon as the surface of the mill-pond has been lowered correspondingly. Action by the FRB may be able to postpone, but not to overcome, the consequences of inadequate government recycling of savings into income.

If a budget-balancing program should actually be carried through, the above analysis indicates that sooner or later a crash comparable to that of 1929 would almost certainly result. To be sure, it would probably be less severe than the depression of the 1930s by reason of the many cushioning factors that have been introduced since, and enthusiasm for the quest of the Holy Grail of a balanced budget may wane in the face of a deepening recession, but the consequences of the aborted attempt would still be serious. To ensure against such a disaster and start on the road to real prosperity it is necessary to relinquish our unreasoned ideological obsession with reducing government deficits, recognize that it is the economy and not the government budget that needs balancing in terms of the demand for and supply of assets, and proceed to recycle attempted savings into the income stream at an adequate rate, so that they will not simply vanish in reduced income, sales, output, and employment. There is too a free lunch out there, indeed a very substantial one. But it will require getting free from the dogmas of the apostles of austerity, most of whom would not share in the sacrifices they recommend for others. Failing this we will all be skating on very thin ice.

Downloaded at Palestinian Territory, occupied on December 29, 2021

المنارة للاستشارات
www.manaraa.com