[redacted]
Chattanooga, TN 37379
June 23, 1993

Mr. Bryan Lamb
C-Span
400 N. Capitol Street
Washington, D. C. 20001

00-004-093

Dear Bryan:

Your position at C-Span prompted including your name on the list of those receiving the enclosed analysis of the deficit problem. This information is being made available to selected individuals in the public arena, since it will be some time before the economic treatise under preparation will be published; whereas the economic plot on the deficit front is thickening rapidly. These enclosures may be of help to you in framing questions for your guests.

The analysis reveals that the solution to the deficit problem is opposite to what is being proposed by the President, or Congress on both sides of the aisle. In fact, all of the proposals being considered by them might well induce another dip in the economy and actually increase the deficit. A serious deficiency exists in official economic knowledge, as evidenced by numerous inconsistencies between theory and actual performance of the economy. The enclosures cite two of them.

As to the deficit, the most startling fact about it waiting to be realized is that it is not nearly big enough! Clear proof of this is the very sluggish performance of the economy in spite of the size of the current deficit. Accordingly, taxes should be reduced - not increased - regardless of whether the deficit is increased. Present excessive taxes from individuals are destroying huge amounts of consumer purchasing power that otherwise would stimulate increased production. Also, curbing or eliminating government programs desired by the people merely adds to unemployment with no offsetting benefit. Thus both "remedies" would be counterproductive.

The real fiscal problem is not the deficit, per se, rather it is the way that the deficit is being financed pursuant to incorrect monetary theory embraced for generations by the economics profession and the financial community. Their deep attachment to this false doctrine is preventing them from seeing the correct solution, which simply is for Congress to fulfill its constitutional obligation to "coin money" as required to serve the needs of the economy, and stop removing savings and capital from the private sector - capital that otherwise would be invested in more production and jobs. This removal now occurs through the unnecessary sale of Treasury securities to the public. The proper fiscal procedure, as well as its limitation to avoid contributing to price inflation, is the heart of the message in the enclosed essays.

I do hope the logic of this analysis will strike a responsive chord with you, and that it will stimulate your own independent inquiry into the subject. Nothing should be accepted, however venerable, that cannot be rigorously proven. If you would do this, I am confident you would come to the same conclusion as outlined in the enclosed essays. It seems inconceivable that the financial community and the educational establishment could be so wrong, but that is the way things are, and this reality will have to be faced sooner or later.

To be understood, the enclosed analysis requires no more than a high school level of scholastic aptitude, although the required "debrainwashing" of deeply entrenched false concepts about the source of federal "tax money", that have been pounded into all of us since childhood, probably will not occur from a single reading. Others have found that several readings of key passages are necessary, not because they are ponderous, but because they are so contrary to principles traditionally thought to be inviolable. This is why they are so difficult to shake off.

Please let me know if I can be of further service in this matter.

Sincerely,

[redacted]

May 27, 1993

To: Selected Public Officials and Journalists

From: [redacted] A compendium of essays under preparation for publication soon, explaining how Economics is governed by simple natural laws that provide complete solutions to current economic problems. ("Natural laws" are the inexorable phenomena with which man is confronted by nature.)

This is to call attention to an economic analysis that, among other things, develops the solution to the deficit problem. It does not involve either of the "remedies" being considered by the administration or Congress. Neither of them would be satisfactory since both of them would increase unemployment significantly with no offsetting benefit. The debates in Congress and in the White House over what to do about the deficit, are not unlike the debates that must have taken place among ancient geographers over their different concepts of a flat earth.

The increased remittances to IRS being proposed would extinguish some of the consumer purchasing power presently supporting an already unsatisfactory level of employment. Arbitrarily reducing government outlays, the other "remedy" being proposed, would deny the people the benefit of worthwhile programs that the economy is perfectly capable of providing, while rejecting to the ranks of the unemployed those presently employed in executing them. Of particular concern in this regard is the proposed dilution of the nation's defense capabilities in a still very hostile world. Moreover, a possible reduced tax base attributable to the above measures might well increase, rather than decrease, the deficit.

A logical conclusion from the foregoing would be that the economics profession itself must be suffering from a serious deficiency in economic knowledge. As fantastic as it might seem, this turns out to be the case. For example, traditional theory taught for generations in colleges and universities, is that large deficits are bad because they result in the expenditure of "excess purchasing power", causing price inflation attributable to "straining" of the productive capabilities of the economy.

However, the above theory is in conflict with the fact that, even with numerous record deficits during the past decade, the economy has consistently operated substantially below its productive capabilities. Present massive unemployment and large unutilized productive capabilities certainly are not a reflection of the "excess purchasing power" that this theory associates with large deficits. Moreover, there was much more price inflation in 1979 (11.3 percent as measured by the Consumer Price Index) when the deficit was only 40 billion dollars, than the 1.9 percent price inflation experienced in 1986 when the deficit soared to over 220 billion dollars. A theory not consistent with reality, even once, is false.

The correct deficit solution is outlined in the attached essay. As might be expected, given the long fruitless search of scholars, the answer lies in an area not yet considered by any of them; namely, monetary theory. But for this solution to be accepted, deeply entrenched doctrine which has been the cornerstone of conventional monetary wisdom for several centuries, and which is still being followed by central banks everywhere, would have to be discarded.

The doctrine is called the "quantity theory of money"; it holds that prices rise sensitively with increase in the quantity of money in existence in the economy, identified by total currency in circulation, plus total bank deposits. However, this theory is no longer applicable because monetary units today, such as the dollar, are no longer tangible entities whose values vary sensitively with their quantity, as they did when they were stipulated measures of the commodity gold. Monetary units are now only abstract units of measure of the exchangeable value of goods and services, analogous to a second of time, a yard of distance or a pound of force. However, the values of monetary units change constantly, as explained below; they do not change with "supply" as commodities do.

The current domestic value of a monetary unit is determined by the current charge for their services, in terms of the unit, made by everyone in the economy having anything to do with the production and distribution of goods and services. (The government's charge for their services is called "taxes") On the other hand, the current value of a monetary unit abroad is determined by its domestic value referred to above, plus or minus a varying increment related to the current flow of international commerce to and from the nation, as well as the current net capital flow to or from the nation. This value is reflected in the current rate of exchange.

It can be shown that, in the final analysis, the charges for services comprising a nation's price structure, consist of total employment costs, business taxes and profits, and nothing else, because all other apparent components of the price of anything can be broken down into someone else's employment costs, business taxes or profits. (Individual income taxes are buried in the employment costs and profit components of the price level out of which they are paid.) Note that none of these price components is related to the size of the "money supply".

Discreditation of the "quantity theory" would not be the first time a venerable theory turned out to be false. Other examples are the ancient concepts of a flat earth and an earth-centered universe - theories that were stubbornly clung to by the intellectual community long after they were first challenged with cogent analyses showing them to be false.

The rejection of Galileo's discovery early in the 17th century that the earth is not the center of the universe, is well known. But not well known is the fact that the Greek astronomer Eratosthenes determined about 250 B.C., through application of present 10th grade mathematics in conjunction with his observation of the difference in length of shadows cast by the same height vertical rod in two cities 500 miles apart, on close to the same meridian, at high noon on the same day, that the earth is a sphere with circumference of about 25,000 miles. This discovery was rejected for about 1,700 years because intellectuals could see for themselves by looking at a large body of water, for example, that the earth is flat.

The important "discovery" presented here is that the "quantity theory of money" is a fallacy. Because practically all present economic theory is based on the presumed validity of this false concept, most present economics textbooks will have to be rewritten. <u>Correct doctrine would recognize that the money supply can grow at any rate whatever without putting upward pressure on prices, so long as aggregate expenditures are within the productive capabilities of the economy</u>. Proper application of this important principle would not only solve the deficit problem, it would also contribute positively to civilized progress as much, or more, than any other discovery in history. The potential here staggers the imagination.

But like all powerful mechanisms, the government's "money machine" (in the U.S., the Federal Reserve) must be used properly. Just as present inadequate money growth is slowly but surely strangulating the economy, so could expenditures arising out of excessive money growth destroy the economy with a "hyper" spiral of "demand-pull"-propelled price inflation. Hopefully, politicians will rise to the occasion and not use their legislative power to direct the Federal Reserve to destroy the economy as was done in Germany in 1923; but use it properly to permit solving the seemingly insolvable social problems that have been plaguing the nation for decades. These problems will never be solved until their principal cause -incorrect monetary theory - is replaced with the above self-evident principle.

THE CONSTITUTION PROVIDES FOR PROPER FINANCING OF THE DEFICIT

By [redacted]

The solution to the deficit problem remains elusive because it involves a fiscal procedure that, although simple and logical, is contrary to traditional monetary doctrine propounded by economists and the financial community.

Conventional wisdom has always assumed, and the public has always accepted - but without supporting analysis - that the government must borrow money to finance the deficit. The result is a balooning "public debt". But the startling fact is that it is never necessary for the government to borrow money. If Congress so directed, the Federal Reserve could credit the Treasury account with additional funds in the amount of the deficit without adding to the "public debt". This procedure would not add to price inflation because aggregate expenditures in the economy would be exactly the same. The only difference would be that the deficit would be financed with newly "coined" money by direction of Congress, instead of money borrowed from the public.

The Constitution gives Congress the authority to "coin money". Having the Federal Reserve credit the Treasury account through official "strokes of the pen" as noted above, is the way that this authority should be implemented today. By financing the deficit in this manner, the present drain of savings from the private sector through government bond purchases would be avoided. Also, the procedure would avoid further increase in the "public debt", while the substantial increase in amounts on deposit in banks seeking borrowers would cause short and long-term interest rates to tumble, thus further stimulating productive activity.

The only remaining question would be this: how large can the deficit be without causing inflationary "excess demand"? The answer: the deficit can be any size whatever (i.e., remittances to IRS can be reduced any amount), so long as total expenditures in the economy are within its productive capabilities. Traditional monetary theory would brand this procedure "inflationary". But the theory is incorrect. It overlooks the vast unutilized productive capabilities of the economy. Instead of rising prices for present output as economists would expect, these dormant productive capabilities would be activated by expenditure by the people of their increased take-home income. Unemployment would drop dramatically.

The large amount of chronic unemployment, poverty and homelessness today, together with many businesses in a state of, or on the verge of bankruptcy, is unmistakable evidence that too much of the people's earned income and business income are being destroyed through excessive remittances to IRS. The result is that the economy is being starved of active purchasing power needed to avoid these tragic symptoms of economic decay. The present "recovery" is much slower than for any previous slump.

The solution: (1) instead of raising them, as the President and Congress are being persuaded to do, remittances to IRS should be reduced across-the-board substantially for both individuals and businesses, and (2) the "deficit" should be financed as outlined above.

Proof that the present deficit could be larger than it is and still not induce "demand-pull" price inflation, is that, even with recent record deficits, the economy has functioned well below its potential, due to insufficient active purchasing power in the hands of consumers. The need for reduced remittances is clear.

Increased expenditures that would be triggered by significantly reduced remittances to IRS would replace the economy's present under-achievement with spectacular prosperity, propelled by increased profitable production and job growth, made possible through expenditure by the people of their increased take-home income. However, monopolistically imposed employment cost increases would have to be outlawed, to avoid imposing "cost-push" price inflation on the economy.

FALSE MONETARY THEORY WORLD'S HIDDEN ECONOMIC PROBLEM

By [redacted]

Before getting to the substance of this message, some monetary history will serve to set the stage. The original Constitution delegated to Congress authority to "coin money" as required to serve the needs of the economy. A group of activists in the U.S. takes the view that this provision of the Constitution requires that U.S. money be either gold or silver coin, and nothing else. However, the Supreme Court rejected this argument over a century ago, stating that "whatever power there is over the monetary system in the U.S., the Constitution vested it in Congress".

In 1792, Congress decided that the monetary unit in the U.S. would be called the dollar, and that its exchangeable value would be determined by the exchangeable value of specified weights of gold and silver, respectively. However, problems arose with this "bimetalism" arrangement, and it was later abandoned in favor of only gold, priced by Congress at about $20 per ounce. This system was later called the "gold standard".

An important feature of the international "gold standard" was its attempt to impose on international money markets fixed rates of exchange between different currencies. This proved to be an unsound system. It was responsible in no small measure for collapse during the early 1930's of banks in Europe and the U. S., as nations attempted to comply with its "discipline". Congress abandoned it in 1933 by prohibiting further use of gold coin for circulating money within the country. But Congress authorized the Treasury, with the approval of the President, to continue the purchase and sale of gold bullion, provided that such activity was considered by the President to be in the interest of the U.S.

The Treasury then offered to purchase gold from domestic producers and from foreigners for $35 per ounce. It also offered to sell gold to foreigners, but only for U.S. dollars at the same price, until President Nixon determined that the policy was not in the interest of the U.S. and ordered it terminated on August 15,1971.

Upon abandonment of gold coin in 1933, the value of the U.S. dollar no longer was influenced by the value of gold. Since then, the dollar's de-facto value has been determined only by what is produced in the U.S. and sold for a dollar. This, in turn, has been determined mostly by the productivity of U.S. workers and their employment costs. As worker productivity goes up, the value of the dollar increases unless this is offset by larger employment cost increases, in which case the value of the dollar goes down by the difference. Higher business taxes and profit rates on sales also have the effect of lowering the value of the dollar by causing higher prices for the same products. These components of price are discussed later herein.

The Federal Reserve was inaugurated about 20 years earlier pursuant to the Act of 1913. Under this Act, Congress set up procedures for the Federal Reserve to "coin money" by crediting the Treasury account and the commercial banking system with additional funds "with a view to accommodating commerce and business". But in August 1935, Congress changed the Act to stipulate that the Federal Reserve could no longer "coin money" by purchasing Treasury securities directly from the Treasury. Instead, the amendment stipulated, in effect, that when the Federal Reserve wants to "coin money", it must do so only by purchasing Treasury securities in the "open market"; i.e., through authorized dealers in Treasury securities who initially purchased them from the Treasury, usually with credit dollars created by the Federal Reserve at its discount window and loaned to them. These authorized dealers were certain large banks and prestigous investment banking firms selected by the Federal Reserve. They were thus given a piece of the action with attendent fees and commissions, plus possible price appreciation as the securities were later sold to the Federal Reserve or to the public.

The statute was again changed in March 1942, early in World War II, to restore authority of the Federal Reserve to "coin money" by purchasing Treasury securities directly from the Treasury, but the amount of such securities held by the Federal Reserve at any one time was limited to 5 billion dollars. Thus, any "coining" of money by the Federal Reserve through bond purchases from the Treasury could be done only up to 5 billion dollars. After that, it had to be done through the "open market".

The above arrangement was continued by a series of amendments extending it for one or two years at a time until April 1979, when the authority of the Federal Reserve to purchase Treasury securities directly from the Treasury was terminated in its entirety for reasons that were never announced. It is doubtdul that many legislators understood what they were voting on, and the public certainly was not aware of what was taking place. In any event, the Federal Reserve is now authorized to "coin money" only by purchasing Treasury securities in the "open market" which consists of about 30 banks and investment banking firms. Most past purchases of Treasury securities by the Federal Reserve were made in this manner. As of May 1993, the cumulative net total of these purchases since the Federal Reserve was inaugurated in 1914 was about 305 billion dollars. Although not officially acknowledged, bonds purchased by the Federal Reserve have been de-facto retired; the real "public debt" is actually less, by the amount of these purchases, than the "debt" officially stated.

Because of the prohibition against Federal Reserve purchases directly from the Treasury, the Federal Reserve must use the "open market" when it wishes to increase bank reserves. When Federal Reserve officials are excessively stingy with these transactions, thus denying the economy monetary fuel needed to keep it growing, a recession soon sets in. The Federal Reserve was particularly stingy starting in late 1990, and this exacerbated the recession already underway as a consequence of no net growth in total bank reserves during the previous two years.

The prohibition against Federal Reserve purchases of securities directly from the Treasury also requires, in effect, that the deficit be financed by having only the public purchase Treasury bonds, using some of their savings and idle capital. Savings and capital are thus transferred from the private sector to the Treasury in the amount of the deficit, as the Federal Reserve credits the Treasury account, and as the public's savings are reduced. Unfortunately, this reduction of the public's savings curbs economic expansion; it results in substantially less capital being left in the private sector for investment in more production, equipment and jobs.

Pursuant to official monetary theory pounded into everyone since childhood, the public has been led to believe that the harmful diversion of savings and capital from the private sector to finance the deficit can be avoided only by achieving a "balanced budget", either by raising taxes or reducing government expenditures, or some combination of both. Most of the debates in Congress about the economy concern how this "balance" should be achieved. But, as will be demonstrated shortly, these debates one day will be recognized as comparable to the debates among ancient geographers over different concepts of a flat earth.

It should be apparent from the present sluggish performance of the economy, attributable to inadequate take-home income, that the financial needs of the government for programs desired by the people are much more than individuals and businesses can afford to have expropriated out of their earned income, and still remain solvent. Since these programs, such as Social Security, universal health care coverage, defence needs, space exploration, improved public education, rebuilding the nation's decaying physical infrastructure, etc., are well within the productive capabilities of the economy, it follows that the money-creating authority of the government should be used to finance the deficit as authorized in the Constitution.

A "balanced budget", which would require taking even more earned income from the people, is simply a harmful goal that is based on false monetary theory. Any increase in the present financial burden on individuals and businesses, such as higher taxes and/or reduced government outlays for programs that employ large numbers of people, will have a counterproductive effect on the already anemic "recovery" presently underway.

Instead of raising taxes, Congress should reduce them substantially across-the-board. At the same time, the Federal Reserve should be directed by Congress to purchase all future Treasury securities which should be non-interest bearing and non-marketable so as to avoid draining savings and capital from the private sector as is now done through the sale of Treasury securities to the public.

Aggregate expenditures would be the same as with the present method for financing the deficit, except for the desirable increased investment made possible by a greater abundance of low cost capital. The only difference would be that no real debt would be created. Hence, the procedure would not put upward pressure on prices as economists and financiers would expect pursuant to the monetary theory they espouse.

Although the above may seem to be a revolutionary concept, it will become more obviously correct as the economy slumps following vain attempts to reduce the ever-larger deficits that will be experienced because of a shrinking tax base that always accompanies such slumps. Higher levies on individuals would reduce their purchasing power and react adversely on businesses. Higher levies on businesses would simply tax many marginal enterprises out of business and slow down other businesses, inducing more unemployment as aggregate demand falls off. There should be a "balance" between aggregate expenditures and the productive capabilities of the economy; not between remittances to IRS and the portion of aggregate expenditures attributable to the federal budget. The wrong "balance" is being sought.

An important beneficial effect of the method proposed herein for financing the deficit would be that short and long-term interest rates would tumble to very low levels and stay there because of a permanent abundance of bank lending authority. There never again would be a "credit crunch". Also, the "public debt" would be retired as fast as it matures, since the maturing debt would be part of the current deficit financed by the Federal Reserve. The Federal Reserve would no longer be able to induce a recession. As to former holders of government securities, their savings and capital would be available for investment in productive activity in the private sector, either directly, or indirectly by depositing it in financial institutions.

Also, the Federal Open Market Committee whose directives have an important bearing on the level of interest rates, could be disbanded because there would be nothing for it to direct. In addition, the open market desk in New York could cease operations, while the federal funds market would no longer be very active since the great abundance of excess bank reserves throughout the country would make this market unnecessary.

Federal Reserve officials could then confine their activity to administering the nation's banking system, which is their proper function. "Monetary policy" would no longer be subject to the "expert feel" of anyone, but would be constantly accommodative of the monetary needs of commerce and business as provided for in the Constitution and as specified by Congress as the governing principle for monetary authorities to follow in administering the Federal Reserve Act.

The financial community, misguided by a serious deficiency in Economics as taught in colleges and universities everywhere, has been executing for generations a thorough "brainwashing" of the people and their elected officials about money, causing them to blindly accept the incorrect theory that prices move up sensitively with money growth fueled by falling interest rates. Exposure of this self-serving, harmful fallacy is a prerequisite to adopting correct monetary procedures.

As every home builder and home purchaser knows, falling interest rates combat price inflation by reducing the interest component of the cost of production and purchases financed with borrowed money. Instead of causing price inflation, more money growth within proper limits would activate the nation's dormant productive capabilities which are reflected in massive unemployment and substantial idle plant capacity.

The U. S. economy has the ability to increase its output much more than the meager 3 or 4 percent annually that economists and monetary authorities preach is all that is "sustainable". In fact, the nation's serious social problems stem to a great extent from monetary policies that have the effect of limiting real output to these inadequate levels. During World War II, the economy increased its real output about 15 percent annually because sufficient money growth was permitted by the Federal Reserve to finance this growth. A by-product of this accommodative stance, which was contrary to established monetary doctrine, was the prompt end of the Great Depression.

Money growth without price inflation can occur at any rate as long as aggregate expenditures are within the productive capabilities of the economy. Official theory to the contrary is false. While it is true that excessive money growth causes "demand-pull" price inflation, it is not correct to say, as most economists do, that all price inflation is the result of excessive money growth. "Cost-push" price inflation attributable to higher employment costs or higher business taxes can occur in the face of negative money growth.

To keep prices in line in the prosperous economic environment that would develop with substantially reduced taxes, it would be necessary for Congress to recognize that the principal cause of the nation's post-war price spiral has been monopolistically imposed employment cost increases at a faster pace than improved worker productivity, and then remove this cause by making the anti-trust statutes applicable to everyone without exception - a policy that already would seem to be required by the "equal protection" concept of constitutional law.

Nothing other than the foregoing program will make satisfactory headway in solving the nation's problems of massive chronic unemployment, poverty and homelessness, all of which, according to latest reports, are continuing to get worse as they have been for decades. Man has no choice but to fathom correct monetary theory if the world's social problems are ever to be solved.

Conventional economic wisdom is in the same category as the "earth is the center of the universe" doctrine at the time of Galileo's discoveries. Unfortunately, the financial sector and academia constitute formidable obstacles to exposing this falsely called knowledge. But sooner or later, the obstacles will be removed for the same reason the strong attachment of the intellectual community to the concept of an earth-centered universe was eventually broken.

The basis for economists' expectation that the foregoing procedure would cause prices to rise is the "quantity theory of money" which holds that money growth causes higher prices. But this "quantity theory", enshrined in the literature by John Stuart Mill over a century and a half ago (when monetary units were stipulated measures of gold or silver), is not applicable to modern monetary systems.

During Mill's era and earlier, it was observed that the value of a monetary unit varied with the supply in the economy of the associated precious metal. An example of this relationship was the spectacular drop in the value of gold and associated money following boatloads of the metal being brought into Europe from Central and South America by Spanish explorers during the sixteenth century. The increaed supply of gold triggered spectacular price inflation throughout Europe. This experience prompted scholars to conclude that the value of money always varies sensitively with its supply, and this "quantity theory" eventually became an unquestioned basic monetary principle.

The "quantity theory" is still embraced by the educational establishment and passed on to successive academic generations, because scholars have failed to realize that the theory became inapplicable when monetary units were divorced from precious metals earlier in the present century. Since then, monetary units have been abstract units of measure of the exchangeable value of goods and services sold, unrelated to the supply of anything - analogous to a second of time, a yard of distance or a pound of force.

Like all units of measure, understanding the value of a monetary unit requires mental appraisal; in this case, mental appraisal of what the unit will buy. Since monetary units are intangible entities, generally used tangible "monetary media" are necessary to identify both the existence and ownership of monetary units. "Monetary media" consist of coin, currency notes and deposits on the books of certain financial institutions. From this it can be seen that coin and currency notes are not monetary units (i.e., are not"dollars", for example), but are monetary media that identify the existence and ownership of intangible, abstract monetary units. In these cases, the owner is the bearer, and the quantity of monetary units is marked on the coins or currency notes. On the other hand, the existence and ownership of "deposit" monetary units are identified by entries on negotiable checks, bank passbooks, certificates of deposit and bank statements. Incidentally, deposit dollars (numbers on the books of banks) comprise about 90 percent of the nation's total money supply. As used herein, the term "money supply" refers to the total of all currency in circulation, plus all deposits of the public in commercial banks.

Monetary media (coin, currency notes and deposits) must be freely exchangeable with each other at par, and the people, through their government, must stipulate which media are "legal tender" that must be accepted for all debts, public and private. In the U. S., officially minted coin and officially engraved currency notes have been designated by Congress as "legal tender". It should be noted that increase in the quantity of these "cash" media does not increase the money supply because deposits are reduced, dollar for dollar, as coin and currency notes are placed in circulation. Thus, increase in the "money supply" occurs only through increase in deposits

As indicated earlier, the value of a monetary unit today, such as the U.S. dollar, is reflected in the price level for goods and services. This value is determined mostly by the output of workers in the economy per monetary unit of employment cost for that output because, on a macro basis, employment costs are, by far, the largest component of the price structure. The only other two basic elements of the price structure are business taxes (taxes remitted to governments by businesses) and profit rates on sales. All other apparent components of a seller's price for anything can be broken down into somebody else's employment costs, business taxes or profits. Economists have not yet fathomed this simple macroeconomic "arithmetic" of the price stucture, of which the "money supply" is no part.

Because monetary units are no longer related to a commodity, the value of which varies with changes in its scarcity, the "money supply" is now only a numerical statistic that, of itself, has no impact on the nation's economic activity or on the price structure. Only <u>expenditure</u> of money impacts on the economy by stimulating production of what is purchased. If the rate of expenditures (demand) is greater than the capability of the economy to produce what is sought to be purchased, "demand-pull" price inflation occurs, as sellers mark up their profit rates so as to equate current prices with effective demand. ("Effective demand" with a given price is the physical quantity that can be sold at that price.) If aggregate expenditures are less than the productive capabilities of the economy, total production will be below its potential and no progress in reducing unemployment will be realized. Thus, aggregate expenditures in relation to unutilized productive capabilities should be the focus of Federal Reserve officials in evaluating the need for greater monetary accommodation, rather than growth in the "money supply".

Since changes in the money supply occur mostly as a consequence of changes in outstanding bank credit, growth in the money supply is mostly a statistic that measures increase in bank credit already granted. Thus, money growth is essentially a measure of past economic activity - not necessarily a valid basis for predicting future price performance as monetary authorities incorrectly believe pursuant to their attachment to the "quantity theory". This is the reason that performance of the economy is often inconsistent with what monetary authorities expect, based on changes in the money supply.

Monetary authorities have noticed the above inconsistency and they are now downgrading the importance of money growth as a tool for deciding current monetary policy. This development should be highlighted in the intellectual community much more than it has, since it is a major discreditation of traditional monetary theory which has been taught for generations to be the foundation of monetary knowledge.

In the past, scholars have insisted that changes in the money supply are the principal engine of changes in the price level. But performance in the U.S. during the period 1980-1986, for example, should have alerted scholars to the fact that the "quantity theory" is not a valid concept. During this period, growth in the "money supply" (M1) increased from an annual rate of 4.1% in 1980 to a rate of 16.8% in 1986. Yet price inflation as measured by the Consumer Price Index <u>fell</u> from a rate of 13.5% in 1980 to 1.9% in 1986. This performance was exactly opposite to what would have occurred in 1986 if the "quantity theory" were a valid concept. It is axiomatic that if a theory fails to conform to reality - even once - the theory is false, since correct theories are <u>always</u> consistent with actual performance.

It is indeed ironical that the elusive solution to most of the nation's economic problems involves application of the very principle thought by conventional wisdom to be the most sinister monetary evil imaginable; i.e., having the government issue some, if not all of its "tax money" to purchase the federal "real tax" which is produced entirely by the non-federal sector.

The "real tax" is turned over to the government for official or community use, or to government employees, including members of the armed forces, and recipients of federal transfer payments, for their personal use. Incidentally, government employees do not pay federal taxes out of their government salaries because all of their take-home pay consists of "tax money" provided by the non-federal sector.

Money thought to be "taxes" paid by government employees is actually imaginary increments of their income and of the federal budget. These "taxes" are never spent by anybody; they are merely <u>numbers</u> representing imaginary dollars shuttling back and forth on the books of the federal government and its employees.

From the viewpoint of an individual with an official government salary of $50,000, requiring $5,000 remittances to IRS, reality is that his entire salary, consisting of federal "tax money" remitted or borrowed from the non-federal sector, is $45,000. The $5,000 thought to be remitted to IRS is an imaginary increment of the federal budget spent neither by the employee nor the government. Net Treasury expenditures would be precisely the same if the employee were told that his government salary is $45,000 and that no remittances to IRS from him are required.

Needed in Congress or the White House is an economic Galileo to point the way out of the nation's economic morass. Hopefully, this will occur soon. In the meantime, Congress and the President will continue to flail the air with harmful proposals for tax increases and feeble proposals for stimulating the economy, while Federal Reserve officials will continue to tinker with interest rates in a vain attempt to halt price inflation, and the economy will continue to perform poorly.

As to why the financial community, which might be expected to understand how the monetary mechanism should be administered on behalf of overall economic progress, and so advise, Adam Smith provided the answer over 200 years ago when he observed that the monetary advice dispensed by financiers to government officials was "addressed by those who were supposed to understand the subject, to those who were conscious to themselves that they knew nothing about the matter. That functioning of the monetary system enriched the country, experience demonstrated to government officials as well as financiers; but how or in what manner, none of them well knew. Financiers knew perfectly in what manner it enriched themselves. It was their business to know it. But to know in what manner it enriched the country was no part of their business".

By failing to understand the certainties of natural economic laws, economists have proven what physicians, scientists and engineers have long known; that nature cannot be commanded, except by being obeyed; and that if we learn to harness the laws of nature, we shall be her masters as, in ignorance, we are her slaves. In dealing with natural laws of any kind, there is no substitute for being correct. Galileo recorded this reality with these words: "Nature is inexorable and immutable; she never transgresses the law imposed upon her, or cares a whit whether her reasons and methods are understandable to men". Natural economic laws are waiting patiently in the wings to move on stage and give the stellar performance they are capable of, and for which they were engaged by nature. It is high time that the performance begin; the very cause of civilized progress is at stake.

The heart of this message is that between present inadequate money growth and the obviously excessive running wild of the printing presses in Germany in 1923, for example, is a wide gap within which lies the correct rate of money growth.

The possibility that there may be something fundamentally wrong with established economic theories already has been sensed by several economists themselves and public officials struggling with economic problems. Harvard Professor Wassily Leontiff, a Nobel laureate in Economics, stated in an address in December 1970 before the American Economic Association:

> "The consistently indifferent performance (of contemporary economic theory) in practical applications is in fact a symptom of a fundamental imbalance in the present state of our discipline".

Professor Arthus F. Burns, former Chairman of the Federal Reserve Board, in testimony before the Joint Economic Committee of Congress, noted early in 1972:

> "... the deep seated economic problems we have been struggling with haven't been solved; more - and perhaps much more - remains to be done to restore the conditions for lasting prosperity".

The Executive Committee of the group of leading international thinkers called the "Club of Rome" announced several years ago:

> "... We are unanimously convinced that rapid, radical redressment of the present unbalanced and dangerously deteriorating world economic system is the primary task facing humanity. This supreme effort is a challenge for our generation. It cannot be passed on to the next".

Upon leaving office, former Secretary of Housing and Urban Development George Romney warned"

> "... We need to make the hard analysis that we don't yet know how to solve this mounting crisis of people with problems in our central cities - but we must find out before it is too late. Failure to do so could result in a fatal national crisis".

The preacher Ecclesiastes wrote several thousand years ago: "There is nothing new under the sun. What man discovers was always there, put there by God, and it is the whole of man's duty to fathom and follow God's laws". The Apostle Paul, in his first letter to Timothy, warned us to "beware of the falsely called knowledge".