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The Monetary Spigot—On or Off?

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THE great guessing game today is whether or not the nation is entering a recession, and how quickly the Federal Reserve Board should act to prevent it. In this day of governmentally-centered economics, a recession is said to exist when the gross national product has declined for two successive quarters. That may have happened in the last half of 1969, although some think if there had not been a General Electric strike, the real GNP would have shown a rise.

However, there certainly has been a decline in many fields — the automotive industry and the stock market being the most prominent. The retrenchment in the stock market is typical of the contraction which occurs when inflation of the so-called money supply stops or slows down appreciably. A feeling of unease is percolating throughout the nation. Ordinarily, this would center on the government as the most responsible agency for preventing a recession. But at present most eyes are glued on the Federal Reserve Board, or the Fed as it is usually called, to see what action it will take.

Why is this? Because it is finally becoming obvious that inflation is a monetary phenomenon. Largely as a result of the work of Milton Friedman, the country's leading academic economist, people are beginning to realize that money *matters*, and that inflation is related to the "money supply." Such phrases as cost-push or demand-pull inflation are not heard as frequently as when the Keynesians held exclusive sway. These terms implied that high prices were the result of costs pushing them up or consumers' demand pulling them up.

Although people are still unclear as to what inflation is, Friedman apparently has educated them to the realization that rising and falling prices are related to the rise or fall of the "money-stock," all other things being equal. No doubt, the redundant phrase "monetary inflation" will crop up soon, if it has not already.

The money-stock, as narrowly defined, is currency in circulation plus demand deposits of commercial banks. A broader definition, which Friedman favors, includes time deposits of commercial banks as certificates of deposit, and commercial savings accounts. At the present time the money-stock is astronomical. Under the narrow definition, it is about $200 billion (roughly $50 billion currency, $150 billion demand deposits). As there are about $194 billion in commercial bank time deposits, the money supply, under the

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broader definition, totals about $394 billion.

By means of the technical devices at its control, the Fed, in effect, has been pouring a river of paper money into a pond (the marketplace) constantly raising its level. Inflation is the emission of this paper money. Rising prices are the effect. Strictly speaking it is not a case of prices rising in terms of real money, as gold, so much as it is the debts of a profligate government being discounted. When the debts of a well known businessman, which have been accepted by the community at par without hesitation, begin to be discounted at increasingly higher rates, it indicates that his peers are beginning to question his solvency.

Inasmuch as our paper money consists largely of the non-interest bearing circulating debts of the government and banks, directly or indirectly, the people consciously or unconsciously are discounting them as more of the paper money is poured into the marketplace, and prices are said to be rising.

During 1967 and 1968, the Fed increased the money supply at a rate of 7 percent, which is quite high, particularly when it is realized that in the 1950s the increase was at an average of about 2 percent annually. In December 1968 it turned off the spigot as prices were rising alarmingly fast. The result was that those fields sensitive to money, like the bond and stock markets, declined drastically, but prices of commodities have not dropped as yet. Most of the price rise probably represents a discounting of debts, and loss of confidence in the government's willingness to pursue a sound fiscal and monetary policy.

Friedman feels the fact that the Fed can turn the monetary spigot on and off is precisely one of its weak points since it invariably adopts the wrong policy. He believes it would be wiser for the money supply to be increased at a constant rate, say 4 percent annually, which is considered to be the rate of increase in the nation's productivity. The assumption is that as long as both increase at the same pace, prices should remain relatively stable, but this is questionable. People could never be certain that the productivity rate would match the rate of increase of the money supply, for it is a lot easier to run printing presses than it is to produce goods. They might assume that prices would tend to increase constantly and attempt to compensate for such increase. The "real bills" doctrine also seems to be at variance with Friedman's idea. This is based on the assumption that banknotes and demand deposits should be created only in response to short-term assets such as goods enroute to the market, and not in response to long-term assets, like buildings, factories and real estate. Friedman's constant rate should be geared to these short-term assets if anything, rather than to total productivity.

The Undesirable Corrective

Of course, no one knows whether goods coming to market will increase at any steady rate as the years go by. Actually, the money supply should be geared to the marketplace, and it would be if the Fed did not interfere. Friedman would be on sounder ground if he advocated getting the Fed entirely out of the business of regulating the money supply and letting the marketplace determine it, just as it determines the number of automobiles to be built each year. Practical politics precludes the abolition of the Fed, however, which may be why Friedman adopted this expedient.

So the question of whether a recession is imminent is up in the air. Georgists are well aware that a depression is the undesirable corrective to the increase in speculative land values, bringing them down to what land values should be, or even below. It is the operation the patient must undergo to pay for previous abuse.

A post-World War II depression may possibly have been prevented by this inflation of the money supply. Much of the speculative rent which has grown up over the years may be frozen in long-term contracts, or it may be capitalized in property prices at the going interest rate at the time when properties were sold. This speculative rent may be attenuated by the inflation. For example, a businessman paying rent on long-term contracts would find it easy to pay it if the sales prices of his goods rose relatively rapidly while his rent was fixed. It is only within the past few years that landlords and banks have instituted escalator clauses to protect themselves. It might be said that inflation has made the speculative rent the equivalent of normal economic rent. This, together with better business methods and the invention of the computer, may be why a depression has not occurred.

At least now the people are aware that money does matter, and the problem of the Fed to attain anything like prosperity by monetary manipulation has been increased manyfold. Maybe its board members will wish that Milton Friedman had not been such a persuasive educator, since people are watching monetary policy very carefully and attempting to compensate for any action taken. If a recession becomes serious enough for government action, the Fed may reverse itself and begin to increase the money supply substantially — but will it work?

As for any fundamental reform, possibly if inflating the money supply doesn't help, attention may at last turn to the land. That is something which we can devoutly hope will happen. It is tiresome, to put it mildly, to observe all the false reforms that are being attempted which only make matters worse.

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NEW YORK BAR ASSOCIATION URGES PROPERTY TAX REFORM

The New York County Lawyers' Association through its Committee on Federal Legislation, issued a report recently on the Housing and Urban Development Act of 1968, which calls for a 10-year rebuilding program for cities.

It urged long-range commitments for promoting job security and developing new job opportunities, also creation of a national rebuilding and development bank to finance the program at low interest rates, using the most modern methods and technologies, along with a "truly effective research program."

Further, states the report, "attention to our real estate and property tax structure is needed. At present, we tax improvements on real estate—such as housing—whereas there is no tax on other forms of 'personal' property in which one may invest. This encourages land to be held vacant or with dilapidated housing to keep taxes down, and encourages land speculation with such properties. By not taxing the value of the land itself to the full extent of the real estate tax burden, we also encourage land speculation with the result that prices in urban areas are often prohibitive for low-cost housing."

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Public funds raised by bridge tolls paid for a high speed transit line in Philadelphia and an insurance executive said his house had gone up in (location) value $8,000 as a result. His secretary is one of 30,000 who benefit by the improved travel. She now makes the trip to the office in 22 minutes where it took 1 to 1¼ hours before. The cost of this transportation could be recovered in location value taxation—the appropriate source.

— L.M.G.