The Monetary Policy Put-on

by DAVID SKLAR

AN examination of monetary theory is very much in order, because it is currently at the top of the academic economists' list of recession remedies.

The public at large, the part with something left to lose, has been pretty well convinced that big depressions can now be prevented by the actions of government, guided by its economic experts. These experts believe they can control the economy by manipulating money. This seems plausible, since they view ours as a money economy. Accordingly, they reason that by controlling what they call the quantity of money and the velocity of money it is possible to arrange for high employment, or stable prices, or rapid growth. Many of the economists tell us that, unfortunately, these three goals are not mutually compatible. A little too much of one will discombobulate the others. The skill of the experts is therefore required to pull the right monetary string at the right time. Should things not work out as promised, they blame each other for not having done things just right. They act as though they really believe they are controlling economic forces. A little less quantity here, a little more velocity there, and—pouff—the economy responds to their fine tuning.

What self-confidence the economists have! Of course, they have had it before. In the 1920s, when the Federal Reserve System was new, the monetary economists attributed the relative prosperity of the period to the Reserve System's capabilities. It was believed then, as it is now by economits and laymen alike, that a device had been found which would make the recurrence of depressions impossible.

Government policy based on monetary theory quietly faded away in the 30s. In the past decade the monetary men have returned as confident as their predecessors of the 20s. After a brief apology for their forefathers, who, they say, did not have "a correct view of the facts," they thrust themselves back into the forefront armed with the "facts as we now know them."

Now let us just see what these "facts" of monetary theory are based on.

First we must know where to look. Should we try the current writings of the economists? Easier said than done. Though the books are easy enough to find, they are not easy to read. This is the first curious fact.

After having gone through the labyrinth of the professors' jargon and following the thin line of thought behind monetary theory, what we emerge with is rather simplistic. After a while we realize that in discussing almost any facet of the economy, the professors are at best dealing with effects rather than causes. This would be legitimate if they did not imply, as they often do, that the effects they are treating *are* causes. This confusion of effect for cause is partly concealed by the economists' use of many different terms to express a single idea. In their jargon, cash balances can mean savings, productive services, or capital. It is hardly necessary to mention the mischief to thought that can result from the confusion of capital with money.

But the most significant source of confusion comes from the basic assumption underlying monetary theory. That basic assumption is the old familiar wages fund theory which Henry George warned would be liable to recur in different forms. The reasoning based on this theory was exploded long ago, but here it has returned in a new guise, just as George warned it might.

This theory, that capital employs labor, that an increase in the supply of capital increases employment of laborers and also increases wages, is implicit in all the writings of the monetary men, such as Kissinger and Friedman.

For example, Milton Friedman, in his essay on "The Optimum Quantity of Money," says: "Beyond some point it pays individuals to hold extra balances to benefit from their increasing purchasing power even if it costs something to do so. The retailer dispenses with an errand boy to economize on cash balances, which is a gain, but at some point he must hire guards to protect his cash hoard. It pays him to do so because of his rising cash value."

The retailer dispenses with his errand boy because business has fallen off—not to economize on his cash balances. The implication here and elsewhere in Friedman's writings is that the errand boy's wages come from the retailer's cash balances.

In another essay, "The Role of Monetary Policy," Friedman says: "At any moment of time, there is some level of unemployment which has the property that it is consistent with equilibrium in the structure of real wage rates. At that level of unemployment, real *wage rates are tending on the average to rise* at a 'normal' secular rate, i.e. *at a rate that can be indefinitely maintained so long as capital formation,* technological improvements, etc. *remain on their long-run trends.*"

Because the monetary theory economists accept the wages fund theory, though they may not even be aware they are doing so, the whole structure of their thought rests on a fallacy—an inversion of cause and effect. The slowdown in investments in industry is not the cause of reduced economic activity; it is reduced economic activity that causes a cutback in investments. To use the economists' jargon, a rise in liquidity preferences does not cause unemployment; unemployment causes a rise in liquidity preferences. With the rise of unemployment of labor there is a corresponding rise in the unemployment of capital (liquidity preferences).

Since labor employs capital, when labor is more fully employed so is capital. Employed labor is the cause of capital. Capital is not the cause of employment of labor.

The cause of the reduction in investment opportunities is the real question to be answered. This George did by showing the cause to be primarily related to land prices. The quantity of money and velocity of money are only reactions, not causes. Money merely responds to economic forces. It does not control them. Higher wages and greater employment of labor will cause an increase in the amount of capital used. It is not the other way round. Now the actual cause of higher wages and greater employment of labor is not even touched on by the monetary men. Knowledge of the quantity and velocity of money can tell us little about this cause. Whether or not we view ours as a money economy, the basic factors remain unchanged. Wealth is the lifeblood of the economy; land and labor its factors. The conditions under which these two unite will determine all the rest: the rate of wages and interest; employment of labor and capital; price levels; and economic growth accompanied or unaccompanied by poverty.

Monetary policy is a put-on, and many people have been taken in by it.

Nathan J. Maltz is chairman of the Housing Committee of the New York Chapter of the American Institute of Architects. This committee has criticized a proposed 1969 plan for New York City because of its failure to establish a general strategy for future growth. Maintaining that the housing problem is far more serious than indicated, and that incentives to interest private enterprise must be provided, the committee begins by proposing land value taxation. This would do what complex tax abatement schemes fail to do, since by simply upgrading the existing assessment mechanism every parcel of land could be assessed by local government according to its location value and relative to its planned use. It would pressure owners to put land to higher and better use by making it unprofitable for them to use it for other purposes, and would reduce costs of land assemblage for large projects by automatically eliminating land speculation. It would also encourage good maintenance of existing housing by lowering the tax rate on well maintained buildings instead of raising it each time an improvement is made.

Other suggestions have to do with public and private funding, construction costs and zoning policies. A plea is made for establishment of a regional metropolitan government to enable non-city residents to pay their fair share and to establish more equitable housing practices in suburban communities.