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Paying Workers for not Working and Businesses for not Producing Has Disastrous Consequences

by Richard W. Rahn

'VERY, VERY SOON, THE CAN IS GOING TO RUN OUT OF ROAD.'

You, your children and your grandchildren are going to be made much poorer than you all would have been because of the ignorance and bad decision-making of most of the world's political leaders — all abetted by many in the global news media and health communities.

Saddam Hussein had weapons of mass destruction — so we were told. On the basis of that bad information, we went to war, with the loss of many thousands of lives on both sides — and a trillion or so of American taxpayer dollars wasted. Countries usually only initiate war when they think they are going to win with little cost — yet many times it doesn't work out that way. Bad intelligence leads to bad decisions.

Long-running economic calamities are always a result of bad decisions by government actors. The Great Depression lasted a decade because of a series of terrible decisions. If the policymakers in Washington had done nothing and let market forces make the corrections, as they did in the previous recessions (or panics as they used to be referred to), the economic turndown would probably have lasted the normal 18 months or less.

As I write this, a series of new studies are showing that the Wuhan virus seems to have spread far faster and wider than originally thought (with far lower death rates), and with little or no consequences for most people other than those over 60 who have underlying conditions (which I am one). For that, global political leaders have shut down a quarter or so of the United States and many other countries' economies — which will have terrible consequences. In retrospect (which will become increasingly apparent) — quite mad.

The global politicos have realized that shutting down much of the economy will lead (and is leading) to mass unemployment. Most people cannot pay their bills for very long without regular income. Many businesspeople are in the same boat. If they have few or no customers, they also cannot pay their bills and their employees. To deal with this self-imposed disaster, noted Hoover Institution economist John Cochrane said it well.

"Our government's basic economic plan to confront this situation is simple: The Federal Reserve will print money to pay every bill, and guarantee every debt, for the duration. And to a somewhat lesser approximation, to ensure that no fixed-income investor loses money."

When the folks in government decide to spend more than the tax revenue, the Treasury sells bonds to banks, financial institutions and others by auction. The Fed buys bonds in the open market, not directly from the Treasury. If the Fed wants to expand the money supply, it buys more bonds by printing money to give to bond sellers. If it wishes to contract the money supply, it becomes a net seller of bonds.

Normally when a business borrows money, it does so to expand the business and/or make it more efficient with better machinery. From the real wealth created by the business loan, the business pays back the loan and interest, and the remainder provides higher real incomes and more wealth. When government spends money to build a new highway financed by bonds, real wealth is created, and the increase in debt does not add to inflation (provided the long-run benefits of the road exceed its cost).

But now the government has decided to pay workers for not working and businesses for not producing in the form of various grants and loans that may or may not be repaid. No new wealth is being created by this printing of money by the Fed. All American taxpayers were supposed to have received a grant this last week from the IRS to help pay their bills. That grant was financed totally by the Fed printing more money.

When the government increases the supply of money faster than the increases in the production of goods and services, it results in inflation (too much money pursuing too few goods). But this effect does not happen instantaneously — perhaps only showing up in subsequent years. The new money flows back into the banking system, with much of it increasing bank "reserves."

A few years ago, the Fed started paying interest on reserves, so the banks have an incentive to keep more money at the Fed. The Fed can adjust the reserve requirements for the banks at will. These reserves are not counted in the debt limit of the government, even though they are equivalent to Treasury bills and bonds, as interest-bearing loans to the government. The banks go along with this charade because it increases their liquidity and income.

All of the debt will need to be "paid back" — which can be done by increased tax revenues or by inflation which causes the value of government-issued fixed-rate bonds to fall in value. With high inflation, bonds (and government money) will eventually become worthless. We have seen this scenario play out in Venezuela and Zimbabwe in the last few years — not pretty — and in many countries over the last century. All of the above is an overly simplified explanation of the disaster to come. And as Sen. John Kennedy, Louisiana Republican, put it so well, "very, very soon, the can is going to run out of road."

Richard W. Rahn is chairman of the Institute for Global Economic Growth and Improbable Success Production

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