The Economic Crisis of the 1980s

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Abstract:

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Every great depression in the era of industrial capitalism has come near the end of a period of relative economic stagnation in the world economy. This was true of the great depressions of the 1940s, the 1890s and the 1930s. The periods of relative stagnation followed periods of very strong and sustained economic growth during which the conditions that brought relative stagnation developed, These "long waves" or "trend cycles" are a well-recognized feature of the enterprise industrial economy and their common features have been documented by economists representing a wide variety of political positions, from Marxists Jan van Gelder en and Nikolai Kondratieff to "mainstream" writers such as Joseph Schumpeter and W.W. Rostow.

At the present time the world economy appears to be in the early stages of the relative stagnation phase of the fourth long wave of the industrial era. The expansion phase of this long wave began with recovery from the great depression of the 1930s and developed through World War II into the greatest era of economic growth in the history of the world economy. The twenty-year period of relatively stable expansion, l946-1965, built to a climax during the inflationary years of the Vietnam War. The phase of rapid growth came to an end in the early 1970s, marked by the recession of l973-1974. However, the 197Os have been a transition period, up to now: we can still find some of the forces at work that helped create

the great prosperity of the period of expansion, just as we can see, in retrospect, that the forces leading to the era of stagnation gradually built up during the later part of the expansion phase.

Each of the great depressions came some ten to fifteen years arcer the onset of stagnation. Their chief function, in each case, was to liquidate finally the imbalances and disequilibria introduced into the capitalist economy by the preceding period of relatively rapid growth, imbalances that brought the growth to a halt and led to relative stagnation. Specifically, depressions bring business bankruptcies that eliminate the excessive debt burdens and credit expansion generated by the previous era of long-continued prosperity; they cause massive unemployment that brings wage rates down and offers the prospect of relatively low wages for the immediate future; they are accompanied by large declines in commodity prices, which means that raw materials can be purchased at favorable prices once more; and they bring interest rates down to levels that again are favorable to business investment and expansion. Stagnation in the capitalist-industrial economy is brought on by sustained and rapid economic growth that leads to relatively high levels of debt, wages, commodity prices and interest rates. The great depressions turn those economic relationships around. In doing so, they exacerbate the economic and political conflicts inherent in modern capitalism while simultaneously setting the stage for another era of economic prosperity if the system is able to survive the crisis.

II

The long wave of economic expansion that began in the mid-1930s and ended in the early 1970s went through four distinct phases. The first phase of about five years, 1935 through 1939, was characterized by a slow and erratic recovery from the low point of the great depression of the 1930s. The chief stimulus in this period was expansion of the armaments industries of the world, aided by stimulative government policies and slow recovery of agriculture and other commodities production. This initial recovery was followed by the second phase, 1939 through l945, the period of World War II. Although highly destructive, the war drove the world economy to full employment and rising prices, particularly in areas like the United States that were largely sheltered from the destructive effects of the war. The third phase, comprising the twenty years after World War II from 1946 through the mid-1960s, was the longest and most rapid period of economic expansion over such a large area of the world in human history. This great period of economic growth had characteristics similar to the expansion phases of the previous long waves, although the details were different.

1. A group of leading industries or sectors, all expanding together and reinforcing each other, and promoting further growth in related industries. Three groups of industries were particularly important after World War II: consumer goods industries like housing, automobiles and other durable consumer goods; industries involving new technologies like electronics, computers and jet propulsion; and government service industries such as education and health care.

2. Monetary expansion on a large scale, which facilitated the growth of credit and added to the expansion of purchasing power. For example, consumer credit and mortgage rapidly from 1946 through l965 to provide financial support for expansion of the housing and consumer durable goods industries. Even in the l970s, expansion of credit and increased consumer debt helped sustain high levels of economic activity in the face of the escalating inflation that accompanied the early years of the period of relative stagnation.
3. Large military expenditures, in World War II, Korea, the Cold War, the conflicts of the colonial independence movement, and Vietnam. The type of military spending was also important, for it involved a mayor shift in military technology away from tanks, ships and aircraft to nuclear weapons. missiles end electronic equipment.
4. Large scale expansion in world trade and investment, within the framework of a stable international financial system and aided by organized systems of international lending like the Marshall Plan and aid programs for the less developed countries.

Underlying these trends were a series of favorable basic economic relationships. Supplies of energy were plentiful and prices were low. The same was true of food supplies. In the advanced industrial countries labor was relatively scarce, with population growth exceeding the growth of the labor force for some fifteen years after the close of World War II. As a result wage rates tended to rise, stimulating both purchasing power of workers and substitution of capital for labor in production processes, which raised productivity and profits enough to make the rising wage rates possible without significant inflation. The cost of capital was low. The depression of the 1930s brought interest rates down, monetary

expansion during World War II kept them there, and a combination of monetary expansion and monetary policy held market rates of interest below the real rate of return on capital until well into the 1950s in the United States. All of the economic fundamentals favored growth: low costs of capital, energy and food, and favorable supply and demand relationships in the labor market that stimulated both consumer demand and business investment.

Nevertheless, economic conditions turned from favorable to unfavorable during the course of the expansion period. First, each of the leading sectors experienced initially a burst of investment to build up production capacity, but as capacity to produce expanded the need for further expansion diminished. One leading sector after another reached production capacities capable of meeting the existing level of demand, reducing investment spending largely to replacement of existing capacity, with little for expansion. This process is seen, particularly, in military spending. Investment in new plant and equipment was stimulated in the 1950s and l960s by the shift in military technology already mentioned and by expansion of demand due to the Korean War, the armaments race with the USSR, and the Vietnam War. With the end of the Vietnam war military spending stabilized and the new technology had been largely installed. While demand for the output from existing plants was stabilized, there was little need for expansion of existing plants and new investment fell off. This pattern was typical of the experience of each of the leading industries of the postwar expansion.

Meanwhile, fundamental conditions were changing. Expansion of the world economy brought increased demand for energy and food, while expansion of output tended to be much slower. Prices of those basic supplies began to rise in the 1960s even before the rapid increases of the early l970s, In labor markets, the rising populations of the 1940s and 1950s

began to hit the labor markets in the late 1960s and 1970s. Declining birth rates began to affect the rate of family formation and the growth of demand for housing and durable goods. New entrants into the labor market now find it difficult to obtain jobs in a production system geared to capital-intensive methods and are turning to the labor-intensive service industries, where wage rates, productivity gains, and opportunities for advancement are relatively limited. For the future, the prospect is one of expansion primarily in the labor-intensive sectors of the economy and a relatively poor environment for capital investment. As for interest rates, the inflation of the 1960s and 1970s, together with tight money policies aimed at holding back inflation, have pushed market rates of interest well above the real rate of return on capital. All of these conditions began to appear in the last stage of the expansion period, from about 1965-66 to 1972, and coincided with the inflation triggered by the Vietnam War. By the early 1970's the economic conditions that were favorable for economic expansion a quarter of a century before had reversed themselves: interest rates were high, prices of commodities and food were rising, labor market conditions were unfavorable, and the investment climate was poor.

The shift from relatively rapid economic growth to relative stagnation serves to heighten the inflationary pressures that arise form the conflict between classes and other interest groups characteristic of a private enterprise economy. A relatively high rate of economic growth requires a high rate of investment, which is made possible by a high rate of profit. When the growth rate slows down the rates of investment and profit are also lower. But corporate managers are not satisfied with lower performance levels, and in the big

business sector where firms have some control over prices, efforts are made to raise prices and thereby sustain profit rates.

Something similar happens in the labor sector. Unions that were successful in obtaining substantial gains in real income for their workers in the period of rapid growth try to continue those gains in the following period of relative stagnation. Their wage demands come in conflict with the profit goals of big business, This conflict is always present in a private enterprise economy, but the problem becomes more acute when the economy's rate of economic growth slows down. The bargains that formerly were satisfactory to both parties can no longer be achieved, because the growth of the pie has slowed down. But both parties can still seek to increase their money wages and money profits at the old rates, and these excessive demands, which outrun the capacity of the economy to increase output, pushes up costs and prices.

Government is not immune to these pressures. Tax revenues rise relatively rapidly when economic growth is strong, and government programs expand-witness the rapid growth of spending for highways, education and medical services, not to mention military spending by governments at all levels during the 1950's and 1960's. Slowed economic growth means that fewer resources are available to expand those government activities at the same rate, and the drive to continue their growth results in budget deficits, higher tax rates, or both.

Inflation is spurred by the efforts of all three of these claimants to the growth dividend to maintain their gains even though growth has declined. The total of money claims to the national product exceed the amount available at existing prices, and prices are pushed upward. The process is spurred by the banking system, whose chief function is to

accommodate the needs of business by government budget deficits, and by government policies designed maintain high levels of aggregate demand. Inflation makes it appear as if the gains to which the parties aspire are continuing, even though it is money incomes and not real incomes that are rising. Inflation is a saf~tv valve that defuses for a time, the struggle between workers, management and government over a smaller growth dividend.

III

Two seriously destabilizing changes occurred in the financial sector of the U.S. economy in the later years of the great economic expansion and the early years of the ensuing stagnation. They were, first, a large increase in market rates of interest relative to the real rate of return on capital, and second, growth of debt incurred by both business firms and consumers relative to both assets and incomes. The first creates the prospect of a collapse of private investment unless inflation keeps profit rates up. The second threatens bankruptcies and financial collapse unless monetary expansion and government budget deficits prevent a culuative process of "debt deflation". But both remedies are only temporary solutions that soon worsen the underlying economic imbalances. These propositions are not self-evident, even to many economists, and further explanation is necessary.

First, on the relationship between market rates of interest and the real rate of return on capital. When the rate of interest business firms have to pay for investment funds rises above the rate at which output is increased by expansion of production facilities (the real rate of return on capital), the maintenance of economic growth and the level of investment spending becomes difficult and problematic. Why pay 10 percent for investment funds when the expected return is only 5 percent? And why invest retained earnings for an expected yield

of 5 percent when those funds can earn l0 percent in the money markets? Yet just such a gap between real returns and market rates of interest developed during the 1970's.

Beginning in 1967, market rates of interest on new investment funds (measured by the yield on high grade corporate bonds) began a steady up ward move, while the real rate of return on capital (measured by the potential growth rate of gross national product, corrected for changes in prive level) began a systematic decline. The rate at which corporations could borrow rose from about 5 percent in 1966 to about 15 percent early in 1980, just a dozen years later. The real rate of return on capital fell from about 5 percent to about 2 percent over the same period. Chart I shows the gap that developed.

Under these conditions, why did not private investment collapse in the 1970's. The answer: inflation. If real yields are 2 per cent, an inflation rate of 13 per cent will enable firms to earn monetary profits of 15 percent. This necessary rate of inflation is over and above any price increases required to compensate firms for increased Costs of production due to higher costs of energy, or increased taxes, or wage increases greater than productivity gains, or any other increases in costs of production. The necessary rate of inflation raises the money value of real earnings to equal market rates of interest. And unless prices increase at that rate, private investment wilt fall, taking output and employment with it. Seen in this perspective, the high rates of inflation of the 1970's, whatever their causes and the reaction of money markets to them, have been necessary to maintenance of relatively high levels of economic activity and avoidance of an economic collapse.

This fundamental imbalance in basic economic relationships has had a devastating effect on public policy. The Keynesian policies of demand management that functioned well in the pre-1967 era to maintain high levels of employment and output without a significant rate of inflation no longer can perform their task. Now the level If output and employment can be maintained at high levels, but only by citing inflationary price increases. Conversely, inflation can be halted only at the expense of reduced levels of output and employment. Neither of the alternatives is politically acceptable.

IV

The second significant ctestabilzing element in todays economy is escalation of debt, in any period of sustained economic expansion like that of l945-1970/72, managers of business firms tend to lose their fear of indebtedness. The stream of income flowing into

business firms is sustained and strong, and short recessions have little impact on it. With a secure and growing income flow, debt is renewed and increased, as firms seek to take advantage of what seem to be secure and growing opportunities for profit. Corporations sell bonds rather than stock to finance their growth; noncorporate business firms borrow to expand. The result is an increase in debt relative to equity and debt relative to income. All would be well if relatively rapid growth continued, but it does not. In the period of relative stagnation that follows rapid growth the high level of debt becomes burdensome. A serious recession that significantly reduces the flow of income to business firms could bring the threat of widespread bankruptcy. when that happens firms seek liquidity above everything else: output is reduced, inventories are dumped, and the economy is in serious trouble.

This process of debt deflation, as Irving Fisher called it in his 1933 analysis of that era's great depression, occurred repeatedly in the past, and the conditions necessary for another such episode are present in today's economy. Over the last decade, each $1 increase in value added in the private business sector has been accompanied by an increase of about $1.40 in business indebtedness. The debt/equity ratio for all American corporations reached an historic high in 1977, and by 1979 was only slightly below its peak.

Something similar has occurred with consumer debt, but for somewhat differed reasons. Installment credit and mortgage debt were a major support for' the growth of the consumer durables and housing industries throughout t the 1950s and 1960s. but were not overexpanded to dangerous levels until recently. As inflation excalated in the seventies the real purchasing power of consumer incomes declined, and families turned increasingly to borrowing to maintain their standard of living. Surging of consumer debt helped sustain the

recovery from the 1974-75 recession through 1979, but it left consumers with responsability for payments of interest and principal on their indebtedness equal to 23 percent of total consumer incomes, far above the "normal" ratio of about 15 percent. Under those conditions the recession that began in 1980, with its reduced consumer incomes, brought greatly reduced purchases of durable goods as consumers sought to eliminate their excessive debts.

The financial underpinnings of the American economy are in serious trouble. Both the private business sector and consumers have excessive levels of debt that increase the volatility of the economy. What would have been a relatively mild recession in the 1950's or early 1960's becomes a major recession in the 1980's as a reduced flow of income forces financially weak business firms and financially overburden consumers to reduce their commitments. As the experience of 1974-75 indicates, economic downturns cumulate into significant setbacks. Unless counterbalanced by vigorous government action, the cumulative debt deflation process could lead to a major depression like that of the 1930's.

Modern industrial nations have developed defenses against such occurrences, however. One line of defense is the Federal Reserve System. The Fed has intervened in the money markets as a lender of last resort four times in the last fifteen years to prevent a financial collapse. In 1966 it rescued the banking system from overuse of certificates of deposit; in 1969-70 it prevented a disorderly collapse of the commercial paper market; in 1974-75 it guaranteed deposits in offshore branches of U.S. banks in the bankruptcy of the Franklin National Bank; and in 1980 it intervened to prevent a break in the price of silver from spreading generally into financial markets as a whole. In each case a weakening financial structure was sustained by a large scale injection of Federal Reserve credit into the

money markets as a "credit crunch" was prevented from becoming a cumulative debt deflation.

The cost was renewed inflation, however. The central bank cannot simultaneously ease the money markets to prevent a debt deflation and tighten money markets to hold back inflation. The monetary ease necessary to avoid financial stringency in the four episodes noted above served both to validate the financial practices that led to the crises in the first place, and promoted easy credit that brought accelerating inflation in the ensuing years. The monetary policies that avert disaster in the short run brough more inflation and a still weaker financial structure.

A second line of defense is large government budget deficits. In part, budget deficits are automatically created by a recession. Tax receipts fall while expenditures remain high. These automatic deficits are increased because of enlarged welfare payments and unemployment benefits. Even more important are the deficits brought about by tax reductions and increased expenditures as political leaders seek to reduce unemployment in time for the next election. Whatever the source, however, deficits serve to increase aggregate demand in the economy, increase the flow of incomes into the hands of consumers and business firms, and enable them to meet their commitments for payment of interest and principal on their debts. The net effect is to prevent the cumulative debt deflation that was such a prominent feature of the 1930's and earlier serious depressions.

Increased flows of income due to budget deficits are quickly transformed into business profits, and this also serves to halt the debt deflation process. The relationship is simple. A deficit in one sector of the economy is transformed via the flow of spending into

a surplus somewhere else. Since the consumer sector does little saving almost 811 income is spent, and this is particularly true in a recession the incomes generated by a government deficit flow through the consumer sector into business enterprise, where they generate higher profits. The result is stimulus to business activity and an increase in investment spending.

These conditions create a highly unstable economic environment for the present era of relative stagnation. The financial weakness of the business and consumer sectors of the economy continually threaten a major economic collapse at any time the economy should move into a recession. A breakdown is avoided only by monetary expansion and government deficits. But those measures lead to inflationary increases in prices once the short-term period of recession is over. So we find that ever since the late 1960's recessions have become sharp and deep, but they offer only a temporary respite from inflation. At the same time, the poor growth performance of the economy leads to high levels of unemployment in comparison to those of the period before 1965. This combination of economic forces has led to rising levels of both prices and unemployment from one business cycle peak to another.

V

Simultaneously with the appearance of economic stagnation, the threat of large destines in business investment, and the possibility of a major debt deflation, changes have occurred in the international financial system that raise once again the spectre of financial collapse. Starting in the late 1960's the Eurocredit banking system began to emerge and a powerful force in the world economy as a means by which large banks can evade the credit restraints imposed by central banks and continue to expand credit without serious restrictions by the monetary authorities.

The Eurobank system is a group of large banks that hold and transfer deposits and make loans in currencies other than the currency of the country in which they are located. For example, a bank in Zurich will do a domestic business within Switzerland with the accounts denominated in Swiss francs. It will also carry on an "external" banking business id which the accounts are denominated in U.S. dollars, or German marks, or other foreign currencies. Or a U.S. bank will own a foreign subsidiary that carries on a banking business in currencies other than the currency of the country in which it is located: for example, a subsidiary in the Cayman Islands that Implies loans and holds deposits in a wide varety of currencies, including U.S dollars. This arrangement enables the Swiss bank or the Cayman Islands subsidiary to lend Italian lira to a French firm for purchase of Italian wine that will be sold in the U.S. market for dollars. Or, more likely, a loan to Brazil, perhaps, in U.S. dollars to buy Saudi Arabian oil.

The advantage derived from making such loans from the "external" subsidiary or department is that the lender avoids credit restrictions imposed by the central banks. Those restrictions take the form of reserve requirements established by the Federal Reserve System, in the United States, and limits on expansion of credit keyed to a bank's assets, in most European countries and Japan. Loans denominated ID foreign currencies subject to those regulations and can be expanded as much as good banking practice and the demand for credit permits. Limitations on loans profits made by banks, and the Eurocredit system enables banks those limits. The world's bankers have devised a way to avoid the constraints on profits inherent in central bank management of the domestic money supply. It's as simple as that.

The expansion has been dramatic. The total amount of Eurocredit deposits rose from about $50 billion in 1968 to about $1000 billion by the end of 1979. About three-fourths of the total is denominated in U.S. dollars. And the total continues to rise, without constraint by any of the world's monetary authorities. About forty percent of the total represents deposits of one bank in another, which probably are not the result of credit expansion, but even if these interbank deposits are excluded the net expansion remains tremendous.

The magnitude of the expansion of Eurocredts can be put in perspective by comparing it with the world's money supply (outside the socialist countries) of domestic currency plus demand deposits. The total money supply of the United States is about $370 billion; that of wester Europe is about the same; adding Japan and the third world nations brings the total to about $900 billion. The gross amount of Eurocredit is about ten percent greater than that total, while the net amount of Eurocredit deposits (deducting interbank deposits) is about two-thirds. In other words, Eurocredit deposits now represent about 40 to 55 percent of the nonsocialist world's money supply, up from about 5 percent only a dozen years ago. If a monetarist were looking for a simple cause for much of the inflation of recent years he could find it, not in domestic monetary expansion, but in the explosion of Eurocredit lending.

Compounding the problem is that much of the Eurocredit expansion has been for unproductive loans; that is loans that do not result in expansion of output. About half of the growth in Eurocredit loans since 1973 has been for the purpose of financing purchases of petroleum, in large part by the less developed countries, in the face of rapidly rising oil prices. These loans expand purchasing power, but they do not increase output of goods

available for sale. In this respect, they represent a purely inflationary increase in the world's money supply. Yet they are absolutely essential to prevent collapse of the economies of the borrowing nations.

The Eurocredit money supply has a serious impaction the effectiveness of traditional montary policy. This is particularly true in the United States, because of the large supply of Eurocredit deposits denominated in dollars. Efforts by the Federal Reserve System to restrict credit and raise interest rates tend to draw funds from Eurocredit accounts into U.S. banks, and large corporations have the option of negotiating Eurodollar loans when domestic lines of credit are not available. Similar difficulties are encountered if the Fed wishes to stimulate economic activity during a recession: creation of new reserves by the Fed in an effort to ease money market conditions brings a shift of funds into the Eurocredit system, lessening or negating the impact on domestic money markets, Management of the domestic monetary system to promote greater economic stability is no longer a reliable policy instrument.

These difficulties in domestic money markets are complicated by central bank reactions in foreign countries. For example, rising interest rates in the United States, brought about by tight money policies of the Fed, attract funds to the United States. The added demand for dollars tends to push up the value of the dollar relative to other currencies. In more normal times a rising dollar would delight the business interests of other countries, but because the price of oil is denominated in dollars a rising dollar increases the cost of imported oil for nations in western Europe, which import the great bulk of their oil supplies. Counter action can be taken through monetary policies in those countries designed to maintain interest rates higher than those in the United States, attract funds from the

international money markets, and prevent the value of the dollar from rising relative to their currencies. Indeed, France and West Germany have been engaged in just such an interest rate war with the United States for the past two years. The result is that interest rates have been driven upward in both Western Europe and North America while credit has been readily available because of both international flows of credit and the creation of credit by the Eurocredit banking system.

At the present time we leave not had enough experience with the new internationa1 banking system fully to understand how much the effectiveness of monetary policy has been reduced, or .the time-lags involved. But the impact of the Eurocredit system on domestic monetary policy seems to be substantial and growing in significance. Indications are that it is strongly inflationary, it inhibits the effectiveness of national monetary policy, and contributes to generally rising interest rates in the present conjuncture of nationalistic reactions to the high price of imported oil. In this new environment we can no longer rely on counter cyclical monetary policy as an effective policy instrument.

The Eurocredit system is a banking system without required reserves or a lender of last resort. It can expand loans indefinitely, limited only by the demand for credit and the caution of the lending institutions Continual expansion of credit by a free banking system, at rates well above the real increase in output, has always led to financial collapse. There is no reason be believe that the Eurocredit system has repealed that law.

The collapse of the Eurocredit system seems already to have begun. The first phase was a flight from the dollar into other currencies, particularly the West German mark in the fall of 1978. This phase ended when the U.S. government, cooperating with major

foreign central banks, took steps in November to stabilize the value of the dollar. A year's respite followed, only to be followed in the fall of l979 and winter of 1980 by a renewed flight from the dollar into both foreign currencies and gold, with the price of gold going briefly to over $900 per ounce. This phase was ended by drastic action by the Fed in early October, 1979 to raise interest rates in the U.S. and draw funds into this country. This action was temporarily successful, although it took several months to take effect and almost brought a financial collapse in late March and early April of 1980. Ace third phase is yet to come. When holders of gold and foreign currencies realize chat all they can get for them is dollars and that the dollar is a fundamentally unsound currency whose value is continually eroded by inflation, there will be no way to prevent a collapse of the Eurocredit monetary system. A general and widespread flight from the dollar will bring it down. This last phase is still in the future, of course, and it may not develop until after we have experienced several more of the recent second phase mini-crises to lull us into believing that the third and final collapse will never occur.

VI

We can now begin to understand the dimensions of the coming crisis. Continuing inflation necessary to maintain politically acceptable levels of output and employment is called for by high rates of interest in the money markets. Misguided efforts to tighten money markets to control inflation only brings still higher rates of interest and requires an escalated rate of inflation. Inflationary pressures are increased still further by a largely uncontrolled expansion of credit in the Eurocredit banking system.

A growing debt burden on firms and consumers periodically leads to the threat of massive debt deflation, which is countered by easy money and government deficit spending, leading to further inflationary pressures.

The inflation, meanwhile, generates periodic recessions. Price increases have a nasty habit of outrunning increases in wages and salaries, bringing on declining real incomes. Increased borrowing by consumers can only delay the onset of the recession. When it comes, planned or unplanned government budget deficits and monetary ease start a recovery and a further episode of inflation that carries prices, interest rates and debt burdens to higher levels than they reached at the previous business cycle peak. We are back at Square One, but the fundamental economic imbalances are worse than before.

This scenario cannot keep repeating itself indefinitely. The dollar is the key international currency and continued inflation in the United States will ultimately undermine the entire Eurocredit banking system. At some point those who hold the billions of Eurocredit deposits will lose confidence in a continuously depreciating dollar, a run will develop on the Eurocredit banking system, and the entire structure will come down amid financial failures, bank closures and business bankruptcies. The ensuing depression will be a long one, lasting until market interest rates are brought down to equality with the real rate of return on capital, excessive debt burdens are liquidated, and prices of commodities and labor have fallen to levels low enough to encourage substantial recovery of production and investment. Those adjustments might require ten or more years of depression, and will only be delayed by efforts to solve the problem through monetary ease and budget deficits.

There are alternatives. One temporizing solution-- the policy now being followed--is to postpone the problem to after the next election through use of traditional Keynesian fiscal and monetary policies, these policies suceed in postponing the day of reckoning, but only make the problem worse in the longer run.

A second alternative is proposed by conservatives and, in the present political conjuncture, is highly likely: make the workers and the poor pay. Abandon Keynesian demand management policies tighten the money markets and bring on a depression that will (maybe) squeeze the inflationary pressures out of the economy. This strategy is based on the highly questionable theory that inflation is caused by expectations of continued inflation, and that reduced inflation will change those expectations and bring stable economic conditions once more. The theory itself is probably wrong, since it largely ignores the very real imbalances that now exist in the economy.

Furthermore, the depth and length of tile depression necessary to eliminate the maladjustments in the economy are probably politically intolerable. Economic and social costs would force either abandonment of the strategy or imposition of political authoritarianism.

A third alternative is available: a strategy that would preserve high levels of output and employment while inflation is brought under control. It would involve price. wage and profit controls to stop inflation, an incomes policy to insure that economic burdens are shared evenly, a new program of credit controls to bring interest rates down to more normal levels and insulate the U.S. economy from the inflationary impact of Eurocredit monetary expansion, and government fiscal policy to maintain high levels of economic activity. In

other words, we can adopt a program of macroeconomic planning that includes the price system and the money markets as well as the level of aggregate demand. Ultimately however, the water will have to be squeezed out of the dollar. If the economic costs of inflation are not to be paid for by unemployment and loss of out-put, they will have to be paid by the rich, through a levy on wealth and a tax on capital. And that, of course, is the reason why it won't be done.