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A trans-Keynesian manifesto (thoughts about an asset-based macroeconomics)

The term “Post Keynesian” might appear to some to imply that Keynes is being left behind (as in “*postwar*”), so I am taking the liberty of introducing an alternative term that I hope has more of a connotation of building on or going beyond Keynes (as in “*trans-Alpine*”). Recent changes in demographics and technology have created a fundamentally new environment in which a reevaluation of the Keynesian approach in terms of the aggregate demand for and supply of assets has become appropriate for the purpose of extending the analysis to a longer-run perspective, though not to that still longer run in which we are all dead. To clear the way for progress, however, it is necessary to start by admitting that there are conditions in which Keynesian demand creation by increasing government debt would not be effective—so that one can be sure to create conditions in which it will be.

Proposition 1: Georgism validates Ricardian equivalence

In a Georgist community, where the only means of financing the debt service is by a tax on land value, a public debt becomes in effect a collective mortgage on the land. A decrease in taxes and an increase in debt leaves each taxpayer with more cash or bonds but with property diminished in net market value by a like amount, so that his net worth is unchanged. Ricardian equivalence is complete, and the stimulative effect is limited to a relatively minor liquidity effect; there may also be a saving of interest if the public debt bears a lower interest rate than private obligations. And if public debt is incurred to finance outlays on infrastructure or other features that enhance land rentals, there will be a substantial stimulative effect.

Proposition 2: Debt served by property taxes inhibits investment

Where the main tax base consists in large part of reproducible or depletable capital, as with local property taxes, deficit finance will have a severe inhibiting effect on capital formation or preservation. These activities would then attract an added share in the burden of servicing the debt. At low debt levels, the hope may persist that other investors will come along to take up some of this burden, but at some point this bubble of hope may vanish rather suddenly, with catastrophic results.

This effect may be mitigated to some extent if the debt is incurred to finance infrastructure that enhances property values. In most cases, however, even if investment in improvements continues unabated, if the debt is financed by taxes on improvements, the investment will fall short of what would take full economic advantage of the increased productivity generated by the public investment.

Proposition 3: National deficits still stimulate

At the U.S. federal level, with heavy reliance on taxes based on earnings (or on consumption), deficit financing shifts tax burdens from present earning effort and consumption to burdens on future earnings and consumption, without capitalization in reduced asset values. Thus, current consumption and income production are encouraged, especially since, for many, the future burden, if any, will be beyond their horizon. The result is a strong stimulative effect.

Proposition 4: Fallacious beliefs can be temporarily self-justifying.

Nevertheless, if a sufficiently strongly held belief prevails in Ricardian equivalence or its close relative the “crowding out” theory, this may for a time hold back investment sufficiently to outweigh the stimulus to consumption, and thus become, for a time, a self-fulfilling prophecy. Agents are people, not robots imbued with an “irrational passion for dispassionate rationality” in the single-minded pursuit of net profits. And even for those not seized with the “crowding-out” fallacy, it would be irrational not to take account of the irrational reactions of others. Eventually, however, this must succumb to the realities of increased disposable income and market demand.

Having posted these caveats, we can now turn to the core of Keynesian analysis as it applies to the contemporary situation.

Proposition 5: Full employment requires large government deficits

For the industrialized world as a whole, and for most of its constituent countries individually, it has become impossible, for the foreseeable future, to achieve sustained adequately full employment without large and growing government debts and corresponding budget deficits.

On the one hand, increased longevity and duration of retirement, higher medical costs of care for the elderly, and the loosening of family ties that call for increasingly individualized provision for old age have led to a sharply increased demand for assets of various kinds to provide for retirement. This is in addition to the greater concentrations of income among those who are more driven to accumulate chips with which to play high-stakes financial games, acquire economic power, or establish dynasties. These tendencies have all led to a sharply increased demand for assets, in terms of market value, relative to GDP.

On the other hand, the ability of the private sector to supply assets that have a realizable market value has grown much more slowly. Capital-saving innovation such as fiber optics, just-in-time scheduling, centralized traffic control, miniaturization, electronic rather than mechanical calculation and switching, and the shift of demand from the products of heavy industry to those of light industry and to services all tend to reduce the ratio of capital to output. Rapid obsolescence and depreciation of high-tech capital and investments in R&D and promotion of intellectual property result in a smaller ratio of net investment in terms of market value of capital to gross investment. The substitution of publicly owned highways and airports for privately owned railway tracks and terminals has reduced the base for privately owned assets. All these factors have combined to keep the ratio to national product of the market value of private-sector assets, net of liabilities, relatively low.

The result has been a large and growing gap between the private demand for and the private supply of assets at a satisfactory level of employment. This gap must be filled by a correspondingly increasing supply of government assets—federal state, and local—if a growing full-employment trend of GDP is to be realized. If the gap is not so filled, and the total asset supply held by individuals falls short of what they

desire to hold, the curtailing of expenditures by individuals in an attempt to bring their net worth up to a desired level will reduce sales, production, employment, and GDP until the corresponding demand for assets has been reduced to the available supply. Economists have for far too long operated in sublime disregard for the macroeconomic implications of these fundamental changes in the technological and demographic environment in which economies operate.

Proposition 6: Monetary policy cannot close the gap

The gap between the private demand and the private supply of assets has become far too large to be closed by any interest-rate or credit-supply adaptation. On the one hand, the demand for asset accumulation and the corresponding supply of savings have become relatively insensitive to interest rates and may even have developed an inverse relationship as lowered interest rates increase the amount of assets required to provide a given level of old-age security.

On the other hand, high risk, rapid obsolescence, maintenance, and other user costs have diminished the long-run responsiveness to interest rates of investment in productive assets. The implicit assumption of the neoclassical paradigm that the potential for profit-seeking capital investment would expand without limit as real interest rates fell, so that there would always be an interest rate that would close the gap, fails in the face of the reality of uncertainty concerning conditions that will obtain in the remote future. As interest rates fall, indeed, more and more remote future conditions, predictable with greater and greater uncertainty, become increasingly important in current investment decisions. Even land, the quintessence of durability, is subject to the vicissitudes of erosion and climatic change, to say nothing of shorter-run uncertainties such as changes in tax rates, zoning, externalities from neighboring uses, and regulatory takings. One cannot afford a palatial estate merely because a 100 percent mortgage at zero interest is available.

There is also a tendency of econometric studies, usually based on time series, to overestimate the long-run effect of reduced interest rates in increasing private investment and asset supply. A reduction in interest rates may stimulate a spurt in housing construction, for example, but once the stock has been built up to the new level of demand, construction is likely to fall back near its old level.

Proposition 7: Alternative means of closing this gap are inadequate

For a while after World War II, in most industrialized countries, the gap between private capital formation and private savings remained small, in part by reason of reduced or low income levels, in part by the fact that the expected duration of retirements was still modest, and in large measure by reason of the high level of opportunities for the repair of war damages and the filling of the gap left by the suspension of civilian capital formation during the war. In Germany, this period was extended by the absorption of East Germany; in Japan, by a spate of export surpluses. But solving the problem with export surpluses to other industrialized countries is essentially a beggar-my-neighbor policy not available as a general solution.

Meeting the problem temporarily through massive export surpluses to the developing world is possible in principle, but in practice encounters formidable obstacles. Unstable or corrupt governments often increase the risks of such investments beyond the level that most private investors are willing to bear. At best, private investors eventually will expect to realize a return on their investment requiring the developing country to generate an export surplus, difficult at best. Even if successful, this merely brings back the original problem in the lending countries.

Meeting the demand for assets by a speculative boom in stock market and other asset prices is a temporary bubble solution that is bound to burst with catastrophic consequences, as in 1929. Creating property by government fiat, as in the creation of a salt monopoly, issuing taxicab medallions, protecting agriculture, or even merely tolerating monopoly, may help to fill the gap but cannot go very far without serious degradation of allocational efficiency, or in some cases aggravating the distribution of wealth. There is in the long run no adequate solution without long-term and continued increases in government debt. Budget balancing over the business cycle, once thought to be the answer, is no longer adequate.

Proposition 8: Measures to promote individual saving produce exactly the opposite of the intended results

One of the more serious fallacies of the conventional wisdom is the notion that investment and growth can be promoted by measures intended to increase individual saving, such as exemption of savings in

various forms such as pension plans, reduced taxation of capital gains, and shifting to consumption taxes. For most individuals, an attempt to save more means actual reduction in consumption spending. This increases the bank account of the saver but decreases the bank account of vendors by a like amount. There is no creation of “loanable funds,” and nothing happens that either encourages or facilitates the creation of new capital to correspond to the attempted savings. If anything, funds in the hands of vendors, such as typically entrepreneurs of one kind or another, would be more likely to provide the basis for active capital investment than the new funds in the hands of the saver.

The increased saving of the individual saver is offset by the decreased income and saving of vendors. In the case of services, such as barber shops, the effect is immediate; where tangible goods are involved here may be a temporary investment in increased inventory, but this is soon converted to reduced incomes of producers as orders are cut back to bring inventory back to normal levels. In either case, reduced income eventually results in reduced consumption purchases, GDP, and aggregate saving. Incentives may indeed result in some individuals increasing their saving, but only at the expense of reducing the savings of others by even more.

Proposition 9: Full employment in open economies requires floating exchange rates

For small open economies, combining free trade with fixed or narrowly constrained exchange rates would make it impossible for any one of them to pursue a full-employment policy independently. Were Denmark or Spain to attempt full-employment policy through deficit finance in the context of a European union, much of the stimulus provided would leak away through the use of the resulting purchasing power to buy foreign goods rather than domestic, implying the acquisition of domestic capital assets by foreigners, a corresponding reduction in the supply of assets available to residents, pressure on the exchange rate, and eventual collapse of the program.

The answer is to retain freely floating exchange rates so that, when domestic purchasing power is increased, the demand for foreign goods will drive the price of foreign exchange and foreign goods up, discouraging imports and encouraging exports in such a way as to keep the economic stimulus at home. Other countries cannot legitimately com-

plain that this is an unfair trade practice: They would be free to adopt a similar full-employment policy of their own.

To be sure, for countries large enough or idiosyncratic enough in terms of resources or tastes to be a significant factor in the international markets, this would entail some deterioration in their terms of trade. There is also some danger of generating speculative gyrations in the foreign-exchange markets at the time of inauguration of the new policy. But as long as the monetary authorities eschew the temptation to interfere in “stabilizing” the market, and thus give additional opportunities for speculation on the basis of rumors of such interventions, these costs would be of little moment compared with the manifold advantages of real full employment.

More serious is the possibility that full employment would attract a volume of immigration that would be difficult to handle. In many cases it can be hoped that family and social ties, linguistic and cultural differences, and costs of making the transition would keep migration at acceptable levels, but if not, some restraints on immigration may have to be imposed.

The Maastricht strictures, if followed, would condemn member countries to continued high levels of unemployment. Even if the constraint on deficits were abandoned and a monetary union as a whole were to attempt a full-employment policy through an increased supply of government securities, in the absence of a large central fiscal authority, it is difficult to imagine how the problem of allocating the necessary aggregate deficit among the various countries could be handled. The proper sequence is first to secure an acceptably low level of unemployment and only then to proceed to monetary union. Otherwise, one is imposing severe hardship on those affected by unemployment for the sake of a relatively minor benefit to international travelers and traders.

The states and localities in a federal system are, of course, the extreme example of small open economies. Macroeconomic policy must accordingly be carried out almost entirely at the national level. In the United States, the macroeconomic impotence of local governments is intensified by their general reliance on property taxes as a chief source of revenue. The main measure they could take to enhance local prosperity would be to shift from a property tax to a land or site-value tax, but that is somewhat outside the Keynesian rubric. But, in any case, it is still necessary to include state and local debt in balancing the demand for and supply of assets.

Proposition 10: “Privatization” or other moves toward full actuarial funding of old-age pension provisions of social security systems can be disastrous

How social security systems are funded strongly affects macroeconomic equilibrium. “Social security wealth,” the excess, for current participants, of the present value of expected future benefits over the present value of expected future taxes, is an important part of the assets that individuals rely on to provide for their retirement. While the actual amount of this wealth as perceived by the individuals concerned (as distinct from that resulting from actuarial estimates) is highly conjectural, it is a very large quantity. In the United States, it is of the same general order of magnitude as the formal funded debt. It is vastly greater than the relatively small social security trust fund, an essentially arbitrary and economically rather meaningless figure.

In a complete accounting, this social security wealth would appear on one side of the national balance sheet as part of individual wealth; on the other side, a like amount would appear as unfunded liability. Accordingly, barring major changes in social security programs, it is not far from the mark, in going from historical data to a scenario for the future, simply to omit this social security wealth from both sides of the asset balance. However, given the political clout that balancing the official budget has acquired as a goal of policy, consideration may well be given to changes in social security programs, especially for pensions, that could significantly reduce unemployment.

As a somewhat fanciful extreme, one way to move substantially toward full employment without continued formal deficits or enlargement of the explicit government debt would be to abolish the social security trust fund, now often counted as part of the formal government debt, and enlarge the amount of social security wealth, as a sort of clandestine debt. One possibility would be to enact generous pensions to be paid on the basis of age to all residents, possibly graduated according to their history of personal income taxes, to be paid for out of future general fund revenues.

To be sure, many might not consider this promise of future benefits, payable out of future general tax revenues, as strongly binding as the present social security arrangements, “paid for” with “dedicated” payroll taxes. Indeed, even these are being considered for downward revision, for example, by raising the age at which payments begin, reducing the amounts exempted from income tax, or changing the rules

for in effect levying in a special surtax on earnings during retirement.

But if sufficient confidence could be engendered that these payments would in the event be made, and at a sufficiently generous level, other asset accumulation for retirement might be reduced to the point where it could be met by private capital formation, and full employment achieved with an “officially balanced” budget. The fact that part of one’s income taxes are going to “buy” retirement benefits on an individual basis could serve as a source of confidence in the payments being ultimately made and allow the income tax to have less of a distorting influence on current activity. Nevertheless, the success of such a program would still depend on the acceptance of the exclusion of the increased in social security wealth from the official deficit and, in the financial community, not being panicked by exaggerated projections of high tax rates. Managing a smooth transition would also require careful attention.

Proposition 11: Downsizing government is a separate issue

Unemployment-reducing fiscal policy does not require an increase in the overall size of government operations. To be sure, anarchy-libertarians have combined the mystique of the balanced budget with appeals to a popular aversion to taxes to promote an indiscriminate downsizing of government. But full employment can be reached either by high taxes and even larger government, or by low government and even smaller taxes. At the extreme, one could have the full-employment economy assured by a government whose main activity would be collecting income taxes and distributing the proceeds in old-age pensions, at a level that would permit individuals to fill their remaining needs for assets from the private-sector supply. This would obviate the need for a formal funded debt: Its functional equivalent would be the social security wealth implicit in the undertaking to pay future pensions.

This might give the appearance of a giant Ponzi scheme, though without a Ponzi to dissipate or abscond with the funds and preserved from collapse by the assurance of a continuous intake of new contributing participants. The participants would, on average, be getting a return on their income tax contributions roughly equal to the rate of growth of the economy. In intergenerational terms, one can think of this as a repayment to the retired cohorts *A* by working cohorts *B* of the contributions previously made by the cohorts *A*, when they were earning, to the rearing and education of cohorts *B*. As compared with the

present situation, there would also be a distribution to the various cohorts of the added product from full employment.

In many ways, minimizing unemployment would facilitate downsizing of government. It would reduce the volume of unemployment compensation and welfare payments, eliminate or reduce the need for minimum wage and other labor regulations, abate opposition to the closing of superfluous military establishments, and might even significantly reduce the cost of the penal system.

Proposition 12: The NAIRU is not an exogenously given datum

The widely held notion that there is a minimal “non-accelerating-inflation rate of unemployment,” or NAIRU, currently put by the Congressional Budget Office at 6.0 percent, below which unemployment cannot be pushed without danger of igniting an unacceptable acceleration of inflation, lacks historical or analytical basis. (The alternative formulation, NAIRU, would syntactically imply a “natural” rate of unemployment emerging from a condition of inflation at a steady rate, but this is not the way the notion is more frequently being used.) In the United States, the unemployment rate in 1926 is estimated to have been about 1.8 percent, with no noticeable inflation, and no explanation is offered as to why this cannot be achieved today. Nearly all countries have enjoyed rates of unemployment of under 2 percent at one time or another, without serious inflation; in Germany in the 1960s, unemployment was reportedly as low as 0.6 percent.

The acceptance of such an NAIRU as a norm, with the implication that if unemployment falls below this level action must be taken to slow the growth of GDP lest the economy become “overheated,” turns efforts to help welfare clients and others find jobs into a cruel game of musical chairs, with work-force advocates threatening to confiscate the crutches of the less agile while NAIRU acolytes religiously keep the supply of chairs inadequate and assure an unabated stream of clients.

There might be some theoretical argument for the existence of an “NAIRRU,” or *rate of reduction* of unemployment, such that an attempt to reduce unemployment more rapidly than this, through the pumping of purchasing power into the economy, would outrun the ability of the production system to expand production to match. There seems to be nothing to prevent bringing unemployment down gradually to below 2 percent, with not only a substantial increase in GDP growth but significant improvement in such areas as poverty, crime, broken families,

homelessness, school dropouts, and drug addiction, provided only that it is done slowly enough.

Even this NAIRRU is not a constant but can be expected to vary according to the amount and distribution of excess production plant capacity, especially in the capital-goods industries, and the level of education and training in the pool of unemployment labor, as well as the prevailing mood of optimism or pessimism. It can be expected to get smaller as full employment is approached and the task of matching job requirements and qualifications becomes more difficult.

In any case, as full employment is approached and the “reserve army of the unemployed” is reduced, eliminating its depressing effect on the wages of the unskilled, there is likely to be a corresponding increase in the prices of products of unskilled labor, raising the measured productivity and the status of these workers and resulting in a small one-time step-up in the overall price level. But this is a far cry from setting off an inflationary spiral.

Even so, the advantages of a faster reduction in unemployment would be well worth enduring a little more inflation. An economy with 10 percent inflation and 2 percent unemployment would be far healthier in human terms than one with 1 percent inflation but 8 percent unemployment. Not only would the real GDP be some 15 percent larger (according to Okun’s ratio of 2.5), but there would be important budgetary benefits in terms of lower costs of unemployment insurance, welfare, and the criminal justice system, as well as alleviation of social problems. Inflation may be akin to legitimized embezzlement, but unemployment is equivalent to arson. Maintaining unemployment as a prophylactic measure against a highly problematic threat of a mismanaged inflation is a cure far worse than the disease.

Proposition 13: Moderate steady inflation has advantages

The optimum rate of inflation is not zero, but a significantly positive one. The adoption of a target rate of inflation somewhere in the range of 3 to 10 percent as the norm has several substantial advantages. First, the higher the target rate of inflation, the more room the monetary authority will have to lower real interest rates and apply a stimulus to the economy in the event of a slip away from full employment, until the slower political process has time to come into action.

Second, inflation coupled with strict accrued nominal income accounting turns the income tax base into a base consisting of real net income

plus a percentage of net worth equal to the rate of inflation. This broadens the base, making it possible to have lower marginal rates for the same revenue, with a smaller impairment of incentives. It also tends to make the tax more progressive. One can consider the net worth element in such an income tax as a desirable substitute for the inheritance, estate, and gift taxes, at least in excess of some nominal low rate. These succession taxes are inherently so capricious in their impact that they have given rise to an entire industry of “estate planners,” and so vulnerable to avoidance as taxes levied on infrequent occasions that can be avoided by a temporary shifting of wealth to forms outside the jurisdiction.

Third, steady inflation gives more scope for the lowering of real rates of interest, stimulating growth and reducing income inequality in the long run. There may be some adverse impacts in the short run on low-income individuals, but this is likely to be much smaller than what is perceived by those who focus on the increase in consumer prices without allowing for growth of nominal income. Those with mortgages or who owe other debts, in particular, will tend to gain rather than to lose.

Fourth, inflation increases the seigniorage profits from the outstanding issue of currency, a burden falling mainly on those engaged in black market and illicit activities.

The main advantage of a zero rate of inflation as a norm is its salience, in that it is easier to obtain agreement among agents involved that this is in fact the norm to be pursued, than to obtain agreement that the rate should be 1 percent rather than 2 percent. This salience may also make it easier to obtain agreement on the steps to be taken to correct deviations from the norm.

On the other hand, if the real interest rate is low—say, 2 percent—a zero inflation norm would severely limit the ability of a monetary authority to provide a stimulus in the event of a downturn. Vigorous action against a threatened overheating might also be inhibited by a fear that it will be impossible to stem a downturn if the braking action should overshoot the mark. Thus, with a 4.5 percent inflation norm, there may be a better chance of keeping inflation between, say, 4 percent and 5 percent than of keeping it between 1 percent and 2 percent. Once the salience of the zero inflation norm is breached, a moderately high inflation rate may provide a lower degree of uncertainty about future prices than a low inflation rate.

Proposition 14: Unemployment is not needed to control inflation

Even if inflation should threaten to get out of hand as a result of a vigorous full-employment policy, there are ways of keeping it under control that do not involve tolerating unemployment. One of these would be a system of tradeable rights or warrants to value added, whereby anyone who ends an accounting period without holding warrants sufficient to cover his value added would be subject to a suitable penalty tax. Warrants would be issued to firms for successive periods on the basis of previous value added with adjustment for changes in inputs of prime factors such as invested capital and labor.

Abba Lerner, shortly before his death, had been suggesting the use of a market in rights to raise prices as an inflation control. This was analogous to proposals then circulating for markets in rights to emit air pollution, the raising of a price being considered to have an externality in terms of its contribution to inflation analogous to that of air pollution. In terms of practicality, this was a nonstarter, given the difficulty of checking on a vast variety of commodity and service prices. When the added difficulty of providing for the pass-through of increases in the prices of supplies and components was considered, the analogy to gross receipts taxes led naturally to recasting the proposal in terms of value added, which makes the proposal practical. Many countries have extensive experience with value-added taxes, and social security and income tax records provide the information for the basic allocation of the warrant issue.

Unlike value-added taxes, failure to include informal sectors is not a serious problem. Purchases by formal-sector firms from informal sectors can be treated as pseudo-prime inputs. Prices of informal-sector outputs will still tend to keep pace with those of the formal sectors. Firms enjoying strong markets for their products will be able to realize higher value-added profits only by purchasing warrants from firms having a less fortunate experience, effecting a kind of profit sharing among firms and reducing risk to investors.

Ultimately, some form of third major macroeconomic control instrument is necessary, in addition to monetary action through interest rates and fiscal action through income generation, if full control is to be exercised over three major macroeconomic variables: the rate of inflation, the level of employment, and the division of the product between current consumption and provision for the future. While with a sufficient

dihedral, one can fly a plane in good weather and make gentle turns with rudder and elevator, it was the Wright brothers' invention of wing warp, later realized as ailerons, that allows landing in a cross-wind without disaster. If value-added warrants won't do the trick, it is up to economists to devise something that will.

Proposition 15: Treasuries should refrain from monopolistic exploitation of their dominant position in the short-term markets

To enhance efficient allocation of capital investment, treasuries should borrow in short markets rather than long up to the point of making compounded expected short-term rates equal to long-term rates. The risks reflected in financial liquidity preference involving unexpected changes in interest rates (as distinct from risks of the borrower's failure to make timely payments) are essentially zero-sum risks in which the gains from unanticipated interest-rate changes to those on one side of the market are balanced by losses to those on the other side. There is no presumption that the social returns in terms of productivity to short-term investment, such as in inventory that can be financed on the basis of short-term interest rates, are any greater than from investments typically financed by long-term obligations. Bringing the long and short rates into line would tend to shift investment from short-term to long-term types of investment until the marginal productivities are equalized. In effect, the market demand for liquidity is one that can be satiated at little or no cost by the Treasury, so that liquidity should be supplied free of charge, or nearly so. In effect, treasuries would enhance economic efficiency by behaving as competitive price-takers rather than as partial monopsonist.

Proposition 16: Large government debt can have a stabilizing effect

In the event of a downturn, when market values of private assets fall, the market value of outstanding government obligations will tend to remain constant in money terms, or even, in the case of longer-term obligations, to increase if interest rates fall. The result is that the proportionate fall in the total net market value of assets will be less than it would have been in the absence of government debt, mitigating the downturn. Similarly, the presence of a large long-term government debt will enhance the effectiveness of a reduction in interest rates induced by monetary policy. The existence of large government debts may be one

reason we have not had a recurrence of a depression of the severity of the 1930s.

There would even be something to be said for giving some priority to longer-term securities, such as by going to zero-coupon bonds instead of annual interest bonds, for the sake of the higher stabilizing effect, though if bondholders fail to “mark to market” either in actual accounts or in overall appraisals, some of the stabilizing effect may be lost. One could even argue for lengthening the maturity of the zero-coupon bonds beyond the point of matching maturities to the preferences of the market for specific maturities, for the sake of an additional stabilizing effect.

On the other hand, a large public debt exacerbates the effect of inflation in producing unemployment in that inflation not only absorbs purchasing power that would otherwise induce added output, but reduces the real value of outstanding debt and thus induces reductions in spending to recoup some of the loss of net worth. With private debt, which appears on both sides of private balance sheets, this effect occurs to a minor extent, if at all.

Proposition 17: A larger government debt can increase the real heritage left to future generations

The conventional wisdom that national debts are a burden on future generations is a fatal fallacy that is almost the exact opposite of reality under conditions of underutilization of resources. A larger supply of government bonds induces a higher level of spendings, and hence of sales and of production. Increased sales induces increased investment to provide the capacity to meet the increased demand. This means an increased heritage of real capital plant and equipment, to say nothing of the enhancement of human capital induced by fuller employment. Under current U.S. conditions, each billion dollars of increased public debt can be expected to result, over a medium long run, in an increase of about two billion dollars in private investment.

The main disadvantage presented by a large government debt is the need to obtain revenues to finance the debt service. But, as long as the economy is growing steadily, implying a need for the amount of government debt to grow at a comparable rate, so that much of the interest will be covered by the needed increase in the debt, while the remainder would be covered by increased revenues from a higher GDP and reductions in unemployment and welfare benefit payments. Even in the event of a cessation of economic growth, as from a decline in birth rates,

exhaustion of natural resources, and failure of technology to advance productivity, the problem is merely the reflection in financial terms of the fundamental problem of providing for the increasing wants of retiring cohorts out of the product of the working cohorts.

The core substance of all of this is that it is necessary to stop thinking of inflation and government deficits as the prime evils. Instead, it is necessary to recognize that government deficits are a rough measure of the net contribution of governments' disposable income, that government bonds provide a needed placement for larger individual savings to provide for retirement, and that it is not the level of inflation but its uncertainty that hampers productivity. Thus, larger deficits, a larger supply of government bonds, and possibly some increase in inflation rates are necessary and proper means to mitigate unemployment as the far greater evil in terms of human welfare. While it may have been good advice to John Alden to be thrifty and balance his budget or even accumulate a surplus, it is foolish to apply this by analogy to a national government planning for the twenty-first century.