

THE FED AND INTEREST RATES

In his Sept. 2 editorial, Norris says much that I want to say, only he says it a lot better. The confusion about the interest rate and inflation and actions of the Federal Reserve Board is not likely to be resolved by anything in the news media nowadays, including the words put out by the Fed. Neither will it be resolved by the partisan voices incriminating the other party. Both parties get the same misinformation from the same textbooks in our institutions of so-called higher learning.

I am no more a lover of the Fed than you are, but let's blame them where they deserve blame instead of for something which is not their fault. The market interest rate is determined by a compromise between the lowest rate that lenders will accept, and the highest rate that borrowers will pay. Lenders will not accept a rate any lower than a few points above the amount that they expect prices to increase next year. They don't need to, because they have the alternative of buying something that will rise in price.

Borrowers will not pay more than they can afford, and that, in the last analysis, depends on the profitability of the business venture which they are borrowing to finance. The Fed cannot influence that rate any more than can any other large borrower (except as will be noted below).

The Fed does not determine the interest rate but only offers a rate on the government debt instruments it wishes to buy or sell. (A minor influence is easing or tightening credit to member banks.) The Fed cannot attempt to deviate very far from the natural market rate without producing drastic changes in the number of treasury bills bought or sold.

Now let's look at a few causes of things and see where blame should fall instead of where it does fall.

When government spends more than it takes in, it has to crank up the money printing presses, or else has to borrow (sell debt instruments). If it simply prints more money and distributes it in some way which does not increase production of goods, then the result is a rise in prices of goods. Then lenders require a higher interest and fewer borrowers can pay it.

But if the deficit is financed by Fed borrowings, the Fed must bid an interest rate a little above market price to attract lenders away from other prospective borrowers. This does not directly increase the money supply, but usually decreases production of goods by crowding out borrowers. The result is still a rise in prices.

Most of the confusion comes from the fact that these connections occur with differing amounts of time delay. In case the Fed offers a lower rate so as to buy back more bonds than it sells, the money and credit supply increases, and the first short range effect is a slightly lower interest rate. If the resulting increased borrowing would be invested productively instead of in production-inhibiting forms of speculation, then prices and interest would both stay down. And net profits would go up and employment would increase and the need for welfare, and prisons and military defense would decrease.

But it doesn't happen that way. The speculative holders of bare land can hold on tighter for a later price rise whenever they see credit easing up. Thus, total production is very much slowed if not stopped.

Result: Easier credit without curtailing land speculation results in no gain where gain is needed.

The Fed's efforts to control the economy are thwarted by failure to take production into account. All of its members and advisers went to college where the facts of production and distribution were not and are not taught correctly, if at all. They studied, and still study, high-flown theories of jugglings of the money supply and not one reference to the relationship between investments in production and investments in anti-production.

Are you saying that you never heard of such a thing and therefore it can't be so? If your library does not contain PROGRESS AND POVERTY by Henry George, contact me, and I will place a copy there.