Where the money is coming from

The Great Tax Cut

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FOR MORE THAN a quarter of a century the fiscal policies of our national government have exploited wage earners and the poor and the unwary. The annual deficit of the treasury has been regularly covered in whole or in part by inflating the country's money supply. Thereby the treasury has confiscated the purchasing power of citizens, and the resulting loss has fallen in unjust measure on the less well-to-do.

The process by which the treasury creates money to make up its deficits is but little understood. The expropriation of purchasing power it effects is accordingly unperceived by its victims. In consequence they make their complaints too late and direct their accusations at the wrong objects.

The annual deficit of the treasury has varied greatly. Huge during war years, it has been much more modest during times of peace. During the peace years, moreover, the inflationary effects of the deficit have been mitigated by three factors: (1) Up to a small amount, an annual increase in money supply is needed to accommodate the annual increase in population and economic activity. Up to this point an increase in money supply does not tend to inflate prices.[1] (2) The excess of social security taxes over social security payments has been used for general treasury expenditures, thereby financing a part of the treasury deficit.[2] (3) Until recently foreigners have made new purchases of a not unimportant quantity of government securities each year, and these purchases, although presenting serious problems, are non-inflationary in character and have financed a part of the deficit.

Now, however, drastic changes are under way. The prospect for the treasury, based on reduced tax collections as legis-

lated and on heavy expenditures as authorized and proposed, is for large annual shortages of taxes below spending. The size of these yearly deficits cannot be estimated except in most general terms. But the Revenue Act of 1964 was intended to produce, and undoubtedly will produce, annual deficits of taxes below spending substantially larger than those heretofore experienced except in times of war.

In order to cover its larger annual deficit the treasury will be compelled to sell securities, and most of these securities—a much larger amount than in the recent past—will have to be purchased by commercial banks and the Federal Reserve Banks. Social security funds can no longer be used to make up the deficit because social security payments are now larger than social security taxes. Nor can foreigners be expected to buy securities to assist in covering the deficit, for they have quit buying, and their purchases relative to the deficits now in prospect would in any case be unimportant.

To enable the commercial banks to buy government securities, the Federal Reserve System will have to increase the capacity of the commercial banks to make investments and create deposits. Thereby the money supply will be increased, the treasury will gain purchasing power, and citizens will lose it. The loss of purchasing power will be borne in large part by wage earners, by people dependent on fixed incomes of modest amount, and by others who will be without protection against the ravages of an inflated money supply. There will be some, however, who will prosper from the inflation. The end will be loss for most, misery for many, and gain for a few.

This forecast rests on the sequential logic of four elemental propositions, four monetary rules always operative in economic affairs. Many times in the past societies have disregarded these basic rules or have persuaded themselves that they were outmoded. The results have invariably been disastrous.

The first rule is simply that the money outgo of a fiscal entity, whether it be an individual's pocketbook or the United States treasury, is limited by its prior money intake. Money outgo, that is to say, is always balanced by money intake.

In the case of an individual this of course is obvious. You cannot pay $1 out of your pocket unless you first put $1 into it. If you buy on credit, you cannot pay when the due date arrives unless you first put the required amount of money in your pocketbook or checking account.

Where the national treasury is concerned, however, the matter seems somehow to become obscure. It is a common assumption, indeed, that the intake and outgo of the treasury have little relation. Public expenditure is typically decided upon with slight or no consideration of the effect which the financing of that expenditure must have on society's welfare, as though the expenditure did not require a prior money intake. So far apart are outgo and intake supposed to be, in fact, that it is often regarded as not only irrelevant, but also immoral, to debate at all the cost of a public expenditure expected to be beneficial in effect.

This disregard of relation between outgo and intake of the treasury is reflected in the popular theory of deficit spending. The argument of this theory is that a deficit of tax collections below expenditures, instead of being employed as a temporary expedient, should be deliberately adopted as a permanent tool of economic planning.

The term "deficit spending" can easily be misleading. For the national treasury cannot of course spend a nonentity, whether it be called a deficit or by any other name, but as our first proposition points

out, can spend only money. Therefore, although a deficit of taxes below money outgo is possible, a deficit of money intake below money outgo is impossible. Accordingly if tax collections at any time are below expenditures, the treasury of necessity is supplementing tax collections by some other form of money intake, to supply itself with the money needed for its money outgo. This supplemental money intake, say the proponents of deficit spending, should be accomplished by inflating the money supply, using the money so created to make up the deficiency in taxes, and this indeed is the only form of supplemental money intake possible under present monetary conditions for anything more than a very short period.

Deficit spending, thus supported by inflation of the money supply (or as J. M. Keynes chose to phrase it, by a "flexible money policy"),[3] is said to stimulate production, employment, and material welfare in three ways.

First, it is said that the spending results in public largess—public works and the distribution of goods—to the enhancement of social welfare. But though much stressed by politicians, this aspect of deficit spending is not much emphasized by Keynesian economists, who on the whole do not seem to regard the particular manner of deficit spending as of great importance. Indeed, Keynes is reported to have said that most of the benefits of inflating money would accrue if the treasury simply used the increase in money to hire men to dig holes and fill them up again.

Regardless of whether Keynes made this statement,[4] it correctly points to the second and third ways in which deficit spending is said to promote economic activity.

The second way, it is said, is by increasing the purchasing power of citizens. Whatever form the deficit spending takes, the argument is, it increases purchasing power and consequently production and employment. For money is purchasing power, and therefore when the treasury collects money as taxes it removes purchasing power from citizens, but when it spends money it places purchasing power in their hands. Accordingly if the money the treasury spends is greater in amount than the money it collects in taxes, then the purchasing power of citizens is said to be increased to the extent of the difference. Since purchasing power is demand for goods, an increase in purchasing power means an increase in the production of goods, and so of employment.

This argument concerning purchasing power seems not to have originated with Keynes but with later economists who followed his analysis. Keynes himself had little to say about deficit spending, but he had a great deal to say about inflating the money supply, and it is because deficit spending is financed by inflating the money supply that it is believed by its supporters to benefit society in still a third way.

Inflating the money supply, it is said, increases profits, and increased profits encourage additional production and employment. Profits are believed to be increased because the larger money supply results in (1) lower interest rates and (2) lower wages relative to general prices. The lower interest rates result from the larger quantity of money seeking investment. The lower wages result from the fact that the increased money supply raises the general prices of goods faster than wages. When the general price level for goods rises, wages, though they rise too, lag behind the general price advance.[5] Therefore as long as inflation of the money supply continues, the products of industry are sold at today's higher level while wages are paid at yesterday's lower level. Thus with interest lowered and with wages lagging behind prices, the profit margin of in-

dustry is widened. And as profits expand, so higher production and additional employment are assured.

The above is an exceedingly brief summary of the Keynesian argument. But it is a fair statement of what it all comes down to in terms of actual public policy. Present day Keynesianism is the advocacy of inflation and deficit spending. The various elements of its complex and tortuous ideology—hoarding, marginal efficiency of capital and of employment, liquidity preference, propensity to consume, and so forth—these elements are all adjuncts of its basic advocacy of increasing the quantity of money, and if Keynesianism does not come down to this practical advocacy of deficit spending and inflation, it is difficult to see that it comes down to anything at all.

But in any event it is not the concern of this paper to consider critically the arguments in support of deficit spending. Its concern is to expose the inhumanity, injustice, and moral wrong of deficit spending, and particularly of the deficit spending envisaged by the Revenue Act of 1964 and the current spending programs. Accordingly I shall advert to the arguments in support of deficit spending only as they bear on the problem of its morality, a problem which has received all too scant attention.

The tax cut effected by the 1964 Revenue Act is an application of the deficit spending theory on a huge scale. The tax intake of the United States treasury, by the time the cut becomes fully effective, is to be reduced by no less than 12 per cent to 15 per cent, something in the neighborhood of $12 billion annually.

But, as our first proposition points out, if tax collections be reduced, nevertheless total money intake of the treasury must be maintained at the level of money outgo. If expenditures, including social security payments, in the fiscal year ending June 30, 1966 (by which time the tax cut will be fully effective), total $130 billion while tax collections including social security taxes total only $115 billion, then the treasury must and will obtain a money intake of $15 billion by some method other than taxes. How will it obtain this additional money and what will be the effect on society's welfare?

The question leads us to our second proposition: A fiscal entity, whether it be an individual's pocketbook or the national treasury, can obtain money in only two general ways, (1) by arranging for a transfer of money to itself from some outside source, or (2) by itself creating money. That is, a fiscal entity can obtain money either from without itself or from within itself, and there is no other possibility.

In the case of an individual, if he obtains money by transfer from others, he does so by selling his services for compensation, by selling goods at a price, by receiving a gift of money, or by stealing it. Or if he creates money, he either takes metal to a mint and receives coins in exchange (if he is permitted by law to do so) or he counterfeits money (if he can get away with it). An individual can also obtain money by borrowing; if he borrows from a bank, he creates money by his act of borrowing; if he borrows money from a non-bank source, he obtains money by transfer and not by creating it. We shall return to this matter of borrowing in just a moment.

In the case of a public treasury, to the extent that it obtains money by transfer—from outside itself—it must do so mainly by taxation; any amounts it can sometimes obtain by selling property or services are comparatively unimportant. It can also obtain money from within itself; that is, it can create money, making use of one or more methods of money creation. A

public treasury, like an individual, can obtain money by borrowing, and here the same consideration applies as in the case of an individual; that is, if the treasury borrows from banks, it creates the money it obtains, whereas if it borrows from non-bank sources, it does not create the money it obtains but instead secures it by transfer from others.

This distinction between bank and non-bank borrowing by the treasury is of the utmost consequence. Before considering it further, however, it will be instructive to look at three other methods, apart from bank borrowing, by which a public treasury can create the money it needs for expenditure.

A simple and very old method is for a public treasury to melt down coin as it is received in payment of taxes and to reissue, say, five new coins in place of four old ones. The new coins contain a larger quantity of base metal and a smaller quantity of precious metal. Thus without being put to the cost of acquiring additional precious metal, the treasury is able to take in four coins and pay out five, financing a part of its expenditure by money creation. This method of financing the treasury was employed over and over during Roman history. The silver content of the denarius, the principal coin, was constantly reduced until the denarius became in fact no more than a copper coin with a thin washing of silver.

A still simpler method of creating money is to print pieces of paper which in effect say "This is money" and to use this paper money in paying soldiers and in discharging other obligations of the treasury. This printing press method was used by the Continental Congress during the War for Independence and by the treasuries of both the United States and the Confederate States during the Civil War. At practically no cost it supplies a treasury with money intake which can then be used to finance money outgo.

Another method of money creation by a treasury is to reduce the amount of metal or other thing of value which will be exchanged for convertible paper money. This method was employed by the American government in 1933 and 1934. American paper money was convertible into gold at the rate of 23.22 grains of gold per dollar prior to 1933. In that year the privilege of conversion was taken from American citizens but retained for certain foreigners, and in 1934 the amount of gold which would be exchanged for dollars at the request of foreigners was reduced to 13-5/7 grains per dollar. This devaluation automatically increased the dollar equivalent of the gold belonging to the treasury.

In each of the foregoing instances, money was created to finance deficit spending. The governments that minted debased coins, printed fiat money, or reduced the conversion rate of paper money were governments operating at a deficit. Deficit spending cannot occur (except for short periods and under special circumstances) without money creation, and when money creation by a treasury occurs, it is always for the purpose of deficit spending.

Even, then, as money creation by treasuries is a very old practice, so too is deficit spending. Far from being new, as often supposed, deficit spending is as old as money and taxes. At least 2,000 years ago it was made use of, and the arch-Keynesian of antiquity was Nero, whose treasury followed a very flexible money policy indeed, operating continuously at a large deficit, covered in part by minting debased coins and in part by confiscating the estates of disliked citizens. The belief that deficit spending is a modern invention does not arise from the facts, but from want of historical knowledge.

The kind of money created by a treas-

ury to finance deficit spending depends of course on the kind of money currently being used. The principal form of money in the United States today is bank money, which consists of so-called "deposits" in banks.[6] These deposits or checking accounts are transferred back and forth by people in paying their bills and financing their transactions. The United States treasury therefore creates bank money, or bank deposits, to obtain the money intake needed to augment tax collections. It does this by borrowing from banks.

The creation of bank money by borrowing from banks is a much misunderstood phenomenon; it is nevertheless a matter essentially simple.

Suppose you borrow $1,000 from a bank. You give the bank your promissory note for $1,000 and the bank gives you a deposit of $1,000.[7] (Conceivably the bank could give you $1,000 in currency but in practice this rarely happens.) By giving you a deposit for $1,000 the bank has become indebted to you in that amount; that is, it has promised to pay you $1,000 on demand. What you and the bank have really done is simply to exchange indebtednesses. You have become indebted to the bank for $1,000 on your promissory note, and in exchange the bank has become indebted to you for $1,000 on the deposit. Why do you and the bank do this, why do you each find it advantageous to exchange your indebtednesses in this way? The reason is this: By virtue of the peculiar position banks have come to occupy in the economic life of today, the bank's indebtedness to you, that is, the deposit it has given you, readily circulates in the community as money, whereas your indebtedness, your promissory note, does not circulate in the community as money. By the exchange you have received the use of a sum of bank money for a period of time, and you can transfer this bank money by check, in paying bills or for whatever other purposes you choose. For this privilege of using bank money you pay the bank interest.

But your act of borrowing has importance not only for your individual affairs but for the affairs of the community as well. Your loan has added to the community's money supply. Before the loan $\$x$ of bank money circulated in the community; after the loan the amount used by the community was expanded to $\$x$ plus $1,000, and this expansion will continue until your loan is paid, at which time the bank will deduct $1,000 plus interest from your checking account and cancel your promissory note.

Observe that if you borrow from a non-bank lender instead of from a bank, your borrowing does not result in an increase in the community's money supply. The non-bank lender cannot give you a deposit in exchange for your promissory note; he can give you only currency or a check on an existing bank deposit. In either case no creation of new money occurs but only a transfer of money already in existence.

When the United States treasury borrows $1 billion from banks the process is exactly similar to the process in the case of your loan, although the words commonly used to refer to what goes on are somewhat different. The treasury gives the banks its promissory notes—variously called bonds, notes, bills, or certificates, depending on their form—in the total amount of $1 billion and receives in exchange deposits totaling $1 billion. All the banks in the United States have accounts for the treasury, to which they credit the deposits due the treasury in exchange for the government securities they purchase.[8] These new deposits totaling $1 billion are then transferred by the treasury to its accounts with Federal Reserve Banks. They are then used in financing the treas-

ury's expenditures; that is, they are used in paying its bills, and the deposits thus transferred to others and placed by them in their deposit accounts in banks around the country become a permanent addition to the money supply, continuing until such time as the treasury effects a net reduction in its outstanding indebtedness, which in practice is never, well, hardly ever. Thus when the treasury borrows from banks or, what is the same thing, when banks buy government securities from the treasury, the process is one of money creation, and there occurs an equivalent increase in the quantity of bank money in the country.

If, however, the treasury sells its securities to non-bank purchasers, no increase in the money supply takes place. Non-bank purchasers cannot pay for the securities by giving the treasury a deposit in the amount of the purchase price; they must pay the treasury by transferring to it money already in existence.

As we have seen, the United States treasury will be compelled in the years immediately ahead to arrange for a very large money intake in addition to taxes. How will the money be obtained? It must be obtained, our second proposition tells us, either by transfer from others or by money creation.

As a practical matter, the only way the treasury can obtain additional money by transfer from others is by borrowing from non-bank sources. But the money intake which can be obtained by borrowing from non-bank sources will be insufficient, and by a substantial margin, to cover the prospective deficit. The total of new issues of securities, governmental and corporate, in 1963, was $31.6 billion, and averaged $31.1 billion for the five years ending with 1963.[9] Assuming that the additional deficit caused by the tax cut will be even as low as $10 billion annually, what chance is there of inducing non-bank investors to increase yearly investments in new securities by 30 per cent—to over $40 billion? Undoubtedly the treasury can increase non-bank investment in its securities by raising the interest rate it will pay, as was dramatically demonstrated by the issuance of 5 per cent bonds in 1959. But to obtain additional non-bank loans of $10 billion annually would require a substantial increase indeed in the interest rate offered by the treasury. And this would have two seriously adverse effects on society. First, it would raise interest rates generally. This would dampen business activity by increasing costs. Secondly, it would divert investment from established channels to the treasury. The treasury would obtain more money, but less money would be spent for homes, factories, utilities, and other capital goods. Both these necessary conditions to non-bank borrowing are so objectionable, economically and politically, that it can confidently be predicted that such borrowing will not be much resorted to during deficit spending years. Most of the coming deficit will be financed, therefore, by borrowing from banks.

Our discussion has just indicated that when the treasury sells its securities to banks, the increase in money supply is equivalent to the amount paid for the securities. In fact, however, the increase in the money supply will be substantially larger than this, because of the part which will be played by the Federal Reserve System.

When the Reserve System was founded a half century ago it was designed to operate with convertible money. With the abandonment of convertibility in 1933, a substantial change occurred in commercial and central banking, and in consequence the principal function of the Reserve System today is to limit the quantity of deposits which commercial banks as a whole can have. Such limitation is necessary be-

cause if commercial banks could increase their earning assets—loans and investments—without limit, simply by creating additional deposits to pay for them, banking would be a very good thing indeed, yes indeed, and continuous and wild inflation of bank money would occur. Accordingly the Reserve System uses three tools—the discount rate, the reserve ratio, and the buying and selling of government securities in the open market—to control the volume of deposits of commercial banks. By using these tools the Reserve System can, as it deems it in the social interest, on the one hand compel banks to restrict their deposits, thereby limiting their loans and investments, or on the other hand permit them to increase their deposits, and correspondingly to expand their loans and investments.

It happens that at the present time the country's banks as a whole are about at their legal limit of deposits. Therefore they are not in a position to buy additional government securities. If they are to buy such securities and thereby finance the treasury's deficit, their capacity to create deposits must be increased. And this increase the Reserve System will certainly effect, expanding the banks' deposit capacity. It will make funds available, as the quaint saying is (although no funds are involved but only the ink required to print additional figures on ledger cards), in order that banks can create more deposits by buying more bonds.

But here's the rub. Although the Reserve System can increase the capacity of banks to lend to the treasury, it cannot compel banks to do such lending. Attractive as the treasury may make its securities, certainly some of the increased capacity of the banks to create deposits will be used to finance business. Suppose the Reserve System increases the deposit capacity of banks by $12 billion. (It can readily do this either by reducing the reserve ratio or by buying about $2 billion of government securities in the open market.) How much of this increase in deposit capacity will be used to finance the treasury? No one can know in advance of the event, but certainly only a part. Thus the conclusion is inescapable that bank money is going to be increased annually by an amount substantially larger than the treasury's deficit. How much larger no one can now say. But if present government policies continue, it would seem that in a few years the yearly increase will be at least $15 billion—perhaps it will be much larger.

What will be the social effect of this expansion of the money supply?

This question leads to our third proposition: An increase in money supply tends to increase prices, and a substantial increase in money supply tends substantially to increase prices.

We have used the term "money supply" thus far without definition. It should be said that it is used in this paper in the commonly accepted sense of demand deposits in banks plus currency outside of banks.[10] The growth of money supply during the past 24 years is indicated by the following figures for approximate money supply at the dates indicated: December 30, 1939, $36 billion; December 31, 1947, $113 billion; December 25, 1963, $157 billion.[11]

Consideration of our third proposition need not detain us long.

In the first place, no one denies its correctness in the general form in which it has been stated. The tendency of an increase in money supply to increase prices is universally recognized. The tendency may be and usually is opposed by other tendencies. But the influence of a larger quantity of money is toward higher prices, and the increase in prices in this country during past years has been induced and

made possible by the increase in money supply noted above.

The advocates of deficit spending, moreover, not only recognize but expressly assert that an increase in the quantity of money tends to result in a higher level of prices. If the reader will turn back to the third argument in favor of deficit spending, outlined above, he will see that the tendency of an increase in money supply to raise prices is an essential part of that argument. Keynes seems to have assumed without question that an increase in money would lead to higher prices.[12]

In the second place, we are not here concerned with any measurement of change in prices, but only with the direction of such change. Doubtless it is correct, as has not infrequently been pointed out, that it is impossible to measure accurately a general level of prices or the relation between prices at different times. But the fact of change is indisputable, and measurement is never precise either in the physical or social sciences; completely accurate measurement is a mental concept rather than a matter of experience.

That the coming increase in prices will probably be substantial can be readily appreciated by considering the figures for present money supply and probable increase in the future. At the end of 1963 the money supply was about $157 billion, and our discussion has indicated a probable increase annually, once the full effect of present tax and spending policies is felt, of at least $15 billion. The probability of a substantial yearly increase in the general level of prices is clearly indicated by these figures.

What will be the social effect of this yearly increase in prices?

This brings us to our fourth and last basic rule. It is this: An increase in the general level of prices lowers the purchasing power of money, and the loss in purchasing power so occasioned is borne in unequal and unjust measure by different groups of people.

If the price of a good rises from $1.00 to $1.10, then the purchasing power of $1.00 declines 9 per cent. If your income on January 1, 1966, is at the rate of $10,000 per year, and if during 1966 the prices of the things you buy rise 10 per cent, then by the end of the year your income will purchase only as much as $9,100 formerly did; $900 in purchasing power will have been taken from you.

This loss of purchasing power follows as the necessary tendency of deficit spending. The steps we have traced: deficit spending makes necessary the creation of money, the treasury creates money by selling its securities to banks, the banks create deposits in favor of the treasury to pay for the securities, the money supply is thereby increased, and prices then tend to rise and purchasing power to fall. By the process the treasury gains purchasing power and citizens lose it.

It may therefore be stated as a law of social action that all the expenditures of a government treasury tend to be currently financed by the requisition of purchasing power from citizens.

To a minor extent, the requisition of purchasing power may be mitigated or offset in certain cases. Thus if a treasury operates at a small deficit, then the money created to finance it may be no more than is needed to accomodate an increase in population and economic activity, and in such case a rise in prices does not tend to occur. Again if the deficit is small, the effect of the increase in the money supply may be offset by a decline in the rate of turnover of money. (This however is not apt to happen.)

But the law of the necessity of financing a government treasury by taking purchasing power from citizens is always in opera-

tion in the way stated, and it operates without regard to the manner in which the treasury secures its intake of money. If the treasury obtains money by taxation, it takes away purchasing power. If it simply seizes property, it takes away purchasing power. If it borrows from non-bank lenders, it takes purchasing power from the lenders. And if instead of securing money by transfer, it itself creates the money it needs, whether by debasing coins, issuing fiat money, reducing the conversion rate of convertible money, or borrowing from banks, the result is all the same—purchasing power is taken from citizens.

The theorists of deficit spending are oblivious of the fact that a deficit always tends to be covered by the requisition of purchasing power, and that it is the taking of purchasing power rather than the taking of money which is realistically important. What matters it that the taxation of money be reduced if the taxation of purchasing power be maintained or increased?

The question to be answered, then, with respect to any fiscal policy under consideration, is, which citizens are going to bear the burden of the loss of purchasing power? When a treasury operates at a substantial deficit financed by selling securities to banks, the ensuing loss of purchasing power is borne almost entirely by three groups.

The first group is composed of wage earners and their families. When prices rise, wages necessarily rise more slowly than the prices of the goods the wage earners buy. Employers are dependent on the prices their products bring as the source of the funds from which wages are paid. If prices are rising, all prices including wages are interacting in their influence on each other. Wages influence other prices, which in turn influence wages. Nevertheless wages tend to lag behind other prices in a period of rise. For in each particular enterprise where wages are paid, the advance in the price of the goods produced must usually establish itself before an increase in wages can be made. This necessity that wages follow behind other prices during a period of general price rise is recognized in the cost of living clauses now being inserted in labor contracts. In these clauses it is provided that at periodic intervals wages will be adjusted to the cost of living index, but the adjustment always —and of necessity—follows after a change in the index, and does not and cannot accompany it. When prices rise, therefore, wage earners suffer a loss in real wages ununtil their money wages are increased. But by the time this is done the continuing rise in prices is bringing additional loss in real wages. Thus the process goes on as long as inflation goes on, and wage earners and their families unjustly suffer a continuous loss of purchasing power and welfare.

That inflation of the money supply thus lowers the real wages of employees was not only recognized by Keynes in his advocacy of inflation, but was in fact supposed by him to be a valid argument for making use of the inflationary process. For lowered wages result in increased profits, and increased profits are necessary according to Keynes, at least in the short term, to stimulate production and employment.[13] And since wage earners will resist any reduction in their money wages, their real wages must be lowered by raising the prices of the things they buy, while their money wages remain stationary. That this surreptitious taking of purchasing power from workers is a wrongful activity on the part of the state seems never to have occurred to Keynes. He has not a word to say about it. The advocacy by present day proponents of inflating the money supply

exhibits the same obtuseness to the moral problem unavoidably involved.

It is perhaps not too surprising that wage earners as a class do not understand and consequently are not concerned about the harm to their welfare occasioned by the inflation of deficit spending. The evil comes silently and masks itself behind sanctimonious promises of security and welfare and prosperity for all. But it is amazing that the professional leaders of wage earning groups are not better advised. Only within the last few months one of the country's most prominent labor leaders issued a booklet calling stridently for a program of deficit spending. Does he not know that Keynes himself, the modern prophet of inflation, admitted that inflation results in the loss of real wages to workers? And does he not know that inflation of the money supply necessarily is produced by deficit spending? Which side is this labor leader on, that of the employers, who benefit by deficit spending, or that of the employees, who are hurt by it?

A second group condemned to a loss of welfare by deficit spending is composed of those who are dependent on more or less fixed money incomes. This group is more advanced in years than the wage earners. Many of them are retired, many are about to retire, and many are widows. They depend wholly on incomes expressed in dollars whose quantity cannot be expected to increase. Their incomes are made up of interest on savings accounts, interest on bonds, pensions, annuities social security benefits, and fixed payments under all kinds of contracts. Deficit spending removes a portion of the purchasing power of each dollar they live on, and the loss is continuous. Their only prospect under continuous inflation is penury and misery, and they have little or no avenue of escape. As the great inflations in Europe proved earlier in the century, there is little the members of this group can do to combat their difficulties. They are the expendables of Operation Deficit.

A third group whose lot is made worse by the inflation of deficit spending consists of creditors. Debtors are benefitted and creditors hurt by debts being paid in deflated dollars. The word creditor is apt to bring up a mental picture of a rich man foreclosing his mortgage on a poor man's farm. But this is misleading fantasy. There are of course rich creditors and poor debtors in modern society. But they are not typical. Observation indicates that most creditors are people of modest means. The rich and the well-to-do seldom invest today in debtor-creditor instruments such as mortgages and bonds. They have seen what has happened to the purchasing power of the dollar, and they avoid the certain loss of investment in obligations payable in dollars. Their investments instead are in equities and real estate. The creditors of today are people of modest means. They own accounts in savings and loan associations, savings accounts in banks, insurance policies, and shares in pension funds, and these institutions—the savings and loan associations, banks, insurance companies, and pension funds—are today's investors in mortgages, bonds, and other instruments payable in dollars. Nor is the debtor class today the poor group often imagined. The debtor class certainly includes some who are poor and some who are of modest means, but it also includes the great corporations of modern life, whose total indebtedness runs to billions of dollars. In economic reality this indebtedness is reduced with every passing month of inflation, and correspondingly the stockholders of corporations are unjustly enriched. The deflation of the money supply during the 1930's enriched creditors at the expense of debtors. The coming inflation of the money supply during the 1960's will enrich debtors at the expense of

creditors. But now the roles are reversed. Thirty years ago debtors were typically less well-to-do than creditors. Now it is the creditors who are typically, or at least to a large extent, less well-to-do than the debtors. The deflation of the '30's harmed the less well-to-do and the inflation of the '60's is going to harm the same group.

If wage earners, persons with fixed money incomes, and creditors lose purchasing power through the inflation of deficit spending, who gains?

First, the national treasury gains. By selling its securities to banks, it gains the money intake needed to meet its money outgo. If in fiscal 1966 the treasury sells $15 billion of new securities to banks, it will gain $15 billion in purchasing power. While citizens are losing purchasing power through the inflation of the money supply, the treasury is gaining purchasing power.

Secondly, various groups of citizens will gain purchasing power. These are the people who, alert to shifts in the winds of fortune, will keep their earnings flexible rather than fixed in stable wages and salaries, and will invest in things rather than in money obligations. As stockholders and executives of corporations they will gain the benefit that employers obtain from inflation in the way already described, and they will also profit from the decline in the real burden of the indebtedness of their companies. Other debtors both large and small will also gain as their debts are paid off simply by the erosion of the value of the dollar. And all citizens who are not wage-earners, or dependent on fixed incomes, or creditors will gain from the shift of taxation to the wage-earning, fixed income, and creditor groups.

Thus the inflation of deficit spending will tend in general to make the rich richer and the poor poorer as the taxation of purchasing power is transferred from more well-to-do to less well-to-do groups.

This transfer of the burden of taxation is all that is accomplished by the great tax cut of 1964. It does not and cannot reduce the total burden of taxation as long as spending is maintained. For the taxation of purchasing power cannot be reduced much below expenditure, as the basic law disclosed by our discussion instructs us. Under the government program now in effect more purchasing power will be taken from poorer groups in our population and less purchasing power will be taken from richer groups. Will anyone defend this shift in the burden as morally right? Must it not be condemned, rather, as a moral monstrosity?

Although the Revenue Act of 1964 is designed to bring about a deficit of tax collections below expenditures, yet the ensuing inflation will prevent tax collections from declining as much as the reduction in rates would indicate. Both corporate and personal incomes will be expressed in more dollars. Corporate profits moreover will be enhanced by lower wage costs, as we have seen. The reduction in the corporate income tax rate from 52 per cent to 48 per cent is a reduction of 7.7 per cent. The reduction in corporate income taxes collected will not be that large. Since personal income tax rates, further, are on a graduated scale, the inflated dollar amount of personal incomes will automatically move incomes into higher taxing brackets, despite the lowering of the scale. In 1962, for example, an income of $10,000 for a married couple with two children was liable for a tax of $1,840. Assume that in 1967 it takes an income of $12,000 to supply the same couple with the same purchasing power, because of inflation. Under the tax rates as reduced by the 1964 act the tax of this couple will be $1,856. Thus in our assumed case the tax collected in 1967 will actually be higher than the tax collected in

1962 on the same purchasing power, despite the lowering of the tax rates. Tax collections on the incomes of individuals, like corporate taxes, will not be reduced as much as the reduction in rates would indicate.

But the same inflation which will increase the number of dollars subject to income taxes will also increase the number of dollars of governmental expenditure. The gap between taxes and spending will continue, and if inflationary precedent be followed, will steadily expand.

Sooner or later, nevertheless, we shall return to a national budget financed by current taxes rather than by the creation of money. Over and over during the past 2,000 years societies have succumbed to the temptation of large-scale deficit spending, and over and over the resulting conditions have become intolerable. It has been an oft-repeated cycle, for human societies learn but little from history. When the inflationary results of our present deficit spending program will have become sufficiently severe, we shall turn again to some form of monetary and fiscal practice which will limit the creation of money to a quantity compatible with the growth of population and economic activity, and will finance the balance of the budget through current taxes.

In the meantime the destructive influence of our deficit spending program will be at work, breeding the illusion of something for nothing, fomenting speculative fever, and encouraging the folly and cheating of inflationary times.[14]

[1]Under a money system based on gold coin, the needed annual increase in the supply of money is furnished by gold mining and by the transfer of gold from industrial to monetary use.

[2]Treasury securities in an amount equal to the excess so spent for general purposes are placed in a reserve or social security trust fund, but since the treasury is both owner of the securities and obligor under them, i.e., both debtor and creditor, the reserve or trust fund has no value, and is only a sham.

[3]J. M. Keynes, *The General Theory of Employment Interest and Money*, New York, p. 267 and numerous other places.

[4]Keynes made essentially this statement, with a slightly different twist, in *The General Theory of Employment Interest and Money*, p. 129.

[5]Keynes dealt at length with the lag of wages behind other prices in a period of inflation of money, as indeed it is a principal point in his system. See *The General Theory of Employment Interest and Money*, pp. 13-22, 232, 301-304.

[6]"Deposits" is a misleading term, because deposits are not really involved in checking accounts, except in a superficial sense. In 1922 D. H. Robertson suggested that the term "chequeries" be used. *Money*, Chicago, 1959, p. 42 et seq. But the term has objections of its own and has not caught on.

[7]In practice the bank will usually give you $1000 less interest discounted in advance. This is disregarded here for the sake of simplicity of statement.

[8]Sometimes the treasury offers securities which banks are not permitted to pay for by crediting the treasury's account, but the over-all influence of this is negligible.

[9]*Federal Reserve Bulletin*, July, 1964, p. 885.

[10]This is the sense in which the term is used (with certain adjustments) in the reports of the Federal Reserve System. See for example *Federal Reserve Bulletin*, October, 1964, p. 1286.

[11]*Federal Reserve Bulletin*, March, 1964, p. 346.

[12]See for example Keynes, pp. 298-303.

[13]"Thus if employment increases, then, in the short period, the reward per unit of labor in terms of wage-goods must, in general, decline and profits increase." Keynes, p. 17.

[14]Discussion of the increasing rate of turnover of demand deposits and of the growing use of time deposits as a partial substitute for demand deposits has been intentionally avoided in the foregoing paper. In general these new developments will accelerate the advent of higher prices.